



सत्यमेव जयते

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

**for the year ended March 2003**

**System Appraisals**

**UNION GOVERNMENT  
(DIRECT TAXES)  
NO. 13 OF 2004**



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Laid on the table of Lok Sabha/Rajya Sabha on

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## PREFACE

The Report for the year ended March 2003 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

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

This Report is arranged in the following order:-

- (i) Chapter I is a broad-based review of the operation of the scheme of taxation of companies under special provisions of the Income Tax Act (Section 115JA/JB).
- (ii) Chapter II deals with assessment of the business of civil construction.
- (iii) Chapter III highlights various facets of the assessment of private schools, colleges and coaching centres.

The observations included in this Report have been selected from the findings of test audit conducted during 2002-2003.





## OVERVIEW

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### **Review on the operation of the scheme of taxation of companies under special provisions of Income Tax Act (Section 115 JA/JB)**

Audit reviewed the operation and implementation of the special provisions in respect of taxation of companies by attempting to cover assessments completed during the financial years 1999-00 to 2002-03 and upto July 2003. Audit test checked 80,682 cases and found mistakes in 2469 cases involving revenue effect of Rs.1734.10 crore.

6185 companies in Maharashtra, Tamil Nadu and West Bengal charges had declared dividends amounting to Rs.2498 crore but did not pay any tax. Atleast 125 of these companies were required to pay tax amounting to Rs.241.12 crore under the special provisions. 630 cases were incorrectly assessed under normal provisions, even though special provisions were attracted and tax amounting to Rs.178.61 crore was required to be levied. Special provisions were invoked in 26 cases when income under normal provisions was higher resulting in short levy of tax of Rs.9.76 crore. Incorporation of a suitable provision in the Act enabling the assessing officer to rectify mistakes in computation of net profit would have prevented loss of revenue of Rs.175.32 crore in 97 cases.

Audit recommend that government may include cases of companies attracting special provisions as one of the parameters for selecting assessments for scrutiny and introduce a mandatory column in the income tax return form to enable identification of companies where special provisions are attracted. Audit further recommend that the assessing officer be empowered to initiate suitable penal action against statutory auditors whose certificates are found to be incorrect or defective. Government may also consider amending relevant provisions of the Act to plug various loopholes discussed in the review so that unintended benefits do not accrue to companies contrary to the spirit of special provisions of taxation.

### **Review on the assessment of business of civil construction**

Audit noticed that the survey powers vested with the department to widen the tax base had not been used effectively. The department made no efforts to prepare database of contractors and could not verify whether returns have been filed by them.

The procedure of accounting through "Project Completion method" adopted by the assesseees in the business of civil construction has resulted in indefinite postponement of accountal of profits and payment of taxes. In 13 cases, government lost revenue of Rs.39.07 crore as the assesseees did not have to declare

minimum 8 per cent of gross receipts as income that was mandatory even for small contractors with a turnover of less than Rs.40 lakh.

Audit also noticed several irregularities in assessments of civil contractors and builders such as incorrect computation of business income, irregular refunds, allowance of excess depreciation, non-levy of interest for default in filing the return of income and short payment of advance tax besides non levy of penalty. These mistakes involved tax effect of Rs.371.92 crore in 894 cases.

Audit scrutiny revealed that there was a short levy of tax of Rs.49.21 crore in 232 cases as related receipts from which tax was deducted were either not taken or incorrectly taken into account while computing taxable income.

Returns of civil contractors who were expected to return income at the minimum rate of 8 percent of gross receipts were accepted by the department even though the accounts were not audited, claims like depreciation and interest were allowed and receipts on account of supply of labour on contract were omitted to be included in gross receipts. The over all tax effect involved in these cases was Rs.3.22 crore in 142 cases.

Audit recommend that the person registering the document for the execution of contract could be bound by statute to furnish details to the assessing officer, of all cases where the value of transaction exceeds rupees one crore. Obtaining tax clearance certificate before registration of immovable property in excess of a threshold level of monetary value may be prescribed in the Act and made mandatory. Government may issue clarification restricting the benefit of exemption of long term capital gains to direct investment in infrastructure companies or funds, which will prevent exploitation of the benefit by investors through speculation in secondary market operations.

### **Review on the assessment of private schools, colleges & coaching centres**

Audit reviewed assessments of private schools, colleges and coaching centres with a view mainly to assessing the effectiveness of implementation of the taxation policy effective from 1 April 1999 which laid down that exemption of income of educational institutions should be granted only after ensuring genuineness of their activities and compliance with the Income Tax Act.

Audit noticed that department did not have a database of educational institutions and coaching centres and failed to evaluate genuineness of exemption claimed by educational institutions as 95 percent assessments had been completed in summary manner. Mistakes in 650 cases involving tax effect of Rs.174.18 crore were noticed relating to several procedural lapses/irregularities, incorrect application of income, income escaping tax, irregular donations, diversion of funds for non charitable purposes and other omissions.

Audit recommend that a single section/clause instead of two separate sections be introduced for exemption of income of educational institutions whether run by trusts or other than trusts. Every educational institution may be mandatorily made to submit audited accounts along with return of income every year whether its annual receipts are less than Rs. one crore or more or financed from government funds or not. More severe penal clauses may be introduced to prevent or deter misuse of income/surplus generated for other than educational purposes as charging maximum marginal rates for unauthorized usage has not proved be an effective enough deterrent.



# Chapter I

## Operation of the scheme of taxation of companies under special provisions of Income Tax Act (Section 115 JA/JB)

- Highlights
- Introduction
- Audit Findings
  - Absence of database in respect of zero tax companies
  - Reserve debited but not added
  - Provision for unascertained liability not added to net profit
  - Reduction of tax liability by allowing incorrect claims of deduction of amounts withdrawn from reserves for meeting additional depreciation on selective revaluation of assets
  - Incorrect exemption
  - Loss or depreciation not reduced correctly
  - Profits derived by an industrial undertaking located in industrially backward area not reduced correctly
  - Incorrect deduction in respect of export profit
  - Incorrect determination of tax credit
  - Incorrect set off of tax credit
  - Tax credit incorrectly treated at par with advance tax & TDS
  - Effect of Supreme Court decision in Apollo Tyres case
  - Capital expenditure not added back
  - Prior period expenses not added back
  - Tax under special provisions not levied
  - Other points of interest
- Audit conclusions and recommendations



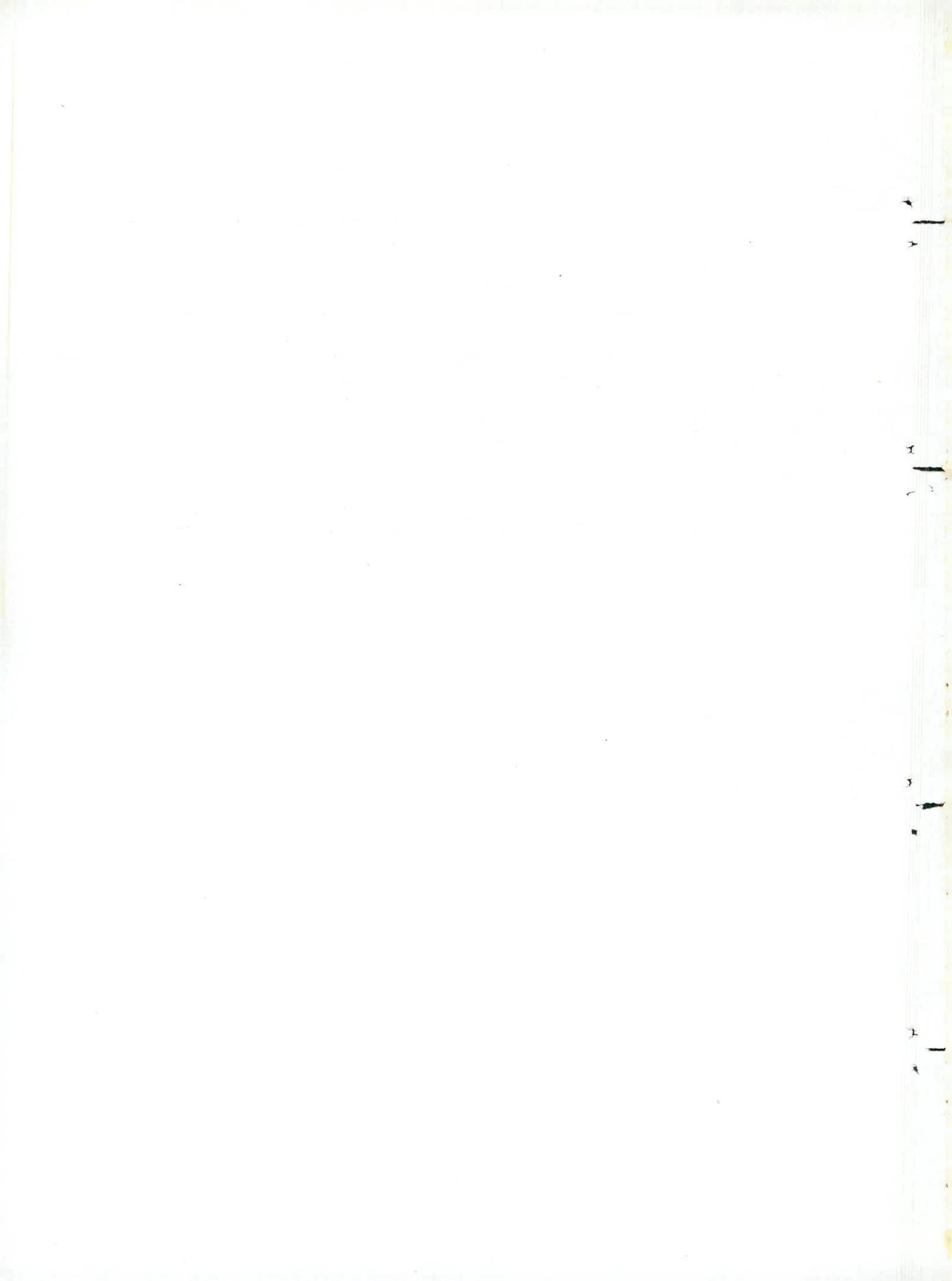
## Highlights

- Audit reviewed the operation and implementation of the special provisions in respect of taxation of companies by attempting to cover assessments completed during the financial years 1999-2000 to 2002-03 and upto July 2003.  
**(Para 1.3.1 & 1.3.2)**
- Audit test checked 80,682 cases and found mistakes in 2469 cases involving revenue effect of Rs.1734.10 crore. 1885 summary assessments resulted in loss of revenue/tax effect of Rs.905 crore.  
**(Para 1.4.1 & 1.4.2)**
- There were 114 cases where tax effect involved in each case was Rs.1 crore or more. Total tax effect involved was Rs.1604.73 crore in these cases  
**(Para 1.4.3)**
- 6185 companies in Maharashtra, Tamil Nadu and West Bengal charges did not pay any tax even though these had declared dividends amounting to Rs.2498 crore. Atleast 125 of these companies referred to in other paragraphs of this review were required to pay tax amounting to Rs.241.12 crore under the special provisions but did not pay.  
**(Para 1.4.4)**
- Audit noticed
  - that 630 cases were incorrectly assessed under normal provisions, even though they attracted special provisions. Tax amounting to Rs.178.61 crore was not levied.  
**(Para 1.4.28)**
  - mistakes in 17 assessments of foreign companies assessed under special provisions involving tax effect of Rs.64.10 crore.  
**(Para 1.4.5)**
  - that special provisions were invoked in 26 cases when income under normal provisions was higher resulting in short levy of tax of Rs.9.76 crore.  
**(Para 1.4.31)**
  - mistakes in arriving at net profit as per the profit and loss account which could have been rectified only by introduction of a suitable provision in the Income Tax Act. This would have averted a loss of revenue of Rs.175.32 crore in 97 cases.  
**(Para 1.4.22)**

- Following are salient individual irregularities covered in this review:
  - Assessing officers irregularly allowed deduction of amounts depicted as withdrawn from reserves against which additional depreciation arising from selective revaluation of assets was set off in the case of M/s. Reliance Industries Ltd., Mumbai, M/s. Videocon International Ltd., M/s. Videocon Appliances Ltd., M/s. Reliance Industrial Infrastructure Ltd., M/s. Southern Petrochemical Industries Corporation Ltd., Chennai and M/s. Janpath Investments & Holdings Ltd., Kolkata, while computing book profit, leading to short levy of tax of Rs.521.51 crore.  
**(Para 1.4.11)**
  - Assessing officer allowed expenditure incorrectly in the case of M/s. Hindustan Steel Works Construction Ltd, in West Bengal Kolkata IV charge, for the assessment year 2000-01 resulting in underassessment of income by Rs.248.16 crore involving tax effect of Rs.127.55 crore.  
**(Para 1.4.12)**
  - Export profits were incorrectly deducted in the case of M/s. Reliance Industries in Mumbai III charge for assessment years 2001-02 and 2002-03 resulting in short levy of tax of Rs.120.49 crore.  
**(Para 1.4.16)**
  - Assessment was completed under normal provisions of the Act even though special provisions were attracted in the case of M/s. Mahanagar Telephone Nigam Ltd. in Delhi charge for the assessment year 2001-02 resulting in short levy of tax of Rs.104.61 crore.  
**(Para 1.4.29)**
  - Tax credit was either incorrectly determined or set off in the case of M/s. Reliance Industries Ltd., Mumbai, M/s. Standard Chartered Bank, Mumbai and M/s. Dena Bank, Mumbai for assessment years 2000-01, 1999-2000 and 1998-99 involving tax effect of Rs.28.92 crore, Rs.19.48 crore and Rs.22.75 crore respectively.  
**(Para 1.4.21, Para 1.4.19 & Para 1.4.20)**
  - Income was incorrectly computed in the case of M/s. Indian Road Construction Corporation Ltd. in Delhi IV charge for assessment year 2001-02 resulting in under charge of tax of Rs.38.73 crore including interest.  
**(Para 1.4.23)**



- Audit recommends that government may like to
  - include cases of companies attracting special provisions as one of the parameters for selecting assessments for scrutiny.
  - introduce a mandatory column in the income tax return form to facilitate identification of companies where special provisions are attracted.
  - empower the assessing officer to initiate suitable penal action against statutory auditors whose certificates are found to be incorrect or defective.
  - consider amending relevant provisions of the Act to plug the loopholes so that unintended benefits do not accrue to companies contrary to the spirit of special provisions of taxation.
  - incorporate a suitable provision in the Act enabling the assessing officer to rectify mistakes in computation of net profit under special provisions.



## **Operation of the scheme of taxation of companies under special provisions of Income Tax Act (Section 115 JA/JB)**

### **1.1 Introduction**

There was a perception in the Government in mid nineties that the phenomenon of 'zero tax companies' reflected an excessive degree of laxity in the tax regime. It was stated that the number of 'zero tax companies' and companies paying marginal tax had grown in the recent past and that studies had shown that inspite of the fact that companies had earned substantial book profits and had paid handsome dividends, no tax had been paid by them to the exchequer. With a view to arresting this laxity in the tax regime and bringing the so called 'zero tax companies' under the tax net, special provisions of tax on deemed income of certain companies were introduced with effect from 1 April 1997 as section 115 JA of the Income Tax Act.

Similar provisions were introduced first in 1984 and again in 1988 but were perceived to have led to extensive litigation and were discontinued from assessment years 1988-89 and 1991-92 respectively.

The provisions introduced in 1997 were revised from 1 April 2001 as section 115 JB of the Act that are described in subsequent paragraphs.

The Advisory Group on Tax Policy and Tax Administration for the Tenth Five Year Plan had inter-alia recommended in May 2001 that a minimal tax on corporations should continue to be levied and that the base for such levy should be changed from book profit which was considered prone to manipulation/misuse and litigation, to a combination of net worth and dividend distributed. It had also recommended that there should not be any separate tax on dividend distributed by companies.

One of the recommendations of the Kelkar committee on corporate tax reforms was elimination of tax on companies under section 115 JB for the reasons that

- the effective tax rate of a sample of companies in 1999-2000 was 21.7 per cent as against the statutory rate of 38.5 per cent which became 21.9 per cent as against the statutory rate of 39.55 per cent in 2000-01,
- the special provisions were a sore point with trade and industry, and
- divergence between taxable income and book profit undermined corporate governance.

The committee had separately suggested redesigning of corporate profit tax so as to align taxable income and book profit.

Even though the provisions were specifically devised, there is no special machinery or apparatus in the Income Tax Department to monitor or examine the cases of companies assessed under special provisions. All assessing officers dealing with cases of companies assessed under normal provisions of the Income Tax Act can assess companies under special provisions of the Act. Assessing officers do not maintain any separate records or data in respect of cases assessed under these special provisions. The Board\* had in September 2002 prescribed a proforma for collecting data on additional taxes through operation of special provisions under section 115 JA/JB from the field formations. Audit sought to ascertain the above data in August 2003. The Board informed in November 2003 that the said data was not yet available.

## 1.2 Law and Procedure

**1.2.1** With effect from assessment year 1997-98 and upto assessment year 2000-01, where in the case of a company, the total income computed under the normal provisions of the Act is less than thirty percent of its book profit, the total income of such assessee chargeable to tax for the relevant previous year shall be deemed to be an amount equal to 30 per cent of such book profit (section 115 JA).

From assessment year 2001-02 and onwards, when income tax payable on total income of a company as computed under normal provisions of the Act in respect of the relevant previous year is less than 7.5 per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable on such total income shall be the amount of income tax calculated at the rate of 7.5 per cent of the book profit or total income (section 115 JB).

Book profit means the net profit as shown in the profit and loss account prepared as per provisions of Parts II and III of Schedule VI to the Companies Act, 1956, as **increased** by the following if **debited** to the profit and loss account:

- the amount of income tax paid or payable and the provision therefor;
- the amounts carried to any reserves, by whatever name called;
- the amount set aside as provisions, for meeting liabilities other than ascertained liabilities;
- the amount by way of provision for losses of subsidiary companies;
- the dividends paid or proposed;
- the amount of expenditure relatable to exempted income-chapter-III income.

The net profit arrived at as above is to be **reduced** by the following:

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\* Central Board of Direct Taxes

- \* the amount withdrawn from any reserves or provisions if any such amount is *credited* to profit and loss account;

Provided that where these provisions are applicable to an assessee in any previous year (including the relevant previous year), the amount withdrawn from any reserves created or provisions made in a previous year relevant to the assessment year commencing on or after 1 April 1997, but ending before 1 April 2001 shall not be reduced from book profit unless book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn).

- exempted income- chapter –III income, if any such amount is *credited* to profit and loss account;
- the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account. For this purpose,
  - loss shall not include depreciation;
  - these provisions shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil,
- the amount of profits derived by an industrial undertaking from the business of generation or generation and distribution of power;
- the amount of profits derived by an industrial undertaking located in industrially backward areas and eligible for 100 percent deduction;
- the amount of profits derived from the business of infrastructure facilities;
- the amount of profit of sick industrial company for the assessment year commencing from the assessment year relevant to the previous year in which the said company had become sick industrial company under section 17 (1) of the Sick Industrial Companies Act, 1985, and ending with the assessment year during which the entire net worth of such company became equal to or exceeded the accumulated losses;
- the amount of profits from export business eligible for deduction (from Assessment year 1998-99 onwards) as in the case of normal assessment; and

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\* replaced w.e.f 1 April 2001 by the Finance Act, 2002 with the following:

The amount withdrawn from any reserve or provision (excluding a reserve created before 1 April 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account.

Provided that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after 1 April 1997, shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this explanation or explanation below second proviso to section 115JA, as the case may be

- the amount of profits from export of computer software eligible for deduction (from A. Y. 1998-99 onwards) as in the case of normal assessment.

**1.2.2** Section 115JB provided that net profit as per profit and loss account would not be reduced by amount withdrawn from any reserve including revaluation reserve created otherwise than by a debit to the profit and loss account. Profits, income and receipts of certain industrial undertakings in North Eastern Region and certain trusts will not be entitled to exemption.

The benefits of deduction towards amount of profits derived by an industrial undertaking from the business of generation or generation and distribution of power or from the business of infrastructure facilities located in industrially backward areas and eligible for 100 percent deduction admissible under section 115 JA were withdrawn under section 115 JB. Deduction of the profits derived from export of films software under section 80 HHF was, however, allowed.

Section 115 JA did not require any audit report to be furnished by the assessee in respect of computation of book profit. Section 115 JB requires audit report from an accountant certifying that book profit has been computed in accordance with the provisions of section 115 JB and such report is required to be filed along with the return

While preparing the accounts under section 115 JB, accounting policies, accounting standards and method and rate of depreciation are to be the same as those applied while preparing accounts for presentation at the Annual General Meeting before the shareholders under section 210 of the Companies Act.

**1.2.3 Tax credit** – Section 115 JAA provides that where any amount of tax is paid under section 115 JA by a company for any assessment year then credit in respect of tax so paid shall be allowed to the company in accordance with the provisions of the Act.

The scheme by which the tax calculated and paid under special provisions can be carried forward for set off against regular tax payable during the subsequent five year period (applicable for assessment years 1997-98 to 2000-01 only) subject to certain conditions, is as under:

- When a company pays such tax, the tax credit earned by it shall be an amount which is the difference between the tax so paid and the tax payable on the basis of normal computation of income of the company. The credit allowed will not bear any interest.
- The tax credit cannot be refunded but shall however be allowed to be carried forward for a period of five assessment years immediately succeeding the assessment year in which the tax under special provision is

paid. In the assessment year when regular tax becomes payable, the difference between the regular tax under the normal computation and the tax under special provision computed for that year will be set off against the tax credit available.

- Where, as a result of an order under sub-section (1) or sub-section (3) of section 143, section 144, section 147, section 154, section 155, sub-section (4) of sections 245D, 250, 254, 260, 262, 263, or section 264, the amount of tax payable under this Act is reduced or increased, as the case may be, the amount of tax credit allowed under this section shall also be increased or reduced accordingly.

Tax credit under section 115 JB is not available.

**1.2.4** Special provisions are applicable to foreign companies as well.

### **1.3 Objectives, period and sample size of the review**

#### **1.3.1 Objectives**

Audit reviewed the operation and implementation of the special provisions in respect of taxation of companies with a view to:

- seeking assurance that systems and procedures are sufficient and ensure compliance with the provisions of the Act/Rules,
- evaluating the degree of compliance by the so called 'zero tax' companies with the Income Tax Act,
- assessing the extent of loss of revenue or underassessment and other irregularities due to mistakes in assessment and
- ascertaining the number of companies that would have attracted the special provisions for assessment but have not been so assessed and attempting to quantify the potential loss of revenue on this account.

#### **1.3.2 Period covered**

Audit attempted to cover assessments completed during the financial years 1999-00 to 2002-03 and upto July 2003 in the review.

#### **1.3.3 Sample Size selected and production/non-production of records**

Audit selected two types of samples:

- **Sample 'A'** for test check of assessments under section 115 JA/JB and

- **Sample 'B'** for cases which were incorrectly assessed under normal provisions of the Act but attracted special provisions (sections 115 JA/JB) of the Act. Details are given in **Appendix-1**.

**1.3.4** Audit faced the following constraints while selecting the planned samples:

- Audit could not identify assessments completed under 115 JA/JB as the department did not maintain separate database of assessments made under these sections.
- Assessing offices did not produce a large number of records on the plea that restructuring of the Income Tax Department in August 2001 had led to mass transfer of records between assessing officers having different jurisdictions causing difficulty in ensuring easy access to the records.

**1.3.5** Audit requisitioned 1,36,323 files but assessing officers could produce 80,370 files. 55,953 files (about 41 per cent) were not produced.

- Assessing officers in Delhi and West Bengal respectively did not produce as many as 95 per cent and 58 per cent of the records requisitioned.
- Similarly, assessing officers in Uttar Pradesh, Lucknow charge, could produce only 179 cases (14.37 per cent) against 1246 cases requisitioned.

**1.3.6** Accountants General/Principal Directors of Audit/Directors General of Audit who had conducted the review in their respective audit jurisdiction had issued draft review reports to the respective CCIT/CIT (Audit) between July 2003 and September 2003 seeking replies and confirmation of facts. Draft review report was issued to the Ministry/Board on 18 November 2003 seeking comments. Replies were awaited.

**Audit findings**

**1.4.1** Audit test checked 13,126 assessments made under special provisions and 67,556 assessments made under normal provisions of the Act from the samples identified for the review.

- Out of 13,126 assessments made under section 115 JA/JB and test checked in audit, mistakes were noticed in 1040 cases with tax effect of Rs.971.80 crore. Out of the above 1040 cases, 312 were assessed after scrutiny and 728 in summary manner involving tax effect of Rs.524.31 crore and Rs.447.49 crore respectively (Sample 'A' in para 1.3.3).
- Out of 67,556 assessments made under normal provisions of the Act and test checked in audit, audit noticed mistakes in computation of income under special provisions in 1429 cases involving loss of revenue of



Rs.762.30 crore. Of the above 1429 assessments, 1157 were assessed in summary manner and 272 after scrutiny involving tax effect of Rs.457.58 crore and Rs.304.72 crore respectively (Sample 'B' in para 1.3.3).

- Audit noticed mistakes in 114 cases where tax effect involved in each case was Rs.1 crore or more. Total tax effect involved in above cases was Rs.1610.41 crore. Of these, 55 cases involving tax effect of Rs.831.90 crore were assessed after scrutiny and 59 cases involving tax effect of Rs.772.83 crore were assessed in summary manner.
- Audit noticed that special provisions were invoked in 26 cases out of assessments indicated above, when income under normal provisions was higher resulting in short levy of tax of Rs.9.76 crore.
- Audit noticed 17 mistakes in respect of assessments of foreign companies assessed under special provisions involving tax effect of Rs.64.10 crore

**1.4.2** Total number of companies on the records of the department as on 31 March 2002 was 3.49 lakh. The department has been completing **90 per cent** of total assessments made in summary manner on an average during the years 2000-01 and 2001-02 in the case of companies. Consequent to the amendment of Income Tax Act, 1961, with effect from 1 June 1999, no prima facie adjustments<sup>#</sup> can be made by the assessing officer in an assessment completed in summary manner. However, assessing officers can withdraw unentitled benefits availed of by the assesseees in summary assessments and rectify mistakes under the powers separately available to them under the Income Tax Act.

Audit noticed mistakes in **1885 cases** of summary assessments involving tax effect of Rs.905.07 crore (out of cases mentioned in paragraph 1.4.1 above). Out of these, 59 cases involved tax effect of Rs.1 crore and above in each case. Of the above 1885 cases, the department accepted audit observations in 336 cases, did not accept the observations in 299 cases and did not furnish reply in 1250 cases. Ministry's replies were awaited.

Reason for non acceptance was essentially that the assessing officer could not rectify mistakes in summary assessments after 1 June 1999. Special provisions could not therefore be applied in summary assessments in the manner they were intended to. Department was accepting the assesseees availing unintended benefits in summary assessments even when special provisions were applicable, the

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<sup>#</sup> Prima facie adjustment that could have been made in a summary assessments prior to 1 June 1999 included rectification of

(i) any arithmetical errors in the return, accounts or documents accompanying it  
(ii) any loss carried forward, deduction, allowance or relief, which on the basis of the information available in the return, accounts or documents is prima facie admissible but which is not claimed in the return or is prima facie not admissible but which has been claimed in the return.

adverse impact on revenues of which is not quantifiable. However, the quantum of revenue loss in mistakes identified by audit was Rs.905.07 crore in 1885 cases of summary assessments.

The department does not have an effective mechanism to identify and take corrective measures in respect of mistakes arising out of assessments made in summary manner, even in cases attracting special provisions. There is also inconsistency in the stand taken by assessing officers regarding remedial action to be taken to safeguard interest of revenue in summary assessments. Government may take urgent action to remove inconsistencies in initiating remedial action and ensuring that special provisions are applied correctly in all applicable cases.

#### **1.4.3 Absence of database in respect of zero tax companies**

The department has neither maintained any database relating to 'zero tax' companies nor introduced any system to monitor the revenue realised in respect of such 'zero tax' companies. In order to ascertain the number of corporate assessee assessed under the special provisions of the Act, audit had to adopt difficult and time consuming methods to collect the actual number of corporate assessee from demand and collection registers maintained by the department and from audit observations made in previous local audits.

Even though the special provisions relating to levy of tax on companies have been in the statute book for over 6 years, no review or study had yet been undertaken directly by the department to evaluate the impact of the scheme. Board has initiated a step on 13 September 2002 for collection of data on additional taxes from operation of special provisions under section 115 JB which was required to be sent by the field formations on or before 15 November 2002. Audit sought the above data in August 2003. The Board informed in November 2003 that the said data was not yet available.

In a limited exercise, audit attempted to collect details of dividend paid/declared and tax ultimately paid under the special provisions of the Act by companies whose assessment records were furnished by assessing officers in Delhi, Maharashtra, Tamil Nadu and West Bengal during the review.

#### **1.4.4 Audit noticed that**

- In Maharashtra, 147 companies had not paid any tax even though these had declared dividends amounting to Rs.2152 crore. Tax under special provisions amounting to Rs.42.09 crore was leviable on two of these identified companies but was not levied.
- Similarly, 2060 companies in Tamil Nadu did not pay any tax under special provisions. 144 of these identified companies had, however, declared dividends amounting to Rs.108 crore. Tax under special

provisions amounting to Rs.4.10 crore was leviable on **56** of these identified companies but was not levied.

- In West Bengal, 3978 companies did not pay tax under the special provisions and 77 of these had declared dividends amounting to Rs.238 crore. Tax under special provisions amounting to Rs.194.93 crore was leviable on **67** of these identified companies but was not levied.
- Audit could not collect similar information in respect of Delhi as the assessing officers did not make available assessment records in 40,010 cases representing 95.37 per cent of total cases requisitioned for review.

#### **1.4.5 Implementation of special provisions – Mistakes in making addition to net profit**

For the purpose of computing book profit, the net profit as shown in the profit and loss account prepared in accordance with the provisions of Part II and III of Schedule VI to the Companies Act, 1956, is required to be increased and reduced by certain amounts (Paragraphs 1.2.3 & 1.2.4 above refer).

Audit noticed that assessing officers committed mistakes while making additions provided in explanation below Section 115 JA/JB to the net profit as per profit and loss account in **305 cases** involving **undercharge** of tax of **Rs.325.45 crore**. **Appendix-2** contains the details.

One case with maximum tax effect in each category is illustrated below. Other cases with tax effect of at least Rs.1 crore each and with similar mistakes are shown in **Appendix-4**.

#### **1.4.6 Income tax debited to profit and loss account but not added back**

In **West Bengal-III, Kolkata charge**, the assessing officer completed the assessment of **M/s. HPL Cogeneration Ltd** for the assessment year 2002-03 in **summary** manner in February 2003 at a total income of Rs.41.72 crore under the special provisions of the Act as against a loss of Rs.151.27 crore returned under the normal provisions of the Act.

Audit noticed that the assessee had debited Rs.24.55 crore to the profit and loss account on account of “provision for deferred tax” that was required to be added to book profit, which was not done. Accounting principles could not override the special provisions of Income Tax Act. Assessing officer should have added back the provision to the book profit. Omission resulted in underassessment of income by Rs.2.46 crore involving total tax effect of Rs.2.05 crore including interest.

The audit observation was not accepted by the department on the ground that section 143(1) of the Income Tax Act did not provide for any such addition. Assessing officer is empowered to take remedial action and safeguard interests of

revenue in cases of underassessment to rectify incorrect and unentitled claims availed by assessees even in summary assessment by taking action under section 147 or 263 of the Act.

Another case with similar mistake and tax effect of more than of Rs.1 crore is shown at Sl. No. 1 of **Appendix-4**.

#### **1.4.7 Reserve debited but not added**

In **Maharashtra, Mumbai X charge**, the assessing officer completed the assessments of **M/s. Infrastructure Leasing and Finance Ltd.**, for the assessment years 2001-02 and 2002-03 in **summary** manner. Audit noticed that the assessee deducted certain amount towards "lease equalization reserve" from the lease rental income which was not added to net profit in the assessment under special provisions. As it was only in the nature of a reserve, the amount of lease equalization reserve debited to the profit and loss account should have been added back for arriving at the book profits. Omission resulted in short levy of tax of Rs.18.83 crore.

Five cases involving similar mistakes are given at Sl. No. 2 to 6 of **Appendix-4**.

#### **1.4.8 Provision for unascertained liability not added to net profit**

In **West Bengal, Kolkata II charge**, audit of the assessments of **M/s. United Bank of India** for the assessment years 1998-99 to 2000-01 revealed that the assessee had debited provisions for doubtful debts, advances etc. to the profit and loss account of the previous years relevant to the assessment years 1997-98 to 2000-01 in excess of the admissible limits under normal provisions for the banking companies. The assessing officer did not add back the same for arriving at the book profit for computation of tax liability under special provisions. The mistake resulted in short levy of tax of Rs.32.91 crore.

Twenty cases involving similar mistakes are given at Sl. No. 7 to 26 of **Appendix-4**.

#### **1.4.9 Expenditure relatable to Chapter III Income debited but not added back**

In **West Bengal, Kolkata II charge**, the assessment of **M/s. Coal India Ltd.**, for the assessment year 1998-99 was completed after **scrutiny** and those for 1999-00 and 2000-01 were completed in **summary** manner. Audit noticed that the assessing officer did not add back the expenditure incurred for earning the income exempt under chapter III of the Act under special provisions although the same was added back in the computation of income under normal provisions. The mistake resulted in short levy of tax of Rs.41.72 crore.

Two cases involving similar mistakes are given at Sl. No. 27 and 28 of **Appendix-4**.

#### **1.4.10 Deduction from net profit not made correctly**

Audit noticed mistakes in deductions provided in explanation below section 115 JA/JB from net profit as per profit and loss account in **481 cases**, resulting in undercharge of tax of **Rs.824.78 crore**, as shown in **Appendix-3**.

One case with maximum tax effect in each category is illustrated below. Other cases with tax effect of at least Rs.1 crore each and with similar mistakes are shown in **Appendix-4**.

#### **1.4.11 Reduction of tax liability by allowing incorrect claims of deduction of amounts withdrawn from reserves for meeting additional depreciation on selective revaluation of assets**

Depreciation under the Income Tax Act is allowed as deduction from the profits of an assessee deriving business income, based on actual cost of the new asset and in the subsequent years based on the written down value of the asset/block of assets (section 32 read with section 43 of the Act, refers). The rates of depreciation have been prescribed in the Income Tax Rules.

The Act does not recognize any additional charge or surplus on account of revaluation of assets. Additional depreciation on account of revaluation of assets is not allowed as a charge against profits and is disallowed in the normal computation of income<sup>5</sup>.

After increasing the net profit shown in the profit and loss account with items mentioned in the explanation to special provisions of the Act, the adjusted net profit is to be reduced, inter alia, by the amount withdrawn from any reserve or provision if any such amount is credited to the profit and loss account. The rationale for the deduction was that accretion to such reserve in the relevant year would have been included in the income subjected to tax in that year.

The Act provided with effect from 1 April 2001 that reduction was not permitted from book profit of the amount transferred from reserve or provision created before 1 April 1997 otherwise than by a debit to the profit and loss account. Board circular no.8 of 2002 dated 27 August 2002, inter alia, specified with effect from 1 April 2001 that the amount withdrawn from 'reserves' in the nature of

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<sup>5</sup> Additional depreciation at 15 per cent is admissible to a new industrial undertaking on the actual cost of machinery or plant acquired and installed after 31 March 2002 which began manufacturing or production of any article or thing on or after 1 April 2002 or any industrial undertaking already in existence before 1 April 2002 during any previous year in which it achieved substantial expansion by way of increase in installed capacity by not less than 25 per cent.

revaluation reserve, if credited to the profit and loss account shall not be reduced from book profit.

Audit noticed instances in assessments completed both before and after 1 April 2001, where the assessee claimed and were allowed reduction from book profit of amounts that were:

- claimed to have been transferred from General Reserve only for presentation purpose, without crediting the same directly to the profit and loss account, or
- transferred from revaluation reserve for presentation purpose and not directly credited to the profit and loss account.

Accretion to reserves in these cases did not increase the book profits of the respective years.

In 12 cases in respect of 6 companies namely M/s. Reliance Industries Ltd., CIT Mumbai III charge, M/s. Videocon International Ltd., CIT Mumbai Central II charge, M/s. Videocon Appliances Ltd., Mumbai Central II charge, M/s. Reliance Industrial Infrastructure Ltd., Mumbai III charge, M/s. Southern Petrochemical Industries Corporation Ltd., Tamil Nadu III Chennai charge and M/s. Janpath Investments & Holdings Ltd., Kolkata II charge, audit scrutiny of assessments revealed loss of revenue of Rs.521.51 crore on account of incorrect application of the special provisions while computing book profit.

Table 1 below contains the details

Sl. No	CIT Charge	Name of the Assessee	Asstt Year	Assessed under section	Nature of mistake	Tax effect (Rs. in crore)
1.	City-III, Mumbai charge	M/s. Reliance Industries Ltd.	1997-98	143(3)	Assessing officer accepted set off of additional depreciation which was depicted as withdrawal from the General Reserve account. Profit and loss account was not credited with the withdrawal. The amount so set off was incorrectly reduced in computation of book profit which was not in accordance with the special provisions. Accretion to 'reserve' was not added to book profit of relevant year.	103.84*
			1998-99	143(3)		83.26
			1999-00	143(3)		96.77
			2000-01	143(3)		76.24
			2001-02	143(1)		90.82
			2002-03	143(1)		47.41

\* A similar observation in the case of the same assessee noticed in summary assessment for assessment year 1997-98 had featured in Audit Report 12 of 2001.

Sl. No	CIT Charge	Name of the Assessee	Asstt Year	Assessed under section	Nature of mistake	Tax effect (Rs. in crore)
2.	Mumbai Central Circle II	Videocon International Ltd.	1999-00	143(3)	-Do-	3.87
3.	Mumbai Central Circle II	Videocon Appliances Ltd.	1999-00	143(3)	-Do-	2.91
4.	Mumbai III	Reliance Industrial Infrastructure Ltd.	2000-01	143(3)	-Do-	1.78
5.	TN-III, Chennai charge	M/s. Southern Petro Chemical Industries Corporation Ltd.	1997-98 1998-99	143(1) 143(1)	Additional depreciation was set off against 'revaluation reserve' and reduced from the book profit without credit to profit and loss account. Accretion to 'reserve' did not increase book profit of the relevant year.	6.63 5.22
6.	Kolkata-II charge	M/s. Janpath Investments & Holdings Ltd.	1999-00	143(1)	Additional depreciation was set off against 'reserve' and reduced from the book profit, without credit to profit and loss account. Accretion to 'reserve' did not increase book profit of the relevant year.	2.76

Department accepted the audit observation in the case of M/s. Southern Petro Chemical Industries Corporation Ltd. and took remedial action to disallow the incorrect deduction from book profit. Department did not accept the observation in the case of M/s. Reliance Industries Ltd. on the grounds that revaluation was done in compliance with accounting standards, the judgement of Supreme Court in Apollo Tyres case enjoins upon the assessing officer to accept the profit and loss account certified by statutory auditors, the assessee had disclosed the effect of revaluation in the accounts, withdrawal from General Reserve was only for 'presentation' purposes, and that the assessee could have also directly credited the profit and loss account.

The reply is not tenable as the claim of deduction was in clear contravention of the letter and spirit of the special provisions of the Act which did not recognize accounting entries made only for presentation purposes, accretion to 'reserve' did not increase book profit of the relevant year and the arguments relating to the accounting standards and Supreme Court judgement are not relevant and do not apply to the case. Department did not reply in other cases.

#### **1.4.12 Incorrect exemption**

In **West Bengal, Kolkata-IV charge**, the assessment of a company, **M/s. Hindustan Steel Works Construction Ltd**, for the assessment year 2000-01 was completed in **summary** manner in March 2002.

An amount of Rs.957.80 crore was credited to the profit and loss account on account of interest on government loan for earlier years that was waived and written back. The assessee while computing book profit under the special provisions of the Income Tax Act, deducted the said amount from the book profit. The amount was not deductible from book profit as it was not an exempted income under chapter III of Income Tax Act. Incorrect deduction resulted in underassessment of income by Rs.248.16 crore (being 30 per cent of adjusted book profit), involving tax effect of Rs.127.55 crore.

#### **1.4.13 Loss or depreciation not reduced correctly**

In **West Bengal, Kolkata-II charge**, the assessments of an assessee, **M/s. United Bank of India** for the assessment year 2001-02 and 2002-03 were completed in **summary** manner in March 2002 and January 2003 respectively under the special provisions of the Act.

Audit noticed that while computing book profit for assessment year 2000-01 the assessing officer allowed deduction of the full amount of unabsorbed depreciation of Rs.18.99 crore from net profit.

There was thus no scope for its further set off in assessment year 2001-02 or 2002-03. Incorrect deduction of non existent unabsorbed depreciation from book profit resulted in short computation of book profit by Rs.16.37 crore and Rs.18.99 crore involving tax effect of Rs.1.57 crore and Rs.1.50 crore for assessment years 2001-02 and 2002-03 respectively.

Two cases involving similar mistakes are given at Sl. No. 29 and 30 in **Appendix-4**.

#### **1.4.14 Profit derived from generation of power not reduced correctly**

Audit scrutiny of the assessments of a company **M/s. Jindal Iron and Steel Co. Ltd** for the assessment years 1998-99 and 1999-2000 completed after **scrutiny** in **Maharashtra, City-V, Mumbai charge**, revealed that there were no profits available from generation of power for deduction, as noticed from the unit wise profit and loss account. However, the department in computation of the book profits incorrectly allowed the deduction claimed by the assessee on account of profit generated from generation of power. Short levy of tax on this account worked out to Rs.1.40 crore.



#### **1.4.15 Profits derived by an industrial undertaking located in industrially backward area not reduced correctly**

Any income from tax free bonds would need to be reduced from net profit while arriving at the amount eligible for deduction towards profits from industrial undertaking in backward area. Audit noticed that the assessing officer had not reduced the income from tax free bonds while calculating the profits derived by an industrial undertaking located in industrially backward area in the case of M/s. Bongaigaon Refineries and Petrochemicals Ltd., in Assam, Guwahati II charge in scrutiny assessments for assessment years 1997-98 and 1999-00. Consequently, the assessing officer gave an excess deduction of such profits while calculating book profits under special provisions. Tax effect involved for the two years was Rs.10.36 crore.

#### **1.4.16 Incorrect deduction in respect of export profit**

The explanation to the special provisions provides that profit derived in respect of export business is eligible for deduction for computing book profit. Such reduction is to be made from net profit as per profit and loss account and not from book profits.

Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to nil or to a loss, no deduction on the above is admissible.

Further, the Act has defined gross total income as the total income computed in accordance with the provisions of the Act before making the deductions under chapter VI A.

In **Maharashtra Mumbai III charge**, the assessments of a company **M/s. Reliance Industries Ltd.** for the assessments years 2001-02 and 2002-03 were completed in **summary** manner. Audit noticed that the assessee had claimed deduction for export profits while computing the income based on book profit and not from the net profit as per profit and loss account. The assessing officer accepted the same without making any adjustment as required under special provisions. Acceptance of the return under summary assessment conferred on the assessee an otherwise unentitled tax benefit of Rs.120.49 crore. The assessing officer had, however, disallowed similar deductions based on book profits in assessments completed after scrutiny in earlier years.

Four cases involving similar mistakes are given at Sl. No. 31 to 34 in **Appendix-4**.

#### **1.4.17 Profits of sick industrial company**

For the purpose of section 115 JA/JB, profit of sick industrial company for the assessment year commencing from the assessment year relevant to the previous year in which the said company had become sick under Sick Industrial Companies Act (1985) and ending with the assessment year during which the entire net worth of such company became equal to or exceeded the accumulated losses, has to be excluded while computing book profit.

In **Maharashtra, Pune City V charge**, in the case of **M/s. Kirloskar Oil Engines Ltd**, the assessments for the assessment years 2001-02 and 2002-03 were processed in **summary** manner accepting 'nil' income as returned. The assessing officer did not bring book profits to tax under the special provisions. The assessee had claimed that the same were not applicable to it, being a sick industrial unit. The contention of the assessee was not tenable as it was a profit making company as seen from the profit and loss account available with the assessment records and the company had also declared dividends. The mistake resulted in short levy of tax of Rs.6.29 crore.

#### **1.4.18 Tax credit under Special Provisions**

Audit scrutiny revealed that in giving effect to tax credit under special provisions, mistakes on various counts were found in **782** cases resulting in short levy/non levy of tax of **Rs.184.43 crore**. **Appendix-5** has the details.

One case with maximum tax effect in each category is illustrated below. Other cases with tax effect of at least Rs.1 crore each and with similar mistakes are shown in **Appendix-4**.

#### **1.4.19 Incorrect determination/allowance of tax credit**

In **Maharashtra, DGIT (International tax) charge**, the assessment of a foreign bank, **M/s. Standard Chartered Bank** for the assessment year 1999-2000 was completed after **scrutiny**. The assessee returned a loss of Rs.39.84 crore under the normal provisions which was assessed at an income Rs.42.40 crore. The book profit returned was Rs.36.65 lakh. As the assessed income under normal provisions was more than that under special provisions, the assessee was allowed to set off tax credit of Rs.19.48 crore relating to assessment years 1997-98 and 1998-99. Audit noticed mistakes in calculation of book profit under special provisions to the extent that provision for taxation, capital expenditure and interest written back on IRFC bonds not credited to profit and loss account, were not added to net profit. After these additions to net profit, taxable income under the special provisions would have been Rs.57.59 crore, which was more than that assessed under normal provisions. The assessee was thus not entitled to tax credit of Rs.19.48 crore which was to be allowed only when tax payable under normal provisions was more than that payable under special provisions.

Ten cases involving similar mistakes are given at Sl. No. 35 to 44 in **Appendix-4**.

#### **1.4.20 Incorrect set off of tax credit**

In **Maharashtra Mumbai II charge**, the assessment of **M/s. Dena Bank** for the assessment year 1998-99 was completed after **scrutiny**. Audit noticed that tax credit of Rs.11.30 crore was allowed to be set off against the tax demand of assessment year 1998-99. This was not admissible as no tax credit was available after giving effect to appellate orders in the assessment for the assessment year 1997-98. The mistake resulted in short levy of tax of Rs.22.75 crore including interest.

Three cases involving similar mistakes are given at Sl. No. 45 to 47 in **Appendix-4**.

#### **1.4.21 Tax credit incorrectly treated at par with advance tax & TDS**

Tax credit cannot be treated at par with advance tax or tax deducted at source. It cannot be deducted from tax liability determined while calculating interest liability for defaults such as late filing of returns, default/deficiency in payment of advance tax etc. It cannot also be treated as tax rebate in the absence of specific provisions to that effect.

Audit noticed that in **629 cases**, there was **short levy of tax** to the government due to excess and irregular refund of tax credit, non-levy/short levy of interest under section 234B, 234C, interest on refunds incorrectly allowed under section 244A and incorrect levy of surcharge amounting to **Rs.78.86 crore**. Details are in **Appendix-5**.

One case is illustrated below:

In **Maharashtra, Mumbai III charge**, tax credit of Rs.61.20 crore was allowed to **M/s. Reliance Industries Ltd.** in assessment year 2000-01. However, while working out interest under section 234B of the Act, tax paid under the special provisions was first set off against the total tax of the year and interest liability was charged on the balance tax. Incorrect set off of tax credit had thus resulted in short levy of interest of Rs.28.92 crore under section 234B.

Assessing officer in reply stated that the observation did not appear to be in accordance with the provisions of the Act and that levy of interest presupposed that the tax payable had to be arrived at after deducting from the total tax payable, any tax credit or rebate available besides advance tax and TDS. As such, tax credit available for set off had to be reduced from the tax payable for calculating interest under section 234 B of the Act.

Reply is not tenable as setting off tax credit ahead of advance tax and tax deducted at source could result in the assessee being paid interest on tax credit which is otherwise not admissible under the Act. A suitable clarification from the Board to assessing officers to allow tax credit strictly in accordance with the spirit behind special provisions would prevent inconsistent approach from being adopted by assessing officers and loss of revenue.

Seven cases involving similar mistakes are given at Sl. No. 48 to 54 in **Appendix-4**.

#### **1.4.22 Effect of Supreme Court decision in Apollo Tyres case**

The Supreme Court has held in the case of Commissioner of Income Tax vs Apollo Tyres Ltd\* (2002) that the assessing officer, while computing the book profits of a company under section 115 J of the Income Tax Act, 1961, had only the power of examining whether the books of account were certified by the agencies prescribed under the said Act as having been properly maintained in accordance with the Companies Act. The assessing officer, thereafter, had the limited power of making addition and reduction as provided for in the explanation to section 115 J.

The implications of the above judicial pronouncement are the following:

- the assessing officer can take the view that he cannot go behind the net profit shown in the certified profit and loss account in a routine manner,
- although the Registrar of Companies has powers to examine the accounts and verify whether those were maintained and finalised in accordance with the Companies Act, he is not under any obligation to report any mistakes in any document filed by a given company to the Income Tax Department and
- the Income Tax Act does not specify what action could be taken
  - when the certified accounts are found by the assessing officer to be not in accordance with the Companies Act, or
  - when the accounts are maintained in accordance with the Companies Act, but there are camouflaged or subtle qualifications made by the statutory auditors – particularly in the Notes on Accounts or on accounting practices which conceal particulars of income.

Audit noticed mistakes in arriving at net profit as per the profit and loss account in **97 cases** in Andhra Pradesh, Assam, Bihar & Jharkhand, Delhi, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh and West Bengal. Non incorporation of a suitable provision in the Act enabling the

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\* 255 ITR 273 (SC)

assessing officers to rectify such mistakes contributed to a loss of revenue of **Rs.175.32 crore** in the above cases that audit had reviewed.

One case with maximum tax effect in each category is illustrated below. Other cases with tax effect of at least Rs.1 crore each and with similar mistakes are shown in **Appendix-4**.

#### **1.4.23 Incorrect debit/credit affecting net profit in profit and loss account**

In **Delhi, CIT-IV charge**, the assessment of **M/s. Indian Road Construction Corporation Ltd.** for the assessment year 2001-02 was completed in January 2003 in **summary** manner at an income of Rs.9.73 crore under normal provisions of the Act. Audit noticed that interest including penal interest of Rs.402.17 crore on government loan payable by the assessee for the period 26 October 1986 to 30 June 1999 was waived off by the government in March 2001. As the said interest had been claimed by the assessee as deduction in the earlier assessment years by debiting the amount to the profit and loss account of relevant previous years, the interest waived off was required to be shown as income in the profit and loss account in the year of waiver which was not done. Above mistake led to underassessment of book profit by Rs.402.17 crore involving under charge of tax of **Rs.38.73 crore** (including interest).

Another case with similar mistake is shown at Sl. No. 55 of **Appendix-4**.

**1.4.24 In Maharashtra, Mumbai III charge**, audit noticed that **M/s. Reliance Consolidated Enterprises Pvt. Ltd.** and **M/s. Reliance Industrial Infrastructure Ltd.** had earned profits from the sale of investments during the previous year relevant to assessment year 2000-01. However the sale proceeds were credited directly to the General Reserve account instead of the respective profit and loss accounts. This resulted in under assessment of deemed income of Rs.2.50 crore and Rs.1.85 crore for assessment year 2000-01 in scrutiny assessments. Tax effect involved for the two assesseees was Rs.2.01 crore.

In the case of **M/s. Reliance Industrial Infrastructure Ltd.** the department stated that the shares were held as investments and not as trading assets and hence the gain realized was in the nature of capital receipts not related to the working of the company.

Reply of the department is not tenable as the sale proceeds of investment were required to be credited to the profit and loss account for computing the book profit as decided by the Mumbai High Court in the case of **CIT vs. Veekayal Investment Co. (P) Ltd. and Hotel Hiramani Pvt. Ltd.\*** (2001). No reply was received in the other case.

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\*249 ITR 597 (Mumbai)

### 1.4.25 Mistakes relating to claims of depreciation not rectified in the absence of enabling provision in the Act

Arrears of depreciation or additional depreciation debited to profit and loss account is not allowed as expenditure under the normal provisions of the Act. Some assessees had debited their profit and loss account with arrears of depreciation or additional depreciation that had arisen out of selective revaluation of assets. No amount was depicted as withdrawn from reserves for the purpose, unlike the cases mentioned in para 1.4.11 of this review. Consequently, the profit and loss account showed a 'net loss'. Special provisions did not specifically provide for any disallowance of additional depreciation. Government lost revenue of Rs.49.81 crore in seven cases listed in Table 2 below, as the assessees had availed the benefit of deduction of arrears of depreciation or additional depreciation under special provisions even when the same was not permitted under normal provisions.

**Table 2**

Sl. No	CIT Charge	Name of the Assessee	Asstt Year	Assessed under section	Nature of mistake	Tax effect (Rs. in crore)
1.	City-III, Mumbai charge	Reliance Port and Terminals	2001-02 2002-03	143(1)	Additional depreciation due to revaluation debited to profit and loss account was not added to book profit under special provisions.	33.41
2.	Mumbai III	Reliance Utilities and Power	2001-02 2002-03	143(1) 143(1)	-Do-	7.53 1.14
3.	Mumbai VI	Century Textile and Industries Ltd.	2001-02 2002-03	143(1) 143(1)	Arrears of depreciation debited to the profit and loss account but not added back under special provisions.	6.11
4.	Kochi	Traco Cable Ltd.	2000-01	143(3)	-Do-	1.62

### 1.4.26 Capital expenditure not added back

Any expenditure, not being in the nature of capital expenditure, laid out wholly or exclusively for the purpose of business, is allowable as deduction in the computation of income.

In Kerala, Kochi charge, the assessments of M/s. Lord Krishna Bank for the assessment years 2001-02 and 2002-03 were processed in summary manner. Audit noticed that Rs.2.19 crore being interest paid on government securities by the assessee from 1 April to the date of purchase in the relevant previous years was debited to the profit and loss account. It was not added back to book profits

although similar expenditure was held to be capital expenditure by the Supreme Court\*. Omission resulted in short levy of tax of Rs.6.25 crore.

Two cases involving similar mistakes are given at Sl. No. 56 and 57 in **Appendix-4**.

#### **1.4.27 Prior period expenses**

Income Tax Appellate Tribunal, Delhi have held in the case of Dy. CIT vs Eicher Goodearth<sup>#</sup> (1999) that prior period items when charged to the accounts cannot be ignored. As a fall out of the Supreme Court decision in Apollo Tyres case and in the absence of any provision for treatment of prior period expenses under special provisions, the assessing officer is unable to change the net profit even when prior period items are incorrectly charged to the profit and loss account. An instance of incorrect treatment of 'prior period expenses' with substantial tax effect is illustrated below:

In **West Bengal I, Kolkata charge**, the assessments of **M/s. Peerless General Financial and Investment Co. Ltd.** for the assessment years 1997-98 to 2000-01 were completed after **scrutiny**. Audit noticed that the assessee was engaged in the business of receiving deposits from the public under several deposit schemes. On maturity, incentives and bonus were paid to the certificate holders in addition to subscriptions received from them. To meet the additional liability, certain amount was to be debited in the profit and loss account with a corresponding credit to its Social Welfare Scheme (SWS) fund account.

The assessee recalculated its collections since 19 April 1993 and found a shortfall in the SWS fund account of Rs.771.22 crore for assessment years 1993-94 to 1995-96. The assessee charged to the profit and loss account for previous years relevant to the assessment years 1997-98, 1998-99, 1999-2000 and 2000-01 amounts of Rs.120.92 crore, Rs.325.15 crore, Rs.65 crore and Rs.65 crore respectively as additional provisions to partially meet the shortfall described above. As the liability to pay the certificate holders was revenue in nature which had already accrued by 31 March 1996 and as the company was following mercantile system of accounting, the whole amount of Rs.771.22 crore was required to be debited to profit and loss account for assessment year 1996-97. Had it been done so, net profit of subsequent years and income under special provisions would have been higher resulting in legitimate additional revenue of Rs.44.76 crore to government. Incorrect application of the provisions of the Act resulted in loss of revenue of similar amount.

Another case with similar mistake is shown at Sl. No. 58 of **Appendix-4**.

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\* Vijaya Bank Ltd. vs CIT (Addl.) 187 ITR 541 (SC)

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**1.4.28 Tax under special provisions (115 JA/JB) not levied**

Audit noticed in **630 cases** assessed under normal provisions, that tax amounting to **Rs.178.61 crore** under special provisions was leviable but **was not levied** as shown in Table 3 below:

<b>Sl.No</b>	<b>Name of the State.</b>	<b>No. of cases</b>	<b>Tax Effect (Rs. in lakh)</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
1.	Andhra Pradesh	20	221.16
2.	Assam	15	138.19
3.	Bihar & Jharkhand	30	16.36
4.	Delhi	5	10969.26
5.	Gujarat	13	46.22
6.	Haryana	16	9.56
7.	Himachal Pradesh	33	22.59
8.	Karnataka	30	122.41
9.	Kerala	61	379.12
10.	Maharashtra	36	4684.20
11.	MP & Chattishgarh	34	53.64
12.	Orissa	86	46.93
13.	Punjab	47	98.19
14.	Rajasthan	83	292.58
15.	Tamil Nadu	76	456.67
16.	Uttar Pradesh	8	24.15
17.	West Bengal	37	279.61
	<b>Total</b>	<b>633</b>	<b>17864.84</b>

Two cases with maximum tax effect are illustrated below:

**1.4.29 In Delhi II charge**, the assessment of a company, **M/s. Mahanagar Telephone Nigam Limited (MTNL)**, for the assessment year 2001-02 was completed in **summary** manner in January 2003 under normal provisions of the Act at an income of Rs.166.20 crore with tax demand of Rs.65.73 crore. Audit noticed that the assessee itself worked out deemed income under the special provisions of Rs.1720.22 crore with tax liability of Rs.145.79 crore. But it claimed to be taxed under normal provisions, which was accepted by the assessing officer. This action of the assessing officer conferred an otherwise unentitled benefit on the assessee who had saved tax of Rs.104.61 crore which was levied short and was due to government.

**1.4.30 In Maharashtra, DGIT (International tax) charge**, the assessments of a foreign company, **M/s. Bank of Tokyo Mitsubishi Ltd.**, for the assessment years 2001-02 and 2002-03 were completed in **summary** manner. Audit scrutiny revealed that the assessee had returned 'nil' income under normal provisions of the Income Tax Act in both the years and Rs.87.60 crore and Rs.66.97 crore under



special provisions respectively. However, no income was taxed either under normal provisions or under special provisions by the department. Consequently the entire tax deducted at source and advance tax along with interest under section 244A amounting to Rs.6.57 crore was refunded. Omission to assess income under special provisions resulted in short levy of tax totalling Rs.11.98 crore.

Assessing officer while not accepting the audit observation replied that the assessment of the year was done under section 143(1) of the Income Tax Act and no prima facie adjustments could be made as the tax liability/refund of the assessee had to be determined on the basis of the returned income. Further, the issue of special provisions would be examined in the scrutiny assessment proceedings.

Reply of the department is not tenable as issuing refund in a case without even a cursory examination of the facts where the assessee itself had declared income under special provisions resulted in not only exempting the assessee from the liability of payment of advance tax but also in depriving the exchequer of a revenue of Rs.11.98 crore otherwise payable even according to the assessee.

Ten cases involving similar mistakes are given at Sl. No. 59 to 68 in **Appendix-4**.

#### **1.4.31 Assessment completed under special provisions when income under normal provisions was more**

If the total income computed under normal provisions of the Act is more, then there is no need to apply the provisions of section 115 JA/JB since the tax payable under normal provisions would be more than that payable under special provisions.

Invoking special provisions incorrectly when income under normal provisions was higher resulted in short levy of tax of Rs.9.76 crore in 26 cases as shown in Table 4 below :

<b>Sl.No.</b>	<b>Name of the State</b>	<b>No. of cases</b>	<b>Tax effect (Rs. in lakh)</b>
<b>1.</b>	<b>2</b>	<b>3</b>	<b>4</b>
1.	Andhra Pradesh	7	271.22
2.	Assam	1	37.34
3.	Haryana	1	0.58
4.	Karnataka	6	34.22
5.	Maharashtra	1	10.49
6.	Rajasthan	2	19.95
7.	Tamil Nadu	7	599.35
8.	Uttar Pradesh	1	3.25
	<b>Total</b>	<b>26</b>	<b>980.4</b>

Two cases involving tax effect of Rs. 1 crore or more are illustrated below:

**1.4.32 In Tamil Nadu-III, Chennai charge**, in the case of **M/s. Pouyet Communication India Limited**, assessments for assessment years 2000-01 and 2001-02 were completed in **summary** manner in August 2002 and July 2002. Income of Rs.98.04 lakh under the normal provisions of the Act and Rs.8.61 crore under the special provisions of the Act were respectively assessed in the assessment years 2000-01 and 2001-02 after allowing deduction of Rs.9.85 crore against normal income for assessment year 2000-01 and Rs.4.96 crore against book profit for assessment year 2001-02 in respect of industrial undertaking in Pondicherry eligible for 100 per cent deduction of profits derived.

Audit noticed that the eligible period of five years for the claim of 100 per cent deduction of profits had already expired in assessment year 1999-2000.

Incorrect deduction resulted in under assessment of income under normal provisions of the Act with consequential short demand of tax of Rs.3.70 crore and Rs.1.15 crore for the assessment years 2000-01 and 2001-02 respectively. The assessing officer accepted the audit observation.

**1.4.33** The assessment of **M/s. Alkali Metals Ltd., CIT-I Hyderabad charge**, for the assessment year 2000-01 was processed in **summary** manner at deemed income of Rs.1.30 crore under the special provisions which was higher than the income of Rs.0.72 crore computed under normal provisions. Audit noticed that the assessee claimed deduction of Rs.1.76 crore being the amount of import duty paid/payable. This amount was claimed as 'duty drawback' but not included in profit and loss account as income for the year. Mistake resulted in short computation of gross income under normal provisions involving short demand of Rs.1.03 crore.

#### **1.4.34 Provision for Wealth Tax - Apparent Lacuna in special provisions**

Under the special provisions of the Act, while arriving at the book profit the amount of income tax paid or payable and the provision thereof, is required to be added to the net profit as shown in the profit and loss account. Wealth tax paid/provision made is not allowed as a deduction under the normal provisions of the Act [Section 40a(ia)]. In the absence of a specific and similar provision under the special provisions, no addition is being made on account of provision for wealth tax to arrive at the book profits. This omission appears to be a lacuna in the Act, as the legislature could not have intended to allow wealth tax liability as an allowable deduction when income tax liability was not allowed as deduction both under the normal as well as special provisions.

In **Maharashtra, M/s. Reliance Industries Ltd.** had debited provisions for wealth tax to the profit and loss account of the previous years relevant to the assessment years along with the provisions for income tax but added back only the

income tax element claiming the provision for wealth tax as admissible expenditure. Lacuna in the Act thus contributed to short payment of tax/loss of revenue of Rs.2.11 crore as detailed in Table 5 below in the case of a single assessee:

<b>Asst. Year</b>	<b>Provision for W.T</b>	<b>Short levy of tax/loss of revenue (Rs.in lakh)</b>
1997-98	100.00	12.90
1998-99	250.00	26.25
1999-00	400.00	42.00
2000-01	400.00	46.20
2001-02	450.00	38.14
2002-03	600.00	45.90
<b>Total</b>		<b>211.39</b>

In reply to the audit observation, the department stated that the Hon'ble Bombay High Court in the case of Echjay Forging Pvt. Ltd\*, had held that the net profit cannot be increased by the amount of wealth tax since what was contemplated in the "explanation" was the amount of income tax paid/provided.

Though the judgment was delivered in February 2001, Department was yet to plug this loophole by introducing a suitable amendment to the special provisions.

#### **1.4.35 Miscellaneous**

Audit noticed various mistakes in **139 cases** in Andhra Pradesh (9 cases), Bihar & Jharkhand (20 cases), Kerala (5 cases), Madhya Pradesh & Chattisgarh (17 cases), Maharashtra (10 cases), Orissa (22 cases), Rajasthan (20 cases), Tamil Nadu (3 cases), Uttar Pradesh (3 cases) and West Bengal (30 cases) in computation of book profit under special provisions, such as incorrectly allowing deduction of non business expenditure, excess allowance of technical know how fees, excess debit of deferred revenue expenditure in profit and loss account and incorrect deduction of income tax refund while computing book profit resulting in short levy of tax of **Rs.26.91 crore**.

One case involving tax effect of Rs. 1 crore and above is illustrated below:

In **Maharashtra, Mumbai I charge**, the assessment of **M/s. A.C.C. Ltd.** for assessment year 2002-03 was processed in **summary** manner. Audit noticed that though net profit of Rs.200.33 crore was shown in the certified profit and loss account, the net profit adopted by the assessee for computing book profit and accepted by the assessing officer was Rs.21.15 crore. The mistake resulted in short levy of tax of Rs.5.62 crore.

\* 251 ITR 15 (Mumbai)

Five cases involving similar mistakes are given at Sl. No. 69 to 73 in **Appendix-4**.

### **Other points of interest**

#### **1.4.36 Double Taxation Relief**

Relief is granted to an assessee against double taxation in respect of income assessed under normal provisions of the Income Tax Act on which tax had been paid both in India as well as in another country with which India has an agreement for avoidance of double taxation. The provisions of the Act shall apply to the extent they are more beneficial to the assessee.

Special provisions of the Act do not provide for and hence do not permit credit on account of double taxation relief when the income is assessed under section 115 JA/JB.

In Maharashtra, audit noticed that the assessing officers had allowed double taxation relief when the income was assessed under the special provisions. Incorrect set off of double taxation relief thus, resulted in short levy of tax of Rs.6.72 crore in three cases as shown in Table 6 below:

**Table 6**

<b>Sl. No.</b>	<b>Name of the assessee</b>	<b>CIT</b>	<b>Assessment year</b>	<b>Section</b>	<b>Tax effect (Rs. in lakh)</b>
1.	Hindustan Construction Co. Ltd.	Central Circle-2	2002-03	143(1)	447.90
2.	Bombay Dyeing Ltd.	Mumbai-2	1998-99	143(3)	185.11
3.	Voltas Ltd.	Mumbai-7	2000-01	143(3)	38.91

#### **1.4.37 Statutory Auditors' Report not furnished**

The Act provides that every company to which the provisions of section 115JB applies should furnish a report in the prescribed form (Form 29-B) from an accountant, certifying that book profit had been computed in accordance with the provisions of the section *ibid* along with the return of income.

Audit noticed that the above certificate was not attached with the returns in the following cases.

**Table 7**

Sl. No.	Name of the State/Charge	No. of cases
1.	Assam, Shilong	5
2.	Himachal Pradesh, Shimla	24
3.	Karnataka, CIT-I, CIT-III and CIT Hubli	10
4.	Orissa, Sambalpur	9
5.	Uttar Pradesh, Bareilly, Gorakhpur, Kanpur Central, Kanpur II and Lucknow-II	10

In the absence of prescribed certificates, correct assessment of tax could not be ascertained in these cases. There are no enabling provisions for taking penal action against the assesseees or statutory auditors for filing defective certificate or not filing prescribed certificate.

## **1.5 Conclusions and recommendations**

### **1.5.1 Issues relating to the administration of the scheme of taxation of companies under special provisions**

The department does not have an effective mechanism to identify and take corrective measures in respect of mistakes arising out of assessments made in summary manner, even in cases attracting special provisions. The department has neither maintained any database relating to 'zero tax' companies nor has introduced any system to monitor the revenue realized in respect of such companies. Even though the special provisions relating to levy of tax have been in the statute for over six years, no review or study has yet been undertaken directly by the department to evaluate the impact of the scheme.

Government may like to include cases of companies attracting special provisions as one of the parameters for selecting assessments for scrutiny. Government may like to introduce a mandatory column in the income tax return form for companies to indicate whether special provisions are attracted or not and extract data therefrom to build database of such companies. Government may like to study the impact of the scheme directly and also evolve a system to monitor the implementation and results of the scheme so that all cases attracting the provisions are invariably assessed thereunder.

### **1.5.2 Issues relating to tax law**

Various items discussed in this review relating to additional depreciation, arrears of depreciation, wealth tax, prior period expenses, relief on account of double taxation and so on, are added back in computation of income under normal provisions of the Act but not while computing deemed income under special provisions. This has considerable adverse effect on revenues of Government.

Government may like to consider amending relevant provisions of the Act to plug the loopholes so that unintended benefits do not accrue to companies against the spirit of special provisions of taxation.

Unless the statutory auditors are held accountable for certificate in support of the correctness of book profits under the special provisions of the Act, Government may not be able to ensure the correctness of claims especially as 90 per cent assessments of companies on an average are completed in summary manner.

Since the assessing officer has to rely upon the certificate issued by statutory auditors in support of correctness of book profits, Government may like to empower assessing officers to initiate suitable penal action against such statutory auditors whose certificates are found to be incorrect and/or defective.

### **1.5.3 Issues relating to Supreme Court decision in Apollo Tyres case**

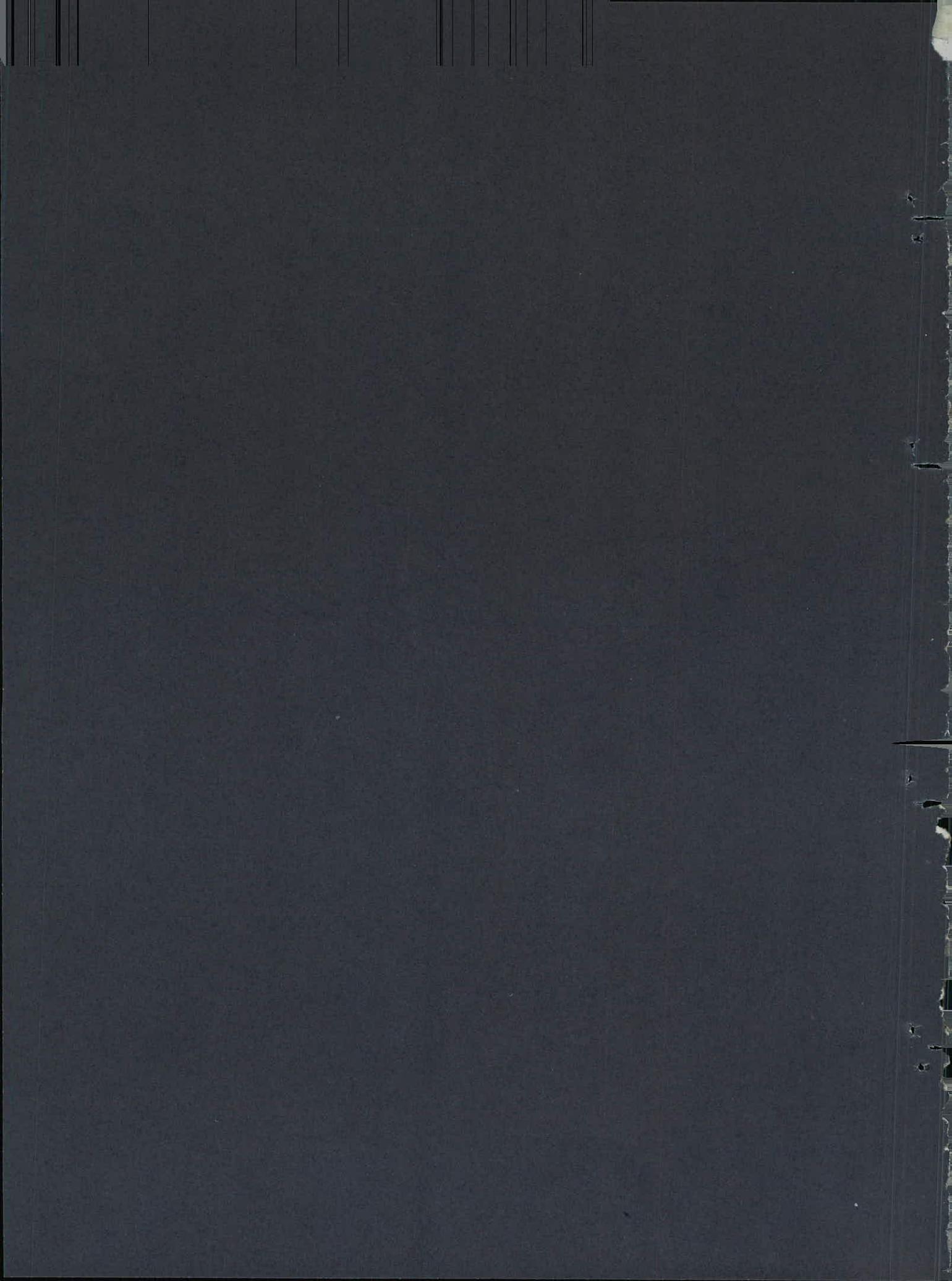
Audit noticed mistakes in arriving at net profit as per the profit and loss account which could have been rectified only by introduction of a suitable provision in the Income Tax Act. This would have averted a loss of revenue of Rs.175.32 crore in 97 cases.

Government may like to incorporate a suitable provision in the Act enabling the assessing officer to rectify mistakes in computation of net profit under special provisions.

# Chapter II

## Assessment of business of civil construction

- Highlights
- Introduction
- Audit Findings
  - Avoidable mistakes in the computation of income and tax
  - Incorrect status adopted in assessment
  - Mistakes in the computation of business income
  - Project completion method of accounting and its misuse
  - Short account of gross contract receipts
  - Non-fulfilment of conditions for computation of income under section 44AD
  - Capital expenditure incorrectly treated as revenue expenditure
  - Incorrect adoption of values of work-in-progress
  - Incorrect allowance of depreciation
  - Irregular carry forward and set off of losses
  - Incorrect relief and exemptions under Chapter VI A
  - Non-levy of penalty and interest
  - Inadequate co-ordination within the department
- Audit recommendations





## Highlights

- Audit compiled a database of civil contractors from various external sources including state and central government departments. The Income tax department was not in a ready position to verify and confirm whether returns were being filed by these contractors. Similar effort of preparing 'database' was not independently undertaken by the department.

**(Para No. 2.12)**

- Information furnished by the department to audit indicated that only 179 new assesseees were added to the tax net during the period 1999-2000 to 2001-2002 through survey. The department could have used survey powers much more effectively and efficiently to widen the tax base of assesseees engaged in civil construction.

**(Para No. 2.11)**

- Audit noticed several irregularities in assessments of civil contractors and builders such as incorrect computation of business income, wrong allowance of expenditure, deductions, unascertained liabilities, provisions, adoption of incorrect rate of tax, interest and status. Tax was levied short by Rs.81.69 crore in 495 cases.

**(Para No. 2.13 to 2.16, 2.20 to 2.28 and 2.31)**

- Audit scrutiny revealed claims of irregular and excess depreciation that were allowed by the Department in 52 cases involving short levy of tax of Rs.212.78 crore.

**(Para No. 2.29)**

- Assessing officer did not levy interest for default in filing the return of income and short payment in advance tax. Refunds were issued without TDS certificate and claims admitted beyond the specified period. Tax effect involved was Rs.4.95 crore in 76 cases.

**(Para No. 2.34 and 2.35)**

- Audit noticed that tax was not deducted at source or tax deducted was not remitted or remitted late to government account. The transaction of repayment of loans/deposits was not carried out through cheques/demand drafts. Penalty and interest were levied short by Rs.72.50 crore in 271 cases.

**(Para No. 2.36 to 2.39)**

- Assessing officers omitted to assess total contract receipts in the hands of the assesseees, as related receipts from which tax was deducted were either not taken at all or incorrectly taken into account resulting in undercharge of tax of Rs.49.21 crore in 232 cases.

**(Para No. 2.18)**

- Returns of civil contractors who were expected to return income at the rate of minimum 8 per cent of their gross receipts without audited statement of accounts were accepted by the Department, even when the income returned was less than 8 percent of gross receipts. This resulted in short levy of tax of Rs.3.22 crore in 142 cases.

**(Para No. 2.19)**

- “Project completion method” of accounting for income from civil construction was accepted by the Department. Audit scrutiny revealed that this method of accounting was misused by builders by postponing accountal of profits and thereby the taxes indefinitely. In two cases where audit could quantify the revenue effect, short levy of tax was Rs.2.06 crores. In 11 cases, government lost revenue of Rs.37.01 crore as these assesseees were exempted from declaring minimum 8 per cent of gross receipts as income that was mandatory even for smaller contractors with a turnover of less than Rs.40 lakh.

**(Para No. 2.17)**

- Audit recommend that: -

➤ the person registering the document for the execution of contract could be bound by statute to furnish details, to the assessing officer, of all cases where the value of transaction exceeds rupees one crore.

**(Para No. 2.42.5)**

➤ obtaining tax clearance certificate before registration of immovable property in excess of a threshold level of monetary value may be prescribed in the Act and made mandatory.

**(Para No. 2.42.6)**

➤ Government may issue clarification restricting the benefit of exemption of long term capital gains to direct investment in infrastructure companies or funds, which will prevent exploitation of the benefit by investors through speculation in secondary market operations.

**(Para No. 2.42.8)**

## Assessment of business of civil construction

### 2.1 Introduction

**2.1.1** Civil construction plays a major role in the development of the economy and infrastructure of any country. Such activity involves construction of multipurpose dams, buildings, roads, canals, flyovers, highway and so on. This work is carried out by various agencies, contractors, corporations and construction companies etc. Buildings include residential, commercial and office buildings.

**2.1.2** Substantial sums of investment and expenditure are required and involved in this line of business. Consequently, it is essential to ensure that correct income from such business is brought to tax by government. Income Tax Act provides the methodology for assessment of income from business of civil construction and lays down responsibilities of the assessee engaged in such business.

### 2.2 Law and Procedure

**2.2.1** The business of civil construction can be executed by entities such as individuals, registered firms, companies, Hindu Undivided Family, association of persons and body of individuals under the Income Tax Act.

**2.2.2** Income from business of the corporate/non-corporate assessee is computed under sections 28 to 44D of the Income Tax Act, 1961 which deal with income from business or profession.

**2.2.3** Special provisions for assessment of such assessee in the Income Tax Act are as follows.

**2.2.4** With effect from the assessment year 1994-95, section 44 AD has been inserted in the Income Tax Act, 1961 as a special provision for computing profits and gains from the business of civil construction by estimating income from the business of civil construction or supply of labour for civil construction work. It is applicable to an assessee whose gross receipts from the business of civil construction do not exceed Rs.40 lakh. Income from business of civil construction is to be adopted at 8 percent of the gross receipts paid or payable to an assessee. A tax payer can voluntarily declare a higher income in his return.

**2.2.5** The income estimated at 8 per cent of the gross receipts is comprehensive and any deduction allowable under the provisions of sections 30 to 38, shall be deemed to have been already allowed and no further deductions will be allowed under these sections. However, in the case of a firm, normal deduction for salary and interest paid to its working partners under section 40(b) shall be allowed.

**2.2.6** An assessee whose gross receipts from civil construction do not exceed Rs.40 lakh and who files the return estimating income at 8 per cent of gross receipts, or a higher income, will neither be required to maintain books of account under the provisions of section 44 AA(2), nor required to get the accounts audited under the provisions of section 44 AB, in respect of income from business of civil construction.

**2.2.7** For the assessment years 1994-95 to 1997-98, the assessee could compute his income at a rate lower than 8 per cent of gross contract receipts provided he produced evidence to prove that the profits from such business were lower than 8 per cent of gross receipts and if the assessee makes such a claim, assessment will have to be made under section 143(3) of the Income Tax Act.

**2.2.8** However, with effect from assessment year 1998-99, above provisions have been amended enabling an assessee to claim his income to be lower than the deemed profits, subject to the conditions that books of accounts and other documents are kept and maintained as required under section 44AA and the assessee gets his accounts audited irrespective of turn over and furnishes a report of such audit as prescribed under section 44AB.

**2.2.9** Where gross contract receipts exceed Rs.40 lakh, the assessee has to get his accounts audited and furnish an audit report in the prescribed form under section 44AB of the Income Tax Act.

**2.2.10** Income from business of civil construction, estimated in accordance with this provision, is to be aggregated with other income of the assessee from any other business or from other heads of income and all deductions under sections 80-CCC to 80-O and rebates under section 88 and 88B would be available to the assessee.

### **2.3 Deductions**

Deduction is allowable on or after 1 April 1995 for 10 out of 15 initial assessment years @ 100 per cent of profits and gains for first 5 assessment years and 25 per cent (30 per cent in the case of companies) for the remaining assessment years. However with effect from assessment year 2002-03, a uniform deduction of 100 per cent of profits and gains is allowable for 10 assessment years when any enterprise carries on business of.

- developing
- maintaining and operating or
- developing, maintaining and operating any infrastructure facility which fulfils all the conditions laid down in the proviso of sub section 4 of section 80IA.

## **2.4 Tax deducted at source**

**2.4.1** The person responsible for making payments to any contractor/sub-contractor of civil construction is required to deduct tax at source and remit it to government account subject to the conditions laid down in chapter XVII B of the Act. Failure to do so would attract penalty prescribed under chapter XXI of the Act. Some of the important provisions are as follows.

**2.4.2** Under section 194 C, any person responsible for paying any sum to any contractor engaged in any business of civil construction or engaged in supply of labour for such work, in pursuance of a contract between the contractor and any specified authority such as Central Government, State Government, local authority etc. shall at the time of credit of such sum to the account of the said contractor or at the time of payment thereof, whichever is earlier, deduct an amount equal to two per cent of such sum as income tax.

**2.4.3** Further, any contractor not being an individual or a Hindu Undivided Family (also an individual or a Hindu Undivided Family whose total sales, gross receipts or turnover from business exceeds the monetary limits specified under clause (a) or clause (b) of Section 44AB w.e.f. 1 June 2002) responsible for paying any sum to any sub-contractor shall deduct an amount equal to one per cent of such sum as income tax on income, comprised therein. Rates of surcharge (if applicable) will be extra. But aforesaid deductions shall not be made, if any sum credited or paid in pursuance of any contract does not exceed twenty thousand rupees. However, if the concerned contractor/sub-contractor requests the assessing officer for deduction of tax at lower rate or no deduction of tax and the assessing officer is satisfied, he may authorize the payer to make payment without deduction of tax at source or to deduct tax at lower rate.

**2.4.4** Any person deducting tax at source is required to pay the tax so deducted to the credit of the Central Government account within two months from the end of the month in which the credit is made when the amount is credited to the account of the payee on the last day of the accounting year, and in other cases within one week from the last day of the month in which deduction is made.

## **2.5 Penalty for non-deduction at source or non or delayed remittance of tax deducted**

**2.5.1** If any person responsible for deduction of tax at source does not deduct tax or after deducting tax fails to deposit tax within the prescribed time, he becomes an assessee in default under section 201(1), and is liable to pay penalty under section 271-C, equal to amount of tax which he failed to deduct or deposit, as the case may be.

**2.5.2** Further, he is liable to pay simple interest at the rate of eighteen per cent upto 31 May 2001 and thereafter with effect from 1 June 2001 at the rate of fifteen

per cent per annum on the amount of such tax for the period of default under section 201 (1A).

**2.5.3** Every person responsible for tax deduction at source is required under section 203 to furnish to the contractors/sub-contractors to whose account such credit is given or to whom such payment is made, a certificate in the prescribed proforma (Form 16 A), within the prescribed time (not later than 30 April of each year), failing which the tax deductor is liable to pay minimum penalty of Rs.100 for every day of default, limited to the amount of tax deductible under Section 272 A (2).

**2.5.4** Further such person will also submit a return under section 206 in prescribed proforma (Form 26-C) to the Income Tax Officer (TDS) by 30 June of each year, failing which the tax deductor is liable to pay minimum penalty under section 272 A (2) at the rate of Rs.100 for each day of default, limited to the amount of tax deductible at source.

## **2.6 Refunds**

If as a result of assessment, refund is due to an assessee and the assessing officer is satisfied as per the provisions of section 237, he may grant refund to the assessee alongwith interest due thereon under section 244 A at the rate of 1 per cent per month for every month or part of the month upto 31 May 2001 and thereafter with effect from 1 June 2001 at the rate of 0.75 per cent, and with effect from June 2003 @ 0.5 per cent per month for every month or part thereof.

## **2.7 Objectives**

Audit undertook a review of selected assessments of the assessee engaged in the business of civil construction with a view to ascertaining: -

- whether all registered contractors including builders in selected cities, who are liable to pay tax are on the records of the Income tax department.
- whether there has been any significant and visible effort by the Income tax department to deepen the tax base in this potential area,
- whether department has ensured proper compliance by the contractors/builders with the provisions of the Income Tax Act and
- loss of revenue or the extent of underassessment due to irregularities in assessments of income from business of civil construction.

## **2.8 Period of Review**

Assessments completed during financial years 1999-2000, 2000-01 and 2001-02 were covered in the review. Results were communicated to the CCITs/CITs between July 2003 and September 2003 by the Accountants General, Principal Directors of Audit/Director General of Audit who had conducted the reviews. Review was issued to Ministry on 18 November 2003 for comments. Reply was awaited.

## **2.9 Sample Size**

**2.9.1** There were 2690 assessing units (691 offices of DCITs/ACITs and 1999 offices of ITOs) in the audit jurisdiction located in 17 states of Andhra Pradesh, Assam, Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, West Bengal and Uttar Pradesh. It was decided to cover 50 per cent offices of DCITs/ACITs and 25 per cent offices of ITOs in metro cities and 75 per cent offices of DCITs/ACITs and 25 per cent offices of ITOs in other cities. Hundred per cent of assessments completed after scrutiny and 25 per cent of assessments completed under summary manner in metro and other than metro cities were decided to be selected for audit scrutiny.

**2.9.2** Based on the above sample size, audit selected 1034 assessment units (434 offices of DCITs/ACITs and 600 offices of ITOs). Besides in the cities of Ahmedabad, Bangalore, Bhopal, Chennai, Hyderabad, Jaipur, Kolkata, Lucknow, Mumbai and New Delhi, cases of builders/land owners of housing projects and commercial complexes were decided to be selected as under: -

- 50 cases of builders in each city (50 per cent summary and 50 per cent scrutiny)
- Of the above 50 cases, 25 cases of land owners in each city (50 per cent summary and 50 per cent scrutiny). Details of land owners were obtained from the registering authority and details of builders from the Municipal Corporations.

## **2.10 Constraints**

**2.10.1** There was no system in the Income Tax Department which could adequately monitor the filing of returns specifically by contractors/builders. There was also no database of contractors/builders, who were required to file their return of income.

**2.10.2** No cross-reference of the transactions of the promoter/builder with that of the owner of the land could be made in the absence of any details of the owner with the assessing officers.

**2.10.3** Assessing officers in Delhi, Bihar and Uttar Pradesh charges did not produce 40.21 per cent, 21.5 per cent and 14.5 per cent of the assessment records requisitioned.

## **2.11 Survey operations**

**2.11.1** The department is empowered to conduct survey of the business premises of tax payers, locate new assesseees and unearth unaccounted income.

**2.11.2** Audit noticed that there was nothing on record to indicate targets fixed for survey operations by the department to identify potential taxpayers particularly in areas like civil construction characterised by substantial economic activity and leakage of revenues.

**2.11.3** Table 1 below shows the consolidated position of the number of surveys conducted during the period 1999-2000 to 2001-02 under sections 133 A and section 133 B of the Act, and the number of contractors brought into the tax net as a result of these surveys.

Sl. No.	Name of the State	No. of surveys conducted under section 133A/133B	No. of contractors/builders identified in the survey	No. of contractors/builders filing return of income
1.	Andhra Pradesh	129	32	32
2.	Assam	6	0	0
3.	Gujarat	1017	43	22
4.	Karnataka	162	3	3
5.	Madhya Pradesh	160	4	4
6.	Maharashtra	823	80	80
7.	Orissa	93	17	2
8.	Rajasthan	456	0	0
	Total	2846	179	143

**2.11.4** Details were not furnished in the charges of Delhi, Jharkhand and Tamil Nadu. However, in the charges of Kerala, Punjab, Uttar Pradesh and West Bengal no survey was conducted. The powers conferred on the department under the Income Tax Act have thus not been used effectively and in an efficient manner. As a result, an important area capable of generating potential revenue remained outside the tax net.

## **2.12 Absence of database of contractors in construction business**

**2.12.1** Prevention of tax evasion and widening of tax base are two important functions of tax administration. With increasing reliance on voluntary compliance by the tax payers at large, it is essential that the department collects, disseminates and utilizes information from various sources to curb evasion of tax by



unscrupulous assesseees and entities not filing returns of income in each important line of business or profession.

**2.12.2** In spite of large scale computerisation introduced in the department, it does not have database of assesseees according to their business or profession. The existing system of maintenance of demand and collection register and 'blue book' does not provide particulars of business or profession of tax payers to enable the department to assess whether the number covered under tax net compares favourably with the number involved in the business of civil construction or any other large economic activity.

**2.12.3** There is no single source of registration of civil contractor's/builders. In order to ascertain whether all civil contractors/builders were complying with the requirement of filing returns of income and were subjected to assessment, Audit contacted the following departments and collected lists of contractors registered: -

- (a) Central Public Works Departments
- (b) State Public Works Departments
- (c) Municipal Corporations
- (d) State Housing Boards
- (e) Metropolitan Development Authority
- (f) Railways
- (g) Military Engineering Services
- (h) Port Trusts and
- (i) Public Health Engineering Departments

### **Audit findings**

#### **2.13 Avoidable mistakes in the computation of income and tax**

While computing the income chargeable to tax the assessing officer takes profit or loss as per profit and loss account as the starting point and then adds back or deducts the amounts not allowable. Despite instructions issued by the Central Board of Direct Taxes (the Board) from time to time, mistakes including incorrect adoption of figures, arithmetical errors, double allowance of claims, failure to add back the claims originally disallowed by the assessing officer etc. continue to occur suggesting the need for better vigilance and highlighting the fact that internal control mechanism needed to be strengthened urgently and effectively.

**2.13.1** Audit scrutiny revealed that in **11 cases** in Delhi, Karnataka, Orissa, Tamil Nadu and West Bengal there was short levy of tax of **Rs.8.73 crore** due to avoidable mistakes such as arithmetical errors, non-inclusion of agricultural income for the purpose of tax rate, and reduction of income by the assessing officer without assigning any reason.

Two illustrative cases with substantial tax effect are described below:-

**2.13.2** In Delhi charge, the assessment of a company **M/s. Continental Construction Ltd.** for the assessment year 2002-03 was completed in summary manner in May 2003 at an income of Rs.80.89 lakh. Audit scrutiny revealed that the assessee had credited net receipts received from foreign clients of Rs.1.15 crore in the profit and loss account of the previous year. While computing the income, the assessee incorrectly deducted gross receipts of Rs.19.19 crore as against correct amount of Rs.1.15 crore. This was allowed by the assessing officer as well. The mistake resulted in under assessment of income by Rs.18.04 crore involving short levy of tax of Rs.7.57 crore including interest.

**2.13.3** In West Bengal III charge, the assessment of a company **M/s. Sahara India Commercial Corporation Ltd.** engaged in the business of acquisition of land and construction for assessment year 1999-2000 was completed in summary manner in September 2000 determining total income of Rs.16.57 crore with tax liability of Rs.5.80 crore. Audit scrutiny revealed that the total expenditure relating to issue of Gold Bonds was to the extent of Rs.15.01 crore. Since the total tenure of Gold Bonds was 2 years, expenses had been spread over 2 years for the purpose of deduction. Accordingly, Rs.7.50 crore was allowed as deduction during assessment year 1997-98 and the balance of Rs.7.50 crore was allowed as deduction in assessment year 1998-99.

Scrutiny of the profit and loss account for the year ended 31 March 1999 relevant to assessment year 1999-2000 revealed that Rs.1.50 crore being 1/10<sup>th</sup> of the Gold Bond issue expenses had been debited to profit and loss account and the same was allowed in the assessment completed in summary manner in September 2000. As the deduction on account of Gold Bond issue expenses of Rs.15.01 crore had already been allowed in assessment years 1997-98 and 1998-99, the allowance of deduction of Rs.1.50 crore in assessment year 1999-2000 was irregular. The mistake resulted in under assessment of income by Rs.1.50 crore with consequent tax effect of Rs.69.85 lakh.

## **2.14 Failure to observe the provisions of Finance Act**

Tax is chargeable every assessment year in respect of the total income of the previous year of an assessee according to the rates prescribed under the relevant Finance Act. In the case of block assessment, the total undisclosed income of the block period shall be chargeable to tax at the rate of sixty per cent and increased by a surcharge, if any, levied under the Act as applicable in the assessment year relevant to the previous year in which the search is initiated.

**2.14.1** Audit scrutiny revealed that the assessing officers did not adopt correct rates of tax or did not levy surcharge leading to short levy of tax of **Rs.5.40 crore** in **3 cases** in Delhi and Gujarat charges.

One illustrative case where tax effect is more than Rs.5 crore is given below:-

**2.14.2** In Delhi charge, the block assessment of a company **M/s. Ansal Properties & Industries Ltd.** for the block period April 1989 to February 2000 was completed in February 2002 at an income of Rs.73.49 crore. Audit scrutiny revealed that the date of search of the assessee's premises was 10 February 2000 which pertained to previous year 1999-2000 relevant to the assessment year 2000-01. The assessing officer did not levy the applicable surcharge of Rs.5.38 crore.

### **2.15 Incorrect status adopted in assessment**

Where any business is discontinued in any year, and any sum is received after such discontinuance, the receipt should be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt.

In Gujarat, Jamnagar charge, the assessment of **M/s. Govind Jakhu & Co.** for the assessment year 1995-96 was completed on best judgement basis in March 2000. Audit scrutiny revealed that the assessee had received arbitration compensation of Rs.2.61 crore in October 1994 whereas the said firm was already dissolved in April 1990 and the fact of the dissolution was also made known to the assessing officer in August 1990. Since the firm had ceased to exist on its dissolution, it could not have been taxed as firm. The dues/receipts received by the partners were assessable in their hands.

However before finalization of assessment, the principal partner had died. The assessment was therefore, required to be finalized in the name of his legal heir by adopting the status as individual. Incorrect status adopted by the department of the assessee as " firm " instead of 'individual' resulted in under charge of tax of Rs.4.37 crore including interest.

### **2.16 Mistakes in the computation of Business income**

An assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in return, accounts and accompanying documents. In scrutiny assessments, the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment.

Any income by way of dividends, interest or long term capital gains of an infrastructure capital fund or an infrastructure capital company, from investments made on or after 1 June 1998 by way of shares or long term finance in any enterprise wholly engaged in the business of development, maintenance and operations of any infrastructure facility and which has been approved by the Central Government, is exempted for the purpose of taxation. It has been

judicially held\* that transaction in land which is in the assessee's line of business is an adventure in the nature of trade, even if it is a solitary transaction.

**2.16.1** Audit scrutiny revealed that in Gujarat, Jharkhand, Madhya Pradesh, Maharashtra and Orissa there was short levy of tax of **Rs.13.09 crore** in **118 cases** due to mistakes in computation of business income. The mistakes included incorrect carry forward of closing balances, treatment of business income as capital gain, allowance of deduction on account of inadmissible expenditure, change of accounting policy and investment not fully disclosed in accounts. Two illustrative cases where tax effect exceeded Rs.50 lakh are given below.

**2.16.2** In Maharashtra, Mumbai Central-II charge, the assessment of **M/s. Kotex Infrastructure Ltd.**, for assessment year 1998-99 was completed after scrutiny. Assessing officer had exempted long-term capital gains of Rs.15.64 crore derived by the assessee from sale of shares of an infrastructure undertaking, M/s. Gujarat Pipav Port Ltd under section 10 (23G) of the Act. Audit scrutiny revealed that the assessee had purchased shares of the said infrastructure company from an investment company and sold the same to another investment company. The investment was in the nature of speculative transaction as it was not a direct investment in the company. The intention behind the exemption was to boost infrastructure growth by exempting dividends, interest and long term capital gains of an infrastructure capital fund or an infrastructure capital company on investments made by way of shares or long-term finance in an enterprise carrying on or set up to develop, maintain and operate an infrastructure facility. The exemption should accordingly be available only to such assessee who are initial investors. Allowance of exemption to capital gains in the hands of the subsequent investors through speculation would lead to exemption being availed by multiple investors on the same amount of initial investment. This would confer unintended benefit to subsequent investors without effectively aiding infrastructure development. As the investment in this case was not made by the assessee directly in the company, exemption should not have been allowed. Government thus lost revenue of Rs.3.13 crore through such exemption.

**2.16.3** In Orissa, Bhubaneswar charge, the assessment of a company **M/s. B. Engineers and Builders (P) Ltd.** for the assessment year 2000-01 was completed after scrutiny in March, 2003 and for the assessment year 2001-02 in summary manner in March 2002. Audit scrutiny revealed that the assessee was engaged in civil construction other than housing as well as construction of housing projects. As the housing projects were stated to be incomplete, the assessee in the profit and loss accounts, disclosed only contract receipts from civil construction work other than housing. Direct expenditure towards construction of housing projects was shown on the asset side in the balance sheet as "works in progress". But the indirect expenditure like "administrative expenses, financial charges and depreciation", were fully debited to the profit and loss account, which should have

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\* Saroj Kumar Majumdar Vs. CIT 37-ITR-242 (SC)

been proportionately distributed between receipts of the civil construction other than housing and works in progress of housing projects. The assessing officer erroneously allowed the excess expenditure from income of civil construction which resulted in understatement of profit by Rs.46.74 lakh for the assessment year 2000-01 and Rs.95.71 lakh for the assessment year 2001-02 involving short levy of tax of Rs.52.37 lakh for two assessment years.

**2.16.4** Three more cases where tax effect exceeded Rs.35 lakh in each case are in Table 2 below.

(Rs. in lakh)

Sl. No	Name of the assessee/ CIT charge	Assessment years	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Katyayan Constructors and Developers Ltd Mumbai IV	2000-01	143(1)	While computing the business income, diminution in the value of investments of Rs.1.92 crore claimed by the assessee as expenses was allowed even though the assessee had not carried out any business activity. Even otherwise, provision for diminution in investment being only a provision should not have been allowed as deduction.	75.93 Potential
2.	M/s. Patel Engineering Company Ltd Mumbai III	1998-99	143(3)	Tax of Rs.31.63 lakh was deducted at source against consultancy charges paid in foreign currency amounting to Rs.1.46 crore but was not credited to government account. The assessing officer disallowed only Rs.15.53 lakh and not the entire amount of Rs.1.46 crore.	69.42
3.	M/s. Suzlon Developers Pvt. Ltd. Ahmedabad IV	2001-02	143(1)	Insurance premium of Rs.97.40 lakh paid on wind turbine generator was allowed though there was no such purchase made either during the year or in earlier year, as disclosed from the assets in the respective balance sheets of the company.	38.52

### 2.17 Project Completion Method of accounting and its misuse

According to the accounting standards prescribed by the Institute of Chartered Accountants (ICAI) of India, the assessee engaged in civil construction activities

can follow the project completion method for accounting for the results of their business activities. According to this method, profits are to be accounted after completion of the project. Estimation of profits based on receipts or work in progress is another method of accounting for the results of civil construction activities. The department as a matter of practice accepted both the methods.

Audit observations on selected assessments of civil contractors/builders of Maharashtra charge where project completion method of accounting was followed and investigations were deficient and incomplete are indicated in the Table 3 below. Such assessees were not required to declare income even at the prescribed minimum rate of 8 per cent of gross receipts applicable to small contractors having turnover of less than Rs.40 lakh.

There are many instances where the Income Tax Act applies special provisions for taxation of income from specific lines of business or profession which are distinct from the provisions laid down in Companies Act or accounting standards of ICAI. Examples of such instances are depreciation, deemed income, clubbing of income, capital expenditure, taxation of 'zero tax' companies and so on. Government could consider introduction of similar and suitable provisions to tax income from civil construction activities on a presumptive basis, and prevent assessees following 'project completion method' of accounting of receipts from not paying or indefinitely postponing payment of tax.

(Rs. in lakh)

**Table 3: Project Completion Method of Accounting**

Sl. No	Name of the assessee /CIT charge	No. of Projects	Assess-ment year	Under Section	Returned Income	Assessed income	Results of scrutiny of assessments
1	M/s. Kiran Construction Co. City-XXIV	1	2000-01 2001-02	143(3) 143(3)	8.84 8.73	20.78 13.06	The assessee was a municipal contractor of Mumbai and Navi Mumbai who claimed expenses of Rs.72.35 lakh, Rs.78.61 lakh and Rs.38.22 lakh towards payment of labour charges, payment to subcontractors and transport charges respectively for assessment year 2000-01. Similarly, expenses of Rs.70.03 lakh and Rs.23.49 lakh towards labour charges and transport charges respectively were claimed for assessment year 2001-02. As per tax audit report, the contractor had not deducted tax at source on these payments. The assessing officer in his assessment order stated that the expenditure was not genuine as the assessee was not able to prove the same. As such, the entire expenditure should have been added back as against 'ad-hoc' addition of Rs.5 lakh made in each year.. Tax effect involved was Rs.1.58 crore

(Rs. in lakh)

Sl. No	Name of the assessee /CIT charge	No. of Projects	Assessment year	Under Section	Returned Income	Assessed income	Results of scrutiny of assessments
2.	M/s. Vijay Developers City-XXVII	1	2001-02	143(3)	18.33	29.35	The assessee is a builder who adopted project completion method and completed a project in Thane during assessment year 2001-02. The total built-up area measuring 2,78,190 sq.ft. was sold @ Rs.956 per sq ft. whereas the minimum sale price of Rs.1300 per sq. ft. was quoted by the assessee for the same project in a leading newspaper. Though the market rate was higher than the rate at which the flats were sold, the assessing officer did not query the builder on this issue. The assessment order was silent on what basis a lower uniform rate offered by the builder was accepted for the entire built up area/for sale of all flats. Therefore prima-facie income of Rs.1.22 crore had escaped tax. Tax effect involved was Rs.47.98 lakh.
3.	M/s. R.N.A. Builders Central Circle-II	2	1998-99	143(3)	22.17	22.17	Two projects that commenced between 1991-92 and 1995-96 were substantially completed. Out of 395 flats and 14 shops to be constructed, 346 flats and 2 shops were completed and sold for Rs.13.14 crore up to 31 March 1998. The sale proceeds were shown by the assessee on the liability side of balance sheet instead of crediting the same to the profit and loss account on the plea that the profit would be declared in the year in which the last unit of the project was sold or occupation certificate was received from BMC, whichever was earlier. Tax effect was Rs.36.79 lakh calculated on the analogy of section 44AD in the absence of any profit declared in the profit and loss account.
4.	M/s. Satellite Developer City-VII	4	1997-98 1998-99 1999-00	143(1) 143(3) 143(3)	0.81 (-) 307.11 (-) 28.21	0.81 (-) 307.11 (-) 28.21	The assessee was working on four projects. Department accepted loss as returned for assessment years 1993-94 to 1998-99. All indirect expenses viz. administrative expenses, interest etc. were set off against interest earned on surplus funds. No receipts were returned from sale of flats. The gross receipts for the assessment year 1998-99 and 1999-2000 were Rs.6.13 crore and Rs.17.77 crore. The tax effect calculated on the analogy of the section 44AD would be Rs.1.91 crore.

(Rs. in lakh)

Sl. No.	Name of the assessee /CIT charge	No. of Projects	Assessment year	Under Section	Returned Income	Assessed income	Results of scrutiny of assessments
5.	M/s. Kalpataru Construction City-III	1	1998-99	143(3) 143(1)	4.19	192.35	The assessee completed 'Sion project', which was started in 1983 and offered loss of Rs.1.85 crore in assessment year 1998-99 on completion of the project. Had the provisions of section 44AD been applied, profit of Rs.2.28 crore would have been brought to tax resulting in tax demand of Rs.79.94 lakh.

Similarly in respect of eight assesseees who had opted for project completion method of accounting, only Rs.15.90 crore was returned as income for assessment years 1998-99 to 2001-02 against gross receipts on account of sale of flats and other income of Rs.424.20 crore. The government lost revenue of Rs.33.94 crore in these cases which were exempted from declaring income at minimum eight per cent of gross receipts that was mandatory for contractors with a turnover of less than Rs.40 lakh.

## 2.18 Short accountal of gross contract receipts

Any tax deducted at source shall be treated as payment of tax on behalf of the person from whose income such deduction was made and credit shall be given to him for the amount so deducted in respect of the assessment year in which such income is assessable. The related receipts from which the tax was deducted have to be taken into account while computing the assessee's total income.

**2.18.1** Audit scrutiny revealed that in Assam, Bihar, Andhra Pradesh, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal there was short levy of tax of **Rs.49.21 crore** in **232 cases** as related receipts from which tax was deducted were either not taken at all or incorrectly taken into account while computing total income.

**2.18.2** Table 4 below contains instances of under assessment of receipts from contract with significant tax effect.

(Rs. in lakh)

Sl No.	Name of the Assessee	CIT Charge	Assessment Year	Section under which assessed	Income not assessed	Tax Effect
1.	M/s. LCI Shapurji Pallonji	Mumbai XII	1999-2000 2000-01 2002-03	143(1)	2315.14	889.31



(Rs. in lakh)						
Sl No.	Name of the Assessee	CIT Charge	Assessment Year	Section under which assessed	Income assessed	Tax Effect
2.	M/s. PNC Construction Co. Ltd.	Agra-II	2002-03	143(1)	1155.36	458.86
3.	Mrs. Shobha Mohanan Nair	Jamshedpur	2001-2002 2002-2003	143(1)	618.09	232.56
4.	M/s. Vikas & Associates	Delhi	2001-02	143(3)	406.11	209.61
5	M/s. CCAP(formerly Central Concrete & Allied Products	Kolkata IV	1998-99 2002-03	143(1)	468.98	179.68

### 2.19 Non-fulfilment of conditions for computation of income under section 44AD

Audit scrutiny revealed that in Andhra Pradesh, Bihar, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal there was short levy of tax of **Rs.3.22 crore** in **142 cases** on account of violation of special provisions under section 44-AD of the Act.

Mistakes involved were: -

- returning total income at less than 8 per cent of gross receipts without getting their accounts audited under section 44 AB
- including interest income and other receipts in the gross turnover and claiming taxable income @ 8 per cent under section 44 AD whereas the provision was applicable in case of receipts of only civil construction work. Other receipts were separately chargeable to tax.
- receipt on account of supply of labour on contract was omitted to be included in the gross contract receipts for the purpose of computing deemed income.
- claims like depreciation and interest which were not to be allowed were allowed.
- account books were not maintained in cases where the turn over exceeded Rs.40 lakh and returns were accepted by the department without audited accounts.

## 2.20 Incorrect allowance of provisions

A provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for deduction. A mere claim against the assessee is not sufficient to justify the deduction.

It has been judicially held\* that where liability to pay damages is under dispute, such liability would accrue only when the settlement of dispute is made, even if the assessee is following mercantile system of accounting. It was also held\*\* that contingent liabilities do not constitute expenditure and cannot be the subject matter of deduction even under the mercantile system of accounting.

**2.20.1** Audit scrutiny revealed that in Delhi, Gujarat, Maharashtra, Orissa, Uttar Pradesh and West Bengal there was short levy of tax of **Rs.2.78 crore** in **9 cases** as the assessing officer had allowed deduction incorrectly of provisions made for anticipated expenditure.

Two illustrative cases with tax effect exceeding Rs.25 lakh in each case are given below.

**2.20.2** In Uttar Pradesh, Meerut charge the assessment of an assessee **M/s. Kriti Builders, Meerut**, was made in summary manner for assessment year 1999-2000. The assessee derived income from sale of constructed flats and shops. The assessee had debited Rs.2.04 crore to the profit and loss account towards provisions for construction expenses of buildings being cost to be incurred for financial year 1999-2000 and 2000-01. The fact that this expenditure was not incurred had been admitted by the assessee through a note in the details furnished for valuation of closing stock. These expenses were thus not allowable. Mistake in allowing the expenditure resulted in under assessment of income by Rs.1.99 crore involving tax of Rs.1.05 crore.

**2.20.3** In West Bengal III charge, the assessment of a company **M/s. Turnkey International Ltd.** for assessment year 1999-2000 was completed in summary manner in February 2000 determining loss of Rs.2.93 crore. Audit scrutiny revealed that a sum of Rs.1.57 crore being interest on bank over draft was debited to the profit and loss account. There was a dispute between the assessee and the bank as to the quantification of interest liability. The debit in profit and loss account for Rs.1.57 crore allowed in the assessment made in February 2000 was thus to be treated as a provision and not an ascertained liability. Allowance of provision of interest resulted in excess computation of loss having potential tax effect of Rs.55.10 lakh.

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\* CIT Vs Phalton Sugar Works Ltd.-162-ITR-622 (Bombay)

\*\* Shree Sajjan Mills Ltd. Vs. CIT [1985]-156-ITR-685 (SC) and Indian Molasses Co. (P) Ltd. Vs. CIT (1959)-37-IR-66 (SC)

## 2.21 Capital expenditure incorrectly treated as revenue expenditure

Any amount paid on account of current repairs in respect of machinery, plant or furniture used for the purpose of business or profession is allowable as deduction in computation of the income chargeable under the head 'profits and gains of the business or profession'.

Expenditure incurred on acquiring technical know how for the purpose of business which is likely to be beneficial to business in the long run is expenditure of capital nature and can not be treated as revenue expenditure. It has been judicially held\* that grant of technical aid fees for setting up factory and right to sell products as per collaboration agreement is not allowable as revenue expenditure and was to be treated as capital expenditure.

It has been judicially held\* that expenditure incurred on preserving or maintaining an existing asset is current repairs, whereas expenditure incurred for bringing into existence a new asset or on replacement where the cost of replaced part constitutes substantial value of the old machinery would constitute capital expenditure.

**2.21.1** Audit scrutiny revealed that in Assam, Andhra Pradesh, Delhi, Jharkhand, Kerala, Maharashtra, Orissa, Punjab and West Bengal there was short levy of tax of **Rs.20.44 crore** in **31 cases** as share issue expenses, loss on sale of assets, purchase of shuttering material and substantial amount spent on repairs and maintenance etc. were allowed as revenue expenditure though these were capital in nature.

Three illustrative cases where tax effect exceeded Rs.2 crore in each case are given below.

**2.21.2** In Delhi charge, the assessment of a company **M/s. Ircon International Ltd.** for the assessment year 1999-2000 was completed after scrutiny in February 2003. Audit scrutiny revealed that the assessee paid a sum of Rs.4.75 crore on account of technical know how and other agency charges during the previous year relevant to assessment year 1999-2000 and the same was allowed by the assessing officer. As the expenditure would have given benefit of enduring nature, it was required to be capitalized. The omission resulted in underassessment of income by Rs.4.75 crore involving short levy of tax of Rs.2.53 crore including interest.

**2.21.3** In Delhi charge, the assessments of **M/s. National Building Construction Corporation Ltd.** for the assessment years 2000-01 and 2001-02 were completed after scrutiny and in summary manner in January 2003 and February 2003 respectively. Audit scrutiny revealed that the assessee had debited Rs.2.56 crore and Rs.3.42 crore to the profit and loss account of the previous years relevant to the assessment years 2000-01 and 2001-02 respectively on account of loss on

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\* Southern Switchgear Limited Vs. CIT and another-232 ITR 359 (SC)

\* Ballimal Navalkishore and another Vs. CIT-224 ITR 414

revaluation of construction equipments like centering, shuttering, scaffolding, loose tools and lab equipments although the expenditure was required to be capitalized. The omission resulted in excess carry forward of loss of Rs.5.98 crore involving potential tax effect of Rs.2.34 crore.

**2.21.4** In West Bengal, III charge, the assessments of **M/s. Rehabilitation Industrial Corporation Ltd.** for the assessment years 1997-98 to 2000-2001 were completed in summary manner. Audit scrutiny revealed that expenditure on voluntary retirement scheme of Rs.87.08 lakh, Rs.34.43 lakh, Rs.25.57 crore and Rs.62.97 lakh was allowed in the assessments for assessment years 1997-98, 1998-99, 1999-2000 and 2000-2001 respectively. The Board had clarified vide circular no. 200/79/2000-ITA I dated 23 January 2001 that expenditure on voluntary retirement scheme would constitute capital expenditure and the amount charged to profit and loss account was not an allowable expenditure. Mistake in allowing the expenditure resulted in excess computation of loss having potential tax effect totaling Rs.9.67 crore.

**2.21.5** Table 5 below contains three more cases involving tax effect of more than Rs.30 lakh in each case

(Rs. in lakh)

**Table 5: Capital Expenditure treated as Revenue Expenditure**

Sl. No.	Name of the assessee/CIT	Assessment Year	Assessed under section	Nature of mistake	Tax Effect
1.	M/s. Bhagheeratha Engg. Ltd. Ernakulam	1999-2000	143(1)	Rs.1.80 crore was written off as bad debt by the assessee who was not engaged in the business of banking or money lending. This amount represented loan granted by the assessee to a subsidiary company. The loan was to be shown as an asset under the head "Loans & Advances" in the balance sheet, which would have in no way affected the profit and loss account. Hence the amount was not allowable as bad debt.	63.10
2.	M/s. Unitech Ltd. Delhi	1999-2000	143(3)	Expenditure on account of diminution in value of investments was capital in nature and hence not allowable.	47.02
3.	M/s. Bhayana Builders (P) Ltd. Delhi	1999-2000	143(1)	Expenditure on centering and shuttering material was allowed as deduction though it was capital in nature.	34.45

## 2.22 Incorrect allowance of expenditure.

Any expenditure laid out or expended wholly or exclusively for the purpose of business is allowable as deduction in computing the business income of the assessee. Only such expenses are allowable as deduction from income as are relevant to the year. The Act also provides that in computing the business income of an assessee, deduction on account of interest paid in respect of capital borrowed for the purpose of business or profession is admissible.

It has been judicially held\* that any expenses incurred on transactions carried out in violation of provisions of statute in force was not allowable.

**2.22.1** Audit scrutiny revealed that in Assam, Delhi, Maharashtra, Tamil Nadu and West Bengal charges there was short levy of tax of **Rs.5.05 crore** in **45 cases** as expenditure not allowable under the Act was allowed by the assessing officers.

One illustrative case with tax effect of Rs.2 crore is given below.

**2.22.2** In West Bengal IV charge, the assessment of a company **M/s. Hindustan Steel Works Construction Ltd.**, for the assessment year 2000-01 was completed in summary manner in March 2002 at a loss of Rs.104.13 crore. Audit scrutiny revealed that an amount of Rs.5.71 crore being provision of penal interest on account of shortfall of interest in EPF account charged in the accounts for the period ending 31 March 2000 was not reduced from the loss in computation of income. It was noticed that an amount of Rs.1.40 crore on this account was reduced from the loss in assessment year 1999-2000 by the assessee himself. The omission resulted in excess computation of loss to the extent of Rs.5.71 crore with potential tax effect of Rs.2.20 crore.

**2.22.3** Gist of other irregularities noticed are given in Table 6 below.

(Rs. in lakh)

**Table 6: Incorrect allowance of expenditure**

Sl. No.	Nature of mistake	No. of cases	Tax Effect
1.	Expenditure not covered by sections 30 to 43B	16	74.90
2.	Incorrect allowance of expenditure toward land cost	3	10.00
3.	Incorrect allowance of expenditure to earn dividend income	1	2.27
4.	Incorrect allowance of prior period expenses	1	4.73
5.	Non inclusion of mobilization advance in the value of the work completed	1	15.81
6.	Bills receivable not brought into account	13	107.56
7.	Non-inclusion of the amount determined under section 40A(3) in the total income	1	9.46
8.	Incorrect waiver of interest under section 234-B	1	39.91
9.	Mistake in giving effect to appellate order	1	8.29
10.	Under statement of profit not rectified	6	12.25

\* Maddi Venkataratnam & Company Vs. CIT-229-ITR-534 (SC)

## 2.23 Unexplained Expenditure

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the assessing officer satisfactory, the amount covered by such expenditure or part thereof, as the case may be, is deemed to be the income of the assessee for such financial year.

In Delhi charge, the assessment of a firm **M/s. S.K.B. Builders and Fabricators** for the assessment year 1999-2000 was completed after scrutiny in January 2001. Audit scrutiny revealed that the assessee had debited Rs.2.03 crore relating to purchase of building material in the profit and loss account. However, scrutiny of month wise details of purchases furnished by the assessee showed that total purchases of building material amounted to Rs.1.25 crore. The difference of Rs.78.02 lakh debited in excess to the profit and loss account should have been treated as unexplained expenditure and added to the income of the assessee. The omission resulted in underassessment of income by Rs.78.02 lakh involving tax effect of Rs.36.59 including interest.

## 2.24 Incorrect allowance of deduction on account of inter-corporate dividends

No deduction shall be allowed of expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act. Accordingly, expenses incurred in connection with exempted income shall not be treated as admissible expenditure and should be added back to the income. It has been judicially held\* that proportionate management expenses should be deducted from the gross dividend income.

Two illustrative cases where the above provisions were not followed involving tax effect exceeding Rs.50 lakh in each case are given below.

**2.24.1** In Delhi charge, the assessment of a company **M/s. D.L.F. Universal Ltd.** for the assessment year 2002-03 was completed in summary manner in February 2003 at an income of Rs.11.44 crore after allowing exemption of dividend income of Rs.6.94 crore. Audit scrutiny revealed that proportionate administrative expenses of Rs.6.20 crore attributable to dividend income were not deducted in computing the admissible exemption. The omission resulted in under assessment of income of Rs.6.20 crore involving tax effect of Rs.2.46 crore including interest.

**2.24.2** In West Bengal IV charge, the assessments of a company **M/s. Bengal Ambuja Housing Development Ltd.** for the assessment years 2000-01 and 2001-02 were completed after scrutiny in March 2002 and March 2003 respectively and for the assessment year 2002-03 in summary manner in February 2003

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\* CIT V/S United General Trust Ltd.-200-ITR-488 (SC)

determining total income of Rs.91.97 lakh, Rs.2.31 crore and Rs.12.35 crore with tax liability of Rs.4.50 lakh, Rs.91.45 lakh and Rs.4.41 crore respectively. Audit scrutiny revealed that proportionate management expenses incurred to earn dividend that was exempt from tax were not deducted from the gross dividend. Omission resulted in excess allowance of exemption and under assessment of income by Rs.1.19 crore with tax effect of Rs.53 lakh for the three assessment years.

## 2.25 Under statement of sales

All income accruing or arising to an assessee in a previous year relevant to the assessment year is to be included in his total income.

In Delhi charge, the assessment of a company **M/s. Unitech Prefab Ltd.** engaged in the business of ready mix concrete and concrete blocks for the assessment year 1999-2000 was completed after scrutiny in March 2002. Audit scrutiny revealed that the assessee had shown sales of ready mix concrete and concrete blocks amounting to Rs.12.25 crore in the profit and loss account. Against this, the statement of details of sales submitted by the assessee alongwith return of income showed sales of Rs.12.79 crore. Thus the sales were under stated by Rs.53.17 lakh and income to that extent had escaped assessment involving short levy of tax of Rs.28.37 lakh including interest.

## 2.26 Incorrect allowance of deduction

The total income of a person for any previous year includes all income from whatever sources derived which is received or which accrues or arises during such previous year unless specifically exempted from tax under the provisions of the Act. Further, any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

**2.26.1** Audit scrutiny revealed incorrect allowance of deduction of various claims of expenditure in the charges of Andhra Pradesh, Bihar, Gujarat, Haryana, Jharkhand, Kerala, Orissa, Punjab Rajasthan, Tamil Nadu and West Bengal involving tax effect of **Rs.4.27 crore** in **103 cases**.

**2.26.2** Table 7 gives the details.

(Rs. in lakh)

Sl. No.	Nature of Mistake	No. of cases	Tax Effect
1.	Incorrect deduction allowed on account of royalty, hire charges, recovery of sales tax and other deductions.	11	32.05
2.	Incorrect allowance of deduction under section 32AB	1	7.99

(Rs. in lakh)			
Sl. No.	Nature of Mistake	No. of cases	Tax Effect
3.	Deduction allowed in the absence of proof under section 35 AC	1	1.16
4.	Deduction allowed on expenditure of interest from income calculated under section 44AD	3	0.69
5.	Deduction made in excess and also of cost of material supplied departmentally without any documentary proof	44	243.56
6.	Deduction on account of secured advance for the purchase of material	4	47.03
7.	Incorrect debit to profit and loss account	3	31.15
8.	Incorrect deduction of remuneration and interest to partners	36	63.42

Audit scrutiny revealed that in Gujarat, Haryana, Kerala, Maharashtra, Rajasthan and West Bengal, there was short levy of tax or **Rs.4.65 crore** in **62 cases** for the following different reasons: -

- interest on loan borrowed from public financial institution not actually paid was not disallowed.
- liabilities on account of 'sales tax and duty' debited in profit and loss account but not paid within the relevant dates were allowed as deduction.
- provident fund/employee state insurance contribution was not deposited with the concerned authorities within the stipulated date and yet these were allowed as deduction and
- delayed payment of provident fund contributions beyond the grace period was not disallowed.

Two illustrative cases involving tax effect exceeding Rs.1 crore in each case are given below.

**2.27.1** In West Bengal, IV charge, the assessment of a company **M/s. KND Engineering Technologies Ltd.** for assessment year 2001-02 was completed in December 2001 after scrutiny at a loss of Rs.34.32 crore. Audit scrutiny revealed that the assessing officer omitted to disallow Rs.3.62 crore debited to profit and loss account on account of bonus and interest on non convertible debentures as these were not paid within the relevant previous year or within the due date of submission of return of income. Omission to do so resulted in over-assessment of loss to the extent of Rs.3.62 crore with potential tax effect of Rs.1.43 crore

**2.27.2** In Kerala, Ernakulam charge, the assessments of **M/s. A to Z Builder (Pvt.) Ltd.** for assessment years 1998-99 to 2000-01 were completed in summary manner. Audit scrutiny revealed that interest on loan borrowed from a public financial institution (HUDCO) not actually paid was not disallowed under section



43-B resulting in under assessment of income of Rs.3.24 crore and short levy of tax of Rs.2.24 crore.

## 2.28 Incorrect adoption of value of work-in-progress

Income under the head 'Profit and gains of business or profession' shall be computed in accordance with the method of accounting regularly employed by the assessee. In the case of corporate assessee following mercantile system of accounting, the work in progress and closing stock are also to be considered for the purpose of determination of income under section 145 of the Income Tax Act.

**2.28.1** Audit scrutiny revealed that in Andhra Pradesh, Delhi, Haryana, Rajasthan and Tamil Nadu there was short levy of tax of **Rs.5.45 crore** in **14 cases** due to incorrect adoption of values of closing and opening stocks of work-in-progress.

Four illustrative cases with tax effect exceeding Rs.50 lakh in each case are given below.

**2.28.2** In Tamil Nadu, Chennai I charge, the assessment of **M/s. J.P.A.Q Global Solutions Limited (erstwhile Dugar Housing Development India Ltd.)** for the assessment year 1999-2000 was completed in summary manner in December 2000. Audit scrutiny revealed that work in progress in respect of "Park Dugar Project" as on 31 March 1998 in the balance sheet under current assets stood at Rs.3.14 crore. However, this item was removed from current assets as on 31 March 1999 and was not brought into the 'Profit on Construction Projects'. Taking the sale value as adopted on 31 March 1998, receipts to the extent of Rs.3.14 crore had escaped assessment involving short levy of tax of Rs.1.45 crore.

**2.28.3** In Andhra Pradesh, Hyderabad Central charge, the assessment of an individual **Sh. Zulfi Ravedjee**, dealing in construction activity for assessment year 2002-03 was completed in summary manner in December, 2002 at a loss of Rs.2.60 crore. Audit scrutiny revealed that Rs.9.14 crore was debited in the profit and loss account towards 'work-in-progress', carried forward from earlier year. In the absence of any construction business during the earlier year, the said debit of Rs.9.14 crore was not allowable and was required to be added back which was not done, resulting in short computation of income to that extent. The mistake resulted in short levy of tax of Rs.3.02 crore including withdrawal of interest under section 244 A.

**2.28.4** In Tamil Nadu, Chennai III charge, the assessment of **M/s. Macro Marvel Projects Ltd.** for assessment year 2000-01 was completed in summary manner. Audit scrutiny revealed that the opening stock as on 1 April 1998 was incorrectly taken as Rs.1.66 crore instead of Rs.3.11 crore and its adverse impact was not corrected even in assessment year 2000-01. This resulted in under assessment of income of Rs.1.45 crore and short levy of tax of Rs.61.11 lakh.

## 2.29 Incorrect allowance of Depreciation

Deduction on account of depreciation on block of plant and machinery and other assets is admissible provided these are owned by the assessee and used for the purpose of business during the relevant previous year. Depreciation was allowed on intangible assets like know how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature through an amendment of the Act made in Finance (No.2) Act, 1998, w.e.f. 1 April 1999.

**2.29.1** Audit scrutiny revealed that in Andhra Pradesh, Assam, Bihar, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu there was short levy of tax of **Rs.212.78 crore** in **52 cases** as rates of depreciation were not applied correctly, depreciation was allowed on non-depreciable assets and was allowed for full period though the asset was put to use for less than 180 days or not used at all.

Two illustrative cases where tax effect exceeded Rs.70 crore in each case are given below.

**2.29.2** In Maharashtra, Mumbai III charge, the assessment of **M/s. Reliance Ports and Terminals Ltd.**, for assessment year 2000-2001 was completed after scrutiny. Audit scrutiny revealed that the assessee constructed jetties at Sikka Port, Gujarat for the Gujarat Maritime Board primarily to serve imports of group companies at the port. According to the agreement, the assessee was entitled to a concession in wharfage charges on use of jetty, which was to be set off against capital investment made by them. The assessee treated this right to use the jetty as a business/commercial right considering it as an "intangible asset" and claimed depreciation on the cost incurred at the rate of 25 per cent which was allowed.

The assessee was not entitled to any depreciation on the cost of construction of jetty as the entire cost was being reimbursed by the Gujarat Maritime Board by way of a rebate on the wharfage charges which otherwise the assessee was liable to pay in full. Further, this right to use the jetty was not in the nature of any business or commercial right similar to normally accepted intangible assets such as know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature. Entire investment in the jetty was quantifiable, the asset was identifiable and the return from the investment was specified based on which rebate on wharfage was determined. In such circumstances, the right of the assessee to avail reduced wharfage charges could not have been treated as an intangible asset of the company. Allowing depreciation incorrectly on what was clearly not an intangible asset or not a business or commercial right of a nature similar to intangible assets mentioned in the Act, resulted in potential short levy of tax of Rs.137.22 crore.

**2.29.3** In Maharashtra, Mumbai V charge, the assessments of **M/s. Maharashtra State Road Development Corporation** for assessment years

2000-01 and 2001-02 were completed after scrutiny and in summary manner respectively. Audit scrutiny revealed that depreciation on bridges and flyovers was allowed at 25 per cent by the assessing officer as against 10 per cent admissible. This resulted in excess allowance of depreciation of Rs.180.49 crore and short levy of tax of Rs.70.43 crore.

**2.29.4** Table 8 contains three more cases where tax effect exceeded Rs.35 lakh in each case.

(Rs. in lakh)

<b>Table 8: Incorrect allowance of depreciation</b>						
Sl. No.	Name of the assessee	CIT Charge	Assessment Year	Section under which assessed	Nature of mistake	Tax Effect
1.	M/s. ICICI Real Estate Co. Ltd.	Mumbai VI	1999-2000 to 2001-02	143(1)	Depreciation of Rs.6.92 crore on land was incorrectly allowed.	273.79 (P)
2.	M/s. Vijayasanthi Builders	Chennai I	1998-99	147	Excess allowance of depreciation on cinematograph films.	42.61
3.	M/s. Sterling Enterprise Ltd.	Ahmedabad IV	1997-98 to 1999-2000	143(3)	(a) Depreciation allowance of Rs.55.62 lakh was granted at the rate of 100 per cent on plant and machinery without verifying the details. (b) Depreciation of Rs.26.27 lakh was granted at the rate of 20 per cent on building without verifying approved plan and the mode of its actual use.	35.21

### **2.30 Incorrect computation of capital gains**

Any profits and gains arising from the transfer of a capital asset are chargeable to tax under the head 'Capital gains' and taxable in the year in which such transfer takes place. Capital asset means property of any kind held by an assessee, whether connected with his business, profession or not. Short term capital assets means a capital asset, held by an assessee for not more than 36 months immediately preceding the date of its transfer. Capital gains arising from the transfer of short term capital asset is called short term capital gain. Long term capital asset mean a capital asset held by an assessee for more than 36 months immediately preceding the date of transfer. Transfer in relation to a capital asset includes the sale, exchange or relinquishment of the asset, or extinguishment of any right therein.

**2.30.1** Audit scrutiny revealed that in **2 cases** in Gujarat and Madhya Pradesh there was a short levy of tax of **Rs.29.34 lakh** as profits arising from sale of trading assets were taxed as capital gain instead of treating the same as business income and short term capital gain was treated as long term capital gain respectively.

One illustrative case with tax effect exceeding Rs.25 lakh is given below.

**2.30.2** In Madhya Pradesh, Bhopal charge the assessment of **M/s. Shamla Builders** for assessment year 1997-98 was completed in March 2000 at a total income of Rs.49.61 lakh in March 2000 after scrutiny. The assessee was engaged in the business of construction of flats.

Audit scrutiny revealed that the assessee received 12 flats in financial year 1996-97 from the promoters in lieu of transfer of possession of land. These flats were sold in the same year for Rs.50.65 lakh to the end users. However, the title of the land remained with the assessee. The department while completing the assessment treated the amount received as long term capital gain. Since the agreement with the promoter and sale of flats was made in the same financial year and the title of the land remained with the assessee the receipts from sale of flats should have been subjected to tax as short term capital gains. The mistake resulted in short levy of tax of Rs.25.10 lakh including interest.

### **2.31 Income escaping assessment**

The total income of a person for any previous year includes all income from whatever source derived unless specifically exempted from tax. In case, the assessee follows mercantile system of accounting, income arising on accrual basis without its actual receipt is liable to be assessed and taxed in the year of such accrual. Interest paid under section 244A of the Act shall form part of the income of the previous year in which such interest was granted.

**2.31.1** Audit scrutiny revealed that in Andhra Pradesh, Bihar, Kerala, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal there was short levy of tax of **Rs.5.01 crore** in **91 cases** as tax was not levied on compensation received, interest income, refund, commission from sub-contracts and rent received.

One illustrative case is given below.

**2.31.2** In Kerala, Thrissur charge, the assessee **Shri K.V. Mohammed Zakir** received an amount of Rs.2.45 crore on account of "Goodwill" of his proprietary concern which was merged with a company M/s. KAP (India) Projects and Construction (P) Ltd., The sale value of "Goodwill" was to be assessed as long term capital gains in the hands of the individual assessee. The assessment in this case was not made and the amount of Rs.2.45 crore escaped assessment which

resulted in short levy of tax of Rs.73.67 lakh in the hands of Sh. K.V. Mohammed Zakir.

### **2.32 Irregular carry forward and set off of losses**

Business losses which can not be wholly set off against income under any other head of the relevant year can be carried forward and set off against the profits and gains of business or profession of the succeeding eight assessment years. Further no loss is allowed to be carried forward for set-off unless the assessee had filed the return of loss within the due date or within such further time as may be allowed by the assessing officer. Where there is any change in the constitution of the firm it is not entitled to carry forward and set-off losses. Similarly any loss computed in respect of speculation business could be carried forward and set off against profits and gains of another speculation business only.

**2.32.1** Audit scrutiny revealed that in Andhra Pradesh, Karnataka, Kerala, Maharashtra, Orissa and Tamil Nadu there was short levy of tax of **Rs.10.56 crore** in **16 cases** as losses relating to speculation business were set-off against business losses, the higher tax rate applicable was not applied and business losses claimed were allowed though these were not shown in the returns of earlier years.

**2.32.2** In Maharashtra, Mumbai VI charge, the assessment of **M/s. Hinduja Properties Development Ltd. later known as M/s. Aasia Properties Development Ltd.** for the assessment year 1998-99 was completed after scrutiny in March 2001. During the year, the assessee engaged in the purchase and sale of shares and incurred a loss of Rs.4.69 crore. Audit scrutiny revealed that main business of the assessee was consultancy services relating to property development and real estate and not trading, banking or finance business. As such, the loss should have been treated as speculative loss. Failure to disallow the speculative loss of Rs.4.69 crore resulted in under assessment of income to that extent with consequent short levy of tax of Rs.2.02 crore including interest.

**2.32.3** In Maharashtra, Nasik II charge, the assessment of **M/s. Khandesh Builders Ltd.** for assessment year 2002-03 was processed in summary manner in February 2002. During the assessment year, the assessee company sold shares of other companies and incurred a loss of Rs.18.29 crore, which was debited to the profit and loss account. Since the assessee's main business was civil construction, loss incurred from trading in shares, should have been treated as loss from speculative business and should not have been set off against business income. The assessing officer incorrectly allowed the loss resulting in under assessment of income of Rs.18.29 crore and consequent short levy of tax of Rs.7.04 crore including potential tax of Rs.6.99 crore.

**2.32.4** Two more cases where tax effect is more than Rs.25 lakh in each case are given below in Table 9.

(Rs. in lakh)

**Table 9: Incorrect carry forward and set-off of losses**

Sl. No.	Name of the Assessee	CIT Charge	Assessment year	Section under which assessed	Nature of mistake	Tax Effect
1.	M/s. Ashoka Builders & Developers	Nashik I	2001-02	143(1)	The loss of Rs.89.16 lakh incurred by the assessee upto 2000-01 was allowed though it was not eligible for set off in assessment year 2001-02 as there was a change in the status of the firm.	31.29
2.	M/s. Prudential Constructions (P) Ltd.	Hyderabad II	2000-01	143(1)	Speculation loss was incorrectly set off against business income.	25.45

### 2.33 Incorrect relief and exemptions under Chapter VI A

Where the gross total income of an assessee under section 80IB includes any profits and gains derived from any business of an industrial undertaking engaged in development and construction of housing project approved by a local authority, entire profit derived from such housing project shall be exempt from tax. The industrial undertaking should also not have been formed by splitting up or the reconstruction of a business already in existence or by the transfer to a new business of machinery or plant previously used for any purpose.

Certain deductions are admissible from gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to "nil" or loss, no deduction is allowed under Chapter VIA.

**2.33.1** Audit scrutiny revealed that in Andhra Pradesh, Assam, Gujarat, Kerala, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu and Uttar Pradesh, there was short levy of tax of **Rs.14.40 crore** in **22 cases** as deductions under section 80IA and 80IB were allowed on partly completed projects, on contract works which were added to industrial activity subsequently, allowed to a firm instead of a company where the conditions laid down in the Act were not fulfilled, and when the project had started before the specified date and the assessee was not carrying out any infrastructure activity.

Four illustrative cases where tax effect exceeded Rs.1.50 crore in each case are given below.

**2.33.2** In Madhya Pradesh, Bhopal charge, the assessment of a company **M/s. Vinod Kumar Shukla Constructions Private Ltd.** engaged in the business of civil construction for assessment year 1997-98 was completed after scrutiny in March 2000 at an income of Rs.35.79 lakh, after allowing a deduction of Rs.1.07 crore on account of income from construction of a bridge under “Build, Own and Transfer” (BOT) Scheme under section 80-IA. Since the assessee company was formed by splitting up or reconstruction of business already in existence, the aforesaid deduction was not allowable.

Similarly, the assessment for assessment year 1998-99 was completed in December 1999 at an income of Rs.18.80 lakh and rectified under section 154 in March 2000 after allowing a deduction of Rs.3.73 crore under section 80-IA which was not allowable for the same reasons as in assessment year 1997-98. Incorrect allowance of deduction for both the years resulted in underassessment of total income of Rs.4.80 crore with consequential short-levy of tax of Rs.1.79 crore including interest.

**2.33.3** In Maharashtra, Mumbai (Central) charge, the assessment of a company **M/s. Patel Engineering Ltd.** engaged in the business of construction of infrastructure projects for assessment year 2001-02 was completed in summary manner during April 2002 by accepting the income declared. Audit scrutiny revealed that the assessee company claimed deduction of Rs.17.72 crore as profit earned from the business of infrastructure undertaking. As the assessee company was not developing, maintaining and operating any infrastructure project and had merely executed a contract work of infrastructure project, the deduction was not allowable. The mistake resulted in irregular allowance of deduction of Rs.17.72 crore involving short levy of tax of Rs.5.57 crore.

**2.33.4** In Gujarat, Vadodara I charge, the assessments of a company **M/s. Ashvika construction Pvt. Limited,** Vadodara engaged in construction activities for the assessment years 2000-2001 and 2001-2002 were completed in summary manner at incomes of Rs.14.58 lakh and Rs.1.80 lakh in May 2001 and March 2003 allowing deduction of Rs.5.43 crore and Rs.1.88 crore respectively under Section 80- IA.

Audit scrutiny revealed that while working out deduction under Section 80-IA, losses amounting to Rs.8.37 crore determined in the earlier assessment years 1997-98 to 1999-2000, were not adjusted against positive income determined for the assessment years 2000-2001 and 2001-02. The irregular deduction resulted in under assessment of Rs.7.30 crore involving short levy of tax of Rs.2.83 crore.

**2.33.5** In Maharashtra, Mumbai II (Central) charge, the assessment of company **M/s. Sheth Developers Ltd.** for assessment year 2001-02 was completed in

summary manner during February 2002 after allowing deduction of Rs.17.80 crore. Audit scrutiny revealed that receipts considered as qualified for deduction under section 80IB included Rs.5.46 crore earned on sale of land, which was not to be considered as income from housing project, as it was earned on activities other than the specified activity. Failure to exclude the same resulted in excess allowance of deduction of Rs.5.46 crore involving short levy of tax of Rs.1.52 crore.

### **2.34 Irregular refunds**

**2.34.1** Every claim for refund shall be made in the prescribed form and verified in the prescribed manner. No such claim shall be allowed, unless it is made within the specified period. Further, where refund of any amount becomes due to the assessee he shall be entitled to receive, in addition to the said amount simple interest thereon. If the proceedings resulting in the refunds are delayed for reasons attributable to the assessee, whether wholly or in part, the period of delay so attributable to him shall be excluded from the period for which interest is payable.

Audit scrutiny revealed that in **52 cases** in Bihar, Karnataka, Kerala, Rajasthan, Tamil Nadu and West Bengal there was excess refund of **Rs.42.10 lakh** as refunds were granted without production of TDS certificate, claims beyond the specified period were admitted, interest was allowed for delays attributable to the assessee company and incorrect rates of tax applied.

**2.34.2** Any person responsible for paying any sum to any contractor for carrying out any work in pursuance of a contract between the contractor and the Central Government, any State Government or any bodies specified in the Act, shall, at the time of payment deduct an amount equal to two percent of such sum as income tax on income comprised therein. The Act further provides that credit on account of tax deducted at source shall be given to the assessee for the amount so deducted in respect of assessment year for which income is assessable. The Board in its circular No.681 dated 8 March 1994 clarified that where advance payments are made during the execution of the contract and such payments are to be adjusted at the time of final settlement of accounts, tax will have to be deducted at the time of making advance payments.

During execution of work, contractors are paid mobilization advances where the agreements for the work stipulate such payments. These advances are generally for mobilization of men, machinery and material and are recoverable either in lump or in instalments from the running account bills as per the agreement.

In their circular No.5 dated 2 March 2001 the Board had prescribed that credit of tax deducted at source from advance rent will be allowed in proportion in which such income is offered for taxation for different assessment years based on a



single certificate furnished for tax deducted. However no such clarification has been issued for similar transactions of tax deducted on mobilization advances.

In the absence of either a specific provision in the Act or subsequent clarification by Board, assessing officers refunded the entire TDS on mobilization advance in the assessment year relevant to the first year of release of advance without ensuring that the income proportionate to such advance was offered to tax.

Audit scrutiny revealed that in Gujarat charge in four cases for assessment years 1999-2000 to 2002-03 the assessments were completed in summary manner where Rs.34.01 crore was received by the assesseees as mobilization/machinery advance. Tax of Rs.56.98 lakh was deducted at source which was claimed by the assesseees as refund. Assessing officer allowed the same. Since the amount of Rs.34.01 crore represented advance and did not form part of the income of the assesseees, the credit of tax deducted at source of Rs.56.98 lakh was not to be allowed. The assessee would be entitled to claim the credit of tax deducted at source as and when income from utilization of these amounts was returned. Incorrect grant of TDS credits resulted in irregular refund of Rs.56.98 lakh.

### **2.35 Short levy of interest for default in filing the return of income**

Where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two percent (one and half percent from 1 June 1999) per month from the date immediately following the specified due date to the date of filing the return, or where no return is furnished, to the date of completion of regular assessment on the amount of tax determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source.

**2.35.1** Audit scrutiny revealed that in Delhi, Gujarat, Madhya Pradesh, Maharashtra and Tamil Nadu charge there was short levy of tax of **Rs.3.96 crore** in **20 cases** due to adoption of incorrect rate of interest, calculation of periods of default incorrectly and short payment of advance tax.

Two illustrative cases where the tax effect involved was Rs.50 lakh or more are given below.

**2.35.2** In Maharashtra, Mumbai XVII charge, the assessment of **M/s. Magji Mathuradas** for assessment year 1998-99 was completed after scrutiny. Audit scrutiny revealed that interest under section 234B was incorrectly levied after rectification of assessment order at Rs.1.66 crore instead of Rs.4.22 crore due to a mistake in calculation.

**2.35.3** In Delhi charge, the block assessment of **M/s. Soldier Properties and Industries Ltd.** for the block period April 1989 to September 1999 was completed after scrutiny in September 2001 at an income of Rs.30.33 crore with

tax demand of Rs.18.20 crore. Audit scrutiny revealed that interest for delay in submission of return for 5 months (28 December 2000 to 15 May 2001) was levied @ one and one quarter percent per month instead of the correct rate of two percent per month. The omission resulted in short levy of interest of Rs.68.24 lakh.

### 2.36 Delay in remittance of TDS to Central Government account

2.36.1 Audit scrutiny revealed that in Andhra Pradesh, Gujarat, Haryana, Jharkhand, Kerala and Orissa, there was short/non levy of interest/penalty of **Rs.6.24 crore** (interest Rs.1.31 crore and penalty Rs.4.93 crore) in **129 cases** as the tax deducted at source was not remitted in time.

2.36.2 Three cases with substantial tax effect are given in the table below.

(Rs. in lakh)

**Table 10: Non-levy of penalty and interest**

Sl. No.	Name of the assessee	CIT Charge	Assessment year	Interest at minimum rate	Penalty at minimum rate
1	M/s. Sadbhav Engineering	Ahmedabad IV	2001-02	3.02	107.83
2	M/s. KMC Constructions (P) Ltd.	Hyderabad II	2001-02 & 2002-03	33.49	--
3	M/s. Backbone Enterprise Ltd.	Rajkot	1999-2000 to 2002-03	1.03	25.54

### 2.37 Non/Short deduction of tax at source

2.37.1 Audit scrutiny revealed that in Assam, Jharkhand, Karnataka, Kerala, Maharashtra, Punjab and Uttar Pradesh, tax was either not deducted at all or deducted at lower rates. Interest and penalty leviable at the minimum applicable rates in **80 cases** worked out to **Rs.7.91 crore** (interest Rs.3.17 crore and penalty Rs.4.74 crore).

An illustrative case is given below.

2.37.2 In Uttar Pradesh, Central Kanpur charge, in the case of an assessee, **M/s. J.P. Industries, Lucknow**, the assessment was made in summary manner for assessment years 2000-01 and TDS certificates were supplied in support of tax payment. Audit scrutiny revealed that the tax deductor company (M/s. J.P. Power Venture Ltd. Dehradun) had deducted tax at the rate of 0.2 per cent as against applicable rate of 2.2 per cent. This resulted in short deduction of tax at source amounting to Rs.2.98 crore. The tax deductor company was in default under section 201 and was liable to pay interest of Rs.1.76 crore, besides being liable to pay Rs.2.98 crore by way of penalty calculated at the minimum applicable rate.

**2.37.3** In 71 assessments in Maharashtra charge alone, audit scrutiny revealed that TDS amounting to Rs.22.61 crore was not credited into government account within the prescribed time. The delay ranged from 1 to 383 days calculated from the details as disclosed in the TDS certificates filed by the assessees with the return of income. Interest leviable under Section 201 (IA) could not be independently verified due to non availability of returns filed by the tax deductors in TDS Wards.

### **2.38 Acceptance of deposits exceeding Rs.20,000.**

No person shall take or accept or repay any loan or deposit of Rs.0.20 lakh or more, otherwise than by account payee cheque or bank draft. He shall be liable to pay by way of penalty a sum equal to the amount of the loan or deposit so taken or accepted.

**2.38.1** Audit scrutiny revealed that in Haryana, Maharashtra and Uttar Pradesh charges penalty amounting to **Rs.57.71 crore** at the minimum applicable rate in **4 cases** was not levied even though there was non-compliance with the provisions of the Act in this regard.

Two illustrative cases where penalty would have exceeded Rs.4 crore each are given below.

**2.38.2** In Maharashtra, Mumbai VII charge, the assessment of a company **M/s. Satellite Developers (P) Ltd.** for assessment year 1999-2000 was completed after scrutiny and for assessment years 2000-01 and 2001-02 in summary manner. Audit scrutiny revealed that the assessee company had taken and repaid loans/deposits amounting to Rs.52.72 crore in form other than cheques and demand drafts for the three assessment years. Department did not initiate any penal proceedings resulting in non-levy of penalty under section 271 D amounting to Rs.52.73 crore at the minimum prescribed rates.

**2.38.3** In Maharashtra, Mumbai V charge, the assessment of a company **M/s. Shreepati Developers (P). Ltd.** for assessment year 2002-03 was completed in summary manner in January 2003. Audit scrutiny revealed that the assessee company had accepted loans amounting to Rs.4.86 crore in form other than cheques and demand drafts during the previous year pertaining to the assessment year. The department had not initiated any penal proceedings. This resulted in non-levy of penalty under section 271 D amounting to Rs.4.86 crore at minimum applicable rates.

### **2.39 Filing of unaudited accounts**

Audit scrutiny revealed that in Andhra Pradesh, Assam, Gujarat, Haryana, Jharkhand, Kerala, Punjab and Tamil Nadu, penalty of **Rs.62.12 lakh** was not levied in **60 cases** where the accounts submitted by the assessee were not audited.

## **2.40 Deficiencies in assessment and inadequate co-ordination within the department**

Where the assessing officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such income. Assessing officers are required to coordinate effectively and promptly with their counterparts in the department to ensure that income/receipts are brought to tax correctly in the hands of all concerned parties/persons.

The Board issued instructions (November 1973, April 1979 and September 1984) for ensuring proper co-ordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and different direct tax assessments viz. wealth tax, gift tax and interest tax, so that there was no evasion of tax.

**2.40.1** Audit scrutiny revealed that these instructions were not complied with strictly by the department which resulted in short levy of tax of **Rs.2.24 crore** in **20 cases** in the Andhra Pradesh, Guajrat, Karnataka, Maharashtra, Tamil Nadu and West Bengal charges.

Two illustrative cases are given below.

**2.40.2** In Maharashtra, Mumbai charge, audit scrutiny of income tax records of **M/s. Eastern Ceramics Ltd** for the assessment year 2000-01 revealed that the assessee company converted its land in industrial zone into residential zone by obtaining necessary approval from municipal authorities. Accordingly, the assessee owned urban land liable to wealth tax on the valuation dates relevant to assessment years 1995-96 to 1999-00. The said property was sold during the previous year relevant to assessment year 2000-01. However, neither did the assessee file the returns of wealth tax nor did the department initiate any wealth tax proceedings. Based on the valuation made by the assessee as on 31 March 1992 at Rs.12.94 crore (as base) and applying cost inflation index specified for computing capital gains, wealth had escaped tax resulting in short levy of wealth tax of Rs.1.05 crore.

**2.40.3** Audit scrutiny revealed that there was an agreement between **M/s. Sterling Infotech Limited** assessed in CIT III, Chennai and M/s. Arihant Foundations and Housing Limited assessed in CIT (Central) I, Chennai for construction of a building for Rs.15.01 crore by the latter company for the former company. Audit could not verify the correctness of the amount of receipts from this particular contract to M/s. Arihant Foundation and Housing Limited as there were no details and the return was processed in summary manner. However, audit scrutiny of the return of M/s. Sterling Infotech Limited for assessment year 2001-02 processed in summary manner revealed that tax amounting to Rs.42.05 lakh was not deducted at source from the amount of Rs.20.01 crore paid to M/s.

Arihant foundations and Housing Limited for the construction of a building as per the agreement.

**2.40.4** Audit scrutiny revealed that in 4 cases in Maharashtra charge for assessment year 1998-99 and 2000-01, Rs.4.96 crore was paid as compensation and transfer of development rights. Assessment records produced did not indicate whether details of such payments were passed on at all to the assessing officers who had jurisdiction over the recipients. Audit therefore could not ensure that the department had taken all possible action under the Act and had brought the receipts to tax in these cases.

#### **2.41 Non-verification of certificates of tax deduction at source**

Under the Board's instructions issued in September, 1990, a small percentage of TDS certificates presented to the assessing officer with the returns of the income were required to be verified by the assessing officer with reference to the records of concerned ITO (TDS) before giving credit for such TDS as a safeguard against wrong and bogus claims. The percentage of certificates to be subjected to cross verification was left to the discretion of respective CCITs/CITs. Again in the orders issued by Board in October, 2000 even the small percentage prescribed earlier was dispensed with and the assessing officers were given discretionary powers to cross verify TDS certificates wherever the quantum of tax deducted or the credibility of the deductor or deductee assessee warranted such cross verification.

Audit scrutiny revealed that in Haryana, Jharkhand, Kerala and Punjab, credit for TDS was allowed without verification of certificates from deductors or from TDS wards in **149 cases** which involved tax credit of **Rs.1.39 crore**. Efforts of audit in conducting a verification of these certificates with the TDS returns did not prove fruitful as these returns were not made available.

#### **2.42 Conclusions and Recommendations**

**2.42.1** Assessment of builders/contractors, who take recourse to the project completion method, may be taken up only after scrutiny in the year in which project has been completed. The stage of project completion could also be defined/specified so that as soon as the project is substantially completed and sale of the properties commenced, the project could be deemed to be suitably and proportionately completed. Failing such a step, the income/profits would be indefinitely kept out of the tax net making it easy for the assessee to escape being taxed. The cases could be kept under compulsory scrutiny even for two to three years after the project is deemed to be completed to ensure that turnover/sale proceeds are correctly computed and offered.

**2.42.2** Government may bring in suitable amendment in the Act to levy more stringent penalties for non maintenance of accounts by assessee engaged in civil construction whose turnover exceed Rs.40 lakh.

**2.42.3** Quoting of Permanent Account Number (PAN) and address of the assessing office in the agreement or contract may be made compulsory so as to ensure assessment of correct income in the hands of the contractor

**2.42.4** Monetary limits may be prescribed for mandatory cross verification of TDS credits to safeguard the interest of revenue.

**2.42.5** The person registering the document for the execution of contract could be bound by statute to furnish details to the assessing officer of all cases where the value of transaction exceeds rupees one crore.

**2.42.6** Obtaining tax clearance certificate before registration of immovable property in excess of a threshold level of monetary value may be prescribed in the Act and made mandatory.

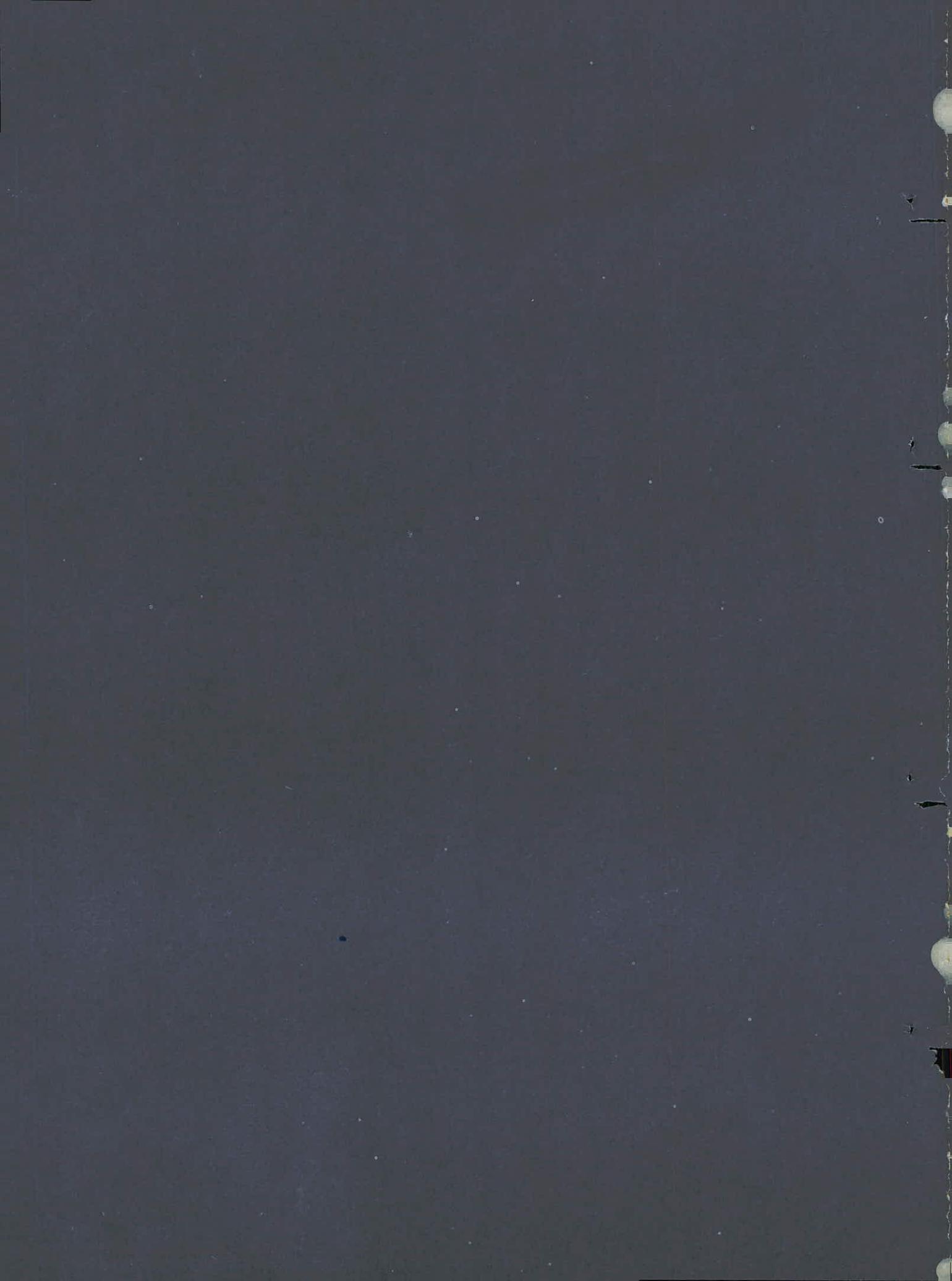
**2.42.7** Government may issue clarification to the effect that the tax deducted at source on mobilization/machinery advance may be allowed only in proportion to the income relating thereto which is offered for taxation in an assessment year.

**2.42.8** Government may also like to issue clarification restricting the benefit of exemption of long term capital gains to direct investment in infrastructure companies or funds, which will prevent exploitation of the benefit by investors through speculation in secondary market operations.

# Chapter III

## Assessment of private schools, colleges & coaching centres

- Highlights
- Introduction
- Audit findings
  - Failure to evaluate the genuineness of exemption claimed by educational institution
  - Exemption of income irregularly without obtaining requisite approval/registration
  - Income of Coaching centres exempted irregularly
  - Exemption of investments made in unspecified modes
  - Unexplained credits/donations/deposits in the name of sister concerns not taxed
  - Contributions/donations received without specific directions and capital gains not taxed
  - Weakness in administration of law
  - Inadequacies in law
- Audit recommendation





## Highlights

- Audit reviewed assessments of private schools, colleges and coaching centres with a view mainly to assessing the effectiveness of implementation of the taxation policy effective from 1 April 1999 which laid down that exemption of income of educational institutions should be granted only after ensuring genuineness of their activities and their compliance with the Income Tax Act.

**(Para 3.6)**

- Audit prepared, on the basis of information obtained from different sources, a database of 62,279 private schools, colleges and coaching centres which were other than those funded by Government. Lists from the database were segregated and forwarded to the respective CITs during January 2003 and February 2003 for confirmation of receipt of returns or otherwise from these institutions. No response was received from the CITs.

**(Para 3.5)**

- There were 2110 assessment units of income tax department under the audit jurisdiction of the selected field audit offices. Audit selected 855 assessment units, could collect assessments of only 10,376 educational institutions from their records and examined 5,558 assessments.

**(Para 3.6.2)**

- Department did not have a database of educational institutions and coaching centres though such a tool would have enabled effective monitoring of the activities of the institutions and assisted in devising a strategy to ensure that income of only genuine educational institutions not working for purpose of profit was exempt from tax.

**(Para 3.8)**

- Department failed to evaluate genuineness of exemption claimed by educational institutions as 95 percent assessments had been completed in summary manner.

**(Para 3.9.3)**

- Audit noticed mistakes in 650 cases involving tax effect of Rs.174.18 crore relating to several procedural lapses/irregularities, incorrect application of income, income escaping tax, irregular donations, cases of diversion of funds for non charitable purposes and other omissions. This indicated that the Ministry needed to tighten the implementation of tax laws and strengthen the tax administration in this important area.

**(Para 3.13)**

- Audit noticed that assessing officers committed the following mistakes:
  - exempted income irregularly without obtaining requisite approval/ registration from the prescribed authority in 129 cases where tax implication was Rs.59.24 crore.  
**(Para 3.17 to 3.20)**
  - exempted income without the institutions fulfilling the prescribed conditions or even without claiming exemption or under incorrect sections in 29 cases involving tax effect of Rs.5.72 crore.  
**(Para 3.21 and 3.29)**
  - exempted income of coaching centres erroneously instead of assessing them under the normal provisions applicable to business in 10 cases involving tax effect of Rs.1.62 crore.  
**(Para 3.22)**
  - gave irregular exemption even when income was accumulated beyond the prescribed percentage in 33 cases involving tax effect of Rs.7.93 crore.  
**(Para 3.27)**
  - exempted investments made in unspecified modes in 38 cases involving tax effect of Rs.16.81 crore.  
**(Para 3.28)**
  - did not tax unexplained credits/deposits/donations made in the name of sister concerns etc in 10 cases involving tax effect of Rs.3.96 crore.  
**(Para 3.31)**
  - exempted 'capitation fee' receipts in 8 cases involving tax effect of Rs.34 crore.  
**(Para 3.34)**
  - allowed depreciation on capital assets whose cost had already been treated as application of income in 34 cases involving tax effect of Rs.5.55 crore, and  
**(Para 3.35)**
  - did not tax contributions/donations received without specific direction and capital gains in 76 cases involving tax effect of Rs.21.12 crore.  
**(Para 3.39 and 3.40)**

- Audit recommend that:
  - a single section/clause be introduced for exemption of educational institutions whether run by trusts or other than trusts. Two separate clauses providing exemption under section 10(23C) and 11&12 overlap each other and are being misused by educational institutions.  
**(Para 3.45.1)**
  - every educational institution may be mandatorily made to submit audited accounts along with return of income every year whether its annual receipts are less than Rs.one crore or more or financed from government funds or not. In the absence of such a mandate, the department had no effective tool to monitor the activities of educational institutions and ensure their compliance with the Income Tax Act.  
**(Para 3.45.3)**
  - more severe penal clauses may be introduced to prevent or deter misuse of income/surplus generated for other than educational purposes as charging maximum marginal rates for unauthorized usage has not proved be an effective enough deterrent.  
**(Para 3.45.6)**



## Assessment of private schools, colleges & coaching centres

### 3.1 Introduction

With a view to encouraging the promotion and development of education, income of educational institutions established solely for the purpose of education either on no-profit basis or run by charitable trusts has been exempted from levy of income tax subject to certain conditions. A large number of private schools, colleges and coaching centres have also come up whose income is not so exempted from levy of income tax. It is required of the Income Tax Department to ensure through the operation of the Income Tax Act that incomes of only genuine and eligible institutions are exempted from levy of income tax and correct amount of tax is paid by all institutions not so exempt.

### 3.2 Tax Policy and laws

Income Tax Act, 1961, (the Act) provides for exemption of income of educational institutions as given below.

#### 3.2.1 Educational Institutions run by Trusts

Sections 11, 12 & 13 of the Act, inter alia deal with exemption in respect of income of educational institutions run by charitable trusts. Section 2(15) defines "Charitable purposes" to include relief of the poor, education, medical relief and the advancement of any other object of general public utility. These institutions are required to fulfill certain conditions to be eligible for availing exemption of income as given below:

**Table 1: Prescribed conditions to be eligible for availing exemption of income**

Sl No.	Section of the Act	Subject	Prescribed conditions
1	11(1)	Application of income	Institution is permitted to set apart and accumulate 15* percent of income for 5 years for application to educational purposes and such amount will be exempt from tax.
2	11(5)	Investment of accumulated income	Accumulated funds are required to be invested in the specified modes such as post office, nationalised banks, public companies etc.
3	12A(a)	Registration	Educational institution is required to obtain registration from CIT within one year from the date of its creation.
4	12A(b)	Audited accounts	Educational institution is required to enclose audited accounts and audit report with the return of income if income exceeds Rs. 50,000 in previous year without giving effect to sections 11&12 of the Act.

\* Prior to assessment year 2002-03, the institution was permitted to accumulate 25 percent of income for 10 years.

### 3.2.2 Educational Institutions run other than by Trusts

- **Upto assessment year 1998-99**

Income of educational institutions existing solely for educational purposes and not for purposes of profit was exempted under section 10(22) of the Income Tax Act. Such institutions could be run by any entity such as individual, Hindu Undivided Family, association of persons, firms, company and so on. No mechanism was however prescribed under the Act through which the Income Tax Department could independently ensure that the institutions exist solely for educational purposes and not for purposes of profit. These were not required mandatorily to file returns of income till assessment year 2003-04.

- **With effect from 1 April 1999**

The memorandum explaining the provisions in Finance Bill 1998, recognized that section 10(22) was reported to be widely misused in the absence of any monitoring mechanism for checking the genuineness of the activities of these institutions. This clause of the section was therefore, omitted. It was clarified that educational institutions, which are of charitable nature but not registered as trusts may now claim exemption of income with certain conditions as applicable to charitable trusts. In appropriate cases, Central Government may also grant exemption by issuing a notification.

### 3.2.3 Following tax laws have been enacted:

- An educational institution existing solely for educational purposes and not for purposes of profit and which is wholly or substantially financed by the Government was exempt from levy of tax, **under section 10(23C) (iiiab)**.
- An educational institution existing solely for educational purposes and not for purposes of profit whose aggregate annual receipts did not exceed Rs.1 crore was exempt, **under section 10(23C) (iiiad)**.
- An educational institution existing solely for educational purposes and not for purposes of profit with annual receipts of more than Rs.1 crore could claim exemption of income after obtaining approval from the prescribed Income Tax authority for a period not exceeding three assessment years at any one time provided it applied its income exclusively to the objects for which it was established, **under section 10(23C) (vi)**.

**3.2.4 Coaching Centres** The Act does not separately deal with exemption of income of coaching centres. It has been judicially\* held that coaching of students for particular examination does not amount to imparting education and such coaching institute is not a charitable institution within the meaning of section

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\* Bihar Institute of Mining and Surveying Vs CIT (208 ITR 608) (Patna), and Aditanar Educational Institutions Vs Addl. CIT in 224 ITR 310 and Lok Siksha Trust Vs CIT in 10 ITR 234 (Supreme Court)

2(15) of the Act. Accordingly, coaching centres are not educational institutions existing for charitable purposes falling within the ambit of sections 10, 11 and 12 of the Act. As such, exemptions described above are not available to them. Their income is to be taxed under the provisions applicable to normal business under sections 15 to 59 of the Act.

### **3.2.5 Salient features of changes in law after 1 April 1999**

- Educational institutions run other than by trusts, could accumulate upto 25 percent of income with effect from assessment year 2000-01 which could be applied to educational purposes within a period of ten years in line with the facility available to educational institutions run by charitable trusts.
- Finance Act, 2002 reduced the percentage of accumulation of income from 25 percent to 15 percent and the period of 10 years to 5 years and these changes have been made applicable to educational institutions run both by trusts and other than trusts with effect from assessment year 2002-03.
- Finance Act, 2003 inserted section 139(4C) which provided that if the total income of any educational institution not working for the purpose of profit exceeded the taxable limit without giving effect to provisions of section 10(23C)(vi), such institution shall furnish its return of income failing which penalty of Rs.100 can be imposed for each day of default under section 272A(2)(e) of the Act. However, educational institutions covered under section 10(23C) (iiiab) & (iiiad) have been left out of the purview of filing returns of income under this provision.
- It has also been provided that where the educational institutions are approved under section 10(23C)(vi) and the prescribed authority is not satisfied about genuineness of their activities or whose activities are not being carried out in accordance with the conditions subject to which these were approved, it may after giving a reasonable opportunity, withdraw the approval.

### **3.3. Objectives**

Audit reviewed the efficiency of assessment of various educational institutions, with a view to ascertaining:

**3.3.1** whether all private schools & colleges and coaching centres are on the records of the Income Tax Department and are subject to assessments;

**3.3.2** whether adequate steps have been taken by the department to bring all the private schools & colleges and coaching centres into the tax net and results of such efforts are quantified;

**3.3.3** the extent of irregularities and mistakes of commission and omission in the assessments of the institutions;

**3.3.4** whether there exists any machinery within the department to exercise adequate and necessary checks in this area of potential and reported misuse; and

**3.3.5** whether tax laws have been enacted with clear, unambiguous and effective provisions for their administration and for prevention of abuse or misuse.

### **3.4 Scope of review**

Review covered assessments of selected private educational institutions, schools, colleges and coaching centres run either by charitable trusts or by private management imparting education including in the fields of computer, banking, civil services, medical, engineering, higher education etc completed during the period 1999-2000 to 2001-02. Some cases pertaining to earlier assessment years have also been selected to assess the efficiency of administration of the exemptions claimed under section 10(22) of the Act.

### **3.5 Audit methodology**

Audit prepared a database of 62,279 private schools, colleges and coaching centres which were other than those funded by Government, from different sources such as advertisements appearing in newspapers and magazines, Directorates of Education, telephone directories etc. These educational institutions were thereafter classified CIT wise based on their addresses/geographical location and separate lists were prepared. Such lists were forwarded to the respective CITs during January 2003 and February 2003 for confirmation of receipt of returns or otherwise from these institutions. No response was received from the CITs confirming receipt of returns of these institutions. Audit thereafter, could locate assessments of 10,376 educational institutions from the demand and collection registers of selected assessing units.

### **3.6 Sample size**

There were 2110 assessing units (524 offices of DCITs/ ACITs and 1586 offices of ITOs) in the audit jurisdiction located in 17 states namely, Andhra Pradesh, Assam, Bihar, Delhi, Gujarat, Himachal Pradesh, Jharkhand, Kerala, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, West Bengal and Uttar Pradesh.

**3.6.1** Audit covered 50 percent offices of DCITs/ACITs and 25 percent offices of ITOs in metro cities and 75 percent offices of DCITs/ACITs and 25 percent offices of ITOs in other cities. 100 percent of assessments completed after scrutiny were selected. 50 percent of assessments completed in summary manner were selected in metro cities and 25 percent in other than metro cities.

**3.6.2** Based on the above sample size, audit selected 855 assessment units (322 offices of DCITs/ACITs and 535 offices of ITOs) and examined assessments in respect of 5,558 educational institutions out of 10,376 educational institutions found recorded in the selected assessment units.



### 3.7 Constraints

The department does not maintain any separate database of educational institutions. Audit had to collect details of assessments in respect of educational institutions by referring to demand and collection registers of selected assessment units and experience of previous audits.

3.7.1 The department did not produce requisitioned assessment records to audit as shown below:

**Table 2: Non production of records by the department**

Name of state	No. of records called for by audit	No. of records not produced to audit	Percentage of non production
Kerala	1050	946	93
Orissa	79	30	38
Jharkhand	259	159	57
Rajasthan	290	58	20
Tamil Nadu	336	84	24
West Bengal	1209	67	6
Delhi	1090	721	66
Gujarat	1911	1160	61
<b>Total</b>	<b>2392</b>	<b>1344</b>	<b>56</b>

3.7.2 Assessing officers generally stated that records were not produced because of non existence of separate and exclusive database of such institutions and also dislocation of records consequent to restructuring of the department. It was, however, essential that department should have maintained data of such institutions for exercising control over receipt of returns of income and ensuring compliance with the Act. Further, more than two years had elapsed after restructuring of the department within which time assessment records should have been handled, stored and documented properly.

3.7.3 Draft audit reviews of effectiveness of assessments of private schools, colleges and coaching centres were forwarded to the respective CCITs/CITs (Audit) by the field audit offices between July 2003 to September 2003 for their comments. Review report was issued to Ministry on 18 November 2003. Reply was awaited.

### 3.8 Database of educational institutions

There is no systematic and organized approach in the department to ensure that all educational institutions which are required to fulfill certain obligations under the Act are in fact doing so before claiming the prescribed benefit or exemption. Though the Act has been amended through Finance Act, 2003 making it obligatory on the part of educational institutions not working for the purpose of profit to file the return, audit noticed that no specific guidelines or monitoring

mechanism have been introduced to ensure that amendment could be given effect to by the assessing officers.

**3.8.1** Out of the database of 62,279 educational institutions collected from different sources, audit could locate only 10,376 institutions from the demand and collection registers of 855 selected assessment units against the total existing 2110 assessment units.

**3.8.2** The department had not made any effort to identify revenue potential in this field by effective co-ordination and correlation with the state government or universities or other regulatory authorities. The department could have effectively exercised control over receipt of return by serving notices to the defaulting private schools/colleges and coaching centres by keeping track through a proper control mechanism after compiling the data themselves. Department started serving notices to the assessee after audit requisitioned assessments for review.

### 3.9 Non selection of assessments for scrutiny

The department completed 95.5 percent of the assessments of educational institutions selected by audit only in summary manner during the period 1999-2000 to 2002-03 as shown below:

<b>Name of state</b>	<b>No. of assessing units selected by audit</b>	<b>Total number of assessments made</b>	<b>No. of scrutiny assessments</b>	<b>No. of summary assessments</b>	<b>Percentage of scrutiny assessments</b>
Delhi	59	690	78	612	11.3
Andhra Pradesh	71	1242	130	112	10.5
Karnataka	63	334	27	307	8
Maharashtra	61	1242	47	1195	3.8
West Bengal	37	1142	44	1098	3.9
Rajasthan	61	564	14	550	2.5
Tamil Nadu	85	1640	23	1617	1.4
Punjab	60	290	1	289	0.34
Orissa	18	630	Nil	630	Zero
<b>Total</b>	<b>515</b>	<b>7719</b>	<b>348</b>	<b>7719</b>	<b>4.5</b>

**3.9.1** In Maharashtra charge, all 402 assessments of educational institutions in Thane, Kolhapur, Nagpur, Aurangabad charges during the years 1999-2000 to 2001-02 were completed in summary manner.

**3.9.2** The department completed about 97 percent of all assessments in summary manner in 2000-01 and 2001-02. Unless cases involving fulfillment of special conditions for claiming exemption of income such as the assessments of educational institutions are identified and adequate number are selected for scrutiny, the department will have no means to ensure effective compliance of law in such cases.

**3.9.3** Audit scrutiny revealed that the department was not in a position to ensure application of the special provisions of the Act in respect of educational institutions in 95 percent of cases available with the assessing officers that were completed in summary manner. Board have not issued any specific instruction for selection of cases for scrutiny relating to the educational institutions during the period covered in this review.

### **3.10 Widening the tax base of educational institutions**

Prevention of tax evasion and widening of the tax base are two of the most important functions of the department and could be achieved through the performance of Central Information Branch and survey operations.

### **3.11 Central Information Branch (CIB)**

In order to fulfill the above objects the department had, with effect from 1 July 1997, commissioned Central Information Branch (CIB) under a Commissioner which collects information about assessees from different sources with respect to their potential for yielding income tax and passes it to the concerned assessing officers. Thereafter, the assessing officers are required to initiate appropriate action under the Act to call for returns and/or examine the specific information in assessments.

**3.11.1** Audit noticed that CIB had not collected and passed on any information to the assessing officers in respect of educational institutions of assessing units selected for review, during the period 1999-2000 to 2001-02. In Rajasthan, however, CIB collected 81 cases of educational institutions in Jaipur, Alwar, Udaipur, Ajmer and Kota charges of which details in respect of 10 cases falling in Udaipur, Ajmer and Kota charges were passed on to the assessing officers which were brought into the tax net. In other charges, assessing officers stated that the above information could not be collected as the required code for private schools/colleges and coaching centres was created by the Board vide their instructions issued only in October 2002.

### **3.12 Survey operations**

The assessing officers are empowered under sections 133A & 133B of the Act to survey the business premises of the taxpayer to locate assessees and unearth unaccounted income.

**3.12.1** Audit examined the records of CITs (Investigating Circles) to see whether the department had taken adequate steps to bring all the private schools, colleges and coaching centres into tax net during the period 1999-00 to 2001-02 through the mechanism of survey.

**3.12.2** Audit noticed that no surveys were conducted in Mumbai, Thane, Pune, Aurangabad, Kolhapur and Nagpur. In Delhi, only one CIT confirmed that no

surveys were conducted and other 13 CITs did not furnish reply. In Tamil Nadu charges, DIT (Exemption) and CIT-VIII Chennai confirmed that no such surveys were conducted and replies from 16 CITs were awaited. In Andhra Pradesh, only one private educational institution in Visakhapatnam charge and 7 in Vijayawada charge were brought into the tax net. In Rajasthan, department conducted 1138 surveys and only one educational institution was brought into tax net. In other charges, no surveys were reported to be conducted.

**3.12.3** Department should utilise powers of survey operations effectively and efficiently to widen the tax base in respect of educational institutions.

### **3.13 Results of examination of assessments of educational institutions**

Audit noticed 650 cases involving tax effect of Rs.174.18 crore relating to procedural lapses/irregularities, incorrect application of income, diversion of funds for non charitable purposes, income escaping assessment and non-levy of penalty for non filing of returns and other omissions during examination of assessments of private schools & coaching centres, as narrated below.

#### **3.14 Procedural lapses/irregularities**

#### **3.15 Irregular exemptions without approval/registration from prescribed authority**

An educational institution existing solely for educational purposes and not for the purpose of profit and whose aggregate annual receipts exceed Rs.one crore is required to obtain an approval from the prescribed authority for claiming exemption of income. The assessee has to submit its application in the prescribed form to the Board /DGIT\* for approval which shall have effect at any time for a period not exceeding three years.

**3.15.1** With effect from 1 April 1997, every trust needed to obtain registration to become eligible to claim exemption of income under sections 11&12. The assessee has to make an application for registration to the CIT either before 1 July 1973 or within one year from the date of creation of trust. If application is made after expiry of the aforesaid period, the Commissioner on reasonable grounds may condone the delay. Every order granting or refusing registration shall be passed before the expiry of six months from the end of the month in which the application is received.

**3.15.2** Above provisions indicate that educational institutions run either by non trusts or trusts could claim exemption of their income under both the sections 10(23C)(vi)/11&12 according to their convenience as these sections are not mutually exclusive in operation. There is no mechanism in the department to ensure that exemption of income is granted only to those institutions who have obtained approval/registration from prescribed authority. Further there is no time

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\* with effect from April 2001 to CCIT/ DI (Exemption)

limit for granting approval or rejection under section 10(23C)(vi) and there is no specific provision for dealing with cases whose applications are pending for approval for any reason. The assessing officer is not competent to grant exemption of income in such cases without approval of prescribed authority.

**3.15.3** Audit scrutiny of assessment records of educational institutions revealed irregularities and violation of the provisions mentioned above as given below:

**3.16 Approvals under section 10(23C)(vi) were pending for a long period**

Audit noticed delays in grant or rejection of approvals under section 10(23C) (vi) of the Act. In Maharashtra charge, as on 31 March 2003, 103 cases were pending approval for exemption. Out of 103 cases, 88 were pending with DI (Exemption) Mumbai alone. Out of 88 pending cases, 24 were pending for more than two years, 33 were pending for more than one year and institutions were claiming exemption under section 10(23C)(vi) without approval of prescribed authority. Thus the objective of introducing the new provision 10(23C)(vi) for grant of approval after examination of the genuineness of the activities of such institutions has not been served.

**3.17 Exemption of income without approval of prescribed authority**

**3.17.1** In Karnataka, Bangalore charge, assessments of **Desheeya Vidyashala Samithi, Shimoga.** and **Education Society of Sisters of St. Joseph of Cluny, Bangalore** for the assessment years 1999-00 to 2001-02 were completed in a summary manner between January 2000 and March 2002. Audit scrutiny revealed that though the annual aggregate receipts of the institutions crossed Rs.1 Crore they did not either get themselves approved by the prescribed authority under section 10(23C) (vi) or get recognized under section 12 A of the Act. However, the assessing officer exempted the income though he was not competent to do so. Non-compliance of either of the provisions viz. sections 10(23C)(vi) or 12A of the Act required withdrawal of exemption. Failure to disallow the exemption resulted in under assessment of income totalling Rs.81.32 lakh with consequent non levy of total tax and interest of Rs.30.51 lakh.

**3.17.2** In Tamil Nadu charge, seven cases of educational institutions run by trusts were noticed where there was no evidence available in the records regarding submission of application for approval under section 10(23C)(vi) by the assesseees. In another six cases, the institutions had submitted application but approvals of the prescribed authority granting exemption were not available on record. However exemption was allowed by the assessing officer in these cases without approval from prescribed authority. These cases attracted levy of tax of Rs.6.73 crore.

**3.17.3** In Delhi, DIT (Exemption) charge, the assessing officer completed the assessments of three educational institutions, **Obero Educational Society, St. Joseph Academy** and **M/s DAV College Trust and Management Society** run by trusts for the assessment years 2000-01 to 2002-03 in summary/scrutiny manner

after allowing exemption under section 10(23C)(vi). Audit scrutiny revealed that DGIT/DIT (Exemption), Kolkata the competent authority had rejected the assessee's applications on 30 August 2000, 19 June 2002 and 18 July 2002, for grant of approval under section 10(23C)(vi) on the grounds that the purpose of the institutions was not solely educational. However the assessing officer irregularly granted exemption of income without approval of DGIT/DIT which resulted in non-levy of tax of Rs.23.35 lakh, Rs.16.35 lakh and Rs.29.36 crore respectively for the three assessment years.

**3.17.4** Similarly, in the case of three other institutions in Delhi, DIT(Exemption) charge, exemption of income was granted by the assessing officers who were not competent to do so without approval of DGIT/DIT, which resulted in non-levy of tax of Rs.2.39 crore, Rs.82.96 lakh and Rs.33.93 lakh respectively.

**3.17.5** Sixty seven similar cases were noticed in Andhra Pradesh, Gujarat, Himachal Pradesh, Jharkhand, Orissa, Madhya Pradesh, Punjab, Rajasthan, and Uttar Pradesh charges where exemption was allowed without approval resulting in non levy of tax of Rs.14.99 crore as shown in **Appendix-6** at serial number **1 to 9**.

### **3.18 Non-renewal of approval after expiry of every three years**

In Andhra Pradesh, DIT (Exemptions), Hyderabad charge, **Devarakonda Educational Society, Jubilee Hills**, an educational institution was approved for exemption under section 10(23C)(vi) for the assessment years 1999-2000 to 2001-2002 as per Board's orders dated 29 August 2002. Audit scrutiny revealed that though the annual receipts exceeded Rs.one crore for the next assessment year 2002-03 also, exemption was claimed without obtaining fresh orders of the competent authority as the time limit of three years of earlier approval was over. The assessing officer accepted the claim in summary manner in December 2002 without approval of the competent authority. Exemption of excess of income over expenditure of Rs.99.34 lakh without renewal of approval resulted in non-levy of tax of Rs.30.40 lakh.

### **3.19 Exemption granted without registration**

Audit noticed 37 cases in Assam, Bihar, Kerala, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal charges where educational institutions run by trusts had not obtained registration under section 12A of the Act. The assessing officers allowed exemption under sections 11 & 12 without registration resulting in non levy of tax of Rs.3.54 crore as shown in **Appendix-6** at serial numbers **10 to 19**.

### **3.20 Registration not granted even after expiry of prescribed time limit**

In Gujarat, Gandhi Nagar charge, assessments of **Sidharth Educational Trust** for the assessment years 1998-99 & 2000-01 were completed in summary manner in March 2000 and October 2000 after exempting income under sections 11&12 of

the Act. The trust was created in September 1994. Application for registration was submitted by the trust on 10 August 1998 which was pending on the dates of completion of assessments though the prescribed time limit of six months for grant or refusal of registration by the CIT had expired by 12 February 1999.

**3.20.1** Three similar cases were noticed in Madhya Pradesh, Jabalpur charge and in Jharkhand, Dhanbad charge where registration or its refusal was not received even after expiry of time limit of six months and assessments were completed assuming registration had been granted. As a result, the time limit indicated in the Act remained in-operational and ineffective. The assessing officers irregularly granted exemption in these cases without registration resulting in non levy of tax of Rs.4.89 lakh.

### **3.21 Exemption of income without evaluation of the activities of institutions**

It was judicially\* held that availability of exemption should be evaluated each year to ascertain whether the institution existed during the relevant year solely for educational purposes and not for the purpose of profit. Finance Act, 1998, also provided that exemption to educational institutions should be granted only after ensuring that their activities were carried out according to their objectives.

**3.21.1** Audit however, noticed that the assessing officers did not ensure whether the institutions were in fact fulfilling the prescribed conditions. Following cases illustrate the irregularities:

**3.21.2** In Tamil Nadu charge, in 28 cases, educational institutions run by trusts claimed exemption of excess of income over expenditure of Rs.7.91 crore for assessment years 1999-00 to 2001-02 under section 10(23C)(iiiad) applicable to institutions with annual receipts below Rs. one crore. The assessing officer granted exemption in summary manner without examining annual receipts.

**3.21.3** In Punjab charge, assessments of 55 educational institutions run by the trusts/societies were completed in summary manner and exemption granted to income of Rs.2.83 crore as claimed by the institutions without verifying the fact that they were working solely for educational purposes.

**3.21.4** In West Bengal, DIT(Exemption) charge, **Ambuja Educational Institute** and **Mohta Educational Society**, had applied for approval under section 10(23C)(vi) for the assessment years 1999-00 to 2001-02. Their applications were not accepted as the annual receipts did not exceed Rs. one crore. Audit scrutiny revealed that their annual receipts were arrived at by not including corpus donations though these were required to be included under section 10(23C)(iiiad). No reasons were recorded for excluding corpus donation.

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\* Aditanar Educational Institution Vs Addl CIT 224ITR 310(SC)

Ambuja Educational Institute was registered under section 12A and claimed exemption under section 11&12 of the Act for assessment years 1999-00 to 2001-02. Mohta Educational Society was not registered under section 12A and claimed exemption under section 10(23C)(vi) for the assessment year 2000-01 without obtaining approval from the prescribed authority. In addition, the assessees had made investments in other than specified avenues of Rs.2.91 crore prior to 1 May 1998 which continued to remain so invested even after 30 March 2001 violating the provisions of section 11(5) of the Act and were required to be taxed. The assessing officer granted exemption in summary manner in these cases though he was not competent to do so without approval from the prescribed authority under section 10(23C) (vi). Failure to disallow exemption resulted in non-levy of tax of Rs.1.12 crore including interest.

**3.21.5** In Andhra Pradesh, Vijayawada charge, an educational society, **Anni Integrated Educational Society, Khammam** registered under section 12A of the Act with effect from September, 1997, was running educational institutions and claiming exemption under section 11. The aims and objects of the above society inter-alia, included, “up-liftment of all socially, economically, educationally weaker sections of the society in general and of the Christian community in particular”. As the assessee was working for the benefit of a particular community, it was not eligible for exemption of income. The assessing officer however, granted exemption of income of Rs.1.62 crore in summary manner for the assessment years 1999-2000 to 2001-02 on which tax of Rs.50.66 lakh was otherwise required to be levied.

**3.21.6** In Maharashtra, Thane charge, an educational institution, **South Indian Association**, run by a trust had been allowed exemption under section 10(23C)(iiiad) to surplus of income over expenditure of Rs.10.65 lakh and Rs.24.84 lakh for assessment years 2001-2002 and 2002-2003 respectively. Audit scrutiny revealed that the receipts were Rs.1.25 crore and Rs.1.38 crore respectively after taking into account receipts on account of Building Fund. Since the annual receipts exceeded the prescribed limit of Rs. one crore, exemption allowed was not correct. Exemption was irregularly allowed to the assessee who did not comply with the provisions applicable to it and had avoided scrutiny of its accounts otherwise required to be carried out under section 10(23C) (vi) of the Act for obtaining approval. The tax effect would work out to Rs.10.45 lakh.

**3.21.7** Seven cases were noticed in Jharkhand and Himachal Pradesh charges where exemption was allowed in summary manner even without assessee claiming it or had claimed it under non-existent section/incorrect section involving tax effect of Rs.64.77 lakh as shown in **Appendix-6** at serial numbers **20 to 24**.



### 3.22 Erroneous exemption and non selection of well known and popular coaching centres for scrutiny

Test check of assessments of educational institutions run by non-trusts or trusts for the assessment years 1999-2000 to 2001-02 revealed that these were running coaching centers and claiming exemption of income under sections 10, 11 & 12. The assessing officers accepted their claims for exemption instead of assessing income under the provisions applicable to “business or profession” as described below:

**3.22.1** In Andhra Pradesh, DIT (Exemption) Hyderabad charge, **Brothers of St. Gabriel Educational Society**, was running educational institution and claiming exemption under section 11 & 12 of the Act. Income and expenditure accounts for the assessment years 1999-2000, 2000-2001 & 2001-2002 revealed that the institution was also coaching students for Engineering/Agricultural/Medical Common Entrance Test (EAMCET) for admission to engineering, agricultural and medical colleges in the State. Income and expenditure on this particular item had been shown separately in these three years. But in the assessment years 1999-2000 and 2001-2002, instead of “EAMCET income”, the assessee used the expression ‘Other Income’ and ‘Miscellaneous Income’ respectively. As a consequence, income which ought not to have been exempted was allowed exemption from levy of tax. As the institution was coaching students for a particular examination which was not an educational purpose, the net income of Rs.71.92 lakh received on this account attracted tax amounting to Rs.22.61 lakh, which was not levied.

**3.22.2** In Maharashtra, **Chate Coaching Classes Private Limited in Aurangabad** charge, conducts widely publicized classes with branches all over Maharashtra for the SSC, medical entrance examination of the state government and other examinations. Assessments for the assessment years 2000-01, 2001-02 and 2002-03 were processed in summary manner. Details of the income/loss are given below:

(Rs. in lakh)

<b>Assessment year</b>	<b>Total receipts Returned Income/loss</b>	<b>Assessed income</b>	<b>Tax paid</b>
2000-01	2219 49.40	49.40	16.00
2001-02	2188 (-) 3.40	Loss (-) 3.40	Nil
2002-03	2534 (-) 91.40	(-) 91.40	Nil

The institution had paid nominal tax in assessment year 2000-01 and ‘no tax’ in subsequent years compared to total receipts. The assessee had written off interest receivable of Rs.19.32 lakh even while deposits with the same party had increased by Rs.42 lakh in assessment year 2001-02. The assessee had returned loss of

Rs.91.40 lakh for assessment year 2002-03. In spite of above unusual aspects noticed, the assessing officer did not take up the returns for scrutiny.

**3.22.3** Following are some cases where assessments could have been completed only after scrutiny but were not done:-

(Rs. in lakh)

**Table 5: Assessments of coaching centres**

Name of assessee and CIT charge	Assessment year & Type of assessment	Gist of mistakes	Tax effect
Krishna Institute Allahabad and Virendra Swarup Memorial trust, Kanpur, Uttar Pradesh	2001-02 Summary	Assesseees were running coaching centres. Exemption was granted u/s 11 instead of applying normal provisions of the Act. Krishna Institute had not credited receipt of Rs.4.10 lakh on account of rent of hostels realised from students. Virendra Swarup Memorial trust had shown net profit of Rs.256.46 lakh but details of charity/donations were not attached.	100.53
Kuttukaran foundation Kochi and three others Kerala	1997-98 to 2000-01 Summary	Assesseees were running coaching centres and carrying on various commercial activities which could not have been treated as incidental to the attainment of objectives of business. Separate accounts were also not maintained for such business.	27.47
Everest Educational & charitable trust, and two others Tamil Nadu	1999-00 Summary 2001-02 Scrutiny	Assesseees were running coaching centres. Exemption was granted under section 11, instead of applying normal provisions of the Act.	12.16

### 3.23 Under reporting of income by institutions running coaching centres

Audit analysed the assessments of following institutions in Maharashtra running coaching classes for various courses. Audit noticed that where the department had completed the assessments after scrutiny, assessed income ranged from 12.7 percent to 57.4 percent of their receipts as per accounts. However, in the assessments completed in summary manner, income ranged from one percent to 39.7 percent of their receipts as per accounts. It was therefore essential that more returns should have been selected for scrutiny as a special case in respect of 'coaching centres' in order to ensure that correct amount of tax was paid by them. Such selective identification of cases for scrutiny having revenue potential or those covered by special provisions was not barred by any existing and applicable instructions for selection of assessments for scrutiny.

(Rs. in lakh)

**Table 6: Under reporting of income by institutions running coaching centres**

Name of the assessee and CIT Charge where assessed	Assessment year and type of assessments made	Receipts as per accounts	Assessed Income	Percentage of assessed income to the receipts as per accounts
Vivekanand Classes CIT XVIII	2000-01 Summary	71.80	9.95	13.8
Vidyalankar and Publications CIT XVII	1998-99 <b>Scrutiny</b> 1999-00 Summary 2000-01 Summary.	212.78 244.86 285.59	43.49 48.95 51.01	20.4 19.9 17.8
Bhatia Commercial Classes CIT XVIII	1999-00 <b>Scrutiny</b>	51.2	16.42	32.0
Shri Bhavesh Jamnadas Bhatt Sukh Sagar , CIT XVIII	2000-01 Summary	162.49	1.66	1.0
Bhatia Classes. CIT XVIII	1999-00 <b>Scrutiny</b> 2000-01 Summary	31.80 36.36	18.19 24.09	57.4 39.7
Ravi Classes CIT XXI	1998-99 <b>Scrutiny</b> 1999-00 Summary 2000-01 Summary	75.77 71.75 78.02	9.63 1.72 1.38	12.7 2.4 1.8
Mahesh Tutorials , CIT XXII	1998-99 Summary 1996-97 Summary	35.38 28.81	1.10 0.95	3.1 3.3
Pravin Classes CIT XVIII	1999-00 Summary 2000-01 Summary 2001-02 <b>Scrutiny</b>	99.44 120.75 103.64	5.16 1.22 42.26	5.2 1.0 40.8
Vidyalankar Gurukul CIT XXII	1999-00 Summary 2000-01 Summary	29.54 31.51	3.11 3.38	10.5 10.7

### 3.24 Exemptions granted without audited accounts & audit report

Where the total income of the trust or institution as computed under the Act without giving effect to the provisions of sections 11 & 12 exceeded Rs.50,000 in any previous year, the accounts of such trusts or institutions should be audited for such accounting year and audit report filed in Form 10B along with the return of income for the relevant assessment year.

**3.24.1** Audit noticed 25 cases in Gujarat, Jharkhand, Maharashtra, Orissa and Rajasthan where the educational institutions run by trusts for the assessment years 1999-2000 to 2001-02 claimed exemption without furnishing audited accounts and audit report. Non-compliance of the above provision required withdrawal of exemption in these cases and levy of tax of Rs.1.26 crore as shown in **Appendix-6** at serial numbers **25 to 29**.

### 3.25 Omission to call for details of specified persons and cross verification with their returns

Entire income of educational institutions run by the trust is liable to tax if part or whole of its income or property is directly or indirectly applied or used for the benefit of certain category of persons such as author/founder of the

trust/institution, any trustee or manager or substantial contributors etc. or any specified relative of the aforesaid persons.

To ensure compliance with the aforesaid provision, the assessing officers are required to call for details of specified persons and also information regarding income of the trust/institution irregularly diverted for such specified persons which should thereafter be brought to tax. During test check of assessments, audit noticed that trustees had availed undue benefit or income had been applied for the benefit of the trustees and no details of specified persons were called for nor any cross verification done.

**3.25.1** In Himachal Pradesh, scrutiny of assessment of **Kalgidhar Trust, Distt Sirmore** running educational institution for the assessment years 2000-01 and 2001-02, assessed in summary manner revealed that the assessee claimed exemption under section 11 of the Act. The trust deed filed by the assessee stipulated "the founder of the trust during his life time shall have the power to veto any decision of the trustees and his decision regarding any matter shall be final and binding and shall be given due respect as if it was a decision of the entire board of trustees". In view of the absolute power of the founder of trust in all matters, the trust could not be regarded as a valid trust eligible for registration under the Act. Exemption allowed was irregular which involved a tax effect of Rs.2.13 crore.

**3.25.2** In Jharkhand, Hazaribagh and Jamshedpur charges, assessments of three trusts running educational institutions for the assessment years 1999-2000 to 2001-2002 were completed in summary manner. Properties held under trust or trust funds were utilized for the benefit of prohibited category of persons as certified by the chartered accountants in the Audit Report (Form 10 B). Members of the governing body rendering services to the society were residing in the premises owned by the society free of charge and honorarium of Rs.0.72 lakh for three members and Rs.3.50 lakh for seven members was paid. Such payments and availing of benefits were against the provisions of the Act and disentitled the institutions from enjoying the benefit of statutory exemption from tax of their entire income amounting to Rs.10.19 crore involving tax of Rs.4.01crore including interest of Rs.86.72 lakh for non payment/short payment of advance tax.

**3.25.3** In Andhra Pradesh, Visakhapatnam II charge, a society, **Aditya Educational Society, Tekkali** running educational institutions was registered under section 12A of the Act with effect from 1 April 2001. It claimed to have received a total sum of Rs.47 lakh from nine of its members. In the written submission, the President of the Society had stated that six out of nine society members were regular Income-tax assesseees and the other three were not. Audit noticed that the returns of the society were accepted without cross verification of the investments made by six members with their income tax returns. On this being pointed out in audit in May 2003, the CIT-II, Visakhapatnam issued instruction vide his letter dated 6 May 2003 to the concerned assessing officer to

cross verify the investments made by all the members from the entries available in their respective individual returns or from other sources.

### **3.26 Incorrect application of income**

#### **3.27 Irregular exemption even where accumulation of income was beyond the prescribed percentage.**

The facility of accumulation of income provided to educational institutions has been described in paragraphs 3.2.1 and 3.2.5 above. Any payment out of such accumulated fund for donation, loan, advance to other institutions or for reinvestment by the same institution is not allowed exemption.

**3.27.1** Audit noticed 33 cases involving tax effect of Rs.7.93 crore in Andhra Pradesh, Delhi, Gujarat, Jharkhand, Kerala, Maharashtra, Orissa and Rajasthan charges where exemption was allowed although the option/notice in the prescribed Form 10B for accumulation of income was not furnished to the assessing officer along with the returns or before completion of assessments. Also, payments made were reinvested back with the donor institution.

**3.27.2** In West Bengal, DIT (Exemption) Kolkata charge, four educational society/trusts, **M P Birla Foundation Educational society, South point School, St. Thomas Schools** and **Birla Education Trust**, had accumulated income either in specified or unspecified modes in assessment years earlier to 1998-99 which was exempted from tax. They had further spent or reinvested the accumulation during the assessment years 1999-2000 to 2001-02 either in donation or in shares, loan or advance which did not qualify for further exemption as the amount redeemed and reinvested, donated etc from accumulated fund loses the character of income again. This was required to be taxed in the previous year in which it was redeemed and not utilized but reinvested, donated etc. Omission to do so resulted in non levy of tax of Rs.6.18 crore including interest.

**3.27.3** In Maharashtra, DIT(E) Mumbai charge, the assessment of **G.D. Birla Medical and Research Foundation**, a trust running educational institutions for the assessment year 2000-01, was completed after scrutiny in February 2002. Audit scrutiny revealed that the assessee received interest of Rs.53.45 lakh on redemption of ICCI bonds. Interest receipt was incorrectly allowed to be treated as capital gain. Subsequently, assessee invested this interest income in specified modes and obtained exemption from tax. Thus by resorting to this technique, the institution did not utilise 75 percent of interest income which worked out to Rs.40.09 lakh for educational purposes as prescribed in the section 11 of the Act. The assessing officer did not levy tax amounting to Rs.16.00 lakh that was attracted in this case.

## 3.27.4 Other similar cases are summarised as under:

(Rs. in lakh)

<b>Name. of assesseees and CIT charge</b>	<b>Assessment year &amp; type of assessment</b>	<b>Gist of mistakes</b>	<b>Under assessment of income</b>	<b>Tax effect</b>
Charotar Education Society, and <b>17 others</b> , Gujarat	1998-99 to 2001-02 Summary	Exemption of income was granted though form 10 for excess accumulation of surplus was not filed till the date of assessment.	184.13	55.24
Delta Schools Society, Kochi, and <b>two others</b> , Kerala	1998-99 to 2001-02 Summary	Form 10 for excess accumulation of surplus was not filed and accumulated income was not utilised for specified purposes within the permissible time.	159.66	50.06
Institute of Technology & Management, Gwalior, MP	2002-03 Summary	Form 10 for excess accumulation of surplus was not filed.	82.67	28.44
Lagan Kala Upvan society, Delhi	2001-02 Summary	The assessee spent only Rs.205.76 lakh against income of Rs.304.28 lakh which was less than 75 percent without exercising any option in writing in Form 10.	22.45	9.10
Shri Venkateswara Vidya Peeth Visakhapatnam and <b>two others</b> , Andhra Pradesh	1994-95 to 2002-03 Summary	There was nothing on record to show that the assesseees had sought permission for short fall in expenditure of 75 percent of total income and the assessing officer also did not raise the issue.	20.88	7.38
Shiksha Vikas Samitee Jodhpur and <b>another</b> , Rajasthan	1998-99 to 2001-02 Summary	Assesseees had not utilised 75 percent of income for charitable purposes and assessments were completed in summary manner.	14.38	5.39

## 3.28 Exemption irregularly given for investments in unspecified mode

Income, if accumulated by way of investment or deposited in the specified forms or modes is exempted viz. post office, nationalized banks, Unit Trust of India, public company etc under sections 11 and 12 of the Act. Further, Finance Act, 1998, effective from 1 April 1999, provided that investment made otherwise than in any one or more of the specified modes before 1 July 1998 is also exempted under section 10(23C) (vi) of the Act, if such funds do not continue to remain or invested or deposited in the specified modes after 30 March 2001.

**3.28.1** Test check of assessments revealed that in the following cases, educational institutions had not made investment of accumulated income in the specified modes. Such income was required to be taxed at the maximum marginal rates, which was not done.

**3.28.2** In Gujarat, Baroda charge, assessment of a trust, **Maganbhai Shankarbhai Patel** for the assessment year 1995-96 was completed in summary manner in March 1997. It was noticed that assessee had shown capital gain of Rs.2.39 crore and claimed exemption for accumulation of Rs.2.27 crore. The assessee had notified to the assessing officer in January 1994 by filing Form 10 for accumulating the fund for 9 years from 1994-95 to 2002-03. It was explained that the trust had intended to build a modern library for which it had given an advance of Rs.3.05 crore. The department however, informed audit in May 2003 that due to technical formalities, the project had got delayed and it was expected to be completed during 2003-04.

Audit scrutiny, however, revealed that the main trustees were contractors and developers and advance of Rs.3.05 crore given out of capital gain remained unutilised for 9 years. Investment of Rs.3.05 crore by way of advance was not one of the specified modes as provided in the Act. The assessing officer should not have accepted Form 10 furnished by the assessee for accumulation of funds in the assessment year 1994-95 itself and taxed the same. But this was not done. Omission resulted in under assessment of Rs.3.05 crore and short levy of tax of Rs.91.5 lakh besides interest thereon.

**3.28.3** Similar other cases are summarised below.

(Rs. in lakh)

**Table 8: Investments in unspecified modes**

Name of assesseees & CIT charge	Assessment years & type of assessment	Gist of mistakes	Investment made in unspecified modes	Tax effect
Delhi Public School Ranchi and 3 others, Jharkhand	1999-00 to 2001-02 Summary	Assesseees had not furnished details of investments as required in annexure D of the return of income.	516.63	200.45
Sri Gobindadeo Educational Institute and four others. DIT (Exemption), Kolkata	1998-99 Scrutiny	The assesseees were registered under section 12A. They had unspecified investments as on 31 March 1998 which required to be checked under section 11 & 12 instead of assessing under section 10 (22).	570.79	171.23
M/s Kasturba Education Trust and Academy of General Education, Bangalore, Karnataka	1999-00 to 2000-01 Summary Scrutiny	Surplus income was not invested in specified modes. Advance was given to other institution without attributing any reason. Capital expenditure was not reflected in the accounts.	352.17	134.38
Vidya Prakash Education Development & Tata Education Trust, Mumbai	1999-00 to 2001-02 Scrutiny	The surplus was invested in Deutsche Bank & Credit Agricole Indosuez Bank, which was not approved mode of investment.	235.44	104.70

Name of assesseees & CIT charge	Assessment years & type of assessment	Gist of mistakes	Investment made in unspecified modes	Tax effect
Sultan Ul-Uloom Education Society Hyderabad and 5 others, Andhra Pradesh	1998-99, 2001-02 & 2002-03, five cases in Summary, one in Scrutiny	Investments were made in Foreign Banks/Chit fund company, NCC Finance Ltd, and ANZ Grindlays Bank, which were not approved modes of investment.	256.43	83.71
Trihut Parish Society Muzafarpur and seven others, Patna, Bihar	2001-02 Summary	Assesseees had invested surplus income in unspecified modes.	153.48	64.69
Kalyan Education Society & Janseva Sikshan mandal Thane, Mumbai	2000-01 to 2001-02 Summary	Investments were made in unspecified mode and advanced for purchase of land without signing conveyance deed for the last three years.	72.08	21.82
Takshashila Kelvani Mandal and two others, Gandhi Nagar, Gujarat	1997-98 to 1999-00 Summary	Accumulation was not invested in specified modes and surplus was given to outsiders as loan/ advances.	55.67	16.70

**3.28.4** In West Bengal, following cases were noticed where investments made in unspecified modes before 1 July 1998 by educational institutions which claimed exemption under section 10(23C)(vi) of the Act remained so invested or deposited even after 30 March 2001. Such investments were required to be taxed which was not done:

(Rs. in lakh)

**Table 9: Investments made in unspecified modes that continued after 30 March 2001**

Name of assesseees & CIT charge	Assessment years & type of assessment	Gist of mistakes	Investment made in unspecified modes	Tax effect
Sukrity Education Society & Somany Education Trust. DIT (Exemption), Kolkata	1999-2000 to 2001-02 Summary	The assesseees had excess of income of Rs.2.23 crore and unspecified investment of Rs.13.26 crore before 1 June 1998 which continued to remain so invested even after 30 March 2001.	1325.69	589.34



Name of assesseees & CIT charge	Assessment years & type of assessment	Gist of mistakes	Investment made in unspecified modes	Tax effect
Birla Education Trust, Birla Education Institution, Vidya Mandir Society and M P Birla foundation Education society DIT (Exemption), Kolkata	2001-02 Summary	Assessee had unspecified investment as on 1 June 1998 which continued to remain so invested after 30 March 2001. Notice for selection of scrutiny was not issued though assessment in summary manner for the assessment year 2001-02 was made u/s 10(23C)(vi) well after this provision became applicable from 1 April 1999.	1397.04	192.81

### 3.29 Erroneous allowance of application/exemption of income

Income from property held under trust wholly for charitable or religious purpose is exempt to the extent to which the income is applied for such purpose. It has been judicially held\* that the mere fact that the application of income resulted in the maintenance or improvement of property held under trust for charitable purposes would not entitle the trust to claim exemption of such income under section 11 of the Act.

**3.29.1** Test check revealed that in the following cases, income was not utilized to achieve the objects of the institutions.

**3.29.2** In Delhi, DIT(Exemption) charge, the assessment of **M/s. DLF Qutab Enclave Complex Educational Trust** for the assessment year 1997-98 was completed after scrutiny in February 2002 and for the assessment years 1999-00, 2000-01 and 2001-02 in summary manner after allowing exemption totalling Rs.1.85 crore. The assessee was earning income from rent and interest which was exempted on the ground that the income was set apart for fulfillment of the objects of the trust. Audit scrutiny revealed that though the object of the trust, inter alia, was to establish educational institutions, it had withdrawn money from funds set apart for fulfillment of the objects of the Trust and spent it on purchase of properties which were not utilized for educational purposes. It was thus not eligible for any exemption. Failure to disallow exemption of rental and interest income not utilized for purpose of the trust resulted in under assessment of income of Rs.1.85 crore involving tax effect of Rs.79.71 lakh including interest.

**3.29.3** In Andhra Pradesh, Vijayawada charge, an educational society, **Mamata Educational Society, Khammam** was registered under section 12A of the Act with effect from 28 May 1992. Its main objective was to promote education. Government of Andhra Pradesh granted permission to establish a Medical College

\* C.I.T Vs. Kannika Parameswari Devasthanam & Charities – 1982 – 133 ITR 779 (Madras).

at Khammam. Civil works were commenced accordingly. But permission granted by Government of Andhra Pradesh was later withdrawn. For want of approval, the society could not take up any activity other than construction of building for Medical College and Teaching hospital. Till 23 March 1998, the society could not commence the College. Though registration was granted in May, 1992, there was no educational activity till end of March 1998. In the light of the judicial pronouncement cited, interest of Rs.56.31 lakh received during the assessment years 1993-94 to 1994-95 and 1997-98 to 1998-99 on Fixed Deposit and other incomes was required to be taxed which would have yielded revenue of Rs.19.69 lakh. This was not done and returns were accepted in summary manner.

**3.29.4** In Assam, Guwahati-I charge, assessments of three trusts, **St. Agnus convent Udalguri, Don Bosco School Majbat and Sacred Heart Convent Tejpur** engaged in school activities, for the assessment years from 1998-99 to 2001-02 were processed in summary manner between March 1999 and March 2002. Audit scrutiny revealed that besides income from school activities, the assesseees had income from church collection, donation from Bishop's house and foreign contribution. It was further revealed that Rs.1.54 crore from the above income was transferred and credited to General fund/Capital account. Again Rs.1.49 crore was deducted from the Capital account as "fund utilized". Deduction of funds from the capital account without making any addition of assets could not be treated as funds utilized for the object of the trust and should have been added back to income and brought to tax. Omission to do so resulted in non-levy of tax of Rs.43.37 lakh.

**3.29.5** Similar cases are summarized below:

(Rs. in lakh)

<b>Name. Of assesseees &amp; CIT charge</b>	<b>Assessment year &amp; type of assessment</b>	<b>Gist of mistakes</b>	<b>Tax effect</b>
South Point High School and 4 others, West Bengal	1999-00 to 2001-02 Summary	Contribution to provident fund was made beyond the due dates, which could not be considered as application of income and was required to be taxed.	100.21
St. Joseph charitable Educational & Social Development Society Trichy and two others, Tamil Nadu	1999-00 to 2001-02 Summary	Assesseees diverted a total sum of Rs.148.51 lakh for religious purposes which was not an educational purpose.	46.52
Modern School Society Kota, and three others, Rajasthan	1999-00 to 2001-02 Summary	The assesseees had debited expenditure on account of provisions for gratuity, contingency fund, building fund and school fund which were not allowable.	44.79

### 3.30 Diversion of funds for non charitable purposes

#### 3.31 Unexplained credits/deposits/donations shown in the name of sister concerns

Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not satisfactory, the sum so credited may be charged to income tax as the income of the assessee of that previous year.

**3.31.1** In the following cases, the balance sheet of the assessee exhibited substantial amounts as sundry creditors. Audit scrutiny revealed that corresponding sundry debtors were not available in the lenders' balance sheets. The amounts involved could not have been accepted as application towards the objects of the trust.

(Rs. in lakh)

**Table 11: Unexplained sundry creditors/debtors**

Name of the CIT	Name of the loanees Assessee Status	Name of the lender	Assessment year /type of assessment	Credit Amount Tax effect
CIT (Central), Hyderabad	Vignan Educational Institutions (P) Limited, Guntur (Company)	Vignan Vidyalayas	2001-02 Summary	<u>118.39</u> 41.43
-do-	Vignan Tutorials (P) Limited, Guntur (Firm)	-do-	2001-02 Summary	<u>55.94</u> 19.58
-do-	M/s.New Millenium Printers Nizampet Hyderabad (Firm)	-do-	2001-02 Summary	<u>16.35</u> 5.72

**3.31.2** In Tamil Nadu, DIT(Exemption) Chennai charge, **M/s. KR Sundararajan Educational Trust** received loans of Rs.1.99 crore from **Indian Institute of Engineering Technology** and **Meenakshi College for women** during the assessment years 1996-97 and 1998-99 and invested the same in fixed deposits. These deposits were, however, withdrawn during assessment year 2001-02. The assessee filed Form 10 belatedly on 28 March 2002 for accumulating funds beyond the prescribed limit for the assessment years 1996-97 to 2001-02 and claimed interest income on the said deposits as "application" as it was held for starting Engineering College.

It was judicially\* held that the assessee will have to apply for claiming the benefit of accumulation of surplus income in Form 10 at any time before completion of assessment proceedings. As the requirement of the Act was not met, delay was not condoned. The assessing officer in the scrutiny assessment for the assessment year 1998-99 completed on 28 March 2002, recorded that the amount of interest reinvested as fixed deposits could not be deemed to have been applied for the objects of the trust for the reason that the trust was yet to commence its

\* CIT Vs Nagpur Hotel Owner Association 247 ITR 202

educational activities. Surplus of interest income of Rs.16.72 lakh for the assessment year 1998-99 after exempting 25 percent was taxed.

Since the educational institution was neither started nor was there any application of income for the fulfillment of the objectives of the trust, the balance 25 percent of such interest income of Rs.5.57 lakh for the assessment year 1998-99 and interest income of Rs.64.56 lakh for the assessment years 1999-00 to 2001-02 was required to be taxed, which was not done. This involved total tax effect of Rs.28.75 lakh.

**3.31.3** Audit analyzed accounts of following educational trusts assessed in DIT(Exemption) Chennai charge for the assessment years 1999-00 to 2001-02 which disclosed unexplained credits where the contra-entry was not found in the same year in the accounts of the transferor/sister concern:

(Rs. in lakh)

<b>Table 12: Unexplained credits/deposits/donations shown in the name of sister concerns</b>					
<b>Name of the Transferor</b>	<b>Name of the transferee</b>	<b>Assessment year &amp; type of assessment</b>	<b>Nature of mistake</b>	<b>Amount</b>	<b>Tax effect</b>
Indian Institute of Engineering Technology (IET)	KRS	1999-00 Summary	Accounts of IET exhibited corpus donation given to KRS but the same was again given back by KRS to IET next year. This was re-circulated next year and was required to be taxed in the hands of IET	21.03	7.85
Meenakshi College for women (run by Ganapathi Educational Trust	KRS	2000-01 Summary	KRS showed Rs.65.80 lakh against Meenakshi College for Women under sundry creditors in the balance sheet. There was no such entry in the accounts of Meenakshi college for women under sundry debtors due from KRS. As such unexplained investment was required to be taxed in the hands of KRS.	65.80	24.97
Ganapathi Educational Trust	IET	2001-02 Summary	Accounts of Ganapathi Educational Trust exhibited corpus donation but accounts of IET did not show it as receipt. Hence it was to be taxed in the hands of Ganapathi Educational Trust	167.54	71.23
KRS & Meenakshi College for women	IET	2001-02 Summary	Accounts of IET exhibited Rs.75.84 lakh and Rs.15.40 lakh received as Endowment deposit from KRS and loan from Meenakshi College respectively. However, instead of Rs.75.84 lakh, Rs.67.86 lakh was shown in the accounts of KRS and no entry of loan of Rs.15.40 lakh was shown in the accounts of Meenakshi College. Hence the difference of Rs.7.98 lakh (Rs.75.84 lakh and Rs.67.86 lakh) and Rs.15.40 lakh was to be taxed in the hands of IET.	23.38	9.13

**3.31.4** In Andhra Pradesh, DIT (Exemptions) Hyderabad charge, **Institute of Chartered and Financial Analysts of India** registered under the Act on 4 April 1986 claimed exemption under section 10(22) upto assessment year 1998-99 and thereafter under section 11. Assessee mentioned in the return relating to assessment year 1999-2000 that it transferred some of its assets and liabilities amounting to Rs.6.22 crore to another public society, (ICFAIN Foundation) registered under societies Act, having similar objects. There is no provision in the Act allowing societies to transfer their properties to other societies during their existence. This type of action is contemplated in the event of dissolution of a society/trust which was not the case here. The value of assets was therefore required to have been brought to tax which was not done. Tax effect would work out to Rs.1.87 crore.

### **3.32 Unexplained difference in capital funds/irregular allowance of expenditure**

Where in any year, an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof or the explanation, if any, offered by him is not in the opinion of the assessing officer satisfactory, the amount covered by such expenditure, or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year.

**3.32.1** In Tamil Nadu, Madurai charge, in the case of **M/s. Jeevana Educational Trust**, a sum of Rs.1.15 crore was the closing balance in the Capital Fund account for the assessment year 1999-2000, while a sum of Rs.91.10 lakh only was exhibited as opening balance in the Capital Fund for the assessment year 2000-01. The onus of proving the claim for exemption lay with the assessee. No explanation for the shortfall in the opening balance was available on record. The amount of shortfall was required to be treated as diversion of the trust fund for unauthorized purposes and taxed at maximum marginal rate. It would have resulted in tax demand of Rs.7.67 lakh excluding interest under section 234 B.

### **3.33 Undisclosed income of other persons in block assessments**

Where the assessing officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search was made under section 132 or whose books of account or other documents or any assets were requisitioned under section 132A, then, the books of account, other documents or assets seized or requisitioned shall be handed over to the assessing officer having jurisdiction over such other person and that assessing officer shall proceed against such other person and the provisions of the chapter shall apply accordingly.

**3.33.1** In Delhi, Central Circle-25, charge, the block assessment in the case of **M/s. Akash Institute (Pvt) Ltd.**, for the block period 1 April 1988 to 18 August 1998 was completed after **scrutiny** in August 2000 at an undisclosed income of Rs.26.70 lakh and revised in January 2001 at an income of Rs.9.63 lakh after giving effect to appellate order. Audit noticed that the department did not obtain

the details of persons who had received payment of Rs.70.67 lakh during the assessment years 1996-97 to 1999-2000 comprised in the block period on account of tuition fee from the assessee, although it was apparent that the payment was undisclosed income of the recipients. As a result, the department could not bring these persons under the block assessment as envisaged under the provisions of section 158 BD of the Act resulting in loss of revenue of Rs.42.40 lakh.

### **3.34 Incorrect exemption allowed against capitation fee receipts**

It has been judicially held\* that there cannot be compromise on commercialization of education and the educational institutions cannot charge more than the fees fixed by the Government in any form either as donation or capitation fees. It has further been held\*\* that the amounts given for "Mutual benefit" did not partake the character of gift or donation. Acceptance of capitation fee has also been prohibited under the "Tamil Nadu Capitation Fee Prohibition Act".

**3.34.1** In Tamil Nadu, Coimbatore and Chennai Central charges, five educational trusts had collected capitation fee of Rs.60.39 crore during the assessment years 1996-97 to 2001-02 from students, which were shown in accounts as donations. The assessing officer had arrived at a factual conclusion that contributions received by the trusts shown as donations were actually capitation fee collected from students in connection with admission to various courses. During the course of assessment proceedings, however, benefit of exemption under section 11 was incorrectly allowed to the assessees. This was contrary to the judicial decisions referred to above. Incorrect exemption allowed in above cases resulted in income escaping assessment involving tax effect of Rs.20.74 crore.

**3.34.2** Similarly, in another case, in Trichy charge, three educational trusts were formed in November 1981/December 1981/March 1990 by the same founder along with his family members as trustees with a corpus fund of Rs.501/- each with the object of running educational institutions and having the incidental object of making donations to other similar trusts. Though only one trust was running 20 educational institutions, donations were collected by all the three trusts, which were transferred to the trust running educational institution showing it as application of income under section 11.

**3.34.3** Audit scrutiny of the assessments of the three educational trusts for assessment years 1999-2000 to 2001-02 revealed that the trusts had collected donations of Rs.40.87 crore. Assessing officer had recorded a factual finding that these were not voluntary contributions but were only capitation fee, which were a "quid pro quo" for allotment of seat. Such amounts could not have been treated as income falling within the ambit of section 11. Further, two of the three trusts were created only for collecting capitation fee and transferring them to the third trust

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\* (Unnikrishnan J.P. & Others Vs State of Andhra Pradesh & Others, 1993 AIR 2178, SCR(1) 594)  
\*\* (CIT Vs P.V.G. Raju – 101 ITR 645)

running the educational institutions to circumvent the law. Hence, provision of section 11 could not have been applied to such income. Incorrect exemption allowed in these cases resulted in income escaping assessment involving tax effect of Rs.13.26 crore.

### **3.35 Depreciation incorrectly allowed as application of income**

Purchase of capital asset that could be used to promote the objectives of educational institutions run by trust is allowed as application of income. Therefore depreciation is not allowable on a capital asset whose entire cost of acquisition is either written off in the first year itself or the cost of acquisition is treated as application of income. This view is supported by the ruling of the Hon'ble Supreme Court in case of Escorts Ltd and another Vs Union of India<sup>∞</sup> and followed by the ITAT Mumbai in the case of Petuk Polytechnic Trust and Petuk Technical High School<sup>∞</sup>.

**3.35.1** Test check of assessments revealed that in the following cases, depreciation was allowed on capital assets whose cost of acquisition had already been written off in the year of acquisition itself or treated as application of income.

**3.35.2** In Tamil Nadu, CCIT I Chennai, Madurai and Trichy charges, 21 educational institutions run by trusts had charged depreciation on the assets acquired out of exempted income which were shown as have been applied for educational purposes during the assessment years 1999-00 to 2001-02. There were certain other inadmissible applications, such as unauthorized donations, repayment of loans, contribution to religious establishments, unspent expenses which were taken to the Capital Fund etc. but stood included in the total amount of application of funds claimed by the trusts to account for more than 75 percent of the gross receipts. If the amount of depreciation and other ineligible expenditure and inadmissible application were disallowed from the total expenditure including the capital expenditure, the amount of application would have fallen short of 75 percent of their gross receipt in all those cases. In case of such shortfall, Form 10 for the amount of short fall during the subsequent years would have been required to be filed. If the short fall in these cases was taxed, there would have been a total tax demand of Rs.3.06 crore.

**3.35.3** In Maharashtra, Mumbai, Nagpur and Pune charges, in six cases of educational institutions run by trusts, depreciation charged on assets was wrongly treated as amount utilized for charitable purposes. It was deducted incorrectly leading to short levy of tax of Rs.1.38 crore.

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<sup>∞</sup> (199 ITR 44)

<sup>∞</sup> (ITAT No 1406/2001)

**3.35.4** In Bihar and Jharkhand charges, seven educational institutions run by trusts had availed depreciation on capital investment which was allowed. Since they had already claimed exemption for the initial expenditure on this account, allowing further depreciation was not in order. Tax effect involved was Rs.1.11 crore in these cases.

### **3.36 Mistakes in allowing depreciation**

Deduction in computing depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purpose of his business during the relevant years. It was judicially held\* that the onus of providing the details of deduction lay with the assessee, and even in summary assessment, the assessing officer is not bound to allow the deduction in the absence of details.

**3.36.1** Test check of assessments revealed mistakes in allowing depreciation on assets at more than the prescribed rates or without enclosing depreciation chart showing details of depreciation in Andhra Pradesh, Bihar, Gujarat, Orissa, Punjab, Rajasthan, Tamil Nadu and Uttar Pradesh resulting in non levy of tax of Rs.46.26 lakh in 11 cases.

### **3.37 Tax not deducted at source**

Tax is required to be deducted at source in respect of certain payments at prescribed rates and remitted to Government account within prescribed time. If a person responsible for deduction of tax at source fails to deduct the tax at appropriate rate or after making the deduction fails to credit the tax into Government account, he is liable to pay the amount of tax deductible into Government account together with simple interest. Penalty under sections 201(1A) and 271C of the Act is also leviable in such cases.

**3.37.1** Test check of assessments revealed that assessing officer did not penalize non compliance with aforesaid provisions for deduction of tax at source in Assam, Gujarat, Karnataka, Madhya Pradesh, Orissa and Tamil Nadu involving tax effect of Rs.5.88 crore in 52 cases.

### **3.38 Income escaping assessment**

### **3.39 Contribution to corpus fund without specific direction**

Any voluntary contributions received with a specific direction that the same shall form part of 'corpus' of the educational institutions run by the trusts are fully exempt. Donations to earmarked funds like building funds, repairs fund etc. are not exempt. Voluntary contributions other than 'corpus' donations are to be treated as income. If voluntary contributions received without specific directions

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\* M/s Mahendra Mills Vs CIT (243 ITR 56) (Supreme Court)



or earmarked donations are not computed as income, the trust gets away from not seeking permission from the assessing officer for accumulation of funds in excess of 25 percent of its receipts and also avoids investing such excess funds in specified modes.

**3.39.1** Audit noticed 74 cases in Assam, Delhi, Gujarat, Rajasthan, Mumbai, Pune and Tamil Nadu charges where donations were added to the corpus fund without specific direction to that effect from donors. These donations were therefore required to be added to the income of the corresponding year which was not done resulting in non levy of tax of Rs.19.55 crore as shown in **Appendix-6** at serial numbers **30** to **38**.

### **3.40 Capital gains escaping assessment**

Where, a capital asset, being property held under trust, wholly for charitable purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable purpose to the extent specified hereunder, namely:-

- (i) where the whole of the net consideration is utilised in acquiring the new capital assets, the whole of such capital gain;
- (ii) where only a part of the net consideration is utilized for acquiring the new capital assets, then, the capital gains to the extent of difference between the amount so applied and original cost of the asset is taken to be applied for charitable purposes.

**3.40.1** Test check of assessments revealed that in the following cases, capital gains were not assessed to tax:-

**3.40.2** In Delhi, DIT(Exemption) charge, the assessments of an educational institution run by a trust, **Delhi Catholic Archdiocese**, for the assessment years 1998-99 and 1999-2000 were completed in summary manner in February 2000 and December 2002 respectively at nil income. Audit scrutiny revealed that the trust had shown 'sale of land' at Rs.4.00 crore and Rs.4.02 crore in the receipt & payment accounts for the previous years relevant to the assessment years 1998-99 and 1999-2000 respectively. The institution had neither shown these receipts as income nor worked out the capital gain therefrom in its return of income.

Further, against sale consideration of Rs.4.00 crore and Rs.4.02 crore, the institution invested only Rs.2.45 crore and Rs.2.99 crore in acquiring capital assets respectively during the assessment years 1998-99 and 1999-2000. As such, exemption was allowed in excess by Rs.1.55 crore and Rs.1.02 crore for the assessment years 1998-99 and 1999-2000. The mistake resulted in under assessment of income of Rs.2.57 crore with tax effect of Rs.1.16 crore including interest.

**3.40.3** In Tamil Nadu, ADIT(Exemptions) IV, Chennai charge, **Vellayan Chettiyar Trust** was formed as a public charitable trust in February 1968 mainly with the view to establishing, running and maintaining educational institutions for the benefit of public. It acquired a shopping complex in the assessment year 1992-93. In the assessments completed between March 1997 and March 2002, the department rejected the assessee's claim treating expenditure on shopping complex as application of income for charitable purposes. While upholding the department's view, the CIT(A) observed in April 2002 that investment made in commercial complexes did not conform to the objects of the institution and could not be said to be charitable in nature.

The assessee sold the said complex in assessment year 1998-99 for a consideration of Rs.98 lakh and invested the amount in securities. As the investment in asset was held to be non-charitable in nature, the sale proceeds of the same were subject to levy of capital gains tax which was not levied. Tax effect involved was Rs.40.70 lakh.

### **3.41 Other mistakes**

Test check of assessments revealed mistakes in giving effect to appellate orders, excess carry forward of loss, application of incorrect rate of tax, non levy of surcharge etc involving tax effect of Rs.1.95 crore in 30 cases in Assam, Andhra Pradesh, Bihar, Chandigarh, Delhi, Mumbai, Rajasthan and Tamil Nadu.

### **3.42 Non-levy of penalty for default in filing returns**

A trust whose total income computed under the Act without giving effect to the provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income tax, is required to file a return failing which penalty of Rs.100 per day is leviable under section 272A(2)(e).

**3.42.1** Test check of assessments revealed that in 91 cases, in Andhra Pradesh, Assam, Bihar, Gujarat, Jharkhand, Orissa, Kerala, Punjab, Rajasthan and Uttar Pradesh, returns were not filed or filed after the due date. Delay in filing returns ranged from 16 to 2455 days. Penalty proceedings for delay in filing of returns were not initiated in these cases. Minimum penalty to be levied in these cases worked out to Rs.42.55 lakh.

**3.42.2** In Maharashtra, audit noticed that 79 educational trusts registered under section 12A in Mumbai and Pune charges, had not filed the returns of income as required under the Act. The assessing officers had not issued notice under section 148 in any of the cases requiring them to file the return. **D.Y. Patil Pratisthan** running several educational institutions in the state including medical colleges, engineering colleges and other professional colleges was registered under section 12A of the Act in November 1991 under the charge of CCIT Pune. Scrutiny of records revealed that this trust had not filed the return after 1 April 1999 for any of the assessment years viz 1999-2000 to 2002-03. The assessing

officer had neither issued notices under section 148 nor initiated proceedings for levy of penalty for such default. When this was pointed out, assessing officer replied in August 2003 that notices requiring the assessee to file the returns were under issue. Penalty leviable in all 79 cases worked out to Rs.2.10 crore at the minimum rate.

### **3.43 Weakness in administration of law**

#### **3.43.1 Non monitoring of filing of returns by educational institutions**

There is no central agency in the department to monitor the filing of income tax returns by educational institutions. Consequently, the department is not in a position to ensure that all private schools/colleges and coaching centres file returns of income.

#### **3.43.2 Non creation of database of educational institutions**

There is no data base with the department in respect of educational institutions and coaching centres though it would have facilitated monitoring and implementation of the amendment made from 1 April 1999 to ensure that educational institutions were carrying out genuine activities. The department had also not taken adequate steps for widening the tax base of educational institutions through adequate and focussed exercise of powers vested with them by conducting surveys and concerted investigations.

#### **3.43.3 Non verification of activities of educational institutions**

The department has no effective and working mechanism to evaluate the genuineness of exemption claimed by educational institutions as maximum assessments had been finalized in summary manner that defeated the very purpose of tax policy decided in Finance Act, 1998 to the effect that exemption to educational institutions should be granted only after ensuring that their activities were in accordance with their objectives.

### **3.44 Inadequacies in law**

Analysis of tax laws made for administration of tax policy revealed the following inadequacies.

**3.44.1** The very purpose of abolition of automatic exemption provided earlier under section 10(22) of the Act has been defeated as new provisions enacted under sections 10(23C)(iiiab)/(iiiad) did not yet provide any monitoring mechanism for checking the genuineness of activities. Such institutions are not required to file returns.

**3.44.2** Educational institutions that claim exemption under section 10(23C)(vi) are required to obtain approval every three years from the prescribed authority

while in the case of trusts, registration once granted is not necessary to be renewed further. There is no specific and clear-cut provision whether educational institutions could claim exemption only under section 11&12 or also under section. 10(23C)(vi) as both the sections are not mutually exclusive. Educational institutions run by trusts which are not obtaining requisite approval under section 10(23C)(vi) are now claiming exemption under sections 11&12 according to their convenience. There is no mechanism to ensure that the institution could claim exemption either only under section 11&12 or 10(23C)(vi) of the Act.

**3.44.3** Under section 12AA(2), every order granting or refusing registration to trusts shall be passed before the expiry of six months from the end of the month in which the application for registration was received. However, there is no time limit for granting approval under clause 10(23C)(vi) and nothing has been specified as to how in the absence of approval, exemption of income during that period is to be regulated.

**3.44.4** Trusts are required to furnish audited accounts with audit certificate along with returns of income while there is no such provision in the case of exemption under section 10(23C)(vi). Hence yearly evaluation of activities is difficult in respect of educational institutions run by other than trusts.

**3.44.5** Under section 11(5) of the Act, the unutilized surplus of the institutions is required to be invested in specified investments for the specified period and used for educational purposes only. However no monitoring mechanism is in place to monitor such investments.

### **3.45 Audit conclusions and recommendations**

**3.45.1** In order to achieve the objective of tax policy provided in the Finance Act, 1998, that income of educational institutions established solely for educational purposes should be exempted only after ensuring genuineness of their activities, there should be only one clause for exemption of income applicable to charitable trusts and other than trusts. Two separate clauses providing exemption under section 10(23C) and 11&12 of the Act overlap each other and are being misused by educational institutions.

**3.45.2** Department may like to make it mandatory for education institutions run by trusts to renew registration after every three years under section 12A, within a prescribed time limit without which exemption should not be allowed. Department would have to monitor approval in such cases by introducing effective and practical measures and procedures.

**3.45.3** Every educational institution should be mandatorily required to submit audited accounts along with return of income every year irrespective of whether their annual receipts are less than Rs. one crore or more or financed by government funds or not. In the absence of such information, it is difficult for the

department to verify the genuineness of their activities in a particular year as receipts could be diverted or under reported by adopting manipulative accounting practices.

**3.45.4** Department should have an exclusive database of educational institutions including coaching centres and update it from time to time, and monitor filing of returns of income every year.

**3.45.5** Department should devise effective verification procedures to monitor accumulation of income as prescribed and also watch whether application of income has been utilized only for educational purposes and investments have been made only under approved modes.

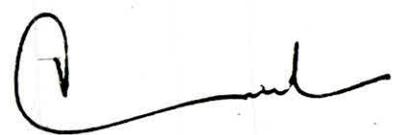
**3.45.6** Suitable penalty clause may be considered to be included in the Act to prevent utilisation of income other than for educational purposes as charging maximum marginal rates for such unauthorized usage of income has not proved to be an effective deterrent.

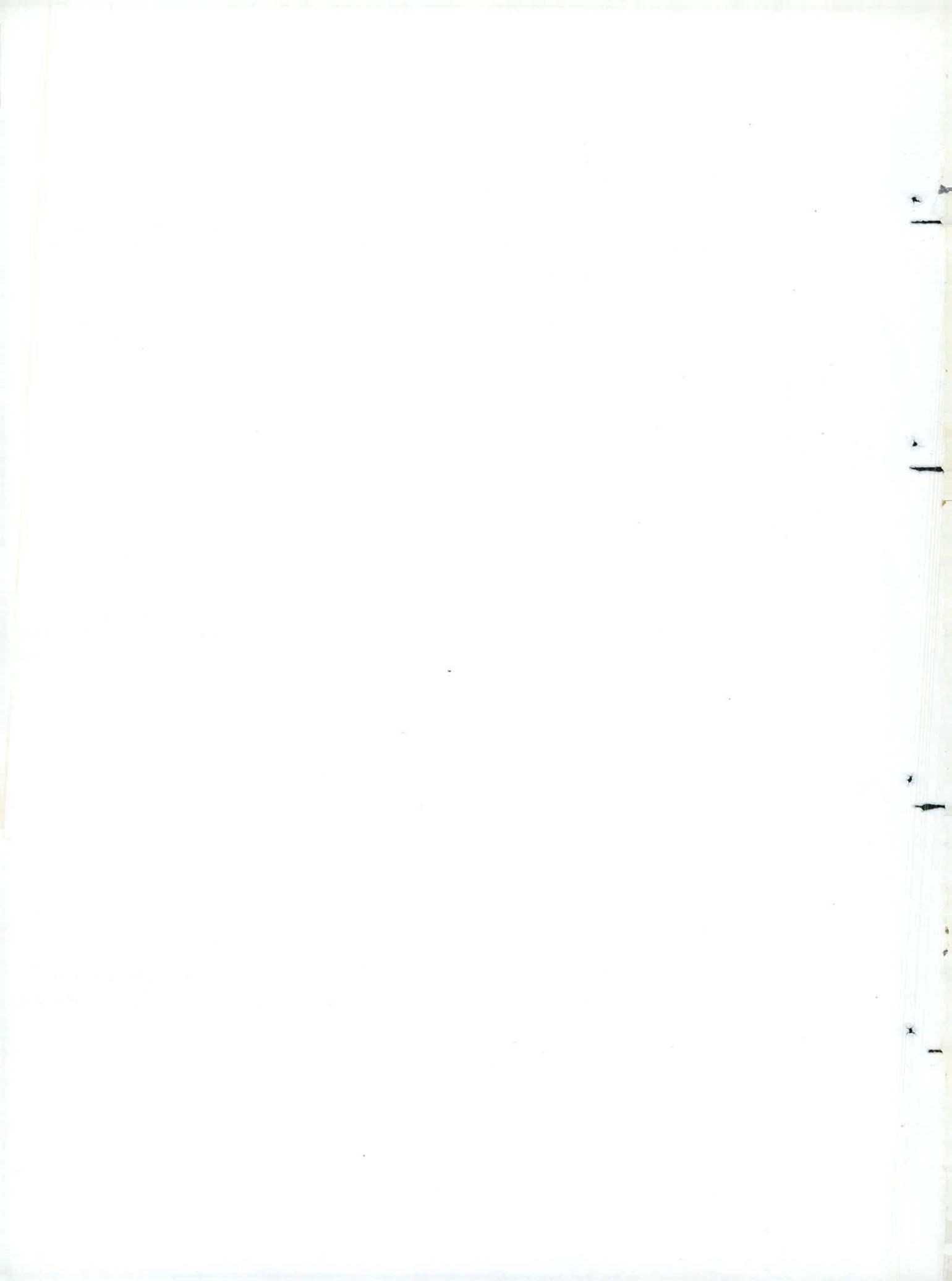
New Delhi  
Dated: 14 May 2004

  
(P. SESHKUMAR)  
Principal Director of Receipt Audit  
(Direct Taxes)

Countersigned

New Delhi  
Dated: 14 May 2004

  
(VIJAYENDRA N. KAUL)  
Comptroller and Auditor General of India



# Appendices





## Appendix-1

<b>Chapter I – Operation of the scheme of taxation of companies under special provisions of the Income Tax Act (Section 115 JA/JB)</b>
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## Selection of units and records (Para 1.3.3)

	<b>Selection of unit for test checking assessments u/s 115 JA/JB</b>	<b>Selection of records in selected units</b>
All field offices	CITs (having company charge) – 100%	Assessments made u/s 115 JA/JB – 100%

Field office	Selection of units <sup>1</sup> for test checking assessments other than those assessed u/s 115JA/JB	Selection of records in selected units		
		Percentage of assessment units to be selected	Category of cases	Scrutiny Summary
Metro charges (Delhi, Maharashtra, Tamil Nadu, West Bengal) & Gujarat, Karnataka	Under jurisdiction of CITs having company charge DCIT/ACIT – 50% ITO – 25% Central Circles – 75%		Income assessed at	
			Nil <sup>2</sup>	100% 25 %
			Loss <sup>2</sup>	100% 25 %
			Profit <sup>3</sup>	10% 10 %
AP, Assam, Bihar & Jharkhand, Haryana, HP, Kerala, MP, Orissa, Punjab, Rajasthan, UP	DCIT/ACIT/ITO under CIT (Company charge) – 100%  Central Circles – 100%		Income assessed at	
			Nil <sup>2</sup>	100% 25 %
			Loss <sup>2</sup>	100% 25 %
			Profit <sup>3</sup>	10% 10 %

<sup>1</sup> Selection of units was done based on the information in previous LARs so as to select greater number of loss/nil income companies.

<sup>2</sup> The selection of loss/nil income cases assessed in summary manner was done by adopting random sampling method.

<sup>3</sup> The selection of records in selected units for income assessed at profit was done in such a way that those companies were selected whose income was bordering between loss and profit.

**Appendix-2**  
**Items not added to net profit (Para 1.4.5)**

Name of the State.	Income tax paid or payable		Amount carried to reserve		Unascertained liabilities		Dividends paid or proposed		Expenditure relatable to exempted chapter -III income	
	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.
Andhra Pradesh	-	-	-	-	1	91.69	-	-	-	-
Bihar & Jharkhand	-	-	-	-	1	0.75	-	-	-	-
Delhi	-	-	-	-	23	1227.42	-	-	1	2.74
Gujarat	-	-	-	-	19	347.69	-	-	-	-
Haryana	-	-	1	208.58	3	0.87	-	-	-	-
Himachal Pradesh	2	0.27	-	-	-	-	-	-	-	-
Karnataka	-	-	-	-	19	100.49	-	-	1	102.51
Kerala	-	-	-	-	15	1367.95	-	-	5	273.25
Maharashtra	3	162.09	17	4513.50	62	8795.50	-	-	1	6.35
MP & Chattishgarh	1	1.33	-	-	1	13.45	1	26.46	3	1.63
Punjab	-	-	-	-	3	10.93	-	-	-	-
Tamil Nadu	-	-	-	-	47	3018.08	-	-	1	103.88
UP & Uttaranchal	-	-	2	1.18	2	29.77	-	-	-	-
West Bengal	5	249.25	9	292.31	49	7419.56	-	-	7	4175.51
<b>Total</b>	<b>11</b>	<b>412.94</b>	<b>29</b>	<b>5015.57</b>	<b>245</b>	<b>22424.15</b>	<b>1</b>	<b>26.46</b>	<b>19</b>	<b>4665.87</b>

No.- Number of cases . T. E.-Tax effect (Rs. in lakh)

**Appendix-3**  
**Incorrect deduction from net profit (Para 1.4.10)**

Name of the State.	Amount withdrawn from reserve not reduced correctly		Exempted income not reduced correctly.		Loss b/f or unabsorbed depreciation whichever is less(loss can not include depreciation and one of the items should not be nil) not reduced correctly		Profits derived by an industrial undertaking from business of generation of power not reduced correctly		Profits derived by an industrial undertaking located in industrially backward area not reduced correctly		Profits derived by an industrial undertaking from the business of infrastructure facility not reduced correctly		Export profits eligible for deduction u/s 80 HHC(from assessment year 1998-99) as in the case of normal assessment not reduced correctly		Profits from export of computer software eligible for deduction u/s 80 HHE(from assessment year 1998-99) not reduced correctly		Profits from export of film software eligible for deduction u/s 80 HHF(from assessment year 2001-02) not reduced correctly		Profit of sick industrial company not reduced correctly.			
	1	2	3	4	5	6	7	8	9	10	11	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.	
Andhra Pradesh					-	-	-	-	-	-	-	3	188.19	-	-			-	-			
Assam					11	24.82	-	-	4	1044.37	5	31.75	-	-	-	-			-	-		
Bihar & Jharkhand					32	14.23	-	-	-	-	-	-	1	24.66	-	-			-	-		
Delhi			1	4.01	5	7.29	-	-	3	33.22	-	-	2	14.65	-	-			-	-		
Gujarat					5	17.25	-	-	-	-	-	-	8	131.00	-	-			-	-		
Haryana					21	7.07	-	-	-	-	-	-	1	9.69	-	-			-	-		
Himachal Pradesh					17	6.87	-	-	-	-	-	-	-	-	-	-			-	-		
Karnataka					14	53.93	-	-	4	5.64	-	-	-	-	-	-			-	-		
Kerala					10	67.32	-	-	-	-	-	-	18	185.60	-	-					2	131.74
Maharashtra	7	49851.59			19	151.98	1	140.44	-	-	-	-	14	12550.72	1	15.31					3	698.70
MP & Chattishgarh			1	180.59	30	26.49	1	28.48	7	21.39	-	-	4	91.87	-	-					-	-
Orissa					-	-	-	-	-	-	-	-	1	37.59	-	-					-	-
Punjab					45	17.69	-	-	-	-	-	-	8	36.00	-	-					-	-
Rajasthan					11	16.18	-	-	1	0.22	-	-	1	29.63	-	-					-	-
Tamil Nadu	5	1278.98	1	9.07	19	116.20			10	274.25	1	37.50	67	745.68	3	4.64	1	10.65				
Uttar Pradesh					2	3.71																
West Bengal	5	431.04	4	12786.34	25	778.87	3	29.92	1	2.71	4	21.98	7	47.12	1	1.26						
<b>Total</b>	<b>17</b>	<b>51561.61</b>	<b>7</b>	<b>12980.01</b>	<b>266</b>	<b>1309.90</b>	<b>5</b>	<b>198.84</b>	<b>30</b>	<b>1381.80</b>	<b>10</b>	<b>91.23</b>	<b>135</b>	<b>14092.40</b>	<b>5</b>	<b>21.21</b>	<b>1</b>	<b>10.65</b>	<b>5</b>	<b>830.44</b>		

No.- Number of cases T. E.-Tax effect (Rs. in lakh)

## Appendix-4

## Cases involving tax effect of Rs.1 crore or more and not illustrated in the review

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
<b>Supplement to para 1.4.6</b>						
1.	M/s. Mangalore Refinery & Petrochemicals Ltd	Mumbai III	1998-99	143(3)	The assessee debited interest on income tax to the profit and loss account which the assessing officer did not disallow under special provisions though he disallowed the same in normal computation.	1.04
<b>Supplement to para 1.4.7</b>						
2.	Infrastructure Leasing and Finance Ltd.	Mumbai X	1997-98 to 1999-00	143(3)	Assessee deducted certain amount towards lease equalization reserve from the lease rental income which was not added to net profit in the assessment under special provision.	14.69
3.	Mafatlal Finance Co. Ltd.	Mumbai I	1997-98 and 1998-99	143(3)	-Do-	7.72
4.	Mafatlal Finance Co. Ltd.	Mumbai I	1999-00	143(1)	-Do-	2.39
5.	Exide Industries Ltd.	Kolkata I	1999-00	143(1)	-Do-	1.31
6.	National Hydro Electric Power Corporation Ltd.	Faridabad	2001-02	143(1)	Provision of Rs.20.91 crore made for contingency reserve was not added to the book profit for arriving at book profits.	2.09
<b>Supplement to para 1.4.8</b>						
7.	Central Bank of India	Mumbai II	1997-98 and 1999-00	143(3)	Provisions made for meeting unascertained liabilities and debited to profit and loss account were not added back to net profit in the	31.54

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					assessment under special provisions though disallowed in normal computation.	
8.	Indian Overseas Bank Ltd.	Tamil Nadu I, Chennai	2001-02	143(1)	-Do-	15.32
9.	Standard Chartered Bank	DGIT	1998-99	143(3)	-Do-	15.15
10.	UCO Bank	Kolkata II	2002-03	143(1)	-Do-	14.06
11.	United Bank of India	Kolkata II	2001-02 and 2002-03	143(1)	-Do-	3.17
12.	Standard Chartered Bank	DGIT International taxation	2001-02	143(1)	-Do-	6.95
13.	Janpath Investment & Holding Ltd.	Kolkata II	2000-01	143(1)	-Do-	6.60
14.	Alstom ltd.	Tamil Nadu I, Chennai	1999-00	143(1)	-Do-	6.29
15.	Federal Bank Ltd.	Kochi	1999-00	143(3)/154	-Do-	5.65
16.	TISCO	Mumbai II	1997-98 and 1999-00	143(3)	-Do-	5.47
17.	Indo Rama Synthetics (I) Ltd.	Delhi IV	2002-03	143(1)	-Do-	3.56
18.	The South Indian Bank Ltd.	Thrissur	1999-00	143(1)	-Do-	2.93
19.	Madura Coats	Madurai I	1998-99	143(3)	-Do-	2.34
20.	Otis Elevators (I) Ltd.	Mumbai II	2000-01	143(3)	-Do-	1.99
21.	Catholic Syrian Bank Ltd.	Thrissur	1997-98	143(3)/154	-Do-	1.36
22.	Philips India Ltd.	Kolkata IV	1999-00	143(1)	-Do-	1.30
23.	Bank of Tokyo Mitsubishi Ltd.	DGIT International taxation	2001-02	143(1)	-Do-	1.18
24.	ACC Ltd.	Mumbai I	2002-03	143(1)	-Do-	1.04
25.	National Fertilizers Ltd.	Delhi V	2001-02	143(1)	-Do-	1.01
26.	Reliance Industries Ltd.	Mumbai III	1997-98 to 2000-01 2001-02 to 2002-03	143(3) 143(1)	The assessee had debited provision for doubtful debts, advances etc. to the profit and loss account. Though the assessing officer added back this provision under normal provisions of	13.66

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					the Act, he omitted to add the same while arriving at book profit.	
<b>Supplement to para 1.4.9</b>						
27.	Premier Polytronics Ltd.	CIT I Coimbatore	2000-01	143(3)	The assessing officer did not disallow expenditure related to export profits the income from which was exempt from tax resulting in short levy of tax of Rs.1.04 crore including interest.	1.04
28.	Vysya Bank Ltd.	CIT-I, Bangalore	2000-01 and 2001-02	143(3)	Expenditure incurred for earning the income exempt under chapter III was added to the income computed under normal provisions but not disallowed in the assessment under special provisions.	1.03
<b>Supplement to para 1.4.13</b>						
29.	United Bank of India	Kolkata II	2000-01	143(3)	Loss brought forward or unabsorbed depreciation whichever is less was not reduced correctly.	2.40
30.	Timken India Ltd.	Kolkata III	1998-99	143(3)	-Do-	1.19
<b>Supplement to para 1.4.16</b>						
31.	Futura Polymers Ltd	Mumbai City I	1998-99 to 2000-01	143(1)	The assessee had returned income of Rs.21.22 lakh, Rs.3.25 crore and Rs.23.24 lakh respectively. While completing assessments under section 115 JA, the assessing officer allowed relief of Rs.9.90 crore, Rs.7.44 crore and Rs.7.31 crore respectively for the three assessment	3.14

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					years, under section 80 HHC though the assessee was not eligible for the deduction.	
32.	Indian Rare Earths Ltd	Mumbai I	1999-00	143(3)	Assessing officer had allowed deduction under section 80 HHC to the extent of Rs.4.58 crore before set off of unabsorbed depreciation of earlier years which was not as per the provisions of the Act.	3.08
33.	Chemisor Drugs Ltd.	Hyderabad I	1998-99	143(3)	Incorrect method of quantification of deduction under section 80 HHC adopted, resulted in short computation of book profit.	1.60
34.	Indian Petrochemicals Ltd.	Baroda I	2001-02	143(1)	-Do-	1.05
<b>Supplement to para 1.4.19</b>						
35.	TELCO	Mumbai II	1998-99	143(3)	Tax credit of Rs.32.81 crore was allowed to be carried forward as against correct tax credit of Rs.15.10 crore.	15.10
36.	Videocon International Ltd.	Central circle II Mumbai	2000-01	143(3)	Tax credit of Rs.8.65 crore was allowed under special provisions. In revision, the income under normal provisions was higher than the computation under special provisions. Thus the assessee was not entitled to any tax credit.	8.65
37.	Reliance Capital Ltd.	Mumbai III	1999-00	143(1)	Income assessed under special provisions in assessment year 1998-99 was revised	3.83

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					after scrutiny at higher income. No tax credit was thus available for assessment year 1999-00 which was not withdrawn.	
38.	Centurion Bank Ltd.	Mumbai II	2000-01	143(1)	Assessments of assessment years 1998-99 and 1999-00 were completed after scrutiny under normal provisions at higher income. Tax credit allowed in assessment year 2000-01 on the basis of scrutiny assessments of 1998-99 and 1999-2000 remained to be withdrawn.	3.20
39.	Madura Coats Ltd.	Madurai I	1997-98 and 1999-00	143(3)	Tax credit was allowed to the assessee. Assessment was revised in March 2000 after scrutiny resulting in taxable income under normal computation. Thus the assessee was not entitled to carry forward of tax credit which was not withdrawn.	2.23
40.	Reliance Capital Ltd.	Mumbai III	1999-00	143(3)	Tax credit was allowed to the assessee. Income of earlier assessment year for which tax credit was allowed was increased under normal provisions after giving effect to appellate orders. Thus the assessee was not entitled to carry forward of tax credit which was not withdrawn.	1.98



Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
41.	Lakshmi Vilas Bank Ltd.	CIT-I, Trichy	2000-01	143(3)	Income after scrutiny assessment for the assessment year 1999-00 became higher and as such no tax credit was available for adjustment in the assessment year 2000-01 which was not withdrawn.	1.87
42.	Crompton Greaves Ltd.	Mumbai VI	1998-99	143(3)	After giving effect to CIT(A)'s orders the income was reduced. Corresponding reduction in tax credit already given was not made.	1.40
43.	V. M. Salgoankar & Bros. Ltd.	Panaji	1997-98	143(3)	Tax credit was allowed to the assessee. Assessment was revised in March 2000 after scrutiny resulting in taxable income under normal computation. Thus the assessee was not entitled to carry forward of tax credit which was not withdrawn.	1.39
44.	Dhariwal Industries Ltd.	Pune-I	1999-00	143(1)	Income assessed under special provisions in assessment year 1998-99 was revised after scrutiny and was higher under normal provisions. No tax credit was thus available for assessment year 1999-00 which was not withdrawn.	1.26
<b>Supplement to para 1.4.20</b>						
45.	Global Tele Systems	Mumbai II	2000-01	143(1)	Set off of tax credit of Rs.2.21 crore allowed in assessment year 2000-01 was	2.63

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					incorrect as the same was required to be allowed in assessment year 1999-00 itself when the income was computed under normal provisions.	
46.	National Fertilizers Ltd.	Delhi V	2002-03	143(1)	Provision of doubtful debts of Rs.28.39 crore and shortfall of Rs.37.99 lakh in stores were not added to the net profit to arrive at the book profit under the special provisions. After these adjustments, book profit worked out to Rs.76.87 crore involving tax liability of Rs.5.88 crore under special provisions. Tax credit allowable for set off was Rs.8.11 crore whereas credit actually set off was Rs.10.30 crore.	2.18
47.	Essar Oil Ltd.	Mumbai V	1999-00	143(3)	Tax credit of Rs.8.27 crore was allowed as against the correct credit of Rs.6.47 crore.	1.80
<b>Supplement to para 1.4.21</b>						
48.	Allahabad Bank	Kolkata II	2000-01	143(3)	Tax credit was allowed from the total tax liability before levying interest for defaults in payment of advance tax and interest for deferment of advance tax.	7.84
49.	Shipping Corporation of India Ltd.	Mumbai V	1998-99	143(3)	Interest on refund was required to be worked out before setting off of tax credit.	4.73

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
50.	Duncan Industries Ltd.	Kolkata II	1998-99	143(3)	Tax credit was allowed from the total tax liability before levying interest for defaults in payment of advance tax and interest for deferment of advance tax.	3.75
51.	National Fertilizers Ltd.	Delhi V	2002-03	143(1)	Tax credit brought forward under section 115JA was adjusted before charging of interest under section 234 B&C.	2.05
52.	Mangalore Refinery & P.C. Ltd.	Mumbai III	1999-00	143(3)	Tax credit was allowed from the total tax liability before levying interest for defaults in payment of advance tax and interest for deferment of advance tax.	1.42
53.	Rassi Cement Ltd.	CIT Central Hyderabad	1998-99	143(3)	-Do	1.24
54.	Exide Industries Ltd.	Kolkata I	2000-01	143(3)	-Do-	1.19
<b>Supplement to para 1.4.23</b>						
55.	Baser Concrete Systems Ltd	Tamil Nadu I, Chennai	2000-01	143(1)	Profit of Rs.7.46 crore arising out of one time settlement of outstanding loan, in consequence of agreement entered into with the bank was not taxed.	1.35
<b>Supplement to para 1.4.26</b>						
56.	The Federal Bank Ltd.	Kochi	1999-00	143(3)	Rs.36.28 crore paid as interest on interest bearing bonds issued by central government, state government, RBI etc. by the assessee for the period from 1 April to the date of purchase in the previous years relevant to the	4.96

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
					assessment year 1999-00 was debited to profit and loss account and not added back to book profits.	
57.	A.C.C. Ltd.	Mumbai I	2002-03	143(1)	Capital expenditure e.g. assets written off, written down value of assets, expenditure on assets not owned by the company, loss on sale of assets/investments and stamp duty paid on land totalling Rs.30.18 crore were debited to the profit and loss account which were disallowed by the assessing officer and added back while computing the income under the normal provisions of the Act. However, no such additions were made in computing the book profit.	2.64
<b>Supplement to para 1.4.27</b>						
58.	A.C.C. Ltd	Mumbai I	2002-03	143(1)	VRS payments of Rs.20.93 crore pertaining to earlier years debited to profit and loss account were not added back while computing book profit.	1.82
<b>Supplement to para 1.4.30</b>						
59.	Sandoz Textiles & Trading Ltd.	Mumbai III	1998-99	143(3)	Difference between the book value and value of assets sold after revaluation was not credited to profit and loss account.	9.59

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
60.	ACC Ltd.	Mumbai I	2002-03	143(1)	Sale proceeds of "trial run" production amounting to Rs.73 crore were not credited to profit and loss account.	6.42
61.	Capable Commercials (p) Ltd.	Mumbai III	1998-99	143(3)	Profit on sale of properties amounting to Rs.28.16 crore was transferred from revaluation reserve and credited to general reserve instead of to profit and loss account.	4.67
62.	National Fertilizers Ltd.	Delhi V	2000-01	143(3)	An amount of Rs.26.34 crore debited to profit and loss account on account of provision for doubtful debts was not added back under special provisions.	4.15
63.	The Nedungadi Bank Ltd.	Thrissur	2002-03	143(1)	30 per cent of book profit was not treated as chargeable income.	2.38
64.	Shree Cement Ltd.	Beawar	1999-00	143(1)	Net profit as per profit and loss account was taken at Rs.9.30 crore instead of Rs.18.82 crore.	1.91
65.	EIH Ltd.	Kolkata III	1998-99	143(1)	30 per cent of book profit was not treated as chargeable income.	1.64
66.	Williamson Financial Services Ltd.	Guwahati II	1997-98	143(1)	Provision for Rs.4.38 crore was not added to net profit.	1.22
67.	Kankhal Investment & Trading Co. (P) Ltd.	Mumbai III	1998-99	143(3)	Profit on sale of properties amounting to Rs.6.27 crore transferred from revaluation reserve and credited to general reserve instead of to profit and loss account.	1.04

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
68.	Precision Fasteners Ltd.	Mumbai I	1997-98	143(3)	Incorrect adoption of net profit for computing book profit.	1.01
<b>Supplement to para 1.4.35</b>						
69.	Usha Beltron Ltd.	Ranchi	1999-00	143(1)/115 JA	Fixed assets written off as per books, loss on sale of fixed assets, provision for contingency and interest on income tax were not disallowed while computing book profit.	1.85
70.	Usha Beltron Ltd.	Ranchi	2001-02	143(1)/115 JA	Provision for bad and doubtful debts and interest on income tax were not disallowed and profit on sale of investment was not taxed while computing book profit.	1.61
71.	Braithwaite Burn & Jessop Construction Company Ltd.	Kolkata I	2000-01	143(1)	Receipt of Rs.13.59 crore not credited to profit and loss account on account of waiver of interest on Government of India loan was not included in computation of book profit.	1.53
72.	Protchem Industries Ltd.	Tamil Nadu III, Chennai	1997-98 1998-99 1999-00 2000-01	143(3) 143(1) 143(1) 143(1)	While filing returns for the four assessment years, the assessee did not opt for the deduction of profits, allowable under special provisions under chapter III of Income Tax Act. Hence the assessee was not eligible to claim deduction of such profit while computing book profit.	1.50

Sl. No.	Name of the assessee	CIT charge	Assessment year	Assessed under section	Audit observation	Tax effect (Rs. in crore)
73.	Jubilant Organosys Ltd.	Moradabad	2000-01	143(3)	Amount of Rs.4.39 crore being loss of amalgamated companies not charged to profit and loss account was deducted while computing book profit. Assessee did not directly credit the profit and loss account with difference in value of stock (Rs.2.73 crore) consequent to the revaluation. This was instead shown as reduction in cost of raw material and was wrongly allowed as deduction from book profit.	1.19

**Appendix-5**  
**Mistakes in tax credit under special provisions (Para 1.4.18)**

Name of the State.	Wrong determination of Tax credit		Incorrect set off of tax credit		Short levy of interest due to incorrect set off of tax credit		Interest not calculated before set off of tax credit		Assessed under special provision but interest u/s 234 B & 234 C not charged		Surcharge not calculated before set off of tax credit	
	1	2	3	4	5	6	7	8	9	10	11	12
	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.	No.	T.E.
Andhra Pradesh	-	-	6	82.94	19	444.69	4	37.49	-	-	-	-
Assam	-	-	2	20.57	1	5.14	-	-	-	-	-	-
Bihar & Jharkhand	-	-	-	-	2	1.90	5	2.36	2	2.21	-	-
Delhi	2	46.70	4	281.73	4	241.39	-	-	-	-	-	-
Gujarat	7	19.87	17	188.42	13	170.59	-	-	-	-	-	-
Haryana	4	16.20	7	8.93	27	20.18	1	0.66	19	33.52	-	-
Himachal Pradesh	-	-	1	0.77	-	-	1	0.60	-	-	-	-
Karnataka	2	165.38	6	13.09	64	122.18	16	26.95	13	13.62	5	5.62
Kerala	9	20.77	-	-	8	33.15	-	-	-	-	1	57.62
Maharashtra	12	5539.66	13	2902.98	36	3435.54	6	518.61	-	-	1	28.25
MP & Chattishgarh	6	115.18	6	6.76	12	24.27	4	0.81	17	82.58	-	-
Punjab	1	48.85	12	31.91	51	40.28	0	-	20	14.82	-	-
Rajasthan	-	-	4	208.06	108	87.17	25	50.58	2	31.55	3	0.29
Tamil Nadu	4	410.64	3	85.88	-	-	90	814.54	-	-	-	-
West Bengal	8	191.51	5	36.36	49	1598.12	10	30.61	-	-	2	22.40
<b>Total</b>	<b>55</b>	<b>6574.76</b>	<b>86</b>	<b>3868.40</b>	<b>49</b>	<b>1598.12</b>	<b>135</b>	<b>1483.21</b>	<b>73</b>	<b>178.30</b>	<b>12</b>	<b>114.18</b>

No.- Number of cases . T. E.-Tax effect(Rs. in lakh)



## Appendix-6

## Chapter-III – Assessment of Private Schools, Colleges &amp; Coaching Centres

(Rs. in lakh)

Sl. No.	Name of assessee & CIT charge	Assessment year	Gist of mistakes	Tax effect
<b>Supplement to Para 3.17.5</b>				
1	M/s Kandi Friends Education, Mohali, Chandigarh, and <b>19 others</b> , Punjab	1999-00 to 2001-02 Summary.	Annual receipts of educational institutions run by trusts exceeded the prescribed limit of Rs.one crore. There was nothing on record to indicate that they were approved by prescribed authority under section 10(23C)(vi). Assessing officer however accepted the returns filed in summary manner.	382.08
2	Indian Institute of Rural Management and <b>8 others</b> Jaipur I &II, Alwar & Kota, Rajasthan	1999-00 to 2001-02 Summary	Assessee's annual receipts were more than Rs. one crore. They claimed exemption of income under section 10 (23C)(vi) without approval from the prescribed authority which was allowed by the assessing officer. In one case, assessee did not file return of income though its annual receipt was more than Rs.one crore.	286.12
3	Jagannath Institute of Engineering and Technology, Cuttack, and <b>6 others</b> , Orissa	2001-02 Summary	In the first two cases, assessees had submitted application for grant of approval under section 10 (23C) (vi) in October 2001 & 2002. Approval was awaited. In third & fourth cases, the assessees did not submit application for approval. In the fifth case, nothing was on record to show that assessee had applied for approval. The assessing officer had accepted claims under section 11&12 without approval from prescribed authority.	233.54
4	Bhopal Campion School Society and <b>3 others</b> Bhopal & Indore, MP	1999-00 to 2002-03 Summary	Assessee had submitted applications for approval under section 10 (23C)(vi) which were pending. Assessing officers however accepted claims for exemption of income without approval from the prescribed authority.	162.20
5	Virendra Swarup Educational foundation, Methodist High School Kanpur, St. Fidelis Schools Educational Institute Aligarh., UP	1999-00 to 2001-02 Summary	Assessee's claim for exemption of income under section 10 (23C) (vi) was accepted without approval from prescribed authority.	158.14
6	Vodithala Educational Society, and <b>2 others</b> Hyderabad, Andhra Pradesh	1999-00 & 2001-02 Summary	Income of the institution for the assessment year 2000-01 was taxed as approval under section 10 (23C)(vi) was not received. However, the assessing officer allowed exemption for next assessment year 2001-02 without approval. On being pointed out by audit, the case was marked for scrutiny. In other two cases, approvals were awaited but exemptions were granted.	78.53
7	Bishop Cotton School Shimla & <b>6 others</b> Himachal Pradesh.	1999-00 to 2001-02 Summary	In four cases, the institutions were allowed exemption under section 10(23C)(vi) without approval of the prescribed authority. In other six cases, exemption claimed under section 11&12 was allowed without registration under section 12A by the Commissioner.	60.09
8	Charotar Vidya mandal and <b>12 others</b> Gujarat	1999-00 to 2002-03 Summary	Annual receipt of the institutions exceeded Rs. one crore. Except in two cases, where applications were pending with the DI (Exemption) Kolkata, other institutions had not applied for approval but assesseees were allowed exemption of income.	52.39

Sl. No.	Name of assessee & CIT charge	Assessment year	Gist of mistakes	Tax effect
9	Guru Nanak Hr. Secondary School, Ranchi, Jharkhand	1999-00 Summary	Assessee's claim for exemption of under section 10(23C)(vi) was accepted though the assessee had not made an application for such approval.	16.36
<b>Supplement to Para 3.19</b>				
10	Kuarmunda don Bosco Society Rourkela and <b>eight others</b> , Orissa	1998-99 to 2001-02 Summary	Assessee had claimed exemption stating that they were registered but registration numbers were not mentioned. Copies of registration were also not made available to audit.	94.80
11	St. Francis of Assisi Church, Lazmi and <b>14 others</b> , Jorhat and Dibrugarh, Assam	1999-00 to 2001-02 Summary	Educational institutions run by the Trusts were neither registered nor had applied for registration but exemption was granted by the assessing officer.	93.26
12	Computer Management Technical Education Society, Trichy and <b>3 others Chennai</b> , Tamil Nadu	1999-00 & 2001-02 Summary	Trusts were granted exemption without obtaining registration.	89.70
13	DAV Model School, CIT Durgapur, Kolkata	1999-00 to 2001-02 Summary	Assessee claimed exemption under section 11 and granted by the assessing officer though it was not registered under section 12A.	21.70
14	Indian Institute of Business and Management, Patna, Bihar	2001-02 Summary	Assessee claimed exemption under section 10(22) though it was not registered and being coaching centre, provisions of exemption were not applicable.	18.50
15	Our Lady of Nazerath School, Thane, Maharashtra	2001-02 Summary	In the absence of trust deeds, trust was not registered. The assessing officer however allowed exemption for income of Rs.40.95 lakh under section 11 without registration.	12.28
16	M/s Indo Friends Foundations Indore, Madhya Pradesh.	2000-01 Summary	Registration was granted with effect from assessment year 2001-02. Hence assessee was not eligible for exemption for assessment year 2000-01.	7.39
17	Ettumanoorappan Educational Society, and Pentecost Educational Society, Kottayam. Kerala	2000-01 to 1995-96 1997-98 Summary	Perusal of audited accounts revealed that the assessee had excess of income over expenditure. Exemption under section 11 was not admissible as registration granted under section 12A was effective from 1 April 2002.	6.33
18	Millat Education Society, Patna, Bihar	2001-02 Summary	Trust was not registered under section 12A. In addition, it received voluntary contribution of Rs.15.30 lakh from different sources without specific direction, which was not taxed.	6.19

Sl. No.	Name of assessee & CIT charge	Assessment year	Gist of mistakes	Tax effect
19	M/s Vinay Prakash Vidya Bhawan Society, Jodhpur and <b>one other</b> at Ajmer, Rajasthan	1996-97 Scrutiny 1999-00 Summary	Assesseees were granted exemption under section 11 though they were not registered under section 12A.	4.27
<b>Supplement to Para 3.21.7</b>				
20	Madhupur Carmelite Sisters, Dhanbad, Jharkhand.	2000-01 Summary	The assessee neither claimed exemption nor paid any tax. However the return was accepted in summary manner allowing exemption.	30.49
21	Audhnic Public School Dharamshala, Don Basco Society, Our Lady Snow School, Kullu, Himachal Pradesh.	1999-00 to 2002-03 Summary	In one case, the society was managed by members and relatives of a family and the institution had advanced funds to its office bearers. In other cases surplus was more than prescribed limit of 25%. Assessee's claims under section 10 (23C) (iiiad) were however, accepted in summary manner without examination.	15.20
22	Denobili School CMRI, Dhanbad, Jharkhand	2000-01 Summary	The assessee's claim for exemption was accepted under non existent section 10(E).	8.52
23	Denobili School Jealgore Dhanbad Jharkhand	1999-00 Summary	The assessee's claim for exemption under section 10(22) was accepted even though this section was omitted.	5.99
24	ABMP Adarsh Uchcha Vidyalaya Jamshedpur Jharkhand	2001-02 Summary	The assessee's claim for exemption under section 10(23C)(iiiab) was accepted even though the basic condition that it should be wholly or substantially financed by Government was not fulfilled and assessee received entire subsidy from private organisation.	4.57
<b>Supplement to Para 3.24.1</b>				
25	Kheda Education Society, and <b>12 other cases</b> , Gujarat	1997-98 to 2001-02 Summary	Accounts were not audited and audit certificates not filed with the returns, though total income of the institutions exceeded Rs.50,000 without giving effect to the provisions of section 11 & 12.	64.65
26	Bhatkya Vimukta Jamati Shikshan Vikas, Pune and six at Kolhapur, Aurangabad, Thane, Maharashtra	1998-99 & 2002-03 Summary	Exemption under section 11 was allowed even though the requisite audit report was not furnished along with the return of income.	64.18
27	St. Stephen's School & Indian Institute of Science and Management, Hazaribagh and Ranchi, Jharkhand	2000-01 to 2001-02 Summary	Audit Reports in the prescribed form No. 10B were not filed though total income of the institutions exceeded Rs.50,000 without giving effect to the provisions of section 11 & 12.	51.23

Sl. No.	Name of assessee & CIT charge	Assessment year	Gist of mistakes	Tax effect
28	Gurunanak Public school, Sambalpur Orissa	1999-2000 to 2001-02 Summary	Certified accounts were not filed along with returns of income.	4.02
29	M/s Sindhi Panchayat Education, Jaipur, Rajasthan	1998-99 & 1999-00 Summary	Accounts of the assessee disclosed that Rs.3.55 lakh was transferred to another institution, MC Sindhi Panchayat Sr. Hr Secondary School. Taking this into account, prescribed income limit of Rs.50,000 was exceeded. Audit Report in the prescribed form No. 10B was not filed.	1.68
<b>Supplement to Para 3.39.1</b>				
30	SNR and Sons run by charitable trust, Coimbatore and 34 other cases Tamil Nadu	1999-00 & 2001-02 Summary	Donations of Rs.5555.44 lakh were added to the corpus fund without specific direction from donors to the effect.	1795.24
31	Vishwas Shikshan Prasark Mandal Chikhali, Kolhapur and St. Ursula Pune, Mumbai	2001-02 Summary	Assessee transferred Rs.150 lakh and Rs.90 lakh from reserve fund to corpus fund which is not in order as earmarked fund should be utilised for the object for which these were created as per section 11(2)(a) of the Act or otherwise the same should be brought to tax.	72.00
32	Noor Education Trust and 11 others, Gujarat	1997-98 to 2001-02 Summary	Assessee had received interest, donations without specified purpose or to corpus fund, receipt on account of payment of loan from students, profit on sale proceeds of vehicles etc, but these were not reflected in computation of income.	28.26
33	Keshav Vidhyapeeth Samiti, Jaipur and Model Public School Society Bhiwadi in Alwar charge, Rajasthan	1998-99 & 2000-01 Summary	Donations to earmarked funds like college fund, Shiksha Sahayta fund and building fund etc were taken directly in the balance sheet instead of adding to the income. Assessee should have applied to the assessing officer for accumulation of excess/surplus beyond the prescribed limit of 25% which was not done. Such surplus was also not invested in specified modes.	23.88
34	Delhi Chinmaya Sewa Trust, Delhi	1997-98 Scrutiny	The assessee had confirmed Rs.20.10 lakh as general donation and the same was required to be treated as income. However, the assessing officer allowed exemption.	13.42
35	St. Xaviers Church Meluri and 16 others, Jorhat and Dibrugarh, Assam	1999-00 to 2001-02 Summary	In four cases, an amount of Rs.13.68 lakh was transferred to the principal trust whose accounts indicated that only Rs.9.80 lakh was credited resulting in income of Rs.3.88 lakh escaping tax. In 15 cases, assessee had shown payment of Rs.14.89 lakh to "Diocese of Kohima" which was not included in income.	11.67
36	The Bharti Vidyapeeth, Pune	2000-01 Summary	Assessee credited Rs.21.39 lakh on account of 20% profit received from a bank to the balance sheet instead of Income & Expenditure Accounts resulting in understatement of the surplus which was liable to tax.	6.41
37	J N Educational Society, Delhi	1995-96 Scrutiny	Assessment was completed after disallowing unexplained donation of Rs.6.88 lakh received by the assessee. In the appeal, the assessing officer was asked to "de-novo" examine the donations. However, the assessing officer allowed the donations without obtaining confirmation, which was irregular.	4.73

Sl. No.	Name of assessee & CIT charge	Assessment year	Gist of mistakes	Tax effect
38	My Home Educational Society Hyderabad, Andhra Pradesh	1998-99 to 2000-01 Summary	Assessee had advanced Rs.16.16 lakh for purchase of land and loan to M/s. Raghavan Constructions. But there was no entry for land in the 'assets schedule" nor was there any entry for capital work in progress in the balance sheet. As the amount was not utilised for educational purpose it was required to be taxed.	4.85

