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

**for the year ended March 1999**

**UNION GOVERNMENT  
(DIRECT TAXES)  
NO. 12 OF 2000**

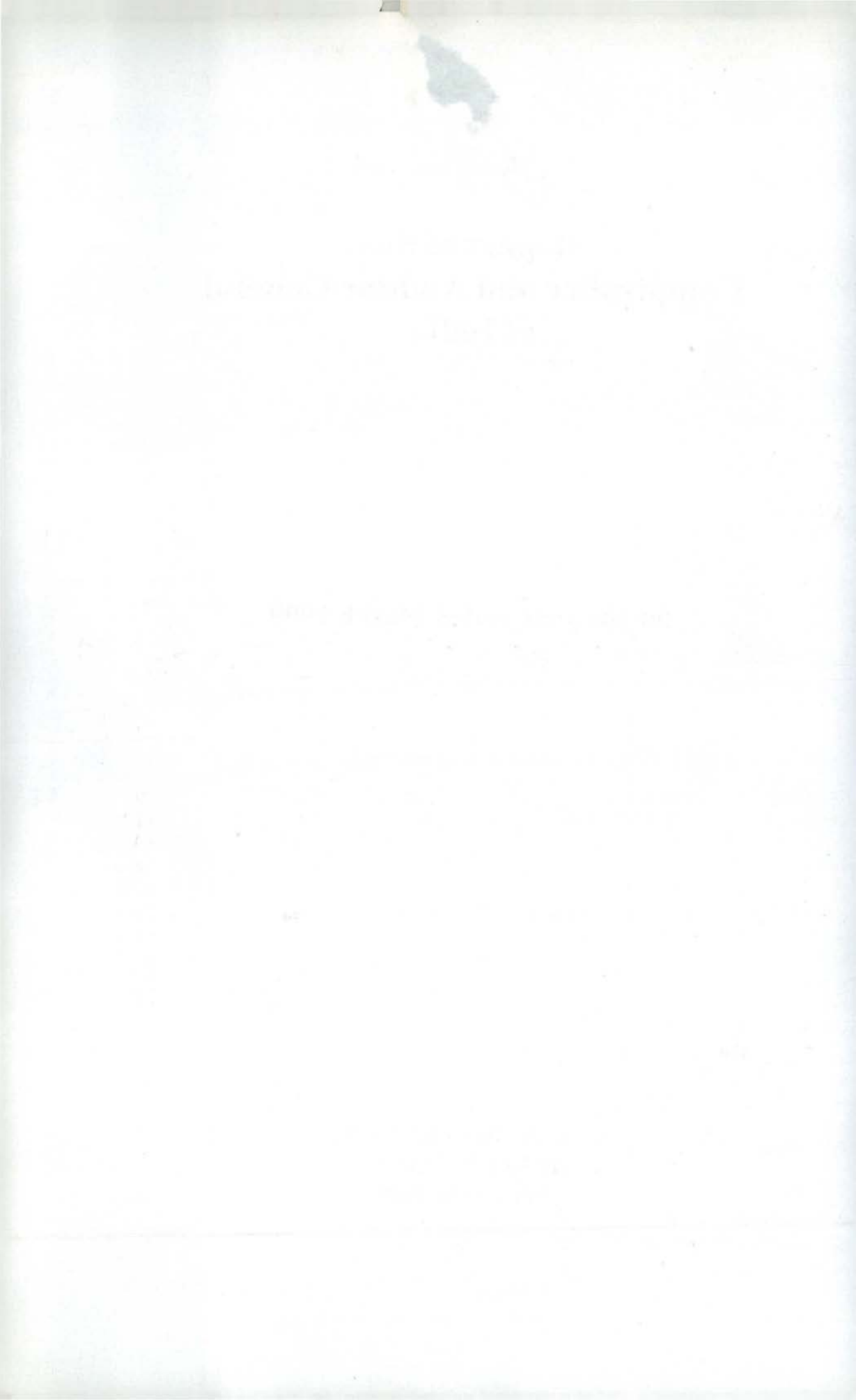




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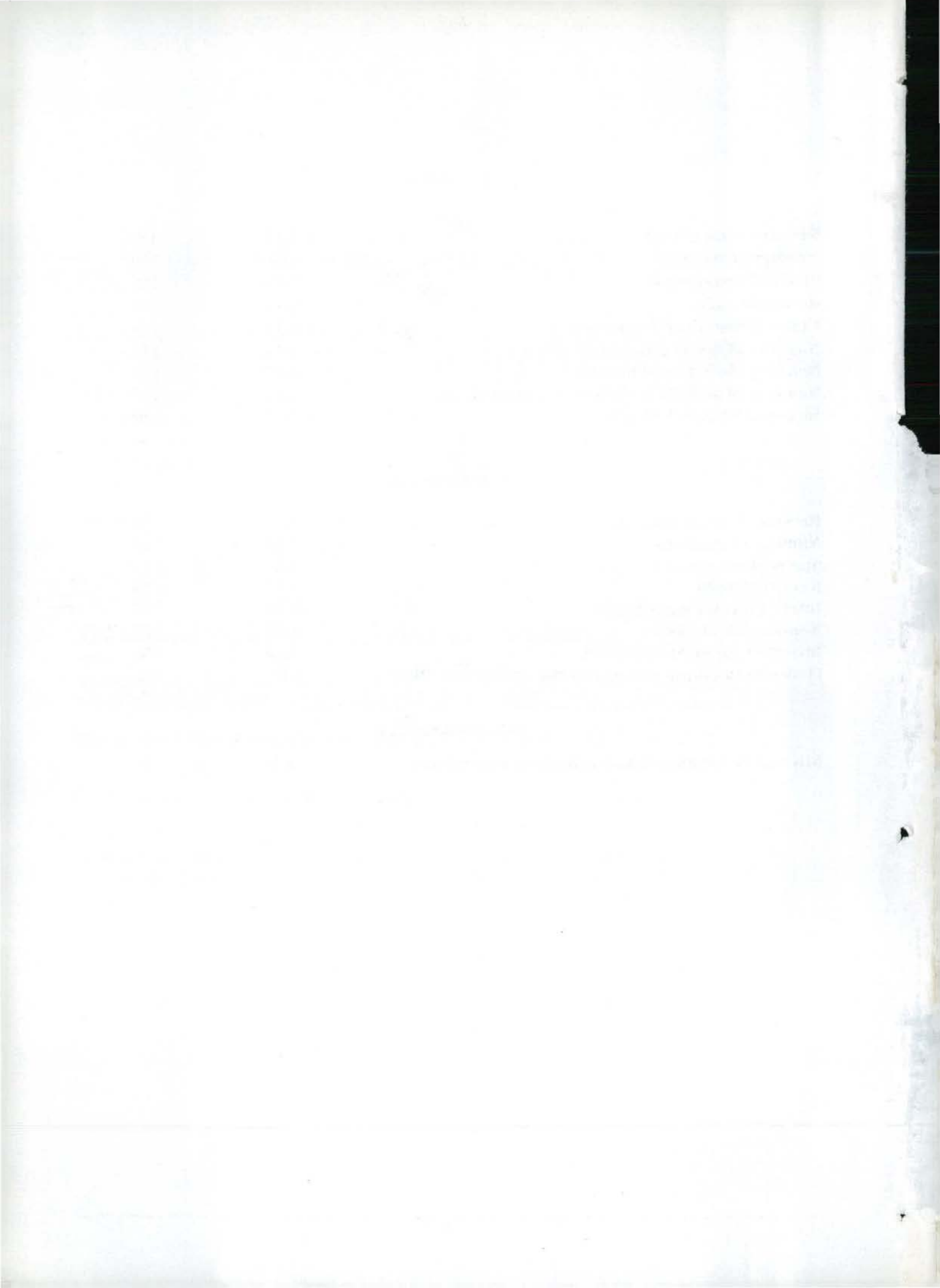
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## PREFATORY REMARKS

This Report for the year ended March 1999 has been prepared for submission to the president under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts - Direct Taxes of the Union Government is conducted under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The Report presents the results of audit of receipts under direct taxes comprising corporation tax, income tax, wealth tax, gift tax etc. The Report is arranged in the following order :-

- (i) Chapter 1 includes information on the arrangements for audit of direct taxes and mentions the results thereof;
- (ii) Chapter 2 incorporates important statistical information on the administration of direct taxes;
- (iii) Chapter 3 includes system appraisals on four topics Assessment of search cases made on or after 1.7.1995 under Income Tax Act, 1961 (Block Assessment); Computerisation in the Income Tax Department; Taxation of foreign telecasting channels through circulars No.742 and 765 and Abolition of tax on dividend income
- (iv) Chapters 4 and 5 mention the issues resulting from the audit of corporation tax and income tax respectively;
- (v) Chapter 6 highlights the results of the audit of wealth tax, gift tax, interest tax and expenditure tax;
- (vi) The observations included in this Report have been selected from the findings of the test audit conducted during 1998-99 as well as in earlier years but which could not be covered in the previous Reports.





## OVERVIEW

### Audit of Direct Taxes and Results of Audit

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

2. During the course of local test audit conducted in 1998-99, 16792 audit observations on underassessment involving tax effect of Rs.3416.02 crore and 76 cases of overassessment involving tax effect of Rs.28.40 crore have been intimated to the department on Corporation tax, Income Tax and Other Direct Taxes. Out of these observations a large number of 5844 cases relating to corporation tax/income tax involving revenue effect of Rs.2302.59 crore pertained to incorrect computation of business income, incomes escaping assessment and irregular set off of losses. Out of 16792 observations, 870 cases with a tax effect of Rs.873.86 crore have been issued to the Ministry as individual draft paragraphs out of which 836 cases involving tax effect of Rs.836.64 crore have been included in this Report. Out of these, 352 cases involving revenue effect of Rs. 298.64 crore have been accepted by the Ministry.

Besides the audit observations in individual assessments, this Report also includes system appraisals on four topics on the following subjects involving revenue effect of Rs.144.15 crore, wherever the same could be quantified.

- Assessment of search cases made on or after 1.7.1995 under Income Tax Act, 1961 (Block assessment)
- Computerisation in the Income Tax Department,
- Foreign Telecasting Channels-Taxation through Circulars Nos. 742 and 765, and
- Abolition of tax on dividend income

3(a) This Report has been prepared after considering the response of the Ministry of Finance to the audit observations, wherever received. The receipt of replies to the cases of individual draft paragraphs this year has been 51 percent as against 59 per cent last year.



Revenues from  
Direct Taxes  
and  
Administration  
of Direct Taxes

(b) In subsequent paragraphs of this section, brief particulars of cases selected from each chapter have been featured to give an idea in brief of the audit findings. Many other interesting cases of different types have been featured in various chapters of this Report.

4. The collections of direct taxes decreased by 3.48 percent, from Rs.48,280.40 crore in 1997-98 to Rs.46,600.07 crore in 1998-99. The ratio of Direct Taxes to the Gross Domestic Product was 2.9 percent. The tax buoyancy of direct taxes during 1998-99 was (-)0.26 and the tax buoyancy with reference to non-agricultural GDP was also (-)0.33.

[Paras 2.3(i),2.5(i),(ii) and (iii)]

While the collections of direct taxes decreased by 3.48 percent, the cumulative arrears of direct taxes increased from Rs.41,230.03 crore in 1997-98 to Rs.44,142.72 crore representing an increase of 7.06 percent. The net arrears of direct taxes, however, came down from Rs.5,821.28 crore in 1997-98 to Rs.4,244.41 crore in 1998-99, a decrease of 27 percent over the previous year. Further, 60.55 percent of net arrears outstanding as on 31 March 1999 was constituted by high demand cases of Rs. 10 lakh and above.

[Paras 2.10(i)(a) and (e)]

5. The expenditure of Rs.925.62 crore incurred in collection of all direct taxes (Rs. 46,600.07 crore) during 1998-99 was 1.98 percent to the total collections. On an average, 83.5 percent of collections were realised at pre-assessment stage during 1996-97 to 1998-99.

[Paras 2.8 and 2.7(i)]

6. During the year, the number of assesseees increased by 40,53,981 and there were 175,21,227 assesseees as on 31 March 1999. Pendency of assessments continued to remain an area of concern as the percentage of cases pending for scrutiny and summary assessments remained high at 66.25 and 53.16 per cent respectively.

[Paras 2.1 and 2.9.1(i)]

The Department could dispose of only 1.09 percent of its total workload of assessments after scrutiny and thus the bulk of the workload was disposed of under the summary assessment scheme. In the high income category of cases, the disposal after scrutiny was, however, 68.97 percent in company cases and 39.98 percent in non-company cases.

[Para 2.9.1(i)]

7. Cases pending with appellate authorities have a perceptible impact on the assessments and collection of direct taxes. There were 2,14,996 cases pending with Commissioners(Appeals) as on 31 March 1999. 29,135 cases (13.55 per cent) pending with the Commissioners(Appeals) were high demand cases. Besides, 1,66,042 cases were pending with the Supreme Court, High Courts and Income Tax Appellate Tribunals.

[Para 2.12]



The arrears of direct taxes which remained uncollected as a result of stay granted or/kept in abeyance by appellate authorities as on 31 March 1999 were Rs.25,717.31 crore.

[Para 2.10(i)(a)]

**System  
Appraisals**

**8.(a) Assessment of search cases made on or after 1.7.1995 under Income Tax Act, 1961 (Block assessment)**

The procedure of 'block assessment' was inserted with effect from 1 July 1995 through Finance Act, 1995 for making efficient and cost effective assessments of search cases with a view to unearthing and bringing the black money expeditiously to tax.

Various mistakes in computation of income and tax, incorrect allowance of deductions, escapement of capital gains, wealth tax and gift tax resulted in short levy of tax aggregating Rs.3900.03 lakh.

Delayed completion of assessments, non completion of block assessments within stipulated period and ineffective search and defective assessments led to loss of revenue totalling to Rs.606.94 lakh.

While surcharge, interest, penalty, amounting to Rs.6251.19 lakh were not levied or short levied, the same were excess levied to the extent of Rs.129.71 lakh.

**(b) Computerisation in the Income Tax Department**

The computerisation programme which started in 1994 suffered from a lack of advance planning. The hardware was procured well before framing of the software design document, leading to improper hardware sizing. Further, bottle necks such as non readiness of sites/terminal banks, delay in implementation of software application systems and delayed acquisition of leased lines leading to non connectivity of Personal Computers with Regional Computer Centers/National Computer Centre contributed to an overall slowdown in the implementation of the computerisation programme. While some progress was made in implementation of two application systems (Tax accounting system and in allotment of Permanent Account Numbers) the progress in other seven application systems did not gather momentum despite the hardware and software facilities existing for this. Thus the intended benefits have not been derived even after a period of five years and incurring expenditure of Rs.104.55 crore.

It was noticed that an amount of Rs.208.64 lakh included in the tender of M/s. TISL as marketing expenses, overhead and local services was accepted by the department in contravention of Government norms. Other cases of avoidable expenditure of Rs.226.19 lakh on procurement of hardware,



software and networking items were also noticed during scrutiny of records.

**(c) Foreign Telecasting Channels-Taxation through circular Nos. 742 dated 2-5-1996 and 765 dated 15-4-1998**

Despite the reservation by the Secretary (Revenue), the circular No.742 dated 2.5.1996 was issued prescribing presumptive tax on 10 percent of the total earnings of the foreign telecasting channels in India with an assurance that the position as to the reasonableness of rate of profit would be reviewed. However, no review/study was conducted and the guidelines thereof were extended indefinitely by the Chairman, CBDT by issue of another circular No.765 dated 15.4.1998.

The circulars were issued without taking into consideration the royalty earnings for 'pay channels' and lease income from rental of 'decoders' as well as the rising trend of advertising revenues. In view of the specific provisions for estimation of income of non-residents which cannot be definitely ascertained for taxation purposes under the Income Tax Act, there was no need for issue of the circular and later extending the same whereby the FTCs, under the special status, avoided the rigors of normal assessment procedures.

Thus, in effect, the circular which was based on assumptions framed on insufficient data and without adequate study of pros and cons of the action, was invalid and needs to be withdrawn.

**(d) Abolition of tax on dividend income**

The decision to abolish tax on dividends in the hands of shareholders and levy of additional tax of 10 percent on the distributed profits was apparently taken based on insufficient facts and incorrect assumptions.

-Analysis of the alternatives was based on incorrect assumptions and without appreciating the relevance of appropriate data.

-The trend of dividend payments by the companies over the years was not considered.

-Percentage growth in retained earnings of the companies over the years was not considered.

-The final decision is at variance with the global practice of taxing dividends twice in the hands of the corporates and those of the shareholders.

Given the prevailing fiscal constraint, and the present scenario of reduced corporate tax rates co-existing with the exemptions/reliefs, the intended



policy objectives of the measure appear to be out of step with the likely adverse impact on revenue.

**Corporation Tax** 9. Corporation tax constituted about 53 percent of the total collections from direct taxes during the year 1998-99. 584 audit observations involving tax effect of Rs. 828.30 crore on various irregularities/ omissions/mistakes in corporate tax assessments were issued to the Ministry of Finance for their comments.

[Paras 4.3 and 4.5]

(i) In 18 cases, the mistakes in assessments resulted in overcharge of tax of Rs.269.42 lakh in different CIT's charges.

[Para 4.6.1]

(ii) Incorrect adoption of figures, arithmetical mistakes, application of incorrect rates of tax resulted in short levy of tax of Rs.10192.87 lakh in 60 cases in Andhra Pradesh, Gujarat, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Delhi, Maharashtra, and West Bengal charges.

[Paras 4.6.2 and 4.7]

(iii) Incorrect allowance of non-business expenditure, capital expenditure and provisions in 50 cases in Andhra Pradesh, Assam, Bihar, Gujarat, Kerala, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu, Delhi, Maharashtra and West Bengal charges led to short levy of tax of Rs.5978.76 lakh.

[Paras 4.9 and 4.12]

(iv) Irregular allowance of liabilities and other mistakes in computation of business income due to incorrect computation of income from tea business, non-correlation with interest tax assessments, incorrect allowance of prior period expenses/preliminary expenses/payments out side India, expenditure on scientific research and know-how in 53 cases in different CIT's charges led to short levy of tax of Rs.7043.71 lakh.

[Paras 4.13 to 4.20]

(v) Due to incorrect valuation of closing stock, short levy of tax aggregating Rs.8807.65 lakh was noticed in 14 cases in Andhra Pradesh, Gujarat, Karnataka, Orissa, Punjab, Maharashtra and West Bengal charges.

[Para 4.21]

(vi) Incorrect computation of income of financial corporations and incorrect allowance of bad debts thereof resulted in short levy of tax aggregating Rs.8354.82 lakh in 5 cases in Bihar, Kerala and Tamil Nadu charges.

[Para 4.23]



(vii) In Andhra Pradesh, Assam, Gujarat, Karnataka, Kerala, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, Delhi, Maharashtra, and West Bengal charges, due to irregular/excess allowance of depreciation and application of incorrect rates for allowance of depreciation, there occurred short levy of tax aggregating Rs.17175.31 lakh in 56 cases.

[Paras 4.24 to 4.26]

(viii) In Andhra Pradesh, Bihar, Gujarat, Haryana, and Tamil Nadu charges, in 3 cases, mistakes in allowance of investment allowance led to short levy of tax of Rs.69.28 lakh.

[Para.4.27]

(ix) Excess/irregular and incorrect carry forward and set off of unabsorbed depreciation and investment allowance resulted in short levy of tax of Rs.1812.46 lakh in 26 cases in Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Punjab, Rajasthan, Tamil Nadu, Maharashtra and West Bengal charges.

[Para 4.28 ]

(x) Omission to assess capital gains and incorrect computation of capital gains resulted in short levy of tax of Rs.315.56 lakh in 8 cases in Tamil Nadu, Uttar Pradesh, Maharashtra and West Bengal charges.

[Para 4.29]

(xi) In 26 cases in Andhra Pradesh, Assam, Bihar, Gujarat, Karnataka, Kerala, Orissa, Tamil Nadu, Maharashtra and West Bengal charges, mistakes committed in assessments of income such as irregular treatment of revenue receipts as capital receipts, failure to account for receipts as per the system of accounting regularly adopted by the assesseees, etc. led to aggregate short levy of tax of Rs.4643.76 lakh.

[Para 4.30]

(xii) Incorrect carry forward and set off of losses and incorrect set off of capital loss resulted in short levy of tax aggregating Rs.6892.16 lakh in 49 cases in Haryana, Chandigarh(UT), Himachal Pradesh, Karnataka, Tamil Nadu, Uttar Pradesh, Delhi, Maharashtra and West Bengal charges.

[Para 4.31]

(xiii) Mistakes committed in assessments while giving effect to appellate orders resulted in short levy of tax totalling to Rs.197.23 lakh in 13 cases in Assam, Karanataka, Rajasthan, Tamil Nadu, Maharashtra and West Bengal charges.

[Para 4.32]

(xiv) In 6 cases in Haryana, Madhya Pradesh, Tamil Nadu and West Bengal charges, irregular allowance of Chapter VIA deductions despite the fact that the gross total income worked out to a loss or due to irregular computation of gross total income resulted in an aggregate short levy of tax of Rs.285.34 lakh.

[Para 4.33]



(xv) Incorrect allowance of deductions in respect of profits and gains from new industrial undertakings established after 31 March 1981 resulted in short levy of tax totalling to Rs.392.56 lakh in 19 cases in Himachal Pradesh, Gujarat, Karnataka, Madhya Pradesh, Punjab, Uttar Pradesh, Delhi, Maharashtra and West Bengal charges.

[Para 4.36]

(xvi) Irregular/incorrect deduction in respect of export profit allowed in 41 cases in Assam, Gujarat, Haryana, Madhya Pradesh, Tamil Nadu, Delhi, Maharashtra and West Bengal charges resulted in short levy of tax aggregating Rs.1794.05 lakh

[Para 4.37]

(xvii) In Bihar, Gujarat, Orissa, Tamil Nadu, Delhi and West Bengal charges, in 11 cases, irregular/incorrect allowance of deduction in respect of profits and gains from new industrial undertakings established after 31 March 1991 resulted in an aggregate short levy of tax of Rs.248.14 lakh.

[Para 4.38]

(xviii) In Mumbai charge, failure to invoke special provisions to levy minimum alternate tax and mistake in computation of book profits resulted in short levy of tax totalling to Rs.355.32 lakh in 6 cases.

[Para 4.39]

(xix) Incorrect allowance of deduction in respect of inter-corporate dividends in 6 cases in Karnataka, Kerala, Tamil Nadu and West Bengal charges resulted in short levy of tax totalling to Rs.623.05 lakh.

[Para 4.40]

(xx) Mistakes committed in levy of interest for delay in filing the return, short payment/deferment of advance tax and for delay in payment of tax demand etc. in 38 cases in different CIT charges resulted in non-levy/short levy of interest aggregating Rs.1910.93 lakh.

[Paras 4.41 to 4.43]

(xxi) In Madhya Pradesh, Rajasthan, Tamil Nadu, Delhi, Maharashtra and West Bengal charges, allowance of interest even though the refund was less than 10 per cent of tax determined and other mistakes resulted in excess payment of interest and short charge of tax aggregating Rs.352.61 lakh in 8 cases.

[Para 4.44]

(xxii) Mistakes committed in determining the amounts of refunds resulted in excess refunds totalling to Rs.432.82 lakh in 3 cases in Gujarat, Maharashtra and West Bengal charges.

[Para 4.45]

(xxiii) In Shillong, Assam charge, the refund determined on rectification of summary assessment was adjusted against the scrutiny assessment which



resulted in short demand of tax of Rs.358 lakh.

[Para 4.46(a)]

(xxiv) Mistakes due to non levy of additional tax, omission to revise assessments, irregular grant of credit for tax deducted at source, non-correlation of records with sales tax records, non levy of interest for failure to deposit tax deducted at source, etc. resulted in total short levy of tax of Rs.629.75 lakh in 12 cases in Assam, Karnataka, Orissa, Punjab, Tamil Nadu, Maharashtra and West Bengal charges.

[Paras 4.46(b) to (e)]

(xxv) Other mistakes such as incorrect computation of income from house property, incorrect allowance of provisions etc. in respect of banks, incorrect computation of income and tax, incorrect/irregular allowance of deductions etc. resulted in short levy of tax aggregating Rs.785.42 lakh in 30 cases under different CIT charges.

[Paras 4.8, 4.10, 4.11, 4.22, 4.34, 4.35 and 4.47]

#### Income Tax

10(i) During the year 1998-99, income tax constituted about 43 percent of the total collections from direct taxes. 172 audit observations involving revenue effect of Rs.37.63 crore on various irregularities/mistakes/omissions in the income tax assessments were issued to the Ministry of Finance during the year for their comments.

[Paras 5.2 and 5.5]

(ii) Avoidable mistakes like adoption of incorrect figures, non-levy of sur charge, application of incorrect rates of tax etc. led to short levy of tax of Rs.464.14 lakh in 26 cases and overcharge of tax of Rs.151.41 lakh in 9 cases in different CIT charges.

[Para 5.6]

(iii) Incorrect computation of business income, incorrect allowance of capital expenditure and provisions, incorrect valuation of closing stock and underassessment of sales etc. resulted in short levy of tax aggregating Rs.302.02 lakh in 19 cases in different CIT charges.

[Paras 5.7 to 5.9]

(iv) In 6 cases in Gujarat, Haryana, Madhya Pradesh, Punjab and Maharashtra charges, incorrect application of rate of depreciation and irregular set off of unabsorbed depreciation led to short levy of tax totalling to Rs.51.51 lakh.

[Paras 5.10 and 5.11]

(v) In Gujarat charge, incorrect allowance of investment allowance resulted in short levy of tax of Rs.29.63 lakh.

[Para 5.12]



(vi) Incorrect computation and exemption in computation of capital gains resulted in short levy of tax of Rs.40.10 lakh in aggregate in 5 cases in Gujarat, Rajasthan, Maharashtra and West Bengal charges.

[Paras 5.13]

(vii) In Gujarat, Rajasthan, Tamil Nadu, Uttar Pradesh and Maharashtra charges, in 9 cases, mistakes in assessment of firms and partners resulted in total short levy of tax of Rs.171.05 lakh.

[Paras 5.14 and 5.15]

(viii) Mistakes committed in assessment of income such as failure to bring to tax the income from business activity, receipts as per accounting system adopted by the assessee, etc. and failure to tax capital gains resulted in short levy of tax totalling to Rs.572.72 lakh in 11 cases in Gujarat, Haryana, Tamil Nadu, Uttar Pradesh and Maharashtra charges.

[Paras 5.16 and 5.17]

(ix) In 5 cases in Uttar Pradesh, Maharashtra and West Bengal charges, incorrect carry forward and set off of losses resulted in an aggregate short levy of tax of Rs.129.79 lakh.

[Para.5.18]

(x) Incorrect allowance of deductions under Chapter VIA without setting off unabsorbed depreciation and investment allowance, refund of central excise duty, brought forward losses from the gross total income resulted in short levy tax totalling to Rs.75.52 lakh in 3 cases in Bihar, Gujarat and Uttar Pradesh charges.

[Para 5.20]

(xi) In 9 cases in Gujarat, Kerala, Madhya Pradesh, Tamil Nadu, Delhi and Maharashtra charges, incorrect grant of deductions in respect of export profits led to total short levy of tax of Rs.143.86 lakh.

[Para 5.21]

(xii) In Maharashtra charge, incorrect allowance of deduction in respect of profits and gains of an industrial undertaking established after 31 March 1981 resulted in short levy of tax of Rs.155.34 lakh.

[Para 5.22]

(xiii) Incorrect allowance of deduction in respect of income of a cooperative society led to short levy of tax of Rs.17.02 lakh in Gujarat charge.

[Para 5.23]

(xiv) In different CIT charges, short levy/ omission to levy/incorrect levy of interest for delay in submission of return, short payment/non-payment of advance tax, delay in payment of tax demand, in 21 cases amounted to Rs.349.90 lakh.

[Para 5.24]



(xv) Other mistakes such as mistakes committed while giving effect to appellate orders, incorrect allowance of expenditure, incorrect computation of income and tax, interest/penalty, etc. resulted in total short levy of tax of Rs.244.43 lakh in 33 cases in various CIT charges.

[Paras 5.19, 5.25 and 5.26]

**Wealth Tax**

11(i) Omission to include rental income, owned specified assets like motor cars/Air Crafts immovable properties disclosed by the assessee themselves for income tax in 39 cases resulted in non levy of Wealth Tax of Rs.161.88 lakh.

[Para 6.5]

(ii) Incorrect valuation of quoted/unquoted equity shares of 6 individuals in Tamil Nadu and West Bengal charges led to underassessment of net wealth aggregating Rs.498.40 lakh with consequent short levy of tax of Rs.11.37 lakh.

[Para 6.8 and 6.9]

(iii) Non levy/short levy of interest for delay in filing the return of wealth in 6 cases aggregated Rs.39.29 lakh.

[Paras 6.11]

**Gift Tax**

12(i) Omission to levy of tax on gift/deemed gift disclosed by the assessee for income tax in 16 cases aggregated to Rs.110.97 lakh.

[Para 6.18]

(ii) Non levy of interest for belated payment of gift tax in case of one company aggregated Rs.22.60 lakh.

[Para 6.20]

**Interest Tax**

13(i) Non-assessment of chargeable interest and discount income resulted in escapement of Rs.4369.17 lakh from interest tax assessment in 18 cases with consequent short levy of tax of Rs.221.67 lakh.

[Para 6.26]

(ii) Non-levy of interest for default in payment of interest tax in advance aggregated Rs.47.85 lakh in 7 case of banking company .

[Para 6.27]

(iii) Incorrect payment of interest on refund in case of one banking company amounted to Rs.86.09 lakh.

[Para 6.28]

**Expenditure Tax**

14 Non-levy/Incorrect levy of rate of tax on the chargeable expenditure in 5 cases aggregated Rs.39.99 lakh.

[Para 6.30]

## Chapter 1 : Introduction

### General

#### 1.1 Taxes levied by Parliament comprise:

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

Laws relating to Direct Taxes are administered by the Central Board of Direct Taxes (hereinafter called 'the Board'). The Board is under the overall control of Department of Revenue, Ministry of Finance. Revenue from Direct Taxes during 1998-99 was Rs.46,600.07 crore. Time series data on revenue from various Direct Taxes and other related statistical information including on tax administration are presented in Chapter 2.

### Statutory Audit

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

The audit of Direct Taxes is conducted through test check of assessments and other records of the department maintained in its field offices. For examination of policy issues, introduction of particular amendments to the Income Tax Act or for examination of any background material behind the issue of circulars, instructions and decisions taken in particular cases, the records of the Central Board of Direct Taxes are also examined by the office of the Comptroller and Auditor General of India. Various checks are applied to ensure that the taxes due from assesseees have been arrived at in accordance with the provisions of law. Reliance is placed on law as interpreted by the judicial authorities including appellate tribunals. The thrust of statutory audit is to ascertain whether the systems and procedures prevalent in the department are satisfactory for the levy and collection of direct taxes. Towards this end, 'System Appraisals' on selected topics are conducted yearly. Our findings are brought to the notice of the field Commissioners of Income Tax through local audit reports by the field offices of the Accountants General/Principal Directors of Audit. Important audit observations are then issued to the Ministry of Finance for their comments after a thorough review at Headquarters of the Comptroller and Auditor General of India.



**Present Report**

1.3 The arrangement of this Report has been mentioned in the prefatory remarks. In each case, response of Ministry, where furnished, has been indicated. Where the reply of the Ministry has been found unacceptable, the reasons therefor have been mentioned alongwith the reply of the Ministry.

The present report contains 836 audit observations out of 870 audit observations referred to Ministry of Finance as draft audit paragraphs as detailed below:

(Rs. in crore)

Category of tax	Number of draft paragraphs	Tax effect
Corporation tax	564	800.03
Income Tax	159	28.78
Wealth Tax	60	2.31
Gift Tax	21	1.41
Interest Tax	27	3.71
Expenditure Tax	05	0.40
<b>Total</b>	<b>836</b>	<b>836.64</b>

The Report also contains following reviews involving revenue effect of Rs.144.15 crore. Thus the total revenue effect in this report amounts to Rs.980.79 crore. Besides, in certain technical reviews there are substantial audit comments with very large tax potential but the tax effect is not immediately quantifiable.

**System Reviews-**

1. Assessment of search cases made on or after 1.7.1995 under Income Tax Act, 1961 (Block assessment),
2. Computerisation in the Income Tax Department,

**Audit of Notifications/Circulars-**

3. Foreign Telecasting Channels-Taxation through circular No.742 & 765

**Special Studies**

4. Abolition of tax on Dividend Income.

**Non-receipt of Board's comments on draft paragraphs**

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

**Position of Replies received from the Ministry at the time of finalisation of Audit Report**

Year of Report	Number of draft paragraphs issued	Replies received before finalisation of Audit Report	Percentage of cases in which replies were received	No. of cases accepted by Ministry	Percentage of cases accepted by Ministry
1994-95	796	668	84	549	82.2
1995-96	831	673	81	565	84
1996-97	685	405	59	295	73
1997-98	918	474	52	339	72
1998-99	870	441	51	352	80

**Local Audit Reports**

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

**Results of Test Audit in general**

**1.5.1** Test audit conducted between 1 April 1998 and 31 March 1999 of the assessments completed by the Income Tax Department revealed 16,792 cases of underassessment involving a total revenue effect of Rs.3,416.02 crore and 76 overassessment cases involving a total revenue effect of Rs. 28.40 crore, which were referred to the department. The department has so far accepted the observations in 2877 cases involving tax effect of Rs.98.46 crore. A resume of the deficiencies noticed is given below:

**Corporation Tax and Income Tax**

(i) During the period under report, 16,039 cases involving a tax effect of Rs.3,375.48 crore were referred to the department. Of these cases, major audit observations were raised in 8,451 cases involving short levy of tax of Rs. 2,164.87 crore. The remaining 7,588 cases accounted for underassessment of tax of Rs. 1,210.61 crore.

The reasons for underassessment of tax of Rs. 3,375.48 crore (including potential tax) are categorised as follows:

		(Rs. in crore)	
		No. of cases	Amount
1.	Avoidable mistakes in computation of income and tax	1,567	216.63
2.	Failure to observe the provisions of the Finance Acts	566	103.28
3.	Incorrect status adopted in assessments	97	5.14
4.	Incorrect computation of salary income	595	16.75
5.	Incorrect computation of income from house property	239	9.76
6.	Incorrect computation of business income	3,933	1,045.76
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1,469	288.45
8.	Irregular computation of capital gains	403	21.55
9.	Mistakes in assessments of firm and partners	253	17.57
10.	Omission to club the income of spouse/minor child etc.	105	16.52
11.	Income not assessed	1,248	431.89
12.	Irregular set off of losses	663	824.94
13.	Mistakes in assessments while giving effect to appellate orders	196	60.76
14.	Irregular exemptions and excess reliefs given	1,246	149.97



15.	Excess or irregular refunds	329	9.80
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1,773	76.96
17.	Avoidable or incorrect payment of interest by Government	100	10.09
18.	Omission/short levy of penalty	504	14.41
19.	Other topics of interest (miscellaneous cases)	691	38.88
20.	Underassessment of surtax	62	16.37
	<b>Total</b>	<b>16,039</b>	<b>3,375.48</b>

**Wealth Tax**

(ii) During test audit of assessments made under Wealth Tax Act, 1957, short levy of tax of Rs.19.57 crore was referred to the department in 514 cases.

The omissions/irregularities and mistakes can be categorised under the following heads:

		(Rs. in crore)	
		No. of cases	Amount
1.	Wealth not assessed	315	15.99
2.	Incorrect valuation of assets	34	0.40
3.	Mistakes in computation of net wealth	35	0.20
4.	Incorrect status adopted in assessments	6	0.01
5.	Irregular/ excessive allowances and exemptions	8	0.04
6.	Mistakes in calculation of tax	23	0.12
7.	Non-levy or incorrect levy of additional wealth tax	10	0.33
8.	Non-levy or incorrect levy of penalty and non-levy of interest	69	2.38
9.	Miscellaneous	14	0.10
	<b>Total</b>	<b>514</b>	<b>19.57</b>

**Gift Tax**

(iii) During test check of gift tax assessments, 128 cases involving short levy of tax of Rs.11.97 crore were referred to the department.

**Interest Tax**

(iv) In the course of test audit of Interest Tax assessments it was noticed that in 107 cases there was short levy of interest tax of Rs. 8.52 crore.

**Expenditure Tax**

(v) During test check of Expenditure tax assessments, 4 cases involving short levy of tax of Rs.0.48 crore were referred to the department.

**Outstanding audit observations**

1.5.2 According to the departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee (Ninth Lok Sabha) in their 20<sup>th</sup> Report recommended that the responsibility for the settlement of audit observations rests with the department and it cannot be contented merely with sending replies to audit observations. In their Action Taken Note, the Ministry of Finance had stated that they would endeavour to see that the targets for settlement of audit observations were achieved. However, large number of audit observations made in 1998-99 and earlier years are still to be settled. The details are mentioned below:

(a) On 31 March 1999, 66,658 observations involving a revenue effect of Rs.7,686.57 crore were pending for final action. This does not include the audit observations communicated during 1 April 1998 to 31 March 1999. The year-wise particulars of the pendency are as follows:

Year	Income Tax		Other Direct Taxes (Wealth Tax, Gift Tax, Interest Tax, Expenditure Tax and Estate Duty)		Total	
	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
1995-96 & before	40,743	3,246.45	6,318	68.82	47,061	3,315.27
1996-97	7,955	1,558.97	518	10.60	8,473	1,569.57
1997-98	10,506	2,751.03	618	50.70	11,124	2,801.73
<b>Total</b>	<b>59,204</b>	<b>7,556.45</b>	<b>7,454</b>	<b>130.12</b>	<b>66,658</b>	<b>7,686.57</b>

(b) There were 4,577 pending audit observations as on 31 March 1999 with a revenue effect of Rs.6,645.24 crore (as against 3,937 cases with a revenue effect of Rs.4,594.91 crore in earlier year) where the income tax involved in each individual case exceeded Rs.10 lakh. The break-up of such cases in respect of a few charges where number of outstanding items are 50 or more is shown below:

Sl. No.	Name of charge	Items	Amount
1.	Assam	107	189.93
2.	Delhi	545	672.23
3.	Gujarat	231	308.11
4.	Kerala	176	94.57
5.	Karnataka	152	166.02
6.	Andhra Pradesh	79	25.65
7.	Maharashtra	1,234	2,479.72
8.	Orissa	70	35.47
9.	Punjab	149	168.38
10.	Rajasthan	115	53.70
11.	Tamil Nadu	651	953.16
12.	Uttar Pradesh	210	251.28
13.	West Bengal	805	1,231.58

(c) Pending audit observations where the tax involved in each case exceeded Rs.5 lakh are as under:

Sl. No.	Category of tax	Number of audit observations	Tax effect (Rs. in crore)
1.	Wealth tax	171	37.44
2.	Gift tax	84	19.03
3.	Interest tax	30	11.72
4.	Expenditure tax	1	0.10
5.	Estate duty	11	7.38

Of the 66,658 pending cases with revenue effect of Rs.7686.57 crore, 4,874 cases (7.31 percent) of high tax effect accounted for Rs.6,720.91 crore (87.43



percent). This underlines the need to assign priority to the settlement of observations with high money value.

**Steps taken to settle audit observations**

**1.5.3** The Action Plan of the department for 1998-99 provided for 100 percent disposal of all pending major audit observations. In respect of current statutory audit observations upto 31 December 1998 (i.e. period of report being 1998-99), replies are to be sent in 64 percent of the cases.

The targets for settlement of the major statutory audit observations for the year 1998-99 according to Action Plan and actual achievements were as under:

	Audit observations				
	For disposal (Rs. in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Achievements (in percentage)	
				Target	Achieved
Current	12,819 (3,054.97)	8,143 (64%)	3,803 (866.90)	64	30
Arrear	22,699 (5,089.00.09)	22,699 (100%)	5,303 (1411.22)	100	23

The achievements were, therefore, very much short of targets.

**Remedial action time barred**

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

In a few charges reviewed during the year 1998-99, a number of audit objections issued during the period 1974-75 to 1991-92 where remedial action became time barred were noticed. Details of these cases have been forwarded to the respective Commissioners. The number of such cases alongwith tax effect are mentioned below:

Sl. No.	Charge	Corporation Tax and Income Tax		Other Direct Taxes	
		No. of observations	Amount (Rs. in crore)	No. of observations	Amount (Rs.in crore)
1.	Karnataka	1	1.91	-	-
2.	Punjab	22	108.42	-	-
3.	West Bengal	8	269.70	40	37.66

**Internal Audit**

**1.6** In addition to the statutory audit, the department also has an Internal Audit Department (IAD) which is required to conduct 100 percent and 50 percent audit of all immediate and priority assessment cases respectively (as defined under departmental instructions of September 1990). Based on this, the department had determined the number of auditable cases by their IAD during 1998-99 as 3.88 lakh. However, the target was fixed at a level based on 150 audit parties working during the period from 1 April 1998 to 31 March

1999 and each party being required to audit 110 cases every month. An analysis of their performance is given below:

Total auditable cases	Targets for disposal	Total cases audited	Excess
3,88,234	1,98,000	2,00,523	2,523

**Outstanding audit observations of Internal Audit**

**1.6.1** According to the departmental instructions, observations of Internal Audit Department are to be attended to by the assessing officers within three months. However, this did not happen. As on 31 March 1999, 39,029 audit observations of the Internal Audit involving a tax effect of Rs.1,094.43 crore were pending settlement. This included 14,781 observations with money value of Rs.577.47 crore made during 1998-99.

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

Financial year	No. of cases for disposal and amount (Rs. in crore)	No. of cases settled and amount (Rs. in crore)	Percentage of total cases disposed	No. of pending cases and amount (Rs.in crore)
1994-95	18,465 (976.34)	6,357 (261.30)	34	12,108 (715.04)
1995-96	18,990 (1,229.17)	6,286 (250.30)	33	12,704 (978.87)
1996-97	19,881 (1,314.28)	8,080 (363.33)	41	11,801 (950.95)
1997-98	19,097 (1,363.05)	6,235 (251.69)	33	12,862 (1,111.36)
1998-99	21,909 (1,686.06)	6,924 (603.81)	32	14,985 (1,082.25)

The Public Accounts Committee, in their 150<sup>th</sup> Report submitted to Eighth Lok Sabha in April 1989, had recommended that observations of Internal Audit should be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases became time-barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken note had stated that assessment- yearwise and age-wise classification was being made so that greater attention could be paid to settlement of older and revenue significant objections. Since the normal period available for re-opening of cases is four years, all observations pertaining to 1995-96 and earlier years should have been settled by March 1999. However, this did not happen as shown in the following table which gives age-wise analysis of the pending items at the end of 1998-99 and revenue effect involved:



(Rs. in crore)

Year of the observation	No. of cases	Revenue effect
1995-96 & before	20,021	337.24
1996-97	3,838	107.33
1997-98	5,556	230.07
1998-99	9,614	419.78
<b>Total</b>	<b>39,029</b>	<b>1,094.42</b>

**Action on observations of Internal Audit**

1.6.2 The Action Plan of the department for 1998-99 provided for 100 percent disposal of all pending major audit observations. In respect of current observations of Internal Audit upto 31 December 1998 (i.e. period of reporting being 1998-99), replies were to be sent in 100 percent of the cases.

The targets according to Action Plan and actual achievement in settlement of the major internal audit observations for the year 1998-99 were as under:

	Audit observations				Achievements (in percentage)	
	For disposal (Rs in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Target Achieved		
				Target	Achieved	
Current	9,047 (574.71)	9,047 (100%)	2,828 (156.53)	100	31	
Arrear	12,862 (1111.36)	12,862 (100%)	4,096 (447.27)	100	32	

The achievements thus fell short of the targets



**Chapter 2 : Administration of Direct Taxes**

- I. The total collection from various direct taxes for the year 1998-99 decreased by 3.48 percent as the total collection for the year was Rs.46,600.07 crore including Rs.334.55 crore from Kar Vivad Samadhan Scheme, 1998 as compared to Rs.48,280.40 crore in 1997-98 despite increase in the overall number of assesseees from 1.35 crore to 1.75 crore.

Collection of corporation tax and income tax other than corporation tax increased by 22.55 percent and 18.36 percent respectively over the previous year.

**[Paras No.2.1 and 2.3]**

- II. Tax buoyancy, a key indicator of efficiency of revenue mobilisation in response to growth in GDP, which had turned negative in the year 1997-98, has further declined during the year

Tax revenues on an average grew at a rate of 16.2 percentage per annum during the last 10 years.

Analysis of tax buoyancy with reference to GDP excluding the agricultural income (exempt from tax) showed continuous decline over the last three years indicating poor mobilisation effort in revenue generation.

Analysis of the growth of assesseees revealed that most of the new assesseees, company and non-company, belonged to low income strata. About 96 percent of the new non company assesseees were from low income range and as a result there was a declining trend in the per capita revenue collection during the last five years.

**[Para No.2.5]**

- III. Collections under corporation tax and income tax other than corporation tax have fallen short of budget estimates by 7.61 percent and 3.30 percent respectively.

**[Para 2.6]**

- IV. On an average, 83.5 percent of total collections were realised at preassessment stage during 1996-97 to 1998-99. Only 16.5 percent of the collection are made on the regular assessments and through other receipts.

**[Para 2.7]**

- V. Total pendency of assessments under income tax including corporation tax has alarmingly increased during 1998-99 (53.6%) as compared to 1997-98 (18.7%) though cases disposed of by scrutiny increased by 14 percent (approx.). On the whole, 1.1 percent of the total work load of assessment cases was disposed of by scrutiny and 45.3 percent by summary manner.

**[Para 2.9(1)]**

VI. The amount of tax which remained uncollected on 31 March 1999 was Rs.44,142.72 crore both in respect of income tax and corporation tax. The uncollected amount has increased by Rs.2,912.69 crore constituting 7.06 percent over the previous year, a major cause for increase being demands kept in abeyance by courts, tribunals and revenue appellate authorities. The uncollected amount comprised arrear demand of Rs.27,324.68 crore of earlier years which included Rs.1,381.36 crore relating to period over 5 years. High demand cases of Rs.10 lakh and above constituted 60.5 percent of the total net arrears.

Arrears of wealth tax and gift tax were alarmingly high as they were 5.2 and 6.7 times of collections of wealth tax and gift tax respectively as on 31 March 1999.

**[Paras No.2.10(i)&(ii)]**

VII. The demand recovered during the years 1996-97 to 1998-99 as a percentage of total demand certified to the tax recovery officer has come down to 19.3 percent as compared to 19.8 percent in 1997-98 and 29.8 percent in 1996-97.

**[Para 2.11(ii)]**

VIII. Out of a total number of 2,04,318 claims for refunds in 1998-99, 1,07,600 (52.7%) claims were disposed of.

**[Para 2.13]**

IX. Over a three-year period, while on an average, 484 cases pertaining to income tax were admitted by the Settlement Commission every year, the backlog of cases averaged 2,090. The Commission settled only 23.8 percent of the total number of pending cases.

**[Para 2.14]**

X. Out of 2,62,157 penalty cases of income tax including corporation tax only 60,912 cases were disposed of during 1998-99 levying penalty in 27,308 cases which constituted 44.1 percent of total cases disposed of. The balance of total demand outstanding by way of penalty and composition money in respect of income tax including corporation tax constituted 85.7 percent and in respect of other direct taxes 79.7 percent.

**[Para 2.15]**

XI. 5,746 cases of search and seizure were conducted in 1998-99 and assets worth Rs.300.54 crore seized. In 3,112 cases, final assessments were completed determining income of Rs.3,646.92 crore and demand of Rs.2,135.23 crore was raised.

Acquittals comprising 49 percent, 81 percent and 60 percent were more than convictions plus compoundings which comprised 51 percent, 19 percent and 40 percent during 1996-97, 1997-98 and 1998-99 respectively.

**[Para 2.16]**

**2.1** The administration of Direct Tax Laws comprises mainly income tax, wealth tax, gift tax, interest tax and surtax.



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

Wealth tax is levied for every assessment year on net wealth of every individual, HUF and company at specified rates. For assessment year 1998-99, no wealth tax was payable in respect of net wealth below Rs.15 lakh.

Gift tax is levied according to specified rates for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including HUF) and a company etc. No gift tax was payable where the value of taxable gifts was below Rs.30,000 during assessment year 1998-99. (Gift tax has been discontinued from 1 October 1998 vide Finance (No.2) Act, 1998).

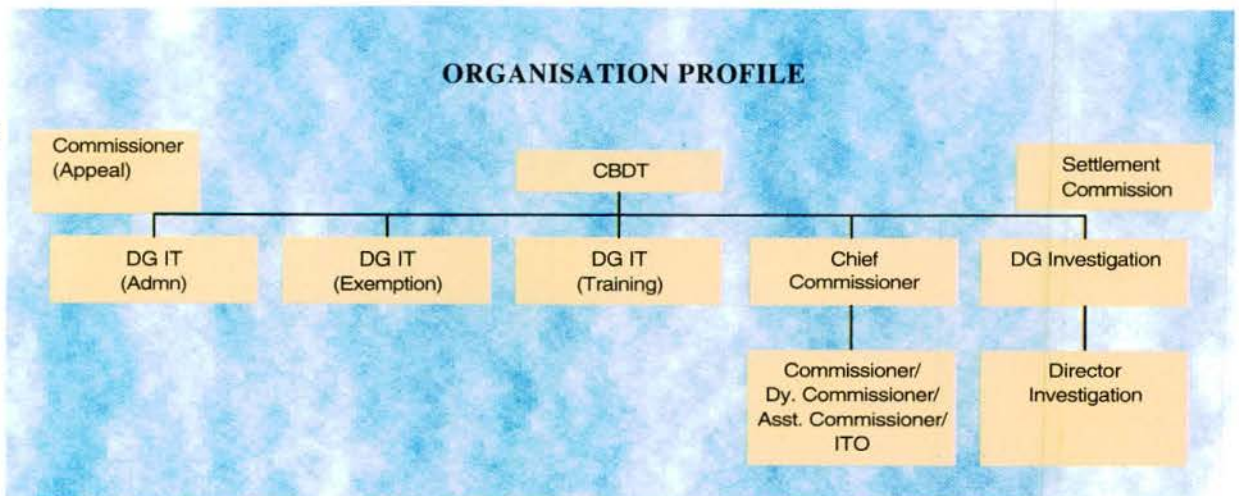
Interest tax is leviable on the chargeable interest income of credit institution which also include co-operative societies engaged in the business of banking.

The number of income tax, wealth tax and gift tax and interest tax assesseees on the books of the department as on 31 March 1998 and 31 March 1999 was as under:

Number of assesseees*	31 March 1998	31 March 1999
Income tax (including Corporation Tax)	1,31,67,736	1,72,54,211
Wealth Tax	2,44,519	2,24,929
Gift Tax	48,911	34,253
Interest Tax	6,080	7,834
<b>Total</b>	<b>1,34,67,246</b>	<b>1,75,21,227</b>

Number of income tax (including corporation tax) assesseees have increased by 40,86,475 (31.03 percent) over last year. Out of this 39, 69,094 (30.14) non corporate assesseees have increased in category having income below 2 lakh and 10,616 (0.08) corporate assesseees in the category having income below 5 lakh

Broad functional profile of the Department of Revenue



\* Status-wise and category-wise details may be referred to in Annexure I.



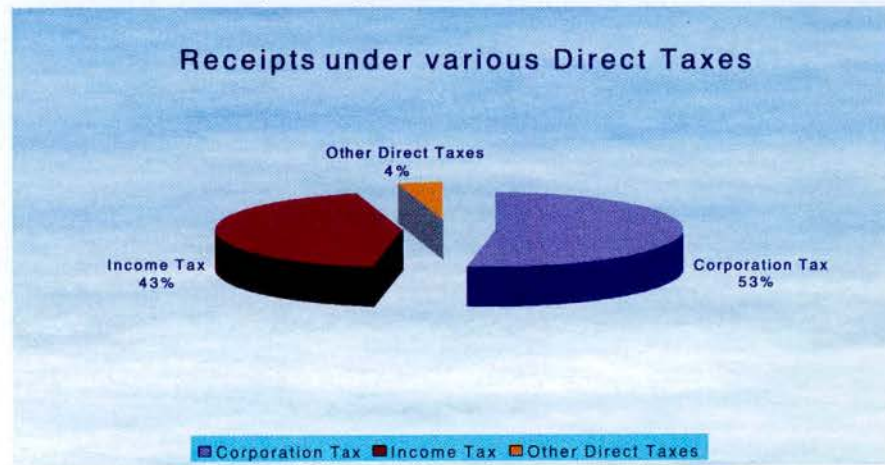
**2.2** The overall responsibility for administration of Direct Tax Laws lies with Department of Revenue which functions through the Income Tax Department with a staff strength of around 60,000 and Central Board of Direct Taxes (Board) at its apex.

The Board consists of a Chairman and five members, and have several attached and subordinate offices throughout the country. The attached offices function under three Directors General of Income Tax viz. Director General of Income Tax (Admn.), Director General of Income Tax (Exemption) and Director General of Income Tax (Training). There are 25 Chief Commissioners of Income Tax, who oversee the work of assessment and collection of direct taxes at regional levels. Besides, there are 5 Directors General of Investigation who are overall incharge of the investigation machinery on a regional basis to curb tax evasion and to unearth black money. The Chief Commissioners of Income Tax/Directors General of Income Tax oversee the work of the Commissioners/Directors of Income Tax in their respective charges and have also been given certain powers under the Income Tax Act, regarding discovery, production of evidence by any person, to requisition books of account, call for information etc., whereby they can issue summons. They are also empowered to authorise search and seizure operations.

The Commissioners/Directors of Income Tax oversee the work of the Dy.Commissioners/Asstt. Commissioners/Income Tax Officers and also have similar powers under the Act as given to the Chief Commissioners. Besides they are also empowered to set aside assessments/orders prejudicial to the interests of revenue (section 263) as well as revise other orders (section 264). There is an appellate machinery under Commissioners (Appeal), who perform the work of quasi-judicial nature and consider appeals against the orders of the assessing officers.

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

**Receipts under various Direct Taxes**





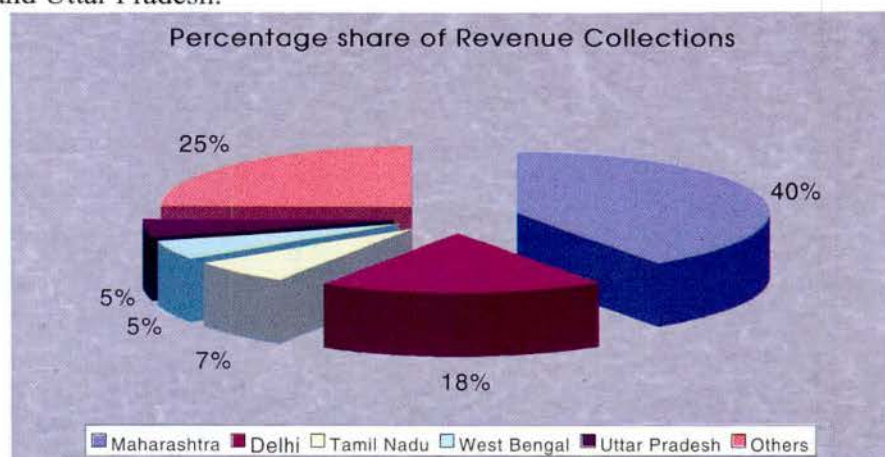
2.3(i) The total collections\* from Direct Taxes for the year 1998-99 amounted to Rs.46,600.07 crore out of which Rs.14,480.36 crore was assigned to the States. The collections for the years 1997-98 and 1998-99 as furnished by the Ministry of Finance are given below

(Rs. in crore)

Head of account	Category of tax	1997-98	1998-99	Increase in 1998-99 over the previous year
0020	Corporation Tax	20,016.00	24,528.87	4,512.87
0021	Taxes on income other than Corporation-tax	17,100.59	20,240.15	3,139.56
0023	Hotel Receipts Tax	2.21	0.20	(-) 2.01
0024	Interest Tax	1,205.18	1263.82	58.64
0028	Other Taxes on Income and Expenditure	9,834.06	395.11	(-) 9,438.95
0031	Estate Duty	0.25	(-)0.08	(-) 0.33
0032	Taxes on wealth	113.03	162.04	49.01
0033	Gift Tax	9.08	9.96	0.88
	<b>Gross Receipts</b>	<b>48,280.40</b>	<b>46,600.07</b>	<b>(-) 1,680.33</b>
<b>Less share of net proceeds assigned to the States:</b>				
	<b>Income Tax</b>	<b>13,507.69</b>	<b>14,480.36</b>	
	<b>Net Receipts</b>	<b>34,772.71</b>	<b>32,119.71</b>	

- Collections under the direct taxes during 1998-99 has decreased by 3.48 percent over 1997-98. It has, however, increased by 20.33 percent over the previous year's collections excluding VDIS-97 collections. The collection during 1998-99 include Rs.334.55 crore from Kar Vivad Samadhan Scheme, 1998.
- Corporation tax and Income tax has increased by 22.55 percent and 18.36 percent respectively over the previous year.
- Collection from Wealth tax has increased by 43.36 percent whereas Gift tax has increased by 9.69 percent.
- Decrease in the collection under Other Taxes on Income and Expenditure is due to the fact that collections of Rs.9,554.25 crore under VDIS-97 were accounted for under this head in 1997-98.

(ii) Maharashtra had the largest collections followed by Delhi, Tamil Nadu, West Bengal and Uttar Pradesh.

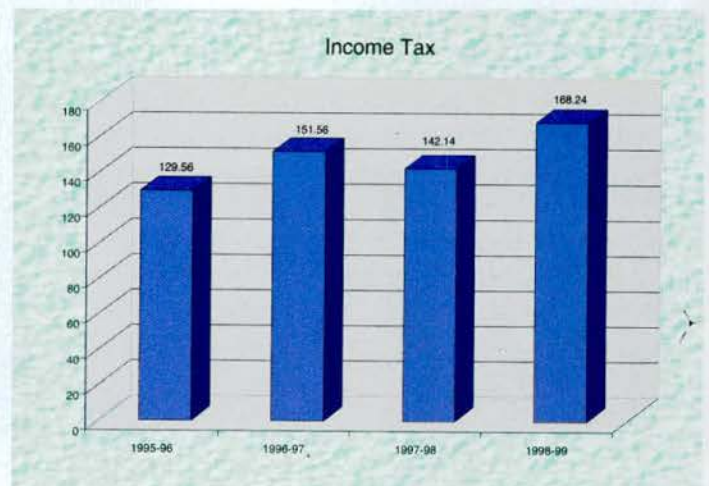
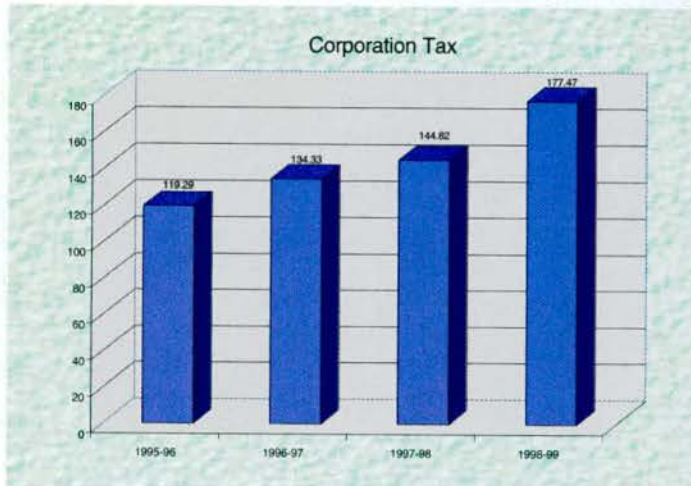


\* State/UT wise break up of direct taxes given in Annexure II.

**Trend of collection**

2.4 The trend in collection of Direct Taxes since 1995-96 is shown below :

(Base year 1994-95)



**Direct Taxes – GDP Ratio**

2.5.1(i) Direct Taxes collections as percentage of the Gross Domestic Product has declined as depicted below:

Year	Collections				GDP at factor cost (current prices)	Percentage of GDP			
	Direct Taxes	Corporation Tax	Income Tax other than Corporation tax	Other Direct Taxes		Direct Taxes	Corporation tax	Income Tax other than corporation tax	Other Direct Taxes
1996-97	38,895.08	18,566.69	18,233.99	2,094.40	11,49,215	3.4	1.6	1.6	0.2
1997-98	48,280.40	20,016.00	17,100.59	11,163.81	14,26,670	3.4	1.4	1.2	0.8
1998-99	46,600.07	24,528.87	20,240.15	1,831.05	16,12,383	2.9	1.5	1.3	0.1

(ii) Tax buoyancy is a key indicator of efficiency of revenue mobilisation in response to growth in GDP, measured by the ratio of percentage change in tax revenues to percentage change in GDP at current prices. Analysis of 10 year

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



time series data during 1989-90 to 1998-99 regarding relative change in GDP vis-à-vis tax revenues revealed the following:

(Amount Rs. in crore)

Year	Change in revenue		Change in GDP		Buoyancy
	Amount	Percentage	Amount	Percentage	
1989-90	1,179	13.35	43,419	12.34	1.08
1990-91	1,021	10.20	77,517	19.61	0.52
1991-92	4,313	39.10	69,228	14.64	2.67
1992-93	2,755	17.95	86,025	15.87	1.13
1993-94	2,201	12.16	79,232	12.61	0.96
1994-95	6,673	32.87	1,46,958	20.78	1.58
1995-96	6,588	24.43	1,31,684	15.41	1.58
1996-97	5,336	15.90	1,63,428	16.57	0.95
1997-98	-169**	-0.43	2,77,455	24.14	-0.01
1998-99	-1,680***	-3.48	1,85,713	13.01	-0.26

- The tax revenues, on an average grew at a rate of 16.2 percentage per annum during the 10 year period, though 1997-98, excluding VDIS-97 collections, and 1998-99 had negative income.
- The overall tax buoyancy has declined and depicted a negative trend during 1997-98 and 1998-99 indicating laxity in the administration of tax laws and poor compliance thereof during last three years.

(iii) Tax buoyancy of revenues with reference to non-agricultural GDP at factor cost on current prices, i.e. excluding agricultural income, which is exempt from income tax, highlights the continuous decline over the last 5 year period, indicative of insufficient mobilisation effort in revenue generation.

Year	Change in revenue over previous year		Change in non agricultural GDP over previous year		Buoyancy
	Amount	Percent	Amount	Percent	
1994-95	6,673	32.87	95,426	19.36	1.69
1995-96	6,588	24.43	1,22,846	20.88	1.17
1996-97	5,336	15.90	1,28,036	18.00	0.88
1997-98	(-)169	(-)0.43	1,95,465	23.29	(-) 0.01
1998-99	(-)1,680	(-)3.48	1,08,507	10.48	(-) 0.33

#### (iv) Analysis of Income Tax (including corporation tax) Assessee Profile

The following table reveals the number of additions during the last 5 year period from 1994-95 to 1998-99 to different types of assesseees under specific income categories\*.

\*\* The gross revenue collection figures do not include collection on account of VDIS-97.

\*\*\* Difference has been worked out on the basis of total collections of 1997-98.

\* Yearwise and category wise assessee status for the period from 1994-95 to 1998-99 is depicted in Annexure III.

(Figure in lakhs)

	As on 31.3.95	As on 31.3.99	Increase	A	B (lower income)	B (higher income)	C	D
Individual	84.49	151.36	66.87	64.53 (96.50)	1.09 (1.63)	1.02 (1.53)	0.23 (0.34)	-
HUF	4.05	4.70	0.65	0.50 (76.92)	0.02 (3.08)	0.09 (13.85)	0.02 (3.08)	0.02 (3.07)
Firms	11.73	12.28	0.55	0.58 (105.45)	(-)0.01 (-1.82)	0.13 (23.64)	0.05 (9.09)	(-)0.20 (-36.36)
Companies	1.76	2.95	1.19	0.80 (67.23)	0.09 (7.56)	0.20 (16.81)	0.10 (8.40)	-
Others (including Trusts)	0.81	1.25	0.44	0.46 (104.54)	(-)0.02 (-4.54)	0.01 (2.27)	-	(-)0.01 (-2.27)
Total	102.84	172.54	69.70	66.87 (95.94)	1.17 (1.68)	1.45 (2.08)	0.40 (0.57)	(-)0.19 (-) 0.27

(Figures in parenthesis depict percentage increase in specific income categories)

It is evident that about 96 percent of the new assessee amongst non-company assessee was accounted for in the low income range of up to Rs.2 lakh while about 75 percent in the case of corporate assessee was in the income range below Rs. 5 lakh.

It is thus clear that bulk of revenue contribution is made by the low income category of assessee.

The above presumption, is also borne out from the per capita revenue collection trends over the last 5 years since 1994-95\*.

Year	Revenue in crore	Assessee	Per capita (in lakh)
1994-95	Company 13,820.96 (37.38)	1,76,594 (9.63)	7.82 (25.32)
	Non Company 12,030.12 (31.87)	1,01,08,012 (7.35)	0.12 (33.35)
1995-96	Company 16,487.13 (19.29)	1,87,574 (6.21)	8.79 (12.40)
	Non Company 15,587.17 (29.56)	1,04,76,940 (3.64)	0.15 (33.33)
1996-97	Company 18,566.69 (12.61)	2,27,228 (21.14)	8.17 (-7.05)
	Non Company 18,233.99 (16.98)	1,14,16,315 (8.96)	0.16 (6.66)
1997-98	Company 20,016.00 (7.80)	2,74,319 (20.72)	7.29 (-10.77)
	Non Company 17,100.59 (-6.21)	1,28,93,417 (12.93)	0.13 (-18.75)
1998-99	Company 24,528.87 (22.55)	2,95,327 (7.66)	8.30 (13.85)
	Non-Company 20,240.15 (18.36)	1,69,58,884 (31.53)	0.12 (-7.69)

(Figures in parenthesis depict percentage of increase over last year's figures)

* 1993-94 Revenue Collection-	Company-10,060.06	Non Company-9,122.62
(Rs. in crore)		
Assessee-	Company 1,61,075	Non Company 94,15,102
Per Capita (in lakhs)	Company 6.24	Non Company 0.09



**Company Assesseees:** The per capita growth in revenue collection has increased as compared to 1997-98. This is attributable to the fact that the number of company assesseees has increased only by 7.66 percent whereas revenue from corporation tax has increased by 22.55 percent as compared to 1997-98.

**Non-Company Assesseees:** The per capita revenue collection has decreased as compared to 1997-98 which could reasonably be attributed to substantial growth in the non company assesseees. Revenue collection from non corporate assesseees has increased by 18.36 percent but assesseees have increased by 31.53 percent.

**(v) Compliance level and Tax incidence borne by assesseees**

According to a study conducted by the National Council of Applied Economics and Research (NCEAR), there were approximately 16.66 crore households (4.74 crore urban and 11.92 crore rural) in the year 1996-97. The NCEAR, in their study, have distributed these households in various income groups. The study provides relevant statistics\* for the year 1996-97 showing urban and rural households and their disposable incomes too. These statistics were analysed in conjunction with the recent All India Income Tax Statistics\*\* pertaining to the assessment year 1996-97 (published by the Directorate of Income Tax, RSP & PR - Income Tax Department). The data in the Income Tax Statistics is based on Income Tax returns filed for the assessment year 1996-97 in Financial year 1996-97 (Returns filed for the earlier assessment years in Financial Year 1996-97 have not been taken into account).

Our analysis shows that on the basis of NCAER data the income share of rural Households in GDP is about 56 percent. Considering that the share of Agriculture in GDP is not more than 25-26 percent, more than half of incomes of rural Households are not exempt from direct taxes by reason of these being agriculture income. Thus, out of rural households with incomes above the taxable limit about half the households may be subject to tax. Based on this premise 50 percent of rural households could be treated as agriculturists and their income taken as agriculture income exempt from tax.

Particulars regarding the number of households in various income groups, number of income tax returns filed, gross income shown, total deductions claimed and tax paid, are as under :

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\* Details in Annexure IV.

\*\* Details in Annexure V.

NCEAR DATA <sup>1</sup>				Income Tax Department Data	NCEAR DATA (total disposable income in crore)			Income Tax Department Data <sup>2</sup> (Rs. in crore)			
Income group (Rs.)	Urban Household	Rural Household (50% of total)#	Total House-hold	Total returns (% w.r.t. total household)	Urban income	Rural income (50% of total)	Total disposable income	Gross income (% w.r.t NCEAR total income)	Total deduction (Chapter VIA etc.)	Net income	Tax paid (% w.r.t. NCEAR total income)
Above 10 lakh	55000	5500 (11000)	60500	Ind. 10265 HUF: 495 Firm: 4695 Others:1416	15900	1500 (3000)	17400	9165 93 2019 750	177 8 190 86	8988 85 1829 664	2516 29 610 221
Total	55000	5500	60500	16871 (27.8)	15900	1500	17400	12027 (69.1)	461	11566	3376 (19.4)
5 lakh to 10 lakh	138000	21000 (42000)	159000	Ind: 21414 HUF: 1029 Firm: 6802 Others: 512	10000	1100 (2200)	11100	1691 85 808 40	117 4 137 2	1574 81 671 38	480 23 240 13
Total	138000	21000	159000	29,757 (18.7)	10000	1100	11100	2624 (23.6)	260	2364	756 (6.8)
2 lakh to 5 lakh	777000	302000 (604000)	1079000	Ind. 100958 HUF: 3932 Firm: 17122 Others: 1268	19700	8500 (17000)	28200	3145 143 861 42	214 4 173 1	2931 139 688 41	824 38 251 14
Total	777000	302000	1079000	123280 (11.4)	19700	8500	28200	4191 (14.8)	392	3799	1127 (3.9)
1 lakh to 2 lakh	5436000	1871500 (3743000)	7307500	Ind: 785741 HUF: 18262 Firm: 44329 Others: 4020	67100	23150 (46300)	90250	11137 299 1969 63	481 11 955 7	10656 288 1014 56	2211 69 34 19
Total	5436000	1871500	7307500	852352 (11.6)	67100	23150	90250	13468 (14.9)	1454	12014	2333 (2.5)
50,000 to 1 lakh	12946000	6991000 (13982000)	19937000	Ind.2545653 HUF 60612 Firm 127284 Others 9260	96300	50350 (100700) 50%	146650	27843 646 2131 98	7873 30 110 15	19970 616 2021 83	2413 100 637 26
Total	12946000	6991000	19937000	2742809 (13.7)	96300	50350	146650	30718 (20.9)	8028	22690	3176 (2.1)
Grand Total	19352000	9191000	28543000	3765069 (13.2)	209000	84550	293600	63028 (21.4)	10595	52433	10768 (3.6)
Upto 50,000	28022000	50454000 (100908000)	78476000	Ind. 3893517 HUF. 190880 Firm 489483 Others 85508	90300	126950 (253900)	217250	17602 1233 3043 272	911 32 158 37	16691 1201 2885 235	789 131 851 37
Total	28022000	50454000	78476000	4659388 (5.9)	90300	126950	127250	22150 (10.1)	1138	21012	1808 (0.3)
Grand Total	47374000	59645000 (119290000)	107019000 (166665000)	8424457 (7.8)	299300	211500 (423000)	510800*	85178 (16.6)	11733	73445	12576 (2.5)

#(Figures shown in the parenthesis are total rural house holds and total rural income)

The analysis of the above statistics, on the assumption of one earner in each household liable to file return of tax having income above Rs.50,000/-, revealed the following:

- ◆ The number of returns of income was far less than the households liable to file the returns and in percentage terms was mere 13.2 of the total.
- ◆ Households having income greater than Rs.10 lakh each and liable to tax were 60,500. However, only 16,871 or 27.8 percent had filed the returns pertaining to the assessment year 1996-97.

<sup>1</sup> NCEAR data given in Annexure IV.

<sup>2</sup> Income Tax Department's data given in Annexure V.

\* The accounting of total disposable income by the NCEAR due to conceptual differences is about seventy percent of GDP.



- ◆ *The households with income above Rs.10 lakh each had returned an aggregate gross income of Rs.12,027 crore, but paid tax at the effective rate of 19.4 percent after considering various deductions.*
- ◆ *Similar trend could be discerned when the data is analysed for the other income groups. The effective tax rate estimated for the groups having income above Rs.50,000 ranged from 2.1 percent to 6.8 percent of their income.*

This shows that in all categories of income the level of compliance in relation to filing of income tax returns and tax incidence borne by them is very low and there is high potential for detecting and adding new assesseees and augmenting the revenues. It has also been noticed that out of 1,04,57,449 non corporate assesseees on the record of the Department as on 31.3.1996 only 84,24,457 assesseees have filed the return for assessment year 1996-97 in the Financial Year 1996-97. Thus a large number of 20,52,992 assesseees have not filed the returns on due dates. It is, therefore, imperative that adequate efforts are made to add new assesseees and due compliance is secured by the existing assesseees.

Further during the period from 1.4.96 to 31.3.97 there is an increase of 9.34 lakh new non corporate tax payers on the registers of the Income Tax Department. Out of these new assesseees 7.90 lakh assesseees constituting 84.5% of new assesseees belong to low income group with incomes below Rs. 2 lakh. In the income group between 2 lakh but below 5 lakh there is increase of 1.31 lakh assesseees which constitute 14 percent of new assesseees. In the income category between 5 lakh but below 10 lakh, increase is 0.06 lakh which is 0.06 percent of new assesseees and in the highest income category of above 10 lakh increase in the number of non corporate assesseees was 0.08 lakh which is 0.9 percent of total new assesseees. Details are given in the table below:

(Figures in lakhs)

Status	Assesseees as on*		Increase between 31.3.1996 to 31.3.1997	Increase in different income categories between 31.3.1996 to 31.3.1997			
	31-3-1996	31.3.1997		Below 2 lakh	2 lakh but below 5 lakh	5 lakh but below 10 lakh	Above 10 lakh
Individuals	87.84	97.44	9.60	8.34 (86.7)	1.16 (12.1)	0.05 (0.06)	0.05 (0.06)
HUFs	4.05	4.10	0.05	(-) 0.01 (-20.0)	0.04 (80.0)	0.01 (20.0)	0.01 (20.0)
Firms	11.88	11.54	(-) 0.34	(-) 0.44 (-129.0)	0.09 (26.5)	-	0.01 (2.5)
Others (including Trusts)	0.80	0.84	0.04	0.01 (25.0)	0.02 (50.0)	-	0.01 (25.0)
TOTAL	104.57	113.92	9.34	7.90 (84.5)	1.31 (14.0)	0.06 (0.06)	0.08 (0.09)

(\* Excluding search and seizure cases)

Further the data obtained from NCEAR for the year 1997-98 reveals the following position regarding the number of households in various income groups, their total income and percentage increase over 1996-97.

Income Group	Households			Increase over 1996-97 (%)	Total income			Increase over 1996-97 (%)
	Urban	Rural (50% of total Households)	Total		Urban	Rural (50% of total income)	Total	
Over 10 lakh	77,000	20,000 (40,000)	97,000	36,500 (60.3)	25,043	4,319 (8,639)	29,362	11,962 (68.7)
5 lakh to 10 lakh	1,45,000	66,500 (1,33,000)	2,11,500	52,500 (33.0)	9,393	4,207 (8,414)	13,600	2,500 (22.5)
2 lakh to 5 lakh	16,13,000	2,84,000 (5,68,000)	18,97,000	8,18,000 (75.8)	43,870	7,997 (15,994)	51,867	23,667 (83.9)

Analysis of the data shows that increase in the number of assessees in different income categories is not compatible with the growth of house-holds in various income groups. It is, therefore, imperative that adequate efforts are called for to add new assessees especially in higher income bracket and to secure compliance to the tax laws.

**Wealth tax and Gift tax Assesseees**

2.5.2 The position of wealth and gift tax assesseees over the last 5 years was as under:-

Year	Wealth tax	Gift tax
1994-95	5,44,801	63,261
1995-96	3,90,589	49,947
1996-97	2,99,908	47,364
1997-98	2,44,519	48,911
1998-99	2,24,929	34,253

From 1994-95 onwards the exemption limit in respect of incidence of wealth tax was increased to Rs.15 lakh. Also the ambit of wealth tax was narrowed down with exclusion of shares, debentures, capital investment Bonds etc. As there has been no change in the law since then, the progressive decline in the number of wealth tax assesseees over the last 5 years period could be reasonably ascribed to the higher incidence of concealment of wealth tax and failure to initiate tax proceedings by the Department.



**Variation  
between budget  
estimates and  
actual receipts**

**2.6** Corporation tax and Income tax other than Corporation tax has fallen short of budget estimates. Other Direct Taxes have increased vis-à-vis budget estimates as compared to previous year.

The comparative\* position of actual receipts vis-a-vis the budget estimates under the different heads for the years 1996-97 to 1998-99 are as follows:

Year	Budget Estimates (Rs. in crore)	Actuals (Rs. in crore)	Variation	Percentage of variation
<b>0020-Corporation Tax</b>				
1996-97	18,688.00	18,566.69	(-)121.31	(-) 0.64
1997-98	21,860.00	20,016.00	(-)1,844.00	(-) 8.43
1998-99	26,550.00	24,528.87	(-)2,021.13	(-) 7.61
<b>0021-Taxes on income other than Corporation Tax</b>				
1996-97	17,843.00	18,233.99	390.99	2.19
1997-98	21,700.00	17,100.59	(-)4,599.41	(-) 21.19
1998-99	20,930.00	20,240.15	(-) 689.85	(-) 3.30
<b>0024-Interest tax</b>				
1996-97	1250.00	1712.39	462.39	36.99
1997-98	2400.00	1205.18	(-) 1194.82	(-) 49.78
1998-99	920.00	1263.82	343.82	37.37
<b>0028-Other taxes on Income and Expenditure</b>				
1996-97	190.00	293.23	103.23	54.33
1997-98	210.00	9,834.06	9,624.06	4,582.88
1998-99	300.00	395.11	95.11	31.70
<b>0031-Estate Duty</b>				
1996-97	1.00	0.06	(-) 0.94	(-) 94.00
1997-98	1.00	0.25	(-) 0.75	(-) 75.00
1998-99	1.00	(-) 0.08	(-) 1.08	(-) 108.00
<b>0032-Wealth tax</b>				
1996-97	110.00	77.44	(-) 32.56	(-) 29.60
1997-98	130.00	113.03	(-) 16.97	(-) 13.05
1998-99	145.00	162.04	17.04	11.755
<b>0033-Gift tax</b>				
1996-97	10.00	10.30	0.30	3.00
1997-98	10.00	9.08	(-) 0.92	(-) 9.20
1998-99	10.00	9.96	(-) 0.04	(-) 0.40

**Analysis of  
collection**

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

(i) The sub-head wise break-up of total income tax collections for companies and non-companies at pre-assessment and post-assessment stages for the years 1996-97 to 1998-99 are given below:

\* Details of variation under the heads subordinate to the major heads 0020 and 0021 for the year 1998-99 are given in Annexure VI.

(Rs in crore)

Year	Tax collections						Refunds (percentage of total collection)	Net Collections
	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections		
<b>Company</b>								
1996-97	5,138.94	14,206.80	1,260.57	4,234.06	1,480.31	26,320.68	7,753.99 (29.45)	18,566.69
1997-98	3,984.32	16,416.67	1,927.13	3,469.94	616.73	26,414.79	6,398.79 (24.22)	20,016.00
1998-99	4,505.06	19,077.46	2,386.64	5,255.02	1,388.22	32,612.40	8,083.53 (24.78)	24,528.87
<b>Non-company</b>								
1996-97	10,195.39	5,472.08	2,028.43	1,298.37	1,048.21	20,042.48	1,808.49 (9.02)	18,233.99
1997-98	9,803.23	4,644.10	2,317.72	1,484.41	1,020.73	19,270.19	2,169.60 (11.25)	17,100.59
1998-99	11,752.80	5,287.15	2,349.31	1,570.06	1,452.66	22,411.98	2,171.83 (9.69)	20,240.15

- On an average, 83.5 percent of collections were realised at preassessment stage during 1996-97 to 1998-99.
- The gross collections from company as well as non company assesseees have increased during 1998-99.

(ii) The details of tax deducted at source during the year 1998-99 vis-à-vis 1997-98 under broad categories are as under:

	1997-98	1998-99 (Rs in crore)
Salaries	5,797.38	6,440.76
Interest on securities	1,136.75	1,276.79
Dividends	470.02	443.41
Interest	2,344.37	2,767.33
Winnings from lottery or cross word puzzles	64.38	69.76
Winnings from horse races	26.18	43.30
Payments to contractors and sub-contractors	2,467.66	3,779.84
Insurance commission	134.25	135.43
Payment to non-residents and others	1,346.56	1,301.24
<b>Total</b>	<b>13,787.55</b>	<b>16,257.86</b>

(iii) The following details of statements of tax deducted at source for the year 1998-99 indicate a shortfall in the returns received from tax deductors:

1.	No. of tax deductors as on 1 April 1998	7,01,975
2.	Adjustment/progressive additions upto 31 March 1999	80,403
3.	Effective tax deductors (1+2)	7,82,378
4.	No. of returns required to be filed by tax deductions at 3	7,82,378
5.	Returns received upto 31 March 1999	6,32,591
6.	Balance 4-5	1,49,787

Above details show that 20 percent of the effective tax deductors have not filed their returns.



**Cost of collection** 2.8 Year-wise total expenditure incurred during the years 1996-97 to 1998-99 in collecting the direct taxes was as under:

(Rs. in crore)

Year	Collection	Expenditure	Percentage
1996-97	38,895.08	494.15	1.27
1997-98	48,280.40	799.36	1.65
1998-99	46,600.07	925.62	1.98

**Arrears of assessments**

2.9 Working strength of officers on assessment/non-assessment duty for the years 1996-97 to 1998-99 was as under:

Nature of posts	1996-97		1997-98		1998-99	
	Assessment Duty	Non-assessment Duty	Assessment Duty	Non-assessment Duty	Assessment Duty	Non-assessment Duty
Addl. Commissioners/ Dy. Commissioners	213	225	195	221	244	313
Asstt. Commissioners	922	128	863	125	1,020	161
Income Tax Officers	2,034	408	1,899	379	2,142	560
<b>Total</b>	<b>3,169</b>	<b>761</b>	<b>2,957</b>	<b>725</b>	<b>3,406</b>	<b>1,034</b>

**Income Tax (including Corporation Tax)**

2.9.1(i) The limitation period for completion of assessments is two years in the case of income tax, wealth tax and gift tax.

The number of assessments completed during the years 1996-97 to 1998-99 was as under:

Financial year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Scrutiny	Summary	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1996-97	5,28,154	1,15,83,285	1,21,11,439	3,66,329 (69.36)	1,00,82,930 (87.05)	1,04,49,259 (86.27)	1,61,825 (30.64)	15,00,355 (12.95)	16,62,180 (13.73)
1997-98	11,08,764	1,27,51,169	1,38,59,933	9,20,701 (83.04)	1,03,54,926 (81.21)	1,12,75,627 (81.35)	1,88,063 (16.96)	23,96,243 (18.79)	25,84,306 (18.65)
1998-99	5,98,076	1,78,32,219	1,84,30,295	2,01,849 (33.75)	83,52,299 (46.84)	85,54,148 (46.41)	3,96,227 (66.25)	94,79,920 (53.16)	98,76,147 (53.59)

- *Despite Board's instructions for according priority for speedy disposal of both summary and scrutiny assessments, the total pendency of assessments, both under summary and scrutiny during 1998-99 has increased as compared to the previous year. In fact, the department's performance in completing the assessments fell sharply during the year 1998-99 compared to earlier years.*
- *On the whole, the department disposed of 1.09 percent of its total workload of assessment cases by scrutiny and 45.32 percent by summary.*
- *The disposal of higher income category assessment by scrutiny (as detailed in Annexure VII) was only 68.97 percent in company cases and 39.98 percent in non-company cases.*

2.9.1(ii) \*Break-up of company and non-company assessments completed during the years 1996-97 to 1998-99 was as under:

Assessments	1996-97	1997-98	1998-99
Company	2,35,385	2,71,481	2,14,922
Non company	1,02,13,874	1,10,04,146	83,39,226
<b>Total</b>	<b>1,04,49,259</b>	<b>1,12,75,627</b>	<b>85,54,148</b>

2.9.1(iii) Status-wise and year-wise break-up of pendency of income tax assessments as on 31 March 1999 was as under:

Status	Upto 1996-97	1997-98	1998-99	Total
<b>Company assessments</b>				
(i) Regular	1,786	55,490	1,50,770	2,08,046
(ii) Re-opened/set aside	1,625	953	821	3,399
<b>Non-company assessments</b>				
(i) Regular	1,34,081	13,08,952	81,50,093	95,93,126
(ii) Re-opened/set aside	8,810	16,745	46,021	71,576

The number of assessments pending as on 31 March 1999 was 98,76,147 as compared to 25,84,306 as on 31 March 1998 and 16,62,180 on 31 March 1997.

**Wealth Tax and Gift Tax**

2.9.2 The percentage disposal of wealth tax and gift tax assessments declined during 1998-99 as compared to 1997-98 as detailed below:

**Wealth Tax**

Year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Company	Non-company	Total	Company	Non-company	Total	Company	Non-company	Total
1996-97	9,516	1,44,145	1,53,661	3,930 (41.30)	70,793 (49.12)	74,723 (48.63)	5,586 (58.70)	73,352 (50.88)	78,938 (51.37)
1997-98	7,618	98,503	1,06,121	4,618 (60.62)	75,633 (76.79)	80,251 (75.62)	3,000 (39.38)	22,870 (23.21)	25,870 (24.38)
1998-99	8,722	1,10,755	1,19,477	5,108 (58.56)	76,279 (68.87)	81,387 (68.12)	3,614 (41.44)	34,476 (31.13)	38,090 (31.88)

**Gift Tax**

Year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Company	Non-company	Total	Company	Non-company	Total	Company	Non-company	Total
1996-97	159	32,334	32,493	60 (37.74)	27,630 (85.45)	27,690 (85.22)	99 (62.26)	4,704 (14.55)	4,803 (14.78)
1997-98	82	31,364	31,446	33 (40.25)	25,861 (82.45)	25,894 (82.55)	49 (59.75)	5,503 (17.55)	5,552 (17.65)
1998-99	149	22,204	22,353	99 (66.44)	15,809 (71.20)	15,908 (71.17)	50 (33.56)	6,395 (28.80)	6,445 (28.83)

\* For status-wise and category-wise break-up refer Annexure VII.



**Surtax and Interest Tax**

**2.9.3** Disposal of surtax assessments has declined to 15.51 percent as compared to 69.70 per cent in 1997-98 while in the case of interest tax assessments, there was marginal improvement as detailed below:

Year	Assessments due for disposal		Assessments completed (percentage)		Assessments pending (percentage)	
	SurTax	Interest Tax	SurTax	Interest Tax	SurTax	Interest Tax
1996-97	984	12,378	68 (9.94)	5,374 (43.42)	616 (90.06)	7,004 (56.58)
1997-98	297	13,971	207 (69.70)	4756 (34.04)	90 (30.30)	9,215 (66.96)
1998-99	187	16,581	29 (15.51)	6,539 (39.44)	158 (84.49)	10,042 (60.56)

**Arrears of demands**

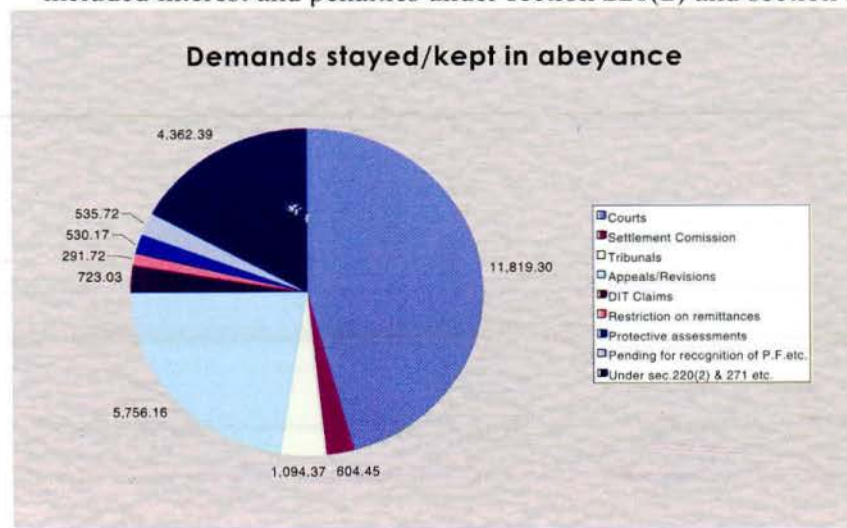
**2.10** The Income Tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 30 days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

**Corporation Tax including Income Tax**

**(i)(a)** Details of uncollected tax for the years 1996-97 to 1998-99 are given below:

	(Rs.in crore)		
	1996-97	1997-98	1998-99
Total amount of tax remaining uncollected as on 31 March	33,585.12	41,230.03	44,142.72
Arrears not fallen due as on 31 March	9,365.96	9,973.37	10,809.31
Amount claimed to have been paid pending verification	2,054.98	2,346.10	2,834.78
Amount stayed/kept in abeyance	15,798.52	22,515.41	25,717.31
Amount for which instalments had been granted	309.96	573.87	536.91

- Thus, the amount remaining uncollected increased by Rs. 2912.69 crore constituting 7.06 percent over the previous year.
- A major cause for the increase in arrears was a large amount stayed/kept in abeyance by courts/tribunals/revenue appellate authorities. This also included interest and penalties under section 220(2) and section 271.



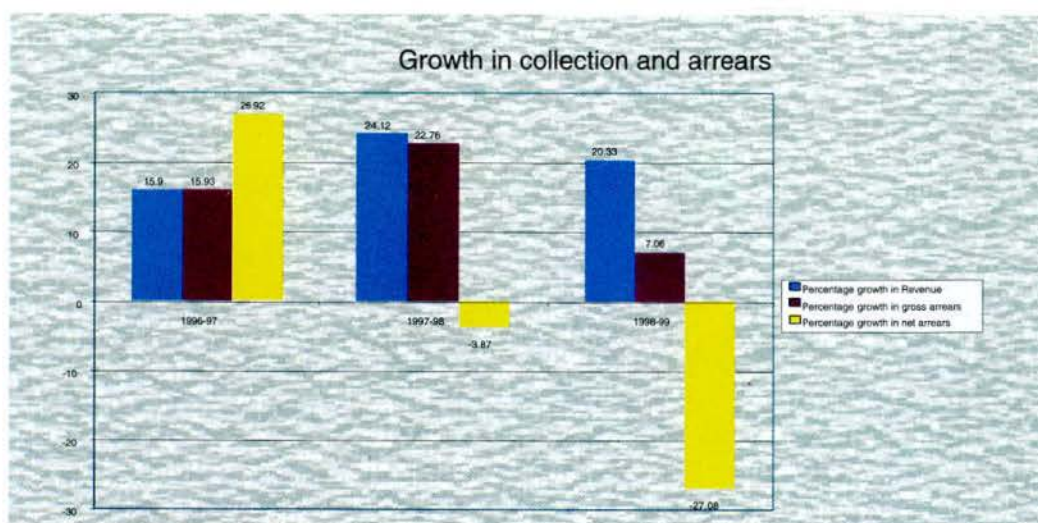
(b) The year-wise position of arrears remaining uncollected in company and non-company cases for the years 1996-97 to 1998-99 is given below:

(Rs.in crore)

	1996-97	1997-98	1998-99
Companies	15,432.64	20,062.46	21,953.84
Non-companies	18,152.48	21,167.57	22,188.88
<b>Total</b>	<b>33,585.12</b>	<b>41,230.03</b>	<b>44,142.72</b>

Thus arrears of both corporation tax and income tax continued to mount despite direction of the Board for according priority to reduction of the arrear demand.

(c) The gross arrears have increased during the year by 7.06 percent over the previous year whereas there was negative growth in revenue collection (-3.48 percent) and in net arrears\* (-27.08 percent).



(d) The total outstanding demand of Rs.44,142.72 crore, remaining uncollected as on 31 March 1999, comprised arrear demand of Rs.27,324.68 crore of earlier years. The age-wise analysis of the arrear demand of Rs. 27,324.68 crore is given below:

(Rs. in crore)

	Corporation Tax	Income Tax	Interest	Others	Total
1. Over 1 year but less than two years	4,108.67	4,926.71	7,323.99	528.58	16,887.95
2. Over 2 years but less than 5 years	1,571.06	4,114.20	3,089.31	280.80	9,055.37
3. Over 5 years but less than 10 years	219.76	291.15	324.15	91.36	926.42
4. Over 10 years	106.66	151.99	137.61	58.68	454.94
<b>Total</b>	<b>6,006.15</b>	<b>9,484.05</b>	<b>10,875.06</b>	<b>959.42</b>	<b>27,324.68</b>

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



(e) The following table gives the break-up of the arrears by certain slabs of income:

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Upto Rs.1 lakh in each case	1,46,758	3,134.83	454.53	47,23,042	3,038.50	660.02	48,69,800	6,173.33	1,114.55
Over Rs.1 lakh to Rs.10 lakh in each case	19,885	1,911.74	231.63	85,319	1,459.96	328.40	1,05,204	3,371.70	560.03
Over Rs.10 lakh to Rs.1 crore in each case	5,309	2,352.48	346.35	7,353	2,052.57	392.14	12,662	4,405.05	738.49
Over Rs. 1 crore in each case	1,778	14,554.79	1,301.04	1,236	15,637.85	530.30	3,014	30,192.64	1,831.34
<b>Total</b>	<b>1,73,730</b>	<b>21,953.84</b>	<b>2,333.55</b>	<b>48,16,950</b>	<b>22,188.88</b>	<b>1,910.86</b>	<b>49,90,680</b>	<b>44,142.72</b>	<b>4,244.41</b>

Thus 60.55 percent of the total net arrears of Rs.4,244.41 crore outstanding as on 31 March 1999 was constituted by high demand cases of Rs.10 lakh and above. The department needs to accord priority for recovering these arrears.

#### Other Direct Taxes

(ii) Year-wise details of arrears of demands outstanding under Wealth Tax, Gift Tax and Interest Tax as on 31 March 1999 is given below:

	(Rs. in crore)		
	Wealth tax	Gift Tax	Interest Tax
Over one year but less than two years	445.60	38.89	384.29
Over two years but less than five years	289.03	19.73	287.80
Over five years but less than ten years	74.93	6.17	0.01
Over ten years	32.04	2.31	3.24
<b>Total</b>	<b>841.60</b>	<b>67.10</b>	<b>675.34</b>

The above data reveals that the arrears of wealth tax and gift tax are alarmingly high as they were 5.2 and 6.7 times of the collections of wealth tax and gift tax respectively as on 31 March 1999.

#### Tax Recovery Machinery

**2.11** Under the Income Tax Act, 1961, every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty days of the service of notice of demand. On the default of an assessee in this respect, the assessing officer may forward a certificate specifying the demand of arrears to the Tax Recovery Officer for recovery of demand. The latter will serve a notice on the defaulter requiring him to pay the demand within fifteen days. If the amount mentioned in the notice is not paid within the time specified therein or within such further time as the Tax Recovery Officer may grant at his discretion, he shall proceed to realise the amount together with interest at the rate of 1.5 percent per month or part of month on the outstandings till the date of recovery by one or more of the following modes:

- (a) by attachment and sale of the defaulter's movable property;
- (b) by attachment and sale of the defaulter's immovable property;
- (c) by arrest of the defaulter and his detention in prison;

(d) by appointing a receiver for management of defaulter's movable and immovable properties.

(i) The number of Tax Recovery Officers engaged in tax recovery work during 1996-97 to 1998-99 was as follows:

Year	Sanctioned Strength	Working Strength
1996-97	163	139
1997-98	212	153
1998-99	202	168

(ii) The tax demands certified to the Tax Recovery Officer and the progress of recovery during the years 1996-97 to 1998-99 are given in the following table:

(Rs. in crore)

Year	Demand at the beginning of the year	Demand certified during the year	Total demand	Demand recovered during the year	Balance at the end of the year
1996-97	1,394.84	1,098.60	2,493.44	742.60 (29.78)	1,750.84
1997-98	1,750.84	2,714.87	4,465.71	884.41 (19.80)	3,581.30
1998-99	3,581.80	2,490.08	6,071.88	1,173.66 (19.33)	4,898.22 <sup>▲</sup>

(Figures in parenthesis depict demand recovered as a percentage of total demand certified)

The demand recovered during the years 1996-97 to 1998-99 as a percentage of total demand certified varied between 19.33 percent to 29.78 percent.

(iii) Details of disposal and pendency of attached properties are indicated below:

Particulars	Movable properties			Immovable properties		
	No. of cases	No. of properties	Approximate value (Rs. in crore)	No. of cases	No. of properties	Approximate value (Rs. in crore)
Properties attached	2,560	-	300.49	3,555	6,744	797.30
Sales conducted	10	5	0.37	14	27	0.75
Sales not conducted						
(i) More than six months but less than one year	159	-	15.36	-	-	-
(ii) More than one year but less than three years	-	-	-	1,220	1,677	150.43
(iii) More than three years	-	-	-	921	1,395	213.65

	Number	Amount (Rs. in crore)
Cases in which receiver appointed	28	7.51
Defaulters against whom arrest proceedings initiated	220	40.69

<sup>▲</sup> Year-wise, tax-wise and amount-wise analysis of pending certificates are given in Annexure VIII.



**Appeals, Revision  
petitions and  
Writs**

**2.12** Under the Income Tax Act, 1961, if an assessee is not satisfied with an assessment, a refund order etc., he can file an appeal with the Commissioner (Appeals).

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

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

Prior to 1 October 1998, appellate machinery consisted of Deputy Commissioners (Appeals) and Commissioners (Appeals). From 1 October 1998, all appeals are required to be made to Commissioners (Appeals) and all pending cases with the Deputy Commissioners (Appeals) have been transferred to Commissioners of Income Tax (Appeals).

Details of disposal and pendency position of appeals during 1998-99 was as follows:

**(i) Appeals pending with the Commissioners(Appeals)**

<b>Number of Commissioners (Appeals)</b>	<b>207</b>
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	<b>Total appeals</b>	<b>High demand* appeals</b>	<b>With demand of Rs. 10 lakh</b>	<b>With demand above Rs.25 lakh</b>
Appeals for disposal	2,98,837	54,225	6,749	7,938
Completed	83,841	25,090	3,731	4,424
Pending	2,14,996	29,135	3,018	3,514

**(ii) Appeals pending with Supreme Court/High Court/Income Tax Appellate Tribunal:**

	<b>Supreme Court</b>	<b>High Court</b>	<b>Income Tax Appellate Tribunal</b>
Appeals, references and writs for disposal	8,031	49,250	1,22,247
Completed	92	1,259	12,135
Pending	7,939	47,991	1,10,112

**Interest paid  
on Refunds**

**2.13** Where the amount of tax paid exceeds the amount of tax payable, the assessee is entitled to a refund of the excess. Simple interest at the prescribed rate also becomes payable to the assessee on the amount of such refund as per

\* An appeal in which tax involved is more than Rs.1 lakh.

law. Refund of any amount which may become due to an assessee as a result of any order passed in appeal or other proceedings without his having to make any claim on that behalf is also admissible. Simple interest at the prescribed rate is payable to the assessee in such cases too.

(i) The particulars of cases of direct refunds for which claims were made during the years 1996-97 to 1998-99 were as under:

Financial year	Opening balance	Claims received during the year	Total	No. of claims disposed off	Balance outstanding
1996-97	34,952	1,22,760	1,57,712	1,07,782	49,930
1997-98	49,930	1,65,616	2,15,546	1,41,877	73,669
1998-99	73,669	1,30,649	2,04,318	1,07,600	96,718

(ii) Details of cases resulting in refund as a result of appellate orders and revision orders etc. as on 31 March 1999 were as under:

Financial Year	Opening Balance	Addition	Total	Disposal	Closing Balance
1996-97	3,280	37,924	41,204	37,031	4,173
1997-98	4,173	27,015	31,188	27,363	3,825
1998-99	3,825	23,623	27,448	24,590	2,858**

(iii) Details relating to interest paid on refunds by Government under certain relevant sections of the Income Tax Act, 1961, for the years 1996-97 to 1998-99 were as under:

(Rs.in crore)

Section under which interest paid	1996-97		1997-98		1998-99	
	No. of assessments	Amount	No. of assessments	Amount	No. of assessments	Amount
214	20,864	7.42	123	14.09	131	52.53
243	9	0.01	-	-	-	-
244	1,66,629	100.41	2,17,720	9.97	2,05,274	74.49
244A	15,31,464	622.13	17,14,828	878.87	13,02,282	1,727.12
<b>Total</b>	<b>17,18,966</b>	<b>729.97</b>	<b>19,32,671</b>	<b>902.93</b>	<b>15,07,687</b>	<b>1,854.14</b>

The high incidence of interest amount calculated @ 1 percent per month till the date of refund is steadily rising over the years. During 1998-99 it has increased by 105.34 percent over the previous year's figure.

Cases settled by Settlement Commission

**2.14** Under the Income Tax Act, 1961, and the Wealth Tax Act, 1957, an assessee may at any stage of a case relating to him, make an application to the Settlement Commission to have the case settled. While making an application to Settlement Commission, an assessee shall make full and true disclosure of his income (not disclosed before the assessing officer) and the additional amount of income tax payable on such income. The Settlement Commission admits/rejects the application after calling for the report from the Commissioner.

\*\* For year -wise analysis of closing balance refer Annexure IX.



(i) The number of cases settled by the Settlement Commission during the years 1996-97 to 1998-99 was as under:

Year	Opening balance	Additions	Total cases for disposal	Number of cases settled	Percentage of cases settled	Number of cases pending
<b>Income Tax</b>						
1996-97	2,146	471	2,617	472	18.03	2,145
1997-98	2,145	362	2,507	526	20.98	1,981
1998-99	1,981	619	2,600	840	32.30	1,760
<b>Wealth Tax</b>						
1996-97	258	49	307	109	35.50	198
1997-98	198	16	214	26	12.14	188
1998-99	188	15	203	71	34.97	132

(ii) The number of cases pending for admission/held up with Settlement Commission as on 31 March 1999 was as under:

Cases pending for admission before Settlement Commission	<b>211</b>
Cases held up with Settlement Commission for want of comments of the department	<b>143</b>

(iii) Year-wise position of additional tax paid/payable and the final demand raised (including interest and penalty) in cases settled by Settlement Commission during the years 1996-97 to 1998-99 was as under:

Financial Year	Income Tax		Wealth Tax	
	(Rs. in lakh)			
	Additional tax paid/payable on admission of applications	Gross demand created in respect of cases settled	Additional tax paid/payable on admission of application	Gross demand created in respect of cases settled
1996-97	4,245.36	5,179.99	30.68	122.54
1997-98	3,284.36	8,509.12	16.90	203.27
1998-99	2,734.33	7,824.74	4.04	279.53

#### Penalties

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

**Income Tax  
(including  
Corporation  
Tax)**

(i)(a) Penalty proceedings initiated, disposed of and pending for the years 1996-97 to 1998-99 were as under:

Year	Opening balance	Additions	Total	Disposal	Closing balance
1996-97	2,15,447	75,335	2,90,782	67,720	2,23,062
1997-98	2,23,062	52,237	2,75,299	71,811	2,03,488
1998-99	2,03,488	58,669	2,62,157	60,912	2,01,245

(b) Details regarding nature of offences and penalties imposed during the year 1998-99 are as follows:

Nature of offence	Number of cases	Cases disposed off	Balance	Balance less than 6 months	Balance more than 6 months
For Concealment	1,40,157	23,126	1,17,031	32,065	84,966
Other than concealment	1,22,000	37,786	84,214	19,199	65,015
<b>Total</b>	<b>2,62,157</b>	<b>60,912</b>	<b>2,01,245</b>	<b>51,264</b>	<b>1,49,981</b>

**Penalties imposed (Rs. in crore)**

Particulars	No. of cases	Amount
For concealment	9,131	324.12
Others	18,197	66.42

*Out of 60,912 cases, penalties were imposed in 27,328 cases constituting 44.86 percent of total cases disposed of.*

(c) Details of penalty and composition money levied, collected and pending for the years 1996-97 to 1998-99 were as under:

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	penalty	composition money	penalty	composition money	penalty	composition money
1996-97	434.73	197.84	110.32	117.74	112.99	67.78	432.06	247.80
1997-98	432.06	247.80	133.27	29.04	58.44	36.07	506.89	240.77
1998-99	506.89	240.77	245.80	150.50	116.32	47.22	636.37	344.05

**Other Direct  
Taxes-  
Wealth Tax,  
Gift Tax**

(ii)(a) Penalty proceedings initiated, disposed of and pending for the years 1996-97 to 1998-99 are given below:

Year	Opening balance	Additions	Total	Disposal	Closing balance
1996-97	38,799	2,662	41,441	9,126	32,335
1997-98	32,335	4143	36,478	5,839	30,639
1998-99	30,639	2,435	33,074	5,021	28,053



(b) Details of pendency of penalty and composition money levied, collected and pending for the years 1996-97 to 1998-99 were as under:

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1996-97	15.69	2.91	0.66	1.98	1.02	0.99	15.33	3.90
1997-98	15.33	3.90	3.95	6.93	1.24	2.03	18.04	8.80
1998-99	18.04	8.80	3.06	0.05	5.34	0.72	15.76	8.13

The balance of total demand outstanding by way of penalty and composition money in respect of income tax (including corporation tax) constituted 79 percent, 88.8 percent and 85.7 percent and in respect of other direct taxes, 90.5 percent, 89.1 percent and 79.7 percent during 1996-97, 1997-98 and 1998-99 respectively.

#### Searches and seizures

2.16 Assessment of search cases are governed by Chapter XIV-B of the Income Tax Act. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approves of the retention for longer period.

(i) Searches and seizures conducted during the years 1996-97 to 1998-99 were as under:

Year	Number of searches and seizures conducted	Value of assets seized (Rs. in crore)
1996-97	4,299	405.63
1997-98	3,653	306.85
1998-99	5,746	300.54

(ii) Particulars of income determined, tax levied, balance tax outstanding after adjustment of value of assets retained on final assessment for the year 1998-99 were as follows:

No. of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery		
		Tax	Penalty	Total		Tax	Penalty	Total
3,112	3,646.92	2,128.02	7.21	2,135.23	104.50	2,023.65	7.08	2,030.73

(iii) Number of prosecutions launched, convictions obtained, compounded and acquittals for the years 1996-97 to 1998-99 was as under:

Year	Number of prosecutions launched			Disposal of cases				Cases pending
	Opening balance	Additions	Total	Convictions	Compoundings	Acquittals	Total	Balance
1996-97	15,951	393	16,344	20	643	637	1,300	15,044
1997-98	15,044	801	15,845	93	143	1,003	1,239	14,606
1998-99	14,606	184	14,790	77	184	407	668	14,122

There were more acquittals than conviction plus compoundings. Acquittals comprised 49 percent, 81 percent and 60 percent as compared to 51 percent, 19 percent and 40 percent of convictions plus compoundings during 1996-97, 1997-98 and 1998-99 respectively.

(iv) Particulars of cases of assets returned, interest paid and cases pending for the year 1998-99 were as under:

Cases where assets were due for return			Cases where assets were returned	Cases where interest was paid during the year	Balance cases pending
Opening balance	Added during the year	Total			
8,199	716	8,915	268	57	8,647

#### Survey

2.17(i) Details of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the years 1996-97 to 1998-99 were as under:

Year	No. of premises surveyed	
	under section 133A	under section 133B
1996-97	9,073	8,09,523
1997-98	7,632	4,51,871
1998-99	7,466	1,87,545

(ii) The number of cases where evidence about ostentatious expenditure was collected under Section 133A(5) of Income Tax Act, 1961, for the years 1996-97 to 1998-99 was as under:

Year	No. of cases
1996-97	386
1997-98	238
1998-99	125

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

2.18 With a view to countering tax evasion and to curb the circulation of unaccounted money in real estate transactions, a new Chapter XX- C was inserted in the Income Tax Act, 1961, with effect from 1 October 1986 empowering the Central Government to purchase immovable properties in certain cases of transfer .



(i) Details of properties purchased by the Central Government during the financial year ended 31 March 1999 were as under:

	Mumbai	Calcutta	Delhi	Chennai	Bangalore	Ahmedabad	Lucknow	Total
(i) No. of statements received in form 37-1	542	181	665	308	451	446	262	2855
(ii) No. of properties purchased	1	-	1	-	3	1	1	7
(iii) Value of properties purchased (Rs. in crore)	2.67	-	0.65	-	1.52	0.90	0.50	6.24
(iv) No. of properties where consideration exceeds Rs.50 lakh	1	-	1	-	2	1	1	6

(ii) The details of properties sold by the appropriate authority and those awaiting disposal during 1998-99 are given below:

(Rs. in crore)			
Number of properties sold	Sale value	Properties awaiting disposal	Amount
10	8.74	192	186.80

Revenue demands written off

2.19(i) Details regarding amount written off by the department during the year 1998-99 as furnished by the Ministry of Finance, are as under:

(Rs. in 000)								
No. of cases identified involving arrear demand of Rs.10,000 and below where recovery certificates were issued			Cases written off during the year			Balance		
No. of assessees	No. of entries	Total amount involved	No. of assessees	No. of entries	Total amount written-off	No. of assessees	No. of entries	Amount
94,946	1,03,319	4,73,921	76,606	79,955	4,40,659	18,340	23,364	33,262

Upto Rs.10,000 the total amount of arrears, for which recovery certificates were issued to Tax Recovery Officers, amounted to Rs.169.10 crore involving 5,29,780 assessee/cases. Out of these, the department identified 94,946 assessees/cases for possible write off involving Rs.47.39 crore and out of this, the department had written off a sum of Rs.44.06 crore in respect of 76,606 assessees/cases.

(ii) Category-wise details of revenue demands written off by the Department during 1998-99 were as under:

**Income Tax (including Corporation Tax)**

(Rs. in crore)

Category	Company cases		Non-company cases		Total cases	
	No.	Amount	No.	Amount	No.	Amount
(a) Assesseees having died leaving behind no assets/ have become insolvent/gone into liquidation/are defunct	6	0.41	1,080	1.97	1,086	2.38
(b) Assesseees being untraceable.	262	0.01	33,015	2.30	33,277	2.31
(c) Assesseees having left India	-	-	2,910	0.11	2,910	0.11
(d) Assesseees who are alive but have no attachable assets/amounts being petty/amounts written of as a result of scaling down of demand.	127	0.01	74,102	42.61	74,229	42.62
(e) Amount written off on grounds of equity or as a matter of international courtesy, or where time, labour and expense involved in legal remedies for realisation are considered disproportionate to the recovery.	-	-	1,570	0.30	1,570	0.30
<b>Grand Total:</b>	<b>395</b>	<b>0.43</b>	<b>1,12,677</b>	<b>47.29</b>	<b>1,13,072</b>	<b>47.72</b>

**Other Direct Taxes**

(Rs.in lakh)

	Wealth Tax		Gift Tax	
	No.	Amount	No.	Amount
Amount written off due to untraceability of assesseees	1,310	54.40	296	17.30



**Annexure I****(Reference: para 2.1)****(i) Status-wise break-up of Income tax (including Corporation tax) assesseees as on 31 March 1998 and 31 March 1999:**

	31 March 1998	31 March 1999
Individuals	1,11,94,953	1,51,35,956
Hindu undivided families	4,37,251	4,69,730
Firms	11,72,647	12,28,023
Companies	2,74,319	2,95,327
Trusts	51,865	83,847
Others	36,701	41,328
<b>Total</b>	<b>1,31,67,736</b>	<b>1,72,54,211</b>

**(ii) Income-wise break-up of Income tax (including corporation tax) assesseees as on 31 March 1999:**

Category	Individuals	Hindu undivided families	Firms	Companies	Others (including Trusts)	Total
Category 'A' <sup>*</sup>	1,46,43,551	4,38,199	11,40,744	1,73,251	1,16,692	1,65,12,437
Category 'B' (Lower) <sup>3</sup>	3,05,352	11,935	44,729	53,001	4,352	4,19,369
Category 'B' (Higher) <sup>4</sup>	1,38,433	11,854	26,732	37,711	2,213	2,16,943
Category C <sup>5</sup>	33,031	2,884	10,393	29,676	1,688	77,672
Category 'D' <sup>6</sup>	15,589	4,858	5,425	1,688	230	27,790
<b>Total</b>	<b>1,51,35,956</b>	<b>4,69,730</b>	<b>12,28,023</b>	<b>2,95,327</b>	<b>1,25,175</b>	<b>1,72,54,211</b>

<sup>\*</sup> Category 'A' assessee- Company assessments with income/loss below Rs.50,000 and non-company assessment with income/loss below Rs. 2 lakh.

<sup>3</sup> Category 'B' assesseees (lower income group) - Company assessments with income /loss of Rs.50,000 and above but below Rs.5 lakh and non-company assessments with income/loss of Rs.2 lakh and above but below Rs.5 lakh.

<sup>4</sup> Category 'B' assesseees (higher income group) - Company and non-company assessments with income/loss of Rs.5 lakh and above but below Rs.10 lakh.

<sup>5</sup> Category 'C' assesseees - Company and non-company assessments with income/loss of Rs.10 lakh and above.

<sup>6</sup> Category 'D' assesseees - Search and Seizure assessments.

(iii) Status-wise break-up of Wealth tax assessees as on 31 March 1998 and 31 March 1999:

	31 March 1998	31 March 1999
Individuals	2,08,266	1,91,802
Hindu undivided families	28,494	25,933
Companies	7,759	7,194
<b>Total</b>	<b>2,44,519</b>	<b>2,24,929</b>

(iv) Status-wise break-up of Gift tax assessees as on 31 March 1998 and 31 March 1999:

	31 March 1998	31 March 1999
Individuals	47,431	33,165
Hindu undivided families	731	487
Companies	128	208
Firms	19	11
Others	602	382
<b>Total</b>	<b>48,911</b>	<b>34,253</b>

(v) Interest tax assessees as on 31 March 1998 and 31 March 1999 were as under:

31 March 1998	31 March 1999
6,080	7,834



## Annexure II

[Reference: para 2.3(i)]

## State/UT wise break up of direct taxes

States	0020	0021	0023	0024	0028	0031	0032	0033	Total
	Corporati on tax	Income Tax	Hotel Receipts Tax	Interest Tax	Expenditure Tax	Estate Duty	Wealth Tax	Gift Tax	
(Rs. in crore)									
Andhra Pradesh	568.43	783.01	0.00	8.06	14.46	-0.23	0.10	-1.45	1372.38
Arunachal Pradesh	0.00	3.32	0.00	0.00	0.00	0.00	0.00	0.00	3.32
Assam	105.68	148.99	0.00	0.04	0.02	0.00	0.81	0.04	255.58
Bihar	28.13	330.04	0.00	0.03	0.00	0.00	0.52	0.06	358.78
Goa	67.39	89.65	0.00	1.30	0.13	0.00	1.32	0.03	159.82
Gujarat	632.75	1336.87	0.03	7.80	11.96	0.00	4.67	0.60	1994.68
Haryana	69.99	297.39	0.00	0.27	0.34	0.00	0.54	0.04	368.57
Himachal Pradesh	13.94	68.83	0.00	1.49	0.11	0.00	0.07	0.01	84.45
Jammu & Kashmir	33.32	44.36	0.00	5.28	0.11	0.00	0.71	0.01	83.79
Karnataka	637.70	1229.78	0.00	22.72	19.34	0.15	7.59	0.43	1917.71
Kerala	276.58	420.70	0.15	38.24	7.35	0.00	2.51	0.06	745.59
Madhya Pradesh	815.39	476.02	0.00	5.99	0.41	0.03	1.41	0.05	1299.30
Maharashtra	11902.06	6077.27	0.00	739.38	167.64	(-0.07)	72.30	1.33	18959.91
Manipur	0.10	5.63	0.00	0.00	0.00	0.00	0.02	0.00	5.75
Meghalaya	2.31	12.67	0.00	0.00	0.00	0.00	0.07	0.00	15.05
Mizoram	0.00	1.33	0.00	0.00	0.00	0.00	0.00	0.00	1.33
Nagaland	0.03	6.27	0.00	0.00	0.00	0.00	0.06	0.00	6.36
New Delhi	4734.94	3344.57	0.00	252.25	72.34	0.01	25.10	1.08	8430.29
Orissa	332.74	155.59	0.00	0.81	0.79	0.00	0.25	0.10	490.28
Punjab	186.57	462.57	0.00	5.09	0.93	-0.01	5.23	0.51	660.89
Rajasthan	199.31	444.92	0.00	14.84	9.06	0.01	1.13	0.12	669.39
Sikkim	0.00	0.09	0.00	0.00	0.00	0.00	0.00	0.00	0.09
Tamil Nadu	1433.81	1618.69	0.00	103.44	24.32	0.01	15.60	6.39	3202.26
Tripura	0.24	8.10	0.00	0.00	3.28	0.00	0.06	0.01	8.41
Uttar Pradesh	1288.66	872.54	0.02	7.50	2.26	0.01	4.64	0.10	2175.71
West Bengal	1046.59	1077.11	0.00	48.99	63.48	0.01	16.87	0.43	2253.48
<b>Union Territories</b>									
Andaman Nicobar	3.10	1.57	0.00	0.01	0.06	0.00	0.01	0.00	4.75
Chandigarh	110.01	89.06	0.00	0.21	0.00	0.00	0.34	0.01	199.63
Daman	0.04	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.05
Diu	0.00	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.05
Dadra N. Haveli	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Pondicherry	4.05	22.95	0.00	0.08	0.00	0.00	0.13	0.02	27.21
Laxadweep	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Silvassa	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
<b>Total</b>	<b>24493.86</b>	<b>19429.96</b>	<b>0.20</b>	<b>1263.82</b>	<b>395.11</b>	<b>0.08</b>	<b>162.04</b>	<b>9.96</b>	<b>45754.87</b>
CTDS (Prov)	35.01	810.19	-	-	-	-	-	-	845.20
<b>Grand Total</b>	<b>24528.87</b>	<b>20240.15</b>	<b>0.20</b>	<b>1263.82</b>	<b>395.11</b>	<b>-0.08</b>	<b>162.04</b>	<b>9.96</b>	<b>46600.07</b>

**Annexure-III**  
**[Reference: Para 2.5(iv)]**

*Year-wise/category wise assessee status for 1994-95 to 1998-99*

**Individuals**

Category	1994-95	1995-96	1996-97	1997-98	1998-99
A	81,90,186	86,09,612	94,43,293	1,07,84,480	1,46,43,551
B(Lower)	1,96,492	1,24,437	2,40,262	2,35,298	3,05,352
B(Higher)	36,049	35,650	40,964	1,33,720	1,38,433
C	10,012	14,535	19,149	27,796	33,031
D	16,383	13,978	17,758	13,659	15,589
<b>Total</b>	<b>84,49,122</b>	<b>87,98,212</b>	<b>97,61,426</b>	<b>1,11,94,953</b>	<b>1,51,35,956</b>

**HUFs**

A	3,88,478	3,93,649	3,92,243	4,15,738	4,38,199
B(Lower)	9,630	8,181	12,162	11,692	11,935
B(Higher)	2,579	2,145	3,696	6,122	11,854
C	924	1,011	2,321	2,117	2,884
D	3,302	1,470	2,048	1,582	4,858
<b>Total</b>	<b>4,04,913</b>	<b>4,06,456</b>	<b>4,12,470</b>	<b>4,37,251</b>	<b>4,69,730</b>

**Firms**

A	10,82,892	11,35,823	10,91,502	10,91,366	11,40,744
B(Lower)	45,508	33,504	41,946	40,459	44,729
B(Higher)	13,228	12,345	12,474	27,502	26,732
C	5,529	6,683	7,860	9,359	10,393
D	25,598	3,838	4,537	3,961	5,425
<b>Total</b>	<b>11,72,755</b>	<b>11,92,193</b>	<b>11,58,319</b>	<b>11,72,647</b>	<b>12,28,023</b>

**Companies**

A	93,478	1,11,218	1,28,137	1,60,961	1,73,251
B(Lower)	43,590	39,908	43,622	54,675	53,001
B(Higher)	18,090	15,354	25,277	31,514	37,711
C	19,166	19,797	26,951	25,465	29,676
D	2,270	1,297	3,241	1,704	1,688
<b>Total</b>	<b>1,76,594</b>	<b>1,87,574</b>	<b>2,27,228</b>	<b>2,74,319</b>	<b>2,95,327</b>

**Others (including Trusts)**

A	70,536	73,385	74,953	78,508	1,16,692
B(Lower)	6,720	4,438	6,545	3,907	4,352
B(Higher)	1,189	601	813	4,386	2,213
C	1,867	1,450	1,645	1,498	1,688
D	910	205	144	267	230
<b>Total</b>	<b>81,222</b>	<b>80,079</b>	<b>84,100</b>	<b>88,566</b>	<b>1,25,175</b>



**ANNEXURE IV**  
**(Reference para 2.5(v))**

**DISTRIBUTION OF HOUSEHOLDS BY INCOME: 1996-97**

Income Class (Rs.)	Households (000)			Total Income (in Billion)			Average Income (In Rs.)		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
<= 27,500	11,589	62,990	74,580	223	1,076	1,299	19,248	17,077	17,415
27,501-55,000	16,433	37,918	54,351	680	1,463	2,143	41,397	38,574	39,428
55,001-85,000	9,616	11,023	20,639	660	739	1,399	68,601	67,033	67,764
85,001-1,00,000	3,330	2,959	6,289	303	268	572	91,043	90,694	90,879
1,00,001-2,00,000	5,436	3,743	9,179	671	463	1,134	123,463	123,610	123,523
2,00,001-5,00,000	777	604	1,381	197	170	366	253,456	280,894	265,457
5,00,001-10,00,000	138	42	180	100	22	122	722,596	525,253	676,927
Over 10,00,000	55	11	66	159	30	189	2,868,900	2,796,908	2,857,367
<b>Total</b>	<b>47,375</b>	<b>119,290</b>	<b>166,665</b>	<b>2,993</b>	<b>4,230</b>	<b>7,223</b>	<b>63,178</b>	<b>35,456</b>	<b>43,336</b>

**DISTRIBUTION OF HOUSEHOLDS BY INCOME: 1997-98**

Income Class (Rs.)	Households (000)			Total Income (in Million)			Average Income (In Rs.)		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
<= 30,000	10,534	61,362	71,896	2,26,957	10,85,055	13,12,012	21,545	17,683	18,249
30,001-60,000	16,576	40,156	56,732	7,90,363	17,70,410	25,60,773	47,681	44,088	45,138
60,001-90,000	10,650	11,944	22,594	8,07,762	8,83,671	16,91,433	75,846	73,984	74,862
90,001-1,25,000	5,439	4,373	9,812	5,71,708	4,53,673	10,25,381	1,05,113	1,03,744	1,04,503
1,25,001-2,00,000	3,127	2,470	5,597	4,74,369	3,62,715	8,37,084	1,51,722	1,46,849	14,95,571
2,00,001-5,00,000	1,613	568	2,181	4,38,709	1,59,947	5,98,656	2,71,968	2,81,495	2,74,450
5,00,001-10,00,000	145	133	278	93,931	84,146	1,78,078	6,49,091	6,31,900	6,40,853
Over 10,00,000	77	40	116	2,50,432	86,390	3,36,822	3,28,118	21,79,378	28,96,930
<b>Total</b>	<b>48,160</b>	<b>1,21,046</b>	<b>1,69,206</b>	<b>36,54,232</b>	<b>48,86,007</b>	<b>85,40,239</b>	<b>75,877</b>	<b>40,365</b>	<b>50,472</b>

**ANNEXURE V**

(Reference para 2.5(v))

**Number of returns, gross income, admissible B/F losses etc. set off, deductions and total tax-By status and range of returned income for assessment year 1996-97**

**Status: Individual**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	1098256	39164793	503900	1018973	37641920	1240390
40- 50	2795261	136861139	367136	7219484	129274519	6649543
50- 100	2545653	278437719	1124713	77608480	199704526	24130882
100- 200	785741	111375216	480306	4336196	1065587714	22114953
200- 300	60236	15708946	75428	1436453	14197065	3914614
300- 400	25418	8879362	37385	423249	8418728	2451766
400- 500	15304	6858837	17080	152153	6689604	1889405
500- 1000	21414	16911559	56388	1109463	15745708	4807246
1000+	10265	91654165	62417	1707968	89883780	25166938
Total	7357548	705851736	2724753	95012419	608114564	92365737

**Status: Hindu undivided family**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	61966	2863902	7172	90308	2766422	277628
40- 50	128914	9469197	11079	212290	9245828	1035559
50- 100	60612	6465794	6111	298940	6160743	1005571
100- 200	18262	2989463	8681	102302	2878480	694812
200- 300	2453	757681	8740	30319	718622	204814
300- 400	1042	432020	3827	3431	424762	119482
400- 500	437	251145	1633	1255	248257	74142
500- 1000	1029	846218	2897	32377	810944	236546
1000+	495	936844	21646	65011	850187	291359
Total	275210	25012264	71786	836233	24104245	3939913

**Status: Registered Firm**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	135953	2599707	45018	284396	2270293	706423
40- 50	353530	27827906	203020	1045984	26578902	7804033
50- 100	127284	21314811	164817	938839	20211155	6379424
100- 200	44329	19689914	355844	9192445	10141625	346555
200- 300	8409	3085165	15288	457779	2612098	948666
300- 400	5317	3262832	15750	992546	2254536	830626
400- 500	3396	2277512	19337	239155	2019020	740917
500- 1000	6802	8088842	54665	1323495	6710682	2406210
1000+	4695	20193224	45771	1852111	18295342	6109947
Total	689715	108339913	919510	16326750	91093653	26272801



**Status: Company**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	54336	2131198	354214	1014359	762625	306806
40- 50	50405	4087982	1063429	1039962	1984591	750376
50- 100	17707	3647032	350564	1417948	1878520	724098
100- 200	12386	3249110	308049	732927	2208134	896606
200- 300	8699	5081859	452470	1914899	2714490	1087029
300- 400	5892	6563406	127793	1257789	5177824	2023696
400- 500	4713	7541684	69325	2146703	5325656	2073227
500- 1000	11712	54588986	877010	4896147	48815829	19303085
1000+	15733	287878566	5325054	50412776	232140736	80030653
Total	181583	374769823	8927908	64833510	301008405	10719557

6

**Status: Others**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	55297	1387847	12795	341243	1033809	350109
40- 50	30211	1340900	5476	15560	1319864	374842
50- 100	9260	987859	4990	153240	829629	261192
100- 200	4020	635326	5357	64350	565619	191096
200- 300	582	152890	478	5437	146975	51699
300- 400	397	140224	416	4265	135543	51199
400- 500	289	127035	222	414	126399	46047
500- 1000	512	399025	1360	11786	385625	138350
1000+	1416	7503756	67244	788766	6647746	2213284
Total	101984	12674862	98338	1385061	11191209	3677818

**All Status**

(Rs. 000)

Range of returned income	No. of returns	Gross income	B/F losses etc. set off	Deductions under Chapter VIA	Income returned	Tax payable
0- 40	1405808	48147447	923099	2749279	44475069	2881356
40- 50	3358321	179587124	1650140	9533280	168403704	166144353
50- 100	2760516	310853215	1651195	80417447	228784573	32501167
100- 200	864738	137939029	1158237	14428220	122352572	24244022
200- 300	80379	24786541	552404	3844887	20389250	6206822
300- 400	38066	19277844	185171	2681280	16411393	5476769
400- 500	24139	17056213	107597	2539680	14408936	4823738
500- 1000	41469	80834630	992320	7373268	72468788	26891437
1000+	32604	408166555	5522132	54826632	347817791	113812181
Total	8606040	1226648598	12742295	178393973	1035512076	233451845

\* Source: All India Income Tax Statistics Assessment Year 1996-97 of Income Tax Department

**Annexure VI**

(Reference: para 2.6)

**Details of variation under the heads subordinate to the  
Major heads 0020 and 0021 for the year 1998-99:**

	Head of revenue	Budget Estimates	Actuals	Variation	Percentage of variation
(Rs. in crore)					
<b>0020-Corporation Tax</b>					
(i)	Income Tax on companies	24,492.68	23,784.93	(-) 707.75	(-) 2.89
(ii)	Surtax	0.30	0.02	(-) 0.28	(-) 93.33
(iii)	Surcharge	1,793.92	36.53	(-) 1,757.39	(-) 97.96
(iv)	Other receipts	263.10	707.39*	444.29	109.95
	<b>Total</b>	<b>26,550.00</b>	<b>24,528.87</b>	<b>(-) 2,021.13</b>	<b>(-) 7.61</b>
<b>0021 - Taxes on income other than Corporation Tax</b>					
(i)	Income tax	19,995.12	19,875.12	(-) 120.00	(-) 0.60
(ii)	Surcharge	398.67	11.03	(-) 387.64	(-) 97.23
(iii)	Other receipts	536.21	354.00**	(-) 182.21	(-) 33.98
(iv)	Total	20,930.00	20,240.15	(-) 689.85	(-) 3.30
(v)	Deduct share of proceeds assigned to States	14,695.47	14,480.36	(-) 215.11	(-) 1.46
	<b>Net Collection</b>	<b>6,234.53</b>	<b>5,759.79</b>	<b>(-) 474.74</b>	<b>(-) 7.61</b>

\* Includes Rs.155.02 crore on account of KVSS, 98

\*\* Includes Rs.179.53 crore on account of KVSS, 98



**Annexure VII**  
**[Reference: para 2.9.1(ii)]**

Status-wise break-up of income tax (including corporation tax) assessments completed during the years 1996-97 to 1998-99

		1996-97	1997-98	1998-99
(a)	<b>Individuals</b>	88,26,523	96,60,004	73,12,213
(b)	<b>Hindu undivided families</b>	3,63,574	3,54,407	2,76,718
(c)	<b>Firms</b>	9,56,127	9,26,451	6,67,834
(d)	<b>Companies</b>	2,35,385	2,71,481	2,14,922
(e)	<b>Others</b>	67,650	63,284	82,551
	<b>Total</b>	<b>1,04,49,259</b>	<b>1,12,75,627</b>	<b>85,54,148</b>

(ii) Status-wise and category-wise break-up of work load, disposals and pendency of assessments as on 31 March 1999:

			Workload		Disposal		Balance	
			Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny
1.	Category 'A' Assessments	Company	35,259	1,84,369	9,522	1,00,677	25,737	83,692
		Non-Company	3,95,890	1,67,78,700	1,16,338	78,21,174	2,79,552	89,57,526
2.	Category 'B' (lower) Assessments	Company	23,651	62,603	10,689	35,498	12,962	27,105
		Non-Company	34,451	2,85,875	18,649	1,40,058	15,802	1,45,817
3.	Category 'B' (higher) Assessments	Company	14,252	33,655	6,529	17,132	7,723	16,523
		Non-Company	23,429	1,92,004	10,282	1,04,792	13,147	87,212
4.	Category 'C' Assessments	Company	28,939	40,077	13,983	19,488	14,956	20,589
		Non-Company	20,114	51,859	9,683	26,468	10,431	25,391
5.	Category 'D' Assessments	Company	2,127	1,435	746	658	1,381	777
		Non-Company	19,964	2,01,642	5,428	86,354	14,536	1,15,288
6.	Total	Company	1,04,228	3,22,139	41,469	1,73,453	62,759	1,48,686
		Non-Company	4,93,848	1,75,10,080	1,60,380	81,78,846	3,33,468	93,31,234

**Annexure VIII**  
[Reference: para 2.11(ii)]

(i) Year-wise break-up of certificates pending as on 31 March 1999 and amount of demand:

Year	No. of Certificates	Amount (Rs. in crore)
1994-95 and earlier years	6,02,492	833.24
1995-96	13,878	337.33
1996-97	15,046	634.31
1997-98	13,705	1,023.65
1998-99	16,706	2,069.69
<b>Total</b>	<b>6,61,827</b>	<b>4,898.22</b>

Tax-wise and amount-wise analysis of pending certificates:

(Rs. in crore)							
	Range of Demand	Corporation Tax		Income Tax		Wealth Tax	
		No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	15,203	4.20	4,35,503	156.70	61,581	6.30
(b)	Over Rs.10,000 and below Rs.1 lakh	7,694	14.65	79,017	86.27	8,602	7.67
(c)	Over Rs.1 lakh to Rs.5 lakh	1610	27.16	13,743	171.84	1,645	6.79
(d)	Over Rs.5 lakh to Rs.10 lakh	643	28.50	3,326	171.24	102	4.93
(e)	Over Rs.10 lakh	1,047	792.70	4,996	3,374.31	89	34.74
	<b>Total</b>	<b>26,197</b>	<b>867.21</b>	<b>5,36,585</b>	<b>3,960.36</b>	<b>72,019</b>	<b>60.43</b>

(Rs. in crore)									
	Range of Demand	Gift Tax		Sur Tax		Others		Total	
		No.	Amount	No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	14,259	1.64	45	0.03	3,189	0.23	5,29,780	169.10
(b)	Over Rs.10,000 and below Rs. 1 lakh	2,530	1.00	35	0.07	1,894	0.20	99,772	109.86
(c)	Over Rs.1 lakh to Rs.5 lakh	2,954	0.55	29	0.43	1,988	0.01	21,969	206.78
(d)	Over Rs.5 lakh to Rs.10 lakh	2	0.12	17	0.39	-	-	4,090	205.18
(e)	Over Rs.10 lakh	13	2.59	65	1.53	6	1.43	6,216	4,207.30
	<b>Total</b>	<b>19,758</b>	<b>5.90</b>	<b>191</b>	<b>2.45</b>	<b>7,077</b>	<b>1.87</b>	<b>6,61,827</b>	<b>4,898.22</b>



**Annexure IX**  
**[Reference: para 2.13(ii)]**

**The year-wise analysis of the closing balance was as under:**

<b>Financial Year in which application was made</b>	<b>Number of cases pending</b>
1994-95	191
1995-96	81
1996-97	123
1997-98	487
1998-99	1,976
<b>Total</b>	<b>2858</b>

## Chapter 3: A-System Appraisals

### 3.1 Review on assessment of search cases made on or after 1 July 1995 under the Income Tax Act, 1961(Block Assessment)

#### Introductory

3.1.1 Various measures including, *inter alia*, conferring of powers of search and seizure on the Income Tax authorities, are existing in Income tax law to unearth black money and check evasion of taxes. The existing procedure for assessment of cases of search initiated up to 30 June 1995 was found to be very cumbersome and time consuming as valuable time was lost in trying to relate the undisclosed income to different assessment years and also led to protracted legal battles.

In order to overcome these difficulties and to make the procedure of assessment of search cases cost effective, efficient and meaningful with the object of unearthing black money and bringing it to tax expeditiously, the Finance Act, 1995 inserted Chapter XIV-B of the Act (Sections 158B to 158BH) to provide a special procedure for assessment of search initiated on or after 1 July 1995. The assessment so made is known as 'Block Assessment'. The concept of 'block period' of assessment consists of the current period from 1 April to the date of search and ten preceding previous years (which was later amended to assessment year). The undisclosed income would be the income determined on the basis of any money, valuables or entries in the books of accounts maintained or other documents or transactions representing wholly or partly any income or property which has not been or would not have been disclosed to tax but for the search.

#### Law and Procedure

3.1.2.1 The method of search and seizure for unearthing black money is adopted by the Income Tax Department only in cases where there is sufficient reason to believe that the person concerned would not disclose the true picture of his income in the normal course.

The power of search and seizure under the Income Tax Act is vested with the Investigation Wing. Subsequent to the search and seizure operation, based on a preliminary scrutiny of the seized documents, an appraisal report is prepared by the Investigation Wing containing, *inter alia*, gist of the information leading to the search, details of seized assets, surrender made under Section 132(4) of the Income Tax Act, outcome of the search and concealment potential of the case. This appraisal report along with the seized material is required to be sent to the concerned Assessing Officer within 60 days of the date of the search.

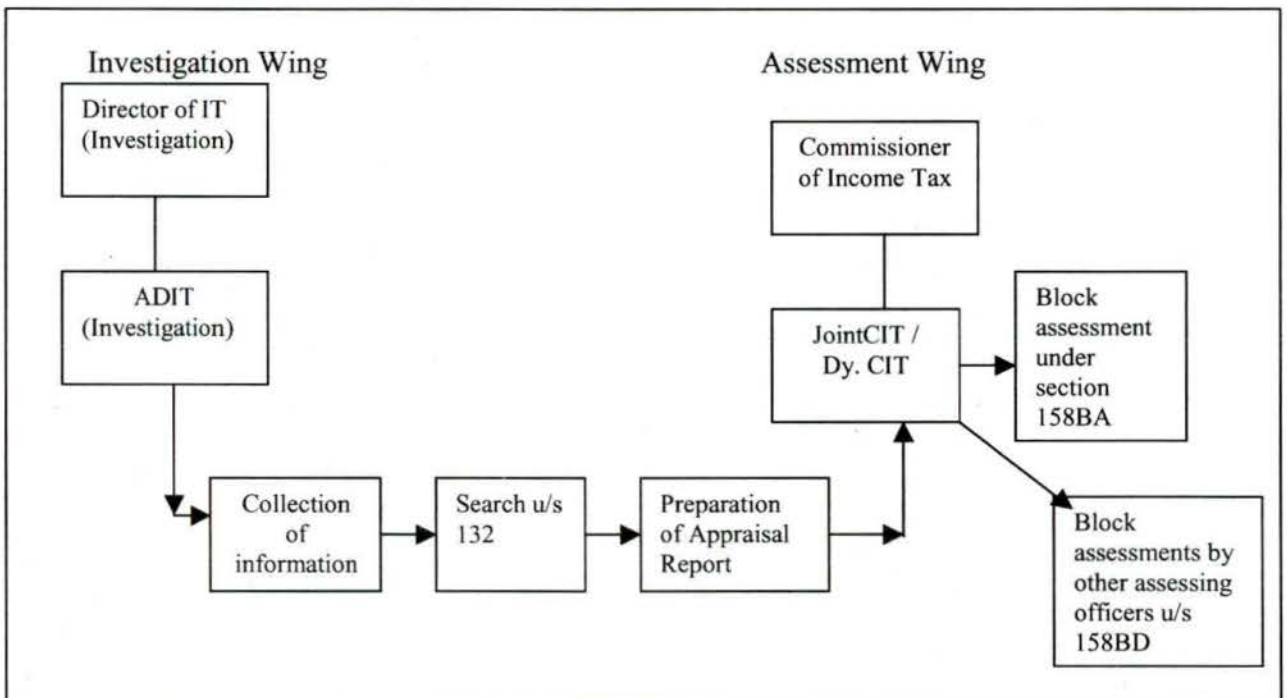
On the basis of the appraisal report, the assessment order for the block period is required to be passed within one year (two years in cases of search executed on or after 1 January 1997) from the end of the month in which the last of the search warrants is executed. The time limit for completion of block assessment excludes the period during which the assessment proceeding is stayed by an order or injunction of any court. Such assessments shall be in addition to the



normal regular assessment and shall be passed by an officer not below the rank of Assistant Commissioner or Deputy Commissioner or an Assistant Director or Deputy Director.

Under the provisions of Section 158BD where the seized assets or books of accounts and documents belong to a person, other than the one against whom search has been conducted, the assets, books and documents have to be handed over to the assessing officer having jurisdiction over such other person, and the subsequent proceedings will be taken up by the latter. In such a situation also, the assessment will be made for the block period.

A flowchart of the various operational procedures involved, starting with the search operations by the investigation wing and culminating with the completion of the block assessment by the assessing officer, is given below:



**Procedure for block assessment**

**3.1.2.2** The assessing officer shall issue a notice under Section 158BC(a) on the assessee requiring him to furnish within the specified time (not being less than 15 days but not more than 45 days), a return in the prescribed Form 2B setting forth his total income including the undisclosed income of the block period. Under Section 158BB the assessing officer shall proceed to determine the undisclosed income of the block period in accordance with the provisions of Chapter IV of the Income Tax Act. The provisions of Sections 68, 69, 69A, 69B and 69C shall apply *mutatis mutandis*. The computation of undisclosed income shall be restricted to the years in respect of which undisclosed income has been found. Such an exercise shall not be taken for all the ten years comprised in the block period. The total undisclosed income relating to the block period shall be charged to tax at a flat rate of 60 percent (plus surcharge on income tax in the case of domestic company) under Section 113. No

interest under Section 234 A, 234 B & 234 C or penalty under Section 271(1)(C) or 271A or 271B shall be levied. However, in cases of search executed on or after 1 January 1997, if the return of income as required by a notice under Section 158BC(a) is furnished after the expiry of the period specified in such notice or is not furnished, the assessee shall be liable to pay interest at the rate of 2 per cent per month or part of a month from the end of the specified period mentioned in the notice to the date of filing of the return and in case of non-filing of return to the date of the block assessment order. Further, for willful failure to furnish the said return in due time, he shall be liable to pay penalty of 100 percent but not exceeding 300 percent of the tax leviable on the undisclosed income.

**Objective of the review**

**3.1.3** The review seeks to evaluate the post-search performance of the department, particularly the timeliness, finality and productivity of assessments made under the new procedure of "Block Assessment" and also to examine the quality of the investigation conducted by the investigating officers as reflected in the appraisal reports prepared by them.

**Coverage of the review**

**3.1.4** The period covered in the review is from 1 July 1995 to 31 December 1998. All cases involving undisclosed income of Rs.50 lakh and above and 20 to 30 percent of the other cases depending on the quantum of search operations/block assessment in the jurisdiction were selected for audit scrutiny. In all 8482 cases were reviewed.

**Constraints**

**3.1.5** The review was conducted in spite of avoidable reluctance on the part of the departmental authorities to make available the appraisal reports. The Central Board of Direct Taxes had issued instructions under letter No.246/14/92 A PAC I dated 29 November, 1994 to make available all records, including appraisal reports, to revenue audit. These instructions were later amplified vide CBDT instruction No.414/41/95 IT (Inv.I) dated 27 November, 1998 pertaining to production of seized materials only to officers of the rank of Deputy Accountant General and above. The Department misinterpreted the instructions and took a stand that even the appraisal reports would be produced to officers of the rank of Deputy Accountant General and above only.

In Maharashtra two assessing charges under Commissioner of Income Tax Central III Mumbai, and all assessing charges under Commissioner of Income Tax, Kolhapur refused to make available the appraisal reports to audit parties.

In Gujarat, basic information regarding names of persons/groups covered under search was not furnished and nil assessment cases were not intimated by many of the Assessing Officers. Appraisal reports were also not furnished by the Joint Commissioner of Income Tax.

In Kerala, 16 cases with assessed income of Rs.50 lakh and above could not be produced as the files were either with the ITAT or the Settlement Commission.



In Rajasthan, ACIT Circle Bhilwara did not make available the appraisal reports although assessment records were furnished. The Central Board of Direct Taxes had also instructed CCIT/Jaipur on 8.12.1997 that appraisal reports could be shown only to a senior officer of the Audit Department.

In West Bengal, a series of correspondence proved abortive. No appraisal report was produced to officers below the level of Dy. Director. Therefore, only ten appraisal reports could be checked.

In Karnataka, appraisal reports were made available to audit only in June 1999. 92 assessment files out of 865 files requisitioned were not produced for review. Out of 773 files produced, appraisal reports in respect of 22 assessments were not made available.

**Highlights**

**3.1.6 The details and amounts of undisclosed income indicated by the Investigation officer in the appraisal report were not eventually sustained during the assessment proceedings. In most of the cases reasons for non-inclusion of the amounts mentioned in the appraisal reports were not recorded in the assessment orders inspite of existing instructions. Thus the Department would not be in a position to fix accountability to find out whether any lapses had occurred due to connivance of departmental officers as desired by the Public Accounts Committee.**

**[Paras 3.1.8.1 and 3.1.8.2]**

**-Delayed completion of assessments and non-completion of block assessment within the stipulated period had resulted in loss of revenue of Rs.272.21 lakh.**

**[Paras 3.1.8.3 and 3.1.8.6(g)]**

**-Various mistakes in computation of income and tax had resulted in short levy of tax of Rs.2909.82 lakh.**

**[Paras 3.1.8.4 and 3.1.8.5(a)]**

**-Non levy/short levy/excess levy of surcharge had resulted in undercharge and overcharge of tax of Rs.3996.04 lakh and Rs.19.90 lakh respectively.**

**[Para 3.1.8.5(b)]**

**-Unintended benefit given to assessee and incorrect computation of undisclosed income under section 158 BB(1)(c) had resulted in short levy of tax of Rs.1944.84 lakh.**

**[Paras 3.1.8.6(a) and (b)]**

**-Incorrect allowance of Chapter VIA deductions had resulted in short levy of Rs.753.42 lakh.**

**[Para 3.1.8.6(e)]**

**-Provisions of section 158BD were not invoked which had a revenue impact of Rs.398.21 lakh.**

**[Para 3.1.8.6(f)]**



-Interest and penalties to the extent of Rs.2254.71 lakh were not levied and Rs.109.81 lakh levied in excess.

[Paras 3.1.8.7(a), (b) and (c)]

-Ineffective search and defective assessments revealed loss of revenue of Rs.334.73 lakh.

[Paras 3.1.8.8(a) and 3.1.8.8(d)]

-Capital gains, wealth tax and gift tax escaped assessment with consequential non-levy of tax of Rs.236.94 lakh.

[Paras 3.1.11 to 3.1.13]

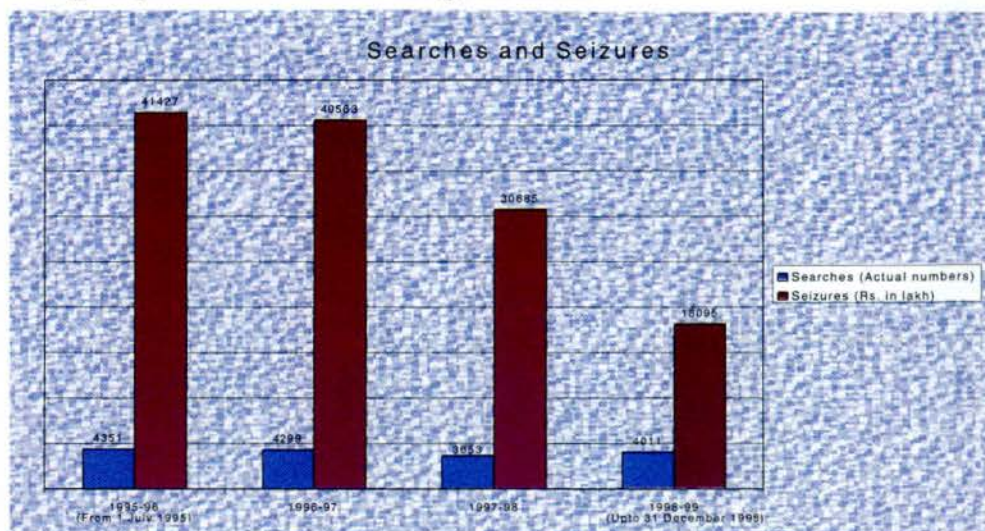
-An important lacuna in the Act was that in cases where search was conducted till 31.12.96 the assessee was charged to tax at a flat rate of 60 percent inclusive of all penalties and interest whereas under normal provisions of the Act the amount of tax together with interest and penalty worked out to a much higher figure. Thus, a search may put an assessee in a relatively advantageous position. This situation was sought to be remedied by the Income Tax (Amendment) Act, 1997 but the Amending Act too does not fully tackle the situation.

[Para 3.1.18]

-Various lacunae in the Act still remains.

[Para 3.1.19]

3.1.7 The All-India figures of searches conducted and the seizures effected during the period under review are given below:



#### Audit Findings

3.1.8 The Public Accounts Committee (PAC) in para 1.11 of their 2<sup>nd</sup> Report 1996-97 (Eleventh Lok Sabha) has stated that "Since the power of search and seizure conferred on the department are extraordinary and exceptional in nature, the Committee desire that in the light of non-detection of concealed income in a large number of cases, the Ministry of Finance should take specific steps and ensure that a thorough groundwork is done before undertaking search and seizure operations and also make a more detailed examination of each of the cases referred to above to find out whether any lapses had occurred due to connivance of departmental officers. In the opinion



of the Committee this is absolutely necessary so as to enhance the success rate to improve the efficacy of search and seizure operations.”

The audit checks to determine whether the Department has since initiated concrete steps on the recommendations of the PAC could not be carried out thoroughly due to non-production of appraisal reports in some cases and non-availability of seized documents. However, an overall position of the mistakes noticed in audit of block assessment cases is given below:

Table No. 1

**Statement showing omission/irregularities noticed in block assessment cases**

Year	Total number of cases in which block assessment completed			No. of cases reviewed in Audit			Mistakes noticed		
	No. of cases	Total undisclosed income (Rs. in lakh)	Tax effect (Rs. in lakh)	No. of cases	Total undisclosed income (Rs. in lakh)	Tax effect (Rs. in lakh)	No. of cases	Total undisclosed income (Rs. in lakh)	Tax effect (Rs. in lakh)
1995-96 (from 1.7.95)	52	641.18	385.72	49	629.67	376.93	6	8.89	5.34
1996-97	4950	248487.43	147515.55	3768	229376.48	133689.43	524	13222.50	9167.99
1997-98	4912	360419.01	226380.78	4002	329892.90	201887.97	557	49248.83	37937.24
1998-99 upto December 1998	852	29573.11	18096.34	663	26722.61	15913.09	68	1644.61	1302.41

**Differences noticed between figures shown in the appraisal reports and those adopted in the block assessments**

**3.1.8.1** One of the objectives of the review was to examine the quality of the appraisal reports prepared by the Investigation wing and the completeness and accuracy of the block assessments done by the assessing officers. An appraisal report is prepared on the basis of material and documents found as a result of the search and contain an estimate of the undisclosed income on the basis of which the assessing officer proceeds to do the block assessment. The assessment order of the assessing officer has to stand the test of law based on documentary evidences before the appellate authorities whereas there is no such challenge before the appraisal report. However, while it is evident that the details and amounts of undisclosed income indicated by the investigating officer in the appraisal report may not eventually be sustained during the assessment proceedings, test-check revealed that in the cases depicted below there were huge differences between the amounts of undisclosed income included in the appraisal reports prepared by the investigating officers and that assessed by the assessing officers in the block assessment. This reflects either an improper and insufficient estimation by the investigation wing or an inadequate attention on assessment by the assessing officer. Examples of some such cases noticed during the review are cited below:

(i) In Maharashtra in CIT XII charge, the appraisal report mentioned that an assessee carried out his entire business of trading in skimmed milk powder and ghee in cash only which remained unrecorded in the books of account. The assessing officer while computing undisclosed income of the block period considered the net profit only as undisclosed income. However, the initial investment of Rs. 961 lakh made in the undisclosed business was not considered. As the entire purchase and sale of the undisclosed business was transacted in cash and was kept out of the books of account, the initial investment should have been added to the profit. Further, as the entire business of trading was carried out in cash the provisions of Section 40A(3) should have been applied while carrying out the assessment which was not done.



In CIT I Pune charge during search operations carried out against an assessee evidence was found indicating unexplained cash payment in land dealings at Pune. The appraisal report mentioned that the assessee has entered into an agreement for purchase of property for documented consideration of Rs. 1100 lakh and a fax message seized during search revealed that an expenditure of Rs. 217 lakh had been incurred through a middleman for getting clearance certificates. Further, the Chairman of the group admitted that none of the expenditure had been reflected in the books of accounts and that a sum of Rs. 142 lakh had already been paid and incurred. The investigating officer therefore concluded that Rs. 217 lakh was to be treated as unexplained investment. The assessing officer however disregarded this suggestion and relied upon the affidavit of the middleman stating that the amount had not been paid but was proposed to be paid and accordingly no addition was made.

(ii) In Tamil Nadu, an assessee state public sector undertaking had claimed business expenditure of Rs.38.16 crore. In the Preliminary Reasonable Estimate of undisclosed income in the appraisal report furnished by the Investigation Wing it was suggested that 30 percent of the expenditure amounting to Rs.11.45 crore could not be treated as expenditure laid out or expended wholly and exclusively for the purpose of business of the assessee and hence, should be considered for disallowance. However, in the block assessment completed on 28.2.1997, this aspect was not considered at all.

(iii) In Kerala, CIT Kochi charge, in the cases of 8 assessee assessed between January 1997 and March 1997 concealed income assessed in the block assessment was for Rs.254.99 lakh only though the estimate in the appraisal report was for Rs.802.31 lakh. The assessee had surrendered income under Section 132(4) of Rs.677.78 lakh. Even if this amount is considered, under charge of tax on the balance would be to the extent of Rs.253.66 lakh. The Hon'ble High Court of Kerala had upheld\* the validity of such evidence under section 132(4) if it is not disputed as having been made under duress or threat.

(iv) In Uttar Pradesh in 41 search cases of a group in CIT Kanpur charge, the undisclosed income was estimated at Rs.13.18 crore in the appraisal report by the investigation wing, but the assessment could be completed for undisclosed income of Rs.3.02 crore only. To cite an example in the case of one assessee in CIT Kanpur charge the investment in plant and machinery for installation of Katha industries was estimated at Rs.300 lakh in the appraisal report while on a reference made to the valuation cell, its value was estimated at Rs.28 lakh. Thus there was a wide difference between the investment in plant and machinery estimated in the appraisal report and that by the valuation cell under a non-statutory reference.

(v) In Karnataka, CIT Hubli charge, a search conducted on a group of 12 assessee engaged in real estate business revealed that at least 8 assessee had undisclosed income of Rs. 96.20 lakh in the appraisal report. The assessing

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\* (219 ITR 235)



officer issued notices to all 12 assessees. However, except in the case of 1 assessee where income was assessed at Rs. 0.073 lakh, all the others were assessed at nil income. Thus, the income assessed against the group worked out at a mere 0.08 per cent of the income quantified in the appraisal report.

(vi) In Haryana, the block assessment of a proprietary concern for the block period 1.4.86 to 24.12.96 was completed on 26.2.98. As per the appraisal report, the concealed income of the assessee, based on seized documents, was estimated at Rs. 36.50 lakh for the assessment year 1997-98 and concealed income for the earlier years was to be estimated after allowing 10 per cent reduction per annum. Audit scrutiny however revealed that the assessing officer estimated the concealed income for the assessment years 1993-94 to 1997-98 at Rs. 25.62 lakh as against Rs. 139.87 lakh worked out on the basis of the appraisal report.

**Non-recording  
of reasons for  
variation**

**3.1.8.2** The CBDT issued instructions in July 1991 that the reasons for any variation in the quantum of undisclosed income between block assessment orders and appraisal reports are to be clearly recorded in the assessment order. Audit checks revealed that in most of the cases the reasons for variation of the amount mentioned in the appraisal reports were not recorded in the assessment orders. In the absence of the same the Department would not be in a position to fix accountability and or take any remedial action. Examples of such cases are cited below:

(i) In Maharashtra, in 6 CIT charges, in respect of 7 assessees undisclosed income of Rs.3281.58 lakh in the appraisal report was not considered by the assessing officer and reasons for variation were also not recorded. Further, in 22 cases in CIT Central I, Mumbai charge involving an amount of Rs.15238.01 lakh, the assessing officers did not record the result of investigation of the facts pointed out by the investigating officers. Out of these in 17 cases it was simply mentioned that the points had been "examined".

As an example, in one case the appraisal report mentioned different transactions amounting to Rs.1092.25 lakh carried out by the assessee with one share broker and the assessing officer was asked to verify whether the profit / gain was accounted for by the assessee. However, neither was such verification carried out nor were reasons for not doing so recorded by the assessing officer.

(ii) In Delhi charge, as per the appraisal report an amount of Rs.94.50 lakh was deposited in cash in the bank account of an assessee. Due opportunity was given to the assessee to explain the source of income. However, neither was the amount assessed as unexplained cash nor was the reason for the exclusion of this amount recorded.

(iii) In Uttar Pradesh, CIT Varanasi charge, a search was conducted on 14.9.96 in the business premises of a nursing home at Varanasi. Undisclosed income for the financial years 1986-87 to 1996-97 amounting to Rs.248.55 lakh was detected by the Investigation Wing. As per the appraisal report, the



professional income of the assessee for the financial years 1986-87 to 1996-97 was estimated at Rs.138 lakh. Against the above estimated undisclosed income, the assessee showed Rs.5 lakh only in the return submitted for the years falling within the block period. The assessing officer was advised by the Director of Investigation to discuss the issue of suppression of professional receipts to the tune of Rs.133 lakh at the time of framing final assessment. However, while completing the assessment the assessing officer neither discussed the issue of suppression of professional receipts to the tune of Rs.133 lakh nor was any addition on this account made to the undisclosed income of the assessee.

(iv) In Assam, during searches conducted in the business and residential premises of two groups of assesseees in September 1995 and November 1995, the investigation wing found evidence of undisclosed investment of Rs.111.62 lakh in land and building and undisclosed income of Rs.305.66 lakh including benami transactions, cash receipts, cash payments, undisclosed loans with interest and undisclosed sales in respect of two firms and four individual assesseees. This was indicated in the appraisal report. In the block assessments completed in September 1996 and November 1996 respectively, the undisclosed income of Rs.111.62 lakh and Rs.305.66 lakh were neither considered for assessment nor were any reasons for non-consideration of the same recorded in the assessment orders.

(v) In Orissa, CIT Bhubaneswar charge, in the case of an assessee individual it was seen from the appraisal report that the assessee had purchased a plot of land and had constructed a building upto roof level as on the date of search. The Investigation Wing indicated in the appraisal report that they felt that the amount of Rs.11.30 lakh as disclosed by the assessee on this account was under stated in view of the prime location of the land and building. However, the assessing officer accepted the valuation of the land and building as indicated by the assessee. Thus, neither was the case referred to the valuation officer to obtain expert advice nor was the issue discussed in the assessment order.

**Delayed  
completion of  
assessments**

**3.1.8.3** In the Memorandum explaining the provisions in the Finance Bill, 1995, the object of introduction of Chapter XIV-B was explained as under:

“Searches conducted by the Income Tax Department are important means of unearthing black money. However, under the present scheme, valuable time is lost in trying to relate the undisclosed incomes to the different years. Tax evaders generally manage to divert the focus to procedural and legal issues and often invent new evidence to explain undisclosed income. By the time the search-related assessments are completed, the effect of the search is considerably diluted. Legal battles continue for many years to decide which income is assessable in which assessment year. No finality is reached and the seized assets remain with the Department for a long time”.



A time limit of one year from the end of the month in which the last of the authorisation for search was executed was prescribed for completion of block assessment considering the time limit of two years too long as in the case of a regular assessment. However, the Income Tax (Second Amendment) Ordinance, 1996 made several amendments in the procedure for assessment of search cases as laid down in Chapter XIV B of the Income Tax Act, including, *inter alia*, increase in the time limit from one year to two years. This extension will however delay the search related assessments and this in turn will dilute considerably the effect of the searches, thereby defeating the main object of introduction of Chapter XIV B in the Income Tax Act.

During the course of the review it was noticed that there were instances of delayed completion of assessments as cited below:

(i) In Rajasthan, during the course of audit it was noticed that notice under Section 158BC was served upon three assesseees (being other persons as defined in Section 158BD), in April 1996. According to the provisions of Section 158BE the block assessments were required to be completed by 30.4.1997. The assessments were, however, completed in April 1998/May 1998. On being objected to by audit it was replied that a second notice was issued under Section 158BD and the assessments have been completed within the time limit and further, the assesseees had also not taken any ground in appeal regarding the limitation of issue of notices/finalisation of assessments.

The reply is not tenable as the notices were served in April 1996 and two assesseees filed returns in December 1996 (the third assessee did not file a return). The assessments should therefore have been completed by April 1997. By resorting to issue of a second notice in April/May 1997 the assessing officer merely sought to gain additional time for completion of assessment proceedings. Issue of such a notice may be held to be bad in law and may lead to loss of revenue of Rs.93.03 lakh.

(ii) In Punjab circle, audit scrutiny revealed that information in respect of 45 assesseees was to be passed on to other assessing officers for further necessary action. Information in respect of 9 cases involving amounts of Rs. 19.91 lakh with tax effect of Rs.11.95 lakh had been passed on to the concerned assessing officers in December 1996 but no action was taken till the date of review (January 1999). Information on the remaining 36 assesseees was not passed on to the concerned assessing officers which resulted in undisclosed income of Rs. 51.55 lakh remaining unassessed.

(iii) In accordance with the instruction of CBDT of July 1995, the Assistant Director of Income Tax (ADIT) is required to forward the appraisal report to the concerned CIT and Assessing Officer within 60 days of the commencement of search. If the period was to be extended written permission of the Director General was to be obtained.

In Uttar Pradesh it was noticed that in contravention of the above instruction, in 13 cases of searches conducted and assessments completed under three



CITs charge (Agra, Kanpur, Allahabad), there was delay in forwarding appraisal report upto 239 days. This also affected the assessment procedure owing to paucity of time. The permission of the Director General was also not obtained for delayed submission of appraisal reports.

In one case in CIT Allahabad charge, a search was conducted at Fatehpur on 5.7.96 but the appraisal report was submitted on 29.4.97 resulting in a delay of 239 days. This, in turn, resulted in delayed issue of notice. The assessment was completed in haste on 15.7.97 as it was becoming time barred on 31.7.97. Due to paucity of time, the assessing officer could not investigate the matter thoroughly. A reference was made to the Departmental Valuation Cell in July 1997 for valuation of plant and machinery in the factory premises but the same could not be obtained. This fact was admitted by the assessing officer in the office note appended with the assessment order dated 31.7.97 as under:

“Since little time was left valuation could not be obtained and the order had to be passed by 31.7.97 i.e. expiry of limitation. This will have to be covered under regular assessment”. Thus, due to delay on the part of both the investigating officer and the assessing officer, the assessee would derive the benefit of a lower rate of tax (30-40 percent) in the regular assessment thereby negating the results of the search.

**Underassessment  
of undisclosed  
income**

**3.1.8.4** Various irregularities on incorrect application of rules/mistakes in computation noticed in audit are discussed below:

(i) In Mumbai, CIT Central I charge, evidence was found during search operation indicating suppression of actual production thereby siphoning the sale proceeds as unaccounted income. It was also reported in the appraisal report that evidence was found indicating certain unaccounted expenditure and the assessing officer was asked to examine the allowance of such expenditure under the provisions of the Income Tax Act. The assessee declared Rs.829.75 lakh as unaccounted sale for the block period and offered net profit of Rs.228.94 lakh as undisclosed income which was accepted by the department on the ground that evidence was found during search indicating unaccounted expenditure also. As the entire expenditure was unaccounted and made in cash, 20% of the same should have been disallowed as per the provision under Section 40A(3). The omission resulted in underassessment of income of Rs. 98 lakh with consequent short levy of tax of Rs.67.62 lakh.

(ii) In Gujarat, in 27 cases underassessment of income had resulted in short levy of tax of Rs.8751.81 lakh. In one case, figures were marked with signs of pounds and dollars in the assessment order and also in the appraisal report. Audit scrutiny revealed that while working out total of “unaccounted receipts” these figures were taken as “rupees” resulting in under assessment of Rs.235.73 lakh and consequential short levy of tax of Rs.141.43 lakh.

(iii) In West Bengal in the case of five assessee companies, four individuals and three firms mistakes were found in the nature of omissions or in aggregation resulting in underassessment of income of Rs.551.22 lakh



involving tax effect of Rs.373.49 lakh. Moreover, in 7 cases on cross-verification of appraisal reports with block assessment mistakes in computation of undisclosed income of Rs.261.04 lakh were noticed. This resulted in undercharge of tax of Rs.172.87 lakh.

As an example, in one group case, the appraisal report estimated unexplained cash credit in the names of four members of the group for the year 1995-96. During the course of block assessment proceedings, the assessee company failed to explain the cash credits in the names of three other members of the group and admitted non-accountal of the said deposits in the cash book of the company. Thus, the assessing officer treated total peak investment in the names of the three persons as unexplained credit of the assessee. The unexplained credit of the assessee itself was however not taken into consideration resulting in undercharge of tax of Rs. 26 lakh and non-levy of surcharge of Rs. 3.91 lakh.

(iv) Similarly, in Assam, Haryana, Punjab, Chandigarh (UT), Bihar, Karnataka, Andhra Pradesh, Madhya Pradesh, Orissa and Rajasthan in respect of 86 assesseees there was underassessment of income of Rs.2545.22 lakh involving short levy of tax of Rs.1548.19 lakh.

**Avoidable mistakes in computation of undisclosed income**

**3.1.8.5(a)** Errors during assessment and incorrect exhibition of arrears, incorrect adoption of figures, etc. in Maharashtra, Gujarat, Andhra Pradesh, Rajasthan, Uttar Pradesh, Orissa, West Bengal, Delhi, Karnataka and Tamil Nadu revealed underassessment of income of Rs.842.51 lakh and short levy of tax of Rs.606.22 lakh.

As an example, in West Bengal, CIT Central II charge, the block assessment of a domestic company for the block period 1.4.86 to 23.9.96 was completed on 31.12.97 at a total undisclosed income of RS. 6053.70 lakh with tax demand of Rs. 3904.64 lakh. Audit scrutiny revealed that aggregate total income for assessment year 1992-93 was computed at Rs. 54.42 lakh instead of Rs. 59.28 lakh while that for assessment year 1994-95 was computed at Rs. 350.54 lakh instead of Rs. 683.09 lakh. These, along with similar mistakes, resulted in underassessment of undisclosed income of Rs. 334.08 lakh with tax effect of Rs. 215.48 lakh.

**Non levy/ short levy/ excess levy of surcharge**

(b) As per the provisions of the respective Finance Acts, surcharge is to be levied @ 15 percent / 7.5 percent in addition to the tax @ 60 percent in the case of a domestic company whose taxable income exceeds Rs.75,000/-.

Audit review revealed non-levy of surcharge of Rs.3086.09 lakh in 177 cases, short levy of Rs.909.95 lakh in 10 cases in Maharashtra and West Bengal and also excess levy of Rs.19.90 lakh in 8 cases in Maharashtra and Orissa.

**Unintended benefit given to assessee**

**3.1.8.6(a)(I)** As per the provisions under Section 158BB(1) the undisclosed income of the block period should be computed on the basis of evidence found

as a result of search or requisition of books of accounts or documents and such other material or information as are available with the assessing officer.

However, in Maharashtra, in respect of three assessees, based on the evidence found during search, addition was made at the time of regular assessment and no cognizance of the same was taken while determining undisclosed income of the block period resulting in unintended benefit to the assessee, the rate of tax being lower in a regular assessment. The total under assessment works out to Rs.174.36 lakh with tax effect of Rs.115.37 lakh. One such case is detailed below:

During search and seizure operation evidence was gathered that the assessee possessed undisclosed bank accounts in a bank at London. The bank accounts were seized by the Directorate of Enforcement and an amount standing in the credit of the account was confiscated. While computing the undisclosed income the assessing officer considered only Rs. 171.03 lakh as undisclosed income and held that the balance was to be considered at the time of regular assessment. The specific reasons for not considering this amount was not recorded in the block assessment order. This resulted in unintended benefit of Rs. 113.92 lakh to the assessee.

**(II)** Under Section 158 BB (1) undisclosed income of the block period is to be computed in accordance with the provisions of Chapter IV. Further, the provisions of Sections 68, 69, 69A, 69B and 69C of the Income Tax Act have also to be applied in computing the undisclosed income/investments under Section 158BB(2). There are no specific provisions in Chapter XIV-B for any set off of undisclosed investments against the undisclosed income without establishing a close nexus. It was noticed that-

**(i)** In Maharashtra, in respect of 7 cases, set off was allowed which resulted in short levy of tax of Rs.90.69 lakh.

**(ii)** Similarly, in Andhra Pradesh, in 3 CIT charges, in 4 cases, such set off was allowed involving a short demand of tax of Rs.86.19 lakh.

**Incorrect  
computation of  
undisclosed  
income under  
section  
158BB(1)(c)**

**3.1.8.6(b)** Under section 158BB(1)(c) in computation of undisclosed income, in cases where the due date for filing of return of income under Section 139 had expired but no return of income was filed, the disclosed income for that previous year was to be taken as 'nil'. Thus no deduction is allowed and the entire income is treated as undisclosed.

**(i)** In Maharashtra, audit scrutiny revealed that in 5 cases the assessing officers failed to observe the above provisions resulting in underassessment and consequent short levy of tax of Rs.1508.69 lakh.

**(ii)** In Delhi charge, in 13 cases, non-observance of the provision in this regard had led to under assessment of income of Rs. 144.30 lakh thereby resulting in short levy of tax of Rs.86.77 lakh. The audit observations were not accepted



by the Department in 5 cases stating that the due date for filing of return had expired but the assessee had subsequently filed the return before completion of block assessment and the income as declared by the assessee was first included in the total income and after that the same had been reduced. The reply is not tenable as the provisions of the Act require that the disclosed income is to be taken as "nil" for the previous year for which the return had not been filed before the due date. Any different interpretation would take away the distinction between undisclosed and disclosed income and thus defeat the provision of law.

(iii) In Kerala, CIT Kochi charge, in the case of an assessee firm, a search was conducted on 8.2.96 when the returns for the assessment years 1993-94, 1994-95 and 1995-96 were not filed. Though the assessee admitted concealed income of Rs.242.71 lakh during the search, the Assessing Officer determined the concealed income on 25.3.97 at Rs.106.07 lakh which was the undisclosed income returned for the assessment year 1995-96. The income for assessment years 1993-94 and 1994-95 were also determined separately on 17.3.97 after scrutiny under Section 143(3) at Rs.69.36 lakh and Rs.86.21 lakh respectively. As the returns were filed after the search the entire undisclosed income should have been brought under the block assessment for the block period ending on 8.2.96. The completion of the assessments for the assessment years 1993-94 and 1994-95 under Section 143(3) thereby gave the assessee the benefit of a lower tax rate amounting to Rs.23.65 lakh. A similar mistake by the Assessing Officer in treating the undisclosed income for the assessment years 1993-94 and 1994-95 as not forming part of the block period ending on 8.2.96 in respect of another assessee of the same group resulted in income escaping assessment by Rs.45.60 lakh involving tax effect of Rs.6.93 lakh.

(iv) Similarly, in Madhya Pradesh, Punjab and Uttar Pradesh in respect of 111 assessee incorrect application of provision of this sub-clause resulted in underassessment of tax of Rs.141.92 lakh.

Salary/  
remuneration  
and interest  
paid to partners  
of firm not  
included in  
computing  
undisclosed  
income

**3.1.8.6(c)** According to the explanation (b) below Section 158BB(1) of the Income Tax Act, 1961, for the purpose of determination of undisclosed income of a firm, returned income and total income assessed for each of the previous years falling within the block period shall be the income determined before allowing deduction of salary, interest, commission, bonus or remuneration by whatever name called, provided that undisclosed income of the firm so determined shall not be chargeable to tax in the hands of the partners whether on allocation or on account of enhancement.

In Assam, while computing undisclosed income of 6 firms for block periods varying between 1 April 1985 and 17 December 1996 in the course of block assessments completed between September 1996 and December 1997, the assessing officers omitted to include the amount of salary, interest and remuneration aggregating to Rs.28.55 lakh paid to the partners in the previous years 1992-93 to 1995-96 which were allowed as deductions while completing the assessment of the respective previous years, resulting in underassessment



of undisclosed income of the identical amount with consequent short levy of tax of Rs.17.13 lakh.

**Irregular set off of losses**

**3.1.8.6(d)** Under the provisions of Section 158 BB(4) of the Income Tax Act, 1961, losses brought forward from the previous years under Chapter VI or unabsorbed depreciation under sub-section (2) of Section 32 shall not be set off against the undisclosed income determined for the block period.

(i) In Uttar Pradesh, it was noticed that in 6 cases involving Rs.43.65 lakh, in contravention of the above provision of the Act, the losses shown in different assessment years were adjusted against the undisclosed income of the relevant years. Thus, irregular adjustment of losses of Rs.43.65 lakh resulted in under charge of tax amounting to Rs.28.71 lakh (including Rs.2.53 lakh surcharge).

(ii) Similarly, in Orissa and West Bengal, in 2 cases, incorrect set off resulted in short levy of tax of Rs.4.65 lakh.

(iii) In Assam, the block assessment of a domestic company of a group of assessee for the block period 1985-86 to 13 September 1995 was completed in September 1996. In course of audit scrutiny it was noticed that unabsorbed depreciation aggregating Rs.22.44 lakh was set off from income of previous years 1991-92 to 1994-95 and allowed in summary/scrutiny assessments for the relevant assessment years from 1992-93 to 1995-96. But while computing undisclosed income of the assessee company for the block period 1985-86 to 13 September 1995 the assessing officer omitted to include the unabsorbed depreciation allowed in assessment in different previous years for determination of undisclosed income for the block period resulting in underassessment of income of Rs.22.44 lakh involving short levy of tax of Rs.15.48 lakh.

**Incorrect allowance of Chapter VI-A deductions**

**3.1.8.6(e)** The explanation to Section 158BB provides that for determination of undisclosed income the total income or loss shall be computed in accordance with the provisions of Chapter IV (Section 14 to 59). In view of this no deductions under Chapter VIA were to be allowed.

(i) In Mumbai, audit scrutiny revealed that in 5 cases undisclosed income was computed after allowing deductions under Chapter VIA which resulted in underassessment of undisclosed income of Rs.1023.77 lakh involving short levy of tax of Rs.702.31 lakh.

(ii) In Madhya Pradesh, Orissa and Uttar Pradesh, in 42 cases, incorrect allowance of Chapter VIA deduction resulted in underassessment of income of Rs.76.62 lakh involving tax effect of Rs.51.11 lakh.

**Provisions of Section 158 BD not invoked**

**3.1.8.6(f)** As per provisions of Section 158 BD of the Income Tax Act, 1961 where the assessing officer is satisfied that any undisclosed income belongs to any person other than the person in respect of whom the search was made



under section 132 or where books of account or other documents or any assets were requisitioned under section 132A, then the books of accounts, 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 Chapter XIV B shall apply accordingly.

Non-utilisation of the special power entrusted in this regard in block assessment and consequent loss of revenue are detailed below:

(i) In Gujarat, it was observed that in assessment of 11 group cases material relating to 100 assesseees having estimated income of Rs.1302.95 lakh (as per appraisal report) was yet to be transferred (June 1999) even though group cases were completed during September 1996 to February 1998. This resulted in non-assessment of these cases and consequent loss of revenue.

(ii) In Delhi charge, in the course of search at the residence of an individual, evidence was found which established that sale consideration of property was higher than that recorded in the books of the individual and the individual himself declared out of books payment of Rs.19.38 lakh for acquisition of the property. Additional Director of Income Tax (Inv.) in June 1996 directed that there was a clear case for initiating proceedings as per provisions of section 158BD of Income Tax Act, 1961 against the two individuals who had sold the property. These cases were proposed to be centralised with D.C. Spl. Range 8. Audit scrutiny, however, revealed that the cases of the sellers of the property were neither centralised nor was any action taken under Section 158BD of the Act with the result that undisclosed income of Rs.19.38 lakh involving tax effect of Rs.11.63 lakh in the hands of the sellers remained unassessed.

(iii) In Tamil Nadu, in 4 CIT charges, in case of 4 assesseees, audit scrutiny revealed that action under Section 158BD had not been taken by the Assessing Officer though the details of escapement of income in such cases were available in records, which resulted in non-levy of tax of Rs.201.40 lakh. In another case, in the appraisal report dated 12.8.96, the Assistant Director (Inv.) Unit II, Coimbatore had stated that a separate report in the name of the person from whom the land had been purchased would be sent. Based on the appraisal report and the assessment order, the sale value of land was determined at Rs.179.20 lakh. However, due to non-furnishing of a supplementary appraisal report, notice under Section 158BD could not be issued to the seller of the land as a result of which capital gains escaped assessment in addition to tax on undisclosed income in the hands of the seller.

(iv) In Haryana, Chandigarh (UT), Madhya Pradesh, Andhra Pradesh, Rajasthan, Punjab and Karnataka in the block assessments of 43 persons, completed between July 1996 and May 1998, non-furnishing of information in respect of 80 other persons to the concerned assessing officers in other states resulted in underassessment of income of Rs.566.93 lakh having tax effect of Rs.185.18 lakh.



**Non-completion  
of block  
assessment  
within the  
stipulated  
period**

**3.1.8.6(g)** As per Section 158BE the assessment order under Section 158BC should be passed within one year from the end of the month in which the last authorisation for search under Section 132 or for requisition under Section 132A in the case of an assessee was executed. For the search cases conducted on or after 1.1.97 the above limitation period is extended upto 2 years.

(i) In Maharashtra, in the case of one assessee group search was conducted from 12.12.95 to 15.1.96 and accordingly the assessment was required to be completed by 31.1.1997. However, it was seen that block assessment had not been completed till the date of audit (January 1998). Thus the assessment has become time barred and may lead to loss of revenue. The amount of undisclosed income involved in the case is more than Rs.182 crore.

On this being pointed out in audit the department stated that since panchnama was not drawn the objection appears to be incorrect. The reply is not acceptable for the reason that in the appraisal report it was clearly mentioned that the assessee was covered by the search under Section 158BA.

(ii) In Delhi charge, in 2 cases, search was completed on 24.8.95 and the block assessment should have been completed by 31.8.1996, whereas the block assessments were completed on 30.9.1996 at a total undisclosed income of Rs.113.63 lakh and demand for Rs.68.18 lakh was raised. Thus, the assessments were hit by limitation.

(iii) In Chandigarh UT, the search in the case of an individual was completed on 17 July 1995 and the block assessment was completed on 28 October 1996 instead of within the last date of 31 July 1996. The delayed assessment would result in a revenue loss of Rs.83.98 lakh as the assessee had also contested the assessment having become time barred by limitation.

(iv) In Karnataka, CIT Panaji charge, a search was conducted from 16.10.96 to 20.10.96 in the premises of an individual and five other members of his family. Block assessments were concluded on 31.12.97 at an undisclosed income of Rs. 84.33 lakh with tax effect of Rs. 50.60 lakh. All the assessee went in appeal to the ITAT Pune Bench against the assessment orders on several issues, amongst which one was that the assessments were barred by limitation as the last date for completion was 31.10.97. The ITAT held that the time limit for completion was 31.10.97 and hence all the assessments were time-barred. The Tribunal's orders were given effect to and the tax demand of Rs. 50.60 lakh was reduced after cancelling all the assessments.

(v) Similarly, in Assam and Orissa in two time-barred cases there was loss of revenue of Rs. 32.65 lakh.

Thus, it is evident from the above that the effects of the search operations are either being diluted due to delayed completion of block assessment



proceedings or are totally negated due to cases becoming time barred thereby leading to the loss of revenue.

**Interest and penalties not levied**

**3.1.8.7(a)** As per the provisions of Section 158BH all other provisions of the Income Tax Act will apply to assessments made under Chapter XIV B.

Section 269SS of the Income Tax Act provides that after 30.6.1984 no person shall take or accept from any other person any loan or deposit otherwise than by an account payee cheque or account payee bank draft if the amount of such loan or deposit is twenty thousand rupees or more. Any person contravening these provisions without reasonable cause is liable to be penalised under section 271D for penalty a sum equal to the amount of loan or deposit.

(i) In Gujarat, in respect of six assessee's loan in excess of Rs.20,000/- was paid/received in cash out of unaccounted income which contravened the provisions referred to above. The assessee's were therefore liable to pay penalty of equal amount of loan paid/received by them. Total amount of penalty leviable worked out to Rs.541.90 lakh.

(ii) Similarly, in West Bengal CIT VI charge, neither did the assessing officer initiate any proceedings nor did he record any reason for non-initiation of the same against an assessee company for receiving loan instalments exceeding Rs.20,000/- in cash from 2 parties amounting to Rs.2.90 lakh resulting in non-levy of penalty of Rs.2.90 lakh.

(iii) In Maharashtra in the case of an assessee under CIT Nagpur charge penalty of Rs.20 lakh on this account was not levied.

**Interest for delay in payment of tax demand**

**3.1.8.7(b)** Under the Income Tax Act, 1961, as amended from 1 April 1989, any demand for tax should be paid by an assessee within thirty days of service of notice of the relevant demand. Failure to do so would attract interest at one and one half per cent per month or part thereof from 1 April 1989 from the date of default till actual payment. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demand. Further instructions were issued in June 1991 that demand for such interest should be raised before 30 April on the balance of demand due from the assessee as on 31 March of the year.

(i) In West Bengal, Calcutta, in 4 cases, there was non-levy of interest of Rs.14.91 lakh. Also in 4 cases, interest calculations were not made and demand notices were not issued by 30 April. The tax effect involved was Rs.76.10 lakh.

(ii) In Uttar Pradesh, in 8 CIT charges for the period 1995-96 to 1998-99 in respect of block assessment, non-exhibition of interest of Rs.704.48 lakh on an arrear demand of tax of Rs.2897.26 lakh accrued on undisclosed income as per CBDT's instruction was pointed out in audit. The department replied that



interest would be charged after the recovery of tax. The reply is not acceptable as the interest was neither calculated/levied nor was demand raised against the various assessees as per instructions.

(iii) Similarly, in Delhi, Andhra Pradesh, Bihar, Orissa, Karnataka and Maharashtra in 204 cases, non-levy of interest on this account was to the extent of Rs. 909.33 lakh.

**Excess levy  
of interest**

**3.1.8.7(c)** As per provisions under Section 158 BFA(1) an assessee is liable to pay per month or part of a month for the period of default simple interest of 2 per cent of the tax on undisclosed income determined in respect of search initiated on or after 1 January 1997 where the return is not furnished or furnished after the expiry of the specified date.

In Maharashtra, CIT Nagpur charge, in the case of an assessee individual, interest of Rs.109.81 lakh under Section 158 BFA(1) was erroneously levied even though the search operation was concluded prior to 1 January 1997.

**Ineffective  
search and  
assessment**

**3.1.8.8(a)** Audit review revealed that in the following cases search operations were not conducted thoroughly and assessments were ineffective as well.

(i) In Tamil Nadu, an assessee who was the spouse/daughter-in-law of the persons in whose names the search authorisation had been issued, was also staying with them. No undisclosed income had been noticed by the assessing officer while completing the block assessment in her case on 23.12.97. However, as per the details furnished by the assessee, in a letter dated 17.3.98, she had declared a sum of Rs.33.08 lakh under VDIS 1997, paid tax of Rs.9.93 lakh at 30 percent and obtained the certificate under Section 68(2) from the Commissioner TN IV, Chennai. The ineffective search and seizure operation conducted and the block assessment completed thus resulted in short levy of tax of Rs.9.93 lakh.

(ii) In another case, based on the search and seizure operations conducted under Section 132 on 31.08.1995 in the residence of a group of assessee, the block assessments were completed on 31.08.1996 in respect of all the family members, who were existing assessee. The regular assessments had been completed upto assessment year 1993-94. The assessee filed their returns belatedly for the assessment years 1994-95 and 1995-96. Hence all those returns were lodged with a remark that "considered in block assessment" and the income for assessment years 1994-95 and 1995-96 had been brought to tax in the block assessment. All the assessee filed appeals against the block assessments and the ITAT Chennai "B" Bench cancelled all the assessments on the ground that there were no jurisdiction over these assessee for completion of block assessments as the authorisation was not in their favour. The block assessments were cancelled in the revision order on 19.11.1997. The reference application was also rejected by ITAT. On the cancellation of block assessments, the regular returns were filed on 26.11.1997 and 28.11.1997. Since these returns were also belated no action was taken for delay. The omission to re-open the assessments and to complete the



assessment in normal course on the cancellation of block assessments by ITAT resulted in non-levy of tax of Rs.61.98 lakh.

(iii) In Karnataka, search and seizure operations were initiated in respect of a group of assesseees consisting of six individuals, three firms and a company all engaged in timber business. Warrants of search were however issued only in the case of two individual assesseees. In response to notices issued all the assesseees filed 'Nil' returns and the assessments were completed on the same day in March 1997. Against the total undisclosed income of Rs. 967.35 lakh estimated by the Investigation wing the income assessed in the block assessments were for Rs. 103.57 lakh only. These assessments were appealed against and the ITAT cancelled all the assessments on several grounds which inter alia included that no warrants of search had been issued and hence the block assessments were uncalled for and further the assessments were time barred. Thus, the entire search operations were rendered infructuous firstly on account of the assessing officer's findings that most of the additions suggested by the Investigation wing were not tenable and secondly, on account of the Tribunal holding that even the additions considered by the assessing officer were unwarranted.

**Non-consideration  
of returns/ items  
in the returns**

**3.1.8.8(b)(i)** Contrary to the provision of the Act, in Uttar Pradesh in 24 search cases (19 cases of CIT Lucknow charge and 5 in CIT Meerut charge) the definition of block period was not adhered to. The period ignored from the block assessment ranged between 2 years and 9 years. It was noticed that in all such cases, the details of income including undisclosed income and the assessed/returned income were neither furnished by the assesseees nor called for and considered by the assessing officers while completing the block assessment. In the absence of these details, the undisclosed income for the ignored period, if any, could not be worked out. On being pointed in audit, it was stated by the department that these periods were ignored in view of CBDT Circular No.717 of August 1995. The reply is not relevant as the circular does not restrict submission/calling for returns.

(ii) In another case in CIT Agra charge it was noticed that as per the appraisal report, the notices under Section 158BC/BD were issued to the concerned assesseees. In response, the assesseees filed their returns in the prescribed form and declared their undisclosed income but the assessing officer, without scrutinising the returns and relevant documents filed/dropped the assessment proceedings in 123 cases, out of which 5 cases were such in which the assessee had shown undisclosed income. Further, no requests had been made by the assesseees to drop the proceedings. A scrutiny of these five cases in Uttar Pradesh, Agra charge, revealed undisclosed income of Rs.14.26 lakh left to be assessed involving tax effect of Rs.8.87 lakh.

**Non-consideration  
of panchnama**

**3.1.8.8(c)** In CIT Bhubaneswar, Orissa charge, the value of various assets e.g. bonds, shares, ULIP etc. was worked out to Rs. 3.44 lakh in the panchnama (list of articles seized). However, neither did the investigating officer include the same in the appraisal report nor did the assessing officer refer to the seized documents while completing the block assessment. Omission in both the



stages resulted in loss of revenue of Rs.2.06 lakh. Moreover, though the list of inventory of gold ornaments comprising nine items was found to have been indicated in the panchnama and kept under prohibitory orders for valuation purpose, neither did the assessing officer call for the valuation report nor was the source of investment discussed in the assessment order while completing the block assessment.

**Defective assessments which did not stand the test of appeal**

**3.1.8.8(d)(i)** In Mumbai, CIT Nagpur charge, in the case of a group of assesseees as a result of search operation conducted in July 1995, undisclosed income of Rs.438.03 lakh was computed ex-parte on 31.7.1996. On the assessee's appeal, the assessment was set aside by ITAT on the ground that the minimum statutory period of 15 days for filing the return was not given and copies of relevant seized books of accounts were also not made available with the result that demand of Rs.262.82 lakh could not be raised.

**(ii)** In Delhi, a search under Section 132(1) the Income Tax Act, 1961, was conducted on the premises of an assessee on 22.11.1996. Accordingly the block assessment was required to be completed by 30.11.1997. However, the notice under Section 158BC for filing of the return of the block period was issued as late as on 21.11.1997. The statutory time allowed for filing the return for the block period is 'not less than fifteen days'. As such the notice issued by the assessing officer was hit by limitation and bad in law. Any assessment made in pursuance thereof was likely to be quashed in appeal. Assessment at 'Nil' undisclosed income was made to cover up the delay in issue of notice under Section 158 BC.

**Underassessment due to incorrect application of directions issued by Commissioners**

**3.1.9** According to Section 158 BG no order of block assessment shall be passed without the approval of the Commissioner (before 1.1.1997) and Joint Commissioner/Joint Director from 1.1.97 where action under Section 132 was taken. A review of draft assessment orders prepared and approvals given by the competent authority in 8 cases in 3 CITs charges in Tamil Nadu revealed short levy of Rs.86.06 lakh due to incorrect directions by the CIT or their incorrect application by the assessing officers.

In an illustrative case, as per the assessee's acceptance, only 50 percent of the sales was admitted in the books and shortage of gold and silver of Rs.20.65 lakh was proposed for addition as per appraisal report. The CIT, Trichy (formerly TN V) directed that the sale proceeds of deficit stock had been utilised for undisclosed investment and hence telescoping method should be allowed. It was observed in audit that since the shortage was computed with reference to the books of account, unaccounted sales should be added to sales turnover. The deletion in place of addition had resulted in short-levy of tax of Rs. 24.78 lakh.

**Appeals preferred by the assesseees**

**3.1.10** The position in respect of appellate proceedings is shown below.



## Statement showing position of appeal cases

Year	No. of cases	Amount of income determined in block assessment	Tax effect (Rs. in lakh)	No. of cases in which appeal filed	No. of appeals pending	Relief allowed		Balance amount of undisclosed income sustained	Tax Rs. in effect (lakh)
						No. of cases	Amount		
1995-96 (from 1.7.1999)	50	633.38	379.72	12	12	-	-	-	-
1996-97	4950	248492.43	147515.97	2111	1898	197	8696.81	121395.25	70701.38
1997-98	4969	359646.87	226387.47	2177	2030	139	32261.34	101641.10	62065.68
1998-99 (upto December 1999)	852	29573.12	18138.74	354	350	4	4.47	2673.61	1871.39

Analysis of the above figures reveals that out of a total number of 10821 block assessment cases finalised during the period under review, in 43 percent of the cases appeals were preferred. Relief was allowed in 7.30 percent cases. Percentage of relief allowed on the amounts in appeal varied from 0.17 percent to 24.09 percent. The high pendency of cases in appeal (92.39 percent) however defeats one of the primary objectives behind the introduction of Chapter XIVB namely, bringing the undisclosed income to tax expeditiously.

(i) In West Bengal, out of the total number of 716 block assessments reviewed, appeals were preferred in 261 cases out of which appeals were pending in 210 cases. In 51 cases relief of Rs.21068.45 lakh was allowed. The undisclosed income sustained in appeal amounted to Rs.37197.22 lakh involving tax effect of Rs.22318.33 lakh. However, in course of review it was found that in six cases huge amount of relief was allowed in appeal and in two cases the entire amount of concealed income assessed was reduced to nil as shown in table below:

Sl.No.	Year	CIT's charge	Undisclosed income assessed	Relief allowed	(Rs. in lakh)	
					Tax effect on sustained amount	Interst leviable u/s 220(2)
1.	1988-99	CIT (C) II, Calcutta	99,52,270	62,45,502	22,24,061	
2.	1996-97	-do-	8,69,733	8,68,188	930	135
3.	1997-98	-do-	18,96,291	11,85,821	4,26,282	89,330
4.	1996-97	CIT WB VI	3,72,35,940	3,72,34,490	870	52
5.	1996-97	CIT WB XI	1,08,90,700	1,08,50,766	27,554	
6.	1996-97	-do-	1,00,15,040	95,44,013	2,82,616	
7.	1997-98	CIT (C) II, Calcutta	14,74,860	14,74,860	Nil	
8.	1997-98	-do-	9,01,180	9,01,180	Nil	

(ii) The following are the particulars of appellate proceedings in respect of block assessment cases concluded by the ranges/circles test-checked in Madhya Pradesh during 1995-96 to 1998-99.

Total No. of Block assessment		No. of cases in which appeals were filed		No. of cases decided in appeal				
No. of cases	Amount	No. of cases	Amount	Total cases	Total income	Income deleted	Income set aside	Income sustained
565	7366.42	415	7202.17	47	586.78	218.73	214.28	153.77

The above information indicates that as against income of Rs.7366.42 lakh assessed in 565 cases (142 cases being of nil income), the assessee have gone in appeal against income of Rs.7202.17 lakh (98 percent) in 415 cases. Further, in 47 cases where appeals were decided, out of assessed income of

Rs.586.78 lakh, income of Rs.218.73 lakh was deleted in 37 cases and income of Rs.214.28 lakh was set aside in 10 cases. Thus, the income sustained in appeal in 37 cases was only Rs.153.77 lakh (41 percent) as against assessed income of Rs.372.50 lakh in these cases.

From the above details it is evident that while determining the undisclosed income after search, the accounts, documents, other details and information available with the assessing officer were not properly examined/scrutinised.

**Capital gains not assessed**

**3.1.11** Under the Income Tax Act, 1961, any profits and gains arising from the transfer of a capital asset are chargeable to tax under the head 'capital gains' except in certain specified cases.

In the following cases in determining the unexplained investment, the assessing officers omitted to consider the capital gains tax arising as a result of transfer.

CIT charge	No. of assessees	Date of assessment	Amount involved	Tax effect (Rs. in lakh)	Remarks
Haryana	2	30 August 1996	3.75	2.25	Short term capital gain not considered.
		28 June 1996	11.52	6.91	Long term capital gain not considered..
CIT Kochi, Kerala	1	6 January 1998	12.82	2.56	ITAT's direction to charge capital gains tax @20% instead of 60% was omitted to be considered.

**Omission to initiate Wealth Tax proceedings**

**3.1.12** Persons having taxable wealth are required to file Wealth Tax returns and pay the tax thereon. If, on the basis of any assessment completed under the Income Tax Act the wealth position of the assessee increases, simultaneous action has to be considered for levy of wealth tax also.

(i) In Chandigarh (UT), though an assessee had immovable and movable assets of Rs.44.67 lakh and block assessment was completed in July 1997 no wealth tax proceedings were initiated even though a footnote to this effect was recorded in the assessment order.

(ii) In Punjab, 2 assesseees of an assessee group had not filed their wealth tax returns for 1995-96 to 1996-97 although amounts of Rs.75.00 lakh and Rs.52.77 lakh were lying in their respective balance sheets.

(iii) Similarly, in Tamil Nadu, Haryana, West Bengal, Bihar, Maharashtra and Uttar Pradesh, in the case of 30 assesseees, non-initiation of wealth tax proceedings, though eligible assets under Wealth Tax Act were included in determining the undisclosed income for the block assessment, resulted in non-levy of wealth tax to the extent of Rs.49.28 lakh.

**Omission to initiate Gift Tax proceedings**

**3.1.13** Under the Gift Tax Act, 1958, gift means the transfer by one person to another of any existing movable or immovable property made voluntarily and without any consideration in money or money's worth.

(i) In Tamil Nadu, in 5 CIT charges, in case of 16 assesseees, scrutiny of block assessment cases revealed that though the investments were brought to tax,



simultaneous action was not initiated to levy gift tax as the investments were made by the assesseees in the names of their family members and relatives in landed properties and shares without any consideration. The omission resulted in non-levy of gift tax of Rs.101.13 lakh.

(ii) Similarly, in Karnataka, Punjab, Chandigarh (UT), Andhra Pradesh and Haryana in 14 cases, non-initiation of gift tax proceedings towards gift and deemed gift resulted in non-levy of tax of Rs.74.81 lakh.

**Non-maintenance of prescribed registers and delay in submission of quarterly statements**

**3.1.14(i)** As per instruction No. 1927 issued by the CBDT in July 1995, the assessing officers handling block assessments are required to maintain separate registers (Blue Book and Demand and Collection Register) in prescribed form regarding pendency and disposal of block assessments as also the tax demand raised and collected in respect thereof. In Madhya Pradesh, it was however, noticed that out of 24 units test-checked, the Blue Book in prescribed form was not maintained by 8 units and the Demand and Collection Register in prescribed form by 9 units. Such Registers are not maintained in Orissa in CIT Bhubaneswar and CIT Sambalpur charges also.

(ii) As per instructions issued by the Board in August 1995, a quarterly progress report regarding 'Block search assessments' in the prescribed form was required to be furnished by each assessing officer handling block assessments to the Chief Commissioners of Income Tax by 10<sup>th</sup> of the month following the end of the respective quarter for their onward transmission to the CBDT by the 20<sup>th</sup> of such month.

In Madhya Pradesh, test check of 126 quarterly progress reports pertaining to the period June 1996 to March 1999 revealed that 74 reports were furnished by the assessing officers with delays ranging upto 84 days.

**Lack of coordination between various agencies**

**3.1.15** As per departmental instructions, the Investigating wing of the department as well as the assessing officers should co-ordinate/liase with other departments and enforcement agencies, viz. Revenue Intelligence, Enforcement Directorate, Customs and Central Excise Department, Sales Tax Department etc.

(i) In Madhya Pradesh, Bhopal charge, the block assessment of an assessee firm was completed in October 1996 and the income was assessed at Rs.22.87 lakh. While completing the block assessment, the assessing officer estimated unaccounted sales of electrical goods etc. during the block period 1985-86 to 25.9.1995 to be Rs.114.34 lakh and therefore gross profit at the rate of 20 percent which works out to Rs.22.87 lakh on such unaccounted sales was determined to be income of the block period. In this case, it is implied that the assessee firm would have also not paid sales tax on these unaccounted sales, but this information was not passed on to the sales tax authorities in the state.

(ii) In Maharashtra, in one case the facts regarding suppressed sale of Rs.272.77 lakh was not intimated to the Sales Tax Authorities.



**Non-initiation  
of prosecution**

**3.1.16** While the new scheme of block assessment provided immunity from penalties, it does not provide for immunity against prosecution.

In Punjab, Jalandhar charge, the search on an assessee was conducted on 10.10.95. The block assessment for the block period 1.4.85 to 10.10.95 was completed in October 1996. Audit scrutiny revealed that as per the CIT's letter dated November 1996, prosecution against the assessee was to be initiated but the assessing officer did not comply with the direction.

**Other points  
of interest-**

**Avoidable loss  
of revenue**

**3.1.17(i)** Under Section 132(1) of the Income Tax Act, 1961, if the authorised officer has reason to believe that any person is in possession of any undisclosed income or property he may search such places. Further, where it is not possible or practicable to take physical possession of any valuable article or thing to remove it to a safe place due to its volume, weight or other physical characteristic or due to its being of a dangerous nature, the authorised officer may serve an order, on the owner or the person who is in immediate possession or control thereof, not to remove the same from the premises.

In Uttar Pradesh, under CIT Bareilly charge, information of unloading of suspected unaccounted goods like dry fruits, brass jali, steel chakka, plastic goods etc. of certain persons from two railway wagons at Moradabad Railway station were received. Restraint order for those goods was issued to the railway authorities under Section 132(3) of the Act. The inventories were prepared on 18.9.96. Action to identify the persons to whom these articles belonged were made by the Departments of Railways and Income Tax, but no purpose was served as the names of the persons on the railway records were fake. As there were no claimant for these goods, these were left in the custody of the Railway authorities. In the appraisal report, a suggestion to auction these goods was made but no such auction could be held by the department (April 1999).

Meanwhile, ex parte assessments under Section 158BC against 58 assesseees whose names and addresses were fake were completed in September 1997 and total demand of Rs.33.40 lakh was raised. The matter regarding auction of the goods, in the possession Railway authorities, were referred to Tax Recovery Officer (TRO) of the department. On action being initiated by the TRO, the railway authorities demanded demurrage amounting to Rs.20.36 lakh upto 4 March 1998 which was raised to Rs.34.08 lakh as on 31 March, 1999. As a result, the seized goods were lying (April 1999) with the railway authorities while demurrage charge was increasing and the commodities were also losing their quality and value with the passage of time. Neither did the Income Tax Department take timely action regarding auction as suggested in the appraisal report nor was the matter taken up with the higher authorities of Railway department to settle the matter in the interest of revenue and to avoid further deterioration of the goods.

**Declaration under  
VDIS 1997 due to  
delay in initiating  
action**

**(ii)** In Karnataka, a search initiated by ADIT (Inv.) Erode, Tamil Nadu on 20.2.97 was completed on 15.4.97. The group of assesseees was centralised and



jurisdiction was placed with an assessing officer in Karnataka as notified by CIT Coimbatore on 27.8.97. Though the appraisal report was prepared in April 1997, notice under section 158 BC was issued on 14.10.97 in the case of 2 assesseees and notices under Section 158 BD were issued on 4 other assesseees only in 16 January 1998 who, in the meanwhile in December 1997, declared Rs.611 lakh and paid taxes under VDIS, 1997. These 4 assesseees therefore derived unintended benefit of Rs.183 lakh due to delay in taking follow up action and frustrated the whole search and seizure operations. No apparent reasons were forthcoming from records as to why the case was notified to a charge in Karnataka when all the assesseees were earlier assessed in Tamil Nadu only and the appraisal report did not indicate any business connection or other wise with any person in Karnataka.

Similarly, in the case of another 3 assessee individuals notices were issued under Section 158BD on 20.8.97 and the assesseees filed 'nil' income returns. The assessments were completed in March 1998 accepting the income returned. The assesseees declared Rs.43.60 lakh under VDIS in December 1997. The income declared under VDIS unearthed fell within the prohibitory clause of Section 64(2)(ii) of the Finance Act, 1997. This has resulted in unintended benefit in the form of lesser levy of tax by Rs.13.08 lakh.

**Lacuna in the Act**

**3.1.18(A)** As per the provisions of the Act as it stood till 1.1.97 a person against whom search was conducted would enjoy complete immunity from the levy of interest under section 234 A, 234B and 234C and penalty under section 271(1)(C). In other words, the assessee would be charged to tax at a flat rate of 60% inclusive of all penalties and interest. Thus, a person in whose case the Department has conducted a search may have been put in a relatively advantageous position compared to an assessee in whose case the Department initiates action under the normal provisions of the Act to bring to tax income not disclosed or which has escaped assessment as the tax liability including interest and penalty in the latter case generally works out to a much higher figure than the amount of tax calculated on the undisclosed income at the flat rate of 60 per cent in the case of search. The Income Tax (Amendment) Act, 1997 inserted a new section 158BFA(2) empowering the assessing officer to levy penalty under Section 271(1)(C) in respect of the undisclosed income. However, as per the proviso to this section, no penalty under Section 271(1)(C) will be levied if the assessee had furnished a return, had paid the tax payable on the basis of the return, had furnished evidence of tax paid alongwith the return and had not filed an appeal against the assessment of that part of income which was shown in the return. Therefore, even after issue of the Amendment Act if a person filed the return within the period specified by the assessing officer in the notice and had shown the undisclosed income correctly therein and also paid the self assessment tax, the liability on him would be lower in comparison to a normal levy in a conventional case. The Amendment does not contain any provision to remedy this situation.

**(B)** Further, certain provisions under Chapter XIV-B remain ambiguous or have become redundant due to subsequent amendments to the Act.

- The provisions of Chapter XIV B do not specify whether an assessee would be subjected to tax @ 60% in respect of long-term capital gains, or whether the rate of 20% as leviable under the normal provisions would be attracted.
- No time limit has been fixed under Section 158BD for handing over books of accounts, documents, etc. to the assessing officer of the other persons as a result of which completion of block assessments are either delayed or proceedings are not initiated at all. Necessary legislation should be introduced to ensure that assessments of other persons are also completed expeditiously to vindicate the results of the search operations.



**3.2 Review on Computerisation in the Income Tax Department**

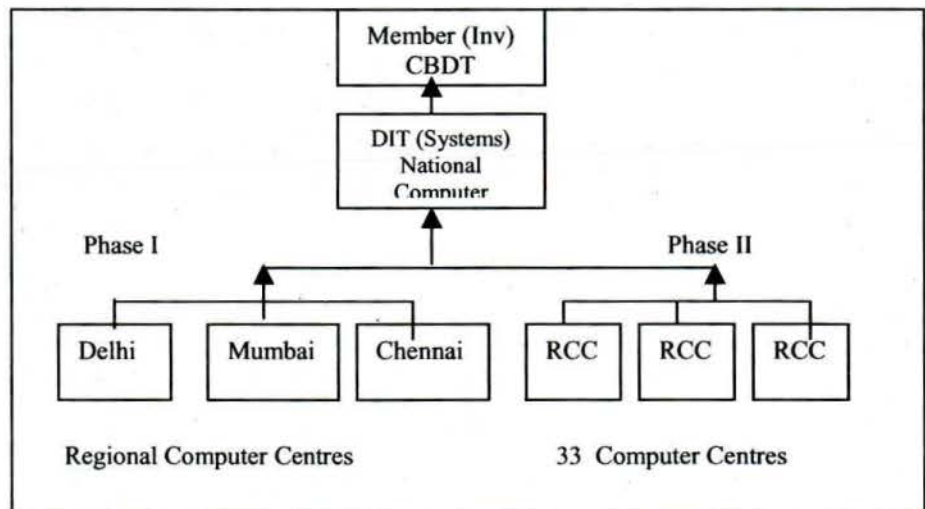
**Introduction**

**3.2.1** With a view to improve the efficiency and effectiveness of Direct Taxes administration and to create a database on its various aspects, a Comprehensive Computerisation programme was approved by the Government in October 1993. In accordance with the programme computerisation was taken up on a three-tier system. At the apex level, a National Computer Centre (NCC) having large computers to maintain databases and to execute processing work of a global nature was envisaged. At the second level, 36 Regional Computer Centres (RCCs) were to be established across the country equipped with large computers to maintain regional databases and to cater to regional processing needs. All the RCCs were to be connected to the NCC through high speed data communication lines. At the third level, computers were to be installed in the rooms of all the assessing officers and connected with the respective RCC for data/information exchange, in a phased manner. Accordingly, in the first phase, Delhi, Mumbai and Chennai City regions were taken up and provided with state-of-the-art hardware and software connected with the RCC through inter-city and intra-city linkages. After stabilising of the computer systems in the 3 RCCs, computerisation of 33 other centres covering the rest of the country was taken up in the second phase.

**Organisational setup**

**3.2.2** The Directorate of Income Tax (Systems) {DIT(S)}, New Delhi, was made the main nodal authority for overall planning and implementation of the computerisation programme including procurement of hardware/ software and development/ installation of application software. In addition, at each Regional Computer Centre the Chief Commissioner of Income Tax (CCIT) was required to monitor and co-ordinate with the DIT(S). He would be assisted by the CIT (Computer Operations) who would monitor the functioning of the RCC.

The organisational set-up is diagrammatically represented below:



**Objectives of computerisation**

**3.2.3** The main objectives of the computerisation programme as approved by the Committee on Non-Plan Expenditure (CNE) were:

- (a) to improve the efficiency and effectiveness of tax administration;
- (b) to ensure timely availability and utilisation of information;
- (c) to reduce compliance burden on honest tax payers;
- (d) to enhance the equitable treatment of tax payers by income tax procedures;
- (e) to ensure better enforcement of tax laws;
- (f) to provide management with reliable and accurate information in time so as to assist them in tax planning and legislation and also in decision making;
- (g) to broaden the tax base ; and
- (h) to keep the cost of administration at an acceptable level over a period of time.

**Budget and Finance**

**3.2.4** The details of budget allocations for computerisation and the expenditure incurred for the period 1994-95 to 1998-99 are given below:

(Rupees in lakh)

Sl.No.	Year	Budget Estimates	Final Revised Estimates	Expenditure
1	1994-95	400	2855.00	2758.15
2	1995-96	500	694.11	665.26
3	1996-97	500	1000.00	944.69
4	1997-98	500	4020.50	4020.50
5	1998-99	1,500	3894.50	2066.28
Total		3400	12464.11	10454.88

It was seen that the budget estimates were revised in all the years. The percentage increase while revising the estimates ranged from 39 to 704 during the years 1994-95 to 1998-99. Total increase in the budget estimates to the expenditure incurred during the years 1994-95 to 1998-99 was 207 percent. This indicates that the estimates were unrealistic. No justification for these variations was furnished by the department.

**Scope of review**

**3.2.5** The review broadly covers two main aspects -- (i) procurement policy and (ii) the computerisation programme with reference to the objectives and its implementation.

**Audit methodology**

**3.2.6** With a view to examine the technical aspects of the computerisation programme which inter alia include a study of the conceptual plan, hardware, software and network sizing and the organisational aspects of the system, a team of IT professionals from IIT Delhi were engaged by C&AG as consultants in May 1999. Their findings have been incorporated in this report along with the audit findings based on scrutiny of records for the period April 1994 to March 1999 maintained at the Directorate of Income Tax (Systems), Delhi and other selected field offices.



**Highlights**

**3.2.7 Conceptual Plan**

The conceptual plan finalised for computerisation in the Income Tax Department grossly underestimated database sizing. The plan restricted itself to three major cities of Delhi, Mumbai and Chennai and failed to consider issues of expansion to 33 other centres. The plan also did not visualise the need for centralised PAN database.

[Para 3.2.8]

**Hardware evaluation**

None of the tenders, invited for procurement of hardwares matched the desired specifications and found to be under configured. Though the Systems requirements specification, required to be prepared before procurement of hardwares, was not finalised, the department placed the order in July 1994 on TISL for procurement of hardwares costing Rs. 1990 lakh without retendering.

[Para 3.2.9.1(i)]

An amount of Rs. 208.64 lakh included in the tender by M/s TISL as marketing expenses, overhead and local services was accepted by the department in contravention of Government norms. Other cases of avoidable expenditure of Rs. 41.59 lakh on procurement of hardware items were also noticed.

[Para 3.2.9.1(iii) and (v)]

As essential prerequisites such as installation sites and terminal banks were not in a state of readiness, the installation of the procured hardware was delayed by a period ranging from 3 to 26 months.

[Para 3.2.9.2(ii)]

Query processing was slow with response time for typical queries varying from 5 minutes to 40 minutes against the requirement of 3 to 5 seconds.

[Para 3.2.9.2(iv)]

**Software evaluation**

None of the application softwares developed by M/s. TCS was capable of utilising the data captured through OCR using bar code technology. This resulted in avoidable expenditure of Rs. 82.08 lakh for the data entry work got done by engaging outside vendors.

[Para 3.2.10.1(b)]

Tenders were invited in February 1994 for development and implementation of nine applications systems to be completed within six months. However the contract was awarded to M/s. TCS in October 1994 by allowing 24 months to develop and implement the application systems. Further, all the application systems except TAS and AIS, were installed after a delay ranging from 6 to 14 months beyond the extended period of 24 months resulting in delay in the whole process of implementation of computerisation programme.

[Para 3.2.10.1(f)]

Cases of avoidable expenditure of Rs.83.25 lakh were noticed on procurement of software items.

[Para 3.2.10.1(g)]

Though the response time in terms of query processing was included in the tender, the same was however ignored by M/s. TCS and the department accepted it as a non-critical parameter in assessing the performance of the vendor. The sizing estimates presented in the Software design document were also inadequate. Further, the hardware will be grossly inadequate once the system grows to its full potential. It was noticed that RCCs are already facing shortage of disk storage.

[Para 3.2.10.1(h) and (j)]

There was heavy shortfall in achieving the targets in respect of PAN allotment and migration of data to AIS in three metro cities as well as in the other 33 centres. There was also a delay in disposal of PAN grievances/complaint cases for more than a year. PAN cards were not designed to have security features as verification of particulars was neither prescribed nor got verified and particulars were accepted on the basis of self attestation

[Para 3.2.10.2(b)(i)]

Assessee Information System (AIS) was not properly designed taking into consideration the actual working of the department as a result of which serious bottlenecks occurred during its implementation.

[Para 3.2.10.2(b)(ii)]

Despite implementation of Tax Accounting System (TAS), there had been heavy short fall in processing of challans, inordinate delay in preparation and dispatch of detailed account by the CIT to ZAOs and in the generation of daily collection/refund register.

[Para 3.2.10.2(v)]

IRLA system was not fully operational as the other systems viz. PAN, TAS, AST and TDS were not stabilised. Other systems viz. EIS, MIS and RMS were also not operational for the main reason that the Personal Computers provided to AOs were not networked with the RCC/TBs.

[Para 3.2.10.2(vi) to (ix)]

#### Networking evaluation

Terminal banks could not be commissioned till July 1996 and the leased lines, which were to be operational before the end of March 1995, could be made operational after a delay ranging from 11 months to 32 months.

[Para 3.2.11.2(i)]

Networking of the entire system could not be made functional even after a period of more than two years from the receipt of hardware, resulting in delay in implementation of the entire programme.

[Para 3.2.11.2(ii)]



Though leased lines were frequently down for more than 96 percent of total time during 1996-97 to 1998-99, no proportionate adjustment from rent paid to MTNL was made. Cases of avoidable expenditure of Rs.19.27 lakh were also noticed in procurement of networking items.

[Para 3.2.11.2(iv) and (v)]

The state of networking is not adequate for on-line computing as was envisaged in the original conceptual document as also in SRS. There was no separate specification and design of either inter city or intra-city networks.

[Para 3.2.11.2(vi)]

### Training

M/s TATA IBM was awarded a contract in August 1997 to impart training for 1080 officers at a cost of Rs. 3.60 lakh. Though 890 Personal Computers allotted to these officers were installed in May/August 1997, only 541 officers could be trained till January 1999 due to less nomination of officers

[Para 3.2.12(a)]

Two contracts to impart training to 6620 officials at a cost of Rs.62.45 lakh were concluded with M/s TCS in March 1996 and December 1997 without inviting tenders. The facts, that the rates were based on the contract of 1994 for different training programme of development of application software and not for training of computer familiarisation, was not brought to the notice of the Ministry/Board.

[Para 3.2.12(c)]

### Evaluation of the conceptual plan

3.2.8 The genesis of the computerisation efforts in the Income Tax Department was based on a feasibility study conducted by M/s CMC Ltd. Subsequently, a working group was appointed whose recommendations gave rise to a conceptual plan for the information systems.

A study of the conceptual plan revealed that the exercise of identifying the processes to be computerized and architecture of the proposed solution is well documented and detailed. The following shortcomings were, however noticed in implementation of the conceptual plan:

- ◆ None of the projected milestones was realised in time. M/s Tata Consultancy Services (TCS) which committed to deliver the fully developed and tested software in 40 weeks took over 104 weeks to deliver all the modules.
- ◆ The working group report reckoned a certain database sizing. This was examined and it was noticed that the sizing was grossly underestimated with reference to database requirements.

*The Ministry replied that the estimate for the disk storage indicated in the working group report was based on actual data expected to be captured in flat files. The Ministry further informed that under RDBMS environment, disk capacity requirement was taken as four times of the actual data size and they provided 50 GB. They maintained, therefore, that the disk storage requirement given in the report of the working group was not underestimated.*

*This contention of the Ministry was verified by the technical consultant appointed by the C&AG who reported that the actual position of hardware disc storage was found to be 20 GB vis-à-vis the actual order placed for 25 GB for Delhi, Mumbai and Chennai. In Chennai the configuration was upgraded to 50 GB subsequently.*

- ◆ The issue of centralised versus decentralised operations was discussed in detail and "centralised" network processing at 36 locations was preferred over "totally decentralised" processing. The conceptual plan however limited itself to implementation at the three major cities of Delhi, Mumbai and Chennai. It did not discuss how its reach would be expanded to the 33 other centres. The conceptual plan did not mention that the expansion beyond the three cities would need its own conceptual plan using the experience gained and lessons learnt in the first phase of execution of the project.
- ◆ The role of National Computer Centre, as visualised in the conceptual plan, was that of development, testing, documentation and maintenance of application software. However, this role was expanded to include a greater role of integrating the operations in the office of the DIT(s).
- ◆ Neither the working group nor the Ministry also visualised the need for centralised PAN data base till the implementation of the first phase of the software system. Since the creation of central PAN database was implemented at a later date by the department, the sizing in all respects of database, network requirements have not been re-worked to give a reasonable response time.

Hardware  
evaluation

### 3.2.9.1 Specification, design and procurement phase

#### Phase I centres

Procurement  
of under-  
configured  
hardware -

(i) For procurement of hardware, a Technical Evaluation and Procurement Committee (TEPC) was set up by the Government in December 1993 which in turn set up a Technical Sub-Committee (TSC) to work out the specifications for hardware requirements, finalise the tender documents and conduct technical evaluation. The Systems Requirements Specification (SRS) was required to be finalised before tendering and procuring hardware. However, before finalisation of the SRS, open tenders for supply of hardware were invited in December 1993 against which bids from 11 vendors were received, out of which five solutions from four vendors were shortlisted for further evaluation.



The TSC conducted technical evaluation test on five shortlisted solutions of four vendors between May-June 1994. The evaluation was conducted on a set of benchmark programme around the ORACLE database and the requirement was projected as 25 transactions per second and response time of 10 seconds. None of the tenders matched the desired specifications and all the tenders were found to be under-configured. The TSC, however, recommended two solutions, namely (i) ES-9000/210 and (ii) RS-6000/590 offered by M/s Tata Information Systems Limited (TISL). The department finally selected RS 6000/590 system and placed the order on M/s. TISL in July, 1994 at a cost of Rs. 1990 lakh. Instead of procuring hardwares of under configured systems, retendering could have been done to procure the hardware of desired specification after finalisation of the SRS.

*The Ministry have accepted the observation regarding procurement of under-configured hardware. However, they stated that retendering was not done as the hardware was selected based on comparable performances of the shortlisted solutions in technical evaluation and it was expected that the performance of these systems would improve by about 30 percent once the solution is implemented in the client/server model.*

*The reply is, however, not satisfactory as the retendering was essential to procure the hardware of desired specification after finalisation of SRS.*

**Tender process vitiated**

(ii) Development of a large scale information system necessarily involves creation of the SRS as part of the standard procedure. The procedure followed by the TSC was to call for tenders and select the configuration that was best among the tenders. Adoption of this procedure led to selection of only one tenderer and rejection of the rest at technical evaluation stage. Having made the selection, the department followed the usual practice of not opening the commercial bids of rejected tenders at technical evaluation stage. Since commercial bid of only one vendor (M/s. TISL Ltd.) was opened, it is difficult to state whether the department obtained the most competitive rates.

*The Ministry replied that invitations for revised commercial bids clearly stated that the commercial bids of only technically shortlisted tenderers will be opened, and therefore tender process was not vitiated in any manner.*

*However, since none of the bids satisfied the tender specifications, technical shortlisting was irregular.*

**Inadmissible items**

(iii) It was further noticed that the commercial bid of M/s. TISL included an amount of Rs. 208.64 lakh towards marketing expenses, overhead recovery and local service charges. Marketing and other overhead expenses are not the items to be accepted under Government purchases. In highly technical purchases also, overhead expenses are not normally covered and paid by the purchaser, hence this change was avoidable.

**Lack of synchronizing of hardware purchase and software developments**

(iv) Further there was no coordination in procuring hardwares and developing the application systems. The contract provided for delivery of hardwares by

October 1994 and development of software application systems by November 1995. It was however, observed that the first machine was delivered around October 1994 and installed in January 1995 whereas out of the eight software application, the first was accepted and made operational in mid-1995. Given the obsolescence rate of hardware in the industry, the decision taken to procure hardware in advance was not a prudent one.

**Cases of avoidable expenditure**

(v) In addition, the following cases of avoidable expenditure amounting to Rs.41.59 lakh were noticed on procurement of hardware items:

1. M/s.TISL offered discount of 35.95 percent on the procurement of hardware items. The department, however, availed of only 30.92 percent resulting in a loss of Rs.9.35 lakh.

*The Ministry have accepted the audit observation.*

2. It was observed that the department excluded certain additional hardware items and computer accessories from the offer of M/s.TISL and reduced the value of these items in the order placed on the firm. However, the department failed to reduce the proportionate overhead/warranty charges necessitated due to reduction of these items in the value of the order resulting in loss of Rs. 14.29 lakh.

*The Ministry have accepted the audit observation.*

3. In December 1997, tenders were invited for upgradation of memory from 8MB to 16MB in respect of 740 PCs procured in October 1994 and for procurement of 2000 PCs. M/s. Siemens Ltd. and M/s. HCL Ltd. were found lowest in the bids but they did not accept the order for upgradation job due to complexities of mismatch of memory modules and accepted the orders for supply of PCs only. However, the department placed the order for upgradation job on M/s. TATA IBM which was found third lowest in the bids without invoking the clause for getting the work done at risk and cost of both the lowest firms resulting in loss of Rs. 5.55 lakh.

*The Ministry replied that it was desirable to place the order on M/s. Tata IBM from the maintenance point of view since the original systems were supplied and installed by them. However, they did not reply on their failure to invoke the clause for getting the job done at risk and cost of both the lowest firms.*

4. One OCR option file server PS 277 alongwith OCR image and two softwares were purchased from TISL in July 1994 at the cost of Rs. 5.00 lakh. However, the same was not found useful for department's work for want of training expertise and could not be utilised.

*The Ministry replied that OCR could not be used as the source documents, viz., Form 49A, Challan forms and tax returns, etc., required some*



*revisions and application software could not be implemented because of staff resistance.*

5. Modems were to be installed on the lease lines at MTNL end. The department however purchased 42 ASM-20 Modems from M/s. TISL in July 1994 without evaluation of actual needs of MTNL. However, actual requirement of modems was decided in June 1995 and 12 modems were also purchased in July 1995 from M/s. Motorola, which were cheaper by Rs.17,620 each in comparison to the earlier one. These modems could also not be put to use by December 1995 as the lease lines were not ready. Thus, haste in procurement of 42 modems resulted in avoidable expenditure of Rs. 7.40 lakh.

*The Ministry replied that 42 modems were installed and were used. Additional modems were also procured as per the requirements of MTNL and supplied to make the leased lines operational. The Ministry, however, did not justify the procurement of 42 modems without obtaining competitive rates and without finalisation of the actual requirements with MTNL.*

### **Phase II centres**

#### **Procurement of hardware**

(vi) In March 1997, the Committee on Non-Plan Expenditure (CNE) approved the proposal regarding supply, installation and commissioning of computer systems and peripherals for 33 centres by replacing the existing SN-73 system. Open tenders were invited in April 1997 and the lowest tender of M/s Tata IBM was selected by the TEPC for supply of hardware, software, peripherals and training at a total cost of Rs. 748 lakh after taking into account the deduction of an amount of Rs. 42.86 lakh towards buy-back of the old SN-73 computer systems. A letter of intent was issued by the DIT (Systems) in September 1997 for purchase of hardware for Rs. 729 lakh. It was however, noticed that against the target period of four to six weeks for delivery and installation of hardware, there was delay in installation that ranged from 6 to 33 weeks in the 33 centres due to delay in site preparation, terminal banks etc., and no penalty could be imposed on the contractor as the delay was on the part of the department.

*The Ministry have accepted the audit observation.*

#### **Procurement of PCs for Deputy Commissioners and above**

(vii) On 3<sup>rd</sup> March 1997, the C.N.E. approved providing of 1077 PCs to the officers of the level of Deputy Commissioners and above with the stipulation that 50 percent of these officers be provided with personal computers (PCs), dot matrix printers (DMPs) and Constant Voltage Transformers (CVTs) in the year 1996-97 and the balance in the next financial year. The department procured 525 PCs/DMPs/CVTs in March 1997 and 552 PCs/DMPs/CVTs in June/July 1997 from M/s. Tata IBM and from M/s. Elecon Engineers. It was noticed that the department had finalised the requirement of 1077 PCs/DMPs/CVTs during the year 1996-97. However, open tenders were

invited for only 525 PCs/DMPs/CVTs on 7.3.1997 instead of 1077. Barely three months later, i.e. on 30<sup>th</sup> June and 1<sup>st</sup> July 1997, the department placed repeat orders for the balance 552 PCs/DMPs and CVTs. These repeat orders were placed on the same firms, at the same rates and without inviting fresh quotations/tenders though the value of the order exceeded Rs.500 lakh and was for more than 50 percent quantity was in contravention of Government purchase procedure. Further, had the department invited tenders for whole quantity of 1077 in March 1997 itself, better competitive rates could have been obtained.

*The Ministry stated that repeat orders were placed on Tata IBM after ascertaining that there had been no change in the prices, taxes, etc. The reply is not tenable as the competitive prices were not obtained from all the five technically short listed firms who submitted their bids in March 1997 and placing the repeat order for more than 50 percent quantities after checking up with Tata IBM alone, was against the Government purchase procedure*

**Procurement of  
PCs for  
Assistant  
Commissioners/  
ITOs**

(viii) To strengthen the infrastructure in the Department, it was decided to procure 4,900 PCs, DMPs and CVTs for ACs/ITOs. An amount of Rs. 2640 lakh was sanctioned in August 1997 so as to cover 2000 officers (40% of the total strength) during 1997-98. Tenders were invited in December 1997 and the TSC after technical evaluation of various offers recommended in March 1998 to place the orders from the firms as detailed below:

i)	M/s. HCL Infosystems Ltd.	1000 PCs
ii)	M/s. Siemens Nixdorf Information Systems	500 PCs
iii)	M/s Wipro Infotech Group	500 PCs

The formal orders were placed on 18.3.1998 with the stipulation to supply the PCs by 15.4.1998. However, the PCs were actually received between April and June 1998 and most of the PCs were installed between May - September 1998 for want of proper space/power points etc which could have been avoided by proper planning.

### **3.2.9.2 Installation acceptance and implementation**

#### **Phase I centres**

**Delay in Site  
Preparation**

(i) The department assured C.N.E. as well as Secretary (Expenditure) that the sites would be ready before the receipt of the hardware and the system would be operational in three Regional Computer Centres (RCC) by August 1994. It was noticed that although the hardware was procured between September to November 1994, CBDT sanctioned (October 1994) only Rs. 353 lakh for site preparation work to be completed by November 1994 and sites at the three RCCs were not ready for installation of equipment till September 1995. Additional funds amounting to Rs. 67 lakh (Rs.40.74 lakh for Delhi, Rs.18.69 lakh for Madras and Rs.7.57 lakh for Bombay) were sought in November 1995 by the three centres. Audit scrutiny revealed that the funds earmarked for the site preparation were diverted and incurred without sanction as detailed below:



- In Chennai, it was noticed that Rs. 11.12 lakh earmarked for installation of diesel generator sets were diverted towards the preparation work of terminals and Central Treasury Unit rooms which was not covered in the original sanctioned plan. Further, this was done without the approval of the competent authority.
- Rs. 6.52 lakh were spent without approval on items other than site preparation such as purchase of computer stationery, water cooler, photocopier, stamps and furniture etc.
- In Delhi, under the approved plan, the site preparation involved only 4500 sq. feet at fourth floor of R.K. Puram office building. However, the department obtained an additional 4500 sq. feet at 2<sup>nd</sup> and 3<sup>rd</sup> floor at the same place and converted it into a site without obtaining the approval of the competent authority resulting in excess expenditure of Rs. 40.74 lakh over the sanctioned funds.

*While confirming that installation of hardware was delayed as the sites could not be prepared in time, the Ministry explained the delay on the part of many agencies involved such as CPWD, electricity authorities, fire control, etc. The reply is however not acceptable as the department should have worked out the time required for site preparation after taking into account all the factors well before finalisation of order for procurement of hardware.*

**Delay in installation of hardware**

(ii) The hardware items which were received between September 1994 and November 1994 were actually installed between January 1995 to December 1996. Therefore, hardware worth Rs. 1370 lakh remained unutilised for a substantial period ranging from 3 to 26 months resulting in blocking of funds besides obsolescence in hardware.

*The Ministry stated that bulk of the hardware items were installed between January-February, 1995 in all the three regional centres. This reply is not acceptable in audit as it was noted that essential items such as PCs, CVTs, UPS and DMPs were not installed till June-December 1996 without which the system hardware (RS 6000-590) worth Rs.1370 lakh remained unutilised.*

**Phase II centres**

**Delay in installation of PCs**

(iii) Out of the 1077 PCs procured, only 890 PCs could be installed till September 1998 against the target of May/August 1997. The remaining PCs have not been functional till March 2000 due to non availability of sanctioned power supply.

**Operations**

(iv) The tender document mentioned that the desirable response time should be 3 to 5 seconds for queries. It was noticed by the IT Consultants engaged by C&AG that this critical parameter of performance could not be achieved by

the system, as it takes 5 to 40 minutes to respond to a typical query, thereby implying either that the hardware is inadequate for such an operational profile or that the design of the database and the requisite application portion did not take into account the nature of queries to be handled. As the system has so far been used only for two applications (PAN<sup>7</sup> & TAS<sup>8</sup>) the extensive use of AIS<sup>9</sup> and AST<sup>10</sup> would considerably slow down the system.

*The Ministry replied that it was not possible to test the response criteria as mentioned in the tender document in the true spirit and sense of the document. Therefore, it was consciously decided to prepare the prototype benchmark test on the data and data bases that were readily available with the department.*

*The Ministry, however, neither replied as to the result of such prototype benchmark tests nor on the present response time for a typical query.*

**Software evaluation-**

**Procurement of ORACLE RDBMS software**

**3.2.10 Specification, design and procurement phase**

**3.2.10.1(a)** To meet the requirements of the application systems, the department decided to procure an appropriate Relational Database Management System Software (RDBMS). Limited tenders were invited in March 1994 from three distributors/vendors and after technical evaluation, the lowest offer of M/s Oracle India Limited was accepted at a total cost of Rs. 283.83 lakh including technical support and on-site support charges for four years for their ORACLE Software. The order was placed in December 1994 to be supplied within six weeks.

**Non-utilisation of OCR software**

**(b)**As per terms and conditions of the tender for design and development of application software, the key characteristics of the application systems were to capture data through OCR from hand-written / printed / type written / bar coded documents. It was also clarified that the applications developed by the consultant should be capable of utilising the data captured through OCR. The software consultant was to supply OCR software and develop applications software to intelligently recognise alphanumeric characters before converting them into ASCII format.

The purpose of using OCR and bar code technology was to avoid any need of data entry. It was, however, noticed that none of the application softwares developed by M/s TCS were capable of utilising the data captured through OCR using bar code technology in clear violation of the tender conditions. Further, though the contract for application software was awarded in September 1994 and applications were received between May 1995 to May 1997, it was only in November 1998 that the department asked the firm to deliver the OCR software. However, OCR software could not be used at this stage for the following limitations:

<sup>7</sup> Permanent Account Number (PAN)

<sup>8</sup> Tax Accounting System (TAS)

<sup>9</sup> Assessee Information System (AIS)

<sup>10</sup> Assessment Information System (AST)



- i) The forms for PAN were not designed for OCR compatibility .
- ii) Software recognition of hand written characters are complex and were not listed as a requirement in the tender.
- iii) Indian type written fonts do not conform to OCR standards.
- iv) Necessary hardwares (scanners) and software required for use of OCR technology were not procured.

It was seen that while accepting the application software, OCR requirement as envisaged in the tender document was not fully considered by the department. Failure to use OCR software and bar code technology for allotment of PAN resulted in outsourcing the work relating to data entry at an avoidable cost of Rs. 82.08 lakh during 1995-96 to November 1998.

*The Ministry stated that the department has deliberately gone slow on the implementation of OCR solution in view of slow acceptance and implementation of the Assessment System due to staff resistance. It was further stated that various forms were also needed to be specially designed for meeting the requirement of OCR and training based on variation of handwriting and fonts. The use of OCR software for PAN data was not envisaged by the department at that stage. However, while floating the tenders for data entry of PAN forms, option was given to the tenderers to offer OCR based solution for which none of the vendors gave any solution based on OCR.*

**Application Software**

(c) The department envisaged to build city/region-wise database of all the taxpayers. Accordingly, it was decided to develop nine applications system as detailed below:

- (i) Assessee Information System (AIS)
- (ii) Assessment Information System (AST)
- (iii) TDS Information System (TDS)
- (iv) Tax Accounting System (TAS)
- (v) Individual Running Ledger Account System (IRLA)
- (vi) Enforcement Information System (EIS)
- (a) Search and Seizure (b) Survey (c) Tax Evasion Petition and (d) CIB System
- (vii) Management Information System (MIS)
- (viii) Resources Management System (RMS)
- (a) Manpower Management System (b) Physical Resource System
- (c) Financial Resource System and (d) Pay-roll System
- (ix) Judicial Referencing System (JRS)

The department invited tenders in February 1994 for engaging the services of a software consultant for system analysis, design, development and implementation of application software for the above listed application systems and awarded the contract to M/s TCS at a total cost of Rs. 72.12 lakh in September 1994. However, the Judicial Referencing System was taken out from the above contract subsequently and was procured from another firm

thus reducing the total contract value to Rs. 67.06 lakh. Test check of the records in this regard revealed as under:

**Prioritisation of application software systems**

(d) The department envisaged to build, city/regionwise database of all the tax payers. In pursuance of that, 9 application systems were decided to be developed. The department, however, did not attempt to distinguish integrated components of the software system and prioritisation of the systems. All the 8 systems (except JRS) were decided to be implemented at the same time. It may be mentioned that out of 8 application software systems, 5 systems (AIS, AST, TDS, TAS & IRLA) are related to on line allotment of PAN, processing of tax returns database for tax deducted at source, tax payments received and comprehensive Individual Running Ledger Accounts of the assesseees. Remaining 3 systems (EIS, MIS & RMS) are independent by themselves. It was, however, noted that M/s.TCS was to undertake complete development, testing, implementation and acceptance of all the 8 systems without any inter se priority by October 1996. It was further noted that only 2 systems, AIS & TAS, were developed in July-August 1996 and other 2 systems (AST & IRLA) were developed in 1997 alongwith 3 systems, EIS, MIS and RMS, while the system for TDS has not been developed till March 2000. The field study revealed that since all the applications have been given the same priority, the implementation was not completed even in one city/region covering all the functions. Planned prioritisation, development and implementation would have resulted in saving of cost, time and efforts and early monitoring/processing of crucial data with revenue implications.

**Deviation from the contract agreement**

(e) As per the contract agreement, M/s.TCS was to develop eight application softwares at a total cost of Rs 67.06 lakh. However, scrutiny of records revealed that as the CBDT desired to allot PAN number to some VIPs at the time of inauguration of the computer centre, a new application software called the Initial PAN allotment system (IPAN) was procured from M/s. TCS which was not originally covered in the contract agreement. An amount of Rs 3.30 lakhs for the extra work on this account was paid to M/s. TCS. In addition, due to various changes made by the department during the development of softwares, extra payment amounting to Rs. 8.70 lakh was also made to the vendor.

*The Ministry accepted that IPAN was not originally envisaged. It was, however, stated that decision to put a batch processing system module for quick allotment of PAN under IPAN application was taken up in all the three cities instead of waiting for development of all applications to utilise the costly hardware.*

**Delay in development of software**

(f) While inviting tenders (February 1994) for development and implementation of software, the tentative period envisaged for completion of the whole task was six months. M/s CMC whose rates were the lowest had agreed to complete the whole task within a period of six and a half months. The Department had ignored the above time frame and awarded the contract to



M/s TCS in October 1994 by allowing a period of 14 months which was later on extended to 18 months and subsequently to 24 months. However, barring only TAS and AIS the remaining softwares were installed in Chennai, Delhi and Mumbai after a delay ranging from 6 to 14 months beyond the extended period.

*The Ministry stated that despite many factors delaying the project, almost all the applications except TDS were completed approximately within the revised time frame. The reply is, however, not acceptable being factually incorrect, as all the five softwares viz. IRLA, EIS, MIS, RMS & AST have also been delayed even after taking the revised time frame for their completion.*

**Cases of  
avoidable  
expenditure**

(g) The following cases of avoidable expenditure amounting to Rs. 83.25 lakh were noticed on procurement of software items as detailed below:-

1. There was a delay of 10 months in installation of Oracle software at Mumbai and Chennai. However, payment for on site support charges made to M/s.Oracle India was adjusted only for 3 and 6 months respectively resulting in excess payment of Rs. 6.60 lakh.
2. TEPC in August 1997 had not recommended procurement of additional licenses for Oracle software as the existing 775 licenses were concurrent and adequate. However the department procured (November 1997), additional 13 licenses costing Rs. 1.27 lakh for Delhi where 290 licenses were already existing against 227 trained users.
3. The department procured 397 additional sets of documentation and media sets from M/s. ITC at a cost of Rs. 9.58 lakh which was avoidable as the department was authorised to make duplicates of documents from the sets offered free of cost alongwith 400 licenses.
4. As per the offer of M/s. Oracle India, on-site technical service for 30 days was included in the Annual technical support. It was also envisaged by the firm that on-site technical service would not be needed beyond 30 days and in the event of any need for further assistance, pricing would be on a mutually agreed basis. While the training should have been arranged in a manner that after 30 days on site assistance, no further on-site help was needed from Oracle, it was noticed that training for use of Oracle software was imparted by M/s. Oracle India to 40 departmental persons towards the end of 1995. It may be noted that these persons were already trained in RS 6000 Computer Systems. The department in addition to the payment of Rs. 48.83 lakh as annual technical support fee, paid Rs. 65.80 lakh for on site support charges for five years from January 1995 to January 1999 which could have been avoided if advance plan for training was in place and trained persons were available in the department from 1996.

*The Ministry have accepted the observation but stated that the training of department personnel has helped in reduction of on site support in recent years in 1998-99 and 1999-2000. However no justification was given for*

*not utilising the services of trained personnel to reduce on site support charges during 1996-97 and 1997-98.*

**Systems requirements specification (SRS)**

(h) The SRS pertaining to software was prepared by M/s TCS and was found conforming to IEEE\* specifications. It was however, noticed that though response time of six seconds was included in the tender, the same was ignored in the SRS developed by M/s. TCS. The department also did not enforce on M/s. TCS to commit on the issue of response time in the SRS. The response time, thus, was accepted as non-critical parameter in assessing the performance of the vendor. It may be noted that software requirement and hardware specifications must match to obtain specified response time.

*The Ministry replied that response time is not normally covered by the SRS. This reply is not acceptable as the hardware and software must synchronise to meet the specifications.*

**Software design document (SDS)**

(j) Development of a comprehensive software depends largely on how well the SDS is derived from the SRS. The SDS, as such, is required to provide adequate information for writing codes compatible with hardware sizing. The standard procedure, therefore, is to finalise SDS before firming up the hardware sizing. The issue of hardware sizing was examined by audit from two angles :

- (a) whether SDS was prepared on the basis of adequate information, and
- (b) whether hardwares already procured before preparation of SDS will be adequate in terms of department's needs.

The audit examination revealed that the sizing estimates presented in the SDS were inadequate based on certain assumptions. As regards adequacy of hardware already purchased, it was noticed that the RCCs are already facing shortage of disk storage. Moreover, the hardware it appears, will be grossly inadequate once the system grows to its full potential.

*The Ministry stated that main reason of shortage of disk space was on account of space occupied by the photograph and signature file of the PAN applications and these will be removed from the system and kept as back up on a off line magnetic media after the job is over.*

*The reply of the Ministry is to be viewed in the light of the fact that allotment of PAN numbers, their revision, frequent use for verification and additional new assesseees would make ever increasing demands on the disk space that is already inadequate now.*

**Installation, Acceptance and Implementation**

**3.2.10.2** It was noticed that the ORACLE software which was to be loaded by January 1995 was actually loaded on the main hardware (RS 6000) as well as 760 PCs connected with servers between March 1995 to June 1996, February

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\* Institute of Electrical Electronic Engineering



1995 to December 1996 and February 1995 to September 1996 in Chennai, Delhi and Mumbai respectively.

**Software testing and acceptance procedures**

(a) The department did not envisage clear procedures for acceptance/testing of the software and the tendency was to wait for modules to be made operational so that testing could be carried out live. It was however, noticed that while considerable effort and planning went into acceptance and implementation of IPAN, TAS and AIS, similar emphasis was not placed on acceptance of other modules.

*The Ministry have accepted the audit observation stating that the delay in acceptance of various modules was due to shortage of technical personnel in the DIT (System).*

**Operation**

(b) Detailed scrutiny of the operation of the various application software revealed the following:

**Permanent Account Number (PAN) /Initial PAN allotment systems (IPAN)**

(i) The working group set up to examine the overall computerisation process emphasised the need for a system of allotment of unique PAN to all tax payers so as to form a key for inter system linkages between different software applications used in the department. It was also recommended that the PAN should have in built safeguards to prevent allotment of duplicate/ multiple PAN and should ensure up to date information (including the assessing officer jurisdiction) of an assessee. The report also emphasised the need for devising a new Unique Identification Number which should not only identify a tax payer uniquely but also should be small and easy to use. Keeping this in mind, a new series of PAN was evolved comprising of two parts, namely:

- (a) Phonetic Permanent Account Number (PPAN); and
- (b) Permanent Account Number (PAN).

While awarding the contract to M/s TCS, IPAN was not amongst the systems envisaged. The IPAN Application Software was an abridged version of AIS Software to be used (a) for one time PAN allotment in Delhi, Mumbai and Chennai (b) during peak periods at the time of due dates for filing of returns and (c) for other cities and centres for all times. A detailed scrutiny of the records revealed as under :

**Non-fulfillment of targets**

(a) Under the Central Action Plan for the year 1998-99, the Board decided to achieve 100 percent targets by 31.10.1998 in respect of complete PAN allotment, dispatch of intimation letters and PAN cards and migration of data to AIS and 100 percent on-line allotment of PAN for applications received during 1998-99 by 31.3.1999 for Chennai, Delhi and Mumbai regions and 70 percent for 33 centres for complete PAN allotment, dispatch of intimation letters and PAN cards for applications received during 1998-99 by 31.3.1999.

However, detailed scrutiny of records revealed that only in six centres out of 33 centres (Nasik, Kolhapur, Bhubneshwar, Ranchi, Agra and Jodhpur) have

completed the targets. Chennai, Delhi and Mumbai and eight centres out of 33 centres could not achieve the desired targets as given below :

Sl. No.	Name of the centre	Total number of forms received for PAN	Percentage of PAN numbers allotted (out of column 3)	Percentage of intimation letters issued (out of column 4)	Percentage of PAN cards issued (out of column 4)
1	2	3	4	5	6
1.	Delhi	1220402	79	64	60
2.	Mumbai	1837565	78	77	47
3.	Chennai	633188	84	89	85
4.	Coimbatore	138360	45	7	7
5.	Jabalpur	460543	3	24	12
6.	Patna	357624	33	33	66
7.	Allahabad	234417	57	13	13
8.	Visakhapatnam	308207	28	2	2
9.	Cochin	322284	15	16	16
10.	Trivandrum	177946	25	31	24
11.	Calcutta	1763632	1	Nil	Nil

In remaining 19 centres, though PAN allotment target was achieved, the targets for intimation letters and dispatch of PAN cards were not achieved at all. The facts remain that out of 36 centers, in 30 centers targets as decided under Central Action Plan for the year 1998-99 in respect of allotment of PAN and issue of PAN cards were not achieved by March 1999.

*The Ministry affirmed that 100 percent targets could not be achieved in the allotment of PAN numbers as on 31.3.2000.*

**Delay in the disposal of grievances**

(b) As per the Central Action Plan it was directed by the Board in July 1998 that no grievance/ complaints should be kept pending for more than a month. The system provides for PAN preview under which the assessee's details which are to be printed on the card are displayed on the screen and these were required to be matched with the details mentioned in Form 49A. However, despite provision of preview, huge number of complaints regarding printing of wrong name, incorrect date of birth, father's incorrect name, mix-up of photographs and signatures in the PAN cards issued to the tax payers were noticed. These deficiencies are indicative of lack of prescribed preview checks.

Test check of the records of RCC, Delhi revealed that the centre did not maintain proper records prior to July 1998 to show the number of complaints received and disposed of. Even after July 1998, there were delays in the disposal of PAN related to grievances cases and out of 76,378 complaint cases only 896 grievances (1 percent) were disposed of and 75,482 were pending as on May 1999. Further analysis of outstanding complaints revealed that 70,139 complaints pertaining to the period after July 1998 were sent by the CCIT office Delhi in February 1999 only.



**Faulty  
designing**

(c) It was observed that the entire income tax system is highly decentralized in terms of operation. However, the PAN system was designed to be centralized. The conceptual plan document described the proposed system as centralized for processing and de-centralized in terms of data input and output. While this concept was seen to be more workable from the RCC standpoint, it was found weak from the NCC standpoint.

**Non-availability  
of security  
feature**

(d) The IPAN design, based on generating a unique PAN number using "phonetic" matching was found over emphasised since during PAN allotment no supporting documents for proof of age etc. were made mandatory for submission. It may be observed that the system of existing procedures could not effectively bar issue of multiple PAN numbers to the same person. Evidently, PAN cards were not designed to contain security features as particulars given in the PAN application form were not got verified and these were accepted on the basis of self attestation.

**Assessee  
Information  
System (AIS)**

(ii) AIS allows on-line allotment of PAN by the assessing officer. The function requires that the AO's terminal should be connected to the RCC and the NCC over the network. The system would create the Assessee Information database of all the taxpayers based on the information contained in the modified Form 49A and would have the facility to update the information on the new assessees. It was envisaged that the AIS would form the hub for the proposed scheme of computerisation as the PAN was the index key to integrate most of the Application Systems. To achieve this, it was necessary that all PAN allotted under IPAN should be migrated to AIS database so as to interact with other systems like TDS, TAS, IRLA and AST.

**Delay in  
implementation**

(a) It was however, noticed that AIS was installed in April 1996 in Delhi, September 1996 in Mumbai and October 1996 in Chennai and 2.98 lakh, 1.10 lakh, & 0.12 lakh PAN allotments were made under AIS as on March 1999 respectively. Though the system was implemented between May 1998 to January 1999 in 10 other centres out of 33, only six PANs were allotted through AIS in only one centre at Rohtak as on 31.3.1999.

Further, as regard to 100 percent transfer of PAN data to AIS, it was noticed that out of 6.72 lakhs, 13.24 lakhs and 5.21 lakhs PANs allotted in Delhi, Mumbai and Chennai only 1.54 lakhs (23 percent), 0.88 lakh (7 percent) and 0.19 lakh (4 percent) transfers could be made as on March 1999 respectively. The reason for shortfall in transfer of data was that the AOs were to identify PAN records pertaining to their jurisdictions from IPAN and send a list to the concerned RCC on a floppy. Only then, these cases could be transferred to the respective AOs in AIS database. Although AO code was made mandatory in the originally developed software but the same was made non-mandatory at the instance of RCC, Delhi owing to urgency in the allotment of PAN with the result that AOs were unable to identify the cases from IPAN. Thus due to non-transfer of PAN data to AIS, benefit of computerisation could not be achieved as other applications like AST, IRLA, TAS etc. could not be used till March 1999 effectively as these, in turn depended on AIS.



*The Ministry stated that as on 31.3.2000, number of on line allotment of PAN through AIS and number of PAN migrated from IPAN to AIS were 6.68 lakh and 100.68 lakh respectively. The Ministry, however, did not furnish the data on items pending for migration from IPAN to AIS and further improvements needed, if any, in the system.*

**Shortcomings noticed in the AIS software**

**(b)** Scrutiny of records revealed that the AIS was not properly designed taking into account the practical situation of working in the department as a result of which serious bottlenecks occurred during its implementation. Though a number of modifications were required as pointed out by various users, these were not acted upon as detailed below:

- (i) Option of deletion of PAN in AIS was not provided in the software with the result that a number of duplicate PAN generated by AOs could not be eliminated from the database.
- (ii) The facility to print the labels for despatching the PAN cards was not available due to which manual procedures had to be adopted that contributed to delay in despatch.
- (iii) There was no provision for dual/ additional charge facilities for AOs with the result that if any AO holding additional charge should allot PAN on AIS for the additional charge, the AO code of his substantive charge would automatically be populated in the AIS, instead of the AO code of the additional charge.
- (iv) The system provides that records complete in all respects could only be transferred from IPAN to AIS. It was noticed that IPAN records, though complete with reference to core fields but incomplete as to non-core fields, could not be transferred. This restriction on transfer of records to the AIS kept the records pending for correction at the RCC, whereas such correction in the non-core fields could have been easily carried out by the concerned AOs subsequently.
- (v) Core fields in IPAN and AIS were different which resulted in rejection and non-transfer of records from IPAN to AIS.
- (vi) AIS operations seem to be limited primarily due to the unavailability of the network at the AO's desk.

*The Ministry stated that necessary modification in the system wherever essential have been carried out and PAN cards have been printed.*

**Assessment Information System (AST)**

**(iii)** The AST envisaged computerised processing of returns filed. The main purpose of this application was to facilitate calculation of tax, interest chargeable under scrutiny, time barring/ due date checks, deduction limit validations, and to generate notices for scrutiny, penalty proceedings, as well as to monitor appeal cases etc. Although the AST was installed in Delhi, Mumbai and Chennai in June 1997, November 1997 and December 1997 respectively, after modifying the system twice, very little use was made of the system in these centres as detailed below:



In Chennai, the implementation of the system could be taken up only in December 1998 after allotment of PAN to all assesseees and transfer of IPAN to AIS, transfer of arrear demand into IRLA and completion of LAN.

In Delhi, although the system started functioning from June 1997 till March 1999 out of a total of 484 ranges/ circles/ wards, in eight ranges/wards only 4526 returns could be processed. Further, in one special range and three circles, only five returns could be processed indicating poor utilisation of the software.

In Mumbai, 4 special ranges were identified to run the system, but none of the DCs made use of AST till March 1999. The system was also not operational (March 1999) in the 33 centres covered under Phase-II.

Thus, the AST module has only undergone simple testing and has not been put into use even though it was available for more than two years.

*The Ministry accepted the observation stating that the system has not been on the desired pace on account of various reasons including staff resistance. It was further stated that the Board has issued instruction in January 2000 to take up salary returns using the AST system.*

**Tax deduction at Source Information System (TDS)**

(iv) The purpose of TDS was to maintain two databases viz. (i) Tax deductors information database and (ii) TDS database. To achieve this, a Tax Deduction Account Number (TAN) was to be allotted to each deductor paying tax. The system was developed to assist the A.O. in performing various activities leading to generation of MIS Reports. It was, however, noticed that the system which was to be developed in October 1996 could not be developed till March 2000 due to deficiencies found in the source documents.

**Tax Accounting System (TAS)**

(v) The objective of TAS was to create and maintain region-wise database of the tax payments received by the Department. Taxes are paid by the assesseees in authorised banks through challans. On receipt of challans/ refund vouchers in Central Treasury Units from banks, these are verified and processed on computer to generate various reports and registers. The TAS was implemented from January 1997, August 1996 and December 1996 in Chennai, Delhi and Mumbai respectively and between May 1998 to August 1998 in the 31 centres. Audit scrutiny revealed as under :

**Shortfall in processing of challans**

(a) Scrutiny of records revealed that against the receipt of 132.74 lakh challans in respect of tax deposited and 80.92 lakh refund vouchers received from the banks during the year 1998-99, the number of challans and refunds processed in all the 36 centres were only 22.29 lakh (16.79%) and 13.68 lakh (16.92%) respectively and there had been a shortfall of above 75 per cent in three centres, 50 – 75 per cent in nine centres, 25 – 50 per cent in ten centres and less than 25 per cent in the remaining 14 centres.

**Inordinate delay in preparation of detailed account**

(b) The detailed account showing the collection received during the month, major/minor head-wise, was also to be forwarded to the ZAO in the prescribed



proforma by 14th of the following month. It was however noticed that there were inordinate delays in the preparation and dispatch of detailed accounts by the CIT to the ZAOs as on 31.03.1999 ranging from 1-3 months (7 centres), 4-6 months (11 centres) and more than six months (5 centres).

**Delay in generation of daily collection register/ refund register**

(c) Daily collection registers (DCR) and daily refund registers were required to be dispatched to the assessing officers by CTU in order to enable them to give credit, for tax paid by the assesseees. Audit scrutiny revealed that despite computerisation of CTU activities, there were delays in the preparation of the daily collection register ranging from 1-3 months in eight centres, 4-6 months in 13 centres and more than 6 months in five centres. Delays in dispatch of registers led to delay in giving credits for the taxes paid and consequent delay in issuance of refund orders which resulted in avoidable inconvenience to tax payers besides payment of interest on refunds. Thus, there was no significant improvement in generation of DCR despite introduction of TAS software.

**Individual Running Ledger Account System (IRLA)**

(vi) The main objective of the IRLA was to generate a comprehensive Individual Running Ledger for each assessee which, interalia would provide details of assessments and year wise up-to-date listing of all demands, collections and refunds that have taken place. Thus, IRLA was dependent on TAS (for collections), on AST (for demands, penalties and refunds) and on TDS Information System (for TDS payment). The role of PAN was very important for the success of this system, as it was necessary that in the Arrear Demand and Collection Registers (ADCR), PAN should be mentioned against the entries of each assessee.

Test check of the records revealed that although IRLA system was installed in May 1997, June 1997 and November 1997 in Chennai, Delhi and Mumbai respectively and in five other centres covered under Phase-II between April 1998 to September 1998, the system was not fully operational as the other systems viz. PAN, TAS, AST and TDS were not stabilised and the PCs supplied to the A.Os. were not networked. Only the work relating to inputting arrear demand on computers by some AOs was started. The centre-wise details were not available with the Department. However, in respect of 24 centres for which information was compiled, out of 1850 AO charges where work was started, only in 1286 charges work was completed and in nine out of 24 centres the percentage of short fall was more than 50.

*The Ministry have informed that the system has been installed in all the 36 centers and is in use in 20 centers though on a limited scale.*

**Enforcement Information System (EIS)**

(vii) The EIS was developed with a view to help the Investigation wing in speeding up investigation work with more effective control so as to ensure reliable, accurate and quick reporting. Under EIS, four operational areas, viz. (i) Search and Seizure, (ii) Tax Evasion Petitions, (iii) Survey and (iv) CIB Information, were identified for computerisation.

Although software for (i) to (iii) was stated to have been installed in Delhi in April 1997 and in Chennai and Mumbai in May 1997 the system was not



operational (March 1999) as the networking of the PCs provided to the officers in Investigation circles/ CIB circles had not been completed. As regards CIB system, the same was at the testing stage (August 1999).

Management Information System (MIS)

(viii) The objective of MIS was to provide the management with reliable, accurate and meaningful information at any point of time. Although the system was installed in May 1997 in Chennai, Delhi and Mumbai, it was not operational in any of the centres as the PCs provided to the Assessing Officers were not networked with the RCC/TBs. (March 1999.)

Resource Management System (RMS)

(ix) Although the software was installed in April 1997 in Delhi and in May 1997 in Chennai and Mumbai, allotment of Employees Code under Manpower Management System only could be implemented in respect of 30 centres for which information was made available and, out of 55054 employees, only 28422 (51%) could be allotted codes till March 2000.

### 3.2.11 Specification, design and procurement phase

Networking evaluation-

(1). The computerisation plan provided for inter-city and intra-city networking of the computer centres through 64 KBPS dedicated lines. There was no separate specification and design of either inter city or intra city network. The exercise of sizing the network vis-à-vis the requirements of the applications was not done formally. The VSAT-based alternative was ruled out since the service provider could not demonstrate the availability of adequate bandwidth. This decision seems unreasonable as the solution was evaluated in terms of unrealistic tender specification that required a vendor to show half a transponder of unused capacity in his resources at the time of bidding.

*The Ministry replied that in 1994, none of the tenderer was in a position to quote for V-SAT based solution as per requirement of the solution proposed. This reply is to be viewed in the light of the fact that the tender condition of 'half-a-transponder' as a spare bandwidth by the tenderers was unreasonable and was not based on any formal framework providing inter/intra city network and applications traffic analysis.*

The purpose of leased lines was to facilitate reliable, secure and faster access for error-free data transfer and to ensure 100 percent uptime. In all, three inter-city and 17 intra city (5 Delhi, 8 Mumbai and 4 Chennai) leased lines were sanctioned in August 1994 and funds amounting to Rs. 75.90 lakh were sanctioned by the Ministry for this purpose in November 1994.

#### 3.2.11.2 Installation, acceptance and implementation

Delay in setting up Terminal Banks (TBs)

(i) To connect different Income tax buildings with RCC/NCC in order to facilitate decentralised input/output and to enable the users to work on various application systems, it was envisaged to setup 36 Terminal Banks (TBs) in 23 buildings (6 at Delhi, 13 at Mumbai and 4 at Chennai). An amount of Rs. 2.00 crores was sanctioned by the CNE in November 1994 for this purpose. As per the implementation schedule, the computerisation programme in Delhi,

Mumbai and Chennai was to be made operational during 1994-95. However, it was observed that out of 36 TBs (Delhi -12, Mumbai-20 and Chennai-4) only 25 (Chennai - 2, Delhi - 4 and Mumbai -19) could be commissioned till July 1996. In Mumbai one TB at Matru Mandir was not set up as of August 1999.

**Delay in Local Area Networking**

(ii) As per the contract agreement of July 1994, M/s TISL was to supply, install and put on network the entire system which included 760 PC terminals through Local Area Network (LAN) and Wide Area Network (WAN) within a period of three months. However, the networking of the entire system could not be made functional even after a period of more than 2 years, resulting in delayed implementation of the entire programme. In addition, the desired purpose of on-line activity with the main systems, to involve the users to work on various application systems as envisaged in the programme could also not be achieved.

**Delay in acquisition of leased lines**

(iii) It was envisaged to make the leased lines operational before the end of March 1995 and for this purpose advance payments amounting to Rs. 72.41 lakh were made to MTNL for obtaining 3 intercity and 16 intracity leased lines between December 1994 to March 1995 and for R.K.Puram - Vikas Bhawan in September 1996. However, it was noticed that the leased lines were actually made operational after a delay ranging from 11 months to 32 months. In addition one leased line between Mumbai RCC to Matru Mandir could not be installed till March 1999 as the concerned site was not ready. The delay in installation of leased lines resulted in non-availability of online co-ordination between the various centres as envisaged.

**Hiring of leased lines**

(iv) The main objective of obtaining dedicated leased lines was to ensure 100% uptime so as to provide uninterrupted on-line service at each of the offices. The department paid Rs. 72.41 lakhs during 1994-95 as advance rent and Rs. 142.20 lakhs as annual rent for the leased lines till March 1999. However, scrutiny of records revealed that against the 100% uptime for which payment was made, the leased lines were down frequently as detailed below:

(a) **Inter-city (3 lines):** The overall percentage of down time is given below:

Leased line between	Percentage of down time (in hours)		
	1996-97	1997-98	1998-99
Delhi RCC – Mumbai RCC	42.1	21	13.4
Delhi RCC – Chennai RCC	55	23.9	10.3
Mumbai RCC – Chennai RCC	71.6	25.98	31



**(b) Intra city (16 lines) :**

Leased line in	Percentage of down time (in hours)		
	1996-97	1997-98	1998-99
Delhi	37 to 85	11 to 31	9 to 29
Chennai	34 to 69	18 to 51	10 to 86
Mumbai	47 to 93	44 to 96	23 to 82

Considering the heavy down time, which at times was more than 96 percent of the total hours, the department should have made proportionate adjustment from subsequent payments as the intended benefit of getting 100 percent uptime required for uninterrupted on-line service could not be achieved.

**Cases of avoidable expenditure**

(v) Following cases of avoidable expenditure amounting of Rs.19.27 lakh were noticed during scrutiny of records:

1. In Mumbai region, the RCC was supplied with 22 constant voltage transformers in March 1996, out of which 7 were installed and 15 CVTs costing Rs. 3.84 lakh were lying idle. These CVTs were found to be in excess as each terminal bank had been connected to UPS systems.

*The Ministry have accepted the audit observation.*

2. In Mumbai, Rs. 5.42 lakh was incurred in April 1997 on site preparation to set up terminal bank at Mantrumandir. The structure erected at Matru Mandir had to be dismantled as it obstructed ventilation and light resulting in wasteful expenditure of Rs. 5.49 lakh.

*The Ministry have accepted the audit observation.*

3. The department had to pay advance rent to MTNL for acquiring lease lines and adjustment of rent was to be made from the date the lines were made available. It was observed that in respect of 10 circuits though there was difference between the dates the lease lines were actually made available and the dates when the rent was charged. However, department did not make adjustment in the rent paid to MTNL resulting in excess payment of rent amounting to Rs. 9.94 lakh.

*The Ministry replied that regular effort has been made to obtain adjustment against payment of leased lines.*

**Operations**

(vi) As stated earlier, the network that exists is a combination of leased line and dial-up circuits for wide area networking and internet LANs for local area networking. Almost all the software requirement specifications state as one of their major assumptions the existence of a high-speed reliable 64 kbps wide-area network. However, it was observed that the state of networking is not

adequate for on-line computing as was envisaged in the original conceptual document as also in the SRS for online component of the income tax information systems.

It was further noticed that the exercise of sizing the network vis-à-vis the requirements of the applications was not done formally. Though the network connectivity options were limited at the time the design was carried out, yet assumption of consistent network availability for many of the software modules has resulted in long delays in simple but essential operations like migration of PANs to AIS. This aspect needs to be examined taking the present available options and also factoring in the network uptime in the design specification. Further, no formal analysis of network traffic has been conducted.

**Training**

**3.2.12** The department conducted training courses for its officials (both technical/non-technical) working at various levels in order to familiarise them in computer usage by engaging outside vendors. Audit scrutiny revealed as under:

**Training of officers of the level of Deputy Commissioners (DCIT) and above**

(a) As part of the contract given to M/s. Tata IBM Ltd. for supply and installation of 1077 Pentium PCs for the officers of the rank of DCITs and above, the firm was required to conduct a five day, full-time training programme for 1080 officials covering office automation software and bilingual software at a cost of Rs. 3.60 lakh. However, audit scrutiny revealed the following:

(i) *Non-fulfillment of targets*

The department did not fix a target date for completion of training of 1080 officials. It was noticed that till January 1999 training was imparted to only 541 (50 percent) officials. The major shortfall in training was noticed in Delhi, Mumbai, Chennai, Chandigarh and Ahmedabad, where the number of officers trained were only 26 (22 percent), 44 (31 percent) 52 (53 percent), 6 (9 percent) and 54 (56 percent).

*The Ministry stated that every effort and regular follow up action was made to complete the training at the earliest. The reasons for not fulfilling of targets and further steps required to be taken in this regard were, however, not furnished by them.*

(ii) *Wastage of slots*

It was agreed to impart training in 52 batches comprising 20-25 officials per batch. However, it was noticed that only 541 persons were trained in 41 batches averaging only 13 officials per batch and in nine batches the number of persons trained were only five to nine resulting in wastage of slots.



*The Ministry have accepted the observation stating that the Chief Commissioners of Income Tax have been directed at the highest level to ensure full attendance.*

**Training of  
ACITs/ITOs**

(b) The Board sanctioned Rs. 87.50 lakhs in August 1997, for training of approximately 5000 ACITs/ITOs in computer operations, with the stipulation that the training should be completed by December 1997. Audit scrutiny revealed as under:

(i) *Sub-letting of contracts*

Though the value of the tender aggregated to more than Rs. 87 lakh, no open tender system was adopted on the ground of urgency. The Department invited limited technical/commercial bids from three firms in August 1997, out of which only two firms submitted their bids. Although the rates of M/s. NIIT Ltd. was the lowest at Rs. 1600 per participant per batch for five days, the Department split the order between M/s NIIT Ltd. and M/s. TCS Ltd. after asking M/s TCS to match the rates of M/s NIIT. The work of training at Bangalore, Chennai, Hyderabad and Mumbai for 1648 officials was awarded to M/s TCS Ltd. and for training of 3224 officials at other stations to M/s. NIIT Ltd. in October 1997. However it was noticed that M/s. TCS Ltd. sublet the contract of training at all the cities to two other agencies in violation of the contract agreement. However, the Department did not take action against the firm for violating the contract conditions and instead made the entire payment of Rs. 21.94 lakh.

*The Ministry stated that the commercial bid included a condition that "if necessary, TCS may utilise faculty from reputed third party association to conduct the training. TCS would ensure that these programmes also meet their own stringent quality measures".*

*However, it was noted that while placing the order, the Ministry had specifically mentioned that in no case, whatsoever, the contractor will be allowed to sub contract the job to any other party or to an individual in any manner or of any nature.*

(ii) *Non-fulfilment of targets*

Though the training was to be completed by December 1997, it was noticed that upto December 1997 only 1138 officials (23 percent) and upto March 1998, only 3577 (73 percent) could be trained and another 657 officials (13 percent) were imparted training during 1998-99 leaving 638 officials untrained till March 1999.

**Training of  
staff members**

(c) For training of officers and staff at Delhi, Mumbai, and Chennai in computer familiarisation course with reference to application system environment, the Ministry accorded approval for training of 3640 and 2980 officials in March 1996 and December 1997 respectively and Rs. 32.65 lakhs

and Rs. 29.80 lakhs were sanctioned for this purpose by the Board in March 1996 / December 1997. Audit scrutiny revealed as under:

(i) *Awarding of contract without inviting tenders*

The department awarded the contract in March 1996 to M/s TCS for training of 3640 officials at the rate of Rs. 4000 per day per batch on the basis of rates approved in September 1994 which was for development of application software and not for conducting computer familiarization trainings. In that tender, only 100 officials (20 Sr. Executives and 80 technical persons) were to be imparted training in the development of application software at a cost of Rs. 3.16 lakhs. Another order for training of additional 2980 officials costing Rs. 29.80 lakhs was also placed on to M/s. TCS in November 1997 at the same rates.

Thus training of 6620 officials costing Rs. 62.45 lakhs was awarded by the Department without inviting tenders/quotations and further the fact that the earlier training programme of M/s TCS covered a different aspect of computerisation was not brought to the notice of the Ministry/Board while obtaining the sanction.

*The Ministry stated that the above training was not limited to computer familiarisation only but it was for application software also and M/s.TCS was given the order at the rates that were lower than the rates obtained in subsequent tender finalised in 1998. It was further stated that the details of the training were brought to the notice of the competent authority.*

*The Ministry's reply comparing two different types of training programmes is not acceptable. The earlier training was imparted based on hardware contract of September 1994 and was for understanding the operation of application systems including design, maintenance and operations aspects for 19 weeks duration varying 1-4 weeks to different categories of 100 personnel only. The latter training programme, on the other hand, was for 6620 personnel comprising of 4 days duration of 20 participants each for computer awareness and familiarisation to handle application systems. The comparison in rates with latter training contract was thus, not proper.*

**Other topics of interest-**

**Delay in commissioning of Air Conditioners (ACs)**

**3.2.13.1** It was envisaged to procure ACs to provide proper air Conditioning and dust free atmosphere for smooth functioning of the PCs. The DIT (Systems) provided Rs. 1.78 crore to Mumbai Region for the purchase of ACs and computer furniture in March 1998. Out of this, Rs. 1.18 crore was utilised in March 1998 for the purchase of 445 ACs. However, the ACs installed in different buildings could not be commissioned for want of augmentation of power supply till January 1999.

In Calcutta centre, 209 ACs purchased in March 1998 at a cost of Rs. 55.45 lakhs were not commissioned till March 1999 due to shortage of power supplied through low tension transformer. It was further noticed that the



department in order to avoid lapse of budget grant, purchased additional 466 ACs at a cost of Rs. 126.19 lakhs in March 1999.

In Bangalore centre an amount of Rs. 42.42 lakhs was spent on purchase and installation of 139 ACs. However, due to shortage of power, only 28 ACs were operational (February 1999). In reply to an audit query as to how the PCs were functioning without ACs, the department stated that all the PCs supplied to the officers were functioning properly and that the PCs can function effectively without ACs. Thus the purchase of ACs at a cost of Rs. 42.42 lakh was not justified.

**Avoidable expenditure**

**3.2.13.2** It was noticed that CCIT, Delhi office purchased 426 ACs during March 1998 and 44 ACs in March 1999 having reverse valve heating facility in order to provide hot air inside the room during winter, at an additional cost of Rs. 18.58 lakh which may affect the functioning PC machines.

**Irregular withdrawal of Government money**

**3.2.13.3** As per Central Government Account Receipt and Payment Rules no money should be drawn from the Government Account unless it is required for immediate disbursement. It is not permissible to draw money from Government Account in anticipation of demands or to prevent the lapse of budget grant. Further, rush of expenditure at the fag end of financial years should be avoided.

Test check of the records revealed that the Department drew cheques in advance in respect of 23 cases amounting to Rs. 2462.76 lakhs. Further, test check of records of Shillong and Guwahati centres also revealed that the Directorate sanctioned funds amounting to Rs. 20.80 lakhs in March 1999 for other related purchases on computerisation during 1998-99. To avoid lapse of sanction, the amounts were shown as spent by drawing cheques against pro forma bills for installation of air conditioners and purchase of computer furniture. On this being pointed out by audit, it was stated that the amount for AC was sanctioned in anticipation of new PCs to be installed for which the DIT(S) had already placed orders in March 1998. However, till May/ June 1999 the PCs were not received and ACs and furniture had also not been delivered.

**Monitoring and Evaluation**

**3.2.14** Although the computerisation process was started during 1994, no independent evaluation study was conducted by the Department on their own or from any independent agency with a view to examine whether the intended benefits have been achieved with reference to the objectives.

**Conclusion**

**3.2.15** The computerisation programme which started in 1994 suffered from a lack of proper planning. None of the projected milestones could be achieved due to ad hoc changes made from time to time in the programme, an example of which was the decision to create the IPAN system. As a result even after six years computerisation is adhoc, incomplete and the sub systems are incompatible with the whole programme.

Against the conventional norms, the hardware was procured well before framing of the software design document, leading to improper hardware sizing. Further, bottlenecks such as non-readiness of sites/terminal banks, delay in the implementation of software application systems, and delayed acquisition of leased lines leading to non-connectivity of PCs with RCC/NCC contributed to an overall slowdown in the implementation of the computerisation programme.

Although the Ministry gave an undertaking to the Supreme Court of India in October 1997 that the process of computerisation including issue of PAN would be accelerated, nothing concrete was achieved till March 1999. While some progress was made in implementation of TAS and in PAN allotment, the progress in other areas like AIS, AST, IRLA, TDS, MIS, EIS and RMS etc. did not gather momentum despite the hardware and software facilities existing for this. Thus, the intended benefits have not accrued even after a period of five years and an expenditure of Rs. 104.55 crore.

*The Ministry replied that with a view to optimise the performance of applications and from the stand point of proper sizing as also capacity planning, a group comprising of representatives from TCS, IBM, Oracle and the department has been constituted to examine the issues in this regard.*



**B- Audit of Notifications/Circulars**

**3.3 FOREIGN TELECASTING CHANNELS-TAXATION THROUGH CIRCULAR NOS. 742 & 765**

**3.3.1 INTRODUCTION**

The foreign telecasting companies (FTC) engaged in telecasting television channels are non-resident entities. A major source of revenue for the FTCs is from the Advertisements. The FTCs have appointed their agents/representatives in India to collect the advertisement revenues on their behalf. These agents/representatives are Indian entities.

Examination of Ministry files revealed that the Board had received representations from the FTCs regarding their tax liability considering the extent of income that could be said to accrue or arise to from the Indian operations. Board felt that this was a new area of commercial activity and no uniform basis was being adopted by the Assessing Officers in computing the income of these companies. The Board therefore decided to prescribe the guidelines for proper and efficient assessment of foreign telecasting companies. In view of the above the Board issued circular No. 742 dated 2.05.1996 that prescribed guidelines on determination of income and taxability of the FTCs.

**3.3.2 Presumptions made in the circular**

- The Advertising agencies retained 15 percent of the gross amounts of bills raised by the FTCs.
- The Indian agents of the FTCs retained 15 percent of the gross bills.
- Balance amount of approximately 70 percent was remitted abroad to the FTC.
- The FTCs do not maintain a branch office or permanent establishment in India.
- The FTCs do not maintain/cannot maintain country wise accounts.
- 10 percent of the gross receipts of Advertisement revenues (excluding 30 percent or so retained by the Advertising agencies and the Indian agents of the FTCs.) would be fair and reasonable profit of the FTC.

Based on these presumptions the Board prescribed a presumptive profit of 10 percent of gross receipts meant for remittance abroad or the income returned whichever is higher. This presumptive income would be subjected to normal tax rate in force. The rate of taxation for A.Y. 1995-96 to 1997-98 was 55%; it was at a reduced rate of 48% with effect from A.Y. 1998-99. The effective rate, thus, worked out to 3.8 percent for the A.Y. 1995-96 to 1997-98 and 3.36 percent with effect from A.Y. 1998-99 on the advertisement revenues of the FTCs.

The circular stated that these guidelines would be applicable to all pending cases until 31.3.1998 after which the position with respect to reasonableness of rate of profit of such companies would be reviewed based on information/data available for this period.

### 3.3.3 SEQUENCE LEADING TO THE ISSUE AND CONTINUATION OF THE CIRCULAR

- A meeting was held by the Board where representatives of FTCs pointed out that FTCs have suffered losses in global operations, and that they would earn substantial profits only after 3-4 years and that it was not possible to maintain country wise accounts. They showed their inability to file Income returns.
- The Board decided (07.02.1996) to issue instructions to the Assessing Officers to adopt a rate of 10 percent of the amount remitted abroad for the purpose of tax. It was also decided to apply these criteria to all pending cases irrespective of the assessment year and also allow waiver of penalty on such assessment.
- The Secretary (Revenue) questioned the authority of the Board to issue such a circular and stated that it would also violate the structure of the Act.
- The Secretary (Revenue) was assured by the Chairman, CBDT that results of this exercise would be watched and in a year or two a section akin to sec 44B or 44 BB, 44AD, or 44AE, would be enacted.
- The Secretary (Revenue) and the Finance Minister thereafter approved the circular on 04.04.1996 and 16.04.1996 respectively.

### 3.3.4 LATER EVENTS

- Circular No.742 was valid only up to 31.03.1998. File note dated 03.04.1998 from Joint Secretary (FT&TR) stated an urgent need for extension of guidelines of the circular. The Chairman CBDT agreed to the proposal. Circular No. 765 was issued on 15.04.1998 and was made effective until *further orders*. It did not make any reference to the assessment year to which its provisions extended.
- The earlier circular stated that the position with regard to the reasonableness of rate of profits of such companies would be reviewed. No such review/re-assessment was carried out.
- The circular No. 765 was issued by the Chairman, CBDT without obtaining the approval of the Board, the Secretary (Revenue) or the Finance Minister.



### 3.3.5 VALIDITY OF THE CIRCULAR

#### A. CIRCULAR NO. 742 DATED 2.5.1996

1. Section 295(3) of the Income Tax Act provides for framing Rules specifying the procedure and methods for estimation of income of non-residents that cannot be definitely ascertained for taxation purposes. Such Rules are also required to be placed before the Parliament under Section 296 of the Act. As such there was no need for issue of the Circular. Uniformity in assessments of the FTCs was unnecessary and could have been otherwise achieved.
2. The Board issued the circular no. 742 without any reference to existence of Double Taxation Avoidance Agreements (DTAAs) that may be applicable to the FTCs. Though a circular issued by the Board under Section 119 of the Income Act, would be binding on the assessing officers and persons employed in the execution of the Act, no circular can go against the provisions of Income Tax Act, 1961. The Circular is violated the provisions of the DTAAs which have the force of the law.

#### B. Circular No. 765 dated 15.4.1998

3. The Chairman, CBDT issued Circular No. 765 without reference to the Board, the Revenue Secretary and the Finance Minister and extended the guidelines contained in the earlier Circular No. 742 *indefinitely*.

### 3.3.6 Defects/lacunae in the Circulars

It was noticed in audit that following aspects/factors were not considered by the Board while issuing the circular and then extending it indefinitely.

1. The Circular No. 742 applies to non resident FTCs. Their income from Indian operations would be taxed in terms of provisions of DTAAs with these countries where the FTC were resident. Their income in India can be taxed **only if** they have a permanent establishment in India. The CBDT has presumed that the FTCs do not have any permanent establishment in India. Therefore, the Circular suffers from an inherent contradiction. Absence of permanent establishment on the part of a non-resident enterprise of the contracting state *ipso facto* leads to its income being not taxed in the other contracting state as per the provisions of the DTAAs.
2. The FTCs have appointed agents who are Indian entities and have entered into an agreement with them. These agreements need to be approved by the RBI. The Indian agents are seen to be related to **a single principal exclusively** for marketing of airtime, liaise with local advertisers, canvassing of business, collecting payments and assist in RBI procedures. These functions and the fact that they were being carried out exclusively on behalf of FTC, led to these agents losing the status of an independent agent of FTC. In the light of the above, the CBDT presumption that the FTC did not have any branch/permanent establishment in India was not correct. **Thus, in terms of DTAAs the entire income of foreign enterprise**

**attributable to its permanent establishment would be taxable at appropriate rates and not at some presumptive rate.** Apart from these specific provisos in the DTAAAs, various other tests exist for determining the status of an agent vis-a-vis its principal which were also ignored by the Board.

3. Comparison with India based channels such as Sun TV, Udaya, Raj TV etc. were ignored by CBDT, these were/should have been basis to ascertain the profitability of telecasting channels. Therefore the presumption of 10 percent as reasonable profit lacked adequate consideration of facts available at the time.
4. It was also noticed that some of the FTCs also operated 'Pay Channels', whereby they earned royalties. Further, lease rent on leasing of decoders was also earned by the FTCs. These sources of income to the FTCs were completely ignored by the Board while framing the scheme of presumptive taxation of FTCs.
5. At the time of issuing circular No. 742, the then Chairman, CBDT had assured the Secretary (Revenue) that the results of this exercise shall be watched and in a year or two a section akin to 44 B or 44 BB, 44 AD, or 44 AE would be introduced in the Act. However, it was seen that neither such an exercise was undertaken nor any such proposal was made in the Finance Act, 1999.
6. It was seen that the CBDT was aware, at the time of extending the Circular 742 vide 765 dated 15.4.1998 of a ruling in a case (CIT Vs. TVM Ltd.) before the *Authority for Advance Ruling* (AAR) under section 245Q of the Income Tax Act. The AAR held, *inter alia*, that the guidelines in Circular No. 742 were general in nature and it was open to assessees to accept it, if beneficial to them. Further, it opined that to the extent the guidelines in the circular purported to extend its applicability of presumptive profitability to cases where the FTC did not have a permanent establishment in India, they **could not be said to be laying down the correct position in law.**

The AAR concluded that **where substance prevails over form, a permanent establishment is deemed to exist.** Though the AAR rulings is not binding on the Board, the AAR had highlighted important issues relating to profitability and taxation of FTCs and also pointed out lacunae in the Circular No. 742. The then Chairman ignored this legal advise and issued Circular No.765 extending circular No. 742 without possessing any authority to do so.

7. The FTCs were allowed approximately, 30 percent **deductions** from the aggregate of their receipts under these circulars. This was a major concession hitherto not available under presumptive taxation leading to an unfair advantage for the FTCs. Existing sections like 44B (non-resident shipping business), 44BB (non-resident business of oil exploration), 44BBA (non-resident business of aircraft operations), and 44BBB (foreign



companies in business of civil construction etc in certain turnkey power projects) also provide for taxation of presumptive profits. However, deductions from the revenues earned including deductions under Sections 28 to 43C are not available to these assesseees. Even in cases of resident assesseees, for example, Section 44AD (business of civil construction) and 44 AE (business of plying , hiring etc. of goods carriage) estimation of income is done by applying tax on presumptive profits without the benefit of deductions available under Sections 28 to 43C.

### 3.3.7 AUDIT OF ASSESSMENTS

It was seen that the RBI has granted approval to ten agreements between nine FTCs and ten Indian agents.

Foreign Telecasting Company (Channel)	Indian Agent
1. Asia Today Ltd.	1. Zee telefilms Ltd.
2. Satellite Television Asian Region Advertising Sales BV	2. News Television India Ltd.
3. SET Satellite Singapore Pvt. Ltd.	3. SET (India) Ltd.
4. Discovery Channel.	4. Discovery Communication India
5. ESPN Asia (S) Pte. Ltd.	5. WD India Pvt. Ltd.
6. MTV	6. MTV India Pvt. Ltd.
7. TVM Ltd.	7. TV India Ltd.
8. As Above	8. C.M. Airtime Promotion Pvt. Ltd.
9. BBC Worldwide Ltd.	9. BBC Worldwide India Pvt. Ltd.
10. Television Eighteen Mauritius Ltd.	11. Eighteen Entertainment India Pvt. Ltd.

- Assessment records of only three Indian agents in New Delhi and two FTCs in Mumbai could be accessed for audit purposes.
- Satellite Television Asian Region Advertising Sales BV was seen to have been assessed as 'FTC' whereas the records showed that it held exclusive rights in India from Satellite Television Asian Region Ltd. for television advertising on various television channels.
- The advertising revenues from India showed a rising trend as follows:

FTC	Rupees in crores		
	A.Y.1996-96	A.Y.1997-98	A.Y.1998-99
ASIA TODAY LTD(ZEE)	116.61	144.71	191.35
SATELLITE TV ASIAN REGION ADVERTISING SALES BV (STAR)	32.89	69.35	76.15
SET SATELLITE SINGAPORE PVT. LTD (SONY)	2.34	29.27	94.48

- FTCs earned royalties from 'Pay Channels' and lease income from rentals of decoders.

**Discovery Communication (I) Pvt. Ltd.:** This assessee is agent of M/S Discovery Communication Inc., USA. The assessee has earned 'facilitation fee' of Rs. 22.63 crore for viewing its channel in the FY 1997-98.

**ESPN Software (I) Pvt. Ltd.:** This assessee has the rights over the ESPN channel in India. The assessee has earned distribution turnover in the nature of subscription income. It has earned a total of Rs.213 crore as distribution income from rights to view STAR and ESPN channel. The assessee has also earned lease rental in respect of decoders amounting to Rs.43.31 crore during the F.Y.1997-98.

### 3.3.8 Audit Conclusions

- 1) *FTCs also earned royalties for 'pay channels' and lease income from rentals of decoders. The Board had not considered this flow of revenue accruing to the FTCs.*
- 2) *The trend of advertising revenues is rising sharply leading to higher profitability of these FTCs.*

*The above two factors have not been considered by the Board before issue and later extending the Circular indefinitely.*

### 3.3.9 SUMMARISED AUDIT FINDINGS

1. There was no need for the Circular No.742 to have been issued since the I.T. Act [Sec. 295 (3) (a) read with Sec. 296] already provides for estimation of income of non-residents that cannot be definitely ascertained for taxation purposes.
2. The Board issued Circular No.742 to the detriment of revenue and benefit of FTCs. However, no systems and procedures or management information system were introduced to monitor the assessments of these entities as promised in the notings prior to securing approval for issue of circular.
3. The Foreign Telecasting Companies were afforded a special status under the circular whereby they could avoid the rigours of normal assessment procedure which are hitherto applicable to India based telecasting companies. Audit attempts to test check some of the assessment records revealed that most of the FTCs did not file the return of income whereas majority of the Indian agents of the FTCs returned losses.
4. The extension of the Circular No. 742 vide Circular No. 765 was solely to the benefit of the FTC, without the Board applying its mind and without the authority of the Finance Minister.
5. In effect, the Circular is invalid and needs to be withdrawn forthwith to avoid legal complications in the proper assessment of the FTCs.



**C-Special Study**

**3.4 Abolition of tax on dividend income**

**Introduction**

**3.4.1** Till recently, the dividend income in India was subjected to double taxation i.e. once in the form of taxation of corporate profits and again in the form of personal income tax in the hands of the recipient share holders. With effect from 1 June 1997, Government of India decided to abolish tax on dividends in the hands of the shareholders in respect of domestic companies and to impose an additional levy over and above the normal income tax charged on domestic companies at a flat rate of 10% on distributed profits. Also, the existing tax concession available in respect of dividend income up to limit of Rs.12,000 and inter-corporate dividends to the extent specified was also simultaneously discontinued.

The following study seeks to evaluate the policy considerations prompting the above Government decision and its probable impact on revenue.

**Methodology**

**3.4.2** Following broad methodology was followed in the preparation of this study paper.

- ◆ Examination of policy files of the Ministry on abolition of dividend tax.
- ◆ Analysis of data compiled by Centre for Monitoring of Indian Economy (CMIE).
- ◆ Consultations with noted public Finance experts and reference from a few articles in media.
- ◆ Study of global practices on dividend taxation.
- ◆ Report of the Chelliah Committee on the tax Reforms.

**Background**

**3.4.3** The existing scheme of double taxation of dividends prior to 1.6.1997 was underpinned by classical logic that corporations are distinct legal entities and should be taxed in their own right, apart from the tax that may be levied on the individual shareholders according to their respective abilities to pay (determined by marginal rates of tax). Under this scheme, a separate tax is levied on the total profit of the corporation and neither the shareholder nor the company is given any relief in respect of the dividend on which the shareholders have to pay tax again.

Main criticisms of the scheme have been as follows:

- 1) That this scheme punishes distribution of dividends. It, therefore, inhibits free flow of funds into viable sectors of the economy.
- 2) That this scheme encourages debt financing as opposed to equity financing, for interest payments are deductible from gross profits while dividends are not.

However, both these criticisms were met by the Chelliah Committee Report in the following manner with specific recommendation that the existing system may continue in view of the facts that

1. The existing system has the merit of simplicity and is easy to administer.
2. With reduction in tax rates, there would be reduced bias in terms of retained/distributed dividend.

The Committee further stated that though some relief could be afforded through a simple and fair method of exempting distributed profits from the corporation tax, it specifically did not recommend such a relief in the short term. The main reason was that with lowering of marginal rate of tax, the total burden of tax on dividend income would be considerably reduced from the previous levels.

In tune with the above recommendation, the Government subsequently reduced the personal income and corporate tax rates to 30% and 35% respectively through the Finance Act 1997. However, the recent decision to abolish tax on dividends is contrary to the specific recommendation of the Tax Reforms Committee.

**Decision making  
process**

**3.4.4** Examination of the policy files of the Ministry revealed that the Government had formulated two alternatives on the subject of taxation of dividends. These were as follows:

**Option 'A'** A permanent withholding tax be levied on dividends to be collected from the companies on behalf of the shareholders.

**Or**

**Option 'B'** A dividend tax be levied at a flat rate on distributed profits of domestic companies.

*Note: The income actually received by the shareholders both in 'A' and 'B' above would be exempt from tax in their hands. However, it may be noted that the Company will have to pay tax on its income as also act as tax deductor for the dividend paid to the shareholders under Option 'A'. Under Option 'B', the company will be required to pay additional tax on distributed profits apart from the regular tax on its income.*

**OPTION 'A' FOUND BETTER THAN OPTION 'B'**

It was seen from the Ministry files that the option at 'A' was initially considered by Government as sound on legal grounds in preference to option



'B' as the latter had connotations of double taxation of the same entity on the same income.

It is important to go into the reasons as to why the Government found Option 'A' of imposition of permanent withholding tax superior to Option 'B'. These are summarised as follows:

- ◆ The government felt that the existing provisions encouraged substantial under reporting of dividend income in as much as for dividend income below Rs. 2500, no TDS was applicable.
- ◆ A single point tax collection procedure was found superior to scrutiny of TDS cases of numerous shareholders when considered in terms of time, cost and manpower deployment.
- ◆ A moderate levy of tax, it was anticipated, would encourage development of capital market through investment of undisclosed income.

Adoption of option 'A' also presupposed that the existing concessions under Section 80L in respect of dividend, tax exemptions upto Rs.12,000 and inter-corporate dividends under section 80 M were to be discontinued.

#### **Revenue forecasting under option 'A':**

The Ministry reckoned that the Option 'A' (withholding tax) would generate TDS collection of Rs.1000 crore at the rate of 20% on dividends. The rate was further pruned to 15% on grounds of equity and fairness for the small shareholders. The TDS collection on this basis worked out to Rs.750 crores. The Ministry files reveal two important assumptions that were made while estimating the net TDS collection from dividends.

1. That the total dividends distributed by companies were in the range of Rs.12,000 - 13,000 crores for the year 1995-96.
2. That the in-built provisions of the Income tax Act provides for exemptions and deductions of roughly 60% of the total dividend declared.

#### **Audit views**

**3.4.5** In this respect, it may be observed that the estimates of Rs.750 crore TDS collection on the basis of above assumptions were, it seems, arrived at erroneously. This could be seen in the light of following facts.

- ◆ A study of the Ministry files reveals that the estimated dividend payout for the financial year 1995-96 was assumed to be in the region of Rs. 12,000 to 13,000 crores based on data collected from two sources -- namely, a research house at Mumbai which furnished data for 2000 companies which had declared dividend of Rs. 8215 crores and from the Centre for Monitoring Indian Economy (CMIE) for 1604 companies which had declared dividend of Rs. 4739 crores. On the basis of this, the total dividend payout figure arrived at was Rs. 12,000 crores. However, it is likely that some companies would feature in the sample size of both

the sources relied upon by the Ministry and hence the figure of Rs. 12000 crores cannot be said to be correct. Further the TDS collections from dividends 1990-91 to 1996-97 (figures available to the Ministry while making the estimates) by and large showed an upward trend, and in the year under consideration (1995-96) it had more than doubled over the previous year's collection.

(Rs. In crores)	
YEAR	TDS ON DIVIDENDS
1990-91	276.64
1991-92	391.27
1992-93	366.28
1993-94	408.89
1994-95	577.73
1995-96	1,176.98
1996-97	1,022.72

Source: C&AG's Audit Reports on Direct taxes for the years 1990-91 to 1996-97

- ◆ The impact of reduced corporate tax rates on growth of dividends and probable consequent impact on revenue collection under TDS was also not accounted for.
- ◆ The dividend income when taxed in the hands of recipients (in higher income bracket) was subjected to tax at rate of 30 percent and the levy of tax on dividend declared or paid at above rate is prejudicial and detrimental to the interest of revenue. The total collection of tax on dividend in the year 1998-99 is Rs.269 crore as against the TDS of Rs.1022.72 crore in the year 1996-97.
- ◆ The Finance Act, 2000 has raised the tax rate on dividend income from 10 percent to 20 percent.

**Final decision**

**3.4.6** The Government of India finally decided to opt with effect from 1<sup>st</sup> June 1997 for **an additional tax on distributed profits (Option 'B') @ 10%** as opposed to final withholding tax on dividends. It provided that the incidence of tax was not to be passed on to the shareholders and was an additional levy on the profits of the company. It may be recalled that the specific recommendation of the Tax Reforms committee to maintain status quo (*i.e. double taxation of dividend once in the form of taxation of corporate profits and again in the form of personal income tax in the hands of shareholders*) was in effect rejected by the Government.

**Audit analysis**

**3.4.7** Since no specific reasons were found recorded in favour of this decision in the Ministry files, the analysis of the policy decision could be made only with reference to the reasons stated in the Finance Bill 1997. These were as follows.



- ◆ To check tendency on the part of companies to distribute exorbitant dividends and
- ◆ To encourage investment in the shares of the domestic companies.
- ◆ To promote fresh investment.

### Exorbitant dividends

3.4.8 It is important to discuss the assumption that the companies have shown tendency to declare exorbitant dividends. This assumption also presupposes that the companies tend to have less retained earnings for growth. In this regard following database analysis was made to arrive at conclusions.

#### 1. Data on frequency distribution of dividend rate for 1995-96.

INTERVAL(%age)	NUMBER OF COMPANIES		PERCENT SHARE	
	Indian	Foreign	Indian	Foreign
Upto 10	611	12	22.3	8.5
11-20	1176	38	42.8	26.8
21-30	591	34	21.5	23.9
31-40	201	24	7.3	16.9
41-50	89	15	3.2	10.6
51-60	30	4	1.1	2.8
61-70	11	1	0.4	0.7
71-80	9	3	0.3	2.1
81-90	4	1	0.3	0.7
91-100	9	1	0.3	0.7
Above 100	15	9	0.6	6.3
<b>Total</b>	<b>2746</b>	<b>142</b>	<b>100.0</b>	<b>100.0</b>

Source: CMIE Feb 1997 issue

The above table would indicate that only a handful of domestic companies (167 out of 2746) declared dividend at exorbitant rates in the region of 40% and above whereas the large majority declared dividend in the region of 11% to 30% only. Similar trend is visible in the case of foreign companies.

#### 2. Growth in rates of dividend payment:

(a) The following table depicts respective growth in rates of dividend payments and retained earnings for the Indian private sector in respect of manufacturing companies during 1991-97.

Year	Growth in %age dividend payment	%age Retained earnings
1991	23.4	64.3
1992	15.9	3.4
1993	19.2	-9.1
1994	51.4	109.2
1995	43.0	73.6
1996	18.1	10.0
1997	4.7	-41.7

(Source: CMIE April 1998 issue)

While there were wide fluctuations in the growth in percentage dividend payments as well as retained earnings, both dividend payments and retained earnings appeared to have registered significant growth trends only during 1994 and 1995 as compared to previous and later years.

- (b) An age-wise distribution of growth in dividend pay-out and retained earnings of manufacturing companies during 1991-97 revealed that the fluctuations were probably caused by exorbitant dividends declared by companies set up after 1991 in particular and those set up between 1986 and 1990. This is evident from the table below which depicts age-wise growth in dividend payment over the last four decades.

Year of incorporation	Growth in dividend payment (%)	Growth in Retained earnings (%)
Before 1950	23.64	19.38
Between 1950 & 1971	20.50	12.12
Between 1972 & 1985	25.47	0.00
Between 1986 & 1990	60.01	32.19
After 1991	119.72	0.00

(Source: CMIE April 1998 issue, Corporate Sector)

#### Audit views

**3.4.9** It could be seen that the percentage growth in retained earnings was nil in respect of companies that were set up after 1991 in particular. By contrast well-established companies seem to have registered more or less stable growth rates in dividends payment.

The above finding reinforces the view that a few companies set up only in the recent past were responsible for very high dividend payments. It, therefore, appears that the reason advanced for levy of additional tax on distributed profits of the company, namely, exorbitant liberal dividend payments, appears to be high-pitched.

#### Implications for revenue

**3.4.10** The existing system of double taxation of dividends in the hands of shareholders as also the companies had an in built bias for encouraging profit retention. On the other hand, the additional tax on distributed profits being a double levy on the *same entity* could result in dividend cut-backs. The adoption of Option 'B', therefore, has implications, not necessarily restricted to tax revenues alone, that need to be revisited.

- ◆ The dividend income is now under a disability of suffering tax more than once. A recipient shareholding company, for example, will have to pay tax on its income (including the dividend income) and an additional tax on the distributed profits that includes the dividend income. This will induce successive reduction in dividend pay-out which apart from translating into



lesser revenue for the Government, could also impact on growth of capital market over long term.

- ◆ Additional tax on distributed profits tends to be unfair in that the dividend income of shareholders falling below the taxable limits would also in effect be taxed away at source. Besides, the tax has the effect of raising the effective corporate tax rate as a result of which the shareholders whose personal income tax rates are lower would be unequally taxed as compared to high income shareholders. Thus, the measure has the inherent disadvantage of conferring greater benefit to higher income shareholders.

#### Short term prognosis

**3.4.11** A fall in corporate tax revenue earning growth over short term is reasonably expected on account of the following:

- ◆ Tax buoyancy in respect of revenue collection from company assesseees during 1997-98 increased by only 7.81% as compared to 12.61% during 1996-97. This is evident from the following table:

(Rs in crore)			
Year	Corporate tax collection	Change	Tax buoyancy (%age)
1995-96	16,487.13	---	---
1996-97	18,566.69	2079.56	12.61
1997-98	20,016.00	1449.31	7.81

- ◆ The lowering of corporate taxes during 1998-99 and the imposition of additional tax on distributed profits coupled with abolition of tax in the hands of shareholders from 1.6.97 could result in immediate decline in growth in revenue collection unless the corporate profits sufficiently grow and/or tax compliance improves.
- ◆ The anticipated widening of the capital market through tapping the undisclosed income on the sole consideration of exemption of tax on dividends is not realistic.

#### Long term prognosis

**3.4.12** The new measure could discourage the expansion of the capital market for the reason that dividend tax by adversely impacting on dividend distribution may work as a disincentive to the small investor whose main motivation to remain in the capital market is to earn a fixed rate of return. By contrast, higher income shareholders are principally motivated by capital gain considerations and are less affected by dividend cut-backs.

#### Global practices

**3.4.13** A comparative study of practices in vogue in a few European and Asian countries as well as U.K. and U.S.A revealed that, by and large, dividend income is not tax exempt.\*

\* Based on Chelliah Committee's Report and the Direct Taxes in selected countries published by the National Institute of Public Finance & Policy.

- In a majority of countries such as Denmark, Germany, France, Indonesia, Japan, Korea, Sri Lanka, U.K., U.S.A., Malaysia, Pakistan, Singapore, and Taiwan, there is a system of double taxation i.e. dividends are taxed in the form of corporate profits and in the hands of the shareholders.
- There is a system of withholding of tax on dividends in countries such as Belgium, Korea, Nigeria, Sri Lanka, Taiwan, Thailand, Indonesia, Zambia. In the case of New Zealand and Malaysia and Korea, the corporate income tax on distributed profits is deemed as withheld in the hands of the shareholders.
- A system of imputation of tax credits exists in a few countries, where dividends are taxed as corporate profits such as Germany, France, Australia, U.K. and Singapore and the shareholders are given tax credits against such tax payments. In U.K. for instance, there is no withholding of income tax on dividends but the company paying the dividend is liable to pay advance corporate tax amounting to one-third dividend to be set off against its corporate tax liability. The advance corporate tax payment is imputed to the shareholders as a tax credit against their income tax liabilities on the dividend plus credit.
- In a number of countries such as UK, USA, Taiwan, Egypt, Germany, Japan, Thailand, Denmark and Belgium, inter corporate dividends is recognised as exempt subject to certain specified limits. An exception is that of Korea where inter corporate dividends are treated as taxable.
- In Pakistan and Nepal, there is no tax on distributed profits and in the case of Philippines, dividend income received from a domestic company is exempt from personal income tax. In Mexico, too, dividends paid out of profits already taxed are exempt.

*A predominant conclusion emerging from the above is that in a majority of countries, there is a limited protection from taxation in respect of inter-corporate dividends. Most countries tax dividends in the hands of individual shareholders or these are deemed as withheld in the hands of companies with or without a system of tax credits/tax reliefs.*

**Summary of audit conclusions**

**3.4.14** The decision to abolish tax on dividends in the hands of shareholders and levy of additional tax of 10% on the distributed profits was, it seems, taken based on insufficient facts and incorrect assumptions.

- ✓ Analysis of the alternatives, was based on incorrect assumptions (Option 'A') and without appreciating relevance of appropriate data (Option 'B').
- ✓ The trend of dividend payments by the companies over the years was not considered.
- ✓ Percentage growth in retained earnings of the companies over the years was not considered.



- ✓ The final decision is at variance with the global practice of taxing dividends twice in the hands of the corporates and those of the shareholders.

Given the prevailing fiscal constraint, and the present scenario of reduced corporate tax rates co-existing with the exemptions / reliefs, the intended policy objectives of the measure appear to be out of step with the likely adverse impact on revenue.

## CHAPTER 4 : CORPORATION TAX

**Number of companies**

4.1 According to the Ministry of Finance (Department of Company Affairs), the number of companies under various categories and the paid-up capital in the case of limited companies, as on 31 March 1999 stood as under:

Sl. No.	Category	No. of Companies	Paid-up capital (Rs. in crore)
1.	Foreign companies as defined under Section 591 of the Companies Act, 1956	956	Not available
2.	Associations 'not for profit' but registered as companies	2727	Not available
3.	Unlimited companies	427	Not available
4.	Limited companies:		
	a) Government companies	1,229	94,708.06
	b) Non-Government companies-		
	(i) Private limited companies	4,40,348	40,413.68
	(ii) Public limited companies	70,413	1,15,342.24
	<b>Total :</b>	<b>5,10,761</b>	<b>1,55,755.92</b> (for Sl.No.4 only)

**Number of assessees**

4.2 The number of company assessees on the records of the Income Tax Department as on 31 March 1999 were 2,95,327 as compared to 2,74,319 as on 31 March 1998.

**Receipts of the Corporation Tax**

4.3 During 1998-99, Corporation Tax receipts were Rs.24,528.87 crore vis-à-vis Rs.20,016.00 crore in 1997-98; for details refer to para 2.3(i) of Chapter 2 of this Report.

**Status of assessments**

4.4 Particulars of assessments due for disposal, assessments completed and pending are given in para Nos. 2.9 of Chapter 2 of this Report.

**Results of audit**

4.5 A total number of 566 draft paragraphs involving undercharge of tax of Rs.825.61 crore and 18 draft paragraphs involving overcharge of tax of Rs. 2.69 crore have been issued to the Ministry of Finance for their comments. Out of these cases, 564 cases involving tax effect of Rs.800.03 crore are indicated in the succeeding paragraphs. The Ministry have accepted the observations in 224 cases involving tax effect of Rs.287.08 crore. Replies are awaited in respect of 301 cases.

**Avoidable mistakes in computation of income and tax**

4.6 Under the Income Tax Act, 1961, an assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer 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. Underassessment and overassessment of tax of substantial amounts on account of avoidable mistakes attributable to the negligence on the part of assessing officers have been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and



instructions issued by the Government from time to time, such mistakes continue to occur suggesting the need for better supervision and control. Various types of mistakes included, inter alia, incorrect adoption of figures, arithmetical errors, double allowance, non-levy of surcharge etc. The extent of such mistakes noticed during test check of the assessments completed by the assessing officers during last five years was as under:

(Rs. in crore)		
Year	Number of items	Amount of tax under assessed
1994-95	1,503	35.04
1995-96	1,643	105.81
1996-97	1,450	418.34
1997-98	1,531	192.32
1998-99	1,567	216.63

Cases of each type noticed in test check are given below:

#### 4.6.1 Overassessment of income and tax

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Chandela Trading Co. (P) Ltd. [Central II, Calcutta]	1995-96	143(3)	Tax was computed at the rate of 55 percent as against the correct rate of 40 percent	54.65
2.	M/s.Haryana Warehousing Corpn. [Panchkula, Haryana]	1991-92	143(3)	Interest for default in payment of advance tax was levied in excess	31.11

Similar mistakes including incorrect adoption of figures, arithmetical errors etc., led to overassessment of Rs. 183.66 lakh in 16 cases in Gujarat, Haryana, Karnataka, Orissa, Rajasthan, Maharashtra and West Bengal charges.

*The Ministry have accepted the audit observations at Sl.Nos.1 and 2 of the statement and in 9 of the other cases.*

#### 4.6.2 Underassessment of income and tax

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.VISL Ltd. [Karnataka III, Bangalore]	1990-91 1991-92	143(3)	Respective year's income was erroneously determined as loss	7402.93 (P)
2.	M/s. Mining & Allied Machinery Corpn. Ltd. [WB XI, Calcutta]	1994-95	143(3)	Due to mistake in totalling, loss was computed in excess	775.73 (P)
3.	M/s.United Phosphorous Ltd. [Surat, Gujarat]	1995-96	143(3)	Differential interest payment disallowed was erroneously omitted to be added back	506.43
4.	M/s.Kudremukh Iron Ore Co. Ltd. [Karnataka II, Bangalore]	1995-96	143(3)	The tax was levied on lesser amount than what was actually assessed	491.41
5.	M/s. German Remedies Ltd. [City V, Mumbai]	1995-96	143(3)	Relief though disallowed by the appellate authority, was allowed	119.00

6.	ABS Spinning Orissa Ltd. [Bhubaneswar, Orissa]	1993-94	144	Disallowed expenses were omitted to be deducted while computing income	96.92 (P)
7.	M/s.IFCI Ltd. [Delhi I]	1995-96	143(3)	Depreciation on leased assets was not fully disallowed	79.78
8.	M/s. Karnataka Silk Industries Corpn. Ltd. [Karnataka II, Bangalore]	1997-98	143(1)(a)	Income was computed erroneously	56.44

Similar mistakes in computation of income and tax in 48 cases in Andhra Pradesh, Gujarat, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Delhi, Maharashtra and West Bengal charges resulted in an aggregate short levy of tax of Rs.612.33 lakh.

The Ministry have accepted the audit observations at Sl.Nos. 2 to 6 and 8 of the statement and in 25 of the other cases.

**Application of incorrect rate of tax**

4.7 Under the provisions of the Income Tax Act, 1961, income tax is chargeable for 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. Where the total taxable income includes long term capital gain, income tax will be levied on taxable income as reduced by the long term capital gain at the rates specified in the annual Finance Act. The long term capital gain will be subjected to tax at a flat rate of 30 percent (20 percent from assessment year 1997-98) in the case of a domestic company.

Few cases of incorrect application of rates are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Century Laminating Co. Ltd. [Central I, Calcutta]	1994-95	143(3)	Tax was levied at the rate of 40 percent as against the applicable rate of 55 percent	22.36
2.	Edward Keventor (P) Ltd. [Central I, Calcutta]	1995-96	143(3)	Capital gains was taxed at 20 percent instead of the correct rate of 30 percent	12.52

In Tamil Nadu and Maharashtra charges, similar mistakes in application of correct rate resulted in total short levy of tax of Rs.17.02 lakh in two cases.

The Ministry have accepted the audit observations at Sl.No.1 and 2 of the statement and in 1 of the other cases.

**Incorrect computation of income from house property**

4.8 Under the Income Tax Act, 1961 while computing the income from house property, only deductions as provided under the provisions for computing income under the said head of income are allowable. If a particular type of deduction is not specifically provided the same cannot be claimed.

In City IV, Mumbai charge, the assessment of M/s. Airline Hotel Ltd. for the assessment year 1989-90 was completed after scrutiny in September 1997



computing the income under the head 'income from house property' even though the same was treated as business income by the assessee company in its return of income. Audit scrutiny revealed that while computing the income, deduction of Rs.6.66 lakh in respect of depreciation of Rs.3.24 lakh and investment deposit of Rs.3.42 lakh not allowable from the income from house property, were allowed. The mistake resulted in underassessment of income by like amount with consequent short levy of tax of Rs.10.93 lakh (including interest).

*The Ministry have accepted the audit observation.*

**Incorrect allowance of capital expenditure**

**4.9** Under the Income Tax Act, 1961, any expenditure not being expenditure of capital nature or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of business, is allowable as deduction in computation of income chargeable to tax under the head "Profits and gains of business or profession". It has been judicially held\* that interest paid before commencement of production on amounts borrowed by the assessee for the acquisition and installation of plant and machinery forms part of the "actual cost" of the assets. It was also held\* that the expenses incurred for test run of plant and machinery before the same is ready to commence commercial production were to be capitalised and included in the actual cost.

Cases where the provisions were not applied are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Indian Iron & Steel Co. Ltd. [WB I, Calcutta]	1994-95 1996-97	143(3) 143(1)(a)	Even though the liability for payment of interest was waived, the same was allowed as deduction	1742.29 (P) 179.03
2.	M/s.Essar Steel Ltd. [Central I, Chennai]	1993-94	143(3)	Interest payable and other expenses incurred during trial run of a new unit were allowed as revenue expenses instead of treating them as capital expenditure in nature	996.52
3.	M/s.Ashima Syntex Ltd. [Central, Ahmedabad]	1996-97	143(1)(a)	Expenses prior to commencement of production and capitalised by the assessee were allowed as deduction	635.71
4.	Godrej & Boyce Mfg. Co. Ltd. [City II, Mumbai]	1995-96	143(1)(a)	Provision towards liability which did not arise during the year was allowed as deduction	200.94
5.	M/s.Gujarat Sidhee Cement Ltd. [Rajkot, Gujarat]	1995-96	143(3)	Payment to rival dealer to ward off competition, being capital expenditure in nature, was allowed as deduction	112.49 (P)
6.	M/s.Sakhti Textiles [Coimbatore, TN]	1991-92 to 1993-94	143(3)	Expenditure of capital nature towards cost of new assets was allowed as deduction	91.36

\* CIT Central Calcutta Vs Hindustan Petroleum Corporation Ltd. 98 ITR 167

\* CIT Vs Food Specialities Ltd. 136 ITR 203 (Delhi HC)

7.	M/s.Uma Parameswari Mills [Coimbatore, TN]	1994-95	143(3)	Deduction was allowed on expenditure of capital nature	78.46
8.	M/s.Mawmluh Cherra Cements Ltd. [NE Region, Shillong]	1994-95	143(3)	-do-	75.09
9.	The Federal Bank Ltd. [Kochi, Kerala]	1996-97	143(1)(a)	Expenses on additional issue of shares were allowed as revenue expenditure	68.56
10.	M/s. Refractory Specialties Ltd. [Dhanbad, Bihar]	1994-95	143(1)(a)	Value of fixed assets written off was allowed as revenue expenditure	45.39 (P) 9.08 (AT)

Mistakes of similar nature in 16 other cases in Gujarat, Kerala, Madhya Pradesh, Tamil Nadu, Delhi, Maharashtra and West Bengal charges resulted in short levy of tax aggregating Rs.329.40 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.1 and 7 of the statement and in 6 of the other cases.*

*The Ministry have not accepted the audit observation at Sl.No.4 of the statement stating that the issue involved was highly debatable since two opinions were possible.*

*The reply is not tenable in view of the clear decision\* of the jurisdictional High Court.*

**Incorrect allowance of provision for bad and doubtful debts in respect of advances made by rural branches of bank**

**4.10** The Income Tax Act, 1961, as amended by the Finance Act, 1993, with effect from April 1994, provides that in respect of any provision for bad and doubtful debts made by a scheduled or non-scheduled bank, an amount not exceeding five percent of its total income (computed before making any deduction under this provision and Chapter VIA) and an amount not exceeding ten percent of aggregate average advance made by the rural branches of such bank computed in the prescribed manner, shall be allowed as deduction while computing the business income of the assessee. 'Rural branch' for this purpose has been defined as a branch of a scheduled or a non-scheduled bank in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

In Varanasi, Uttar Pradesh charge, the assessment of **The Benares State Bank Ltd.** for the assessment year 1995-96 was completed after scrutiny in March 1998 allowing a deduction of Rs.41.54 lakh towards provision made in respect of bad and doubtful debts for twenty eight rural branches of the bank. Audit scrutiny revealed that out of twenty eight rural branches, twenty one branches for which deduction of Rs.38.72 lakh was allowed towards bad and doubtful debts were situated in places with a population exceeding ten thousand according to the last census. As such those branches did not fall within the meaning of rural branches and were not entitled to the said deduction. The mistake in allowing deduction resulted in underassessment of income by

\*CIT Vs Rajkumar Mills Ltd.: 80 ITR 244 (Bombay)



Rs.38.72 lakh involving potential tax effect of Rs.17.81 lakh including surcharge.

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

**Incorrect allowance of bad debts in case of banking companies**

**4.11** Under the Income Tax Act, 1961, as amended from 1 April 1989, the amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing the income chargeable to tax under the head 'profits and gains of business or profession'. In the case of a bank to which provision for bad and doubtful debts is admissible, the amount of deduction shall be limited to the amount by which such debt or part thereof exceeds the "credit balance in the provision for bad and doubtful debts' account" made under the Act. Further, as amended by Finance Act 1986, with effect from April 1987, in respect of any provision for bad and doubtful debts made by a scheduled or a non-scheduled bank, an amount not exceeding five percent of its total income computed before making any deduction under this provision and Chapter VIA shall be allowed while computing the business income of the assessee.

Cases of irregular/incorrect allowance of bad debts noticed during test check are indicated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Tamil Nadu Mercantile Bank Ltd. [Madurai, Tamil Nadu]	1989-90 1990-91	143(3) 143(3)	Claim for bad debts was allowed without deducting the provision for bad and doubtful debts	92.32
2.	The South Indian Cochin Bank Ltd. [Cochin, Kerala]	1995-96	143(3)	Deduction was allowed for bad debts written off even though the same had not exceeded the provision for bad and doubtful debts	87.87

Other mistakes in allowing deduction towards bad debts in 6 cases in Kerala, Tamil Nadu, Uttar Pradesh and Maharashtra charges resulted in aggregate short levy of tax of Rs.104.64 lakh.

*The Ministry have accepted the audit observations in 2 out of the 6 cases.*

*The Ministry have not accepted the audit observation at Sl.No.1 of the statement on the ground that under section 36(1)(vii), proviso in the case of a bank to which section 36(1)(viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad debts amount. It is the entire credit balance in the above account that has to be considered and not the provision made in the current year as pointed out by the audit. Further, section 36(1)(vii) will apply to urban debts and 36(1)(viia) proviso will apply to the rural debts relating to bank.*

*The reply is not tenable as the case of a banks provision of bad and doubtful debts is allowed as a special case. When there is a claim for actual bad debts the claim should be set off with the provision allowed and if still any balance is left thereafter then that can be allowed as deduction under the proviso to section 36(1)(vii).*

**Incorrect allowance of provisions**

**4.12** 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. It has been judicially held\* that in order that a loss be deductible it must have actually arisen and incurred and not merely anticipated as certain to occur in future. Further, it has been judicially held\*\* that where a liability arising out of a contractual obligation is disputed, the assessee is entitled, in the assessment year relevant to the previous year in which the dispute is finally adjudicated upon or settled, to claim a deduction on that behalf. It has also been judicially held\*\*\* that neither leave salary nor leave encashment benefit payable to the employees can be said to be a present liability and an assessee is not entitled to the deduction of the provision made to meet such liability.

Cases where the above provisions were not applied are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Ratnam Gems Impex Ltd. [City II, Mumbai]	1996-97	143(3)	Contingent liability being interest payable to a bank, though under dispute, was erroneously allowed as deduction.	481.15 (P)
2.	M/s.I.C.I.. (India) Ltd. [WB IV, Calcutta]	1996-97	143(1)(a)	Provision towards encashment of outstanding leave and retirement benefits of employees was allowed as deduction	270.48
3.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1996-97	143(1)(a)	Provision for bad and doubtful debts was allowed as deduction	122.47 (P) 24.29 (AT)
4.	M/s.Shree Cement Ltd. [Udaipur, Rajasthan]	1993-94	143(3)	Provision for proposed payment of dividends was allowed as deduction	125.25
5.	M/s.Precision Fastners Ltd. [City V, Mumbai]	1995-96	143(1)(a)	Liabilities, for which payment arose only at a future date, were allowed as deduction	63.47 12.69 (AT)

Other mistakes of similar nature in 19 cases in Andhra Pradesh, Bihar, Gujarat, Karnataka, Orissa, Tamil Nadu, Delhi, Maharashtra and West Bengal charges resulted in total short levy of tax of Rs.314.44 lakh.

\* CIT Vs. Indian Overseas Bank 151-ITR-446 (Madras)

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

\*\*\* CIT Vs Bharat General & Textile Industries 157 ITR 158 (Cal)



*The Ministry have accepted the audit observations at Sl.No.2 of the statement and 3 out of the other cases.*

*The Ministry have not accepted the audit observation at Sl.No.3 of the statement on the ground that admissibility or non-admissibility of bad debt is beyond the scope of prima facie adjustment as per Board's instruction No.689. Moreover, it has been held\*\* by Gujarat High Court that even if the debt is squared up by debiting debtor and crediting provision for bad debt it would amount to writing off that debt. Therefore one cannot just conclude that merely because a provision has been debited in the profit and loss account, it is prima facie disallowable.*

*The reply is not tenable due to the reason that though admissibility or non-admissibility of bad debt is beyond the scope of prima facie adjustment no deduction is permissible in respect of provision for bad debt except in case of banks and financial institutions subject to certain conditions. The assessee not being a bank or financial institution deduction on account of such provision was patently inadmissible in law and covered by the Central Board of Direct Taxes instructions cited. Moreover, the judicial decision quoted was delivered on 20 August 1980 while the provision under section 36(1)(vii) was enacted in its present form with effect from 1 April 1989. Hence the latter would have an overriding effect on all earlier situations.*

*The Ministry have also not accepted the audit observation at Sl.No.5 of the statement stating that the issue was debatable.*

*The reply is not tenable as the contractual liability had crystallised only in the previous year relevant to the assessment year 1996-97 and the details thereof were prima facie available with the return.*

**Incorrect allowance of liability**

**4.13** Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment on types of expenditure specified under Section 43B of the Act. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are also deductible on actual payment basis. No deduction in respect of contribution to the above funds is, however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds. It has been judicially held\* that the amount of sales tax collected by a trader in the course of business constitutes his trading or business income.

Instances of incorrect/irregular allowance of liability are illustrated below:

\*\* Vittal Das H. Dharjibhai Vardanwalla Vs CIT : 130 ITR 95

\* Chowringhee Sales Bureau (P) Vs CIT (1973) 87 ITR 542(SC)

(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1996-97	143(1)(a)	Electricity duty and other levies due to Government were allowed as deduction even though these were not paid within the prescribed dates	1893.91 (P) 378.78 (AT)
2.	M/s. Rajasthan State Electricity Board [Jaipur, Rajasthan]	1995-96	143(3)	-do-	1209.77 (P)
3.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1995-96	143(3)	Provident fund contributions not deposited with the appropriate authority within the stipulated due date were allowed as deductions	1112.19 (P)
4.	M/s. Mining and Allied Machinery Corp. Ltd. [WB XI, Calcutta]	1994-95	143(3)	Sales tax collections not paid to government were not added back	336.43 (P)
5.	M.P. State Electricity Board [Jabalpur, MP]	1995-96	143(1)(a)	Contribution towards provident fund was not disallowed even though not paid before the due date	237.63 (P) 47.53 (AT)
6.	M/s. Philips Carbon Blacks Ltd. [WB II, Calcutta]	1994-95	143(3)	Customs duty, though unpaid by the due date, was not added back to income	231.87
7.	M/s. Rashtriya Ispat Nigam Ltd. [Vasakhapatnam, AP]	1994-95	143(3)	Guarantee fee not paid to Government of India within the due date was allowed as deduction	142.82 (P)
8.	M/s. Pennar Aluminum Co. Ltd. [Central, Bangalore]	1995-96	143(3)	Excess amount was allowed as deduction towards 'sales tax paid and deferred'	106.39 (P)

Similar nature of mistakes in 20 cases in Andhra Pradesh, Assam, Gujarat, Karnataka, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh, Delhi, Maharashtra and West Bengal charges resulted in short levy of tax aggregating Rs.226.30 lakh.

The Ministry have accepted the audit observations at Sl.No.1 and 2 of the statement and in 9 of the other cases.

#### Incorrect computation of income from tea business

**4.14** Under the Income Tax Rules, 1962, only 40 percent of the income derived from the tea grown and manufactured by a seller in India is deemed to be the income derived from manufacturing and selling operation of the assessee and liable to income tax, the remaining 60 percent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to tax. This rule regarding apportionment of income applies only to income from tea business. It has been judicially\* held that an assessee is entitled to deduction of cess on green leaves from 60 percent of the composite agricultural income.

\* Jorhaut Group Ltd. Vs Agricultural ITO 226 ITR 622 (Guwahati)



Cases of underassessment of income due to incorrect computation of income are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.A.F.T. Industries Ltd. [Central I, Calcutta]	1993-94, 1994-95, 1995-96	143(3)	Green leaf cess being exclusively agricultural in nature was not disallowed	128.14
2.	M/s.Jayshree Tea & Industries Ltd. [WB II, Calcutta]	1995-96  1996-97	143(3)  143(1)(a)	Green leaf cess was allowed 100 percent deduction instead of 60 percent of the composite income	41.36

Mistakes of similar nature in two other cases in Assam and West Bengal charges resulted in total short levy of tax of Rs.18.46 lakh.

*The Ministry have accepted the audit observation in one out of the two cases.*

*The replies of the Ministry to the audit observations at Sl. Nos. 1 and 2 of the statement have not been received.*

**Non-correlation with interest tax assessment**

**4.15** Under the Interest Tax Act, 1974 in computing the income of a Scheduled bank chargeable to income tax under the head 'profits and gains of business or profession' the interest tax payable by the scheduled bank for any assessment year shall be deductible from the profits and gains of the bank assessable for that assessment year. Further, under the Interest Tax Act, there is no time limit for completion of interest tax assessment. The Central Board of Direct Taxes issued instructions in December 1981 that interest tax assessments should as far as possible be completed alongwith the income tax assessments.

In the following 4 cases, even though the interest tax liability was reduced as per the appellate order, the income tax assessments were not revised to reduce the enhanced deductions originally allowed. The mistake resulted in aggregate short levy of tax of Rs.221.02 lakh.

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Tax effect	
1.	Central Bank of India [City III, Mumbai]	1993-94	143(3)	186.00	
2.	S.B.I. Capital Market Ltd. [City III, Mumbai]	1993-94	143(3)	19.57	
3.	M/s. Bank of Baharin and Kuwait [City III, Mumbai]	1993-94	143(3)	11.50	
4.	M/s.Prakash Leasing Ltd. [Bangalore, Karanataka]	1993-94	143(3)	3.95	

*The Ministry have accepted the audit observation at Sl.No.4 of the statement.*

**Incorrect allowance of prior period expenditure, etc.**

**4.16** Under the Income Tax Act, 1961, income under the head 'profits and gains of business or profession' is computed in accordance with the method of

accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment. Only such expenses are allowable as deduction from a previous years' income as are relevant to that year.

Few cases of incorrect allowance of prior period expenses are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Geep Industrial Syndicates Ltd. [Allahabad, Uttar Pradesh]	1994-95	143(3)	Interest on deposit and payment of central excise duty paid in advance were not considered while computing income	39.48

Additionally, in 3 cases incorrect allowance of prior period expenses etc. resulted in aggregate short levy of tax of Rs.61.68 lakh in Bihar, Uttar Pradesh and Delhi charges.

*The replies of the Ministry to the audit observations have not been received.*

**Preliminary expenses**

4.17 Under the Income Tax Act, 1961, the admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with the extension of an industrial undertakings is limited to 2.5 percent of the cost of the project or capital employed at the option of the assessee and is allowed in equal instalments spread over ten years.

Cases. where the above provisions were not applied correctly are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Surat Electricity Co. Ltd. [Surat, Gujarat]	1994-95	143(3)	Expenditure on issue of debentures was not limited to one-tenth of capital employed	10.80 (P)

Similar mistakes in 3 other cases in Tamil Nadu, Delhi and Maharashtra charges led to total short levy of tax of Rs.26.99 lakh.

*The Ministry have accepted the audit observation in one out of the 3 cases.*

*The Ministry have not accepted the audit observation at Sl.No.1 of the statement on the ground that section 35D of the Act is applicable in two situations-before the commencement of business, or after the commencement of business in connection with extension of industrial undertaking or in connection with his setting up of new industrial unit, that is section 35D is applicable only if either of the two situation exist. If no such situation exists, provision of section 35D*



cannot come into play. As the debentures were issued to augment the working capital and to meet normal capital expenditure it would be regarded as part of normal borrowing and expenditure and thereby it would be revenue expenditure and therefore allowable. Further more, there is no extension or expansion, it would not be possible to apply the provision of section 35D of the Act and thus the issue of fully convertible debenture is revenue in nature.

The reply is not tenable as the fund was utilised for non revenue purposes and the assessee himself debited one-third of the debenture issue expenses to the profit and loss account. Since the expenditure was incurred both for extension of an existing unit and also to establish new units the provisions of section 35D are attracted.

**Payments  
outside India**

**4.18** Under the Income Tax Act 1961, where in any financial year an assessee has paid any interest, royalty or fees for technical services or other sum chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted at source, such amounts (payable outside India) shall not be deducted in computing the income chargeable under the head 'profits and gains of business or profession'.

Cases of omission to follow the above provisions are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Avon Cycles Ltd. [Ludhiana, Punjab]	1992-93, 1995-96	143(3)	Commission paid outside India without deduction of tax at source was allowed as deduction	189.33
2.	M/s Standard Batteries Ltd. [City II, Mumbai]	1994-95 1995-96	143(3)	Even though tax was not deducted at source, royalty payments made outside India were allowed as deduction	97.35 (P)
3.	M/s. Wipro System Ltd. [City I, Mumbai]	1994-95	143(3)	-do-	79.67

Similar mistakes in 2 cases in Haryana and West Bengal charges resulted in total short levy of tax of Rs.54.18 lakh.

The Ministry have accepted the audit observations at Sl.Nos.2 and 3 of the statement.

**Irregular  
allowance of  
expenditure on  
scientific  
research**

**4.19(a)** Under the Income Tax Act, 1961, expenditure of a capital nature incurred after 31 March 1967 on scientific research related to the business carried on by the assessee is admissible as a deduction while computing the business income. The Act further provides that an assessee, carrying on business whose total turnover exceeds forty lakh rupees in the previous year, is mandatorily required to furnish a Tax Audit Report in the prescribed form after getting the accounts audited by an accountant providing statement of certain particulars. The particulars include, inter alia, expenditure on scientific research indicating separately expenditure of capital nature. The Act also provides that if



any question arises as to whether, and if so, to what extent any activity constitutes or constituted, or any asset is or was being used for, scientific research the Board shall refer the question to the prescribed authority, whose decision shall be final.

In West Bengal VI, Calcutta charge, the assessment of **M/s.Ananda Bazar Patrika Ltd.** for the assessment year 1994-95 was completed after scrutiny in January 1997 allowing a deduction of Rs.187.98 lakh towards capital expenditure on scientific research as per claim of the assessee in the revised return. Audit scrutiny revealed that in the Tax Audit Report submitted by the assessee, the expenditure on scientific research was shown as nil and no expenditure of capital nature was indicated separately. Further, in the original return submitted by the assessee, no claim for deduction on account of scientific research was made by the assessee and the asset valuing Rs.187.98 lakh was included in an amount of Rs.321.83 lakh being addition to the plant and machinery block and depreciation was claimed accordingly. Moreover, under the provision of the Act, the assessing officer was required to refer the question as to whether the asset was being used for scientific research to the Board who in turn would refer the matter to the prescribed authority viz. Director General (Exemption). In the absence of any information in the Tax Audit Report as stipulated in the prescribed form regarding incurring of any kind of expenditure on scientific research and failure to obtain concurrence of Director General (Exemption) the deduction of Rs.187.98 lakh allowed to the assessee on this account was irregular. The mistake led to underassessment of income of Rs.140.98 lakh (after allowing depreciation of Rs.47 lakh at the rate of 25 percent on the machinery) with consequent short levy of tax of Rs.81.06 lakh.

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

**(b)** Under the Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure, laid out or expended on scientific research related to the business, or any sum paid to a scientific research association which has as its object the undertaking of scientific research, or to a university, college or other institution to be used for scientific research shall be allowed as deduction, provided that such association, university, college or institution is for the time being approved for this purpose, by the prescribed authority by notification in the Official Gazette.

In Tamil Nadu IV, Chennai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997 at a loss of Rs.148.70 lakh allowing a deduction of Rs.90.33 lakh towards expenditure on scientific research. Audit scrutiny revealed that as per the orders of the Commissioner of Income Tax (Appeals), an amount of Rs.34.50 lakh being the grant received by the assessee for scientific research was to be disallowed from the claim. Failure to do so resulted in excess computation of loss by Rs.34.50 lakh involving potential tax effect of Rs.19.84 lakh.

*The Ministry have accepted the audit observation.*



**Incorrect allowance of expenditure on know-how**

**4.20** Under the Income Tax Act, with effect from 1 April 1986 where the assessee has paid in any previous year any lump sum consideration for acquiring any know-how for use for the purpose of his business, one-sixth of the amount so paid shall be deducted in computing the business income for that year and the balance amount shall be deducted in equal instalments in each of the five immediately succeeding previous years.

In the following 2 cases, non-restriction of the allowable deduction to one-sixth of the total expenditure on know-how together with excess deduction towards payment of interest in the first case resulted in total short levy of tax of Rs.50.83 lakh.

(Rs. in lakh)				
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Tax effect
1.	M/s.Triveni Structural Ltd. [Allahabad, Uttar Pradesh]	1994-95	143(3)	28.74 (P)
2.	M/s.India Pistons Ltd. [TN I, Chennai]	1993-94	143(3)	22.09

*The Ministry have accepted the audit observation at Sl.No.2 of the statement.*

**Incorrect valuation of closing stock**

**4.21** It has been judicially held\* that any system of accounting which excludes for the valuation of stock-in-trade all costs other than the cost of raw materials is likely to result in a distorted picture of the true state of business, for the purpose of computing its chargeable income. According to accounting practices as enunciated by the Institute of Chartered Accountants of India, excise duty is a manufacturing expense and is an element of cost for inventory valuation. The Board clarified in 1981 that central excise/customs duties, if any, payable by the manufacturer/trader should go into calculation of production cost and the closing inventory should include an element of such duty to represent such cost. Further, the valuation of stock is a vital factor in determining the taxable income from business, as correct profits of the assessee can not be ascertained unless the opening and closing stock are valued correctly. Though the valuation of stock does not generate funds, it does affect the taxable income of the business.

Cases noticed during test check where the closing stock was not valued correctly are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Reliance Industries [City VI, Mumbai]	1994-95	143(3)	Central excise duty had not been debited to profit and loss account on accrual basis and added back to arrive at the income	3973.00 (P)

\* CIT Vs British Paints India Ltd. 188 ITR 44 (SC)

2.	Upper Ganges Sugar and Industrial Ltd. and 20 others [WB I, II,IV,Central I,II Calcutta]	1991-92 to 1996-97	143(3) 143(1)	Central Excise duty payable on finished goods was not taken into account in valuing the closing stock	2507.81
3.	M/s Alfa Laval India Ltd & 16 others [City I to VI,, Central I, Mumbai, Poona,Vidarbha Maharashtra]	1993-94 to 1996-97	143(3)	-do-	1257.41
4.	M/s Gujarat State Fertiliser Co. Ltd [Gujarat I Ahmedabad]	1995-96	143(3)	-do-	603.52
5.	M/s Caprihans India Ltd and 2 others [City IV Mumbai]	1994-95	143(3)	-do-	181.99
6.	M/s Syntex Industries Ltd. [Gujarat I Ahmedabad]	1995-96	143(3)	-do-	100.09
7.	M/s Alembic Chemical Works Ltd. [Baroda, Gujarat]	1995-96	143(3)	-do-	84.91

Similar nature of mistakes as well as other mistakes such as incorrect valuation/under valuation of closing stock, short account of closing stock etc. , in 7 cases of assesseees in Andhra Pradesh, Gujarat, Karnataka, Orissa and Punjab charges resulted in an aggregate short levy of tax of Rs.98.92 lakh.

*The Ministry have accepted the audit observation at Sl.No.5 of the statement.*

**Incorrect allowance of contribution to unapproved fund**

**4.22** Under the Income Tax Act, 1961, any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to any fund, or trust, other than a recognised provident fund or an approved superannuation or an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust, shall not be allowed as deduction.

In Coimbatore, Tamil Nadu charge, the assessment of **M/s. Cheran Transport Corporation** for assessment year 1994-95 was completed after scrutiny in March 1997 at a loss of Rs.158.65 lakh. Audit scrutiny revealed that the assessee was allowed a deduction of Rs.64.05 lakh towards accumulation of interest on the deposits made with the employees retirement benefit fund, which was an unapproved fund and hence was required to be withdrawn. Omission to do so resulted in overassessment of loss by Rs.64.05 lakh involving a potential tax effect of Rs.33.15 lakh.

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

**Incorrect computation of income of financial corporations**

**4.23(a)** Under the Income Tax Act, 1961 financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to a special deduction of an amount transferred by them out of their profits, to a special reserve account upto an amount not exceeding 40 percent of their total income. Similarly, in respect of any provision for bad and doubtful debts made by the public financial institutions or state financial corporation or



state industrial investment corporation, an amount not exceeding five percent of the total income is admissible. The total income in either case is that computed before allowing this deduction and any deduction under Chapter VIA.

Cases where the above provision were not adhered to are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Bihar State Financial Corporation [Patna, Bihar]	1995-96 1996-97	143(1)(a) 143(1)(a)	Deduction was erroneously allowed in respect of provision for bad and doubtful debts even though there was no income	6038.35 (P) 1207.66 (AT)
2.	M/s. Tamil Nadu Industrial Investment Corpn. Ltd. [TN III, Chennai]	1996-97 1997-98	143(1)(a) 143(1)(a)	Deduction was erroneously allowed not considering other income included in the total income	560.09
3.	Kerala Financial Corpn. [Trivandrum, Kerala]	1996-97	143(1)(a)	Even though no special reserve was created, deduction was allowed	327.22
4.	M/s Tamil Nadu Industrial Development Corporation Ltd. [TN III, Chennai]	1994-95	143(3)	Deduction was allowed in excess of the amount of reserve created	25.58

*The replies of the Ministry to the audit observations have not been received.*

(b) Under the Income Tax Act, 1961, the amount of bad debts or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year shall be allowed. As per the amended provisions, applicable with effect from the assessment year 1992-93, in the case of an assessee to whom deduction is allowable towards any provision for bad and doubtful debts made, the amount of deduction relating to bad debts or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under relevant clause.

In Tamil Nadu III, Chennai charge, the assessments of **M/s. Tamil Nadu Industrial Investment Corporation Ltd.** for the assessment years 1994-95 to 1997-98 were completed between December 1997 and March 1998 after scrutiny/in a summary manner allowing deductions aggregating Rs.9959.72 lakh and Rs.278.61 lakh towards bad debts written off on loans and reserve for bad debts created respectively, for the above assessment years. Audit scrutiny revealed that while allowing the deduction of Rs.9959.72 lakh towards bad debts written off, the provision of Rs.278.61 lakh made in the accounts, was not adjusted against such debts. The mistake resulted in underassessment of total income of Rs.278.61 lakh with consequent short levy of tax of Rs.195.92 lakh (including interest and additional tax).

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

**Irregular allowance of depreciation**

**4.24** Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction of account of depreciation on buildings, plant and machinery, furniture and fittings and ships is admissible at the prescribed rates, provided these are owned by the assessee and used for the purpose of his business during the relevant previous year. Plant includes ships, vehicles, books, scientific apparatus and surgical equipment but does not include tea bushes or live stock. Further, no depreciation is allowed on lumpsum expenditure incurred for acquiring technical know-how. Taxation Laws (Amendment) Act, 1991 provided that for the assessment year 1991-92, depreciation allowance on any block of assets in the case of companies shall be restricted to seventy five percent of the amount calculated at the prescribed percentage of the normal allowance.

Cases of incorrect allowance of depreciation noticed during test check are illustrated below:

(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.National Aluminium Co. Ltd. [Bhubaneswar, Orissa]	1995-96	143(3)	Depreciation was allowed twice	13669.00 (P)
2.	M/s.Mangalam Cement Ltd. [Jaipur, Rajasthan]	1995-96	143(3)	Depreciation was allowed twice	1098.25 (P)
3.	M/s.Tamil Nadu Industrial Investment Corporation Ltd. [TN III, Chennai]	1997-98	143(1)(a)	Depreciation was allowed on investment in the absence of any provision in the Act	203.86
4.	M/s.Damodar Valley Corporation [WB I, Calcutta]	1988-89	143(3)	Depreciation was allowed on assets acquired out of interest due on withheld payments	158.00 (P)
5.	M/s.Ponds (India) Ltd. [TN II, Chennai]	1992-93	143(3)	Depreciation was allowed even though the unit had not commenced production during the relevant year	80.14

Similar and other nature of mistakes in 16 cases in Assam, Gujarat, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh Delhi Maharashtra and West Bengal charges resulted in aggregate short levy of tax of Rs.240.83 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.1 and 4 of the statement and in 9 of the other cases.*

*The Ministry have not accepted the audit observation at Sl.No.5 of the statement stating that 100 percent export oriented unit started commercial production in December 1991 and therefore 30 percent depreciation had correctly been allowed.*

*The reply is not tenable. Once the income of the 100 percent export oriented*



unit is claimed as exempt under section 10B of the Income Tax Act, no depreciation in respect of the assets of the unit can be allowed.

**Incorrect adoption of written down value**

**4.25** Under the Income Tax Act, 1961, the written down value of any block of assets in respect of any previous year relevant to the assessment year commencing on or after the first day of April 1989 is the written down value of that block of assets at the beginning of the previous year as increased by the actual cost of any asset falling within that block acquired during the previous year and as reduced by the money payable in respect of any asset falling within that block which is sold or discarded or destroyed during the previous year.

Cases of incorrect application of the above provisions are indicated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Sawant Food Products Ltd. [City V, Mumbai]	1997-98	143(1)(a)	Incorrect figure of written down value was adopted for allowing depreciation	108.20
2.	M/s. Star Iron Works (P) Ltd. [WB V, Calcutta]	195-96	143(3)	The written down value was adopted from the schedule as per Companies Act, instead of Income Tax Act.	107.68

In Gujarat, Karanataka, Madhya Pradesh, Punjab, Tamil Nadu, and Maharashtra charges, in 6 cases, other mistakes in adoption of written down value resulted in total short levy of tax of Rs.58.70 lakh.

The Ministry have accepted the audit observations at Sl.Nos.1 and 2 of the statement and in 3 of the other cases.

**Incorrect application of rates of denreciation**

**4.26** Depreciation is calculated on the cost or written down value of the assets according to the rates prescribed in the Income Tax Rules, 1962. Further, where any assets falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction on account of depreciation in respect of such assets shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the assets comprising such block.

Cases of incorrect application of rates of depreciation noticed during test check are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Videocon Leasing Industrial Finance Ltd. [Gujarat I, Ahmedabad]	1995-96, 1996-97	143(3)	Though trucks were leased out to another company, higher rate of depreciation was allowed	618.52

2.	M/s.BPL Refrigeration Ltd. [Central, Bangalore]	1995-96	143(3)	Higher rate of depreciation was allowed on an inadmissible item of machinery	149.48 (P)
3.	M/s.Rama Paper Mills Ltd. [Bareilly, Uttar Pradesh]	1995-96	143(3)	Depreciation was allowed in full even though the plant and machinery was put to use for less than 180 days	133.63
4.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1995-96	143(3)	-do-	110.73 (P)
5.	Karnataka Jewels Ltd. [Gujarat I, Ahmedabad]	1992-93	143(3)	-do-	2.54 59.96 (P)
6.	M/s.Jindal Menthol India Ltd. [Delhi I]	1995-96	143(3)	Depreciation was allowed at 100 percent instead of 25 percent	57.97

Similar nature of mistakes in 21 cases in Andhra Pradesh, Gujarat, Karnataka, Kerala, Madhya Pradesh, Punjab, Rajasthan, Tamil Nadu, Delhi, Maharashtra and West Bengal charges led to total short levy of tax of Rs.317.82 lakh.

*The Ministry have accepted the audit observations at Sl.No.5 of the statement and in 8 of the other cases.*

*The Ministry have not accepted the audit observation at Sl. No. 2 of the statement on the ground that the depreciation at higher rate of 40 percent was allowed on the basis of a decision of ITAT in another case.*

*The reply is not tenable as the Income Tax Rules specify only general rate of depreciation at 25 percent on such tools and dies which should only have been allowed.*

**Incorrect grant of investment allowance**

4.27 Under the Income Tax Act, 1961 investment allowance is admissible in respect of new machinery and plant installed by an assessee and used for the purpose of his business or profession subject to the condition that an amount equal to 75 percent of the sum so allowed has been debited to the profit and loss account of the relevant previous year and credited to a reserve account and the amount so credited is used within a period of ten years for acquiring new plant and machinery for the purpose within the specified period. If the above condition is not fulfilled, the investment allowance is deemed to have been wrongly allowed and the assessing officer may recompute the total income of the assessee for the relevant previous year.

Cases of incorrect grant of the investment allowance are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.SC Seshasayee Paper and Boards Ltd. [Coimbatore, Tamil Nadu]	1994-95	143(3)	Allowance was allowed in the absence of the 'reserve'	50.86



In 2 cases in Andhra Pradesh and Haryana charges, investment allowance was irregularly allowed where the concerned machinery, was sold out before 8 years, or the reserve was mis-utilised, or was allowed at higher rate. The mistakes resulted in total short levy of tax of Rs.18.42 lakh.

*The Ministry have accepted the audit observation at Sl.No.1 of the statement.*

**Incorrect carry forward of unabsorbed depreciation/ investment allowance**

**4.28** Under the Income Tax Act, 1961, where for any assessment year, unabsorbed depreciation or investment allowance or both cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be set off against profit and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off upto a maximum of eight assessment years immediately succeeding the assessment year for which it was first computed.

Cases where the above provisions were not correctly applied are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year t	Section under which assessed	Nature of mistake	Tax effect
1.	Malabar Cements Ltd. [Calicut, Kerala]	1995-96	143(3)	Unabsorbed investment allowance was allowed to be carried forward beyond eight years	381.65 (P)
2.	M/s.U.B.Ltd. [Bangalore Central, Karnataka]	1995-96	143(3)	Depreciation was set off in excess	295.02
3.	Peerless Shipping & Oil Field Services Ltd. [WB I, Calcutta]	1995-96	143(3)	Unabsorbed investment allowance, though not available was allowed set off	253.86
4.	M/s. Mysore Cements Ltd. [Karnataka I, Bangalore]	1997-98	143(3)	Unabsorbed investment allowance was allowed to be carried forward beyond eight years	248.18 (P)
5.	M/s.National Textile Corporation [Karnataka III, Bangalore]	1992-93	143(3)	The carried forward depreciation allowed was not revised subsequent to reduction in the amount carried forward	211.20 (P)
6.	M/s. British India Steels Ltd. [WB I, Calcutta]	1996-97	143(1)(a)	Carry forward of investment allowance was allowed beyond eight years	63.50
7.	M/s. Hindusthan Wires Ltd. [WB V, Calcutta]	1989-90 to 1991-92	143(3)	Set off/carry forward was irregularly allowed even though income for set off was available	12.34 45.29 (P)
8.	M/s.Inares Ltd. [City I Mumbai]	1995-96	143(3)	Though the unabsorbed investment allowance was set off in earlier year, set off was allowed again	52.77
9.	M/s.KAP Steel Ltd. [Karnataka II, Bangalore]	1995-96	143(3)	Carry forward of investment allowance was allowed beyond eight years	51.11 (P)

Similar mistakes in 17 cases in Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Punjab, Rajasthan, Tamil Nadu, and Maharashtra charges resulted in total short levy of tax of Rs.197.54 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.1,2,5 and 7 to 9 of the statement and in 11 of the other cases.*

**Incorrect computation of capital gains**

**4.29** Under the Income Tax Act,1961, any profits or gains arising from the transfer of a capital asset effected in the previous year, should be charged to income tax under the head 'capital gains'. A capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer shall be treated as short term capital asset. The Act further provides that (upto assessment year 1994-95) the units held for not more than 36 months are short term capital assets. Short term capital gains is computed by deducting from the full value of consideration received, the expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the asset and the cost of any improvement thereto. However, in the case of long term capital gains, the indexed cost of acquisition, the indexed cost of improvement and the cost of expenditure for the transfer would be deducted from the full value of consideration.

Instances of failure to apply the above provisions correctly are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.E.I.D. Parry (India) Ltd. [TN I, Chennai]	1993-94 1994-95	143(3) 143(3)	Even though 'units' were held for less than 36 months they were treated as long term assets	117.22
2.	M/s.Oberoi Hotels (P) Ltd. [WB III, Calcutta]	1994-95	143(3)	The cost of acquisition of shares of non-resident companies was computed erroneously	77.90

Similar and other mistakes in computation of capital gains such as mistake in adoption of indexed rate of acquisition, omission to treat premium received on lease of land as capital gains etc. in 6 cases in Tamil Nadu, Uttar Pradesh, Maharashtra and West Bengal charges resulted in total short levy of tax of Rs.120.44 lakh.

*The Ministry have accepted the audit observations at Sl.No.1 of the statement and in 3 of the other cases.*

**Income escaping assessment**

**4.30(a)** Under the Income Tax Act, 1961, the total income of a person for any previous year includes all income from whatever sources derived which is received or deemed to be received or which accrues or arises or is deemed to accrue or arise during such previous year unless specifically exempted from tax by the provisions of the Act. It has judicially been held\* that any amount that is

\* CIT Vs T.V.Sundram Iyengar and Sons Ltd.: 222 ITR 344 (SC)



not taxable in the year of receipt as being of revenue character, changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right, and the amount should be treated as income of the assessee. It has also been held\* that interest on fixed deposits received during construction period was assessable as income from other sources and could not be adjusted against the capital cost of the assets.

Cases where the incomes escaped assessment are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Essar Steels Ltd. [TN]	1993-94 1994-95	143(3) 143(3)	Profits on cancellation of forward cover contract with bank were wrongly treated by the department as capital receipts instead of revenue receipts	4050.73
2.	M/s.North East Electric Power Corporation [NE Region, Shillong]	1994-95	143(3)	Interest on advance to contractors/suppliers during construction period was irregularly allowed to be set off against capital expenditure	137.11
3.	M/s.Dai Ichi Karkaria [City III Mumbai]	1995-96	143(1)	Duty draw back was not treated as income even though the assessee was accounting the same on accrual basis	90.36
4.	M/s.C.K.G. Pathwala (P) Ltd. [Surat, Gujarat]	143(3)	143(3)	Instead of total receipt for which tax credit was allowed only a part was brought to tax	55.04

Similar nature of mistakes in 18 cases in Andhra Pradesh, Bihar, Gujarat, Kerala, Tamil Nadu, Maharashtra and West Bengal charges resulted in aggregate short levy of tax of Rs.255.81 lakh.

*The Ministry have accepted the audit observations in 8 out of the 18 cases.*

*The replies of the Ministry to the audit observations at Sl. Nos. 1 to 4 have not been received.*

(b) Any expenditure or trading liability incurred for the purpose of business carried on by the assessee is allowed as a deduction in the computation of business income. Where on a subsequent date, the assessee obtains any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof, the benefit that accrues thereby, shall be deemed to be profits and gains of business or profession to be charged to tax as the income of the previous year in which the remission or cessation takes place.

In West Bengal V, Calcutta charge, the assessment of **M/s.Krebs and Cil (India) Ltd.** for the assessment year 1995-96 was completed after scrutiny in June 1997 at a loss of Rs.299.33 lakh which was allowed to be carried forward.

\* CIT Vs Hindustan Electro Graphite Ltd. (1989); 177 ITR 165 (MP)

Audit scrutiny revealed that the assessee received a remission of interest of Rs.54.31 lakh on loans borrowed by it from a nationalised bank and a State Industrial Promotion and Investment Corporation. Since the liability for interest which was provided in earlier years was waived, the amount of interest written back and credited to the accounts was required to be treated as income and assessed to tax. Omission to do so resulted in escapement of income of Rs.54.31 lakh involving potential short levy of tax of Rs.24.98 lakh.

*The Ministry have accepted the audit observation.*

(c) It has been judicially held\* that in the case of contract business, in order to ascertain the income it is open to the revenue to estimate the profit on the basis of work-in-progress although the work is not completed.

In Gujarat charge, in three cases, failure to estimate the profits on the basis of work-in-progress resulted in aggregate short levy of tax of Rs.29.73 lakh.

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

**Incorrect  
carry forward/  
set off of losses**

**4.31(a)** Under the Income Tax Act, 1961, where the net result of computation under the head 'profits and gains of business or profession' in a loss and such loss cannot be wholly set off against income under any other head of the relevant year, so much of the losses that has not been set off shall be carried forward to the following assessment year/years to be set off against profits and gains of business or profession of those years upto a maximum of eight assessment years succeeding the assessment year in which such loss was first determined. It has been provided that the loss, if any, under the head 'income from house property' shall not be set off against income under other heads. The Act further provides that where as a result of an order of scrutiny assessment or best judgement assessment or on revision, rectification or on settlement relating to any earlier assessment year and passed subsequent to the filing of return of income processed under the summary assessment scheme for any subsequent year, there is any variation in the carry forward of loss, deduction, allowance or relief claimed in the return and as a result of that if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable and such intimation shall be deemed to be a notice of demand and all the provisions of the Act shall apply accordingly and if a refund is due, it shall be granted to the assessee. In the case of loss, omission to rectify the carried forward unabsorbed loss figures has the inherent risk of the incorrect figures remaining undetected and unrectified .

Cases of incorrect carry forward/set off of losses noticed during test check are given below:

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\* Tirath Ram Ahuja (P) Ltd. Vs CIT 103 ITR 15



(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1996-97	143(1)(a)	Though the loss for earlier assessment year was revised to positive income and adjusted against brought forward losses of previous years, the assessment for 1996-97 was not revised	3233.39 (P)
2.	M/s. National Insurance Co. Ltd. [WB V, Calcutta]	1996-97	143(1)(a)	-do-	984.19
3.	M/s. West Bengal State Electricity Board [WB I, Calcutta]	1995-96	143(3)	Set off of unabsorbed loss/depreciation was allowed in excess of the actual amount remaining to be set off	667.40 (P)
4.	M/s. Mahendra Ugine Steel Co. Ltd. [City IV, Mumbai]	1995-96	143(3)	Brought forward business loss was irregularly set off against the income from long term capital gain	166.95
5.	R.B.L. Ltd. [WB I, Calcutta]	1995-96	143(1)(a)	The assessment was not revised to withdraw excess carry forward loss event though the earlier years' brought forward loss was reduced	165.73 (P)
6.	M/s. J.C.T. Ltd. [WB II, Calcutta]	1995-96	143(3)	Excess amount was set off	156.12
7.	M/s. Tamil Nadu Magnesite Ltd. [Coimbatore, Tamil Nadu]	1991-92 1993-94	143(3)	The assessments were not revised to withdraw excess carry forward losses etc. consequent upon their reduction	156.09
8.	The Kolhapur Sugar Mills Ltd. [Kolhapur, Maharashtra]	1995-96	143(3)	Excess set off was allowed	112.19 (P)
9.	M/s. Telerama India Ltd. [WB I, Calcutta]	1996-97	143(1)(a)	The assessment was not revised to withdraw excess set off originally given consequent upon reduction under the scrutiny assessment for the earlier year	86.21 (P)
10.	M/s. Meleoad Russel Ltd. [WB II, Calcutta]	1996-97	143(1)(a)	-do-	83.62
11.	M/s. The Nuddea Mills Co. Ltd. [Central I, Calcutta]	1995-96	143(1)(a)	-do-	81.58
12.	M/s. S.K.G Consolidated Ltd. [WB III, Calcutta]	1994-95	143(3)	Set off of unabsorbed loss/depreciation was allowed for excess amount than that was available for set off	76.49
13.	M/s. Bharat Pump & Compressor [Allahabad, Uttar Pradesh]	1994-95	143(3)	Though the amount of carried forward loss was reduced due to scrutiny assessment of earlier year, the assessment was not revised to reduce the amount originally set off	69.05 (P)

14.	Lily Biscuit Company Pvt. Ltd. [WB III, Calcutta]	1996-97	143(1)(a)	The assessment was not revised to withdraw the amount of carry forward loss originally set off, even though the amount was reduced due to scrutiny assessment for earlier year	63.02 (P)
15.	M/s.Cantreads Pvt. Ltd. [Karnataka Central, Bangalore]	1996-97	143(3)	Set off of unabsorbed loss was given beyond eight years. In addition, the assessment was not revised to withdraw excess set off allowed even though the amount of brought forward loss was reduced subsequently in respect of previous assessment year.	60.26 (P)
16.	M/s.Tata Industries [City I, Mumbai]	1995-96	143(3)	Set off was allowed even though no such brought forward amount was available for set off	58.04
17.	M/s.Park Hotel (P) Ltd. [Central I, Calcutta]	1994-95	143(3)	Loss under 'house property income' was erroneously set off against income from business and 'other sources'	57.83
18.	M/s.Numesh Embellage Ltd. [City V, Mumbai]	1995-96	143(3)	Loss was allowed to be carried forward in excess of available amount	53.29

In 29 cases in Andhra Pradesh, Gujarat, Haryana, Chandigarh(UT), Karnataka, Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Delhi, Maharashtra and West Bengal charges, similar mistakes of irregular/incorrect set off of losses resulted in aggregate short levy of tax of Rs.536.44 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.4,8,12 and 15 to 17 of the statement and in 11 of the other cases.*

*The Ministry have not accepted the audit observation at Sl.No.1 of the statement observing that assessing officer would send revised intimation within the time limit allowed by the Act and thus there was no mistake or omission.*

*The reply is not tenable as action for revision was found pending in February 2000.*

*The Ministry have also not accepted the audit observation at Sl.No.2 of the statement stating that the time limit for revision of assessment had not expired and no revenue was involved since additional tax cannot be charged under section 143(1)(b).*

*The reply is not tenable as no remedial action was initiated/taken till the audit observation was raised. Had the provision under section 143(1)(b) been invoked immediately after the completion of the scrutiny assessment of the preceding year, additional demand of Rs.9.84 crore which was pointed by audit, could have been raised/collected earlier.*

**(b)** No loss under the head 'profits and gains of business or profession' is allowed to be carried forward for set off unless the assessee had filed the return



of loss voluntarily within the due date. If any person, having furnished a return under sub-section (1) of section 139 or in pursuance of a notice issued under sub-section (1) of Section 142, discovers any omission or any wrong statement, therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

In 2 cases in West Bengal charge the loss was irregularly allowed to be carried forward even though the assessee submitted the returns after the due date which resulted in total short levy of tax of Rs.24.27 lakh.

*The replies of the Ministry to the audit observations have not been received.*

**Mistake in assessments while giving effect to appellate orders**

**4.32** Under the Income Tax Act, 1961 an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and the assessing officer shall comply with the direction given in the appellate order. Omission to make consequential revision of assessments of subsequent assessment years in the computation of income will result in underassessment of income.

In 13 cases in Maharashtra, Tamil Nadu, Karnataka, Rajasthan, West Bengal and NE Region charges, mistakes committed in assessments while giving effect to appellate orders resulted in short levy of tax aggregating Rs.197.23 lakh.

*The Ministry have accepted the audit observations in 11 cases.*

**Mistake in allowing deductions under Chapter VIA**

**4.33** Under the provisions of Chapter VIA of the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the total income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. Gross total income has been defined in the Act as the total income computed in accordance with the provision of the Act before making the deductions under Chapter VIA. 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 under Chapter VIA is admissible.

Instances of irregular/incorrect allowance of deductions in violation of the above provisions are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/a. Apeejay Surrendra Park Hotel Ltd. [Central I, Calcutta]	1996-97	143(1)(a)	Unabsorbed brought forward loss and depreciation were not adjusted against total income before allowing deduction	180.50 (P) 36.10 (AT)

In 5 cases in Haryana, Madhya Pradesh, Tamil Nadu and West Bengal charges, non-observance of the above provisions led to short levy of tax aggregating Rs.68.74 lakh.

*The Ministry have accepted the audit observations at Sl.No.1 of the statement and in 3 of the other cases.*

**Mistake in allowance of deduction of profits derived from services provided to foreign tourists**

**4.34** Under the provisions of the Income Tax Act, 1961, with effect from assessment year 1989-90, in the case of an assessee being an Indian company or other person resident in India engaged in the business of hotel or of a tour operator approved by the prescribed authority, there shall be allowed in computing the total income of the assessee, a sum equal to the aggregate of 50 per cent of the profit derived from services provided to foreign tourists and so much of the amount out of remaining profits derived as such as is debited to profit and loss account and credited to a reserve account to be utilised by the assessee for the purpose of his business under the conditions prescribed in the Act. For this purpose, the profits derived from services provided to foreign tourists shall be the amount which bears to the profits of the business as computed under the head 'profits and gains of business or profession' the same proportion as the receipts in relation to services for foreign tourists received in convertible foreign exchange bears to the total receipts of the business carried on by the assessee.

Details of 2 cases where the above provisions were not applied correctly are indicated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.East India Hotels Ltd. [WB III, Calcutta]	1994-95	143(3)	The deduction was allowed on income certified by the auditor instead of the profits determined by the assessing officer	102.22
2.	M/s. Hotel Leela Venture Ltd. [City VI, Mumbai]	1995-96	143(3)	Unabsorbed brought forward depreciation etc. was not reduced from profits before computing deduction	95.42

*The Ministry have accepted the audit observation at Sl.No.1 of the statement.*

**Incorrect allowance of deduction in respect of profits and gains from industrial undertakings established in certain cases**

**4.35** Under the provisions of the Income Tax Act, 1961, prior to its amendment by Finance Act, 1980 with effect from the assessment year 1981-82, where the gross total income of an assessee included any profits and gains derived from a newly established industrial undertaking which went into production before 1 April 1981, the assessee becomes entitled to tax relief in respect of such profits and gains upto 6 percent per annum of the capital employed in the undertaking in respect of the assessment year relevant to the previous year in which the undertaking began to manufacture or produce articles and in respect of each of the four immediately succeeding assessment years. Where however, such profits and gains fall short of the relevant amount of the capital employed during the



previous year, the amount of such shortfall or deficiency is to be carried forward and set off against future profits upto seventh assessment year reckoned from the end of the initial assessment year.

In Kochi, Kerala charge, the assessment of **M/s.Asian Techs Ltd.** for the assessment year 1996-97 was processed in a summary manner in May 1997 at nil income. Audit scrutiny revealed that deduction of Rs.29.85 lakh was allowed being relief in respect of capital employed in units commenced before 1 April 1981 which related to a period beyond seven years and was, therefore, not eligible for being carried forward and set off against the income of the assessment year 1996-97. Since the information that the claim for deduction pertained to assessment years from 1981-82 to 1984-85 was available in the return/accompanying documents, the claim should have been disallowed as a prima facie adjustment. Omission to do so resulted in underassessment of income of Rs.19.97 lakh with consequent short levy of tax of Rs.12.57 lakh (including additional income tax and excess interest on refund).

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

**Incorrect computation of profits under section 80I**

**4.36** Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a newly established industrial undertaking which goes into production after 31 March 1981, the assessee is entitled to a deduction of twenty five percent of such profits provided the industrial undertaking does not manufacture or produce any article or thing specified in the Eleventh Schedule. It has been judicially held\* that the use of the term 'derived from' in the relevant provisions of the Act indicates the restricted meaning given by the legislature to cover only the profits and gains directly accruing from the conduct of the business undertaking.

Cases of incorrect computation of income under the above provisions leading to short levy of tax are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. M.S.L. Industries Ltd. [WB II, Calcutta]	1995-96 1996-97	143(3) 143(1)(a)	Dividend income and interest income were not deducted from profits for computation of the deduction	80.12
2.	M/s.MUL Health Care Products Ltd. [City V, Mumbai]	1994-95 1995-96	143(3) 143(3)	Though the assessee was not a small scale industry, deduction was allowed as applicable to a small scale industry	68.28

Similar and other nature of mistakes committed in allowance of deduction under the above provision in 17 cases resulted in aggregate short levy of tax of Rs.244.16 lakh in Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Punjab, Uttar Pradesh and Maharashtra charges.

\* Combay Electric Supply Industrial Co. Ltd. Vs. CIT Gujarat II-13 ITR-84(SC)

The Ministry have accepted the audit observations in 4 out of the 17 cases.

The replies of the Ministry to the audit observations at Sl.Nos.1 and 2 of the statement have not been received.

**Incorrect allowance of deduction in respect of export profit**

**4.37(a)** Under the Income Tax Act, 1961, as amended by the Finance Act, 1988, with effect from 1 April 1989, an assessee being an Indian company or other assessee resident in India, engaged in export business, is entitled to a deduction equal to the profit derived from the export of goods or merchandise other than the exempted items if sale proceeds thereof are received in convertible foreign exchange. With effect from 1<sup>st</sup> April 1992, for the purpose of the deduction 'profits and gains of business or profession' means the profits of the business as computed under the head 'profit and gains of business or profession' as reduced by ninety percent of certain receipts specified in the Act. The eligible profits would further be reduced in proportion to turnover attributable to supporting manufacturer to total turnover, when part of the profits is passed onto supporting manufacturer through disclaimer certificate.

In the following cases test checked, considerable amounts of short levy of tax had occurred due to incorrect application of the above provisions.

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Karamchand Thapar & Brothers (Coal Sales) [WB II, Calcutta]	1995-96	143(1)(a)	90 percent of certain receipts like interest on loans and deposits, rebate, commission etc. was not deducted from the profits for computing the deduction	128.12
2.	M/s.National Organic Chemicals Ltd. [City II, Mumbai]	1995-96	143(3)	Even though the assessee was trader as well as manufacturer the claim was allowed as an export house	84.67
3.	M/s.Rail India Technical Economic Services Ltd. [Delhi I]	1995-96	143(3)	90 percent of receipts towards, interest and miscellaneous income was not deducted from profits for computing the deduction	53.18

The Ministry have not accepted the audit observation at Sl. No. 1 of the statement stating that the issue involved was disputable and not covered under prima facie adjustment. They have further stated that the above receipts formed part of business receipts.

The reply, however, is not tenable as the receipts referred to above did not have any direct nexus with the business of export and thus 90 percent thereof should have been reduced from the profits as prima facie adjustment in view of the specific provision contained in explanation (baa) below section 80 HHC(4A) of the Act.



(b) Where the export out of India is of goods or merchandise manufactured or processed by the assessee and also of trading goods, the profit derived from such export shall be aggregate of the adjusted profits in proportion to the export turnover in relation with the manufacturing/processing of goods and in relation to the trading activity, the amount arrived after deducting the direct and indirect costs of the trading from the export turnover of the activity. The profit so arrived at shall be further increased by ninety percent profit on sale of licences and export incentives in the ratio of export turnover to total turnover.

In Central I, Mumbai charge, the assessment of **M/s. Ipca Laboratories Ltd.** for the assessment year 1995-96 was completed after scrutiny in March 1998 and for the assessment year 1997-98 in a summary manner in March 1998, inter alia, allowing a deduction aggregating Rs.766.06 lakh towards export profit on the basis of the Tax Audit Report. Audit scrutiny revealed that while allowing the above deduction, the assessing officer had taken into consideration only profit of Rs.524.96 lakh derived from export of manufactured goods but omitted to consider the loss of Rs.1229.17 lakh sustained by the assessee from export of trading goods during the two assessment years. Had the loss, which was apparent from records, been taken into account, the resultant amount would be negative and thus no deduction would be admissible. Omission to consider the loss from export of trading goods resulted in underassessment of income of Rs.766.06 lakh with consequent short levy of tax of Rs.537.12 lakh (including additional tax of Rs.26.53 lakh and interest).

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

(c) From the assessment year 1992-93, the profits derived from export of trading goods will be equivalent to the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to the export of such trading goods. The indirect cost has been defined as cost, not being direct cost, allocated in the ratio of export turnover in respect of trading goods to the total turnover.

In North East Region, Shillong charge, the assessments of **M/s. Kitply Industries Ltd.** for the assessment years 1995-96 and 1996-97 were completed after scrutiny between August 1997 and January 1998 (rectified in February 1998) allowing deduction towards export profits of Rs.575 lakh and Rs.171 lakh respectively. Audit scrutiny revealed that indirect cost attributable to trading goods exported amounted to Rs.449 lakh and Rs.504 lakh respectively on the basis of expenses debited to the profit and loss account and allocated in the ratio of export turnover in respect of trading goods to the total turnover as against Rs.210 lakh and Rs.173 lakh indicated in the certificates of the accountant furnished with the return. Consequently, the deduction towards export profits of trading goods was overcalculated by Rs.239 lakh and that of manufactured goods undercalculated by Rs.4 lakh in the assessment year 1995-96, while deduction of Rs.171 lakh towards export profits of trading goods was allowed erroneously in the assessment year 1996-97 even though no deduction was admissible as there occurred loss in export of trading goods. The incorrect adoption of indirect cost resulted in underassessment of income of Rs.406 lakh



in aggregate with consequent short levy of tax of Rs.264.82 lakh (including interest).

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

(d) Under the Income Tax Act, 1961, as amended by the Finance Act, 1988 with effect from 1 April 1989, an assessee being an Indian company or other assessee resident in India and engaged in export business is entitled to a deduction equal to the amount derived from the export of goods or merchandise other than the exempted items, if the sale proceeds thereof are received in convertible foreign exchange. Where the business of the assessee does not consist exclusively of export of goods/merchandise, profit derived from export shall be the amount which bears to the profit of the assessee as computed under the head 'profits and gains of business or profession' the same proportion as export turnover bears to the total turnover. With effect from 1 April 1992 for the purposes of the deduction 'profits of the business' means the profits of the business as computed under the head 'profits and gains of business or profession' as reduced by ninety percent of certain receipts specified in the Act. The profits so derived from export shall be increased by the amount which bears to 90 percent of export incentives the same proportion as the export turnover bears to total turnover.

In City I, Mumbai charge, the assessment of **M/s. Hindusthan Spinning and Weaving Mills Ltd.** for the assessment year 1995-96 was completed after scrutiny in March 1998 allowing a deduction of Rs.74.59 lakh towards export profits in respect of manufactured goods. Audit scrutiny revealed that income derived from property development of Rs.500 lakh was not deducted in computing the profits of business which resulted in excess allowance of deduction and underassessment of income by Rs.74.59 lakh with consequent short levy of tax of Rs.59.01 lakh.

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

(e) In 35 cases, mistakes of similar and of other nature in allowance of deduction in respect of export profits resulted in total short levy of tax of Rs.667.13 lakh in Gujarat, Haryana, Madhya Pradesh, Tamil Nadu, Delhi, Maharashtra and West Bengal charges.

*The Ministry have accepted the audit observations in 12 cases.*

**Incorrect deduction in respect of profits from new industrial undertaking started functioning after 1 April 1991**

**4.38** Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a newly established industrial undertaking which goes into production after 1 April 1991, the assessee is entitled to a deduction of 30 percent of such profit subject to fulfilment of the conditions that it is not formed by splitting up or reconstruction of a business already in existence and it is not formed by the transfer to a new business of machinery or plant previously used for any purpose. The industrial undertaking has been defined as an undertaking which is engaged in the business of generation or distribution of electricity or any other



form of power or in construction of ship or manufacturing or processing of goods or in mining.

Cases of incorrect application of the above provisions are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.C.M.P.D.I. Ltd. [Ranchi, Bihar]	1993-94 1994-95	143(3) 143(1)(a)	Deduction was irregularly allowed even though the assessee was not engaged in mining business but only in exploration activities	85.55

In 10 other cases in Gujarat, Orissa, Tamil Nadu, Delhi and West Bengal charges, mistakes in allowing deductions under the above provisions led to total short levy of tax of Rs. 162.59 lakhs.

*The Ministry have accepted the audit observations in 3 out of the 10 cases.*

*The reply of the Ministry to the audit observation at Sl. No. 1 of the statement has not been received.*

**Incorrect computation of business income under special provisions**

**4.39** Under the special provisions of Income Tax Act, 1961, the income chargeable to tax of any company, other than a company engaged in the business of generation of electricity, whose total income as computed under the normal provisions of the Act in respect of any previous year is less than 30 percent of its book profit, the profit shall be deemed to be the amount equal to 30 percent of such book profit. For this purpose, book profit means the net profit shown in the profit and loss account for the relevant previous year prepared in accordance with the provisions of Companies Act, 1956 subject to certain additions/deductions as mentioned in the provisions

Cases where the above provisions were not applied correctly are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Procter & Gamble Home Products Ltd. [City V, Mumbai]	1997-98	143(1)(a)	30 per cent of book profits was not brought to tax even though the same was more than the profits under normal provisions.	162.55
2.	M/s. Larsen & Toubro Ltd. [City III, Mumbai]	1990-91	143(3)	Provisions made towards job works and gratuity were not considered while computing book profits.	114.00

Similar nature of mistakes in applying the special provisions resulted in short levy of tax totalling to Rs.78.77 lakh in 4 cases in Uttar Pradesh, Delhi, Maharashtra and West Bengal charges.

*The replies of the Ministry to the audit observations have not been received.*

**Incorrect allowance of deduction in respect of certain inter-corporate dividends**

**4.40.** Under the provisions of the Income Tax Act, 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed in computing the total income, a deduction of an amount equal to so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the former company on or before the due date. The Act was amended through Finance (No.2) Act, 1980, with retrospective effect from April, 1968 to provide that the deduction on account of inter-corporate dividends is to be allowed with reference to the net dividend income as computed in accordance with the provisions of the Act and not on the gross amount of dividends. It has been judicially held\* that proportionate management expenses should be deducted from the gross dividend for the purposes of deduction. The Act further provides that where any domestic company receives any income by way of dividend from the units of the Unit Trust of India, such dividend shall be eligible for deduction to the extent of four-fifth of such income in respect of the previous year relevant to the assessment year 1994-95 and two-fifth of such income in respect of the previous year relevant to the assessment year 1995-96.

Cases of incorrect allowance of deduction noticed in test check are given below:

(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. South Indian Bank Ltd. and Parry Agro Industries Ltd. [Cochin, Kerala]	1994-95 and 1995-96, 1995-96	143(3) 143(3)	The deductions were allowed on gross dividends without taking into account, the proportionate management expenses.	284.82
2.	M/s. I.T.C. Classic Finance Ltd. [WB III, Calcutta]	1994-95, 1995-96	143(3)	The deduction was allowed without deducting proportionate management expenses and eligible deduction in respect of dividends from UTI was not limited to prescribed limits.	207.96
3.	M/s. Indian Telephone Industries Ltd. [Karnataka II, Bangalore]	1992-93, 1993-94	143(3)	The deduction was allowed on gross dividend instead of on net dividend	85.45

In 3 cases in Tamil Nadu and West Bengal charges, mistakes in allowance of deduction under the above provision resulted in total short levy of tax of Rs.44.82 lakh.

*The Ministry have accepted audit observations in 2 out of the 3 cases.*

*The replies of the Ministry to the audit observations at Sl. Nos. 1 to 3 of the statement have not been received.*

\* CIT Vs United General Trust Ltd. 200 ITR 488



**Non levy of interest for delay in filing the return**

**4.41** Under the Income Tax Act, 1961, 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 per month or part thereof 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.

In 4 cases in West Bengal, Maharashtra, Madhya Pradesh and Karnataka charges even though the returns were not submitted by the assessee within the due dates, interest was not levied totalling to Rs.32.98 lakh.

*The Ministry have accepted the audit observation in 1 case.*

**Short levy of interest for short payment of advance tax**

**4.42** Under the Income Tax Act, 1961, as applicable from assessment year 1989-90 onwards, where in any financial year, an assessee who is liable to pay advance tax, has failed to pay such tax or where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent every month or part thereof reckoned from 1 April next following such financial year to the date of determination of total income by processing the return of income and where a regular assessment is made to the date of such regular assessment on the amount equal to the assessed tax or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax.

Cases of short levy/non levy of interest noticed during test check are given below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Oil India Ltd. [Assam, Shillong]	1995-96	143(3)	Interest was not levied for short payment of advance tax	437.00
2.	S.B.Petroleum Ltd. [Lucknow, Uttar Pradesh]	1994-95	143(3)	-do-	341.88
3.	M/s.Otis Elevators Co. (I) Ltd. [City IV, Mumbai]	1995-96	143(3)	-do-	61.10

Similar mistakes of short levy or non-levy of interest for delay in payment/short payment/non-payment of advance tax in 21 cases in Gujarat, Haryana, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh, Delhi, Maharashtra and West Bengal charges, resulted in aggregate short/non levy of interest of Rs. 281.34 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.1 to 3 of the statement and in 12 of the other cases.*

**Non levy of interest due to delay in payment of tax demand**

**4.43** Under the Income Tax Act, 1961, as amended from 1 April 1989, any demand for tax should be paid by the assessee within thirty days of service of notice of the relevant demand and failure to do so would attract levy of simple

interest at one and one half percent for every month or part thereof from the date of default till actual payment.

Cases of non levy/short levy of interest noticed during test check are indicated below:

(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s Peerless General Finance and Industrial Co. Ltd. [WB III, Calcutta]	1993-94	143(3)	Interest was not levied even though tax was not paid within the stipulated due date	512.94
2.	M/s Phipson & Co. Ltd [WB V, Calcutta]	1985-86, 1990-91		Interest was short levied/not levied even though the tax was paid beyond the stipulated due dates	130.53

Similar nature of mistakes in 8 cases in Haryana, Karnataka, Tamil Nadu, Maharashtra and West Bengal charges resulted in non levy of interest aggregating Rs.113.16 lakh.

*The Ministry have accepted the audit observations at Sl.No.1 of the statement and in 7 of the other cases.*

**Irregular grant of interest by Government to the assessee**

**4.44** Under the Income Tax Act, 1961, interest on excess payment of advance tax, tax deducted or collected at source and any other tax or penalty becoming refundable will be paid at the rate of one percent for every month and part of month for the period from 1<sup>st</sup> April of the relevant assessment year to the date on which refund is granted. No interest will be payable, if the amount of refund is less than ten percent of the tax determined under summary or on regular assessment.

Instances of irregular/incorrect grant of interest noticed in test check are illustrated below:

(Rs. in lakh)

Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Northern Coalfields Ltd. [Jabalpur, Madhya Pradesh]	1997-98	143(1)(a)	Interest was allowed even though the amount of refund was less than 10 per cent of the tax determined.	230.37

Mistakes in 7 other cases in Rajasthan, Tamil Nadu, Delhi, Maharashtra and West Bengal charges resulted in payment of interest totalling to Rs.122.24 lakh.

*The Ministry have accepted the audit observations in 3 out of the 7 cases.*

*The reply of the Ministry to the audit observation at Sl.No.1 of the statement has not been received.*



**Excess/irregular refund**

**4.45** Under the Income Tax Act, 1961, where as a result of any order passed in assessment, appeal, revision or any other proceedings under the Act, refund of any amount becomes due to the assessee, the assessing officer may grant the refund in cash or adjust or set off the refund against outstanding dues of the assessee for any assessment year.

Details of cases of irregular/excess refund noticed in test check are illustrated below:

(Rs. in lakh)					
Sl. No.	Name of the assessee and CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s.Gujarat Mineral Development Corpn. Ltd. [Gujarat I, Ahmedabad]	1995-96	143(3)	While completing scrutiny assessment, the refund granted at the summary assessment stage was not taken into account	394.97

In two other cases in Maharashtra and West Bengal the excess refund totalled to Rs.37.85 lakh.

*The replies of the Ministry to the audit observations have not been received.*

**Other topics of interest-  
Short levy of tax**

**4.46(a)** Under the Income Tax Act, 1961, when any tax, interest, penalty, fine or other sum is payable in consequence of any order passed under the Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. The Act also provides that where a regular assessment is made, any tax or interest paid by the assessee on assessment made by processing of return shall be deemed to have been paid towards such regular assessment and if no refund is due on regular assessment or the amount refunded at the time of processing the return exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded shall be deemed to be tax payable by the assessee and the provisions of the Act shall apply accordingly.

In Shillong, Assam charge, the assessment of **M/s. Oil India Ltd.** for the assessment year 1995-96, originally completed in a summary manner in January 1996, was subsequently rectified in August 1996, November 1997 and March 1998. Audit scrutiny revealed that in the rectification order of summary assessment, a refund of Rs.358 lakh was determined as due to the assessee which was adjusted against the tax demand of Rs.514 lakh determined in scrutiny assessment and consequently a net demand of Rs.156 lakh was raised. Since the scrutiny assessment was completed on the same day on which rectification of summary assessment was made and an amount of tax of Rs.514 lakh was arrived at, the adjustment of Rs.358 lakh against the scrutiny assessment was not in order. The mistake resulted in raising of short demand of tax of Rs.358 lakh.

*The Ministry have accepted the audit observation.*

**Non levy of additional income tax**

**(b)** The Income Tax Act, 1961, provides that an assessee may furnish a revised return at any time before the expiry of one year from the end of the relevant



assessment year or before the completion of the assessment, whichever is earlier. Further, under the provisions of the Act, as applicable from 1 April 1989, where as a result of adjustment, the returned income of an assessee is increased or loss decreased by any amount, the assessing officer shall increase the amount of tax payable by the assessee by an amount of additional tax calculated at the rate of twenty percent of tax payable on such excess amount.

In West Bengal XI Calcutta charge, **M/s. Eastern Coal Fields Ltd.** filed the original return for the assessment year 1992-93 in December 1992 and revised return in November 1994. The assessment initially completed in a summary manner in January 1995 was later completed after scrutiny in March 1995 at 'nil' income. Audit scrutiny revealed that the revised return was not filed within the stipulated time and as such processing of the same was not regular as per law. Further, out of the addition of inadmissible expenditure of Rs.4207.53 lakh, a sum of Rs.2942.93 lakh was prima facie inadmissible on the basis of accounts and documents accompanying the return which attracted levy of additional income tax of Rs.304.59 lakh. Failure to carry out prima facie adjustments to the original return, the revised return being invalid, resulted in non levy of additional income tax leading to loss of revenue of Rs.304.59 lakh.

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

**Omission to  
revise the  
assessment**

(c) Under the provisions of the Income Tax Act, 1961, any mistake apparent from records can be rectified by amending any order passed by the assessing officer.

In Tamil Nadu II, Chennai charge, the assessment of **M/s. Ponds (India) Ltd.** for the assessment year 1994-95 was completed after scrutiny in March 1997 on an income of Rs.2,772.44 lakh, and an additional demand of Rs.283.68 lakh was raised after deducting the demand of Rs.92.82 lakh raised in the revision made in November 1996. Audit scrutiny revealed that consequent on the revision made in March 1997 as a result of orders of appellate authority subsequent to the scrutiny assessment, the demand of Rs.92.82 lakh was reduced to Rs.3.41 lakh. As the demand raised in November 1996 subsisted for Rs.3.41 lakh only as against Rs.92.82 lakh taken into account in the scrutiny assessment order for calculating the further demand payable, necessary rectification of the scrutiny assessment order was to be effected to include the balance demand of Rs.89.41 lakh in the demand payable. Omission to do so resulted in reduction in demand of Rs.89.41 lakh without collection.

*The Ministry have accepted the audit observation.*

**Irregular grant  
of credit to tax  
deducted at  
source**

(d) Under the Income Tax Act, 1961, any tax deducted at source shall be treated as a payment of tax on behalf of the person from whose income the deduction was made and credit shall be given to him for the amount so deducted in respect of the assessment year for which such income was assessable. The related receipt of the tax deducted has to be taken into account in computing the assessee's total income.



In City III, Mumbai charge, the assessment of **M/s. Mashreq Bank** for the assessment year 1995-96 was completed after scrutiny in December 1997 at a total income of Rs.1798 lakh. Audit scrutiny revealed that while determining the quantum of tax payable, credit was allowed for a sum of Rs.454.87 lakh towards tax deducted at source as against the correct amount of Rs.418.57 lakh as claimed by the assessee. The mistake resulted in excess credit of Rs.36.30 lakh involving short recovery of tax of Rs.63.89 lakh including interest.

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

(e) Other mistakes such as non levy of additional tax, omission to issue revised intimation, non-correlation of records with sales tax records, irregular grant of tax deducted at source and non levy of interest for failure to deposit tax deducted at source resulted in short levy of tax, short/non levy of interest etc. totalling to Rs.171.86 lakh in 9 cases in Assam, Chandigarh (UT), Karnataka, Orissa, Punjab, Maharashtra and West Bengal charges.

*The Ministry have accepted the audit observations in 3 cases.*

**General**

**4.47** Other mistakes in computation of income and tax, allowance of deductions etc. resulted in non-levy/short-levy of tax/penalty aggregating Rs.228.49 lakh in 16 cases under various CIT charges.

*The Ministry have accepted the audit observations in 2 cases.*

**Surtax**

**Omission to make assessment of surtax**

**4.48** Under the Companies (Profits) Surtax Act, 1964, there is no statutory time limit for completion of surtax assessment. Pursuant to the recommendations of the Public Accounts Committee in para 6.7 of their 128<sup>th</sup> Report (Fifth Lok Sabha), the Central Board of Direct Taxes, issued instructions in October 1974 that surtax assessment proceedings should be initiated alongwith income tax assessments. The Board further laid down that the surtax assessment should not be kept pending on the ground that the additions made in the income tax assessments were disputed in appeal and the time lag between the date of completion of income tax and surtax assessments should not ordinarily exceed a month, unless there were special reasons justifying the delay.

In Ranchi, Bihar charge, the assessments of **M/s. Bihar Merchandise (P) Ltd.** for the assessment years 1985-86, 1986-87 and 1987-88 were completed in December 1993 at Rs.112.28 lakh, Rs.21.12 lakh and Rs.11.94 lakh respectively. The company had chargeable profits which required it to file the return of surtax which was not done nor did the department initiate any action to call for the same. The omission to initiate the proceedings under Surtax Act resulted in non-levy of surtax of Rs.38.39 lakh (including interest).

*The Ministry have accepted the audit observation.*

**CHAPTER 5 : INCOME TAX**

**General** 5.1 Income Tax collected from persons other than companies is booked under the major head '0021-Taxes on income other than corporation tax'. In accordance with the recommendations of the Finance Commission 77.5 percent of the net proceeds of this tax, except insofar as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States.

**Receipts of income tax** 5.2 During 1998-99 Income Tax receipts were Rs.20 240.15 crore vis-à-vis Rs.17,100.59 crore in 1997-98; for details refer to para 2.3(i) of Chapter 2 of this report.

**Number of assesseees** 5.3 The number of assesseees (other than companies) borne on the books of the Income Tax Department as on 31 March of the last two years (1998 and 1999) are given in Annexure I of Chapter 2 of this Report.

**Status of assessments** 5.4 Particulars of assessments due for disposal, assessments completed and pending are given in Annexure VII to para 2.9.1. The details of demands remaining uncollected during the last three years ending 31 March 1999 are as given in para number 2.10(i)(b) of Chapter 2 of this Report.

**Results of audit** 5.5 A total number of 163 audit observations involving undercharge of tax of Rs.36.12 crore and 9 audit observations involving overcharge of tax of Rs.1.51 crore were issued to the Ministry of Finance for comments.

Out of these, 159 cases involving tax effect of Rs.28.78 crore are indicated in the succeeding paragraphs. The Ministry have accepted the observations in 67 cases involving tax effect of Rs. 6.99 crore. Replies are awaited in 86 cases.

**Avoidable mistakes in computation of income and tax** 5.6 Underassessment and overcharge of tax of substantial amounts on account of avoidable mistakes attributable to negligence on the part of the assessing officers have been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and instructions issued by the Government from time to time, such mistakes continue to occur suggesting the need for better supervision and control.

Cases of each type noticed in test check are given below:

**(a) Overassessment of income and tax**

(Rs. in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Shri Gautambhai A. Parmar [Individual]	Gujarat I, Ahmedabad	1990-91, 1992-93 1993-94	143(3)	Interest for default in payment of advance tax was erroneously levied in excess.	84.90



Similar mistakes in 8 cases in Andhra Pradesh, Bihar, Karnataka Rajasthan and Maharashtra charges resulted in total short levy of tax of Rs.66.51 lakh.

The Ministry have accepted the audit observations in 5 out of the 8 cases.

**(b) Underassessment of tax**

(Rs. in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Shri Pramod Kumar Jaiswal [Individual]	Patna, Bihar	1995-96	143(3)	Incorrect computation of income	135.33
2.	M/s.Shaikh Construction [R.F.]	City XII, Mumbai	1985-86 to 1992-93	144	Application of incorrect rate of tax	101.87
3.	Shri Surendra N.Khandhar [Individual]	City II, Mumbai	1993-94	143(3)	Taxable income was computed less due to arithmetical error	52.42
4.	Shri S.Srinivasan [Individual]	TN V, Chennai	1990-91 to 1994-95	144	There was a totalling mistake in tax and interest leviable	25.62
5.	The Nagpur Vinkar Sahakari Soot Girni Ltd. [Coop Society]	Nagpur, Maharashtra	1996-97	143(1)(a)	Loss was computed in excess due to failure to add back disallowed amount	17.30 (P)

Mistakes such as underassessment of tax due to incorrect adoption of figures, omission to levy surcharge/to add back ineligible amounts/to consider refunds, arithmetical errors, incorrect rates/status adopted and other mistakes noticed in 21 cases in different CIT charges led to short levy of tax aggregating Rs.131.60 lakh.

The Ministry have accepted the audit observations at Sl.Nos.4 and 5 of the statement and in 13 of the other cases.

**Mistakes in computation of business income**

5.7 Under the Income Tax Act, 1961, income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the profits are worked out on due or accrual basis regardless of the actual receipt or payment of any amount. As regards liability, the Act provides that any provision made for an accrued or known liability only is an admissible deduction and not merely anticipated to occur in

future. Further, any expenditure, not being expenditure of a capital in nature or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of business is allowable as deduction in computing the income. It has been judicially held\* that insurance premium paid on policies taken by the firm on the lives of its partners with a view to pay off the legal representative of the deceased partner is not an allowable expenditure.

Cases where the above provisions have not been observed are indicated below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	The Fatehgarh Sahib Central Coop. Bank Ltd. [Coop society]	Patiala, Punjab	1997-98	143(1)(a)	Anticipated provisions for non-performing assets and gratuity were erroneously allowed as deductions	17.91 57.87 (P)
2.	Mrs. Anindita Das Venkatraman [Individual]	TN III, Chennai	1995-96	143(3)	Payment made to an individual was irregularly allowed as deduction	6.07 9.92 (P)

Similar mistakes in 7 cases in different CIT charges led to total short levy of tax of Rs.42.81 lakh

*The Ministry have accepted the audit observations at Sl.No.1 of the statement and in 1 of the other cases.*

**Incorrect allowance of liability**

**5.8** Under the Income Tax Act,1961, as applicable from the assessment year 1984-85, certain deductions are allowable on actual payment on types of expenditure specified under section 43B of the Act. From 1 April 1988, tax or duty actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income shall also be allowed as deduction. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. is also deductible on actual payment basis. No deduction in respect of contribution to the above fund is, however, allowable unless such sum has actually been paid into the fund approved by the competent authority before the stipulated due date as specified under the relevant statute governing the fund.

Cases of incorrect allowance of liability noticed in test check are given below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of liability allowed as deduction	Tax effect
1.	Chotanagpur Cattle food Supply Co. and 3 others [Firms : 2, individuals : 2 ]	Ranchi, Bihar	1993-94 1994-95 1995-96	143(3) 143(3) 143(1)(a)	Outstanding sales tax liabilities	80.98

\* CIT Vs Khodidas Motiram Panchal: 161 ITR 98 (Guj.)



2.	M/s. The West Godavari Coop. Sugars Ltd. [Coop society]	Visakhapatnam, Andhra Pradesh	1995-96	143(1)(a)	Outstanding liability towards 'cane purchase tax' payable to Government	24.07
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Mistakes of similar nature were noticed in 4 cases leading to total short levy of tax of Rs.27.69 lakh.

*The replies of the Ministry to the audit observations have not been received.*

Mistakes in valuation of closing stock

5.9 It has been judicially held<sup>@</sup> that any system of accounting which excludes for the valuation of stock-in-trade, all costs other than the cost of raw materials is likely to result in a distorted picture of the true state of business, for the purpose of computing its chargeable income. The Board clarified in 1981 that the central excise/customs duties, if any, payable by the manufacturer/trader should go into calculation of production cost and the closing inventory should include an element of such duty to represent such cost. It has been judicially held<sup>#</sup> and later confirmed by the Supreme Court that where a business comes to an end, stock-in-hand would be valued at the market rate in order to determine the true profits of the business on the date of closure of the business. It has also been judicially held<sup>§</sup> that difference between the stock disclosed to the bank and stock valued in the books of account should be treated as income from undisclosed sources and added to the income of the assessee.

Cases of incorrect valuation of closing stock noticed in test check are indicated below:

Sl. No.	Nature of mistake	No. of cases	CIT's charge	(Rs. in lakh)	
				Section under which assessed	Tax effect
1.	Valuation of closing stock without including customs duties on closing stock	1	Ludhiana, Punjab	143(3)	4.21
2.	Stock in hand not valued at market rate on closure of business	1	City X, Mumbai	143(3)	4.87
3.	Difference between stock declared to the bank and in books of accounts not added back	2	Delhi VII, Delhi VIII,	143(3)	25.62

*The replies of the Ministry to the audit observations have not been received.*

Application of incorrect rate of depreciation

5.10 Central Board of Direct Taxes had clarified (June 1993) that higher rate of depreciation of 40 percent would not be admissible if motor vehicles are used in non-hiring business.

In 5 cases in Gujarat, Haryana, Madhya Pradesh and Punjab charges, application of incorrect rate of depreciation, allowance of depreciation at higher rates even though the motor vehicles were used in non-hiring business and non-restriction to 50 percent of the admissible rate in cases where the assets were put

<sup>@</sup> CIT Vs British Paints India Ltd. 188 ITR 44 (SC)

<sup>#</sup> A.L.A.Firms Vs CIT: 189 ITR 285 (SC)

<sup>§</sup> Swadeshi Cotton Mills Ltd. Vs CIT: 180 ITR 651 (Alld.)



to use for less than 180 days in a year led to an aggregate short levy of tax of Rs.28.27 lakh.

*The Ministry have accepted the audit observations in 2 cases.*

**Incorrect set off  
of unabsorbed  
depreciation**

**5.11** Under the Income Tax Act, 1961, where for any assessment year, unabsorbed depreciation under the head 'profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year for set off against 'profits and gains of business or profession' of that year, and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off.

In Kolhapur, Maharashtra charge, the assessment of **Kumbhi Kesari Sahakari Sakhar Karkhana Ltd.** (an association of persons) for the assessment year 1995-96 was completed after scrutiny in February 1998 allowing set off of unabsorbed depreciation and investment allowance of Rs.139.54 lakh pertaining to earlier years. Audit scrutiny revealed that the assessing officer had set off brought forward depreciation of Rs.114.01 lakh pertaining to the assessment year 1994-95 as against the correct amount of Rs.88.35 lakh and the mistake had subsequently been rectified. On verification of the correctness of the brought forward depreciation pertaining to the assessment year 1992-93 it was noticed that even though no depreciation was left to be carried forward to subsequent assessment years the assessing officer had allowed an amount of Rs.44.43 lakh to be carried forward and set off amounts of Rs.23.54 lakh and Rs.20.89 lakh in the assessment years 1993-94 and 1995-96 respectively without considering the left out unabsorbed investment allowance of Rs.10.09 lakh pertaining to the assessment years 1985-86 to 1988-89. After allowing full set off of unabsorbed investment allowance of Rs.10.09 lakh, there was an excess set off of depreciation of Rs.13.45 lakh in the assessment year 1993-94 and Rs.25.44 lakh in the assessment year 1995-96. The mistake resulted in incorrect set off of depreciation and underassessment of income aggregating Rs.38.89 lakh with consequent short levy of tax of Rs.23.34 lakh (including interest).

*The Ministry have accepted the audit observation.*

**Incorrect allowance  
of investment  
allowance**

**5.12** Under the Income Tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction shall be allowed in the previous year in which it was installed or first put to use, of a sum equal to 25 percent (20 percent with effect from 1 April 1989) of the actual cost of the machinery to the assessee.

In Baroda, Gujarat charge, the assessment of **M/s. Petrofils Co-op. Ltd.** (co-operative society) for the assessment year 1990-91 was completed after scrutiny in March 1993 allowing investment allowance of Rs.973.53 lakh. Audit scrutiny revealed that the cost of plant and machinery considered for deduction of investment allowance included an amount of Rs.234.50 lakh in respect of contribution made to Gujarat Electricity Board for power transmission line. As the contribution made to Gujarat Electricity Board did not confer any right of



ownership on the assessee, no investment allowance was admissible thereon. The excess investment allowance of Rs.46.90 lakh (20 percent of Rs.234.50 lakh) resulted in underassessment of income of Rs.18.25 lakh (after absorbing the balance amount of admissible deduction under section 80-I of Rs.28.65 lakh) with consequent short levy of tax of Rs.29.63 lakh (including interest).

*The Ministry have accepted the audit observation.*

**Incorrect exemptions in computation of capital gains**

**5.13** Under the Income Tax Act, 1961 any profits or gains arising from the transfer of a capital asset shall be chargeable to income tax under the head 'capital gains'. In the case of an individual, capital gains arising from the transfer of a long term capital asset other than a residential house is exempt from tax to the extent of the amount of net consideration received from such transfer, if such amount is invested in the purchase or construction of a residential house, provided the assessee did not own any other residential house on the date of transfer of the capital asset, income from which is assessable under the head 'Income from house property' other than the new asset. Further, the amount of the net consideration which is not utilised by the assessee towards purchase or construction of a new house within the specified period shall be exempted from capital gains tax provided such amount is deposited in any bank or institution in accordance with Capital Gains Accounts scheme on or before the due date of submission of return and such return shall be accompanied by proof of such deposit.

In Gujarat, Rajasthan, Maharashtra and West Bengal charges, in 5 cases, capital gains were allowed exemption irregularly even though the required conditions as per the above provisions were not fulfilled. The mistakes resulted in aggregate short levy of tax of Rs.40.10 lakh.

*The Ministry have accepted the audit observation in 1 case.*

**Mistakes in the assessment of firms and partners**

**5.14** Under the Income Tax Act, 1961, if the assessment of the firm has not been completed, the share income from the firm is to be included in the assessment of the partners on provisional basis and revised later to include the final share income on completion of the assessment of firm. For this purpose the Central Board of Direct Taxes instructed in March 1973 that the assessing officer should maintain a register of cases of provisional share income so that these cases are not omitted to be rectified. No revision of assessment of partner can however, be made under the Act after expiry of four years from the end of the financial year in which the final order was passed in the case of the firm.

In the following cases the assessment of the partners were not revised after completion of the assessment of the firm even though the partners were assessed in the same wards or requisite intimations were not sent to the wards where the partners were assessed to tax to arrive at the correct share income of the partner.

(Rs.in lakh)

Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Tax effect
1.	M/s. International Steel Corpn. & 3 others [Registered Firm]	Rajkot, Gujarat	1992-93	143(3)	72.09
2.	M/s.Ganga Developers [Registered Firm]	Central I, Mumbai	1990-91	143(3)	28.35
3.	M/s.G.H.Reddy & Associates [Registered Firm]	TN IV, Chennai	1992-93	143(3)	23.40

In 5 other cases in Gujarat, Rajasthan and Uttar Pradesh charges, short levy of tax aggregating Rs.31.78 lakh was noticed.

*The Ministry have accepted the audit observations at Sl.No.3 of the statement and in 1 of the other cases.*

**Mistake in assessment of income of partners**

**5.15** Under the provisions of the Income Tax Act, 1961, as applicable upto the assessment year 1992-93, in the case of a registered firm, the income tax payable by the firm itself shall be determined after assessing its total income and the share of each partner in the income of the firm shall be included in his total income and assessed to tax accordingly.

In Central II, Mumbai charge, the assessment of **M/s. Ganga Developers** (registered firm) for the assessment year 1990-91 was completed after scrutiny in March 1998 at a divisible income of Rs.52.92 lakh. This divisible income was allocated among the three partners at thirty percent, forty percent and thirty percent respectively. Audit scrutiny revealed that in respect of two of the partners having thirty percent share of profit, share income was computed at Rs.1.59 lakh each as against correct share income of Rs.15.88 lakh each. Thus share of income had been allocated short by Rs.14.29 lakh which resulted in underassessment of income aggregating to Rs.28.58 lakh in respect of both the partners leading to short levy of tax of Rs.15.43 lakh.

*The Ministry have accepted the audit observation.*

**Capital gains escaping assessment**

**5.16** It was judicially held\* that in the case of sale of entire business as a going concern by a firm to a company formed for such takeover, the difference between the transfer price and the written down value of assets is assessable to tax under capital gains.

In Tamil Nadu V, Chennai charge, the assessment of **M/s. East Coast Construction and Industries** (firm) for the assessment year 1995-96 originally completed after scrutiny in April 1996 was revised in December 1996, consequent on the order of the appellate authority and the total income was determined at Rs.119.58 lakh. Audit scrutiny revealed that the business of the firm was taken over as a going concern in April 1995 by a newly formed company with all the partners of the firm as shareholders. The assets of the firm were revalued and taken over by the company with liabilities. The difference of

CIT Vs \*M/s. Artex Manufacturing company (227 ITR 260)



Rs.400.62 lakh between the value of total assets (both depreciable and non-depreciable assets) after revaluation, aggregating Rs.550.33 lakh and the written down value/original cost aggregating Rs.149.71 lakh as on the 31st day of March 1995 was assessable to tax as capital gains. However, neither did the assessee file income tax return for the assessment year 1996-97 declaring income from capital gains, nor did the department initiate any proceedings to assess the same. The omission resulted in short term capital gains of Rs.248.73 lakh and long term capital gains of Rs.151.88 lakh escaping assessment involving non-levy of tax aggregating Rs.298.82 lakh including interest for the assessment year 1996-97.

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

**Income not assessed**

**5.17(a)** Under the Income Tax Act, 1961, the total income of a person for any previous year includes income from whatever sources derived which is received or deemed to be received or which accrues or arises during such previous year unless specifically exempted from tax by the provision of the Act. The income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee.

Cases where the incomes were not assessed are given below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of amount escaping assessment	Tax effect
1.	Shri Karim M.Maredia [Individual]	Central I, Mumbai	1994-95	143(3)	Amounts aggregating Rs.250 lakh received for standing as guarantor for loan	112.00
2.	Gujarat State Coop Bank Ltd. [Coop Bank]	Gujarat II, Ahmedabad	1995-96 1996-97	143(3) 143(1)(a)	Interest paid by the department on tax paid in excess	56.36

Similar mistakes in 4 cases in Gujarat, Haryana and Maharashtra charges resulted in total short levy of tax of Rs.20.68 lakh.

*The Ministry have accepted the audit observations in 2 out of the 4 cases.*

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

Cases where the above provisions were not applied correctly are indicated below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Mitra Guha Builders (India) [Firm]	WB IV, Calcutta	1995-96	143(3)	As against Rs.507.74 lakh on which credit for tax was allowed only Rs.437.09 lakh was offered for tax.	49.05
2.	M/s.Hardev Singh [Firm]	WB VIII, Calcutta	1990-91	143(3)	Out of total contract receipts of Rs.120.50 lakh for which tax credit was allowed, Rs.70.99 lakh only was offered for tax.	24.64

Similar mistakes in 2 cases in Gujarat and Uttar Pradesh charges led to total short levy of tax of Rs.11.17 lakh.

*The replies of the Ministry to the audit observations have not been received.*

**Incorrect carry forward and set off of losses**

**5.18** Under the Income Tax Act, 1961, where the net result of computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss can not be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those years. No loss under the head 'profits and gains of business or profession' is allowed to be carried forward from 1 April 1985 for set off unless the assessee had filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer. Further, any loss in respect of a speculation business carried on by the assessee shall not be set off except against profits and gains if any, of another speculation business.

Cases of incorrect carry forward and set off of losses noticed in test check are illustrated below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. A.P.Dairy Development Cooperative Federation Ltd. [Coop. Society]	AP I, Hyderabad	1993-94	143(3)	Though the assessee filed the revised return after the due date, the loss was allowed to be carried forward	100.54 (P)

In Uttar Pradesh, Maharashtra and West Bengal charges, 4 cases of incorrect carry forward and set off of losses when no loss was carried forward from earlier years, loss allowed to be carried forward although the returns were not submitted by due dates or irregular set off of speculation loss resulted in short levy of tax aggregating Rs.29.25 lakh.

*The Ministry have accepted the audit observations in all the 4 cases.*



*The reply of the Ministry to the audit observation at Sl.No.1 of the statement has not been received.*

**Mistake in assessment while giving effect to appellate orders**

**5.19** Under the Income Tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and the assessing officer shall comply with the directions given in the appellate order.

In Kolhapur, Maharashtra charge, the assessment of **M/s.Deshbhakta Ratnappa Kumbhar Panchaganga Sehtkari S.S.K.Limited** (co-operative society) for the assessment year 1995-96 was completed after scrutiny in December 1997 at nil income allowing set off of earlier years' depreciation from assessment year 1980-81 to 1987-88. Audit scrutiny revealed that in the assessment for the year 1986-87 completed after scrutiny in March 1987, income was computed at Rs.101.52 lakh which was adjusted against brought forward unabsorbed depreciation for the assessment years 1979-80 and 1980-81. The assessment was revised in November 1995 to give effect to appellate order allowing relief of Rs.98.97 lakh on account of development funds. However, while giving effect to the appellate order, the deduction of Rs.42.40 lakh already allowed in the original assessment was not deducted from the relief granted to the assessee. Omission to do so resulted in excess carry forward of depreciation to that extent in subsequent years which was set off in the assessment year 1995-96 involving potential tax effect of Rs.14.84 lakh.

*The Ministry have accepted the audit observation.*

**Incorrect allowance of deduction under Chapter VIA**

**5.20** Under the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the total income chargeable to tax. The overriding condition is that the total deductions should not exceed the gross total income computed as per provisions of the Act, before allowing deductions under Chapter VI A but after setting off of any unabsorbed loss, depreciation, investment allowance etc. pertaining to earlier years. Where the set off of unabsorbed loss, depreciation, investment allowance, etc. of earlier years results in reducing the total income to nil or to a loss, no deduction under Chapter VI A is admissible.

Case of incorrect allowance of deductions under the above provisions are indicated below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	M/s. Kisan Sahakari Chini Mills Ltd. [Coop society]	Bareilly, Uttar Pradesh	1994-95	143(3)	Deductions were computed without setting off of unabsorbed depreciation and investment allowance	34.20(P)
2.	M/s.Gellorm Gourishankar [Firm]	Patna, Bihar	1991-92 1992-93	143(3) 143(3)	Refunds of Central Excise duty were not deducted from total	22.54

					income for computing the admissible deductions	
3.	M/s.Bharuch Dist. Coop. Bank Ltd. [Coop society]	Baroda, Gujarat	1995-96	143(3)	Brought forward losses of earlier years were not set off while computing the deductions.	18.78 (P)

The Ministry have accepted the audit observation at Sl.No.3 of the statement.

**Incorrect allowance of deduction in respect of export profits**

**5.21** Under the Income Tax Act, 1961, as amended by the Finance Act, 1988, with effect from 1 April 1989, an assessee being an Indian company or other assessee resident in India, engaged in export business, is entitled to a deduction equal to the profit derived from the export of goods or merchandise other than the exempted items if the sale proceeds thereof are received in convertible foreign exchange. Where the business of the assessee does not consist exclusively of export of goods/merchandise, profit derived from export shall be the amount which bears to the profit of the assessee as computed under the head 'profits and gains of business or profession' the same proportion as export turnover to total turnover. With effect from 1 April 1992, for the purpose of the deduction, 'profits of the business' means the profits of the business as computed under the head profits and gains of business or profession as reduced by ninety percent of certain receipts specified in the Act.

Cases of incorrect/irregular allowance of deductions under the above provisions noticed in test check are given below:

(Rs.in lakh)

Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Shri R.Prakash [Individual]	Trivandrum, Kerala	1994-95	143(3)	Ninety percent of other income was not deducted from the profits while computing the eligible profits.	50.93
2.	M/s.Maneklal Vadilal & Co. [Firm]	City XIV, Mumbai	1995-96	143(3)	Foreign exchange was not received before the prescribed date and 90 percent of other receipts was not deducted from the profits.	21.88
3.	M/s.NAFED [Co-op. Society]	Delhi I	1995-96	143(3)	Ninety percent of interest income and dividend were not deducted from the profits	18.44

Similar omissions were noticed in 6 cases in Gujarat, Madhya Pradesh and Tamil Nadu charges which resulted in total short levy of tax of Rs.52.61 lakh.

The Ministry have accepted the audit observation in 1 out of the 6 cases.

In respect of the audit observation at Sl.No.1 of the statement, the Ministry informed that remedial action was taken in accordance with the audit observation by excluding 90 percent of the processing charges which on a later



date were restricted to 90 percent of the net processing charges based on the decision of the CIT (Appeal).

**Incorrect allowance of deduction to new industrial undertaking established after 31 March 1981**

**5.22** Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking established after 31 March 1981, the assessee is entitled to a deduction of twenty five percent of such profits and gains.

In City XII, Mumbai charge, the assessment of **M/s.Wimco Pen Company** (firm) for the assessment year 1994-95 was completed after scrutiny in December 1996 after allowing relief of Rs.215.96 lakh in respect of profits of new industrial undertaking established after 31 March 1981. Audit scrutiny revealed that the profit of Rs.1079.78 lakh included Rs.1044.43 lakh being receipts like export benefits and cash premium against export and sale of license premium. As the deduction was admissible only in respect of profits and gains derived from the profit of business activity, the deduction allowed in respect of other income was not in order. After excluding the above amount, the aggregate admissible deduction would work out to Rs.7.07 lakh as against Rs.215.96 lakh allowed by the department. The mistake resulted in underassessment of income of Rs.208.89 lakh with consequent short levy of tax of Rs.155.34 lakh (including interest).

*The Ministry have not accepted the audit observation stating that export benefits, cash premium against export and sale of licence premium are treated as income derived from business, hence correctly included for computation of deduction.*

*The reply is not tenable as the law does not provide for deduction in respect of income but of profits and gains derived from the industrial undertaking under section 80 I of the Income Tax Act. The above mentioned items cannot be said to be profits and gains derived from the actual conduct of business of industrial undertaking.*

**Irregular allowance of deduction in respect of income of cooperative society**

**5.23** Under the Income Tax Act, 1961, the income of a co-operative society attributable to certain specified activities is wholly exempt. It has been judicially held\* that the income derived from the investment in Government securities placed with the State Bank of India or the Reserve Bank of India could not be regarded as an essential part of assessee's banking activity in as much as the same did not form part of its stock-in-trade or working/circulating capital. Hence the same could not qualify for exemption under the Income Tax Act.

In Gujarat III, Ahmedabad charge, the assessment of **M/s.Uttar Gujarat Ru-Vechan Sangh Ltd. Coop. Society** (co-operative society), engaged in marketing of agriculture produce, for assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that an amount of Rs.24.68 lakh being interest income from traders and depositors not wholly attributable to the co-operative venture was erroneously considered as exempt.

\* M.P.Co-operative Bank Ltd. Vs Addl.CIT-218 ITR-438 (SC)

The mistake resulted in underassessment of income by Rs.24.68 lakh with consequent short levy of tax of Rs.17.02 lakh (including interest).

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

**Short levy of interest-  
Non submission/  
delay in  
submission of  
return**

**5.24(a)** Under the Income Tax Act, 1961, 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 per month or part thereof (from 1 April 1989), 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. The Act further provides that where, with a view to reassessment, the return of income required by a notice issued after the completion of regular assessment is furnished after the expiry of the time allowed in such notice, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part of a month comprised in the period commencing on the day immediately following the expiry of the time allowed and ending on the date of furnishing the return on the amount by which the tax on the total income determined on the basis of such reassessment exceeds the tax on the total income determined under regular assessment.

Instances of short levy/non-levy of interest under the above provisions are given below:

(Rs.in lakh)

Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Shri Gautambhai A.Parmar [Individual]	Gujarat I, Ahmedabad	1990-91 1992-93 1993-94	143(3)	Even though notices were issued, the returns were not filed within the due dates.	35.69
2.	Shri A.D.Narottam [Individual]	Central, Mumbai	1995-96	144	Interest was not levied even though return was not submitted	26.85
3.	Shri Monilal Thakkar [Individual]	Central II, Calcutta	1989-90 to 1992-93	143(1)(a)	Interest was short levied even though the returns were submitted beyond the dates specified in the notices.	20.54
4.	Shri Babul Bhattacharjee [Individual]	Central I, Calcutta	1992-93 to 1994-95	143(3)	Tax was computed short resulting in short levy of interest for non payment of advance tax and interest for delay in submission of return was computed less/not levied	20.23

Similar mistake in 2 cases were noticed in Delhi and Maharashtra charges which resulted in short levy of tax of Rs.9.63 lakh in aggregate.

*The Ministry have accepted the audit observation at Sl.No.1 to 4 of the statement and in 1 of the other cases.*



**Short payment  
/non-payment of  
advance tax**

(b) Under the Income Tax Act, 1961, where in any financial year, an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part thereof reckoned from 1 April next following such financial year to the date of determination of total income by processing the return of income and where a regular assessment is made, to the date of such regular assessment on the amount equal to the assessed tax or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax.

Cases of short levy/non levy of interest under the above provisions are given below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	Laxminarayan T.Thakkar [HUF]	Central, Ahmedabad	1995-96	143(3)	Interest was short levied for short payment of advance tax	116.48
2.	M/s.Deep Chand Manik Chand Rauna Bela [Firm]	Varanasi, Uttar Pradesh	1995-96	143(3)	Interest was short levied for non payment of advance tax	26.21
3.	Aruna D.Mehrotra [Individual]	City VII, Mumbai	1995-96	143(3)	The assessable amount of interest was worked out erroneously	21.04

Similar mistakes in 4 cases in Gujarat and Madhya Pradesh charges resulted in total short levy of tax of Rs.18.40 lakh.

*The Ministry have accepted the audit observation at Sl.No.3 of the statement.*

**Delay in  
payment of tax  
demand**

(c) Under the Income Tax Act, 1961, any demand for tax should be paid by an assessee within thirty days of service of notice of the relevant demand. Failure to do so would attract levy of simple interest at one and one half per cent per month or part thereof from the date of default till actual payment. Where the assessment made originally by the assessing officer is either varied or even set aside by one appellate authority but on further appeal the original order of the assessing officer is restored either in parts or wholly, the interest payable will be computed with reference to the due date reckoned from the original demand notice.

Cases of short levy/non levy of interest under the above provisions are given below:

(Rs.in lakh)						
Sl. No.	Name of the assessee and status	CIT's charge	Assessment year	Section under which assessed	Nature of mistake	Tax effect
1.	SPORTS [AOP]	Kochi, Kerala	1992-93 1993-94 1994-95	143(1)(a) 143(1)(a) 143(1)(a)	Even though the demands were not paid within the dates specified in the notices, interest was short levied for 2 years and not levied for 1 year	10.33



2.	Kallakurichi Coop. Sugar Mills Ltd. [Coop society]	TN V, Chennai	1992-93 March 1995	143(3)	Even though tax demand was paid belatedly no interest was levied	10.24
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Similar mistakes in respect of non-filing/delay in filing of return, non-payment/short-payment of advance tax/tax demand and non-levy of surcharge were noticed in 8 cases in Bihar, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Uttar Pradesh and Maharashtra charges resulting in short/non-levy of tax totalling to Rs.34.26 lakh.

*The Ministry have accepted the audit observations at Sl.Nos.1 and 2 of the statement and in 6 of the other cases.*

**Incorrect allowance of expenditure on cinematographic films**

**5.25** Under the Income Tax Act, 1961, read with Income Tax Rules 1962, where an assessee produces/acquires distribution rights of feature film and the film is not released for exhibition on commercial basis or the rights of exhibition is not sold during the previous year, no deduction shall be allowed in respect of the cost of production/acquisition of the film in computing the profits and gains of such previous year and the entire cost shall be carried forward to the next following previous year and allowed as a deduction in that year. It is also provided that no deduction shall be allowed in respect of cost of production/acquisition of distribution rights of feature films, unless the amount realised by exhibiting the film or by selling the rights of exhibition or the aggregate of such amounts is credited in the books of account maintained by the assessee in respect of the year in which deduction is admissible.

In Tamil Nadu III, Chennai charge, the assessment of **Sri Nesamany Maran** (individual), for the assessment year 1996-97 was processed in a summary manner in February 1997 allowing 100 percent depreciation amounting to Rs.75.85 lakh on cinematographic films. Audit scrutiny revealed that the assessee had not accounted for the amounts, if any, realised by exhibiting the films or by selling the rights for exhibiting the films in his books of accounts and offered the same to income tax. Hence the claim for 100 percent depreciation was required to be disallowed. Omission to do so resulted in underassessment of income of Rs.75.85 lakh involving short levy of tax of Rs.43.08 lakh (including additional tax and interest).

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

**General**

**5.26** Other mistakes noticed in determining income and computation of tax, interest and penalty, etc., were noticed in 31 cases in various CIT charges resulting in total loss of tax revenue of Rs. 166.51 lakh.

*The Ministry have accepted the audit observation in 14 cases.*



## CHAPTER 6 : OTHER DIRECT TAXES

### A-Wealth Tax

#### Revenue from wealth tax

6.1 The following table gives a time series analysis of wealth tax receipts as against budget estimates during 1994-95 to 1998-99.

Year	Budget estimates	Actuals	Variation	Percentage variation
<b>(Rs. in crore)</b>				
1994-95	125.00	104.87	(-)20.13	(-)16.1
1995-96	90.00	74.16	(-)15.84	(-)17.6
1996-97	110.00	77.44	(-)32.56	(-)29.6
1997-98	130.00	113.03	(-)16.97	(-)13.0
1998-99	145.00	162.04	(+) 17.04	(+) 11.75

#### Number of assessees

6.2 The number of wealth tax assessees borne on the books of the Income Tax Department as on 31 March of the last two years (1998 and 1999) are given in Annexure I of para 2.1 of Chapter 2 of this Report.

#### Status of assessments

6.3 Particulars of assessments completed, assessments pending and demands in arrear for the last three years ending 31 March 1999 are as given in para number 2.9.2(i)&2.10(ii) of Chapter 2 of this Report. Arrears continued to mount despite direction of the Board for assigning priority to reduction of arrear of demands.

#### Results of audit

6.4 During the test audit of assessments completed under the Wealth Tax Act, 1957, conducted during the period 1 April 1998 to 31 March 1999, short levy of wealth tax of Rs.19.57 crore was noticed in 514 cases as given in para 1.5.1(ii) of Chapter I of this Report.

A total number of 60 audit observations involving tax effect of Rs.230.96 lakh were issued to the Ministry of Finance as draft paragraphs for comments during August 1999 to December 1999. The Ministry of Finance have so far accepted the observations in 32 cases involving tax effect of Rs. 87.98 lakh. Replies are awaited in respect of 27 cases. 6 cases involving tax effect of Rs. 49.51 lakh were checked by the Internal Audit Wing of the department but the mistakes were not detected by them. The category-wise break up of the audit observations issued to the Ministry of Finance is given below:

Sl. No.	Category	Draft paragraphs issued to the Ministry	
		Nos.	Tax effect
1.	Wealth not assessed	39	161.88
2.	Avoidable mistake in computation of wealth tax	5	5.30
3.	Incorrect computation of net wealth	3	2.20
4.	Incorrect valuation of quoted equity shares	3	5.43
5.	Incorrect valuation of unquoted equity shares	1	5.94
6.	Irregular grant of exemption	1	4.31
7.	Non/short levy of interest for delay in filing the return	6	39.29
8.	Non levy of interest for delay in payment of tax demand	2	6.61
<b>Total</b>		<b>60</b>	<b>230.96</b>

(Rs. in lakh)

**Wealth not assessed**

**6.5** Under the Wealth Tax Act, 1957, where the net wealth of an individual or Hindu undivided family or a company exceeds Rs.15 lakh, tax is levied at one percent of the amount by which the net wealth exceeds Rs.15 lakh. Net wealth means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date. Under the Act 'assets' *inter alia*, include properties exclusively used for residential purposes, motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade) and aircrafts (other than those used by the assessee for commercial purposes). Further, from assessment year 1997-98, assets include commercial properties also. The Central Board of Direct Taxes issued instructions (November 1973, April 1979 and September 1984) for proper co-ordination of assessment records pertaining to different direct taxes to check evasion of tax.

Audit scrutiny of income tax assessment records revealed that the assessees had disclosed rental income from residential and commercial properties or owned specified assets like motor cars/aircrafts which were chargeable to wealth tax. However, neither did the assessees file their returns of net wealth nor did the department initiate wealth tax proceedings despite CBDT's instructions. The omission resulted in wealth escaping assessment with consequent non-levy of wealth tax. Illustrative cases are given below:

(Rs. in lakh)						
Sl. No.	Assessee name and status	CIT's charge	Assessment Years	Nature of mistake	Non-assessed wealth	Tax effect
1.	M/s.Tivoli Investment & Trading (P) Ltd. [company]	Mumbai City IV & V	1997-98	The assessees received rent from let-out properties, values of which considering rent capitalisation method were chargeable to wealth tax but escaped assessment with consequent non-levy of wealth tax	1318.19	13.03
2.	M/s. New India Maritime Agencies (P) Ltd. [company]	TN I, Chennai	1990-91 to 1992-93		460.52	9.21
3.	M/s.Loyal Engg. Ltd. [company]	TN IV, Chennai	1991-92 1992-93		140.50	5.62
4.	M/s.Paramsukh Prop. P.Ltd. [company]	WB II, Calcutta	1989-90 to 1993-94		124.00	3.89
5.	M/s.Sudera Enterprises (P) Ltd. [company]	WB II, Calcutta	1988-89 1989-90		174.00	3.58

Similar mistakes were noticed in 12 cases (5 company, 6 individual and 1 HUF) involving tax effect of Rs.20.83 lakh out of which the Ministry accepted 5 observations amounting to Rs.8.29 lakh.

*The Ministry have accepted two observations at Sl.No.2 and 3 amounting to Rs.14.83 lakh.*



6.	M/s Balaji Industries (P) Ltd. [company]	Chennai TN IV	1988-89 to 1991-92	The company owned specified assets of motor cars and aircraft, value of which were chargeable to wealth tax but escaped assessment with consequent non levy of wealth tax	2049.12	41.18
7.	M/s. Eastern Clay & Ceramics Ltd. [company]	Kerala, Calicut	1987-88 to 1992-93		271.24	11.60
8.	M/s.Kumar Hotels (P) Ltd. [company]	Maharashtra Nagpur	1986-87 to 1991-92		272.00	5.39
9.	M/s.Essar Power Ltd. [company]	Mumbai City III	1996-97		526.95	5.12
10.	M/s.Madras Refineries Ltd. [company]	TN II Chennai	1993-94		282.29	4.05

*The Ministry have accepted 3 observations at Sl.No.7,8 and 10 amounting to Rs.21.04 lakh. Their response to the remaining observations has not been received.*

Similar mistakes were noticed in 5 company cases involving tax effect of Rs.12.30 lakh out of which the Ministry accepted 3 observations amounting to Rs. 8.94 lakh.

11.	Mrs. Vimal C. Khanwilkar [individual]	MP, Indore	1991-92 to 1993-94	The assessee owned immovable properties which were chargeable to wealth tax but escaped assessment with consequent non-levy of wealth tax	141.53	4.70
12.	Shri Ramaniklal R. Shah [company]	AP Hyderabad	1995-96 to 1997-98		293.93	4.17
13.	Shri Amarnath V.Bhide [company]	Mumbai X	1995-96		278.40	3.62

*The reply of the Ministry to the audit observations have not been received.*

Similar mistakes were noticed in 9 cases (2 company and 7 individual) involving tax effect of Rs.13.59 lakh out of which the Ministry accepted 5 observations amounting to Rs. 6.8 lakh.

**Avoidable mistake in the computation of wealth tax**

**6.6** Overassessment/underassessment of tax of substantial amounts on account of avoidable mistakes attributable to negligence on the part of assessing officers has been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and issue of repeated instructions by the CBDT, such mistakes continue to occur suggesting the need for close supervision and control.

In Tamil Nadu I, Chennai charge, the wealth tax assessment of a company, *M/s. South India Hotels (P) Ltd.*, for assessment year 1993-94 was completed after scrutiny in March 1998 on a net wealth of Rs.136.92 lakh and wealth tax of Rs.2.74 lakh was levied. Audit scrutiny revealed that wealth tax was levied at the rate of two percent instead of one percent. The tax levied would be Rs.1.22 lakh as against Rs.2.74 lakh levied. The mistake resulted in over charge of wealth tax of Rs.1.52 lakh.

*The Ministry have accepted the observation.*

Besides, cases of undercharge of tax were also noticed as detailed below:

(Rs. in lakh)					
Sl.No.	Assessee name and status	CIT's charge	Assessment year	Nature of mistake	Tax effect
1.	M/s. Swadesa Mitran Ltd. [company]	Chennai II	1988-89	Surcharge was not levied	1.46
2.	Shri Lalit Suri [individual]	Delhi III	1995-96	Net wealth was erroneously arrived at	0.79
3.	M/s Ceat Ltd. [company]	Mumbai City IV	1995-96	Refund allowed in summary assessment was not taken into account while completing scrutiny assessment	0.78
4.	Shri S. Kamal Hassan [individual]	Chennai IV	1992-93	Wealth tax was levied at the rates applicable for the assessment year 1993-94 instead of that for assessment year 1992-93. Additional tax was also not levied.	0.75

*The Ministry have accepted 3 observations at Sl.No.1,3 and 4 amounting to Rs.2.99 lakh.*

*Their response to the remaining observation has not been received.*

**Incorrect computation of net wealth**

**6.7** Under the Wealth Tax Act, 1957, the value of any asset other than cash shall be its value as on the valuation date, determined in the manner laid down in Schedule III to the Act. From the assessment year 1992-93, the value of any asset shall be either its value determined in the manner laid down in Schedule III to the Act or its value, disclosed in the balance sheet of the company, on the valuation date, whichever is higher.

(i) In following cases, the value of property was worked out based on the value declared by the registered valuer/shown in the balance sheet instead of adopting rent capitalisation method laid down in Schedule III to the Act.



(Rs. in lakh)					
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Under assessed wealth	Tax effect
1.	M/s.E.L. Properties (P) Ltd. [company]	WB III Calcutta	1992-93	44.55	0.89
2.	Master Abhishek Jhunjunwala [individual]	WB V Calcutta	1992-93	36.00	0.69

The Ministry have accepted both observations amounting to Rs.1.58 lakh. Their response to the observation at Sl.No.2 has not been received.

(ii) In following case the assessee had received rental deposit from the tenants but the annual rent was not increased by the amount calculated @15 percent on the amount deposit as required under schedule III of the Wealth Tax Act to arrive at the maintainable rent and the value of the immovable property. The omission resulted in underassessment of wealth with consequent short levy of tax as given below:

3.	Shri Suresh Chandra Malik [individual]	AP II Hyderabad	1991-92 and 1992-93	30.42	0.62
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The Ministry have accepted the observation.

**Incorrect valuation of quoted equity shares**

6.8 Under the Wealth Tax Act, 1957, from 1 April 1989, the value of any asset other than cash shall be its value, as on the valuation date, determined in the manner laid down in Schedule III to the Act. This Schedule specifies that the value of an equity share in any company which is a quoted share shall be taken as the value quoted at the recognised stock exchange in respect of such share on the valuation date. Further the value of such share may, at the option of the assessee, be taken on the basis of the average of the value quoted on 31st March immediately preceding the assessment year and values quoted in respect of such share on the said dates in relation to each of the immediately preceding nine assessment years provided that where the assessee opts for average of values so quoted, he shall get such value certified by an accountant and attach the same along with the return of wealth.

Following cases were noticed in test check:-

(Rs. in lakh)						
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Nature of mistake	Value of under-assessed wealth	Tax effect
1.	Shri Kush Narayan Sahgal [individual]	WB V Calcutta	1992-93	The assessee opted and returned the value of quoted equity shares on the basis of average quoted value instead at the quoted rates which were higher than adopted average quoted value without attaching the valuation certificate. The assessing officer accepted the same which resulted in underassessment of wealth with consequent undercharge of wealth tax	192.99	4.13

2.	Smt. Sumitra Devi Chowdhury [individual]	WB VIII Calcutta	1992-93		21.08	0.56
3.	Smt.Geeta Dutta [individual]	WB V Calcutta	1992-93		38.00	0.74

*The replies of the Ministry to the audit observations have not been received.*

**Incorrect valuation of unquoted equity shares**

**6.9** Under the Wealth Tax Act, 1957, the value of an unquoted equity share in a company, other than an investment company, shall be determined by dividing the value of assets in excess of all liabilities as shown in the balance sheet by the total amount of its paid up equity share capital and by multiplying the result by the paid up value of each equity share and eighty percent of break up value so determined shall be the value of the equity share. Further, an investment company has been defined to mean a company whose gross total income consists mainly of income which is chargeable to income tax under the heads "Income from House Property", "Capital gains" and "Income from other sources".

Following cases were noticed in test check:

(Rs. in lakh)					
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Nature of mistake	Tax effect
1.	Sh.Ajit Kumar Chordia [individual]	Tamil Nadu I Chennai	1990-91 to 1992-93	Liabilities not shown in the balance sheet were deducted from the value of assets. Further, value of shares was arrived at after allowing a deduction of 20 percent applicable for non-investment company and value of house property was taken as shown in balance sheet instead of computing under the rent capitalisation method. Incorrect adoption of value of shares resulted in underassessment of wealth of Rs.246.33 lakh	2.25
2.	Smt.Kanta Devi [individual]	-do-	1990-91 to 1992-93		2.46
3.	Sh.Navratnamall Chordia & sons [HUF]	-do-	1992-93		1.23

*The Ministry have accepted the observations amounting to Rs.5.94 lakh.*

**Irregular grant of exemption**

**6.10** Under the Wealth Tax Act,1957, as amended by the Finance Act,1993, one house or part of a house whatever may be its value, belonging to an individual or a Hindu undivided family is exempt from wealth tax with effect from 1 April 1994.

In West Bengal III charge, audit scrutiny of the wealth tax assessments of a company, *M/s.Viny International Ltd.*, for the assessment years 1994-95 to 1996-97 completed in summary manner in February 1997 revealed that the assessee company claimed in its return exemption of one house worth Rs.119.60 lakh in each year which was allowed by the assessing officer. As the assessee was a company, it was not entitled to such an exemption. The exemption being, prima facie inadmissible should have been disallowed. Omission to do so resulted in wealth aggregating Rs.359 lakh escaping assessment with consequent short levy of wealth tax of Rs.4.31 lakh (including additional tax).

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



**Non-levy/short  
levy of interest  
for delay in  
filing the return**

**6.11** Under the Wealth Tax Act, 1957, where the return of net wealth for any assessment year is furnished after the specified due date, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part of a month from the date immediately following the due date to the date of furnishing the return, on the amount of tax determined in regular assessment. In following cases test checked interest for delay in filing the return was not levied.

(Rs. in lakh)				
Sl.No.	Assessee name and status	CIT's charge	Assessment year	Tax effect
1.	M/s.Balaji Industries (P) Ltd. [company]	TN IV Chennai	1990-91 to 1993-94	30.04

*The Ministry have not accepted the observation on the ground that facts were relevant till March 1997 and after that Commissioner of Wealth Tax(Appeals) did not uphold the value of the property as determined by the assessing officer and directed him to recompute the same as per Schedule III of the Wealth Tax Act.*

*The reply is not tenable as the fact remains that on assessment, the assessing officer failed to charge the interest for delay in filing the return as per Section 17B of W T Act which resulted in short levy of interest. The decision given by the Commissioner of Wealth Tax(Appeals) later on has no relevance as the full amount of interest would have been levied alongwith the tax due, had it been charged properly by the assessing officer.*

Similar mistakes were noticed in 5 cases (one company, 3 individual and 1 HUF) involving tax effect of Rs.9.25 lakh out of which the Ministry accepted 4 observations amounting to Rs.8.82 lakh.

**Non-levy of  
interest for  
delay in  
payment of tax  
demand**

**6.12** Under the Wealth Tax Act, 1957, a demand of tax should be paid by an assessee within thirty days, (thirty five days prior to the assessment year 1989-90) of service of notice of demand. Failure to do so attracts simple interest at one and one half percent per month or part thereof (fifteen percent per annum prior to the assessment year 1989-90) from the date of default till the date of actual payment.

Omission to levy interest for delay in payment of tax demand was noticed in the cases detailed below:

(Rs. in lakh)				
Sl.No.	Assessee name and status	CIT's charge	Assessment year	Tax effect
1.	Smt. Vidya Singh [individual]	TN V Chennai	1982-83 to 1984-85	5.62
2.	Sh.S.Kamal Hassan [individual]	TN IV Chennai	1989-90	0.99

*The Ministry have accepted above two observations amounting to Rs. 6.61 lakh.*

**B-Gift Tax**

**Revenue from gift tax**

**6.13** In the financial years 1994-95 to 1998-99, gift tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget estimates	Actuals	Variation	Percentage variation
(Rs. in crore)				
1994-95	5.00	14.98	9.98	200
1995-96	10.00	11.40	1.40	14.00
1996-97	10.00	19.30	0.30	0.3
1997-98	10.00	9.08	(-)0.92	(-) 9.2
1998-99	10.00	9.96	(-) 0.04	(-) 0.4

**Number of assesseees**

**6.14** The number of gift tax assesseees borne on the books of the Income Tax Department as on 31 March of the last two years (1998 and 1999) are given in Annexure I of para 2.1 of Chapter 2 of this Report.

**Status of assessments**

**6.15** Particulars of assessments completed, assessments pending and demands in arrear for the last three years ending 31 March 1999 are as given in para number 2.9(i) and 2.10(ii) of Chapter 2 of this Report.

**Results of audit**

**6.16** During the test audit of assessments completed under the Gift Tax Act, 1958, conducted during the period 1 April 1998 to 31 March 1999, short levy of gift tax of Rs.11.97 crore was noticed in 128 cases as given in para 1.5.1(ii) of Chapter I of this Report.

A total number of 22 audit observations involving tax effect of Rs.151.45 lakh were issued to the Ministry of Finance as draft paragraphs for comments during August 1999 to December 1999. The Ministry of Finance have so far accepted the observations in 8 cases involving tax effect of Rs. 41.57 lakh. Replies are awaited in respect of 9 cases. 2 cases involving tax effect of Rs. 8.38 lakh were checked by the Internal Audit Wing of the department but the mistakes were not detected by them.

Out these, 21 audit observations involving tax effect of Rs.141.21 lakh are given below:

**Under valuation of deemed gift**

**6.17** Under the Gift Tax Act, 1958, where property is transferred without any consideration, the market value of the property shall be treated as gift. The Act further provides that where property is transferred otherwise than for adequate consideration, the amount by which the market value of the property on the date of transfer as determined in the manner laid down in Schedule II to the Gift Tax Act, exceeds the value of the consideration shall be deemed to be a gift made by the transferor. The Act also provides that the value of the property shall be estimated to be the price which it would have fetched if sold in the open market on the date on which the gift was made. Schedule II to the Gift Tax Act, 1958 provides that from 1 April 1989, the value of any property other than cash shall



be its value determined in accordance with the provision of Schedule III to the Wealth Tax Act, 1957.

In West Bengal I, Calcutta charge, the gift tax assessment of a company, *M/s Dr. C. Otto & Co.*, for the assessment year 1993-94 was completed after scrutiny in February 1997 on a taxable gift of Rs.114.20 lakh. Audit scrutiny revealed that the assessee transferred 1,00,000 equity shares to another company in April 1992 at a sale consideration of DM 4,70,000. The sale value was converted to Indian currency at the rate of Rs.18.35 per DM and the total sale was taken and considered in the gift tax assessment at Rs.86.24 lakh and taking the break up value of 100,000 equity shares at Rs.200.47 lakh the deemed gift was determined at Rs.114.20 lakh. But on verification of the income tax assessment of the assessee company for the assessment year 1993-94 it was noticed that the rate of conversion as filed and accepted in the income tax assessment by the assessing officer was Rs. 16.25 lakh per DM. Adoption of incorrect rate of conversion of the sale consideration resulted in under valuation of deemed gift by Rs.9.69 lakh with consequent under charge of tax of Rs. 5.17 lakh (including interest).

*The Ministry have accepted the audit observation.*

**Non-levy of tax on gift/ deemed gift**

**6.18** In the cases cited below income tax records revealed that the assessees had transferred properties without any/adequate consideration which constituted gifts/deemed gifts but neither did the assessees file returns for gift tax nor did the department initiate any gift tax proceedings resulting in non-levy of gift tax.

(Rs. in lakh)					
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Value of taxable gift	Tax effect
(i)	M/s. Therapeutics Inv.(P) Ltd. [company]	Mumbai, City V	1988-89	142.69	42.75
(ii)	Yogesh Kumar [individual]	Haryana Punchkula	1997-98	41.84	16.32

*The Ministry have not accepted the observation in respect of Sl.No.(ii) on the ground that the Municipal Committee had assessed the annual value of the entire building in 1991-92 at Rs.4.30 lakh which remained unchanged upto 1996-97 based on which the fair market value of the portion sold works out to Rs.3.15 lakh where as the assessee sold the said portion for Rs.61 lakh. They have also referred to Mumbai High Court decision in *CGT Vs Cawas Jahangir Co. (P) Ltd. [1977] 106 ITR 390* according to which the excess adequate consideration has to be construed in a broad sense and some difference between the consideration for a transfer and the true value of the property transferred would not attract the applicability of section 4(1)(a) of Gift Tax Act.*

*The reply, however, is not tenable mainly because under Rule 20 of schedule III of the Wealth Tax Act, which has been adopted for purpose of Gift Tax Act, the fair market value of the property by the valuation officer was statutorily worked out at Rs.47.95 lakh as on 31-3-1993 and the value of the portion sold worked*

out to Rs.103.14 lakh. In view of rule 5 (ii) of schedule III the valuation of annual value by the Municipal Committee earlier as reported in Ministry's reply was not relevant.

Keeping in view of the substantial difference between the statutory valuation as per rule 20 of the Schedule III (Rs.103.14 lakh) and the consideration fetched (Rs.61 lakh) the ratio of the aforesaid High Court judgment is not applicable and it is eminently a case where the provisions the section 4(1)(a) of Gift Tax Act fully attracted.

Their response to the observation at Sl.No.1 has not been received.

Similar mistakes were noticed in 14 cases (8 individual, 4 company, 1 firm and 1 HUF) involving tax effect of Rs.51.90 lakh out of which the Ministry accepted 4 observations amounting to Rs.12.11 lakh.

**Non-levy/short-levy of interest**

**6.19** Where the return of gift for any assessment year is furnished after 30 June of such year, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part of a month comprised in the period commencing on the 1st day of July of the assessment year and ending on the date of filing of the return on the amount of tax payable on the taxable gift determined on regular assessment. An assessment made for the first time in respect of gift escaping assessment shall be regarded as regular assessment for the purpose of charging interest.

In the cases cited below, interest for delay in filing the return of gift was either not levied or short levied.

(Rs. in lakh)				
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Tax effect
(i)	Santosh Kumar Saha [individual]	West Bengal III	1991-92	0.58
(ii)	Smt. S. Valliammai [individuals]	Chennai III	1995-96	1.11

The Ministry have accepted both observations amounting to Rs.1.69 lakh.

**Non-levy of interest for belated payment of tax**

**6.20** Under the provisions of the Gift Tax Act, 1958, where any amount specified in a notice of demand is not paid within thirty days of service of the notice of demand, the assessee shall be liable to pay simple interest at the rates specified for every month or part of a month comprised in the period commencing from the day immediately following the due date and ending with the day on which the amount is paid. As per the Board Circular dated 3 April 1982, where the assessment made originally by an assessing officer is set aside by one appellate authority but, on further appeal, the original order is restored in part or wholly, the interest payable for belated payment of tax will be computed with reference to the due date reckoned from the original demand notice and with reference to the tax finally determined.



In Tamil Nadu III, Chennai charge, the gift tax assessment of a company, **M/s Kasthuri Estates (P) Ltd.**, for assessment year 1963-64 was completed after scrutiny in March 1979 on a taxable gift of Rs.31.98 lakh and a notice of demand for Rs.7.75 lakh was issued on 23 March 1979. Audit scrutiny revealed that the above assessment was cancelled in December 1981 consequent on the order of ITAT and was restored in November 1997 as per the decision of the Madras High Court raising the same demand. The assessee paid the demand on 8 January 1998. However, the interest payable for the belated payment of tax for the period from May 1979 to January 1998 was not levied. The omission resulted in non-levy of interest of Rs.22.60 lakh.

*The Ministry have accepted the audit observation.*

**Incorrect  
valuation of  
gift**

**6.21** Under the provisions of the Gift Tax Act, 1958, where a person makes a gift which is not revocable for a specific period, the value of the property gifted shall be the capitalised value of the income from such property during the period for which the gift is not revocable. The capitalised value of the income shall be taken to be the product of the number of complete years included in the period for which the gift is not revocable and average of the income received from the property during the three years or such lesser period of complete years in which such property was in existence preceding the previous year for the year of assessment after discounting it at the rate of four percent per annum.

In Maharashtra, Nagpur charge, the gift tax assessments of two individuals (**Shri Amolchand Hirachand Munot and Shri Harish Kumar A. Munot**) for the assessment year 1996-97 were completed after scrutiny in October 1996 at taxable gifts of Rs.2.28 lakh and Rs.2.40 lakh respectively. The assessees had revocable gift of equity shares of a company in favour of the members of the family for a period of five years. For gift tax purposes the assessees had made valuation per share at Rs.24/-. Audit scrutiny revealed that the company had issued bonus shares at the ratio 1:1. The face value of each share was Rs.10 per share. As these bonus shares constituted income of the assessees in addition to dividend declared by the company, capitalised value per share worked out would be Rs.37.34 instead of Rs.24 per share worked out by the department. The incorrect valuation computed by the department resulted in under valuation of gift of Rs.2.60 lakh with consequent short levy of gift tax of Rs.0.78 lakh.

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

**C - Interest Tax**

**Revenue from interest tax**

**6.22** In the financial years 1994-95 to 1998-99, interest tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget estimates	Actuals	Variation	Percentage variation
(Rs. in crore)				
1994-95	1,044.00	801.40	(-) 242.60	(-) 23.20
1995-96	1,000.00	1,170.05	(+) 170.05	(+) 17.00
1996-97	1,250.00	1,712.39	(+) 462.39	(+) 37.00
1997-98	2,400.00	1,205.18	(-) 194.82	(-) 49.70
1998-99	920.00	1,263.82	(+) 343.82	(+) 27.20

The large variation between the budget estimates and actuals indicates the necessity to prepare budget estimates on realistic basis.

**Number of assessees**

**6.23** The number of interest tax assessees borne on the books of the Income Tax Department as on 31 March of the last two years (1998 and 1999) are given in Annexure I of para 2.1 of Chapter 2 of this Report.

**Status of assessments**

**6.24** Particulars of assessments completed, assessments pending and demands in arrear for the last three years ending 31 March 1999 are as given in para number 2.9(i)&2.10(ii) of Chapter 2 of this Report.

**Results of audit**

**6.25** During the test audit of assessments completed under the Interest Tax Act, 1974, conducted during the period 1 April 1998 to 31 March 1999, short levy of interest tax of Rs.8.52 crore was noticed in 107 cases as given in para 1.5.1(ii) of Chapter I of this Report.

A total number of 27 audit observations involving tax effect of Rs.371.31 lakh were issued to the Ministry of Finance as draft paragraphs for comments during August 1999 to December 1999. The Ministry of Finance have so far accepted the observations in 18 cases involving tax effect of Rs.299.66 lakh. Replies are awaited in respect of 9 cases. 3 cases involving tax effect of Rs. 113.59 lakh were checked by the Internal Audit Wing of the department but the mistakes were not detected by them.

The cases are given below:

**Interest income not assessed**

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



portion of any credit sanctioned and discount on promissory notes and bills of exchange. The returns of chargeable interest are required to be filed by 31 December of the relevant assessment year.

Following cases were noticed in test check:

(Rs. in lakh)						
Sl. No.	Assessee name and status	CIT's charge	Assessment year	Nature of mistake	Chargeable interest	Tax effect
(i)	The Himachal Pradesh State Co-operative Bank, Shimla [company]	Shimla	1992-93	Income tax records revealed that the assessee had received interest and discount income. However, interest tax return was not filed nor was the same called for by the department resulting in interest escaping assessment	3998.96	70.39
(ii)	M/s.Kanoi Industries (P) Ltd. [company]	West Bengal I Calcutta	1993-94 to 1995-96		370.21	30.70

The Ministry have accepted the observation at Sl.No.(i) and (ii) amounting to Rs.101.09 lakh.

Similar mistakes were noticed in 16 cases involving tax effect of Rs.120.58 lakh out of which the Ministry accepted 8 cases with tax effect aggregating Rs.64.63 lakh.

#### Non-levy of interest

6.27 Under the Interest Tax Act, 1974, 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 per month or part thereof 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 interest tax assessment on the amount of tax determined as reduced by the advance tax, if any, paid. The Act also provides that where an assessee who is liable to pay advance tax for any financial year has failed to pay such tax or where the advance tax so paid falls short of ninety percent of the tax determined on interest tax assessment, interest at the rate of two percent for every month or part of a month is payable by the assessee on the amount by which the advance tax paid falls short of the assessed interest tax from the first day of the next financial year to the date of determination of chargeable interest.

Assessee name and status	CIT charge	Assessment year	Nature of mistake	Short levy of tax
M/s.Ind Bank Merchant Banking Services Ltd. [company]	CIT IV Chennai	1994-95	While completing interest tax assessment the assessing officer omitted to levy interest for non-payment/short-payment of advance tax	22.79

The Ministry have accepted the observation .

Similar mistakes were noticed in 6 cases involving tax effect of Rs.25.06 lakh out of which the Ministry accepted 6 observations amounting to Rs.25.06 lakh.



**Incorrect  
payment of  
interest**

**6.28** Under the Income Tax Act, 1961, as applicable from assessment year 1989-90, where any refund is due to an assessee out of any advance tax (including tax deducted at source), he shall be entitled to receive, in addition to the said amount, simple interest thereon at the rate of one percent per month from October 1991 (one and half percent upto 30 September 1991), for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted. No interest shall be payable if the amount of refund is less than ten percent of the tax determined under summary or regular assessment. This provision is applicable to refunds under Interest Tax Act also.

In Karnataka III, Bangalore charge, the interest tax assessment of a nationalised bank, *M/s. Canara Bank*, for the assessment year 1994-95 originally completed after scrutiny in February 1996 was rectified in July 1996 and revised in January 1997 and November 1997 to give effect to appellate orders (December 1996) and the orders of the Tribunal (September 1997) and the chargeable interest income and tax determined finally was Rs.90,914.38 lakh and Rs.2727.43 lakh respectively. The assessee having already paid advance tax of Rs.2940 lakh, tax of Rs.212.57 lakh paid in excess was refunded in May 1997 (Rs.124.08 lakh) and November 1997 (Rs.88.49 lakh) together with aggregate interest of Rs.86.09 lakh calculated from April 1994 to November 1997. Audit scrutiny revealed that as the tax refundable was less than 10 percent of the tax determined, the assessee was not entitled to interest on refund. The omission resulted in incorrect payment of interest of Rs.86.09 lakh to the assessee.

*The Ministry have accepted the observation.*

**Omission to  
take action on  
internal audit  
observation**

**6.29** According to the executive instruction issued by the Board in 1977, mistakes pointed out by internal audit parties of the Department should be rectified by the assessing officers promptly. The remedial action should be initiated within a month and completed as far as possible within three months of the report of internal audit.

In Tamil Nadu, Trichy charge, in the case of *M/s. Karur Vysya Bank*, the interest tax assessment for assessment year 1993-94 completed in March 1996 was revised in August 1996, on a chargeable interest of Rs.3097.13 lakh. Audit scrutiny revealed that the discount income of Rs.304.24 lakh from commercial papers, which are negotiable instruments in the nature of promissory notes as instructed by the Board in March 1993, was not offered by the assessee to interest tax for the above assessment year. Though this omission was already pointed out by the special audit party of the department in October 1996, no action was taken to revise the assessment for assessment year 1993-94. As a result, chargeable interest amounting to Rs.304.24 lakh escaped assessment with consequential short levy of interest tax of Rs.15.70 lakh (including interest).

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



**D - Expenditure Tax****Mistake in computation of chargeable expenditure**

**6.30** The Expenditure Tax Act, 1987 provides for levy of tax at 15 percent on the expenditure incurred in a restaurant before 1 June 1992, 20 percent with effect from 1 June 1992 and at 10 percent with effect from 1 June 1994 on the expenditure incurred in a hotel wherein the room charges for any of the residential accommodation at the time of incurring such expenditure exceeds Rs.400 (Rs. 1200 or more with effect from 1 June 1992) per day per individual. Under the Act, the assessee has to remit the tax collected during any calendar month to the credit of the Central Government by the 10<sup>th</sup> day of the succeeding month and if any person responsible for collecting such tax fails to collect it, he shall, notwithstanding such failure, be liable to pay the tax to the credit of the Central Government within the said period failing which, he shall be liable to pay simple interest at the rate of one and a half percent for every month or part thereof during the period the default continues.

Following cases were noticed in test check:

(Rs. in lakh)						
Sl. No.	Name of the assessee	CIT's charge	Assessment year	Nature of mistake	Chargeable expenditure not assessed	Tax effect
(i)	M/s. Hotel Banjara Ltd.	AP II, Hyderabad	1993-94	Income tax assessment records revealed that the assessee received income from sale of food and soft drinks but expenditure tax thereon was not collected nor did the department initiate action to bring the chargeable expenditure to tax	9.94	2.51
(ii)	M/s.I.T.C. Ltd.	WB III, Calcutta	1992-93	While completing the expenditure tax assessment the assessing officer levied incorrect rate of tax on the chargeable expenditure	4138.05	12.69

*The Ministry have accepted observation at Sl.(ii) amounting to Rs.12.69 lakh.*

Similar nature of mistakes were noticed in 3 cases involving tax effect of Rs.24.79 lakh out of which the Ministry have accepted 2 observations amounting to Rs.14.03 lakh.



(MUKESH ARYA)

Principal Director of Receipt Audit  
(Direct Taxes)

New Delhi  
Dated: 26 July 2000

Countersigned



(V.K.SHUNGLU)

New Delhi  
Dated: 26 July 2000

Comptroller and Auditor General of India

