REPORT OF THE

COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR 1980-81

UNION GOVERNMENT (CIVIL)

REVENUE RECEIPTS

VOLUME II

DIRECT TAXES

ERRATA

Page	Para	Line	For	Read
iii	Table of contents	11 from top	of	or
v	Table of contents	4 from bottom	charge	change
17	1.08(ii)(e)(3)	10 from top	No. of cases	*No. of cas
25	1.10(ii)(a)	9 from top	pettions	petitions
26	1.10(v)(i)(a)	14 from bottom	filled	filed
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69	2.12(a)	3rd from bottom	2,61,285	2,16,285
70	2.12(c)	1st from bottom	77,77,232	7,77,232
73	2.13(c)	15th from top	non-sesident	non-resident
83	2.16(e)(ii)	16th from bottom	This item which was	This item was
85	2.18	11th from bottom	allwoance	allowance
86	2.18(a)	2nd from bottom	3,65,529	2,65,529
99	2.24(e)	4th & 5th from bottom	Compution	Computation
105	2.26(e)	1st & 2nd from bottom	the of Rs. 90,000	the claims o the assessee fo the deduction o a lump sum pro vision of Rs 90,000
106	2.26(e)	14th from bottom	now	new
108	2.27	14th from bottom	of	or
114	2.30	8th from bottom	charged	changed
118	2.32(c)(i)	11th from bottom	1970	1979
132	3.03(ii)	17th from top	(Delete the line)	
133	3.04(b)	8th from top	taxes	taxed
147	3.13(c)	2nd line from top	(c)	(b)
150	3.15(c)	10th from bottom	"resultant in short-levy"	"resultant shor levy"
155	3.17(ii)	3rd line from top	Rs. 54,00	Rs. 54,000
155	3.17(b)	7th from bottom	"municipality of cantonment"	municipality o cantonment

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7	3.24	19th from top	abservations	observations
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80	4.06(b)(i)	1	assessees	assessee
96	4.11(a)(i)	17	essessee	assessee
99	4.11(d)	6 (bottom)	assessments	assessment
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00	4.11(e)	9 (bottom)	seemed	seen
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204	4.14(b)	7	"March"	"July"
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209	4.22(i)	6	limit	limitation
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209	4.22(ii)	6 (bottom)	Insert the word "were" in between the words "settlements" and "valued"	
211	4.22(iv)	3 & 4	proparties	properties
212	4.22(vi)	10	put	out
212	4.22(vii)	5 (bottom)	escapment	escapement
214	4.23(iii)	8 (bottom)	limitatoin	limitation
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219	4.23(xi)	4	regards	regard
220	4.25(i)	8 (bottom)	Insert the words "to be" in between the words "is" and "computed"	
226	4.28	1	"would it"	"it would"
226	4.28(a)(i)	15 (bottom)	heir	their
226	4.28 (a)(ii)	2 (bottom)	receipts	receipt
226	4.28(a)(ii)	last line	21	31
232	4.31	2	receipt	receipts
234	4.34(ii)	10 (bottom)	Insert the word "was" in between figure "6,738" and word "required"	
234	4.34(iii)	5 (bottom)	immoveable	immovable
236	4.36	13 (bottom)	provision	provisions
239	4.38	15	Insert the words "but have not stated whether delay in issue of notices" in between the words "notice" and "was"	

REPORT OF THE

COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR
1980-81

Union Government (Civil)

REVENUE RECEIPTS

VOLUME II

DIRECT TAXES

TABLE OF CONTENTS

PREFATORY REMARKS

As mentioned in the prefatory remarks of Volume I of the Audit Report on Revenue Receipts of the Union Government, the results of audit of receipts under Direct Taxes are presented in this separate volume. The Report is arranged in the following order :—

(i) Chapter I sets out statistical and other information relating to Direct Taxes.

(ii) Chapter 2 mentions the results of audit of Corporation Tax.

(iii) Chapter 3 deals, similarly, with the points that arose in the audit of Income-tax receipts.

(iv) Chapter 4 relates to Wealth-tax, Gift-tax and Estate Duty.

The points brought out in this Report are those which have come to notice during the course of test audit. They are not intended to convey or to be understood as conveying any general reflection on the working of the Department concerned.

VOLUME II

CHAPTER 1

GENERAL

1.01 *Receipts under various Direct Taxes*

The total proceeds from Direct Taxes for the year 1980-81 amounted to Rs. 2,996.93* crores out of which a sum of Rs. 1,014.35 crores was assigned to the States. The figures for the three years 1978-79, 1979-80 and 1980-81 are given below :—

(In crores of rupees)

	1978-79	1979-80	1980-81
020 Corporation Tax	1251.47	1391.90	1310.79
021 Taxes on Income other than Corporation Tax	1177.39	1340.31	1506.39
023 Hotel Receipts Tax	..	..	**(—)0.09
028 Other Taxes on Income and Expenditure	24.53	0.01	***89.59
031 Estate Duty	13.08	14.05	16.31
032 Taxes on Wealth	55.41	64.47	67.43
033 Gift Tax	5.85	6.83	6.51
GROSS TOTAL	2527.73	2817.57	2996.93
Less share of net proceeds assigned to the States			
Income-tax	706.62	864.88	1001.97
Estate duty	10.71	10.94	12.38
TOTAL	717.33	875.82	1014.35
Net receipts	1810.40	1941.75	1982.58

*Figures furnished by the Controller General of Accounts are provisional.

**Rs. 30.69 lakhs received under this Major head "023—Hotel Receipt tax" was to be shared with states. Provisional allocation for sharing was made for Rs. 40.01 lakhs of estimated receipts which gave rise to a negative figure of Rs. 0.09 crore.

***Interest Tax receipts are booked under this head. This tax was discontinued with effect from 28 February 1978 but reimposed with effect from 30 June 1980. Receipts of Rs. 0.01 crore in the year 1979-80 represents arrear recoveries.

The gross receipts under Direct Taxes during 1980-81 went up by Rs. 179.36 crores when compared with the receipts during 1979-80 as against an increase of Rs. 289.84 crores in 1979-80 over those for 1978-79. Receipts under Corporation Tax registered a decrease of **Rs. 81.11 crores** while receipts under 'Taxes on income other than Corporation Tax' accounted for an increase of Rs. 166.08 crores.

1.02 *Variations between budget estimates and actuals*

(i) The actuals for the year 1980-81 under the Major heads '021—Taxes on Income etc.', '031—Estate Duty', '032—Taxes on Wealth' and '033—Gift Tax' exceeded the budget estimates.

The figures for the years from 1976-77 to 1980-81 under the various heads are given below :—

Year	Budget estimates	Actuals	Variation	Percentage of variation
1	2	3	4	5
			(In crores of rupees)	
020—Corporation Tax				
1976-77	1025.00	984.23	(—)40.77	(—)3.98
1977-78	1298.20	1220.77	(—)77.43	(—)5.96
1978-79	1441.90	1251.47	(—)190.43	(—)13.20
1979-80	1529.50	1391.90	(—)137.60	(—)8.99
1980-81	1515.00	1310.79	(—)204.21	(—)13.48
021—Taxes on income etc.				
1976-77	957.00	1194.40	237.40	24.81
1977-78	1038.20	1002.02	(—)36.18	(—)3.48
1978-79	1134.80	1177.39	42.59	3.75
1979-80	1247.10	1340.31	93.21	7.47
1980-81	1426.00	1506.39	80.39	5.64
031—Estate Duty				
1976-77	8.75	11.73	2.98	34.06
1977-78	10.75	12.30	1.55	14.42
1978-79	11.00	13.08	2.08	18.91
1979-80	12.00	14.05	2.05	17.08
1980-81	13.00	16.31	3.31	25.46

032—Taxes on Wealth				
1976-77	52.00	60.44	8.44	16.23
1977-78	54.90	48.46	(—)6.44	(—)11.73
1978-79	55.00	55.41	0.41	0.75
1979-80	60.00	64.47	4.47	7.45
1980-81	65.00	67.43	2.43	3.74
033—Gift Tax				
1976-77	4.75	5.67	0.92	19.37
1977-78	5.50	5.55	0.05	0.91
1978-79	5.75	5.85	0.10	0.18
1979-80	5.75	6.83	1.08	18.78
1980-81	6.25	6.51	0.26	4.16

(ii) The details of variations under the heads subordinate to the Major Heads 020 and 021 for the year 1980-81 are given below :—

	Budget	Actuals	Increase(+) Short-fall (—)	Percentage of variation
1	2	3	4	5
			(In crores of rupees)	
020—Corporation Tax				
(*i*) Income-tax on companies	1446.00	1230.53	(—)215.47	(—)14.90
(*ii*) Surtax . . .	62.00	21.54	(—)40.46	(—)65.26
(*iii*) Surcharge . . .	..	52.55	52.55	..
(*iv*) Receipts awaiting transfer to other minor heads .	..	0.07	0.07	..
(*v*) Other receipts . .	7.00	6.10	(—)0.90	(—)12.86
TOTAL	1515.00	1310.79	(—)204.21	(—)13.48

021—Taxes on income other than Corporation Tax				
(*i*) Income-tax . . .	1196.00	1362.55	166.55	13.93
(*ii*) Surcharge . . .	215.00	129.58	—85.42	39.73
(*iii*) Receipts awaiting transfer to other minor Heads .	..	3.72	3.72	..
(*iv*) Other receipts	15.00	10.54	—4.46	29.73
Deduct share of proceeds assigned to States . .	932.20	1001.97	69.77	7.48
TOTAL	493.80	504.42	10.62	2.15

1.03 *Analysis of collections*

Under the provisions of the Income-tax Act, 1961, income-tax is chargeable for any assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act, however, 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 residuary taxes not so paid.

(i) The break-up of total collections of Corporation Tax and Taxes on income other than Corporation Tax, during 1980-81 as furnished by the Ministry of Finance, is as under :—

Pre-assessment and post-assessment collection of tax* during 1980-81 :—

	(In crores of rupees)
(*i*) Deduction at source	745.23
(*ii*) Advance tax	1739.77
(*iii*) Self-assessment	260.14
(*iv*) Regular assessment	334.01

*Figures furnished by the Ministry of Finance are provisional and inclusive of surcharge (Union).

Besides, the Ministry of Finance have intimated tax collection of Rs. 105.76 crores representing Surtax, Surcharge on Corporation tax, Other Receipts and Receipts awaiting transfer to other Minor Heads, and Refunds of Rs. 367.73 crores.

(ii) The details of deduction at source under broad categories are as under :—

	(In crores of rupees)
1. Salaries	263.81
2. Interest on securities	124.77
3. Dividends	81.89
4. Lottery or cross-word puzzles	3.07
5. Horse races	1.65
6. Payment to contractors & sub contractors	104.48
7. Insurance Commission	3.99
8. Other items	161.57

(iii) Advance Tax—Demand and collection. Demand raised (*i.e.* notices issued) and collected by way of advance tax during 1980-81 :—

	No. of cases	Amount (In crores of rupees)
1	2	3
(*i*) Demand raised	Not furnished	1855.74*
(*ii*) Demand collected out of (i)	—do—	1704,69*
(*iii*) Arrears under advance tax as on 31 March 1981	—do—	151.05*

1.04 *Interest*

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

*Figures furnished by Ministry of Finance are provisioal.

The particulars of interest levied and interest paid by Government under different provisions of the Act are given below :—

(In crores of rupees)

(*a*) The total amount of interest levied under various provisions of the income-tax Act during the year 1980-81 . . .	155.40
(*b*) Of the amount of interest levied, the amount	
(1) Completely waived by the department . . .	6.23
(2) Reduced by the department	45.39
(*c*) The total amount of interest paid	
(1) On advance tax paid in excess of assessed tax .	11.04
(2) For delay in grant of refunds	2.39

1.05 *Cost of collection*

(i) The expenditure incurred during the year 1980-81 in collecting Corporation Tax and Taxes on Income other than Corporation Tax, together with the corresponding figures for the preceding three years is as under :—

(In crores of rupees)

	Gross collections	Expenditure on collections
020–Corporation Tax		
1977-78	1220.77	5.18
1978-79	1251.47	5.68
1979-80	1391.90	5.93
1980-81*	1310.79	6.78
021—Taxes on income etc.		
1977-78	1002.02	36.28
1978-79	1177.39	47.59
1979-80	1340.31	41.48
1980-81*	1506.39	47.50

*Figures furnished by the Controller General of Accounts are provisional.

(ii) The expenditure incurred during the year 1980-81 in collecting other direct taxes *i.e.* Taxes on Wealth, Gift-tax and Estate Duty and the corresponding figures for the preceding two years are as under :—

(In crores of rupees)

	Gross collections	Expenditure on collections
031—Estate Duty		
1978-79	13.08	1.01
1979-80	14.05	1.05
1980-81	16.31	1.21
032–Taxes on wealth		
1978-79	55.41	3.53
1979-80	64.47	3.69
1980-81	67.43	4.22
033–Gift Tax		
1978-79	5.85	0.50
1979-80	6.83	0.53
1980-81	6.51	0.60

1.06 *Total number of assessees*

Under the provisions of the Income-tax Act, 1961, tax is chargeable on the total income of the previous year of every person which term includes an individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals, a local authority and an artificial juridical person and such person by whom tax is payable is called an assessee. For the assessment year 1980-81, no income-tax was payable on a total income not exceeding Rs. 10,000 except in the case of companies, co-operative societies and local authorities.

(i) The total number of assessees in the books of the department as on 31 March 1981 was 45,94,425. As compared to the previous year ending 31 March 1980 there was an increase of 4,18,810 assessees. The number of assessees status-wise as on 31 March 1980 and 31 March 1981 was as under :—

	As on 31 March 1980	As on 31 March 1981
Individuals	31,60,414	34,89,377
Hindu undivided families	2,35,935	2,34,483
Firms	6,72,817	7,53,718
Companies	42,581	44,125
Others	63,868	72,722
TOTAL	41,75,615	45,94,425

(ii) The break up of assessees category-wise was as under :—

	Individuals	Hindu undivided families	Firms	Companies	Others	Total
(*a*) Below taxable limit	7,63,242	51,079	1,00,120	22,077	39,576	9,76,094
(*b*) Above taxable limit but upto Rs. 25,000	19,08,034	1,22,907	3,00,926	9,133	22,734	23,63,734
(*c*) Rs. 25,001 to Rs. 50,000	6,50,333	46,267	2,04,230	4,338	6,655	9,11,823
(*d*) Rs. 50,001 to Rs. 1,00,000	1,52,116	12,735	1,11,972	2,867	2,933	2,82,623
(*e*) Rs. 1,00,001 to Rs. 5,00,000	14,826	1,438	34,993	3,211	744	55,212
(*f*) Above Rs. 5,00,000	826	57	1,477	2,499	80	4,939
TOTAL	34,89,377	2,34,483	7,53,718	44,125	72,722	45,94,425

(iii) The total number of wealth-tax assessees in the books of the department as on 31 March 1980 and 31 March 1981 was as follows :—

	As on 31 March 1980	As on 31 March 1981
Individuals	2,98,375	3,38,763
Hindu undivided families	44,278	51,420
Others	3,638	143
TOTAL	3,46,291	3,90,326

(iv) The total number of gift-tax assessment cases for the years 1979-80 and 1980-81 was as follows :—

1979-80	54,601
1980-81	59,123

(v) The total number of estate duty assessment cases for the years 1979-80 and 1980-81 was as follows :—

1979-80	39,630
1980-81	33,889

1.07 *Foreign companies*

A. Cases where returns have been filed for the assessment year 1980-81 and assessments completed, as on 31 March 1981 :—

	Number	Amount (In crores of rupees)
(*i*) No. of foreign companies	152	
(*ii*) Income returned		120.09
(*iii*) Income assessed		219.53
(*iv*) Gross demand		115.17
(*v*) Demand outstanding out of (iv) as on 31 March 1981		5.62
(*vi*) Tax paid upto 31 March 1981 (iv—v)		109.55

B. Cases where returns have been filed for the assessment year 1980-81 but assessments were pending as on 31 March 1981.

	Number	Amount (In crores (of rupees)
(*i*) No. of foreign companies.	413	
(*ii*) Income returned		2475.21 (—) 2.04
(*iii*) Gross demand, being tax due on income returned		1091.63
(*iv*) Demand outstanding out of (iii) as on 31 March 1981		903.02
(*v*) Tax paid upto 31 March 1981 (iii— (iv)) .		188.61

C. Cases where no returns have been filed for the assessment year 1980-81; position as on 31 March 1981 :—

Number of foreign Companies	517

1.08 *Arrears of assessments*

The limitation period for completion of assessments is 2 years in the case of Income-tax, 4 years in the case of Wealth-tax and Gift-tax and 5 years in the case of Estate Duty.

(i) *Income-tax including Corporation Tax*

(a) The number of assessment cases to be finalised as on 31 March 1981 has increased as compared to that at the close of the previous year. The number of assessments pending as on 31 March 1981 was 25.56 lakhs as compared to 22.99 lakhs as on 31 March 1980 and 19.26 lakhs as on 31 March 1979. Of the 25.56 lakhs of pending cases as many as 16.76 lakhs cases related to summary assessments.

(b) The number of assessments completed out of arrear assessments and out of current assessments during the past five years is given below :—

Financial year	Number of assessments for disposal	Number of assessments completed				Number of assessments pending at the end of the year
		Out of current	Out of arrears	Total	Percentage	
1976-77	56,90,717	24,88,743	14,60,136	39,48,879	69.4	17,41,838
1977-78	55,81,355	25,72,678	14,71,135	40,43,813	72.5	15,37,542
1978-79	52,35,891	21,07,544	12,02,783	33,10,327	63.2	19,25,564
1979-80	57,89,055	18,97,276	15,92,514	34,89,790	60.0	22,99,265
1980-81	65,91,180	18,12,511	22,22,702	40,35,213	61.2	25,55,967

(c) Category-wise break-up of the total number of assessments completed during the years 1979-80 and 1980-81 is as under :—

	1979-80	1980-81
Scrutiny assessments	9,17,776	9,53,757
Summary assessments	25,72,014	30,81,456
TOTAL	34,89,790	40,35,213

(d) Status-wise break-up of income-tax assessments completed during the years 1979-80 and 1980-81 is as under :—

	1979-80	1980-81
(*i*) Individuals	26,61,417	30,58,611
(*ii*) Hindu undivided families	1,89,820	2,06,836
(*iii*) Firms	5,54,787	6,70,533
(*iv*) Companies	38,033	44,937
(*v*) Association of persons etc.	45,733	54,296
TOTAL	34,89,790	40,35,213

(e) Assessment year-wise position of pendency of income-tax assessments at the end of the last two years was as under :—

	As on 31 March 1980	As on 31 March 1981
1976-77 and earlier years	48,669	26,231
1977-78	72,323	17,437
1978-79	6,48,858	94,465
1979-80	15,29,415	6,20,980
1980-81	..	17,96,854
TOTAL	22,99,265	25,55,967

(f) Category-wise break-up of pending income-tax assessments as on 31 March 1980 and 31 March 1981 is as under :—

	As on 31 March 1980	As on 31 March 1981
Scrutiny assessments	10,27,300	8,80,128
Summary assessments	12,71,965	16,75,839
TOTAL	22,99,265	25,55,967

(g) Status-wise and year-wise break-up of pendency of income-tax assessments in respect of various assessment years as on 31 March 1981 was as under :—

Status	1976-77 and earlier years	1977-78	1978-79	1979-80	1980-81	Total
(a) Company assessments	3491	1134	3532	14,820	29,273	52,250
(b) Non-Company assessments	22,740	16,303	90,933	6,06,160	17,67,581	25,03,717
TOTAL	26,231	17,437	94,465	6,20,980	17,96,854	25,55,967

(ii) *Wealth-tax, Gift tax and Estate Duty*

(a) The total number of wealth-tax assessments completed during the years 1979-80 and 1980-81 was as under :—

	1979-80	1980-81
Individuals	2,80,765	*2,58,461
Hindu undivided families	41,456	*39,143
Others	3,497	*72
TOTAL	3,25,718	*2,97,676

*Figures furnished by the Ministry of Finance are provisional and those of 16 commissioners' charges are still to be included.

(b) The total number of gift-tax assessments completed during the years 1979-80 and 1980-81 was as follows :—

	1979-80	1980-81
Individuals	61,540	58,904
Hindu undivided families	1,358	1,550
Others	144	108
TOTAL	63,042	60,562

(c) The total number of estate duty assessments completed during the years 1979-80 and 1980-81 was as under :—

1979-80	32,607
1980-81	32,428

The break-up of the estate duty assessments completed during the year 1980-81 according to certain slabs of principal value of estate is given below :—

Principal value of property	Number of assessments completed
(1) Exceeding Rs. 20 lakhs	12
(2) Between Rs. 10 lakhs and Rs. 20 lakhs	64
(3) Between Rs. 5 lakhs and Rs. 10 lakhs	317
(4) Between Rs. 1 lakh and Rs. 5 lakhs	5,728
(5) Between Rs. 50,000 and Rs. 1 lakh	6,016
TOTAL	12,137

(d) Assessment year-wise details of wealth-tax, gift-tax and estate duty assessments pending as on 31 March 1981 are given below :—

	Number of assessments pending		
	Wealth tax	Gift-tax	Estate duty
1976-77 & earlier years	14,277	2,097	7,005
1977-78	56,701	2,921	4,256
1978-79	76,587	5,261	5,628
1979-80	1,12,905	9,433	7,726
1980-81	2,39,433	18,514	11,247
TOTAL	4,99,903	38,226	35,862

(e) Reopened assessments and set aside assessments which are pending :—

A. *Income Tax*

(1) Year-wise details of cases of assessments cancelled under Section 146 of Income-tax Act, 1961 (or under the corresponding provisions of the old Act) and which are pending finalisation on 31 March 1981 was as follows :—

Assessment year	Number of cases
1972-73 and earlier years	3,147
1973-74	810
1974-75	881
1975-76	1,444
1976-77	2,932
1977-78	5,023
1978-79	4,328
1979-80	1,470
1980-81	1,345
TOTAL	21,380

(2) Year-wise details of cases of assessments cancelled under Section 263 of Income-tax Act, 1961 (or under the corresponding provisions of the old Act) and which are pending finalisation on 31 March 1981 was as follows :—

Assessment year	Number of cases
1972-73 and earlier years	216
1973-74	70
1974-75	124
1975-76	163
1976-77	205
1977-78	136
1978-79	101
1979-80	97
1980-81	79
TOTAL	1,191

(3) Year-wise details of cases of assessments set-aside by the Appellate Assistant Commissioner under Section 251 of the Income-tax Act, 1961 (or under the corresponding provisions of the old Act), by the Appellate Tribunal under Section 254 of Income-tax Act, 1961 (or under the corresponding provisions of the old Act) where fresh assessments had not been completed as on 31 March 1981.

Set aside by Appellate Assistant Commissioners		Set aside by Appellate Tribunal	
Assessment year	*No. of cases	Assessment year	No. of cases
1972-73 and earlier years	3,384	1972-73 and earlier years	660
1973-74	590	1973-74	121
1974-75	758	1974-75	180
1975-76	1,139	1975-76	188
1976-77	1,457	1976-77	146
1977-78	1,302	1977-78	90
1978-79	689	1978-79	67
1979-80	380	1979-80	29
1980-81	214	1980-81	24
TOTAL	9,913	TOTAL	1,505

B. *Wealth Tax and Gift Tax*

(i) Year-wise details of assessments cancelled under Section 25 of the Wealth-tax Act, 1957 and under Section 24(2) of the Gift-tax Act, 1958 and which were pending finalisation as on 31 March 1981.

Assessment year	No. of cases W.T.	G.T.
1972-73 and earlier years	415	13
1973-74	108	4
1974-75	119	3
1975-76	71	4
1976-77	41	3
1977-78	35	1
1978-79	15	..
1979-80	6	..
1980-81	1	1
TOTAL	811	29

*Figures for one commissioner's charge still to be included.

'(ii) Year-wise details of cases of assessments set aside by the Appellate Assistant Commissioner/Appellate Tribunal under Section 23(5)/24(5) of Wealth-tax Act, 1957, Section 22(5)/23(5) of the Gift-tax Act, 1958 and Section 62(5)/63(5) of the Estate Duty Act, 1953 where fresh assessments had not been completed as on 31 March 1981.

Assessment years	Set aside by AACs			Set aside by Appellate Tribunal		
	*No. of cases			*No. of cases		
	W.T.	G.T.	E.D	W.T.	G.T.	E.D.
1972-73 & earlier years	2,244	58	9	149	2	2
1973-74 . . .	471	13	2	38	4	1
1974-75 . . .	535	14	3	45	..	2
1975-76 . . .	465	18	9	36	..	3
1976-77 . . .	223	12	7	15	1	5
1977-78 . . .	116	3	15	15	4	7
1978-79 . . .	91	2	22	1	5	7
1979-80 . .	56	..	27	3	4	5
1980-81 . .	43	..	26	1	..	6
TOTAL . . .	4,244	120	120	303	20	38

1.09 *Arrears of tax demands*

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 35 days unless the time for payment is extended by the Income-tax 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 has been paid before filing the appeal.

*Figures for one Commissioner's charge still to be included.

(i) *Corporation Tax and Income-tax*

(a) The total demand of tax raised and remaining uncollected as on 31 March 1981 was Rs. 1,112.89 crores including Rs. 250.00 crores in respect of which the permissible period of 35 days had not expired as on 31 March and Rs. 6.06 crores claimed to have been paid but remaining to be verified/adjusted, Rs. 199.62 crores stayed/kept in abeyance and Rs. 21.67 crores for which instalments had been granted by the department and the Courts.

(b) Demands of Income-tax (including Corporation tax) stayed as on 31 March 1981 on account of appeals and revision petitions were as under :—

	(In crores of rupees)
(1) By Courts	32.18
(2) Under Section 245F(2) (applications to Settlement Commission)	13.66
(3) By Tribunal	4.87
(4) By income-tax authorities due to :—	
(*i*) Appeals and revisions	111.99
(*ii*) Double income-tax claims	8.30
(*iii*) Restriction on remittances-Section 220(7)	1.72
(*iv*) Other reasons	26.90
TOTAL	199.62

(c) The figures of Corporation tax, Income-tax, interest and penalty comprised in the gross arrears of Rs. 1,112.89 crores and the years to which they relate are given below :—

(in crores of rupees)

	Corporation tax	Income-tax	Interest	Penalty	Total
Arrears of 1970-71 and earlier years	18.14	42.72	10.91	10.44	82.21
1971-72 to 1977-78	30.26	131.43	61.68	39.23	262.60
1978-79	15.67	52.04	27.14	12.27	107.12
1979-80	44.84	87.38	45.80	21.10	199.12
1980-81	182.04	167.37	91.36	21.07	461.84
TOTAL	*290.95	480.94	236.89	104.11	1112.89

*Includes tax on SPT, ST, EPT and BPT.

(d) The table below gives the number of assessees from whom gross arrears of Rs. 1,112.89 crores were due :—

Arrear demands	Number of assessees	Total arrears of tax (In crores of rupees)
Upto Rs. 1 lakh in each case	30,01,582	536.93
Over Rs. 1 lakh upto Rs. 5 lakhs in each case . .	7,838	123.63
Over Rs. 5 lakhs upto Rs. 10 lakhs in each case .	981	65.50
Over Rs. 10 lakhs upto Rs. 25 lakhs in each case .	520	81.97
Over Rs. 25 lakhs in each case	346	304.86
TOTAL	3011,267	1112.89

(e) Where an assessee defaults in making payment of a tax, the Income-tax Officer may issue a certificate to the Tax Recovery Officer for recovery of the demand by attachment and sale of the defaulter's movable or immovable property, arrest of the defaulter and his detention in prison, appointing a receiver for the management of the defaulter's movable and immovable property etc. The tax demands certified to Tax Recovery Officers and State Government Officers for recovery and its year-wise particulars to the end of 1980-81 are as under :—

	Demand certified				
	At the beginning of the year	During the year	Total	Demand recovered	Balance
				(In crores of rupees)	
1	2	3	4	5	6
1969-70 . .	359.52	183.55	543.07	116.45	426.62
1970-71 . .	425.25	181.36	606.61	145.37	461.24
1971-72 . .	483.53	208.79	692.32	167.52	524.80
1972-73 . .	530.57	264.98	795.55	189.06	606.49

1	2	3	4	5	6
1973-74 . .	598.15	192.62	790.77	161.93	628.84
1974-75 . .	616.07	188.16	804.23	176.29	627.94
1975-76 . .	616.35	333.92	950.27	290.56	659.71
1976-77 . .	678.72	330.30	1009.02	370.67	638.35
1977-78 . .	638.00	258.00	896.00	244.00	652.00
1978-79 . .	655.00	309.00	964.00	267.00	697.00
1979-80 . .	703.96	323.65	1027.61	287.61	740.00
1980-81 . .	752.07	301.70	1053.77	258.58	795.19

NOTE (1) Recovery certificates were issued during the year 1980-81 in 4,80,897 cases.

NOTE (2) A few illustrative cases are given below paragraph 1.15

(ii) *Other Direct Taxes* (i.e. *Wealth-tax, Gift-tax and Estate Duty*)

The following table gives the year-wise arrears of demands outstanding and the number of cases relating thereto under the three other direct taxes *i.e.* wealth-tax, gift-tax and estate duty as on 31 March 1981 :—

(In crores of rupees)

	Wealth-tax		Gift-tax		Estate duty	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
1976-77 and earlier years . . .	55,080	16.53	14,443	2.18	6,981	5.85
1977-78 . . .	28,304	8.34	6,098	0.84	2,340	1.78
1978-79 . . .	53,848	57.13	9,722	5.15	2,649	3.12
1979-80 . . .	56,960	42.02	10,279	2.98	3,818	6.03
1980-81 . . .	85,697	93.09	16,732	18.37	9,482	10.87
TOTAL . .	2,79,889	217.11	57,274	29.52	25,270	27.65

(iii) A partnership firm established for manufacture of cycles was converted into a private limited company in 1955. It became a public limited company in May 1960. It terminated its business in February 1972 and the High Court, on 31 January 1975 ordered its winding up and appointed an official liquidator. The company did not file the income-tax returns for the assessment years 1964-65 to 1968-69 and 1972-73 to 1973-74 while for the assessment years 1962-63, 1963-64, 1969-70 and 1971-72 the returns reflected huge losses. The books of accounts had been seized by the Company Law Board and Special Police Establishment, and the accounts prepared were not complete.

The company did not deposit the tax deducted at source from the salaries of its employees and despite the liquidation, assessments and re-assessments, the failure to deposit the deductions to the credit of the Government is still under investigation. However the amount of tax deducted at source and the period to which it pertained could not be ascertained by the department from the records available.

The arrears of income-tax demand outstanding against the company based on assessments and reassessments done between 1966 to 1978 for the various assessment years (but excluding 1962-63 to 1964-65 for which re-assessments were not completed) come to Rs. 92,55,000. After the stay granted by the Income-tax Appellate Tribunal on 9 March 1972 was vacated on 26 July 1974, action was taken to seal the registered office of the company, attach its bank account and its deposits with the telephone department. The Tax Recovery Officer attached the premises of the factory of the company on 9 January 1975. However, the Mercantile Bank, which was a secured creditor of the Company for Rs. 1.40 crores, obtained a decree in its favour from the High Court and successfully contested the attachment made by the department on the ground that it had a prior claim, which was upheld by the High Court. The receiver appointed by the High Court had got the plant and machinery of the company valued on 12 January 1974 at Rs. 20,31,300

and the value of the company's land measuring 1,10,000 sq. meters and other assets, was estimated at Rs. 60 lakhs. In the result, after meeting the prior claim of the bank no amount is likely to be recovered by the department from the assessee against the tax demands of Rs. 92.55 lakhs.

The amount of tax deducted at source and not remitted to the department, not having been ascertained, is not included in the figure of Rs. 92.55 lakhs. No further action has been taken to recover the demand in any other way (or to estimate the tax deducted at source which has to be demanded in addition); however, a proposal to scale down the demand to 50 per cent of the assessed demand is under consideration of the department.

(iv) Wealth-tax demands for Rs. 52,58,943 are outstanding against a trust set up by an ex-ruler. The jewellery held by the trust had been declared as art treasure and its sale prohibited by Government. The Government is still to take a decision on the plea of the assessee's inability to pay the tax demanded.

Further, wealth-tax demands for Rs. 6,05,51,957 relating to the assessment years 1957-58 to 1978-79 are outstanding from one of the members of the family of the ex-ruler. Some of his properties were attached in April 1981, but no recovery has been effected so far. In addition, income tax demands for Rs. 33,98,021 are also outstanding from the member.

The cases mentioned at (iii) and (iv) were reported to the Ministry of Finance on 6 November 1981, their reply is awaited (December 1981).

(v) Income-tax demands for Rs. 55.60 lakhs are outstanding against an individual and in addition income-tax and wealth-tax demands of Rs. 21.44 lakhs are also outstanding against his wife in respect of his properties held by her benami. Out of demands outstanding against the husband, nothing has been recovered so far and demands to the extent of Rs. 49.00 lakhs were certified in March 1979 as irrecoverable. However, he

had submitted a compromise petition to the Board in March 1973, asking for scaling down the demands against him, and admitting that certain individuals and firms were holding his assets benami. Action on the petition is pending and no recoveries have been effected.

The Ministry of Finance have stated that as a result of recovery action pursued by the department a sum of Rs. 1,57,345 was recovered through the Tax Recovery Officer. The department had also attached a partly completed building held in the name of the assessee's wife and agricultural lands situated in seven places held in the names of the assessee, his wife and minor sons. The debts amounting to Rs. 2 lakhs due to the assessee had also been attached. No other assets have come to the notice of the department. The Ministry have further stated that due to non-availability of bidders and passing of Land Ceiling Act, the building and the agricultural lands could not be disposed of and that since the assessee is facing financial difficulties a partial write off is being processed.

1.10 *Appeals and Revision Petitions*

The Acts provide for appellate as well as revisionary proceedings.

(i) Particulars in respect of Income-tax appeals pending as on 31 March 1981 are as under :—

	Income-tax appeals with Appellate Assistant Commissioners/ Cs. I.T. (Appeals)	Income-tax revision petitions with Commissioners of Income-tax
Number of appeals/revision petitions . . .	2,63,837	9,638
(*a*) Out of appeals/revision petitions instituted during 1980-81	1,30,486	4,694
(*b*) Out of appeals/revision peititons instituted in earlier years	1,33,351	4,944

(ii) Particulars in respect of wealth-tax, gift-tax and estate duty appeals and revision petitions pending as on 31 March 1981 are as under :—

	Appeals with Asstt. Appeallate Commissioners/ Cs.I.T. (Appeals)			Revision petitions with Commissioners of Income-tax		
	W.T.	G.T.	E.D.	W.T.	G.T.	E.D.
(*a*) No. of appeals/ revision petitions pending .	85,540	4,414	5,802	2,640	114	Nil
(*b*) Out of appeals/ revision petitions instituted during 1980-81 .	34,609	1,776	1,912	1,031	39	Nil
(*c*) Out of appeals/ revision petitions instituted in earlier years .	50,931	2,638	3,890	1,609	75	Nil

(iii) Year-wise break-up of income-tax appeal cases and revision petitions pending with Appellate Assistant Commissioners and Commissioners of Income-tax (Appeals), and Commissioners of Income-tax as on 31 March 1980 and 31 March 1981 respectively with reference to the year of their institution is as under :—

Years of institution	Appeals pending with Appellate Assistant Commissioners/ Cs. I.T. (Appeals)		Revision petitions pending with Commissioners of Income-tax	
	31 March, 1980	31 March, 1981	31 March 1980	31 March 1981
1972-73 and earlier years .	733	615	242	219
1973-74	554	785	92	91
1974-75	1,306	2,116	116	110
1975-76	3,464	3,536	193	193
1976-77	10,284	5,448	432	333
1977-78	24,165	11,031	1,307	700
1978-79	70,697	35,270	2,343	1,274
1979-80	1,42,178	74,550	5,732	2,024
1980-81	..	1,30,486	..	4,694
TOTAL	2,53,381	2,63,837	10,457	9,638

(iv) Year-wise break-up of wealth-tax, gift-tax and estate duty appeal cases and revision petitions pending with Appellate Assistant Commissioners and Commissioners of Income-tax as on 31 March 1981, with reference to the year of their institution is as under :—

Years of Institution	Appeals pending with Appellate Asstt. Commissioners			Revision petitions pending with Commissioners of Income-tax		
	W.T.	G.T.	E.D.	W.T.	G.T.	E.D.
1972-73 and earlier years	55	5	23	92	4	..
1973-74 . . .	53	8	5	45	1	..
1974-75 . . .	178	5	19	47	2	..
1975-76 . . .	874	49	126	48	1	..
1976-77 . . .	1,618	76	399	89	5	..
1977-78 . . .	3,560	182	811	199	6	..
1978-79 . . .	9,476	760	1,212	248	17	..
1979-80 . . .	35,117	1,553	1,295	841	39	..
1980-81 . . .	34,609	1,776	1,912	1,031	39	..
TOTAL . . .	85,540	4,414	5,802	2,640	114	Nil

(v) The following table gives details of appeals/references disposed of during the years 1978-79, 1979-80 and 1980-81 :—

	1978-79	1979-80	1980-81
(1) (*a*) No. of appeals filled before Appellate Assistant Commissioners/ Cs.I.T. (Appeals) . . .	2,18,589	2,08,778	2,19,062
(*b*) No. of appeals disposed of during 1980-81 by AACs/Cs.I.T. (Appeals)	1,63,510	1,55,319	2,08,744
(2) No. of appeals filed before Income-tax Appellate Tribunals during 1980-81			
(*a*) by the assessees. . . .	25,080	24,478	24,999
(*b*) by the department . . .	17,089	18,354	18,899
(3) No. of assessees' appeals decided by the Tribunal in favour of the assessees fully out of (2)(a) above. . .	12,996	11,321	11,519

(4) No. of departmental appeals decided by the Tribunals in favour of the department fully out of (2) (b) above	3,389	3,245	4,284
(5) No. of references, filed to the High Courts :			
(*a*) by the assessees. . . .	1,645	1,634	1,763
(*b*) by the department . . .	4,517	4,262	4,598
(6) No. of references in the High Courts disposed of in favour of the			
(*a*) assessees	260	228	357
(*b*) department	616	566	428
(7) No. of appeals filed to the Supreme Court			
(*a*) by the assessees . . .	36	46	11
(*b*) by the department . . .	65	60	218
(8) No. of appeals disposed of by the Supreme Court in favour of the			
(*a*) assessees	28	2	31
(*b*) department	8	1	4

1.11 *Writ petitions pending in courts*

	In Supreme Court	In High Courts	Total
1	2	3	4
(*a*) No. of writ petitions pending as on 31-3-81	281	3,451	3,732
(*b*) Out of (a) above :			
(*i*) Pending for over 5 years . .	8	184	192
(*ii*) Pending for 3 to 5 years . .	61	400	461
(*iii*) Pending for 1 to 3 years . .	85	1,730	1,815
(*iv*) Pending upto 1 year . . .	127	1,137	1,264

***1.12 Relief and Refunds**

Refunds

(i) Where the amount of tax paid exceeds the amount of tax payable, the assessee is entitled to a refund of the excess. If the refund is not granted by the department within three months from

*Figures furnished by the Ministry of Finance are provisional and figures for two commissioners' charges still to be included.

the end of the month in which the claim is made, simple interest at the prescribed rate becomes payable to the assessee on the amount of such refund.

Refunds under Section 237 :—

1. No. of applications pending on 1-4-1980	15,221*
2. No. of refunds applications received during the year 1980-81	1,32,662
3. No. and amount of refunds made during 1980-81 :	
(*a*) Out of (1) above :	
(*i*) Number	14,877
(*ii*) Amount (in thousands of rupees)	25,579
(*b*) Out of (2) above :	
(*i*) Number	1,15,716
(*ii*) Amount (in thousands of rupees)	1,60,771
4. No. of refund cases in which interest was paid under Section 243, the amount of such interest, and the amount of refund on which such interest was paid during 1980-81 :	
(*a*) Out of (1) above :	
(*i*) Number	Nil
(*ii*) Amount of refund (in thousands of rupees)	Nil
(*iii*) Amount of interest paid (in thousands of rupees)	Nil
(*b*) Out of (2) above :	
(*i*) Number	331
(*ii*) Amount of refund (in thousands of rupees)	346
(*iii*) Amount of interest paid (in thousands of rupees)	42
5. No. and amount of refunds made during 1980-81 on which no interest was paid :—	
(*a*) Number	1,30,262
(*b*) Amount (in thousands of rupees)	1,86,004
6. No. of refund applications pending as on 31-3-1981	17,290
7. Break-up of applications mentioned at (6) above :	
(*a*) Refund applications for less than a year	16,942
(*b*) Between 1 year and 2 years	343
(*c*) For 2 years and more	5

* The Ministry have revised the closing figure of 15269 furnished for the year 1979-80.

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

The particulars of appeal/revision etc. effects, refunds under Section 240 and payment of interest under Section 244, as furnished by the Ministry of Finance for the year 1980-81, are given below :—

1.	No. of assessments which were pending revision on account of appellate/revision etc. orders as on 1-4-1980 *	9,187*
2.	No. of assessments which arose for similar revision in 1980-81	1,02,335
3.	No. of assessments which were revised during 1980-81 :—	
	(*a*) Out of those pending as on 1-4-1980	7,779
	(*b*) Out of those arising during 1-4-1980 to 31-3-1981	96,906

4. No. of assessments which resulted in refunds as a result of revision and total amount of refund given :—

	Number	Amount of refund (In thousands of rupees)
(*a*) Under item 3(a) above	1,805	10,712
(*b*) Under item 3(b) above	47,300	4,99,186

5. No. of assessments in which interest became payable under Section 244 and amount of interest :

(*a*) Under item 4(a) above	267	1,252
(*b*) Under item 4(b) above	4,246	22,620

6.	No. of assessments pending revision as on 31-3-1981 :	
	(*a*) Out of (1) above	1,408
	(*b*) Out of (2) above	5,429
7.	Break-up of assessments mentioned at (6) above :	
	(*a*) Pending for less than 1 year	5,393
	(*b*) Pending for more than 1 year and less than 2 years	1,444

*The Ministry of Finance have revised the closing figure of 9322 furnished for the year 1979-80.

1.13 *Searches, Seizures and Rewards*

Sections 132, 132A and 132B of the Income-tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director of Inspection, the Commissioner of Income-tax or a specified Dy. Director of Inspection or Inspecting Assistant Commissioner. Where any money, bullion, jewellery or other valuable article or thing is seized, the Income-tax Officer has, after necessary investigations, to make an order with the approval of the I.A.C. within 90 days of the seizure, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability and retain in his custody such assets as are, in his opinion sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the person from whose custody they were seized. The books of account 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 a longer period

(i) **Searches and Seizures*

(1) Number of search cases in which assessments were awaiting completion at the beginning of the year :—		
(*a*) Number of assessees		3,595
(*b*) Number of assessments		8,194
(2) Total number of cases where search and seizure were conducted during the year :—		
(*a*) Number of assessees		2,105
(*b*) Number of assessments		4,102
(3) Number of search cases in which assessments were completed during the year :—		
(*a*) Number of assessees		1,771
(*b*) Number of assessments		3,738

*Figures furnished by the Ministry of Finance are provisional.

(4) (A) Number of search cases in which assessments are awaiting to be completed at the end of the year :—

(*a*) Number of assessees	3,929
(*b*) Number of assessments	8,558

(B) Number out of (A) above, which are pending for more than 2 years after the date of search :

(*a*) Number of assessees	940
(*b*) Number of assessments	2,404

(5) Total concealed income assessed in cases referred to in item (3) above :

(*a*) Number of cases	849
(*b*) Amount	Rs. 20.69 crores (approx)

(6) Penalty levied for concealment of income in search cases during the year (irrespective of whether assessments completed in this year or earlier) :

(*a*) Number of cases	138
(*b*) Amount	Rs. 1.52 crores (approx)

(7) Number of search cases in respect of which prosecution was launched in the Court during the year (irrespective of whether assessments completed in this year or earlier) . . . 26

(8) Number of convictions obtained during the year 6

(9) Number of cases where no concealr ent or tax evasion found on completion of assessments . 922

(10) Total amount of cash, jewellery, bullion and other assets seized during the year (approximate value) :

(*a*) Cash	Rs. 4.68 crores
(*b*) Bullion & Jewellery	Rs. 8.93 crores
(*c*) Others	Rs. 5.65 crores
TOTAL	Rs. 19.26 crores

(11)	Number of search cases in respect of which summary assessment orders under section 132(5) of the Income-tax Act were passed during the year	665
(12)	Amount of undisclosed income determined in the orders under section 132 (5) referred to in tem (11)	Rs. 40.87 crores
(13)	(*a*) Value of assets retained as a result of orders passed under section 132(5) referred to in item (12) above	11.88 crores
	(*b*) Value of assets returned as a result of orders passed under section 132(5) referred to in item (12) above	2.29 crores
(14)	Amount of cash, jewellery, bullion and other assets held on 31-3-1981 irrespective of the year of search :	
	(*a*) Cash	8.44 crores
	(*b*) Bullion & Jewellery	13.53 crores
	(*c*) Others	7.54 crores
	TOTAL	29.51 crores
(15)	Arrangements made for the safe custody of the assets still held and for their physical verification.	Cash is deposited in the Personal Deposit Account of the Commissioners of Income-tax in the Reserve Bank of India. Other valuables are kept either in well guarded strong rooms in the office building or in the treasuries or in Bank Vaults etc.

(ii) *Rewards to informers

(1) Number of informants to whom rewards were paid (including interim) during the years :	
1978–79.	206
1979–80.	196
1980–81.	200
(2) Total amount of rewards (including interim) paid :	Rs.
1978–79.	9.5 lakhs
1979–80.	9.2 lakhs
1980–81.	15.6 lakhs
(3) Amount of additional income assessed as a result of action taken on the informers' information :	
1978–79.	2.38 crores
1979–80.	2.40 crores
1980–81.	4.57 crores
(4) Amount of extra gain (additional tax, penalty, interest etc.) received by the department on account of the information furnished by informants at (1) above for the years :	
1978–79.	99.6 lakhs
1979–80.	77.0 lakhs
1980–81.	156.9 lakhs

1.14 *Cases settled by Settlement Commission*

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

*Figures furnished by the Ministry of Finance are provisional.

Analysis of cases settled by the Settlement Commission during the years 1976-77 to 1980-81 are given below :—

(a) Income-tax

	1976-77	1977-78	1978-79	1979-80	1980-81	Total
1	2	3	4	5	6	7
(*i*) No. of cases with the Commission on 1-4-1980 (with year-wise details)	62	179	410	325	..	976
(*ii*) No. of cases filed with the Commission during 1980-81	..	..	..	..	297	297
(*iii*) No. of cases disposed of by the Commission (with year-wise details)						
(*a*) Disposed of by issue of orders under section 245D(4)	11	34	91	11	4	151
(*b*) Applications rejected	3	21	55	46	16	141
(*iv*) No. of cases pending on 31-3-1981 (with year-wise details)	48	124	264	268	277	981
(*v*) No. of assesement years involved in (iii)(*a*) above	..	..	..	..	..	414

(*vi*) Total income determined in (iii)(*a*) and details thereof:

	No. of cases	No. of assessment years	Amount Income	(In lakhs of rupee) Loss
Income below Rs. 1 lakh	28	45	9.77	0.49
Between Rs. 1 lakh and 5 lakhs	74	173	105.46	..
Rs. 5 lakhs and above	49	196	514.17	12.06
TOTAL	151	414	629.40	12.55

(*vii*) Tax on (*vi*) above . .		Rs. 223.43 lakhs
(*viii*) Penalty & Interest	No. of cases	Amount (in lakhs of rupees)
(*a*) Penalties under section 271(1)(c) . .	6	40.04
(*b*) Other penalties .	37	4.88
(*c*) Interest levied . .	47	13.44
(*ix*) Recovery of tax, penalty and interest upto 30-6-1981		145.67
(*x*) Balance of tax outstanding as on 1-7-1981 . .		136.12

(b) Wealth-Tax

	1976-77	1977-78	1978-79	1979-80	1980-81	Total
(*i*) No. of cases with the Commission on 1-4-80 (with year-wise details)	29	124	191	87	..	431
(*ii*) No. of cases filed with the Commission during 1980-81 . .	..	..	..	..	69	69
(*iii*) No. of cases disposed of by the Commission (with year-wise details) :						
(*a*) Disposed of by issue of an order under section 22D(4)	2	20	6	..	..	28
(*b*) No. of cases where application have been rejected	2	5	17	12	7	43
(*iv*) No. of cases pending on 31-3-81 (with year wise details)	25	99	168	75	62	429
(*v*) No. of assessment years involved in (iii)(a) above	..	..	..	..	..	195

	No. of cases	No. of asstt-years	Amount (In lakhs of rupees)
(*vi*) Total wealth determined in (iii)(a) and details thereof			
Wealth below Rs. 5 lakhs	5	27	12.31
Between Rs. 5 lakhs & 10 lakhs	2	7	13.80
10 lakhs and above	21	161	1220.42
TOTAL	28	195	1246.53
(*vii*) Tax on (vi) above			18.00

(*viii*) Penalty & Interest :

	No. of cases	Amount (In lakhs)
(*a*) Penalties u/s 18(1)(c)	1	0.04
(*b*) Other penalties	6	0.90
(*c*) Interest levied	..	..

(*ix*) Recovery of tax, penalty and interest upto 30-6-81	9.97
(*x*) Balance of tax outstanding as on 1-7-81	8.97

1.15 **Revenue demands written off by the Department*

(i) A demand of Rs. 1465.60 lakhs in 72,911 cases was written off by the department during the year 1980-81. Of this, a sum of Rs. 428.27 lakhs relates to 2,003 company assessees and Rs. 1037.33 lakhs to 70,908 non-company assessees.

(In lakhs of rupees)

	Companies		Non-companies		Total	
	No.	Amount Rs.	No.	Amount Rs.	No.	Amount Rs.
1	2	3	4	5	6	7	8
1. (*a*) Assessees having died leaving behind no assets or gone into liquidation or become insolvent	..	..	753	325.31	753	325.31
(*b*) Companies which are defunct though not gone into liquidation	126	141.32	..	..	126	141.32
TOTAL	126	141.32	753	325.31	879	466.63

*Figures furnished by the Ministry of Finance are provisional.

II. Assessees being untraceable. .	1,780	62.62	15,122	226.20	16,902	288.82
III. Assessees having left India . .	4	5.01	35	78.00	39	83.01
IV. Other reasons :						
(*a*) Assessees who are alive but have no attachable assets	1	0.50	1970	224.64	1971	225.14
(*b*) Amount being petty etc. .	10	0.04	44,531	96.69	44,541	96.73
(*c*) Amount written off as a result of settlement (cases of scaling down of demand)	1	..	8,377	36.03	8,378	36.03
TOTAL .	12	0.54	54,878	357.36	54,890	357.90
V. Amount written off on grounds of equity or as a matter of international courtesy or where time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery . .	81	218.78	120	50.46	201	269.24
GRAND TOTAL	2,003	428.27	70,908	1037.33	72,911	1465.60

(ii) Wealth-tax, Gift-tax and Estate Duty demands written off by the department during the year 1980-81 are given below categorywise :—

(In lakhs of rupees)

	*Wealth-tax		*Gift-tax		*Estate-Duty	
	No.	Amount Rs.	No.	Amount Rs.	No.	Amount Rs.
1	2	3	4	5	6	7	8
I. Assessees having died leaving behind no assets or have gone in liquidation or become insolvent						
(*a*) Assessees having died leaving behind no asset	2	1.25	..	..	..	..
(*b*) Assessees having gone in liquidation	1	1.00	..	..	..	..
(*c*) Assessees having become insolvent	..	..	..	..	..	—
TOTAL	3	2.25	..	..	..	..
II. Assessees being untraceable.	11	0.13	23	0.05	..	..
III. Assessees having left India	..	..	..	..	..	..
IV. Other reasons :						
(*a*) Assessees who are alive but have no attachable assets	3	3.08	..	..	..	..

*Figures of C.s.I.T. Patna, Bombay (all City charges), Bombay (C) II, Delhi IV, VI and Kanpur (C) are still to be included.

1	2	3	4	5	6	7	8
	(*b*) Amount being petty etc.	..	..	..	..	..	0.01
	(*c*) Amount written off as a result of settlement with assessees	..	..	..	..	..	..
	(*d*) Demands rendered unenforceable by subsequent developments such as duplicate demands wrongly made demands being protective etc.	1	2.38	..	..	..	..
	TOTAL	18	7.84	23	0.05	..	0.01
V.	Amount written off on grounds of equity or as a matter of international courtesy or where the time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	..	..	..	..	..	..
	GRAND TOTAL	18	7.84	23	0.05	..	0.01

(iii) An ex-ruler had incomes from royalties and rents from mines, house property, dividends, remuneration as director, revenues from forest etc. After prolonged litigation, including dispute on jurisdiction of assessing officer and innumerable adjournments and delays in assessments, arrears of tax amounting to Rs. 1,85,07,422 in respect of the assessment years 1947-48 to 1952-53 and 1967-68 to 1973-74, could still not be demanded finally or collected till 1977 when the ex-ruler died. Only a demand of Rs. 3.29 lakhs in respect of the assessment year 1947-48 became final on 7 August 1951. In the course of these years, five house properties, shares in limited companies, bank deposits and his other assets were disposed of by the ex-ruler, during his lifetime, in such a manner that Government could

not prevent his alienating them. The house properties which had been sold to third parties and relatives did not pass on to legal heirs on his demise, and his interests in 23 companies floated by him in regard to the business of mining were "benami". Trusts were also created in some properties. With the abolition of Zamindari, his mining rights vested in the State and only two of the companies floated by him claimed compensation, the remaining 21 companies having gone out of existence. The shares held by the ex-ruler in a company were sold in July 1948 and the balances to his credit in various banks were either negligible or in the red. Thus no recovery was effected from any of the assets transferred or disposed of by the ex-ruler.

Out of the tax arrears of Rs. 1,85,07,422 a sum of Rs. 1,40,07,422 was written off by Government in July 1980.

The case was reported to the Ministry of Finance on 6 November 1981; their reply is awaited January 1982.

1.16 Penalties for concealment and prosecution

(*i*) *Income-tax*

(*a*)	No. of orders of penalty under Section 271(1)(c) passed during 1980-81 . . .	11,977
(*b*)	Concealed income involved in (a) above. .	Rs. 10.15 crores
(*c*)	Total amount of penalty levied in (a) above ...	Rs. 9.29 crores
(*d*)	Position of prosecution cases under the provisions of the Income-tax Act :	
	(1) No. of prosecutions pending before the courts on 1-4-1980	2718
	(2) No. of prosecution complaints filed during 1980-81 under Section 276 C (Substituted with effect from 1-10-1975), 276CC, 276D, 277 and 278	182
	(3) No. of prosecutions decided during 1980-81	141
	(4) No. of convictions obtained in (3) above	21
	(5) No. of cases which were compounded before launching prosecutions . .	36
	(6) Composition money levied in such cases (5) above (Amount in thousands) . .	213

(ii) Wealth-tax and Gift-tax

		Wealth tax	Gift Tax
		(In thousands of Rs.)	
(a)	No. of orders of penalty under Section 18(1)(c)/ 17(1)(c) passed during 1980-81 . . .	9,158	406
(b)	Amount of concealed net wealth/value of gift involved in (a) above	239,284	3,889
(c)	Total amount of penalty levied in (a) above .	1,77,472	229
(d)	Position of prosecution cases under the provisions of Wealth/Gift-tax Act :		
	(1) No. of prosecutions pending before the courts on 1-4-1980	305	
	(2) No. of prosecution complaints filed during 1980-81 under Sections 35A, 35B, 35C, 35D and 35F	18	
	(3) No. of prosecutions decided during 1980-81	2	
	(4) No. of convictions obtained in (3) above	2	
	(5) No. of cases which were compounded before launching prosecutions . .	2	
	(6) Composition money levied in such cases (5) above	2	

1.17 *Results of functioning of the Valuation Cells*

The results of functioning of the Valuation Cells are detailed below :—

(i) No. of Valuation Units/Districts :

Year	No. of valuation Units	No. of valuation Districts functioning
1978–79	80	10
1979–80	80	10
1980–81	80	10

(ii) No. of cases referred to the Valuation Cells excluding cases brought forward from previous years :—

	Income tax	Wealth tax	Gift tax	Estate duty
1978–79.	1,525	19,193	162	296
1979–80.	1,180	11,853	117	214
1980–81.	1,146	10,836	85	302

(iii) No. of cases decided by the Valuation Cells and the total amount of valuation made by the Cells compared with the returned value in the decided cases.

(In lakhs of rupees)

Year	Income-tax			Wealth-tax		
	No. of cases	Value returned	Value determined	No. of cases	Value returned	Value determined
1	2	3	4	5	6	7
1978–79	1,620	2,997.06	4,825.49	26,152	38,924.70	1,09,733.96
1979–80	1,341	2,585.79	3,499.33	12,045	13,600.81	37,109.51
1980–81	1,170	3,377.00	4,503.00	10,655	13,128.00	41,854.00

Year	Gift-tax			Estate Duty		
	No. of cases	Value returned	Value determined	No. of cases	Value returned	Value determined
1	2	3	4	5	6	7
1978–79	252	683.69	1,056.05	321	356.04	821.77
1979–80	92	65.87	212.92	331	554.41	1,085.66
1980–81	100	59.00	132.00	341	603.00	1,192.00

(iv) Expenditure incurred on Valuation Cells during 1978-79, 1979-80 and 1980-81 is as under :—

Year	Expenditure
	Rs.
1978-79.	91,91,091
1979-80.	88,74,613
1980-81.	93,36,262

1.18 *Results of test audit in general*

(i) *Corporation tax and Income-tax*

During the period from 1 April 1980 to 31 March 1981 test audit of the documents of the income-tax office revealed total under-assessment of tax of Rs. 3,076.21 lakhs in 18,227 cases. Besides these, various defects in following the prescribed procedures also came to the notice of Audit.

Of the total 18,227 cases of underassessment, short levy of tax of Rs. 2,563.54 lakhs was noticed in 1,363 cases alone. The remaining 16,864 cases accounted for under-assessment of tax of Rs. 512.67 lakhs.

The under-assessment of tax of Rs. 3,076.21 lakhs is due to mistakes categorised broadly under the following heads :—

	No. of items	Amount (In lakhs of rupees)
1	2	3
1. Avoidable mistakes in computation of tax	1,288	65.33
2. Failure to observe the provisions of the Finance Acts	279	27.42
3. Incorrect status adopted in assessments	307	47.82
4. Incorrect computation of salary income	715	27.44
5. Incorrect computation of income from house property	720	28.66
6. Incorrect computation of business income	2,721	627.03
7. Irregularities in allowing depreciation and development rebate	1,096	612.37
8. Irregular computation of capital gains	253	457.21
9. Mistakes in assessment of firms and partners	787	91.02
10. Omission to include income of spouse/minor child etc..	198	18.49
11. Income escaping assessment	1,410	183.01
12. Irregular set off of losses	184	85.55
13. Mistakes in assessments while giving effect to appellate orders	83	26.06
14. Irregular exemptions and excess reliefs given	1,406	195.83
15. Excess or irregular refunds	520	59.14
16. Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc..	1,604	87.68
17. Avoidable or incorrect payment of interest by Government	541	89.94
18. Omission/short levy of penalty	1,370	128.11
19. Other topics of interest/miscellaneous	2,665	158.62
20. Under-assessment of Surtax/Super Profits Tax	80	59.48
TOTAL	18,227	3076.21

(ii) *Wealth-tax*

During test audit of assessments made under the Wealth-tax Act, 1957, short levy of Rs. 438.92 lakhs was noticed in 4,567 cases.

The under-assessment of tax of Rs. 438.92 lakhs was due to mistakes categorised broadly under the following heads :—

	No. of items	Amount (in lakhs of rupees)
1	2	3
1. Wealth escaping assessment	784	68.81
2. Incorrect valuation of assets	929	102.11
3. Mistakes in computation of net wealth	541	31.52
4. Incorrect status adopted in assessments	106	5.63
5. Irregular/excessive allowances and exemptions	721	24.99
6. Mistakes in calculation of tax	675	22.83
7. Non-levy or incorrect levy of additional wealth-tax	275	54.03
8. Non-levy or incorrect levy of penalty and non-levy of interest	272	25.35
9. Miscellaneous	264	103.65
TOTAL	4,567	438.92

(iii) *Gift-tax*

During the test audit of gift-tax assessments it was noticed that in 816 cases there was short levy of tax of Rs. 158.16 lakhs.

(iv) *Estate Duty*

In the test audit of estate duty assessments it was noticed that in 386 cases there was short levy of estate duty of Rs. 80.57 lakhs.

CHAPTER 2

CORPORATION TAX

2.01 The trend of recovery of Corporation tax *i.e.* the income-tax payable by companies, during the last five years was as follows :—

Year	Amount (In crores of rupees)
1976–77	984.23
1977–78	1220.77
1978–79	1251.47
1979–80	1391.90
1980–81	1310.79

2.02 According to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs there were 63,955 companies as on 31 March 1981. These included 300 foreign companies and 1478 associations "not for profit" registered as companies "limited by guarantee" and 176 companies with unlimited liability. The remaining 62,001 companies comprised 851 Government companies and 61,150 non-Government companies with paid up capitals of Rs. 10,853 crores and Rs. 3,823 crores respectively. Among non-Government companies, over 85 per cent were private limited companies.

2.03 The number of companies on the books of the income-tax department during the last five years was as follows :—

As on 31 March	Number
1977	40,237
1978	42,084
1979	41,532
1980	42,581
1981	44,125*

*Figures furnished by the Ministry of Finance.

2.04 The following table indicates the progress in the completion of assessments and the collection of demand under corporation tax during the last five years :—

Year	Number of assessments		Amount of demands	
	Completed during the year	Pending at the close of the year	Collected during the year	In arrears at the close of the year
			(In crores of rupees)	
1976–77	41878	34008	984.23	146.38
1977–78	41533	34864	1220.77	185.96
1978–79	35982	40563	1251.47	168.04
1979–80	38033	43886	1391.90	190.34
1980–81	44937	52250	1310.79	290.95

2.05 Some instances of mistakes noticed in the assessments of companies under the Income-tax Act are given in the following paragraphs.

2.06 *Avoidable mistakes in the computation of tax*

Short levy of taxes of significant amounts have been noticed in audit every year on account of avoidable mistakes attributable to carelessness or negligence.

The Public Accounts Committee, in para 3.21 of their 186th Report (5th Lok Sabha) and paragraphs 5.11, 6.13 and 6.14 of their 193rd Report (5th Lok Sabha) emphasised the need to guard against the common mistake of dropping a digit (generally one lakh of rupees) from the assessed total income of an assessee. Following this, the Central Board of Direct Taxes, in their instructions issued in December 1968, May 1969, October 1970, October 1972, August 1973 and January 1974, emphasised the need for ensuring arithmetical accuracy in the computation of income and tax, carry forward of figures etc. Despite repeated instructions, such mistakes continue to come to the notice of audit.

(a) (i) A private limited company was assessed on 7 April 1979 (for the assessment year 1978-79), on a total income

of Rs. 21,12,540. This income was arrived at in respect of profits and gains derived by the assessee from a newly established industrial undertaking, after allowing a deduction of Rs. 5,07,297. In computing the capital employed for the purpose of working out the above-mentioned relief, the cash and bank balances were taken as Rs. 21,63,890 instead of the correct figure of Rs. 1,63,890. The mistake occured while deducting a sum of Rs. 45,304, being cash and bank balance of old unit, from the cash and bank balance amounting to Rs. 2,09,194 as shown in the balance sheet as on 1 April 1977. As a result there was excess computation of capital by Rs. 20 lakhs, involving under-assessment of income by Rs. 1,20,000 and undercharge of tax by Rs. 75,600.

The Ministry of Finance have accepted the objection.

(ii) The assessment of a banking company for the assessment year 1976-77 was finalised in September 1979, on a taxable income of Rs. 87,23,580. In the assessment order, however, the gross total income was incorrectly worked out as Rs. 87,95,418 instead of the correct figure of Rs. 88,95,418. In the result the taxable income of the company was short computed by Rs. 1,00,000 resulting in short levy of tax by Rs. 62,372 (inclusive of excess interest of Rs. 4,622 allowed under section 214) in respect of the assessment year 1976-77.

The assessment was checked by the Internal Audit, but the mistake was not pointed out.

The Ministry of Finance have accepted the objection.

(iii) The total income of a private limited company in respect of the assessment year 1976-77 was determined (June 1979) at Rs. 5,41,067 (before adjusting business loss of Rs. 4,32,506 in respect of the assessment year 1975-76). While computing the gross income the total of various items was incorrectly struck as Rs. 8,23,228 instead of Rs. 9,23,228. This resulted in under-assessment of income by Rs. 1,00,000.

Further, extra-shift depreciation of Rs. 14,698 was allowed which was not admissible and excess deduction of Rs. 5,000 was allowed in respect of expenses incurred on proceedings before the assessing authorities.

The above mistakes led to short computation of the assessee's total income by Rs. 1,19,698 and short levy of tax by Rs. 95,354 (including penal interests).

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified raising additional demand of Rs. 95,354 which has been collected.

(iv) The assessment of a company for the assessment year 1974-75 was revised in March 1979 to give effect to certain appellate orders reducing the income from Rs. 35,22,266 to Rs. 35,07,037. The reduction of income of Rs. 15,229 resulted in refund of Rs. 8,795. The refund due was however incorrectly arrived at as Rs. 1,08,795 due to a simple mistake in subtraction. The mistake resulted in excess refund of Rs. 1,00,000 for the assessment year 1974-75.

The Ministry of Finance have accepted the objection.

(v) In the case of a company assessee, in the assessment order passed on 12 August 1977 in respect of the assessment year 1967-68 in order to give effect to appellate orders, credit for tax paid earlier was given. However, it was given erroneously as Rs. 1,18,45,360 as against the correct amount of Rs. 1,17,84,343. The mistake arose owing to a wrong refund of Rs. 31,550 given to the assessee instead of raising a demand of Rs. 29,467. The net short levy of tax amounted to Rs. 61,017.

The Ministry of Finance have accepted the objection and have stated that the assessment has been revised and additional demand of Rs. 61,017 raised which has also been collected.

(b) Under the provisions of the Income-tax Act, 1961, interest at the prescribed rate is payable by an assessee in case

the advance tax paid on the basis of his own estimate is less than seventy five per cent of the assessed tax.

In the case of an assessee company for the assessment year 1973-74, the advance tax paid by the company on the basis of its own estimate having been less than seventy five per cent of the assessed tax, the assessee was liable to pay interest which correctly worked out to Rs. 3,82,463. The department, however, levied interest amounting to Rs. 2,80,070 only. The mistake in calculation led to short levy of interest of Rs. 1,02,393.

The Ministry of Finance have accepted the objection.

(c) An assessee company had debited to the profit and loss account for the previous year relevant to the assessment year 1976-77, an amount of Rs. 1,22,576 towards "Loss on Farm Operation". This being an inadmissible expenditure the assessee had offered it for taxation in the computation of income filed along with the return of income. The Income-tax Officer, while computing the total income, however, failed to add back the amount of Rs. 1,22,576 as inadmissible expenditure. This resulted in under-assessment of income by Rs. 1,22,576 with tax undercharge of Rs. 99,818 including penal interest for short payment of advance tax on estimate.

The case was checked (September 1980) in internal audit, but the mistake was not noticed.

The Ministry of Finance have accepted the objection and stated (August 1981) that additional demand of Rs. 99,705 has been raised.

(d) A company returned a net income of Rs. 17,50,160 after deducting a sum of Rs. 75,500 on account of exemption related to donation made to a certain trust. In the assessment order the Income-tax Officer mentioned that the assessee's

claim for the deduction would not be allowed as the trust was not approved for the purpose. However, while computing the taxable income in May 1979, the Income-tax Officer started from the net income as returned by the assessee and omitted to add back the aforesaid sum of Rs. 75,500. The mistake led to under-assessment of income by Rs. 75,500.

Further, while working out the net tax payable by the assessee, a sum of Rs. 46,770 deposited by the assessee was erroneously given credit twice once by way of adjustment against the total surcharge payable by the assessee and again as a part of advance tax payment made by the assessee.

The above mistakes resulted in short levy of tax of Rs. 94,335.

The Ministry of Finance have accepted the objection.

(e) In the assessment of a company in respect of the assessment year 1976-77 (completed in April 1979) the assessing officer while computing the business income disallowed expenses aggregating Rs. 4,18,627 which were incorrectly taken as Rs. 3,18,627 in totalling. Further, deduction on account of export markets development alowance calculated at 50 per cent of the admissible expenditure of Rs. 1,43,157 was incorrectly allowed at Rs. 76,758 instead of Rs. 71,578. The mistakes led to under-assessment of business income by Rs. 1,05,000. The assessment was revised in June 1980 on some other grounds and the total income was reduced to nil after adjustment of a portion of unabsorbed development rebate of earlier years. The aforesaid mistakes were not noticed during this revision. As a result there was excess carry forward of unabsorbed development rebate of Rs. 1,05,100 at the end of the assessment year 1976-77.

The Ministry of Finance have accepted the objection.

(f) For the assessment year 1976-77, a company in which the public were substantially interested claimed deduction of a

total depreciation of Rs. 35,35,112. In the assessment completed on 6 April 1979, the Income-tax Officer computed the total depreciation admissible as Rs. 39,78,240. Instead of adding Rs. 4,43,128 to the amount of depreciation claimed by the assessee to make up the total admissible amount of depreciation, the Income-tax Officer added a figure of Rs. 5,27,128. This mistake resulted in excess allowance of Rs. 84,000 leading to short levy of tax of Rs. 55,454 including surtax amounting to Rs. 6,944.

The Ministry of Finance have accepted the objection.

(g) In the case of a company the department granted in July 1978 a refund of tax of Rs. 14,20,886, in respect of the assessment year 1973-74 as a result of an appellate order passed in May 1978. Subsequently in April 1979, the department paid to the assessee further interest of Rs. 3,49,764 (after adjusting Rs. 1,118 payable by the assessee as penal interest for delayed payment of tax) relating to the tax paid by the assessee in excess of the assessed tax of Rs. 27,30,668. However, the department had already refunded a sum of Rs. 13,09,782 on the basis of the provisional assessment made in February 1975. Therefore, the amount of tax paid by the assessee in excess (on which interest was payable on regular assessment) was only Rs. 14,20,886 (being Rs. 27,30,668 less Rs. 13,09,782). On this basis, interest admissiible to the assessee worked out to only Rs. 1,68,865 and not Rs. 3,49,764. Further after adjusting the penal interest of Rs. 41,764 payable by the assessee for delayed payment of tax, the net interest payable to the assessee was only Rs. 1,27,101 as against Rs. 3,49,764 actually paid on this account. The mistake resulted in excess payment of interest of Rs. 2,22,663.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

2.07 *Failure to observe the provisions of the Finance Acts*

Under the provisions of the Finance Acts, 1974 and 1975 an industrial company means a company which is mainly engaged in the manufacturing or processing of goods and for this purpose, a company shall be deemed to be mainly engaged in the manufacturing or processing of goods, if the income attributable to such activity included in its gross total income of the previous year is not less than fiftyone per cent of such total income.

A domestic company in which the public are not substantially interested and which is mainly engaged in industrial activity is charged to tax at 55 per cent on the first two lakhs of rupees of its total income and at 60 per cent on the excess over two lakhs of rupees. In the case of such a company which is not engaged in industrial activity, however, the rate of tax is 65 per cent of the total income.

(a) The total incomes of a company for the assessment years 1974-75 to 1976-77 were computed at Rs. 39,42,500, Rs. 79,11,730 and Rs. 33,85,786 respectively. Income-tax was charged at a flat rate of 55 per cent on the entire income. Since the assessee was an industrial company in which the public were not substantially interested, income-tax was correctly chargeable at the slab rate of 60 per cent on the excess of income over Rs. 2 lakhs for the assessment years 1974-75 and 1975-76 and at 60 per cent on the entire total income for the assessment year 1976-77. The mistake led to a short levy of tax of Rs. 10,11,283 including penal interest for short payment of advance tax on estimate, in respect of the assessment years 1974-75 to 1976-77.

The Ministry of Finance have accepted the objection and stated that additional demand of Rs. 10,11,283 has been raised and that the assessee has filed an appeal against the remedial action. Further report is awaited (December 1981).

(b) During the previous year relevant to the assessment years 1974-75 and 1975-76 a private limited company engaged in the

publication of newspapers, whose income attributable to the business activity was less than 51 per cent of its gross total income was charged to tax at the lower rate applicable to industrial companies instead of at the higher rate applicable to non-industrial companies. This mistake resulted in short levy of tax of Rs. 4,94,373 in respect of the assessment years 1974-75 and 1975-76.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

2.08 *Incorrect status adopted in assessments*

Under the Income-tax Act, 1961 a company which is treated as one in which the public are substantially interested is subject to a lower rate of tax. To be so treated, the company should not be a private company, and its equity shares should be listed in a recognised stock exchange in India or its shares carrying more than 50 per cent (more than 60 per cent in the case of an industrial company) of the voting power should not at any time during the relevant previous year have been controlled or held by five or less persons.

(a) In assessing a company in respect of the assessment year 1976-77 (assessment completed in January 1980) the status of the company was taken as one in which the public were substantially interested and tax was levied accordingly. It was, however, noticed in audit (August 1980) that the shares of the company were not listed in any stock exchange in India and that more than 97 per cent of the equity shares of the company were held by only two persons during the relevant previous year as evidenced from the list of shareholders available in the assessment records. The company was, therefore, required to be taken as one in which the public were not substantially interested and thus subjected to higher rate of tax. The mistake in determining the status of the company resulted in short levy of tax by Rs. 1,13,501 and short levy of interest by Rs. 10,216 for delayed submission of return of income.

The Ministry of Finance have accepted the objection.

(b) Under the Income-tax Act, 1961 as amended by the Finance Act 1971, a company in defined to "include" *inter alia* any body corporate incorporated by or under the laws of a country outside India.

In the case of a company incorporated under the laws of a foreign country, however, its income arising in India was charged to tax in the status of an "Association of Persons" and not that of a non-resident "company". This resulted in undercharge of tax by Rs. 72,602 in respect of the four assessment years 1974-75 to 1977-78.

The Ministry of Finance have accepted the objection.

(c) Under the provisions of the Income-tax Act, 1961, where the profits and gains distributed as dividends within twelve months of the expiry of the previous year by a company in which the public are not substantially interested are less than the statutory percentage of the distributable income of that previous year, additional tax, is leviable. The rate of additional tax is 50 per cent in the case of an investment company, 37 per cent in the case of a trading company, and 25 per cent in the case of any other company.

An assessee-company, which was engaged in the business of purchasing and selling cloth after getting it processed by others became liable to additional tax, for non-distribution of adequate dividends. The company was treated as an industrial company by the department and additional income-tax of Rs. 1,47,663 was levied on it at the rate of 25 per cent on the shortfall of Rs. 5,90,654. As the assessee-company itself was not engaged in the processing activity but was merely bringing and selling cloth after due processing carried out by others, it could not be treated as an 'industrial company'. The company should have been treated as a trading company and charged to additional income-tax at the rate of 37 per cent instead of 25 per cent of

the shortfall. The wrong classification resulted in short levy of tax Rs. 70,878.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(d) As per the provisions of the Finance Act, 1977, a domestic company in which the public are not substantially interested and which is mainly engaged in industrial activity is chargeable to tax at the rate of 55 per cent of the total income where it does not exceed Rs. 2 lakhs and at 60 per cent of the total income where it exceeds Rs. 2 lakhs. Under the Income-tax Act, 1961, a subsidiary company is treated as a company in which public are substantially interested only if the whole of the share capital of such a subsidiary company is held by a parent company or by its nominees throughout the relevant previous years and the parent company is a company in which public are substantially interested.

In the assessment of an industrial company in respect of the assessment year 1977-78 which was completed in March 1980, its total income was computed at Rs.16,60,980 and tax was levied at 55 per cent treating it as a company in which the public are substantially interested. It was, however, noticed in audit that in the return of income furnished, the assessee had itself indicated that it was neither a company in which the public are substantially interested nor a hundred per cent subsidiary of another such company. The assessee company was therefore correctly chargeable to tax at the rate of 60 per cent of its total income. Incorrect adoption of the status of the assessee as a company in which public are substantially interested and application of the concessional rate of tax resulted in undercharge of tax of Rs. 87,201 in respect of the assessment year 1977-78.

The Ministry of Finance have stated (October 1981) that the assessee company is a subsidiary of a parent company which, in turn, is a subsidiary company of another parent company. The last mentioned is a public limited company which held only 65.07

per cent shares of the parent company of the assessee. The entire shares of the assessee company were held by its parent company along with its nominees throughout the relevant previous year but that parent company was not a company in which the public are substantially interested. The Ministry of Finance contended that as the parent company is a subsidiary of its parent which is a public limited company and this parent company with the nominees held the entire shares of the assessee company (but not of the intermediate parent) the assessee should be treated as a company in which public are substantially interested. This is, however, not in conformity with the law and has been pointed out to the Ministry (November 1981); final reply of the Ministry is awaited (December 1981).

(e) In the assessment of a company for the assessment year 1974-75 (assessment done in August 1978 and March 1979) the department levied a tax of Rs. 14,34,435 applying the flat rate of 55 per cent on the total income determined, treating it as a company in which the public were substantially interested, although the status of the company for the assessment year 1974-75 was one in which the public were not substantially interested. As the correct amount of tax leviable in terms of the provisions of the Finance Act, 1974 was Rs. 15,54.338, the application of incorrect rate of tax led to undercharge of tax of Rs. 91,578.

The Ministry of Finance have accepted the objection.

(f) In the case of industrial companies which are domestic companies in which the public are not substantially interested, tax is levied at a lower rate. For this purpose, an industrial company is defined as one which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining. Where income is attributable to more than one activity, the company will be an industrial company if its income from such activities is not less than 51 per cent of the total income. It has been judicially

held that while assembly of different parts amounts to manufacture, repairing, reconditioning and remaking does not amount to manufacture.

A non-resident company incorporated in the U.S.A. was carrying on business in India of importing various machines and selling them and rendering after-sale services in India to the purchasers. An Indian company took over the business and continued providing services like reconditioning, repairing or overhauling of the machines. The company was not a central excise licensee and was not paying any central excise duty.

The Indian company was therefore assessable in the status of a trading company and chargeable to tax at the rate of 65 per cent. The department, however, while completing the assessments for the assessment years 1976-77 to 1978-79 in November 1979, January 1980 and March 1980 treated the company as a closely held industrial company and levied concessional rate of tax. The mistake resulted in undercharge of tax of Rs. 99,117 in respect of the three assessment years 1976-77 to 1978-79.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

Incorrect Computation of Business Income

Under the provisions of the Income-tax Act, 1961, any expenditure laid out or expended wholly and exclusively for the purposes of business is allowable as deduction in computing the business income of an assessee, provided the expenditure is not in the nature of capital expenditure or personal expenses of the assessee.

2.09 *Misclassification of capital expenditure as revenue expenditure*

(a) It has been judicially held that, where profit or loss arises to an assessee on account of appreciation or depreciation in value of foreign currency held by him, such profit or

loss would ordinarily be trading profit or loss, if the foreign currency is held on revenue account. If on the other hand, the foreign currency is held as a capital asset or a fixed asset valued in foreign currency such loss would be of capital nature. Where an assessee has acquired a capital asset out of loans taken in foreign currency and at the time of repayment of loan, a chang in rate of exchange occurs, there is an increase or decrease in the liability in terms of domestic currency for repayment of the whole or part of the moneys borrowed. As the increase or decrease partakes of the character of capital expenditure, it has to be added or reduced from the cost of the asset and not accounted for as revenue expenditure or receipt in computing the income of business.

(i) A company had incurred additional liabilities of Rs. 9,80,191, Rs. 9,74,119 and Rs. 16,40,476 for the assessment years 1974-75, 1975-76 and 1976-77 respectively owing to fluctuations in foreign exchange rates in respect of instalments of loans obtained for purchase of machinery. These were allowed by the department as revenue expenditure. As any repayment of loan taken for purchase of capital asset is not allowed as a revenue expenditure, the corresponding exchange fluctuations also are not allowable as revenue expenditure. The incorrect allowance of the liabilities as revenue expenditure resulted in total under-assessment of income by Rs. 35,94,786 and aggregate undercharge of tax of Rs. 20,75,980 for the assessment years 1974-75, 1975-76 and 1976-77.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(ii) Another assessee company had obtained a loan of DM 24,12,142 (equivalent to Rs. 49,43,030) from a company in West Germany for purchase of plant and machinery. While paying the instalments of the loan, the assessee incurred additional liabilities of Rs. 10,94,867 for the assessment year 1976-77 and Rs. 10,53,548 for the assessment year 1977-78

owing to fluctuations in foreign exchange rates. These were allowed by the department as revenue expenditure.

This resulted in under-assessment of income of Rs. 21,48,415 and aggregate undercharge of tax of Rs. 12,40,707 in the two assessment years 1976-77 and 1977-78.

The paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

(iii) While paying the instalments of loan taken for purchase of machinery, two companies incurred additional liabilities of Rs. 1,44,681 in the assessment year 1976-77 and Rs. 1,79,410 in the assessment year 1977-78 due to changes in the rates of foreign exchange. These were allowed by the department as revenue expenditure. The incorrect allowances resulted in under-assessment of income and excess carry forward of loss of Rs. 3,24,091 for the assessment year 1977-78.

The paragraph was sent to Ministry of Finance in September 1981; their reply is awaited (December 1981).

(iv) While remitting a loan instalment in respect of a loan taken for the purchase of plant and machinery, a company had to pay an extra amount of Rs. 81,516 due to difference in exchange rate which was allowed as a deduction in the computation of the business income for the previous year relevant to the assessment year 1976-77 (completed on 26 November 1979). As the loan was taken for the acquisition of an asset the exchange rate difference was a capital expenditure and hence not allowable as deduction. This resulted in under-assessment of income of Rs. 81,516 and consequent excess carry forward of loss as there was no positive income in that year.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(b) It has been held judicially that obtaining capital by issue of shares is an advantage for the enduring benefit of the

business of an assessee and any expenditure incurred in effecting increase in share capital is capital in nature.

In the assessment of a company for the assessment year 1976-77, completed in August 1979, an expenditure of Rs. 1,95,000 incurred by the assessee on payment of fees to the Registrar of Joint Stock Companies for obtaining further capital by issue of equity shares was allowed as deduction while computing the total income. The expenditure being of capital nature was not an admissible item to be allowed as deduction. The mistake resulted in under-assessment of business income by Rs. 1,95,000 involving a short levy of tax by Rs. 1,12,613 in respect of the assessment year 1976-77.

The paragraph was sent to the Ministry of Finance in August, 1981; their reply is awaited (December 1981).

(c) The Auditors of a company in their Notes annexed to the accounts for the previous year relevant to the assessment year 1975-76 had observed that there was a change in the basis of capitalisation of expenses inasmuch as the indirect expenses incurred during "Cold repair" which had hitherto been capitalised, had in that year been charged to revenue and that, had the previous practice been followed, the pre-tax profit in the year would have been more by approximately Rs. 4,15,000.

"Cold-repair" work referred to construction of furnace and a new sheet glass furnace had been constructed by the assessee during the relevant previous year at a cost of Rs. 40,25,965 which had been duly capitalised. Depreciation, development rebate etc. had also been allowed thereon as being direct cost of new addition to furnace. All expenses direct or indirect incurred during the construction of an asset *i.e.* before the asset is put into use, are capital in nature (as was also hitherto treated by the assessee himself and as was judicially held by the Supreme Court in two cases in October 1974). Therefore, the change in the basis of capitalisation of expenses and the charging of indirect expenses to revenue account was not in order. The

incorrect deduction allowed by the department on this account in the assessemnt which was completed on 5 July 1979 in respect of the assessment year 1975-76 thus led to under-assessment of net profit by Rs. 4,15,000 with consequent undercharge of tax by Rs. 2,39,663.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

2.10. *Expenditure not laid out in the previous year*

(a) Under the Income-tax Act, 1961 any sum paid by an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust is admissible as a deduction while computing income from business. In September 1970, the Central Board of Direct Taxes issued instructions that the provision made by the assessee in his accounts on a scientific basis in respect of estimated service gratuity payable to employees is admissible as deduction, even though the assessee might not have created a fund under an irrevocable trust and obtained recognition for it. These instructions were cancelled by the Board in September 1974 stating that such provisions for gratuity should not be allowed in any pending and future assessments.

With a view to mitigating hardship in cases where provisions had been made by the assessees in their accounts for the previous years relevant to the assessment years 1973-74 to 1975-76 on the basis of their understanding of the law and the clarification given by the Board in 1970 and to put matters beyond doubt, the Income-tax Act, 1961 was amended in 1975 to provide specifically that no deduction shall be allowed in the computation of business income, in respect of any provision made by an assessee for the payment of gratuity made to his employees. The provisions for gratuity during the assessment years 1973-74 to 1975-76 were, however, saved by the amendment, if such provisions were made in accordance with an actuarial valuation of the liabilities of the assessee for payment of gratuity to his

employees and the assessee had created an approved gratuity fund and transferred the amount of such provisions to such fund before 1 April 1977 in the manner prescribed.

(i) In the case of a company, provisions for gratuity of Rs. 5,22,248 and Rs. 45,504 made in the previous years relevant to the assessment years 1974-75 and 1975-76 respectively completed on 25 March 1980 were allowed as deduction. From the accounts of the following year relevant to the assessment year 1976-77, it transpired that the provisions made in the assessment years 1974-75 and 1975-76 were not determined actuarially, that no approved gratuity fund was created and further, the gratuity was being accounted for on cash basis only and not on accrual basis as in the earlier years. Hence, the gratuity provisions of Rs. 5,22,248 and Rs. 45,504 allowed in the assessment years 1974-75 and 1975-76 should have been withdrawn. Omission to do so resulted in under-assessment of income of like amounts leading to aggregate undercharge of tax of Rs. 3,83,046 including surtax of Rs. 55,162 for the assessment year 1974-75.

The Ministry of Finance have accepted the objection and stated (November 1981) that the assessment has been rectified and additional demand of Rs. 3,27,884 on account of income-tax raised; report regarding rectification of surtax assessment is awaited (December 1981).

(ii) A non-resident tea company paid a gratuity of Rs. 4,36,080 to its employees in the previous year relevant to the assessment year 1974-75. The company claimed a further deduction of Rs. 4,38,248 in the return of income for that year on account of liability for gratuity for past services arrived at on actuarial valuation for which no provision was, however, made by it in the accounts. The company had no approved gratuity fund till December 1975. In computing the business income of the company in respect of the assessment year 1974-75, in November 1978, the department allowed the sum of Rs. 4,38,248 as claimed by the company in addition to the actual payment of

Rs. 4,36,080 for gratuity. As the company had no approved gratuity fund for the previous year relevant to the assessment year 1974-75, the allowance of provision of Rs. 4,38,248 was not in order. The incorrect allowance led to under-assessment of income by Rs. 1,75,299 with undercharge of tax of Rs. 1,28,846.

The Ministry of Finance have accepted the objection and stated that the assessment has been rectified in January 1981, raising additional demand of Rs. 1,28,846 which has been collected.

(iii) In the assessment of a company for the assessment year 1976-77 completed on 15 November 1979, a provision of Rs. 1,07,309 made by the assessee in its accounts for the year ending 31 December 1975 in respect of estimated service gratuity payable to its employees was allowed as deduction. It was noticed that the gratuity fund constituted by the company was approved by the Commissioner of Income-tax with effect from 31 March 1976. As no approved gratuity fund was in existence during the relevant previous year, the allowance of the gratuity provision of Rs. 1,07,309 was not in order. The mistake resulted in under-assessment of business income by Rs. 1,07,309 with consequent tax undercharge of Rs. 61,970 in the assessment year 1976-77.

The paragraph was sent to the Ministry of Finance in July 1981 ; their reply is awaited (December 1981).

(iv) An assessee company (a Central Government enterprise) made a provision of Rs. 6,00,000 under mines cess in the accounts for the year relevant to the assessment year 1976-77 in addition to the actual payments made on this account amounting to Rs. 4,44,913. While completing the assessment in September 1979, the assessing officer disallowed a sum of Rs. 1,55,087 only as being excess provision made while allowing the amount of actual payment of Rs. 4,44,913. The balance

provision of Rs. 4,44,913 was, however, not disallowed. This resulted in double allowance for the same amount resulting in excess computation and carry forward of loss of Rs. 4,44,913 for the assessment year 1976-77.

The Ministry of Finance have accepted the objection and stated that the assessment has been revised reducing the loss by Rs. 4,44,913.

(v) In the case of an assessee company, the aforesaid deduction aggregating Rs. 11,25,091 was allowed in the assessment years 1974-75 and 1975-76 (assessments completed on 20 July 1979 and 21 September 1978 respectively and assessment for 1975-76 revised on 31 March 1979, although according to the details furnished by the assessee, the deduction allowable (on this account) was only Rs. 9,53,190. The excess deduction allowed erroneously, resulted in under-assessment of income of Rs. 1,71,901, leading to short levy of tax of Rs. 1,17,323 in the assessment year 1975-76.

While accepting the objection, the Ministry of Finance have stated that the assessment in respect of the assessment year 1975-76 has been set aside by the Commissioner on a different issue, Report regarding fresh assessment and rectification of the mistake is awaitel (December 1981).

(b) The Board clarified in May 1974 that any sum set apart by an employer in any year for meeting the contingency of some of his workers going on leave in the next year cannot be regarded as admissible expenditure under the Act as it would not be an ascertained liability.

(i) An assessee company made a provision of Rs. 2,45,560 in its accounts ended on April 30 1974 for "holiday with payment of wages" by debit to the profit and loss account. After meeting the expenditure during that year, the balance provision of Rs. 2,28,468 was shown as a liability in its balance sheet. This balance of Rs. 2,28,468 was merely a 'provision'

for a contingent liability and any expenditure or liability to pay in this regard would arise only on the contingency of an employee proceeding on leave. This provision was to be added back in the computation of business income. Omission to do so resulted in under-assessment of income of Rs. 2,28,468 with short levy of tax of Rs. 1,31,940 in the assessment year 1975-76.

The Ministry of Finance have accepted the objection.

(ii) Similarly, in the case of another company in respect of the assessment year 1975-76 (assessment completed in June 1978 and revised in January 1979), the provision made by the assessee for payment of leave wages to the employees amounting to Rs. 63,946 was allowed as deduction though it was not an ascertained liability. This led to under-assessment of income by Rs. 63,946 and short levy of tax by Rs. 55,602 including interest under Section 215 of the Act.

The Ministry of Finance have accepted the objection.

(c) It has been judicially held that where accounts are maintained on the mercantile system, if liability to make the payment has arisen during the time the business is carried on, it may appropriately be regarded as expenditure. But where the liability does not cast any definite obligation during the time that the business is carried on, it cannot be considered as expenditure laid out or expended wholly and exclusively for the purpose of the business.

In the profit and loss accounts of a company for the previous years relevant to the assessment years 1974-75 and 1975-76 (assessed on 6 March 1979) sums of Rs. 1,24,383 and Rs. 1,06,851 respectively were debited on account of "provision for doubtful debts and advances". These provisions were allowed in the assessments for the respective years. As the amounts were mere provisions and there was no definite business liability in the accounting years relevant to the assessment years 1974-75 and 1975-76, the aforesaid provisions were not admissible

deductions and should have been disallowed while completing the assessments. The erroneous allowance of the provisions resulted in under-assessment of income of Rs. 1,12,583 for the assessment year 1974-75 (taking into account the amount of Rs. 11,800 realised) involving a short levy of tax of Rs. 65,016. For the assessment year 1975-76, the result was excess computation of loss by Rs. 1,06,851.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

2.11 *Excessive remuneration to directors and other employees*

(a) Under the Income-tax Act, 1961, any expenditure incurred by a company which results directly or indirectly in the provision of any remuneration, benefit or amenity to a director or to any person who has a substantial interest in the company or to a relation of the director or such person as the case may be, is not allowable as deduction from the business income to the extent such expenditure or allowance is in excess of Rs. 72,000 during a previous year comprising more than eleven months.

(i) During the previous years relevant to the assessment years 1975-76 and 1976-77 completed on 2 March 1977 and 4 March 1978 respectively, a company paid sums of Rs. 2,12,783 and Rs. 1,83,475 respectively by way of salary and perquisites to two of its directors. Accordingly, in the computation of business income of the company for the respective assessment years, the deduction on account of such expenditure should have been restricted to the allowable limit of Rs. 1,44,000 for two directors in each year. This having not been done, there was under-assessment of business income by an aggregate sum of Rs. 1,08,258 with consequent short levy of tax by Rs. 73,887 in the two assessment years.

The paragraph was sent to the Ministry of Finance in August 1981, their reply is awaited (December 1981).

(ii) Another company incurred a total expenditure of Rs. 4,55,400 on account of remuneration paid to five of its directors at the rate of Rs. 91,080 per director during the previous year relevant to the assessment year 1977-78. The Income-tax Officer, while computing the business income of the company for the assessment year 1977-78 in March 1980 allowed the expenditure in full without restricting it to the admissible limit of Rs. 3,60,000 calculated at the rate of Rs. 72,000 for each director. The mistake resulted in under-assessment of income by Rs. 95,400 with consequent undercharge of tax of Rs. 64,910 including excess payment of interest of Rs. 4,808 under Section 214 of the Act towards excess advance tax paid.

The Ministry of Finance have accepted the objection and have stated that the assessment has been revised and additional demand of Rs. 64,910 collected.

(b) Under the Income-tax Act, 1961 salary paid to an employee in excess of Rs. 5,000 per month and perquisites in excess of one fifth of salary (subject to a limit of Rs. 1,000 per month) should be disallowed in computing the business income of the assessee. Therefore the maximum allowable deduction on account of payment of salary and perquisites to an employee during a year will be Rs. 72,000 only.

(i) In respect of the assessment year 1975-76, a public limited company engaged in the production of heavy automobile vehicles paid to four of its employees, salary and perquisites amounting in all to Rs. 3,70,652 out of which an aggregate amount of Rs. 94,652 was to have been disallowed in computing its business income. But the department disallowed (February 1978) only Rs. 36, 558 resulting in under-assessment of income by Rs. 58,094.

For the assessment year 1976-77, the same company paid to six of its employees, a total amount of Rs. 5,74,981 towards salary and perquisites. As against aggregate amount of Rs. 1,51,081, the department disallowed (April 1979) only a sum of Rs. 71,466 resulting in under-assessment of business income by Rs. 79,615.

As a result of these mistakes, there was short levy of tax of Rs. 79,196.

The Ministry of Finance have accepted the objection relating to the assessment year 1975-76. Their reply in respect of assessment year 1976-77 is awaited (December 1981).

(ii) In the assessment of another company for the assessment year 1972-73 as revised in July 1979 pursuant to an appellate order, the Income-tax Officer while disallowing the excess of salary and perquisites paid to the employees over the statutory limit, considered only the perquisites in excess of Rs. 12,000 per annum paid to two directors but failed to disallow the excess of salary over Rs. 60,000 paid to them during the relevant previous year. Similarly, while revising the assessments for the assessment years 1973-74 and 1974-75 in March 1980, salary and perquisites paid to the two directors were not restricted to the allowable limit of Rs. 6,000 per month. The mistakes resulted in excess allowance of deduction of an aggregate sum of Rs. 1,91,285 in the three assessment years leading to excess carry forward of loss of the same amount.

The Ministry of Finance have accepted the objection.

2.12 *Computation Mistakes*

(a) A company in its return of income for the previous year relevant to the assessment year 1975-76 returned a business income of Rs. 3,54,98,686. In the return of income, the company returned another sum of Rs. 2,16,285 separately on account of profits on sale of assets. While computing the total income of the company in March 1978 the department incorrectly deducted the amount of Rs. 2,16,285 from the returned business income of Rs. 3,54,98,686 and then added Rs. 2,61,833 as profits on sale of assets as per the revised computation of the company. As the profits of Rs. 2,61,285 on sale of assets was not included in the business income returned by the assessee company, the deduction thereof led to under-assessment of business income by

Rs. 2,16,285 involving short charge of tax of Rs. 1,24,876 in the assessment year 1975-76 and undercharge of surtax of Rs. 24,994.

The Ministry of Finance have accepted the objection and stated that the assessment has been rectified raising an additional demand of Rs.1,49,870 which was collected by adjustment.

(b) In the accounts of the previous year relevant to the assessment year 1971-72 the assessee, a tea company, valued the closing stock at Rs. 12,61,182. The Auditor of the company in the report on the accounts stated that the closing stock shown in the accounts at Rs. 12,61,182 was inflated by Rs. 2,74,376. While making reassessment consequent to appellate order in January 1980, the department reduced the value of the closing stock by Rs. 2,74,376 and completed the assessment at a loss of Rs. 2,12,715. Although the value of the closing stock was reduced for the assessment year 1971-72, the department did not reduce the value of the opening stock in the assessment of the following previous year relevant to the assessment year 1972-73 by the sum of Rs. 2,74,376. The loss of Rs. 1,54,685 assessed in the assessment year 1972-73 was, therefore, over-assessed by Rs. 1,09,750 (being 40 per cent of Rs. 2,74,376). The loss carried forward in excess was set off in respect of the assessment year 1977-78 (assessment completed in February 1980) leading to under-assessment of business income by Rs. 1,09,750 and short levy of tax by Rs. 53,292.

The Ministry of Finance have accepted the objection and have stated that after rectification of assessment, additional demand of Rs. 53,292 has been raised. Report regarding collection is awaited (December 1981).

(c) While scrutinising the assessment of a State Road Transport Corporation in respect of the assessment year 1976-77 it was noticed in audit that entire cost of the temporary structures constructed during the previous year relating to the assessment year amounting to Rs. 21,35,159 along with the cost of establishment of Rs. 77,77,232 was claimed by the assessee as revenue

expenses. A sum of Rs. 16,29,249 being the cost of structures meant to last for a year was allowed by the Income-tax Officer as revenue expenditure and the balance of Rs. 5,05,910 was treated as capital expenditure. The proportionate establishment expenditure relating to this, amounting to Rs. 1,49,769 was also proposed to be added back. However, while computing the business loss, the *pro rata* establishment cost, instead of being added back to the cost of the structures capitalised, was actually deducted therefrom. Thus as against the actual addition of Rs. 6,55,679 to be made, only an amount of Rs. 3,56,141 was added back, and depreciation allowed on the reduced amount capitalised. This resulted in excess carry forward of loss to the extent of Rs. 2,71,468.

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified reducing the loss by Rs. 2,71,468.

(d) Under the provisions of the Income-tax Act, 1961, the amount of any debt or part thereof, which is established to have become bad in the previous year, is allowable as a deduction in computing the income chargeable to tax under the head "profits and gains of business or profession".

The records of an assessee company were burnt in fire in the previous year relevant to the assessment year 1974-75. While finalising the account of the year relevant to the assessment year 1976-77 in September 1979, the assessee found that debtors owing amounts to the extent of Rs. 5,73,213 were not traceable and it wrote off this amount as bad debt. The department, after considering the case, found that the claim could not be accepted as a bad debt as the attendant conditions were not satisfied. The department, however, allowed an amount of Rs. 3,82,142 out of the said sum of Rs. 5,73,213 as a trading loss. As a trading loss is allowable only in the year in which such loss arises, admission of a trading loss of 1974-75 in the assessment year 1976-77 was not in order. The incorrect allowance led to under-assessment of income of Rs. 3,82,142 and undercharge of tax of Rs. 2,73,851

(including additional interest for late filing of the income tax return).

The paragraph was sent to the Ministry of Finance in July 1981 ; their reply is awaited (December 1981).

2.13 *Other cases*

(a) Under the Income-tax Act, 1961 any loss computed in respect of speculation business can be set off only against profits and gains if any, of another speculation business. A speculative transaction is defined in the Act as one in which a contract for the purchase or sale of any commodity is periodically or ultimately settled otherwise than by actual delivery of the commodity.

In computing the business income of a company for the previous year relevant to the assessment year 1973-74 (assessed in March 1976), speculation loss of Rs. 3,66,969 arising from contracts for purchase of gunnies, settled otherwise than by actual delivery, was incorrectly adjusted by the department against assessee's business income.

Further the company made a payment of Rs. 45,888 from out of provision made for payment of gratuity, which provision related to the assessment year 1972-73. The department wrongly allowed deduction for the aforesaid payment in respect of the assessment year 1973-74.

The aforesaid mistakes led to a total under-assessment of business income by Rs. 4,12,860 with consequent short levy of tax of Rs. 2,38,427 in the assessment year 1973-74.

The Ministry of Finance have accepted the objection regarding payment of gratuity. However, the Ministry have stated that the speculation loss would work out to only Rs. 60,154 and that remedial action has been taken. Further reports is awaited (January, 1982).

(b) A shipping company which was maintaining its accounts on mercantile system, debited an amount of Rs. 62,20,407 in the profit and loss account of the previous year relevant to the assessment year 1976-77 on account of loss on one of its services. This amount included an expenditure of Rs. 4,12,541 relating to the accounting year ending 31 March 1975 relevant to the assessment year 1975-76. This was also allowed erroneously in the assessment for the assessment year 1976-77 completed on 22 September 1979.

The mistake resulted in excess carry forward of loss of Rs. 4,12,541 in the assessment year 1976-77.

While accepting the objection, the Ministry of Finance have stated that the assessment has been revised reducing the loss determined in the original assessment by Rs. 4,12,541.

(c) A non-sesident company returned an income of £ 91,666 for the previous year ended 31 March 1977 relevant to the assessment year 1977-78. Calculated at the conversion rate of £ 1=Rs. 18 prescribed in Rule 115 of the Income-tax Rules, 1962 as it stood prior to the amendment with effect from 1 November 1977 the income in rupees worked out to Rs. 16,49,988 with tax liability of Rs. 3,29,998. The department, however, while completing the assessment (October 1977) incorrectly adopted the conversion rate provided in the amended rule and applied the telegraphic buying rate as on 31 March 1977 and levied a tax of Rs. 2,80,110 only. This resulted in a short demand of tax of Rs. 49,888.

The Ministry of Finance have accepted the objection and stated (November 1981) that the additional demand of Rs. 49,888 has been raised and collected.

(d) Under the Income-tax Act, 1961, any expenditure not laid out or expended wholly and exclusively for the purpose of business is not allowable in computing business income. It has been judicially held that expenditure which was incurred in connection

with proceedings relating to breach of law was not due to any exigency of the business carried on by an assessee. and would not be deductible even if incurred for the purpose of business.

In the accounts of a company in respect of assessment years 1972-73 and 1974-75, sums of Rs. 93,275 and Rs. 1,60,000 respectively were debited to the profit and loss account being payments of interest made to the Commissioner of Provident Fund for failure to deposit employer's and employees' contributions to provident fund in time. The debits were allowed by the Income-tax Officer as deduction in computing the company's total income. As the payments were made for infringement of statutory orders and they were not due to any exigency of the business, they would not constitute admissible expenditure. The incorrect deduction allowed on this account led to excess computation and carry forward of loss of Rs. 2,53,275 in the aggregate in respect of the two assessment years.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

2.14 *Incorrect computation of Income of Financial Corporations*

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 in the computation of their taxable profits, of the amount transferred by them out of such profits to a special reserve account up to a specified percentage of their total income, as computed before making any deduction under Chapter VI-A of the Act.

The Board issued instructions in November 1969, to the effect that this deduction is to be calculated, by applying the specified percentage to the total income arrived at after the deduction is made. In a subsequent clarification, however,

the Board stated in November 1973 that the percentage should be applied to the total income computed before making the said deduction. It was pointed out to the Board by Audit that this latter clarification was not in accordance with the clear provisions of the Act. The Board thereafter issued further instructions in August 1979 restoring the original position contained in the 1969 instructions. The Board also instructed the assessing authorities to take remedial action, wherever feasible, to withdraw the enhanced deduction allowed previously.

In respect of the assessment year 1976-77, an Industrial Investment Corporation eligible for this concession was allowed (January 1980) a special deduction of Rs. 46,50,000 by applying the prescribed rate of 40 per cent on a total income of Rs. 1,16,39,638 but restricting it to the actual reserve (Rs. 46,50,000) created in the accounts of the relevant previous year. It was seen in audit that the income of Rs. 1,16,39,638 taken as the base for determining the amount of the special deduction was the amount before and not after allowing the special deduction. The correct amount of the special deduction worked out to Rs. 33,25,611 only, as against Rs. 46,50,000 allowed. The excess deduction of Rs. 13,24,389 resulted in a short levy of tax of Rs. 7,74,755.

The Ministry of Finance have accepted the objection.

2.15 *Mistakes in the grant of export markets development allowance*

The Income-tax Act, 1961 provides for an export markets development allowance to resident assessees engaged in the business of export of goods outside India or in providing services or facilities outside India. The allowance from the income assessed under the head "profits and gains of business or profession" is at one-and-one-third times the qualifying expenditure (widely held domestic companies were entitled to the deduction

at one and one-half times the qualifying expenditure incurred upto 31 March 1978).

Mistakes in giving the weighted allowance to domestic companies in 5 Commissioners' charges resulted in short levy of tax of Rs. 38,65,204 as detailed below.

(a) In assessing a domestic banking company, only a specified proportion of the aggregate expenditure incurred on its foreign branches is deemed to be incurred in deriving income from investments, such as government securities, debentures, etc. assessable under the head of income "interest from securities" and the balance expenditure is allowed as a deduction under the head "profits and gains of business or profession". Consequently, the assessee can be allowed the weighted allowance only in respect of such balance expenditure and not on the total expenses incurred by the foreign branches.

(i) In assessing a nationalised bank in respect of the assessment years 1970-71 to 1976-77, the income from interest on government securities/debentures was determined, after deducting the proportionate interest payments and overhead expenses (including those incurred on the foreign branches), but in allowing the weighted export markets development allowance, the entire expenditure incurred on the foreign branches (without reducing it by the amount already deducted against interest on securities) was taken into account. As a result, the business income in respect of seven assessment years was under-assessed by **Rs. 57,93,222 involving short levy of tax by Rs. 33,20,634.**

(ii) By an amendment to the Income-tax Act, 1961, made in 1974, the weighted allowance for domestic companies in which the public are substantially interested, was increased to one and one-half times the actual expenditure incurred after 28 February 1973 (but before 1 April 1978). In assessing the above referred nationalised bank, weighted allowance was given at the

higher rate of one and one-half times the entire expenditure of Rs. 1,67,10,278 incurred on export promotion in respect of the assessment year 1974-75, overlooking the provision that the higher rate was not applicable on the expenditure incurred in the first two months (January and February 1973) of the assessee's accounting year ending 31 December 1973. On a *pro rata* basis, the under-assessment of income was estimated at Rs. 4,64,174 involving short levy of tax of about Rs. 2,02,830. Despite the Special Audit Party pointing out the mistake in January 1979 and the assessment undergoing revision twice thereafter no action to rectify the mistake was taken.

The Ministry of Finance have accepted the objection at (ii) above, and have stated that additional demand of Rs. 2,02,830 has been raised. In respect of (i) above, reply is awaited (December, 1981).

(b) Though expenditure incurred on export of goods outside India qualified for the weighted deduction, the Act specifically disqualified the expenditure (wherever incurred) on the carriage of such goods to their destination outside India. In assessing a domestic company in which the public were substantially interested, a sum of Rs. 1,14,061 being 50 per cent of the expenditure of Rs. 2,28,122 incurred on steamer freight in connection with the export of goods outside India was allowed as weighted allowance in respect of the assessment year 1978-79. As the expenditure was incurred on carriage of goods outside India, it did not qualify for the weighted deduction. The mistake resulted in under-assessment of income by Rs. 1,14,061 and short levy of tax by Rs. 67,189.

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified raising additional demand of Rs. 67,189 which has been collected.

(c) In the assessment of a company, in respect of the assessment year 1975-76 (assessment completed in September 1978), the department allowed weighted deduction of a sum of

Rs. 1,73,712 equal to one and one-third times the expenditure of Rs. 1,30,284 incurred by the assessee towards development of export markets. While doing so, the department omitted to add back the sum of Rs. 1,30,284 which already stood debited to the profit and loss account of the relevant previous year. The mistake resulted in under-assessment of business income by Rs. 1,30,284 with consequent short levy of tax by Rs. 82,047 in respect of the assessment year 1975-76.

The Ministry of Finance have accepted the objection.

(d) (i) The assessment of a private limited company was completed at a loss of Rs. 26,922 (September 1979) for the assessment year 1978-79 after allowing export markets development allowance against the expenditure of Rs. 4,59,379 which sum included inadmissible expenditure on account of ocean freight and cargo charges amounting to Rs. 2,83,498. The incorrect allowance resulted in short computation of assessee's income by Rs. 94,499 (1/3rd of Rs. 2,83,498) with consequent short charge of tax of Rs. 44,917 for the assessment year 1978-79.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(ii) In the assessment of an assessee company, in respect of the assessment year 1977-78, weighted deduction of an amount of Rs. 3,61,603, equal to one-half of the total expenditure of Rs. 7,23,206 incurred by the assessee towards the development of export markets, was allowed by the department. As the said total expenditure of Rs. 7,23,206 included an expenditure of Rs. 5,11,124 on account of freight, weighted deduction to the extent of Rs. 2,55,562 being one-half of Rs. 5,11,124 was incorrectly allowed to the assessee. This resulted in short levy of tax of Rs. 1,47,587.

The Ministry of Finance have accepted the objection.

Irregularities in allowing depreciation and development rebate

2.16 *Irregular allowance of depreciation*

In computing the income from business, the Income-tax Act, 1961 provides for the grant of depreciation on buildings plant and machinery and furniture owned by the assessee and used for the purpose of business.

(a) Under the Income-tax Rules, 1962 a general rate of 10 per cent is prescribed for depreciation in respect of machinery and plant for which no special rate of depreciation has been prescribed therein. Special rates ranging from 15 per cent to 100 per cent have, however, been prescribed for certain specified items of machinery and plant.

The machinery for sugar mills is not an item of machinery and plant for which any special rate is prescribed and therefore only the general rate of depreciation of 10 per cent is applicable.

An assessee company running sugar mills was assessed in March 1979 for the assessment year 1975-76 on a loss of Rs. 3.74 lakhs which was carried forward and set off against the income for the assessment year 1976-77. This loss included excess allowance of depreciation at the rate of 15 per cent instead of 10 per cent. Depreciation on machinery and plant at the enhanced rate was also allowed for 1976-77 by applying the incorrect rate of 15 per cent instead of 10 per cent. Further, the written down value of the machinery and plant for that year was wrongly adopted at Rs. 1,89,829 instead of the correct figure of Rs. 89,829. These mistakes resulted in short charge of tax of Rs. 1.44 lakhs for the assessment year 1976-77.

The assessee had filed income return for the year 1976-77 late. The interest on account of late filing of return charged by the department (Rs. 2.73 lakhs) would also increase by Rs. 0.13 lakh after taking into account the above short charge.

As a result of these mistakes, there was a total short charge of tax of Rs. 1,56,978.

The Ministry of Finance have accepted the objection and have stated that the assessment has been revised raising an additional demand of Rs. 1,57,000. Report regarding collection is awaited (December 1981).

(b) The Rules provide for special rate of depreciation at 15 per cent on artificial silk manufacturing machinery and plant except wooden parts.

In the assessment of a company for assessment years 1974-75 to 1976-77 depreciation at 15 per cent was allowed on "art silk machinery" although it was only textile machinery as claimed by the assessee for the purpose of higher development rebate at 25 per cent applicable to textile machinery covered by the Fifth Schedule to the Act. In central excise assessments also the assessee was not found to be engaged in the manufacture of art silk fabrics (processed or unprocessed). The textile machinery was entitled to depreciation at the general rate of 10 per cent only. The erroneous allowance of depreciation at 15 per cent resulted in short levy of tax of Rs. 2,23,184.

The Ministry of Finance have accepted the objection and stated that the assessments have been rectified. Further report is awaited (December 1981).

(c) Under the provisions of the Income-tax Act, 1961, depreciation is allowed on the actual cost to the assessee in the case of assets acquired in the relevant previous year.

An assessee company incorporated in January 1976, for carrying on the business of manufacture of vegetable oil products, took over a factory from another company, as a going concern. According to the sale agreement of January 1976, the total consideration for the business assets taken over was Rs. 50 lakhs which was discharged by payment of Rs. 6.51 lakhs in cash and the balance of Rs. 43.49 lakhs by undertaking to discharge certain

liabilities on behalf of the vendor company. The written down value of these assets as on 1 January 1976 as per the books of the previous owner was Rs. 61,74,442. In the assessments concluded in August 1979, the depreciation allowance for the assessment year 1976-77 and also for the subsequent assessment year 1977-78 was allowed by the department on the basis of such written down value of the assets as per the books of the vendor instead of restricting the allowance on the actual cost to the assessee, which was only Rs. 50 lakhs. As a result there was an excess allowance of depreciation of Rs. 2,23,143 for the assessment years 1976-77 and 1977-78 and corresponding excess carry forward of business loss of Rs. 2,23,143.

While accepting the objection, the Ministry of Finance have stated that the assessment in respect of assessment year 1976-77 has been set aside by the Commissioner of Income-tax and remedial action in respect of assessment year 1977-78 will be taken. Further report is awaited (December 1981).

(d) Under the Income-tax Rules, 1962 annual depreciation on ocean-going ships (other than vessels ordinarily operating in inland waters) is admissible at the rate of 5 per cent of actual cost (except that it is 10 per cent of actual cost in respect of ocean-going ships which are fishing vessels with wooden hull). Speed boats and other vessels ordinarily operating in inland waters are entitled to an annual depreciation of 20 per cent and 10 per cent respectively on the written down value. The Ministry of Law clarified in March 1972 that barges which carry considerable cargo (including self-propelled oar type, flats for cargo, inland tug boats and speed boats) should be treated as ships for the purpose of income-tax law. The Ministry of Shipping have ruled that a barge is a vessel within the meaning of Merchant Shipping Act and only sailing vessels are excluded from the definition of a 'ship'. Therefore, barges which are not sailing vessels will be deemed to be ships.

It was noticed that in one Commissioner's charge depreciation on trawlers (mechanised wooden vessels with a single deck) used for ocean-going purpose was allowed depreciation at 5 per cent

subject to modification based on expectancy of life. But in another Commissioner's charge it was noticed that on two barges depreciation was allowed at the rate of 10 per cent though the barges were engaged in carrying cargo from Bombay to Karachi, Muscat and other places and though as ocean-going ships (not a wooden hulled fishing vessel) only 5 per cent depreciation was to be allowed in respect of them. This resulted in excess allowance of depreciation of Rs. 3,70,737 in respect of the assessment years 1975-76 and 1976-77 with consequent short-levy of tax of Rs. 1,81,061.

In yet another Commissioner's charge it was noticed that on three vessels (mechanised country craft of wooden construction) used for export of timber and other commodities to Gulf countries, depreciation was allowed at 10 per cent instead of only 5 per cent admissible to ocean-going ships (other than wooden hull fishing vessels). This resulted in undercharge of tax of Rs. 11,850 apart from the undercharge of tax of Rs. 1,81,061 in the case referred to above.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(e) (i) An assessee company returned an income of Rs. 1,27,44,700 for assessment year 1974-75. The returned income included loss of Rs. 47,563 in one of its divisions, which was arrived at after deducting depreciation (Rs. 2,73,193) and development rebate (Rs. 64,250). In the original assessment completed by the Income-tax Officer in June 1977, the loss of Rs. 47,563 in full was allowed and in addition depreciation (Rs. 2,73,193) and development rebate (Rs. 64,250) were allowed again. The double allowance of depreciation and development rebate resulted in under-assessment of income of Rs. 3,37,443 and short levy of income-tax of Rs. 2,12,587 and surtax of Rs. 37,458.

The assessment for the assessment year 1974-75 was subsequently revised by the Income-tax Officer in March 1979 to revise the depreciation allowed from the assessment year

1965-66 onwards with reference to appellate orders. The double allowance of depreciation and development rebate wrongly allowed in the original assessment was not noticed by him at the time of revising the assessment. Instead, depreciation allowed for one of the units of the assessee was revised without adding back the depreciation allowed for a second time in the original assessment. This mistake resulted in further under-assessment of income of Rs. 2,73,193 and consequent short levy of income-tax of Rs. 1,72,110 and surtax of Rs. 30,324.

These mistakes resulted in total undercharge of tax of Rs. 4,52,479 including surtax of Rs. 67,782.

While accepting the objection, the Ministry of Finance stated that the assessment has been rectified and additional demands of Rs. 3,84,697 on account of income-tax and Rs. 67,782 on account of surtax have been raised and collected.

(ii) In the case of a company in respect of the assessment year 1976-77, (completed in January 1980), depreciation and extra shift allowance at the rate of 15 per cent were allowed on 'foundry' item valuing Rs. 23,23,125. This item which was also included in the written down value of other items amounting to Rs. 1,87,83,311 brought forward from the previous assessment year on which depreciation and extra-shift allowance at the rate of 15 per cent and 7.5 per cent had already been claimed and allowed in respect of the assessment year 1976-77. Thus, the depreciation on foundry item was allowed twice and the mistake resulted in excess depreciation allowance of Rs. 5,22,702 involving short levy of tax of Rs. 4,25,622 including interest payable under section 215 of the Act.

While accepting the objection, the Ministry of Finance have stated that the assessment has been revised raising additional demand of Rs. 4,25,622 which has also been collected.

(iii) An assessee company returned in July 1977 a loss of Rs. 25,70,865 for the previous year relevant to the assessment year 1977-78. The assessment was completed by the department

in April 1979 with a total loss of Rs. 36,20,408. The company debited in the profit and loss account of the relevant previous year an amount of Rs. 11,88,127 on account of depreciation. The department computed the depreciation at Rs. 17,96,509. While completing the assessment the department erroneously deducted an amount of Rs. 1,18,827 instead of Rs. 11,88,127 on account of depreciation from the net loss of the year and then allowed the depreciation of Rs. 17,96,509. The mistake led to excess computation of business loss and excess carry forward of business loss by Rs. 10,69,300 in the assessment year 1977-78.

The Ministry of Finance have accepted the objection and stated that the assessment has been rectified in October 1981 reducing the business loss by Rs. 10,69,300.

(f) In the assessment order dated 1 September 1979 for the assessment year 1974-75 the unabsorbed depreciation relating to the assessment year 1971-72 was determined as Rs. 26,27,810. After adjusting an amount of Rs. 71,280, being profit available for the assessment year 1975-76, the net amount of unabsorbed depreciation to be carried forward in respect of assessment year 1971-72 was Rs. 25,56,530. In the assessment order dated 11 September 1979 for the assessment year 1976-77, instead of adopting this amount, an amount of Rs. 27,63,656 was incorrectly shown for further carry forward of unabsorbed depreciation as relating to the assessment year 1971-72 resulting in excess carry forward of depreciation by Rs. 2,07,126.

In addition, in the assessment for the assessment year 1976-77 finalised on 11 September 1979, depreciation on "crushing and grinding plant" was incorrectly allowed at the rate of 15 per cent instead of at the general rate of 10 per cent as decided in appeal earlier (February 1978) resulting in the grant of excess depreciation allowance by Rs. 66,151.

The aggregate excess carry forward of depreciation on account of the above two mistakes worked out to Rs. 2,73,277.

The Ministry of Finance have accepted the excess carry forward of depreciation and have stated that the assessment has been revised. Further report is awaited (December 1981).

2.17 *Irregular allowance of extra shift allowance*

Under the Income-tax Rules, 1962, extra shift depreciation allowance at the prescribed rates is allowed where the concern works extra shifts. No extra shift allowance is admissible in respect of stationary plant and machinery and wiring and fittings of electric light and fan installation described under 'Electrical Machinery'.

In the assessments for the assessment years 1970-71 to 1975-76, a company was allowed extra shift depreciation allowance amounting to Rs. 2,17,017 on electrical machinery comprising stationary plant and wiring and fittings of electric light and fan installations. As no extra shift depreciation was admissible on such assets the allowance thereof was irregular. This resulted in undercharge of tax of Rs. 1,39,241 in respect of the five assessment years.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

2.18 *Irregular allwoance of initial depreciation and development rebate*

Under the provisions of the Income-tax Act, 1961, in computing the income from business, an allowance by way of initial depreciation at the rate of twenty per cent of the actual cost of the new plant or machinery installed and used for the purpose of business is available to an assessee, in addition to the normal depreciation, in respect of new plant or machinery installed after 31 May, 1974, for the manufacture or production of articles or things specified in the Ninth Schedule to the Act.

If the plant and machinery was installed for the purpose of manufacture or production of any one or more of the articles or things specified in the Fifth Schedule to the Act, development rebate at a higher rate is admissible.

"Textiles (including those dyed, printed or otherwise processed) made wholly or mainly of cotton including cotton yarn, hosiery and rope" is an item specified both in the Ninth Schedule and the Fifth Schedule to the Act and accordingly initial depreciation at the rate of 20 per cent and development rebate at the higher rate of 25 per cent are admissible in respect of plant and machinery relating to them.

The Board had occasion to consider the interpretation of the word "mainly" appearing in the Ninth Schedule. The Board clarified in March 1977 that if the cotton content in any of the fabrics produced was less than 51 per cent, the machinery installed cannot be said to be for the purpose of production of textile made wholly or mainly of cotton.

(a) In the case of three assessee companies manufacturing cotton textiles including terene, polyester, blended and art silk fabrics, initial depreciation allowance of Rs. 8,88,425 was allowed in respect of machinery installed during the previous year relevant to the assessment year 1976-77. Development rebate amounting to Rs. 6,54,509 calculated at the higher rate of 25 per cent was also allowed in the case of one company in respect of the assessment year 1976-77. As these companies were also manufacturing polyester, terene and other synthetic fabrics, the condition that the cotton content in any of the fabrics produced should not be less than 51 per cent was not fulfilled, and therefore, they are not eligible for the initial depreciation and development rebate at higher rates. The erroneous allowances on this account resulted in under-assessment of income by Rs. 15,42,934 involving short levy of tax of Rs. 8,91,042 (including notional tax of Rs. 3,65,529) for the assessment year 1976-77.

The Ministry of Finance have not accepted the objection in one case stating that the total consumption of cotton constitutes more than 51 per cent of the total raw material used. But as per Board's circular, cotton content in each of the fabrics manufactured by the use of the machinery should be more than 51 per cent for the purpose of determining the admissibility of initial depreciation. The reply to this point, as well as to other two cases is awaited (January 1982).

(b) No deduction shall be allowed in respect of any machinery or plant installed in any office premises or any residential accommodation, including any accommodation in the nature of a guest house. Similarly, no deduction by way of development rebate is to be allowed in respect of any machinery or plant installed in office premises or in any residential accommodation.

While assessing the income of a company for the assessment year 1976-77 initial depreciation of Rs. 12,94,007 at the rate of 20 per cent on machinery costing Rs. 64,70,033 and development rebate amounting to Rs. 25,463 on machinery valued at Rs. 1,01,854 installed in the township were allowed. As the machinery installed in the township as well as the machinery installed in a residential area, could not be said to have been used for the manufacture of articles specified in the Ninth Schedule, such machinery was not eligible for initial depreciation or development rebate. The erroneous allowances resulted in under-assessment of income of Rs. 13,19,470 leading to short levy of tax of Rs. 7,61,993.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(c) An assessee company claimed initial depreciation of Rs. 5,44,276 at the rate of 20 per cent in respect of machinery valued at Rs. 27,21,383 and relating to assessment year 1975-76. This was allowed by the department at the time of completing the assessment in March 1978.

The assessee company was also engaged in the business of hiring out machinery, such as sugarcane crushers and juice boiling pans etc. Out of the machinery valuing Rs. 27,21,383, machinery valuing Rs. 25,83,000 had been used by the assessee company for hiring out. As such initial depreciation to the extent of Rs. 5,16,600 being 20 per cent of Rs. 25,83,000 had been incorrectly allowed which resulted in excess computation of loss to be carried forward by an equal amount.

The Ministry of Finance have accepted the objection.

2.19 *Incorrect determination of the written down value*

Under the Income-tax Act, 1961, if any building, machinery or plant owned by an assessee is sold at a price below the written down value, a further allowance termed as terminal depreciation being the difference between the written down value of the asset and the price for which the same is sold will be allowed. In determining the written down value, all depreciation allowances (including initial depreciation allowance) allowed are required to be taken into consideration. The above position has been clarified in the Explanatory Notes on Direct Taxes (Amendment) Act, 1974.

In the assessment of a company for the assessment year 1976-77, completed in October 1979 although initial depreciation allowance was allowed for Rs. 1,89,500 on generators owned by the assessee and sold out during the relevant previous year, the same was not taken into consideration while determining the written down value of the asset for the purpose of working out the amount of terminal depreciation allowable to the assessee. This resulted in incorrect determination of the written down value of the asset leading to excess allowance of terminal depreciation by Rs. 1,89,500 in the assessment year 1976-77. As the assessment resulted in a loss there was excess carry forward of loss by that amount.

While accepting the objection, the Ministry of Finance have stated that the assessment has been revised in August 1981 to give effect to the audit objecion.

2.20 *Irregular grant of development rebate*

(a) Under the Income-tax Act, 1961 development rebate on plant and machinery installed after 31 March 1970 used for the purpose of business carried on by an assessee is allowable at 15 per cent of such cost of the plant and machinery. By the Finance Act, 1974 development rebate was abolished from 1 June 1974; but by a special provision in the Act the benefit was continued in certain cases on the condition that the plant and machinery should have been purchased or the contracts for the purchase entered into before 1 December 1973.

(i) In the assessment of an assessee company for the assessment year 1975-76 completed on 26 February 1976, development rebate of Rs. 1,26,630 at 15 per cent on plant and machinery valued at Rs. 8,44,200 was allowed. Since the machinery had been purchased on 1 July 1974 and the installation was completed later on, the development rebate was not admissible.

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified raising a demand of Rs. 80,756. Report regarding collection is awaited (December 1981).

(ii) In the case of two other companies it was noticed in audit that no evidence was on records to show that the said conditions had been satisfied prior to allowance of development rebate of Rs. 1,40,229 in respect of the assessment year 1975-76. As a result there was short levy of tax of Rs. 88,343.

While accepting the objection, the Ministry of Finance have stated that the assessments have been revised raising additional demand of Rs. 88,343 out of which Rs. 32,023 has been collected. Report regarding collection of balance is awaited (December 1981).

(b) Under the Income-tax Act, 1961, development rebate on plant and machinery installed after 31 March 1970, for the purpose of construction, manufacture or production of any one

or more of the articles or things specified in the Fifth Schedule to the Act is allowable at 25 per cent of the actual cost of plant and machinery. Similarly, plant and machinery installed after 31 March 1970 being an asset representing expenditure of a capital nature on scientific research related to the business of the assessee is also entitled to development rebate at the higher rate of 25 per cent. In other cases development rebate is allowable only at the lower rate of 15 per cent.

(i) In the case of a company for the asessment years 1972-73 to 1974-75 completed in November 1978 and April 1979 development rebate on computers was allowed at 25 per cent although these computers were not plant and machinery engaged in the manufacture by the assessee, of articles specified in the Fifth Schedule to the Act. It did not also represent expenditure of a capital nature on scientific research, satisfying the conditions for the grant of the higher rate of development rebate. Therefore the rebate was allowable at the lower rate of 15 per cent for assessment years 1972-73 to 1974-75. This resulted in excess allowance of development rebate of Rs. 6,01,016 with undercharge of tax of Rs. 3,45,014 for the three assessment years.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

(ii) In the assessments of an assessee company for the assesment years 1971-72 and 1972-73 development rebate on the plant and machinery, installed after 31 March 1970 was allowed at 35 per cent (as admissible to machinery installed before 1 April 1970) instead of at the admissible rate of 25 per cent. The mistake resulted in excess allowance of development rebate by an aggregate sum of Rs. 31,77,801 leading to excess carry forward of loss by the same amount for the two assessment years.

The Ministry of Finance have accepted the objection.

(c) Development rebate originally allowed to an assessee is liable for withdrawal, if the assets on which development rebate was allowed were sold within a period of eight years of their acquisition or installation.

From the assessment records of a company for the assessment year 1979-80 completed on 18 March 1980 it was seen that during the relevant previous year the company had sold certain plant and machinery originally valued at Rs. 14,15,841 before the expiry of eight years from the end of the previous years in which they were acquired/installed. Hence development rebate amounting to Rs. 3,53,960 originally allowed on such plant and machinery was required to be withdrawn. Omission to do so resulted in under-assessment of income to that extent and under-charge of tax of Rs. 2,04,412.

The Ministry of Finance have accepted the objection.

(d) (i) In the revised assessment of an assessee company for the assessment year 1974-75 finalised on the 20 January 1979, an amount of Rs. 2,85,591, being the amount of development rebate that could not be adjusted against the profits of the year, was allowed to be carried forward. While rectifying the assessment of the assessment year 1975-76, on 7 December 1979, this unabsorbed development rebate was adjusted against the income of the year and hence there was no unadjusted balance left to be carried forward from the assessment year 1975-76 onwards. However, the same amount of Rs. 2,85,591 was allowed to be carried forward from the assessment year 1975-76 to 1977-78. This resulted in excess carry forward of Rs. 2,85,591 as unabsorbed development rebate.

The Ministry of Finance have accepted the objection.

(ii) In the assessment of an assessee company for the assessment year 1974-75 finalised in January 1977, unabsorbed development rebate of Rs. 2,43,255 relating to the assessment years 1967-68 to 1972-73 was given set off. It was, however, seen that the assessment for the earlier assessment year 1973-74 was subsequently revised in February 1978 and March 1978 for positive income wherein the development rebate for the assessment years 1967-68 to 1972-73 was recalculated and the increased

figure of Rs. 3,70,228 was given set off. In view of this, the previous year's development rebate of Rs. 2,43,255 originally allowed in the assessment year 1974-75 was to have been withdrawn. Failure to carry out consequent rectificatory orders for the assessment year 1974-75 resulted in under-assessment of income of Rs. 2,43,255 with consequent undercharge of tax of Rs. 1,53,250.

The Ministry of Finance have accepted the objection.

2.21 *Irregular allowance of contribution to scientific research*

In computing the business income of an assessee under the Income-tax Act, 1961, any sum paid by him to a scientific research association, university, college or other institution for scientific research, is an admissible deduction, provided that such association, university, college or institution is approved by the prescribed authority. With a view to encouraging development of indigenous technology and self-reliance in industry, the Act was amended in 1974 to provide that, if the contribution was to be used for specific research undertaken by the institution under a programme approved by the prescribed authority having regard to the social, economic and industrial needs of India, a deduction of a sum equal to one and one-third times of the contribution so paid shall be allowed.

In the previous year relevant to the assessment year 1976-77, an industrial company in which the public were substantially interested contributed a sum of Rs. 8,50,000 to two scientific research centres approved by the Council of Scientific and Industrial Research, which is the prescribed authority. In the assessment completed in April 1979, the department allowed the assessee's claim for extra deduction of 33-1/3 per cent of the contribution. Audit check, however, revealed that there was no approval from the prescribed authority for undertaking the specific research programme. This being so, the extra deduction of Rs. 2,83,333, being 33-1/3 per cent of the contribution, was not admissible under the Act. This resulted in short levy of tax by Rs. 1,63,626 and surtax by Rs. 29,927.

The Ministry of Finance have accepted the objection and stated that remedial action is being initiated. Further report is awaited (December 1981).

2.22 *Mistakes in allowing deductions under Chapter VI A*

Chapter VI-A of the Income-tax Act, 1961 provides for certain deductions to be made from the gross total income. The overriding condition is that the total deductions should not exceed the gross total income of the assessee. 'Gross total income' has been defined as the total incom computed in accordance with the provisions of the Act before making deductions under chapter VI-A. Set-off of un-absorbed losses of earlier years being an anterior stage, it follows that where such set-off results in reducing the total income to 'nil', no deductions under chapter VI-A are admissible.

The total income of an assessee company in respect of the assessment year 1975-76 was determined (assessment revised on 6 November 1979) at a loss of Rs. 44,835 before allowing any deductions under chapter VI-A. As there was no positive income no deduction under chapter VI-A was admissible. The department, however, allowed a deduction of Rs. 4,04,684 in respect of fees for consultancy services rendered in India (Section 80MM). This resulted in excess computation of loss with consequent excess carry forward of loss of Rs. 4,04,684.

The Ministry of Finance have accepted the objection.

2.23 *Mistakes in the computation of income from capital gains*

Under the Income-tax Act, the quantum of capital gains chargeable to tax on the sale of a capital asset is determined by deducting from the sale price, the cost of acquisition of the capital asset and of improvements, if any, made thereto and the expenses incurred for effecting the sale.

(a) The term "cost of acquisition" normally means the amount actually spent by the assessee in acquiring the asset. However, if the assessee had acquired the asset before 1 January 1954 (1 January 1964 from the assessment year 1978-79), he is given the option to adopt the fair market value of the asset as on 1st January 1954, as its cost of acquisition. This option is however not available if the asset was being used in his business and allowed depreciation. In such cases, only the actual cost of acquisition would form the basis of computation of capital gains. Where the asset had been acquired by the assessee by one of the special modes, (such as partition in his family, gift, will, dissolution of partnership, liquidation of company, amalgamation with another company etc.) and where the previous owner had acquired the capital asset before 1 January 1954, the option of substituting the fair market value as on that date is available to the assessee even in respect of depreciable assets.

(i) During the previous year relevant to the assessment years 1970-71, 1973-74 and 1974-75, a public limited company, running a textile mill, sold some of its business assets, such as factory buildings, plant and machinery, frames, boilers, etc. for Rs. 55,000, Rs. 6,62,277 and Rs. 1,89,440. The assets had been acquired by the assessee in 1947 or earlier and were being allowed depreciation every year. The capital gains arising from the sales were assessed as Rs. 19,311, Rs. 4,08,495 and loss of Rs. 3,58,070 respectively, with reference to the fair market values of the assets as on 1 January 1954 (which were higher than the actual cost of acquisition). The assessee would be entitled to adopt the fair market value, only if it had acquired the assets under any of the specified modes but audit check revealed that there was no evidence of such acquisition by the assessee. In fact, the assessee had described the year of acquisition of these assets as the 'year of purchase', indicative of acquisition for a price. The department's action in assessing the capital gains with reference to the fair market value was irregular and resulted in under-assessment of capital gains of Rs. 4,869, Rs. 15,070 and Rs. 3,72,517 leading to a total short levy of tax of Rs. 1,55,323.

The Ministry of Finance have accepted the objection.

(ii) In the case of another company, in the assessment for the assessment year 1972-73 made on 18-1-1980, a capital gain of Rs. 4,83,623 was determined in respect of a building which was sold for Rs. 8,70,000. The capital gain was arrived at by taking the fair market value of the building as Rs. 3,84,000 on 1 January 1954. As the assessee had acquired the building by purchase and as depreciation was allowed thereon from year to year the assessee was not entitled to substitute the fair market value on 1 January 1954 as cost of acquisition. The capital gain correctly assessable in this case worked out to Rs. 6,15,691 being the sale value less cost of building and expenses incurred in connection with the transfer of the asset. As a result of the incorrect computation of capital gain, there was under-assessment of income of Rs. 1,32,068 and under-charge of tax of Rs. 64,660, including interest of Rs. 5,229 leviable for late filing of the income tax return.

The paragraph was sent to the Ministry of Finance in May 1981 ; their reply is awaited (December 1981).

(b) Land admeasuring 12416 sq. metres, belonging to an assessee company was acquired by Government during the period relevant to the assessment year 1977-78 and an amount of Rs. 9,89,780, including solatium of Rs. 1,29,102 was paid to the company as compensation. While computing the gain arising from the transaction, the department did not take into account the solatium of Rs. 1,29,102 received by the company. Since solatium was part of the total compensation, its exclusion led to under-assessment of income of Rs. 1,29,102 with consequent undercharge of tax of Rs. 64,550.

The Ministry of Finance have accepted the objection.

2.24 *Income escaping assessment*

(a) Under the provisions of the Income-tax Act, 1961, a non-resident has to pay tax on any income which accrues or arises

to him in India. All income accruing or arising directly or indirectly to the non-resident from any business connection in India is deemed to accrue or arise in India and is taxable.

In computing the total income of a non-resident company in respect of the assessment year 1977-78, the department omitted to assess income of Rs. 8,68,075 representing commission received by the company in respect of exports effected through it by its Indian subsidiary and inventor's remuneration, which was in the nature of royalty. The omission led to under-assessment of income by Rs. 8,68,075 and consequent short levy of tax by Rs. 3,47,270.

The assessment was checked in Internal Audit; however, the omission was not reported.

The paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

(b) The Income Tax Act, 1961 provides for an allowance or deduction from the income of an assessee in respect of expenditure or trading liability incurred for the purpose of business carried on by the assessee. 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 the profits and gains of business or profession and the same is required to be charged to income-tax, as the income of the previous year in which such remission or cessation takes place.

(i) A sum of Rs. 6,69,000 representing provision for gratuity made in earlier years was written back in the accounts of the year relevant to the assessment year 1975-76, in the books of an assessee company (assessment made on 17 April 1979). Provision for gratuity to the extent of Rs. 6,68,485 had earlier been allowed as a deduction in the assessments in respect of the assessment years 1972-73 to 1974-75. Accordingly, an amount

of Rs. 6,68,485 was required to be treated as income chargeable to tax in respect of the assessment year 1975-76. This having not been done, income of Rs. 6,68,485 in respect of the assessment year 1975-76 escaped assessment. Taking into account the loss of Rs. 1,81,816 already computed in respect of the assessment year 1975-76 the net under-assessment of income was Rs. 4,86,669 involving a short levy of tax by Rs. 2,92,294 (including excess interest paid under section 214 of the Act).

The Ministry of Finance have accepted the objection.

(ii) An assessee company received two refunds of customs duty amounting to Rs. 96,200 during the previous year relevant to the assessment year 1976-77. These refunds were not included in its total income assessed to tax in respect of that year. The omission resulted in under-assessment of income by Rs. 96,200 and undercharge of tax by Rs. 55,555.

The Ministry of Finance have stated (August 1981) that although the assessee follows the mercantile system of accountancy in respect of its business, it has been allegedly following the cash system in respect of receipts from Government. However the assessment in respect of assessment year 1976-77 has been set aside and report on rectification and collection of additional demand is awaited (December 1981).

(c) The Income-tax Act, 1961, provides that income from business shall be computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee adopts the mercantile system of accounting, a legal liability incurred by the assessee is debited to his accounts and is allowed to be deducted in the computation of assessable income even if the actual payment thereof is not made during the accounting year. However, if no specific liability has arisen during the year or the liability incurred is only a contingent liability, its deduction is not permissible in that year even under the mercantile system

of accounting followed by the assessee. It has been judicially held that when a liability is disputed, it is either allowable as a deduction in the year to which it relates or in the year in which it is paid.

A company, following the mercantile system of accounting, claimed Rs. 70,44,000 relating to the period 16 March 1972 to 30 June 1976 as a deduction in computing the income in respect of the assessment year 1977-78. The liability was stated to be relatable to central excise duty payable on doubled yarn manufactured by the assessee company. The Excise Department had issued a notice to the assessee company to show cause why it should not be charged additional central excise duty of Rs. 51,20,018 for the period 16 March 1972 to 15 September 1975. The further sum of Rs. 19,23,995 (making upto Rs. 70,44,000) related to the period 16 September 1975 to 30 June 1976. The assessee disputed the claim and obtained an injunction from a High Court staying the Central Excise proceedings. Nevertheless, the assessee claimed the entire amount of Rs. 70,44,000 from its taxable income in respect of the assessment year 1977-78 instead of limiting it to what related to the assessment year 1977-78. The claim was allowed. The erroneous deduction resulted in under-assessment of income of Rs. 48,15,255 (taken *pro rata* as relating to the period 16 March 1972 to 30 June 1975) leading to short levy of tax of Rs. 27,80,808 in respect of the assessment year 1977-78.

The audit paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(d) Under the provisions of the Income-tax Act, 1961, the total income of a person should include all income that accrues to or is received by him during the year. Where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax in the year of receipt, if such income relates to such business.

A company engaged in the business of fabrication and manufacture of machinery went into liquidation in October 1972. In respect of the assessment year 1976-77, the liquidator realised an amount of Rs. 7,64,830 from the sale of imported goods and stock-in-trade worth Rs. 5,68,930, which had remained with the assessee company on the date of liquidation. The profit of Rs. 1,95,900 realised from the sale of stock was assessable in the hands of the company in respect of the assessment year 1976-77. The company did not return the profit and the assessing officer also did not subject it to tax in respect of the assessment year 1976-77. As a result, an income of Rs. 1,95,900 escaped assessment, leading to a short levy of tax Rs. 1,33,702.

The Ministry of Finance have accepted the objection.

(e) A company returned (December 1972) a loss of Rs. 26,40,962 in respect of the previous year relevant to the assessment year 1972-73. On a provisional assessment made in November 1973, the refund due to the company on account of advance tax paid by it for the year and the interest payable thereon, computed at Rs. 20,50,710 and Rs. 5,77,616 respectively were adjusted against the tax demands outstanding against its earlier assessments. The assessment was revised in December 1976 to give effect to appellate orders as a result of which interest amounting to Rs. 4,82,745 out of Rs. 5,77,616 was withdrawn. The balance of Rs. 94,871 constituted the income of the assessee for the previous year relevant to the assessment year 1974-75. The company did not, however, declare this income in respect of the assessment year 1974-75 and the department also did not include it in the assessment. The income of Rs. 94,871 escaped assessment and led to computation of loss in excess by an equal amount in respect of the assessment year 1974-75. Consequently there was undercharge of tax of Rs. 83,826 including short levy of interest on account of delay in submission of the return of income and short

payment of advance tax on its own estimate in respect of the assessment year 1975-76.

The Ministry of Finance have accepted the objection.

(f) A non-resident tea company received from the Government in May 1972 interest of Rs. 1,31,873 in respect of advance tax paid by the company in excess of the tax determined on regular assessment for the assessment year 1968-69. In the revised returns of income in respect of the assessment year 1973-74 furnished in July 1975 and September 1975, the company declared this interest received but in the assessment made on 26 March 1979 the department omitted to include the amount of Rs. 1,31,873 and bring it to tax. As a result there was undercharge of tax of Rs. 96,926. As the Government also paid interest on the advance tax paid by the company in excess of the tax determined on regular assessment in respect of the assessment year 1973-74, the aforesaid undercharge of tax of Rs. 96,926 led to excess payment of interest of Rs. 33,916 to the assessee company in respect of the assessment year 1973-74. The total short levy thus amounted to Rs. 1,30,844.

While accepting the objection, the Ministry of Finance have stated that the excess payment of interest of Rs. 33,916 has been recovered in January 1980 and the additional demand of Rs. 96,928 has also been raised and collected.

2.25 *Irregular set-off of losses*

(a) Under the Income-tax Act, 1961, any loss computed in respect of a speculation business carried on by the assessee shall not be set off except against profits and gains, if any, in another speculation business. Further, with effect from the assessment year 1977-78 the business of purchase and sale of shares carried on by companies which are not 'investment', 'banking' or 'finance' companies should be treated as speculation business.

A company carrying on, *inter alia*, the business of purchase and sale of shares also took up during the previous year relevant to the assessment year 1977-78, transport business and business of acquiring, hiring and running of river transport barges. According to the assessee's accounts for this year, income from boat hire business was Rs. 4,08,941 and interest income of Rs. 41,853 was derived from loans and advances granted by it. The assessee suffered a loss of Rs. 87,763 in its share dealing business. The Income-tax Officer while completing the assessment set off the loss of Rs. 87,763 against income computed. It was noticed that the company was neither an investment company as defined in the Act nor was its principal business that of granting loans and advances. Accordingly, the aforesaid loss of Rs. 87,763 arising out of share dealing business constituted a loss arising from speculation business and this could be set off only against income from speculation business. The incorrect set-off of speculation loss against income from other than speculation business thus resulted in under-assessment of income by Rs. 87,763 with consequent tax undercharge of Rs. 65,172 in respect of the assessment year 1977-78.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(b) Under the Income-tax Act, 1961, where for any assessment year, the loss under the head "profits and gains of business or profession" cannot be set off against any other income, such loss shall be carried forward to the following assessment year and shall be set off against the profits or gains of any business or profession, provided that the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant for that assessment year.

A company in which public were substantially interested, owned and managed a colliery and was also engaged in other business activities. The coal mines were taken over by the Coal Mines Authority Limited on 31 January 1973. On

the revised return submitted by the company for its previous year relevant to the assessment year 1974-75 the department computed in January 1978 the business loss of the company at Rs. 3,73,028 (loss of Rs. 9,00,762 on the working of the coal mine less business income of Rs. 5,27,734 in respect of other activities of the company). While computing the business income of the company for the previous year relevant to the assessment year 1975-76, the department incorrectly set off a loss of Rs. 3,73,008 as relating to the working of the coal mine business which had been discontinued in the earlier assessment year on account of nationalisation.

Further an unabsorbed depreciation computed at Rs. 3,02,375 included balancing allowance of Rs. 2,29,239 in respect of the assets of the coal mine of the company which were taken over by the Government at less than their written down book value. The incorrect set off of loss of a discontinued business against the business income of the company from other activities, in respect of the assessment year 1975-76, resulted in short levy of tax by Rs. 2,15,414. The incorrect set off of balancing allowance led to short levy of tax by Rs. 1,32,376. The short levy of interest (on failure to furnish the return of income in time and on shortfall in amount of advance tax paid on own estimate) was Rs. 1,17,194.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

2.26 *Mistakes in assessments while giving effect to appellate orders.*

(a) In its income tax return for the assessment year 1975-76, a private company (which was a partner in a firm) declared as its share of income from the firm to be a net loss of Rs. 7,42,980 (consisting of interest income of Rs. 16,70,168 and a business loss of Rs. 24,13,148). Pending finalisation of the firm's assessment, the Income-tax Officer completed (September 1978) the partner-company's assessment without

deducting its share of net loss (Rs. 7,42,980) from its total income. However, on the appellate authority directing the Income-tax Officer to modify the assessment to take into account the share of loss also, the assessment was revised in May 1979 accordingly. While revising the order, the total income was reduced by Rs. 24,13,148 ignoring the interest income of Rs. 16,70,168 from the firm. This resulted in a short levy of tax by Rs. 11,39,889.

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified raising an additional demand of Rs. 11,39,889. Report regarding collection is awaited (December 1981).

(b) In the assessment of a company in respect of the assessment year 1972-73 completed in February 1975, the Income-tax Officer added, *iter alia* a sum of Rs. 3,68,711 on account of under-valuation of closing stock. On an appeal preferred by the assessee the Appellate Assistant Commissioner, in his orders of February 1977, deleted the above addition and allowed several other reliefs, effect to which was given in March 1977. The company and department preferred appeals against the orders of the Appellate Assistant Commissioner and the Appellate Tribunal in their orders of July 1978 set aside the orders of the Appellate Assistant Commissioner with a direction to decide the issue afresh in accordance with law. The orders of the Tribunal were received in the Income-tax office in September 1978 but while effect was given to the orders, no action was taken on the sum of Rs. 3,68,711.

Similarly, in the assessment of the company for the assessment year 1973-74 completed on 18 September 1976 a sum of Rs. 6,85,777 added back in September 1976 on account of under-valuation of closing stock was subsequently deleted in May 1977 pursuant to an order of the Appellate Assistant Commissioner. The company as well as the department filed appeals to the Appellate Tribunal. The Tribunal in their orders of October 1978 granted some relief to the assessee but at the same time set

aside the deletion of 6,85,777 made by the Appellate Assistant Commissioner with a direction to decide the issue afresh in accordance with law. The Income-tax Officer, while revising the assessment pursuant to orders of the Tribunal, gave effect to the relief allowed to the assessee but omitted to withdraw the deletion of Rs. 6,85,777.

The omissions resulted in business income of Rs. 10,54,488 in respect of the two assessment years escaping assessment.

The Ministry of Finance have accepted in principle the audit observations regarding the time taken in passing fresh orders on undervaluation of closing stock. They have also informed that fresh orders have been passed by the Commissioner of Income-tax (Appeals) and the assessments revised in June 1981. Report regarding raising of additional demand and collection is awaited (December 1981).

(c) In the income-tax assessment of a non-resident shipping company, in giving effect to the orders of the Appellate Assistant Commissioner, the income originally assessed in respect of the assessment year 1971-72 was turned into a loss of Rs. 4,60,195. Consequently the assessment in respect of the assessment year 1972-73 was revised (in December 1978) to set off the loss in respect of the assessment year 1971-72. Subsequently, as per order of the Income-tax Appellate Tribunal (made in January 1979) the income in respect of the assessment year 1971-72 again turned into a positive income. This necessitated the revision of the assessment in respect of the assessment year 1972-73 in order to withdraw the set-off earlier given. The department, however, failed to rectify the assessment in respect of the assessment year 1972-73 till objection was raised by audit, whereupon rectification was made and under-assessment of income by Rs. 4,60.195 in respect of that year, involving short levy tax by Rs. 4,55,007 including interest leviable under the Act, was set right.

The Ministry of Finance have accepted the objection and confirmed (August 1981) that the assessment has been rectified since.

(d) Under the Income-tax Act, 1961, a domestic company in which the public are substantially interested incurring expenditure after 28 February 1973, wholly and exclusively on any of the items specified in the Act in connection with the development of export markets, is entitled to a weighted deduction from the taxable income at the rate of one and one-half times the amount of such expenditure.

A domestic company claimed weighted deduction of Rs. 60,43,885 equal to one-half of the total expenditure of Rs. 1,20,87,769 incurred by it towards the development of export markets, in the previous year relevant to the assessment year 1976-77. The assessing officer, while computing the income of the company in respect of the assessment year 1976-77, however, allowed deduction of Rs. 49,47,494 after disallowing certain items of expenditure. The assessee company preferred an appeal against the disallowance and the Commissioner of Income-tax (Appeals) in his order dated 15 January 1980 allowed certain reliefs to the assessee company. On the basis of the appellate order, the weighted deduction allowable to the assessee worked out to Rs. 55,33,996. While giving effect to the appellate orders, the assessing officer allowed weighted deduction of Rs. 58,92,011. Thus, deduction of Rs. 3,58,005 was allowed in excess in respect of the assessment year 1976-77 resulting in undercharge of tax by Rs. 2,06,747.

The Ministry of Finance have accepted the objection (November 1981). Report on collection of additional demand is awaited (December 1981).

(e) In the computation of business income of an industrial company in which the public were substantially interested, the of Rs. 90,000 towards estimated gratuity liability relating to its

managerial staff, and a provision of Rs. 3,75,224 relating to other staff ascertained on actuarial valuation in respect of the assessment year 1972-73 were rejected by the department on the grounds that the assessee had not created an approved gratuity fund. On appeal by the assessee, the Appellate Assistant Commissioner partly allowed the appeal (June 1978) on the basis of the Appellate Tribunal's decision on a similar issue in respect of an earlier assessment year, in which the Tribunal had allowed the provision for gratuity based on actuarial valuation, namely, that relating to the non-managerial staff and not the lump sum provision made in respect of the managerial staff. However, while giving effect to the Appellate Assistant Commissioner's orders in respect of the assessment year 1972-73 on 14 August 1978, the Income-tax Officer allowed also the lump sum provision of Rs. 90,000 relating to the managerial staff, in addition to the provision of Rs. 3,75,224 covered by the actuarial certificate. This resulted in under-assessment of income by Rs. 90,000 involving short levy of tax by Rs. 50,740.

In assessing the same assessee in respect of the assessment year 1970-71, deduction of Rs. 4,08,450 claimed under Section 80-J, (being six percent of the capital employed in two of its new industrial undertakings) was not allowed by the department (April 1978) on the ground that the two units had no surplus profits after setting off the unabsorbed depreciation/development rebate relating to the two units in respect of earlier assessment years. On appeal by the assessee, the Commissioner of Income-tax (Appeals) held (December 1978) that for allowing the deduction, the surplus from the new units should be arrived at on the current years figures only without taking into account the unabsorbed depreciation/development rebate in respect of earlier assessment years.

While giving effect to the appellate orders in February 1979, deduction was incorrectly allowed to the extent of Rs. 4,08,450 as against the correct figure of Rs. 2,06,624. The excess deduction resulted in short levy of tax by Rs. 1,11,004.

The Ministry of Finance have accepted the objection (September 1981). Report on rectification is awaited (December 1981).

(f) In revising the assessment of a company in order to give effect to appellate orders in respect of the assessment year 1976-77 (revised in February 1980), a deduction of Rs. 3,22,590 was allowed under Section 80-J of the Income-tax Act. But in doing so, deduction of Rs. 1,68,450 already allowed on this account in an earlier revision in September 1977 was omitted to be added back. This resulted in excess refund of Rs. 97,280 and payment by Government of interest under section 244 (1A) amounting to Rs. 31,000.

The Ministry of Finance have accepted the objection (November 1981) and have intimated the collection of additional demand of Rs. 1,28,280.

(g) In computing the income of a company in respect of the assessment year 1975-76 (assessment done in August 1978) excess provision of Rs. 4,32,455 on account of bonus was disallowed by the department. Deduction for the same amount was allowed in the assessment year 1976-77. The assessment in respect of the assessment year 1975-76 was revised on 13 September 1979 as a result of appellate orders, and the provision disallowed earlier was allowed in the assessment year 1975-76 itself. While doing so the deduction allowed in the assessment year 1976-77 was not withdrawn. This resulted in excess carry forward of business loss by Rs. 4,32,455.

The Ministry of Finance have accepted the objection and have intimated that the remedial action was completed in September 1981 and loss reduced.

Similarly, in computing the income of another company in respect of the assessment year 1975-76 (assessment done in August 1978) excess provision of Rs. 6,69,342 on account of bonus was disallowed by the department. Deduction for that amount was allowed in respect of the assessment year 1976-77.

The assessment in respect of the assessment year 1975-76 was revised on 13 September 1979 in order to give effect to appellate orders and the provision disallowed earlier was allowed in the assessment year 1975-76. The deduction allowed in the assessment year 1976-77 was not withdrawn. This resulted in excess carry forward of business loss by Rs. 6,69,342.

The Ministry of Finance have accepted the objection and have stated that the assessment has been revised in September 1981 and business loss of Rs. 6,69,342 reduced.

(h) While revising the income-tax assessment of an assessee company to give effect to the Appellate Tribunal's orders for the assessment year 1974-75 in August 1979, a deduction of Rs. 5,03,040 under section 80J of the Income-tax Act was allowed. While doing so, deduction of Rs. 2,26,066 already allowed on this account when the assessment was previously revised in November 1977 was omitted to be added back. This resulted in the grant of excess relief to the extent of Rs. 2,26,066 and consequent non-levy of tax of Rs. 1,53,468 including interest under Section 244 (1A).

The Ministry of Finance have accepted the objection.

2.27 *Excess of irregular refunds*

(a) In the case of a company, advance tax of Rs. 78,01,400 paid by it during the financial year relevant to the assessment year 1975-76, exceeded the amount of tax of Rs. 68,52,542 determined on regular assessment completed on 28 February 1979. The interest of Rs. 4,36,448 on the amount of advance tax deposited in excess was paid on 4 April 1979 to the company. It was noticed in audit that while completing the assessment in February 1979, the department had incorrectly allowed a sum of Rs. 1,33,27,561 against the correct amount of Rs. 1,13,27,561, on account of carried forward deficiency of relief for the assessment years 1973-74 and 1974-75 on a new industrial undertaking of the company. This had resulted in under-assessment of total income of the company by Rs. 20 lakhs with undercharge of

tax of Rs. 11,55,000. Taking this undercharge of tax into account there was no excess of advance tax paid by the assessee company over and above the tax payable by it and it was not entitled to any interest from Government. There was thus an excess refund of tax of Rs. 15,91,448 including interest.

The Ministry of Finance have accepted the objection.

(b) The Income-tax Act, 1961 provides that, where an assessee files a return of income claiming that the advance tax paid and the tax deducted at source exceed the tax payable on the basis of the return of income filed by him, the Income-tax Officer should make a provisional assessment to refund the excess tax paid by the the assessee, if the regular assessment is not likely to be made within six months from the date of the submission of the return. In doing so, the Income-tax Officer should give allowance for unabsorbed development rebate|business loss carried forward from the earlier year, provided the unabsorbed rebate| loss was computed in the regular assessment for that earlier year.

For the previous year ended 31 December 1973, relevant to the assessment year 1974-75, a public company returned (September 1974) an income of Rs. 36,62,873 and claimed, on that basis, a refund of Rs. 3,33,273 against advance tax paid. Accepting this claim, the department made (November 1974) a provisional assessment ordering a refund of Rs. 3,33,273. During audit (December 1977) it was seen that in declaring the income of Rs. 36,62,873, the assessee had set off unabsorbed business loss of Rs. 25,040 relating to the assessment year 1972-73 and an unabsorbed development rebate of Rs. 5,36,815 relating to the assessment year 1973-74 although the assessment for the assessment year 1973-74 had not been completed in November 1974, when the provisional assessment was made. The failure to disallow this claim by the Income-tax Officer resulted in wrong determination of income in the provisional assessment for the assessment year 1974-75 as Rs. 36,62, 873 as against the correct figure of Rs. 42,24,728. The adoption of wrong figures resulted

in refund of tax of Rs. 3,33,273 which was adjusted against the then existing tax arrears. On the completion of regular assessment in March 1977, a net tax demand of Rs. 3,49,562 was raised as against the refund of tax irregularly determined in the provisional assessment in November 1974.

While accepting the objection in principle the Ministry of Finance have stated that there is no real loss of revenue as the refund has been adjusted against the arrears. The incorrect adjustment of refund against arrears however resulted in the Government foregoing interest amounting to Rs. 90,850 on delayed payment/adjustment of tax by 2 years and 4 months.

(c) According to the procedure laid down by the Central Board of Direct Taxes, an order sheet showing briefly, the date-wise record of income-tax proceedings is to be maintained with each assessment record to show at a glance the action taken at different stages of proceedings. The order sheet is an important record as it has functional value. Omission to record complete details of proceedings during various stages of assessment resulted in excess refund of tax in two cases as detailed below :—

(i) An assessee company paid advance tax of Rs. 30,434 in the previous year relevant to the assessment year 1977-78. On the basis of the company's income-tax return filed on 1 November 1977) which showed a loss, the department made provisional assessment on 21 November 1977 and refunded advance tax of Rs. 30,434. When the department made a regular assessment subsequently on 12 February 1980, it once again refunded the amount of Rs. 30,434 and in addition paid interest of Rs. 8208 upto the date of regular assessment.

(ii) The income-tax assessment of another company in respect of the assessment year 1973-74 was revised in January 1980 computing the tax payable at Rs. 31,912. This demand was however wholly set off against a total credit of Rs. 33,553 comprising refunds of Rs. 14,432 and Rs. 19,121 and the balance amount of Rs. 1,641 was refunded to the assessee company. It was

noticed in audit that in December 1977 itself the amount of Rs. 14,432 had been refunded to the assessee company as a result of a rectificatory order passed on the assessment for the assessment year 1972-73. Thus there was double refund of tax to the extent of Rs. 14,432 in January 1980.

The above two paragraphs were sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

Avoidable payment of interest by Government

2.28 *Avoidable payment of interest due to failure to make provisional assessment*

Under the Income-tax Act, 1961 where the advance tax paid by an assessee exceeds the amount of tax payable as determined on regular assessment, the Government is liable to pay interest on the amount of advance tax paid in excess for the period from 1st April of the assessment year to the date of regular assessment. The Board issued instructions in April 1966 directing the Income-tax Officers to complete regular assessments as soon as possible after receipt of the returns.

In 1968 the Act was amended to provide for provisional assessment and grant of refund of advance tax paid in excess on the basis of provisional assessment. The Board also issued instructions that provisional assessment should be made in all cases where regular assessment is delayed beyond six months from the date of receipt of the return. These instructions were reiterated by the Board in March 1971 and again in July 1972.

In September 1974 the Board prescribed a register to be kept in the personal custody of the Income-tax Officer for noting down the cases where provisional assessments would have to be made. The Income-tax Officers were also required to leave notes on the files, giving reasons as to why regular assessments could not be completed within six months. While stating that any payment

of avoidable interest would be viewed seriously the Board required the Commissioners and the Inspecting Assistant Commissioners to call for half-yearly statements of interest paid, exceeding Rs. 1,000 in each case in order to satisfy themselves that the payment of interest was unavoidable.

In their further instruction of July 1977 the Board prescribed the proforma of a register to be maintained by the Income-tax Officers for making provisional assessments. All applications for provisional refunds and all returns with income exceeding Rs. 50,000 were required to be entered in this register as and when they were received. The Board also stated that provisional assessment for refund should be made not only in cases where the assessees had specifically claimed refunds but also where refunds were apparently due on the basis of the returns filed. Despite the controls prescribed by the Board, cases where provisional assessments were not done, continued to be noticed involving avoidable payment of substantial amounts of interest by Government.

It was noticed during the course of audit that in the assessments for the assessment years 1974-75 to 1977-78 of 15 companies in 8 Commissioners' charges advance tax and tax deducted at source amounting to Rs. 5,63,14,860 had been paid by the companies who filed their returns between July 1975 and January 1978. As refunds were, *prima facie*, due to these assessees, provisional assessments were required to be made under the Act as well as under the Board's instructions. No action was, however, taken by the assessing officers to make provisional assessments within the statutory period of six months, with a view to refunding the taxes paid in excess by the assessees. The regular assessments in respect of these assessees in respect of the assessment years 1974-75 to 1977-78 were completed between July 1977 and March 1980 and taxes amounting to Rs. 1,10,05,792 paid in excess were refunded to them along with interest of Rs. 42,01,641. Had provisional assessments been made in these cases within the prescribed time limit of 6 months,

payment of interest (for a period of over 2 years) amounting to Rs. 26,10,191 could have been avoided.

The above objections on the avoidable payments of interest by Government and failure to follow Board's instructions regarding making of provisional assessments were accepted by the Ministry of Finance except in one case. The Ministry have also stated that no remedial action for the failure is possible, the interest having been paid as per the provisions of the Income-tax Act.

2.29 *Avoidable payment of interest due to delay in implementing appellate orders*

Under the provisions of the Income-tax Act, 1961, where as a result of any order passed in appeal or other proceedings under the Act, refund of any amount becomes due to the assessee and the Income-tax Officer does not grant the refund within a period of 3 months from the end of the month in which such order is passed, the Government shall pay to the assessee simple interest at 12 per cent per annum on the amount of refund due, from the date immediately following the expiry of the period of 3 months aforesaid to the date on which the refund is granted. Instructions were issued by the Central Board of Direct Taxes in July 1962 to the effect that the Income-tax Officer should dispose of such refund cases within a fortnight of the receipt of appellate orders.

Consequent upon certain appellate orders passed in October 1973 and May 1975 by the Appellate Assistant Commissioner of Income-tax and Income Tax Appellate Tribunal respectively, an assessee company became entitled to a refund of Rs. 14,06,146 in respect of the assessment year 1970-71. The refunds which should have been granted in January 1974 and August 1975 were actually paid to the assessee in March 1974 and April 1976 only. The delay in the payment of the refunds resulted in payment of

interest of Rs. 38,547. Similarly in view of the Appellate Assistant Commissioner's orders passed in February 1976 the assessee company became entitled to a refund of Rs. 3,25,548 in respect of the assessment year 1971-72. Though the assessment was rectified in May 1976, the refund due was omitted to be considered. Subsequently, this refund was allowed by the department only in February 1977. As a result of delay of 8 months in the payment of the refund, the department had to pay interest of Rs. 26,040. Thus the total avoidable payment of interest in respect of the two assessment years totalled Rs. 64,587.

While accepting the objection in principle the Ministry of Finance stated that there was only slight delay in issuing the refund and the interest was paid according to the provisions of law.

2.30 *Avoidable payment of interest due to change of previous year*

The interest is payable on the amount by which the aggregate sum of advance tax paid by an assessee exceeds the tax determined on regular assessment.

An industrial company in which the public were substantially interested, used to close its accounts on the 31 March every year. Its income for the previous year ended 31 March 1978 was assessed as that of the assessment year 1978-79. Its accounts for the year ended 31 March 1979, were not closed on account of labour unrest and lock-out in the factory. After obtaining the consent (June 1979) of the Income-tax Officer, which is statutorily required, the assessee company charged the date of closure of its accounts to 30 June. Accordingly the income earned during the period of fifteen months from April 1978 to June 1979 became assessable as that of the assessment year 1980-81. In respect of the intervening assessment year 1979-80, there was no "previous year" and consequently no assessment was done. Prior to change of accounting period (decided upon in June 1979), the assessee had, in the normal

course, filed its own estimates of advance tax payable in respect of the assessment year 1979-80 and remitted during the period (September 1978 to March 1979) amounts totalling Rs. 59,92,750 towards advance tax. Immediately after the department gave its consent to the change in the accounting year, the assessee filed (on 30 June 1979) a nil return of income in respect of the assessment year 1979-80 and claimed refund of the entire amount of advance tax paid. On the same day, the the Income-tax Officer authorised not only the refund of the advance tax (Rs. 59,92,750), but interest of Rs. 1,19,854 also which was later (in October 1979) enhanced to Rs. 1,79,781.

In the absence of a "previous year" to the assessment year 1979-80 in respect which the assessee could have earned income, the department had no authority under the Act to initiate assessment proceedings in respect of the assessment year 1979-80, and consequently, the question of payment of interest by Government on the refund of advance tax in excess of "the tax determined on regular assessment" does not arise at all in respect of the assessment year 1979-80. This resulted in irregular payment of interest amounting to Rs. 1,79,781.

The Ministry of Finance have accepted the objection and stated that additional demand of Rs. 1,79,781 has been raised and collected.

2.31 *Irregular payment of interest on provisional assessment*

Under the Income-tax Act, 1961, interest at the prescribed rate is payable by Government to an assessee if the advance tax paid during any financial year exceeds the amount of tax determined on regular assessment. Where, however, a provisional assessment is done and any part of the advance tax paid, is refunded, interest thereon is not payable at the time of such refund but only on completion of the regular assessment, such interest being payable from Ist April of the assessment year to the date of regular assessment, provided that in respect of any amount refunded on the basis of provisional assessment, no interest shall be paid on it for any period after the date of such refund.

A public limited company was provisionally assessed in December 1975 in respect of the assessment year 1973-74 at a loss of Rs. 61.26 lakhs. The assessee was allowed a refund of Rs. 34.97 lakhs out of the advance tax paid. In addition, payment of Rs. 9.53 lakhs was also made on 27 March 1975 towards interest, though payment of interest was to be made only after completion of regular assessment. The regular assessment was made on 2 January 1978 and the total income was assessed at a positive figure of Rs. 77.66 lakhs; the tax payable was determined at Rs. 44.87 lakhs. Not only was the recovery of tax delayed on account of refund of advance tax but because of irregular payment of interest of Rs. 9.53 lakhs on the basis of the provisional assessment, this amount also had to be recovered. The demand has not been paid by the assessee so far (May 1981).

The Ministry of Finance have stated (November 1981) that the payment of interest was made in terms of the Board's instruction of August 1969, and advice of the Ministry of Law had been sought on the amendment of the said instruction, in the light of later High Court decision.

2.32 *Non-levy of Interest/penalty*

(a) The Income Tax Act, 1961 provides that a company responsible for paying any sum exceeding Rs. 5000 to any resident contractor for carrying out any work including supply of labour in pursuance of a contract between the contractor and the company shall at the time of credit of such sum to the account of the contractor or at the time of payment thereof, whichever is earlier, deduct an amount equal to 2 per cent of such sum as income-tax. Failure to deduct the tax shall make the company liable to interest at 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. The company is also liable, in such a case, to pay such penalty as the Income-tax Officer may direct but not exceeding the amount of tax in arrears.

Three companies, which made a total payment of Rs. 5,35,70,985 to their resident contractors during the previous years relevant to the assessment years 1975-76 to 1978-79, were required to deduct tax amounting to Rs. 10,71,416 from such payments. As the tax was not deducted, the companies were liable to penal interest and penalty amounting to Rs. 4,20,513 and Rs. 1,07,142 (calculated at the rate of 10 per cent of the tax deductible at source as was usually adopted by the department) respectively. These were not, however, levied by the department.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(b) Under the Income-tax Act, 1961 any person who has not been assessed previously has to send to the Income-tax Officer, in each financial year, before the date on which the last instalment of advance tax is due, an estimate of his total income for the relevant previous year and pay advance tax based on this estimate on the specified dates. Failure to file the estimate and pay the tax within the due date renders the assessee liable to pay interest. A minimum penalty of ten per cent of assessed tax is also leviable by the Income-tax Officer for failure to file the estimate of advance tax.

A non-resident company entered into agreements with two Indian companies for import of technical know-how by the Indian companies. The non-resident company which was not assessed previously received sums amounting to Rs. 22,50,000 from the two Indian companies in the previous year relevant to the assessment year 1976-77. The non-resident company filed a 'Nil' return in respect of the assessment year 1976-77, in February 1977, stating that the agreements were executed in the U.K. and the amounts were payable in the U.K. and that it had no business operation in India and so the income did not accrue in India. The department, however, held that the income accrued to the non-resident company in India and computed in September, 1979 a total income of Rs. 20,25,000 in its hands after deducting, on estimate, ten per cent of Rs. 22,50,000 on account of expenses

incurred for earning the income. Net tax of Rs. 8,90,157 was demanded accordingly. As the income arose and accrued in India, the assessee, who was not assessed previously, was required to furnish an estimate of the income and pay advance tax thereon on the specified dates. As the assessee had not furnished the estimate and paid advance tax for the previous year relevant to the assessment year 1976-77 interest of Rs. 3,64,941 was leviable. Further a minimum penalty of Rs. 89,015 was leviable for failure to furnish the estimate. The department did not however levy the interest and the penalty.

The paragraph was sent to the Ministry of Finance in June 1981 ; their reply is awaited (December 1981).

(c) Where an assessee had paid advance tax on his own estimate for any financial year and the advance tax so paid falls short of seventy five per cent of the tax determined on regular assessment, interest at the prescribed rate is chargeable on the shortfall in the payment of advance tax, from 1 April next following the relevant financial year to the date of regular assessment.

(i) An assessee company filed its estimate of advance tax at Rs. 6,60,000 on 14 December 1976, in respect of the assessment year 1977-78. It paid the advance tax accordingly. However, the advance tax so paid was less than seventy-five per cent of the assessed tax of Rs. 10,39,332 determined on 13 December 1970. The assessee was, therefore, liable to pay interest amounting to Rs. 1,21,376 calculated at the rate of twelve per cent per annum for the period 1 April 1977 to 30 November 1979, on Rs. 3,79,332 being the amount of advance tax short paid. The interest was however not levied by the department.

The Ministry of Finance have accepted the objection and stated that additional demand of Rs. 1,21,376 has been raised. Report regarding collection is awaited (December 1981).

(ii) In response to the notice demanding advance tax by the department for the previous years relevant to the assessment years 1971-72 and 1976-77, a company filed 'nil' estimate and did

not pay any advance tax. However, on regular assessment total tax of Rs. 6,45,905 became payable on the incomes of Rs. 6,48,852 and Rs. 4,98,680 in respect of the assessment years 1971-72 and 1976-77 respectively. Accordingly interest of Rs. 2.32,666 was chargeable in respect of the assessment years 1971-72 and 1976-77. No interest was, however, levied or demanded by the department.

While accepting the objection, the Ministry of Finance have stated that the assessments have been revised and a penal interest amounting to Rs. 18,852 only has been levied. The Ministry have added that the tax payable for both the years has been reduced to Rs. 1,11,144 and Rs. 73,371 respectively as per orders dated 22 May 1981 of the Commissioner of Income-tax while considering the assessee's plea for waiver of interest under the Income-tax Rules, 1962.

(d) Under the provisions of the Companies (Profits) Surtax Act, 1964, an assessee shall pay the surtax demand within 35 days of the service of the notice of demand on him and for any delay in payment beyond the period, he shall be liable to pay interest at the prescribed rates.

From the assessment records of an assessee company, it was noticed that there was delay in payments of surtax demanded by an assessee in respect of the assessment years 1970-71, 1972-73 and 1973-74 (the delay being beyond the prescribed period of 35 days). For the belated payment, the assessee was liable to pay interest of Rs. 97,834 in respect of the assessment years 1970-71, 1972-73 and 1973-74. While in respect of the assessment year 1970-71 interest to the extent of Rs. 15,141 as against Rs. 24,344, was levied and collected, no demands for interest were made in respect of the assessment years 1972-73 and 1973-74 or for balance of interest due in respect of assessment year 1970-71.

The omission resulted in short levy of interest by Rs. 82,693.

The Ministry of Finance have accepted the objection and stated that interest amounting to Rs. 82,693 has been collected in April 1981.

Other Topics of Interest

2.33 *Omission to take remedial action on internal audit objection*

For the purpose of checking the correctness of assessments made by the assessing authorities, the Central Board of Direct Taxes have created internal audit parties in every Commissioner's charge. According to executive instructions issued in 1977, the mistakes pointed out by them should be rectified by the assessing authorities promptly, by initiating remedial action within a month of receipt of their report and completing it, as far as possible, within three months.

During the previous year relevant to the assessment year 1972-73, a domestic company in which the public were substantially interested, was a partner in a registered firm. Its income-tax assessment for that year was completed (February 1975), provisionally adopting its share income from the firm as a loss of Rs. 3,85,826. Subsequently, in July 1975, the assessee brought to the notice of the department that the correct share of its loss, as determined in the firm's assessment, was only Rs. 1,59,359. However, the department failed to raise the requisite additional demand. The omission was also pointed out by the department's internal audit two years later, in August 1977. It was noticed in audit in November 1980, that despite the omission being pointed out by the internal audit, no action was taken to rectify the mistake. After it was again pointed out by Audit, the assessment was rectified in January 1981 raising additional demand of Rs. 33,154 which was also collected.

The Ministry of Finance have accepted the objection.

2.34 *Non-levy of additional income-tax*

Under the provisions of the Income-tax Act, 1961, where the profits and gains distributed as dividends within twelve months immediately following the expiry of the previous year by a company, not being a company in which the public are substantially

interested, are less than the statutory percentage of the distributable income of that previous year, the company is liable to pay additional income-tax at the prescribed percentage on the distributable income, as reduced by the amount of dividends actually distributed if any, within the said period of twelve months. By a notification issued in August 1969, the Central Government have exempted every Indian company from the payment of additional income-tax from the assessment year commencing on 1 April 1970, provided that such company (a) exports goods or merchandise out of India or (b) performs any constructional operations or renders any service outside India or (c) provides to any enterprise, institution etc. outside India any technical know-how, subject to the condition that such export receipts constitute fifty per cent or more of the gross receipts of the assessee and such receipts are received in or brought into India in accordance with the Foreign Exchange Regulation Act, 1947.

For the previous year ended 31 March 1977 relevant to the assessment year 1977-78, a closely held domestic company engaged in the business of providing technical know-how and exporting textile machinery and spare parts, did not declare any dividend despite having a distributable income of Rs. 2,89,293 No additional income-tax was levied on the ground that the assessee had exported spare parts and machinery worth Rs. 5,69,996 and in terms of notification of August 1969, the assessee was not liable for the levy. However, as the export receipts amounting to Rs. 6,43,636 were less than fifty per cent of the gross business receipts of Rs. 20,94,385, the exemption allowed to the company, in terms of the said notification, was not in order. This incorrect exemption resulted in non-levy of additional income-tax of Rs. 1,07,038 in respect of the assessment year 1977-78.

The Ministry of Finance have accepted the objection.

2.35 *Non-levy of interest*

Under the Income-tax Act, 1961, where advance tax paid by an assessee exceeds the tax determined by the department on

regular assessment, interest on such excess is payable by Government from the 1 April of the assessment year to the date of regular assessment. In case however, any part of such excess had been refunded on the basis of a provisional assessment no interest is payable on such part after the date of such provisional assessment.

Where an assessee has paid advance tax on his own estimate for any financial year and the advance tax so paid falls short of seventy five per cent of the tax determined on regular assessment, interest at the prescribed rate is chargeable on the shortfall from the first day of the next financial year. Where, however, the amount of advance tax refunded on provisional assessment results in the balance advance tax falling short of seventy five per cent of the tax determined on regular assessment there is no provision in the Act to levy interest on such excess refund.

In the case of eight assessees for the assessment years 1976-77 to 1978-79 advance tax totalling Rs. 22,52,509 was refunded on the basis of provisional assessments. On completion of regular assessments in these cases the total tax payable by the eight assessees was determined as Rs. 52,21,500. The advance tax paid less refund allowed on provisional assessment was less than seventy five per cent of the tax found payable on regular assessment in each of these cases. No interest on the amount of refund, which was found to be not admissible on regular assessment could be levied in the absence of any provision in the Act. Calculated at twelve per cent as prescribed for other purposes in the Act, an amount of interest of Rs. 2,83,558 would have accrued to the Government in these cases.

The Ministry of Finance have pointed out with reference to one case that the interest under Section 215 of the Income-tax Act has to be worked out as per existing provision in the Act, only on the difference between the regular tax and advance tax paid in full and not on the difference between the regular tax and advance tax retained after refunding a part of the advance tax. Reply in respect of the other cases is awaited.

SURTAX

2.36 *Surtax*

As a disincentive to excessive profits and to help to keep down the prices, a special tax called super profits tax was imposed on companies making excessive profits during the assessment year 1963-64 under the Super Profits Tax Act, 1963. This tax was replaced, from the assessment year 1964-65, by surtax levied under the Companies (Profits) Surtax Act, 1964. Surtax is levied on the 'chargeable profits' of a company insofar as they exceed the statutory deduction, which is an amount equal to 10 per cent (15 per cent from 1 April 1977) of the capital of the company or Rs. 2 lakhs, whichever is greater.

During the period under review, under-assessment of super profits tax/surtax of Rs. 59.48 lakhs was noticed in 80 cases. A few illustrative cases are given in the following paragraphs.

2.37 *Incorrect computation of capital*

(a) The Central Board of Direct Taxes have issued instructions in November 1974 that reserves for redemption of shares and exchange reserve are only provisions and not reserves and hence they are not to be included in computation of capital.

In computing the capital of an assessee company in respect of the assessment year 1975-76 it was noticed that capital redemption reserve of Rs. 15 lakhs and exchange reserve of Rs. 28,059 were incorrectly taken into account. This resulted in excess computation of capital and statutory deduction with consequent under charge of surtax by Rs. 61,123.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(b) Where no specific provision is made for payment of taxes and they are to be paid out of general reserve, the general reserve is to be reduced by such taxes since to that extent it is not a free reserve. The Finance Act, 1976 amended the relevant

provisions of the Surtax Act, 1964 to exclude such amounts while computing the capital base.

(i) In the case of a company, liability on account of taxation was not provided in the accounts for the previous year ending 31 March 1974. A note in the balance sheet as on 31 March 1974 indicated that tax liability was to be met out of general reserve. Therefore, the general reserve balance was required to be reduced by the amount of tax payable and the balance of the general reserve as on the first day of the previous year 1974-75 was alone to be considered in the computation of capital for the purpose of surtax for the assessment year 1975-76 (completed on 31 March 1980). Omissions to so exclude the tax liability resulted in excess computation of capital and statutory deduction, to the extent of Rs. 18,85,511 involving short levy of surtax by Rs. 4,95,716 in respect of the assessment year 1975-76.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(ii) In the surtax assessment of another company in respect of the assessment year 1975-76 (assessment completed in March 1979), it was noticed (February 1981) that although the company had substantial book profit during the previous year ending 31 March 1974 on the basis of which there was a net tax liability of Rs. 34,18,357, it had not made any provision for taxation. Accordingly, the general reserve for the purpose of computation of capital should have been reduced by the aforesaid sum of Rs. 34,18,357. Instead, the department reduced the general reserve by Rs. 8,61,000 only. The mistake resulted in computation of capital in excess by Rs. 25,57,357 with consequent short levy of surtax by Rs. 1,21,475 in respect of the assessment year 1975-76.

The Ministry of Finance have accepted the audit objection.

(c) Where any part of income, profits or gains of a company is not includible in its total income, its capital shall be the sum ascertained in accordance with the provisions of the Act diminished by an amount which bears to that sum the same proportion

as the amount of the aforesaid income, profits or gains bears to the total income amount of its income, profits and gains.

(i) While computing the capital of a non-resident tea company, for the purpose of levy of surtax in respect of the assessment year 1975-76, surplus in the profit and loss account, amounting to Rs. 43,65,791 on the first day of the relevant previous year, was incorrectly included in the capital. Further a sum of Rs. 8,41,223 being interest receipts from abroad, which was not includible in the total income, as computed under the Income-tax Act, was required to be taken into account for determining the proportionate capital for surtax purposes. However, this was not done. These mistakes led to short levy of surtax of Rs. 63,938.

The Ministry of Finance have accepted the objection.

(ii) Similarly in the case of another company, the capital of Rs. 6,65,68,127 of the company should have been reduced by Rs. 84,52,020 to arrive at the proportionate capital for the purposes of levy of surtax. Due to an arithmetical error, the department reduced the capital by Rs. 33,54,807 only, resulting in the adoption of a capital base in excess by Rs. 50,97,213. The arithmetical error in the computation of the capital base resulted in excess allowance of statutory deduction by Rs.5,09,721 in respect of the assessment year 1975-76, involving short levy of surtax by Rs. 1,37,024.

The Ministry of Finance have accepted the objection in principle.

2.38 *Incorrect computation of chargeable profits*

The chargeable profits of any year are computed with reference to the total income assessed for levy of income-tax for that year after making certain prescribed adjustments. Under the rules for computing the chargeable profits, the income received by an assessee by way of dividends from an Indian company is required to be excluded from the total income for this purpose.

In the income-tax assessment of a company in respect of the assessment year 1975-76, while computing its total income, a

deduction of Rs. 5,54,558 (being sixty per cent of inter-corporate dividend of Rs. 9,24,263 received by the company), was allowed as per the provisions of the Income-tax Act. Thus, under the aforesaid Rules, the sum required to be excluded from the total income for computing the chargeable profits was only Rs. 3,69,705. However, while computing the chargeable profits for levy of surtax in December 1978 the entire dividend income of Rs. 9,24,263 was excluded from the total income. This mistake resulted in under-assessment of chargeable profits by Rs. 5,54,558, with consequent undercharge of surtax by Rs. 1,52,980 in respect of the assessment year 1975-76.

The Ministry of Finance have accepted the objection and stated that the assessment has been revised raising additional demand of Rs. 1,52,980. Report regarding collection is awaited (December 1981).

2.39 *Omission to make surtax assessments*

There is no statutory time limit for completion of surtax assessments unlike in the case of income-tax assessments. Pursuant to the recommendations of the Public Accounts Committee contained in para 6.7 of their 128th Report (Fifth Lok Sabha), the Central Board of Direct Taxes issued instructions in October 1974 that proceedings for completion of regular surtax assessments should be taken up along with the income-tax proceedings and that the surtax assessments should be finalised within a month of the completion of relevant income-tax assessments. The Board further instructed that the surtax assessments should not be kept pending on the ground that the additions made to the income-tax assessments were disputed in appeal.

(a) The income-tax assessment of an assessee company in respect of the assessment year 1978-79 was finalised in October 1979 computing the taxable incomes and tax as payable thereon at Rs. 9,33,970 and Rs. 5,39,368 respectively. On that basis the chargeable profits of the company worked out to Rs. 3,93,647 which exceeded the amount of statutory deduction by Rs. 1,93,647.

The company had neither filed a surtax return nor was any action initiated by the department to call for the same. The chargeable profits of Rs. 1,93,647 therefore, escaped assessment resulting in non-levy of surtax of Rs. 72,283 in respect of the assessment year 1978-79.

The Ministrty of Finance have accepted the objection and stated that the demand for Rs. 72,283 has been raised which is being adjusted against the income-tax refund due. Further report is awaited (December 1981).

(b) The income-tax assessment of a private limited company in respect of the assessment year 1971-72 was finally completed in July 1978 at Rs. 9,05,360. According to the accounts of the company filed along with the income-tax return, its chargeable profits worked out to Rs. 4,55,610 which exceeded the amount of statutory deduction of Rs. 2,38,666 (10 per cent of capital of Rs. 23,86, 657 employed in the company) by Rs. 2,16,944. The company was therefore liable to surtax. The company neither filed any return nor did the department initiate action to call for the same. The omission resulted in non-levy of surtax of Rs. 54.236 in respect of the assessment year 1971-72.

The Ministry of Finance have accepted the objection in principle.

(c) The income-tax assessment of a private limited company which did not file its return of income in respect of the assessment year 1976-77 was completed *ex parte* under section 144 of the Income-tax Act, 1961, in March 1979. The tax payable was determined at Rs. 20 lakhs on the basis of details filed by the company in respect of the earlier assessment year 1975-76. Since there was no application from the company for cancelling the assessment under Section 146 of the Act, the assessment became final.

According to the accounts of the company filed in respect of the earlier assessment year 1975-76 for the purpose of income-tax

assessment, its chargeable profits worked out to Rs. 6,35,000 which exceeded the amount of statutory deduction of Rs. 2 lakhs (being greater than 10 per cent of capital of Rs. 5,91,500 employed in the company) by Rs. 4,35,000. The company was thus liable also to surtax. The department had not taken any action to call for the return in order to assess the company to surtax. Accordingly surtax of Rs. 1,69,564 leviable on the chargeable amount (Rs. 4,35,000) escaped assessment for the assessment year 1976-77. Further, penalty under provisions of section 9 of the Surtax Act, 1964 was also leviable for default in filing of the return.

The Ministry of Finance have accepted the objection in principle.

CHAPTER 3

INCOME TAX

3.01 Income-tax collected from persons other than companies is booked under the Major Head "021-Taxes on Income other than Corporation Tax". Under Article 270 of the Constitution, 85 per cent of the net proceeds of this tax, except insofar as these are attributable to Union emoluments, Union Territories and Union surcharges, is assigned to the States in accordance with the recommendations of the Seventh Finance Commission.

3.02 Some instances of mistakes noticed in the assessments of persons other than companies are given in the following paragraphs.

3.03 *Avoidable mistakes in the computation of tax*

Under-assessment of taxes of substantial amounts have been noticed year after year on account of avoidable mistakes resulting from carelessness or negligence. Such mistakes continue to occur in spite of remedial action taken by the department.

A few cases which came to the notice of Audit are given below :—

(a) An assessee remitted tax amounting to Rs. 1,50,000 on 28 February 1977 against the demand raised on 19 August 1976 for the assessment year 1973-74. The assessment was rectified on 31 March 1978 and credit for Rs. 1,50,000 was correctly taken into account. However, while giving effect to appellate orders of Commissioner of Income-tax (Appeals) on 23 March 1980, this credit was wrongly adopted

as Rs. 2,50,000 instead of Rs. 1,50,000 resulting in a wrong refund of Rs. 1,36,500 including interest payable to Government.

While accepting the objection the Ministry of Finance have stated that the assessment has been rectified raising additional demand of Rs. 1,36,500 which has been collected.

(b) In the case of an individual, an amount of Rs. 79,562 was determined on 31 March 1978, as the net tax refundable, in respect of the assessment year 1975-76. The amount was adjusted against the tax due from the same assessee in his status as a 'body of individuals'. On a subsequent revision of the individual's assessment in respect of the same assessment year 1975-76, which was done on 6 November 1979, the tax due from him was determined to be Rs. 1,01,020. The department overlooked the refund of Rs. 79,562 already made and raised a demand of Rs. 21,458 only instead of Rs. 1,01,020, resulting in short demand of tax by Rs. 79,562.

The Ministry of Finance have accepted the objection and have stated that the assessment has been revised raising an additional demand of Rs. 79,562. Report regarding collection is awaited (December 1981).

(c) The assessment of an individual, in respect of the assessment year 1977-78, was finalised in January 1980. While computing the total income the assessing officer disallowed certain items of expenditure for Rs. 52,401 but failed to include the amount as taxable income in the assessment. This resulted in under-assessment of income of Rs. 52,401, short levy of tax by Rs. 34,584 and non-levy of

interest of Rs. 18,485 entailing a total short levy of Rs. 53,069.

The paragraph was sent to the Ministry of Finance in September 1980; their reply is awaited (December 1981).

(d) Under the Income-tax Act, 1961, as applicable from the assessment year 1969-70, a non-corporate tax-payer resident in India incurring expenditure after 29 February 1968 wholly and exclusively on the development of export markets is entitled to a weighted deduction from the taxable income at the rate of one and one-third times the amount of such expenditure incurred by him.

(i) In the income-tax assessment of an assessee in respect of the assessment year 1977-78, (assessment completed on 10 August 1979), a weighted deduction of Rs. 2,80,997 (equal to one and one-third times the expenditure of Rs. 2,10,748 incurred by the assessee towards development of export markets was allowed by the department. It was seen in audit that the actual expenditure of Rs. 2,10,748 was already debited to the profit and loss account of the assessee before arriving at the net profit, which was adopted by the Income-tax Officer and that, while deducting the full amount of Rs. 2,80,997, the sum of Rs. 2,10,748 earlier debited was not added back. This led to under-assessment of income by Rs. 2,10,748 involving a short levy of income-tax by Rs. 1,51,085, including irregular interest of Rs. 11,990 paid by Government towards excess advance tax.

While accepting the objection, the Ministry of Finance have stated that the assessment has been rectified in October 1980, raising an additional demand of Rs. 1,52,595 inclusive of interest and the amount has been collected in March/April 1981.

(ii) For the previous year, relevant to the assessment year 1977-78, a registered firm returned an income of Rs. 93,242

after claiming, *inter alia*, a deduction of Rs. 68,690 towards export markets development allowance. The Income-tax Officer held (January 1980) that the allowance was admissible only to the extent of Rs. 15,503. Accordingly, to arrive at the taxable income with reference to the admitted income (Rs. 93,242), he should have added back Rs. 68,690 and deducted Rs. 15,503. But, in the actual working, while the deduction (Rs. 15,503) was made, the addition (Rs. 68,690) was omitted which resulted in under-assessment of income and consequent short levy of tax by Rs. 42,596 in the hands of the firm and its partners.

While accepting the objection the Ministry of Finance have stated that the assessments in the case of the firm and one partner have been rectified raising additional demands of Rs. 34,591 out of which Rs. 15,930 has been collected. Further report regarding revision in the case of the other partner and collection of balance of demand is awaited (December 1981). September 1981; their reply is awaited (December 1981).

3.04 *Incorrect computation of salary income*

The Income-tax Act, 1961 allows, under certain conditions, exemption from tax on remuneration of foreign technicians in the employment of Government or a local authority or statutory corporation or any business carried on in India. Exemption is admissible (i) on remuneration not exceeding Rs. 4,000 per month and (ii) on the tax paid on the remuneration exceeding Rs. 4,000 per month by the employer. In cases of payment of tax by Indian concerns on behalf of the technicians who are under the employment of foreign collaborators, it has been judicially held that the tax paid by the Indian concern is to be treated as 'Income from other sources' and subjected to tax.

(a) In the case of a foreign technician, exemption was allowed on the tax of Rs. 1,68,100 paid by the Indian concern in respect of assessment years 1977-78 and 1978-79. As he was an employee of the foreign collaborators, the tax paid by the Indian concern was to be treated as 'Income from other sources' and taxed. Because of the failure to do so, tax was

short levied by Rs. 1,13,597 in respect of the two assessment years.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(b) In the case of a foreign technician, who was the employee of an Indian company, the tax was paid by his employer but was treated as 'Income from other sources' though in that case it was required to be treated as perquisite and taxes on "tax-on-tax" basis. This resulted in under-assessment of tax by Rs. 26 lakhs in respect of the assessment year 1973-74.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

3.05 *Incorrect computation of income from house property*

Under the Income-tax Act, rental income from any buildings or lands appurtenant thereto owned by an assessee is chargeable to tax under the head "Income from house property". Where, however, an assessee derives rental income from vacant sites, the income should be charged under the head "Income from other sources". Computation of income under these two heads is done differently.

During the three previous years which ended on 31 March 1974, 31 March 1975 and 31 March 1976, relevant to the assessment years 1974-75, 1975-76 and 1976-77 a Hindu undivided family derived gross rental income of Rs. 20,408, Rs. 21,783 and Rs. 51,953 by letting out certain plots in an urban area. The assessee offered the income from this source, for tax under the head "Income from house property" and claimed deductions amounting to Rs. 76,337 towards municipal taxes, urban land tax, collection charges, repairs and cost of forming roads in the sites. The classification of the income by the assessee under the head "Income from house property" and the deductions

claimed were accepted by the department (March to December 1976) in the relevant income-tax assessments.

Audit check of the wealth tax returns of the assessee disclosed that he had no house property. The rental income received by him was, therefore, only from vacant sites, correctly assessable under the head "Income from other sources". The erroneous deduction of Rs. 76,337 resulted in short levy of tax of Rs. 56,947.

The Ministry of Finance have accepted the objection and have stated that the assessments have been rectified raising additional demand of Rs. 56,947 which has been collected.

3.06 *Incorrect computation of business income*

Under the provisions of the Income-tax Act, 1961, any expenditure, not being expenditure in the nature of capital expenditure or personal expenses of the assessee, which is incurred wholly and exclusively for the purposes of the business or profession, is allowable as deduction in computation of income chargeable under the head "Profits and gains of business or profession". But compensation paid to the partners in consideration for the transfer of their right to a property or for the transfer of business, is capital expenditure and hence this amount is not deductible from income. Also interest paid on borrowed money which is not expended for the purpose of the business would not be allowed as deduction in computation of business income.

(a) A registered firm claimed payment of Rs. 1,00,000 made by the firm to the retiring partners, as business expenditure. The payment was made for acquiring full rights, shares, titles, interest and property claims and demands of the retiring partners and was, therefore, of a capital nature. The amount of Rs. 1,00,000 was incorrectly allowed as business expenditure incurred towards stock in trade, and this resulted in short levy of income-tax by Rs. 57,339 in the assessment of the firm and its partners.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(b) In the case of a registered firm it was noticed that loans were granted free of interest to its partners (for their private use) and to another firm by raising loans from financiers. Interest on such borrowings was claimed and allowed as deductible business expenditure in respect of the assessment year 1978-79. Since the borrowed funds were not used by the firm for the purpose of its business, the interest paid on them would not be allowable as a deduction in computing the business income of the firm. Accordingly proportionate amount of interest charges of Rs. 72,800 paid, which was related to such borrowed funds, should have been disallowed while computing the business income of the firm. Omission to do so resulted in under-assessment of income by Rs. 72,800 in respect of the assessment year 1978-79 leading to short levy of tax by Rs. 56,461 in the hands of the firm and partners.

The Ministry of Finance have stated (February 1982) that the assessment has since been set aside and the Income-tax Officer has been instructed to critically examine the issue. Further report is awaited.

3.07 *Mistake in valuation of closing stock*

(a) Under the Income-tax Act, 1961, as amended by the Finance Act, 1975 and effective from 1 April 1976 income derived from the business of live-stock breeding or poultry or dairy farming is subject to tax. In computing the income, birds or animals used otherwise than as stock-in-trade and which died or became permanently useless for the purpose of the business are considered for allowing deduction. The difference between their actual cost to the assessee and the amount, if any, realised in respect of them or their carcasses is allowed as a deduction. Consequently, while computing the income, the question of their valuation at market rates would not arise since the cattle in question is not stock-in-trade of the business.

(i) A registered firm, was doing the business of dairy farming. The buffaloes maintained by the dairy farm were capital assets

and they did not represent stock-in-trade. The assessee's main business was not to buy and sell buffaloes. However, the business profits in respect of the assessment year 1979-80 were computed on 31 March 1980 by valuing the closing stock of buffaloes at market rate instead of at the cost price. This resulted in under assessment of income by Rs. 3,94,299 after allowing the statutory deduction admissible to a business of dairy farming and consequent short levy of tax by Rs. 2,78,272 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

(ii) Similarly in the assessment of another such firm in respect of the assessment year 1977-78, (assessment completed on 17 May 1980), loss in respect of useless buffaloes which were sold or cattle that died was allowed as deduction, but in addition the closing stock was also valued at market rates instead of at cost price. This resulted in excess deduction of Rs. 1,17,230 and under-assessment of income by Rs. 78,153 after allowing the statutory deduction admissible to the dairy farm. Consequently income-tax was short levied by Rs. 45,940 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objections.

(iii) In two other cases the business profits relating to dairy farming in respect of assessment year 1979-80 (assessment completed in March 1980) were computed by valuing the closing stock of animals, on estimate, instead of at the cost price or on the average cost basis. This resulted in an under-assessment of income by Rs. 5,94,066 after allowing the statutory deduction admissible on the business of dairy farming. Consequently tax was short levied by Rs. 2,91,849 in the hands of the firms and their partners.

The Ministry of Finance have accepted the objections.

(b) In order to determine the profits of his business, an assessee, who maintains his accounts on mercantile basis, may

choose to value the closing stock of his business every year, at cost price or market price whichever is lower. It has been judicially held that the privilege of valuing closing stock in a consistent manner would be available only to a continuing business and that it cannot be adopted where a business comes to an end when stock on hand should be valued in order to determine the true profits of the business on the date of closure of business. In such a case it has been held that the closing stock should be valued at the market price.

A partnership, dealing in jaggery, was valuing its closing stock every year at cost price (which was less than the market price). On 25 October 1975, the partnership was dissolved and the business was taken over by one of its partners. The assessment of income of the partnership firm, for the assessment year 1976-77, was completed in March 1978, and the income was determined at Rs. 49,230 adopting the value of closing stock on 25 October 1975 at Rs. 97 lakhs. Since the partnership ceased to exist on 25 October 1975 and proprietory concern came into being on that date, the closing stock of the terminated business (also the opening stock value in the new concern) was to be valued at the market value for purposes of computation of taxable profits in both the concerns. It was noticed in audit (January 1980) that the assessee had valued the closing stock at cost price and not at the market value which was Rs. 109.64 lakhs. As the profits related to a business which was terminated by the firm, the department should have adopted the market price (which was higher) as the value of the closing stock. Omission to do so resulted in under-assessment of income by Rs. 12,64,516 with consequent short levy of tax by Rs. 3,28,739 in the case of the partnership and by Rs. 4,21,307 in the hands of the partners.

The Ministry of Finance have stated (July 1981) that similar legal issue arising in another case has been referred to the Ministry of Law for advice and their advice is awaited. Final reply from the Ministry of Finance is awaited (December 1981).

3.08 *Other mistakes in the computation of business income*

(a) The total income of an individual, in respect of the assessment year 1973-74 corresponding to financial year 1972-73, was computed in September 1973, at Rs. 22,146. As a result of search (22 March 1974), conducted in his premises, the assessee was held to be in possession of total assets of Rs. 2,02,500 on 31 March 1972 and Rs. 3,02,169 on 31 March 1973. The Income-tax Officer, while completing (March 1980), the re-assessment of his income in respect of the assessment year 1973-74, treated Rs. 77,523 (the increase of Rs. 99,669 in his total assets from 1972 to 1973 less income assessed earlier at Rs. 22,146) as income from undisclosed sources. It was, however, seen that immovable property valuing Rs. 39,000 included in the total of assets as on 31 March 1972, was not found included in the total assets of Rs. 3,02,169, as on 31 March 1973. As a result, the income from undisclosed, sources was computed less by Rs. 39,000 resulting in short levy of tax by Rs. 35,860.

The Ministry of Finance have accepted the objection.

(b) Sales-tax collected by a business-man forms part of his trading receipts and is included in the total income computed for levy of income-tax and sales tax paid to Government is allowed as deduction. Accordingly any excess of tax collected over that paid to Government is taxable.

In the case of an assessee, an amount of Rs. 1,23,771 being the difference between the Central Sales tax collected from customers, at the rate of 4 per cent, and the sales tax paid to Government at 3 per cent, was not included in the total income of the assessee in respect of the assessment year 1976-77. This resulted in short demand of tax by Rs. 71,197 from the firm and from its partners.

The Ministry of Finance have accepted the objection and have stated that the assessments have been revised raising

additional demand of Rs. 71.197 out of which Rs. 32,976 have been collected. Further report is awaited (December 1981).

(c) Chapter VI-A of the Income-tax Act, 1961 provides for a number of deductions being made in the computation of total income. The aggregate amount of deductions to be made under the provisions of that Chapter should not, in any case, exceed the gross total income. Tax holiday under Section 80J is one of these deductions.

In assessing the income of a co-operative society, its income under the head "profits, and gains of business" was assessed at Rs. 1,06,02,217, in respect of the assessment year 1975-76 (assessment done in March 1980). Depreciation and development rebate, of earlier years, to the extent of Rs. 1,06,37,073 had been carried forward and were to be adjusted. There was also carry forward of tax holiday relief under Section 80J of the Act, amounting to Rs. 20,08,223. Depreciation and development rebate of earlier years to the extent of the profit assessed at Rs. 1,06,02,217 were to be first set off and the remaining unabsorbed development rebate of Rs. 34,856 carried forward. However, tax-holiday relief of Rs. 20,08,223 along with other items were incorrectly set off first against the income and unabsorbed depreciation of Rs. 21,03,079 was allowed to be carried forward. The tax holiday relief of Rs. 20,08,223 could not be carried forward beyond the assessment year 1975-76 *i.e.* beyond 8 years and a period of seven assessment years from the initial assessment year (namely 1968-69) had expired at the end of the assessment year 1975-76. The incorrect set off of the tax holiday relief in order to beat the legal limitation resulted in under-assessment of income by Rs. 6,02,755 (after allowing deduction of Rs. 20,000 under Section 80P) with consequent undercharge of tax of Rs. 2,60,810 in respect of the assessment year 1976-77 and also irregular carry forward of depreciation of Rs. 14,44,468.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

3.09 *Irregularities in allowing depreciation and development rebate*

The Income-tax Act, 1961, provides for grant of depreciation allowance on buildings, plant and machinery owned by the assessee and used for the purpose of business, in computing the income from business. The Rules prescribed in this regard provide for specific rates of depreciation for certain items of plant and machinery and a general rate of 10 per cent for the remaining items calculated on the written down value of the assets.

(a) In the case of a co-operative society, running a sugar mill, in arriving at the written down value of plant and machinery in respect of the assessment year 1975-76, extra shift depreciation allowance of Rs. 10,84,086 allowed in the earlier assessment year was omitted to be deducted from written down value. This error resulted in allowing depreciation in excess by Rs. 2,16,816 in respect of the assessment year 1975-76, Rs. 1,73,456 in respect of the assessment year 1976-77 and Rs. 1,38,762 in respect of the assessment year 1977-78. Further in respect of all the three years extra shift allowance amounting to Rs. 1,66,092 was allowed erroneously on electrical installation and weighing scales on which no extra shift allowance is admissible. The aggregate excess depreciation allowed in respect of the three assessment years amounted to Rs. 6,95,126.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(b) Under the provisions of the Income-tax Act, 1961, where an asset being building, machinery, plant or furniture owned by the assessee and used for the purpose of business or profession is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use), the amount by which the moneys payable in respect of such asset, falls short of the written down value thereof, is

allowable as a deduction provided such deficiency is actually written off in the books of the assessee. Further, the Act provides for allowance of any expenditure, not being in the nature of capital expenditure, laid out wholly and exclusively for the purposes of business or profession, in computing the income chargeable under the head "Profits and gains of business or profession".

The assessment of an Electric Supply Co-operative Society for the assessment year 1976-77 was completed in February 1977 at a loss of Rs. 23,75,580 representing unabsorbed depreciation on plant and machinery. The loss was arrived at, after deducting a sum of Rs. 13,14,388 being cost of transformers which were stolen (Rs. 1,79,147) or damaged (Rs. 11,35,241). However, the accounts rendered by the assessee showed that only an amount of Rs. 1,70,000 on account of damaged transformers, was actually written off in the accounts. The loss by way of theft was capital loss and was not allowable as admissible deduction.

The incorrect and excessive allowance of loss resulted in consequent excess carry forward of unabsorbed depreciation by Rs. 11,44,388.

Similarly, in respect of the assessment year 1977-78, deduction of Rs. 8,92,749 representing cost of stolen (Rs. 72,887) and damaged (Rs. 8,19,862) transformers was allowed in the determination of loss. Since an amount of Rs. 50,000 only was actually written off in the books of accounts and the admissible deduction was to be restricted to that amount, the excess deduction resulted in excess carry forward of unabsorbed depreciation by Rs. 8,42,749 in respect of that year.

The Ministry of Finance have accepted the objection and have stated that the assessments have been rectified in October 1980 and no additional demand has been raised as there was loss of Rs. 12,14,192 in respect of the assessment year 1976-77 and Rs. 24,98,809 in respect of the assessment year 1977-78 on account of carry forward of unabsorbed depreciation.

3.10 *Incorrect allowance of initial depreciation*

Under the provisions of the Income-tax Act, 1961, as applicable to the assessment years 1975-76 and 1976-77 initial depreciation equal to twenty per cent of the value is admissible in respect of new plant and machinery installed for production of one or more articles specified in the Ninth Schedule, in respect of the assessment year relevant to the previous year in which the plant and machinery were installed or put to use. A small scale industrial undertaking is, however, entitled to initial depreciation on the value of new plant and machinery installed and put to use for manufacture or production of any article whether the article is included in the Ninth Schedule or not.

Two assessees (registered firms) did not fall under the category of small-scale industry, but were engaged in the business of processing nylon yarn, and art silk cloth which did not fall in the Ninth Schedule. In the income-tax assessment of the assessees, in respect of the assessment year 1976-77 (assessment finalised in March 1979) initial depreciation of Rs. 3,14,690 being 20 per cent of the cost of the new plant and machinery installed during the relevant previous year was erroneously deducted. This resulted in under-assessment of income by Rs. 3,14,690 involving under-charge of tax by Rs. 2,52,474 (including Rs. 1,69,396 in the hands of the partners).

The Ministry of Finance have accepted the objection in principle.

3.11 *Irregular grant of export markets development allowance*

Under the Income-tax Act, domestic companies and resident non-corporate assessees who incur expenditure, under specified heads, on export of goods, services etc. outside India are entitled, subject to certain conditions, to an export markets development allowance equal to the actual amount of the qualifying expenditure plus an extra amount of one-third thereof.

In respect of the assessment years 1976-77 to 1979-80 the assessments of a registered firm were completed between March

to December 1979. The firm was engaged in business of export sale of hides and skins and claimed export markets development allowance in respect of trade discounts given to foreign buyers. The claim was accepted by the department. It has been held by the Supreme Court that the term "expenditure" would constitute something "actually paid out or away" and for the purpose of Income-tax Act a trade discount would not constitute expenditure. The Central Board of Direct Taxes has also clarified in January 1980 that trade discount would not qualify for such allowance. The claim of export markets development allowance on the trade discount was, therefore, not in order and should have been disallowed by the department. Omission to do so resulted in under-assessment of income by Rs. 2,39,903.

In respect of the assessment years 1976-77 to 1978-79 the allowance was given to the firm in respect of expenditure on staff salary, godown rent, stationery and postage and agents' commission incurred in connection with export sales. Under the Act, allowance was to cover only expenditure not incurred in India. However, it was noticed in audit that the entire expenditure was incurred in India and therefore it did not qualify for the allowance. The under-assessment of income on this account was Rs. 1,43,316.

In respect of expenditure incurred on or after 1 April 1978, an assessee is entitled to the export markets development allowance only if he is either a "small scale exporter" or a holder of an "Export House Certificate", as defined in the Act. The assessee-firm, in the instant case, was given allowance of Rs. 78,113 on expenditure incurred during the year ended 31 March 1979 (relevant to the assessment year 1979-80) in connection with export sales. But no evidence of the assessee being a small scale exporter or the holder of an Export House Certificate was available on record.

The above mistakes resulted in total under-assessment of income by Rs. 4,61,332 involving short levy of tax by Rs. 3,36,245.

The Ministry of Finance have accepted the objection.

3.12 *Irregular exemptions and reliefs*

(a) According to the provisions of the Income-tax Act, 1961 income derived from property held under trust wholly for charitable or religious purposes is exempt from income-tax to the extent to which such income is applied to such charitable or religious purposes in India. This exemption is not available if the funds of the trust are invested, for any period during the previous year, in any concern in which the trustees are substantially interested, if the quantum of investment is in excess of five per cent of the capital of the concern.

The income of a charitable trust which held 200 out of the total 2000 shares issued by a company in which the trustees were substantially interested was erroneously exempted from income-tax, although the investment by the trust in the said company exceeded five per cent of the capital of the company. The irregular exemption resulted in under-assessment of income by Rs. 86,200 in respect of the assessment year 1976-77, and short levy of tax by Rs. 42,933.

The Ministry of Finance have accepted the objection.

(b) Under the Income-tax Act, 1961 voluntary contributions received or income derived by a trust set up wholly for charitable purposes is exempt from income-tax, but not if such income is applied for purposes other than charitable purposes, which are defined in the Act.

A charitable trust applied Rs. 4,25,000 of its income in making donation to a sports association having the purpose of

promotion of cricket. The donation was deemed by the department as income applied wholly for charitable purposes in India. The Central Board of Direct Taxes had in its Circular of 23 August 1973 stated that such donations would not qualify for tax relief as the mere promotion of any game or sport was not regarded as a charitable purpose. The income-tax Act was, however, amended with effect from 1 April 1974, whereby for the purposes of allowing deduction of 50 per cent of such donations made to sports associations approved by Government from the income subjected to tax (and only for such purposes), such associations may be deemed to be established for a charitable purpose. Earlier in 1959 it had been judicially held that the mere promotion of the practice of the game of cricket, in general, either for entertainment of the public or for advancement of the game itself is not a charitable purpose and therefore income applied for such purpose by a charitable trust was not exempt from tax. Thus, in any case, income equal to 50 per cent of the donation i.e. Rs. 2,12,500 escaped tax of Rs. 1,37,545 in respect of assessment year 1975-76.

Correspondingly, under the Wealth-tax Act 1957, the sports association in question was assessable to wealth-tax as the property held by it being not property held for any public purpose of charitable nature, was not eligible for exemption. However, its wealth aggregating Rs. 3.02 crores in respect of assessment years 1974-75 and 1978-79 was not assessed resulting in non-levy of wealth tax of Rs. 33.10 lakhs.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

3.13 *Irregular allowance of relief in respect of newly established industrial undertakings*

(a) According to the provisions of the Income-tax Act, 1961, where the gross income of an assessee includes any profits and gains derived from a newly established industrial undertaking, the assessee becomes entitled to tax relief in respect of

such profits and gains upto six per cent per annum of the capital employed in the industrial undertaking in the assessment year in which the industrial undertaking begins to manufacture or produce articles and also in each of the following four assessment years. Under the rules prescribed for computing the capital employed in the unit, the value of the assets and liabilities as on the first day of the computation period is to be considered.

(i) In the case of a registered firm, the relief in respect of its new industrial undertaking was computed (in May 1979) at Rs. 2,23,550 in respect of the assessment year 1978-79, on the capital computed at Rs. 37,25,798 by averaging the values of the assets as on the first and last days of the previous year and without taking into account the liabilities as prescribed. The net value of the assets, after deducting liabilities as on the first day of the previous year was only Rs. 6,00,872, on which relief due at six per cent worked out to Rs. 36,052 as against a sum of Rs. 2,23,550 allowed by the department. This resulted in under-assessment of income by Rs. 1,87,498 and short levy of tax by Rs. 81,269 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

(ii) In the assessment of a registered firm, in respect of the assessment year 1977-78 (assessment completed in November 1979) relief on its new industrial undertaking was computed at Rs. 63,919 on the basis of capital of Rs. 10,65,322 employed on the first day of the computation perod *i.e.* first day of April 1976. However, liabilities to the extent of Rs. 10,16,522, which should have been deducted from the value of assets were ignored. The net value of the assets as on the first day of the previous year was only Rs. 48,800 and relief admissible at six per cent worked out to Rs. 2,928. Relief to the extent of Rs. 63,919 provided to the assessee resulted in under-assessment of income by Rs. 60,991 and short levy of tax by Rs. 28,978 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

(c) Where the gross total income of an assessee owning shares in a company included any income by way of dividends paid by the company in respect of such shares, the assessee was entitled to a deduction from such income or the part thereof as is attributable to the profits and gains derived by the company from its newly established industrial undertaking on which it is entitled to a deduction under the Act.

It was seen in the case of a private industrial company that in respect of the assessment years 1975-76 to 1977-78, there were no assessable profits from the new unit of industrial undertaking for which relief under the Act was claimed. Consequently, no deduction from the dividend income in the hands of three shareholders of this company was allowable in respect of the relevant assessment years. However, such deduction was allowed to the three shareholders. This incorrect deduction led to under-assessment of income by Rs. 1,02,975 in the aggregate in respect of the assessment years 1975-76 to 1977-78, involving short levy of tax by Rs. 70,889.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

3.14 *Incorrect deduction of expenditure on bonus*

Under the provisions of Income-tax Act, 1961 an assessee carrying on business or profession is entitled to a deduction in respect of any amount paid to an employee as bonus. But, under the amended provisions which came into effect from 25 September 1975, in respect of bonus paid to an employee in a factory or other establishment to which the provisions of Payment of Bonus Act, 1965 apply, the deduction shall not exceed the amount of bonus payable under that Act. The Central Board of Direct Taxes also clarified that in view of the above-mentioned limitation, resort cannot be had to the other provisions of the Act to claim deduction in excess even on the grounds of commercial expediency.

In the case of an assessee firm to which provisions of the Payment of Bonus Act, 1965 did apply, it was noticed that the assessee had claimed an expenditure of Rs. 87,510, in respect of the assessment year 1976-77, by way of ex-gratia payment for the accounting year relevant to the assessment year 1972-73 and the same was allowed by the department. Since the maximum amount of bonus had already been allowed in respect of the assessment year 1972-73, the ex-gratia payment made was not allowable. The incorrect allowance resulted in tax being short levied by Rs. 81,023 (including interest leviable) in the hands of firm and its partners.

The paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

3.15 *Income escaping assessment*

(a) The Income-tax Act, 1961 provides that if an assessee has made investments in any financial year and the Income-tax Officer finds that the amount expended on making such investments exceeds the amount recorded in this behalf in the books of account maintained by the assessee and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Income-tax Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

(i) The Income-tax returns of an assessee showed that he had made investments on the construction of a building. Assessments in respect of the assessment years 1974-75 to 1976-77 were completed on 24 January 1978 and a note was kept in the assessment order to the effect that the investment made should be examined on completion of the building with reference to the valuation report thereof. The valuation report was received in the Income-tax Office on 14 March 1978 indicating the cost of superstructure to be Rs. 10,73,900 as against the declared investment of Rs. 6,76,358. Although the assessment in respect of the assessment year 1977-78 was completed

a week thereafter (on 20 March 1978) action was not taken on the valuation report and there was omission to include the unexplained expenditure of Rs. 3,99,507 as income from undisclosed sources. This resulted in under-charge of tax by Rs. 3,73,714 and non-levy of interest of Rs. 1,07,094 in respect of the assessment years 1974-75 to 1976-77.

The paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

(ii) In the wealth-tax returns of an individual in respect of the assessment year 1978-79, there was an increase of Rs. 3,71,300 in his net wealth, compared to that in respect of the preceding assessment year, mainly due to discharge of debt liability of Rs. 2,92,000. The assessee's only source of income was share income from a firm and it amounted to Rs. 68,104 in respect of the assessment year 1978-79. The increase in wealth by Rs. 3,71,300 or the source of income by which debt liability was discharged was not explained. The increase was therefore required to be added as income of the assessee in respect of the assessment year 1978-79. Omission to do so resulted in undercharge of tax by Rs. 2,15,614 and non-levy of penalty for filing incorrect particulars of income.

The paragraph was sent to the Ministry of Finance in September 1981 who have in reply stated that debt liability was not discharged by the assessee but certain debts due were waived and certain liabilities were not claimed. The Department has since started gift-tax proceedings in that respect. Further report is awaited (January 1982).

(b) Under the Act, all income accruing or arising or deemed to accrue or arise to an assessee in India in a previous year relevant to the assessment year is includible in the total income of that assessee.

In the case of two foreign technicians who worked in India in different organisations during different periods within the same

previous year relevant to the assessment year 1977-78 (assessed in February 1980) only income from salary on account of their employment in a public sector company was brought to tax. Income from salary arising to them within the same previous year from another public sector company, where also they were employed, was omitted to be included and consequently there was undercharge of tax by Rs. 1,08,449 in respect of the assessment year 1977-78.

The Ministry of Finance have accepted the objection and have stated that the assessments have been revised raising a demand of Rs. 1,08,449 out of which Rs. 42,645 has been collected.

(c) Salary paid or due or allowed in the previous year is taxable in the assessment year relevant to the previous year in which it was paid or was due or was allowed by the employer. The expression 'salary' includes commission also.

In respect of the assessment years 1978-79 and 1979-80, the company, instead of paying the Commission in cash, as before, purchased deferred annuity policies for values of Rs. 25,482 and Rs. 30,000 respectively. These sums were neither returned by the assessee nor taxed by the department, although commission payable to the assessee was taxable on due basis under the head 'salary'. The omission resulted in under-assessment of income by Rs. 55,482 in the aggregate with resultant in short-levy of income-tax by Rs. 37,870 in respect of the two assessment years.

The Ministry of Finance have accepted the objection.

3.16 *Irregular computation of capital gains*

Any profits or gains arising from transfer of a capital asset are chargeable to income-tax under the head "capital gains." The capital gain is determined by deducting the cost of acquisition of the asset and of any improvements thereto, from the value of the consideration received or accruing on the transfer.

(a) Under the Act as it stood upto 31 March 1978 where the capital asset became the property of the assessee or of the previous owner before 1 January 1954 the fair market value of the asset as on that date is allowed to be substituted, at the option of the assessee, for the actual cost of acquisition for determining the amount of capital gain. It has been judicially held that in respect of depreciable assets, the concession of substituting the fair market value as on 1 January 1954 is available only if the asset became the property of the assessee by gift or will or on distribution of assets on partition of Hindu undivided family or dissolution of a firm or by other such specified modes and not, if such assets were acquired by the assessee by purchase.

An assessee, a registered firm, sold land, building and machineries during the previous years relevant to the assessment years 1972-73 and 1974-75. The assets were acquired by the assessee by purchase and depreciation was allowed thereon from year to year. While working out the capital gain for land, building, and machineries, the assessee substituted the value of the assets as on 1 January 1954, which was allowed by the department. This erroneous substitution resulted in incorrect computation of capital gain and consequently in an under-assessment of income by Rs. 8.21,166 involving short-levy of tax by Rs. 6,11,091 in the hands of the firm and partners.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(b) Where the gross total income of an assessee other than a company includes long term capital gains, and such capital gains do not exceed Rs. 5000, the whole of such long term capital gains shall be allowed as deduction. In any other case deduction will be Rs. 5000, as increased by 25 per cent of the amount by which the long term capital gain relating to capital assets being lands or buildings exceed Rs. 5000. In the case of an assessee, for the assessment year 1976-77 assessment was completed on

11 September 1979 but such deduction was erroneously allowed at 40 per cent instead of at 25 per cent and the excess deduction allowed amounting to Rs. 46,667 resulting in short levy of tax by Rs. 35,936.

The Ministry of Finance have accepted the objection.

(c) An assessee purchased a house in the year 1958, for Rs. 45,000 in the name of his minor sons. In the wealth tax assessment of the assessee, the Wealth-tax Officer had held that the house actually belonged to the assessee himself and the sons were only benamidars. The assessee sold the house for Rs. 2,00,000 on 3 January 1977, but the capital gains thereon was not brought to tax. By taking the cost of acquisition at Rs. 45,000, the capital gain which escaped assessment, for the assessment year 1977-78, was Rs. 1,12,500 after allowing deduction of Rs. 42,500 under Section 80-T of the Act. This omission led to short-levy of tax by 70,100.

The Ministry of Finance have accepted the objection.

(d) Where a capital gain arises from the transfer of a house belonging to the assessee and used by him or his parents as a residence for two years before the date of transfer and where the assessee had within a year before or after that, purchased or has within two years after that date, constructed another house for his residence, then the net excess of capital gains over the cost of the new house alone is chargeable to tax as 'income' of the previous year in which the transfer took place.

(i) The house property owned by an assessee was acquired by the State Government with effect from 25 September 1973, and from the capial arising out of the compensation of Rs. 10,09,184 paid by the State Government, the assessee claimed a deduction of Rs. 3,17,557 being the cost of construction of a new house property for personal use. In the assessment in respect of assessment year 1974-75, completed in February 1977

the deduction claimed was allowed by the department, even though, the construction of the new house had been completed much before the transfer of the said house property and the assessee had occupied it in August 1973.

The irregular allowance of deduction resulted in under-assessment of income of the assessee by Rs. 3,17,557 and short-levy tax by Rs. 2,01,767.

The Ministry of Finance have accepted the objection and have stated that the assessment has been rectified raising additional demand Rs. 2,01,767. Report regarding collection is awaited. (December 1981).

(ii) No exemption from tax would be admissible if the capital gain arising from transfer of house property was merely invested by way of advance for purchase of another house.

An assessee sold a house property (20 February 1979) in the previous year relevant to the assessment year 1979-80. The assessee claimed exemption from capital gains tax under the aforesaid provisions on the ground that he had invested the amount as an advance for purchase of a new house property and this was allowed by the department in the assessment, for the assessment year 1979-80, which was completed on 29 September 1979.

Since the purchase of the new house was not completed on the date of assessment, and the capital gains was merely utilised/ invested as an advance the exemption allowed was not in order.

It was, also seen in audit that the assessee died on 31 July 1979 and that the purchase of the new house property was completed only on 15 January 1980. Although the new property was purchased within one year of the sale of old property, it was not purchased by the assessee nor could it be any longer used for the purpose of the residence of the assessee in view of the fact that he was already dead. The incorrect exemption

allowed resulted in under-assessment of income of Rs. 2,86,948 and short-levy of tax by Rs. 1,44,612 in respect of the assessment year 1979-80.

The Ministry of Finance have accepted the objection.

3.17 *Omission to levy capital gains tax*

(a) Under the Income-tax Act, 1961 any profits or gains arising from the 'transfer' of a capital asset is chargeable to income tax under the head 'capital gains'. For the purpose of computation of capital gains the term 'transfer' has been defined in the Act to include "sale, exchange or relinquishment of the asset or extinguishment of any rights therein". It has been held that, when a person brings his assets into a firm, in which he is a partner, as his capital contribution, it amounts to a transfer of capital assets, as the person loses his exclusive right over the said assets which become the property of the firm, his right in the assets being limited to his share in money representing the value of the property of the firm.

(i) An assessee entered into partnership and transferred his plot of land at a value of Rs. 4,85,000 for which he was given credit in the capital account. The original value of the land in the hands of the assessee was only Rs. 35,600 as on 1 January 1954. Though the transfer of the land to the firm as share capital is "transfer" within the meaning of the Act and attracts levy of capital gains tax, no tax was levied by the department. Omission to do so led to under-assessment of income of Rs. 2,88,860 and consequent short levy of income tax by Rs. 2,70,647.

(ii) Another assessee transferred during the previous year relevant to the assessment year 1977-78 his jewellery acquired in the previous year relevant to the assessment year 1963-64 for Rs. 25,000 to a firm in which he was admitted as a partner. The firm credited the assessee's capital account with a sum of Rs. 1,20,000 being the value of his jewellery as per a valuer's report. This transaction amounted to a transfer of a long term

asset, involving a capital gain of Rs. 95,000 which was taxable. The department failed to tax the same which led to under-assessment of income of Rs. 54,00 involving non-levy of tax of Rs. 35,640.

(iii) An assessee transferred during the previous year relevant to assessment year 1975-76 his half share in an agricultural land to a firm, in which he was a partner. The capital gain arising from this 'transfer' was neither returned by the assessee nor assessed to tax by the department. The cost of the property as per wealth tax return of the assessee in respect of the assessment year 1970-71, was Rs. 40,939 and the market value as on 31 July 1974, as per department's valuation, was Rs. 1,88,000. Thus the capital gain on 1 January 1975, the date of transfer of property, worked out to Rs. 1,06,546 after allowing admissible deduction in respect of long term capital gains. The capital gains escaped assessment resulting in undercharge of tax of Rs. 82,043.

The Ministry of Finance in their reply in respect of these three cases have stated that the legal issues involved in the matter have been referred to the Ministry of Law whose advice is still awaited (December 1981).

(b) Any gain arising on transfer of a capital asset is chargeable to tax as income. Effective from 1 March 1970, the term 'capital asset' includes agricultural lands situated within the jurisdiction of a municipality or a cantonment board with a population of not less than 10,000 or within such distance not exceeding eight kilometers from the local limits of such municipality of cantonment board as may be notified by the Central Government. Also, it has been judicially held that, under the scheme of the Land Acquisition Act, 1894, land acquired by Government vests absolutely in Government only when the Collector takes possession of the land, whether before or after making his award determining the compensation payable against acquisition.

A piece of agricultural land situated in an urban area and belonging to an assessee was notified for acquisition under the Land Acquisition Act, 1894, on 9 August 1967. It was acquired by the State Government under an order of acquisition passed on 26 August 1970 and possession was taken on 15 February 1975. In respect of the assessment year 1976-77, the assessing officer accepted the plea of the assessee that he had lost the right to deal with the land after it was notified for acquisition on 9 August 1967 and hence the date of transfer of the property for purposes of levy of capital gains tax would be the date of that notification and on that date agricultural land did not come within the definition of 'capital asset'. However the actual transfer took place only on 15 February 1975, the date on which possession of the land was taken over by the Government. Accordingly, capital gains tax was leviable in respect of the assessment year 1975-76. Failure to assess capital gains of Rs. 95,467 led to non-levy of capital gains tax of Rs. 79.301.

The Ministry of Finance have accepted the objection.

3.18 *Mistakes in assessment of firms and partners*

(a) Under the Income-tax Act, 1961, firms are classified into registered firms and unregistered firms. A registered firm pays only a small amount of tax on its income, the rest of its income being apportioned among the partners and included in their individual assessments. An unregistered firm pays full tax on its total income. Where, at the time of completion of the assessments of the partners, the assessment of the firm has not been completed, the share income from the firm is included in the assessments of the partners on a provisional basis and revised later to include the final share income when the assessment of the firm is completed. For this purpose, the Income-tax Officers are required to maintain a "Register of cases of provisional share income" to guard against omission to do such revision. Instances of default in the revision of the partners' assessments in such cases have been commented upon in Paragraph 61(1) of the

Audit Report 1975-76, Paragraph 59 of Audit Report 1976-77, Paragraph 53(b)(ii) of Audit Report 1977-78, Paragraph 54 of Audit Report 1978-79, and Paragraph 3.11 of Audit Report 1979-80.

Based on the cases reported in the Audit Reports in the past, the Public Accounts Committee have, from time to time expressed concern at the delay in the revision of provisional assessments of partners' share income after completion of the firms' assessments and have taken serious note of the failure to keep a proper watch over such cases. Their recommendations/observations are contained in Paragraph 65 of their 21st Report (Third Lok Sabha), Paragraph 45 of their 28th Report (Third Lok Sabha), Paragraph 2.224 of their 186th Report (Fifth Lok Sabha). The Central Board of Direct Taxes also issued instructions in the matter in March 1973.

Eight more cases of omissions were noticed involving short levy of tax of Rs. 4,41,832 as detailed below :

(i) The income-tax assessment of a female partner of a registered firm for the assessment year 1971-72 was completed in December 1971, provisionally adopting her share income from the firm as Rs. 49,207. Even after eight years, no action was taken to ascertain her correct share income. In the meantime, in respect of another partner with equal rights in the firm, the Income-tax Officer received information that his correct share income for the same year was Rs. 1,98,884 and, on that basis, revised the assessment of that partner in October 1979. This information was not made use of, to amend the female partner's assessment. The omission to do so resulted in non-levy of tax of Rs. 1,25,875.

The Ministry of Finance have accepted the objection.

(ii) In three other cases relating to the assessment years 1971-72 to 1976-77, the assessments of partners of three

different firms were completed by taking provisional share incomes from the firms. A note of the pending action was not kept in the prescribed registers. Though the assessments of the firms were finalised subsequently, no action was taken to revise the assessments of the partners adopting their correct share incomes. The omissions resulted in short levy of tax of Rs. 1,23,577.

The Ministry of Finance have accepted the objection and have stated that the assessments have been revised raising additional demand of Rs. 1,23,577 out of which a sum of Rs. 38,822 has been collected. Report regarding realisation of balance demand is awaited (December 1981).

(iii) In the case of a registered firm, the share incomes of two partners were assessed on provisional basis for the assessment years 1974-75 to 1977-78, subject to revision on completion of the assessment of the firm. The assessments of the firm for the assessment years 1974-75 to 1977-78 were completed in March 1977, March 1978, September 1979 and August 1980 respectively, but the assessments of the partners on the basis of final share incomes were not revised even after a period of 3 to 44 months after the completion of revised assessments of the firm. It was also noticed that no note for making such a revision had been kept by the Income-tax Officer in the prescribed register to watch revision of partner's assessments. This resulted in short demand of tax by Rs. 1,23,285.

The Ministry of Finance have accepted the objection and have stated that the assessments have been rectified raising additional demand of Rs. 1,23,285. Report regarding collection is awaited (December 1981).

(iv) Two assessees were partners in a firm and the assessments of the partners for the assessment year 1975-76, were completed on the basis of the assessment of the firm made in March 1978. The firm's assessment was subsequently revised in September 1978. The consequential revision of the partners' assessments was not made till it was pointed out in Audit in October 1980. The omission to revise partners' assessments

resulted in a tax under charge of Rs. 69,095 including interest in respect of the assessment year 1975-76.

The Ministry of Finance have accepted the objection.

(b) Under the Income-tax Act 1961 and the Rules made thereunder, applications for registration of firms are required to be signed personally by all the partners in the firm, but if a partner is absent from India, the application may be signed by a person duly authorised by him in this behalf. If these conditions are not fulfilled, the firm has to be assessed as an unregistered firm.

A firm was granted registration in respect of the assessment years 1975-76 and 1976-77 and assessments were completed in February 1979. On scrutiny of application forms for registration for these years it was noticed that in respect of one partner (out of twelve partners in the firm), a person who was said to be holding a power of attorney from him had signed the application forms. Neither the power of attorney was obtained and kept with the records nor was there any proof to show that the said partner was absent from India. The registration granted to the firm was not in order and additional tax which was leviable by treating the firm as unregistered firm in respect of both the assessment years 1975-76 and 1976-77 was Rs. 78,078. This was not levied.

The Ministry of Finance have accepted the audit objection.

3.19 *Omission to include income of spouse/minor children*

(a) Under the provisions of the Income-tax Act, 1961 in computing the total income of an individual, there shall be included all such income as arises directly or indirectly to the minor child of the individual from the admission of the minor to the benefits of partnership in a firm. For this purpose, the income of the minor shall be included in the income of that parent whose total income is greater.

In the case of an assessee, assessments in respect of the assessment years 1976-77 to 1978-79 were completed in October

1976, August 1977 and August 1978 respectively but incomes of the minor children were not included in the total income of either of the parents in respect of the assessment years 1976-77 and 1977-78. The inclusion was not made in the total income of the assessee who was the mother of the minors and whose total income was greater in respect of the assessment year 1978-79. This resulted in under-assessment of tax by Rs. 44,606.

While accepting the objection the Ministry of Finance have stated that the assessments have been rectified raising additional demand of Rs. 44,606 which has been collected.

(b) The Act as amended from 1 April 1976, provides that the income arising to a minor child of an individual from the admission of the minor to the benefit of partnership is to be included in computing the income of that individual even if such individual is not a partner in a firm.

In three Commissioners' charges it was noticed in audit that share income of 16 minor children who were admitted to the benefits of partnership firms amounting to Rs. 3,25,651 in the aggregate, in respect of different assessment years from 1976-77 to 1978-79 were not included in the hands of the respective parents. Omission to do so led to under-assessment of income by Rs. 3,25,651 resulting in short levy of tax and interest by Rs. 2,27,213 in the aggregate.

The Ministry of Finance have accepted the objection in respect of 8 minor children. Reply in respect of the remaining cases which were referred to them in August 1981, is awaited (December 1981).

(c) Under the provisions of the Income-tax Act, in computing the total income of an individual, there shall be included all such income as arises directly or indirectly to the spouse of such individual from the membership of the spouse in a firm carrying on a business in which such individual is a partner, and also any income received by the spouse of such individual

by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest.

The salary received by the wife of an assessee during the previous year relevant to the assessment year 1976-77, from the proprietory concern of the assessee, was clubbed with the income of the assessee. However, for the assessment year 1977-78 (assessment completed in June 1980), the salary income of the wife was not so included. The wife was also employed in a private limited company in which the assessee had substantial interest. The salary received by the wife from that company should also have been clubbed with the income of the assessee but was not so included in respect of the assessment years 1976-77 and 1977-78. Consequently, there was underassessment of income by Rs. 25,800 in respect of the assessment year 1976-77 and by Rs. 43,200 in respect of the assessment year 1977-78 in the hands of the assessee. In all, tax short levied in respect of the two years aggregated Rs. 46,793.

The paragraph was sent to the Ministry of Finance in July 1981; their reply is awaited (December 1981).

3.20 *Short-levy or non-levy of interest/penalty*

(a) According to the provisions of the Income-tax Act, 1961, where the return of income is not furnished by an assessee within the specified date, interest at the prescribed rate is chargeable from the day immediately following the specified date to the date of furnishing the return or where no return is filed and assessing officer makes assessment on best judgement, to the date of completion of such assessment.

An individual having income from 'salaries' and 'other sources' in respect of the assessment year 1974-75, did not furnish the return of income for that year in spite of notice issued to him by the department. His total income in respect of that year, on best judgement, was assessed on 15 March 1980 at Rs. 1,17,930. For the default in filing return, interest was

chargeable for a period of sixty eight months *viz.* from 1 July 1974 to 29 February 1980 which worked out to Rs. 51,822 against that, interest of Rs. 7,733 only was levied by the department resulting in short levy by Rs. 44,089 in respect of the assessment year 1974-75.

The Ministry of Finance have accepted the audit objection.

(b) Under the Income-tax Act, 1961, where the amount specified in a notice of demand is not paid within thirty five days of the service of the notice the assessee is liable to pay interest from the day commencing after the end of the said thirty-five days upto the date of payment of tax.

The assessment of an individual in respect of assessment year 1963-64 was completed in February 1968 raising a demand of Rs. 2,53,046. No demand notice for the said amount was, however, served on the assessee, though a number of notices in connection with various proceedings were served on him from October 1968. In March 1969 a certificate of recovery was sent to the Tax Recovery Officer on the tax and penal interest of Rs. 20,447. In July 1970, the assessee, on receipt of a letter stated that he had been allowed to pay the demand in instalments. The demand of Rs. 2,53,046 was later reduced to Rs. 1,90,137 in June 1974 pursuant to an appellate order. The assessee declined to pay interest of Rs. 20,447 (levied on account of delay in payment) on the ground that demand notice had not been served on him and thereupon the interest demanded was reduced to Rs. 16,422. The assessment was again revised in March 1975 and a demand notice (for the first time) was served on the assessee on 25 September 1975 for Rs. 1,46,441. In March 1977, the Income tax Officer issued a revised certificate showing interest of Rs. 16,422 only (as was determined on revision of the assessment in June 1974) and recovered it by adjustment against refunds due in respect of the assessment year 1973-74. Owing to the failure to issue the demand notice in February 1968 for Rs. 2,53,046 interest on the amount due or on the final demand of Rs. 1,46,441 could not be demanded or realised. This led to loss of interest of Rs. 1,06,849.

The Ministry of Finance have stated (January 1982) that the demand notice had evidently been served on the assessee as he has filed an appeal against the Income-tax Officer's order on 11 April 1968. Their reply on the loss of interest is awaited.

(c) Under the provisions of the Income-tax Act, 1961, effective from 1 April, 1976, where any tax payable on the basis of a return and an assessee fails to pay the tax or any part thereof, the Income-tax Officer may direct that a sum equal to two per cent of such tax or part thereof shall be recovered from him by way of penalty for each month during which the default continues.

An assessee submitted his income-tax return in respect of the assessment year 1976-77 on 1 March 1977. He was required to pay tax on self assessment basis at Rs. 5,39,791 prior to submission of the return. However, he paid only an amount of Rs. 1,50,000 on 24th August 1977 and Rs. 3,36,721 on 18 October 1977 i.e. after filing the income-tax return. The penalty of Rs. 82,292 for late payment of tax on self assessment basis was not levied.

The Ministry of Finance have accepted the objection.

3.21 *Excess carry forward of loss*

Under the Income-tax Act, 1961 as it stood prior to 1 April 1980, only income and not loss arising to the spouse of an individual from the membership of the spouse in a firm carrying on a business in which such individual was a partner was to be included in the total income of such individual.

While completing the income tax assessments of an individual assessee for the assessment years 1977-78 and 1978-79 the assessing officer wrongly included the share of loss of his spouse amounting to Rs. 53,306 and Rs. 65,051 respectively in the hands of the assessee resulting in excess carry forward of loss of Rs. 1,18,357.

The Ministry of Finance have accepted the objection and have stated that the assessments have been rectified in December 1980 reducing the loss by Rs. 1,18,357.

3.22 *Irregular carry forward and set off of loss*

Under the Income-tax Act, the unabsorbed business loss incurred by an assessee in respect of an assessment year is carried forward and set off against the assessee's business profits in subsequent years. But, where the assessee is a registered firm, the unabsorbed business loss should not be so carried forward by the firm but should be apportioned among the partners of the firm in respect of the same assessment year. It will be set off against their other income by the partners and unabsorbed loss carried forward by the partners.

In respect of the assessment years 1975-76 to 1977-78, a registered firm incurred business losses, which were determined by the department at Rs. 80,937, Rs. 2,69,230 and Rs. 1,64,890 respectively in the assessments completed between March 1979 and March 1980. In respect of the subsequent assessment years 1978-79 and 1979-80 (assessment completed in March 1980), the Income-tax Officer erroneously set off the above business losses against the business profits of the firm, thereby reducing the firm's income from Rs. 1,08,360 and Rs. 1,12,107 respectively to nil. The irregular set off resulted in non-levy of income tax of Rs. 28,650 on the registered firm. It also led to consequential escapement of income of Rs. 1,91,817 from tax in the hands of the two partners in respect of the same assessment years and non-levy of tax of Rs. 54,660. In all, tax of Rs. 83,310 remained to be levied.

The Ministry of Finance have accepted the objection and have stated that the assessments are being revised. Further report is awaited (December 1981).

3.23 *Compulsory Deposit Scheme (Income-tax Payers), 1974*

Under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974 in respect of the assessment year 1975-76 and onwards where the current income of an individual or Hindu undivided family or trustees of discretionary trusts exceeds fifteen

thousand rupees, the assessee is required to make a compulsory deposit at specified rates and by specified dates. If the assessee fails to make the deposit or the deposit made by him falls short of the requisite amount, he is liable to pay penalty at 25 per cent of the amount of compulsory deposit not paid or short paid.

Mention was made of non-levy of penalty on default in payment of compulsory deposit, in paragraph 64 of Audit Report 1976-77. Pursuant to the audit observations the Central Board of Direct Taxes, their Directorate of Inspection, directed the Commissioners, in March 1979, to ensure that in all cases of default suitable action is promptly taken and collection of deposits is effectively watched and controlled.

The All India statistics compiled by the department indicate that the number of assessees having incomes assessed at above Rs. 15,000 (who are liable to make compulsory deposits) around 6,50,000 in respect of the assessment year 1978-79. The amount of deposits credited, in Government accounts, under the Compulsory Deposit Scheme (Income-tax Payers) was Rs. 139 crores and Rs. 125 crores in respect of the accounting years 1978-79 and 1979-80 respectively.

Based on a test check conducted during the course of audit in 127 wards under 25 Commissioners' charges it was noticed that out of 39,660 assessees who were liable to make compulsory deposits under the scheme, in respect of the assessment years 1977-78, 1978-79 and 1979-80, only 25,238 (64 per cent) assessees had deposited the required amounts in full. Deposits amounting to Rs. 86,50,053 had not been made by 10,428 assessees in respect of the three assessment years. Though failure to make the deposit or delay in making it, renders the assessee liable to levy of penalty, action to levy penalty under the Act was taken by the department only against 8,002 assessees. Also penalties amounting to Rs. 3,16,568 were imposed only on 1,742 assessees and only Rs. 1,25,943 had been recovered there against.

As on 31 March 1980 deposits amounting to Rs. 77,79,262 had not been collected though due, and penalties amounting to Rs. 7,88,039 had also not been collected in the said 127 wards where test check was conducted. It was further noticed that only in 3 out of the 127 wards, records to watch the levy and recovery of compulsory deposits were maintained.

In a separate test check conducted in 11 Commissioners' charges in a metropolitan city and in three Commissioners' charges in three leading cities, it was noticed with regard to 850 assessees, who had not made compulsory deposits in respect of the assessment years 1975-76 to 1978-79 that penalties amounting to Rs. 5,88,940 had not been levied.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

OTHER TOPICS OF INTEREST

3.24 *Defalcation of tax collected in a tax recovery office*

It was noticed in audit in September 1976 that the entries in the stock register of receipt books relating to a Tax Recovery Officer did not tally with the receipt books which were with him since 8 October 1975. The stock in hand was physically verified last on 30 October 1972. A few fraudulent receipts came to the notice of the department in February 1978. Detailed investigation by the department revealed that only 48 out of 50 receipt books received from the form stores of Government of India in October 1975 were available (they were taken on stock in April 1978) and for a sum of Rs. 27,644 receipts had been issued from the two missing books and the said amounts had not been credited to Government upto August 1978 and were apparently misappropriated. By January 1979, the department had detected two more cases of embezzlement involving Rs. 8,849 and by then 86 receipts forms were still to be accounted for. A clerk was placed under suspension and departmental enquiry proceedings instituted against him were in progress (November 1980).

The following procedural mistakes were noticed in audit ;

(i) Blank receipt books on receipt from the form stores were not entered in the Register of receipts and issues of receipt books nor were details of issues together with name of person(s) to whom they were issued noted therein.

(ii) Receipt books were not kept under lock and key in the personal custody of officers authorised to sign receipts on behalf of Government.

(iii) More than one receipt book was issued to an official and return of counterfoils of used books were not watched and proper accountal of realisations checked.

(iv) The system of notifying to the public (through newspaper advertisements) the names of officials authorised to receive money on behalf of Government had not been followed till April 1978.

The Ministry of Finance have stated that in the light of the above abservations, the Board of Direct Taxes has issued instructions in December 1981 to all the Commissioners of Income-tax.

3.25 *Failure to file second appeal*

A co-operative society, besides carrying on activities the income from which is exempt from tax was also carrying on the business of sale of commodities, such as groceries, foodgrains, etc. on cash/credit basis, to its members. The income attributable to the latter activities though chargeable to tax in respect of the assessment years 1960-61 to 1967-68 was incorrectly exempted from tax by the assessing officer, on the ground that the society was engaged in the business of providing credit facilities to its members. The incorrect exemption was pointed out in paragraph 51(a) of the Audit Report 1970. After consulting the Ministry of Law, the Ministry of Finance accepted the mistake in March 1973. In the meantime, as a result of

remedial action taken by the assessing authority a demand of Rs. 1,12,924 was raised in May 1970, in respect of the assessment years 1964-65 to 1967-68. On appeal by the assessee, the Assistant Appellate Commissioner held (January 1975) that the assessee was entitled to the exemption and directed the Income-tax Officer to allow the necessary rebate. The appellate decision was accepted by the Commissioner of Income-tax. Despite the advice of the Ministry of Finance and the Ministry of Law that the assessee, in the instant case, was not entitled to the exemption, no second appeal was filed by the department.

The Ministry of Finance have reported in June 1981 that the reasons for not filing the second appeal are not readily forthcoming as the concerned file is not readily available. The Ministry have further stated that the judicial section of the Commissioners' office was not aware of the Law Ministry's advice and the concerned Commissioner was being advised to avoid such lack of co-ordination in future. The Board was also contemplating issue of general instructions in this behalf.

Failure to file a second appeal despite Law Ministry's advice resulted in a loss of revenue of Rs. 1,12,984.

The paragraph was sent to the Ministry of Finance for their further comments in September 1981 ; their reply is awaited (December 1981).

CHAPTER 4

OTHER DIRECT TAXES

A. *Wealth-tax*

4.01 In the financial years 1975-76 to 1980-81 the wealth-tax receipts vis-a-vis the budget estimates were as given below :

Year	Budget estimates	Actual
	(In crores of rupees)	
1975–76	43	53.73
1976–77	52	60.44
1977–78,	54.90	48.46
1978–79	55	55.41
1979–80	60	64.47
1980–81	65	67.43
		(Provisional)

4.02 The arrears of demand pending collection and number of cases pending assessment as at the end of the years 1976-77 to 1980-81 are given below :

Year	No. of cases pending assessment as at the end of	Arrears of demand pending collection as at the end of
		(Rupees in crores)
1976–77	2,88,949	52.75
1977–78	3,14,224	56.41
1978–79	3,31,561	184.08
1979–80	4,32,988	180.54
1980–81	4,99,903	217.11

4.03 During the test audit of assessments made under the Wealth-tax Act, 1957 conducted during the period from 1 April 1980 to 31 March 1981, the following types of mistakes were noticed :

(i) Wealth escaping assessment.
(ii) Incorrect valuation of immovable properties.
(iii) Incorrect valuation of unquoted shares.
(iv) Incorrect valuation of gold and jewellery.
(v) Incorrect computation of net wealth.
(vi) Short-levy or non-levy of additional wealth-tax.
(vii) Incorrect exemptions and other deductions.
(viii) Mistakes in application of rates of tax.
(ix) Mistakes in calculation of tax.
(x) Incorrect levy or non-levy of penalty.

A few important cases illustrating the above types of mistakes are given in the following paragraphs.

4.04 *Wealth escaping assessment*

(i) A building Trust was created by a Chamber of Commerce and Industries, in the year 1946, for the purposes of construction of a building on lands acquired by the Chamber. The building was to be utilised for purposes of meetings, lectures, running a library and letting out. Trust was to pay to the Chamber 75 per cent of net collections so that the Chamber could utilise the amount for advancement of its objects. As per the balance-sheet of the Trust as on 31 December 1977, the accumulation in the trust funds amounted to Rs. 11,27,338. The income of the trust was held to be taxable, by the Income-tax Appellate Tribunal, the trust being not a charitable trust under the Income-tax/Wealth-tax Act. Therefore, the trust was assessable to wealth-tax and tax of Rs. 2,98,783 on the aggregate (including additional wealth-tax of Rs. 1,74,307 on urban immovable property) was leviable in respect of the assessment years 1965-66 to 1974-75. This tax was not levied.

In not accepting the objection, the Ministry of Finance have stated that the trust is holding the building for the benefit and use of the Chamber which is a company and a company is exempt from wealth-tax. The argument is not acceptable for the reason that in law, the company and the trust are separate entities and the legal ownership of the property vests in the trustees and not the company. The finding that the trust is not a charitable trust is a finding of fact by the Income-tax Appellate Tribunal.

(ii) In December 1975, under the Scheme for Voluntary Disclosure of Income and Wealth, a Hindu undivided family disclosed wealth of Rs. 1,60,600. It also filed a return of wealth in respect of the assessment year 1975-76, declaring a net wealth of Rs. 1,60,600. The department assessed the net wealth at Rs. 13,79,637 including the value of cinema building for Rs. 12,27,203 as determined by the departmental valuation Cell, whereas the value certified by a registered valuer was Rs. 2,74,165. It was noticed that the assessee did not file the wealth-tax returns in respect of the assessment years prior to the assessment year 1975-76, nor in respect of the assessment years 1976-77 to 1978-79. The department also did not call for the returns of wealth in respect of these years nor was any entry made in the register of pending returns maintained by the assessing officer. The ownership of the cinema building was in the knowledge of the department in the income-tax records of the family in respect of the assessment year 1965-66. Even taking the wealth escaping assessment as Rs. 13,79,600 (the net wealth assessed in respect of the assessment year 1975-76), wealth of Rs. 96,57,200, in the aggregate escaped assessment in respect of the assessment years 1972-73 to 1974-75 and 1976-77 to 1979-80, with consequent undercharge of wealth-tax by Rs. 2,48,191. Further, penalty for non-filing of returns of wealth, which was leviable, was also not levied.

The Ministry of Finance have accepted the objection (August 1981). Report on re-assessment and raising of additional demand and collection is awaited (December 1981).

(iii) Under the Wealth-tax Act, 1957, as amended by the Taxation Laws (Amendment) Act, 1975 ; no assessment for an assessment year commencing before 1 April 1975 shall be made after four years after that date or after one year from the date of filing a return or a revised return, whichever is later.

An individual filed return of wealth in respect of the assessment year 1970-71 in June 1970 declaring a net wealth of Rs. 8,09,558. The returns in respect of the assessment years 1971-72 and 1972-73 were filed in September 1972 declaring net wealth of Rs. 8,56,370 and Rs. 7,60,623 respectively. The department served notices on the assessee in October 1972 asking her to produce evidence in support of the returned wealth. The department did not, however, proceed further with the completion of the assessments, till the omission came to notice of Audit and was pointed out (June 1980). Further, on the basis of the valuation of the immovable properties of the assessee made by the departmental Valuation Officer, in March 1980, in respect of the assessment years 1965-66 to 1977-78, the valuation of the properties was required to be increased by Rs. 4,70,306, Rs. 4,94,306 and Rs. 5,41,306 in respect of the assessment years 1970-71, 1971-72 and 1972-73 respectively. As the assessments were not completed before the expiry of the statutory limitation period, on 31 March 1979, wealth aggregating Rs. 39,32,500 escaped assessment resulting in loss of revenue of Rs. 1,25,728 in respect of the three assessment years.

The Ministry of Finance have accepted the omission.

(iv) In assessing the wealth of an assessee in respect of assessment year 1971-72 (assessment done on 21 March 1979, a few days prior to the expiry of the statutory time limit on 31 March 1979), the Wealth-tax Officer did not take into account movable property of Rs. 9,69,770 returned by the assessee. This omission resulted in short levy of wealth-tax by Rs. 23,652.

The assessment was required to be checked in Internal Audit. However, it was not so checked. The Ministry of Finance have

accepted the objection.

(v) Gold ornaments weighing 14,105 grams were found by the Central Excise authorities, during a raid conducted in 1970, in the premises of a Hindu undivided family. Out of the quantity so found jewellery weighing 7,948 grams was not considered for assessment to wealth-tax on account of its being considered as pledged gold ornaments with the assessee. Of the balance of 6,157 grams, the assessability of 1,061 grams was under dispute; 2,654 grams were claimed to be 'stridhan' without any evidence thereof and 2,442 grams were not considered for taxing, for no reason. In the result, all the 6,157 grams remained to be included in the net wealth of the assessee in respect of the assessment years 1971-72 to 1978-79 and wealth aggregating Rs. 19,52,120 escaped assessment in respect of these assessment years with consequent short levy of wealth-tax by Rs. 34,760.

The Ministry of Finance have accepted the objection (October 1981) except for the jewellery held to be stridhan, on which their finding is still awaited. Report on the re-assessment is also awaited (December 1981).

(vi) From the income-tax assessment records of an individual assessed in a film circle it was seen that professional receipts amounting to Rs. 4,40,910 were due to him. However, in his wealth-tax assessment in respect of the assessment year 1975-76, these receipts were neither returned by the assessee nor were they included by the department in computing his net wealth. The omission resulted in under-assessment of his wealth by Rs. 4,40,910 with consequent short levy of wealth-tax by Rs. 32,660.

This assessment was required to be checked in Internal Audit as per standing instructions of the Board, but it was not so checked.

The Ministry of Finance have accepted the objection.

4.05 *Certain types of wealth escaping assessment*

(a) Under the Wealth-tax Act where the assessee is a partner in a firm, the value of his interest in the firm determined in the prescribed manner, shall be included as belonging to that individual assessee, in computing his net wealth.

(i) Certain lands and the buildings owned by a partnership firm were valued by the departmental valuer in respect of the assessment years 1964-65 to 1977-78. As per his report dated 25 January 1979, the value was assessed at three times the value declared by the firm in the relevant balance-sheets. Consequently, the value of the interest of each of the eight partners in the firm went up. However, in respect of the assessment years 1974-75 to 1979-80 assessments of two partners already done, were not revised. In respect of the assessment years 1971-72 to 1979-80, assessment of five partners was not also revised and in respect of assessment year 1971-72, the assessment of one partner was not also revised. Due to non-revision of the assessments, wealth was under-assessed by Rs. 87,02,548, leading to short levy of wealth-tax by Rs. 1,18,353 in the aggregate.

The Ministry of Finance have accepted the objection (October 1981) ; report of rectification is awaited (December 1981).

(ii) A cinema hall owned by another partnership firm was valued at Rs. 1,35,404 as on 31 December 1974, in its income-tax return. The hall was, however, valued at Rs. 15,28,600 by the departmental Valuation Officer as per his report which was received by the assessing officer on 5 May 1978. Accordingly, the value of the interest of each of the five partners in the firm rose to a level whereby they were subject to wealth-tax. Necessary returns for assessing the wealth of the partners were not called for as required under the standing instructions of the Board, though the assessees had not filed returns of wealth in respect of any of the assessment years from 1975-76

onwards. In the result, aggregate wealth of Rs. 55,77,300 in the hands of five partners escaped assessment in respect of the four assessment years from 1975-76 to 1978-79, with consequent non-levy of wealth-tax of Rs. 43,280. Though the report of the departmental Valuation Officer was received in May 1978, when statutory limitation period had not expired, the assessments in respect of the assessment years 1971-72 to 1974-75 were not reviewed by the assessing officer.

The Ministry of Finance have accepted the objection.

(b) Under the Wealth-tax Act, 1957 where assets are held by a trustee on behalf of some other persons, wealth-tax shall be levied upon and recoverable from the trustee in the like manner and to the same extent as it would be leviable upon and recoverable from the person on whose behalf or for whose benefit the assets are held.

In the case of a private family trust wherein the shares of the beneficiaries were determinate and known the trustees were duly taxed under the Income-tax Act, 1961, on behalf of the beneficiaries, on the income from the corpus of the trust in respect of the assessment years 1971-72 to 1976-77. However, no wealth-tax proceedings were initiated by the department, even though, according to the ratio for allocation of the shares of income, five out of the eight beneficiaries of the said trust had taxable wealth in respect of the assessment years 1971-72 to 1976-77 and another beneficiary had taxable wealth in respect of the assessment years 1971-72 to 1973-74. Thus, wealth aggregating Rs. 78,56,596 escaped assessment resulting in non-levy/short levy of wealth-tax by Rs. 71,571 in respect of the said six assessment years.

The Ministry of Finance have accepted the objection (November 1981). Report on re-assessment and collection of additional demand is awaited.

(c) The net wealth of a Goanese communion of husband and wife was assessed to tax in respect of assessment years 1968-69 and 1969-70. The assessment was rectified in February 1972, so as to tax only half of the total wealth in the hands of the husband, who filed his returns of wealth in respect of the assessment year 1970-71 and onwards separately. Notice under Section 17 of the Wealth-tax Act was issued to the wife in May 1975 calling on her to file her wealth-tax returns in respect of the assessment years 1968-69 and 1969-70. The notice was not pursued and as a result the assessments in respect of the wife became barred by limitation on 31 March 1979 under Section 17(1)(a) of the Wealth-tax Act. This failure resulted in a loss of revenue of Rs. 43,996.

The para was sent to the Ministry of Finance in September 1981, the Ministry have in reply stated (January 1982) that there is still time to pursue the notice and make the assessment. Their further report on the assessment is awaited (February 1982).

4.06 *Incorrect valuation of immovable properties*

(a) The Wealth-tax Act, 1957 provides that subject to the rules made in this behalf the value of any property shall be estimated to be the price which, in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market on the valuation date. The Board had also issued instructions laying down guidelines for cases of immovable properties which were required to be referred to the valuation officer of the department for valuation.

(i) Six individuals jointly owning a house property situated in a metropolitan city were assessed in respect of assessment years 1964-65 to 1974-75 on 1 and 2 March 1979 (the statutory limitation period for completion of the assessment was to expire on 31 March 1979). The value of the property was taken as that returned by the assessees. Earlier a reference had been made by the Wealth-tax Officer to the departmental Valuation Officer on 31 December 1977 for valuation of the property and the valuation report dated 3 March 1979 was received by the assessing officer on 5 March 1979. The

departmental valuer had valued the property at Rs. 33,53,670 in respect of the assessment years 1964-65 to 1966-67 as against the valuation of the assessees at Rs. 25,87,840. Similarly valuation by departmental valuer was at Rs. 36,79,592 in respect of assessment years 1967-68 to 1969-70 and at Rs. 40,30,639 in respect of the assessment years 1970-71 to 1972-73 and at Rs. 44,39,430 in respect of assessment years 1973-74 and 1974-75 as against Rs. 26,11,472, Rs. 20,63,120 and Rs. 18,00,096 respectively as by the assessees. The assessments were not revised as per the departmental valuations. This resulted in under assessment of wealth by Rs. 1,66,83,075 in the aggregate, with consequent short-levy of tax by Rs. 4,87,172 in the aggregate which included non-levy of additional wealth-tax of Rs. 2,96,855. The omission was pointed out in audit in February 1980.

The Ministry of Finance have accepted the objection.

(ii) An assessee had 50 per cent share in certain immovable properties, which were sold for Rs. 16,00,000 in February 1973 as per information available on record. In respect of the assessment years 1970-71 to 1972-73 the value of the share of assessee was taken at Rs. 1,16,099, Rs. 1,25,979 and Rs. 1,41,104 respectively, as was returned by the assessee. The assessments were completed accordingly on 26 March 1979, (a few days prior to expiry of statutory limitation period on 31 March 1979). Even adopting the share of the assessee to be Rs. 7,00,000, Rs. 7,50,000 and Rs. 8,00,000 respectively in respect of assessment years 1970-71, 1971-72 and 1972-73, there was short levy of wealth-tax and additional wealth-tax by Rs. 1,02,632 in respect of these three assessment years.

The audit paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(iii) Coffee plantations included in the net wealth of an assessee were valued at Rs. 4,000/Rs. 4,500 per acre in respect of assessment year 1976-77 which went up to Rs. 6,000/Rs. 7,000

per acre in respect of assessment year 1978-79. The prevalent market rates were Rs. 12,000 to Rs. 16,000 per acre for coffee estates in and around the area, where the assessee had his plantations. Though in respect of 101 assessments action was initiated by the department to revalue the plantations with reference to the market value, no such action was taken in this case with the result that there was short levy of wealth-tax by Rs. 50,293 in respect of the assessment years 1976-77 to 1978-79.

The Ministry of Finance have intimated that the assessments in question have been re-opened and they are awaiting decision on representation made to higher authorities.

(iv) In the wealth-tax assessment of an individual assessee, in respect of the assessment year 1966-67 (assessment completed in March 1979), the value of an urban house property was determined by the department to be the average of the two values arrived at by the 'Land and Building' method and by the 'yield' method. The average worked out to Rs. 29,08,000 while value as per yield method worked out to Rs. 37,20,960.

It had been judicially held in May 1967 that in the case of buildings which are in possession of tenants, the appropriate method of valuation would be to capitalise the annual rent by a certain number of years purchase.

In the above stated computation under yield method, deduction was allowed in respect of periods for which house was vacant, though the deduction was contrary to Board's instructions of August 1958 and July 1960. Also contrary to the instruction of the Board, deduction on account of 'repair and collection charges' were allowed in full although nothing was spent on such account by the assessee.

The mistakes led to under-assessment of wealth by Rs. 29,24,268 with consequential undercharge of wealth-tax by Rs. 1,85,072 including additional wealth-tax of Rs. 1,10,970 in respect of the assessment year 1966-67.

The case was required to be checked by the Internal Audit under instructions of the Board ; however, it was not so checked.

The paragraph was sent to the Ministry of Finance in September 1981 ; their reply is awaited (December 1981).

(v) In respect of the assessment year 1974-75 (valuation date 31 March 1974 and assessment completed on 21 March 1979 prior to the expiry of the statutory time-limit on 31 March 1979), two lands situated within the limits of the city corporation were valued at Rs. 1.51 lakhs and Rs. 1.61 lakhs respectively. However, in the income-tax assessment of the same assessee in respect of the assessment year 1975-76 one of the lands was shown as sold on 24 April 1974 for Rs. 5.09 lakhs at Rs. 7 per sq. ft. (area sold 72,735 sq. ft.). The non-adoption of the value at or near Rs. 7 per sq. ft. for both the properties in the wealth-tax assessments resulted in under-valuation of wealth by Rs. 7.57 lakhs in respect of the assessment year 1974-75 with a consequent short levy of tax by Rs. 47,373 (wealth-tax Rs. 15,733 and additional wealth-tax Rs. 31,640). Further, in respect of the unsold property, in respect of assessment year 1975-76 also, there was short computation of wealth by Rs. 3.98 lakhs resulting in short levy of tax by Rs. 13,839.

The paragraph was sent to the Ministry of Finance in September 1981 ; reply of the Ministry is awaited (December 1981).

(b) Under the provisions of the Wealth-tax Act, 1957 as amended by the Finance Act, 1969, agricultural land owned by an assessee was brought within the charge of wealth-tax with effect from the assessment year 1970-71. Upto the assessment year 1974-75, the value of agricultural land by itself or along with the value of an urban house was exempt upto a limit of one and one-half lakhs of rupees.

(i) In the wealth-tax assessments of an assessee which were completed in February 1978, the Wealth-tax Officer accepted the

value of Rs. 32,900 returned by the assessees on his one-fourth share in an agricultural farm and therefore exempted this entire amount from tax in respect of assessment years 1971-72 to 1974-75. In the wealth-tax return of the assessee in respect of the assessment year 1968-69, however, value of his investment in the agricultural farm was shown as Rs. 3,53,869. Therefore the value of Rs. 32,900 adopted by the department in the assessment in respect of the assessment years 1971-72 to 1974-75 led to under-assessment of wealth by Rs. 3,03,869 (real value less exemption up to Rs. 50,000) in each of the four assessment years, caused by failure to use information available in the assessment records for earlier assessment years. The consequent short levy of wealth-tax amounted to Rs. 76,913. Under the standing executive instructions of the Board, this assessment was required to be checked by Internal Audit. However, it was not so checked.

The Ministry of Finance have accepted the objection.

(ii) In the wealth-tax assessments of two assessees in respect of the assessment years 1970-71 to 1972-73 the value of assessees' shares in agricultural land, amounting to Rs. 3,53,869 each, were shown incorrectly in the wealth-tax returns filed by them during the years 1970 to 1973. Either the shares were not shown or were shown at a value which was below the exemption limit. The valuations, as per returns, were accepted by the Wealth-tax Officer and net wealth assessed accordingly in 1977 and 1978. Information was available in the records for the assessment year 1968-69 (when agricultural land was not subject to wealth-tax) to the effect that the two assessees had invested Rs. 3,53,869 each in the agricultural land. Failure to make use of this information led to escapement of wealth leading to short levy of wealth-tax by Rs. 75,101 in the aggregate.

Though both the cases were required to be checked by Internal Audit staff, only one of these cases was checked in Internal Audit ; however, the mistake was not detected.

The paragraph was sent to the Ministry of Finance in June 1981, they have accepted the objection in one case and their reply in respect of the other case is awaited (December 1981).

(c) As per executive instructions issued by the Central Board of Direct Taxes in June 1970 where the value of a property in respect of any assessment year is shown at a figure which is more than that declared in an earlier year by more than 25 per cent, the assessments in respect of the earlier years should be re-opened for revaluation even if the higher valuation in the subsequent years was attributable to the adoption of a different basis for valuation.

(i) In the wealth-tax assessment of a Hindu undivided family in respect of the assessment year 1973-74 (assessment done in March 1977), one-fifth share of the assessee in an immovable property (share valued at Rs. 18,95,000 by the departmental Valuation Officer) had been valued at only Rs. 4,30,000. It was pointed out (March 1978) in audit that the earlier assessments were required to be re-opened for revaluation, as the difference in valuation exceeded 25 per cent of the value adopted in earlier years. Thereafter the department accordingly re-opened the earlier assessments in respect of the assessment years 1970-71 to 1972-73 in March 1979 and the departmental Valuation Officer determined the market value of the assessee's share in the property at Rs. 8,95,000 as on 31 March 1970 and 31 March 1971 and at Rs. 12,72,000 as on 31 March 1972. The department also revised the assessments in respect of the assessment years 1970-71 to 1972-73 (in March 1980) and raised additional demand of Rs. 99,399 (including additional wealth-tax on urban assets).

The case was required to be checked by the Internal Audit under the standing instructions of the Board ; however, it was not so checked.

The Ministry of Finance have accepted the objection.

(ii) An assessee was having one-half share in a plot of land (in a metropolitan town) the value of which was returned by the assessee at Rs. 15,00,000 in respect of the assessment year

1972-73. This plot was valued by the departmental Valuation Officer on the valuation dates relevant to the assessment years 1968-69 and 1969-70 at Rs. 22,50,000 and relevant to assessment years 1970-71 and 1971-72 at Rs. 24,62,000. While the assessments in respect of the assessment years 1968-69 to 1971-72 were re-opened by the Wealth-tax Officer to adopt the values reported by the departmental Valuation Officer, the value of Rs. 24,62,000 as on 31 March 1971 was not similarly adopted by the Wealth-tax Officer in respect of the assessment year 1972-73 and instead the value as returned at Rs. 15,00,000 was incorrectly adopted. This mistake led to under-assessment of the assessee's share in the property by Rs. 4,91,000 leading to a short levy of wealth-tax by Rs. 58.281, including additional wealth-tax of Rs. 39,567 in respect of the assessment year 1972-73. Similar mistakes in the case of the owner of the other share of the property was also pointed out by Audit.

The paragraph was sent to the Ministry of Finance in July 1981 ; their reply is awaited (December 1981).

4.07 *Incorrect valuation of unquoted shares*

Under the provisions of the Wealth-tax Act, 1957, the value of unquoted equity shares of a company is to be determined on the basis of the net value of the assets of the business as a whole having regard to its balance-sheet. For valuation of unquoted equity shares of investment companies, the Central Board of Direct Taxes prescribed in their circular dated 31 October 1967 that the value should be the average of (i) break-up value of these shares based on the book value of assets and liabilities of the company disclosed in the balance sheet and (ii) the capitalised value on the yield as a percentage of the maintainable profits of the company. This average value was to be taken as the fair market value of the shares. This method would fail to disclose the fair market value of investments held by a company where the market value far exceeds the book value.

(i) Eight assessees belonging to a family group held shares in two private investment companies controlled by the family and the shares of these companies were not quoted on the stock exchange.

The paid-up capital of the first investment company was Rs. 26 lakhs (26,000 shares of Rs. 100 each) but the market value of the net assets of the company on the valuation date relevant to assessment year 1974-75 was Rs. 2.60 crores. In the wealth-tax assessments of the aforesaid eight assessees, in respect of the assessment year 1974-75, the market value of the shares was estimated only at Rs. 210 per share (as per Board's instruction dated 31 October 1967) while on the basis of the market value of the investments held, it would work out to Rs. 1,002.26 per share. There was similar incorrect valuation in respect of assessment years 1969-70 to 1977-78 also. There was under-assessment of wealth by Rs. 198 lakhs in the aggregate and short levy of tax by Rs. 9.20 lakhs in the aggregate, in respect of the assessment years 1969-70 to 1977-78 in the assessments of five of the assessees.

The paid-up share capital of the second private company was Rs. 5 lakhs made up of 5,000 shares of Rs. 100 each. It had made investments in shares quoted on the stock exchange apart from investing in 1,611 shares of the first investment company. The difference between the book value and market value of the investments as on the valuation date relevant to assessment year 1974-75 was Rs. 1.25 crores and consequently the market value of each share of the second private company in respect of the assessment year 1974-75 was Rs. 2,880 as against the value of Rs. 450.90 adopted in the wealth-tax assessments. There was similar incorrect valuation in respect of other assessment years also. Consequently three assessees were under-assessed on 4,997 shares of the second company in respect of the assessment years 1969-70 to 1972-73 and on 4267 shares in respect of the assessment year 1974-75. This resulted in under-assessment of wealth by Rs. 406.58 lakhs in the aggregate and short levy of tax by

Rs. 21.63 lakhs in the aggregate in respect of the assessment years 1969-70 to 1974-75.

The paragraph was sent to the Ministry of Finance in August 1981 who have in reply stated (January 1982) that amendment of the Board's instructions is under consideration.

(ii) While computing the net wealth in the case of four Hindu undivided families in respect of the assessment years 1972-73 to 1974-75 (assessments completed in November 1977 and February 1978) the Wealth-tax Officer valued the unquoted equity shares held by the assessees in two private limited companies on the basis of the valuation reports of a registered valuer. The registered valuer had valued the shares of the first company at Rs. 2,668, Rs. 2,902 and Rs. 1,800 per share in respect of the assessment years 1972-73, 1973-74 and 1974-75 respectively and of the second company at Rs. 1373 and Rs. 1404 in respect of the assessment years 1972-73 and 1973-74. The valuation of the shares of the companies had, however, been referred to the departmental Valuation Officer in connection with computation of capital gain on transfer of the shares of these companies (under the Income-tax Act, 1961) and he had determined the market value of the shares of the first company at Rs. 7,400 and of the second company at Rs. 3,650, as on 31 December 1973. This fact was known to the department before the wealth-tax assessments were finalised ; however the valuation of the shares for wealth-tax purposes was not referred to the departmental valuer nor the higher valuation made by him in a related context made use of. Omission to do so resulted in under-assessment of wealth totalling Rs. 63.33 lakhs based on the value of the shares at Rs. 7400 and Rs. 3650 with consequent short levy of wealth-tax by Rs. 3,59,360 in the aggregate in respect of the three assessment years.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December, 1981).

(iii) On the valuation date relevant to assessment year 1974-75 *viz.* 31 March 1974, three assessee Hindu undivided

families of a family group held shares of a private limited investment company which was not quoted in the market. In the wealth-tax return in respect of the assessment year 1974-75, the assessees had valued these shares at Rs. 59 per share as determined by a registered valuer. The registered valuer treated the company as an investment company and arrived at the market value of Rs. 59 per share as the average of the value under break-up value method (Rs. 117) and that under the yield method (nil). While assessing the net wealth of the assessee families, the Wealth-tax Officer, on the same basis, determined the value under break-up value method at Rs. 129.32 (after disallowing certain tax liabilities taken into account by the registered valuer as they were not provided for in the accounts of the company) and under the yield method at 'Nil', giving an average of Rs. 65 per share.

The investment company, whose shares were held by the three Hindu undivided families, was incorporated on 6 March 1973 with nominal (issued and paid-up) share capital of Rs. 200. It amalgamated itself with two private limited companies of the family group with effect from 1 January 1974. The shares of the first private limited company accounted for more than 95 per cent of the assets of the new amalgamated company and that company's shares had been valued by the departmental Valuation Officer at Rs. 7,400 (as on 31 December 1973) as against a face value of Rs. 1,000 (and a value of Rs. 1,800 determined by the registered valuer). It had been a manufacturing company upto 30 June 1973 whereafter it was an investment company and it showed loss of over rupees ten crores on sale of shares effected from one group of subsidiaries of the company to another group of subsidiaries and its net worth was reduced. This factor had weighed with the Valuation Officer. However, under the yield method, the company not having derived any income during the period it was an investment company, its share was valued at 'nil'.

As against the market value of the shares assessed at Rs. 65 per share as on 31 March 1974 the share of the first

amalgamating company would work out to around Rs. 343 per share and accordingly on the value of 11,768 shares included in the wealth of the three assessees, in respect of the assessment year 1974-75, wealth was under-assessed by Rs. 32,65,944 (approx.) with consequent short levy of tax of Rs. 1,91,760. Further in respect of the assessment year 1975-76, in the case of one of the three assessees, the wealth was under-assessed by Rs. 20,17,224 (again taking the market value of shares as Rs. 343 per share approx.) with consequent short levy of tax by Rs. 1,39,181 in regard to the 7,128 shares held by it.

The paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

(iv) In the wealth-tax assessments of three discretionary trusts, the value of unquoted equity shares in a private limited company was taken at Rs. 2,902 per share in respect of assessment year 1973-74. In the case of one of these trusts, the value of the shares in another newly incorporated investment company was taken at Rs. 56 per share in respect of the assessment year 1974-75. The value of shares in yet another private limited company was taken at Rs. 1,162 per share (in respect of assessment year 1973-74) while valuing the 40 shares held by another individual assessee though 180 shares in the same company held by one of the trusts of which the individual was the sole beneficiary were valued at Rs. 2,211 per share. The valuation of all these shares had been referred to the departmental Valuation Officer who had valued the shares of the three companies at Rs. 7,400 per share (as on 30 June 1973 as aainst Rs. 2,902), Rs. 200 per share (as on 31 March 1975 as against Rs. 56) and Rs. 3,650 per share (as on 31 March 1973 as against Rs. 1,162/2,211) respectively. However, the valuations done by the departmental Valuation Officer were not adopted in the wealth-tax assessments and this resulted in under-assessment of wealth totalling Rs. 56.89 lakhs and consequent short levy of wealth-tax on the three trusts and the one beneficiary, by Rs. 3,06,682 in the aggregate in respect of the three assessment years 1973-74 to 1975-76.

The paragraph was sent to the Ministry of Finance in September 1981 which has in reply stated (January 1982) that the instructions of 1967 are going to be replaced by new rules.

4.08 *Incorrect valuation of gold and jewellery*

Under the Wealth-tax Act, 1957, the value of any property (which includes gold, jewellery etc.) is to be estimated to be the price which, in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market on the valuation date.

(i) A handout detailing the market rates of diamonds, precious stones, gold and silver jewellery on different dates upto 31 March 1975, circulated by the Technical Committee of the Gem and Jewellery Export Promotion Council Bombay (which was, in turn, circulated by the Central Board of Direct Taxes in May 1976) gave out the market rates of standard gold and silver as on 26 October 1973, (the valuation date relevant to the assessment year 1974-75) as Rs. 356 per 10 grams and Rs. 771 per kg. respectively. In the wealth-tax assessments of an assessee, in respect of the assessment year 1974-75, which was completed on 26 March 1979, the values of 42,424 grams of primary gold and 52.5 kg. of silver, held by him on 26 October 1973 (the relevant valuation date) were taken by the department as Rs. 11,03,024 and Rs. 38,325 respectively instead of the correct values of Rs. 15,10,294 and Rs. 40,477 as per the market rates circulated. This resulted in under-assessment of wealth by Rs. 4,09,422 and consequent short-levy of wealth-tax by Rs. 12,874 in the aggregate in respect of the assessment year 1974-75.

The case was seen in Internal Audit, but the mistake was not detected.

The Ministry of Finance have accepted the objection.

(ii) The net wealth of an assessee in respect of the assessment years 1973-74, 1974-75 and 1975-76 (assessments done in March 1979 and November 1979) included gold jewellery which was valued by the department at Rs. 3,14,000, Rs. 3,60,000 and

Rs. 3,80,000 respectively. On the basis of a valuation done by a registered valuer in January 1972 and enhancing it as per data published by the Technical Committee of Gem and Jewellery Export Promotion Council, Bombay (circulated by the Board in May 1976) the market value of gold jewellery worked out to Rs. 4,32,390, Rs. 7,82,626 and Rs. 8,35,062 in respect of the three assessment years respectively. The under-valuation of jewellery included in the net wealth resulted in short levy of wealth-tax by Rs. 23,428 in the aggregate.

The Ministry of Finance have accepted the objection.

(iii) An assessee had, as far back as 1958, filed details of her jewellery valued at Rs. 1,17,120. The departmental records showed that the jewellery had been owned by her all along (except for 96 grams of gold *i.e.* 12 sovereigns donated in the previous years relevant to the assessment years 1963-64 and 1967-68). The value of the jewellery was revised to Rs. 1,26,120 by the department in respect of the assessment year 1964-65 (assessment completed in November 1974). However, a lower value of Rs. 86,120 returned in respect of the assessment years 1965-66 and 1966-67 and a still lower value of Rs. 85,950 in respect of the assessmnt year 1967-68 were accepted, notwithstanding the upward revision in value made by the department in respect of the assessment year 1964-65. The assessments for the subsequent years from 1968-69 to 1973-74 were also made on the value of Rs. 85,950 adopted in respect of the assessment year 1967-68. In the wealth-tax assessments for the assessment years 1974-75 to 1977-78 (assessments completed in October 1974, November 1975, January 1977 and October 1977 respectively) the department valued the jewellery at Rs. 94,950 after adding Rs. 9,000 to the value of Rs. 85,950 returned by the assessee.

According to the prices circulated by the Central Board of Direct Taxes in May 1976, there was a five-fold increase in the price of gold between 1956 and 1976 and a three-fold increase in the price of precious stones. However, the jewellery of the assessee was not re-valued upward.

In August 1974, the Internal Audit had pointed out the need to call for details and to recompute the value of the jewellery in respect of the assessment year 1973-74 and earlier years. However, no such action was taken by the department.

On a conservative estimate, the under valuation of jewellery and consequent under-assessment of wealth led to a short levy of wealth-tax by Rs. 1,02,000 (approx.) in respect of the assessment years 1974-75 to 1977-78.

Though the Ministry of Finance have acknowledged the objection (November 1981) they have not accepted it pending re-valuation of the actual items of jewellery as ascertained to have been with the assessee all along; however, necessary action has been initiated subsequent to the receipt of the audit objection.

(iv) The net wealth of three individuals (belonging to the same family) which was assessed in February and March 1979 (shortly before the expiry of the statutory limitation period ending on 31 March 1979) included silver utensils weighing 2,411 kgs., 1,568 kgs. and 1,529 kgs. in respect of the assessment years 1972-73 to 1974-75 respectively. They were valued by the department at Rs. 500, Rs. 550 and Rs. 750 per kg. against the market rates of Rs. 534.50, Rs. 619 and Rs. 1,260, on the respective valuation dates. This resulted in a total under-assessment of wealth by Rs. 9.26 lakhs and consequent short levy of tax by Rs. 68,630.

The audit paragraph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

4.09 *Incorrect computation of net wealth*

(i) As per the rules framed under the Wealth-tax Act, 1957, any amount of loss shown in the balance-sheet as a debit balance, having been carried over from the profit and loss account, is not to be included as an asset in determining the

net value of the assets of a business for the purpose of computing wealth-tax.

In the wealth-tax assessment of a Hindu undivided family in respect of the assessment year 1972-73 (assessment completed on 20 March 1979, a few days before the expiry of the statutory time-limit expiring on 31 March 1979), the net value of the assets of the business of the assessee was computed correctly without taking into account the loss (reflected from the profit and loss account) of Rs. 9,09,475, shown in the relevant balance-sheet. But the amount was wrongly taken as a negative asset and deducted from the aggregate value of other assets. Further, liabilities of Rs. 48,31,789 (instead of Rs. 43,31,789), reflected in the balance-sheet and also claimed by the assessee, were deducted incorrectly from the value of the assets of the business, resulting in under-assessment of wealth by Rs. 14,09,475, with consequent undercharge of tax by Rs. 1,04,462.

The Ministry of Finance have accepted the objection (November 1981).

(ii) In the wealth-tax assessment of a Hindu undivided family, completed in March 1980 in respect of the assessment year 1975-76, the net wealth computed by the department included the value of immovable property at Rs. 34,65,292 and that of jewellery at Rs. 15,000. These assets have been valued at Rs. 39,85,600 and Rs. 25,000 respectively in respect of the earlier assessment years. There was, thus, under-assessment of wealth by Rs. 5,30,308 with consequent undercharge of tax by Rs. 23,130. The department also omitted to levy additional wealth-tax on the aforesaid immovable property. These mistakes led to undercharge of tax aggregating Rs. 2,57,122, including additional wealth-tax of Rs. 2,33,992.

The case was required to be checked in Internal Audit under the standing instructions of the Board ; it was not so checked.

The Ministry of Finance have accepted the objection.

(iii) An assessee owned two immovable properties which were valued at Rs. 11,10,350 and at Rs. 1,25,000 in respect of the assessment years 1971-72 to 1974-75 and at Rs. 11,10,350 and Rs. 1,27,500 in respect of the assessment year 1975-76. The assessee had claimed exemption in respect of the second property and its value was not included in the value of assets returned by him. However, in respect of the assessment years 1971-72 to 1975-76 a further deduction was allowed by the department in respect of the second property without including its value in the net wealth of the assessee. This incorrect deduction resulted in short levy of wealth-tax and additional wealth-tax aggregating Rs. 41,085 in respect of the five assessment years.

The case was seen in Internal Audit, but the mistake was not pointed out.

The audit paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited.

4.10 *Short levy or non-levy of additional wealth-tax*

Under the Wealth-tax Act, 1957, before its amendment by the Finance Act, 1976, where the net wealth of an individual or a Hindu undivided family included buildings or lands (other than business premises used throughout the previous years for the purpose of his or its business or profession) situated in an urban area, or any rights therein, additional wealth-tax was leviable on the value of such urban assets, in excess of the prescribed limit.

(i) In respect of the assessment years 1971-72 to 1974-75 the net wealth of a Hindu undivided family was assessed on 14 March 1979, a few days prior to the expiry of the statutory time limit on 31 March 1979, at Rs. 18,55,600, Rs. 19,21,300, Rs. 21,36,600 and Rs. 24,98,200 respectively. On the urban

immovable properties included in the assessed wealth, additional wealth-tax was leviable. The department, however, did not levy the same. The omission resulted in non-levy of additional wealth-tax aggregating Rs. 4,08,777 in respect of the four assessment years.

Further, no penalty was levied for non-payment or short payment of tax, based on self-assessment, in respect of the assessment years 1971-72, 1973-74 and 1974-75. The case was required to be checked in Internal Audit, but it was not checked.

The Ministry of Finance have accepted the objection (August 1981). The report on reassessment, raising of additional demands and collection, is awaited (December 1981).

(ii) The assessments of a Hindu undivided family in respect of the two assessment years 1973-74 and 1974-75 was completed on 27 March 1979 (four days prior to the expiry of the statutory limitation period on 31 March 1979). Urban immovable properties of the assessee, on which additional wealth-tax was leviable in respect of the assessment years 1973-74 and 1974-75 were valued at Rs. 33,93,100 and Rs. 35,35,800 respectively. Additional wealth-tax of Rs. 3,95,023 leviable in respect of these two assessment years was not levied.

The case was required to be checked in Internal Audit, under the standing instructions of the Board; however, it was not so checked.

The Ministry of Finance have accepted the objection (September 1981). The assessments, having been set aside in appeal, report on reassessment, raising of demand and collection, is awaited.

(iii) The net wealth of a trust assessed at Rs. 19,66,895, Rs. 19,67,877, Rs. 19,41,052, Rs. 18,61,173, Rs. 17,90,086, Rs. 17,65,241, Rs. 14,55,393 and Rs. 13,39,390 in respect of the assessment years 1967-68 to 1974-75 respectively, should

have included urban immovable property valued at Rs. 20.06,000. Additional wealth-tax was leviable on this urban property. But in the assessments done in respect of all these assessment years (completed by the Wealth-tax Officer on 15 March 1979, just before expiry of the statutory limitation period on 31 March 1979) additional wealth-tax was not levied. It was stated that possession of the building had been given to an intending purchaser. Since, however, sale deed transferring ownership had not been executed there was no transfer of property and the tax was leviable. Additional wealth-tax not levied amounted to Rs. 3,52,616.

The Ministry of Finance have not accepted the objection on the ground that the property was in the process of conveyancing and the asset held by the assessee was only a debt due (*viz.* balance of purchase money). They have relied on Section 53A of the Transfer of Property Act. It has, however, been judicially held that that section contains only a rule of estoppel and does not create any real right, nor does it confer any title on the transferee, and that the legal title in the property remains with the transferor.

(iv) The net wealth of a Hindu undivided family assessed on 24 March 1979 a few days prior to expiry of the statutory limitation period on 31 March 1979 in respect of the assessment years 1971-72 to 1974-75, included urban buildings and land which were valued by the departmental valuer at Rs. 21,71,300, Rs. 21,16,300, Rs. 20,81,300 and Rs. 23,22,450 respectively. None of the properties was used by the assessee for its own business or profession. However, additional wealth-tax of Rs. 4,07,398, which was leviable, was not levied on these urban properties in respect of the four assessment years.

The case was required to be checked in Internal Audit under the standing instructions of the Board; however, it was not checked.

The Ministry of Finance have accepted the objection (November 1981).

(v) In the wealth-tax assessments of an individual assessee in respect of the assessment years 1969-70 to 1975-76 his net wealth valuing Rs. 14,99,734, Rs. 15,32,000, Rs. 16,31,996, Rs. 15,59,237, Rs. 14,37,305, Rs. 14,63,505 and Rs. 14,69,804 respectively included *inter alia* urban immovable assets valuing Rs. 11,73,000, Rs. 13,36,000, Rs. 13,36,000, Rs. 12,36,000, Rs. 12,36,000, 12,36,000 and Rs. 12,36,000 respectively, on which additional wealth-tax was leviable. But the department omitted to levy such tax (the assessment in respect of assessment year 1969-70 was done on 14 March 1979 and those in respect of the assessment years 1970-71 to 1975-76 were done on 13 March 1980 and 14 March 1980, the returns having been filed on 21 July 1979). The mistake led to a total short levy of wealth-tax by Rs. 2,17,873 in respect of the seven assessment years.

The case was required to be checked in Internal Audit under the Board's standing instructions ; however, it was not checked.

The Ministry of Finance have accepted the objection.

(vi) Although the value of urban assets included in the net wealth of a Hindu undivided family, computed for the assessment years 1971-72 to 1974-75, exceeded the exemption limit in respect thereof (the values being Rs. 12,90,000 in the assessment year 1971-72 and Rs. 14,10,000 in the assessment years 1972-73 to 1974-75), additional wealth-tax was not levied by the department. This omission in the assessments completed on 26 March 1979 (5 days before expiry of the statutory time limit on 31 March 1979) resulted in non-levy of total additional wealth-tax of Rs. 2,06,400 in respect of the four assessment years 1971-72 to 1974-75.

The case was checked in Internal Audit ; however the mistakes were not pointed out.

The Ministry of Finance have accepted the objection.

(vii) The wealth-tax assessments of an assessee individual in respect of the assessment years 1971-72 to 1974-75 were finalised on 26 March 1979 and 30 March 1979 (statutory limit expired on 31 March 1979). Additional wealth-tax on urban assets was not levied though the value of urban assets owned by the assessee on the relevant valuation dates exceeded the prescribed monetary limit. This resulted in non-levy of additional wealth-tax aggregating Rs. 1,50,029.

The case was checked by the Internal Audit Party ; however the mistake was not pointed out by them.

The Ministry of Finance have accepted the objection.

(viii) In the case of two individuals and one Hindu undivided family, the value of urban immovable properties included in their net w[illegible] assessed in respect of various assessment years between ye[illegible]65-66 and 1974-75, exceeded the prescribed exemption limit ; however additional wealth-tax was not levied by the department. The omission resulted in non-levy of additional wealth-tax aggregating Rs. 2,63,000. The assessments were completed on 19 and 21 March 1979, a few days before the expiry of the statutory time limit on 31 March 1979.

The assessments were required to be checked in Internal Audit ; however, they were not so checked.

The Ministry of Finance have accepted the objection.

(ix) In 51 other cases in 30 Commissioner's charges additional wealth-tax of Rs. 21,23,391 was similarly omitted to be levied for various assessment years between 1965-66 and 1976-77. The tax not levied in each of these cases was above Rs. 20,000.

4.11 *Incorrect exemptions and other deductions*

(a) Under the provisions of the Wealth-tax Act, 1957, the value of one house or part of a house belonging to an assessee is exempt upto a limit of Rs. 1 lakh. However, the exemption in respect of agricultural land and a house or part of a house together were not to exceed one hundred and fifty thousand rupees in respect of the assessment years 1970-71 to 1974-75. From the assessment year 1975-76 onwards, the exemption in respect of agricultural land, was linked up with the exemptions in respect of specified financial assets and the total exemption in respect of these linked assets was not to exceed one hundred and fifty thousand rupees.

(i) In the assessments for the assessment years 1971-72 to 1974-75, an assessee was allowed exemption in respect of agricultural land and house in excess of the permissible limit of one hundred and fifty thousand rupees. In the assessment year 1975-76, the same essessee was allowed exemption in respect of agricultural land and specified financial assets in excess of one hundred and fifty thousand rupees. These assessments were completed on 19 March 1979, i.e. just before the expiry of the statutory limitation period on 31 March 1979. As a result of these excessive exemptions urban immovable assets were under-assessed by Rs. 4,46,500 in respect of the five assessment years resulting in short levy of wealth-tax of Rs. 27,417.

The assessments for the assessment years 1973-74 to 1975-76 were required to be checked in internal audit, but these were not so checked.

While accepting these mistakes, the Ministry of Finance have stated that the assessments are being rectified (December, 1981).

(ii) In the wealth-tax assessments of two assessees, in respect of the assessment years 1971-72 to 1974-75, a deduction of Rs. 1,00,000 was allowed to each towards his house property. While revising the assessments in March 1978, on some other

grounds, a sum of Rs. 1,50,000 was also allowed as further deduction for agricultural property instead of limiting the total exemption to Rs. 1,50,000. This mistake resulted in excess allowance of deduction by Rs. 1,00,000 in each of the four assessment years, resulting in short levy of wealth-tax by Rs. 42,898 in the aggregate.

The case was seen in internal audit, but the mistake was not noticed.

The Ministry of Finance have accepted the objection (November 1981) ; report on collection of additional demand is awaited.

(iii) In the wealth-tax assessments of an assessee for the assessment years 1971-72 and 1972-73, completed on 31 March 1979 which was the last date of the limitation period, exemption of one hundred and fifty thousand rupees was allowed twice, once because the assessee had claimed it in his return of wealth having declared only the taxable wealth after taking credit for the exemption, and again because the Wealth-tax Officer proceeded from the figure of the net investment returned by the assessee and allowed further exemption of one hundred fifty thousand rupees. The double allowance of the same exemption resulted in under-assessment of wealth by Rs. 1.50 lakh in each of the assessment years and consequent short levy of wealth-tax by Rs. 18,610 in the aggregate.

The case was seen in internal audit but the mistake was not noticed.

The Ministry of Finance have accepted the objection.

(b) Under the provisions of Wealth-tax Act, 1957, inserted with effect from 1 April 1977, in respect of an assessee, being a person of Indian origin, who was ordinarily residing in a foreign country and who, on leaving such country returned to India with the intention of permanently residing in India, money and assets

brought by him into India and assets acquired by him out of such moneys are exempt from wealth-tax for a period of seven successive assessment years commencing with the assessment year next following the date on which such person returned to India. It was clarified by the Board that since the relevant clause came into operation only with effect from 1st April 1977, the exemption would not be applicable to a person who returned to India before 1 April 1976.

It was noticed in audit (October 1980), that the above exemption was allowed to an assessee, who returned to India on 6 May 1974 in respect of the assessment years 1977-78 and 1978-79. The incorrect exemption resulted in escapement of wealth of Rs. 8,40,847 and Rs. 8,50,371 and consequent non-levy of wealth-tax of Rs. 10,370 and Rs. 10,556 in respect of the two assessment years respectively.

The mistake was pointed out to the department in January 1981, subsequently it was noticed that the mistake had occurred in respect of the assessment years 1979-80 and 1980-81 also.

The Ministry of Finance have accepted the audit objection.

(c) In the computation of net wealth, the Wealth-tax Act, 1957 does not permit deduction of tax liabilities which may have been outstanding for more than twelve months, as on the valuation date.

In the case of an assessee who submitted his returns in respect of the assessment years 1971-72 and 1972-73 in July 1971 and July 1972, net wealth was assessed by the department on 28 March 1978, allowing deduction in respect of assessment year 1972-73 on account of income tax liabilities of Rs. 2,84,024 which had been outstanding for more than twelve months on the valuation dates. However, the Wealth-tax Officer allowed deduction for income-tax liabilities of Rs. 2,81,186 for each of the assessment years 1971-72 and 1972-73 though in fact there was no outstanding income-tax liability for the year 1971-72 and that for the year 1972-73 was only Rs. 58,285. These incorrect

deductions led to under-assessment of net wealth by Rs. 2,81,186 and Rs. 5,06,925 respectively in the two years and consequent short levy of wealth-tax of Rs. 48,989 in the aggregate.

The case was required to be checked by the Internal Audit under the standing instructions of the Board, but it was not so checked.

The para was sent to the Ministry of Finance in July 1981 ; their reply is awaited.

(d) Under the provisions of the Wealth-tax Act, 1957, where debts are secured on any property in respect of which wealth-tax is not leviable under the Act, such debts are not to be deducted in computing net wealth. The Act exempts the value of the right or interest of an assessee in a life insurance policy till the moneys under it become due and payable to the assessee. Accordingly a loan taken from the Life Insurance Corporation of India, on the security of a subsisting life insurance policy which is exempt under the Act, does not qualify for deduction as a liability in computing net wealth.

In making an assessment in respect of the assessment years 1971-72 to 1975-76 a loan of Rs. 69,090 obtained by the assessee from the Life Insurance Corporation of India and secured on his life insurance policies, was allowed to be deducted in the computation of net wealth, although the policies in question were exempted assets. The incorrect allowance of the deduction resulted in short levy of wealth-tax aggregating Rs. 17,270 in respect of the five assessment years.

It was also seen that while the assessments in respect of the assessment year 1970-71 had been done on 30 June 1976 and that in respect of the years 1971-72 to 1975-76 on 28 February 1978, the demand notices were issued only on 31 March 1979.

The Ministry of Finance have accepted the objection (September 1981). Report on collection of additional demand

is awaited.

(c) According to the provisions of the Wealth-tax Act, 1957, private discretionary trusts, under certain circumstances, are not entitled to exemptions in respect of specified investments which are, however, admissible to other assessees, upto a ceiling limit of Rs. 1.50 lakhs in regard to their investments in company shares, debentures, national savings certificates etc. Such trusts are also to be taxed at the rates specified in Part I of the Schedule to the Wealth-tax Act or at the flat rate of one and one-half per cent of total wealth, whichever course would be more beneficial to revenue.

The net wealth of such a discretionary trust included investments in ordinary and preference shares, debentures, 7 year national savings certificates and fixed deposits, which were not entitled to the aforesaid exemptions. However, while assessing the trust in respect of the assessment years 1974-75 and 1975-76, the department incorrectly allowed exemption upto Rs. 1.50 lakhs in respect of each assessment year. The department also charged wealth-tax at the flat rate of one and one-half per cent although tax at the rates prescribed in the Schedule to the Act would have been more beneficial to revenue. The two mistakes resulted in short levy of tax by Rs. 1,06,393 in the aggregate in respect of the two assessment years. The mistakes were pointed out to the department in September 1980 and the assessments were seemed to have been rectified subsequently.

The Ministry of Finance have accepted the audit objection.

4.12 *Mistakes in application of rates of tax.*

From the assessment year 1974-75 the Schedule to the Wealth-tax Act, 1957, prescribes a higher rate of tax for every Hindu undivided family (HUF) having at least one member with assessable net wealth exceeding one lakh of rupees.

(i) In the assessments of ten of such families, in six Commissioners' charges, it was noticed that the prescribed higher rates

were not applied in the assessments for the assessment years 1974-75 to 1979-80. This resulted in under-charge of tax by Rs. 1,55,240 in these cases.

The Ministry of Finance have accepted the mistake in all the ten cases (November 1981) ; report on the collection of additional demands is awaited.

(ii) In respect of another such Hindu undivided family, assessments in respect of the assessment years 1974-75 to 1977-78 were originally completed in May 1977. In the revised assessments made in September 1977, lower rates applicable to non-specified families were charged in respect of all the four assessment years though the particular family had a member with net wealth exceeding Rs. 1 lakh as per records of assessments of the members. The adoption of the lower rate of tax resulted in under-assessment of tax by Rs. 37,832.

Further, under-valuation of house properties in respect of the assessment years 1974-75 to 1977-78 also led to undercharge of tax.

The total short levy of tax came to Rs. 40,938 in respect of the four assessment years.

The Ministry of Finance have accepted the audit objection (August 1981).

(iii) In ten more cases in ten Commissioners' charges, similar mistakes were committed and lower rates were wrongly applied where higher rates were applicable. These mistakes resulted in short levy of tax of Rs. 2,04,444 in the aggregate, the tax short levied in each case being more than Rs. 10,000. The objections have been accepted.

4.13 *Mistakes in calculation of tax*

(i) Urban house property valued at Rs. 70,000 was omitted to be taken into account in computing the additional wealth-tax

leviable on an assessee in respect of the assessment year 1975-76 (assessment completed in March 1980). Further, additional wealth-tax on urban assets valuing Rs. 64,96,000 was calculated wrongly at Rs. 59,482 instead of Rs. 4,02,720. The mistakes resulted in undercharge of tax by Rs. 3,43,238.

The Ministry of Finance have accepted the objection (November 1981).

(ii) The Schedule to the Wealth-tax Act, 1957 was amended by Finance Act, 1974 and the rates of wealth-tax applicable in respect of three slabs, in the range of rupees five lakhs to above rupees fifteen lakhs were increased.

Each of six individuals belonging to one family, had net wealth in excess of rupees fifteen lakhs in respect of the assessment year 1975-76. The tax was, however, calculated at the pre-revised rates as in the earlier assessment years, instead of at the revised rates. This resulted in short levy of wealth-tax by Rs. 53,887 in the aggregate in the six cases.

All the six cases, involving net wealth above Rs. 10 lakhs were required to be checked in Internal Audit. These were not so checked.

The Ministry of Finance have accepted the objection (October 1981).

(iii) An assessee was holding 10308 equity shares of a company, (each share being valued at Rs. 164.46) on the valuation date relevant to the assessment year 1975-76. In assessing the net wealth of the assessee, the department wrongly calculated the value of these shares at Rs. 11,64,329 instead of the correct figure of Rs. 16,95,254. The arithmetical mistake resulted in an under-assessment of wealth by Rs. 5,30,925 and short levy of wealth-tax by Rs. 32,547.

The case was checked in Internal Audit, however, the mistake was not pointed out.

The Ministry of Finance have accepted the objection.

4.14 *Incorrect levy/non-levy of penalty*

(a) Under the provisions of the Wealth-tax Act, if an assessee has concealed the particulars of any assets or furnished inaccurate particulars of any assets or debts, he is liable to penalty.

An assessee filed returns of his net wealth in respect of the assessment years 1973-74, 1974-75 and 1975-76 on 13 August 1973, 30 July 1974 and 30 July 1975 respectively. For concealment of wealth by the assessee penalties of Rs. 500, Rs. 1,190 and Rs. 1,200 were levied in respect of these three years. As per instructions of the Board of 7 June 1968, the amended penalty provisions from 1 April 1968 would apply to the returns submitted after that date and this point was settled by a judgement of the Supreme Court given in 1979. Under the amended provisions, the penalties leviable worked out to Rs. 45,668, Rs. 23,708 and Rs. 1,16,026 respectively in respect of the assessment years 1973-74, 1974-75 and 1975-76. Action to levy additional penalty of Rs. 1,82,512 was not taken even after the point was settled by the Supreme Court.

The Ministry of Finance have accepted the objection.

(b) The Wealth tax Act, 1957 provides for levy of penalty, if an assessee has, without reasonable cause, failed to furnish the wealth-tax return within the prescribed time. In their executive instructions issued in July 1969, the Central Board of Direct Taxes directed that where the Wealth-tax Officer has decided not to levy penalty, having regard to the circumstances of the case, a note should be recorded in the order sheet giving reasons for not invoking the penalty provisions.

A Hindu undivided family filed its wealth-tax return in respect of the assessment year 1975-76 on 27 October 1977, though it was due on 30 June 1975. The assessing officer neither initiated penalty proceedings for the belated filing of return, while finalising the assessment in March 1980, nor did he record any reasons for non-levy of penalty, which worked out to Rs. 61,774 for the period of default from 1 March 1975 to 30 September 1977.

The Ministry of Finance have stated (November 1981) that in such cases judicially the wealth-tax officer could be deemed to have exercised his discretion against levy of penalties; they have, however, admitted that in accordance with the Board's instructions, the Wealth-tax Officer should have left an office note giving his reasons for not having initiated the penalty proceedings. They have also added that reassessment is being done.

OTHER TOPICS OF INTEREST

4.15 *Effect of change of previous year*

Under the provisions of the Wealth-tax Act, wealth-tax is chargeable in respect of each assessment year on the net wealth of the assessee as on the valuation date (which has been defined in the Act as the last date of the 'previous year', as defined in the Income-tax Act) corresponding to that assessment year. Date of commencement of previous year once chosen and used by the assessee cannot be changed except with the consent of the Income-tax Officer and the change may be allowed by him upon such conditions as he may impose. Since wealth-tax is chargeable on net wealth, as on a particular date, the Board had issued executive instructions in 1968 and in 1980 to the effect that Income-tax Officers, while aggreeing to any request of assessees for change in the 'previous year' should ensure that liability to wealth-tax would not be adversely affected.

An Income-tax Officer permitted a charitable trust related to an industrial group to extend its accounting year ending on

31 March 1974 to end on 30 June 1974 and by reason of such change no wealth-tax assessment could be made in respect of the assessment year 1974-75. Consequently, wealth valued at Rs. 72,26,500 as assessed in respect of the assessment year 1973-74 escaped assessment to wealth-tax in respect of the assessment year 1974-75, resulting in loss of revenue of about Rs. 4,88,000.

The paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited.

4.16 *Delayed refund*

Any refund becoming due to a wealth-tax assessee as a result of appellate orders is required to be made without the assessee having to make any claim in that behalf. If such a refund is not made within six months, interest is payable by the Government on the amount of refund due.

Refund of Rs. 27,125 became due to an assessee as a result of an order passed by an Appellate Assistant Commissioner on 16 February 1970. The refund was made only in June 1979. The delay of more than nine years resulted in avoidable payment of interest of Rs. 27,270.

The Ministry of Finance have accepted the objection.

4.17 *Penal procedure*

The Wealth-tax Act, 1957 provides that no order imposing penalty shall be made unless the person concerned has been given reasonable opportunity of being heard.

As assessee submitted his wealth-tax returns in respect of the assessment years 1971-72, 1972-73, 1973-74 and 1974-75 on 21 November 1974 as aainst the due dates of 29 February 1972, 31 July 1972, 16 August 1973 and 31 July 1974 respectively. The department initiated penalty proceedings on 24 February 1975, for delayed submission of

returns in respect of all the assessment years. Orders imposing penalty of Rs. 9150 in respect of the assessment year 1971-72 were passed on the same date. The case of the assessee was subsequently transferred to another ward and the concerned Wealth-tax Officer issued show cause notices in respect of the assessment years 1972-73, 1973-74 and 1974-75 on 18 March 1977 and fixed hearing for 23 March 1977. Orders imposing penalties amounting to Rs. 7,180, Rs. 4,650 and Rs. 910 in respect of these assessment years were passed on 24 March 1977. On an appeal preferred by the assessee, the Appellate Tribunal cancelled the penalties on the ground that notice dated 24 February 1975 was served on the assessee after the date of the order levying the penalty and there was nothing on record to show that notices dated 18 March 1977 had been received by the assessee before the subsequent orders levying penalty were passed. Further, the assessee was allowed refund of Rs. 26,480, being penalty of Rs. 21,890 collected and interest thereon, of Rs. 4,590.

The pararaph was sent to the Ministry of Finance in August 1981 ; their reply is awaited (December 1981).

4.18 *Double refund*

In the case of an individual in respect of the assessment year 1958-59, a tax demand of Rs. 5,556 was worked out (November 1979), after allowing credit for Rs. 20,000 paid on 29 September 1979. This demand was subsequently (February 1980) cancelled and a refund of Rs. 14,444 was arrived at after giving further credit of Rs. 20,000 also paid on 29 September 1979. It was seen in audit (February 1981) that the chalan dated 29 September 1979, for which credit was given in the subsequent adjustment was nothing but a duplicate copy of the original challan which had already been adjusted, while working out the demand of Rs. 5,556. Thus, the refund of Rs. 14,444 allowed to the assessee was incorrect and resulted

in short levy of wealth-tax of Rs. 20,000, because of the defect in the system of record keeping and internal check with accounts records.

The Ministry of Finance have accepted the mistake (September 1981). Report on rectification is awaited (December 1981).

B—*Gift-tax*

4.19 Gift-tax is levied on the aggregate value of all gifts made by a person during the relevant previous year. All transfers of property which are made without adequate consideration in money or money's worth are liable to tax unless specifically exempted by the Gift-tax Act. The term 'property' for the purpose of Gift-tax Act connotes not only tangible movable and immovable property including agricultural land but also other valuable rights and interests.

The receipts under Gift-tax in the financial years 1975-76 to 1980-81 compared as under with the budget estimates of these years :—

Year	Budget estimates (In crores of rupees)	Actuals
1975–76	4.50	5.11
1976–77	4.75	5.67
1977–78	5.50	5.55
1978–79	5.75	5.85
1979–80	5.75	6.83
1980–81	6.25	6.51 (Provisional)

4.20 Number of cases pending assessment and the arrears of demand are given below :—

Year	No. of pending assessments	Arrears of demand at the end of (In crores of of rupees)
1976–77	22,580	5.90
1977–78	22,925	6.97
1978–79	21,807	17.72
1979–80	27,403	15.77
1980–81	38,226	29.52

4.21 During the test audit of assessments made under the Gift-tax Act, 1958 conducted during the period from 1 April 1980 to 31 March 1981, the following types of mistakes were noticed :—

(i) Gifts escaping assessment.

(ii) Non-levy of tax on deemed gifts relating to immovable property, unquoted equity shares, interest in partnership firm and relinquishment of rights.

(iii) Incorrect valuation of gifts.

(iv) Mistakes in calculation of tax.

(v) Failure to aggregate gifts for purpose of calculation of tax.

A few important types of these mistakes are given in the following paragraphs.

4.22 *Gifts escaping assessment*

(i) A film actor filed a gift-tax return in October 1973 declaring a gift of Rs. 33,000 made in July 1972 (assessment year 1973-74). Under the Voluntary Disclosure Scheme of 1975, he disclosed in December 1975 that he had gifted jewellery worth Rs. 1,25,000, other articles worth Rs. 75,000 and one lakh of rupees in cash to his wife (month of marriage March 1973) which also, therefore, were relevant to the assessment year 1973-74. As per the revised wealth-tax return in respect of the assessment year 1975-76 filed in August

1979 he had gifted jewellery worth Rs. 9,65,000 to his wife, though in the wealth-tax return in respect of the assessment year 1974-75, there was no mention of such a gift.

The gift-tax assessment in respect of the assessment year 1973-74 was made on 30 March 1979 (a day before the expiry of the statutory limit period on 31 March 1979) as per return and without taking into account the gifts worth Rs. 3 lakhs which had already come to the notice of the department in December 1975. The wealth-tax assessment in respect of the assessment year 1975-76 was made on 31 March 1980, however, the gift of jewellery worth at least Rs. 8,40,000 (even assuming that Rs. 1,25,000 worth of jewellery, gifted in March 1973, stood included in the figure of Rs. 9,65,000) which had come to the notice of the department in August 1979 was not assessed to gift-tax. The gift-tax short levied aggregated to Rs. 45,800 in respect of the assessment year 1973-74 and the gift-tax not levied in respect of the assessment years 1975-76 to Rs. 2,07,000 (even ignoring the fact that the market value of the jewellery had not been ascertained by reference to the Valuation Cell).

The Ministry of Finance have accepted the objection in respect of the assessment year 1973-74. In respect of assessment year 1975-76, they have stated that the department have not accepted the assessee's version of the gift made, and have instead assessed the properties worth Rs. 8,40,000 as his wealth under the Wealth-tax Act. In response to a notice issued in January 1981, the assessee also filed a gift-tax return in August 1981 declaring nil gift.

(ii) During the previous year relevant to the assessment year 1971-72, two Hindu undivided families (HUF) settled certain agricultural lands on two minor daughters (aged about 3 years and 5 years). The settlements valued Rs. 2,77,810 and Rs. 2,08,180 respectively. During the gift-tax proceedings, the assessees contended that there was no element of gift in the settlements which were in discharge of the obligation of the HUF under the Hindu Law to maintain the minor daughter, perform their marriages and meet their Streedhanam expenses. This

contention was accepted by the deparment and the assessment proceedings were dropped in February/March 1975. Each of the two HUFs consisted of only a sole coparcener and it has been judicially held by the Supreme Court that in such cases the obligation of HUF to maintain the daughter and to perform her marriage is only a moral obligation of a Hindu father. Therefore, the settlement of properties involving transfers of property from HUF to the minor daughters without consideration attracted gift-tax under the provision of the Act. There was non-levy of gift-tax of Rs. 49,703 in one case and Rs. 32,295 in the other. On the omissions being pointed out, the department raised (in February 1980) a demand of Rs. 49,703. The appeal of the assessee against the same is pending (July 1981).

The department also initiated remedial action in the second case in August 1980.

The audit paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(iii) Under the provisions of the Gift-Tax Act a non-resident individual is liable to be charged to gift-tax on the value of movable property gifted by him if the property is situated in India.

It was noticed from the income-tax file of a partnership firm that during the period March 1977 to April 1977, a non-resident remitted to his daughter-in-law, a resident in India, Rs. 6,05,116 by bank remittances. As the title to the amounts remitted from abroad passed on to the donee only on their delivery in India and as there was no evidence that the gift had been accepted on behalf of the donee outside India and then remitted to India, the non-resident donor was liable to gift-tax in India. However, gift-tax amounting Rs. 1,36,530 as required under the law had not been levied by the department.

The audit paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(iv) A waqf (trust under muslim law) was created by a settlor for the benefit of his four sons and five daughters by transferring (in January 1962), to it certain immovable properties. The Gift-tax Officer initiated proceedings for levy of gift-tax and issued notices under the Gift-tax Act. The taxable gift was assessed at Rs. 3,31,000 (in April 1972) after issuing notices to the trustee and one of the sons as legal heir (the settlor having expired). The son on whom alone assessment was made, filed an appeal to the Appellate Assistant Commissioner and contended that as four sons and five daughters of the settlor were given specific shares of waqf property as per waqf deed, the issue of notice to one heir only was not valid. The Appellate Assistant Commissioner annulled (October 1973) the assessment on the ground that the assessment was not validly made. On further appeal by the department, the Income-tax Appellate Tribunal confirmed (August 1974) the orders of the Appellate Assistant Commissioner on the ground that assessment proceedings were defective as the estate was not fully and completely represented. In the result revenue of Rs. 28,250 was lost to Government, due to defective assessment proceedings.

The Ministry of Finance have accepted the objection and the loss of revenue.

(v) While conducting audit of the wealth-tax assessment of an individual for the assessment year 1971-72, in September 1979, it was noticed that during the relevant previous year the assessee had gifted an immovable property valued at Rs. 1,37,800 to his sons. But the assessment records indicated that the assessee had not filed gift-tax return in respect of this gift nor had action been initiated by the department till the date of audit to call for the return. Thus, gift of Rs. 1,37,800 had escaped assessment in respect of the assessment year 1971-72, resulting in non-levy of gift-tax of Rs. 18,060.

The Ministry of Finance have accepted the objection (November 1981) and intimated the raising and collection of

additional demand of Rs. 12,415 after allowing for exemption on stamp duty and advance gift-tax paid.

(vi) During the previous year relevant to the assessment years 1974-75 to 1976-77 a private limited company made donations of Rs. 51,387, Rs. 54,930 and Rs. 79,052 which were not claimed by it as expenditure connected with its business. On these donations, the department did not consider the gift-tax liability of the company, which amounted to Rs. 22,158 (after aggregating the gifts made in the assessment year 1976-77 with those of the two earlier years). This was pointed put in audit in March 1980.

The Ministry of Finance have accepted the objection (September 1981); their report on raising and collection of additional demand (after allowing exemption under consideration) is awaited (December 1981).

(vii) A private limited company donated a sum of Rs. 15,00,000 to a research institution without receiving any consideration in return. The donation was allowed as business expenditure in computing the business income of the assessee under the relevant provisions in the Income-tax Act. The research institution was not set up for charitable purpose and was not one which would qualify the donor for exemption from gift-tax. The gift was also not made for the purposes of the business of the assessee. The donation in question, therefore, attracted gift-tax. The assessee did not, however, file any return nor were any proceedings initiated by the department to levy gift-tax. This resulted in escapment of gift to the extent of Rs. 15,00,000 in respect of the assessment year 1978-79 leading to non-levy of gift-tax of Rs. 4,54,500.

The audit paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

Non-levy of tax on deemed gifts

4.23 *Deemed gift of immovable properties etc.*

Under the provisions of the Gift-tax Act, 1958, where property is transferred otherwise than for adequate consideration, the amount, by which the market value of the property on the date of transfer exceeds the value of consideration received is deemed to be a gift made by the transferor and is chargeable to gift-tax.

(i) In February 1973, an individual transferred a property belonging to him to a private limited company on lease for a period of 98 years. The capitalised value of the lease rights as assessed in the income-tax/wealth-tax assessments was Rs. 20,27,000. The market value of the property was determined by the departmental valuer at Rs. 74,45,000 in respect of the assessment year 1970-71. Even taking this sum to be the value of the property as on the date of transfer of the property on lease, there was deemed gift to the extent of Rs. 54,18,000 on which a gift tax of Rs. 32,36,250 was leviable in respect of the assessment year 1974-75. The department did not, however, initiate any gift-tax proceedings.

The audit paragraph was sent to the Ministry of Finance in September 1981, their reply is awaited (December 1981).

(ii) The wealth-tax assessment records of two assessees showed that, during previous years 1972-73 and 1973-74 they had sold 325 bighas of agricultural land at a rate of Rs. 200 per bigha, for a total consideration of Rs. 65,000. However, it was seen in audit (July 1980) that the fair market value of the land sold was far in excess of the consideration declared to have been received, because the rate of compensation payable by the Government for acquisition of a similar type of land in the vicinity (as arrived at by the courts), was more than Rs. 10,000 per bigha. If the fair market value of the land sold is computed at Rs. 10,000 per bigha, there was a deemed gift of Rs. 31,80,000 in these two cases. On this, gift-tax of Rs. 4,42,500 was leviable in one case in respect of the assessment year 1972-73 and

Rs. 4,27,500 in the other case, in respect of the assessment years 1972-73 and 1973-74.

The Ministry of Finance have acknowledged the objection but not accepted it pending action which has now been taken by the department to do protective assessment and to have the land valued through the Collector. The results of valuation proposed by the department are awaited (December 1981).

(iii) An individual assessee transferred 45 cottahs of land and 9 house flats in the previous year relevant to assessment year 1973-74, 4 house flats in the previous year relevant to assessment year 1974-75 and one house flat in the previous year relevant to assessment year 1975-76, to a land development and housing industries company in which the husband of the assessee was the managing director. The declared value for the house flats as per the registered valuer's report was Rs. 6,98,000. The land was transferred for a declared consideration of Rs. 4.5 lakhs plus an annual rent of Rs. 12,000 and proportionate amount of rates and taxes. The department referred the properties for valuation to its Valuation Cell for purposes of wealth-tax and gift-tax assessments. The Valuation Cell determined the market values of these properties at Rs. 18,77,600 against the declared value of Rs. 11,48,000 (not including the present value of the lease rent of Rs. 12,000 per annum and proportionate amount of rates and taxes, on the 99 years lease, which may work out to around Rs. 1 lakh).

Notwithstanding the departmental valuation available, the gift-tax assessments in respect of the three assessment years (return was received in June 1974 only in respect of first two assessment years) was completed on 28 March 1979 (three days prior to expiry of the statutory limitatoin period on 31 March 1979) without including the difference between the market value and the declared value referred to above, as deemed gift. Consequently a sum of Rs. 7,29,600 (or at least a little over Rs. 6 lakhs allowing for the present value of the lease money recoverable for 99 years) escaped assessment to gift-tax, leading to a short levy of gift-tax aggregating to Rs. 1,79,404 in respect of the assessment years 1973-74 to 1975-76.

The audit paragraph was sent to the Ministry of Finance in August 1981 who in their reply have not accepted the objection. They have, however, stated that pending reassessment of wealth-tax, consequent on earlier assessments having been set aside on the question of proper valuation of immovable property, precautionary gift-tax proceedings have been initiated in respect of the three assessment years.

(iv) Two individual assessees sold two plots of land each, in May 1976, to a Co-operative Society, the members of which belonged to an industrial group. The market value of the properties sold by them was determined at Rs. 6,59,824 and Rs. 9,12,527 on the basis of the departmental valuer's report while the declared considerations were only Rs. 1,98,042 and Rs. 2,01,711 respectively. While capital gains in relation to the market value was computed on the sales and subjected to tax, no action was, taken by the department to levy gift-tax, as required under the Gift-tax Act, on the deemed gifts of Rs. 4,61,782 and Rs. 7,10,816, being difference between the market value and the declared consideration. Thus, gift-tax aggregating to Rs. 2,63,940 remained to be levied in respect of the assessment year 1977-78.

The audit paragraph was sent to the Ministry of Finance in September, 1981 which has in reply stated that necessary notice under the Gift-tax Act has been issued in September 1981. Further report on reassessment is awaited.

(v) A registered firm transferred certain immovable properties to another registered firm and to a company for a consideration of Rs. 7,00,000 in the previous year relevant to the assessment year 1974-75. The value of the properties was determined by the departmental valuer in April, 1979 at Rs. 13,45,898. The difference of Rs. 6,45,898 between the fair market value of Rs. 13,45,898 and the declared consideration of Rs. 7,00,000 was not brought to tax as a 'deemed gift'. The non-levy of tax on this account worked out to Rs. 1,46,770. As the firm failed to file the returns in respect the gift, penalty of Rs. 96,855 was also leviable.

The Ministry of Finance have accepted the objection.

(vi) On 23 July 1971 an assessee, a registered firm, sold certain land and buildings for a declared consideration of Rs. 25 lakhs. The departmental Valuation Officer determined the market value of the property on the date of sale viz. 23 July 1971 at Rs. 30,19,000. The 'fair market value' being higher than the declared consideration, the excess of Rs. 5,19,000 attracted gift-tax as a 'deemed gift'. Similarly, certain other property owned by the same assessee was also declared as sold for Rs. 5 lakhs by an agreement dated 16 November 1973. The market value of the said property was estimated by the departmental Valuation Officer at Rs. 10,49,709, as on 31 March 1974. In this case also, there was a 'deemed gift' of Rs. 5,49,709 on which gift-tax was leviable. No action was, however, taken by the department to levy gift-tax on these 'deemed gifts'. The gift-tax chargeable in these two cases amounted to Rs. 1,10,700 and Rs. 1,19,910 in respect of the assessment years 1972-73 and 1974-75 respectively.

The Ministry of Finance have accepted the objection in principle but, pending decision of the appeal filed by the assessee against the valuation done by the departmental Valuation Officer, have not confirmed the tax effect so far.

(vii) Two assessees each had one-half share in a plot of land in a metropolitan city. Each of them declared Rs. 7,50,000 as the value of the consideration received for the sale made on 29 September 1972 of the half shares. From the income-tax assessment records, it was seen that the departmental Valuer had valued the entire plot of land at Rs. 24,62,000, as on 31 March 1971. Adopting this as the fair market value of the plot on the date of sale, the fair market value of the half shares would be Rs. 12,31,000 as against the declared consideration of Rs. 7,50,000. The excess of fair market value over the declared consideration being a 'deemed gift', Rs. 4,81,000 was liable to gift-tax. As this was not taxed, there was non-levy of gift-tax of Rs. 1,00,500 in each of the two cases, leading to

non-levy of gift-tax of Rs. 2,01,000 in the aggregate in respect of the assessment year 1973-74.

The audit paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

(viii) The accounts of a partnership firm revealed sale of two flats owned by it in a multi-storeyed building in a metropolitan town during the previous years relevant to the assessment years 1974-75 and 1975-76 to the mother and wife respectively of one of its partners for sums of Rs. 1,65,000 and Rs. 1,35,000 while their 'fair market value', as determined by the departmental Valuation Officer, was Rs. 3,55,400 and Rs. 3,55,000 respectively. As the flats were sold at prices lower than fair market value, the difference was liable to be charged to gift-tax as 'deemed gift'. However, no gift-tax proceedings were initiated by the department. Omission to bring the deemed gifts to tax resulted in escapement of gifts of Rs. 1,90,400 and Rs. 2,20,000 in the assessment years 1974-75 and 1975-76 leading to non-levy of gift-tax of Rs. 63,830 in the aggregate in respect of the two assessment years.

The assessment of the partnership firm in respect of the assessment year 1975-76 was checked by the Internal Audit, however, the omission was not noticed.

The Ministry of Finance have intimated that the departmental valuation was done by Income-tax Officer (Survey) and not the Valuation Cell. However, the valuation has not been held to be wrong and the Ministry have neither accepted nor contested the escapement of deemed gift to tax. The further reply of the Ministry is awaited (December 1981).

(ix) A building owned by three persons was transferred by them to a firm in the previous year relevant to assessment year 1976-77 as their share capital. The value of the building was declared as Rs. 5,10,000 and the credit given to each in their respective share capital account was Rs. 1,70,000. The property was valued by the departmental Valuation Officer at

Rs. 10.39 lakhs. The difference of Rs. 5,29,000 between the fair market value and the declared consideration for which it was transferred was required to be taxed as deemed gift in the hands of these three partners. Failure to do so resulted in non-levy of gift-tax of Rs. 77,280 in the aggregate in respect of the assessment year 1976-77.

The audit paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(x) During the previous years relevant to the assessment year 1973-74, an individual wrote off a debt of Rs. 2,64,331 as bad debt. The amount was due from a firm of two partners who were related to the assessee. The loan was given interest free, and the amount had not been written off as bad debt in the books of the firm, nor had it become insolvent, as far as was known to the department. The abandonment of the claim was, therefore, a gift and gift-tax was leviable. Neither did the assessee file return on the amount of the gift nor did the department initiate any gift-tax proceedings. The escapement of deemed gift of Rs. 2,64,331 from assessment resulted in non-levy of gift-tax of Rs. 46,333 in respect of the assessment year 1973-74.

The audit paragraph was sent to the Ministry of Finance in August 1981 who have in their reply stated that the matter is under examination and notice for re-opening of assessment has been issued.

(xi) On 1 January 1975, two assessees transferred their respective half shares in an agricultural land to a firm and their capital account with the firm was credited on that date with Rs. 55,300 each, representing the value of half share in the agricultural land. However, in the wealth-tax records of one of the assessees, the value of his half share, as on 31 March, 1974, had been determined by the department at Rs. 1,88,000. Even considering the 'fair market value' of the land, as on 1 January 1975, to be the same as what was determined by the Wealth-tax Officer to be its value on 31 March 1974, the transaction involved a 'deemed gift' of Rs. 1,32,700 by each of the two assessees. As the deemed gift was not subjected to tax there

was non-levy of gift-tax of Rs. 34,080 in all in the two cases, in respect of the assessment year 1975-76.

The audit paragraph was sent to the Ministry of Finance in August 1981 who have stated that the enquiries in regards to liability to gift-tax made already at the time of wealth-tax assessment is being now pursued and gift-tax escaping assessment was likely to be Rs. 24,464 only. Further report on the assessment is awaited (January 1982).

(xii) A husband and wife owned certain properties like silver utensils in which the wife had one-half share. The husband died without leaving any will in respect of his half share. Consequently, the widow and her three sons acquired one-fourth share each in the property of the deceased. The entire property was sold for Rs. 6,89,826 in December 1974 and the sale proceeds were invested in the name of the widow. The investments were claimed by the widow to be her properties, and, therefore, the three sons of the deceased persons had allowed the transfer of their share of the property to their mother without any consideration. Consequently, gift-tax was leviable on the gift of Rs. 86,238 each, deemed to have been made by each of the three sons to their mother. No gift-tax proceedings were, however, initiated by the department. The aggregate value of gift which thus escaped tax was Rs. 2,58,684 and gift-tax of Rs. 26,052 on it was not levied.

The audit paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

4.24 *Undeclared capital gains and deemed gift*

In November 1973, the Central Board of Direct Taxes specifically required Gift-tax Officers to levy gift-tax on 'deemed gift' in cases where they, as Income-tax Officers, noticed and brought to capital gains tax the excess of the fair market value over the consideration received.

Two individuals (co-owners of certain lands and buildings) formed a partnership firm, on 1 April 1975, with two private

companies in which they were directors. They transferred the lands and buildings to the new firm which was, however, dissolved on 30 March 1976. Thereupon, the properties were taken over by the two private companies at the book value of Rs. 22 lakhs (instead of the market value of Rs. 30,59,000). The Income-tax Officer held (September 1979) that the creation of the firm was a sham transaction designed to evade tax on capital gains and assessed the capital gains of Rs. 8,59,900 to tax in the hands of the two individuals in respect of the assessment year 1976-77. He, however, omitted to initiate proceedings for levy of gift-tax, resulting in non-levy of gift-tax of Rs. 1,76,135.

The Ministry of Finance have accepted the objection.

4.25 *Deemed Gift of Unquoted Shares*

The value of any property transferred by way of gift is the price it would fetch if sold in the open market on the date on which the gift is made. The value of unquoted equity shares in a private limited company, where such shares are not saleable in the open market, is to be determined in the manner contained in Rule 10(2) of the Gift-tax Rules. The prescribed manner requires the ascertaining of value of such shares by reference to the value of the total assets of the company.

(i) In his income-tax returns, an assessee indicated that, during the previous year relevant to the assessment year 1979-80 he had sold 2900 unquoted equity shares in a private company, which he had held. He declared the consideration received as Rs. 8,70,000, at Rs. 300 per share. Though the value of the shares for gift-tax purposes is computed under the aforesaid Rule 10(2), even going by the lower valuation of Rs. 13,50,211 made under the Wealth-tax Rules, the value of the shares was declared less than their market value by at least Rs. 4,80,211 which amount was taxable under the Gift-tax Act, as deemed gift. But neither the assessee had filed any return showing the deemed gift nor had the department called for the same. A gift of at least Rs. 4,80,211, thus escaped assessment in respect of

the assessment year 1979-80, resulting in non-levy of tax to the extent of Rs. 1,00,300.

The audit paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

(ii) In the previous year relevant to the assessment year 1975-76 an individual sold (on 30 December 1974) 1,55,107 unquoted equity shares of a private limited company for a declared consideration of Rs. 3,69,154 to one of his relatives and to the Hindu undivided family of which he was the karta. Based on the balance-sheet of the company as on 31 December 1973 the value of the shares was computed at Rs. 7,44,517 in the manner prescribed in Wealth-tax Rules. Even taking this value to be the open market value of the shares, the excess of the fair market value over the declared sale value, amounting to Rs. 3,75,360 was taxable as "deemed gift". However, neither the assessee had filed gift-tax return nor had the department called for it. This resulted in non-levy of gift-tax of Rs. 74,090 besides non-levy of penalty for non-submission of the return in respect of the assessment year 1975-76. The tax leviable would work out to a larger amount if the market value of the assets of the company had been ascertained instead of going by the book value in the balance sheet, for purposes of valuation.

The Ministry of Finance have accepted the objection (November 1981); report on raising and collection of additional demand is awaited.

(iii) During the previous year relevant to the assessment year 1974-75 an individual sold 14,900 shares of a private limited company to the Hindu undivided family of which he was the 'Karta', for a consideration which was declared by him to be Rs. 14,900. The fair market value of the shares computed by reference to the balance-sheet of the company as on 30th September, 1972 (which was done in the absence of the market value of the assets including goodwill of the company) was Rs. 3,52,832 i.e. Rs. 23.68 per share. The excess of the fair market value of the consideration actually received over the

declared consideration was a deemed gift and chargeable to gift-tax. Neither the assessee had filed any return of gift, nor had the department called for a return. A gift of at least Rs. 3,37,932 (Rs. 3,52,832 minus Rs. 14,900) thus, escaped assessment resulting in undercharge of gift-tax by Rs. 64,732; besides there was omission to levy penalty of Rs. 32,366 for non-submission of return of gift for the assessment year 1974-75.

The amount of gift-tax would work out to be more, if the valuation had been done with reference to market value as prescribed in Rule 10(2) of the Gift-tax Rules, 1958.

The Ministry of Finance have accepted the objection (November 1981); report on raising and collection of additional demand is awaited.

(iv) The business of a registered firm which derived income mainly from a let-out urban house property, was transferred in October 1974 to a company consisting of the three partners of the firm as its only share-holders and directors. The house property was transferred to the company at Rs. 3,73,108 which was its book value in the accounts of the partnership firm. As the house property was let out, for rent, the fair market value of the asset was determinable at Rs. 10,93,284 under the 'income-capitalisation' method, capitalising income at 12 times the net annual rental value as determined in the income-tax assessment of firm. The property, was, thus, transferred otherwise than for adequate consideration. Consequently, the difference of Rs. 7,20,176 between the fair market value and the book value was taxable as 'deemed gift' in the hands of the firm. No proceedings for levy of tax on the gift were, however, initiated by the department. The omission led to non-levy of gift-tax of Rs. 1,71,053 in respect of the assessment year 1976-77.

The audit paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

4.26 *Deemed gift of interest in partnership*

Under the Gift-tax Act the creation of a partnership in property is transfer of property, which if made otherwise than for adequate consideration gives rise to deemed gift which is subject to levy of gift-tax. The Central Board of Direct Taxes, issued executive instructions in March 1976, clarifying that when a partnership firm was reconstituted either with the same old partners or on retirement of one of the partners or on admission of new partners or on conversion of a sole proprietorship into a partnership, and the profit sharing ratios of the partners are revised, any interest surrendered or relinquished by one or more of such persons (without adequate consideration in money or money's worth) in favour of others would attract levy of gift-tax. Valuation of such interest surrendered or relinquished is required to be done on the basis of the market value of the assets of the business including the value of its goodwill.

(i) An individual entered into a partnership with a private limited company and on 27 March 1972 transferred, towards his capital contribution of Rs. 8 lakhs, immovable properties, which were valued by him at Rs. 7,90,000 and a further sum of Rs. 10,000 in cash. He acquired 60 per cent share in the profits and losses of the firm. For wealth-tax purposes the departmental valuer had estimated the value of the properties at Rs. 17,98,700 as on 31 March 1972. Therefore, the difference of Rs. 10,08,700 between the fair market value and the declared consideration was liable to gift-tax, as a deemed gift, in respect of the assessment year 1972-73. No gift-tax proceedings were, however, initiated by the department and gift-tax of Rs. 2,57,980 was not levied.

The audit paragraph was sent to the Ministry of Finance in September 1981, who have not accepted the objection and have in their reply given their view of the meaning attaching to the term 'transfer' under the Gift-tax Act. However, they have intimated issue of notice to the assessee on their having been a gift in principle.

(ii) A firm had four partners with two partners sharing profit at 33 per cent each and the other two at 17 per cent each. The firm was reconstituted in the previous year relevant to the assessment year 1976-77 by bringing in two new partners and admitting them to the benefits of partnership with a share of 16 per cent each. The new partners did not bring in any capital for investment in the firm. Since the original partners relinquished a part of their right in the goodwill of the firm, gift of Rs. 1,10,330 by way of relinquishment of right in goodwill to the extent of reduction in the ratio of profit sharing by two partners escaped assessment and resulted in non-levy of gift-tax of Rs. 25,132. The department has since (November 1980) rectified the assessment.

The audit paragraph was sent to the Ministry of Finance in September 1981; their reply is awaited (December 1981).

(iii) The income-tax assessment records of an individual revealed that a proprietory business owned by him for several years was converted into a partnership, the proprietor retaining only 30 per cent share in the new partnership, the remaining 70 per cent being given equally to his wife and four major sons. The partnership deed did not indicate the consideration received by the proprietor against the 70 per cent share in profits surrendered by him in favour of the new partners who did not bring in any capital of their own into the business. The surrender, therefore, amounted to deemed gift attracting the levy of gift-tax. The department did not, however, initiate any gift-tax proceeding which resulted in escapement of gift of Rs. 1,67,380 (approximate) and non-levy of gift-tax of Rs. 23,976 for the assessment year 1977-78.

The audit paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

(iv) During the year ended 31 March 1973, an individual having 37.5 per cent share in a partnership business, retired foregoing his share of interest in the goodwill of the firm valued at Rs. 1,33,612 and also his share in the 'development rebate reserve' amounting to Rs. 45,826 in favour of one of

the continuing partners. The department did not initiate proceedings to tax this gift of Rs. 1,79,438, which would have fetched tax of Rs. 26,388.

The audit paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited (December 1981).

4.27 *Deemed gift of relinquishment of rights*

The Gift-tax Act, 1958, provides that, where there is a release, surrender or abandonment of any debt or any interest in any property by a person, the value of release, surrender or abandonment which is not found to be bonafide, shall be deemed to be a 'gift' made by the person responsible for the release, surrender or abandonment.

The income-tax assessment records of a private limited company, in respect of the assessment year 1977-78, revealed that an individual to whom a sum of Rs. 4,49,152 was due, had surrendered her right to receive the amount. This fact of surrender was reflected in a note in the balance-sheet of the company. As the individual had forgone her right to receive the amount without any consideration, it amounted to a deemed gift and attracted the levy of gift-tax. No gift-tax proceedings were initiated by the department on this surrender. The assessing officer dealing with the income tax assessments of the company had not sent any intimation to the assessing officer concerned for levy of gift-tax. The omission on the part of the department to initiate gift-tax proceedings, thus, led to non-assessment of gift of Rs. 4,49,152 and consequent non-levy of gift-tax of Rs. 92,538.

The audit paragraph was sent to the Ministry of Finance in June 1981; their reply is awaited (December 1981).

4.28 *Incorrect valuation of gifts*

(a) Under the provisions of the Gift-tax Act, 1958, the value of a gifted property should be estimated to be the price

which in the opinion of the Gift-tax Officer would it fetch if sold in the open market on the date on which the gift was made.

(i) In respect of the assessment year 1976-77, an assessee declared in his return, gift of part of his business which he valued at Rs. 1,48,000 and which had been transferred to his sons through a settlement deed executed on 19 July 1975. The Gift-tax Officer, while completing the assessment of the gift on 28 March 1979, based on the return received in October 1978, valued the gift at Rs. 2 lakhs on the basis of the value of the property shown by the assessee in his wealth-tax assessment records. However, as per information in the wealth-tax assessment records relating to the assessment year 1975-76, the building (part of which was gifted property) had belonged to a firm, and it had been valued at Rs. 10,39,000 on 26 October 1973 by the departmental Valuation Officer. These details were made available only in November 1979 by another assessing officer and were not used in the gift-tax assessment. Failure to adopt even the value of Rs. 5,19,500 instead of Rs. 2 lakhs resulted in short levy of gift-tax by Rs. 80,350.

The audit paragraph was sent to the Ministry of Finance in September 1981, who have in heir reply (January 1982) stated that re-assessment has been done in December, 1980 raising additional demand of Rs. 80,350.

(ii) In October 1964, an individual gifted 155.38 acres of agricultural lands to three persons. On coming to know of it from the State Government revenue records the department issued notice in September 1965 and the assessee filed a 'nil' return in March 1966. The value of the gift indicated in the deed of settlement was Rs. 90,000 but as per the registered valuer's report the lands were valued at Rs. 2,01,066. As per the guidelines for valuation adopted by the State Revenue Officers for registering transfers, the value of the lands was Rs. 5,82,575.

The gift-tax assessment was completed in February 1979 (nearly thirteen years after receipts of the return and a few weeks before the expiry of the statutory time limit on 21

March 1979 and the gift was valued at Rs. 3,91,820 being the average of the estimates of the registered valuer (Rs. 2,01,066) and that as per the guidelines of the State Government (Rs. 5,82,575). No reference was made to the departmental Valuation Officer. There was under valuation of the gift by Rs. 1,90,755 reckoned with reference to the valuation done by State Government for purposes of registration and consequent short levy of gift-tax by Rs. 95,377.

The audit paragraph was sent to the Ministry of Finance in September 1981 and the Ministry have replied that the revision petition of the donor pleading that there was no valid gift and therefore, no liability to gift-tax is pending with the department.

(b) Without prejudice to the statutory provision that the value of any property transferred by way of gift is the price it would fetch if sold in the open market on the date on which the gift is made, the value of unquoted equity shares in a private limited company, where such shares are not saleable in the open market, is to be determined in the manner laid down in Rule 10(2) of the Gift-tax Rules. The prescribed manner is to ascertain the value of such shares by reference to the value of the total assets of the company. It was clarified by the Central Board of Direct Taxes in their executive instructions issued in 1974, that the provisions under the Wealth-tax Rules do not apply to the valuation of such unquoted equity shares under the Gift-tax Rules.

(i) In the previous year relevant to the assessment year 1973-74 an individual gifted, *inter alia*, 543 shares of a foreign private limited company and declared their value as Rs. 705 per share on the basis of valuation done by a registered valuer. The gift-tax was assessed on the basis of such valuation on 27 March 1979 (four days before the statutory time limit which was to expire on 31 March 1979). The approved valuer had based the valuation on the book value of the assets and liabilities of the company and not on the market value thereof. He had further allowed 25% discount in computing the value as per the books. This he had done by applying the provisions in the Wealth-tax Rules to this valuation under the Gift-tax Act. The under-

valuation of the gift on account of 25 per cent discount alone was for an amount of Rs. 1,27,605 with consequent short levy of gift-tax by Rs. 89,604. The short levy with reference to the market value of the assets could not be ascertained.

The assessment was checked in Internal Audit; however, no objection was raised.

The Ministry of Finance have accepted the objection.

(ii) Two assessees gifted 13,000 and 7,000 shares of a private limited company, in March 1975, to two private trusts. The value of shares gifted was taken at Rs. 13.98 per share by valuing them in the manner provided for in the Wealth-tax Rules. However, on the basis of reference to the total value of the assets of the company, as reflected in the balance-sheet of the company as on 30 June 1974, the value per share worked out to Rs. 26.97 There was, therefore, under -assessment of the gift by Rs. 2,59,800 and consequent short levy of gift-tax by Rs. 64,211.

The Ministry of Finance have accepted the objection (November 1981). Report on rectification and collection of additional demand is awaited.

(iii) An assessee gifted 5,650 unquoted equity shares of a private limited company in respect of the assessment years 1972-73 to 1974-75. In assessing the gifts to tax the department valued the shares in the manner prescribed under the Wealth-tax Rules. Because of this there was under-assessment of gifts by Rs. 1,43,080, Rs. 84,770 and Rs. 50,084 in respect of the three assessment years 1972-73, 1973-74 and 1974-75 and short levy of gift-tax by Rs. 63,836 in the aggregate.

The audit paragraph was sent to the Ministry of Finance in August 1981; their reply is awaited.

(iv) Two assessees gifted 960 shares each of a private limited company in October 1974. The value of the shares in a private

limited company was determined by the department at Rs. 291.90 per share on the basis of the book value of the assets shown in the balance-sheet of the company as on 31 December 1973 and after allowing 15 per cent reduction in the manner prescribed in the Wealth-tax Rules. In the absence of the market value of the shares, had the book value of the assets as per the balance sheet of the company as on 31 December 1974 been adopted and the 15 per cent reduction not allowed, the value of the 960 shares of the company gifted by each of the two assessees in October 1974, would work out to Rs. 461.96 per share as against the value of Rs. 291.90 per share adopted by the department.

The incorrect determination of the value of the shares led to under-assessment of gift by at least Rs. 2,42,946 in each case and short levy of gift-tax by Rs. 1,25,255 in the aggregate. The short levy would work out to a larger amount if market value of the assets had been adopted instead of the book value.

The Ministry of Finance have accepted the objection.

(v) An individual gifted 4,000 unquoted equity shares in a private limited company to a family trust on 19 March 1975. The assessing officer, who completed the gift-tax assessment in March 1980 (return received in June 1975 and revised return in October 1979) computed the value of these shares at Rs. 96.31 each as per the rules framed under the Wealth-tax Act, 1957 allowing discount of twenty-five per cent under these rules. The market value of the shares or that of the total assets of the company, were not ascertained by the Gift-tax Officer. The value of the total assets of the company, if determined under the Gift-tax Rules, would have been more, at least, by the extent of discount allowed *i.e.* the shares would have been valued at least at Rs. 128.41 each. The incorrect valuation of the shares led to under-assessment of gift by at least Rs. 1,28,400 with consequent short levy of gift-tax by Rs. 33,782.

The case was required to be checked in Internal Audit under the standing instruction of the Board; it was, however, not so checked.

The Ministry of Finance have accepted the objection.

(vi) In May 1976, an assessee gifted 700 shares and also sold 3,059 shares of a private limited company and declared their value as also consideration received, as Rs. 130 per share The market value of the shares gifted was determined by the department at Rs. 139.23 per share in the manner prescribed under the Wealth-tax Rules after allowing 15 per cent discount. Further, the department stated that in the income-tax assessment the market value of the share was taken at Rs. 170 per share. However, in respect of the 700 gifted shares the market value was taken as only Rs. 139.27 while finalising the gift-tax assessment. Also, the deemed gift on 3,059 shares sold, being the difference between the assessed market value and the declared value, was not subjected to gift-tax. Consequently due to incorrect valuation, gifts were under-assessed by Rs. 1,43,901 with consequent short levy of gift-tax by Rs. 30,270 in the aggregate.

The Ministry of Finance have accepted the objection (November 1981). Report on collection of additional demand is awaited.

4.29 *Mistake in calculation of tax*

On the taxable gift of Rs. 1,98,890 made by an individual in respect of the assessment year 1974-75, the amount of gift-tax correctly leviable, as per the prescribed rates, was Rs. 31,278. However, the tax due was incorrectly determined by the department at Rs. 13,477. This mistake which resulted from tax computation in respect of a slab of rate as Rs. 1,971 instead of

the correct amount of Rs. 19,778 thus led to short levy of gift-tax by Rs. 17,801.

The Ministry of Finance have accepted the objection.

4.30 *Failure to aggregate gifts for purposes of calculation of tax*

A new section 6A was inserted in the Gift-tax Act, 1958 by the Taxation Laws (Amendment) Act, 1976, with effect from 1st April 1976. As a result of this new provision, gifts spread over five previous years are aggregated. Gift-tax is first computed on the gift of the relevant previous year aggregated with gifts of the preceding four previous years (excluding gifts made before 1 June 1973) at the rates applicable to the assessment year in question. From the gift-tax so computed, gift-tax on the aggregate of the gifts of the preceding four previous years calculated at the same rate is deducted. The balance is the gift-tax payable on the chargeable gift in respect of the relevant assessment year.

In the case of an individual who made taxable gifts of Rs. 1,14,500, Rs. 5,000 and Rs. 21,000 during the previous years relevant to assessment year 1976-77, 1977-78 and 1978-79 respectively, the gifts were not aggregated with the gifts made during the relevant earlier previous years, *i.e.* taxable gifts of Rs. 21,000 and Rs. 80,500 made in the previous years relevant to assessment years 1974-75 and 1975-76 respectively. The assessing officer while making the assessments in January/February 1980 over-looked the amendment regarding aggregation of gifts. The failure to observe the provisions of the Gift-tax Act, 1958 led to under-charge of gift-tax by Rs. 14,450 in the aggregate in respect of the three assessment years 1976-77 to 1978-79.

The Ministry of Finance have accepted the objection and intimated that the mistake which was intended to be rectified even earlier has since been rectified.

C. *Estate Duty*

4.31 The receipt under estate duty in the financial years 1975-76 to 1980-81 compared as under with the budget estimates of these years :—

Year	Budget estimates	Actual
1	2	3
	(In crores of rupees)	
1975-76	9.25	11.65
1976-77	8.75	11.73
1977-78	10.75	12.30
1978-79	11.00	13.08
1979-80	12.00	14.05
1980-81	13.00	16.31

4.32 The arrears of demand and the number of assessments pending as at the end of various assessment years were as follows :

Year	No. of assessments pending	Arrears of demand
1	2	3
		(In crores of rupees)
1976-77	27,256	15.56
1977-78	28,287	17.52
1978-79	28,278	17.11
1979-80	34,891	17.23
1980-81	35,862	27.65

4.33 During the test audit of assessments made under the Estate Duty Act, 1953, conducted during the period from 1 April 1980 to 31 March 1981, the following types of mistakes resulting in under-assessment of duty were noticed :—

(i) Incorrect valuation of assets.

(ii) Incorrect valuation of unquoted equity shares.

(iii) Incorrect valuation of principal value of estate.

(iv) Irregular grant of relief.

(v) Mistakes in giving effect to appellate orders.

(vi) Loss of revenue due to other mistakes.

A few instances of these mistakes are given in the following paragraphs :—

4.34 *Incorrect valuation of assets*

Under the provisions of the Estate Duty Act, the value of a property included in the principal value of the estate, shall be estimated to be the price which it would fetch if sold in the open market at the time of death.

According to the executive instructions issued in July 1965 and reiterated in December, 1971, in regard to the valuation of immovable properties, the 'income capitalisation method' or the 'land and building' method is to be adopted ; the latter where the land value is very high as in many urban areas, as the income from the building does not itself give a correct value of the land and building as a whole.

(i) In assessing the duty on the estate of a deceased person, who died in November 1969, the department estimated the value of a house property on a land covering an area of 35 *cottahs*, situated in a metropolitan city at Rs. 1,21,500, being one and a half times the valuation adopted, in assessing the wealth of the deceased, which was Rs. 81,000. The latter figure had been arrived at on the basis of the maintainable rent of Rs. 4,500 per annum and adopting a multiple of 18. The property had been let out at a monthly rental of Rs. 500 to a company in which the sons (to whom the property had been gifted in October 1968) of the deceased as also the wife of the deceased were promoter-directors and the deceased himself had also been an advisor. Had the urban property with considerable land area been valued under the 'land and building method', value of the building would have been estimated at Rs. 43,500 and the 35 *cottahs* of land at Rs. 5,60,000 (at Rs. 16,000 per *cottah*). The adoption of an incorrect method of valuation, resulted in under-assessment of the estate by Rs. 4,82,000 with consequent undercharge of duty by Rs. 1,56,153.

The audit paragraph was sent to the Ministry of Finance in June 1981 ; their reply is awaited (December 1981).

(ii) In determining the value of 277 unquoted equity shares of a company (in which public are substantially interested), with a view to including it in the principal value of the estate passing on the death of a person, there was underestimation of value by Rs. 1,02,213. This resulted from the allowance of an amount of Rs. 15,87,818, representing income-tax payable on amounts credited in the balance sheet of the company under "reserve for collection", as a liability. In determining the value of the shares for wealth-tax purposes under the Wealth-tax Rules, the Wealth-tax Officer had disallowed this income-tax liability on the ground that it was not a liability included in the relevant balance-sheet of the company ; the disallowance had also been upheld by the Appellate Tribunal. Further, there was no indication that this liability represented an existing and ascertained liability. Excluding this liability, as it should have been, the break-up value would have worked out to Rs. 864 per share as against Rs. 495 adopted in the estate duty assessment.

Further, the accountable person furnished a revised valuation report including therein the value of Rs. 5.77 acres of coffee estate omitted to be included in the valuation report originally filed. While completing the assessment, however, the value as per the original report alone was considered, resulting in escapement of estate valued at Rs. 15,310, remaining unassessed.

Further still, a part of the income-tax refund which was due amounting to Rs. 6,738 required to be included in the principal value of the estate but was not so included. As a result of these mistakes there was short levy of estate duty by Rs. 53,049.

The Ministry of Finance have accepted the objection.

(iii) The return received on 24 August 1977 in respect of a deceased person included shares in immoveable properties owned by two Hindu undivided families which shares were valued at Rs. 62,500 and Rs. 1,03,150 by the accountable person. The assessing officer referred the properties to the departmental Valuation Officer in February 1978 for valuation.

However, the assessment was completed in March, 1979 (at the request of the accountable person), prior to the receipt of the valuation report. On the basis of Inspector's reports, values of Rs. 75,035 and Rs. 1,17,002 were adopted in respect of the said shares respectively, subject to rectification on receipt of the departmental Valuer's report. The values of the shares of the deceased in the two properties were arrived at by the departmental Valuation Officer as Rs. 1,26,900 and Rs. 2,36,717 respectively in his reports received in April and September, 1979. However, the assessment done earlier was not rectified till this was pointed out by Audit in December 1979 and the additional estate duty of Rs. 27,870, which became due had not been demanded.

The Ministry of Finance have accepted the objection (November 1981); report on completion of re-assessment and collection of additional demand is awaited (December 1981).

4.35 *Incorrect valuation of unquoted equity shares*

According to the provisions of the Estate Duty Act, 1953 and the executive instructions issued by the Central Board of Direct Taxes (No. 774 of 29 October 1974 and 835 dated 23 May 1975) the unquoted shares in a private limited company should be valued for the purpose of levy of estate duty by reference to the market value of the assets of the company, including goodwill, as on the date of death. Where the market value of the various assets cannot be readily ascertained, the value of the assets as shown in the balance-sheet of the company as on the date nearest to the date of death is to be taken allowing suitable appreciation to provide for the increase in value of the assets. The valuation of shares for estate duty purposes is to be done independently as per the provisions of the Estate Duty Act, 1953 and the Rules framed thereunder; the provisions relating to the valuation of shares under the Wealth-tax Act, 1957 and Rules thereunder are not applicable to estate duty assessments.

(i) While computing the value of the estate of a deceased person, who died on 2 August 1978, the value of such equity

shares held by the deceased was determined as per instructions issued by the Board, taking goodwill also into account. However a deduction of 15 per cent was allowed on the basis of a provision in the Wealth-tax Rules 1957, in arriving at the market value. Such deduction was not admissible under the Estate Duty Act and the Rules. The erroneous abatement resulted in under-assessment of the principal value of the estate by Rs. 1,10,000 and short levy of estate duty by Rs. 44,000.

The Ministry of Finance have accepted the objection.

(ii) In an estate duty assessment made in December 1979, on the estate of a person who died in May 1977, the assessing officer computed the value of unquoted equity shares in two companies incorrectly by resort to the manner prescribed under the Wealth-tax Rules and after allowing discount for non-declaration of dividends by the companies. Based on the value of assets shown in the balance-sheet of the company (in the absence of information on market value of the asset which could be higher) the value of shares would have been Rs. 43,152 more. There was short-levy of estate duty by Rs. 12,939.

The Ministry of Finance have accepted the objection.

4.36 *Incorrect computation of the principal value of estate.*

Under the provision of the Estate Duty Act, in determining the value of an estate, allowance has to be made for debts and encumbrances.

(i) While determining the principal value of the estate of a deceased person, who died on 3 March 1979, the aggregate value of the movable properties was incorrectly taken at Rs. 1,34,816 although the details added up correctly to Rs. 2,34,816 as returned by the accountable person. Further, although the accountable person declared certain bank balances of the deceased amounting to Rs. 13,385, the department omitted to include the same in the estate of the deceased. Thus, the principal value of the estate was under-assessed by Rs. 1.13,385 with consequent undercharge of duty by Rs. 28,956.

The Ministry of Finance have accepted the objection.

(ii) As per the provisions of the Estate Duty Act, 1953, Estate duty is levied on all properties passing on death.

While determining the principal value of the estate of a deceased person at Rs. 5,31,556 (assessed in June 1979 and subsequently revised in July 1979), an amount of Rs. 71,245 representing the value of gold jewellery returned by the accountable person, was omitted to be included in the principal value. The omission resulted in short levy of estate duty by Rs. 21,373.

The Ministry of Finance have accepted the objection.

4.37 *Irregular grant of relief*

As per the provisions of section 61 of the Estate Duty Act, any mistake apparent from record in any order passed by the Assistant Controller of Estate Duty can be rectified within a period of five years from the date of such order.

An estate duty assessment was completed on 31 August 1965, determining the value of the estate at Rs. 6,09,055 and the estate duty payable at Rs. 82,741. An amount of Rs. 80,254 was paid in instalments by the accountable person towards estate duty. The estate of the deceased included properties gifted by the deceased within a period of two years before his death and gift-tax thereon was assessed in December 1969 at Rs. 2,52,775. The accountable person paid only Rs. 16,000 as gift-tax against the demand of Rs. 2,52,775 (reduced later in November 1977 to Rs. 2,18,046 on appeal to High Court). However, estate duty assessment was revised in January 1973 giving consequential relief of Rs. 10,117 in the estate duty payable, under the provisions of Section 50A of the Estate Duty Act, whereunder the gift-tax 'paid' is to be deducted from the estate duty payable. The relief was given by book adjustment from estate duty already paid; the amount of Rs. 10,117 being deemed deducted from the estate duty paid; and the amount taken as credited as further gift-tax of Rs. 10,117 paid

over and above Rs. 16,000. The further credit of Rs. 10,117 of gift-tax deemed paid by book adjustment was deemed to lead to further relief in estate duty payable, to a further extent of Rs. 10,117. Again a book adjustment was made and a further payment of gift-tax of Rs. 10,117 was deemed paid against a deemed deduction from estate duty paid. This cycle was repeated till August 1974 when the estate duty paid (as also payable after the revisions in assessment) came down to almost nil as against Rs. 80,254 of estate duty assessed as payable in August 1965 (total refunds so effected by repeating the cycle seven times in 1973 and 1974 amounted to Rs. 76,588).

It was pointed out in audit (April 1976) that the five year limit for making reassessment having expired, reassessment done during the period from January 1973 to August 1974 were not provided for in the Act. Re-assessment made after the expiry of the statutory limitation period, led to irregular refund of estate duty of Rs. 80,254.

On this being pointed out, the department stated that the five year limit was not applicable in such cases, as it had been judicially held that analogous relief contemplated in section 50 of the Estate Duty Act in respect of stamp duty paid on account of probate of succession certificate was allowable even after the assessment of estate duty had been made. Unlike stamp duty, the gift-tax on the gifts made had become a liability of the estate, on the date of death and the Act takes this fact fully into account in laying down that on the date of assessment, relief is allowable only on account of gift-tax that has been paid. The law does not use the word "payable".

While confirming the facts, the Ministry of Finance have stated that the adjustments made in this case could not be denied under the present scheme of the Act.

4.38 *Loss of revenue due to other reasons*

In respect of the estates of two deceased persons (who died in November 1965 and December 1968), the Assistant Controller of Estate Duty issued notices (in August 1966 and Novem-

ber 1973 respectively) to persons other than the accountable persons asking them for the submission of the accounts of the estates. The notices to the accountable persons were issued only later, in February 1972 and July 1977 respectively. Since the proceedings for the levy of estate duty were not commenced in the two cases by the assessing officer, within five years from the dates of death, as enjoined in section 73-A of the Estate Duty Act, 1953, the assessments done in October 1977 and February 1978 and resulting in demand of estate duty of Rs. 13,125 and Rs. 14,152 in the two cases were quashed in appeal. This resulted in loss of revenue amounting to Rs. 27,277 in the two cases.

The audit paragraph was sent to the Ministry of Finance in June 1981 who have in their reply advanced the view that action under the act was commenced notwithstanding the non-issue of the notice was wholly justifiable.

(R. S. GUPTA)
Director of Receipt Audit.

NEW DELHI
The ....., 1982
9th march 1982

Countersigned

(GIAN PRAKASH)
Comptroller and Auditor General of India.

NEW DELHI
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