Report of the Comptroller and Auditor General of India

for the year ended March 1998

UNION GOVERNMENT

(DIRECT TAXES)

NO. 12 OF 1999

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Comptroller and Auditor General
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PREFATORY REMARKS

This Report for the year ended 31 March 1998 has been prepared for submission to the president under Article 151(1) of the Constitution of India.

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

(i) Chapter 1 includes information on the arrangements for audit of direct taxes and mentions the results thereof;

(ii) Chapter 2 incorporates important statistical information on the administration of direct taxes;

(iii) Chapter 3 includes system appraisals on five topics viz. Export incentives and deductions in respect of profits retained for exports business, Tax deduction at source under sections 194C and 194E of Income Tax Act, 1961, Working of film circles, Audit of notifications/circulars and Sahara Group of Companies;

(iv) Chapters 4 and 5 mention the issues resulting from the audit of corporation tax and income tax respectively;

(v) Chapter 6 highlights the results of the audit of wealth tax, gift tax, interest tax and expenditure tax;

(vi) The observations included in this Report have been selected from the findings of the test audit conducted during 1997-98 as well as in earlier years but which could not be covered in the previous Reports.

OVERVIEW

Audit of Direct Taxes and Results of Audit

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

2. The tax effect of 281 audit observations and system appraisals on five topics featured in this report is Rs.1,239.20 crore and that of 23 cases of overassessment is Rs.19.24 crore.

During the course of local test audit conducted in 1997-98, 16,468 audit observations on underassessment involving tax effect of Rs.3,086.83 crore and 94 cases of overassessment involving tax effect of Rs.38.02 crore have been intimated to the department on Corporation tax, Income Tax and Other Direct Taxes. Of these, 890 cases with a tax effect of Rs.752.59 crore and 28 cases of overassessment involving revenue effect of Rs.20.14 crore have been issued to the Ministry as individual draft paragraphs. Out of the cases issued to the Ministry, 304 draft paragraphs with tax effect of Rs.571.35 crore (including potential tax effect of Rs.257.37 crore) have been included in this Report. Thus, a very small fraction of audit findings have been included in this Report. Some cases noticed in earlier years have also been featured. The cases reported herein are those which either have substantial tax effect or have certain important/interesting features which in the perception of audit, should be reported. Of the cases featured in this Report, 91 cases involving revenue effect of Rs.91.27 crore (including potential tax effect of Rs.29.08 crore) have been accepted by the Ministry.

Besides the audit observations in individual assessments, this Report also includes system appraisals on five topics on the following subjects:

-Export incentives and deductions in respect of profits retained for export business,
-Tax deduction at source under sections 194C and 194E of the Income Tax Act, 1961,
-Working of film circles,

-Audit of Notifications/Circulars, and
-Sahara Group of Companies

3(a) This Report has been prepared after considering the response of the Ministry of Finance to the audit observations, wherever received. However, the receipt of replies to the cases of individual draft paragraphs this year has only been 52 percent as against 59 percent last year.

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

Revenues from Direct Taxes and Administration of Direct Taxes

4. Though the actual collections of direct taxes increased by 24 percent, from Rs. 38,895.08 crore in 1996-97 to Rs.48,280.40 crore in 1997-98, the increase was only due to the collections amounting to Rs.9,554.25 crore under the VDIS-97. But for the VDIS collections, the total tax collection decreased by Rs.168.93 crore (0.43 percent) as compared to the previous year. The ratio of Direct Taxes to the Gross Domestic Product was 3.4 percent. The tax buoyancy of direct taxes during 1997-98 was (-)0.01 and the tax buoyancy with reference to non-agricultural GDP was also (-)0.01.

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

While the collections of direct taxes increased by 24 percent, the cumulative arrears of direct taxes also increased from Rs.33,585.12 crore in 1996-97 to Rs.41,230.03 crore representing an increase of 23 percent. The net arrears of direct taxes, however, came down from Rs.6,055.69 crore in 1996-97 to Rs.5,821.28 crore in 1997-98, a decrease of 4 percent over the previous year. Further, 61 percent of net arrears outstanding as on 31 March 1998 was constituted by high demand cases of Rs.10 lakh and above which showed an increase of 5 percent over the previous year.

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

5. The expenditure of Rs.799.36 crore incurred in collection of all direct taxes (Rs.48,280.40 crore) during 1997-98 was 1.65 percent to the total collections. On an average, 85 percent of collections are realised at pre-assessment stage.

[Paras 2.8 and 2.7(i)]

6. During the year, the number of assessees increased by 14,72,519 and there were 1,34,67,246 assessees as on 31 March 1998. Pendency of assessments continued to remain an area of concern as the percentage of cases pending for scrutiny and summary assessments remained high at 17 and 19 percent respectively.

[Paras 2.1 and 2.9.1(i)]

The Department could dispose off only 6.7 percent of its total workload of assessments after scrutiny and thus the bulk of the workload was disposed off under the summary assessment scheme. In the high income category of cases, the disposal after scrutiny was, however, 50 percent in company cases and 55 percent in non-company cases.

[Para 2.9.1(i)]

7. Cases pending with appellate authorities have a perceptible impact on the assessments and collection of direct taxes. There were 1,49,124 cases pending with Commissioners (Appeals) and 60,884 cases with Dy. Commissioners (Appeals) as on 31 March 1998. 27,911 cases (18.7 percent) pending with the Commissioners were high demand cases. Besides, 1,89,052 cases were pending with the Supreme Court, High Courts and Income Tax Appellate Tribunals.

[Para 2.12]

The arrears of direct taxes which remained uncollected as a result of stay granted or/kept in abeyance by appellate authorities as on 31 March 1998 were Rs.22,515.11 crore.

[Para 2.10(i)(a)]

System Appraisals

8(a) Export incentives and deductions in respect of profits retained for export business

(i) Even though the tax holiday provisions, export incentives and deductions from profits retained from exports have been in the statute for over 15 years, no review/study has been made so far by the department to evaluate the impact of the scheme, and no record is maintained in respect of assessees who have been availing the export incentives under various provisions of the scheme.

(ii) With reference to the cases test checked in audit, the net foreign exchange realisation has increased by more than 3 times during 1994-95 to 1996-97 and the number of beneficiaries availing the deductions raised from 1,296 to 3,348 during the above period.

(iii) Out of 6,680 cases test checked, irregular deductions were noticed in 1,273 cases involving aggregate tax effect of Rs.438.74 crore and the revenue foregone on account of irregular deductions constituted 16 percent of total revenue concession.

(iv) Irregular relief allowed in 11 cases of new industrial undertakings established in free trade zones and in 41 cases of 100 percent export oriented units resulted in total short levy of tax of Rs.6,823.58 lakh.

(v) Incorrect allowance of deductions due to non-compliance with the provisions relating to grant of deductions resulted in an aggregate short levy of tax of Rs.19,082.84 lakh in 254 cases.

(vi) Mistakes in computation of total turnover, export turnover, export profits/adjusted profits of business and direct/indirect costs in 668 cases led to total short levy of tax of Rs.13,055.48 lakh.

(vii) Omission to set off unabsorbed depreciation, etc, against the profits, to exclude other incomes chargeable under other heads of incomes and to set off export losses against the export incentives resulted in short levy of tax aggregating Rs.5,130.44 lakh in 194 cases.

[Para 3.1]

(b) Tax deduction at source (TDS) under sections 194C and 194E of Income Tax Act,1961

(i) In 2,177 cases out of 29,842 cases test checked, tax was not deducted at all or deducted in short involving total revenue effect of Rs.24.01 crore attracting levy of interest and penalty of Rs.31.83 crore. Defaulters, inter alia, included drawing and disbursing officers of Government departments and tax deductors of public sector undertakings.

(ii) Delay in remittance of TDS into Government account in 498 cases and failure to issue TDS certificates in time in 2,028 cases attracted levy of interest and penalty totalling to Rs.5.44 crore.

(iii) In 764 cases, the tax deductors had not applied for allotment of TANs inviting penalty of Rs.38.20 lakh while in 2,825 cases where such applications were made, the TANs were either not issued or issued late. There was no coordination between TAN allotting authority and TDS authority.

(iv) As on 31 March 1997, demand on account of penalty and interest amounting to Rs.63.61 crore was outstanding in 6,523 cases. While penalty action involving Rs.2.70 crore had become time-barred in 108 cases, in 104 cases, though action had been initiated, final action for disposal had not been taken in Gujarat charge which involved revenue effect Rs.1.49 crore.

(v) Out of 1,66,244 effective tax deductors, annual returns were either not furnished or were furnished late in 29,747 cases. In 26,270 cases, no penalty proceedings were initiated. Out of 29,842 returns, checked by audit, in 8,938 cases, the belated submission of returns attracted levy of penalty of Rs.32.73 crore.

(vi) The procedure prescribed for watch of receipt of annual returns and for test check of the returns by the assessing officers was not adhered to. Barring few exceptions, no internal audit was ever conducted in TDS charges.

[Para 3.2]

(c) Working of film circles

(i) The objective of creating film circles to bring about improvement in the quality of assessments of film related personalities was not achieved in view of the shortcomings like non-analysis of records of other organisations like Central Board of Film Certification (CBFC) to ensure that all film related personalities had filed their returns, increasing tax arrears and pendency in disposal of cases coupled with mistakes like incorrect amortisation of cost of production, non-verification of royalty payment from TV Channels to film personalities.

(ii) Recommendations of the Public Accounts Committee relating to strengthening of the Intelligence Wing and for evolving a proper system or methodology to ascertain incomplete/abandoned films were not paid adequate attention.

(iii) Examination revealed that procedures introduced to monitor reasonableness of film expenditure had become redundant due to the changes made in 1991 in regard to availability of raw stock of film from various sources instead of the single source- NFDC.

[Para 3.3]

(d) Audit of Notifications/Circulars

(i)The Board issued circular No.769 dated 6.8.1998 enumerating certain circumstances in which a refund could be made in certain cases independent of the provisions of the Act. This circular, which is against the provisions, constituted an interference in the functioning of the assessing officers and is beyond the competence of the Board.

[Para 3.4]

(ii) Similarly, the Board issued instructions on 23.5.1996 with effect from the assessment year 1989-90 authorising reduction/waiver of interest levied under sections 234A, 234B or 234C of the Act under certain circumstances. Powers to do so having been bestowed upon the Board only from 1.4.1990 (for sections 234A and 234B) and from 1.4.1991 (for section 234C), the instructions were beyond the scope of the Income Tax Act and thus required to be withdrawn.

[Para 3.5]

(iii) The Delhi Golf Club Ltd. was allowed exemption under section 10(23) despite the fact that on similar facts, Chandigarh Golf Club was denied the same.

The departmental officers had opined that the sale of wine and other provisions, rendering catering services, swimming pool, etc. which constituted about 72 percent of the total receipts for the years 1987-88 to 1991-92 appeared to be the primary activities of the club which however do not qualify for the exemption under the Act.

Past history revealed that the club was given favourable treatment by giving exemption with effect from 3.6.1967 without any limit and also without issuing the requisite notification as per the provisions.

Non-filing of return for the assessment year 1990-91 by the club and its non-enforcement resulted in loss of revenue of Rs.82.94 lakh (including interest) in respect of casual membership fee alone.

[Para 3.6]

(e) Sahara Group of Companies

The assessments were to be undertaken under 'best judgement assessment' due to non-cooperative attitude and non-filing of tax returns by the assessee.

The orders of the CBDT on transfer of the case records of the Group from Lucknow to Delhi for assessment were irregular, unwarranted and beyond the

scope of the provisions of the Income Tax Act. The Board not only accepted the application moved by the assessee but also issued orders in favour of the assessee.

Despite non-compliance by the assessee to the notices issued by the department and denial by the Director General (Inv.), North Lucknow for the stay of the demand notice, the application of the assessee for stay of the demand notices for Rs. 381 crore raised by the Assessing Officer was considered favourably by the Board.

Irregularities in the assessments finalised by the new Assessing Officer in the nature of arithmetical mistakes, adoption of incorrect figures, etc. resulted in short levy of tax of Rs.60.72 crore. Due to the change in the incumbency of the Assessing Officer, the investigation trail into certain deposits, property valuations, huge investments by and loans to the Directors etc. and follow up action on notices issued to the field tax officers was completely discontinued.

The undue consideration shown by the CBDT helped the assessee in avoiding deep investigation by the field income tax authorities.

[Para 3.7]

Corporation Tax

9. Corporation tax constituted about 41 percent of the total collections from direct taxes during the year 1997-98. 594 audit observations involving tax effect of Rs.710.69 crore on various irregularities/omissions/mistakes in corporate tax assessments were issued to the Ministry of Finance for their comments.

[Paras 4.3 and 4.5]

(i) In 17 cases, the mistakes in assessments resulted in overcharge of tax of Rs.1,080 lakh in different CIT's charges.

[Para 4.6(1)]

(ii) Incorrect adoption of figures, arithmetical mistakes, application of incorrect rates of tax resulted in short levy of tax of Rs.2239.41 lakh in 11 cases in Delhi, Maharashtra, West Bengal, Gujarat, Tamil Nadu, Karnataka and Uttar Pradesh charges.

[Paras 4.6(2) and 4.7]

(iii) Incorrect allowance of non-business expenditure, capital expenditure and provisions in 12 cases in West Bengal, Maharashtra, Tamil Nadu, North East Region, Orissa and Andhra Pradesh charges led to short levy of tax of Rs.4,078.70 lakh.

[Paras 4.9 and 4.11]

(iv) In Kerala, Jammu & Kashmir, West Bengal, Haryana and Rajasthan charges, incorrect allowance of bad and doubtful debts in respect of advances made by rural branches of banks and bad debts in the case of 5 banking companies resulted in short levy of tax of Rs.1,916.90 lakh.

[Para 4.10]

(v) Irregular allowance of liabilities and mistakes in computation of business income in 27 cases in different CIT's charges led to short levy of tax of Rs.20,126.75 lakh.

[Paras 4.12, 4.15 and 4.16]

(vi) Due to incorrect valuation of closing stock, short levy of tax aggregating Rs.4,131.61 lakh was noticed in 10 cases in West Bengal, Maharashtra, Gujarat and North East Region charges.

[Para 4.17]

(vii) In Uttar Pradesh, Delhi, Maharashtra, West Bengal, Punjab and Andhra Pradesh charges, due to irregular/excess allowance of depreciation and application of incorrect rates for allowance of depreciation, there occurred short levy of tax aggregating Rs.1,449.84 lakh in 10 cases.

[Paras 4.19 to 4.21]

(viii) Excess/irregular and incorrect carry forward and set off of unabsorbed depreciation resulted in short levy of tax of Rs.1,546.49 lakh in 8 cases in Maharashtra, Karnataka, Kerala, West Bengal and Uttar Pradesh charges.

[Para 4.22]

(ix) In Gujarat, Karnataka, Maharashtra and Tamil Nadu charges, in 4 cases, mistakes in allowance of investment allowance and incorrect set off of unabsorbed investment allowance led to short levy of tax of Rs.970.23 lakh.

[Paras 4.23 and 4.24]

(x) Omission to assess capital gains and incorrect computation of capital gains resulted in short levy of tax of Rs.1,247.27 lakh in two cases in Tamil Nadu and Maharashtra charges.

[Paras 4.25 and 4.26]

(xi) In 7 cases in Maharashtra, West Bengal, Gujarat, Uttar Pradesh and Jammu & Kashmir charges, mistakes committed in assessments of income such as irregular treatment of revenue receipts as capital receipts, failure to account for receipts as per the system of accounting regularly adopted by the assessees, etc. led to aggregate short levy of tax of Rs.2,144.33 lakh.

[Para 4.27]

(xii) Incorrect carry forward and set off of losses and incorrect set off of capital loss resulted in short levy of tax aggregating Rs.1,857.97 lakh in 11 cases in West Bengal, Tamil Nadu, Kerala, Karnataka and Maharashtra charges.

[Paras 4.28 and 4.29]

(xiii) Mistakes committed in assessments while giving effect to appellate orders resulted in short levy of tax totalling to Rs.407.76 lakh in 5 cases in Madhya Pradesh, Maharashtra, Jammu & Kashmir and North East Region charges.

[Para 4.31]

(xiv) In 4 cases in West Bengal, Maharashtra and Kerala charges, irregular allowance of Chapter VIA deductions despite the fact that the gross total income worked out to a loss or due to irregular computation of gross total income resulted in an aggregate short levy of tax of Rs.1,346.44 lakh.

[Para 4.32]

(xv) Incorrect allowance of deductions in respect of profits and gains from new industrial undertakings established after 31 March 1981 and in backward areas after certain date resulted in short levy of tax totalling to Rs.544.15 lakh in 6 cases in Karnataka, Maharashtra, West Bengal, Madhya Pradesh, Kerala and Rajasthan charges.

[Paras 4.35 and 4.36]

(xvi) In Madhya Pradesh, Maharashtra, Karnataka and Uttar Pradesh charges, in 4 cases, irregular/incorrect allowance of deduction in respect of profits and gains from new industrial undertakings established after 31 March 1991 resulted in an aggregate short levy of tax of Rs.411.36 lakh.

[Para 4.37]

(xvii) Incorrect allowance of deduction in respect of inter-corporate dividends in 7 cases in West Bengal, Maharashtra, North East Region and Karnataka charges resulted in short levy of tax totalling to Rs.1,183.61 lakh.

[Para 4.38]

(xviii) In Delhi charge, incorrect allowance of deduction in respect of commission etc. from foreign enterprises resulted in underassessment of income of Rs.95.23 lakh involving short levy of tax of Rs.84.67 lakh.

[Para 4.39]

(xix) Irregular allowance of double taxation relief in 2 cases in North East Region and Tamil Nadu charges resulted in total short levy of tax of Rs.173.30 lakh.

[Para 4.41]

(xx) Mistakes committed in determining the amounts of refunds resulted in excess refunds totalling to Rs.42.98 lakh in 2 cases in Tamil Nadu and Gujarat charges.

[Para 4.42]

(xxi) Mistakes committed in levy of interest for delay in filing the return, short payment/deferment of advance tax and for delay in payment of tax demand etc. in 10 cases in West Bengal, Punjab and Gujarat charges resulted in non-levy/short levy of interest aggregating Rs.1,760.01 lakh.

[Paras 4.43 to 4.45]

(xxii) In West Bengal, Punjab, Andhra Pradesh and Maharashtra charges, due to failure to refund/short refund of tax paid by way of TDS and advance tax and other mistakes, there occurred irregular/excess payment of interest and short charge of tax aggregating Rs.243.22 lakh in 4 cases.

[Para 4.46]

(xxiii) In Maharashtra charge, non-initiation of penalty proceedings even though the assessee obtained loans and repaid the same in cash exceeding the prescribed monetary limits resulted in non-levy of penalty of Rs.632.40 lakh.

[Para 4.47]

(xxiv) In Tamil Nadu charge, failure to levy interest for non-remittance of TDS amount into Government account led to non-levy of penal interest of Rs.97.15 lakh.

[Para 4.48]

(xxv) In West Bengal charge, as against Rs.2,868.18 lakh leviable on account of disallowance of loss by way of prescribed adjustment made in the summary assessment, additional income tax of Rs.2,494.07 lakh only was levied resulting in short demand of additional income tax of Rs.374.11 lakh.

[Para 4.50]

(xxvi) Due to absence of enabling provision in the Act and failure to rectify the assessment made in a summary manner before the scrutiny assessment there occurred a loss of revenue of Rs.75.82 lakh towards additional income tax leviable in one case in West Bengal charge.

[Para 4.51]

(xxvii) In Tamil Nadu charge, omission to give effect to the observation made by internal audit resulted in excess carry forward of unabsorbed depreciation involving short levy of tax of Rs.146.49 lakh.

[Para 4.52]

(xxviii) In Maharashtra charge, failure to gross up for arriving at the taxable incomes of the individual employees on the basis of tax paid by the assessee on their behalf, there occurred a total short levy of tax of Rs.584 lakh (including interest).

[Para 4.53]

Income Tax

10(i) During the year 1997-98, income tax constituted about 35 percent of the total collections from direct taxes.

213 audit observations involving revenue effect of Rs.48.35 crore on various irregularities/mistakes/omissions in the income tax assessments were issued to the Ministry of Finance during the year for their comments.

[Paras 5.2 and 5.5]

(ii) Avoidable mistakes like adoption of incorrect figures, non-levy of sur charge, application of incorrect rates of tax etc. led to short levy of tax of Rs.884.86 lakh in 12 cases and overcharge of tax of Rs.839.11 lakh in 6 cases in different CIT's charges.

[Paras 5.6 and 5.7]

(iii) Adoption of incorrect status of the assessee, mistakes committed in computation of salary income and income payable net of tax resulted in short levy of tax totalling to Rs.28.73 lakh in 3 cases in Bihar and Kerala charges.

[Paras 5.8 to 5.10]

(iv) Incorrect computation of business income, incorrect allowance of capital expenditure and provisions, incorrect valuation of closing stock and underassessment of sales etc. resulted in short levy of tax aggregating Rs.247.07 lakh in 11 cases in Maharashtra, North East Region, Karnataka, Uttar Pradesh, Gujarat, Punjab and West Bengal charges.

[Paras 5.11 to 5.16]

(v) In 3 cases in Punjab, Bihar and Rajasthan charges, incorrect application of rate of depreciation and irregular set off of unabsorbed depreciation led to short levy of tax totalling to Rs.28.37 lakh.

[Paras 5.17 and 5.18]

(vi) In Gujarat charge, incorrect carry forward of unabsorbed investment allowance beyond prescribed period of eight years resulted in short levy of tax of Rs.54.02 lakh.

[Para 5.19]

(vii) Incorrect computation and exemptions and incorrect adoption of index cost in computation of capital gains resulted in short levy of tax of Rs.146.20 lakh in aggregate in 5 cases in Maharashtra, West Bengal and Gujarat charges.

[Paras 5.20 to 5.22]

(viii) Mistakes committed in assessment of income such as failure to bring to tax the income from business activity, receipts as per accounting system adopted by the assessee, etc. resulted in short levy of tax totalling to Rs.107.65 lakh in 5 cases in Haryana, Orissa, Himachal Pradesh and Kerala charges.

[Paras 5.23 to 5.25]

(ix) In 5 cases in West Bengal, Uttar Pradesh, Tamil Nadu and Karnataka charges, incorrect carry forward and set off of losses resulted in an aggregate short levy of tax of Rs.177.40 lakh.

[Para.5.26]

(x) Incorrect allowance of deductions in respect of incomes of 2 cooperative societies led to short levy of tax totalling to Rs.67.46 lakh in Tamil Nadu and Kerala charges.

[Para 5.30]

(xi) In Chandigarh, Delhi, Bihar and Madhya Pradesh charges, short levy/ omission to levy/incorrect levy of interest for short payment of advance tax, delay in payment of tax demand, non-filing of returns etc. in 4 cases amounted to Rs.113.85 lakh.

[Paras 5.31 to 5.33]

(xii) In Maharashtra and Karnataka charges, there was irregular payment of interest totalling to Rs.37.71 lakh by the Government to 2 assessees.

[Para 5.34]

(xiii) Other mistakes committed in assessments such as omission to make reassessment within the prescribed period, omission to bring receipts to tax and to make prescribed adjustments etc. resulted in loss of revenue of Rs.11.63 lakh in one case and an aggregate short levy of tax of Rs.62.50 lakh in 5 cases in Tamil Nadu, North East Region, Andhra Pradesh and Karnataka charges.

[Paras 5.36 to 5.40]

Wealth Tax

11(i) In Maharashtra charge, omission to include certain specified assets in the net wealth of an individual resulted in short levy of tax of Rs.237.87 lakh.

[Para 6.4.1(i)]

(ii) Incorrect valuation of immovable properties of two individuals in Maharashtra charge led to underassessment of wealth aggregating Rs.544.52 lakh with consequent short levy of tax of Rs.13.14 lakh.

[Para 6.5]

(iii) In West Bengal, Maharashtra and Tamil Nadu charges, in the case of 11 companies, owning specified assets chargeable to wealth tax were not assessed which resulted in non-levy of tax aggregating Rs.116.55 lakh.

[Paras 6.7 and 6.10]

(iv) In Tamil Nadu charge, incorrect valuation of immovable property of a closely held company led to underassessment of wealth of Rs.950 lakh with consequent short levy of tax of Rs.52.34 lakh.

[Para 6.9]

Gift Tax

12(i) In Karnataka charge, omission to assess deemed gifts resulted in escapement of gifts aggregating Rs.44.91 lakh with consequent non-levy of gift tax of Rs.13.05 lakh.

[Para 6.16]

(ii) In Bangalore charge, incorrect exemption of gift to a trust not established for any charitable purposes for income tax purposes resulted in Rs.43.38 lakh escaping assessment involving non-levy of gift tax of Rs.24.60 lakh.

[Para 6.17]

Interest Tax

13(i) In Kerala charge, non-assessment of chargeable interest resulted in escapement of Rs.7,059 lakh from interest tax assessment with consequent short levy of tax of Rs.287.56 lakh.

[Para 6.23(i)]

(ii) Short-levy of interest for default in payment of interest tax in advance aggregated Rs.50.59 lakh in the case of one banking company in Kerala charge.

[Para 6.24]

Expenditure Tax

14. In Tamil Nadu charge, irregular allowance in computation of chargeable expenditure resulted in short levy of expenditure tax aggregating Rs.7.18 lakh.

[Para 6.25]

CHAPTER 1 : INTRODUCTION

General

1.1 Direct Taxes levied by Parliament comprise:

— **Corporation Tax** (taxes on income paid by companies, corporations etc.)

— **Income Tax**

— **Wealth Tax**

— **Gift Tax**

— **Interest Tax**

— **Expenditure Tax**

Laws relating to Direct Taxes are administered by the Central Board of Direct Taxes (hereinafter called 'the Board'). The Board is under the overall control of Department of Revenue, Ministry of Finance. Revenue from Direct Taxes during 1997-98 was Rs.48,280.40 crore. Time series data on revenue from various Direct Taxes and other related statistical information including on tax administration are in presented Chapter 2.

Statutory Audit

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

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

brought to the notice of the field Commissioners of Income Tax through local audit reports by the field offices of the Accountants General/Principal Directors of Audit. Important audit observations are then issued to the Ministry of Finance for their comments after a thorough review at Headquarters of the Comptroller and Auditor General.

Present Report

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

A total of 16,468 audit observations on Corporation Tax, Income Tax and other Direct Taxes involving underassessment of tax of Rs.3,086.83 crore and 94 audit observations involving overassessment of tax of Rs.38.02 crore as noticed during test check of assessment records in 1997-98 were referred to the department. The department has so far accepted the observations in 5,633 cases involving tax effect of Rs.723.95 crore.

Out of the cases referred to the department, 890 cases involving underassessment of tax of Rs.752.59 crore (including potential tax of Rs.278.61 crore) and 28 cases of overassessment involving revenue effect of Rs.20.14 crore (including potential* tax of Rs.7.19 crore) were issued to the Ministry of Finance as **draft paragraphs**. Only a small fraction of these cases has been featured in this Report. The selection of cases featured is based on either their monetary significance or which, in the perception of Audit, require the attention of the Parliament.

The present Report contains 281 audit observations pertaining to corporation tax, income tax, wealth tax, gift tax, interest tax and expenditure tax. The revenue effect of these cases amounts to Rs.552.11 crore (including potential tax of Rs.250.18 crore in 60 cases). 23 cases on overassessment of tax amounting to Rs.19.24 crore (including 6 cases with potential tax effect of Rs.7.19 crore) has also been featured in the Report. Besides these individual audit observations, the Report also contains system reviews on five topics viz. Export incentives and deductions in respect of profits retained for export business, Tax deduction at source under Section 194C and 194E of the Income Tax Act, 1961, Working of film circles, Audit of notifications/circulars and Sahara Group of Companies the tax effect which is Rs.687.09 crore. Audit observations in 91 individual cases with tax effect of Rs.91.27 crore (including 24 cases involving potential tax effect of

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* 'Potential' tax effect or (P) wherever occurring in this Report indicates the tax effect of the irregularity/mistake. In certain 'loss' cases, it may happen that even after correcting the mistake, there is a net loss and no tax would be leviable in the assessment year under examination. However, in future years when there is profit, there may be a tax liability.

Rs.29.08 crore) have been accepted by the Ministry. Of the cases referred to the Ministry those in which the Ministry have accepted the audit observations and have also taken remedial action including raising and collection of the resultant additional demand, have not been included in the Report except in special cases.

Non-receipt of Board's comments on draft paragraphs

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

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

Year of Report	Number of draft paragraphs issued	Replies received before finalisation of Audit Report	Percentage of cases in which replies were received	No. of cases accepted by Ministry	Percentage of cases accepted by Ministry
1993-94	620	536	86.5	427	79.7
1994-95	796	668	84	549	82.2
1995-96	831	673	81	565	84
1996-97	685	405	59	295	73
1997-98	918	474	52	339	72

Local Audit Report

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

Results of Test Audit in general

1.5.1 Test audit conducted between 1 April 1997 and 31 March 1998 of the assessments completed by the Income Tax Department revealed 16,468 cases of underassessment involving a total revenue effect of Rs.3,086.83 crore and 94 overassessment cases involving a total revenue effect of Rs.38.02 crore, which were referred to the department. A resume of the deficiencies noticed is given below:

Corporation Tax and Income Tax

(i) During the period under report, 15,702 cases involving a tax effect of Rs. 3,044.52 crore were referred to the department. Of these cases, major audit observations were raised in 8,966 cases involving short levy of tax of Rs.2,890.56 crore. The remaining 6,736 cases accounted for underassessment of tax of Rs.153.96 crore.

The reasons for underassessment of tax of Rs. 3,044.52 crore (including Potential Tax) are categorised as follows:

		No. of cases	Amount (Rs. in crore)
1.	Avoidable mistakes in computation of income and tax	1,531	192.32
2.	Failure to observe the provisions of the Finance Acts	458	67.64
3.	Incorrect status adopted in assessments	124	5.27
4.	Incorrect computation of salary income	466	29.77
5.	Incorrect computation of income from house property	160	1.79
6.	Incorrect computation of business income	3,896	973.66
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1,454	394.72
8.	Irregular computation of capital gains	349	76.28
9.	Mistakes in assessments of firm and partners	219	2.79
10.	Omission to club the income of spouse/minor child etc.	42	53.81
11.	Income not assessed	1,326	357.16
12.	Irregular set off of losses	597	156.20
13.	Mistakes in assessments while giving effect to appellate orders	72	6.72
14.	Irregular exemptions and excess reliefs given	1,116	561.15
15.	Excess or irregular refunds	304	11.95
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1,727	71.41
17.	Avoidable or incorrect payment of interest by Government	181	4.73
18.	Omission/short levy of penalty	595	18.40
19.	Other topics of interest (miscellaneous cases)	1,054	57.43
20.	Underassessment of surtax	31	1.32
	Total	**15,702**	**3,044.52**

Wealth Tax

(ii) During test audit of assessments made under Wealth Tax Act, 1957, short levy of tax of Rs.28.09 crore was referred to the department in 528 cases.

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

		No. of cases	Amount (Rs. in crore)
1.	Wealth not assessed	257	23.61
2.	Incorrect valuation of assets	57	2.24
3.	Mistakes in computation of net wealth	56	1.15
4.	Incorrect status adopted in assessments	3	0.09
5.	Irregular/ excessive allowances and exemptions	11	0.04
6.	Mistakes in calculation of tax	14	0.08
7.	Non-levy or incorrect levy of additional wealth tax	10	0.14
8.	Non-levy or incorrect levy of penalty and non-levy of interest	85	0.58
9.	Miscellaneous	35	0.16
	Total	**528**	**28.09**

Gift Tax

(iii) During test check of gift tax assessments, 157 cases involving short levy of tax of Rs.4.98 crore were referred to the department.

Interest Tax

(iv) In the course of test audit of Interest Tax assessments it was noticed that in 73 cases there was short levy of interest tax of Rs. 8.36 crore.

Expenditure Tax

(v) During test check of Expenditure tax assessments, 8 cases involving short levy of tax of Rs.0.88 crore were referred to the department.

Outstanding audit observations

1.5.2 According to the departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee (Ninth Lok Sabha) in their 20th Report recommended that the responsibility for the settlement of audit observations rests with the department and it cannot be contented merely with sending replies to audit observations. In their Action Taken Note, the Ministry of Finance had stated that they would endeavour to see that the targets for settlement of audit observations were achieved. However, large number of audit observations made in 1997-98 and earlier years are still to be settled. The details are mentioned below:

(a) On 31 March 1998, 71,766 observations involving a revenue effect of Rs.6,467.38 crore were pending for final action. This does not include the audit observations communicated during 1 April 1997 to 31 March 1998. The year-wise particulars of the pendency are as follows:

(Rs. in crore)

	Income Tax		**Other Direct Taxes (Wealth Tax, Gift Tax, Interest Tax, Expenditure Tax and Estate Duty)**		**Total**	
Year	**Items**	**Revenue effect**	**Items**	**Revenue effect**	**Items**	**Revenue effect**
1994-95 & before	43,436	3,243.69	6,972	63.05	50,408	3,306.74
1995-96	8,901	1,178.17	1,052	16.43	9,953	1,194.60
1996-97	10,681	1,956.17	724	9.87	11,405	1,966.04
Total	**63,018**	**6,378.03**	**8,748**	**89.35**	**71,766**	**6,467.38**

(b) There were 3,937 pending audit observations as on 31 March 1998 with a revenue effect of Rs.4,594.91 crore (as against 4,064 cases with a revenue effect of Rs.3,823.99 crore in earlier year) where the income tax involved in each individual case exceeded Rs.10 lakh. The break-up of such cases in respect of a few charges where number of outstanding items are 50 or more is shown below:

Sl. No.	**Name of charge**	**Items**	**Amount (Rs. in crore)**
1.	Assam	103	182.10
2.	Bihar	56	93.72
3.	Delhi	488	634.68
4.	Gujarat	182	202.12
5.	Kerala	149	62.07
6.	Karnataka	96	116.24
7.	Madhya Pradesh	356	699.66
8.	Maharashtra	950	1,279.59
9.	Orissa	67	34.94
10.	Punjab	101	91.38
11.	Rajasthan	94	35.80
12.	Tamil Nadu	478	536.97
13.	Uttar Pradesh	166	101.01
14.	West Bengal	577	492.96

(c) There were 143 pending audit observations with a revenue effect of Rs. 18.88 crore where the wealth tax involved in each case exceeded Rs.5 lakh.

(d) There were 66 pending audit observations with a revenue effect of Rs.13.05 crore where the total gift tax involved in each case exceeded Rs. 5 lakh.

(e) There were 14 pending audit observations with revenue effect of Rs.3.52 crore where the total interest tax in each case exceeded Rs.5 lakh.

(f) There was 1 pending audit observation with revenue effect of Rs.10.23 lakh where the expenditure tax exceeded Rs.5 lakh.

Of the 71,766 pending cases with revenue effect of Rs.6,467.38 crore, 4,161 cases (5.80 percent) of high tax effect accounted for Rs.4,630.46 crore (71.60 percent). This underlines the need to assign priority to the settlement of observations with high money value.

Steps taken to settle audit observations

1.5.3 The Action Plan of the department for 1997-98 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of statutory audit upto 31 December 1997 (i.e. period of report being 1997-98), replies are to be sent in 80 percent of the cases.

The targets for settlement of the major statutory audit observations for the year 1997-98 according to Action Plan and actual achievements were as under:

	Audit observations				
	For disposal (Rs. in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Shortfall	
				Cases	Percentage
Current	9,482 (10803.70)	7,586 (80%)	2,756 (778.16)	4,830	63.67
Arrear	20,454 (4494.09)	18,409 (90%)	4,944 (1107.95)	13,465	73.15

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

Remedial action barred by time

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

In a few charges reviewed during the year 1997-98, a number of audit objections issued during the period 1973-74 to 1990-91 where remedial action became barred by limitation were noticed. Details of these cases have been forwarded to the respective Commissioners. The number of such cases alongwith tax effect are mentioned below:

Sl. No.	Charge	Corporation Tax and Income Tax		Other Direct Taxes	
		No. of observations	Amount (Rs. in crore)	No. of observations	Amount (Rs.in crore)
1.	Bihar	387	10.58	68	0.19
2.	Karnataka	16	1.59	-	-
3.	Madhya Pradesh	-	-	01	0.01
4.	Maharashtra	01	0.05 (potential)	-	-

Internal Audit

1.6 In addition to the statutory audit, the department also has an Internal Audit Department (IAD) which is required to conduct 100 percent and 50 percent audit of all immediate and priority assessment cases respectively (as defined under departmental instructions of September 1990). Based on this, the department had determined the number of auditable cases by their IAD during 1997-98 as 3.72 lakh. However, the target was fixed at a level based on 150 audit parties working during the period from 1 April 1997 to 31 March 1998 and each party being required to audit 110 cases every month. An analysis of their performance is given below:

Total auditable cases	Targets for disposal	Total cases audited	Excess
3,71,559	1,98,000	1,98,458	458

Outstanding audit observations of Internal Audit

1.6.1 According to the departmental instructions, observations of Internal Audit Department are to be attended to by the assessing officers within three months. However, this did not happen as seen from the fact that as on 31 March 1998, 37,238 audit observations made by the Internal Audit involving a tax effect of Rs.1,124.78 crore were pending settlement. This included 13,228 observations with money value of Rs.414.52 crore made during 1997-98.

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

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

The Public Accounts Committee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that observations of Internal Audit should be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases became time-barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken note had stated that assessment- yearwise and

age-wise classification was being made so that greater attention could be paid to settlement of older and revenue significant objections. Since the normal period available for re-opening of cases is four years, all observations pertaining to 1994-95 and earlier years should have been settled by March 1998. However, this did not happen as shown in the following table which gives age-wise analysis of the pending items at the end of 1997-98 and revenue effect involved:

Year of the observation	No. of cases	Revenue effect (Rs. in crore)
1994-95 & before	20,546	592.64
1995-96	3,498	92.53
1996-97	4,870	112.90
1997-98	8,324	326.71
Total	**37,238**	**1,124.78**

Action on observations of Internal Audit

1.6.2 The Action Plan of the department for 1997-98 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of Internal Audit upto 31 December 1997 (i.e. period of reporting being 1997-98), replies were to be sent in 80 percent of the cases.

The targets according to Action Plan and actual achievement in settlement of the major internal audit observations for the year 1997-98 were as under:

	Audit observations				
	For disposal (Rs in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Shortfall	
				Cases	Percentage
Current	7,296 (412.10)	4,483 (80%)	2,825 (87.30)	1,658	36.98
Arrear	11,801 (950.95)	10,621 (90%)	3,410 (164.40)	7,211	67.90

The achievements thus fell short of the targets.

CHAPTER 2 : ADMINISTRATION OF DIRECT TAXES

I. The total collection from various direct taxes for the year 1997-98 was Rs.48,280.40 crore including Rs.9,554.25 crore from VDIS-97. Though there was an overall increase in revenue collection by Rs.9,385.32 crore, collection from VDIS was at the cost of the normal growth in revenue collection as the total collection (excluding VDIS) declined by Rs.168.93 crore as compared to 1996-97 despite increase in the overall number of assessees from 1.20 crore to 1.35 crore.

Collection of corporation tax increased by 7.8 percent but collection of income tax other than corporation tax decreased by 6.2 percent.

[Para No.2.1 and 2.3]

II. Tax buoyancy, a key indicator of efficiency of revenue mobilisation in response to growth in GDP, was on an average greater than one over the last ten years. However, it turned negative in the year 1997-98. Simultaneous operation of VDIS and reduction in tax rates during 1997-98 resulted in decline in total revenue collection despite the increase in the number of assessees.

Tax revenues on an average grew at a rate of 19.6 percentage per annum during the last 10 years except in 1997-98.

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

Analysis of the growth of assessees revealed that most of the new assessees, company and non-company, belonged to low income strata. It was seen that reduction in tax rates did not yield better tax compliance among higher income strata of companies.

About 95 percent of the new non company assessees were from low income range and as a result there was a declining trend in the per capita revenue collection during the last five years. It also showed that lowering of tax rates had not resulted in a marked increase in tax compliance among higher income groups.

[Para No.2.5]

III. Collections under corporation tax, income tax other than corporation tax and other direct taxes have fallen short of budget estimates by 8.43 percent, 21.19 percent and 41.49 percent respectively.

[Para 2.6]

IV. On an average, 85 percent of total collection are realised at preassessment stage and only 15 percent of the collection are made on the regular assessments and through other receipts. Refunds constituted 27 percent in company cases and 10 percent in non-company cases.

[Para 2.7]

V. Total pendency of assessments under income tax including corporation tax has increased during 1997-98 (18.7%) as compared to 1996-97 (13.7%) though cases disposed of by scrutiny increased by 14 percent (approx.). On the whole, 6.7 percent of the total work load of assessment cases was disposed of by scrutiny and 74.7 percent by summary manner.

[Para 2.9(1)]

VI. The amount of tax which remained uncollected on 31 March 1998 was Rs.41,230.03 crore in the case of income tax including corporation tax. The uncollected amount has increased by Rs.7,644.91 crore constituting 22.7 percent over the previous year, a major cause for increase being demands kept in abeyance by courts, tribunals and revenue appellate authorities. The uncollected amount comprised arrear demand of Rs.25,703.80 crore of earlier years which included Rs.1,444.05 crore relating to period over 5 years. High demand cases of Rs.10 lakh and above constituted 61 percent of the total net arrears.

Arrears of wealth tax were alarmingly high as they were 7.5 times of collections of wealth tax as on 31 March 1998

[Para No.2.10(i)&(ii)]

VII. The demand recovered during the years 1995-96 to 1997-98 as a percentage of total demand certified to the tax recovery officer has come down to 19.8 percent as compared to 29.8 percent in 1996-97 and 34.4 percent in 1995-96.

[Para 2.11(ii)]

VIII. Out of a total number of 2,15,546 claims for refunds in 1997-98, 1,41,877 (65.8%) claims were disposed of.

[Para 2.13]

IX. Over a three-year period, while on an average, 454 cases pertaining to income tax were admitted by the Settlement Commission every year, the backlog of cases averaged 2,131. The Commission settled only 19.5 percent of the total number of pending cases.

[Para 2.14]

X. Out of 2,75,299 penalty cases of income tax including corporation tax only 71,811 cases were disposed of during 1997-98 levying penalty in 34,571 cases which constituted 48.1 percent of total cases disposed of. The balance of total demand outstanding by way of penalty and composition money in respect of income tax including corporation tax constituted 88.8 percent and in respect of other direct taxes 89.1 percent.

[Para 2.15]

XI. 3,653 cases of search and seizure were conducted in 1997-98 and assets worth Rs.306.85 crore seized. In 10,045 cases, final assessments were completed determining income of Rs.5,045.62 crore and demand of Rs.2,592.73 crore was raised.

[Para 2.16]

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

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

Wealth tax is levied for every assessment year on net wealth of every individual, HUF and company at specified rates. For assessment year 1997-98, nc wealth tax was payable in respect of net wealth below Rs.15 lakh.

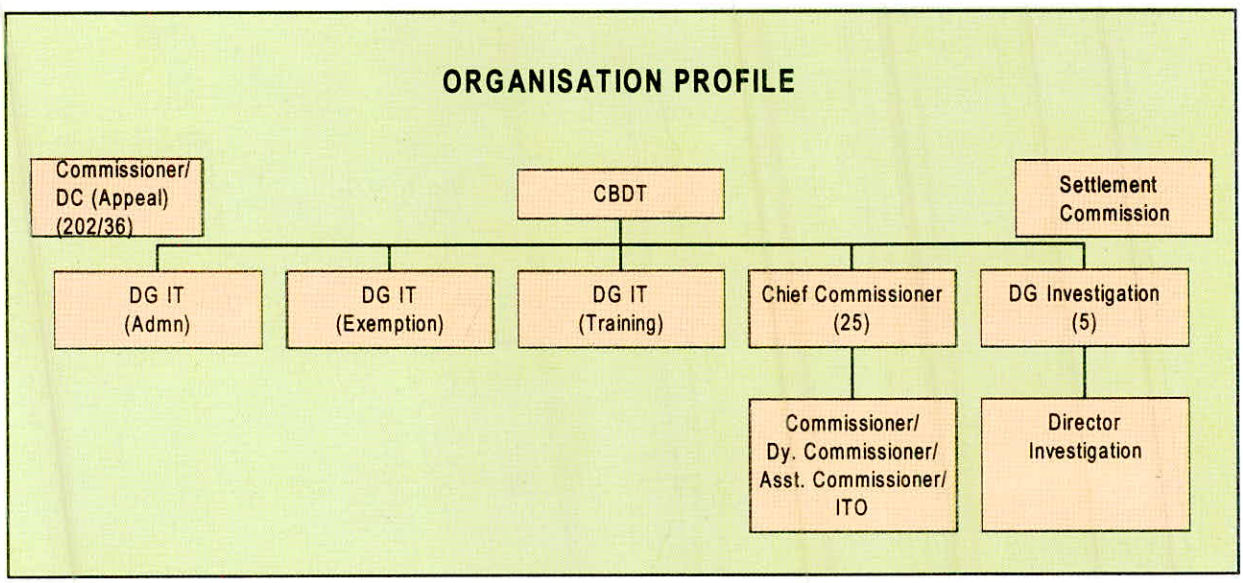
Gift tax is levied according to specified rates for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including HUF) and a company etc. No gift tax was payable where the value of taxable gifts was below Rs.30,000 during assessment year 1997-98.

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

The number of income tax, wealth tax and gift tax and interest tax assessees on the books of the department as on 31 March 1997 and 1998 was as under:

Number of assessees	31 March 1997	31 March 1998
Income tax (including Corporation Tax)	1,16,43,543	1,31,67,736
Wealth Tax	2,99,908	2,44,519
Gift Tax	47,364	48,911
Interest Tax	3,912	6,080
Total	1,19,94,727	1,34,67,246

Broad functional profile of the Department of Revenue



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

The Board consists of a Chairman and five members, and have several attached and subordinate offices throughout the country. The attached offices function under three Directors General of Income Tax viz. Director General of Income Tax (Admn.), Director General of Income Tax (Exemption) and Director General of Income Tax (Training). There are 25 Chief Commissioners of Income Tax, who oversee the work of assessment and collection of direct taxes at regional levels. Besides, there are 5 Directors General of Investigation who are in overall charge of the investigation

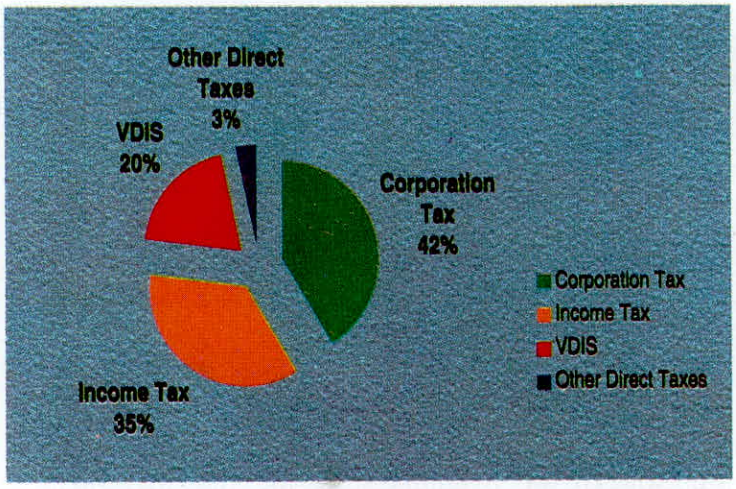
* Status-wise and category-wise details may be referred to in Annexure I.

machinery on a regional basis to curb tax evasion and to unearth black money. The Chief Commissioners of Income Tax/Directors General of Income Tax oversee the work of the Commissioners/Directors of Income Tax in their respective charges and have also been given certain powers under the Income Tax Act, regarding discovery, production of evidence by any person, to requisition books of account, call for information etc., whereby they can issue summons. They are also empowered to authorise search and seizure operations.

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

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

Receipts under various Direct Taxes



2.3(i) The total collections* from Direct Taxes for the year 1997-98 amounted to Rs.48,280.40 crore out of which Rs.13,507.69 crore was assigned to the States. The collections for the years 1996-97 and 1997-98 as furnished by the Ministry of Finance are given below:

* State/UT wise break up of collections of direct taxes is given in Annexure II

(Rs. in crore)

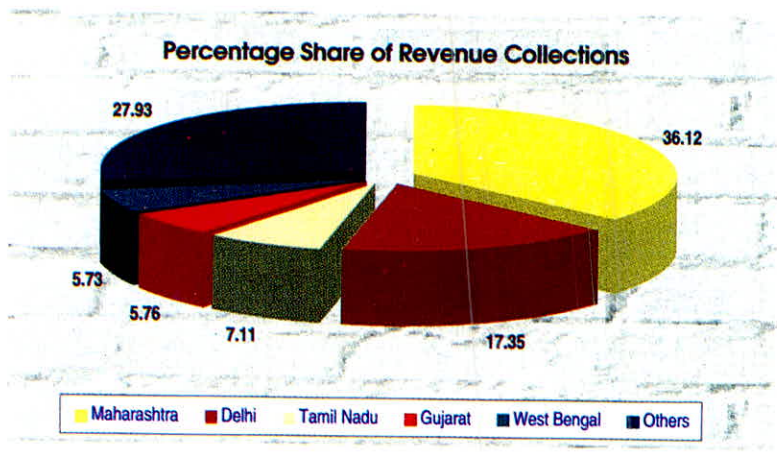
Head of account	Category of tax	1996-97	1997-98	Increase in 1997-98 over the previous year
0020	Corporation Tax	18,566.69	20,016.00	1,449.31
0021	Taxes on income other than Corporation-tax	18,233.99	17,100.59	(-) 1,133.40
0023	Hotel Receipts Tax	0.98	2.21	1.23
0024	Interest Tax	1,712.39	1,205.18	(-) 507.21
0028	Other Taxes on Income and Expenditure	293.23	9,834.06	9,540.83
0031	Estate Duty	0.06	0.25	0.19
0032	Taxes on wealth	77.44	113.03	35.59
0033	Gift Tax	10.30	9.08	(-) 1.22
	Gross Receipts	**38,895.08**	**48,280.40**	**9,385.32**
	Less share of net proceeds assigned to the States:			
	Income Tax	**13,515.94**	**13,507.69**	
	Net Receipts	**25,379.14**	**34,772.71**	

- *Collection of Rs.48,280.40 crore during 1997-98 also includes Rs.9,554.25 crore collected from VDIS-97. The amount is booked under 0028-Other Taxes on Income and Expenditure. VDIS collections were responsible for boosting overall revenue collection. But for VDIS, total collections have decreased by Rs.168.93 crore (0.43 percent) as compared to 1996-97.*

- *There was a net increase of 1.6 percent in combined revenue collections of Corporation tax and Income tax after allowing for positive growth in corporation tax (7.8%) and negative growth in income tax (6.2%).*

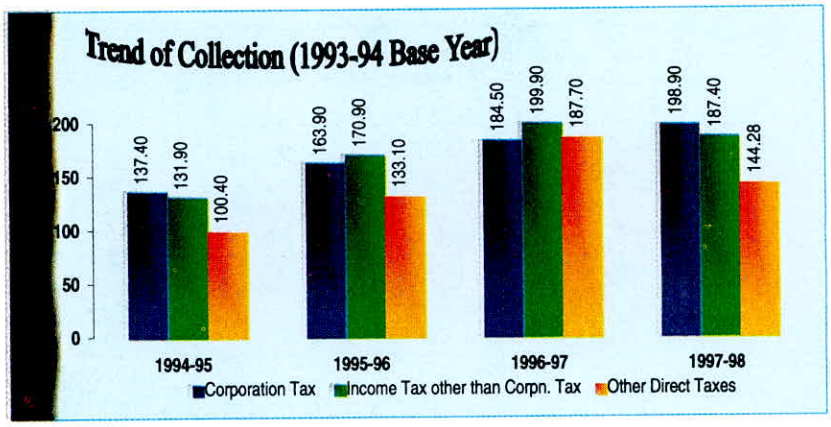
- *Interest tax collections decreased by Rs.507.21 crore though Interest tax assessees increased by 2,118 over previous year.*

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



Trend of collection

2.4 The trend in collection of Direct Taxes since 1994-95 is shown below:



Direct Taxes -GDP Ratio

2.5(i) Direct Taxes collections as percentage of the Gross Domestic Product have remained stagnant over the last three years. During 1997-98, though the overall proportion of direct taxes collection remained constant, both corporate and income tax share of GDP declined as depicted below:

Percentage of Direct Taxes to GDP*

Year	Direct Taxes	Corporation Tax	Income Tax other than Corporation Tax
1995-96	3.4	1.7	1.6
1996-97	3.4	1.6	1.6
1997-98	3.4	1.4	1.2

(ii) Tax buoyancy is a key indicator of efficiency of revenue mobilisation in response to growth in GDP, measured by the ratio of percentage change in tax revenues to percentage change in GDP at current prices. Analysis of 10 year time series data during 1988-89 to 1997-98 (as below) regarding relative change in GDP vis-à-vis tax revenues revealed the following:

(Rs. in crore)

Year	Change in revenue		Change in GDP		Buoyancy
	Amount	Percentage	Amount	Percentage	
1988-89	2,072	30.66	57,458	19.52	1.57
1989-90	1,179	13.35	43,419	12.34	1.08
1990-91	1,021	10.20	77,517	19.61	0.52
1991-92	4,313	39.10	69,228	14.64	2.67
1992-93	2,755	17.95	86,025	15.87	1.13
1993-94	2,201	12.16	79,232	12.61	0.96
1994-95	6,673	32.87	1,46,958	20.78	1.58
1995-96	6,588	24.43	1,31,684	15.41	1.58
1996-97	5,336	15.90	1,63,428	16.57	0.95
1997-98	-169**	-0.43	2,77,455	24.14	-0.01

* GDP figures at factor cost on current prices, collected from National Accounts Statistics Organisation, Ministry of Planning. The figure for 1997-98 are as per their estimates.

- The tax revenues, on an average grew at a rate of 19.6 percentage per annum during the 10 year period with the exception of 1997-98.

- The growth rate in revenue collection was maintained though there was successive reduction of individual and corporate tax rates during 1992-93, 1994-95 and 1997-98.

- The overall tax buoyancy, though on an average was greater than one, tended to decline and depicted a negative trend during 1997-98. Lean tax buoyancy during 1993-94, 1996-97 and 1997-98 is suggestive of low mobilisation of tax revenues particularly during the last 2 years.

- The simultaneous operation of VDIS and reduction in tax rates during 1997-98 resulted in decline in total revenue collection (168.93 crore) despite the increase in the overall number of income tax payers from 11.6 million to 13.1. million by end of 31.3.1998. It may be reasonably concluded that the augmentation of revenue achieved through VDIS (Rs.9554.25 crore) was at the cost of the normal growth in revenue collection.

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

Year	Change in revenue over previous year		Change in non agricultural GDP over previous year		Buoyancy
	Amount	Percent	Amount	Percent	
1993-94	2,201	12.16	64,634	15.09	0.80
1994-95	6,673	32.87	95,426	19.36	1.69
1995-96	6,588	24.43	1,22,846	20.88	1.17
1996-97	5,336	15.90	1,28,036	18.00	0.88
1997-98	(-)169	(-)0.43	1,95,465	23.29	(-) 0.01

(iv) Analysis of Income Tax (Including corporation tax) Assessee Profile

The following table reveals the number of additions during the last 5 year period from 1993-94 to 1997-98 to different types of assessees under specific income categories*.

** The gross revenue collection figures do not include collections on account of VDIS-97.
* Yearwise and category wise assessee status for the period from 1993-94 to 1997-98 is depicted in Annexure III.

(Figure in lakhs)

	As on 31.3.94	As on 31.3.98	Increase	A[1]	B[2] (lower income)	B[3] (higher income)	C[4]	D[5]
Individual	77.44	111.95	34.51	32.84 (95.16)	0.52 (1.50)	0.98 (2.84)	0.19 (0.55)	(-)0.02 (-0.05)
HUF	4.03	4.37	0.34	0.29 (85.30)	-	0.04 (11.76)	0.01 (2.94)	-
Firms	12.00	11.73	(-)0.27	(-)0.41 (-151.85)	(-)0.06 (-22.22)	0.16 (59.26)	0.04 (14.81)	-
Companies	1.61	2.74	1.13	0.74 (65.49)	0.16 (14.16)	0.17 (15.04)	0.05 (4.42)	0.01 (0.89)
Others (including Trusts)	0.68	0.88	0.20	0.17 (80.95)	-	0.04 (19.05)	-	-
Total	95.76	131.68	35.92	33.63 (93.62)	0.62 (1.73)	1.39 (3.87)	0.29 (0.81)	(-)0.01 (-0.03)

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

It is evident that about 95 percent of the new assessees amongst non-company assessees was accounted for in the low income range up to Rs.2 lakh while about 80 percent in the case of corporate assessees was in the income range below Rs. 5 lakh.

Given the predominance of low income category it can be reasonably presumed that the bulk of the revenue contribution is thus accounted for by this category.

The above presumption, is also borne out from the per capita revenue collection trends over the last 5 years since 1993-94*.

Year	Revenue in crore		Assessee	Per capita (in lakh)
1993-94	Company	10,060.06	1,61,075	6.24
		(13.17)	(23.53)	(-8.37)
	Non Company	9,122.62	94,15,102	0.09
		(16.01)	(2.88)	(nil)
1994-95	Company	13,820.96	1,76,594	7.82
		(37.38)	(9.63)	(25.32)
	Non Company	12,030.12	1,01,08,012	0.12
		(31.87)	(7.35)	(33.35)

[1] Category 'A' assessee-Company assessments with income/loss below Rs.50,000 and non-company assessment with income/loss below Rs.2 lakh.

[2] Category 'B' assessees (lower income group)-Company assessments with income/loss of Rs.50,000 and above but below Rs.5 lakh and non-company assessments with income/loss of Rs.2 lakh and above but below Rs.5 lakh.

[3] Category 'B' assessees (higher income group)-Company and non-company assessment with income/loss of Rs.5 lakh and above but below Rs.10 lakh.

[4] Category 'C' assessees-Company and non-company assessments with income/loss of Rs.10 lakh and above.

[5] Category 'D' assessees-Search and Seizure assessments

* 1992-93 Revenue Collection- Company-8,889.24 Non Company-7,863.49 (Rs. in crore)
Assessees- Company 1,30,388 Non Company 82,32,350
Per Capita (in lakhs) Company 6.81 Non Company 0.09

1995-96	Company	16,487.13 (19.29)	1,87,574 (6.21)	8.79 (12.40)
	Non Company	15,587.17 (29.56)	1,04,76,940 (3.64)	0.15 (33.33)
1996-97	Company	18,566.69 (12.61)	2,27,228 (21.14)	8.17 (-7.05)
	Non Company	18,233.99 (16.98)	1,14,16,315 (8.96)	0.16 (6.66)
1997-98	Company	20,016.00 (7.80)	2,74,319 (20.72)	7.29 (-10.77)
	Non Company	17,100.59 (-6.21)	1,28,93,417 (12.93)	0.13 (-18.75)

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

Company Assessees: The per capita growth in revenue collection has shown a negative trend during 1996-97 and 1997-98 after, registering 25% and 12% income respectively during the earlier 2 years. The substantial growth in assessees recorded during 1996-97 (21.14%) and 1997-98 (20.72%) was not matched by similar growth in the total revenue collection on account of the fact that most of the assessees belonged to low income strata below Rs.5 lakh and indicative of the fact that reduction in tax rates did not yield higher tax compliance among higher income strata.

Non-Company Assessees: The per capita growth in revenue collection registered substantial increase during 1994-95 and 1995-96 as the growth in revenue collection was far ahead of the increase in the number of the assessees. However, incremental growth in per capita revenue collection tended to decline, with higher growth in the number of assessees during 1996-97 and 1997-98. This is attributable to the fact that most of non-company assessees are predominantly from low income strata and about 95 percent of fresh accretion has occurred in this group. It could be reasonably presumed that lowering of the tax liability had not resulted in a marked increase in compliance among higher income groups, though it may have added to or widened the overall tax base.

Wealth tax and Gift tax Assessee

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

Year	Wealth tax	Gift tax
1993-94	6,39,473	51,064
1994-95	5,44,801	63,261
1995-96	3,90,589	49,947
1996-97	2,99,908	47,364
1997-98	2,44,519	48,911

From 1993-94 onwards the exemption limit in respect of incidence of wealth tax was increased to Rs.15 lakh. Also the ambit of wealth tax was

narrowed down with exclusion of shares, debentures, capital investment Bonds etc. As there has been no change in the law since then, the progressive decline in the number of wealth tax assessees over the last 5 years period could be reasonably ascribed to the following factors

- Higher incidence of concealment of wealth tax and non initiation of wealth tax proceedings by the Department.

- The bulk of increase in the number of income tax assessees is confined to lower income groups.

Variation between budget estimates and actual receipts

2.6 Both during 1996-97 and 1997-98, the Corporation tax revenue collection has tended to fall short of budget estimates and the overall variation has ranged within 10 percent during the last three years. The collection of taxes on income other than corporation tax declined steeply to 21.2 percent during 1997-98 vis-à-vis budget estimates. Collections under other direct taxes have also fallen short of budget provision by 41.5 percent.

The comparative* position of actual receipts vis-a-vis the budget estimates under the different heads for the years 1995-96 to 1997-98 are as follows:

Year	Budget Estimates (Rs. in crore)	Actuals (Rs. in crore)	Variation (Rs. in crore)	Percentage of variation
0020- Corporation Tax				
1995-96	15,500.00	16,487.13	987.13	6.37
1996-97	18,688.00	18,566.69	(-)121.31	(-) 0.64
1997-98	21,860.00	20,016.00	(-)1,844.00	(-) 8.43
0021- Taxes on income other than Corporation Tax				
1995-96	13,500.00	15,587.17	2,087.17	15.46
1996-97	17,843.00	18,233.99	390.99	2.19
1997-98	21,700.00	17,100.59	(-)4,599.41	(-) 21.19
Other Direct Taxes$*				
1995-96	1,276.00	1,484.98	208.98	16.38
1996-97	1,561.00	2,094.36	533.36	34.16
1997-98	2,751.00	1,609.56**	(-)1,141.44	(-) 41.49

* Details of variation under the heads subordinate to the major heads 0020 and 0021 for the year 1997-98 are given in Annexure IV.

$ Includes Hotel Receipts Tax, Interest Tax, Estate Duty, Wealth Tax, Gift Tax & other Taxes on Income and Expenditure.

** Collection of Rs.9,554.25 crore from VDIS-97 is excluded

Analysis of collection

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

(i) The sub-head wise break-up of total income tax collections for companies and non-companies at pre-assessment and post-assessment stages for the years 1995-96 to 1997-98 are given below:

(Rs in crore)

Year	Tax collections							
	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds (percentage of total collection)	Net Collections
Company								
1995-96	5,096.71	11,477.04	1,112.19	4,598.40	665.27	22,949.61	6,462.48 (28.15)	16,487.13
1996-97	5,138.94	14,206.80	1,260.57	4,234.06	1,480.31	26,320.68	7,753.99 (29.45)	18,566.69
1997-98	3,984.32	16,416.67	1,927.13	3,469.94	616.73	26,414.79	6,398.79 (24.22)	20,016.00
Non-company								
1995-96	8,849.02	4,871.94	1,701.62	1,170.16	530.49	17,123.23	1,536.06 (8.97)	15,587.17
1996-97	10,195.39	5,472.08	2,028.43	1,298.37	1,048.21	20,042.48	1,808.49 (9.02)	18,233.99
1997-98	9,803.23	4,644.10	2,317.72	1,484.41	1,020.73	19,270.19	2,169.60 (11.25)	17,100.59

- *On an average, 85 percent of collections are realised at preassessment stage*
- *The gross collections from company assessees increased marginally during 1997-98.*
- *Except for advance tax collections and self assessment, collections from TDS, regular assessments and other receipts declined in absolute terms during the year in the case of corporate taxes.*
- *In the case of non-company assessees, TDS collections registered a decline as compared to previous year's level.*
- *Refunds constituted, on an average, 27 percent in company cases and 10 percent in non-company cases.*

(ii) The details of tax deduction at source during the year 1997-98 vis-à-vis 1996-97 under broad categories are as under:

	1996-97	1997-98 (Rs in crore)
Salaries	6,026.13	5,797.38
Interest on securities	2,044.20	1,136.75
Dividends	1,022.72	470.02*
Interest	2,811.86	2,344.37
Winnings from lottery or cross word puzzles	57.30	64.38
Winnings from horse races	47.87	26.18
Payments to contractors and sub-contractors	2,233.28	2,467.66
Insurance commission	130.53	134.25
Payment to non-residents and others	960.44	1,346.56
Total	**15,334.33**	**13,787.55**

The decline in TDS collection under salaries and dividends could be reasonably attributed to reduction in tax rates in the case of individuals and abolition of TDS in the case of dividends. However, there was substantial decline in TDS from interest and interest on securities (28.3 percent with reference to the preceding year).

(iii) The following details of statements of tax deducted at source for the year 1997-98 indicate a shortfall in the returns received from tax deductors:

1.	No. of tax deductors as on 1 April 1997	5,44,840
2.	Adjustment/progressive additions upto 31 March 1998	1,57,135
3.	Effective tax deductors (1+2)	7,01,975
4.	No. of returns required to be filed by tax deductions at 3	7,01,975
5.	Returns received upto 31 March 1998	6,16,564
6.	Balance 4-5	85,411

Cost of collection

2.8 Year-wise total expenditure incurred during the years 1995-96 to 1997-98 in collecting the direct taxes was as under:

(Rs. in crore)

Year	Collection	Expenditure	Percentage
1995-96	33,559.28	492.24	1.47
1996-97	38,895.08	494.15	1.27
1997-98	48,280.40	799.36*	1.65

* TDS from dividends was abolished with effect from 1.6.97.

* This includes expenditure of Rs.24.10 crore on VDIS-97.

Arrears of assessments

2.9 Working strength of officers on assessment/non-assessment duty for the years 1995-96 to 1997-98 was as under:

Nature of posts	1995-96		1996-97		1997-98	
	Assessment Duty	Non-assessment Duty	Assessment Duty	Non-assessment Duty	Assessment Duty	Non-assessment Duty
Addl.Commissioners/ Dy.Commissioners	236	250	213	225	195	221
Asstt. Commissioners	948	180	922	128	863	125
Income Tax Officers	2,054	420	2,034	408	1,899	379
Total	**3,238**	**850**	**3,169**	**761**	**2,957**	**725**

Income Tax (including Corporation Tax)

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

The number of assessments completed during the years 1995-96 to 1997-98 was as under:

Financial Year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Scrutiny	Summary	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1995-96	4,55,446	1,01,66,080	1,06,21,526	3,01,534 (66.21)	79,98,319 (78.68)	82,99,853 (78.14)	1,53,912 (33.79)	21,67,761 (21.32)	23,21,673 (21.86)
1996-97	5,28,154	1,15,83,285	1,21,11,439	3,66,329 (69.36)	1,00,82,930 (87.05)	1,04,49,259 (86.27)	1,61,825 (30.64)	15,00,355 (12.95)	16,62,180 (13.73)
1997-98	11,08,764	1,27,51,169	1,38,59,933	9,20,701 (83.04)	1,03,54,926 (81.21)	1,12,75,627 (81.35)	1,88,063 (16.96)	23,96,243 (18.79)	25,84,306 (18.65)

- *Despite Board's instructions for according priority for speedy disposal of both summary and scrutiny assessments, the total pendency of assessments, both under summary and scrutiny during 1997-98 has increased as compared to the previous year, though the cases disposed of by scrutiny increased by 14 percent (approx.).*

- *On the whole, the department disposed of 6.7 percent of its total workload of assessment cases by scrutiny and 74.7 percent by summary.*

- *The disposal of higher income category assessment by scrutiny (as detailed in Annexure IV) was only 50.5 percent in company cases and 54.9 percent in non-company cases.*

(ii) *Break-up of company and non-company assessments completed during the years 1995-96 to 1997-98 was as under:

Assessments	1995-96	1996-97	1997-98
Company	1,99,086	2,35,385	2,71,481
Non company	81,00,767	1,02,13,874	1,10,04,146
Total	**82,99,853**	**1,04,49,259**	**1,12,75,627**

(iii) Status-wise and year-wise break-up of pendency of income tax assessments as on 31 March 1998 was as under:

	Status	Upto 1995-96	1996-97	1997-98	Total
	Company assessments				
(i)	Regular	3,305	25,040	87,226	1,15,571
(ii)	Re-opened/set aside	1,074	714	536	2,324
	Non-company assessments				
(i)	Regular	10,568	3,50,441	20,90,407	24,51,416
(ii)	Re-opened/set aside	5,343	2,891	6,761	14,995

The number of assessments pending as on 31 March 1998 was 25,84,306 as compared to 16,62,180 as on 31 March 1997 and 23,21,673 on 31 March 1996.

Wealth Tax and Gift Tax

2(i) The percentage disposal of wealth tax assessments during 1997-98 showed some improvement as compared to the previous two years while in the case of gift tax assessments, there was marginal decline as detailed below:

Wealth Tax

Year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Company	Non-company	Total	Company	Non-company	Total	Company	Non-company	Total
1995-96	8,516	1,76,894	1,85,410	3,851 (45.22)	81,533 (46.10)	85,384 (46.05)	4,665 (54,78)	95,361 (53.90)	1,00,026 (53.95)
1996-97	9,516	1,44,145	1,53,661	3,930 (41.30)	70,793 (49.12)	74,723 (48.63)	5,586 (58.70)	73,352 (50.88)	78,938 (51.37)
1997-98	7,618	98,503	1,06,121	4,618 (60.62)	75,633 (76.79)	80,251 (75.62)	3,000 (39.38)	22,870 (23.21)	25,870 (24.38)

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

Gift Tax

Year	Assessments due for disposal			Assessments completed (percentage)			Assessments pending (percentage)		
	Company	Non-company	Total	Company	Non-company	Total	Company	Non-company	Total
1995-96	148	31,589	31,737	83 (56.08)	24,026 (76.05)	24,109 (75.96)	65 (43.92)	7,563 (23.95)	7,628 (24.04)
1996-97	159	32,334	32,493	60 (37.74)	27,630 (85.45)	27,690 (85.22)	99 (62.26)	4,704 (14.55)	4,803 (14.78)
1997-98	82	31,364	31,446	33 (40.25)	25,861 (82.45)	25,894 (82.55)	49 (59.75)	5,503 (17.55)	5552 (17.65)

Sur Tax and Interest Tax

(ii) The number of surtax and interest tax assessments due for disposal, completed and pending for the years 1995-96 to 1997-98 was as follows:

Year	Assessments due for disposal		Assessments completed (percentage)		Assessments pending (percentage)	
	SurTax	Interest Tax	SurTax	Interest Tax	SurTax	Interest Tax
1995-96	929	7,189	73 (7.86)	2,864 (39.84)	856 (92.14)	4,325 (60.16)
1996-97	684	12,378	68 (9.94)	5,374 (43.42)	616 (90.06)	7,004 (56.58)
1997-98	297	13,971	207 (69.70)	4756 (34.04)	90 (30.30)	9,215 (66.96)

The decline in disposal of interest tax assessments completed both in absolute terms and in terms of overall workload is also reflected in lower interest tax collections during 1997-98.

Arrears of demands

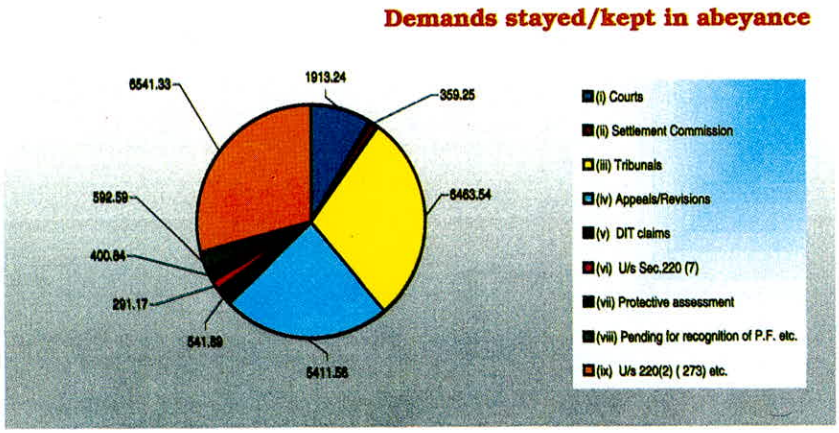
2.10 The Income Tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 30 days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

Corporation Tax (including SurTax) and Income Tax

(i)(a) Details of uncollected tax for the years 1995-96 to 1997-98 are given below:

	1995-96 (Rs. in crore)	1996-97 (Rs.in crore)	1997-98 (Rs.in crore)
Total amount of tax remaining uncollected as on 31 March	28,969.59	33,585.12	41,230.03
Arrears not fallen due as on 31 March	7,598.32	9,365.96	9,973.37
Amount claimed to have been paid but remaining to be verified/adjusted	3,167.56	2,054.98	2,346.10
Amount stayed/kept in abeyance	9,698.16	15,798.52	22,515.41
Amount for which instalments had been granted but had not fallen due	218.34	309.96	573.87

- *Thus, the amount remaining uncollected increased by Rs. 7,644.91 crore constituting 22.76 percent over the previous year.*
- *A major cause for the increase in arrears was a large amount stayed/kept in abeyance by courts/tribunals/revenue appellate authorities. This also included interest and penalties under section 220 (2) and section 273.*



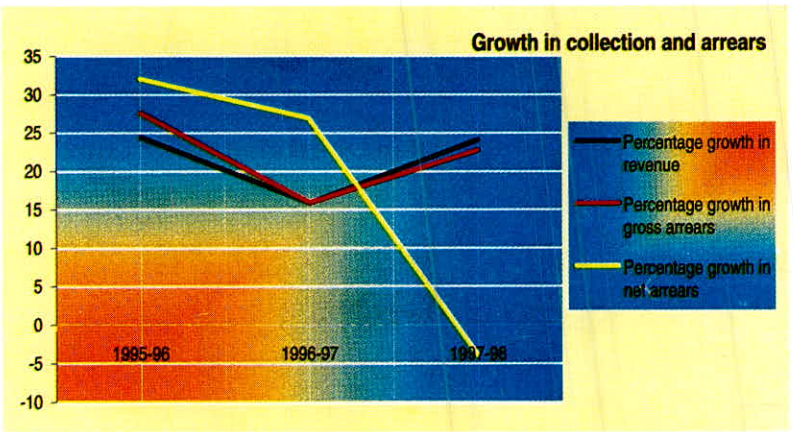
(b) The year-wise position of arrears remaining uncollected in company and non-company cases for the years 1995-96 to 1997-98 is given below:

	1995-96 (Rs.in crore)	1996-97 (Rs.in crore)	1997-98 (Rs.in crore)
Companies	12,433.53	15,432.64	20,062.46
Non-companies	16,536.06	18,152.48	21,167.57
Total	**28,969.59**	**33,585.12**	**41,230.03**

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

(c) The percentage increase in gross arrears was marginally higher as compared to the percentage increase in the revenue collection during 1997-98. However, there was a negative growth in net arrears (-3.87%)[Ψ] during 1997-98 due to substantial increase in the number of cases stayed/kept in abeyance.

Growth in collection and arrears



(d) The total outstanding demand of Rs.41,230.03 crore, remaining uncollected as on 31 March 1998, comprised arrear demand of Rs.25,703.80 crore of earlier years. The age-wise analysis of the arrear demand of Rs. 25,703.80 crore is given below:

(Rs. in crore)

		Corporation Tax	Income Tax	Interest	Others	Total
1.	Over 1 year but less than two years	3,889.24	5,202.58	7,474.67	539.43	17,105.92
2.	Over 2 years but less than 5 years	1,239.52	2,550.22	3,131.12	232.97	7,153.83
3.	Over 5 years but less than 10 years	297.88	307.82	330.26	83.94	1,019.90
4.	Over 10 years	112.98	151.47	112.25	47.45	424.15
Total		**5,539.62**	**8,212.09**	**11,048.30**	**903.79**	**25,703.80**

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

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

(Rs. in crore)

	Company cases			Non-company cases			Total		
	No. of cases	**Gross arrears**	**Net arrears**	**No. of cases**	**Gross arrears**	**Net arrears**	**No. of cases**	**Gross arrears**	**Net arrears**
Upto Rs.1 lakh in each case	2,79,851	2,651.36	610.65	49,25,058	2,845.92	756.94	52,04,909	5,497.28	1,367.59
Over Rs.1 lakh to Rs.10 lakh in each case	24,684	1,905.24	355.68	85,482	1,643.44	542.97	1,10,166	3,548.68	898.65
Over Rs.10 lakh to Rs.1 crore in each case	5,050	2,698.91	739..17	6,915	2,082.87	680.09	11,965	4,781.78	1,419.26
Over Rs. 1 crore in each case	1,447	12,80,6.95	1,306.94	1,032	14,595.34	828.84	2,479	27,402.29	2,135.78
Total	**3,11,032**	**20,06,2.46**	**3,012.44**	**50,18,487**	**21,167.57**	**2,808.84**	**53,29,519**	**41,230.03**	**5,821.28**

Thus 61 percent of the total net arrears of Rs.5,821.28 crore outstanding as on 31 March 1998 was constituted by high demand cases of Rs.10 lakh and above. The department needs to accord priority for recovering these arrears.

Other Direct Taxes

(ii) Year-wise arrears of demands outstanding under Wealth Tax, Gift Tax and Interest Tax as on 31 March 1998 is given below:

(Rs. in crore)

	Wealth tax	**Gift Tax**	**Interest Tax**
Over one year but less than two years	266.66	24.26	312.79
Over two years but less than five years	473.47	13.41	200.30
Over five years but less than ten years	77.23	5.06	0.01
Over ten years	34.04	3.29	-
Total	**851.40**	**46.02**	**513.10**

The above data reveals that the arrears of wealth tax are alarmingly high as they were 7.5 times of the collections of wealth tax as on 31 March 1998.

Tax Recovery Machinery

2.11 Under the provisions of the Income Tax Act, 1961, every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty days of the service of notice of demand. On the default of an assessee in this respect, the assessing officer may forward a certificate specifying the demand

of arrears to the Tax Recovery Officer for recovery of demand. The latter will serve a notice on the defaulter requiring him to pay the demand within fifteen days. If the amount mentioned in the notice is not paid within the time specified therein or within such further time as the Tax Recovery Officer may grant in his discretion, he shall proceed to realise the amount together with interest at the rate of 1.5 percent per month or part of month (from 1 April 1989) on the outstandings till the date of recovery by one or more of the following modes:

(a) by attachment and sale of the defaulter's movable property;

(b) by attachment and sale of the defaulter's immovable property;

(c) by arrest of the defaulter and his detention in prison;

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

(i) The number of Tax Recovery Officers engaged in tax recovery work during 1995-96 to 1997-98 was as follows:

Year	Sanctioned Strength	Working Strength
1995-96	192	157
1996-97	163	139
1997-98	212	153

(ii) The tax demands certified to the Tax Recovery Officer and the progress of recovery during the years 1995-96 to 1997-98 are given in the following table:

(Rs. in crore)

Year	At the beginning of the year	Demand certified during the year	Total	Demand recovered during the year	Balance at the end of the year
1995-96	1,371.79	753.54	2,125.33	730.49	1,394.84
1996-97	1,394.84	1,098.60	2,493.44	742.60	1,750.84
1997-98	1,750.84	2,714.87	4,465.71	884.41	3,581.30♠

The demand recovered during the years 1995-96 to 1997-98 as a percentage of total demand certified varied between 19.8 percent to 34.4 percent.

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

♠ Year-wise, tax-wise and amount-wise analysis of pending certificates are given in Annexure VI.

Particulars	Movable properties			Immovable properties		
	No. of cases	No. of properties	Approximate value (Rs. in crore)	No. of cases	No. of properties	Approximate value (Rs.in crore)
Properties attached	1,785	-	167.81	3053	5917	533.12
Sales conducted	9	15	0.55	10	50	2.42
Sales not conducted (i) More than six months but less than one year	66	-	1.83	-	-	-
(ii) More than one year but less than three years	-	-	-	801	1196	116.87
(iii) More than three years	-	-	-	859	1246	180.33

	Number	Amount (Rs.in crore)
Cases in which receiver appointed	33	39.31
Defaulters against whom arrest proceedings initiated	66	7.74

Appeals, Revision petitions and Writs

2.12 Under the provisions of the Income Tax Act, 1961, if an assessee is not satisfied with an assessment, a refund order etc., he can file an appeal with the Appellate Assistant Commissioner (now Deputy Commissioner (Appeals)). The Act also provides for appeal by the assessee direct to the Commissioner (Appeals).

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

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

The number of Commissioners and Deputy Commissioners (Appeals) during 1997-98 was as follows:

Commissioners	**202**
Deputy Commissioners	**36**

Pendency position of appeals as on 31 March 1998

(i) Pending with Commissioners (Appeals)

	Total appeals	High demand* appeals	With demand of Rs. 10 lakh	With demand above Rs.25 lakh
Appeals for disposal	2,16,157	51,321	5,823	6,296
Completed	67,033	23,410	3,264	3,545
Pending	1,49,124	27,911	2,559	2,751

(ii) Pending with Deputy Commissioners (Appeals)

	Total Appeals	High demand*
Appeals for disposal	80,387	3,785
Completed	19,503	1,122
Pending	60,884	2,663

(iii) Pending with Supreme Court/High Court/Income Tax Appellate Tribunal:

	Supreme Court	High Court	Income Tax Appellate Tribunal
Appeals, references and writs for disposal	7,914	57,042	1,35,246
Completed	126	2,646	8,378
Pending	7,788	54,396	1,26,868

Interest paid on Refunds

2.13 Where the amount of tax paid exceeds the amount of tax payable, the assessee is entitled to a refund of the excess. If the refund is not granted by the department within three months from 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 (vide Section 237 read with Section 243 of the Income Tax Act). Refund of any amount which may become due to an assessee as a result of any order passed in appeal or other proceedings without his having to make any claim on that behalf is also admissible. Simple interest at the prescribed rate is payable to the assessee in such cases too.

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

(i) The particulars of cases of direct refunds for which claims were made during the years 1995-96 to 1997-98 were as under:

Financial year	Opening balance	Claims received during the year	Total	No. of claims disposed off	Balance outstanding
1995-96	16,722	1,22,592	1,39,314	1,04,362	34,952
1996-97	34,952	1,22,760	1,57,712	1,07,782	49,930
1997-98	49930	1,65,616	2,15,546	1,41,877	73,669

(ii) Details of cases resulting in refund as a result of appellate orders and revision orders etc. as on 31 March 1998 were as under:

Financial Year	Opening Balance	Addition	Disposal	Closing Balance
1996-97	3,280	37,924	37,031	4,173
1997-98	4,173	27,015	27,363	3,825*

(iii) Details relating to interest paid on refunds by Government under certain relevant sections of the Income Tax Act, 1961, for the years 1995-96 to 1997-98 were as under:

(Rs.in crore)

Section under which interest paid	1995-96		1996-97		1997-98	
	No.of assessments	Amount	No.of assessments	Amount	No.of assessments	Amount
214	22,067	7.79	20,864	7.42	123	14.09
243	1,274	6.64	9	0.01	-	-
244	9,83,633	305.57	1,66,629	100.41	2,17,720	9.97
244A	2,99,749	669.36	15,31,464	622.13	17,14,828	878.87
Total	**13,06,723**	**989.36**	**17,18,966**	**729.97**	**19,32,671**	**902.93**

Cases settled by Settlement Commission

2.14 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. While making an application to Settlement Commission, an assessee shall make full and true disclosure of his income (not disclosed before the assessing officer) and the additional amount of income tax payable on such income. The Settlement Commission admits/rejects the application after calling for the report from assessing authority.

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

(i) The number of cases settled by the Settlement Commission during the years 1995-96 to 1997-98 was as under:

Year	Opening balance	Additions	Total cases for disposal	Number of cases settled	Percentage of cases settled	Number of cases pending
Income Tax						
1995-96	2,103	528	2,631	485	18.43	2,146
1996-97	2,146	471	2,617	472	18.03	2,145
1997-98	2,145	362	2,507	526	20.98	1,981
Wealth Tax						
1995-96	327	29	356	98	27.53	258
1996-97	258	49	307	109	35.50	198
1997-98	198	16	214	26	12.14	188

(ii) The number of cases pending for admission/held up with Settlement Commission as on 31 March 1998 was as under:

Cases pending for admission before Settlement Commission	336
Cases held up with Settlement Commission for want of comments of the department.	193

(iii) Year-wise position of additional tax paid/payable and the final demand raised (including interest and penalty) in cases settled by Settlement Commission during the years 1995-96 to 1997-98 was as under:

Financial Year	Income Tax (Rs. in lakh)		Wealth Tax	
	Additional tax paid/payable on admission of applications	Gross demand created in respect of cases settled	Additional tax paid/payable on admission of application	Gross demand created in respect of cases settled
1995-96	2,814.74	4,726.89	189.66	119.30
1996-97	4,245.36	5,179.99	30.68	122.54
1997-98	3,284.36	8,509.12	16.90	203.27

Penalties

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

Income Tax (including Corporation Tax)

(i)(a) Penalty proceedings initiated, disposed of and pending for the years 1995-96 to 1997-98 were as under:

Year	Opening balance	Additions	Total	Disposal	Closing balance
1995-96	2,19,226	64,144	2,83,370	67,923	2,15,447
1996-97	2,15,447	75,335	2,90,782	67,720	2,23,062
1997-98	2,23,062	52,237	2,75,299	71,811	2,03,488

(b) Details regarding nature of offences and penalties imposed for the year 1997-98 are as follows:

Nature of offence	Number of cases	Disposal	Balance	Balance more than 6 months
For Concealment	1,40,034	28,187	1,11,847	84,649
Other than concealment	1,35,265	43,624	91,641	65,749
Total	**2,75,299**	**71,811**	**2,03,488**	**1,50,398**

Penalties imposed (Rs. in crore)

Particulars	No. of cases	Amount
For concealment	11,453	185.04
Others	23,118	99.33

Out of 71,811 cases, penalties were imposed in 34,571 cases constituting 48.1 percent of total cases disposed of.

(c) Details of penalty and composition money levied, collected and pending for the years 1995-96 to 1997-98 were as under:

(Rs. in crore)

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	composition money	penalty	composition money	penalty	composition money	penalty	composition money
1995-96	309.65	140.19	152.89	68.71	53.05	18.09	409.49	190.81
1996-97	434.73	197.84	110.32	117.74	112.99	67.78	432.06	247.80
1997-98	432.06	247.80	133.27	29.04	58.44	36.07	506.89	240.77

Other Direct Taxes

(Wealth Tax, Gift Tax)

(ii) (a) Penalty proceedings initiated, disposed of and pending for the years 1995-96 to 1997-98 are given below:

Year	Opening balance	Additions	Disposal	Closing balance
1995-96	48,713	922	10,836	38,799
1996-97	38,799	2,662	9,126	32,335
1997-98	32,335	4143	5,839	30,639

(b) Details of pendency of penalty and composition money levied, collected and pending for the years 1995-96 to 1997-98 were as under:

(Rs. in crore)

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1995-96	14.29	2.89	2.42	0.30	1.67	0.28	15.04	2.91
1996-97	15.69	2.91	0.66	1.98	1.02	0.99	15.33	3.90
1997-98	15.33	3.90	3.95	6.93	1.24	2.03	18.04	8.80

The balance of total demand outstanding by way of penalty and composition money in respect of income tax (including corporation tax) constituted 89.4 percent, 79 percent and 88.8 percent and in respect of other direct taxes, 90.2 percent, 90.5 percent and 89.1 percent during 1995-96, 1996-97 and 1997-98 respectively.

Searches and seizures

2.16 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/Commissioner of Income Tax or a specified Deputy Director or a Deputy Commissioner of Income Tax. Where as a result of search before 1 July 1995, any money, bullion, jewellery or other valuable article or thing is seized, the assessing officer after necessary investigations, has to make an order with the approval of the Deputy Commissioner of Income Tax within 120 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 persons from whose custody they were seized. From 1 July 1995, assessment of search cases are governed by Chapter XIV-B of the Income Tax Act. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approves of the retention for longer period.

(i) Cases of searches and seizures conducted during the years 1995-96 to 1997-98 were as under:

Year	Number of searches and seizures conducted	Value of assets seized (Rs. in crore)
1995-96	4,612	458.14
1996-97	4,299	405.63
1997-98	3,653	306.85

(ii) Particulars of income determined, tax levied, balance tax outstanding after adjustment of value of assets retained on final assessment for the year 1997-98 were as follows:

(Rs.in crore)

No. of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery		
		Tax	Penalty	Total		Tax	Penalty	Total
10,045	5,045.62	2,572.43	20.30	2,592.73	270.89	2,302.07	19.77	2,321.84

(iii) The number of cases of prosecutions launched, convictions obtained, compounded and acquittals for the years 1995-96 to 1997-98 was as under:

Year	Number of prosecutions launched			Disposal of cases				Cases pending
	Opening balance	Additions	Total	Convictions	Compoundings	Acquittals	Total	Balance
1995-96	17,821	288	18,109	79	1,592	487	2,158	15,951
1996-97	15,951	393	16,344	20	643	637	1,300	15,044
1997-98	15,044	801	15,845	93	143	1,003	1,239	14,606

(iv) Particulars of cases of assets returned, interest paid and cases pending for the year 1997-98 were as under:

Cases where assets were due for return			Cases where assets were returned	Cases where interest was paid during the year	Balance cases pending
Opening balance	Added during the year	Total			
1,432	7,022	8,454	255	2	8,199

Survey

2.17(i) Cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the years 1995-96 to 1997-98 were as under:

Year	No. of premises surveyed	
	under section 133A(1)	under section 133B
1995-96	8,277	7,74,595
1996-97	9,073	8,09,523
1997-98	7,632	4,51,871

(ii) The number of cases where evidence about ostentatious expenditure was collected under Section 133A(5) of Income Tax Act, 1961, for the years 1995-96 to 1997-98 was as under:

Year	No. of cases
1995-96	not furnished by Ministry
1996-97	386
1997-98	238

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

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

(i) Details of properties purchased by the Central Government during the financial year ended 31 March 1998 were as under:

	Mumbai	Calcutta	Delhi	Chennai	Bangalore	Ahmedabad	Lucknow	Total
(i) No. of statements received in form 37-I	671	173	795	416	427	521	237	**3240**
(ii) No. of properties purchased	3	-	3	3	1	-	1	**11**
(iii) Value of properties purchased (Rs. in crore)	9.65	-	6.62	5.58	1.65	-	0.31	**23.81**
(iv) No. of properties where consideration exceeds Rs.50 lakh	3	-	2	3	1	-	-	**9**

(ii) The details of properties sold by the appropriate authority and those awaiting disposal during 1997-98 are given below*:

Number of properties sold	Sale value (Rs. in Crore)	Properties awaiting disposal	Amount
5**	9.58**	60**	63.50**

Revenue demands written off by the department

2.19(i) Details regarding amount written off for the year 1997-98 as furnished by the Ministry of Finance, are as under:

(Rs. in 000)

No. of cases identified involving arrear demand of Rs.10,000 and below where recovery certificates were issued			Cases written off during the year			Balance		
No. of assessees	No. of entries	Total amount involved	No. of assessees	No. of entries	Total amount written-off	No. of assessees	No. of entries	Total amount to be written off
67,459	81,902	1,56,187	50,597	63,022	1,15,124	16,862	18,880	41,063

* The information relates to properties purchased by the appropriate authority in the entire country.

** These figures include the figures for the previous years also and are in respect of properties free from litigation.

(ii) Category-wise details of revenue demands written off by the Department during 1997-98 were as under:

Income Tax (including Corporation Tax)

(Rs. in crore)

Category	Company		Non-company		Total	
	No.	Amount	No.	Amount	No.	Amount
(a) Assessees having died leaving behind no assets/ have become insolvent/gone into liquidation/are defunct	1	0.03	4,968	0.87	4,969	0.90
(b) Assessees being untraceable.	68	1.77	38,655	6.06	38,723	7.83
(c) Assessees having left India	-	-	243	0.01	243	0.01
(d) Assessees who are alive but have no attachable assets/amounts being petty/amounts written of as a result of scaling down of demand.	228	0.27	89,741	5.58	89,969	5.85
(e) Amount written off on grounds of equity or as a matter of international courtesy, or where time, labour and expense involved in legal remedies for realisation are considered disproportionate to the recovery.	-	-	1,195	0.06	1,195	0.06
Grand Total:	**297**	**2.07**	**1,34,802**	**12.58**	**1,35,099**	**14.65**

Other Direct Taxes

(Rs.in lakh)

	Wealth Tax		Gift Tax	
	No.	Amount	No.	Amount
Amount written off due to untraceability of assessees	57	0.18	197	0.84

Annexure I

(Reference: para 2.1)

(i) Status-wise break-up of income tax (including corporation tax) assessees as on 31 March 1997 and 31 March 1998:

	31 March 1997	**31 March 1998**
Individuals	97,61,426	1,11,94,953
Hindu undivided families	4,12,470	4,37,251
Firms	11,58,319	11,72,647
Companies	2,27,228	2,74,319
Trusts	49,629	51,865
Others	34,471	36,701
Total	**1,16,43,543**	**1,31,67,736**

(ii) Category-wise break-up of income tax (including corporation tax) assessees as on 31 March 1998:

Category	**Individuals**	**Hindu undivided families**	**Firms**	**Companies**	**Others (including Trusts)**	**Total**
Category 'A'*	1,07,84,480	4,15,738	10,91,366	1,60,961	78,508	1,25,31,053
Category 'B' (Lower)[1]	2,35,298	11,692	40,459	54,675	3,907	3,46,031
Category 'B' (Higher)[2]	1,33,720	6,122	27,502	31,514	4,386	2,03,244
Category C'[3]	27,796	2,117	9,359	25,465	1,498	66,235
Category 'D'[4]	13,659	1,582	3,961	1,704	267	21,173
Total	**1,11,94,953**	**4,37,251**	**11,72,647**	**2,74,319**	**88,566**	**1,31,67,736**

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

[1] Category 'B' assessees (lower income group) - Company assessments with income /loss of Rs.50,000 and above but below Rs.5 lakh and non-company assessments with income/loss of Rs.2 lakh and above but below Rs.5 lakh.

[2] Category 'B' assessees (higher income group) - Company and non-company assessments with income/loss of Rs.5 lakh and above but below Rs.10 lakh.

[3] Category 'C' assessees - Company and non-company assessments with income/loss of Rs.10 lakh and above.

[4] Category 'D' assessees - Search and Seizure assessments.

(iii) Status-wise break-up of Wealth tax assessees as on 31 March 1997 and 31 March 1998:

	31 March 1997	**31 March 1998**
Individuals	2,55,136	2,08,266
Hindu undivided families	33,141	28,494
Companies	11,631	7,759
Total	**2,99,908**	**2,44,519**

(iv) Status-wise break-up of Gift tax assessees as on 31 March 1997 and 31 March 1998:

	31 March 1997	**31 March 1998**
Individuals	45,777	47,431
Hindu undivided families	1,246	731
Companies	124	128
Firms	18	19
Others	199	602
Total	**47,364**	**48,911**

(v) Interest tax assessees as on 31 March 1997 and 31 March 1998 were as under:

31 March 1997	**31 March 1998**
3,962	6,080

Annexure II

[Reference: para 2.3(i)]

State/UT wise break up of direct taxes

States	0020 Corporation tax	0021 Income Tax	0023 Hotel Receipts Tax	0024 Interest Tax	0028 Expenditure Tax	0031 Estate Duty	0032 Wealth Tax	0033 Gift Tax	Total
									(Rs. in crore)
Andhra Pradesh	515.78	677.99	0.00	28.96	379.47	0.00	1.98	0.44	1604.62
Arunachal Pradesh	0.00	4.08	0.00	0.00	0.00	0.00	0.00	0.00	4.08
Assam	111.90	115.71	0.00	0.14	39.29	(-)0.01	0.45	0.06	267.54
Bihar	26.43	319.30	0.00	0.02	129.16	0.00	0.18	0.18	475.27
Goa	65.71	84.77	0.00	0.00	18.79	0.00	0.44	0.01	169.72
Gujarat	672.88	1,175.06	2.12	1.67	924.31	(-)0.04	3.52	0.37	2779.89
Haryana	61.92	242.07	0.00	0.41	92.07	0.00	0.38	0.09	396.94
Himachal Pradesh	10.99	62.88	0.00	0.42	16.60	0.00	0.06	0.00	90.95
Jammu & Kashmir	(-)17.75	36.17	0.00	7.10	32.04	0.00	0.03	0.00	57.59
Karnataka	675.67	1,094.93	0.00	(-)25.19	572.47	0.02	4.38	0.46	2322.74
Kerala	251.45	400.22	0.09	46.08	136.03	0.00	2.91	0.58	837.36
Madhya Pradesh	757.22	396.20	0.00	4.71	302.57	0.02	1.73	0.13	1462.58
Maharashtra	8,461.84	5,262.34	0.00	741.07	2,921.16	(-)0.08	51.13	2.96	17,440.42
Manipur	0.08	5.68	0.00	0.00	2.58	0.00	0.01	0.01	8.36
Meghalaya	4.26	12.46	0.00	0.06	4.77	0.00	0.04	0.00	21.60
Mizoram	0.00	0.90	0.00	0.00	0.00	0.00	0.00	0.00	0.90
Nagaland	0.04	4.24	0.00	0.00	1.31	0.00	0.06	0.01	5.66
New Delhi	4,397.10	2,454.34	0.00	230.58	1,273.09	0.00	19.58	0.81	8,375.50
Orissa	383.94	137.18	0.00	0.69	52.85	0.00	0.11	0.06	574.83
Punjab	134.75	435.05	0.00	9.30	400.92	0.00	1.48	0.02	981.52
Rajasthan	152.33	363.21	0.00	22.85	274.42	0.00	0.64	0.31	813.76
Sikkim	0.04	0.50	0.00	0.03	0.00	0.00	0.01	0.00	0.58
Tamil Nadu	1,106.23	1,377.87	0.00	82.63	851.42	0.31	12.53	1.31	3,432.30
Tripura	0.34	9.22	0.00	0.00	3.28	0.00	0.04	0.02	12.90
Uttar Pradesh	937.99	751.53	0.00	1.28	573.53	0.01	1.71	0.32	2,266.37
West Bengal	1,033.69	892.98	0.00	50.31	780.54	0.02	9.30	0.90	2,767.74
Union Territories									
Andaman Nicobar	2.20	3.03	0.00	0.00	0.00	0.00	0.01	0.00	5.24
Chandigarh	98.66	119.78	0.00	1.61	42.93	0.00	0.27	0.01	263.26
Daman	0.03	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.13
Diu	0.00	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.08
Dadra N. Haveli	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Pondicherry	4.48	17.41	0.00	0.45	8.46	0.00	0.05	0.02	30.87
Laxadweep	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Silvasa	0.01	0,09	0.00	0.00	0.00	0.00	0.00	0.00	0.10
Total	19,850.21	16,457.38	2.21	1,205.18	9,834.06	0.25		9.08	47,471.40
CTDS (Prov)	165.79	643.21	-	-	-	-	-	-	809.00
Grand Total	20,016.00	17,100.59	2.21	1,205.18	9,834.06	0.25	113.03	9.08	48,280.40

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

Year-wise/category wise assessee status for 1993-94 to 1997-97

Individuals

Category	1993-94	1994-95	1995-96	1996-97	1997-98
A	75,00,275	81,90,186	86,09,612	94,43,293	1,07,84,480
B(Lower)	1,82,954	1,96,492	1,24,437	2,40,262	2,35,298
B(Higher)	36,061	36,049	35,650	40,964	1,33,720
C	9,177	10,012	14,535	19,149	27,796
D	15,105	16,383	13,978	17,758	13,659
Total	77,43,572	84,49,122	87,98,212	97,61,426	1,11,94,953

HUFs

A	3,86,725	3,88,478	3,93,649	3,92,243	4,15,738
B(Lower)	11,590	9,630	8,181	12,162	11,692
B(Higher)	2,226	2,579	2,145	3,696	6,122
C	1,095	924	1,011	2,321	2,117
D	1,838	3,302	1,470	2,048	1,582
Total	4,03,474	4,04,913	4,06,456	4,12,470	4,37,251

Firms

A	11,32,256	10,82,892	11,35,823	10,91,502	10,91,366
B(Lower)	46,691	45,508	33,504	41,946	40,459
B(Higher)	11,786	13,228	12,345	12,474	27,502
C	5,288	5,529	6,683	7,860	9,359
D	4,020	25,598	3,838	4,537	3,961
Total	12,00,041	11,72,755	11,92,193	11,58,319	11,72,647

Companies

A	87,067	93,478	1,11,218	1,28,137	1,60,961
B(Lower)	38,473	43,590	39,908	43,622	54,675
B(Higher)	14,101	18,090	15,354	25,277	31,514
C	20,214	19,166	19,797	26,951	25,465
D	1,220	2,270	1,297	3,241	1,704
Total	1,61,075	1,76,594	1,87,574	2,27,228	2,74,319

Others (including Trusts)

A	62,082	70,536	73,385	74,953	78,508
B(Lower)	3,903	6,720	4,438	6,545	3,907
B(Higher)	573	1,189	601	813	4,386
C	1,337	1,867	1,450	1,645	1,498
D	120	910	205	144	267
Total	68,015	81,222	80,079	84,100	88,566

Annexure IV

(Reference: para 2.6)

Details of variation under the heads subordinate to the Major heads 0020 and 0021 for the year 1997-98:

	Head of revenue	Budget Estimates	Actuals	Variation	Percentage of variation (Rs. in crore)
	0020-Corporation Tax				
(i)	Income Tax on companies	21,352.00	19,643.72	(-)1,708.28	(-)8.000
(ii)	Surtax	1.00	0.71	(-)0.29	(-)29.0
(iii)	Surcharge	412.00	86.41	(-)325.59	(-)79.02
(iv)	Other receipts	95.00	285.16	190.16	200.16
	Total	**21,860.00**	**20,016.00**	**(-)1,844.00**	**(-)8.43**
	0021 - Taxes on income other than Corporation Tax				
(i)	Income tax	21,086.00	16,719.85	(-)4,366.15	(-)20.70
(ii)	Surcharge	90.00	120.39	30.39	33.76
(iii)	Other receipts	524.00	260.35	(-)263.65	(-)50.31
(iv)	Total	21,700.00	17,100.59	(-)4,599.41	(-)21.19
(v)	Deduct share of proceeds assigned to States	15,690.58	13,507.69	(-)2,182.89	(-)13.91
	Net Collection	**6,009.42**	**3,592.90**	**(-)2,416.52**	**(-)40.21**

Annexure V
[Reference: para 2.9.1(ii)]

Status-wise break-up of income tax (including corporation tax) assessments completed during the years 1995-96 to 1997-98

		1995-96	1996-97	1997-98
(a)	Individuals	68,91,794	88,26,523	96,60,004
(b)	Hindu undivided families	2,92,996	3,63,574	3,54,407
(c)	Firms	8,55,645	9,56,127	9,26,451
(d)	Companies	1,99,086	2,35,385	2,71,481
(e)	Others	60,332	67,650	63,284
	Total	**82,99,853**	**1,04,49,259**	**1,12,75,627**

Status-wise and category-wise break-up of work load, disposals and pendency of assessments as on 31 March 1998:

			No. of assessments		Disposal		Balance	
			Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny
1.	Category 'A' Assessments	Company	27,086	1,67,642	19,638	1,20,183	7,448	47,459
		Non-Company	9,16,150	1,20,03,577	8,09,292	98,05,673	1,06,858	21,97,904
2.	Category 'B' (lower) Assessments	Company	19,684	60,321	9,793	47,522	9,891	12,799
		Non-Company	40,635	2,76,339	23,989	2,01,316	16,646	75,023
3.	Category 'B' (higher) Assessments	Company	13,037	33,233	6,196	25,904	6,841	7,329
		Non-Company	25,640	1,25,082	15,175	97,098	10,465	27,984
4.	Category 'C' Assessments	Company	28,238	37,330	14,686	25,685	13,552	11,645
		Non-Company	20,047	43,824	9,899	28,256	10,148	15,568
5.	Category 'D' Assessments	Company	2,626	179	1,709	165	917	14
		Non-Company	15,621	3,642	10,324	3,124	5,297	518
6.	**Total**	**Company**	**90,671**	**2,98,705**	**52,022**	**2,19,459**	**38,649**	**79,246**
		Non-Company	**10,18,093**	**1,24,52,464**	**8,68,679**	**1,01,35,467**	**1,49,414**	**23,16,997**

Annexure VI
[Reference: para 2.11(ii)]

Year-wise break-up of certificates pending as on 31 March 1998 and amount of demand:

Year	No. of Certificates	Amount (Rs. in crore)
1993-94 and earlier years	6,26,028	600.94
1994-95	24,146	243.26
1995-96	27,298	382.42
1996-97	15,247	760.83
1997-98	18,389	1,593.85
Total	**7,11,108**	**3,581.30**

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

(Rs. in crore)

	Range of Demand	Corporation Tax		Income Tax		Wealth Tax	
		No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	18,493	3.76	46,5472	158.57	59,088	6.84
(b)	Over Rs.10,000 and below Rs.1 lakh	7,267	6.23	83,842	102.22	6,555	6.04
(c)	Over Rs.1 lakh to Rs.5 lakh	1,134	19.23	12,811	190.69	1,945	17.14
(d)	Over Rs.5 lakh to Rs.10 lakh	526	31.44	5,841	227.10	2,417	4.85
(e)	Over Rs.10 lakh	869	537.12	6,402	2,208.18	1,771	37.59
	Total	28,289	597.78	5,74,368	2,886.76	71,776	72.46

(Rs. in crore)

	Range of Demand	Gift Tax		Sur Tax		Others		Total	
		No.	Amount	No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	15,874	2.15	246	0.06	2,680	0.67	5,61,853	172.05
(b)	Over Rs.10,000 and below Rs. 1 lakh	3,754	1.73	235	0.31	2,017	0.60	1,03,670	117.13
(c)	Over Rs.1 lakh to Rs.5 lakh	2,433	1.22	6	0.03	2,365	0.28	20,694	228.59
(d)	Over Rs.5 lakh to Rs.10 lakh	1,855	1.18	-	-	1,696	0.39	12,335	264.96
(e)	Over Rs.10 lakh	1,816	13.50	2	0.45	1,696	1.73	12,556	2,798.57
	Total	25,732	19.78	489	0.85	10,454	3.67	7,11,108	3,581.30

Annexure VII
[Reference: para 2.13(ii)]

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

Financial Year in which application was made	Number of cases pending
1993-94 and earlier years	261
1994-95	351
1995-96	440
1996-97	831
1997-98	1,942
Total	**3,825**

CHAPTER 3 : A-SYSTEM APPRAISALS

3.1 Export incentives and deductions in respect of profits retained for export business

An appraisal of the implementation of scheme under the Income Tax Act revealed that net foreign exchange realisation had increased alongwith the number of beneficiaries during 1994-95 to 1996-97. Irregular concessions to exporters led to short levy of tax of Rs.43874 lakh, constituting 16 percent of total revenue concession.

Introductory

3.1.1 With a view to encouraging establishment of export oriented industries to boost the foreign exchange earnings for the country, the Income Tax Act provided for exemption of profits and gains derived by an assessee from an industrial undertaking in a free trade zone or a hundred percent export oriented undertaking or from exports to outside India of eligible goods and merchandise.

Legal provisions and procedure

3.1.2 (A) Newly established industrial undertakings in free trade zones (FTZ)-Section 10A.

The section was inserted by Finance Act, 1981 with effect from 1 April 1981 and is applicable to an industrial undertaking which begins to manufacture or produce articles or things on or after 1 April 1981, in any free trade zone. From 1 April 1994, the benefit has been extended to any industrial undertaking in any notified electronic hardware technology park or software technology park. In order to allow the industrial undertakings to dispose of the export rejects and by- products, industrial undertakings which begin to manufacture or produce things or articles on or after 1.4.1995 are allowed to sell upto 25% of total sale in the domestic market. The scheme contemplates 100% tax holiday in respect of entire profits derived by the exporter including sales in domestic market, provided a minimum of 75% of total sales in terms of value is exported. If the actual export achieved falls short of the prescribed minimum, the exporter does not qualify for any tax exemption under the scheme and he may avail tax concession as proportionate export profits under section 80 HHC.

Under the provisions, the entire profits and gains derived by the undertaking are exempt in respect of any five consecutive assessment years as specified by the assessee at his option, falling within a period of eight assessment years

from the assessment year in which it begins to manufacture or produce articles or things subject to the condition that the assessee will not be allowed the benefit of certain specified unabsorbed allowances etc. carry forward of business loss or capital loss and other deductions as specified during the tax holiday. Accordingly, unabsorbed depreciation allowance, unabsorbed investment allowance and development rebate, unabsorbed capital expenditure on scientific research, etc. relating to tax holiday period will not be taken into account after that period. Similarly, unabsorbed business loss or loss under the 'capital gains' cannot be carried forward and set off. Further, no deduction under Sections 80HH, 80HHA, 80-I or 80-IA or 80J will be allowed during tax holiday period.

(B) Newly established hundred percent export oriented undertakings (EOU)- Section 10B

This section was inserted by the Finance Act, 1988 with effect from 1 August 1989 and is applicable to any approved hundred percent export oriented undertaking which manufactures or produces any article or thing. In relation to an undertaking which begins to manufacture or produce any article or thing on or after 1 April 1994, it has been allowed the same economic flexibility as in the case of section 10A of the Act. Under the provisions of this section, entire profits and gains derived from the above mentioned undertaking shall not be included in the total income of the assessee in respect of any five consecutive assessment years to be specified by him at his option, and falling within a period of eight assessment years from the assessment year in which it begins to manufacture or produce articles or things. The provisions regarding bar on availing other benefits under other provisions of the Act are similar to that of section 10A as indicated at para 2Ä above.

Audit observations on legal requirements

Both Sections 10A & 10B have prescribed eligibility criterion on the basis of percentage export turnover achieved and have no nexus with the profit earnings. It is conceivable that a 100% export oriented unit achieves the prescribed percentage sales turnover in the export market though the actual quantity exported may be far less as compared to the sales in the domestic market. In such cases, the overall profit earned from the domestic market could far exceed the export earnings; yet the entire profits get exempted on the basis of the sales turnover criterion.

Moreover, there is no requirement of certification of the audit of accounts of the assessee to ensure legal compliance by a qualified Chartered Accountant as provided for under section 80 HHC.

Under the Export-Import policy (1992-97), a 100 percent EOU or a unit in the FTZ is liable to pay excise duty at a concessional rate on the manufactured goods which the unit is permitted to sell in the Domestic Tariff Area. The excise regime is more justified inasmuch as the manufactured goods sold in

the DTA are chargeable to excise levies, though at a concessional rate. Similar provisions need to be made for taxing the profits earned by such units from their sales in the DTA alongwith requirement of certification of export performance.

(C) Profits retained for export business- 80 HHC

This section was inserted by Finance Act, 1983 with effect from 1 April 1983. Originally the incentive was turnover based, being certain percent of export turnover and incremental turnover. From 1 April 1989, the entire profits from export have been exempt from tax and the benefit has been extended also to the supporting manufacturers selling goods or merchandise to any Export/Trading House.

(a) Under the provisions of Section 80HHC, the deduction is allowed on profits retained from the export out of India of any goods or merchandise other than mineral oil (including crude as well as petroleum and natural gas) or minerals and ores (other than processed minerals and ores specified in the Twelfth Schedule to the Act).

The deduction is eligible to an assessee who directly exports outside India, the goods, subject to fulfillment of eligibility conditions, manufactured or processed by him, manufactured or processed by others (trading goods),

- manufactured or processed by him and those by others, and
- to a supporting manufacturer i.e. an assessee who supplies goods or merchandise manufactured by him to an Export/Trading House for purposes of export.

(b)Quantum of deduction allowable

The deduction under section 80HHC is available, out of the export profits as per the formulae prescribed depending upon as to whether the assessee is an exporter of manufacturing goods, trading goods or both.

Objective and scope of the review

3.1.3 The implementation of the scheme has been reviewed with a view to evaluate the impact of the concessions on the total revenue collection vis-à-vis net foreign exchange realisation and the degree of statutory compliance by the assessing officers in the implementation of the incentive scheme. The review covered a test check of 6680 assessments completed in 1217 wards/circles across the country during the years 1994-95 to 1996-97.

Highlights

3.1.4 (i) Despite the fact that the tax holiday provisions, export incentives and deductions from profits retained from exports have been in the statute for over 15 years, no review/study has ever been made by the department to evaluate the impact of the scheme. No records had been maintained in the department in respect of the assessees who are availing the export incentives under various provisions of the Act.

[Para 3.1.5]

(ii) There was a net increase by more than three times in net foreign exchange realisation with reference to the cases test checked during 1994-95 to 1996-97 and the number of beneficiaries availing of the deductions increased from 1296 to 3348 during the period.

[Para.3.1.6(a)]

(iii) The total amount of irregular deductions in 1273 cases out of 6680 cases test checked formed 10 percent of total deductions during the period from 1994-95 to 1996-97 and involved an aggregate tax effect of Rs.43874 lakh. The revenue foregone on account of irregular deductions constituted 16 percent of total revenue concession. A few of the cases are highlighted as follows:

(a) In 11 cases, irregular relief allowed to the new industrial undertakings established in free trade zones resulted in short levy of tax of Rs.609.72 lakh.

[Para.3.1.7]

(b) Irregular relief allowed in 41 cases to newly established 100 percent export oriented units resulted in short levy of tax of Rs.6213.86 lakh.

[Para.3.1.8]

(c) Incorrect deductions allowed on export of ineligible goods and other than goods and merchandise resulted in short levy of tax of Rs.15349.36 lakh in 29 cases.

[Para.3.1.9]

(d) Incorrect computation of total turnover, export turnover and export profits/adjusted profits of business in 609 cases resulted in short levy of tax of Rs.10594.62 lakh.

[Paras.3.1.11 to 3.1.13]

(e) Omission to set off of unabsorbed depreciation etc. against the profits and to exclude incomes chargeable under other heads of income resulted

in short levy of tax of Rs.2130.66 lakh in 159 cases.

[Paras.3.1.14 and 3.1.15]

(f) Incorrect computation of direct and indirect costs in 59 cases resulted in short levy of tax of Rs.2460.86 lakh.

[Para.3.1.16]

(g) Incorrect allowance of deduction to supporting manufacturers, allowing deduction despite non-realisation of foreign exchange within the prescribed period, omission to file the requisite forms alongwith the return and other mistakes in allowing the deductions resulted in short levy of tax of Rs.3733.48 lakh in 225 cases.

[Paras.3.1.10, 3.1.17, 3.1.18 and 3.1.20]

(h) Omission to set off export losses against the export incentives in 35 cases resulted in short levy of tax of Rs.2999.78 lakh.

[Para.3.1.19]

Constraints

3.1.5 Even though the tax holiday provisions, export incentives and deduction from profits retained for exports have been in the statute for over 15 years, no review or study has ever been undertaken by the department to evaluate the impact of the scheme. No data registers have been maintained by the department in respect of assessees who are availing export incentives under the sections 10A,10B and 80HHC (or any other deduction under Chapter VIA of the Act). As such, audit was unable to gauge the impact of the scheme in totality except with reference to the cases test checked.

Impact of the scheme

3.1.6(a) Test check by Audit in 1217 ranges/wards/ circles revealed that during 1994-95 to 1996-97 export incentives and deductions (under sections 10A, 10B and 80HHC) allowed in 6680 cases amounted to Rs.163338 lakh and Rs.629916 lakh respectively as shown below:

(Amounts in lakhs of rupees)

Year 1	No of cases where deduc-tions were allowed 2	Foreign exchange earned on exports 3	Foreign exchange outgo on Imports 4	Export incentives allowed 5	Deduc-tions Allowed 6	Tax effect (ref col 6) 7	No. of cases of irregular dedu-ctions (ref col 2) 8	Amount of irregular dedu-ctions 9	Tax Effect (ref col 9) 10
1994-95	1296	1115676	326182	32808	100717	44174	256	7465	5544
1995-96	2036	1574725	325878	40367	180550	81936	378	10869	7843
1996-97	3348	3457954	871040	90163	348649	153438	639	46722	30487
Total	**6680**	**6148355**	**1523100**	**163338**	**629916**	**279548**	**1273**	**65056**	**43874**

Note: Above figures represent cases of which assessments were finalised during the years, 1994-95 to 1996-97 and are not relatable to foreign exchange earnings during the financial years.

From the statement it may be seen that the foreign exchange earnings from exports with reference to cases finalised and test checked have gone up by 210 percent in 1996-97 as compared to 1994-95, and the foreign exchange outgo on imports registered an increase of 167 percent in 1996-97 (Rs.871040 lakh) from 1994-95 (Rs.326182 lakh) and the net foreign exchange realised i.e. foreign exchange earnings as reduced by export incentives and foreign exchange outgo on imports grew by 230 percent during the period. The total deductions allowed ranged from 13.31 percent in 1994-95 to 13.96 percent in 1996-97 of the net foreign exchange earned. The number of beneficiaries has increased by more than two and one-half times during the period.

(b) The total amount of irregular deductions constituted 10 percent of the total deductions during the period from 1994-95 to 1996-97 involving tax effect totalling Rs.43874 lakh. The number of cases where irregular deductions were granted has increased from 256 (20 percent of total cases of 1296) in 1994-95 to 639 (19 percent of total cases of 3348) in 1996-97 with the corresponding amount of irregular deductions to total deductions increasing from 7 percent to 13 percent during the above period and the revenue foregone on account of irregular deductions (Rs.43874 lakh) constituted 16 percent of the total revenue foregone (Rs.279548 lakh).

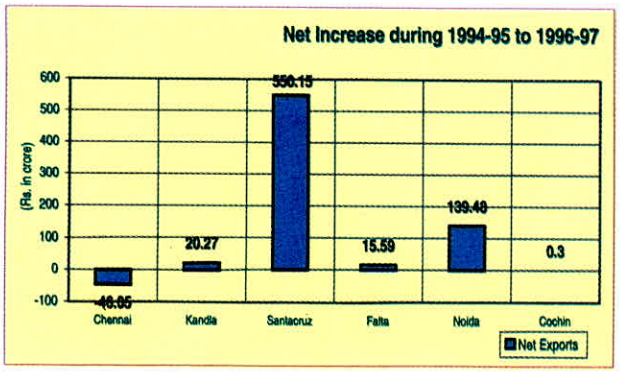
(c) There were 537 number of units functioning as on 31 March 1997, as against 839 units approved by Government during 1994-95 to 1996-97. During the period value of total exports aggregated Rs.11181.45 crore as against import value of Rs.6781.45 crore with a net increase of Rs.4400 crore.

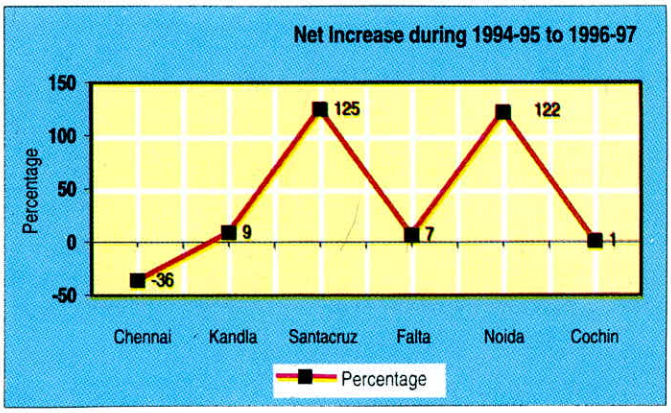
This represented 57 percent increase in net value of exports over imports over the period. FTZ details are given below:

	Units approved			Units functioning			Value of exports			Value of imports		
	(number)			(number)			(Rupees in crore)			(Rupees in crore)		
	1994-95	1995-96	1996-97	1994-95	1995-96	1996-97	1994-95	1995-96	1996-97	1994-95	1995-96	1996-97
Chennai	123	136	136	93	102	80	281.36	391.91	993.81	152.26	371.96	910.76
Kandla	36	39	44	98	91	97	320.02	325.29	374.15	95.57	83.59	129.43
Santacruz	4	5	2	155	155	157	1549.54	1876.29	2189.90	1110.59	1305.03	1200.80
Falta	23	28	23	34	40	52	286.92	395.17	358.77	61.20	90.59	117.46
Noida	34	17	21	119	119	111	366.69	496.89	586.53	252.80	328.88	333.16
Cochin	51	53	64	31	36	40	102.53	120.31	165.37	50.75	72.73	113.89
TOTAL	271	278	290	530	543	537	2907.06	3605.86	4668.53	1723.17	2252.78	2805.50

- Above information in respect of FTZ, Visakhapatnam has not been received from the concerned Development Commissioner
- Source : Development Commissioners, Export Processing Zones.

Out of 6 ports covered under FTZ, Chennai registered 36 percent decrease in the growth in terms of net exports while Santacruz and Noida recorded net percentage increase of 125 and 122 respectively. The other ports namely Kandla, Falta and Cochin recorded negligible growth rates.





Audit Findings

A-Newly established industrial undertaking in Free Trade Zone (FTZ) (Section 10A)

3.1.7 In test check in audit in Gujarat, Kerala, Tamil Nadu, Delhi and Maharashtra charges, during the period from 1994-95 to 1996-97, reliefs aggregating Rs.1025.10 lakh were allowed in 11 cases resulting in short levy of tax of Rs. 609.72 lakh (10 percent of total revenue forgone Rs.6096.96 lakh) as summarised in the table below:

Year	Cases where deductions were allowed	Foreign exchange earned on exports	Export incentives allowed	Deductions Allowed	Tax effect	Cases of irregular deductions	Amount of irregular deductions	Tax effect
	Numbers	(Rupees in lakh)				Numbers	(Rupees in lakh)	
1994-95	22	12568.82	197.02	2350.69	1310.52	-	-	-
1995-96	20	16532.47	55.17	3225.69	1539.74	5	433.75	270.42
1996-97	24	115058.68	66.92	6577.39	3246.70	6	591.35	339.30
Total	**66**	**144159.97**	**319.11**	**12153.77**	**6096.96**	**11**	**1025.10**	**609.72**

Some illustrative cases are as under:

(a) Under the provisions of the Act, the benefit of the 'tax holiday' is available in respect of profits and gains derived by the industrial undertaking in respect of articles or things manufactured or processed in Free Trade Zone.

In Cochin, Kerala charge, the assessments of a firm for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and February 1997 respectively allowing an aggregate deduction of Rs.288.51 lakh. Audit scrutiny revealed that the unit located at FTZ had derived the profits in respect of the assessment years 1993-94 and 1994-95 from export/sale of processed marine products mainly transferred from its head office which undertook bulk procurement. Audit scrutiny also revealed that the assessee had not maintained separate accounts in respect of the processing unit and bulk of the expenses attributed to the unit were only by way of shipment and steamer freight and no processing charges were incurred at the unit. As the FTZ unit had not carried on processing activity, the profits derived in respect of transferred products for export were not eligible for exemption. The irregular exemption resulted in short levy of tax of Rs.129.25 lakh for the two years (excluding interest).

(b) As amended by Finance Act,1995, an undertaking which begins to manufacture or produce any article or thing on or after 1 April 1995, shall be eligible for the deduction if a minimum 75 percent of its production is exported out of India. Prior to 1 April 1995, the assessee was required to export 100 percent to avail the tax benefit.

(i) In City VI, Mumbai charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in February 1996 allowing a deduction of Rs.584.14 lakh. Audit scrutiny revealed that export sales during the previous year relevant to the assessment year 1995-96 were only 70.36 percent of its total turnover. As such, the assessee was not entitled to tax holiday. Incorrect allowance of deduction of Rs.584.14 lakh led to short levy of tax of Rs.381.56 lakh.

(ii) In Kerala charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in February 1996 allowing the entire gross total income of Rs.60 lakh including a short term capital gain of Rs.0.74 lakh as exempt from tax. Audit scrutiny revealed that the exports amounting to Rs.76.99 lakh during the previous year constituted only 23

percent of the total turnover of Rs.334.95 lakh and there was no record to show that sales other than exports valued at Rs.257.97 lakh related to sales towards export obligation under the Import Export Policy. As the assessee had commenced production prior to 1 April 1995, and the entire turnover was not exported, exemption allowed on the profits of Rs.59.26 lakh was not correct. The incorrect exemption resulted in short levy of tax of Rs.34.22 lakh including tax on short term capital gains of Rs.0.74 lakh included in the total income which was not eligible for exemption.

(c) Under the provisions, full effect of depreciation allowance, investment allowance, development rebate, etc. should be given during tax holiday period of five years falling within a period of eight assessment years from the assessment year in which it begins to manufacture or produce articles or things.

(i) In City III, Mumbai charge the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995 at Rs.2.97 lakh allowing a deduction of Rs.64.34 lakh. Audit scrutiny revealed that neither the assessee nor the department considered the allowable depreciation of Rs. 51.40 lakh for arriving at the profits of the business for computing the deduction. The omission resulted in excess allowance of deduction and underassessment of income of Rs.51.40 lakh with consequent short levy of tax of Rs.29.55 lakh.

(ii) In Delhi I charge, the assessment of a company for the assessment year 1995-96 was completed after scrutiny in January 1997. Audit scrutiny revealed that the assessee was allowed lesser amount of depreciation during the tax holiday period than worked out at the prescribed rates under Income Tax Act which resulted in the availability of higher written down value in respect of the fixed assets at the end of the tax holiday period. Accordingly, during the assessment year 1995-96, the depreciation was claimed less by Rs.23.73 lakh. This involved a tax effect of Rs.15.72 lakh (including interest).

(d) Under the provisions, an assessee is required to furnish a declaration to the effect that the provisions of the section 10A may not be made applicable to him for the relevant assessment year. If no such declaration was filed, the provisions of the section would automatically operate and the consecutive five year tax holiday period would apply.

In Tamil Nadu IV, Chennai charge, the assessments of a company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in March 1997 and in a summary manner in October 1996 respectively allowing an aggregate deduction of Rs.161.18 lakh. Audit scrutiny revealed that the assessee company had not exercised the option of availing the exemption for the assessment year 1989-90 being initial assessment year and for the assessment years 1990-91 and 1991-92 during which losses were incurred The assessee company exercised the option only in the assessment year 1992-93 and the exemption was allowed for assessment years 1992-93 to 1995-96. As the assessee had not exercised the option in the initial assessment year, the five

year tax holiday period would automatically get fixed from the assessment year 1989-90 to 1993-94. Hence the assessee company was not eligible for exemption for the assessment years 1994-95 and 1995-96. The irregular exemption resulted in underassessment of income of Rs.161.18 lakh with consequent short levy of tax of Rs.123.32 lakh.

B-Newly established hundred percent export oriented undertakings (EOU) - Section 10B

3.1.8 Test check by Audit revealed that during the period from 1994-95 to 1996-97, out of 105 cases of exemptions in respect of 100 percent export oriented units in Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, exemptions aggregating Rs.9422.90 lakh were allowed irregularly in 41 cases which resulted in short levy of tax of Rs.6213.86 lakh. The revenue effect thereon constituted 66 percent of total revenue foregone. Table below summarises the audit findings.

Year 1	Cases where deduc-tions were Allowed 2	Foreign exchange earned on exports 3	Export incentives allowed 4	Deduc-tions Allowed 5	Tax effect (ref col 5) 6	Cases of irregular dedu-ctions (ref col 2) 7	Amount Of Irregular Dedu-ctions 8	Tax Effect (ref col 8) 9
	Numbers	(Rupees in lakh)				Numbers	(Rupees in lakh)	
1994-95	22	9418.94	5.03	2779.68	1589.96	6	1591.46	1414.31
1995-96	32	29661.32	205.98	7608.81	3921.74	12	3114.72	2310.21
1996-97	51	48113.27	482.42	8131.72	3882.76	23	4716.22	2489.34
Total	**105**	**87193.53**	**693.43**	**18520.21**	**9394.46**	**41**	**9422.40**	**6213.86**

Few illustrative cases are given below:

3.1.8.1 Under the provisions, where the undertaking has commenced its operation prior to 1 April 1989, the assessee is required to indicate his option specifying five consecutive assessment years for availing the exemption.

In Tamil Nadu charge, the assessments of two closely held companies, in respect of one unit at Chennai was completed after scrutiny for the assessment year 1995-96 and after scrutiny and in a summary manner in regard to the unit at Coimbatore for the assessment years 1994-95 and 1995-96 respectively allowing an aggregate exemption of Rs.601.41 lakh. Audit scrutiny revealed that the assessees had commenced production before 1April 1989 but omitted to exercise the option and declaration as required under the provisions. The irregular deductions resulted in short computation of aggregate income by Rs.601.41 lakh with consequent short levy of tax of Rs.450 lakh and excess carry forward of loss involving potential tax effect of Rs. 9.90 lakh.

CIT's charge	Assessment year and date of assessment	Section under which assessed	Amount of exemption (Rs. in lakh)	Tax effect (Rs. in lakh)
Tamil Nadu IV	1995-96 November 1996	143(3)	88.25	56.62
Coimbatore	1994-95, 1995-96 December 1996, January 1996	143(3), 143(1)(a)	273.58 239.58	261.13 9.90(P) 132.25
			601.41	**459.90**

Transfer of old machinery to a new unit

3.1.8.2 Under the provisions, the eligible unit shall not be formed as a result of reconstruction or revival of the business already in existence or by transfer to a new business of machinery and plant provided that in the case of the transfer of plant and machinery, the total value of machinery transferred does not exceed 20 percent of the cost of machinery used in the business.

M/s. Tata Tea Ltd.

In West Bengal VI, Calcutta charge, the assessments of a company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and March 1997 respectively and that of the assessment year 1995-96 in a summary manner in June 1996 allowing exemptions aggregating Rs.3337.36 lakh. Audit scrutiny revealed that the new unit in respect of which the exemption was allowed was using old fixed assets including plant and machinery of written down value of Rs.339.77 lakh as on 31.3.1992 while the new addition during the previous year 1992-93 amounted to Rs.355.86 lakh. As 49 percent of the plant and machinery was brought on transfer from the existing units, the assessee was not entitled to the exemption. The irregular exemption resulted in underassessment of income of Rs.3407.36 lakh with consequent short levy of tax of Rs.1720.32 lakh.

Non-fulfillment of prescribed export quota

3.1.8.3 Under the provisions, an undertaking which begins to manufacture or produce any articles or things on or after 1 April 1994, is allowed to sell upto 25 percent of its total sales in the domestic market in order to provide economic flexibility to allow it to dispose of the export reject and by-products. Prior to 1 April 1994, the assessee should have exported cent per cent for availing the benefit.

(a) In Indore, Madhya Pradesh charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in March 1996 allowing exemption of its entire income of Rs.204.60 lakh. Audit scrutiny revealed that the assessee having started its commercial production on 10 January 1994 was required to export 100 percent of its turnover to claim the benefit as against which the exports were only 82 percent during the relevant previous year. Thus, the exemption was irregular and resulted in underassessment of income of Rs.53.86 lakh (after allowing deduction

admissible under section 80HHC) with consequent short levy of tax of Rs.35.77 lakh (including additional tax and interest).

(b) In City I, Mumbai charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in December 1994 allowing an exemption of Rs.131.08 lakh. Audit scrutiny revealed that the unit had not achieved the minimum required export obligation during 1991-92 under the Export-Import policy and had made deemed export sale of Rs.429.47 lakh in domestic tariff area under global tender conditions and other domestic area sales of Rs.37.23 lakh and hence was not entitled to duty-free clearance in respect of domestic tariff area sales during that year. Therefore, the assessee should have been denied exemption during assessment year 1992-93. The irregular exemption of Rs.131.08 lakh resulted in underassessment of income of like amount with consequent short levy of tax of Rs.125.11 lakh (including interest).

(c) In Kerala charge, the assessment of a company for the assessment year 1995-96 originally done in a summary manner in November 1996 was completed after scrutiny in January 1998 at nil income allowing exemption of the entire profits of Rs.69.05 lakh in respect of 100 percent EOU owned by it, which started commercial production from November 1991. Audit scrutiny revealed that out of sales of Rs.2294.50 lakh during the relevant previous year, Rs.2012.06 lakh only related to exports and the balance Rs.282.45 lakh related to local sales and inter branch sales. As the undertaking started production prior to 1 April 1994, hundred percent of the turnover was required to be exported for availing the benefit of exemption under the special provisions. The irregular exemption resulted in underassessment of income of Rs.69.05 lakh involving a potential tax effect of Rs.31.76 lakh.

Inclusion of income from other sources

3.1.8.4 As per provisions, profits and gains derived from 100 per cent export-oriented undertaking only shall be eligible for the exemption. It has been judicially held* that interest on deposits in the nature of securities for the purpose of contracts entered into by the assessee and interest from supplies of raw materials is income attributable to business (and not derived).

(a) In Andhra Pradesh, Hyderabad charge, the assessments of a company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in March 1997 and in a summary manner in December 1996 respectively allowing exemption of incomes aggregating Rs.261.76 lakh. Audit scrutiny revealed that while computing the total income, amounts aggregating Rs.37.84 lakh being interest income received from banks and others not derived from export business during the two assessment years were not deducted. This resulted in a total short levy of tax of Rs.31.46 lakh.

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*English Electric Co. of India Vs CIT (1987) 168 ITR 513 (Madras)

(b) In Karnataka I, Bangalore charge, the assessments of a widely held company for the assessment years 1994-95 and 1995-96 were completed in a summary manner allowing relief aggregating Rs.210.72 lakh under the above provisions. Audit scrutiny revealed that the incomes of the EOU in respect of which the relief of carry forward loss was allowed included amounts of Rs.3.24 lakh relating to a non-EO unit and Rs.12.05 lakh being interest income on long term deposits respectively during the two assessment years. Irregular allowance of relief on incomes other than that of EOU had resulted in underassessment of income of Rs.15.29 lakh with consequent short levy of tax of Rs.7.15 lakh.

Irregular computation of business income

3.1.8.5 As per the provisions, the profits and gains of the hundred percent EOU are not includible in the total income. Hence, before allowing exemption, the profits and gains of the unit are to be computed in accordance with the provisions of the Act (under sections 28 to Sec.44D), after allowing current year depreciation and unabsorbed depreciation of previous years which should be treated on par with current year depreciation. Hence the assessee's business income from 100 percent EOU should be determined after adjusting the unabsorbed depreciation and the balance, if any only would qualify for exemption.

(a) In Delhi VII charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 allowing a relief of Rs.385.24 lakh. Audit scrutiny revealed that the assessee had claimed and was allowed depreciation at lesser rates than those prescribed under the Income Tax Act. Since the assessee had been allowed exemption of 100 percent income from the EOU, failure to give full effect of depreciation resulted in excess allowance of relief under the special provisions. Further, the written down value of the fixed assets would be inflated at the end of the tax-holiday period and consequent allowance of higher depreciation thereby reducing the tax liability. Such irregular claim of depreciation in the assessment year 1993-94 resulted in underassessment of income of Rs.385.24 lakh with consequent short levy of tax of Rs.342.90 lakh (including interest).

(b) In Tamil Nadu IV, Chennai charge, the assessment of a widely held company for the assessment year 1995-96 was completed in a summary manner in March 1997 allowing an exemption of Rs.453.65 lakh. Audit scrutiny revealed that unabsorbed depreciation brought forward was not deducted from the business income before allowing the exemption. This had resulted in excess computation of profits by Rs.453.65 lakh involving a potential tax effect of Rs.208.68 lakh.

(c) In Tamil Nadu V, Chennai charge, the assessment of a closely held company for the assessment year 1993-94 originally completed after scrutiny in January 1996 was revised in January 1997 and for the assessment year 1994-95 was completed after scrutiny in January 1997 allowing exemptions of

Rs.124.09 lakh and Rs.242.15 lakh respectively. Audit scrutiny revealed that unabsorbed depreciation brought forward from the assessment year 1990-91 was not deducted from business income of the 100 percent EOU while computing the qualifying amount and for allowing exemption. This resulted in excess computation of profits by Rs.366.24 lakh in aggregate involving a potential tax effect of Rs.146.50 lakh.

Irregular relief beyond tax holiday

3.1.8.6 Under the provisions, the relief is available in respect of any five consecutive assessment years as specified at the option of the assessee falling within a period of eight assessment years from the assessment year in which the undertaking begins to manufacture or produce articles or things. Also, the assessee shall not be entitled to carry forward losses or unabsorbed depreciation, investment allowance, etc. relating to the tax holiday period for set-off in the subsequent assessment years

(a) In Panaji, Goa charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner allowing a relief of Rs.231.29 lakh under the relevant provisions. Audit scrutiny revealed that the assessee had availed the relief for the five consecutive years upto the assessment year 1994-95. Hence the relief granted beyond the tax-holiday period was irregular and resulted in underassessment of income of Rs.231.29 lakh with consequent short levy of tax of Rs.201.98 lakh.

(b) In Andhra Pradesh, Hyderabad charge, the assessments of a company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in September 1995 and May 1996 respectively allowing carry forward of Rs.17.04 lakh towards unabsorbed depreciation relating to the assessment year 1994-95 for set off in the subsequent years. Audit scrutiny revealed that the assessee has exercised option to avail the benefit under the section 10B for the five consecutive years 1990-91 to 1994-95 and hence the carry forward of depreciation relating to the tax-holiday period beyond assessment year 1994-95 was irregular. Further, miscellaneous income aggregating Rs.34.11 lakh being income from other source which stood included in the total incomes of the two assessment years was not reduced while computing the eligible profits. The mistakes resulted in underassessment of income aggregating Rs.51.15 lakh with consequent short levy of tax of Rs.35.83 lakh.

Relief to ineligible units

3.1.8.7 As per the provisions, a newly established hundred percent export-oriented undertaking which had been approved as such by the Board appointed in this behalf by the Central Government would only be eligible for the exemption.

In 8 cases under Karnataka, Goa and Tamil Nadu charges, relief aggregating Rs.3693.79 lakh was allowed even though there was no evidence on record that the assessees, had obtained approval as 100 percent EOU by the concerned authority. The details of the cases are as under:

Assessee	Sl. No.	CIT's Charge	Assessment year and date of assessment	Section under which assessed	Exemption allowed (Rs. in lakh)	Tax effect (Rs. in lakh)
M/s. Moon Rock Agencies (P)Ltd.	1.	Karnataka I	1994-95, 1995-96 January 1995, March 1997	143(1)(a), 143(1)(a)	139.77	88.36
M/s. Index Computing (P)Ltd.	2.	Karnataka III	1995-96, 1996-97 November 1996/ December 1997, March 1997	143(1)(a)/ 143(3), 143(1)(a)	367.71	169.15
M/s. Sociedade-de Fomento Ind. Ltd.	3.	Panaji, Goa	1992-93, 1993-94, 1994-95, 1995-96 December 1994, January 1996, January 1995, November 1995	143(3), 143(3), 143(1)(a), 143(1)(a)	2581.28	2373.88
M/s. Mayfair Exports (P)Ltd.	4.	Tamil Nadu IV	1995-96 November 1996	143(3)	98.50	63.44
M/s. Chamundi Taxtiles (Silk Mills) Ltd.	5.	Madurai	1993-94 February 1996	143(3)	43.44	24.98
M/s. Rajapalayam Mills Ltd.	6.	Madurai	1994-95, 1995-96, 1996-97 December 1996, October 1996, December 1996	143(3), 143(1)(a), 143(1)(a)	348.65	67.44 115.67(P)
M/s. Relco (P)Ltd.	7.	Coimbatore	1993-94 March 1996	143(3)	57.47	18.98 22.01(P)
M/s. United Granites Pvt. Ltd.	8.	Coimbatore	1995-96 March 1996	143(1)(a)	56.97	37.74
					3693.79	**2843.97 137.68(P)**

C-Profits retained for export business-section 80 HHC

Out of 6509 cases covered under Section 80HHC test checked, audit detected 1221 cases of irregular deductions involving Rs.54607 lakh with a revenue effect of Rs.37051 lakh constituting 13 percent of revenue foregone on account of irregular deductions.

Year	No. of cases where deductions were allowed	Foreign exchange earned on exports	Export incentives allowed	Deductions Allowed	Tax effect (Ref. Col.5)	No. of cases of irregular deductions (Ref. Col.2)	Amount of irregular deductions	Tax Effect (Ref. Col.8)
1	2	3	4	5	6	7	8	9
			(Rs. in lakh)				(Rs. in lakh)	
1994-95	1252	1093688	32606	95586	41274	250	5873	4130
1995-96	1984	1528531	40106	169715	76474	361	7320	5263
1996-97	3273	3294782	89614	333940	146308	610	41414	27658
Total	**6509**	**5917001**	**162326**	**599241**	**264056**	**1221**	**54607**	**37051**

Deduction allowed on items other than goods or merchandise

3.1.9 Under the Income Tax Act, 1961, an assessee being an Indian company or a person other than a company resident in India and engaged in the business of export of any goods or merchandise other than mineral oil and mineral ores as specified in XII Schedule during the previous year is entitled to a deduction of the profits derived from such business. The Act further provides that export out of India shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situated in India, not involving clearance at any Customs station as defined in the Customs Act, 1962. Exhibition rights of films are not considered goods or merchandise eligible for deduction under this section.

In Karnataka, Kerala, Tamil Nadu, Delhi and Maharashtra charges, in 29 cases, the irregular deductions allowed on items other than eligible goods or merchandise resulted in short levy of tax of Rs.15349.36 lakh.

A few examples are given below:

M/s.Zee Telefilms Ltd.

(a) In City I, Mumbai charge, the assessments of a company for the assessment years 1995-96 and 1996-97 were completed in a summary manner in July 1996 and February 1997 respectively allowing aggregate deduction of Rs.3568.89 lakh. Audit scrutiny revealed that the assessee had earned foreign exchange for providing the telecasting rights. As the assessee was not engaged in the export of eligible goods or merchandise, as per the provisions, the claim of the assessee, being prima facie inadmissible should have been disallowed. Omission to do so resulted in under assessment of income of total income of Rs.3568.89 lakh with consequent short levy of tax of Rs.2377.48 lakh (including interest and additional tax).

In the same charge, in the assessments of 14 cases for the assessment years 1990-91, 1991-92 and 1993-94 to 1996-97, the assessments of which have been completed after scrutiny/in summary manner between March 1991 and March 1997, deductions aggregating Rs.343.05 lakh have been allowed on export of films, sale of satellite rights of films/TV serials for exhibition abroad. The irregular deductions resulted in underassessment of income totalling to Rs.343.05 lakh with consequent short levy of tax of Rs.184.29 lakh.

(b) In Tamil Nadu IV, Chennai charge, the assessments of a firm for the assessment years 1994-95 and 1995-96 were completed after scrutiny in December 1996 and February 1997 allowing a deduction of Rs.96.94 lakh and Rs.96.38 lakh respectively. Audit scrutiny revealed that the assessee firm exported title sound track, film songs in the form of Dat master audio cassettes and sold rights to record and sell audio cassettes on particular territory basis. This would amount to transfer of rights only and could not be treated as sale of eligible goods for the claim of deduction. The irregular deduction resulted in aggregate underassessment of income of Rs.193.32 lakh with consequent short levy of tax of Rs.128.08 lakh.

M/s Indian Oil Corpn. Ltd.

M/s. Bharat Petroleum Corporation .Ltd

(c) In City II, Mumbai charge, the assessments of two companies for the assessment years 1995-96 were completed in a summary manner in May 1996 and January 1997 allowing deductions of Rs.17301.05 lakh and Rs.1171.68 lakh respectively. Audit scrutiny revealed that deductions had been allowed on the profit derived from the sale of aviation turbine fuel to foreign Airlines in India though the product is covered under the term 'mineral oil'. As the information was apparent on record, the deduction, as prima facie inadmissible, should have been disallowed. The omission to do so had resulted in underassessment of income aggregating Rs.18472.73 lakh with consequent short levy of tax of Rs.12425.33 lakh.

(d) The Central Board of Direct Taxes(CBDT) in their circular dated 22 May 1984 have clarified that the export of cut and polished diamonds and granite stones will not amount to export of minerals and ores and hence will qualify for relief under section 80HHC.

In Tamil Nadu II, Chennai charge, the assessment of a firm for the assessment year 1993-94 was completed in summary manner in October 1994 allowing a deduction of Rs.81.04 lakh. Audit scrutiny revealed that the assessee had exported only minerals such as Feldspar, Quartz, Red Oxide and Steatite. Further, in scrutiny assessment for the assessment year 1992-93, the Assessing Officer disallowed similar claim for deduction as there was no processing or manufacturing activity and the items were not included in the Twelfth Schedule. On the same analogy, the deduction for the assessment year 1993-94 was required to be withdrawn. Omission to do so resulted in underassessment of income of Rs.81.04 lakh with consequent short levy of tax of Rs.50.82 lakh.

Similarly, in Delhi III charge, in the assessments of a company for the assessment years 1994-95 and 1995-96 completed after scrutiny in January 1997 and March 1997 respectively, a deduction of Rs.32.78 lakh was allowed on profits from export of granite stones in rough form. As per above provisions, and CBDT's clarification, the deduction is allowable only on profit from export of cut and polished granite stone. Hence, the deduction of Rs.32.78 lakh as claimed by the assessee should have been disallowed and added back to the assessee's income. Omission to do so resulted in underassessment of income of Rs.32.78 lakh with consequent short levy of tax of Rs.21.14 lakh.

Non-realisation of convertible foreign exchange

3.1.10 The sale proceeds of goods or merchandise exported out of India should be received in, or brought into India by the assessee (other than the supporting manufacturer) in convertible foreign exchange within a period of six months from the end of the previous year or within such further period as may be extended by the Chief Commissioner or Commissioner of Income Tax for reasons to be recorded in writing.

In 48 cases in Bihar, Gujarat, Haryana, Chandigarh(UT), Punjab, Rajasthan, Tamil Nadu, Utter Pradesh, West Bengal and Maharashtra charges, deductions granted in contravention of the above provisions resulted in short levy of Rs.947.58 lakh.

A few instances are given below:

(a) In Delhi III charge, the assessments of two companies for the assessment years 1993-94 and 1994-95 were completed after scrutiny in February 1996 and February 1997 respectively. Audit scrutiny revealed that amounts of Rs.90.99 lakh and Rs.106.80 lakh towards sales proceeds had not been realised and brought in convertible foreign exchange. Thus, deduction allowed on these amounts should have been withdrawn. Omission to do so resulted in excess allowance of deduction and underassessment of income aggregating Rs.192.85 lakh with consequent short levy of tax of Rs.178.67 lakh.

(b) In Rohtak, Haryana charge, the assessment of an individual for the assessment year 1995-96 engaged in the business of export of manufactured goods was completed in a summary manner in March 1996 allowing deduction of Rs.266.11 lakh being the entire profits derived from export business. Audit scrutiny revealed that the assessee had not brought convertible foreign exchange amounting to Rs.319.44 lakh within the stipulated period from the end of previous year as this amount was shown as foreign exchange recoverable in the balance sheet. There was no proof on record in support of any extension granted by the Commissioner. As the information was apparent on record, this amount was required to be excluded for the purpose of calculating deduction. Omission to do so resulted in allowing excess deduction and underassessment of income of Rs.52.39 lakh with consequent short levy of tax of Rs.29.99 lakh (including additional tax and interest).

Incorrect computation of total turnover

3.1.11 As per the provisions, the allowable deduction would be the amount of profit derived from exports in the same proportion as the export turnover bears to the total turnover. Profits of export business are computed broadly with reference to the ratio of export turnover vis-à-vis total turnover as given by the formula:

$$\frac{\text{Total Profits of business X Export turnover}}{\text{Total turnover}}$$

The total turnover should include all items, except freight and insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, and export incentives referred to in clauses (iiia), (iiib), (iiic) of section 28 of I.T.Act. Further, it has been judicially held* that excise duty and Sales Tax collected form part of the

* Mc Dowell and Co. Ltd. Vs. CTO 154 ITR 148 (SC)

turnover of manufacturer. Inclusion of any component of income not related to total profits of the business or exclusion of component of turnover from total turnover will have the impact of overstatement of export profits.

In Andhra Pradesh, Gujarat, Chandigarh(UT), Karnataka, Kerala, Madhya Pradesh, Punjab, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, incorrect computation of total turnover resulted in short levy of tax of Rs. 946.70 lakh in 125 cases.

A few cases are cited below:

(a)(i) In Panaji, Goa charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in February 1995. Audit scrutiny revealed that an amount of Rs.1096.32 lakh on account of sale of iron ore on buy back arrangement in respect of local sales had not been included in the total turnover. The omission resulted in grant of excess relief of Rs.207.81 lakh leading to underassessment of income of a like amount with consequent short levy of tax of Rs.170.43 lakh (including interest).

(ii) In Delhi I charge, the assessment of a company for the assessment year 1995-96 was completed after scrutiny in March 1997. Audit scrutiny revealed that an aggregate amount of Rs.454.60 lakh being high sea export turnover of trading goods, and sale of import license entitlement had not been included in the total turnover. The omission resulted in excess allowance of deduction of Rs.93.74 lakh leading to underassessment of income of a like amount with consequent short levy of tax of Rs.63.82 lakh (including interest).

(iii) In Madurai, Tamil Nadu charge, the assessment of a closely held company for the assessment year 1993-94 originally completed after scrutiny in March 1996 was revised in December 1996. Audit scrutiny revealed that for arriving at the total turnover, turnover of all the four units and excise duty collected was not considered. Further, 90 percent of receipts by way of rent, hank yarn obligation, premium received and gross interest receipts were not excluded from the business profit to compute the profit of the business. The mistakes resulted in an excess allowance of deduction and underassessment of income of Rs.40.25 lakh with consequent short levy of tax of Rs.39.81 lakh.

Similarly in the same charge, in the assessments of a widely held company for the assessment years 1992-93 and 1993-94 completed after scrutiny in January 1996 and March 1996 respectively, deductions aggregating Rs.719.76 lakh were allowed without including receipts on account of sale of yarn, machinery repairs, recovery for job works and interest recovery for job works totalling Rs.383.83 lakh. This resulted in allowance of excess deduction and underassessment of income of Rs.49.12 lakh with consequent short levy of tax aggregating Rs.39.70 lakh (including interest).

(b) In Chandigarh (U.T.) charge, the assessment of a co-operative society for the assessment year 1995-96 was completed in a summary manner in February 1996 allowing a deduction of Rs.82.79 lakh towards exports profits. The

audited certificate depicted total turnover and profit of business at Rs.7619.38 lakh and Rs.455.55 lakh respectively in the annexure to form 10 CCAC without any supporting computation details and worked out the deduction admissible at Rs.82.79 lakh. Audit scrutiny of the assessment records, however, revealed that the total turnover and profit of business for the purpose of working out deduction actually worked out to Rs.123772.42 lakh and Rs.1214.31 lakh respectively as the chartered accountant had not taken into account the turnover as well as profit from other trading activities of wheat, paddy and fertilizer etc. Thus, the permissible deduction worked out to Rs.13.58 lakh instead of Rs.82.79 lakh allowed by the department with consequent short levy of tax of Rs.34.39 lakh (including additional income tax and interest).

(c) In West Bengal IV, Calcutta charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in February 1997 allowing a deduction of Rs.621.06 lakh. Audit scrutiny revealed that Rs.703.27 lakh being Central Excise Duty and Sales Tax effected had been deducted from the net sales instead of adding the same. Further, 90 percent of erection charges, design charges and lease rent (aggregating Rs.146 lakh) was not deducted from in arriving at the business profits. After considering the above, the allowable deduction would work out to Rs.509.68 lakh as against Rs.621.06 lakh allowed. This resulted in excess allowance of deduction and underassessment of income of Rs.111.38 lakh with consequent short levy of tax of Rs.108.88 lakh.

Incorrect computation of export turnover

3.1.12 Export turnover means the sale proceeds received in, or brought into India by the assessee in convertible foreign exchange but does not include freight or insurance attributable to the transport of the goods or merchandise beyond the custom station as defined in the Customs Act, 1962.

In Assam, Haryana, Karnataka, Kerala, Madhya Pradesh, Tamil Nadu, Delhi and Maharashtra charges, the irregular/incorrect computation of export turnover resulted in short levy of tax of Rs.767.45 lakh in 42 cases.

A few cases are given below:

(a) In Karnataka II, Bangalore charge, the assessment of a widely held company, engaged in the export and domestic sales of trading goods (i.e. coffee seeds) for the assessment year 1995-96 was completed after scrutiny in October 1997. Audit scrutiny revealed that the FOB value of export of Rs.11213.40 lakh was not adopted as the export turnover, instead the export turnover adopted included freight or insurance attributable to the transport of the goods or merchandise beyond the custom station as defined in the Customs Act,1962. Further, the indirect cost of Rs.204.45 lakh was computed by the assessee without taking into consideration all items of expenses viz., materials, trading expenses, interest on borrowing etc. valued at Rs.473.70 lakh. Incorrect computation of cost attributable to export of trading goods and non-

adoption of FOB value of export as export turnover had resulted in excess relief of Rs.471.49 lakh with consequent short levy of tax of Rs.394.72 lakh (including interest and additional tax).

(b) Under Section 80 HHC of the Income Tax Act, 1961, sale proceeds received in, or brought into India in convertible foreign exchange within the prescribed time limit shall only be considered for determining "export turnover" at the time of allowing deduction in respect of profits derived from export business. Expenses incurred in foreign currency on account of commission, brokerage etc., on export, paid or deducted by the agency should, therefore, be excluded from the export turnover.

In North East Region, Assam charge, the assessments of a widely held company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in March 1995 and February 1996 allowing deductions of Rs.249.07 lakh and Rs.209.84 lakh respectively. Audit scrutiny revealed that the assessee incurred expenditure of Rs.368.47 lakh and Rs.380.95 lakh in foreign currency during the previous years relevant to the assessment years 1992-93 and 1993-94 respectively for payment of brokerage, commission, warehouse charges, selling and other charges. But in determining the net earnings in foreign currency, the assessing officer omitted to deduct the above expenditure incurred in foreign currency from the FOB value of exports (arrived at after deduction of ocean freight and marine insurance from overseas sales). Accordingly, the export turnover and the total turnover should also be reduced to reflect net foreign exchange receipts for allowance of deductions of the proportionate profits derived by the assessee company from the export business. Omission to do so resulted in excess allowance of deductions aggregating Rs.13.93 lakh and Rs.18.82 lakh leading to underassessment of income by an identical amount with consequent short levy of tax aggregating to Rs.39.69 lakh (including interest).

Incorrect computation of profits of the business and adjusted profits of the business

3.1.13 As per the provisions, the profits of the business means profits of the business computed under the head 'profits and gains of business' as reduced by ninety percent of any sum referred to in clause (iiia) (iiib) (iiic) of Section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipts of a similar nature included in such profits and the profits of any branch office, warehouse or any other establishment of the assessee situated outside India.

In Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Chandigarh(UT), Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, in 442 cases, the incorrect/irregular computation of the profits of business and adjusted profits of business resulted in short levy of tax of Rs.8880.47 lakh.

A few cases are given below:

M/s.Chougule & Co. Ltd.

(a) In Karnataka I, Bangalore charge, the assessments of a closely held company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in December 1994 and September 1995 respectively while that of the assessment year 1994-95 in a summary manner in January 1995. Audit scrutiny revealed that while arriving at the profits of business, 90 percent of receipts such as engineering work contracts, loading, truck and machinery hire charges, despatch money, service charges, refund of custom duty and donation to temple aggregating Rs.2109.16 lakh was not deducted. This resulted in grant of excess relief totalling Rs.976.21 lakh during the assessment years 1992-93 and 1993-94 and incorrect allowance of deduction of Rs.381.45 lakh for the assessment year 1994-95 since no deduction was admissible as the deduction of 90 percent would result in loss during that year. The total underassessment of income would work out to Rs.1357.66 lakh with consequent short levy of tax of Rs.1190.34 lakh (including interest).

(b) In Panaji, Goa charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that while computing the profits of the business, 90 percent of Rs.710.58 lakh being receipts on account of service charges, lease hire, miscellaneous income, interest, premium on license and discounting charges amounting to Rs.639.52 lakh was not deducted. This omission resulted in excess allowance of deduction and underassessment of income of Rs.477.29 lakh with resultant short levy of tax of Rs.509.41 lakh (including interest).

Similarly, in the same charge, in the assessment of another company for the assessment year 1996-97 which was completed in summary manner in March 1997, the business profits were computed without reducing Rs.484.35 lakh being 90 percent of service charges, machinery and barge hire charges. This led to excess allowance of deduction and underassessment of income of Rs.296.60 lakh with consequent short levy of tax of Rs.136.44 lakh.

(c) In Tamil Nadu III, Chennai charge, the assessments of a firm for the assessment years 1992-93, 1993-94 and 1995-96 were completed after scrutiny in August 1994, March 1995 and March 1997 respectively. Audit scrutiny revealed that 90 percent of job work receipts were not deducted to compute the eligible 'profits of the business'. Omission to deduct 90 percent of job work receipts being analogous to the excluded receipts such as interest, brokerage, commission, etc. resulted in excess allowance of deduction aggregating Rs.422.75 lakh leading to underassessment of income by a like amount with resultant short levy of tax of Rs.203.92 lakh in addition to Rs.35.50 lakh in the hands of the partners for assessment year 1992-93.

(d) In Karnataka I, Bangalore charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in November 1994 and February 1996 respectively and that of the assessment year 1994-95 in a summary manner in March 1995. Audit scrutiny revealed that amounts aggregating Rs.64.82 lakh towards profit on sale of shares,

dividend, income from property, profits from sale of assets etc., were not deducted from the total turnover though these were 'Other incomes not forming part of turnover'. Further, 90 percent of machinery hire charges, service charges and processing charges aggregating Rs.332.68 lakh was not reduced from the business profits for computation of deduction. These mistakes resulted in excess allowance of deduction and underassessment of income totalling Rs.228 lakh with consequent short levy of tax of Rs.197.75 lakh including additional tax for the assessment year 1994-95 and interest.

(e) In City VII, Mumbai charge, the assessment of a firm for the assessment year 1994-95 was completed after March 1997 allowing deduction of Rs.1051.85 lakh. Audit scrutiny revealed that during the previous year relevant to the above assessment year, the assessee had received Rs.278.43 lakh and Rs.18.87 lakh respectively towards premium on surrender of import licences from the DGFT and labour charges. As the incomes were not directly related to exports, the same should have been treated as 'other incomes' and not as part of turnover. After considering the above, the admissible deduction would work out to Rs.806.78 lakh as against Rs.1051.85 lakh allowed. This resulted in underassessment of income of Rs.245.07 lakh with consequent short levy of tax of Rs.188.85 lakh.

Similarly, in the same charge, the assessments of 13 assesees for the assessment year 1994-95 and 2 assessees for the assessment year 1995-96 were completed after scrutiny in March 1997, allowing deductions aggregating Rs.6947.03 lakh on premium amounts received on surrender of import licenses treating the same as part of total turnover instead of as 'Other income". The mistake resulted in underassessment of income of Rs.745.81 lakh in aggregate with consequent short levy of tax of Rs.573.93 lakh.

(f) In Delhi III charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in January 1995 allowing a deduction of Rs.1037.15 lakh. Audit scrutiny revealed that losses amounting to Rs.57.15 lakh from foreign branches/offices of the assessee were included and 90 percent of other interest income and assembling charges amounting to Rs.92.72 lakh was not deducted from the business profits. These mistakes resulted in excess allowance of deduction of Rs.138.27 lakh leading to underassessment of income of a like amount with resultant short levy of tax of Rs.120.21 lakh (including interest).

(g) In Trivandrum, Kerala charge, the assessment of an individual exporting processed cashew kernels for the assessment year 1992-93 was completed after scrutiny in March 1995 after allowing a deduction of Rs.706 lakh. Audit scrutiny revealed that 90 percent of receipts towards processing charges of Rs.148 lakh was not reduced while arriving at pro-rata computation of profits, being not related to direct export by the assessee. The incorrect computation resulted in excess allowance of the relief by Rs.105 lakh leading to underassessment of income of a like amount with consequent short levy of tax of Rs.107 lakh.

Omission to deduct unabsorbed depreciation etc.

3.1.14 Under the provisions of the Income Tax Act, 1961, business income shall be arrived at after set off of business loss, unabsorbed investment allowance and unabsorbed depreciation relating to the earlier years.

In Andhra Pradesh, Bihar, Gujarat, Haryana, Chandigarh(UT), Karnataka, Kerala, Rajasthan, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, non-observance of the above provisions resulted in short levy of tax of Rs.854.59 lakh in 86 cases.

A few illustrative cases are given below:

(a) In City II, Mumbai charge, the assessment of a widely held company for the year 1991-92 originally completed after scrutiny in February 1994 was subsequently rectified in August 1994, January 1995, February 1995 and March 1995 allowing a deduction of Rs.182.58 lakh. Audit scrutiny revealed that as per the latest rectification order of March 1995, the set off of unabsorbed depreciation was reduced to Rs.228.41 lakh from 265.58 lakh and unabsorbed investment allowance of Rs.992.66 lakh was allowed to be carried forward. However, the unabsorbed investment allowance was not set off, while determining profits and gains of business or profession. The omission resulted in underassessment of income by Rs.182.58 lakh involving short levy of tax of Rs.142.78 lakh (including interest).

(b) In City I, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing a deduction of Rs.1370.90 lakh. Audit scrutiny revealed that while computing the business income, depreciation of Rs.747.84 lakh allowable as per Income Tax Rules was not deducted. This resulted in excess computation of deduction of Rs.237.24 lakh leading to underassessment of income of a like amount with consequent short levy of tax of Rs.122.77 lakh.

(c) In Jaipur, Rajasthan charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in November 1996 allowing a deduction of Rs.75.72 lakh. Audit scrutiny revealed that unabsorbed losses and investment allowance of earlier years totalling Rs.6907 lakh were not set off from the profits before allowing the deduction. After adjusting the above amount, the allowable deduction would work out to Rs.12.81 lakh as against Rs.75.72 lakh allowed by the department. This resulted in excess allowance of deduction and underassessment of income of Rs.62.91 lakh with consequent short levy of tax of Rs.34.72 lakh (including additional income tax of Rs.5.78 lakh).

Omission to exclude income chargeable under other heads of income.

3.1.15 Under the provisions of the Income Tax Act, 1961, only business income derived from the export of goods or merchandise qualifies for deduction and thus income not derived from the export of goods assessable

under other heads such as capital gains and income from other sources is required to be excluded while arriving at the business income.

In Assam, Bihar, Chandigarh(UT), Karnataka, Kerala, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, in 73 cases, non-exclusion of incomes chargeable under other heads of income resulted in short levy of tax of Rs.1276.07 lakh.

A few cases are given below:

(a) In Panaji, Goa charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in March 1995 and January 1996 respectively allowing an aggregate relief of Rs.7156.47 lakh. Audit scrutiny revealed that while computing the business profits 'income from other sources totalling Rs.367.75 lakh towards lease hire charges derived from leasing business, were not deducted from the profits. Further, in respect of assessment year 1992-93 the business profits were not reduced by 90 percent of miscellaneous income of Rs.8.75 lakh and items of expenditure viz. finance charges, administrative expenses, other expenses etc., were not considered in computing the indirect cost of trading goods. These mistakes resulted in excess allowance of deduction of Rs.290.55 lakh with consequent short levy of tax of Rs.229.05 lakh (including interest) and excess refund of Rs.411.21 lakh.

(b) In City IV, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in December 1995 allowing a deduction of Rs.78.09 lakh. Audit scrutiny revealed that the income considered for the deduction included dividend income and interest income assessable under the head 'income from other sources.' As the exclusion of the aforesaid income resulted in loss, the assessee was not entitled to any deduction. The incorrect allowance of deduction of Rs.78.09 lakh resulted in underassessment of income of an identical amount with consequent short levy of tax of Rs.40.41 lakh.

Irregular deduction due to incorrect computation of direct and indirect costs

3.1.16 Under the provisions, where the assessee is an exporter of trading goods, the profits derived from such export shall be the export turnover in respect of such goods as reduced by the direct cost and indirect cost attributable to such exports. Direct cost means costs directly attributable to the trading goods exported out of India including the purchase price of such goods. Indirect cost means costs not being direct costs allocated to the ratio of export turnover in respect of trading goods to the total turnover.

In Gujarat, Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu, Delhi and Maharashtra charges, incorrect computation of direct and indirect costs resulted in short levy of tax of Rs. 2460.86 lakh in 59 cases.

A few examples are cited below:

M/s.V.M.Salgaocar and Brothers Ltd.

(a) In Panaji, Goa charge, the assessment of a widely held company, engaged in the business of mining and export of iron ore and acting as Export House/Trading House, for the assessment year 1993-94 was completed after scrutiny in January 1996 allowing a deduction of Rs.3396.23 lakh, inter alia, adopting a loss of Rs.461.69 lakh towards export of trading goods. Audit scrutiny revealed that the direct cost of the trading goods exported by the assessee was adopted by the assessing officer as Rs.3356 lakh as against Rs.2693.07 lakh correctly worked out on the purchase cost and other charges directly attributable to the purchase of ore exported in the ratio of the quantity exported to the total quantity of ore purchased. Further, due to adoption of incorrect cost towards administrative overheads/salaries, the indirect cost attributable to trading goods was erroneously adopted as Rs.915.28 lakh as against the correct amount worked out at Rs.267.89 lakh. The incorrect computation of the direct cost and indirect cost resulted in excess allowance of relief of Rs.1374.02 lakh with consequent short levy of tax of Rs.1346.10 lakh.

(b) In Jammu and Kashmir, Amritsar charge, the assessments of a company, engaged in the export of manufactured as well as trading goods for the assessment year 1994-95 and of only trading goods for the assessment year 1995-96 were completed after scrutiny in March 1995 and March 1996 respectively allowing deductions of Rs.153 lakh and Rs.331 lakh. Audit scrutiny revealed that the direct and indirect costs attributable to the export of trading goods were adopted as Rs.1254 lakh and Rs.1645 lakh as per the Form No. 10CCAC respectively for the two assessment years instead of Rs.1330 lakh and Rs.1781 lakh correctly worked out as per the accounts. This resulted in allowance of excess deductions aggregating Rs.204 lakh leading to underassessment of like amounts with consequent short levy of tax totalling to Rs.101.58 lakh.

(c) In Delhi Central II charge, the assessment of a firm for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that while computing the deduction, transportation charges of Rs.139.63 lakh were omitted to have been included in the direct cost while travelling/conveyance, other sales expenses and other expenses aggregating Rs.249.54 lakh had not been considered for arriving at indirect cost. This omission resulted in excess deduction and underassessment of income of Rs.112.64 lakh with consequent short levy of tax of Rs.86.79 lakh (including interest).

(d) In Patiala, Punjab charge, the assessment of a company for the assessment year 1993-94 was completed in March 1995 allowing a deduction of Rs.71.06 lakh. Audit scrutiny revealed that expenses such as sales expenses, internal and financial charges, and transport and octroi aggregating Rs.453.16 lakh though debited to profit and loss account had not been included in the indirect cost attributable to export of trading goods resulting in non deduction of

Rs.73.99 lakh from export turnover for arriving at profit/loss on export of trading goods. The mistake resulted in inadmissible grant of deduction of Rs.71.06 lakh with resultant short levy of tax of Rs.36.77 lakh.

(e) In Bhopal and Indore, Madhya Pradesh charges, the assessments of two companies for the assessment year 1995-96 were completed in a summary manner. Audit scrutiny revealed that the indirect cost attributable to the export of trading goods was incorrectly worked out to a total of Rs.115.78 lakh instead of the correct amount of Rs.277.29 lakh. The mistake resulted in excess allowance of deduction and underassessment of income aggregating Rs.86.88 lakh with consequent short levy of tax of Rs.58.92 lakh (including additional income tax and interest).

Incorrect allowance of deduction to supporting manufacturers

3.1.17 Under the provisions, where the business carried on by the supporting manufacturer consists exclusively of sale of goods or merchandise to one or more Export/Trading Houses, the entire profits of the business are exempt. Where the business carried on by the supporting manufacturer does not consist exclusively of sale of goods or merchandise to one or more Export Houses, the deduction will be the amount which bears to the profits of the business the same proportion as the turnover in respect of sale to the respective Export House bears to the total turnover of the business carried on by the assessee.

In Haryana, Chandigarh(UT), Karnataka, Kerala, Orissa, Rajasthan, Tamil Nadu, Utter Pradesh, Delhi and Maharashtra charges, non-observance of the above provisions resulted in short levy of Rs.749.36 lakh in 41 cases.

Few illustrative cases are given below:

(a) In Tamil Nadu II charge, the assessment of a private company engaged in export of marine foods for the assessment year 1994-95 was completed after scrutiny in December 1996 allowing a deduction of Rs.124.14 lakh. Audit scrutiny revealed that in computing admissible deduction, the assessee claimed 90 percent of export incentives (sale of advance license) of Rs.70.39 lakh both in respect of direct export as well as export through Export House. However, as per provisions, deduction for 90 percent of export incentives would be admissible only in respect of direct export and not for the export through Export House. This had resulted in excess deduction of Rs.34.65 lakh with consequent short levy of tax of Rs.33.48 lakh.

(b) In Panaji, Goa charge, the assessment of a company for the assessment year 1996-97 was completed in a summary manner in March 1997 allowing a deduction of Rs.65.22 lakh. Audit scrutiny revealed that the assessee incurred expenditure only on transportation of goods/merchandise processed by third party for export through the Export/Trading House. As such, the assessee, not being engaged in export of manufactured or trading goods, was not eligible for the deduction. The irregular deduction resulted in underassessment of income of Rs.65.22 lakh with consequent short levy of tax of Rs.26.09 lakh.

Omission to file requisite forms alongwith the return

3.1.18 As per the provisions, deduction shall not be allowed unless the assessee furnished with the return of income the report of an accountant in the prescribed Form No.10CCAC certifying that the deduction has been correctly claimed on the basis of net foreign exchange realisation. In the case of an assessee being a supporting manufacturer besides the report in Form No.10CCAC the assessee is also required to furnish a disclaimer certificate in Form No.10CCAB to the effect that in respect of export turnover mentioned in the certificate, the Export House or Trading House has not claimed the deduction.

In Andhra Pradesh, Bihar, Gujarat, Chandigarh(UT), Kerala, Rajasthan, Tamil Nadu, Utter Pradesh, West Bengal and Maharashtra charges, deductions allowed in contravention of the above provisions resulted in short levy of tax of Rs. 684.23 lakh in 33 cases.

(a) In Jaipur, Rajasthan charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in December 1996 in which the assessee had claimed deduction for both in respect of export of trading goods as well as for manufactured goods. Audit scrutiny revealed that the assessee had exported goods directly and also through the Export House as a supporting manufacturer as per the certificate, in form No.10CCAC attached with the return. However, the above certificate was defective as it could not be ascertained whether goods were exported by himself or through the Export House. As the certificate was defective, the deductions should have been denied to the assessee as the export of manufactured goods without disclaimer certificate in form No.10CCAB and export of trading goods through Export House do not qualify for the deduction. The irregular deductions resulted in underassessment of income of Rs.292.87 lakh with consequent short levy of tax of Rs.134.72 lakh.

(b) Some more important cases where deductions were allowed in violation of the above provisions are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1	Chandigarh(UT)	1994-95 February 1997	143(3)	Deduction was allowed in the absence of disclaimer certificate in Form 10CCAB even though the assessee was a supporting manufacturer and Form 10CCAC was also not filed alongwith the return which resulted in underassessment of income of Rs.239.70 lakh.	159.74
2	City V, Mumbai	1995-96 October 1996	143(1)(a)	A deduction of Rs.233.59 lakh was erroneously allowed even though the prescribed certificate (Form 10CCAC) was not furnished.	107.45
3	Kanpur, Uttar Pradesh	1994-95 March 1994, 1995-96 March 1995, 1996-97 March 1996	143(1)(a)	Deductions aggregating Rs. 139.96 lakh were allowed even though the assessee had not submitted the disclaimer certificate in Form 10CCAB alongwith the return.	84.00
4	Tamil Nadu IV, Chennai	1995-96 November 1996	143(1)(a)	Deduction was allowed in the absence of Form 10CCAC resulting in under assessment of income of Rs.120.72 lakh.	77.75

Omission to set off export losses against export incentives

3.1.19 Under the provisions, the deduction allowable in respect of export profits shall be the aggregate of export incentives, trading profits and manufacturing profits as computed in accordance with the provisions of the Act. The eligible income for computing deduction is arrived at by adding 90 percent of export incentives to the export profits or loss from trading and/or manufacturing activity.

Test check in Madhya Pradesh, Punjab, Tamil Nadu and Maharashtra charges revealed that in 35 cases, the assessees had incurred losses in export activity but were entitled to deductions only by virtue of adding the export incentives though in these cases there was no accretion of foreign exchange. There was an aggregate short levy of tax of Rs.2999.78 lakh as the assessing officer had allowed deductions to the assessees ignoring even the losses incurred on export business.

A few instances are cited below:

(a) In City II, Mumbai charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in December 1996 allowing a deduction of Rs.4235.82 lakh. Audit scrutiny revealed that while computing the business profits, loss of Rs.1701.13 lakh incurred in export of trading goods had not been considered. This resulted in underassessment of income of Rs.1701.13 lakh with consequent short levy of tax of Rs.939.03 lakh.

(b) In City I, Mumbai charge, the assessment of a company for the assessment year 1996-97 was completed in a summary manner in March 1997 allowing a deduction of Rs.762.81 lakh. Audit scrutiny revealed that while computing the deduction, trading loss and manufacturing loss aggregating Rs.15350.66 lakh was not adjusted against the export incentive of Rs.762.81 lakh. After adjusting the aforesaid losses, there being no profit from the export business, the assessee was not entitled to any deduction. The omission to disallow the incorrect claim resulted in underassessment of income of Rs.762.81 lakh with resultant short levy of tax of Rs.537.78 lakh (including interest and additional tax and grant of interest on refund).

(c) In Indore, Madhya Pradesh charge, the assessment of a company for the assessment year 1996-97 was completed in summary manner in February 1997 allowing a deduction of Rs.238.91 lakh. Audit scrutiny revealed that proportionate amount of deduction allowable out of export incentives was only considered ignoring losses of Rs.577.34 lakh in respect of export of manufactured goods and Rs.51.65 lakh in respect of export of trading goods. As the resultant outcome of export business was a loss of Rs.309.08 lakh, no deduction was allowable. This incorrect deduction of Rs.238.91 lakh resulted in underassessment of income of like amount with consequent short levy of tax of Rs.156.05 lakh (including additional tax and interest).

(d) In Ludhiana, Punjab charge, a company engaged in trading and manufacturing of cotton yarn was allowed (March 1997) deduction of Rs.369.21 lakh in the assessment year 1996-97 completed in summary manner. Audit scrutiny revealed that loss of Rs.181.67 lakh sustained by the assessee on export of trading goods was overlooked and had not been adjusted against profit from export of manufactured goods. The non adjustment of loss resulted in grant of excess deduction of Rs.181.67 lakh involving short levy of tax Rs.100.28 lakh including additional tax of Rs.16.71 lakh.

Other mistakes in allowance of deduction

3.1.20 During test check in review in Andhra Pradesh, Assam, Bihar, Haryana, Chandigarh(UT), Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu, Utter Pradesh, Delhi, West Bengal and Maharashtra charges, it was noticed that other irregularities committed in allowance of deductions resulted in short levy of tax of Rs.1352.31 lakh in 103 cases.

A few illustrative cases are given below:

Incorrect allowance of relief on the income derived from the licences acquired from other

(a) Under the provisions, of the Income Tax Act, 1961, the profits computed under sub-section (3) of section 80HHC shall be further increased, among other items, by the amount which bears to 90 per cent of the profits on sale of licence granted under the Imports (Control) Order 1955. However, this clause shall not be applicable to the profits on sale of a licence acquired from any other person.

In Karnataka II, Bangalore charge, the assessments of a firm for the assessment years 1992-93 and 1994-95 were completed after scrutiny in April 1994 and December 1996 and that of 1995-96 in summary manner in March 1996 allowing deduction aggregating Rs.520.37 lakh. Audit scrutiny revealed that the relief was allowed on export incentives i.e. licences acquired from others, which was irregular. The irregular relief resulted in underassessment of income of Rs.520.37 lakh with consequent short levy of tax of Rs.273.31 lakh.

Similarly, in Karnataka III, Bangalore charge, in the assessment of another firm for the assessment year 1994-95 completed after scrutiny in March 1997, deduction of Rs.47.36 lakh towards relief on exports incentives i.e. licences acquired from others was allowed which led to underassessment of income of Rs.47.36 lakh with consequent short levy of tax of Rs.32.56 lakh.

Incorrect allowance of deduction

(b) The benefit of deduction is available only to an assessee who is engaged in the business of export of goods or merchandise out of India.

(i) In Kerala charge, the assessment of a company, regularly engaged in the business of export of tea, for the assessment year 1993-94 was completed after scrutiny in March 1996 computing the total income at Rs.264.81 lakh after allowing a deduction of Rs.90.16 lakh on account of profit on exports. Audit scrutiny revealed that the export profits included Rs.81.27 lakh being the profit derived from export of tea machinery purchased by the company from local sources and exported under equity participation in a joint venture in Sri Lanka. Since the assessee company was not engaged in the business of export of machinery items, the profit earned from the 'one-time export of the machinery' was not eligible for deduction. The irregular deduction resulted in underassessment of Rs.90.16 lakh with consequent short levy of tax of Rs.74.02 lakh.

(ii) In North East Region, Shillong charge, in the assessment of an individual, for the assessment year 1994-95 completed after scrutiny in March 1997, the assessing officer disallowed the claim on the ground that the assessee was maintaining an office in another place, his export business was carried on by

an authorised signatory through export house and the payments were received by the assessee from a third party and the profits from export business never came to his place of business. Audit scrutiny revealed that in the assessment years 1992-93 and 1993-94, the deductions of Rs.13.36 lakh and Rs.25.96 lakh under Section 80 HHC claimed by the assessee were allowed in the assessments completed in a summary manner in May 1994 and May 1995 respectively. Even though in his assessment order for the assessment year 1994-95, the assessing officer observed that the assessee had claimed similar deductions in the assessment year 1992-93, no action had been taken to select the above cases for scrutiny. Failure to do so resulted in allowance of inadmissible deductions of Rs.13.36 lakh and Rs.25.96 lakh in the assessment years 1992-93 and 1993-94 respectively leading to underassessment of income totalling to Rs.39.32 lakh with consequent short levy of tax of Rs.36.12 lakh (including interest).

(c) In Punjab charge, the assessment of a closely held company for the assessment year 1995-96 was completed after scrutiny in March 1997 allowing a deduction of Rs.90.65 lakh towards export profits. Audit scrutiny revealed that the above profits included Rs.21.97 lakh on account of sale proceeds of a "Non-transferable Value Based Advance Licence". As the sale proceeds did not form part of export turnover, these did not qualify for deduction. The irregular deduction resulted in underassessment of Rs.21.97 lakh with consequent short levy of tax of Rs.10.11 lakh.

3.2 Tax deduction at source under sections 194C and 194E of Income Tax Act, 1961

Test check of functioning of TDS charges across the country revealed irregularities on account of failure to comply with statutory provisions in respect of mandatory deduction at source from payments to contractors/sub-contractors and non resident sportsmen/sports associations involving revenue effect of Rs.164.24 crore. These included inter alia, failure to file TDS returns, failure to deduct taxes at source, remit into government account and to initiate penalty proceedings against defaulters.

Introductory

3.2.1 Deduction of tax at source on the taxable income is a convenient and economical method of tax collection. The taxes deducted at source have been steadily rising over the years and stood at 42 percent of the collection of income and corporate tax as on 31.3.1997.

The Income Tax Act, 1961 prescribes deduction of tax on income, inter alia, income from any person responsible for paying any sum to any resident contractor or sub contractor for carrying out any work in pursuance of a contract between the contractor and the Government, Local Authority, Statutory Corporation, Company, Co-operative Society, Registered Society, Trust, University and Firm and payments made to non-resident sportsmen/sport associations/institutions.

The objectives of deduction of tax at source are twofold:

(i) Collection of tax revenue while the income is being earned.

(ii) Safeguard against possible avoidance/concealment of taxable income.

Scope and coverage of review

3.2.2 A review on 'Tax deduction at source with reference to Section 194C, payments to contractors and sub-contractors and Section 194E,-payments to Non-resident sportsmen or sports associations, was conducted for the period 1993-94 to 1995-96. In all 202 TDS wards/circles were covered and 29842 TDS returns (25%) test checked out of 1,05,594 TDS returns. Returns for 1996-97 were also test checked in the case of Gujarat, Kerala, Orissa, Himachal Pradesh, Andhra Pradesh, Tamil Nadu, Assam, Bihar and Jammu & Kashmir, wherever records were made available.

The purpose of the review was to evaluate the performance of tax implementation machinery in terms of compliance with control and monitoring procedures for timely realisation of revenue.

Audit Constraint-production of records

3.2.3 As per Board Circular No.1856, TDS returns alongwith certificates where no immediate action is called for, shall be kept in bundles and alphabetically arranged for easy retrieval and shall be weeded out only after 5 years. However, in a few cases indicated below, the returns were prematurely weeded out and mixed up with old records and consequently these were not made available to audit.

Gujarat-	1 TDS Ward of Ahmedabad (1993-94 to 1995-96)
Maharashtra-	14 ITO/TDS Wards of Mumbai (1993-94)
	3 ITO/TDS Wards in Pune (1993-94)
	2 ITO/TDS Wards in Nagpur (1993-94 & 1994-95)
Karnataka	10 Wards/Circles (1994-95 & 1995-96)

In Karnataka charge in one of the wards ITO (TDS Gudag), all the relevant records were burnt due to arson and rioting.

Failure to maintain the records yearwise and category wise and to list them out impeded easy retrievability and cross checking of returns by audit with TDS certificates in Karnataka charge as well as in Kerala charge. In Maharashtra charge, it was claimed by the Department that there were no pending demand cases. However, this could not be verified due to non availability of records.

In Rajasthan charge, out of 10 TDS wards records of 7 TDS wards were not made available to audit for the entire period.

Audit Highlights

3.2.4 (i) Out of 29,842 cases test checked by audit taxes were deducted short or not deducted at all in 2,177 cases involving revenue effect of Rs.24.01 crore attracting interest and penalty of Rs.31.83 crore. The defaulters included drawing and disbursing officers of Government departments and tax deductors of Public Sector Undertakings.

[Para 3.2.5]

(ii) In 498 cases, TDS of Rs. 2.42 crore was remitted late into government account, delay ranging from 17 days to 3 years, attracting interest of Rs.0.18 crore including 1 case of leading Public Sector Undertaking in Gujarat charge where tax deducted was deposited in personal account amounting to Rs.2.22 lakh.

(Para 3.2.6)

(iii) Failure in 2,028 cases to issue timely TDS certificates attracted penalty of Rs.5.26 crore. In 88 cases certificates were issued before TDS amount was deposited into government account.

[Para 3.2.7]

(iv) In 764 cases the officials responsible for deducting tax at source (ODTAs) had not applied for the allotment of TAN inviting penalty of Rs.38.20 lakh and in another 2,825 cases, though the tax deductors had applied for TAN the cases were either pending or numbers were issued very late involving delay ranging between 23 days to 40 months.

(Para 3.2.8)

(v) There was no coordination between TAN allotting authority and TDS authority for monitoring of receipt of filing of annual returns. In Jaipur, same TAN was allotted to different 17 tax deductors and was rectified on audit observation.

(Para 3.2.9)

(vi) Out of 1,66,244 effective tax deductors, 29,747 annual returns were not furnished or furnished belatedly. In 26,270 cases, no penalty proceedings were initiated. Out of 29,842 returns checked by audit in 8938 cases, the belated returns attracted penalty of Rs.32.73 crore.

(Para 3.2.10)

(vii) The procedures prescribed for watch of receipt of annual returns and for test check of returns including cross verification by assessing officers were not adhered to.

(Para 3.2.11)

(viii) There were 15 cases where assessees had claimed excess credits of Rs. 57.64 lakh.

(Para 3.2.12)

(ix) In 6523 cases, demand on account of interest and penalty amounting to Rs.63.61 crore was outstanding as on 31 March 1997.

(Para 3.2.14)

(x) In 108 cases, penalty action had become time barred involving amount of Rs.2.70 crore. In 104 cases pertaining to Gujarat, though penalty action had been initiated, no action for final disposal has been taken for more than two years involving Rs.1.49 crore.

(Para 3.2.15)

(xi) In Maharashtra charge, BCCI had failed to deduct tax at source on guarantee monies paid to non resident sports persons/bodies for participation in Wills World Cup held in India in 1996 involving Rs. 60.40 lakh. Interest and penalty thereon amounted to Rs.86.47 lakh.

(Para 3.2.17)

(xii) No internal audit was conducted in TDS charges with minor exceptions.

(Para 3.2.18)

3.2.5 Non-deduction/Short deduction of tax at source

Tax Deduction at Source from Contractors and Sub-Contractors Section 194C

Under the Income Tax Act, the authority making payments to resident contractors for carrying out work, including supply of labour, carriage of goods and passengers by any mode of transport (other than railways), catering, advertising, broadcasting and telecasting in pursuance of any contract shall deduct tax at source at the time of credit of such sum to the account of contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, at the rate of 2 percent (1 percent for advertisement and payments to sub-contractors) where the consideration of contract exceeds Rs.20,000/- (substituted for Rs.10,000 with effect from 1 July 1995). The Assessing Officer is, however, required to issue certificate allowing deduction of tax at any lower rate or non deduction of tax on an application made by the contractor or sub-contractor. Failure to deduct tax or pay tax attracts interest at the rate of 15 percent per annum on the amount of such tax from the date such tax is deductible to the date on which such tax is actually paid. If a person fails to deduct tax, he shall be liable to pay by way of penalty a sum equal to the amount of tax which he failed to deduct.

Test check of records of Gujarat, Kerala, Orissa, Himachal Pradesh, Andhra Pradesh, Karnataka, Madhya Pradesh, Haryana, Tamil Nadu, Uttar Pradesh, Assam, Haryana (UT), Punjab, Delhi, West Bengal, Maharashtra, Bihar and J&K charges revealed that the provisions of the Act are not being followed by tax deductors. Table given below summarises the position of non deduction/short deduction of tax at source.

(Rs. in lakh)

TDS wards/ Circles checked by audit	Total Returns	Returns test checked by audit	Cases where non deduction/ short deduction noticed	Amount involved	Interest and penalty leviable
202	1,05,594	29,842	2,177	2,401.45	3,182.97

The cases mentioned above included omission of tax deduction/short deduction on the part of various Government Departments/PSUs and Autonomous bodies.

Some illustrative cases, charge-wise, are given below:

(Rs. in lakh)

Charge	Year	Department/undertaking	Amount not deducted/ short deducted	Penalty & Interest	Total
Delhi	1993-94 to 1996-97	1. Doordarshan Commercial Service 2. Commercial Broadcasting Service of AIR	524.90	524.90 198.00	1,247.80
Payment of Rs.26,258 lakh was made to advertising agencies without deducting tax at source.					
Delhi	1995-96	Ministry of External Affairs	1.71	1.71 0.51	3.93
Payments were made to Indian Tourism Development Corporation against catering contract. No tax at source was deducted.					
Karnataka	1993-94 to 1995-96	1. 290 ODTAS of various departments, Town/City municipalities. 2. Karnataka Land Army Corporation	497.83	497.83 204.24	1199.90
Non deduction/short deduction of tax at source was noticed from various payments					
Tamil Nadu	1993 to 1996-97	1. Panchayat Union Poonamallee 2. AIR Chennai 3. DDK Chennai 4. Sports Dev. Authority 5. Rural Dev. Department 6. Ennore Thermal Power Station 7. M/s. Priya Lotteries Pvt. Ltd.	185.78	185.78 61.25	432.81
Payments were made to various agencies without deducting tax at source					
Uttar Pradesh	1993-94 to 1995-96	1. Garhwal Mandal Vihas Nigam, Dehradun 2. Kumao Vikas Mandal Nigam, Nainital 3. UP Tourism Dev. Corporation Lucknow	149.27	149.27 67.17 (approx.)	365.71
Payment of Rs.7143.48 was made to private tour operators for providing buses for conducting all India tours without deducting tax at source					
Uttar Pradesh	1994-95 & 1995-96	1. Information and Public relations Department 2. UP Education Pariyojana Parishad 3. M.P SRTC Lucknow 4. Lucknow Dev. Authority 5. U.P.SEB, Shakhti Bhawan, Lucknow	27.48	27.48 8.24 (approx.)	63.29
Payment of Rs.1,657 lakh was made against advertisement contracts but TDS was not deducted/short deducted					

Charge	Year	Department/undertaking	Amount not deducted/ short deducted	Penalty & Interest	Total
Gujarat	1994-95 & 1995-96	State Road Transport Corporation, Gujarat	90.73	90.73 40.93	222.39
	Lease rent was paid to private leasing and financial companies for hiring of buses but tax was not deducted at source				
Maharashtra	1993-94 to 1995-96	1. BCCI 2. Civil Supplies, Bombay 3. Police Department, Bombay 4. Distt. Supply Officer, Kolhapur, Chanderpur and Thane 5. Distt. Seed Officer, Dhule 6. Public Works Thane & Aurangabad 7. Directorate Police Wireless Pune 8. DP Health Services Kolhapur 9. State Police & Custom Authorities Ratnagiri 10. Election Officer, Ratnagiri, Raigarh, Thane, Nagpur & Sholapur	67.51	67.51 26.89	161.91
	No tax at source was deducted from the payments made to various contractors				
Maharashtra	1993-94 to 1996-97	Hindustan Petroleum Corporation Ltd.	46.97	46.97 19.25	113.19
	In 43 cases tax at source was deducted from contractors at lower rates though no certificate from the competent authority authorising ODTAS to deduct the tax at lower rate was attached with return				
Maharashtra	1995-96	Central Warehousing Corporation Mumbai	1.80	1.80 0.54	4.14
	TDS was not deducted from payment of Rs.78.16 lakh made to a contractor who was having tax deduction exemption certificate. Audit perusal revealed that exemption certificate was relevant to financial year 1996-97 and not to 1995-96.				
Assam	1989-90 to 1995-96	Greater Lunglie Water Supply Division	32.22	32.22 14.49 (approx.)	78.93
	Payment of Rs.1611.08 lakh was released to a firm Subhash Project & Marketing Ltd. without deducting tax at source.				
Haryana & Himachal Pradesh	1994-95 1995-96	1. Chief Electoral Officer Haryana 2. Chief Electoral Officer Himachal Pradesh	28.73	28.73 7.58	65.04
	Payment of Rs.1389.98 lakh was made against contracts for preparation of voters identity cards to Haryana State Electronics Development Corporation & Himachal Pradesh State Electronic Development Corporation without deducting tax at source. No evidence regarding certificate issued by AO for non deduction of TDS was on record				

Charge	Year	Department/undertaking	Amount not deducted/ short deducted	Penalty & Interest	Total
Madhya Pradesh	1993-94	1. Election office 2. Nagar Nigam 3. MP SR TC Depot. 4. M.P. H.B. Division 5. Registrar of Universities 6. Public Service Commission 7. Dugdha Sangh Sehkari Marydit Raipur and Jabalpur etc. 8. FCI Jabalpur	14.45	14.45 6.10	35.00
	Payments were made in 43 cases but tax was not deducted at source				
Haryana (UT)	1994-95 to 1995-96	1. 1.M/s.Telephone Cables Ltd. 2. M/s. Winsome Yarns Ltd. 3. M/s. Samrat Forging Ltd.	3.21	3.21 1.39	7.81
	In 5 cases of Pvt. Limited Companies tax at source was deducted at lower rate without producing certificate for deduction of tax at lower rates				
Bihar	1994-95 to 1995-96	1. P.H. Divisions Chaibasa 2. P.H. Division Chakradharpur	2.91	2.91 1.00	6.82
	Payment of Rs.196.55 lakh was made to contractors and sub-contractors but no tax was deducted at source.				
West Bengal	1994-95 & 1995-96	Tourism Development Corpn.	Expenditure booked did not specified details	Tax being deductible on the portion relating to hire charges, need to be quantified	-
	Amount of Rs.325.20 lakh and Rs.196.32 lakh was booked against the head "expenditure on conducted tour" which included amount paid for hiring of buses from private parties.				

Audit observation in the case of Doordarshan Commercial Service Delhi and Commercial Broadcasting Service of AIR, Delhi was not accepted by the department stating that no cheques are being issued to advertising agencies and payment is adjusted through book adjustment and it is not practically feasible to deduct tax at source. The reply is not tenable as the tax is required to be deducted at source at the time of payment or credit to the account of the payee, whichever is earlier.

Non-deduction of surcharge

Tax deduction at source under section 194C is required to be increased by amount of surcharge in respect of the domestic companies.

Test check of Assam, Delhi, Bihar and Maharashtra charges revealed that in 401 cases surcharge of Rs.45.36 lakh was not realised alongwith the tax at source.

Some illustrative cases are given below:

(Rs. in lakh)

Charge	Department/undertaking	Cases	Surcharge not levied	Penalty and interest leviable	Total
1. Maharashtra	**1. Indian Oil Corpn. 2. Mistry Extrusion (P) Ltd. 3. Mr. Praveen Dani 4. Anuradha Silk Industries 5. Ramachandra Sirnivas Saraf 6. Bharat Kumar & Co. 7. Star Silk Mills 8. Indo-German Chamber of Commerce 9. CPWD, CBD, Belapur 10. CIDCO**	**19**	**1.21**	**1.21 0.49**	**2.91**
2. Assam	**1.M/s. Numaligarh Refinery Ltd. 2. Telecom Electrical Division, Guwahati**	**41**	**1.06**	**1.06 0.23**	**2.35**
3. Bihar	**23 ODTAS**	**340**	**18.33**	**18.33 3.20**	**39.86**

Deduction at source on net value

The tax at source is to be deducted on the gross value of work done.

Test check of TDS certificates issued to 6 contractors in Punjab and 8 Haryana (UT) charges during 1993-94 revealed that TDS was deducted after excluding the cost of material from gross value of work done. This resulted in short deduction of tax of Rs.2.56 lakh as shown below:

(Rs. in lakh)

Charge	Department/undertaking	Year	Cases	Amount short deducted	Penalty and interest
Punjab	Divisional Engg. Bhatinda	1993-94	6	0.28	0.28 0.16
Haryana (UT)	SDE Const. SD No.2 Chandigarh	-do-	8	0.74	0.74 0.36
Total			**14**	**1.02**	**1.54**

Failure to remit Tax Deducted at Source to Govt. account.

3.2.6 Any person deducting tax at source shall pay the sum so deducted to the credit of the Central Government within specified time, i.e., in the case of deduction by or on behalf of the government on the same day and in other cases, within two months. Omission to remit tax within specified period attracts interest at the rate of 15 percent per annum from the date on which

such sum was deductible to the date on which such tax was actually paid to Government account.

Test check of Maharashtra, Kerala, Orissa, Andhra Pradesh, Bihar, Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Assam, Delhi and West Bengal charges has revealed that in 498 cases, the amount of Rs. 242.17 lakh collected on account of TDS was remitted late into Government account. The delay ranged from 17 days to 3 years. Interest leviable for late remittance worked out to Rs.17.53 lakh. Some of the major defaulters are listed as under:

(Rs. in lakh)

Charge	Year	Department/undertaking	Amount of TDS	Delay	Interest leviable
Maharashtra	1995-96	Steel Authority of India (Nagpur) Ex.Engg. Ujjaine Canal Div. I (Solarpur)	0.93 0.10	3 years 213 days	0.42 0.12
Delhi	-do-	Northern telecom	4.36 (14 cases)	17 days to 43 days	0.05
Assam	1993-94	Ex.Engg. PWD TCC Div. Guwahati	4.50 (10 cases)	7 months to 11 months	0.47
Madhya Pradesh	1993-94 1995-96	Ex.Engg. MP Housing Board, Bhilai Commissioner Municipal Corpn. Raipur	4.31 5.55	1 month to 6 months 1 month to 7 months	0.18 0.35

In Gujarat charge, a leading Public Sector Undertaking, Sardar Sarovar Project, received demand draft for Rs.2.22 lakh on account of tax deducted on advance payment to a contractor during 1994-95. Instead of crediting the amount to Government account, the same was credited to personal account of Assistant Manager. Thus, in addition to Rs.2.22 lakh, which remained out of Government accounts, Rs.1.55 lakh on account of interest was also recoverable.

Failure to timely certify tax deducted

3.2.7 Every person deducting tax shall issue a certificate on Form 16A, to the person from whom the sum has been deducted within one month from the end of the month during which the credit has been given or the sum has been deducted. If any person fails to issue a certificate, penalty not less than one hundred rupees, which can extend to two hundred rupees per day, is leviable.

Test check of Gujarat, Kerala, Karnataka, Madhya Pradesh, Haryana, Uttar Pradesh, Delhi and Maharashtra charges has revealed that in 2,028 cases the certificates were not issued by the ODTAS within the specified time. The delay, ranging between 45 days to 2 years involved penalty of Rs.526.45 lakh.

Some of the illustrative cases are given below.

(Rs. in lakh)

Charge	Department/undertaking	Year	Cases	Delay	Penalty leviable
Maharashtra	Doordarshan Kendra, Mumbai	1993-94 to 1995-96	132	4 days to 447 days	6.12
Delhi	Stephen chemical Ltd. Delhi Punjab Fibres Ltd. Delhi	1995-96 1995-96	12 41	65 days to 159 days 43 days to 358 days	1.83 6.58
Karnataka	Karnataka Food & Civil Supply Department Low Level Canal Div. Bly. HMT :Ltd. Oceamine Peninsula (P) Ltd.	1995-96 1994-95 to 1996-97 1996-97 1996-97	5 6 4 14	249 days to 253 days 79 days to 255 days 52 days to 284 days 50 days to 408 days	1.26 1.16 0.51 2.13
Kerala	DMI & DE Ltd. KSHB, TVM	1994-95 to 1996-97	6	81 days to 477 days	1.19
Gujarat	1. Doordarshan Kendra 2. All India Radio 3. Sardar Sarovar Project 4. Gujarat Electricity Board 5. State Road Trans.Corpn. 6. Civil Supplies Department 7. Tractor Corpn. 8. Film Dev. Corpn. 9. State Warehousing Corpn. 10. Forest Dev. Corpn. 11. State Petroleum Corpn.	1992-93 to 1996-97	311	137 days to 484 days	296.93

Defective TDS Certificates

ODTAS while issuing TDS certificates should record PAN/GIR No. of TDS payee/assessment ward etc. so as to correlate, the certificate with assessment files for purpose of cross checking/allowance of credit.

Scrutiny of records of Kerala, Uttar Pradesh and West Bengal charge revealed that in 1,698 cases (22 cases, 1,644 cases and 32 cases respectively) PAN/GIR No. and relevant assessment ward was not recorded. In these cases, remittances to Government account with credits actually allowed could not be cross linked by audit.

Irregular TDS Certificates

A ODTAS is required to issue a T.D.S. Certificate only after deposit of the tax deducted at source.

Test check of records of Uttar Pradesh and Delhi for financial year 1994-95 revealed that in 88 cases (58 and 30 respectively) certificates were issued before making payment/depositing the sums into government account.

Besides the above case, in Punjab, Ludhiana charge, an instance of fraudulent issuing of TDS certificates, recording fictitious challan number and date without depositing of the amount into government account amounting to Rs.19.28 lakh was unearthed on a public complaint. Failure to check the TDS returns alongwith challans at initial stages led to the non detection of fraud.

Failure to apply/ allot Tax Deduction Account Number (TAN)

3.2.8 Every person deducting tax at source shall apply to the assessing officer for the allotment of Tax Deduction Account Number within one month from the end of the month in which tax was deducted. TAN is to be quoted in all challans, TDS certificates, periodical returns etc. Failure to apply for TAN attracts penalty which may extend to five thousand rupees.

Test check of Gujarat, Kerala, Orissa, Andhra Pradesh, Rajasthan, Haryana, Delhi and Uttar Pradesh charges, revealed that in 764 cases, TAN was not recorded in the returns and further verification revealed that the tax deductors had not applied for TAN. No action for levy of penalty was taken. Penalty at the maximum amount on this account worked out to Rs.38.20 lakh.

Besides, in 2,825 cases of Rajasthan, Madhya Pradesh, Haryana, Uttar Pradesh and Delhi charges, though ODTAS had applied for TAN, the TAN allotting authority had not allotted the number at all or issued very late. Period of delay ranged between 23 days to 40 months.

Some illustrative cases are as under:

Charge	TAN allotting authority	Cases	Period of application	Delay
Madhya Pradesh	ITO (Computer) Jabalpur	1,211	February 1995 to December 1997	Not allotted even upto May 1998 (date of audit)
Rajasthan	ITO Jaipur Ward	15	April 1994 to November 1996	3 months to 26 months.
Haryana	ITO (Computer) Faridabad, Karnal, Ambala and Hisar	1,433	October 1994 to March 1997	12 months to 40 months

Absence of Co-ordination between TAN Allotting authority and TDS authority

3.2.9 As per computerisation plans of the Income Tax Department, the task of allotment of tax-deduction account number (TAN) in metropolitan charges is assigned to an officer (ACIT/DCIT computers) other than the TDS authority. Whenever new numbers are allotted, TAN authority shall intimate TDS authority to enable the TDS authority to update the records and take effective action on tax deductors who fail to furnish annual returns. TDS authority on finding from annual returns that TAN has not been allotted, shall intimate TAN allotting authority for taking appropriate punitive action.

Audit scrutiny of Gujarat, Karnataka, Madhya Pradesh, Delhi and Maharashtra charges, has revealed that no such co-ordination existed between TAN allotting authority and TDS authority.

In Jaipur though the ITO (TDS) was also TAN allotting authority, the same TANs were allotted to different tax deductors in 17 cases and were amended subsequent to audit observation.

Non filing/ belated filing of Annual Returns

3.2.10 Every person responsible for deduction of tax is required to furnish annual return in respect of tax deducted by him within the prescribed time. Due date of filing annual returns for deductions from payments to contractors and sub-contractors is 30 June falling in the financial year immediately following the previous year. Omission to furnish annual return attracts penalty at the rate of Rs.100/- but may extend to Rs.200/- per day.

Audit scrutiny of TDS wards/circles of Gujarat, Kerala, Orissa, Rajasthan, Himachal Pradesh, Andhra Pradesh, Haryana, Madhya Pradesh, Assam, Haryana (UT), Delhi, West Bengal, Jammu & Kashmir, Karnataka, Tamil Nadu, Uttar Pradesh, Punjab, Maharashtra and Bihar charges revealed that in a large number of cases the returns were either not filed or filed belatedly and the enforcement of penal provisions by the TDS authority was lacking. The following table indicates the position of annual returns received in TDS wards/Circles and test checked by audit.

Year	Due date of submission of annual return	Effective tax deductors	Cases where returns filed in time	Cases where returns filed belatedly/ not filed	Cases where penalty proceedings initiated	Cases where no penalty proceedings initiated
1993-94	30 June, 1994	15,018	13,097	1,921	816	1,105
1994-95	30 June, 1995	46,932	37,352	9,580	1,076	8,504
1995-96	30 June, 1996	71,985	61,743	10,242	1,333	8,909
1996-97	30 June, 1997	32,309	24,305	8,004	252	7,752
Total		**1,66,244**	**1,36,497**	**29,747**	**3,477**	**26,270**

In 202 wards, out of 29,842 TDS returns checked by audit (refer para 5), in 8,938 cases returns were filed belatedly. Penalty in such cases leviable worked out to Rs.3,272.50 lakh.

Some illustrative cases included in the above table are briefly discussed as under:

(i) In Gujarat charge, Civil Construction wing of AIR Rajkot, had been deducting TDS from various persons since September 1989 but did not file TDS returns. Penalty leviable thereon worked out to Rs.12.38 lakh. Doordarshan Kendra, Ahmedabad also deducted TDS from various persons during 1993-94 to 1995-96 but did not file TDS return inviting penalty of Rs.2.43 lakh.

(ii) In Kerala charge, it was seen that Executive Division I, D.E. Unit of Kerala State Housing Boards (TDS Trivendrum) had not filed returns from 1994-95 to 1996-97. Penalty leviable worked out to Rs.1.71 lakh.

(iii) In Tamil Nadu charge, Tamil Nadu Aids Control Society and Panchayat Union Council, Poonamallee did not file returns from 1993-94 to 1995-96. Penalty leviable worked out to Rs.5.49 lakh.

(iv) In Maharashtra charge, 28 Election Officers, 3 State Government Department including 1 Central Works Division and Doordarshan Mumbai did not file the returns during 1993-94 to 1995-96. Operation Business group and Drilling Business group of ONGC also have not filed returns during 1993-94 to 1996-97. Penalty leviable in all 34 cases worked out to Rs.81.65 lakh.

3.2.11 Receipt of Annual Returns

Lack of effective monitoring and control

As per instructions of the Board dated September 1990 I.T.O. (TDS) is required to ensure that all persons within his jurisdiction who are liable to deduct or collect tax at source are brought on his registers. For this purpose he is required to organise an internal survey of important assessment records as also an out-door survey of organisations within his jurisdictions viz. Trade and commerce, Accounts, Registrar of Companies, Business houses, Firms, Companies, Clubs, Hospitals, Educational institutions etc. who are responsible for deducting tax at sources. He is also required to ensure that the statutory returns are received within specified time, whether correct amount has been deducted and whether interest and penalty leviable has been invoked. In order to initiate timely action on issue of notices of demand including interest and penalty, various control registers have been prescribed by the Board, as detailed in para 16.

Test check of Gujarat, Orissa, Karnataka, Uttar Pradesh, Assam (excepting ITO ward-3 Shillong), Punjab, and Tamil Nadu (in respect of 6 wards), revealed that there existed no effective watch over receipt of annual returns or to ensure that all returns due from the effective tax deductors were received nor were such internal or outdoor surveys conducted in TDS wards. In Kerala charge, though surveys were reported to have been conducted, no such evidence was produced to audit nor was there any substantial increase in the number of ODTAS.

Norms for check of returns

As per instructions of the Board issued in October 1990, there would be a sample checking of the correctness of TDS returns filed by the ODTAS. The CCIT/CIT is required to lay down detailed guidelines for the method of selection of sample and also prescribe percentage of returns to be checked by TDS authorities.

Test check of the records of TDS wards in Maharashtra, Gujarat, Kerala, Orissa, Himachal Pradesh, Andhra Pradesh, Rajasthan, Karnataka, Uttar Pradesh, Assam, Haryana, Delhi, Punjab, West Bengal, Tamil Nadu, Bihar and Jammu & Kashmir revealed that no such guidelines for method of

selection and percentage of returns to be checked were laid down by the CCIT/CIT. Besides, it was seen that no specific checks have been laid down by the Board for cross verification of outstation challans, with the result the TDS authorities had not carried out prescribed test checks of TDS returns.

Absence of cross verification by Assessing Officers

As per the Board's instructions dated September 1990 a small percentage of TDS certificates presented to the concerned assessing officer with the returns of income are required to be verified by the assessing officer with reference to the records of concerned ITO (TDS) before giving credit for such TDS in order to safeguard against wrong and bogus claims. The percentage of certificates to be subjected to cross verification has been left to the respective CCIT/CIT.

Audit scrutiny of the Maharashtra, Gujarat, Kerala, Orissa, Andhra Pradesh, Karnataka, Madhya Pradesh, Haryana, Tamil Nadu, Uttar Pradesh, Assam, Haryana(UT), Punjab, West Bengal, Bihar, Jammu and Kashmir charges, revealed that such percentage of cross check was neither prescribed by the respective CCIT/CIT nor was such cross verification being done. In absence of the cross verification, especially in the cases involving high revenue effect, possibility of frauds cannot be ruled out.

In Punjab CIT, Patiala charge audit had noticed an instance where an assessee firm was allowed TDS refund of Rs.18,844 on the basis of Form 16A issued by FA&CAO DCW Patiala during the financial year 1994-95. However, cross verification with return filed by the FA&AO with ITO(TDS) Patiala revealed that no such amount was deducted from the assessee.

Irregular credits without corresponding income being taxed

3.2.12 Cross verification by audit of TDS returns with income tax returns of Punjab, Haryana, Gujarat, Kerala and Maharashtra charge, revealed excess credit of Rs.57.64 lakh in 15 cases.

Some illustrative cases are as under:

(i) In Punjab, Bhatinda charge, an assessee received advance payment of Rs.57 lakh during 1995-96 on which tax at source was deducted. However, against this contract, receipt of Rs.6.65 lakh only was assessed to tax whereas credit of entire tax deducted at source on Rs.57 lakh was allowed. Thus, assessee availed excess credit of Rs.1.50 lakh (including interest).

(ii) In Haryana charge, in the case of an assessee firm against the TDS of Rs.0.46 lakh certificate was issued for Rs.0.80 lakh which resulted in excess credit of Rs.0.34 lakh.

(iii) In Gujarat, Vadodra charge, three firms, had claimed credit of TDS amounting to Rs.4.27 lakh on payment of Rs.200 lakh received by them during the financial years 1992-93 to 1994-95. During scrutiny of Profit and Loss account it was found that only an amount of Rs. 31.23 lakh was credited as contract receipts in accounts. Against permissible TDS credit of Rs.0.63

lakh on the basis of contract receipt of Rs.31.23 lakh, excess credit of Rs.3.64 lakh was allowed.

(iv) In Maharashtra, CCIT Mumbai charge, in the case of an assessee TDS credit of Rs.81.34 lakh was allowed as against TDS certificate for Rs.46.50 lakh during 1994-95 resulting in excess credit TDS of Rs.34.84 lakh.

(v) In same charge audit scrutiny of trading account of an assessee for the year 1994-95 revealed that the gross receipts from contracts was shown at Rs.122.04 lakh whereas as per the TDS certificates the gross contract receipts were Rs.180.07 lakh. Thus, there was a difference of Rs.58.03 lakh between the contract receipts as per TDS certificates and accounts of the assessee. The assessee was allowed credit of entire TDS of Rs.2.06 lakh deducted on gross receipts of Rs.180.07 lakh though gross receipt of Rs.122.04 lakh only was included in the return of income. Excess credit availed by the assessee was Rs.0.66 lakh.

(vi) In the case of an assessee firm, in Maharashtra, CCIT Mumbai charge, audit scrutiny revealed the tax of Rs.3.98 lakh was deducted at source from gross receipts of Rs.196.67 lakh in assessment year 1995-96. The assessee had credited Rs.45.60 lakh only to profit and loss account out of Rs.196.67 lakh, but was allowed credit of entire amount of Rs.3.98 lakh excess TDS credit availed by assessee amounted to Rs.3.06 lakh.

The department did not accept the objection stating that the assessment was done under Section 143(1)(a) and the point raised was not covered by prima facie adjustment. Department's reply is not acceptable for the reason that as per the details available from the documents filed alongwith the return the assessee had not credited the entire income as shown in TDS certificates, to his accounts. The excess TDS credit should have either been disallowed or entire income brought to tax.

(vii) In the case of another assessee firm, in Maharashtra, CCIT Pune charge, the assessee was allowed credit of TDS of Rs.4.45 lakh, which was deducted from the gross amount of Rs.222.30 lakh in the assessment year 1996-97, though Rs.148.55 lakh only was assessed to tax. Similarly for the assessment year 1995-96 TDS credit of Rs.1.79 lakh, deducted on gross receipts of Rs.89.33 lakh was allowed though Rs.36.35 lakh only was brought to tax. The assessee was thus allowed excess credit of Rs.2.53 lakh.

Irregularities in Returns

3.2.13 Omission to attach Challans with the returns

An official responsible for deducting tax at source (ODTA) is required to furnish a copy of challan with the return through which the tax deducted was remitted to Government account.

Test check of Kerala, Tamil Nadu, Haryana , Bihar charges, revealed that in 30 cases, copies of challans were not attached with the return. In 7 cases of Maharashtra charge, xerox copies of challans were attached with the return. No certificate regarding authentication with original challan was recorded on the xerox copies. In Tamil Nadu and Delhi charges 7 challans were not attested by the bank authorities.

Omission to classify income tax and surcharge

When annual TDS returns are filed with the Income Tax department, copies of challans through which the payments are made to the credit of the Central Government should be enclosed with the returns. The Income Tax and Surcharge deducted from the payments made to contractors should be indicated separately under the specific heads provided for, such as "Income Tax" and "Surcharge".

In 20 cases out of 5,007 cases under CCIT, Mumbai and in 5 cases out of 2,703 cases under CCIT, Pune it was observed from the challans enclosed with the TDS returns that a combined figure was shown, instead of indicating separately under the heads Income Tax and Surcharge. Clubbing of Income Tax and Surcharge is irregular and may lead to improper allocation of revenue between Centre and States as only income tax is divisible.

Misclassification of challan

Receipts on account of Income Tax from companies are creditable to Major Head 020-Corporation Tax and Other than companies to 021-Taxes on Income other than Corporation tax.

Test check of Kerala, Gujarat and Karnataka charges, has revealed that proper classification showing the correct head of account is not being recorded on challans nor are the correct forms of challans used for remittance into Government account.

In Kerala and Gujarat charges, in 181 cases amount of Rs.258.53 lakh actually creditable to 020-Corporation Tax was credited to 021-Taxes on income other than Corporation tax leading to excess allocation of income tax receipts divisible between Centre and States.
In Karnataka, ACIT(TDS) Mysore charge, an amount aggregating Rs.17.96 lakh stated to have been remitted by a tax deductor between February 1995 to December 1995, was not traceable and the head of account under which the amount was classified could not be located.

Analysis of Demand outstanding

3.2.14 Whenever a demand notice is issued on account of short/non deduction of tax, penalties leviable etc. the demand is required to be paid within 30 days from the date of issue of such demand notice.

Test check of Demand and Collection Registers of Gujarat, Kerala, Orissa, Himachal Pradesh, Andhra Pradesh, Rajasthan, Karnataka, Madhya Pradesh, Haryana (UT), Tamil Nadu, Uttar Pradesh, Assam, Haryana, Punjab, Delhi, West Bengal, Maharashtra, Bihar and Jammu and Kashmir charges, revealed that the outstanding demands by way of penalty and interest as on 31 March 1997, stood at Rs.5,311.88 lakh and Rs. 1,049.36 lakh respectively. Yearwise break up of outstanding demand is given below:

Penalty

(Rs. in lakh)

Year	Demand raised		Demand collected		Demand outstanding	
	Number	Amount	Number	Amount	Number	Amount
1993-94	1,162	231.88	899	183.32	263	48.56
1994-95	2,830	2,098.36	2,455	1,766.73	375	331.63
1995-96	10,302	9,353.81	8,926	7,400.29	1,376	1,953.52
1996-97	12,511	2,886.92	10,201	73.07	2,310	2,978.17
Total	**26,805**	**14,570.97**	**22,481**	**9,423.41**	**4,324**	**5,311.88**
1993-94	386	596.69	174	3.43	212	593.26
1994-95	1,092	286.36	617	85.02	4.75	201.34
1995-96	2,086	143.68	1,307	59.27	779	84.41
1996-97	2,259	252.98	1,526	107.11	733	170.35
Total	**5,823**	**1,279.71**	**3,624**	**254.83**	**2,199**	**1,049.36**
Grand Total	**32,628**	**15,850.68**	**26,105**	**9,678.24**	**6,523**	**6,361.24**

(Demand and Collection Register (TDS) of Tamil Nadu charge did not have break up of penalty and interest. In Maharashtra also penalty and interest figure were not available separately. Entire figure taken under penalty)

Imposition of penalties

3.2.15 Under the Income Tax Act, 1961, no order of penalty should be passed after the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later.

Test check of Registers of penalties of Gujarat, Orissa, Himachal Pradesh, Andhra Pradesh, Rajasthan, Haryana, Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Assam, Haryana (UT), Punjab, Delhi, Maharashtra, Bihar and Jammu & Kashmir revealed that out of 6,590 cases, where penalty proceedings were initiated, in 2,735 cases these were dropped. In 108 cases, action had become time barred. The yearwise details are as under:

(Rs. in lakh)

Year	Cases where penalty proceedings initiated	Cases where penalty levied	Cases where penalty proceedings dropped	Time barred cases	Tax effect of time barred cases
1993-94	903	137	729	18	198.25
1994-95	1,970	756	695	30	29.12
1995-96	2,278	535	1,064	56	38.14
1996-97	1,439	93	247	4	4.83
Total	**6,590**	**1,521**	**2,735**	**108**	**270.34**

These include 59 cases of Maharashtra charge, proposals for which were sent to the concerned authorities for initiating penal action. But no penalty orders were issued even after expiry of the limitation period. The penalty involved worked out to Rs.263.75 lakh.

Besides, in Gujarat charge in 192 cases though penalty action under Section 272(A(2)(c) or 272(A(2)(G) had been initiated by Income Tax Officer (TDS) these were lying pending with DCIT TDS Ahmedabad for 2 to 3 years. As a result additional revenue of Rs.149.13 lakh in 104 cases remained to be collected. In 88 cases, penalty chargeable was not quantified.

In Karnataka charge, no prescribed register of penalties was maintained in any wards/circles. Audit could not test check the position.

Maintenance of Registers

3.2.16 In order to ensure proper documentation in the office of ITO (TDS) and to facilitate regular monitoring by higher authorities, a number of control registers has been prescribed. Audit scrutiny revealed that many prescribed registers were either not being maintained or improperly maintained thus defeating the purpose of controls. The position of non maintenance/improper maintenance of registers is as under:-

Registers	**Not maintained**	**Not maintained properly**	**Remarks**
1. Register for allotment of TAN to tax deductors for Tax deduction at source	Tamil Nadu (Tambaram, Tuticorin, Madurai, Karaikudi, Nagercoil, Trichy II, Chennai III, IV, V, VII & VIII) Haryana (UT)	Kerala (Alwaye, Trivendrum & Ernakulam), Orissa, Karnataka, Madhya Pradesh, Haryana, Assam, West Benga!	Not maintained in Alphabetic order and prescribed format date of receipt not recorded, allotment number status of applicant not recorded, columns not filled in.
2. T.D.S. Control Register NO.1 (for offices of Govt. & local authorities)	Gujarat (one ward under Ahmedabad, one ward under Vadodra for 1995-96 and one ward under Surat for 1994-95), Tamil Nadu (same ward as mentioned against Sr. No.1) Assam (Guwahati upto 1995-96), Jammu & Kashmir (TDS Jammu), Haryana (UT) & Delhi	Gujarat (one ward under Ahmedabad, one under Vadodra), Kerala (3 wards as shown against No.1) Orissa (Cuttack & Dhenkawal),Andhra Pradesh, Karnataka, Madhya Pradesh (Gwalior, Jabalpur & Bhillai) Haryana, Assam (Shillong) & Bihar	Proforma not maintained, columns not filled in, control register number 1 and 2 combined, source wise entries not given. Records were not produced in the case of Haryana (UT) & Delhi
3. TDS Control Register No.2 (for tax deductors other than Govt. & local authorities)	Gujarat (one ward under Ahmedabad, one ward under Vadodra for 1995-96 and one ward under Surat for 1994-95), Kerala (Alwayee & Ernakulam), Tamil Nadu (wards as shown in Sr. No.1), Uttar Pradesh (1993-94), Assam (Guwahati upto 1995-96), Jammu & Kashmir (TDS Jammu) Haryana (UT) & Delhi	Gujarat (Ahmedabad, one ward) Orissa (Cuttack & Dhenkawal), Andhra Pradesh (Hyderabad), Karnataka, Madhya Pradesh (Gwalior, Jabalpur, Bhillai), Haryana, Assam (Shillong), Bihar & West Bengal	-do- Records were not produced in the case of Haryana (UT) & Delhi

Registers	Not maintained	Not maintained properly	Remarks
4. Demand & Collection Register (TDS)	Orissa (except ITO-TDS Rourkela), Tamil Nadu (Tambaram, Tuticorin, Madurai, Karaikudi, Nagercoil and Trichy-II), Uttar Pradesh (1994-95 & 1995-96).	Gujarat (Ahmedabad), Kerala, Haryana, Assam, Maharashtra, West Bengal.	Old demands not carried over to subsequent years, source wise details not given, nil demand, cases not recorded, section wise details not given, challan nos. not recorded
5. Daily Collection Register (TDS)	Orissa, Tamil Nadu (Same wards as mentioned in Sr.No.4) Jammu & Kashmir (TDS Jammu) West Bengal (2 units) & Delhi	Andhra Pradesh, Haryana (Hisar), West Bengal (6 units)	Not in proforma, challans not recorded, cross reference to D&C register not recorded, section wise collection not shown. Records were not produced in the case of Delhi.
6. Register of penalties under section 271C, 272A and 272BB	Gujarat (Vadodra), Orissa, Haryana, Tamil Nadu (same wards as against Sr.No.4), Assam, Punjab (Bhatinda & Jallandhar) West Bengal (3 units), Karnataka	Gujarat (Ahmedabad), Kerala, Haryana (UT), Punjab, Maharashtra, West Bengal (5 units)	Not in proper form, action initiated not recorded, date of issue of penalty order not recorded, section wise penalties not recorded. Delhi records not produced to audit.
7. Register of cases for prosecution proceedings under section 276B/276BB	Gujarat (Vadodra), Orissa, Himachal Pradesh, Tamil Nadu (same wards as against Sr.No.4), Assam, Punjab (Amritsar upto 95-96 & Other wards for entire period), West Bengal (7units) Jammu & Kashmir (TDS Jammu)	Gujarat (one ward of Ahmedabad)	Not in prescribed format
8. Alphabetical Register of Employees (ITNS-IIB)	Orissa, Tamil Nadu (same wards as against S.No.1), West Bengal & Jammu & Kashmir (TDS Jammu) & Delhi	-	Delhi records not produced to audit.
9. Special watch Register	Orissa, Tamil Nadu (same wards as against Sr.No.1), West Bengal, Jammu & Kashmir (Jammu) & Delhi	-	Delhi records not produced to audit.

Deduction of tax at source from non resident sportsman and sports associations (194E)

3.2.17 Under the Income Tax Act, 1961, an income payable to a non resident sportsman not being an Indian citizen is liable to tax deduction at source if-

- the assessee participates in India in any game (other than specifically mentioned under 115BB), or sport or advertisement,
- contributes articles relating to any game or sport in India in newspapers, journals etc.,

- in the case of non resident association/institution guarantee money payable or paid in relation to sports played in India

at the rate of 10% at the time of credit/payment of such income.

During the course of review, two cases of failure to file returns/deduct tax at source, noticed in West Bengal and Maharashtra charges, are briefly stated as under:

In West Bengal charge, under the existing procedure, any non resident sportsmen intending to join any Sports Association like Mohan Bagan Athletic Club, Mohammedan Sporting Club etc, were required to register their names first in the books of the Indian Football Association. Scrutiny of the records of Indian Football Association Calcutta revealed that during the financial year 1995-96, as many as six non-resident sportsmen registered their names to play in favour of three sports associations namely the Mohan Bagan Athletic Club, Peerless Sporting Club and Mohammedan Sporting Club. None of these sports associations had submitted their annual returns in respect of tax deducted at source from the payments made to those non-resident sportsmen.

In Maharashtra charge the records of Board for Control of Cricket in India, for the years 1991-92 to 1997-98 revealed that the BCCI made payments towards guarantee money in respect of Wills World Cup held in India 1996 to various non-resident sports bodies as follows.

S.No.	Assessment year	Payee	Amount (Rs.)	Tax-deductible at source (Rs.)
1.	1993-94	Zimbabwe	1,52,750	15,275
2.	-do-	England	34,80,822	3,48,082
3.	1995-96	West Indies	2,73,24,794	27,32,479
4.	-do-	New Zealand	31,52,000	3,15,200
5.	1996-97	-do-	94,78,350	9,47,835
6.	1997-98	South Africa	1,24,47,600	12,44,760
7.	-do-	Australia	43,58,878	4,35,887
		Total	**6,03,95,194**	**60,39,518**

From payments made to England, New Zealand and Australia, no tax at source was deducted on the stated ground of Double Taxation Avoidance Agreement. The argument is not tenable for the reason that DTAA can be invoked only by a resident of either country who is liable to taxation in that country. There has to be an income which will be doubly taxed in both the countries. Since all the Cricket Boards are exempted from tax in their respective countries, the applicability of DTAA does not arise in the present case. Even on merits of the argument, article 22(2) of the DTAA between India and Australia, India and U.K. and India and New Zealand clearly states that items of income of a resident of one of the contracting states which are not expressly mentioned in the agreement and such income is derived from source in the other contracting state may be taxed in that other state. These specified categories did not include income by way of prize or guarantee money. Hence, income arising

from sources in India to a non-resident sports-body of New Zealand, Australia and U.K. was taxable in India and attracted the provisions of section 194E for deduction at source and the guarantee monies paid to the sports-bodies of Australia, New Zealand and England were liable to be taxed at source.

In the case of Zimbabwe, South Africa and West Indies, there is no Double Taxation Avoidance Agreement with India as such the plea is ill founded. As per information available on records, the BCCI had not deducted tax at source from the payments made to non resident sports bodies of Zimbabwe, West Indies and South Africa amounting to Rs.60.40 lakh. Failure to deduct tax at source and to file TDS return thereon attracted interest and penalty amounting to Rs.86.47 lakh (total tax effect worked out to Rs.146.87 lakh)

The department did not accept the audit observation in March 1998 on the strength of CBDT's letter dated 17 May 1996 stating that in view of Double Taxation Avoidance Agreement with Australia, England and New Zealand, no liability to tax arises even under section 115 BBA. The department's reply is not tenable as the CBDT had since withdrawn the instruction of May 1996 at the instance of audit. Further pursuance of the matter in accordance with the law by the department is still pending.

Internal Audit

3.2.18 Internal Audit was introduced in the Income Tax Department to play a corrective and vigilant role against errors of omissions and commissions.

TDS wards III, V, VII and VIII Chennai
TDS Special Ward Tambaram
TDS ward Tirunelveli
TDS ward Nagercoil
TDS ward Cuddalore
TDS ward Pondicherry
TDS wards I & II Trichy

Test check of Gujarat, Kerala, Orissa, Rajasthan, Karnataka, Madhya Pradesh, Uttar Pradesh, Assam, Haryana, Punjab, Maharashtra and Bihar charges has revealed that no internal audit of TDS wards/circles was conducted during 1993-94 to 1995-96.

In Andhra Pradesh charge, internal audit was taken up for the first time in September 1997 to October 1997 for 1995-96 and 1996-97 under one charge only.

In Haryana, though the department intimated that internal audit was being conducted every year, no reports/connected records were produced before audit.

In Delhi charge, no internal audit was conducted till June 1995, when a unit for the purpose was set up.

In Tamil Nadu internal audit was not conducted in 11 wards out of 21 TDS wards.

The absence of Internal Audit of TDS wards/Circles, resulted in non detection of most of the irregularities found during the course of review and early remedial action found wanting.

Lacunae in the Act

3.2.19 (i) There is no statutory time limit for processing of TAN with the result that large number of applications for allotment of numbers are awaiting action.

(ii) There is no provision laid down under the Income Tax Act for completion of assessments of TDS returns within a specified period with the result, a large number of returns are pending for assessment.

(iii) There is no provision for levy of penalty against tax deductors for filing incomplete TDS returns as in the case of concealment of income during filing of Income Tax returns.

3.3 Working of film circles

Introduction

3.3.1 With a view to achieving greater Co-ordination and effective handling of the assessments of film personalities special film circles were created at Calcutta, Mumbai, Chennai, Bangalore and Hyderabad. While the film circles at Calcutta and Mumbai started functioning from 1963 and 1964 respectively, those at Chennai, Bangalore and Hyderabad started functioning from 1982 onwards. Over the period, some of the film circles, notably Calcutta, Hyderabad, Chennai and Bangalore, no longer remained exclusively for film related assessments.

In their 91st Report (1981-82), the Public Accounts Committee (Seventh Lok Sabha), recommended inter alia a review of the method of allowing the cost of production/distribution rights of feature films. The Committee desired that a Study Group consisting, among others, of experts in taxation, accountancy and audit and eminent non-officials having intimate knowledge of the operations of the film industry should be set up to make an indepth study to devise ways and means to curb the growing tendency to funnel large amounts of unaccounted money into star studded films and to ensure that the interests of revenue are adequately protected.

Some aspects of working of the Film Circle, Bombay were reviewed in audit in March-May 1983. The results of the review were incorporated in paragraph 3.26 of the Report of the Comptroller and Auditor General of India for the year 1982-83, Union Government (Civil), Revenue Receipts, Vol. II, Direct Taxes relating to working of a film circle.

Organisational set up

3.3.2 In West Bengal, Maharashtra and Andhra Pradesh there were circles/wards for the exclusive assessment of film personalities. However, in Tamil Nadu, Karnataka, Kerala and Orissa, assessing officers were dealing with other business cases also along with film personalities.

Law and Procedure

Section 285B of Income Tax Act

3.3.3(A) The special provisions as applicable exclusively to the assessment of film producers, distributors etc., had been specified in section 285B of the Income Tax Act, 1961, and Rules 9A and 9B of the Income Tax Rules, 1962 respectively. Under section 285B, introduced with effect from 1st April, 1976 and as amended from 1st April 1989, every person carrying on production of cinematograph film is required to furnish a statement in Form No.52A giving

particulars of all payments of over Rs.5000 in aggregate, made by him or due to him for each financial year or part thereof till completion of production, within thirty days of the financial year or within thirty days from the date of completion of production, whichever is earlier. This provision is intended to document and account for receipts and payments by the film producer. Omission to comply with these provisions under section 272A according to which a penalty of not less than Rs.100/- per day, which may extend to Rs.200/- per day, is leviable during which the default/failure continues.

Rules 9A and 9B of the Income Tax Rules, 1962

(B) These rules as amended from 1st April 1989, provide for deduction in respect of cost of production of a feature film and the cost of acquisition of distribution rights of a feature film from the profits and gains of business of the producers and distributors respectively.

Besides the above, other relevant provisions applicable in the assessment of film personalities are section 44AB, Section 194J and Section 80RR.

Constraints

3.3.4 Despite the assurance given to the Public Accounts Committee and issue of subsequent instructions by the Ministry of Finance, Appraisal Reports forming part of the assessment records relating to 3 Film personalities were not made available to Audit in Chennai. Similarly in Chennai, only one assessment file of a producer out of forty assessment files of producers/distributors who had received payment from Doordarshan Kendra/NFDC was produced to audit.

Highlights

3.3.5 (i) The audit review revealed that the objective of bringing about improvement in the quality of assessment of film related personalities by creating Film Circles was not achieved.

[Paras 3.3.10 &11)

(ii) Examination revealed shortcomings in the work procedures like non-analysis of records of other organisations like Central Board of Film Certification to ensure that all film related personalities had filed their returns, increasing tax arrears and mounting figures of pendency in disposal of cases.

[Paras 3.3.9 to 3.3.11]

(iii) Despite the Public Accounts Committee's recommendation the department had neither evolved any proper system or methodology nor were any records maintained to show the list of incomplete/ abandoned films. Therefore, there is total absence of any administrative machinery to detect the leakage of revenue on this account.

[Para 3.3.12]

(iv) Audit of the system of filing of Form 52A by a producer revealed the absence of monitoring the mechanism for filing of such forms as well as non analysis of wide variations in the figures of cost of production of a film with the statements furnished in Form 52A. Penalty leviable but not levied in 1067 cases for non filing/late filing of Form 52A amounted to Rs.1248.27 lakh.

[Para 3.3.13A]

(v) The procedure evolved by the Department as a means to verify the reasonableness of expenditure incurred by a producer in 1990 on the recommendations of the Public Accounts Committee remained on paper as certain changes in 1991 as regards availability of raw stock of films from various sources instead of a single source from NFDC made the procedure redundant.

[Para 3.3.14]

(vi) Seizure of assets to the tune of only Rs.1.82 crore in 18 searches conducted in Mumbai during 1995-96 and 1996-97 coupled with issues not examined by assessing officers though adequately raised by investigation wing also pointed to inadequate attention paid to the recommendations of the PAC on strengthening of Intelligence wing.

[Para 3.3.15]

(vii) Weaknesses noticed by Audit in the assessment procedures like incorrect amortisation of cost of production, non verification of Royalty payment from TV Channels to Film Personalities and other mistakes led to tax leakages amounting to Rs.927.26 lakh (including potential tax of Rs.50.07 lakh).

[Paras 3.3.16B, 3.3.20, 3.3.22 to 3.3.31]

Recommendations of the Public Accounts Committee

3.3.6 In their 175th (1989-90) Report on action taken by Government on the recommendations of the Public Accounts Committee contained in their Seventy First Report (8th Lok Sabha)-1986-87 on working of a Film Circle, the Committee desired that:

(i) The department of Revenue should pursue vigorously with the Ministry of Information and Broadcasting to devise a fool-proof system of maintaining records as regards the incomplete/abandoned films so that no undue advantage is taken by the film producers/cine artists.

(ii) Department of Revenue would undertake a study to evolve certain norms for the Assessing Officers to find out the reasonableness of the

expenditure incurred by the film producers in the course of film production and report the results of their study to the Committee.

(iii) The strengthening of the investigating machinery would result in detection of substantial tax-evasion cases in film industry and the Committee would like to be apprised of the extent of results achieved in this regard.

(iv) In the light of the Committee's findings that film personalities having undisclosed income came before the Settlement Commission with the object of pre-empting raids on their premises, the Ministry of Finance under whose administrative control the settlement commission functions, should see that the Commission functions efficiently and effectively.

Administrative measures

3.3.7 The Action stated to have been taken by the Ministry were as under ad seriatim:

(i) A procedure has been evolved whereby a copy of each of the forms filled by the film producers for release of raw stock are to be forwarded every quarter by the National Film Development Corporation (NFDC) to the nominated officers of the Income Tax Department at Bombay, Madras, Calcutta and New Delhi. The said procedure has already come into force with effect from the quarter ending 31st December 1990. The information furnished is being transmitted to the concerned assessing officers so that the same can be utilized in the assessments of the producers and cine artists. As a result the information in respect of all films for which raw stock was issued, whether completed or abandoned, will reach the concerned assessing officers. The information however, does not contain financial details which will have to be obtained by the assessing officers from the concerned persons.

(ii) Steps have been taken to evolve a procedure to make the investigation of cases of film production more effective. It was seen that the NFDC was the only institution which issued the raw stock of films for producing films of all kinds. For this purpose, the film producers had to apply to National Film Development Corporation in Form "N-A" and these applications contained information in regard to the artists, technicians and the laboratories where the film was proposed to be processed.

Alongwith the information, particulars with regard to the quantity of raw stock issued for producing a film could also be obtained by the assessing officers from the National Film Development Corporation. The other information contained in Form "N-A" is also quite useful.

(iii) Additional posts for the Investigation Wing of Income Tax Department were sanctioned during the financial year 1986-87. Besides, surveys have also

been conducted in the cases of persons associated with the film industry from time to time.

(iv) For liquidating the arrears the strength of Departmental Representatives had been augmented and that greater involvement of the Settlement Commission in scrutiny of the cases during the hearing of the cases had been ensured with a view to finalise the cases expeditiously.

Objective and scope of the review

3.3.8 Against the background of the recommendations of the PAC in the 175th Report 1989-90 (8th Lok Sabha) for effective and better co-ordination of the working of the circles to ensure that legislation does not remain in the statute book only, this audit review has been attempted to ascertain:

- The extent of cross checking of assessments of film producers vis-à-vis film artists and those of film producers vis-à-vis distributors.

- The extent of compliance of mandatory information to be furnished by the producers and the extent to which the department has utilised the information in regulating the scrutiny assessment.

- The extent of coordination with other agencies like National Film Development Corporation, Doordarshan and other broadcasting/telecasting agencies for detection of non-disclosure or wrong-disclosure of information and the implementation of the relevant provisions governing the assessments of personalities connected with film industry.

- To assess the effectiveness of the investigation wing in investigation of the undisclosed income and the quality of the assessments thereof and increase in tax base.

For this purpose, the records of 2669 assessment cases for the period 1992-93 to 1996-97 in Maharashtra, West Bengal, Tamil Nadu, Andhra Pradesh, Karnataka, Uttar Pradesh were test checked. Additionally, assessments of film related personalities in Kerala and Orissa were also examined. The important discrepancies/deficiencies noticed during the course of review are mentioned in the succeeding paragraphs.

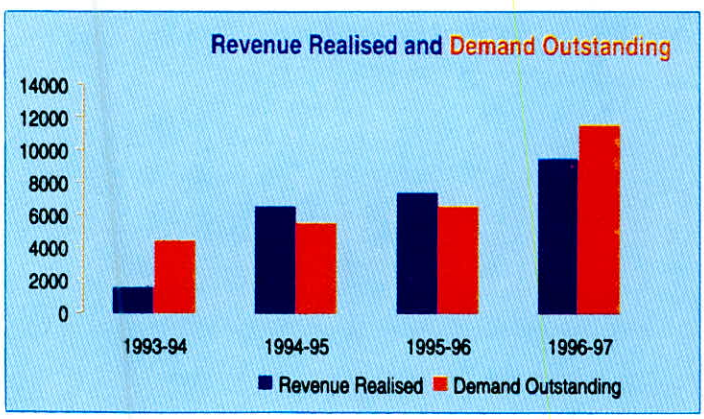
Demand, collection and arrears of tax

3.3.9 The tax amount outstanding both as per the assessing officer and the Tax Recovery Officer (TRO) charges have increased over the period. The table below shows the arrears of demand of tax at the commencement of the year, the demand made during the year, the tax collected and the balance outstanding as on 31 March 1998.

(a) As per Assessing officers charges:

(figures in Rupees in lakh)

Financial Year	Demand outstanding as on 1st April	Addition due to transfer in from other special ranges, wards	Demand made during the year	Total demand due	Amount realised during the year	Demand outstanding as on 31st March
1993-94		--				
Mumbai	1,999.63		473.21	2,472.84	478.56	1,994.29
Chennai	1,220.10		1,575.45	2,795.55	992.32	1,803.23
Calcutta	279.53		420.60	700.13	82.77	617.36
1994-95						
Mumbai	1,994.29	662.00	5,965.59	8,621.88	5,138.67	3,483.21
Chennai	1,803.23	4.10	903.40	2,710.73	1,254.21	1,456.52
Calcutta	617.36		60.17	677.53	132.68	544.85
1995-96						
Mumbai	3,483.21	1,231.00	5,973.19	10,687.40	6,445.39	4,242.01
Chennai	1,456.52		613.24	2,069.76	800.04	1,269.72
Calcutta	544.85		611.74	1,156.59	133.17	1,023.42
1996-97						
Mumbai	4,242.01	168.08	12,904.53	17,314.62	8,570.28	8,744.34
Chennai	1,269.72	63.21	1,190.61	2,523.54	736.05	1,787.49
Calcutta	1,023.42		145.22	1,168.64	159.41	1,009.23
1997-98						
Mumbai	8,744.34	337.47	12,236.19	20,980.53	11,040.62	9,939.91
Chennai	1,787.49		1,115.72	3,240.68	942.91	2,297.77
Calcutta	1,009.23		21.25	1,030.48	6.58	1,023.90



The above figures show that demands outstanding have been increasing. One of the yardsticks to measure and judge the effectiveness of the functioning of any revenue raising department is to examine the quantum of tax actually collected out of that assessed and levied. However, the figures in the above table shows that the demand outstanding for Mumbai, Chennai and Calcutta (Film Circles) increased from Rs.4414.88 lakh as on 31 March 1994 to Rs.11541.06 lakh on 31 March 1997 i.e. 261.41 percent. Correspondingly, the revenue collected from these circles increased by 112.76 percent only from 1993-94 to 1996-97.

(b) As per Tax Recovery Officer charges:

With a view to achieve better collection of Direct Taxes, the laws and procedures for effecting recovery of tax were changed in April 1989. While normally the assessing officer is responsible for collecting taxes etc., in cases where the assessees are in default and coercive action is required, proceedings are carried out by Tax Recovery Officers (TROs) who enjoy wide powers of attachment & sale of property, arrest and detention etc. The figures given below reveal that despite this specialised mode of recovery, the demand outstanding in the books of TRO increased from 2219.20 lakh on 31 March 1994 to 5944.07 lakh on 31 March 1998.

(Figures in Rupees in lakh)

Financial Year	Demand outstanding as on 1st April	Demand certified to TRO during the year	Total demand due	Amount collected Remission	Cash	Demand outstanding as on 31st March
1993-94						
Mumbai	134.93	547.33	682.26	94.15	26.87	561.24
Chennai	147.63	1,588.32	1,735.95	25.06	52.93	1,657.96
1994-95						
Mumbai	561.24	377.58	938.82	94.15	63.98	780.69
Chennai	1,657.96	72.14	1,730.10	39.09	48.62	1,642.39
1995-96						
Mumbai	780.69	1,351.17	2,131.86	81.94	111.00	1,208.92
Chennai	1,642.39	83.39	1725.78	5.53	31.59	1,688.66
1996-97						
Mumbai	1,208.92	441.18	1,650.10	106.68	217.76	1,325.66
Chennai	1,688.66	127.15	1,815.81	282.52	7.74	1,525.55
1997-98						
Mumbai	1,325.66	4,025.33	5,350.99	751.85	69.06	4,530.08
Chennai	1,525.55	68.70	1,594.25	258.39	19.13	1,316.73

The position in respect of Calcutta could not be ascertained since the records of the TRO disclosed combined figures of demand outstanding against film personalities, Doctors and Hundi Groups.

(c) As an illustrative case, the number of cases referred to the TRO during 1992-93 to 1997-98 in Tamil Nadu charge were analysed in Audit as below:

Year	Cases referred to T.R.O.		Tax Collected by TRO	Tax Reduced	Total Tax collected/ reduced	
	No. of cases	Rs. in lakh	Rs. in lakh	Rs. in lakh	No. of cases	Rs. in lakh
1992-93	18	113.47	17.64	35.03	17	52.67
1993-94	43	1588.32	52.93	25.06	12	77.99
1994-95	22	72.14	48.62	39.09	5	87.71
1995-96	5	83.39	31.59	5.53	6	37.12
1996-97	4	127.15	7.74	282.52	18	290.26
1997-98	3	68.70	19.13	258.39	10	277.52

The percentage of tax revenue collected by the Tax Recovery Officer worked out to 8.3% as compared to the total demand for tax recovery. The percentage of tax reduction due to reliefs allowed by appellate authorities, etc., worked out to 30.17 which was very high as compared to tax recovery.

Lack of correlation between number of film personalities and those actually assessed

3.3.10 In West Bengal, the number of film assessees as supplied by the Income Tax Department do not tally with the number of film personalities collected by audit from the Central Board of Film Certification and also obtained from the Cultural Directory.

The intention behind the creation of film circle was for proper cross linking of receipts and payments between film personalities. As a natural corollary of this, the Income Tax Department should have analysed the figures of film personalities available with other organisations, Cultural Directories etc. so as to ensure that all film related personalities had filed their returns. Audit scrutiny in Calcutta and Mumbai revealed that no such efforts had been made. It was revealed that in West Bengal the number of film assessees as supplied by Income Tax Department did not tally with the number collected by Audit from Central Board of Film Certification and Cultural Directory as cited below:

As per Income Tax Department in Calcutta the number of film makers, producers, distributors and artists as on 31.3.1997 was 199 whereas the number of film related personalities, category-wise as on 31.3.97 as obtained from the CBFC and the Cultural Directory for Calcutta were as under:

Film Producers		235
Film Distributors		410
Film Makers		450
Feature Films	259	
Short Films & Documentation	121	
T.V. Serials	70	
Artists (Acting in Feature Films, Short Films, Documentaries and Serials)		856
Total		**1,951**

In Mumbai a privately published film directory lists 7,890 film personalities whereas the department had received only 4,834 returns of income during the financial year 1996-97. The department appears to have made no efforts to reconcile the figures and to ensure that film related personalities file their return.

3.3.11(a) Disposal of work load

Film Circles no longer Exclusive Film Circles

In Mumbai despite the creation of film circle, the assessing officers are also burdened with assessments relating to non-film personalities and the trend over the five year period is as shown in the table below:-

Financial year	Cases assessed	Other than film personality cases	Percentage
1992-93	171	36	21
1993-94	351	41	11
1994-95	302	49	16
1995-96	337	60	18
1996-97	481	58	12

This was also substantiated by the fact that in quite a number of cases, the assessments of the film personalities are being assessed in non-film circle/wards. As the intention of the film circle was to correlate and cross examine information pertaining to assessments between film personalities, the efficacy of the film circles could not be realised to the full extent.

(b) Increase in Pendency of cases

Financial year	Assessment for disposal	Assessment completed	Assessment pending	Percentage of pendency
1992-93				
Mumbai	3,022	2,230	792	26
Chennai	1,406	1,291	115	8
Calcutta	1,114	966	148	13
1993-94				
Mumbai	4,878	3,910	968	20
Chennai	1,578	1,468	110	7
Calcutta	1,288	1,050	238	19
1994-95				
Mumbai	4,433	3,594	839	19
Chennai	1,385	1,249	136	10
Calcutta	1,301	855	446	34
1995-96				
Mumbai	5,212	4,123	1,089	21
Chennai	1,473	1,223	250	17
Calcutta	1,626	1,214	412	25
1996-97				
Mumbai	4,830	3,406	1,424	29
Chennai	1,561	1,517	44	3
Calcutta	1,570	1,056	514	33

The number of assessments pending by end of each year had tended to increase in absolute terms and the percentage of pendency of average remained at 22 in Mumbai, 9 in Chennai and 25 in Calcutta. The department had not devised suitable strategies to ensure liquidation of pending cases. In Calcutta, it was seen that the percentages of pendency had gone up from 13 in 1992-93 to 33 in 1996-97. The reason for this increase in percentage could also be attributed to assessment of non-film assessees like investment companies, jute companies, nursing homes, doctors etc.

No system to monitor abandoned films

3.3.12 When a producer starts a film and leaves it half way, the entire expenditure would be written off as capital loss. The payments made to the artistes in the case of abandoned films whether taxed or not should be ascertainable. The PAC also pointed out in their 175th Report 8th Lok Sabha-(1989-90) in para 1.8 that the producers who suffer losses due to abandoning of the film mid-way, may avail of the benefit of reducing their tax liability by getting their losses set off against their income. Test checks by Audit in Maharashtra and Tamil Nadu revealed that there was neither any proper system or methodology evolved as desired by the PAC nor were any records maintained to show the list of incomplete/abandoned films. Therefore, there is total absence of any administrative machinery to detect the leakage of revenue on this account.

Shortcomings in Assessment Procedure

3.3.13 Keeping in view the well known fact that cine artists, film producers and other connected with film industry spend lavishly on their living, travels, entertainment and enter into benami transactions to hide their income and assets, the Public Accounts Committee had laid stress on the need for strengthening the intelligence wing of the Department to collect necessary information on extravagant spending and underhand practices resorted to by the film personalities. As the percentage collection of revenue from film industry when compared to total direct taxes remained at a meagre figure, the shortcomings in the assessments of film related personalities were analysed. These are listed below:

(A) Lacuna in submission/monitoring of form 52A

Based on the recommendations of study group, the Central Board of Direct Taxes (CBDT) issued instructions in August 1986 prescribing the details which should be filed with the assessing authority in Form No.52A in accordance with the provision of section 285B of the Income Tax Act. Following defects are noticed in audit as to compliance with the stated provisions.

(i) No system to monitor filing of Form 52A.

Audit scrutiny in all the circles revealed that there was no system to monitor the filing of Form 52A. The department made no efforts to correlate and examine whether the requisite number of Forms 52A had indeed been filed. In the absence of a system, the department was not in a position to effectively utilise information needed for proper assessment. For instance, in Mumbai, the department failed to maintain the Register for Form 52A, for the years 1992-93 to 1994-95. As a result, the department was not able to enforce the provisions relating to section 285B in terms of PAC's recommendations in para 103 of 71st Report (1986-87) as also there was non-compliance of CBDT's instruction No.1727 {(F.No.298/3/85-IT (Inv. III)} that where form No.52A should have been filed by the film producers and has not been filed should be reviewed with a view to imposing penalties and launching prosecution under the provisions of Income Tax Act by field offices as could be illustrated below:

(a) In Karnataka (Bangalore), though 435 films were certified by CBFC during the period from 1.4.1992 to 31.3.1997 in respect of producers stationed in Bangalore, only 117 producers filed Form 52A. The department called for information in only 96 films certified by CBFC for release during April 1995 to March 1997 and took no action in other cases.

(b) Absence of monitoring mechanism was also found in Calcutta. The Income Tax Department had not made any attempts to call for information about films produced from Calcutta office of Central Board of Film Certification and Eastern India Motion Picture Association who maintain record of films. The number of films as certified by Calcutta Regional Office of the Central Board of Film Certification during the period 1992-93 to 1996-97 were as under:-

Category of films	1992-93	1993-94	1994-95	1995-96	1996-97
Feature films	55	65	46	36	48
Advertisement	14	28	27	28	11
Documentary	25	21	25	10	18
Trailer	46	06	09	03	16
Educational	14	03	11	02	03
Others	02	02	04	--	--
Total	**156**	**125**	**122**	**79**	**96**

(ii) Non filing of Form 52A

Despite the fact that number of Forms 52A due to be filed was not ascertainable in the absence of monitoring system, some test checks of enclosed statements with the return for the period from 1.4.92 to 31.3.97 revealed non-levy of minimum penalty of Rs.1215.45 lakh as illustrated below:

State	Films released	Form 52A not received	Penalty leviable (Rs. in lakh)
Maharashtra	1328	51	•
Uttar Pradesh	Not available	Nil	14.23
Karnataka	435	291	425.74
Kerala	Not available	51	82.84
Tamil Nadu	556	532	679.10
Andhra Pradesh	Not available	23	14.54

(iii) Late filing of Form 52A

Similarly, in Maharashtra, Karnataka, Andhra Pradesh and Kerala, audit scrutiny revealed 119 instances of belated submission of Form 52A. The minimum penalty leviable was Rs.32.81 lakh.

• Not ascertainable in the absence of date of submission

(Figures in Rupees in lakh)

State	Number of cases	Delays ranging (in days)		Penalty leviable
		From	To	
Maharashtra	**66**	**2**	**344**	**5.67**
Karnataka	**44**	**41**	**2461**	**21.18**
Andhra Pradesh	**6**	**3**	**1208**	**2.02**
Kerala	**3**	**164**	**2161**	**2.94**

(iv) Variations between expenditure as per Form 52A and Returns not analysed.

Test checks in Maharashtra, Andhra Pradesh, Karnataka revealed that in 32 cases, cost of production was shown in the return of income as Rs.2881.90 lakh and the cost of feature film according to 52A forms amounted to Rs.830.19 lakh only. Though the Form 52A shall not include expenditure below Rs.5000 in aggregate, the department have not attempted to analyse causes of wide variation in the figures mentioned above and as such the probability of exaggerated expenses of unrelated expenses cannot be ruled out.

3.3.14 Reasonableness of expenditure incurred by film producers

Based on the PAC's observations in para 1.15 of 175th Report that the Ministry would undertake a study to evolve certain norms for assessing officers to find out the reasonableness of the expenditure incurred by the film producers in the course of film production, the Ministry assured that steps have been taken to evolve a procedure to make the investigation of cases of film production more effective. It was seen that the NFDC was the only institution which issued the raw stock of films for producing films of all kinds. For this purpose, the film producers had to apply to NFDC in Form "N-A" and these applications contained information in regard to the artists, technicians and the laboratories where the film was proposed to be processed.

It was also decided that a copy of each of the forms filled by the film producers for release of raw stocks would be forwarded every quarter by the NFDC to the nominated officers of the Income Tax Department at Bombay, Calcutta, Madras and New Delhi. This procedure had come into force with effect from the quarter ending 31st December 1990. The information received from the NFDC was being transmitted to the concerned assessing officers so that the same can be utilised in the assessments of the producers and the cine artists. Despite the assurance given by the Ministry as mentioned above the legislation became ineffective in practice as it became evident from the following:

Audit scrutiny of information available in the department as well as in NFDC revealed that the issue of raw film stock to film producer had been discontinued since 1991. Since the raw film stock is now available from many sources in the country, the procedure evolved by the Ministry regarding submission of Form N-A had become redundant. The PAC's recommendations that the legislation should not remain in statute book only

was not attended to as no other alternative system was devised by the Ministry to guard the leakage of revenue.

Search and Seizure Cases

3.3.15 The investigation wing of the Income Tax Department conducts searches in the premises of Tax Evaders including film personalities and collects information relating to both movable and immovable assets possessed by them to find out the unaccounted money. Thereafter, the investigating officer prepares the appraisal report in respect of each raid and forwards the same together with seized documents and materials to the assessment wing of the department for framing the assessments after detailed scrutiny of seized materials and other records. The total number of search and seizures conducted and the value of assets seized in the country was compared with that in Mumbai during the years 1995-96 and 1996-97 as under:

Year	Total No. of Search and Seizure conducted	On film personalities	Value of assets seized (Rs.in crore)	Of film personalities (Rs. in crore)
1995-96	4612	1	458.14	0.23
1996-97	4299	17	405.63	1.59

In Chennai the position could not be ascertained in the absence of files.

In the light of the PAC's recommendations that the intelligence wing should be strengthened for collecting information on extravagant spending and underhand practices in film industry, the fact that only 18 searches took place in Mumbai during 1995-96 and 1996-97 and that value of assets of Rs.1.82 crore was seized in respect of film personalities out of 8911 searches and value of assets of Rs.863.77 crore seized in the country is a pointer that more attention needs to be paid to the PAC's recommendation.

Non examination of investigation points in the Appraisal Report

(A) The Appraisal Report which is prepared by the Investigation Wing contains general lines of Investigation which the assessing officer should take into consideration and is meant to assist him. The assessing officer may differ with the views expressed in the appraisal report based on his examination of facts but he should record evidence of his having examined issues raised in the Appraisal Report. Audit examination of the 18 assessment records in Mumbai revealed a large number of points which the Assessing Officer had failed to examine while completing the assessment. While it would not be proper for Audit to compute a tax effect for these omissions, it is obvious that inadequate attention is being paid by assessing officers to issues raised in the Appraisal Reports. Several instances in the case of 4 assessees are cited below as illustrative:

(i) Actor 'A' (Individual): CIT Central II:

(a) Assessee received more remuneration in 15-20 days from foreign country than for 1 to 2 years work done in India and claimed 80 RR deduction. Eligibility of this deduction and how income was earned was not examined.

(b) The issue of the assessee acting in a film without consideration was not examined.

(c) Source of income for investment in an apartment in Mumbai not probed.

(d) Actual value of a Pajero Car (shown as Rs.6,00,000) in lieu of remuneration not scrutinised.

(ii) Producer 'A' (Individual): Central II ACCC 23

(a) Payments made in cash amounting to Rs.10,85,500 was inadmissible under section 40A(3).

(b) Payments made to various persons amounting to Rs.5,19,944 were not verified.

(c) Source of income for investment in jewellery amounting to Rs.25.62 lakh not examined.

(iii) Company 'A' : Central II

ACCC 23

(a) Source of investment of fixed deposit of Rs.1,71,91,702 found in possession of assessee not examined.

(b) Payments made to artists by assessee as per books of account of assessee with artists account not verified.

(c) Nature of expenses on a film amounting to Rs.10.75 lakh not entered in books of account not verified.

(d) Transaction in which only Rs.22.99 lakh was received by assessee as against Rs.81 lakh receivable has not been examined.

(e) Shooting expenses of Rs.24,77,098 and party expenses of Rs.3,05,206 not scrutinised.

(iv) Actress 'A' (Individual) OSD I

(a) Amount of Rs.2.32 crores which the assessee had invested in money market was required to be scrutinised as unexplained investment which however was not done.

(b) Assessing officer overlooked examining investment made in plot at Lohegaon.

Incorrect amortisation of cost of production

3.3.16(A) Rules 9A and 9B of the income tax Rules 1962, as amended from 1 April 1989 provide for deduction in respect of cost of production of a feature film and cost of acquisition of distribution rights of feature film from the profit and gain of business of the producers and distributors respectively.

The main conditions mentioned therein are as under:-

i) Expenditure on positive print and advertisement incurred after certification of release will not be included in cost of production.

ii) Subsidy received from Govt. will not be included in cost of production.

iii) If the producer sells all rights of exhibition of the films during the previous year, the entire cost of production to be allowed as deduction.

iv) If released for 180 days or more, entire cost allowed as deduction, if less than 180 days, expenditure is to be allowed to the extent of amount realised and balance to be carried forward to next year in order to allow entire cost as deduction.

(B) Audit scrutiny of 37 cases in Maharashtra, Tamil Nadu, Karnataka, West Bengal and Orissa revealed that non adherence to the above mentioned provisions of Rules 9A and 9B led to escapement of income involving tax effect of Rs.194.73 lakh (including potential tax of Rs.50.07 lakh). Three illustrative cases are given below:

(i) In Maharashtra, audit scrutiny of 64 cases of producers and 59 cases of distributors, revealed that department had not obtained any information from assessees regarding the date of release of the films i.e., whether released on commercial basis, for more than 180 days or less. It was also noticed that while allowing deduction in respect of producers cases, department had not taken cognizance of the balance of cost of production. Irregularities noticed during the audit in 11 cases of the above involved short levy of tax of Rs.66.06 lakh (including potential tax effect of Rs.46.86 lakh)

(ii) In Tamil Nadu, Chennai, scrutiny of assessment records of 4 film producers and 2 distributors revealed underassessment of income of Rs.121.10 lakh and Rs.61.05 lakh involving Tax Effect of Rs.51.74 lakh and Rs.34.43 lakh.

(iii) Similarly in Karnataka, in 16 cases subsidies amounting to Rs.59.50 lakh received from Government of Karnataka during the period from 1992-93 to 1994-95 were not considered either by the assessee or by the assessing officer while computing the profits and gains of the business of production of feature films. This resulted in short computation of income by Rs.59.50 lakh and consequent short levy of tax of Rs.31.17 lakh.

Moreover, in 112 cases producers of regional language films did not file the return of income even though they received subsidy amounting to Rs.406.00 lakh from the Government during the period from 1992-93 to 1994-95.

Non maintenance of books of accounts

3.3.17 As per Rule 6F of Income Tax Rule 1962 read with section 44AA(3) of the I.T. Act, 1961 every film artist shall keep and maintain the books of accounts and other documents specified in sub-rule (2). Film artist means any person engaged in his professional capacity in the production of a cinematograph film produced by him or any other person as (1) an actor (2) a director including assistant director and other film personnel whose income exceeds Rs. Sixty thousand. Omission to comply with the provision of section 44AA attracts levy of penalty under section 271 A under which penalty leviable shall not be less than Rs.2,000/- which may extend upto Rs. 1 lakh. The following cases illustrate non-application of this provision by assessing officers.

(i) In Karnataka, in 3 cases involving 6 assessments during assessment years 1992-93 to 1996-97, the assessees did not maintain accounts. The department did not initiate the proceedings for levy of penalty amounting to Rs.1.20 lakh in these cases.

(ii) In Tamil Nadu, the assessing officer estimated the income of 2 assessees on percentage basis in the absence of books of accounts. The assessing officers had not initiated any action to levy penalty under section 271A for the failure of maintenance of books of accounts and also not recorded any reasons therefor.

Omission to levy penalty for non submission of Audit Report

3.3.18 The Income Tax Act, 1961, as amended from assessment year 1985-86 and onwards has made it obligatory for every assessee whose total sales turnover or gross receipts in business exceeds forty lakh rupees in any previous year to get his accounts audited by an authorised accountant before the specified due date for submission of return of income and obtain the report of such auditor within the due dates. Non observance of the above provisions renders the assessee liable to penalty equivalent to one half percent of the turnover or one lakh rupees, which ever is lower as per section 271B.

In Mumbai, audit scrutiny revealed that in 3 cases assessees had not submitted Audit Report even though their turnover exceeded Rs.40 lakhs. The department did not initiate penalty proceedings which amounted to Rs.0.65 lakh during assessment years 1993-94, 1995-96 and 1996-97.

Failure to deduct tax at source under section 194 J & 194C

3.3.19(A) As per provision of the section 194J introduced with effect from 1 July, 1995 any person not being individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of fees for professional services or fees for technical services shall at the time of credit of such sums to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode is required to deduct an amount equal to 5 percent of such sum as income tax on income comprised therein if the aggregate of the amounts exceed twenty thousand rupees.

As notified under section 44AA film artists, cameraman, technician etc. fall under the ambit of professional services and hence covered under provision of section 194J.

Audit scrutiny in Mumbai, Chennai, Calcutta, Karnataka and Kerala revealed 63 instances where tax had not been deducted at source though provisions of section 194J were attracted. The amount of TDS not deducted amounted to Rs. 42.84 lakh and the penalty leviable under section 271C was Rs.21.14 lakh. The illustrative examples are given below:

(i) Audit scrutiny in Mumbai of records of 64 producers revealed that in 31 cases payment exceeding Rs.20,000 in aggregate had been made to various artistes, technicians but no T.D.S. had been deducted. Total amount of T.D.S. not deducted was Rs.16.10 lakh and penalty under section 271 C leviable was Rs.16.10 lakh

(ii) In Chennai omission to recover tax at source from professional fees payments made to film personalities as per the provisions of section 194J was noticed in four cases amounting to Rs.58.13 lakh. The penalty leviable under section 271C and interest payable under section 201 (1A) of the Income Tax Act amounting to Rs.3.07 lakh in those cases were not levied.

(B) As per section 194C any person responsible for payment of any sum to any resident for any work in pursuance of a contract between the contractor and central government or any State Government etc. shall at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode deduct the amount equal to

i) One percent in case of advertisement

ii) Two percent in other cases.

As per explanation III thereto: Expression "works" shall include a) Advertising b) Broad-casting and Telecasting including production of programmes for such broadcasting and telecasting etc.
Audit scrutiny of 4 cases in Mumbai during assessment years 1993-94 to 1996-97 revealed that the assessees had received royalties for telecasting T.V. Serials, Songs etc. but no tax was deducted at source. The T.D.S. not deducted amounted Rs.6.08 lakh and penalty under section 271C leviable was Rs.6.08 lakh.

Non-verification of Royalty payment from TV Channels to Film Personnel leads to Tax Leakages

3.3.20 The producers/distributors who hold rights of telecasting films, producers of TV Serials, documentary films and teleplays receive Royalty from TV Channels for telecast of their films/works. Cross referencing of such payments with the tax returns of the recipients would be an ideal way of broadening the tax base as well as ensuring that there is no leakage of Tax revenues. However, audit scrutiny in Chennai, Mumbai, Orissa, Karnataka revealed that the department did not have any system to ascertain payments

made by TV Channels to producers/distributors. Some instances listed below reveal inadequate/no action taken by the department:

(i) In Karnataka, Doordarshan Kendra, Bangalore had made payments of royalties to 259 producers/distributors during the period 1992-93 to 1995-96. Audit scrutiny revealed that out of these, as may as 211 producers/distributors did not file their returns of income during these years despite receiving Rs.325.03 lakh from Doordarshan Kendra, Bangalore. There was no evidence of any action being taken by the assessing officers in this regard. Similarly, 12 assessees (out of 211) who had filed returns had omitted to include royalties amounting to Rs.25.79 lakh received by them leading to short levy of tax of Rs.12.58 lakh for assessment years 1993-94 to 1996-97.

(ii) Similarly, in Karnataka, NFDC Ltd. paid Royalty aggregating Rs.34.13 lakh to 13 distributors for telecasting Kannada Films on Doordarshan Kendra Bangalore during 1995-96. The recipients did not however, file any return nor did the department take any action to call for the same. Similarly inaction on the part of the department was noticed in the case of 58 producers/distributors who were paid Rs.113.33 lakh by Karnataka Film Industries Development Corporation during the period 1991-92 to 1995-96 but who failed to file their returns.

(iii) In Tamil Nadu (Chennai) charge, only one assessment file of a producer out of forty assessment files of producers/distributors who had received payment from Doordarshan Kendra/NFDC was given to Audit. Even this file revealed that a total sum of Rs.109.72 lakh received as royalty from Doordarshan for the period 1992-93 to 1995-96 was not shown in its return leading to short computation of tax by Rs.54.86 lakh.

(iv) In Mumbai, audit scrutiny of details submitted by Zee TV revealed that in 30 cases, the recipients had not accounted for an amount of Rs.85.76 lakh with a tax effect of Rs.44.74 lakh. There was no evidence that the assessing officers had made attempts to correlate the payments with the tax returns of the recipients so as to correctly compute their incomes.

(v) In Orissa charge, it was revealed in audit that though royalty was paid in 76 cases by Doordarshan Kendra, Bhubaneswar, neither they filed any return on TDS deduction nor did the department pursue it.

Non accountal of other incomes by film personalities

3.3.21 In West Bengal charge, audit scrutiny of 7 film related personalities who also did modelling assignments revealed that in three cases income from modelling was declared by the assessee. But in the other cases the amount received from such professional income was not specifically mentioned by the assessee. The Income Tax Department had neither made any attempt to collect any information regarding the income of the assessees from modelling (although these advertisements are widely shown on television or appear in newspapers/magazines), nor have they directed the assessees to disclose the same as in most of the cases the assessments are processed in a summary manner under section 143(1)(a).

Effects of summary assessments of film personalities

3.3.22 The Public Accounts Committee in their 71st Report (1986) had recommended (Para 109) that some positive measures had to be taken to critically analyse the returns of income filed by the film personalities to obviate the possibility of understatement of income. Under the summary assessment the assessing officer is empowered to only make prima facie adjustments apparent from the assessment return. Since only 4 percent or so of the returns are selected for scrutiny, adherence to the norms for selection of the cases for scrutiny would not be in conformity to the recommendations of the Public Accounts Committee.

(a) Audit scrutiny of film circles at Chennai revealed that only 550 cases (8.04%) were taken up for scrutiny out of 6839 cases including the pending cases of earlier years processed under section 143(1)(a) for the past five years i.e. from 1992-93 to 1996-97.

Consequently, routine checks and other checks as detailed below could not be adequately enforced:

(i) Scrutiny of Form 52A statements and comparison of payments noted therein with the returns of income

(ii) Proper applications of provisions of Rules 9A and 9B.

(iii) Proper allowance of deductions under section 80RR of Income Tax Act.

(iv) Fact of returning of advances received by the artistes in their returns of income (which were noted only in the cash flow statement and not included in the total receipts for which no breakup was furnished by the artistes)

(v) Verification of fact of inclusion of receipts shown in the Tax Deduction at Source (TDS) certificates and other receipt of income (i.e. from Television, All India Radio and Modelling etc.) in the total income.

(vi) Verification of omissions in returning/short returning of House property income/long term capital gain.

(vii) Correctness of deduction such as depreciation etc., allowed.

(viii) Comparison of wealth returned with the details in the Income Tax Returns and

(ix) Verification of genuineness of adoption of deferred annuity scheme by the Film personalities.

Non examination of the above issues owing to the fact that such assessments had been completed in a summary manner scheme had resulted in income

escaping assessment to the extent of Rs.99.41 lakh involving a tax effect of Rs.49.70 lakh.

The above audit findings reveal that the Department should consider assessing returns after scrutiny so as to critically analyse the returns as per the recommendations of PAC.

Excess allowance of depreciation

3.3.23 Audit scrutiny of 7 assessments of film personalities in Calcutta and Mumbai for assessment years 1992-93 to 1996-97 revealed excess allowance of depreciation involving a tax effect of Rs.16.83 lakh.

Irregular Tax credit given

3.3.24 In Uttar Pradesh, the assessment of an individual assessee for the assessment year 1994-95 was completed after scrutiny in September 1996. Audit scrutiny revealed that TDS credit of Rs.34,944 (Deducted by Doordarshan Kendra, Lucknow from the payment of Rs.15.60 lakh made to the assessee during March 94) was allowed to the assessee in the assessment year 1994-95, whereas the payment of Rs.15.60 lakh was not shown by the assessee as Income in profit and loss account. As such the Income of assessee was short computed by Rs.15.43 lakh (after reducing expenses claimed) which resulted in short charge of tax Rs.13.13 lakh (including interest).

Incorrect computation of business income

3.3.25 Under the Income Tax Act, 1961 any expenditure not being expenditure of a capital nature or personal expenses of the assessee laid out or expended wholly or exclusively for the purpose of business is allowable as deduction in computing the income chargeable under the head "profit and gains of business or profession". As per judicial decision* it is held that loss suffered by the assessee in acquiring distribution right is not allowable as deduction.

Audit scrutiny of assessments of film personalities including producers, distributors in Mumbai revealed mistakes in computation of business income in 24 cases involving short levy of Tax Rs.164.56 lakh. Three instances are cited below.

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* CIT Vs Sembi Traders (1996) 221 ITR 410/89 (Taxman 21) Madras

Sl. No.	Assessee	Ward CIT City I	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
(i).	Distributor Producer	DCSR 21	1994-95 31.12.96	143(3)	Expense of film distribution of Rs.21 lakh claimed as loss in respect of advance given to producer before releasing the film and also expenses of Rs. 9 lakh incurred by distributor on behalf of the assessee. Total Rs.30 lakh.	12.00
(ii).	Individual Distributor	-do-	1993-94 15.3.94	143(i)(a)	Assessee has sold right of film and written off Rs.29,89,265/- as amount not recoverable. As assessee had to receive this amount in near future as per agreement, the reasons for writing off not given. This amount had also not been accounted for as debt in debtor lists.	16.05
(iii)	Registered Firm	-do-	1994-95 30.5.95	143(3)	Amount of Rs.13 lakh received from Directorate of Adult Education Department Delhi, not accounted for.	7.45

Incorrect set off and carry forward of losses

3.3.26 Audit scrutiny in 5 cases in Mumbai and Calcutta revealed that the assessing officers while adjusting the past losses had not taken into consideration the losses already adjusted. The mistakes resulted in short levy of tax of Rs.17.17 lakh.

Short levy of interest for short payment/non payment of advance tax

3.3.27 In respect of a registered firm in Mumbai, the assessment for assessment year 1989-90 was completed on best judgement basis under section 147 of I.T. Act in December 1996. Audit scrutiny revealed that interest under section 234 B was levied upto the date of assessment completed under section 143(3). The assessment was reopened under section 147 & 148, but interest under section 234B was not levied upto the date of assessment completed under section 147 as required in such cases. Failure to do so resulted in short levy of tax of Rs.16.52 lakh.

Incorrect deduction in respect of profits from new industrial undertakings established after 31 March 1981; incorrect computation of profit section 80I/80IA

3.3.28 Under the Income Tax Act, 1961 where the gross total income of an assessee includes any profits and gain derived from newly established industrial undertaking which goes into production after 31 March 1981 the assessee is entitled to a deduction of twenty five percent of such profit provided the industrial undertaking does not manufacture or produce any article or things specified in the eleventh schedule.

As per Central Excise Act "manufacture" includes any process incidental or ancillary to the completion of a manufactured product. A film produced by a producer is not a good/product manufactured by industrial undertaking. The deduction under section 80I/80IA is thus not applicable for film producer.

In Mumbai, audit scrutiny in respect of 3 cases revealed that the assessees have been allowed 80I/80IA deduction in respect of profit derived by them from production of film. Short levy of tax involved is Rs.302.21 lakh during the assessment year 1994-95 to 1996-97.

Irregular deduction under section 80 RR

3.3.29 As per section 80RR of Income Tax Act where gross total income of a resident artist includes any income derived by him in exercise of his profession from the Government of a foreign state or any person not resident in India, there shall be allowed in computing the total income of the individual a deduction from such income of an amount equal to fifty percent of professional income or seventy five percent of such professional income as is brought into India by or on behalf of the assessee in accordance with the Foreign Exchange Regulation Act, 1973 and rules made there under which ever is higher. The resident status of a person is to be determined as per section 6 of IT Act. The deduction under chapter VIA are allowable only on net income computed under the provision of the act.

In Mumbai, during test check of cases of 91 film artists in audit it was noticed in 33 cases that the deduction under section 80 RR amounting to the Rs.414.57 lakh was allowed without scrutinising following points:

(i) In all the cases department had not verified the resident status of the organiser whether or not he was resident in India.

(ii) In all the cases date of show/place of show was not verified. In very few scrutiny cases, passport of the artists was verified for examining whether he/she travelled abroad.

(iii) In 1 case deduction was allowed in respect of a show held in India, leading to short levy of Income Tax of Rs.0.75 lakh.

(iv) Deduction in respect of 5 cases was allowed without verifying the proof of payment received in foreign currency. Out of this in 2 cases assessment was done under scrutiny. The short levy of tax works out to Rs.33.40 lakh.

(v) In 28 cases deduction was allowed without deducting proportionate expenses under section 80AB.

Failure to scrutinise validity of LIC annuity scheme

3.3.30 In the film industry remuneration by way of LIC policy in favour of artists in lieu of lumpsum consideration is a common feature. By this means , the film artists can carry forward the tax liability as a debt on the condition that as and when the annuity installment falls due, the same would be treated as an income and clubbed with the assessee's other income for that year. In

order to check the exercise of this scheme Public Accounts Committee in their 177th report (83-84) had specifically recommended that department shall devise a suitable mechanism to monitor all such cases with due care.

In Mumbai, during audit of 91 cases of artists in respect of assessment completed during 1992-93 to 1996-97, in 10 cases assessees had received payments in the form of LIC annuity scheme. The department had neither maintained any register nor evolved any other mechanism to monitor the progress of annuity falling due, whether the concerned assessee had offered income in the relevant assessment year or not. The total amount of policy received amounted to Rs.70.63 lakh and the exact amount of annuity falling due, if any was not ascertainable in the absence of data.

Failure to file wealth tax return

3.3.31 Audit scrutiny of assessment records in Mumbai, Chennai and Kerala revealed 15 cases of failure of the assessees in filing their return of wealth. The department's failure to look into this aspect was also revealed during audit scrutiny. The non recovery of Wealth Tax amounted to Rs.6.08 lakh in 7 cases of Mumbai alone.

Conclusion

3.3.32 The review revealed that the objective of bringing about improvement in the quality of assessment through better co-ordination of the accounts of the producers/distributors, film artists is yet to be achieved. Though special procedures were laid down on the basis of the recommendations of the Public Accounts Committee, the CBDT do not appear to have taken serious action in regard to their due compliance and Action Taken Notes. As such, the recommendations remained on paper only. The investigation wing also does not appear to have effectively contributed to unearthing concealed wealth in the film industry. The PAC had criticised meagre percentage of revenue collection of 0.31 percent when compared to total revenue from direct taxes during 1984-85 though the turn over of film industry in India is fairly high. The same remained at o.35 percent in 1996-97 also.

The department has failed to develop a database about the film personnel engaged in various activities such as acting in TV serials, advertisements, drama eventhough there are sufficient non government sources available to make this possible. As such no attempts were made to club income of the assessees derived from different sources. The Income Tax Department also had not evolved any system to verify and co-relate the records of different assessees with a view to broadening the tax base and ensuring correct assessments of income.

B-Audit of Notifications/Circulars

3.4 Procedure for refund of TDS under Section 195 of the Income Tax Act-Powers of Central Board of Direct Taxes

Law and procedure

3.4.1(i) Under Section 119 of the Income Tax Act, the Board may issue, from time to time, such orders, instructions and directions to other income tax authorities as it may deem fit for the proper administration of Income Tax Act. Such action of the Board, however, should not interfere with the discretion of the Dy. Commissioner (Appeals)/Commissioner (Appeals) in the exercise of their appellate functions and also should not be in the nature which may require any income tax authority to make a particular assessment or to dispose of a particular case in a particular manner. To avoid genuine hardship in any case or class of cases if the Board considers it desirable or expedient so to do it may, by general or special order, authorise any income tax authority other than Dy. Commissioner (Appeals) / Commissioner (Appeals) to admit an application or claim for any exemption, deduction, refund or any other relief under the Income Tax Act after the expiry of the period specified or under the Act for making such application or claim and deal with the same on merits in accordance with law.

(ii) Under Section 195 of the Act, any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest on securities) or any sum chargeable under the provisions of Income Tax Act (not being income chargeable under the head salaries) shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, which ever is earlier, deduct income tax thereon at the rates inforce.

Judicial pronouncements

3.4.2. Various judicial pronouncements* of High Courts and Supreme Court of India have held that while a circular issued by the Board would be binding on all officers and persons employed in the execution of the Act, no circular can go against the provisions of Income Tax Act,1961.

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* **(i)** State Bank of Travancore Vs CIT (1986) 185-ITR-102 (SC).
(ii) I.T.O.Vs A.V.Thomas & Co. (1986)-160-ITR-818(Ker).
(iii) CIT Vs Sahney Steel & Press Works Ltd. (1985)-152-ITR-39,63(AP).
(iv) Ram Co. Coke Industries Vs CST (1985)-Tax LR 2932(AII).
(vi) T.M. Mohan Vs Addl. Ag. ITO(1987)-168-ITR-270, 284(Mad).
(v) Aphali Pharmaceuticals Ltd. Vs State of Maharashtra AIR 1989 SC 2227,2240.
(vi) Park view Enterprises Vs State Govt. of Tamil Nadu (1991) 189-ITR-192, 256 (Mad).

Also, while the Board can relax the rigour of the law or grant relief which is not to be found in the terms of the Statute, such circular making for a just and fair administration of the law, no instruction contrary to the provisions of the statute could be issued[**] .

Further, executive instructions can supplement a statute or cover areas to which the statute does not extend. But they cannot run contrary to statutory provisions or whittle down their effect[***]

Background

3.4.3(1) Under the Income Tax Act, a refund could be issued only if a valid return claiming the refund was filed. The assessing officers are not empowered to refund the tax deducted at source to the person who has deducted it. Even adjustment of the excess tax or tax erroneously deducted under Section 195 is not allowed.

The Board had received representations suggesting that either the law should be amended to enable the assessing officers to refund or adjust the excess amount or some guidelines be issued by the Board to the assessing officers to issue refund in the circumstances where

(i) after the deposit of tax deducted at source under Section 195,

(a) the contract is cancelled and no remittance is required to be made to the foreign collaborator;

(b) the remittance is duly made to the foreign collaborator, but the contract is cancelled and the foreign collaborator returns the remitted amount to the person responsible for deducting tax at source,

(c) the tax deducted at source is found to be in excess of tax deductible for any other reason,

(ii) the tax is deducted at source under Section 195 and paid in one assessment year and remittance to the foreign collaborator is made and or/returned to the Indian Company following cancellation of the contract in another assessment year.

(II) The Board in its meeting held on 20.11.97 decided that in view of Section 248 of Income Tax Act a person who denies his liability to deduct tax on remittance to foreigner could file an appeal under that Section. However, in Board's meeting held on 16.3.98 it was decided that a circular might be issued so as to cover cases under Section 195 for refund of the excess payment of TDS in the circumstances enumerated in the brief.

** CIT Vs Malayala Manorama & Co.Ltd. (1983)143-ITR-2938(Ker).
*** State of Madhya Pradesh Vs G.S.Dall & Flour Mills,(1991) 187-ITR-478,499(SC).

In view of this decision, circular No.769 dated 6.8.98 was issued enumerating, inter alia, the above circumstances and present position in the statute that a refund may be made independent of the provisions of Income Tax Act,1961 to the person responsible for deducting the tax at source from payments to the non-resident after taking the prior approval of the CCIT concerned.

Audit view

3.4.4 The powers under Section 119 of Income Tax Act, as mentioned above do not allow the Board to issue directions to assessing officers to issue/grant refund independent of the provisions of Income Tax Act. Judicial decisions including that of Supreme Court as aforesaid have decided that no circular can go against the provisions of Act and no executive instruction can be issued so as to restrict the operation of the statutory rules. As such Central Board of Direct Taxes circular No.769 dated 6.8.98 is neither in accordance with provisions of the Act nor is in conformity with judicial pronouncements. The circular needs to be withdrawn.

Impact of the circular

3.4.5 The question of financial benefits derived by assessees on the basis of this circular could not be readily quantified. The issuance of this circular constitutes an interference in the functioning of assessing officers.

The audit observation has not been accepted by the Ministry of Finance on the grounds that (i) the excess/erroneous TDS made cannot be said to be tax paid under Income Tax Act where TDS is in respect of a sum which is not taxable at all under Income Tax Act, (ii) the use of the phrase " independent of the provisions of the Income Tax Act" does not ipso facto mean that the provisions of the Income Tax Act are totally disregarded but would only envisage that such a refund would be issued independent of the normal procedure, (iii) the Board is empowered to issue circulars under the provisions of section 119(1) of the Income Tax Act for proper administration of the Act and to mitigate the genuine hardships of the assessees as narrated in the circular. Filing of returns by non residents (who have no office in India and do not have any subsequent dealing with Income Tax Department in India) for obtaining refunds thereafter takes considerable time and is a cumbersome process. Moreover, the type of cases covered by the circular are those where the tax liability is paid by the Indian enterprise and the tax is to be refunded to the Indian enterprise and not the non resident on whose behalf such tax was deducted and (iv) the circular neither in any way run against the provisions of the Income Tax Act nor does it interfere with the judicial discretion of assessing officer. It only simplifies the procedure for grant of refunds on account of excess TDS that is not legitimately due to the Government and for adequate safeguards can be made only with the approval of concerned Chief Commissioner of Income Tax.

The Ministry's contention are not acceptable for the following reasons:

(i) All refunds, whether excess or erroneous are in respect of taxes leviable under Income Tax Act. The Act, prescribes a specific procedure for claim of refunds from concerned assessing officers in respect of erroneous or irregular tax deductions who are required to exercise discretion taking into account the overall tax liability by the assessee. In this background there can be no refund effected without authority of law. As such refund of TDS or other taxes effected in pursuance of legal provisions can be granted only under/within the statutory frame work and not independent of the provisions of the Act.

(ii) Though the Board has been empowered under section 119(1) of the Act to issue directions in the interest of proper and efficient management of the work of assessment and collection of revenue and to relax provisions in respect of special category of cases only, remedies within the statutory frame work and not independent of the provisions of the Act are envisaged.

The other argument that the impugned circular attempts to simplify the cumbersome procedure for grant of refunds in certain categories of cases is not convincing as each case will now require clearance of Chief Commissioner of Income Tax as opposed to independent discretion exercised by the assessing officer in the grant of refunds against overall tax dues or liability of the assessee.

(iii) Though the procedure laid down in the circular circumvents the normal statutory provisions, it lacks appropriate legislative sanction.

3.5 Powers of Central Board of Direct Taxes to issue instructions to its subordinate authorities

Introduction

3.5.1(i) Under section 119(2)(a) of Income Tax Act, 1961 Central Board of Direct Taxes may, if it considers it necessary or expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue, issue, from time to time (whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147, 148, 154, subsection (1A) of the section 201, section 210, 211, [234A,234B,234C][@], 271 and 273 or otherwise, general or special orders in respect of any class of incomes or class of cases, setting forth directions and instructions (not being prejudicial to assessees) as to the guidelines, principles or procedures to be followed by other income tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties and any such order may, if the Board is of the opinion that it is necessary in the public interest so to do be, published and circulated in the prescribed manner for general information.

(ii) The Direct Tax Laws (Amendment) Act, 1987 made it mandatory to levy interest for default in furnishing return of income, for default in payment of advance tax and for deferment of advance tax by insertion of section 234A, 234B and 234C respectively in the Income Tax Act, 1961 with effect from 1.4.1989.

Judicial Pronouncement

3.5.2 The Supreme Court of India[*] has held that a circular issued by the Central Board of Direct Taxes would be binding on all officers and persons employed in the execution of the tax but no instruction or circular can go against the provisions of the Act. The Kerala High Court[**] decided that while the Board can relax the rigours of the law or grant relief which is not to be found in the terms of the statute, such circular making for a just and fair administration of law, no instruction which is ultra vires of the provisions of the statute could be issued.

[@] Sections 234A and 234B were inserted by Finance Act,1990 with effect from 1.4.1990 and section 234C by the Finance (No.2) Act, 1991 with effect from 1.4.1991.

[*] State Bank of Travancore Vs CIT (158-ITR-102)

[**] CIT Vs Malayala Manorama & Co. Ltd. (143-ITR-29,38)

Background

3.5.3 The Central Board of Direct Taxes issued instructions under section 119(2)(a) of the Income Tax Act, 1961 vide F.No.400/234/95-IT(B) dated 23.5.1996 to the effect that the CCIT and DGIT may reduce or waive interest charged under section 234A or section 234B or section 234C of the Act in certain classes of cases or classes of income specified for the period and to the extent the CCIT/DGIT deem fit. These mainly relate to circumstances such as inability to file return due to seizure of books, due to proceedings under section 132, non payment of advance tax, due to seizure of cash, income which accrues or arises to an assessee (other than Capital Gains) after the first or subsequent instalments etc. As per this circular the CCIT/DGIT could reduce or waive the interest with reference to assessment year 1989-90 and onwards.

Audit view

3.5.4 The instructions issued by the Board under section 119(2)(a) of the Income Tax Act, 1961 vide F.No.400/234/95 IT(B) dated 23.5.1996 with effect from assessment year 1989-90 regarding reduction or waiver of interest levied under section 234A, 234B and 234C of the Income Tax Act, 1961 is not in accordance with powers of the Board. The powers of the Board to reduce or waive the interest were introduced with effect from 1.4.1990 through Finance Act, 1990 for section 234A and 234B and for section 234C with effect from 1.4.1991 through Direct Taxes (Amendment) Laws 1991. Thus the Board is not competent under section 119 to allow relief from assessment year 1989-90 since the powers to give such relief were bestowed by Parliament from subsequent dates. Had the intention of the Parliament been to give relief to the assessees from the retrospective effect (i.e. from the date of insertion of sections 234A, B&C in the Act), the inclusion of sections 234A, B and C would have been made with retrospective effect from that date i.e. 1.4.1989. The issuance of this circular needs to be reconsidered.

The audit observations have not been accepted by the Ministry of Finance on the grounds, interalia, that the amendment made in section 119 were procedural in nature which gave powers to the CBDT to issue instructions regarding waiver of interest in suitable cases. These powers came to be vested with effect from 1.4.1990. The provision bestowing such powers and the provision governing chargeability of interest are substantially different in nature. Once such powers are vested in any authority, the waiver could be for any year, be it for the year prior to or after the amendment. The stand taken by the CBDT is, therefore, in accordance with the principles of general law.

The reply of the Ministry of Finance is not tenable since the Supreme Court* has decided, interalia that no instruction or circular of the Central Board of Direct Taxes can go against the provisions of the Act.

Further, it is well settled that all statutes other than those which are merely declaratory or only relate to matter of procedure or of evidence are prospective and retrospective operation should not be given to a statute so as to affect, alter or destroy an existing right and create a new liability or obligation unless that effect can not be avoided without doing violence to the language of the enactment. Section 119(2) bestows authority to exercise limited discretion on waiver of interest in suitable cases/classes of assessees in respect of section 234A, 234B and 234C and these powers were vested with effect from 1.4.90/1.4.91. Far from being procedural, as contended by the Board, the provision allows dilution of existing law in certain situations of hardship to be identified by the Board which has the consequence of altering the existing obligations of assessees inter-se. Also the argument that Parliament intended unlimited waiver, is fraught with the danger of opening floodgates of appeal in respect of such cases where penalties had been imposed prior to the amendment of the statute with effect from 1.4.90/91 and overlooks the fact that all decided cases/assessed cases would be discriminated against as compared to other assessees who had appealed against. Alternatively, reopening of all assessments for fresh decision may become imminent under this interpretation. Such an interpretation, sweeping in intent, is not supported by the amended provision. Section 234A, B and C inserted by Direct Taxes Laws (Amendment) Act, 1987 were enacted with a specific purpose to impose mandatory levies for specific defaults and intended to take away the discretion vested with the assessing officers. The amended law with effect from 1.4.90 and 1.4.91 only recognised that the operation of existing amended statute may have resulted in extreme hardships and sought to reduce the gravity by empowering the Board under section 119(2) to pass specific orders to mitigate the distress. It could not be therefore, reasonably construed in the circumstances that Parliament intended to undo the amendment introduced with effect from 1.4.1989 without an express provision. Supreme Court of India in the case of State Bank of Travancore Vs CIT (158 ITR 102) held that circular issued by CBDT is binding on all officers and persons employed in execution of the tax but no instruction or circular can go against the provisions of the Act. Therefore, any executive order in pursuance of the enabling statute must also necessarily fall within the statutory limits.

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* State Bank of Travancore Vs CIT (158 ITR 102)

3.6 Improper exemption under section 10(23) of Income Tax Act, 1961 to Delhi Golf Club Ltd.

Introduction

3.6.1 Under section 10(23) of Income Tax Act, 1961 any income of an association or institution established in India which may be notified by the Central Government in the official Gazette having regard to the fact that the association or institution has as its object the control, supervision, regulation or encouragement in India of the games of cricket, hockey, football, tennis or such other games or sports as the Central Government may, by notification in the official Gazette, specify in this behalf shall be exempt from tax. However, the proviso provides that nothing contained in this clause shall apply in relation to any income of the association or institution, being profits and gains, unless the business is incidental to the attainment of its objectives and separate books of accounts are maintained by it in respect of such business. For notifying the association or institution under clause (23) of section 10 of Income Tax Act, 1961, the Central Government may call for such documents (including audited annual accounts) or information from the association or institution as it thinks necessary in order to satisfy itself about the genuineness of the activities of the association or institution and Government may make such enquiries as it may deem necessary in this behalf. The effect of such notification shall be for a year or years not exceeding three assessment years as specified in the notification.

Judicial Pronouncements

3.6.2 The Gujarat High Court has held* that the principles of mutuality should be confined to transactions with members only. The mutual and non-mutual activities can, in appropriate cases, be separated and the profits derived from non-members can be brought to tax.

Further Supreme Court of India decided** that excess over expenditure received by club from facilities extended to members as part of advantages attached to such membership is not taxable as income.

Background

3.6.3 Delhi Golf Club Ltd. is a company set up in 1949 and registered under section 25 of the Companies Act, 1956 for the promotion and encouragement

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* Sports Club of Gujarat Ltd. Vs CIT (171 ITR 504)

** CIT Vs Bankipura Club Ltd. (226 ITR 97)

of golf. Since golf was one of the specified sports as per notification No.2688 dated 16.10.1961, the club applied for exemption as per the then section 10(23) of Income Tax Act which was allowed vide CBDT letter No.37/10/66-IT(AI) dated 1.8.1968 with effect from 3.6.1967 with no time limit. No notification was issued at that time. The Act was amended with effect from 1.4.1990. In view of amended section 10(23) which provided that any notification issued by the Central Government under this clause, in relation to any association or institution, shall, at any one time have effect for such year or years, not exceeding 3 years, Delhi Golf Club Ltd. applied for renewal of exemption vide application dated 10.11.1990 in form No.55. The Chairman CBDT approved the exemption under section 10(23) on 30.4.1998 and a notification No.10584 (F.No.196/23/95-ITA I) dated 6.5.98 was issued exempting the income of this club for assessment years 1991-92 to 1993-94.

Audit scrutiny

3.6.4 Audit scrutiny of the records of the Delhi Golf Club Ltd. alongwith those of other entities revealed the following:

(i) Delhi Golf Club Ltd. has been given exemption under section 10(23) of the Act despite the fact that the application for exemption in case of Chandigarh Golf Club had been rejected by the CBDT on similar facts. The writ petition of the Chandigarh Golf Club in Punjab and Haryana High Court against this decision of CBDT is being contested by the Income Tax Department thereby strengthening the view that the notification in respect of Delhi Golf Club Ltd. was improper.

(ii) Perusal of the accounts of the club revealed that sales of wine and others provisions, rendering catering services, swimming pool, (excluding bridge room and video library which were not ascertainable) constituted about 72% of the total receipts for the years 1987-88 to 1991-92. As brought out by the Income Tax Department officers, provision of such facilities could be termed as the main activities of the club with playing golf only a secondary activity.

(iii) Past assessment history of the club revealed that the Delhi Golf Club Ltd. had been granted exemption under section 10(23) of the Income Tax Act, 1961 with effect from 3.6.1967 without any time limit vide CBDT letter No.37/10/66 IT(AI) dated 1.8.68.

(iv) Examination of the files revealed that the only return of income filed by the club was on 11.12. 1991 for assessment year 1991-92 (the last return filed was for assessment year 1976-77). Since notification No.10584 dated 6.5.98 exempting the income of the club was for assessment years 1991-92 to 1993-94 and accepting the assessee's plea that the earlier exemption vide letter dated 3.6.1967 was valid upto 31.3.89 i.e. assessment year 1989-90 the club was required to file a return for the assessment year 1990-91. Omission to enforce filing of return lead to revenue loss of Rs.82,94,029 (including interest). The tax

effect is computed only on casual membership fee based on judicial decisions that income from casual membership is not covered under mutuality concept and is not tax exempt. Income from beverage, provisions, catering service, swimming pool, bridge room, video library etc. from casual members could also be taxed but the tax effect of the same could not be computed since this information was not available.

Conclusion

3.6.5 The said notification exempting the income of Delhi Golf Club was irregular and improper. Had the legislative intention been to exempt the incomes of such sports clubs, other clubs like *Sports Club of Gujarat Ltd. National Sports Club of India which have as their main objects the promotion of sports would have also been eligible for such exemptions. The notification enabled the Delhi Golf Club to escape the rigours of a normal assessment process. Had the normal assessment process taken place, the income of casual and non members would have been taxed in accordance with the Supreme Court judgements.

The audit observation has not been accepted by the Ministry of Finance on the grounds that (i) no irregularity was committed by notifying the income of Delhi Golf Club as exempt during the pendency of the writ petition filed by the Chandigarh Golf Club since a review petition of the Chandigarh Golf Club had been filed with the CBDT and matter regarding the Chandigarh Golf Club was yet to reach finality when the notification of Delhi Golf Club was issued in May, 1998, (ii) the fact that sale of wine and other provisions constituted 72% of the total receipt cannot be a criteria for determining the primary nature of the Club since the membership fees is a paltry sum of Rs.40 per month or Rs.500 per annum for an outstation member. A member who pays less than Rs.100 per month on membership fees may spend several hundreds on wine, snacks and other facilities, (iii) the department is already seized of the matter regarding non-filing of the return for the assessment year 1990-91, (iv) the case of the Delhi Golf Club is different from others like Sports Club of Gujarat Ltd. and National Sports Club of India in the sense that Delhi Golf Club does not promote sports in general but promotes a notified game i.e. Golf and (v) the principles of mutuality and exemption under section 10(23) are mutually exclusive. Mutuality is not condition precedent for determining eligibility for exemption under section 10(23). The Delhi Golf Club is primarily and substantially devoted to the game of Golf.

The reply of the Ministry is not tenable due to the following reasons:

(i) The audit observation that notifying Delhi Golf Club under section 10(23) was irregular stands. Audit scrutiny of the relevant files of the Ministry and of the Chief Commissioner of Income Tax, Chandigarh clearly indicate that the

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* Sport Club of Gujarat Ltd. Vs CIT (171 ITR 504)

Ministry had contested the writ petition filed by Chandigarh Golf Club on 7 December 1992 against denial of exemption under section 10(23). The contention of the Ministry that the Chandigarh Golf Club had filed a review petition dated 4.4.1998 is not borne out from the notings (dated 27.4.1998) of Deputy Secretary who speaks of a suo moto review of the case of Chandigarh Golf Club and is silent on the so-called review petition.

(ii) The Ministry uses dual yardsticks to measures the primary nature of the activities of a Club. While in the case of Delhi Golf Club, the Ministry is of the view that the fact of sale of wine and other provisions constituting 72 percent of the total receipts cannot be a criteria for determining its primary nature, interestingly the CBDT took a stand in the case of Chandigarh Golf Club Vs Union of India, that running a bar was not essential for promotion of golf. Similarly, in the same case CBDT's view was that since purchase of refreshments, whisky etc. constituted a major portion of expenditure, it was spent on other aims and objectives not qualifying for exemption under section 10(23).

(iii) The fact that the notice for reassessment was issued only on 10 March 1999 i.e. after the receipt of the Audit Note on the Delhi Golf Club by CBDT belies the view of CBDT that it was seized of the matter. But for the audit note, the reassessment would have escaped notice.

(iv) While the Ministry could try to draw a fine distinction with the case of Clubs like National Sports Club of India on grounds that these clubs promote sports in general and not golf in particular, the case of Chandigarh Golf Club (which was denied exemption) or the Royal Calcutta Golf Club and Bombay Presidency Golf Club which have not been given exemption is similar. This tends to show the differential treatment accorded to Delhi Golf Club vis-à-vis others.

(v) The Ministry is trying to obfuscate the issue of taxability of income of casual members for the assessment year 1990-91 which has been brought out by Audit, by trying to draw a distinction between the concept of mutuality and exemption under section 10(23). Audit has pointed out the fact that when exemption under section 10(23) has not been given by the Ministry to Delhi Golf Club for assessment year 1990-91, principles of mutuality enunciated in judgement of Supreme Court would apply and omission by the tax authorities to enforce submission and consequent non assessment of the returns for assessment year 1990-91 led to a revenue loss of Rs.82.94 lakh (including interest).

C-Other Topic of Contemporary Interest

3.7 Sahara Group of Companies

Audit scrutiny revealed that the orders of the CBDT on transfer of the case records of the Group from Lucknow to Delhi for assessment were irregular, unwarranted and beyond the scope of the provisions of the Income Tax Act. The Board not only accepted the application moved by the assessee but also issued orders in favour of the assessee.

The application of the assessee for stay of the demand notices for Rs. 381 crore raised by the Assessing Officer was also considered favourably by the Board despite non-compliance by the assessee to the notices issued by the department and denial by the Director General (Inv.), North Lucknow for the stay of the demand notice.

Audit noticed irregularities in the assessments finalised by the new Assessing Officer. These were in the nature of arithmetical mistakes, adoption of incorrect figures, etc., and which resulted in short levy of tax of Rs.60.72 crore. Investigation trail into certain deposits, property valuations, huge investments by and loans to Directors etc. and follow up action on notices issued to field tax officers was completely discontinued with the change of the incumbent assessing officer.

The review of the cases point to the undue consideration shown by the CBDT whereby the Assessee was successful in avoiding thorough investigation by the field income tax authorities.

Introduction

3.7.1 M/s. Sahara India (Registered Firm) is the earliest business entity of the well known Sahara Group of business concerns. The business was established in the early 1980's with the sole objective of deposits mobilisation through various schemes and chit funds and advancing of loans and making investments. With the passage of time, eighteen companies were set up which diversified into various activities such as mass communication, aviation, textiles, pharmaceuticals, construction, printing, hotels and marketing of products. Sahara India (Registered Firm) acted as 'Agent' for mobilisation of deposits under various schemes for the four sister concerns. These concerns are:

(a) M/s. Sahara India Saving & Investment Corporation Ltd. (Presently known as Sahara India Financial Corporation Ltd.).
(b) M/s. Sahara Investment India Ltd.
(c) M/s. Sahara India Ltd.
(d) M/s. Sahara India Mutual Benefit Co. Ltd.

Initially the firm was engaged in the business of deposits mobilisation and advancing loans through its reported 1100 branches spread over different States. The firm was acting as agent of group companies for

collecting deposits and managing loans and investments since 1991-92. The source of income of the firm is commission received from sister companies on deposits mobilised, reimbursement of expenses incurred on their behalf, property rent and interest.

The assessments of the different inter related assessees pertaining to this group were centralised with ACIT Central Circle 3, Lucknow for coordinated investigation and administrative convenience with effect from 1.7.1991 and 15.5.1993.

Audit scrutiny of the case

3.7.2 Audit learnt that CBDT had directly interfered in the assessment cases pertaining to the Sahara Group. Audit requisitioned and examined the assessment and related records of the field authorities in Lucknow and records of the CBDT in Delhi pertaining to this group.

Constraints

3.7.3 Certain files relating to this group pertaining to transfer of jurisdiction of the case from Lucknow to Delhi, demands raised by assessing authorities stayed by Chairman CBDT and records of enquiry conducted by the CBDT into the conduct of the field assessing authorities were initially requisitioned by Audit in July 1997 followed by subsequent reminders. These files were not produced to audit on grounds that they dealt with individual/administrative subjects (December 1997). The Ministry finally sent them to Audit in December 1998.

Background

3.7.4 The Indian Express dated 14.2.1997 contained a full page advertisement given by M/s. Sahara Group stemming from a notice issued under section 142(1) of the Income Tax Act, 1961 issued by ACIT, Central Circle III, Lucknow for the assessment years 1994-95 and 1995-96 alongwith a list of names of important persons in political life. This list included the names of some former Prime Ministers, former Ministers and other leading political figures.

The Chairman, CBDT taking cognizance of the advertisement took a view (14.2.97) that the Assessing Officer had shown his immaturity and naivete in dealing with the sensitive issues in investigation of tax evasion cases by sending a list of persons to the assessee firm to find out whether any of them had made investment/deposit with any of the Group Companies rather than asking the assessee to produce the names and addresses of all persons who had invested or deposited funds with the Sahara Group of Companies. Consequently, the following actions proposed by the Chairman CBDT were approved by the Revenue Secretary (18.2.97) and the Finance Minister (20.2.97).

(a) ACIT, Central Circle III, Lucknow and Addl. CIT(C) to proceed on leave immediately till the investigation was completed by an Inquiry Officer.

(b) An efficient and mature ACIT to be posted to continue the work of investigation of tax evasion by M/s. Sahara Group of cases and to

ensure that all 29 time-barring cases were completed expeditiously.

(c) An investigation into various aspects of tax evasion practised by Sahara India Group of cases should be continued unabated and cases dealt with firmly, efficiently and necessary conclusions drawn on the basis of facts of the cases.

Results of Audit Scrutiny

3.7.5 Audit scrutiny revealed the following facts.

Unjustifiable action against Assessing Officer

Section 133(4) of the Income Tax Act, 1961 empowers the Assessing Officer to require any assessee to furnish a statement of names and addresses of all persons to whom the assessee has paid in any previous year rent, *interest, commission*, royalty or brokerage of more than one thousand rupees together with particulars of such payments made. Section 133(6) of the Act further provides that the Assessing Officer may require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, *giving information in relation to such points or matters as, in the opinion of the Assessing Officer will be useful for, or relevant to, any enquiry or proceeding under the Act.*

It was noted from the CBDT files that ACIT, Central Circle III, Lucknow and Additional CIT(C) were ordered to proceed on leave immediately on the grounds that the Assessing Officer had issued Notice U/S 142(1) of the Act requiring the assessee to furnish information on deposits made by certain politicians. The Chairman, CBDT held that the Assessing Officer had shown his immaturity and naivete in dealing with the sensitive issues in investigation of tax evasion cases by sending a list of persons to the assessee firm.

It was noted from the relevant records that the Assessing Officer had taken all legitimate actions for the purposes of the Act and had acted within the provisions of the Act, particularly those relating to his powers to call for information under sections 133(4) and 133(6) mentioned *ibid.*

The Assessee's media offensive in the nature of publishing an advertisement containing the notice received under section 142(1) along with the list of politicians and the commentary was the apparent desperate attempt to constrain the tax authorities and deflect income tax investigations. The reasonableness of the administrative action against the assessing officer is to be viewed in the following context:

(i) Because of non-cooperative attitude of the Sahara Group of Companies and non-filing of tax returns in time in most of the cases, the Assessing Officer was attempting 'Best Judgement Assessment' under section 144 of the Act.

(ii) Requiring the Assessee to furnish information on deposits received

from politicians is not barred by the Income Tax Act. The list of politicians forwarded by the Assessing Officer made no distinction as to politicians and was merely a list of all politicians connected with Uttar Pradesh.

(iii) It was seen from the files that the decision to issue a press note by the CBDT informing the public about sending the Assessing Officer and his superior on leave, on the basis of advertisement by the Assessee, was taken without affording an opportunity to the tax officers of being heard in the matter.

Transfer of case records/Jurisdiction from Lucknow to Delhi

(a) Section 127 of the Income Tax Act, 1961 contains the powers of the various authorities to transfer cases from one assessing officer to another. Under section 127 (2), where the Assessing Officer or Assessing Officers from whom the case is to be transferred and the Assessing Officer or Assessing Officers to whom the case is to be transferred are not subordinate to the same Director General or Chief Commissioner or Commissioner, the Board or any such Director General or Chief Commissioner of Income Tax or Commissioner may pass the order transferring the case where the Directors General or Chief Commissioners or Commissioners are not in agreement. Where they are in agreement, then the Director General or Chief Commissioner of Income Tax or Commissioner from whose jurisdiction the case is to be transferred may pass the order, after giving the assessee a reasonable opportunity of being heard in the matter, wherever it is possible to do so.

Unwarranted consideration of application by the Board

Audit scrutiny of the records revealed that an application for transfer of records belonging to Sahara Group (18 cases) from Lucknow to an appropriate Assessing Officer of New Delhi was made on 17.10.96 to the CBDT on the grounds that the Administrative/Control offices of the Group companies/firms had shifted to Delhi at Ambadeep Building, 14 Kasturba Gandhi Marg, New Delhi. It may be noted that the assessee's earlier request to CCIT (Central), Delhi (21.10.94) for transfer of cases to Delhi had been rejected vide letter dated 9.11.94 on grounds that the headquarters of the group of the companies remained in Lucknow and assessment proceedings had made much headway in Lucknow. The application (dated 17.10.96) was accepted and Member (Inv.) gave his consent for the transfer of these cases to Delhi on 15.11.1996. Acceptance of the application for transfer of jurisdiction from the Assessee directly in the Board, its consideration and granting the consent by the Board were unwarranted.

Transfer in violation of provisions

(b) Under section 127 (2) as elucidated above, the Board has powers to allow transfer in only those cases between two assessing officers working under different Directors General or Chief Commissioners of Income Tax or Commissioners when the concerned Director General or Chief Commissioner of Income Tax or Commissioner *do not agree* for such transfer.

As seen from the files, the concerned CCIT in Delhi and the Director

General (Inv.) Lucknow had not discussed the issue. After issue of the order on 15.11.96, Director General (Inv.), Lucknow (2.12.96) objected to the proposed transfer on the grounds, inter alia that 29 time barring cases were involved and it would be difficult task for the new Assessing Officer at New Delhi to carry out proper investigation in the time barring cases and transfer of jurisdiction over Sahara Group of cases from Lucknow to Delhi would cause substantial loss of revenue. As a result of the objections raised by Director General (Inv.) Lucknow, Member (Inv.), agreed (3.12.96) to cancel the order and advised the Director General (Inv.) Lucknow and Director General (Inv.) Delhi to decide on inter charge transfer at a later date in 1997-98 without coming to the Board.

However, the stand of Member (Inv.) was overruled by the then Chairman, CBDT who ordered that jurisdiction of the cases should be transferred to Delhi with effect from 1.5.97 in modification of its earlier order dated 20.11.96. The Board, however, subsequently reversed its order and cancelled the proposed transfer altogether (29.4.97). The fact, however, remains that ordering the transfer of these cases by the Board was legally indefensible in view of the provisions enunciated above.

Transfer to avoid thorough investigation

3.7.6 Scrutiny of files of the income tax authorities in Lucknow and CBDT revealed that concerted efforts were made by the assessee to avoid thorough investigation into the affairs of the Group. The sequence of events as detailed below and the subsequent consequences as revealed in audit test check lead to the conclusion that the assessee was successful in avoiding proper investigation by the Income Tax authorities.

Sequence of events:

1. Investigations by the Income Tax Officials into the Sahara Group begins on 27.5.1996. The Income Tax Officers issue several notices calling for specific information on various dates during the period.

2. The Sahara Group of companies makes an application to the CBDT on 17.10.96 for transfer of assessment jurisdiction from Lucknow to Delhi on the grounds that the principal office of the company has been shifted from Lucknow to New Delhi. The company also attaches a copy of the resolution under section 209 of the Companies Act for the change in principal office of the company duly passed by the Board of Directors.

3. CBDT accepts the transfer plea of the assessee on 15.11.1996.

4. Field Income Tax Authorities in Lucknow object to transfer on grounds of complexity of cases and time barring nature of some cases that would lead to loss of revenue. Chairman, CBDT stays transfer of cases to Delhi on 21.2.97 and directs that the transfer may be effected from 1.5.97.

5. Income Tax Investigations into the Group gather momentum. Queries

are issued to Income Tax Officials in Deoria, Rai Bareilly, Gorakhpur, Patna, Kanpur and Bareilly. The Income Tax Authority launches surveys, initiates penalty proceedings and issues summons to the main promoters of the Group viz. Shri Subrata Roy, Shri J.B.Roy and Shri O.P. Shrivastava for examination on oath. Verification of depositors is also taken up.

6. Sahara Group launches a media offensive through advertisement in the Indian Express (14.2.97). CBDT takes congnizance of the advertisement and decides to transfer two Income Tax Officials dealing with Sahara Group of cases since May 1996 ignoring the contention of the Commissioner (Central) that the assessee is trying to deflect investigation. Chairman, CBDT issues a press note on the same day stating that the case was of misapplication of mind by the Assessing Officer, if not abuse of Power. The press note was issued without waiting for clarifications/explanations from the concerned officials, viz. CIT (Central), Kanpur, Addl. CIT (Central), Lucknow and ACIT (Central) whom he was supposed to meet on the same day. Chairman, CBDT ignores reports sent to the Board (14.2.97) that the detailed progress of investigations and also discovery by the officers of certain issues like depositors ledgers not having the address of depositors, names of depositors missing in certain cases, torn pages of depositors ledgers, cases of violations of provisions of section 269 SS.

7. The new officer takes over the charge on 21.2.97. CBDT also orders DCIT (Kanpur) to hold additional charge of Central Range in Lucknow. The new assessing officer completes the time barring cases by 31.3.97.

8. Another advertisement (14.3.97) by the Sahara Group in 'Dainik Jagran' reveals that the administrative headquarters will continue to remain at Lucknow only. The assessee writes to CBDT (19.4.97) informing that they have no objection to be assessed at Lucknow.

9. CBDT cancels the transfer of jurisdiction from Lucknow to Delhi and restores status quo on 29.4.97.

Viewed above, the request for transfer of assessment jurisdiction to Delhi and media offensive against the tax officers and income tax department by the assessee were designed to dilute deep investigations.

Weaknesses in the Assessment Order

3.7.7 The field income tax authorities had been repeatedly stressing that the concerned assessing officer (ACIT Central III, Lucknow) had gone much ahead in the investigations of this group of cases and that it would be difficult for a new assessing officer to handle 29 time barring cases with the same comprehensive perception of relevant facts (2.12.96). Following weaknesses were noticed by audit in the test check of assessment orders for the assessment year 1994-95.

(a) Avoidable mistakes in computation of income

Audit scrutiny of the assessment of M/s. Sahara India Savings & Investments Ltd. revealed that due to arithmetical mistake, total amount of collection of deposits made by its agent during the year was taken as Rs.16,976 lakh only instead of Rs.28,986 lakh. The mistake resulted in an underassessment of income by Rs.12,010 lakh and consequent underassessment of taxable income due to adoption of reduced figures. Accordingly, while assuming percentages on best judgement assessment basis there was short charge of tax of Rs.4,651 lakh.

Mistake in the assessment orders

Similarly, audit scrutiny in the case of M/s. Sahara India Mutual Benefits Co. Ltd. revealed that the assessing officer while disallowing 50 percent of the total deposits collected during the year, an amount of Rs.200 lakh was taken less which resulted in an underassessment of income by a like amount involving short charge of tax Rs.209.30 lakh (including interest).

(b) Income not assessed

Under the Income Tax Act, 1961, where any sum is found credited in the books of an assessee maintained for any previous year and the assessee offered no explanation about the nature and source thereof or the explanation offered by him is not found satisfactory, the sum received may be charged to income tax as the income of that previous year.

Audit scrutiny of the records relating to M/s. Sahara India Ltd. revealed that the assessee had credited Rs.20 lakh received from two persons for addition to their capital shares but while completing assessment, the amount was not added to capital shares of the above two persons and hence the amount was to be computed as an income treating it as an unexplained credit. The omission resulted in underassessment of income of Rs.20 lakh with consequent short levy of tax of Rs.17.46 lakh (including interest).

(c) Incorrect computation of income

Under the Income Tax Act, 1961, while completing assessment in scrutiny manner the assessing officer shall make a correct assessment of the total income or loss of assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment.

Audit scrutiny in the case of M/s. Sahara India (Registered Firm) revealed that the assessee was collecting deposits under various schemes for its sister concerns apparently engaged in the business of deposits mobilisation as an agent. The assessing officer, while completing assessment, treated service charges at the rate of 10 percent of the total collection of Rs.28,985.80 lakh as its income. However, while calculating the amount of service charges it was erroneously worked out to Rs.1,697.63 lakh, instead

of the correct amount of Rs.2,898.57 lakh. The mistake resulted in underassessment of income by Rs.1,200.94 lakh with the consequential short charge of tax of Rs.1,177.04 lakh including interest and surcharge.

(d) Non-levy of surcharge

Under the Income Tax Act, 1961, where the individual share of the members of an association of persons are indeterminate or unknown, tax shall be charged on the total income of the association at the maximum marginal rate.

Audit scrutiny of the records of M/s. Sahara India Marketing Ltd. revealed that though income tax was charged at the rate of 40 percent surcharge leviable thereon at the rate of 12 percent was, however omitted to be levied. This mistake resulted in short charge of tax of Rs.17.28 lakh (including interest).

Shortcomings/ Weaknesses in Investigation

3.7.8 Audit scrutiny of the assessment records of the group revealed that certain issues which the assessing officer had been pursuing and investigating could not be incorporated in the relevant assessments due to change in the incumbency. While it would not be proper to compute a tax effect, the following issues were important for proper assessment of the cases.

(i) The assessing officer in the course of assessment proceedings of Sahara India Mutual Benefit Co. Ltd. on 11,12,and 13 February 1997 recorded the statement on oath of 8 employees of Sahara India who had been given loans ranging from Rs.15 lakh to Rs.85 lakh at the rate of 24 percent per annum. These loans had been taken to purchase land/shares by these employees. As revealed from the detailed questioning by the Assessing Officer, these employees were not aware of details like terms and conditions of loan, mode of payment, name of seller, agreement papers for land. It appeared that these employees would find it impossible to repay the loan from their only source of income i.e. salary. These facts pertaining to assessment year 1994-95 should have been probed further since the Sahara India Mutual Benefit Co. Ltd. showed an amount of Rs.51 crore as loans and advances in its balance sheet.

(ii) Certain assets belonging to (1) Sahara India Savings and Investment Corporation Ltd. (2) Sahara India Mutual Benefit Co. Ltd. (3) Sahara India Airlines, for the assessment years 1994-95 and 1995-96 were referred to the valuation cell. The valuation Reports were neither pursued nor received till the completion of assessment.

(iii) The veracity of depositors were being examined by the ACIT Central III. This was not pursued. The verification of depositors was being done through issue of summons under section 131 of Income Tax Act, notice under section 133(6) and asking the assessee to produce the depositors. No records evidencing further progress in the matter could

be seen.

(iv) Statement of two main directors out of eight, viz. (a) Mrs. Vandana Bhargava (b) Mr. Sanjay Bahadur could not be recorded to whom summons were issued. The statement on oath was very crucial keeping in view the fact that these directors have been given loans and advances by the Sahara Group of Companies. These persons had also made huge investments in shares and had claimed heavy losses. These facts were not found examined further.

(v) No follow up action was taken on the commissions, notices issued under section 131(1) to ADIT, Gorakhpur, ITO, Deoria, ADIT, Bhopal, ACIT Circle, Kanpur. However, no reports were found received from them regarding the verification of depositors, violation of 269SS provision etc.

Demand of Sahara Group stayed by Chairman CBDT

3.7.9 The assessing officer while completing the 26 time barring assessments out of 29 by 31.3.97 had raised a demand of Rs.381 crores. The assessee's application for stay of demand made to Director General (Inv.) North, Lucknow was rejected mainly on the ground that they had not complied with the direction of the CIT (Central), Kanpur for payment of Rs.4 crore till 31.3.98 or finalisation of first appeal. Subsequently, the assessing officer attached all the bank accounts, FDRs etc. as a coercive measure.

The assessee petitioned Member (Investigation) (25.8.97) against the order of the Director General (Investigation) North. The reasons given for stay of demand were as follows:

(a) All the demands are in appeal before the CIT(A).

(b) Major additions have been made on ground in which either no addition was made in earlier assessment year or additions made were deleted in appeal.

(c) Considerable tax demand had already been adjusted against refund due for subsequent assessment year.

(d) As per CBDT instruction dated 2.12.93, disputed demands should be stayed till decision in the appeal.

The then Member (Investigation) while taking "an overall view" of the case, recorded (1.9.97) that the group is mainly engaged in para banking business and if bank accounts remained attached entire business operation will come to stand still and will ruin the company and that the public confidence will be shattered if deposits on maturity can not be paid to the public. After examining some of the assessment orders passed in the group cases, he found that the additions had been made on 'surmises' and 'ex-parte' decisions as the assessee did not comply with various notices issued by the Assessing Officer either in full or in part.

Member (Investigation) also had stated that some of the additions had been made on the grounds on which the assessee had got relief in earlier assessment years. Member (Inv.) was also of the view that if the assessee agrees to pay Rs.8 crore immediately on vacation of attachment order and monthly instalment of Rs.2.50 crore paid by 25th of each month starting from September, 1997 the attached bank accounts and FDRs should be released.

Audit examination of the files revealed that the assessee had neither furnished complete replies to the notices of the Assessing Officer nor complied with the assessment proceedings. The assessment orders were found approved by the Director General (Investigation) and CIT (Central) Lucknow. To dismiss these assessment orders as based on 'surmises' and 'ex-parte' decisions lacked full considerations of the cases in hand.

The other main argument in favour of stay of demands was that some additions were made on grounds on which in the earlier years the assessee had got relief from the Appellate Authorities. However, audit scrutiny of the relevant assessment folders revealed that out of a demand of Rs.381 crore raised after completion of time barring assessments by 31.3.97, Rs.272.66 crore related to issues which were new and did not contain any grounds covered by the Appellate Authorities in earlier years.

These new issues were as follows: **(Rs. in crore)**

I. M/s. Sahara India Savings and Investments Co. Ltd. (Assessment year 1994-95)

(a) Revenue receipts being @ 3% of deposits during the year and @15% of deposits of pending balance	Rs.96.55
(b) Income of investment in securities	Rs.15.25
(c) Expenses reimbursed to Sahara India (Firms) in excess of 3% of deposits received during the year	Rs.28.04
Total:	Rs. 139.84

II. M/s. Sahara India Mutual Benefits Co. Ltd. (Assessment year 1994-95)

(a) Excess expenses reimbursed to Sahara India (Firm)	Rs. 4.81
(b) Interest paid on borrowed capital to the extent it was advanced to Agent free of interest	Rs. 2.30
(c) Unverified deposits under section 68 of IT Act.	Rs.74.47
(d) Interest provision on unverified deposits	Rs. 5.35
Total:	Rs. 86.93

III. M/s. Sahara India Mass Communication Ltd. (Assessment Year 1994-95)

(a) Addition on account of free newspapers/magazines	Rs. 0.35
(b) Excess wastage of news prints claimed	Rs. 0.65
Total:	Rs. 1.00

IV. M/s. Sahara India (Registered Firm) (Assessment Year 1994-95)

(a) Service charges from depositors of scheme pertaining to M/s. Sahara India Saving and Investment Co.,	Rs.16.98
(b) Provident fund paid beyond the statutory time as per section 43B,	Rs. 0.84
(c) Commission/development/collection expenses in excess of 2% of deposits received during the year,	Rs. 9.69
(d) Expenses in excess of reimbursement by sister concerns	Rs.14.75
Total:	Rs.42.26

V. M/s. Sahara India Airlines Ltd. (Assessment Year 1994-95)

(a) Expenses on account of Air Travel allowed free of cost for other than business consideration	Rs.2.63

Considering the above, it appears that the decision by the Board to stay the demands against the assessee was taken without appreciating the full facts in the case.

CHAPTER 4 : CORPORATION TAX

Number of companies

4.1 According to the Ministry of Finance (Department of Company Affairs), the number of companies under various categories and the paid-up capital in the case of limited companies, as on 31 March 1998 stood as under:

Sl. No.	Category	No. of Companies	Paid-up capital (Rs. in crore)
1.	Foreign companies as defined under Section 591 of the Companies Act, 1956	871	Not available
2.	Associations `not for profit' but registered as companies	2,652	Not available
3.	Unlimited companies	420	Not available
4.	Limited companies:		
a.	Government companies	1,223	86,680.52
b.	Non-Government companies-		
	Private limited companies	4,15,348	33,907.70
	Public limited companies	67,929	92,120.52
	Total :	**4,88,443**	**2,12,708.74 (for Sl.No.4 only)**

Number of assessees

4.2 The number of company assessees on the records of the Income Tax Department during the last five years was as follows:

As on 31 March	Number
1994	1,71,419
1995	1,76,594
1996	1,87,574
1997	2,27,228
1998	2,74,319

Trend of receipts

4.3 The trend of receipts from corporation tax i.e., income tax and surtax payable by companies during the last five years was as follows:

Year	Receipts from Corporation tax	Gross collection of all direct taxes	Percentage of Corporation tax to gross collection (Rs. in crore)
1993-94	10,060.06	20,298.24	49.56
1994-95	13,820.96	26,970.88	51.24
1995-96	16,487.13	33,559.28	49.13
1996-97	18,566.69	38,895.08	47.73
1997-98	20,016.00	48,280.40	41.46

Status of assessments

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

Year	Number of assessments				Total Demand		
	For disposal	Completed during the year	Pending at the close of the year	Percentage of pendency to total cases for disposal	Demand for collection (Rs. in crore)	Collection during the year (Rs. in crore)	Percentage of collection to total demand
1993-94	2,55,344	1,81,130	74,214	29.06	16,686.69	10,060.06	60.29
1994-95	2,58,059	1,86,938	71,121	27.56	23,711.08	13,820.96	58.29
1995-96	2,85,161	1,99,086	86,075	30.18	28,920.66	16,487.13	57.01
1996-97	3,25,551	2,35,385	90,166	27.70	33,999.33	18,566.69	54.61
1997-98	3,89,376	2,71,481	1,17,895	30.28	40,078.46	20,016.00	49.94

Results of Audit

4.5 A total number of 575 draft paragraphs involving undercharge of tax of Rs.699.08 crore and 19 draft paragraphs involving overcharge of tax of Rs.11.61 crore have been issued to the Ministry of Finance during March 1998 to October 1998 for their comments. The Ministry have accepted 227 cases involving tax effect of Rs.138.84 crore.

Of the total 594 cases issued to the Ministry, 171 number of illustrative cases with aggregate undercharge of tax of Rs.520.12 crore relating to various categories and 17 cases of overcharge of tax involving Rs.10.81 crore are indicated in the succeeding paragraphs. Out of these, the Ministry have accepted the observations in 55 cases involving tax effect of Rs. 79.97 crore. Replies are awaited in respect of 120 cases. Of the cases included, 26 cases involving tax effect of Rs.32.20 crore have been checked by the Internal Audit Wing of the department but the mistakes remained undetected by it. The

repetitive nature of the mistakes noticed during test check by Audit indicates the inadequate attention given by the assessing officers in the assessments of even those involving substantial revenue.

Avoidable mistakes in computation of income and tax

4.6 Under the Income Tax Act, 1961, an assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer shall make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment. In all these assessments, the tax or refund shall be determined after taking into account the prepaid taxes and refunds made. Underassessment of tax of substantial amounts and overcharge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and issue of instructions by the Government from time to time, such mistakes continue to occur suggesting the need for better supervision and control. The various types of mistakes noticed included, inter alia, incorrect adoption of figures, arithmetical errors, double allowance, non-levy of surcharge etc. The extent of such mistakes noticed during test check of the assessments completed by the assessing officers during last five years was as under:

Year	No. of items	Amount of tax underassessed (Rs. in crore)
1993-94	1,104	21.01
1994-95	1,503	35.04
1995-96	1,643	105.81
1996-97	1,450	418.34
1997-98	1,531	192.32

Some important cases of each type noticed in test check are given below:

1.Overassessment of income and tax

Mistakes by the assessing officers resulted in overcharge of income and tax from some assessees. Of the many cases noticed during test check in audit, a few major cases are mentioned below:-

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1	Karnataka III, Bangalore	1987-88 March 1995	143(3)	Due to erroneous adding back of subsidy of earlier years, excess disallowance of undercharged sales tax liability and disallowance of lesser amount towards provision for arrears of salaries, the income was determined incorrectly at Rs.334.23 lakh instead of loss of Rs.73.50 lakh.	203.87 (P)
2.	West Bengal III, Calcutta	1993-94 March 1996	143(3)	As against the correct amount of Rs.37.79 lakh to be disallowed towards amortisation of public issue expenses, Rs.377.87 lakh had been disallowed leading to excess determination of income by Rs.340.08 lakh.	176.00 (P)
3.	City II, Mumbai	1987-88 March 1990 (revised in January 1997)	143(3)	Due to erroneous set off of entire pre incentive income instead of restricting the same to 70 percent, carry forward amount of unabsorbed investment allowance was incorrectly adopted at Rs.694.30 lakh as against Rs.943.85 lakh. This resulted in less carry forward of loss by Rs.249.55 lakh.	124.78 (P)
4.	Meerut, Uttar Pradesh	1994-95 March 1997	143(3)	Incorrect computation of income at Rs.2190 lakh instead of the correct amount of Rs.2087 lakh led to overassessment of income by Rs.103 lakh.	102.32
5.	West Bengal IV, Calcutta	1994-95 March 1997	143(3)	Depreciation which was disallowed from the Profit and Loss account on separate consideration was again disallowed erroneously while computing assessed loss which led to less computation of loss by Rs.192.35 lakh.	99.54 (P)
6.	City III, Mumbai	1993-94 December 1995	143(3)	Instead of adding the allowable expenditure of Rs.83.12 lakh to the loss as per profit and loss account, the same had been deducted which led to short determination of loss by Rs.166.24 lakh.	86.03 (P)
7.	Rajkot, Gujarat	1995-96 March 1997	143(3)	As against penalty of Rs.311 lakh leviable for short payment of advance tax, Rs.386 lakh was erroneously levied.	75.00
8.	West Bengal IV, Calcutta	1994-95 March 1997	143(3)	Due to arithmetical mistakes, income tax payable on capital gains was incorrectly computed at Rs.271.51 lakh instead of the correct amount of Rs.217.51 lakh.	62.10
9.	Bhubaneswar, Orissa	1986-87 March 1997	143(3)	Instead of serving the notice for Rs.66.80 lakh after adjustment of prepaid taxes of Rs.36.29 lakh against the tax determined at Rs.102.29 lakh, Rs.98.60 lakh was demanded which resulted in excess demand of tax of Rs.32.60 lakh.	32.60
10.	Karnataka III, Bangalore	1992-93 March 1995	143(3)	As against correct amount of Rs.167.20 lakh to be disallowed towards provision for gratuity, Rs.223.69 lakh was disallowed which led to excess disallowance of Rs.56.49 lakh.	29.24 (P)

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
11.	City IV, Mumbai	1989-90 October 1995, 1990-91 November 1995	143(3) 143(3)	Interest of Rs.22.10 lakh was charged in excess for short payment of advance tax.	22.10
12.	Ahmedabad I, Gujarat	1991-92 February 1997 1992-93 February 1997	144	Due to incorrect levy of tax at the rate applicable to companies in which public are not substantially interested, even though the assessee was assessed in earlier years as a company in which public are substantially interested, there occurred overcharge of tax of Rs.16.64 lakh.	16.64
13.	Madurai, Tamil Nadu	1992-93 February 1995 1993-94 June 1995 (revised in July 1995-January 1996)	143(3) 143(3)	Even though an item of capital expenditure was disallowed in respect of replacement of machinery, depreciation for the same was not allowed for the assessment year 1993-94 which resulted in overassessment of income by Rs.15.57 lakh.	13.07
14.	West Bengal III, Calcutta	1991-92 March 1994	143(3)	Due to erroneous deduction of net dividend of Rs.16.73 lakh from the net profit for separate consideration, gross dividend of Rs.41.82 lakh was deducted which led to overassessment of income by Rs.25.03 lakh.	11.54
15.	Ahmedabad I, Gujarat	1991-92 March 1996	143(3)	Due to not setting off of unabsorbed loss pertaining to earlier years amounting to Rs.29.95 lakh, there occurred overassessment of income of Rs.10.53 lakh.	9.03
16.	Central I, Mumbai	1994-95 March 1997	143(3)	Due to erroneous raising of demand treating the loss of Rs.9.98 lakh as income there occurred an excess demand of Rs.8.89 lakh.	8.89
17.	Ahmedabad I, Gujarat	1993-94 March 1996	143(3)	As against the correct amount of unabsorbed depreciation of Rs.22.61 lakh available for set off, Rs.14.57 lakh was allowed set off which resulted in overassessment of Rs.8.04 lakh.	8.13

The Ministry have accepted the audit observations at Sl. Nos. 1,2, 5,6,9,10,12,14 and 16. Their response to the remaining cases has not been received.

(2) Underassessment of income and tax, incorrect adoption of figures etc.

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	Delhi I	1994-95 August 1995	143(1)(a)	Failure to reduce the interest initially granted consequent on enhancement of income and the tax liability resulted in grant of excess interest to the assessee.	426.03
2.	City II, Mumbai	1994-95 March 1997	143(3)	Non-levy of surcharge on long term capital gains resulted in short levy of tax of Rs.369.08 lakh.	369.08
3.	West Bengal I, Calcutta	1993-94 March 1996	143(3)	Instead of treating the income of Rs.276.29 lakh as loss and deducting income of Rs.34.15 lakh therefrom, taxable income was underassessed. The mistake resulted in excess carry forward of loss by Rs.552.47 lakh taking into unabsorbed depreciation etc. of earlier years.	285.96 (P)
4.	Central II, Mumbai	1994-95 March 1997	143(3)	Failure to charge tax on long term capital gains without levy of surcharge resulted in short levy of tax of Rs.252 lakh.	252.00
5.	Rajkot, Gujarat	1994-95 January 1997 1995-96 March 1997	143(3) 143(3)	Instead of withdrawing the interest paid in earlier years aggregating Rs.292.66 lakh, the assessing officer had incorrectly withdrawn only Rs.44.20 lakh which resulted in short levy of tax.	248.47
6.	West Bengal III, Calcutta	1989-90, March 1992	143(3)	Interest on sticky loan of Rs.24106 lakh was considered at 15 percent instead of the correct lending rate of 16 percent as per the Director's report which resulted in underassessment of income of Rs.241 lakh.	218.00

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
7.	Central I, Chennai	1988-89 March 1991 1989-90 March 1992 (revised in March 1995)	143(3) 143(3)	The assessments for the assessment years 1990-91 and 1991-92 were not revised consequent on reduction in the amount of brought forward loss of the assessment years 1988-89 and 1989-90 on revision. Further, loss carried forward in the assessment year 1991-92 was wrongly computed at Rs.50.80 lakh as against the correct amount of Rs.28.46 lakh. These mistakes resulted in underassessment of income by Rs.69.04 lakh.	63.32 12.32 (P)
8.	Tamil Nadu IV, Chennai	1988-89 March 1991	143(3)	In the revised computation of income consequent on appeal orders in March 1992, additional depreciation allowable on appeal only was added back but the depreciation allowed in the original assessment was omitted to be withdrawn which led to excess allowance of depreciation by Rs.134.12 lakh.	67.06 (P)
9.	Karnataka II, Bangalore	1992-93 December 1994 (revised in June 1995)	143(3)	As against correct amount of Rs.152.93 lakh, deduction of Rs.184 lakh was allowed towards advance interest tax which led to underassessment of income of Rs.31.07 lakh.	26.69
10.	Lucknow, Uttar Pradesh	1992-93 December 1993	143(3)	Even though Rs.13.79 lakh being work-in-progress was disallowed, Rs.24.52 lakh on account of total work-in-progress were irregularly deducted from the taxable income which resulted in underassessment of Rs.8.98 lakh and excess carry forward of loss of Rs.13.62 lakh to the assessment year 1993-94.	20.09

The Ministry have accepted the audit observations at Sl. Nos. 1 and 5 to 8.

They have not accepted the audit observations at Sl. Nos.2 and 4 on the ground that mistake was known to the department as evident from notice under section 154 dated 8 July, 1997 issued prior to the audit observation.

The reply is not tenable since when the objections were raised in September 1997, either a reply to the audit query should have been given or while discussing the local audit report, the action taken to rectify the mistake should have been brought to the notice of Audit. Neither this was done nor notices issued were available on record. Further, while finalising the local audit report, the assessing officer certified that the issues raised were neither pointed out by IAP nor by assessee himself.

Their response to the remaining cases has not been received.

Application of incorrect rate of tax

4.7 The Income Tax Act, 1961, provides that income tax is chargeable for every assessment year in respect of the total income of the previous year of an assessee according to the rates prescribed under the relevant Finance Act. The Finance Act, 1994, provided that domestic companies in which the public are substantially interested were chargeable to tax at the rate of 45 percent of the total income.

In West Bengal III, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in February 1997. Audit scrutiny revealed that tax was levied at the rate of 40 percent instead of the correct rate of 45 percent as applicable to a company in which public are substantially interested. The mistake resulted in short levy of tax of Rs.250.39 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect computation of income from house property

4.8(a) Under the provisions of Income Tax Act, 1961, the annual letting value of the property consisting of building or land appurtenant thereto of which the assessee is the owner is chargeable to income tax under the head "income from house property". The income is computed after allowing the permitted deductions from annual value.

In City VI, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 accepting th income from house property as returned. Audit scrutiny revealed that th assessee company apart from the rent, had received Rs.740 lakh as intere free security deposit from other company and while computing the annua value the amount of Rs.740 lakh was not considered. The omission resulted in underassessment of income by Rs.106.56 lakh involving short levy of tax of Rs.94.85 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) It has been judicially held[1] by the Supreme Court that income derived from letting out of buildings owned by the assessee to tenants is to be computed under the head "income from house property" and not under the

[1] SG Mercantile Corporation P.Ltd. Vs CIT 83 ITR 700(SC).

head income from profits and gains of business or profession. It will remain so even if property is held by the assessee as stock in trade of a business or if the assessee is engaged in the business of letting out of property on rent or if the assessee is a company which is incorporated for the purpose of owning house property. House owning, however profitable, is neither trade nor business for the purpose of the Act.

In Patna, Bihar charge, the assessments of a private limited company engaged in the business of construction and sale of buildings and leasing of properties, for the assessment years 1993-94 and 1994-95 were completed in a summary manner in December 1995 computing income under the head "profits and gains of business or profession". Audit scrutiny revealed that the gross receipts of the assessee for the assessment years 1993-94 and 1994-95 included rental income of Rs.23.87 lakh and Rs.24.50 lakh respectively derived from the buildings owned by the assessee. The income from ownership of buildings was correctly chargeable to tax under the head 'income from house property' and not under the head 'profits and gains of business'. Failure to carry out the adjustment prima facie resulted in underassessment of income aggregating Rs.36.13 lakh with resultant short levy of tax totalling Rs.34.46 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of non-business expenditure

4.9(a) Under the Income Tax Act, 1961, any expenditure not being in the nature of a capital expenditure or personal expense of the assessee laid out or expended wholly or exclusively for the purpose of business is allowable as deduction computing the income chargeable under the head "Profits and gains of business or profession". The Act also provides that in computing the business income of an assessee, a deduction on account of the interest paid in respect of capital borrowed for the purposes of business or profession is admissible. It has been judicially held[2] that where a parent company borrowed money and diverted it to its subsidiary company, and the subsidiary company used the money for its business, interest paid on the borrowed amount is not allowable as a deduction to the parent company.

In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that the assessee borrowed loans amounting to Rs.19,324 lakh from different financial institutions and banks and paid interest of Rs.3,034 lakh at the average rate of 15.70 percent on the said borrowings. The assessing officer, while computing the total income chargeable to tax, allowed the payment of interest as deduction though the assessee company advanced loans aggregating Rs.4,986 lakh to its two subsidiary companies out of the aforesaid borrowings without charging any interest on the amount of loans advanced to them. Omission to disallow the non-business expenditure has resulted in underassessment of income of Rs.783 lakh (at an average rate

[2] Phaltan Sugar Works Ltd. Vs.CIT 208-ITR-989 (Bom.)

of 15.70 per cent on the loan of Rs.4,986 lakh) leading to excess carry forward of unabsorbed depreciation by an identical amount involving potential short levy of tax of Rs.405 lakh.

The Ministry have not accepted the audit observation on the grounds that there was no direct nexus between the loan taken by the assessee and the interest free loan given to subsidiaries and that the loan was advanced in the previous year 1992-93 relevant to assessment year 1993-94. The loan outstanding is only the opening balance as on 1 April 1993.

The reply is not tenable since interest free loan was sanctioned in the earlier assessment year, the loan was not fully wiped off in the previous year relevant to the assessment year 1994-95 to which the audit objection relates. There was also no change in the Reserves and Surplus account which might suggest that the interest free loan was financed from the Reserve Fund of the company. Therefore, the interest on the said amounts of loan amounting to Rs.783 lakh was to be disallowed being expenses not expended for the purpose of business.

(b) The Board clarified in August 1994 that any claim which is patently inadmissible in law is within the scope of prima facie disallowances in a summary assessment.

In City I, Mumbai charge, the assessment of a closely held company for the assessment year 1995-96 was completed in a summary manner in December 1996 at a loss of Rs.290.29 lakh as returned by the assessee. Audit scrutiny revealed that the assessee had claimed a deduction of Rs.368.82 lakh on account of 'premium on capital reduction'. As premium so paid was prima facie apparent from records and patently inadmissible being not a revenue expenditure, the same should have been disallowed and added back. Omission to do so resulted in underassessment of income by Rs.78.52 lakh involving short levy of tax of Rs.76.40 lakh (including additional tax and withdrawal of interest granted to the assessee). Further, the irregular carry forward of loss of Rs.290.29 lakh involved potential short levy of tax of Rs.133.53 lakh.

The Ministry have not accepted the audit observation on the ground that the issue involved is complex and such kind of additions are certainly beyond the purview of section 143(1)(a).

The reply is not tenable as it has been judicially held[ψ] *that though the increase in capital results in expansion of the capital base of the company and incidentally helps in profit making, the expenses incurred in this connection retains the character of a capital expenditure. This being so, buy-back of shares resulting in reduction of capital base should necessarily fall within the scope of prima facie adjustment .*

[ψ] Punjab State Industrial Development Corporation Vs CIT 225 ITR 792 SC.

Incorrect allowance of capital expenditure

(c) Under the provisions of Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure laid out wholly or exclusively for the purpose of business is allowable as deduction in computing income chargeable under the head 'profits and gains of business or profession'. Further, the expenditure incurred prior to commissioning of project is capital in nature and is required to be disallowed.

(i) In Tamil Nadu, Coimbatore charge, the assessments of a private textile company for the assessment years 1991-92 to 1994-95 were completed after scrutiny between September 1993 and August 1995 except 1993-94 which was processed in a summary manner in March 1994. Audit scrutiny revealed that the company claimed deduction towards expenditure incurred for replacing machinery of Rs.107.83 lakh, Rs.86.45 lakh, Rs.12.38 lakh and 192.47 lakh respectively during the previous years relevant to the respective assessment years 1991-92 to 1994-95. Audit scrutiny revealed that the cost of these machineries was allowed as revenue expenditure in the relevant assessment years. The incorrect allowance of expenditure of Rs.399.13 lakh resulted in short levy of tax of Rs.170.87 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Central I, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in March 1995. Audit scrutiny revealed that the assessing officer omitted to disallow expenses of capital nature amounting to Rs.123 lakh relating to civil construction work which was in progress as a part of major expansion project of the cement division. The omission resulted in underassessment of income by Rs.123 lakh with consequent short levy of tax of Rs.109.48 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In City VI, Mumbai charge, the assessment of an assessee company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that the assessee had capitalised Rs.200.63 crore being prior period expenses in its books of accounts and claimed Rs.148.67 crore as revenue expenditure consisting of Rs.125.62 crore in respect of projects commissioned and Rs.23.05 crore in respect of projects yet to be commissioned. Assessing officer, however, while admitting the claim had allowed Rs.114.20 crore out of expenditure pertaining to projects commissioned as revenue expenditure and the rest was treated as capital expenditure. But as per individual project wise profit and loss account an amount of Rs.1.87 crore representing expenditure incurred before commencement of production of the project of one division was also included in Rs.114.20 crore and had been allowed as revenue expenditure. Failure to treat the same as capital expenditure had resulted in underassessment of income of Rs.1.41 crore after allowing depreciation leading to potential short levy of tax of Rs.72.80 lakh.

The Ministry have accepted the audit observation.

(iv) In City I, Mumbai charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in February 1997. Audit scrutiny revealed that an amount of Rs.99.54 lakh was debited under the head 'Charities and donations' towards 20 point programme though the item was neither allowable as a specified donation under section 80G of the Income Tax Act nor was it allowable as an expenditure in the normal course of business. The claim being patently inadmissible in law and prima facie apparent from records should have been disallowed by the assessing officer. Omission to do so resulted in underassessment of income of Rs.99.54 lakh and consequent short levy of tax of Rs.67.58 lakh (including additional tax and withdrawal of interest on refund).

The Ministry have not accepted the audit observation on the ground that such addition can not be made without giving an opportunity to the assessee and it is not possible to make such disallowances at the stage of Section 143(1)(a).

The reply is not tenable as per Board's circular 689, any expenditure which is patently inadmissible in law can be disallowed while processing the return under section 143(1)(a) and in the instant case the expenditure incurred for 20 point programme is neither falling under the head "Charities and donations" nor can it be taken as expended wholly and exclusively for the purpose of business. Moreover, the same has been disallowed in the scrutiny assessment on the basis of facts which were known to the department even while completing the summary assessment. Hence, the same should have been disallowed, being prima facie apparent from the records.

(d) In North East Region, Shillong charge, the assessment of a widely held company engaged in oil industry for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that the assessee company had borrowed Rs.4,760.27 lakh mobilised through loans from banks, in the relevant previous year. Its investment in tax free IRFC Bonds and units stood at Rs.2,132.86 lakh. The interest earned on the invested tax free public sector bonds was not included in the total income. Since the funds were utilised for non-business purpose, the proportionate debt charges absorbed in the accounts of the relevant previous year should have been disallowed as non-business expenditure. Omission to do so resulted in under assessment of income by Rs.192.88 lakh being the proportionate debt charges on Rs.1,420.36 lakh invested in bonds with consequent short levy of tax of Rs.99.82 lakh.

The reply of the Ministry to the audit observation has not been received.

(e) It has been judicially held* that interest on borrowed capital in respect of the period before commencement of production is part of actual cost of the assets.

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* Challapalli Sugars Ltd. Vs. CIT 98 ITR 167 (SC)

In Orissa, Bhubaneswar charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in March 1997 determining the total loss at Rs.13,545.03 lakh. Audit scrutiny revealed that the assessee company claimed the interest of Rs.4,065.26 lakh on borrowed capital for purchase of machinery prior to the commencement of the business and the same was allowed by the assessing officer. The mistake resulted in potential tax effect of Rs.1,577.83 lakh after allowing depreciation.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of provision for bad and doubtful debts in respect of advances made by rural branches of banks

4.10(a) Income Tax Act, 1961, as amended by the Finance Act, 1986 and further by Finance Act, 1993 with effect from 1 April 1994 provided that in respect of any provision for bad and doubtful debts made by a scheduled or non-scheduled bank, an amount not exceeding five percent of its total income (computed before making any deduction under this provision and chapter VIA) and an amount not exceeding specified percent of the aggregate average advances made by the rural branches of such banks computed in the prescribed manner, shall be allowed as deduction, while computing the business income of the assessee. 'Rural branch' for this purpose has been defined as a branch of the scheduled or non-scheduled bank situated in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

(i) In Cochin, Kerala charge, the assessment of a banking company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that out of total claim for deduction of Rs.828 lakh towards provision made for bad and doubtful debts of 159 rural branches of the bank, the Assessing Officer disallowed the claim in respect of 16 rural branches on the ground that those branches were situated in places with a population exceeding ten thousand with reference to the population figures of 1981 census though according to the last preceding census of 1991 published before the 1st day of the previous year relevant to the assessment year 1994-95, 61 more branches were situated in places with a population exceeding ten thousand and therefore they were not entitled to the relief available to rural branches. Proportionate deduction allowed in respect of 64 ineligible branches (excluding 13 branches out of 16 branches already considered for disallowance in the assessment) worked out to Rs.333 lakh. The mistake resulted in underassessment of income of Rs.333 lakh with consequent short levy of tax of Rs.330 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that the bank is governed by the guidelines issued by the Reserve Bank of India in classifying the branch as rural, urban and semi-urban. The rural branches are classified in accordance with the population of the specified place where the particular branch is situated.

The reply is not tenable as under the Income Tax Act, deduction is not admissible for rural branch in a place which has a population exceeding ten

thousand according to the last preceding census. The assessing officer should have adopted last preceding census Report of 1991 instead of 1981. Incidentally, the Ministry had accepted similar audit observation at para 4.11.2 of the Report of the Comptroller and Auditor General of India for the year ended 31 March 1995.

(ii) In Amritsar, Jammu & Kashmir charge, the assessments of a banking company for the assessment years 1990-91, 1992-93, 1993-94 and 1995-96 were completed after scrutiny. Audit scrutiny revealed that the assessing officer allowed deductions of Rs.14.26 lakh, Rs.37.27 lakh, Rs.38.20 lakh and Rs.271.30 lakh towards provisions made in respect of bad and doubtful debts of rural branches of the bank though they were situated in places with a population exceeding ten thousand according to the last preceding census of 1981. The mistake in treating these branches as rural branches resulted in underassessment of income of Rs.361.03 lakh in aggregate with consequent short levy of tax of Rs.201.48 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of bad debts in case of banking companies

(b) Under the Income Tax Act, 1961, as amended from Ist April 1989, the amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing the income chargeable to the tax under the head `profits and gains of business or profession'. In the case of a bank to which provision for bad and doubtful debts is admissible, the amount of deduction shall be limited to the amount by which such debts or part thereof exceeds the "credit balance in the provisions for bad and doubtful debts account" made under the Act.

(i) In West Bengal III, Calcutta charge, the assessment of a public sector bank for the assessment year 1991-92 was completed in a summary manner in September 1993 at a loss of Rs.8,685.08 lakh. Audit scrutiny revealed that while processing the return of income, the assessing officer allowed bad debts of Rs.2,353.85 lakh as claimed by the assessee whereas out of the total provision only an amount of Rs.64.12 lakh was written off in the accounts and the balance amount of Rs.2,289.73 lakh already stood included in Rs.3807.13 lakh towards provision for bad debts charged to the profit and loss account. The incorrect allowance of bad debts which was prima facie apparent from records resulted in excess carry forward of loss by Rs.2,289.73 lakh involving potential undercharge of tax of Rs.1,053.28 lakh. Besides, additional income tax of Rs.210.66 lakh was also leviable after making prescribed adjustments.

The reply of the Ministry to the audit observation has not been received.

(ii) Some other important cases of the above nature noticed during test check are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	Rohtak, Haryana	1994-95 September 1996	143(3)	As against the credit balance of Rs.191.58 lakh in the provision for bad debts, deduction of Rs.222.72 lakh on account of bad debts written off which resulted in short computation of income by Rs.191.58 lakh.	99.14
2.	Jaipur, Rajasthan	1994-95 December 1996	143(3)	In addition to the deduction of bad debts actually written off, Rs.33.47 lakh on account of provision for bad debts was incorrectly allowed as deduction which led to under-assessment of income of Rs.33.47 lakh.	22.34

Incorrect allowance of provisions

4.11 Under the Income Tax Act, 1961, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for the deduction. It has been judicially held* that in order that a loss be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur in future.

Some important cases noticed during test check are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	West Bengal III, Calcutta	1989-90 March 1992	143(3)	Even though no settlement with the employees was made during the relevant previous year, provision of Rs.870 lakh for payments to employees was not disallowed.	786.00
2.	City II, Mumbai	1995-96 December 1996	143(1)(a)	Provision of Rs.677.03 lakh debited on account of provision for doubtful debts and advances was not disallowed which led to underassessment of income by a like amount.	373.72
3.	West Bengal I, Calcutta	1991-92 January 1994	143(3)	Provision of Rs.250.56 lakh was not disallowed even though the claim for revision of pay scales of officers and supervisors was not finalised during the relevant previous year.	166.63 16.07 (P)
4.	Andhra Pradesh I, Hyderabad	1993-94 December 1995	143(3)	Provision of Rs.24.07 lakh towards agent's commission was erroneously allowed as a deduction.	22.97

The Ministry have accepted the audit observation at Sl.No.1.

* CIT Vs Indian Overseas Bank 151 ITR-446 (Madras)

They have not accepted the audit observation at Sl.No.4 on the ground that agent's commission was not of the nature of 'Provision'. The assessee debits the commission etc. once it is finalised, twice a year and that during the month of March, 1993 the commission for the period January 1993 to March 1993 was ascertained and had crystallised. As the commission for the period was determined and was for the business, income corresponding to which was credited in the profit and loss account, the same was rightly allowed by the assessing officer.

The Ministry's reply is not tenable due to the fact that if the liability was ascertained and crystallised during the previous year relevant to the assessment year 1993-94, the same should have been directly debited to Profit and loss account without creating any provision for such expenditure. In this instant case Rs.24.07 lakh was categorically stated to be a provision for 'Agents Commission' besides crystallised expenditure already charged on this account.

Their response to the remaining cases has not been received.

Incorrect allowance of liability

4.12 Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment on types of expenditure specified under Section 43B of the Act. From 1 April 1988, tax or duty actually paid by the assessee on or before the date applicable in his case for furnishing the return of income shall also be allowed as deduction. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. are also deductible on actual payment basis. No deduction in respect of contribution to the above funds is, however, allowable unless such sum has actually been paid into the fund approved by the competent authority before the stipulated due date as specified under the relevant statute governing the funds.

(i) In West Bengal I, Calcutta charge, the assessment of a State Public Sector Company for the assessment year 1994-95 was completed in a summary manner in October 1995 computing loss at Rs.12,146 lakh as per return. Audit scrutiny of the Tax Audit Report of the company's auditor accompanying the return revealed that an amount of Rs.1,038 lakh debited to the profit and loss account on account of contribution to Provident Fund and family Pension Fund was not paid within the stipulated due date. The amount was, therefore, required to be disallowed. Omission to disallow this unpaid liability though prima facie apparent from records resulted in excess computation of loss by an identical amount involving potential tax effect of Rs.537 lakh besides non-levy of additional tax of Rs.107 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in February 1997 at a loss of Rs.7,500 lakh. Audit scrutiny of the tax audit report

and accounts submitted with the return of income revealed that Rs.1,194 lakh debited to the profit and loss accounts as taxes and duties for the previous year relevant to the assessment year 1994-95, was not paid within the relevant previous year or within the due date of the submission of the return of income. In the computation of the total income, the assessing officer while disallowing Rs.596 lakh on account of outstanding liabilities in respect of tax and duties out of the total unpaid liability, omited to disallow the balance of Rs.598 lakh. As the amount of outstanding liability stood debited to the relevant profit and loss accounts, but remained unpaid even upto the due date of furnishing the relevant return of income, the entire sum of Rs.1,194 lakh should have been added back in place of Rs.596 lakh. The incorrect disallowance resulted in excess computation and carry forward of loss by Rs.598 lakh involving potential short levy of tax of Rs.309 lakh.

The Ministry have accepted the audit observation.

(iii) In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1990-91 was completed after scrutiny in March 1993. Audit scrutiny revealed that the assessee recovered a sum of Rs.233.01 lakh from its employees during the previous year relevant to the assessment year 1990-91 and contributed an equivalent amount to a pension fund which was not approved during the relevant previous year. The assessing officer however, allowed the sum of Rs.233.01 lakh as deduction. Since the superannuation fund was not an approved one, contribution to such fund was required to be disallowed. Omission to do so resulted in excess carry forward of loss by Rs.233.01 lakh involving potential undercharge of tax of Rs.125.83 lakh.

The Ministry have accepted the audit observation.

(iv) In Raipur, Madhya Pradesh charge, the assessment of a public company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that assessing officer allowed provision amounting to Rs.42.16 lakh made to cover up the deficit arising out of interest payment made by Employees Provident Fund Trust to its members. Since the liability of payment of interest was that of Fund and not of company, the same was required to be disallowed treating the expenditure as not related to the business. Omission to do so, resulted in underassessment of income of Rs.42.16 lakh involving short levy of tax of Rs.37.53 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(v) Some other important cases noticed during test check in audit are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	Jaipur,	1995-96	143(3)	Even though interest to financial	69.70

	Rajasthan	November 1997		institutions, Central Sales Tax and bonus etc. totalling Rs.151.52 lakh were unpaid during the relevant previous year, provision therefor has been allowed as deduction.	(P)
2.	West Bengal III, Calcutta	1994-95 March 1997	143(3)	Provision of Rs.125.10 lakh towards employer's contribution to Provident Fund was allowed as deduction even though the same was not paid during the relevant previous year.	64.74 (P)
3.	Bhopal, Madhya Pradesh	1992-93 January 1997	143(3)	As against Rs.17.41 lakh actually paid before the stipulated dates, the entire amount of Rs.50.39 lakh being contribution to Provident Fund debited to profit and loss account was allowed as deduction.	36.87

The Ministry have accepted the audit observation at Sl. No. 1. .Their response to the remaining items has not been received.

Mistake in computation of income from tea business

4.13 Under the Income Tax Rules 1962, only 40 percent of the income derived from the sale of tea grown and manufactured by a seller in India is deemed to be income derived from manufacturing and selling operations and liable to income tax, the remaining 60 percent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to tax. This rule regarding apportionment of income applies only to the income from tea business.

In West Bengal II, Calcutta charge, the assessment of a widely held company engaged in the business of growing and manufacturing tea for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that during the relevant previous year, the assessee company had interest income of Rs.165.20 lakh on Rs.1,223.74 lakh advanced to several parties (outside tea business) and in pursuance of an order of the Commissioner of Income Tax, the assessing officer, in the assessment order, decided that the aforesaid interest income was taxable in full and the rule regarding apportionment of income was not applicable to it. But in actual computation of total income the amount of interest income of Rs.165.20 lakh was incorrectly added to the composite income from tea business and after allowing deduction of Rs.33.04 lakh therefrom on account of deposit under tea development account calculated at the rate of 20 percent of Rs.165.20 lakh, 40 percent of the balance amount of Rs.132.16 lakh i.e. Rs.52.86 lakh was brought to income tax instead of the whole interest income of Rs.165.20 lakh assessable under the head 'Other sources'. The incorrect grant of deduction resulted in underassessment of income of Rs.112.34 lakh involving short levy of tax of Rs.99.99 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of deposit under tea development account

4.14 Under the Income Tax Act,1961, where an assessee carrying on business of growing and manufacturing tea in India has, before the expiry of six months from the end of the previous year or before furnishing the return of his income, whichever is earlier, deposited with a nationalised bank any amount or amounts in an account maintained by the assessee with that bank for the specified purposes approved by the Tea Board, the assessee shall, subject to other provisions of the Act, be allowed a deduction of a sum equal to the amount or the aggregate of the amounts so deposited or a sum equal to twenty percent of the profits of such business (Computed under the head "profits and gains of business or profession before making any deduction under this section), whichever is less.

In West Bengal II, Calcutta charge, the assessment of a widely held company engaged in the business of growing and manufacturing of tea for the assessment year 1992-93 was originally completed after scrutiny in March 1995 allowing a deduction of Rs.285.61 lakh on account of deposit under tea development account being 20 percent of income derived from the business of growing and manufacturing of tea instead of the admissible deduction of Rs.110 lakh being the actual deposit made by the assessee with the NABARD for the specified purpose. The assessment was subsequently revised in July 1996 and excess deduction amounting to Rs.4.24 lakh only was withdrawn. Audit scrutiny revealed that in the revised assessment of July 1996, the assessing officer incorrectly computed the figure of excess deduction at Rs.4.24 lakh only and added it to the total income instead of the correct figure of Rs.70.24 lakh. The mistake resulted in underassessment of income of Rs.66 lakh involving short levy of tax of Rs.74.44 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of business income

4.15(a) Under the Income Tax Act, 1961, in a scrutiny assessment, the assessing officer shall make a correct assessment of the total income or loss of the assessee. While computing the income chargeable to tax, the assessing officer takes the profit or loss as per profit and loss account of the assessee as the starting point and then adds back or deducts the amount not allowable or which requires special consideration.

(i) In Baroda, Gujarat charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that, the following remarks of external auditors on the accounts of the company were yet to be effected in the accounts as under:-

1. Deferred credit of Rs.864.39 lakh included unwarranted provisions made of Rs.19.87 lakh for interest on borrowing from banks through bill discounting as the discount was already deducted at front end by the bank.

2. Other interest of Rs.79.63 lakh included Rs.22.70 lakh due to incorrect inclusion of interest on staff welfare scheme.

3. Other charges of Rs.1,979.99 lakh included guarantee fee of Rs.138 lakh payable to the Government on public loan for the year 1993-94 which has been accounted for twice.

Non-disallowance of the above sums resulted in underassessment of income to the extent of Rs.180.57 lakh involving potential tax effect of Rs.93.44 lakh.

The Ministry have accepted the audit observation.

(ii) In West Bengal III, Calcutta charge, the assessment of a closely held company, engaged in the business of real estates, for the assessment year 1993-94 was completed after scrutiny in September 1995 at a loss of Rs.100.98 lakh which was allowed to be carried forward. Audit scrutiny revealed that the assessing officer allowed a sum of Rs.115 lakh being compensation paid to a tenant towards vacating the premises. Since the assessee was engaged in the business of real estates the amount of the compensation paid was part and parcel of the purchase price of the property and was required to be added to the value of the stock-in-trade. Omission to add the same to the total income resulted in excess carry forward of loss of Rs.100.98 lakh and underassessment of income of Rs.14.02 lakh involving potential undercharge of tax of Rs.58.06 lakh and positive tax effect of Rs.12.90 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) The Income Tax Act, 1961, as amended with effect from 1 April 1989, provides that where the association of persons/body of individuals is chargeable to tax on its total income at the "maximum marginal rate" or at any higher rate, the share of member will not be included in its total income. The Board had further clarified in January 1990 that there are no provisions in the Income Tax Act for set off or carry forward of the share of loss of an association of persons or body of individuals by its member in its own assessment.

In Bhopal (now Indore), Madhya Pradesh charge, the assessment of a company for the assessment year 1989-90 was completed in March 1992. Audit scrutiny revealed that the assessee company had entered into two different joint ventures with two other companies, forming an association of persons and was liable to tax at the rates applicable to the members in the status of association of persons. However, the share of losses of Rs.43.42 lakh from the joint venture was set off against the income of the assessee company. The share of losses from these joint ventures was thus not includible in the assessee's income. Incorrect allowance of set off of losses resulted in underassessment of income of Rs.43.42 lakh involving short levy of tax of Rs.43.13 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(c) Under the Income Tax Act, 1961, the computation of sale of finished goods should be assessed at a uniform rate so that it may reflect the true profit of the business .

In Lucknow, Uttar Pradesh charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in January 1996 on a net loss of Rs.1,030.25 lakh. Audit scrutiny revealed that the assessee company sold 5,75,372 quintals of baggasse to its two sister units for which the department applied an average rate of Rs.16.54 per quintal at the time of assessment, where as the baggasse was sold to general buyers during the previous year relevant to the assessment year at the prevailing rate ranging from Rs.22 to Rs.35 per quintal. The assessing officer should have adopted an average rate or at least the lowest of the selling price to general buyers. The omission in computation of taxable income resulted in short computation of income of Rs.45.80 lakh involving undercharge of tax of Rs.26.33 lakh on the basis of average rate of Rs.24.50 per quintal.

The reply of the Ministry to the audit observation has not been received.

Other mistakes in computation of business income

4.16(a) Under the Income Tax Act, 1961, income under the head `profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment.

(i) In City VI, Mumbai charge, the assessment of a public undertaking company for the assessment year 1994-95 was completed after scrutiny in February 1997 allowing a deduction of Rs.13861 lakh as loss on account of variation in the rate of exchange on its outstanding liabilities. Audit scrutiny revealed that the assessee had obtained Kuwait Dinar 30 million loan in 1981 to meet the foreign exchange component of its project which was due for payment in December 1988. Since the plan outlay available for fertiliser sector was low as advised by Government of India, the assessee obtained a fresh loan of Kuwait Dinar 30 million in December 1988 to repay the old loan. As the loan was obtained at the instance of Government of India, the assessee had taken up with the Government to bear the increase in Kuwait Dinar loan liability on account of fluctuation in exchange rate as was borne by the Government on previous occasions and the question of allowing the exchange loss to the assessee did not arise. This view was upheld by CIT(A) while deciding the issue for the assessment year 1992-93 in December 1995. Thus, the deduction allowed on account of loss on exchange rate variation amounting to Rs.13,861 lakh reimbursable by Government of India in the computation of income for assessment year 1994-95 was incorrect. The mistake resulted in underassessment of income of an identical amount leading to short levy of tax of Rs.1,888 lakh. The incorrect carry forward of loss of Rs.9,756 lakh also involved potential short levy of tax of Rs.4,488 lakh. The

interest granted to the assessee of Rs.487 lakh was also required to be withdrawn.

The reply of the Ministry to the audit observation has not been received.

(ii) In Surat, Gujarat charge, the assessment of a company for the assessment year 1995-96 was completed after scrutiny in April 1996 at a loss of Rs.20.26 lakh. According to the tax audit report, the assessee company was following mercantile system of accounting except for 'expenditure on gratuity and payment of additional wages on account of rise linked with cost of living allowance under Minimum Wages Act' which were accounted for on payment basis. Audit scrutiny revealed that an amount of Rs.103.72 lakh representing 'payment of additional wages on account of rise linked with cost of living allowance' was allowed by the assessing officer though it was not actually paid by the assessee. The allowance was not in order in view of the method of accounting followed by the assessee for the specific transaction, which resulted in underassessment of income of Rs.103.72 lakh involving short levy of tax of Rs.48.37 lakh (including interest) and potential tax effect of Rs.9.32 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of contingent liability

(b) Under the provisions of Income Tax Act, 1961, expenditure which is deductible for income tax purposes is towards a liability actually existing at the time. Contingent liabilities do not constitute expenditure and cannot be the subject matter of deduction. It has been judicially held* that a sum set apart by any employer in any year for meeting the contingency of leave in next year cannot be regarded as permissible expenditure.

In City II, Mumbai charge, the assessment of widely held company for the assessment year 1996-97 was finalised in a summary manner in March 1997. Audit scrutiny revealed that the assessee company had claimed deduction of Rs.2,027 lakh as liability for leave encashment as per actual valuation and the same was allowed. As the deduction claimed by the assessee is not permissible being prima facie apparent from records, the same should have been disallowed. Omission to do so has resulted in underassessment of income of Rs.2,027 lakh involving short levy of tax of Rs.1,119 lakh including additional tax.

Similarly, in City I, Mumbai charge, in the assessment of a company for the assessment year 1996-97 processed under summary manner in March 1997, the assessee was allowed a deduction of a provision of Rs.134.67 lakh on account of encashable leave salary, the liability of which did not arise during the previous year. The incorrect deduction, which was apparent from records, resulted in underassessment of income of a like amount with consequent short levy of tax of Rs.74.33 lakh (including additional tax).

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* CIT Vs Rajkumar Mills 80 ITR 244(Bom.)

The Ministry have not accepted the audit observation in the second case on the ground that the remedial action could not be taken as the objections raised are on the issues where two opinions are possible following the decision of Bombay High Court in the case of M/s. Khatau Junkar Ltd and another[$]

The reply is not tenable as the issue was already settled by the jurisdictional High Court in the case of CIT Vs Rajkumar Mills Ltd., referred to above that provision for leave encashment is a contingent and not ascertained liability. Moreover, Karnataka High Court had also held[@] *the same decision in the case of CIT Vs Bharat Earth Movers Ltd. (1995)". As such, the decision in M/s. Khatau Junkar Ltd. is not material to the case.*

Their response to the remaining case has not been received.

Non-correlation with interest tax assessments

(c) Under the Interest tax Act, 1974 in computing the income of a Scheduled bank chargeable to income tax under the head profits and gains of business or profession the interest tax payable by the bank for any assessment year shall be deductible from the profits and gains of the bank assessable for that assessment year. Further, there is no time limit for completion of interest tax assessment. The Central Board of Direct Taxes issued instructions in December 1981 that interest tax assessments should as far as possible be completed alongwith the income tax assessments.

(i) In City III, Mumbai charge, the income tax assessment of a bank for the assessment year 1992-93 was completed after scrutiny in September 1995 allowing a deduction on account of interest tax liability of Rs.10,471.55 lakh. Audit scrutiny revealed that as per the appellate order of January 1996 in respect of interest tax assessment, chargeable interest was reduced to Rs.10,154.34 lakh. Excess interest tax liability of Rs.317.21 lakh allowed in the income tax assessment was not withdrawn. Omission to do so resulted in allowance of excess interest tax liability of Rs.317.21 lakh resulting in short levy of tax of Rs.302.04 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal III, Calcutta charge, the income tax assessment of a nationalised bank for the assessment year 1994-95 was completed after scrutiny on 14 March 1997 determining loss at Rs.10,470 lakh. Audit scrutiny revealed that in computing the aforesaid loss, the assessing officer allowed deduction of Rs.1,380 lakh being advance interest tax paid by the bank instead of the interest tax liability determined in the interest tax assessment of the assessee for the assessment year 1994-95 on 7 March 1997 wherein interest tax payable was worked out to Rs.1,081 lakh. The mistake resulted in excess allowance of interest tax liability of Rs.299 lakh leading to overassessment of loss by an identical amount involving a potential tax effect of Rs.155 lakh.

[$] 196 ITR 55
[@] 211 ITR 515

The reply of the Ministry to the audit observation has not been received.

(iii) In West Bengal III, Calcutta charge, the assessment of a closely held financial company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that the assessing officer allowed Rs.493.33 lakh as deduction on account of Interest Tax liability and determined total taxable income at Rs.46,867 lakh, though the interest tax assessment of the assessee company for the assessment year 1994-95 was completed in March 1997 and chargeable interest tax of Rs.441.91 lakh was levied. The assessee was, therefore, entitled to a deduction of Rs.441.91 lakh, being interest tax liability determined in the interest tax assessment instead of Rs.493.33 lakh incorrectly allowed as deduction by the assessing officer and the income tax assessment was not revised accordingly. The omission resulted in an excess allowance of deduction of interest tax liability of Rs.51.42 lakh leading to an underassessment of income by an identical amount involving short levy of tax of Rs.53.82 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Expenditure on prospecting, etc. for certain minerals

(d) Under the provisions of Income Tax Act, 1961, amortisation of the qualifying expenditure relating to prospecting for or extraction or production of any mineral, is allowed in equal instalments over a period of ten years against the profits derived from commercial production/exploitation of any mine in respect of which the expenditure was incurred. However, the amortisation is not allowed against any other income of the assessee.

(i) In Jabalpur, Madhya Pradesh charge, the assessments of a company for the assessment years 1988-89 to 1991-92 were completed after scrutiny in March 1994. Audit scrutiny revealed that assessee company had claimed and was allowed deduction under the aforesaid provision of the Act amounting to Rs.733.30 lakh, Rs.2,297.07 lakh, Rs.3,121.67 lakh and Rs.3,456.53 lakh respectively in respect of qualifying expenditure incurred on prospecting and developing mines against the profits of the revenue mines. Since the commercial production/exploitation in the prospecting or developing mines in respect of which, the amortisation of qualifying expenditure was allowed had not yet commenced, the deduction was not admissible. The mistake resulted in overassessment of loss aggregating Rs.9,608.57 lakh involving potential tax effect of Rs.4,866.64 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in January 1997 at a loss of Rs.10,416.12 lakh after allowing deduction of Rs.5,971.90 lakh towards expenditure on prospecting etc. for certain minerals. Audit scrutiny revealed that before allowing this deduction the total income of business was computed at a loss of Rs.4,444.22 lakh. Since the total income of business before making the deduction was determined at loss, no deduction under the provision of this section was admissible. The incorrect allowance of

deduction resulted in excess computation of loss of Rs.5,971.90 lakh involving potential tax effect of Rs.3,090.46 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996, after allowing deduction of Rs.6,830.04 lakh towards expenditure on prospecting etc. for certain minerals. Audit scrutiny revealed that the said deduction was allowed on the whole amount of expenditure of Rs.5,048.64 lakh incurred during the previous year towards 'Mines Development Expenditure' instead of restricting the same to Rs.5,04.86 lakh, being one tenth of the amount of expenditure, plus the unallowed instalment of Rs.1,781.40 lakh relating to earlier years. The mistake resulted in excess deduction of Rs.4,543.78 lakh involving potential tax effect of Rs.2,351.40 lakh.

The reply of the Ministry to the audit observation has not been received.

Payments outside India

(e) Under the Income Tax, 1961, where in any financial year the assessee has paid any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted, such amounts (payable outside India) shall not be deducted in computing the income chargeable under the head 'Profits and gains of business or profession'.

(i) In West Bengal II, Calcutta charge, the assessments of a widely held company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and March 1997 respectively. Audit scrutiny revealed that the assessing officer incorrectly allowed deductions of Rs.92.47 lakh and Rs.119.34 lakh in the assessment years 1993-94 and 1994-95 respectively towards payment of royalty outside India, though no tax at source was deducted therefrom. The mistake resulted in excess computation of loss by Rs.211.81 lakh involving potential tax effect of Rs.109.62 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal XI, Calcutta charge, the assessments of a widely held company for assessment years 1994-95 and 1995-96 were completed in a summary manner in December 1995. Audit scrutiny revealed that deductions of Rs.103.43 lakh and Rs.47.16 lakh towards royalty paid outside India were allowed without deduction of tax at source though it was prima-facie apparent from records. Irregular allowance of deduction led to underassessment of income of Rs.150.59 lakh in aggregate involving potential tax effect aggregating Rs.93.52 lakh including additional income tax.

The Ministry have accepted the audit observation.

(iii) In West Bengal XI, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996 at nil income after setting off part of the unabsorbed business loss of the previous assessment years and balance remained to be set off in future. Audit scrutiny revealed that while computing total income the assessing officer allowed deduction of royalty of Rs.120.63 lakh payable outside India though tax was not paid or deducted at source in respect of such royalty. The mistake resulted in excess computation of loss by Rs.120.63 lakh involving potential tax effect of Rs.62.43 lakh.

The Ministry have accepted the audit observation.

Preliminary expenses

(f) Under the Income Tax Act, 1961, the admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with the extension of an industrial undertaking is limited to 2.5 percent of cost of the project or capital employed in the business and is allowed a deduction in equal instalments spread over ten years.

(i) In West Bengal IV, Calcutta charge, the assessment of a domestic company for the assessment year 1995-96 was completed in a summary manner in May 1996. Audit scrutiny revealed that a sum of Rs.483.04 lakh was incurred as 'Deferred Project Development and Advertisement expenses' as a part of major campaign for promotion of assessee's diversified activities. Out of the said sum, the assessee claimed deduction of Rs.48.30 lakh being one tenth of the total amount as preliminary expenses and the assessing officer allowed the same. It was, however, noticed that the assessee further claimed the balance amount of Rs.434.74 lakh as business expenditure which was also allowed. The mistake resulted in underassessment of income by Rs.434.74 lakh involving tax effect of Rs.239.98 lakh (including additional tax of Rs.40 lakh) and incorrect payment of interest of Rs.28.58 lakh on refund.

The reply of the Ministry to the audit observation has not been received.

(ii) In Central I, Chennai charge, the assessments of a widely held company for the assessment years 1992-93, 1993-94 and 1994-95 were completed after scrutiny in March 1995 to March 1997. Audit scrutiny revealed that the deductions allowed on preliminary expenses included an amount of Rs.159.94 lakh incurred and capitalised upto the end of previous year relevant to assessment year 1990-91 and which was in excess of the prescribed limits under the provisions of the Act and hence subsequently reduced to Rs.78.10 lakh on the basis of audit observation. Similar excess allowance was also withdrawn for assessment year 1991-92 in December 1994. But such excess deduction for assessment years 1992-93 to 1994-95 was not withdrawn. This had resulted in excess carry forward of loss of Rs.81.84 lakh in each of the assessment years 1992-93 and 1993-94 and underassessment of income of Rs.81.84 lakh for assessment year 1994-95. Thus there was consequential underassessment of income aggregating Rs.245.52 lakh and short levy of tax of Rs.218.54 lakh (including interest).

The Ministry have accepted the audit observation.

(iii) In Andhra Pradesh I, Hyderabad charge, the assessment of an assessee company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that a deduction of Rs.26.80 lakh was allowed as expenditure on 'commission and brokerage charges' incurred towards procurement of share application money. As the amount was incurred in connection with the extension of industrial undertaking, the expenditure was to be treated as preliminary expenses and the deduction allowable was required to be limited to Rs.2.68 lakh. Omission to do so resulted in short computation of income by Rs.24.12 lakh with consequent short levy of tax of Rs.26.98 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect valuation of closing stock

4.17 It has been judicially held[Ψ] that any system of accounting which excludes for the valuation of stock in trade all costs other than the cost of raw materials is likely to result in a distorted picture of the true state of business, for the purpose of computing its chargeable income. According to accounting practices as enunciated by the Institute of Chartered Accountants of India, excise duty is a manufacturing expense and is an element of cost for inventory valuation. The Board clarified in 1981 that Central Excise/ Customs Duties, if any, payable by the manufacturer/trader should go into calculation of production cost and the closing inventory should include an element of such duty to represent such cost. Under the Income tax Act,1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment on types of expenditure specified under Section 43 B of the Act. For the purpose of payment of tax, duty or fee "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.

Some important cases of irregular deductions are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	West Bengal II, Calcutta	1993-94 March 1996	143(3)	Even though according to the regular accounting policy followed by the assessee closing stock was valued on the principle of cost or net realisable value at the year end, the closing stock at the end of the year 1992-93 was valued at prices prevailing in May 1993 resulting in under valuation of stock by Rs.2217.08 lakh with consequent excess computation of loss by Rs.1357.54 lakh and underassessment of income of Rs.859.54 lakh.	1147.34

[Ψ] CIT Vs British Paints India Ltd. 188 ITR 44 SC

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
2.	West Bengal II, V and VI, Calcutta	1992-93 to 1995-96 May 1996-March 1997	143(3)	In respect of 8 assessees, Central Excise duty aggregating Rs.1574.59 lakh payable on finished goods was not taken into account in valuing the closing stock which resulted in underassessment of income totalling to Rs.1574.59 lakh.	811.86 255.55 (P)
3.	West Bengal I, Calcutta	1994-95 December 1996 March 1997 (revised in March 1997 and September 1997)	143(3)	In respect of two assessees excise duty of Rs.432 lakh payable in one case and excise duty of Rs.330 lakh payable on finished goods in the other case have not been considered while valuing the closing stock which resulted in underassessment of income of Rs.762 lakh.	720.00
4.	City IV, Mumbai	1994-95 March 1997	143(3)	Excise duty and customs duty totalling Rs.533.42 lakh were not considered for valuation of closing stock which resulted in underassessment of income by a like amount.	276.04
5.	West Bengal IV, Calcutta	1993-94 March 1996 (rectified in May 1996)	143(3)	Amount of Rs.307.24 lakh being excise duty payable on finished goods was not included in the value of closing stock resulting in underassessment of income of Rs.307.24 lakh.	273.47
6.	City IV, Mumbai	1994-95 March 1997	143(3)	Rs.425 lakh being the excise duty liability on manufactured goods has not been included in valuation of closing stock which resulted in underassessment of income by a like amount.	220.00
7.	City V, Mumbai	1993-94 November 1995	143(3)	Proportionate customs duty on the goods confiscated in earlier years amounting to Rs.367.06 relating to goods still remaining in the stock was not considered while valuing the closing stock which resulted in underassessment of income by Rs.367.06 lakh.	189.95 (P)
8.	Ahmedabad I, Gujarat	1994-95 April 1996	143(3)	Excise duty of Rs.234.07 lakh payable on finished goods was not considered in the value of closing stock resulting in underassessment of income by a like amount.	121.13
9.	Baroda, Gujarat	1993-94 March 1996	143(3)	Excise duty of Rs.121 lakh and customs duty of Rs.97.12 lakh had not been included in the closing stock which resulted in underassessment of income totalling to Rs.218.12 lakh.	113.27 (P)
10.	NE Region, Shillong	1994-95 March 1997	143(3)	Excise duty and customs duty amounting to Rs.37.08 lakh have not been included in the valuation of closing stock which resulted in underassessment of income of Rs.37.08 lakh.	33.00

The Ministry have accepted the audit observation at Sl. No.1.

They have not accepted the audit observations at Sl.Nos.6 and 8 on the ground that the liability for excise duty is not incurred unless the goods are removed from warehouse and therefore, there is no question of including excise duty in the valuation of closing stock.

The reply is not tenable in view of explanation 2 below section 43(B)(a) which clarifies that "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year. According to the Excise Rules no excisable goods shall be removed from the factory or warehouse until the payment thereof has been made. Supreme Court has held that a duty on home produced goods will obviously be imposed at a stage which the authority finds to be the most convenient and the most lucrative, wherever it may be, but that is a matter of the machinery of collection, no matter at what stage it is collected. Therefore, under Income Tax Act, the duty becomes payable once the liability is attracted in the previous year in respect of the closing stock, though the exact duty may be determined at a subsequent date. The Institute of Chartered Accountants of India has also concluded that excise duty should normally be considered as a manufacturing expenses and like other manufacturing expenses be considered as an element of cost for inventory valuation.*

The above view finds support with the insertion of a new clause 145 A in the Finance Act, 1998 that the valuation of inventory for the purpose of determining the income chargeable under the head "profits and gains of business or profession" shall be further adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Their response to the remaining cases has not been received.

Incorrect computation of income of financial corporations

4.18 Under the Income Tax Act, 1961, financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to special deduction of an amount transferred by them out of their profits to special reserve account, upto an amount not exceeding 40 percent of their total income as computed before making this deduction and any deduction under chapter VIA. Similarly in respect of any provision for bad and doubtful debts made by public financial institutions or State Financial Corporations or State Industrial Investment Corporations an amount not exceeding five percent of the total income as computed before making this deduction and any deduction under chapter VI A is admissible. The total income in either case is that computed before allowing the respective deduction and before allowing deduction under chapter VI-A.

(a) In Trivandrum, Kerala charge, the assessment of a widely held financial company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing deduction of Rs.70.04 lakh towards special reserve as applicable to financial companies. Audit scrutiny revealed that the amount of

* Union of India Bombay Tyre International Limited 15 Taxman 29(SC)

special reserve of Rs.71.19 lakh shown as created in the accounts during previous year was simultaneously transferred to 'provision for bad and doubtful debts' in the accounts of the same previous year. As no special reserve existed in the assessee's accounts, as aforesaid, during the previous year, the assessee was not entitled to the deduction. The mistake resulted in excess grant of deduction of Rs.70.04 lakh involving short levy of tax of Rs.69.59 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) In the same charge, the assessment of a widely held company for the assessment year 1995-96 was completed in a summary manner in November 1996 at an income of Rs.963 lakh after allowing deductions of Rs.65.14 lakh and Rs.521 lakh towards provision for bad and doubtful debts and special reserve respectively. Audit scrutiny revealed that each of the aforesaid deductions was allowed with reference to the total income computed before making both the deductions instead of adopting total income after giving effect to special deduction allowable for banking companies. The mistake led to allowance of excess deduction to the tune of Rs.41.17 lakh involving short levy of tax of Rs.30.30.lakh.

The Ministry have accepted the audit observation.

Irregular allowance of depreciation

4.19 Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for purpose of his business during the relevant previous year. It has been judicially held* that if plant and machinery have not at all been used at any time during the relevant previous year, no depreciation is allowable. It is also held# that if the factory of an assessee remained under lock out through out the previous year and plant and machinery was not actually used for the purpose of business for a single day during the lockout period, depreciation on plant and machinery is not admissible.

In Kanpur, Uttar Pradesh charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in November 1994 and March 1995. Audit scrutiny revealed that the plant and machinery were not put to use for a single day in manufacture of goods during the previous years 1991-92 and 1992-93 due to lockout of the company. Thus the assessee was not entitled for allowance of depreciation of Rs.342 lakh and Rs.260.71 lakh respectively. Omission to disallow depreciation resulted in excess computation of loss aggregating Rs.602.71 lakh involving potential tax effect aggregating Rs.346.60 lakh.

The reply of the Ministry to the audit observation has not been received.

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* 25 ITR (SC)-Liquidators of India Vs.C.I.T.
# 206 ITR 682(Cal)-C.I.T. Vs.Oriential Coal Co.Ltd.

Mistakes in allowance of depreciation

4.20 Under the Income Tax Act, 1961, in computing the business income of an assessee, deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purpose of his business during the relevant previous year. Depreciation is calculated on the cost or written down value of the assets according to the rates prescribed in Income Tax Rules, 1962. Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction in respect of such asset shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the block of assets comprising such asset. No depreciation is admissible where the written down value has been reduced to zero on the last day of the previous year.

(a) In Delhi I charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing deductions of Rs.150 lakh and Rs.223.23 lakh on account of 100 percent depreciation on specified blocks of assets (the actual cost of each asset in the block being less than five thousand rupees). Audit scrutiny revealed that the above blocks of assets were purchased by the assessee and leased back to the seller companies which had already availed 100 percent depreciation on these assets. Thus, the written down value thereof in the hands of the seller companies at the time of their sale was NIL. However, instead of treating the written down value of the assets as NIL, the department had allowed depreciation on the purchase cost of the assets leased back. This mistake resulted in underassessment of income of Rs.373.23 lakh with consequent short levy of tax of Rs.332.22 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Excess allowance of depreciation

(b) Under the provisions of Income Tax Act, 1961, depreciation shall be allowed on the block of assets on such percentage on the written down value as prescribed. However, where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof shall be allowed as a deduction in respect of the previous year in which such machinery or plant is first put to use by the assessee for the purpose of business or profession. With effect from 1 April 1996, provision of 100 percent depreciation (applicable from assessment year 1996-97) on plant and machinery and other assets whose cost does not exceed Rs.5,000 has been deleted.

In City V, Mumbai charge, the assessments of two assessees for the assessment year 1996-97 were completed under summary manner in March 1997. Audit scrutiny revealed that the assessees were allowed 100 percent depreciation of Rs.305.74 lakh and Rs.14.24 lakh on the assets of which the value of individual item was less than Rs.5,000. In view of the amendment in the Finance Act, 1995, (applicable from assessment year 1996-97) the depreciation on the above assets should have been allowed only at the normal rate which was worked out to Rs.76.43 lakh and Rs.1.75 lakh respectively.

Omission to disallow the excess claim resulted in excess computation of loss aggregating Rs.241.80 lakh involving potential tax effect of Rs.111.23 lakh and additional tax of Rs.22.25 lakh.

The reply of the Ministry to the audit observation has not been received.

(c) In West Bengal III charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in July 1996 allowing depreciation aggregating Rs.1,329.31 lakh which included depreciation of Rs.1,226.42 lakh allowed on plant and machinery. Audit scrutiny revealed that the actual cost of plant and machinery installed during the year for a period of more than 180 days including the written down value at the beginning of relevant previous year after adjustment of sale/transfer amounted to Rs.3,447.24 lakh and the value of additions of plant and machinery which was put to use for a period of less than one hundred and eighty days was Rs.1,471.26 lakh. The depreciation allowable on the plant and machinery would, therefore, workout to Rs.1,045.72 lakh as against Rs.1,226.42 lakh allowed. On the basis of information available in the return and accompanying documents, the excess claim of depreciation should have been disallowed as prima facie inadmissible. The omission to do so resulted in excess allowance of depreciation of Rs.180.70 lakh with a consequent excess carry forward of the same by an identical amount involving a potential short levy of tax of Rs.83.12 lakh, besides non-levy of additional tax of Rs.16.62 lakh.

The reply of the Ministry to the audit observation has not been received.

(d) Other important cases are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	City VI, Mumbai	1995-96 May 1996	143(3)	In respect of machinery received and put to use for a period of less than 180 days, depreciation of Rs.292.57 lakh at full rate was allowed which resulted in excess computation of loss by Rs.146.96 lakh being 50 percent of the above amount.	67.29 (P)
2	West Bengal IV, Calcutta	1994-95 January 1997	143(3)	Even though the machinery was commissioned in the previous year relevant to the assessment year 1995-96, depreciation of Rs.109.75 lakh was allowed for the preceding assessment year which led to underassessment/ excess carry forward of depreciation of a like amount.	23.88 45.51 (P)

3	Meerut, Uttar Pradesh	1995-96 October 1996	143(1)(a)	Depreciation was incorrectly allowed on machinery not owned by the assessee but was taken on rent which resulted in underassessment of income of Rs.93.09 lakh.	61.77
4.	Ludhiana, Punjab	1993-94 March 1996	143(3)	Due to erroneous allowance of depreciation on the same written down value to the amalgamated and amalgamating companies Rs.485.53 lakh was allowed as against the total amount of Rs.367.41 lakh as depreciation leading to excess allowance of depreciation of Rs.118.12 lakh.	61.13

The Ministry have accepted the audit observations at Sl. Nos. 1 and 2. Their response to the remaining cases has not been received.

Incorrect application of rates of depreciation

4.21 Under the Income Tax Act, 1961, in computing the business income of an assessee, deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purpose of his business during the relevant previous year. Depreciation is calculated on the cost or written down value of the assets according to the rates prescribed in Income Tax Rules, 1962. Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction in respect of such asset shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the block of asset comprising such asset.

Some important cases of irregular deductions are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	Andhra Pradesh I, Hyderabad	1995-96 July 1996	143(1)(a)	As against the correct rate of 25 percent, depreciation of Rs.672.03 lakh was allowed at 100 percent on captive power plant. Further, though the assets were used for less than 180 days, depreciation was allowed without restricting the same to 50 percent of normal rate. The mistakes resulted in excess computation of loss by Rs.934.34 lakh.	85.96 429.80 (P)
2.	West Bengal V, Calcutta	1993-94 May 1996 1994-95 May 1996 1995-96 July 1996	143(3) 143(1)(a) 143(3)	Depreciation aggregating Rs.292.39 lakh was allowed erroneously at 40 percent instead of correct rate of 20 percent applicable to vehicles not used in the business of running on hire. This resulted in excess allowance of depreciation totalling Rs.114.12 lakh.	83.38

3.	Jalandhar, Punjab	1996-97 February 1997	143(1)(a)	Depreciation of Rs.124.12 lakh calculated at 40 percent (20 percent for vehicles used for less than 180 days) was allowed instead of the correct rate of 25 percent/12.5 percent respectively even though the vehicles were not used in running the business of transportation of goods. This led to underassessment of income of Rs.46.54 lakh.	25.69

The Ministry have not accepted the audit observation at Sl.No.3 stating that as per Board's circular of August 1994, no disallowance should be made of items on which two opinions are possible while processing assessment in a summary manner.

The reply is not tenable in view of the facts being apparent on records in the light of the Board's specific clarification in June 1993 stating that higher rate of depreciation will be admissible on motor lorries used in the assessee's business of transportation of goods on hire.

Their response to the remaining cases has not been received.

Excess/irregular set off of unabsorbed depreciation

4.22(a) Under the provisions of the Income Tax Act, 1961, where for any assessment year unabsorbed depreciation under the head "profits and gains of business or profession" can not be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year and shall be set off against the profits and gains of business or profession of that year. If there is no positive income in that year, it can be carried forward to the subsequent year for set off.

Few examples are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	City II, Mumbai	1994-95 March 1997	143(3)	Rs.205.59 lakh of unabsorbed depreciation was allowed set off as against Rs.15.27 lakh available which resulted in underassessment of income of Rs.190.32 lakh.	98.49
2.	Karnataka III, Bangalore	1993-94 March 1996	143(3)	Even though the unabsorbed depreciation allowed to be carried forward was only Rs.829.75 lakh, set off was allowed for Rs.956.70 lakh which led to excess carry forward of depreciation by Rs.126.95 lakh.	65.70 (P)

3.	City V, Mumbai	1994-95 October 1996 1995-96 June 1996	143(3) 143(1)(a)	As against unabsorbed depreciation of Rs.39.39 lakh available, Rs.67.32 lakh and Rs.77.56 lakh were allowed set off in the assessment years 1994-95 and 1995-96.	50.13
4.	Cochin, Kerala	1991-92 March 1994 (revised January 1995, January 1997, March 1997)	143(3)	Even though unabsorbed depreciation of Rs.30.12 lakh was once set off in March 1994, the same was again allowed set off in the revisions made in January/March 1997 which led to excess carry forward of unabsorbed depreciation in the assessment year 1991-92 and consequent underassessment of income of Rs.18.17 lakh in the assessment year 1993-94.	16.18

The Ministry have accepted the audit observations at Sl. Nos. 2 and 4. Their response to the remaining cases has not been received.

Incorrect carry forward and set off of unabsorbed depreciation

(b) Under the Income Tax Act, 1961, where as a result of an order of scrutiny assessment or the best judgement assessment or on revision, rectification or on settlement relating to any earlier assessment year and passed subsequent to the filing of the return of income processed under the summary assessment scheme for any subsequent year, there is any variation in the carry forward of loss, deduction, allowance or relief claimed in the return and as a result, if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable and such intimation shall be deemed to be a notice of demand and all the provisions of the Act shall apply accordingly and if a refund is due, it shall be granted to the assessee. In case of loss, omission to rectify the carry forward of loss has the inherent risk of the incorrect carry forward figures remaining undetected and unrectified.

(i) In West Bengal IV, Calcutta charge, the assessment of a domestic company for the assessment year 1995-96 was completed in a summary manner in November 1996 allowing set off of unabsorbed business loss and depreciation of Rs.763.32 lakh pertaining to the assessment year 1994-95. Audit scrutiny revealed that in the assessment for the assessment year 1994-95 completed after scrutiny in March 1997, unabsorbed depreciation of Rs.41.81 lakh only relating to the assessment year 1991-92 was allowed to be carried forward. Since the assessment for the assessment year 1994-95 was completed subsequent to the filing of the return of income of the assessment year 1995-96 (return was filed in November 1995), the assessing officer was required to issue revised intimation for the assessment year 1995-96 specifying the sum payable by the assessee due to excess set off of unabsorbed loss. Omission to do so resulted in underassessment of income by Rs.721.51 lakh involving short levy of tax of Rs.464.65 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal III, Calcutta charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in February

1997 allowing set off of unabsorbed depreciation of Rs.2,618 lakh and carry forward of balance amount of Rs.622 lakh for further set off. Audit scrutiny revealed that in the order of scrutiny assessment for the assessment year 1994-95 made subsequently in March 1997, unabsorbed depreciation was determined at Rs.2,103 lakh. Since the scrutiny assessment for the assessment year 1994-95 was completed after the date of filing of return of income for the assessment year 1995-96 in November 1995 and there was a wide variation in the entitlement of depreciation, the assessment for assessment year 1995-96 was required to be revised in order to withdraw excess allowance of brought forward depreciation of Rs.1,137 lakh and fresh intimation sent under the provisions of Act. Omission to revise the same resulted in excess allowance of depreciation of Rs.515 lakh and excess carry forward of unabsorbed depreciation of Rs.622 lakh involving short levy of tax of Rs.236.68 lakh and potential short levy of tax of Rs.286.15 lakh in the assessment year 1995-96.

The reply of the Ministry to the audit observation has not been received.

(iii) In West Bengal II, Calcutta charge, in the assessment of a company for the assessment year 1994-95 completed in a summary manner in August 1995 unabsorbed loss of Rs.606 lakh pertaining to the assessment year 1993-94 was allowed to be carried forward for future set off. Audit scrutiny revealed that in the scrutiny assessment for the assessment year 1993-94 completed in February, 1996 loss was determined at Rs.437 lakh. Since the scrutiny assessment for the assessment year 1993-94 was completed after the date of filing of return of income for the year 1994-95 in November 1994 and there was a variation in carried forward loss the assessment for assessment year 1994-95 was required to be revised in order to withdraw excess carry forward of loss of Rs.168 lakh and fresh intimation sent under the provisions of the Act. Omission to revise the same resulted in excess carry forward of loss by Rs.168 lakh involving a potential tax effect of Rs.87.19 lakh.

The reply of the Ministry to the audit observation has not been received.

(c) Under the Income Tax Act, 1961, where as a result of an assessment order relating to any earlier assessment year and passed subsequent to the filing of the return under section 143(1)(a), there is any variation in the carry forward loss, deduction, allowance or relief claimed in the return and as a result of which if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable.

In Lucknow, Uttar Pradesh charge, the assessment of a company for the assessment year 1995-96 was completed in summary manner in March 1996 allowing set off of unabsorbed depreciation and investment allowance aggregating Rs.14,618 lakh pertaining to assessment year 1994-95. Audit scrutiny revealed that assessment for assessment year 1995-96 was followed by completion of scrutiny assessment for assessment year 1994-95 during the same month and the unabsorbed depreciation and investment carried forward from assessment year 1994-95 worked out to Rs.14,093 lakh. Thus the assessment of assessment year 1995-96 was required to be revised

withdrawing excess set off and thereby revising the demand and intimating the assessee accordingly. Failure to do so resulted in underassessment of income of Rs.524.61 lakh involving short levy of tax of Rs.241.32 lakh.

The reply of the Ministry to the audit observation has not been received.

Mistake in allowance of investment allowance

4.23 Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction by way of investment allowance shall be allowed subject to the condition that an amount equal to seventy five percent of the sum actually allowed is debited to profit and loss account of any previous year in respect of which the deduction is to be allowed or any previous year (being a previous year not earlier than the year in which the plant or machinery was installed or first put to use) and credited to Investment Allowance Reserve Account.

In Baroda, Gujarat charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in January 1997. Audit scrutiny revealed that during the period from assessment years 1983-84 to 1994-95 assessee had created investment allowance reserve of Rs.10,014 lakh against which assessee was allowed total investment allowance of Rs.14,227 lakh upto assessment year 1994-95. On the basis of total reserve of Rs.10,014 lakh created upto assessment year 1994-95, the assessee was entitled to investment allowance upto Rs.13,352 lakh only. Mistake resulted in excess allowance of investment allowance and underassessment of income of Rs.875 lakh with consequent short levy of tax of Rs.761 lakh (including interest).

The Ministry have not accepted the audit observation stating that an additional reserve of Rs.29 crore was created in assessment year 1994-95 and no remedial action is required to be taken as the investment allowance allowable is more than the amount actually allowed.

The Ministry's reply is not tenable as the verification of records has revealed that the additional reserve of Rs.29 crore was created in assessment year 1995-96 and not in the assessment year 1994-95.

Incorrect set off of unabsorbed investment allowance

4.24 Under the Income tax Act, 1961, where for any assessment year unabsorbed investment allowance under the head 'profit and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be set off against the profits and gains, if any, of any business and profession and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off up to a maximum of eight assessment years, immediately succeeding the assessment year relevant to the previous year in which the said asset was acquired or installed or put to use. According to the priority for set off of losses and allowances, business loss of earlier years has to be first set off followed by unabsorbed depreciation and investment allowance. The Act further provides that in the case of domestic companies the unabsorbed depreciation allowance

and unabsorbed investment allowance to be set off for the assessment year 1992-93 shall be restricted to two third of such allowance or allowances.

(i) In Karnataka II, Bangalore charge, the assessment of a company for the assessment year 1992-93 initially completed after scrutiny in February 1995 and subsequently revised in December 1995 allowing set off of unabsorbed depreciation and investment allowance aggregating Rs.207.71 lakh pertaining to earlier years. Audit scrutiny revealed that the unabsorbed allowances were not restricted to two third of such allowances. Further, in the assessments for the assessment years 1989-90 to 1991-92 the order of priority was not followed. Unabsorbed investment allowance was first fully set off against income and thereafter, unabsorbed business losses and depreciation allowance. Also unabsorbed investment allowance of Rs.54.75 lakh pertaining to assessment years 1981-82 to 1983-84 was adjusted in the assessment years 1990-91 to 1992-93 though it had lapsed due to time bar. The mistakes resulted in excess set off of unabsorbed losses including unabsorbed depreciation and investment allowance aggregating Rs.181.57 lakh with consequent short levy of tax of Rs.102.35 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In City V, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in December 1996 after allowing set off of unabsorbed business loss amounting to Rs.52.27 lakh and unabsorbed investment allowance of Rs.15.06 lakh pertaining to assessment year 1988-89. Audit scrutiny revealed that in the re-assessment for the assessment year 1988-89 completed in March 1994, no unabsorbed allowances had remained for set off in future years. Thus, the incorrect set off has resulted in under assessment of income aggregating Rs.67.83 lakh involving short levy of tax of Rs.64.28 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In Tamil Nadu IV, Chennai charge, assessment of a company for assessment year 1994-95 was completed after scrutiny in January 1997 allowing set off of unabsorbed investment allowance of Rs.33.63 lakh relating to earlier years and carry forward of balance amount of Rs.92.60 lakh. Audit scrutiny revealed that as per the assessment completed in February 1996 for assessment year 1993-94, an amount of Rs.10.07 lakh only was allowed to be carried forward for set off in subsequent years. Omission to adopt the correct figure resulted in underassessment of income of Rs.23.76 lakh and excess carry forward of unabsorbed allowance of Rs.92.60 lakh involving short levy of tax of Rs.20.07 lakh (including interest) and potential tax effect of Rs.42.60 lakh.

The Ministry have accepted the audit observation.

Omission to assess capital gains

4.25 Under the Income Tax Act, 1961, any transfer of a capital asset by a company to its wholly owned subsidiary company is not regarded as transfer.

However, the exemption is withdrawn where at any time before the expiry of eight years from the date of transfer the capital asset is converted as stock-in-trade of its business or the holding company ceases to hold the whole of the share capital of the subsidiary company and the amount of profits or gains arising from the transfer of such capital asset not charged by virtue of the provisions of exemption supra, shall be deemed to be income chargeable under the head "capital gains" of the previous year in which such transfer took place. It has judicially been held[1] that in the case of sale as a going concern where value of each asset is ascertainable, surplus arising over and above (i.e. the difference between actual cost of acquisition and written down value) is capital gain and where the sale consideration is in lumpsum payment without reference to the value of each asset, consideration received is liable to tax under capital gains.

In Central I, Chennai charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996 at nil income. Audit scrutiny revealed that the assessee company realised a profit of Rs.1,516 lakh on sale of three units at a total consideration of Rs.23,000 lakh as a going concern to its wholly owned subsidiary companies, the shares held in them being subsequently divested of within eight years of transfer. While rejecting the assessee's contention that the profit on sale was a capital receipt, the assessing officer treated the entire sale consideration as moneys payable under section 43(6) of Income Tax Act and deducted Rs.1,516 lakh received as sale consideration from the block of assets. However, as the assessee had divested its holdings in wholly owned subsidiaries within eight years from the date of transfer, exemption available for transfer of assets to wholly owned subsidiary companies had to be withdrawn and the assessee was liable to tax under capital gains. Omission to do so resulted in underassessment of income of Rs.1,266.16 lakh with consequent short levy of tax of Rs.1,127.01 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of capital gains

4.26 Under the provisions of the Income Tax Act, 1961, where the gross total income of an assessee includes any income arising from the transfer of a long term capital asset, the gross total income shall be reduced by the amount of such income as reduced by the long term capital gains and the long term capital gains will be taxed separately at the flat rates as provided in the Act.

In City III, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed in a summary manner in May 1995 after allowing the deduction of Rs.135.08 lakh under chapter VI A. Audit scrutiny revealed that the gross total income included the long term capital gain of Rs.208.86 lakh . Omission to reduce the long term capital gain from the gross total income before allowing chapter VI A deduction resulted in underassessment of income of Rs.135.08 lakh with consequent short levy of

[1] 227 ITR 260 (SC) 227 ITR 278 (SC)

tax of Rs.120.26 lakh (including the additional tax and interest). The excess interest paid to the assessee was also required to be withdrawn.

The reply of the Ministry to the audit observation has not been received.

Income escaping assessment

4.27(a) Under the Income Tax Act, 1961, the total income of a person for any previous year includes all income from whatever sources derived or which accrues or arises or is deemed to accrue or arise during the previous year unless specifically exempted from the tax by the provisions of the Act. It has been judicially held [*] that where the subsidies or grants are given by the Government to assist the trader in his business, they are generally payments of revenue nature. These are supplementary trade receipts.

In City IV, Mumbai charge, in the case of a widely held company for the assessment year 1996-97 completed in a summary manner in March 1997, a deduction of Rs.1,823 lakh being transportation subsidy received from the Government of Himachal Pradesh was allowed as capital receipt. Audit scrutiny revealed that as per details available on record, the transport subsidy was granted to assist the company in its business and this was revenue receipt as per law laid down by Supreme Court. As such, the treatment of the item as capital receipt was irregular. Omission to disallow the deduction had resulted in underassessment of income of Rs.1,823 lakh with consequent short levy of tax of Rs.839 lakh. Further, additional tax of Rs.168 lakh was also leviable.

The Ministry have not accepted the audit observation on the ground that the issue whether the transport subsidy was a capital or revenue receipt requires close examination and can not be adjusted under summary assessment.

The reply, however, is not tenable as the issue is decided in the case cited above by the Supreme Court and thus falls within the scope of prima facie adjustment.

(b) In West Bengal IV, Calcutta charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in December 1993. In the assessment, an amount of Rs.340.14 lakh being gains arising from fluctuation of foreign currency rate was not brought to tax on the plea that no foreign currency transaction had been carried out in connection with the work in the foreign country from which the company had pulled out on 20 July 1988. Audit scrutiny revealed that transactions were carried out in the said account by the assessee company in succeeding years. Further, in the preceding assessment year 1990-91, difference in exchange rate of Rs.474.26 lakh, being loss was claimed by the assessee company and allowed in the assessment. Accordingly, the gain of Rs.340.14 lakh was required to be brought to tax. Omission to consider the gain of Rs.340.14 lakh resulted in over computation of loss by like amount involving potential short levy of tax of Rs.156.44 lakh.

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[*] VSSV Meenakshi Achi and another Vs CIT (1965) 60 *253*

The reply of the Ministry to the audit observation has not been received.

(c) Some other important cases are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	City V, Mumbai	1993-94 December 1995	143(3)	The difference of Rs.437.81 lakh between the sales accounted for as per profit and loss account and the quantitative details furnished in the published account was not brought to tax which resulted in underassessment of income of a like amount.	376.09
2.	Rajkot, Gujarat	1994-95 January 1997, 1995-96 March 1997	143(3) 143(3)	The interest on income tax refunds aggregating Rs.391.97 lakh relating to earlier years as per orders of the department of March 1994 and May 1994 was not considered for taxation which led to underassessment of total income of Rs.391.97 lakh.	256.91
3.	City I, Mumbai	1995-96 March 1996	143(1)(a)	Even though the assessee was accounting for the income on accrual basis, duty draw back of Rs.347.82 lakh was not considered for taxation which led to underassessment of a like amount.	192.00
4.	Lucknow, Uttar Pradesh	1993-94 March 1993 1994-95 March 1997 (both revised in May 1997)	143(3) 143(3)	Interest received by the assessee on refund of tax totalling to Rs.170.63 lakh was not added to the income leading to underassessment of income of a like amount.	88.30
5.	Amritsar, Jammu & Kashmir	1994-95 December 1996, 1995-96 July 1997	143(3) 143(3)	Interest of Rs.56.24 lakh received by the assessee on excess advance tax paid for the assessment year 1994-95 was not included in the income chargeable to tax during the assessment year 1995-96. Further, as against Rs.524.90 lakh due for the assessment year 1994-95, Rs.525.90 lakh was allowed as refund.	67.59

The Ministry have not accepted the audit observation at Sl.No.3 on the ground that the assessee had consistently been offering the duty draw back on receipt basis and not on accrual basis.

The reply, however, is not tenable due to the fact that even though the above receipts were offered by the assessee on receipt basis, the same were being accounted for by him on accrual basis in his accounts. The information being available in return and accompanying documents, the receipt should have been considered for prima facie addition.

Their response to the remaining cases has not been received.

Incorrect carry forward and set off of losses

4.28 Under the Income Tax Act, 1961, where the net result of the computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession. No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined. Further, no loss is allowed to be carried forward for set off unless the assessee has filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer.

(a) In West Bengal III, Calcutta charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in February 1997 allowing carry forward of loss of Rs.1,533.65 lakh. Audit scrutiny revealed that the return of loss was filed on 16 January 1997 against the due date of 30 November 1995. There was no evidence of either the company having applied for or having been granted extension of time for filing the return. As the return of loss was filed beyond the prescribed due date, the benefit of carry forward of loss was not admissible to the assessee company. The mistake resulted in incorrect carry forward of loss of Rs.1,533.65 lakh involving potential short levy of tax of Rs.705.48 lakh.

The Ministry have accepted the audit observation.

(b) In Tamil Nadu V, Chennai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing set off of brought forward loss of Rs.290.73 lakh relating to assessment year 1993-94. Audit scrutiny revealed that as per assessment order for assessment year 1993-94, there was taxable income of Rs.29.27 lakh and no loss was allowed to be carried forward to subsequent assessment years. The mistake resulted in excess set off of loss of Rs.290.73 lakh with consequent underassessment of income of Rs.290.73 lakh and short demand of tax of Rs.258.78 lakh (including interest).

The Ministry have accepted the audit observation.

(c) In West Bengal III, Calcutta charge, the assessment of a widely held Banking Company for the assessment year 1993-94, originally completed in a summary manner in January 1994, was revised in August 1995 at a loss of Rs.10,871.15 lakh. In computing the loss, the assessing officer allowed interest tax of Rs.1,515.11 lakh debited to the relevant profit and loss account. Audit scrutiny, however, revealed that the interest tax payable by the assessee for the assessment year 1993-94 was assessed at Rs.1,294.89 lakh. Interest tax was thus allowed in excess by Rs.220.22 lakh. The mistake resulted in excess

carry forward of loss by Rs.220.22 lakh involving potential undercharge of tax of Rs.113.96 lakh.

The Ministry have accepted the audit observation.

(d) In Trivandrum, Kerala charge, in the assessment of a company for the assessment year 1994-95 completed after scrutiny in March 1993, loss of Rs.238.63 lakh was carried forward from assessment year 1990-91. Audit scrutiny revealed that the said loss of Rs.238.63 lakh had comprised loss of Rs.114.90 lakh relating to assessment year 1989-90 which was already set off against incomes of assessment years 1992-93 and 1993-94 in December 1995 and June 1996 respectively leaving no portion thereof to be set off in assessment year 1994-95. The mistake resulted in excess set off of loss of Rs.114.90 lakh with consequent short levy of tax of Rs.102.27 lakh.

The Ministry have accepted the audit observation.

(e) Other important cases of incorrect carry forward and set off of losses are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	West Bengal III, Calcutta	1991-92 April 1992	143(1)(a)	Even though the return of income was on the basis of unaudited figures and did not accompany auditor's report and audited accounts, loss of Rs.123.39 lakh was determined and allowed to be carried forward instead of treating the return as defective. This resulted in undue benefit of carry forward of loss by an identical amount.	63.85 (P)
2.	West Bengal IV, Calcutta	1994-95 March 1997	143(3)	As against the correct amount of unabsorbed losses of previous years amounting to Rs.136.51 lakh, an amount of Rs.239.20 lakh was allowed which resulted in excess carry forward of loss of Rs.102.69 lakh.	59.05 (P)
3.	Karnataka II, Bangalore	1994-95 December 1996	143(3)	Even though the unabsorbed loss of Rs.112.24 lakh for the assessment year 1986-87 had lapsed after expiry of the prescribed period, the same was allowed set off leading to excess carry forward of loss of Rs.112.24 lakh.	51.63 (P)

4.	Tamil Nadu IV, Chennai	1994-95 March 1997	143(3)	As against Rs.24 lakh available for set off relating to previous years, set off of Rs.27.17 lakh and carry forward of Rs.84.53 lakh were allowed towards unabsorbed losses, depreciation and investment allowance which resulted in underassessment of income of Rs.3.17 lakh and excess carry forward of unabsorbed depreciation/ investment allowance of Rs.84.53 lakh.	2.75 48.61 (P)

The Ministry have accepted the audit observations at Sl.Nos.3 and 4.

Their response to the remaining cases has not been received.

Incorrect set off of capital loss

4.29 Under the Income Tax Act, 1961, where in respect of any assessment year, the net result of the computation under the head 'capital gains' is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under any other head. The loss under the head 'capital gains' can be set off only against income from capital gains in subsequent years.

(a) In City II, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing set off of loss under the head capital gains of assessment year 1993-94 amounting to Rs.321.11 lakh. Audit scrutiny revealed that in the assessment for assessment year 1993-94, no loss under the head capital gains was remaining for set off in subsequent years. Therefore, the set off of Rs.321.11 lakh allowed was irregular. Incorrect set off resulted in underassessment of income of Rs.321.11 lakh under the head short term capital gains involving short levy of tax of Rs.166.17 lakh.

The reply of the Ministry to the audit observation has not been received.

(b) In West Bengal II, Calcutta charge, the assessment of a closely held company for the assessment year 1992-93 completed after scrutiny in November 1994 was first revised in July 1995 and finally rectified in August 1995. Audit scrutiny revealed that in the revision made in July 1995, capital loss of Rs.157.15 lakh arising out of sale of shares was allowed to be set off against business income of Rs.177.10 lakh. This irregular set off of capital loss thus resulted in underassessment of income of Rs.157.15 lakh with consequent short levy of tax of Rs.165.80 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(c) In City III, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in December 1995 computing the loss as Rs.991.23 lakh. Audit scrutiny revealed that during the previous year relevant to the assessment year 1993-94, the assessee had sold certain capital assets for a consideration of Rs.900 lakh. As the consideration

received was in excess of the written down value of the block of assets amounting Rs.693.04 lakh, the excess should have been taxed as short term capital gain. Audit scrutiny further revealed that the department had also allowed depreciation of Rs.24.20 lakh on this block of assets which was incorrect. The incorrect computation resulted in excess carry forward of loss of Rs.231.16 lakh involving potential tax effect of Rs.119.62 lakh.

The Ministry have accepted the audit observation.

Incorrect allowance of loss on unascertained claims

4.30 Under the Income Tax Act, 1961, taxable income or loss shall accrue or arise during the previous year relevant to the assessment year. In the case of claims contingent upon final determination at a future point of time, these will be treated as strictly uncertain till finally quantified.

In North East Region, Shillong charge, the assessment of a transport company for the assessment year 1993-94 was completed after scrutiny in March 1996 determining income of Rs.114.87 lakh. In the second phase of a contract work entered into by the assessee with a State Government during transportation of a Statue to a particular location, an accident occurred in March 1990, after incurring an expenditure of Rs.135.30 lakh for which the assessee claimed "dead loss" of Rs.69.80 lakh in the assessment year 1990-91 and showed balance of Rs.65.50 lakh as work-in-progress. The claim of dead loss was disallowed in the assessment and also confirmed by the appellate authority on the ground that loss could not be ascertained before completion of contract. On completion of the work in the previous year relevant to the assessment year 1993-94, the assessing officer assessed loss in the project at Rs.98.01 lakh and allowed write off of dead loss of Rs.69.80 lakh disallowed earlier, before settlement of the insurance claims. Audit scrutiny, however, revealed that the assessee received instalments of insurance claim amounting to Rs.56.87 lakh during the previous years 1993-94 and 1994-95. As such, allowance of dead loss in the assessment year 1993-94 was premature and not in order, pending settlement of insurance claims. Incorrect allowance resulted in underassessment of income of Rs.69.80 lakh in the assessment year 1993-94 involving undercharge of tax of Rs.62.13 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Mistakes in assessments while giving effect to appellate orders

4.31(a) Under the Income Tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and the latter shall comply with the direction given by him in the appellate order. Underassessment of tax of substantial amounts and over charge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Reports of the Comptroller and Auditor General of India. Despite this and issue of repeated instructions by the Government such mistakes continue to occur suggesting the need for better supervision and control.

In Indore, Madhya Pradesh charge, the assessment of a widely held company for the assessment year 1985-86 originally completed under scrutiny in March 1988 was revised to give effect to the orders of the ITAT in August 1996 at 'nil' income adopting Rs.112.40 lakh as determined under orders of CIT(A) in September 1992. Audit scrutiny revealed that while working out the above total income of Rs.112.40 lakh, relief of Rs.320.56 lakh was allowed towards royalty as against the correct amount of Rs.118.43 lakh determined as per orders of the CIT(A) in September 1992. The mistake resulted in underassessment of income of Rs.202.13 lakh with consequent short levy of tax of Rs.116.73 lakh (including potential tax effect of Rs.94.91 lakh).

The reply of the Ministry to the audit observation has not been received.

(b) In City II, Mumbai charge, the assessment of a company for the assessment year 1986-87 was completed after scrutiny in December 1989 making an addition of Rs.226.19 lakh on account of change in method of valuation of closing stock from the total cost method to direct cost method without disturbing the valuation of closing stock, the addition of which was confirmed by the appellate authority. Audit scrutiny revealed that the assessee company then contested in appeal for modification of the value of opening stock of assessment year 1987-88. The appellate authority directed the assessing officer to verify the factual basis and to modify the opening stock, if correct. However, the department without verifying the factual basis, enhanced the value of opening stock of the assessment year 1987-88 in order to give effect to appeal order in June 1992. Since the additions were effected in assessment year 1986-87 for consistent valuation of the stock, the action taken to enhance the value of opening stock of assessment year 1987-88 was incorrect. The mistake resulted in underassessment of income of Rs.226.19 lakh with consequent short levy of tax of Rs.113.09 lakh.

The reply of the Ministry to the audit observation has not been received.

(c) In Jammu and Kashmir, Amritsar charge, the assessment of a banking company for the assessment year 1992-93 was completed after scrutiny in March 1995, inter alia, allowing a deduction of Rs.444.01 lakh towards provision for bad and doubtful debts, being 5 per cent of the total income of Rs.8,880.24 lakh. The assessment was subsequently revised in July 1995 and March 1996 to give effect to appellate orders allowing a relief of Rs.2,406.06 lakh. Audit scrutiny revealed that while giving effect to the above appellate orders, the deduction allowable for bad and doubtful debts was not restricted to Rs.323.71 lakh, being 5 percent of the total income finally determined at Rs.6,474.18 lakh. The omission resulted in underassessment of income of Rs.120.30 lakh with consequent short levy of tax of Rs.62.26 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(d) In City VI, Mumbai charge, the assessment of a company for the assessment year 1992-93 was revised in January 1997 to give effect to CIT

(A)'s order granting relief aggregating to Rs.1,718.42 lakh. Audit scrutiny revealed that while computing the revised income to give effect to the above appellate order, the dividend income which was initially reduced from the total income remained to be added back to the total income. Omission to add back the dividend income resulted in underassessment of income of Rs.69.61 lakh with consequent short levy of tax of Rs.61.05 lakh (including the excess interest granted to the assessee on refund).

The Ministry have accepted the audit observation.

(e) In North East Region, Shillong charge, the assessment of a widely held company for the assessment year 1989-90 was completed originally after scrutiny in February 1991 allowing a deduction of Rs.623.25 lakh towards investment deposit account. The same was revised in June 1992 to give effect to appellate orders allowing further deduction of Rs.298.88 lakh on the above account on income from interest not allowed in the original assessment. Audit scrutiny revealed that the interest income of Rs.1,479.30 lakh of the assessee included interest receipts totalling Rs.297.58 lakh from tax free bonds and on refunds from the Income Tax Department and was not treated as income for the assessment year 1989-90 as the same was subjected to tax in the earlier assessment year 1987-88. Accordingly, the net assessable income assessed would work out to Rs.1,181.72 lakh and the allowable deduction to Rs.236.34 lakh as against Rs.298.88 lakh allowed on revision in June 1992. The irregular deduction resulted in excess allowance of deduction and underassessment of income of Rs.62.54 lakh with consequent short levy of tax of Rs.54.63 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deductions under Chapter VIA

4.32(a) Under the provisions of the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. Gross total income has been defined as the total income computed in accordance with the provisions of the Act before making any deduction under Chapter VIA. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to 'nil' or to a loss, no deduction under Chapter VIA is admissible.

(i) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1995-96 was completed in a summary manner in July 1996 at 'nil' income after allowing a deduction of Rs.1,390.45 lakh towards profits and gains from new industrial undertaking established after 31 March 1981. Audit scrutiny revealed that had the brought forward unabsorbed loss of Rs.23,534.56 lakh been adjusted first, the gross total income would have been a loss and hence the deduction of Rs.1,390.45 lakh would not have been admissible. As the information was prima facie apparent from the return, the deduction should have been withdrawn. The incorrect

allowance of the deduction resulted in excess set off of loss of Rs.1,390.45 lakh involving potential tax effect of Rs.639.61 lakh and additional income tax of Rs.127.92 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In City II, Mumbai charge, the assessment of widely held company for the assessment year 1986-87 originally completed after scrutiny in March 1989 was revised in March 1997 to tax the payment of Rs.170.60 lakh made to welfare organisations as per reversionary powers of CIT. Audit scrutiny revealed that after disallowance of payments made to welfare organisation, the loss was computed at Rs.578.34 lakh after allowing deduction of Rs.194.29 lakh towards Chapter VIA deductions though no such deduction was permissible in the instant case. This has resulted in overstatement of loss of Rs.194.29 lakh involving potential short levy of tax of Rs.102 lakh.

The reply of the Ministry to the audit observation has not been received.

(b) The Act further provides that from assessment year 1993-94, where in respect of any assessment year the gross total income of an assessee includes any income arising from the transfer of a long term capital asset, the gross total income shall be reduced by the amount of such income and deduction under chapter VIA shall be allowed on the income so reduced. In other words, no deduction under Chapter VIA shall be allowed from the income from long term capital gains.

In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1996-97 was completed in a summary manner in March 1997 at nil after allowing deductions aggregating Rs.2,439.42 lakh under Chapter VIA. Audit scrutiny revealed that the gross total income of Rs.2,439.42 lakh, *inter alia*, included long term capital gains of Rs.994.03 lakh and the same was not reduced before allowing deductions under Chapter VIA. After reducing the gross total income by the amount of capital gains of Rs.994.03 lakh, the total admissible deductions under chapter VIA, would work out to Rs.1,445.39 lakh as against Rs.2,439.42 lakh allowed. Since the information regarding long term capital gains was available in the return and accompanying documents, the excess deduction under Chapter VIA claimed by the assessee should have been disallowed as prima facie inadmissible. Omission to do so resulted in underassessment of income of Rs.994.03 lakh with consequent short levy of tax of Rs.460.91 lakh (including additional tax and interest).

The reply of the Ministry to the audit observation has not been received.

(c) Under the Income Tax Act, 1961, where any deduction is required to be made or allowed under Chapter VIA in respect of any income of the nature specified in that section which is included in the gross total income of the assessee then, for the purpose of computing the deduction under that section,

the amount of income of that nature as computed in accordance with the provisions of the Act (before making any deduction under chapter VIA) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

In Trivandrum, Kerala charge, the assessment of a company for assessment year 1995-96 was completed in a summary manner in November 1996 allowing deductions aggregating Rs.48.10 lakh under the provisions of Chapter VIA. Audit scrutiny revealed that while computing the profits and gains with reference to which the said deductions were to be allowed, Rs.71.69 lakh being special deduction towards capital expenditure on scientific research was not reduced. The mistake along with another mistake in computation of profits retained for export business resulted in excess allowance of deductions of Rs.15.13 lakh with consequent short levy of tax of Rs.16 lakh (excluding interest).

The reply of the Ministry to the audit observation has not been received.

Mistake in allowance of deduction of profit derived from services provided to foreign tourists

4.33 Under the Income Tax Act, 1961, as applicable to the assessment year 1992-93, where an assessee being an Indian company or person resident in India, is engaged in the business of a hotel or of a tour operator approved by the prescribed authority, there shall be allowed in computing the total income of the assessee, a sum equal to the aggregate of 50 percent of the profit derived from services provided to foreign tourists and so much of the amount out of the remaining profits derived as such, as is debited to the profit and loss account credited to a reserve account to be utilised by the assessee for the purpose of his business under the conditions prescribed in the Act. For this purpose, the profits derived from services provided to foreign tourists shall be the amount which bear to the profits of the business (as computed under the head 'profits and gains of business or profession') the same proportion as the receipts in relation to services for foreign tourists received in convertible foreign exchange bear to the total receipts of the business carried on by the assessee.

In Delhi VIII charge, the assessments of a company for the assessment years 1995-96 and 1996-97 were completed in a summary manner in October 1996 and February 1997 at incomes of Rs.290.66 lakh and Rs.219 lakh after allowing deductions of Rs.229.15 lakh and Rs.176.26 lakh respectively. Audit scrutiny revealed that while computing the above deductions, the business profits were considered as Rs.746.09 lakh and Rs.568.08 lakh instead of Rs.520.32 lakh and Rs.397.83 lakh as shown in the computation sheet accompanying the return of income for the two assessment years respectively. After considering the correct profits, the allowable deduction would work out to Rs.283.25 lakh in aggregate as against Rs.405.41 lakh allowed. The incorrect allowance of deduction resulted in underassessment of income aggregating Rs.122.16 lakh with consequent short levy of tax of Rs.58.64 lakh (including additional tax).

The Ministry have not accepted the audit observation on the ground that the adjustments pointed can not be made under summary assessment.

The reply is not tenable as according to the provisions, any deduction claimed in the return which is prima facie inadmissible on the basis of information available in such return or documents accompanying shall be disallowed. In the instant case, the information was available in the computation sheet accompanying the return and as such the excess claim on the basis of such information should have been disallowed.

Incorrect allowance of carry forward and set off deficiency in respect of profits and gains from newly established industrial undertaking etc. in certain cases

4.34(a) Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains from an industrial undertaking or ship or business of a hotel, there shall be allowed subject to certain provisions, a deduction from such profits and gains of so much of amount thereof as does not exceed the amount calculated at six percent of the capital employed. Where the amount of profits and gains falls short of the relevant amount of the capital employed, the amount of such shortfall shall be carried forward for set off against the profits and gains in the following assessment years. However, the deficiency or any part thereof shall not be carried forward beyond the seventh assessment year as reckoned from the end of the initial assessment year.

In Bhopal, Madhya Pradesh charge, the assessment of a public limited company for the assessment year 1990-91 originally completed after scrutiny under the provisions of section 147 of the Act in December 1994 was subsequently revised in March 1997 at Rs.502.03 lakh. In the above assessment, a deficiency of Rs.96.47 lakh under the above provisions relating to the assessment years 1984-85 and 1985-86 was adjusted. Audit scrutiny revealed that assessment year 1981-82 being the initial assessment year, the deficiency was to be carried forward and set off upto the assessment year 1988-89 only being the seventh assessment year. The irregular adjustment of the deficiency beyond the seventh year resulted in underassessment of income of Rs.96.47 lakh with consequent short levy of tax of Rs.88.55 lakh (including interest paid on refund).

The reply of the Ministry to the audit observation has not been received.

(b) In Kochi, Kerala charge, the assessment of a closely held company for the assessment year 1995-96 originally completed in a summary manner in January 1996 was rectified in May 1996 at 'nil' income. Audit scrutiny revealed that the deductions allowed in the rectification of May 1996, inter alia, included relief in respect of capital employed in units commenced before 1 April 1981 which related to a period beyond seven years and were therefore, not eligible for being carried forward and set off against the income of the assessment year 1995-96. Since the information that the claim for deduction pertained to assessment years from 1980-81 to 1984-85 was available in the return/accompanying document, the claim should have been disallowed as a prima facie adjustment. Omission to do so resulted in underassessment of

income of Rs.35.59 lakh with consequent short levy of tax of Rs.21.61 lakh (including additional income tax and excess interest on refund).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of profits and gains from industrial undertakings etc.

4.35 Under the provisions of Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking established after 31 March 1981, the assessee is entitled to a deduction of twenty five percent (30 percent in respect of profits derived from a company established on or after 1 April 1990 but before 31 March 1991) of such profits and gains for the initial assessment year and each of the seven subsequent assessment years.

In Karnataka Central, Bangalore charge, the assessment of a widely held company for the assessment year 1996-97 was completed in a summary manner in January 1997 at Rs.106.42 lakh after allowing deduction of Rs.42.28 lakh under the above provisions. As the assessee company's production started in the previous year relevant to assessment 1988-89, the above deduction would be eligible upto the assessment year 1995-96 only being the eighth year. Since the information regarding year of claim etc. was available with the documents accompanying the return of income, the deductions beyond the eighth assessment year should have been disallowed by making prescribed adjustment. Omission to do so resulted in incorrect allowance of deduction and underassessment of income aggregating Rs.42.28 lakh with consequent short levy of tax of Rs.25.94 lakh (including additional tax and interest).

The Ministry have accepted the audit observation.

Incorrect deduction in respect of profits from new industrial undertaking established in backward area after 31 March 1981

4.36(a) Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from industrial undertaking established in backward area, the assessee is entitled, subject to certain provisions, to a deduction of twenty percent of such profits and gains for a period of ten assessment years including the one relevant to the previous year in which the assessee begins to manufacture or produce articles or things. A further deduction of twenty five percent of such profits and gains is also admissible if the industrial undertaking goes into production after 31 March 1981.

(i) In City II, Mumbai charge, the assessment of the public sector oil company for the assessment year 1992-93 was finanlised after scrutiny in January 1995 for taxable income Rs.19,992.71 lakh allowing deductions aggregating Rs.2,141.70 lakh under the above provisions. As the company has not maintained separate unit-wise accounts, the department computed the eligible profits of the units concerned at the ratio of cost of the project (unit) at the end of the year to the cost of gross block of the corporation at the beginning of the year. As the value of the cost of the project had been taken on the closing day, the cost of gross block also should have been adopted as at the end of the year. The incorrect adoption of gross block at the beginning of the year instead of at

the end of the year has resulted in excess aggregate allowance of deduction of Rs.372.20 lakh with consequent short levy of tax of Rs.192.61 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal I, Calcutta charge, the assessments of a widely held company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in September 1995 and March 1997 allowing deductions aggregating Rs.142.42 lakh and Rs.84.35 lakh under the above provisions in the two assessment years respectively in respect of ceiling fan division situated in a backward area. Audit scrutiny revealed that the company started manufacturing and selling of ceiling fans from the assessment year 1984-85 and was allowed deductions under the provisions of the Act from the same assessment year. As deductions were admissible only for ten and eight assessment years respectively which expired in assessment years 1993-94 and 1991-92 no further deductions were admissible under the above mentioned provisions of the Act. The irregular deduction of Rs.226.77 lakh in aggregate resulted in underassessment of income by a like amount with consequent short levy of tax of Rs.183.92 lakh (including excess payment of interest on refund).

The reply of the Ministry to the audit observation has not been received.

(iii) In Bhopal, Madhya Pradesh charge, the assessments of a public limited company for the assessment years 1992-93 to 1995-96 were completed after scrutiny between March 1995 and March 1997 in which the capitalised amount of interest paid by the assessee was allowed as deduction treating the same as interest paid on funds borrowed for expansion of existing business. Audit scrutiny revealed that interest amount of Rs.339.42 lakh being interest payment attributable to the new unit of the industrial undertaking was not reduced for arriving at the eligible profits for the purpose of allowing deductions. Further, during the assessment for the assessment the year 1992-93, after considering the unabsorbed brought forward investment allowance of Rs.115.55 lakh relating to an earlier assessment year 1987-88, there would be no profits and thus no deduction was allowable under Section 80I. The above mistakes resulted in underassessment of income aggregating Rs.72.39 lakh with consequent short levy of tax of Rs.57.58 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) The Act further provides that in determining the quantum of deduction, the profits and gains of the industrial undertaking shall be computed as if such profits and gains from the business were the only source of income of the assessee during the previous year relevant to the initial assessment year and every subsequent assessment year upto and including the assessment year to which determination is to be made. The Central Board of Direct Taxes while explaining the scope and effect of section 80 I had explained in September 1980 that losses, depreciation and investment allowance of earlier years of the

new industrial undertaking will be taken into account in determining the quantum of deduction even though they may have actually been set off against the profit of the assessee from other source. Further, it was judicially held* that similar procedure is to be followed for the deduction under section 80 HH also.

In Trivandrum, Kerala charge, the assessment of a widely held company for the assessment year 1992-93 originally completed after scrutiny in March 1995 was revised in July 1995 allowing deductions of Rs.32.60 lakh and Rs.40.75 lakh in respect of profits and gains of its two industrial units under the provisions as applicable to new industrial undertaking established in backward area and new industrial undertaking gone into production after 31 March 1981. Audit scrutiny revealed that the two units had no profit left after set off of unabsorbed depreciation and investment allowance relating to those units and as such, the assessee would not be entitled to the above deductions. The mistake resulted in incorrect allowance of deduction of Rs.73.35 lakh in aggregate with consequent tax effect of Rs.57.91 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(c) It has been judicially held[2] by Rajasthan High Court that in order to arrive at the profit under the above provisions, effect shall first be given to the deduction admissible, if any, in respect of profits and gains from newly established undertaking in backward area.

In Jaipur, Rajasthan charge, in the assessments of 2 companies for the assessment years 1990-91, 1993-94 and 1994-95 completed after scrutiny in July 1995, January 1997 and March 1997, the assessees were allowed deductions aggregating Rs.145.87 lakh at 25 percent of profits and gains from new industrial undertaking established after 31 March 1981. These assessees were also allowed aggregate deductions of Rs.116.69 lakh at 20 percent towards profits and gains from newly established industrial undertaking in backward areas. Accordingly, the aggregate admissible deduction worked out to Rs.116.69 lakh as against Rs.145.87 lakh allowed by the department. The mistakes resulted in excess allowance of deductions aggregating Rs.29.18 lakh leading to total underassessment of income of an identical amount with consequent short levy of tax of Rs.26.19 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect deduction in respect of profits from new industrial undertaking established after 31 March 1991

4.37(a) Under the Income Tax Act, 1961, as amended by the Finance (No.2) Act, 1991, where the gross total income of an assessee includes profits and gains derived from an industrial undertaking established after 31 March 1991, the assessee is entitled to a deduction of twenty-five percent of such profits and gains provided it is not formed by splitting up or reconstruction of a

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* CIT Vs Kerala Solvent Extractions (1987) 165 ITR 174 (Kerala)

[2] CIT Vs Shree Engineers, Jodhpur

business already in existence. It has been judicially held* that if the newly established unit is itself an integrated and independent unit in which new plant and machinery are put up and is independently capable of production of goods, then it can be classified as a newly established industrial undertaking.

In Jabalpur, Madhya Pradesh charge, the assessments of a widely held company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in December 1995 and October 1996. Audit scrutiny revealed that the assessee company reconstructed and expanded the capacity of its original unit from 100 tons per day (TPD) to 500 TPD (licensed and installed capacity)and treating this reconstructed and expanded unit as a new unit, the assessee was allowed deduction under the above provisions amounting to Rs.56.41 lakh for the two assessment years. As there was nothing on record to prove that the reconstructed and expanded unit was capable of producing the goods independently of the old unit, it could not be classified as a newly established industrial undertaking. Hence, the deduction allowed was irregular. The irregular deduction resulted in underassessment of income aggregating Rs.56.41 lakh with consequent short levy of tax of Rs.38.74 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking established after 31 March 1991 in notified backward areas, the assessee is entitled to a deduction of thirty per cent of such profits and gains.

(i) In city I, Mumbai Charge the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in March 1997 at Rs.500.54 lakh in which the assessee company had not claimed deduction under aforesaid provisions since unit entitled to claim this deduction was in loss. The assessing officer while not accepting the loss relating to the unit, had recomputed the loss after excluding other income as the said loss would be set off in future from the profits of the unit to arrive at the allowable deduction. Audit scrutiny revealed that while recomputing the loss, the assessing officer had not considered interest amounting to Rs.1,572.60 lakh pertaining to the concerned unit allowed in the computation of income under Section 36 (1)(iii) even though capitalised in the books of accounts. Since the profits of the units are to be computed as per the provisions of the Act, the interest payment capitalised in the accounts but allowed as revenue item amounting to Rs.1,572.60 lakh was also required to be considered in arriving at the profit of the unit. Omission to do so had resulted in understatement of loss from the unit to the extent of Rs.1,572.60 lakh involving underassessment of income of Rs.471.78 lakh being 30 percent of Rs.1,572.60 lakh involving potential short levy of tax of Rs.244.14 lakh.

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* CIT Vs Associated Cement Companies Ltd. (1979) 118-ITR-406 (Bombay HC)

The reply of the Ministry to the audit observation has not been received.

(ii) In Bangalore Central, Karnataka charge, the assessments of a closely held company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in March 1997 and that of the assessment year 1996-97 in a summary manner in February 1997 allowing deduction aggregating Rs.136.57 lakh under the above provisions. Audit scrutiny revealed that the assessee was a 'service company' having no stock in trade at any time and was engaged in engineering activities. Further, as per column 12 of form 3 CD, no manufacturing activities were conducted by the assessee and the account did not show manufacturing expenses or inventories. Thus, the assessee not being an industrial undertaking engaged in manufacturing/production of articles/things, was not entitled to the above deduction. The irregular allowance of deduction of Rs.136.57 lakh resulted in underassessment of income of a like amount with resultant short levy of tax of Rs.99.29 lakh (including interest and additional tax).

The Ministry have accepted the audit observation relating to the assessment years 1994-95 and 1995-96. As regards the observation for the assessment year 1996-97, the Ministry have stated that the allowability of the deduction was a debatable issue and thus was beyond the scope of summary assessment.

The reply, however, is not tenable inasmuch as the information that the assessee was not engaged in manufacturing activity was apparent from the Tax Audit Report under section 44AB and other documents accompanying the return of income. Thus, the deduction should have been disallowed under prima facie adjustment.

(c) It has been judicially held* that the business of poultry farming could not be characterised as an industrial undertaking engaged in the manufacture or production of articles, under the Income Tax Act, 1961.

In Allahabad, Uttar Pradesh charge, the assessments of a widely held company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in October 1995 and June 1996 allowing deduction aggregating Rs.46 lakh. Audit scrutiny revealed that the assessee was engaged in the business of poultry farming and hence was not eligible for the deduction in view of the judicial decision. The irregular allowance of deduction resulted in underassessment of income of Rs.44.01 lakh with consequent short levy of tax of Rs.29.19 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction in respect of certain inter-corporate dividends

4.38(a) Under the Income Tax Act, 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed, in computing the total income, a deduction of an amount equal to so much of the amount of income by way of dividends from another domestic company as does not exceed the

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* CIT Vs.Dejay Hatcheries (1994) 211 ITR 652 (Bombay)

amount of dividend distributed by the former domestic company on or before the due date.

In Central I, Calcutta charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995 allowing, inter alia, a deduction of Rs.158.60 lakh under the above provisions on the plea that the assessee had distributed dividend of Rs.362 lakh in the relevant previous year. Audit scrutiny, however, revealed that the said distribution of dividend related to earlier assessment year 1991-92, as Rs.151.07 lakh of the dividend income was received only on 31 March 1992. Further, the dividend declared in respect of the assessment year 1992-93 was distributed beyond the specified date. Thus, the deduction allowed in respect of dividend income of Rs.151.07 lakh was irregular. The irregular deduction resulted in underassessment of income of a like amount with consequent short levy of tax of Rs.134.46 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(b) The Act further provided that in the assessment year 1994-95, the amount of deduction in respect of dividend received from the Unit Trust of India (UTI) shall be limited to four-fifth of such dividend income.

In City II, Mumbai charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing a deduction of Rs.2,260.13 lakh under the above provisions. Audit scrutiny revealed that the dividend income of Rs.1,375.46 lakh received by the assessee included Rs.1,063.30 lakh received from the UTI. Accordingly, the deduction allowable under the aforesaid provisions would work out to Rs.1,162.79 lakh as against Rs.2,260.13 lakh allowed by the department. The mistake resulted in underassessment of income of Rs.1,097.33 lakh with consequent short levy of tax of Rs.567.87 lakh.

The reply of the Ministry to the audit observation has not been received.

(c) The Act was amended through the Finance (No.2) Act,1980, with retrospective effect from April 1968, to provide for deduction on account of inter-corporate dividends to be allowed with reference to the net dividend income as computed in accordance with the provisions of the Act and not on the gross amount of dividends. It has also been judicially held* that proportionate management expenses should be deducted from the gross dividend for the purpose of the deduction.

(i) In North East Region, Shillong charge, the assessment of a widely held Oil Company for the assessment year 1994-95 was completed after scrutiny in March 1997 allowing a deduction of Rs.520 lakh on gross dividend income of Rs.650 lakh from Unit Trust of India. It was noticed from the cash flow and

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* CIT Vs. United General Trust Ltd. 200 ITR 488 (SC)

liquidity position of the company as reflected in the printed accounts as well as assessment orders for the assessment years 1990-91 to 1994-95 that the amount of K.D (Kuwaiti Dinar) loans raised in the assessment year 1990-91 for augmenting working capital were utilised for investment in Units aggregating Rs.4,722.95 lakh. After accounting for proportionate debt charges on loan so invested in units i.e. Rs.476.07 lakh, net dividend income qualifying for deduction of gross dividend receipts of Rs.650 lakh would be Rs.139.14 lakh, being four-fifth of qualifying dividend of Rs.173.93 lakh as against Rs.520 lakh allowed. The irregular deduction resulted in underassessment of income of Rs.380.86 lakh with consequent short levy of tax of Rs.197.09 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) Some other important cases are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	Central I, Calcutta	1991-92 March 1994 1992-93 March 1995 1993-94 November 1995	143(3) 143(3) 143(1)(a)	Due to failure to deduct proportionate administrative expenses of Rs.240.21 lakh attributable to dividend income from the gross income, deduction was computed at Rs.567.97 lakh as against the correct amount of 327.70 lakh which resulted in underassessment of income of Rs.240.27 lakh.	185.12
2.	NE Region, Shillong	1994-95 March 1997	143(3)	Due to non-deduction of proportionate finance charges and administrative expenditure aggregating Rs.98.94 lakh paid towards borrowed funds invested in Units, deduction was allowed in excess by Rs.79.15 lakh which led to underassessment of income by a like amount.	40.96
3.	NE Region, Shillong	1994-95 March 1997	143(3)	In respect of two widely held tea companies, omission to deduct proportionate administrative expenditure of Rs.28.50 lakh and Rs.25.93 lakh respectively from the gross dividend incomes led to excess allowance of deduction and consequent underassessment of income aggregating Rs.39.82 lakh.	35.44
4.	Central, Bangalore	1994-95 March 1997	143(3)	Due to failure to deduct the amount of tax deducted at source of Rs.12.91 lakh and proportionate management expenses of Rs.12.56 lakh attributable to dividend income, deduction of Rs.52.38 lakh was allowed as against the correct amount of Rs.26.91 lakh which led to underassessment of income of Rs.25.47 lakh.	22.67

The Ministry have not accepted the audit observation at Sl.No.3 stating that the administrative and other expenses were all incurred for the purpose of business and no expenses were incurred for earning the dividend incomes.

This view is however not tenable in view of the judicial decision referred to above. Further, there would be certain expenses which have to be compulsorily incurred on earning the dividends such as arrangements for receiving warrants/cheques and remitting the same to the banks, collection charges payable to the banks, arrangements for keeping watch on receipt of the incomes and their realisation etc.

Their response to the remaining cases has not been received.

Incorrect allowance of deduction in respect of commission etc. from foreign enterprises

4.39 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any income by way of royalties, commission, fee or any other similar payment received by him in convertible foreign exchange, a deduction equal to fifty percent of such income is allowed in computing the total income of the assessee. It has also been judicially held[3] that such deduction is to be computed after deducting expenditure incurred to earn such income.

In Delhi II charge, the assessments of a company for the assessment years 1992-93 and 1994-95 were completed after scrutiny in November 1994 and January 1996 respectively allowing a total deduction of Rs.205.98 lakh in respect of commission received from foreign enterprises. Audit scrutiny revealed that proportionate expenditure aggregating Rs.240.14 lakh incurred in Indian currency in the previous years relevant to the assessment years on salary, wages, administrative expenses and employees remuneration etc. for earning such commission, was not considered for computing net receipts on which deduction was allowed. The mistake resulted in excess allowance of deduction of Rs.95.23 lakh with underassessment of income by a like amount involving short levy of tax of Rs.84.67 lakh (including interest and withdrawal of interest).

The Ministry have accepted the audit observation.

Incorrect deduction in respect of profits and gains from the business of publication of books

4.40 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains from the business of printing and publication of books, a deduction of 20 percent of such profits and gains shall be allowed in computation of the total income.

In Patna, Bihar charge, the assessment of a government company for the assessment year 1995-96 was completed in a summary manner in February 1996 at an income of Rs.102.65 lakh after allowing, inter alia, a deduction of Rs.25.66 lakh under the above provisions. Audit scrutiny revealed that while computing the above deduction, income from other sources was not reduced

[3] Distributors (Baroda) P Ltd. Vs Union of India and Others 155 ITR 120 (SC)

from the eligible profits and the omission resulted in excess allowance and underassessment of income of Rs.20.68 lakh. In addition, a deduction amounting to Rs.6.18 lakh was irregularly allowed towards unpaid bonus. These mistakes resulted in a total underassessment of income of Rs.26.86 lakh with consequent short levy of tax of Rs.23.40 lakh (including interest and additional tax).

The reply of the Ministry to the audit observation has not been received.

Irregular allowance of double taxation relief

4.41(a) Under the provision of an agreement entered into between India and Japan for avoidance of double taxation, tax to be paid on royalty/fees for technical services arising in one contracting state and paid to an assessee resident in the other contracting state, shall not exceed 20 percent of the gross amount of such royalty/fees. The above provision shall, however, not apply if the assessee carries on business through a permanent establishment situated in the other contracting state in which case the assessee would be treated as a foreign company and the royalty/fees taxed at thirty percent as per the provisions of the Income Tax Act,1961.

In North East Region, Shillong charge, the assessments of a company incorporated in Japan and engaged in rendering technical services to a power corporation in India, for the assessment years 1994-95 and 1995-96 were completed after scrutiny in January 1996 and April 1996 respectively charging tax at the rate of 20 percent of the gross amount of the technical fees received by it. Audit scrutiny revealed that the assessee entered into an agreement with the corporation relating to completion and operation of or project and with the approval of the Reserve Bank of India set up a project office in New Delhi and a site office in Assam with effect from September 1992. As such, the assessee was to be treated as a foreign company carrying on business through permanent establishment in India and thus was liable to be taxed at 30 percent of the technical fees aggregating Rs.901.42 lakh received by it during the two assessment years. Omission to apply correct rate of tax resulted in short levy of tax of Rs.115.55 lakh.

The reply of the Ministry to the audit observation has not been received.

(b) It has been judicially held* that when regular assessment is made under special provisions for shipping business of non-residents, all provisions in determination of tax liability including ancillary or incidental or consequential matters pertaining to it are attracted.

In Tamil Nadu I, Chennai charge, the income tax assessment of a foreign company registered in Ukraine State, (formerly USSR) for the assessment year 1993-94 was completed after scrutiny in February 1996 on a total income of Rs.21.76 lakh being export/import freight earned in India between Indian ports and third country ports. Audit scrutiny revealed that the assessee had earned a

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* A.S.Glittre Vs.CIT: 91 Taxman 286 (SC)

sum of Rs.692.92 lakh as export freight earned at Chennai and Cochin between Indian ports and Ukraine ports and that it was not offered to tax claiming that as exempt. After disintegration of USSR, bilateral agreement between India and Russian Federation alone was continued as per the Notification issued in December 1992. As no agreement for avoidance of double taxation existed between India and Ukraine state, the assessee was not entitled to tax exemption on bilateral freight. Consequently, seven and a half percent of Rs.692.92 lakh earned by way of export freight by the Ukraine company was chargeable to tax. Omission to charge the freight income to tax resulted in underassessment of income by Rs.52.27 lakh with consequent short levy of tax of Rs.57.75 lakh (including interest).

The Ministry have accepted the audit observation.

Excess refund of tax

4.42 Under the Income Tax Act, 1961, where as a result of any order passed in assessment, appeal, revision, or any other proceedings under the Act, refund of any amount becomes due to the assessee, the Assessing Officer may grant the refund in cash or adjust the refund against outstanding dues of the assessee.

(a) In Coimbatore, Tamil Nadu charge, the assessment of a company for the assessment year 1991-92 was revised in July 1996 to give effect to the appellate order resulting in a total refund of Rs.162.85 lakh. Audit scrutiny revealed that while determining the refundable amount of Rs.162.85 lakh in July 1996, the refund of Rs.27.39 lakh already allowed in March 1996 was again considered by assessing officer. The mistake resulted in excess refund of Rs.27.76 lakh (including interest).

The Ministry have accepted the audit observation.

(b) In Baroda, Gujarat charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in November 1996 allowing a refund based on T.D.S. credit of Rs.37.01 lakh and interest of Rs.7.40 lakh. Audit scrutiny revealed that actual T.D.S. certificate filed alongwith the return was for Rs.24.33 lakh. The excess allowance of credit, thus, resulted in excess refund of Rs.15.22 lakh (including interest of Rs.2.54 lakh allowed on refund to be withdrawn).

The Ministry have accepted the audit observation.

Short levy of interest for delay in filing the return

4.43 Under the Income Tax Act, 1961, where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two percent per month or part thereof from 1 April 1989 (15 percent per annum prior to assessment year 1989-90), from the date immediately following the specified due date to the date of filing the return or where no return is furnished, to the date of completion of regular assessment on the amount determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source. Further, where the return of income

furnished by the assessee is regarded as defective on grounds of non-fulfilment of specified conditions and no rectification of the defects as indicated by the assessing officer has been done within the period specified in the Act, the return submitted shall be treated as invalid return and the provisions of the Act shall apply as if the assessee had failed to furnish the return.

Two cases of non-levy of interest are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB III, Calcutta	1993-94 March 1996 (revised in December 1996)	143(3)	Though the assessee filed the return belatedly on 28 July 1994 as against the specified date of 31 December 1993, no interest was levied for the delay.	334.36
2.	Patiala, Punjab	1994-95 December 1996	143(3)	Even though the assessee failed to furnish revised return the original return filed in November 1994 having been held invalid, no interest was levied for non-submission of return.	99.18

The Ministry's response to the audit observations has not been received.

Short levy of interest for short payment of advance tax

4.44 Under the Income Tax Act, 1961, as applicable from the assessment year 1989-90 onwards, where in any financial year, an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent for every month or a part thereof reckoned from 1 April next following such financial year to the date of determination of total income by processing the return of income and where a regular assessment is made, to the date of such regular assessment on the amount equal to the assessed tax, or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax. The Act further provides that the self assessment tax paid should include interest, if any, liable to be paid by the assessee, under any provision of the Act. In the event of shortfall of the aggregate of the tax and interest, the amount so paid shall first be adjusted towards interest payable and the balance, if any, be adjusted towards the tax payable.

Some cases involving large tax effect are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax Effect (Rs.in lakh)
1.	West Bengal II, Calcutta	1994-95 March 1997	143(3)	In respect of deficiency in the advance tax paid by the assessee, interest of Rs.285.53 lakh was levied as against the correct interest of Rs.643.03 lakh leviable for 36 months from April 1994 to March 1997.	357.50
2.	West Bengal V, Calcutta	1991-92 March 1994 (revised March 1997)	143(3)	As against the correct amount of interest of Rs.328.84 lakh leviable for 36 months from April 1991 to March 1994, only Rs.89.73 lakh was levied.	239.12
3.	Gujarat I, Ahmedabad	1990-91 to1992-93 March 1996-February 1997	144	As against the correct amount of Rs.213.16 lakh, interest of Rs.81.28 lakh only was levied towards short payment of advance tax.	131.88
4.	West Bengal II, Calcutta	1994-95 March 1997 (revised April 1997)	143(3)	Instead of Rs.201 lakh leviable as interest for short payment of advance tax for 36 month from April 1994 to March 1997, interest of Rs.134 lakh only was levied.	67.00
5.	Patiala, Punjab	1994-95 March 1997	143(3)	Even though advance tax paid by the assessee fell short of 90 percent of the assessed tax as against Rs.267.61 lakh from April 1994 to March 1997, only Rs.246.10 lakh was levied as interest for short payment of advance tax.	21.51

The Ministry have accepted the audit observations at Sl. Nos. 2 to 5.

Their response to the remaining case has not been received.

Non-levy of interest for delay in payment of tax demand

4.45 Under the Income Tax Act, 1961, as amended from 1 April 1989, any demand for tax should be paid by an assessee within thirty days (thirty five days prior to the assessment year 1989-90) of service of notice of the relevant demand. Failure to do so would attract interest at twelve percent per annum (fifteen percent per annum from 1 October 1984 and one and one half percent per month or part thereof from 1 April 1989) from the date of default till actual payment.

Some cases involving large tax effect are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB III, Calcutta	1988-89 (revised in March 1994)	143(3)	Even though the amount of Rs.2,673 lakh being the tax demanded on 31 March 1994 was paid by the assessee belatedly between October 1994 and February 1995, interest was not levied for the delay.	303.03
2.	WB II, Calcutta	1990-91 March 1993 1991-92 March 1994 (revised in March 1995)	144	The assessee had not paid tax against the demand notices issued on 30 March 1993 and 28 March 1994. However, interest aggregating Rs.143.51 lakh was not levied.	143.51
3.	WB II, Calcutta	1985-86 December 1988 and February 1993 (revised in March 1994)	144	Though the original demand was served on 15 December 1988, the assessee paid the demand by way of adjustment of refunds relating to earlier assessment years, in January 1994, October 1994 and December 1995. However, as against the correct amount of interest of Rs.75.58 lakh leviable, Rs.12.66 lakh only was levied which resulted in short levy of interest.	62.92

The Ministry's response to the audit observations has not been received.

Incorrect payment of interest by government to the assessee

4.46(a) Under the Income Tax Act, 1961, as applicable from assessment year 1989-90 onwards, where any refund is due to an assessee out of any advance tax (including the tax deducted at source), he shall be entitled to receive in addition to the said amount, simple interest thereon at the rate of one percent per month, from 1 October 1991 (one and half percent upto 30 September 1991), for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted. No interest shall be payable if the amount of refund is less than ten percent of the tax determined under summary or regular assessment.

(i) In West Bengal V, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 originally completed after scrutiny in March 1996 was subsequently revised in March 1997 at total income of Rs.7,100.15 lakh with a reduced tax demand of Rs.3,674.97 lakh. Audit scrutiny revealed that the assessee, having paid a total sum of Rs.3,904.07 lakh towards tax deducted at source and advance tax was granted a refund of Rs.229.10 lakh together with interest of Rs.108.49 lakh. Since the amount of refund was less than ten percent of the tax determined in the assessment, no interest on excess amount paid was admissible. The mistake thus, resulted in irregular payment of interest by Rs.108.49 lakh.

The Ministry have accepted the audit observation.

(ii) In Patiala, Punjab charge, the assessment of a company for the assessment year 1994-95 initially completed in summary manner in January 1995 was completed after scrutiny in March 1997. Audit scrutiny revealed that the assessee, having paid a total sum of Rs.6,358.03 lakh towards tax deducted at source and advance tax was granted a refund of Rs.917.51 lakh inclusive interest of Rs.83.41 lakh at the time of summary assessment completed in January 1995. Since the amount of refund was less than ten percent of the tax assessed, no interest on excess amount paid was admissible as per provision of the Act. The entire interest was required to be withdrawn instead of Rs.57.65 lakh actually withdrawn. Omission to do so resulted in irregular allowance of interest of Rs.25.76 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In Visakhapatnum, Andhra Pradesh charge, the assessment of an assessee company for the assessment year 1994-95 originally completed after scrutiny in March 1997 was revised in March 1997 determining the refund of Rs.89.59 lakh which included an amount of Rs.18.42 lakh interest payable to the assessee. Audit scrutiny revealed that the assessee had defaulted in filing the Tax Deducted at Source certificates in time and therefore no interest was allowable to the assessee for the period of delay in filing the Tax Deducted at Source certificates. The interest allowable to the assessee worked out to Rs.1.12 lakh against the amount of Rs.18.42 lakh actually allowed. The mistake resulted in excess payment of interest of Rs.17.30 lakh.

The reply of the Ministry to the audit observation has not been received.

(b) Under the Income Tax Act, 1961, where as a result of an order under scrutiny assessment the amount on which interest payable to the assessee is increased or reduced, the interest granted shall be increased or reduced accordingly.

In City V, Mumbai charge, the assessment of a widely held company for the assessment year 1994-95 initially completed in a summary manner in March 1995 was completed after scrutiny in March 1997 determining total tax demand of Rs.2,346.88 lakh. Audit scrutiny revealed that while computing the tax demand, the assessing officer did not withdraw the interest paid to the assessee at the summary assessment stage. The mistake resulted in short charge of tax of Rs.91.67 lakh

The Ministry have accepted the audit observation.

Non-levy of penalty under sections 271D and 271E

4.47 Under the provisions of the Income Tax Act, 1961, no person shall after 30 June 1984, take or accept from any other person any loan or deposit of Rs.20,000 (Rs.10,000 up to March 1989) or more otherwise than by account payee cheque or bank draft subject to certain exceptions. Similarly, no person

shall repay in cash to any person any deposit or deposit with interest if the amount is Rs.10,000 or more. Any person contravening these provisions without reasonable cause is liable to pay a penalty equal to the amount of such loan or deposit accepted or repaid. The Central Board of Direct Taxes have also directed that in cases where the income tax officer does not initiate penalty proceedings, he should record the reason for not doing so.

In City IV, Mumbai charge, the assessment of an assessee for the assessment year 1996-97 was completed in a summary manner in March 1997. Audit scrutiny of Tax Audit Report revealed that the assessee company had obtained loan from a party of Rs.2.40 lakh in cash and repaid a loan of Rs.630 lakh to another party in cash. As the assessee company violated the above provisions, he was liable for penalties prescribed in the Act. However, neither did the assessing officer initiate any penalty proceedings nor did he record reasons for not doing so. The mistake led to non-levy of penalty of Rs.632.40 lakh.

The Ministry have not accepted the audit observation on the ground that the same was premature as there is no time limit for initiation of penalty proceedings and such proceedings can be initiated before, during or any time after the completion of assessment proceedings. As normally penalty proceedings are initiated during the course of assessment proceedings, there was time to do so during the pendency of completion of proceedings under scrutiny assessment.

The reply is not tenable as the audit observation was made on the basis of information in the Tax Audit Report accompanying the return. Incidentally a similar observation at para No.4.37(ii) in the Report of the Comptroller and Auditor General of India for the year ended 31 March 1994 has been accepted by the Ministry.

Non-deduction/credit of tax at source

4.48 Under the Income Tax Act, 1961, if any person, who is responsible for deducting the tax at source, does not deduct or after deducting tax fails to pay the tax as required, such person shall be deemed to be an assessee in default in respect of the tax. Besides initiation of penal action, such person shall be liable to pay simple interest at 15 percent 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.

In Coimbatore, Tamil Nadu charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that the assessee company had deducted tax at source of Rs.189.57 lakh during the previous year relevant to assessment year 1994-95 from the interest credited to the accounts on the loans received from various persons which was not remitted to a Government account. The assessee was thus liable to pay interest which was not levied by the department till August 1997. The omission resulted in non-levy of penal interest of Rs.97.15 lakh.

The reply of the Ministry to the audit observation has not been received.

Short-levy of surcharge

4.49 As per the Finance Act, 1994, the amount of income tax computed in the case of every domestic company having a total income, including income from long term capital gains, exceeding seventy five thousand rupees, be increased by a surcharge calculated at the rate of fifteen percent of such income tax.

In Lucknow, Uttar Pradesh charge, the assessment of a widely held company for the assessment year 1994-95 was completed after scrutiny in March 1997 determining taxable income at Rs.316.81 lakh. Audit scrutiny revealed that while completing assessment, surcharge leviable amounted to Rs.21.38 lakh instead of Rs.2.38 lakh charged by the department. This mistake resulted in short levy of surcharge by Rs.32.68 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Short levy of additional income tax

4.50 Under the Income Tax Act, 1961, as applicable from 1 April 1989 where as a result of adjustments, the returned income of the assessee is increased or loss decreased by any amount, the assessing officer shall increase the amount of tax payable by the assessee by an amount of additional tax calculated at the rate of twenty percent of tax payable on such excess amount.

In West Bengal III, Calcutta charge the assessment of a company for the assessment year 1993-94 was completed in summary manner in November 1995 at a loss of Rs.45,020.95 lakh after disallowing loss of Rs.27,711.94 lakh by way of prescribed adjustments to the returned loss of Rs.72,732.89 lakh. Audit scrutiny revealed that though the additional income tax of Rs.2,868.18 lakh was required to be levied the assessing officer levied additional income tax of Rs.2,494.07 lakh. The mistake led to short demand of additional income tax of Rs.374.11 lakh.

The reply of the Ministry to the audit observation has not been received.

Loss of revenue due to absence of enabling provision

4.51 Under the Income Tax Act, 1961, as applicable from 1 April 1989 where, as a result of adjustments, the returned income of an assessee is increased or loss decreased by any amount, the assessing officer shall increase the amount of tax payable by the assessee by an amount of additional tax calculated at the rate of twenty percent of tax payable on such excess amount. Cases have, however, been noticed in audit that rectifications which come under the ambit of prescribed adjustments of section 143(1)(a) of the Act are subsequently corrected under section 143(3) thereof. However, due to absence of a specific provision under section 143(3), no additional tax becomes leviable as a result of adjustment carried out under scrutiny, which should have been prima facie, effected under section 143(1)(a).

In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that in the summary assessment done in July 1998, the assessing officer omitted to make prima facie adjustment of Rs.732.60 lakh

involving potential tax effect of Rs.379.12 lakh and consequential non-levy of additional tax of Rs.75.82 lakh and the omission was also pointed out to the department by Audit in January 1996. Audit scrutiny further revealed that the assessing officer instead of rectifying the assessment made in a summary manner in July 1994 made an addition of Rs.732.60 lakh in the assessment completed after scrutiny in March 1996. However, no additional tax could be levied. Absence of an enabling provision in the Act and failure to rectify the assessment made in a summary manner before the scrutiny assessment led to the loss of revenue of Rs.75.82 lakh representing additional income tax payable by the assessee.

The reply of the Ministry to the audit observation has not been received.

Omission to initiate action on internal audit observation

4.52 According to the executive instructions issued by the Board in 1977, mistake pointed out by internal audit parties of the department should be rectified by the assessing authorities promptly. The remedial action should be initiated within three months of the report of internal audit.

In Tamil Nadu IV, Chennai charge, the assessment of a transport corporation for assessment year 1994-95 was completed after scrutiny in December 1996 at nil income and the unabsorbed depreciation for assessment year 1993-94 was quantified at Rs.369.19 lakh. Audit scrutiny revealed that as per the internal audit observation in March 1996 the unabsorbed depreciation relating to assessment year 1993-94 was Rs.50.73 lakh. Omission to give effect to the internal audit observation resulted in excess carry forward of unabsorbed depreciation of Rs.318.46 lakh with consequent potential tax effect of Rs.146.49 lakh.

The Ministry have accepted the audit observation.

Other topics of interest

4.53 Under the Income Tax Act, 1961, where under any agreement or other arrangement the tax chargeable on any income is to be borne by person by whom the income is payable then for the purpose of deduction of tax, such income shall be increased to such amount as would after deduction of tax thereon at the rates in force for financial year in which such income is payable be equal to the net amount payable under such agreement or arrangement.

In City XI, Mumbai charge, the audit scrutiny of Public Limited company engaged in air transportation revealed that some allowances which were not exempted under section 10(14) of the Act, were paid to the pilot and crew members for the assessment years 1989-90 to 1994-95 without deducting tax at source from their employees. The assessing officer raised demand of Rs.397 lakh and interest of Rs.132 lakh under section 201(1A) which was paid by the assessee in January 1994 and May 1995 on behalf of their employees. As these taxes were paid by the company assessee on behalf of pilots and crew members, the same should have been grossed up for arriving at the taxable income of respective individuals on behalf of whom these taxes were paid. This was not done. Accordingly the tax payable by individual assessees

worked out to Rs.865 lakh as against Rs.397 lakh paid by the Company on their behalf. Further, interest on delay in deduction of TDS and their credit to Government worked out to Rs.249 lakh as against Rs.132 lakh levied by the Department. The total short levy of tax on account of grossing up of the incomes of the individual assessees by the amount of tax paid by company thus worked out to Rs.584 lakh.

The reply of the Ministry to the audit observation has not been received.

CHAPTER 5 : INCOME TAX

General

5.1 Income Tax collected from persons other than companies is booked under the major head '0021 Taxes on income other than corporation tax'. In accordance with the recommendations of the Finance Commission 77.5 percent of the net proceeds of this tax, except insofar as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States.

Receipts from income tax

5.2 The trend of receipts from income tax during the last five years is shown below:

Year	Total Collection of all Direct Taxes	Amount of Income Tax	Percentage of Income Tax to total collection
	(In crore of rupees)		
1993-94	20,298.24	9,122.62	44.94
1994-95	26,970.88	12,030.12	44.60
1995-96	33,559.28	15,587.17	46.44
1996-97	38,895.08	18,233.99	46.88
1997-98	48,280.40	17,100.59	35.42

Number of assessees

5.3 The number of assessees (other than companies) borne on the books of the Income Tax Department during the last five years was as follows:

As on 31 March	Number of assessees
1994	**1,00,28,974**
1995	**1,01,08,012**
1996	**1,04,76,940**
1997	**1,14,16,315**
1998	**1,28,93,417**

Status of assessments

5.4 The following table indicates the progress in the completion of assessments and collection of demand under income tax (excluding corporation tax) during the last five years:

Year	No. of assessments				Total demand		
	For disposal	Completed during the year	Pending at the close of the year	Percentage of pendency to total cases	Demand for collection (In crore	Collected during the year of rupees)	Percentage of collection
1993-94	85,10,569	72,42,046	12,68,523	14.90	12,403.40	9,122.62	73.55
1994-95	97,47,151	74,05,828	23,41,323	24.02	24,838.64	12,030.12	48.43
1995-96	1,03,36,365	81,00,767	22,35,598	21.62	32,123.23	5,587.17	48.52
1996-97	1,17,85,888	1,02,13,874	15,72,014	13.33	36,386.47	18,233.99	50.11
1997-98	1,34,70,557	1,10,04,146	24,66,411	18.31	38,268.16	17,100.59	44.69

Results of audit

5.5 A total number of 204 audit observations involving undercharge of tax of Rs.39.82 crore (including potential tax effect of Rs.3.16 crore) and 9 audit observations involving overcharge of tax of Rs.8.53 crore were issued to the Ministry of Finance for comments. The Ministry have accepted the observations in 71 cases involving tax effect of Rs.8.77 crore (including potential tax effect of Rs.0.64 crore in 6 cases).

Out of total 213 cases issued to Ministry, 65 illustrative cases with aggregate under charge of tax of Rs.20.47 crore relating to various categories and 6 cases of overcharge of tax involving Rs.8.39 crore are indicated in the succeeding paragraphs. Out of these, the Ministry have accepted the observation in 22 cases involving tax effect of Rs.6.48 crore. Replies are awaited in 48 cases. Of the cases included, 7 cases involving tax effect of Rs.4.52 crore had been checked by the Internal Audit Wing of the department but the mistakes remained undetected.

Avoidable mistakes in computation of income and tax

5.6 Underassessment of tax of substantial amounts and overcharge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Report of the Comptroller and Auditor General of India. Despite this and issue of instructions by Government from time to time, such mistakes continue to occur suggesting the need for close supervision and control. The various types of mistakes noticed included, inter-alia, incorrect adoption of figures, non-levy of surcharge, mistakes in computation etc. Some important cases of each type noticed in test check are given below:

(I) Overassessment of Income and Tax

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of Mistake	Tax effect (Rs.in lakh)
1.	Central II, West Bengal	1991-92 March 1997	143(3)	The cash receipt was taken erroneously as Rs.444.91 lakh instead of Rs.144.91 lakh leading to over assessment of income.	647.17
2.	Nasik, Maharashtra	1994-95 March 1997	143(3)	The disallowance of Rs.394.75 lakh was added back twice which led to overassessment of income of Rs.394.75 lakh.	154.70
3.	Ranchi, Bihar	1988-89 March 1995	144	Incorrect levy of interest for filing of return after the due date and for default in payment of advance tax.	16.14
4.	Jodhpur, Rajasthan	1988-89 and 1989-90 January 1991/ March 1992	143(3)	Interest for failure to pay advance tax was erroneously charged at Rs.12.63 lakh instead of Rs.4.45 lakh.	8.18
5.	Karnataka III	1994-95 March 1997	143(3)	Taxable income was erroneously determined at Rs.57.35 lakh instead of correct amount of Rs.47.03 lakh.	7.71
6.	Dhanbad, Bihar	1994-95 March 1997	143(3)	Rounding of the total income was taken at Rs.9.65 lakh instead of Rs.3.47 lakh and levy of surcharge on the erroneously rounded figure including interest.	5.21

The Ministry have accepted the audit observations at Sl.Nos.2,3,4 and 5. Their response to the remaining cases has not been received.

(II) Underassessment of Income and Tax

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of Mistake	Tax effect (Rs.in lakh)
1.	**City XIII, Mumbai**	**1994-95 March 1997**	**143(3)**	**Omission to disallow dual deduction of depreciation of Rs.701.04 lakh and non levy of additional tax of Rs.62.81 lakh.**	**Rs.479.41 8.07(P)**
2.	**Nasik, Maharashtra**	**1994-95 March 1997**	**143(3)**	**Computation of net taxable income at Rs.212.89 lakh instead of correct taxable income of Rs.600.11 lakh.**	**261.08**
3.	**Amritsar, Jammu**	**1993-94 February 1996**	**143(3)**	**Adoption of incorrect figures.**	**18.67**

4.	Kolhapur, Maharashtra	1994-95 March 1997	143(3)	Non-inclusion of refund of Rs.17.05 lakh in the tax demand.	17.05
5.	Delhi Central -2	1994-95 March 1997	143(3)	Disallowance of Rs.16.60 lakh and totalling mistake of Rs.3.50 lakh were not given effect while working out taxable income.	16.75
6.	City V, Mumbai	1995-96 March 1997	143(3)	Refund of Rs.12.05 lakh was granted as against tax demand of Rs.4.13 lakh for assessment year 1994-95.	16.18
7.	Lucknow, Uttar Pradesh	1993-94 March 1995	143(1)(a)	The interest payment of Rs.22.52 lakh already disallowed was omitted to be deducted from the amount of loss.	9.86(P) 1.97 (Addl. Tax)
8.	Dhanbad, Bihar	1995-96 February 1997	143(3)	The carry forward of unabsorbed depreciation of assessment years 1988-89 to 1994-95 was allowed at Rs.22.45 lakh as against Rs.8.76 lakh allowable.	7.96
9.	Bhopal Madhya Pradesh	1994-95 January 1997	143(3)	Surcharge on tax not levied.	7.12
10.	Agra Uttar Pradesh	1994-95 March 1997	143(3)	Surcharge on tax not levied.	7.02
11.	Karnataka-I	1994-95 March 1997	143(3)	Surcharge on tax not levied.	6.87

The Ministry have accepted the audit observation at Sl.Nos.2,5,6, 8 and 11. Their response to the remaining cases has not been received.

Application of incorrect rate of tax

5.7 Under the Income Tax Act, 1961, income tax is chargeable for every assessment year in respect of the total income of the previous year of a person according to the rates under the relevant Finance Act. Where the total taxable income includes long term capital gain, income tax will be levied on taxable income as reduced by long term capital gain, at the rates specified in the Finance Act. The long term capital gain will be subjected to flat rate of income tax under the provisions of the Act. The flat rate of income tax for long term capital gain for the assessment year 1995-96 for a resident association of persons/Body of individuals/Trust is thirty percent.

In Maharashtra, Mumbai City II charge, the assessments of three assessee trusts for the assessment year 1995-96 were completed in a summary manner in March 1996 taxing the long term capital gains of Rs.53.34 lakh, Rs.16.06 lakh and Rs.54.32 lakh respectively returned by the assessees at 20 percent applicable to individual instead of the correct rate of tax of 30 percent as applicable to Trust. Audit scrutiny revealed that since it was apparent from the status of the assessees that they were trusts and not individuals, it should have been taxed at 30 percent. Omission to apply the correct rate of tax resulted in short levy of tax of Rs.26.85 lakh in aggregate.

The reply of the Ministry to the audit observation has not been received.

Incorrect status adopted in assessment

5.8 Under the Income Tax Act, 1961, where, in respect of any assessment year, there is, on the part of a firm, any such failure as is mentioned in section 144, the assessing officer may cancel the registration of the firm for that assessment year and on cancellation shall amend the assessment of the firm and its partners on the footing that firm is an unregistered firm. It has been held* by Patna High Court that in case of wilful default on the part of assessee for withholding information or documents, the authorities are bound to cancel the registration of the assessee for the relevant assessment year.

In Bihar, Ranchi charge, the assessment of a registered firm for the assessment year 1992-93 was completed on best judgment basis in March 1995 determining the total income at Rs.26.52 lakh. Audit scrutiny revealed that the assessee firm had failed to comply with the terms of notices issued under section 142(1) and 143(2) of Income Tax Act. For failure to comply with the terms of the notices, the registration of the firm should have been cancelled and the firm assessed in the capacity of unregistered firm. Further, returns of income were neither filed by 6 partners of the assessee firm out of total of 7 partners nor any action initiated by the department to obtain them. The mistake in adoption of incorrect status of the firm resulted in under charge of tax of Rs.17.61 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of salary income

5.9 Under the Income Tax Act, 1961, any special allowance specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of duties of an office of employment of profit, will be allowable only to the extent to which such expenses are actually incurred for that purpose.

In Bihar, Dhanbad charge, the assessment of an individual, a Development Officer of Life Insurance Corporation, for the assessment year 1992-93 was completed after scrutiny in October 1993, and subsequently rectified to give appeal effect in February 1994 determining the total income at Rs.8.41 lakh. Audit scrutiny of the assessment record, however, revealed that additional conveyance allowance amounting to Rs.7.12 lakh was allowed as deduction, although in the certificate of tax deducted at source, the employer had not certified that the additional allowance had been utilized in full for the purpose it had been paid for. Since the deduction was allowed without valid certificate from the employer, it contravened the provisions of the Act. The mistake resulted in excess allowance of deduction of Rs.7.12 lakh with consequent undercharge of tax of Rs.5.53 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of income payable net of tax

5.10 Under the Income Tax Act, 1961, where, under an agreement or other arrangement, the tax chargeable on any income subject to deduction at source is to be borne by the person by whom the income is payable, then, for the

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* CIT Vs Standard Mercantile Co. (1985) 23 Taxman 452 (Patna)

purpose of deduction of tax, such income shall be increased to such amount as would, after deduction of tax thereon, at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement.

In Kerala, Thiruvananthapuram charge, the assessments of two individual assessees "resident but not ordinarily resident" working with a widely held domestic company as employees of a foreign company and receiving salary net of tax in foreign currency during the previous year relevant to the assessment year 1994-95 were completed after scrutiny in January 1997 and February 1997. The entire tax liability was contractually borne by the domestic company. Audit scrutiny revealed that while arriving at the tax payable in assessments for the assessment year 1994-95 the assessing officer had worked out the tax on net amount payable instead of the grossed up income. The mistake resulted in short levy of tax of Rs.5.59 lakh in the aggregate.

The Ministry have accepted the audit observation.

Incorrect computation of business income

5.11.1 Under the Income Tax Act, 1961, payment of remuneration to a working partner during the previous year relevant to the assessment year commencing on the 1st day of April 1993 in accordance with the terms of the partnership deed is allowable deduction subject to specified condition provided for such payment. The Board had also issued instructions in March 1996 that in case the quantum of remuneration is left to be determined by the partners, such payment cannot be allowed as deduction.

In Maharashtra, Mumbai City IX charge, the assessment of an assessee 'Registered firm' for the assessment year 1995-96 was completed after scrutiny in May 1996 at a taxable income of Rs.43.31 lakh. The assessee partnership firm consisting of two partners with fifty percent share each came into existence in April 1994. Prior to that, it was a proprietary concern. Audit scrutiny revealed that one of the partners had received Rs.20 lakh as salary. However, in the partnership deed, the quantum of remuneration was not specified. Hence, the salary paid to the partner should have been disallowed as per the provisions of the Act and as per Board's instructions. Omission to do so resulted in underassessment of income of Rs.20 lakh with consequent short levy of tax of Rs.10.56 lakh.

The Ministry have accepted the audit observation.

5.11.2 Under the Income Tax Act, 1961, where the accounts are correct and complete to the satisfaction of the assessing officer but the method employed is such that, in the opinion of the assessing officer the income cannot be properly deduced therefrom, then the computation shall be made upon such basis and in such manner as the assessing officer may determine. However, where the assessing officer is not satisfied about the correctness and completeness of the accounts of the assessee, the assessing officer may make an assessment to the best of his judgment.

In North East Region, Shillong charge, the assessment of a partnership firm, engaged in the business of manufacture of guns and ships, and undertaking civil contracts for the assessment year 1994-95 was completed after scrutiny in March 1997 determining income of Rs.25.54 lakh after rejecting the accounting results of the job and contract works. The assessing officer estimated the net profit from different jobs and contract works at five percent of total receipts, before considering depreciation, as in his opinion the income from contract business could not be deduced properly due to defects in accounts. Further, assesee's claim for relief in respect of profits from new industrial unit established in backward area was disallowed in view of the Hon'ble Supreme Court decision regarding admissibility of the deduction in case of assessee engaged in civil contracts. Audit scrutiny, however, revealed that while the assessee had disclosed income from jobs and contracts at Rs.26.47 lakh before claiming the said relief, the income from contract receipts as estimated by the assessing officer was Rs.14.40 lakh being five percent of gross contract receipts of Rs.308.73 lakh and after deduction of depreciation therefrom Rs.15.44 lakh (minus Rs. 04 lakh). Thus in rejecting assese's accounts the assessing officer underassessed income from contract receipts as shown in books of accounts by Rs.12.07 lakh resulting in short levy of tax and interest of Rs.9.63 lakh.

The reply of the Ministry to the audit observation has not been received.

5.11.3 Under the Income Tax Act, 1961, the profits and gains of any business which was carried on by the assessee at any time during the previous year shall be chargeable to income tax under the head 'profits and gains of business or profession'. It has been judicially held* that the right acquired on the agreement to sell is not a capital asset and therefore compensation received for its loss cannot be treated as capital receipt.

In Karnataka, Bangalore charge, the assessments of an individual, engaged in the business of real estate for assessment years 1988-89 and 1989-90 were completed after scrutiny in December 1990 and reassessed in March 1994 determining capital gain at Rs.36,000 and Rs.2.56 lakh respectively. Audit scrutiny revealed that the assessee had received compensation of Rs.12.62 lakh on account of breach of contract by a seller who had entered into an agreement with the assessee to sell certain properties. As there was no element of transfer of capital asset in the transaction and the amount was received in the course of real estate business it constituted business income assessable under the head 'profits and gains from business or profession' and not under 'capital gain'. The mistake resulted in underassessment of income of Rs.9.70 lakh involving aggregate short levy of tax of Rs.7.73 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of capital expenditure

5.12 Under the Income Tax Act, 1961, as applicable from assessment year 1988-89, the value of any discarded asset forming part of the block of assets

*CIT Vs. R. Dalmia (Decd) 163-ITR-517 (Delhi)

will be reduced from the written down value of that block of assets.

In Karnataka I, Bangalore charge, the assessment of an individual for the assessment year 1993-94 was completed after scrutiny in March 1995. While assessing the 'income from business' a sum of Rs.14.86 lakh being the revalued cost of the shuttering plates construed as unserviceable and written off and debited to the profit and loss account as works expenditure under concrete structure had been allowed. Audit scrutiny revealed that the assessee was claiming depreciation on shuttering plates at normal rates upto the assessment year 1992-93. Since the asset was charged to capital account, its removal therefrom will only reduce the value of the fixed asset and will not constitute revenue expenditure. It was, therefore, not a proper charge on profit and loss account and was liable to be disallowed and added back to the income. Omission to do so resulted in underassessment of income of Rs.14.86 lakh with consequent short levy of tax of Rs.9.85 lakh.

The Ministry have accepted the audit observation.

Incorrect allowance of expenditure

5.13 Under the Income Tax Act, 1961, income chargeable under the head "Income from other sources" shall be computed after making certain deductions which are a reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such income.

In Karnataka III, Bangalore charge, the assessment of an assessee an association of persons (Staff Welfare Fund) for the assessment year 1991-92 was completed after scrutiny in December 1992. Audit scrutiny revealed that though the assessing officer conceded the mutuality of the fund, the interest of Rs.9.06 lakh received from banks on investment of reserves and surplus funds and dividends of Rs.15,946 received on shares included in the total income were held as taxable income from other sources. However, the proportionate expenditure of Rs.9.03 lakh was erroneously allowed as deduction even though no expenditure was laid out wholly and exclusively for the purpose of earning the above income. This resulted in short computation of income of Rs.9.03 lakh with consequent short levy of tax of Rs.6.97 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of provisions

5.14 Under the Income Tax Act, 1961, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for deduction.

In Uttar Pradesh, Meerut charge, the assessment of a registered firm for the assessment year 1992-93 was completed in February 1994 after scrutiny and income was determined at Rs.1.93 lakh. Audit scrutiny revealed that the assessing officer allowed a sum of Rs.27.89 lakh, being a provision for unforeseen and unascertained expenditure during the previous year 1991-92.

The amount of the said provision had remained unspent not only during the said previous year 1991-92 but also till the date of submission of the return for the assessment year 1992-93. Thus the amount of provision so made for Rs.27.89 lakh should have been added to the income as a contingent liability while completing the assessment. Failure to do so led to underassessment of income by an identical amount involving short levy of tax of Rs.8.05 lakh (including interest and surcharge).

The reply of the Ministry to the audit observation has not been received.

Incorrect valuation of closing stock

5.15.1 In order to determine the true profits of business, the assessee values the closing stock of his business according to the method of valuation consistently adopted every year. It has been judicially held* that difference between the stock disclosed to the bank and stock valued in the books of account should be treated as income from undisclosed sources and added to the income of the assessee.

(i) In Gujarat, Surat charge, the assessment of a co-operative society for the assessment year 1994-95 was completed after scrutiny in August 1996. Audit scrutiny revealed that the aggregate value of stock as on 31 March 1994 as per books of accounts was Rs.4,402.47 lakh whereas the assessee had declared the value of above stock at Rs.4,476.59 lakh to the bank. The difference in the value of stock of Rs.74.12 lakh was therefore required to be added back to the income of the assessee. Omission to do so resulted in short levy of potential tax of Rs.29.01 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Punjab, Amritsar charge, the assessment of a registered firm for the assessment year 1992-93 was completed after scrutiny in December 1994. Audit scrutiny revealed that the aggregate value of stock as on 31 March 1992 as per books of accounts was Rs.52.39 lakh whereas the assessee firm had declared the value of above stock at Rs.78.41 lakh to the bank. The difference in value of stock of Rs.26.02 lakh was, therefore, required to be added back to the income of the assessee firm. Omission to do so resulted in underassessment of income of Rs.26.02 lakh involving short levy of tax of Rs.16.88 lakh (including tax amounting to Rs.11.63 lakh in the hands of partners).

The reply of the Ministry to the audit observation has not been received.

5.15.2 Under the Income Tax Act, 1961, the income of an assessee from business or profession shall be computed in accordance with the method of accounting regularly employed by the assessee. In order to determine the profits from business, an assessee who maintains accounts on mercantile basis may choose to value closing stock of his business every year at cost or at

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* Swadeshi Cotton Mills Ltd. Vs.CIT (180-ITR-651 (Allahabad)

market price whichever is lower. It has been judicially held and later confirmed by Supreme Court* and the Ministry of Law that where a business comes to an end stock in hand would be valued at the market rate in order to determine the true profits of the business. The Act further provides that any stock-in-trade held for the purpose of his business or profession does not constitute 'capital asset' of an assessee.

In West Bengal IV, Calcutta charge, the assessment of a firm for the assessment year 1994-95 was completed after scrutiny in March 1997. Audit scrutiny revealed that the firm was dissolved on 30 June 1993 and the shares held by the firm were distributed among the two partners. It was further noticed that profit arising out of the distribution of shares held by the firm at the time of dissolution of the firm was assessed to tax under the head Capital gains which was worked out to Rs.7.97 lakh. However, as the assessee was a dealer in shares and the shares held by the assessee at the time of dissolution represented its stock-in-trade, the closing stock should have been valued at market rate. By adopting the value of closing stock at market rate (Rs.54.16 lakh), the profits on it would work out to Rs.29.25 lakh after allowing interest on loan and other charges amounting to Rs.1.19 lakh. Omission to do so resulted in underassessment of income by Rs.22.47 lakh with consequent undercharge of tax of Rs.20.86 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Understatement of sales

5.16 Under the Income Tax Act, 1961, all income accruing or arising to an assessee in a previous year relevant to the assessment year is includible in his total income.

(i) In West Bengal IX, Calcutta charge, the assessment of a firm for the assessment year 1994-95 was completed after scrutiny in November 1995. Audit scrutiny revealed that the assessee had shown sales amounting to Rs.893.55 lakh in its profit and loss account whereas the total sales figure shown in the statement of details of commission paid, as submitted by the assessee alongwith the return of income, was Rs.1,079.11 lakh. There was, therefore, underassessment of sales by Rs.185.56 lakh involving undercharge of tax of Rs.116.38 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Maharashtra, Pune charge, the assessment of a firm for the assessment year 1995-96 was completed in a summary manner in February 1996. Audit scrutiny revealed that the assessee had understated the sales of washing machines by Rs.19.63 lakh. Though the mistake was prima facie apparent from the details of sales, closing stock, etc. filed along with the return the same was not checked at the time of processing the case. The mistake resulted in underassessment of income of Rs.19.63 lakh involving short levy of tax of Rs.11.15 lakh (including additional income tax and interest).

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* ALA Firm Vs. CIT 189-ITR-285(SC)

The reply of the Ministry to the audit observation has not been received.

Incorrect application of rate of depreciation

5.17 Under the Income Tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the rates prescribed in Income Tax Rules, 1962, provided these are owned by the assessee and used for the purpose of his business during the relevant previous year. Further, where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof is allowed deduction as depreciation in respect of the previous year in which such machinery or plant is first put to use. It has been judicially held* that for any article or thing, component or object to be termed plant by itself so as to qualify for depreciation allowance at 100 percent, these must be used by the assessee as a self-contained unit and not as a part or attachment of a bigger unit. Moreover, where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in the previous year, the deduction in respect of such assets shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the block of assets comprising such assets.

(i) In Punjab, Jalandhar charge, the assessment of an assessee firm engaged in construction of roads for the assessment years 1992-93 and 1993-94 were completed after scrutiny in February 1995 and March 1996 allowing depreciation on trucks amounting to Rs.12.72 lakh and Rs.21.85 lakh calculated at the rate of 40 percent (20 percent for the trucks used for less than 180 days) on their written down value. Audit scrutiny revealed that the assesesee firm was not engaged in the business of running the trucks on hire, it was, therefore, entitled to depreciation at the normal rate of 25 percent (12.5 percent for the trucks used for less than 180 days) which worked out to Rs.7.95 lakh and Rs.14.85 lakh for the assessment years 1992-93 and 1993-94 respectively. Excess allowance of depreciation resulted in underassessment of income aggregating Rs.11.77 lakh involving short levy of tax of Rs.6.20 lakh.

The Ministry have accepted the audit observation.

(ii) In Bihar, Ranchi charge, the assessments of an association of persons for the assessment years 1994-95 and 1995-96 were completed after scrutiny in August 1996, on a total income of Rs.6.87 lakh and Rs.12.72 lakh respectively. Audit scrutiny revealed that depreciation allowance was allowed at 100 percent on the entire cost of shuttering plates worth Rs.6.66 lakh and 8.99 lakh acquired during the respective previous years on the ground that each plate would cost less than Rs.5000. Since shuttering plates would not individually constitute a self contained plant, rather shuttering plates were component of a bigger plant called "shuttering and centering plant", depreciation on shuttering plates was to be allowed at 25 percent as was applicable to general item of plant and machinery instead of 100 percent

* Pathange Poultry Farm Vs 210-ITR-668-Karnataka.

allowed by the department. Further, shuttering plates worth Rs.1.72 lakh and Rs.4.05 lakh respectively were acquired during the previous years after 30th September and were utilised for less than 180 days. As such depreciation was to be allowed at 12.5 percent on those assets, instead of at 100 percent allowed by the department. Omission to adopt correct rates of depreciation resulted in underassessment of income by Rs.11.16 lakh with consequent short levy of tax of Rs.5.57 lakh (including interest) in the aggregate.

The reply of the Ministry to the audit observation has not been received.

Irregular set off of unabsorbed depreciation

5.18 Under the Income Tax Act,1961, when for any assessment year unabsorbed depreciation, and business loss can not be set off against any income in the relevant year, such unabsorbed losses shall be carried forwarded to the following assessment year and shall be set off against profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to subsequent year for set off.

In Rajasthan, Jaipur charge, in the assessment of an assessee registered firm for the assessment years 1992-93 and 1993-94 completed in a summary and scrutiny manner in December 1994 and 1995 a set off of Rs.30.47 lakh on account of unabsorbed depreciation and brought forward losses was allowed by the assessing officer and income was assessed at nil. Audit scrutiny revealed that actual unabsorbed depreciation of earlier years amounted to Rs.4.42 lakh only which was required to be set off. Excess set off of depreciation resulted into under-computation of income by Rs.26.05 lakh involving short levy of tax of Rs.16.57 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect carry forward of investment allowance

5.19 Under the Income Tax Act, 1961, where for any assessment year unabsorbed investment allowance under the head 'Profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the subsequent year and shall be set off against the profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward for set off upto a maximum eighth assessment year immediately succeeding the assessment year for which it was first computed.

In Gujarat, Surat charge, the assessment of a co-operative society for the assessment year 1994-95 was completed after scrutiny in September 1996, inter alia, allowing unabsorbed investment allowance of Rs.137.91 lakh pertaining to the assessment year 1984-85 to be carried forward. Audit scrutiny revealed that since carry forward of such unabsorbed investment allowance/losses beyond eight years was not permissible, the carry forward was irregular. The mistake resulted in excess carry forward of similar amount with potential tax effect of Rs.54.02 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of capital gains

5.20 Under the Income Tax Act, 1961, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the capital gain arising from the transfer of such assets is considered as capital gain arising from the transfer of short term capital asset. The Act does not provide for allowance of depreciation on land.

In Maharashtra, Mumbai City XII charge, the assessment of a registered firm for the assessment year 1994-95 was completed after scrutiny in February 1997 at income of Rs.18.94 lakh being long term capital gain. Audit scrutiny revealed that during the previous year relevant to assessment year 1994-95 assessee had sold land and factory building for a consideration of Rs.103 lakh on which depreciation had been claimed by the assessee for earlier years. Since the capital gain related to a depreciable asset, the capital gain should have been assessed as short term capital gain. It was noticed that the assessing officer accepting the contention of the assessee had bifurcated the value of the land and building treating sale consideration received on building as short term capital gain and that on land as long term capital gain. Since the sale was a composite sale and the bifurcation was done by the assessee to avoid computation as short term capital gains, the assessing officer should have assessed it as short term capital gain. Omission to do so resulted in underassessment of capital gain of Rs.68.74 lakh leading to short levy of tax of Rs.55.78 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect exemptions in computation of capital gains

5.21.1 Under the Income Tax Act, 1961, where the whole of the net consideration received from transfer of a long term capital asset has been invested in purchase or construction of a residential house within a specified period after the date of transfer, the whole of the capital gains arising out of such transfer shall not be charged to tax. The Act further provides that the amount of the net consideration which is not appropriated or utilised by the assessee towards the purchase or construction of new house within the specified period, shall be exempted from capital gains tax provided such amount is deposited in any bank or institution in accordance with capital gains accounts scheme on or before the due date of submission of return and such return shall be accompanied by proof of such deposit.

In West Bengal IX, the assessment of an individual for the assessment year 1994-95 completed in summary manner in January 1996 was subsequently rectified in March 1996. Audit scrutiny revealed that exemption from capital gains amounting to Rs.118.82 lakh claimed by the assessee was originally rejected by the department at the time of summary assessment on the ground that the assessee did not furnish any evidence in support of investment in residential house/deposit in capital gains accounts. The claim was, however, allowed in subsequent rectification on the basis of assessee's application to the effect that her accounts were required to be audited by the Chartered Accountant and therefore, the due date of filing the return was 31 October 1994 and that she deposited the consideration money on 28 October 1994.

Audit scrutiny, however, revealed that since the assessee's gross turnover from business during the relevant previous year was Rs.16.54 lakh only, her accounts were not required to be audited and the due date of filing the return thus fell on 31 August 1994. This due date had been shown by the assessee as 31 August for the assessment year prior to 1994-95 and after 1994-95. Accordingly as the sum of Rs.136.55 lakh was deposited in the capital gain account on 28 October 94 which was beyond the due date of submission of return, exemption of Rs.118.82 lakh was erroneously allowed. The mistake resulted in short computation of capital gains by Rs.118.82 lakh leading to short levy of tax of Rs.45.46 lakh (inclusive of additional income tax and interest).

The reply of the Ministry to the audit observation has not been received.

5.21.2 Under the Income Tax Act, 1961, (as it stood prior to assessment year 1993-94) where a residential house belonging to an individual or a H.U.F. and held for more than three years is transferred, the long term capital gain arising therefrom will be exempt provided the full value of consideration does not exceed Rs.2 lakh and the assessee does not own on the date of transfer any other residential house other than residential house sold. However, in cases where the consideration received or accruing exceeds Rs.2 lakh, the exemption will be allowed proportionately. Further, where an assessee being an individual or a H.U.F. transfers residential house, whether self occupied or not, the capital gain arising as a result of transfer or sale of such property will be fully exempt and will not be included in the gross total income of the assessee provided certain conditions are fulfilled.

In Gujarat, Ahmedabad charge, the assessment of an assessee H.U.F for the assessment year 1991-92 was completed after scrutiny in March 1994. The assessee had sold its agricultural land alongwith farm house, servant quarters, water tank etc. as per conveyance deed dated 26 November 1990 for total consideration of Rs.30 lakh and claimed exemption of Rs.1.44 lakh and Rs.14 lakh and the same was allowed. Since the asset in question was agricultural asset, the deduction allowed considering it as residential house was irregular. The incorrect exemptions thus resulted in underassessment of capital gain of Rs.15.44 lakh involving short levy of tax of Rs.20.35 lakh, (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect adoption of Index cost in computation of capital gains

5.22.1 Under the Income Tax Act, 1961, where the capital asset became the property of the assessee under a gift or will, the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner, or the assessee, as the case may be.

In Maharashtra, Mumbai City II charge, the assessment of an individual for the assessment year 1994-95 was completed after scrutiny in November 1996. Audit scrutiny revealed that while computing the long term capital gains,

assessee had worked out the indexed cost of acquisition by adopting the index of financial year 1981-82 at 100 instead of correct index of financial year 1991-92 at 199 as the said property was acquired by the assessee by an order of probate passed by Delhi High Court in April 1991. The long term capital gain by applying the correct index at 199 would work out to Rs.123.16 lakh as against Rs.86.84 lakh worked out by the assessee and allowed by the Department. The incorrect adoption of index cost resulted in underassessment of long term capital gain of Rs.36.32 lakh involving short levy of tax of Rs.13.34 lakh.

The reply of the Ministry to the audit observation has not been received.

5.22.2 Under the Income Tax Act, 1961, as applicable from 1 April 1993 any profits and gains from the transfer of a capital asset shall be chargeable to income tax under the head "capital gains" and is taxable in the year in which the transfer took place. The mode of computation of capital gains in respect of long term capital asset provides for deduction, from the consideration received, of the indexed cost of acquisition and indexed cost of improvement of the assets as well as expenditure incurred wholly and exclusively in connection with such transfer. The Act further provides that where the capital asset became the property of the assessee before 1 April 1981, cost of any improvement would mean any expenditure or alteration to the asset on or before the said date.

In West Bengal V charge, the assessment of an individual for the assessment year 1995-96 was completed after scrutiny in August 1996 computing total income of Rs.304.83 lakh which included long term capital gain of Rs.299.72 lakh on sale of a flat at Bombay during the relevant previous year. Audit scrutiny revealed that in computing the capital gains chargeable to tax a deduction of Rs.48.84 lakh as indexed cost of improvement was claimed by the assessee and was allowed by the department. This indexed cost of improvement related to a payment of Rs.40 lakh made to one of the assesee's relative who occupied the residence of the assessee since 1971 without payment of any rent or any consideration in order to get the premises vacated. As the expenditure was not incurred in making any additions or alterations to the capital asset, the said payment could not be allowed as deduction towards the cost of improvement of the asset under the provisions of the Act. The mistake resulted in underassessment of long term capital gain of Rs.48.84 lakh involving short levy of tax of Rs.11.27 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Income not assessed

5.23.1 Under the Income Tax Act, 1961, the total income of any previous year of a person who is a resident includes all income from what-ever source derived which is received or is deemed to be received in India in such year by or on behalf of such person or which accrues or arises or is deemed to accrue or arise to him in India during such year. Further, the income under the head profits and gains of business or profession is computed in accordance with the method of accounting regularly employed by the assessee.

(i) In Orissa charge, the assessment of a firm which followed a cash system of accounting for the assessment year 1991-92, was completed in summary manner in September 1992 and revised in April 1993 after scrutiny and again in March 1994. Audit scrutiny revealed that the income was determined at Rs.5.92 lakh by the assessing officer and that the assessment had been completed taking gross receipt of Rs.185.08 lakh instead of the correct gross receipt of Rs.203.50 lakh from the execution of labour oriented works. Besides, a sum of Rs.13.39 lakh representing an advance received against increase of wages by the assessee was not taken as receipt in the profit and loss account but shown as a liability in the balance sheet as at the end of 31 March 1991 relevant to the assessment year 1991-92. As the assessee adopted cash system of accounting, the receipt of advance was required to be added to the income of the assessee by carrying out prescribed adjustment as per the provisions of the Act, which was not carried out. These omissions resulted in underassessment of income by Rs.31.80 lakh involving short levy of tax of Rs.10.44 lakh (including interest, additional income tax and interest on refund of tax deducted at source).

The reply of the Ministry to the audit observation has not been received.

(ii) In Haryana, Rohtak charge, the assessment of an individual assessee for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that the assessee alongwith his brother purchased land measuring 13 Bighas 3 Biswas (2.74 acres) in May 1983 for Rs.1.54 lakh and sold 10 Bighas 10.5 Biswas (2.19 acres) to different parties after converting the land into plots on different dates relevant to assessment years 1989-90, 1990-91, 1992-93, and 1993-94. In the said assessment order passed in March 1996 for the assessment year 1993-94 in a scrutiny manner, the above activity of the assessee was held as business activity and the profit derived therefrom was treated as 'income from business'. But no action was taken by the assessing officer for the assessment years 1989-90, 1990-91 and 1992-93. The omission resulted in underassessment of income of Rs.8.55 lakh involving under charge of tax of Rs.5.96 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

5.23.2. Under the Income Tax Act, 1961, if the assessing officer has reasons to believe that any income chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of proceedings under the Income Tax Act, or recompute the loss or the depreciation allowance or any other allowance, as the case may be for the assessment year concerned. The Act further provides that before making the assessment, reassessment or recomputation, the assessing officer shall serve on the assessee, a notice requiring him to furnish within such period as may be specified in the notice, a return of his income in respect of which he is assessable during the previous year corresponding to the relevant assessment year.

In Himachal Pradesh, Shimla charge, Audit scrutiny of the assessment records of an individual who had shown capital gain in his return of income on the acquisition of his land by the Shimla Development Authority revealed that similar compensation received by three other persons was enhanced from Rs.22.56 lakh to Rs. 98.20 lakh in October 1987. It was further revealed that neither these persons had filed any income tax returns for the assessment years 1984-85 onwards nor did the department call for these returns. This resulted in escapement of income involving tax effect of Rs.72.74 lakh (including interest) as determined by the department on completion of assessment proceedings.

The reply of the Ministry to the audit observation has not been received.

Income not assessed due to lack of correlation with the records of Commercial Tax

5.24 The Central Board of Direct Taxes in their instructions issued in November 1974 directed that proper liason should be maintained with Sales-Tax authorities so that various matters arising from the proceedings under Sales Tax Act which have bearing on the income tax assessment are taken due note of by the income tax authorities in the relevant assessment proceedings. The need for a proper co-ordination among the assessment records pertaining to direct taxes to ensure an over all improvement in the administration of these taxes has been repeatedly emphasised by the Public Accounts Committee. In this respect mention may be made of Paragraph 4.12 and 4.13 of 186th Report (Fifth Lok Sabha) and paragraph 1.19 of the 61st Report (Sixth Lok Sabha) of the Public Accounts Committee. The Central Board of Direct Taxes have also issued instructions from time to time, the latest being 11 April 1979 for carrying out such correlation.

In Orissa charge, the assessment of an assessee individual, for the assessment year 1989-90 was completed after scrutiny in July 1993 determining the total income at Rs.35,370 accepting the sales of Rs.9.60 lakh disclosed by the assessee in his return of income. Audit scrutiny of the Sales tax assessment proceedings available on record revealed that the gross turn over of the assessee was determined by the sales tax authorities for the previous year 1988-89 relevant to the assessment year 1989-90 at Rs.15.64 lakh. Omission to adopt the sales turn over of the assessee as determined by the sales tax authorities in the income tax assessment resulted in underassessment of income of Rs.6.04 lakh involving short levy of tax of Rs.9.08 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Unexplained investment

5.25 Under the Income Tax Act, 1961, where in any financial year, the assessee has made investments and the assessing officer finds that the amounts expended on making such investments exceeds the amount recorded in this behalf in the books of accounts maintained by the assessee and the assessee offers no explanation about such excess amount or the explanation offered by him is not satisfactory, the excess amount shall be deemed to be the income of the assessee for such financial year.

In Kerala, Thiruvananthapuram charge, in the case of an individual assessee the assessment for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee had made unexplained investments in the construction of a new building during the previous years relevant to the assessment years 1989-90, 1990-91 and 1991-92. While the unexplained investments relating to assessment year 1991-92 was brought to tax, the notices issued for charging similar unexplained investment of Rs.5.97 lakh made during the assessment years 1989-90 and 1990-91 were not linked with the returns of income filed for those years. The returns showed incomes below taxable limit without taking into account the unexplained investment which were accepted in a summary manner in December 1994. The omission resulted in escapement of income of Rs.5.97 lakh involving tax effect of Rs.9.43 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect carry forward/ set off of losses

5.26 Under the Income Tax Act, 1961, where the assessee is a firm, any loss in relation to the assessment year commencing on or before 1st day of April 1992, which could not be set off against any other income of the firm and which had been apportioned to a partner of the firm but could not be set off by such partner prior to the assessment year commencing on the 1st day of April 1993, shall be allowed to be set off against the income of the firm. Further, where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss and the assessee has income assessable under any other head, the assessee shall not be entitled to set off such loss against income under the other head. The amount of loss not set off shall be carried forward to the following assessment year. No loss under the head 'Profits and gains of the business' is allowable to be carried forward for set-off in the subsequent assessment years unless the assessee has filed return of loss voluntarily within the due date specified in the Act or within the time extended by the assessing officer.

Few cases of incorrect carry forward and set off of losses are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of Mistake	Tax effect (Rs.in lakh)
1.	Uttar Pradesh Agra	1996-97 March 1997	143(1)(a)	The assessee was not entitled to carry forward loss of Rs.192.17 lakh as the return was not filed before the due date.	Rs.67.22(P) Rs.13.44 (Addl.) tax
2.	West Bengal-III Calcutta	1994-95 December 1995	143(1)(a)	Omission to issue fresh intimation for reassessment of income for assessment year 1994-95 which was necessitated due to variation in setting off carryforward losses against assessment year 1993-94 which resulted in underassessment of income of Rs.57 lakh and irregular carried forward of unabsorbed depreciation of Rs.18.17 lakh.	Rs.31.73 (including interest) Rs.7.33 (P)
3.	Karnataka-II Bangalore	1993-94 1995-96 February 1996 December 1995	143(3) 143(1)(a)	The unabsorbed losses of Rs.57.19 lakh apportioned to the partner were omitted to be reverted back to the firm for set off against its income.	Rs.1.32 (Addl.Tax) Rs.25.11(P)
4.	West Bengal-II Calcutta	1994-95 March 1997	143(3)	The long term capital loss of Rs.45.79 lakh was erroneously allowed to be set off against income under the other heads.	Rs.20.51(P)
5.	Tamil Nadu Madurai	1993-94 January 1995	143(1)(a)	The carry forward and set off of losses in assessment year 1994-95 amounting to Rs.15.28 lakh was erroneously allowed as there was no loss to be carried forward in assessment year 1993-94.	Rs.10.74

The Ministry have accepted the audit observation at Sl.No.3. Their response to the remaining cases has not been received.

Incorrect allowance of exemption

5.27 Under the Income Tax Act, 1961, where seventy percent of the income derived from the property held under a trust wholly for charitable or religious purpose, is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year but is accumulated or is set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income provided, *inter aila*, that the money so accumulated or set apart is invested or deposited in the forms or modes specified in the Act. Such forms or modes, *inter alia*, include investment or deposit in any public sector company. The Act has defined the term 'public sector company' to mean any corporation established

by or under any central, state or provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956. The Act further provides that the exemption is not available if for any period during the previous year, shares in a company (not being a public sector company) are held by the trust or institution after 30th day of November 1983.

In Maharashtra, Mumbai City IX charge, the assessment of a trust, an association of persons for the assessment year 1993-94 was completed after scrutiny in March 1996 at nil income allowing exemption available to a trust wholly for charitable or religious purposes. Audit scrutiny revealed that the assessee had invested/deposited its funds in private sector companies and that these investments/deposits were made by the assessee prior to 1 March 1983 which continued to remain so invested/deposited even after 30 November 1983. As these investments/deposits are not specified under the Act, exemption allowed to the assessee is not in order. Incorrect allowance of exemption resulted in underassessment of income of Rs.66.53 lakh with consequent short levy of tax of Rs.29.81 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction

5.28 Under the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee which has been defined in the Act as the total income computed in accordance with the provisions of the Act before making deductions under Chapter VIA but after setting off unabsorbed losses, depreciation, investment allowance, etc. pertaining to earlier years. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to nil or to a loss, no deduction under Chapter VIA is admissible.

In Gujarat, Surat charge, the assessment of a firm for the assessment year 1996-97 was completed in a summary manner in February 1997 allowing deduction of Rs.51.96 lakh in respect of export profit and carry forward of unabsorbed loss of Rs.67.77 lakh of the earlier years. Audit scrutiny however revealed that deduction was allowed before setting off of unabsorbed loss of earlier years which was irregular. After setting off, the allowable deduction worked out to Rs.3.85 lakh only as against Rs.51.96 lakh erroneously allowed by the department. The mistake resulted in excess carry forward of loss of Rs.48.11 lakh involving short levy of tax of Rs.19.24 lakh (potential) and non-levy of additional income tax of Rs.3.85 lakh.

The reply of the Ministry to the audit observation has not been received.

Irregular deduction under section 80 IA of the Income Tax Act

5.29 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking which begins to manufacture or produce articles or things after a specified date there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount

equal to the percentage specified in the Act subject to fulfillment of the prescribed conditions. One of the conditions is that it is not formed by transfer of plant and machinery previously used for any purpose.

In Uttar Pradesh, Kanpur charge, the assessment of an assessee for the assessment year 1994-95 was completed in December 1994 after scrutiny allowing a deduction of Rs.14.69 lakh out of the income determined at Rs.44.63 lakh. Audit scrutiny revealed that the assessee was a new industrial undertaking which obtained the plant and machinery on lease from its sister concern engaged in the manufacture of the same products. As the prescribed condition was not fulfilled the said deduction of Rs.14.69 lakh was not allowable. The omission to disallow inadmissible deduction resulted in underassessment of income by a like amount involving short charge of tax of Rs.7.85 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction in respect of income of Co-operative Societies

5.30.1 Under the Income Tax Act, 1961, where the gross total income of a Co-operative Society included any income from carrying on the business of banking or providing credit facilities to its members, deduction shall be allowed on the whole of the amount of profits and gains of business attributable to any one or more of such activities of the Co-operative Society. It has been judicially held* that interest earned from Government securities and long-term deposits are not eligible for deduction in respect of income of Co-operative Societies.

In Tamil Nadu, Coimbatore charge, the assessment of a Co-operative Society carrying on the business of banking or providing credit facilities to its members for assessment year 1995-96 was completed in a summary manner in March 1996 accepting the claim for Rs.915.04 lakh as deductible in respect of its eligible income. Audit scrutiny revealed that the income claimed as exempt by the Society included an amount of interest income of Rs.141.55 lakh from Government securities and long term deposits which was not entitled to deduction under the above provisions in view of the decision. The allowance of the inadmissible deduction resulted in short computation of income by Rs.141.55 lakh with consequent short levy of tax of Rs.61.24 lakh (including interest).

The audit observation has not been accepted by the Ministry on the grounds that since the assessee is doing banking business, it needs to maintain cash/deposit to meet business exigencies and based on a Supreme Court judgment reported in 101-ITR-87 interest from Government Scheme is to be treated as business income. The Ministry has also argued that the issue is debatable and beyond the scope of prima facie adjustment.

The reply is not tenable firstly, because the judgment quoted by the Ministry is that of a High Court and not of Supreme Court. Secondly, there is a Supreme

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* Madhya Pradesh Co-operative Bank Vs. CIT (Additional) 218-ITR-438(SC)

Court Judgment in the case of another co-operative Bank (218-ITR-438) that income derived from investment in Government securities could not be regarded as an essential part of the assessee's banking activity as it did not form part of the stock in trade or working/circulating capital and hence such interest did not qualify for exemption under Section 81 (now 80 P). The audit observation being squarely covered by this Supreme Court judgment is not a debatable one.

5.30.2 Under the Income Tax Act, 1961, the income of a co-operative society attributable to certain specified activities is eligible for full deduction. Income derived from activities other than the specified ones is also eligible for deduction to a limited extent, subject to the fulfillment of prescribed conditions. Deductions are to be made with reference to the income included in the gross total income of the assessee.

In Kerala, Thiruvananthapuram charge, the assessments of a co-operative society for the assessment years 1990-91 and 1991-92 were completed after scrutiny in December 1992 and in February 1994 respectively. Audit scrutiny revealed that the entire receipts on account of auctions for cardamom sales credited to the profit and loss account was allowed as deduction instead of restricting it to the income included in the gross total income after taking into account the expenses incurred in connection with such auctions. It was also noticed that in order to work out deduction in respect of transaction with members, the percentage was worked out on the basis of sales turnover only ignoring other elements like trade income and sales tax collected. The aforesaid mistakes resulted in underassessment of income of Rs.10.80 lakh in aggregate with tax effect of Rs.6.22 lakh.

The Ministry have accepted the audit observation.

Short levy/ Incorrect levy of interest

5.31 Under the Income Tax Act, 1961, where an assessee who is liable to pay advance tax for any financial year on the basis of his own estimate has failed to pay such tax or where the advance tax so paid falls short of ninety percent of the tax determined on regular assessment, interest at the rate of two percent for every month or part of a month is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax from the first day of the next financial year to the date of determination of total income in a summary manner or regular assessment.

In Chandigarh charge, the assessment of a society for the assessment year 1993-94 was completed after scrutiny in February 1996. Audit scrutiny revealed that interest for short payment of advance tax was erroneously levied at Rs.884.14 lakh instead of the correct amount of Rs.909.71 lakh. The mistake resulted in short levy of interest of Rs.25.57 lakh.

The Ministry have accepted the audit observation.

Omission to levy interest for delay in payment of tax demand

5.32 Under the Income Tax Act, 1961, any demand of tax should be paid by an assessee within 30 days of service of notice of the relevant demand and failure to do so would attract simple interest of one and a half percent for every month or part thereof from the date of default. In April 1992 CBDT issued instructions clarifying that the interest is to be calculated with reference to date of service of original demand notice on tax finally determined in cases of assessment set aside or varied by appellate authority, and the fact that during the intervening period there was no tax payable by the assessee under any operative order would make no difference to the position.

(i) In Delhi City II charge, the assessments of two individuals for the assessment years 1990-91 and 1991-92 originally completed after scrutiny in March 1993 and March 1994 were set aside in appeal and fresh assessments were completed in February 1997 and March 1997 at an income of Rs.47.69 lakh and Rs.34.71 lakh respectively. Audit scrutiny revealed that even though the assessees had not paid the demand raised in March 1993 and March 1994 no interest for non-payment of demand was levied at the time of revising the assessments (February/March 1997) on tax of Rs.25.27 lakh and Rs.19.04 lakh finally determined. The omission resulted in non-levy of interest of Rs.27.69 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Bihar, Patna charge, the assessment of an individual assessee for the assessment year 1987-88 was completed after scrutiny in March 1990 and revised in March 1995 and notice of demand for Rs.16.57 lakh was served upon the assessee in April 1990. Audit scrutiny revealed that though demand of the same amount was raised and served upon the assessee in March 1995 after revision order no demand for interest for non-payment of tax demand was raised. The omission resulted in non-levy of interest for deferred payment of tax demand amounting to Rs.14.66 lakh from May 1990 to March 1995.

The Ministry have accepted the audit observation.

Short levy of interest due to non-filing of return

5.33 Under the Income Tax Act, 1961, where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two per cent per month or part thereof from 1 April 1989, from the date immediately following the specified due date to the date of filing the return or where no return is furnished, to the date of completion of regular assessment on the amount of tax determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source.

In Madhya Pradesh, Bhopal charge, the assessments of an individual for the assessment years 1990-91 to 1993-94 were completed in March 1996 on best judgment assessment basis. Audit scrutiny revealed that the assessing officer had levied the interest for not filing the returns from the date immediately following the period allowed by notice under section 148 to the date of regular assessment instead of charging the interest from the date immediately following the due date of furnishing of return to the date of regular

assessment. The mistake resulted in short levy of interest aggregating Rs.45.93 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect payment of interest by Government to the assessee

5.34 Under the Income Tax Act, 1961, as applicable from the assessment year 1989-90 onwards, where any refund is due to an assessee out of any advance tax (including the tax deducted at source) he shall be entitled to receive in addition to the said amount, simple interest thereon at the rate of one percent per month from 1 October 1991 for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted.

(i) In Maharashtra, Mumbai City II charge, the assessment of an assessee, Association of persons, for assessment year 1993-94 originally completed after scrutiny in October 1995, was revised in March 1996 in pursuance of the appeal orders dated 29 February 1996 determining a loss of Rs.33.49 crore and allowing a refund of Rs.27.31 lakh. Audit scrutiny revealed that the department had calculated an amount of interest of Rs.40.96 lakh from April 1993 to March 1996 on the refund of tax deducted at source. As the entire amount of Rs.113.78 lakh of tax paid by the assessee had been refunded along with interest of Rs.13.65 lakh in March 1994, the allowance of interest for the period from April 1994 to March 1996 was not in order. The mistake resulted in excess allowance of interest of Rs.27.31 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Karnataka Central, Bangalore charge, the assessment of a firm for the assessment year 1993-94 was completed after scrutiny in March 1996 determining loss of Rs.27.91 lakh. Audit scrutiny revealed that an amount of Rs.80 lakh was deposited by the assessee voluntarily for revoking an order initiated under section 281 B of the Act and was in no way connected with the assessment for the assessment year 1993-94 since the assessee had no taxable income. Further, the assessee himself had requested the department in March 1996 to treat this deposit as advance tax for the assessment year 1996-97. However, the department treated the deposit as `tax paid otherwise' for the assessment year 1993-94 and allowed interest of Rs.10.40 lakh on granting refund of the same. The mistake resulted in incorrect payment of interest of Rs.10.40 lakh.

The Ministry have accepted the audit observation.

Omission to levy penalty

5.35 Under the Income Tax Act, 1961, no person shall after 30 June 1984, take or accept or repay any loan or deposit of Rs.20,000 or more, otherwise than by account payee cheque or bank draft subject to certain exceptions. For contravention of this provision without reasonable cause an assessee is liable to pay by way of penalty, a sum equal to the amount of deposit or loan so taken or accepted or repaid. The Board have also directed that in cases where

the assessing officer does not initiate penalty proceedings, he should record reasons for not doing so.

(i) In Gujarat, Ahmedabad II charge, the assessment of a registered firm for the assessment year 1995-96 was completed in a summary manner in February 1996. Audit scrutiny revealed that the chartered accountant had certified that the assessee had received Rs.3.61 lakh and repaid Rs.9.27 lakh in cash in contravention of the above provisions. However, no penalty proceedings were initiated by the department nor were reasons recorded for not doing so. The omission which was prima facie apparent from records resulted in non-levy of penalty of Rs.12.88 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Haryana, Rohtak charge, the assessments of a firm for the assessment years 1989-90 to 1992-93 were completed after scrutiny in March 1994. Audit scrutiny revealed that the assessee accepted loan/deposits of Rs.3.42 lakh in cash and made repayments of deposits of Rs.3.17 lakh in cash. Therefore, the assessee was liable to pay penalty of Rs.6.59 lakh which was not levied by the department.

The Ministry have accepted the audit observation.

Other topics of interest

Omission to make reassessment

5.36 Under the Income Tax Act, 1961, the time limit prescribed for completion of reassessments is two years from the end of the financial year in which the order setting aside or cancelling an assessment was passed by the appellate authority. The assessment will be barred by limitation of time if the assessment/reassessment is not made within the time frame and the demand for balance of tax payable, if any, can not be raised resulting in loss of revenue.

In Tamil Nadu IV, Chennai charge, in the case of two assessees who were partners in a firm, the assessments completed after scrutiny for the assessment years 1986-87 to 1989-90 in March 1992, making additions towards unexplained investments in construction of new building, etc. were set aside by the Commissioner of Income Tax (Appeals) in January 1993 with a direction to re-do the same after ascertaining the ownership of the building. The time available for completing the set aside assessments *de novo* was upto March 1995. After ascertaining that the investments made were from the funds of the partners themselves and that the partners were the owners, the assessing officer had not proceeded to make the assessments within the time limit. Failure to complete the reassessment resulted in loss of revenue of Rs.11.63 lakh towards the demand payable.

The reply of the Ministry to the audit observation has not been received.

Receipt not brought to tax

5.37 Under the Income Tax Act, 1961, any tax deducted at source shall be treated as payment of tax on behalf of the person from whose income the deduction was made and credit shall be given to him for the amount so

deducted in respect of the assessment year for which such income is assessable. The related receipt from which the tax was deducted has to be taken into account in computing the assessee's total income.

(i) In North East Region, Shillong charge, the assessment of a partnership firm for the assessment year 1994-95 was completed after scrutiny in February 1997. Audit scrutiny revealed that while determining the quantum of tax payable, credit was allowed for a sum of Rs.6.74 lakh towards tax deducted at source from interest payment amounting to Rs.60.16 lakh even though the said interest income was offered for taxation to the tune of Rs.18.28 lakh only. The grant of credit in respect of tax deducted at source from interest, when part of the interest income itself was not offered for taxation was irregular. Omission to assess the balance of interest income of Rs.41.88 lakh not offered for taxation, resulted in underassessment of income by like amount and under charge of tax and interest of Rs.32.66 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Andhra Pradesh I charge, the assessment of a registered firm for the assessment year 1992-93 was completed after scrutiny in January 1995. Audit scrutiny revealed that the assessee was allowed credit for tax of Rs.1.95 lakh deducted at source from payment of different bills aggregating Rs.87.08 lakh, drawn by the assessee in respect of contract works. However, out of the total receipt of Rs.87.08 lakh on which tax had been deducted and credit claimed, only Rs.51.10 lakh was offered for tax. Since the credit for tax was allowed for the entire amount the same should have been brought to tax in the assessment year 1992-93. Omission to do so resulted in underassessment of income of Rs.35.98 lakh involving undercharge of tax of Rs.9.48 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Omission to make prescribed adjustment

5.38 Under the Income Tax Act, 1961, deductions are admissible for certain specified period to a newly established industrial undertaking in notified backward areas where it begins to manufacture or produce articles or things after 31 March 1981. It was held* by the Hon'ble Supreme Court that such deductions were not admissible to civil contractors. The Act provides that on receipt of return of income from the assessee all the cases are to be mandatorily processed by the assessing officer in summary manner making prescribed adjustment wherever necessary on the basis of information available in such return and accompanying documents and in accordance with the rulings of Supreme Court or jurisdictional High Court.

In North East Region, Shillong charge, the return of income of a partnership firm engaged in civil contract works for the assessment year 1996-97 was processed in a summary manner in August 1997 on the income of Rs.24.97 lakh as returned by the assesee. Audit scrutiny revealed that the assessee had claimed total deduction of Rs.14.02 lakh under the aforesaid provisions. The

* CIT. Vs N.C. Budhiraja and Co. and another (204-ITR-412 SC)

assessee not being an industrial undertaking manufacturing any article or thing, was not entitled to the deductions as held by the Supreme Court judgment regarding admissibility of the deduction in case of civil contractors. Omission to add back the incorrect claims as a prescribed adjustments resulted in underassessment of income of Rs.14.02 lakh with consequent short levy of tax of Rs.8.63 lakh (including additional income tax and interest).

The reply of the Ministry to the audit observation has not been received.

Failure to make proper assessment

5.39 Under the Income Tax Act, 1961, a return of income filed by an assessee under section 139 or in response to a notice under section 142(1) shall be mandatorily processed. While doing so, prescribed adjustments shall be made to rectify any arithmetical errors or to allow/disallow any deduction, allowance or relief on the basis of the information available in such return, accounts or documents. Where as a result of the above adjustments the income returned by the assessee is increased or the loss reduced or converted into income, additional tax at the rate of 20 percent of the tax on additions made shall also be leviable.

In Karnataka charge, the return of income for the assessment year 1994-95 filed by an individual assessee in October 1994 in an Income Tax ward Office, was transferred to a Special Range, in November 1994 due to jurisdictional change. The return was not processed in any of the offices. Notice under section 148 and under section 143(2) were issued to the assessee in August 1995 and November 1995 but no action was taken due to invalidity of the notices. The case was pending before Settlement Commission. Audit scrutiny revealed that the assessee had claimed depreciation on motor lorries and tippers at 33.33 percent and on tractors at 40 percent against 25 percent admissible but this was not disallowed by way of prescribed adjustment. Thus failure to process the return resulted in non creation of demand of Rs.5.96 lakh (including additional income tax) on excess claim of depreciation of Rs.6.28 lakh.

The reply of the Ministry to the audit observation has not been received.

Short demand of tax

5.40 Under the Income Tax Act, 1961, when any tax, interest, penalty, fine or other sum is payable in consequence of any order passed under the Act, the assessing officer shall serve upon the assessee, a notice of demand in the prescribed form, specifying the sum payable. The Act also provides that where a regular assessment is made, any tax or interest paid by the assessee at the time of processing of return shall be deemed to have been paid towards such regular assessment, and if no refund is due on regular assessment or the amount refunded on processing of return exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded shall be deemed to be tax payable by the assessee and the provisions of the Act shall apply accordingly.

In Andhra Pradesh, Vishakhapatnum charge, the assessment of an assessee individual for the assessment year 1992-93 originally completed in a summary manner in March 1993 was completed after scrutiny in March 1995 and revised in September 1995. Audit scrutiny revealed that while computing the demand payable by assessee the refund of Rs.3.73 lakh granted to him at the summary assessment stage was not taken into account. Further, it was also noticed that even though the demands raised were not paid within due dates, interest under section 220(2) was not levied. Both the mistakes resulted in short demand of Rs.5.77 lakh.

The Ministry have accepted the audit observation.

CHAPTER 6 : OTHER DIRECT TAXES

A-Wealth Tax

Revenue from wealth tax

6.1 The following table gives a time series analysis of wealth tax receipts as against budget estimates during 1993-94 to 1997-98.

Year	Budget estimates	Actuals	Variation	Percentage variation
		(Rs. in crore)		
1993-94	200.00	153.98	(-)46.02	(-)23.0
1994-95	125.00	104.87	(-)20.13	(-)16.1
1995-96	90.00	74.16	(-)15.84	(-)17.6
1996-97	110.00	77.44	(-)32.56	(-)29.6
1997-98	130.00	113.03	(-)16.97	(-)13.0

Status of assessments

6.2 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1998 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrear of demands at the end of the year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1993-94	6,13,751	4,32,574	1,81,177	29.5	423.28
1994-95	3,06,289	2,37,725	68,564	22.4	425.21
1995-96	1,85,410	85,384	1,00,026	53.9	806.23
1996-97	1,53,661	74,723	78,938	51.3	808.44
1997-98	1,06,121	80,251	25,870	24.3	851.40

Although there was reduction in the work load, the department could complete 0.80 lakh assessments in 1997-98 against 0.85 lakh assessments completed in 1995-96 and 0.74 lakh in 1996-97. Arrears continued to mount despite direction of the Board for assigning priority to reduction of arrear of demands.

Results of audit

6.3 During the test audit of assessments completed under the Wealth Tax Act, 1957, conducted during the period 1 April 1997 to 31 March 1998, short levy of wealth tax of Rs.28.09 crore was noticed in 528 cases.

A total number of 70 audit observations involving tax effect of Rs.545.44 lakh were issued to the Ministry of Finance for comments during May 1998 to October 1998. Out of these, the Ministry of Finance have accepted the observations in 21 cases involving tax effect of Rs.27.47 lakh in respect of non-company assessments and 8 cases with tax effect of Rs.46 lakh in respect of company assessments. The category-wise break up of the audit observations issued to the Ministry of Finance is given below:

Sl.No.	Category	Draft paragraphs issued to the Ministry	
		Nos.	Tax effect (Rs.in lakh)
1.	Wealth not assessed	18	297.34
2.	Non levy of wealth tax on companies	19	129.82
3.	Incorrect valuation of assets	9	73.75
4.	Incorrect computation of net wealth	7	8.68
5.	Avoidable mistake in computation of wealth tax	2	1.11
6.	Mistake in application of rate of tax	2	1.25
7.	Incorrect allowance of liability	3	17.97
8.	Non/short levy of interest	5	11.35
9.	Incorrect allowance of exemption	4	2.50
10.	Omission to initiate proceedings for recovery of tax	1	1.67
	Total	**70**	**545.44**

21 illustrative cases with tax effect of Rs.492.54 lakh are discussed in the succeeding paragraphs to highlight the important audit observations. Paragraphs 6.4.1 to 6.6 are on wealth tax relating to other than companies and paragraphs 6.7 to 6.11 relate to company cases. Out of these, the Ministry of Finance have so far accepted the observations in 5 cases involving tax effect of Rs.48.33 lakh. Replies are awaited in respect of 16 cases. Of the cases included, 4 cases involving tax effect of Rs.22.83 lakh were checked by the Internal Audit Wing of the department but the mistakes were not detected by them.

Assessees other than companies

Wealth not assessed

6.4.1 Under the Wealth Tax Act, 1957, prior to 1 April 1993, wealth tax on assessees other than companies is chargeable in respect of each assessment year on the net wealth of the assessees as on the valuation date relevant to that assessment year at the rates prescribed in the Schedule to the Act. From the

assessment year 1993-94, where net wealth of an individual, Hindu undivided family and a company exceeds Rs.15 lakh, tax leviable is one percent of the amount by which net wealth exceeds Rs.15 lakh. Net wealth means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date. The Central Board of Direct Taxes issued instructions (November 1973, April 1979 and September 1984) for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to tax the cases of evasion.

(i) In Maharashtra, Central II, Mumbai charge, the wealth tax assessment of an individual for the assessment year 1992-93 was completed after scrutiny in March 1995 at a net wealth of Rs.3,035.10 crore. Audit scrutiny of the income tax assessment (revised trading and profit and loss account based on appraisal report) completed ex-parte in February 1995 revealed that the assessee was engaged in money market transactions and was in possession of bonds of various companies for an aggregate value of Rs.121.27 crore as on the valuation date i.e. 31 March 1992. Further, the 'assessee' was in possession of two motor cars, the value of which as on the valuation date was Rs.4.27 lakh. These assets being specified assets were includible in the net wealth of the assessee for the assessment year 1992-93. However, the assessing officer had not included the same in the net wealth of the assessee. The omission resulted in wealth of Rs.121.31 crore escaping assessment with consequent short levy of tax of Rs.237.87 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Madhya Pradesh, Jabalpur charge, the income tax assessments of four individuals for the assessment year 1996-97 were completed in March 1997 under summary manner in three cases and after scrutiny in one case. Audit scrutiny revealed that the assessees had disclosed rental income from let out house properties during the assessment years from 1993-94 to 1996-97. Aggregate value of net wealth comprising these house properties under the provisions of Wealth Tax Act worked out at Rs.1922.59 lakh for all the four assessment years. Though the wealth of these assessees exceeded the limit of Rs.15 lakh in each case they did not file their returns of wealth and the department also did not initiate any wealth tax proceedings (except in one case for the assessment year 1993-94). The omission resulted in non-assessment of wealth aggregating Rs.1922.59 lakh with consequent non-levy of tax of Rs.26.30 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

6.4.2 It has been judicially held* that the assessee's own valuation report/sale value filed in respect of properties for subsequent years could be treated as information for re-opening the assessment of earlier years. Further, under the residuary valuation provisions of Schedule III of the Wealth Tax Act from

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* Dr. Keki Hormusji Gharda Vs B.H.Raisinghani W.T.O (1981)-135-ITR-387-Bombay HC.

assessment year 1989-90 onwards the value of the land shall be estimated to be the price which in the opinion of the assessing officer it would fetch if sold in the open market on the valuation date.

In Maharashtra, City VIII, Mumbai charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1994-95 revealed that the assessee sold a plot of land in a metropolitan city during the relevant previous year in the joint ownership having one-third share. The value of assessee's share of property as exhibited in his balance sheet as on March 1993 was Rs.49,030 whereas as per the valuation report, submitted by the assessee, the fair market value of the assessee's share in plot as on April 1981 for the purpose of computation of capital gain was Rs.31.77 lakh. The plot of land, being a specified asset constituted wealth of the assessee attracting levy of wealth tax. The plot of land was in the possession of the assessee during the assessment years 1982-83 to 1993-94. However, the assessee did not file wealth tax returns for any of these assessment years nor did the department initiate any wealth tax proceedings. Based on the cost inflation index method, wealth aggregating Rs.578.21 lakh escaped assessment with consequent non-levy of wealth tax aggregating Rs.10.98 lakh.

The reply of the Ministry to the audit observation has not been received.

6.4.3 It has been judicially held* that the moment an assessee's land is acquired or otherwise vests in the state, he becomes entitled to compensation and that the right to receive compensation is an asset for wealth tax purposes. It has also been judicially held** that accrued interest is an asset.

In Haryana, Rohtak charge, audit scrutiny of the income tax assessments of an individual for the assessment years 1987-88 to 1992-93 completed after scrutiny revealed that the assessee and his brother received in equal shares enhanced compensation amounting to Rs.34.98 lakh together with accrued interest of Rs.19.41 lakh relating to the period from May 1986 to March 1991 against the land acquired by the State Government in May 1986. As the compensation and interest thereon had accrued to both the assessees on the date on which the land was acquired from them, it was includible in their net wealth for assessment years 1987-88 to 1992-93. However, no wealth tax returns were filed by the assessees for these years nor did the department initiate any wealth tax proceedings. The omission resulted in wealth aggregating Rs.283.94 lakh escaping assessment with consequent non-levy of wealth tax of Rs.6.50 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

6.4.4 Under the provisions of Wealth Tax Act,1957, as it stood prior to its amendment with effect from 1 April 1993, 'assets' does not include any interest in the property where the interest in the property is available to the

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* CWT.V Smt Anjamli Khan 187-ITR-345 (SC)

** CWT.V M/s. Pachigolla Narasimha Rao 134-ITR-640-(AP-HC)

assessee for a period not exceeding six years from the date the interest vests in the assessee. Hence, it follows that if the interest in the property vests in the assessee for a period exceeding six years that interest is includible in the assets of the assessee.

In Maharashtra, Central II, Mumbai charge, audit scrutiny of the income assessment records of an individual for the assessment year 1991-92 revealed that the assessee created substantial interest in a property by making certain payments to the owner of the property under an agreement during the previous years relevant to assessment years 1981-82 to 1987-88 and as such full payments were not made. Further as per a tripartite agreement between the assessee, owner of the property and the purchaser, the property was sold for a consideration of Rs.2 crore of which the assessee received Rs.1.12 crore which were offered as capital gain and taxed accordingly for the assessment year 1991-92. This being specified asset, the assessing officer re-opened the wealth tax assessments for earlier years 1984-85 to 1989-90 and completed the assessments in March 1997 adopting the fair market value of the property by discounting 10 percent for each year. However, the wealth tax assessment for the assessment year 1990-91 was not re-opened. The omission resulted in wealth of Rs.100.80 lakh (adopting the value of the property by discounting 10 percent from the fair market value for the assessment year 1991-92) escaping assessment with consequent short levy of tax of Rs.1.98 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect valuation of immovable properties

6.5 Under the Wealth Tax Act,1957, prior to the assessment year 1989-90, subject to any rules made under the Act, 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, Further, under Wealth Tax Rules,1957, prior to 1 April 1989 with effect from 1 April 1979 for the propose of the above statutory valuation provision, the value of a house which is wholly or mainly used for residential purposes would be worked out under rent capitalisation method. It has been judicially held* that the assessee's own valuation report/sale value filed in respect of the properties for subsequent years could be considered as relevant information for re-opening the assessment of earlier years. The Central Board of Direct Taxes had issued instructions in June 1970 clarifying that where the value of a property in respect of any assessment year is shown at a figure exceeding the declared consideration in respect of an earlier year by more than 25 percent the assessment of the earlier years should be re-opened for revaluation even though the higher valuation in the subsequent years was attributable to the adoption of a different basis of valuation. The Central Board of Direct Taxes had also issued instructions (November 1973, April 1979 and September 1984) for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to bringing to tax the cases of evasion.

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* Dr. Keki Hormusji Gharda Vs B.H Raisinghani W.T.O.(1981)-135-ITR-387-Bombay HC.

In Maharashtra, Kolhapur charge, the assessed net wealth of two individuals for the assessment years 1981-82 to 1988-89, inter alia, included value of let out buildings used for running a school therein. The value of these properties was adopted at Rs.1.27 lakh as returned by the assessees in each of the aforesaid assessment years. Audit scrutiny of wealth tax assessment records of the assessees for the assessment year 1991-92 revealed that the Departmental Valuation Officer had determined the market value of the aforesaid properties at Rs.109.90 lakh as on 31 March 1991. Further, audit scrutiny of the income tax assessments of the assessees for the assessment years 1995-96 revealed that they had sold the properties for Rs.150 lakh in April 1994 and returned income on account of long term capital gain and for this purpose, the assessees themselves had adopted fair market value of Rs.27.58 lakh as on 1 April 1981. In view of the subsequent market value of Rs.27.58 lakh as on 1 April 1981 as adopted by assessees for capital gain purpose, sale value of Rs.150 lakh in April 1994 and Rs.109.90 lakh determined by the Departmental Valuation Officer as on 31 March 1991, the adoption of value of Rs.1.27 lakh in each of the wealth tax assessments for the assessment years 1981-82 to 1988-89 was on lower side and as such the assessments for those assessment years should have been re-opened to adopt the fair market value in the light of above mentioned provisions of the Act, jurisdictional High Court decision and Board's instructions of June 1970 which was not done. However, on the basis of valuation of Rs.109.90 lakh determined by the Departmental Valuation Officer as on 31 March 1991 and cost deflation index for the purpose of capital gain, the market value of the properties would work out to Rs.27.58 lakh, Rs.60.38 lakh, Rs.65.82 lakh, Rs.70.04 lakh, Rs.75.48 lakh, Rs.80.30 lakh, Rs.84.54 lakh and Rs.90.58 lakh for the assessment years 1981-82 to 1988-89 respectively as against the value of Rs.1.27 lakh adopted in each of those assessment years. Omission to re-open the assessments and consequent non-revision of the value of the properties by considering the appreciation in the value in those assessment years resulted in under assessment of wealth aggregating Rs.544.52 lakh with consequent short levy of tax of Rs.13.14 lakh.

The reply of the Ministry to the audit observation has not been received.

Non-levy of interest for delay in filing the return

6.6 Under the Wealth Tax Act, 1957, where the return of net wealth for any assessment year is furnished after the specified due date or is not furnished, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part of the month from the date immediately following the due date to the date of filing the return on the amount of tax determined in regular assessment.

In Karnataka, Central, Bangalore charge, the wealth tax assessments of 3 individuals, 6 Hindu undivided families and 1 association of persons belonging to the same group and assessed by the same assessing officer for the assessment year 1991-92 were completed after scrutiny in February 1997 on an aggregate net wealth of Rs.545.12 lakh levying tax of Rs.11.65 lakh. Audit scrutiny revealed that all the assessees filed the wealth tax returns in February

1994 as against the specified due date of 30 June 1991. All the assessees were therefore liable to pay interest from July 1991 to February 1994 for delay in furnishing the return. However, the interest was not levied in all the 10 cases. The omission resulted in non-levy of interest aggregating Rs.7.40 lakh.

The Ministry of Finance have accepted the audit observation.

Company cases

Non-levy of wealth tax

6.7 Under the provisions of Section 40 of Finance Act, 1983, with effect from the assessment year 1984-85, companies other than those in which the public are substantially interested are liable to wealth tax at a flat rate of 2 percent (plus 10 percent surcharge for the assessment year 1988-89 only) of the net wealth comprising the aggregate market value upto the assessment year 1991-92 and for assessment year 1992-93 either value determined in the manner laid down in Schedule III to the Act or value disclosed in balance sheet of the company on the valuation date, whichever is higher, of the specified assets belonging to the company reduced by the debts owed by the company pertaining to such assets on the valuation date.

In West Bengal and Maharashtra charges audit scrutiny of the income tax assessment records of 9 closely held companies for the assessment years 1986-87 to 1992-93 revealed that the companies owned specified assets which were chargeable to wealth tax. However, neither did the assessee companies file their return of net wealth nor did the department initiate any wealth tax proceedings. The omission resulted in aggregate wealth of Rs.2577.44 lakh escaping assessment with consequent non-levy of wealth tax of Rs.49.40 lakh. Brief particulars of these cases are given below:-

(Rs. in lakh)

Sl. No.	Commissioner's charge	No. of Companies	Assessment year	Type of assets owned	Aggregate value of assets escaping assessment	Tax effect
1	West Bengal I to V, Calcutta	7	1989-90 to 1992-93	Buildings and house properties	1265.50	25.32
2.	City I, Mumbai	1	1991-92 to 1995-96	Buildings	887.20	15.60
3.	City IX, Mumbai	1	1987-88 to 1991-92	Buildings	424.74	8.48

The Ministry have accepted the audit observation at Sl.No.3. Their response to the remaining cases has not been received.

Incorrect computation of net wealth

6.8.1 The Act also provides that where any debt secured on any asset is incurred for, or ensures to the benefit of any other person, or is not represented by an asset belonging to the assessee the value of such debt shall not be taken into account in computing the net wealth of the assessee.

(i) In Tamil Nadu I charge, the wealth tax assessments of a closely held company for the assessment years 1990-91 and 1991-92 were completed after scrutiny in March 1993 and November 1994 respectively. Audit scrutiny revealed that the assessee owned a house property in a metropolitan city and one-fourth portion of that property was let out. In addition to above, the assessee also owned landed property. In computing the net wealth of the assessee for the aforesaid assessment years, the value of the above stated properties were not brought to wealth tax on the ground that the debt secured thereon were more than the market value of the properties. As the debts secured on the asset were not represented by any asset belonging the assessee, no deduction of such liability was admissible. The irregular allowance of liabilities thus resulted in non-assessment of the above assets valued at Rs.724 lakh with consequent short levy of wealth tax of Rs.14.48 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal, Central I charge, the wealth tax assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994 at net wealth of Rs.331.09 lakh. Audit scrutiny revealed that the company owned residential house property during the previous year relevant to the assessment year 1991-92 and it's market value of Rs.40 lakh, being specified asset was includible in it's net wealth. However, during assessment, the same was omitted to be included in the net wealth of the assessee. Besides, the said company was allowed a deduction toward debt of Rs.90 lakh from the value of its asset which was not in order as the debt was secured against an asset which was not included in assessee's net wealth. The omission resulted in underassessment of wealth aggregating Rs.130 lakh with consequent undercharge of wealth tax of Rs.2.36 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

6.8.2 The Finance Act, 1983, provides for the inclusion of assets wherever located in the net wealth of resident company. Further, under the provisions of Wealth Tax Act, 1957, the assets and debts outside India of a non-resident company during the year ending on the valuation date are not to be included in the wealth of the company for the wealth tax purpose.

In Tamil Nadu II, Chennai charge, audit scrutiny of the income tax assessment records of a closely held resident company for the assessment years 1989-90 to 1992-93 revealed that the assessee returned income from house properties at Malaysia and got exemption from income tax and sur tax in terms of the provisions of the Double Taxation Avoidance Agreement between Malaysia and India. Considering rent capitalistion, the value of the house properties at Malaysia aggregating Rs.71 lakh for the four assessment years constituted wealth of the assessee attracting levy of wealth tax for which no relief was provided in the Agreement ibid. However, the assessee did not file any wealth tax returns nor did the department initiate any wealth tax proceedings. The omission resulted in wealth of Rs.71 lakh escaping assessment with

consequent non-levy of tax of Rs.1.39 lakh. Further, interest for non-filing of returns was also leviable.

The reply of the Ministry to the audit observation has not been received.

Incorrect valuation of immovable properties

6.9 Prior to its amendment by Finance (No.2) Act,1991, effective from assessment year 1992-93, the value of specified assets owned by the company 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.

In Tamil Nadu I, Chennai charge, the wealth tax assessments of a closely held company for the assessment years 1990-91 and 1991-92 were completed after scrutiny on taxable wealth of Rs.2.34 lakh and Rs.51.56 lakh in February 1993 adopting the value of two immovable properties situated in prime location at Chennai under the provisions of Schedule III to the Wealth Tax Act. Audit scrutiny revealed that valuation of immovable properties as per Schedule III was made applicable from the assessment year 1992-93 onwards only and as such in this case market value of the properties was required to be adopted. However, it was not done. The omission resulted in underassessment of wealth of Rs.950 lakh with consequent short levy of tax of Rs.52.34 lakh.

The reply of the Ministry to the audit observation has not been received.

Non-levy of Wealth Tax

6.10 Under the provisions of Wealth Tax Act, 1957, as amended with effect from the assessment year 1993-94, wealth tax shall be charged for every assessment year in respect of the net wealth on the corresponding valuation date of every individual, Hindu undivided family and company, at the rate of one per cent of the amount by which the net wealth exceeds fifteen lakh rupees. Under the Act, 'assets' means, inter-alia, motor cars (other than those used by the assessee in the business of running them on hire or as stock in trade), aircraft (other than those used by the assessee for commercial purposes) and urban land.

In Chennai and Mumbai charges, audit scrutiny of the income tax assessment records of 6 companies for the assessment years 1993-94 to 1996-97 revealed that the companies owned specified assets which were chargeable to wealth tax. However, neither did the assessee companies file their return of net wealth nor did the department initiate any wealth tax proceedings. The omission resulted in aggregate wealth of Rs.5,312.79 lakh escaping assessment with

consequent non-levy of wealth tax of Rs.65.77 lakh. Brief particulars of these cases are given below:

(Rs. in lakh)

Sl. No.	Commissioner's charge	Assessment year	Type of assets owned	Aggregate value of assets escaping assessment	Tax effect
1.	City III, Mumbai	1995-96 and 1996-97	Motor Cars and Aircraft	2716.00	26.85
2.	Tamil Nadu IV, Chennai	1993-94 to 1995-96	Urban land and Motor Cars	1520.08	24.43 (including interest)
3.	Coimbatore, Tamil Nadu	1993-94 and 1994-95	Urban land	269.46	4.33 (including interest)
4.	Tamil Nadu IV, Chennai	1993-94 and 1994-95	Motor Cars and Residential House properties	269.22	4.31 (including interest)
5.	Tamil Nadu IV, Chennai	1993-94 to 1995-96	Motor Cars	293.89	3.71
6.	City IV, Mumbai	1994-95 and 1995-96	Urban land and Vehicles	244.14	2.14

The Ministry of Finance have accepted the audit observations at Sl.Nos.2, 4 and 5. Their response to the remaining cases has not been received.

Incorrect allowance of liability

6.11 Under the Wealth Tax Act, 1957, with effect from 1 April 1993, net wealth of an assessee means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.

In Maharashtra, City VI, Mumbai charge, the wealth tax assessment of two companies for the assessment year 1994-95 were completed after scrutiny in March 1997. Audit scrutiny revealed that during the previous year both the assessees owned immovable properties which were let out and the assessees received security deposits of Rs.263.63 lakh from the tenants for letting out the properties. The assessing officer while framing the assessments had deducted the aforesaid security deposits from assessees' net wealth treating the same as debt incurred in relation to the above assets which was not in order. The incorrect allowance of the liability treated as incurred in relation to the specified asset resulted in underassessment of wealth of Rs.263.63 lakh with consequent short levy of tax of Rs.2.63 lakh.

The reply of the Ministry to the audit observation has not been received.

B-Gift Tax

Revenue from gift tax

6.12 In the financial years 1993-94 to 1997-98, gift tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget estimates	Actuals	Variation	Percentage variation
	(Rs. in crore)			
1993-94	10.00	4.99	(-) 5.01	(-) 50.1
1994-95	5.00	14.98	9.98	200.0
1995-96	10.00	11.40	1.40	14.0
1996-97	10.00	10.30	0.30	0.3
1997-98	10.00	9.08	(-) 0.92	(-) 9.2

Status of assessments

6.13 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1998 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrear of demands at the end of year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1993-94	36,478	28,489	7,989	21.9	31.81
1994-95	33,928	28,145	5,783	17.1	30.70
1995-96	31,737	24,109	7,628	24.0	30.51
1996-97	32,493	27,690	4,803	14.8	33.75
1997-98	31,446	25,894	5.552	17.6	46.02

Arrear of demands continued to mount despite direction of the Board for assigning priority to reduction of arrears.

Results of audit

6.14 During the test audit of assessments made under the Gift Tax Act, 1958, conducted during the period 1 April 1997 to 31 March 1998, short levy of gift tax of Rs.4.98 crore was noticed in 157 cases.

A total number of 15 audit observations involving tax effect of Rs.80 lakh were issued to the Ministry of Finance for comments during May to October 1998. Out of these, the Ministry of Finance have so far accepted the observations in 2 cases involving tax effect of Rs.12.18 lakh.

6 cases involving tax effect of Rs.57.06 lakh are discussed below. Out of these the Ministry of Finance have so far accepted the audit observation in 2 cases involving tax effect of Rs.12.18 lakh. Replies are awaited in respect of 4 cases. Out of the cases included one case involving tax effect of Rs.13.05 lakh was checked by the Internal Audit Wing of the Department but the mistake was not detected by them.

Gift not assessed

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

(i) In Madhya Pradesh, Indore charge, audit scrutiny of the income tax assessment records of two individuals for the assessment year 1994-95 revealed that the assessees purchased out of their own money, house properties valued at Rs.8.82 lakh (including registration charges etc.) in the names of their wives. This transfer of money without any consideration constituted gift attracting levy of gift tax. However, the assessees did not file returns of gift nor did the department initiate any gift tax proceedings. The omission resulted in non-assessment of gift aggregating Rs.8.82 lakh with consequent non-levy of gift tax of Rs.4.50 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Uttar Pradesh, Meerut charge, audit scrutiny of the income tax assessment records of two individuals for the assessment year 1991-92 revealed that the assessees received compensation aggregating Rs.16.87 lakh on account of acquisition of their agricultural land out of which they incurred a sum aggregating Rs.9.46 lakh for purchasing of new agricultural land in favour of their sons without any consideration from them. The sum so incurred constituted gift attracting levy of gift tax. However, assessees did not file any return of gift nor did the department initiate any gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.2.73 lakh.

The reply of the Ministry to the audit observation has not been received.

Non-levy of tax on deemed gift

6.16 Under the Gift Tax Act,1958, the value of transactions such as release, discharge, surrender, forfeiture or abandonment of any debt, contract, and actionable claim or of any interest in property, if not bonafide are deemed gifts. The Central Board of Direct Taxes issued instructions in march 1976 and May 1977 clarifying that when a partnership firm is reconstituted either with the same old partners or on admission of new partners or on conversion of a sole proprietorship into firm and the profit sharing ratio of the partners are revised, any interest surrendered or relinquished by one or more of such

partners without adequate consideration in money or money's worth in favour of other partners would attract levy of gift tax.

In Karnataka II, Bangalore charge, a partnership firm initially having four partners was reconstituted during the previous year relevant to assessment year 1990-91 with two more new partners and three of the existing partners relinquished 8 per cent of their share of interest in the partnership firm in favour of the new partners and the remaining existing partner. Similarly during the previous year relevant to assessment year 1991-92, the firm was again reconstituted in April 1990 with two more new partners and the existing four initial partners of the firm retired relinquishing 96 percent of their share of interest in favour of the remaining four partners. Audit scrutiny of the income tax assessment records of the firm revealed that the firm had a reserve of Rs.43.19 lakh under head 'Export Development Reserve' at the end of the relevant previous years. Thus the out-going partners surrendered their share of interest of the "Export development reserve" of Rs.3.45 lakh and Rs.41.46 lakh during the previous year relevant to the assessment years 1990-91 and 1991-92 respectively without adequate consideration which constituted deemed gift attracting levy of gift-tax. However, the assessees did not file any return of gift nor did the department initiate any gift tax proceedings. The omission resulted in deemed gift aggregating Rs.44.91 lakh escaping assessment with consequent non-levy of gift tax of Rs.13.05 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect exemption of gift

6.17 Under the Gift Tax Act, 1958, gift means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth. The Act further provides that gift made by any person to any institution established for charitable purposes is exempt from gift tax, if the gift made to such institution qualifies for deduction under the Income Tax Act,1961.

In Karnataka II, Bangalore charge, audit scrutiny of income tax assessment records of an association of persons (Trust) for the assessment year 1986-87 revealed that the assessee transferred a piece of land together with buildings constructed thereon with all its equipment, furniture and furnishings valued at Rs.43.38 lakh in August 1985 to another trust not established for any charitable purposes as laid down under the Income Tax Act. As such the transfer of immovable property by the assessee to another trust without any consideration in money's worth constituted gift under the Gift Tax Act attracting levy of gift tax. However, the assessee did not file any gift tax return nor did the department initiate any gift tax proceedings. The omission resulted in gift aggregating Rs.43.38 lakh escaping assessment with consequent non-levy of gift tax of Rs.24.60 lakh.

The reply of the Ministry to the audit observation has not been received.

Short levy of interest for delay in filing return of gift

6.18 Under the Gift Tax Act,1958, where a return of gift for any assessment year is not filed by an assessee on or before 30 June of the corresponding assessment year, the assessee shall be liable to pay simple interest at the rate of two per cent, for every month or part of a month comprised in the period commencing on 1 July of the assessment year and ending on the date of furnishing of the return.

In Tamil Nadu I, Chennai charge, the gift tax assessment of a company for the assessment year 1989-90 completed after scrutiny in March 1995 was revised in December 1995 on a taxable gift of Rs.106.96 lakh levying gift tax of Rs.32.03 lakh. Audit scrutiny revealed that the assessee filed its return of gift in November 1992 as against the due date of filing the return on 30 June 1989 i.e. after 41 months. However, interest for delay in filing the return was computed for the period of 35 months incorrectly reckoning the due date of filing the return from January 1990. Thus the interest was computed less for 6 months. The omission resulted in short-levy of interest of Rs.3.84 lakh.

The Ministry have accepted the audit observation.

Omission to take timely action on internal audit objection

6.19 According to the executive instructions issued by the Central Board of Direct Taxes in 1977, mistakes pointed out by internal audit parties of the department should be rectified by the assessing authorities promptly. The remedial action should be initiated within a month and completed as far as possible within three months of the objection raised by internal audit.

In Tamil Nadu, Coimbatore charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1990-91 revealed that the internal audit of the department raised an audit observation against the assessee in May 1991 with regard to non-assessment of deemed gift of Rs.10 lakh on which no action was taken by the department till March 1996. The omission to take timely action on internal audit objection resulted in non-assessment of deemed gift of Rs.10 lakh with consequent non-levy of gift tax of Rs.8.34 lakh (including interest).

The Ministry have accepted the audit observation.

C-Interest Tax

Revenue from interest tax

6.20 In the financial years 1993-94 to 1997-98, interest tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget Estimates	Actuals	Variation	Percentage variation
	(Rs. in crore)			
1993-94	900.00	727.58	(-)172.42	(-)19.3
1994-95	1,044.00	801.40	(-)242.60	(-)23.2
1995-96	1,000.00	1,170.05	(+)170.05	(+)17.0
1996-97	1,250.00	1,712.39	(+)462.39	(+) 37.0
1997-98	2,400.00	1,205.18	(-)1,194.82	(-)49.7

The large variation between the budget estimates and actual indicates the necessity to put budget estimation on realistic basis.

Status of assessments

6.21 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1998 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrear of demands at the end of the year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1993-94	2,381	395	1,986	83.4	0.62
1994-95	6,704	1,810	4,894	73.0	0.60
1995-96	7,189	2,864	4,325	60.1	102.82
1996-97	12,378	5,374	7,004	56.6	234.46
1997-98	13,971	4,756	9,215	65.9	513.10

Results of audit

6.22 During the test audit of assessments made under the Interest Tax Act, 1974 conducted during the period 1 April 1997 to 31 March 1998 short levy of interest tax of Rs.8.36 crore was noticed in 73 cases.

A total number of 23 audit observations involving tax effect of Rs.723.13 lakh were issued to the Ministry of Finance for comments during May to October 1998. Out of these the Ministry of Finance have so far accepted the observation in 10 cases involving tax effect of Rs.427.68 lakh.

15 illustrative cases involving tax effect of Rs.582.44 lakh are given in the following paragraphs to highlight the important audit observations. Out of these the Ministry of Finance have so far accepted the audit observations in 7 cases involving tax effect of Rs.421.21 lakh. Of the cases included, one case involving tax effect of Rs.287.56 lakh was checked by the Internal Audit Wing of the department but the mistake was not detected by it.

Underassessment of chargeable interest/omission to make assessment of interest tax.

6.23 Under the Interest Tax Act, 1974, as reintroduced with effect from 1 October, 1991 by the Finance (No.2)Act, 1991, interest tax is leviable on the chargeable interest income of 'credit institutions'. Such credit institutions, inter alia, included Co-operative Societies engaged in the business of banking , not being Co-operative Societies which provide credit facilities to farmers or village artisans, for the assessment year 1992-93. The interest income chargeable to tax includes interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange. The Central Board of Direct Taxes issued instructions in March 1995 that interest on debentures, bonds, securities etc. is eligible to interest tax. The Board further issued notification in September 1995 exempting income from interest on securities in the case of banking companies with effect from the financial year 1995-96 only. The returns of chargeable interest are required to be filed by 31 December of the relevant assessment year.

(i) In Kerala, Kochi charge, the interest tax assessments of a banking company for the assessment years 1992-93 and 1993-94 were completed in March 1995 and revised in January 1996. Audit scrutiny revealed that income from interest on securities amounting to Rs.3,851 lakh and Rs.5,134 lakh received during the previous years relevant to the assessment years 1992-93 and 1993-94 respectively were not considered for assessment though exemption from interest tax in respect of interest on securities in the case of banking companies was available from financial year 1995-96 only. The chargeable interest which was assessable to interest tax, but not assessed, worked out to Rs.1,925 lakh for assessment year 1992-93 on proportionate basis and Rs.5,134 lakh for 1993-94. The omission resulted in chargeable interest aggregating Rs.7,059 lakh escaping assessment with consequent short levy of interest tax of Rs.287.56 lakh.

The Ministry have accepted the audit observation.

(ii) In West Bengal III, Calcutta charge, audit scrutiny of the income tax assessments of a non-banking financial company, engaged in the business of receiving deposits by way of sale of units or certificates etc, for the assessment years 1993-94 and 1994-95 revealed that the assessee company received Rs.217.09 lakh and Rs.903.52 lakh towards interest income on bonds,

debentures and inter corporate deposits during the relevant previous years attracting levy of interest tax. However, the assessee did not file the returns of chargeable interest for any of the assessment years nor did the department initiate any interest tax proceedings. The omission resulted in non-assessment of chargeable interest aggregating Rs.1,120.61 lakh with consequent non-levy of interest tax of Rs.87.17 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In addition to above high value cases, similar omissions in certain other cases are mentioned below:

(Rs. in Lakh)

Sl.No.	Commissioner's charge	Assessment year	Nature of income	Amount of interest income escaping interest tax assessment	Tax effect
1.	Central I, Tamil Nadu	1992-93 to 1994-95	Interest on housing loans	1,048.82	54.79 (including interest)
2.	West Bengal V, Calcutta	1993-94 and 1994-95	Interest on Bills of exchange	398.11	26.32 (including interest)
3.	Delhi I	1994-95	Income from hire purchase transactions and interest	299.03	14.53 (including interest)
4.	Maharashtra City IV, Mumbai	1994-95 to 1996-97	Interest and bill discounting charges	193.53	13.64 (including interest)
5.	West Bengal IV, Calcutta	1993-94 and 1994-95	Interest on loans	168.20	13.23 (including interest)
6.	Maharashtra City III, Mumbai	1993-94	Interest income	157.00	9.24 (including interest)
7.	Maharashtra City IV, Mumbai	1995-96	Interest and bill discounting charges	116.95	5.91 (including interest)
8.	West Bengal VI, Calcutta	1994-95 and 1995-96	Interest income	81.29	5.63 (including interest)
9.	Tamil Nadu, Coimbatore	1993-94 to 1996-97	Interest income	65.55	4.38 (including interest)
10.	Chennai, Trichy	1992-93 to 1994-95	Interest income	43.58	3.60 (including interest)
11.	Delhi I	1994-95	Interest income	63.51	3.09 (including interest)
12.	West Bengal I, Calcutta	1994-95	Finance charges	53.85	2.75 (including interest)

The Ministry have accepted the audit observation at Sl.No.1,4,7,8 and 11. Their response to the remaining cases has not been received.

Non-levy/Short levy of interest for default in payment of interest tax in advance

6.24 Under the Interest Tax Act, 1974, as re-introduced with effect from 1 October 1991, by the Finance (No.2) Act, 1991, where an assessee who is liable to pay interest-tax in advance has failed to pay such tax, or where the interest tax so paid falls short of ninety percent of the tax determined, simple interest at the rate of two percent for every month or part of a month is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax from the 1st day of the next financial year to the date of determination of chargeable interest.

In Kerala, Kochi charge, the interest tax assessments of a banking company for the assessment years 1992-93, 1993-94 and 1995-96 were completed in March 1993, March 1994 and September 1996 and revised in September 1996. Audit scrutiny revealed that the interest leviable for default in payment of interest tax in advance for assessment years 1992-93 and 1995-96 was short by Rs.22.85 lakh and Rs.2.27 lakh respectively and that for assessment year 1993-94 an amount of Rs.25.47 lakh was omitted to be levied. The mistakes resulted in short levy of interest tax aggregating Rs.50.59 lakh.

The Ministry have accepted the audit observation.

D- Expenditure Tax

Mistake in computation of chargeable expenditure

6.25 Under the provisions of the Expenditure Tax Act,1987, there shall be charged a tax at the rate of twenty percent (ten percent with effect from 1 June 1994) of the chargeable expenditure incurred in a hotel wherein the room charges for any unit of residential accommodation are one thousand two hundred rupees or more (Four hundred rupees or more upto 31 May 1992) per day per individual. 'Chargeable expenditure' for this purpose is defined as any expenditure incurred in or payments made to the hotel in connection with certain items specified in the Act but, interalia, does not include any expenditure by way of any tax including tax under this Act.

In Tamil Nadu, Coimbatore charge, the expenditure tax assessments of a hotel for the assessment years 1992-93 and 1993-94 were completed in November 1994 determining the chargeable expenditure at Rs.94.11 lakh and Rs.19.63 lakh respectively. Audit scrutiny revealed that while determining chargeable expenditure, a sum of Rs.21.12 lakh and Rs.5.04 lakh representing property tax, urban land tax, sales tax, additional sales tax, motor vehicle tax and expenditure tax were allowed as deductions. The action of the department was not in order as these taxes did not form part of the gross chargeable expenditure collected from customers and as such their exclusion was irregular. The irregular allowance of deductions resulted in short levy of expenditure tax aggregating Rs.7.18 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Non-levy of interest and penalty for failure to pay expenditure tax

6.26 Under the Expenditure Tax Act, 1987, the tax collected during any calendar month shall be paid to the credit of the Central Government by the 10th of the month immediately following the said calendar month. Failure to do so attracts simple interest at the rate of one and one half percent for every month or part of the month by which such crediting of tax is delayed under section 14 of the Act. Moreover, for failure to pay such tax to the credit of the Central Government in accordance with the provisions of the Act would also attract penalty equal to a sum not less than one hundred rupees for every day during which the failure continues which shall not exceed the amount of tax the assessee failed to pay.

(i) In Bihar, Patna charge, audit scrutiny of the income tax assessment records of a company for the assessment year 1994-95 completed after scrutiny in January 1997 revealed that expenditure tax to the extent of Rs.8.67 lakh was collected by the assessee company during the relevant previous year. However, as certified by the Chartered Accountant in Form 3CD the tax collected was not paid to the credit of the Central Government. Moreover, return of expenditure tax was also not filed by the assessee for the assessment year 1994-95. As such, failure to pay the collected tax attracted both interest and penalty under the provisions of the Act. Interest and penalty for failure on the part of the assessee to furnish prescribed return was also leviable. The omission resulted in non-levy of interest and penalty of Rs.6.74 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Karnataka, Bangalore charge, the expenditure tax assessments of a company carrying on hotel business for the assessment years 1991-92 and 1992-93 were completed in February 1996 and December 1996 and the assessment for 1991-92 was revised in June 1996. Audit scrutiny revealed that the assessee hotel collected expenditure tax of Rs.18.26 lakh and Rs.17.26 lakh during the relevant previous years and remitted to Government account after a delay of 5 to 9 months and 3 to 16 months relevant to assessment years 1991-92 and 1992-93 respectively attracting the levy of interest which was not levied. The omission resulted in non-levy of interest aggregating Rs.5.99 lakh.

The Ministry have not accepted the audit observation on the grounds that there is no provision under the Expenditure Tax Act which specifies that the Expenditure Tax which has not been collected should be remitted by the 10th of the following month and the Act also does not specify that the tax for a particular month should be collected during the said month itself and remitted by 10th of the following month.

The reply of the Ministry is, however, not tenable in the light of provisions relating to collection and recovery of Expenditure Tax under sub section (4) of Section 7 of the Act which clearly provide that any person responsible for collection of the tax, and who fails to collect the tax in accordance with the provisions of sub section (1) or sub section (2) of Section 7 should notwithstanding such failure, be liable to pay the tax to the credit of the Central Government in accordance with the provisions of sub section (3) of Section 7 which states that the tax collected during any calendar month in accordance with the provisions of sub-section (1) and (2) shall be paid to the credit of the Central Government by the 10th of the month immediately

following the said calendar month. This presupposes that the assessee was previously responsible for paying the tax to the Government on the due date irrespective of the fact whether or not the assessee collected the tax on chargeable expenditure in the relevant month. Thus, failure on the part of the assessee to collect the tax on chargeable expenditure in relevant month makes himself liable to pay such tax.

(MUKESH ARYA)
Principal Director of Receipt Audit
(Direct Taxes)

New Delhi
Dated : 2 October 1999

Countersigned

(V.K.SHUNGLU)
Comptroller and Auditor General of India

New Delhi
Dated : 2 October 1999