सत्यमेव जयते

REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR ENDED 31 MARCH 1995
NO. 5 OF 1996

UNION GOVERNMENT
(REVENUE RECEIPTS - DIRECT TAXES)

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Prefatory Remarks

This Report for the year ended 31 March 1995 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's (Duties, Powers and Conditions of Service) Act, 1971. This Report presents the results of audit of receipts under direct taxes comprising corporation tax, income tax, wealth tax, gift tax etc. The Report is arranged in the following order:-

(i) Chapter 1 includes information on the arrangements for audit of direct taxes and mentions the results thereof;

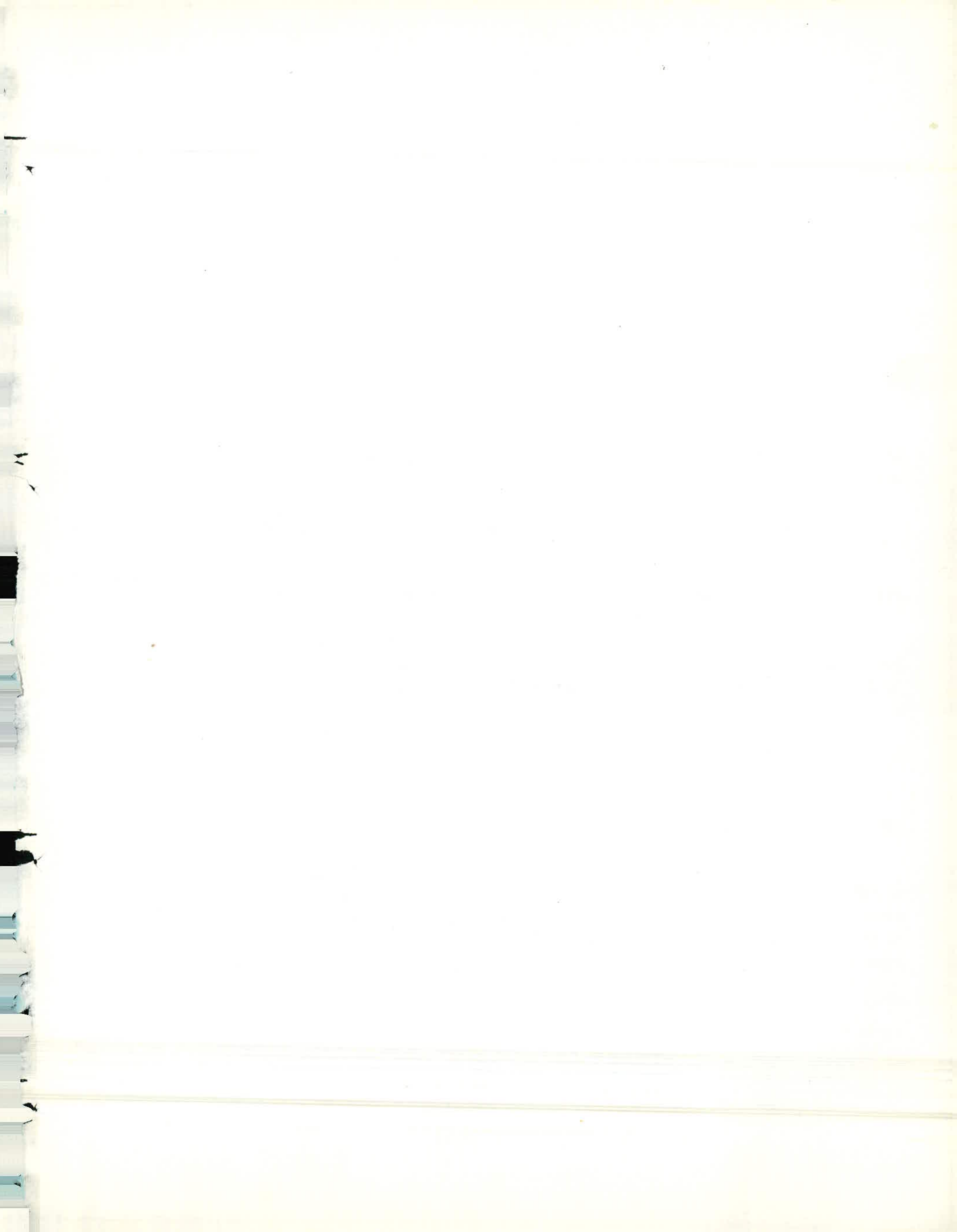
(ii) Chapter 2 incorporates important statistical information on the administration of direct taxes;

(iii) Chapter 3 includes three system appraisals on "Working of Directorate of Income Tax (Special Investigation), New Delhi", "Working of Tax Recovery Machinery" and "Interest, Penalties and Prosecutions".

(iv) Chapters 4 and 5 mention the issues resulting from the audit of corporation tax and income tax respectively;

(v) Chapter 6 highlights the results of the audit of wealth tax, gift tax and interest tax.

The observations included in this Report have been selected from the findings of the test audit conducted during 1994-95 as well as in earlier years but which could not be covered in the previous Reports.



Overview

General

1. Audit of the revenues of the Union Government from Direct Taxes is conducted by the Comptroller and Auditor General of India under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. This audit which is conducted through test check of assessment and other records maintained by the Income Tax Department, has a two-fold objective - firstly to obtain an assurance that the systems and procedures laid down by the department in the critical areas of tax administration are working reasonably effectively and secondly to evaluate the degree of compliance with tax laws, rules and judicial pronouncements in assessing, demanding and collecting tax revenues from various assessees.

2. Only a very small fraction of audit findings have been included in this Report. The revenue effect of the 293 audit observations and the three system appraisals featured in this Report is Rs. 216.90 crores. The audit observations on individual assessments with revenue effect of Rs. 157.47 crores included in this Report, have been selected out of 16256 audit observations involving underassessments of Rs.855.39 crores which were intimated to the department during the course of test audit conducted in 1994-95. Some cases noticed in earlier years have also been featured. The cases reported herein are those which either have substantial tax effect or have certain features which, in the perception of audit, should be reported. Beside the audit observations on individual assessment cases, this Report also includes three system appraisals on the following subjects:

— Working of the Directorate of Income Tax (Special Investigation), New Delhi
— Working of the Tax Recovery Machinery
— Interest, Penalties and Prosecutions.

3. Of the cases featured in this Report, 220 cases involving revenue of Rs. 136.52 crores have been accepted by the Ministry and remedial measures have been initiated. Further, 42 cases with tax effect of Rs. 171.29 lakhs which have been accepted by the Ministry and in which remedial action has also been completed, have not been included in this Report. Similarly, 49 other cases with potential tax effect of Rs.30 lakhs and below, aggregating Rs.6.75 crores have also not been included in this Report. Out of

these, 43 observations with potential tax effect of Rs.6.11 crores have been accepted by the Ministry and necessary remedial action has been taken.

In 2 cases involving tax effect of Rs.13.20 lakhs, the department had not taken action on mistakes pointed out by their Internal Audit Wing.

4. In the subsequent paragraphs of this section, brief particulars of a few cases selected from each chapter of this Report, has been featured to give an idea of the extent and depth of audit findings. Many other interesting cases of different types have been featured in the chapters.

Revenues from Direct Taxes

5. The actual collection of Direct Taxes for the year 1994-95 was Rs.26,970.88 crores against the budget estimates of Rs.24,790 crores. While the actual collections grew by 32.87 percent over the previous year's level, arrears of tax also recorded a growth of 110.56 percent. Cumulative arrears of corporation tax and income tax increased from Rs.10780.13 crores in 1993-94 to Rs.22,698.64 crores on 31 March 1995. Of these, Rs.15,041.13 crores was accounted for by 1225 cases each with tax arrears of more than Rs. one crore.

[Paras 2.2 and 2.9]

6. The expenditure incurred on the collection of all Direct Taxes during 1994-95 was 1.44 percent of the total collection. Gross pre-assessment collection of income tax and corporation tax during the year by way of tax deducted at source, advance tax and self-assessment tax, before adjustment of refunds, was Rs.26,513.29 crores (86.82 percent of the total collection under these heads).

[Paras 2.6.1 and 2.5(I)]

7. During the year the number of assessees increased to 1.03 crores from 1.02 crores in the previous year. Pendency of asssessments remained an area of concern as despite instructions issued by the Central Board of Direct Taxes for according priority to increasing the disposal of both summary and scrutiny assessments, overall pendency of assessments increased from 15.41 lakhs cases on 31 March 1994 to 24.12 lakhs cases on 31 March 1995.

[Paras 2.7(I) and 2.8.1(i)]

System Appraisals

8(a) Working of the Directorate of Income Tax (Special Investigation), New Delhi.

A review of the working of the Directorate of Income Tax (Special Investigation) which was set up in 1972 at New Delhi, revealed that it is yet to establish suitable procedures and appropriate practices to achieve its objective of playing a crucial role in preventing tax evasion and augmenting State revenues. Some other major findings of the systems study were:

(i) Certain records and information which were crucial for a proper examination and appreciation of the working of the organisation were not made available to Audit despite being requisitioned.

(ii) The line of investigation communicated in the scrutiny notes of the Directorate to the assessing officers only duplicated actions which were routine in nature and were also required to be taken statutorily by the assessing officers.

(iii) The Directorate had taken credit for additions of Rs.9119.95 lakhs in income and Rs.4750.72 lakhs in tax effect in respect of certain cases although no observations had been made in their scrutiny notes. Of the total additions of Rs.9044.25 lakhs in income claimed to have been made by the Directorate between 1989-90 and 1993-94, additions of Rs.41.53 lakhs (0.46 percent) only were made on the observations in their scrutiny notes. The remaining additions of Rs. 9,002.72 lakhs (99.54 percent) were made by the assessing officers on their own during the process of assessments.

(iv) Arithmetical mistakes and incorrect calculation of tax effect in respect of cases mentioned in the Annual Reports resulted in the Directorate reporting credit in excess of real addition to the extent of Rs.1,779.29 lakhs towards income and Rs.1,020.34 lakhs towards the tax effect.

(v) There were cases in Delhi charge overseen by the Directorate where some important irregularities of law or facts were overlooked by them resulting in underassessment of income of Rs.507.10 lakhs with consequent short levy of tax of Rs.388 lakhs.

(vi) In 41 cases covering 72 assessments in Bombay, Delhi, Calcutta, Punjab and Haryana charges overseen by the Directorate during the years 1989-90 to 1993-94, out of total additions of Rs.30,829.11 lakhs made at the instance of the Directorate,

additions of Rs.6,381.58 lakhs (20.70 percent) had been deleted in appeal and additions of Rs.18,966.20 lakhs (61.52 percent) were lying disputed in appeal.

(vii) The working of the Research Cell of the Directorate set-up in May 1990 primarily to analyse and evaluate data on malpractices, tax frauds and results of investigation in the search and seizure cases, could not be evaluated as records and replies to information requested for were not furnished to Audit. The Annual Reports of the Directorate also do not indicate that any appraisal of work done by the Research Cell has ever been undertaken.

[Para 3.1]

8(b) Working of the Tax Recovery Machinery

An efficient tax recovery machinery is a sine-quoa-non for a revenue raising department like the Income Tax Department. A review of the systems relating to the working of the tax recovery machinery of the department revealed the following:

(i) Deficiencies in implementation of the law and procedure negated the objective of the amendments thereto made in April 1989 to make collection more effective. Tax arrears in respect of cases where recovery certificates have been drawn, increased from Rs.1,034.75 crores in 1990-91 to Rs.3,179.59 crores in 1993-94. Further, the reduction in arrear demand which was 61 percent of the target in 1990-91 came down to 49 percent thereof in 1993-94. The clearance of outstanding demand was almost entirely due to adjustments, remissions, write-off etc. and the achievement in respect of cash collection which is the real index of performance of the TROs, ranged from 22 to 43 percent of the targets set. Although several properties were attached, yet very few could be sold and dues remained outstanding against the defaulters.

(ii) There was inadequate coordination between the assessing officers and the TROs with consequential adverse impact on the effective functioning of the tax recovery machinery. Reconciliation and verification of outstanding arrear demands, one of the key areas for such coordination was not given due attention resulting in 20,512 cases involving arrear demand of Rs.45.82 crores remaining outstanding.

(iii) There were several cases of inadequate action both on the part of the TROs and the assessing officers which resulted in large

arrears remaining uncollected. In a number of cases the tax arrears had become irrecoverable and had to be written off.

(iv) Though the Income Tax Act,1961, requires issue of a tax clearance certificate before a person goes abroad, there were several cases where defaulters left the country leaving arrears of tax dues.

(v) The Directorate of Income Tax (Recovery) was set up to monitor and initiate action for containing the growth in outstanding arrears of high demand cases (in cases where RCs have not been drawn). The arrears, however, rose from Rs. 3093.62 crores to Rs.8624 crores during the period 1990-91 to 1993-94.

(vi) In order to make a perceptible impact on containing the growth of tax arrears, the department needs to evolve effective procedures for introducing accountability for targets not met, lack of coordination between TROs and the assessing officers who are now working under the jurisdiction of the same Commissioner, delays in taking recovery action, non-pursuance or non-monitoring of pending cases especially those with high tax demands etc.

[Para 3.2]

8(c) Interest, Penalties and Prosecution

A review to evaluate the degree of compliance with the law and procedural requirements relating to levy of interest, penalties and prosecutions by the department revealed:

(i) The department did not produce records and certain information relating to Rajasthan, Punjab, Tamil Nadu and Gujarat charges.

(ii) Cases of overpayments or avoidable payment of interest to assessees amounting to Rs.814.04 lakhs were noticed in test check by audit due to non-compliance with statutory provisions or executive instructions of the Board.

(iii) In 38 cases interest of Rs. 104.12 lakhs were not paid to the assessees.

(iv) The non-levy/short levy of interest diluted the deterrent impact of these provisions. The revenue impact of 894 cases noticed in test check was Rs.2,545.60 lakhs.

(v) Non-enactment of a provision in the Income Tax Act for

charging interest on refunds made at the summary assessment stage which are subsequently found to be in excess or not admissible due to additions made after scrutiny assessment, although recommended by the Public Accounts Committee, resulted in Rs. 175.55 lakhs not being levied in 4 cases alone.

(vi) The disposal of penalty proceedings during the years 1991-92 to 1993-94 ranged from 36.8 to 26.5 percent which was rather low. The trend of disposals was also declining. Further, although executive instructions require the assessing officer to record reasons for non-initiation of penalty proceedings, penalty amounting to Rs.748.21 lakhs was not levied in 949 cases without recording reasons therefor.

(vii) The acquittal rate of 52.9 percent of the prosecution cases decided during 1991-92 to 1993-94 indicated inadequate preparation of cases by the department.

(viii) There were delays ranging from 1 year to 8 years in launching of prosecution proceedings in a court of law from the date of initiation of complaint by assessing officer.

(ix) The departmental registers and records were either defectively maintained or not maintained at all. The very objective of monitoring by instituting these controls was thus not achieved.

[Para 3.3]

Audit observations on Corporation Tax

9(i) Avoidable mistakes like overassessment of income and tax, incorrect adoption of figures, arithmetical errors, double allowance of deduction and other mistakes continue to occur despite Board's instructions to ensure accuracy in the computation of income and tax. These mistakes in 8 cases led to overassessment of tax of Rs. 142.31 lakhs (including potential* tax effect of Rs. 67.50 lakhs). In 15 cases there was undercharge of tax of Rs. 914.91 lakhs including potential tax effect of Rs. 565.09 lakhs.

[Para 4.6]

(ii) In West Bengal and Maharashtra charges, incorrect application of rate of tax in 4 cases resulted in short levy of tax of Rs. 112.82 lakhs.

[Para 4.7]

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* (P) or 'potential tax effect' wherever occurring in this Report indicates the tax effect of the transaction commented upon considered in a 'stand alone' manner. In certain 'loss' cases, it may happen that even after correcting the mistake, there is a net loss. In such cases no tax would be leviable.

(iii) In Maharashtra charge, incorrect allowance of bad debts on interest element of advances in the case of a banking company resulted in underassessment of income of Rs. 517.40 lakhs involving short levy of tax of Rs. 409.37 lakhs (including interest).

[Para 4.11.1(i)]

(iv) Incorrect allowance of provisions on account of appropriation to contingency fund, future possible losses, provision for bad and doubtful debts, provision for anticipated liability on account of revision of pay scales etc. resulted in aggregate short levy of tax of Rs.366.92 lakhs (including potential tax effect of Rs.206.30 lakhs) in 9 cases.

[Para 4.12.2]

(v) In Madhya Pradesh charge, allowance of irregular deduction towards the deferred sales tax liability in the case of a company, led to underassessment of income aggregating Rs. 311.75 lakhs involving short levy of tax of Rs. 193.69 lakhs (including potential tax effect of Rs. 65.13 lakhs and interest).

[Para 4.13(i)]

(vi) Erroneous allowance of liabilities, such as interest and penal interest not actually paid, custom and central excise duty not paid, unpaid cess on green tea leaves etc., resulted in aggregate short levy of tax of Rs.368.66 lakhs (including potential tax effect of Rs.176.34 lakhs) in 10 cases.

[Para 4.13(ii) to (iv)]

(vii) In West Bengal charge, allowance of deduction of entertainment expenditure amounting to Rs. 50 lakhs instead of restricting it to the permissible amount of Rs. 50,000 resulted in underassessment of income by Rs. 49.50 lakhs with consequent short levy of tax of Rs. 39.16 lakhs (including interest).

[Para 4.16.6]

(viii) In West Bengal charge, in case of a foreign banking company, deduction on account of provision for taxes amounting to Rs. 125.92 lakhs inadmissible under the Act, was allowed resulting in underassessment of income of Rs. 125.92 lakhs involving undercharge of tax of Rs.81.85 lakhs.

[Para 4.16.7]

(ix) In Assam charge, guest house expenses and royalty not paid

were erroneously allowed resulting in underassessment of income aggregating Rs. 112.77 lakhs with an undercharge of tax of Rs. 89.22 lakhs (including interest).

[Para 4.16.9]

(x) In Gujarat charge, a company had changed its method of valuation of goods in transit, closing stock of raw materials, work in progress and closing stock of finished goods by excluding customs/excise duty paid/payable. This was in contravention of the Board's Circular of 1981 clarifying that Union excise/customs duties, if any payable by the manufacturer/trader should form part of calculation of production cost and the closing inventory should include an element of such duty to represent such cost. The irregular method of valuation adopted resulted in under valuation of stock by Rs. 176.83 lakhs with consequent short levy of tax of Rs. 175.64 lakhs (including interest).

[Para 4.16.11 (i)]

(xi) In Delhi charge, a deduction of Rs. 97.39 lakhs claimed by the assessee on account of amount written off due to depreciation in market value of the investments was allowed though the same was not admissible with effect from April 1989. The mistake resulted in under charge of tax of Rs. 65.70 lakhs (including interest).

[Para 4.16.13]

(xii) In West Bengal charge, incorrect allowance of depreciation of Rs.5589.04 lakhs in case of a widely held company as against the correct amount of Rs. 3845.81 lakhs, resulted in excess allowance of depreciation by Rs.1743.23 lakhs involving potential tax effect of Rs. 871.61 lakhs.

[Para 4.17.1(i)]

(xiii) In Punjab charge, depreciation of Rs. 7,298.45 lakhs for which details of actual cost or written down value of assets and the rate at which depreciation was worked out were not furnished by the assessee and as such deduction of Rs. 7,298.45 lakhs was not admissible. The mistake resulted in potential tax effect of Rs. 3,831.68 lakhs.

[Para 4.17.3]

(xiv) In Madhya Pradesh charge, the order of priority in which the deduction towards depreciation was to be allowed first was not followed. The deduction of Rs. 333.27 lakhs for expenditure on prospecting etc. for certain minerals was allowed first followed by a

portion of allowable amount of current depreciation. The mistake resulted in allowance of excess carry forward of depreciation of Rs. 333.27 lakhs with consequent potential tax effect of Rs. 174.97 lakhs.

[Para 4.17.7(i)]

(xv) In Delhi charge, mistake in excess allowance of investment allowance amounting to Rs. 190.91 lakhs resulted in underassessment of income of Rs. 139.17 lakhs with consequent short levy of tax of Rs. 73.07 lakhs.

[Para 4.18.1(i)]

(xvi) In Maharashtra charge, capital gains arising on sale of flat were assessed as short term capital gains instead of as long term capital gains. This resulted in short levy of tax of Rs.48.99 lakhs.

[Para 4.20.1]

(xvii) It has been judicially held that under the Income Tax Act grant of lease amounts to a transfer of capital asset and, therefore, the profits and gains of the transfer would be chargeable to tax under the head 'capital gains'. In Tamil Nadu charge, on the transfer by way of lease of a building for a period of 99 years, short term capital gains were not assessed to tax. This resulted in non levy of tax of Rs.46.38 lakhs (including interest and potential tax).

[Para 4.20.3]

(xviii) In Haryana charge, a State warehousing corporation acting as agent of the State Government for purchase and sale of wheat was allowed exemptions of Rs. 466.81 lakhs which was irregular since the assessee's income was derived from the trading of wheat and not from letting of godowns or warehouse. The mistake resulted in short levy of tax of Rs. 352.24 lakhs (including interest and additional tax).

[Para 4.21.1]

(xix) In Maharashtra charge, the incorrect computation of the sale price of loose diamonds exported, diamonds set in jewellery and loose diamonds sold in the local market resulted in underassessment of income of Rs. 30.82 lakhs involving short levy of tax of Rs. 40.34 lakhs (including interest).

[Para 4.21.3]

(xx) In West Bengal, Tamil Nadu, Maharashtra, Gujarat and

Orissa charges, an aggregate income of Rs.498.55 lakhs was not assessed to tax in 8 cases which resulted in short levy of tax aggregating Rs. 319.23 lakhs (including potential tax effect of Rs.39.46 lakhs).

[Para 4.21.5]

(xxi) In Tamil Nadu, West Bengal, Maharashtra, Delhi, Madhya Pradesh, Rajasthan, Assam and Punjab charges, incorrect carry forward and set off of losses of earlier years in 12 cases resulted in aggregate short levy of tax of Rs.1406.19 lakhs (including potential tax effect of Rs. 1194.90 lakhs).

[Para 4.22]

(xxii) In Rajasthan, Delhi and Bihar charges, mistakes in assessments while giving effect to appellate order resulted in short levy of tax of Rs. 26.09 lakhs besides potential tax effect of Rs.260.95 lakhs.

[Para 4.23]

(xxiii) In Gujarat charge, in the case of a company for the assessment years 1991-92 and 1992-93, the overriding condition that the total deduction under Chapter VI A of the Income Tax, 1961 shall not exceed the gross total income of the assessee, was not observed. This resulted in underassessment of income of Rs. 57.54 lakhs with consequent short levy of tax of Rs. 34.02 lakhs (including interest).

[Para 4.24(ii)]

(xxiv) In West Bengal and Maharashtra charges, incorrect relief in respect of profits from export business in two cases resulted in aggregate underassessment of income of Rs. 145.76 lakhs with consequent short levy of tax of Rs. 91.59 lakhs (including interest).

[Paras 4.27 (i) and (ii)]

(xxv) In Kerala, West Bengal, Haryana, Gujarat, Madhya Pradesh and Delhi charges, in 10 cases, incorrect deduction in respect of profits from new industrial undertakings established after 31 March 1981 by failing to give precedence to the Section 80HH deduction available to an industrial undertaking established in backward areas resulted in excess allowance of deductions aggregating Rs. 122.13 lakhs leading to total underassessment of an identical amount with consequent short levy of tax of Rs. 81.94 lakhs (including interest).

[Para 4.28.1]

(xxvi) In Tamil Nadu and. Maharashtra charges, in 2 cases, incorrect allowance of deduction in respect of certain inter-corporate dividends resulted in underassessment of income of Rs. 94.99 lakhs with consequent short levy of tax of Rs. 65.54 lakhs (including interest).

[Paras 4.29 (i) and (ii)]

(xxvii) In Maharashtra charge, avoidable mistake in the allowance of double taxation relief resulted in short levy of tax of Rs. 89.70 lakhs.

[Para 4.31]

(xxviii) In Uttar Pradesh, Punjab, Tamil Nadu and Karnataka charges erroneous refunds of tax resulted in aggregate short levy of tax of Rs.194.76 lakhs in 4 cases.

[Para 4.33]

(xxix) Under the Income Tax Act, 1961, there is no provision for levy of additional tax for such rectifications made in scrutiny assessment for which additional tax would have been leviable had the prescribed adjustment been carried out in the assessment earlier completed in summary manner. In one case alone of West Bengal charge, this resulted in loss of revenue of Rs.254.78 lakhs. An appropriate provision in the Act appears to be necessary in the interest of revenue.

[Para 4.35]

Audit observations on Surtax

10(i) In Delhi charge, mistake in computation of chargeable profits for levying surtax resulted in underassessment of net chargeable profit leading to aggregate short levy of surtax of Rs.111.17 lakhs (including interest)

[Para 4.37]

(ii) In Delhi charge, due to incorrect inclusion of provisions as reserves for the purpose of computation of capital, there was excess determination of capital with consequent excess grant of statutory deductions aggregating Rs.240.78 lakhs with consequent undercharge of surtax of Rs.181.18 lakhs (including interest) in two assessment years.

(Para 4.38)

(iii) In Gujarat charge, in the case of a widely held company the income tax assessment was revised in February 1993 but the surtax assessment was not revised even after six months of the completion of revised income tax assessment. The omission resulted in short

levy of surtax of Rs.43.38 lakhs.

(Para 4.39)

Audit observations on Income Tax other than Corporation Tax.

11(i) Avoidable mistakes like calculation errors, adoption of incorrect figure, double deductions and mistakes in application of rate of tax in 17 cases led to undercharge of tax of Rs.223.97 lakhs (including interest and potential tax of Rs.30.24 lakhs).

[Paras 5.6 (ii) and 5.7]

(ii) In West Bengal charge, while computing the profits of the business, the assessing officer adopted the purchase price of alcoholic liquor at Rs.144.82 lakhs without taking into consideration a sum of Rs.336.87 lakhs as duty (Nirgam Mulya) paid in the State of Uttar Pradesh as debited to its account which resulted in underassessment of income by Rs.134.75 lakhs involving undercharge of tax of Rs.126.77 lakhs (including interest).

[Paras 5.9.1(ii)]

(iii) In Rajasthan charge, failure to tax the returned income in the case of country liquor contractor which was more than the presumptive income, resulted in short levy of tax of Rs.29.42 lakhs.

[Para 5.9.1(iii)]

(iv) In Haryana, Maharashtra and Bihar charges, in 5 cases, incorrect allowance of liabilities such as unpaid statutory liability, interest payable to a financial institution etc. in scrutiny assessment which were disallowed earlier in summary assessment besides other irregularities like bonus paid to staff being allowed twice and deduction of bonus allowed in excess to that debited in profit and loss account resulted in aggregate short levy of tax of Rs.49.85 lakhs.

[Para 5.9.3(i)]

(v) In Madhya Pradesh charge, irregular deduction of Rs.23.69 lakhs on account of deferred sales tax liablilty resulted in short levy of tax of Rs.18.84 lakhs (including interest).

[Para 5.9.3(ii)(b)]

(vi) In Maharastra charge, due to undervaluation of closing stock by Rs.101.11 lakhs, the income of an assessee was underassessed by Rs.108.47 lakhs which resulted in short levy of tax of Rs.56.95

lakhs.

[Para 5.9.4(i)(a)]

(vii) In Maharashtra charge, the sale value of ten flats measuring 5460 square feet was adopted at Rs.420 per square foot as against the value of Rs.700 per square foot for assessment year 1990-91 adopted in earlier assessment year. This resulted in underassessment of income of Rs.15.40 lakhs with consequent short levy of tax of Rs.17.53 lakhs in the hands of firm and partners (including interest).

[Para 5.9.4(ii)]

(viii) In Karnataka charge, irregular set off of loss of Rs.112 lakhs resulted in short levy of tax of Rs.61.64 lakhs (including interest).

[Para 5.10.3(ii)]

(ix) In Bihar charge, an assessee had received refunds of Union excise duty of Rs.29.37 lakhs which constituted taxable income but was not brought to tax which resulted in underassessment of income of Rs.29.37 lakhs with consequent undercharge of tax of Rs.47.92 lakhs (including interest) in the hands of the firm and partners.

[Para 5.13(c)]

(x) In Maharashtra, Punjab and Tamil Nadu charges, incorrect set off of unabsorbed loss and depreciation of Rs.351.06 lakhs in 5 cases resulted in potential short levy of tax of Rs.147.63 lakhs.

[Para 5.14.1]

(xi) In Maharashtra charge, while revising the assessment of a co-operative society in January 1993 to give effect to appellate order deleting the addition of Rs.67.29 lakhs, the assessing officer incorrectly took the last determined income as Rs.63.93 lakhs instead of the correct amount of Rs.131.22 lakhs. The mistake resulted in underassessment of income by Rs 63.93 lakhs involving potential short levy of tax of Rs.33.14 lakhs.

[Para 5.15(I)]

(xii) In Maharashtra, West Bengal and Gujarat charges, incorrect allowance of relief in respect of export turnover in eight cases resulted in short levy of tax aggregating Rs.50.95 lakhs (including tax liability of partners).

[Para 5.16.1(i)]

(xiii) In Maharashtra charge, a registered firm had incurred a loss of Rs.33.49 lakhs in export business. After addition of the eligible amount of export incentives amounting to Rs.190.66 lakhs, the allowable deduction from the profits of the business was Rs.157.17 lakhs as against Rs.207.78 lakhs deducted by the department. The mistake led to underassessment of income of Rs.50.60 lakhs involving short levy of tax of Rs.32.81 lakhs.

[Para 5.16.3]

(xiv) In Kerala charge, refund of tax was already made in three cases but in final assessment these were not taken into account while calculating the refunds which resulted in aggregate excess refund of Rs.13.34 lakhs.

[Para 5.19(i) and (ii)]

Audit observations on Wealth Tax

12 (i) In Assam charge, non-levy of wealth tax on immovable properties worth Rs. 3357.29 lakhs owned by five individuals resulted in undercharge of tax of Rs. 82.62 lakhs.

[Para 6.4(i)(a)]

(ii) In Tamil Nadu charge, value of interest of an assessee's two minor sons amounting to Rs. 286 lakhs was not included in his net wealth which resulted in short levy of tax of Rs. 5.38 lakhs.

[Para 6.4(iii)]

(iii) In West Bengal, Maharashtra, Madhya Pradesh, Kerala and Tamil Nadu charges, non-levy of wealth tax on specified assets worth Rs.1109.88 lakhs owned by 7 closely held companies amounted to Rs. 25.19 lakhs.

[Para 6.9]

(iv) In Maharashtra charge, omission to adopt market value of properties as determined by the Departmental Valuation Officer and value shown in Balance Sheet of two closely held companies respectively, resulted in underassessment of wealth of Rs. 166.89 lakhs with consequent short levy of tax of Rs. 3.29 lakhs.

[Para 6.12]

Audit observations on Gift Tax

13 (i) In Uttar Pradesh charge, two individuals purchased plots of land valued at Rs. 13.87 lakhs in the names of their four sons without any consideration. The transaction which constituted a gift was not assessed to tax resulting in non-levy of gift tax of Rs. 5.58

lakhs.

[Para 6.17(i)]

(ii) In Maharashtra charge, difference of Rs. 106.24 lakhs between the value of equity shares as worked out under the provisions of Gift Tax Act and sale consideration of the shares of a closely held company constituted deemed gift. No gift tax proceedings were, however, initiated, resulting in non levy of gift tax of Rs. 52.81 lakhs (including interest).

[Para 6.18(i)(a)]

(iii) In Haryana charge, difference of Rs.62.09 lakhs between the declared consideration and fair market value of an immovable property constituted deemed gift. No gift tax proceedings were, however, initiated which resulted in non-levy of gift tax of Rs.18.51 lakhs.

[Para 6.18 (i)(b)]

Audit observations on Interest Tax

14 In Kerala charge, no interest tax proceedings were initiated on interest income of Rs.2.23 crores received by a District Cooperative Bank which resulted in non-levy of tax of Rs. 14.31 lakhs (including interest).

[Para 6.21(i)]

Chapter 1

Introduction

General

1.1 The Direct Taxes levied by the Union Government comprise:

— **Corporation Tax** (taxes on income paid by companies, corporations etc.)
— **Income Tax**
— **Wealth Tax**
— **Gift Tax**
— **Interest Tax**
— **Expenditure Tax**

The various laws relating to Direct Taxes are administered by the Department of Revenue, Ministry of Finance through the Central Board of Direct Taxes (hereinafter called 'the Board'). The revenue from Direct Taxes during 1994-95 amounted to Rs. 26,970.88 crores. Time series data on the different components of the revenue from Direct Taxes and other important statistical information on working of the tax administration machinery are given in Chapter 2 of this Report.

Statutory Audit

1.2 The audit of Direct Taxes by the Comptroller and Auditor General of India is carried out under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The important findings are reported by him to the President of India under Article 151 (1) of the Constitution of India who causes this Report to be submitted to the Parliament.

The audit of Direct Taxes is conducted through test checks of assessment and other records of the department maintained in its various offices. Various prescribed checks are applied to ensure whether the taxes due from assessees have been worked out in accordance with the provisions of law and levied. Reliance is placed on law as interpreted by the judicial authorities including appellate tribunals. The thrust of statutory audit is to verify whether the systems and procedures prevalent in the department for administration of Direct Tax Laws are satisfactory and to that extent, the objective is to lay emphasis on 'general' than on 'particular'. With this end in view, certain topics are selected for conducting 'System Appraisals' every year.

Present Report

1.3 The arrangement of this Report has been mentioned in the prefatory remarks. In each case appearing in subsequent sections of this Report, the response of Ministry, to the extent available, has been indicated. Where the reply of the Ministry has not been found acceptable, the reasons therefor have been mentioned alongwith the reply of the Ministry.

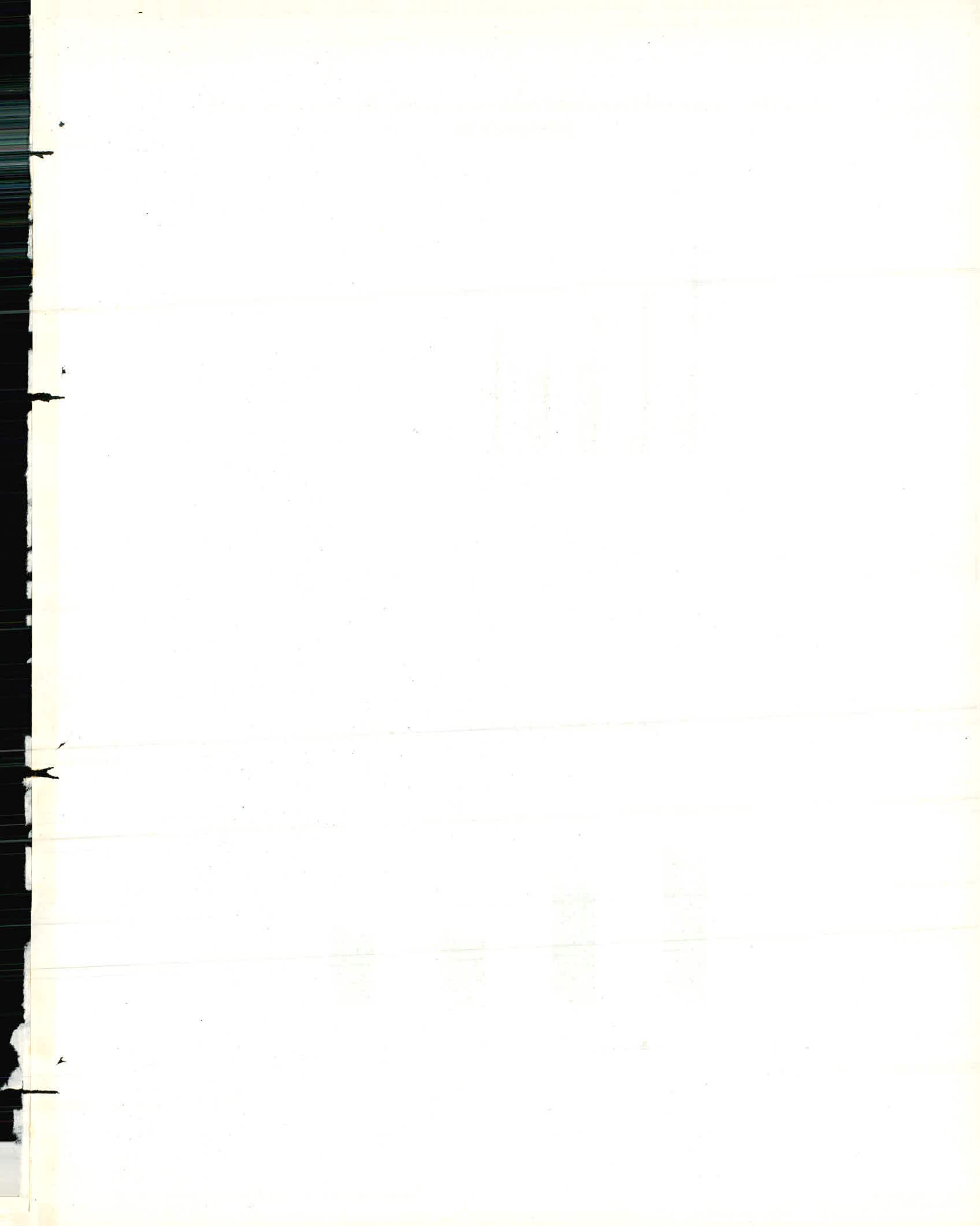
Of the total 16,256 audit observations involving underassessment of tax of Rs.855.39 crores as noticed during test check of assessment records in 1994-95 and referred to the department, only a small fraction has been featured in this Report. The selection of cases featured is based on either their monetary significance or which, in the perception of Audit, require the attention of the Parliament. The present Report contains 293 audit observations pertaining to corporation tax, surtax, income tax, wealth tax, gift tax, and interest tax. The revenue effect of these cases amounts to Rs.157.47 crores. Besides these individual audit observations, the Report also contains system reviews on three topics viz. 'Working of the Directorate of Income Tax (Special Investigation)', 'Working of the tax recovery machinery' and 'Interest, penalties and prosecution'.

Audit observations in 220 individual cases with tax effect of Rs.136.52 crores have been accepted by the Ministry. Of the cases referred to the Ministry those in which the Ministry have accepted the audit observations and have also taken rectificatory action including raising and collection of the resultant additional demand, have not been included in the Report unless the tax effect is very large or the case has some special features. Forty two cases each with reasonably large tax effect aggregating Rs.171.29 lakhs have not been included in this Report on these considerations. Similarly, 49 other cases with potential tax effect of Rs.30 lakhs and below with their revenue effect aggregating Rs.6.75 crores have also not been included in the Report. Out of these, the Ministry have accepted the audit observations in 43 cases involving potential tax effect of Rs.6.11 crores and have taken the necessary remedial action.

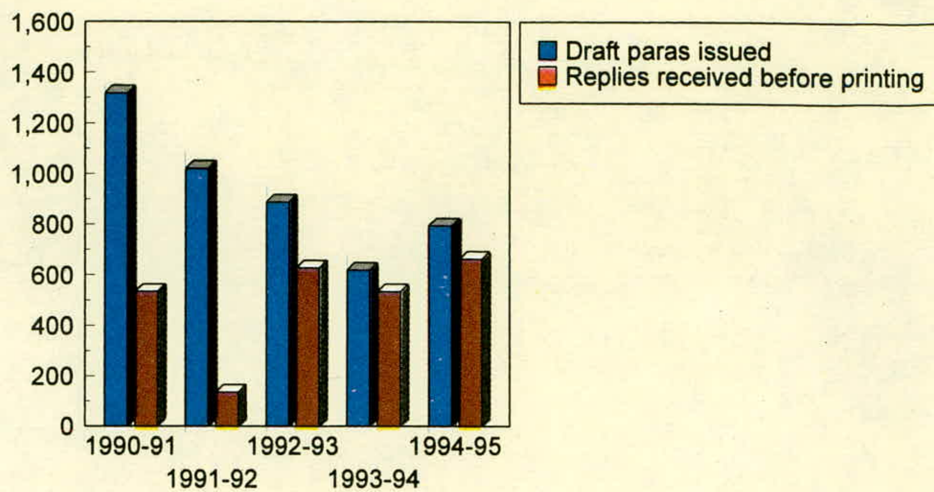
Of the total 16,256 audit observations referred to earlier as resulting from test check, 2638 cases with tax effect of Rs.56.08 crores have so far been accepted by the department.

Non receipt of Board's comments on draft paragraphs

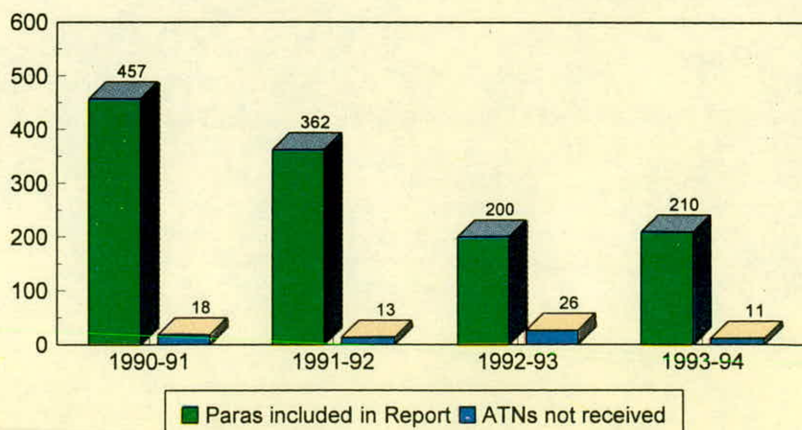
1.4 Cases with substantial tax effect are brought to the notice of the Income Tax Department and the Ministry in the form of 'draft paragraphs'. Sufficient time is allowed thereafter to them for their response so that these could be considered before finalising this Report. However, despite Board's instructions that all 'draft paragraph' cases should receive the personal attention of the Commissioners of Income Tax for expeditious action, inordinate



Replies received to cases referred to the Ministry as draft paragraphs



Action Taken Notes not received



delays continue to occur in the receipt of departmental responses as indicated below in respect of the preceding five Reports.

Year of Report	Number of draft paragraphs issued	Period of issue	Replies received before finalisation of Audit Report	Percentage of cases in which replies were received
1990-91	1319	Jan-Jul 1991	535	40.56
1991-92	1022	Mar-Jul 1992	136	13.30
1992-93	889	Mar-Aug 1993	629	70.75
1993-94	620	Mar-Sep 1994	536	86.45
1994-95	796	Mar-Sep 1995	668	84.00

Non-receipt of Action Taken Notes from the Government

1.5 The Lok Sabha Secretariat issued instructions (April 1982) to all the Ministries requesting them to furnish notes indicating remedial/corrective action taken by them on the various paragraphs contained in the Audit Reports as soon as they are laid on the table of the House duly vetted by Audit. Such notes are required to be submitted even for paragraphs which are not selected by the Public Accounts Committee for detailed examination.

A review of the Reports on Union Government Direct Taxes for the years 1990-91 to 1993-94 revealed that the Ministry are yet to submit remedial/corrective action taken notes in several cases as shown below:

Audit Report for the year	No. of paras included	No. of action taken notes not received
1990-91	457	18
1991-92	362	13
1992-93	200	26
1993-94	210	11

Local Audit Reports

1.6 In the field, after completion of audit of each assessment unit, audit observations are conveyed to the department through Local Audit Reports. In case of important observations, a Statement of Facts is issued to the department to verify the facts and to obtain their views on the observation.

1.6.1 Results of Test Audit in general

Test audit conducted between 1 April 1994 and 31 March 1995 of the assessments completed by the Income Tax Department revealed 16,256 cases of underassessment involving a total revenue effect of Rs.855.39 crores which were referred to the department. A resume of the deficiences noticed is given below:

(i) Corporation Tax and Income Tax

During the period under report, 14,803 cases involving a tax effect

of Rs.844.04 crores were referred to the department. Of these cases, major audit observations were raised in 6,981 cases involving short levy of tax Rs.788.97 crores. The remaining 7,822 cases of accounted for underassessment of tax of Rs. 55.07 crores.

The underassessment of tax of Rs.844.04 crores arose due to mistakes which can broadly be categorised under the following heads:

		No. of cases	Amount (in crores of rupees)
1.	Avoidable mistakes in computation of income and tax	1503	35.05
2.	Failure to observe the provisions of the Finance Acts	657	122.33
3.	Incorrect status adopted in assessments	203	5.47
4.	Incorrect computation of income	216	6.31
5.	Incorrect computation of income from house property	175	2.16
6.	Incorrect computation of business income	3003	201.18
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1643	172.57
8.	Irregular computation of capital gains	293	19.07
9.	Mistakes in assessments of firm and partners	347	6.55
10.	Income not assessed	1014	90.57
11.	Irregualr set-off of losses	417	24.92
12.	Irregular exemptions and excess reliefs given	1058	50.18
13.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	2031	40.67
14.	Avoidable or incorrect payment of interest by Government	244	5.26
15.	Omission/short levy of penalty	578	9.09
16.	Other topics of interest (Miscellaneous)	1421	52.66
	Total	14803	844.04

(ii) Wealth Tax

During test audit of asessments made under Wealth Tax Act, 1957, short levy of Rs.7.55 crores was referred to the department in 1,256 cases.

The mistakes can be categorised under the following heads:

		No. of cases	Amount (in crores of rupees)
1.	Wealth not assessed	348	3.36
2.	Incorrect valuation of assets	325	2.06
3.	Mistakes in computation of net wealth	125	0.41

4.	Incorrect status adopted in assessments	24	0.07
5.	Irregular/ excessive allowances and exemption	110	0.23
6.	Mistakes in calculation of tax	64	0.14
7.	Non-levy or incorrect levy of additonal wealth tax	68	0.30
8.	Non-levy or incorrect levy of penalty and non-levy of interest	133	0.54
9.	Miscellaneous	59	0.44
	Total	1256	7.55

(iii) Gift Tax

During test check of gift tax assessments, 195 cases involving short levy of Rs. 3.78 crores were referred to the department.

(iv) Interest Tax

In the course of test audit of Interest Tax assessments it was noticed that in two cases there was short levy of interest tax of Rs.2.10 lakhs.

1.6.2 Outstanding audit observations

According to the departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee (Ninth Lok Sabha) in their 20th Report recommended that the responsibility for the settlement of audit observations rests with the department and it cannot be contented merely with sending replies to audit observations. In their Action Taken Note, the Ministry of Finance had stated that they would endeavour to see that the targets for settlement of audit observations were achieved. However, large number of audit observations made in 1994-95 and earlier years are still to be settled. The details are mentioned below:

(a) On 31 March 1995, 65,780 observations involving a revenue of Rs.6,009.28 crores were pending for final action. This does not include the audit observations communicated during 1 April 1994 to 31 March 1995. The year-wise particulars of the pendency are as follows:

(Amount in crores of rupees)

	Income Tax		Other Direct Taxes (Wealth Tax, Gift Tax and Estate Duty)		Total	
Year	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
1991-92 and before	39201	1951.75	7699	52.02	46900	2003.77

1992-93	7671	3248.89	1094	16.65	8765	3265.54
1993-94	8856	723.97	1259	16.00	10115	739.97
Total	55728	5924.61	10052	84.67	65780	6009.28

(b) There were 2380 pending audit observations as on 31 March 1995 with a revenue effect of Rs. 4,894.82 crores (as against 2,141 in earlier year) where the income tax involved in each individual case exceeded Rs.10 lakhs. The break-up of such cases in respect of a few charges where number of outstanding items are 50 or more is shown below:

Sl. No.	Name of charge	Items	Amount (in crores of rupees)
1.	Assam	56	31.56
2.	Delhi	369	511.06
3.	Gujarat	134	170.54
4.	Madhya Pradesh	205	160.27
5.	Maharashtra	571	3370.04
6.	Tamil Nadu	253	139.68
7.	West Bengal	439	282.32

(c) There were 71 pending audit observations with a revenue effect of Rs.11.11 crores where the wealth tax involved in each case exceeded Rs.5 lakhs.

(d) There were 54 pending audit observations with a revenue effect of Rs.16.28 crores where the total gift tax involved in each case exceeded Rs. 5 lakhs.

Of the 65,780 pending cases with revenue effect of Rs.6,009.28 crores, 2,505 cases (3.8 percent) of high tax effect accounted for Rs.4,922.21 crores (81.9 percent). This underlines the need to assign priority to the settlement of observations with high money value.

1.6.3 Steps taken to settle audit observations

The Action Plan of the department for 1994-95 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of statutory audit upto 31 December 1994 (i.e. period of report being 1994-95), replies are to be sent in 80 percent of the cases.

The targets for settlement of the major statutory audit observations for the year 1994-95 according to Action Plan and actual achievements thereagainst were as under:

	Audit observations				
	For disposal (Amount in crores of rupees)	To be settled as per targets fixed	Settled (Amount in crores of rupees)	Shortfall	
				Cases	Percentage
Current	8699 (761.84)	6959 (80%)	2544 (175.80)	4415	63.44
Arrear	18384 (1891.51)	16546 (90%)	6673 (549.40)	9873	59.67

The achievements were, therefore, well short of targets set.

1.6.4 Remedial action barred by time

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

In a few charges reviewed during the year 1994-95, a number of cases where remedial action became barred by limitation were noticed. The number of such cases alongwith tax effect involved in a few selected charges are mentioned below:

Sl. No.	Charge	Corporation Tax and Income Tax	
		No. of observations	Tax effect (in crores of rupees)
1.	Uttar Pradesh	339	1.63
2.	Haryana	58	0.07
3.	Maharashtra	130	0.08
4.	Tamil Nadu	23	0.08
5.	Punjab	98	0.23

Internal Audit

1.7 In addition to the statutory audit, the department also has an Internal Audit Department (IAD) which is required to conduct 100 percent and 75 percent audit of all immediate and priority assessment cases respectively (as defined under departmental instructions of September 1988). Based on this, the department had determined the number of auditable cases by their IAD during 1994-95 as 3.08 lakhs. However, the target was fixed at a much lower level based on 150 audit parties working during the period from 1 April 1994 to 31 March 1995 and each party being required to audit 110 cases every month. An analysis of their peformance is given below:

Total auditable cases	Targets for disposal	Total cases audited	Shortfall
3,07,865	1,98,000	1,58,052	39,948

Thus achievement fell short of the targets set by 20.17 percent.

1.7.1 Outstanding observations of Internal Audit

According to the departmental instructions, observations of Internal Audit Department are to be attended to by the assessing officers within three months. However, this did not happen as seen from the fact that on 31 March 1995, 33,217 audit observations made by the Internal Audit involving a tax effect of Rs.721.81 crores were pending settlement. This included 13,105 observations with money value of Rs.452.16 crores made during 1994-95.

The details of the major observations of IAD and their settlement is mentioned in the following table:

Financial year	No. of cases for disposal and amount (in crores of rupees)	No. of cases settled and amount (in crores of rupees)	Percentage of total cases disposed	No. of pending cases and amount (in crores of rupees)
1991-92	18625 (936.61)	7159 (570.50)	38	11466 (366.11)
1992-93	18053 (614.59)	6750 (146.78)	37	11303 (467.82)
1993-94	18006 (788.17)	7752 (259.57)	43	10254 (526.61)
1994-95	18465 (976.34)	6357 (261.30)	34	12108 (715.04)

The Public Accounts Committee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that observations of Internal Audit should be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases became time-barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken note had stated that assessment-yearwise and agewise classification was being made so that greater attention could be paid to settlement of older and revenue significant objections. Since the normal period available for re-opening of cases is four years, all observations pertaining to 1991-92 and earlier years should have been settled by March 1995. However, this did not happen as shown in the following table which gives age-wise analysis of the pending items at the end of 1994-95 and revenue effect involved:

Year of the observation	No. of cases	Revenue effect (in crores of rupees)
1991-92 and before	13,471	169.90
1992-93	4,581	72.71

1993-94	5,669	92.13
1994-95	9,496	387.07
Total	33,217	721.81

1.7.2 Action on observations of Internal Audit

(i) The Action Plan of the department for 1994-95 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of Internal Audit upto 31 December 1994 (i.e. period of reporting being 1994-95), replies were to be sent in 80 percent of the cases.

The targets according to Action Plan and actual achievement in settlement of the major internal audit observations for the year 1994-95 were as under:

	Audit observations				
	For disposal (Amount in crores of rupees)	To be settled as per targets fixed	Settled (Amount in crores of rupees)	Shortfall	
				Cases	Percentage
Current	8211 (449.74)	6569 (80%)	2498 (64.67)	4071	61.97
Arrear	10254 (526.61)	9229 (90%)	3859 (196.63)	5370	58.19

The achievements were, therefore, below the targets set.

(ii) According to instructions issued by the Board in 1977, mistakes pointed out by internal audit party should be rectified by the assessing officer promptly. The remedial action should be initiated within a month and completed as far as possible within three months of the report of internal audit. The delay in taking remedial action on the mistakes pointed out by Internal Audit is fraught with the risk of revenue loss. Two such cases in which remedial action has not been taken are given below:

(a) In Maharashtra charge, the assessment of an individual for the assessment year 1990-91 originally completed in November 1992 after scrutiny was revised in August 1993 enhancing the deduction towards investment deposit account to Rs.42.79 lakhs which included Rs.30.79 lakhs expended for purchase of plant and machinery and Rs.12 lakhs towards deposit in IDBI. The Internal Audit wing had noticed that out of Rs.30.79 lakhs claimed to have been utilised for purchase of plant and machinery, Rs.17.16 lakhs pertained to payment made for purchase of imported moulds for dish grinder which had not been received in the relevant previous year. As such

the amount could not be treated as utilised for purchase of machinery and the deduction allowed should have been reduced. Audit scrutiny revealed that no action had been taken on the observation of the Internal Audit Wing resulting in underassessment of income of Rs.17.16 lakhs involving short levy of tax of Rs.9.26 lakhs.

The reply of the Ministry to the audit observation has not been received.

(b) In Tamil Nadu charge, the assessment of a widely held company for the assessment year 1989-90 was completed in summary manner in March 1990. The Internal Audit wing of the department while auditing the assessment had pointed out the omission in not bringing to tax Rs.5.90 lakhs toward cash compensatory support received by the assessee during the relevant assessment year. Audit scrutiny revealed that no action had been taken on the observation of the Internal Audit wing resulting in non-assessment of income of Rs.5.90 lakhs with consequent short-levy of tax of Rs.3.94 lakhs (including interest).

The Ministry have accepted the audit observation.

Chapter 2

Statistical Information on Administration of Direct Taxes

Administration of Direct Taxes

2.1 The overall responsibility for administration of Direct Tax Laws lies with Department of Revenue which functions through the Income Tax Department with a staff strength of around 60,000 and with Central Board of Direct Taxes (Board) at its apex.

The Board consists of a Chairman and five members, and have several attached and subordinate offices throughout the country. The attached offices function under three Directors General of Income Tax viz. Director General of Income Tax (Admn.), Director General of Income Tax (Exemption) and Director General of Income Tax (Training). There are 25 Chief Commissioners of Income Tax, who oversee the work of assessment and collection of direct taxes at regional levels. Besides, there are 5 Directors General of Investigation who are in overall charge of the investigation machinery on a regional basis to curb tax evasion and to unearth black money. The Chief Commissioners of Income Tax/Directors General of Income Tax are assisted by the Commissioners of Income Tax/ Directors of Income Tax. The Deputy Commissioners/ Deputy Directors, Assistant Commissioners /Assistant Directors and Income Tax Officers assist the Commissioners of Income Tax/ Directors of Income Tax in their respective jurisdictions. There is an appellate machinery consisting of Commissioners (Appeal) and Deputy Commissioners (Appeal), who perform the work of quasi-judicial nature and consider appeals against the orders of the assessing officers.

The Settlement Commission which was constituted under the Income Tax Act with effect from April 1, 1976 provides a statutory remedy for avoiding protracted litigation between the assessee and the department. The Commission deals with the settlement of Income Tax and Wealth Tax cases on applications being made by the assessees declaring their intention to pay tax on undisclosed income discovered by the department. The Commission has four benches at Delhi, Bombay, Calcutta and Madras.

Receipts under various Direct Taxes

2.2 The total collections from Direct Taxes for the year 1994-95 amounted to Rs.26,970.88 crores out of which Rs.8,559.88 crores was assigned to the States. The collections for the three years 1992-93, 1993-94 and 1994-95, as furnished by the Ministry of Finance are given below:

(Amounts in crores of rupees)

Head of account	Category of tax	1992-93	1993-94	1994-95	Increase in 1994-95 over the previous year
0020	Corporation Tax	8889.24	10060.06	13820.96	3760.90
0021	Taxes on income other than Corporation-tax	7863.49	9122.62	12030.12	2907.50
0023	Hotel Receipts Tax	0.37	0.05	0.16	0.11
0024	Interest Tax	714.70	727.58	801.40	73.82
0028	Other Taxes on Income and Expenditure	152.00	228.75	196.87	(-) 31.88
0031	Estate Duty	0.95	0.21	1.52	1.31
0032	Taxes on wealth	467.27	153.98	104.87	(-) 49.11
0033	Gift Tax	9.27	4.99	14.98	9.99
	Gross Receipts	18097.29	20298.24	26970.88	6672.64
	Less share of net proceeds assigned to the States:				
	Income Tax	6059.45	7767.50	8559.88	
	Net Receipts	12037.84	12530.74	18411.00	

The above data reveal the following :

(i) While the Direct Taxes collections increased by 32.8 percent over the previous year, the two important components namely Corporation Tax and Income Tax increased by 37.4 percent and 31.9 percent respectively.

(ii) There was a reduction of Rs. 49.11 crores in "Taxes on wealth" due to reduction in Wealth Tax rates.

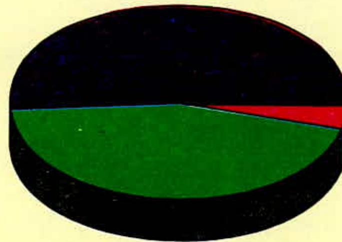
Trend of collection

2.3(i) The trend in collection of Direct Taxes since 1990-91 is shown below:

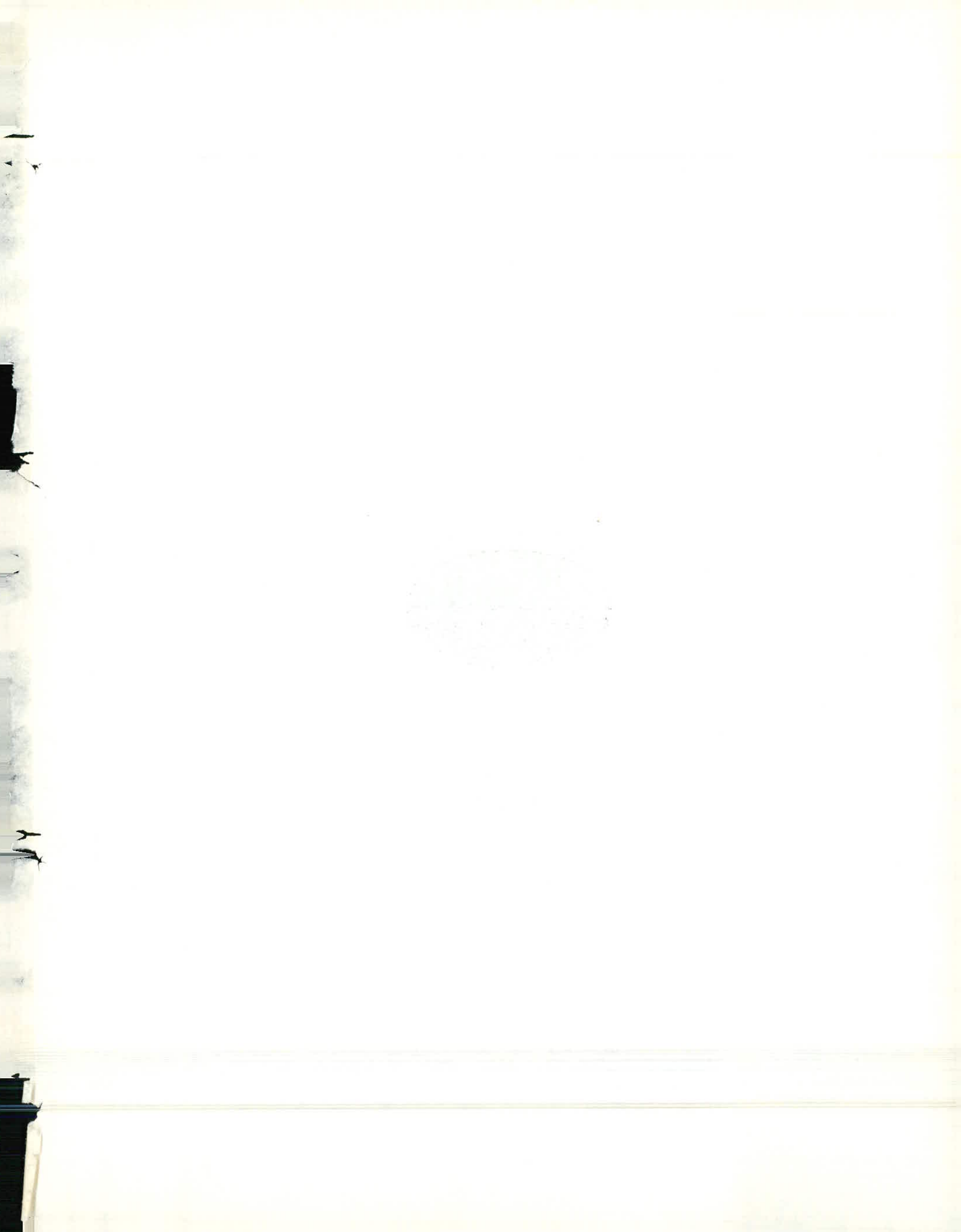
Collection (in crores of rupees)					Index taking 1990-91 as base			
Year	Corporation Tax	Income Tax other than Corporation Tax	Other Direct Taxes	Total	Corporation Tax	Income Tax other than Corporation Tax	Other Direct Taxes	Total
1990-91	5335.27	5375.34	318.33	11028.94	100	100	100	100
1991-92	7867.67	6705.80	768.89	15342.36	147.5	124.7	241.5	139.1
1992-93	8889.24	7863.49	1344.56	18097.29	166.6	146.3	422.4	164.0
1993-94	10060.06	9122.62	1115.56	20298.24	188.6	169.7	350.4	184.0
1994-95	13820.96	12030.12	1119.80	26970.88	259.0	223.8	351.8	244.6

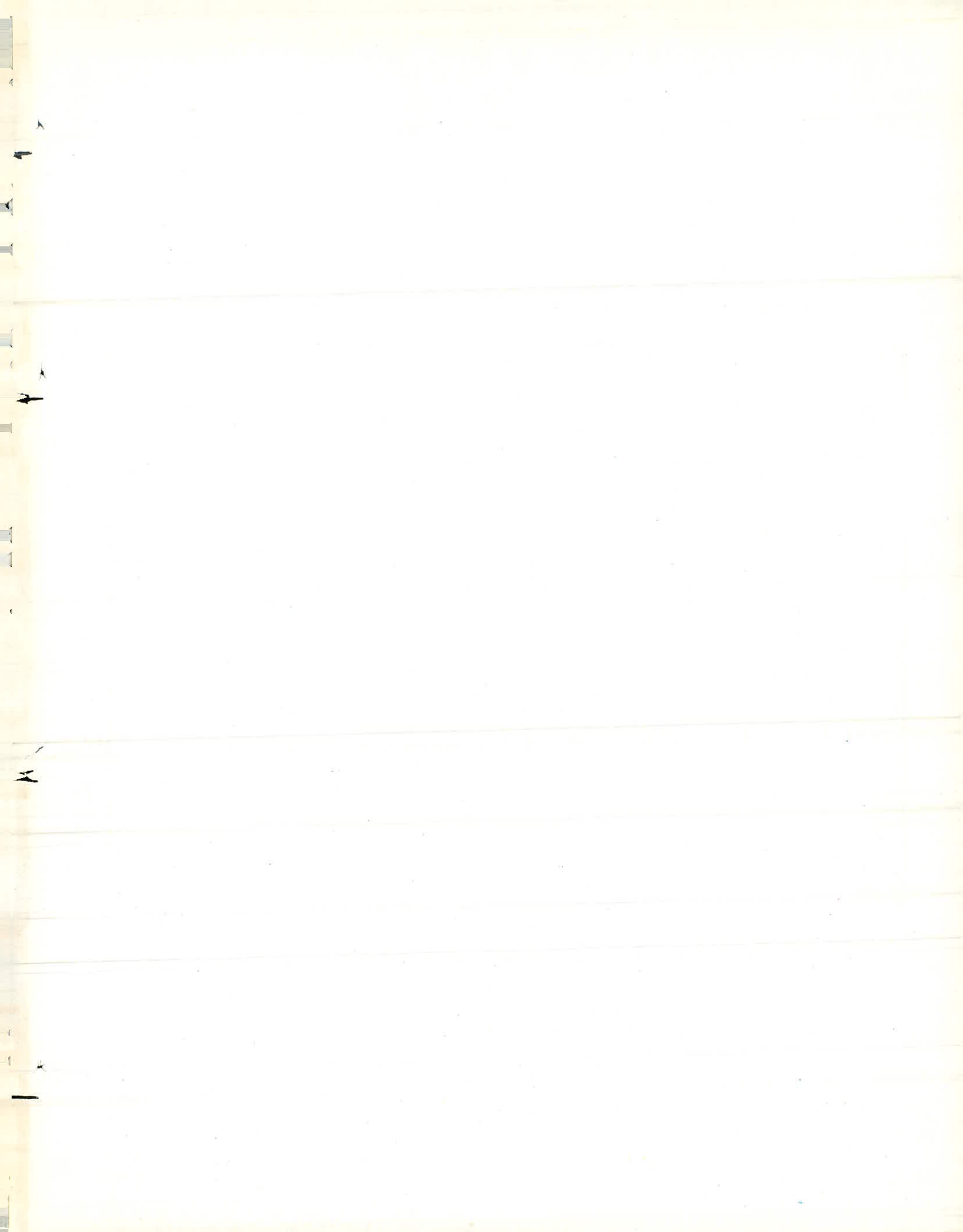
(ii) Corporation tax and income tax collections since 1990-91 are shown below as percentage of the Gross Domestic Product:

Collection of Direct Taxes
(1994-95)

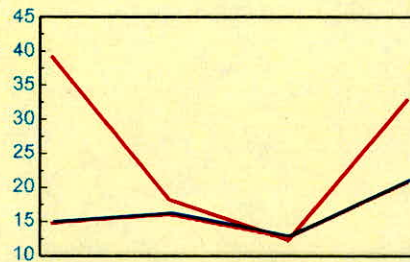


Corporation Tax :	Rs. 13820.96 crores
Income Tax :	Rs. 12030.12 crores
Other Direct Taxes :	Rs. 1119.80 crores





GDP and tax buoyancy



	1991-92	1992-93	1993-94	1994-95
% change in rev. —	39.1	18.0	12.2	32.9
% change in GDP—	14.6	15.9	12.6	20.8

Year	Corporation Tax	Income Tax other than corporation tax	GDP at factor cost (current prices)*	As a percentage of G.D.P. Corporation Tax	Income Tax
	(In crores of rupees)			(Percentage)	
1990-91	5335.27	5375.34	4,72,660	1.1	1.2
1991-92	7867.67	6705.80	5,41,888	1.5	1.2
1992-93	8889.24	7863.49	6,27,913	1.4	1.2
1993-94	10060.06	9122.62	7,07,145	1.4	1.3
1994-95	13820.96	12030.12	8,54,103	1.6	1.4

(iii) Buoyancy or income elasticity of tax is defined as the percentage change in tax revenue divided by the percentage change in Gross Domestic Product (GDP). The average buoyancy which is measured by the ratio of change in tax revenues to change in GDP at current prices would be a reliable indicator of whether the tax administration have taken full advantage of the growth in GDP to optimise the resources mobilised through tax collections. As the following table shows, this has not happened indicating the need for streamlining the collection mechanism:

Year	Change in revenue over previous year		Change in GDP over previous year		Average Buoyancy
	Amount (in Rs. crores)	Percent	Amount (in Rs. crores)	Percent	
1991-92	4313	39.10	69228	14.64	0.06
1992-93	2755	17.95	86025	15.87	0.03
1993-94	2201	12.16	79232	12.61	0.02
1994-95	6673	32.87	146958	20.78	0.04

Variation between budget estimates and actual receipts

2.4(i) The comparative position of actual receipts vis-a-vis the budget estimates under the different heads for the years 1990-91 to 1994-95 are as follows:

Year	Budget Estimates	Actuals	Variation	Percentage of variation
	(In crores of rupees)			
0020- Corporation Tax				
1990-91	5,289.00	5,335.27	46.27	0.87
1991-92	6,704.00	7,867.67	1163.67	17.35
1992-93	8,125.00	8,889.24	764.24	9.41
1993-94	10,500.00	10,060.06	(-) 439.94	(-) 4.19
1994-95	12,480.00	13,820.96	1340.96	10.74
0021- Taxes on income other than Corporation Tax				
1990-91	5,676.00	5,375.34	(-) 300.66	(-) 5.30
1991-92	6,152.00	6,705.80	553.80	9.00

* GDP figures collected from National Accounts Statistics Organisation, Ministry of Planning. The figures for 1994-95 are as per their estimates.

1992-93	7,870.00	7,863.49	(-) 6.51	(-) 0.08
1993-94	9,500.00	9,122.62	(-) 377.38	(-) 3.97
1994-95	10,925.00	12,030.12	1105.12	10.11

Other Direct Taxes				
1990-91	187.50	236.76	49.26	26.27
1991-92	801.30	623.27	(-) 178.03	(-) 22.21
1992-93	1158.00	1344.56	186.56	16.11
1993-94	1260.00	1115.56	(-) 144.44	(-) 11.46
1994-95	1385.00	1119.80	(-) 265.20	(-) 19.15

While actual collections under 'Corporation Tax' and ' Income Tax' in 1994-95 exceeded the budget estimates by 10.74 and 10.11 percent respectively, those under 'Other Direct Taxes' fell short by 19.15 percent.

(ii) The details of variation under the heads subordinate to the Major heads 0020 and 0021 and under Major head 0024 - Interest Tax for the year 1994-95 are as follows:

	Head of revenue	Budget Estimates	Actuals	Variation	Percentage of variation
		(In crores of rupees)			
	0020-Corporation Tax				
(i)	Income Tax on companies	10,811.00	13212.61	2401.61	22.21
(ii)	Surtax	15.00	16.79	1.79	11.93
(iii)	Surcharge	1,622.00	490.68	(-) 1131.32	(-) 69.74
(iv)	Other receipts	32.00	100.88	68.88	215.25
	Total	12,480.00	13820.96	1340.96	10.74

	0021 - Taxes on income other than Corporation Tax				
(i)	Income-tax	10,249.00	11,831.56	1,582.56	15.44
(ii)	Surcharge	614.00	98.36	(-) 515.64	(-) 83.98
(iii)	Other receipts	62.00	100.20	38.20	61.61
(iv)	Total	10,925.00	12,030.12	1,105.12	10.11
(v)	Deduct share of proceeds asigned to States	8,204.55	8,559.88	355.33	4.33
	Net Collection	2,720.45	3,470.24	749.79	27.56

* includes Interest Tax, Estate Duty, Wealth Tax and Gift Tax.

0024 - Interest Tax			
1044.00	801.40	(-) 242.60	(-) 23.24

Analysis of collection

2.5 Under the Income Tax Act, 1961, income tax is chargeable for any assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act provides for pre-assessment collection by way of deduction of tax at source, advance tax and payment of tax on self-assessment. The post-assessment collection is of additional demand arising after assessment.

(i) The sub-head wise break-up of total income tax collections for companies, non companies at pre-assessment and post-assessment stages for the years 1990-91 to 1994-95, as furnished by the Ministry of Finance, are given below:

(Amount in crores of rupees)

Year	Tax collections							
	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds	Net Collections
				Company				
1990-91	1,499.58	4,085.01	355.98	1,127.67	207.17	7,275.41	1,944.79	5,330.62
1991-92	2,348.13	5,962.38	455.31	1,157.09	543.56	10,466.47	2,613.67	7,852.80
1992-93	2,321.19	6,886.67	1032.48	1,437.88	424.86	12,103.08	2,489.04	9,614.04
1993-94	2,772.27	7,303.43	1,250.58	2,382.51	397.46	14,106.25	4,045.96	10,060.29
1994-95	3,810.91	9,770.02	952.84	2,030.36	614.59	17,178.72	3,357.76	13,820.96
				Non-company				
1990-91	2,583.36	2,227.64	639.30	562.18	175.89	6,188.37	827.74	5,360.63
1991-92	3,627.80	2,504.81	721.32	414.33	255.71	7,523.97	794.79	6,729.18
1992-93	3,888.34	3,030.98	1005.38	676.60	459.49	9,060.79	1165.44	7,895.35
1993-94	4,510.31	3,794.34	1156.06	714.19	285.17	10460.07	1340.96	9,119.11
1994-95	5,792.84	4,725.06	1,461.62	982.73	396.14	13,358.39	1,328.29	12,030.10
				Total				
1990-91	4,082.94	6,312.65	995.38	1,689.85	383.06	13,463.78	2,772.53	10,691.25
1991-92	5,975.93	8,467.19	1,176.63	1,568.08	802.61	17,990.44	3,408.46	14,581.98
1992-93	6,209.53	9,917.65	2037.86	2,114.48	884.35	21,163.87	3,654.48	17,509.39
1993-94	7,282.58	11,907.77	2,406.64	3,096.70	682.63	24,566.32	5,386.92	19,179.40
1994-95	9,603.75	14,495.08	2,414.46	3,013.09	1,010.73	30,537.11	4,686.05	25,851.06

Thus 85 percent of the collections in company cases and 90 percent in non-company cases in 1994-95 were made at pre-assessment stage with the balance being collected after assessment.

(ii) The details of tax deduction at source during the year 1994-95 under broad categories are as under:

	Amount (in crores of rupees)
Salaries	2,402.69
Interest on securities	2,302.25
Dividends	577.73
Interest	1,474.82
Winnings from lottery or cross word puzzles	38.95

Winnings from horse races	5.85
Payments to contractors and sub-contractors	1,359.02
Insurance commission	66.71
Payment to non-residents and others	1,375.73
Total	9,603.75

(iii) The following details of statements of tax deducted at source for the year 1994-95 indicate a shortfall in the returns received from tax deductors:

1.	No. of tax deductors as on 1 April 1994	508756
2.	Adjustment/progressive additions upto 31 March 1995	67323
3.	Effective tax deductors (1+2)	576079
4.	No. of returns required to be filed by tax deductos at 3	576079
5.	Returns received upto 31 March 1995	415008
6.	Balance 4-5	161071

Cost of collection

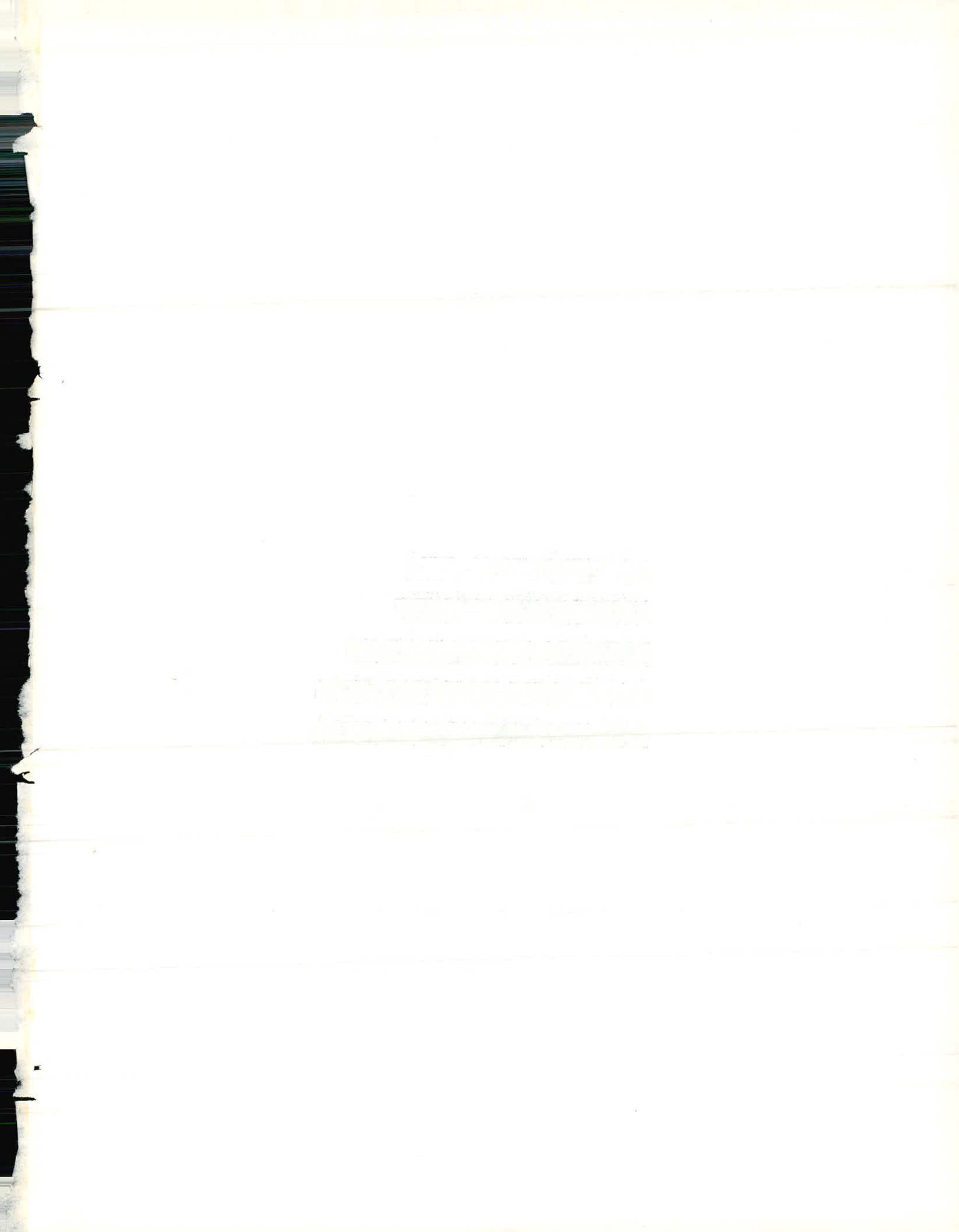
2.6.1 The total expenditure incurred during the years 1991-95 in collecting the direct taxes was as under:

Year	Collection (In crores of rupees)	Expenditure	Percentage
1991-92	15,342.36	256.46	1.67
1992-93	18,097.29	296.48	1.63
1993-94	20,298.24	335.43	1.65
1994-95	26,970.88	388.27	1.44

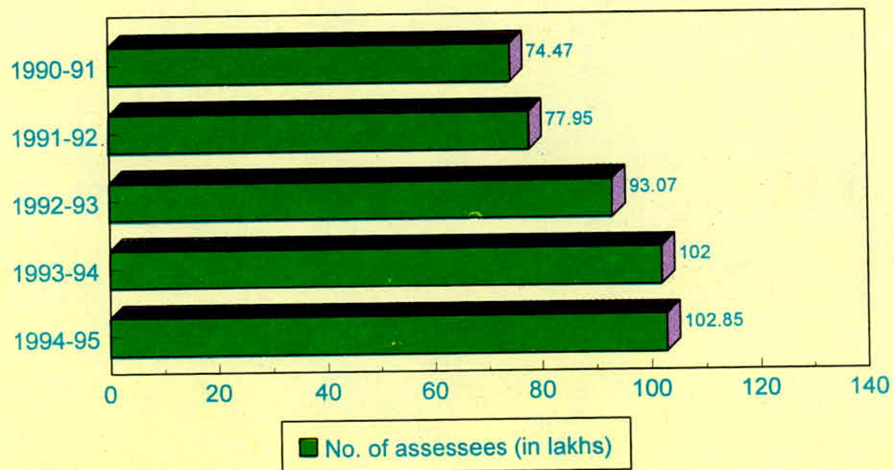
The cost of collection has been showing a declining trend as the department's work force and as a consequence its expenditure, have remained more or less static. As mentioned in para 2.5 (i), over 85 percent of the tax collected is through voluntary compliance. The department needs to utilise its work force more effectively to widen the tax base.

2.6.2 The expenditure incurred during the year 1994-95 in collecting corporation tax, taxes on income other than corporation tax and other direct taxes together with the corresponding figures for the preceding three years, is as follows:

Year	Collection (in crores of Rupees)	Expenditure on collection	Percentage
0020-Corporation Tax			
1991-92	7,867.67	30.77	0.39
1992-93	8,889.24	35.44	0.39
1993-94	10,060.06	40.04	0.39
1994-95	13,820.96	46.84	0.34



Number of assessees
(1990-91 to 1994-95)



0021-Taxes on income etc.			
1991-92	6,705.80	200.02	2.98
1992-93	7,863.49	230.43	2.93
1993-94	9,122.62	260.63	2.85
1994-95	12,030.12	302.51	2.51

Other Direct Taxes*			
1991-92	767.65	25.67	3.34
1992-93	1,344.56	30.61	2.27
1993-94	1,115.56	34.76	3.12
1994-95	1,119.80	38.92	3.47

Number of assessees

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

2.7.1 Income tax

For the assessment year 1994-95, no income tax was payable on a total income not exceeding Rs.30,000 in case of individuals non specified Hindu undivided families, association of persons and body of individuals. For specified Hindu undivided family, firms, co-operative society and local authority, lower limits were applicable. Corporate assessees are required to pay taxes at specified rates on their income.

(i) The department brought 84,213 additional assessees on its books during 1994-95, bringing the total number of assessees as on 31 March 1995 to Rs.1.03 crores. The comparative break-up of the number of assessees as on 31 March 1994 and 31 March 1995 is given below.

	As on 31 March 1994	As on 31 March 1995
Individuals	82,12,965	84,49,122
Hindu undivided families	4,35,246	4,04,913
Firms	12,95,477	11,72,755
Companies	1,71,419	1,76,594
Trusts	42,886	42,564
Others	42,400	38,658
Total	1,02,00,393**	1,02,84,606

(ii) The following table indicates the category wise break up of assessees:

* Includes interest tax, expenditure tax, estate duty, wealth tax and gift tax.

** Reported as 95.76 lakhs by the Ministry and printed as such in the Audit Report 1993-94

Category	Individuals	Hindu undivided families	Firms	Companies	Others (including Trusts)	Total
(i) Category 'A'[1]	81,90,186	3,88,478	10,82,892	93,478	70,536	98,25,570
(ii) Category 'B' (Lower)[2]	1,96,492	9,630	45,508	43,590	6,720	3,01,940
(iii) Category 'B' (Higher)[3]	36,049	2,579	13,228	18,090	1,189	71,135
(iv) Category 'C'[4]	10,012	924	5,529	19,166	1,867	37,498
(v) Category 'D'[5]	16,383	3,302	25,598	2,270	910	48,463
Total	84,49,122	4,04,913	11,72,755	1,76,594	81,222	1,02,84,606

2.7.2 Surtax

Under the Companies (Profits) Surtax Act, 1964, surtax is levied on the chargeable profits of a company insofar as they exceed the statutory deductions, which is equal to 15 percent (from 1 April 1977) of the capital of the company or Rs. two lakhs, which ever is greater.

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

Year ending	No. of assessees
31 March 1993	1,037
31 March 1994	1,190
31 March 1995	Not furnished by the Ministry

2.7.3 Interest Tax

Under the Interest Tax Act, 1974, as reintroduced with effect from 1 October 1991, by the Finance (No.2) Act,1991, interest tax is leviable on the chargeable interest income of 'Credit Institutions'. Such credit institutions, inter alia, included co-operative societies engaged in the business of banking, not being co-operative societies which provide credit facilities to farmers or village artisans, for the assessment year 1992-93. The interest income

[1] Category 'A' assessees - Company assessments with income/loss below Rs.50,000/- and non-company assessments with income/loss below Rs. 2 lakhs.

[2] Category 'B' assessees (lower income group) - Company assessments with income /loss of Rs.50,000/- and above but below Rs.5 lakhs and non-company assessments with income/loss of Rs.2 lakhs and above but below Rs.5 lakhs.

[3] Category 'B' assessees (higher income group) - Company and non-company assessments with income/loss of Rs.5 lakhs and above but below Rs.10 lakhs.

[4] Category 'C' assessees - Company and non-company assessments with income/loss of Rs.10 lakhs and above.

[5] Category 'D' assessees - Serach and Seizure assessments.

chargeable to tax includes interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange.

The number of assessees for interest tax in the books of the department as furnished by the Ministry of Finance for the last three years were as under:

Year ending	No. of assessees
31 March 1993	850
31 March 1994	1,385
31March 1995	2,121

2.7.4 Wealth Tax

Under the provisions of the Wealth Tax Act, 1957, wealth tax is levied for every assessment year on the net wealth of every individual and Hindu undivided family according to the rates specified in the schedule to the Act. No wealth tax was levied on companies with effect from 1 April 1960. However, levy of wealth tax on companies has been revived in a limited way with effect from 1 April 1984. For the assessment year 1994-95, no wealth tax was payable where the net wealth was less than Rs.15 lakhs.

The number of wealth tax assessees in the books of the department as on 31 March 1994 and 31 March 1995 were as follows:

	As on	
	31 March 1994	31 March 1995
Individuals	5,52,914	4,71,190
Hindu undivided family	70,153	58,379
Companies	16,406	15,232
Total	6,39,473	5,44,801

2.7.5 Gift Tax

Under the provisions of the Gift Tax Act, 1958, gift tax is levied according to the rates specified in the schedule for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including Hindu undivided family) or a company or an association of persons or body of individuals (whether incorporated or not) during the previous year. During the assessment year 1994-95 no gift tax was payable where the value of taxable gifts did not exceed Rs.30,000.

The number of gift tax assessees in the books of the department as on 31 March 1994 and 31 March 1995 were as follows:

Year	No. of assessees
1993-94	51,064
1994-95	63,261

Arrears of assessments

2.8 The limitation period for completion of assessment is 2 years in the case of income tax, wealth tax and gift tax.

Sanctioned and working strength of officers on assessment duty as on 31 March 1995 was as under:

	Nature of posts	Sanctioned strength	Working strength
(a)	Income Tax officers on assessment duty	1804	1778
(b)	Assistant Commissioners	948	880
(c)	Additional Commissioners/Deputy Commissioners	223	224
	Total	2975	2882

2.8.1 Income Tax including Corporation Tax

(i) The number of assessments completed during the five years was as under:

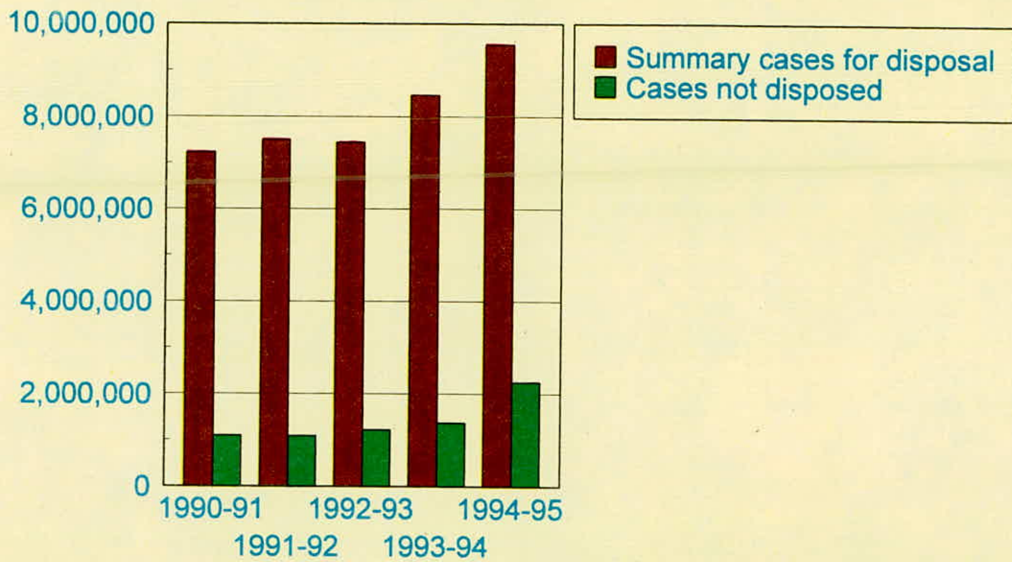
Financial Year	Number of assessments for disposal			Number of assessments completed			Percentage of disposal
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	
(i)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1990-91	4,41,797	72,28,910	76,70707	2,60,722	61,27,783	63,88,505	83.28
1991-92	5,34,174	75,00,631	80,34,805	3,06,495	64,06,919	67,13,414	83.55
1992-93	5,09,406	74,43,737	79,53,143	2,85,867	62,17,076	65,02,943	81.76
1993-94	4,98,327	84,65,578	89,63,905	3,36,894	70,86,282	74,23,176	82.81
1994-95	4,53,353	95,51,857	1,00,05,210	2,98,669	72,94,097	75,92,766	75.89

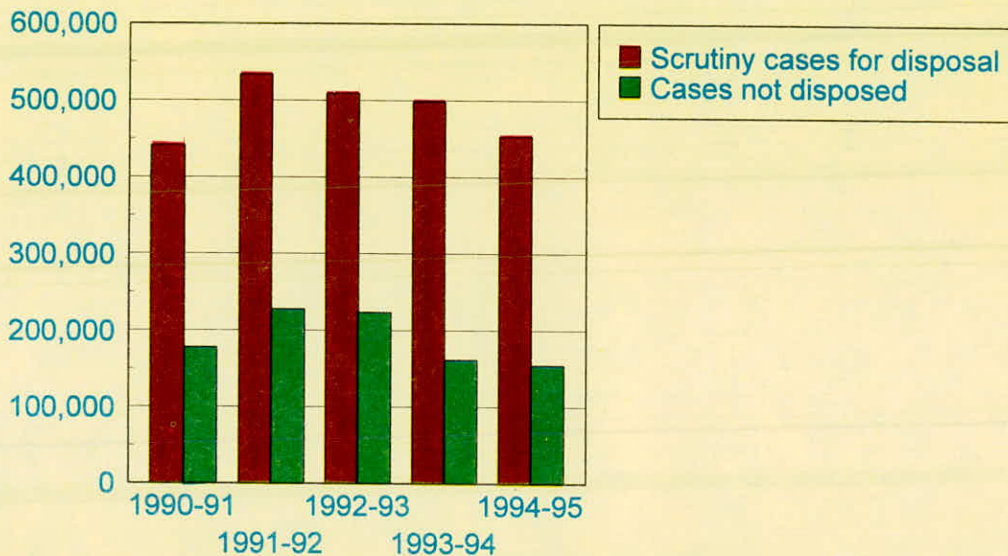
The break-up of assessments pending at the end of the year 1994-95 is given below:

Year	Scrutiny	Summary	Total
1990-91	1,77,766 (40.23)	11,04,436 (15.28)	12,82,202
1991-92	2,27,679 (42.62)	10,93,712 (14.58)	13,21,391
1992-93	2,23,539 (43.88)	12,26,661 (16.47)	14,50,200
1993-94	1,61,403 (32.39)	13,79,296 (16.29)	15,40,699
1994-95	1,54,684 (34.12)	22,57,760 (23.64)	24,12,444

(Figures in parentheses denote percentage of pendency with reference to the number of assessments for disposal)

It would be seen from the above table that percentages of pending


Disposal of summary assessment cases
10,000,000
8,000,000
6,000,000
4,000,000
2,000,000
0
1990-91
1991-92
1992-93
1993-94
1994-95
Summary cases for disposal
Cases not disposed


Disposal of scrutiny assessment cases
600,000
500,000
400,000
300,000
200,000
100,000
0
1990-91
1991-92
1992-93
1993-94
1994-95
Scrutiny cases for disposal
Cases not disposed

scrutiny and summary assessment cases were not only very high but have also shown an increase compared to the preceding year though the Board had issued instructions for according priority to increasing disposal of both summary and scrutiny assessments.

(ii) Status-wise break-up of income tax assessments completed during the year 1993-94 and 1994-95 are as under:

		1993-94	1994-95
(a)	Individuals	59,68,510	62,28,273
(b)	Hindu undivided families	2,87,786	3,01,731
(c)	Firms	9,27,505	8,17,282
(d)	Companies	1,81,130	1,86,938
(e)	Others	58,245	58,542
	Total	74,23,176	75,92,766

(iii) Status-wise and category-wise break-up of work load, disposals and pendency of assessments as on 31 March 1995 was as under:

			Workload		Disposal		Balance	
			Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny
1.	Category 'A' Assessments	Company	19460	100272	11125	80975	8335	19297
		Non-Company	290180	9165280	198615	7002740	91565	2162540
2.	Category 'B' (lower) Assessments	Company	14991	41783	9657	30340	5334	11443
		Non-Company	35165	130256	23502	98985	11663	31271
3.	Category 'B' (higher) Assessments	Company	9039	19856	5443	15137	3596	4719
		Non-Company	19348	39900	13142	24169	6206	15731
4.	Category 'C' Assessments	Company	24718	24406	14892	17110	9826	7296
		Non-Company	14915	16123	9350	12896	5565	3227
5.	Category 'D' Assessments	Company	2247	1287	1241	1018	1006	269
		Non-Company	23290	12694	11702	10727	11588	1967
6.	Total	Company	70455	187604	42358	144580	28097	43024
		Non-Company	382898	9364253	256311	7149517	126587	2214736

(iv) Status-wise and year-wise break-up of pendency of income tax assessments as on 31 March 1995 is as under:

	Status	1990-91 and earlier years	1991-92	1992-93	1993-94	1994-95	Total
(a)	Company assessments						
(i)	Regular	197	89	1383	19202	45719	66590
(ii)	Reopened/set aside	647	429	177	362	2916	4531

(b)	Non-company assessments						
(i)	Regular	1904	1702	5828	325522	1149269	1484225
(ii)	Reopened/set aside	2801	1603	1660	3793	847241	857098
	Total	5549	3823	9048	348879	2045145	2412444

The number of assessments pending as on 31 March 1995 was 24,12,444 as compared to 15,40,699 as on 31 March 1994 and 14,50,200 on 31 March 1993.

2.8.2 Wealth Tax and Gift Tax

(A) Wealth Tax

(i) Status-wise number of wealth tax assessments due for disposal completed and pending for the years 1993-94 and 1994-95 was as follows:

Assessments	Year	Individual	Hindu Undivided families	Companies	Total
Due for disposal	1993-94	5,31,384	63,561	18,806	6,13,751
	1994-95	2,60,006	34,876	11,407	3,06,289
Compieted	1993-94	3,77,127	42,443	13,004	4,32,574
	1994-95	2,05,495	25,278	6,952	2,37,725
Pendency at the end of the year (percentage in parentheses)	1993-94	1,54,257 (29.03)	21,118 (33.22)	5,802 (30.85)	1,81,177 (29.52)
	1994-95	54,511 (20.96)	9,598 (27.52)	4,455 (39.05)	68,564 (22.38)

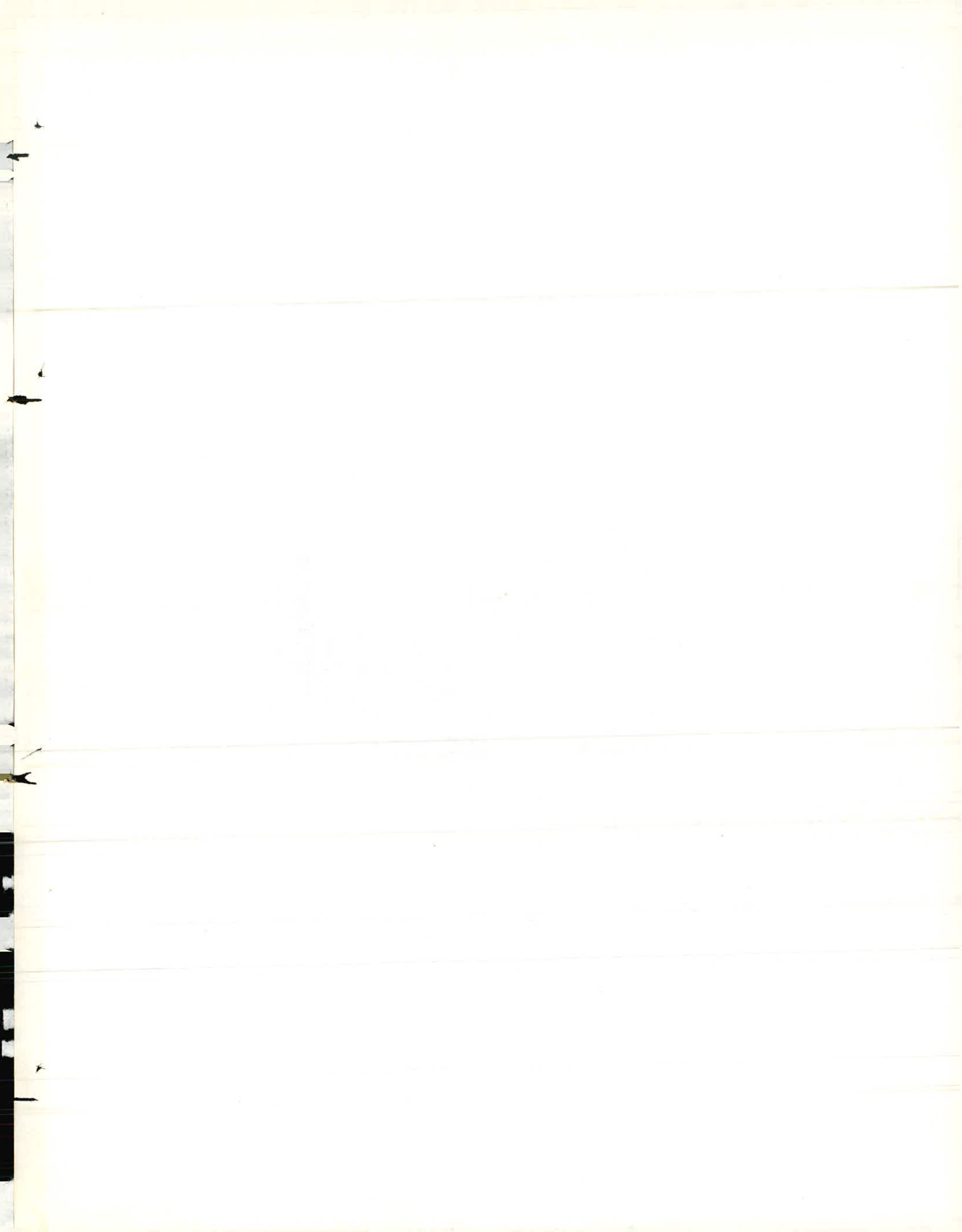
The pendency position improved marginally from 29.5 percent in 1993-94 to 22.4 percent in 1994-95 though the number of assessments for disposal had reduced.

(B) Gift Tax

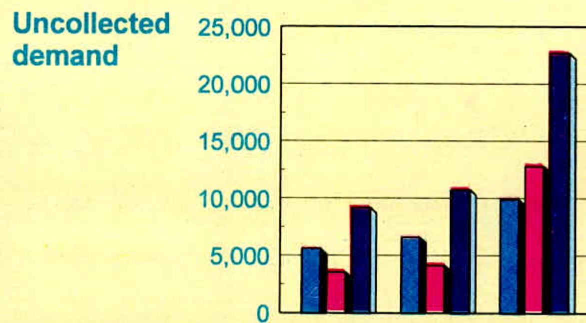
Status-wise number of gift tax assessments due for disposal completed and pending for the years 1993-94 and 1994-95 was as under:

Assessments	Year	Individual	HUF	Company	Firms	Others	Total
Due for disposal	1993-94	35,544	799	80	16	39	36,478
	1994-95	29,806	753	90	15	3264	33,928
Completed	1993-94	27,773	626	52	9	29	28,489
	1994-95	24,625	609	44	3	2864	28,145
Pendency at the end of the year (Percentage in parentheses)	1993-94	7,771 (21.86)	173 (21.65)	28 (35.00)	7 (43.75)	10 (25.64)	7,989 (21.90)
	1994-95	5,181 (17.38)	144 (19.12)	46 (51.11)	12 (80.00)	400 (12.25)	5,783 (17.04)

There was a marginal improvement in pendency of assessments from 21.90 percent in 1993-94 to 17.04 percent in 1994-95.



Uncollected tax demand



	1992-93	1993-94	1994-95
Companies (Rs. crores)	5,623.6	6,626.6	9,890.1
Non-companies (Rs. crores)	3,587.4	4,153.5	12,808.5
Total (Rs. crores)	9,211.0	10,780.1	22,698.6

2.8.3 Surtax and Interest Tax

The number of surtax and interest tax assessments due for disposal, completed and pending for the years 1993-94 and 1994-95 was as follows:

Assessments	Year	Surtax	Interest Tax
Due for disposal	1993-94	1,245	2,381
	1994-95	1,649	6,704
Completed	1993-94	117	395
	1994-95	499	1,810
Pendency at the end of the year	1993-94	1,128 (90.60)	1,986 (83.41)
(Percentage in parentheses)	1994-95	1,150 (69.73)	4,894 (73.00)

Arrears of demands of Corporation Tax (including surtax) and Income Tax

2.9 The Income Tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 30 days unless the time for payment is extended by the assessing officer on application made by the assessee. The Act has been amended with effect from 1 October 1975 to provide that an appeal against an assessment order would be barred unles the admitted portion of the tax as per return has been paid before filing the appeal.

(a) The total amount of tax remaining uncollected as on 31 March 1995 was Rs.22,698.64 crores, out of which arrears of Rs.9,890.12 crores related to companies. The arrears included Rs. 11,014.43 crores which had not fallen due as on 31 March 1995, Rs.658.47 crores claimed to have been paid but remaining to be verified/adjusted, Rs.4,530.25 crores stayed/kept in abeyance and Rs.157.78 crores for which instalments had been granted and instalments not fallen due.

(b) The year-wise position of arrears remaining uncollected in company and non-company cases for the years 1992-93 to 1994-95 is given below:

	1992-93	1993-94	1994-95
	(Amount in crores of rupees)		
Companies	5,623.63	6,626.63	9,890.12
Non-companies	3,587.37	4,153.50	12,808.52
Total	9,211.00	10,780.13	22,698.64

Thus arrears continued to mount despite direction of the Board for according priority to reduction of the arrear demand.

(c) The details of demands of income tax (including corporation

tax) stayed/kept in abeyance as on 31 Marh 1995 were as follows:

(Amounts in crores of rupees)

(1)	By courts	998.57
(2)	Under Section 245 (F) (2) (Application to Settlement Commission)	130.31
(3)	By Tribunals	214.79
(4)	By Income tax authorities due to	
	(i) Appeals and revisions	840.70
	(ii) Double income tax claims	32.66
	(iii) Restriction on remittance Sec.220 (7)	4.58
	(iv) Other reasons	2308.64
	Total	4530.25

(d) The total outstanding demand remaining uncollected as on 31 March 1995 of Rs.22698.64 crores comprised arrear demand of Rs.8498 crores of earlier years. The age wise analysis of the arrear demand of corporation tax, income tax, interest and penalty is given below:

(Amount in crores of rupees)

		Corporation Tax	Income Tax	Interest	Others	Total
1.	Over 1 year but less than two years.	1303.10	1605.49	2289.95	207.16	5405.70
2.	Over 2 years but less than 5 years	777.37	443.85	576.11	177.53	1974.86
3.	Over 5 years but les than 10 years	193.00	199.63	262.13	120.73	775.49
4.	Over 10 years	51.37	116.75	109.98	63.85	341.95
	Total	2324.84	2365.72	3238.17	569.27	8498.00

(e) The following table gives the break-up of the gross arrears of Rs.22,049.08 crores by certain slabs of income:

(Amount in crores of rupees

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Upto Rs.1 lakh in each case	96311	1026.99	475.98	3985103	1651.56	1115.26	4081414	2678.55	1591.24
Over Rs.1 lakh to Rs.10 lakhs in each case	14859	718.89	248.38	50579	857.16	442.39	65438	1576.05	690.77
Over Rs.10 lakhs to Rs.1 crore in each case	3962	1498.87	643.76	4415	1254.48	508.40	8377	2753.35	1152.16

Over Rs. 1 crore in each case	719	5975.85	1805.39	506	9065.28	1035.42	1225	15041.13	2840.81
Total	115851	9220.60	3173.51	4040603	12828.48	3101.47	4156454	22049.08	6274.98*

Thus 63.6 percent of the total net arrears of Rs.6,274.98 crores outstanding on 31 March 1995 was constituted by high demand cases of Rs.10 lakhs and above. The department needs to take concerted action in liquidation of these arrears.

(ii) The following table gives the year-wise arrears of demands outstanding under wealth tax and gift tax as on 31 March 1995.

(Amounts in crores of rupees)

	Wealth tax	Gift Tax
Over one year but less than two years	158.97	14.06
Over two years but less than five years	162.71	8.94
Over five years but less than ten years	68.74	4.77
Over ten years	34.79	2.93
Total	425.21	30.70

(iii) Information on various aspects of the work relating to taxes in arrears has been featured separately in paragraph 3.2 of chapter III of this Report.

Appeals, Revision petitions and Writs

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

A second appeal can be taken to the Income Tax Appellate Tribunal. After the Tribunal's decision, appeal on a point of law can be made to the High Court. An appeal thereafter lies to the Supreme Court. The assessee can also initiate writ proceedings under Article 226 of the Constitution.

A taxpayer can approach the Commissioner of Income Tax to revise an order passed by an assessing officer or by an Appellate Assistant Commissioner within one year from the date of such orders. The Commissioner can also take up for revision an order which, in his view, is prejudicial to the interest of revenue.

(I) Income Tax including Corporation Tax

(i) Particulars of income tax appeals as on 31 March 1995 for

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* 1. Figures do not tally with those given in para 2.9. (a) as reconciliation remains yet to be done by the Ministry in respect of certain charges.

2. Net arrears comprise gross arrears minus arrears not fallen due, amount claimed to have been paid pending verification, amount for which instalments were granted, amounts stayed/kept in abeyance.

disposal, completed and pending with Commissioner and Deputy Commissioner (Appeals) were as follows:

	Appeals for disposal	Disposal	Pending
(a) Commissioner of Income Tax (Appeals)	2,72,236	97,985	1,74,251
(b) Deputy Commissioner of Income Tax (Appeals)	1,33,346	50,025	83,321

(ii) Details of high demand (revenue involved more than Rs. 1 lakh) appeals pending with Commissioner and Deputy Commissioner (Appeals) were as under:

	Appeals for disposal	Disposal	Pending
(a) Commissioner of Income Tax (Appeals)	54,202	28,528	25,674
(b) Deputy Commissioner of Income Tax (Appeals)	5,786	2,846	2,940

(iii) The year-wise break up of pending appeals has not been maintained by the Ministry.

(iv) Details regarding appeals, references and writs in Supreme Court, High Court and Income Tax Appellate Tribunal are as under:

	No. for disposal	Disposal	Pending
Supreme Court	7,811	15	7,796
High court	53,093	2,159	50,934
Income Tax Appellate Tribunal	1,37,914	11,879	1,26,035
Total	1,98,818	14,053	1,84,765

(II) Other Direct Taxes

Particulars of wealth tax and gift tax appeals pending with Commissioner and Deputy Commissioner (Appeals) and year-wise pendency of high demand appeals (more than Rs.50,000) were not furnished by the Ministry of Finance.

Reliefs and refunds

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

(i) The particulars of cases of direct refunds on which claims were made during 1990-91 to 1994-95 were as under:

Financial year	Opening balance	Claims received during the year	Total	No. of claims disposed off	Balance outstanding
1990-91	24,609	72,314	96,923	81,274	15,649
1991-92	15,649	97,486	1,13,135	96,470	16,665
1992-93	16,665	90,402	1,07,067	91,249	15,818
1993-94	15,818	68,228	84,046	72,971	11,075
1994-95	11,075	87,377	98,452	81,730	16,722

Yearwise analysis of the outstanding direct refund claims as on 31 March 1995 was not furnished by the Ministry.

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

Details of cases resulting in refund as a result of appellate orders and revision orders etc. as on 31 March 1995 were not furnished by the Ministry.

Interest

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

Information relating to interest paid on refunds by Government was not furnished by the Ministry of Finance.

Cases settled by Settlement Commission

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

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

(i) Income Tax				
Financial year	No. of cases for disposal	No. of cases settled	Percentage of cases settled	No. of cases pending
1990-91	2000	480	24.00	1520
1991-92	2014	457	22.69	1557
1992-93	2115	342	16.17	1773
1993-94	2439	403	16.52	2036
1994-95	2553	450	17.63	2103

(ii) Wealth Tax				
Financial Year	No. of cases for disposal	No. of cases settled	Percentage of cases settled	No. of cases pending
1990-91	538	136	25.28	402
1991-92	479	166	34.66	313
1992-93	420	99	23.57	321
1993-94	385	52	13.51	333
1994-95	386	59	15.28	327

(iii)	No. of cases pending for admission before Settlement Commission as on 31.3.1995	715
(iv)	No. of cases held up with Settlement Commission for want of comments of the dpeartment.	32

(v) Year-wise position of tax determined (including interest and penalty) in cases settled by Settlement Commission.

Financial Year	Income Tax (in lakhs of rupees)		Wealth Tax	
	Additional tax collected/collectable on admission of applications	Gross demand created in respect of cases settled	Additional tax collected/collectable on admission of application	Gross demand created in respect of cases settled
1991-92	864.17	1,593.93	22.70	101.97
1992-93	1,795.71	1,895.67	11.53	781.68
1993-94	2,547.85	3,773.15	125.45	90.22
1994-95	3,089.39	2,412.73	36.49	34.00

Penalties and prosecutions

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

(i) Income Tax and Corporation Tax

(a) Penalty proceedings initiated, disposed of and pending for each of the three years ending 1994-95 were as under:

Year	Opening balance	Additions	Total	Disposals	Closing balance
1992-93	1,66,442	64,142	2,30,584	64,238	1,66,346
1993-94	1,66,346	1,49,306	3,15,652	83,491	2,32,161
1994-95	2,32,161	72,282	3,04,443	85,217	2,19,226

(b) Details regarding prosecutions launched, convictions/ compoundings and acquittals for the three years ending 1994-95

were as under:

Year	Complaints filed during the year			Convictions	Compounding	Acquittal	Total
	For tax evasion	Others	Total				
1992-93	808	683	1491	102	391	808	1301
1993-94	552	389	941	57	507	570	1134
1994-95	257	70	327	47	106	98	251

(c) Details relating to penalties such as work load, disposal, pendency and penalties imposed for the year 1994-95 are as follows:

Nature of penalty	Work load	Disposal	Balance
For Concealment	1,38,397	33,505	1,04,892
Others	1,66.046	51,712	1,14,334
Total	3,04,443	85,217	2,19,226

Analysis of pendency particulars	Less than 6 months	More than 6 months
For concealment	34,222	70,670
Others	29,711	84,623

Penalties imposed (in crores of rupees)		
Particulars	No. of cases	Amount
For concealment	18,160	187.20
Others	35,819	58.04

Details of year-wise pendency of penalties and composition money levied, collected and pending upto the year 1994-95 were not furnished by the Ministry of Finance.

(ii) Other Direct Taxes

(a) Penalty proceedings initiated, disposed of and pending for each of the three years ending 1994-95 are given below:

Year	Opening balance	Additions	Disposal	Closing balance
1992-93	44,436	10,842	15,173	40,105
1993-94	40,105	27,310	13,896	53,519
1994-95	53,519	8,178	12,984	48,713

(b) Details regarding prosecutions launched, convictions obtained and cases pending in courts of law regarding other direct taxes for the last three years were not furnished by the Ministry of Finance.

Searches and seizures

2.15 Sections 132, 132-A and 132-B of the Income Tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director/Commissioner of Income Tax or a specified Deputy Director or a Deputy Commissioner of Income

Tax. Where any money, bullion, jewellery or other valuable article or thing is seized, the assessing officer after necessary investigations, has to make an order with the approval of the Deputy Commissioner of Income Tax within 120 days of the seizure, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability, and retain in his custody such assets as are, in his opinion, sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the persons from whose custody they were seized. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approved of the retention for longer period.

(i) The number of cases in which searches and seizures were conducted for the three years 1992-93 to 1994-95 were as under:

Year	Total No. of searches and seizures conducted	Value of assets seized (Rs. in crores)
1992-93	4777	384.02
1993-94	5026	396.46
1994-95	4830	381.43

(ii) (a) Particulars of income determined, tax levied, balance tax outstanding after adjustment of value of assets retained on final assessment for the three years ending 1994-95 were as follows:

(Amount in crores of rupees)

Year	No. of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery		
			Tax	Penalty	Total		Tax	Penalty	Total
1992-93	3412	623.94	289.79	12.97	302.76	191.63	98.61	12.51	111.12
1993-94	Information was not funished by the Ministry of Finance.								
1994-95	Information was not funished by the Ministry of Finance.								

(b) The number of cases of prosecutions launched, compounded and convictions obtained for the three years ending 1994-95 were as under:

Year	No. of prosecutions launched			Disposal of cases		
	Opening balance	During the year	Total	No. of cases compounded	No. of cases in which convictions were obtained	No. of cases pending
1992-93	17541	319	17860	118	472	17270
1993-94	17270	941	18211	507	57	17647

1994-95	17647	327	17974	106	47	17821

(c) Particulars of cases of assets returned, interest paid and cases pending for three years ending 1994-95 were as under:

Year	No. of cases where assets were due for return			No. of cases where assets were returned	No. of cases where interest was paid during the year	Balance cases pending
	Opening balance	Added during the year	Total			
1992-93	737	178	915	145	3	770
1993-94	Information was not funished by the Ministry of Finance.					
1994-95	Information was not funished by the Ministry of Finance.					

Survey

2.16 (i) Number of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the three years ending 1994-95 are given below:

Year	No. of premises surveyed	
	under section 133A(1)	under section 133B
1992-93	6,173	10,87,560
1993-94	6,329	4,91,701
1994-95	10,237	7,81,307

(ii) Number of cases where evidence about ostentatious expenditure was collected under Section 133A(5) of Income Tax Act, 1961.

Year	No. of cases
1992-93	664
1993-94	487
1994-95	462

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

2.17 With a view to countering tax evasion and to curb the circulation of black money in real estate transactions, a new Chapter XX- C was inserted in the Income Tax Act, 1961, with effect from 1st October 1986 empowering the Central Government to purchase immovable properties in certain cases of transfer. To begin with, these provisions were made applicable to properties proposed to be transferred for an apparent consideration exceeding Rs.10 lakhs in each case in the metropolitan cities of Bombay, Calcutta, Delhi and Madras. It was extended to 24 more cities from 1 April 1991.

(i) Details of properties purchased by the Central Government during the financial year ended March 1995 are as under:

	Calcutta	Madras	Ahmedabad	Delhi	Bombay	Total
(i) No. of statements received in form 37-I	378	2019	1878	3325	6949	14549
(ii) No. of properties purchased	5	9	9	25	72	120
(iii) Value of properties purchased (Rs. in crores)	1.49	1.77	5.48	15.81	93.76	118.31
(iv) No. of properties where consideration exceeds Rs.50 lakhs	-	-	7	9	39	55

(ii) The disposal of acquired properties and those awaiting disposal (for entire country) during 1994-95 is given below.

No. of properties sold	Sale value	Properties awaiting disposal	Amount
	(In crores of rupees)		
64	153.73	76	69.92

Revenue demands written off by the department

2.18 Details regarding amount written off for the year 1994-95 as furnished by the Ministry of Finance, are as under:

No. of cases identified involving arrear demand of Rs.10,000/- and below where recovery certificates were isued upto 31.3.79			Details of cases considered for write off during the year.			Details of cases written off during the year			Details of balance of cases to be written - off		
No. of assessees	No. of entries	Total amount involved (Rs. '000)	No. of assessees	No. of entries	Total amount involved (Rs. '000)	No. of assessees	No. of entries	Total amount written-off (Rs. '000)	No. of assessees (1-7)	No. of entries (2-8)	Total amount for write off (Rs. '000) (3-9)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
31,058	35,836	28,167	22,395	23,963	11,524	21,097	22,337	10,910	9,961	13,499	17,257

Chapter 3

System Appraisals

3.1 Working of the Directorate of Income Tax (Special Investigation), New Delhi

Introductory

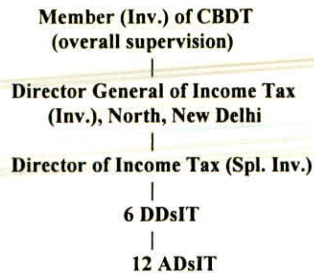
3.1.1 Tax evasion occurs when legally taxable income is either not reported or is under-reported to the tax authorities. A strong tax administration with a high probability of detecting evasion is one of the pre-requisites to act as a deterrent for tax evasion. Apart from the investigation machinery available with the department with special powers of search and seizure, a centralised agency for surveillance over large industrial houses, popularly known as monopoly houses, was, therefore, set up to assist the assessing officers in thorough investigation of these groups as well as to detect methods and techniques of tax evasion practised by them.

The Directorate of Income Tax (Special Investigation) was set up as a special cell in August 1972 in Delhi within the Directorate of Inspection (Investigation). It was made into a full fledged Directorate in June 1981. From March 1982, this Directorate was placed under the overall supervision of a Director General of Income Tax (Special Investigation). In October 1987, it came under the supervision of the Director General (Investigation), North, New Delhi. Currently, it oversees the selected cases of 12-13 groups of big industrial houses.

The efficacy of the working of the Directorate of Income Tax (Special Investigation) was examined and commented upon by the Public Accounts Committee in its 143rd Report 1982-83 (7th Lok Sabha). The action taken by the Ministry in this context has been discussed subsequently in paras 3.1.16 and 3.1.17.

Organisational set-up

3.1.2 The head of the Directorate is Director of Income Tax (Special Investigation) who functions directly under the Director General of Income Tax (Investigation), North, New Delhi under the overall supervision of Member (Investigation) of the Central Board of Direct Taxes with its headquarters at Delhi. The Director of Income Tax (Special Investigation) is assisted by 6 Deputy Directors of Income Tax. These Deputy Directors of Income Tax are further assisted by 12 Assistant Directors of Income Tax. The structure of the Directorate is as follows:-



Objectives

3.1.3 As per the Charter of objectives seen from the Office Procedure Manual of the Income Tax Department the objectives set down were as follows:

(a) Collection and supply of information to the Central Board of Direct Taxes regarding (i) assessments completed, (ii) concealments detected, (iii) penalties levied, (iv) prosecutions launched, (v) tax recovered, (vi) tax in arrears, (vii) progress of appeals and (viii) reference applications, etc. in respect of cases belonging to big industrial houses;

(b) Research into techniques employed by big industrial houses for minimising tax liability in cases of companies, individuals and trusts belonging to the groups;

(c) Expediting the completion of assessments, hearing of appeals and collection of dues;

(d) Ascertaining deficiencies and shortcomings of the department in dealing with such groups;

(e) Suggesting measures for adding to the effectiveness of the department in dealing with cases of big business groups more expeditiously and adequately; and

(f) Providing guidance and assistance to field officers on the mode of investigations and take coordinated action on priority basis in the cases of groups assigned.

Neither the Directorate nor the Board furnished a copy of the charter of objectives to audit despite requests.

Functions of the Directorate

3.1.4 The Directorate of Income Tax (Special Investigation) has mainly been entrusted with the following work:-

(a) Overseeing of the selected cases belonging to big industrial houses/groups

Every year, the Central Board of Direct Taxes assigns about 12-13 groups for overseeing by the Directorate which in turn selects some

cases belonging to each of the assigned groups for overseeing. These cases are spread throughout the country. Though the groups are selected only after final approval of the Board, the Working Group which selects the industrial groups comprises Member (Investigation) in the Board, Director General of Income Tax (Investigation) and Director of Income Tax (Special Investigation). Thus, the groundwork for selection of the groups is done by the Directorate of Income Tax (Special Investigation). For the period under review, i.e. 1989-90 to 1993-94, the Directorate selected the industrial groups on the basis of list of MRTP companies prepared by the Monopolies and Research Unit in the Department of Company Affairs. The work of the Directorate also involves co-ordination of the investigation among various assessing officers by maintaining a constant liaison with them and ensuring that cases of a given group are not assessed in isolation. However, the Directorate does not exercise any statutory powers of survey, search and seizure, issuing of notices, etc. but provides help and suggestions to the assessing officers and operates through them.

(b) Preparation of Study Reports

The Directorate also prepares study reports on the subjects assigned by the Central Board of Direct Taxes. These study reports give an overall picture of a specific industry/institution and the tax-evasion techniques adopted by that industry or institution.

(c) Work relating to the Research Cell

The main aim of the Research Cell which was placed under this Directorate after April 1990 (earlier with the Investigation wing) was to create a rich reservoir of data to help the department in its investigation work by analysing, evaluating and disseminating information on tax frauds and tax evasion techniques in a trade or industry. Besides, analysing results of search and seizure cases and co-ordination with other economic agencies were also its assigned functions.

Methodology

3.1.5 Once a case is taken up for overseeing, the Directorate corresponds with the concerned assessing officer and calls for certain documents, viz. copies of annual report, tax audit report, annual accounts, statement of computation of total income alongwith copies of other connected documents filed by the assessee for the relevant assessment year and a copy of the questionnaire already issued by the assessing officer. Similar documents for the last two completed assessments are also called for. After studying these documents, the Directorate prepares a scrutiny note which is sent to the assessing officer communicating the line of scrutiny/investigation to be adopted while finalising the assessment.

The case is followed up by corresponding with the assessing officers and discussions are held with them and the concerned Commissioners before the case is finalised. In order to ensure quality of the investigation work and proper coordination among the members of the team, periodical meetings are held by the Director of Income Tax (Special Investigation) with the Deputy Directors of the Directorate.

The Directorate also liaises with other government agencies like Directorate of Revenue Intelligence, Enforcement Directorate, Central Economic Intelligence Bureau, Directorate of Anti Evasion (Central Excise), Department of Company Affairs, BIFR, etc.

Constraints in conducting the review

3.1.6 Certain avoidable reluctance was shown by the department in furnishing records, data and information to Audit inspite of repeated requests. Such records included its Charter, study reports for 1989-90 to 1992-93, periodical reports sent by the Directorate to the Director General of Income Tax (Investigation), North, New Delhi and to the Board, Annual Report as well as Annual Action Plan for 1993-94, file pertaining to selection of cases for overseeing for the years 1989-90 to 1993-94 etc. Information in response to specific enquiries made by Audit were also not furnished by the Directorate.

Ministry have endorsed the Directorate's reply that no charter of objectives was available with the latter. However, the charter should have been available with the former but they did not furnish a copy thereof. An organisation may not be able to function effectively without being aware of the specific objectives for which it was set-up.

Scope of audit

3.1.7 The review seeks to evaluate the functioning of the Directorate of Income Tax (Special Investigation) with reference to the objectives with which it was set up. Further, it also aims at examining the methodology employed by the Directorate to assess the strengths and weaknesses of the existing system and the overall efficacy of its implementation. Test check of records of the Directorate for the years 1989-90 to 1993-94 was conducted by Audit from November 1994 to May/June, 1995 on the basis of the records made available. For the cases overseen by the Directorate, the assessments of which were under Commissioners' charges of Bombay, Calcutta, Punjab, and Haryana, the concerned records were also test checked.

Highlights

3.1.8 (a) Certain records and information having vital bearing on the examination of the working of the organisation and on the appreciation of its performance were not made available to Audit despite being requisitioned.

(Para 3.1.6)

(b) The amount of additions to income or disallowances of deductions, such as additions to fixed assets, unsecured loans, provision for bad and doubtful debts, commission paid, advertisement expenses, miscellaneous expenses, technical know-how fees paid, earlier years' expenses, etc. made by the assessing officers in their normal statutory duty were communicated in the scrutiny notes of the Directorate to the assessing officers suggesting these actions. This was a duplication of the assessing officers' duties.

(Para 3.1.10(II))

(c) In the cases test checked it was noticed that the Directorate had taken credit for additions of Rs.9119.95 lakhs in income and Rs.4750.72 lakhs in tax effect although no observations had been made in their scrutiny notes. It was also noticed that out of the total additions of Rs.9044.25 lakhs in income claimed by the Directorate to have been made at its instance between 1989-90 and 1993-94, additions of Rs. 41.53 lakhs (0.46%) only were made on the observations in the scrutiny notes of the Directorate. The remaining additions of Rs.9.002.72 lakhs (99.54%) were made by the assessing officers on their own during the process of assessments.

(Para 3.1.10(III))

(d) Arithmetical mistakes and incorrect calculation of tax effect in respect of cases mentioned in the Annual Reports resulted in the Directorate reporting credit in excess of real addition to the extent of Rs.1,779.29 lakhs for additions and Rs.1,020.34 lakhs for the tax effect.

(Para 3.1.10(IV))

(e) Test check of 4 cases (covering 6 assessments) in Delhi charge revealed some important omissions of law or facts, which were overlooked by the Directorate in cases overseen, resulting in under-assessment of income of Rs.507.10 lakhs with consequent short levy of tax of Rs.388.00 lakhs.

(Para 3.1.12)

(f) One of the measures of ascertaining the quality of assessments in cases overseen by the Directorate was the actual gain by way of revenue to the exchequer. A test check of 41 cases covering 72 assessments in Bombay, Delhi, Calcutta, Punjab and Haryana charges overseen by the Directorate during the years 1989-90 to 1993-94 revealed that out of total additions of Rs.30,829.11 lakhs, which were found to be made at the instance of the Directorate, additions of Rs.6,381.58 lakhs (20.70%) had been deleted in appeal and additions of Rs.18,966.20 lakhs (61.52%) were lying disputed in appeal.

(Para 3.1.13)

(g) The main job of the Research Cell functioning under the Directorate since May 1990 was to analyse and evaluate data on malpractices, tax frauds and results of investigation in the search and seizure cases. Work done by this Cell could not be evaluated as records and replies to information requested for were not furnished to audit. The Annual Reports of the Directorate also do not indicate that any appraisal of work done by the Research Cell has ever been undertaken.

(Para 3.1.15)

Action Plans

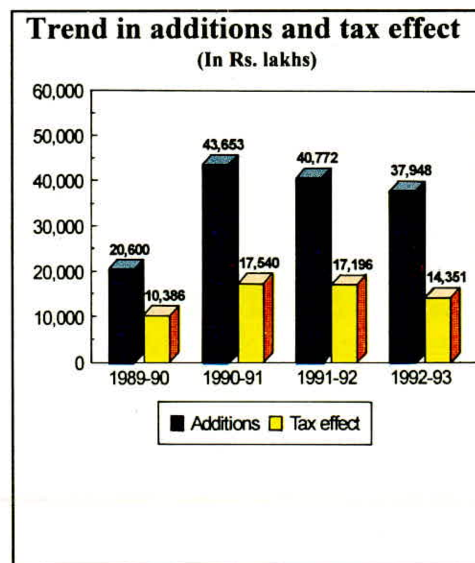
3.1.9 Annual Action Plans of the Directorate are approved by the Central Board of Direct Taxes specifying, inter-alia, the groups and the cases to be overseen during the respective financial years.

The Directorate did not supply information regarding number of cases selected for overseeing and the number of cases actually overseen by it during the financial years 1989-90 to 1993-94. It was also noticed that the Directorate had not prepared its Annual Report for the year 1993-94 till December 1994, though it was required to be prepared by the end of June 1994.

The Ministry have mentioned that list of cases selected for overseeing during 1993-94 was furnished. However, this was of no use in the absence of the Annual Action Plan approved by the Board outlining groups/cases selected and finally overseen. The reply is silent on non-production of information for the years 1989-90 to 1992-93.

Oversight Management

3.1.10 (I) Details of cases overseen



The Directorate had exhibited in its Annual Reports additions of Rs.1,42,972.48 lakhs to the income tax and wealth tax assessments of companies and non-companies belonging to 55 large industrial houses and consequent tax effect of Rs.59,472.66 lakhs in 405 cases covering 504 assessments overseen during the years 1989-90 to 1992-93, as shown below:-

Year	No of Large Industrial Houses overseen	No of cases overseen	No. of assessments completed	Additions	Tax effect
				(Rs in lakhs)	
1989-90	11	90	105	20600.20	10386.16
1990-91	15	99	145	43652.89	17540.04
1991-92	16	103	135	40771.85	17195.78
1992-93	13	113	119	37947.54	14350.68
Total	55	405	504	142972.48	59472.66

Audit scrutiny, however, revealed that a substantial part of the additions to income and consequential tax effect did not flow from any special guidance on lines of investigation suggested by the Directorate but resulted from the statutory duties exercised by the assessing officers. A few representative cases out of many noticed in test check, are mentioned in the ensuing paragraphs.

(II) Overlap between the normal assessing and oversight functions

One of the primary objectives in setting up the Directorate was to provide the assessing officers with specialised knowledge and information and giving them guidelines on non-routine lines of investigation without duplicating the routine statutory functions and scrutiny already exercised by the assessing officers. A detailed scrutiny of the Annual Reports of the Directorate for the years 1989-90 to 1992-93, however, revealed that the amount of additions or disallowances exhibited by the Directorate in their Annual Reports for the years under review was generally the difference between the income returned by the assessee and the income finally assessed by the assessing officer, not wholly and exclusively be attributable to the oversight functions of the Directorate. Many of these additions or disallowances, such as additions to fixed assets, unsecured loans, provision for bad and doubtful debts, commission paid, advertisement expenses, miscellaneous expenses, technical know-how fees paid, earlier years' expenses, etc. were of routine nature which were made by the assessing officers on their own as statutorily required.

In reply to (I) and (II) above the Ministry have stated it was unjustified to create a functional dichotomy between the Directorate and the field functionaries as the additions were a result of the collective efforts of the assessing officers and the Directorate. This view is not tenable as the Directorate was not set up to discharge the functions of the assessing officers. Its key objective was detection of tax evasion techniques employed by monopoly houses and should have been adhered to rather than this duplication.

However, no new technique was evolved by the Directorate. Even in their objective of aiding and assisting the assessing officers, they mostly did not provide any interesting or new angle of investigation and limited themselves to pointing out adjustments which should have been carried out by the assessing officers as part of their statutory functions.

(III) Examination of Scrutiny Notes

(a) Credit taken by the Directorate though no observations were made in the scrutiny notes

In 16 cases covering 18 assessments of Bombay and Delhi charges overseen for the years 1989-90 to 1992-93, credit of additions of Rs.9,535.19 lakhs was taken by the Directorate by taking the difference between the income returned and the income assessed, of which additions of Rs.9,119.95 lakhs involving tax effect of Rs.4,750.72 lakhs were made by the assessing officers without any observation having been made in the scrutiny notes of the Directorate. The details are given below:-

Charge	No.of cases test checked	Assessments involved	Difference between income returned and income assessed	Credit of additions taken by the Directorate	Additions made by the Assessing Officer on his own together with tax effect	
					Amount	Tax effect
					(Rs. in lakhs)	
Bombay	11	13	5,535.05	5,535.05	5,092.63	2,608.22
Delhi	5	5	4,000.14	4,000.14	4,027.32	2,142.50
Total	16	18	9,535.19	9.535.19	9,119.95	4,750.72

Thus, the Directorate had taken credit of additions made by the assessing officers in the course of regular assessments.

As the Annual Report for 1993-94 was not supplied upto June 1995, similar additions made at the instance of the Directorate could not be verified.

(b) Credit taken for general observations in the scrutiny notes which the assessing officers were statutorily required to investigate.

It was observed from the scrutiny notes issued by the Directorate that in 13 cases relating to companies (involving 16 assessments) assessed in Bombay and Delhi charges observations in the scrutiny notes were of general nature which the assessing officers were statutorily required to investigate/scrutinise before finalising assessments. Details of these cases are shown in the following table:

(Amounts in Rs. lakhs)

Charge	No. of cases	No. of assessments	Amount of additions made at the instance of the Directorate	Amount of additions made by the Assessing Officers on their own	Amount of additions, credit of which taken by the Directorate
Bombay	6	7	36.10	4,634.80	4,670.90
Delhi	7	9	5.43	4,367.92	4,373.35
Total	13	16	41.53	9,002.72	9,044.25

A few illustrative cases are mentioned below:-

BOMBAY

(i) Assessee 'A' - A.Y.1987-88

It was mentioned in the Annual Report of the Directorate for the year 1989-90 that additions made at the instance of the Directorate were of Rs.131.36 lakhs. It was seen during scrutiny of the assessment records that the addition to the returned income on account of disallowance of claim by the assessing officer under Section 80 HHC alone amounted to Rs.107.50 lakhs, which was not one of the points mentioned in the scrutiny note. Remaining additions of Rs.23.86 lakhs were of routine and general nature.

The Ministry have stated that merely because a point is not mentioned in the scrutiny note it does not mean that the Directorate have not given adequate guidance. Joint discussions are held with the assessing officers from where lines of investigation emerge. This reply is vague and not acceptable as no records were kept of such discussions and is also not susceptible to verification. The fact remains that additions made were such adjustments which the assessing officers were required to make in the course of their normal functioning.

(ii) Assessee 'B' - A.Y.1987-88 .

In the scrutiny note, the Directorate had indicated the need for scrutiny by the assessing officer of shortage of 120 truck and bus chassis as claimed by the assessee. The assessing officer had not made any addition on this account after scrutiny. The assessing officer had made additions of Rs.2144.31 lakhs out of which the addition on account of production linked bonus alone amounted to Rs.1030 lakhs as the liability for this item had not crystallised in the previous year. Thus the only point on which investigation was suggested by the Directorate could not be sustained on scrutiny by the assessing officer and no other addition was suggested by them although the Directorate had taken credit for the entire addition

made by the assessing officer.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(iii) Assessee 'C' - A.Ys. 1989-90 and 1991-92

An addition of Rs.121.11 lakhs was made to the returned income for the A.Y. 1989-90. The two main additions were (a) bonus disallowed (Rs.82.68 lakhs) and (b) provision for premium on redemption of debentures (Rs.7.50 lakhs). Both these additions though indicated by the Directorate were of general and routine nature which the assessing officers were statutorily required to investigate. The only substantial item of addition indicated in the note was regarding disallowance of claim under Section 32 A B amounting to Rs.11.99 lakhs but the Directorate had taken credit for the entire amount.

In the case of A.Y. 1991-92, addition to returned income was Rs.168.88 lakhs. Out of this, an amount of Rs.147.18 lakhs was on account of (a) MODVAT credit (Rs.65.79 lakhs), (b) money credit to closing stock (Rs.46.59 lakhs), (c) expenses on issue of debentures (Rs.23.53 lakhs) and (d) expenses on issue of shares (Rs.11.27 lakhs). None of these items were indicated by the Directorate in their scrutiny notes. The other additions made were of routine nature.

(iv) Assessee 'D' - A.Y. 1987-88

The assessing officer had made total additions of Rs.555.79 lakhs in this case on account of brought forward losses of Rs.440.59 lakhs, expenditure on scientific research of Rs.20.94 lakhs and other expenditure of Rs.56.18 lakhs. None of these items were indicated in the Directorate's note for investigation but the Directorate had claimed additions as at their instance.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(v) Assessee 'E' - A.Y. 1990-91

Total additions of Rs.1477.39 lakhs (actual Rs.433.29 lakhs) were made to the returned income U/S 115-J by the assessing officer. Besides directing the assessing officer to generally check the 115-J computation, no specific item of addition U/S 115-J was pointed out by the Directorate in the scrutiny note for investigation. However the entire addition, which was done by the assessing officer in the course of finalising the assessment has been claimed by Directorate as done at their instance.

The Ministry have replied that there were discussions with the assessing officer which would have covered all the relevant aspects. In the absence of any records thereof, this remains only a presumption and the view is, therefore, untenable.

(vi) Assessee 'F' - A.Y. 1990-91

In this case, addition of Rs.72.06 lakhs (actual: Rs.43.10 lakhs) was made to the returned income by the assessing officer. Out of this, the only item of addition indicated in the scrutiny note was regarding 'royalty payable' amounting to Rs.24.11 lakhs. The Directorate had shown the entire addition as made at its instance.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

D E L H I

(vii) Assessee 'G' - A.Ys. 1989-90 and 1990-91

The credit for additions of Rs.104.17 lakhs (A.Y.1989-90) and Rs.153.59 lakhs (A.Y.1990-91) aggregating to Rs.257.76 lakhs was taken by the Directorate though all the points of additions, except 'Commission paid' were the same as in the earlier assessment years, which were not overseen by the Directorate. No additions could be made on account of 'Commission paid' and the additional points suggested by the Directorate. Nevertheless, the Directorate took credit for the entire additions.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(viii) Assessee 'H' - A.Y. 1990-91

Points on which additions of Rs.128.50 lakhs were made, were already in the knowledge of the assessing officer as additions on all these points had been made by the assessing officer in the immediately preceding assessment year (1989-90), which was not overseen by the Directorate.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(ix) Assessee 'I' - A.Ys. 1988-89 and 1989-90

In the assessment year 1988-89, additions of Rs.80.12 lakhs (actual Rs.22.78 lakhs) were made to the returned income. Out of this, the additions (Rs.17.35 lakhs) were of routine and general nature. Further, total additions of Rs.11.00 lakhs (actual: Rs.9.24 lakhs)

were made in the assessment for the assessment year 1989-90. None of the items, on which these additions had been made, were at the instance of the Directorate.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(x) Assessee 'J' - A.Y.1987-88

An addition of Rs.50.18 lakhs was made to the returned income on account of disallowance of 'Net deficit on operation of Other's Import Licences'. However, this point was found to be in the notice of the assessing officer prior to the issue of the scrutiny note (March 1990). But the Directorate had claimed credit for the addition made.

(xi) Assessee 'K' - A.Y. 1989-90

Addition of Rs.42.70 lakhs was made to the returned income, which mainly consisted of addition on account of 'Commission paid' amounting to Rs.41.23 lakhs. This point was already in the notice of the assessing officer, who had raised query on this point on his own (August 1991) before the same was pointed out in the scrutiny note (September 1991).

The Ministry have contended that the assessing officer had issued a questionnaire after receiving directions on this issue from the Directorate. However, the issue was already in the notice of the assessing officer and discussed by him in his assessment order (March 1988) for the assessment year 1985-86. In their scrutiny note the Directorate had only reiterated (November 1989) the issue without indicating any additional original line of investigation.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(xii) Assessee 'L' - A.Y. 1990-91

In this case, total additions of Rs.3545.55 lakhs were shown by the Directorate in its Annual Report for the year 1992-93. These additions included disallowance of unabsorbed depreciation allowance of Rs.1089.91 lakhs, which was not indicated in the scrutiny note of the Directorate. Remaining additons of Rs.2455.64 lakhs were of routine and general nature, as the assessing officer had already raised the points on these items in the questionnaire (July 1992) which was issued before the issue of scrutiny note by the Directorate (November 1992). Thus the additions were not at the instance of the Directorate.

The Ministry's reply is on similar lines as indicated at (i) above and is not tenable for reasons mentioned there.

(xiii) Assessee 'M' - A.Y. 1989-90

Total additions of Rs.257.54 lakhs were made to the returned income U/S 115-J of the Income Tax Act, 1961. The difference of Rs.257.54 lakhs arose due to addition of Rs.858.49 lakhs made by the assessing officer while computing book profit U/S 115-J of the Act. None of the items on which these additions were made had been mentioned in the note of the Directorate.

The Ministry's reply is on similar lines as indicated at (I) above and is not tenable for reasons mentioned there.

It would thus be seen from the illustrative cases above that the points for investigation suggested by the Directorate were a repetition of issues which already stood covered in the assessments of the earlier years, or were routine points to be seen in assessment proceedings. No specific tax evasion techniques could be detected by the Directorate in these cases. **In a nutshell, out of the total additions of Rs.9,044.25 lakhs, credit of which was taken by the Directorate, additions of Rs.41.53 lakhs (0.46%) could be attributed to the guidance notes of the Directorate and the remaining additions of Rs.9,002.72 lakhs (99.54%) were made by the assessing officers on their own.**

(IV) Erroneous credit of additions and tax effect.

The Directorate obtains feed back from the assessing officers in respect of assessments overseen by it during the financial year by collecting copies of assessment orders and prepares the Annual Report of the work done by it. In the Annual Report, additions made to the declared income of companies/non-companies of large industrial houses assigned to it during the financial year are exhibited.

Scrutiny of Annual Reports furnished to Audit revealed that there were arithmetical inaccuracies like totalling errors, erroneous reproduction of figures from assessment orders etc. resulting in the Directorate taking excess credit of Rs.1779.29 lakhs for additions to income and Rs.1020.34 lakhs towards tax effect.

The Ministry have accepted the above audit observation.

Additions on points deleted in appeals

3.1.11 It was seen in audit that the Directorate was not keeping a watch over the end result of additions being made at its instance, with the result that it continued to suggest additions through the scrutiny notes on the points which had already been deleted in

appeals at various levels.

In Delhi, test check of two cases overseen by the Directorate and highlighted by it in the Annual Reports as one of the tax evasion techniques, revealed that additions of Rs.508.87 lakhs and Rs.73.92 lakhs aggregating Rs.582.79 lakhs involving tax effect of Rs.305.96 lakhs were made to the returned income of the assessee companies for the assessment year 1989-90 at the instance of the Directorate, holding that the expenditure claimed on issue of convertible bonds was of capital nature and deduction of 1/10th of the expenditure could be allowed under section 35 D of Income Tax Act, 1961. These additions had been deleted by the I.T.A.T. in January, 1993 upholding the claim of the assessee that the entire expenditure on bond issue expenses was revenue in nature. In subsequent assessment year i.e. 1990-91, the additions of Rs.1,330.76 lakhs and Rs.116.99 lakhs (actual Rs.116.89 lakhs) aggregating Rs.1,447.75 lakhs having tax effect of Rs.781.79 lakhs were made by the assessing officer at the instance of the Directorate on similar points while finalising the assessments in March, 1993, even after the receipt of the appellate decision for the assessment year 1989-90 was known.

The Department did not inform audit whether it had filed reference applications against the appellate decisions for the assessment year 1989-90.

The Ministry have not accepted the observation on the ground that the issue involved was a question of law which could not be left out in the subsequent assessment year simply for the reason that ITAT had deleted the addition. This reply does not appreciate the fact that on a point of law, the assessing officer has to act within the confines of the interpretation of the ITAT or a court of law until such time it gets overruled by the orders of a higher judicial authority. The Ministry have still not informed (December 1995) whether an appeal has been preferred against the decision of the ITAT.

Mistakes in assessments

3.1.12 Important irregularities of law or omission of facts noticed in respect of assessments in Delhi charge, were not rectified despite the cases being overseen by the Directorate. Some important omissions as seen in test check, are mentioned in the succeeding paragraphs.

(i) Omission to levy minimum tax on book profit

In a case overseen in Delhi in 1992-93, failure to increase the book profits by provisions for unascertained liabilites, liabilities relating to earlier years and incorrect set off of losses, income chargeable to minimum tax (assessed income under the normal provisions of the

Act being nil) for the assessment year 1990-91 was short computed by assessing officer while finalising the assessment. The omission resulted in taxable income of Rs. 452.77 lakhs escaping tax of Rs. 359.69 lakhs.(inclusive of interest). Though this case was overseen by the Directorate, this point remained to be brought to the notice of the assessing officer for remedial action.

(ii) Incorrect deduction towards investment deposit

In the assessment of 2 companies for the assessment years 1987-88 to 1990-91 of Delhi charge and overseen by the Directorate in 1989-90 to 1992-93, deduction towards investment deposit amounting to Rs. 42.99 lakhs was allowed on non-business profits, which did not qualify for the said deduction resulting in under-assessment of income of Rs. 42.99 lakhs involving short-levy of tax of Rs. 22.64 lakhs.

(iii) Incorrect allowance of depreciation

In a case overseen in Delhi, for the assessment year 1987-88 and overseen in 1989-90, though the assessee company had not carried on any manufacturing activity during the previous year relevant to the assessment year 1987-88, as evident from the Director's Report and company Auditor's Report, it was allowed depreciation allowance of Rs. 11.34 lakhs on plant & machinery which remained idle and unused throughout the relevant previous year. The mistake resulted in excess carry forward of unabsorbed depreciation allowance of an identical amount involving potential tax effect of Rs. 5.67 lakhs.

The Ministry have replied that the Directorate is not expected to perform pre audit or post audit function to ensure zero error assessments in the cases overseen by it. They are expected only to give overall guidance to the assessing officers. This view is not tenable as pointing out errors is an integral part of guidance. In the cases overseen by the Directorate which are limited in number, it would be meaningless if they see these only cursorily and do not point out the mistakes committed. In fact, mistakes commonly committed or even certain unusual types of errors should be identified by the Directorate and circulated to all the assessing officers to aid them in avoiding such mistakes. It may be added that aiding the assessing officers is one of the objectives of the Directorate.

Sustainability of additions in appeal

3.1.13 One of the objectives of the Directorate, as defined in its Charter, is to collect and supply information to the Board on progress of appeals and reference applications, etc. in respect of cases belonging to large industrial houses overseen by it. Further, the quality of assessment of cases overseen is primarily determined

by the sucess rate in appellate proceedings. However, these objectives were not met as seen from a test-check of 41 cases (covering 72 assessments) in Bombay, Delhi, Calcutta, Punjab and Haryana charges overseen during the years 1989-90 to 1993-94. The details as shown in the table below reveal that out of additions of Rs.30829.11 lakhs, Rs.5481.33 lakhs were only confirmed in appeal with the balance being either deleted (Rs.6381.58 lakhs) or being still pending in appeal (Rs.18966.20 lakhs).

Charge	No. of cases	No. of Assessments	Amount of additions	Amount of additions deleted in appeal	Amount of additions lying disputed in appeal
			(Rs. in lakhs)		
Bombay	22	35	20,912.40	3,487.48	12,967.77
Delhi	8	11	281.88	9.86	272.02
Calcutta	8	19	7,175.02	2,878.77	3,375.33
Punjab	1	5	203.81	5.47	95.08
Chandigarh (UT)	2	2	2,256.00	---	2,256.00
Total	41	72	30,829.11	6,381.58	18,966.20

The detailed position is as follows:-

BOMBAY

Out of 22 cases (covering 35 assessments) seen, in 10 cases involving 14 assessments, additions to income returned amounting to Rs.7,944-63 lakhs involving tax effect of Rs.3,800.45 lakhs were made at the instance of the Directorate, of which Rs.3487.48 lakhs having tax effect of Rs.1596.65 lakhs were deleted in appeal. Information on second appeal filed by the department on these points was not furnished to Audit.

In 5 cases (6 assessments), additions of Rs.12,967.77 lakhs involving tax effect of Rs.6,847.47 lakhs were pending in appeals filed by the assessees.

In 3 cases covering 3 assessments, there were no additions to income even as per the scrutiny notes.

DELHI

In 8 cases (covering 11 assessments), additions amounting to Rs.281.88 lakhs only having tax effect of Rs.147.41 lakhs were found to have been made at the instance of the Directorate as against total additions of Rs.4826.15 lakhs with tax effect of Rs.2298.17 lakhs exhibited by it in the Annual Reports. Out of the total additions of Rs.281.88 lakhs, those amounting to Rs.129.80

lakhs involving tax effect of Rs.65.29 lakhs had been deleted by Commissioners of Income Tax (Appeals). The Department had accepted deletion of Rs.9.86 lakhs involving tax effect of Rs.5.18 lakhs and filed second appeal with the Income Tax Appellate Tribunal in respect of the remaining deletions of Rs.119.94 lakhs. Additions of Rs.152.08 lakhs involving tax effect of Rs.82.12 lakhs were pending in appeals filed by the assessees.

CALCUTTA

In 6 cases (involving 14 assessments), additions to income returned made at the instance of the Directorate amounting to Rs.3799.69 lakhs having tax effect of Rs.1836.57 lakhs were made, of which Rs.2878.77 lakhs involving tax effect of Rs.1106.10 lakhs were deleted in appeal. Information on second appeal filed by the Department on these points was not available.

In 5 cases (including one wealth tax assessment) involving additions of Rs.3375.33 lakhs, having tax effect of Rs.1524.96 lakhs the appeals filed by the assessees were pending.

PUNJAB

In one case (involving 5 assessments), additions amounting to Rs.203.81 lakhs having tax effect of Rs.107.42 lakhs were found to have been made at the instance of the Directorate as against total additions of Rs.245.28 lakhs with tax effect of Rs.158.53 lakhs depicted by it in the Annual Reports. Out of the total additions of Rs.203.81 lakhs, additions of Rs.76.63 lakhs involving tax effect of Rs.39.85 lakhs had been deleted by C.I.T. (Appeals). The Department had accepted deletion in respect of additions of Rs.5.47 lakhs involving tax effect of Rs.2.96 lakhs and filed second appeal with the I.T.A.T. in respect of the remaining additions of Rs.71.16 lakhs.

Additions of Rs.23.92 lakhs involving tax effect of Rs.11.73 lakhs were pending in appeals filed by the assessees.

CHANDIGARH (U.T.)

In 2 cases involving additions of Rs.2256.00 lakhs and tax effect of Rs.1037.76 lakhs, the appeals filed by the assessees were pending.

The above findings reveal that the Directorate had neither done adequate study of the facts and the legal position before suggesting the points for scrutiny to the assessing officers nor did they take proper follow up action on the points deleted in appeals.
The Ministry have replied that the Directorate was not required to keep a constant watch on the progress of appeals.

The Ministry's reply contravenes the objectives of the Directorate as stated in its Charter. Moreover, in absence of monitoring of progress of appeals and reference applications, the Directorate can not ensure that the points suggested for scrutiny/investigation to the assessing officers are legally sustainable. Further, the contention of the Ministry that the details of the individual cases were not furnished by Audit is factually incorrect as these details had been furnished to the Board in September 1995. These had also been furnished earlier to the Directorate.

Study Reports

3.1.14 For the purpose of creating a reservoir of data, studies are conducted by the Directorate on topics assigned by the C.B.D.T. These study reports give an overall picture of the industry and the tax evasion techniques, if any, employed by the industry.

During 1989--90 to 1993-94, 22 studies were conducted by the Directorate covering some major industries, such as Liquor, Hotel and Tourism, Advertising, Leasing Financing and Hire Purchase Companies, Sugar Industry, Leather Industry, Real Estate Transactions, etc.

It was noticed in audit that:

(i) The Board had assigned a study in 1983 to the National Institute of Public Finance and Policy covering "Aspects of the Black Economy in India". This Institute's major function is to carry out research, consultancy work and impart training in the area of public finance and policy. The study attempted to examine tax evasion in the economy in general and in specific sectors and classes of transactions which included the sugar industry and urban real estate transactions. The conclusions on the study of these two industries were made available to the Board in 1985.

The Directorate of Income Tax (Special Investigation) had, on the direction of the Board, completed studies on the same topics in 1993-94; Comparison with the study conducted earlier by the NIPFP revealed that the later study by the Directorate was repetitive in nature and did not add any substantial finding to the conclusions reached by the NIPFP study and which were already available with the Board. The action taken on the earlier study was not furnished to Audit despite being requested.

The Ministry have in their reply mentioned that there was no duplication as the study on the "Aspects of Black Economy in India" was general in nature while those on the sugar industry and urban real estate were on specific topics. The reply is silent on the audit observation that the study conducted by the Directorate did not add to the conclusions already reached in the study by the NIPFP which was already available with the Board. The latter

study was, therefore, repetitive.

(ii) The Directorate had made a study on hire purchase, leasing and finance companies in 1993-94 and had concluded that there is tax evasion by these companies and had commented on the need for suitable legislation to plug the loopholes and the necessity to issue circular instructions to the assessing officers to ensure that the assessments of these companies are completed after due scrutiny. The action, if any, taken by the Board to plug the loopholes or changes in the Act, was not intimated by the Directorate.

The Ministry have not responded to the above.

(iii) The Directorate did not furnish information, though requested for, on whether it had carried out any evaluation to assess the extent of utilisation of the study reports by the various assessing officers to ensure that the intended purpose of these reports was being achieved.

The Ministry have stated that it was not required by the Directorate to take any follow-up action on the extent of utilisation of the study reports by the various assessing officers. The Ministry have not clarified whether in the absence of the Directorate discharging such crucial monitoring function, they themselves or some other designated office were undertaking an evaluation of the utility of the study reports. It has to be appreciated that study reports on curbing of evasion and avoidance of tax would have no utility unless the modes suggested are capable of being implemented. This can be determined only through periodical evaluation.

Work relating to Research Cell

3.1.15 Functions of the Research Cell, inter-alia, include:

(a) analysis, evaluation and dissemination of information about economic malpractices, tax frauds, tax evasion techniques in any particular trade or industry;

(b) analysis and evaluation of results of investigation in the cases including search & seizure cases; and

(c) coordination with other economic enforcement agencies.

In one case, it appeared in a newspaper (August 1994) that an ingenious way of tax avoidance by wrongly claiming depreciation on computers by two main Delhi-based companies and 80 firms had been detected by the Directorate of Income Tax (Investigation), New Delhi, thus unearthing a novel depreciation claims racket. On an audit enquiry, with the Directorate of Income-tax (Investigation), it was stated that further investigation could not be carried out as the assessee companies were not cooperating.

As the Research Cell is under the Directorate of Special Investigation and its main job was to analyse and evaluate data on malpractices, tax frauds and results of investigation in the search and seizure cases and the fact that both the Investigation Directorates are under one Director General, information on action taken by the Research Cell in the Directorate in the matter was requested for by Audit. It was, however, not furnished. Further, the work done by the Research Cell could not be evaluated in the absence of records and reply to information requisitioned in audit. Besides, the Annual Reports of the Directorate did not indicate any appraisal of work done by the Research Cell.

The Ministry have replied that no action was required by the Directorate as the Investigation Wing of the department was already alive to the issue. The reply is silent on the furnctioning of the Research Cell. It is also not tenable in view of the fact that analysis and evaluation of information which was one of the major objectives of the Research Cell includes collection of information from all sources including newspapers. It cannot, therefore, be held that no action was required on this important item of information on the novel depreciation claims racket.

Selection of Industrial Houses

3.1.16 In their 143rd Report - 1982-83 (Seventh Lok Sabha), the Public Accounts Committee, inter alia, was of the view that the Directorate should so organise its work that it was able to cover all the large industrial houses/MRTP companies at least once in five years. In its action taken note to the PAC, the Ministry had stated (December 1983) that the recommendation was under their consideration. Further information in the matter was not available.

Audit scrutiny, revealed that 17 large industrial houses/M.R.T.P. companies had not been covered for overseeing by the Directorate within the period of five years. Some of them had been selected for overseeing as far back as in 1984-85 and 1985-86.

The Ministry have not clarified the action taken on the recommendation of the Public Accounts Committee and have merely stated that the Directorate functioned within the parameters of the Action Plan as approved by them.

Conclusion

3.1.17 The Directorate of Income Tax (Special Investigation) was set-up to play a crucial role in preventing tax evasion and augmenting revenues for the State Exchequer. The review of its performance, however, reveals that the organisation is yet to establish suitable procedures and appropriate practices to achieve its objectives. It has yet not geared itself to achieve some of the most important objectives like aiding and assisting the Board by collection and supply of information in respect of tax collection and tax evasion, expediting the completion of assessments and

subsequent process, ascertaining and reviewing deficiency and suggesting measures for adding to the effectiveness to the Department in dealing with cases of big business groups. It is necessary, therefore, to review the present organisational arrangements to realign them to achieve these objectives.

The present methodology employed by the Directorate in oversight management results in considerable overlapping of functions between the Assessing Authorities and the Directorate, with consequential avoidable waste of resources. These methods need to be realigned to develop sharp focus on prevention of tax evasion, avoiding the overlap within the functions normally performed by the Assessing Authorities.

The Directorate is presently issuing scrutiny notes and watching and securing compliance through the Assessing Officer. This method has the effect of eroding its effectiveness. Suitable changes in organisational structure need to be considered to arm the Directorate with necessary authority not only to investigate but also to assess the specific cases and bring desired results. In this connection, it would be relevant to mention that the Public Accounts Committee (Seventh Lok Sabha) had in their 143rd Report (1982-83) desired that the organisation should be suitably strengthened to tackle its tasks and financial constraints should not be an alibi for not strengthening the structure.

The Directorate has stopped monitoring the appeal effects of the additions made at its instance from the year 1991-92 as a result of which it is not possible to evaluate actual gain to the Exchequer by way of addition to the tax revenue. Another result of the absence of such monitoring is that the Directorate is not aware of judicial pronouncements in respect of the additions made at their instance. The possibility of their repeating the additions already pronounced invalid in law, in other or similar cases can not, therefore, be ruled out.

The functions of the Research Cell, which is a part of the Directorate since May, 1990, could not be evaluated in the absence of records and reply to information requisitioned in audit.

The Ministry while not accepting the above suggestions, have not mentioned whether in their own assessment the objectives of the Directorate have been achieved and how they proposed to change the methodologies employed by the Directorate to make it more effective as well as to prevent the present overlapping of functions between them and the assessing authorities.

3.2 Working of the Tax Recovery Machinery

Introductory

3.2.1. One of the yardsticks to judge the effectiveness of the functioning of a revenue raising department like the Income Tax Department would be the quantum of tax collected out of that assessed and levied. A very efficient tax recovery machinery is, therefore, needed to fulfill the objectives of this department.

Law and procedure

3.2.2. Under the Income Tax Act, 1961, the amount specified in a notice of demand served on an assessee in respect of any tax, interest, penalty etc. as is payable in consequence of any order passed by the assessing officer, is required to be paid within 30 days (35 days prior to April 1, 1989) or such extended time as may be granted failing which the assessee shall be deemed to be in default. The assessing officer is, in the normal course, responsible for the collection and recovery of all taxes, interest etc. In cases, where the assessee is in default and where coercive action is necessary to effect the recovery, these proceedings are carried out by the Tax Recovery Officers (TROs) who enjoy special powers under the Act. Upto 31 March 1989, it was the duty of the assessing officer to draw a certificate called Tax Recovery Certificate (TRC) and send the same to the TRO concerned to initiate recovery of the dues from the defaulter. From 1 April 1989, the procedure has been changed and the TRO has been empowered to draw the certificate in respect of tax arrears in his jurisdiction.

Sections 220 to 232 of the Income Tax Act, 1961, Schedules II and III thereto and the Income Tax (Certificate Proceedings) Rules, 1962, together constitute a self contained code prescribing the various modes of recovery of arrears of tax. These provisions have also been made applicable to the recovery of arrears of Wealth Tax and Gift Tax by virtue of sections 32 and 33 of the Wealth Tax Act, 1957 and Gift Tax Act, 1958 respectively. The Board had issued instructions (February 1990) intimating the revised procedure to be followed by the TROs and assessing officers for recovery of tax arrears.
The principal modes of recovery envisaged in the Act are:

(i) Attachment and sale of defaulter's movable property
(ii) Attachment and sale of defaulter's immovable property
(iii) Arrest and detention of the defaulter
(iv) Appointment of receivers for the management of defaulter's properties.

Organisational set-up

3.2.3 From 1 April 1989, the Chief Commissioner of Income Tax/ Commissioner of Income tax have been authorised to nominate an Income Tax Officer to exercise the powers of TRO. The TROs, coordinate with all concerned assessing officers and work under the administrative control of concerned Deputy Commissioner and

Commissioner of Income Tax.

Objective and scope of the review

3.2.4 The procedures followed by the tax recovery machinery were reviewed in audit to examine:

(i) their effectiveness in recovery of dues and to highlight the lacunae and the loopholes;
(ii) whether the amendments and administrative changes subsequent to 1 April 1989 have contributed in reducing the arrears with reference to targets fixed and whether procedures prescribed have been complied with;
(iii) to assess the overall efficiency of the department in initiating action for collecting dues and the extent of co-ordination between the TROs and assessing officers;

For this purpose the records of 125 out of 203 TROs working in the country for the years 1990-91 to 1993-94, were test checked. Besides, in Delhi, the working of Directorate of Income Tax (Recovery) which monitors the progress in recovery of high demand cases was also reviewed. The important discrepancies/ deficiencies noticed during the course of review are mentioned in the succeeding paragraphs.

Recommendations of the Public Accounts Committee

3.2.5 In the Report of the Comptroller and Auditor General of India on Direct Taxes for the year 1987-88, audit conclusions flowing from a review of the efficacy of the `procedure of collection and recovery of tax and arrears of demands were featured. The main findings were as follows:

(i) the arrears of demands were progressively increasing which indicated that the collection machinery was not proving effective.
(ii) the disposal of tax recovery certificates was perceptibly declining. Of the various coercive modes of recovery, only attachment of properties was generally resorted to but actual sale of such properties seldom took place.
(iii) a sizable amount of tax arrears was locked in appeal due to delays in disposal by appellate authorities.
(iv) many applications were pending before the Settlement Commission.

The mounting arrears of tax demands have also repeatedly engaged the attention of Parliament and the Public Accounts Committee (1994-95) in their 93rd Report on Action Taken on the recommendations contained in the Ist Report of the PAC (10th Lok Sabha) (1991-92) reiterated that the department should:

(i) take stringent and deterrent measures to discipline tax evaders including invoking prosecution under the law to create fear in

the minds of habitual tax evaders;

(ii) augment the strength of the first appellate authorities and take steps to set up additional benches of the Appellate Tribunal to cope with the increasing workload;

(iii) incorporate in law a time limit for disposal of appeals upto the Appellate Tribunal in consultation with Ministry of Law, if necessary;

(iv) amend the law suitably to provide for the payment of full undisputed demand as a pre-condition to the admission of appeal so that there is no avoidable accumulation of arrears;

(v) set up a National Court of Direct taxes/National Tribunal of Direct Taxes without any further delay;

(vi) review the manpower requirements cost and impart training to the personnel deployed in the field of tax recovery;

Administrative measures

3.2.6 The Board have taken several administrative steps between 1983 and 1989 to accelerate the pace of recovery. Some of these measures are:

(i) Monthly progress of recovery of tax arrears in respect of cases of arrears of over Rs. 1 crore (dossier cases) should be monitored by the Board. Dossier cases below 1 crore are to be monitored by the Chief Commissioner of Income Tax.

(ii) Director of Inspection (Recovery) during his tours should conduct an on the spot study of the assessment records and hold discussions so as to accelerate efforts for speedy recovery of tax arrears where large amounts are involved, particularly of dossier cases of over Rs. 1 crore. The Board would supervise the work done.

(iii) The Board impressed upon all Commissioners of Income Tax (Appeals) individually for quick disposal of all appeals involving tax arrears of Rs. 1 lakh and above.

(iv) The Board issued instructions to the Commissioners of Income Tax that they should watch each important event in the top 100 cases in their charge and that they should also see that those working under them are taking adequate steps on these top cases.

(v) Action plan targets were fixed every year in regard to collection of tax arrears, current as well as old, and the achievements were watched.

From 1 April 1989, following changes were made to rationalise the tax recovery procedure:

(i) The posts of Tax Recovery Commissioners in the cities of Delhi, Bombay, Calcutta, Madras and Ahmedabad were abolished and to bring about better co-ordination the TROs and the assessing officers were placed under the charge of the same Commissioner.

(ii) The Chief Commissioner of Income Tax/Commissioner of Income Tax were authorised to nominate an Income Tax Officer to exercise the powers of TRO. Earlier, an officer used to be authorised by the Central Government through issue of notification in the official gazette, to function as TRO.
(iii) The TRC can be drawn by the TRO himself under section 222 of the Income Tax Act.
(iv) The maximum time limit of three years within which the assessing officer had to issue the recovery certificates (RC) to TRO was deleted with effect from April 1, 1989. In view of heavy pendency of RCs and in view of the fact that new RCs/ statements can be drawn up at any point of time, it was decided that RCs/statements will be drawn up only where the assessing officer comes to the conclusion that he cannot effect recovery and that specialised recovery action by the TRO is required.

Highlights

3.2.7 **(i)** Although RCs were required to be drawn up selectively, yet no specific guidelines were formulated resulting in a uniform procedure not being followed for their drawal and also in RCs being drawn up for petty and/or current demand.

Failure of the assessing officers in implementing the Board's instructions of intimating the details of movable and immovable properties to the TROs resulted in the latter not being able to initiate coercive recovery action. Quarterly review was also not being conducted by the assessing officers of cases requiring specialised recovery action by the TRO.

(Para 3.2.8)

(ii) Although the law and procedure for recovery of arrears were amended after April 1989 with a view to making collection more effective, yet because of deficiencies in implementation, tax arrears in respect of cases where recovery certificates have been drawn, increased manifold from Rs.1,034.75 crores in 1990-91 to Rs. 3,179.59 crores in 1993-94.

The reduction in arrear demand was far below the target of 60 percent set by the Board. There was also a decline in the performance indicated by the fact that the clearance of arrear demand which was 61 percent of the target in 1990-91 came down to 49 percent of the target in 1993-94. The clearance of outstanding demand was almost entirely due to adjustments, remissions, write-off etc. and the achievement in respect of cash collection which is the real index of performance of the TROs, was below the target of 12.5 percent set by the Board and ranged from 22 to 43 percent of the targets set. Besides, though several properties were attached, yet very few could be sold and dues remained outstanding against the defaulters. Thus, during the period 1990-91 to 1993-94 only 31 immovable and 24 movable properties respectively could be sold

out of 952 immovable and 918 movable properties attached.

(Para 3.2.9)

(iii) There was inadequate coordination between the assessing officers and the TROs though they were functioning under the same Commissioners with consequential adverse impact on the effective functioning of the tax recovery machinery. Reconciliation and verification of outstanding arrear demands, one of the key areas for coordination between the TROs and the assessing officers, was not being done. In 20512 cases involving a demand of Rs. 45.82 crores, arrears remained outstanding due to lack of coordination between the two.

(Para 3.2.10)

(iv) There were several cases of inadequate action both on part of the TROs and the assessing officers which resulted in large arrears remaining uncollected. Cases test checked in audit revealed a demand of Rs.21.59 crores outstanding in 382 cases due to this reason.

(Para 3.2.11)

(v) Though the Income Tax Act, 1961, requires issue of a tax clearance certificate before a person goes abroad, there were several cases of arrears remaining outstanding due to the defaulters having left the country.

(Para 3.2.12)

(vi) There were major discrepancies in the departmental progress reports and records maintained by the TROs. Further, many of the important registers were either not maintained or improperly maintained. This would have seriously affected the quality of monitoring.

(Paras 3.2.13 & 3.2.15)

(vii) In a number of cases the tax arrears became irrecoverable due to the absence of timely adequate action and had to be written off. Further, in many cases where arrears have been determined as irrecoverable, the demands are yet to be written-off for want of sanction from competent authorities or for other reasons. Test check revealed that write-off proposals in 16 cases involving demand of Rs. 3.77 crores, were pending for more than 5 years since initiation.

(Para 3.2.14)

(viii) The Directorate of Income Tax (Recovery) was set up to monitor and initiate action for containing the growth in outstanding arrears of high demand cases (in cases where RCs have not been drawn). The arrears, however, rose from Rs.3,093.62 crores to

Rs.8,624 crores during the period 1990-91 to 1993-94. In dossier cases involving demand of Rs. 4.35 crores reviewed by the Directorate, they had not suggested any action for accelerating the pace of recovery. Further, out of the 31 write-off proposals involving aggregate demand of Rs. 71.07 crores received by the Directorate during 1990-91 to 1993-94, only 3 cases involving demand of Rs. 2.09 crores could be disposed finally.

(Para 3.2.16)

Issue of Tax Recovery Certificates according to new procedure

3.2.8 According to the new procedure effective from 1 April 1989, RCs are required to be drawn up by the TROs themselves after ascertaining from the assessing officers, full particulars of the assessees, such as office and residential addresses and movable/immovable properties held by them etc. In February 1990, the Board, however, issued the following guidelines:

(a) As the relevant records are available with the assessing officer, the assessing officers will get these statements prepared and then pass them on to TROs for latter's signatures. These statements will be accompanied by details of assets of the defaulters.
(b) The recovery certificates will be drawn up only in selective cases where assessing officer comes to the conclusion that he can not effect the recovery and coercive action is required. The recovery certificates are to be prepared with the approval of higher authorities i.e. Deputy Commissioner (Range) for cases assessed by ITOs/Assistant Commissioners and Commissioner for cases assessed by the Deputy Commissioners.
(c) The assessing officers will conduct a quarterly review to decide which cases required drawing up of the recovery certificates under section 222 of the Act.
(d) The fact of having drawn a tax recovery statement will have to be mentioned by the assessing officer against the relevant entry in the demand and collection register.

The following general inconsistencies in drawing up of new certificates were noticed with the result that in a large number of certificate cases no coercive action could be taken by the TROs and a large demand remained uncollected:

(i) No criteria have been laid down for the selection of cases for drawing up of RCs by TROs. Though department's instructions require drawal of RCs to be selective, for such selection to be uniform and not done in a subjective manner, suitable guidelines need to be given by the Board. While it is for the Board to decide what criteria could be laid down, monetary limit could be one and another could be the number of years that the arrears remained uncollected. Audit scrutiny revealed quite a few cases in which instead of the assessing officers requesting the TROs to draw-up

RCs, the latter had to collect the details from the demand and collection registers for preparing the RCs. Further, in some charges, certificates were found drawn for amounts below Rs.10,000 which was contrary to the Board's guidelines that drawal of cases had to be selective. The lack of uniformity was because no criteria had been laid down for drawal of RCs. Specific guidelines, therefore, need to be drawn up to ensure uniformity of action and setting forth appropriate criteria for selection in the cases of recovery.

(ii) Statement containing the details of movable/immovable assets, complete address and other particulars of the defaulters were not being supplied to the TROs by the assessing officers though they were required to do so thus disabling the former from initiating coercive action.

(iii) Board's instructions for quarterly review by the assessing officers of cases which require specialised recovery action by the TROs are not being complied with.

Details of some of such cases are cited below:-

(A) Maharashtra

(a) In Pune charge, out of 1374 cases where recovery proceedings were initiated in 1993-94, 894 cases involved amounts less than Rs.10,000. This was contrary to the instruction of the Board that RCs should be drawn selectively and not for petty amounts.

(b) A test check of 100 recovery cases in Bombay charge disclosed that while in all the cases the address of the defaulters were furnished to the TROs, the details of movable properties had been intimated only in 66 cases and in the remaining 34 cases these details had not been furnished. Similarly, in 89 of these cases where the defaulters possessed immovable properties, the details thereof were not furnished in 32 cases. It was also noticed that in 18 cases out of 100, the wanting information had not been called for by the TRO.

(c) In one case, the assessing officer issued TRC for Rs.35.74 lakhs covering demands for the assessment years 1989-90 and 1990-91 to the TRO in July 1993 without the list of properties owned by the assessee. Subsequently the assessing officer furnished to the TRO in November 1993 the details of bank accounts and list of persons from whom advances were recoverable by the assessee. When the recovery proceedings were initiated by the TRO in December 1993, there was no response from the partners on whom prohibitory orders were issued and the TRO also did not take any further action (January 1995).

(B) West Bengal

(a) In 32 cases involving demands aggregating Rs.1,583.90 lakhs which related to old assessment years 1971-72 to 1989-90, recoveries had not been made. Further, even after introduction of the revised procedure in 1989, the assessing officers did not send any statement from April 1, 1989 to the TROs concerned for drawal of recovery certificates although it was necessary to send such statements.

The assessing officer sends a monthly return to the Commissioner (CIT) showing the action taken on demand raised which are pending. The CIT should have analysed these returns and asked the reasons for non-drawal of RCs in these cases. The fact that the assessing officers did not send the required statement to the TROs for drawal of RCs would have then come to his notice for appropriate remedial action. Despite the TRO and the assessing officer being under the jurisdiction of the same CIT, old demands remained outstanding without any recovery action being taken.

(b) In 21 cases involving demand of Rs.1,220 lakhs relating to assessment years 1974-75 to 1990-91, it was noticed that details of properties as required were not sent resulting in mere issue of certificates without any effective result in the matter of recovery of dues.

(C) Delhi

In case of 5 TROs, the list of cases sent by the assessing officers for drawal of RCs did not either contain the details of assets of the defaulters or the names of the persons from whom money was due. However, in none of the cases these statements were returned by the TROs to the assessing officers.

(D) Madhya Pradesh

(a) TRC in respect of an assessee for Rs.10.03 lakhs relating to the assessment year 1989-90 was received by TRO, Bhilai in September 1992 and first notice was issued to the assessee in the same month. The notice could not be served upon the defaulter assessee as the RC was not supported by office/residential address of the assessee. The RC was eventually returned one and a half years later to the assessing officer in March 1994 and the demand remained uncollected.

(b) Test check of 48 cases involving large demands aggregating Rs.1034,97 lakhs under CIT, Bhopal revealed that the TRCs were issued by assessing officer without appending the details of movable and immovable properties of the defaulting assessees thus disabling the TRO from initiating coercive proceedings. Out of

these cases, 17 RCs involving Rs.549.94 lakhs were found to have been issued without the details of residential/office address of the defaulting assessees. Similarly under CIT charge, Jabalpur, RCs involving Rs.64.75 lakhs were not supported by the above details. In 3 cases (2 in Bhopal and 1 in Jabalpur), recovery certificates involving Rs.30.24 lakhs were subsequently returned by TROs to the assessing officers without taking any action.

(E) Haryana

No quarterly review was conducted by the assessing officers and consequently recovery certificates in 10 cases were not drawn despite the fact that the recovery in excess of Rs. one lakh in each case was outstanding for more than three years. In one TRO charge, out of 923 RCs drawn during the period 1990-91 to 1993-94, 692 RCs contributing 75 percent of the RCs were drawn for demands not exceeding Rs.10,000 in each case

(F) Chandigarh

(a) RCs are required to be drawn after satisfying that no appeal was pending. However, in 23 cases involving demand of Rs.82.15 lakhs, this was not done rendering them virtually infructuous because these were cancelled within a period of six months from the date of issue as a result of appellate orders or the assessment orders being set aside.

(b) In 22 cases involving demand of Rs.40.58 lakhs the recovery certificates were drawn immediately after the service of demand notices. As such certificates were to be drawn only in selective cases after exhausting all possible means of collection by the assessing officer, drawal of RCs was, therefore, premature and irregular.

(G) Punjab

In one charge, RCs for Rs.25.65 lakhs for demand relating to assessment years 1985-86 to 1987-88 could not be drawn during the period from January 1992 to January 1993 by the TRO as the details of properties were not furnished by the assessing officers

(H) Rajasthan

A certificate in the case of a private company for the assessment year 1989-90 amounting to Rs.13.82 lakhs was drawn up by the assessing officer and passed on to the TRO in January 1993 without giving full particulars viz., the current address of the defaulter, details of movable/immovable assets etc. The certificate was however, returned to the assessing officer as he had failed to rectify the above deficiencies inspite of these being pointed out by the

TRO. The certificate was received back again by the TRO in November 1993 without rectification of the deficiencies. The matter was reported by the TRO to the Deputy Commissioner Range in January 1994 for appropriate remedial action. The D.C. Range had not, however, responded (May 1995). The certificate was consequently lying with the TRO without any action being taken on it.

(I) Himachal Pradesh

During the year 1992-93, the TRO had drawn certificates in 72 cases of petty demands of less than Rs.10,000 each involving tax demand of Rs.31,808 out of which 34 cases involving tax demand of Rs.21,210 were such where the assessees had already discharged the tax liability before the dates of their certification and any action by TRO was not called for.

(J) Orissa

In 10 cases involving demand of Rs.6.33 lakhs, the intimation letters received from the assessing officers did not have full particulars of present address, details of movable/immovable properties etc. of the defaulters.

The Ministry while not responding to the specific cases cited have made a general observation that as the area of work of the TROs was neither properly defined nor monitored, the Board in June 1995 laid down a detailed procedure relating to the work of the TROs. According to this procedure, the assessing officer shall request, with the approval of the concerned Deputy Commissioners and Commissioners, the TRO for drawing up the cases under section 222 of the Act, only after satisfying himself that he has taken all possible action under the law to recover the demand. The assessing officer is also required to send certain relevant documents such as covering letter certifying that proceedings under the law have been completed, Form No.57 and a list of movable and immovable properties of the assessee against which the TRO can initiate recovery proceedings. The Ministry have added that the reports of tax recovery work are scrutinised in the Board and wherever required remedial action to be taken are brought to the notice of the Chief Commissioners/Commissioners of Income Tax.

In this context it is observed that requirement under the guidelines of June 1995 that an RC shall be drawn only when the assessing officer has satisfied himself that all possible action under the law had been taken, existed even in the February 1990 guidelines laid down by the Board. As audit has indicated in the specific cases cited above, despite the guidelines of February 1990 that the drawal of RCs had to be selective, these were also drawn for petty amounts

and there was also no uniformity in the procedure being followed for action in cases of recovery. The February 1990 guidelines and even the revised guidelines of June 1995 do not lay down specific criteria for determining the drawal of RCs.

Receipts and Disposals of Tax Recovery Certificates

3.2.9 (A) Action Plan for TROs

For the period under review, it was seen that the Board had fixed targets for reduction in arrear demand, number of pending RCs and cash collection.

(a) Amount of arrears outstanding as on 31 March of different years with reference to which Action Plan targets were fixed was as below:

Year	No. of RCs	Amount (in Rs. crores)
1990-91	10,07,563	1,034.75
1991-92	9,81,109	2,588.52
1992-93	11,46,903	2,567.78
1993-94	9,47,574	3,179.59

Note: The above figures as well as those in the next table have been compiled from the data furnished by the Chief Commissioners and Commissioners in individual charges. (Figures were not furnished by 7 CITs in Bombay charge for all the years, in Delhi for 1990-91 and 1991-92 and in Gujarat and Haryana for 1990-91) The figures are at variance with those furnished by the Ministry of Finance and incorporated in para 2.8.2 of the Report of the Comptroller and Auditor General of India on Direct Taxes for the year ended 31 March 1994.

Thus though the number of RCs outstanding on 1 April 1994 was slightly lower than in the earlier years, the amount outstanding was more than 3 times of that due on 1 April 1991. This indicates the need for the department to take focussed action for liquidating high value arrear demand cases.

(b) Action plan targets fixed and achievements

Against the target of 30 percent reduction in the number of TRCs, 60 percent reduction in arear demand and 12.5 percent for cash collection of outstanding demand at the beginning of the year, the achievements were as follows:

Year	Targets		Achievement		Percentage achievement of the target		Recovery	
							By cash	By remissions, write off transfer etc.
	No. of RCs (in lakhs)	Amount (Rs. in crores)	No. of RCs (In lakhs)	Amount (Rs. in crores)	No. of RCs	Amount	Amount (Rs. in crores)	Amount (Rs. in crores)
1990-91	3.02	620.84	1.33	380.54	44	61	46.81	333.73
1991-92	2.95	1,553.11	1.65	488.00	56	31	71.46	416.54
1992-93	3.44	1,540.66	1.15	689.05	33	45	124.40	564.65
1993-94	2.84	1,907.73	0.88	931.26	31	49	170.14	761.12

The achievements were thus substantially below the targets set. Further, against the target of 12.5 percent cash collection of the outstanding arrear demand at the beginning of the year, the achievement ranged from 22 to 43 percent of the target during 1990-91 to 1993-94. Thus the cash collection, which is the real index of performance of the TROs was below the targets fixed during the period. It has to be noted that the above conclusion is on the basis of incomplete statistics.

(B) Achievements in individual charges

The arrears of tax demand and achievements against targets in some charges are analysed below:

(a) West Bengal

Audit scrutiny revealed that out of 3,51,605 RCs involving a demand of Rs. 174.20 crores as on 31 March 1994, 2,94,701 certificates involving arrear demand of Rs.38.94 crores were outstanding for more than 10 years.

The annual target of 60 percent reduction in arrear demand was found to be much lower than the targets fixed in West Bengal Circle. The achievement in the reduction of certified demand during the period 1990-91 to 1993-94 was 43.88 percent, 31.52 percent, 28.24 percent and 34.22 percent against the target of 60 percent. The cash collections were far below the targets being Rs. 2.86 crores, Rs.2.07 crores and 1.99 crores during 1991-92 to 1993-94 against the targets of Rs. 10.46 crores, Rs. 7.83 crores and Rs. 9.02 crores for these years respectively.

(b) Maharashtra

Though the number of tax recovery certificates came down from 1,10,661 in 1990-91 to 79,323 in 1993-94, the amount of tax arrear increased from Rs. 258.70 crores to Rs.1,239.20 crores during the same period.

For the years 1990-91 to 1993-94, 80 per cent of the clearance of number of TRCs by way of adjustments, remission revisions, rectification, write off etc. Thus, bulk of the amount recovered was by modes other than cash recoveries.

(c) Delhi

It was seen that out of 2,39,491 RCs pending at the end of 1993-94, 1,27,237 RCs involving arrear demand of Rs. 25.94 crores pertained to 1985-86 and earlier years and 84.5 percent outstanding RCs pertained to period prior to 1989-90, thereby indicating heavy pendency of old arrears.

As against target of 30 per cent fixed by the Board for clearance of TR certificates achievement was 4.24 percent in 1992-93 and 10.37 percent in 1993-94. Actual cash collection was 3.69 percent in 1992-93 and 6.44 percent in 1993-94 as against the target of 12.5 percent of outstanding demand. Thus achievements were far below targets fixed.

(d) Tamil Nadu

The total number of cases which were 3,63,382 at the end of 1990-91 rose to 4,09,557 in 1993-94 and the amount of tax arrear went up sharply from Rs. 372.82 crores to Rs. 568.62 crores during the period. Audit scrutiny revealed that number of cases involving demands exceeding Rs. 10 lakhs and below Rs.25 lakhs, increased from 174 involving aggregate demand of Rs.11.29 crores to 521 involving total demand of Rs. 142.17 crores during the same period.

As against the targets of 30 percent fixed by the Board for the clearance of TRCs, the acheivement was 10 percent during the years 1990-91 and 1991-92, 6 percent in the year 1992-93 and 9 percent in the year 1993-94. The actual cash collection ranged from 4.01 percent to 6.31percent as against the target of 12.5 percent fixed by the Board. Although the return "Action Plan for the TROs" is furnished by the Chief Commissioners to the Board, further action taken in this regard was not intimated to Audit.

(e) Gujarat

Though the number of TRCs came down from 42,972 in 1990-91 to 36293 in the year 1993-94, the tax arrears increased from Rs. 688.80 crores to Rs. 813.84 crores during the period.

The percentage of disposal of recovery certificates in the year 1991-92, 1992-93 and 1993-94 was 42.29, 32.99 and 13.77 respectively which indicated that disposal of RCs was decreasing every year. Percentage of actual cash collection was 1.67, 3.16 and 1.28 percent

respectively of the total outstanding demand of 1991-92, 1992-93 and 1993-94.

(f) Madhya Pradesh

In Madhya Pradesh charge, cases with arrears exceeding Rs.10 lakhs and below Rs.25 lakhs increased from 109 involving aggregate demand of Rs. 13.73 crores in 1990-91 increased to 124 cases with aggregate tax demand of Rs. 17.54 crores at the end of the year 1993-94. Similarly, cases involving arrear exceeding Rs.25 lakhs increased from 51 in 1990-91 to 80 in 1993-94 and the aggregate tax demand also increased from Rs. 31.92 crores to Rs. 51.19 crores during that period.

The Action Plan targets for the TROs have not been achieved in the CIT charges Bhopal and Jabalpur. The percentage of total arrear collection by the 5 TROs under Commissioner's charge Bhopal has considerably declined from 51.57 percent in 1990-91 to 38.05 percent in 1993-94. In both the charges, cash collection targets have also not been achieved except in 1993-94. In CIT Jabalpur charge, the achievement against the target of cash collection was even below 50 percent of the target fixed for the years 1990-91 to 1992-93.

During the years 1990-91 to 1993-94, 22,834 recovery certificates involving Rs.8.28 crores were deleted/removed from the registers by the TROs either without assigning any reasons or on the ground that the amounts were petty.

(g) Uttar Pradesh

In Uttar Pradesh charge, the percentage of collection as compared to outstanding demand came down from 78.51 percent in 1990-91 to 38.10 percent in 1993-94. The reasons for the steep fall were not intimated to Audit.

(h) Rajasthan

In one charge, the percentage of collection of the demand outstanding decreased from 52.05 percent in 1991-92 to 40.69 percent in 1992-93 and to 28.36 percent in 1993-94 which shows a downward trend in the collection of tax demands. During the four years period 1990-91 to 1993-94, the actual cash collection was very low and ranged between 2.60 and 16.19 percent of the total collection.

(i) Punjab

Audit scrutiny revealed that there was no appreciable improvement in the clearance during the years 1992-93 (30.18 percent) and 1993-

94 (28.84 percent) as compared to 1990-91 (50.15 percent) and 1991-92 (51.57 percent) and the clearance was largely by way of adjustments. The clearance by cash collection ranged from 6.03 percent to 9.35 percent of the demand in arrears during the years 1990-91 to 1993-94.

(j) Orissa

It was seen that the achievement for reduction of arrear demand for the years 1992-93 and 1993-94 was 35 percent and 27 percent respectively against the target. Exact achievement for the years 1990-91 and 1991-92 could not be ascertained. The target fixed for disposal of RCs (i.e. 30 percent) could not be achieved during 1990-91 to 1993-94 and the shortfall varied from 7.35 percent to 70.3 percent. The shortfall in meeting the targets for cash collection during 1992-93 and 1993-94 was 82.75 and 82.18 percent respectively.

(k) Haryana

The target of reduction of certified demand was met only to the extent of 68 percent in 1991-92. This came down sharply in 1993-94. The actual cash collection was 7.65 percent, 10.09 percent, 6.96 percent and 7.92 percent in the years 1990-91 to 1993-94 against the target fixed i.e. 12.5 percent.

(l) Karnataka

In TRO (Margo) office a large number of R.Cs in respect of which protective demands had been raised were pending although no action could be taken for recovery in such cases. In the monthly progress reports for June 1992 to March 1993, the T.R.O. also reduced the pendency by Rs.1.47 crores as relating to Body of Individuals(BOI) demands. As seen from the progress report for March 1994, 7,640 RCs. for Rs.37.73 lakhs still remained with the T.R.O. under protective and other demands for which no action had been taken subsequent to February 1993, to identify the cases relating to Body of Individuals demands.

(C) Analysis with reference to modes of recovery

The modes of recovery resorted to for recovery of dues during the years 1990-91 to 1993-94 were as under:

Charge	By rent/bank account attached		By movable properties				By immovable properties			
			Attached		Sold		Attached		Sold	
	No. of cases	Amount (in Rs. lakhs)	No.	Amount (in Rs. lakhs)	No.	Amount (in Rs. lakhs)	No.	Amount (in Rs. lakhs	No.	Amount (in Rs. lakhs)
Andhra Pradesh	1	0.04	*	*	1	0.01	6	0.41	*	*

Maharashtra	1,388	1,847.06	407	191.00	17	74.00	100	1,033.00	1	123.00
West Bengal	21,504	8,675.56	-	*	1	*	1	*	6	*
Delhi	557	*	37	*	*	*	21	*	*	*
Haryana	1,398	261.07	91	17.08	*	*	*	*	*	*
Himachal Pradesh	180	18.55	*	*	*	*	4	5.97	*	*
Gujarat	73	61.88	67	89.03	3	31.54	87	226.86	18	86.04
Madhya Pradesh	301	*	116	460.05	*	*	461	2,567.98	2	3.70
Karnataka	273	34.46	*	*	*	*	28	33.00	1	1.02
Orissa	261	*	*	*	*	*	41	156.23	*	*
Punjab	11	*	*	*	*	*	16	*	*	*
Tamil Nadu	33	10.46	4	2.18	2	10.08	96	308.01	3	32.62
Uttar Pradesh	97	134.11	196	19.87	*	*	91	633.37	*	*
Total	26,077	11,043.19	918	779.21	24	115.63	952	4,964.83	31	246.38

Note: The above figures were not furnished by the department in Assam, Kerala, Jammu and Kashmir, Chandigarh and Bihar charges for all the years. In Delhi and Gujarat charges, the information was furnished for the years 1990-91 and 1991-92 . In some charges, amount involved in the case was either not furnished or was incomplete.

*** Information not furnished by the department although asked for in audit.**

Audit scrutiny, however, revealed that out of four modes prescribed as coercive measures of effective recovery under the Act, only three modes namely attachment of rent and bank accounts and attachment of movable and immovable properties were generally resorted to during 1990-91 to 1993-94. Though several properties were attached and the dues continued to remain outstanding, very few could be sold to recover these. Thus, though 952 immovable properties for demand of Rs.49.65 crores were attached only 31 could be sold for recovering demand of Rs.2.46 crores. Similarly, out of 918 moveable properties which were attached for demands of Rs.7.79 crores, only 24 could be sold recovering demands of Rs.1.16 crores. Some points on attachment and disposal of properties in individual charges are given below:

(i) Orissa

During the year 1990-91 to 1993-94, 261 cases were shown disposed of by attachment of rent and bank accounts without indicating the amount recovered. Audit scrutiny revealed that out of the above, in 7 cases only a sum of Rs.5.92 lakhs was collected by one TRO by way of attachment of bank accounts. The remaining 254 cases were shown as disposed off in the CIT's office without indicating the amount recovered on the plea that no amount was outstanding in these cases. The TRO's records, however, did not indicate any such disposal. Therefore, the disposal of 254 cases cannot be accepted as genuine reduction.

(ii) Madhya Pradesh

In the CIT charge, Jabalpur, out of the 33 movable properties attached during 1990-91 to 1993-94, none was sold. Similarly, out

of 309 immovable properties valuing Rs. 9.67 crores attached during 1990-91 to 1993-94, none was disposed to effect recovery of arrear demand. In no case, proceedings for arrest of defaulters were initiated.

(iii) Uttar Pradesh

Monthly progress reports of five TROs disclosed that in 70 cases 83 properties valuing Rs. 6.67 crores were attached which were awaiting disposal as on 31 March 1994. Out of above, in 33 cases involving 26 properties valuing Rs. 3.25 crores have not been sold since 1990-91 and earlier years. Further, in 5 cases involving 6 properties valued at Rs. 56.28 lakhs in case of TRO (Central) Kanpur, no disposal was shown in monthly progress report/other records.

(iv) Kerala

In 2 CIT charges of Thiruvananthapuram and Cochin, in 49 cases involving arrear demands of Rs.2.70 crores immovable properties were attached, but they could neither be sold nor the amounts recovered though the attachments were made between the period 1975-1990.

(v) Haryana

(a) Although recovery amounting to Rs. 1.07 crores was stated to have been effected in 344 cases during the year 1990-91 to 1993-94 by one TRO, the details of movable properties attached were not available in the register maintained for the purpose.

(b) In the case of two TROs (Hissar and Faridabad), out of 25 cases of immovable properties attached, properties in 4 cases were attached five to eighteen years back i.e. on 10 October 1977, 13 February 1989, 6 December 1989 and 5 April 1990 but no action to dispose any property was taken by the TROs for the recovery of tax in arrears.

The Ministry have accepted that the tax arrears in respect of cases where recovery certificates have been drawn have increased and also that the reduction in arrear demand was below targets set by the Board over the years. They have attributed the latter to substantial portion of the demand having been stayed or kept in abeyance by various appellate/judicial authorities. The Ministry have also added that while the arrears have increased, the collection of direct taxes have also shown significant growth between 1990-91 and 1993-94.

The Ministry's reply which does not touch upon the specific cases

cited, is not tenable for the following reasons:

(i) The targets fixed by the Board for reduction in arrear demand was after excluding the disputed portion of arrears with various authorities.

(ii) As mentioned in the audit findings, the reduction in arrear demand was largely by way of remissions, transfers, write off etc. whereas cash collection which is the real index of performance of the tax collection machinery was below the target of 12.5 percent.

The Ministry have also stated that the subject of attached properties was pending in various courts in large number of cases and the department was restrained from proceeding with their arrangement for sale. This reply is vague as it does not give the details in respect of the specific cases cited.

Lack of co-ordination between assessing officer and Tax Recovery Officers

3.2.10 Adequate coordination between the assessing officers and TROs is essential for effective functioning of the tax recovery machinery. Instructions have, therefore, been issued by the Board for proper and adequate co-ordination between the TROs and the assessing officers. They have also emphasised the need to avoid large variations between the arrears as certified in the recovery certificates and the actual arrears as appearing in the books of the assessing officers. The TROs are expected to reconcile their figures with those of the assessing officers to ensure that demand continues to exist and the latter have not themselves cleared/reduced the arrears. In this connection, the Board prescribed (April 1993) certain guidelines which are broadly as under:

(a) Arrears should be correctly brought forward and reconciliation statements prepared and pasted in the Demand and Collection Register.
(b) Reconciliation and verification of outstanding demands stated in the recovery certificates with reference to demand and collection Register must be undertaken and completed.
(c) Action to update names and address of assessees given in the recovery certificates should be taken up.

Audit scrutiny of the records maintained by most of the TROs and the assessing officers in different States revealed that:

(i) the required certificate to the effect that all the entries of arrear demand have been duly carried over from the demand and collection register of the last year was not found recorded.
(ii) verification and reconciliation of arrear demand were not done and required certificates of authenticity and reconciliation were not appended in the demand and collection register.
(iii) no action to update names and addresses of assessees given in

recovery certificates was taken by theTROs.

Some cases are cited below:

(A) West Bengal

18,125 certificates involving tax demand in arrears of Rs.931.74 lakhs as on 31 March 1994 were kept pending for want of information from assessing officers. It was noticed that in most cases assessing officers did not inform the TROs concerned of subsequent changes in quantum of demand due to rectification, revision in appeal etc. as also transfer to other wards due to jurisdictional changes.

(B) Maharashtra

One assessing officer had intimated an arrear demand for Rs.19.79 lakhs for assessment years 1987-88 to 1989-90 to the TRO as late as in July 1993 for recovery at the earliest. On initiation of the recovery proceedings by the TRO in August 1993, the assessee asked him to keep the proceedings in abeyance as various rectifications and appeal effect were pending with the assessing officer. There was no response of the assessing officer to the clarification sought by the TRO and consequently the demand remained unpursued.

(C) Delhi

(i) In one case, the assessing officer asked the TRO (January 1994) to draw RC for Rs.20.07 lakhs pertaining to the assessment years 1983-84 to 1987-88 and 1990-91. The assessee in his reply (March 1994) informed that only Rs.12.21 lakhs was outstanding out of this demand and of this Rs.3.57 lakhs were lying in appeal with ITAT. This discrepancy indicated that the correctness of arrear demand was not verified by the assessing officer before asking the TRO to draw the RC.

(ii) In ten cases involving demand of Rs. 373.42 lakhs, it was noticed in audit that the assessees were corresponding with the TROs regarding the correctness of the demand. There was no confirmation from the assessing officers indicating lack of coordination between the two. As a result, RCs drawn without any confirmation from the assessing officer did not result in recovery action.

(iii) In the case of an assessee company, RCs for Rs.21.04 lakhs, pertaining to assessment years 1982-83,1984-85,1987-88,1989-90 and 1990-91 were drawn in January 1994.It was seen during audit of assessment records that interest under section 220(2) was not charged. Moreover, in one of the assessment years (1987-88) the demand was intimated as Rs.6.17 lakhs against the actual demand

of Rs.5.47 lakhs. Similarly, a demand of Rs.3.28 lakhs was intimated for assessment year 1989-90 against actual demand of Rs.2.86 lakhs which was reduced to Rs.2.22 lakhs in July 1994 but reduction in demand was not intimated to TRO.

(D) Tamil Nadu

(i) In 3 cases, there were variations between the amount of arrears communicated by the assessing officers and the amount of arrears in the TRCs issued by the TROs. The arrear demand intimated by the assessing officer was Rs. 66.52 lakhs whereas it was Rs. 54.25 lakhs as per TRO's records.
In reply to the above, TRO has stated that difference is under verification in one case and that demand has wrongly been included twice by the assessing officer in another case. No reply has been furnished for the third case.
(ii) In 28 cases involving tax demands aggregating Rs.1,472 lakhs, the reductions in tax demand affected by the assessing officers due to appellate orders were neither communicated by them to the TROs nor ascertained by the latter from the former. Consequently, the demand records of the TROs remained unnecessarily inflated.

(E) Gujarat

(i) As a defaulter had failed to pay outstanding demand of Rs.27.56 lakhs, his account in a bank was attached on 27 January 1995, under section 226(3) of the Act by the TRO-8 Ahmedabad.The notice was served to the defaulter at 4.30 p.m. on the same day by the Inspector. It was, however, noticed in audit that the order of attachment of the same account was withdrawn on the same day by the TRO though as verified by audit from the cash book, no payment was made by the defaulter. Further, as verified by audit from the assessment records of the defaulter in circle 9(1) Ahmedabad, a refund of Rs.13.63 lakhs was granted by the assessing officer in February 1995 for assessment year 1994-95 without adjusting it against the outstanding demand of Rs.27.56 lakhs. Thus, due to lack of co-ordination between the TRO and the assessing officer, the demand of Rs.27.56 lakhs remained outstanding.

(ii) It was seen that 605 RCs for the amount of Rs.17.95 lakhs pertaining to the years 1965-66 to 1985-86 were pending with TRO-V, Ahmedabad due to non-receipt of complete details of assets of the defaulters, their addresses etc. alongwith the recovery certificates from various assessing officers. There was no progress and the demand remained outstanding.

(F) Madhya Pradesh

Lack of co-ordination between the TROs and the assessing officers resulted in non-verification/non-adjustment of the payments claimed to have been made by the assessees. Consequently the demands remained inflated. As on 31 March 1994, 1562 RCs involving an amount of Rs.1,611.08 lakhs under C.I.T. charge, Bhopal,. and 703 RCs involving an amount of Rs.24.41 lakhs in the C.I.T.charge, Jabalpur remained outstanding on this account.

(G) Chandigarh

In 77 cases involving demand of Rs.14.28 lakhs, it was noticed that though the assessing officer had no jurisdiction under the Act after RCs had been drawn up, yet he collected the demand shown in the RCs and did not intimate this fact to the TRO. The RCs remained outstanding in the books of the latter due to this lack of coordination till he verified with the assessing officer.

The Ministry while accepting that there was lack of adequate co-ordination between the assessing officers and the TROs, have stated that reconciliation and verification of outstanding arrear demands were being done by the TROs and the assessing officers. They have added that as a result of close monitoring of the functioning of the TROs by the Chief Commissioners and the Commissioners of Income Tax it is hoped that this problem will no longer remain. The second part of the reply is general and does not give the reasons in respect of the specific cases cited by audit.

Inadequacy of action to effect recovery of demand outstanding

3.2.11 (i) Inadequate action on the part of TROs

The Second Schedule to the Income Tax Act and the Tax Recovery Inspector's Manual clearly lay down the modes of recovery procedure to be followed at various stages and the time schedule right from the issue of first notice to the final stage of disposal. A few illustrative major cases showing inadequacy in action taken to effect recovery of demand are given below:

(A) Delhi

Test check revealed that in 11 cases involving a demand of Rs. 300.51 lakhs pertaining to 3 TROs, summons under Rule-83 of the Second Schedule to the Income Tax Act and show cause notices were only issued after the drawal of RCs. No other action beyond mere issue of these notices were taken to recover the dues.

(B) Maharashtra

(a) In the case of a company, RCs for Rs. 86.91 lakhs covering

demand for the assessment years 1988-89 and 1989-90 created between March 1989 and July 1990 were sent to the TRO for recovery in February 1992 i.e. after lapse of 20 to 35 months. Since no appeal was pending against the said demand, immediate action was to be taken to recover the dues. The reasons for late initiation of action, though called for was not furnished. The TRO initiated the recovery proceedings in February 1992 itself but could not succeed in recovering the dues except Rs. 9.05 lakhs by liquidating company's fixed deposit with the bank as the company had closed down and it did not have any attachable assets in Bombay (the whereabouts of its directors were also not known to the department) and the only assets available were the factory premises and a plant and machinery at Nasik which were already attached by the Bank of India against their debts. The department has not so far lodged a claim with the official liquidator of the company but has forwarded a duplicate RC to the TRO at Nasik for attaching the factory premises. He could not, however, do so due to resistance of watchman posted at the factory. The TRO, Bombay advised him to take police help in the matter. Further development has not been intimated (March 1995) by the TRO, Nasik. Thus, belated action in initiating recovery proceedings and inaction at various levels resulted in the demand remaining outstanding.

(b) Tax of Rs. 255.91 lakhs relating to assessment years 1985-86 and 1988-89 was due from an assessee individual. Of this, Rs. 15.96 lakhs was recovered by the assessing officer by freezing his bank account in February 1993. The assessing officer intimated the balance arrears to the TRO in October 1993 for recovery and the recovery proceedings were initiated by TRO in the same month. In the meantime the assessee obtained permission from the Commissioner to pay Rs. 12 lakhs by way of monthly instalments of Rs. 1 lakh. The amount was collected from the assessee by December 1994 by the TRO. Considering the quantum of arrears, the instalment of Rs. 1 lakh fixed by the Commissioner was unrealistically low. The assessee discontinued payment of the instalment since or after December 1994 on the ground of having filed an appeal before ITAT and there has been no progress in recovery thereafter.

(c) TRO- 16, Bombay transferred RCs for Rs. 73.08 lakhs (inclusive of interest) covering the demand for assessment years 1965-66 to 1992-93 of an individual (deceased) to the TRO, Pune in February 1994. During the course of the recovery proceedings, the present Karta of the Hindu Undivided Family intimated the department (May 1993) that 17 acres of land belonging to family at Pune may be sold to meet the government dues. There was delay in attaching (August 1994) the property. Further, it is yet (March 1995) to be disposed as the valuation officer at Bombay has not fixed the reserve price. The dues remain unrealised.

(d) An individual was in arrears of tax of Rs. 43.77 lakhs relating to assessment years 1971-72 to 1975-76 and 1978-79. The recovery proceedings were initiated by the TRO only in November 1993. Meanwhile, the assessee informed the department in September 1994 that he had filed revision petition under section 264 before CIT and the recovery proceedings may not be initiated till its disposal and that he was not in a position to pay the demand due to paucity of funds with him. No action thereafter was initiated by the department to recover the dues (March 1995).

(e) In respect of an assessee company, the assessing officer intimated arrear demands of Rs. 129.98 lakhs in November 1991 pertaining to assessment years 1984-85 to 1986-87 to TRO for recovery. The demand was subsequently reduced to Rs. 78.88 lakhs in September 1992 and October 1993 after giving effect to appellate orders. The TRO initiated recovery proceedings in November 1991 and as there was no response from the assessee company, prohibitory orders for attachment of properties of its Directors were issued in March 1992 by the TRO. Since the factory was at Baroda, the TRO, Baroda was asked to attach it. He, however, informed in April 1992 that the attachment notice issued to company was returned by the postal authorities with a remark that the company had been closed down long ago. Finally, in March 1993, when the property in which one of the Directors was staying was attached, it was reported by the Director personally that the assets of the company were liquidated through court by the GIDC, Gujarat against secured loans and also that he did not have any property in his name and was staying with his son. As the department was aware that the company had stopped filing its return since 1987-88 onwards, it should have ascertained its financial position and lodged a claim before the liquidator. Belated action has resulted in demand not being realised with remote possibility of recovery.

(C) West Bengal

In an RC case drawn in 1985-86 and involving a demand of Rs.59.11 lakhs pertaining to assessment years 1962-63 to 1980-81, no action had been taken by the TRO and the assessing officer to dispose the seized jewellery by auction, despite the specific instructions of the CIT from time to time.

(D) Gujarat

(a) In one case, the TRO received intimation from the assessing officer in November 1993 that an arrear demand of Rs. 105.69 lakhs was outstanding against a defaulter for assessment years 1988-89, 1989-90 and 1990-91. As the defaulter did not turn up for payment of the dues, it was decided (April 1994) to sell the plant

and machineries worth Rs. 143.65 lakhs (as on 25 March 1994) belonging to him by auction. The auction was, however, postponed on payment of Rs. 2.50 lakhs only by the defaulter in March 1994 after taking a bond from him that he will pay the entire arrear demand and expenses in respect of recovery, by regular instalments. Prior permission of the competent authority was, however, not taken for this course of action. The defaulter failed to pay the arrear demand even by instalments and the auction could not be executed by the TRO till February 1995 as the plant and machineries were hypothecated to a Bank which filed a Civil suit against the TRO action.In the meanwhile in October 1994 the department transferred the case to TRO-2, Surat stating that it pertained to his jurisdiction. TRO-2, Surat has started the procedure de-novo and issued a notice in October 1994 with the result the large demand remained outstanding.

(b) A defaulter assessee and his wife expired in August 1978 and 1982 respectively leaving Rs. 41.23 lakhs (income tax Rs. 24.33 lakhs and wealth tax Rs. 16.90 lakhs) outstanding against them. The department attached three immovable properties of the defaulter in September 1982. During the period of 11 years from the date of attachment of properties to September 1993, no effective coercive action was taken by the TRO for recovery of the dues. In September 1993, the High Court at Bombay, appointed a court receiver for the properties who leased out the attached properties. The TRO requested for remittance of income generated by use and occupation of the properties under attachment for adjustment against government dues. The receiver advised the TRO that the matter be taken up with the High Court for seeking necessary relief. However, no action was taken by the TRO with the result that the demand remained outstanding.

(c) A TRC for an amount of Rs. 264.94 lakhs was received by TRO, Ahmedabad in August 1993 from the assessing officer in respect of a defaulter who was declared absconder by the Government of Gujarat and a non bailable warrant was issued. He was also declared insolvent in December 1993 and two custodians were appointed for administration of his assets which were attached.

The TRO in his letter of December 1993 reported that despite making all efforts, it appeared that even in future it was not possible to recover more than 50 percent of the total arrear demand. A proposal for partial write off of demand relating to assessment years 1980-81 to 1986-87 was, therefore, submitted and non-recovery certificate was issued partly to the extent of non-recoverable demand of Rs. 135.00 lakhs.

Audit scrutiny revealed that the creditors, including the government

were required to register their claims before the custodian/receiver of the court for the dues outstanding against the defaulter. There was nothing on record to indicate that a formal claim had been registered by the department before the court receiver with the result that the large demand had remained outstanding.

(E) Tamil Nadu

(a) For the recovery of a tax demand of Rs. 43.33 lakhs from an individual, the TRO attached his house property in October 1990. The defaulter obtained a tax clearance certificate for the sale of the property on the assurance that the arrears would be cleared and sold the property. He did not pay the tax arrears. The tax clearance certificate was issued without obtaining adequate security for the realisation of the tax arrears and consequently the demand remained outstanding.

(b) In 4 tax recovery offices, no action has been initiated for recovery of the tax demands after the issue of initial notice of demand in 12 cases for a tax demand of Rs.17.96 lakhs. The delay in these 12 cases ranged from 18 to 55 months.

(F) Orissa

(a) It was noticed in 5 cases that the first notice to defaulter were prepared but not issued by the TRO, Sambalpur. In TRO, Cuttack charge, in 39 cases first notice was not issued at all even after 1 year to 6 years.

(b) It was seen that in 10 cases (TRO, Sambalpur-3 cases and TRO, Cuttack- 7 cases) no follow up action like issue of reminder, summons etc. was taken by the TROs for 2 to 5 years after issue of first notice.

(c) It was noticed from the register of immovable properties of TRO, Cuttack that in 27 cases involving arrear demand of Rs. 143.02 lakhs (assessment years 1959-60 to 1992-93), immovable property was attached during the period from November 1971 to March 1993 but no proclamation for sale of the property was made (February 1995). It was stated by the TRO that sale proclamation in these cases could not be made for want of certain information from the field offices and because of appeals pending before the higher authorities. Despite the departmental instructions for expeditious disposal of appeal cases, no steps have been taken to approach the concerned authorities in these cases.

(d) In a certificate case of TRO Sambalpur, against an arrear demand of Rs. 19.04 lakhs, land and building were attached by the TRO in December 1977. The recovery proceedings were stayed by

the CIT, Orissa. The date of stay could not be furnished by the TRO. Further, while he stated that CIT, Orissa has been moved to vacate the stay order, no supporting documents could be shown to audit. Even after a lapse of 17 years, no effective steps could be taken to get the stay order vacated.

(G) Madhya Pradesh

(a) TRC in respect of an assessee for arrear demand of Rs.46.35 lakhs was received by TRO, Bhopal on 11 March 1993. The first notice of demand was also issued on the same date and it was followed by another notice issued on 17 August 1993. The details of properties in which the assessee had a share were intimated by the Assistant Commissioner of Income Tax (Investigation circle), Bhopal to the assessing officer in August 1993. Despite the Deputy Commissioner of Income Tax, Bhopal's directions (October 1993) to the TRO to speed up the recovery of arrear demand, no effective steps were taken to attach the aforesaid properties.

The TRO Bhopal stated (November 1994) that as even the first notice of demand remained unserved on the assessee, no further action regarding attachment of immovable properties could be taken.

(b) TRO, Bhopal, received an RC in respect of a defaulting assessee, from TRO, Chandigarh on 17 February 1992. The first notice of demand for Rs. 31.41 lakhs was issued on 21 February 1992 which was followed by another notice on 8 March 1992. The defaulting assessee, deposited an amount of Rs. 2 lakhs in January 1993. Thereafter, a notice was issued to the assessee on 17 March 1993, indicating to him that unless he deposited the remaining arrear demand of Rs. 29.41 lakhs alongwith uptodate interest, coercive action would be taken against him. But except issuing a reminder on 26 October 1993, no further action had been taken (November 1994) to recover the remaining arrear demand.

(H) Punjab

An irrecoverability certificate issued on 6 December 1983 in favour of an HUF assessee, was subsequently revised to Rs. 6.52 lakhs and a fresh RC was issued in January 1989. The proposal to write off the arrears was submitted to the Commissioner of Income Tax, Patiala in March 1986 which was still pending. As per the records of the department, the assessee who had settled in Canada, had 3000 preferential shares of Rs. 100 each of two companies but no efforts were made to attach these shares with the result that the tax due remained unrealised.

(I) Rajasthan

In Ajmer, a statement of arrear demand amounting to Rs. 124.68 lakhs for the assessment years 1967-68, 1968-69 and 1985-86 in respect of a defaulter company (Jaipur charge) was drawn up and passed on to the TRO on 25 July 1991 to initiate recovery proceedings. Notices were issued to the assessee on 23 August 1991 and 15 November 1991. The TRO attached the registered office and factory building of the defaulter company on 20 February 1992 and 24 April 1992 respectively. The defaulter company was declared a sick unit under BIFR's order of 21 April 1992, which allowed recovery of arrear demand to the extent of Rs. 43 lakhs only against the total demand of Rs. 152.60 lakhs and that too between the years 1999-2002. Inordinate delay in initiating recovery proceedings thus resulted in issuing of irrecoverability certificate for the balance demand of Rs.109.60 lakhs for writing it off.

(J) Jammu & Kashmir

(a) In one case, assessment was completed in May 1991 after scrutiny and notice of demand was served on the assessee in May itself for making payment of Rs. 29.55 lakhs. After appellate orders the demand was reduced to Rs. 28.63 lakhs. The TRO was advised by the assessing officer to initiate recovery proceedings in view of the large amount involved. An order for attachment was issued on 3 February 1992. No further action was taken for recovery of the arrears thereafter.

(b) In 15 cases involving arrear demands of Rs. 187.94 lakhs, action taken by the department was not recorded anywhere in the Register of recovery certificates. The relevant case files were also not made available to audit.

(K) Assam

In 4 cases of Tax Recovery certificates, notices for arrear demand of Rs. 10.50 lakhs relating to the assessment years 1967-68, 1968-69 and 1969-70 were issued by TRO, Silcher to a defaulter. The Board was requested to withhold payment out of compensation money payable to the company. The entire amount was kept in abeyance by the CIT in his letter dated 3 December 1987 in view of Board's circular letter of December 1970, as the compensation payable to the defaulter had not been finalised by the Board. Even after more than 24 years, the compensation payable to the company has not been finalised resulting in the amount remaining unrecovered.

(L) Chandigarh

In five cases of defaulters, an assessing officer forwarded RCs aggregating Rs. 12.72 lakhs plus interest leviable. A proclamation for attachment of immovable properties, comprising shops and a hall owned by the defaulters was made in November 1990. However, no action to fix a reserve price for sale of the property was taken by the TRO although the above order had become final in the absence of any appeal filed by the defaulters against it.

An official receiver was, however, appointed under the Income Tax Act by TRO on 6 June 1991. He also rejected an appeal filed by the defaulters against such appointment. The latter appealed against this order before Commissioner of Income Tax, Patiala who cancelled (December 1991) the appointment of official receiver on the basis of the assessing officer's report (December 1991) indicating the outstanding amount as Rs. 75,129 only. The detailed working out of the above amount was not available on record.

The official receiver filed a review petition on 20 October 1993 on which the Commissioner asked for a report from both the TRO and the new assessing officer. In response, the assessing officer intimated that arrears of Rs. 10.54 lakhs plus interest on delayed payment of demand as outstanding whereas according to the TRO this amount was Rs. 12.72 lakhs plus interest. The order (December 1991) cancelling the appointment of official receiver by Commissioner of Income Tax, Patiala without attempting to reconcile the different amounts intimated by the then assessing officer and the TRO, rendered the arrears irrecoverable. No progress has been made in this case (April 1995).

(M) Haryana

(a) Test check of records of 2 TROs (Hissar and Faridabad) revealed that 284 recovery certificates involving demand of Rs.38.81 lakhs received upto 31 March 1989 were still outstanding. Out of these 113 cases related to the period prior to 31 March 1984.

(b) In the case of an assessee `Individual', the tax demand of Rs. 34 lakhs pertaining to the assessment years 1980-81 to 1984-85 was outstanding for which notices were issued in January 1990, May 1990 and July 1991. File containing recovery certificates and action taken by the TRO in the case was not produced to audit. However, according to the Register of attachment of immovable properties maintained by TRO, the defaulter owned two houses and agricultural land. However, no action in regard to the sale of immovable properties as well as agricultural produce was taken for recovering the dues.

(c) In the case of an assessee company, tax demand of Rs. 29.05 lakhs pertaining to assessment years 1980-81 to 1984-85 was outstanding. The company was stated to have filed an application before BIFR for revival. There was nothing on record to show whether any efforts to find out the details of the immovable property owned by the defaulter and its current assets were made.

(ii) Inadequate action on the part of the assessing officers

With effect from 1 March 1989, the assessing officers were to exhaust all the modes of recovery before drawal of certificates by the TRO. It was seen in audit that the assessing officers whose primary responsibility was to ensure timely recovery of dues, were not initiating timely and effective measures to recover the dues as is evident from the following cases:

(A) Delhi

(a) In April 1994, the assessing officer asked the TRO to draw an RC for Rs.20.07 lakhs pertaining to assessment years 1983-84 to 1987-88 and 1990-91. Audit scrutiny revealed that the assessee preferred appeals in respect of the assessment years 1984-85 and 1987-88 for penalties imposed and partial demand. Though the various appellate proceedings were finalised by July 1993, the assessing officer took no action to at least recover the demand of Rs.10.87 lakhs pertaining to assessment years 1984-85, 1986-87 and 1987-88 which had not been disputed by the assessee. The balance sheet of the assessee disclosed that even on March 31, 1990 he had assets like debtors, stock, loans etc. valued at Rs.64.26 lakhs. No action was taken to attach these. Only the bank account of the assessee which had a balance of Rs.2,400 was attached. The date of attachment of bank account though called for was not furnished to audit.

(b) The TRO was asked on 28 January 1994 to draw recovery certificate for Rs. 17.34 lakhs pertaining to assessment years 1979-80, 1983-84, 1989-90 and 1990-91. While scrutinising the assessment records for 1989-90 involving demand of Rs. 13.56 lakhs, it was seen that the demand was raised on 30 March 1992 and appeal of the assessee was rejected by the CIT(A) (January 1993). However, no efforts were made by the assessing officer to recover the demand before transferring the case to TRO after one year.

(B) Maharashtra

TRCs for Rs. 55.95 lakhs covering the demand for assessment years 1982-83 to 1985-86 which were received on transfer from Patna in January 1991 were issued by the TRO-I, Bombay in March

1991 to the assessee, a public limited company, which informed the department that it had no liquid assets or attachable properties and the demand raised against them were subject to appeal with CIT (Appeals), Bombay. The TRO stated (January 1995) that appellate orders were passed granting considerable relief but the orders had not been given effect to by the assessing officer resulting in a large demand being shown as outstanding.

(C) Madhya Pradesh

(a) In 7 cases in the CIT charge, Bhopal, subsequent reduction in demands due to rectification, appeal effect etc. were not intimated to the TROs resulting in inflated demands continuing to appear in latter's records. Similarly, in 7 cases in the CIT charge, Jabalpur, subsequent reduction in demands were not intimated by the assessing officer resulting in large variation in demands.

(b) In CIT charge, Jabalpur, in respect of 4 cases involving recovery of Rs. 50.07 lakhs, the first notice of demand (ITCP-1) was delayed by more than a year.

The Ministry have accepted that there were several cases where large arrears remained uncollected due to inadequate action on the part of the TROs and the assessing officers. They have added that the Chief Commissioners of Income Tax have been asked to pay greater attention to the work of recovery of outstanding arrears pending with the TROs. Reply to the specific cases cited has not been furnished by the Ministry.

Lacuna in the Act

3.2.12 Section 230 of the Income Tax Act,1961, requires a person who is not domiciled in India or a person who is domiciled in India but intends to leave the country as an emigrant or on a work permit or under any other circumstances necessary in the opinion of an income tax authority, to obtain a tax clearance certficate before leaving the territory of India. For obtaining the requisite certificate, the person has to apply to the competent authority (assessing officer - foreign section) after obtaining an authorisation in Form no.32 from the assessing officer who has jurisdiction to assess him. The certificate is given after the authority is satisfied that the applicant has either paid or made satisfactory provision for payment of all existing liabilities under the Act. If he is not satisfied he is empowered to pass a written order refusing to grant the certificate.

Audit scrutiny revealed that there were several cases of tax defaulters having left the country, though RCs were drawn and the dues remained pending. The details of a few such cases are given below:

(i) In the case of Maharashtra charge, the department was aware

that the assessee company had discontinued its business in 1985 and liquidator of company was filing its return for assessment years 1986-87 and 1987-88 for 'nil' amount. Despite this, the assessing officer forwarded the arrear demand of Rs. 44.12 lakhs relating to assessment years 1983-84 and 1985-86 to the TRO for recovery only in July 1990 i.e. after a lapse of five years. All the three Directors out of four had left India in the meanwhile and settled abroad. As there was no chance of recovery either from the company or from its Directors, the TROs proposed the case for write off in April 1992 which was still pending. The fact that the Directors could obtain the tax clearance certificate and without which they would not have been able to leave the country, besides indicating a lacuna in the procedure for granting such certificates, also indicates serious lack of co-ordination between the TRO and the assessing officer.

(ii) In Gujarat charge, a TRC dated 11 April 1990 was received by TRO-I, Surat from the assessing officer for the recovery of outstanding demand of Rs. 107.21 lakhs. The department had attached his only immovable property for public auction. However, efforts to sell the attached property failed as the bids were lower than the reserve price fixed. Consequently, the assessing officer was requested to expedite the proposal for partial write off of outstanding arrear demand. He informed (February 1995) that the defaulter had left India permanently with his family members and the chances of his returning were remote. It is not clear how the defaulter could obtain the requisite tax clearance certificate under section 230 of the Act from the assessing officer who had jurisdiction over the case when a large demand was outstanding.

Similarly, in another case the department could not take any effective steps to recover an outstanding demand of Rs. 60.29 lakhs for assessment year 1984-85 due to the reason that two partners of the firm had left India.

(iii) In Tamil Nadu charge, the tax arrears of Rs. 16.35 lakhs was due from a firm for the assessment years 1979-80 to 1981-82. While requesting (October 1992) the TRO, Madras, for recovery, the assessing officer did not furnish the details of the assets and the partners of the firm. The TRO on enquiry learnt (September 1993) that the firm was closed and both its partners had left for Dubai. It is not clear how the defaulters could get income tax clearance from the assessing officer which is necessary under section 230 of the Act before leaving the country.

The above indicate a need for tightening of the procedure for issue of tax clearance certificate to ensure that persons who have not paid the taxes due are not allowed to leave the country without making

adequate provisions for payment of their tax liabilities. Further, as visas may not be necessary to visit certain countries and also as defaulters may leave initially on a tourist or other kind of visa rather than as an emigrant, it may be considered whether a tax clearance certificate for leaving the country on any ground whatsoever, should be obligatory for a tax defaulter in the interest of revenue. This would also involve excellent coordination with the immigration authorities who should be furnished with updated list of tax defaulters with a prescribed periodicity. To limit the paperwork a floor level of arrears could be considered for fixing, beyond which a tax clearance should be made mandatory before the defaulter is allowed to leave the country.

The Ministry have stated that the existing provisions and instructions of the Board are sufficiently deterrent to reduce the chances of persons having tax arrears leaving the country surreptitiously. However, if required, the Board would issue further instructions to ensure proper application of the provisions so that tax defaulters do not leave India. The reply is general and does not cover any of the specific cases cited. Further, the fact that tax defaulters have managed to leave the country and settle abroad without clearing their tax dues indicates that the Act/Rules/procedures as prescribed now are either not sufficiently deterrent or need to be streamlined.

Review of Progress Reports

3.2.13 The department has prescribed periodical progress reports of outstanding demands and clearance to be submitted to Commissioner/Chief Commissioner every month/quarter. However, test check in audit revealed a large number of discrepancies in the figures shown by the TROs in the progress reports and exhibited in their records. **An important control mechanism for monitoring these cases was thus rendered ineffective**. Details of some of such major cases are given below:

(A) Gujarat

(a) The number of RCs shown as disposed by the TRO-3 Ahmedabad in his monthly progress report of March 1994 was 1509 during the month and 1692 during the year whereas, the certificate disposal register showed the figures as 964 and 1020 respectively.

(b) Verification of movable and immovable property attachment register for the years 1991-92 to 1993-94 of TRO-8 Ahmedabad revealed that during these years, no property (movable or immovable) was attached. However, in the progress report for March 1994, 7 movable and 4 immovable properties worth Rs. 28,000 and Rs. 17.50 lakhs respectively were shown as attached.

(c) During 1993-94, the actual closing balance of the RCs pending with the TRO, Bulsar was 4795. However, in the progress report of March 1994 it was shown 4657, i.e. less by 138. The RC disposal register was not maintained for the years 1991-92 to 1993-94, with the result the correctness of the figures shown in the monthly progress report could not be verified.

(B) Delhi

As against the reduction of arrear demand and cash collection of Rs. 5,837.77 lakhs and Rs. 846.05 lakhs for 1992-93 as shown in the Action Plan Report, the half yearly progress report (ending March 1993) depicted the reduction of arrear demand and collection by Rs. 10,362.57 lakhs and Rs. 928.50 lakhs respectively.

Similarly, in Action Plan Target Report for the Chief Commissioner of IT-III charge for 1993-94, the arrear demand pending on April 1, 1993 was taken as Rs. 1,970.31 lakhs instead of Rs. 2,079.69 lakhs shown in the half yearly progress report (ending March 1994).

(C) Orissa

Monthly progress report for March 1994 of TRO, Sambalpur showed the progressive total number of cases disposed during 1993-94 as 569 involving Rs. 19.70 lakhs. The corresponding figure as per the Disposal Register was 624 involving Rs. 16.59 lakhs. Thus there was a discrepancy of 55 cases involving an amount of Rs. 3.11 lakhs.

(D) Kerala

Progress reports of TRO, Kollam and disposal register maintained by him showed that the number of RCs reported to be disposed in the progress reports was 1366 whereas the disposal register showed a figure of 1223 only.

(E) Assam

(a) The monthly progress report (MPR) submitted by TRO, Guwahati for the month of March 1993 showing the progressive figures for the year 1992-93 revealed the following discrepancies:

— 213 cases of TRCs were shown as wholly disposed in the MPR against 64 cases of RCs worked out from the Register of closed cases during 1992-93.

— Arrears of Rs. 27.20 lakhs were shown as reduced by rectification, appeal effect, adjustment etc. in respect of RCs wholly

closed in the MPR during 1992-93 against Rs. 5.48 lakhs worked out from the Register of closed cases.

— In the MPR for the month of September 1991 an addition of 667 cases of RCs involving arrear demand of Rs. 13.14 lakhs was made on physical verification of records. This shows that the arrear position of RCs was not correctly brought forward upto September 1991. The details of the cases were not kept on record.

(b) The monthly progress reports of TRO, Dibrugarh revealed:

— In 23 cases of RCs received during 1991-92, the arrear demand involved was worked as to Rs. 40.83 lakhs against Rs. 29.20 lakhs shown in the MPR.

— The MPR of TRO (Dibrugrarh) for April 1993 showed a balance of 19 RCs while the balance as worked out from the Receipt and disposal registers for RCs was 3612. The discrepancy of 3593 cases had not been reconciled.

— Against one case of RC of arrear demand of Rs. 4.80 lakhs as per Register of RCs for the year 1993-94, 28 cases involving arrear demand of Rs. 22.10 lakhs were shown in the MPR.

(c) The monthly progress reports of TRO, Tezpur revealed:

— MPR for the months of March 1992 and March 1993 showed that 5911 cases of RCs involving arrear demand of Rs. 184.85 lakhs relating to the year of receipt prior to 1990-91 were received in 1991-92. As a result the arrear demand of Rs. 184.85 lakhs in 5911 cases Tax Recovery Certificates remained under-stated as on 1st April 1990.

The MPR is a very important tool for monitoring. For it to be a reliable and effective instrument, it has to reflect the data correctly. The above instances reveal that even the higher authorities did not exercise any periodical checks to ascertain whether the information being furnished by the TROs was correct.

(F) Rajasthan

(a) The following irregularities were noticed in TRO, Jaipur:

— in the Register for certificates finally disposed 82 certificates were shown as returned in the month of March 1991 but there was no entry to this effect in the MPR. Further, as per Disposal register for the year 1992-93, 602 certificates amounting to Rs. 16.04 lakhs were shown as returned to the assessing officers whereas the MPR

of March 1993 indicated that 823 certificates amounting to Rs. 17.69 lakhs were returned to assessing officers. Similar mistakes were noticed in other months also.

— the closing balance of defaulters in the month of March 1993 was 1065 but only 975 cases were carried over in the MPR for the month of April 1993.

— the grand total of the totals of 22 Registers of TRCs received worked out as 1433 certificates amounting to Rs. 561.64 lakhs. However, the MPR as on 1 April 1993 depicted it as 1285 certificates for Rs. 465.27 lakhs.

(b) In TRO, Jodhpur, the following irregularities were noticed:

— The grand total of the totals of the Register of TRCs received worked out to 3508 certificates involving arrears demand of Rs. 538.45 lakhs whereas the MPR for the month of March 1993 depicted 1978 certificates involving arrear demand of Rs. 462.55 lakhs.

(G) Karnataka

In the annual progress report of TRO Mysore for 1993-94, a year wise abstract for the closing balance of Rs. 382.71 lakhs in 1,867 cases was given, according to which 49 RCs for Rs. 108 lakhs related to the year 1993-94, whereas according to RC register of Mangalore alone, there were 29 cases for Rs. 434.84 lakhs relating to the year 1993-94 were outstanding at the end of the year. Out of these 29 cases, 23 cases for Rs. 329 lakhs related to a same group of assessees.

(H) Haryana

As against 534 RCs shown in the MPRs for 1991-92 to 1993-94, 65 only were actually drawn during the said period.

The Ministry have admitted that there were certain discrepancies in he departmental records maintained by the TROs. They have added that instructions were being issued to the Chief Commissioners/Commissioners of Income Tax to ensure proper maintenance of progress reports and records and that they should personally inspect the work of TROs.

Write-off of demands of irrecoverable arrears

3.2.14 Inadequate or delayed action in recovering of dues led to write-off of demands. Some cases are mentioned below:

(A) Jammu & Kashmir

Sanction to write off of arrear demands amounting to Rs.30.80

lakhs in 2702 cases had to be accorded mainly because the amounts were overdue by 5 years and no efforts were made to trace whereabouts of the defaulters.

(B) Uttar Pradesh

In two cases the amount of Rs.37.61 lakhs pertaining to the assessment years 1979-80, 1980-81, 1983-84 and 1990-91 to 1991-92 could not be recovered as the assessees had no property. The department had no alternative except to write off the amounts.

(C) Tamil Nadu

One TRO has removed 320 items aggregating Rs.1.56 lakhs from the register on the ground that the tax effect in each case is less than Rs.1,000 and the assessment records and details of defaulters were not available though no orders for write off of the amount were obtained.

(D) In many cases, the write off proposals involving heavy demands pertaining to old assessment years were pending for over 5 years for want of sanction of the competent authority or for other reasons. Some of the cases are given in the table below:

Charge	No. of cases	Amount of arrear demand (Rs. in lakhs)	Assessment years involved	Year in which proposal was moved
Maharashtra	1	53.51	1975-76,1977-78,1978-79 & 1982-83	August to October 1991
Madras	3	42.30	1961-62 to 1979-80	February 1989 to November 1991
Punjab	5	14.12	n.a.	February 1989
Madhya Pradesh	2	61.72	prior to 1982	February 1981
Uttar Pradesh	5	204.93	1964-65 to 1986-87	In December 1985 in one case involving demand of Rs.30.87 lakhs. Information not available for the balance cases.

The Ministry in their reply have stated that detailed instructions have been issued by the Board for write off of irrecoverable outstanding demands but sometimes the pendency of the write off proposals is due to want of irrecoverability certificate from the TROs. They have further stated that details of cases outstanding for more than 5 years as cited by audit are being obtained for remedial action.

Maintenance of records

3.2.15 With a view to facilitate control, quick transmission of relevant data to various supervisory authorities and to have effective control over the arrears and their clearance, the department has prescribed various registers and records to be maintained by the TROs. As these records are important tools for close monitoring of

reduction of arrears, their maintenance requires special attention.

Test check in audit disclosed that in many TROs Offices, a number of important registers were either not being maintained or wherever maintained, these were not found in the prescribed proforma or the entries are not being recorded.

The status of maintenance of some of the important records/ registers is given below:

Sl. No.	Name of register	Purpose in brief	Charges where not maintained at all	Omissions observed in maintenance in other charges and impact thereof
1.	Cash Book	This register is required to be maintained for recording the day to day transactions of cash/cheque collections made from the defaulters and payments remitted to the treasury/bank.	8 TROs in Tamil Nadu, 2 TROs in Madhya Pradesh and all TROs in Bihar and Himachal Pradesh	Not maintained in prescribed form, monthly closing not done and balances not certified by TROs, details of cash/cheques received such as the number and date of receipt and realisation etc. not indicated. In Rajastan and Tamil Nadu charges, arrear demands collected through cheques were not entered in cash book. In Gujarat and Union Territory of Chandigarh, monies received were credited to Government account after delays ranging from 2 to 47 days in contravention of rules. Further, Rs.143.85 lakhs received by TRO, Chandigarh as seen from the DCR, was not recorded in the cash book. Inadequate or non-maintenance of this regiser besides making monitoring of timely remittances difficult, is also fraught with the risk of frauds being committed and not detected.
2.	Execution register	This register gives the number of warrants isued to and executed by the TRO and enables him to know the warrants pending for execution.	3 TROs in Assam, 2 in Orissa, 5 in Tamil Nadu, 1 in Uttar Pradesh , 5 in Punjab and all TROs in Gujarat, Kerala, J&K, Bihar, Chandigarh & West Bengal.	No major deficiency was noticed in the charges where this register was maintained. In Punjab charge, entries were not attested. In the absence of this register there is no record to monitor the execution of warrants.
3.	Register of daily reduction/ collection of certified demand.	This register is the source record for the collection and reduction figures for arrear demands to be furnished in the monthly progress report.	4 TROs in Gujarat, 1 in Uttar Pradesh, 2 in Orissa and 1 in Delhi.	No major deficiency was noticed in the charges where this register was maintained. In Punjab charge, entries were neither attested nor the certificate of the carry forward of arrears/balance recorded. In absence of this record the figures for the progress reports can not be compiled correctly.
4.	Register of movable and immovable properties.	This register records all details of the movable and immovable properties attached.	4 TROs in Gujarat, 1 in U.P., 1 in Delhi, 4 in Tamil Nadu, 2 in Punjab and all TROs in Bihar	No major deficiency was noticed in the charges where this register was maintained. Entries in the register were not attested in Punjab charge. In the absence of this register monitoring of safe keeping of the assets and their disposal is not possible.
5.	Stay Register	This register enables monitoring of cases in which demands have been stayed.	1 TRO in Assam, 7 in Gujarat, 1 in Uttar Pradesh, 1 in Delhi, 2 in Tamil Nadu , 4 in Punjab and all TROs in Jammu and Kashmir, Bihar and Chandigarh	Entries of addition and clearance not attested, date of clearance not noted, there were no remarks against pending cases for action taken etc. Inadequate or non-maintenance of this record rendered monitoring of stayed demands ineffective.

6.	Instalment register	This register enables TRO to see whether a defaulter adheres to the time schedule of payments in cases where instalments are granted.	9 TROs in Gujarat, 1 in Uttar Pradesh, 2 in Madhaya Pradesh, 2 in Punjab, 4 in Tamil Nadu and all TROs in Assam, Himachal Pradesh, Jammu and Kashmir, Bihar, Rajasthan and Chandigarh	In 3 cases in MP charge, instalments were granted in respect of demand of Rs.24.89 lakhs. However, in the absence of any entry, the actual payment of the instalments could not be verified. The absence or inadequate maintenance of this register would render monitoring of timely payment of instalments difficult.
7.	Disposal register for certficates finally disposed off	This register records the details of final disposal of cases.	1 TRO in Gujarat, 8 in Tamil Nadu, 2 in Rajasthan and all TROs in Assam, Uttar Pradesh, Jammu and Kashmir and Bihar.	Necessary entries such as rent and bank accounts attached and amounts realised, attachment of properties, their proclamation and sale etc. were not recorded. The record of the mode of final disposal of the certificates were not available.
8.	Closed certificates register	This register records details of certificate cases closed on account of reduction, rectification etc. made on appellate orders.	3 TROs in Assam, 10 in Gujarat, 3 in Kerala, 2 in Orissa, 1 in Delhi, 4 in Tamil Nadu , 2 in Punjab and all TROs in Jammu and Kashmir, Bihar, Chandigarh and West Bengal.	No major deficiency was noticed in the charges where this register was maintained. The cases which were closed cannot be verified in the absence of these registers.
9.	Custody register	This register records the particulars of articles seized and kept in the strong room.	8 TROs in Gujarat, 1 in Uttar Pradesh, 2 in Orissa, 6 in Tamil Nadu, 2 in Rajasthan , 6 in Punjab and all TROs in Kerala, Himachal Pradesh, Jammu and Kashmir and Bihar charges.	No major deficiency was noticed in the charges where this register was maintained. In the absence of this register record of articles seized can not be verified.
10.	Daily Diary	Work done daily by Tax Recovery Inspector is entered in Daily Diary.	3 TROs in Kerala, 1 in Delhi, 6 in Punjab, 8 in Madhya Pradesh, 8 in Tamil Nadu and all TROs in Assam, Gujarat, Uttar Pradesh, Himachal Pradesh, Orissa, Bihar, Chandigarh and West Bengal	No major deficiency was noticed in the charges where this register was maintained. Absence of this record adversely affects the supervision of work done by Inspectors.

From the above it appears that registers at serial number 4 serves the same purpose as the one at 9. This is the case with the registers mentioned at serial numbers 7 and 8 also. The Department could review whether one of each could be reduced to bring down the multiplicity of registers without affecting operational efficiency.

The Ministry have covered the audit observations made in this para also in their reply incorporated under para 3.2.13.

Working of the Directorate of Income Tax (Recovery)

3.2.16 (i) Objective

The Directorate of Income Tax (Recovery) functioning under the overall supervision of the Director General (Administration) North and headed by Director of Income Tax (Recovery) and assisted by

Deputy Directors and Assistant Directors,was created in December 1978, with the purpose of collating, compiling and reviewing, on behalf of the Board, quarterly dossiers of cases involving outstanding demand of above Rs. 10 lakhs. Later, from December 1989, the work of review of dossier cases of arrears above Rs. 1 crore was assigned to the Directorate. The Directorate also processes write off proposals involving arrear demands of Rs.15 lakhs. It has also been assigned inspections of field offices.

(ii) Review of dossiers

The function of review of dossiers cases i.e. each involving outstanding demand of more than Rs.1 crore was entrusted to the Directorate from December 1989 mainly with a view to monitor the growth of the outstanding demand and to initiate effective action for containing it. However, it was seen in audit that the net collectable demand (i.e. after reducing the demands which are disputed in appeal, rectification, revision as well as those claimed to have been paid but not verified etc.) rose from Rs.1,778.11 crores in June 1993 to Rs.2,244.84 crores in June 1994. It was also noticed that the aggregate demand of dossier cases increased from Rs.3,093.62 crores to Rs.8,624 crores during June 1990 to September 1994.

The above indicates the need for concerted action by the Directorate in monitoring the high demand cases and to find out and implement effective measures to contain the growth. Audit could not evaluate the quality of the review conducted of the dossier cases and the action taken thereafter as the Directorate did not furnish the details of the dossiers reviewed by it during the years 1990-93 which were requested for by audit.

Complete dossier file of an individual assessee provides ready reference in respect of comments and progress made by the assesing officer, from time to time regarding progress in reduction of tax arrears. It was noticed in audit that the dossier cases received in the Directorate, from various charges have been kept in bundles and it was also seen that the dossiers received during 1992-93 and 1993-94 have not been posted in any register. This is indicative of the fact that a proper system of maintenance of records which is a prerequisite for monitoring receipt and disposal of dossiers, does not exist in the Directorate.

In reply the Directorate stated that a large number of dossiers are received from far off places and some time the papers are not received completely particularly because of mishandling in the post. While they have had a proper system of maintenance of records since inception, it got derailed a couple of years back on account of shortage of staff. Now the system was back on track

and individual files in respect of the dossiers were being maintained.

(iii) Quality of review

An analysis of the quality of review conducted by the Directorate is given below:

(a) In one case the dossier report for March 1991 showed outstanding demands of Rs.14.19 lakhs including arrear demand of Rs.12.27 lakhs pertaining to assessment years 1965-66 to 1985-86 which were raised in the financial year 1979-80 to 1989-90. The concerned assessing officer had been repeating the comment that no reply had been received to the notice under section 220 and further steps were being taken for recovery, in the dossiers submitted for the quarter ended September 1990, December 1990 and March 1991. The Directorate had not made any suggestions for accelerating the process of tax recovery in any of the quarter mentioned above.

In reply, the Ministry have stated that it is difficult for the Directorate to individually monitor all the cases above Rs.10 lakhs especially when the emphasis since September 1989 has been on high demand cases above Rs.1 crore. The view is untenable as Rs.14.19 lakhs cannot be considered as low demand and a mechanism has to be evolved for monitoring these cases and revcovering the taxes due. Otherwise, the dossiers submittted for different quarters become meaningless.

(b) In the dossier report for September 1993 of a company, arrear demand of Rs.2,290.13 lakhs pertaining to 1986-87 to 1988-89 and 1990-91 was shown outstanding whereas a sum of Rs.2,449.90 lakhs were outstanding in September 1993 indicating an unreconciled amount of Rs.159.77 lakhs. Of this demand, Rs.2286.64 lakhs pertaining to assessment year 1986-87 to 1988-89 was stayed by the ITAT and the balance demand of Rs.163.26 lakhs pertaining to assessment year 1990-91 was pending in first appeal.

The suggestion of the Directorate on the dossiers reports for recovery action were also not available.

In reply, the Ministry have stated that the case is under constant monitoring. However, the fact remains that the difference is still unreconciled.

(c) In the case of an individual assessee, it was seen that he had filed an application for the entire demand of Rs.218.44 lakhs with the Settlement Commission in June 1984 pertaining to assessment

years 1981-82, 1982-83 and 1983-84. The Settlement Commission had granted stay till orders of the Commission under section 245-D(4) or any other order of recovery whichever is earlier. The department had not been able to pursue the case for early disposal although more than 8 years had elapsed since the stay was granted by the Commission, nor had any other orders for recovery passed in the case. The Directorate had not offered any suggestions.

In reply, the Ministry have stated that the work has since been streamlined and the Directorate is constantly monitoring this case. The fact, however, remains that the case is yet to be settled.

(d) In the dossier report of an assessee company for September 1994 it was seen that though the arrear demand of Rs.39.29 lakhs pertaining to assessment year 1987-88 to 1989-90 was undisputed, the department had not been able to recover this nor any specialised recovery action was initiated by the Directorate while reviewing the dossier.

In reply, the Ministry have stated that the case is not being reviewed by the Directorate as the demand was less than Rs.1 crore. The Ministry's reply is not tenable as the gross demand outstanding as per the dossier report for June 1994 submitted to the Commissioner, was Rs.1.71 crores and hence this case required monitoring by the Directorate. Further, even the undisputed demand of Rs.39.29 lakhs which is a substantial amount, has also not been recovered. As mentioned above at (a), a mechanism has to be evolved for monitoring of such cases.

(e) Write off proposals

For writting off the tax arrears of Rs. 15 lakhs and above, a proposal for write off alongwith the recommendations of the Zonal Committee (ZC) has to be submitted to the Board through the Director of Income Tax (Recovery) for administrative approval. The Board has laid down the elaborate procedure to be adopted and documents to be enclosed for processing of write off cases.

The Directorate received 31 write off proposals involving demand of Rs. 7,107.42 lakhs during 1990-91 to 1993-94. Three cases involving demand of Rs. 209.05 lakhs were disposed of during 1992-93 and 1993-94. No disposal was made during 1990-91 and 1991-92. Analysis revealed that the cases were not examined thoroughly by the Directorate. Two cases are mentioned below:

(i) The partial write off proposal of an individual assessee for Rs. 1,053.70 lakhs and Rs. 47.01 lakhs was received in the Directorate on 1 January 1991. It was sent to the Board for write off on 1

November 1991. The case was received back from the Board on 1 January 1992 with the comments of the Director General of Administration and also clarification on whether interest under section 220(2) had been charged upto the end of August 1991, the month preceding the month in which the ZC held its meeting. The case was resubmitted by the Directorate to the Board on 21 March 1994 i.e. after over 2 years. It was again returned by the Board on 29 July 1994 pointing out a number of lacunae in its processing.

(ii) Write off proposal of an assessee company for Rs. 181.40 lakhs was sent to the Board by the Directorate in December 1992 for their administrative approval. The Board returned the case to the Directorate pointing out a number of lacunae in its processing. The Directorate attributed these to absence of consolidated instructions at one place.

(f) Inspections

During the period 1991-92 to 1994-95 the Directorate could conduct 24 inspections against 40 which were planned. As the inspection mechanism is desgined to evaluate the effectiveness of the action taken by the Chief Commissioners/Commissioners of Income Tax in getting the dues collected, the large shortfall has effectively negated this objective. The shortfall has been accepted by the Ministry and attributed to shortage of manpower.

Conclusion

3.2.17 In April 1989 the laws and procedures for effecting recovery of tax were changed with a view to achieve better collection of the taxes due. The Board also issued administrative instructions for toning up the functioning of the tax recovery machinery. However, these changes, for the reasons brought out in the foregoing paragraphs, have not had any perceptible impact on containing the growth of tax arrears. This is evident from the fact that the arrears certified for recovery by TROs alone have increased by over 307 percent from the level of Rs.1,034.75 crores in 1990-91 to Rs.3,179.59 crores in 1993-94. It would be interesting to note that the revenue from Direct Taxes recorded only 84 percent growth during this period. The department needs to evolve effective procedures for ensuring timely recovery of taxes due by avoiding the deficiencies mentioned in the above paragraphs. Such measures should include introducing accountability for targets not met, lack of coordination between TROs and the assessing officers who are now working under the jurisdiction of the same Commissioner, delays in taking recovery action, non-pursuance or non-monitoring of pending cases especially those with high tax demands etc.

The Ministry have accepted that the tax recovery machinery being a very important sector of the department needs to be treated with

utmost priority and noted the deficiencies in the functioning of the tax recovery machinery as pointed out in the above appraisal. They have added that the arrear certified for recovery by TROs includes demand locked up in appeal which is not strictly recoverable and the Board is actively considering measures to address the bottlenecks.

3.3 Interest, penalties and prosecutions

Introductory

3.3.1 The Income Tax Act, 1961, contemplates, inter alia, levy of mandatory interest for late filing of return of income, for defaults in payment, as well as deferment of advance tax. Under Wealth Tax Act, 1957 and Gift Tax Act, 1958, interest is levied for defaults in furnishing return of wealth/gift respectively. Apart from levy of interest, penalties are also levied for non-disclosure of material facts leading to concealment of income, wealth and gifts made and also for non compliance with the procedures prescribed under the three Acts. The Acts also provide for launching of prosecutions in cases of wilful concealment of income, wealth and gift leading to evasion of tax.

Law and Procedure

3.3.2 In order to enforce compliance with statutory provisions, the Income Tax Act provides for certain coercive measures.These are interest payable by the assessee under section 234 A, 234B and 234C, additional tax under section 143(1A), penalties leviable under section 140 A (3) and 221 and Chapter XXI and prosecution under Chapter XXII. Under section 244 A of the Income Tax Act, interest is payable to an assessee where refund is due to excess payment of tax. Under the new provisions, there is no need for making a claim for refund and it is granted automatically if found due. Under section 17 B of the Wealth Tax Act, an assessee is liable to pay interest for failure to submit return. Sections 15 B(3), 18(1)(ii), 18 (1)(iii), 18 A(1)(a),(b) and (c), 18 A(2) and 32 contain provisions dealing with levy of penalty under the Wealth Tax Act. Provisions relating to prosecutions are contained in chapter VIII of the Wealth Tax Act.

The coercive provisions on this issue relating to Gift Tax Act are interest (section 16B), penalties imposable (sections 14B(B), 17 (1) (ii), 17 (1) (iii), 17 A (a),(b) and (c), 17A(2), 33) and prosecutions (sections 35(1), 35(2) and 35((2A).

Scope of the review

3.3.3 This review seeks to evaluate the degree of compliance with the law and procedural requirements relating to interest, penalties and prosecutions by the department. It also aims to see whether the department has safeguarded the interests of assessees by granting

interest on refunds. The review was carried out through test check of records of 463 assessing officers for the assessment years 1991-92 to 1993-94. Cases relating to earlier assessment years have also been included wherever considered necessary.

Constraints

3.3.4 The records relating to prosecution cases were not made available to audit in case of Rajasthan (CIT Jaipur) and Tamil Nadu (CIT Coimbatore) charges. In case of Gujarat charge, case records of more than 50 percent of the prosecution cases selected for audit scrutiny were not given to audit. Certain purely statistical information requisitioned by the audit parties in Punjab charge was not given.

Highlights

3.3.5 (i) During the course of the review of enforcement of statutory coercive provisions available in the various Acts relating to Direct Taxes for the levy of interest, penalty and launching of prosecutions, the department did not produce records and certain information relating to Rajasthan, Punjab, Tamil Nadu and Gujarat charges.

(Para 3.3.4)

(ii) Under the Income Tax Act, interest is payable where any refund arises due to excess payment of tax. Out of the cases selected for audit scrutiny, in 119 cases there were overpayments or avoidable payment of interest to assessees to the extent of Rs.814.04 lakhs due to non-compliance with statutory provisions or executive instructions of the Board.

(Paras 3.3.6(A) to (F),(I),(J))

(iii) Audit scrutiny revealed 38 cases of non payment of interest of Rs.104.12 lakhs to assessees. Further, in Himachal Pradesh charge, 659 cases of non payment of interest to assessees were noticed.

(Paras 3.3.6 (G),(H))

(iv) During audit 894 instances of non-levy/short levy of interest of Rs.2545.60 lakhs were noticed. This diluted the deterrent impact of these provisions.

(Paras 3.3.7 (A), (B)(a)(b)(c)(e),(C))

(v) Despite a recommendation made by the Public Accounts Committee, no provision has been enacted in the Income Tax Act for charging interest on refunds made at the summary assessment stage which are subsequently found to be in excess or not admissible due to additions made after scrutiny assessment. This resulted in Rs.175.55 lakhs not being levied in 4 cases alone.

(Para 3.3.7(B)(d))

(vi) The disposal of penalty proceedings during the years 1991-92 to 1993-94 ranged from 36.8 to 26.5 percent which was rather low. The trend of disposals was also declining.

(Para 3.3.11)

(vii) Though most penalty provisions are discretionary in nature, executive instructions require the assessing officer to record reasons for non initiation of penalty proceedings. Audit scrutiny, however, revealed that in 949 cases, penalty amounting to Rs.748.21 lakhs was not levied without recording reasons therefor.

(Paras 3.3.11 (a) to (l))

(viii) During the period 1991-92 to 1993-94, 52.9 percent of the prosecution cases decided resulted in acquittals indicating inadequate preparation of cases by the department.

(Para 3.3.12)

(ix) There were delays ranging from 1 year to 8 years in launching of prosecution proceedings in a court of law from date of initiation of complaint by assessing officer.

(Para 3.3.12 (A))

(x) The departmental registers and records were either defectively maintained or not maintained at all. The very objective of monitoring by instituting these controls was thus not achieved.

(Para 3.3.13)

Interest payable by the Government to assessee

3.3.6 Interest is payable where any refund arises due to excess payment of tax. Where refund is of any advance tax (including tax deducted at source), interest is payable at the rate of one percent per month from 1 October 1991(one and half percent upto 30 September 1991), for every month or part of a month from the 1st day of April of the assessment year to the date on which the refund is granted. No interest shall be payable if the amount of refund is less than 10 percent of tax determined under summary assessment or on regular assessment.

(A) Irregular payment of interest

In 27 cases in Tamil Nadu, Assam, Kerala, Karnataka, Madhya Pradesh and West Bengal charges, interest aggregating Rs.62.69 lakhs was paid to the assessees though refunds made were less than 10 per cent of tax determined. Two illustrative cases are mentioned below:-

(i) In West Bengal charge, the assessment of a widely held

company for the assessment year 1992-93 was completed in a summary manner in March 1994, granting a refund of Rs.28.16 lakhs after adjustment of tax deducted at source and advance tax paid. A sum of Rs.6.76 lakhs was also paid to the assessee as interest. Audit scrutiny revealed that since the amount of refund was less than ten percent of the assessed tax of Rs.941.97 lakhs, payment of interest was irregular.

(ii) In Karnataka charge, the assessment of a company for the assessment year 1989-90 initially processed in a summary manner in April 1990, was completed after scrutiny in February 1991. Audit scrutiny revealed that after considering relief allowed in appellate proceedings, the amount refundable to assessee was Rs.11.32 lakhs which was less than 10 per cent of assessed tax. Interest of Rs.2.21 lakhs was allowed on this amount although it was not admissible.

(B) Avoidable interest paid due to delay in delivery of refund order

In 12 cases in Punjab, Kerala and Gujarat charges, interest of Rs.1.67 lakhs was paid on account of delays in delivery of refund orders. One such case is given below:-

In the case of a company in Punjab charge refund order of Rs.15.24 lakhs relating to assessment year 1990-91 was prepared in October 1991 (including interest amounting to Rs.2.80 lakhs upto September 1991). The refund order was not delivered to the assessee for three months and the department had to pay additional interest amounting to Rs.0.37 lakh for 3 months (October 1991 to December 1991). It was further revealed that while giving effect to appeal orders in January 1993, relief of Rs.5.34 lakhs was allowed by the assessing officer instead of Rs.1.54 lakhs allowed by appellate authority.This resulted in excess relief of Rs.3.80 lakhs with tax effect of Rs.2.25 lakhs. The department also paid interest amounting to Rs.1.06 lakhs.

(C) Application of incorrect rate of interest

In eight cases in Madhya Pradesh, Orissa and Delhi charges, interest aggregating Rs.20.56 lakhs was paid due to application of incorrect rate of interest. Two such cases are given below:-

(i) In Orissa charge, in the assessment of a company for the assessment year 1986-87, the addition of Rs.24.70 lakhs was deleted by the Appellate Tribunal in December 1993. While giving effect to the orders of the Tribunal, the assessing officer reassessed the income resulting in a refund. Audit scrutiny revealed that the assessing officer had irregularly allowed interest of Rs. 13.40 lakhs on the refund by applying the provisions of section 244 A of

Income Tax Act, which were not applicable in this case as these became applicable from the assessment years commencing from 1 April 1989. The assessee was only entitled to interest of Rs.25,170 for the period from 1 April to 3 August 1994 under section 244(1) of the Act. This mistake resulted in excess payment of interest of Rs.13.16 lakhs to the assessee.

(ii) In Delhi charge, in the case of a foreign company for the assessment year 1989-90, the assessing officer allowed interest of Rs.38 lakhs for the period from 19 June 1991 to 31 January 1994 on a refund of Rs.98.07 lakhs. However, the interest payable correctly worked out to Rs.31.37 lakhs. The mistake arose due to application of flat rate of interest at 15 percent per annum instead of 1.5 percent per month from 19 June to 30 September 1991 and one percent per month from 1 October 1991 to 31 January 1994. The mistakes resulted in excess payment of interest of Rs.6.13 lakhs.

(D) Non-modification of interest payable due to revision or rectification of assessment.

Under clause (3) of section 244 A, where the amount on which interest was payable under section 244 A (1) is increased or reduced as the case may be, due to an order under section 143(3), 144, 147, 154, 155, 250, 260, 262, 263, 264 or an order of the Settlement Commission under section 245 D(4), then the interest shall be increased or reduced accordingly and a notice of demand shall be served on the assessee in case of reduction in amount of interest paid to the assessee.

In 18 cases in Tamil Nadu, Delhi, Madhya Pradesh, Kerala and Maharashtra charges, interest of Rs.25.61 lakhs was paid in excess due to non-consideration of subsequent revision of the assessment. Three such cases are given below:-

(i) In Delhi charge, the assessment of a company for the assessment year 1992-93 initially completed in a summary manner in June 1993 was completed after scrutiny in March 1995. It was revealed that though the assessed tax in the scrutiny assessment exceeded the prepaid taxes (advance tax and tax deducted at source), the interest which had earlier been allowed to the assessee at the summary stage was not withdrawn resulting in overpayment of interest of Rs.7.92 lakhs.

(ii) In Kerala charge, the assessment of a closely held banking company for the assessment year 1990-91 was originally completed after scrutiny in March, 1993 and was subsequently revised in December 1993. Audit scrutiny revealed that while granting a refund to the assessee in August 1993, the assessing officer erroneously allowed interest of Rs.6.19 lakhs although it had

already been allowed earlier in August 1991 resulting in overpayment of interest of Rs.6.19 lakhs.

The Ministry have accepted the audit observation.

(iii) In Maharashtra charge, in the case of an assessee an order was passed rectifying the assessment for assessment year 1987-88 withdrawing certain deductions allowed, as excessive. However, the department failed to reduce the interest initially paid to the assessee, consequent on enhancement of the income and the tax payable. This resulted in payment of excess interest of Rs.2.01 lakhs to the assessee.

(E) Interest paid though delay in refund could be attributed to assessee

Under Section 244A(2), if the proceedings resulting in the refund get delayed for reasons attributable to the assessee, no interest is payable for such period.

In 17 cases in Tamil Nadu, Kerala, Madhya Pradesh, Gujarat and Punjab charges, interest of Rs.48.84 lakhs was paid to the assessee though delay in refund was attributable to assessee.Two such cases are given below:-

(i) In Tamil Nadu charge, a corporate assessee returned income of Rs.641.38 lakhs for assessment year 1989-90 on 14 December 1989. Subsequently it filed a revised return on 24 September 1990 declaring the total income as Rs.477.23 lakhs. The need for filing a revised return arose due to the fact that the assessee claimed investment deposit allowance under section 32 AB as against investment allowance under section 32 A in the original return. Based on the revised return, the assessee was granted a refund of Rs.241.61 lakhs as well as interest of Rs.60.38 lakhs under section 244A. As the delay of 9 months in filing the revised return could be attributable to the assessee, of Rs.30.81 lakhs out of the total interest granted to him was irregular.

(ii) In Gujarat charge, in the assessment of a widely held company for the assessment year 1990-91 completed after scrutiny in March 1993, interest amounting to Rs.18.23 lakhs was granted to the assessee. Audit scrutiny revealed that the assessee company had delayed filing its return by nine months. This period of delay attributable to the assessee was required to be excluded while allowing interest on the refund due. Omission to do so resulted in excess payment of interest of Rs. 5.47 lakhs.

The Ministry have accepted the audit observation.

(F) Irregular interest paid on self assessment tax

Where any tax is payable on the basis of a return filed under section 139 or 148 (after deducting advance tax or tax deducted or collected at source, if any), the assessee is required to pay such tax (self assessment) before the return is filed. However, in respect of payments made by way of such self assessment, no interest is allowable. Two cases are mentioned below:

(i) In a case in Andhra Pradesh charge, for assessment year 1991-92, self assessment tax of Rs.28 lakhs paid was treated as advance tax. This resulted in an excess payment of Rs.3.92 lakhs as interest to the assessee on the refund due.

(ii) In one case in Tamil Nadu charge, interest payment of Rs.1.55 lakhs was made for payment of tax under section 140 A (self assessment).

(G) Loss to assessee due to non-payment of interest promptly

In 35 cases in Tamil Nadu, Assam, Gujarat and Kerala charges, though interest payable had been determined, its payment was delayed. This resulted in non payment of interest of Rs.31.56 lakhs for the delayed period.Three such cases are given below:-

(i) In a case, in Tamil Nadu charge, the refund payable was determined as Rs.431.80 lakhs on 31 March 1993 but the refund order was despatched on 27 April 1993 only. Interest of Rs.8.63 lakhs payable to the assessee for the delay was not paid.

(ii) In Tamil Nadu charge, a refund of Rs.82.61 lakhs was determined on 28 September 1993 and interest amounting to Rs.14.04 lakhs payable under section 244A was calculated upto that date. However, the refund order was despatched on 22 November 1993. Interest of Rs.2.48 lakhs was payable to the assessee for the delay which was, however, not paid.

(iii) In Kerala charge, the assessment of a banking company for assessment year 1992-93 was completed in a summary manner in January 1993. Audit scrutiny revealed that the refund voucher alongwith interest payable to assessee was issued only on 6 April 1993. Consequently the assessee lost interest amounting to Rs.1.82 lakhs for three months.

(H) Non-payment/short payment of interest

Audit scrutiny during the review revealed instances of short payment/non payment of interest . Four cases are cited below:

(i) In Maharashtra charge, a provident fund trust was refunded Rs.77.84 lakhs, Rs.40.24 lakhs and Rs.0.31 lakh pertaining to assessment years 1985-86 to 1989-90, in January 1989, October 1989 and February 1990 respectively being tax deducted at source on interest on securities. Audit scrutiny revealed that in addition to the refunds, the assessee was entitled to interest also for delay in making the refunds. The interest claim of the assessee has not so far been discharged (March 1995). The amount of interest payable to the assessee worked out to Rs.51.51 lakhs.

(ii) In Karnataka charge, the assessment of a widely held company for the assessment year 1987-88 was completed after scrutiny in March 1990 resulting in a demand of Rs.1.81 crores which was paid by the assessee in May 1990. However, consequent to the appellate order of July 1990 which was given effect to in March 1991, the entire amount of Rs.1.81 crores paid by the assessee was refunded in May 1991 together with interest of Rs.13.56 lakhs. Audit scrutiny revealed that interest payable by the department on Rs.1.81 crores actually worked out to Rs.24.86 lakhs as against Rs.13.56 lakhs determined by the assessing officer. This resulted in short payment of interest of Rs.11.30 lakhs.

The Ministry have accepted the audit observation.

(iii) In Tamil Nadu charge, in one case interest was granted at 1 percent per month for the period from 1 April 1989 to 30 September 1991 on the instructions of the Chief Commissioner of Income Tax as against the correct rate of 1.5 percent per month. The instructions, which were subsequently withdrawn were based on a decision of the Madras High Court (110 ITR 32). The reliance on this judgement was misplaced as it related to some other issue and not to the interest payable under section 244 A of the Act which was ambiguous. The mistake resulted in short payment of interest of Rs.9.75 lakhs to the assessee.

(iv) In Himachal Pradesh charge, audit scrutiny of Demand and Collection Registers (D&CRs) for the assessment years 1991-92 to 1993-94 revealed that in 659 cases, no interest was paid to assessees even though amount refunded to them due to excess payment of tax exceeded ten percent of the assessed tax.

(I) Avoidable payment of interest due to non-compliance with executive instructions

(a) Under the provisions of the Income Tax Act, 1961, where as a result of any order passed in appeal, revision or any other proceedings under the Act, the refund of any amount becomes due to the assessee, he shall be entitled to interest on the amount of the refund at the rate of one per cent for every month from the 1st day

of April of the assessment year to the date on which refund is granted if the refund is out of any tax paid by way of advance tax. In any other case such interest shall be calculated from the date of payment of the tax to the date on which the refund is granted. The Board have issued executive instructions in January 1977 directing that such refunds should be granted within a month of receipt of appellate orders.

In 24 cases in Delhi, Rajasthan, Gujarat, Kerala, Assam, Madhya Pradesh, West Bengal and Haryana charges, Rs.634.03 lakhs was paid as interest due to delay in taking revisionary action and non-issue of refund order within one month of appellate orders.Two such cases are given below:-

(i) In Rajasthan charge, based on a direction dated 31 March 1987 of an appellate authority to allow relief after verification of certain facts, the assessing officer issued a notice to the assessee on 14 April 1987 to produce/file evidence/details in respect of the issue on or before 27 April 1987 for verification. Audit scrutiny revealed that though the assessee had furnished requisite information vide his letter dated 27 April 1987, the refund was issued on 27 March 1989 in full alongwith interest amounting to Rs.129.29 lakhs. This amount of interest included Rs.85.98 lakhs which had to be paid for the period from April 1987 to February 1989 (23 months) which could have been avoided had the refund been made within one month of appellate orders dated 31 March 1987.

(ii) In Rajasthan charge, in the case of an assessee company the original assessment for the assessment year 1975-76 passed in August 1978 on a total income of Rs.1008.36 lakhs underwent several revisions and ultimately as a result of CIT(A)'s order dated August 1989 assessment was finalised under section 250 in December 1990 at a loss of Rs.58.29 lakhs, Since the assessee had paid tax of Rs.100.38 lakhs, he became entitled for refund which was made in May 1992 alongwith interest of Rs. 27.39 lakhs. Audit scrutiny revealed that the assessing officer took one year and three months to revise the assessment order in the light of appellate order and thereafter took another year and five months for issuing the refund order. Had he acted promptly, payment of interest of Rs.27.39 lakhs could have been avoided.

(b) The Board issued instructions in September 1991 that where the amount of refund is Rs.10 lakhs or more in the metropolitan charges of Bombay, Calcutta, Madras, Delhi and Ahmedabad, the Deputy Commissioner will, after certifiying that he is satisfied that the refund can be issued, forward his report along with the case records to the Commissioner for his approval.The latter will examine the records and after satisfying himself that the refund can be issued, return the file with his approval expeditiously and

immediately thereafter, the assessing officer will issue the refund.

In West Bengal charge, the return of income of an insurance company for the assessment year 1992-93 was processed in January 1993 determining tax of Rs.2613.28 lakhs and after giving credit for advance tax and tax deducted at source, the assessee was entitled to a refund of Rs.1944.34 lakhs and also interest thereon of Rs.194.43 lakhs. Since the amount of refund due to the assessee exceeded Rs.10 lakhs the assessing Deputy Commissioner forwarded (18 January 1993) his report on refund to the Commissioner who accorded his approval on 23 February 1993. The refund was granted to the assessee on 5 March 1993 by the assessing officer. The department had to pay an interest of Rs.38.73 lakhs due to the delay in granting of the refund. Of this Rs.19.37 lakhs could have been saved if the Commissioner had accorded his approval within January 1993 instead of taking over a month in processing of the case. The inability of the department to make the refund within February 1993 after getting Commissioner's approval added another Rs.19.36 lakhs towards interest burden for the entire month of March 1993.

(c) In Gujarat charge, the assessment of a company for the assessment year 1990-91 was initially completed in a summary manner in March 1991, computing a refund of Rs.131.16 lakhs. Audit scrutiny revealed that the assessing officer sought permission to withhold the refund on 2 May 1991 and periodically renewed the request. The Commissioner granted permission from time to time upto 30 April 1992. Though the assessing officer sought permission to issue refund on 1 April 1992 the Commissioner gave such permissions only on 22 June 1993 i.e. after a delay of 14 months. As a result of this procedural delay, the Government had to pay interest of Rs.13.89 lakhs from 1 May 1992 to 31 March 1993.

(d) In Delhi charge, the processing of the return of loss of a foreign company for the assessment year 1991-92 was completed in July 1993, though the return had been filed on 30 December 1991. The assessee was allowed a refund of Rs.1406.87 lakhs (inclusive of interest amounting to Rs.307.75 lakhs). Audit scrutiny revealed that had the processing been done by 31 July 1992 as laid down by the Board in their instructions of June 1992, payment of interest of Rs.131.89 lakhs could have been avoided.

(J) Incorrect computation of interest

The Public Accounts Committee in its 186th Report (5th Lok Sabha), 196th Report (5th Lok Sabha) and in 51st Report (7th Lok Sabha) have repeatedly expressed concern over underassessment of tax on account of mistakes due to carelessness or negligence which

could have been avoided had the assessing officers and their staff been a little more vigilant. The Board in their instructions issued in December 1968, May 1969, October 1970, October 1972, August 1973, January 1974 and Directorate of Inspection (Income Tax) in their circular issued in July 1981 have emphasised the need for ensuring arithmetical accuracy in the computation of income and tax, carry forward of figures etc. These observations/instructions would also hold good for levying interest. Besides the cases of overpayment of interest reported in the Reports of the Comptroller and Auditor General of India on Direct Taxes for the past years, 11 more cases in Kerala and Gujarat charges were noticed where interest of Rs.15.18 lakhs was overpaid to the assessees, due to calculation mistakes

Interest payable by assessee

3.3.7 (A) Interest payable by assessee for default in furnishing returns

Under the Income Tax Act, 1961, as applicable from the assessment year 1989-90, where the return of income for an assessment year is furnished after the specified due date, the assessee shall be liable to pay simple interest at the rate of two percent per month or part thereof from the date immediately following the specified date to the date of filing return or where no return is furnished to the date of completion of regular assessment on the amount of tax determined in the regular assessment as reduced by the advance tax if any paid and tax deducted at source. Similar provisions exist in the Wealth Tax Act and Gift Tax Act.

(a) Belated filing of return

In 102 cases of income tax including corporation tax in Tamil Nadu, Haryana (U.T.), Punjab, Haryana, Bihar, Delhi, Karnataka, Madhya Pradesh, Maharashtra, West Bengal, Uttar Pradesh and Gujarat charges, 93 cases of wealth tax in Haryana, Tamil Nadu, Delhi, Karnataka, Haryana (U.T.), Maharashtra, Kerala and West Bengal charges, and 7 cases of gift tax in Tamil Nadu and Karnataka charges, interest aggregating Rs.149.66 lakhs, Rs.23.59 lakhs and Rs.6.33 lakhs respectively was not levied /short levied for late filing of return. Three such cases of income tax (including corporation tax) and one case each of wealth tax and gift tax are given below:

(i) In West Bengal charge, the return of income of a registered firm for the assessment year 1991-92 initially completed in a summary manner in January 1993 was subsequently assessed after scrutiny in March 1994. The assessee had filed its return of income on 18 January 1993 while the due date was 31 October 1991.It was revealed in audit that the assessing officer had levied interest for belated submission of return for three months only amounting to

Rs.6.70 lakhs while such interest was leviable for 15 months. This omission led to short levy of interest by Rs.26.78 lakhs.

(ii) In West Bengal charge, the assessment of a widely held company for the assessment year 1991-92 was completed in March 1994. Since the assessee company filed its return of income on 31 March 1993 as against the due date of 31 December 1991, it was liable to pay interest of Rs.8.94 lakhs. The assessing officer, however while raising the demand, did not levy interest of Rs.8.94 lakhs for belated submission of return.

(iii) In Delhi charge, the assessment of an individual for the assessment year 1991-92 was completed after scrutiny in March 1994. It was noticed in audit that the return of income was filed by the assessee on 22 January 1993 as against the due date of 31 October 1991 i.e. late by 15 months for which the assessee was liable to pay interest of Rs.5.26 lakhs. The assessing officer, however, did not levy any interest.

(iv) In Karnataka charge, the wealth tax assessments of a closely held company for the assessment years 1989-90 to 1991-92 were completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee company filed its wealth tax returns in February 1993 instead of specified due date of 31 December of relevant assessment year. The period of delay in filing of returns ranged from 14 months to 38 months for which the assessee company was liable to pay interest which was not levied. The omission resulted in non levy of interest aggregating Rs.2.55 lakhs.

The Ministry have accepted the audit observation.

(v) In Karnataka charge, the gift tax assessments of three individuals for the assessment years 1990-91 and 1991-92 were completed after scrutiny in March 1994. Audit scrutiny revealed that the assessees submitted their gift tax returns belatedly on 17 February 1993 instead of the specified due date of 30 June of each relevant assessment year. Since the returns were furnished after the specified due date, interest of Rs.4.16 lakhs on assessed gift was leviable, which was not demanded.

The Ministry have accepted the audit observation.

(b) Interest not charged upto date of filing of revised return

Under section 139(5) of the Income Tax Act, an assessee can file a revised return at any time before expiry of one year from the end of the relevant assessment year or before the completion of assessment which ever is earlier. Further, intimation under section 143(1)(a) is not considered as assessment.

It has been judicially held* that when a revised return of income is filed by the assessee, the return filed earlier gets substituted by the revised return. In view of this, interest should be charged upto the date of filing revised return which alone is to be taken cognizance of.

Out of the cases test checked, interest aggregating Rs.277.34 lakhs in 26 cases in income tax (including corporation tax) and Rs.2.51 lakhs in 4 cases in wealth tax was not charged upto the date of filing revised returns in Kerala, Karnataka and Tamil Nadu charges. Two such cases are given below:

(i) An assessee company in Tamil Nadu charge filed the original return of income for assessment year 1991-92 on 30 December 1991 which was revised twice on 28 August 1992 and 29 October 1992. The assessment was completed after taking into account the return filed on 29 October 1992 as the earlier returns were deemed to have been withdrawn. The interest under Section 234 A for belated filing of revised return was not, however, charged resulting in non levy of interest of Rs.27.70 lakhs.

(ii) An assessee in Tamil Nadu charge filed original return on 31 December 1991 returning income of Rs.11.59 lakhs which was processed in a summary manner and a refund of Rs.96.74 lakhs was allowed to the assessee along with interest. Subsequently the assessee filed a revised return on 31 December 1992 declaring total income as Rs.276.79 lakhs. Audit scrutiny revealed that the assessment was completed after scrutiny without levying any interest under section 234A. This was done on the ground that the revised return though filed under section 139(5) and was treated as original return filed under section 139(1) for the purposes of levy of interest. This mistake resulted in non levy of interest of Rs.24.46 lakhs.

(B) Interest for default in payment of advance tax

Where an assessee who is liable to pay advance tax in a financial year fails to pay such tax or where the advance tax paid by him is less than 90 per cent of the assessed tax, the assessee is liable to pay simple interest at 2 per cent every month or part thereof reckoned from 1st April of the relevant assessment year to the date of regular assessment otherwise upto the date of determination of income under section 143(1)(a) of the Income Tax Act. Further, where as a result of an order of re-assessment or recomputation, the amount on which interest was payable is increased, the assessee is

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* CIT vs.Mangalore Chemicals and Fertilizers Ltd. 191-ITR-156 (Karnataka HC)
CIT vs.Dr.N. Srivastava 170-ITR-556 (M.P..HC)
Beci Engineering Co. Ltd. vs. CIT, Rohtak, 148-ITR-478 (Punjab and Haryana HC)

liable to pay interest at 2 percent per month or part of month comprised in the period commencing on the day following the date of determination of total income under section 143(1) or regular assessment and ending on the date of reassessment or recomputation on the amount by which tax on total income determined on the basis of reassessment or recomputation exceeds the tax on total income determined under section 143 (1) (a) or on regular assessment.

(a) Non-levy/short-levy of interest on short payment of advance tax

Audit scrutiny revealed that in 416 cases, in Maharashtra, Tamil Nadu, Orissa, Assam, Jammu and Kashmir, West Bengal, Karnataka, Gujarat, Delhi, Punjab, Madhya Pradesh and Haryana charges, interest aggregating Rs.478.05 lakhs was not levied for non/short payment of advance tax. Three such cases are given below:

(i) In West Bengal charge, the assessment of a closely held company for the assessment year 1991-92 was completed in March 1994 after scrutiny. Audit scrutiny revealed that while computing tax payable on the total income, surcharge of Rs.2.16 lakhs was levied instead of the leviable amount of Rs.21.56 lakhs. Since the assessee company had filed its return after the due date, the assessee was also liable to pay interest of Rs.7.47 lakhs for a period of three months as against interest of Rs.4.20 lakhs levied for two months. It was further revealed that the assessee company had paid no advance tax for the relevant assessment year. Consequently it was liable to pay interest of Rs.77.49 lakhs computed at the rate of 2 per cent per month for 36 months from April 1991 to March 1994 instead of Rs.6.36 lakhs levied by the department. These mistakes led to a short demand of tax by Rs.93.80 lakhs in aggregate.

(ii) In Maharashtra charge, the assessment of a company for the assessment year 1991-92 was completed in January 1994. Audit scrutiny revealed that though the advance tax paid by the assessee fell short of 90 percent of the asseessed tax, no interest was levied. The omission resulted in non levy of interest of Rs.19.78 lakhs.

(iii) In Madhya Pradesh charge, in the case of a State public sector corporation, the regular assessment for the assessment year 1989-90 was originally completed on 19 December 1990, determining the income as 'nil'. Subsequently the assessing officer reassessed the total income at Rs.43.76 lakhs and tax payable was computed at Rs.22.97 lakhs on 14 December 1993. The assessee had deposited self assessment tax of Rs. 58.96 lakhs on 30th October 1993. Since the assessee company had not paid any advance tax, it was liable to pay interest of Rs.16.99 lakhs for 37 months from 19 December

1990 to 14 December 1993 (the date of reassessment). The assessing officer, however, levied interest of Rs.9.65 lakhs only for 21 months from 1st April 1989 to 19th December 1990, resulting in short levy of interest of Rs.7.34 lakhs.

(b) Omission to levy interest upto date of regular assessment

In 73 cases in Tamil Nadu, Punjab, Bihar, Orissa, Haryana, Uttar Pradesh, Kerala, Maharashtra, Madhya Pradesh and West Bengal charges, interest was levied upto the date of processing the assessment under section 143(1)(a) instead of upto the date of regular assessment resulting in short levy of interest aggregating Rs. 1203.22 lakhs. Three cases are illustrated below:

(i) In West Bengal charge, the assessment of a widely held company for the assessment year 1990-91 initially completed in a summary manner in March 1991 was subsequently completed after scrutiny in March 1993 and revised in July 1993 levying tax of Rs.556.45 lakhs. Since the advance tax paid fell short of 90 per cent of the assessed tax, the assessee was liable to pay interest of Rs.53.03 lakhs calculated at the rate of 2 per cent per month or part of a month from 1 April 1990 to the date of regular assessment on 30 March 1993, in place of Rs.17.68 lakhs levied by the department for a period of 12 months from 1 April 1990 to 19 March 1991.The mistake led to short levy of interest by Rs.35.35 lakhs.

(ii) In Uttar Pradesh charge, regular assessment for the assessment year 1990-91 was completed in January 1993 and tax of Rs.114.13 lakhs was levied. Since the advance tax paid by the assessee was less than ninety per cent of the assessed tax, the assessee was liable to pay interest for short payment of advance tax till the date of regular assessment. But the department levied interest upto the date of processing only. The mistake resulted in short levy of interest by Rs.17.97 lakhs.

(iii) In respect of one company in Tamil Nadu charge, interest was levied upto 19 November 1993 (i.e. the date of 143(1)(a) intimation) although it was leviable upto 31 March 1994 i.e. the date of regular assessment. This resulted in short levy of interest of Rs.9.35 lakhs.

(c) Omission to adjust self assessment tax against interest due

As per the provisions of section 140(A) (1) of the Income Tax Act, the amount of self assessment tax paid by the assessee is to be first adjusted towards interest payable under the Act and the balance only is to be treated as self assessment tax.

In 84 cases in Tamil Nadu, Gujarat, Punjab, Delhi, Bihar,

Karnataka, Maharashtra and Madhya Pradesh charges, omission to adjust self assessment tax first against interest due resulted in non levy of tax of Rs.164.06 lakhs. Three such cases are given below:-

(i) In Karnataka charge, the assessment of an assessee for the assessment year 1990-91 initially completed in a summary manner, was completed after scrutiny in March 1993. There were many rectifications between March 1993 and November 1994 and in the assessment concluded in November 1994, the income arrived at was Rs.344.59 lakhs. Interest of Rs.71.80 lakhs was levied, as the taxes paid fell short of ninety per cent of the assessed tax. However, the correct amount of interest leviable was Rs.105.71 lakhs for the period from April 1990 to March 1993. The mistake arose on account of adjustment of self assessment tax paid by the assessee in April 1990, August 1990 and March 1992 against the tax due and calculation of interest on the balance of tax and resulted in short payment of tax of Rs.33.91 lakhs.

(ii) In the case of a cooperative society in Tamil Nadu charge, for assessment year 1990-91 interest had been computed at Rs.8.44 lakhs. The self assessment tax amounting to Rs.23.61 lakhs paid on 29 October 1990 and the balance tax of Rs.26.49 lakhs paid on 7 February 1991 was not adjusted first towards interest payable resulting in short levy of interest of Rs.6.68 lakhs.

(iii) In Madhya Pradesh charge, the regular assessment of a company for the assessment year 1989-90 was completed in March 1992. The assessee had paid self assessment tax amounting to Rs.69.65 lakhs in 14 instalments, deposited on different dates between December 1989 and February 1991. The assessing officer adjusted each instalment of self assessment tax first against the amount of tax payable, leaving the interest portion unadjusted. Thus by acting in contravention of the provisions of the Act, the assessing officer had charged from the assessee interest of Rs.43.31 lakhs only as against an interest of Rs.49.87 lakhs payable. This resulted in short computation of interest by Rs.6.56 lakls.

(d) Lacuna in the Act

Refunds are often made after processing a return under summary assessment. However, there is no provision in the Income Tax Act for charging interest on such refunds or parts thereof which are found to be in excess after assessing the case under scrutiny. The PAC had considered this issue in their 100th Report (7th Lok Sabha) and recommended that Government should examine it and bring forth suitable amendment in the Act. No action has been taken as yet despite the Ministry's reply in their Action Taken Note in March 1983 that the recommendations of the Committe had been noted and would be processed while formulating proposal for the

comprehensive amendment expected to be introduced in 1983. No such amendment has yet been introduced.

Four cases out of several noticed during audit scrutiny which illustrate this aspect are mentioned below:

(i) In Bihar charge, the assessments of a company for assessment years 1989-90 and 1990-91 were initially completed in a summary manner, allowing refunds of Rs. 192.21 lakhs and Rs. 102.38 lakhs in March 1991 and January 1991 respectively. The regular assessments which were completed in March 1994 and March 1995 resulted in substantial additions to the income. Since the tax liability was more than the advance tax paid by the assessee company, the entire refunds of Rs.192.21 lakhs and Rs.102.38 lakhs became excessive. As there is no provision in the Act to charge interest on refunds found to be excessive on regular assessment, the exchequer sustained loss of Rs.37.05 lakhs and Rs.55.33 lakhs respectively in the shape of interest for short payment of advance tax for the assessment years 1989-90 and 1990-91.

(ii) The returns of income of a company in Madhya Pradesh charge, for the assessment years 1989-90 and 1990-91 were processed on 31 August 1990 and 31 July 1991 respectively and refunds of Rs.306.84 lakhs and Rs.303.51 lakhs alongwith interest thereon were authorised. Subsequently, on completion of scrutiny assessment in respect of these assessment years, the amounts of refund was reduced substantially to Rs.171.74 lakhs and Rs.196.22 lakhs respectively. Even if rate of interest at 1 percent per month is assumed on the analogy of rate of interest payable under section 244 A of the Income Tax Act, the loss of interest to the Government on the amount of excess refund would amount to Rs. 24.60 lakhs and Rs. 17.03 lakhs for the assessment years 1989-90 and 1990-91 respectively.

(iii) In West Bengal charge, the assessment of a widely held company for the assessment year 1990-91 was initially completed in a summary manner in May 1991 (rectified in August 1991), allowing a refund of Rs. 59.62 lakhs being excess payment of advance tax besides interest. In the regular assessment completed on 30 March 1993 the assessed income was enhanced by Rs. 143.79 lakhs and no refund was due since tax liability was more than advance tax paid. Though the refund remained with the assessee for 19 months, credit was allowed to him at the scrutiny assessment stage for entire advance tax (including amount refunded). If credit could be allowed after reducing the amount refunded, the interest chargeable from the assessee would have been higher by Rs. 22.67 lakhs.

(iv) In Delhi charge, the return of income of a banking company

for the assessment year 1991-92 was initially processed in March 1992 and rectified in June 1992, allowing a refund of Rs.47.18 lakhs on 31 July 1992. In the scrutiny assessment completed subsequently in March 1994, interest for short payment of advance tax was computed by considering the entire amount of advance tax (including TDS) paid by the assessee. Since a refund of Rs. 47.18 lakhs out of total advance tax had already been granted to the assessee, the balance of advance tax of Rs.112.72 lakhs only remained with the Government from 31 July 1992. Therefore, interest from 31 July 1992 to 24 March 1994 should have been levied considering the advance tax as Rs.112.72 lakhs and not as Rs.159.90 lakhs. This would have resulted in the levy of interest of Rs.702.99 lakhs instead of Rs.684.12 lakhs. Due to want of enabling provisions, the Government could not demand the difference of Rs.18.87 lakhs.

(e) Mistake in computation of interest

Underassessment of tax on account of mistakes in the determination of tax payable or in the computation of total income, attributable to carelessness or negligence involving substantial revenue have been featured in the Reports of the Comptroller and Auditor General of India on Direct Taxes every year.

The PAC in paragraph 5.21 of their 186th Report (5th Lok Sabha), 196th Report (5th Lok Sabha) and in their 51st Report (7th Lok Sabha) expressed concern over underassessment of tax on account of mistakes due to carelessness or negligence which could have been avoided had the assessing officers and their staff been little more vigilant. The Board in their instructions issued in December 1968, May 1969, October 1970, October 1972, August 1973, January 1974 and Directorate of Inspection (Income Tax) in their circular issued in July 1981 emphasised the need for ensuring arithmetical accuracy in the computation of income and tax, carry forward of figures etc. These observations/instructions would also hold good for levying interest.

In 68 cases in Haryana, Tamil Nadu, Haryana (U.T.), Andhra Pradesh, Rajasthan, Kerala, Delhi and Gujarat charges, interest to the extent of Rs.182.14 lakhs was short levied due to calculation mistake. One such case is given below:-

In Delhi charge, the return of income of a company for the assessment year 1991-92 initially processed in March 1992, was subsequently completed after scrutiny in February, 1994 computing total income at Rs.784.13 lakhs. Audit scrutiny revealed that due to subtraction error, there was short levy of interest of Rs.111.70 lakhs. Further, the advance tax paid by the assessee was less than ninety per cent of the assessed tax. As against the correct amount of

Rs.130.80 lakhs, the department erroneously levied interest of Rs.128.12 lakhs i.e. less by Rs. 2.68 lakhs for short payment of advance tax. The total short levy of interest for short payment of advance tax was thus Rs.114.38 lakhs.

(C) Interest for deferment of advance tax

Under the Income Tax Act, 1961, interest is payable under section 234 C if an assessee has failed to pay advance tax or has underestimated instalments thereof. Such interest is to be computed at the rate of one and one half percent per month of the shortfall where the advance tax paid on or before the 15th day of September is less than twenty (thirty with effect from 1.6.1992) percent of the tax due on returned income. Similarly, interest is chargeable where the advance tax paid on or before the 15th day of December is less than fifty (sixty with effect from 1.6.1992) of the tax due on the returned income.

In 21 cases in Assam, Tamil Nadu, Madhya Pradesh, West Bengal, Kerala, Uttar Pradesh, and Delhi charges, interest of Rs.58.70 lakhs was not levied/ short levied. Two such cases are given below:

(i) In Uttar Pradesh charge, the assessment for the year 1992-93 of a company was completed in February 1994 determining taxable income of Rs.386.69 lakhs against the returned income of Rs.383.97 lakhs. It was seen in audit that the advance tax paid by the assessee on the basis of the returned income fell short by 20 percent on 15th September 1991 and 50 per cent by 15 December 1991. The assessee was, therefore, liable to pay interest of Rs.3.91 lakhs against which interest of Rs.0.62 lakh only was levied. This resulted in short levy of interest of Rs.3.29 lakhs.

(ii) In Delhi charge, the assessment of a public sector corporation engaged in tourism business, for the assessment year 1991-92 was completed in March 1994. Audit scrutiny revealed that the assessee had filed income tax return for the assessment year 1991-92 for Rs.91.79 lakhs which was revised to Rs. 263.90 lakhs during the course of assessment proceedings. The corporation was liable to pay advance tax of Rs.24.28 lakhs as the first instalment and Rs.60.70 lakhs as the second instalement of advance tax on the returned income (revised) of Rs.263.90 lakhs. However, it paid only Rs.6.52 lakhs as first instalment and Rs.11.20 lakhs as second instalment.The department did not levy any interest on the shortfall in the payment of advance tax resulting in undercharge of interest of Rs.3.03 lakhs

Overcharge of interest

3.3.8 A few cases of overcharging of interest from the assessees as revealed during test checks, are mentioned below:

(i) In Tamil Nadu charge, while calculating interest under section 234 B, self assessment tax of Rs.55.53 lakhs paid by the assessee was omitted to be taken into account. This has resulted in excess levy of interest of Rs.22.92 lakhs.

(ii) In Delhi charge, the assessment of a company for the assessment year 1991-92, originally completed in a summary manner in March 1992 was subsequently completed after scrutiny in February 1994. Audit scrutiny revealed that the assessing officer had erroneously charged interest of Rs.5.72 lakhs in scrutiny assessment for default in payment of instalments of advance tax. The mistake arose as he worked out the shortfall in payment of advance tax with reference to the amount of tax due of Rs.3.32 crores determined in scrutiny assessment instead of the amount of tax due of Rs.1.50 crores on returned income.

(iii) In Delhi charge, the return of income of a company showing a loss of Rs.48.98 lakhs for the assessment year 1991-92 was initially processed in March 1992. Audit scrutiny revealed that while computing taxable income at Rs.130.38 lakhs under scrutiny assessment completed in March 1994, the assessing officer levied interest of Rs.2.31 lakhs for shortfall in payment of instalments of advance tax. Since the return was filed for loss, no amount of advance tax was due from the assessee and the interest of Rs.2.31 lakhs was erroneously levied.

Interest for belated payment of demand

3.3.9 Under the Income Tax Act, 1961, as amended from 1 April 1989, any demand for tax should be paid by the assessee within thirty days (thiry five days prior to the assessment year 1989-90) of service of notice of the relevant demand and failure to do so would attract levy of simple interest at one and one half percent for every month or part thereof (fifteen percent per annum upto 31 March 1989) from the date of default till actual payment. The Board issued instructions in November 1974 that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demand. Similar provision exists in Wealth Tax Act and Gift Tax Act also.

In 53 cases of income tax (including corporation tax) in Tamil Nadu, Assam, H.P. Karnataka, Kerala, Maharashtra, M.P, Gujarat, Bihar and West Bengal charges and 6 cases of wealth tax in Tamil Nadu and Kerala charges, demand was paid after the dates specified in demand notice but interest aggregating Rs.447.10 lakhs and 12.02 lakhs respectively was not levied. Four such cases are given below:-

(i) In West Bengal charge, the assessment of a widely held company for the assessment years 1986-87 and 1987-88 originally completed in March 1989 and March 1990 were later revised in

March 1993 and in February 1992 respectively. The revised demand for these assessment years for Rs.51.38 lakhs and Rs.33.10 lakhs though served in March 1989 and March 1990 respectively, was collected by way of adjustment against refund for the assessment year 1992-93 in January 1994. The assessee was liable to pay interest of Rs.66.60 lakhs for delay in payment of tax and the amount of penalty. This was not, however, levied.

(ii) In Gujarat charge, in the case of an assessee company, the demand for Rs.1381 lakhs towards tax for the assessment year 1990-91 was issued on 29 March 1993 and was subsequently reduced to Rs.701.75 lakhs by a rectification order passed on 12 April 1993. Audit scrutiny revealed that the amount of refund granted for assessment year 1991-92 was adjusted against the outstanding demand for the assessment year 1990-91 in July 1993 and net demand outstanding was shown at Rs.398.73 lakhs. However, the interest leviable amounting to Rs.42.10 lakhs on tax demand of Rs.701.75 lakhs was not levied.

(iii) In Kerala charge, in the case of an individual assessee, for the assessment year 1969-70, penalty of Rs.20 lakhs was levied on 20 October 1982 and demand notice was served on the next day. The penalty levied was confirmed in January 1992 after several appeals. Interest leviable on the demand from the original due date of payment of demand (November 1982) amounting to Rs.35.90 lakhs (upto 31 March 1994) was, however, not demanded.

(iv) In Tamil Nadu charge, the wealth tax assessments of an individual for the asesssment years 1971-72 to 1974-75 were completed in March 1984, raising tax demands aggregating Rs.4.48 lakhs and the notices of demands were served on the assesee in the same month. The demands were paid in full by the assessee during the period between October 1987 and October 1992. Audit scrutiny revealed that as demands were belatedly paid by the assessee, he was liable to the levy of interest aggregating Rs.4.89 lakhs. This was, however, not levied.

Interest for non-deduction of tax at source

3.3.10 Under the Income Tax Act, 1961, where a person responsible for deducting tax at source does not deduct such tax or after deducting fails to pay the tax as required by the Act, he is liable to pay interest at the rate of 15 percent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

In four cases in Kerala, West Bengal and Tamil Nadu charges, interest of Rs. 11.03 lakhs was not levied for non-deducting and/or non-depositing tax deducted at source in Government account. Two such cases are given below:

(i) In Tamil Nadu charge, the assessment of a company for the assessment year 1992-93 was completed in May 1993 in a summary manner determining a loss of Rs.351.84 lakhs. Audit scrutiny of the tax audit report revealed that the assessee had not remitted to Government account a sum of Rs.16.95 lakhs being tax deducted at source from interest payments to sub-contractors. Since the information was available from documents accompanying the return, the assessing officer should have levied interest on the amount not remitted. Failure to do so led to non-levy of interest of Rs.5.74 lakhs.

The Ministry have accepted the audit observation.

(ii) In Kerala charge, an assessee company paid an amount of Rs.61.41 lakhs in the previous year relevant to assessment year 1992-93 to a State trading corporation towards commission. But tax deductible at source was not deducted by the company. The assessing officer also had not demanded interest for default in non deduction and non-payment of tax to the extent of Rs.1.53 lakhs (upto date of audit).

Penalties

3.3.11 Penalty is a pecuniary burden imposed on an assessee for non compliance with the provisions of the different Direct Taxes Acts like, delay in filing return of income, disobedience of the summons in the nature of notices under sections 142(1) and 143(2), delay in the matter of payment of taxes, concealment of particulars of income or furnishing inaccurate particulars thereof, failure to pay advance tax or self assessment tax etc.

The following information furnished by Ministry of Finance in respect of penalty proceedings initiated by various assessing officers relating to income tax for the years 1991-92 to 1993-94 indicates that the disposal during those years was very low and even in that there was continuously falling trend:

Year	Opening balance of cases	Additions during the year	Total	Disposal	Closing balance of pending cases	Percentage of disposal
1991-92	1,92,597	70,723	2,63,320	96,878	1,66,442	36.8
1992-93	1,66,442	64,142	2,30,584	64,238	1,66,346	27.9
1993-94	1,66,346	1,49,306	3,15,562	83,491	2,32,161	26.5

Penalty proceedings not initiated for which no reasons were recorded

A number of provisions levying penalty are discretionary provisions. However, the Board have issued instructions that where penalty is not levied,the assessing officer should record reasons for

not doing so. However, different categories of cases were noticed where these instructions were not observed by the concerned authorities. Some cases are discussed below:

(a) Penalty for assessee in default.

The Act provides that where an assessee fails to pay the whole or any part of income tax or interest or both in accordance with the provisions of section 140A(1) of Income Tax Act, the assesee is deemed to be in default in respect of the tax or interest or both remaining unpaid. Further, as per section 221, where the assessee is in default or deemed to be in default, he shall be liable to pay such penalty as the assessing officer may direct. However, the total amount of penalty shall not exceed the amount of tax to arrears. Similar provisions exist in Wealth Tax Act.

In 320 cases of income tax in Tamil Nadu, Himachal Pradesh and Gujarat charges and 18 cases of wealth tax in Tamil Nadu charges, penalty proceedings were not initiated resulting in non-levy of penalty aggregating Rs.340.61 lakhs and Rs.11.09 lakhs respectively. Three such cases are given below:

(i) In Tamil Nadu charge, the assessment of an individual, for the assessment year 1990-91, was completed on 26 March 1993 determining the tax payable as Rs. 19.73 lakhs. The notice of demand was served on 3 April 1993. The petition of the assessee requesting for stay of collection till the disposal of appeal was rejected and he was asked to make payments in monthly instalments from June to October 1993. The assessee, however, did not make any payment for which neither any penalty proceedings under section 221(1) were initiated nor were reasons recorded for not doing so.

(ii) In Tamil Nadu charge, the return of a company for the assessment year 1993-94, was processed under section 143(1)(a) in March 1994 and the tax payable was determined at Rs. 10.55 lakhs. Though the demand had not been paid till date and the assessee was deemed to be in default, no penalty proceedings were initiated. The reasons therefor were also not recorded.

(iii) In Tamil Nadu charge, the wealth tax assessment of an assessee for assessment year 1989-90 was completed after scrutiny on 4 May 1993 determining the tax and interest at Rs.78,378. The assessee who had paid self assessment tax of Rs.5,000, did not pay the wealth tax. Similarly, for assessment year 1990-91, tax payable amounting to Rs.67,818 was not paid though demand notice was issued on 4 May 1993. He was, therefore, liable to penalty proceedings under section 15B(3) read with section 32 of the Wealth Tax Act which were not initiated. The maximum penalty

leviable was Rs.1.41 lakhs.

(b) Penalty for failure to comply with notices

Under section 271(1)(b) of Income Tax Act, if the assessing officer is satisfied that any person has failed to comply with the notice under sections 143 (2) or 142(1) or to comply with directions under section 142 (2A), he may impose penalty which shall not be less than Rs.1000 but may extend to Rs.25,000 for each such failure.

In three cases in Tamil Nadu and West Bengal charges, penalty under section 271(1)(b) was not levied for failure to comply with the directions therein. One such case is given below:

In Tamil Nadu charge, an assessee failed to comply with the penalty notices thrice by the assessing officer for defaults under section 271(1)(b). Though the notice was issued on 18 October 1993, the case is yet to be finalised even though 18 months have lapsed. The maximum penalty leviable would be Rs.75,000 (i.e. Rs.25,000 for each occasion).

(c) Penalty for concealment of income

Under section 271(1)(c) of the Income Tax Act, if the assessing officer is satisfied that a person has concealed the particulars of his income or furnished inaccurate particulars, he may direct that such a person shall pay by way of penalty, a sum which shall not be less than but which shall not exceed three times the amount of tax sought to be evaded by reason of such concealment or furnishing of inacurate particulars. Similar provisions exist in Wealth Tax Act.

In 24 cases in Tamil Nadu, Kerala, West Bengal, Assam and Gujarat charges, penalty proceedings were not initiated though concealment of income or furnishing of inaccurate particulars were established. Similarly in 4 cases in Tamil Nadu charge, such action was not taken in respect of Wealth Tax. Three such cases are given below:

(i) In West Bengal charge, the regular assessment of an assessee individual for assessment year 1987-88 was completed on 30 March 1993. Penalty proceedings for concealment of income of Rs.166.49 lakhs (as finally determined) were also initiated. Though the assessment was partly set aside in appeal on 28 January 1991, the appellate authority, however, dismissed the appeal of the assessee against levy of penalty for concealment of income. In the revised assessment made on 26 August 1993, total income was determined at Rs.166.66 lakhs (including concealed income of Rs.166.49 lakhs). However, no penalty proceedings were intiated till 31 January 1995. Since the order for initiation of penalty proceedings

for concealment of income was upheld in appeal, at least minimum penalty of Rs.83.12 lakhs being 100 per cent of tax sought to be evaded should have been levied within six months from 10 August 1993 or by March 1994 whichever date was later. As this was not done, the case became barred by limitation of time. No reasons were recorded for not levying the penalty.

(ii) In West Bengal charge, the regular assessment of a closely held company for the assessment year 1991-92 was completed on 31 March 1994 determining the total income as Rs.13.21 lakhs and tax of Rs.7.59 lakhs was levied apart from the interest. Though the assessing officer had concluded that the entire income assessed was concealed income of the assessee, shown in the books of accounts as share application money, loan and interest thereon which were unverifiable, no action was taken to complete penalty proceedings initiated on 31 March 1994. There was also no indication that the assessee had preferred any appeal against initiation of penalty proceedings. The penalty proceedings stood barred by limitation of time on 30 September 1994. The omission led to loss of revenue by Rs.7.47 lakhs.

(iii) In Tamil Nadu charge, a company declared the value of immovable property at Rs.45.84 lakhs in its wealth tax return for the assessment year 1989-90. The value of Rs.675.10 lakhs as determined by assessing officer was determined by the Commissioner of Income Tax (Appeals) as Rs.569.12 lakhs during appeal. As the value of the property returned was less than 70 percent of that determined in the assessment order, the assessee was liable to penalty proceedings as per explanation 4 under section18(1)(c) of the Wealth Tax Act. Omission to do so resulted in non levy of minimum penalty of Rs.10.46 lakhs. (The maximum penalty leviable was Rs.52.3 lakhs). No reasons were recorded for non-levy of penalty.

(d) Penalty for failure to keep, maintain or retain books of accounts, documents etc.

Under the Income Tax Act, 1961, where an assessee fails to keep and maintain or retain such books of accounts and other documents etc. as required by section 44AA or rules made thereunder, the assessing officer may direct that such persons shall pay by way of penalty a sum which shall not be less than two thousand rupees but which may extend to one hundred thousand rupees where the assessee's income from business or profession exceeds rupees twenty five thousand (forty thousand w.e.f. 1 April 1993).

In 35 cases in Tamil Nadu, Chandigarh (UT), Kerala, H.P and Bihar charges, penalty proceedings for non maintenance of books of accounts were not initiated. One such case is given below:-

In Patna charge, the penalty proceedings for non maintenance of books of accounts alongwith for concealed income in the case of an assessee having professional income exceeding rupees twenty five thousand for the assessment year 1990-91 were initiated in the month of February 1991. Audit scrutiny revealed that after giving effect to an appellate order in March 1994, penalty proceedings were initiated only for concealed income and not for non maintenance of books of accounts. No reasons were recorded for dropping the penalty proceedings for non-maintenace of books of accounts.

(e) Omission to levy penalty for not filing audit report from authorised accountant

The Income Tax Act, 1961, as amended from the assessment year 1985-86, makes it obligatory for every assessee whose total sales, turnover or gross receipts in business exceed forty lakhs rupees in any assessment year to get his accounts audited by an authorised accountant before the specified due date for submission of return of income and obtain the report of such audit in the prescribed form within the due date. The specified due date for filing the return for business cases where the assessee is a company is 31 December and in any other case 31 October of the assessment year. Failure to get the accounts audited and to obtain the audit report within the due dates renders the assessee liable to penalty equivalent to one half percent of the turnover or one lakh rupees whichever is lower. The Board had issued instructions, from time to time, that where the assessing officer did not initiate penalty proceedings, he should record the reasons for not doing so.

In 200 cases in Tamil Nadu, Haryana (UT), Maharashtra, Orissa, Assam, Haryana, U.P, Kerala, Delhi, Madhya Pradesh, Himachal Pradesh, Bihar, Gujarat and West Bengal, penalty proceedings were not initiated for non observance of the provisions involving an amount of Rs.154.48 lakhs. Two such cases are given below:

(i) In Assam charge, the assessment of a registered firm for the assessment year 1991-92 was completed in February 1994. Audit scrutiny revealed that the audit report from the authorised accountant was dated February 1992 and was obtained in May 1992 alongwith revised return even though the due date for obtaining the audit report for the assessment year 1991-92 was October 1991. For the failure to observe the statutory provisions, the assessee was liable to pay a penalty of Rs. 1 lakh. This was not imposed nor were any reasons recorded by the assessing officer.

(ii) In Haryana charge the turnover of an assessee co-operative society, exceeded Rs.40 lakhs for the assessment year 1992-93. It was, therefore, liable to get its accounts audited. However, the

statutory audit was done on 27 January 1993 against due date of 31 October 1992. Penalty of Rs.1 lakh for failure on this account was not imposed without recording any reason.

(f) Penalty for failure to deduct tax at source

Under section 271 C of the Income Tax Act, 1961, if a person fails to deduct the whole or any part of the tax as required by or under the provisions of the Act he shall be liable to pay, by way of penalty, a sum equal to the amount of tax which he failed to deduct as aforesaid.

In 16 cases in Punjab, Tamil Nadu, Madhya Pradesh, Bihar and Orissa charges, penalty proceedings under Section 271 C involving an amount of Rs.100.42 lakhs were not initiated. One such case is given below:

In Punjab charge, in one case the assessee had failed to deduct surcharge on the amount of tax deducted at source on the interest paid to various financial institutions on account of securities/bonds for the financial year 1990-91 to 1992-93. Non-deduction of surcharge attracted, interest and penalty under the Act. Though the department charged interest for all the three years yet penalty was levied only for the financial year 1990-91 and 1991-92. The penalty leviable for the financial year 1992-93 worked out to Rs.91.93 lakhs (i.e equal to amount of surcharge). No reasons therefor were recorded.

(g) Penalty for failure to comply with provisions of section 269SS

Under the provisions of Income Tax Act, 1961, no person shall after 30 June 1984, take or accept any loan or deposit of Rs.10,000 (Rs.20,000 from 1 April 1989) or more otherwise than by an account payee cheque or an account payee bank draft subject to certain exceptions. For contravention of this provision without reasonable cause, such a person is liable to pay penalty equal to the amount of such loan or deposit. The Board have also issued instructions that in cases where the assessing officer did not initiate penalty proceedings, he should record reasons for not doing so.

In 40 cases in Tamil Nadu, Maharashtra, Madhya Pradesh and Gujarat charges, penalty of Rs.97 lakhs was not levied though the assessees had taken or accepted loan or deposit exceeding the prescribed limit in cash. One such case is given below:-

In Gujarat charge, the assessment of a company for the assessment year 1989-90 was completed in March 1993 after scrutiny. Audit scrutiny of the company auditor's report filed with the return

revealed that the assessee had accepted in cash loans/deposits amounting to Rs.14.40 lakhs in excess of the limit prescribed. The assessing officer, however, did not initiate any penalty proceedings for levy of penalty of Rs.14.40 lakhs nor recorded any reasons for not doing so. Omission to do so resulted in non levy of penalty of Rs.14.40 lakhs.

The Ministry have accepted the audit observation.

(h) Penalty for failure to comply with section 269 T

Under the provisions of Income Tax Act, 1961, no company (including banking company), co-operative society or firm shall repay to any person any deposit other than by an account payee cheque or account payee bank draft, where the amount of the deposit, or where the amount of deposit is to be repaid together with any interest, the aggregate of the amount of the deposit and such interest, is ten thousand rupees or more. The Act further provides that if a person repays any deposits referred to above otherwise than by account payee cheque /bank draft, he shall be liable to pay by way of penalty, a sum equal to the amount of deposit so repaid.

Audit scrutiny revealed 17 such cases in Tamil Nadu, Madhya Pradesh and Bihar charges where penalty amounting to Rs.17.28 lakhs was omitted to be levied. One such case is given below:-

Audit scrutiny revealed that in Bihar charge, a registered firm during the previous year relevant to the assessment year 1990-91, whose assessment was completed on 30 March 1993, repaid Rs. 1.94 lakhs to the depositors in cash on different dates.Thus the assessee was liable to pay penalty of Rs.1.94 lakhs. But no penalty proceedings were initiated by the assessing officer without recording any reasons. Omission to do so resulted in non-levy of penalty amounting to Rs.1.94 lakhs in the assessment year 1990-91.

(i) Penalty for failure to furnish certain returns.

Under the Income Tax Act, 1961, every person responsible for deducting tax at source, under the provisions of the Act, shall within the prescribed time after the end of the financial year, prepare and deliver or cause to be delivered to the prescribed authority such returns in such forms and verified in such manner as may be prescribed. If any person fails to furnish, in due time, any of the prescribed returns, statements or particulars, he shall pay by way of penalty, a sum which shall not be less than one hundred rupees, but which may be extended to two hundred rupees for every day during which the failure continues.

In 271 defaulting cases in Orissa, Bihar and Punjab charges penalty

of Rs.21.10 lakhs was not levied during review. One such case is given below:-

In Punjab charge, audit scrutiny of annual returns of an assessee company revealed that the person responsible for filing return had filed returns for the assessment years 1985-86 to 1989-90 belatedly, with delays ranging between 90 days and 1670 days. The department, however, did not initiate any penalty proceedings. No reasons were recorded therefor. Omission to do so led to non levy of minimum penalty amounting to Rs.2.69 lakhs.

The Ministry have accepted the audit observation.

(j) Penalty for failure to pay Advance Tax

(i) Under the Income Tax Act, 1961, if an assessee has failed to furnish a statement of the advance tax payable by him in accordance with the provisions of clause (a) of sub-section (1) of section 209A, the assessing officer may direct that such person shall, in addition to the amount payable by him, pay penalty as per section 273(1)(b) of the Act.

In West Bengal charge, an assessee, individual, paid no advance tax for the assessment year 1987-88. The regular assessment was completed on 30 March 1993 levying tax and, interalia, initiating penal proceedings for non-payment of advance tax. The assessment was partly set aside on 31 May 1993 by the Commissioner of Income Tax (Appeals) (Central-I). The initiation of penalty proceedings was, however, upheld in appeal dismissing the assessee's plea as not maintainable. The revised assessment was made on 26 August 1993 determining total income as Rs.166.66 lakhs and levying tax of Rs.83.12 lakhs, but no penal proceedings were initiated following such revised assessment although its initiation/leviability was upheld in appeal. Penalty ought to have been levied within six months of the appellate order or by March 1994. Because of omission to do so, levy of penalty for non payment of advance tax got barred by limitation of time involving loss of revenue by Rs.6.23 lakhs (being 10 per cent of seventy five per cent of assessed tax as reduced by the amount of advance tax which was nil in respect of the assessee).

(ii) It has been judicially* held that there is no legal bar on levying penalty during the course of pendency of appeal against assessment orders.

In sixty cases in Tamil Nadu and West Bengal charges, penalty

* Messrs Suraj Mal Mathura Prasad Deoria Vs. CIT 46-ITR-226 (Allahabad HC)
Sait Bansilal and Rangisetti veeranna Vs. CIT, AP 83-ITR-750 (AP HC)

proceedings were initiated but not completed on the grounds that appeal proceedings were pending. Two such cases are given below:

(a) A corporate assessee in Tamil Nadu charge, admitted a total income of Rs.17.09 lakhs for assessment year 1991-92. During scrutiny, an addition of Rs.18.54 lakhs was made and penalty proceedings were also initiated under section 271(1)(c) on 16 March 1994. However the penalty proceedings were not completed on the plea that the assessee had gone in appeal before Commissioner of Income Tax. Since there was no legal bar on levying penalty during the course of pendency of appeal, the omission led to non-levy of minimum penalty of Rs. 10.13 lakhs.

(b) In Tamil Nadu charge, the addition of Rs. 15.20 lakhs made as concealed income in case of a company was upheld by the Commissioner (Appeals) on 28 October 1993. Audit scrutiny revealed that though a penalty notice was issued on 27 September 1993, these proceedings were kept pending on the grounds that assessee had preferred an appeal to Appellate Tribunal. Since appellate proceedings are not a bar to completion of penalty proceedings, these could have been completed. The omission led to non-levy of penalty of Rs. 8.20 lakhs at minimum rates.

(k) Non-completion of penalty proceedings in violation of executive instructions

The Board have issued instructions in July 1991 that where penalty for concealment of income under section 271(1)(c) is not to be initiated or is to be dropped after its initiation, it will be done only with the approval of the Deputy Commissioner in respect of search case.

In 6 cases in Tamil Nadu and Delhi charges, penalty proceedings involving Rs.5.01 lakhs were dropped erroneously. Two such cases are given below:

(i) In Delhi charge, in the assessment of a company for the assessment year 1985-86 completed in January 1988 after scrutiny, inter alia, additions on account of advertisement and sales promotions expenses were made and penalty proceedings under section 271(1)(c) of Income Tax Act, 1961 for concealment and furnishing inaccurate particulars of income were initiated. Based on the decision of the Appellate Tribunal directing the assessing officer to examine certain details, the latter after due examination did not grant relief to the assessee in respect of certain advertisement and sales promotion expenses amounting to Rs. 4 lakhs. Audit scrutiny revealed that penalty proceedings were dropped on the grounds that additions were deleted by the Appellate Tribunal. This was not correct as the Tribunal had restored the

matter to the assessing officer and the latter after due consideration made an addition of Rs. 4 lakhs as the assessee could not file requisite details. Thus penalty proceedings were dropped erroneously resulting in non levy of penalty of Rs.2.52 lakhs at the minimum of the prescribed rates.

(ii) In Tamil Nadu charge, penalty proceedings initiated under section 18(1)(c) of Wealth Tax in respect of search cases were dropped without getting the approval from Deputy Commissioner in violation of executive instructions. The view of the assessing officer that the Board's instructions were applicable only to penalty proceedings initiated under section 271(1)(c) and not to proceedings under section 18 (1)(c) of Wealth Tax Act does not appear to be correct as both these sections deal with penalty for concealment of income/funishing inaccurate particulars and can be regarded as analogous sections. Thus there was non-compliance with Board's instructions in such cases.

(l) Penalty short levied

In Haryana charge based on an order of Appellate Authority, the concealed income of an assessee for the assessment year 1985-86 was estimated at Rs. 11. 07 lakhs. While giving effect to the orders of the Appellate Authority, penalty of Rs.1.70 lakhs was levied against the minimum penalty of Rs.6.63 lakhs (equivalent to the amount of tax evaded on Rs.11.07 lakhs) leviable under the Act. This omission resulted in short levy of penalty of Rs.4.93 lakhs.

(m) Non levy/short levy of additional tax

Section 143(1A) of the Income Tax Act provides that where as a result of adjustments made to a return processed in a summary manner, the income declared by an assessee is increased or loss declared is reduced or/converted into income, the assessing officer shall increase the amount of tax payable by additional income tax, calculated at the rate of twenty percent of the difference between the tax on total income so increased and tax that would have been chargeable had such total income been reduced by the amount of adjustment. In respect of reduction of loss/conversion into income, twenty percent of the tax that would have been chargeable on the amount of adjustments shall be the additional tax. The Board in their instruction of 31 October 1989 had clarified that this additional tax was a sort of negligence tax on the assessee and compensates the department for the effort involved in detecting the obvious mistakes committed by tax payers in their returns. This provision thus takes the colour of a deterrent provision.

In 91 cases in M.P, Bihar, Gujarat, West Bengal, Assam, U.P, Tamil Nadu, Karnataka and Kerala, additional tax of Rs.530.04

lakhs was not levied. The deterrent provision was thus not implemented. Three such cases are given below:

(i) In Assam charge, the assessment of a widely held oil company for the assessment year 1991-92 was completed in a summary manner in February 1992. Audit scrutiny revealed that enhanced royalty payable amounting to Rs. 17.68 crores was neither paid during the previous year nor before the due date for filing of return. As per information available in the return, the amount was not paid and was required to be disallowed being prima-facie inadmissible. Omission to add back the unpaid liability under prescribed adjustment resulted in underassessment of income of similar amount involving tax effect of Rs. 813 lakhs besides non-levy of additional tax of Rs. 162.66 lakhs.

The Ministry have not accepted the audit observation on the ground that in view of the provisions of section 43 B, section 143 (1) (a), Board's Circulars Nos. 547, 581, 669 and in view of a decision of Bombay High Court* , the disallowance does not fall within the ambit of section 143 (1) (a). The reply is not tenable since royalty payable on crude oil is a statutory liability levied under the Oilfield (Regulation & Development) Act, 1948 and should, therefore, have been allowed only on actual payment basis in terms of section 43 B (a). The amount was also to be disallowed as there was no evidence regarding payment of royalty before the date of filing of return which was required under section 43 B and reiterated in Board's Circular No. 689 of August 1994. The judgement of the Bombay High Court does not apply to this case which is of non-compliance with a statutory provision.

(ii) In West Bengal charge, the assessment of a widely held company for the assessment year 1993-94 was completed in January 1994 in a summary manner determining the total income as Rs.2659.22 lakhs after making adjustments amounting to Rs.3779.99 lakhs to the returned loss of Rs.1120.77 lakhs. Audit scrutiny revealed that though additional income tax of Rs.391.23 lakhs was required to be levied on the amount of adjustment of Rs.3779.99 lakhs as made, the assessing officer levied additional income tax of Rs.275.23 lakhs on the total income of Rs.2659.22 lakhs. The mistake resulted in short levy of additional income tax by Rs.116 lakhs.

The Ministry have accepted the audit observation.

(iii) In Uttar Pradesh charge, the additional tax of Rs. 10.42 lakhs levied in respect of a company for assessment year 1990-91 was withdrawn on the ground that since the adjustments had merely

* Khatan Junkar Ltd. and another vs K.S. Pathania and another (196-ITR-55-Bombay H.C.)

reduced the loss, additional tax was not leviable as per decision of the jurisdictional High Court. Audit scrutiny revealed that since section 143(1A) had been amended to provide for levy of additional tax even where the adjustments result in reduction of loss and did not lead to conversion into income, the assessing officer should have amended the assessment order. Omission to do so resulted in non-levy of additional tax of Rs. 10.42 lakhs.

(n) Lacuna in the Act

Section 275 of the Income Tax Act prescribes certain time limits for completion of penalty proceedings under Chapter XXII. This is to ensure that penalty proceedings are completed within the time limits prescribed and do not drag on indefinitely.

In Tamil Nadu charge, penalty proceedings under section 140A(3) initiated on 7 April 1993 for non-payment of the tax of Rs.1.75 lakhs were not disposed off till date (February 1995). This was based on the ground that there is no limitation of time to dispose off the penalty proceedings and that the limit under section 275 would not apply in respect of penalty leviable under section 140(A)(3). In this case, it was found that the proceedings were kept pending for more than 2 years and the very purpose of initiating them defeated. The anomaly in not prescribing a time limit should be considered.

Prosecutions

3.3.12 It has been observed that in combating tax evasion, monetary penalties are often not enough since many a recalcitrant tax dodger finds it a profitable proposition to carry on evading taxes if the only risk to which he is exposed is a monetary penalty. It is in this background that the powers of prosecution assume importance. It has been observed in the Report of the Direct Taxes Enquiry Committee (1971) that the prospect of landing in jail is a more dreaded consequence to erring tax payers. The prosecution policy of the department should, therefore, be truly deterrent aiding efficient enforcement of tax laws.

The information furnished by the Ministry on the complaints received and their disposal for the years 1991-92 to 1993-94 indicate the following:

Year	Complaints filed during the year			Cases			
	For tax evasion	Others	Total	Convicted	Compounded	Acquitted	Total
1991-92	1234	1214	2448	165	153	169	487
1992-93	808	683	1491	102	391	808	1301
1993-94	552	389	941	57	507	570	1134
Total	2594	2286	4880	324	1051	1547	2922

Thus out of a total of 2922 cases disposed off by way of conviction,

compounding and acquittal during the years 1991-92 to 1993-94, only 324 cases (11.08 percent) resulted in conviction. Over 52 percent (1547 cases) were acquitted. Such a high number of acquitals revealed that the department was not taking adequate care to prepare watertight cases where they have decided to prosecute. Although the Wanchoo Committee was of the opinion that the compounding powers should be used very sparingly by the department, 1051 cases (35.97 percent) were compounded during this period.

(A) Delays in launching prosecutions

Though there is no time limit prescribed for launching of cases, delay in launching of prosecution could provide an opportunity to a taxpayer to tamper with evidence or cook up fresh evidence or to tutor witnesses. In such circumstances it would be administratively expedient to launch prosecution cases expeditiously after collecting requisite evidence and after fulfilling all formalities etc. Normally, in order to file a complaint for prosecution in a court, the proposal from the assessing officer is sent to the prosecution cell. The cell examines the case and after obtaining legal opinion from the government counsel, the administrative approval of the Chief Commissioner is obtained, if the case is fit for prosecution. A lawyer is then appointed and the assessing officer after obtaining sanction/authorisation from the concerned Commissioner of Income Tax launches the prosecution proceedings.

Audit scrutiny of the prosecution cases in West Bengal, Maharashtra, Madhya Pradesh, Rajasthan, Karnataka and Gujarat charges revealed delays ranging from 1 year to 8 years in launching prosecution proceedings from the date of initiation of complaint by assessing officer to actual date of filing of complaint in court. Two illustrative cases are cited:

(i) In Karnataka charge, a proposal for launching prosecution of an assessee was received in the prosecution cell in February 1988. After exchange of correspondence between the Assistant Director of Prosecution and the assessing officer, complete details/documents were received in January 1991 from the assessing officer. Though the counsel's opinion was obtained in December 1991, the Chief Commissioner's administrative approval was sought in July 1992 under section 276 C. Approval was accorded in October 1992. The counsel to whom the file was sent for drafting the complaint immediately returned the file with the suggestion that Chief Commissioner's approval under section 278B read with section 276CC and 277 should be obtained. This was finally obtained in February 1993 and a complaint was filed in the court in March 1993. There was thus a delay of nearly 3 years in correspondence between the officers of the department, 10 months delay in

obtaining the legal opinion and 7 months delay in submission of the proposal to the Chief Commissioner after receipt of legal opinion.

(ii) In Gujarat charge, the original prosecution proposal in a case was made by the assessing officer on 18 March 1992. The Commissioner accorded administrative approval for launching prosecution on 22 March 1993 after obtaining opinion of counsel on 28 January 1993. It was, however, revealed that the complaint was filed in the court only on 25 November 1993 i.e. after a delay of about 8 months.

(B) Lack of co-ordination

Since a prosecution case involves several authorities, it is a primary requirement that a case initiated by an assessing officer also appears in the records of other authorities involved in the chain.

In West Bengal charge, it was, however, seen that all prosecution cases appearing in the prosecution register maintained by the assessing officer did not appear in a like register maintained in the Commissioner's office or vice versa. Further, the cases disposed by the courts as shown in these two registers maintained by the assessing officer and the concerned Commissioner differed. This also impaired effective control and follow up of the cases under prosecution.

(C) Lack of monitoring

Effective monitoring is a *sine qua non* for a successful enforcement programme. It was observed during the review that lack of monitoring by the superior officials frequently led to delays in deciding whether to file a complaint or not. Audit scrutiny of case records in Madhya Pradesh, West Bengal and Punjab (Union Territory of Chandigarh) charges revealed instances of no decision being taken on launching/dropping of complaints even after three years of receipt, no evidence of any follow up action on queries of the Commissioner even after several years and non-receipt of the copies of the decisions of the courts even after one year which affected filing of appeals in higher courts.

(i) In one case pertaining to Madhya Pradesh charge, since the penalty had been confirmed by Appellate Tribunal, the Commissioner, Bhopal directed the assessing officer on 19 January 1993 to submit a proposal for prosecution. Audit scrutiny revealed that such a proposal had already been received in the office of the Commissioner in October 1991 as a result of which a complaint had been filed in the court on 14 February 1992. The Commissioner's direction for initiation of a case which had been initiated and disposed is indicative of poor maintenance of records and

monitoring.

(ii) In another case relating to Madhya Pradesh charge, a proposal for initiating prosecution was forwarded to the Commissioner on 1 October 1990 who on 30 November 1990, directed the assessing officer to offer his comments on the applicability of Amnesty Scheme and furnish other related information. Though more than 4 years have lapsed, the information has not been received from the assessing officer nor were any reminders issued.

(iii) In 13 other cases relating to Madhya Pradesh charge, no action was taken by the Commissioner to either approve the launching of prosecution proceedings or drop the complaints, though three years had lapsed since date of initiation of complaint.

(iv) In West Bengal charge, the copies of the decisions of the courts were not obtained by the department in three cases even after the lapse of one year or more. Audit scrutiny revealed that the time limit for filing revision petition in the High Court had lapsed in these cases.

(v) In Union territory of Chandigarh charge, the Commissioner of Income Tax, Patiala asked the Dy. Commissioner of Income Tax, Solan to examine a case from a prosecution angle on 25 August 1993 and send the proposal after obtaining legal opinion of the standing counsel. Though the reply of the assessee to the show cause notice served by the new assessing officer was received on 27 October 1993, no action was taken to obtain legal opinion or take any other action even after expiry of a period of 20 months.

(D) Acquittals due to reasons attributable to the department

Audit scrutiny of selected case records in Tamil Nadu, Maharashtra, Gujarat and Karnataka charges, revealed that in several cases the acquittal was mainly due to:

— documentary evidence in support of the offence was not produced in the court
— counsel was not regular in attending court with documents
— the department could not adduce evidence that the partners were incharge of the management of the firm etc.

(i) In Tamil Nadu charge, the assessment of a firm was estimated at an enhanced figure considering the defective nature of accounts. Prosecution proceedings, however, resulted in acquittal due to the reason that account books were not produced and the statement given by the assessee had not been marked by prosecution. The acquittal was mainly due to non-appearance of Public Prosecutor with the relevant documentary evidence. Further, the copy of the

judgement was obtained after a delay of 26 months. Since it was not obtained within 6 months, the department was not in a position to consider filing a further appeal before the High Court.

(ii) In another case relating to Tamil Nadu charge, the prosecution case against a firm and its partners for failure to deduct tax from payments made to five persons, resulted in their acquittal. These partners were acquitted on the ground that there was no documentary evidence to prove that the partners were in charge of the management of the firm. The department had not issued a notice fixing any principal officer on whom responsibility could be fixed. The firm was acquitted since it could not be committed to prison. The department's omission to fulfill technical requirement led to acquittal of the assessee.

(E) Prosecution proceedings not launched on the ground that penalty proceedings are pending

It has been judicially* held that pendency of appeal is not a bar to launching of prosecution proceedings. However, in 27 cases relating to Madhya Pradesh charge, prosecution proceedings were not initiated by the assessing officers on the grounds that the assessee had gone in appeal against penalty imposed.

(F) Delays in disposal of cases due to non-attendance by departmental witnesses

The department should make all efforts to ensure that prosecution proceedings are not delayed. In Madhya Pradesh charge, it was, however, noticed that out of 85 cases relating to CIT Bhopal and CIT Jabalpur, in 64 cases departmental witnesses did not attend the court on respective dates of hearings. Failure of the department to ensure their attendance thus contributed to delays. The relevant statistics are given below:

CIT, Bhopal Charge

Year of filing of complaint	No. of cases	No. of hearings fixed upto March 1995	No. of hearings on which depttl. witness did not attend the court	Percentage of total hearings on which departmental witness did not appear
upto 1989-90	35	1343	428	31..9
1990-91	**	**	**	**
1991-92	5	96	32	33.3
1992-93	4	54	38	70.4

* Shankar and Co. & ORS vs. The Third I.T.O. 97 CTR (Kar) 92

** Information not furnished by CIT, Bhopal

CIT, Jabalpur Charge

upto 1989-90	16	562	177	31.5
1990-91	01	19	15	78.0
1991-92	01	22	12	54.6
1992-93	02	30	13	43.3

(G) Delay in submission of report to the Board on compounding petitions

As per the Board's circular dated 8 August 1990, a comprehensive report should reach them within one month of receipt of their communication. This circular was issued in the background of non-receipt of reports regarding compounding petition in time leading to delays. However, in Gujarat charge, audit scrutiny of 6 compounding cases revealed that there were delays ranging between 10 and 47 months in sending this report to the Board. These delays would eventually result in decisions on the compounding petitions being delayed.

Maintenance of registers

3.3.13 For facilitating control and quick transmission of relevant data for follow up action, the department has prescribed maintenance of certain registers. A review of these registers in some selected wards/circles revealed that either they were not maintained or were not maintained properly. The purpose and position of various registers in different charges are tabulated below:

Sl. No.	Register for	Purpose in brief	Charges where not maintained at all	Charges where not maintained properly	Brief omissions relating to column (5)
(1)	(2)	(3)	(4)	(5)	(6)
1.	Proceedings against defaulters	This register contains information in respect of each defaulter relating to notice of demand and warrant of attachment issued, prohibitory orders relating to property, proclamation of sale and certificate of sale of property etc.	Madhya Pradesh, Himachal Pradesh, Jammu and Kashmir, Assam, Kerala, Union Territory of Chandigarh, Orissa, Rajasthan, Gujarat, West Bengal, Haryana, Tamil Nadu, Karnataka	Bihar	Not maintained in prescribed form and the entries were not uptodate.
2.	Recovery limitation	It is maintained to watch that the time limit prescribed for the recovery proceedings in the Income Tax Act, 1961 is in no case ignored.	Madhya Pradesh, Himachal Pradesh, Union Territory of Chandigarh, Orissa, Rajasthan, Gujarat, West Bengal, Haryana, Tamil Nadu, Karnataka, Jammu and Kashmir	Assam and Bihar	Not maintained in prescribed form and the entries were not uptodate.
3.	Irrecoverable demands	This register is maintained to keep record of demands which having become irrecoverable are written off. In this register the names of assessees, their addresses, amount of demand, date of	Madhya Pradesh, Himachal Pradesh, Kerala, Union Territory of Chandigarh, Orissa, Rajasthan, Gujarat, West Bengal, Haryana, Tamil Nadu and	Jammu and Kashmir, Punjab, Bihar and Assam	Not maintained in prescribed form and entries were not attested by the designated officer.

		write off with reasons thereof etc. are indicated.	Karnataka		
4.	Pending action	It is maintained by an assessing officer to enable him to plan his work in such a manner so as to complete all pending cases relating to assessment and miscellaneous proceedings. This reigster serves as an internal administrative check.	Madhya Pradesh, Himachal Pradesh, Kerala, Union Territory of Chandigarh, Orissa, Rajasthan, Gujarat, West Bengal, Haryana, Tamil Nadu, Karnatka.	Jammu and Kashmir, Assam, Punjab and Bihar.	Not maintained in prescribed form and not submitted to competetnt authority regularly etc.
5.	Penalty Register	This register which is kept in three parts, furnishes full particulars of penalties imposed on assessees after penalty proceedings.	Himachal Pradesh, Karnataka and Bihar	Jammu and Kashmir, Kerala, Assam, Rajasthan, Gujarat, West Bengal, Delhi, Tamil Nadu, and Punjab	Not maintained in prescribed form. Columns relating to tax demand, date of completion of proceedings, date of penalty order passed, details of appeal filed by the assessee, date when the case will become time barred, whether case pending in 1st/2nd appeal or dropped etc. were not filled. The certficate that all the entries from previous register had been carried to the present register were not found recorded in several charges.
6.	Prosecution	Similar to the register of penalties, another reigster is maintained showing particulars of assessees who are prosecuted for tax offences. This register also gives particulars of any composition money taken from the assessee for compounding the offences and particualrs of persons convicted etc.	Himachal Pradesh, Jammu and Kashmir, Assam, Orissa, Rajasthan, Gujarat, West Bengal, Kerala	Punjab, Tamil Nadu, Bihar	Columns like date and nature of court decision/punishment awarded, whether court decision was accepted or revision/appeal was filed, etc. were left blank and entries were not attested.
7.	Daily Refund	In this register entries are made regarding amount of refund paid immediately on receipt of the advice memo from the Reserve Bank/State Bank of India. There are specific columns in this register for showing the refund of advance tax paid, interest payable by Government and interest collected from the assessee.	Himachal Pradesh, Tamil Nadu	Jammu and Kashmir, Assam, Kerala, Union Territory of Chandigarh, Rajasthan, Gujarat, West Bengal, Haryana, Bihar and Punjab	Not maintained in prescribed form, columns like refund of advance tax, interest payable by Government, interest collected from assessees were left blank in some cases. In some charges bank scrolls were treated as registers. Entries were not attested by designated officers

					in some charges.
8.	Assessing Officer's Blue Book	This register is maintained to enable the assessing officer to take prompt action for issue and revision of advance tax notices, self and regular assessments, collections etc. This register is to be reviewed by the Dy. Commissioner to ensure that timely and appropriate action is taken by the assessing officer. Since the register has records of names of assessees alongwith PAN, details of pending assessments and proceedings, etc. it enables the assessing officer to know at a glance, the work load of the year. With the help of this information he can plan the workload in such a manner that all cases are completed in time and much before these become time barred.		Rajasthan, West Bengal, Tamil Nadu, Karnataka, Punjab and Bihar	Columns regarding submission of returns, issue of notice, initiation of penalty proceedings etc. were left blank in some cases. Entries were not attested by designated officer.

Other topics of interest

3.3. 14 (i) Penalty for failure to furnish return

Under the provisions of Wealth Tax Act, 1957, as it stood prior to 1 April 1989, if any assessee fails to furnish the return required to be filed under the Wealth Tax Act within the time allowed, the assessing officer may impose a penalty under section 18(1)(a) calculated at the rate of two percent of assessed tax for every month during which the default continued.

In Gujarat charge, an assessee investment company was assessed to wealth tax for assessment years 1984-85 to 1991-92 after scrutiny in January 1994. The wealth tax returns were filed late by 13 months to 99 months. While passing assessment orders it was recorded by the assessing officer that penalty/interest for late filing of return should be charged. However, it was omitted to be levied. The omission worked out to Rs.1.77 lakhs.

(ii) Omission to launch proceedings for failure to comply with provisions of section 269 SS.

Under the provisions of section 276 DD of the Income Tax Act, if a person takes or accepts any loan or deposits in excess of Rs.10,000 in cash which is in contravention of the provisions of section 269 SS, he shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine equal to the amount of such deposit. This provision has, however, been omitted with effect from 1April, 1989.

In Gujarat charge, the assessments of three individuals for

assessment years 1986-87 and of one individual for assessment year 1988-89 were completed after scrutiny between Februrary 1993 and March 1993. Audit scrutiny of the records revealed that the assessees had accepted loans/deposits in cash aggregating to Rs.5.16 lakhs in excess of the prescribed limits of Rs.10,000 in each case, thereby infringing the provisions of section 269 SS. The assessing officer, however, did not initiate any prosecution proceedings nor did he record any reason for not doing so. Omission to do so led to non-levy of a fine of Rs.5.16 lakhs.

The response of the Ministry to the above audit observations have not been received so far except their reply in certain individual cases which have been incorporated suitably.

Chapter 4

Corporation Tax

General

4.1 According to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, there were 3,56,702 companies as on 31 March 1995. These included 619 foreign companies and 2,416 associations functioning `not for profit' but registered as companies limited by guarantee and 375 companies with unlimited liability. The remaining 3,53,292 companies with limited liability comprised 1,199 Government companies and 3,52,093 non-Government companies with paid-up capital of Rs. 71,753.97 crores and Rs. 59,569.72 crores respectively. Among non-Government companies, over 86.91 percent (3,06,017) were private limited companies with a paid-up capital of Rs. 16,389.39 crores.

Number of assessees

4.2 The number of assessee companies in the records of the Income Tax Department during the last five years was as follows:

As on 31 March	Number
1991	1,24,402
1992	1,34,779
1993	1,55,418
1994	1,71,419
1995	1,76,594

Trend of receipts

4.3 The trend of receipts from corporation tax i.e., income tax and surtax payable by companies during the last five years was as follows:

Year	Receipts from Corporation tax	Gross collection of all direct taxes	Percentage of Corporation tax to gross collection
	(In crores of rupees)		
1990-91	5,335.27	11,028.94	48.37
1991-92	7,867.67	15,342.36	51.28
1992-93	8,889.24	18,097.29	49.12
1993-94	10,060.06	20,298.24	49.56
1994-95	13,820.96	26,970.88	51.24

Status of assesments

4.4 The following table indicates the progress in the completion of assessments and collection of demand under corporation tax during the last five years:

Year	No. of assessments				Total demand		
	For disposal	Completed during the year	Pending at the close of the year	Percentage of pendency to total cases for disposal	Demand for collection	Collection during the year	Percentage of collection to total demand
					(In crores of rupees)		
1990-91	1,76,338	1,19,265	57,073	32.36	7925.48	5335.27	67.32
1991-92	2,13,359	1,46,998	66,361	31.10	10938.21	7867.67	71.93
1992-93	2,26,665	1,51,913	74,752	32.98	13088.96	8889.24	67.91
1993-94	2,55,344	1,81,130	74,214	29.06	16686.69	10060.06	60.29
1994-95	2,58,059	1,86,938	71,121	27.56	23711.08	13820.96	58.29

Results of Audit

4.5 A total number of 522 draft paragraphs involving tax effect of Rs. 242.04 crores were issued to the Ministry of Finance for comments during March to September 1995. The Ministry have accepted the observations in 372 cases involving tax effect of Rs.180.49 crores. 173 illustrative cases involving tax effect of Rs.141.91 crores are indicated in the succeeding paragraphs. Out of these, the Ministry of Finance have accepted the observations in 131 cases involving tax effect of Rs.126.66 crores. Of these, 22 cases involving tax effect of Rs.8.03 crores were checked by the Internal Audit wing of the department but the mistakes were not detected by it. The repetitive nature of the mistakes committed by the assessing officers indicates that adequate attention is not being given even to assessments involving substantial revenue.

Avoidable mistakes in computation of income and tax

4.6 Under the Income Tax Act, 1961, an assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer shall make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment. Underassessment of tax of substantial amounts and overcharge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Reports of the Comptroller and Auditor General of India. Despite this and issue of repeated instructions by the Government, such mistakes continue to occur suggesting the need for close supervision and control. The various types of mistakes noticed included, inter alia, incorrect adoption of figures, arithmetical errors, double allowance, non-levy of surcharge etc. The extent of such mistakes noticed during test check of the assessments completed by the assessing officers during last five years was as under:

Year	No. of items	Amount of tax underassessed (in lakhs of rupees)
1990-91	1,153	1,135.00

1991-92	878	8,857.00
1992-93	907	1,470.48
1993-94	1,140	2,101.49
1994-95	1,503	3,504.60

Some important cases of each type noticed in test check are given below:

(1) Overassessment of income and tax

Mistakes by the assessing officers resulted in overcharge of income tax from some assessees. Of the numerous cases noticed, a few major cases are mentioned below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	Karnataka III, Bangalore	1988-89 December 1993	143(3)	Tax on a public sector bank was charged erroneously at the rate of 55 percent instead of the correct rate of 50 percent	51.51
2	CIT I, Ahmedabad	1990-91 January 1993	143(3)	Instead of the correct amount of Rs. 5.77 lakh representing provision for gratuity Rs. 66.07 was erroneously disallowed	32.56(P)*
3	Karnataka II, Bangalore	1993-94 March 1994	143(1)(a)	Returned loss of Rs. 38.87 lakhs was erroneously adopted as Rs. 3.89 lakhs	20.12(P)
4	Karnataka III, Bangalore	1991-92 March 1994	143(3)	Tax on a company in which public were substantially interested was charged erroneously at the rate of 50 percent instead of the correct rate of 40 percent	12.50
5	Tamil Nadu V, Madras	1991-92 November 1993	143(3)	Interest payable to financial institution which was not claimed by the assessee disallowed by the assessing officer leading to short computation and carry forward of loss by Rs. 15.55 lakhs	8.05(P)
6	Karnataka I, Bangalore	1991-92 February 1994	143(3)	Expenditure of Rs. 14.71 lakhs not charged to profit and loss account was erroneously added to the income	6.77(P)
7	Karnataka II, Bangalore	1984-85 March 1994	143(1)(a)	Surcharge on income tax was erroneously determined at Rs. 6.37 lakhs instead of the correct amount of Rs.63,636	5.73
8	Tamil Nadu II, Madras	1991-92 November 1993	143(3)	Export incentives of Rs.22.62 lakhs were erroneously deducted from profits of the business	5.07

The Ministry have accepted the observations at Sl.Nos.1 to 5, 7 and

* (P) or 'potential tax effect' wherever occurring in this Report indicates the tax effect of the transaction commented upon considered in a stand-alone manner. In certain 'loss' cases, it may happen that even after correcting the mistake, there is a net loss. In such cases no tax would be leviable.

8. In the remaining case, the response of the Ministry has not been received.

(2) Underassessment of income and tax

(i) Incorrect adoption of figures

(a) In Uttar Pradesh charge, in the assessment of a company for the assessment year 1991-92 completed after scrutiny in March 1994, the assessing officer added back Rs.453.96 lakhs towards depreciation instead of the correct amount of Rs.727.55 lakhs. The mistake resulted in excess computation of loss by Rs. 273.59 lakhs involving potential tax effect of Rs.125.88 lakhs.

The Ministry have accepted the audit observation.

(b) In Rajasthan charge, in the assessment of a company for the assessment year 1991-92 completed after scrutiny in March 1994, unabsorbed depreciation of Rs.378.19 lakhs for the assessment year 1987-88 was set off instead of the actual unabsorbed depreciation of Rs.131.38 lakhs. The mistake resutled in excess set off of Rs.246.81 lakhs involving potential tax effect of Rs.119.95 lakhs.

The Ministry have accepted the audit observation.

(c) In Maharashtra charge, in the assessment of a company for the assessment year 1991-92 completed after scrutiny in February 1994, business income of Rs.408.24 lakhs was erroneously adopted at Rs.170.64 lakhs by the assessing officer. This resulted in underassessment of income of Rs.237.60 lakhs involving potential tax effect of Rs.109.30 lakhs.

The Ministry have accepted the audit observation.

(d) In West Bengal charge, in the assessment of a widely held company for the assessment year 1990-91 completed in March 1993 after scrutiny, the assessing officer incorrectly adopted business income as Rs.227.17 lakhs instead of Rs.279.17 lakhs. There was also a mistake in allowing a deduction of Rs.819.19 lakhs instead of Rs.797.83 lakhs. The mistakes resulted in underassessment of income by Rs. 73.36 lakhs with consequential undercharge of tax by Rs.39.61 lakhs.

The Ministry have accepted the audit observation.

(e) Some more such mistakes noticed in other charges are mentioned in the following table:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	City III, Bombay	1991-92 March 1994	143(3)	Returned income of Rs. 168.59 lakhs was erroneously adopted as loss	155.10(P)
2	City VI, Bombay	1988-89,1989-90, 1990-91 December 1992	143(3)	Written down value of depreciable assets was erroneously adopted at Rs. 85.10 lakhs instead of correct amount of Rs. 8.13 lakhs leading to excess allowance of depreciation	17.03
3	City II, Bombay	1991-92 November 1993	143(3)	Unaccounted sales of Rs. 2.71 lakhs was erroneously added back instead of the correct amount of Rs. 20.16 lakhs	16.92

The Ministry have accepted the audit observations at Sl. Nos. 1 and 2. Their response to the remaining case has not been received.

(ii) Arithmetical errors

(a) In Tamil Nadu charge, in the assessment of a widely held company for the assessment year 1993-94 completed in a summary manner in February 1994 a loss of Rs.1376.17 lakhs was determined instead of Rs.1170.82 lakhs as per the documents accompanying the return. The mistake resulted in excess computation of loss by Rs.205.35 lakhs involving potential tax effect of Rs.106.26 lakhs and non-levy of additional tax of Rs.21.25 lakhs.

The Ministry have accepted the audit observation.

(b) In West Bengal charge, in the assessment of a widely held company for the assessment year 1992-93 completed in a summary manner in June 1993, the department erroneously charged tax aggregating Rs.211.90 lakhs as against the correct amount of Rs.252.66 lakhs. The mistake in calculation of tax resulted in short levy of tax of Rs.40.77 lakhs.

The Ministry have accepted the audit observation.

(c) In Maharashtra charge, in the assessment of a company for the assessment year 1991-92 completed after scrutiny in November 1993, the assesing officer had disallowed Rs.35.99 lakhs on account of inadmissible expenses. However, while computing the income, this was deducted from the net profit instead of adding it back. the mistake resulted in underassessment of income of Rs.71.98 lakhs and excess carry forward of unabsorbed depreciation to that extent involving potential short levy of tax of

Rs.37.25 lakhs.

The Ministry have accepted the audit observation.

(iii) Double allowance of deduction and other mistakes

(a) In Kerala charge, assessment of a widely held company for the assessment year 1989-90 was completed after scrutiny in March 1992, followed by rectification in September 1993. Audit scrutiny revealed that in computing its business income, depreciation of Rs.54.47 lakhs was allowed without adding back the depreciation of Rs.45.28 lakhs already charged to the profit and loss account. The mistake resulted in excess carry forward of loss of Rs.45.28 lakhs in the assessment year 1989-90 and undercharge of tax of Rs.24.27 lakhs in the assessment years 1990-91 and 1991-92 as the amount got fully set off in these assessment years.

The Ministry have accepted the audit observation.

(b) In West Bengal charge, in the assessment of a widely held company for the assessment year 1991-92 completed after scrutiny in February 1994, out of a sum of Rs.45.77 lakhs allowed on account of statutory bonus of earlier years paid during the previous year relevant to the assessment year 1991-92, Rs. 45.03 lakhs relating to the assessment year 1989-90 had already been allowed in the assessment for year 1989-90. Thus the bonus of Rs.45.03 lakhs was allowed by the assessing officer twice. The mistake resulted in underassessment of income of Rs.45.03 lakhs involving short levy of tax of Rs.21.72 lakhs.

The reply of the Ministry to the audit observation has not been received.

(c) In Maharashtra charge, the asssessment of a company for the assessment year 1991-92 originally completed in February 1992 in a summary manner was completed after scrutiny in January 1994 resulting in a refund of Rs.10.03 lakhs. However, in doing so the refund of Rs.10.03 lakhs allowed to the assessee at the summary assessment stage was not considered. The omission resulted in short levy of tax of Rs.10.03 lakhs.

The reply of the Ministry to the audit observation has not been received.

(d) Two more cases relating to different charges are mentioned in the following table:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	Haryana, Rohtak	1992-93 March 1993	143(1)(a)	Depreciation of Rs. 3.26 lakhs admissible under Income Tax Act was allowed without adding back the depreciation charged to profit and loss account amounting to Rs. 54.44 lakhs	31.30(P) 6.26
2	Tamil Nadu I, Madras	1991-92 November1993	143(3)	Surcharge was not charged on income tax	31.96

The Ministry have accepted both the audit observations.

Application of incorrect rate of tax

4.7 Under the Finance Act, a domestic company is chargeable to tax at specified different rates depending on whether it is a company in which public are substantially interested or not substantially interested and in the latter case, whether it is an industrial company or trading and investment company or any other company. In the case of a foreign company tax is levied at different rates on income by way of royalties and fees and other income. Instances of incorrect application of rates were noticed during the test check involving substantial undercharge of tax. Some important cases are given below.

(a) In West Bengal charge, in the assessment of a banking company incorporated in Netherlands and also having its business in India, tax for the assessment year 1989-90 was levied at the lower rate of 50 percent instead of 65 percent prescribed for non specific category of income. The irregular application of rate of tax led to a short levy of tax by Rs.70.77 lakhs.

The Ministry have accepted the audit observation.

(b) In Maharashtra charge, in the assessment of a domestic company in which public are not substantially interested, tax for the assessment year 1993-94 was levied at the rate of 45 percent instead of at the correct rate of 50 percent. The mistake resulted in short levy of tax of Rs.18.96 lakhs (including interest).

The Ministry have accepted the audit observation.

(c) In West Bengal charge, the assessment for the assessment year 1989-90 of a closely held trading company in which public are not substantially interested was completed in March 1994 on best judgement basis. Income Tax rate of 50 percent as applicable to widely held companies was applied instead of correct rate of 60 percent applicable to closely held trading companies. The mistake resulted in short levy of tax by Rs.12.03 lakhs (including interest).

The Ministry have accepted the audit observation.

(d) In Maharashtra charge, in the assessment for the assessment year 1991-92 of a trading company in which public are not substantially interested, tax was levied at the rate of 45 percent instead of the correct rate of 50 percent. The mistake resulted in short levy of tax of Rs.11.06 lakhs (including interest).

The Ministry have accepted the audit observation.

Adoption of incorrect status

4.8 Under the Income Tax Act, 1961, the incidence of tax is higher in respect of a closely held trading or investment company than in case of association of persons.

Under the Income Tax Act, 1961, a company is deemed to be a company in which the public are substantially interested, if, interalia, it fulfils the condition that (a) the shares in the company were, as on the last day of the previous year, listed in a recognised stock exchange in India or (b) shares carrying not less than fifty percent of voting power throughout the previous year were beneficially held by Government or a Corporation established by Central, State or provincial Act, or any company in which the public are substantially interested or a hundred percent subsidiary company of such company. The incidence of tax is lower in respect of a company in which the public are substantially interested.

In West Bengal charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994 treating the company as one in which the public were substantially interested and levying tax at the rate of 40 percent. Audit scrutiny revealed that the shares of the company were not registered with the stock exchange as required under the Act. The condition at (b) above was also not satisfied. The assessee company in its return for the relevant assessment year had shown its status as a closely held investment and trading company. As such the company should have been assessed as a company in which public were not substantially interested and taxed accordingly. Omission to do so resulted in short levy of tax by Rs. 11.43 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of capital expenditure

4.9 Under the provisions of Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure laid out or expended wholly or exclusively for the purpose of business is allowable as deduction in computing income chargeable under the head "profits and gains of business or profession".

In Kerala charge, the assessment of a company for assessment year

1991-92 was completed in December 1991 after scrutiny allowing expenditure on modernisation amounting to Rs. 132.95 lakhs as deduction. Audit scrutiny revealed that this amount included Rs. 91 lakhs expended on a new machinery on replacement of an old machine. As the assessee derived an advantage of an enduring nature through improved quality of yarn, increased productivity and reduced cost, the expenditure should have been treated as of capital nature and disallowed. Omission to do so resulted in underassessment of income of Rs. 68.25 lakhs (after considering depreciation on the machinery) involving tax effect of Rs. 35.59 lakhs.

The Ministry have accepted the audit observation.

Incorrect treatment of income as capital gains

4.10 Under the Income Tax Act, 1961, any profits or gains arising from the transfer of a capital asset are chargeable to income-tax under the head `capital gains' to the specified extent. Capital asset is defined in the Act as a property of any kind held by an assessee, whether or not connected with his business or profession but does not include stock in trade. Any profits or gains from sale and purchase of the latter are, therefore, taxable as income.

In Chandigarh charge, assessments of six companies for the assessment years 1991-92 and 1992-93 were completed after scrutiny between June 1993 and March 1994 computing capital gains of Rs. 62.85 lakhs on the profits of Rs. 76.21 lakhs derived from the sale of investments in shares and dividends. Audit scrutiny revealed that the assessee companies were engaged in the sale and purchase of shares and the investments were held as stock-in-trade. As these shares in no way could be termed as capital assets, the profits on sale thereof should be treated as income and not capital gain. Incorrect treatment of investments as capital asset led to underassessment of income of Rs. 13.36 lakhs involving undercharge of tax of Rs. 8.96 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of bad debts/provision in case of banking companies

4.11.1 Under the Income Tax Act, 1961, as amended from 1 April 1989, the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing income chargeable to tax under the head `profits and gains of business or profession'. However, in the case of a bank to which provision for bad and doubtful debts is admissible, the amount of deduction shall be limited to the amount by which such debts or part thereof exceeds the credit balance in the `provision for bad and doubtful debts' account made under the Act. Further, with effect from the assessment year 1989-90, the assessing officer, while processing a

return of income under the summary assessment scheme, has to disallow any deduction claimed in the return which on the basis of information available in such return and accounts and documents accompanying it, is parima facie inadmissible. Any such disallowance attracts levy of additional tax also.

(i) In Maharashtra charge, the assessment of a banking company for the assessment year 1991-92 was completed in March 1994 after scrutiny. Audit scrutiny revealed that a claim for write off of bad debts amounting to Rs. 1648.16 lakhs being other foreign debts was disallowed by the assessing officer on the ground that the assessee had granted the credits liberally without proper evaluation of the securities against those credits and without taking proper measures to safeguard the interest of business. Hence it was concluded that the money lent could not be said to have been done in the ordinary course of business. It was further revealed that though bad debts were disallowed in respect of principal amount, no disallowance was made in respect of amounts of interest written off on such debts. On the same analogy, the interest element on such advance amounting to Rs. 517.40 lakhs which was claimed as a bad debt was also required to be disallowed. Omission to do so resulted in underassessment of income of Rs. 517.40 lakhs involving short levy of tax of Rs.409.37 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, the assessment of a public sector bank for the assessment year 1989-90 was completed in March 1992 under special provisions relating to companies. In computing the income of the assessee under the normal provisions of the Act, the assessing officer allowed a deduction of Rs. 751.74 lakhs towards bad and doubtful debts written off to provision account. Audit scrutiny revealed that a deduction of Rs. 320 lakhs was already allowed towards provision for bad and doubtful debts in the assessment for assessment year 1987-88 completed in March 1990. The deduction allowed in respect of bad debts, however, should have been limited to the amount by which the same exceeded the amount allowed towards provision for bad and doubtful debts. Omission to do so resulted in excess allowance of bad debts by Rs. 320 lakhs with an excess carry forward of loss by the like amount involving potential tax effect of Rs. 168 lakhs.

The Ministry have accepted the audit observation.

(iii) In West Bengal charge, the assessment of a non-resident banking company for the assessment year 1990-91 was originally completed in a summary manner in February 1990, interalia, allowing Rs.49.88 lakhs towards reserve for bad debts. Audit scrutiny revealed that a further amount of Rs.35.38 lakhs towards

provision/reserve for bad debts was also allowed in the assessment. Since the provision of Rs.35.38 lakhs exceeded the statutory limits and the information regarding the income, provision for bad debts was available in the return and its acompanying documents, the amount was prima facie inadmissible. Omission to disallow it led to underassessment of income of Rs.35.38 lakhs involving tax effect of Rs.38.18 lakhs (including additional income tax and interest).

The Ministry have accepted the audit observation.

4.11.2 Income Tax Act, 1961, as amended by the Finance Act 1986 with effect from 1 April 1987 provided that in respect of any provision for bad and doubtful debts made by a scheduled or non-scheduled bank, an amount not exceeding five per cent of its total income (computed before making any deduction under this provision and chapter VI A) and an amount not exceeding two per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, shall be allowed as deduction, while computing the business income of the assessee. `Rural branch' for this purpose has been defined as a branch of a scheduled or a non-scheduled bank situated in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

In Kerala charge, in the assessment of a widely held banking company for the assessment year 1990-91 completed after scrutiny in December 1991, the assessing officer allowed a deduction of Rs.129.81 lakhs towards provisions made in respect of bad and doutbful debts of rural branches of the bank. Audit scrutiny revealed that twelve of the branches for which the deduction was allowed were situated in places with a population exceeding ten thousand accoding to the last preceding census.As such the branches did not qualify as rural branches and therefore were not entitled to the deduction. The mistake resulted in underassessment of income of Rs.23.55 lakhs, and consequent undercharge of tax of Rs.12.72 lakhs.

The Ministry have accepted the audit observation.

Incorrect allowance of provision for gratuity

4.12.1 Under the Income Tax Act, 1961, no deduction shall be allowed in respect of any provision for gratuity to employees on retirement or on termination of employment for any reason unless it is by way of contribution towards an approved gratuity fund or for payment of gratuity that has become payable during the previous year. Further, with effect from the assessment year 1989-90 the assessing officer while processing the return of income under summary assessment scheme, has to disallow any deduction

claimed in the return, which on the basis of the information available in such returns and the documents accompanying is prima facie inadmissible. Any such disallowance attracts levy of additional tax also.

In Madhya Pradesh charge, the assessment of a public company, for the assessment years 1990-91, 1992-93 and 1993-94 were completed after scrutiny/in a summary manner between March 1993 and February 1994. Audit scrutiny revealed that the assessing officer allowed provisions aggregating Rs. 98.42 lakhs, made to re-imburse the deficit arising out of interest payment made by employees' provident fund trust to its members. As the liability of payment of interest was that of the fund and not of company, the same was required to be added back. Omission to do so resulted in underassessment of income, aggregating Rs. 98.42 lakhs involving short levy of tax of Rs. 77.99 lakhs for the three years (including interest and additional tax).

The reply of the Ministry to the audit observation has not been received.

4.12.2. Under the Income Tax Act, 1961, 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 in order that a loss be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur in future. Further, write back of provision not required is to be treated as income of the previous year in which so written back. Some important cases noticed during test check are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	WB I, Calcutta	1992-93 March 1994	143(1)(a)	Appropriation to contingency fund in the case of a company engaged in the generation and distribution of electricity amounting to Rs. 182.71 lakhs was erroneously allowed	94.55(P) 18.91
2	WB II, Calcutta	1991-92, 1992-93 March 1994 June 1993	143(3)	Provision of Rs. 126.48 lakhs for bad and doubtful debts and advances were erroneously allowed leading to overcomputation of loss	63.57(P) 9.70
3	WB III, Calcutta	1988-89 August 1989	143(1)(a)	Provision of Rs. 91.76 lakhs for future losses against slow moving items of closing stock was erroneously allowed	48.18(P)
4	WB VI, Calcutta	1991-92 March 1994	143(3)	Provision of Rs. 42.50 lakhs for anticipated shortfall in the realisation of insurance claims was	33.63

* CIT vs Indian Overseas bank (1985) - 151-ITR-446(Mad)

				erroneously allowed	
5	Uttar Pradesh, Kanpur	1990-91 March 1992	143(3)	Provisions for excess lease rent and interest liability under negotiation amounting to Rs. 32.54 lakhs were erroneously allowed	29.98
6	WB I, Calcutta	1991-92 December 1993	143(3)	Provision of Rs. 50 lakhs for anticipated liability on account of revision of pay scales which crystalised in the previous year relevant to assessment year 1992-93 was erroneously allowed	27.83
7	WB I, Calcutta	1991-92 December 1993	143(3)	Provision of Rs. 55.77 lakhs for likely losses by way of damaged and unserviceable raw materials and stores was erroneously allowed. Besides a totalling mistake of Rs. 21.81 lakhs led to net excess computation of loss by Rs. 33.96 lakhs in the aggregate.	15.62
8.	Central I, Calcutta	1991-92 February 1992	143(1)(a)	Provision of Rs.23.57 lakhs for premium payable on redemption on debenture at a future date was erroneously allowed	14.83
9	WB I Calcutta	1990-91 March 1993	143(3)	Provision of Rs. 10.90 lakhs payable towards premium on redemption of debentures at a future date erroneously allowed deduction	10.12

The Ministry have accepted the audit observations at Sl. No.1 to 4, 6 and 9. Their response to remaining cases has not been received.

Incorrect allowance of liability

4.13 Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment on types of expenditure specified under section 43 (B) of the Act. From 1 April 1988, tax or duty actually paid by the assessee on or before due date applicable in his case for furnishing the return of income shall also be allowed as deduction. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are also deductible on actual payment basis. No deduction in respect of contribution to the above funds is, however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds. It has been judicially held* that the amount of sales tax collected by a trader in the course of business constitutes his trading or business receipts and as such is liable to be included in his business income.

The Board in consultation with the Ministry of Law have clarified (September 1987) that in regard to cases where sales tax payable by

* Chowringhee Sales Bureau (P) Ltd. vs. CIT (1973) 87-ITR-542 (SC)

a registered dealer has been deferred under specific sales tax deferment scheme of a State Government and tax so deferred is deemed to have been paid in the year in which the liability thereof has arisen, the dealer would be entitled to claim, in the relevant assessment year, the amount of tax deemed to have been paid in the relevant previous year. To facilitate availing of this benefit by the dealers registered under the M.P. General Sales Tax Act, 1958 the Government of Madhya Pradesh introduced a new provision in Section 22 of M.P. General Sales Tax Act, 1958 vide Act 14 of 1988. According to this provision, a registered dealer liable to pay sales tax but `enjoying the benefit of deferment of this liability, would be deemed to have paid the tax equal to the amount for which agencies specified by the State Government have created, against a dealer, loan liability equal to the amount of his tax liability during the period of its eligibility under the tax deferment scheme.

(i) In Madhya Pradesh charge, the assessments of a company for the assessment years 1991-92 and 1992-93 were completed after scrutiny in February 1994 allowing deduction towards the deferred sales tax liability of the assessee company to the extent of Rs. 141.60 lakhs and Rs. 283.59 lakhs respectively, on the ground that the assessee company had produced a certificate from the State Government indicating that the company was eligible to avail of the facility of sales tax deferment. Audit scrutiny, however, revealed that the payment of sales tax, stated to have been deferred, could not be claimed as a deduction under the provisions because no evidence had been produced during assessment to indicate that a corresponding loan liability had been created by any of the agencies specified by the State Government for this purpose. As such the deduction allowed for the two years was irregular. The irregular deduction resulted in underassessment of income aggregating Rs. 311.75 lakhs involving potential tax effect of Rs. 65.13 lakhs and short levy of tax of Rs. 128.56 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In West Bengal charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in November 1993. Audit scrutiny of the Tax Audit Report and accounts accompanying the return revealed that Rs.383.36 lakhs representing interest payable to a public Financial Institution were not paid within the relevant previous year or within the due date of submission of return. Omission to disallow this unpaid interest liability resulted in excess computation and carry forward of loss by an identical amount involving potential tax effect of Rs.176.34 lakhs.

The Ministry have accepted the audit observation.

(iii) In West Bengal charge, the assessment of a closely held company for the assessment year 1989-90 was completed in February 1992 after scrutiny. Audit scrutiny of the Tax Audit Report of the company's auditor accompanying the return revealed that Rs.109.93 lakhs debited to the profit and loss account on account of contribution to provident fund, pension fund, Employees State Insurance etc., was not paid before the due date of filing the return of income. The amount was, therefore, required to be disallowed. Omission to do so resulted in excess carry forward of loss by Rs.109.93 lakhs involving potential tax effect of Rs.63.48 lakhs.

The Ministry have accepted the audit observation.

(iv) Some other important cases are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistakes	Tax effect (Rs. in lakhs)
1	City I, Bombay	1990-91 February 1993	143(3)	Interest of Rs. 78.08 payable to financial institutions though not actually paid was erroneously allowed deduction	42.16
2	Tamil Nadu, Coimbatore	1991-92 March 1994	143(3)	Premium on redemption of debentures amounting to Rs. 18.68 lakhs which was payable in assessment year 1992-93 as the debentures were redeemable in October 1991, was erroneously allowed in assessment year 1991-92	14.77
3	Uttar Pradesh Meerut	1990-91 January 1991	143(1)(a)	Sales tax of Rs. 2.65 lakhs and interest of Rs. 19.72 lakhs payable to public financial institutions was erroneously allowed deduction though not actually paid	14.70
4	WB-IV, Calcutta	1990-91 March 1993	143(3)	In the absence of evidence of actual payment of tax /duty etc. amounting to Rs. 23.03 lakhs allowance was erroneously made	12.44
5	City II, Bombay	1991-92 February 1994	143(3)	Unpaid bonus of Rs. 25.68 lakhs for which liability was incurred in the subsequent assessment year was erroneously allowed as deduction.	11.81
6	WB-III, Calcutta	1990-91 March 1993	143(3)	Unpaid commission and incentives to employees amounting to Rs.10.47 lakhs was not disallowed	11.67
7	Tamil Nadu II, Madras	1989-90 March 1990	143(1)(a)	Contribution towards provident fund amounting to Rs. 12.65 lakhs paid after stipulated due date was erroneously allowed deduction	10.98
8	Kerala, Kochi	1989-90 January 1990	143(1)(a)	Unpaid interest to financial institution amounting to Rs. 98.17 lakhs erroneously allowed	10.31

The Ministry have accepted the audit observations.

Incorrect allowance of deduction in respect of deposit under tea development account

4.14 Where an assessee carrying on business of growing and manufacturing tea in India has, before the expiry of six months from the end of the previous year or before furnishing the return of his income, whichever is earlier, deposited with a nationalised bank any amount or amounts in an account maintained by the assessee with that bank for the specified purposes approved by the Tea Board, the assessee shall, subject to other provisions of the Act be allowed a deduction of a sum equal to the amount or the aggregate of the amounts so deposited or a sum equal to twenty percent of the profits of such business (computed under the head `profits and gains of business or profession' before making any deduction under this section), whichever is less. As such the income which is attributable to the business of manufacturing of tea from tea leaves purchased from outside is not eligible.

In West Bengal charge, the assessment of a closely held company engaged in the business of growing and manufacturing of tea for the assessment year 1991-92 was completed after scrutiny in March 1994 allowing a deduction of Rs.42.68 lakhs on account of deposit under tea development account. Audit scrutiny revealed that since the deduction was to be computed on the income attributable to the busines of manufacturing of tea from the tea leaves grown by the assessee himself and not on income attributable to the manufacturing of tea from tea leaves purchased from outside, it was wrongly computed by not segregating the composite income into income derived from growing and manufacturing tea and manufacturing tea from tea leaves purchased from outside. The mistake resulted in irregular allowance of deduction of Rs. 42.68 lakhs as against Rs. 27.72 lakhs allowable leading to underassessment of income by Rs. 14.88 lakhs involving short levy of tax of Rs. 13.24 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of expenditure on know-how

4.15 Under the Income Tax Act, 1961, with effect from April 1986, where an assessee had paid, in any previous year, any lump sum consideration for acquiring know-how for the purpose of his business, one-sixth of the amount so paid shall be deducted in computing the business income for that year and the balance amount shall be deducted in equal instalments in each of the five immediately succeeding years. In view of the specific provision, the expenditure on technical know-how would not qualify for depreciation, investment allowance etc.

Two illustrative cases with large revenue implication noticed in audit are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	City I, Bombay	1991-92 December 1993	143(3)	Expenditure of Rs. 77.02 lakhs was erroneously allowed deduction instead of the correct amount of Rs. 12.84 lakhs being one sixth thereof	33.22
2	WB V, Calcutta	1991-92 March 1994	143(3)	Instead of the correct amount of Rs. 4.97 lakhs, being one sixth of the technical know-how fees of Rs. 29.84 lakhs the entire expenditure was erroneously allowed	19.42

The Ministry have accepted the audit observations.

Other mistakes in the computation of business income

4.16.1. Prior period expenses

Under the Income Tax Act, 1961, income under the head "Profits and gains of business or profession" shall be computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting, the annual profits are worked out on due basis i.e., after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have accrued regardless of their actual receipt or payment.

In West Bengal charge, the assessment of a widely held company, for the assessment year 1989-90, was completed after scrutiny in March 1992. Audit scrutiny revealed that an amount of Rs. 16.16 lakhs being net of expenditure/ income pertaining to the earlier years not relevant to the assessment year 1989-90 was debited to the profit and loss account of the relevant previous year. As the assessee had been following mercantile system of accounting, expenditure should have been disallowed and added back. Omission to do so resulted in underassessment of income by Rs. 16.16 lakhs involving short levy of tax by Rs. 14.59 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.2 Payments outside India

Under the Income Tax Act, 1961, where in any financial year the assessee has paid any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted, such amounts (payable outside India) shall not be deducted in computing the income chargeable under the head `profits and gains of business or profession'.

In West Bengal charge, the assessment of a widely held company

for the assessment year 1991-92 was completed in March 1994 after scrutiny. Audit scrutiny revealed that the assessing officer incorrectly allowed a deduction of Rs. 30.83 lakhs towards payment of royalty outside India though no tax at source was deducted therefrom. Failure to disallow the payment resulted in underassessment of income by Rs.30.83 lakhs involving undercharge of tax of Rs. 24.39 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.3 Receipt not brought to tax

Under the Income Tax Act, 1961, any deduction of tax made at source and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made and credit shall be given for such tax on the production of the certificate furnished under the Act in the assessment for the assessment year for which such income is assessable.

In West Bengal charge, the assessment of a closely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee was allowed credit for tax of Rs. 4.28 lakhs deducted at source from payment of different bills aggregating Rs. 186.10 lakhs drawn by the assessee company in respect of consultation fees for certain contract works. However, out of the total receipt of Rs.186.10 lakhs on which tax had been deducted and credit claimed, only Rs.18.61 lakhs was offered for tax and balance treated as an 'advance'. Since credit for tax was allowed for the entire amount which was also received against regular bills, the entire amount should have been brought to tax in the same assessment year i.e. 1991-92. Omission to do so resulted in underassessment of income of Rs.167.49 lakhs involving undercharge of tax by Rs.150.82 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.4 Mistakes in computation

While computing the income of an assessee, the assessing oficer normally takes the net profit in the profit and loss account as the starting point and then makes necessary adjustments by way of additions or deletions in accordance with the provisions of the Act to arrive at the total income.

In West Bengal charge, the assessment of a closely held company for the assessment year 1989-90 was completed in March 1992 after scrutiny computing loss of Rs. 17.26 lakhs. Audit scrutiny

revealed that the assessing officer proceeded with the net loss of Rs.89.29 lakhs instead of taking the correct amount of loss of Rs.53.54 lakhs after adjustment of an amount shown by the assessee in its profit and losss appropriation account as concealed income relating to assessment years 1984-85 and 1985-86. The omission resulted in underassessment of income by Rs. 18.49 lakhs involving undercharge of tax by Rs.20.03 lakhs (including interest) and excess carry forward of loss by Rs.17.26 lakhs with potential tax effect of Rs.10.87 lakhs.

The Ministry have accepted the audit observation.

4.16.5 Incorrect allowance of preliminary expenses

Under the Income Tax Act, 1961, the admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with the extension of an industrial undertaking is limited to 2.5 percent of cost of the project or capital employed at the option of the assessee and is allowed in equal instalments spread over ten years.

(i) In Tamil Nadu charge, in the assessment of a widely held company, for the assessment year .1991-92 completed in March 1994 after scrutiny, the assessing officer allowed a deduction of Rs. 159.94 lakhs at one-tenth of the preliminary expenses incurred towards setting up of a new sponge iron plant and debenture issue expenses. Audit scrutiny revealed that the cost of the project was Rs.312.50 crores which was more than the capital employed in this case. Hence the preliminary expenses should have been restricted to Rs. 7.81 crores, being 2.5 percent of the cost of the project, and a deduction of Rs. 78.10 lakhs only, being one-tenth of Rs. 7.81 crores should have been allowed instead of Rs. 159.94 lakhs allowed. The mistake resulted in excess carry forward of loss by Rs.81.84 lakhs involving potential tax effect of Rs.37.65 lakhs.

The Ministry have accepted the audit observation.

(ii) In Mahrashtra charge, the assessment of a company engaged in the business of long term housing finance for assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that an expenditure of Rs.186.81 lakhs incurred for public and rights issue of shares was treated as capital expenditure. However, the assessing officer allowed one-tenth of these expenses and the balance was added back to income. Since the expenditure incurred by the assessee was not before the commencement of business (it had commenced much earlier), the company was neither an industrial undertaking nor had it set up a new industrial unit, the said provisions of the Act were not attracted. Consequently the allowance of Rs.18.68 lakhs was not in

order. The mistake resulted in underassessment of income by an identical amount involving short levy of tax of Rs.14.78 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

4.16.6 Incorrect allowance of entertainment expenditure

Under the Income Tax Act, 1961, admissibility of entertainment expenditure is based on a graded percentage of profit earned by an assessee during the previous year relevant to the assessment year.

In West Bengal charge, the assessment of a widely held company for the assessment year 1991-92 was completed in March 1994 after scrutiny. The assessing officer added an amount of entertainment expenditure of Rs. 1.55 lakhs for separate consideration. Audit scrutiny, however, revealed that the assessing officer had allowed a deduction of Rs. 50 lakhs on account of entertainment expenditure instead of restricting it to the permissible amount of Rs. 50,000. The mistake resulted in underassessment of income by Rs. 49.50 lakhs involving short levy of tax by Rs. 39.16 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.7 Tax paid on profits

Under the Income Tax Act, 1961, any sum paid on account of rate or tax levied on the profits or gains of any business or profession, shall not be allowed as deduction in computing the business income.

In West Bengal charge, the assessment of a foreign banking company for the assessment year 1991-92 was completed in March 1994 after scrutiny . Audit scrutiny revealed that out of an amount of Rs.1429.49 lakhs being provision for taxes and reserves for taxes, only an amount of Rs.1303.57 lakhs being tax deducted at source and reserve for taxes was added back by the assessing officer. As provison for tax is inadmissible under the Act, the balance amount of Rs.125.92 lakhs should also have been disallowed in the assessment. Omission to do so resulted in underassessment of income by Rs.125.92 lakhs involving undercharge of tax by Rs.81.85 lakhs.

The Ministry have accepted the audit observation.

4.16.8 Suppression of sales

Under the Income Tax Act, 1961, all income accruing or arising to an assessee in a previous year relevant to the assessment year is includible in his total income.

In West Bengal charge, the assessment of a closely held company for the assessment year 1991-92 was completed in March 1994 after scrutiny. Audit scrutiny revealed that the assessee company had shown sales (including sales tax) amounting to Rs.293.60 lakhs in its profit and loss account whereas the statement of sales furnished by the assessee revealed that sales over Rs.10,000 alone, during the relevant previous year, amounted to Rs.313.77 lakhs (including sales tax). This resulted in understatement of sales by Rs.20.17 lakhs (excluding transactions of sales below Rs.10,000) involving undercharge of tax of Rs.17.96 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.9 Expenditure on guest house and irregular allowance of liability

Under the Income Tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee on maintenance of any residential accommodation in the nature of guest house. The Act further provides that any accommodation by whatever name called, maintained, hired, reserved or otherwise arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person on tour or visit to the place at which such accommodation is situated, is accommodation in the nature of guest house. Further, a deduction otherwise allowable under the Act in respect of any sum payable by the assessee by way of tax or duty under law for the time being in force shall be allowed in computing the business income of that previous year in which such sum is actually paid by him and not merely on the basis of accrual of the liability.

In Assam charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that an expenditure of Rs. 14.95 lakhs paid to clubs for accommodation for visiting officers which was depicted in the audit report as guest house expenses were not disallowed by the assessing officer. Further, royalty of Rs. 97.82 lakhs in respect of value of stock in pipe which was debited in accounts was not paid and should have been disallowed. The mistakes resulted in underassessment of income aggregating Rs. 112.77 lakhs involving undercharge of tax of Rs. 89.22 lakhs (including interest).

The Ministry have not accepted the audit observation on the grounds that expenses in connection with the maintenance of accommodation for visiting officers incurred in mining lease area were allowable under section 42 of Income Tax Act and the unpaid royalty did not represent any statutory liability but was only a gain to crude oil producers in consequence of enhanced prices of crude oil. This view is not tenable as the audit observation relates to non-disallowance of inadmissible expenditure for accommodation of visiting officers in a club which is covered by provision of section 37 (4) read with clause (5) and not under section 42 of the Act. Further, it has been judicially held* that the royalty on crude oil is a statutory liability in the nature of tax inasmuch as its payment is governed by a notification issued by the Central Government under the Oilfield (Regulation and Development) Act, 1948. This view also finds sustenance in the Board's circular 550 of January 1990 specifying that the objective behind these provisions was to provide a tax disincentive by denying deduction in respect of a "statutory liability" which is not paid in time.

4.16.10 Fine in lieu of confiscation of goods

Under the Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of the business is an allowable deduction in computing the income chargeable under the head `profits and gains of business or profession'. It has been judicially held** that infraction of law is not a normal incident of business and, therefore, no expense which is paid by way of penalty for breach of law can be said to be an amount wholly and exclusively laid out for the purpose of business and hence not an allowable expenditure.

In Maharashtra charge, assessment of a company for the assessment year 1988-89 originally completed after scrutiny in March 1991 was revised in March 1994. Audit scrutiny revealed that the assessing officer had allowed a deduction of Rs. 154 lakhs on account of payment of fine paid to Customs Department in lieu of confiscation of goods as the assessee had imported crude oil against the additional import licence of diamond export. Since penalty paid in lieu of confiscation of goods is not an allowable deduction, the same should have been disallowed. Omission to do so resulted in underassessment of income of Rs. 75.93 lakhs and excess carryforward of loss of Rs. 78.07 lakhs involving undercharge of tax of Rs. 80.85 lakhs (including potential tax effect of Rs. 40.99 lakhs).

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* Laddu Mal and others vs. The State of Bihar AIR 1965-parterner 491 (V-52 C.138)

** Cineramas vs CIT 110-ITR-762 (Punjab and Haryana)

The Ministry have accepted the audit observation.

4.16.11 Incorrect valuation of closing stock

It has been judicially held* that any system of accounting which excludes, for the valuation of stock in trade, all costs other than the cost of raw materials is likely to result in a distorted picture of the true state of business, for the purpose of computing its chargeable income. The Board clarified in 1981 that the central excise/customs duties, if any, payable by the manufacturer/trader should go into calculation of production cost and the closing inventory should include an element of such duty to represent such cost.

(i) In Gujarat charge, the assessment of a company for the assessment year 1989-90 was completed in March 1992 after scrutiny. Audit scrutiny revealed that the assessee had changed its method of valuation of goods in transit, closing stock of raw-materials, work in progress and closing stock of finished goods by excluding customs/excise duty paid/payable during the previous year relevant to assessment year 1989-90. The irregular method of valuation resulted in undervaluation of stock by Rs. 176.83 lakhs with consequent underassessment of income to the same extent and short levy of tax of Rs. 175.64 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal charge, the assessments of two companies, one closely held and the other widely held for the assessment year 1991-92, were completed after scrutiny in March and April 1994 respectively. Audit scrutiny revealed that excise duty of Rs. 49.81 lakhs and Rs. 25.59 lakhs payable on stocks held in the bonded warehouse had not been included in the value of closing stocks. This excise duty payable should have been debited to profit and loss account on accrual basis. As excise duty was deductible on actual payment basis, the said amounts not paid to government account should have been added to arrive at the total income of the assessees. Omission to do so resulted in underassessment of income by identical amounts involving undercharge of tax of Rs. 44.34 lakhs and Rs. 20.25 lakhs (including interest) respectively.

The audit observation has not been accepted by the Ministry on the ground that excise duty is leviable when goods leave the factory/warehouse and since in the present case goods had not left the factory, excise duty had neither been levied nor had it accrued. This view is not tenable in view of the decision of the Supreme

* CIT vs British Paints India Ltd. 188-ITR-44 (SC)

Court* that excise duty is a levy on manufacture and the liability arises at the time of manufacture though the collection may be deferred to a later stage as a measure of convenience or expediency. Further, according to accounting practices as enunciated by the Institute of Chartered Accountants of India, excise duty is a manufacturing expense and is an element of cost for inventory valuation. This has also been reiterated by the Board in its instruction no. 1389 of March 1981. Accordingly, the excise duty payable on finished goods included in the closing stock should have been provided and included in manufacturing expenses. While computing income for income tax purposes, this amount should have been disallowed in terms of provisions of section 43 B of the Act.

4.16.12 Arbitration award liabilities recoverable from third parties

Under the Income Tax Act, 1961, income under the head `profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting, the annual profits are worked out on due basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment.

In West Bengal charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that during the previous year relevant to the assessment year 1991-92, the assessee company accounted for a liability of Rs. 23.06 lakhs including legal charges and interest payable to foreign suppliers in terms of a final arbitration award which was to be recovered from different consumers on whose behalf this expenditure was incurred. The amount recoverable was, however, not credited to profit and loss account pending acceptance by such consumers. This resulted in underassessment of income by Rs. 23.06 lakhs involving undercharge of tax by Rs. 10.61 lakhs and consequential excess refund of tax by an identical amount and excess payment of interest by Rs. 1.17 lakhs.

The reply of the Ministry to the audit observation has not been received.

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* Mc Dowell and Co. Ltd. vs CTT 154 ITR 148
Union of India vs Bombay Tyre International Ltd. (1983) 15 Taxman 29

4.16.13 Incorrect computation of income of an insurance company

Under the Income Tax Act, 1961, any amount either written off or reserved in the accounts to meet depreciation or loss on the realisation of investments was allowed as deduction upto 31 March 1989. With the deletion of this proviso with effect from 1 April 1989 no such deduction is admissible

In Delhi charge, the assessment of an insurance company for the assessment year 1989-90 was completed after scrutiny in November 1991. Audit scrutiny revealed that a deduction of Rs.97.39 lakhs claimed by the assessee on account of amount written off due to depreciation in market value of the investment was allowed by the assessing officer, which was irregular. The mistake resulted in underassessment of income of an identical amount involving undercharge of tax of Rs.65.70 lakhs (including interest).

The Ministry have accepted the audit observation.

4.16.14 Incorrect computation of income of the financial corporation

Under the Income Tax Act, 1961, financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to a special deduction of an amount transferred by them out of their profits to a special reserve account, upto an amount not exceeding 40 percent of their total income as computed before making any deduction under Chapter VI A of the Act.

In Madhya Pradesh charge, the assessment of a State financial Corporation for the assessment year 1989-90, was completed on best judgement basis in February 1992 and revised in May 1992. Audit scrutiny revealed that the assessee was allowed a special deduction of Rs. 214.50 lakhs based on 40 percent of the total income. However, while computing the total income, on which the special deduction was to be based, the assessing officer omitted to deduct statutory deduction of Rs. 99.99 lakhs from long term capital gains included in the total income and to calculate the special deduction on the balance amount. Since this mistake was apparent from record, it constituted a prima-facie adjustment and additional tax was also leviable. The mistake led to excess deduction of Rs. 40.03 lakhs involving short levy of tax of Rs. 25.22 lakhs (including additional tax).

The reply of the Ministry to the audit observation has not been received.

4.17

Mistake in allowance of depreciation

4.17.1 Allowance of ineligible claims

Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purposes of his business during the relevant previous year. The Direct Tax Laws (Amendment) Act, 1987, provided for certain special provisions for the computation of total income of the transitional previous year relevant to the assessment year 1989-90, which may in certain circumstances exceed twelve months. It provided, inter alia, for the allowance of increased depreciation in respect of income of more than one period included in the transitional previous year under the head `profits and gains of business or profession'. The depreciation allowance shall be calculated separately for each such period and increased, where necessary, by multiplying it by a fraction of which the numerator is the number of months in such period and the denominator is 12. The intention was to remove hardships faced by tax payers for compulsory changeover of the previous year and accordingly, assets in use for 13 months or more in the relevant previous year would get the benefit of proportionately higher depreciation and where these are used for less than 13 months, the benefit would be restricted to 12 months only.

(i) In West Bengal charge, the assessment of a widely held company for the assessment year 1990-91 was completed after scrutiny in March 1993 at a loss of Rs. 14550.36 lakhs which was allowed to be carried forward for set off against future profits. Audit scrutiny revealed that the depreciation of Rs. 5589.04 lakhs allowed by the assessing officer was not correctly computed with reference to the net value of the assets as shown in the `Depreciation Schedule' for income tax purpose. The correct amount of depreciation worked out to Rs. 3845.81 lakhs. The mistake resulted in excess allowance of depreciation by Rs. 1743.23 lakhs leading to excess carry forward of loss by an identical amount involving potential tax effect of Rs. 871.61 lakhs.

The Ministry have accepted the audit observation.

(ii) In West Bengal charge, assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that total amount of depreciation of Rs. 9165.65 lakhs allowed by the assessing officer included depreciation of Rs. 699.11 lakhs calculated on development expenses which was not an asset eligible for depreciation. The amount should, therefore, have been disallowed by the assessing officer. Omission to do so resulted in underassessment of income by Rs. 699.11 lakhs leading to excess

carry forward of loss by an identical amount involving potential tax effect of Rs. 321.59 lakhs.

The Ministry have accepted the audit observation.

4.17.2 Depreciation on assets not used

No depreciation is allowable on assets not at all used in the business of the assessee during the previous year.

In Assam charge, the assessment of a widely held transport company for the assessment year 1991-92 was completed after scrutiny in March 1994, allowing depreciation of Rs. 54.98 lakhs in respect of trucks, trailers and tractors. Audit scrutiny revealed that an imported trailer of the company met with an accident in March 1990 for which the company was awaiting compensation from the insurance company. As the trailor was not used in the business, its written down value of Rs. 125.91 lakhs was required to be reduced from block of assets in computing allowable depreciation. The omission resulted in excess allowance of depreciation of Rs. 31.47 lakhs (being 75 percent of Rs. 41.97 lakhs) with consequential short levy of tax of Rs. 28.02 lakhs (including interest).

The Ministry have accepted the audit observation.

4.17.3 Non furnishing of particulars

Under the Income Tax Act, 1961, an assessee is required to furnish the specified particulars of the assets for purposes of claims of depreciation. It has been judicially held* that where the required particulars have not been furnished, the deduction is not to be allowed.

In Punjab charge, the assessment of a company for the assessment year 1986-87 was completed after scrutiny in October 1988 allowing depreciation of Rs. 16,121.83 lakhs. Audit scrutiny revealed that the deduction included depreciation of Rs. 7298.45 lakhs for which details of actual cost or written down value of assets and the rate at which depreciation was worked out were not furnished. The deduction in the absence of such details was not admissible. The mistake resulted in excess computation of loss by a like amount involving potential tax effect of Rs.3831.68 lakhs.

The Ministry have accepted the audit observation.

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*Beco Engg Co. Ltd. vs CIT (1984) 148-ITR-478

4.17.4 Mistakes in computation of written down value

Under the Income Tax Act, 1961, the written down value of any block of assets in respect of any previous year relevant to the assessment year commencing on or after the first day of April 1989 is the written down value of that block of assets at the beginning of the previous year as increased by the actual cost of any asset falling within that block acquired during the previous year and as reduced by the moneys payable in respect of any asset falling within that block which is sold or discarded or destroyed during the previous year.

(i) In West Bengal charge, the assessments of a widely held company for the assessment years 1990-91 and 1991-92 were completed after scrutiny in March 1993 and March 1994 respectively. Audit scrutiny revealed that in both the years depreciation was allowed on the written down value of the block of assets in respect of building/plant and machinery by reducing them by the written down value of the asset sold instead of by actual sale proceeds. The mistake in adjustment of written down value resulted in excess grant of depreciation of Rs.39.78 lakhs in assessment year 1990-91 and Rs.20.68 lakhs in assessment year 1991-92 with consequent excess carry forward of unabsorbed depreciation to that extent involving aggregate potential tax effect of Rs.30.99 lakhs.

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, the assessment of a widely held company for the assessment year 1991-92 was completed in March 1994 after scrutiny allowing deduction on account of depreciation of Rs. 932.88 lakhs. Audit scrutiny revealed that the written down value in respect of buildings, plant, machinery and furniture as on 31 March 1990 was not adopted as the opening written down value as on 1 April 1990. The incorrect adoption of written down value resulted in excess allowance of depreciation of Rs. 46.55 lakhs with consequent undercharge of tax of Rs. 21.41 lakhs.

The Ministry have accepted the audit observation.

4.17.5 Non-restriction of depreciation allowance

Taxation Laws (Amendment) Act 1991 provided that for the assessment year 1991-92, depreciation allowance on any block of assets in the case of companies was to be restricted to seventy five percent of the amount calculated at the prescribed percentage of the normal allowance.

(i) In Maharashtra charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994, computing the loss at Rs. 277.64 lakhs after inter alia allowing depreciation of Rs. 275.95 lakhs. Audit scrutiny revealed that while computing depreciation, the written down value of the assets was incorrectly carried forward from the assessment year 1990-91. It was further revealed that the depreciation was not restricted to 75 percent of the amount calculated at the prescribed percentage. The mistakes resulted in excess allowance of depreciation and excess computation of loss of Rs. 135.66 lakhs involving potential short levy of tax of Rs. 70.20 lakhs.

The Ministry have accepted the audit observation.

(ii) In case of 2 other companies in Gujarat and Maharashtra charges, failure to restrict the normal depreciation to 75 percent of the amounts calculated at prescribed rates in the assessments for assessment year 1991-92 completed in scrutiny manner in March 1994 led to overassessment of loss/underassessment of income by Rs. 48.85 lakhs involving tax effect of Rs. 23.60 lakhs (including potential tax effect of Rs. 10.18 lakhs)

The Ministry have accepted the audit observation in one case. Their response in the other case has not been received.

4.17.6 Application of incorrect rate of depreciation

Under Income Tax Rules, 1962, different rates of depreciation have been prescribed for specified block of assets. Where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof is allowed as a deduction in respect of the previous year in which such plant and machinery is first put to use.

Some important cases in which depreciation was allowed at higher rate than admissible are given below:

Sl.No	Commissioners' charges	Assessment. year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	Karnataka II, Bangalore	1991-92 & 1992-93 October/November 1993	143(3)	Depreciation at 100 percent on the replacement cost of ring frames amounting to Rs. 57.51 lakhs treating each frame as separate unit instead of one unit led to excess allowance of depreciation of Rs. 43.13 lakhs	25.24
2	Delhi I	1990-91 & 1991-92 November 1991/ June 1993	143(3)	Depreciation on motor trucks was erroneously allowed at 50 percent as if used in the business of running them on hire instead of the correct rate of 33.33 percent leading to excess allowance of	14.05

				depreciation of Rs. 23.21 lakhs	
3	Madhya Pradesh, Bhopal	1988-89 December 1993	143(3)	Depreciation on vehicles not used in the business of running on hire was erroneously allowed at 50 percent instead of the correct rate of 33.33 percent leading to excess depreciation of Rs. 15.29 lakhs	11.44

The Ministry have accepted the audit observation at Sl. No. 1 and 3. Their response in the remaining case has not been received.

4.17.7 Mistakes in set off of depreciation

Under the Income Tax Act, 1961, where for any assessment year, unabsorbed depreciation under the head `profits and gains of business or profession' cannot be set off or is not wholly set off against any other income of the relevant year, such unabsorbed depreciation shall be carried forward to the following year and is set off against the profits or gains of any business or profession. For assessment year 1992-93, in computing the profits and gains of business of a domestic company, where effect is to be given to unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before the first day of April 1991, the deduction shall be restricted to two-thirds of such allowance or allowances. The Board in their instruction of July 1976 have prescribed that in case where allowance like depreciation allowance, investment allowance, development allowance etc. are to be deducted from profits, and such profits are insufficient to absorb all of them; current depreciation would be deducted first and current investment allowance last. There are also judicial rulings* that current depreciation has to be deducted first. By the same analogy, deduction under section 35E (which is to be carried forward for only 10 years) should be deducted only after deducting current depreciation.

(i) In Madhya Pradesh charge, the assessment of a company for the assessment year 1988-89 was originally completed in December 1989 after scrutiny and revised in December 1992. Audit scrutiny revealed that the order of priority for deduction was not followed in which the deduction towards depreciation was to be allowed first. The deduction of Rs. 333.27 lakhs for expenditure on prospecting etc. for certain minerals was allowed first followed by a portion of allowable amount of current depreciation. The carry forward of depreciation of Rs. 6865.98 lakhs was thus in excess by Rs. 333.27 lakhs. This resulted in potential tax effect of Rs. 174.97 lakhs.

The Ministry have accepted the audit observation.

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* Mysore Paper Mills Ltd. vs CIT (1979) 117-ITR-132 (Karn) and CIT vs Coromandel Steels Ltd. (1981) 130-ITR-856 (Mad)

(ii) Some other important cases are given below:

Sl.No	Commissioners' charges	Assessment. year and date	Section under which assessed	Nature of mistakes	Tax effect (Rs. in lakhs)
1.	City V, Bombay	1990-91, 1991-92, 1992-93 Between March 1993 and March 1994	143(3)	Against the correct amount of Rs. 179.23 lakhs of unabsorbed depreciation an amount of Rs. 306.45 was erroneously set off	65.84(P)
2	Delhi I	1992-93 March 1993	143(1)(a)	Against the correct amount of Rs. 56.65 lakhs an amount of Rs. 103.69 lakhs on account of unabsorbed business loss, depreciation and investment allowance was erroneously allowed	14.99 11.18(P)
3	WB V, Calcutta	1992-93 March 1994	143(3)	Failure to restrict unabsorbed depreciation to two third of the amount of Rs. 79.98 lakhs led to excess set off of Rs. 26.66 lakhs	13.80
4	WB IV, Calcutta	1992-93 December 1993	143(1)(a)	Failue to restrict the unabsorbed depreciation to two third of the amount of Rs. 50 lakhs led to excess set off of Rs. 16.67 lakhs	10.35

The Ministry have accepted the audit observations.

4.17.8 Under the Income Tax Act 1961, with effect from the assessment year 1988-89, where the total income of a company as computed under the normal provision of the Act in respect of any previous year is less than 30 percent of its book profits, total income shall be deemed to be the amount equal to 30 percent of such book profits. Nothing contained in this section shall, however, affect the determination of the amounts of unabsorbed depreciation, investment allowance, business loss etc. in relation to the relevant previous year to be carried forward to the subsequent year or years under the normal provisions of the Inocme Tax Act.

In Maharashtra charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994, allowing set off of unabsorbed depreciation and unabsorbed investment allowance aggregating Rs.419.37 lakhs brought forward from assessment year 1990-91. Audit scrutiny revealed that since in the assessment year 1990-91, the income was computed under the special provisions of the Act, the unabsorbed depreciation and investment allowance to be carried forward was to be determined with reference to income computed under normal provisions of the Act. It was further revealed that the assessing officer had calculated the amounts to be carried forward after deducting the amount taxable under the special provisions of the Act from the income computed under normal provisions. The mistake resulted in excess set off of unabsorbed depreciation and unabsorbed investment allowance of Rs.194.73 lakhs in assessment year 1991-92 leading

to short levy of tax of Rs.89.58 lakhs.

The Ministry have accepted the audit observation.

Incorrect allowance of investment allowance

4.18.1 Under the Income Tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction by way of investment allowance, shall be allowed in the previous year of installation or in the previous year of first usage, of a sum equal to 20 percent of the actual cost of machinery. The Act further provides that no investment allowance is admissible on road transport vehicles. It has been judicially held* that `dumpers' are road transport vehicles.

(i) In Delhi charge, the assessment of a company for the assessment year 1989-90 initially completed in a summary manner in February 1990 was subsequently completed after scrutiny in May 1991, allowing investment allowance of Rs. 384.69 lakhs. Audit scrutiny revealed that the assessee company purchased plant and machinery for Rs. 968.88 lakhs during the transitional previous year relevant to assessment year 1989-90, on which investment allowance of Rs. 193.78 lakhs was admissible at the rate of 20 percent of value of plant and machinery instead of Rs. 384.69 lakhs erroneously allowed by the department. The mistake resulted in excess allowance of investment allowance of Rs. 190.91 lakhs involving underassessment of income of Rs. 139.17 lakhs with consequent short levy of tax of Rs. 73.07 lakhs.

The Ministry have not accepted the audit observation stating that for assessment year 1989-90 the applicable rate is 25 percent and for assessment year 1988-89 the deduction has been allowed as per the provision to section 32 (A) (8B) (a). This view is not tenable as according to the amended provision of the Act, the applicable rate was 20 percent for and from assessment year 1989-90. The reply for assesssment year 1988-89 is not relevant to the audit observation which is based on the assessment year 1989-90.

(ii) In Uttar Pradesh charge, the assessment of a widely held company for the assessment year 1987-88 was completed after scrutiny in April 1993 allowing investment allowance of Rs. 67.45 lakhs. Audit scrutiny revealed that the plant and machinery in respect of which investment allowance was allowed included `dumpers' also. The mistake in allowing investment allowance for these road transport vehicles resulted in excess carry forward of investment allowance of Rs. 46.10 lakhs upto the assessment year 1991-92 and its irregular adjustment against the income for the assessment years 1991-92 to 1993-94 involved non/short levy of tax of Rs. 30.37 lakhs (including interest).

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* Shiva Construction Co. vs CIT 165-ITR-160 (Guj)

The Ministry have accepted the audit observation.

4.18.2 It has been judicially held** that a company engaged in the construction of dams and canals is not entitled to the allowance of investment allowance.

In Maharashtra charge, the assessment of a private limited company for the assessment year 1985-86 was finalised after scrutiny in January 1993 determining a total income of Rs. 8.70 lakhs after setting off unabsorbed investment allowance of Rs. 20.31 lakhs. The balance amount of Rs. 5.05 lakhs of unabsorbed investment allowance and Rs.20.68 lakhs of current investment allowance were allowed to be carried forward. Audit scrutiny revealed that the assessee company was engaged in the construction of dams, bridges, buildings, road, canals etc. and hence was not entitled to investment allowance. In view of the judicial decision the assessment should have been revised and investment allowance withdrawn. Failure to do so resulted in underassessment of income of Rs. 20.31 lakhs, involving short levy of tax of Rs. 12.80 lakhs and potential tax of Rs. 16.21 lakhs on the incorrect carry forward of investment allowance.

The reply of the Ministry to the audit observation has not been received.

4.18.3 Under the Income Tax Act, 1961, the grant of investment allowance is subject to the condition that an amount equal to seventy five percent of the sum so allowed is debited to the profit and loss account of the relevant previous year and credited to reserve account.

In Karnataka charge, the assessment of a closely held company for the assessment year 1991-92 was completed by the assessing officer to the best of his judgment in February 1994 at an income of Rs.2.65 lakhs after setting off unabsorbed investment allowance of Rs.37.64 lakhs. Audit scrutiny revealed that the assessee had created investment allowance reserve of Rs.6.69 lakhs only,entitling him for investment allowance of Rs.8.92 lakhs. The incorrect set off of investment allowance of Rs.37.64 lakhs as against the admissible amount of Rs.8.92 lakhs resulted in underassessment of income of Rs.28.72 lakhs involving short levy of tax of Rs.28.07 lakhs (including interest).

The Ministry have accepted the audit observation.

4.18.4 Under the Income Tax Act,1961, where for any assessment

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** N.C. Budharaja and Co.vs CIT 204-ITR-412 (SC)

year, unabsorbed investment allowance under the head "Profits and gains of business and profession" cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be set off against the profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off upto a maximum period of eight assessment years, immediately succeeding the assessment year for which it was first computed.

Some important cases in which the mistakes were noticed are given below:

Sl.No	Commissioners' charges	Assessment. year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	City V, Bombay	1991-92 January 1994	143(3)	Instead of the correct amount of Rs. 119.47 lakhs left for set off an amount of Rs. 160.77 lakhs was erroneously set off	31.92
2	Karnataka I, Bangalore	1990-91 March 1993	143(3)	As against the correct amount of Rs. 31.88 lakhs pertaining to assessment year 1987-88 an amount of Rs. 46.73 lakhs was erroneously set off	13.80
3	Uttar Pradesh, Meerut	1992-93 July 1993	143(3)	Unabsorbed investment allowance was not restricted to Rs. 181.72 lakhs being two third of the amount of Rs. 272.59 lakhs	12.16
4	Delhi II	1990-91 December 1992	143(3)	Instead of the correct amount of Rs. 13.57 lakhs available for set off an amount of Rs. 30.44 lakhs was erroneously allowed	11.29
5	TN II, Madras	1989-90 August 1992	143(3)	Failure to revise the assessment led to excess set off of unabsorbed investment allowance of Rs. 17.66 lakhs pertaining to assessment year 1987-88	10.94

The Ministry have accepted the audit observations at Sl. Nos. 1,2, 4 and 5. Their response in the remaining case has not been received.

Incorrect grant of deductions in respect of investment deposit account and in respect of profits derived from industrial units situated in backward areas

4.19.1 Under the Income Tax Act, 1961, in the case of an assessee whose total income includes income under the head `profits and gains of business or profession' and who has out of such income deposited any amount in the deposit account maintained by him with the Development Bank within a period of six months from the end of the previous year or before furnishing of the return of income whichever is earlier or has utilised any amount during the previous year for the purchase of any new ship, new air craft, new machinery or plant without depositing any amount in a deposit account in accordance with the scheme framed by the Central Government is allowed a deduction with effect from the assessment year 1987-88 equal to the amount deposited and or any amount so

utilised. The amount of deduction is however limited to twenty percent of profits of the eligible business as per audited accounts. Eligible business means business other than the business of construction, manufacture or production of an article specified in the list in the Eleventh Schedule carried on by an industrial undertaking other than a small scale industrial undertaking. However, the deduction was withdrawn by Finance Act 1990 with effect from 1 April 1991. Further, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, which begins to manufacture or produce articles in any backward area as included in the eighth schedule of the Act, there shall in accordance with these provisions be allowed in computing the total income of the assessee a deduction from such profits and gains of an amount equal to twenty percent thereof for a period of ten yers.

(i) In Assam charge, the assessments of a widely held company for the assessment years 1991-92 to 1993-94 were completed after scrutiny in March 1994. Audit scrutiny revealed that deduction towards investment deposit account aggregating Rs. 71.69 lakhs was allowed though the provision for the deduction was no longer in operation since April 1991. The erroneous grant of deduction resulted in underassessment of income by Rs. 71.69 lakhs in aggregate involving short levy of tax of Rs. 66.85 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Haryana charge, the assessment of a widely held company for the assessment year 1988-89 originally completed in July 1989 after scrutiny, was revised in December 1992 to give effect to appellate orders, inter alia, allowing a deduction of Rs. 210.90 lakhs towards investment deposit account. Audit scrutiny revealed that the total deduction allowed was not restricted to twenty percent of the profits of eligible business of the assessee. Failure to restrict the deduction resulted in underassessment of income of Rs. 35.73 lakhs involving tax effect of Rs. 22.51 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In Tamil Nadu charge, the assessment of a widely held company for the assessment year 1987-88 was completed, after scrutiny, in March 1990 and revised in March 1991 allowing a deduction of Rs. 129.44 lakhs towards investment deposit account. Audit scrutiny revealed that though the assessee had admitted that a sum of Rs. 151 lakhs relating to recoverable claim of excise duty refund had been erroneously taken to the profit and loss account and had deducted this sum in computing its income, it was not

deducted from the profits for the purpose of computing the deduction in respect of investment deposit account. Omission to do so resulted in excess allowance of deduction of Rs. 30.20 lakhs. After allowing further deduction under sections 80-HH and 80-I, the net excess deduction allowed worked out to Rs.16.68 lakhs with consequent short levy of tax of Rs. 13.06 lakhs (including withdrawal of interest).

The Ministry have accepted the audit observaton.

4.19.2 Under the Income Tax Act, 1961, where any asset acquired, in accordance with the scheme of `Investment deposit account' is sold or otherwise transferred in any previous year within 8 years from the end of the previous year in which it was acquired, such part of its cost as is relatable to the deduction allowed under the relevant section shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and accordingly shall be liable to income tax as the income of that previous year.

In Maharashtra charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in November 1993. Audit scrutiny revealed that the assessee had sold machinery worth Rs. 41.27 lakhs during the previous year, which included machinery purchased in the previous year relevant to the assessment year 1990-91 and on which deduction of Rs. 26.71 lakhs on account of investment deposit account was allowed. As the machinery purchased in assessment year 1990-91 was sold within 8 years of its purchase, the deduction of Rs. 26.71 lakhs allowed in the assessment year 1990-91 was required to be treated as profits and gains of business and brought to tax as per the provisions of the Act. Omission to do so resulted in underassessment of income of Rs.26.71 lakhs involving short levy of tax of Rs. 15.36 lakhs.

The Ministry have accepted the audit observation.

4.19.3 The Act also provides that no deduction shall be allowed in respect of any amount utilised for the purchase of any machinery or plant, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income.

In Maharashtra charge, the assessment of a Bank for the assessment year 1990-91 was completed after scrutiny in March 1993, allowing a deduction of Rs. 781.71 lakhs on account of deduction towards investment deposit account. Audit scrutiny revealed that the net profits on which the deduction was computed included an amount of Rs. 49.08 lakhs being the capital expenditure on various items of

office appliances which are classifiable as plant and machinery for the purpose of section 43 (3) of the Act, costing Rs. 5000 or less each. Since the Act provides that no deduction in respect of investment deposit account shall be allowed on such amount, it should have been excluded while computing the eligible business profits for the allowance. The mistake resulted in excess allowance of deduction and underassessment of income of Rs. 9.81 lakhs involving short levy of tax of Rs. 10.97 lakhs (including interest).

The Ministry have accepted the audit observation.

Non-levy of capital gains tax

4.20.1 Under the Income Tax Act, 1961, as applicable from 1 April 1988, where full value of consideration received or accruing as a result of transfer of any capital asset falling within a block of assets on which depreciation has been allowed under the Act during the previous year, exceeded the aggregate amount of (i) the expenditure incurred wholly and exclusively in connection with such transfer, (ii) the written down value of the block of assets at the beginning of the relevant previous year and (iii) the actual cost of any asset falling within that block of assets acquired during the year, such excess shall be deemed as capital gains arising from the transfer of short term capital assets. In the case of a capital asset which is held by the assessee for more than the specified period immediately preceding the date of transfer, the capital gains is reduced by a deduction of Rs. 10,000 and a percentage of the excess over Rs. 10,000 depending on the class of assets.

In Maharashtra charge, the assessment of a company for assessment year 1991-92 was completed after scrutiny in January 1994. Audit scrutiny revealed that the company had sold a flat purchased by it in 1979 for a consideration of Rs. 170 lakhs. The gain arising on such transfer was assessed to tax as capital gains arising from a short term capital asset. Since the department had not allowed depreciation on such asset, it should not have been regarded as a short term capital asset but as a long term capital asset. On this basis the tax leviable would be computed after reducing the cost of acquisition from sale consideration and then allowing admissible deductions, while in case of short term capital asset, the written down value of the assets comprised in the block would be reduced from sale consideration to compute the gains. The capital gains in case of former would thus be higher. The incorrect treatment resulted in underassessment of income of Rs. 94.66 lakhs involving short levy of tax of Rs. 48.99 lakhs.

The reply of the Ministry to the audit observation has not been received.

4.20.2 The Act further provides that with effect from assessment year 1988-89, definition of the term `transfer' includes any

transaction involving the allowing of possession of any immovable property to be taken or retained in part performance of a contract and also any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.

In Tamil Nadu charge, the assessment of a closely held company for the assessment year 1989-90 was completed on `best judgement assessment' basis in March 1992. Audit scrutiny revealed that the assessee company had transferred an immovable property in a metropolitan city for a sum of Rs. 30 lakhs to another company and the relevant sale deed was registered in December 1988 subject to the condition that the necessary income tax clearance certificate would be produced in due course by the assessee. It was further revealed that the entire sale consideration was received by the assessee in instalments between April and December 1988 and the purchaser also took possession of the property in December 1988 itself. Though the property was transferred by the assessee in December 1988, relevant to assessment year 1989-90, the capital gains of Rs. 16.59 lakhs arising from the transfer was neither offered by the assessee for tax in assessment year 1989-90 nor was brought to tax by the assessing officer. This resulted in short levy of tax of Rs. 23.62 lakhs (including interest).

The Ministry have accepted the audit observation.

4.20.3 It has been judicially held* that the definition of 'transfer' in the Income Tax Act, 1961, is an inclusive definition and intended to enlarge the meaning and connotation of the word 'transfer' so as to include the granting of a lease. It has also been judicially held** that a lease of land is transfer of interest in the land and creates a right in rem and there is a transfer of title in favour of the lessee though the lessor has right of reversion after the period of the lease terminates.

In Tamil Nadu charge, the assessment of a closely held company for the assessment year 1990-91 was completed after scrutiny in February 1993 under the special provisions relating to levy of minimum tax on book profits of companies on an income of Rs.1.18 lakhs since the computation of income under the normal procedure resulted in a loss of Rs.2.99 lakhs. Audit scrutiny revealed that in the computation of income under the normal procedure the assesssee had received income from house property which was assessed at Rs.67,083. It was further revealed that the income from house property related to lease of a building constructed during previous year 1989-90 on leasehold land which had been acquired at a cost of Rs.40 lakhs in January 1986 by the

* A.R. Krishnamurthy vs CIT (1989) 176-ITR-417(SC)
** R.K. Palshikar vs CIT (1988) 172-ITR-311-317 (SC)

assessee company. The company had leased this building for a period of 99 years. Since the grant of the lease amounted to transfer of capital asset in view of judicial pronouncements, the assessee should have been assessed to capital gains tax. Omission to do so resulted in non-assessment of short term capital gains of Rs.47.03 lakhs (i.e. total lease rent less cost of acquisition of land plus cost of construction) resulting in non levy of tax of Rs.44.83 lakhs (including interest) and potential tax effect of Rs.1.55 lakhs.

The Ministry have accepted the auidt observation.

Income not assessed

4.21.1 Under the Income Tax Act 1961, in the case of an authority constituted under any law for the time being in force for the marketing of commodities, any income derived from the letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities shall not be included in the total income of the assessee.

In Haryana charge, the assessment of a State Warehousing Corporation for the assessment year 1989-90 was completed in a summary manner in July 1990 and for assessment year 1990-91 was completed after scrutiny in September 1991. Audit scrutiny revealed that the assessee acting as an agent of State Government for purchase and sale of wheat was allowed an exemption aggregating Rs. 466.81 lakhs in respect of profits earned from trading of wheat with Food Corporation of India. Since the assessee's income was derived from the trading of wheat and not from letting of godowns or warehouse, the said income formed part of total income and was not income exempt under the aforesaid provisions of the Act. The allowance of incorrect exemption of income resulted in underassessment of income aggregating Rs. 466.81 lakhs with consequent short levy of tax of Rs. 352.24 lakhs (including interest and additional tax).

The Ministry have accepted the audit observation.

4.21.2 Under the Income Tax Act, 1961, any receipts which are of casual and non-recurring nature exceeding five thousand rupees other than the capital gains and certain other receipts specified in the Act shall be included in computing the total income of a previous year of an assessee. Further, any profits or gains arising from the transfer of any capital asset is chargeable to Income Tax under the head capital gains in the year in which the transfer took place. The Act further provides that where the whole of the net consideration received from the transfer of a capital asset is invested in any of the specified assets within a period of six months after the date of transfer, the whole of the capital gains arising out of the transfer shall not be chargeable to Income tax. As per the provisions of transfer of property tax Act, a contract for sale of the

immovable property does not create any interest or charge on such property. It confers only a right to sue in the event of failure to fulfil the contract and therefore it is not an actionable claim.

In Maharashtra charge, the assessment of a company for the assessment year 1990-91 was completed after scrutiny in March 1993, at a taxable income of Rs. 7.46 lakhs computed under the special provisions of the Act being more than income of Rs. 4.78 lakhs computed under the normal provisions of the Act. Audit scrutiny revealed that the assessee had entered into an agreement in March 1980 for the purchase of an office premises. However, before taking possession of the premises, the assessee had sold its rights for a consideration of Rs. 25.23 lakhs during the relevant previous year. It was further revealed that this amount was invested in capital bonds of Industiral Development Bank of India and exemption claimed from capital gains tax which was allowed by the assessing officer. As mere contract for sale of immovable property does not create any interest or charge on such immovable property, no transfer of asset was involved and hence no capital gains arose from the deal. Such a contract did not create any interest in property, but only gave the assessee a right to sue for damages which could not be transferred. Therefore, the amount of Rs. 25.18 lakhs after allowing basic deduction of Rs. 5000 should have been treated as casual receipts and brought to tax. Consequently the income computed under the normal provisions of the Act would be Rs. 29.97 lakhs which should have been brought to tax as against the income of Rs. 7.46 lakhs computed under the special provisions of the Act. The mistake resulted in underassessment of income of Rs. 22.51 lakhs involving short levy of tax of Rs.13.37 lakhs.

The reply of the Ministry to the audit observation has not been received.

4.21.3 Under the Income Tax Act, 1961, where an assesse is found in any financial year to be the owner of any jewellery or other valuable articles and such jewellery or valuable article is not recorded in the books of account and the assessee offers no explanation or explanation offered by him is not found satisfactory, the value of such jewellery or other valuable article may be deemed to be the income of the assessee for such financial year. Further, in a search and seizure case, the statement made by the assessee on oath before the authorised person may be used as evidence in any proceedings under the Act. The Board issued instructions in July 1991 that the reasons for any variation between regular assessment order and appraisal reports as well as interim orders are required to be clearly recorded in regular assessment orders.

In Maharashtra charge, the assessment of a company engaged, inter

alia, in the export of diamonds, was completed after scrutiny for the assessment year 1990-91 in March 1993 determining total income of Rs.90.40 lakhs. The assessment order was framed after taking into account the search and seizure operation carried out on the business permises of the assessee. The assessing officer had recorded that it was established by the department that the modus operandi of the assessee was to inflate the quantity of diamonds exported in the documents that were submitted to the department. During the year the assessee had inflated the quantity of diamonds exported by 1,094.94 carats. During the search proceedings the assessee company had declared the sale proceeds of such diamonds at Rs.33.05 lakhs applying the average sale price of Rs.3,019 per carat. However, the department had adopted the average rate of Rs.4413 per carat and calculated the sale proceeds of 1,094.94 carats at Rs.48.32 lakhs. Audit scrutiny revealed that the department had determined the sale price at Rs.4,413 per carat by taking the average sale value of loose diamonds exported, diamonds set in jewellery and exported and loose diamonds sold in the local market. Since what was actually sold in the local market as per the assessee's own declaration and accepted by the department were loose diamonds out of the export invoices, the sale price of loose diamonds exported should have been adopted for the purpose of the valuation of these diamonds. Thus, the value of Rs.7,228 per carat should have been adopted instead of Rs.4,413 adopted by the department. The sale value would have then worked out to Rs.79.14 lakhs as against Rs.48.32 lakhs brought to tax. The incorrect computation of the price resulted in underassessment of income of Rs.30.82 lakhs involving short-levy of tax of Rs.40.34 lakhs inclusive of interest for belated filing of return and short payment of advance tax.

The Ministry have not accepted the audit observation on the ground that the department's appeal to the appellate Tribunal against the decision of the CIT (appeals) fixing a rate lower than the value fixed by the assessing oficer was pending and that the observation was based on assumption without any relevant/concrete evidence. The reply is not tenable since the assessee had itself made a declaration that these diamonds which were meant for export were sold loose in the local market outside the books of accounts. Accordingly the value of Rs.7228 per carat was computed on the basis of details of export invoices furnished by the assessee and information regarding which was incorporated in the assessment order. Further, no reasons had also been recorded by the assessing officer for not taking the export value which would have been realised had the diamonds been exported especially in the light of the assessee's admission. He also did not record any reasons for differing with the order under section 132(5) of the Act rejecting the valuation done by the assessee on the basis of averaging of different prices.

4.21.4 Under the Income Tax Act, 1961, where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year the assessee had obtained whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit, accruing to him shall be deemed to be profits and gains of business or profession chargeable to income tax as income of that previous year.

In West Bengal charge, the assessment of an investment company for the assessment year 1983-84 was completed in March 1987 after scrutiny. As per terms, a certificate holder was required to pay a total subscription of Rs. 790 and Rs. 780 only at the rate of yearly subscription of Rs. 79 and Rs. 52 respectively to receive an endowment certificate of Rs. 1,000 for a term of 10/15 years. As per the accounting procedure consistently followed, the assessee company offered first year's subscription for taxation while subsequent subscriptions were accumulated with compound interest in a fund styled as `Welfare Endowment Certificate Fund'. The matured value including bonus payable were paid by debiting the fund. The interest and bonus were credited to the fund by debiting the profit and loss account each year and these debits were allowed in the assessment for the assessment year 1983-84. Audit scrutiny revealed that the amount of subscription alongwith compound interest and bonus exceeded the matured value of Rs. 1,100 and Rs. 1,210 actually paid to the subscriber in respect of each certificate. Hence, there remained an excess of bonus and interest in the fund for which deduction had already been allowed at the time of assessment. Moreover, many of the certificates lapsed to the assessee company due to failure to pay subscriptions or surrender of the certificates by the certificate holders. Thus the unpaid amount Rs. 79.03 lakhs representing interest, bonus and profit on surrender of certificates was, therefore, required to be added back. Omission to do so resulted in underassessment of income by Rs. 79.03 lakhs involving undercharge of tax of Rs. 81.21 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

4.21.5 Under the Income Tax Act, 1961, the total income of a person for any previous year includes all incomes from whatever sources derived which is received or deemed to be received or which accrues or arises or is deemed to accrue or arise during such previous year unless specifically exempted from tax by the provisions of the Act. Appellate authorities have held that the discounted interest from investments in IDBI bonds received in advance is taxable in the year of receipt.

(a) In West Bengal charge, in the assessment of a widely held company for the assessment year 1990-91 completed in March 1993 after scrutiny, income of Rs.196.30 lakhs from other sources was not assessed to tax. This led to undercharge of tax by Rs.106 lakhs.

The Ministry have accepted the audit observation.

(b) In West Bengal charge, in the assessment of a widely held company for the assessment year 1983-84 completed after scrutiny in December 1990, Rs.70 lakhs received by the assessee during the relevant previous year from the joint receivers in pursuance of the order of a High Court was credited to Nationalisation Adjustment Account. Since the amount was received on account of sale of goods, it should have been credited to the sales account and added to the income of the assessee for the assessment year 1983-84. The mistake resulted in excess carry forward of loss by Rs.70 lakhs involving potential tax effect of Rs.39.46 lakhs.

The Ministry have accepted the audit observation.

(c) Some more important cases of incomes not assessed are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	TN IV & V, Madras	1990-91, 1991-92, and 1992-93 September 1993 and March 1994	143(3)	In case of two assessees, discounted interest on IDBI Bonds received was Rs. 50.77 lakhs of which only Rs. 13.59 lakhs was erroneously brought to tax leading to underassessment of income by Rs. 37.18 lakhs	49.07
2	Gujarat, Ahmedabad I	1985-86 , 1987-88 to 1990-91 Not assessed		Income of a charitable and religious trust exempted after the expiry of period of exemption leading to non-assessment of income of Rs.48.14 lakhs	37.39
3	CIT, Orissa	1989-90 March 1992	143(3)	In the case of a state warehousing corporation, the receipt representing handling and transportation charges of Rs. 32.67 lakhs was not assessed as income	29.46
4	CIT, Orissa	1991-92 March 1994	143(3)	Accrued income of Rs. 33.92 lakhs representing contract bills was not assessed to tax	28.93
5	City II, Bombay	1993-94 January 1994	143(1)(a)	Reimbursement of fees of Rs. 80.34 lakhs was not assessed to tax	28.92

The Ministry have accepted the audit observations at Sl. No. 1 and partially accepted the audit observation at Sl. No.2. In respect of the latter, the Ministry while accepting the audit observation for the assessment years 1985-86 to 1989-90, have mentioned that the exemption was not allowed to the assessee in the assessment year

1990-91 completed under section 143 (3). This view is not tenable as the exemption was initially allowed in the assessment completed under summary assessment scheme. On the irregularity thereof being pointed out in audit, it was disallowed subsequently at the regular assessment stage. The Ministry have not accepted the audit observation at Sl. No.5 stating that the same has become infructuous on account of the fact that assessments have been completed under section 143(3) and even otherwise the issue being subject matter of an appeal in earlier years, is debatable and hence does not fall in the category of prima facie adjustments. The reply is not tenable as the information regarding receipt of income was available in the documents accompanying the return and hence was apparent from record and should have been rectified as a prima facie adjustment. Mere fact of the issue being in appeal in earlier years does not make it a debatable one. Further, although the assessments have been completed under section 143(3), it has nevertheless resulted in loss of revenue in the shape of additional tax which would have been leviable had the mistake been rectified first in the summary assessment. The Ministry may refer to the suggestion contained in para 4.35 of this chapter on rectification of such mistakes. Their response in the remaining cases has not been received.

Carry forward and set off of losses

4.22 Under the Income Tax Act, 1961, where the net result of the computation under the head `profits and gains of business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those years. No loss can be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined. Further, if any assessee sustained a loss in a previous year under the head `profits and gains of business or profession' and claims that the loss should be carried forward for adjustment in the following assessment year, he is required to file the return of loss voluntarily within the due date, in prescribed form which, inter alia, requires the assessee to furnish the report of audit of the accounts. The Act provides that from assessment year 1992-93, where in respect of any assessment year, the net result of the computation under the head `capital gains' is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head. The amount of loss not so set off shall be carried forward to the following assessment year and set off against the capital gains.

(a) In Madhya Pradesh charge, the assessment of a government company for the assessment year 1989-90 for which return was

filed after due date was completed in March 1994 after scrutiny allowing a business loss of Rs.1557.03 lakhs. As this loss was determined to be carried forward in pursuance of the return filed as a result of issue of a notice by the department and not voluntarily, the carry forward was irregular thus resulting in underassessment of income of Rs.1557.03 lakhs with consequent potential tax effect of Rs.817.44 lakhs.

The Ministry have accepted the audit observation.

(b) In Rajasthan charge, in the assessments of two State government companies for the assessment year 1991-92 completed after scrutiny, business losses of Rs.179.30 lakhs and Rs.298.90 lakhs respectively were allowed to be carried forward for set off against future profits eventhough the accounts furnished by the companies alongwith the returns were not accompanied by the reports of auditors certifying that the accounts were audited. The mistake resulted in underassessment of incomes by identical amounts involving potential tax effect aggregating Rs.219.97 lakhs.

The Ministry have accepted the audit observation in one case. Their response in the other case has not been received.

(c) In Tamil Nadu charge, in the assessment of a company for the assessment year 1990-91 completed after scrutiny in March 1993, the income was computed at 'nil' after setting off unabsorbed depreciation and losses pertaining to assessment year 1986-87. Audit scrutiny of the assessment records for the assessment year 1986-87 revealed that due to reassessment/revision made in March 1991/September 1991, no part of the unabsorbed depreciation or carried forward losses for that assessment year remained to be set off. The set off of loss for the assessment year 1986-87 in the assessment year 1990-91 was thus irregular, resulting in excess carry forward of unabsorbed depreciation of Rs.167.30 lakhs involving a potential tax effect of Rs.86.58 lakhs.

The Ministry have accepted the audit observation.

(d) In Tamil Nadu charge, the assessment of a banking company, for the assessment year 1989-90 completed after scrutiny in March 1992 and revised in September 1992, February 1993 and March 1994. In the revision made in March 1994, business income was computed in accordance with income as computed in the revision made in September 1992 instead of the income as computed in the subsequent revision made in February 1993. This resulted in excess carry forward of loss of Rs.127.76 lakhs and erroneous set off against the income for assessment year 1991-92 with consequent under charge of tax of Rs.65.82 lakhs (including withdrawal of interest on refunds) for the assessment year 1991-92.

The Ministry have accepted the audit observation.

(e) Some more important cases of incorrect carry forward and the set off of losses are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	WB II, Calcutta	1991-92 March 1994	143(3)	Against the correct amount of Rs. 29.95 lakhs representing unabsorbed depreciation pertaining to assessment year 1989-90, an amount of Rs. 85.99 lakhs was erroneously allowed to be carried forward and set off in assessment year 1991-92	44.34
2	City I, Bombay	1992-93 October 1993	143(3)	The assessed loss for the assessment year 1988-89 which could be carried forward amounted to Rs.61.09 lakhs against which an amount of Rs. 125.02 lakhs was erroneously carried forward	36.76(P)
3	Assam, NE Region, Shillong	1988-89 to 1991-92 Between March 1991 and July 1993	143(3)	Business loss of Rs. 65.99 lakhs was erroneously allowed to be carried after the expiry of prescribed eighth assessment year	34.15(P)
4	Delhi I	1989-90 January 1990	143(1)(a)	Loss arising out of forfeiting of shares, speculation loss in the case of a non-investment financial company was erroneously allowed set off against business income	25.02
5	WB VI, Calcutta	1991-92 March 1994	143(3)	The business loss of Rs. 31.30 lakhs pertaining to assessment year 1982-83 was erroneously allowed to be set off after the expiry of prescribed period in which it could be done	24.77
6	Ludhiana	1989-90 December 1992	143(3)	Unabsorbed depreciation of Rs. 32.29 lakhs pertaining to assessment year 1987-88 was erroneously allowed to be set off twice in assessment years 1988-89 and 1989-90	18.65
7	City III, Bombay	1991-92 February 1994	143(3)	Against the correct amount of unabsorbed business loss of Rs. 29.54 lakhs ,an amount of Rs. 49.56 lakhs was erroneously allowed to be set off	17.61
8	TN II, Madras	1992-93 March 1993	143(1)(a)	Short term capital loss on sale of units purchased during the same year amounting to Rs. 21.68 lakhs was erroneously allowed to be set off against income under the other heads	15.08

The Ministry have accepted the audit observations at Sl. No. 1 to 3 and 6 to 8. Their response in the remaining cases has not been received.

Mistake in assessment while giving effect to appellate order

4.23 Under section 246 of the Income Tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and the latter shall comply with the direction given by him

in the appellate order.

(i) In Rajasthan charge, in the assessment of a government company for the assessment year 1991-92 completed after scrutiny in October 1993, an expenditure of Rs.1521 lakhs incurred on construction of a dam was treated as capital expenditure and depreciation of Rs. 380 lakhs was allowed on it. On appeal by the company, the Commissioner (Appeals) held that the expenditure incurred on construction of the dam was to be treated as revenue expenditure. Audit scrutiny, however, revealed that while giving effect to the appellate order in March 1994, the depreciation already allowed was not withdrawn resulting in excess determination of loss by Rs. 380 lakhs with consequent potential tax effect of Rs. 175 lakhs.

The Ministry have accepted the audit observation.

(ii) Two other important cases in which mistakes in giving effect to appellate order were noticed are given below:

Sl.No	Commissioners' charges	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1	Bihar Ranchi	1988-89 February 1990 and December 1993	143(3)	Disallowance of Rs. 109.24 lakhs which were made earlier were erroneously allowed though they were not subject matter of the appeal	57.35(P)
2	Delhi II	1986-87 March 1989 and January 1990	143(3)	Liability of sales tax of Rs. 100.98 lakhs pertaining to assessment year 1985-86 already allowed in that year was again allowed though it was not subject matter of the appeal	26.09 28.60(P)

The Ministry have accepted the audit observation at Sl. No.1. The Ministry have not accepted the audit observation at Sl. No.2 stating that the amount has to be ultimately allowed in one year and disallowed in another year. They have further stated that the Commissioner of Income Tax (Appeals) had confirmed the addition made by the assessing officer but directed that if it is allowed for assessment year 1985-86 at a subsequent stage by the High Court/Supreme Court, then it should be deleted for assessment year 1986-87. The reply is not tenable as the department did add back the amount of Rs.100.18 lakhs vide order of October 1990 withdrawing the extra deduction allowed in assessment year 1986-87. However, this order which was quashed in appeal, resulting in double benefit being restored to the assessee company, was rectified only on being pointed out in audit.

Mistakes in allowing deduction in excess of gross total income

4.24 Under Chapter VI-A of the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The

overriding condition is that the total deduction should not exceed the gross total income of the assessee which has been defined in the Act as the total income computed in accordance with the provisions of the Act before making the deductions under Chapter VI A but after setting off unabsorbed losses, depreciation, investment allowance etc. of earlier years. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to `nil' or to a loss, no deduction under Chapter VI A is admissible.

(i) In Kerala and West Bengal charges, the assessment of two widely held companies for the assessment year 1992-93 and 1993-94 were completed in a summary manner in July 1993 and January 1994, determining a loss of Rs. 78,806 and 'nil' income, inter alia, allowing deductions of Rs.146.85 lakhs and Rs. 33.05 lakhs respectively under Chapter VI-A. The loss together with amounts of Rs.241.31 lakhs and Rs.95.77 lakhs on account of unabsorbed business loss, investment allowance and depreciation, were allowed to be carried forward. Audit scrutiny revealed that after setting off unabsorbed business loss, investment allowance and depreciation, the gross total income worked out at negative figures and as such no deduction in Chapter VI-A was admissible. Further, since information regarding earlier years' unabsorbed losses, depreciation and investment allowance was available in the returns and accompanying documents, the deductions should have been disallowed as prima facie inadmissible. The incorrect allowance resulted in excess carry forward of loss of Rs.146.85 lakhs and Rs. 33.05 lakhs with potential tax effect of Rs.75.99 lakhs and Rs. 17.10 lakhs besides non-levy of additional tax of Rs.17.02 lakhs and Rs. 3.42 lakhs respectively.

The Ministry have accepted the audit observations.

(ii) In Gujarat charge, the assessment of a company, for the assessment years 1991-92 and 1992-93 was completed after scrutiny in February 1994 allowing deductions of Rs. 47.19 lakhs and Rs.47.51 lakhs respectively towards the export turnover. Audit scrutiny revealed that since the company had unabsorbed business loss of Rs. 60.39 lakhs in the beginning of the assessment year 1991-92, the gross total income after adjustment of unabsorbed business loss worked out at a loss of Rs. 9.65 lakhs and Rs.41.26 lakhs for assessment years 1991-92 and 1992-93 respectively. Therefore, no deduction under Chapter VI A was admissible for the assessment year 1991-92. For the assessment year 1992-93, after allowing deduction under Chapter VI A, there remained positive income of Rs. 3.39 lakhs instead of loss of Rs. 54.15 lakhs erroneously worked out by the assessing officer. The mistakes resulted in underassessment of income of Rs. 57.54 lakhs for the assessment year 1992-93 with consequent short-levy

of tax of Rs. 34.02 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction in respect of donation

4.25 Under the Income Tax Act, 1961, in computing the total income there shall be allowed a deduction from the gross total income of an amount equal to fifty percent of the sums paid by the assessee as donation in the previous year to the funds specified in the Act. The qualifying amount of deduction is, however, limited to 10 percent of the gross total income of the relevant previous year.

In Assam charge, the assessment of a tea company for the assessment year 1991-92 was completed after scrutiny at gross total income of Rs. 116.55 lakhs. Audit scrutiny revealed that during the relevant previous year the company donated Rs. 10.75 lakhs to charitable institutions. While calculating the quantum of deduction at fifty percent of donation of Rs. 10.75 lakhs, the assessing officer erroneously calculated and allowed deduction at Rs. 53.75 lakhs instead of allowable deduction of Rs. 5.37 lakhs. The mistake resulted in underassessment of income of Rs. 48.38 lakhs with consequent short-levy of tax of Rs. 38.28 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect deduction in respect of profits and gains from newly established small scale industrial undertakings in certain areas

4.26.1 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from any industrial undertaking in a backward area, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to twenty percent of such profits and gains. Further, a deduction at twenty five percent is also admissible under the Act, to an industrial undertaking which goes into production after 31 March 1981.

In Maharashtra charge, in the assessment of a company for the assessment year 1991-92, completed after scrutiny in February 1993, deductions of Rs. 1,158 lakhs in respect of the profits and gains derived from certain newly established industrial units in backward areas and Rs. 854 lakhs to certain other units as applicable to industrial undertakings which goes into production after 31 March 1981 were allowed. Audit scrutiny revealed that while computing the allowable deductions, the assessing officer omitted to allocate the proportionate charges towards the statutory liabilities and scientific research attributable to the units eligible for the deductions and reduce the same from the respective profits derived from the concerned units. The omission resulted in excess computation of profits of Rs. 220.78 lakhs and Rs. 177.58 lakhs leading to excess allowance of deductions of Rs. 44.16 lakhs and

Rs. 44.39 lakhs respectively with consequential aggregate short levy of tax of Rs. 40.73 lakhs.

The reply of the Ministry to the audit observation has not been received.

4.26.2 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a small scale industrial undertaking in certain areas, a deduction from such profits and gains of an amount equal to twenty percent thereof is allowed. For this purpose, an industrial undertaking is deemed as a small scale industrial undertaking, if the aggregate value of the machinery and plant installed for the purposes of the business does not exceed Rs. 35 lakhs as on the last day of the previous year and for this purpose the value of any machinery or plant shall be the actual cost thereof to the assessee.

In Gujarat charge, in the assessment of a closely held company for the assessment year 1990-91 completed after scrutiny in August 1992 and subsequently rectified to give appeal effect in March 1993, a deduction of Rs. 16.28 lakhs was allowed in respect of the profits from newly established undertaking treating the company as a small scale industrial undertaking adopting the value of plant and machinery at Rs. 34.74 lakhs as returned. Audit scrutiny revealed that the assessee did not include in the cost of plant and machinery the value of DMA cylinders worth Rs. 68,314 which were purchased in the relevant previous year on which depreciation at the rate of 100 percent was allowed. Considering the value of the cylinders, the cost of plant and machinery on the last day of the relevant previous year exceeded Rs. 35 lakhs and by virtue of the definition in the Act, the company was not a small scale industrial undertaking and as such was not entitled to the deduction. The mistake resulted in underassessment of income of Rs. 16.28 lakhs with consequent short levy of tax of Rs. 15.28 lakhs.

The Ministry have not accepted the audit observation stating that the DMA cylinders in question were used as containers and packing materials to bring gas to the assessee's plant and hence did not form part of plant and machinery. The reply is not tenable as cylinders alongwith valves and regulators form part of plant and machinery in terms of item G (v) of depreciation rates prescribed vide Rule 5 of the Income Tax Rules, 1962. Accordingly these were included in the block of assets of plant and machinery in the year 1989-90 and 100 percent depreciation was claimed by the assessee and allowed by the assessing officer. The character of the DMA cylinders can not change in the next assessment year from plant and machinery to packing materials. For assesment year 1990-91 what was to be included towards value of plant and machinery was the actual cost and not the written down value as per provisions of section 80

HHA. The undercharge of tax resulted from this omission.

Incorrect relief in respect of profits from export business

4.27 Under the Income Tax Act, 1961, as amended by the Finance Act, 1988, with effect from 1 April, 1989, an assessee being an Indian Company or other assessees resident in India, engaged in export business, is entitled to a deduction equal to the profit derived from the export of goods or merchandise other than the exempted items if the sale proceeds thereof are received in convertible foreign exchange, so treated for the purposes of the Foreign Exchange Regulation Act, 1973 and any rules made thereunder. Where the business of the assessee does not consist exclusively of export of goods/merchandise, profit derived from export shall be the amount which bears to the profit of the assessee as computed under the head `profits and gains of business or profession' the same proportion as export turnover bears to the total turnover. From the assessment year 1991-92, the Act provides that where deduction is also allowable to the supporting manufacturer, the deduction would be reduced by profit attributable to the supporting manufacturer. With effect from 1 April 1992, for the purpose of calculation of deduction on pro-rata basis `profits of the business' means the profits of the business as computed under the head `profits and gains of business or profession' as reduced by ninety percent of certain receipts specified in the Act. The profits so derived from export shall be further increased by the amount which bears to the ninety percent of export incentives the same proportion as the export turnover bears to the total turnover. It has been judicially held* that central excise duty and sales tax collected form part of the turnover of a manufacturer.

(i) In West Bengal charge, in the assessment of a widely held company for the assessment year 1991-92 completed after scrutiny in March 1994, a deduction of Rs. 173.35 lakhs in respect of export profits was allowed. The computation was with reference to value of export turnover of Rs. 1,449.37 lakhs. Audit scrutiny revealed that as per company auditor's report, the net export turnover of Rs. 1,449.37 lakhs included Rs. 493.50 lakhs on account of export under rupee payment method. Since the amount of Rs. 493.50 lakhs was not received in converted foreign currency, it did not qualify for the deduction towards export turnover and was required to be deducted from the total export turnover. Failure to do so resulted in excess allowance of relief of Rs. 59.02 lakhs with consequent short-levy of tax of Rs. 46.70 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Maharashtra charge, in the assessment of a company for the

* Mcdowell and Co. Ltd. vs CIT 154-ITR-148(SC)

assessment year 1991-92, completed in March 1994 after scrutiny, a deduction of Rs.259.76 lakhs in respect of export profits was allowed. Audit scrutiny revealed that while computing the deduction, brought forward unabsorbed investment allowance of Rs. 360.48 lakhs of earlier years was not deducted from profits of the business. Further, the export profits of Rs. 12.77 lakhs attributable to the supporting manufacturer was also not reduced from the export profit. After effecting these adjustments, the admissible deduction would work out to Rs. 173.02 lakhs as against Rs. 259.76 lakhs allowed by the assessing officer. The incorrect allowance of deduction resulted in underassessment of income of Rs.86.74 lakhs with consequent short-levy of tax of Rs. 44.89 lakhs.

The reply of the Ministry to the audit observation has not been received.

(iii) In Tamil Nadu charge, in the assessment of a closely held company for the assessment year 1992-93 completed in June 1993 in a summary manner, a deduction of Rs.36.12 lakhs was allowed towards relief in respect of export profits. Audit scrutiny revealed that the profits of the business for computing the deduction were arrived at before setting off the unabsorbed depreciation and investment allowance of earlier assessment years. Further, as per the report of the statutory auditor, the export turnover included a sum of Rs. 3.79 lakhs which was not received in or brought into India within a period of six months from the end of the previous year. This was required to be excluded from the export turnover for purpose of calculating the amount of deduction. The deduction computed in accordance with the provisions of the Act, should have been Rs. 3.18 lakhs as against Rs.36.12 lakhs erroneously allowed. The mistake resulted in underassessment of income by a like amount with consequent short-levy of tax of Rs.28.79 lakhs (including additional tax and interest).

The Ministry have not accepted the audit obsevation on the ground that the claim under section 80 HHC was allowed as it was supported by a report of a Chartered Accountant required to be furnished for the purpose and any recalculation of such adjustment was not permissible under section 143(1) (a), in view of a judgement by the High Court* at Bombay. They have added that the audit view that deduction under section 80 HHC should have been computed with reference to gross total income and not with reference to profits and gains of the business is unacceptable. The Ministry's view that the issue is beyond the purview of prima facie adjustment is not tenable as a report from a Chartered Accountant is only one of the requirements for claiming the deduction. Further, the judicial decision cited by the Ministry in support is not relevant

* Tanna Exports and another vs. M.G. Kamat and Another (1993) 202 ITR 219.

inasmuch as the case relates to the adjsutment of interest income earned by the assesee for purposes of calculating the claim under section 80 HHC and it does not prohibit any adjustments under section 143(1)(a). Further, the audit observation is not based on gross total income of the assessee as claimed by the Ministry but is based on the requirement that profits and gains of the business for the purposes of section 80 HHC are to be computed in accordance with provisions of sections 28 to 44 of the Act as per explanation (baa) of section 80 HHC after allowing two-thirds of unabsorbed depreciation and investment allowance of earlier years. The issue, therfore, is not a debtable issue which can not be rectified under section 143(1)(a) of the Act. Incidentally, similar audit observations featured in paragraphs 2.0.3.11 and 3.29.1 of the Reports of the Comptroller and Auditor General of India on Union Government Direct Taxes for the years ended 31 March 1990 and 31 March 1993 respectively, have been accepted by the Ministry.

(iv) In Tamil Nadu charge, the assessment of a closely held company for the assessment year 1992-93 was completed after scrutiny in October 1993 and subsequently revised in March 1994 allowing a deduction of Rs. 200.74 lakhs towards export profits in respect of manufactured goods and trading goods. Audit scrutiny revealed that while computing the adjusted profits of Rs. 418.02 lakhs for calculating the deduction in respect of manufactured goods, 90 percent of certain receipts like service income, lease income and packing and forwarding collections aggregating Rs. 153.44 lakhs were not excluded from the profits of the business for arriving at the above deduction. The mistake resulted in excess allowance of deduction of Rs. 30.05 lakhs leading to underassessment of income of like amount with consequent short levy of tax of Rs. 17.28 lakhs.

While accepting the audit observation relating to non-execution of lease income in computing the deductions, the Ministry have stated that service income and packing and forwarding charges cannot be treated as similar to brokerage, commission, rent or interest receipts as specifically mentioned in explanation (baa) to section 80 HHC. The reply is not tenable since clause (1) under explanation (baa) covers the 'charges or any other receipt of a similar nature included in the profits' and is thus wide enough to include service income and packing and forwarding charges which have the nature of 'similar other income'. Such inclusion would also be in consonance with the rule of 'ejusdem generis' used in interpretation of statutes.

(v) In Tamil Nadu charge, in the assessment of a closely held company for the assessment year 1990-91 completed after scrutiny in March 1993, the assessing officer had allowed a deduction of Rs. 17.16 lakhs towards relief in respect of export profits as claimed.

Audit scrutiny revealed that the deduction was claimed at 100 percent of the profit derived from the export of goods which was not proper. Since the income of the assessee was not exclusively from export business, the deduction on account of export profits was required to be calculated pro-rata in the ratio of export turnover to total turnover. The correct amount thus, worked out to Rs. 3.24 lakhs as against Rs. 17.16 lakhs allowed. The mistake resulted in underassessment of income of Rs. 13.92 lakhs with consequent shor-levy of tax of Rs. 15.51 lakhs (including interest).

The Ministry have accepted the audit observation.

(vi) In Tamil Nadu charge, in the assessment of a closely held company for the assessment year 1992-93, originally completed in March 1993 in a summary manner, was revised in November 1993 allowing a deduction of Rs. 443.15 lakhs towards export profits. Audit scrutiny revealed that while computing the deduction, the assessing officer incorrectly adopted the net profit of Rs. 461.77 lakhs as per the profit and loss account as the profits of the business instead of the correct amount of Rs. 445.77 lakhs computed under the head `profits and gains of business or profession' in the return. The mistake resulted in excess allowance of deduction of Rs. 15.61 lakhs leading to underassessment of a like amount with consequent non-levy of tax of Rs. 12.07 lakhs (including additional tax and interest).

The Ministry have accepted the audit observation.

(vii) In Maharashtra charge, in the assessment of a company for the assessment year 1990-91 completed after scrutiny in March 1993, a deduction of Rs.77.26 lakhs was allowed in respect of export profits.Audit scrutiny revealed that the total turnover of the company amounting to Rs.1886.49 lakhs considered for computing the deduction in respect of such profits of the business did not include central excise duty and sales tax included in total sale value of the goods. Considering the total turnover of Rs.2,169.35 lakhs including only central excise duty amounting to Rs.282.86 lakhs (details of sales tax recovery being not available) the deduction allowable would work out to Rs.67.18 lakhs as against Rs.77.26 lakhs allowed by the department. The incorrect allowance of deduction resulted in under-assessment of income of Rs.10.08 lakhs with consequent short-levy of tax of Rs.10.29 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect deduction in respect of profits from the new industrial undertakings established after 31 March 1981

4.28.1 Under the Income Tax Act, 1961, where the gross total income of an assessee includes profits and gains derived from an industrial undertaking established after 31 March 1981, the assessee is entitled to a deduction of twenty five percent of such profits and gains provided it does not manufacture or produce articles or things specified in the Eleventh Schedule. However, where the assessee is also entitled to a deduction in respect of profits and gains from newly established industrial undertaking in backward areas, effect shall first be given to the latter deduction before allowing the former deduction.

In Kerala, West Bengal, Haryana, Gujarat, Madhya Pradesh and Delhi charges, in the assessments of ten companies for the assessment years 1989-90 to 1991-92 completed after scrutiny between January 1991 and March 1994, the assessees were allowed deductions aggregating Rs. 567.19 lakhs at 25 percent of profits and gains from newly established industrial undertaking established after 31 March 1981. These assessees were also allowed aggregate deductions of Rs. 457.44 lakhs at 20 percent towards profits and gains from newly established industrial undertaking in backward areas. As the assessees were allowed both the deductions, that in respect of profits and gains from newly established industrial undertaking after 31 March 1981 should have been allowed on the profits and gains as reduced by the deduction allowed in respect of profits and gains from new industrial undertaking in backward areas. Accordingly, the aggregate admissible deduction worked out to Rs. 452.84 lakhs as against Rs. 567.19 lakhs allowed by the department. Further, in the case of a company in West Bengal charge, while completing the assessment for assessment year 1989-90 in January 1992, the above deductions were incorrectly allowed on gross total income of Rs.60.18 lakhs before making a deduction of Rs. 11.92 lakhs towards investment deposit account. As such, the admissible deductions allowable worked out to Rs. 19.30 lakhs as against Rs.27.08 lakhs allowed by the department. These mistakes resulted in excess allowance of deductions aggregating Rs. 122.13 lakhs leading to total underassessment of an identical amount with consequent short-levy of tax of Rs. 81.94 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

4.28.2 Under the Income Tax Act, 1961, deductions are allowed in respect of income of the nature specified under any sections of Chapter VI A (except section 80 M) as computed in accordance with the provision of the Act which is included in the gross total income of the assessee. The overriding condition is that the aggregate of deductions cannot exceed the gross total income which is defined as total income as computed under the provisions of the

Act before making any deduction under Chapter VI A. The Act specifically provides that for the purpose of deduction in respect of profits from new industrial undertaking established after 31 March 1981, the profits of the business shall be computed as if such industrial undertaking was the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year upto and including the assessment year for which the determination is to be made. The deduction is admissible upto eighth assessment year including the initial assessment year. It has been judicially held* that the expressions `manufacture' and `produce' are normally associated with movables, articles and goods, big and small but never employed to denote construction of dam, bridge or building etc.

(i) In Delhi charge, the assessment of a company engaged in the business of construction of water treatment plants (specific to customer's requirements at their premises as evident from the notes to account and Tax Audit Report of the Statutory auditors) for the assessment year 1991-92 was completed after scrutiny in June 1993 allowing a deduction of Rs. 27.38 lakhs towards profits and gains from industrial undertaking established after 31 March 1981. Similarly, in the assessment of another company engaged in the business of building construction for the assessment year 1993-94 completed in November 1993 in a summary manner, a deduction of Rs. 9.41 lakhs was allowed as claimed. Since the companies were engaged in construction and not manufacturing activities, the deductions allowed were irregular. The mistake was apparent from the documents accompanying the return and the deduction was prima facie inadmissible. The mistake resulted in underassessment of income aggregating Rs. 36.79 lakhs with consequent short-levy of tax of Rs. 28.31 lakhs (including interest and additional tax).

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, the assessment of a closely held company for the assessment year 1992-93 was completed in a summary manner in August 1993. Audit scrutiny revealed that the assessee had claimed deduction in respect of profits and gains from new industrial undertaking established after 31 March 1981 which was computed at Rs.57.60 lakhs but restricted it to the gross total income of Rs.20.75 lakhs. As per details available in the documents annexed to the return of income, the assessee company had not deducted current depreciation, unabsorbed depreciation and investment allowance of earlier years amounting to Rs.209.90 lakhs in respect of the said industrial undertaking to arrive at the profit derived from it which was included in the gross total income of the assessee. As the profits derived from the industrial undertaking

* N.C. Budhiraja & Co. vs. CIT 204- ITR-412 (SC)

included in the gross total income thus worked out to Rs. 20.75 lakhs only, the deduction should have been restricted to twenty five percent thereof, i.e. Rs. 5.19 lakhs. The mistake resulted in excess allowance of deduction of Rs. 15.56 lakhs with consequent short-levy of tax of Rs. 13.61 lakhs (including interest, additional tax and withdrawal of interest granted on refund).

The Ministry have accepted the audit observation.

(iii) In Gujarat charge, in the assessment of a closely held company for the assessment year 1990-91, completed after scrutiny in February 1993, deduction of Rs. 12.44 lakhs was allowed in respect of profits and gains of new industrial undertaking. Audit scrutiny revealed that the assessee had commenced manufacture of chemicals in the previous year relevant to the assessment year 1982-83. Thus, he was eligible for deduction upto the assessment year 1989-90 only. The irregular allowance of deduction in assessment year 1990-91 resulted in underassessment of income of Rs. 12.44 lakhs with consequent short-levy of tax of Rs. 12.57 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of certain inter-corporate dividends

4.29 Under the Income Tax Act, 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed in computing the total income, a deduction of an amount equal to so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the former domestic company on or before the due date. The Act was amended through Finance (No.2) Act, 1980, with retrospective effect from April 1968 to provide that the deduction on account of inter-corporate dividends is to be allowed with reference to the net dividend income as computed in accordance with the provisions of the Act and not on the gross amount of dividends. It has been judicially held* that proportionate management expenses should be deducted from the gross dividend for purposes of the deduction.

(i) In Tamil Nadu charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee company received Rs. 72.29 lakhs as dividend during the previous year and the entire amount was allowed as deduction towards inter-corporate dividend. It was further revealed that an amount of Rs.289.26 crores obtained as unsecured loans during the year, were invested and the company paid Rs. 10.46 crores towards finance

* CIT Vs United General Trust Ltd. 200-ITR-488 (SC)

charges and Rs.1.95 crores towards administration and other expenses. The expenditure on finance charges and administrative expenses were not deducted from gross dividend though required. Since the amount of such expenditure which could be attributable to dividend income was not ascertainable from the assessment records, it was apportioned to the dividend income in the ratio of the dividend income to the total receipts. Consequently, the deduction on account of expenses debitable to the dividend income would work out to Rs. 59.58 lakhs and allowable deduction would work out to Rs. 12.71 lakhs as against Rs. 72.29 lakhs allowed. The mistake resulted in underassessment of income of Rs. 59.58 lakhs with consequent short-levy of tax of Rs.33.43 lakhs (including withdrawal of interest of Rs. 6.03 lakhs paid on refund).

The Ministry have not accepted the audit observation on the ground that investment in shares/units was made by the assessee out of their own funds and not out of borrowed funds. They have added that as no expenditure had been incurred to earn the dividend claimed which is exempt under section 80 M of the Act, there was no question of allocating any expenditure relating to earning of the dividend income. This view is not tenable as in the absence of any details in the assessment order on the source of the funds invested to earn the dividend income it can not be concluded that the investment in shares/units was not made out of borrowed funds. Further, there would be certain expenditure which has to be compulsorily incurred on such income such as on arrangements for receiving the warrant/cheque and remitting it to the banks, collection charges payable to the bank, arrangements for keeping a watch on receipt of the income and its actual realisation etc. Such charges are also required to be deducted as per Board's instructions of September 1980.

(ii) In Maharashtra charge, the assessment of a company for the assessment year 1989-90 was completed, after scrutiny, in February 1991 allowing a deduction of Rs. 295.68 lakhs in respect of inter-corporate dividends. Audit scrutiny revealed that though an amount of Rs. 54.76 lakhs towards expenses incurred on earning the dividend had been reduced from gross amount of dividend, the assessing officer had omitted to reduce Rs. 59 lakhs being interest paid on money borrowed for investment. Since deduction on account of inter-corporate dividends is to be allowed with reference to net dividend income as computed in accordance with the provisions of the Act, the interest paid was to be reduced. Omission to do so resulted in excess allowance of deduction of Rs. 35.41 lakhs with consequent short-levy of tax of Rs.32.11 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of royalties etc. from foreign enterprises

4.30 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any income by way of royalty, commission, fees or any similar payment received by him in convertible foreign exchange from a foreign government/enterprise, interalia, in consideration of technical services to such government/enterprise, a deduction equal to fifty percent of such income is allowed in computing the total income of the assessee.

In Maharashtra charge, the assessment of a company for the assessment year 1992-93 was completed in October 1993 in a summary manner allowing a deduction of Rs. 75.01 lakhs under the above provisions of the Act after apportioning related expenses of Rs. 228.72 lakhs against the convertible foreign exchange of Rs. 378.73 lakhs claimed as realised. Audit scrutiny revealed that while determining the percentage of the total expenses to the total receipts, in order to allocate pro-rata the expenses between the receipts from foreign enterprise and other income, Rs.51.50 lakhs relating to provision for taxation and Rs.15 lakhs towards expenditure on scientific research were reduced from the total expenses incurred by him. The exclusion of the above amounts resulted in the expenses apportionable being computed at 60.38 percent of the total expenses whereas the correct percentage worked out to 74.37. After reducing the expenses at 74.37 percent from the convertible foreign exchange received, the amount eligible for deduction was Rs. 97.07 lakhs on which admissible deduction worked out to Rs. 48.54 lakhs as against Rs. 75.01 lakhs incorrectly allowed. The mistake resulted in underassessment of income of Rs. 26.47 lakhs with consequent short-levy of tax of Rs. 16.44 lakhs (including additional tax).

The Ministry have accepted the audit observation.

Avoidable mistake in the allowance of double taxation relief

4.31 Under the Income Tax Act, 1961, in a scrutiny assessment, the assessing officer shall make a correct assessment of the total income or loss of the assessee. While computing the income chargeable to tax, the assessing officer takes the profit or loss as per profit and loss account of the assessee as the starting point and then adds back or deducts the amount not allowable or which requires special consideration. The Board have, from time to time, issued instructions stressing the necessity for ensuring accuracy in the computation of income and tax etc.

In Maharashtra charge, the assessment of a public limited company for the assessment year 1990-91 was completed after scrutiny in March 1993 allowing aggregate deduction of Rs. 480.41 lakhs in respect of double taxation relief and income by way of royalties etc. from certain foreign enterprises. Audit scrutiny revealed that the company had debited Rs.12.45 lakhs in its profit and loss account of the relevant previous year towards United Kingdom Pay Roll

taxes which were added back in computing the total income. However, before completion of the assessment, the assessee company, in January 1991, pointed out to the assessing officer that the United Kingdom Pay Roll taxes claimed for double taxation relief was actually an allowable expenditure and was accordingly to be reduced from the claim of double taxation relief. In addition to this, the assessee also revised its claims for relief to Rs. 198.63 lakhs. However, these aspects were not considered while completing the assessment and relief of Rs.296.41 lakhs as originally claimed was allowed. The mistakes in not allowing the Pay Roll taxes of Rs. 12.45 lakhs as deduction and not excluding the amount from claim for double taxation relief as well as not limiting the revised DIT relief to Rs. 198.63 lakhs as claimed, resulted in short-levy of tax of Rs. 89.70 lakhs.

The Ministry have accepted the audit observation.

Incorrect computation of book profits and deemed income to levy minimum tax

4.32 Under section 205 of the Companies Act 1956, depreciation shall be calculated in accordance with the rates specified in Schedule XIV to the Companies Act, delinking depreciation under the Companies Act from the Income Tax Act. Under Schedule XIV depreciation on additions made to the fixed assets during any financial year shall be provided on pro-rata basis from the date of such additions.

(i) In Assam charge, the assessments of a widely held company for the assessment years 1988-89 and 1990-91 were completed after scrutiny in February and December 1992 computing taxable income at Rs. 7.95 crores and Rs. 10.50 crores respectively under the special provisions of the Act as under normal provisions taxable income was `nil'. Audit scrutiny revealed that while computing the book profits under the special provisions of the Act, provisions for gratuity, estimated loss on stores, doubtful debts and shortage of stores aggregating Rs. 225.53 lakhs charged in the relevant profit and loss accounts were not added to net profit to arrive at the correct amount of book profits. The omission to add back the amounts set apart for unascertained liabilities resulted in short computation of book profit by an identical amount leading to underassessment of income aggregating Rs. 67.66 lakhs with consequent short-levy of tax of Rs. 37.98 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, the assessments of two closely held companies for the assesment year 1989-90 originally completed in March 1992 were revised in October 1992 and January 1993 and in the case of another company, assessment for assessment year 1990-91 was completd after scrutiny in December 1992 determining their total income at Rs. 5.29 lakhs, Rs. 7.92 lakhs and

Rs. 18.13 lakhs under the special provisions of the Act. Audit scrutiny revealed that in computing the book profits, the assessee companies were incorrectly allowed depreciation for the entire year in respect of additions made to fixed assets during the relevant previous year instead of the proportionate depreciation from the date of acquisition of such assets to the end of the accounting year as per requirements of section 205 of the Companies Act, 1956. Besides, in one case, the investment allowance reserve of Rs. 3 lakhs debited to profit and loss account was not added to the net profits. The mistakes resulted in short computation of book profits by Rs. 31.89 lakhs, Rs. 35.41 lakhs and Rs. 20.22 lakhs which led to underassessment of income of Rs. 26.26 lakhs with consequent short-levy of tax of Rs. 17.64 lakhs (including interest).

The Ministry have not accepted the audit observation contending that Schedule XIV has no relevance in the case and book profit for the purpose of section 115 J is to be computed in accordance with parts II and III of Schedule VI to the Companies Act. The reply is not tenable as provisions of section 115 J as well as Explanatory Notes issued by the CBDT in September 1987 stipulate that provisions of section 205 have to be observed for purposes of calculation of profits and depreciation is to be calculated as per rates and notes laid down in Schedule XIV of the Act. A harmonious reading of Schedule VI with Schedule XIV would thus make Schedule XIV relevant for the purposes of section 115 J.

(iii) In Gujarat charge, the assessment of a company for assessment year 1990-91 was completed in November 1992 after scrutiny at an income of Rs. 18.40 lakhs under the normal provisions of the Act. Audit scrutiny revealed that the assessee had returned an income of Rs.44.08 lakhs being thirty percent of book profits under the special provisions. Since the income under special provisions was higher, the assessing officer should have adopted the income of Rs.44.08 lakhs as returned by assessee. Omission to do so resulted in underassessment of income of Rs. 25.68 lakhs with consequent short-levy of tax of Rs. 16.84 lakhs (including interest).

The Ministry have accepted the audit observation.

(iv) In Tamil Nadu charge, the assessment of a closely held company for the assessment year 1988-89 originally completed after scrutiny in March 1991 was subsequently revised to give effect to the orders of the Appellate Tribunal in August 1993 assessing a loss of Rs. 24.03 lakhs. Audit scrutiny revealed that since the company had a book profit of Rs. 71.38 lakhs, thirty percent thereof amounting to Rs. 21.41 lakhs was required to be brought to tax under the special provisions. However, it was not done. The omission resulted in non-levy of tax of Rs. 12.37 lakhs.

The Ministry have accepted the audit observation.

(v) In Tamil Nadu charge,the assessment of a widely held company for the assessment year 1989-90 originally completed in March 1992 after scrutiny was revised in June 1992, adopting income at Rs. 145.47 lakhs under the special provisions of the Act as against the lesser income of Rs. 123.35 lakhs computed under the normal provisions of the Act. Audit scrutiny revealed that in computing the income under the special provisions of the Act, a sum of Rs. 35 lakhs towards income tax provision considered for addition to the net profit and another sum of Rs. 2.64 lakhs being prior period adjustments returned by the assessee company were omitted to be added to the net profit. This mistake resulted in underassessment of income of Rs. 11.29 lakhs (30 percent of Rs. 37.64 lakhs) with consequent short-levy of tax of Rs. 10.20 lakhs (including interest).

The Ministry have accepted the audit observation.

Excess refund of tax

4.33 Under the Income Tax Act, 1961, where as a result of any order passed in assessment, appeal, revision or any other proceedings under the Act, refund of any amount becomes due to the assessee, the assessing officer may grant the refund in cash or adjust or set off the refund against outstanding dues of the assessee.

Some important cases of excess refund are given below.

(a) In Uttar Pradesh charge, in the assessment of a widely held company for the assessment year 1983-84 completed after scrutiny in October 1986, and subsequently revised in February 1989, March and August 1991 and December 1993 to give effect to appellate orders, the tax refund of Rs.95.39 lakhs already allowed in August 1991 was not considered while determining the refundable amount of Rs.153.37 lakhs in December 1993. The mistake resulted in excess refund of Rs.95.39 lakhs.

The Ministry have accepted the audit observation.

(b) In Punjab charge, in the assessment of a company for the assessment year 1993-94 completed in a summary manner in March 1994, credit of Rs.41.16 lakhs was given towards tax deducted at source from payment of interest while determining the quantum of tax payable. Since the amount was deducted and deposited in December 1993, credit for this amount should have been allowed during the assessment year 1994-95 instead of assessment year 1993-94. Further, interest of Rs.4.94 lakhs for the period April 1993 to March 1994 on this refund was also erroneously allowed. The mistake resulted in excess allowance of refund of Rs.46.10 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

(c) In Tamil Nadu charge, in the assessment of a company for assessment year 1990-91 rectified in March 1993 to give effect to orders of an appellate authority, a refund of Rs.51.08 lakhs determined due to this rectification was computed without taking into account the scrutiny assessment made in March 1993 in which the same additions had been sustained. This resulted in excess refund of Rs.43.17 lakhs (after reducing the additional tax by Rs.7.27 lakhs on account of amounts deleted by the appellate authority).

The Ministry have accepted the audit observation.

(d) In Karnataka charge, the assessment of a company for the assessment year 1990-91 which was initially completed in a summary manner in September 1991 was completed subsequently in a scrutiny manner in December 1992. While giving effect to the appellate order striking down certain additions made at summary assessment stage, the assessing officer refunded Rs.10.10 lakhs paid earlier instead of setting off the refund against the tax determined at the scrutiny assessment stage. The mistake resulted in irregular refund and consequently non-creation of demand of Rs.10.10 lakhs.

The Ministry have accepted the audit observation.

Short demand of tax

4.34 Under the Income Tax Act, 1961, when any tax, interest, penalty, fine or other sum is payable in consequence of any order passed under the Act, the assessing officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. The Act also provides that where a regular assessment is made, any tax or interest paid by the assessee on assessment made by processing of return shall be deemed to have been paid towards such regular assessment, and if no refund is due on regular assessment or the amount refunded at the time of processing the return exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded shall be deemed to be tax payable by the assessee and the provisions of the Act shall apply accordingly.

(i) In West Bengal charge, the assessment of a widely held company for the assessment year 1988-89 completed in March 1991 after scrutiny, was revised twice in February 1992 and March 1993. In the revised order of March, 1993 the total income was assessed at Rs. 238.91 lakhs and net tax demand of Rs. 52.95 lakhs (including interest) was computed as payable by the assessee. Audit noticed that the demand notice was issued for Rs. 74,900

instead of Rs. 52.95 lakhs. Issue of incorrect demand notice resulted in short demand of tax by Rs. 52.20 lakhs.

The Ministry have accepted the audit observation.

(ii) In another case, the assessment of a company for the assessment year 1991-92 originally completed in a summary manner in February 1992, was completed after scrutiny in March 1994. Audit scrutiny revealed that a refund of Rs. 35.09 lakhs granted to the assessee at the summary assessment stage was not taken into account while computing the demand payable by the assessee after the scrutiny assessment was completed. The omission resulted in short raising of demand by Rs. 35.09 lakhs.

The reply of the Ministry to the audit observation has not been received.

Incorrect procedure followed in levying additional tax

4.35 Under the Income Tax Act, 1961, as applicable from 1 April 1989 where, as a result of adjustments, the returned income of an assessee is increased or loss decreased by any amount, the assessing officer shall increase the amount of tax payable by the assessee by an amount of additional tax calculated at the rate of twenty percent of tax payable on such excess amount.

Cases have, however, been noticed in audit that rectifications which come under the ambit of prescribed adjustments of section 143(1) (a) of the Act are subsequently corrected under section 143 (3) thereof. This resulted in additional tax which would have been leviable had there been a provision under Section 143(3) or had the mistake been mandatorily rectified under section 154 pursuant to the assessment done under section 143 (1) (a), not being levied. While there is a provision in the Act that if the amount on which additional income tax payable under section 143(1A) is increased or reduced as a result of an order under section 143 (3), the additional income tax shall be increased or reduced accordingly, there is no provision in the Act / Board's instructions to rectify such an omission under section 154 instead of section 143 (3) to levy it where not done. A provision/instruction appears to be necessary in the interest of revenue. A case where substantial revenue was lost on this account is discussed below.

In West Bengal charge, the assessment of a company for the assessment year 1991-92, was completed in March 1994. Audit scrutiny had revealed that the assessing officer omitted to make prima facie adjustment of Rs. 2,324.48 lakhs involving potential tax effect of Rs. 1,069.26 lakhs and consequential non-levy of additional tax of Rs. 185.96 lakhs. This omission which was pointed out to the department in December 1993 had been accepted by the Ministry in February 1995. Audit scrutiny further revealed

that the assessing officer instead of rectifying the assessment made in a summary manner in July 1992, made an addition of Rs. 2,769.39 lakhs (in place of Rs. 2,324.48 lakhs as pointed out in audit in December 1993) in the assessment made after scrutiny in March 1994 and levied additional tax of Rs. 254.78 lakhs. Under the provisions of the Income Tax Act, 1961, additional tax would be leviable on the basis of prima facie adjustment only at the time of processing the return in summary manner and not while making a scrutiny assessment. Accordingly, the assessing officer had to rectify the assessment (made in scrutiny manner in March 1994) in December 1994 deleting the demand of additional tax of Rs. 254.78 lakhs. Absence of an enabling provision in the Act and failure to rectify the assessment made in a summary manner before the scrutiny assessment led to the loss of revenue of Rs. 254.78 lakhs representing additional tax payable by the assessee.

The Ministry have accepted the audit observation.

Omission to deduct tax at source

4.36 Under the Income Tax Act, 1961, any person responsible for paying chargeable interest (not being interest on securities) on behalf of the Government to a foreign company shall, at the time of payment, deduct income tax thereon at the rates in force and shall pay the sum so deducted to the credit of the Central Government on the same day. If such person responsbile for deducting tax at source fails without reasonable cause to deduct or after deducting fails to pay to the credit of the Central Governemnt, he will be deemed to be an assessee in default and be liable to penalty equal to the amount of the tax which he failed to deduct without reasonable cause, besides being liable to pay simple interest at 15 percent per annum on the amount of such tax from the date on which such tax was deductable to the date on which the tax is actually paid.

In Karnataka charge, the assessment of an assessee foreign company for the assessment years 1977-78 and 1981-82 to 1983-84 were revised to give effect to appellate orders in April 1991. Audit scrutiny revealed that the assessing officer had allowed interest of Rs.41.07 lakhs on the refunds but did not deduct tax at source at the prescribed rates. This resulted in non-deduction of tax of Rs.26.70 lakhs.

The Ministry have not accepted the audit observation on the ground that provisions of section 195 of the Act are not applicable as initially the interest was received by the non-resident company, it was passed on to a resident company in terms of an agreement and thus the real beneficiary was the resident company. The reply is not tenable since the interest received by the non-resident company constituted its income and its subsequent passing constituted application of income, thus attract the provisions of section 195.

SURTAX

Mistake in computation of chargeable profits for surtax

4.37 Under the Companies (Profits) Surtax Act, 1964, Surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction which is an amount equal to 15 percent of the capital of the company as on the first day of the previous year or rupees two lakhs whichever is greater. Under the provisions of Finance Act, 1984, the liability for surcharge on income tax is reduced by one half, if the amount deposited in Industrial Development Bank of India during the financial year 1983-84 payable and equals or exceeds half of the surcharge payable or is reduced to the extent to which the amount is deposited in Industrial Development Bank of India .

In Delhi charge, the surtax assessments of an insurance company for the assessment years 1984-85 and 1985-86 were completed in September 1991. Audit scrutiny revealed that while working out the net tax payable for the purpose of computation of chargeable profits, the assessing officer omitted to take into account the reduction in the liability for surcharge of income tax to the tune of Rs. 60.50 lakhs and Rs. 130.62 lakhs for the two assessment years, since these amounts had been deposited with the Industrial Development Bank of India. The mistake resulted in underassessment of net chargeable profits leading to short-levy of surtax aggregating Rs. 111.17 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect computation of capital

4.38 As per the Surtax Act, any amount standing to the credit of any account in the books of a company which is of the nature of a liability or a provision, shall not be regarded as a reserve for the purpose of computation of capital.

In Delhi charge, in the surtax assessments of an insurance company for the assessment years 1984-85 and 1985-86 completed in September 1991, the assessing officer, while computing the capital base for levy of Surtax, included therein amounts of Rs. 801.07 and Rs.819.94 lakhs respectively, representing provisions for export reserve and reserves for bad and doubtful debts treating them as reserves for computation of capital employed. Audit scrutiny revealed that export reserves and reserves for bad and doubtful debts were exhibited as current provisions in the respective balance sheets corresponding to the first day of the previous year relevant to assessment years 1984-85 and 1985-86 and hence were not reserves. Due to incorrect inclusion of these provisions in the capital base, there was excess determination of capital of Rs. 801.07 lakhs and 819.94 lakhs in those years with consequent excess grant of statutory deductions of Rs. 118.15 lakhs and Rs. 122.63 lakhs and undercharge of surtax aggregating Rs. 181.18 lakhs (including interest).

The Ministry have accepted the audit observation.

Omission to revise surtax assessment

4.39 Under the Companies (Profit) Surtax Act 1964, there is no statutory time limit for completion of surtax assessment. However, pursuant to the recommendations of the Public Accounts Committee in para 6.7 of its 128th Report (Fifth Lok Sabha), the Board issued instructions in October 1974 that surtax assessment proceedings should be initiated along with the income tax assessment. The Board further laid down that the surtax assessment should not be kept pending on the ground that the additions made in the income tax assessment were disputed in appeal and that the time lag between the dates of completion of income tax and surtax assessments should not ordinarily exceed one month unless there were special reasons to justify the delay.

In Gujarat charge, the surtax assessment of a widely held company for the assessment year 1986-87 was completed in February 1991 with reference to total income of Rs. 4,784.65 lakhs assessed under the Income Tax Act, 1961. Audit scrutiny revealed that though the income tax assessment was revised in February 1993, the surtax assessment was not revised even after six months of the completion of revised income tax assessment. Failure to revise resulted in short-levy of surtax of Rs. 43.38 lakhs.

The Ministry have accepted the audit observation.

Chapter 5

Income Tax

General

5.1 Income Tax collected from persons other than companies is booked under the major head `0021 Taxes on income other than corporation tax'. Eighty five percent of the net proceeds of this tax, except insofar as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States in accordance with the recommendations of the Finance Commission.

Receipts from income tax

5.2 The trend of receipts from income tax during the last five years is shown below:

Year	Total collection of all Direct Taxes (in crores of rupees)	Amount of Income Tax	Percentage of Income Tax to total collection
1990-91	11,028.94	5,375.34	48.74
1991-92	15,324.07	6,729.18	44.56
1992-93	18,097.29	7,863.49	43.45
1993-94	20,298.24	9,122.62	44.94
1994-95	26,970.88	12,030.12	44.60

Number of assessees

5.3 The number of assessees (other than companies) borne on the books of the Income tax department during the last five years was as follows:

As on 31 March	Number of assessees
1991	73,22,010
1992	76,60,407
1993	82,32,350
1994	1,00,28,974*
1995	1,01,08,012

Status of assessments

5.4 The following table indicates the progress in the completion of assessments and collection of demand under income tax (excluding corporation tax) during the last five years:

* The figure furnished by Ministry of Finance is at variance with that furnished last year and printed in Report of the Comptroller and Auditor Genral of India for that year.

Year	No. of assessments				Total demand		
	For disposal	Completed during the year	Pending at the close of the year	Percentage of pendency to total cases for disposal	Demand for collection	Collected during the year	Percentage of collection to total demand
					(in crores of rupees)		
1990-91	74,97,231	62,68,326	12,28,905	16.39	6,909.93	5,375.34	77.79
1991-92	78,21,446	65,66,416	12,55,030	16.04	9,127.88	6,729.18	73.72
1992-93	77,28,312	63,51,030	13,77,282	17.82	9,922.87	7,863.49	79.24
1993-94	85,10,569	72,42,046	12,68,523	14.90	12,403.40	9,122.62	73.55
1994-95	97,47,151	74,05,828	23,41,323	24.02	24,838.64	12,030.12	48.43

Results of audit

5.5 A total number of 176 audit observations involving tax effect of Rs. 16.61 crores were issued to the Ministry of Finance for comments during March to September 1995. The Ministry have accepted the observations in 125 cases involving tax effect of Rs.11.34 crores. 84 illustrative cases involving tax effect of Rs.12.71 crores are given in the following paragraphs. Out of these, the Ministry have accepted the observations in 62 cases involving tax effect of Rs.8.20 crores. Of the cases accepted by the Ministry, 12 cases involving tax effect of Rs.2.30 crores were checked by the Internal Audit wing of the department but the mistakes remained undetected.

Avoidable mistakes in computation of income and tax

5.6 Underassessment of tax of substantial amounts on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Reports of the Comptroller and Auditor General of India. Despite this and issue of repeated instructions by Government, such mistakes continue to occur suggesting the need for close supervision and control. The various types of mistakes noticed included, inter-alia, incorrect adoption of figures, totalling errors, double allowance, application of lower rate of tax etc.

(i) Over computation of income and tax

(a) In Haryana charge, the assessment of an individual for the assessment year 1990-91 which was originally completed in May 1992 was revised on several occasions. In the latest revision completed in January 1994 the income of Rs.1.41 lakhs instead of Rs.20,490 was erroneously adopted as the starting point for the recomputation. The mistake resulted in overassessment of income by Rs.1.21 lakhs involving consequent excess demand of Rs.1.20 lakhs (including interest).

The Ministry have accepted the audit observation.

(b) In Punjab charge, the assessment of an assessee firm for the assessment year 1992-93 was completed after scrutiny in February 1994. The loss of Rs.23.48 lakhs returned by the assessee

comprised business loss and unabsorbed depreciation. Audit scrutiny revealed that the assessing officer determined the net business loss after adjustments as Rs.15.21 lakhs instead of Rs.19.30 lakhs as worked out by the assessee in arriving at the total loss. The omission resulted in less determination and consequent lower carry forward of business loss of Rs.4.09 lakhs with potential overassessment of tax of Rs.2.65 lakhs.

The reply of the Ministry to the audit observation has not been received.

(ii) Under computation of income and tax

(a) In Uttar Pradesh charge, the assessment of an assessee (association of persons), for assessment year 1991-92 was completed after scrutiny in February 1994. Audit scrutiny revealed that the assessing officer starting from net loss of Rs.347.68 lakhs incorrectly deducted disallowances amounting to Rs.402.12 lakhs instead of adding it to the loss figure and thereby worked out a loss of Rs.54.44 lakhs instead of a profit of similar amount. The mistake resulted in underassessment of income by Rs.108.88 lakhs involving short charge of tax of Rs.86.17 lakhs.

The Ministry have accepted the audit observation.

(b) In Andhra Pradesh charge, the assessment of a co-operative society for the assessment year 1991-92 was completed after scrutiny in March 1994 determining a loss of Rs.60.06 lakhs. Audit scrutiny revealed that the assessing officer while computing assessable income had allowed depreciation amounting to Rs.77.25 lakhs. Since the amount of depreciation was already adjusted in the figure which was taken as the starting point by the assessing officer, depreciation was incorrectly allowed again. The mistake resulted in over-computation of loss by Rs.77.25 lakhs with a potential tax effect of Rs.30.24 lakhs.

The Ministry have accepted the audit observation.

(c) Brief particulars of 12 representative cases involving short levy of tax of Rs. 77.97 lakhs are given below:

S.No.	Commissioner's charge, Assessee's status	Assessment year and date	Section under which assessed	Nature of Mistake	Tax effect (Rs. in lakhs)
1.	Central II, Madras AOP	1990-91 & 1991-92 March 1994	144	Tax payable was incorrectly computed as Rs.36.26 lakhs and Rs.32.09 lakhs instead of Rs. 50.16 lakhs and Rs.43.25 lakhs respectively	25.06 (including interest)

2.	Jaipur Individual	1991-92 March 1994	143 (3)	While making additions to book results "income from undisclosed sources" was adopted at Rs. 16,380 instead of Rs.16,16,380 and "income from other sources" at Rs.1,57,14,545 instead of Rs.1,57,40,545. Also closing stock worked out to Rs.4,91,377 instead of Rs.4,34,923 adopted	16.20 (including interest)
3.	City IV Bombay AOP	1990-91 March 1993	143 (3)	Deduction of Rs.4.98 lakhs towards establishment expenses was allowed twice in the computation of income	4.60 (including interest)
4.	CIT - IX Delhi Individual	1991-92 March 1994	143 (3)	In computing income, certain receipts on account of cut-back in prize money not shown by the assessee estimated at Rs.2 lakhs by assessing officer were erroneously subtracted instead of being added.	4.17 (including surcharge & interest)
5.	City VII Bombay HUF	1990-91 February 1992	143(3)	Total sales as per trial balance amounting Rs.43.77 lakhs was shown at Rs.36.89 lakhs in the consolidated manufacturing trading & profit and loss account	4.09
6.	Trivandrum Individual	1980-81 March 1993	143(3)	Tax on total income worked out at Rs.78,022 instead of Rs.2.22 lakhs. Also interest for late filing of return correctly worked out to Rs.3.91 lakhs instead of Rs.1.47 lakhs levied.	3.88
7	Jodhpur Individual	1991-92 December 1993	143(3)	Due to calculation and totalling mistakes income was underassessed by Rs.2.60 lakhs	3.70 (including interest)
8	Agra Individual	1991-92 February 1994	143 (3)	Net tax payable was taken as Rs.7.57 lakhs instead of correct amount of Rs.9.57 lakhs	3.50 (including interest)
9	City I, Bombay Individual	1991-92 March 1994	143 (3)	Certain additions discussed in assessment order for addition were not added while computing taxable income	3.41
10.	AP II Hyderabad Registered firm	1989-90 March 1992 (rectified in June 1993)	143 (3)	Income-tax and interest on delay in payment of advance tax on total income of Rs.30.03 lakhs was erroneously levied at Rs.6.98 lakhs instead of the correct amount of Rs.10.13 lakhs	3.15
11.	Central Circle Kanpur Individual	1990-91 March 1994	143(3)	Tax liability and interest leviable for late filing of return and short payment of advance tax was determined at Rs.88,467 and Rs.1.44 lakhs instead of Rs.1.93 lakhs and Rs.3.51 lakhs respectively	3.12
12.	WB - X Individual	1989-90 January 1994	143(3)	Tax on total income of Rs.7.57 lakhs levied as Rs.2.71 lakhs instead of Rs.3.76 lakhs leviable	3.09 (including interest)

The Ministry have accepted the audit observations in eleven cases. Their response to the remaining one case at Sl No.11 has not been received.

Application of incorrect rate of tax

5.7 The Income Tax Act, 1961, provides that income tax is chargeable for every assessment year in respect of the total income of the previous year of a person according to the rates prescribed

under the relevant Finance Act. Further, where total income of the members of the association of persons is chargeable to tax at a rate which is higher than the maximum marginal rate applicable to association of persons, tax shall be charged on the total income of the association at such higher rate. Also the income of an association of persons where the shares of the beneficiaries are unknown is liable to be taxed at maximum marginal rate except in certain cases.

S.No.	Charge	Status of assessee	Type of assessment Assessment Year	Nature of omission	Short levy of tax (Rs. in lakhs)
1.	Maharashtra	Individual	Best judgement 1991-92	Income tax charged at the rate applicable to registered firm instead of at the rate applicable to an individual.	5.50 (including interest)
2.	Maharasthra	AOP	Summary 1993-94	Income tax charged at the rate applicable for individuals. The members of the association were all taxable entities and were charged to tax at a higher rate applicable to them. The income of the association should also be charged at such higher rate.	10.52 and excess grant of interest of Rs.84,130
3.	Maharashtra	110 discretion ary trusts	Scrutiny 1991-92 and 1992-93	Income tax charged at the rate applicable to individuals instead of maximum marginal rate.	12.73

The Ministry have accepted the audit observations.

Incorrect computation of salary income

5.8 Under the Income Tax Act, 1961, income received by an employee from an employer is chargeable to tax under the head 'salary' which also includes wages, fees, commission etc. It has been judicially held* that if on the basis of terms of employment recompense or remuneration is based as a fixed percentage of turnover then such payment would partake the form of salary. Development officers of the Life Insurance Corporation (LIC) are full time employees and a clear employer-employee relationship exists between them. Accordingly, their entire income including incentive bonus payable, though calculated and paid on the basis of the volume of business secured, constitutes salary as defined in the Act. As such no deduction other than standard deduction is admissible against the aforesaid incentive bonus or bonus commission received by the Development officers. This was also clarified by the Board in September 1987. Further, Board's circular of August 1994 clarifies the scope of prima facie deductions.

In Maharasthra charge, in the assessments of 14 individual assessees for the assessment years 1991-92 to 1993-94 completed in a summary manner between September 1993 and March 1994, the assessees had claimed and were allowed bonus expenses as deduction from bonus and commission returned and assessed under

* Gestetner Duplicators (P) Ltd. vs. CIT West Bengal (117-1TR-1 Supreme Court)

the head 'salary'. Similarly, in the assessments of a Development officer of Life Insurance Corporation for the assessment year 1991-92 in Gujarat charge and 17 Development officers of Life Insurance Corporation in Tamil Nadu charge for the assessment years 1991-92 and 1992-93 completed in a summary manner in March 1992 and between August 1992 and January 1993, they were allowed a deduction of Rs.1.26 lakhs and Rs.8.81 lakhs respectively at the rate of 40 percent of gross amount of incentive bonus. All these deductions were allowed in addition to standard deduction. Since the assessees were employees and there existed an employee-employer relationship, deduction allowed in addition to standard deduction was irregular and inadmissible. The omission resulted in short levy of tax of Rs.13.52 lakhs in aggregate (including additional tax in the cases of Development officers).

The Ministry have accepted the audit observations in the cases of Gujarat and Maharashtra charges. The audit observation in respect of Tamil Nadu cases has, however, not been accepted by the Ministry on the grounds that there were conflicting decisions of the ITAT and High Courts on this issue and therefore, it would not constitute a prima facie adjustment. This view is not tenable in view of the judicial pronouncement by the Supreme Court* that if on the basis of terms of employment, recompense or remuneration is based as a fixed percentage of turnover, then such payment would partake the form of salary. In this background and as incentive bonus is in the nature of salary, allowance of deduction other than standard deduction would not only be irregular but also patently inadmissible in terms of Board's circular of August 24, 1994 clarifying the scope of prima facie deductions.

Incorrect computation of business income

5.9.1 (i) Under the provisions of the Income Tax Act, 1961, any profits and gains, arising from the transfer of an asset other than a capital asset is chargeable to income tax under the head `profits and gains of business or profession'.

In West Bengal charge, in the assessment of an individual for the assessment year 1990-91 completed in March 1993 after scrutiny, a deduction of Rs. 3.34 lakhs was allowed from long term capital gain of Rs. 5.50 lakhs arising from sale of 10,000 shares. Audit scrutiny revealed that the shares were purchased during the previous year relevant to assessment year 1987-88. These shares were shown as stock-in-trade in the accounts of that previous year and were taken into account in arriving at the trading loss for the assessment year 1987-88. Since the profit arising from the sale of trading assets is chargeable to tax under the head `profits and gains of business or profession', incorrect allowance of deduction resulted in underassessment of income by Rs. 3.34 lakhs involving

* Gestetner Duplicators P.Ltd. vs. CIT, West Bengal (117-ITR-1-SC)

undercharge of tax of Rs. 3.16 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) Under the Income Tax Act, 1961, from April 1,1991 in the case of an assessee, (other than a public sector company) being a buyer, obtaining in any sale by way of auction, tender or any other mode, conducted by any other person or his agent, any goods in the nature of alcoholic liquor for human consumption (other than Indian made foreign liquor), a sum equal to forty per cent of the amount paid or payable by the buyer as the purchase price in respect of such goods shall be deemed to be the profits and gains of the buyer from the business of trading in such goods chargeable to tax under the head " profits and gains of business or profession". The Board clarified in November 1990 that the excise duty paid or payable by the buyer will also form part of the purchase price for the purpose of Section 44 AC and on the same analogy Nirgam Mulya paid by a buyer in the State of Uttar Pradesh will also form part of the purchase price.

In West Bengal charge, the assessment of an association of persons, engaged in the business of alcoholic liquor (other than Indian made foreign liquor) for the assessment year 1991-92, was completed after scrutiny in January 1994. Audit scrutiny revealed that while computing the profits of the business, the assessing officer adopted the purchase price at Rs.144.82 lakhs comprising cost price of Rs.46.74 lakhs and bottling price of Rs.98.09 lakhs and considered the profit of the business at Rs.57.93 lakhs being forty percent of Rs.144.82 lakhs without taking into consideration a sum of Rs.336.87 lakhs as duty (Nirgam Mulya) paid in the state of Uttar Pradesh as debited to its accounts. As clarified by the Board, "Nirgam Mulya" was required to be considered as a part of the purchase price. Omission to do so resulted in underassessment of income by Rs.134.75 lakhs (40 per cent of Rs.336.87 lakhs) involving undercharge of tax by Rs.126.77 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) Under the Income Tax Act, 1961, as applicable from assessment year 1989-90 for determining income of an assessee, engaged in sale of alcoholic liquor for human consumption (other than Indian made foregin liquor), a sum equal to forty percent of the amount paid by him as purchase price shall be deemed to be the profits and gains of the assessee and chargeable to tax under the head "profits and gains of business or profession". Another provision for collection of tax at source was simultaneously introduced in respect of aforesaid goods and given effect from 1 June 1988 (previous year 1988-89). It has been judicially held by

three High Courts during March 1989 to September 1990 that the newly introduced provisions were not independent provisions and did not dispense with the existing provisions in the Act. A regular assessment had to be made in respect of an assessee dealing in aforesaid goods in accordance with the normal provisions of the Act for computing "profits and gains of business or profession". Besides, the avowed objective, as explained by the Finance Minister in his Budget speech while introducing the aforesaid provisions of the Act, was to curb tax evasion. It could not be the legislative intent to ignore cases where the book profits were more than the deemed profits. The provisions thus introduced for the purpose of countering tax evasion, cannot be used as an instrument for evasion of tax.

In Rajasthan charge, a country liquor contractor returned an income of Rs.149.02 lakhs for the assessment year 1992-93. Audit scrutiny revealed that the assessing officer reduced this income to Rs.101.26 lakhs being 40 percent of the amount of purchase of country liquor. Since in this case the returned income was more than the presumptive income, the assessing officer ought to have taxed the income which was higher of the two. The action to tax the lower income even though the returned income was higher resulted in underassessment of income by Rs.47.77 lakhs and consequent short levy of tax of Rs.29.42 lakhs.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of provision on non-ascertained liability

5.9.2 Under the Income Tax Act, 1961, while a provision made in the accounts for an accrued or known liability is an admissible deduction, other provisions made do not qualify for deduction.

In West Bengal charge, the assessment for the assessment year 1991-92 of a proprietorship concern was completed after scrutiny in November 1993. Audit scrutiny revealed that the assessing officer allowed a provision of Rs.4.89 lakhs towards work in progress. As the amount was merely a provision and not an ascertained liability, it was not an allowable deduction. The mistake resulted in under assessment of income of Rs.4.89 lakhs involving undercharge of tax by Rs.4.52 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of liability

5.9.3.(i). Under the Income Tax Act,1961, as applicable from the assessment year 1984-85, a deduction otherwise allowable under

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*A. Sanyasi Rao vs. Govt. of Andhra Pradesh (178-ITR-31 AP HC).
Satpal and Co. vs. Excise and Taxation Commissioner and others (185-ITR-375 Pb and Haryana HC).
Sri Venketeswara Timber Depot vs. Union of India (189-ITR-741 Orissa HC)

the Act in respect of any sum payable by the assessee by way of tax or duty under any law for the time being in force or any sum payable by him as an employer by way of contribution to any provident fund or superannuation or gratuity or any other fund for the welfare of the employees shall be allowed in computing the business income of that previous year in which such sum is actually paid and not merely on the basis of accrual of the liability. From 1 April 1988 taxes and duties actually paid on or before the due date of submission of return of income for the relevant previous year shall also be allowed as deduction.

Five illustrative cases involving tax effect of Rs.49.85 lakhs are given below:

Sl. No.	Commissioner's charge, Assessee's status	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1.	Rohtak Co-operative Sugar Mill	1992-93 November 1993	143(3)	Unpaid statutory liability of cane cess of Rs.48.31 lakhs though not paid before the due date of filing the return was allowed by the assessing officer	16.87 (P)
2.	Nasik Co-operative Society	1992-93 January 1994	143(3)	Interest of Rs.42.35 lakhs payable to a financial institution, earlier disallowed while processing assessment under section 143 (1) (a) in November 1992 and confirmed by Commissioner (Appeals) was not disallowed. No evidence seen on record that net interest payable was paid before the due date of filing of return.	16.55 (P)
3.	Haryana Co-operative Society	1989-90 October 1991 (Revised in February 1992 and January 1993)	143(3)	Bonus paid to staff amounting to Rs.12.23 lakhs was allowed twice once in assessment year 1989-90 on the basis of its proof of payment before the due date of filing the return and again in assessment year 1990-91 when the amount was debited in the accounts and actually paid.	8.32 (including interest)
4.	Ranchi Two partnership firms	1993-94 March 1994 and February 1994	143 (3)	Out of total bonus of Rs.39.82 lakhs debited in profit and loss account and allowed by assessing officer as deduction, Rs.15.32 lakhs was paid to the employees after the due date of filing the return as certified by the Chartered Accountant	8.11

The Ministry have accepted the audit observations.

(ii) It has been held by the Supreme Court* that the amount of sales tax collected by a trader in the course of business constitutes his trading or business receipts and is liable to be included in his business income. Several state governments have introduced sales

* Chowringhee Sales Bureau Pvt. Ltd. vs. CIT (87-ITR-542 SC)
Sincere Murry Co. Pvt. Ltd. vs. CIT WB (97-ITR-615 SC)

tax deferment schemes as a part of the incentive offered to entrepreneurs for setting up industries in the backward areas. Under these schemes eligible units are permitted to charge sales tax and retain the amount of tax so collected for a prescribed period and on expiry of this period the amount of sales tax so collected and retained is to be paid to Government. The Board in its circular issued in September 1987 clarified that if the State Government make an amendment in the Sales Tax Act to the effect that sales tax deferred under the scheme shall be treated as actually paid, such a deeming provision will meet the requirements of the provision of Income Tax Act. The Government of Maharashtra had amended the State Sales Tax Act to introduce such deeming provision. However, no such provision has been made in respect of Central Sales Tax Act.

(a) In Maharashtra charge, the assessments of an association of persons for assessment years 1989-90 to 1991-92 were completed between January 1990 and February 1992. Audit scrutiny revealed that amounts of Rs.1.94 lakhs, Rs.2.76 lakhs and Rs.1.42 lakhs being Central sales tax liability for the previous years relevant to assessment years 1989-90,1990-91 and 1991-92 were outstanding as per the balance sheets. The aggregate amount of Rs.6.12 lakhs being unpaid liability of Central sales tax should have been added back to income of the respective years by the assessing officers. Omission to do so resulted in aggregate underassessment of income of Rs.6.12 lakhs involving short levy of tax of Rs.4.17 lakhs.

The reply of the Ministry to the audit observation has not been received.

(b) The Government of Madhya Pradesh introduced a new provision in the M.P. General Sales Tax Act,1958 providing that a registered dealer liable to pay sales tax but enjoying the benefit of deferment of the liability would be deemed to have paid the tax if the agencies specified by the State Government have created against the dealer, a loan liability equal to the amount of his tax liability.

In Madhya Pradesh charge, assessment of an individual for the assessment year 1992-93, was completed after scrutiny in December 1993. Audit scrutiny revealed that the assessing officer allowed a deduction of Rs.23.69 lakhs towards deferred sales tax liability of the assessee without furnishing the requisite order/evidence of the specified agency of the State Government, converting the amount of deferred tax into a provisional/final loan liability, as required for allowance of deduction under section 43 B of the Act. The mistake resulted in underassessment of income of Rs.23.69 lakhs involving short levy of tax of Rs.18.84 lakhs (including interest).

The Ministry have accepted the audit observation.

Incorrect valuation of closing stock

5.9.4 (i) Under the Income Tax Act, 1961, the income of an assessee from business or profession shall be computed in accordance with the method of accounting regularly employed by the assessee. In order to determine the profits from business, an assessee who maintains accounts on mercantile basis may choose to value closing stock of his business every year at cost or market price whichever is lower. It has been judicially held and later confirmed by Supreme Court* and the Ministry of Law that where a business comes to an end, stock in hand would be valued at the market rate in order to determine the true profits of the business on the date of closure of the business.

(a) In Maharashtra charge, the assessment of an assessee for the assessment year 1989-90 was completed after scrutiny in March 1992. Keeping in view the opening stock of standard gold as disclosed in the accounts, audit scrutiny revealed that the assessee had sold 2800 grams of standard gold out of 6720 grams purchased during the previous year at an average rate of Rs.3029 per 10 grams. Since the average purchase price of standard gold for the year was Rs.3292 per 10 grams and the minimum price of such gold from October 1987 onwards was not less than Rs.3150 per 10 grams, the sale of gold was at a lower price than its purchase price. Comparing the sale price with purchase price, the sale was understated to the extent of Rs.7.36 lakhs. It was further revealed that the value of closing stock of 22 carat gold of 49749 grams was shown at Rs.28.23 lakhs in the trading account. Considering the purchases of 64186 grams of 22 carat gold made by the assessee during the year, the value of closing stock should have been Rs.129.34 lakhs based on average purchase price of Rs.2600 per 10 grams. Moreover, the auditor had commented that valuation was on cost basis. This resulted in undervaluation of closing stock by Rs.101.11 lakhs. Thus, there was underassessment of income of Rs.108.47 lakhs involving short levy of tax of Rs.56.95 lakhs (including surcharge)

The reply of the Ministry to the audit observation has not been received.

(b) In Maharashtra charge, the assessment of a firm for the assessment year 1993-94 was completed after scrutiny in March 1994. Audit scrutiny revealed that the business of the firm was taken over by a partner on its dissolution and the closing stock was valued at Rs.24.07 lakhs at cost. As the business run by the registered firm was taken over by the proprietory concern, the closing stock held by the firm should have been valued at market

* A.L.A. Firm vs. CIT (189-ITR-285 SC)

price to determine the true profits of business on the date of its closure. In the absence of details of market value, the ratio between the sales and cost of goods sold should have been adopted to determine the market price of closing stock. Had this been done, an amount of Rs.14.18 lakhs would have been added to income in the hands of assessee involving a tax effect of Rs.7.88 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) Under the Income Tax Act, 1961, where the accounts are correct and complete, but the method employed is such that the income cannot properly be deduced therefrom, the computation will be made upon such basis and in such manner as the assessing officer may determine. If closing stock does not include any element of cost correctly, the assessing officer should conclude that the account does not reflect the true profits and should bring the under valuation of stock to tax. In real estate transactions, the term 'on money' is popularly used to denote unaccounted money which changes hands in such transactions. Such money would form part of sale price.

In Maharashtra charge, the assessment of a registered firm for the assessment year 1990-91 was completed after scrutiny in March 1993. Audit scrutiny revealed that the assessee had sold ten flats with a total floor area of 5460 square feet at the rate of Rs.420 (approximately) per square foot. Further scrutiny of the assessment records revealed that in the assessment year 1989-90, the sale prices of the flats in the same building were taken to be Rs.600 to 700 per square foot considering 'on money' of Rs.275 per square foot which the assessee admitted receiving the same. Based on this information and admission by the assessee, the sale price of the ten flats of the same building, sold out during the assessment year 1990-91, should also have been adopted at Rs.700 per square foot taking into consideration the 'on money' received. Omission to adopt this value in the assessment resulted in underassessment of income of Rs.15.40 lakhs with consequent short levy of tax of Rs.17.53 lakhs in the hands of the firm and its partners (including interest).

The Ministry have accepted the audit observation.

Irregularities in allowing depreciation

5.10.1 Mistake in allowance of depreciation

Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purpose of his business during the relevant previous year.

5.10

In several assessments it was noticed that depreciation was not allowed correctly. 3 illustrative cases involving tax effect of Rs.29.23 lakhs are mentioned below:

S.No.	Commissioner's charge Assessee's status	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1.	Pune AOP	1991-92 March 1994	143(3)	Depreciation of Rs.92.61 lakhs was allowed as against correct amount of Rs.84.48 lakhs admissible	8.65 (including interest)
2.	Kolhapur Co-operartive Society	1990-91 December 1992	143(3)	Depreciation of Rs.224.84 lakhs as claimed in original return was erroneously allowed without taking into consideration the revised return filed later claiming depreciation of Rs.191.23 lakhs	15.38(P)
3.	Kanpur Registered firm	1991-92 March 1994	143(3)	Depreciation on transport vehicles not used for the business of running them on hire was allowed at the rate of 50 percent instead of 33.1/3 percent of written down value.	5.20

The Ministry have accepted the audit observations.

Incorrect allowance of depreciation on technical know how

5.10.2 Under the provisions of the Income Tax Act, 1961, as inserted by the Finance Act, 1985, with effect from 1 April 1986, where an assessee has paid, in any previous year, any lump sum consideration for acquiring know-how for the purpose of his business, one-sixth of the amount so paid shall be deducted in computing the business income for that year and the balance amount shall be deducted in equal instalments in each of the five immediately succeeding years. As the payments are allowed to be deducted as revenue expenditure, such payments cannot be treated as incurred for acquiring any capital asset from assessment year 1986-87 onward so as to qualify for depreciation, investment allowance etc.

In Gujarat charge, the assessment of a co-operative society, for the assessment year 1991-92 was completed in February 1994 after scrutiny. Audit scrutiny revealed that depreciation at one third of the amount of Rs. 227.27 lakhs paid as technical know-how fees to foreign collaborators was erroneously allowed instead of one sixth thereof. The incorrect allowance of depreciation resulted in underassessment of income of Rs. 37.87 lakhs involving short levy of tax of Rs. 25.24 lakhs (including interest).

The Ministry have not accepted the audit observation on the ground that the observation was based on a judgement of Bombay High

Court which had missed a judgement of Supreme Court* holding that technical knowhow was akin to a plant and hence entitled to claim depreciation. This view has been overtaken by the introduction of section 35 AB with effect from 1 April 1985 stipulating that expenditure on technical knowhow is to be deducted in six equal instalments. The special provision i.e. section 35 AB should override any judgement rendered prior to its introduction and based on this, the Ministry have earlier accepted a similar observation featured as paragraph 3.12.2 of the Report of the Comptroller and Auditor General of India on Union Government Direct Taxes for the year 1990-91.

Excess carry forward and set off of unabsorbed depreciation

5.10.3 (i) Under the Income Tax Act, 1961, where for any assessment year, unabsorbed depreciation under the head 'profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year for set off against profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off.

Two illustrative cases where this provision has not been followed are given below:

S.No.	Commissioner's charge/Assessee's status	Assessment year/Date of assessment	Nature of mistkae	Tax effect (Rs. in lakhs)
1.	Karnataka II Bangalore Co-op.society	1991-92 March 1994	Unabsorbed depreciation of Rs.186 lakhs for assessment year 1990-91 and 1991-92 was allowed to be carried forward as against Rs.29.33 lakhs pertaining to assessment year 1990-91.	61.49 (P)
2	City Kolhapur Co-operative Society	1991-92 February 1994	Unabsorbed depreciation of assessment year 1989-90 was set off to the extent of Rs.47.51 lakhs as against correct amount of Rs.31.76 lakhs	7.90 (including interest)

The Ministry have accepted the audit observations.

(ii) Under the Income-tax Act, 1961, as applicable from the assessment year 1989-90, where as a result of an order of scrutiny assessment or best judgement assessment or revision, rectification or on settlement relating to any earlier assessment year and passed subsequent to the filing of the return of income processed under the summary assessment scheme for any subsequent year, there is any variation in the carry forward of loss, deduction, allowance or relief claimed in the return and as a result of that if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable and such intimation shall be deemed to be a notice

* CIT vs Elecon Engineering Co. Ltd. (166 ITR-66-SC)

of demand and all the provisions of the Act shall apply accordingly.

In Karnataka charge, the assessment of a co-operative society for the assessment year 1992-93 was completed in December 1992 in a summary manner computing `nil' income after setting off entire unabsorbed depreciation and investment allowance of Rs.114 lakhs of the earlier assessment year against income of Rs.119 lakhs. Audit scrutiny revealed that in the assessment for the assessment year 1991-92 completed after scrutiny in November 1993, the entire unabsorbed loss of Rs.114 lakhs was allowed as set off against income of that year and the balance income was brought to tax. Consequently, no amount was to be carried forward to assessment year 1992-93. Since scrutiny assessment for the assessment year 1991-92 was completed after the date of filing of return of income for the assessment year 1992-93, the order determining the set off of loss processed for the assessment year 1992-93, was required to be revised to rectify irregular set off and to send a fresh intimation. Omission to do so resulted in irregular set off of loss to the extent of Rs.112 lakhs (after allowance of admissible deduction) with consequent short levy of tax of Rs.61.64 lakhs (including interest for non payment of advance tax).

The Ministry have not accepted the audit observation on the ground that returns are processed in a summary manner on the basis of details filed by assessee and not with reference to earlier records. They have added that this case was subsequently completed after scrutiny considering the incorrect carry forward of loss, hence there was no loss of revenue. The reply is not tenable since as per provisions of section 143(1)(b), an assessment earlier done under section 143(1)(a) is to be revised statutorily where there is a variation in the carry forward of loss, allowance or relief due to an order under section 143(3) being passed for any earlier assessment subsequent to the intimation under section 143(1)(a). This was not done in this case.

Irregularities in allowing investment allowance

5.11.1 Incorrect allowance of investment allowance

Under the Income Tax Act, 1961, a deduction by way of investment allowance is allowed in the case of an industrial undertaking, not being a small scale undertaking, in respect of machinery or plant installed or put to use in the previous year for the purpose of business of construction, manufacture or production of any article or thing not being an article or thing specified in the Eleventh Schedule. It has been judicially held* in September 1993 that a company engaged in the construction of dams, bridges, roads or canal or similar other construction is not entitled for allowance of investment allowance.

* CIT vs N.C. Budharaja and Co. and others (204-ITR-412-SC) (and other connected appeals)

Three illustrative cases where investment allowance was incorrectly allowed, involving tax effect of Rs.23.40 lakhs are given below:

S.No.	Commissioner's charge, Assessee's status	Assessment year and date	Nature of mistake	Tax effect (Rs. in lakhs)
1.	City IX Bombay Firm	1987-88 and 1988-89 /July 1990 (revised)	Investment allowance of Rs.34.16 lakhs was erroneously allowed though the assessee was engaged in the business of construction of dams, canals etc.	8.61 (firm alone)
2.	City IX Bombay Registered firm	1990-91 December 1991	Investment allowance at the rate of 25 percent amounting to Rs.52.45 lakhs was allowed on earth moving machinery used for construction of irrigation channels	8.28
3.	Tamil Nadu IV Madras Individual	1989-90 and 1990-91 /March 1992 and February 1993	Investment allowance of Rs.4.33 lakhs and Rs.2.83 lakhs was allowed though the assessee was engaged in the business of contruction of buildings	6.51 (including interest)

The Ministry have accepted the audit observations.

5.11.2 Incorrect set off of investment allowance

Under the Income Tax Act, 1961, where for any assessment year unabsorbed investment allowance under the head " profits and gains of business or profession" cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be set off against the total income computed in the specified manner and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off up to a maximum of eight assessment years, immediately succeeding the assessment year relevant to the previous year in which the said asset was acquired or installed or put to use in the succeeding previous year.

In Gujarat charge, in the assessment of a cooperative society for the assessment year 1990-91 completed after scrutiny in February 1993, the assessing officer allowed set off of unabsorbed investment allowance of earlier years amounting to Rs.5.39 lakhs on the basis of details of investment allowance filed by the assessee. Audit scrutiny, however, revealed that as against investment alllowance of Rs.15.22 lakhs and Rs.1.28 lakhs shown to have been allowed for the assessment years 1986-87 and 1987-88 as per details filed by the assessee, the correct amounts were Rs.22.84 lakhs and Rs.8.39 lakhs actually allowed. Incorrect adoption of figures of investment allowance resulted in excess set off of unabsorbed investment allowance amounting to Rs.14.72 lakhs involving short levy of tax of Rs.9.46 lakhs.

The reply of the Ministry to the audit observation has not been received.

Computation of capital gains

5.12.1 Incorrect computation of capital gain on transfer of a land and building/ goodwill

(i) Under the Income Tax Act, 1961, any profits 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 capital asset provides for deduction, from the consideration received, of the cost of the asset and the cost of any improvement thereto and of expenditure incurred wholly and exclusively in connection with its transfer. In the case of an assessee other than a company, where the capital gains relate to transfer of a land and buildings, a further deduction of Rs.10,000 plus 50 percent of the amount in excess of Rs. 10,000 is allowed. The percentage depends upon the class of asset. However, cost of acquisition in relation to a capital asset being goodwill of the business in the case of acquisition of such asset by the assessee by purchase from a previous owner shall be the amount of the purchase price and in any other case it shall be taken to be 'nil'.

(a) In Maharashtra charge, the assessment of an individual for the assessment year 1989-90 was completed after scrutiny in January 1993 computing total income of Rs. 67.47 lakhs which included long term capital gain of Rs. 44.88 lakhs on sale of land and building during the relevant previous year. Audit scrutiny revealed that while computing the taxable capital gains, a deduction of Rs. 67.57 lakhs being Rs. 10,000 plus sixty percent of the excess over Rs. 10,000 of the total capital gain was allowed as against the allowable deduction of Rs. 56.28 lakhs being Rs. 10,000 plus fifty percent of the excess over Rs. 10,000 . The mistake resulted in underassessment of long term capital gains of Rs. 11.29 lakhs involving short levy of tax of Rs. 5.88 lakhs.

The Ministry have accepted the audit observation.

(b) In Maharashtra charge, the assessment of a registered firm for the assessment year 1993-94 was completed in February 1994 after scrutiny, allowing a deduction of Rs.18.19 lakhs being the cost of acquisition of goodwill as computed by approved valuer from the amount of Rs.27 lakhs received on its transfer. Audit scrutiny revealed that the assessee had acquired the goodwill by running the business of motor repairs over an uninterrupted period of 48 years. As the goodwill was not purchased its cost should have been taken as ` nil'. The incorrect deduction resulted in underassessment of long term capital gain of Rs.18.19 lakhs involving short levy of tax of Rs.7.46 lakhs including interest and surcharge.

The Ministry have accepted the audit observation.

(c) The Board have clarified in September 1987 that the provisions relating to the exemptions will have to be applied first and the deduction of Rs.10,000 plus a percentage of the excess over Rs.10,000 will be allowed on the remaining part of the capital gains.

In Maharashtra charge, the assessment of an individual for assessment year 1991-92 was completed after scrutiny in October 1993 and no capital gains was charged on sale of house property after availing of all deductions/ exemption available. Audit scrutiny revealed that the assessee had incorrectly computed the taxable capital gain as 'nil' by claiming the deduction of Rs.10,000 plus 50 percent of the excess over Rs.10,000 first and then claiming the balance amount as exempt under the provisions of the Act. The omission in not allowing the exemptions first resulted in underassessment of capital gains by Rs.6.05 lakhs involving short levy of tax of Rs.6.07 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

(d) The Act further provides that where the capital gains arises from the transfer of agricultural land and the assessee purchases, within a period of two years after the date of transfer, any other land for being used for agricultural purposes, then the difference between the amount of capital gains and the cost of the new land shall be charged as income of the previous year under the head `capital gains'.

In Tamil Nadu charge, the assessment of an individual for assessment year 1992-93 was completed in a summary manner in March 1993 and revised in December 1993 to give effect to the orders of an appellate authority. Audit scrutiny revealed that the assessee had computed capital gains on certain lands sold during the relevant previous year by reducing the cost of new lands purchased (Rs.117 lakhs) and cost of improvement like levelling, fencing etc (Rs.13 lakhs). This deduction of cost of improvements from the capital gains was accepted by the assessing officer. As there was no provision in the Act to allow such cost as a deduction from the capital gains and the information was available in the return and its accompanying documents, the mistake should have been rectified as a prima facie adjustment. The omission resulted in under assessment of income of Rs.13 lakhs with consequent short levy of tax of Rs.11.21 lakhs (including additional income tax and interest).

The Ministry have accepted the audit observation.

(ii) Under the Income Tax Act, 1961, where the capital asset is an

asset forming part of a block of assets in respect of which depreciation has been allowed, the capital gain arising from the transfer of such assets is considered as capital gain arising from the transfer of short term capital asset. The Act does not provide for allowance of depreciation on land.

In Maharashtra charge, the assessment of a registered firm for the assessment year 1990-91 was completed in February 1993. Audit scrutiny revealed that the consideration received on sale of land and building forming part of its factory on which depreciation had been claimed from assessment year 1981-82 to 1988-89 was to be assessed as short term capital gains since it related to depreciable assets. It was further revealed that the assessing officer accepted the contention of the assessee and bifurcated the value of land and building treating consideration on building received as short term capital gain and that for land as long term capital gain. Since the sale was a composite sale and the bifurcation was done to avoid computation as short term capital gains, the assessing officer should have assessed it as short term capital gains. Omission to do so resulted in underassessment of capital gains of Rs. 4.12 lakhs leading to short levy of tax of Rs. 2.89 lakhs in the hands of firm and partners. As the actual cost of Rs. 20 lakhs of the new assets acquired during the previous year would be adjusted against the sale consideration reducing the written down value of the block of assets to which the new assets may belong, the assessee would not be eligible for depreciation on the block of asset to that extent in subsequent years.

The Ministry have accepted the audit observation.

5.12.2 Incorrect computation of capital gain on depreciable asset

The Act further provides that where an asset transferred is part of a block of assets in respect of which depreciation has been allowed and where the full value of the consideration received as a result of such transfer exceeds the aggregate of the expenditure incurred in connection with such transfer, the written down value of the block of assets at the beginning of the previous year and the actual cost of any asset falling within the block of assets acquired during the previous year, such excess shall be treated as short term capital gain.

In Maharashtra charge, the assessment of a registered firm for the assessment year 1992-93 was completed after scrutiny in March 1994. Audit scrutiny revealed that an amount of Rs. 2.75 lakhs was brought to tax as capital gain arising from transfer of long term capital asset on account of failure of the assessee to utilise the amount of capital gains for specified purposes within the prescribed

time limit. The capital gain arose in the previous year relevant to assessment year 1989-90 from the transfer of a depreciable asset on which depreciation was allowed. As the asset transferred was a depreciable asset, capital gain thereon was required to be computed as short term capital asset under the special provisions for computation of capital gain on such assets. Accordingly, short term capital gain of Rs. 6.58 lakhs was chargeable to tax as against long term capital gain of Rs. 2.75 lakhs brought to tax. The mistake resulted in underassessment of income of Rs. 3.83 lakhs involving short levy of tax of Rs. 2.49 lakhs in the hands of the firm and its partners.

The Ministry have not accepted the audit observation on the grounds that section 50 is not applicable in this case since the present income did not arise out of transfer of capital assets but due to failure to utilise the long term capital gains in term of section 54 G of the Act. This view is not tenable since section 50 which deals with capital gains for capital assets overrides and excludes the operation for other provisions. Thus, as per this provision, the capital gains to be charged can only be short term capital gains for the transfer in assessment year 1989-90. Once it is short term capital gains in assessment year 1989-90, it would remain a short term capital gain in 1992-93.

5.12.3 Irregular exemption allowed in the computation of capital gains for construction of residential house

Under the Income Tax Act 1961, capital gains arising from the transfer of a long term capital asset other than a residential house is exempt from tax to the specified extent if the assessee has, within a period of one year before or two years after the date of transfer, purchased or has within a period of three years after that date constructed a residential house, provided the assessee did not own any other residential house on the date of transfer of capital asset.

In West Bengal charge, the assessment of an individual assessee for the assessment year 1993-94 was completed in a summary manner in March 1994 determining taxable capital gain arising from the transfer of capital asset other than residential house at Rs.12.88 lakhs after allowing exemption of Rs.39.51 lakhs being amount utilised for the purpose of acquiring a residential house. Audit scrutiny revealed that the information that the assessee owned on the date of transfer several residential houses, the income from which was charged to tax under the head 'income from house property', was available from the documents accompanying the return of income. Accordingly, the assessee was not entitled to the exemption as allowed by the assessing officer. The incorrect grant of exemption resulted in underassessment of income of Rs.39.51 lakhs involving short levy of tax of Rs.10.98 lakhs (including

interest) besides non-levy of additional income tax of Rs.1.77 lakhs.

The reply of the Ministry to the audit observation has not been received.

5.12.4 Incorrect computation of interest income as capital gains

Under the Income Tax Act, 1961, income of every kind which is not to be excluded from the total income under the Act shall be chargeable to income tax under the head income from other sources', if it is not chargeable to income tax under any other head of income specified in the Act.

In Bihar charge, the assessment of an individual for the assessment year 1993-94 was completed after scrutiny in February 1994 at a total income of Rs.95,050 which included a capital gain of Rs. 51,457. Audit scrutiny revealed that the assessee had received in the relevant previous year fifty percent share of refund of bid money alongwith interest thereon amounting to Rs. 60.38 lakhs in pursuance of a judicial decision. As no transfer of capital asset was involved giving rise to capital gain, the interest income was required to be brought to tax as income from other sources. Failure to do so resulted in underassessment of income by Rs. 29.60 lakhs involving undercharge of tax of Rs. 16.16 lakhs (including interest).

The Ministry have accepted the audit observation.

Income escaping assessment

5.13 (a) Under the Income Tax Act, 1961, the total income of a person for any previous year includes all incomes from whatever source derived which is received or deemed to be received or which accrues or arises or is deemed to accrue or arise in such previous year unless specifically exempted from tax by the provisions of Act.

(i) In Tamil Nadu charge, the assessment of a co-operative society for the assessment year 1985-86 originally completed after scrutiny in February 1988 was revised in March 1988. Audit scrutiny revealed that an amount of Rs. 16.55 lakhs had been appropriated towards `Area Development Fund' as shown in the Balance Sheet. It was further revealed that the fund represented retention and appropriation of part of cane price payable to cane growers by the assessee. The receipt being in the nature of trading receipt was required to be brought to tax. Failure to do so resulted in underassessment of income of Rs. 16.55 lakhs involving short levy of tax of Rs. 8.87 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Maharashtra charge, the assessment of a registered firm deriving income from construction business for the assessment year 1991-92 was completed after scrutiny in February 1994. Audit scrutiny revealed that though the main criterion for determining profit was certification of completion of work by the architect, the assessing officer accepted the estimate of the assessee ignoring the architect's certificate available on record. This certificate disclosed that 45 percent of the project estimate was completed by 31 March 1991 as against 40 percent adopted by the assessing officer. After reducing the work already considered in earlier years, the underassessment of income would work out to Rs.9.69 lakhs involving short levy of tax of Rs.6.29 lakhs (including tax liability in the hands of partners).

The Ministry have accepted the audit observation.

(b) Under the Income Tax Act, 1961, any tax deducted at source and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made and credit shall be given to him for the amount so deducted on production of the certificate in the assessment made for the assessment year for which such income was assessable. The related receipts from which the tax was deducted were, therefore, to be taken into account in computing the assessee's total income.

In Maharashtra charge, the assessment of an assessee individual, for the assessment year 1991-92 was completed after scrutiny in December 1992, allowing credit for a sum of Rs. 34,452 towards tax deducted at source from contract receipts of Rs. 16.35 lakhs. Audit scrutiny, however, revealed that out of these receipts, only Rs. 6.55 lakhs was assessed to tax. Omission to bring to tax the balance amount of Rs. 9.81 lakhs resulted in underassessment of income to that extent involving short levy of tax of Rs. 5.49 lakhs.

The Ministry have accepted the audit observation.

(c) Under the Income Tax Act, 1961, any expenditure or trading liability incurred for the purpose of business carried on by the assessee is allowed as a deduction in the computation of business income. Where on a subsequent date, the assessee obtains any benefit in respect of such expenditure or liability allowed earlier, by way of remission or cessation thereof, the benefit that accrues thereby shall be deemed to be profits and gains of business or profession to be charged to tax as the income of the previous year in which such remission or cessation takes place.

In Bihar charge, the assessment of an assessee firm for the assessment year 1989-90 was completed after scrutiny in July 1990. Audit scrutiny revealed that the assessee had received refunds of

central excise duty of Rs. 29.37 lakhs during the relevant previous year which constituted taxable income but was not brought to tax. The omission resulted in underassessment of income of Rs.29.37 lakhs involving undercharge of tax of Rs.47.92 lakhs (including interest) in the hands of the firm and partners.

The Ministry have accepted the audit observation.

(d) Under the Income Tax Act, 1961, where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery, or other valuable article and the assessing officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the assessing officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

(i) In Orissa charge, the assessment of an individual assessee, who had disclosed an investment of Rs.11.88 lakhs in the construction of a nursing home, for the assessment year 1990-91 was completed after scrutiny in March 1993. The assessing officer while completing the assessment computed the value of the nursing home at Rs. 17.23 lakhs. Audit scrutiny, however, revealed that instead of adding the difference of Rs. 5.35 lakhs, only an amount of Rs.35,873 (relating to percentage of work completed during the previous year relevant to assessment year 1990-91) was added as income from undisclosed sources. Omission to bring to tax the remaining unexplained investment resulted in underassessment of income of Rs.4.05 lakhs (after adjusting loss of Rs.94,509 as assessed) involving short levy of tax of Rs.3.37 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Maharashtra charge, the assessments of an individual for the assessment years 1986-87 to 1988-89 were completed after scrutiny in March 1994. Audit scrutiny revealed that a search operation was carried out in the residence and business premises of the assessee in August 1988 during which he declared unaccounted income of Rs.7 lakhs in his personal capacity and Rs.18.12 lakhs in the hands of the three concerns of the assessee. Though the entire amount of Rs.25.12 lakhs was considered by the department as unaccounted income of the assessee and was spread over the assessment years 1986-87 to 1989-90, the amount of Rs.7 lakhs relating to the assessment year 1989-90 was not added to the income of that year in the assessment completed in March 1993. The omission resulted

in income of Rs.7 lakhs escaping tax of Rs.12.79 lakhs (including interest and penalty).

The Ministry have accepted the audit observation.

Set off or carry forward of losses

5.14.1 Incorrect set off and carry forward of losses

Under the Income Tax Act, 1961, where for any assessment year, the net result of the computation under the head `profits and gains of business or profession' is a loss to the assessee, not being a loss sustained in speculation business, and such loss cannot be or is not wholly set off, shall, subject to other provisions of the Act, be carried forward for adjustment in the following assessment year.

In Maharashtra, Punjab and Tamil Nadu charges, in the case of 3 co-operative societies and two individuals whose assessments for the assessment years 1990-91 to 1992-93 were completed after scrutiny between February 1993 and February 1994, unabsorbed loss of Rs.208.98 lakhs and unabsorbed depreciation and loss of Rs.142.08 lakhs pertaining to earlier years was allowed to be carried forward in excess. The omission resulted in potential short levy of tax of Rs.147.63 lakhs.

The Ministry have accepted the audit observations.

5.14.2 Incorrect set off of loss

Under the Income Tax Act, 1961, where a change has occured in the constitution of a firm due to the death or retirement of a partner, the loss of the previous year proportionate to the share of the deceased or retired partner, computed under the provisions of the Act, shall not be allowed to be carried forward for set off against the income of the firm in the subsequent year. It has been judicially held* that unabsorbed depreciation is only a species of business loss.

In Tamil Nadu charge, the assessments of a registered firm, for the assessment years 1988-89 and 1991-92 were completed after scrutiny in March 1991 and August 1993 respectively. Audit scrutiny revealed that carried forward proportionate share of unabsorbed depreciation loss of Rs.48.84 lakhs in the aggregate relating to the assessment years 1984-85, 1986-87,1987-88,1989-90 and 1990-91 of retired/ deceased partners was set off against the income of the firm for the assessment years 1988-89 and 1991-92. The incorrect set off resulted in underassessment of income of Rs.48.84 lakhs for assessment year 1991-92 with consequent under charge of tax of Rs.31.68 lakhs in the hands of the firm and

* Garden Silk Weaving Factory vs CIT (189-ITR-512-SC)

partners.

The Ministry have not accepted the audit observation relying on a decision by Bombay High Court* holding that in a case of a registered firm, the unadjusted amount of unabsorbed depreciation should be carried forward and set off in the subsequent assessment years. The Ministry's reply is not tenable as besides the facts of the present case being different from the one cited in the judicial ruling, it has also been clearly held by the Supreme Court** that unabsorbed depreciation is a species of business loss. This ruling from the apex court would bring the issue within the ambit of section 78 of the Act.

Mistake in giving effect to appellate orders

5.15 Under the Income Tax Act 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeal)/appellate tribunal against orders of specified authorities and the assessing officer shall comply with the directions given in its appellate order. The Board have from time to time issued instructions for prompt action to give effect to appellate orders. In reiterating the instructions, the Board desired in February 1973 and November 1985 that in all instances, appellate orders should be given effect to within a fortnight of receipt of the relevant orders by the assessing officer.

(i) In Maharashtra charge, the assessment of a co-operative society for the assessment year 1983-84, completed in September 1985 on a taxable income of Rs.69.28 lakhs,was rectified on several occasions. Audit scrutiny revealed that in the revision made in January 1993 to give effect to appellate order deleting the addition of Rs.67.29 lakhs, the assessing officer incorrectly took the last determined income as Rs.63.93 lakhs instead of the correct amount of Rs.131.22 lakhs.This resulted in under assessment of income by Rs.63.93 lakhs involving potential short levy of tax of Rs.33.14 lakhs.

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, in the assessment of a registered firm for assessment year 1991-92 completed in March 1992 after scrutiny, the assessing officer had disallowed Rs. 10.82 lakhs towards provident fund remittance made in April 1991 but allowed the same in the assessment for assessment year 1992-93 completed in June 1993. Audit scrutiny revealed that while the assessment for assessment year 1991-92 was revised in March 1994 to give effect to appellate orders directing partial allowance of Rs. 5.06 lakhs, the consequential revision of assessment for assessment year 1992-93

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* CIT vs Nagpur gas and Domestic Appliances (147-ITR-440 Bom HC)

** Garden Silk Weaving Factory vs CIT (189-ITR-512-SC)

was not carried out to withdraw the deduction of Rs. 5.06 lakhs allowed. The mistake resulted in underassessment of income for assessment year 1992-93 by a like amount involving short levy of tax of Rs. 3.28 lakhs in the hands of the firm and partners.

The Ministry have accepted the audit observation.

Incorrect allowance of relief in respect of export turnover

5.16.1 Under the Income Tax Act, 1961, an assessee being an Indian company or a person other than a company resident in India and engaged in export business, is entitled to a deduction equal to the profit derived from the export of eligible goods or merchandise if the sale proceeds thereof are received in convertible foreign exchange within a period of six months from the end of the previous year. The profits derived from the export of manufactured goods shall be the amount which bears to the profits of the business the same proportion as the export turnover in respect of such goods bears to the total turnover of the business. The Act further provides that the profits of the business shall not take into account ninety percent of profits on sale of an import licence, cash assistance against export or duty drawback and any brokerage, commission etc. However, the profits drived from export shall be increased by the amount which bears to ninety percent of any receipt on account of profits on sale of an import licence, cash assistance against export or duty draw back the same proportion as the export turnover bears to the total turnover.

(i) Eight illustrative cases involving tax effect of Rs.50.95 lakhs are given below:

Sl. No.	Commissioner's charge, Assessee's status	Assessment year and date	Section under which assessed	Nature of mistake	Tax effect (Rs. in lakhs)
1.	City VII Bombay Registered firm	1992-93 February 1994	143(3)	Labour charges ,export commission and interest amounting to Rs.17.58 lakhs were adjusted against the amount payable under the respective heads and not disclosed separately. Consequently 90 percent of these receipts required to be reduced from profits of business for computing relief in respect of export turn over was not done and hence value computed in excess by Rs.15.82 lakhs.	10.26
2.	City XIII Bombay Registered firm	1992-93 February 1994	143(3)	Taxable income of Rs.3.32 lakhs computed after allowing deduction of Rs.13.39 lakhs towards relief in respect of profits from export turn over overlooking the fact that 90 percent of labour charges of Rs.66.35 lakhs received by the assessee were required to	8.68

				be reduced from the profits of the business while computing the relief which would have resulted in a loss of Rs.49.70 lakhs from export business. Hence relief in respect of export turnover was irregular.	
3.	WB-IX Registered firm	1992-93 March 1994	143(3)	Total income of Rs.46.56 lakhs was computed after allowing a deduction of Rs.34.63 lakhs in respect of export profit. But 90 percent of commission and service charges of Rs.84.54 lakhs and Rs.47.25 lakhs respectively received by the assessee and included in the profits of the business was not reduced while computing the adjusted profits. Hence the assessee was not entitled to any deduction in respect of export profits.	6.87
4.	Baroda Firm	1989-90 March 1992	143(3)	Deduction of Rs.39.96 lakhs allowed on export profit was computed before allowance of deduction under section 32AB.	5.72
5.	City VII Bombay Registered firm	1992-93 February 1994	143(3)	For computing deduction in respect of export business 90 percent of interest received (Rs. 7.92 lakhs) i.e. Rs.7.13 lakhs was required to be reduced from the profits of the business which was not done.	5.19 (including tax liability of partners)
6.	City I Bombay Registered firm	1992-93 March 1994	143(3)	In export business the assessee incurred a loss of Rs.20.58 lakhs and was granted export incentives of Rs.80.57 lakhs. To export profit, only Rs.72.51 lakhs (90 percent of Rs.80.57 lakhs) was requried to be added. Had this been done, the deduction for export business would have been Rs.51.93 lakhs instead of Rs.59.98 lakhs actually allowed.	5.18
7.	Poona Registered firm	1991-92 March 1994	143(3)	While working out deduction of Rs.13.52 lakhs in respect of export profit allowed, the total turnover was erroneously taken at Rs.106.65 lakhs instead of Rs.231.51 lakhs resulting in working out wrong computation of relief of Rs.13.52 lakhs as against Rs.6.23 lakhs to be allowed.	4.82
8.	City I Bombay Registered firm	1991-92 February 1994	143(3)	For working out export profit, share of profits from registered firm (Rs.35,680) and share of profit from an AOP (Rs.10 lakhs) was erroneously treated as business income of the assessee resulting in excess deduction of Rs.7.56 lakhs.	4.23

The Ministry have accepted the audit obsevations at Sl. Nos. 3 and

5. In another case, the Ministry while accepting the audit observation relating to export commission at Sl. No.1, have not accepted audit view relating to labour charges and interest on the ground that the difference of receipts and payments under these heads was the amount which qualifies for computing the relief admissible under these provisions. This view is not tenable as explanation (baa) under section 80 HHC of the Act mentions the word receipts while setting out the items that would be deductible to constitute 'profits of the business'. Ascribing a meaning of 'net of any expenditure' would be adopting a restrictive definition not envisaged under the Act. Also in view of the above, the non-acceptance of audit observation by the Ministry in the case at Sl. No.6 on the grounds that as interest receipts were offset by interest payments no adjustment was necessary, is not tenable. It may incidentally be added that the audit view that tax should be computed on gross receipts and adjustment should be made on gross receipt basis has been accepted by the Ministry in a case featured as para no. 4.14.5 (1) of the Report of the Comptroller and Auditor General of India on Union Government Direct Taxes for the year 1992-93. The audit observation at Sl.. No.2 has also not been accepted by the Ministry on the grounds that neither clause (1) nor (2) of explanation (baa) to section 80 HHC (4-A) refer to labour charges received which have to be excluded. The view of the Ministry is not tenable since clause (1) referred to in the preceding sentence refers to any receipt by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature. The term 'charges or any other receipt of a similar nature' would include 'labour charge' which has the nature of similar other income. Such inclusion would be in consonance with the rule of 'ejusdem generis' used in interpretation of statutes. Their reply to the remaining observations has not been received.

(ii) Further, the Act provides that aggregate amount of deductions under Chapter VI A cannot exceed the gross total income of the assessee computed in accordance with the provisions of the Act before making any deduction under the said Chapter.

In Maharashtra charge, the assessment of a registered firm for the assessment year 1992-93 was completed in March 1994 after scrutiny allowing deduction of Rs.3.45 lakhs for export profits. Audit scrutiny revealed that the assessee incurred a loss of Rs.4.61 lakhs in the export of trading goods and the amount which bears to 90 percent of incentives the same proportion as export turnover bears to total turnover amounted to Rs.3.45 lakhs only. As the resultant profits of the business was still a negative figure, the assessee was not entitled to any deduction. Failure to disallow the deduction resulted in underassessment of income of Rs.3.45 lakhs involving short levy of tax of Rs.2.24 lakhs including tax liability in the hands of partners.

The reply of the Ministry to the audit observation has not been received.

5.16.2. Under the Income Tax Act, 1961, an assessee being an Indian company or a person other than a company, resident in India and engaged in the business of export out of India of any goods or merchandise other than mineral oil, minerals and ores is entitled to a deduction at the prescribed rate. Export of processed mineral and ores as specified in the Twelfth Schedule is eligible for incentive deduction from 1 April 1991 being the date of introduction of the schedule. Thus no incentive deduction was admissible for export of processed mineral and ores upto 31 March 1991.

In West Bengal charge, the assessments of a registered firm for the assessment years 1988-89 to 1990-91 were completed in a summary manner/after scrutiny between September 1989 and September 1991. Audit scrutiny revealed that deductions aggregating Rs.16.67 lakhs were allowed to the assessee for export of processed mica during these assessment years. As the export relief in respect of processed mineral and ores was admissible only from the assessment year 1991-92, no deduction should have been allowed to the assessee prior to that assessment year. The incorrect allowance resulted in underassessment of income of Rs.16.67 lakhs involving tax effect of Rs.4.35 lakhs (including aggregate interest for delay in filing return of income).

The Ministry have accepted the audit observation.

5.16.3. Under the Income Tax Act 1961, an assessee being an Indian company or other assessee resident in India and engaged in the business of export, is entitled to a deduction of the profits derived from the export of eligible goods, if the sale proceeds thereof are received in convertible foreign exchange. From assessment year 1992-93, the profits derived from export in the case of an assessee who is engaged in the export of goods not manufactured or processed by him (i.e. trading goods) will be the export turnover in respect of such trading goods as reduced by the direct cost and indirect cost attributable to the export of such trading goods. Such profits are further to be increased by an amount which bears to 90 percent of the export incentives, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee. The amount received by an assessee under International Price Re-imbursement Scheme (IPRS) will be cash assistance within the meaning of section 28 (iii b) and will qualify for deduction .

In Maharasthra charge, the assessment of a registered firm, a hundred percent exporter of trading goods, for the assessment year 1992-93 was completed after scrutiny in July 1993 determining the

total income at Rs.60,690 after allowing a deduction of Rs.207.78 lakhs in relation to exports as claimed by the assessee. Audit scrutiny revealed that the assessee had incurred a loss of Rs.33.49 lakhs in the export business. Adding to it the eligible amount of export incentives amounting to Rs.190.66 lakhs, the profits of the business entitled to deduction amounted to Rs.157.17 lakhs as against Rs.207.78 lakhs considered by the department. This led to underassessment of income of Rs.50.60 lakhs involving short levy of tax of Rs.32.81 lakhs .

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction in respect of profits and gains from newly established industrial undertaking after certain date

5.17 Under the Income Tax Act, 1961, where the gross total income of an assessee included any profits and gains derived from a newly established industrial undertaking which went into production after 31 March 1981, the assessee is entitled to a deduction of 20 percent of such profits provided the industrial undertaking does not manufacture or produce any non priority article or thing specified in the Eleventh Schedule. It has been judically held* that an assessee engaged in the construction of dam, bridge, road, canal or other similar construction is not an industrial undertaking.

In Maharashtra charge, the assessment of a registered firm engaged in construction of roads and pipelines for the assessment years 1991-92 and 1992-93 was completed in March 1993 in a summary manner. Audit scrutiny revealed that the assessee had been allowed a deduction of Rs.3.11 lakhs and Rs.2.64 lakhs respectively for the assessment years 1991-92 and 1992-93 on account of profits and gains from industrial undertaking. As the assessee company was not engaged in any manufacturing activity, the deduction allowed was not in order. The mistake resulted in aggregate underassessment of income of Rs.5.75 lakhs involving short levy of tax of Rs.3.71 lakhs including tax liability in the hands of partners. The Ministry have accepted the audit observation.

Incorrect deduction in respect of profits and gains from newly established small scale industrial undertaking

5.18 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits from a newly established small scale undertaking in a rural area which is engaged in the business of manufacture or production of articles or things, a deduction equal to twenty percent of such profits is allowed while computing the business income. An industrial undertaking shall be deemed to be a small scale industrial undertaking if the aggregate value of the machinery and plant other than tools, jigs, dies and moulds, installed as on the last day of the previous year, for the

* CIT vs N.C. Budharaja and Co. and others (204-ITR-412 SC) (and other connected appeals)

purpose of the business of the undertaking does not exceed Rs.35 lakhs.

In Maharashtra charge, assessment of a registered firm for the assessment year 1992-93 was completed in July 1993 in a summary manner determining the total income at Rs.30.78 lakhs after allowing relief in respect of profits and gains from newly established small scale industrial undertaking amounting to Rs.10.31 lakhs. Audit scrutiny revealed that the aggregate value of plant and machinery installed as on the last day of the previous year relevant to the assessment year 1992-93 as per the balance sheet accompanying the return of income was Rs.76.77 lakhs. As the value of the plant and machinery exceeded Rs.35 lakhs, the firm was not a small scale industrial undertaking within the meaning of the Act and was not entitled to the said deduction. The mistake in allowing the deduction resulted in underassessment of income of Rs.10.31 lakhs involving short levy of tax of Rs.7.77 lakhs in the hands of the firm and partners (including interest).

The Ministry have accepted the audit observation.

Excess refund made to assessee

5.19 Under the Income Tax Act, 1961 where as a result of any order passed in appeal, revision or other proceedings under the Act, refund of any amount becomes due to the assessee, the assessing officer may grant the refund in cash or adjust or set off the same against outstanding dues of the assessee.

(i) In Kerala charge, the assessment of an individual assessee for assessment year 1982-83 was revised in February 1993 to give effect to orders of an appellate authority, reducing the penalty levied from Rs.36.07 lakhs to Rs.2.70 lakhs and the amount of refund was computed at Rs.17.32 lakhs. Audit scrutiny revealed that the amount was finally refunded partly in cash and partly by adjusting against outstanding demand without taking into account the amount of Rs.7.66 lakhs (demand refunded in March 1993). The mistake resulted in excess refund of Rs.7.66 lakhs.

The Ministry have accepted the audit observation.

(ii) In Kerala charge, in the revision of assessments of two individuals for assessment year 1981-82, made in November 1993, an amount of Rs.12 lakhs in aggregate was determined as refundable (including interest on refund). Audit scrutiny revealed that amount of Rs.1.28 lakhs already refunded to the individuals in December 1983 and February 1984 was not adjusted while making the said refund. Further, instead of deducting the refund already made of Rs.1.28 lakhs from the excess tax payments by the assessees, a sum of Rs.1.24 lakhs was added. These mistakes resulted in excess refund of Rs.5.68 lakhs (including interest on refund).

The Ministry have accepted the audit observation.

Failure to make proper assessment

5.20 Under the Income Tax Act, 1961, an assessment order is required to be made within two years from the end of the assessment year in which the income was first assessable. When any tax, interest etc. is payable in consequence of such order, the assessing officer is required to serve upon the assessee a notice of demand specifying the sum so payable.

In Kerala charge, a company registered under section 25 of the Indian Companies Act, 1956, filed the returns of its income for assessment years 1988-89 and 1989-90 in June 1988 and December 1989 claiming exemption in respect of the entire income derived from business amounting to Rs.4.38 lakhs and Rs.4.94 lakhs respectively. Audit scrutiny revealed that though the department had rejected the assessee's claim for exemption and determined an amount of Rs.2.53 lakhs as payable for assessment year 1988-89, no notice of demand was served on the assessee. Further, no action was initiated in time for assessment of income relating to assessment year 1989-90. The omission resulted in non-raising of demand of Rs.11.31 lakhs.

The Ministry have accepted the audit observation.

Chapter 6

Other Direct Taxes

A - Wealth Tax

Revenue from Wealth Tax

6.1 The following table gives a time series analysis of wealth tax receipts as against budget estimates during 1990-91 to 1994-95:

Year	Budget estimates	Actuals	Variation	Percentage variation
	(In crores of rupees)			
1990-91	175.00	231.17	56.17	32.1
1991-92	255.00	306.93	51.93	20.4
1992-93	300.00	467.27	167.27	55.7
1993-94	200.00*	153.98*	(-) 46.02	(-)23.0
1994-95	125.00*	104.87*	(-) 20.13	(-) 16.1

The rather large variations between the budget and actual figures indicate the need to put the budgetary estimation on a realistic basis.

Status of assessments

6.2. Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1995 are given below:

Year	No. of assessments			Percentage of total cases pending	Arrear of demands at the end of the year (in crores of rupees)
	Due for disposal	Completed during the year	Pending at the end of the year		
1990-91	9,27,525	5,96,411	3,61,114	37.7	429.52
1991-92	10,15,199	6,87,158	3,28,041	32.3	473.28
1992-93**	10,05,524	6,57,971	3,47,553	34.6	480.55
1993-94	6,13,751	4,32,574	1,81,177	29.5	423.28
1994-95	3,06,289	2,37,725	68,564	22.4	425.21

There was a steep fall in the number of assessments for disposal in 1993-94 and 1994-95 as with effect from 1 April 1993 net wealth below Rs.15 lakhs was exempted from levy of wealth tax.

* The drop in revenues in 1993-94 and 1994-95 with reference to preceding years was apparently due to the fact that with effect from assessment year 1993-94, net wealth upto Rs.15 lakhs became exempt from wealth tax and there a flat rate of 1 percent was imposed for net wealth exceeding Rs.15 lakhs for all categories of assessees.

** The above revised figures for 1992-93 furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally and incorporated in the Report of the Comptroller and Auditor General of India on Union Government - Direct Taxes for that year.

Although there was reduction in the work load, the department could complete 2.38 lakhs assessments in 1994-95 against 4.32 lakhs assessments completed in the earlier year. This resulted in the pendency position improving only marginally from 29.5 percent in 1993-94 to 22.4 percent in 1994-95.

Results of audit

6.3 During the test audit of assessments completed under the Wealth Tax Act, 1957, conducted during the period 1 April 1994 to 31 March 1995, short levy of wealth tax of Rs.7.55 crores was noticed in 1256 cases.

A total number of 80 audit observations involving tax effect of Rs.238.28 lakhs were issued to the Ministry of Finance for comments during March to September 1995. Out of these, the Ministry of Finance have accepted the observations in 39 cases involving tax effect of Rs. 68 lakhs in respect of non-company assessments and 15 cases with tax effect of Rs.32.48 lakhs in respect of company assessments. 8 cases involving tax effect of Rs.15.71 lakhs were checked by the Internal Audit wing of the department but the mistakes were not detected by them.

27 illustrative cases with tax effect of Rs.176.86 lakhs are discussed in the succeeding paragraphs to highlight the important audit observations. Out of these, the Ministry of Finance have accepted the observations in 19 cases involving tax effect of Rs.60.68 lakhs. While paragraphs 6.4 to 6.7 are on wealth tax on assessees other than companies, paragraphs 6.9 to 6.13 relates to company cases

Wealth not assessed

6.4 (i) Under the Wealth Tax Act, 1957, wealth tax on assessees other than companies is chargeable in respect of each assessment year on their net wealth as on the valuation date relevant to that assessment year at the rates prescribed in the Schedule to the Act. Net wealth means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date.

(a) In Assam charge, five individuals co-owned urban land and buildings in a city in equal shares. The income tax return of one of the co-owners for the assessment year 1989-90 disclosed that he declared sale of 4 bighas 2 kathas 6 lechas of urban land to State Bank of India for a sale consideration of Rs.55.51 lakhs and claimed exemption from capital gains tax on investment in specified assets. The assessee again entered into an agreement in January 1991 to sell another 3 bighas 15 lechas of land of same locality to National Bank of Agricultural and Rural Development which was eventually settled at Rs.63.86 lakhs in October 1992. Audit scrutiny revealed that upto assessment year 1977-78, the house property was valued at Rs.4 lakhs and entire holding of 28 bighas 1 katha 7 lechas of land was shown as agricultural land by

the original owner and was exempted from tax as claimed by the assessee. Accordingly, in the income tax assessment of one of the co-owners for the assessment year 1989-90, the assessing officer treating the land as agricultural land had rejected the assessee's claim for exemption from capital gains tax. The said assessment was set aside in appeal considering the assessee's submission that entire land was originally brought under Urban Land Ceiling Act of 1976 and subsequently final settlement orders issued by the local authority in June 1983 permitting the assessee to legally retain the urban land. Thus, for all practical purposes the land was legally treated as urban land since the assessment year 1984-85. The market value of the land estimated on the basis of the sale consideration of land, investment shown in the income tax returns and adopting 10 percent reduction in value of land for assessment years preceding 1988-89 (on basis of cost inflation index for capital gains), a practice generally adopted by the department when actual valuation is awaited or is not known, the value of assets would range between Rs.234.84 lakhs and Rs.529.60 lakhs. However, all the five assessees being co-owners of aforesaid assets had not filed wealth tax returns for the assessment years 1984-85 to 1992-93 nor did the department initiate any wealth tax proceedings. The omission resulted in wealth aggregating Rs.3,357.29 lakhs escaping assessment with consequent non-levy of wealth tax of Rs.82.62 lakhs.

The reply of the Ministry to the audit observation has not been received.

(b) In West Bengal charge, the income tax assessments of an individual for the assessment years 1980-81 to 1984-85 were completed ex-parte between March 1987 and March 1989. Audit scrutiny revealed that these assessments were framed on the basis of bank deposits of the assessee ranging between Rs.10 lakhs to Rs.112.38 lakhs relating to aforesaid assessment years, unearthed after a search operation at his premises. Bank deposits being an asset of the assessee constituted his wealth on which he was liable to pay wealth tax. However, the assessee did not file any returns of wealth nor did the department initiate any wealth tax proceedings. The omission resulted in wealth aggregating Rs.145.48 lakhs escaping assessment with consequent non-levy of wealth tax of Rs.10.64 lakhs (including penalty for concealing the particulars of wealth).

The reply of the Ministry to the audit observation has not been received.

(c) In West Bengal charge, the income tax assessment of an individual for the assessment year 1990-91 was completed after scrutiny in March 1993. Audit scrutiny revealed that the assessee

owned immovable and movable properties valued at Rs.229.63 lakhs on the valuation date 31 March 1990 relevant to assessment year 1990-91. Since the assessee had taxable wealth, he was liable to pay wealth tax on his net wealth. However, no wealth tax return was filed by the assessee nor did the department take any action to initiate wealth tax proceedings.The omission resulted in wealth of Rs.229.63 lakhs escaping assessment with consequent non-levy of wealth tax of Rs.4.15 lakhs.

The reply of the Ministry to the audit observation has not been received.

(d) In Bihar charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1991-92 revealed that the assessee owned let out house properties which were chargeable to wealth tax. The assessee had received house rent of Rs. 5.82 lakhs in the relevant previous year, based on which the value of the properties worked out to Rs. 61.81 lakhs. However, the assessee did not file the return of wealth nor did the department initiate any wealth tax proceedings. The omission resulted in wealth of Rs. 61.81 lakhs escaping assessment with consequent non levy of wealth tax of Rs. 1.74 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) It has been judicially held* that the moment an assessee's land is acquired or otherwise vests in the state, he becomes entitled to compensation and that the right to receive compensation is an asset.

In Punjab charge, the wealth tax assessments of an individual for the assessment years 1986-87 to 1988-89 and 1991-92 were completed after scrutiny in October 1989, November 1991 and March 1994 and for assessment years 1989-90 and 1990-91 in a summary manner in March 1991. Audit scrutiny revealed that the assessee had received compensation amounting to Rs.14.78 lakhs in May 1985 and Rs.20.71 lakhs in March 1991 besides interest of Rs.24 lakhs in March 1991 for his land acquired by the State Government in February 1983. As the compensation had accrued to the assessee on the date on which the land was acquired from him, it was includible in his wealth from assessment year 1983-84 to 1991-92. However, no wealth tax returns were filed by the assessee for assesment years 1983-84 to 1985-86 and for assessment years 1986-87 to 1991-92, he had not filed revised returns for assessment of compensation of Rs.20.71 lakhs and interest of Rs.24 lakhs received in March 1991. No action was taken by the department to initiate any wealth tax proceedings for assessment years 1983-84 to 1985-86 and also to revise

* CWT vs Smt. Anjamli Khan - 187 ITR 345 (SC)

assessments for assessment years 1986-87 to 1991-92. The omission resulted in wealth aggregating Rs.254.73 lakhs escaping assessment with consequent non-levy of wealth tax of Rs.6.52 lakhs.

The reply of the Ministry to the audit observation has not been received.

(iii) Under the Wealth Tax Act, 1957, where a minor is admitted to the benefits of partnership in a firm, the value of his interest in the firm, determined in the manner laid down in Schedule-III to the Act, shall be included in the net wealth of the parent of the minor.

In Tamil Nadu charge, the wealth tax assessments of an individual, for the assessment years 1990-91 and 1991-92, were completed in December 1992 and February 1994 determining a taxable wealth of Rs. 272.95 lakhs and Rs. 346.06 lakhs respectively. Audit scrutiny revealed that the value of interest of the assessee's two minor sons in two firms aggregating Rs. 95.80 lakhs and Rs.190.20 lakhs for the assessment years 1990-91 and 1991-92 respectively, constituted wealth of the assessee but it was not included in his net wealth. The omission resulted in underassessment of wealth aggregating Rs. 286 lakhs with consequent short levy of tax of Rs. 5.38 lakhs.

The Ministry have accepted the audit observation.

(iv) Under the Wealth Tax Act, 1957, `asset' includes property of every description, movable or immovable. The right to receive compensation on account of acquisition of land is, therefore, an asset, includible in the net wealth.

In Himachal Pradesh charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1990-91 revealed that six other individuals became entitled to receive compensation of Rs. 27.79 lakhs, Rs. 12.67 lakhs, Rs. 57.34 lakhs, Rs. 20.60 lakhs, Rs. 15.78 lakhs and Rs. 9.18 lakhs respectively on account of acquisition of their land by the Land Acquisition Officer in October 1987. Since the right to receive compensation was an asset, they were liable to pay wealth tax for assessment years 1988-89 to 1990-91. However, none of the assessees filed wealth tax return nor did the department initiate any wealth tax proceedings. The omission resulted in wealth aggregating Rs. 143.36 lakhs escaping assessment with consequent short levy of tax of Rs. 4.89 lakhs.

The Ministry have accepted the audit observation.

(v) Under the Wealth Tax Act, 1957, where assets are held by a trustee on behalf of some other persons,wealth tax shall be levied

upon and recoverable from the trustee in a like manner and to the same extent as it would be leviable on the person for whose benefit the assets are held.

In West Bengal charge, a pension fund was constituted under a duly executed trust fund in November 1943 for the benefit of certain specified class of workers working in the companies managed by another company as managing agent. The capital of the trust fund consisted of contributions originally made by those companies which was increased in the subsequent years through investments in government securities and by granting loans to private parties and receiving interest thereon. As per balance sheet of the trust fund relevant to assessment year 1989-90,the trust owned a house property valued at Rs.25.08 lakhs. Audit scrutiny revealed that though the assessee trust submitted its income tax returns for assessment years 1957-58 to 1991-92 and its income was assessed in the status of Association of Persons, no wealth tax return was filed by the assessee nor did the department take any action to initiate wealth tax proceedings. The omission resulted in wealth aggregating Rs.252.23 lakhs escaping assessment with consequent non levy of wealth tax of Rs.3.74 lakhs for assessment years 1985-86 to 1991-92.

The Ministry have accepted the audit observation.

(vi) Under the Wealth Tax Act, 1957, net wealth of an assessee means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date other than the debts owed which have been incurred in relation to any property in respect of which wealth tax is not chargeable under the Act.

In Rajasthan charge, the wealth tax assessments of an individual for the assessment years 1987-88 to 1989-90 were completed after scrutiny between March 1991 and March 1992. Audit scrutiny revealed that the assessing officer allowed deductions of Rs.39.05 lakhs, Rs.46.82 lakhs and Rs. 54.53 lakhs respectively while computing net wealth in the aforesaid assessment years. These outstanding liabilities related to the building used by the assessee as his official residence and was not included in his net wealth being an exempt asset for levy of wealth tax under the Act. Thus in computing the net wealth the allowance of debt incurred in relating to exempted asset was irregular. The mistake resulted in underassessment of wealth of Rs. 140.40 lakhs with consequent short levy of wealth tax aggregating Rs. 2.84 lakhs.

The Ministry have accepted the audit observation.

Incorrect valuation of assets

6.5.1 Immovable properties

(i) Under the Wealth Tax Act, 1957, in a scrutiny assessment, the assessing officer shall make a correct assessment of taxable wealth of the assessee and determine the correct tax payable by him or refundable to him on the basis of such assessment. The Central Board of Direct Taxes have, from time to time, issued instructions stressing the necessity for ensuring accuracy in the computation of income/wealth and tax etc.

In Karnataka charge, the wealth tax assessment of a Hindu undivided family for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee owned an immovable property (a palace) valued at Rs. 9426.12 lakhs as returned. In computing the net wealth, the assessing officer incorrectly adopted the value at Rs. 9314.79 lakhs as against the returned value. The mistake resulted in underassessment of wealth of Rs. 111.33 lakhs with consequent short levy of tax of Rs. 3.70 lakhs (including interest for late filing of return).

The Ministry have accepted the audit observation.

(ii) (a) Under the Wealth Tax Act, 1957, prior to 1 April 1989, the assessing officer shall estimate the value of any asset other than cash, to be the price which, in his opinion, it would fetch if sold in the open market on the valuation date. The Act further provides that the assessing officer may make a reference to the Departmental Valuation Officer for valuation of the assets and the order of the valuation officer in respect of the value of the asset would be binding on the assessing officer.

In Himachal Pradesh charge, the wealth tax assessment of a Hindu undivided family for the assessment year 1988-89 was completed after scrutiny in March 1989. Audit scrutiny revealed that the value of a plot measuring 692 square yards owned by the assessee in a posh area of the capital was adopted at Rs.1.38 lakhs considering the rate at Rs.200 per square yard. Since the rate appeared to be lower than the prevalent market rate, the asset should have been referred to the valuation cell for valuation which was not done. On the omission being pointed out in audit, in November 1989, the department referred the case to departmental valuation officer who valued the property at Rs.66.54 lakhs and on this basis, the value of the land was under valued by Rs.65.16 lakhs with consequent short levy of tax of Rs.1.99 lakhs.

The Ministry have accepted the audit observation.

(b) In Tamil Nadu charge, in the wealth tax assessments of a Hindu undivided family (specified) for the assessment years 1988-89 and 1989-90 completed after scrutiny in March 1992, the value of the immovable property (consisting of 84 cents of land) owned by the assessee was adopted at Rs. 7,000 and Rs. 8,000 per cent respectively as returned. Audit scrutiny revealed that as per valuation report of the departmental valuation officer, the property was required to be valued at Rs. 40,000 and Rs. 50,000 per cent of land for assessment years 1988-89 and 1989-90 respectively instead of the values of Rs. 7,000 and Rs. 8,000 per cent adopted in the assessments. Failure to adopt the value fixed by the departmental valuation officer which was binding on the assessing officer resulted in underassessment of wealth aggregating Rs. 63 lakhs with consequent short levy of wealth tax of Rs. 1.94 lakhs.

The Ministry have accepted the audit observation.

6.5.2. Quoted shares

(i) Under the Wealth Tax Act,1957, from 1 April 1989, the value of any asset other than cash, shall be its value, as on the valuation date, determined in the manner laid down in Schedule III to the Act. This schedule specifies that the value of an equity share in any company which is a quoted share shall be taken as the value quoted in respect of such share on the valuation date. Further, the value of an equity share in any company which is a quoted share may, at the option of the assessee or a company, be taken on the basis of the average of the value quoted on the 31st of March immediately preceding the assessment year and values quoted in respect of such share on the said dates in relation to each of the immediately preceding nine assessment years provided where the assessee opts for the average of the values so quoted, he shall get such value certified by an accountant and attach the certificate alongwith the return.

In Punjab and Himachal Pradesh charges, the wealth tax assessments of four individuals for the assessment year 1992-93 were completed after scrutiny between March and October 1993. Audit scrutiny revealed that the value of 1,66,433 quoted equity shares of several companies, owned by the assessees was adopted at average quoted value under the special valuation provisions of Schedule III to the Act as opted and returned by the assessees. For adoption of such value, the assessees were required to get a certificate of valuation by an accountant and to attach the same with the return which was, however, not done. Since the statutory requirement of furnishing the certificate of an accountant was not fulfilled by the assessees to substantiate their claim, the value of shares should have been adopted at quoted rates of shares on the respective valuation date i.e. 31 March 1992 which was higher than

the adopted average quoted value. The omission resulted in underassessment of wealth aggregating Rs. 146.82 lakhs with consequent short levy of tax of Rs. 3.22 lakhs (including penalty in one case).

The Ministry have accepted the audit observations.

(ii) The Board clarified in August 1994 that in summary assessment cases, prima facie disallowances shall be made in respect of any claim in respect of which there is omission of the information which is required under the specific provisions of the Act, to be furnished alongwith the return to substantiate such claim.

In Uttar Pradesh charge, the wealth tax assessment of an individual for the assessment year 1992-93 was completed in January 1993 in a summary manner. Audit scrutiny revealed that the value of 1,03,100 shares of a company held by the assessee was adopted at average quoted value of Rs.67.57 per share as claimed. For claiming the average value by the assessee, the required certificate of the accountant was not furnished alongwith the return. Since the statutory requirement of furnishing the certificate from an accountant was not fulfilled by the assessee, the value of shares should have been adopted at quoted rate of Rs. 185 per share on the valuation date 31 March 1992 instead of adoption of average quoted value. Thus not carrying out prima facie adjustments as per Board's aforesaid instructions of August 1994 resulted in underassessment of wealth of Rs. 121.07 lakhs with consequent short levy of tax of Rs. 2.35 lakhs (including additional tax).

The Ministry have accepted the audit observation.

6.5.3. Unquoted equity shares of investment company

Under the Wealth Tax Act, 1957, the value of an unquoted equity share in an investment company shall be worked out by reducing the value of all liabilities from the value of all assets as shown in the balance sheet. The net amount so arrived at shall be divided by the total paid-up equity share capital of the company as shown in the balance sheet and the result multiplied by the paid-up value of each equity share shall be the value of the unquoted equity share in the investment company. For this purpose, the value of an asset disclosed in the balance sheet of the company whose shares are being valued shall be in accordance with the rules as applicable to that particular asset and in this regard the value of an equity share, a preference share or a debenture of any company shall be its quoted value on the valuation date.

In Maharashtra charge, the wealth tax assessment of an individual for the assessment year 1991-92 was completed after scrutiny in

February 1993 at net wealth of Rs. 59.28 lakhs. The assessee owned 134 shares in a private limited investment company. Audit scrutiny of the balance sheet of the company disclosed that though the market value of the quoted investments of the company was Rs. 348.68 crores, while working out value of unquoted shares owned by the assessee the valuation was done by adopting book value of investments at Rs. 44.56 crores instead of its quoted market value of Rs. 348.68 crores. The omission resulted in undervaluation of Rs. 65,014 per share leading to underassessment of wealth of Rs. 87.12 lakhs with consequent short levy of tax of Rs. 1.71 lakhs.

The Ministry have accepted the audit observation.

Mistake in application of rate of tax

6.6 Under the Wealth Tax Act, 1957, as per Schedule I applicable to the assessment year 1991-92, where the net wealth of a Hindu undivided family (specified) exceeds Rs. 10 lakhs, tax leviable is Rs. 13,500 plus three percent of the amount by which the net wealth exceeds Rs. 10 lakhs.

In Maharashtra charge, the wealth tax assessment of a Hindu undivided family (specified) for the assessment year 1991-92 was completed after scrutiny in January 1994 on a net wealth of Rs. 192.31 lakhs and wealth tax of Rs. 3.58 lakhs was levied. Audit scrutiny revealed that the status of the assessee was Hindu undivided family (specified) as per assessee's declaration in the return. Accordingly, the tax was leviable at higher rate of 3 percent which worked out to Rs. 5.55 lakhs as against Rs. 3.58 lakhs levied by the department. The mistake in application of rate of tax resulted in short levy of tax of Rs. 1.97 lakhs.

The Ministry have accepted the audit observation.

Incorrect refund of tax

6.7 Under the provisions of the Wealth Tax Act, 1957, where an assessment is set aside or cancelled as a result of any order passed in an appeal or any other proceeding (including a rectification proceeding) under this Act and an order of fresh assessment is directed to be made, the refund if any, shall become due only on making of such fresh assessment.

In Tamil Nadu charge, the wealth tax assessments of an individual for the assessment years 1988-89 and 1989-90 were completed in March 1992 adopting inter alia the value of the hospital building owned by him at Rs. 96.04 lakhs and Rs. 105.70 lakhs respectively. On appeal by the assessee, the assessments were set aside by the Commissioner of Income Tax (Appeals) in November 1993 with a specific direction to the assessing officer to re-do them after considering the value of the above property with reference to Schedule III of the Act. Audit scrutiny revealed that by an order in March 1994 the entire tax collected for these two years aggregating

Rs. 3.39 lakhs was refunded to the assessee though the reassessment was not done which was contrary to the provisions of the Act.

The Ministry have accepted the audit observation.

Wealth tax on companies

6.8 Under the provisions of Section 40 of Finance Act, 1983, with effect from the assessment year 1984-85, companies other than those in which the public are substantially interested are liable to wealth tax at a flat rate of 2 percent (plus 10 percent surcharge for the assessment year 1988-89 only) of the net wealth comprising the aggregate market value upto the assessment year 1991-92 and for assessment year 1992-93 either value determined in the manner laid down in Schedule III to the Act or value disclosed in balance sheet of the company on the valuation date, whichever is higher of the specified assets belonging to the company reduced by the debts owed by the company pertaining to such assets on the valuation date.

Non-levy of wealth tax

6.9 Some cases of omissions in levy of wealth tax on companies are discussed in the ensuing paragraphs.

In West Bengal , Maharashtra, Madhya Pradesh, Kerala and Tamil Nadu charges, audit scrutiny of the income tax assessment records of 7 closely held companies for the assessment years 1986-87 to 1993-94 revealed that the companies owned specified assets which were chargeable to wealth tax. However, neither did the assessee companies file their returns of net wealth nor did the department initiate any wealth tax proceedings. The omissions resulted in aggregate wealth of Rs. 1109.88 lakhs escaping assessment with consequent non-levy of wealth tax of Rs. 25.19 lakhs. Brief particulars of these cases are given below:

Sl. No.	Commissioner's charge	Assessment year	Type of assets owned	Aggregate value of assets escaping assessment	Tax effect
				(in lakhs of rupees)	
1	WB V Calcutta	1989-90 to 1992-93	House properties	239.78	7.07
2	City II Bombay	1986-87 to 1992-93	House property	281.26	5.49
3	Bhopal (Two companies)	1988-89 to 1992-93	Buildings	114.66	3.75
4	Central II Calcutta	1990-91 to 1992-93	House properties	170.32	3.28
5	Trivandrum	1990-91 to 1992-93	Godown, land and car	174.82	3.43
6	Tamil Nadu II Madras	1987-88 to 1993-94	Building	129.04	2.17

The Ministry have accepted the audit observations at Sl. Nos. 1, 2, 5 and 6. Their response to the remaining cases have not been received.

Wealth not assessed

6.10 The Board issued instructions in August 1990 that assessment under the Wealth Tax Act, 1957, should be completed after scrutiny in all cases where the returned wealth was Rs. 10 lakhs and above. Further, under the Act, where an assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him, the assessee shall be deemed to be the owner of such building or part and the value thereof shall be included in computing his net wealth.

In Maharashtra charge, the wealth tax assessment of a company for the assessment year 1992-93 was completed in October 1993 in a summary manner determining a taxable wealth of Rs. 315.72 lakhs as against returned net wealth of Rs. 311.99 lakhs. Audit scrutiny revealed that the assessee company owned flats valued at Rs. 66.25 lakhs in various co-operative societies which were not included in net wealth while the same were included in the net wealth of the assessee in the assessment completed in a summary manner for assessment year 1991-92. Under the aforesaid provisions of the Act, the value of flats owned by the company were includible in the net wealth of the assessee. Further, since the returned net wealth was more than Rs. 10 lakhs, the assessment should have been completed after scrutiny. The omissions resulted in wealth of Rs. 66.25 lakhs escaping assessment with consequent short levy of tax of Rs. 1.80 lakhs (including interest and additional tax).

The Ministry have accepted the audit observation.

Incorrect computation of net wealth

6.11 In Maharashtra charge, the wealth tax assessment of a closely held company for the assessment year 1991-92 was completed after scrutiny in March 1994 computing the net wealth at Rs. 52.02 lakhs. Audit scrutiny revealed that the assessee was allowed a liability of Rs. 98.45 lakhs which was received by the assessee as advance against sale of free hold land pending conveyance. Since the liability was not incurred for acquiring the property, it should not have been allowed. The irregular allowance of the liability resulted in underassessment of wealth of Rs. 98.45 lakhs with consequent short levy of tax of Rs. 1.93 lakhs.

The Ministry have not accepted the audit observation on the ground that pending execution of the deed, the advance taken by the assessee was shown as a liability in the balance sheet of the assessee and the same was utilised by the assessee for the purposes of his business and the assets acquired out of the aforesaid advance would not come under the purview of specified assets as per

Section 40 of the Finance Act, 1983. Ministry have further contended that the advance received would be treated as a "deductible debt" under section 2(m) of the Wealth Tax Act. The reply is not tenable as the assessee is a company and under sub-section (2) of Section 40 of Finance Act 1983, only debts owed in the nature of loan transactions which are secured on or which have been incurred in relation to the taxable asset are deductible. Since the amount of advance received against sale of the asset was neither a debt secured on nor incurred for acquiring the taxable asset, it was not a debt owed by the company under the aforesaid specific provision of the Act and would not be treated as a "deductible debt".

Incorrect valuation of specified assets

6.12 Under the Wealth Tax Act, 1957, an assessment may be completed in scrutiny or summary manner. The Board issued instructions in July 1986 that in cases where the returned net wealth is more than Rs. 5 lakhs, the assessment may be made after due enquiry.

In Maharashtra charge, the wealth tax assessments of two closely held companies for the assessment year 1989-90 were completed in a summary manner in March 1992. Audit scrutiny revealed that both the assessees returned net wealth of Rs. 11.56 lakhs and Rs. 10.62 lakhs respectively and since the returned net wealth was in excess of Rs. 5 lakhs, the assessments should have been completed after scrutiny in view of Board's aforesaid instructions. However, in the case of one assessee the value of movable and immovable properties was incorrectly adopted as Rs.11.56 lakhs as against Rs.42.02 lakhs adopted on the basis of departmental valuation officer's report in the assessment for assessment year 1988-89. Similarly, in the case of another assessee the value of immovable properties was incorrectly adopted as Rs. 10.62 lakhs as against the value of Rs. 147.06 lakhs shown in the balance sheet of the company as on the relevant valuation date 31 March 1989 which was adopted in the assessment for assessment year 1988-89. Thus non-selection of the cases for assessment after scrutiny resulted in underassessment of wealth aggregating Rs. 166.89 lakhs with consequent short levy of tax of Rs. 3.29 lakhs.

The Ministry have not accepted the audit observation contending that the issues were beyond the purview of section 16(1) (a). The reply is not relevant as it does not explain why, as observed by audit, the cases of returned net wealth of over Rs. 5 lakhs, were not selected for scrutiny despite Board's instruction of July 1986.

Non-levy of surcharge on wealth tax

6.13 In Tamil Nadu charge, the wealth tax assessment of a closely held company for the assessment year 1988-89 was revised in March 1994 levying wealth tax of Rs. 18.61 lakhs. Audit scrutiny revealed that while making this revision, the assessing

officer omitted to levy surcharge on the wealth tax. The mistake resulted in short levy of tax of Rs. 1.86 lakhs.

The Ministry have accepted the audit observation.

B - GIFT TAX

Revenue from Gift Tax

6.14 In the financial years 1990-91 to 1994-95, gift tax receipts vis-a-vis the budget estimates were as given below:

Year	Budget estimates	Actuals	Variation	Percentage variation
	(in crores of rupees)			
1990-91	9.00	3.38	(-) 5.62	(-) 62.4
1991-92	9.00	8.44	(-) 0.56	(-) 6.2
1992-93	5.00	9.27	4.27	85.4
1993-94	10.00	4.99	(-) 5.01	(-) 50.1
1994-95	5.00	14.98	9.98	200.0

The large variation between the budget estimates and actuals (except in 1991-92) indicate the necessity to put budget estimation on a realistic basis.

Status of assessments

6.15 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1995 were as given below:

Year	No. of assessments				Arrear of demands at the end of the year (in crores of rupees)
	Due for disposal	Completed during the year	Pending at the end of the year	Percentage of total cases pending	
1990-91	62,572	46,621	15,951	25.5	54.49
1991-92	52,859	42,176	10,683	20.2	37.86
1992-93*	45,667	34,447	11,220	24.6	35.26
1993-94	36,478	28,489	7,989	21.9	31.81
1994-95	33,928	28,145	5,783	17.1	30.70

The above figures indicate that though the number of cases for disposal have been consistently declining, finalisation of assessments have also been declining and consequently the percentage of pendency has ranged between 17.1 to 25.5.

Results of audit

6.16 During the test audit of assessments made under the Gift tax Act,1958, conducted during the period 1 April 1994 to 31 March

* The above revised figures for 1992-93 furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally and incorporated in the Report of the Comptroller and Auditor General of India on Union Government - Direct Taxes for that year.

1995, short levy of gift tax of Rs.3.78 crores was noticed in 195 cases.

A total number of 17 audit observations involving tax effect of Rs.99.12 lakhs were issued to the Ministry of Finance for comments during March to September 1995. Out of these, the Ministry of Finance have accepted the observations in 11 cases involving tax effect of Rs.91.83 lakhs.

7 illustrative cases involving tax effect of Rs. 86.40 lakhs are given in the following paragraphs to highlight the important audit observations. Out of these, the Ministry of Finance have accepted the audit observations in 6 cases involving tax effect of Rs.83.89 lakhs.

Gift not assessed

6.17 Under the Gift Tax Act, 1958, gift means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth.

(i) In Uttar Pradesh charge, audit scrutiny of income tax assessment records of two individuals for the assessment years 1990-91 and 1991-92 revealed that they purchased plots of land for Rs. 13.87 lakhs between November 1989 and December 1990 relevant to assessment years 1990-91 and 1991-92 in the names of their four sons without receipt of any consideration from them. The transaction constituted gift under the Gift Tax Act attracting levy of gift tax. However, neither did the assessees file any gift tax returns nor did the department initiate any gift tax proceedings. The omission resulted in gift aggregating Rs. 13.07 lakhs (after allowing aggregate basic exemption of Rs. 80,000) escaping assessment with consequent non-levy of gift tax of Rs. 5.58 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Tamil Nadu charge, survey wing of the department collected information from jurisdictional sub-registrar's records that seven individuals made gifts of plots of land valued at Rs. 7.02 lakhs between April 1992 and June 1992 and information in this regard was passed on by them to the assessing officer in August 1992. Audit scrutiny revealed that the assessees did not file any return of gift in respect of the gifted properties nor did the department initiate any gift tax proceedings on the basis of the information received. The omission resulted in gift of Rs. 5.62 lakhs escaping assessment (after allowing basic aggregate exemption of Rs. 1.40 lakhs) in the hands of the seven donors for assessment year 1993-94 with consequent non-levy of gift tax aggregating Rs. 2.18 lakhs (including interest).

The Ministry have accepted the audit observation.

Non-levy of tax on deemed gift

6.18 (i) Under the Gift Tax Act, 1958, prior to 1 April 1992 where property is transferred otherwise than for adequate consideration, the amount by which the market value of the property on the date of transfer exceeds the value of consideration shall be deemed to be a gift made by the transferor and is chargeable to tax. From 1 April 1989, Schedule II of the Gift Tax Act, 1958, provides that the value of gift of shares or debentures of companies will be taken as per Schedule III of the Wealth Tax Act.

(a) In Maharashtra charge, audit scrutiny of the income tax assessment records of a closely held company for the assessment year 1991-92 revealed that the assessee had sold, in the relevant previous year, 16,99,860 equity shares of the company for a total consideration of Rs. 509.96 lakhs. These shares were sold at Rs. 30 per share as against the market value of Rs.36.25 per share on the date of sale. Thus the difference of Rs.106.24 lakhs between the value as worked out under the provisions of the Gift Tax Act and the sale consideration, constituted deemed gift attracting levy of gift tax. Besides, there was mention in the assessment order for initiation of gift tax proceedings separately. However, neither did the assessee file any gift tax return nor did the department initiate any gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.52.81 lakhs (including interest).

The Ministry have accepted the audit observation.

(b) In Haryana charge, the wealth tax assessment of a closely held company for the assessment years 1991-92 and 1992-93 disclosed that the company had sold 13,500 sq. yards of land for a consideration of Rs.14.19 lakhs to its subsidiary company in March and June 1991. Audit scrutiny revealed that the value of the land as on 31 March 1989 was determined at Rs.76.28 lakhs by the departmental valuation officer which was adopted in wealth tax assessment of the assessee for assessment year 1990-91 completed in March 1993. As the property was transferred at a declared consideration which was less than the fair market value adopted in the wealth tax assessments, the difference of Rs.62.09 lakhs constituted deemed gift liable to gift tax. However, no return of gift was filed by the assessee company. The department also did not initiate any gift tax proceedings resulting in non assessment of taxable gift of Rs.61.69 lakhs (after allowing statutory deductions of Rs.20,000 each for assessment years 1991-92 and 1992-93) with consequent non-levy of gift tax of Rs.18.51 lakhs.

The Ministry have accepted the audit observation.

(ii) It has been judicially held* that if a capital asset is transferred for a consideration below its market value, the difference between the market value and the full value of the consideration received in respect of the transfer would amount to a gift liable to tax under the Gift Tax Act and such difference would not be liable to be added as part of capital gains taxable under the provisions of the Income Tax Act, 1961.

In Punjab charge, the income tax assessment of an individual for the assessment year 1991-92 was completed after scrutiny in October 1992. Audit scrutiny revealed that the assessee had sold 4640 shares of a company at Rs.120 per share to her close relatives and returned capital gain of Rs.33,120 against which the assessing officer adopted the value of shares at Rs.300 per share and assessed capital gain of Rs.3.67 lakhs. On the basis of market value at Rs.300 per share, the value of 4640 shares sold would work out to Rs.13.92 lakhs. As such the difference of Rs.8.35 lakhs between the market value and sale consideration of Rs.5.57 lakhs constituted deemed gift attracting levy of gift tax under the provisions of Gift Tax Act. It was not liable to levy of tax on capital gains under the omitted provisions of Income Tax Act, 1961. Omission to initiate the gift tax proceedings resulted in non assessment of deemed gift of Rs. 8.35 lakhs with consequent non-levy of gift tax of Rs.2.51 lakhs.

The Ministry have not accepted the audit observation on the ground that the issue which was raised in audit in June 1993 was already in the knowledge of the department since October 1992 and a notice to reopen the gift tax assessment was served on the assessee in November 1992. The reply is not relevant as the audit observation was on an entirely different issue. What was in the knowledge of the department in October 1992 was the transaction of gifts in cash made by the assessee to 4 individuals and a minor whereas the issue pointed out in audit in June 1993 resulting from auditing the income tax assessment records of the assessee for the year 1991-92 pertained to the deemed gift transaction on sale of shares of a company by the assessee to close relatives. Incidentally, pursuant to this audit observation, the department reopened the case in March 1994 assessing additional deemed gift of Rs.8.35 lakhs and raising an additional demand of Rs.2.51 lakhs.

(iii) Under Rule 9 of Part C of Schedule III to Wealth Tax Act, the value of an equity share in any company which is quoted shall be taken as the value quoted on the valuation date or where there is no such quotation on the valuation date, the quotation on the date closest to the valuation date and immediately preceding such date.

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* K.P. Varghese vs. ITO 131 ITR 597, 617(SC)

In Maharashtra charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1992-93 revealed that the assessee had sold 33,891 shares of a company on 19 February 1992 at Rs. 315 per share against the lowest market quotation of Rs. 340 per share on that date. Since the assessee had sold the shares at a lower value than the quoted market value, the difference of Rs. 8.47 lakhs constituted deemed gift attracting levy of gift tax. However, neither did the assessee file any gift tax return nor did the department initiate any gift tax proceeding. The omission resulted in non-levy of gift tax of Rs. 2.48 lakhs.

The Ministry have accepted the audit observation.

(iv) Under the Gift Tax Act, 1958, as per Schedule II, the value of closing stock is as adopted for the purpose of income tax assessment. In a case where the business came to an end, the value to be adopted for income tax assessment is the market price.

In Maharashtra charge, the income tax assessment records of a partnership firm for the assessment year 1993-94 disclosed that the firm was dissolved on 31 August 1992 and its business was taken over by one of its partners in his individual capacity. It was further revealed that on the date of dissolution, the firm had a closing stock of Rs. 24.07 lakhs which was sold to the ex-partner and the current proprietor at cost price instead of the market price. As the market value was not available,, it was determined on the basis of the ratio between the sales and cost of goods sold. The market value would thus be Rs. 38.25 lakhs which was higher than cost price by Rs. 14.18 lakhs. Hence sixty percent of Rs. 14.18 lakhs relating to the other two partners (thirty percent each) amounting to Rs. 8.51 lakhs was thus assessable to gift tax as deemed gift. However, no gift tax return was filed by the partners nor did the department initiate any gift tax proceedings. Omission to do so resulted in non-levy of gift tax of Rs. 2.33 lakhs.

The Ministry have accepted the audit observation.

C - Interest Tax

Revenue from Interest Tax

6.19 In the financial years 1990-91 to 1994-95, interest tax receipts vis-a-vis the budget estimates were as given below:

Year	Budget Estimates	Actuals	Variation	Percentage variation
	(in crores of rupees)			
1990-91*	-	(-) 0.86	(-) 0.86	-

* No budget estimate was prepared because levy of interest tax was not in operation from 1.4.1985 to 30.9.1991. Further, actuals in minus is due to more refunds than receipts.

1991-92	535.00	305.04	(-)229.96	(-) 42.9
1992-93	800.00	714.70	(-)85.30	(-) 10.6
1993-94	900.00	727.58	(-)172.42	(-) 19.3
1994-95	1044.00	801.40	(-)242.60	(-) 23.2

Status of assessments

6.20 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1995 were as given below:

Year	No. of assessments				Arrear of demands at the end of the year (in crores of rupees)
	Due for disposal	Completed during the year	Pending at the end of the year	Percentage of total cases pending	
1990-91	33	23	10	30.3	11.22
1991-92	48	3	45	93.7	10.79
1992-93**	972	77	895	92.1	0.96
1993-94	2381	395	1986	83.4	0.62
1994-95	6704	1810	4894	73.0	0.60

Two important cases of non-levy of interest tax noticed during 1994-95 as mentioned in the following paragraphs were referred to the Ministry of Finance for their comments during March to September 1995.

Omission to make assessment of interest tax

6.21 Under the Interest Tax Act,1974, as reintroduced with effect from 1 October, 1991, by the Finance (No.2) Act, 1991, interest tax is leviable on the chargeable interest income of 'Credit Institutions'. Such credit institutions, inter alia, included co-operative societies engaged in the business of banking, not being co-operative societies which provide credit facilities to farmers or village artisans, for the assessment year 1992-93. The interest income chargeable to tax includes interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange. The returns of chargeable interest are required to be filed by 31 December of the relevant assessment year. The procedures for assessment and collection of interest tax are more or less on the same lines as those of corresponding provisions in the Income Tax Act, 1961.

(i) In Kerala charge, the income tax assessment of a District Co-operative bank for the assessment year 1992-93 was completed in November 1992 on a total income of Rs.14.30 lakhs. Audit scrutiny of the income tax assessment revealed that the assessee had received Rs.4.46 crores towards interest income for the year.

** The above revised figures for 1992-93 relating to pendency in completion of assessments furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally incorporated in the Report of the Comptroller and Auditor General of India on Union Government - Direct Taxes for that year.

Details of the income from 1 October 1991 to 31 March 1992 were not available. However, on a proportionate basis, Rs.2.23 crores could be taken to be chargeable to interest tax. The assessee had not filed any return of chargeable interest for assessment year 1992-93. The assessing officer also did not initiate any action for its assessment. The omission, therefore, resulted in non-assessment of chargeable interest of Rs.2.23 crores involving a revenue effect of Rs.14.31 lakhs (including interest).

The Ministry have accepted the audit observation.

(ii) In Himachal Pradesh charge, for levy of interest tax for the assessment year 1992-93, audit scrutiny revealed that a financial company did not file its return under the Interest Tax Act though it was liable to pay tax on the chargeable interest accrued from 1 October 1991 to 31 March 1992. The return was also not called for by the department. The omission resulted in non-levy of interest tax of Rs.7 lakhs.

The Ministry have accepted the audit observation.

(A.K. BANERJEE)
Principal Director of Receipt Audit
(Direct Taxes)

New Delhi
The 16 FEB 1996

Countersigned

(C.G. SOMIAH)
Comptroller and Auditor General of India

New Delhi
The 19 FEB 1996