

सत्यमेव जयते

# Report of the Comptroller and Auditor General of India

## The Appeal Process

Union Government (Direct Taxes)  
No. 20 of 2009-10



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

**for the year ended March 2009**

**The Appeal Process**

**UNION GOVERNMENT  
(DIRECT TAXES)  
NO. 20 OF 2009-10**

Laid on the table of Lok Sabha/Rajya Sabha on \_\_\_\_\_

13 अगस्त 2010  
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## PREFACE

The report for the year ended March 2009 containing the results of the performance audit of The Appeal Process has been prepared for submission to the President under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts – Direct Taxes of the Union Government is conducted under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

Our findings are based on mainly test audit conducted during the period January 2009 to September 2009. Some findings of audit conducted in earlier years, but could not be covered in previous reports, have also been included.

Summary  
of  
Recommendations

## Executive Summary

An aggrieved tax payer has the right to dispute a tax demand with the Income Tax Department through the Commissioner of Income Tax (Appeals). Second appeal against the orders of CIT (A) lies in the Income Tax Appellate Tribunal (ITAT) which functions under the Ministry of Law. On any question of law arising out of an order of ITAT, a taxpayer may appeal progressively to the High Court and the Supreme Court. Analogous right to appeal is also available to the Department against the orders of CIT (A) and onwards.

The dimensions of disputes in income tax are staggering. Rs 2.2 lakh crore is the amount locked up in appeals at various levels, which can almost wipe off the revenue deficit of the Union Government in 2008-09. On an average, 48 *per cent* of tax demands remain uncollected and disputes account for 45 *per cent* of uncollected demands. These factors, we felt, merited a performance evaluation of the appeal process. This is the first time we have attempted a holistic study of appeals. The topic was also suggested by the Central Board of Direct Taxes (Board) during our consultations on areas of concern in the Department.

In our study covering the period 2006-09, we sought an assurance that the processes ensure speedy resolution of disputes; they also identify litigious provisions in the Act for correction; the decisions for escalation of disputes to higher levels in the appellate hierarchy are based on a fair assessment of cost-benefit; the appeals are filed by the Department within the prescribed timeframe to avoid dismissal due to limitation; and the appellate orders are implemented accurately and timely to avoid inconvenience to the taxpayer as well as avoidable payment of interest.

We worked with several constraints. The absence of a centralised database on appeals at the State level, hampered the selection of the audit samples. We, therefore, had to examine individual assessment records for the selection, which considerably strained our audit plan. Poor maintenance of records across the assessment and judicial wings of the Department, is an area of concern. Non-production of records was a major constraint as well as concern. The Department produced only 49 *per cent* of the records we requisitioned for audit; it was as low as 5 *per cent* in the case of Delhi Office.

We found that despite a steady reduction in number of appeals preferred to CsIT (A), the inventory of appeals with CsIT (A) was building up because of low disposal of appeals. The disposal of appeals was 1/3<sup>rd</sup> of the targeted level and at the current levels of disposal, the CsIT(A) would take 2.4 years to clear the inventory. The average time taken for disposal of a case by CIT (A) is 14 months, which is substantially longer than the international standards. Low-end appeals (with demand of less than Rs. 1 lakh) constituted 66 *per cent* of the total appeals. The assessment process evidently is unable to satisfy the small taxpayer, the category of taxpayers which is least equipped



to bear the cost of litigation. This must be viewed with the fact that the success rate of the Department at various levels of appeals is low and appeals go decidedly in favour of the taxpayers.

There are some provisions in the Act (like imposition of penalty) that lead to disputes. Deviations from prescribed procedures by the assessing officers (AOs) have also contributed to disputes. We find that there is a tendency to escalate the disputes to higher levels even in cases where the Department is on a weak ground, which strains the system and the resources besides causing inconvenience to the taxpayer. On the other hand, we also found instances of inaction in such cases where a second appeal would have safeguarded revenue. There is lack of consistency while considering a case for second appeal; divergent actions weakening the departmental stand in appeals. The absence of independent evaluation of decisions for escalation creates unchecked avenues for arbitrary exercise of discretionary powers by the AOs.

One of our biggest concerns is the lack of credible and reliable data on the volume and impact of appeals. Widely divergent data is compiled by different sources which have not been subjected to reconciliation. Records to monitor filing of appeals and implementation of appellate orders were not maintained properly in the assessment units. Inadequate controls led to time barring of appeals and delays in implementation of appellate orders. AO's work on appeals is not subjected to internal audit, denying the process an independent appraisal.

We feel that implementation of appellate orders is placed low in the AOs' priorities. Inadequate attention on correctness in implementation of appellate orders, led to mistakes amounting to Rs. 1,456 crore in 385 cases. 97 *per cent* of these mistakes in implementation led to under-assessment of tax benefitting the tax payer, which raises doubts on the integrity of the process.

## Summary of recommendations

### ❖ **On managing the inventory of appeals** (Paragraphs 2.1 to 2.8)

We recommend that:

small tax payers' disputes may be hived off and dealt separately through an alternate dispute resolution mechanism. This would bring relief to a large number of disputants (66 *per cent*) and clear the pendency. Segregation of complex corporate disputes from such low end disputes, would promote greater focus on the "big ticket" appeals and also facilitate rationalisation of the workload of CsIT(A);

the reasons for low satisfaction in assessment of small taxpayers leading to disputes need to be identified;

the Act may be amended to stipulate a definite time limit in finalising appeals at the CIT(A) level, which may be in line with international best practices;

the Kelkar Committee had recommended that as a confidence building measure, the Board should release annual information on the performance of officers. Greater public disclosure on the performance of the AOs, capturing the error rates, would enforce greater accountability. Such information should provide break-up on the assessments completed, demands raised, number of refunds (and amount) and number in appeals (with amount) disputed. To begin with, such a data would serve as a Management Information System for the Department;

reasons for low disposal of appeals by CsIT(A) need to be analysed; wherever pendency is due to lower efficiency, strict administrative measures may need to be taken;

lacunae in the provisions of the Act need to be addressed without linking them to the Direct Taxes Code (DTC).

### ❖ **On escalation of disputes** (Paragraphs 3.1 to 3.15)

We recommend that:

a system of peer review at the AO level to examine the merits in escalation should be in place. The periodicity of such review may be such that it does not render the AO's workload unviable;

Kelkar Committee had recommended a stricter accountability structure within the Department that is seen to be taking decisive action against the tendency to "appealitis".

Internal audit should in its audit plan, include coverage of a prescribed percentage of appeals, to identify needless escalation or inaction where there is merit.



❖ **On issues leading to disputes** (Paragraphs 4.1 to 4.6)

We recommend that:

a sectoral analysis of disputes to identify frequently disputed provisions of the Act should be done. This would serve as a template while finalising the provisions of DTC;

there is a need to remove ambiguities in the provisions of the Act to reduce the use of discretion by the AOs. The penal provisions of the Act, for instance, require a re-look, since the deterrent edge to these provisions is being blunted due to inability to sustain the penalty orders in appeals;

a databank of cases in which permission is not granted by Committee on Disputes (COD) containing details on the disputed provisions of the Act may be created so that similar cases are not pursued or referred to COD;

responsibility must be fixed on AOs for technical or procedural lapses that drag the Department to needless litigation;

the DTC seeks to change the very basis of exemptions. After its operationalisation, the only purpose behind continuation with the disputes could be the realisation of revenue as no substantial clarification on law would be necessary. Hence it may be useful if a process of plea bargaining [in the form of Kar Vivad Samadhan Scheme] is considered.

❖ **On effectiveness of internal controls** (Paragraphs 5.1 to 5.11)

We recommend that:

automation of receipt and disposal of appellate orders, with inbuilt supervisory controls be implemented. Pending automation, maintenance and updation of control registers should be monitored regularly;

a system for periodic reconciliation of data maintained by different sources, may be instituted;

an effective system, involving departmental representative/legal counsel may be laid down to ensure timely collection of appellate orders to stem the delays in implementation;

as a confidence building measure, the data on AO-wise receipt and implementation of appellate orders should be placed on the website.

❖ **On accuracy in implementation** (Paragraphs 6.1 to 6.3)

We recommend that:

there should be supervisory review of orders giving effect to appeal, to detect mistakes;

a stricter accountability structure should be formulated to fix responsibility on AOs for incorrect implementation of appellate orders.

# Executive Summary

# **CHAPTER 1**

## **INTRODUCTION**

**Tax disputes: Process and impact**

**Goals of appeals**

**Why we chose the topic**

**Objectives of audit**

**Scope of audit**

**Acknowledgement**



## CHAPTER 1 Introduction

### Tax disputes: Process and impact

**1.1** There can be no levy of tax without the taxpayer being given the right to dispute it. The right to appeal is an indispensable part of the federal tax administration system.

**1.2** It is universally accepted that litigation is not only costly and time consuming but also destructive of cooperative relationships between the tax department and the taxpayer. Large amounts of assessee's monies and departmental revenues get locked up in litigation for long periods. The dispute resolution process strains the departmental resources. The budgeting of receipts is also rendered awry when a substantial portion of the Government's projected revenues end up in appeal. Repeated references on issues to the judicial authorities make it difficult for the Department to firm up its practices which, in turn, affects assessments.

#### Avenues of dispute resolution for taxpayers in India

\* **Appeals** by which the taxpayer can approach Commissioner of Income Tax (Appeals)-CIT (A).

\* Before resorting to the Appellate mechanism, an assessee can apply<sup>1</sup> to the Commissioner for **revision of an order** within one year. Taxpayers do not find this avenue attractive since the next appeal lies with the High Court, thus excluding ITAT as an option.

\* **Settlement Commission**<sup>2</sup> that allows errant taxpayers to make a clean breast of their affairs through a compromise settlement. But the Income Tax Act, 1961 (Act) does not prescribe time limits for disposal of cases by the Commission and our past studies<sup>3</sup> showed that delays marred its effectiveness in reducing escalation of disputes.

\* **Authority for Advance Rulings (AAR)**<sup>4</sup> mainly for non-residents (and also specified categories of residents) on applications from taxpayers for rulings on impending taxable transactions. The rulings are binding on the taxpayer (and the Department) and the first appeal lies with High Court, which makes corporates shy away from AAR.

\* A new section 144C<sup>5</sup> introduced in the Act in 2009 seeks to set up a **Dispute Resolution Panel**. The assessing officer can approach the Panel for a draft order that will be issued to the taxpayer who can then present his case with the Panel. The final order will be binding on the Department although the taxpayer can appeal against the decision before the ITAT.

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<sup>1</sup> Under section 264 of the Act

<sup>2</sup> Incorporated in Chapter XIX-A of the Income-tax Act

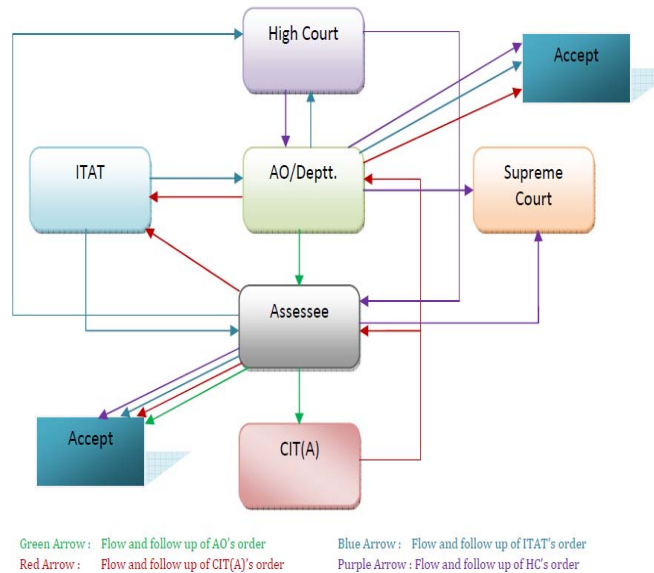
<sup>3</sup> Report of the CAG on Union Government (Direct Taxes) No. 12A of 2001

<sup>4</sup> AAR (Procedure) Rules, 1996 provide detailed procedure for obtaining advance rulings.

<sup>5</sup> Inserted by the Finance (No. 2) Act, 2009, w.e.f. 1 April 2009. Income Tax (Dispute Resolution Panel) Rules, 2009 govern the panel.

**1.3** Chapter XX of the Act confers the right on an aggrieved taxpayer to initiate the appellate mechanism from within the Income Tax Department (Department) i.e., Commissioner of Income Tax (Appeals)-CIT (A). Second appeal against the orders of CIT (A) lies to the Income Tax Appellate Tribunal (ITAT) which functions under the Ministry of Law. On any question of law arising out of an order of ITAT, a taxpayer may appeal progressively to the High Court (HC) and the Supreme Court (SC). Analogous right to appeal is also available to the Department against the orders of CIT (A) and onwards. The appellate level of HC was sought to be replaced by the National Tax Tribunal (NTT) through the National Tax Tribunal Act, 2005. Since NTTs are yet to be established, appeals against the ITAT order are still being instituted in the HC.

**Chart 1.1: Flow and follow up of appeals at different levels**



**1.4** The system places the primary onus of implementing the appellate orders on the assessing officer (AO). The administrative Commissioners (CsIT) monitor their implementation by AOs under his charge. The decision on second appeal is taken with the approval of CsIT. The judicial wing under each CIT maintains records to monitor filing and pendency of appeal as well as of implementation of appellate orders.

**1.5** The departmental judicial system in the country is divided into four geographical zones, each headed by the CIT (Judicial). CsIT (J) are required to highlight contradictory judicial pronouncements of HC that need harmonisation, for which they maintain a centralised database of cases that are referred to HC and above.

### Goals of appeals

**1.6** The appeals play a vital role in tax administration. But the Department has not enunciated the goals for appeals or laid down the performance indicators for its evaluation. We were constrained by the absence of identified benchmarks for evaluation. For the purpose of our study, we assumed that the goals of appeals would be to:

Ensure that the appeal process provides equitable and fair play to the taxpayers and at the same time rightful dues of the Department do not remain uncollected;

Harness the departmental resources optimally for timely and cost effective settlement of appeals;

Provide to the AOs a greater certainty with regard to the tax provisions and thus reduce inventory of disputes in the long run;

Enhance the assessee's satisfaction, which in turn would promote voluntary compliance and public confidence in the Department's integrity and efficiency.

We evaluated the performance of appeals on the above assumptions.

### Why we chose the topic

**1.7** The performance in the area of appeals is an important parameter to evaluate the Department on its functional efficiency. The impact of the disputes is substantial as would be evident<sup>6</sup> from the following data for the period 2006-09:

48 per cent of the demands raised by AOs remains uncollected;

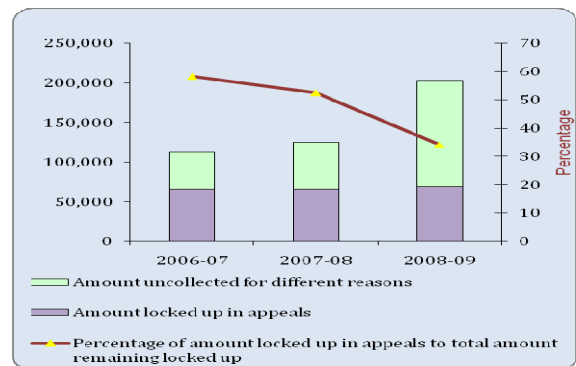
Disputes account for 45 per cent of the uncollected demands;

22 per cent of the demands raised in assessments are disputed by the taxpayers;

Incidence of appeals as a percentage of scrutiny assessments has reduced substantially from 46 per cent in 2006-07 to 17 per cent in 2008-09;

The total amount locked up in appeal at various levels is a staggering Rs. 2.2 lakh crore which is 87 per cent of the revenue deficit in 2008-09.

**Chart 1.2: Percentage of amount locked up in appeals to total amount remaining locked up**



This we felt, merited a performance evaluation. This is the first time we have attempted a holistic study of appeals. The topic was also suggested by the Central Board of Direct Taxes (Board) during our consultations on areas of concern in the Department.

<sup>6</sup> The first three bullets are based on the demand and collection report (CAP -I) of Directorate of Income Tax (O & M S). The fourth & fifth bullets are based on the information provided by DGIT (L & R).



## Objectives of audit

- 1.8** The objectives of our audit were to seek an assurance that:
- The Department has been able to contain the inventory of appeals to a manageable level through rationalising the workload of its officers at different levels enabling speedy resolution of disputes;
  - The provisions in the Act that lead to disputes are identified and the ambiguities are removed to reduce the incidence of disputes;
  - The decisions for escalation of disputes to higher levels of appellate hierarchy are based on a fair assessment of cost-benefit;
  - The appeals are filed by the Department within the prescribed timeframe to avoid dismissal due to limitation;
  - The appellate orders are implemented accurately and timely to avoid inconvenience to the taxpayer and avoidable payment of interest;

## Scope of audit

**1.9** The assessments which went in appeal or were decided at various appellate levels viz. CIT (A), ITAT, HC and SC during the years 2006-07 to 2008-09 were the subject of our study. We selected all HC and SC cases during these years in respect of each CIT charge.

**1.10** We stood hampered in selection of appellate orders decided by CIT (A) and ITAT due to absence of a centralised database<sup>7</sup> on appeals at the State level. We, therefore, had to examine individual assessment records for the selection, which considerably strained our audit plan. Cases involving tax effect below Rs. 5 lakh were excluded from sample selection. The details of the cases requisitioned and cases produced to audit are given in **Appendix I**.

**1.11** Our work was hampered due to other constraints as well. Poor maintenance of records (commented in detail in chapter 5) especially those relating to appeal registers with AOs and in the judicial wings of the Department, is an area of concern. **Non-production of records by certain charges despite repeated requests was a serious constraint as well as a matter of concern. The Department produced only 5 per cent records in the case of Delhi, 49 per cent in case of Orissa, 46 per cent in case of Punjab and 52 per cent in case of Uttarakhand office.**

**1.11.1** The Ministry assured (July 2010) during the exit conference that action would be taken against the concerned officers for non-production of records.

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<sup>7</sup> Database was available only in the Union Territory, Chandigarh and Punjab charges. In some charges indicative lists of cases were provided by the Department.

## **Acknowledgement**

**1.12** An entry conference was held on the 31 March 2009, with the Member (Audit & Judicial) and other senior officers of the Board, in which we explained to them the audit objectives, scope and methodology. Audit was conducted in the respective field formations of the Department.

**1.13** The exit conference was held (July 2010) with the Ministry/Board wherein the report was discussed. The views expressed by the Ministry/Board in the exit conference have been suitably incorporated in this report. Replies received (July 2010) from the Ministry have also been suitably incorporated.

## **CHAPTER 2**

# **MANAGING THE INVENTORY OF APPEALS**

**Inventory of appeals**

**Time taken to dispose appeals**

**Recommendations**

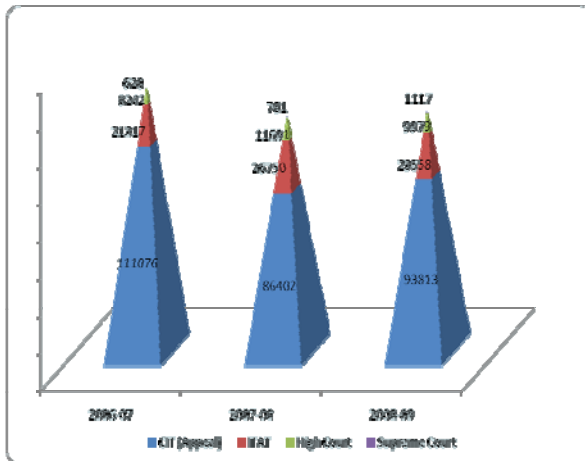


## Chapter 2 Managing the inventory of appeals

The average number of appeals preferred annually to all levels of appellate authorities was 1.40 lakh cases during 2006-09. Despite a reduction in referrals at the CIT(A) level, the inventory of appeals with CsIT(A) was building up because of low disposal of appeals. At 20-22 appeals in a month per CIT(A), the disposal of appeals was 1/3<sup>rd</sup> the targeted level. The present inventory with the CsIT(A) would take 2.4 years to clear at the current levels of disposal. The time taken to dispose off a case that goes to appeal with CIT (A) is 14 months, which is substantially longer than the international standards. The assessment process is unable to satisfy the small taxpayer and low-end disputes (with disputed demand of less than Rs. 1 lakh) constituted 66 per cent of the total appeals. The low-end taxpayer is also the category which is least equipped to bear the litigation cost.

### Inventory of appeal

2.1 The average number of appeals preferred annually to all levels of appellate authorities was 1.40 lakh cases during 2006-09. The CIT (A) bears 74 per cent of the appeal cases preferred at the base of the pyramid being the first level of appeal (Chart 2.1). The number of appeals preferred at CIT (A) level had decreased from 1.1 lakh in 2006-07 to 0.9 lakh in 2008-09.

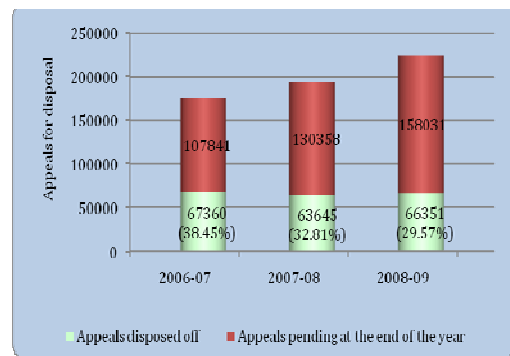


CsIT are deployed in appeals. The number of appeals finalised per month per CIT (A) remained by and large stagnant, at an average of 20-22. The disposal was substantially lower as compared to the levels of 43 and 28 appeals disposed per month per CIT (A) in 1999-2000 and 2003-

bears 74 per cent of the appeal cases preferred at the base of the pyramid being the first level of appeal (Chart 2.1). The number of appeals preferred at CIT (A) level had decreased from 1.1 lakh in 2006-07 to 0.9 lakh in 2008-09.

2.2 Around 36-38 per cent of the

Chart 2.2: Appeals disposed off and pending



04 respectively<sup>8</sup>. Currently, the target<sup>9</sup> for disposal is 60 appeals per month per CIT (A); the actual disposal being 1/3<sup>rd</sup> of the target.

**2.3** The efficiency in disposal measured by number of appeals disposed as a percentage of their pending appeals showed a dip from 38.5 *per cent* in 2006-07 to 29.6 *per cent* in 2008-09. Thus, despite the reduction in appeals preferred the inventory of appeals at the CIT (A) level increased by 46 *per cent* during 2006-09. 1.58 lakh appeals were pending with CsIT(A) at the close of 2008-09. **On an average, the inventory of appeals with each CIT (A) was 637, which would translate to a pendency of 29 months<sup>10</sup> or 2.4 years.**

### Time taken to dispose appeals

**2.4** The Act<sup>11</sup> prescribes that CIT (A) “where it is possible, may hear and decide the appeal within a period of one year”. The time limit is thus not binding on the CIT (A). Our analysis showed that the average time taken by CIT (A) in disposing an appeal was 14 months<sup>12</sup>. Most refined tax administrations bind the appeals to a time frame for the convenience of the taxpayer; the time limits prescribed ranging from 45 days to 6 months being far lower than the time taken by CsIT(A) in India.

Her Majesty Revenue and Customs (HMRC) Department of the United Kingdom prescribes that the review of an assessment is usually to be completed within 45 days. In case longer period is required by HMRC to complete the review, the extension in time has to be in agreement with the taxpayer. In case the outcome of the review is not communicated within the review period, the taxpayer has the option to appeal to the tribunal.

Country	Time limit
Austria	6 months
Canada	90-180 days
Portugal	6 months
Bulgaria	45 days
China	60 days
South Africa	60 days
Source: OECD report (Comparative Series -2008) Information	

**2.5** During restructuring of the Department in 2001, it was projected that the disposal time in CIT (A) would be reduced from the then prevalent level of 18 months to 6 months. Our analysis shows that this milestone is far from achieved. The inter-zonal swings in turnaround time (Table 2.1) could be a function of several parameters such as complexity of the cases preferred; efficiency in disposal and volume of cases preferred. In the absence of data, we could not ascertain the reasons for the skew displayed in disposal across the zones.

<sup>8</sup>Source: Report of the CAG on Union Government (Direct Taxes) No. 13 of 2005

<sup>9</sup> Central Action Plan 2008-09. In the 25<sup>th</sup> Annual Conference of Chief Commissioners & Directors General of Income Tax held in August 2009, it was suggested that the target should be raised to 75 per month per CIT.

<sup>10</sup> Disposal per month is not higher than 22 appeals per month. 637/22= 29 months

<sup>11</sup> Section 250 6(A)

<sup>12</sup> An appeal takes 21 months for a decision in the 54 benches of ITAT.

**Table 2.1: Age wise analysis<sup>13</sup> of pending cases at CIT(A) level in different zones**

	All India	Mumbai	West Zone (Excluding Mumbai)	East Zone	North Zone	South Zone	Central Zone
No. of pending appeals (in 000)	158	22	43	23	35	23	12
No. covered in age analysis (in 000s)	101	12	29	16	26	12	6
No. of CIT(A)	248	33	58	36	53	45	23
Pendency per CIT(A)	637	667	741	639	660	511	522
<b>Age analysis of pending cases as a percentage of total pendency</b>							
6-9 months	31.6	35.5	24.6	32.1	39.6	25.3	34.6
9-12 months	15.5	19.7	13.7	13.6	18.2	13.4	13.1
1-2 years	29.9	30.7	28.5	31.2	25.3	37.6	36.2
more than 2 years	23.0	14.2	33.3	23.0	16.9	23.7	16.2

**2.6** Analysis of the inventory at the level of CIT (A) showed that high-end disputes (where the disputed amount exceeds Rs. 10 lakh) account for 93 *per cent* of the pending tax demand but constituted only 17 *per cent* of the appeals. 66 *per cent* of the appeals were instituted by taxpayers on disputes on tax less than Rs. 1 lakh. The assessment process is unable to satisfy the small taxpayer, leading to greater appeals; a fact that should be viewed with the low success of the Department in appeals at the levels of ITAT and above (discussed in paragraph 3.3). The disputes thus hit the small taxpayer more;

**Focus on high value appeals: Departmental strategies<sup>14</sup>**

- \* Prioritise pending high demand appeals that can result in recovery at CIT(A) level; in case of ITAT, request the benches for early disposal.
- \* Monitor such appeals in ITAT to ensure that Departmental Representatives do not seek adjournment without prior approval of the respective CCIT.
- \* Clear all brought forward high demand appeals pending with CIT(A) within the year.
- \* Current high demand appeals to be disposed of within 4/6<sup>15</sup> months of filing of appeals.

the category of taxpayers who are least equipped to bear the cost. He has to meet the litigation costs on his own while large corporates can claim the litigation costs as deductions while computing the tax liability. The demand raised remains uncollected during the pendency of the appeal. The corporate appellant by stretching out the pendency of the demand until he exhausts all

<sup>13</sup> On the basis of information provided by DGIT (L & R) for the year ending March 2009.

<sup>14</sup> Sources: Strategy for Budget Collection- 2006-07, 2007-08 and 2008-09; Recovery of arrear demand; Central Action Plan 2006-07, 2007-08 and 2008-09

<sup>15</sup> Central Action Plan 2008-09



options is also deriving an arbitrage to the extent that the unmet liability eases his cash flow during the locked-in period.

**2.7** There are two provisions of the Act, which in our opinion are not in the interest of revenue. In fact, these provisions cause least discomfort to the taxpayer if he were to remain in appeal, especially to a corporate taxpayer who can bear the litigation costs:

The Department is liable to pay interest on refund up to the date<sup>16</sup> of actual payment of refund (i.e., up to the date of issue of refund voucher). On the other hand, if an appeal is decided against the assessee, any excess refund to be deposited back by the assessee is liable<sup>17</sup> for interest only up to the date of the regular assessment.

An assessee is not considered<sup>18</sup> 'in default' for any amount payable by him against a tax demand as long as the appeal remains 'un-disposed off'. This provision of the Act basically relates to pending appeal<sup>19</sup> with CIT (A). But the phrase 'as long as appeal remains un-disposed off' being a very wide term, we found that AOs were still considering the assessee not in default even if his case is pending at higher levels of appeal.

**2.8** These lacunae were brought to the notice of the Department in June/July 2009. In August 2009, the Government released the draft Direct Taxes Code (DTC) which seeks to correct the anomalies<sup>20</sup>. However, the issues would remain till such time the Code is enforced.

## **2.9 Recommendations**

*We recommend that the small taxpayers' disputes may be dealt with by the Department separately through an alternate dispute resolution mechanism<sup>21</sup>. This would bring relief to a large number of disputants (66 per cent) and clear the pendency as in such a situation disposal rate would also be higher. Segregation of complex corporate disputes from such low end disputes, would promote greater focus on the "big ticket" appeals and also facilitate rationalisation of the workload of CsIT(A).*

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<sup>16</sup> As per section 244A of the Act

<sup>17</sup> As per section 234D of the Act

<sup>18</sup> In terms of section 220 (6) of the Act

<sup>19</sup> In accordance with section 246 or 246A of the Act

<sup>20</sup> The DTC extends the interest liability till the date of actual payment to bring in parity. It would also allow the assessee extension of time for payment of amount demanded during the pendency of appeal with the Commissioner (Appeals) only.

<sup>21</sup> In Internal Revenue Service (IRS) of the United States, there are Low Income Taxpayer Clinics (LITCs), which are independent from the IRS. These clinics provide representation to low income taxpayers for tax collection disputes before the IRS, free or for a nominal charge.

The Ministry stated (July 2010) that an Alternate Dispute Resolution Mechanism for small tax payers would further strain available resources. The present CIT(A) structure is co-terminus with jurisdictional CIT charge. This segregates corporate from non-corporate assessees and appeals of small tax payers would automatically get clubbed together. Further, the work allocation to CsIT (A) has been streamlined recently, which will facilitate rationalisation of workload. Implementation of Central Action Plan 2010-11 is likely to result in higher disposal of appeals.

*The reasons for low satisfaction in the assessment of small taxpayers leading to disputes need to be identified.*

The Ministry stated (July 2010) that by selecting only large taxpayers in CASS (Computer Assisted Scrutiny System) for scrutiny assessment, additions made by the AOs in respect of small taxpayers would reduce thereby reducing attendant disputes.

*The Act may be amended to stipulate a definite time limit for finalising the appeals at the CIT(A) level, which may be in line with international best practices.*

The Ministry stated (July 2010) that the Board has been taking various steps to stem the delays. Action Plan 2010-11 reflects the importance that the Board places on this issue.

*The Kelkar Committee had recommended that as a confidence building measure, the Board should release annual information on the performance of officers. Greater public disclosure on the performance of the AOs, capturing the error rates, would enforce greater accountability. Such information should provide break-up on the assessments completed, demands raised, number of refunds (and amount) and number in appeals (with amount) disputed. To begin with, such data would also serve as a Management Information System for the Department.*

The Ministry felt (July 2010) that the benefit from such transparency may be outweighed by the risk of demoralisation of AOs. On the other hand, the Department plans to put such data on the Central Appeal Registry which will ensure transparency at-least within the Department.

*Reasons for low disposal of appeals by CsIT(A) need to be analysed. Wherever pendency is due to lower efficiency, strict administrative measures may need to be taken.*

The Ministry stated (July 2010) that constraints of resources have been identified and necessary action is being taken to further improve the position.

*Lacunae in the provisions of the Act need to be addressed without linking them to the DTC.*

The Ministry stated (July 2010) that lacunae in the provisions of the Act are discussed at various fora although such analysis is not available in an integrated form.

## **CHAPTER 3**

# **ESCALATION OF DISPUTES**

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**Satisfaction index**

**The “appealitis” syndrome**

**Inaction on appeals with merit**

**Disputes with Public sector  
Undertakings**

**Internal audit**

**Recommendations**

### Chapter 3 Escalation of disputes

The outcomes of the appellate mechanism provide reasonable level of satisfaction to the taxpayer. Overall success rate achieved by the Department at various levels of appeals was low and appeals go decidedly in favour of the taxpayers. The tendency to escalate the disputes to higher levels even on cases where the Department is on a shaky ground, strain the system and the resources besides adding to the inconvenience of the taxpayer, especially the small taxpayer. On the other hand, we found cases of inaction on such cases where a second appeal would have safeguarded revenue. There is lack of consistency while considering a case for second appeal; divergent actions weakening the departmental stand in appeals. The AO's work on appeal is not subjected to internal audit. The absence of independent evaluation of decisions for escalation leaves an unchecked avenue for arbitrary use of discretionary powers by the AOs.

#### Satisfaction index

**3.1** Appeals must provide satisfactory solutions especially in the first tier, to reduce the incidence of escalation of the dispute to the higher levels of the appellate system. We used the satisfaction index as a parameter to evaluate achievement of this goal.

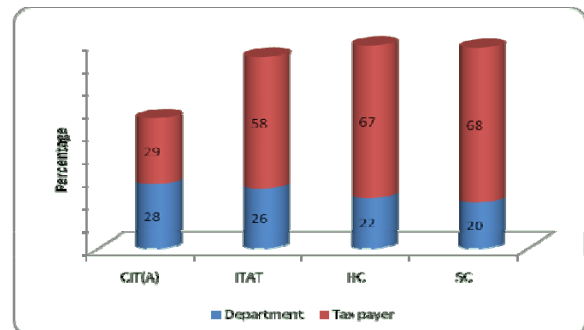
**3.2** On the assumption that the Department has no control on the disposal of appeals by the ITAT or higher levels, we restricted the analysis to CIT (A). On an

Table 3.1: Aggregate satisfaction index

Year	Percentage of appeal instituted in ITAT against the cases disposed by CIT (A)		Aggregate satisfaction index
	By Department	By taxpayer	
2006-07	23	9	32
2007-08	31	11	42
2008-09	26	9	35

average, nearly 36 per cent of the orders of the CIT (A) were escalated to the ITAT during 2006-09 (Table 3.1). Less than

Chart 3.1: Success rate achieved by the Department and Taxpayers



10 per cent of the appeals decided by CIT (A) are escalated by the taxpayer, which shows that the taxpayer gets a reasonable level of satisfaction from the first tier of appeals.

**3.3** The Department escalated the dispute to ITAT on 26 per cent of the appeals decided by CIT (A). Overall, the success rate achieved by the Department at various levels of appeals was low

(Chart 3.1) and appeals go decidedly in favour of the taxpayer.



## The “appealitis” syndrome

**3.4** The Law Commission of India in its 126<sup>th</sup> Report on “Government and Public Sector Undertaking litigation policy and strategies” coined the word “appealitis”. The Report while lamenting the burgeoning litigations, quoted (paragraph 2.12 of the report) a Kerala HC judgment which said that “The State is no ordinary party trying to win a case against one of its own citizens by hook or crook; for the State’s interest is to meet honest claims, vindicate a substantial defence and never to score a technical victory or over-rule a weaker party, to avoid just liability or score an unfair advantage simply because legal devices provide such an opportunity”.

**3.5** The Task Force on Direct Taxes (Kelkar Committee) had observed that “assessment is one sided, high pitched, completed in a hurry and when it is close to getting time barred by limitation, ignoring the contentions of the assessee. When the case goes through first and second appeal, the additions are deleted”. A common perception is that the cause of unsustainable high pitched assessments is the fear among AOs of not achieving internal targets of tax collection<sup>22</sup>.

*Charge: CIT-2 Mumbai, Maharashtra; AY: 2003-04*  
*Assessee: Tata Petrodyne Limited*

The AO disallowed depreciation of Rs. 7.5 crore, which was disputed by the assessee. The CIT (A) while allowing (May 2008) the depreciation inadvertently mentioned the amount as Rs. 7,979 instead of Rs. 7.5 crore. The AO, instead of seeking a clarification from CIT (A), opined that the CIT (A) “erred” in allowing the appeal but “*since, the tax is very meager, second appeal is not recommended on this ground*”. The assessee approached the CIT (A) once again who rectified the order (September 2008) by directing the AO to allow the deduction of Rs. 7.5 crore on account of depreciation. This time the AO recommended not to file second appeal on the rectification order since “*it arose from a mistake apparent from the records*”.

The AO’s response in this case, illustrates the symptom that the Kelkar Committee pointed out, where high pitched assessment was made and then defended without a feeling of responsibility.

The Ministry stated (July 2010) that steps are being taken to amend the grounds of appeal incorporating the additional ground raised by the Audit.

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<sup>22</sup> Source: Report on “The compliance Cost of the Personal Income Tax and its determinants” by Planning Commission (1999)

*Charge: CIT-III Delhi; AY: 2005-06*  
*Assessee: Nainital Bank Limited*

The assessee was assessed (December 2007) on best judgment<sup>23</sup> by adding “undisclosed” income of Rs. 46.1 crore. The assessee repeatedly pleaded that its Head Office being registered in Nainital, it was filing the returns with the ACIT, Nainital. On appeal, CIT (A) deleted the addition of Rs. 46.1 crore (March 2008) on the ground that the AO did not have legal jurisdiction.

The Ministry stated (July 2010) that the assessee did not respond to the cited notices issued to them and submitted full facts only to the CIT(A) after which it was transferred to the jurisdictional ACIT in Nainital. However, departmental records show that the assessee had earlier also informed the AO in Delhi that the Bank had been filing return with the office of Asstt. Commissioner, Nainital. Issuance of notice in the first place itself was not proper as the Department should have known that the assessee had been an income tax assessee for the last 40 years and was filing its return in Nainital.

**3.6** There is also a perception that the Department has a tendency to opt for appeals even when it is on a weak wicket, partly because the decisions are prompted by ITAT counsels, who stand to gain from them<sup>24</sup>. It could also be fuelled by the officers deciding to play safe rather than judge a case on its merits and save the system of the strain that weak cases place on it.

**3.7** The “appealitis” in the Department, is more detrimental when applied on small taxpayers who constitute a large chunk of appellants (paragraph 2.6; Chapter-2). The prescribed<sup>25</sup> monetary floor levels for filing appeals are Rs. 2 lakh, Rs. 4 lakh and Rs. 10 lakh with ITAT, HC and SC respectively. We found eight appeals filed before ITAT on tax demands ranging between Rs. 0.25 lakh and Rs. 1.8 lakh. Two other appeals filed with the HC were on demand of Rs. 1 lakh and Rs. 2.4 lakh. Of these, the ITAT and HC dismissed four appeals on the ground that the tax effect was below the floor level.

**3.8** We found instances of escalation of appeals on feeble and indefensible cases as illustrated below:

*Charge: CIT-II Kolkata, West Bengal; AY: 2003-04*  
*Assessee: Orient Paper & Industries Limited*

<sup>23</sup> Made under section 144 when the assessee does not submit the income tax return.

<sup>24</sup> Source: Income Tax Compliance Cost of Corporations in India, 2000-01 by Arindam Das Gupta; Study conducted by NIPFP

<sup>25</sup> vide, Instruction No.2/2005 dated 24 October 2005 and Instruction No.5/2008 dated 15 May 2008. It is also specified that adverse judgment in a case where Revenue Audit objection has been accepted by the Department, should be challenged in appeal irrespective of the tax effect.

The assessment (March 2006) was challenged by the assessee before the CIT (A), on three issues (total tax effect: Rs. 1.3 crore) who decided in favour of the assessee.

Sl. No.	Appeal issues: disallowance of	CIT(A)'s ruling	Further appeal by the Department in ITAT on the grounds that
(i)	Rs. 9.2 lakh spent on plantation, which the AO held, was not for business purposes;	On a similar issue, the ITAT had decided in favour of the assessee for AY 1993-94.	It was not known whether the ITAT decision (on AY 1993-94) had been challenged.
(ii)	Provision of gratuity of Rs. 1.15 crore;	Kerala High Court <sup>26</sup> had ruled that if the approved gratuity fund had been credited by the provisional amount, it would be allowable as a deduction under Section 40 A (7) <sup>27</sup> .	There was a favourable decision <sup>28</sup> of jurisdictional (Calcutta) High Court in favour of the Department.
(iii)	Cess of Rs. 2.20 crore paid to M.P. Electricity Board.	The liability had accrued irrespective of the fact that the assessee has challenged its imposition. CIT (A) at the same time observed that Gujarat <sup>29</sup> and Kerala <sup>30</sup> High Court had ruled that if the assessee is entitled to a particular relief provided in the law it is obligatory on the part of the assessing officer to draw the attention of the assessee to the lawful relief or deduction although the assessee did not claim it.	The claim of assessee was premature.

The departmental grounds for escalation of issues (i) and (iii) were feeble; yet, it opted for appeal on all the three issues to ITAT, which dismissed the appeal (February 2007). A further appeal in the HC was also dismissed (June 2007) on the ground that there was no substantial question of law involved. The matter was taken to the SC (November 2007) which dismissed (November 2008) the appeal on the ground of delay.

The Ministry stated (July 2010) that the issue (iii) was a question of law; hence, it was required to be decided on merit by higher judicial authorities. The fact that the case was dismissed by the HC on the grounds that 'no question of law was

<sup>26</sup> CIT vs Common Wealth Trust Pvt. Ltd 269 ITR 290

<sup>27</sup> The special provisions of section 40A (7) would overrule the non-obstante clause of section 43B; the latter states that the amount should have been paid within the due date.

<sup>28</sup> Shree Kamakhya Tea Co. Pvt. Ltd. 199 ITR 714

<sup>29</sup> Chokshi Metal Refinery vs CIT [1977] 107 ITR 63

<sup>30</sup> Parekh Bros. vs CIT [1984] 150 ITR 105

involved' shows that decision of the Department to appeal to HC was not based on sound footing.

*Charge: CIT-Gwalior, Madhya Pradesh; AY: 2005-06*  
*Assessee: Cardinal Drugs Limited*

The CIT(A) rejected (March 2008) addition of Rs. 8.3 crore by treating interest waived by banks, as the assessee's income. CIT (A) held that since the assessee had not claimed the interest as deductions in earlier assessment years, it cannot be treated as his deemed income<sup>31</sup>. Despite clear provisions in the Act, the matter was taken to ITAT; the decision was awaited as of August 2009.

*Charge: CIT Shillong, Assam; AYs: 1990-91 to 2000-2001*  
*Assessee: Executive Engineer, P H E, Water Supply Division, Lunglei*

Interest was levied on delay in deposit of TDS<sup>32</sup>. CIT (A) rejected the appeal on the ground that the Department did not bring on record the actual date of deposit of tax. The case was escalated to ITAT without this detail, to be once again rejected on the very same ground.

**3.9** The Department has at times, taken divergent stand over the same provision, rendering its own position vulnerable. A case reported by us earlier<sup>33</sup>, is being re-visited as an illustration.

Section 80IB allows exemption from income tax, of profits earned in production or refining of mineral oil. Hindustan Petroleum Corporation Ltd. (HPCL) claimed (for AY: 2004-05) and was allowed deduction on marketing margin. When we raised the issue<sup>34</sup>, the Department sought to justify the assessment on the ground that the Bombay High Court<sup>35</sup> had ruled (July 2006) that 80IB benefit would be available on marketing margin. The Department also assured the Public Accounts Committee that it was following the Bombay High Court's judgment.

However, it disallowed deduction on marketing margin claimed by Indian Oil Corporation Ltd. (IOC), which was contested by IOC on the strength of the above judgment, with CIT (A). CIT (A) ruled in favour of the assessee which was further escalated to the ITAT by the Department. Needless to emphasise, such an inconsistent stand erodes the Department's credibility as much as it weakens its case in appeals.

<sup>31</sup> Under the provisions of section 41(1)(a)/43B of the Act

<sup>32</sup> Tax deducted at source by the EE from bills paid to contractors but not deposited to the Government account on time.

<sup>33</sup> Paragraph 2.7.2 of Report of the CAG on Union Government (Direct Taxes) No. PA 25 of 2009

<sup>34</sup> The grant of deduction was objected to by us as the marketing margin was only a trading profit and not a profit derived out of manufacturing activities.

<sup>35</sup> In the assessee's own case for the assessment year 1989-90

### Inaction on appeals with merit

**3.10** On the other hand, we found that despite being on a strong wicket, the Department did not escalate or committed errors in framing the grounds in 32 appeals disputing aggregate tax of Rs. 43.1 crore. Few such cases are illustrated below:

*Charge: CIT-I Ahmedabad, Gujarat; AY: 2002-03*  
*Assessee: Atul Limited*

AO recommended acceptance of CIT (A)'s decision rejecting additions on the issue of "non-inclusion of sales tax and excise duty in the total turnover<sup>36</sup>" while computing exemptions on exports, since this issue had already been settled by the SC<sup>37</sup>. Instead, the AO recommended that an appeal may be filed on another issue viz., disallowance of double deduction<sup>38</sup> on which a demand of Rs. 2.3 crore had been raised. The Department inexplicably preferred an appeal on the 1<sup>st</sup> issue, on which it had no case.

*Charge: CIT-LTU Mumbai, Maharashtra; AY: 2004-05*  
*Assessee: Reliance Industries Limited*

CIT (A) ordered (October 2008) that the assessee, among other issues, should be allowed exemption on export profits under Section 80HHC (refer footnote 36) on book profit, which would provide the assessee benefit of tax of Rs. 22.6 crore. The AO had computed the exemption based on business profits which is consistent with the provisions of the Act. Despite a clear case, the Department did not include this issue in its appeal with the ITAT (March 2009). We also found that the Department had contested this issue in respect of assessments of AY 2001-02 to 2003-04 before the ITAT but chose to ignore it in AY 2004-05. We are of the view that this issue merited an appeal for a firm and consistent legal view.

The Ministry stated (July 2010) that mistake in leaving the ground mentioned by audit was a bonafide mistake and additional ground of appeal has been filed before the ITAT.

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<sup>36</sup> Section 80 HHC of the Act allows tax exemption on profit earned in exports. The export profit is calculated by {(export turnover/ total turnover)\* total profits}. The SC ruled in favour of the assessee that the tax and duties paid on total turnover may not be included in the total turnover (denominator); if included, it would have reduced the exemption available to the assessee.

<sup>37</sup> CIT vs Lakshmi Machine Works, 160 Taxman 404. Date of judgement: 25 April 2007

<sup>38</sup> The issue being that deduction under section 80IA and 80IB should be reduced from profits for the purpose of calculation of deduction under section 80HHC.



**3.11** We noticed two cases<sup>39</sup> where the AO failed to offer his comments on the additional/new evidence produced by the assessee before the CIT (A), on the basis of which addition of Rs. 52 lakh was deleted by the CIT (A). One case was also dismissed by the HC on the ground that sufficient opportunity had been given to the Department to rebut the additional evidence.

### Disputes with Public Sector Undertakings

**3.12** It has been recognised that PSUs and the Government have to conserve their resources so that unproductive litigation is avoided at all costs. Apart from the litigation costs which the State and PSUs have to bear, the State has also to bear the expenses on setting up courts, provide personnel and bear other incidental expenditure<sup>40</sup>. The Committee on Disputes (COD) was constituted on the directions of the Supreme Court to provide a forum to the disputing parties (both being arms of the Government) an opportunity for in-house reconciliation. The COD's decision becomes binding on both the parties in dispute. The SC observed<sup>41</sup> that even if the Department/PSU considers the decision of COD unpalatable, discipline requires that they abide by it. The SC further noted that 'every party against whom the decision is made will claim that they have been wronged and that their rights are affected. This is not to be allowed to be done'. A recent Delhi High Court's decision<sup>42</sup> held that if an application is not made to the COD within one month from the filing of appeal in the court, the appeal would have to be dismissed on that ground itself.

**3.13** With respect to sheer numbers, the COD has been effective in reducing litigation. Out of 591 disputes referred to COD from Delhi during the period April 2006 to December 2008, it refused permission on 269, representing 46 *per cent* of the total. The decisions are by and large, being granted within 6 months to a year.

**3.14** We found 12 cases where the Department did not seek COD's approval or the second appeal was filed without waiting for the approval, resulting in cases being dismissed by the appellate authorities with a tax effect of Rs. 161.5 crore.

### Internal audit

**3.15** We noticed<sup>43</sup> that internal audit does not check cases relating to filing and implementation of appellate orders in ordinary course. Denying the process an independent appraisal.

<sup>39</sup> Charge CIT 1, Guwahati (Shri Parimal Kanti Chandra and Assam Government Marketing Corporation Ltd.)

<sup>40</sup> Law Commission of India in its 126<sup>th</sup> Report on "Government and Public Sector Undertaking litigation policy and strategies"

<sup>41</sup> MTNL vs CBDT (2004) 267 ITR 647

<sup>42</sup> (2008) 296 ITR 693

<sup>43</sup> In Orissa, Punjab, Haryana and Rajasthan charges

### 3.16 Recommendations

*We recommend a system of peer review at the AO level to examine the merits in escalation. The periodicity of such review may be such that it does not render the AO's workload unviable.*

The Ministry stated (July 2010) that it may not be practical and feasible to have a system of peer review.

*Kelkar Committee had recommended a stricter accountability structure within the Department. We recommend an independent evaluation of decisions for escalation as a check against the tendency to "appealitis".*

The Ministry stated (July 2010) that AOs tendency to appeal further is partly due to AOs lack of confidence or knowledge. The National Judicial Reference System will provide data on the sustainability of the action against specific provisions of the Act and then empower the AOs to propose a closure, if so warranted. This would bring greater discipline and transparency in approach.

*Internal audit should in its audit plan, include coverage of a prescribed percentage of appeals, to identify needless escalation or inaction where there is merit.*

The Ministry felt (July 2010) that CsIT(A) provide an oversight and internal audit is not an effective remedy. We are of the opinion that it is not prudent to wish away internal audit; by doing so an important internal control is being compromised.

## **CHAPTER 4**

### **ISSUES LEADING TO DISPUTES**

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**Sector analysis**

**Appeals of PSU banks referred  
to COD**

**Case studies**

**Recommendations**

## Chapter 4 Issues leading to disputes

Lack of clarity in the provisions of the Act introduces subjectivity in the assessments, which leads to disputes. Deviations from prescribed procedures by the AOs also contribute to disputes.

**4.1** In our study on shipping sector<sup>44</sup>, we found that ambiguity and inconsistency on issues relating to port trusts, had led to tax dispute amounting to Rs. 756 crore.

The income of port trusts was previously exempt from income tax as they were deemed to be local authorities. Since 2003-04, there is no consistency on the status of the port trusts. The issue of quantifying the written down value (WDV) of assets purchased and put to use prior to 2003-04 when port trusts were not taxable, led to most of the disputes, which were escalated by the Department. The Act was amended (2008) to clarify that WDV in the books of accounts would be the deemed depreciation that will be allowed for the purpose of income tax. However, no action had been taken by the Department to settle the past disputes despite such a large quantum of demands locked-up on this account.

**4.2** We attempted a sectoral analysis to identify the provisions which are leading to disputes. The absence of a reliable database that captures appeals sectorally was a limitation. We analysed 517 pending appeals spread across 39 sectors with a total disputed tax of Rs. 3,392.9 crore. 155 appeals in Karnataka constituting 30 *per cent* of the appeals filed related to software industry; the disputed tax constituted 68 *per cent* of the total tax disputed. The main issues involved related to sections dealing with exemption on exports and business in free trade zones<sup>45</sup>.

**4.3** The data on appeals relating to PSU banks referred to the COD during three years (January 2004 to December 2007) provided a reference point (Table 4.1) for analysis. In three years, 118 references were made in respect of 10 banks, averaging to 3 disputes per bank every year. We selected a few banks for further analysis.

**Table 4.1: Cases referred to COD**

Bank	No of cases referred to COD
Andhra Bank	6
Bank of Baroda	8
Bank of India	12
Bank of Maharashtra	6
Syndicate Bank	24
Canara Bank	18
Dena Bank	12
Punjab National Bank	13
State Bank of India	11
UCO Bank	8

<sup>44</sup> Paragraph 1.10.3 of Report of the CAG on Union Government (Direct Taxes) No. PA 25 of 2009

<sup>45</sup> Under sections 10A, 10B, 80HHC and 80HHE

**4.4** In Karnataka, the Department referred 42 disputes to COD relating to Syndicate Bank and Canara Bank in which a staggering amount of Rs. 5,435 crore was involved. The disputes occurred repeatedly on two main issues: chargeability of income tax on interest tax recovered from customers and interest on sticky loans treated as income. The COD denied permission in 12 cases relating to Syndicate Bank and in 6 cases of Canara Bank. But the cases rejected by COD, did go to CIT (A) straining the system at that level. In Delhi, 13 disputes (disputed tax: Rs. 480 crore ) relating to Punjab National Bank were referred by the Department to COD, the main issue being additions made on income on account of disallowance of expenditure<sup>46</sup> incurred to earn income exempted from tax under the Act. Repeated disputes on the same issue, call for a sectoral analysis and decisive action to remove ambiguities.

**4.4.1** The Ministry stated (July 2010) during the exit conference that a system is being developed internally by which a database would be created with details of the decisions of the COD, which would be accessible to the AOs.

**4.5** Two case studies also illustrate the need for the Department to conduct an evaluation on the efficacy of the provisions in the light of their preponderance to being disputed and set aside at the first stage of appeal.

### Case study I

We took a sample of 14 appeals against the penalties<sup>47</sup> (total: Rs. 322 crore) imposed by AOs in Delhi charge. The CIT (A) decided in favour of the taxpayer in 13 cases. The one appeal that was decided against the assessee, was contested by him in the ITAT which deleted the penalty, but the Department appealed to the HC against the ITAT order.

The Department filed appeals with the ITAT in nine<sup>48</sup> out of the 13 appeals. ITAT dismissed the appeals in five cases. The remaining four cases are pending. Department further appealed to the HC in three cases<sup>49</sup>; the one case decided by the Court went in favour of the assessee. This too was contested by the Department in SC, on which a decision is awaited.

The Act grants considerable discretionary powers to the AO in deciding the incidence and the quantum of penalty. It is the subjectivity inherent in the exercise of this power that leads to appeals in which the penalty becomes unsustainable. The repeated failures in appeals did not deter the Department

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<sup>46</sup> Under Section 14A

<sup>47</sup> Under section 271(1) (c)

<sup>48</sup> It did not contest the CIT(A) decision in 4 cases.

<sup>49</sup> It did not contest the ITAT decision in one case.



from further appeals without analysing the reasons for failure. The deterrent effect of penalty undoubtedly stands compromised in this situation.

The Ministry stated (July 2010) during the exit conference that the AOs are being given training at institutional level and the analysis of such cases is a continuous process.

## Case Study II

15 appeals in Delhi charge were on additions made by AOs on income on account of disallowance of expenditure<sup>50</sup> (Rs. 254 crore) incurred to earn income exempted from tax under the Act. CIT (A) deleted additions of Rs. 237 crore in ten cases. The Department went in appeal before the ITAT in eight cases involving addition of Rs. 202 crore. The ITAT too decided four cases in favour of the assessee deleting the additions of Rs. 13 crore; the remaining cases were yet to be decided. The Department filed appeals in two cases<sup>51</sup> to the HC which further deleted the amount. Thus out of the total additions amounting to Rs. 254 crore, additions amounting to Rs. 250 crore were deleted in different stages of appeals.

The methodology for computing the additions on exempted income has not been laid down on an objective basis. The subjectivity in the process makes such cases unsustainable in appeals. Yet, the Department opts for repeated appeals.

**4.6** We found that technical lapses by the AOs also lead to appeals. 17 appeals in our sample involving tax of Rs. 447.8 crore occurred because of these lapses.

*Charge: CIT-LTU, Mumbai, Maharashtra; AYs: 1992-93 to 1994-95*  
*Assessee: Industrial Development Bank of India Limited*

The assessments for the three years were revised/re-assessed after the prescribed time limit in the Act. The assessee appealed against the orders with ITAT, which quashed the orders on account of time barring. The tax revenue involved in this case was Rs. 307.9 crore. The Department further escalated the dispute on two appeals to the HC.

The Ministry stated (July 2010) that reopening was quashed on legal issue and not due to time barring. However, the orders of ITAT clearly mention time barring as the reason for quashing the reopening.

*Charge: CIT-3, Mumbai, Maharashtra; AY: 1996-97*  
*Assessee: ICICI Bank Limited*

<sup>50</sup> Under section 14A

<sup>51</sup> Department did not contest the deletion of additions by the ITAT amounting to Rs. 13.41 crore in two cases.

The CIT revised<sup>52</sup> (March 2003) the assessment, which was given effect by the AO by raising a demand for Rs. 158.1 crore. The ITAT, without going into the merits of the case, quashed (September 2008) the order on the ground that it was barred by limitation, based on which the amount was refunded.

#### 4.7 Recommendations

*We recommend a sectoral analysis of disputes to identify frequently disputed provisions of the Act. This can serve as a template while finalising the provisions of DTC.*

The Ministry stated (July 2010) that the Central Appeal Registry and National Judicial Reference System will facilitate such analysis.

*There is a need to remove ambiguities in the provisions of the Act to reduce the use of discretion by the AOs. The penal provisions of the Act, for instance, require a re-look, since the deterrent edge to these provisions is being blunted due to inability to sustain the penalty orders in appeals.*

The Ministry stated (July 2010) that these are discussed at various forums towards a cohesive approach.

*A databank of cases in which permission is not granted by COD containing details on the disputed provisions of the Act may be created so that similar cases are not pursued or referred to COD.*

The Ministry stated (July 2010) that such a database will also form part of National Judicial Reference System.

*Responsibility must be fixed on AOs for technical or procedural lapses that drag the Department to needless litigation.*

The Ministry stated (July 2010) that responsibility is fixed and necessary action taken, wherever needed.

*The DTC seeks to change the very basis of exemptions. After its operationalisation, the only purpose behind continuation with the disputes could be the realisation of revenue as no substantial clarification on law would be necessary. Hence it may be useful if a process of plea bargaining [in the form of Kar Vivad Samadhan Scheme] is considered.*

The Ministry accepted (July 2010) the recommendation.

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<sup>52</sup> Under section 263 of the Act.

## **CHAPTER 5**

# **EFFECTIVENESS OF INTERNAL CONTROLS**

**Collection of data**

**Process after the appellate  
decision**

**Receipt of the appellate orders**

**Filing of second appeal: Timeliness**

**Implementation of appellate  
orders: Timeliness**

**Recommendations**

## Chapter 5 Effectiveness of internal controls

One of our biggest concerns is the lack of credible and reliable data on the volume and impact of appeals. Widely divergent data is compiled by different sources which have not been subjected to reconciliation. Records to monitor filing of appeals and implementation of appellate orders, were not maintained properly in the assessment units. Inadequate controls led to time barring of appeals and delays in implementation of appellate orders.

### Collection of data

**5.1** To begin with, the Department does not have accurate data on the amount locked up in appeals, reconciled across different sources of compilation. The Directorate of Income Tax (O&MS) which prepares the Central Action Plan (CAP-I) estimated the locked-up amount at CIT(A) level for the year 2008-09 to be Rs. 49,388 crore. The figures<sup>53</sup> of Directorate General of Income Tax (Legal and Research) was around four times this amount at Rs. 1.99 lakh crore. The total disputed amount (for 2008-09) reported in the Receipts Budget of the Union Government 2010-11 was Rs. 53,810 crore while CAP-I reported Rs. 69,253 crore and DGIT(L&R) reported Rs. 216,635 crore. There are thus three sets of information for the same item; the disputed amount is the basis for any administrative intervention on appeals; the absence of accurate data is a pointer to the need for establishing sound internal controls.

### Process after the appellate decision

**5.2** Once the appellate order is received, the AO has two options either implementing the order or preferring a second appeal. It<sup>54</sup> is primarily the AO's duty to scrutinise the appellate order to ascertain if a second appeal is necessary and prepare a *scrutiny report* to the respective CIT, who approves the decision. Time limits<sup>55</sup> have been fixed for preferring appeals (Table 5.1).

**Table 5.1: Period within which an appeal is to be filed with the appellate authorities**

Sl. No.	Appellate authority	Period within which appeal is to be filed
1.	CIT (A)	Within 30 days of the date of the payment of tax or from the date of service of the notice of demand relating to the assessment or penalty or in any other case, the date on which intimation of the order sought to be appealed against is served.

<sup>53</sup> Compiled for the first time by DGIT (L &R). Information discussed in the 25<sup>th</sup> Annual Conference of Chief Commissioners & Directors General of Income Tax held in August 2009.

<sup>54</sup> Paragraph 25.1 of the Manual of Office Procedure (Chapter 18, Volume-II, Part A Technical)

<sup>55</sup> If for any reason, appeals cannot be filed within this timeframe, a notice of motion for condonation of delay along with the affidavit explaining the delay should be filed before the High Court and in case of an extraordinary delay, a detailed affidavit explaining every day of delay should be attached.

2.	ITAT	Within 60 days of the date on which the order sought to be appealed against is communicated to the assessee or to the CIT, as the case may be.
3.	High Court	Within 120 days from the date on which the order appealed against is received by the assessee or the CCIT or CIT.

### Receipt of the appellate orders

**5.3** In order to ensure that the decisions on appeals are given effect to timely (for taxpayers’ convenience and to reduce the interest liability), the AO must receive the appellate order on time. CIT (A) sends copies of the appellate order on a fortnightly basis to the respective Commissioner, endorsing a copy to the AO. The orders of ITAT are routed through the Departmental representatives in ITAT to the judicial wing of CIT, through whom it is sent to the respective Commissioner and the AO. The order of the HC and SC are sent to the concerned Commissioner through whom it reaches the AO.

**5.4** We found instances of delays in receipt of the appellate orders. For

Time taken for receipt of order	Appellate level		
	CIT(A)	ITAT	HC
15-60	15	65	9
61-90	-	12	3
91-220	1	3	6
221-381	-	-	6

instance in Himachal Pradesh, 26 per cent of the orders were received by the AOs after 60 days; the delays being particularly high with respect to orders from HC. We are not in a position to quantify the delay for all the charges as the AOs who are

required to maintain the relevant records, are either not maintaining the records or the records are not complete. We also observed<sup>56</sup> that there was no correlation between the records maintained by judicial wing in the office of CIT and that of records maintained by the AO.

### Filing of second appeal: Timeliness

**5.5** The monitoring of appeals, particularly to ensure that second appeals do not get time barred by limitation, is through the appeal registers maintained by the AO and the Commissioner. The register traces the appeal at various stages and captures comprehensive data on the appeals filed, the appellate orders at different levels and the implementing orders of the AO.

**5.6** While the second appeal to the ITAT is filed with the approval of the respective Commissioner, the case for filing it with the HC is approved by the Chief Commissioner. The approval for Special Leave Petition (SLP) with the SC goes through a chain across seven<sup>57</sup> levels including the Law Ministry.

<sup>56</sup> In Gujarat charge

<sup>57</sup> The AO, the Range head, the Commissioner, the Chief Commissioner, the DGIT(Legal & Research), Member (Audit & Judicial) of CBDT and the Law Ministry



5.7 The appeal registers were either not maintained or were not filled in completely, thus providing inadequate control on stemming delays in filing appeals. On some appellate orders (18 cases with tax effect of Rs. 3.7 crore), the scrutiny report of the AO recommending escalation was available on file, but subsequent action of either rejecting the recommendation or of implementing the order, was not available. While correlating appeal registers, we found instances where the orders of HC were not placed in the respective assessment files.

5.7.1 The Ministry stated (July 2010) during the exit conference that suitable instructions for maintenance of appeal registers would be issued so as to ensure that the appeal registers are maintained properly.

5.8 We found 91 cases in Maharashtra and 49 cases in West Bengal involving tax effect of Rs. 66.0 crore and Rs. 12.1 crore respectively were dismissed by the respective HCs only on the issue of time barring due to delays in filing appeal ranging from 190 days to 2193 days. The Department replied (June 2009) that SLPs were not filed on 12 of the rejected cases in Maharashtra because the cases did not merit escalation. The reply raises doubts on why the Department appealed in these 12 cases to HC in the first place. In respect of the cases in West Bengal delays were attributed (August 2009) to delay in receipt of approval from the Ministry of Law.

*Charge: CIT-3 Mumbai, Maharashtra; AY: 1982-83*

*Assessee: Indian Express Newspapers Private Limited*

The Department filed (November 2008) an SLP after a delay of 481 days as against the prescribed time limit of 90 days from the date of the HC's judgment. The SC while dismissing the SLP said that "it is high time the CIT should try to set its own house in order. SLPs are filed after more than 20 years; it is beyond any comprehension as to why action is not taken against the officers (for) whose fault the delay has occurred". The Department stated (July 2009) that the delay in filing the SLP was a systemic failure and could not be attributed to an individual.

### **Implementation of appellate orders: Timeliness**

5.9 We are of the opinion that the departmental monitoring of appeals is geared more towards ensuring that the escalation does not become time barred, although there were gaps in that area as well. In doing so, both implementation of the appellate orders as well as effective screening of appeals (for escalation) on the merits of the case, have taken a back seat.

**5.10** The Act does not specify any timeframe for implementation of appellate orders. The Citizen's Charter of the Department aims for implementation within 45 days from the date of receipt of the order by the AO. Our study showed that only 11 per cent of the orders were implemented within 2 months and in 34 per cent of the cases, the Department took 3 to 6 months. The delays hurt the taxpayer; the interest liability on delayed refunds would be Rs. 250.3 crore.

**Table 5.2: Age-wise analysis: Time for implementation of orders**

Period (Months)	No of cases	Percentage
1 - 2	44	11.0
3 - 6	135	33.8
7 - 12	74	18.6
13 - 24	81	20.3
25 - 50	48	12.0
51 - 100	15	3.8
101 - 150	2	0.5
<b>Total</b>	<b>399<sup>58</sup></b>	

*Charge: CIT-III Kolkata, West Bengal; AYs: 1993-94 & 1994-95*  
*Assessee: The Peerless General Finance and Investment Company Limited*

CIT (A) allowed (December 1996/March 1998) partial relief to the assessee. The Department and the assessee preferred separate appeals before the ITAT. The ITAT gave further relief (June 2003). The AO gave effect to the orders of ITAT and CIT (A) in April 2009; the delays being over 5 years and 12 years respectively. This resulted in avoidable payment of interest of Rs. 24.2 crore.

*Charge: CIT-IV Delhi; AY: 1999-2000*  
*Assessee: G.E. Capital Transportation Financial Services Limited*

The Department took over 6 years and 2 years to give effect (March 2009) to the appellate orders<sup>59</sup> of CIT (A) and ITAT respectively. This resulted in avoidable payment of interest of Rs. 35.6 lakh.

**5.11** We found 31 appeals with tax effect of Rs. 8.3 crore in which the orders favouring the assessee were yet to be implemented as on date of audit, despite the lapse of 2 months. There were 17 other appeals which were adjudicated in favour of the Department for collection of tax amounting to Rs. 13 crore, which were not implemented. One such case is discussed below:

*Charge: CIT-II Chandigarh, UT Chandigarh; AY: 1991-92*  
*Assessee: Punjab State Cooperative Supply and Marketing Federation*

<sup>58</sup> In Andhra Pradesh, Assam, Bihar, Chhattisgarh, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Madhya Pradesh, Maharashtra, Karnataka, Kerala, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttarakhand, Uttar Pradesh and West Bengal

<sup>59</sup> Orders of CIT (A)-XIII dated 29 November 2002 and ITAT dated 3 March 2006

AO allowed deduction<sup>60</sup> of Rs. 57.0 crore on the basis of HC judgment<sup>61</sup>. Subsequently, the SC reversed the HC decision and ruled that the assessee was not eligible for the deduction<sup>62</sup>, following which the income was re-assessed. The assessee went to appeal on additional grounds to the ITAT (in 2007 after CIT (A) ruled in favour of the Department) which restored back the file to the AO. Fresh adjudication or assessment orders were not on the file and despite requests we were not informed of the status of the case. The tax involved in this case was Rs. 6.9 crore. We found that the assessee's case for AY 2000-01 and 2001-02 had also been referred back by ITAT to the AO. There were no documents on this referral either on file.

## 5.12 Recommendations

*We recommend automation of receipt and disposal of appellate orders, with inbuilt supervisory controls. Pending automation, maintenance and updating of control registers should be monitored regularly.*

The Ministry stated (July 2010) that the Central Appeal Registry will create such a database.

*A system for periodic reconciliation of data maintained by different sources may be instituted.*

The Ministry, while accepting the recommendation, stated (July 2010) that the Board is seized of the matter.

*We recommend that an effective system involving departmental representative/legal counsel may be laid down to ensure timely collection of appellate orders to stem the delays in implementation.*

The Ministry accepted (July 2010) the recommendation.

*As a confidence building measure, the data on AO-wise receipt and implementation of appellate orders should be placed on the website.*

The Ministry stated (July 2010) that the need for updation will make this unviable.

*We recommend strict enforcement of accountability of AOs for unwarranted delays in filing of appeals and implementation of appellate orders.*

The Ministry accepted (July 2010) the recommendation.

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<sup>60</sup> Under section 80P(2)(a)(iii) and 80 P(2)(a)(iv)

<sup>61</sup> Punjab and Haryana High Court in the decision in 182 ITR 58 (P&H)

<sup>62</sup> SC ruled that the deduction was to be allowed only to those cooperative societies whose membership consists of agriculturists.

## **CHAPTER 6**

# **ACCURACY IN IMPLEMENTATION**

**Mistakes in assessments**

**Recommendations**

## Chapter 6 Accuracy in implementation

We feel that implementation of appellate order is placed low on the AOs' priorities. Inadequate attention to correctness in implementation of appellate orders, led to mistakes amounting to Rs. 1,456 crore in 385 cases. 97 per cent of these mistakes in implementation led to under-assessment of tax benefitting the tax payer, which raises concerns.

**6.1** The appeal process is expected to provide clarity to the AO on the assessment and he is expected to implement the order in its letter and spirit. We would assume that an assessment which has gone through a protracted (and costly) dispute, would be treated with greater care in implementation to avoid mistakes especially since the assessee's options for further appeal are thereafter limited.

**6.2** The AO is monitored on achievement of targets of collections but implementation of appellate orders remains an unsupervised area. In such a situation, implementation of appellate orders would fall way below the hierarchy of priorities. The delays in implementation are a reflection of this scenario. This also led to inadequate attention on the correctness in implementation of appellate orders. The fact that detailed examination at various stages of appeal and judgments that would be expected to return a firm view, do not together preclude mistakes by AOs would raise doubts on the integrity of the process. This is also to be viewed in the context of the fact that 97 per cent of the mistakes in implementation detected by us led to under-assessment of tax of Rs. 1,446 crore thus benefitting the assessee.

**6.3** We found mistakes in 385 cases in assessment of tax amounting to Rs. 1,456 crore. A few are illustrated below:

*Charge: CIT-3 Mumbai, Maharashtra; AY: 1995-96*

*Assessee: ICICI Bank Limited (erstwhile ICICI Limited)*

The scrutiny assessment (March 1998) disallowing depreciation on leased assets, was disputed by the assessee in CIT (A) which not only upheld the AO's order, but made further disallowance on depreciation. The AO effaced the original order and re-assessed (February 2000/September 2003) the income as Rs. 294.1 crore. In the meanwhile the assessee approached (June 1999) the ITAT against the CIT (A)'s order, which was on the original assessment. The ITAT granted relief of Rs. 136.9 crore to the assessee. The AO gave effect (March 2007) to the ITAT order by reducing the re-assessed income of Rs. 294.1 crore by Rs. 136.9 crore.

Since the original assessment order had been effaced, ITAT order was, in effect, on an assessment that no longer existed and, therefore, could not be implemented as per the SC's<sup>63</sup> ruling. The AO first implemented the order and then misled the Commissioner in his Scrutiny Report (August 2007) recommending no second appeal, stating that "since the original order does not survive..... the (ITAT) appeal be treated as non-est". The AO's actions raise doubts on his intent in granting the assessee of relief of Rs. 136.9 crore and require investigation and appropriate administrative action.

*Charge: CIT-2 Mumbai, Maharashtra; AY: 2004-05*

*Assessee: Tata Sons Limited*

The assessee had filed business loss of Rs. 225.2 crore but in scrutiny assessment (December 2006) income of Rs. 758.6 crore was determined including other income. While implementing the order (January 2009) of CIT (A), the business income was reduced to Rs. 56 crore and Double income tax<sup>64</sup> (DIT) relief was given on the entire income, although the relief was required to be restricted on the tax payable on business income. This led to providing of excess relief of Rs. 34.5 crore.

*Charge: CIT LTU Mumbai, Maharashtra; AY: 1991-92*

*Assessee: Bajaj Auto Limited*

The AO added "sales tax incentive" to the income of the assessee, which was rejected<sup>65</sup> by the ITAT. ITAT's order, in effect, reduced the business profits (and tax liability) of the assessee. The assessee had also claimed deduction under section 80HH (for new units in backward areas) and 80I (for units after a specified date), which are calculated in proportion to business profits. Thus, the relief under these provisions was required to be re-worked in proportion to the reduced profits after implementation of ITAT order. This was not done leading to excess relief of Rs. 12.7 crore to the assessee.

*Charge: CIT-II Hyderabad, Andhra Pradesh; AY: 2004-05 and 2005-06*

*Assessee: Andhra Pradesh Paper Mills Limited*

The assessee's claim for deduction<sup>66</sup> in respect of captive steam and power plants was rejected by the AO during scrutiny assessment. CIT (A) ruled that the assessee was eligible for the deduction. However, we found that the assessee

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<sup>63</sup> ITO vs. K. L. Srihari (HUF) and others 250 ITR 193

<sup>64</sup> Double income tax relief on a transaction is given to taxpayer on account of tax on transaction in another country.

<sup>65</sup> CIT (A) confirmed the inclusion.

<sup>66</sup> Under section 80IA. The deduction is on the profits earned by the units that are eligible for deduction; the eligibility being for businesses engaged in infrastructure development.



showed inflated profits<sup>67</sup> at Rs. 21.7 crore for the two AYs together, in order to enhance his claim for more deductions. The AO failed to notice these infractions while implementing the CIT (A)'s orders, and disallow the deductions, thus providing benefit of Rs. 7.9 crore to the assessee.

The Ministry stated (July 2010) that since the CIT (A) allowed the appeal, there is no mistake in the consequential order. This is an unacceptable stand since CIT (A) had clarified only on the eligibility of the unit u/s 80IA and not on the quantum of deduction, which we found, was substantially inflated.

#### 6.4 Recommendations

*We recommend supervisory review of orders giving effect to appeal, to detect mistakes.*

The Ministry accepted (July 2010) the recommendation.

*A stricter accountability structure should be formulated to fix responsibility on AOs for incorrect implementation of appellate orders.*

The Ministry accepted (July 2010) the recommendation.

New Delhi  
Dated

(REBECCA MATHAI)  
Principal Director (Direct Taxes)

Countersigned

New Delhi  
Dated

(VINOD RAI)  
Comptroller and Auditor General of India

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<sup>67</sup> By not claiming depreciation on turbine, not capitalising pre-operative interest expenditure on boiler and claiming incorrect amount of depreciation on boiler

**Appendix - I**  
**(Referred to in para 1.10)**

**State wise selection of cases**

Sl.No.	State	No. of records requisitioned	No. of records produced	Records not Produced (Col. 3- Col. 4)	Percentage of records not produced
1	2	3	4	5	6
1.	Assam	434	432	2	0.46
2.	Andhra Pradesh	483	413	70	14.49
3.	Bihar	117	86	31	26.49
4.	Chattisgarh	142	94	48	33.80
5.	Chandigarh UT	355	355	Nil	Nil
6.	Delhi	8873	410	8463	95.38
7.	Goa	530	530	Nil	Nil
8.	Gujarat	1069	642	427	39.94
9.	Haryana	602	602	Nil	Nil
10.	Himachal Pradesh	114	114	NIL	NIL
11.	Jammu & Kashmir	82	50	32	39.02
12.	Jharkhand	162	125	37	22.84
13.	Karnataka	1008	632	376	37.30
14.	Kerala	356	356	Nil	Nil
15.	Madhya Pradesh	1489	1483	06	0.40
16.	Maharashtra	7372	3956	3416	46.34
17.	Orissa	426	209	217	50.94
18.	Punjab	2988	1388	1600	53.55
19.	Rajasthan	652	481	171	26.23
20.	Tamil Nadu	736	627	109	14.81
21.	Uttarakhand	170	89	81	47.65
22.	Uttar Pradesh	91	65	26	28.57
23.	West Bengal	1581	1417	164	10.37
	<b>Total</b>	<b>29835</b>	<b>14560</b>	<b>15275</b>	

## **Glossary**

**CBDT:** Central Board of Direct Taxes, which functions under the Ministry of Finance.

**Assessing Officer (AO):** Income Tax Officer or Assistant Commissioner of Income Tax or Deputy Commissioner of Income Tax or Joint Commissioner of Income Tax or Additional Commissioner of Income Tax who is authorised by the Board to exercise or perform all or any of the powers and functions conferred on, or assigned to an AO under the Income tax Act, 1961.

**ITAT:** Income Tax Appellate Tribunal which functions under the Ministry of Law.

**NTT:** National Tax Tribunal, the appellate level in place of the High Court where the appeals against the ITAT order are to be instituted.

**COD:** Committee on Disputes, a High Powered Committee headed by the Cabinet Secretary to litigate the disputes between the Government Departments/Ministries or between Public Sector Enterprises or between a Public Sector Enterprise and a Ministry/Department of the Government of India.

**SLP:** Special leave petition means special permission to be heard in appeal against any High Court/tribunal verdict.

**Assessment year (AY):** Period of 12 months commencing on the 1<sup>st</sup> day of April every year.

**DGIT (L&R):** Directorate General of Income Tax (Legal & Research).

**OECD:** Organisation for Economic Co-operation and Development.