

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

for the year ended March 2014

**Performance Audit on
Appreciation of Third Party
(Chartered Accountant)
Reporting in Assessment Proceedings**

**Union Government
Department of Revenue - Direct Taxes
Report No. 32 of 2014**

Laid on the table of Lok Sabha/Rajya Sabha on.......... 2014

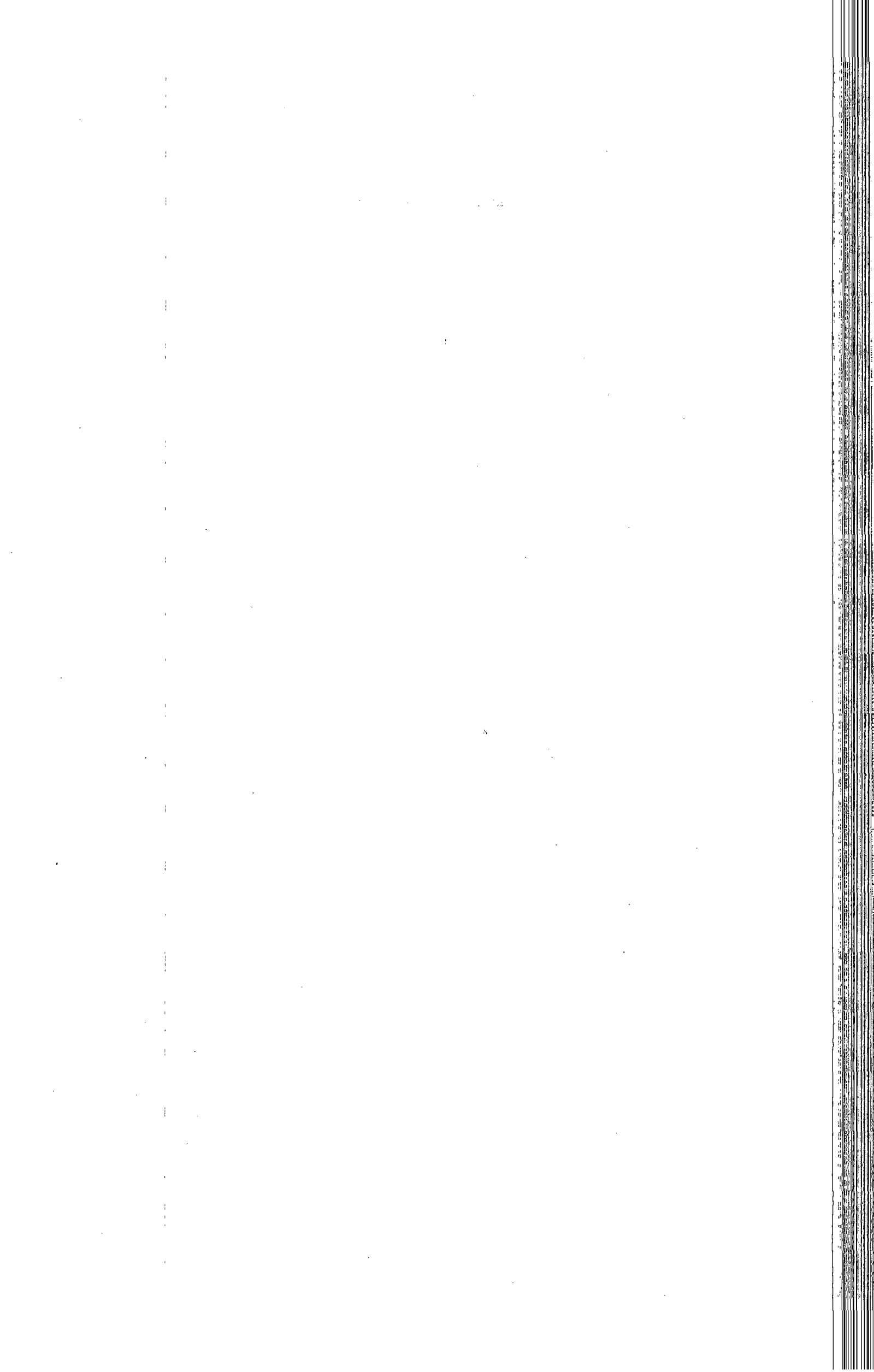
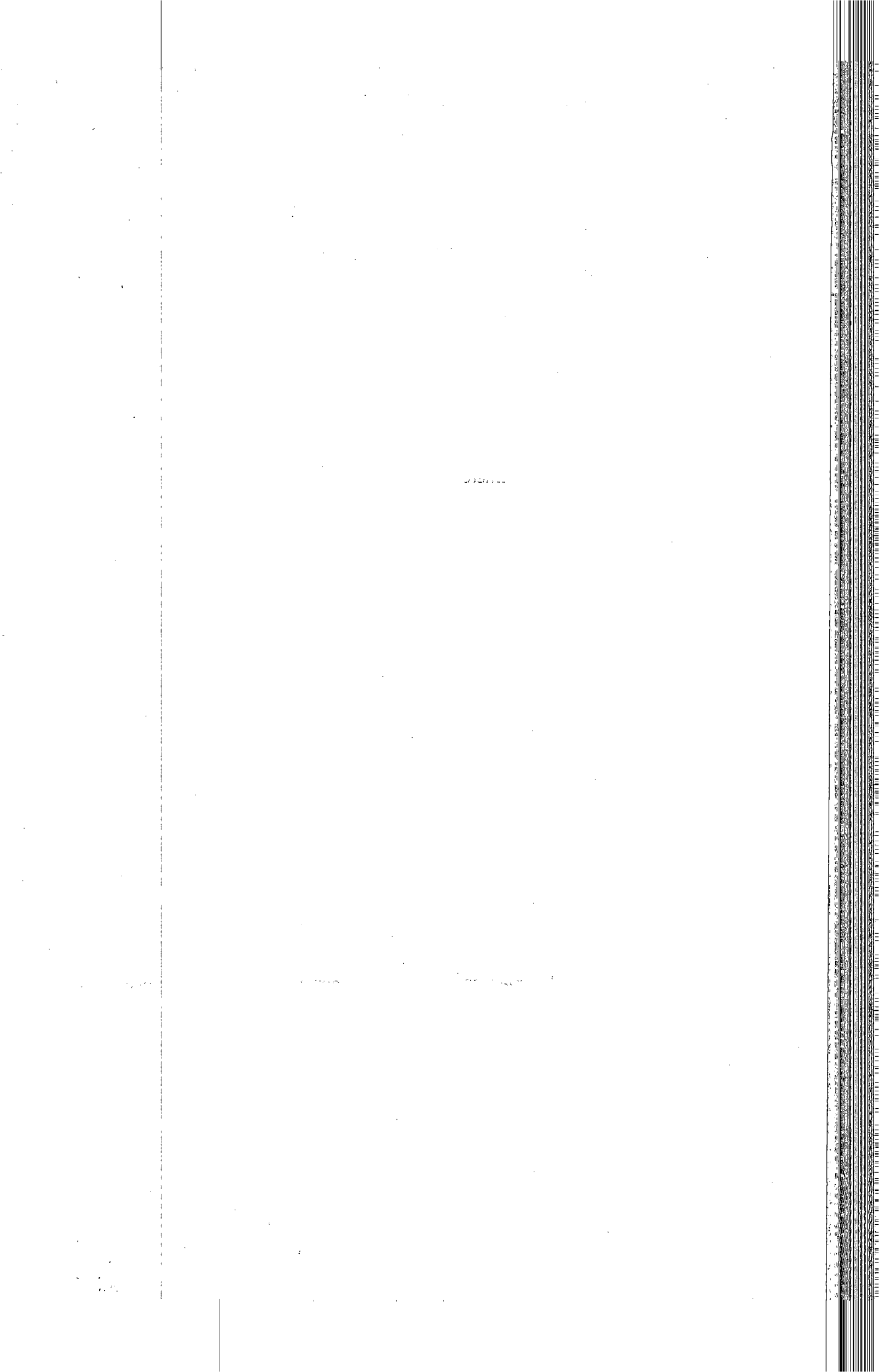


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Preface

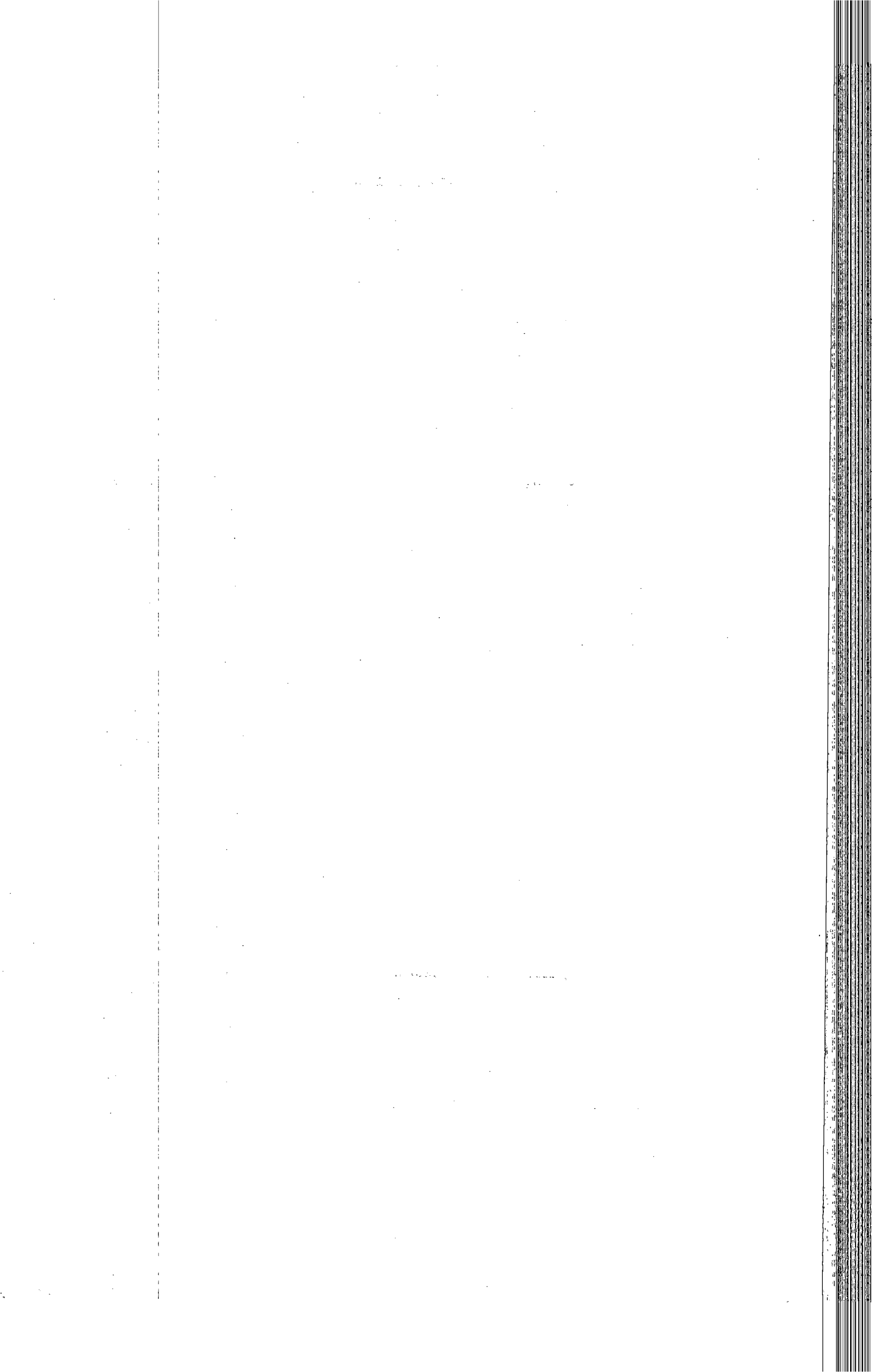
This Report for the year ended March 2014 has been prepared for submission to the President under Article 151 of the Constitution of India.

The Report contains significant results of the performance audit of Appreciation of Third Party (Chartered Accountant) Certification in Assessment Proceedings of the Department of Revenue – Direct Taxes of the Union Government.

The instances mentioned in this Report are those, which came to notice in the course of test audit for the period 2010-11 to 2013-14 conducted during January to May 2014.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Audit wishes to acknowledge the cooperation received from the Department of Revenue - Central Board of Direct Taxes at each stage of the audit process.



Executive Summary

The Income Tax Act, 1961 (Act) contains several provisions which mandate the assesseees to furnish audit reports and certificates issued by the 'Accountant' in the prescribed Form for meeting the specific objectives. Tax audit under Section 44AB under the Act was introduced in 1984 in order to ensure that the books of account and other records of the assesseees are properly maintained and faithfully reflect the true income of the taxpayer. The objective of reporting/certification is to discourage tax avoidance and tax evasion.

The Act defines an 'Accountant' as a Chartered Accountant (CA) within the meaning of the Chartered Accountants Act, 1949 under explanation to Section 288(2) of the Act. Audit reporting and certification by CAs under the Act are thus Third Party Reporting. The CAs are regarded as facilitators for the Income Tax Department (ITD) in administering the provisions of the Act correctly. The Tax Audit Reports (TARs)/certificates issued by them serve as a valuable reference guide to the Assessing Officers (AOs) while making assessments.

We conducted Performance Audit on "Appreciation of Third Party (Chartered Accountant) Certification in Assessment Proceedings" with the objectives to see whether (a) all the requisite reports/certificates were obtained and kept on record at the time of assessments; (b) tax audit reports were complete to provide sufficient and requisite information to the AO, thereby, aiding him in completing the assessment as required under the Act; (c) the AO had evaluated and utilized the information while completing assessments, (d) in case of professional negligence of the Accountant, the matter has been taken up by the Commissioners with the Institute of Chartered Accountant of India (ICAI) and (e) there are lacunae or ambiguities in the provisions of the Act/reports.

This Performance Audit covered assessments completed during the period from financial years 2010-11 to 2012-13 and upto the date of audit. In case of major audit observations, assessment records of previous assessment years were also linked wherever found necessary. All circles/wards taken up for regular audit during the period from January to May 2014 were treated as selected units. All cases of scrutiny assessments, appeal and rectification cases within the selected units were examined in audit. We conducted entry meeting with CBDT in February 2014 in which audit objectives, scope and methodology were discussed.

We found cases (a) where the CAs failed to report full and correct information in 367 cases leading to short levy of taxes of ₹ 2,813.11 crore and (b) where the AOs failed to utilize the information available in 102 reports/certificates

submitted to them leading to short levy of taxes of ₹ 1,310.05 crore. Some of the important audit findings are as follows:

- a. Tax auditors failed to give correct information relating to allowance of depreciation in 66 cases involving short levy of tax of ₹ 457.79 crore (*Paragraph 2.3*).
- b. Tax auditors did not report correct information regarding brought forward loss/depreciation resulting in irregular brought forward loss/depreciation allowance in 46 cases involving short levy of tax of ₹ 557.79 crore (*Paragraph 2.4*).
- c. In 42 cases personal/capital expenditure was incorrectly allowed as the tax auditors did not report the amount in their tax audit reports which resulted in short levy of tax of ₹ 477.89 crore (*Paragraph 2.5*).
- d. CAs have certified wrong information/claims for various exemptions and deductions in 74 cases having tax effect of ₹ 259.72 crore (*Paragraph 2.7*).
- e. CAs gave incorrect/incomplete information in TARs/certificates in 132 cases having a revenue impact of ₹ 1,037.61 crore (*Paragraph 2.8*).

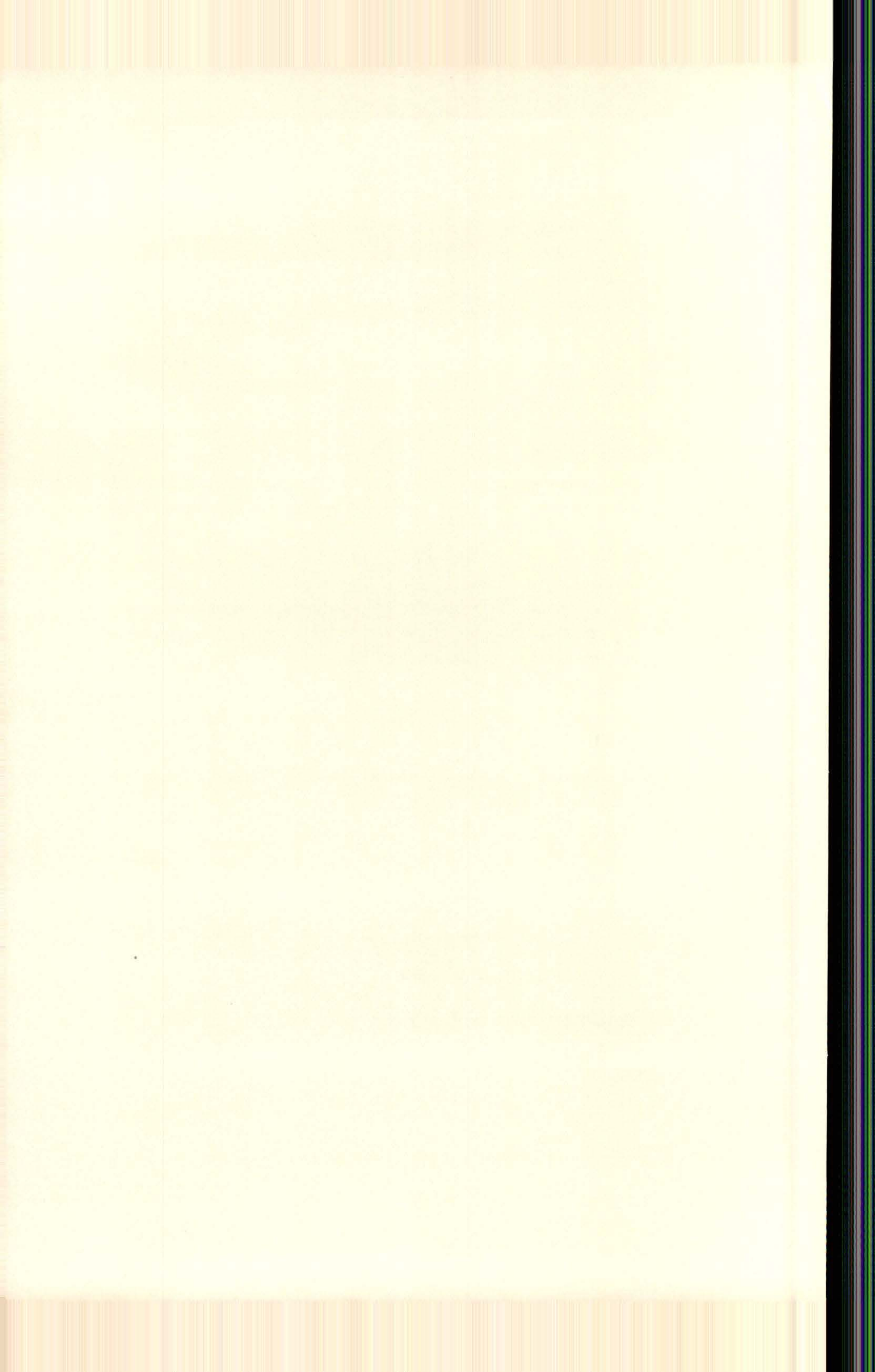
We also found in another 616 cases where CAs committed mistakes viz. in allowance of exemption/deductions, charging of tax on Book Profit under Section 115JB, adoption of Arm's Length Price and reporting on cash payments exceeding ₹ 20,000 per day (*Paragraphs 2.6 and 2.10-2.12*). In 109 cases, assessee did not furnish requisite Form 3CEB on verification of ALP and Form 29B relating to certification for Book Profit (*Paragraphs 2.10-2.11*).

We have also commented on lacunae in the existing Forms which need modification in order to capture full information of the affairs of assessee so that taxes are applied correctly (*Paragraph 3.2-3.4*). Regarding monitoring of work of CAs and ensuring quality tax audit, ICAI issued guidance to its members for limiting the tax audit assignments in a financial year. We found that 18.87 per cent of CAs (12,435 CAs) for AY 2013-14 issued more tax audit reports than prescribed by ICAI (*Paragraph 3.6*). We also got cases where CAs did not mention their membership numbers (*Paragraph 3.7*). ITD did not refer any case for professional negligence to ICAI for taking action against erring CAs in terms of Section 288 of the Act (*Paragraph 3.9*).

The audit findings on non-adherence to various provisions of the Act by CAs led to deny proper dues to the Government. AOs have also failed to utilize information available in Accountant's reports/certificates. CBDT have emphasized the use of information available in Accountant's reports/certificates by AOs at the time of assessments.

In our recommendations, we have suggested ITD to utilize information available in tax audit reports/certificates at the time of assessment proceedings. To improve the quality of work done by CAs, we recommend referring the cases of professional negligence to ICAI. Besides, we also recommended to make provisions in the Act to limit the number of tax audit, provide suitable controls in the ITD system and validating the membership of CAs at the time of e-filing (Paragraph 3.11).

Since the introduction of Section 44AB in the Act in 1984, we have evaluated the system of tax audit/certification by Accountants in 1997 (Para 3.2 of Audit Report No. 12 of 1997) and again in Audit Report No. PA 7 of 2008. In both the Audit Reports, we pointed out non-utilization of information by AOs in assessment proceedings and incorrect information furnished by CAs in TARs/Certificates. These irregularities are still persisting. Thus objective of introducing tax audit and certification by Accountants gets defeated. With growing revenue forgone every year and complex nature of business environments, Accountant's role in ensuring true picture of accounts and taxes due to the Government as per the Act is very crucial. It is joint responsibility of ITD and ICAI to ensure compliance to the Act. Necessary control mechanism over the third party certification in assessment proceedings must be ensured, by making suitable provisions in the Act, if necessary.



Summary of Recommendations

1. The Ministry may ensure that the AOs shall not grant exemptions/ deductions if the assessee does not submit necessary certificates/ reports.

(Paragraphs 2.06-2.07)

The Ministry replied (October 2014) that there are sufficient provisions in Sections 10A, 10(23C), 80IA, 80IB, etc. of the Act which ensure that tax audit reports are available with the ITD. These provisions themselves ensure that in case of failure to file prescribed audit reports, exemptions/deductions thus claimed are not allowed. The Ministry also replied that the CBDT's Instruction No.9/2008 also reiterated that the tax audit reports as well as other statutory audit reports should be critically examined along with connected records and other available evidence while scrutinizing the cases. The Ministry also replied that a proviso to Rule 12 of IT Rules 1962 has been substituted with retrospective effect from 01 April 2013 requiring the assessee, claiming exemptions/ deductions under various provisions of the Act, to file the prescribed reports of audit electronically.

Audit is of the opinion that though sufficient provisions are available in the Act, however, AOs did not follow during assessment meticulously which need attention by the Ministry.

2. The Ministry may ensure that the AOs fully utilize the available information in CAs report/certificates.

(Paragraph 2.14)

The Ministry replied (October 2014) that necessary instructions have been issued in 2008 to critically examine tax audit reports as well as other statutory audit reports and to utilize effectively the information available in these reports while finalizing scrutiny assessments. The Ministry further replied (October 2014) that e-filing of audit reports has been introduced from AY 2013-14. Information furnished in e-filed audit reports was used in selecting cases for scrutiny under Computer Assisted Scrutiny Selection. The reason for selection of case was also displayed to the AOs for effective utilization of available information.

3. The Ministry may consider modifying the Form 3CD to incorporate date of declaration/ payment of distributed profits in order to verify whether the tax has been paid within the stipulated period or any interest is to be charged due to delay.

(Paragraph 3.2)

4. The Ministry may consider modifying the Form 3CD or 29B certificate to give details of the available MAT credit assessment year-wise that can be carried forward by the assessee in order to ensure the correctness of the claim for credit under Section 115JAA of the Act.

(Paragraph 3.3)

On recommendations 3 and 4 above, the Ministry replied (October 2014) that Tax Audit Report (Form 3CA, Form 3CB and Form 3CD) have been comprehensively revised in July 2014 therefore it would not be advisable to again revise the same for capturing the date of declaration/payment of dividend for the purpose of verifying whether DDT is paid within the specified time or capturing the available MAT credit assessment year-wise. The Ministry also mentioned that the required details are already being captured in the Income-tax Return forms in schedules MATC and DDT of Form ITR-6 from 2013-14 onwards. However, the Ministry has noted the suggestions raised by audit and replied that it would be considered for incorporation in the next revision of forms of Tax Audit Report.

5. The Ministry may consider modifying Form 10B and 10BB for providing details regarding last ten years accumulation or utilization of amounts set aside as application by the Charitable Trusts/Institutions in order to check correctness of investment and application of the accumulated fund

(Paragraph 3.4)

The Ministry stated (October 2014) that the required details were already being captured in the Income-tax Return forms. Incorporating similar details in Form 10B and 10BB would amount to duplication.

Audit is of the opinion that though ITR captures the relevant information, the certification by CAs would ensure the correctness of information furnished in ITR.

6. The Ministry may ensure limiting the tax audit assignments in order to ensure quality of tax audit.

(Paragraph 3.6)

The Ministry replied (October 2014) that it would be for the regulatory body i.e. the Institute of Chartered Accountants of India (ICAI) to lay down restrictions on the number of tax audit and to enforce the same. The Ministry further replied (October 2014) that it is difficult to place control in ITD systems to regulate the number of tax audit reports (TAR) as CAs affix their signatures on TAR in their individual capacity and also while representing Firms of CAs and certain types of audits are exempted from the maximum number specified as per ICAI guidelines. ITD provides the list of cases where the number of TARs is apparently exceeded to ICAI for their action.

Reply of the Ministry is not acceptable as the Act requires tax audit under Section 44AB is to be conducted by an Accountant, not by a firm of CAs. Further, limit on tax audit assignment has been fixed by ICAI for all tax audits to be done under Section 44AB.

Audit is of the opinion that CAs has been assigned the work of tax audit which is very crucial in claiming exemptions/deduction by assessees. Therefore, in the interest of revenue and ensuring quality of tax audit, the Ministry may introduce suitable control mechanism in the IT system to adhere to the limit on tax audits in consultation with ICAI.

7. The Ministry may ensure to prohibit a CA who is a relative of the assessee or directors of a company, from signing any report or certificates.

(Paragraph 3.9)

The Ministry stated (October 2014) that prohibiting a CA who is relative of the assessee or director of a company from signing any report or certificates may be examined during budgetary exercise of 2015.

8. The Ministry may ensure the implementation of CBDT instruction no.1959 of 1999 and Section 288 of the Act.

(Paragraph 3.9)

The Ministry stated (October 2014) that in view of the initiatives already taken vide instructions nos. 1959 of 1999 and 09/2008 and provisions contained in section 288 of the Act, no further action was required on this issue.

Audit is of the opinion that though instructions have been issued in past, audit has come up with cases where AOs have not fully utilise the information available in CA reports/certificates. The Ministry may provide intensive training to AOs on utilisation of information and strengthen its internal audit in this regard.

9. The Ministry may put in place a mechanism in the ITD system for AO to record instances of mistakes committed by CAs in order to take action under Section 288 of the Act.

(Paragraph 3.9)

The Ministry stated (October 2014) that suggestion of audit can be incorporated by DGIT (System) to facilitate AOs for recording such instances in the system.

Chapter I: Introduction

1.1 Introduction

The Income Tax Act, 1961 (Act) contains several provisions¹ which mandate the assesseees to furnish audit reports and certificates issued by the 'Accountant' in the prescribed Form for meeting the specific objectives. The Finance Minister in his Budget Speech in the year 1984 and Central Board of Direct Taxes (CBDT) vide its circular² of 1985 explained the rationale for introducing compulsory audit under Section 44AB of the Act as "intended to ensure that the books of account and other records are properly maintained and faithfully reflect the true income of the taxpayer". The objective of reporting/certification is to discourage tax avoidance and tax evasion.

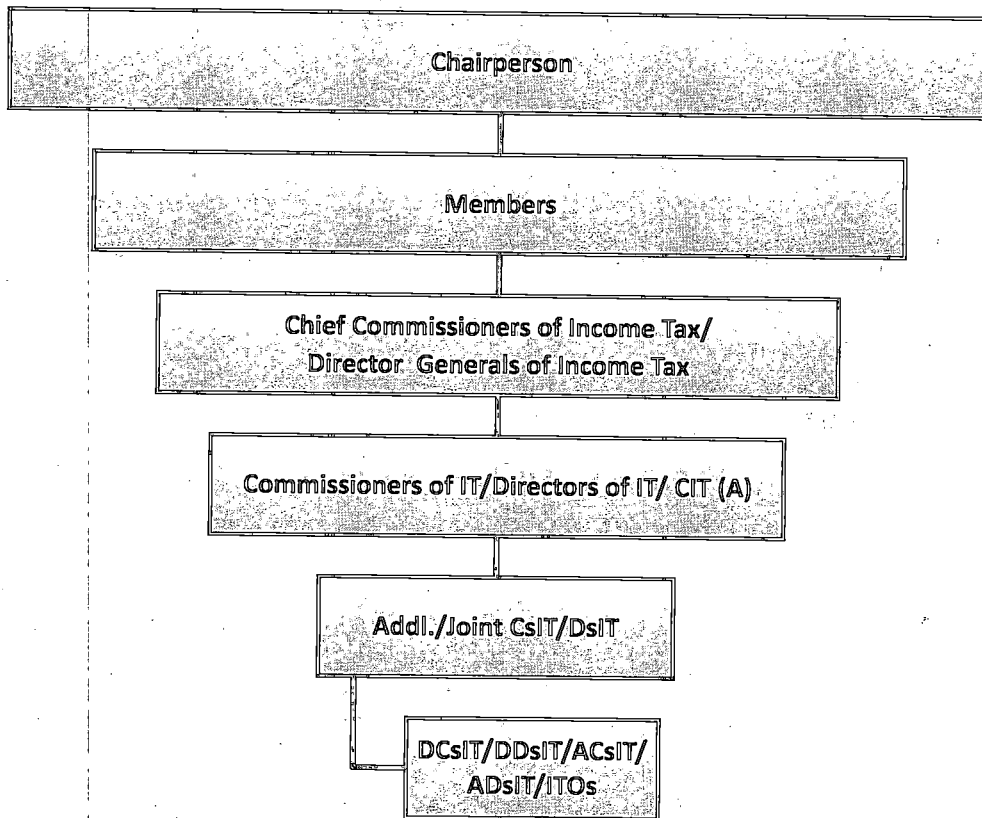
The Act defines an 'Accountant' as a Chartered Accountant (CA) within the meaning of the Chartered Accountants Act, 1949 under explanation to Section 288(2). Audit reporting and certification by CAs under the Act are thus Third Party Reporting. The CAs are regarded as facilitators for the Income Tax Department (ITD) in administering the provisions of the Act correctly. The Tax Audit Reports (TARs)/certificates issued by them serve as a valuable reference guide to the Assessing Officers (AOs) while making assessments. The AO is expected to make an independent judgment while finalizing the assessment and can require the assessee to justify his claims with reference to records and evidences. The Delhi High Court³ has observed that tax audit does not provide any immunity from scrutiny or investigation by the ITD.

1.2 Organizational setup

Central Board of Direct Taxes (CBDT), as a part of Department of Revenue, Ministry of Finance (Ministry), is the apex body charged with administration of Direct Taxes. CBDT is headed by the Chairperson and comprises of six Members. In addition to their functions and responsibilities, the Chairperson and Members are responsible for exercising supervisory control over field offices of the CBDT, known as Zones. Chief Commissioner of Income Tax (CCIT) heads the field office whose jurisdiction is generally co-terminus with the state. Commissioners/Directors of Income Tax head the assessment functions which are carried out through the Additional CIT/DIT, JCIT/JDIT and DDIT/DC/ADIT/AC/ITO.

1 Details of the provisions are discussed under para 1.3 of this Chapter.
2 Circular no. 387 of 06 July 1985.
3 Goodyear India Ltd. Vs. CIT [2000] {112 Taxman 419}-Delhi High Court.

Graph 1.1: Organogram of CBDT



The Institute of Chartered Accountants of India (ICAI) established under the Chartered Accountants Act, 1949 regulates the profession of Chartered Accountancy. The Chartered Accountants Act provides that only a member who holds a certificate of practice obtained from council of ICAI can practice the profession. Under the provisions of the Income Tax Act, 1961 (Act), assessee appoint Accountants as tax auditor. As per the instructions⁴ issued by CBDT, ITD may take up matter relating to professional negligence on part of CA for instituting disciplinary proceedings in terms of Section 288 of the Act. CAs are guided by Code of Ethics issued by ICAI. Central Vigilance Commission (CVC) has also issued Code of Ethics for Chartered Accountants⁵ in view of vital information contained in the Financial Statements prepared by CAs.

4 Instruction no. 1959 of 28 January 1999.

5 <http://cvc.nic.in/codeethics.pdf> accessed on 01 September 2014.

1.3 Legal Framework

Section 44AB of the Act, introduced by Finance Act, 1984 provides for audit of accounts of assessees having total sales, turnover or gross receipts exceeding the specified limits. Further the Act makes it obligatory for a person to get his accounts audited before the specified date by an Accountant and furnish the report of such audit in the Forms prescribed under Rule 6G of Income Tax Rules, 1962 (Rules) duly signed and verified by such Accountants. In addition, Forms prescribed under various Sections of the Act/Rules, duly certified by an Accountant, are required to be submitted by an assessee for claiming exemptions, rebates and deductions. Some of the important Sections of the Act requiring such reports/certificates have been elaborated in *Appendix 1* and discussed in Chapters dealing with audit findings.

Penalty Provisions: Section 271B provides that if any person fails to get his accounts audited in respect of any previous year or years relevant to an assessment year or furnish a report of such audit as required under section 44AB, AO may direct that person to pay, by way of a penalty, a sum equal to one-half *per cent* of the total sales, turnover or gross receipts, as the case may be in case of a business, or of the gross receipt in case of a profession, in such previous year or ₹ 1,50,000, whichever is less. Section 271BA provides that if any person fails to furnish a report from an accountant as required by section 92E, the AO may direct that such person shall pay, by way of penalty, a prescribe sum of ₹ 1,00,000.

E-Filing: With the introduction of e-filing of income tax return (ITR) in 2008, requirement of filling of all the documents like Tax Deducted at Source (TDS) certificates, accounts, certificates/reports etc. were dispensed with by making provision in Rule 12(2) of the Rules. However, this provision has been changed by introducing a proviso to Rule 12(2) in June 2013 for compulsory e-filing of audit reports under Section 44AB (tax audit report along with financial statements), Section 92E (transfer pricing – international & domestic), Section 115JB (Form 29B for MAT), Form 10B (charitable trusts), Form 10BB (educational/medical institutions) and Form 10CCB (80IA/80IB/80IC/80ID/80JJAA/80LA). These reports have to be digitally signed by the CAs while uploading them to website maintained by ITD (<https://incometaxindiaefiling.gov.in>).

1.4 Why we chose the topic

Third party certification has a significant effect in allowance of deductions and exemptions and thereby assessment of income under the Act. During FY 2012-13, revenue forgone on account of corporate assesseees was ₹ 68,008 crore (19 *per cent* of Corporate Tax collection) which made the effective tax rate 22.85 *per cent*. Assesseees claim these deductions and exemptions based on certification by Accountant. The tax audit report/certificate is important as approximately 1.53⁶ *per cent* assessments are completed after scrutiny. It may be possible that vital information may remain outside the tax audit reports/certificates or may be incorrect; thus the very purpose of correct reflection of income and claims for deduction of the tax payer and thus checking the fraudulent practices is defeated. Therefore, it was felt necessary to undertake the review of the system to seek assurance in the system of tax audits/certification by Accountants.

Earlier we have commented upon the system of "Audit of Accounts under Section 44AB of Income Tax Act, 1961" in C&AG's Compliance Audit Report No. 12 of 1997. We made number of observations on the lapses committed by the ITD in ensuring that assesseees comply with the provisions and the proper utilization of the information in the audit report by the AO in making assessment of income. The Public Accounts Committee (PAC) also expressed concern over the fact that due to inadequate attention to this aspect, the objectives of the introducing Section 44AB gets defeated. We again conducted a review on "Appreciation of Third Party Reporting/Certification in Assessment Proceedings" featured in C&AG's Report No. PA 7 of 2008.

ICAI and CVC have issued code of ethics to be followed by CAs in carrying out their profession. This indicates the criticality of work done by CAs, based on which many stakeholders take vital decisions. Therefore, we decided to undertake the Performance Audit of Third Party Reporting/Certification in the Assessment Proceeding.

1.5 Audit objectives

The objective of the study was to see whether:

- a. all the requisite reports/certificates were obtained and kept on record at the time of assessments;
- b. tax audit reports were complete to provide sufficient and requisite information to the Assessing Officer, thereby, aiding him in completing the assessment as required under the Act;

⁶ Average scrutiny assessments completed during FY 2010-11 and FY 2012-13

- c. the AO had evaluated and utilized the information provided in prescribed reports while completing assessments;
- d. in case of professional negligence of the Accountant, the matter has been taken up by the Commissioners with the Institute of Chartered Accountant of India (ICAI);
- e. there are lacunae or ambiguities in the provisions of the Act/Rules/forms of reports.

1.6 Audit scope

This Performance Audit covered assessments completed during the period of financial years 2010-11 to 2012-13 and upto the date of audit. In case of major audit observations, assessment records of previous assessment years were also linked wherever found necessary.

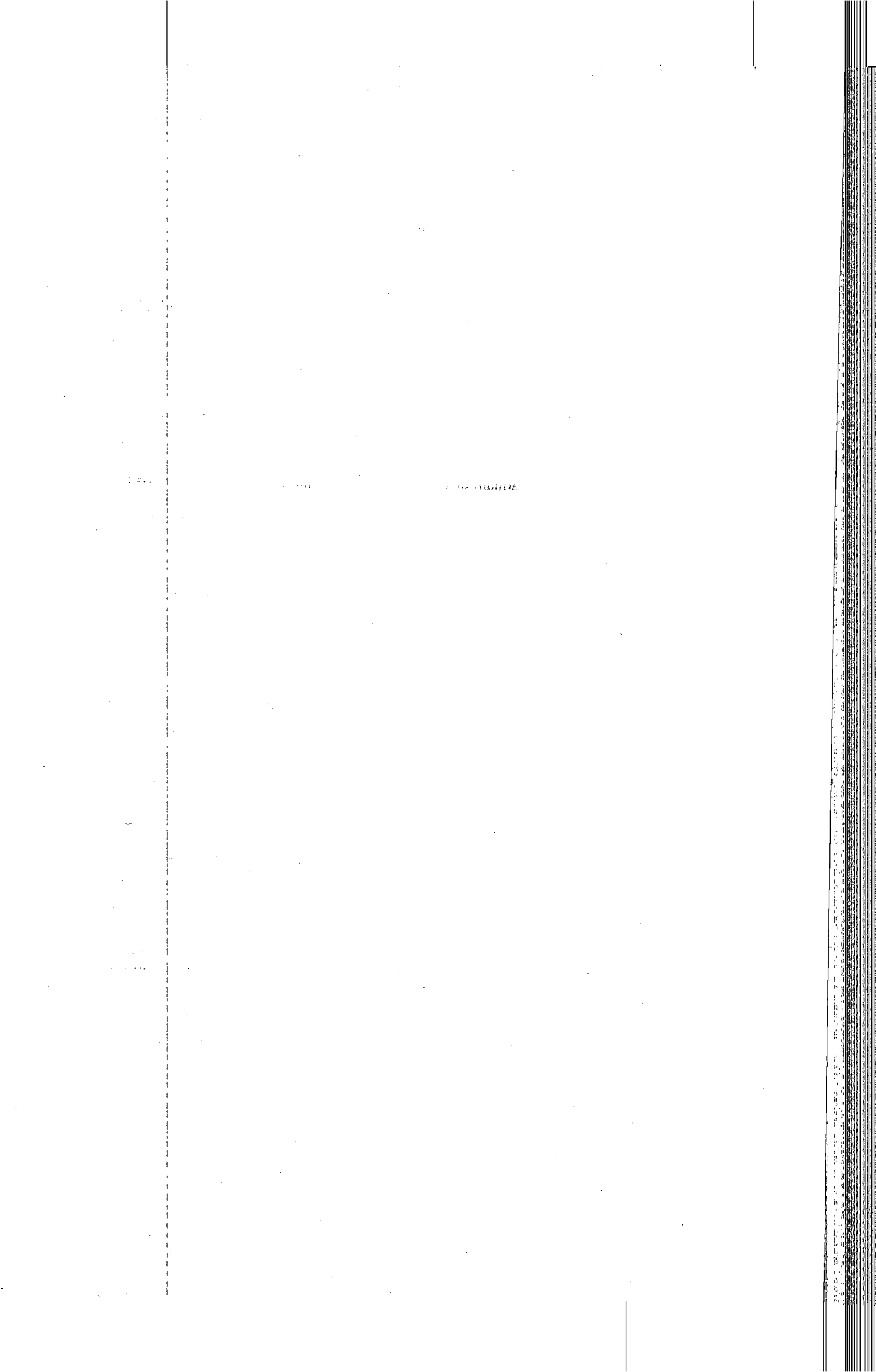
1.7 Sample selection

All cases of scrutiny assessments, appeal and rectification cases within the selected units were examined in audit. All circles/wards taken up for regular audit during the period from January to May 2014 were treated as selected units. We examined 98,078 scrutiny assessment cases in 546 circles/wards.

1.8 Acknowledgement

We acknowledge the co-operation of ITD in facilitating the audit by providing necessary records and information in connection with the conduct of this performance audit. An entry conference with CBDT was held on 06 February 2014 wherein audit objectives, scope of audit and main areas of audit examination were explained.

We issued draft Performance Report to the Ministry in September 2014 for their comments. After receipt of the Ministry's reply in October 2014, we held exit conference on 16 October 2014 to discuss our findings and recommendations vis-à-vis Ministry's comments. We again issued draft Performance Report in October 2014 containing Ministry's views and audit stand thereon for their further comments. We received further comments from the Ministry in October 2014 which have also been appropriately incorporated in the report together with audit comments thereon.



Chapter II: Appreciation of Accountants' certifications

2.1 Introduction

Certain assessees⁷ are required to get their accounts audited by a CA under Section 44AB of the Income Tax Act, 1961 (Act) and submit the report in the Forms prescribed in Rule 6G of the Income Tax Rules, 1962 (Rules). The CAs (also tax auditor) furnish the Tax Audit Report (TAR) in Form 3CA or 3CB and 3CD. In TAR, the CAs are required to furnish various information/details. In addition, the assessee is required to obtain certificates from a CA in the prescribed Forms and furnish them to the AOs to claim various deductions/exemptions available under the various provisions of the Act. All these reports/certificates are helpful to the AOs in detailed scrutiny of the accounts during the assessment proceedings. It is, therefore, necessary that (a) the AOs collect all the required reports/certificates at the time of assessment and (b) the CAs furnish correct reports/ certificates.

CBDT's Instruction no. 1959 issued in January 1999 provides that cases where the information given in the TAR is incomplete or non-committal, should be taken up by the CIT to see if these reflected any professional negligence on the part of the Accountant signing the TAR whereupon action is to be taken as per Section 288 of the Act.

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

Cases where inadequate/inaccurate information is furnished in Accountant's report and additions is made by the AO or at the instance of the audit, this fact should be brought to the notice of the ICAI for initiating action against the Accountant who had certified inadequate/inaccurate information in TAR.

In a Court case⁸, it was held that not only 'gross negligence', but 'due diligence' is equally relevant and important criterion in measuring and determining "professional misconduct" in case of a CA. Thus, a CA shall be punishable even if he does not exercise due diligence and it is not necessary for ICAI to prove that there was negligence on the part of the Accountant.

7 Corporate, Firms, Association of Persons, Body of Individuals, Charitable Trusts and Institutions etc.

8 C A Rajesh vs. Disciplinary Committee the High Court of Gujarat [2012] 28 taxmann.com 100 (Gujarat)

During this performance audit, we came across certain instances:

- a. Where the CAs failed to report full and correct information.
- b. Where the AOs failed to utilize the information available in the reports/certificates submitted to them.

Audit findings on the above issues are discussed under Section A and Section B respectively.

Section A
Cases where CAs failed to report full and correct information

2.2 The present section deals with cases where CAs reported incorrect/partial information to the AOs. We found 367 cases with tax effect of ₹ 2,813.11 crore where CAs either in their TAR or various certificates committed mistakes (See Table 2.1).

Table 2.1: Category-wise cases with tax effects

Categories	Cases	Tax Effects (₹ in crore)
a. Allowance of depreciation and amortization	66	457.79
b. Allowance of brought forward losses/depreciation	46	557.79
c. Allowance of personal/capital expenditure	42	477.89
d. Incorrect certification of claims	74	259.72
e. Incorrect/Incomplete information in TAR/Certificate	132	1,037.61
f. Irregular allowance of provisions	7	22.31
Total	367	2,813.11

Table 2.2 shows cases where CAs committed mistakes in compliance with various provisions of the Act.

Table 2.2: Category wise mistakes committed by CAs

Categories	Cases
a. Allowance of exemptions/deductions	128
b. Charging of tax on Book Profit under Section 115JB	27
c. Non-adoption of Arm's Length Price	153
d. Reporting by CAs on Cash payment exceeding ₹ 20,000 per day	308
Total	616

Table 2.3: Cases where assesses did not furnish required Forms/Certificates

Forms/Certificates	Cases
a. Non furnishing of Form 3CEB on verification of ALP	43
b. Non furnishing of Form 29B on certification of Book Profit	66
Total	109

Tax auditors furnished incorrect information on depreciation and amortization in Form 3CD leading to short levy of taxes.

2.3 Allowance of depreciation and amortization

In computing the business income of an assessee, a deduction on account of depreciation on the cost or written down value of fixed assets like building, plant and machinery, furniture, fixtures etc. is admissible as per the provisions contained in Section 32 of the Act and at the rates prescribed in the Rules provided the assets are owned by the assessee and used for the purpose of the business during the previous year.

Under Section 32(1)(iia) of the Act, additional depreciation was available at the rate of 20 *per cent* on the actual cost of plant and machinery acquired and installed after 31 March 2005. If the asset is put to use for less than 180 days in the year in which it is acquired, the rate of depreciation shall be restricted to half as per provisions to section 32(1)(ii)(b).

Any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, shall be amortized over a period of licence as provided in Section 35ABB of the Act.

Particulars of depreciation allowable as per the Act and amount of amortization are required to be disclosed by the tax auditor in Clause 14 and 15 of TAR in Form 3CD.

We found that tax auditors failed to give correct information in 66 cases involving short levy of tax of ₹ 457.79 crore (See Box 2.1).

Box 2.1: Illustrative cases on allowance of depreciation

- a. **Charge: CIT 1, Mumbai**
Assessee: Gannon Dunkerley & Co. Ltd.
Assessment Year: 2010-11
Tax Auditor: Sanghavi & Company, signed by Manoj Ganatra (Membership No: 043485)

The assessee claimed additional depreciation of ₹ 11.39 crore on plant and machinery based on the TAR, which was disallowed by the AO as the activity of construction could not be treated as manufacturing activity.

- b. **Charge: CIT 3, Mumbai**
Assessee: Idea Cellular Ltd.
Assessment Year: 2011-12
Tax Auditor: Suresh Surana & Associates, signed by partner Nirmal Jain
(Membership No: 34709)

The assessee paid an amount of ₹ 3,366.09 crore as 3G spectrum band fees for six circles which were put into operation during the previous year and claimed depreciation of ₹ 420.76 crore under the category of intangible assets which was also verified in TAR. The 3G spectrum licence fee was eligible for amortization over the period of licence i.e. in 20 years instead of depreciation. Incorrect certification by the tax auditor resulted in under assessment of income by ₹ 336.61 crore and consequent short levy of tax of ₹ 111.81 crore.

- c. **Charge: CIT Central 1, Kolkata**
Assessee: Binani Cement Limited
Assessment Years: 2008-09, 2009-10 and 2010-11
Tax Auditor: (i) V.B. Doshi & Co., signed by Vijay B. Doshi for AY 2008-09
(Membership No: 37024) (ii) Kanu Doshi Associate, signed by Arati Parmar
for AY 2009-10 and AY 2010-11 (Membership No: 102888)

The assessee acquired some new plant and machineries which were put to use at the second half of the year i.e. for less than 180 days in the year. Accordingly additional depreciation was claimed in the relevant financial year in which the plant and machineries were acquired at half of the applicable rate i.e. at the rate of 10 per cent on the value of assets. However, in the subsequent AYs, the assessee again claimed the additional depreciation at the rate of 10 per cent which was also reported in the Tax Audit Report. The same was allowed in respect of AYs 2008-09, 2009-10 and 2010-11 for an amount of ₹ 3.18 crore, ₹ 19.86 crore and ₹ 2.62 crore respectively (total ₹ 25.66 crore). This allowance was irregular as additional depreciation is allowable only in the year of commissioning. This irregular allowance has a potential tax effect of ₹ 8.72 crore.

- d. **Charge: CIT 2 Kanpur**
Assessee: Commercial Engineers & Body Builders Company Limited
Assessment Year: 2011-12
Tax Auditor: G.L. Jain (Membership No: 075079)

The assessee engaged in the business of body building of vehicles and running vehicles on hire, purchased a refrigerated van at a cost of ₹ 12.02 crore in March 2012 and claimed additional depreciation of ₹ 1.20 crore (at the rate of 10 per cent) treating it as plant & machinery. This additional claim was verified and reported by the tax auditor in his TAR. Claim of the assessee for additional claim was allowed by the AO. Since the refrigerated van is a road transport vehicle and not involved in any manufacture or production of any article or thing, no additional depreciation was admissible under Section 32(1)(ia). Irregularity in allowance of additional depreciation of ₹ 1.20 crore resulted in short charge of tax of ₹ 39.94 lakh.

Tax auditors furnished incorrect information relating to brought forward losses/depreciation in Form 3CD leading to short levy of taxes.

2.4 Allowance of brought forward losses/depreciation

As per the Act, unabsorbed depreciation shall be carried forward in subsequent year(s) and shall be set-off against profits and gains from any business or profession for that year(s).

Section 72 of the Act provides that where 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' provided that no loss shall be carried forward for more than eight years.

Tax auditors are required to disclose details of brought forward loss/depreciation allowance to the extent available in clause 25 of TAR.

We observed that the tax auditors did not report correct information regarding brought forward loss/depreciation resulting in irregular brought forward loss/depreciation allowance in 46 cases involving short levy of tax of ₹ 557.79 crore (See Box 2.2).

Box 2.2: Illustrative cases on allowance of brought forward losses/depreciation

- a. **Charge: CIT 8, Mumbai**
Assessee: SKOL Breweries Ltd.
Assessment Year: 2008-09
Tax Auditor: BSR & Co. signed by partner Zubin Shekary (Membership No: 48814)

The auditor has shown an amount of ₹ 168.07 crore as unabsorbed depreciation for the period 1987 to 2008 while the assessee has claimed business loss/unabsorbed depreciation in its returns for the period 2002 to 2008 at ₹ 168.08 crore. If the unabsorbed depreciation for the period 2002-2008 given in TAR is summed up it comes to ₹ 140.81 crore only. The AO, however, ultimately allowed unabsorbed depreciation and business loss of ₹ 22.55 crore after reviewing the assessment orders from AY 2004-05 onwards after considering change in the shareholding pattern exceeding 51 *per cent* in the AY 2006-07, did not entitle the assessee to carry forward the business loss of the earlier years.

b. Charge: CIT 7, Mumbai

Assessee: Transactional Documents India Pvt. Ltd.

Assessment Year: 2008-09

Tax auditor: Sushil Budhia Associates signed by partner **Usha Gopalan**
(Membership No: 45720)

The auditor mentioned in TAR carry forward losses to be set off by the assessee as 'Nil'. The assessee, however, claimed in income tax return brought forward losses of ₹ 3.12 crore. Verification of the records from 2004-05 onwards showed that brought forward loss was of ₹ 1.16 crore only. This shows that the tax auditor has not reported the correct information about brought forward losses.

c. Charge: CIT-VI, Delhi

Assessee: TV Today Network Limited

Assessment Year: 2010-11

Tax Auditor: S. Mukherjee (Membership No: 57084)

Radio broadcasting business of Radio Today Broadcasting Limited was transferred to the assessee company. The assessee company claimed brought forward unabsorbed loss of ₹ 48.49 crore of Radio Today Broadcasting Limited as deemed loss under Section 72A of the Act. This brought forward loss was also reported in TAR. This loss was not allowable as the conditions imposed by Section 72A were not fulfilled since Radio Today Broadcasting Limited was engaged in the business of radio broadcasting and trading business, which were not industrial activities. This resulted in incorrect set off of losses of ₹ 48.49 crore involving tax effect of ₹ 17.93 crore.

d. Charge: CIT-I, Delhi

Assessee: Cement Corporation of India Limited

Assessment Year: 2011-12

Tax Auditor: Sandeep Garg (Membership No: 75312)

As per the details given in TAR the assessee had available unabsorbed business loss of ₹ 880.43 crore. Audit observed that this figure included the business loss of ₹ 791.33 crore pertaining to AYs prior to 2002-03 (i.e. beyond eight years) also, which was not available for set off under Section 72. Incorrect reporting by the tax auditor in TAR resulted in undue claim of unabsorbed business loss having potential tax effect of ₹ 244.52 crore.

e. Charge: CIT, Bareilly

Assessee: Kisan Sehkari Chini Mills, Semikhera

Assessment Year: 2010-11

Tax Auditor: Krishna Kumar Agarwal (Membership No: 071030)

Brought forward loss of ₹ 9.91 crore for AY 2003-04 was reported as ₹ 10.48 crore in TAR by the tax auditor resulting excess claim of ₹ 56.70 lakh having a potential tax effect of ₹ 17.52 lakh.

f. Charge: CIT:-III, Hyderabad
Assessee: Sai Life Sciences Ltd.
Assessment Year: 2011-12
Tax Auditor: M/s. Siva Krishna & Narayan signed by partner R.V.N. Sastry
(Membership No: 206635)

The total brought forward business loss of ₹ 18.85 crore was allowed to set-off based on the reporting by the chartered accountant in TAR. Verification of previous years assessment records revealed that the total business loss available for setoff during the AY 2011-12 was only ₹ 14.63 crore. The excess allowance of set off of losses of ₹ 4.22 crore resulted in excess allowance of MAT credit of ₹ 1.73 crore.

Tax Auditors furnished incorrect/inadmissible information on personal/capital expenditure leading to undue deduction to assessee resulting in short levy of taxes.

2.5 Allowance of personal/capital expenditure

As per the Act, expenditure, not being in the nature of capital expenditure laid out wholly or exclusively for the purpose of business, is allowable as deduction in computing the income chargeable under the head 'Profits and gains of business or profession'. It has been judicially held that interest liability up to the stage of commencement of production should be capitalised⁹. It has also been judicially held that loss on account of cost incurred on abandoning of technology before being put to use is not an allowable deduction as it is in the nature of capital expenditure¹⁰; and expenses incurred before the commencement of business are not revenue expenditure under Section 37(1)¹¹.

Tax auditor is required to give particulars of amount debited to the Profit and Loss account being expenditure of capital nature in clause 17(a) and (b) of tax audit report in Form 3CD.

Our examination revealed that in 42 cases personal/capital expenditure was incorrectly allowed as the tax auditors did not report the amount in their tax audit reports. This resulted in short levy of tax of ₹ 477.89 crore (See Box 2.3).

⁹ M/s. Challapalli Sugars Limited vs CIT(1975)98 ITR 167 (SC)

¹⁰ M/s. Kanoria Chemicals & Industries Limited vs CIT (1995) 78 Taxman 455 (Calcutta High Court)

¹¹ CIT vs. Mohan Steel Limited (2004) 191 CTR (ALL) 279

Box 2.3: Illustrative cases on irregular allowance of personal/capital expenditure

- a. **Charge: CIT-II, Chennai**
Assessee: Ennore Port Limited
Assessment Year: 2011-12
Tax Auditor: E. Prakash (Membership No: 019388)

Loss of ₹ 9.92 crore incurred on sale of fixed asset was incorrectly debited to Profit and Loss account. The tax auditor failed to report this which resulted in under assessment of tax by ₹ 3.29 crore.

- b. **Charge : CIT 2 Baroda**
Assessee: National Dairy Development Board
Assessment Year: 2009-10
Tax Auditor: Anil Karnik (Membership No: 031005)

The assessee paid premium of ₹ 3.16 crore on purchase of debentures/bonds in government companies, financial institution during AY 2009-10. This amount was charged to Income & Expenditure account. As the assessee was not a bank or financial institution mandated by RBI to invest in such debentures/bonds of government companies, financial institution as SLR or as to Held Till Maturity (HTM), it was required to be capitalized the premium with the cost of investment. The tax auditor failed to report this in tax audit report. This resulted in short levy of tax of ₹ 1.42 crore.

Accountants gave incorrect information resulting in excess allowance of exemption in Form 3CEA/10B/56F/56G resulting in short levy of taxes.

2.6 Allowance of exemptions/deductions

Sections 10A/10B of the Act provide for a deduction, with effect from 01 April 2001, of such profits and gains as derived by a newly established undertaking in a free trade zone or by a newly established hundred *per cent* export oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce. To claim this deduction, assessee is required to furnish a certificate from an Accountant certifying the claim in Form 56F/56G, along with the ITR.

Income derived from property held under trust for charitable or religious purposes, to the extent such income applied to such purposes in India and where any such income is accumulated and set apart, upto 15 *per cent* of the income from such property, for application to such purposes in India is exempt from income tax under Section 11 of the Act subject to certain conditions. An audit report in Form 10B from an Accountant was required to be submitted under Section 12A(b) of the Act to claim this exemption.

Any profits and gains arising from the slump sale were chargeable to income tax as long term capital gain under Section 50B. In the case of slump sale, the assessee is required to furnish a report of a CA in the prescribed format (Form 3CEA), indicating therein the computation of the net worth of the undertaking and certifying that the net worth of the undertaking has been correctly arrived at in accordance with the provisions contained in Section 50B.

Our audit examination revealed that in 128 cases where Accountants failed to give correct information about exemption in Form 3CEA/10B/56F/56G and certified excess exemption of ₹ 9,478.45 crore (See Box 2.4).

Box 2.4: Illustrative cases on irregularity in allowance of exemptions/deductions

a. **Charge:** CIT 10, Mumbai

Assessee: Oracle Financial Services Software Ltd.

Assessment Year: 2009-10

Chartered Accountant: Vijay V. Rajwade (Membership No. 46344)

The CA certified deduction under section 10A at ₹ 674.40 crore in Form 56F. ITD after verification of records found that computation of claim was not correct as the assessee had (i) not set off the losses of two units in which it had claimed 10A deduction in earlier years, (ii) had considered unrealized foreign exchange and (ii) included expenditure incurred in foreign currency in export turnover for computation of 10A exemption. ITD worked out deduction under section 10A at ₹ 615.71 crore.

b. **Charge :** DIT (Exemption), Mumbai

Assessee: The Synthetic & Rayon Textiles Export Promotion Council

Assessment Year: 2009-10

Chartered Accountant: N.P Jhaveri & Associates (Membership No. 33851)

Accountant in the certificate in Form 10B certified that the assessee had applied ₹ 3.56 crore for charitable or religious purpose in India during the year. The AO in scrutiny assessment disallowed an amount of ₹ 91.86 lakh which was incurred in foreign exchange outside India for promotion of exports. The provisions of Section 11 clearly does not allow expenditure incurred outside India (unless for promoting international welfare under section 11(1) (c)) to be consider as application of income.

<p>c. Charge : CIT-I Kochi Assessee: Nest Power Electronics Private Limited Assessment Year: 2010-11 Chartered Accountant: Sunney Sebastian (Membership No: 023198)</p> <p>A claim for deduction of ₹ 2.63 crore under Section 10A of the Act was allowed. As per certificate furnished in Form 56F, the date of commencement of manufacture or production was 25 March 2000. Since production was commenced in the previous year relevant to the AY 2000-01, therefore deduction was allowable up to AY 2009-10 only. This resulted in short levy of tax of ₹ 1.32 crore.</p>
<p>d. Charge : CIT-I Kochi Assessee: Kerala Books Publications Society Assessment Year: 2008-09 Chartered Accountant: Not applicable as Form 10B was not furnished</p> <p>Exemption of ₹ 4.88 crore was allowed under Section 11 of the Act without obtaining report under Section 12A(b) in Form 10B. Revenue involved in this case worked out to ₹ 1.66 crore.</p>

CAs have certified wrong information/claims which resulted into excess allowance of exemptions/deductions.

2.7 Incorrect certification of claims

For claiming various exemptions and deductions under various sections of the Act, an assessee is required to furnish certificates/audit reports signed by a CA. We observed that the CAs have certified wrong information/claims in 74 cases having tax effect of ₹ 259.72 crore (See Box 2.5).

<p>Box 2.5: Illustrative cases on incorrect certification of claims</p> <p>a. Charge : CIT 2, Thane Assessee: Gurukripa Developers Assessment Year: 2009-10 Chartered Accountant: Kukreja-Dialani & Co., (Firm registration No. 126893W)</p> <p>Section 80IB(10) provides for deduction of 100 <i>per cent</i> of profit subject to conditions which <i>interalia</i> includes that the commercial premises in the housing project should not exceed five <i>per cent</i>. The CA in his report issued in Form 10CCB certified that the housing project had residential premises of 72,700 sq ft. and shops and other commercial premises of 90,000 sq ft. CA certified that the assessee fulfills the conditions stipulated in Section 80IB(10) even though the details given by him in his certificate indicated that the assessee was not entitled for the deduction as the commercial space was more than five <i>per cent</i>. This incorrect certifications lead to claim of irregular deduction by the assessee of</p>
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₹ 87.10 lakh during the assessment years 2006-07 to 2009-10. This has resulted in short levy of tax to the extent of ₹ 26.13 lakh.

b. Charge : CIT 8, Mumbai

Assessee: Time Technoplast Ltd.

Assessment Year: 2010-11

Chartered Accountant: Manish Hingar (Membership No: 109060)

The assessee claimed deduction of ₹ 37.32 crore under section 80IB for the assessment year 2010-11 based on 10CCB certificate issued by CA on profit of seven industrial undertakings. CA certified that undertaking or enterprise satisfied the conditions stipulated in section 80IB. One of the condition in section 80IB(4) was that the unit should not start manufacturing after March 2004. However it was seen that six units started manufacturing after March 2004 hence were not eligible for deduction under Section 80IB. This showed that the Accountant had not done due diligence and has given the declaration even though the assessee did not meet the conditions stipulated in 80IB. Further clause 18 and 19 of the Form 10CCB were not filled in at all in all the above 7 cases. Incorrect allowance of deduction resulted in underassessment of income by ₹ 36.60 crore and short levy of tax of ₹ 12.44 crore.

c. Charge : CIT-IV, Kolkata

Assessee: Simplex Infrastructures Limited

Assessment Year: 2010-11

Chartered Accountant: H.S. Bhattacharjee & Co., signed by Binayak Dey (Membership No: 062177)

The assessee claimed deduction of ₹ 82.66 crore under Section 80IA(4), available for developing, operating and maintaining an infrastructure facility. This claim was certified by the CA in required Form 10CCB certifying that the assessee satisfies conditions stipulated in the Section. During the assessment, the AO noticed that the assessee was merely undertaking part of a project on works contract basis and not as "developer". Therefore, the assessee was not eligible for deduction under Section 80IA(4) read with Explanation. Accordingly, deduction under Section 80IA(4) claimed by the assessee was disallowed avoiding leakage of revenue of ₹ 28.10 crore.

CAs gave incorrect/incomplete information in Tax Audit Reports/certificates leading to loss of revenue.

2.8 Incorrect/Incomplete information in Tax Audit Report/Certificate

We observed that CAs gave incorrect/incomplete information in TARs/certificates in 132 cases having a revenue impact of ₹ 1,037.61 crore. However, the AOs did not take any action against the assessee or the concerned CA (See Box 2.6).

**Box 2.6: Illustrative cases on incorrect/incomplete information
in Tax Audit Report/Certificate**

- a. **Charge : CIT-1 Kochi**
Assessee: Synthite Industrial Chemical Limited
Assessment Year: 2008-09
Chartered Accountant: Thomson Thomas (Membership No: 25567)

Section 40(a) of the Act prescribes that if any interest, royalty, fees for technical services or other sums chargeable under this Act are paid without deducting tax at source under Chapter XVII-B, such sums shall not be deducted in computing 'profits and gains from business or profession'. The tax auditor against Clause 27(a) (whether the assessee had complied with the provisions of Chapter XVII-B) of the TAR certified as "Yes" though commission, advertisement expenses etc. were paid to non-residents (₹ 1.82 crore) without deducting tax at source under Section 195 of the Act. Hence, these were allowed as expenditure.

- b. **Charge: CIT-I Chennai**
Assessee: Daimler India Commercial Vehicles Private Limited
Assessment Year: 2010-11
Chartered Accountant: Vijay Mathur (Membership No: 46476)

Any expenditure not allowable as deduction under Section 40(a) has to be mentioned by the CA in clause 17(f) of Form 3CD. We observed that though the assessee itself added back a sum of ₹ 2.44 crore towards non-deduction of tax on salaries involving tax effect of ₹ 82.81 lakh. This disallowance, however, was not mentioned by the CA in Form 3CD as required in clause 17(f).

- c. **Charge: CIT II Kolkata**
Assessee: UCO Bank
Assessment Years: 2008-09 and 2010-11
Chartered Accountant: (i) For AY 2008-09: S. N. Guha & Co., signed by M. K. Datta (Membership No: 12701, Kansal Singla & Associates, signed by S. K. Kansal (Membership No: 80632), Parikh & Jain, signed by Anurag Jain (Membership No: 76362), S. P. Puri & Co., signed by Rajiv Puri (Membership No: 84318), K. K. S. & Co., signed by S L Kochar (Membership No: 016573) and A. R. & Co., signed by Anil Gour (Membership No: 017546)
(ii) For AY 2010-11: A. R. & Co., signed by Pawan Kumar Goel (Membership No: 072209), Chatterjee & Co., signed by S Chatterjee (Membership No: 003124), D. R. Mohnot & Co., signed by Vipin Kanoongo (Membership No: 072716), Goel Garg & Co., signed by A. K. Agarwal (Membership No: 084600), Bansal & Co., signed by Rajendra Sharma (Membership No: 072424), Kothari & Co., signed by Manaswy Kothari (Membership No: 64601)

The AO made additions of ₹ 19.04 crore and ₹ 21.93 crore for AY 2008-09 and AY 2010-11 respectively on account of 'gain on securitization' under Section 28 of the Act. Since this amount was not credited to Profit & Loss Account, AOs also made additions of ₹ 1.73 crore and ₹ 36.60 crore towards disallowance of expenditure

under Section 14 for earning exempt income. We observed that the CAs failed to mention these amounts in clause 13 and 17 of 3CD report of the respective years. These additions have revenue impact of ₹ 26.96 crore.

- d. **Charge : CIT I Kolkata**
Assessee: Exide Industries Limited
Assessment Years: 2008-09 and 2009-10
Chartered Accountant: S.R. Batliboi & Co., signed by R. K. Agarwal
(Membership No: 016667)

The tax auditors computed expenses disallowable under Section 14A of ₹ 1.86 lakh for AY 2008-09 and ₹ 2.26 lakh for AY 2009-10. AOs, however, computed this disallowance as ₹ 12.19 crore and ₹ 7.06 crore respectively for AY 2008-09 and AY 2009-10, applying Rule 8D of the Income Tax Rules, 1962. On appeal of the assessee, disallowance for AY 2009-10 was determined at ₹ 11.67 crore. This shows that the tax auditors did not compute the disallowance applying rules properly. These additions avoided leakage of ₹ 6.35 crore of tax revenue.

- e. **Charge : CIT 8, Mumbai**
Assessee: P.K. International Exports Pvt. Ltd.
Assessment Year: 2010-11
Chartered Accountant: D.S. Solanki (Membership No: 115223)

CA in clause 27 of TAR reported that the assessee had complied with the provisions of Chapter XVII i.e. the assessee had deducted and paid TDS wherever applicable. However during the course of assessment proceedings the assessing officer made disallowances of ₹ 6.56 crore under Section 40(a)(ia) as the assessee did not furnish any details in respect of TDS deducted on the above amount of expenditure and payment made to Government Treasury.

- f. **Charge : CIT 10, Mumbai**
Assessee: Quest Portfolio Services Pvt. Ltd.
Assessment Year: 2010-11
Tax Auditor: Rajiv Luthia (Membership No. 039673)

Tax auditor was required to disclose under clause 16(a) of TAR sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividends. Bonus of ₹ 10 crore was paid to the Director of the assessee company out of the profits of the company of ₹ 11.17 crore. Director held 91 per cent of the shares in the company and the bonus given was commensurate with the percentage of his holding in the company. This was done to avoid payment of dividend distribution tax which would be otherwise payable if the amount was paid as dividend. The tax auditor failed to disclose this amount. The AO disallowed the amount under Section 40A(2)(b) being unreasonable and excessive.

2.9 Irregular allowance of provisions

Under the Act, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions do not qualify for deduction. Particulars to this effect are required to be disclosed in Clause 17(k) of Form 3CD.

We observed that the tax auditors failed to report this information in seven cases which resulted in under assessment of income of ₹ 65.66 crore having a tax effect of ₹ 22.31 crore (See Box 2.7).

Box 2.7: Illustrative cases Irregular allowance of provisions

Charge : CIT 6, Mumbai

Assessee: Mazgoan Docks Ltd.

Assessment Year: 2008-09

Chartered Accountant: G.P. Kapadia & Co signed by partner Nimesh Bhimani (Membership No: 30547)

The CA failed to report provision of ₹ 5.70 crore for payment of post retirement scheme which was not paid before filing of return. As a result this provision could not be disallowed. This resulted in underassessment of income of ₹ 5.70 crore and short levy of tax of ₹ 1.94 crore

Accountant did not compute 'Book Profit' and did not furnish Form 29B under Section 115JB which lead to short levy of taxes.

2.10 Charging of tax on Book Profit under Section 115JB

Section 115JB of the Act provides for levy of Minimum Alternative Tax (MAT) at prescribed percentage of the 'Book Profit' if the tax payable on the total income under normal provisions is less than such percentage of 'Book Profit' arrived at after certain additions and deletions as prescribed.

Every company to which provisions of Section 115JB applies, is required to furnish a report in Form 29B from an Accountant certifying that the 'Book Profit' has been computed in accordance with the provisions of this Section along with the return of income. With the introduction of e-filing of return, Form 29B is not required to be submitted with the ITR. However, it is submitted to the AO at the time of scrutiny assessment.

We observed that 66 company assesseees did not furnish the report in Form 29B. We also observed that Accountants failed to compute the 'Book Profit' in 27 cases in accordance with the provisions of the Act (See Box 2.8).

Box 2.8: Illustrative cases on charging of tax on 'Book Profit' under Section 115JB

- a. **Charge :** CIT-I Kochi
Assessee: Parry Agro Industries Limited
Assessment Year: 2009-10
Chartered Accountant: M K Ananthanarayanan (Membership No: 19521)

The assessee did not furnish the certificate from the CA in Form 29B. In this case tax under Section 115JB was levied on 'Book Profit' of ₹ 7.73 crore as against correct amount of ₹ 8.63 crore, resulting in short levy of tax of ₹ 13.50 lakh.

- b. **Charge:** CIT Central 2, Mumbai
Assessee: Jyoti Bright Bars Limited
Assessment Year: 2008-09
Chartered Accountant: Bhuta Shah & Co signed by partner Shailesh P. Bhuta ; (Membership No:33958)

The assessee worked out profit under normal provisions at ₹ 1.15 crore and under 115JB at ₹ 1.14 crore and paid tax under normal provisions considering that the tax under normal provisions was more. Audit Report under Section 115JB was not obtained by the AO and kept on record. Audit observed that the assessee in order to avoid payment of tax under the provisions of Section 115JB directly credited the capital gains of ₹ 7.46 crore on sale of shares (exempted under the provisions of Section 10(38) but taxable under the provisions of MAT) directly to capital reserves instead of Profit and Loss account as required in Accounting Standards 10. Incorrect computation of Book Profit resulted in short levy of tax of ₹ 77.56 lakh.

- c. **Charge:** CIT II, Agra
Assessee: Shree Radhe Govind Ice & Cold Storage (P) Ltd.
Assessment Year: 2010-11
Chartered Accountant: Dolly Mittal (Membership No: 410931)

The assessee had not submitted Form 29B under section 115JB of the Act. The assessment was concluded under normal provisions of the Act after allowing exemption of ₹ 11.36 crore of Long Term Capital Gain (LTCG) under Section 10(38), determining the tax at ₹ 10.03 lakh. However, we observed that the income by way of LTCG, though exempt under section 10(38) of the Act, was liable to be considered for determination of tax under Section 115JB. Accordingly, the tax under section 115JB works out to ₹ 2.74 crore which is higher than the tax of ₹ 10.03 lakh levied. The AO also failed to invoke the provisions of section 115JB resulting in short levy of tax of ₹ 2.64 crore.

Chartered Accountants furnished incorrect/incomplete information in Form 3CEB on Arm's Length Price.

2.11 Adoption of Arm's Length Price (ALP)

Section 92(1) of the Act provides that any income arising from an international transaction shall be computed having regard to the arm's length price (ALP). Computation of ALP has to be done as per Section 92C. Section 92E read with rule 10E prescribe for obtaining a report from a CA in Form 3CEB, by the person entered into an international transaction during a previous year and furnish the same to the assessing officer on or before the specified date. In case of specified domestic transactions above ₹ five crore as defined in Section 92BA of the Act, such cases have to be referred by the AO to the Transfer Pricing Officer (TPO). In Form 3CEB, CA has to verify the arm's length price as computed by the assessee.

Our audit revealed that the assessee did not furnish required report in 43 cases. We also observed that CAs gave incorrect/incomplete information in the report in 153 cases (See Box 2.9).

Box 2.9: Illustrative cases on non-adoption of Arm's Length Price (ALP)

- a. **Charge: CIT V, Chennai**
Assessee: Polaris Software Lab Limited
Assessment Year: 2009-10
Chartered Accountant: S. Vishwa (Membership No: 20572)

The Transfer Pricing Officer (TPO) on reference, made an upward adjustment of ₹ 73.87 crore to the value of transactions made by the assessee company with its associated enterprises involving a tax effect of ₹ 25.01 crore. However, the CA who certified the Form 3CEB failed to consider this transaction.

- b. **Charge: CIT 4, Kolkata**
Assessee: Akzo Nobel India Limited (Formerly ICI India Limited)
Assessment Year: 2008-09
Chartered Accountant: BSR & Associates, signed by Kaushal Kishore (Membership No: 090075)

ALP of an international transaction as per Form 3CEB filed by the assessee was ₹ 18.45 crore. The case was referred to the Transfer Pricing Officer who determined the ALP of the transaction as zero. Therefore, there was an upward adjustment of income of ₹ 18.45 crore having a tax effect of ₹ 6.27 crore.

c. Charge: CIT 8, Mumbai
Assessee: Sitel India Limited
Assessment Year: 2009-10
Chartered Accountant: Gourav Gupta & Associates (Membership No. 077992)

TPO recommended upward adjustment of ₹ 25.45 crore in ALP of ₹ 170.67 crore certified by the CA in 3CEB report. TPO recommended this adjustment considering that (i) the transfer pricing study report (TPSR) relied upon by CA to certify the transactions was based on a segmental account which was neither certified by the statutory auditor or auditor certifying the 3CD report or the auditor certifying the Form 3CEB, (ii) The segmental accounts did not tally with the audited Profit and Loss account, (iii) the account was prepared for two business segments i.e. Associated Enterprise (AE) segment and non AE segment which showed that the operating profit margin of 21.14 *per cent* and for (-) 10.06 *per cent* respectively. This was done only to show higher margin of profit from AE segment and loss in non AE segment. Operating margin was revised to 33.56 *per cent* by TPO on the basis of 24 comparables against six comparables used in TPSR of which TPO rejected three comparables, as against 14.18 *per cent* declared by the assessee.

d. Charge : CIT 3, Mumbai
Assessee: KKR India Ltd.
Assessment Year: 2010-11
Chartered Accountant: Mihir Shah & Associates (Membership No: 41919)

TPO suggested addition of ₹ 10.71 crore in ALP of ₹ 43.22 crore certified by CA in Form 3CEB. TPO observed that (i) the assessee was compensated by the associate enterprises for the service rendered at cost plus 10 *per cent* for the investment advisory services rendered, (ii) all the comparable used by the assessee were operating from different geography locations and not a single Indian comparable was used. TPO after benchmarking with six comparable operating in India suggested addition of ₹ 10.71 crore.

Chartered Accountants did not point out verification of payments made through crossed cheque/bank draft for amount exceeding ₹ 20,000 per day.

2.12 Reporting by CAs in Form 3CD on cash payment exceeding ₹ 20,000 per day

As per Section 40A(3) of the Act, no deduction shall be allowed where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds ₹ 20,000. Such disallowance is required to be reported by the tax auditor in his report in Clause 17(h) of Form 3CD.

ICAI in the Guidance Note on Section 44AB (2005 edition) vide Para 35.3 had stated that “there may be practical difficulties in verifying of payments made through crossed cheques or bank drafts. If no proper evidence for verification of the payment by crossed cheque or draft is available, such a fact could be brought out by appropriate comments in the following manner”. Thus, in case the verification is impossible the CA requires to furnish the certificate as: *“It is not possible for me/us to verify whether the payments in excess of ₹ 20,000 have been made otherwise than by crossed cheque or bank draft, as the necessary evidence is not in the possession of the assessee”*.

We observed 308 cases where the tax auditors failed to point out the disallowance under Section 40A(3).

In one case noticed by audit, tax auditor did not give a proper report on verification of cash payment instead he proposed an adhoc disallowance. In the case of **Sree Lakshmi Industrial Forge and Engineers Limited** under CIT III Bengaluru of AY 2009-10, the tax auditor, **R Ashok Kumar (Membership No: 18446)** reported in clause 17(f) of Form 3CD {amounts inadmissible under Section 40(a)} *“We have broadly verified the payments on which tax to be deducted at source. While the assessee has mostly complied with the law, but due to volume of transactions, we are not in a position to confirm that tax has been deducted wherever applicable. Hence, we recommend an adhoc disallowance of ₹5,00,000”*. This shows that the tax auditor did not conduct the tax audit and reported the same properly as envisaged under Section 44AB.

Issuing directions by Assessing Officers for Special Audit under Section 142(2A) of the Act by nominated Chartered Accountants raised question on performance by original Chartered Accountants.

2.13 Special audit under Section 142(2A)

As per Section 142(2A) of the Act, during the course of scrutiny assessment, the AO, considering the nature and complexity of the accounts and in the interest of revenue finds it necessary to have the accounts re-audited, may direct the assessee to get the accounts audited by a CA nominated in this behalf by ITD. Order for special audit under Section 142(2A) indicates that the AO is not satisfied with the audit report furnished by the assessee. We observed that AOs issued directions in 78 cases for special audit under Section 142(2A). As a result of special audit, income of 16 assesseees was increased by ₹ 197.79 crore. This indicates that the original auditor did not perform his task properly.

Section B
Cases where the AOs failed to utilize the information available in the reports/certificates

CBDT issued instruction to all its field formations in 1999 to utilize information for making meaningful additions in the assessment proceedings by Assessing Officers. Public Accounts Committee also expressed concern over inadequate attention given to Accountant's report. Despite this, Assessing Officers did not utilize the information available in Accountant's reports which led to short levy of taxes.

2.14 Utilization of information available in Accountants' reports

Accountants are required to give details on various information in 3CD reports. CBDT's instruction 09/2008 requires that tax audit reports and as well as other statutory reports should be critically examined along with connected records and other available evidences and the information as available in these reports should be effectively utilized while finalizing the scrutiny assessment. We observed in 102 cases having a tax effect of ₹ 1,310.05 crore where AOs failed to utilize the information available in 3CD reports (See Box 2.10).

Box 2.10: Illustrative cases on non-utilization of information available in Accountants' reports

- a. **Charge: CIT-LTU Delhi**
Assessee: Mahanagar Telephone Nigam Limited
Assessment Year: 2011-12
Chartered Accountant: Ravinder Khullar (Membership No: 82928) and Ajay Rastogi (Membership No: 84897)

The tax auditor in his tax audit report mentioned the amount of gratuity paid to the employees of the assessee during the relevant financial year as ₹ 38.10 crore against pre-existed liability. The assessee, however, claimed ₹ 107.08 crore against gratuity which was allowed by the AO, resulting in over assessment of loss by ₹ 68.98 crore having potential tax effect of ₹ 23.45 crore.

- b. **Charge: CIT-VI Delhi**
Assessee: Thomson Press (India) Limited
Assessment Year: 2010-11
Chartered Accountant: S. Mukherjee (Membership No: 57084)

As per 3CD Report, total depreciation allowable to assessee as per the Act was ₹ 22.04 crore. The AO, however, allowed ₹ 46.89 crore on the basis of the income tax return filed by the assessee. Thus, excess depreciation of ₹ 24.85 crore was allowed by AO inspite of tax auditor's report resulting in under assessment of income having potential tax effect of ₹ 7.67 crore.

- c. Charge : CIT 2 Lucknow**
Assessee: Madhyanchal Vidyut Vitran Nigam Limited
Assessment Year: 2011-12
Chartered Accountant: M.K. Gupta (Membership No: 075475)

The CA in its TAR reported disallowance of the expenditure under Section 43B of ₹ 20.15 crore on account of interest paid to Rural Electrification Corporation Ltd. We observed that the AO while concluding the assessment failed to utilise the said information and allowed the expenditure disregarding TAR. This omission resulted in short computation of business income by ₹ 20.15 crore with consequential short charge of potential tax of ₹ 6.23 crore.

- d. Charge : CIT I, Kochi**
Assessee: Lisie Medical Institutions,
Assessment Years: 2008-09 and 2009-10
Chartered Accountant: Paul T Mampilly (Membership No: 10496)

Though CA had certified in Form 10B that the income of ₹ 5.19 crore and ₹ 3.17 crore set apart under section 11(2) of the Act in AYs 2008-09 and 2009-10 was not deposited in the manner laid down in section 11(2)(b) of the Act, the amount was not brought to tax. This has resulted in short levy of tax of ₹ 3.71 crore.

- e. Charge: CIT, Bareilly**
Assessee: Kisan Sehkari Chini Mills, Semikhera
Assessment Year: 2010-11
Tax Auditor: Krishna Kumar Agarwal (Membership No: 071030)

The assessing officer allowed brought forward losses of ₹ 36.67 crore for AYs 2006-07 and 2007-08 instead of ₹ 28.63 crore as reported by the tax auditor in TAR, resulting excess allowance of loss of ₹ 8.04 crore having tax effect of ₹ 2.48 crore (potential).

2.15 Conclusions

In this chapter, we have attempted to highlight cases involving tax audit and certification by CAs under the various provisions of the Act. CAs have reported incorrect/incomplete information in 367 cases with tax effects of ₹ 2,813.11 crore (summary in Table 2.1 and 2.2). They have also failed to furnish required certificates (summary in Table 2.3). This resulted into denying proper dues to the Government. AOs have also failed to utilize information in 102 cases available in Accountant's reports/certificates with tax effect of ₹ 1,310.05 crore. CBDT in its instruction of 1999 and 2008 emphasized the use of information available in Accountant's reports/certificates by AOs at the time of assessments. PAC had also observed that due to inadequate attention to this aspect, the objectives of the introducing Section 44AB gets defeated. In view of this, it is imperative to see the adequacies of monitoring aspect of work done by CAs by ITD and ICAI.

We have commented on system and monitoring aspect in Chapter III of this report with our recommendations thereon.

2.16 Recommendations

We recommend that

- a. The Ministry may ensure that the AOs shall not grant exemptions/deductions if the assessee does not submit necessary certificates/reports.

The Ministry replied (October 2014) that there are sufficient provisions in Sections 10A, 10(23C), 80IA, 80IB, etc. of the Act which ensure that tax audit reports are available with the ITD. These provisions themselves ensure that in case of failure to file prescribed audit reports, exemptions/deductions thus claimed are not allowed. The Ministry also replied that the CBDT's Instruction No.9/2008 also reiterated that the tax audit reports as well as other statutory audit reports should be critically examined along with connected records and other available evidence while scrutinizing the cases. The Ministry also replied that a proviso to Rule 12 of IT Rules 1962 has been substituted with retrospective effect from 01 April 2013 requiring the assessee, claiming exemptions/deductions under various provisions of the Act, to file the prescribed reports of audit electronically.

Audit is of the opinion that though sufficient provisions are available in the Act, however, AOs did not follow during assessment meticulously which need attention by the Ministry.

- b. The Ministry may ensure that the AOs fully utilize the available information in CAs report/certificates.

The Ministry replied (October 2014) that necessary instructions have been issued in 2008 to critically examine tax audit reports as well as other statutory audit reports and to utilize effectively the information available in these reports while finalizing scrutiny assessments. The Ministry further replied (October 2014) that e-filing of audit reports has been introduced from AY 2013-14. Information furnished in e-filed audit reports was used in selecting cases for scrutiny under CASS. The reason for selection of case was also displayed to the AOs for effective utilization of available information.

Chapter III: Systemic Issues and Controls

3.1 Introduction

Income Tax Act, 1961 (Act) prescribes for tax audit and certification by Accountants under provisions of the Act. Accordingly, various Forms (details in **Appendix 1**) have been devised for the purpose of tax audit and certification to be furnished by Accountants in order to assist ITD in its efforts in revenue mobilization. While reviewing the certification in assessment proceedings, we have noticed certain deficiencies in the prescribed Forms. We have also observed lack of monitoring by the ITD on the work done by the Accountants. The present Chapter deals with systemic issues and monitoring mechanism by the ITD in dealing with tax audit and certification done by Accountants under provisions of the Act.

Due to non-availability of date of declaration of payment of distributed profits in Form 3CD, we could not verify the correctness of tax paid within stipulated period or any interest to be charged due to delay.

3.2 Declaration of date of payment of distributed profits

Section 115-O of the Act provides that in addition to the income tax chargeable in respect of the total income of a domestic company for any AY, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) out of profits shall be charged to additional income tax at the rate of 15 *per cent* with effect from 01 April 2007. Further, Section 115P of the Act *ibid* provides that where the company fails to pay the whole or any part of the tax on distributed profits, within the time limit (14 days from the date of declaration/ payment), it shall be liable to pay simple interest at the rate of one *per cent* for every month.

We observed that serial number 29 of Form 3CD require the details of the amount of distributed profits, tax paid thereon and dates of payment of tax. It does not provide for the date of declaration/ payment of distributed profits. In absence of this, it is difficult to verify whether the tax has been paid within the stipulated period or any interest is to be charged due to the delay.

We tried to find out the dates of declaration/payment of dividend from available sources in 88 cases, but could not get these dates. As a result we were unable to work out the amount of interest for delay, if any, in payment of dividend distribution tax in these cases. (See Box 3.1).

Box 3.1: Illustrative case on non-declaration of date of distributed profits

Charge: CIT - Kottayam

Assessee: MAS Pack Limited

Assessment Year: 2009-10

Chartered Accountant: P. Rajagopal (Membership No: 202134)

The assessee created a provision for Interim Dividend of ₹ 1.06 core and Dividend Tax of ₹ 19.01 lakh in the profit and loss account for the year ended 31.03.2009. However, in Clause 29 of the Form 3CD for the assessment year 2009-10, it was recorded as "NA". As per the details subsequently filed by the assessee, it was seen that the payments were made on 29.09.2009 and the provision for tax of ₹ 19.01 lakh includes interest of Rs. 1.08 lakh. In the absence of date of declaration and payment of dividend in the Tax Audit Report, the correctness of interest charged could not be verified in audit.

Therefore, ITD may consider capturing date of declaration of payment of distributed profits in Form 3CD in order to arrive at payment of taxes within the stipulated period or any interest is to be charged due to delay.

In absence of furnishing details of MAT credit in the Accountants' report, we could not verify the correctness of MAT credit availed by assesseees.

3.3 Declaration of Minimum Alternative Tax (MAT) credit in Accountants' reports

Under Section 115JAA of the Act, the assessee is entitled to avail MAT credit¹² which can be carried forward for adjustment in any of the years when the normal tax payable is more than the tax payable under Section 115JB for a period of seven years (increased to 10 years from AY 2010-11). There is no clause either in 3CD report or 29B certificate to give details of the available MAT credit assessment year-wise that can be carried forward by the assessee (as in the case of carry forward of unabsorbed depreciation and business losses). In absence of this, correctness of MAT credit is difficult to ensure which could lead to short levy of taxes.

During the course of audit, we noticed from the details for MAT credit availability that the CA or the assesseees did not furnish any working sheet to show the tax liability under the normal provisions of the Act and under MAT. In the absence of the detailed working of the credit availability, we could not ensure the correctness of the claim for credit under Section 115JAA.

¹² Difference between the tax paid under Section 115JB and the normal tax payable

We noticed in 30 such cases that excess MAT credit was allowed resulting in tax effects of ₹ 54.26 crore (See Box 3.2).

Box 3.2: Illustrative cases on MAT credit

- a. **Charge:** DCIT Circle-1, Surat
Assessee: Gujarat Enviro Protection and Infrastructure Ltd.
Assessment Year: 2010-11
Chartered Accountant: Niranjani P. Desai (Membership No: 39210)

While computing tax liability for AY 2010-11 under normal provision of the Act, MAT credit of ₹ 4.17 crore was allowed. Audit ascertained from earlier assessment records that MAT credit of only ₹ 85.86 lakh pertaining to AYs 2006-07 to 2009-10 was available in AY 2010-11. Excess grant of MAT credit of ₹ 3.31 crore resulted in short levy of tax of ₹ 4.51 crore (including interest).

- b. **Charge:** CIT 8 Mumbai
Assessee: Shah Pulp & Paper Mills Ltd.
Assessment Year: 2006-07
Chartered Accountant: R.R. Munni & Co. (Membership No: 030834)

ITD completed assessment in December 2008 for AY 2006-07 assessing total income at ₹ 2.86 crore and revised to ₹ 2.64 crore while giving effect to ITAT order of 24 May 2012. Assessee vide letter dated 09.06.2012 requested grant of MAT credit of AY 1999-2000 to AY 2004-05. ITD passed rectification order under Section 154 in May 2013 granting MAT credit of ₹ 74.28 lakh and gave refund of ₹ 84.08 lakh after including interest. MAT credit of the years earlier to 2000-01 had lapsed and there was no provision in the Act to grant MAT credit for the period 2001-02 to 2005-06. This resulted in incorrect grant of MAT credit of ₹ 74.28 lakh and consequent incorrect grant of refund of ₹ 84.07 lakh including interest.

- c. **Charge:** CIT II Kanpur
Assessee: J.K. Cement Ltd.
Assessment Year: 2007-08
Chartered Accountant: P.P. Singh (Membership No: 072754)

Assessment for AY 2007-08 was completed by allowing MAT credit of ₹ 4.27 crore as claimed by the assessee in its computation of income. In contravention of the provisions of section 115JAA of the Act, MAT credit of ₹ 4.27 crore, which included surcharge and education cess of ₹ 46.40 lakh, was irregularly allowed by the AO as claimed by the assessee.

Therefore, ITD may consider modifying Form 3CD or 29B certificate to give details of the available MAT credit assessment year-wise that can be carried forward by the assessee in order to ensure the correctness of the claim for credit under section 115JAA.

There is no provisions in Form 10B and Form 10BB for providing details regarding last 10 years accumulation or utilization of amounts set aside as application by Charitable Trusts/Institution.

3.4 Deficiencies in Forms 10B and 10BB

Section 11(2) provides that where 85 *per cent* of income is not applied for charitable or religious purpose in India during the previous year but as accumulated or set apart, either in whole or part, for application to such purpose in India, such income so accumulated or set apart shall not be included in the total income of the previous year of person, provided such person specifies by notice in writing to the AO the purpose for which the income is being accumulated or set apart and period which shall in no case exceed five years. The money so accumulated or set apart is invested or deposited in the form of modes specified in the Section 11(5).

Form 10B and 10BB have been devised for the purpose of audit certificates by the Accountant for charitable or religious trusts or institutes. In these Forms, there is no column for providing details regarding last ten years accumulation or utilization of amounts set aside as application. ITD has no mechanism to capture this crucial information.

While the Form 10BB asks for details of donations under Section 115BBC, no such information is required to be given in Form 10B. Quantification of non-compliance has not been provided for in these Forms. These Forms were silent on aspect of compliance with TDS provisions. Similarly, these Forms do not have column for nature of activities and objects of trust. These Forms do not provide for information regarding registration number and validity of registrations under 12AA, 80G and 10(23C). This aspect was already commented upon in the performance Audit Report on exemptions to Charitable Trusts and Institutions (Report No. 20 of 2013). However changes have not been notified till date (June 2014).

Audit is of the opinion that the only means to keep a watch would be to make it obligatory for Accountants to disclose deviation from the provisions of the Act, in investment and application of accumulated fund.

Non-maintenance of Control register /discontinuation of maintenance of Control register after introduction of e-filing, rendered difficulty in keeping watch over filing of TARs within prescribed limit.

3.5 Maintenance of Control Register

In order to ensure that the assessee, the Accountant and AOs comply with the various provisions of the Act, CBDT issued Instructions no. 1959 and 1976 in January 1999 and November 1999 respectively which contain detailed procedures for effective utilization of information available in the Tax Audit Reports (TAR) while finalizing assessments.

To keep effective control on all cases where tax audit under Section 44AB is mandatory, AOs were required to maintain a "Control register of tax audit cases under Section 44AB" in the format prescribed in Instruction no. 1976. Maintenance of this register would enable AOs in keeping a watch on cases of non-filing or late filing of TAR, penalty proceedings under Section 271B for failure to get accounts audited or furnishing report of such audit and irregularities in TARs. AOs were also required to report progress on tax audit cases in the format prescribed in Instruction no. 1976 with the Quarterly Progress Report.

We observed that Control registers were not maintained in 11 states¹³. In remaining states¹⁴, it was maintained partially. AOs of Mumbai Offices of ITD stated that they have discontinued maintenance of the Control register after introduction of e-filing of ITR.

In the case of e-filed returns, the assessee is required to mention whether the assessee is liable to audit under Section 44AB; and the name and membership number of the tax auditor. The assessee is also required to fill up the details given in TAR which is useful for computation of the income. There was no facility to query the database of ITD of e-filed returns to obtain details of audit and to ascertain as to whether the assessee has furnished details of tax audit. In such a scenario when the control register has not been maintained by the units and there is no facility in the e-return filing system to query the database, it is not clear how ITD ensures that the assessee has furnished all the required information on tax audit correctly in ITR.

After introduction of e-filing and absence of maintenance of Control Register, it is difficult for AOs to keep watch over filing of TAR within prescribed time limit. Therefore, AOs are also unable to initiate penalty proceedings under Section 271B of the Act.

13 Andhra Pradesh, Bihar, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Uttar Pradesh, Uttarakhand

14 Delhi, Kerala, Odisha and West Bengal

There is no monitoring mechanism in ITD on number of tax audit assignments, prescribed by ICAI in order to maintain quality tax audit to be conducted by CAs

3.6 Control on number of tax audit assignment

In order to maintain the quality of tax audit to be conducted by CAs, ICAI issued Guidelines¹⁵ for the Members under the provisions of the Chartered Accounts Act, 1949. It prescribed a limit of 45 tax audit assignments that can be under taken by a CA in a FY under Section 44AB of the Income Tax Act, 1961. In case of a Firm, specified number of tax audit assignments shall be applicable for every partners of the Firm. In view of the enhancement of professional competence of members to perform service in IT enabled environment, ICAI raised (February 2014) the limit of tax audit assignments from 45 to 60, to be made effective from audits conducted during FY 2014-15 onwards.

We observed that there was no system in field offices of ITD to see that a CA had not crossed the limit prescribed by ICAI on number of tax audit assignments. ICAI has prescribed Form of Tax Audit particulars to be maintained by members/Firm. We approached ICAI (August and September 2014) to intimate whether any mechanism exist to ensure the compliance of its guidelines by CAs. It was informed by ICAI (September 2014) that maintenance of records is self regulatory mechanism and the information so maintained can be called upon by ICAI for checking adherence of the guidelines. However, any formal complaint received by ICAI was acted upon within the framework provided in the Chartered Accountants Act and the Misconduct Rules framed there under.

As per the information provided by DGIT (Systems) of ITD (August 2014), 65,898 CAs submitted at least one TAR for AY 2013-14. Out of total 65,898 records of CAs, 81.13 *per cent* of CAs adhered to the limit prescribed by ICAI. Remaining 18.87 *per cent* of CAs (12,435 CAs) submitted more than 45 TARs. Excess number of TARs ranged from 46 to 2461. Table 3.1 shows stratification of the total number TARs issued by CAs and its percentage.

15 Council Guidelines no. 1-CA(7)/02/2008 dated 08 August 2008

Table 3.1: Stratification of total TARs issued by CA for AY 2013-14

Range of TARs issued	Total Number of Accountants	Percentage of Total Accountants
1-45	53,463	81.13
46-100	10,838	16.45
101-200	1,364	2.07
201-300	166	0.25
301-400	45	0.07
401-500	10	0.02
501-1000	11	0.02
> 1000	1	0
Total Accountants	65,898	

Table 3.2 shows top 22 CAs who issued more than 45 TARs for AY 2013-14.

Table: 3.2 showing CAs issuing more than 400 TAR for AY 2013-14

Chartered Accountants	Membership Number	Number of TARs
1. Pralay Chakraborty	059736	2,471
2. Partha Pratim Mukhopadhyay	056366	990
3. R Muralidharan	024060	796
4. Rajesh Kumar Gupta	074194	640
5. Swapan Acharyya	062815	638
6. D Sundararajan	010150	619
7. B C Vadivel	206700	612
8. Raj Hans	087767	586
9. Samir Pushpvadan Gandhi	039251	551
10. Navin Agarwal	078175	522
11. Poulouse Shaji	022909	513
12. A Kulathooran Pillai	018792	510
13. Sukdeb Halder	051185	494
14. Chetan Premchand Shah	031239	487
15. P Ramalingam	019516	478
16. Arun Kumar	097929	461
17. S Vairavanathan	004736	457
18. Radhakanta Das	062863	428
19. Suresh Kumar Goyal	084153	417
20. Hetal Bhailalbai Dhamelia	119864	415
21. TS Ventakaraman Lakshmi	022214	414
22. Jai Bhagwan Mittal	084512	401

The information available with DGIT (Systems) has not been shared by ITD to ICAI nor did ICAI approach ever to ITD to furnish such information. In view of lack of monitoring of number of tax audit assignments either by ITD or ICAI, the purpose of maintaining the quality of tax audit have suffered. As the work of tax audit assignments is voluminous work, issuing more than prescribed TARs is fraught to suffer in quality.

In the interest of revenue, the Act should have provision to prescribe for quality of tax audit assignments rather than relying on ICAI. Therefore, ITD may consider making suitable provision in the Act by restricting number of tax audit assignments in consultation with ICAI. In an automated environment of e-filing by CAs, prescribed limit can be adhered by providing suitable controls.

There is no system in ITD to validate the membership number issued by ICAI to stop unscrupulous CAs practicing the profession.

3.7 Authenticity of the membership of the Accountant

CA is required to mention his name and membership number while signing TARs and certificates to be issued under various Sections of the Act. A scrutiny of Forms prescribed under various Rules indicates that 26 Forms do not have columns for quoting membership number. With introduction of compulsory e-filing of audit reports under Section 44AB in June 2013, these are to be digitally signed by CAs in order to stop unscrupulous CAs practicing the profession.

During the course of audit of assessments completed during the period of financial year 2010-11 to 2012-13, we observed that there is no control mechanism in ITD to ensure that no TAR was filed without mention of membership number of the CA signing TAR. We observed in 379 cases where TARs and certificates were filled without mentioning membership number of the CA. We also observed that tax auditors mentioned fake membership number on TAR.

We approached ICAI (August and September 2014) for any institutional mechanism for taking action on erring members. It was informed by ICAI (September 2014) that the framework did not enable them to readily cull out the information regarding this specific non-compliance. Where ever such allegations were received as a part of complaint, the same are dealt with in accordance with the provisions of the Chartered Accountants Act, 1949 and Rules framed there under. ITD has also no system in place to ensure that TARs with valid membership number of the tax auditors were filed. ITD did not take any action against the assessee/tax auditor for this lapse (See Box 3.3).

Box 3.3: Illustrative case on fake membership

Charge: CIT 2, Thane

Assessment Year: 2007-08

Chartered Accountant: Devedra Vyas (Membership no: 41292)

For AY 2007-08, four returns were filed in CIT 2, Thane charge on 31 October 2010 in the name of four assessee viz. **Smt. Shilpa Chaudheri (PAN AFCPC4801R)**, **Sandeep Ashar (PAN AGPPA6048P)**, **Shachin Kadale (PAN ANPHK2662K)** and **Sheetal Sane (PAN AJNPS8336C)**. Verification during the course of assessment revealed that Tax Audit Reports issued by the tax auditor and TDS certificates issued by India Infoline Insurance Services Ltd. were forged and ITD concluded that it was essentially a case of filing bogus return with the sole purpose to claim refund. ITD did not take any action to file FIR or took action to identify and prosecute the persons who tried to perpetuate the crime of making fraudulent claim for refund.

With the increasing reliance on e-filing by CAs, ITD may devise mechanism to validate the membership number with the database maintained by ICAI to check against the fraudulent CAs.

3.8 Penalty under Section 271B and 271BA

Section 271B provides that if any person fails to get his accounts audited in respect of any previous year or years relevant to an assessment year or furnish a report of such audit as required under section 44AB, AO may direct that person to pay, by way of a penalty, a sum equal to one-half *per cent* of the total sales, turnover or gross receipts, as the case may be in case of a business, or of the gross receipt in case of a profession, in such previous year to years or a ₹ 1,50,000, whichever is less. Section 271BA provides that if any person fails to furnish a report from an accountant as required by Section 92E, the AO may direct that such person shall pay, by way of penalty, a sum of ₹ 1,00,000.

The penal provisions are deterrent mechanism and are to be applied in cases of non-submission of reports under Sections 44AB and 92E by assessee. But, in case of incomplete/inaccurate information furnished by CAs, ITD can only refer the cases to ICAI for professional negligence to take action against erring CAs under Section 288 of the Act. As we have observed in Section A of Chapter II of this reports, there are cases where CAs have furnished incomplete/partial information which led to short levy of taxes.

Therefore, in the interest of revenue, ITD may consider introducing penal provision in the Act against erring CAs found indulging in gross professional misconduct.

The Ministry stated (October 2014) that there is no need for any fresh provision in the Income-tax Act for taking penal action against CAs who signed incorrect reports as there were already sufficient provisions in sections 277, 277A and 278 of the Act.

Audit is of the opinion that though provisions are available to take action against erring CAs, we have not noted cases where these have been exercised. Therefore, the Ministry may ensure compliance to the provisions as laid in the Act.

ITD did not take any action on professional negligence on the part of CAs signing TAR/certificates under Section 288 of the Act in spite of issuing instruction in 1999.

3.9 Action not taken for furnishing of inadequate/inaccurate information in Tax Audit Report

Under Section 44AB of the Act, the Accountant is required to certify the correctness of the accounts of the assessee with reference to the requirements indicated in various clauses of Form 3CD. These clauses contain particulars of certain pertinent information which would enable and facilitate proper determination of taxable income of the assessee.

Further, an assessee is required to obtain audit reports/certificates in the prescribed Form in order to avail exemptions or deductions under various Sections of the Act. Since the Accountant is required to furnish true and correct information, such information would aid the AO in finalizing the assessment.

Section 92E of the Act also requires that every person who has entered into an international transaction during a previous year shall obtain a report from an Accountant in Form 3CEB. This information helps ITD in determining the true picture of international transaction.

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

In view of our earlier work on audit on accounts under Section 44AB of the Act, which featured in Para 3.2 of C&AG's Audit Report No 12 of 1997, CBDT issued Instruction No. 1959 in January 1999 citing importance of attention for utilization of information available in tax audit reports. It also mentioned that cases where the information given in TAR is incomplete or non-committal, should be taken up by the CIT to see if these reflected any professional negligence on the part of the accountant signing the TAR whereupon action is to be taken as per Section 288 of the Act. Cases where inadequate/inaccurate information is furnished in Accountant's report and addition is made by the AOs or at the instance of the audit, this fact should be brought to the notice of the ICAI for initiating action against the Accountants who had certified inadequate/inaccurate information in TARs.

During the period of performance audit, we did not come across any case where ITD brought to the notice of ICAI, cases for initiating action against CAs under Section 288 of the Act. Chapter 2 of this Report deals with 367 cases where CAs failed to report full and correct information in TARs/certificates with tax effects of ₹ 2,813.11 crore. In addition to these cases, we come across cases where AOs made additions to total income during the assessments than the reported income by CAs raising tax collection efforts of CBDT. In all cases, there is professional negligence on part of CAs. In addition to this, Central Action Plan (CAP) is devised by CBDT, focuses on measurable activities for revenue mobilization. It also includes advisories to superior authorities. CAP does not have mention about raising the matter with ICAI. This indicates that CBDT has accorded low priority in referring the matter to ICAI.

As per clause (4) of part 1 of the second schedule of the CA Act, 1949, a CA in practice shall be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statement of any business or any enterprises in which he, his relative, his firm or a partner in his firm has substantial interest (See Box 3.4).

Box 3.4: Illustrative case on professional misconduct by CA

Charge: CIT V, Chennai

Assessee: Redisolve Software Private Limited

Assessment Year: 2010-11

Chartered Accountant: Ashok Duraisamy (Membership No: 205424)

The assessee was a closely held company whose shareholders were the Managing Director and her spouse. We observed that the financial statements and certificate in Form 56F of the assessee company was prepared and signed by the CA, who was a relative (brother) of the Managing Director. Thus, the CA is guilty of professional misconduct as per CAs Act. Therefore, ITD should have initiated action against him under the provisions of the CAs Act as well as of the Income Tax Act.

Section 144 of the Companies Act, 2013 debars person from being appointed as an auditor of the company in which he/she directly or indirectly performs specified activities. ITD may also consider introducing similar provision in the Act in the interest of revenue.

As entire exemptions/deductions available to the assesseees under the Act lies on the shoulder of professionals like CAs, ITD needs to bring to the notice of ICAI about those CAs who are found guilty of misconduct in his profession.

3.10 Conclusion

Since the introduction of Section 44AB in the Act in 1984, we have evaluated the system of tax audit/certification by Accountants in 1997¹⁶ and again in 2008¹⁷. In both the Audit Reports, we pointed out non-utilization of information by AOs in assessment proceedings and incorrect information furnished by CAs in TARs/Certificates. These irregularities are still persisting. Thus objective of introducing tax audit and certification by Accountants gets defeated. With growing revenue forgone every year and complex nature of business environments, Accountant's role in ensuring true picture of accounts and taxes due to Government as per the Act is very crucial. It is joint responsibility of ITD and ICAI in ensuring compliance to the Act. Necessary control mechanism over the third party certification in assessment proceedings must be ensured, by making suitable provisions in the Act, if necessary.

¹⁶ Para 3.2 of C&AG's Audit Report No. 12 of 1997

¹⁷ C&AG's Report No. PA 7 of 2008

3.11 Recommendations

We recommend that

- a. The Ministry may consider modifying Form 3CD to incorporate date of declaration/ payment of distributed profits in order to verify whether the tax has been paid within the stipulated period or any interest is to be charged due to delay.
- b. The Ministry may consider modifying Form 3CD or 29B certificate to give details of the available MAT credit assessment year-wise that can be carried forward by the assessee in order to ensure the correctness of the claim for credit under Section 115JAA of the Act.

On recommendations a and b above, the Ministry replied (October 2014) that Tax Audit Report (Form 3CA, Form 3CB and Form 3CD) have been comprehensively revised in July 2014 therefore it would not be advisable to again revise the same for capturing the date of declaration/payment of dividend for the purpose of verifying whether DDT is paid within the specified time or capturing the available MAT credit assessment year-wise. The Ministry also mentioned that the required details are already being captured in the Income-tax Return forms in schedules MATC and DDT of Form ITR-6 from 2013-14 onwards. However, the Ministry has noted the suggestions raised by audit and replied that it would be considered for incorporation in the next revision of forms of Tax Audit Report.

- c. The Ministry may consider modifying Form 10B and 10BB for providing details regarding last ten years accumulation or utilization of amounts set aside as application by the Charitable Trusts/Institutions in order to check correctness of investment and application of the accumulated fund.

The Ministry stated (October 2014) that the required details were already being captured in the Income-tax Return forms. Incorporating similar details in Form 10B and 10BB would amount to duplication.

Audit is of the opinion that though ITR captures the relevant information, the certification by CAs would ensure the correctness of information furnished in ITR.

- d. The Ministry may ensure limiting the tax audit assignments in order to ensure quality of tax audit.

The Ministry replied (October 2014) that it would be for the regulatory body i.e. the Institute of Chartered Accountants of India (ICAI) to lay down restrictions on the number of tax audit and to enforce the same. The Ministry further replied (October 2014) that it is difficult to place control in ITD systems to regulate the number of tax audit reports (TAR) as CAs affix their signatures on TAR in their individual capacity and also while representing Firms of CAs and certain types of audits are exempted from the maximum number specified as per ICAI guidelines. ITD provides the list of cases where the number of TARs is apparently exceeded to ICAI for their action.

Reply of the Ministry is not acceptable as the Act requires tax audit under Section 44AB is to be conducted by an Accountant, not by a firm of CAs. Further, limit on tax audit assignment has been fixed by ICAI for all tax audits to be done under Section 44AB.

Audit is of the opinion that CAs has been assigned the work of tax audit which is very crucial in claiming exemptions/deduction by assessee. Therefore, in the interest of revenue and ensuring quality of tax audit, the Ministry may introduce suitable control mechanism in the IT system to adhere to the limit on tax audits in consultation with ICAI.

- e. The Ministry may ensure to prohibit a CA who is a relative of the assessee or directors of the assessee company, from signing any report or certificates.

The Ministry stated (October 2014) that prohibiting a CA who is relative of the assessee or director of a company from signing any report or certificates may be examined during budgetary exercise of 2015.

- f. The Ministry may ensure the implementation of CBDT instruction no.1959 of 1999 and Section 288 of the Act.

The Ministry stated (October 2014) that in view of the initiatives already taken vide instructions nos. 1959 of 1999 and 09/2008 and provisions contained in section 288 of the Act, no further action was required on this issue.

Audit is of the opinion that though instructions have been issued in past, audit has come up with cases where AOs have not fully utilise the information available in CA reports/certificates. The Ministry may provide intensive training to AOs on utilisation of information and strengthen its internal audit in this regard.

- g. The Ministry may put in place a mechanism in the ITD system for AO to record instances of mistakes committed by CAs in order to take action under Section 288 of the Act.

The Ministry stated (October 2014) that suggestion of audit can be incorporated by DGIT (System) to facilitate AOs for recording such instances in the system.

New Delhi
Dated: 27 November 2014



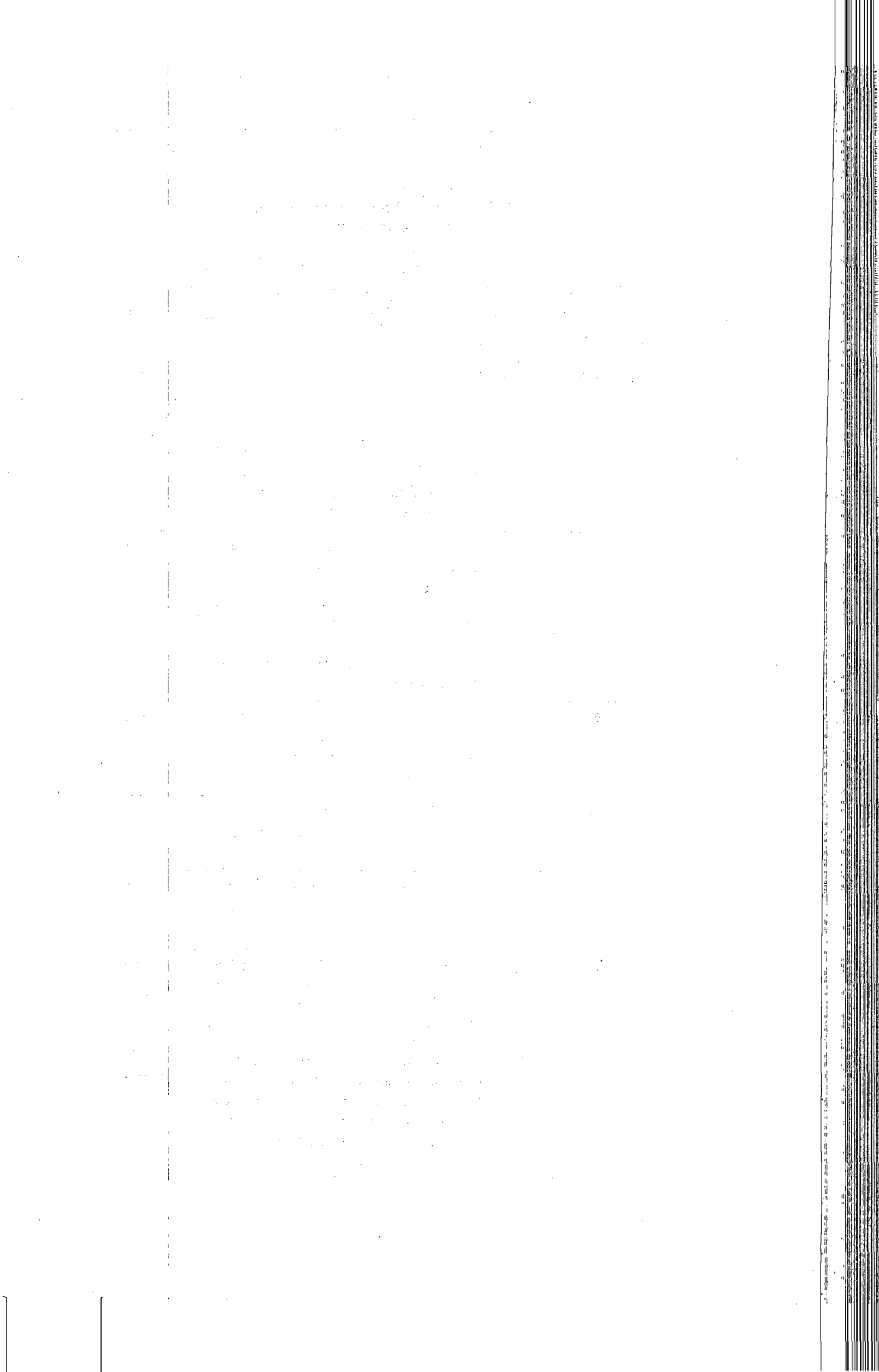
(NILOTPAL GOSWAMI)
Principal Director (Direct Taxes)

Countersigned

New Delhi
Dated: 27 November 2014



(SHASHI KANT SHARMA)
Comptroller and Auditor General of India



**Annexure-I (Refer paragraph No. 1.3)
Legal Framework**

Reports/certificates that are required to be issued by an Accountant and submitted by the assessee along with his return of income for claiming deduction/exemption etc. under various specific provisions of the Act are shown below:

Sections of the Act involved	Relevant Rules	Applicable to	Requisite Form
32(1)(iia)	5A	Assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power	3AA
10(23C)	16CC	Fund, Trust, Institutions, University, Educational Institution, Hospital or Medical Institution.	10BB
12A(b)	17B	Public Charitable or Religious Trusts or Institutions whose income exceeds maximum amount not chargeable to tax before exemption.	10B
33AB(2)	5AC	Assessee growing and manufacturing tea or coffee or rubber, claiming deduction in respect of special deposits made u/s 33AB(1).	3AC
33ABA(2)	5AD	Assessee claiming deduction in respect of Deposits under Site Restoration Fund Account/Scheme.	3AD
35D(4)	6AB	Assessee other than Companies or Co-op. Societies claiming amortization of certain preliminary expenses.	3AE
35E(6)	6AB	Assessee other than Companies or Co-op. Societies claiming deduction for expenditure on prospecting, etc. of certain minerals.	3AE
44AB	6G	It is obligatory for a person to get his accounts audited before the specified date by an Accountant and furnish by that date the report of such audit in the prescribed Form (viz. Form 3CA, Form 3CB or Form 3CD, as the case may be) duly signed and verified	3CA, 3CB and 3CD

by such Accountant and setting forth such particulars as may be prescribed if

(i) the total sales, turnover or gross receipts from carrying on any business for the previous year exceeded ₹ 60 lakh (₹ 1 crore w.e.f. AY 2013-14) or

(ii) his gross receipts from carrying on any profession for a previous year exceeded ₹ 15 lakh (₹ 25 lakh w.e.f. AY 2013-14) or

(iii) his profits and gains from carrying on any business for a previous year are deemed to be the profits and gains of such person under Section 44AD or Section 44AE or Section 44AF or Section 44BB or Section 44BBB, as the case may be, and he has claimed his income to be lower than the profits of gains so deemed to be the profits and gains of his business or

(iv) his profits and gains from carrying on any business for a previous year are deemed to be the profits and gains of such person under Section 44AD and he has claimed such income to be the profits and gains of his income exceeded the maximum amount, not chargeable to income tax in any previous year

For the purpose of this Section,

(i) "Accountant" shall have the same meaning as in the Explanation below sub Section (2) of Section 288 and "Specified date", in relation to the accounts of the assessee of the previous year relevant to an AY, means the 30 September of the AY.

44DA	6GA	Special provisions for computing income by way of Royalties, etc. in case of Non-residents.	3CE
80-I(7)/80-IA	18BBB	Assessees having an industrial undertaking or an enterprise for Infrastructure Facility, Telecommunication Services, Industrial Park or Power, etc. and special provision in respect of certain undertakings or enterprises in certain special category status.	10CCB
80-ID(3)(iv)	18DE	Assessees claiming deduction in respect of profit & gains from business of hotels &	10CCBBA

		convention centre in specified areas.	
80-IB(11B)	18DD	Assessee having an undertaking deriving profits from business of operating and maintaining a hospital in a rural area.	10CCBC
80-IB(7A) & (7B)	18DB/DC	Assessee claiming deduction in respect of business of owning and operating a multiplex theatre or a convention centre.	10CCBA/ 10CCBB
115VW(ii)	11T	Companies engaged in the business of operating qualifying ships and which have opted for Tonnage tax scheme.	66
142(2A)	14A	Special audit at the instance of the AO.	6B
10A(5)	16D	Assessee claiming deduction in respect of newly established undertakings in Free Trade Zones, EPZ, SEZ, STP, etc.	56F
10B(5)	16E	Assessee claiming deduction in respect of newly established EOUs.	56G
10BA(5)	16F	Assessee claiming deduction in respect of profits from export of eligible articles or things, [handmade articles or things made of wood as the main raw material].	56H
50B(3)	6H	In case of slump sale, for computation of Net Worth of the Undertaking/Division.	3CEA
72(A)(2)(iii)	9C	Assessee being amalgamated company – regarding compliance with prescribed conditions.	62
80-IA(6)	18BBE	Assessee claiming deduction in respect of profits of housing or other activity which is integral part of Highway project.	10CCC
80LA	19AE	Scheduled bank which owns an offshore banking unit in Special Economic Zone	10CCF
80-IB(11C)	18DDA	Assessee claiming deduction from profits & gains from operating and maintaining a hospital located anywhere in India.	10CCBD
80JJAA(2)	19AB	Assessee claiming deduction in respect of employment of new workmen.	10DA
92E	10E	Relating to International Transactions or Specified Domestic Transactions and particulars thereof.	3CEB

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115JB	40B	Company assesseees to which provisions of Section 115JB applies.	29B
115JC	40BA	For LLP (AY 2012-13) and Persons other than a company (from AY 2013-14) to which provisions of S. 115JC applies.	29C
201/206C	31ACB/37J	For resident who has failed to deduct/collect tax in accordance with provisions of Chapter XVIIIB/XVIIIBB.	26A/27BA
285	114DA	Statement by a non-resident having liaison office.	49C

Abbreviations

ACIT	Assistant Commissioner of Income Tax
Act	Income Tax Act, 1961
AO	Assessing Officer
AY	Assessment Year
CA	Chartered Accountant
CASS	Computer Assisted Scrutiny Selection
CBDT	Central Board of Direct Taxes
CCIT	Chief Commissioner of Income Tax
CIT	Commissioner of Income Tax
DDT	Dividend Distribution Tax
DIT	Directorate of Income Tax
FY	Financial Year
ICAI	Institute of Chartered Accounts of India
ITAT	Income Tax Appellate Tribunal
ITD	Income Tax Department
ITO	Income Tax Officer
ITR	Income Tax Return
JCIT	Joint Commissioner of Income Tax
MAT	Minimum Alternate Tax
Rules	Income Tax Rules, 1962
TAR	Tax Audit Report
TDS	Tax Deducted at Source
WDV	Written Down Value

