REPORT OF THE
COMPTROLLER AND AUDITOR GENERAL
OF INDIA

FOR

THE YEAR 1984-85

UNION GOVERNMENT (CIVIL)

REVENUE RECEIPTS

VOLUME II

DIRECT TAXES

ERRATA

Page No.	*Para No.*	*Column No.*	*Line*	*For*	*Read*
1	1.01	1	25 from top	State	States
2	1.04(i)	2	7 from bottom	11.54*	11.54
3	1.04(ii)	1	14 from top	031–Texes on Wealth	032–Taxes on Wealth
3	1.05(i)(c)	2	2 from bottom	47	87
4	1.05(ii)	1	8 from top	Wealth-tax com-	Wealth tax on com-
5	1.08(c)	1	11 from bottom	1983-84 an 1984-	1983-84 and 1984-
8	1.09.02	2	16 from bottom	828.46 617.52 1446.04 988.41	828.47 617.58 1446.05 988.42
14	1.09.04(i)	2	30 from top	16	616
18	1.09.04(iv)(g)	2	28 from top	*The position	The position
19	1.09.04(v)(b)	1	11 from bottom	maneuvered	manoeuvered
20	1.10(iv)	2	16 from bottom	Revisions	Revision
26	1.16(m)	2	6 from bottom	Rs. 147.81 crores	147.82 crores
27	1.16(o)	1	9 from top	others	other
43	2.09	2	4 from bottom	shorty	short
43	2.09	2	5 from bottom	shorty	short
48	2.14	1	9 from top	1,81,81	1,81,813
56	2.22	1	2 from top	personnel	personal
57	2.22	2	5 from bottom	as	an
59	2.22	1	20 from top	suspence	suspense
63	2.23	2	26 from bottom	computed	completed
63	2.23	2	7 from bottom	involving levy	involving short levy
70	2.28	1	11 from top	udertaking	undertaking
70	2.28	2	25 from top	manufacture of	manufacture or
73	2.28	2	10 from bottom	awited	awaited
74	2.28	1	12 from top	ools	tools
76	2.29	2	12 from bottom	the development	of the development
78	2.31	2	26 from top	reuslt	result
80	2.31	1	24 from top	assets and treat the remaining amount of Rs. 1403507	assessee company resulted in the income of Rs.
81	2.03	2	14 from bottom	busienss	business
90	2.36	1	16 from bottom	while	While
96	2.46	1	18 from bottom	fourth	forth
101	2.53	1	19 from top	manufacture of	manufacture or
107	2.58	1	22 from bottom	(vii)	(vi)
109	3.06	2	8 from top	such	Such
111	3.08(i)	2	22 from bottom	aavilable	available
113	3.10(i)(a)	2	21 from top	assesing	assessing
115	3.10(iii)(b)	2	11 from top	the total	tax
119	3.13(i)	1	4 from bottom	ensure	enure
119	3.13(i)	1	3 from bottom	ensures	enures
126	3.18(i)	2	15 from top	prev us	previous
135	3.21(iv)	1	14 from top	secrutiny	scrutiny
137	3.23(i)	1	6 from bottom	share-hoders	share-holders
140	3.24(i)	1	21 from bottom	fianalised	finalised
143	3.28(ii)	2	6 from top	co-opertive	co-operative
145	3.30(iv)	2	21 from bottom	pa able	payable
153	4.04(v)(a)	2	19 from top	resutled	resulted
156	4.05 A(i)(c)	2	15 from top	assessment years 1975-76 to 1982-83. The assess-	returned by the assessee, for the assessment years
158	4.05 A(iii)(a)	1	10 from bottom	res ctively	respectively
159	4.05 A(vii)	2	11 from top	nade	made
162	4.05 D.	1	2 from bottom	not	net
167	4.11(iii)(a)	2	23 from top	1914-75	1974-75
167	4.11(iii)(b)	2	7 from bottom	assessee	assessees
170	4.17(ii)	1	27 from top	gi t	gift
170	4.17(ii)	1	28 from top	escapment	escapement
176	4.23	1	14 from bottom	clapsed	elapsed
177	4.25 A(iii)	2	15 from bottom	f or	of
182	4.26(iii)	1	1 from top	or	of
186	4.29	2	14 from bottom	"paragraph.....(1986)	"of Rs. 31,26,635 (the amount of duty levied)

REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR

THE YEAR 1984-85

UNION GOVERNMENT (CIVIL)

REVENUE RECEIPTS

VOLUME II

DIRECT TAXES

TABLE OF CONTENTS

PREFATORY REMARKS

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

(i) Chapter 1 sets out statistical information and reviews on Functioning of Institution of Commissioners of Income-tax (Recovery), Disposal of immovable properties attached towards tax recovery, Acquisition of immovable properties and Outstanding audit objections.

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

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

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

The points brought out in this Report are those which have come to notice during the course of test audit

VOLUME II

CHAPTER 1

GENERAL

1.01 Receipts under various Direct Taxes

The total proceeds from Direct Taxes for the year 1984-85 amounted to Rs. 4,797.33 crores out of which a sum of Rs. 1,251.67 crores was assigned to the States. The figures for the three years 1982-83, 1983-84 and 1984-85 are given below :—

(In crores of rupees)

	1982-83	1983-84	1984-85
020 Corporation Tax	2,184.51	2,492.73	2,555.89
021 Taxes on Income other than Corporation Tax	1,569.72	1,699.13	1,927.75
023 Hotel Receipts Tax	0.07	@	£
024 Interest Tax	265.47	177.91	170.88
028 Other Taxes on Income and Expenditure	†	$	**
031 Estate Duty	20.38	26.46	24.37
032 Taxes on Wealth	90.37	93.31	107.58
033 Gift Tax	7.71	8.84	10.86
Gross Total	4,138.23	4,498.38	4,797.33

@The actual amount is Rs. 25,200.
£The actual amount is Rs. 30,734.
†The actual amount is Rs. 31,733.
$The actual amount is Rs. 36,163.
**The actual amount is Rs. 48,880.

Less share of net proceeds assigned to the State :

(In crores of rupees)

	1982-83	1983-84	1984-85
Income-tax	1,131.77	1,171.64	1,231.47
Estate Duty	15.98	16.57	20.20
Hotel Receipts Tax	..	..	..
Total	1,147.75	1,188.21	1,251.67
Net Receipts	2,990.48	3,310.17	3,545.66

The gross receipts under Direct Taxes during 1984-85 went up by Rs. 298.95 crores when compared with the receipts during 1983-84 as against an increase of Rs. 360.15 crores in 1983-84 over those for 1982-83. Receipts under Corporation Tax and Surtax registered an increase of Rs. 63.16 crores while receipts under "Taxes on Income other than Corporation Tax" accounted for an increase of Rs. 228.62 crores.

1.02 Variations between budget estimates and actuals

(i) The actuals for the year 1984-85 under the Major heads 021—Taxes on Income other than Corporation Tax, 031—Estate Duty, 032—Taxes on Wealth and 033—Gift Tax exceeded the budget estimates.

The figures for the years from 1980-81 to 1984-85 under the various heads are given below :—

Year	Budget estimates	Actuals	Variation	Percentage of variation
1	2	3	4	5
			(In crores of rupees)	
020—Corporation Tax				
1980-81	1,515.00	1,377.45	(—)137.55	(—)9.08
1981-82	1,690.00	1,969.96	279.96	16.56
1982-83	2,382.00	2,184.51	(—)197.49	(—)8.29
1983-84	2,362.00	2,492.73	130.73	5.54
1984-85	2,568.00	2,555.89	(—)12.11	(—)0.47
021—Taxes on Income other than Corporation Tax				
1980-81	1,426.00	1,439.93	13.93	0.98
1981-82	*1,444.00	1,475.50	31.50	2.18
1982-83	1,562.75	1,569.72	6.97	0.45
1983-84	1,669.60	1,699.13	29.53	1.75
1984-85	1,746.00	1,927.75	181.75	10.41
024—Interest Tax				
1982-83	220.00	265.47	45.47	20.67
1983-84	156.00	177.91	21.91	14.04
1984-85	190.00	170.88	(—)19.12	(—)10.06
031—Estate Duty				
1980-81	13.00	16.23	3.23	24.85
1981-82	15.00	20.31	5.31	35.40
1982-83	17.00	20.38	3.38	19.88
1983-84	19.00	26.46	7.46	39.26
1984-85	20.00	24.37	4.37	21.85
032—Taxes on Wealth				
1980-81	65.00	67.37	2.37	3.65
1981-82	66.00	78.12	12.12	18.36
1982-83	80.00	90.37	10.37	12.96
1983-84	90.00	93.31	3.31	3.67
1984-85	97.00	107.58	10.58	10.91
033—Gift Tax				
1980-81	6.25	6.51	0.26	4.16
1981-82	6.25	7.74	1.49	23.84
1982-83	6.75	7.71	0.96	14.22
1983-84	8.50	8.84	0.34	4.00
1984-85	8.50	10.86	2.36	27.76

*Figures have been revised and confirmed by Ministry of Finance.

(ii) The details of variations under the heads subordinate to the Major Heads 020 and 021 for the year 1984-85 are given below :—

(In crores of rupees)

	Budget estimates	Actuals	Increase (+)/ shortfall (—)	Percentage of variation
1	2	3	4	5
020—Corporation Tax				
(i) Income-tax on companies	2,492.00	2,490.46	(—)1.54	(—)0.06
(ii) Surtax	67.00	54.90	(—)12.10	(—)18.06
(iii) Receipts awaiting transfer to other minor heads	—	(—)1.55	(—)1.55	—
(iv) Other receipts	9.00	12.08	3.08	34.22
Total	2,568.00	2,555.89	(—)12.11	(—)0.47
021—Taxes on Income other than Corporation Tax				
(i) Income-tax	1,521.00	1,736.86	215.86	14.19
(ii) Surcharge	211.00	166.76	(—)44.24	(—)20.97
(iii) Receipts awaiting transfer to other minor heads	—	4.91	4.91	—
(iv) Other receipts	14.00	19.22	5.22	37.29
(v) Deduct Share of proceeds assigned to States	1,186.52	1,231.47	44.95	3.79
Total	559.48	696.28	136.80	24.45

1.03 **Analysis of collections**

Under the provisions of the Income-tax Act, 1961, income-tax is chargeable for any assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act, however, provides for pre-assessment collection by way of deduction of tax at source, advance tax and payment of tax on self-assessment. The post-assessment collection is of residuary taxes not so paid.

(i) The break-up of total collections of Corporation-tax, Surtax and Taxes on Income other than Corporation-tax by pre-assessment and post-assessment, during the year 1984-85*, as furnished by the Ministry of Finance, is as under :—

	Amount (In crores of rupees)
1. Deduction at Source	1,100.26
2. Advance tax	2,607.81£
3. Self-assessment	270.10
4. Regular assessment	302.84

Besides, the Ministry of Finance have intimated tax collection of Rs. 810.40* crores representing surcharge, surtax, other Receipts and Receipts awaiting Transfer and Refunds of Rs. 593.77* crores.

*Figures furnished by Ministry of Finance are provisional.
£The discrepancy in figures with those shown under sub-para (iii)(2) is under verification by Ministry of Finance.

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

	Amount (In crores of rupees)
1. Salaries	333.48
2. Interest on securities	258.43
3. Dividends	93.41
4. Interest other than interest on securities	84.93
5. Payment to contractors and sub-contractors	174.65
6. Other items	155.36

(iii) Advance Tax—Tax payable and collected by way of advance-tax during the year 1984-85 is as under :—

	Amount (In crores of rupees)
1. Tax payable by way of advance tax as per statements received, self-estimates or revised estimates filed and notices issued	2857.55
2. Tax collected out of (1))above	2413.83£
3. Arrears out of (1) above on 31 March 1985	443.72

*Figures furnished by Ministry of Finance are provisional.
£The discrepancy in figures with those shown under sub-para (i)(2) is under verification by Ministry of Finance.

1.04 **Cost of collection**

(i) The expenditure incurred during the year 1984-85 in collecting Corporation-tax and Taxes on Income other than Corporation-tax, together with the corresponding figures for the preceding three years is as under :—

	Gross collection	Expenditure on collection
	(In crores of rupees)	
020—Corporation Tax		
1981-82	1,969.96	7.64
1982-83	2,184.51	9.02
1983-84	2,492.73	10.37
1984-85	2,555.89	11.54*
021—Taxes on Income other than Corporation Tax		
1981-82	1,475.50	53.48
1982-83	1,569.72	63.17
1983-84	1,699.13	72.60
1984-85	1,927.75	80.81

(ii) The expenditure incurred during the year 1984-85 in collecting other direct taxes, i.e., Taxes on Wealth, Gift-tax and Estate Duty, together with the corresponding figures for the preceding three years is as under :—

	Gross collection	Expenditure on collection
	(In crores of rupees)	
031—Estate Duty		
1981-82	20.31	1.36
1982-83	20.38	1.60
1983-84	26.46	1.84
1984-85	24.37	2.04
031—Texes on Wealth		
1981-82	78.12	4.75
1982-83	90.37	5.62
1983-84	93.31	6.45
1984-85	107.58	7.18
033—Gift Tax		
1981-82	7.74	0.68
1982-83	7.71	0.80
1983-84	8.84	0.92
1984-85	10.86	1.03

1.05 **Number of assessees**

(i) *Income Tax*

Under the provisions of the Income-tax Act, 1961, 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, or a body of individuals, a local authority and an artificial juridical person.

For the assessment year 1984-85, no income-tax was payable on a total income not exceeding Rs. 15,000 except in the case of specified Hindu undivided family, registered firms, co-operative society, local authority and company where a lower limit is applicable.

(a) The total number of assessees in the books of the department was 49,37,657 as on 31 March 1985 as against 49,32,094 as on 31 March 1984. The break-up of the assessees on the said two dates was as under :—

	As on 31 March 1984	As on 31 March 1985
Individuals	36,38,075	36,46,638
Hindu undivided families	2,72,707	2,60,084
Firms	8,54,860	8,74,912
Companies	52,951	58,478
Others	1,13,501	97,545
Total	49,32,094	49,37,657

(b) The number of trust assessees in the books of the department as on 31 March 1984 and 31 March 1985 included under "others" in sub-para (a) above were as follows :—

	As on 31 March 1984	As on 31 March 1985
(i) Public Charitable trusts	39,847	42,883
(ii) Discretionary trusts	11,687	15,593
Total	51,534	58,476

(c) The following table indicates the break-up of assessees according to slabs of income :—

	Individuals	Hindu undivided families	Firms	Companies	Others	Total
(i) Below taxable limit	9,38,879	73,735	1,35,451	27,463	44,992	12,20,520
(ii) Above taxable limit but upto Rs. 25,000	17,25,692	1,14,650	3,10,765	13,506	26,065	21,90,678
(iii) Rs. 25,001 to Rs. 50,000	7,39,339	52,893	2,41,970	5,360	13,974	10,53,536
(iv) Rs. 50,001 to Rs. 1,00,000	2,15,878	15,952	1,39,493	4,601	7,441	3,83,365
(v) Rs. 1,00,001 to Rs. 5,00,000	25,922	2,767	45,341	3,953	4,904	82,887
(vi) Above Rs. 5,00,000	928	47	1,892	3,595	169	6,671
Total	36,46,638	2,60,084	8,74,912	58,478	97,545	49,37,657

(ii) *Wealth Tax*

Under the Wealth-tax Act, 1957, wealth-tax is levied for every assessment year in respect of the net wealth on the corresponding valuation date of every individual and Hindu undivided family according to the rates specified in the Schedule to the Act. No wealth-tax is levied on companies with effect from 1 April 1960. However, levy of wealth-tax companies has been revived in a limited way with effect from 1 April 1984.

For the assessment year 1984-85 no wealth-tax was payable where the net wealth is less than Rs. 1.50 lakhs.

The number of wealth-tax assessees in the books of the department as on 31 March 1984 and 31 March 1985 were as follows :—

	As on 31 March 1984	As on 31 March 1985
Individuals	3,80,289	4,29,976
Hindu undivided families	56,832	66,359
Others	14	4,727
Total	4,37,135	5,01,062

(iii) *Gift Tax*

Under the provisions of the Gift-tax Act, 1958, gift-tax is levied according to the rates specified in the Schedule for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including Hindu undivided family or a company or an association of persons or body of individuals whether incorporated or not) during the previous year.

During the assessment year 1984-85, no gift-tax was payable where the value of taxable gifts did not exceed Rs. 5,000.

The number of gift-tax assessment cases for the years 1983-84 and 1984-85 were as follows :—

1983-84	65,966
1984-85	77,015

(iv) *Estate Duty*

Under the provisions of the Estate Duty Act, 1953, in the case of every person dying after 15 October 1953, estate duty at rates fixed in accordance with Section 35 of the Act is levied upon the principal value of the estate comprised of all property settled or not settled including agricultural land and which passes on the death.

During the assessment year 1984-85, no estate duty was chargeable where the principal value of the estate passing on death, did not exceed Rs. 1,50,000.

The number of estate duty assessment cases for the years 1983-84 and 1984-85 were as follows :—

1983-84	35,892
1984-85	36,133

1.06 **Public Sector Undertakings***

	Central Govt. undertakings	State Govt. undertakings
(1) No. of Public undertakings (including nationalised banks) out of the company assessees, assessed to tax during the financial year 1984-85	160	456
(2) Tax paid by these undertakings during the financial year 1984-85	(In crores of rupees)	
(i) Advance tax	1,005.43	30.16
(ii) Self-assessment tax	12.36	2.31
(iii) Regular tax paid in 1984-85 out of arrear and current demands	100.85	3.63
(iv) Surtax	16.01	3.44
(v) Interest tax	66.52	0.89
Total	1,201.17	40.43

*Provisional figures intimated by Ministry of Finance in their letter dated 14-1-86 have been adopted as the revised final figures sent in their letter dated 27-1-86 were not comparable and were under reconciliation by Ministry of Finance.

1.07 **Foreign company assessees****

(1) Cases where returns had been filed for the assessment year 1984-85 and assessments completed as on 31 March 1985 :—

	Number	Amount (In crores of rupees)
(i) Number of foreign companies	157	
(ii) Income returned		42.10
(iii) Income assessed		55.50
(iv) Gross demand		34.44
(v) Demand outstanding out of (iv) above as on 31 March 1985		0.26
(vi) Tax paid upto 31 March 1985 (iv—v)		34.18

**Figures furnished by Ministry of Finance are provisional.

(2) Cases where returns had been filed for the assessment year 1984-85 but assessments were pending as on 31 March 1985 :—

	Number	Amount (In crores of rupees)
(i) Number of foreign companies	217	
(ii) Income returned		55.44
(iii) Gross demand being tax due on income returned		28.29
(iv) Demand outstanding out of (iii) as on 31 March 1985		0.04
(v) Tax paid upto 31 March, 1985 (iii—iv)		28.25

(3) Cases where no returns had been filed for the assessment year 1984-85 as on 31 March 1985 :

No. of foreign companies 162

1.08 **Arrears of assessments**

The limitation period for completion of assessments is 2 years in the case of income-tax, 4 years in the case of wealth-tax and gift-tax.

(i) *Income-tax including Corporation-tax*

(a) The number of assessments completed out of arrear assessments and out of current assessments during the past five years were as under :—

Financial Year	Number of assessments for disposal	Number of assessments completed				Number of assessments pending at the end of the year
		Out of current	Out of arrears	Total	Percentage	
1980-81	65,91,180	18,12,511	22,22,702	40,35,213	61.2	25,55,967
1981-82	72,08,405	20,05,194	25,42,522	45,47,716	63.0	26,60,689
1982-83	70,15,368	20,19,664	24,15,450	44,35,114	63.2	25,80,254
1983-84	68,92,824	23,47,201	24,64,620	48,11,821	69.8	20,81,003
1984-85	66,44,955	30,31,952	23,57,265	53,89,217	81.1	12,55,738

(b) Category-wise break-up of the total number of assessments completed during the years 1983-84 and 1984-85 was as under :—

	1983-84	1984-85
Scrutiny assessments	9,71,654	11,13,525
Summary assessments	38,40,167	42,75,692
Total	48,11,821*	53,89,217

(c) Status-wise break-up of income-tax assessments completed during the years 1983-84 an 1984-85 was as under :—

	1983-84	1984-85
(i) Individuals	36,55,895	40,79,453
(ii) Hindu undivided families	2,42,879	2,86,017
(iii) Firms	7,84,887	8,79,651
(iv) Companies	51,923	64,059
(v) Association of persons, etc.	88,208	80,037
Total	48,23,792*	53,89,217

*Discrepancy in the figures is still under reconciliation by Ministry of Finance.

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

	As on 31 March 1984	As on 31 March 1985
1980-81 and earlier years	38,814	15,492
1981-82	1,62,867	12,886
1982-83	5,54,477	82,967
1983-84	13,25,344	2,97,417
1984-85	..	8,46,976
Total	20,81,502£	12,55,738

(e) Category-wise break-up of pending income-tax assessments as on 31 March 1984 and 31 March 1985 was as under :—

	As on 31 March 1984	As on 31 March 1985
Scrutiny assessments	7,54,822	7,02,785
Summary assessments	13,26,181	5,52,953
Total	20,81,003£	12,55,738

£Discrepancy in figures is still under reconciliation by Ministry of Finance.

(f) Status-wise and year-wise break-up of pendency of income-tax assessments in respect of various assessment years as on 31 March 1985 was as under :—

Status	1980-81 and earlier years	1981-82	1982-83	1983-84	1984-85	Total
(a) Company assessments	2,006	833	2,900	16,748	35,374	57,861
(b) Non-company assessments	13,486	12,053	80,067	2,80,669	8,11,602	11,97,877
Total	15,492	12,886	82,967	2,97,417	8,46,976	12,55,738

The number of assessment cases to be finalised as on 31 March 1985 has decreased compared to that at the close of the previous year. The number of assessments pending as on 31 March 1985 was 12,55,738 as compared to 20,81,003 as on 31 March 1984 and 25,80,254 as on 31 March 1983. Of the 12,55,738 of pending cases as many as 5,52,953 cases related to summary assessments.

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

(a) The total number of wealth-tax assessments completed during the years 1983-84 and 1984-85 were as under :—

	1983-84	1984-85
Individuals	4,03,481	4,15,799
Hindu undivided families	53,541	58,273
Others	1,511	1,761
Total	4,58,533	4,75,833

(b) The number of gift-tax assessments completed during the years 1983-84 and 1984-85 were as follows :—

	1983-84	1984-85
Individuals	79,254	81,489
Hindu undivided families	1,790	1,930
Others	96	158
Total	81,140	83,577

(c) The number of estate duty assessments completed during the years 1983-84 and 1984-85 were as under :—

1983-84	37,688**
1984-85	36,856

**Figures furnished by Ministry of Finance in February 1985 have been adopted.

The break-up of the estate duty assessments completed during the year 1984-85 according to certain slabs of principal value of property was as under :—

Principal value of property	Number of assessments completed
(1) Exceeding Rs. 20 lakhs	9
(2) Between Rs. 10 lakhs and Rs. 20 lakhs	115
(3) Between Rs. 5 lakhs and Rs. 10 lakhs	729
(4) Between Rs. 1 lakh and Rs. 5 lakhs	6,359
(5) Between Rs. 50,000 and Rs. 1 lakh	6,069
(6) Below Rs. 50,000	23,575
Total	36,856

(d) Assessment year-wise details of wealth-tax, gift-tax and estate duty assessments pending as on 31 March 1985 were as under :—

	Number of assessments pending		
	Wealth Tax	Gift Tax	Estate Duty
1980-81 and earlier years	10,226	2,088	9,032
1981-82	54,300	3,989	4,552
1982-83	70,608	5,559	4,562
1983-84	99,620	8,755	6,009
1984-85	2,18,821	17,794	10,244
Total	4,53,575	38,185	34,399

(e) The number of assessments completed under the Companies (Profits) Surtax Act, 1964, during the years 1983-84 and 1984-85 were as under :—

Year	No. of assessments for disposal	No. of assessments completed	No. of assessments pending at the end of the year
1983-84	5,594	1,569	4,025
1984-85	4,921	1,258	3,663

(f) The year-wise details of assessments under Companies (Profits) Surtax Act, 1964, pending as on 31 March 1985 were as under :—

Year	Number of assessments
1980-81 and earlier years	842
1981-82	393
1982-83	647
1983-84	811
1984-85	970
TOTAL	3,663

(g) The number of assessments completed under the Interest Tax Act, 1974, during the years 1983-84 and 1984-85 were as under :—

Year	No. of assessments for disposal	No. of assessments completed	No. of assessments pending at the end of the year
1983-84	396	42	354
1984-85	420	36	384

(h) The year-wise details of assessments under the Interest Tax Act, 1974 pending as on 31 March 1985 were as under :—

Year	No. of assessments
1980-81 and earlier years	155
1981-82	44
1982-83	49
1983-84	65
1984-85	71
Total	384

1.09 **Arrears of tax demands**

1.09.01 The Income-tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 35 days unless the time for payment is extended by the Income-tax Officer on application made by the assessee. The Act has been amended with effect from 1 October 1975 to provide that an appeal against an assessment order would be barred unless the admitted portion of the tax has been paid before filing the appeal.

(i) *Corporation-tax and Income-tax*

(a) The total demand of tax raised and remaining uncollected as on 31 March 1985 was Rs. 2,519.40 crores including Rs. 942.32 crores in respect of which the permissible period of 35 days has not expired as on 31 March and Rs. 12.46 crores claimed to have been paid but remaining to be verified/adjusted, Rs. 368.16 crores stayed/kept in abeyance and Rs. 24.98 crores for which instalments had been granted by the department and the Courts.

(b) Demands of Income-tax (including Corporation Tax) stayed as on 31 March 1985 on account of appeals and revision petitions were as under :—

	(In crores of rupees)
(1) By Courts	29.90
(2) Under Section 245(F)(2) (applications to Settlement Commission)	26.81
(3) By Tribunal	15.27
(4) By income-tax authorities due to :—	
(i) Appeals and revisions	217.24
(ii) Double income-tax claims	6.54
(iii) Restriction on remittance—Section 220(7)	2.28
(iv) Other reasons	70.12
Total	368.16

(c) The amounts of Corporation Tax, Income-tax, interest and penalty making up the gross arrears and the year-wise details thereof are given below :—

	Corporation Tax	Income Tax	Interest	Penalty	Total
			(In crores of rupees)		
Arrears of 1974-75 and earlier years	18.52	47.99	22.62	19.88	109.01
1975-76 to 1981-82	65.55	151.23	84.01	39.43	341.22
1982-83	45.32	67.66	49.37	13.53	175.88
1983-84	165.45	112.26	78.92	22.74	379.37
1984-85	732.33	435.51	314.68	31.40	1513.92
Total	1028.17	814.65	549.60	126.98	2519.40

(d) The following table gives the break-up of the gross-arrears of Rs. 2,519.40 crores by certain slabs of income :—

	Number of assessees	Total arrears of tax (In crores of rupees)
Upto Rs. 1 lakh in each case	31,70,214	1,077.86
Over Rs. 1 lakh upto Rs. 5 lakhs in each case	12,826	214.18
Over Rs. 5 lakhs upto Rs. 10 lakhs in each case	1,780	117.29
Over Rs. 10 lakhs upto Rs. 25 lakhs in each case	984	157.17
Over Rs. 25 lakhs in each case	784	952.90
Total	31,86,588	2,519.40

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

The following table gives the year-wise arrears of demands outstanding and the number of cases

relating thereto under the three other direct taxes, i.e., wealth-tax, gift-tax and estate duty as on 31 March 1985 :—

(Amount in lakhs of rupees)

	Wealth-tax		Gift-tax		Estate Duty	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
1980-81 and earlier years	77,105	6,516	19,119	956	7,699	810
1981-82	31,017	1,769	5,793	135	2,511	299
1982-83	41,222	2,131	7,617	313	2,879	310
1983-84	63,165	4,028	12,047	594	4,636	654
1984-85	2,36,798	6,681	21,862	664	9,710	2,039
Total	4,49,307	21,125	66,438	2,662	27,435	4,112

1.09.02 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 five days of the service of notice of demand. On the default of an assessee in this respect, the Income-tax Officer may forward a certificate specifying the demand in arrears to the Tax Recovery Officer for recovery of the demand. The Tax Recovery Officer 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, the Tax Recovery Officer shall proceed to realise the amount together with interest at the rate of 12 per cent (15 per cent from 1st October 1984) 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 the management of the defaulter's movable and immovable properties.

The tax demands certified to the Tax Recovery Officers and the progress of recovery to end of 1984-85 are given in the following table :—

Year	Demand Certified			Demand recovered during the year	Balance at the end of the year
	At the beginning of the year	During the year	Total		
				(In crores of rupees)	
1980-81	752.07	301.70	1,053.77	258.58	795.19
1981-82	861.58	400.24	1,261.82	273.33	988.49
1982-83	964.96	349.38	1,314.34	376.72	937.62
1983-84*	925.64	1,192.54	2,118.18	594.11	1,524.07
1984-85	828.46	617.52	1,446.04	457.63	988.41

Note :—No. of certificates issued during the year 1984-85 : 780,943

*Figures furnished by Ministry of Finance in Jun. 1985 have been adopted.

1.09.03 *Functioning of Institution of Commissioners of Income-tax (Recovery)*

(i) With a view to have close supervision of tax recovery in metropolitan cities, in September 1981, the Government of India sanctioned 5 posts of Commissioner of Income-tax (Recovery) to be stationed at Bombay, Delhi, Calcutta, Madras and Ahmedabad. These posts were filled up between September 1981 and January 1982. The Commissioners of Income-tax (Recovery) are vested with specific powers as per provisions of Income-tax Act, 1961. According to the instructions issued as late as July 1982, the Commissioners of Income-tax (Recovery) would perform the functions of the Tax Recovery Commissioners for the areas notified and would exercise administrative control over all the Tax Recovery Officers and Inspecting Assistant Commissioners (Recovery). It was clarified that the responsibility of the Commissioner of Income-tax (Recovery) is to accord due attention to collection/reduction of certified demands while the collection/reduction of arrears remained the overall concern of the territorial Commissioners of Income-tax. In respect of certified demands, Commissioners of Income-tax (Recovery) and their officers would be responsible for the recovery

proceedings, grant of stay and recovery by instalments and they would be, as far as possible, be members of all Zonal Committees formed for write off/ scaling down of arrears. Copies of all dossiers of cases with arrears above Rs. 10 lakhs sent to Directorate of Inspection (Recovery) are to be endorsed to Commissioners of Income-tax (Recovery) so that they can focus their special attention on the cases so far as certified demands are concerned.

The Public Accounts Committee in their 157th Report (1982-83—Seventh Lok Sabha) observed that "mere creation of additional posts does not add to the efficiency of tax collection machinery", and desired to be apprised of the concrete steps taken and results achieved, particularly in the towns mentioned where the department had strengthened the tax recovery administration. The Ministry of Finance stated in October 1983 that the Commissioners of Income-tax (Recovery) had been posted in the five places with a view to have close supervision exclusively of tax recovery work and added that "as a result of creation of separate posts of Commissioner of Income-tax (Recovery) there is marked improvement in the work relating to tax recovery."

While examining the paragraph 1.05 of the Report of the Comptroller & Auditor General of India for the year 1981-82 on Revenue Receipts (Direct Taxes) on cost of collection, the Public Accounts Committee in their 217th Report (1983-84) (Seventh Lok Sabha) noted that no review of the efficacy of the tax recovery machinery had been conducted by the Board so far and recommended *inter alia* that the Government should examine how far the objects with which a separate organisation for recovery with five Commisssioners had been set up, had been achieved.

(ii) At the instance of the Public Accounts Committee, the Central Board of Direct Taxes conducted a limited study on the working of Tax Recovery Machinery. The Study Report (April 1985) mentioned the following as some of the significant achievements by the Institution of Commissioners of Income-tax (Recovery).

(a) Commissioners of Income-tax (Recovery) have organised their offices for better results by making ABC analysis of the arrears. Monetary limits have been fixed so that bigger cases are handled by Commissioner of Income-tax (Recovery) himself slightly less important cases by Inspecting Assistant Commissioner (Recovery) and still less important cases by the Tax Recovery Officer.

(b) In the metropolitan charges there had been more emphasis on coercive action being taken against hard-core defaulters due to personal involvement of the Commissioner of Income-tax (Recovery). In Bombay, immovable properties of several influential personalities connected with film industry and of the big industrialists were sold due to the "guidance and moral support provided by Commissioner of Income-tax (Recovery) to the Tax Recovery Officers". In another case at Bombay, where a certified demand of more than Rs. 66 lakhs was outstanding and where 3 different Zonal Committees had recommended a scaling down of the demand to Rs. 12 lakhs, concerted efforts by Commissioner of Income-tax (Recovery) resulted in collection of about Rs. 30 lakhs of the arrears upto 31 March 1985. In the case of a "notorious smuggler" an amount of Rs. 72 lakhs was collected due to the "involvement of Commissioner of Income-tax (Recovery), Bombay".

(c) The Commissioners of Income-tax (Recovery) have been able to make sustained effort for write-off in cases of old certified demand, where there is no hope of recovery.

(d) Even in dossier cases being overseen by the Directorate of Inspection (Recovery) the contribution of Commissioner of Income-tax (Recovery) is significant since they are dealt with by Commissioner of Income-tax (Recovery) in metropolitan charges.

The Study Report thus mentioned only in general terms about the role of Commissioners of Income-tax (Recovery) in tax recovery operations but did not spell out the specific role played, if any, by the Commissioners of Income-tax (Recovery) to improve cash recovery in certified cases, tackling hard-core cases of old arrears, disposal of immovable and movable properties attached by the department towards tax arrears and improvement of systems and practices of the tax recovery organisation.

(iii) A review of the performance of the new institution of Commissioner of Income-tax (Recovery) was conducted by Audit in 1984-85, however, revealed the following :

(a) *Lack of guidelines from Central Board of Direct Taxes*

The Board have not so far issued any detailed guidelines regarding the day to day functioning of Commissioners of Income-tax (Recovery). In the absence of specific guidelines from the Board, different procedures and practices are observed by the five Commissioners of Income-tax (Recovery). There

were, however, no written procedural instructions. In Madras, the Commissioner of Income-tax (Recovery) on the basis of report furnished by Inspecting Assistant Commissioner Incharge, in respect of all cases of arrears over Rs. 1 lakh, called for reports of the details of action taken from Tax Recovery Officers. Although the demands ranging from Rs. 1 lakh to Rs. 10 lakhs require the personal attention of Commissioner of Income-tax (Recovery), only a few cases are selected out of top 100 cases.

In Bombay, the Commissioners of Income-tax (Recovery) gave directions in respect of arrears of Rs. 1 lakh and above in each case and the Inspecting Assistant Commissioner in respect of cases between Rs. 50,000 and Rs. 1 lakh.

The Commissioner of Income-tax (Recovery) at Calcutta periodically visited the offices of the Tax Recovery Officers or held meetings with them, issued instructions after study of monthly progress reports furnished by the Tax Recovery Officers and maintained individual files in respect of each Tax Recovery Officer containing copies of all instructions issued to them and also instructions issued on individual cases.

The Commissioners of Income-tax (Recovery) Ahmedabad and Delhi reviewed all cases where demand outstanding was more than Rs. 1 lakh and issued instructions and directions in specific cases where arrear demands exceed Rs. 1 lakh held periodical meetings with the Tax Recovery Officers to discuss the problems faced by them in reducing the tax arrears and maintain individual files in respect of cases dealt with by them. In Delhi from 1985 individual cases of demand exceeding Rs 2 lakhs are dealt with by Commissioner of Income-tax (Recovery) and demands less than Rs. 2 lakhs are finalised by Inspecting Assistant Commissioner (Recovery).

(b) There are no control registers with Commissioners of Income-tax (Recovery) indicating the details of cases in which direction had been given by them. There are also no registers indicating important and high value cases which require close attention of the Commissioners.

(c) Further even in cases involving substantial arrears, the maintenance of files in the tax recovery offices was far from satisfactory. There is no master card or control chart showing the details of Recovery Certificates issued against particular assessees and recoveries made thereagainst. As a result, to ascertain the total amount of tax recovery certificates issued one had to go through various recovery certificates kept in different files; in cases where Recovery Certificates pertained to old periods, chances of errors could not be ruled out. The existing system did not enable the Tax Recovery Officers to find out the total dues from an assessee at any given point of time. The Commissioners have not taken any steps to streamline the procedures in this regard to have better and effective control over tax recovery, particularly in heavy arrear cases.

(d) *Tax Recovery Certificates for disposal and clearance*

Tax Recovery Certificates for disposal and the number of certificates actually cleared and the amounts involved pertaining to the five Commissioners of Income-tax (Recovery) for the three years 1982-83, 1983-84 and 1984-85 are given in the table below :—

Tax Recovery Certificates for disposal/cleared

(Rupees in Crores)

Commissioners of Income-tax (Recovery)	1982-83		1983-84		1984-85	
	No.	Amount	No.	Amount	No.	Amount
Madras	75837	66.46	83270	69.59	86775	94.48
	7528	17.86	7845	13.55	7957	21.01
Bombay	645754	264.02	633648	261.44	624674	313.68
	84639	91.54	57884	87.47	146997	167.94
Calcutta	773533	348.50	776679	350.78	731344	311.34
	58008	78.90	103115	59.05	151572	107.57
Ahmedabad	218973	96.33	235018	87.72	253327	97.20
	29402	31.54	31056	18.61	49200	24.42
Delhi	523298	222.41	459716	201.01	482787	246.01
	130675	74.95	61122	56.54	80065	68.20
Total (for disposal)	2237395	997.72	2188331	970.54	2178907	1062.71
(cleared)	310252	294.79	261022	235.22	435791	389.14

It will be observed that while the clearance of Tax Recovery Certificates had deteriorated over the years in Commissioners of Income-tax (Recovery) Ahmedabad and Delhi, the same had shown some improvement in the other three Commissioners of Income-tax (Recovery); the Commissioner of Income-tax (Recovery) Bombay and Calcutta having an edge over others. However, the clearance in terms of cash collections due did not indicate any improvement, the increased clearance being mainly due to paper clearance by adjustment, remission, write off of tax dues as indicated in succeeding paras.

The total number of tax recovery certificates for disposal and the number of certificates actually cleared pertaining to the five Commissioners of Income-tax (Recovery) for the three years 1982-83, 1983-84 and 1984-85 are given in table below :—

(Rupees in Crores)

Year	Tax Recovery Certificates for disposal		Tax Recovery Certificates disposed of			Percentage of Tax Recovery Certificates disposed of total/by cash recovery to Tax Recovery Certificates for disposal		
	No.	Amount	Total No.	Total Amount	By recovery in cash	Total No. (4 to 2)	Total clearance (5 to 3)	By cash recovery (6 to 3)
1	2	3	4	5	6	7	8	9
1982-83	2237395	997.72	310252	294.79	16.83	13.86	29.55	1.68
1983-84	2188331	970.54	261022	235.22	21.29	11.93	24.23	2.10
1984-85	2178907	1062.71	435791	389.14	34.44	20.00	36.62	3.24

It will be seen therefrom that percentages of tax certificates cleared to total number of tax certificates for disposal came down to 11.93 in 1983-84 from 13.86 in 1982-83. It has gone up to 20.00 in 1984-85. Amount-wise the percentage of clearance has ranged from 29.55 in 1982-83 to 36.62 in 1984-85. However, the bulk of the clearance was by way of adjustments, reduction of taxes in appeal and rectificatory orders, remissions and write-offs of irrecoverable amounts. The clearance of tax recovery certificates by cash recovery of tax due, which is really the index of performance of Commissioners of Income-tax (Recovery) had gone up from 1.68 per cent in 1982-83 to a mere 3.24 per cent in 1984-85.

(e) *Recovery of tax arrears by cash collection*

Tax Recovery Certificates have to be disposed of by adjustments of taxes paid in cash, reduction of taxes in appeal and rectificatory orders passed by the Income-tax Officers and write-off of the irrecoverable amounts. The efficiency of the tax recovery machinery can be assessed in terms of number of tax recovery certificates cleared by recovery of tax from tax defaulters in cash by coercive action, where called for, and other similar steps. The tax recovery machinery has very little role to play in the matter of disposal of tax recovery certificates by reduction of the demands in appeal or rectificatory orders or write-off, as this is basically a function of the tax assessing officers. The amounts of Tax Recovery Certificates cleared by cash collection and by other reasons for the five Commissioners of Income-tax (Recovery) for the years 1982-83, 1983-84 and 1984-85 are given in the table below :—

Tax Recovery Certificates cleared

(Amount in crores of rupees)

Commissioners of Income-tax (Recovery)	1982-83			1983-84			1984-85		
	By cash	Other reasons	Total	By cash	Other reasons	Total	By cash	Other reasons	Total
1	2	3	4	5	6	7	8	9	10
Madras	1.12	16.74	17.86	1.83	11.72	13.55	5.04	15.97	21.01
Bombay	5.42	86.12	91.54	8.66	78.81	87.47	15.24	152.70	167.94
Calcutta	3.16	75.74	78.90	4.99	54.06	59.05	5.45	102.12	107.57
Ahmedabad	1.34	30.20	31.54	2.17	16.44	18.61	2.32	22.10	24.42
Delhi	5.79	69.16	74.95	3.64	52.90	56.54	6.39	61.81	68.20
Total	16.83	277.96	294.79	21.29	213.93	235.22	34.44	354.70	389.14

An analysis of tax recovery certificates (amount) cleared by all the five Commissioners of Income-tax (Recovery) by cash recovery of tax arrears and by other reasons (viz., adjustments, remissions etc.) during each of the three years 1982-83, 1983-84 and 1984-85 is as below :—

Tax Recovery Certificates cleared

(Amount in crores of rupees)

Year	Total clearance	Portion recovered in cash	Portion cleared by other reasons	Percentage of	
				Cash Recovery to total clearance	Clearance by other reasons to total clearance
1982-83	294.79	16.83	277.96	5.7	94.3
1983-84	235.22	21.29	213.93	9.0	91.0
1984-85	389.14	34.44	354.70	8.8	91.15

It is clear that more than 90 per cent of the clearance of tax recovery certificates has been by adjustments, remissions, revisions, rectification, write offs etc. Recovery by cash collection of arrears of tax was highest in 1983-84, a mere 9 per cent. In 1984-85 cash collection dropped to 8.8 per cent.

An analysis of Tax Recovery Certificates (amounts) cleared by the five Commissioners of Income-tax (Recovery) individually by cash recovery of tax arrears and by other reasons for all the three years 1982—1985 is as below :—

Tax Recovery Certificates cleared

(Amount in crores of rupees)

Commissioners of Income-tax (Recovery)	Total clearance	Portion cleared in cash	Portion cleared by other reasons	Percentage of	
				Cash recovery to total clearance	Clearance by other reasons to total clearance
Madras	52.42	7.99	44.43	15	85
Bombay	346.95	29.32	317.63	8	91
Calcutta	245.52	3.60	231.92	5.5	94.5
Ahmedabad	74.57	5.83	68.74	7.8	92.2
Delhi	199.69	15.82	183.87	7.9	92.1

It will be seen that in all cases, except Commissioner of Income-tax (Recovery) Madras, cash recovery of tax ranged from 5.5 per cent to 8 per cent while clearance by adjustments etc. ranged from 91 per cent to 94.5 per cent.

(f) *Pendency of Recovery Certificates*

The total number of tax recovery certificates pending together with the amount of tax arrears involved at the end of 1982-83, 1983-84 and 1984-85 for the five Commissioners of Income-tax (Recovery) are given in the table below :—

Pendency of Recovery Certificates

(Rupees in crores)

Commissioners of Income-tax (Recovery)	At the end of 1982-83		At the end of 1983-84		At the end of 1984-85	
	No.	Amount	No.	Amount	No.	Amount
Madras	68309	48.60	75425	56.04	78818	73.47
Bombay	561115	172.48	575764	173.97	477677	145.74
Calcutta	715525	269.60	673564	291.73	579772	203.77
Ahmedabad	189571	64.79	203962	69.11	204127	72.78
Delhi	392623	147.46	398594	144.47	402722	177.81
Total	1927143	702.93	1927309	735.32	1743116	673.57

It will be observed that the pendency has been steadily increasing insofar as Commissioners of Income-tax (Recovery), Madras, Ahmedabad and Delhi are concerned while the arrears in respect of Commissioners of Income-tax (Recovery), Bombay and Calcutta have shown marginal decrease. This improvement is attributable to sizeable remissions etc. of tax due, as already mentioned.

(g) *Tax Recovery Certificates pending for 5 years and over*

Tax Recovery Certificates pending clearance for 5 years and over (issued upto 1980-81) as on 31 March 1985, and the amounts involved for the five Commissioners of Income-tax (Recovery) are as below :—

Commissioners of Income-tax (Recovery)	Total pendency		Pending for over 5 years		Percentage of cases pending for over 5 years to total pendency	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
		(Rupees in crores)				
Madras	78818	73.47	46032	38.85	58	53
Bombay	477677	145.74	261840	38.42	55	26
Calcutta	579772	203.77	284431	122.23	49	60
Delhi	402722	177.81	180626	55.23	45	31
Ahmedabad	204127	72.78	74376	14.49	36	19

It will be seen from above that sizeable outstandings (both in terms of number of tax recovery certificates and the amount) pertained to old period, viz. 1980-81 and earlier years. Therefore, there has been no improvement in the clearance of old hard core items.

(iv) *Conclusion*

(a) The statistics reveal no significant improvement in clearance of arrear demands even after 3 years of coming into being of the Institution of Commissioners of Income-tax (Recovery).

(b) The recovery was mainly due to reduction of arrears due to other reasons like remission, rectification, revision etc. and the actual collection by the Tax Recovery Organization was not significant.

(c) No improvement in control systems, monitoring of performance and results and procedures whatsoever had been effected by the Commissioners *vis-a-vis* the existing procedures of the Taxe Recovery Organizations; and

(d) Sizeable outstanding demands pertain to old periods (1980-81 and earlier years) and there was hardly any dent on the hardcore items.

The review was sent to the Ministry of Finance on 16 October 1985 and their comments are awaited (January 1986).

1.09.04 **Disposal of immovable properties attached towards tax recovery**

According to information furnished by the Ministry of Finance to the Public Accounts Committee in April 1984 and March 1985, the number of movable and immovable properties attached towards tax arrears and pending disposal as on 31 March 1983 in respect of 35 Commissioners charges was as under :

Number of Charges	Properties attached pending disposal			
	Movable		Immovable	
	No.	Value(Rs.)	No.	Value (Rs.)
35	6397	19.30 crores	2180	77.52 crores

Information in respect of the other charges is yet to be furnished by the Ministry to the Committee.

A review of the records relating to immovable properties attached and pending disposal as on 31 March 1983 was conducted in Audit during 1984-85. The results of the review are stated below :

State	Commissioners' charges	Total No. of properties attached	Properties awaiting disposal for			Properties for which details are not available
			More than 10 years	Between 5 and 10 years	Upto 5 years	
Orissa	1	29	9	16	4	..
Tamil Nadu	1	33	2	1	22	8
New Delhi	3	30	1	4	25	..
Bombay	5	164	69	48	47	..
Haryana	1	28	5	14	9	..
Assam	1	13	13	..	..	..
Uttar Pradesh	5	160	8	27	125	..
Bihar	1	7	..	..	7	..
Himachal Pradesh	1	11	..	1	10	..
Calcutta	1	260	2	117	51	90
Andhra Pradesh	1	347	32	61	244	10
Rajasthan	2	55	18	10	27	..
Punjab	4	114	3	45	66	..
Madhya Pradesh	2	163	33	36	94	..
Gujarat	1	206	38	41	35	92
Karnataka	2	219	128	27	64	..
Kerala	2	459	60	168	231	..
Total	34	2298	421	16	1061	200

Out of these properties, as many as 79 properties (Karnataka 78 and Bombay 1) were awaiting disposal for more than 30 years and 40 properties (Madhya Pradesh 21, Bombay 16 and Rajasthan 3) between 20 and 30 years.

(ii) *Non-maintenance/defective maintenance of attachement registers*

According to departmental instructions the attaching officer is required to maintain two registers (one for movable properties and another for immovable properties) giving information regarding the name of the tax defaulter, amount of arrears, date of attachment, description of property attached, date of sale etc. The review in audit disclosed that in a large number of Tax Recovery Offices this register was either not being maintained or maintained in a defective manner. In view of this position, it is not clear how the department ensures proper watch on attachment and disposal of properties. In the absence of these registers, it is not possible also to ascertain the extent of loss by way of depreciation and deterioration due to delays in disposal of the properties. The following table summarises the results of test check of Audit.

Sr. No.	Charges	No. of Tax Recovery Offices inspected	No. of offices where registers were wanting or were defective
1	2	3	4
1.	Kerala	4	4
2.	Karnataka	5	3
3.	Madhya Pradesh	6	4
4.	Gujarat	15	5
5.	Delhi	4	2
6.	Calcutta	15	13
7.	Tamil Nadu	12	5
8.	Rajasthan	6	6
9.	Himachal Pradesh	1	1
10.	Haryana	2	2
11.	Assam	2	1
12.	Bihar	3	3
13.	Punjab	3	1
14.	Bombay	37	9
15.	Uttar Pradesh	15	14
16.	Andhra Pradesh	6	Nil.
17.	Orissa	2	Nil.

The registers specifically provide for indication of the estimated value of each property attached to serve as an index regarding adequacy or otherwise of the action taken to realise the arrears. In the offices where the prescribed registers were maintained, this important column was not filled up.

(iii) *General reasons for delay in disposal of attached properties*

The Audit Review disclosed that the immovable properties attached for recovery of tax dues remained without disposal generally for the following reasons :

(a) Real ownership of the immovable properties attached had not been enquired into prior to attachement as a result of which cases were pending in Courts for settling the issue regarding ownership.

(b) Encumbrances on the properties attached with prior claims were not ascertained at the time of attachement.

(c) Defective servicing of attachment notices.

(d) Stay orders granted by Commissioners of Income-tax on ground of appeals pending before the appellate authorities.

(e) Cases pending in Courts for long period without the department taking any action for expediting their disposal.

(f) Departmental delays in getting the properties valued by competent authority.

(g) Frequent changes in the jurisdiction of Tax Recovery Officers; and

(h) Instructions of Central Board of Direct Taxes in some cases staying auction sales for various reasons.

(iv) *Analysis of reasons for delay in disposal of properties in certain cases*

The lack of effective action on the part of the Revenue Department to dispose of attached properties and realise tax arrears will be clear from the details of a few cases furnished below :

(a) *Karnataka charge*

The approximate tax arrears outstanding in respect of defaulters whose immovable properties were attached amounted to Rs. 1.72 crores.

(1) According to the Tax Recovery Certificates issued, in the case of a deceased defaulter 'S' arrears of Rs. 39.78 lakhs were outstanding towards income-tax, wealth-tax, interest and penalties for the assessment years 1951-52 to 1973-74. The defaulter's several house properties in Bangalore, Mysore and Ooty were attached during 1967—1973. Two attached properties in Mysore were sold in public auctions held in 1969 and 1973, for Rs. 40,500 and Rs. 64,600 respectively. A portion of another property in Bangalore was disposed of in December 1981 and out of proceeds, Rs. 9.75 lakhs was adjusted towards income-tax arrears. No action had been taken till date by the department to dispose of the remaining 25 properties in Mysore attached in 1967, 6 properties in Mysore attached in 1972 portion of property in Bangalore (attached in 1967) and properties in Ooty attached in 1973.

(2) In the case of defaulter 'B', demand of Rs. 19.91 lakhs comprising of income-tax, interest and penalties for the assessment years 1960-61 to 1973-74 were outstanding. Agricultural land measuring 12 acres of the defaulter was attached in 1972. On his application, the Court directed the Tax Recovery Officer in 1974 not to sell the land, pending disposal of certain appeals before the Income-tax authorities. Though the High Court had disposed of the defaulter's petition in 1974 itself, no action has been taken so far by the Department to dispose of the property attached and realise the tax arrears.

(b) *Kerala charge*

(1) In the case of a defaulter 'A' (assessed in Bombay) with tax arrears (income-tax and wealth-tax) of Rs. 140.22 lakhs pertaining to the assessment years 1964-65 to 1976-77, immovable property valuing approximately Rs. 18 lakhs only was attached in 1975. The sale of the property had been kept in abeyance till date under instructions from the Income-tax Officer, Bombay issued as far back as 1979.

(2) According to the Tax Recovery Certificate issued during 1958—1967, demand of Rs. 50.43 lakhs on account of income-tax, interest and penalty arrears were due for recovery from another defaulter 'M' (now deceased) and 40 immovable properties (mostly land) were attached in 1968. Some of the properties were put up for sale in January 1980 but the auction proceedings were postponed on account of petition filed with the Cenral Board of Direct Taxes by the legal heirs on 24 January 1980. According to the Tax Recovery Officer, the legal heirs had addressed petition for reduction of tax liability to the Central

Board of Direct Taxes in 1982 on which orders of the Board are awaited. Pending orders of the Board no action had been taken to recover the arrears by auction sale of the attached properties.

(c) *Gujarat charge*

In Gujarat circle, the 206 properties attached as on 31 March 1983 pending disposal related to 165 defaulting assessees against whom tax demand of approximately Rs. 7.23 crores was pending recovery.

For realising the tax demand of about Rs. 22 lakhs outstanding against an assessee, 'G' a commercial building property owned by him was attached by the Department in 1977. The building was already occupied on rent by the Income-tax department and another Government Department. The Income-tax department intended to acquire the building for its own use from 1980 onwards but this had not rructified till date due to differing opinions on valuation of the property and area to be purchased.

(d) *Calcutta charge*

Though the Department had intimated that 260 immovable properties attached in West Bengal under the jurisdiction of 15 Tax Recovery Officers were pending disposal as on 31 March 1985, records pertaining to only 170 properties were produced to Audit.

(1) A defaulter 'C' had arrears of tax amounting to Rs. 58.51 lakhs pertaining to the assessment years 1951-52 to 1979-80 due for recovery. Seven properties of the defaulter were attached by the department in 1983. The properties could not be disposed of for realising the tax arrears as the High Court had issued an injunction order prohibiting the sale in March 1985.

(2) Another defaulter 'D' had arrears of tax (income-tax, wealth-tax, interest etc.) pertaining to the assessment years 1949-50 to 1975-76 amounting to Rs. 17.34 lakhs outstanding and 11 house properties and 1 piece of vacant land owned by him were attached by the Department in 1981. The sale of the properties had not been effected till date in view of Central Board of Direct Taxes' directions to Commissioner of Income-tax in 1983 that "proposed sales of properties for the present be postponed and notice of sale proclamation allowed to abate".

(3) In four other cases of tax defaulters each with outstanding demand of over Rs. 10 lakhs properties attached remained undisposed from 5 to 10 years of attachement as per details below :

Sr. No.	Assessee	Outstanding tax demand	No. of properties attached	Year of attachment
1.	'G'	Rs. 13.97 lakhs	11	1978
2.	'S'	Rs. 16.99 lakhs	1	1978
3.	'B'	Rs. 41.86 lakhs	6	1979
4.	'SR'	Rs. 25.64 lakhs	1	1977

In the first case, the tax demands pertained to the assessment years 1960-61 to 1972-73. The reasons for the delay in disposal of the attached properties were stated to be "awaiting decisions from High Court". In the second case, the tax demands pertained to the assessment years from 1948-49 onwards to 1980-81 and the attached properties were stated to have been not disposed of as most of the demands had been disputed in appeal, Tribunal and High Court. In the third case the tax demands pertained to the assessment years 1969-70 to 1978-79. The properties had not been disposed of as the matter was stated to be "subjudice before Court". In the fourth case, the tax demands pertained to the assessment years from 1956-57 onwards to 1969-70. For disposing of the attached property in this case notice for auction in June 1977 was issued but the said auction was not held for reasons not on record. No action, thereafter was taken by the department till January 1985. The defaulter had obtained injunction order against sale upto March 1985 from High Court.

(e) *Tamil Nadu charge*

In Tamil Nadu charges as on 31 March 1983 properties were attached in 33 cases for effecting recovery of arrears of tax amounting to Rs. 1.16 crores.

(1) In one case, the assessee 'S' owed the Department Rs. 10.72 lakhs towards tax dues pertaining to the assessment years 1963-64 to 1974-75. Seven immovable properties owned by the assessee were attached by the Department in December 1981. These properties could not be brought to auction as these were reported to be involved in litigation in Court.

(2) A sum of Rs. 5.38 lakhs was due from another assessee 'V'. The arrears pertained to the assessment years 1960-61 and 1970-71 to 1978-79. Five immovable properties owned by the assessee were attached in December 1972. One more property was attached in January 1985. Though the Commissioner of Income-tax had issued instructions in November 1984

for initiating proceedings for sale, till date the attached properties had not been put for sale for recovery of the tax dues.

(f) *Bombay, Nagpur charges*

The position in regard to some high value cases are indicated in the table below :

Sr. No.	Assessee	Arrears of tax (in lakhs of rupees) and assessment years	No. of properties attached and year of attachment	Reasons for delay in disposal of properties attached
1	2	3	4	5
1.	'G'	93.58 Not available	12 house properties 1964	2 properties have been sold for Rs. 1.07 and Rs. 0.40 lakhs respectively. The Commissioner of Income-tax proposed partial write off of arrears in 1983. The Central Board of Direct Taxes had not agreed to the proposal and called for further information which is yet to be furnished.
2.	'B'	68.59 No details available	6 properties 3 in 1966 3 in 1982	Efforts were made to dispose of two properties but without success. The party made application for scaling down demand. The Central Board of Direct Taxes directed Commissioner of Income-tax in March 1983 to stay sale proceedings till decision was taken on the petition. Defaulter had been allowed to pay tax in quarterly instalments of Rs. 6 lakhs from June 1984.
3.	'C'	63.69 1970-71 onwards	1 land and land with structurals and plant machinery 1974, 1978	No progress in regard to land. As regards land with structurals valuation was solicited in 1984 and received in 1985. The Tax Recovery Officer had been asked to proceed with auction of the property.
4.	'S'	60.30 1962-63 onwards	1 house property 1975	Sale proclamation made in 1981 and 1984 but property was yet to be sold. Proposal for write off of portion of tax arrears was stated to be under consideration.
5.	'D'	26.20 1944-45 to 1957-58 and 1962-63	1 house property at Juhu (Value Rs. 3.85 lakhs in 1973 and Rs. 1.77 crores in 1984)	The department has not taken any further action for disposal of the property even though the chronology of the events indicated that the defaulter had succeeded in avoiding recovery of tax for over 25 years.
6.	'N'	21.24 1970-71 onwards	2 house properties 1982-83	Company went into liquidation in 1984. Department's claims filed with liquidator in June 1984.
7.	'R'	31.44	Agricultural lands 1972	Sales fixed in 1972, 1973 1974 but no bidders came forward in these auctions. Part of land had been sold by Sales Tax Department for realisation of their dues. Civil suit filed by defaulter in 1978. No developments thereafter.

Certain salient aspects of four of the cases are discused below :

Assessee 'B'

Six immovable properties of the assessee were attached—3 in 1966 and 3 in 1982. An attempt was made in 1982 to auction one property for which reserve price was fixed at Rs. 80 lakhs. However, the entire property had been encroached by hutments and no buyer came forward to purchase it. Another property was proposed for auction in March 1983, when a direction was received from the Central Board of Direct Taxes directing the Commissioner of Income-tax to stay the sale proceedings till a decision was taken on the scaling down petition and revision petition filed by the defaulter. The defaulter had also been allowed to pay tax in quarterly instalments of Rs. 6 lakhs from June 1984.

Assessee 'D' (individual)

The outstanding tax arrears against the defaulter assessee amounted to Rs. 26.20 lakhs and related to assessment years 1944-45 and onwards. The assessee's immovable property in a fashionable locality in Bombay was attached in June 1954. In February 1975, the Commissioner of Income-tax made a proposal to the Central Board of Direct Taxes for partial write-off to the extent of 80 per cent of the arrears leaving a balance of Rs. 5.26 lakhs. This was not agreed to and the Central Board of Direct Taxes directed disposal of the property by public auction and also considering of feasibility of arrest and detention of the assessee. In March 1976, the Tax Recovery Officer reported that the defaulter's annual income was Rs. 6,000 only and in the context of the then arrears of Rs. 26 lakhs, time was not ripe for such a course of action. No progress was made in this direction and again in 1979, the Commissioner of Income-tax made a proposal to the Board for partial write off of tax arrears. Even with the posting of Commissioner of Income-tax (Recovery) in October 1981 no further developments occurred in this case. In October 1982 as a result of search and seizure operations it was found that the defaulter had regular source of

income and led a luxurious life and according to the appraisal report of the search and seizure this was not a fit case for scaling down of the arrears. The value of the property was estimated in 1984 as Rs. 1.77 crores after inspection of the property. The writ petition filed by the defaulter's wife questioning the competence of the Commissioner of Income-tax (Recovery) to dispose of the property by auction was rejected by the Bombay High Court in September 1984. The defaulter met the Commissioner of Income-tax (Recovery) in September 1984 and the Commissioner of Income-tax (Recovery) granted a stay on disposal of the property by auction subject to the condition that the defaulter should chalk out the arrangement for payment of the bulk of the remaining demand by December 1984. Till April 1985, the defaulter has paid only Rs. 4 lakhs. The department has not taken any further action for disposal of the property even though the chronology of the events showed that the defaulter had succeeded in not paying the tax demands for over 25 years and had also not kept up the assurance given to the Commissioner of Income-tax (Recovery) of clearing bulk of the demands by December 1984.

Assessee 'N' (Company)

In this case, the Income-tax Officer had intimated the Tax Recovery Officer in November 1982 about the details of the immovable properties of the assessee that could be attached and the Tax Recovery Officer was also cautioned that if recovery was postponed or delayed it might be difficult to recover the arrears. The properties were attached in December 1982 and March 1983. The Commissioner of Income-tax instructed the Tax Recovery Officer in October 1983 to take expeditious steps to collect the demand. The valuation reports for the property attached in 1982 were called for in October 1983 and the valuation report was received in January 1984. The auction sale fixed for March 1984 did not fructify for want of sufficient bidders. In the meanwhile the Court issued orders winding up the company in March 1984 and the official Liquidator took possession of the properties in March 1984 and prohibited the auction sales of the attached properties. The department had filed claims with the Liquidator in June 1984.

Assessee 'R'

In this case immovable property in the form of agricultural lands were attached in May 1972. Sales were fixed in 1972, 1973 and 1974 but no bidders came forward in any of the years. In the meanwhile it had been reported that a part of attached land had been sold by the Sales Tax Department in December 1974 to recover its dues. The assessee filed Civil Suit in 1978 and the matter was stated to be pending before the Court. The department had not taken any steps for expediting the disposal of the case.

(g) *Andhra Pradesh charge*

*The position regarding certain old and high value cases is indicated in the table below :

Sr. No.	Assessee	Tax arrears (in lakhs) and year of assessment	Number of properties attached and year of attachment	Reasons for delay in disposal
1	2	3	4	5
1.	'U'	Rs. 133.62 (income-tax) and Rs. 27.71 (wealth-tax) 1967-68 to 1976-77	6 (1 house property 5 lands) 1972, 1971	The properties were put for auction on several occasions but the sales did not fructify for want of bidders. The properties attached were not of substantial value. The department was considering partial write-off of tax dues for reasons of irrecoverability.
2.	'M'	Rs. 39.30 1978-79 to 1980-81	4 (2 house properties and 2 lands) 1982	The properties had not been sold so far as the Commissioner of Income-tax had directed the Tax Recovery Officer in August 1983 to keep the properties in attachment but not to make auction or sale until the demand became final at the Income-tax Appellate Tribunal stage. The appeal before the Income-tax Appellate Tribunal had not been finalised.
3.	'H'	Rs. 35.96 1975-76 to 1977-78	One land, buildings, plant and machinery 1983	On an application filed by the assessee, Settlement Commission had stayed the collection of arrears of tax (November 1983). The stay had not yet been vacated.
4.	'L'	Rs. 24.29 1966-67 to 1977-78	25 1982	The properties had not been sold so far. The party resided in Bombay. The party had filed appeals before the Commissioner of Income-tax (Appeals), Bombay, who had granted a stay (March 1984). The stay had not so far been vacated.
5.	'V'	Rs. 12.24 1971-72 to 1973-74	3 1980-81	The objection petitions filed by the assessee in 1980 was not replied to by the Income-tax Officer by filing counter-objections. In the meanwhile, it appeared the properties had been sold away to a third party notwithstanding the fact that they were already under attachment.

(h) Delhi

The position regarding two of the old pending cases is shown below :

Sr. No.	Assessee	Arrear of tax (in lakhs of rupees) and assessment year	No. of properties attached and year of attachment	Reason for delay in disposal
1	2	3	4	5
1.	'M'	120 1955-56 to 1975-76 with the exception of the years 1957-58, 1958-59, 1966-67, 1970-71, 1971-72 and 1973-74.	Two 1982	The High Court had vide order dated 25 July, 1983 authorised the department to auction of one of the properties in case the assessee failed to pay Rs. 20 lakhs by 15 August 1983. The property could not, however, be sold as the maximum bid was below the reserved price.
2.	'H'	26.73 1972-73 to 1976-77	One 1980	Commissioner of Income-tax had given stay of proceedings till 31 March 1985 against part payment. An amount of Rs. 70,000 was paid by assessee on 31 March 1985. Demand reduced to Rs. 11.04 lakhs by Commissioner of Income-tax in appeal. Case pending before Income-tax Appellate Tribunal.

(v) *Conclusions*

(a) After attachment of the immovable properties, expeditious action was not taken to issue a proclamation of sale and to bring the properties to sale. The departmental instructions, however, lay down that the time interval between the date of a fixture of proclamation and the date of sale is 30 days. The absence of a statutory time limit for sale of properties, once attached, had led to considerable delays, over 10 years in innumerable cases. Making full use of the inordinate delay in this regard, the defaulters had arranged their affairs in such a manner as to render the department's efforts futile.

(b) The law lays down that where any immovable property is attached, the attachement should relate back and take effect from the date on which the notice to pay the arrears was served upon the defaulter. In the absence of an enabling provision for the department to take possession, the attached properties together with their title deeds are allowed to remain in the custody of the tax defaulter who besides continuing to enjoy the benefits therefrom, more often than not, maneuvered to transfer/sell or otherwise dispose of the property leaving no option to the department except to seek time consuming legal remedy.

(c) The law provides that where an immovable property is attached, the Tax Recovery Officer may instead of directing a sale of the property, appoint a receiver to manage such property. This provision was not at all resorted to.

(d) The law vests complete authority with the Tax Recovery Officer to investigate any claim or objection made to the attachment or sale of property in execution of a certificate. The order of the Tax Recovery Officer who is deemed to act judicially, subject to the result of any suit in a Civil Court, which may be instituted by the defaulter, is conclusive. No interference by any administrative authority is contemplated in the law. Instances were noticed where sale of attached properties, in individual cases, was stayed by the Commissioner of Income-tax and the Central Board of Direct Taxes.

The review was sent to the Ministry of Finance on 23 September 1985 and their comments are awaited (January 1986).

1.10 **Appeals, Revision petitions and writs**

Under the provisions of the Income-tax Act, 1961, if an assessee is dissatisfied with an assessment, a refund order, etc., he can file an appeal to the Appellate Assistant Commissioner. 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, a reference on a point of law can be taken to the High Court from which an appeal lies to the Supreme Court. The assessee can also initiate writ proceedings under Article 226 of the Constitution.

A tax payer can approach the Commissioner of Income-tax to revise an order passed by an Income-tax 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 interest of revenue.

(i) Particulars of income-tax appeals and revision petitions pending as on 31 March 1985 were as under :

	Income-tax appeals with Appellate Assistant Commissioners/ CsIT (Appeals)	Income-tax revision petitions with Commissioners
Number of appeals/revision petitions pending :—		
(*a*) Out of appeals/revision petitions instituted during 1984-85.	1,27,255	5,654
(*b*) Out of appeals/revision petitions instituted in earlier years.	1,10,901	10,150
TOTAL	2,38,156	15,804

(ii) Particulars of wealth-tax, gift-tax and estate duty appeals and revision petitions pending as on 31 March 1985 were as under :—

	Appeals with Appellate Assistant Commissioners/Commissioners of Income-tax (Appeals)			Revision peititions with Commissioners		
	Wealth Tax	Gift Tax	Estate Duty	Wealth Tax	Gift Tax	Estate Duty
Number of appeals/revision petitions pending :—						
(*a*) Out of appeals/revision petitions instituted during 1984-85.	28,121	1,420	1,376	1,093	39	—
(*b*) Out of appeals/revision petitions instituted in earlier years.	40,351	1,793	3,302	2,754	137	—
TOTAL	68,472	3,213	4,678	3,847	176	—

(iii) Year-wise break-up of income-tax appeal cases and revision petitions pending with Appellate Assistant Commissioners and Commissioners of Income-tax (Appeals) and Commissioners of Income-tax as on 31 March 1984 and 31 March 1985, respectively, with reference to the year of their institution was as under :

Years of Institutions	Appeals pending with Appellate Assistant Commissioners/Commissioners of Income-tax (Appeals)		Revision petition pending with Commissioners	
	31 March 1984	31 March 1985	31 March 1984	31 March 1985
1975-76 and earlier years.		1,123		291
1976-77		947		157
1977-78		1,489		306
1978-79		1,990		434
1979-80	17,067**	3,900	2,110**	555
1980-81	13,963	6,131	1,361	796
1981-82	25,263	11,135	2,337	1,575
1982-83	58,879	26,244	3,326	2,403
1983-84	1,30,300	57,942	6,145	3,633
1984-85	—	1,27,255	—	5,654
TOTAL	*2,45,472	2,38,156	*15,279	15,804

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures for 1979-80 and earlier years. year-wise break-up not furnished by Ministry of Finance.

(iv) Year-wise break-up of wealth-tax, gift-tax and estate duty appeal cases and revision petitions pending with Appellate Assistant Commissioners and Commissioners as on 31 March 1985 with reference to the year of their institution was as under :

Year of Institution	Appeals pending with Appellate Assistant Commissioners/Commissioners of Income-tax (Appeals)			Revisions petitions pending with Commissioners		
	Wealth Tax	Gift Tax	Estate Duty	Wealth Tax	Gift Tax	Estate Duty
1975-76 and earlier years	61	4	37	72	—	—
1976-77	143	6	96	82	3	—
1977-78	312	7	145	101	1	—
1978-79	737	47	158	116	3	—
1979-80	3,570	139	233	223	14	—
1980-81	2,919	201	232	244	14	—
1981-82	5,197	264	477	479	30	—
1982-83	9,909	407	791	643	28	—
1983-84	17,503	718	1,133	794	44	—
1984-85	28,121	1,420	1,376	1,093	39	—
TOTAL	68,472	3,213	4,678	3,847	176	—

(v) The following table gives details of appeals references disposed of during the years 1982-83, 1983-84 and 1984-85 :—

		1982-83	1983-84	1984-85
(*a*)	(1) Number of appeals filed before Appellate Assistant Commissioners/Commissioners of Income-tax (Appeals).	2,34,804*	2,48,729	2,42,307
	(2) Number of appeals disposed of by Appellate Assistant Commissioners/Commissioners of Income-tax (Appeals).	2,61,341*	2,60,206	2,49,488
(*b*)	Number of appeals filed before Income-tax Appellate Tribunals :			
	(1) by the assessee	25,088	28,544	25,835*
	(2) by the department	24,935	27,849	25,935*
(*c*)	Number of assessee's appeals decided by the Tribunal in favour of the assessees fully out of (b)(1) above.	8,610	10,483	9,085*
(*d*)	Number of departmental appeals decided by the Tribunals in favour of the department fully out of (b)(2) above.	3,208	4,511	4,077*
(*e*)	Number of references filed to the High Courts :			
	(1) by the assessees	1,992	1,595	1,556*
	(2) by the department	5,240	4,542	5,588*
(*f*)	Number of references in the High Courts disposed of in favour of the			
	(1) assessees	143	231	1,220*
	(2) department	474	977	722*
(*g*)	Number of appeals filed to the Supreme Court			
	(1) by the assessees	9	19	9*
	(2) by the department	25	31	37*
(*h*)	Number of appeals disposed of by the Supreme Court in favour of the :			
	(1) assessees	1	15	2*
	(2) department	—	1	2*

*Figures furnished by Ministry of Finance are provisional.

(vi) Writ petitions pending :—

	In Supreme Court	In High Court	Total
1	2	3	4
(*a*) Number of writ petitions pending as on 31-3-1985.	336	3,844	4,180
(*b*) Out of (*a*) above :			
(*i*) Pending for over 5 years.	29	239	268
(*ii*) Pending for 3 to 5 years.	80	732	812
(*iii*) Pending for 1 to 3 years.	218	2,257	2,475
(*iv*) Pending upto 1 year	9	616	625

1.11 **Completion of Reopened and set aside assessment**

(i) *Income-tax*

(a) Disposal of cases of assessments cancelled under Section 146 of Income-tax Act.

Year	No. of assessments for disposal	No. of assessments completed	No. of assessments pending at the end of the year
1983-84*	23,649	14,315	9,334
1984-85**	15,060	9,681	5,379

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures furnished by Ministry of Finance are provisional.

(b) Year-wise details** of cases of assessments cancelled under Section 146 of Income-tax Act, 1961 (or under the corresponding provisions of the old Act) and which are pending finalisation as on 31 March 1985.

Year	No. of cases
1975-76 and earlier years	445
1976-77	173
1977-78	226
1978-79	295
1979-80	423
1980-81	830
1981-82	1,171
1982-83	555
1983-84	557
1984-85	704
TOTAL	5,379

**Figures furnished by Ministry of Finance are provisional.

(c) Disposal of cases of assessment cancelled under Section 263 of Income-tax Act.

Year	No. of assessments for disposal	No. of assessments completed	No. of assessments pending at the end of the year
1983-84*	1,641	717	924
1984-85**	1,664	1,034	630

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures furnished by Ministry of Finance are provisional.

(d) Year-wise details** of cases of assessments cancelled under Section 263 of the Income-tax Act, 1961 (or under corresponding provisions of the old Act) and which are pending finalisation as on 31 March 1985.

Year	No. of cases
1975-76 and earlier years	23
1976-77	20
1977-78	11
1978-79	49
1979-80	80
1980-81	100
1981-82	127
1982-83	92
1983-84	71
1984-85	57
TOTAL	630

**Figures furnished by Ministry of Finance are provisional.

(e) Disposal of cases of assessment cancelled/set aside by Appellate Assistant Commissioner/Commissioner of Income-tax (Appeals) under Section 251 of Income-tax Act or by Income-tax Appellate Tribunal under Section 254 of Income-tax Act.

Year	No. of assessments for disposal	No. of assessments completed	No. of assessments pending at the end of the year
1983-84*	11,538	5,480	6,058
1984-85**	8,521	4,310	4,211

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures furnished by Ministry of Finance are provisional.

(f) Year-wise details** of cases of assessment set aside by the Appellate Assistant Commissioner/Commissioner of Income-tax (Appeals) under Section 251 of the Income-tax Act, 1961 (or under the corresponding provisions of the old Act) by the Appellate Tribunal under Section 254 of the Income-tax Act, 1961 (or under the corresponding provisions of the old Act) where fresh assessments have not been completed as on 31 March 1985**

Assessment year	Set aside by Appellate Assistant Commissioners/ Commissioners of Income-tax (Appeals) No. of cases	Set aside by Appellate Tribunal No. of cases
1975-76 and earlier years	430	106
1976-77	201	36
1977-78	218	41
1978-79	334	46
1979-80	470	54
1980-81	618	54
1981-82	650	42
1982-83	307	16
1983-84	234	17
1984-85	296	41
TOTAL	3,758	453

**Figures furnished by Ministry of Finance are provisional.

(ii) *Wealth-tax and Gift-tax*

(a) Disposal of cases of assessment cancelled under Section 25 of the Wealth-tax Act, 1957 and under Section 24(2) of the Gift-tax Act, 1958.

Year	No. of assessments for disposal		No. of assessments completed		No. of assessments pending at the end of the year	
	Wealth Tax	Gift Tax	Wealth Tax	Gift Tax	Wealth Tax	Gift Tax
1983-84*	1,386	14	206	8	1,180	6
1984-85**	1,879	61	296	24	1,583	37

(b) The year-wise** details of assessments cancelled under Section 25 of the Wealth-tax Act, 1957 and under Section 24(2) of the Gift-tax Act, 1958,

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures furnished by Ministry of Finance are provisional.

which were pending finalisation, as on 31 March 1985, were as follows :—

Assessment year	No. of cases	
	Wealth Tax	Gift Tax
1975-76 and earlier years	390	—
1976-77	238	—
1977-78	428	1
1978-79	200	4
1979-80	157	6
1980-81	73	8
1981-82	40	9
1982-83	17	5
1983-84	21	1
1984-85	19	3
TOTAL	1,583	37

(c) Disposal of cases of assessments set aside by the Appellate Assistant Commissioner/Commissioner (Appeals)/Appellate Tribunal under Section 23(5)/24(5) of the Wealth-tax Act, 1957, Section 22(5)/23(5) of the Gift-tax Act, 1958 and Section 62(5)/63(5) of the Estate Duty Act, 1953.

Year	No. of assessments for disposal			No. of asessments completed			No. of assessments pending at the end of the year		
	Wealth Tax	Gift Tax	£ Estate Duty	Wealth Tax	Gift Tax	£ Estate Duty	Wealth Tax	Gift Tax	Estate Duty
1983-84*	3,796	85		1,222	24		2,574	61	88
1984-85**	2,453	79		1,003	29		1,450	50	33

£Figures awaited from Ministry of Finance.

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

**Figures furnished by Ministry of Finance are provisional.

(d) The year-wise details of assessments set aside by the Appellate Assistant Commissioner/Commissioner (Appeals)/Appellate Tribunal under Section 23(5)/24(5) of the Wealth-tax Act, 1957, Section 22(5)/23(5) of the Gift-tax Act, 1958 and Section 62(5)/63(5) of the Estate Duty Act, 1953, where fresh assessments had not been completed as on 31 March 1985** were as under :—

Assessment years	Set aside by Appellate Assistant Commissioners/ Commissioners (Appeals)			Set aside by Appellate Tribunal		
	Number of cases			Number of cases		
	Wealth Tax	Gift Tax	Estate Duty	Wealth Tax	Gift Tax	Estate Duty
1975-76 and earlier years.	368	18	—	62	1	1
1976-77	171	2	—	14	—	—
1977-78	174	5	—	8	—	—
1978-79	203	7	2	15	2	1
1979-80	137	1	1	10	—	—
1980-81	75	2	2	9	1	—
1981-82	60	4	1	4	—	—
1982-83	53	3	4	2	1	1
1983-84	35	1	11	2	—	—
1984-85	40	2	7	8	—	2
TOTAL	1,316	45	28	134	5	5

**Figures furnished by Ministry of Finance are provisional.

1.12 Reliefs and Refunds

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 become payable to the assessee on the amount of such refund (*vide* Section 237 read with Section 243 of the Income-tax Act).

(i) (a) The particulars of cases of refunds for which claims were made, the claims settled and the balance outstanding during 1984-85.

Financial year	Opening Balance	Claims received during the year	Total	No. of refunds made	Balance outstanding
1980-81	15,269	1,33,691	1,48,960	1,31,584	17,376£
1981-82	17,506£	1,91,587	2,09,093	1,93,660	15,433
1982-83	15,433	1,34,306	1,49,739	1,22,680	27,059
1983-84*	27,059	1,40,163	1,67,222	1,37,981	29,241+
1984-85	29,?21+	1,50,161	1,79,382	1,41,835	37,547

(b) Year-wise analysis of the balance claims as on 31 March 1985.

Financial year in which application was made	No. of cases pending
1981-82 and earlier years	13
1982-83	279
1983-84	7,036
1984-85	30,219
TOTAL	37,547

£ and +The discrepancy in figures is under verification by Ministry of Finance.

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

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

The particulars of assessment pending revision, revisions actually made and the number of cases of assessments outstanding as on 31 March, 1985.

Financial year	Opening Balance	Assessments for revision during the year	Total	No. of assessments revised out of Col. 4	No. of assessments which resulted in refunds as a result of revision of Col. 5	Assessments pending revision
1	2	3	4	5	6	7
1980-81 .	9,240	1,04,447	1,13,687	1,06,771	50,104	6,916£
1981-82 .	6,961£	1,04,114	1,11,075	1,05,296	20,700	5,779
1982-83 .	5,779	91,631	97,410	90,387	33,963	7,023
1983-84* .	7,023	80,061	87,084	79,302	29,222	7,782
1984-85 .	7,782	66,760	74,542	68,859	27,935	5,683

£ The discrepancy in figures is under verification by Ministry of Finance.

*Figures furnished by Ministry of Finance in March 1985 have been adopted.

(b) Year-wise analysis of balance as on 31 March 1985.

Financial year	No. of cases pending
1981-82 and earlier years	294
1982-83	398
1983-84	473
1984-85	4,518
TOTAL	5,683

1.13 Interest

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

The particulars of interest levied and interest paid by Government under different provisions of the Act during the year 1984-85 are given below :—

	No. of assessments	Amount (In crores of rupees)
1	2	3
(*a*) The total amount of interest levied under various provisions of the Income-tax Act.	10,48,304	485.18
(*b*) Of the amount of interest levied, the amount :		
(1) Completely waived by the department.	24,526	16.27
(2) Reduced by the department	1,53,494	132.72
(3) Collected by the department	3,18,772	58.67
(*c*) The total amount of interest paid :		
(1) On advance tax paid in excess of assessed tax.	1,19,281	12.72
(2) On delayed refunds	334	0.24
(3) Where no claim is needed for refund.	5,757	4.01

1.14 Cases settled by Settlement Commission

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

The number of cases settled by the Settlement Commission during the past five years was as under :—

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	Pending cases
(i) Income tax				
1980-81	1,276	294	23.04	982
1981-82	1,231	159	12.91	1,072
1982-83	1,430	186	13.00	1,244
1983-84	1,799	224	12.45	1,575
1984-85	1,988	270	13.57	1,718
(ii) Wealth-tax				
1980-81	497	69	13.88	428
1981-82	506	86	16.99	420
1982-83	551	47	8.52	504
1983-84	702	92	13.10	610
1984-85	733	86	11.73	647

(iii) Year-wise position of tax determined (including interest and penalty) in cases settled by Settlement Commission.

Financial year	Income-tax	Wealth tax
	(Rs. in lakhs)	
1980-81	281.79	18.94
1981-82	124.90	6.92
1982-83	207.02	10.39
1983-84	373.91	26.62
1984-85	225.19	23.43

1.15 Penalties and prosecutions

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 laws also provide for levy of penalty and prosecution for failure to produce accounts and documents, failure to deduct or pay tax, etc.,

(i) Income-tax

A. Penalties

(a) No. of penalty orders passed under Section 271(1)(c) during 1984-85.	42,902
(b) Concealed income involved in (a) above.	Rs. 18.58 crores
(c) Total amount of penalty levied in (a) above :	
(i) No. of orders	8,712
(ii) Amount	Rs. 16.85 crores
(d) Total amount of penalty collected in (c) above :	
(i) No. of orders	1,315
(ii) Amount	Rs. 0.79 crores
(e) No. of penalty orders passed under other Sections of the Act during 1984-85.	7,74,653
(f) Income involved in (e) above	Rs. 78.90 crores
(g) Total amount of penalty levied in (e) above :	
(i) No. of orders	2,27,070
(ii) Amount	Rs. 23.96 crores
(h) Total amount of penalty collected in (g) above :	
(i) No. of orders	52,657
(ii) Amount	Rs. 4.58 crores

B. Prosecutions

(a) No. of prosecutions pending before the Courts as on 1-4-1984.	1,213
(b) No. of prosecution/complaints filed during 1984-85 under Sections 276C, 276CC, 276D, 277 and 278.	783
(c) No. of prosecutions decided during 1984-85.	84
(d) No. of convictions obtained in (c) above.	13
(e) No. of cases which were compounded before launching prosecutions.	60
(f) Composition money levied in cases in (e) above.	Rs. 1.49 lakhs

(ii) Wealth-tax and Gift-tax

*A. Penalties**

	Wealth-tax	Gift-tax
(a) No. of penalty orders passed under Section 18(1)(c)/17(1)(c) during 1984-85.	7,650	429
(b) Amount of concealed net wealth/value of gift involved in (a) above (in lakhs of rupees).	1,107.91	54.11
(c) Total amount of penalty levied in (a) above :		
(i) No. of orders	1,362	53
(ii) Amount (in lakhs of rupees)	186.37	11.88
(d) Total amount of penalty collected in (c) above :		
(i) No. of orders	180	9
(ii) Amount (in lakhs of rupees)	2.90	0.05
(e) No. of penalty orders passed under other sections during 1984-85.	64,419	4,761
(f) Amount of net wealth/value of Gift involved in (e) above (in lakhs of rupees).	3,193.48	113.31
(g) Total amount of penalty levied in (e) above :		
(i) No. of orders	15,534	1,015
(ii) Amount (in lakhs of rupees)	371.91	17.45
(h) Total amount of penalty collected in (g) above :		
(i) No. of orders	2,476	281
(ii) Amount (in lakhs of rupees)	21.75	1.31

*Figures furnished by Ministry of Finance are provisional.

*B. Prosecutions**

(*a*)	No. of prosecutions pending before the Courts on 1-4-1984.	240
(*b*)	No. of prosecution complaints filed during 1984-85 under Sections 35A, 35B, 35C, 35D and 35F.	50
(*c*)	No. of prosecutions decided during 1984-85.	9
(*d*)	No. of convictions obtained in (*c*) above.	—
(*e*)	No. of cases which were compounded before launching prosecutions.	3
(*f*)	Composition money levied in cases in (*e*) above (in lakhs of rupees).	1.33

*Figures furnished by Ministry of Finance are provisional.

1.16 Searches and Seizures

Sections 132, 132A and 132B of the Income-tax Act, 1961, provide for search and seizure operations. A search has to be authorised by a Director of Inspection, Commissioner of Income-tax or a specified Dy. Director of Inspection or Inspecting Assistant Commissioner. Where any money, bullion, jewellery or other valuable article or thing is seized, the Income-tax Officer has, after necessary investigations, to make an order with the approval of the I.A.C. within 90 days of the seizure, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability and retain in his custody such assets as are, in his opinion sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the person from whose custody they were seized. The books of account and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approved of the retention for a longer period.

Searches and Seizures

(*a*) Number of cases in which search and seizure were conducted during the last three years :

	No. of assessees	No. of assessments
1982-83	3,070	5,692
1983-84	2,691*	5,278*
1984-85	3,301	5,026

*Figures furnished by Ministry of Finance in April 1985 have been adopted.

(*b*)	No. of search cases in which assessments were awaiting completion at the beginning of the year 1984-85 :	
	(1) No. of assessees	6,575
	(2) No. of assessments	13,410
(*c*)	No. of search cases in which assessments were completed during the year 1984-85 :	
	(1) No. of assessees	4,911
	(2) No. of assessments	8,697
(*d*) (*A*)	No. of search cases in which assessments are awaiting to be completed at the end of the year 1984-85 :	
	(1) No. of assessees	4,965
	(2) No. of assessments	9,739
(*B*)	Number out of (*A*) above, which are pending for more than 2 years after the date of search :	
	(1) No. of assessees	1,618
	(2) No. of assessments	3,566
(*e*)	Total concealed income assessed in cases referred to in item (*c*) above :	
	(1) No. of cases	1,883
	(2) Amount	Rs. 112.89 crores
(*f*)	Penalty levied for concealment of income in search cases during the year (irrespective of whether assessments are completed in this year or earlier) :	
	(1) No. of cases	543
	(2) Amount	Rs. 12.45 crores
(*g*)	No. of search cases in respect of which prosecution was launched in the Court during the year 1984-85 (irrespective of whether assessments are completed in this year or earlier).	104
(*h*)	No. of convictions obtained during the year 1984-85.	12
(*i*)	No. of cases where no concealment or tax evasion found on completion of assessments.	3,028
(*j*)	Total amount of cash, jewellery, bullion and other assets seized during the year 1984-85 (approximate value) :	
	(1) Cash	Rs. 152.96 crores
	(2) Bullion and jewellery	Rs. 279.12 crores
	(3) Others	Rs. 324.19 crores
	TOTAL	Rs. 756.27 crores
(*k*)	No. of search cases in respect of which summary assessment orders under section 132(5) of the Income-tax Act were passed during the year 1984-85.	963
(*l*)	Amount of undisclosed income determined in the orders under section 132(5) referred to in item (*c*) above.	Rs. 27.11 crores*
(*m*)	(1) Value of assets retained as a result of orders passed under section 132(5) referred to in item (*k*) above.	Rs. 147.81 crores*
	(2) Value of assets returned as a result of orders passed under section 132(5) referred to in item (*k*) above.	Rs. 10.73 crores*

*Figures are under verification by Ministry of Finance.

(*n*)	Amount of cash, jewellery, bullion and other assets held on 31-3-1985, irrespective of the year of search :	
	(1) Cash	Rs. 35.99 crores
	(2) Bullion and jewellery	Rs. 223.94 crores
	(3) Others	Rs. 87.98 crores
	TOTAL	Rs. 347.91 crores*
(*o*)	The break-up of the amount of cash jewellery, bullion and others assets held on 31-3-1985 :	
	(*i*) Over 5 years	Rs. 2.36 crores
	(*ii*) Between 3 to 5 years	Rs. 25.41 crores
	(*iii*) Below 3 years	Rs. 341.07 crores
	TOTAL	Rs. 368.84 crores*
(*p*)	Arrangements made for the safe custody of the assets still held and for their physical verification.	Cash is deposited in the personal Deposit Account of the Commissioners of Income-tax in the Reserve Bank of India. Other valuables are kept either in well guarded strong rooms in the office or in Bank vaults, etc.

*The discrepancy in the figures is under verification by Ministry of Finance

1.17 Acquisition of Immovable Properties

1.17.01 Chapter XXA of the Income-tax Act, 1961, introduced with effect from 15 November 1972, empowers the Central Government to acquire an immovable property, where such property is transferred by sale or exchange and the true consideration for such transfer is concealed with the object of evading tax. The scope of these provisions has been extended through the Income-tax (Amendment) Act, 1981 with effect from 1 July 1982, to cover :

(a) transfers of flats or premises owned through the medium of co-operative societies and companies;

(b) agreements of sale followed by part performance, *viz.*, by actual physical possession of the property by the defacto buyer; and

(c) long term leases, *i.e.* leases for a period of 12 years or more.

The provisions were introduced in the statute on the recommendation of the Direct Taxes Enquiry Committee popularly known as Wanchoo Committee (1971) Report on black money. The objective of the legislation is to counter evasion of tax through under-statement of the value of the immovable property in sale deeds and also to check the circulation of black money, by empowering the Central Government to acquire immovable properties, including agricultural lands.

1.17.02 Acquisition proceedings under these provisions can be initiated where an immovable property of fair market value exceeding Rs. 25,000 (Rs. 1 lakh with effect from 1 June 1984) is transferred for an apparent monetary consideration, which is less than the fair market value by more than 15 per cent of the apparent monetary consideration. The compensation payable on acquisition is the amount of the monetary consideration shown in the transfer document plus 15 per cent of such amount. Regarding taking over and management of the immovable properties vested in the Government under the provisions of the Income-tax Act, it was agreed in November 1976 in the Ministry of Works and Housing and the Ministry of Finance that the Central Public Works Department would take over the immovable properties from the Revenue authorities after the forfeiture had become absolute and all formalities relating to appeal etc., provided under the law have been completed and manage the same. Accordingly the Central Board of Direct Taxes issued instructions in May 1977.

1.17.03* Particulars of cases where notices of acquisition issued, acquisition made, etc., are given in the table below :—

		1982-83	1983-84	1984-85
1.	Total number of Commissioners charges.	21	21	21
2.	No. of cases where notices of acquisition issued.	11,040	12,442	19,134
3.	No. of cases where notices were withdrawn.	3,599	4,534	10,784
4.	No. of cases where acquisition made pursuant to the notice.	9	23	38£
5.	In respect of properties at 4 above :	Rs.	Rs.	Rs.
	(*a*) The value determined in respect of property acquired.	29,18,149	59,13,180	2,50,58,155
	(*b*) Whether the amount was actually paid.	—	—	—
	(*c*) Whether the acquisition was appealed against.	8	18	29
	(*d*) Expenditure incurred in the maintenance of property wherever acquired.	**	**	**
	(*e*) If the property is not resold whether rental income is received and accounted for.	**	**	**

*Figures furnished by Ministry of Finance are provisional.

£In three cases possession is still to be taken.

**Information not furnished by the Ministryof Finance.

During examination of para 1.18 of the Report of the Comptroller and Auditor General of India for the year 1981-82—Union Government (Civil) Revenue Receipts (Direct Taxes) the Public Accounts Committee (1983-84) in their 211th Report (Seventh Lok Sabha) found that as against 77 lakh intimations of sale or transfer of properties during the period (15 November 1972 to 31 March 1983), the Department issued notices in 53,310 cases, dropped acquisition proceedings in 26,616 cases, passed acquisition orders in 435 cases and actually took over 15 properties—the cases finalised representing a negligible fraction of the cases taken up. The Committee also expressed the hope that with the enhancement of the monetary limits in respect of intimations and fair market value for initiation of acquisition proceedings, the Department would show better results in future. However, during the three years 1982-83 to 1984-85 out of 43,007 cases where notices of acquisition were issued notices were withdrawn in as many as 18,917 cases and the Department acquired the properties in 70 cases only involving a value of Rs. 3.39 crores.

1.17.04 In respect of the 15 immovable properties taken over by the Department during the period 15 November 1972 to 31 March 1983, referred to in the 211th Report of the Public Accounts Committee (1983-84), against the apparent consideration of Rs. 15.15 lakhs the fair market value was estimated at Rs. 24.38 lakhs. The acquisition of these properties and their utilisation were reviewed in audit during 1984-85. The results are indicated in the following paragraphs.

(i) A person purchased in October 1974 an immovable property (a double storey building) in Delhi for an apparent consideration of Rs. 1,60,000. The fair market value of the property as determined by the Departmental Valuation Officer, in March 1975, was Rs. 2,28,400 which exceeded the apparent consideration by 42 per cent. The Competent Authority passed an acquisition order in January 1976, after obtaining the approval of the Commissioner of Income-tax.

The Central Public Works Department took possession of the property which was occupied by tenants, in March 1978 and the transferee of the property was paid a sum of Rs. 1,84,000 towards compensation.

In March 1981, the Competent Authority intimated the Central Public Works Department to take action to recover damages from the tenants for the unauthorised use and occupation of the property and initiate proceedings for eviction of unauthorised occupants. The Department was also asked to prepare draft building plan for construction of office/residential flats for approval by the Central Board of Direct Taxes.

A verification of the records in audit disclosed that

(a) the property was not taken into the Register of Buildings and Lands maintained by the Executive Engineer, Central Public Works Department,

(b) no rent had been realised from the tenants of the property, and

(c) a cheque for Rs. 1,650 towards rent from 1 February 1976 to 30 April 1977, sent by one of the tenants, lay uncashed in the Central Public Works Department.

(ii) An open plot of land admeasuring 6660 sq. feet in Baroda was sold for an apparent consideration of Rs. 26,500 in July 1973. The fair market value of the property was determined as Rs. 41,500. The acquisition order passed in August 1976 became final in September 1976. The compensation of Rs. 30,475 was paid to the transferee, and the property was taken possession of in December 1977. The property was handed over, after acquisition to the Central Public Works Department who had kept a note of the property in their Register of Immovable Properties. The property had been earmarked (February 1983) for Government use, *i.e.*, for construction of staff quarters for Government servants and construction was expected (September 1985) to commence in October 1985.

(iii) A residential property at Jalandhar was sold for a consideration of Rs. 25,000 in May 1975. The fair market value of the property was, however, determined by the Competent Authority as Rs. 1,19,290 and an order for acquiring the property issued in March 1977 became final in September 1977. In March 1979, formal possession of the property was taken over by the Competent Authority, though the property was still under the occupation of a tenant. The compensation of Rs. 28,750 was paid to the transferee in March 1979.

The Competent Authority allowed the tenant to continue in occupation to end of May 1979 on payment of fair rent of Rs. 450 per month. The tenant, however, vacated the premises only on 30 June 1980.

The tenant sent a cheque for Rs. 900 to the Competent Authority towards rent for March 1979 and April 1979. The cheque was forwarded by the Competent Authority to the Central Public Works Department for further action but the latter returned the cheque stating that since the property was under the control of the Competent Authority, the rent should be collected by that authority only. The verification in audit indicated that

(a) there was nothing to establish that the cheque was realised and the proceeds credited to the Government,

(b) no rent for the period from May 1979 to June 1980 at the rate of Rs. 450 per month would appear to have been collected from the tenant and credited to Government,

(c) neither the Income-tax Department nor the Central Public Works Department maintained any records about the property acquired, and

(d) on the tenant vacating the building on 30 June 1980, the Commissioner of Income-tax allotted it to the Income- tax Officer (Headquarters) for his occupation. The Income-tax Officer occupied the property on 24 August 1980 and a rent amounting to 10 per cent of his salary was being recovered since then.

(iv) A person sold a plot of land in Chandigarh for a sum of Rs. 49,000 in February 1976. The fair market value of the property was determined as Rs. 72,000 and as the sale consideration was found to have been understated, the Competent Authority passed an order (February 1977) for acquisition thereof, after obtaining the approval of the Commissioner of Income-tax. The compensation of Rs. 56,420 was paid to the transferee by the Central Public Works Department in June 1977. Immediately thereafter, the Central Public Works Department took possession of the plot.

Verification by Audit of the records in July 1984, disclosed the following position :

(a) The Superintending Engineer, Central Public Works Department proposed to the Chief Engineer in June 1982 that the plot should be utilised for the construction of 4 quarters for Central Public Works Department Officers and submitted preliminary estimate for the construction of quarters at the cost of Rs. 3.62 lakhs in November 1983.

(b) The proposal and the estimates are yet to be approved by the Government of India (October 1985).

(v) An owner of an immovable property in Amritsar consisting of nine shops (let out to tenants) sold it for a consideration of Rs. 63,000 in March 1973, to two parties. The fair market value of the property was fixed by the Valuation Cell of the Department as Rs. 1.08 lakhs. As the sale consideration was found to have been understated, the Competent Authority passed orders for the acquisition of the property after obtaining the approval of the Commissioner, in September 1974, which became final in 1976.

As the property was in occupation of the tenants, the possession thereof could be taken over only in April 1977, with the help of the Police Department. The compensation of Rs 71,200 (after deducting Rs. 1,250 for damages to property) was paid to the transferees in July 1977, by the Central Public Works Department. The property was not put to any use during the period from April 1977 to February 1981. The Police Department of the State occupied the building in March 1981 and set up therein a Police Post. The Central Public Works Department demanded rent at the rate of Rs. 215 per shop for the period from March 1981 onwards.

The review in Audit disclosed that

(a) no records were kept in the Central Public Works Department to watch the receipt of rent,

(b) the Central Public Works Department have claimed rent amounting to Rs. 1,02,535 for the period from March 1981 to July 1985 from the State Police Department but so far nothing has been realised (October 1985), and

(c) the State Police Department's proposal to purchase the property has not so far materialised (October 1985).

(vi) An open land admeasuring four Bighas (approximately) in Karnal was sold for a consideration of Rs. 36,000 in January 1976. The fair market value of the property was determined as Rs. 1,05,000. In view of the fact that the sale consideration was understated the Competent Authority passed an acquisition order in March 1979 which became final in August 1979. The compensation of Rs. 41,400 was paid in March 1981 and the property was taken over by the Central Public Works Department on the same day. The property was awaiting disposal (October 1985).

(vii) A factory building situated in Bahadurgarh, consisting of two units, was sold for a consideration of Rs. 81,000 in April 1973. The fair market value of the property was determined as Rs. 1,04,972. As the sale consideration was found to have been understated, the Competent Authority passed an acquisition order in May 1976 which became final in November 1977. The compensation of a sum of Rs. 1,23,826 was paid in July 1980 and immediately thereafter the property was taken possession of. The property is still under the possession of the Commissioner of Income-tax concerned and had not been handed over to the Central Public Works Department. The Revenue Department had employed a Chowkidar for looking after the property and had incurred an expenditure of Rs. 27,974 till June 1984, towards his salary and allowances. The property remained to be disposed of.

(viii) A plot of land and a godown in Allahabad, were sold to an association of persons for a sum of Rs. 45,000 in March 1974. The fair market value of the property was determined as Rs. 70,000. As the fair market value was higher than the sale consideration plus 15 per cent thereof, the Competent Authority passed an acquisition order in October 1975 which became final in August 1979. No compensation was paid as one of the transferees filed (1979) a writ petition before the High Court against the acquisition order and taking over possession of the property. In October 1982 the Court allowed the writ petition and quashed the acquisition proceedings.

(ix) A residential property at Allahabad was sold to a group of persons for a consideration of Rs. 1,20,000 in November 1974. The fair market value of the property was Rs. 2,06,000. As the sale consideration was found to have been understated, an acquisition order was passed in January 1976 which became final in August 1979. The possession of the property was taken over by the Central Public Works Department in August 1979. In January 1980, the Central Public Works Department informed the Income-tax Department that no compensation for the property could be paid as the owners had not claimed it.

The property had been let out to a number of tenants who deposited the monthly rent in the Central Public Works Department. A register of rent is maintained by the Central Public Works Department to watch the recovery of the rent. One of the tenants, however, filed a writ petition (1979) in the Allahabad High Court against the acquisition order and the appeal was allowed in his favour (1982) on the grounds that the petitioner was not given any opportunity to raise objection to the acquisition as provided in the Income-tax Act. The Central Board of Direct Taxes advised the Competent Authority (August 1983) against filing Special Leave Petition before the Supreme Court.

(x) An individual sold a plot of land situated in Varanasi to a private limited company stationed at Calcutta in January 1974, showing the apparent consideration as Rs. 3,50,000. The fair market value of the property was, however, determined as Rs. 5,62,000. As the fair market value was found to be in excess of the apparent consideration plus 15 per cent thereof, the Competent Authority issued a notice for acquisition of the property in November 1975 which became final in May 1980 when the property was taken over by the Income-tax Department. A compensation of Rs. 4,02,500 was paid by the Central Public Works Department.

Forty residential quarters for the Income-tax Department had been constructed in the plot during 1984-85 and a proposal made in July 1982 to build additional 60 quarters for the Officers of the Central Excise Department is yet to fructify.

(xi) Two vacant plots in Meerut were sold to two parties in January 1975 for Rs. 36,932 and Rs. 22,827 and the fair market value of the two properties was determined at Rs. 55,400 and Rs. 34,240 respectively. In view of the fact that the fair market value exceeded the apparent consideration by more than 15 per cent, the Competent Authority issued notices in March 1976 for the acquisition of two properties which became final in May 1976.

It was found in Audit that the property had not been taken possession either by the Central Public Works Department or the Competent Authority. Further, according to the Competent Authority, the transferees had sold some part of the properties after they were acquired by him.

According to the Competent Authority, the plots of land were not required for Government use. However, no steps have been taken to dispose of the properties (October 1985).

(xii) A property situated in Chowringhee Road in Calcutta was sold by a company to another company for a consideration of Rs. 5 lakhs in April 1973. The fair market value of the property was determined as Rs. 7,18,000. As the sale consideration was found to have been understated by more than the prescribed

percentage, the Competent Authority issued a notice in September 1974 for the acquisition of the property, which became final in February 1976. The property was taken over by the Central Public Works Department in December 1978 and the compensation of Rs. 5,75,000 was paid in February 1979.

The property was under the occupation of Indian Oil Corporation under a lease agreement entered into with the transferor of the property at a monthly rent of Rs. 7,562.50 per month. The Central Public Works Department has proposed construction of transit residential accommodation for Government officers on the property but so far no progress has been made in this regard.

Conclusion :

Despite the understanding reached between the Ministry of Works and Housing and Ministry of Finance in November 1976 and the instructions of the Central Board of Direct Taxes in May 1977 regarding acquisition, possession, custody and disposal of properties, the particulars of the 15 properties as above bring out that

(i) after acquisition the properties were not taken into the special records relating to immovable properties;

(ii) if tenanted, recovery of rents due was not watched and rents realised as and when falling due;

(iii) if required for Government use, early action was not taken to put the acquired properties to beneficial use;

(iv) if not required for Government use, no action was taken to dispose them off in public auction and replenish Government funds invested in the acquisition; and

(v) proper arrangements were not made to safeguard the property till they find final disposal.

The Public Accounts Committee (1983-84)—Seventh Lok Sabha in their 211th Report had expressed their trust that the properties acquired under the Act will be utilised in the best interest of Government. The Committee desired that prompt decisions should be taken by Government in regard to their retention/disposal. The Committee are particular that in no case any of the acquired properties should be allowed to be used for any individual officer of the Department.

It will be seen from above that

(i) 7 properties acquired during June 1977 to March 1981 at a total cost of Rs. 4.06 lakhs have not been put to any use by the Government;

(ii) 3 properties acquired during 1977-79 at a total cost of Rs. 6.46 lakhs are under lease to Police Department/Indian Oil Corporation; and

(iii) one property acquired in March 1979 at a cost of Rs. 0.29 lakh is being used by an Income-tax Officer as residence.

1.18 **Functioning of Valuation Cells**

The Central Government established in October 1968, a departmental Valuation Cell manned by Engineering Officers taken on deputation from the Central Public Works Department to assist the assessing officers under various direct tax laws. Certain details about the functioning of the Valuation Units under the Cell are given in the following sub-paragraphs :

(i) No. of Valuation Units/Districts :

Year	No. of Units	No. of Districts
1982-83	80	11
1983-84	80	11
1984-85	79	12

	Income Tax	Wealth Tax	Gift Tax	Estate Duty
(ii) No. of cases referred :				
1982-83	11,619	15,815	129	599
1983-84	13,138	15,585	166	633
1984-85	13,344	14,492	208	925
(iii) No. of cases decided :				
1982-83	9,864	11,444	101	424
1983-84	10,849	10,580	100	417
1984-85	10,636	10,976	168	639
(iv) No. of cases pending :				
1982-83	1,755	4,369	28	175
1983-84	2,289	5,005	66	216
1984-85	2,708	3,516	40	286

1.19 **Revenue demands written off by the department**

(i) *Income-tax*

A demand of Rs. 1,681.28 lakhs in 1,97,126 cases was written off by the department during the year 1984-85, of this a sum of Rs. 129.96 lakhs relate to

230 company assessees and Rs. 1,551.32 lakhs to 1,96,896 non-company assessees. Income-tax demands written off by the department during the year 1984-85 are given below category-wise :

(Amount in lakhs of rupees)

	Companies		Non-Companies		Total	
	No.	Amount	No.	Amount	No.	Amount
1 2	3	4	5	6	7	8
I. (*a*) Assessees having died leaving behind no assets or have become insolvent.	63	74.11	2,926	59.82	2,989	133.93
(*b*) Companies which have gone into liquidation and are defunct	50	35.27	..	..	50	35.27
TOTAL	113	109.38	2,926	59.82	3,039	169.20
II. Assessees being untraceable	17	8.60	66,842	497.71	66,859	506.31
III. Assessees having left India	6	0.17	15,715	115.92	15,721	116.09
IV. Other reasons :						
(*a*) Assessees having no attachable assets	81	8.92	19,176	200.90	19,257	209.82
(*b*) Amount being petty, etc.	7	2.77	72,506	543.29	72,513	546.06
(*c*) Amount written off as a result of scaling down of demands	6	0.12	19,223	128.94	19,229	129.06
TOTAL	94	11.81	1,10,905	873.13	1,10,999	884.94
V. Amount written off on grounds of equity or as a matter of international courtesy or where time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	..	..	508	4.74	508	4.74
GRAND TOTAL	230	129.96	1,96,896	1,551.32	1,97,126	1681.28

(ii) Wealth-tax, Gift-tax and Estate Duty demands written off by the department during the year 1984-85 are given below category-wise :—

(Amount in lakhs of rupees)

	Wealth-tax		Gift-tax		Estate Duty	
	No.	Amount	No.	Amount	No.	Amount
1 2	3	4	5	6	7	8
I. (*a*) Assessees having died leaving behind no assets or become insolvent	4	0.13	11	0.06	..	..
(*b*) Companies which have gone into liquidation and are defunct	..	..	..	..	..	..
TOTAL	4	0.13	11	0.06	..	..
II. Assessees being untraceable	37	0.48	94	0.31	..	..
III. Assessees having left India	..	..	..	..	..	..
IV. Other reasons :						
(*a*) Assessees who are alive but have no attachable assets	31	8.36	59	0.59	..	..
(*b*) Amount being petty, etc.	168	1.50	588	5.31	64	0.16
(*c*) Amount written off as a result of scaling down of demands	..	..	..	..	..	..
TOTAL	199	9.86	647	5.90	64	0.16
V. Amount written off on grounds of equity or as a matter of international courtesy or where time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	..	..	..	..	..	..
GRAND TOTAL	240	10.47	752	6.27	64	0.16

(iii) *Demands written off in the absence of relevant records*

Arrears of outstanding demands of tax may be rendered irrecoverable if an assessee has no attachable assets or has become insolvent or is untraceable or dies leaving behind no assets. In the case of a firm or company tax arrears are rendered irrecoverable if the firm or company is dissolved/has gone into liquidation and the business is discontinued, with the assessee having no attachable assets.

There is no specific provision in the Income-tax Act or in any of other direct taxes for writing off the tax arrears which become irrecoverable. As per the Delegation of Financial Power Rules, 1978, the Commissioners of Income-tax have full powers to write off irrecoverable balances of tax dues, subject to a report to the next higher authority.

The Central Board of Direct Taxes have issued instructions empowering the income-tax authorities to write off irrecoverable tax arrears in the following manner :—

Name of authority	Monetary Powers
Commissioner of Income-tax	Full powers in each case.
Inspecting Assistant Commissioner.	Upto Rs. 10,000 in each case.
Income-tax Officer Grade 'A'	Upto Rs. 10,000 in each case.

Although, the Commissioner has got full powers to write off any demand yet where the tax arrears are Rs. 10 lakhs and above in each case he is required to take the prior approval of the Central Board of Direct Taxes before passing the orders of write off of tax arrears as irrecoverable. The administrative approval to the proposal of the Commissioner is accorded in the following manner :—

Where the tax arrears are between Rs. 10 lakhs and upto Rs. 25 lakhs.	Individual member of the Board.
Where the tax arrears are above Rs. 25 lakhs and upto Rs. 50 lakhs.	Full Board.
Where the tax arrears are above Rs. 50 lakhs.	Full Board with the prior approval of the Minister.

In para 1.18(iii) of the Report of Comptroller and Auditor General of India for the year 1982-83 (Revenue Receipts—Volume II) mention was made about write-off by the department of demands amounting to Rs. 102.83 lakhs in 108 cases during the years 1979-80 to 1981-82 on the grounds that relevant assessment records, papers relating to recovery proceeding, etc., were missing or were not traceable.

A test check conducted in 13 Commissioners' charges revealed that in 78 cases involving a sum of Rs. 143.43 lakhs, demands were written off by the department during the years 1982-83 to 1984-85 for reasons of absence of relevant assessment records. The cases written off *inter alia* included a case where the demand written off was Rs. 111.96 lakhs, brief details of which are given below :—

A Hindu undivided family owed Rs. 149.27 lakhs towards the income-tax dues for the assessment years 1945-46 to 1959-60 and 1961-62 to 1965-66 and excess profits tax relating to the period 1940 to 1946. Tax Recovery Certificates were issued between March 1958 and March 1967 for the entire tax dues. The 'karta' of the Hindu undivided family died on 1 November 1965 and the business activities were discontinued thereafter. The Zonal Committee recommended in December 1976 and February 1977 write off of part of the demands. According to the minutes of the Zonal Committee held in February 1977—

> "The case was first started by the Income-tax Officer, Raigarh. It was later transferred to the Income-tax Officer, Special Investigation Circle, 'B' Ward, Nagpur. Subsequently, the file had been transferred to the Income-tax Officers at Raipur and Delhi and ultimately the case records of the assessee were transferred to the Income-tax Officer, District II(1) Calcutta on 7 August 1969 in view of the fact that most of the properties and assets were located in Calcutta and a number of suits relating to those properties were being contested before Calcutta High Court. Needless to say that revisions rectifications, appeals, Tribunal's orders had taken place at all these places. Many court cases and writ petitions had also been filed from time to time. Since complete records are not available, it is not possible to chronologically note all these occurrances as also the returned income, assessed income, revised income, demand raised, demand realised, date of assessments, etc., and of revision and appeal orders."

In March 1983, the Board conveyed the administrative approval to the Commissioner for write off of tax demand of Rs. 111.96 lakhs out of the total demand of Rs. 149.27 lakhs outstanding. On 30 March 1983, the Commissioner issued orders for writing off of the demand of Rs. 111.96 lakhs, keeping alive the balance demand of Rs. 37.31 lakhs.

A specific finding that the loss of revenue did not disclose a defect in rules or procedure and that

there had been no serious negligence on the part of any government servant calling for disciplinary action, as rquired under the Financial Rules, had not been recorded in the case.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

1.20 *Outstanding audit objections*

As on 31 March 1985, 1,06,657 audit objections involving revenue of Rs. 321.70 crores (approximately) raised by the internal audit of the department and by the statutory audit, are pending without settlement. Of these, 9208* cases (only major cases) of the internal audit accounted for Rs. 90.58 crores. The remaining 97,449 were statutory audit objections involving Rs. 231.12 crores.

(i) *Internal Audit*

Internal Audit was introduced in the department in June 1954. Initially, the scope was limited to checking the arithmetical accuracy of computation of income and determination of tax. However, after the introduction of the statutory audit in 1960, the scope of internal audit was widened and is now co-extensive with that of statutory audit. There are 150 internal audit parties (including special parties) sanctioned as on 31 March 1985. Out of these 144 internal audit parties were actually working.

The work of the internal audit is supervised by the Income-tax Officers (Internal Audit) and by Inspecting Assistant Commissioners (Audit) under the overall charge of Commissioners of Income-tax. The Central Board of Direct Taxes have laid down that mistakes pointed out in internal audit should be rectified within 3 months from the date of intimation to the assessing officer. The assessing officers have to ensure that the rectifications are effected before action becomes time-barred.

As per the Monthly Reports drawn up by the Directorate of Inspection (Income-tax and Audit) of the department, the number of major objections (with tax effect of Rs. 10,000 and above, under income-tax and Rs. 1,000 and above under other direct taxes) disposed of and pending during the five year period 1980-81 to 1984-85 are as follows :

Financial Year	No. of cases for disposal and amount	No. of cases disposed of and amount	Percentage of disposals to total number of cases for disposal	No. of pending cases and amount
		(Amount in crores of rupees)		
1980-81	16,114 131.19	3,894 21.50	24.16 16.38	12,220 109.69
1981-82	18,036 141.86	5,039 23.56	27.94 16.61	12,997 118.30
1982-83	17,218 143.85	5,516 49.16	32.03 34.19	11,702 94.69
1983-84	16,335 133.74	5,415 36.43	33.15 27.24	10,920* 97.31
1984-85	16,167 138.46	6,959 47.88	43.04 34.58	9,208* 90.58

NOTE : *Out of pending cases at the end of 1984-85, 5,838 items of value of Rs. 57.94 crores were over 1 year old.

No year-wise analysis of the age of the pending items is being undertaken by the Central Board of Direct Taxes to enable them to watch that old items are cleared expeditiously.

(ii) *Statutory Audit*

(a) As on 31 March 1985, 97,449 objections, involving a revenue of Rs. 231.12 crores, are outstanding without final action. The year-wise particulars of the pendency, as compared to the position as on 31 March 1984, are as follows :—

*Figures furnished by the Central Board of Direct Taxes.

Amount of tax effect (in crores of rupees)

Year	Position as on:	Income-tax		Wealth-tax		Gift-tax		Estate Duty		Total	
		Items	Rev. effect	Items	Rev. effect	Items	Rev. effect	Items	Rev. effect	Items	Rev. effect
Upto 1979-80 and earlier years.	(*i*) 31-3-84	49,498	72.69	8,433	8.37	2,186	3.61	873	8.28	60,990	92.95
	(*ii*) 31-3-85	36,424	65.58	5,412	5.35	1,564	2.87	678	8.15	44,078	81.95
1980-81	(*i*) 31-3-84	11,587	21.41	2,456	2.26	480	2.12	330	0.20	14,853	25.99
	(*ii*) 31-3-85	8,749	20.58	1,604	1.70	328	0.83	304	0.16	10,985	23.27
1981-82	(*i*) 31-3-84	12,488	29.07	2,298	3.11	507	0.89	361	0.95	15,654	34.02
	(*ii*) 31-3-85	9,958	19.21	1,698	2.22	343	0.79	302	0.75	12,301	22.97
1982-83	(*i*) 31-3-84	13,991	32.70	2,303	3.29	479	1.30	272	0.37	17,045	37.66
	(*ii*) 31-3-85	11,727	29.98	1,814	2.50	334	1.06	245	0.41	14,120	33.95
1983-84	(*i*) 31-3-85	13,166	62.60	2,128	3.22	381	2.10	290	1.06	15,965	68.98
TOTAL	(*i*) 31-3-84	87,564	155.87	15,490	17.03	3,652	7.92	1,836	9.80	1,08,542	190.62
	(*ii*) 31-3-85	80,024	197.95	12,656	14.99	2,950	7.65	1,819	10.53	97,449	231.12

The reduction in the number of objections outstanding as on 31 March 1985 (*i.e.* 97,449) as compared to those outstanding as on 31 March 1984 (*i.e.* 1,08,542) and the increase in the revenue effect of the objections from Rs. 190.62 crores (as on 31 March 1984) to Rs. 231.12 crores (as on 31 March 1985) indicates that cases involving larger revenue effect were not given priority in the matter of settlement.

(b) In the following charges the total income tax involved in the outstanding objections exceeded rupees one crore.

Sr. No.	Charge	Items	Tax effect (Rs. in crores)
1.	Bombay	9,957	53.37
2.	West Bengal	7,278	40.10
3.	Tamil Nadu	6,394	28.00
4.	Uttar Pradesh	3,531	19.67
5.	Gujarat	8,578	11.09
6.	Delhi	10,399	8.03
7.	Andhra Pradesh	7,967	7.02
8.	Madhya Pradesh	3,563	6.97
9.	Karnataka	1,380	6.03
10.	Kerala	2,432	4.69
11.	Assam	1,067	4.26
12.	Orissa	661	2.37
13.	Bihar	3,518	1.83
14.	Jammu & Kashmir	718	1.67
15.	Punjab	7,683	1.57

(c) In the following charges total wealth-tax involved in the outstanding objections exceeded rupees 20 lakhs.

Sr. No.	Charge	Items	Tax effect (Rs. in lakhs)
1.	Madhya Pradesh	899	240.68
2.	Andhra Pradesh	1,222	238.32
3.	Tamil Nadu	1,281	232.02
4.	Bombay	1,435	193.97
5.	Gujarat	1,279	156.08
6.	West Bengal	1,151	95.95
7.	Uttar Pradesh	992	64.76
8.	Delhi	1,342	58.97
9.	Assam	318	55.55
10.	Karnataka	592	51.96
11.	Rajasthan	484	30.11
12.	Orissa	101	28.43
13.	Kerala	429	24.24

(d) In the following charges total gift-tax involved in the outstanding objections exceeded rupees 10 lakhs.

Sr. No.	Charges	Items	Tax effect (Rs. in lakhs)
1.	Gujarat	263	305.09
2.	Bombay	261	285.78
3.	West Bengal	401	46.55
4.	Tamil Nadu	243	37.58
5.	Madhya Pradesh	231	17.85
6.	Andhra Pradesh	501	15.41
7.	Karnataka	181	12.62
8.	Kerala	216	12.61

(e) In the following charges the total estate duty involved in the outstanding objections exceeded rupees 10 lakhs.

Sr. No.	Charges	Items	Tax effect (Rs. in lakhs)
1.	Andhra Pradesh	71	705.74
2.	Madhya Pradesh	170	83.40
3.	West Bengal	371	124.61
4.	Tamil Nadu	203	37.37
5.	Bombay	138	23.24
6.	Karnataka	25	15.10
7.	Gujarat	55	12.68
8.	Kerala	40	10.59

(iii) *Steps taken to settle objections*

(a) Inadequacy of control machinery : The Central Board of Direct Taxes have laid down in April 1970 that the Department should furnish replies to the audit objections within 45 days of receipt of the audit objections. In February 1975, the Board introduced a system of selective control in relation to audit objections. The Commissioner is responsible for ensuring remedial action within a month of the receipt of the local audit report in cases where the tax involved is Rs. 25,000 or more in income-tax and Rs. 5,000 or more in other direct taxes cases. The Range Inspecting Assistant Commissioners are responsible for remedial action in respect of objections involving revenue between Rs. 10,000 and Rs. 25,000 in income-tax and Rs. 1,000 and Rs. 5,000 in respect of other direct taxes.

Pursuant to recommendations of the Public Accounts Committee in their 75th Report 1981-82 (Seventh Lok Sabha) the Central Board of Direct Taxes issued instructions in February 1984 that an inter-departmental machinery should be set up to

expedite settlement of audit objections and to sort out contentious issues. Monthly meetings between Inspecting Assistant Commissioner (Audit) from income-tax side and the Deputy Accountant General/Senior Deputy Accountant General/Joint Director from audit side and quarterly meetings between Commissioners of Income-tax and Accountants General (Audit)/ Directors of Audit are to be held with a view to settle objections having large revenue effect.

Despite the aforesaid instructions issued by the Board, much headway has not been made in the settlement of audit objections particularly old objections and objections having large revenue effect, as many as 44,078 outstanding objections involving revenue of Rs. 81.95 crores relate to 1979-80 and earlier years.

It is apparent that the control system is inadequate as the pace of settlement of audit objections is unsatisfactory. The action plan target of the department for 1984-85 included 100 per cent disposals of all arrear major audit objections (both internal and statutory) and the clearance of objections raised during 1984-85 (upto December 1984) by 31 March 1985 and this is nowhere near achievement.

(b) Remedial action barred by time : With a view to having an effective control over the pursuance and settlement of objections raised by the statutory audit and to ensure rectification/revision before objections become barred by time, the Central Board of Direct Taxes had, in pursuance of the recommendation by Public Accounts Committee (46th Report, Third Lok Sabha—1965-66) issued instructions in February 1966 prescribing maintenance of a Register in the Commissioners' offices. In May 1977, the Central Board of Direct Taxes instructed that two registers (one for major and one for minor objections) should be maintained by each Income tax Officer.

In a case where remedial action was initiated after considerable delay on an objection raised in revenue audit, the Public Accounts Committee in para 5.16 of their 38th Report (1980-81—Seventh Lok Sabha) observed as under :

> "It is a matter of regret that audit objections are not being attended to expeditiously inspite of the fact that specific instructions have been issued by the Central Board of Direct Taxes from time to time whereby the Commissioners of Income-tax have been made personally responsible for carefully examining and issuing necessary instructions to Income-tax Officers in cases where substantial revenue is involved. On a large number of cases, remedial actions have been unduly delayed, although the mistakes pointed out by audit were obvious. The Committee would like to emphasise that audit objections should be given prompt attention."

Noticing a case of loss of revenue of Rs. 4,57,257 due to omission to take prompt action on an audit objection, the Public Accounts Committee in para 4.6 of their 85th Report (1981-82—Seventh Lok Sabha) commented as below :

> "The Committee would also emphasise that in view of the limitations of time laid down in the fiscal laws for remedial action, it is essential that audit objections, those raised by the Internal Audit as well as those raised by Revenue Audit, should be given prompt attention at various levels from the Income-tax Officers right up to the Commissioners of Income-tax so as to make sure that the points involved are properly examined and the most appropriate remedial action is taken well in time."

Despite these instructions, there have been instances of heavy losses of revenue on account of lack of timely action on objections raised by Revenue Audit which resulted in remedial action being barred by limitation of time. A few illustrative cases are given blow :

(1) The Department did not initiate remedial action in time on 25 audit objections (income-tax, wealth-tax and gift-tax) relating to 13 Commissioners of Bombay and Nagpur, pointing out short assessments. These objections were issued to the department between February 1978 and February 1984. This failure to take remedial action in proper time resulted in the claims becoming barred by limitation of time leading to loss of revenue of Rs. 9,33,371. The Department accepted the mistakes between November 1984 and April 1985 but expressed inability to initiate remedial action due to limitation of time.

(2) It was also noticed during test audit that in another three cases in three Commissioners' charges, loss of revenue amounting to Rs. 13,58,198 occurred due to Department's failure to take timely

action on audit objections although time was available for rectificatory action when the mistakes were initially brought to notice. The details are as under :—

Sr. No.	Commissioner's Charge/ Assessment year	Nature of objection	Date of pointing out of the mistake by Internal Audit/ Receipt Audit	Date upto which rectificatory action could be taken	Loss of revenue Rs.
1.	A 1978-79	Non-withdrawal of development rebate already allowed on transfer of asset.	September 1981 (Receipt Audit)	March 1982	8,06,387
2.	B 1976-77	Non-reduction of opening balance of stock in the light of Appellate Authority's Orders.	October 1979 (Internal Audit)	September 1983	3,64,124
3.	C 1976-77	Non-deduction of 15 per cent of interest payments on deposits from the public.	September 1980 (Internal Audit)	September 1983	1,87,687

(iv) *Non receipt of Board's comments on draft paragraphs*

Under the existing procedure all important audit objections are communicated to the Revenue Department initially through audit memos and local audit reports. Adequate time is available to its field formations to examine the validity of the audit objections and furnish replies to Audit. Thereafter paragraphs are issued to the Ministry of Finance, Central Board of Direct Taxes in respect of more important cases involving substantial revenue, which are likely to find a place in the Audit Report and the Board is required to furnish their comments thereon within six weeks. As an audit paragraph case passes through stage of local audit memo, local audit report etc., generally about 7-8 months are available to the department for dealing with Audit paragraph cases. There are instructions of the Board that all draft paragraph cases should receive personal attention of the Commissioners of Income-tax and replies thereto furnished to the Board with the utmost expedition, and in any case within a period of 30 days of the receipt of the draft paragraph from the Board. Despite these instructions the comments of the Board on the draft paragraphs issued in Audit are not being received according to the time schedule laid down. For the Audit Report 1984-85, 864 draft paragraphs (on Income-tax, Wealth-tax, Gift-tax and Estate Duty cases) involving a total revenue of Rs. 39.71 crores were issued to the Board for which comments have been received only in respect of 406 draft paragraphs (January 1986). Lack of action or belated action in respect of these cases is likely to result in loss of revenue on account of claims becoming time-barred.

The review was sent to the Ministry on 18 October 1985; their comments are awaited.

1.21 **Results of test audit in general**

(i) *Corporation-tax and Income-tax*

During the period under report test audit of the documents of the Income-tax Offices revealed total under-assessment of tax of Rs. 9,609.59 lakhs in 17,943 cases.

Of the total 17,943 cases of under-assessment short-levy of tax of Rs. 9,003.82 lakhs was noticed in 2,512 cases alone. The remaining 15,431 cases accounted for under-assessment of tax of Rs. 605.77 lakhs.

The under-assessment of tax of Rs. 9,609.59 lakhs is due to mistakes categorised broadly under the following heads :—

	No. of cases	Amount (In lakhs of rupees)
1	2	3
1. Avoidable mistakes in computation of tax	1536	272.51
2. Failure to observe the provisions of the Finance Acts	300	141.26
3. Incorrect status adopted in assessments	300	97.79
4. Incorrect computation of salary in-come	575	49.72
5. Incorrect computation of income from house property	672	54.73
6. Incorrect computation of business income	3059	2546.06
7. Irregularities in allowing depreciation and development rebate	1543	2153.11

1	2	3
8. Irregular computation of capital gains	220	174.75
9. Mistakes in assessment of firms and partners	737	90.45
10. Omission to include income of spouse/ minor child etc.	84	20.17
11. Income escaping assessment	1694	1038.46
12. Irregular set off of losses	412	958.26
13. Mistakes in assessments while giving effect to appellate orders	60	12.82
14. Irregular exemptions and excess reliefs given	1628	429.56
15. Excess or irregular refunds	534	63.83
16. Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1802	318.03
17. Avoidable or incorrect payment of interest by Government	314	83.67
18. Omission/Short levy of penalty	625	157.71
19. Other topics of interest/miscellaneous	1721	483.61
20. Underassessment of surtax/super profits tax	127	463.09
Total	17,943	9,609.59

(ii) *Wealth-tax*

During test audit of assessments made under the Wealth-tax Act, 1957 short levy of Rs. 334.91 lakhs was noticed in 3,220 cases.

The under-assessment of tax of Rs. 334.91 lakhs was due to mistakes categorised broadly under the following heads :

	No. of cases	Amount (In lakhs of rupees)
1	2	3
1. Wealth escaping assessment	699	123.32
2. Incorrect valuation of assets	713	100.46
3. Mistakes in computation of net wealth	480	27.83
4. Incorrect status adopted in assessments	126	6.89
5. Irregular/excessive allowances and exemptions	465	20.76
6. Mistakes in calculation of tax	313	11.66
7. Non-levy or incorrect levy of additional wealth-tax	64	18.45
8. Non-levy or incorrect levy of penalty and non-levy of interest	173	8.57
9. Miscellaneous	187	16.97
Total	3,220	334.91

(iii) *Gift-tax*

During the test audit of gift-tax assessments it was noticed that in 612 cases there was short levy of tax of Rs. 234.86 lakhs.

(iv) *Estate Duty*

In the test audit of estate duty assessments it was noticed that in 638 cases there was short levy of estate duty of Rs. 96.13 lakhs.

CHAPTER 2

CORPORATION TAX

2.01 The trend of receipts from corporation-tax i.e. income-tax and surtax payable by companies was as follows during the last five years :—

Year	Amount (In crores of rupees)
1980-81	1,377.45
1981-82	1,969.96
1982-83	2,184.51
1983-84	2,492.73
1984-85	2,555.89

2.02 According to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, there were 1,09,665 companies as on 31st March 1985. These included 324 foreign companies and 1677 associations "not for profit" registered as companies limited by guarantee and 295 companies with unlimited liability. The remaining 1,07,369 companies comprised 980 Government companies and 1,06,389 non-Government companies with paid up capitals of Rs. 21,447.3 crores and Rs. 5838.5 crores respectively. Among non-Government companies, over 86 per cent (92,240) were private limited companies with a paid up capital of Rs. 1578.1 crores.

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

As on 31st March	Number
1981	44,125
1982	46,355
1983	48,597
1984	52,951
1985	58,478

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

Year	No. of assessments		Amount of demand	
	Completed during the year	Pending at the close of the year	Collected during the year	in arrears at the close of the year
			(In crores of rupees)	
1980-81	44,937	52,250	1377.45	290.95
1981-82	47,238	55,861	1969.96	311.74
1982-83	47,505	57,638	2184.51	442.07
1983-84	51,923	61,599	2492.73	619.33
1984-85	64,059	57,861	2555.89	1028.17

2.05 Some instances of mistakes noticed in the assessments of companies under the Income-tax Act and the Surtax Act, 1964 are given in the following paragraphs. In a number of these cases, assessment work had been done by Inspecting Assistant Commissioner (Assessment). Pursuant to the recommendations of the Public Accounts Committee, the Revenue Department created in October 1978, the institution of Inspecting Assistant Commissioners (Assessment) with a view to utilising the experience gained by Senior Officers, amongst other things on making assessments in bigger and complicated cases. The mistakes pointed out in these paragraphs would indicate that the expectations of improvement in the standard of performance and reduction in the possibility of mistakes on the introduction of Inspecting Assistant Commissioners of Income-tax for assessment work remain largely to be realised.

2.06 Avoidable mistakes in the computation of income-tax

Under-assessment of tax on account of mistakes in the determination of tax payable or in the computation of total income, attributable to carelessness or negligence involving substantial losses of revenue have been reported every year.

The Public Accounts Committee in paragraph 5.21 of their 186th Report (5th Lok Sabha), in paragraphs 5.11, 6.13 and 6.14 of their 196th Report (5th Lok Sabha) and in paragraphs 5.24 and 5.25 of their 51st Report (7th Lok Sabha) expressed concern over under-assessment of tax on account of mistakes due to carelessness or negligence, which could have been avoided had the assessing officers and their staff been a little more vigilant. The Central Board of Direct Taxes in their instructions issued in December 1968, May 1969, October 1970, October 1972, August 1973, January 1974 and the Directorate of Inspection (Income-tax) in their circular issued in July 1981 emphasised the need for ensuring arithmetical accuracy in the computation of income and tax, carry forward of figures etc.

Inspite of these repeated instructions such mistakes continue to occur.

The under-assessment of tax due to avoidable mistakes in the computation of income or tax noticed in the test audit of assessment records from the year 1980-81 onwards are given below :—

Year	Number of items	Amount of tax under assessed
		(In lakhs of rupees)
1980-81	1,288	65.33
1981-82	1,133	71.92
1982-83	1,548	127.04
1983-84	1,533	458.94
1984-85	1,536	272.51

A few illustrative cases noticed in audit are given in the following paragraphs.

(i) In the case of six companies in six commissioners' charges assessed between September 1983 and March 1984 for the assessment years 1980-81 and 1981-82, owing to dropping of digits in adopting the figures for determining the taxable income, there was short computation of income by Rs. 17,00,000 in four companies and excess carry forward of loss of Rs. 7,76,949 in the remaining two companies. As a result there was total short levy of tax of Rs. 9,72,250 in four cases and potential tax effect of Rs. 5,32,144 in two cases involving carry forward of loss.

Of these, in one case while making the assessment, the Inspecting Assistant Commissioner (Assessment) wrongly added back a sum of Rs. 14,05,223 instead of the correct amount of Rs. 24,05,223 resulting in short computation of income of Rs. 10,00,000. In another case instead of deducting a sum of Rs. 4,68,746 on account of donation for separate consideration, a sum of Rs. 68,746 only was deducted by the Income-tax Officer leading to under-assessment of income by Rs. 4,00,000. In yet another case the Inspecting Assistant Commissioner (Assessment) disallowed a sum of Rs. 5,69,249 only against the actual inadmissible deduction of Rs 6,69,249 leading to under-charge of income by Rs. 1,00,000. In another case the income of the company was computed as Rs. 75,216 although the correct income worked out to Rs. 7,52,165.

The Ministry of Finance have accepted the mistake in two cases and their comments in respect of the remaining four cases are awaited (January 1986).

(ii) While computing the income chargeable to tax, the assessing officer takes the profit or loss as per the Profit and Loss Account of the assessee as the starting point and then adds back or deducts the amount not allowable or which require separate consideration.

In the case of eleven companies assessed in ten different commissioner's charges between August 1982 and March 1984 for the assessment years 1972-73, 1979-80 to 1981-82 and 1983-84 failure to add back the expenditure already debited to the respective Profit and Loss Account of the companies while allowing the admissible expenditure at the time of assessment or erroneous deduction of same expenditure twice over rsulted in under-assessment of income of Rs. 24,68,330 in nine cases involving short levy of tax of Rs. 14,55,803 and excess carry forward of loss by Rs. 10,82,742 with a potential tax effect of Rs. 6,61,968 in the remaining two cases.

Four of these assessments were made by Inspecting Assistant Commisioner (Assessment) the details of which are as under :—

(a) Bad debts amounting to Rs. 4,50,366 disallowed, for want of proof of the debt having become bad, was omitted to be included while computing chargeable income.

(b) Disallowed capital expenditure of Rs. 2,27,723 debited to the profit and loss account was omitted to be included while computing the assessable income.

(c) A sum of Rs. 90,099 on account of entertainment expenditure debited to profit and loss account was omitted to be added to income even though the maximum allowable expenditure of Rs. 30,000 on this account had been allowed separately.

(d) Expenditure of Rs. 1,01,172 relating to the house property debited to the profit and loss account of a company was not added back although the admissible deduction in the computation of income under house property was allowed separately.

Of the eleven assessments, three assessments were checked by the internal audit party of the department, but the mistakes escaped its notice.

The Ministry of Finance have accepted the mistakes in four cases and their comments in the remaining cases are awaited (January 1986).

(iii) In 12 cases owing to arithmetical mistakes in the computation of assessable income and tax leviable thereon income was short computed by Rs. 24,29,381 resulting in undercharge of tax of Rs. 17,38,645 in ten cases and excess carry forward of unabsorbed depreciation/loss of Rs. 16,35,939 involving a potential tax effect of Rs. 9,55,325 in the remaining two cases.

The details are given below :

Sl. No.	C.I.T. charge/ assessment year	Nature of the mistake	Tax effect/ Revenue involved
1.	A 1980-81	Interest on short payment of advance tax was calculated as Rs. 5,34,265 instead of as Rs. 8,34,265.	Rs. 3,00,000
2.	B 1978-79	Income from house property and income from other sources adopted at Rs. 21,27,709 and Rs. 1,53,368 as against the correct amounts of Rs. 21,71,709 and Rs. 5,98,506 respectively.	Rs. 2,82,477
3.	C 1977-78	The value of opening stock was required to be reduced by Rs. 11,49,102 to arrive at the value of closing stock. Instead the value of closing stock was reduced by Rs. 11,49,102.	Rs. 2,63,098
4.	D 1976-77	The company was assessed on an income of Rs. 1,02,83,600. Subsequently while giving effect to appellate orders the incomes of the company was adopted as Rs. 1,00,65,600 instead of Rs. 1,02,83,600.	Rs. 1,88,658
5.	E 1980-81	Income-tax on a total income of Rs. 59,35,052 was calculated as Rs. 31,64,450 instead of the correct amount of Rs. 32,64,279.	Rs. 1,07,315
6.	F 1981-82	Unabsorbed business losses and depreciations of Rs. 59,90,359 and Rs. 1,16,99,380 for the assessment years 1979-80 and 1980-81 were wrongly adopted in the assessment for assessment year 1981-82 as Rs. 63,39,359 and Rs. 1,26,74,798.	Rs. 7,81,943
7.	B 1974-75	Omission to deduct refund of Rs. 1,12,890 already made in March 1978 for assessment year 1974-75 from the refund amount finally determined in November, 1982 for the same assessment year.	Rs. 1,12,890
8.	G 1981-82	Double allowance of expenditure of Rs. 2,80,084.	Rs. 1,24,201
9.	H 1981-82	Depreciation of Rs. 2,81,921 already charged in the accounts was omitted to be added back though actual depreciation was allowed separately.	Rs. 1,73,382 (potential)
10.	I 1977-78	Investment allowance of Rs. 2,03,658 debited in the Profit & Loss Account was not added back though Investment allowance was allowed to the Company separately.	Rs. 1,98,786
11.	B 1980-81	Penal interest for short payment of advance tax was incorrectly calculated as Rs. 1,24,107 instead of the correct amount of Rs. 2,12,523.	Rs. 88,416
12.	J 1981-82	The period for calculating interest chargeable for non-filing of revised estimate of current income was incorrectly taken as 23 months instead of 35 months.	Rs. 72,804

Two out of the 12 companies were assessed by Inspecting Assistant Commissioner (Assessment).

The Ministry of Finance have accepted the mistakes in eight cases and their comments in respect of other cases are awaited (January 1986).

2.07 *Application of incorrect rate of tax*

Adoption of incorrect rate of tax is another common mistake. A few illustrative cases are given in the following paragraphs.

Under the provisions of the Finance Acts, as applicable to the assessment years 1979-80 to 1983-84 the income of the companies are charged to tax at the following rates.

(i) In the case of a domestic company

1. Where the company is a company in which the public are substantially interested.	
Total taxable Income upto	
(A) Rs. 1 lakh	45 per cent
(B) above Rs. 1 lakh	55 per cent
2. Where the company is a company in which the public are not substantially interested.	
(i) in the case of industrial company.	
(a) where the total income does not exceed Rs. 2,00,000.	55 per cent of the total income.
(b) where the total income exceeds Rs. 2,00,000.	60 per cent of the total income.
(ii) in any other case	65 per cent of the total income.
3. In the case of foreign companies.	
Royalties and fees.	50 per cent.
Balance income.	70 per cent.

(i) Four private non-industrial companies were taxed at the rate of 60 per cent of the total income (in one case at the rate of 55 per cent) in four different commissioners charges for the assessment years 1980-81, 1981-82 and 1983-84, instead of at the correct rate of 65 per cent incorrectly treating them as industrial companies or company in which the public are substantially interested. Similarly two other private industrial companies in two different commissioners charges were assessed to tax, for the assessment years 1979-80, 1982-83 and 1983-84 at the rate of 55 per cent instead of at the correct rate of 60 per cent, treating them erroneously as companies in which public are substantially interested. Also a foreign company deriving income from exhibition of imported cinematograph films in India was taxed at the rate of 65 per cent as applicable to a domestic non-industrial company instead of at the correct rate of 70 per cent applicable to foreign companies.

The application of incorrect rate of tax in these seven cases resulted in short levy of tax of Rs. 6,22,710.

Of these, three companies were assessed by the Inspecting Assistant Commissioner (Assessment); the assessment of one company was checked by the internal audit party of the department, and the mistake escaped its notice.

The Ministry of Finance have accepted the mistake in two cases and have not disputed the facts in another case. Their comments in respect of other cases are awaited (January 1986).

(ii) Under the Income-tax Act, 1961 a company is said to be a company in which the public are substantially interested if it is a company which is registered under Section 25 of the Companies Act, 1956 or if it is a company having no share capital and if having regard to its objects, the nature and composition of its membership and other relevant consideration, it is declared by order of the Board to be a company in which the public are substantially interested. The income of a company in which the public are substantially interested suffers a lower rate of tax at the rate of 55 per cent of the total income as against 60 or 65 per cent of total income in respect of closely held companies.

A club incorporated as a company limited by guarantee was engaged in the encouragement development and promotion of automobile movements and social friendly association amongst motorists and also to provide suitable club house at Bombay and other places was treated as a company in which public were substantially interested and was taxed at a lower rate of 55 per cent.

The club was neither registered under Section 25 of the Companies Act nor was declared by the Central Board of Direct Taxes to be a company in which the public were substantially interested and, therefore, the application of a lower rate of tax was not in order. Omission to charge the income to tax at the rate of 65 per cent in the assessments made in August 1982 and October 1982 for the assessment years 1979-80 and 1980-81 resulted in short levy of tax of Rs. 1,08,410 including short levy of interest for late filing of returns and for failure to file the estimate of higher income for payment of advance tax.

The Ministry of Finance have accepted the mistake.

(iii) Under the provisions of the Finance Act as applicable to the assessment years 1980-81 and 1981-82 surcharge on income-tax in the case of companies was leviable at the rate of seven and half per cent.

In the case of three companies, for the assessment years 1980-81 and 1981-82 the surcharge on income-tax was charged at the rate of 5 per cent (in one case at the rate of two and half per cent) instead of at the correct rate of seven and half per cent. The application of incorrect rate of surcharge resulted in short levy of tax of Rs. 1,06,721.

Two out of these three companies were assessed by Inspecting Assistant Commissioner (Assessment).

The Ministry of Finance have accepted the mistake in one case; their comments in respect of the remaining cases are awaited (January 1986).

2.08 Incorrect computation of income from house property as business income

Under the provisions of the Income-tax Act, 1961, the annual value of property consisting of buildings and lands appurtenant thereto, of which the assessee is the owner is assessable as income from house property. It has been judicially held by the Supreme Court in 1972 that the 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 head 'income from profits and gains of business or profession'.

(i) In the previous years relevant to the assessment years 1980-81 and 1981-82 a private limited company derived rental income of Rs. 11,42,957 and Rs. 10,17,082 respectively from two house properties owned by it and let out to tenants. Claiming the income as income from business, the company returned a net income of Rs. 1,30,710 and Rs. 57,480 as the total income after deducting business expenditure and depreciation for the two assessment years respectively. Accepting the contention of the company, the assessing officer assessed the income in February 1982 under the head 'profits and gains of business or profession' and determined the income after allowing the deductions as claimed by the assessee company though the income derived from letting out of the properties was correctly assessable as 'income from house property'.

The mistake resulted in under-assessment of income of Rs. 14,57,975 involving short levy of tax of Rs. 9,29,099.

The assessments were checked by the internal audit party of the department but the mistake escaped its notice.

The Ministry of Finance have accepted the mistake.

(ii) During the previous years relevant to the assessment years 1978-79 and 1979-80, a company derived income from rent on its industrial estate building and returned this income under 'Income from house property' and the assessment for these years were completed by the Inspecting Assistant Commissioner (Assessment) in September 1981 and March 1982 respectively. The assessee claimed and was allowed depreciation of Rs. 1,47,080 for the two assessment years in respect of the said property and also Rs. 30,177 in the assessment year 1979-80 on account of house tax and ground rent from his business income though the deductions were not admissible in computing income from house property. These erroneous deductions together with other minor mistakes resulted in under-assessment of income for these years by Rs. 2,09,815 respectively involving short levy of tax of Rs. 12,809 in the assessment year 1978-79 and deduction of carry forward of loss for the assessment year 1979-80 by Rs. 1,19,544 involving potential tax effect of Rs. 69,012.

The comments of the Ministry of Finance are awaited (January 1986).

Incorrect computation of business income

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

Some instances of mistakes noticed in the computation of business income in the case of companies and corporations are given in the following paragraphs.

2.09 **Mistakes in the allowance of ex-gratia or ad hoc payments**

Under the Income-tax Act, 1961 bonus paid to employees covered by the Payment of Bonus Act, 1965 in excess of the limits prescribed therein or any ex-gratia payment in addition to the bonus paid under that Act is not an admissible expenditure. The Central Board of Direct Taxes issued instructions in December 1980 clarifying that such additional payment cannot be treated as any other expenditure incurred wholly and exclusively for the purpose of business and resort cannot, therefore, be had to any other provision of the Income-tax Act to claim deduction in excess of what is admissible under the Bonus Act.

The Payment of Bonus Act, 1965 prescribes the maximum payment of bonus at a rate, not exceeding 20 per cent of the effective gross salary of the employees, subject to availability of allocable surplus. The allocable surplus is computed at the rate of 60 per cent of the available balance of profits, which is determined in the manner prescribed in the Act.

(i) During the previous years relevant to the assessment years 1979-80 to 1981-82, in Five Commissioners' charges, nine companies to which the provisions of the Payment of Bonus Act, 1965 applied made *ad hoc* ex-gratia payment amounting to Rs. 59,64,418 to their workers in addition to bonus of Rs. 1,16,23,508. The ex-gratia payment over and above the amount of bonus was not allowable in computing the income of the companies.

However, while completing the assessment for the assessment years 1979-80 to 1981-82 between June 1982 and March 1984 the ex-gratia payments made by the companies were not disallowed by the assessing officers. The omission to disallow the ex-gratia payments resulted in short computation of income by Rs. 34,91,322 involving, shorty levy of tax of Rs. 31,00,059 (including shorty levy of surtax of Rs. 4,14, 472 in one case) in the case of five companies and excess carry forward of loss of Rs. 24,73,096 involving potential short levy of tax of

Rs. 15,68,493 in the remaining cases of four companies. The assessment in one case was made by Inspecting Assistant Commissioner of Income-tax.

The Ministry of Finance have accepted the mistakes in five cases. The comments of the Ministry in respect of the other cases are awaited (January 1986).

2.10 **Incorrect allowance of gratuity and Superannuation Fund liability**

Under the Income-tax Act, 1961, any contribution made by an assessee towards an approved gratuity fund/Superannuation fund created by him for the exclusive benefit of his employees under an irrevocable trust is allowable as a deduction in computing his business income. The income tax Rules 1962 further provide that the amount to be allowed as a deduction on account of an initial contribution which an employer may make in respect of the past services of an employee shall not exceed eight and one-third per cent of the employee's salary for each year of his past service with the employer.

(i) During the previous year relevant to the assessment year 1976-77, an assessee company created a gratuity fund for the exclusive benefits of its employees which was approved by the Commissioner of Income-tax with effect from June 1975. The company had in the balance sheet for the assessment year 1977-78 disclosed that the amount payable to the trust fund upto June 1975 was actuarily valued at Rs 3,14,44,690. In the assessment for the assessment year 1980-81 completed by an Inspecting Assistant Commissioner (Special Range) in December 1983, as against the total gratuity liability of Rs. 3,14,44,690 determined by the actuary a sum of Rs. 3,97,45,806 was actually allowed as deduction in its seven income tax assessments for assessment years 1972-73 to 1976-77, 1979-80 to 1980-81. This erroneous deduction led to an excess deduction of Rs. 83,01,116 in the assessment year 1980-81 resulting in under assessment of business income of an equal amount with consequent short levy of tax of Rs. 70,17,348 (including interest on advance tax).

The actuarial valuation of contribution of Rs. 3,14,44,690 included a contribution of Rs 9,31,205 calculated at the rate exceeding eight and one-third per cent of the salary of each employee (as stated by the actuary himself) during the assessment years 1973-74 to 1976-77. The amount of Rs. 9,31,205 was therefore not deductable as a liability. While completing the assessment for the assessment year 1980-81 in December 1983, the I.A.C. (Special Range), however omitted to reduce the gratuity liability by Rs. 9,31,205 resulting in under assessment of business income by Rs. 9,31,205 and short levy of tax of Rs. 7,87,193 (including interest on advance tax).

The mistakes resulted in short levy of tax of Rs. 78,04,541 (including interest on advance tax).

The comments of the Ministry of Finance are awaited (January 1986).

(ii) In the assessment of a company for the assessment year 1974-75 (assessment made in May 1977) a sum of Rs. 23,33,000 debited to the accounts towards actual payment of gratuity to its retiring employees was allowed as deduction. In the assessment years 1972-73 and 1973-74 sums of Rs. 2,97,72,039 and Rs. 3,18,16,800 respectively being assesee's claim for gratuity liability on accrual basis and determined on actuarial valuation, which were initially disallowed, were later allowed in full in June 1977 and July 1979 respectively under appellate orders. The actuary certified that the gratuity liability for those employees retiring during the calendar year 1973 (corresponding to the assessment year 1974-75) was also covered by the above valuation. Thus allowance of gratuity liability of Rs. 23,33,000 was allowed twice, once in the assessment years 1972-73 and 1973-74 under appellate orders and again in the assessment year 1974-75. The double allowance led to under assessment of income of Rs. 23,33,000 involving undercharge of tax of Rs. 13,47,307.

The comments of the Ministry of Finance are awaited (January 1986).

(iii) The actuarial valuation of gratuity liability of a company as at the end of the previous year relevant to the assessment year 1978-79 worked out to Rs. 93,92,718. The company made a provision of Rs. 24,49,359, on account of gratuity liability in the accounts for the assessment year 1978-79 and the balance of Rs. 69,43,359 in its accounts for the assessment years 1975-76 to 1977-78 and the entire provision was allowed in the respective assessment years. For the assessment year 1972-73 a sum of Rs. 5,90,279 claimed by the assessee towards gratuity liability on actuarial valuation, but not provided in the accounts was also allowed as deduction in January 1977, while giving effect to the order of November 1976 passed by the Assistant Appellate Commissioner. It was noticed in audit that the

aforesaid gratuity liability of Rs. 5,90,279 already stood included in the amount of total gratuity liability of Rs. 93,92,718 as determined at the end of the assessment year 1978-79. Accordingly at the time of completing the assessment for the assessment year 1978-79 in February 1981 the Inspecting Assistant Commissioner (Asstt.) was to have adjusted the sum of Rs. 5,90,279 as already allowed in the assessment year 1972-73. As this was not done, there was excess allowance of gratuity liability of Rs. 5,90,279 in the assessment year 1978-79 leading to under assessment of business income by the same amount with consequent tax under charge of Rs. 3,40,887. There was also consequent surtax undercharge of Rs. 99,757.

The comments of the Ministry of Finance are awaited (January 1986).

(iv) In the case of a banking company the gratuity for the previous year ending 31st December, 1979 relevant to the assessment year 1980-81 was calculated by the Actuary of the bank incorrectly at Rs. 30,54,740 instead of the correct amount of Rs. 28,54,422 due to incorrect adoption of salaries at Rs. 11,10,81,464 instead of Rs 10,37,97,170. While completing the assessment in February 1983 for the assessment year 1980-81, the Inspecting Assistant Commissioner (Assessment) also allowed the gratuity liability of Rs. 30,54,740 without verifying its correctness. The mistake resulted in short computation of income by Rs. 2,00,318 with consequent short-levy of tax of Rs. 1,18,438.

The comments of the Ministry of Finance are awaited (January 1986).

(v) For the assessment year 1979-80, a company claimed a deduction of Rs. 33,14,500 on account of contribution to the recognised gratuity fund and in the assessment completed by the Inspecting Assistant Commissioner (Asstt.) in January 1983, a deduction of Rs. 32,89,500 only was allowed. However, it was noticed that this included an amount of Rs. 2,99,052 already allowed as deduction for the assessment years 1971-72 and 1972-73 as per the Tribunals orders. Failure to reduce this amount from the total liability allowed resulted in under assessment of income of Rs. 2,99,052 and consequent short-levy of tax of Rs. 1,72,701.

The comments of the Ministry of Finance are awaited (January 1986).

(vi) In the previous year relevant to the assessment year 1978-79, an assessee company made a total initial contribution of Rs. 17,91,000 to its approved superannuation fund and claimed the entire sum as deduction. The Income-tax Officer allowed deduction for a sum of Rs. 2,86,560 only. Pursuant to an appellate order of May 1982 directing allowance of deduction for the entire sum, the assessment for the assessment year 1978-79 was revised in September 1982 and the balance amount of Rs. 15,04,440 was also allowed. In the assessments for the previous years relevant to the assessment years 1979-80, 1980-81 and 1981-82 completed in September 1982, March 1983 and March 1984 respectively, deduction for a sum of Rs. 2,86,560 was again allowed in each of these assessment years towards the initial contribution, overlooking the fact that the entire sum of Rs. 17,91,000 had already been allowed in the assessment year 1978-79. The deduction amounting to Rs. 8,59,680 in aggregate allowed again in the three assessment years 1979-80 to 1981-82 led to under assessment of income with consequent total under charge of tax of Rs. 7,57,722 (including excess payment of interest on advance tax).

The comments of the Ministry of Finance are awaited (January 1986).

2.11 Incorrect allowance of contribution to scientific research

Under the Income-tax Act 1961, in computing the business income of an assessee, any sum paid by him to a scientific research association, university, college or other institution for scientific research, is an admissible deduction provided that such association, university, college or institution is approved by the prescribed authority. The Act was amended in 1974 to provide that, if the contribution was to be used for specific research undertaken by the institution under a programme approved by the prescribed authority having regard to the social, economic, and industrial needs of India, a deduction of a sum equal to one and one third times of the contribution so paid, shall be allowed. This deduction has, however, been discontinued with effect from 1 April 1984 by an amendment to the Act by Finance Act, 1984.

(i) In the previous year relevant to the assessment year 1980-81, a widely held company paid a sum of Rs. 5,30,000 to two scientific research institutions approved by the prescribed authority and claimed the above sum as a deduction from the total income. While completing the assessment for the assessment year 1980-81 in September 1983, the assessing Officer allowed a deduction of Rs. 7,06,667 being one and one third times the amount of Rs. 5,30,000 treating the sum as a contribution for undertaking specified

research programme approved by the prescribed authority. It was noticed in audit that although the research institution had been approved by the prescribed authority, no approval for undertaking the specific research programme had been obtained so as to entitle the assessee-for the weighted deduction. The mistake in granting weighted deduction resulted in incorrect allowance of Rs. 1,76,657 with consequent short levy of tax of Rs. 1,04,448.

The Ministry of Finance have accepted the mistake.

(ii) A private limited company debited in its accounts, for the previous year ending 31 December 1978 relevant to the assessment year 1979-80 an amount of Rs. 1,01,534 on account of "Research and Development expenses", which was allowed by the department, while completing the assessment in September 1979 for assessment year 1979-80.

It was not clear from the records whether the recipient of the amount of Rs. 1,01,534 was an approved research institution. On Audit pointing out the absence of the status of the recipient institution on record, the department investigated the matter and found that the firm was a bogus and non-existing one. The allowance of the expenditure of Rs. 1,01,534 made without adequate scrutiny by the assessing officer, while computing the business income resulted in under-assessment of income of Rs. 1,01,534 and consequent short levy of tax of Rs. 63,970.

The comments of the Ministry of Finance are awaited (January 1986).

2.12 **Incorrect allowance of bad debt**

Under the Income-tax Act, 1961 all income accruing or arising to an assessee in India in a previous year relevant to the assessment year is includible in the total income of the assessee. The Act further provides that the amount of any debt or part thereof or any recoverable dues which is established to have become bad in the previous year and written off in the accounts shall be allowed as deduction in computing the business income of the assessee.

(i) A company included a sum of Rs. 12,88,376 being one half of the amount of Rs. 25,76,752 retained by a foreign company on account of unsatisfactory performance of an oil complex plant supplied by the assessee company, in its total income for the assessment year 1979-80 on accrual basis. The company admitted in the return of income that the sum of Rs. 25,76,752 represented retention money held by a customer on an export contract for supply of oil complex plant on turn key basis, and the chances of recovery were remote in view of the various complaints made by the customer regarding the unsatisfactory performance of the plant. The assessee, however, agreed to return the receipt of Rs. 25,76,752 as income as and when the claim was settled. In the assessment made in September 1982 and revised in March 1983, accepting the contention of the assessee company, the Income-tax Officer did not include the balance of Rs. 12,88,376 in the total income for the assessment year 1979-80. As the assessee held a good title to the claim, the entire receipts of Rs. 25,76,752, due, was includible in the total income. Allowance for bad debt could be made in the year when the claim becomes bad subject to fulfilment of the other conditions prescribed.

The omission to add back the remaining amount of Rs. 12,88,376 resulted in short levy of tax of Rs. 12,09,398 including interest of Rs. 3,97,621 for failure to file the estimate of higher income for payment of advance tax and late filing of returns.

The Ministry of Finance have accepted the mistake.

(ii) In the previous year relevant to the assessment year 1980-81, an assessee company claimed deduction on account of bad debt amounting to Rs. 1,01,304. This amount was paid by the assessee company to a dealer in pursuance of an agreement for purchase of land and it was not in the course of business dealings of the assessee. The land was not registered by the dealer in favour of the assessee nor the amount advanced refunded to him. However in the assessment completed in November 1982, the Inspecting Assistant Commissioner (Assessment) allowed the aforesaid amount of Rs. 1,01,304 as bad debt as claimed by the assessee company. As the payment made by the company was not in the course of its business dealings and the loss incurred was not connected with the business carried on by the assessee, the amount in question was not allowable as a bad debt. The incorrect allowance resulted in under assessment of business income by Rs. 1,01,304 and short levy of tax of Rs. 70,783.

The comments of the Ministry of Finance on paragraph are awaited (January 1986).

(iii) In the case of an assessee company, while computing its taxable income for the assessment year 1980-81 (assessment made in September 1983) amount of Rs. 1,34,320 representing provision for bad and doubtful debts was allowed as deduction from income. As the sum represented only a provision and

not actual bad debt, it was not deductible. The mistake resulted in under assessment of income of Rs. 1,34,320 with consequent short levy of tax of Rs. 86,636 for the assessment year 1980-81.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.13 Omission to disallow interest paid on deposits

Under the Income-tax Act, 1961 where the assessee being a company other than a banking or financial company, incurs any expenditure by way of interest in respect of any deposit received by it 15 per cent of such expenditure shall not be allowed as deduction in the computation of business income.

An assessee company received public deposits during the previous years relevant to the assessment years 1976-77 to 1978-79 and the balance of such deposists as on the last days of the relevant previous years were Rs. 43,42,000, Rs. 49,84,000 and Rs. 66,46,000 respectively. The company *inter alia* paid interest of Rs. 8,94,270 during the previous year relevant to the assessment year 1978-79 on the public deposits and the department in computing the business income of the company for this year disallowed 15 per cent of the interest paid. However, in respect of the assessment years 1976-77 and 1977-78 no details of the amount of interest paid on the deposits were furnished by the company and the Inspecting Assistant Commissioner (Asstt.) who assessed the company also did not call for the same, while completing assessments in April 1979 and March 1980 respectively. Consequently no disallowance was made in these assessment years. However, on the basis of estimated minimum interest of 10 per cent as paid on the deposits, the amount disallowable would work out to Rs. 1,39,790 leading to under-assessment of business income by the same amount involving short levy of tax of Rs. 99,077 (including excess payment of interest of Rs. 18,290) in the two assessment years.

The Ministry of Finance have accepted the mistake.

2.14 Mistakes in the grant of export markets development allowance

The Income-tax Act, 1961, as it stood prior to its amendment by the Finance Act, 1983, provided for an export markets development allowance to resident assessees engaged in the business of export of goods outside India or in providing services or facilities outside India. A domestic company was entitled to a deduction on account of this allowance from the income assessed, under the head 'profits and gains of business or profession' at one and one-third times of qualifying expenditure as prescribed in the Act. Widely held domestic companies were entitled to a deduction at one and half times the qualifying expenditure incurred during the period from 1 March 1973 to 31 March 1978. Expenditure incurred after 31st March 1978 was not entitled to the weighted deduction unless the domestic company was engaged in the business of export of goods either as a small scale exporter or holder of an Export House Certificate or in the business of provision of technical know-how or rendering of services in connection with the provision of technical know-how to persons outside India. The term "Provision of technical know-how" means the transfer of all or any rights, or imparting of any information concerning the working of or the use of a patent, invention, model, design, secret formula or process or similar property. It has been explained in the Act that expenditure incurred by an assessee engaged in the business of operation of any ship or other vessel or carriage of or making arrangements for the carriage of passengers, live stock, mail or goods shall not be regarded as expenditure on supply of services or facilities outside India.

In the case of 12 companies assessed in 12 different commissioners' charges for the assessment years 1974-75 to 1976-77 and 1978-79 to 1981-82 (assessments completed between July 1980 and July 1984) due to incorrect application of the above provisions of the Act export markets development allowance of Rs. 42,12,217 was erroneously allowed on expenditure which did not qualify for the weighted deduction. This resulted in under assessment of income of Rs. 35,44,177 involving short levy of tax of Rs. 25,20,335 in nine cases and carry forward of loss of Rs. 6,68,040 with a potential tax effect of Rs. 3,99,825 in the remaining three cases. The following table gives the details of the cases :

Sr. No.	C.I.T. Asstt. year	Nature of Mistake	Tax effect
			R
1.	F 1981-82	Weighted deduction of Rs. 1,28,943 was wrongly allowed on expenditure incurred in India.	90,098
2.	J 1974-75 to 1976-77	Weighted deduction of Rs. 1,81,683 was allowed on expenditure incurred in India which did not qualify.	1,04,922
3.	K 1980-81	Weighted deduction of Rs. 2,39,942 was allowed on commission to foreign buyer and expenditure incurred in India which did not qualify.	1,52,598

Sr. No.	C.I.T. Asstt. year	Nature of Mistake	Tax effect Rs.
4.	L 1978-79	Weighted deduction of Rs.2,46,415 allowed on expenditure incurred in India in connection with export promotion which did not qualify.	1,42,305
5.	C 1981-82	Weighted deduction at one and one half times the expenditure of Rs. 9,53,180 incurred after 31 March 1978 was allowed instead of at the rate of one and one third times. The deduction also included expenditure of Rs. 2,96,087 incurred in India which did not qualify for weighted deduction.	1,81,81
6.	E 1980-81	Weighted deduction of Rs. 3,74,618 calculated at one and one-half times the actual expenditure was allowed instead of the amount of Rs. 2,49,745 being one and one-third times the expenditure.	94,247
7.	G 1979-80	Inadmissible deduction of Rs. 90,873 allowed to assessee company which was neither a small-scale exporter nor a holder of Export House certificates.	52,507
8.	H 1979-80	Inadmissible deduction of Rs. 74,107 allowed to assessee company which was neither a small-scale exporter or holder of Export House certificate.	50,777
9.	I 1979-80	Inadmissible weighted deduction of Rs. 93,557 allowed to company which is not a small-scale exporter.	81,106
10.	B 1979-80	Allowance of weighted deduction of Rs. 4,29,007 to a company which only supplied prequalification survey, quality control during planning and production of goods to foreign buyers which did not constitute provision of technical know-how.	2,95,722
11.	A 1978-79	Allowance of expenditure of Rs. 20,94.222 in connection with the operation of ship not qualifying for deduction.	15,64,558
12.	D 1980-81	Weighted deduction of Rs. 2,67,682 was allowed instead of the correct amount of Rs. 87,324.	1,09,507

One of the companies was assessed by Inspecting Assistant Commissioner (Assessment). The internal audit party of the department checked the assessments in 3 cases but the mistake was not noticed by them.

In four cases the Ministry of Finance have accepted the mistakes. The comments of the Ministry in the remaining cases are awaited (January 1986).

2.15 Incorrect allowance of guarantee commission

The Central Board of Direct Taxes have in their circular of August, 1963 clarified that the commission payable to banks for furnishing guarantees regarding deferred payments for import of plant and machinery, being in the nature of capital expenditure, cannot be allowed as deduction in computing the total income under the Income-tax Act. The Gujarat High Court held (July 1981) that such expenditure formed integral part of payment of cost price of machinery which is a capital asset and hence the expenditure was capital in nature. The Madras and Andhra Pradesh High Courts, however, in February 1979 and in August 1976 held that payment of guarantee commission was unrelated to the working out of the cost of acquisition of plant and machinery but was a revenue expenditure which was incurred in the course of carrying on the business. The Department preferred an appeal to the Supreme Court against the Madras High Court judgement as in its view guarantee commission in respect of a capital asset constituted capital expenditure and not revenue expenditure.

During the previous years relevant to the assessment years 1980-81 and 1981-82 three companies assessed in two different commissioners' charges incurred expenditure of Rs. 6,02,459 towards guarantee commission in respect of purchase of plant and machinery on deferred payments and claimed deduction treating the expenditure as revenue expenditure. Accepting the claim of the companies, the assessing officers allowed the same in computing the business income between April 1983 and March 1984. Since the expenditure on account of guarantee commission constituted capital expenditure, the allowance of the expenditure in the computation of business income was not in order. The incorrect allowance resulted in under-assessment of income by Rs. 6,02,459 involving short levy of tax of Rs 3,99,459 including non-levy of interest for short payment of advance tax and short levy of surtax amounting to Rs. 96,801 in the case of two companies and excess carry forward of loss of Rs. 1,11,443 in the case of the third company.

The comments of the Ministy of Finance on the cases are awaited (January 1986).

2.16 Omission to disallow the value of perquisites

The Income-tax Act, 1961 provides that where an assessee incurs any expenditure which results, directly or indirectly, in the payment of any salary to an

employee, then so much of the expenditure as is in excess of an amount calculated at the rate of five thousand rupees (Rs. 7,500 with effect from 1st April 1985) for each month or part of a month of his employment during the previous year, shall not be allowed as a deduction in computing the assessee's income under the head 'Profits and gains' of business or Profession. Also any expenditure incurred by the assessee resulting, directly or indirectly in the provisions of any perquisite (whether convertible into money or not) to an employee, the excess over one-fifth of the amount of salary payable to the employee or an amount calculated at the rate of one thousand rupees for each month or part thereof, whichever is less, is not allowable as deduction. The Central Board of Direct Taxes in their circular of July 1964 clarified that the expenditure incurred in cash or in kind after 29 February 1964 in providing any benefit, amenity or perquisite would be subjected to dissallowance if the prescribed limits were exceeded. In their instructions of March 1972, the Central Board of Direct Taxes reiterated that all payments in the form of benefits or amenities such as re-imbursement of medical expenses, provision of electricity, water, gas at the residence of the employees etc. would form part of the perquisite which would be restricted to one-fifth in the assessment of the employer. While the Calcutta, Allahabad, Madras, Andhra Pradesh, Karnataka and Delhi High Courts had taken the view that the disallowance contemplated under the law was not applicable in regard to cash payments, the full bench of the Kerala High Court lent support to the Revenue Department's views that the disallowance under the law is applicable in regard to perquisites to employees incurred in cash or in kind. Despite these conflicting judicial decision, the Central Board of Direct Taxes have not so far issued clarification to their instructions of July 1964 and March 1972.

(i) A company paid a salary (inclusive of allowances) amounting to Rs. 75,300 to its General Manager during the previous year relevant to the assesment years 1980-81. The company also paid a sum of Rs. 1,09,269 to him in re-imbursement of medical expenses incurred on heart surgery. In the assesment of the company made in March 1983, the Inspecting Asstt. Commissioner (assessment) disallowed only an expenditure of Rs. 900. In view of the Board's instructions and the decision of the Kerala High Court, salary and allowance in excess of Rs. 60,000 and medical expenses in excess of Rs. 12,000 were disallowable, instead of Rs. 900 only disallowed by the Inspecting Assistant Commissioner (Asstt.). The omission resulted in short-assessment of income of Rs. 1,11,669 involving short-levy of tax of Rs. 66,024.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The Act further stipulates that this ceiling limit on expenditure on salary is, however not applicable to any expenditure or allowance in relation to any employee in respect of any period of his employment outside India.

The income-tax assessment of a widely held company carrying on the business of transport of bulk cargo in ships in international tramp trade, for the assessment year 1980-81 was completed by the Income-tax Officer in August 1983 after getting directions from the Inspecting Assistant Commissioner (Assessment) wherein the assessing officer admitting the assessee's revised claim, disallowed a sum of Rs. 4,47,442 on account of expenditure on salary to employees in excess of the prescribed ceiling limits.

In the original return filed in August 1980, the assessee company made a disallowance of Rs. 6,71,000 on account of salary paid in excess of the ceiling limit at the rate of Rs. 5,000 per month to the shore staff and the floating staff. In the revised return of income filed by the assessee company in October 1982 for the assessment year 1980-81 the company revised the amount of the above disallowance to Rs. 4,47,442 stating that the salary amounting to Rs. 2,23,558 was paid to the staff for the period of their duty outside India. Accepting the assessee's contention, amount of Rs. 4,47,442 only was disallowed by the Income-tax Officer in the assessment made in August 1983. Since the employees were outside India in the course of their travel on duty outside India, in connection with their employment in India and since they were not employed outside India, the disallowance of Rs. 4,47,442 instead of Rs. 6,71,000 was not in order. The incorrect allowance of expenditure amounting to Rs. 2,23,558 resulted in short levy of tax of Rs. 1,68,731 including surtax of Rs. 36,552.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.17 Omission to disallow excessive expenditure on advertisement, publicity and sales promotion

Under the provisions of the Income-tax Act, 1961 as applicable during the period 1 April 1979 to 31st March 1981, where the aggregate expenditure on advertisement, publicity and sales promotion in India

does not exceed 1/4 per cent of the turnover or gross receipts of the business or profession, 10 per cent of the adjusted expenditure, where such aggregate expenditure exceeds 1/4 per cent but does not exceed 1/2 per cent of the turnover, 12½ per cent of the adjusted expenditure and where such aggregate expenditure exceeds ½ per cent of the turnover, 15 per cent of the adjusted expenditure has to be disallowed excepting in cases where the aggregate amount of such expenditure did not exceed Rs. 40,000. In the absence of a statutory definition of the term "sales promotion" any expenditure for effecting sales such as a sales organisation, commission paid to salesman, commission paid to sales agents and whatever expenses which were in connection with sales would constitute expenditure on sales promotion. The Act had specifically laid down that any expenditure incurred by an assessee on advertisement in any small newspapers or in any newspaper for recruitment of personnel or any notice required to be published under any law in any newspaper, the maintenance of any office or payment of salary of employees for the purpose of advertisement, publicity or sales promotion, holding of or participating in sales conference, trade fairs, convention or exhibition and participation of Journals, catalogue or price lists had to be excluded from the purview of advertisement, publicity and sales promotion expenses. In other words, in view of the fact that the law itself lays down what is to be excluded, all the expenses other than those mentioned above had to be treated as constituting expenditure on advertisement, publicity and sales promotion.

The expression "adjusted expenditure" means the aggregate of expenditure incurred on advertisement publicity and sales promotion, in India as reduced by expenditure not allowable as business expenditure in the computation of business income of the assessee and further reduced by expenditure specifically exclued in the Act.

(i) In the case of four companies assessed in four different Commissioners' charges for the assessment years 1979-80 and 1980-81 expenditure of Rs. 49,20,504 incurred on supply of free samples, commission on sales, commission paid to agents, cash discount, incentive bonus, advertisement, publicity and sales promotion exceeded one-half per cent of the gross turnover of the companies and accordingly an expenditure of Rs. 7,34,285 being 15 per cent of the aggregate expenditure on these items was required to be disallowed in the computation of business income of the companies. While completing the assessment of these companies for the two assessment years between January 1980 and August 1983, the Income-tax Officers omitted to disallow the expenditure, as a result of which, there was short computation of business income amounting to Rs. 7,34,285 involving short levy of tax Rs. 4,72,456.

The Ministry of Finance have accepted the mistake in one case. Their comments are awaited in other cases (January 1986).

(ii) In the case of two other companies assessed in two different Commissioners' charges application of incorrect rate of disallowance at 12.5/10 per cent instead of 15/12.5 per cent led to disallowance of Rs. 20,86,870 only as against Rs. 25,57,932, being the excess expenditure on advertisement and sales promotion. This resulted in short computation of business income by Rs. 4,71,062 for the assessment year 1980-81, and short levy of tax of Rs. 2,98,569.

The Ministry of Finance have accepted the mistake.

(iii) A company engaged in the manufacture of perfumery, cosmetics and toilet preparations was assessed in July 1982 for the assessment year 1980-81 on an income of Rs. 32.57 lakhs after disallowing a sum of Rs. 3,81,328 on account of publicity, sales promotion etc. For the previous year relevant to the assessment year 1980-81 the company showed the opening stock of its products as 153 tonnes and during the year the actual production was 959 tonnes. The sales during the year were 961 tonnes and the closing stock for the assessment year was thus worked to 151 tonnes. However the closing stock was shown short by 16 tonnes in the accounts for the assessment year 1980-81 and the same was adopted in the assessment also. The shortage of 16 tonnes valued at Rs. 13.50 lakhs was explained by way of a note in the accounts as due to adjustment of samples and replacement. Since free supply of samples constitutes sales promotion, the value of such samples supplied free, though not depicted in the accounts was required to be disallowed to the extent prescribed in the Act. In the absence of the value of replacements in the assessment records and assuming that the entire shortage was on account of supply of free samples, a further sum of Rs. 2,02,500 was required to be disallowed on account of publicity and sales promotion in addition to the sum of Rs. 3,81,328 already disallowed. Omission to do so resulted in under-assessment of income by Rs. 2,02,500 involving short levy of tax of Rs. 1,19,727.

The comments of the Ministry of Finance are awaited (January 1986).

2.18 Incorrect allowance of entertainment expenditure

Under the provisions of the Income-tax Act, 1961, any expenditure laid out or expended wholly and exclusively for the purpose of business is allowable as deduction in computing the business income, provided the expenditure is not in the nature of capital expenditure or personal expenses of the assessee. The Act stipulated that no deduction shall be made in respect of expenditure in the nature of entertainment expenditure incurred by a company in excess of Rs. 30,000, i.e., 1/4 per cent of Rs. 1.20 crores of profit and gains of business. Entertainment expenditure has been explained in the Act to include *inter alia*, expenditure on provision of hospitality of every kind including by way of provision of food, beverages etc. to any person other than the employee of the company.

In the assessment of a public limited company made in February 1983 for the assessment year 1980-81 the Inspecting Assistant Commissioner (Assessment) allowed expenditure towards entertainment expenditure upto the maximum permissible limit of Rs. 30,000. However, while computing the income an inadmissible expenditure of Rs. 3,33,924 incurred by the company during the previous year relevant to the assessment year 1980-81 on account of refreshment and other expenses for the families of its staff, its shareholders and visitors, for the opening day inaugural function which was in the nature of entertainment included under the Miscellaneous expenditure of Rs. 3.69 crores was not added back. Failure to do so resulted in under assessment of income of Rs. 3,33,924 involving short levy of tax of Rs. 1,97,431.

The comments of the Ministry of Finance are awaited (January 1986).

2.19 Incorrect allowance of expenditure on guest house

Under the Income-tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee after 28th day of February 1970 on the maintenance of any residential accommodation in the nature of guest house. The Act was amended retrospectively with effect from 1st April, 1979 by the Finance Act, 1983 to include any accommodation by whatever name called, arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person (including any employee or Company Director) on tour or visit to the place at which such accommodation is situated.

(i) In computing the business income of two companies assessed in two different charges for the assessment years 1979-80 and 1980-81 assessments made in March and May 1983 expenditure of Rs. 3,55,013 incurred on the maintenance and on provisions and groceries purchased for the guest house was allowed as a deduction. Since no deduction in respect of any expenditure incurred on the maintenance of guest house was admissible after 28 February, 1970, the incorrect deduction allowed resulted in under-assessment of income by Rs. 3,55,013 leading to short levy of tax of Rs. 2,06,413.

The Ministry of Finance have accepted the mistakes in both the cases.

Owing to the retrospective amendment to the Act, the expenditure on guest houses already allowed is required to be withdrawn, wherever it is permissible, by revising the assessment.

In the case of a company, while computing its income in July 1982 for the assessment year 1980-81 an expenditure of Rs. 1,44,940 incurred by it on the maintenance of guest houses was allowed by the Inspecting Assistant Commissioner (Asstt.) as deduction. The expenditure of Rs. 1,44,940 allowed by the Inspecting Assistant Commissioner (Asstt.) prior to the amendment of the Act, was required to be withdrawn by revising the assessment. The omission to do so resulted in under-assessment of income of Rs. 1,44,940 involving short levy of tax of Rs. 93,486.

The Ministry of Finance have accepted the mistake.

2.20 Incorrect valuation of closing stock

Under the provision of the Income-tax Act, 1961, income chargeable under the head 'Profits and gains of business' shall be computed in accordance with the method of accounting regularly employed by the assessee. The Act further stipulates that in any case where the accounts are correct and complete but the method employed is such that the income cannot be properly determined therefrom, the Income-tax Officer shall compute income on such basis and in such manner as may be determined by him.

(i) Till the assessment year 1978-79 an assessee company, was regularly debiting the cost of machinery spares to 'Repairs' in the Profit and loss Account at the time of their issue from stock for consumption. The company changed this method of accounting from the accounting year relevant to assessment year 1979-80 and started charging the entire machinery spares to 'Repairs' at the time of their purchase itself.

In addition the value of stock of spares as at the beginning of the accounting year relevant to assessment year 1979-80 was also debited to the repairs account with the result the value of such spares as on 1 January, 1978 forming part of closing stock were reduced from the closing stock and charged off to Profit and Loss Account for the year 1978 relevant to assessment year 1979-80. As a result for the assessment year 1979-80 the change in the method of accounting led to excess charge to profit and loss account to the extent of Rs. 44,21,741. But for the change in method of accounting the amount of Rs. 44,21,741 representing the value of stock of spares at the end of the accounting year would have been included in closing stock and the profit of the company would have also been correspondingly revised. Accepting the change in the method of accounting without examining its effect on the taxable income of the company the income for the assessment year 1979-80 was assessed by Income-tax Officer in January 1983. The erroneous acceptance of change in the method of accounting resulted in under-assessment of income of Rs. 44,21,741 involving short levy of tax of Rs. 25,53,554 in the assessment year 1979-80.

The Ministry of Finance have accepted the mistake.

(ii) Two private limited Tea companies changed the method of valuation of closing stock in the previous year relevant to the assessment year 1978-79 and the Income-tax Officer added back sums of Rs. 12,17,690 and Rs. 4,25,000 resulting from the undervaluation of closing stock to the income of the companies. On appeal the Commissioner (Appeals) deleted the additions and the assessments were duly revised in October 1982. As the value of the closing stocks for the previous year relevant to the assessment year 1978-79 would be the value of opening stock for the previous year relevant to the assessment year 1979-80 the Income-tax Officer incorrectly deducted the two sums of Rs. 12,17,690 and Rs. 4,25,000 while computing income for the assessment year 1979-80 in March 1983 with reference to the original assessments for the assessment year 1978-79 overlooking the fact that the assessments for the assessment year 1978-79 were revised to give effect to the appellate orders in October 1982, deleting these additions originally made. The mistakes remained undetected even when the assessments for the assessment year 1979-80 underwent revision in October 1983 and November 1983, respectively.

This mistake together with a totalling mistake in one of the assessments accounted for under-assessment of income by Rs. 6,74,876, for the assessment year 1979-80 resulting in short levy of tax of Rs. 4,49,873 (including interest allowed on excess advance tax paid).

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.21 Incorrect allowance of liability or omission to include accrued income

Under the Income-tax Act, 1961, income chargeable 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 an assessee follows mercantile accounting system, the net profit or loss is calculated after taking into account all the income actually received as well as accrued or deemed to accrue as well as all expenditure incurred and the liability relating to the period regardless of their actual receipt or payment.

(i) A company following mercantile system of accounting debited in its accounts for the year relevant to the assessment year 1975-76 a sum of Rs. 4,90,030 towards 'adjustment in respect of previous years', which included expenditure of Rs. 3,66,935 on purchases, transport bills etc. in respect of earlier years. The expenditure was allowed by the department while computing the business income of the company for the assessment year 1975-76. As the expenditure was not incurred in the previous year relevant to the assessment year 1975-76 the deduction allowed was not in order. The incorrect allowance of expenditure of Rs. 3,66,935 in the assessment year 1975-76 resulted in short levy of tax of Rs. 2,11,904.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) In the case of an assessee company interest income amounting to Rs. 7.96 lakhs accruing on advances during the previous year relevant to assessment year 1980-81 was exhibited in the balance sheet under 'interest suspense account', instead of being credited to the profit and loss account. It was indicated in the account that certain mortgage loans where the mortgagers were persistent defaulters or where rate of interest was being disputed had been kept in the suspense account and the credit for the same would be taken in the year of realisation. Agreeing with the contention of the assessee company the interest of Rs. 7.96 lakhs accrued was not included in the total income. Since the company was maintaining mercantile system of accounting the accrued interest was includible in the total income

for the assessment year 1980-81 completed in March 1984. The omission resulted in under statement of income by Rs. 7.96 lakhs involving short-levy of tax of Rs. 6,91,817 including excess payment of interest of Rs. 2,21,182 on advance tax.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) In the assessment of a widely held company for the assessment year 1979-80 completed in June 1982 a sum of Rs. 2,39,138 due from Railways towards compensation was included in the taxable income of Rs. 13,98,720 on accrual basis. The assessment for the assessment year 1980-81 was completed in September 1982 and the compensation amounting to Rs. 2,39,138 was not taken into account in the computation of taxable income. Consequent upon the orders of the Commissioner of Income-tax (Appeals) in November 1982 deleting the addition of Rs. 2,39,138 from the assessment year 1979-80 on the ground that even under mercantile system, the amount would be taxable only when the Railways accepted the claim, the assessment for the assessment year 1979-80 was revised in February 1983 to exclude the compensation from the total income. The claim for compensation was accepted by the Railways in the previous year relevant to the assessment year 1980-81 and, therefore, the amount of compensation was required to be included in the income for the assessment year 1980-81. However, the assessment for the assessment year 1980-81 was not correspondingly revised to include the amount. The omission to do so resulted in short-levy of tax of Rs. 1,03,491.

The Ministry of Finance have stated that the necessary additional demand has been created and collected.

(iv) A private limited company which had been regularly following mercantile system of accounting claimed and was allowed by the Inspecting Assistant Commissioner (Asstt.) a deduction of Rs. 74,019 on account of payment of bonus pertaining to earlier years from the business income for the previous year relevant to assessment year 1978-79 (assessment completed in August 1980).

As the payment of bonus related to the earlier assessment years and not to the previous year relevant to the assessment year 1978-79, the deduction allowed on this account was not in order. The erroneous deduction resulted in short-levy of tax of Rs. 42,746.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) An assessee company, maintaining its accounts on mercantile system, debited in its accounts for the year relevant to the assessment year 1980-81, an amount of Rs. 4,35,25,991 on account of interest on Government of India loans and claimed the interest in the assessment year 1980-81, although it actually related to the accounting years relevant to the assessment years 1978-79 and 1979-80. The interest of Rs. 4,35,25,991 was allowed by the department as claimed by the company in the assessment for the assessment year 1980-81 completed in June 1983. Since, the amount actually related to the previous years relevant to the assessment years 1978-79 and 1979-80, the allowance thereof as deduction in the assessment year 1980-81 was not in order. The mistake resulted in excess carry forward of loss of Rs. 4,35,25,991 for the assessment year 1980-81, involving revenue of Rs. 2.61 crores.

The Ministry of Finance have accepted the mistake in principle.

(vi) In the assessment of a private limited company, for the assessment year 1979-80 completed in October 1983 the provision of Rs. 1,67,867 towards payment of general sales tax which stood debited to the profit and loss account was not disallowed even though no general sales tax was payable on the relevant goods as per the assessment made by the Sale Tax authorities and no liability existed as per sales tax assessment order on record. Omission to disallow this inadmissible liability resulted in under assessment of income of Rs. 1,67,867 involving short levy of tax of Rs. 1,08,276.

The Ministry of Finance have accepted the mistake.

(vii) It has been judicially held that the liability to sales tax would ordinarily relate to the year in which the transaction took place.

In the previous year ended December 1977 relevant to the assessment year 1978-79 a widely held company claimed a deduction of Rs. 1,90,886 towards the sales tax liability relating to the year 1973-74 in respect of one of its units and the claim was allowed by the Income Tax Officer while completing the assessment for the assessment year 1978-79 in April 1981. The deduction allowed related to the demand made by the Sales Tax Department in March 1979 for the assessment year 1973-74. Since assessment of every assessment year is a self contained unit and no deduction relating

to a liability of an earlier assessment year is admissible under the mercantile system of accounting, the allowance of the deduction in the assessment completed in April 1981 was not in order. The erroneous deduction resulted in short levy of tax of Rs. 1,24,961 including sur tax of Rs. 28,290.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.22 **Other mistakes in the computation of business income**

It has been judicially held (August 1974) that expenditure relating to breach of law would not be deductible even if incurred for the purpose of the business.

(i) (a) In computing the business income of a private construction company in June 1982 for the assessment year 1981-82, the Inspecting Assistant Commissioner (Assessment) allowed as business expenditure a sum of Rs. 95,700 being compensation paid by the company to a party which was not provided with office accommodation as per agreement with it. The contracted office accommodation could not be provided as the Municipal Corporation refused permission for the construction of additional floor space on the 14th floor of the building constructed by the assessee company. The contract to sell the office premises was executed before obtaining necessary permission from the Municipal Corporation and, therefore, in the absence of such a permission the contract, was bad in law. The compensation thus paid for failure to fulfil such an agreement cannot be regarded as admissible business expenditure. Failure to disallow the compensation resulted in under-assessment of income by Rs. 95,700 involving short levy of tax of Rs. 66,870.

The Ministry of Finance have accepted the mistake.

(b) A private limited company debited a sum of Rs. 4,17,337 in its accounts of the previous year relevant to the assessment year 1981-82 on account of penalty for belated payment of sales tax levied under the States Sales Tax Act. While completing the assessment for the assessment year 1981-82 in February 1984, the Income-tax Officer allowed the penalty as business expenditure. Since the penalty was paid for infringement of law, it was not admissible as a deduction. The incorrect deduction resulted in under-assessment of income of Rs. 4,17,331 involving short-levy of tax of Rs. 2,69,182.

The Ministry of Finance have accepted the mistake.

(c) It was held by the Gujarat and Allahabad High Courts that the damages paid by an assessee under Section 14B of the Employees Provident Fund and Miscellaneous provisions Act, 1952, for non-contribution to the Provident Fund constituted damages not allowable as business expenditure under the Income tax Act. It was also held by the Supreme Court in a Civil case that damages as imposed under Section 14B of the Act include a punitive sum quantified according to circumstances of the case. Keeping in view these judicial decisions, in para 1.24 of their 204th Report (7th Lok Sabha 1983-84) the Public Accounts Committee observed *inter alia* "that in the absence of any modification of Section 14B of the Employees Provident Fund and Miscellaneous Provision Act, 1952", the contention of the Ministry of Finance that "the present provision as they stand, cannot be construed to mean that the assessee had paid a penalty violating any statutory provision". The Committee note that this stand of the Ministry of Finance is different from the stand the Central Board of Direct Taxes had earlier taken in several cases before High Court wherein they had contended that the damages paid by an assessee under Section 14B of the Employees Provident Fund and Miscellaneous Provision Act, for non-payment of contribution to the Provident Funds constituted damages not allowable as business expenses under Section 37 of the Income-tax Act, 1961. The Board's contention was accepted by the High Courts and the damages paid by the assessee were not allowed while computing business income. The Committee added that "the Supreme Court, in Organic Chemical Industries and another *Vs.* Union of India and others held that damages as imposed by the Section 14B, include a punitive sum quantified according to the circumstances of the case. However, in order to set the matter beyond any margin of doubt, the Committee will like the Government to consider feasibility of making an amendment in the Employees Provident Fund Act, 1952 to bring out unambiguously the penal nature of the damages levied under Section 14B thereof."

In the account of a company relevant to assessment year 1981-82, a sum of Rs. 2,15,920 was debited to the profit and loss account paid on account of damages imposed by the Regional Provident Fund Commissioner for delay in the payment of contribution to Provident Fund. In the assessment for the assessment year 1981-82 made in March 1984 the Inspecting Assistant Commissioner allowed this expenditure in computing the company's total income. As the payment was made for infringement of statutory

orders, and it was not due to any exigency of business, it would not constitute admissible expenditure. The incorrect allowance of the expenditure as deduction resulted in under-assessment of income of Rs. 2,15,920 involving short-levy of tax of Rs. 1,39,268.

The comments of the Ministry of Finance are awaited (January 1986).

(ii) Under the Income-tax Act 1961, any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of any such profits or gains shall not be deducted in computing the income chargeable under the head 'profits and gains of business or profession'.

During the previous year ended 31 March 1980 and 31 December 1980, relevant to the assessment years 1980-81 and 1981-82 a widely held company had paid Rs. 3,46,760 and Rs. 40,849 towards income-tax paid to foreign governments on the net freight income earned by it in those countries. In the assessments for assessment years 1980-81 and 1981-82 completed in August 1983 and March 1984 respectively the assessing officer allowed deduction of income-tax of Rs. 3,87,609 paid to Foreign Governments as business expenditure although such deductions are not admissible under the Act. The erroneous allowance of the expenditure for the assessment years 1980-81 and 1981-82 had resulted in a total short-levy of income-tax and surtax aggregating to Rs. 2,92,548 (including short levy of surtax of Rs. 63,373) for both the years.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the Income-tax Act 1961, where at the time of completion of assessment of the partners of a firm, assessment of the firm has not been completed, and the final share income of the partners is not known, the assessment of the partner may be completed by taking his share income from the firm on a provisional basis. In such cases, the assessments of the partners are to be revised subsequently to include the final share income, when the assessment of the firm is completed. For this purpose, the Income-tax Officers are required, under instructions of (February 1959) of the Central Board of Direct Taxes as reiterated in March 1973 to maintain a register of cases of provisional share income, so that timely action may be taken to revise the partners assessments and to ensure that no assessments are omitted to be rectified. The instructions of the Board issued in July 1976 provide that the cases of partners of a firm should, as far as possible, be assessed in the same ward/circle where the firm is assessed so as to reduce the rectification work to the minimum.

The assessments of a private limited company which was a partner in a firm, for the assessment years 1974-75 and 1976-77 were completed by the Income-tax Officer in September 1977 and September 1979 taking the income from the Registered firm as a loss of Rs. 1,04,627 and Rs. 3,01,873 respectively. On the completion of assessment of the Registered Firm, the assessments of the company for the assessment years were revised in May and June 1983 as a result of which the correct loss amounting to Rs. 3,14,343 and Rs. 62,144 respectively were considered. However, the share of loss as originally taken at Rs. 1,04,627 and Rs. 3,01,873 for these assessment years remained to be added back. The mistake resulted in under-assessment of income aggregating to Rs. 4,06,500 with consequent short levy of tax Rs. 2,56,093 for both the assessment years 1974-75 and 1976-77.

The Ministry of Finance have accepted the mistake.

(iv) It has judicially been held by the Supreme Court (56 ITR 61) that interest paid on deferred payment of cost of machinery is revenue expenditure.

During the previous year relevant to the assessment year 1981-82 a closely held company purchased machinery costing Rs. 5,94,000 on deferred payment basis, the interest payable thereon being Rs. 3,01,800. In the assessment completed in January 1984 the interest payable was capitalised and depreciation allowance and investment allowance aggregating Rs. 1,65,990 calculated on the total amount including the amount of interest capitalised as claimed by the assessee company were allowed by the Inspecting Assistant commissioner (assessments). As interest relating to the relevant previous year alone is an allowable expenditure in computing the business income of the year, the capitalization of the interest payable and the deduction of depreciation allowance and investment allowance thereon for the assessment year 1981-82 was not in order. After allowing the interest of Rs. 1,780 correctly admissible for the assessment year 1981-82, the net under assessment of income was Rs 1,64,210 involving short levy of tax of Rs. 1,05,915.

The Ministry of Finance have accepted the mistake.

(v) Any expenditure other than capital expenditure and personnel expenses of the assessee laid out or expended wholly and exclusively for the purpose of business of an assessee is admissible as a deduction. Where an assessee company borrows monies on interest and advances the same free of interest to its subsidiaries, it cannot be said to have borrowed monies for the purpose of its business as the assessee company and its subsidiaries are separate legal entities and also assessable to tax separately.

A paper mill obtained a loan of Rs. 15,00,000 during the previous year relevant to the assessment year 1981-82 from the state industrial and investment corporation and passed it on free of interest to its subsidiary company for being utilised by the subsidiary company for the purchase of machinery. The assessee company, being the parent company, debited interest amounting to Rs. 1,01,238 payable on this loan in its profit and loss Account for the year ending 30 June 1980 relevant to the assessment year 1981-82. While completing the assessment in February 1984, the Inspecting Assistant Commissioner (Asstt.) allowed the interest of Rs. 1,01,238 as business expenditure. As the loan was not obtained and laid out for the purpose of assessee's business, the interest paid thereon was not admissible as a deduction. The omission to disallow the interest resulted in under-assessment of income by Rs. 1,01,238 involving short levy of tax of Rs. 80,207 including non-levy of interest for short payment of advance-tax.

The Ministry of Finance have accepted the mistake.

(vi) A non-resident tax payer is chargeable to tax in India in respect of income which is received or deemed to be received or which accrues or deemed to accrue or arise in India. Further under the provisions of the Act any interest which is payable outside India on which tax has not been paid or deducted and in respect of which there is no person in India who may be treated as an agent under the Income-tax Act will not be allowed as a deduction in computing income chargeable to tax.

A non-resident company had obtained loan from a Bank in Japan for purchase of two trawlers which were given on charter basis to an Indian Company. The non-resident company paid interest of Rs. 1,52,424 in assessment year 1977-78 and Rs. 3,15,008 in assessment year 1978-79 respectively on the loans taken from the Bank of Japan. The amount of interest paid by the company was allowed by the Income-tax Officer as deduction in computing the business income of the company

As the interest on the loans was paid by the non-resident company to the Bank in Japan and no tax was deducted on such interest the interest paid was not an allowable deduction in determining the income of the non-resident company. The failure to disallow the interest resulted in excess computation of loss to the extent of Rs. 4,67,432 for both years with a potential tax effect of Rs. 3,43,563.

In the case of the same non-resident company for the assessment year 1977-78, it was recorded in the assessment order by the Income-tax Officer that the assessee company had received U.S. $ 1,37,500 on account of charterage for the period from 14 September 1976 to 31 March 1977 from the Indian company. Considering the financial condition of the Indian company, the non-resident assessee company waived 50 per cent of the charterage amounting to U.S. $ 31,250 for the initial three months from the execution of agreement on 20 May 1976. Since the waiver of the charterage related to the period prior to 14 September 1976, reduction of the amount of U.S. $ 31,250 from the charterage of U.S. $ 1,37,500 actually paid by the non-resident company for the later period was not in order. The incorrect deduction resulted in excess computation of loss to the extent of Rs. 2,34,375 involving potential tax-effect of Rs. 1,72,226.

The Ministry of Finance have accepted the mistake.

(vii) While computing income under the mercantile system of accounting a provision made for any accrued or known liability is allowable as deduction whereas an amount appropriated to a reserve is not. The Income tax Act, however, specifically provides that any provision for bad and doubtful debts made by a scheduled bank in relation to advances made by its rural branches and any special reserve created by a Financial Corporation engaged in providing long-term finance for industrial or agricultural development or by a public company having its object of providing long-term finance for construction or purchase of house properties in India for residential purposes are allowed as deduction in the computation of income. Reserves in all other cases and provisions made, not for accrued or known liability, are not allowable.

The question whether reserves|provisions made by an assessee under statutory compulsions can be allowed as deduction while computing taxable income

of an assessee had come under judicial scrutiny in a number of cases. The Kerala (December 1972), Bombay (July 1973) and Patna (July 1978) High Courts had held that the amount taken to the reserve was allowable as a deduction while computing income from business, whereas the Madras (December 1976), and Calcutta (March 1981 and June 1983) High courts had taken the view that the amounts credited to the reserve was not admissible as a deduction while computing income. The Calcutta High Court in its decision of June 1983 exhaustively dealt with all the earlier case laws and upheld the departmental view that the reserve was not to be allowed as a deduction. According to the High Court, if a sum is set apart by an assessee under compulsion of law for meeting unknown business needs of the company, a diversion of income at source by an overriding title does not take place. In such cases, according to the High Court, the assessee has title to the fund, exercises dominion over the fund, and regulates its use. The Court further held that it cannot be said that the amount that has been appropriated to the fund does not form part of the real income of the assessee. The Madras High Court in a case arising under the co-operative societies Act ruled that merely because the statute contemplated creation of a particular fund and its utilisation in a particular manner, it did not mean that there was any diversion by overriding title as such. The High Court came to the conclusion that the contribution by way of fixed percentage of net profits to the Education fund, for subsequent remittance to the co-operative union was done after the profits were earned and had reached the assessee and hence was not admisible as a deduction while computing income. This decision of the High Court went also in favour of the Department of Revenue.

The department have not issued any instructions for the guidance of the assessing officers to regulate the deduction so as to ensure uniformity in assessment.

In terms of the provisions of U.P. Sheera Niyantran (Sanshodan) Act, 1964 as subsequently amended, an assessee debited a sum of Rs. 3,94,454 to the profit and loss accounts relevant to the assessment years 1979-80, 1980-81 and 1981-82 by credit to Molasses Storage Fund. The fund was intended for construction and maintenance of adequate storage facilities of Molasses. The sum of Rs. 3,94,454 was allowed as deduction while computing income for these assessment years even though credit to the Fund was only an appropriation of income and hence was not allowable. The incorrect allowance resulted in under-assessment of income by Rs. 3,94,454 involving short levy of tax of Rs. 76,434 in the assessment year 1979-80 and a total carry forward of excess loss of Rs. 2,62,100 for the assessment years 1980-81 and 1981-82.

The comments of the Ministry of Finance are awaited (January 1986).

(viii) In computing the business income of an assessee, the amount of interest paid in respect of capital borrowed for the purposes of the business is an allowable deduction.

In Road Transport Corporations Act, 1950, it is laid down that the Central Government and the State Government may provide to a Corporation established by the State Government, any capital that may be required by the Corporation for the purpose of carrying on the undertaking or for purposes connected therewith. The Act *ibid* contemplates that Corporation should pay interest on such capital at the rate as may be fixed by the State Government in consultation with the Central Government and such interest shall be deemed to be part of the expenditure of the Corporation. Clarifying the above provisions, the Central Board of Direct Taxes in February 1961 issued instructions that the interest paid by the Corporation to the Central and State Governments is allowable as a deduction as it is in respect of capital borrowed for the purpose of business or alternatively under the residual section of the Income tax Act which provides for deduction of any expenditure laid out or expended wholly and exclusively for the purpose of the business.

The Department, however, contended in a case before the Punjab and Haryana High Court that interest paid by a Road Transport Corporation in respect of capital provided (under the Road Transport Corporation Act of 1950) was not an admissible deduction while computing income of the Corporation as the capital provided to the Corporation was not capital borrowed. The Department of Revenue succeeded in their contention and Punjab and Haryana High Court held in February 1981 that Governments were obliged to provide capital not by virtue of any agreement but because of statutory provision and that there was no obligation to refund the capital provided by Government and hence the interest paid on capital provided is not as admissible deduction. The Central Board of Direct Taxes have not, however, revised their executive instructions of February 1961 in the light of the judicial opinion.

A public sector Road Transport Corporation during the previous years relevant to the assessment years 1981-82 and 1982-83 paid interest of Rs. 1,73,87,011 and Rs. 2,49,04,573 respectively on amounts of capital contributed by State and Central Governments under the Road Transport Corporation Act, 1950. These payments of interest were allowed as deductions by the assessing officer while computing the income for the assessment years 1981-82 and 1982-83 (assessment completed in July and August 1983 respectively). Since the capital provided was not capital borrowed by the assessee as held by the judiciary, the deductions allowed thereof were inadmissible.

The mistake resulted in excess carry forward of business loss of Rs. 1,69,94,224 and of unabsorbed depreciation of Rs. 8,92,787 for the assessment year 1981-82 and excess carry forward of depreciation of Rs. 2,49,04,573 for the assessment year 1982-83 with potential tax effect of Rs. 2,46,15,648.

The comments of the Ministry of Finance are awaited (January 1986).

(ix) In computing business income a liability for expenditure is allowable as deduction if it is an ascertained liability and not merely a contingent liability.

The assessment of a Private Limited company for the assessment year 1981-82 was completed in February 1984, on a loss of Rs. 2,64,715. While computing the income the assessee's claim for deduction for bank interest on secured loan of Rs. 4,32,410 among other interest items was allowed by the department. However, the notes annexed to the relevant profit and loss account indicated that the assessee was disputing and denying the interest liability in the courts of Law. As the liability to pay interest had not crystallised till the decision of the court, the amount of interest was merely a contingent liability and not an ascertained liability to be allowed as deduction. The incorrect allowance of deduction resulted in net under assessment of business income by Rs. 1,67,695 with consequent tax undercharge of Rs. 99,149 for the assessment year 1981-82 instead of loss of Rs. 2,64,715 computed by the department.

The Ministry of Finance stated that on the assessee company committing a default in payment of interest, the bank obtaining the orders of Court sold the shares and realised their dues. However these later events have no relevance in the case commented upon as the assessee followed mercantile system of accounting and the interest liability of the company for the assessment year 1981-82 was only contingent.

(x) Under the provisions of Income-tax Act, 1961, where an assessee being an Indian company incurs any expenditure, after 31 day of March, 1970 in connection with issue, for public subscription of shares in or debenture of the company, before commencement of the business or after commencement in connection with the extension of his industrial undertking or setting up of new industrial unit, the assessee shall in accordance with the provisions of the Act, be allowed a deduction of an amount equal to one tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or extension is completed or the new industrial unit commences production or operation.

An assessee company incurred expenditure of Rs. 1,19,639 in connection with the issue of shares during the previous year relevant to the assessment year 1979-80 and debited the entire amount to the profit and loss account of the company. The department while computing the income of the company for the assessment year 1979-80 in September 1982, allowed the amount in full instead of limiting it to Rs. 11,964 being the amount equal to one-tenth of such expenditure as was admissible under the Act. The excess allowance of such expenditure resulted in under-assessment of income of Rs. 1,07,675 involving short levy of tax of Rs. 62,182 for the assessment year 1979-80.

The Ministry of Finance have accepted the mistake.

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

A Company made provision of Rs. 1,44,298, 2,08,636 and Rs. 2,38,280 in its accounts ended in December, 1977, 1978 and 1979 respectively for "leave pay for workers and staff", by debit to the respective Profit and Loss accounts. After meeting the expenditure during these years, the balance provisions of Rs. 52,325, 1,20,848 and Rs. 1,61,879 were shown as liabilities in its balance sheets relevant to the assessment years 1978-79, 1979-80 and 1980-81 respectively. These balances of Rs. 52,325, 1.20,848, and Rs. 1,61,879 were merely provisions

for contingent liabilities and any expenditure or liability to pay in this regard would arise only on the contingency of an employee proceeding on leave and therefore these provisions were to be added back in computing the business income of the respective assessments. Omission to do so resulted in under assessment of income by Rs. 3,35,052 in the three assessment years 1978-79 to 1980-81 involving short levy of tax of Rs. 2,13,508 in these three assessment years.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(xii) The profits and gains of any business which was carried on by an assessee at any time during the previous year is chargeable to income tax under the head 'profits and gains of business or profession'. All trading receipts have to be taken into consideration in the computation of income from business, though the trading receipts might have been credited by the assessee to a suspence or any head of account. The Supreme Court held in October 1972 (87 ITR, 542) that it is the true nature and quality of the receipt and not the head under which it is entered in the account books as would prove decisive. If a receipt is a trading receipt, the fact that it was not so shown in the account books of the assessee would not prevent the assessing authority from treating it as a trading receipt. While reiterating the decision, the Supreme Court in another case in November 1974 (97 ITR 615) held that the amount collected by an assessee as sales tax constituted its trading receipt and had to be included in its total income and that if and when the assessee paid the amount collected to the State Government or refunded any part thereof to the purchaser, the assessee would be entitled to claim deduction of the sum so paid or refunded. Again, in November 1978, the Supreme Court in another case (116 ITR 60) observed that the true nature or character of the receipts would have to be considered to find out whether they constitute a part of the price received by the assessee while effecting sales and therefore trading receipts. The Calcutta High Court in January 1981 held in a case that the sales tax charged by the dealer from his customer is a part of the sale price and it is a revenue receipt. As and when the amount paid to the Government the dealer could claim the same as an allowable deduction. In a recent judgment (154 ITR 259) of March 1985, the Patna High Court held in the case of Motipur Sugar Factory Private Ltd. that the sums charged and realised by the assessee from the dealers for payment to the India Sugar Syndicate, but not actually paid pending settlement of disputes, constituted trading receipts includible in total income for purposes of levy of tax.

Four sugar companies sold in the previous years relevant to the assessment years 1979-80 to 1981-82 levy sugar to the Food Corporation of India at a price in excess of the price fixed by Government. Simultaneously, the assessee filed a writ petition in the High Court contending that the sale price fixed by Government was not commensurate with the expenses incurred and hence needed revision upwards. The High Court granted interim injunction and allowed the assessee to retain the excess amount realised by it on sale of sugar at higher price, subject to furnishing a bank guarantee. The High Court also held *inter alia* that in the event of any amount becoming refundable by the assessee, it would be liable to pay interest at a specified rate on the amount realised in excess.

The assessee companies credited the profit and loss account with the sale price of levy sugar at the price fixed by Government and took the difference between the actual sale price at a higher rate and the sale price fixed by Government amounting to Rs. 2,06,58,201 in the Balance Sheet as a liability without treating it as a trading receipt. In justification of not bringing the amount as a trading receipt, the assessees contended that in the event of the writ petition proving unsuccessful, they might have to refund the difference to the Food Corporation of India. Accepting the contention, the Income-tax Officer did not consider the sums of Rs. 2,06,58,201 as trading receipts in the assessments made for the assessment years 1979-80 to 1981-82. In the light of the judicial decisions cited the sum of Rs. 2,06,58,201 constituted trading receipts and the omission to include them in the income resulted in short levy of tax of Rs. 1,76,77,880, including non-levy of interest on short payment of advance tax and short levy of surtax amounting to Rs. 68,25,940, in the case of 3 companies and excess carry forward of loss of Rs. 8,39,249 involving potential tax effect of Rs. 5,41,350 in the remaining case.

The comments of the Ministry of Finance on the cases are awaited (January 1986).

(xiii) The Income-tax Act, 1961, provides for deduction from the income of an assessee for any expenditure or trading liability incurred for the purpose

of business carried on by the assessee. When on a subsequent date, the assessee obtains any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof, the benefit that accrues thereby is deemed to be profits and gains of business or profession to be charged to income-tax as income of the previous year in which such remission or cessation takes place.

A State Government Seeds Corporation engaged in the business of purchase of seeds from the growers and sale thereof to the cultivators debited its purchase account with the value crediting the Growers' accounts for the amount due. In the account for the year ending 31 March, 1980 relevant to the assessment year 1980-81, the company created a Price Stabilisation Reserve for Rs. 3,25,000 through two sets of accounting adjustments viz. (i) by debit to the growers' account and credit to the Profit and Loss Appropriation Account and (ii) by debit to the Profit and Loss Appropriation Account and credit to the Price Stabilisation Reserve Account.

The debits to the Growers' Accounts of Rs. 3,25,000 showed that the value of purchases had been inflated by Rs. 3,25,000 and consequently the net profits had been understated to the same extent. To arrive at the correct income, the sum of Rs. 3,25,000 was to be added back to the net profits. The omission to do so resulted in under assessment of income of Rs. 3,25,000 involving potential short levy of tax of Rs. 1,92,156.

The Ministry of Finnce have accepted the mistake.

Irregularities in allowing depreciation development rebate and investment allowance

2.23 **Mistakes in the allowance of depreciation**

Under the Income-tax Act, 1961 in computing the business income of an assessee a deduction on account of depreciation is admissible at the prescribed rates on plant, machinery or other assets provided it is owned by the assessee and used for the purpose of his business during the relevant previous year.

Depreciation on buildings and plant and machinery is calculated on their written down value according to the rates prescribed in the Income-tax Rules, 1962. Special rates of depreciation ranging from 15 per cent to 100 per cent are prescribed for certain specified items of machinery and plant. A general rate of 10 per cent (15 per cent from the assessment year 1984-85) is prescribed in respect of machinery and plant for which no special rate has been prescribed.

(i) (a) It has been judicially held that the expression "used for the purpose of business" means that the assets must be used by the owner for purposes of carrying on the business and earning profits therefrom. If the assets have not at all been used for any part of the accounting year, no depreciation allowance can be claimed.

In the Auditor's as well as the director's report of a company for the previous year relevant to the assessment year 1981-82, it was stated that the manufacturing activity of the assessee company was totally suspended throughout the entire period. While completing the assessment in November 1983 for the assessment year 1981-82, the income-tax officer allowed depreciation of Rs. 7,82,765 on plant and machinery which remained wholly unused throughout the entire period. The incorrect allowance of depreciation resulted in excess carry forward of unabsorbed depreciation of Rs. 7,82,765 for the assessment year 1981-82.

The Ministry of Finance have accepted the mistake.

(b) In the case of a company in which public are substantially interested while completing the assessment for the assessment year 1980-81 in September 1983, depreciation as also extra shift depreciation amounting to Rs. 1,20,816 was allowed on machinery costing Rs. 6,04,080 though the machinery was not commissioned for operation and thus not put to use for the purpose of the assessee's business. This resulted in excess carry forward of unabsorbed depreciation by Rs. 1,56,534 with a potential tax effect of Rs. 92,551.

The Ministry of Finance have accepted the mistake.

(ii) In the assessment of 4 companies, for the assessment years 1980-81 to 1983-84, due to incorrect application of rates of depreciation allowance and other calculation mistakes, there was an aggregate excess allowance of depreciation of Rs 37,65,965 resulting in short levy of tax of Rs. 1,76,581 in two cases and excess carry forward of unabsorbed depreciation involving potential tax effect of Rs. 20,93,213 in the

remaining 2 cases. The particulars of these cases are as under :—

Sl. No.	Commissioner's charge / Assessment year	Mistake	Tax effect
			Rs
1.	A 1981-82	Depreciation on second class building was wrongly worked as Rs. 26,68,000 instead of the correct figure of Rs. 2,66,850.	14,19,680
2.	B 1980-81 to 1983-84	On Rig units used in digging bore wells, depreciation was allowed at 20% of the written down value against the rate of 10 per cent.	6,73,533
3.	C 1981-82 to 1983-84	Depreciation on Road Rollers Concrete mixer, generator, air Compressor allowed at 30 per cent against the correct rate of 10 per cent.	79,231
4.	D 1981-82	Depreciation on Crane and Lift allowed at 40 per cent instead of the correct rate of 10 per cent.	97,350

Of these one assessment was done by the inspecting Assistant Commissioner (Assessment).

The Ministry of Finance have accepted the objection in one case; their reply in the remaining 3 cases is awaited (January 1986).

(iii) Under the Income tax Rules 1962, depreciation on Motor buses, Motor lorries and Motor taxis is admissible at 40 per cent, if used in the business of running them on hire: otherwise at 30 per cent.

In the assessment of a company for the assessment year 1981-82 assessments completed in January 1984, the assessing officer erroneously allowed depreciation allowance at the rate of 40 per cent on fleet of lorries owned by the company for its own transport business instead of at the correct rate of 30 per cent applicable to such items. This led to under-charge of income of Rs. 2,81,776 with resultant tax under charge of Rs. 1,96,891.

The comments of Ministry of Finance are awaited (January 1986).

(iv) With a view to encouraging the use of renewable energy devices, depreciation at the rate of 30 per cent was allowed with effect from 1 April 1981 on any special devices including electric generators and pumps running on wind energy.

In the assessments of a company engaged in the business of manufacturing and sale of jute goods, for the assessment years 1981-82 and 1982-83 (assessments made in January 1983 and February 1984 respectively) normal depreciation on electric generators was allowed at 30 per cent and at 15 per cent for double shift, as claimed by the assessee. As the electric generators were not running on wind energy, depreciation was allowable at the general rate of 10 per cent only. The mistake resulted in excess allowance of depreciation of Rs. 6,84,667 and Rs. 8,34,030 leading to under-charge of tax of Rs. 4,24,570 including interest of Rs. 19,760 in assessment year 1981-82 and excess carry forward of loss of Rs. 8,34,030 in the assessment year 1982-83.

The Ministry of Finance have accepted the mistake for the assessment year 1981-82. Further report is awaited (January 1986).

(v) Under the provisions of the Income-tax Act, 1961, expenditure of a capital nature incurred by an assessee on scientific research during the relevant previous year is deductible in computing the taxable income for that assessment year. In such a case the assessee will not be entitled to depreciation in respect of the capital expenditure on scientific research represented by any asset either in the same or in any other previous year.

(a) While computing income of three companies in three Commissioners' charges between February 1981 and February 1984, for the assessment years 1976-77, 1980-81 and 1981-82 depreciation of Rs. 10,16,587 was allowed by the department on assets acquired for scientific research during the earlier year(s) though the entire expenditure incurred on acquiring the assets was allowed as deduction in the earlier assessments. The incorrect allowance of depreciation resulted in under-assessment of income of Rs. 10,16,587 with a consequent under-charge of tax of Rs. 6,17,772 in the two cases.

The Ministry of Finance have accepted the mistake in one case. Their comments in the other cases are awaited (January 1986).

(b) In the assessment of a closely held company engaged in the business of production of cine films for the assessment year 1979-80 completed in September 1982, an amount of Rs. 11,81,261 being the cost of 17 numbers of 'imported lens for cine cameras' was allowed as deduction on account of depreciation accepting the assessee's claim that the expenditure has

been incurred for replacing the old lenses and hence a revenue expenditure. Lenses do not find a specific mention in the table of rates of depreciation appended to the Income-tax Rules 1962, as eligible for 100 per cent depreciation and the assessing officer should have treated the expenditure as capital and allowed depreciation at 20 per cent as provided in the table of rates of depreciation. The mistake resulted in a short levy of tax of Rs. 4,73,445.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) The written down value has been defined in the Act to mean the actual cost to the assessee in the case of a new asset acquired during the previous year and actual cost less depreciation (both normal and additional depreciation) allowed under the Act in the case of an old asset acquired in earlier years. The Act further provides that where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purpose of business or profession and the Income-tax Officer is satisfied that the main purpose of the transfer of such assets directly or indirectly to the assessee was the reduction of a liability to income-tax, the actual cost to the assessee shall be such an amount as may be determined by the Income-tax Officer with the prior approval of the Inspecting Assistant Commissioner having regard to all circumstances of the case.

(a) A private limited company which was a partner in a firm, took over the business of the firm on 8-9-1978 on its dissolution on 7-9-1978. The Directors of the company were the partners of the dissolved firm. Prior to dissolution, the firm had been allowed 100 per cent depreciation to the extent of Rs. 39,18,737 on gas cylinders, and pressure regulators costing Rs. 39,18,737. The value of the gas cylinders and pressure regulators was adopted at Rs. 39,18,737 in the books of the company on its taking over of these assets from the firm, which showed the value of assets at book value.

In the assessment for the assessment year 1979-80, the assessee company claimed 100 per cent depreciation on the same gas cylinders and pressure regulators and the assessing officer allowed the depreciation of Rs. 39,18,737 on these assets while completing assessments in June 1982.

These assets were used by the firm for the purpose of its business before the business was taken over by the partner company, and 100 per cent depreciation of Rs. 39,18,737 had already been allowed to the firm. Obviously the purpose of transfer of the assets on the dissolution of the firm at book value to one of the partners instead of at the written down value which was nil, was to reduce the liability to income-tax. The omission to redetermine the actual cost as nil by the department resulted in incorrect allowance of depreciation to the extent of Rs. 39,18,737 in the assessment year 1979-80 leading to a short levy of tax of Rs. 8,02,383 and excess carry forward of unabsorbed depreciation of Rs. 27,70,425 to assessment year 1980-81.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) In the case of a company additional depreciation amounting to Rs. 18,94,124 was allowed on plant and machinery in the assessment year 1981-82 completed in June 1983. This was, however, not taken into account in determining the written down value of the assets for the assessment year 1982-83 completed in June 1983, as a result the written down value of the plant and machinery was taken in excess by Rs. 18,94,124 involving excess allowance of depreciation of Rs. 4,59,518 in the assessment year 1982-83. As the assessment resulted in carry forward of unabsorbed investment allowance, there was excess carry forward of unabsorbed investment allowance of Rs. 4,59,418.

The Ministry of Finance have accepted the mistake.

(c) In the case of a Public limited company while completing the assessment in August 1983 for the assessment year 1980-81, the inspecting Assistant Commissioner allowed depreciation of Rs. 570.86 lakhs on buildings, plant and machinery and furniture instead of admissible amount of depreciation of Rs. 564.08 lakhs due to incorrect adoption of the written down value of the various assets. This resulted in excessive allowance of depreciation of Rs. 6.78 lakhs leading to a tax under charge of Rs. 4.01 lakhs.

The comments of the Ministry of Finance on the case are awaited (January 1986).

(d) A public limited company engaged in manufacture of artificial silk fabrics was allowed depreciation on machines at the general rate of 10 per cent and in addition another 10 per cent towards extra shift allowance for double and triple shifts for the

assessment years 1978-79, 1979-80 and 1980-81. On appeal by the assessee, however, it was held by the appellate authority that a normal rate of 15 per cent is allowable as depreciation on these machines. While giving effect to the appellate orders and while applying the same ratio of appellate orders for subsequent assessment year, the written down value of the machines for the purpose of calculation of depreciation at the special rate of 15 per cent and extra shift allowance based on the said rate was worked out without taking into consideration the depreciation and extrashift allowance already allowed originally at the general rate of 10 per cent. The incorrect computation of written down value resulted in grant of excess depreciation on machinery to the extent of Rs. 5,74,363 for the assessment year 1980-81 (assessment completed in January 1984) and Rs. 11,91,919 for the assessment year 1981-82 (assessment completed in February 1984). The excess depreciation granted for the two assessment years resulted in excess carry forward of these allowances to the extent of Rs. 17,66,282 with a potential tax effect of Rs. 9,71,455.

The Ministry of Finance have accepted the mistake.

(vii) The Act, provides that the term 'actual cost' for the purpose of allowance of depreciation means the actual cost of the assets to the assessee reduced by that portion of the cost, if any, as has been met directly or indirectly by any other person or authority. The Central Board of Direct Taxes clarified in March 1976 that the subsidy received under "10 per cent Central out right grant of subsidy scheme, 1971" for establishing industrial units in selected backward areas constitute capital receipts in the hands of the recepient and as such this amount would have to be reduced from the cost of the assets, for the purpose of allowing depreciation on such assets.

During the previous years relevant to the assessment years 1978-79 to 1980-81, three companies assessed in two different Commissioner's charges received subsidy amounting to Rs. 45,00,000 from the Madhya Pradesh Financial Corporation and the Central Government for the purchase of plant and machinery. However, the assessing Officers while calculating depreciation allowance on the plant and machinery, omitted to reduce the amount of subsidy of Rs. 45,00,000 from the cost of the plant and machinery. The omission resulted in excess grant of depreciation allowance of Rs. 5,90,547 and consequent aggregate under charge of tax of Rs. 3,59,503 in these three cases.

The Ministry of Finance have accepted the objection in two cases. Their reply in the remaining case is awaited (January 1986).

(viii) (a) Under the provisions of the Income-tax Act, 1961 where in any previous year owing to there being no profits or gains of business chargeable to tax during that previous year or profits of business being less than the depreciation allowance, the depreciation allowance or part thereof to which effect has not been given, shall be added to the depreciation allowance for the following previous year and deemed to be the part of allowance for that previous year and shall be allowed in that previous year or years. Such unabsorbed depreciation will , however, be adjusted against the profits of business of relevant previous year after set off of business loss or unabsorbed business loss, if any, of the assessee.

In the case of a company assessee for the assessment year 1980-81 the assessment of which was computed by the Income-tax Officer after getting directions on the draft assessment from the Inspecting Assistant Commissioner (Assessment) in August 1983, total income though computed at Rs. 11,00,265 was reduced to nil owing to adjustment of unabsorbed depreciation relating to the assessment years 1964-65 and 1965-66. It was however, seen from the assessment records pertaining to the assessment year 1979-80 the assessment of which was finalised in the same month (August 1983), that while giving effect to the orders of Commissioner of Income-tax (Appeals) for the assessment years 1973-74 and 1975-76 in January 1983, the unabsorbed depreciation for the assessment years 1964-65 and 1965-66 was fully adjusted. Thus by adjusting the unabsorbed depreciation again in August 1983 in the assessment for the assessment year 1980-81 there was double adjustment, resulting in under-assessment of income by Rs. 11,00,265 involving levy of tax of Rs. 7,09,671.

The comments of the Ministry of Finance are awaited (January 1986).

(b) The assessment of a closely held industrial company for the assessment year 1976-77 was completed in July 1979 determining a business loss of

Rs. 98,998 and carry forward of unabsorbed depreciation of Rs. 20,27,076. The unabsorbed depreciation was adjusted to the extent of Rs. 20,27,013 in the assessments for the assessment years 1978-79 and 1979-80 completed in September 1981 and September 1982 respectively leaving a balance amount of Rs. 63 only to be carried forward for set off in the assessment year 1980-81. However, in the assessment for the assessment year 1980-81 completed in July 1983 (revised in August 1983) an amount of Rs. 1,92,047 was adjusted as unabsorbed depreciation instead of the correct amount of Rs. 63. The mistake resulted in excess adjustment of Rs. 1,92,344 with consequent short levy of tax of Rs. 1,24,061 for the assessment year 1980-81.

The Ministry of Finance have accepted the mistake.

(c) In the case of a company unabsorbed depreciation of the assessment year 1969-70 was computed by the department at Rs. 6,17,305. Out of it a sum of Rs. 1,14,545 was set off against the income for the assessment year 1980-81 (revised in August 1983) and a further sum of Rs. 2,11,051 was set off against the income for the assessment year 1981-82 computed in August 1983. Thus unabsorbed depreciation of Rs. 2,91,709 only remained to be carried forward at the end of the assessment year 1981-82 instead of Rs. 3,91,679 as computed by the department. The mistake resulted in an excess carry forward of unabsorbed depreciation of Rs. 99,970 at the end of the assessment year 1981-82.

The Ministry of Finance have accepted the mistake.

(d) An assessee, a public limited company, claimed depreciation of Rs. 6,92,297 on tippers during the previous year relevant to the assessment year 1980-81. The claim included depreciation of Rs. 4,31,287 on tippers valued at Rs. 14,37,624 purchased in the subsequent accounting year relevant to assessment year 1981-82. The Income-tax Officer while assessing the income in September 1983 for the assessment year 1980-81 proposed to disallow the above depreciation of Rs. 4,31,287 but actually disallowed only Rs. 2,61,010 leading to excessive allowance of depreciation of Rs. 1,70,277 for the assessment year 1980-81. This resulted in excess carry forward of unabsorbed depreciation to the tune of Rs. 1,70,277 involving potential tax effect of Rs. 98,330.

(ix) Under the Income-tax Act, 1961, in the case of any building, machinery, plant or furniture which is sold, discarded, demolished or destroyed in the previous year, the amount by which the moneys payable fall short of the written down value thereof, is allowed as terminal depreciation provided the deficiency is actually written off in the books of the assessee. However, the loss if any, computed under the head 'Capital gains' shall be carried forward to the following assessment years and set off against capital gains relating to long term capital assets for those assessment years.

In the assessment of a public limited company for the assessment year 1978-79, completed in September 1981, in a Central circle, the assessing Officer allowed loss of Rs. 2,67,762 as terminal depreciation on the sale of buildings and sanitary fittings. The loss was computed by deducting the sale value of buildings of Rs. 75,000 from the total cost of building at Rs. 3,27,496 and the written down value of Rs. 15,266 of sanitary fittings. No deficiency was, however, actually written off in the books of the assessee and the original cost and the written down value of the assets remained the same. Consequently, no deduction was allowable in respect of the sale of buildings. The loss on sale of buildings being, therefore, capital loss was required to be set off against capital gains relating to long-term capital assets and not against the business income of the assessee. There was thus excess allowance of terminal depreciation to the extent of Rs. 2,64,181 and consequent excess determination of loss by Rs. 2,64,181.

The comments of the Ministry of Finance are awaited (January 1986).

2.24 **Incorrect grant of additional depreciation**

Under the Income-tax Act, 1961, as amended by the Finance (No. 2) Act, 1980 a further deduction is allowed by way of additional depreciation in respect of new plant or machinery installed after 31st March, 1980, but before 1st day of April, 1985, the additional sum being equal to one-half of the normal depreciation in respect of the previous year in which such plant or machinery is installed or if the plant and machinery is first put to use in the immediately suceeding previous year, then in respect of that previous year.

(i) In computing the business income of a company for the assessment year 1981-82 (assessment completed in November 1983), the assessing officer allowed additional depreciation of Rs. 3,19,455 even though the assessee had not claimed the normal depreciation on this machinery which was also not used in the relevant previous year. The irregular allowance resulted in under assessment of income of Rs. 3,19,455 and consequential under-charge of tax of Rs. 2,06,047.

(ii) In another case, for the assessment year 1981-82 (assessment done in February 1984) normal depreciation on plant and machinery was allowed at Rs. 5,14,062, though the additional depreciation allowance admissible worked to Rs. 2,57,031 the actual allowance amounted to Rs. 6,78,991. This resulted in excess grant of additional depreciation allowance of Rs. 4,21,960 with under-charge of tax of Rs. 2,49,484.

(iii) In a third case, assessment for the assessment year 1981-82 was completed in March 1984. While allowing additional depreciation on plant and machinery the assessing officer irregularly allowed additional depreciation allowance of Rs. 2,23,902 though the machinery was installed prior to 31st March 1980. This resulted in under-assessment of income of Rs. 2,23,902 and consequent short levy of tax of Rs. 1,38,806.

The Ministry of Finance have accepted the mistake in two cases. Their reply in the third case is awaited (January 1986).

2.25 **Incorrect grant of extra depreciation to hotels**

Under the Income-tax Act, 1961, Indian companies engaged in the hotel business were entitled to deduction from their business income on account of development rebate at the rate of thirty five per cent of the actual cost of machinery and plant installed after 31st March 1967 but, before 1st April 1970 in premises used by it as a hotel and at the rate of twenty five per cent where the plant and machinery was installed after 1st April 1970 provided such hotel was for the time being approved by the Central Government. By a notification issued in May 1971 the Central Government abolished the allowance towards development rebate in respect of plants and machinery installed after 31st May 1974. The Finance Act, 1974 as amended by Finance Act, 1975, continued the development rebate in respect of certain specific cases. After 1st June 1977, the development rebate is not admissible on any plant and machinery.

The Income-tax Rules, 1962 provide for an extra allowance of depreciation of an amount equal to one-half of the normal allowance in the case of machinery and plant installed by an assessee, being an Indian company, in premises used by it as a hotel where such hotel is for the time being approved by the Central Government for the purpose of grant of development rebate.

With the withdrawal of the deduction on account of development rebate with effect from 1st June 1974 and in certain special cases upto 31st May 1977, there could be no approval by the Central Government to hotels for the purpose. As there cannot be any approval under provisions which are non-existent the extra allowance of depreciation in respect of plant and machinery installed in the premises of hotels will not be admissible.

While completing the income-tax assessments of a widely held company engaged in hotel business for the assessment year 1981-82 in February 1984 the assessee company was allowed a sum of Rs. 1,66,576 being extra allowance of depreciation in respect of hotels run by it based on the approval given by Department of Tourism in the Government of India in June 1980. As the provisions relating to grant of development rebate (except in certain cases) had been abolished from 1st June 1974, the grant of extra depreciation of Rs. 1,66,576 in respect of approved hotels was not in order. The incorrect allowance resulted in under-assessment of income of Rs. 1,66,576 and a short-levy of tax of Rs. 98,486.

The comments of the Ministry of Finance are awaited (January 1986).,

2.26 **Incorrect allowance of extra shift depreciation**

In the case of plant and machinery, extra shift depreciation allowance is given where a concern claims such allowance on account of double or triple shift working. At the instance of audit, it was clarified by the Ministry of Finance in September 1966 that extra shift allowance should be granted only in respect of machinery which has actually worked extra shift and not in respect of all machinery of the concern which has worked extra shift. Similar instructions were issued by the Central Board of Direct Taxes in December 1967 pointing out that extra shift allowance was being granted without verifying as to how many days the plant and machinery had actually worked extra shift.

In September 1970, the Board issued instructions in modification of their instructions of December 1967 stating that where a concern has worked double shift or triple shift, extra shift allowance may be allowed in respect of the entire plant and machinery used by the concern without making any attempt to determine the number of days on which each machine had actually worked double or triple shift during the relevant previous year. These instructions ran counter to the instructions of September 1966 issued at the instance of audit and as such grant of extra shift allowance for the concern as a

whole without reference to each machinery, is not in accordance with the law. The Board was accordingly requested in July 1971 to re-examine the question. The Board, however, repeated the instructions in their circular of March 1973. On a reference seeking their advice, the Ministry of Law opined in February 1978 that if in any particular year any particular machine or plant was not at all used even for a day, the normal depreciation allowance was not admissible and as a corollary thereto extra shift depreciation would not be admissible and suggested that the Board's instruction of September 1970 should be modified. It followed from the Law Ministry's advice that depreciation both normal and extra shift should be calculated not for the entire concern but with reference to the various items of machinery and plant.

In January 1979, the Board informed audit that the extra shift allowance is allowed as a percentage of the normal depreciation and where no normal depreciation has been allowed on any particular machinery, because it has not worked even for a day, no extra shift allowance would become allowable on it. They added that the Board's instructions of September 1970 would not require modification even in the light of Law Ministry's advice of February 1978. It was pointed out to the Board in March 1979 that the Act allows depreciation only in respect of plant and machinery and not for a concern so that calculation of extra shift allowance on the basis of number of days for which the concern as a whole has worked extra shift, would be contrary to the provisions of the Income-tax Act. The Board agreed in April 1979 to examine whether the instructions would require any modification. In June 1981 also the Ministry informed audit that the matter was under consideration in consultation with the Ministry of Law. The Board were again requested in June 1982 to review and revise their instructions of September 1970.

The point came before different High Courts on a number of occasions. The Madras High Court held in September 1981 that the Income-tax Officer has to apply his mind and examine whether the machinery owned by the assessee has been used by him in extra shift. As long as the particular machine has worked extra shift, it would be eligible for extra shift allowance on the number of days it has worked. Earlier the Calcutta and Allahabad High Courts had also held in 1968, 1972, 1974 and 1980 that the extra shift allowance has to be calculated in proportion to the number of days the plant and machinery had actually worked and not an amount equal to the full amount of normal depreciation. In fact these two High Courts had held even prior to the issue of Board's instruction of September 1970 that the extra shift allowance should be allowed proportionately for the actual number of days the machinery had worked. In all these cases, the department presented its case and succeeded in obtaining the Court's verdict that the extra shift allowance is to be allowed only for the number of days the plant and machinery has worked double or triple shift. There is no judicial decision for the opposite view taken in the Board's instruction of September 1970.

The non-maintainability in law of Board's instructions of September 1970 was again pointed out to the Board in May 1984 suggesting issue of revised instructions which would be in conformity with the Act and judicial pronouncements.

In February 1985 the Board issued instructions directing the asssessing officers to grant extra shift allowance on plant and machinery calculating the same with reference to the working of a factory situated at a place and not with reference to the number of days each plant and machinery have worked. These instructions further provide that where a concern has more than one factory the extra shift allowance will be regulated for each factory in the above manner. The revised Instructions are still not in conformity with the provisions of the law. Further these instructions have also serious revenue implications to the Government.

The matter has again been referred to the Ministry of Finance in May 1985. Their reply is awaited.

A few cases where extra shift allowance was incorrectly allowed were reported in the Report of the Comptroller and Auditor General of India for the year 1982-83 and 1983-84. Details of nine representative cases noticed during the year under report having a total revenue implication of Rs. 19,10,530 are given below.

The Ministry of Finance have justified the grant of extra shift allowance in five cases stating that this was in conformity with the Board's instructions of February 1985|September 1970 which as mentioned earlier is not in accordance with the judicial decision in the matter.

(i) During the previous years ending 31st March 1979 and 31st March 1980 relevant to the assessment years 1979-80 and 1980-81, a company in

which the public are substantially interested purchased certain items of plant and machinery and claimed extra shift depreciation equal to the normal depreciation. While completing the assessments for the two assessment years in August 1982, the assessing officer allowed the extra shift depreciation as claimed by the assessee company. It was noticed in Audit in June 1984 that the plant and machinery were actually purchased in different months during the course of the respective previous years, and the machinery had worked for a period ranging from 1 day to 217 days. A few machinery had worked for as small a period as 1 day, 3 days, 5 days, 17 days, 28 days, 33 days etc. Therefore, in the light of the judicial pronouncement the allowance for extra shift allowance at an amount equal to the normal depreciation was not in order and the claim should have been regulated with reference to the actual number of days the plant and machinery had actually worked extra shift. The omission to do so resulted in excess allowance of depreciation aggregating to Rs. 4,20,330 involving short-levy of tax (including surtax of Rs. 70,010) of Rs. 3,15,314 for the two assessment years.

(ii) A private company installed machinery worth Rs. 26,90,047 during the previous year relevant to the assessment year 1979-80. Initially the assessee company claimed extra shift depreciation allowance of Rs. 4,463 on these additions taking into account the dates of installation but revised the claim later to Rs. 2,69,041 being one hundred per cent of depreciation allowance for triple shift working. In the assessment made in August 1982 the extra shift allowance was not limited to the number of days the plant and machinery had actually worked extra shift but was allowed in full. The excess allowance resulted in under-assessment of income by Rs. 2,64,578 with a consequent short-levy of tax of Rs. 1,96,368 (including surtax of Rs. 29,683).

(iii) In the case of a public company, extra shift depreciation allowance of Rs. 2,21,451 was allowed on additions of Rs. 22,24,456 in the assessment for the assessment year 1979-80 (completed in January 1982 and revised in November 1982) without regulating the claim with reference to the number of days of working of each machinery. The excessive allowance resulted in short-levy of tax of Rs. 99,370.

(iv) In the assessment of a closely held company for the assessment year 1979-80 (previous year ending 31st March 1979) completed in September 1982, extra shift allowance of Rs. 1,95,315 equal to the normal depreciation was allowed for triple shift working of machinery valued at Rs. 19,53,153. The machinery was installed on various dates between 10th March 1979 and 30th March 1979 and the machinery had thus worked between 2 to 22 days in the relevant previous year out of 304 days, the factory had worked triple shift during the relevant previous year. If the extra shift allowance had been restricted to the number of days for which the machinery had actually worked the amount of allowance admissible would be Rs. 4,675 only. The extra deduction of Rs. 1,90,640 resulted in short-levy of tax of Rs. 1,48,318 including surtax of Rs. 28,215.

(v) During the previous year ending 31st March 1979 relevant to the assessment year 1979-80 a widely held company made additions to its machinery valued at Rs. 19,56,226 and claimed extra shift depreciation allowance thereon at hundred per cent of normal depreciation. In the assessment completed in July 1982 the extra shift allowance as claimed by the assessee was allowed in full. The items of machinery were purchased on various dates between 4th December 1978 and 23rd March 1979. Even assuming that the machineries were installed on the very same date of their purchases, the total extra shift allowance allowable with reference to the number of days each machinery had actually worked during the previous year, would work out to Rs. 11,865 as against Rs. 1,95,623 allowed in the assessment. The excess allowance of Rs. 1,83,758 resulted in a short levy of income-tax of Rs. 1,06,753 besides a surtax liability of Rs. 19,251.

(vi) A public limited company claimed, Rs. 1,18,989 and Rs. 1,72,623 on account of extra shift allowance on the newly installed plant and machinery for the accounting years ending March 1982 and 1983 relevant to the assessment years 1982-83 and 1983-84 respectively. The claim was allowed by the Department in the assessment made in November 1982 and October 1983. It was found that according to the Works Manager's certificate kept in the assessment records the company had installed the new machinery in February 1982 and March 1983 in the relevant assessment years. However the extra shift allowance was allowed for the full year instead of restricting the claim proportionate to the number of days the machineries had actually worked in extra shift. The omission led to excess allowance of extra shift depreciation of Rs. 1,05,297 and Rs. 1,40,089 involving short levy of tax of Rs. 66,011 and excess carry forward of unabsorbed depreciation of Rs. 1,40,089.

(vii) In the case of a public limited company, extra shift allowance on plant and machinery was allowed in the assessment for assessment year 1981-82 equal to normal depreciation for triple shift working of the concern instead of restricting the same in proportion to the number of days each machinery had actually worked double and triple shifts. The incorrect allowance resulted in excess carry forward of unabsorbed depreciation to the extent of Rs. 14,15,554 with a potential tax effect of Rs. 7,78,550.

(viii) In the case of a Company, extra shift allowance equal to cent per cent of the normal depreciation allowance for triple shift working was allowed by the income-tax Officer in the assessment year 1980-81 completed in September 1983 on the machinery purchased during the relevant previous year. The machinery purchased during this year had not worked for the entire period and the extra shift allowance should have been restricted to the proportionate amount on the basis of number of days, each machinery had actually worked in triple shift. Out of the machines installed during the previous year in respect of 5 machines (for which alone the dates of installation was available in the assessment records) there was excess allowance of depreciation amounting to Rs. 1,27,265 (approximately) in the assessment year 1980-81 leading to under charge of tax of Rs. 1,08,352 including penal interest.

(ix) An assessee company was allowed extra-shift allowance for triple shift working equal to normal depreciation allowance in the assessment year 1978-79 on new machinery installed during the year. Out of the new machinery valuing Rs. 20,37,478, machineries valuing Rs. 16,01,753 and Rs. 2,64,340 were added in the months of December, 1977 and March, 1978 respectively and worked for only 121 days. The extra-shift allowance was not calculated in proportion to the actual number of days the new machinery worked in triple shift to the normal number of working days. The mistake resulted in under-assessment of income of Rs. 1,05,854 and short levy of tax of Rs. 72,243.

2.27 **Other cases of extra shift depreciation allowance**

(i) Under the Income-tax Rules, 1962 extra shift depreciation allowance shall be allowed upto a maximum of one half of normal depreciation allowance where the concern had worked double shift and upto the maximum of amount equal to the normal allowance where the concern had worked triple shift. Further, the extra shift allowance for double or triple shift working shall be calculated separately in the proportion which the number of days for which the factory worked double or triple shift bears to the normal number of working days during the previous year. Under the rules normal number of working days during the previous year shall be deemed to be a maximum of 180 days in the case of seasonal factory and a maximum of 240 days in the case of a non-seasonal factory.

(i) In the assessment of a private industrial company for the assessment year 1980-81 completed in August 1983, extra shift depreciation allowance was allowed at hundred per cent of the normal depreciation allowance on machinery valued at Rs. 98,63,100 in one of the units of the company. The unit started functioning from 26 March, 1980, six days prior to the close of the relevant previous year which ended on 31st March 1980. The Income-tax officer should, therefore, restrict the allowance to six days only and calculate the allowance in the proportion of 6 days to the normal working of 240 days. The omission resulted in excess allowance of Rs. 9,61,646 and a short levy of tax of Rs. 6,20,260.

The Ministry of Finance have accepted the mistake.

(ii) During the previous year ended 31st March 1979, relevant to the assessment year 1979-80, a company commissioned a new unit in October 1978 for the manufacture of industrial alcohol and claimed for the assessment year 1979-80 extra shift depreciation allowance in respect of the plant and machinery in the unit at one hundred per cent of the normal depreciation allowance. The claim was allowed by the Income-tax Officer in full for the assessment year 1979-80 after getting the directions from the Inspecting Assistant Commissioner (Assessment) on the draft assessment order. The new unit was, however, commissioned only during October 1978 and hence the extra allowance was required to be restricted to 155 days being the actual number of working days of the unit during the previous year. The omission to do so resulted in total short levy of tax of Rs. 1,79,024 including surtax of Rs. 27,681.

The Ministry of Finance have accepted the mistake.

(iii) In the assessment for the assessment year 1979-80 completed in June 1982 an assessee company was allowed extra-shift depreciation allowance of Rs. 1,97,814 instead of the correct amount of Rs. 98,907. The error in calculation led to excess allowance of extra-shift depreciation allowance of Rs. 98,907 involving short levy of tax of Rs. 81,109.

The Ministry of Finance have accepted the mistake.

(iv) In the assessment of a widely held company for the assessment year 1979-80 completed in August 1982 extra shift allowance of Rs. 2,69,335 was allowed calculating the allowance in the proportion of number of days which the factory worked double/ triple shift bore to 129 days being the actual number of days it worked extra shifts. According to the particulars furnished by the company the factory had actually worked double shift for 20 days and triple shift for 108 days. Accordingly, the assessing officer should have restricted the extra shift allowance to Rs. 1,44,768 in the same proportion the number of days the factory actually worked extra shift bears to 240 days as provided under the Rules. The omission resulted in excess allowance of Rs. 1,25,567 involving short levy of tax of Rs. 70,788. The assessment was checked by the internal audit party of the department but the mistake was not detected.

The comments of the Ministry of Finance are awaited (January 1986).

(v) A private limited company started production of iron and steel in November, 1977 and worked triple shift for 46 days during the previous year relevant to the assessment year 1978-79. In the assessment completed in September 1980 for the previous year ending on 31st December, 1977 relevant to the assessment year 1978-79, the assessing officer allowed extra shift depreciation at the rate of normal depreciation amounting to Rs. 10,63,712 instead of allowing proportionate extra shift depreciation of Rs. 2,03,878. This resulted in an excess computation of loss by Rs. 8,59,834 with notional tax effect of Rs. 5,41,695.

(vi) No extra shift depreciation allowance for multiple shift is admissible in respect of plant and machinery against which the letters NESA appear in the depreciation schedule in the Income-tax Rules, 1962.

A company in its assessments for the assessment years 1978-79 and 1979-80 claimed special rate of depreciation of 15 per cent on cranes used in its construction works. The company also claimed extra shift allowance on this machinery for extra shift working. Both the normal depreciation as well as extra shift allowance were allowed by the department as claimed while completing the assessments for the assessment years 1978-79 and 1979-80 in May 1983 and June 1983 respectively. Since special rate of depreciation at 15 per cent was allowed on the cranes treating them as building contractor's machinery and the letter 'NESA' have also been inscribed against them, no extra shift allowance was admissible. The incorrect grant of extra shift allowance resulted in excess allowance of depreciation of Rs. 13,67,288 and Rs. 20,82,462 for the assessment years 1978-79 and 1979-80 respectively leading to excess carry forward of loss by Rs. 34,49,750.

The Ministry of Finance have accepted the mistake.

(vii) The Income-tax Rules 1962 prohibit grant of extra shift allowance on cretain types of plant and machinery specified therein which inter-alia include refrigeration plant and for which a special rate of depreciation (15 per cent) has been prescribed.

In the assessment for the assessment year 1979-80 completed in September 1982 depreciation at a flat rate of 20 per cent including extra shift allowance on the refrigeration plant was allowed by the department as claimed by the assessee-company. No extra shift allowance was admissible in respect of refrigeration plant; instead depreciation at special rate of 15 per cent was allowable on it. This erroneous grant of extra shift depreciation resulted in excess allowance of Rs. 1,43,475 with consequent undercharge of tax of Rs. 82,857.

The comments of the Ministry of Finance are awaited (January 1986).

(viii) Under the Income-tax Rules, 1962, no extra shift allowance is admissible in respect of stationery plant and machinery and wirings and fittings of electric light and for installation falling under 'Electrical Machinery'.

In computing the business income of an assessee-company for the previous years relevant to the assessment years 1978-79 and 1979-80 extra shift allowance of Rs. 1,93,282 and Rs. 1,60,902 respectively was allowed erroneously in respect of electrical machinery/equipment fittings excluding motors and process plant which were stationery. The incorrect allowance resulted in an under assessment of Income of Rs. 3,54,184 with consequent short levy of tax undercharge of Rs. 2,04,550 in the two assessment years.

The comments of the Ministry of Finance are awaited (January 1986).

2.28 Incorrect grant of investment allowance

(i) As per the provisions of the Income tax Act, 1961, in respect of machinery owned by the assessee and used for purpose of business carried on by him, a deduction shall be allowed in the previous year of installation or in the previous year of first usage, of a sum by way of investment allowance, equal to twenty-five per cent of the actual cost of the machinery to the assessee. No investment allowance is admissible on machinery and plant which are not used in the industrial udertaking for the purpose of business of construction, manufacture or production of article or thing.

In the assessment of 9 companies for the assessment years 1979-80 to 1983-84 investment allowance of Rs. 41,96,581 was erroneously allowed on the machinery used by the companies although the companies were not engaged in the business of construction, manufacture or production. The irregular grant resulted in short levy of tax of Rs. 20,11,403 in 5 cases and excess carry forward of loss of Rs. 10,92,575 with a potential tax effect of Rs. 6,56,900 in the remaining four cases.

Details of the cases are as under :

Sr. No.	Commissioner's charge / Assessment year	Particulars of the mistakes	Tax under charge (Rs.)
1.	'A' / 1981-82	A private Ltd. company deriving income mainly from dying and printing of fabrics for others and not engaged in manufacture was erroneously allowed investment allowance of Rs. 15,08,353.	9,72,886
2.	'B' / 1980-81	Incorrect allowance of investment allowance of Rs. 8,83,616 to a company engaged in processing yarn by different processes such as crimping, texturising and twisting and not actually engaged in manufacture or production.	5,69,931
3.	'C' / 1981-82	Incorrect allowance of investment allowance of Rs. 4,05,962 to a company engaged in processing, blending of oil supplied by Indian Oil Corporation for which processing fees was received by the company.	2,40,024
4.	'A' / 1981-82	Irregular allowance of investment allowance of Rs. 2,43,344 to a company engaged in processing of yarn and not manufacture.	1,43,875 (Potential)
5.	'A' / 1980-81 1981-82	Incorrect allowance of investment allowance of Rs. 3,23,791 to a company merely doing work given by customers for which labour charges were received by the company.	2,05,121 (Potential)
6.	'D' / 1980-81	Incorrect allowance of investment allowance of Rs. 2,14,371 to a company running a cold storage unit, and not manufacturing any article.	1,17,904 (Potential)
7.	'E' / 1980-81 to 1982-83	Incorrect allowance of investment allowance of Rs. 3,11,069 to a company engaged in the business of storage of potatoes in cold storage.	1,90,000 (Potential)
8.	'F' / 1979-80	Erroneous grant of investment allowance of Rs. 1,40,867 to a hotel which was not an industrial undertaking engaged in the manufacture of production of articles.	96,142
9.	'D' / 1981-82 & 1983-84	Incorrect grant of investment allowance of Rs. 1,65,208 on fork Lift Trucks used for loading and unloading of cargo from ship and not used in the manufacture or production of things or articles.	1,32,420

In one case the asssessment was completed by the Inspecting assistant Commissioner (assessment).

The Ministry of Finance have accepted the mistake in one case. While not accepting the mistake in another case the Ministry of Finance stated that the cold storage plant carried on manufacturing process as has been held by the Punjab and Haryana High Court and accordingly satisfied the conditions for investment allowance. This is not tenable as according to the Supreme Court, in a manufacture, the commodity should be so transformed so as to loose its original character and should be put to a different use. In the cold storage process this does not happen. In an another case the Ministry of Finance have however, argued that the assessee company was engaged in the business of blending of various types of oils into lubricants/lube oil and the blended oil is different from raw materials. The Ministrys' reply is not acceptable as blending is only a process of mingling intimately the components so as to be indistinguishable to get a certain quality and not a manufacturing operation entitling grant of investment allowance. Mere carrying out the blending process mechanically will not alter the position.

The Ministry's reply in other cases are awaited (January 1986).

(ii) The Act stipulates that investment allowance shall be allowed on any new machinery or plant installed after 31 March 1976 in any industrial undertaking for the purpose of construction, manufacture or production of any article or thing except those specified in the list in the Eleventh Schedule to the Act.

In the assessment of 4 companies for the assessment years 1980-81 and 1981-82 investment allowace of Rs. 25,46,036 was erroneously allowed on the machinery used in the manufacture of items listed in Eleventh Schedule. The irregular grant resulted in short levy of tax of Rs. 15,65,123 in three cases and excess carry forward of loss of Rs. 2,49,631 with a potential tax effect of Rs. 1,60,931 in one case. Details of these cases are as under :—

Sl. No.	Commissioners' charge Assessment year	Particulars of mistakes	Tax under charge Rs.
1.	'A' 1981-82	Investment allowance of Rs. 13,02,053 was erroneously allowed on plant & machinery used in the manufacture of refrigerators strong doors and fire resistant cabinets.	8,39,790
2.	'B' 1981-82	Incorrect grant of investment allowance of Rs. 7,97,206 to a new unit of a company engaged in processing of photographic goods.	5,14,194
3.	'B' 1980-81	A company engaged in the manufacture of soft drinks using blended flavouring concentrates was irregularly allowed investment allowance of Rs. 2,49,631.	1,60,931 (Potential)
4.	'C' 1981-82	Company engaged in manufacture of sheet glass and glass tubes was allowed investment allowance of Rs. 1,97,146.	2,11,139

The Ministry of Finance have accepted the objection in one case; their reply in the remaining 3 cases is awaited (January 1986).

(iii) Industrial company as defined in the Finance Act 1966 means a company which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture of or processing of goods or in mining.

It has been judicially held that the term industrial company covers a construction company only when it is engaged in the construction of ships. Hence companies engaged mainly or otherwise in the construction of anything other than ships cannot be considered as industrial companies and no investment allowance in respect of plant and machinery installed therein would be admissible.

A Private Limited company engaged in the execution of contracts for construction of storage and fitting sheds, earthwork and fencing of barbed wires etc., claimed and was allowed during the previous year relevant to the assessment year 1983-84 investment allowance of Rs. 1,08,895. While completing the assessment in February, 1984 relief admissible to the company under the Act to newly established undertakings was disallowed by the assessing officer on the ground that it was not an industrial undertaking. But the investment allowance claimed by the assessee which was also not admissible on similar ground was not withdrawn The omission resulted in short levy of tax of Rs. 72,555. In addition, depreciation allowed to the company was also not worked out correctly, which resulted in further under assessment of tax of Rs. 23,692. Thus there was aggregate short levy of tax of Rs. 96,247.

The comments of the Ministry of Finance are awaited (January 1986).

(iv) The Income tax Act, 1961 was amended by the Finance Act, 1977 to provide for higher rate of investment allowance at the rate of 35 per cent in respect of machinery or plant installed after 30 June 1977, but before 1 April 1982 for the purpose of manufacture or production of any article or thing in cases where the article or thing is manufactured or produced by the asssesee by using technology or knowhow developed in a article or thing invented in a laboratory owned or financed by Government or by a public sector company or University or a recognised institution subject to the condition interalia that the assessee furnishes a certificate to this effect from the prescribed authority.

(a) In the assessment of a company (assessment completed in September 1983) for the assessment year 1980-81 investment allowance of Rs. 48,36,324 at the higher rate of 35 per cent was allowed on the machinery valued Rs. 1,38,18,068. The higher rate of investment allowance was granted following the assessment made in March 1982 for the assessment year 1979-80. The assessment for assessment year 1979-80 which was originally completed

in March 1982 granting higher investment allowance was set aside by the Commissioner of Income-tax and in the fresh assessment completed in October 1984, the investment allowance at 25 per cent only had been allowed on the ground that company had not filed the prescribed certificate for grant of higher investment allowance. As a consequence thereof the assessment for the assessment year 1980-81 should have also been revised to withdraw the higher investment allowance since the prescribed certificate had not been furnished by the company for the assessment year 1980-81 also. Failure to do so resulted in underassessment of income of Rs. 13,81,807 involving short levy of tax of Rs. 8,16,993.

The Ministry of Finance have accepted the mistake.

(b) In the assessment of a company for the assessment year 1979-80 a deduction by way of investment allowance was allowed for a sum of Rs. 4,54,851 calculated at the rate of 35 per cent on the cost of Rs. 12,99,575 on 22 sets of T.S.I. Anodes installed during the relevant previous year. However the requisite certificate from the prescribed authority was not furnished alongwith the return of income. In the absence of the certificate, grant of investment allowance at the higher rate resulted in an underassessment of income of Rs. 1,29,958 with consequent under charge of tax of Rs. 75,051.

The Ministry of Finance have accepted the mistake.

(v) No deduction of investment allowance shall be allowed in respect of any office appliances or plant and machinery installed in any office premises.

In the assessment of a company for the assessment year 1982-83 a deduction of Rs. 1,48,386 by way of investment allowance was allowed in July 1983 on computer and data processing machine installed in the office premises in the relevant previous year. As machinery installed in office premises does not quality for investment allowance, the grant of investment allowance was not in order. The irregular grant of investment allowance resulted in under assessment of income by Rs. 1,48,386 and consequtnt short levy of tax of Rs. 91,257.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) Investment allowance in respect of new plant or machinery is admissible subject to the condition that an amount equal to seventy five percent of the allowance is debited to the profit and loss account of the relevant previous year and credited to reserve account. In case the reserve created is below the prescribed percentage, the investment allowance to be granted to the assessee should be reduced proportionately.

(a) The assessment of an industrial company in which the public are not substantially interested for the assessment year 1980-81 was made by the Income-tax Officer in September 1983 after obtaining directions from the Inspecting Assistant Commissioner (Assessment) on the draft assessment order and in computing the business income of the company, the Income-tax Officer allowed investment allowance of Rs. 49,78,456. The assessee company had created investment allowance reserve of Rs. 34,20,000 only in the accounts of the previous year relevant to the assessment year 1980-81 instead of the correct reserve of Rs. 37,33,842. Based on the reserve of Rs. 34,20,000 actually created by the assessee company, it was entitled to the investment allowance of Rs. 45,60,000 only. This resulted in excess grant of investment allowance of Rs. 4,18,456 resulting in short levy of tax of Rs. 2,69,904.

The Ministry of Finance stated that the assessee company was entitled under the law to make up the deficiency but was not given the necessary notice. This contention is not acceptable as the shortfall was not made up before the completion of the assessment as required under the law.

(b) In the case of all assessee company, investment allowance of Rs. 82,427 was allowed by the Inspecting Assistant Commissioner (Assessment) in the assessment year 1977-78 (assessment made in September 1983). Similarly in the assessment made in March 1984 for the assessment year 1981-82 carried forward investment allowance of Rs. 6,65,331 pertaining to assessment year 1980-81 was allowed to be set off against its income. However, in both these years, no investment allowance reserve was created by the company. In the absence of the requisite reserve, the grant of investment allowance was not in order. Irregular grant of investment allowance resulted in underassessment of income aggregating to Rs. 7,47,758 with consequent short levy of tax of Rs. 4,40,976 for both the assessment years.

The Ministry of Finance have accepted the mistake for the assessment year 1977-78. Their comments for the assessment year 1981-82 are awaited (January 1986).

(vii) The new machinery has been explained in the Act to include machinery or plant which before its installation by the assessee was used outside India by any other person, or the machinery was not used previous to its installation by the assessee in India or such machinery was imported into India from abroad or no deduction of depreciation in respect of such machinery has been allowed or allowable under the Act in computing the total income of any person.

In the assessment of a widely held industrial company for the assessment years 1978-79 and 1979-80 completed in March 1981 and August 1982 respectively, the investment allowance aggregating Rs. 5.17 lakhs claimed by the assessee was allowed on machinery valued at Rs. 20.69 lakhs which were taken over from a co-operative federation during the relevant previous years. As these items of machinery were not new but used by the previous owner no investment allowance was admissible on these machinery. The incorrect allowance of investment allowance of Rs. 5.17 lakhs involved a resultant tax effect of Rs. 2.9 lakhs.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(viii) The Act further provides that, where the total income is nil or less than the full amount of investment allowance admissible only so much of the investment allowance is to be allowed as is sufficient to reduce the total income to nil and the balance of investment allowance is to be carried forward to the following assessment year and so on upto eight assessment years.

(a) In the case of a Private Limited Company, for the assessment year 1980-81 (assessment completed in December 1982) a sum of Rs. 6,34,927 on account of carried forward depreciation and investment allowance relating to the assessment years 1977-78 to 1979-80 were set off against the income of Rs. 8,90,510. The following mistakes were committed in the calculation of the amount of carried forward depreciation and investment allowance in respect of the assessment years 1977-78 and 1978-79.

While giving effect to an appellate order in January 1981 for the assessment year 1977-78, a deduction of Rs. 2,31,526 was allowed as extra shift depreciation allowance as against the correct amount of Rs. 8,688 by overlooking the deduction of Rs. 2,22,838 already allowed in the original order.

The net loss of Rs. 3,30,525 to be carried forward for the assessment year 1977-78 arrived at in the same revision order (January 1981) was incorrectly taken as Rs. 3,67,661 and for the assessment year 1978-79 as against the correct amount of Rs. 2,88,245 on account of unabsorbed depreciation and investment allowance to be carried forward, the amount was computed erroneously as Rs. 3,76,615 in the assessment made in March 1981, due to arithmetical errors.

These mistakes resulted in undercharge of income of Rs. 3,48,344 in the assessment year 1980-81 involving short levy of tax of Rs. 2,05,954.

The Ministry of Finance have accepted the mistake.

(b) In the assessment made in a central circle in September 1981 for the assessment year 1978-79 of a public limited company the total income was computed at a loss of Rs. 26,14,51,153 after deducting investment allowance of Rs. 17,56,908 as claimed by the assessee company. As there was no positive income and the total income computed was a loss, the deduction of Rs. 17,56,908 allowed towards investment allowance was not in order. The mistake resulted in incorrect allowance of Rs. 17,56,908 and excess determination of loss by Rs. 17,56,908.

The assessment was checked in Internal Audit of the department; but the mistake was not noticed by it.

The comments of the Ministry of Finance are awited (January 1986).

(ix) Under the provisions of the Income-tax Act, 1961 if a machinery on which investment allowance is granted is sold at any time before the expiry of eight years from the end of the previous year in which it was installed the investment allowance originally granted has to be withdrawn.

In the assessment of two companies under the charge of two different Commissioners for the assessment years 1979-80 and 1981-82 (assessments

completed in May 1981 and March 1984) investment allowance of Rs. 2,05,058 was allowed on machinery installed in the relevant previous years. These machineries were sold during the assessment years 1981-82 and 1982-83 within the prescribed period of eight years. No action was however, taken to withdraw the investment allowance incorrectly allowed which resulted in undercharge of tax of Rs. 1,29,590 in the two cases.

The Ministry of Finance have accepted the mistake.

(x) Loose tools not being fitted to the machinery do not form part and parcel of the machinery in itself and thus are not eligible for investment allowance. In the computation of business income of a company for the assessment year 1978-79 in September 1982 investment allowance of Rs. 2,39,633 was incorrectly allowed on loose tools. The incorrect grant of investment allowance on loose tools resulted in under assessment of income of Rs. 2,39,633 with consequent short levy of tax of Rs. 1,50,968.

The assessment was checked by the Internal Audit Party of the department but the mistake was not noticed.

The comments of the Ministry of Finance are awaited (January 1986).

(xi) In the computation of the business income of another company for the assessment year 1980-81, deduction by way of investment allowance of Rs. 1,35,763 was allowed by the Inspecting Assistant Commissioner (Assessment) on loose tools, purchased during the relevant previous year. The incorrect grant of investment allowance on the loose tools resulted in under assessment of income of Rs. 1,35,763 involving short levy of tax of Rs. 80,270.

The comments of the Ministry of Finance are awaited (January 1986).

(xii) Deduction on account of investment allowance is calculated on the basis of the actual cost of new plant or machinery installed and used for the purpose of business. Actual cost is defined to mean the actual cost of the assets to the assessee reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

In the assessment of the two companies for the assessment years 1978-79, 1979-80 and 1982-83, while working out the amounts of investment allowance admissible, the department omitted to reduce the aggregate subsidy of Rs. 20,14,674 received from Central|State Governments for arriving at the actual cost of the assets. The omission resulted in excess grant of investment allowance of Rs. 5,03,668 and resultant under charge of tax of Rs. 2,16,562 in one case and excess carry forward of investment allowance of Rs. 1,28,668 in the other case.

The comments of the Ministry of Finance in two cases are awaited (January 1986).

(xiii) No deduction on account of investment allowance is allowable on any plant or machinery acquired and used in the business by the assessee if whole of the actual cost of it is allowed as a deduction in computing business income in any previous year whether by way of depreciation or otherwise.

For the assessment year 1977-78, an assessee company claimed deduction of the entire cost of plant and machinery of Rs. 7,75,357 incurred on scientific research. As investment allowance of Rs. 1,93,839 on the said value was also claimed in the assessment made in September 1980, the assessing officer disallowed the assessee's claim of deduction of the cost of plant and machinery and allowed investment allowance of Rs. 1,93,839 thereon.

Pursuant to an appellate order of November 1981 directing allowance of the cost of machinery the assessment was revised in April 1982 and the entire cost of Rs. 7,75,357 was allowed as deduction. The cost of the plant and machinery having thus been allowed in its entirety no investment allowance was admissible to the assessee. Accordingly, the deduction of Rs. 1,93,839 already allowed to the assessee towards investment allowance was required to be withdrawn.

The required revision not having been done there was under assessment of business income by Rs. 1,93,839 with consequent tax under charge of Rs. 1,28,418 (including surtax under charge of Rs. 21,807) for the assessment year 1977-78.

The Ministry of Finance have accepted the mistake.

(xiv) In the assessment for the assessment year 1979-80 made in December 1981 a private limited company was allowed an investment allowance of Rs. 1,71,610 on the total cost of the plant and machinery of Rs. 6,86,441. The machines worth Rs. 3,70,227 were, however, purchased during the period relevant to the assessment year 1980-81. The investment allowance for these machines was, therefore, not admissible in the assessment year 1979-80. This mistake resulted in excessive grant of investment

allowance amounting to Rs. 92,556 involving short levy of notional tax of Rs. 53,420.

The comments of the Ministry of Finance are awaited (January 1986).

2.29 **Incorrect grant of development rebate**

(i) Under the provisions of Income-tax Act 1961, development rebate is allowable at the prescribed rate in respect of new plant and machinery installed before 1 June 1974. The development rebate was abolished with effect from 1 June 1974. As a transitory measure, development rebate was allowed under the provisions of Finance Act, 1974 in respect of plant and machinery, installed before June 1975 if the assessee established that the plant and machinery was purchased or the contract for its purchase was entered into with the seller before December 1973. In respect of plant and machinery installed on or after 1 June 1975 no development rebate should be allowed.

In the assessment of a public limited industrial company for the assessment year 1977-78 (assessment completed in August 1980), development rebate of Rs. 19,13,278 was allowed based on a certificate furnished by the assessee that it had installed plant and machinery valuing Rs. 72,88,363 in its business before the specified date *viz.* June 1975. It was, however, found that :

(i) the list of plant and machinery enclosed to the certificate given by the assessee company with reference to which the rebate was allowed only indicated that the plant and machinery was acquired after 31 May 1974 and before 1 June 1975. There was no indication about their installation|erection before 1 June 1975.

A part of the machinery was commissioned and the trial run was made on 12 June 1975.

According to the printed accounts of the company for the previous years ended 31 July 1975 and 31 July 1976, the entire plant and machinery acquired at the cost of Rs. 1,04,87,059 was awaiting installation as on 31 July 1975.

As the plant and machinery was not installed before 1 June 1975 as claimed in the certificate, the company was not entitled for development rebate for the assessment year 1977-78. The incorrect grant of development rebate of Rs. 18,13,278 allowed in the assessment year 1977-78 led to short levy of (potential) tax of Rs. 10,88,000.

The comments of the Ministry of Finance are awaited (January 1986).

(ii) The Act further provided that if any machinery or plant on which development rebate was allowed in any assessment year was sold or otherwise transferred before the expiry of eight years from the end of the previous year in which it was installed, the development rebate so granted was to be withdrawn, treating it to have been wrongly allowed and the Income-tax Officer should recompute the income of the assessee for the relevant previous years and make necessary amendment.

The term "transfer" in relation to a capital asset has been defined in the Act to include the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law. Any profits and gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income tax under the head 'Capital gains'. No capital gains tax will however be levied under the Act in the case of transfer of any capital asset by a company to its subsidiary if the parent company holds the whole of the share capital of the subsidiary company and the subsidiary company is an Indian company. These transfers are not regarded as transfers for the purpose of levy of capital gains tax only and for no other purpose.

(a) During the previous year relevant to the assessment year 1981-82 a company in which the public were substantially interested, which was engaged in the manufacture of cotton yarn transferred all the assets of one of its units to its wholly owned subsidiary company which was formed and incorporated in March 1980. The assessee company was allowed a deduction of Rs. 4,09,212 towards development rebate and investment allowance in the assessment years 1973-74 to 1975-76 and 1977-78 to 1980-81 on the additions made to its plant and machinery. Since these assets were transferred to the subsidiary company within the period of eight years from the year of their installation, the development rebate and investment allowance amounting to Rs. 4,09,212 already allowed had to be withdrawn.

The Inspecting Assistant Commissioner who completed the assessment for the year 1981-82 did not however, withdraw the development rebate and investment allowance already allowed.

The omission to withdraw the development rebate and investment allowance resulted in short levy of tax of Rs. 3,03,814 including surtax liability of Rs. 66,659 for the assessment years 1974-75, 1979-80 and 1980-81 in which years the carried forward unabsorbed development rebate and investment allowance was set off.

The assessment for the assessment year 1980-81 was checked in Internal Audit; but the mistake was not pointed out by it.

The Ministry of Finance contended that where a holding company vests one entire unit to its subsidiary company, what is involved is an adjustment and not a transfer. The Ministry's reply is not tenable as it is not in conformity with the provisions of the Income-tax Act, 1961.

(b) During the previous year relevant to the assessment year 1980-81 a widely held company transferred certain machinery by way of sale and by way of transfer to its subsidiary company. These items of machinery had been acquired by the company during the previous years relevant to assessment years 1972-73 to 1979-80 and a total development rebate/investment allowance of Rs. 14,37,568 had been allowed by the department in the assessments of the respective assessment years. Consequent upon the transfer of the machinery within the specified period of eight years, the development rebate/investment allowance allowed in respect of these assets in the earlier assessment years was required to be withdrawn. This was however not done while completing the assessment for the assesment year 1980-81 in January 1983. The omission to withdraw the development rebate/investment allowance resulted in short-levy of tax of Rs. 8,31,989.

The assessment was checked by the Special Audit Party of the department but the mistake was not pointed out by it.

The comments of the Ministry of Finance are awaited (January 1986).

(iii) It has been judicially held that when an asset owned by an assessee is destroyed, for which he received compensation from the insurance company, the assessee's right over the asset is extinguished and hence the said asset is to be treated as 'transferred' as defined in the Act.

In the case of a company development rebate of Rs. 7,80,456 was allowed in the assessment year 1974-75 on a barge acquired by it during the previous year relevant to assessment year 1974-75. The barge was destroyed in an accident in March 1980 and the assessee company received compensation of Rs. 18 lakhs from an insurance company. The receipt of compensation on the destruction of the barge constitute as 'transfer' within the meaning of the Income-tax Act and as the transfer was within the period of 8 years from the expiry of the previous year in which the barge was acquired, the development rebate allowed initially in the assessment year 1974-75 should have been withdrawn. Omission to do so resulted in under assessment of income by Rs. 7,80,456 leading to a short levy of tax of Rs. 4,91,686.

The comments of the Ministry of Finance are awaited (January 1986).

(iv) For the assessment year 1974-75 a closely held company was allowed a development rebate of Rs. 1,37,167 on farm equipment. Due to insufficiency of income this was carried forward and finally allowed to be set off in the assessment year 1977-78. The machinery in respect of which the development rebate was allowed was transferred by the assessee to its subsidiary company in May 1977. The assessee had also withdrawn in the previous year relevant to the assessment year 1980-81 the development rebate reserve of Rs. 1,37,167 created in the accounts for the year ended 31 March 1974 relevant to the assessment year 1974-75. As the asset was transferred in the previous year ended 31 May 1977 and the reserve also withdrawn within the prescribed period of 8 years, the development rebate allowed was required to be withdrawn before May 1981. The omission to do so resulted in non-levy of tax of Rs. 88,955 for the assesment year 1980-81.

The Ministry of Finance have accepted the mistake.

(v) One of the conditions for the allowance of development rebate as prescribed in the Act was that the assessee should create a development rebate reserve of an amount equal to seventy five per cent the development rebate to be actually allowed and should utilise the reserve for the purpose of business in a period of eight years following the previous year in which the reserve was created. If the assessee utilises the amount credited to the reserve account amongst other things for distribution by way of dividend or profits the development rebate originally allowed shall be deemed to have been wrongly allowed. It has been judicially held that these provisions are mandatory and breach of these cannot be overlooked merely on the ground that the breach was technical or venial.

During the previous year (August 1974) relevant to the assessment year 1975-76, a widely held company transferred a sum of Rs. 2 crores from out of the development rebate reserve created in the previous years relevant to the assessment years 1968-69 to 1970-71 and utilised it for the issue of bonus shares to its shareholders. The assessee maintained that the capitalisation of the development rebate reserve and the issue of bonus shares did not amount to utilisation of the reserve for a purpose other than the purpose of the business of the undertaking as contemplated under the Act, on the ground that the moneys represented by the reserve were permanently retained in that business on such capitalisation. While completing the assessment for the year 1975-76 on 26 October 1978, the Income-tax Officer accepted this contention of the assessee and accordingly the development rebate allowed in the assessment years 1968-69 to 1970-71 was not withdrawn.

The creation and utilisation of the reserve for the prescribed period for the purposes of the business of the undertaking is a condition precedent to the allowance|retention of the development rebate. On the issue of the bonus shares by capitalisation of the reserve, the development rebate reserve ceased to exist and had become the property of the shareholders as their capital. Accordingly the development rebate allowed in assessment years 1968-69 to 1970-71 aggregating to Rs. 3.26 crores was required to be withdrawn. The omission to do so resulted in short levy of income-tax of Rs. 1.88 crores for the assessment year 1975-76.

The remedial action in this case became time barred in March 1979. The case came up for audit in June 1979 but records were not made available. Thereafter the records were requisitioned in July 1980 and August 1981 with the same results.

The Ministry of Finance contended in November 1985 that the issue of bonus shares on capitalisation of development rebate reserve was on the basis of a sanction obtained from the Controller of capital issues and under the guidelines issued by the Controller of capital issues and that the development rebate reserve is considered as a free reserve which is also allowed to be capitalised. Relying on a decision of the Gujarat High Court, the Ministry of Finance further contended that by issue of bonus shares, only the nomenclature is changed from reserve to capital and reserves which were already employed for the purpose of the business did not cease to be so employed when they were capitalised by issue of bonus shares.

The argument of the Ministry that the capitalisation of the reserve is authorised by the Controller of Capital Issues is not relevant to an issue that has to be decided strictly according to the provisions of Income-tax Act, 1961. It has been judicially held that under the Income-tax Act, the reserve should remain intact, while being used for the purpose of the business of the undertaking. It is not correct to say that by issue of bonus shares only the nomenclature is changed from reserve to capital, as issue of bonus shares results in the conversion of the reserve into capital and the distinct identity of the reserve disappears. Further, the ownership of the moneys also changes and the shareholders become the owners of the bonus shares issued to them. Thereafter the utilisation of funds is out of share capital funds and not out of development rebate reserve funds. Thus, the reserve had lost its character on its being capitalised and further the same had been distributed to shareholder by way of bonus shares. Accordingly, the requirements of law in regard to entitlement of tax relief on development rebate reserve which are mandatory were not complied with and as such the development rebate allowed in assessment years 1968-69 to 1970-71 ought to have been withdrawn.

2.30 **Incorrect computation of capital gains**

Under the provisions of the Income-tax Act, 1961, the income chargeable under the head 'capital gains' shall be computed by deducting from the full value of the consideration, the cost of acquisition of the asset including the cost of any improvements thereto and the expenditure incurred wholly and exclusively in connection with the transfer. It has been judicially held that where bonus shares are issued in respect of existing shares held by an assessee their cost will be determined by spreading the cost of the original shares to the assessee on the original shares and bonus shares taken together, as if the shares rank *pari passu* and thereafter the cost of each share, original as well as bonus shares will be the average price as so worked out.

(i) During the previous year relevant to the assessment year 1980-81 a closely held company held 15,568 shares consisting of 6,102 original shares of face value of Rs. 100 each and 9,466 bonus shares of another company. All the shares were acquired after 1 January 1964. During this previous year the company sold 1,830 original shares and 2,725 bonus shares for a consideration of Rs. 10,38,540 at Rs. 228 per share. While computing the capital gains on the sale of the shares in August 1983, the

assessing officer took the cost of acquisition at Rs. 39.16 per share as determined by the average method for bonus shares only and at the face value of Rs. 100 per share for original shares and determined the long-term capital gains at Rs. 7,48,829.

After the issue of bonus shares and the spreading of the cost of original as well bonus shares the average cost per share worked out to Rs. 39.16 which was to be adopted as cost of acquisition per share both for original as well as bonus shares. Instead the average cost per share was adopted at Rs. 39.16 per bonus share and Rs. 100 per original share. The omission to adopt the correct cost of acquisition resulted in under-assessment of income to the extent of Rs. 1,11,592 with a consequential short demand of tax of Rs. 44,637.

The Ministry of Finance have accepted the mistake.

(ii) During the previous year relevant to the assessment year 1979-80 a company sold its old assets for a sum of Rs. 14,82,691. The cost of acquisition of these assets was Rs. 7,82,711. The capital gains of Rs. 6,99,980 being the difference between the total sale proceeds and the cost of acquisition of the assets was however not brought to tax by the assessing officer in the assessment for the assessment year 1979-80. The omission resulted in non-levy of capital gains tax of Rs. 2,79,990.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.31 **Income escaping assessment**

(i) If the advance tax paid by an assessee during a financial year exceeds the amount of the tax determined on regular assessment, the Central Government is liable to pay simple interest from the 1st day of April next following the said financial year to the date of regular assessment for the assessment year. Such interest constitutes income liable to tax.

Two companies assessed in two different charges received sums totalling Rs. 3,44,248 on account of interest paid by the Government on the excess advance tax paid by them. The interest amounts were received by the companies during the previous years relevant to assessment years 1975-76 and 1982-83 respectively. While computing income in respect of these two assessment years, the Income-tax Officer omitted to include the interest amounts in the total incomes. The omission to do so resulted in escapement of income from assessment of Rs. 3,44,248 involving short levy of tax of Rs. 2,12,109.

The Ministry of Finance have accepted the mistake in one case. The comments of the Ministry are awaited in another case.

(ii) Under the provisions of the Income-tax Act, 1961, interest is payable by Government on the amount of refund due to an assessee if the refund is not granted within the time stipulated in the Act. The interest so paid by the Government constitute income of the assessee and be chargeable to tax in the assessment year relevant to the previous year in which it is paid.

A sum of Rs. 1,86,060 was received by a non-resident company on account of interest in February 1981 relevant to the assessment year 1982-83 on belated grant of refund of Rs. 15.51 lakhs for the assessment years 1958-59 to 1972-73. The amount of interest of Rs. 1,86,060 being income of the assessee was to be included in this income and subjected to tax in the assessment year 1982-83. However, neither the assessee returned the amount of interest nor was it brought to tax in the assessment for the assessment year 1982-83 completed by the Income-tax Officer in December 1983. The omission to do so reusIted in short levy of tax of Rs. 1,33,498.

The Ministry of Finance have accepted the mistake .

(iii) Under the provisions of Income-tax Act, 1961 the total income of a person for any previous year includes all income from whatever source derived which is received or accrued to him during such previous year.

(a) While computing the business income of a company for the assessment year 1979-80, the income of Rs. 6,39,599 received on account of interest on sale of assets and shown in the Receipts and Payments Account for the period ending 30 June 1978, was not included by the Income-tax Officer in the computation of income. The omission resulted in escapement of income from tax by Rs. 6,39,599 involving short levy of tax of Rs. 4,58,562 inclusive of interest for late filing of the income-tax return of Rs. 21,825 and Rs. 210 refundable by the company which was paid earlier for excess payment of advance tax.

The Ministry of Finance have accepted the mistake.

(b) A State Government undertaking, following the mercantile system of accounting in the previous year ending 31 March 1981 relevant to the assessment year 1981-82 had not accounted for, the income earned by it by way of supervision charges recoverable at 17 per cent on the cost of certain works (called 'Dasida' works), undertaken by it as also income arising on the sale of lorries and tractor.

On the escapement of income being pointed out in audit in January 1984 the assessing officer initiated action in response to which the assessee company filed a revised return in March 1984 for the assessment year 1981-82 including (i) an amount of Rs. 10,41,260 towards supervision charges on Dasida works and (ii) profit of Rs. 22,219 on sale of lorries and tractors. The escaped income of Rs. 10,63,479 involved tax of Rs. 7,41,094 including interest of Rs. 1,12,312 towards delay in filing of return and short payment of advance tax.

The Ministry of Finance have accepted the mistake.

(iv) It has been judicially held that income is accrued when the assessee has acquired a right to receive it and created a debt in his favour. The Central Board of Direct Taxes also issued instructions in June 1978 to tax such income even when the amount of such accrued interest stands credited to a suspense Account. A financial corporation providing long term finance to industries advanced loan to sick textile mills and had been crediting the amount of accrued interest to a suspense account by debit to respective loan accounts. The amount of accrued interest credited to suspense account in assessment years 1975-76 and 1976-77 was Rs. 6,92,228 and Rs. 8,65,529 respectively. While completing the assessments for the two years the accrued interest of Rs. 15,57,757 was not however taken into consideration by the Inspecting Assistant Commissioner (Assessment) in July 1978 and September 1979 resulting in short levy of tax amounting to Rs. 8,99,600.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) The Income-tax Act, 1961 provides for deduction from the income of an assessee for any expenditure or trading liability incurred for the purpose of business carried on by the assessee. When, on a subsequent date, the assessee obtains any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof the benefit that accrues thereby is deemed to be profits and gains of business or profession to be charged to income-tax as income of the previous year in which such remission or cessation takes place.

(a) A shipping company paid an amount of Rs. 3,69,218 as insurance premium during the previous year relevant to the assessment year 1980-81 and the same was allowed as an expenditure by the department. An insurance refund amounting to Rs. 1,25,317 was credited to the company's profit and loss appropriation account in the previous year relevant to the assessment year 1981-82. However while completing the assessment for the assessment year 1981-82, in March 1984, the amount of Rs. 1,25,317 was not assessed as income and charged to tax. As a result, income of Rs. 1,25,317 escaped assessment in the assessment year 1981-82, leading to excess carry forward of loss by the same amount, with a potential tax effect of Rs. 87,566.

The assessment was checked by Internal Audit Party of the department but the mistake was not detected by it.

The mistake has been accepted by the Ministry of Finance.

(b) In the assessment year 1979-80 (assessment made in March 1982) a widely held domestic company was allowed a weighted deduction of Rs. 3,21,450 calculated at one and one-half times the expenditure of Rs. 2,14,300 incurred by it towards development of export markets. The said expenditure was fully recouped to the assessee subsequently in the previous year relevant to the assessment year 1980-81. Consequent on recoupment of the whole expenditure of Rs. 2,14,300 the benefit of weighted deduction of Rs. 3,21,450 allowed previously was required to be treated as income and taxed in its entirety. However, a sum of Rs. 2,14,300 was treated as income in the assessment year 1980-81 and a sum of Rs. 1,07,150 escaped assessment leading to under charge of tax of Rs. 63,352.

The comments of the Ministry of Finance on the case are awaited (January 1986).

(c) In the profit and loss appropriation account for the previous year relevant to assessment year 1980-81 a company credited a sum of Rs. 1,64,703 being writeback of excess provision for bonus allowed in earlier assessment year 1979-80. As the excess provision of bonus had already been allowed in the earlier assessment, the sum of Rs. 1,64,703 was required to be treated as income and charged to tax in the assessment year 1980-81. But in the assessment for the assessment year 1980-81 completed in September

1983, the assessing officer did not include the write-back of the excess provision for bonus as income of that year. The omission resulted in under assessment of income of Rs. 65,881 with under charge of tax of Rs. 46,035 and short levy of interest amounting to Rs. 26,886 for the assessment year 1980-81.

The case was seen by the internal audit party of the department but the mistake was not detected.

The comments of Ministry of Finance on the case are awaited (January 1986).

(vi) A private company, showed in its return of income for the previous year ending September 1979 relevant to the assessment year 1980-81 an amount of Rs. 6,45,315 as having been received towards service charges from another private limited company and the assessment was made in December 1983 by the Income Tax Officer accepting the figure. The payer company assessed in the same ward had however, claimed in its return for the previous year ending September 1979 relevant to 1980-81 as having paid an amount of Rs. 7,82,014 to the assessee company towards service charges. Omission to disclose the correct amount of service charges received by the assets and treat the remaining amount of Rs. 14,03,507 1,36,699 escaping assessment involving a short levy of tax of Rs. 95,518.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vii) An assessee company received during the previous year ending 30 June 1979 relevant to the assessment year 1980-81, an amount of Rs 40,00,000 by way of insurance claim against the destruction of ship, and credited Rs. 15,33,332 to its profit and loss account for the year ending 30 June 1979 being the excess amount over the written down value of Rs. 24,66,668 of the ship. In the assessment completed in a central circle, in September 1983 for the assessment year 1980-81, it was decided by the Income-tax Officer to add an amount of Rs. 1,29,825 out of Rs. 15,33,332 as profit on account of sale of assets and treat the remaining amount of Rs. 14,03,587 as income of the assessee company. However, while computing the income of the assessee for the assessment year 1980-81 a sum of Rs. 1,29,825 was incorrectly deducted from the amount of Rs. 14,03,507 and a sum of Rs. 12,73,682 only was considered as income instead of Rs. 14,03,507. This mistake resulted in excess carry forward of loss of Rs. 1,29,825 with a potential tax effect of Rs. 83,733.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(viii) The assessable business income of a private limited company for the assessment year 1978-79 (assessment made in February 1984) was computed by the Inspecting Assistant Commissioner (Assessment) at a loss of Rs. 27,24,612. While computing the income of the company, although the Inspecting Assistant Commissioner (Asstt.) added the income from house property, share income from the firm etc., he did not add the net income of Rs. 1,40,260 on account of interest on securities, dividend and profit on sale of assets etc. The omission to do so resulted in underassessment of income of Rs. 1,40,260 leading to excess carry forward of loss by an identical amount with potential short levy of tax of Rs. 88,363.

The Ministry of Finance have accepted the mistake.

(ix) Under the Income-tax Act, 1961, an assessment, reassessment or recomputation in consequence of or to give effect to any finding or direction in an appellate order may be completed at any time and the normal time limit prescribed under the Act for completion of assessments or reassessments shall have no application. The Act was amended by the Taxation Laws (Amendment) Act, 1970 operative from the assessment year 1971-72 fixing a time limit of two years for making a fresh assessment pursuant to an appellate order, at any time before the expiry of two years from the end of the financial year in which the order is passed.

In the case of a widely held company, for the assessment year 1976-77, it was held (April 1982) in appeal that the interest income of Rs. 2,95,309 on delayed payment of compensation was not assessable in the assessment year 1976-77 but was to be spread over to the relevant assessment years commencing from the assessment year 1964-65. Consequently, the assessing officer revised the assessments for the assessment years 1972-73, 1973-74 and 1974-75 in June 1982 and also gave corresponding relief for the assessment year 1976-77. It was noticed in audit in January 1984 that the assessment for assessment years 1964-65 to 1971-72 and 1975-76 were not simultaneously revised to assess the interest income pertaining to each year. The omission resulted in escapment of income of Rs. 1,77,444 and a non-levy of tax of Rs. 93,314.

On this being pointed out in audit (January 1984) the department stated that remedial action for the assessment years 1971-72 and 1975-76 are being initiated and that for the assessment years 1964-65 to 1970-71, time was not available to assess the interest income even at the time of completing the regular

assessment for the assessment year 1976-77 in July 1979. It was again pointed out (May 1985) that under the provisions of the Act, as applicable upto the assessment year 1970-71, the normal time-limits prescribed under the Act shall have no application where assessment, reassessment or recomputation is made on the assessee in consequence of or to give effect to a finding or direction of an appellate authority. In view of this assessment for the assessment years 1964-65 to 1970-71 were required to be revised and additional demand raised.

The comments of the Ministry of Finance are awaited (January 1986).

(x) Under the Income-tax Act, 1961, where an assessee incurs after March 1967 any expenditure of a capital nature on scientific research related to his business the whole of such expenditure incurred in any previous year is allowable as deduction for that previous year. If the asset is sold subsequently without having been used for other purposes and the proceeds of the sale together with the amount of deductions exceed the amount of capital expenditure, the excess or the amount of deductions so made, whichever is less is chargeable to tax as business income of the previous year in which the sale took place.

An assessee company was allowed during the assessment year 1977-78 a deduction of Rs. 4,16,988 on account of cost of the machinery purchased in March 1976 and used for scientific research. The machinery was disposed of for a consideration of Rs. 1,10,000 during the assessment year 1981-82. However this amount was not treated as income by the Inspecting Assistant Commissioner (Assessment) at the time of completing assessment for the assessment year 1981-82 in February 1984. The omission resulted in the income of Rs. 1,10,000 escaping assessment involving short levy of tax amounting to Rs. 65,038 in the assessment year 1981-82.

The comments of the Ministry of Finance are awaited (January 1986).

2.32 *Incorrect computation of total income*

Under the Income-tax Act, 1961, income of every kind which is not to be excluded from the total income shall be chargeable to income-tax under the head 'income from other sources' if it is not chargeable to income-tax under any other specified head. Such income is computed after making deduction of any other expenditure not being in the nature of capital exenditure incurred wholly and exclusively for the purpose of making or earning of such income. It has been judicially held that interest income derived from borrowed funds placed in short term deposits by a company before commencement of business is income from other sources. It has also been held that interest paid in respect of such borrowed funds does not constitute expenditure in earning the income. It has further been held that the expenditure incurred prior to the date of setting up or commencement of business is not allowable as business expenditure.

(i) During the previous year ending 30 June 1980 relevant to the assessment year 1981-82 a company which was under construction and had not commenced production deposited the borrowed funds in short term fixed deposits with banks and earned interest income, thereon amounting to Rs. 3,09,939. The assessing officer assessed the income of Rs. 2,96,962 (out of Rs. 3,09,939) as "income from other sources" after allowing one per cent of pre-operative expenses amounting to Rs. 12,977 as having incurred in earning the income. While computing the total income the pre-operative expenses of Rs. 12,96,465 was set off against the income of Rs. 2,96,962 from other sources though the pre-operative expenses were not business expenditure and required to be capitalised. Incorrect set off of interest income of Rs. 2,96,962 against the pre-operative expenses resulted in under assessment of income of Rs. 2,96,962 involving non-levy of tax of Rs. 1,75,577.

The comments of the Ministry of Finance are awaited (January 1986).

(ii) During the previous years relevant to the assessment years 1982-83 and 1983-84 a company in which public are substantially interested received a loan of $ 60 million from International Bank for construction of the factory and deposited the borrowed funds in short term fixed deposits in banks. The company earned interest income of Rs. 10,25,46,000 on these short term deposits which was set off against the expenditure on account of interest paid by the company on borrowings. As the company had not commenced its busienss operations the interest received on short term deposits was required to be treated as "income from other sources" and the pre-operative expenses as capital expenditure without being set off against the income from other sources. The incorrect set off of interest income of Rs. 10,25,46,000 allowed in the assessments made in February 1984 for both the assessment years resulted in the income of Rs. 10,25,46,000 escaping assessment leading to non-levy of tax of Rs. 7,00,56,339. The Department has accepted the mistake and re-opened the assessment.

The Ministry of Finance have accepted the mistake.

2.33 *Incorrect set of losses*

Where for any assessment year, the net result of the computation under the head—Profits and gains of business or profession, is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of the Act, so much of the loss as has not been so set off shall, subject to the other provisions of the Act, be carried forward to the following assessment year. No loss shall however, be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

(i) The assessment of a banking company for the assessment year 1979-80 was completed in September 1982. This was revised in February 1983 to give effect to an appellate order. The business loss and unabsorbed depreciation relating to the assessment years 1974-75 to 1978-79 amounting to Rs. 53,13,188 was set off against the revised income for the assessment year 1979-80. The assessment was again revised in March 1983 to allow double taxation relief.

The assessment for the assessment year 1977-78 had also been revised in March 1983 for charging certain income which had escaped assessment and the actual loss and unabsorbed depreciation to be carried forward was reduced to Rs. 17,26,571. Consequently the business loss|unabsorbed depreciation to be carried forward and set off for the assessment years 1974-75 to 1978-79 correctly worked out to Rs. 24,36,435 only. Omission to consider the correct amount of loss as determined in the revision order of March 1983 for the assessment year 1977-78 while allowing double taxation relief for the assessment year 1979-80 subsequently in the same month resulted in excess set off of loss by Rs. 28,76,753 involving short levy of tax of Rs. 12,69,000. In addition an amount of Rs. 3,47,240 was also leviable towards interest for short payment of advance tax.

The Ministry of Finance have not disputed the facts of the case.

(ii) In the case of an assessee company while computing the total income, for the assessment year 1981-82 in December 1983, the Income-tax Officer adjusted the brought forward loss of the previous years to the extent of Rs. 1,15,11,817 determining the total assessable income as 'nil'. However, the brought forward loss from previous years correctly worked out to Rs. 1,08,31,377 only as a result of set off of loss of Rs. 8,88,978 in the rectification made for the assessment year 1980-81 in October 1983. The incorrect adjustment of loss of Rs. 1,15,11,817 instead of Rs. 1,08,31,377 resulted in short-assessment of income of Rs. 6,80,440 in the assessment year 1981-82 involving short levy of tax of Rs. 6,17,793 including interest for non-payment of advance tax.

The Ministry of Finance have accepted the mistake.

(iii) The assessment of a widely held company for the assessment year 1979-80 was completed in February 1983 determining the taxable income as 'Nil' after adjusting the carried forward business loss of Rs. 30,67,867 relating to the assessment year 1978-79. The assessment for the assessment year 1978-79 was revised in March 1984 and the correct loss to be carried forward for set off in the assessment year 1979-80 was re-determined as Rs. 5,36,666. The assessment for the assessment year 1979-80 was not however, correspondingly revised and the excess amount of loss carried over was not withdrawn. Omission to do so resulted in the non-levy of tax of Rs. 5,79,060.

The Ministry of Finance have informed that remedial action was taken in January 1985 raising additional demand of Rs. 5,79,060 which has been collected.

(iv) In the assessment of a company made in September 1983 for the assessment year 1980-81 loss amounting to Rs. 8,08,775 for assessment years 1977-78 and 1978-79 was adjusted against the income of the year. It was however found that the total loss was already adjusted in the assessment year 1979-80 itself and no business loss remained to be set off against the income for the assessment year 1980-81. The double adjustment of loss resulted in under-assessment of income of Rs. 8,08,775 involving short levy of tax of Rs. 5,21,659 in the assessment year 1980-81.

The Ministry of Finance have accepted the mistake.

(v) While computing the income of a company in January 1984 for the assessment year 1983-84 the accumulated loss appearing in the balance sheet amounting to Rs. 8,41,482 was set off by the assessing officer against the income of Rs. 3,93,652 as desired by the assessee. However, in the assessment orders for the preceding eight assessment years 1975-76 to 1982-83 no loss had been determined for any of these years, except in the assessment year 1978-79 wherein a loss of only Rs. 7,130 had been allowed to be carried forward. The income of the assessee for assessment year 1983-84 was, therefore, to have been assessed at Rs. 3,86,522 after setting off the loss of Rs. 7,130 brought forward from the assess-

ment year 1978-79. Instead the department set off the loss of Rs. 8,41,482 as shown in the balance sheet against the income of Rs. 3,86,522 and determined a net loss of Rs. 4,64,330. This mistake resulted in under-assessment of income of Rs. 3,13,452 involving non-levy of tax of Rs. 1,92,772.

The assessment has been checked by the Internal Audit party of the Department but the mistake was not noticed by it.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) During the previous year relevant to the assessment year 1981-82, a State Sheep Development Corporation (a Government company) debited in its profits and loss account, a sum of Rs. 9,97,285 representing expenditure on salary, wages, bonus etc. The assessee received grant-in-aid of Rs. 5 lakhs from the State Government. An additional grant-in-aid of Rs. 2,60,599 was also received by the Corporation in the previous year relevant to the assessment year 1981-82 from the State Government towards the expenditure incurred by it on maintaining farms and staff transferred by the State Government.

In the assessment made in January 1984 for the assessment year 1981-82, the corporation was assessed at loss of Rs. 6,56,449. However, while determining the loss the additional grant-in-aid amounting to Rs. 2,60,599 received by the assessee company from the State Government was not taken into account. Omission to do so resulted in excess carry forward of loss by Rs. 2,60,599 leading to a potential short levy of tax of Rs. 1,54,077.

The assessment was checked by the Internal Audit Party of the department but the mistake was not detected by it.

The Ministry of Finance have accepted the mistake.

(vii) The regular assessment of a closely held company, for the assessment year 1977-78 was completed in September 1980 determining the loss as Rs. 17,44,150. In the revision order of March 1983, the loss was recomputed as Rs. 21,61,110 comprising unabsorbed depreciation of Rs. 19,63,386 and unabsorbed investment allowance of Rs. 1,97,724. However in the assessments for the assessment years 1978-79 and 1979-80 completed in December 1983, the Inspecting Assistant Commissioner (Asstt.) had incorrectly taken the unabsorbed depreciation of Rs. 21,61,110 instead of Rs. 19,63,386 and adjusted another sum of Rs. 1,44,322 towards unabsorbed investment allowance and carried forward a sum of Rs. 53,402 as unabsorbed investment allowance. The incorrect set off of the amount resulted in excess carry forward of investment allowance of Rs. 1,97,724 with a potential tax effect of Rs. 1,11,466.

The Ministry of Finance have accepted the mistake in principle.

(viii) Under the provisions of the Income-tax Act, 1961, where in respect of any assessment year the net result of the computation under 'Capital gains' relating to short term capital assets is a loss, such loss can be carried forward and set off only against income from short term capital gains in subsequent years and not against income under any other head of income.

In the assessment of a company for the assessment year 1977-78 (completed in December 1982) an amount of Rs. 1,36,497 being unabsorbed short term capital loss on sale of motor cars relating to the assessment year 1976-77 had been erroneously set off against business income. The incorrect set off had resulted in under assessment of income by Rs. 1,36,497 with consequent short levy of tax of Rs. 92,754.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ix) Under the provisions of the Finance Acts applicable to the assessment years 1979-80 and 1980-81, the net agricultural income is computed in accordance with the rules framed thereunder. Where the result of the computation for the previous year in respect of any source of agricultural income is a loss such loss shall be set off against any other source of agricultural income and not against any income from business.

While completing the assessments of a private limited company for the assessment years 1979-80 and 1980-81 in March 1983, the Income-tax Officer wrongly allowed the set off of the agricultural loss of Rs. 20,038 and Rs. 80,154 respectively against the income from business as claimed by the assessee. The incorrect set off of agricultural loss resulted in aggregate short-levy of income-tax of Rs. 69,684.

The assessments were checked by the Internal Audit Party of the Department but the mistake was not pointed out by it.

The Minisry of Finance have accepted the mistake.

2.34 *Mistakes in assessments while giving effect to appellate orders*

(i) In the assessment of a widely held company for the assessment year 1979-80 completed by an Income-tax Officer in September 1983 after getting directions from the Inspecting Assistant Commissioner (Assessment) the entire unabsorbed depreciation of Rs. 1,53,48,082 relating to the assessment year 1976-77 was set off against the net income from business. The assessment for the assessment year 1976-77 was revised in November 1983 and the unabsorbed depreciation for that assessment year was redetermined as Rs. 2,91,46,512. Consequent to the revision of the earlier years' assessments, the assessments for the assessment years 1979-80 and 1980-81 were revised in November 1983. In order to allow certain reliefs ordered by the Commissioner of Income-tax (Appeals) the assessments for the assessment years 1979-80 and 1980-81 were again revised in December 1983.

In the revised assessment for the assessment year 1980-81 in December 1983, unabsorbed depreciation relating to the assessment year 1976-77 was, however, set off to the extent of Rs. 2,35,13,338 (out of Rs. 2,91,46,512 determined in November 1983) and the balance of only Rs. 46,33,174 instead of the correct amount of Rs. 56,33,174 was carried forward for set off against the income of the subsequent assessment years. While simultaneously revising the assessment for the assessment year 1979-80 in December 1983 the unabsorbed depreciation of Rs. 1,53,48,082 already set off in the assessment made in September 1983 was also not added back leading to double allowance of depreciation. As a result thereof unabsorbed depreciation was allowed in excess to the extent of Rs. 1,43,48,082 after taking into account the arithmetical mistake of Rs. 10,00,000 leading to excess carry forward of loss of an equal amount from the assessment year 1980-81 involving a potential tax effect of Rs. 80,88,731.

The Ministry of Finance have accepted the mistake.

(ii) In the previous year relevant to the assessment year 1979-80 an assessee company incurred a liability amounting to Rs. 99,90,362 on account of purchase tax on alcohol and claimed the liability as deduction from its income. This was disallowed by the Income-tax Officer while completing the assessment in April 1982. On appeal by the assessee company the Commissioner (Appeals) in his orders of March 1983 allowed the liability as deduction and directed the Income-tax Officer to carry out necessary adjustment regarding purchase tax liability on the alcohol purchased and remaining as closing stock.

While giving effect to the appellate orders of March 1983 the Income-tax Officer did not carry out adjustment in respect of the closing stock as at 31 December 1978, relevant to the assessment year 1979-80. As the incidence of purchase tax on the closing stock was to the extent of Rs. 20,04,055 the closing stock should have been increased by this amount. Further, the opening stock for this year also was required to be increased by Rs. 6,92,194 on account of adjustment of closing stock relating to the earlier year. The non-adjustment of purchase tax liability for the opening and closing stocks of alcohol resulted in a net under-assessment of income of Rs. 13,11,861 and consequent short levy of tax of Rs. 7,57,599.

The department accepted the mistake and rectified the assessment in February 1985.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) The assessments of a public limited company for the assessment years 1976-77 and 1977-78 were revised in May 1981 and June 1982 respectively to give effect to the orders of the Commissioner of Income-tax disallowing the extra shift depreciation allowed earlier. Based on the increased written down values for these two assessment years, further depreciation of Rs. 7,33,846 and Rs. 4,70,373 were allowed by the Inspecting Assistant Commissioner (Assessment) in the revisions made for the assessment years 1977-78 and 1978-79 in May 1982 and June 1982 respectively. On appeal, the orders of the Commissioner of Income-tax, for both the assessment years 1976-77 and 1977-78 were struck down by the Appellate Tribunal in July 1983. Accordingly, the assessments revised in May 1981 and June 1982 for the assessment years 1976-77 and 1977-78 were again revised in August 1983 and November 1983 respectively. Consequently the assessments for the assessment years 1977-78 and 1978-79 were to be revised to withdraw the excess depreciation of Rs. 7,33,846 and Rs. 4,70,373 allowed in May 1982 and June 1982 respectively. The Inspecting Assistant Commissioner (Assessment) however, did not revise simultaneously these assessments and the omission to do so resulted in under-assessment of income of Rs. 12,04,219 with consequent under charge of tax of Rs. 6,95,436.

On the mistake being pointed out in audit in May 1984, the department accepted the same in January 1985 and revised the assessments raising an additional demand of Rs. 6,95,712 which had also been collected.

The Ministry of Finance have stated that the fact that the rectifications were pending was in the knowledge of the Inspecting Assistant Commissioner (Assessment) and there was time available therefor. However, the rectifications were carried out and additional demand collected only when the issues were raised in Audit.

The assessments for the two assessment years were checked by the Internal Audit Party of the department; but the mistake was not detected by the department.

(iv) Under the provisions of the Income-tax Act, 1961 (Prior to its amendment by the Finance Act, 1983), in computing the business income an export market development allowance was admissible to resident assessees engaged in the business of export of goods outside India or in providing services or facilities outside India at one and one third times the qualifying expenditure. In the case of widely held domestic companies, the deduction was increased from 1 April 1973 to one and one half times the qualifying expenditure incurred after the 28 February 1973 but before 1 April 1978.

(a) For the assessment year 1974-75 (previous year ending 31st December, 1973) a public limited company claimed a weighted deduction of Rs. 7,15,133 on the qualifying expenditure of Rs. 15,14,400 incurred prior to and after 1 March 1973 in the ratio of 1 : 5. In the assessment completed in a Central Circle in September 1977, the assessing officer allowed a deduction of Rs. 3,89,907, but the Appellate Assistant Commissioner allowed the assessee's claim except for one item. The assessment was accordingly revised in February 1978 allowing a deduction of Rs. 6,90,511. On further appeal, the Appellate Tribunal set aside the orders of the Appellate Assistant Commissioner for reconsideration of the assessee's claim. While re-doing the assessment in October 1981, the assessing officer allowed a further deduction on the qualifying expenditure of Rs. 2,41,987 in the ratio of 10.66 : 89.34 on the basis of export sales. The deduction already allowed in the order of February 1978 was however not withdrawn. In the re-assessment the assessing officer had also held a deduction of Rs. 4,81,637 made in the revision order of February 1978 as not allowable but had not actually disallowed. The excess deduction thus resulted in under assessment of income of Rs. 3,34,306, the tax effect involved being Rs. 1,93,060.

For the assessment year 1975-76, the assessee company claimed a deduction of Rs. 5,66,366 but in the assessment completed in August 1978 the assessing officer allowed a deduction of Rs. 2,33,224 only disallowing the deduction in respect of certain items of expenditure. The Commissioner of Income-tax (Appeals) partly allowed the assessee's claim and the assessment was revised in March 1979. The appellate Tribunal set aside the order of the Commissioner of Income-tax (Appeals) for reconsideration of the deduction allowed. While re-doing the assessment in October 1981 (revised in December 1981) and allowing a total deduction of Rs. 5,47,122 the assessing officer omitted to withdraw the allowance in respect of an expenditure of Rs. 4,25,550 already allowed in the revision order of March 1979. This resulted in excess deduction of Rs. 2,12,775 involving additional tax of Rs. 1,22,870. The department accepted the mistake and collected the additional demand in December 1983 and January 1984.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) In the case of a domestic company in which public were not substantially interested, the income tax officer while completing the assessment for the assessment year 1977-78 in February 1980 did not allow weighted deduction on expenditure incurred by the assessee company in connection with export of goods, though the expenditure amounting to Rs. 8,09,686 was allowed as deduction. The Commissioner (Appeals) directed the assessing officer (August 1983) to consider the expenditure of Rs. 8,09,686 as qualifying for weighted deduction. While giving effect to the appellate orders in September 1983 the assessing officer erroneously allowed the entire amount of Rs. 8,09,686 as weighted deduction instead of restricting the same to one third of the qualifying sum viz. Rs. 2,69,895 resulting in excess computation of business loss by Rs. 5,39,791 with consequent excess carry forward of loss by the same amount involving potential tax effect of Rs. 3,11,228.

The Ministry of Finance have accepted the mistake.

(v) While computing the income of a company for the assessment year 1980-81 in May 1983, out of Rs. 12,87,358, claimed by the company as revenue

expenditure on modernisation of plant the Income-tax Officer allowed only a sum of Rs. 4.29,120 and treated the balance viz. Rs. 8,58,238 as capital expenditure. On appeal by the company, the Commissioner (Appeals), held (December 1983) that out of the total claim of Rs. 12,87,358 a sum of Rs. 1,52,066 only was to be treated as capital expenditure. However, while revising the original income-tax assessment pursuant to the appellate orders (January 1984), without the prior approval of the Inspecting Assistant Commissioner, the Income Tax Officer deducted a sum of Rs. 11,35,292 (Rs. 12,87,358—Rs. 1,52,066) from the income as originally assessed but failed to add back the deduction of Rs. 4,29,120 already allowed in the original assessment. This resulted in excess allowance of carry forward loss of Rs. 3,70,503, for the assessment year 1980-81 (after setting off unabsorbed depreciation adjustable to the extent of Rs. 58,617 of earlier years) for set off against the income for subsequent assessment years with a consequential short levy of tax of Rs. 2,53,719 in the assessment year 1981-82.

The Ministry of Finance have accepted the mistake.

(vi) In computing business income of an assessee under the Income-tax Act, 1961, any expenditure of revenue or capital nature incurred on scientific research relating to the business carried on by an assessee is allowed as deduction. If any question arises as to whether and to what extent any asset is being used for scientific research, the Central Board of Direct Taxes shall refer the case to the prescribed authority. whose decision shall be final.

In the assessment of a private limited company for the assessment year 1978-79 (completed in March 1981) deduction of Rs. 3,49,268 claimed to have been incurred as capital expenditure on scientific research was disallowed by the Inspecting Assistant Commissioner (Assessments), as no attempt was made by the assessee to establish that the items of machinery etc. purchased were meant for scientific research.

On appeal, the Commissioner of Income Tax (Appeals) set aside the assessment in July 1981 with the directions that the case be referred to the Central Board of Direct Taxes, for obtaining the decision of the prescribed authority as required under the law as to whether the disputed assets had been used for scientific research or not.

The assessing officer while giving appeal effect in September 1981, however, allowed the entire amount of Rs. 3,49,268 claimed by the assessee as deduction. Thereafter, the set aside assessment in July 1981 was reassessed in September 1982 on the basis of evidence produced by the assessee on the usage of the assets for scientific research allowing deduction of Rs. 2,04,183 out of Rs. 3,49,268 claimed. While doing so, the Inspecting Assistant Commissioner (Assessments), however, overlooked to add back the amount of Rs. 3,49,268 already allowed as deduction in September 1981. This resulted in underassessment of income of Rs. 3,49,268 involving short levy of tax of Rs. 2,25,928 including interest for short payment of advance tax. The Department accepted the mistake and rectified the assessment.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(vii) During the course of the assessment of an assessee company for the assessment year 1976-77, the assessing officer held that the assessee was entitled to depreciation of Rs. 1,51,254 only in respect of machinery against its claim for Rs. 2,70,737 and the further claim for extra shift allowance of an equal amount was also not admissible in the absence of particulars. In the regular assessment completed in August 1979, the assessing officer, however, disallowed a sum of Rs. 1,19,373 only being the excess depreciation claimed but the extra shift allowance of Rs. 2,70,737 was omitted to be disallowed. This resulted in excess allowance of depreciation of Rs. 2,70,737. In August 1980 the Commissioner of Income-tax (Appeals) allowed the assessee's appeal for the depreciation and extra shift allowance on the machinery. While allowing depreciation and extra shift allowance according to the appeal order in June 1981, the assessing officer made no adjustment of the sum of Rs. 2,70,737 allowed erroneously as extra shift allowance in the order of August 1979.

The mistake resulted in double allowance of extra shift allowance amounting to Rs. 2,70,737 with a consequent short levy of tax of Rs. 1,56,350.

The Internal Audit of the department which had checked the case could not detect the mistake.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(viii) When a company makes any deposit under the Companies Deposits (Surcharge on Income-tax)

Scheme, 1976, the amount of surcharge on Income-tax payable will be to the extent as below :—

(1) In the case where the amount of deposit so made is equal to or exceeds the amount of surcharge on income tax payable by it, shall be nil; and

(2) in a case where the amount of the deposit so made falls short of the amount of surcharge on Income-tax payable by it, shall be reduced by the amount of the deposit.

In accordance with the Companies Deposits (Surcharge on income-tax) Scheme, 1976 an assessee company made a deposit of Rs. 39,550 in March 1977, in respect of the assessment year 1977-78. In the assessment completed in August 1980, the Income-tax officer did not allow the abatement of Rs. 39,550 on surcharge on income-tax payable by the assessee on the ground that the said deposit was not made before the prescribed due date. On an appeal preferred by the assessee the Appellate Commissioner upheld the decision of the Income-tax Officer. On a further appeal by the assessee the Appellate Tribunal held that the said deposit was actually made before the due date and that no surcharge could be levied by the Income tax Officer. In pursuance of the said appellate order, the Income tax Officer revised the assessment for the assessment year 1977-78 in March, 1983, and did not levy any surcharge. As however, surcharge leviable against the assessee amounted to Rs. 91,885, an abatement of Rs. 39,550 only being the sum deposited by the company should have been allowed and the balance sum of Rs. 52,335 was payable by the assessee as surcharge on Income-tax.

The omission resulted in non-levy of surcharge of Rs. 52,335 with consequent short-levy of penal interest aggregating Rs. 23,493 for short payment of advance tax and belated submission of return of income for the assessment year 1977-78.

The Ministry of Finance have accepted the mistake.

(ix) Under the provisions of the Income-tax Act, 1961, any sum paid to an employee as bonus is allowable as deduction while computing business income.

In the case of a company assessee provision for bonus amounting to Rs. 1,27,570 claimed by the company for assessment year 1977-78 was disallowed by the Income-tax Officer at the time of completing the assessment in August 1982. The bonus was, however, allowed in the assessment year 1978-79 by the Income-tax Officer on actual payment. The assessee company had gone in appeal against the disallowance made for the assessment year 1977-78 and the Commissioner of Income-tax (Appeals) admitted the company's appeal and allowed the deduction. The departments appeal against the orders of Commissioner of Income-tax (Appeals) to the Income-tax Appellate Tribunal was rejected, but the Tribunal directed the Income-tax Officer to rectify the assessment for assessment year 1978-79 to withdraw the deduction already allowed. It was noticed in audit that the bonus of Rs. 1,27,570 allowed in the assessment year 1978-79 remained to be withdrawn inspite of the directions given by the Income-tax Appellate Tribunal. This resulted in under-assessment of income of Rs. 1,27,500 involving tax of Rs. 73,640.

The Ministry of Finance have accepted the mistake.

(x) Under the provisions of the Income-tax Act, 1961 a company in which public is not substantially interested is required to distribute a statutory percentage of its distributable income of any previous year as dividends within twelve months following the expiry of the said previous year. When the actual profits distributed are less than the statutory requirement additional tax is payable at the prescribed rates. Further the provision of the Act as substituted by the Taxation Laws Amendment Act, 1975 is made applicable to all the Indian companies and remained in force upto 31 March 1978. The amendment made by Finance Act (2) 1977, was effective from 1 April 1978.

In a case the Inspecting Assistant Commissioner (Asstt.) levied an additional tax of Rs. 51,000 for the assessment year 1977-78 as the dividend declared (Rs. 15,300) was less than the statutory requirement (Rs. 98,866). This levy was nullified by the Commissioner of Income-tax (Appeals) in March 1983 for the reason that the relevant provisions of the Income-tax Act was amended by Finance Act (No. 2) 1977 and was not applicable to the assessee. The Inspecting Assistant Commissioner (Assessment) refunded the amount of Rs. 51,000 together with interest of Rs. 12,000 (Total Rs. 63,000) at the time of rectification carried out in November 1983.

The department neither brought the correct position of law to the notice of the Commissioner of

Income-tax (Appeals) nor filed an appeal before the Tribunal thus foregoing a revenue of Rs. 63,000.

The case was reported to the Commissioner of Income-tax in May 1985. Reply is awaited.

The case was checked by the Internal Audit Party of the Department but the mistake was not detected by it.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

INCORRECT EXEMPTIONS AND EXCESS RELIEFS

2.35 Incorrect deduction under Chapter VI-A of the Act

Under the provisions of Chapter VI-A 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 over-riding condition is that the total deduction should not exceed the gross total income of the assessee. Gross total income has been defined in the Act as the total income computed in accordance with the provisions of the Act before making deductions under Chapter VI-A. Where set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years, being an anterior stage, results in reducing the total income to nil or to loss, no deduction under Chapter VI-A is admissible.

While completing the assessment of six assessees (companies) for the assessment years 1979-80 to 1981-82 and 1983-84 under the charge of six Commissioners, deduction amounting to Rs. 39.32 lakhs towards intercorporate dividends, royalty received from foreign enterprises, profits and gains of newly established industrial undertakings in backward areas etc. was made by allowing the deduction on the gross total income without reducing it by the amount of unabsorbed depreciation, development rebate and investment allowance as required under the Act and without restricting the deduction to the gross total income as so computed. This resulted in short levy of tax of Rs. 3.64 lakhs in five cases and excess carry forward of unabsorbed depreciation allowance and investment allowance to the tune of Rs. 34.92 lakhs in two cases.

In two cases, the assessments were completed by the Inspecting Assistant Commissioner (Assessment). The Ministry of Finance have accepted the mistakes in all these cases.

2.36 Incorrect allowance of relief in respect of newly established business undertaking

Under the provisions of Income-tax Act, 1961, prior to its amendment by the Finance Act, 1980 with effect from the assessment year 1981-82 where the gross total income of an assessee included any profits and gains derived from a newly established undertaking which went into production before 1 April 1981, the assessee became entitled to tax relief in respect of such profits and gains upto 6 per cent per annum 7½ per cent from 1 April 1976 of capital employed in the undertaking in the assessment year in which it began to manufacture or produce articles and also in each of the four succeeding assessment years.

Where, however, such profits and gains fall short of the relevant amount of capital employed during the previous year the amount of such short fall or deficiency was to be carried forward and set off against future profits upto the seventh assessment year reckoned from the end of initial assessment year.

The method of computing capital employed in the industrial undertaking was laid down in Income-tax Rules, 1962 according to which the capital employed would be the value of assets on the first day of the computation period of the undertaking, as reduced by moneys and debts owed by the assessee on that day.

Further in the computation of the value of capital employed in the industrial undertaking, the value of depreciable assets should be taken at their written down value as on the first day of the computation period. The capital employed was calculated on the basis of owned capital and reserves only exclusive of borrowed capital. By an amendment through the Finance Act, 1980 to the Act, the provisions of the Rules were incorporated in the Act itself retrospectively from 1 April 1972.

(i) In the assessment of 12 companies adoption of inflated figures of capital employed and application of incorrect rate for purposes of calculating the relief in respect of newly established undertakings resulted in excess allowance of relief totalling Rs. 1,14,99,896 leading to short-levy of tax of Rs. 54,35,464 in 8

cases and excess carry forward of loss with potential tax effect of Rs. 14,85,296 in four cases.

The details are as under :—

Sr. No.	C.I.T. Asstt. Year	Nature of mistake	Tax effect Rs.
1	2	3	4
1.	B 1975-76 & 1977-78	Double deduction of carried forward deficiency of tax holiday relief of Rs. 57,15,000, once in assessment year 1974-75 and also in assessment years 1975-76 and 1977-78.	33,00,412
2.	C 1980-81	Omission to withdraw excess tax holiday relief of Rs. 6,07,923 in assessment year 1980-81 arising out of redetermination of tax holiday relief for the assessment years 1977-78 to 1979-80.	4,58,830 (Potential Tax)
3.	D 1980-81	Incorrect adoption of the value of the total assets and omission to deduct liabilities from the capital employed.	5,09,765 (Potential tax)
4.	A 1973-74	Omission to revise the assessment for the assessment year 1973-74 consequent on the retrospective amendment of Act by Finance Act 1980 to redetermine the tax holiday relief as a result of which, against a tax holiday relief due of Rs. 22,378, relief of Rs. 2,63,349 was allowed.	1,47,654
5.	E 1976-77 to 1978-79	(a) Omission to deduct borrowed capital secured loans and loans to sundry creditors.	37,624 2,77,970 (Potential tax).
		(b) Incorrect deduction of value of depreciable assets at the book value on the first day of computation period instead of written down value.	
		(c) Erroneous applications of rate of relief of 7½ per cent of the capital employed instead of correct rate of 6 per cent.	
6.	E 1980-81	Excess adjustment of Rs. 5,93,665 of carried forward tax holiday relief.	3,51,005
7.	F 1982-83	Incorrect allowance of tax holiday relief of Rs. 6,17,277 for the sixth assessment year instead of restricting relief to five assessment years only.	3,47,989 and penal interest of Rs. 56,916
8.	G 1977-78	Erroneous allowance of tax holiday relief of Rs. 3,33,761 beyond the seventh assessment year reckoned from the end of the initial assessment year.	2,10,263
9.	H 1977-78	Incorrect adoption of value of assets of Rs. 1,04,87,059 instead of Rs. 77,43,368 as on the first day of the computation period.	3,06,395
10.	A 1979-80	Erroneous addition of assets of value of Rs. 39,82,620 not acquired on the first day of the computation period.	1,76,604
11.	I 1979-80	Written down value of assets was incorrectly adopted. Also relief was erroneously calculated at 6 per cent instead of at 7½ per cent of the capital employed.	2,38,731 (Potential tax)
12.	J 1979-80	Carried forward tax holiday relief of Rs. 7,12,886 of one ship which would have lapsed was erroneously set off against income from another unit.	5,00,602

Of these 12 companies, 2 companies were assessed by Inspecting Assistant Commissioners (Assessment). The assessment of 3 companies were checked by the internal audit party of the department but the mistakes were not detected.

The Ministry of Finance have accepted the mistakes in four cases and the comments of the Ministry are awaited in the remaining cases.

(ii) A company having income from old and new units did not keep separate accounts for the new unit and prepared a combined profit and loss account. In the assessment years 1976-77 to 1980-81, the profit from the new unit was not sufficient to absorb the full amount of deduction. With a view to availing of full deduction, it allocated the profit amongst old and new units on an ad-hoc basis inflating the profit of new unit and decreasing the profit of the old unit. In such cases, according to the decision of the Calcutta High Court (September 1975) the quantum of capital and profit of new unit should be determined on methods based on recognised commercial principles. One such method is to base the calculation on the comparative position of assets and the ratio between the old and new units as 1 : 3. The assessed income for the assessment years 1976-77 to 1980-81 allocable to old and new units according to the ratio was Rs. 4,57,260 and Rs. 9,14,540 against Rs. 1,04,980 and Rs. 12,66,820 respectively actually adopted by the assessing officer resulting in under-assessment of income from old unit to the extent of Rs. 3,52,280 and short levy of tax of Rs. 2,04,600.

Further in the assessments for the assessment years 1974-75 to 1976-77 made as a result of appellate orders of January 1980 deduction was worked out by taking average capital employed during the year and not capital employed as on first day of computation period as laid down in the Act. Though the law was amended with retrospective effect, appellate authorities were not approached to rectify their order, which resulted in excess allowance of deduction. Money borrowed was also not deducted from the value of assets. In assessment year 1977-78 the amount of term loan and current liabilities aggregating Rs. 37,60,178 was not deducted from the value of assets. The mistake resulted in allowance of excess deduction amounting to Rs. 13,06,505 in assessment years 1974-75 to 1977-78. This had potential tax effect of Rs. 7,54,500 at the rates applicable to assessment year 1977-78.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) With effect from 1 April 1981, where gross total income of a company includes profits and gains derived from a new industrial undertaking the company is entitled to a deduction of 25 per cent of such profits for a period of eight years including the year in which the manufacture has started.

In the assessment of a company for the assessment year 1983-84 (completed in July 1983 and rectified in March 1984) the Income-tax Officer determined the profits of the new industrial undertaking as Rs. 6,56,047 and allowed a deduction of Rs. 1,64,012 (25 per cent of profits) towards relief for the new industrial undertaking, while determining the profits the Income-tax Officer overlooked to take into account the investment allowance of Rs. 9,89,995 admitted to the new unit. As after providing investment allowance, the profits of the new unit are nil, the assessee was not entitled to any deduction towards new industrial undertaking profits. The incorrect deduction of Rs. 1,64,012 resulted in tax under charge of Rs. 1,11,967 (including excess payment of interest on advance tax and surtax undercharge).

The case was checked by Internal Audit of the department but the mistake was not detected by them.

The Ministry of Finance have accepted the mistake.

2.37 **Incorrect deduction in respect of newly established undertakings in backward areas**

Under the provisions of Income-tax Act, 1961, where the gross income of an assessee includes any profits and gains derived from an Industrial Undertakings established in backward areas, a deduction of twenty per cent of profits derived from such undertakings is allowed in computing taxable income for a period of ten years. However where the undertaking starts production after 1 December 1970 but before 1 April 1973, the period for which the deduction will be allowed is to be reduced by the number of assessment years which expired before the assessment year 1974-75. In addition, the assessee is also entitled to tax relief in respect of such profits and gains upto six per cent of the capital employed in the undertaking in the assessment year in which it begins to manufacture or produce articles and also in each of the four succeeding assessment years. The Act, however, prohibits such deduction/relief to an industrial undertaking which is formed by splitting up or reconstruction of the business already in existence.

(i) After dissolving the partnership firm in December 1980, the erstwhile partners formed a private company in February 1981 transferring to the company the plant and machinery previously used by the firm. At the time of completing the assessments of the company for the assessment years 1982-83 and 1983-84 in November 1983 and March 1984 respectively, deductions of twenty per cent of profits and tax relief in respect of such profits and gains upto six per cent of the capital employed were allowed. As the industrial undertaking was estabilshed by reconstruction of a business already in existence the assessee was not entitled to the allowance. The incorrect deduction/relief resulted in short computation of income of Rs. 8,85,601 in the assessment years 1982-83 and 1983-84 leading to aggregate tax under charge of Rs. 5,44,645.

The comments of the Ministry of Finance on the case are awaited (January 1986).

(ii) In the assessments of a company for the assessment years 1982-83 and 1983-84 deduction in respect of profits and gains from new industrial undertaking in backward areas was allowed to the extent of Rs. 37,434 and Rs. 57,000 respectively. It was noticed that the production of the company had actually commenced from the assessment year 1972-73. Hence the specified deduction was available for eight years commencing from the assessment year 1974-75, *i.e.* upto the assessment year 1981-82 only. The

allowance of the aforesaid deduction in the assessment years 1982-83 and 1983-84 was therefore not correct leading to under assessment of income by Rs. 37,434 and Rs. 57,000 respectively. Further in the assessment for 1981-82 the aforesaid deduction was allowed on the gross income before allowance of investment allowance instead of on net income only leading to excess allowance of deduction of Rs. 4,006 and under assessment of income by the same amount. The mistakes resulted in total tax under charge of Rs. 75,005 (including, penal interest) in the assessment years 1981-82 to 1983-84.

The comments of the Ministry of Finance on the case are awaited. (January 1986).

2.38 **Incorrect exemption of dividend income**

Under the Income-tax Act, 1961, where any dividend is declared by a company from out of profits attributable to the relief granted to it under the Act in respect of a new industrial undertaking set up by it the dividend or the part thereof which is so attributable to the tax holiday relief will be exempt from income-tax. For this purpose the Income-tax Officer is required to issue a certificate indicating the extent to which the dividend declared by the company would be so exempt from tax.

In the case of a widely held company the assessing officer issued a certificate stating that the entire dividend declared by the company for the year ended 31 March 1977 would be exempt from tax. As against a tax holiday relief amounting to Rs. 2,91,32,013 available for the year ended 31 March 1975 the assessing officer had issued a certificate in March 1983 exempting the full dividend of Rs. 1,60,00,000 for the year ended 31 March 1975. The balance of tax holiday relief available as at the end of 31 March 1975 was only Rs. 1,31,32,013 and further dividends of Rs. 80,00,000 were declared for each of the years ended 31 March 1976 and 31 March 1977 respectively. Out of the dividends of Rs. 80,00,000 declared for the year ended 31 March 1977 only an amount of Rs. 51,32,013 would be held as paid out of tax holiday profits and be exempt. The incorrect exemption to the full extent of Rs. 80,00,000 granted by the Income-tax Officer in respect of the dividend declared for the year ended 31 March 1977 instead of restricting it to Rs. 51,32,013 resulted in dividend of Rs. 28,67,987 escaping tax liability in the hands of the shareholders. Assuming an average rate of tax of 40 per cent in their hands the incorrect exemption would result in a short levy of tax in the hands of the shareholders to the extent of Rs. 12,62,000 (approx).

The comments of the Ministry of Finance on the paragraph are awaited. (January 1986).

2.39 **Incorrect deduction in respect of intercorporate dividends**

Under the Income Tax Act, 1961, in the case of a domestic company, where the gross total income including any income by way of dividends from another domestic company, there shall be allowed in computing the total income, a deduction at a specified percentage of such income. The Act was amended through Finance Act (No. 2) 1980 with retrospective effect from 1st April 1968 to provide that the deduction on account of intercorporate dividends is to be allowed with reference to the net dividend income as computed in accordance with the provisions of the Act and not on the gross amount of the dividend. The Act further stipulates that where the gross total of an assessee includes any income by way of dividends on shares in a company attributable to profits and gains from the new industrial undertaking of such company a deduction equal to the whole of such dividend attributable to such profits and gains of the undertaking shall be allowed in computing the income of the assessee.

In the case of three assessees (companies) under the charge of three Commissioners, excess deduction amounting to Rs. 18.75 lakhs was made by allowing the deduction towards intercorporate dividends on the gross amount of dividends instead of on the net amount during the assessment years 1971-72 to 1972-73, 1974-75 to 1980-81 and 1982-83 resulting in short levy of tax totalling to Rs. 10.99 lakhs for the assessment years 1972-73, 1974-75 and 1975-76. Two of the assessments have been completed after the amendment to the Act in 1980 propounding the correct position in law. In the other cases the excess deduction originally allowed in the assessments was not withdrawn despite the amendment to the Act retrospectively from 1 April 1968. One case had been checked by the Internal Audit Party of the department and the mistake was not noticed by it.

In two cases the mistakes have been accepted by the department.

The Ministry of Finance have accepted the mistake in one case. Their comments in other cases are awaited (January 1986).

2.40 **Incorrect deduction allowed on income for technical services rendered outside Inda**

Under the Income-tax Act, 1961, where the gross total income of an Indian company includes income by way of royalty, fees or any similar payment received by the company from foreign Government or a foreign enterprise in consideration for technical services rendered outside India to the foreign enterprise, under an agreement approved by the Board and such income is received in convertible foreign exchange in India, a deduction of the whole of such income shall be allowed in computing the total income of the company. The payments made by the foreign enterprise to the Indian company for or to cover overhead and establishment expenses in India and included in the fees or other similar payment received do not partake the character of income as defined in the Act. It was also clarified by the Board in their circular of December 1975 that services such as those relating to management, organisation, sales, finance and accounts and technical services which are rendered or to be rendered in India will not qualify for such deduction.

(i) A public limited company engaged in the execution of contracts abroad, claimed a deduction of Rs. 1,14,96,227 for the assessment year 1980-81 as income representing fees for technical services received from foreign concern. While completing the assessment in September 1983, the assessing officer disallowed a sum of Rs. 81,746 only on account of reimbursement of overhead expenses incurred in India, whereas the amount of overhead expenses actually amounted to 57,63,066 Rials equivalent to Rs. 6,70,317. Thus the correct amount of disallowance on this account should have been Rs. 6,70,317 instead of Rs. 81,746 disallowed by the assessing officer. The omission to disallow the correct amount of over head expenses resulted in short levy of tax of Rs. 3,47,992.

The department did not also consider similar payment in another contract amounting to Rs. 2,97,905 involving a further tax demand of Rs. 1,76,135.

The total short levy of tax on this account was Rs. 5,24,127.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) An assessee company received payments of Rs. 9,39,007 and Rs. 5,08,300 in the previous years relevant to assessment years 1981-82 and 1982-83 respectively from foreign governments for rendering technical service for execution of works in those countries. The Inspecting Assistant Commissioner (Assessment) while completing assessment for assessment years 1981-82 and 1982-83 in October 1983 and February 1982 respectively allowed deduction of these receipts from gross total income without taking into account the expenditure of Rs. 4,43,264 and Rs. 4,37,047 incurred in earning the income in the assessment years 1981-82 and 1982-83 respectively. This resulted in underassessment of income of Rs. 8,80,311 in these years involving short levy of tax of Rs. 6,00,720 including excess interest allowed for excess payment of advance tax.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

2.41 **Incorrect exemption of income of a Warehouse**

Under the provisions of the Income-tax Act, 1961, in the case of an authority constituted under any law for the time being in force for the marketing of commodities, any income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities would be exempt from Income-tax. What is exempt under the aforesaid provisions is the income derived from the specific activities mentioned therein and not in respect of other incomes. This view has also been held by the Madhya Pradesh High Court (133-ITR-158) in January 1981.

During the previous year relevant to the assessment year 1979-80, a state warehousing corporation received a sum of Rs. 6,56,618 on account of service charges for rendering services such as loading, unloading and transportation of commodities etc. In the assessment for the assessment year 1979-80 completed in August 1981, the assessing officer did not include the amount of service charges in the total income. As the income on account of service charges did not constitute income derived from letting of warehouse for storage etc., the same was required to be included in the total income. The omission to include the service charges received resulted in under assessment of income of Rs. 6,65,618 involving short levy of tax of Rs. 3,84,395.

The assessment was checked by the internal audit party of the department, but the mistake was not detected by it.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.42 **Excess Refunds**

Where the amount of tax paid exceeds the amount of tax payable the assessee is entitled to a refund of the excess. According to the executive instructions issued in September 1974, the assessing officer is required to take prior approval of the Inspecting Asstt. Commissioner of Income-tax before issue of tax refunds of Rupees one lakh and more.

(i) In the case of a public limited company, a sum of Rs. 4,27,185 was determined as refundable for the assessment year 1980-81 in the provisional assessment made in July 1980. After adjusting a sum of Rs. 2,58,244 on account of tax arrears relating to the assessment year 1974-75, the Income-tax Officer sought the approval of the Inspecting Asstt. Commissioner of Income-tax for refund of the balance amount of Rs. 1,68,941 only. The Inspecting Asstt. Commissioner (Special Circle) ordered a recomputation of the total income and rectification of the provisional assessment. After recomputation in December 1980, a sum of Rs. 3,93,607 was re-determined as refundable to the assessee company. The assessing officer refunded the full amount of Rs. 3,93,607 without taking into account the sum of Rs. 2,58,244 already refunded in July 1980 by way of adjustment of tax arrears for the assessment year 1974-75. The regular assessment for the assessment year 1980-81 was made in August 1982 raising a tax demand of Rs. 6,05,373 taking into account the refund of Rs. 3,93,607 made in July 1980 only. The refund of Rs. 2,58,244 was thus lost sight of resulting in excess refund of Rs. 2,58,244.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The assessment of a closely held company for the assessment year 1979-80 was revised by the Inspecting Asstt. Commissioner (Asstt.) in April 1982 and a sum of Rs. 1,48,553 being the tax of Rs. 1,45,639 paid in January 1982 and interest of Rs. 2,914 thereon was refunded in November 1982. The assessment for the assessment year 1979-80 was again revised in November 1983 to give effect to the orders of May 1983 of the Commissioner of Income tax (Appeals) and in the revision, the Income-tax Officer gave credit for the sum of Rs. 1,45,639 (being the tax paid in January 1982) stating that it was omitted to be taken into account. The refund issued in November 1982 was thus lost sight of by the assessing officer and the credit given in November 1983 resulted in double credit of Rs. 1,45,639 and payment of interest of Rs. 32,032 there on involving excess refund of Rs. 1,77,671.

The Ministry of Finance have accepted the mistake.

(iii) In the case of an assessee Public Limited Company engaged in carrying on the business of manufacturing hardened and ground gear in India on contract basis with parties including State and Central Government agencies, the assessing officer refunded an amount of Rs. 17,32,224 while making the provisional assessment for the assessment year 1981-82, in July 1981 and again Rs. 5,47,172 while making rectification on provisional assessment in March 1982, both refunds being in consideration of advance tax of Rs. 28,00,000 and of Rs. 12,48,183 tax deducted at source. The certificate of tax deducted at source, showed tax amounting Rs. 3,21,209 deducted at source did not pertain to the accounting period of calendar year 1980, relevant to the assessment year 1981-82. The omission to exclude the amount resulted in excess refund of Rs. 3,21,209.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Under the provisions of the Income-tax Act, 1961 an Indian Company or a company which had made the prescribed arrangements for the declaration and payment of dividends within India shall, before making any payments, deduct tax at source from the amount of dividend at the prescribed rates in force and deposit the tax so deducted to the credit of the Central Government. The Act further provides that the tax so credited to Central Government shall be treated as a payment of tax on behalf of the persons from whose income the deduction was made. The Act does not however allow similar treatment towards deduction of tax on dividend made by a foreign company which has not made the prescribed arrangements for the declaration and payament of dividend within India.

The assessment of a company for the assessment year 1980-81 was completed in March 1984 resulting in a refund of tax of Rs. 1,11,51,353. In the assessment the department allowed a credit for tax deducted at source of Rs. 1,24,80,466 which included a sum of Rs. 1,59,092 in respect of tax on dividends received from foreign companies, incorporated outside India. Similarly, in the assessment for the assessment year 1979-80, a total credit for a sum of Rs. 1,09,12,042 was allowed to the assessee company which included tax on dividend declared by foreign companies amounting to Rs. 15,425. Since

the Act does not permit allowance of credit of tax in respect of the deduction of tax on dividends made by a foreign company which had not made the prescribed arrangements for the declaration and payment of dividends within India, the credit for tax so allowed in the hands of the assessee company was not in order and resulted in excess refund to the extent of Rs. 1,74,517 for the two assessment years.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

NON-LEVY OR INCORRECT LEVY OF INTEREST

2.43 Delay in filing the return

Under the Income-tax Act, 1961, if the return of income for any assessment year is not furnished within the prescribed due date the assessee shall be liable to pay simple interest at 12 per cent (15 per cent from October 1984) per annum from the date immediately following the due date to the date of furnishing of the return, on the amount of tax determined in the regular assessment as reduced by the advance tax, if any paid and any tax deducted at source.

(i) A closely held company filed its return of income for the assessment year 1980-81 on 29 August 1980 as against the due date of 30 June 1980. In the assessment completed in October 1981, the tax of Rs. 57,10,939 paid in advance by the assessee company was not treated as 'advance tax' as the 'statement of advance tax' filed by the company was not in accordance with the provisions of the Act. The advance deposit of tax was accordingly not taken into account either for levy of interest for non-filing of the estimate of advance tax or for payment of interest on the excess of advance tax. Consequent on ignoring the advance payment of tax the assessee company would be liable to pay interest of Rs. 57,730 for belated filing of the return. The levy was, however, not considered by the department.

On this being pointed out by audit in January 1983, the department levied the interest in August 1984.

The Ministry of Finance have accepted the mistake.

(ii) In another case, assessed in yet another commissioner's charge, there was short levy of interest of Rs. 67,104 for the assessment year 1980-81 owing to erroneously calculating the period of delay in filing the return of income for the year as four months instead of sixteen months. The comments of the Ministry of Finance on the case are awaited (January 1986).

(iii) The Act also provides that where a return filed is defective, the Income-tax Officer, may at his discretion, allow the defect to be rectified within fifteen days or such further time as may be allowed. Where the defect is rectified by the assessee at any time within the period allowed by the Income-tax Officer, the return already filed will be treated as valid return. When the defect is rectified after the time allowed, but before the assessment is made, the Income-tax officer may condone the delay in rectifying the defect and treat the return filed as a valid return. The Act specifically provides that the income tax return of a company shall be signed and verified by the Managing Director or where there is no Managing Director by any Director of the company. A return of income is to be regarded as defective only if it contains any of the defects referred to in the Act.

A company in which the public are substantially interested filed its return of income for the assessment year 1980-81 in August 1981 signed by its Secretary instead of by the Joint Managing Director, the competent person. A revised return duly signed by the Joint Managing Director was filed in September 1982. The assessing officer treated the original return filed in August 1981 as defective, condoned the delay in filing the revised return and had ordered (March 1983) that no interest need be charged for the belated filing of the return. The assessment for the assessment year 1980-81 was made in March 1983 on a total income of Rs. 61,16,190 with a tax demand of Rs. 36,16,197 and no interest for belated filing of the return was charged.

There is no provision in the Act to condone any delay in filing the original return and the assessee having filed a return for the first time for the assessment year 1980-81 in August 1981 only instead of by 31st July 1980 the non-levy of interest for the period upto the date of filing the original return was not in order. The non signing of the return by the competent person is not one of the conditions explained in the Act for regarding a return as defective and the relaxation from the levy of interest permitted by the Income-tax Officer on account of this omission is also not in order. This resulted in non-levy of interest of Rs. 4,33,932.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.44 Omission to deduct tax at source

Any person not being an individual or a Hindu Undivided family, who is responsible for paying to a resident any income by way of interest other than

income chargeable under the head "Interest on Securities" 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 issue of a cheque whichever is earlier, deduct income tax thereon at the rates in force and deposit the same to the credit of the Government. Failure to deduct tax at source renders the assessee liable to

(1) pay the amount of tax; and

(2) pay penal interest at the prescribed rate from the date on which it was deductible to the date on which it is actually paid.

In regard to interest paid to a non-resident however, the Income-tax Act provides for deduction of tax at source at the time of payment. The omission to deduct tax or failure to pay the tax deducted to the credit of Government, renders the payer liable to charge of interest at 9 per cent and 12 per cent per annum and penalty as laid down in the Act.

The expression 'at the time of payment' in the provisions applicable to non-residents, is construed by the Central Board of Direct Taxes to mean "at the time of actual payment". When a non-resident bank advances loans to a resident person and appropriates the periodical interest by debit to his running account with the bank, no tax is being deducted at source such interest payment on the plea that only a book adjustment has been carried out and no actual payment of interest has taken place. In July 1980, the Ministry of Finance accepted that there was a lacuna in the provisions of the Act relating to non-residents and it was engaging their attention. The lacuna has not, however, been rectified so far.

(i) In the previous years relevant to the assessment years 1975-76 to 1981-82 and 1972-73 to 1979-80, two companies incurred interest liability aggregating to Rs. 60,79,901 on loans taken by them from two non-resident banks. As the assessees had running accounts, the two non-resident banks debited the accounts of the assessees with interest due. However, tax of Rs. 44,63,025 was not deducted at source from such interest payments and credited to Government. The department did not also invoke the provisions of law for the levy of penal interest and penalty for the failure.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) A company made a total payment of Rs. 10,04,787 by way of interest to residents during the previous years relevant to the assessment years 1976-77 to 1979-80. No tax was deducted from the residents at the time of payment of interest by the assessee as a result of which tax amounting Rs. 2,11,005 was not recovered by the company. For failure to recover the tax at source, the Company was liable to pay penal interest of Rs. 61,370. However the assessing officer did not levy interest.

Accepting the omission the Ministry of Finance reported that the interest of Rs. 61,370 had since been collected.

2.45 Delay in payment of tax demand

Under the Income-tax Act, 1961, any demand for tax should be paid by an assessee within thirty-five days of service of notice of the relevant demand and failure to do so would attract simple interest at twelve per cent (15 per cent from 1 October 1984) per annum from the date of default. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demands. In April 1982, the Board issued instructions clarifying that the interest is to be calculated with reference to the date of service of original demand notice on tax finally determined in cases of assessments 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.

In the case of seven companies assessed in seven different Commissioners charges, income-tax and surtax demands amounting to Rs. 3,02,52,661 and Rs. 35,34,701 respectively for the assessment years 1972-73 and 1977-78 to 1982-83 (assessments completed between March 1978 and November 1983) were raised and the demands became due for payment in all the cases between May 1980 and December 1983. The tax demands were paid by the assessee companies between March 1981 and March 1984 after a delay ranging from 2 months to 28 months. As the demands were paid beyond the admissible period of 35 days, these companies were liable to pay interest of Rs. 22,37,428 on the belated payment of tax.

No interest was levied by the assessing officers in any of these cases and the omission resulted in non-levy of interest of Rs. 22,37,428 for the seven assessment years.

Three of these seven cases were assessed by Inspecting Assistant Commissioners (Assessments) and

one of the cases was checked by the internal audit party of the department which did not point out the omission.

The Ministry of Finance have accepted the mistake in two cases and comments of the Ministry in the remaining cases are awaited (January 1986).

2.46 **Non-levy of interest on non payment of advance tax due to lacuna in the Act**

The Act further stipulates that where the advance tax paid by the assessee during a financial year exceeds the amount of tax determined on regular assessment, the Government is liable to pay interest at the rate of twelve per cent (fifteen per cent with effect from 1 October 1984) on such amount of advance tax as is found to be in excess and the interest is computed from 1st April next following the said financial year upto the date of regular assessment.

Where, however, the amount of advance tax refunded on provisional assessment results in the balance advance tax falling short of seventy five per cent of the tax determined on regular assessment there is no provision in the Act to levy interest on such excess refund. Finding the absence of the enabling provision in the Act for levy of interest on such excess refund of advance tax and to prevent the abuse of such advance refunds by the assessees and considering the inequitous situation to the disadvantage of the Government, the Public Accounts Committee, in their 100th Report (7th Lok Sabha 1982-83), observed that 'this is apparently an anomalous situation which calls for a suitable amendment of the law to remove the lacuna', and the committee recommended that Government should examine this question and bring fourth suitable amendment to the Act forthwith. In their 'action taken note' on this recommendations furnished to the Public Accounts Committee in March 1983, the Ministry of Finance stated that "the recommendation of the Public Accounts Committee has been noted and would be processed while formulating proposals for the comprehensive Amendment Bill, expected to be introduced this year" (1983). The Income-tax Act, 1961, has been amended in 1984 and 1985, but no amendment to the Act to plug the lacuna pointed out by the Public Accounts Committee has been made so far. As a result, though the exchequer continues to be deprived of the benefit of advance tax, interest for non-payment of advance tax could not be levied.

Four companies assessed in three different Commissioners' charges made payment of advance tax of Rs. 42,26,535 for the assessment years 1978-79 and 1979-80. Provisional assessments in respect of these companies were made between October 1978 and July 1980 and a sum of Rs. 37,02,020 was refunded on account of advance tax paid in excess. In the regular assessments made between September 1981 and January 1983, a tax of Rs. 30,32,710 was determined as payable by the companies and consequently the refund of advance tax already made proved excessive and the amount refunded as aforesaid remained with the companies till they were demanded again on completion of regular assessment. However, in the absence of an enabling provision in the Act, no interest could be charged on the amount of advance tax refunded to the companies. Had such a provision been introduced as recommended by the Public Accounts Committee and agreed to by the Ministry of Finance, interest amounting to Rs. 6,57,191 would have accrued to the Government computed at the rate of 12 per cent prescribed in similar instances.

The Ministry of Finance have not disputed the facts in one case. Their comments in the remaining cases are awaited (January 1986).

2.47 **Non levy of interest on short payment of advance-tax**

(i) Under the Income-tax Act, where an assessee has paid advance tax on the basis of his own estimate for any financial year and the advance tax so paid falls short of seventy five per cent of the tax determined on regular assessment, interest at the prescribed rate is payable by the assessee on the amount by which the advance tax paid falls short of assessed tax from the first day of the next financial year to the date of regular assessment.

Two companies assessed in one Commissioner's charge for the assessment years 1979-80 and 1980-81 from whom the advance tax amounting to Rs. 27,06,442 was demanded by the Department, paid Rs. 11,35,928 as advance tax. As the advance tax so paid fell short of 75 per cent of the assessed tax of Rs. 22,42,058 penal interest of Rs. 5,41,287 was attracted but not considered in these cases in the assessments completed in September 1983 and June 1984. The department, however, levied interest of Rs. 91,108 only (as against Rs. 2,35,099 leviable) in one case and did not levy any interest in the other case resulting in a total non-levy of tax amounting to Rs. 4,50,179.

The Ministry of Finance have accepted the mistake in one case. Their reply is awaited in the other case (January 1986).

(ii) Under the Income-tax Act, where on making regular assessment, the assessing officer finds that an assessee has under-estimated the advance tax payable by him and has thereby reduced the amount payable in either of the first two instalments, he may direct that the assessee shall pay simple interest at 12 per cent per annum for the period during which the payment was deficient.

In the case of two companies assessed in two different Commissioners' charges for the assessment years 1976-77 and 1979-80 assessed in March 1979 and May 1983 respectively the companies paid advance tax of Rs. 94,89,175 in the first two instalments on the basis of own estimate and made up the shortfall of Rs. 56,75,865 in the last instalment by filing revised estimates. For the total deficiency of Rs. 56,73,865 the company was liable for penal interest. No interest was, however, levied and the omission resulted in the non-levy of interest amounting to Rs. 2,10,721.

The comments of the Ministry of Finance on the cases are awaited (January 1986).

(iii) In the case of a private limited company, the department issued a notice in July 1973 to the assessee to pay advance tax amounting to Rs. 1,30,000 for the assessment year 1974-75. The computation of advance tax was based on the assessed income for assessment year 1970-71. A revised notice was issued to the assessee in November 1973 demanding advance tax of Rs. 4,20,400, computed on the basis of self assessment tax for the assessment year 1973-74 paid by the assessee. The notice issued by the department in July 1973 was cancelled by the Department in December 1973 owing to the reduction in the total income to "nil" for the assessment year 1970-71. In the regular assessment for assessment year 1974-75 completed in November 1976, the department demanded interest of Rs. 96,410 for failure to file estimate of income. This was objected to by the assessee on the following grounds :

(1) the revised notice issued for advance tax by the department in November 1973 became infructuous as a result of the cancellation of the earlier notice of July 1973 and

(2) there was no legal obligation on the part of the company to file an estimate.

This contention of the assessee was accepted by the department and interest demanded was withdrawn.

It was pointed out by audit in March 1979 that :

(1) the Income-tax Officer was competent to issue a revised notice for payment of advance tax anytime before the date which was 15 days prior to the date on which the last instalment was payable; and

(2) the failure to file an estimate rendered the assessee liable to pay interest amounting to Rs. 96,410.

The department accepted the mistake and rectified the assessment in March 1984 creating an additional demand of Rs. 87,650 after adjusting a sum of Rs. 10,039 which was deducted at source from the assessee.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

2.48 **Short levy of interest**

Under the Rule framed under the Act, the period of calculation of interest is to be rounded off to a whole month or months and for this purpose any fraction of a month shall be ignored. Such rounding off of a month, however, is to be made only once and not at every stage of intermediary payment of taxes.

The assessment of a company for the assessment year 1980-81 was completed on 25 March, 1983. As there was short payment of advance tax on estimates, the department levied penal interest of Rs. 11,45,460. The amount of interest was to be calculated from 1 April 1980 to 28 February, 1983 omitting the fraction of a month in March 1983. Besides advance tax, the assessee paid self assessment tax of Rs. 1,52,451 on 6 September 1980 and a further sum of Rs. 4,25,866 on 30 July, 1981. The actual number of months for which interest was leviable for the aforesaid period worked out to 35 months instead of 33 months as calculated by the department as a result of rounding off of months at every stage of the said intermediary payment of taxes. Further the department erroneously considered the date of payment of Rs. 4,25,866 as on 30 July 1980 instead of the correct date of 30 July 1981 as evident from the relevant challan on record. The mistakes resulted in short levy of interest of Rs. 1,25,319 for the assessment year 1980-81.

The comments of the Ministry of Finance are awaited (January 1986).

2.49 **Avoidable payment of interest by Government**

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

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

In September 1974 the Board prescribed a register to be kept in the personal custody of the Income-tax officer for noting down cases where provisional assessment would have to be made. The Income-tax Officers were also required to leave notes on the files, giving reasons as to why regular assessments could not be completed within six months. While stating that any payment of avoidable interest would be viewed seriously, the Board required the Commissioners and the Inspecting Assistant Commissioners to call for half-yearly statements of interest paid, exceeding Rs. 1,000 in each case in order to satisfy themselves that the payment of interest was unavoidable.

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

Despite the controls prescribed by the Board, the omission to make provisional assessments continue to occur involving avoidable payment of substantial amounts of interest by Government apart from the delay caused in refunding the amounts due to the assessees under the law.

Four companies assessed in four commissioners charges filed their return of income for the assessment years 1979-80 to 1981-82 between June 1979 and July 1981 showing a total income of Rs. 18,43,26,745. (One company returned a loss of Rs. 40,57,877 for the assessment year 1979-80 in June 1979 but revised the return in February 1982 showing income of Rs. 2,17,061). A sum of Rs. 12,24,59,089 was paid by these companies as advance tax including tax deducted at source in respect of these assessment years. As refund of advance tax paid in excess was prima facie due to these companies, provisional assessments were required to be made in pursuance of the provisions of the Act and the executive instructions issued by the Board. No provisional assessments were made to refund the tax paid in excess in the case of three companies. The regular assessment in respect of these three companies were made between March 1983 and March 1984 raising a demand of Rs. 7,10,71,299 and the advance tax of Rs. 1,04,74,207 paid in excess was refunded to the assessee companies along with interest of Rs. 39,21,725 thereon.

In the fourth case, the provisional assessment which was required to be done before March 1981 was made in August 1982 after a delay of 17 months, raising a demand of Rs. 3,81,76,523 and advance tax of Rs. 32,05,977 was refunded to the company. The regular assessment of the company was made in August 1983 and a sum of Rs. 8,41,820 was paid to the assessee on account of interest on advance tax paid in excess.

Had provisional assessment been made in time within the prescribed period of six months from the date of filing of the returns, payment of interest to the extent of Rs. 35,41,003 by the Government could have been avoided.

Two of these companies were assessed by Inspecting Assistant Commissioner (Assessment). The Internal Audit Party of the department has checked the assessment of two companies but the above omission escaped its notice.

The Ministry of Finance have accepted the mistake in one case. In an another case they have contended that the provisional assessment was not made under the law as there was no claim for refund from the assessee. This is not in accordance with the instructions of the Board on the subject.

Their replies in respect of the other cases are awaited (January 1986).

2.50 **Avoidable payment of interest due to delay in giving effect to appellate orders**

Under the provisions of the Income-tax Act, 1961, where as a result of any order passed in appeal or other proceedings under the Act, refund of any amount becomes due to the assessee and the Income-tax Officer does not grant the refund within a period of three months from the end of the month in which such order is passed, the Government shall pay to the assessee simple interest at twelve per cent per annum on the refund due from the date immediately following the expiry of the period of three months aforesaid to the date on which the refund is granted. The Central Board of Direct Taxes issued executive instructions in January 1977 directing that such refunds should be granted within a month of the receipt of appellate orders.

(i) Two companies became entitled to a total refund of Rs. 72,58,192 (including surtax refund of Rs. 6,00,479) for the assessment years 1970-71 1971-72, 1973-74, 1975-76 and 1976-77 as a result of appellate orders passed between December 1977 and November 1980. The refund was however authorised by the assessing officers between April 1981 and March 1982. As a result of delay in authorising the refund, the department had to pay interest of Rs. 14,79,679 (including interest of Rs. 1,81,309 on surtax) to the assessee companies. Had timely action been taken by the department to refund the tax pursuant to the appellate orders, the payment of interest of Rs. 14,79,679 could have been avoided.

The Ministry of Finance have accepted the mistakes.

(ii) Pursuant to certain appellate orders passed in March 1980 for the assessment year 1971-72, the assessment of a public company for the assessment year 1971-72 was revised in November 1980. Consequent upon this revision, the assessment for the assessment year 1977-78 was also required to be revised. The assessment for the assessment year 1977-78 was revised in February 1981 determining a refund of Rs. 71,97,047 to the assessee. The refund was actually made to the assessee company in March 1981.

The delay in giving effect to the orders of the Appellate Tribunal in respect of the assessment year 1971-72 and further delay in making the consequential revision of the assessment relating to the assessment year 1977-78 resulted in payment of interest of Rs. 5,77,760 to the assessee company which could have been avoided had timely action been taken by the assessing officer.

The assessment was checked by the Special Audit Party of the department but the mistake escaped its notice.

The comments of the Ministry of Finance are awaited (January 1986).

2.51 **Incorrect payment of interest by Government**

(i) Under the Income-tax Act, 1961 where the advance tax paid by an assessee during a financial year exceeds the amount of tax determined on regular assessment, the Government is liable to pay interest at the prescribed rate on the amount of advance tax paid in excess for the period from 1 April next following the financial year to the date of regular assessment. The manner of payments and the dates of instalment of advance tax are laid down in the Act. Interest on excess advance tax paid by an assessee is payable by government at the time of regular assessment.

The Central Board of Direct Taxes have also reiterated in October 1975 that any payment made after the last date of the instalment of advance tax would not be considered as advance tax and would not therefore qualify for payment of interest to an assessee. They had further held that there is no enabling provision for relaxation of the dates of instalments of advance tax since the dates have been fixed by law itself and in any case the last date for payment of advance tax cannot be relaxed.

In the case of a private limited company whose previous years ended on 31st March every year advance tax for the assessment year 1980-81 was payable by the company on 15 September, 1979, 15 December, 1979 and 15 March, 1980. The company however, made a total payment of tax of Rs. 90,30,000 on 17 November 1979, (Rs. 19,35,000) 20 December 1979 (Rs. 19,35,000) and 15 March 1980 (Rs. 51,60,000).

The provisional assessment of the assessee for the assessment year 1980-81 was completed in November, 1980 and a refund of Rs. 28,00,051 (including interest on the advance tax paid in excess amountnig to Rs. 1,83,176) was made to assessee in the same month viz November, 1980. The payment of interest of Rs. 1,83,176 aforesaid to the assessee on provisional assessment was not in accordance with the provisions of the law.

The regular assessment for the assessment year 1980-81 was completed in August 1983 and the total income and tax thereon were finaly determined at Rs. 89,82,310 and Rs. 57,93,590 respec-

tively. The tax paid in excess was determined at Rs. 32,36,410 and refunded to the assessee along with interest amounting to Rs. 4,30,983. As refund of Rs. 28,00,051 (including interest of Rs. 1,83,176) was made earlier in November 1980 after provisional assessment, the balance amount of Rs. 8,67,342 (including interest of Rs. 2,47,807) was refunded to the assessee in August 1983 after final assessment.

As the first two instalments of Rs. 19,35,000 each were deposited by the assessee on 17 November 1979 and 20 December 1979 which were beyond the due dates as fixed by the Act *viz.* 15 September 1979 and 15 December 1979, they could not be considered as payment of advance tax for allowing interest to the assessee. Further, as the deposit of Rs. 51,60,000 by the assessee as third instalment of advance tax on 15 March 1980 did not fully cover the assessed tax of Rs. 57,93,590, the total payment of interest to the assessee amounting to Rs. 4,30,983 (in November 1980 and August 1983) was irregular and incorrect under the Act and the instructions issued by the Central Board of Direct Taxes in October 1975.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

The case was checked by the Internal Audit party of the Department and the mistake was not noticed by the party.

(ii) Under the provisions of the Income-tax Act, 1961, where an assessee becomes entitled to refund of any amount paid after 31 March 1975 as a result of any orders passed in appeal or other proceedings the Central Government shall pay interest at 12 per cent (15 per cent from 1 October 1980) per annum on the amount so refundable from the date on which the refund is granted. No interest will, however, be payable for a period of one month from the date of the order passed in appeal or other proceedings. Executive instructions have also been issued in January 1977 that refund should be granted in such cases within a month of the date of the appellate orders.

Consequent to certain appellate orders passed in March 1980 for the assessment year 1971-72, a widely held company became entitled to refunds of Rs. 84,87,247 and Rs. 74,08,031 for the assessment years 1975-76 and 1976-77. The refunds were actually paid in November 1980 and December 1980 respectively due to delay in giving effect to the appellate orders for the assessment year 1971-72 and consequential delay in revising the assessment for the assessment years 1975-76 and 1976-77. The delay of six and eight months respectively in making the refunds for the two assessment years 1975-76 and 1976-77 resulted in avoidable payment of interest of Rs. 11,01,632.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

2.52 **Non-levy of additional Income-tax**

Under the provisions of the Income-tax Act, 1961, where the profits and gains of any previous year distributed as dividends within the twelve months immediately following the expiry of the previous year by a company, not being one in which the public are substantially interested or a hundered per cent subsidiary of any such company, are less than the statutory percentage of the distributable income of that previous year, the company is liable to pay additional income-tax at the rates given below on the distributable income as reduced by the amount of dividends actually distributed, if any :—

(1) Investment company—50 per cent.

(2) Trading company—37 per cent.

(3) Any other company—25 per cent.

(a) On the basis of the Income-tax assessment made in September 1983 of a private limited company for the assessment year 1980-81 the distributable income for the previous year relevant to this assessment year calculated at the prescribed percentage worked out to Rs. 7,69,519. No dividend was declared by the assessee company for the previous year and consequently the company became liable for additional income-tax. However, no additional income-tax was levied by the department. The omission resulted in non-levy of additional income-tax of Rs. 1,92,380.

The Ministry of Finance have accepted the mistake.

(b) Two trading companies in which the public were not substantially interested had distributable income of Rs. 5,57,735 for the previous year relevant to the assessment year 1980-81. No dividend was distributed, by the companies for this year. The non distribution of dividend attracted levy of additional income-tax. However, no action was taken to levy the additional tax. The omission to do so resulted

in the non-levy of additional income-tax of Rs. 1,92,930.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

OTHER TOPICS OF INTEREST

2.53 Grant of investment allowance

Under the Income-tax Act, 1961, in respect of a machinery owned by an assessee and used for the purposes of business carried on by him, a deduction shall be allowed in the previous year of installation or in the previous year of first usage, of a sum by way of investment allowance, equal to 25 per cent of the actual cost of the machinery to the assessee. This section as amended in the Finance Act, (No. 2) 1977 with effect from 1 April 1978 provided that the machinery used in an industrial undertaking, other than a small scale industrial undertaking are eligible for the investment allowance provided that they are used in the manufacture of production of any article not specified in the Eleventh Schedule to the Act. Aerated waters in the manufacture of which blended flavouring concentrates in any form are used, figure as item 5 of the schedule.

Under the Central Excise Tariff as it stood prior to 17 June 1977, "Aerated Waters in the manufacture of which blended flavouring concentrates in any form are used" were subject to a duty of 20 per cent advalorem as against 10 per cent advalorem applicable to other aerated waters. It was judicially held by the Bombay High Court that 'synthetic essences' were not covered by the term 'blended favouring concentrates' and consequently only the lower rate of duty was leviable.

Finance Act (No. 2) 1977 amended the Excise Tariff levying 20 per cent advalorem rate on 'All aerated waters other than those which are only charged with carbon-di-oxide gas under pressure and which contain no other added ingredient thus removing the distinction between use of 'synthetic essences' and 'blended flavouring concentrates'. However, item 5 of Eleventh Schedule to the Income-tax Act, 1961 was not correspondingly amended to conform with the Excise Tariff description of aerated waters. As a result, plant and machinery engaged in the manufacture of aerated waters using, blended flavouring concentrates' were ineligible for investment allowances, while those using 'synthetic essenses' continued to be eligible for the allowance even though the distinction was done away with in the Central Excise Tariff.

An assessee company which was manufacturing aerated waters using 'synthetic essences' claimed investment allowance of Rs. 1,16,152 for the assessment year 1981-82 and Rs. 5,21,731 for the assessment year 1982-83 and the same were allowed by the assessing authority in the assessments completed in May 1983 and August 1983 respectively on the plea that aerated waters manufactured with synthetic essences were not covered by item 5 of the Eleventh Schedule to the Act. Had the Income Tax Act been amended on the lines of the amendment of the Central Excise Tariff, the claim of investment allowance for the two years would have been rendered inadmissible with consequential accrual of additional revenue of Rs. 3,73,953 to the Government.

The comments of the Ministry of Finance are awaited (January 1986).

2.54 Omission to frame fresh assessment

For the assessment year 1978-79 a company returned a loss of Rs. 1,27,335. While making the best judgment assessment in December 1980, the assessing officer disallowed long term capital loss and a few other items of expenditure totalling to Rs. 3,90,874 and determined the income as Rs. 2,63,540 and raised a demand for Rs. 1,31,770 calculating the same at the prescribed rates of tax applicable to capital gains.

The Special Audit Party of the department which checked the assessment in February 1981 pointed out that after disallowing the capital loss etc., from the loss as returned by the assessee, the taxable income consisted of income from interest which was required to be charged to tax at the normal rates which worked out to Rs. 2,00,898.

Before remedial action could be taken on this observation, the ex-parte assessment was cancelled at the request of the assessee on 31st March 1981 under the provisions of the Act. A fresh assessment was required to be concluded by 31 March 1983 which was not done, as a result of which no assessment could be done due to operation of time bar. Omission to conclude a fresh assessment within the prescribed time-limit resulted in loss of revenue of Rs. 2,00,898.

The comments of the Ministry of Finance are awaited (January 1986).

2.55 Loss of revenue due to non-completion of assessment

Under the provisions of the Income-tax Act, 1961 an order for fresh assessment, in pursuance of an order setting aside or cancelling an assessment has to be completed by the assessing officer within two years

from the end of the financial year in which such orders are received.

The Income-tax Officer is required to note down the revival of the proceedings in the prescribed Blue Book (Control Register) to be maintained by him and take steps to complete the assessment in accordance with Appellate Authority's orders within the time limit prescribed in the Act. The Register of Appeals and the Control Register required to be maintained by the assessing officer are intended to help keeping a watch over the pending action.

In the assessment of a private company (made in July 1978), the Income-tax Officer determined the income at Rs. 1,25,620 against the declared loss of Rs. 1,03,530 after adding a sum of Rs. 2,24,171 representing concealed income by way of under-valuation in the cost of construction of a building under the head 'other sources' and raised a demand for tax of Rs. 1,20,886 (including interest for non payment of advance tax and belated filing of return). On an appeal preferred by the assessee, the Commissioner of Income-tax (Appeals) set aside the assessment in February 1979 directing the assessing officer to frame the assessment in accordance with the law. These orders were received by the assessing officer in February 1979. The assessing officer failed to keep a note of the pending action in the prescribed register. As a result the fresh assessment required to be framed by 31 March 1981 was not made by the assessing officer resulting in loss of revenue of Rs. 1,20,886.

The Ministry of Finance have accepted the mistake.

2.56 Omission to take action on the internal audit objection

With a view to providing a second check over the arithmetical accuracy of computation of income and calculation of tax with reference to the growing complexity of tax laws and to improve the quality of assessment, the department set up internal audit parties to check the assessments done by the various assessing officers. Special Audit Parties headed by senior level officers were created by the department in July 1976 to check the assessment cases made in company circles, central circles, special circles and all other important revenue yielding circles.

Not satisfied with the functioning of the internal audit of the department which was attributed by the department to the shortage of staff, Public Accounts Committee in their 194th Report (Seventh Lok Sabha-1983-84) inter-alia stated that "the Committee are strongly of the view that there is an urgent need to strengthen the Internal Audit Wing particularly in a revenue earning department like income-tax where any extra expenditure incurred in this behalf is certain to be more than compensated by increase in revenue as a result of detection of mistakes by the Internal Audit Wing". The Committee further observed that "there should be in addition to quantitative strengthening, qualitative strengthening of internal audit so as to make it more effective and better subserve the end in view."

According to the executive instructions issued 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 report of the internal audit. Inspite of the internal audit wing pointing out mistakes in assessments involving large revenue effect and despite the above instructions of the Board, failure to take remedial action on internal audit objection has been noticed in audit. A few instances are given below :—

(i) In the income-tax assessment of a closely held industrial company for the assessment year 1978-79, completed in September 1981, the Special Audit Party of the department had pointed out (in June 1982) double deduction of Rs. 5.30 lakhs on account of investment allowance and omission to disallow interest of Rs. 3,099 which led to a potential tax demand of Rs. 3.3 lakhs for the assessment year 1980-81. No remedial action thereon was taken by the department till August 1984 when the revenue audit pointed out the omission. The assessment was rectified thereafter in March 1985.

The Ministry of Finance have informed that the department has rectified/reopened the assessment.

(ii) In the assessment of a widely held company for the assessment years 1977-78 and 1978-79 deduction in respect of inter-corporate dividends was allowed with reference to the gross dividends of Rs. 3,66,966 and Rs. 4,77,981 instead of on the net dividend of Rs. 2,58,490 and Rs. 2,68,030 respectively. The erroneous deduction was pointed out by the Special Audit Party of the department in December 1980. No action to rectify the mistake was initiated till October 1983, when the omission was pointed out by Revenue Audit. The assessment was rectified thereafter in November 1983 raising additional demand of Rs. 81,422.

The Ministry of Finance have also stated that remedial action has been taken.

(iii) While completing the regular assessment of a company in August 1978 for the assessment year 1975-76, the Income-tax Officer disallowed an amount of Rs. 1,25,361 being contribution to a superannuation fund on the ground that no contribution was made to the Fund. This disallowance was not contested by the company in appeal proceedings. However, while giving effect to the orders of July 1979 of Commissioner of Income-tax (Appeal) in September 1979 on certain other issues this amount of Rs. 1,25,361 was omitted without giving any reason resulting in excess carry forward of loss. The internal audit party of the department pointed out the mistake in March 1980. No action was taken on the observation of the internal audit party and the carry forward loss was adjusted in the assessment year 1978-79. Failure to act on the internal audit party's remark resulted in under-assessment of income of Rs. 1,25,361 involving short levy of tax of Rs. 72,395.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

SURTAX

As a disincentive to excessive profits, a special tax called super profits tax was imposed on companies making excessive profits during the assessment year 1963-64 under the Super Profits Tax Act, 1963. This tax was replaced from the assessment year 1964-65 by surtax levied under the Companies (Profits) Surtax Act, 1964.

Surtax is levied on the "Chargeable Profits" of a company in so far as they exceed the statutory deduction, which is an amount equal to 10 per cent (15 per cent from 1 April 1977) of the capital of the company or Rs. 2 lakhs, whichever is greater.

During the period under review, under-assessment of super profits tax/surtax of Rs. 463.09 lakhs was noticed in 127 cases. A few illustrative cases are given in the following paragraphs.

2.57 Incorrect computation of capital

(i) Under the provisions of the Companies (Profits) Surtax Act, 1964, surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction, which is an amount equal to 15 per cent of the capital of the company as on the first day of the previous year or Rs. 2 lakhs whichever is greater. Capital for the purpose includes the paid up share capital and reserves. It has been judicially held that reserves would not include any liability or provision included therein. The chargeable profits of any year for this purpose are computed with reference to the total income assessed for levy of income-tax for that year after making the prescribed adjustments.

(a) In the surtax assessment of a company for the assessment year 1976-77 completed in July 1981, the liability towards payment of tax to be deducted from general reserve was taken at Rs. 32,70,475 only as against the correct tax liability of Rs. 1,59,30,000 which was required to be reduced from the general reserve. This resulted in the capital base of the company being determined excessively by Rs. 1,26,59,525 with a consequent short-levy of surtax by Rs. 6,01,328.

The Ministry of Finance have accepted the mistake.

(b) The paid up share capital and the reserves of a company as on 1 January 1973 *viz.* on the first day of the previous year relevant to the assessment year 1974-75 was Rs. 35,00,000 and Rs. 32,89,926 respectively. Several other companies were merged with the assessee company with effect from 1 January 1974 and in its accounts for the year relevant to assessment year 1974-75 the director's report indicated that the share of the transferee company and the merged companies before 1 January 1974 stood cancelled and the new authorised share capital and the amount of issued share capital from that day amounted to Rs. 20,00,00,000 and Rs. 2,90,30,450 respectively. While computing the capital as on 1 January 1973 for the purpose of surtax assessment for the assessment year 1974-75 in February 1974, the department took into account share capital of Rs. 2,90,30,000 which constituted share capital as on the first day of the previous year relevant to assessment year 1975-76 and not the previous year relevant to assessment year 1974-75.

Further, reserve aggregating to Rs. 6,65,88,000 as on the closing day of the previous year relevant to assessment year 1974-75 was taken in the capital computation instead of the correct amount of Rs. 32,89,926.

The mistakes in the computation of capital resulted in excess computation of capital by Rs. 8,88,28,074 and under-assessment of chargeable profit by Rs. 88,82,807 involving under charge of surtax by Rs. 28,86,912 in the assessment year 1974-75.

The comments of Ministry of Finance are awaited (January 1986).

(c) The surtax assessment of a company in which the public are substantially interested, for the assessment year 1979-80 was completed in December 1983. While working out the capital as on the first day of the previous year relevant to the assessment year 1979-80, the assessing officer *inter alia*, wrongly included the surplus of Rs. 24,95,395 in the profit and loss account and also housing subsidy of Rs. 80,250, not specifically appropriated as a reserve. The error resulted in short computation of the chargeable profits by Rs. 3,86,346, with consequent short levy of surtax of Rs. 1,54,538.

The comments of the Ministry of Finance are awaited (January 1986).

(ii) The Surtax Act lays down that any amount standing to the credit of any account in the books of a company which is of the nature of liability or provision, shall not be regarded as a reserve for the purpose of computation of capital.

(a) A company did not provide for its liabilities amounting to Rs. 89,39,716 as ascertained on actuarial valuation in the accounts of the previous year relevant to the assessment year 1980-81. While computing the capital for the purpose of surtax for assessment year 1980-81, the General Reserve which included this liability was, however, reduced by Rs. 29,00,000 which represented ascertained liability only. As the first day, (and not the last day of the previous year) relevant to the calendar year 1979 was the crucial date for surtax for assessment year 1980-81, the necessary adjustment should have been made with reference to position prevailing on 30 December 1978 and not on 29 December 1979 as was done.

The mistake resulted in excess computation of capital by Rs. 60,39,716 involving surtax under charge of Rs. 4,06,011 for assessment year 1980-81.

The Ministry of Finance have not disputed the facts of the case.

(b) A widely held company computed the capital for the purpose of surtax for the assessment year 1976-77 with reference to its share capital and reserves. The company had not provided for tax liability that might arise in the event of disallowance of Rs. 34,00,000 being provision for gratuity made in the accounts for the year ended 31 March 1975 and also tax liability of Rs. 25,27,000 which was disputed in appeal. The computation of capital without taking into account these two liabilities resulted in the chargeable profits being computed (in December 1979) as a deficiency of Rs. 63,063 due to higher statutory deduction. Had the capital been computed according to law by excluding the aforesaid liabilities, there would be a chargeable profit of Rs. 2,09,110 involving a surtax liability of Rs. 52,280.

The comments of Ministry of Finance are awaited (January 1986).

(c) In the accounts for the previous years relevant to the assessment years 1976-77 and 1977-78 a company provided sums of Rs. 17,68,447 and Rs. 25,03,449 on account of arrear contribution to the gratuity fund and the amount was allowed as deduction in the respective income-tax assessments. As these contributions constituted ascertained liability and created a charge on the reserves of the company, the general or other reserves of the company were required to be reduced by the amount of liabilities provided for determining the capital for purpose of surtax. However, in the computation of capital, the entire reserves were included without reducing the liability. The omission to reduce the liability led to under-assessment of chargeable profits by Rs. 63,79,555 involving short levy of surtax of Rs. 2,55,334.

The comments of the Ministry of Finance are awaited (January 1986).

(iii) Where no specific provision is made for payment of dividends and the proposed dividends are to be paid out of general reserve, the general reserve for the purposes of Surtax Act is to be reduced by such proposed dividends.

In the surtax assessment of a company for the assessment year 1975-76 completed in October 1983, on a chargeable profit of Rs. 7,71,529, the entire balance of general reserve amounting to Rs. 54,33,665 was taken into account in the computation of capital. The Director's report in the accounts for the previous year ending 30 June 1973 relevant to assessment year 1974-75 revealed recommendation of payment of dividend of Rs. 13,88,439 out of general reserve and this was approved in the year relevant to assessment year 1975-76. Hence the general reserve of Rs. 54,33,665 as on 1 July 1973 (first day of the previous year) was required to be reduced by Rs. 13,88,439 which was not done.

Further, a sum of Rs. 2,50,848 on account of "depreciation reserve" was taken in the capital computation but no such reserve was shown in the balance sheet. Hence the amount was required to be excluded from the capital computation.

In addition, the cost of investment as on 1 July 1973 as per balance sheet amounted to Rs. 38,17,368 and not Rs. 29,15,288 as taken by the department. The cost of investment was thus taken less by Rs. 9,02,080.

The mistakes in the computation of capital led to excess allowance of statutory deduction of Rs. 2,54,136 with undercharge of surtax of Rs. 1,20,715 in the assessment year 1975-76.

The comments of the Ministry of Finance are awaited (January 1986).

(iv) In the surtax assessment of a company for the assessment year 1976-77 the department, while computing the capital as on 1 January 1975, took into consideration general reserve amounting to Rs. 13,66,41,349. For the calendar years 1973 and 1974 the directors had recommended payment of dividends of Rs. 34,83,654 and Rs. 58,06,090 respectively to be paid out of general reserves. The said dividends were declared and paid in the calendar years 1975 and 1976. Accordingly, in computing the capital base, the general reserve should have been reduced by the sums of Rs. 34,83,654 and Rs. 58,06,090.

Similarly, in the surtax assessment for the assessment year 1977-78 the general reserve of Rs. 17,40,02,000 was entirely taken by the department in the capital computation. However, as per accounts, dividends of Rs. 58,06,090 and Rs. 58,06,000 relating to calendar years 1974 and 1975 were recommended by the directors to be paid out of general reserve and the said dividends were declared and paid in the years 1976 and 1977 respectively. Accordingly, the general reserve amounting to Rs. 17,40,02,000 as on 1 January 1976 relevant to the assessment year 1977-78, should have been reduced. The omission to reduce the reserves by the amounts of dividends declared led to excess computation of capital by Rs. 92,89,744 and Rs. 1,16,12,090 resulting in under-assessment of chargeable profit by Rs. 9,28,974 and Rs. 17,41,814 involving short levy of surtax of Rs. 4,41,263 and Rs. 7,83,816 for the assessment years 1976-77 and 1977-78 respectively.

The Ministry of Finance have accepted the mistake.

(v) As per Rules laid down for capital computation, where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, the capital base is to be reduced proportionately.

During the previous year relevant to the assessment year 1977-78 a company received tax credit of Rs. 37,44,329 under the scheme of Tax Credit Certificates. The tax credit of Rs. 37,44,329 though forming part of the income, profit and gains of the company was not includible in total income for purposes of tax and accordingly was required to be reduced proportionately to arrive at the capital of the company for purposes of surtax. This was not done in the assessment for the assessment year 1977-78 resulting in excess computation of capital by Rs. 57,88,826 and excess determination of statutory deduction. Thus, there was under assessment of chargeable profits by Rs. 8,68,324 involving short levy of surtax of Rs. 3,90,746.

The comments of the Ministry of Finance are awaited (January 1986).

(vi) The income-tax assessment of a public limited tea company for the assessment year 1980-81 was completed in February 1983 on the taxable income of Rs. 13,04,310. No surtax assessment was done although the assessee company itself indicated a surtax liability of Rs. 47,527 for this assessment year in one of the statements enclosed to the income-tax returns. On being pointed out in audit (October 1984) that no surtax assessment was made, the assessing officer replied that there was no surtax liability as the statutory deduction was more than the chargeable profits. It was noticed in audit that the assessing officer had computed the chargeable profits wrongly with reference to the total capital base of Rs. 51,60,604 without reducing it in proportion to the agricultural income of Rs. 16,53,017 not included in the total income. The incorrect computation of capital led to the non-levy of surtax of Rs. 30,877.

The Internal Audit Party of the department checked the assessment but did not point out the mistake.

The Ministry of Finance have accepted the mistake.

(vii) The Central Board of Direct Taxes clarified in November 1974 that 'debenture sinking fund' and 'debenture redemption reserve' are only provisions and not reserve and as such, they are not to be included in computation of capital.

In computing the capital of an assessee company in March 1984, in respect of the assessment year 1981-82, the debenture redemption reserve of Rs. 50,00,000 was taken into account in computation of capital. The item being a provision and not a

reserve, was not includible in computation of capital. The mistake, resulted in excess computation of capital with consequent under charge of surtax of Rs. 2,12,913 for the assessment year 1981-82.

The Ministry of Finance have however, citing a Calcutta High Court decision held that debentures sinking fund as constituting reserve for the purposes of surtax Act. This contention is not tenable as according to the Board's instructions of November 1974 the debentures redemption reserve, being created for a known liability was only a provision and not a reserve.

2.58 **Mistakes in the computation of chargeable profits**

Under the Companies (Profits) Surtax Act, 1964, surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction which is an amount equal to ten per cent (fifteen per cent from April 1977) of the capital of the company or rupees two lakhs, whichever is greater. The chargeable profits of any year are computed with reference to the total income assessed for levy of income-tax for that year after making certain prescribed adjustments. Under the rules for computing chargeable profits, the income received by an assessee by way of dividends from an Indian Company is required to be excluded from the total income for this purpose.

(i) In computing the chargeable profits of a company for the assessment year 1974-75, in February 1984, for the purpose of levy of surtax, the department inadvertently deducted from total income the dividend income of Rs. 1,89,64,490 in place of actual dividend income of Rs. 89,64,490 included in the total income thereby reducing the chargeable profits by rupees one crore. Consequently, the income-tax liability of Rs. 57,75,000 on the excess amount of dividend income of rupees one crore was also deducted from total taxes payable by the assessee. This resulted in excess computation of chargeable profits by Rs. 57,75,000.

The above mistakes resulted in under assessment of chargeable profits by Rs. 42,25,000 with consequent short levy of surtax of Rs. 12,67,500 for the assessment year 1974-75.

The comments of the Ministry of Finance on the case are awaited (January 1986).

(ii) The total income assessed as reduced by income-tax payable on the said income is the basis for computation of chargeable profits of a company for the purpose of levy of surtax. Income-tax payable means the gross tax as reduced by any relief, rebate or deduction allowable under the Income-tax Act or the relevant annual Finance Act.

An assessee company had deposited a sum of Rs. 1,27,500 under the Companies Deposits (Surcharge on Income-tax) Scheme, 1976 and accordingly the surcharge payable by the company was less to the same extent. Hence, the income-tax to be deducted in computation of chargeable profits in the assessment year 1977-78 would have to be reduced by Rs. 1,27,500. This was not done and the omission led to under assessment of net chargeable profits by Rs. 1,27,500 with consequent short levy of surtax of Rs. 51,000 in the assessment year 1977-78.

The Ministry of Finance have accepted the mistake.

(iii) In the computation of chargeable profits of a company for the assessment year 1977-78 the deduction allowed on account of income-tax liability included surcharge of Rs. 1,76,391 although no surcharge on income-tax was levied in the relevant income-tax assessment in view of the deposit of Rs. 2,61,250 made by the assessee under the Companies Deposits (surcharge on income tax) Scheme, 1976.

The mistake led to under assessment of chargeable profits by Rs. 1,76,391 in the assessment completed in March 1985 for the assessment year 1977-78 involving surtax under charge of Rs. 44,100.

The Ministry of Finance have accepted the mistake.

(iv) For the assessment year 1977-78, a company made a deposit of Rs. 15,00,000 under the Companies Deposit (surcharge on income tax) Scheme 1976. In the income-tax assessment for this year, the Income-tax Officer did not allow adjustment of this deposit against surcharge on income-tax and levied surcharge of Rs. 13,92,152. The assessee appealed against it and also paid the sum as demanded. In the surtax assessment for 1977-78 made in February 1983 while computing the chargeable profits, a deduction of Rs. 2,92,35,187 was allowed towards income-tax payable which included surcharge of Rs. 13,92,152. Subsequently pursuant to the appellate order of May 1983 the income-tax assessment was revised and the surcharge of Rs. 13,92,152 was refunded to the assessee in December 1983. However, the surtax assessment was not revised pursuant to revision of income-tax demand in December 1983 and accordingly there was under assessment of net chargeable profits by Rs. 13,92,152 with consequent under charge

of surtax of Rs. 3,72,539 for the assessment year 1977-78.

The Ministry of Finance have accepted the mistake.

(v) Whenever the income-tax assessment of a company is revised to give effect to appellate orders or otherwise, the corresponding surtax assessments of the company is also required to be revised to determine the surtax liability afresh.

The income-tax assessment of a company for the assessment year 1980-81 was completed in March 1983 in the status of a company in which public are not substantially interested and the tax payable was computed as Rs. 72,75,587. The corresponding surtax assessment was also completed in March 1983. The income-tax assessment was revised in March 1984 to give effect to the appellate orders of February 1984 of Commissioner of Income-tax (Appeals) treating the company as a company in which the public are substantially interested and the income and tax payable was recomputed as Rs. 1,03,19,990 and Rs. 61,01,695 respectively. As a result of reduction in the income-tax liability of the company, the chargeable profits for the purpose of levy of surtax will be increased resulting in additional demand of tax. However, the surtax assessment was not simultaneously revised till October 1984. The omission to do so resulted in non-levy of additional surtax of Rs. 4,54,668.

The Ministry of Finance have accepted the mistake.

(vii) The income-tax assessment of a company for the assessment year 1980-81 was made in July 1983 levying tax of Rs. 29,22,759. The corresponding surtax assessment was made in November 1983 and in the computation of chargeable profits, a deduction of Rs. 29,22,759 was allowed towards income-tax payable by the company. The income-tax assessment was subsequently revised in January 1984 to set right mistake in tax calculation and the tax liability was reduced to Rs. 26,79,196. But the surtax assessment was not revised accordingly, till date of audit in September 1984, to withdraw the excess deduction of income-tax liability of Rs. 2,43,563. The omission resulted in under assessment of net chargeable profits by Rs. 2,43,563 with consequent surtax under charge of Rs. 97,430 for the assessment year 1980-81.

The Ministry of Finance have accepted the mistake.

2.59 **Omission to make surtax assessments**

Under the Companies (Profits) Surtax Act, 1964, there is no statutory time limit for completion of surtax assessments. Pursuant to the recommendations of the Public Accounts Committee in para 6.7 of their 128th Report (Fifth Lok Sabha) the Central Board of Direct Taxes issued instructions in October 1974 that surtax assessment proceedings should be initiated alongwith the income-tax assessments. The Board further laid down that the surtax assessments should not be kept pending on the ground that the additions made in the income-tax assessment were disputed in appeal and the time lag between the date of completion of income-tax assessments and surtax assessments should not ordinarily exceed a month unless there are special reasons justifying the delay.

Noticing the persistent delay or omission in completing the surtax assessments despite the above recommendations and issue of instructions by the Board, the Public Accounts Committee recommended in paragraph 3.3 to 3.10 of their 85th Report (Seventh Lok Sabha) that a statutory time limit for completion of surtax assessments under the Surtax Act should be prescribed. The need for a statutory time limit for completion of surtax assessment was again stressed by the Public Accounts Committee in para 1.16 of their 193rd Report (Seventh Lok Sabha).

Instances of delay in the computation of surtax assessments continue to occur leading to postponement of realisation of larger revenue.

(i) In the case of 19 companies assessed in 10 Commissioners' charges for the assessment years 1975-76, 1976-77 and 1979-80 to 1983-84, although the income-tax assessments had been completed between December 1977 and May 1984, the corresponding surtax assessments had not been made, the delay ranging from 3 months to 74 months (as on the date of audit). The omission resulted in non-levy of surtax of Rs. 65,80,413.

The Ministry of Finance have accepted the omission in principle in seven cases. While not disputing the facts in three cases the Ministry of Finance have argued that it was reasonable to wait for the outcome of the appeal on assessment of Income-tax. This is contrary to the Board's instructions of October 1974.

Reply of the Ministry of Finance is awaited in the remaining cases (January 1986).

The Internal Audit Party of the department had checked the assessment in one case and the mistake escaped their notice.

(ii) In the case of three companies assessed in 3 different Comissioners' charges for the assessment years 1976-77 to 1980-81, although provisional surtax assessment was made between December 1980 and November 1983, the final surtax assessments had not been made. The omission to do so resulted in short levy of surtax of Rs. 63,33,206 for the above assessment years.

The Ministry of Finance have accepted the mistake in principle in one case. Their comments in respect of the other cases are awaited (January 1986).

2.60 **Mistake in the calculation of surtax**

Under the provisions of the Companies (Profits) Surtax Act, 1964, in the case of a company in which public are substantially interested, if the aggregate of the income-tax payable by the company and the amount of surtax computed on its chargeable profits, exceeds seventy per cent of the total income of the company, the excess thereof shall be deducted from the amount of surtax.

In the case of a private limited company a deduction of Rs. 1,45,702 had been allowed by the Income-tax Officer under the above provisions in the assessment for the assessment year 1980-81 made in September 1983, even though the assessee was only a private company and not a company in which the public were substantially interested. The incorrect deduction allowed resulted in short-levy of surtax to the extent of Rs. 1,45,702.

The Ministry of Finance have accepted the mistake.

CHAPTER 3

INCOME TAX

3.01 Income-tax collected from persons other than companies is booked under the Major Head "021-Taxes on Income other than corporation tax". Eighty five per cent of the net proceeds of this tax, except in so far as these are attributable to union emoluments, Union Territories and Union surcharges is assigned to the States in accordance with the recommendations of the Eighth Finance Commission.

3.02 The trend of receipts from income-tax was as follows during the last five years :—

Year	Amount (In crores of rupees)
1980-81	1439.93
1981-82	1475.50
1982-83	1569.72
1983-84	1699.13
1984-85	1927.75

3.03 The number of assessees (other than companies) on the books of the income-tax department during the last five years was as follows :—

As on 31 March	Number
1981	45,50,300
1982	46,14,530
1983	47,47,756
1984	48,79,143
1985	48,79,179

3.04 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		Amount of demand	
	Completed during the year	Pending at the close of the year	Collected during the year	In arrears at the close of the year
			(In crores of rupees)	
1980-81	39,90,276	25,03,717	1439.93	480.94
1981-82	45,00,478	26,04,828	1475.50	513.95
1982-83	43,87,609	24,29,262	1569.72	532.00
1983-84	47,71,869	20,19,903	1699.13	616.08
1984-85	53,25,158	11,97,877	1927.75	781.59

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

3.06 Avoidable mistakes in the computation of tax

Under assessment of tax of substantial amount has been noticed year after year on account of avoidable mistakes resulting from carelessness or negligence. such mistakes continue to occur inspite of repeated instructions of the department. In 10 cases such errors resulted in total short levy of tax of Rs. 17,49,827 of which in one case alone short levy amounted to Rs. 9,37,200. The details are as under :—

Sl. No.	Commissioner's charge	Assessment year	Nature of mistake	Tax effect/ Financial implication
1.	A	1977-78	Total income of Rs. 12,27,370 taken as Rs. 2,27,370 for levy of tax and interest.	Rs. 9,37,200
2.	A	1980-81	Amount for calculation of tax taken as Rs. 20,231 while it was Rs. 2,02,310.	2,07,234 (including interest of Rs. 76,138)
3.	B	1980-81	Refund of Rs. 1,72,870 allowed for a second time.	1,72,870
4.	C	1978-79 and 1979-80	Total income taken incorrectly while computing tax as also interest.	78,780
5.	B	1975-76	Demand notice issued for amount of Rs. 1,24,015 instead of Rs. 1,96,195.	72,150
6.	A	1980-81	Double credit of Rs. 63,920 given for tax deducted at source.	69,671 (including interest of Rs. 5,751).
7.	D	1978-79	Error in calculation of tax liability.	68,641
8.	E	1981-82	Rate of tax for registered firm adopted instead of that for individuals.	54,364
9.	B	1980-81	Rate of tax applicable for assessment year 1981-82 applied instead of that for 1980-81.	45,665
10.	E	1981-82	Depreciation of Rs. 68,154 charged to account was not added back even though actual depreciation had been allowed separately	43,252

The Ministry of Finance have accepted the mistake in eight cases; their comments in the remaining two cases are awaited (January 1986).

3.07 **Incorrect status adopted in assessments**

(i) Under the Income-tax Act, 1961, firms are classified into registered firms and unregistered firms. A registered firm pays only a small amount of tax on its income, the rest of its income is apportioned among the partners and included in their individual assessments. In the case of an unregistered firm, tax is payable by the firm itself on its total income at higher rates as applicable to individuals etc.

In the assessments of an unregistered firm, for the assessment years 1980-81 to 1982-83, completed between February 1983 and September 1983, the assessing officer erroneously applied the rates of tax applicable to a registered firm. This led to short levy of tax aggregating Rs. 2,73,280.

The Ministry of Finance have accepted the mistake.

(ii) 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 every person. The term "person" for this purpose includes an "association of persons". The term "association of persons" as used in the Act means an association in which two or more persons join in a common purpose or common action (39 ITR 546 SC). It has been judicially held (42 ITR 115 SC) and (59 ITR 728 SC) that if two or more persons join in the promotion of a joint enterprise with the object of producing income, profits or gains, the income has to be assessed jointly in their hands as "association of persons". Such income should not be split up for the purpose of assessment.

A partnership firm was constituted in November 1976 to carry on the business of distribution and exhibition of films. The firm entered into agreements in December 1976, February 1977 and April 1977 with three theatre owners for securing to itself exclusive rights for supply of motion pictures to the three theatres subject to the firm furnishing of interest free deposit (advance) of Rs. 2,00,000, Rs. 1,00,000 and Rs. 1,50,000 to the theatre owners. As the firm was not in a position to raise the entire funds for the purpose, it entered into two separate agreements one in December 1976 with a trust and an individual A and the other in April 1977 with the same trust and another individual B, by which these parties contributed 25 per cent (15 per cent by the trust and 10 per cent by the individual in each case) of the amount to be deposited with the theatre owners and became entitled to receive from the firm a total of 25 per cent of the profits of the joint ventures. Thus, the two agreements for promotions of joint ventures gave rise to two distinct taxable entities one consisting of the partnership firm, the trust and the individual A and the other consisting of the partnership firm, the trust and the individual B and since they had joined in a common purpose with the object of producing income, these two entities had to be taxed, in the status of "association of persons".

However, the assessing officer instead of taxing the income accruing from each joint venture in the status of "association of persons", taxed 75 per cent of the income from ventures in the hands of the firm, 15 per cent in the hands of the trust and 10 per cent in the hands of the concerned individual for the assessment years 1977-78 to 1982-83. In respect of the assessments for the assessment years 1977-78 and 1978-79 the assessing officer left a note in the assessment order that three separate files had been opened in the status of unregistered firm and notice for filing of return had been issued to the joint ventures. The outcome of the issue of the said notice was not ascertainable from records. However, the essential condition of each partner acting as agent of all other partners being absent in this case they cannot be assessed as unregistered partnership firms as proposed by the department.

These assessments were checked by the Internal Audit Party of the department, but the mistake was not detected by them.

The omission to assess the joint ventures as two distinct association of persons for the assessment years 1979-80 to 1982-83 resulted in short levy of tax of Rs. 1,67,516.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the Income-tax Act, 1961 rental income from any building or land appurtenant thereto owned by an assessee is chargeable to tax under the head "income from house property". The annual value of property chargeable to income-tax under this head is the sum for which the property might reasonably be expected to be let from year to year.

An assessee firm owning a hotel building, leased it out to a sister firm at Rs. 4,000 per month. The rental income from the hotel building was assessed as business income after allowing depreciation on the building. As the assessee did not carry on the hotel

business but received only rent for the use of the building owned by it, the same was assessable as income from house property.

The fair market value of the hotel building was determined at Rs. 24,45,000 by departmental valuer for purposes of wealth-tax ignoring the rental of Rs. 4,000 per month on the ground that the lease was between members of the same family and the lease rent was quite low. Taking the return at 6 per cent of the fair market value of Rs. 24,45,000, income assessable under income from house property worked out to Rs. 1,33,220 in each of the assessment years 1979-80 and 1980-81. After taking into account the income already assessed as business income, the net under assessment of income was Rs. 1,16,808 in each of the said assessment years involving a total short levy of tax of Rs. 1,39,533 for both the years.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Under the Income-tax Act, 1961, all income accruing or arising to a person in India in a previous year relevant to the assessment year is includible in the total income of that person. The term 'person' as defined in the Act includes individuals, Hindu undivided families, companies etc. For the purposes of the Act these entities are treated as separate units for making the assessments. It has been judicially held that an assessment can be completed only in the status in which the return has been filed. If the assessing officer is of the opinion that the person was assessable in another status a fresh notice, required by law, shall have to be issued to the assessee for filing the return in that status (84 ITR 705).

An assessee filed returns of income for the assessment years 1976-77 and 1977-78 in July 1976 and October 1977 respectively, claiming the status of 'Hindu undivided family'. The assessing officer did not accept the claim of status and assessed the income in the status of individual on the basis of returns filed. These assessments were quashed by the Appellate Assistant Commissioner of Income-tax as per his orders issued in March 1982. The department's second appeal with the Tribunal was also rejected in May 1983 and accordingly, therefore, the entire tax of Rs. 57,245 paid for the two years was refunded to the assessee. On issue of fresh notice by the Income-tax Officer the assessee filed fresh returns in the status of 'individual' but in the meantime the Commissioner of Income-tax accepted the status of the assessee as Hindu undivided family and issued directions to the Income-tax Officer accordingly. As the time limit to initiate further action had expired the case could not be pursued further, causing a loss of revenue of Rs. 57,245.

The earlier assessments for the years from 1971-72 to 1973-74 were also quashed by the Tribunal on similar grounds resulting in tax refund of Rs. 72,980. The total loss to the revenue due to adoption of incorrect status amounted to Rs. 1,30,125.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

3.08 **Incorrect computation of salary income**

Under the provisions of the Income-tax Act, 1961, income received by an employee from an employer is chargeable to tax under the head salary.

(i) Salary has been defined in the Act to include wages, any fees, commission etc. There is no difference between commission which is wholly dependent upon work done and fixed salary on a monthly basis. Fees, commission, perquisites paid either in lieu of or in addition to regular remuneration are all taxable as regular salary or wages. According to the Central Board of Direct Taxes instructions dated 22 September 1965, where detailed accounts regarding expenses incurred are not maintained, the commission earned by the insurance agents of the Life Insurance Corporation is subject to *ad hoc* deduction at 40 per cent for the renewal commission where separate figures to this effect are available. In case such separate figures are not aavilable the *ad hoc* deduction would be limited to 25 per cent of the total commission. The Act also provides for standard deduction at prescribed rates in respect of expenditure incidental to the employment of an assessee. It has been judicially held that if under the terms of contract of employment remuneration or recompense for the services rendered by the employee is determined at a fixed percentage of turnover achieved by him then such remuneration or re-compense will partake the character of salary [Gestetner Duplicator (P) Ltd. (117 ITR 1)].

The Development Officers of the Life Insurance Corporation of India are full time servants of the Corporation and a relationship of master and servant exists between them. In addition to the monthly salary, the Development Officer also receive commission and incentive bonus based on the life insurance business secured, at the rates prescribed by the corporation. The said officers being full time employees of the Corporation, the entire income including incentive bonus though paid on the basis of volume of business secured was a part of salary as defined in the Act.

In the assessment of three assessees for the assessment years 1981-82 to 1984-85 assessed between March 1983 and December 1984, in addition to the standard deduction admissible under the Act, a further deduction of Rs. 2,05,500 towards expenses claimed was allowed at the rate of forty per cent of the commission and incentive bonus received during these years. As the instructions issued by Board in September 1965 only applied to life insurance agents and not regular employees of the Corporation the deduction of Rs. 2,05,500 allowed to the three officers serving the Corporation was not admissible and eventually resulted in short levy of tax of Rs. 1,01,463.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Any special allowance or benefit specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit to the extent to which such expenses are actually incurred for that purpose, shall not be included in the total income of an assessee. It is further clarified that any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides, shall not be regarded as a special allowance granted to meet expenses wholly, necessarily and exclusively incurred in the performance of such duties.

In the assessment of salary cases of employees of a Hydro-electric project and thermal power station, for the assessment years 1980-81 to 1983-84 completed under summary assessment scheme, during 1982-83 and 1983-84, certain special allowances like compensatory allowance, bad climate allowance, shift allowance etc., and amounts received on encashment of leave otherwise than on retirement (surrender leave salary) were not included in their total incomes. This resulted in under assessment of income for the assessment years 1980-81 to 1983-84 with a short levy of tax of Rs. 82,348 in 18 cases.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.09 Incorrect computation of income from house property

(i) Where a house property is subject to an annual charge (not being a charge created by the assessee voluntarily or a capital charge), the amount of such charge is allowable as deduction in computing income from house property. It was judicially held in May 1982 that when a deity becomes vested with a property and becomes the legal owner of the property, the expenditure incurred on puja of the deity is not an admissible deduction as it was a charge on the owner of the property himself and is not in discharge of an obligation in the nature of an annual charge.

In the assessments for the assessment years 1980-81 and 1981-82 (the assessments completed in March 1983 and December 1983 respectively of an artificial juridical person, the puja expenses, salary of pujari and other periodic expenses relating to the deity aggregating Rs. 1,26,666 and Rs. 1,11,862 respectively were deducted by the department as constituting annual charge on the property. The incorrect deduction, together with another minor mistake in the allowance of collection charges in excess of the prescribed percentage resulted in under assessment of income of Rs. 2,75,199 leading to short levy of tax of Rs. 1,90,071.

The Ministry of Finance have accepted the mistake.

(ii) Under the Income-tax Act, 1961, in computing the house property income in a case where the cost of repairs to the property is to be borne by the tenant and not by the assessee (owner) deduction in respect of repairs is allowable to the extent of the excess of the annual value of the property over the amount of rents payable for a year by the tenant, or a sum equal to one-sixth of the annual value, whichever is less. A co-owner is treated as an owner in respect of his share income from property and is entitled to the statutory reliefs independently.

A house property jointly owned by four individuals was leased out on rent to a tenant with an agreement that the tenant was to carry out repairs to the property from time to time and to maintain it in good condition. The statutory deductions on account of repairs claimed by the four individuals at one-sixth of the annual value of the building, to the extent of their one-fourth share out of Rs. 58,236, Rs. 41,787 and Rs. 51,773 for the assessment years 1979-80, 1980-81 and 1981-82 respectively, were allowed by the assessing officer without limiting the deductions to the extent their share of excess of annual value over the amount of annual rents payable by the tenant for each of the assessment years, assessments of which were completed between January 1982 and March 1984. The excess of annual value over the amount of rent payable by the tenant for each year being nil, the four joint owners were not entitled to the statutory deduction on account of repairs at all. This erroneous deduction resulted in aggregate under assessment of

tax of Rs. 1,07,414—including interest for the belated filing of the return and short payment of advance tax in the hands of the four joint owners for the assessment years 1979-80 to 1981-82.

The assessment was checked by the Internal Audit Party of the department, but the mistake escaped its notice.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the Act, the annual letting value of the property is chargeable to income-tax under the head "income from house property". The income is to be computed on a notional basis and not necessarily with reference to actual receipts.

An assessee owned a property consisting of land measuring 26 grounds and buildings thereon. One portion thereof comprising of 12 grounds of land was let out on a monthly rent of Rs. 500 to the assessee's grandson. The other portion of the property in 14 grounds of land had been let out on a monthly rent of Rs. 3,500 to a limited company. In the income-tax assessments for the assessment years 1980-81 to 1983-84 completed in March 1983, May 1983 and November 1983, the income from the first mentioned portion of the property was computed by taking into account the actual rent of Rs. 500 received. For the purpose of wealth-tax assessment a reference was made in January 1984 to the valuation officer to determine the fair market value of the properties as on 31 October 1978. The valuation officer, following the yield method, fixed the fair rent of the property at Rs. 3,000 per month in March 1984 as against Rs. 500 actually paid by the tenant. Though the fair rent of Rs. 3,000 per month, was reasonable when compared with the rent received for the property let out to the company, the assessments were not revised adopting the annual value of Rs. 3,000 in computing the income from this property. This resulted in incorrect computation of income from house property to the extent of Rs. 25,000 per year and short-levy of tax of Rs. 52,300 for the assessment years 1980-81 to 1983-84.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.10 **Incorrect computation of business income**

(i) Under the provisions of the Income-tax Act, 1961 as operative during the period April 1979 to March 1981, where the aggregate expenditure on advertisement, publicity and sales promotion in India exceeds half a per cent of the turn over, 15 per cent of the adjusted expenditure thereof has to be disallowed. This provision which applied, to all categories of tax payers, carrying on business or profession was not applicable to cases where the aggregate expenditure did not exceed Rs. 40,000. The expression 'adjusted expenditure' meant the aggregate expenditure incurred on advertisement, publicity and sales promotion in India as reduced by expenditure not allowable as business expenditure under the general head and further reduced by expenditure specifically stated in the Act as admissible.

(a) An assessee registered firm dealing in the manufacture of pump sets incurred an expenditure of Rs. 34,94,002 during the assessment year 1980-81 as 'after sales service allowance' representing rebate at 4 per cent paid to the dealers for attending defects, complaints and repairs in respect of pump sets. In the draft assessment order for the assessment year 1980-81, the assesing officer held that this expenditure would only represent sales promotion expenses and as such were proposed to be disallowed. The Inspecting Assistant Commissioner, however, did not approve the disallowance and accordingly the assessment was completed in June 1982 allowing the expenditure as such. As the sum of Rs. 34,94,002 represented payment made to the dealers by the assessee at a flat rate of 4 per cent of the value of sales effected and was nothing but an incentive aimed at sales promotion, 15 per cent thereof was required to be disallowed. The omission to do so resulted in short levy of an aggregate tax of Rs. 4,26,380 in the hands of the firm and the partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) A registered firm, running a circus, incurred an expenditure of Rs. 4,18,343 and Rs. 6,64,286 for the assessment years 1979-80 and 1980-81 towards advertisement and publicity, which was allowed as deduction in the assessments completed in March 1982 and March 1983 respectively. Audit scrutiny revealed (May 1984) that the expenditure incurred exceeded half per cent of the gross receipts of Rs. 40,24,477 for the assessment year 1979-80 and Rs. 48,37,683 for the assessment year 1980-81 and hence fifteen per cent thereof should have been disallowed. The omission to make the disallowance resulted in total under assessment of income of Rs. 1,62,393 and aggregate short levy of tax of

Rs. 1,24,517 in the hands of the firm and its two partners for the two assessment years.

The assessments were checked by the Internal Audit party of the department, but the mistake escaped its notice.

The Ministry of Finance have accepted the mistake.

(c) In computing business income a liability for expenditure is allowable as a deduction if it is an ascertained liability and not merely a contingent liability.

In the case of an assessee firm while computing income for assessment year 1980-81, the entire expenditure of Rs. 4,11,487 incurred on advertisement and sales promotion was allowed as business expenditure even though the expenditure exceeded the prescribed limit of Rs. 40,000 and also half percent of the total turnover of Rs. 66.70 lakhs. As a result, the assessing authority failed to disallow Rs. 61,723 (equal to 15 per cent of the adjusted expenditure) as required under the Act. This together with the omission to add back, an amount of Rs. 40,892 provided for contingent liabilities (on account of leave with wages) in the business income of the respective assessment years, resulted in underassessment of income by Rs. 1,02,615 involving short-levy of tax of Rs. 62,900.

The assessment for the year 1980-81 was checked by Internal Audit Party of the department but the mistake escaped its notice.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) While computing income under the mercantile system of accounting a provision made for any accrued or known liability is allowable as deduction whereas an amount appropriated to a reserve is not. The Income-tax Act, however, specifically provides that (1) any provision for bad and doubtful debts made by a scheduled bank in relation to advances made by its rural branches and (2) any special reserve created by a financial corporation engaged in providing long-term finance for industrial or agricultural development or by a public company having its objects in providing long-term finance for construction or purchase of house properties in India for residential purposes be allowed as deduction in the computation of income. Reserves in all other cases and provisions made, except for accrued or known liability, are not allowable.

The question whether reserves/provisions made by an assessee under statutory compulsions can be allowed as deduction while computing taxable income of an assessee had been dealt with by the Supreme Court and High Courts in a number of cases. The Kerala (December 1972), Bombay (July 1973) and Patna (July 1978) High Courts had held that the amount taken to the reserve was allowable as a deduction while computing income from business, whereas the Madras (December 1976), and Calcutta (March 1981 and June 1983) High Courts had taken the view that the amounts credited to the reserve was not admissible as a deduction while computing income. The Calcutta High Court in its decision of June 1983 exhaustively dealt with all the earlier case-laws and lent support to the departmental view that the reserve was not to be allowed as a deduction. According to the High Court, if a sum is set apart by an assessee under compulsion of law for meeting unknown business needs of the company, a diversion of income at source by an over-riding title does not take place. In such cases, according to the High Court, the assessee has title to the fund, exercises dominion over the fund and regulates its use. In the opinion of the High Court, it cannot be said that the amount that has been appropriated to the fund does not form part of the real income of the assessee. The Madras High Court, in a case arising under the Co-operative Societies Act ruled that merely because the statute contemplated creation of a particular fund and its utilisation in a particular manner, it did not mean that there was any diversion by over-riding title as such. The High Court came to the conclusion that the contribution by way of fixed percentage of net profits to the Education Fund, for subsequent remittance to the co-operative union was done after the profits were earned and had reached the assessee and hence was not admissible as a deduction while computing income. This decision of the High Court was also in favour of the Revenue.

In spite of conflicting views of various High Courts on the subject of admissibility as a deduction while computing income, of amounts appropriated to reserves/provisions under a statute, the department have not issued any instructions for the guidance of the assessing officers to regulate the deduction so as to ensure uniformity in assessment.

The assessment of a co-operative society for the assessment year 1980-81 was completed in January 1984 determining loss of Rs. 1,04,05,926. While computing the loss, a deduction of Rs. 1,04,794 was allowed by the assessing officer, on account of

'reserve for molasses tank' created as per Molasses Control Amendment Order, 1975. This being not an ascertained liability would amount to appropriation of profits already earned and was required to be added back in the computation of business income. The incorrect deduction together with a mistake in irregular allowance of depreciation of Rs. 32,543 on the work-in-progress resulted in computation of loss in excess by Rs. 1,37,337.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the provisions of Income-tax Act, 1961, an assessee carrying on business or profession is entitled to a deduction in respect of any amount paid to an employee as bonus. In respect of bonus paid to an employee in a factory or other establishment to which the provisions of Payment of Bonus Act, 1965 apply, the deduction shall not exceed the amount of bonus payable under that Act. Bonus is payable at an amount not exceeding the "allocable surplus" computed in the manner prescribed therein, subject to a minimum of Rs. 8.33 per cent and a maximum of 20 per cent of the salaries and wages of the employees. However, where there is no allocable surplus, the minimum bonus at 8.33 per cent of the salaries and wages would be payable.

(a) In computing the business income of an assessee firm to which the provisions of the Bonus Act, 1965, applied, in respect of the previous year relevant to the assessment year 1979-80 in April 1982, a sum of Rs. 4,46,152 was allowed as deduction on account of bonus to workers and staff which was in excess of 20 per cent of the salary of Rs. 17,36,792 paid during the relevant period. The actual amount allowable on this account worked out to Rs. 3,54,892. The mistake resulted in excess allowance for bonus of Rs. 1,11,260 involving short levy of tax aggregating Rs. 1,34,006 including interest for short payment of advance tax in the hands of the firms and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) While computing the business income of an individual for the assessment years 1980-81 to 1982-83, completed during the period from April 1982 to January 1983, deductions of Rs. 1,04,994, Rs. 1,02,470 and Rs. 1,79,598 respectively were allowed towards bonus paid to employees. In respect of the accounting periods relevant to the assessment years 1980-81 and 1982-83, the maximum amount payable as bonus which could not exceed the allocable surplus, worked out to Rs. 52,836 and Rs. 1,29,882 respectively, while in respect of the accounting period relevant to the assessment year 1981-82, the business having suffered loss and there being no allocable surplus, only minimum bonus, amounting to Rs. 39,433, was payable. The allowance of deduction towards bonus paid in excess of what was statutorily payable resulted in underassessment of income to the extent of Rs. 52,158 and consequent short levy of the total of Rs. 49,967 for the assessment year 1980-81, and allowing of excess carry forward of loss of Rs. 63,037 and Rs. 49,716 respectively for the assessment years 1981-82 and 1982-83.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Under the provisions of the Income-tax Act, 1961 any expenditure, not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head profits and gains of business or profession. While a provision made in the accounts for an ascertained liability is an admissible deduction, provision made for a contingent liability does not qualify for deduction.

(a) A registered firm carrying on the business of dealing in lottery tickets was appointed as agent for the conduct of the lottery on behalf of a Union Territory as also the sole selling agent for the lotteries conducted by a State Government. The firm conducted its business through stockists and sub-agents who were paid service charges on sales and bonus, including the prize winning tickets, at specified rates. Unsold tickets returned by the stockists and sub-agents were accepted by the firm. In the case of sole selling agency, the State Government paid bonus and sellers' commission, at the specified rates, directly to the stockists.

During the previous years relevant to the assessment years 1982-83 and 1983-84 the firm made payments towards service charges on sales on the total value of tickets printed and released for sale. Similarly, the firm also paid bonus, service charges on Prize Winning Tickets and service charges on the bonus on prize winning tickets on full value of prize winning amounts. The assessee firm claimed all the above charges as business expenditure for the above two assessment years. In the assessment for

the assessment years 1982-83 and 1983-84 completed in March 1983/December 1983 and December 1983 respectively, the assessing officer allowed the claim in full. Scrutiny of the assessment records revealed (May 1984), that tickets worth Rs. 10,07,886 and Rs. 8,61,955 relating to the assessment years 1982-83 and 1983-84 respectively had actually been returned by the sub-agents as unsold. The firm had also written off the above value of tickets in its accounts. As no service charges were payable on unsold tickets, the assessing officer should have disallowed the proportionate claim aggregating Rs. 52,338 towards service charges on the value of the unsold tickets as well as service charges on the bonus on prize winning tickets aggregating Rs. 72,355, for the two assessment years. Further, the assessee firm had received from the State Government, bonus and sellers' commission amounting to Rs. 44,680 on the unsold prize winning tickets, for the two assessment years, which should have been treated as assessable income. The above omissions resulted in total under-assessment of income of Rs. 58,517 and Rs. 1,10,856 for the two assessment years and a total short levy of tax of Rs. 1,24,675 on the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) While completing the assessment for the assessment year 1983-84 in respect of a registered firm in March 1984 under the summary assessment scheme, the department allowed an amount of Rs. 2,00,000, which the assessee had debited as provision of interest on loans, in the profit and loss account. Generally 'provisions' are not to be allowed unless the liability was ascertained. In the absence of supporting details substantiating the assessee's claim an amount of Rs. 2,00,000 should have been disallowed. Omission to do so resulted in under assessment of income of Rs. 2,00,000 and short levy of tax of Rs. 1,06,330 in the hands of the firm and partners.

The Ministry of Finance have stated that remedial action has been taken accepting the merits of the objection.

(c) The assessments of a firm trading in fertilisers, for the assessment years 1979-80 and 1980-81 were completed in March 1981 and March 1982 respectively. For the purposes of business, the firm had taken deposits from various persons (including two minor sons of its managing partner) at interest of 24 per cent per annum. While each minor's account showed a credit balance of Rs. 44,800, for the year ended March 1977, the subsequent years' accounts showed substantial debit balances against the minor's who withdrew Rs. 3,68,500 each in the previous year relevant to the assessment year 1978-79 for introduction as capital in another firm. The latter firm was dissolved on 31 March 1978 when certain assets and a theatre belonging to the firm were released in favour of the minors who in turn leased them out to their father.

As a part of the deposits on which the assessee firm was paying interest was diverted to the minors and indirectly utilised for acquiring assets, interest at 24 per cent should have been charged on the sum of Rs. 1,04,360 and Rs. 96,700 overdrawn by the minors in the assessment years 1979-80 and 1980-81 respectively. The omission to do so resulted in short demand of tax of Rs. 88,605 (in the aggregate) in the hands of the assessee firm and its partners.

The Ministry of Finance have accepted the mistake.

(d) An assessee who was engaged in the business of providing camping facilities to tourists on rental basis and was also running a snack bar, incurred an expenditure of Rs. 63,211 towards extensive repairs to the business premises on installation of tents and new construction works during the previous year relevant to the assessment year 1979-80. Although the entire expenditure was of capital nature, the department disallowed only a sum of Rs. 1,000 in the assessment made in March 1981. The omission to disallow the balance of Rs. 62,211 along with certain other petty mistakes led to under-assessment of income of Rs. 69,019 with a short-levy of tax of Rs. 65,686 including interest for short payment of advance tax.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) Under the Income-tax Act, all income accruing or arising or deemed to accrue or arise to an assessee in India in a previous year relevant to the assessment year is includible in the total income of that assessee. It has been judicially held that where by an obligation, income is diverted before it reaches an assessee, it is not taxable, but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence in law does not follow as it is merely an obligation to pay another a portion of one's own income [41-ITR 367(SC)].

An individual became a partner in a firm on its reconstitution, during the previous year relevant to assessment year 1974-75 on the death of a partner. Under an agreement of April 1973 according to which the assessee instead of being required to introduce her share of capital in cash was treated as having incurred a liability of rupees three lakhs and was required to repay this amount to the four daughters of the deceased with interest. The assessee discharged this liability of rupees three lakhs out of the share income received from the firm for three assessment years 1976-77, 1977-78 and 1978-79 and claimed the repayments of Rs. 50,000, Rs. 1,00,000 and Rs. 1,50,000 as a charge on income earned from the firm for those three years on the ground that the income was alienated at source under the agreement and pronote executed treating the same as 'diversion of income by over-riding title'. The claim was accepted by the department and the assessments for the assessment years 1976-77, 1977-78 and 1978-79 were revised (November 1981) and accordingly a refund of Rs. 1,53,829 was granted to the assessee including an interest of Rs. 10,914 for the three assessment years in question. The exclusion of the sum of rupees three lakhs from the total income for the three assessment years was not in order as the transaction between the assessee and the third parties was simply a dicharge of a liability of the assessee from out of the share income after the income had reached the assessee and there was no question of diversion of income by any over-riding title'. The omission to assess the income correctly resulted in short levy of tax of Rs. 1,13,493.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) Under the provisions of Income-tax Act, 1961, any expenditure of a capital nature incurred by an assessee on scientific research related to the business carried on by him is allowable as deduction from the business profit. The term 'scientific research' as defined in the Act means any activities for the extension of knowledge leading to or facilitating extension of assessee's business or as the case may be of business of that class.

(a) While completing the assessment of an assessee registered firm, for the assesment year 1980-81 in January 1983 the department allowed a sum of Rs. 89,580 as deduction on account of capital expenditure incurred on scientific research. The assessee firm was purely a trading concern, neither did it hold an industrial licence for manufacture nor did it pay any excise duty. Besides, the laboratory charges incurred by the assessee firm during the previous year relevant to the assessment year were only Rs. 648 which would indicate that the assessee did not carry out any scientific research to be eligible for deduction, and as such the deduction allowed for Rs. 89,580 by the department was not correct. This resulted in short levy of tax of Rs. 74,702 in the hands of the firm and its partners.

The Ministry of Finance have accepted the mistake.

(b) An assessee registered firm engaged in the manufacture and sale of machines, imported four prototype pop corn machinery from Taiwan during the previous year relevant to assessment year 1983-84. The declared purpose of import as made out in application for import was modernisation and indigenisation of manufacturing process, since the machines manufactured by the firm had become obsolete. The assessee had thus no intention of conducting any scientific research through the imported machinery. In the assessment for the assessment year 1983-84 completed in March 1984, a sum of Rs. 2,40,797 was allowed as deduction on account of expenditure laid out on scientific research on the basis of the assessee's statement that the machines imported were used, and on the basis of that knowledge, the assessee converted six mechanically operated machines into electronically operated machines. As no scientific research was involved in this case and the assessee merely made use of the already available knowledge, to modernise the assessee's manufacturing process, the expenditure of Rs. 2,40,797 was not admissible as deduction. The irregular allowance of expenditure towards scientific research resulted in under assessment of income of Rs. 1,69,173 with under charge of tax of Rs. 69,639 including interest for belated filing of the return in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vii) Under the Income-tax Act, 1961, where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year, the assessee has obtained whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of the

benefit accruing to him is deemed to be profits and gains of business or profession chargeable to income-tax as the income of that previous year. Accordingly therefore, refund of sales-tax or excise duty or drawback of customs duty which were claimed as expenditure in earlier years should be treated as income of the previous year in which such refund, drawback is received.

In the assessment year 1981-82, an assessee individual received Rs. 40,300 as drawback of customs duty. While computing the business income for the assessment year 1981-82 instead of offering the drawback amount of Rs. 40,300 as income, the assessee erroneously deducted the same from "sales" and the same was allowed by the assessing officer in the assessment completed in September 1983. This resulted in short computation of taxable income by Rs. 80,600 with consequent short demand of tax of Rs. 51,592.

The Ministry of Finance have accepted the mistake.

3.11 Mistakes in the grant of export markets development allowance

Under the provisions of Income-tax Act, 1961, domestic companies and resident non-corporate asessees engaged in the business of export of goods outside India or for providing services or facilities outside India were entitled upto March 1983, to export markets development allowance equal to the actual amount of qualifying expenditure plus an additional amount of one-third thereof as weighted deduction. Expenditure on distribution and supply of goods in India and expenditure wherever incurred on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit did not qualify for this allowance. It has been judicially held (June 1981) that payment of commission for procuring orders from the foreign buyers would not qualify for weighted deduction.

In the assessment of four registered firms assessed in three Commissioner's charges for the assessment years 1980-81 to 1983-84 (assessed between August 1982 and May 1984), additional weighted deduction of one-third of expenditure incurred in India on account of commission paid to Indian and foreign parties for procuring orders and concluding sales outside India (not qualifying for grant of weighted deductions towards export markets development allowance), was allowed. In addition, in one case weighted deduction was also incorrectly allowed on expenditure incurred in India for blending tea. Under the Act, these expenses did not qualify for weighted deduction. The details of the cases are as under :—

Sl. No.	Assessee (Registered firm)	Assessment year	Inadmissible weighted deduction allowed (Rs.)	Under-charge of tax (Rs.)
(1)	(2)	(3)	(4)	(5)
1.	A	1980-81	1,64,190 (Includes deduction on account of blending tea)	2,52,526
		1981-82	69,174	
		1982-83	1,21,040	
2.	B	1981-82 1982-83 1983-84	4,66,531	1,17,001 and excess carry forward of loss by Rs. 2,01,492
3.	C	1980-81	2,03,246	1,39,236
4.	D	1981-82 1982-83	2,04,368	1,25,503

The incorrect allowance of weighted deductions on the inadmissible items of expenses resulted in total under charge of tax of Rs. 6,34,293 and excess carry forward of loss of Rs. 2,01,492 in the hands of these four firms and their partners.

The comments of the Ministry of Finance on these cases are awaited (January 1986).

3.12 Mistakes in valuation of closing stock

In order to determine the profits from business, an assessee who maintains accounts on mercantile basis, may choose to value the closing stock of his business every year, at cost or market price whichever is lower. It has been judicially held in September 1980 that the privilege of valuing closing stock in a consistent manner would be available only to a continuing business and that it cannot be adopted where a business comes to an end when stock on hand should be valued at the market price in order to determine the true profits of business on the date of closure of business (102 ITR 622). The Ministry of Law also had confirmed this position in August 1982 and March 1984. The Central Board of Direct Taxes have not, however, issued any instructions in this regard for the guidance of assessing officers.

(a) A partnership firm, dealing in silver ornaments valued their closing stock of 721.247 kilograms as on 7 November 1980 at Rs. 1,255.70 per kilogram.

The firm was dissolved on the same day viz., 7 November 1980 (Diwali year), the last day of the previous year relevant to the assessment year 1981-82. In the assessment finalised in October 1983, the business income was computed without revaluing the closing stock at market price prevailing on the date of dissolution which worked out to Rs. 2,318 per kilogram. The omission to do so resulted in under assessment of income by Rs. 7,66,638 and short levy of tax of Rs. 5,34,150 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) During the previous year ended 31 March 1979 relevant to the assessment year 1979-80, a registered firm was formed with seven partners, two of them representing a trust each. The firm was dissolved on 31 March 1979 to relieve the trustee partners and another partnership was formed with the remaining partners and thus the original partnership firm ceased to exist from April 1979. While completing the fresh assessment for the assessment year 1979-80 in March 1984, the assessing officer accepted the value of the closing stock at cost price (Rs. 15,20,803) as on 31 March 1979 instead of valuing it at market rate to ascertain the true profits of the firm on the date of dissolution. By adopting the gross profit rate of 5.544 per cent (in the absence of other details), the market value of the closing stock would have to be taken at Rs. 16,10,044. The omission to adopt the market rate thus resulted in under assessment of income of Rs. 89,240 and a total short-levy of tax of Rs. 47,819 in the hands of the firm and its partners.

The assessment was checked by the Internal Audit Party of the department but it did not notice the mistake.

The Ministry of Finance have accepted the mistake in principle.

3.13 Mistakes in computation of trust income

(i) Under the provisions of the Income-tax Act, 1961 income derived from property held under trust wholly for charitable or religious purposes is exempt from tax to the extent to which such income is applied for such purposes in India. Any part of the income which does not ensure for the benefit of the public or which ensures for the benefit of an interested person is not so exempted. The Act further provides that where the individual shares of the persons on whose behalf or for whose benefit such income is receivable by a trust, are indeterminate or unknown, tax is chargeable on such income in the hands of trust at the maximum marginal rate. Further, where the total income of a trust before exemptions admissible for religious and charitable purposes exceeds Rs. 25,000 in any year the accounts of the trust for the year are to be audited by a Chartered Accountant and an audit report duly signed and verified by such accountant in the prescribed form is to be furnished by the assessee alongwith the return of income.

(a) While assessing the income of a trust for the assessment year 1979-80 in March 1982, the department allowed, out of the gross income of Rs. 8,26,172 exemption of Rs. 5,00,664 as income spent for charitable purposes, the statutory deduction of Rs. 2,06,543 being 25 per cent of the gross income, and taxed only the surplus of Rs. 1,18,965. The auditors had, however, observed that they were not able to furnish the particulars required in the statutory audit report, i.e., in regard to investments held at any time during the previous year in concerns in which interested persons have a substantial interest—as the assessee had not been able to ascertain and furnish the concerned information. The assessment records also revealed that the auditors in their report to the Charity Commissioner "on irregularities noticed", narrated that the accounts of the assessee were rewritten to accommodate the transactions, the funds and assets and the related income and expenditure of two other trusts and they (the auditors) were not able to verify all the title deeds for the immovable properties held by the assessee and the inventory of motor cars etc., with registration books. In view of the fact that the auditors had not furnished the prescribed statutory report in a complete shape and in view of the other irregularities noticed, the assessee was not entitled to the exemption available to a charitable institution. Under the law, therefore, the assessee's entire gross income was chargeable to tax at the maximum rate laid down. The omission to do so resulted in short levy of tax of Rs. 4,68,484.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) Under the Indian Trusts Act, 1882 where a trust is incapable of being executed, the trustee must hold the trust property for the benefit of the author of the trust or his legal representative.

Two ladies created a trust in March 1979 by a deed of settlement (of Rs. 5,000 each) under which nine persons including two Hindu undivided families were the beneficiaries. For the assessment years 1980-81 to 1982-83, the trust was treated as a definite trust and the assessments were completed in March 1982 and November 1982 allocating the income to the beneficiaries as laid down in the trust deed.

A perusal of the trust deed disclosed *inter alia* the following contradictory provisions :

(1) Though, two of the beneficiaries happened to be Hindu undivided families, there was no provision regarding distribution of the share of the families in the event of the total partition.

(2) The trust, according to the deed, shall stand dissolved on 31 of December 1994 or earlier but not earlier than 31 of December 1986 and in the event of death of 'kartas' of the Hindu undivided families before 31 December 1994 the income or the share of the deceased in the trust fund shall be paid to the legal representatives for the residue of the period as if the 'kartas' died intestate and not to the remaining family members of the respective Hindu undivided family though, in another clause, it was stipulated that the benefits under the trust would accrue to the members of the Hindu undivided families.

In view of the above, the classification of the trust for purpose of levy of tax as a definite trust by the Income-tax Officer was not in order. The contradictions in the deed render the trust incapable of being executed in which case the trust property reverts back to the author of the trust. Hence, the income for assessment years 1980-81 to 1982-83 was chargeable to tax in the hands of the two settlors in equal proportion. In the absence of details of income and other particulars of the settlors in the assessment records, it was pointed out in audit in April 1983 that if the income of the trust was charged to tax separately as body of individuals, additional tax of Rs. 1,51,592 would become recoverable.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the provisions of the Income-tax Act, 1961, any income of a hospital or other institution for the reception and treatment of persons suffering from illness, etc., and existing solely for philanthropic purposes and not for purposes of profit, is wholly exempt from income-tax. Also, the income of a Trust, in so far as it is applied to charitable purposes as defined in the Act, is exempt from tax, subject to the fulfilment of the conditions stipulated in the Act. "Charitable purpose" includes medical relief also for the purpose of the Act. However, as the Act stood during the period from 1 April 1977 to 31 March 1984, in the case of a charitable trust for medical relief which carried on any business, any income from such business would not be exempt from income-tax unless the business was carried on in the course of actually carrying out the primary purpose of the trust.

A Trust which was created in March 1972, and was running a hospital, derived major portion of its income by way of share income as a partner from three business firms. The trustees resolved in April 1976 to set apart the share income from two of the three firms exclusively for the purpose of the hospital and also to run the hospital as separate unit of the trust. Later, in November 1977, the trust deed was amended, providing for medical relief as the sole object of the Trust.

The assessment of the Trust for the assessment year 1978-79 (previous year ended 31 March 1978) was completed in January 1981, on a total income of Rs. 21,386, and no exemption was granted to the trust in respect of its income. While computing the total income, the Income-tax Officer, however, did not include the share income of Rs. 1,85,350 and Rs. 62,525 respectively from the two firms, on the grounds that, as the income accrued to the hospital, it was wholly exempt from income-tax under the provisions of the Act. However, the trust being a partner in the firms and having invested its funds as capital therein, was, in fact, carrying on business through the firm, and, as such, the income from such business actually accrued only to the Trust, and not to the hospital. Merely because the share income from the firms was to be set apart for the purpose of the hospital, it did not lose its character of the income of the Trust and become the income of the hospital eligible for exemption provided in the Act specifically in respect of income of a hospital. Moreover, as the business carried on by the Trust was not in the course of executing its primary object, i.e.

medical relief, the income derived therefrom would not be eligible for the exemption.

It was also noticed in audit (April 1981) that under identical circumstances, the assessment of the Trust for the assessment year 1977-78 was completed in August 1980 under the directions of the Inspecting Assistant Commissioner, holding that the share income from the two firms accruing to the Trust through its business activities could not be held to be the income of the hospital and was therefore, assessable to tax. The omission to include the share income from the two firms in the income of the Trust for the assessment year 1978-79 resulted in underassessment of income of Rs. 2,47,875 in the hands of the Trust, with a consequential short-levy of tax of Rs. 1,63,124.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the provisions of Income-tax Act, 1961, the income receivable under a discretionary family trust where the individual shares of the beneficiaries are indeterminable and unknown, tax is chargeable on such income at the maximum marginal rates. But, if the income is receivable under a trust declared by a person by will, tax is chargeable at the rates applicable to association of persons, etc. With effect from assessment year 1980-81, where more than one discretionary trusts have been declared by a person under will, tax in such cases is chargeable at the maximum marginal rates.

A person created three discretionary family trusts by will in which the shares of the beneficiaries were indeterminate and unknown. The tax on the income of these trusts for the assessment year 1980-81 assessed in December 1982 was charged at the rates applicable to association of persons as against the maximum marginal rates applicable. This resulted in short demand of tax of Rs. 57,690 including interest for short payment of advance tax.

The Ministry of Finance have accepted the mistake.

3.14 Incorrect computation of income from other sources

Under the income-tax Act, 1961, expenditure laid out or expended wholly and exclusively for the purpose of earning 'income from other sources' is allowed as a deduction in computing such income.

For the assessment year 1980-81 an assessee had returned gross income of Rs. 5,71,373 received by him in the form of salamis from his followers. While a sum of Rs. 5,46,120 was deposited in bank, a sum of Rs. 25,253 was stated to have been received in cash and spent by the assessee. Out of these gross receipts the assessee was allowed while computing his income for the assessment year 1980-81 in November 1982, a deduction of Rs. 1,42,843 i.e. 25 per cent on account of expenditure on customary presents given to the followers. The assessee's bank account did not show any withdrawals for this purpose. As the source from which the payments were made was not brought out, the assessee was entitled only to the deduction of Rs. 25,253 i.e. the amount stated to have been actually spent and not the amount of Rs. 1,42,843 on an estimate basis. A deduction of Rs. 1,17,590 allowed in excess resulted in short levy of tax of Rs. 87,202 including interest leviable for short payment of advance tax.

The assessment was checked by the Internal Audit Party of the department but the mistake escaped its notice.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.15 Incorrect allowance of depreciation

(i) Under the Income-tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation is admissible at the prescribed rates on plant and machinery or other assets owned by the assessee and used for the purpose of his business during the relevant previous year. The Rules prescribed in this regard provide for specific rates of depreciation ranging from 15 per cent to 100 per cent for certain items of plant and machinery and general rate of 10 per cent (15 per cent from the assessment year 1984-85) in respect of plant and machinery for which no special rate has been prescribed. Where, in any case, new plant and machinery has been installed after 31 March 1980 but before 1 April 1985, the Act provides for allowing additional depreciation of sum equal to half of the normal depreciation admissible in respect of previous year in which such plant or machinery is installed. No additional depreciation is, however, admissible in respect of any plant or machinery installed in any office premises or any residential accommodation.

In the assessments of three firms and an individual for the assessment years 1980-81 to 1983-84 (assessments completed between October 1982 and March 1984), under four Commissioner's charges depreciation on plant and machinery for which no specific rate of depreciation is provided like oxygen

plant, boring machine and rock drill, compressor, other boring machines for sinking of tubewells, air conditioning machines and electric generator etc., was allowed at rates ranging from 20 per cent to 30 per cent instead of at the admissible general rate of ten per cent. In one case of a firm, additional depreciation was also allowed for the assessment years 1981-82 and 1982-83 on an electric generator installed in assessee's show room which was not admissible as show room constituted office premises. The mistakes in these four cases resulted in excess allowance of depreciation aggregating Rs. 8,62,886 and consequent short levy of tax of Rs. 3,53,701.

The comments of the Ministry of Finance in all these cases are awaited (January 1986).

(ii) Under the Income-tax Rules, 1962, depreciation on motor buses, motor lorries and motor taxis is admissible at 40 per cent if used in the business of running them on hire; otherwise the admissible rate is at 30 per cent.

In the assessment of two assessees (one firm and one individual) under two Commissioner's charges, for the assessment years 1980-81 and 1981-82 (assessments completed during September 1983 to March 1984) who were using their motor lorries in their own businesses, depreciation on the vehicles at the higher rate of 40 per cent was allowed erroneously treating them as motor buses, motor lorries and motor taxis used in the business of running them on hire. This irregular grant of depreciation allowance led to aggregate excess grant of depreciation allowance of Rs. 1,26,317 and consequent under charge of tax of Rs. 1,12,976.

The comments of the Ministry of Finance in all the two cases are awaited (January 1986).

(iii) According to the Central Board of Direct Taxes instructions issued in March 1975 in consultation with the Ministry of Law, the dumpers and tippers should not be treated as road transport vehicles if there is evidence to show that in a particular establishment they are intended or are in fact normally to be used on roads. Road making plant and machinery are entitled to depreciation at 15 per cent while road transport vehicles other than those used in the business of hire are entitled to depreciation at 30 per cent. The Income-tax Act, 1961 also provides for grant of investment allowance at the rate of 25 per cent of actual cost of plant and machinery installed for the purposes of business of construction, manufacture or production of any article or thing not specified in the Eleventh Schedule.

(a) In the assessment of a registered firm engaged in the road construction work, for the assessment years 1981-82 and 1982-83 finalised in October 1982 and February 1983 respectively, the assessee was allowed depreciation of Rs. 3,28,473 and Rs. 2,57,096 at the rate of 30 per cent on the cost of hot mix plant and tippers. As the hot mix plant and tippers were road making machineries, the depreciation was admissible at the rate of 15 per cent. The incorrect allowance of depreciation at higher rates resulted in the under assessment of income by Rs. 1,64,086 and Rs. 1,03,936 for assessment years 1981-82 and 1982-83, involving short levy of tax aggregating Rs. 1,41,236 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) An assessee registered firm engaged in the work of road construction, purchased new tippers in the previous years relevant to assessment years 1981-82 and 1982-83. The assessing officer, treating the tippers as 'road making plant and machinery', allowed investment allowance in the assessment year 1982-83. But, while allowing depreciation, the tippers were treated as "road transport vehicles" and depreciation for old and new tippers allowed at 30 per cent instead of 15 per cent in the assessment years 1981-82 and 1982-83 finalised in December 1982 and March 1983. Similarly, the depreciation in the case of road rollers also was allowed at the rate of 30 per cent as against 15 per cent for these two assessment years. This resulted in grant of excess allowance of depreciation on tippers and road rollers to the extent of Rs. 1,50,914 and consequential short levy of tax aggregating to Rs. 71,263 (including tax in the hands of partners) for these two assessment years.

The Ministry of Finance have accepted the mistake.

(iv) Under the Income-tax Rules 1962, a special rate of depreciation of thirty per cent has been prescribed in respect of earthmoving machinery used in open-cast mining while for building contractors machinery and road making plant and machinery, the rate prescribed is 15 per cent.

While computing the income for the assessment year 1981-82 in July 1982 an assessee registered firm was allowed depreciation at the rate of 30 per cent as applicable to earthmoving machinery, on road-rollers, air compressor and concrete mixer

which are of the type of road-making machinery or building contractors machinery on which depreciation admissible is only 15 per cent. The excess allowance of depreciation of Rs. 72,238 resulted in an aggregate short levy of tax of Rs. 56,877 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) Depreciation is allowed at the prescribed rates on the actual cost or the written down value of the assets, as the case may be.

In the case of an assessee firm, for the assessment year 1979-80, (assessment originally completed in March 1982 and subsequently revised in March 1984) depreciation on transport vehicles was allowed on their cost of Rs. 15,37,433 instead of the correct written down value of Rs. 13,72,218 (adopted in the revised order of March 1984). The omission resulted in excess allowance of depreciation, with consequent short levy of tax of Rs. 57,313.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) With a view to encouraging the use of renewable energy devices, depreciation at the rate of 30 per cent was allowed with effect from 1 April 1981 on any special devices including electric generators and pumps running on wind energy.

In the case of a registered firm total income for the assessment year 1982-83 was computed at Rs. 1,61,620 in September 1982 after allowing a sum of Rs. 42,120 on account of depreciation on a diesel generator at the rate of ten per cent of its cost and additional depreciation at five per cent. On an application moved by the assessee, the assessment was revised in July 1983 to allow depreciation at 30 per cent and additional depreciation at 15 per cent, for a total sum amounting to Rs. 1.26,360. As there was nothing on record to show that the generator was being run on wind energy to be eligible for depreciation at 30 per cent, the depreciation was correctly admissible at the general rate of 10 per cent as also the additional depreciation at the rate of 5 per cent only. The excess allowance of depreciation aggregating Rs. 84,240 resulted in undercharge of tax of Rs. 55,787 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.16 **Incorrect grant of investment allowance**

(i) Under the provisions of the Income-tax Act, 1961 while computing the business income of an assessee, a deduction is allowed by way of investment allowance at twenty five per cent of the actual cost of the machinery or plant installed in any industrial undertaking after 31 March 1976 for the purposes of construction, manufacture or production, of any one or more of the articles or things except those specified in the Eleventh Schedule to the Act.

In the following seven cases of six registered firms and an individual, investment allowance was erroneously allowed even though the assessees were not entitled to the same as their plant and machinery was not engaged in any manufacturing activity or had been leased out and hence not 'wholly' engaged in the business of the assessees. This resulted in under assessment of income of Rs. 28,96,410 with consequential short levy of tax of Rs. 4,80,744 and excess carry forward of loss of Rs. 11,68,716. The details of the cases are as under :

Sl. No.	Commissioner's charge/ assessment year	Nature of mistake	Under assessment/ less computation of loss	Financial implication/ tax effect
1.	A 1982-83	Allowance admitted on Cold Storage plant which is not a manufacturing activity.	5,21,412	1,23,044
2.	B 1982-83	Allowance admitted on Cold Storage plant which is not a manufacturing activity.	2,71,490	1,20,513
3.	C 1979-80 1980-81 1982-83	Allowance admitted on Cold Storage plant which is not a manufacturing activity.	2,99,832	66,992 (includes minor mistake)
4.	D 1981-82 to 1983-84	Allowance admitted on building and plant and machinery for manufacture of biscuits leased out and hence not engaged 'wholly' in the business of the assessee.	14,99,886	Excess carry forward of loss Rs. 11,68,716 and tax of Rs. 66,257
5.	E 1981-82	Allowance admitted on plant and machinery for manufacture of biscuits leased out and hence not wholly' in the business of the assessee.	2,24,190	59,186
6.	F 1981-82	Allowance admitted on film projector, air cooling plant and electrical equipment not engaged in any manufacturing activity.	76,600	44,752

The Ministry of Finance have accepted the objection in two cases; their comments in the remaining four cases are awaited (January 1986).

(ii) The investment allowance is allowed subject, *inter alia,* to the condition that an amount equal to 75 per cent of the sum so allowed has been debited to the profit and loss account of the relevant previous year and credited to a reserve account and the amount so credited is used within a period of ten years for acquiring new plant and machinery for the purpose of the business of the undertaking. If the reserve is not utilised for the specified purpose within the specified period, the investment allowance is deemed to have been wrongly allowed and has to be withdrawn.

An assessee firm consisting of two partners was allowed investment allowance of Rs. 1,55,293 and Rs. 81,000 on the plant and machinery during the assessment years 1977-78 and 1978-79 (the assessments completed in November 1979 and March 1981 respectively). The firm was dissolved on the 31 March 1978 and according to the dissolution deed dated 19 September 1978, the business of the firm with its assets and liabilities was taken over by one of the partners, with the second partner receiving an amount of Rs. 1,55,405 in lieu of his share. As the firm itself ceased to exist there was no question of it utilising the amount of the reserve for acquisition of new plant and machinery for the purpose of the business of the undertaking as prescribed. Accordingly, the investment allowance was not admissible in the hands of the partnership firm and was to be withdrawn. Non-withdrawal of investment allowance resulted in underassessment of income of the firm by Rs. 1,55,293 and Rs. 81,000 with aggregate short levy of tax of Rs. 1,40,550 for the two assessment years, in the hands of the firm and one of the partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Where the total income of an assessee, including a registered firm, determined before deduction of the investment allowance, is less than the full admissible amount, the rebate allowable is only such amount as to reduce the total income to 'nil' and the unabsorbed investment allowance is carried forward for adjustment in the next assessment year. No carry forward is admissible for more than eight assessment years subsequent to the assessment year relevant to the previous year in which the acquisition is made.

In the assessment of a registered firm for the assessment year 1979-80 completed in December 1981, the income was computed at Rs. 43,432 before deducting the investment allowance of Rs. 3,50,252. On allowing the investment allowance of Rs. 3,50,252. the total income amounted to minus Rs 3,06,820 which represented unabsorbed investment allowance to be carried forward in the assessment of the firm for adjustment in future years. Instead, the Income-tax Officer determined the total income as business loss of Rs. 3,06,820 and allocated it to the partners for adjustment in their assessments. The mistake resulted in short levy of tax of Rs. 1,04,460 in the assessments of partners.

The Ministry of Finance have accepted the mistake.

(iv) The Act provides for withdrawal of relief already allowed if the assets are sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which the assets were installed or acquired.

In the assessment of an assessee individual carrying on a proprietary business, an investment allowance of Rs. 1,09,190 for the cost of the machinery of Rs. 4,36,761, installed in the factory owned by the assessee was allowed in the previous year relevant to the assessment year 1981-82 (assessment completed in March 1984). On the same day the Income-tax Officer finalised the assesment of the assessee's income for assessment year 1982-83 also by recording therein that in the previous year relevant to the assessment year 1982-83, the said proprietary business was converted into a Private Limited Company, in justification of the assessee not returning any income from the said business. As the conversion of the entire proprietary business (including the said machinery) to the Private Limited company in the next year itself, amounted to transfer and as the transfer had taken place within eight years of the acquiring of the machinery the investment allowance of Rs. 1,09,190 already allowed had to be withdrawn which was not done. The omission to withdraw the allowance resulted in short levy of tax of Rs. 72,065.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.17 Incorrect allowances of depreciation, development rebate and investment allowance

(i) Under the provisions of the Income-tax Act, 1961, depreciation, initial depreciation and investment allowance are allowed with reference to actual cost of the assets to the assessee, reduced by that portion of the cost thereof as has been met directly or indirectly by any other person or authority. The Central Board of Direct Taxes clarified in March 1976 that the subsidy received from the Central Government for establishing industrial units in selected backward areas constitute capital receipts in the hands of the recipient and as such this amount would have to be reduced from the cost of assets for the purpose of allowing depreciation on such assets. Further, in determining the written down value of the assets, both normal depreciation and extra shift allowance are required to be taken into account.

In the assessments of the two registered firms (assessed in two different Commissioner's Charges) for the assessment years 1976-77 to 1980-81, 1982-83 and 1983-84, though the two assessees received subsidies totalling to Rs. 8,23,019 from the Central Government/Financial Corporation for the purchase of machinery, the amount was not deducted by the asssessing officers while allowing investment allowance. In one case, however, the depreciation on generator was also not allowed on actual cost and incorrect rate of depreciation was applied. These mistakes resulted in excess allowance of Rs. 7,68,007 and undercharge of tax of Rs. 4,35,450.

The comments of the Ministry of Finance in both the cases are awaited (January 1986).

(ii) The Income-tax Act, 1961, provided (upto 31 May 1974/May 1977) for the grant of development rebate in respect of plant and machinery installed for use in the assessee's business, at the rates specified in the Act. If the total income assessable before deduction of development rebate was less than the full amount of the admissible amount, the rebate allowed should be to the extent of reducing the total income to 'nil' and unabsorbed rebate should be carried forward for adjustment in the next assessment year. No portion of the development rebate would, however, be carried forward for more than eight assessment years immediately succeeding the assessment year relevant to the previous year in which the machinery or plant had been installed.

(a) The assessments of a co-operative sugar mill for assessment years 1980-81 and 1981-82 were completed in August 1983 and March 1984 on a taxable income of Rs. 'nil' and Rs. 30,53,100 respectively after setting off unabsorbed development rebate of Rs. 53,76,042 and Rs. 10,75,079 carried over from the assessment year 1973-74. In the assessment of the sugar mill for the assessment year 1973-74 completed in December 1977 the unabsorbed development rebate had been determined as Rs. 40,04,017 and the same had been carried forward and partly set off to the extent of Rs. 25,52,896 in the assessment year 1975-76 (assessment order dated April 1979). The department had, however, revised the assessment for the assessment year 1973-74 in July 1979 and recomputed the admissible development rebate as Rs. 23,99,888 and out of that a sum of Rs. 14,18,031 had been set off in the reassessment for the assessment year 1974-75 completed in March 1980, leaving only a balance of Rs. 9,81,857 to be carried forward and adjusted beyond assessment year 1974-75. The assessments for the assessment years 1975-76, 1980-81 and 1981-82 were, however, not correspondingly revised. Failure to take note of the above revision in the assessment for the assessment year 1973-74 reducing the admissible development rebate and set off of a portion of the unabsorbed development rebate against the income for assessment year 1974-75 led to the incorrect carry forward and set off of unabsorbed development rebate to the extent of Rs. 30,22,160 in the aggregate against the incomes for assessment years 1975-76, 1980-81 and 1981-82. This resulted in loss of revenue of Rs. 5,48,605 for assessment year 1975-76 and short levy of tax of Rs. 5,13,625 for the assessment years 1980-81 and 1981-82 besides non-levy of interest of Rs. 1,30,900 for assessment year 1981-82.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) In the assessment of an assessee co-operative society for the assessment year 1980-81 (assessment completed in December 1982) it was seen that out of the total income of Rs. 18,73,784 unabsorbed development rebate to the extent of Rs. 4,07,898 pertaining to the assessment years 1969-70, 1970-71 and 1971-72 had been adjusted. The allowance of deduction for unabsorbed development rebate for the above assessment years being beyond the period of eight years, was not admissible and eventually resulted in under assessment of Rs. 4,07,898 and tax effect of Rs. 1,75,071.

The Ministry of Finance have accepted the mistake.

(iii) The Act provides for withdrawal of the relief already allowed if the assets are sold or otherwise transferred to any person at any time before the expiry of eight years from the end of the previous year in which the assets were acquired or installed.

In the previous year relevant to the assessment year 1974-75 a registered firm acquired four generators valued at Rs. 5,19,291 on which development rebate of Rs. 1,29,822 was allowed in the assessment for the assessment year 1974-75 (assessed in September 1977). Three generators valued at Rs. 3,11,058 were sold by the assessee during the previous year relevant to the assessment year 1978-79, and the fourth generator valued at Rs. 2,08,233 was sold in the previous year relevant to the assessment year 1980-81 for Rs. 1,25,000. The department should have, therefore, initiated action for withdrawing the development rebate of Rs. 1.29,822 as the generators were sold within the period of eight years from the end of the previous year in which they were installed. This was not done till it was pointed in audit in August 1984.

In the case of another registered firm, for the assessment year 1980-81 a sum of Rs. 3,40,528 as profits on sale of assets was returned by the assessee. The assets sold included a generator installed at a cost of Rs. 1,10,603 in the previous year relevant to the assessment year 1974-75 on which development rebate of Rs. 27,651 had been allowed. The assessing officer should have initiated action (before March 31, 1984) to withdraw the development rebate of Rs. 27,651. This was not done till August 1984.

The omission to withdraw the development rebate in the case of the two firms for the assessment year 1974-75 before March 1984 resulted in an aggregate loss of revenue of Rs. 1,50,547 in the hands of the firm and the partners.

The Ministry of Finance have accepted the mistake.

3.18 **Omission to levy capital gains tax**

(i) Under the provisions of Income-tax Act, 1961, any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income-tax under the head 'capital gains' and shall be deemed to be the income of the previous year in which the transfer took place. The term 'transfer' has been defined in the Act to include 'sale' exchange or relinquishment of any asset or extinguishment of any rights therein'. The income chargeable under the head 'capital gains' shall be computed by deducting from the full value of the consideration received or accruing as a result of transfer, the cost of acquisition of the capital asset and the cost of any improvement thereto. It has been judicially held in March 1964 that where bonus shares are issued in respect of ordinary shares held in a company by an assessee, their real cost to the assessee has to be valued by spreading the cost of the ordinary shares over the old shares and the new issue (viz. bonus shares) taken together if they rank pari passu (52 ITR 567 SC).

An assessee firm holding originally 7,613 shares of the face value of Rs. 10 each was subsequently issued 1,22,387 bonus shares thereon. In the previous year relevant to the assessment year 1975-76, the assessee sold all the 1,30,000 shares for a consideration of Rs. 73,77,500 and offered long-term capital gain of Rs. 69,09,658 for taxation, the difference of Rs. 4,67,842 representing the cost of acquisition. The assessment was also made accordingly in March 1982. The cost of the acquisition of the shares adopted at Rs. 4,67,842 for the purpose of arriving at the capital gains was not, however, correct. The assessee had initially purchased 7,613 shares at Rs. 10 each costing Rs. 76,130 and the remaining 1,22,387 shares were bonus shares for which assessee had not incurred any extra cost. Hence the total cost of acquisition of 1,30,000 shares amounted to only Rs. 76,130. The incorrect adoption of the cost of acquisition as Rs. 4,67,842 instead of Rs. 76,130, resulted in underassessment of capital gains by Rs. 2,93,784 after allowing deduction for long term capital gains involving short levy of tax of Rs. 2,44,052 in the hands of the firm and its partners.

The Ministry of Finance have accepted the mistake in principle.

(ii) The gains arising out of the transfer of assets owned by a Hindu undivided family, firm or other association of persons or body of individuals are computed in the manner provided in the Act. Effective from 1 March 1970, the term 'capital asset' included agricultural lands situated within the jurisdiction of municipality or a cantonment board with a population of not less than 10,000 or within such distance not exceeing eight kilometers from the local limits of such municipality or cantonment board as may be notified by the Central Government. It has been judicially held that 'body of individuals' would be a combination of individuals who have unity of interest but who are not actuated by a common design, and one or more of whose members produce or held to produce income for the benefit of all.

(a) In March 1973, five assessees had sold a set of agricultural lands situated within the jurisdiction of a municipality and notified by the Central Government, which they jointly owned for a consideration of Rs. 1,90,356. The assessing officer completed the assessment for the assessment year 1973-74 in October 1975 and assessed the capital gains arising out of the transfer in the hands of the five owners separately. On being held by the Appellate Assistant Commissioner that there was no capital gains, unless the population of the area being the locality, ward or block where the agricultural lands were situated exceeded 10,000, the assessing officer in October 1977 decided that the lands were not capital assets for the purposes of capital gains, being not situated within such an area. As the population of the municipality of origin was the criterion and the same exceeded 10,000 it was pointed out in September 1978 that the transfer of the agricultural lands attracted capital gains and that the capital gain of Rs. 1,49,566 was correctly assessable in the status of 'body of individuals'.

The department replied in February 1985 that the assessment was reopened and completed in March 1984 raising an additional demand of Rs. 1,11,192 including interest of belated filing of return.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) In the case of an individual certain agricultural lands belonging to him through a will and located within the municipal limits of a city were acquired and possession thereof taken over by the State Government for colonization in the previous year relevant to the assessment year 1973-74. Compensation money aggregating Rs. 3,61,213 in lieu was paid to him subsequently in December 1974/February 1981. Adopting cost of acquisition as Rs. 2,14,071 being the fair market value of the asset as on 1 January 1964, the net capital gain (long term) assessable for the assessment year 1973-74 amounted to Rs. 92,392 after allowing for deductions permissible under the Act. Capital gain was neither returned by the assessee nor was brought to tax by the department by correlation with the records of other direct taxes. Failure to assess capital gains of Rs. 92,392 led to non levy of tax of Rs. 57,751 for the assessment year 1973-74.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Capital gain arising from the transfer of agricultural land is exempt from tax, if the assessee purchases any other land for being used for agricultural purposes within a period of two years after the date of transfer or sale and the amount of capital gain does not exceed the cost of new land. If, however, the amount of capital gain is greater than the cost of land so purchased, the difference between the amount of the capital gain and the cost of the new asset shall be charged as the income and taxed as such.

(a) The wealth tax return of an assessee for the assessment year 1975-76 assessed in February 1981 revealed that 5 acres of agricultural land was sold by him for Rs. 3 lakhs in the previous year relevant to the assesment year 1975-76 which involved capital gain of Rs. 2,75,000, the cost of land being Rs. 25,000. Out of this amount, the assessee purchased agricultural land for Rs. 1,65,676. On the balance amount of Rs. 1,09,324 capital gains tax was leviable but was not levied. This resulted in short assessment of income of Rs. 78,243 involving short-levy of tax of Rs. 78,304 including interest of Rs. 41,456 for late filing of return.

The Ministry of Finance have initiated remedial action on the objection.

(b) According to details available in the wealth tax assessment records, an individual assessee had sold (20 March 1980) 3.77 acres of his agricultural property, situated in a notified area, for a consideration of Rs. 3,75,000 and purchased (25 July 1981) another agricultural property for a consideration of about Rs. 1,50,000. In the assessment for the assessment year 1980-81 completed in March 1981, however, the net capital gain arising from the sale of the property, less the cost of the newly purchased property, was not subject to tax which was not in order. Failure to include net capital gain of Rs. 1,10,600 in the income of the assessee thus resulted in short levy of tax of Rs. 50,744.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Where enhanced compensation was awarded by a court/tribunal in respect of assets acquired under any law, the department is empowered to issue a revised order within the specified time limit to bring to charge in the year of transfer, the quantum of compensation which does not enjoy exemption. With effect from the assessment year 1978-79 onwards, the Act provides for exemption from income-tax, the capital asset if the net value of the consideration received or accruing as a result of the transfer is invested or deposited by the assessee in specified assets

within a period of six months after the date of transfer. During the period 28 February 1979 to 1 March 1983 relevant to the assessment years 1979-80 to 1983-84 the benefit of exemption would be available only if the net consideration was invested in 7 year National Rural Development Bonds. The capital gains arising prior to 1978-79 would thus be exempted only if the additional compensation was utilised within the specified period of the compulsory acquisition for purchasing any other land or building or for constructing any other building as the case may be.

An assessee owned land which was acquired by the Municipal Corporation in July 1974, i.e. in the assessment year 1975-76. The assessee agitated against the quantum of compensation in the court of law which awarded higher compensation in April 1979. The entire compensation of Rs. 97,911 was paid to him in May 1980 and assessee returned it for the assessment year 1981-82 claiming it as exempt on the ground that he had purchased 7 years Rural Development Bonds in November 1980 i.e. within six months of the receipt of compensation. His claim was accepted by the assessing officer in the assessment year 1980-81 assessed in February 1984.

Since the acquisition of land was made in July 1974 and the transfer of land would be deemed to have taken place in the previous year relevant to the assessment year 1975-76, the entire profits or gains arising from the transfer of capital asset was chargeable to tax as the income of the previous year in which the transfer took place. The department did not, however, re-open the assessment for the assessment year 1975-76 on this account. Besides, the exemption allowed for purchase of rural development bonds was not available in the assessment year 1975-76. The omission to levy capital gains tax resulted in under assessment of income by Rs. 97,911 and short levy of tax of Rs. 44,860. Penalty for concealment of income was also leviable.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) The Act further provides that the entire income of a co-operative society from specified activities viz., carrying on the business of banking or providing credit facilities to its members, is exempt from income-tax.

A central co-operative bank assessed as an association of persons by the Income-tax Officer returned (June 1980) an income of Rs. 80,04,383 for the assessment year 1980-81 and claimed the entire amount as exempt from income-tax as being profits and gains of business attributable to the activity of banking or providing credit facilities to its members. While completing the assessment in December 1982, the assessing officer allowed the claim under the provisions of the Act and completed the assessment as 'nil' assessment. A scrutiny of the miscellaneous records relating to the assessment year 1980-81 indicated that in the course of completing the assessment, the assessing officer had mentioned in the order sheet that the assessee bank sold 2.9 grounds of lands (from out of a total of 9 grounds and 1,700 sq. ft. purchased in January 1973 for a total cost of Rs. 13,21,378) for a sale consideration of Rs. 1,93,090 per ground and that the sale consideration had been arrived at after adding interest of Rs. 80,282 per ground to the cost of the ground amounting to Rs. 1,36,073 and deducting therefrom the proportionate sale proceeds of the old building. The interest of Rs. 80,282 per ground charged by the bank was apparently treated as part of the cost of acquisition of the lands for the assessee and thus it was held that the transaction was on a no profit no loss basis and involved no capital gains. Neither the interest charged by the assessee nor the sale proceeds of the old building were to be considered while computing the capital gains and the income was also not attributable to the business of banking or providing credit facilities to its members. The transaction thus involved capital gains which worked out to Rs. 2,32,820. The omission to assess the income resulted in non-assessment of taxable capital gains of Rs. 1,70,865 and a non-levy of tax of Rs. 77,217.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) With effect from the assessment year 1983-84, where in the case of an assessee being an individual, the capital gain arises from the transfer of any long-term capital asset, not being a residential house, and the assessee has within a period of one year before or after the date of transfer purchased or within a period of three years after that date constructed a residential house and if the cost of the new asset is not less than the net consideration in respect of the original asset, then the entire capital gain is not to be charged to tax. However, where in the assessment for any year a capital gain arising from the transfer of any such capital asset is charged to tax and if the assessee complies with the conditions as specified above, the Act provides for amending the order of assessment to exclude the capital gain not chargeable to tax.

During the previous year relevant to assessment year 1983-84 an 'individual' sold a building site for a consideration of Rs. 1,92,600 and earned capital

gains of Rs. 1,52,175. While filing the return of income for the assessment year the assessee stated that the capital gains is not taxable as the consideration would be invested in the construction of a new residential house, in another site purchased by her and excluded the amount from the income returned. This was accepted by the assessing officer in the assessment for assessment year 1983-84 completed in March 1984. As the assessee had not fulfilled the conditions precedent for claiming the exemption from tax and the assessment could be re-opened to consider the exemption only when the conditions are fulfilled, the capital gains of Rs. 1,52,175 should have been brought to tax in the assessment for assessment year 1983-84. The omission resulted in short-levy of tax of Rs. 69,647.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.19 **Incorrect computation of capital gains tax**

(i) Under the provisions of the Income-tax Act, 1961, as applicable upto the assessment year 1982-83, where a capital gain arises from the transfer of a house belonging to the assessee and used as a residence by him or his parents for two years before the date of transfer and the assessee has within a year before or after that date purchased or has within two years from that date, constructed another house for his residence, then the net excess of capital gains over the cost of the new house alone is chargeable to tax as income of the previous year in which the transfer took place. According to the executive instructions issued in August 1977 the aforesaid relief is available only to an individual transferring the house property and not to a Hindu undivided family. It has also been judicially held in July 1978 that the relief is not available in respect of property transferred by a Hindu undivided family.

(a) An assessee, a Hindu undivided family of the specified category, sold its house in a metropolitan city in October 1980 for a consideration of Rs. 10 lakhs and purchased another house in November 1981 in the same place at a cost of Rs. 4,66,000. For the assessment year 1981-82, the Hindu undivided family offered an income of Rs. 2,45,500 being the net excess of the capital gain over the cost of the new asset. This was accepted by the assessing officer and the assessment completed in February 1984 even though the assessee being a Hindu undivided family was not entitled to the relief from capital gains. It was also noticed that the new asset was purchased after the stipulated period of one year under the Act and that a substantial part of the asset sold represented open land not appurtenent to the building and hence did not qualify for exemption from capital gains. The incorrect relief resulted in a short levy of tax of Rs. 2,30,670.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) While completing the assessment for the assessment year 1980-81 (completed in December 1982) in respect of two Hindu undivided families, capital gain to the extent of Rs. 1,67,500 and Rs. 53,000 respectively on the sale of flat was exempted from levy of tax. The assessees being the Hindu undivided family, the said exemption was not admissible. This resulted in underassessment of income of Rs. 1,67,500 and Rs. 53,000 and aggregate short-levy of tax of Rs. 1,13,672.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(c) A Hindu undivided family sold two house properties one in October 1979 and the other, in parts, in March 1980 and May 1980, and returned a capital gain of Rs. 1,31,500 for the assessment year 1980-81 and Rs. 68,200 for the assessment year 1981-82. It also claimed exemption from capital gains tax for having purchased another house in July 1980 for Rs. 1,45,000. In the assessments for the assessment years 1980-81 assessed in December 1981 in a summary manner and 1981-82 assessed in July 1983 the capital gain arising from the transfers was exempted which on account of the assessee being a H.U.F. was not admissible. The incorrect exemption resulted in short computation of income of Rs. 94,875 for the assessment year 1980-81 and Rs. 47,400 for the assessment year 1981-82 leading to an aggregate short levy of tax of Rs. 71,022 including interest for the belated filing of the return for the assessment year 1980-81.

While accepting the mistakes, the Ministry of Finance have stated that the assessments have been revised.

(ii) Where the gross total income of a non-corporate assessee includes capital gains from long-term assets, deduction of first Rs. 5,000 as increased by forty per cent of the amount by which the capital gains relating to capital assets being other than lands and buildings exceed Rs. 5,000, is admissible. The 'gross total income' means the total income computed as per the provisions of the Act before making the said deduction. The statute also provides that if there is any short-term capital loss, such loss is to be set off against the long-term capital gains included in gross total income.

While completing the assessment (September 1980) of an assessee individual for the assessment year 1977-78, a deduction of Rs. 2,11,989 was allowed on a long term capital gain of Rs. 5,22,473. The long term capital gain of Rs. 5,22,473 had, however, been adjusted against the short-term capital loss of Rs. 6,00,000 and the net amount of short-term capital loss of Rs. 77,527 only was included in gross total income. Since no long term capital gains were included in the gross total income, no deduction on this account was admissible. The incorrect deduction allowed resulted in under-assessment of income of Rs. 2,11,989 involving short levy of tax of Rs. 1,39,912. The interest of Rs. 57,359 on account of interest paid to the assessee on excess advance tax paid had also to be withdrawn.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Capital gain on the transfer of a capital asset is computed with reference to the cost of acquisition of the asset or where the capital asset became the property of the assessee before 1 January 1964, at the option of the assessee, fair market value of the asset as on that date.

(a) In the assessment of two individuals for the assessment year 1982-83 (assessments completed in March 1983 having 37½ per cent interest each in a property), a capital gain of Rs. 5,02,797 was determined on the sale of the property during the relevant previous year. The gain was arrived at by taking the fair market value as on 1 January 1964 at Rs. 8,60,000 as shown by the assessee on the basis of valuation made by a registered valuer in July 1981. This value together with the subsequent improvement and charges for transfer amounting to Rs. 1,37,207 was deducted from the sale value of Rs. 15,00,000. However, in the wealth tax assessment for the assessment year 1964-65 (valuation date being 31 March 1964), the value of the property was taken at Rs. 4,51,380 as shown by the assessee. Accordingly, in working out capital gain arising on the transaction, the fair market value as on 1 January 1964 was to be taken at Rs. 4,51,380. On that basis, capital gain of Rs. 3,41,780 each instead of capital gain of Rs. 1,88,547 each ought to have been assessed in the hands of these two assessees. The incorrect adoption of fair market value resulted in short levy of tax of Rs. 1,51,744.

The Ministry of Finance have accepted the mistake.

(b) The assessment of an assessee for the assessment year 1979-80 was completed in November 1981 determining a loss of Rs. 1,66,457 which included loss of Rs. 1,23,762 under the head long term capital gains on transfer of plots of land during the relevant previous year. The loss under the head capital gains had been arrived at by substituting the value of the property as on 1 January 1964 as Rs. 1,85,678. However, the records for the assessment year 1978-79 disclosed that as per assessee's accepted valuation as also certified by the approved valuers, the value of the property as on 1 January 1964 had been shown as Rs. 2 per sq. feet. If this value was adopted, the value of the property as on 1 January 1964 would be only Rs. 48,764 instead of Rs. 1,85,678 adopted by the department. As a result there would be capital gain to the extent of Rs. 13,152 as against capital loss of Rs. 1,23,762 computed by the department. Incorrect computation of capital loss resulted in short levy of tax (notional) of Rs. 70,554.

The case had been seen by the Internal Audit Party but it did not notice the mistake.

The Ministry of Finance have accepted the mistake.

(iv) The capital gains arising from the transfer of a long term capital asset are exempted from tax, if the full value of the consideration received or accruing as a result of the transfer, is invested or deposited by the assessee in specified assets within a period of six months after the date of the transfer. In case a part of the consideration only is so invested or deposited, only that part of the capital gains shall be so exempted. Where, however, the long term capital gain accrues or arises after 28 February 1979, but before 1 March 1983, the benefit of exemption shall be available only if the net consideration is invested in 7 year National Rural Development Bonds.

(a) In the assessment of an individual for the assessment years 1980-81 and 1981-82, it was observed (January 1985) that an assessee had sold two plots of land at Rs. 1,91,000 and Rs. 1,22,000, and therefrom derived capital gains of Rs. 1,84,436 and Rs. 94,614 respectively. Out of the capital gains, the assessee invested Rs. 1,57,000 and Rs. 80,000 in cash certificates and fixed deposit certificate. While computing the taxable income in March 1984, the assessing authority exempted the aforesaid amounts. Since the capital gains were not invested in the National Rural Development Bonds, Rs. 1,57,000 and Rs. 80,000 for the assessment years 1980-81 and 1981-82 respectively did not qualify for exemption.

The irregular allowance of exemption resulted in aggregate short levy of tax of Rs. 1,05,970.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) An assessee sold a property, in the previous year relevant to the assessment year 1982-83 (assessed in December 1983) for a consideration of Rs. 4,50,000 and made a capital gain of Rs. 2,59,392 after reducing the sale price by Rs. 45,500 on account of stamp duty and brokerage paid and Rs. 1,45,108 being the cost of acquisition. Out of the net consideration of Rs. 4,04,500 the assessee invested a sum of Rs. 1,50,000 in the National Rural Development Bonds. After allowing exemption of proportionate part of the capital gain and basic and percentage deduction admissible in respect of long-term capital gain under the provisions of the Act, net capital gain charageable to tax worked to Rs. 1,18,652 against Rs. 40,794 worked out by the department. This mistake resulted in under-assessment of income of Rs. 77,858 and a short levy of tax amounting to Rs. 47,958.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(v) It has been judicially held in April 1977 that several self-contained dwelling units which are contiguous and situate in the same compound and within common boundaries and having unity of structure could be regarded as one house. This position has been accepted by the Central Board of Direct Taxes. It has also been judicially held in March 1980 that for the purposes of exemption from capital gains, the house property should have principally been used for the purpose of residence by the assessee.

An individual sold his house property in a metropolitan city in the previous year relevant to the assessment year 1982-83 to a registered firm by two instruments of sale (one for the let out portion and another for the self-occupied portion), for a total consideration of Rs. 11,00,000, the consideration for the let out portion being Rs. 7,25,000. For the purpose of computation of capital gains, the assessee treated the two portions of the house property as separate and claimed appropriate exemptions from capital gains for the investment of Rs. 1,36,382 in a residential house against the self-occupied portion and for the deposit of Rs. 7,00,000 in specified assets against the sale consideration of Rs. 7,25,000 from the let out portion. Net capital gains of Rs. 1,77,550 was returned for assessment and the assessing officer, accepting the claim completed the assessment for the assessment year 1982-83 in November 1983.

Though, house property comprised two dwelling units with separate basements, it represented a single house property situated in the same compound with a single door number. The assessee occupied one-third of the house property which was also evidenced by the allocation of one-third of the sale consideration and the cost of acquisition for the portion occupied by the assessee, in the computation of the capital gains. As has been judicially held, the assessee was therefore, not entitled to any claim for relief in respect of the property used for residence and the correct capital gains assessable worked out to Rs. 3,12,270 with reference to the investment in specified asset. The incorrect exemption allowed, resulted in under assessment of capital gains of Rs. 1,34,720 and a short-levy of tax of Rs. 66,686.

The department did not accept the audit objection and stated (October 1984) that there was no evidence in fact and in law that the properties sold in two distinct portions, the identity of which were recognised by the Registration Officers, were to be considered as one unit by the income-tax department. The department's contention was not in accordance with the provisions of the Act as interpreted by the High Courts.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.20 Mistakes in the assessments of firm and partners

(i) Under the provisions of the Income-tax Act, 1961 firms are classified into registered firms and unregistered firms. A registered firm pays only a small amount of tax on its income and the rest of its income is apportioned among the partners and included in their individual assessments. An unregistered firm pays full tax on its total income. When at the time of completion of the assessments of the partners the assessment of the firm has not been completed, the share income from the firm is included in the assessments of the partners on a provisional basis and revised later to include the final share income, when the assessment of the firm is completed. For this purpose, the Income-tax Officers are required, under the instructions of the Central Board of Direct Taxes issued in March 1973, to maintain a "register of cases of provisional share income" so that these cases are not omitted to be rectified. No revisions of partners' assessments can, however, be done under the Act after the expiry of four years from the end of the financial year in which the final order was passed in the case of the firm.

(a) The assessments of an individual for the assessment years 1979-80 to 1981-82 were completed in March 1982, October 1982 and March 1984 respectively, adopting the provisional share income of Rs. 1,75,191, Rs. 1,84,774 and Rs. 4,04,811 including Rs. 77,360, towards share of minor children for the respective years from a firm in which the assessee was a partner. The assessments of the firm for the three years were completed in January 1982 and revised in February 1983 determining the correct share income of the assessee at Rs. 3,31,238, Rs. 1,92,538 and Rs. 5,05,467 (including minors' share) respectively. However, the assessments for all the three assessment years were not revised till September 1984 adopting the correct share income. Besides, the prescribed register of cases of provisional share income was neither maintained properly nor any follow up action on the entries in the register taken. The non-adoption of correct share resulted in an aggregate short-levy of tax of Rs. 2,00,920.

The Ministry of Finance have stated that additional demand for Rs. 2,00,920 has been raised.

(b) In the case of an individual, who was partner in a firm, assessments for the assessment years 1977-78 and 1978-79 completed on provisional basis adopting the share income from a firm at Rs. 16,108 and Rs. 15,120 respectively, were not revised although the assessments of the firm for the two assessment years had been completed subsequently in September 1980 and September 1981 allocating to the assessee a share income of Rs. 2,10,848 for the assessment year 1977-78 and Rs. 1,03,223 for the assessment year 1978-79. No note was kept in the assessment records; the register of provisional share income was not also maintained. Non-revision of the assessee's assessments adopting the correct share income from the firm resulted in (i) loss of revenue of Rs. 1,21,878 (including interest for short payment of advance tax for the assessment year 1977-78 as the revision was barred by time and (ii) short levy of tax of Rs. 67,105 including interest for the belated filing of the return and short payment of advance tax for the assessment year 1978-79.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(c) The assessments of the three partners of a registered firm for the assessment years 1978-79 to 1981-82 were completed during the period March 1981 to March 1984 adopting their share incomes provisionally. The assessments of the registered firm for these assessment years were finalised on 20 February 1982, 23 March 1983 and 5 March 1984 respectively but the assessments made provisionally in respect of three partners were not revised. The assessing officer did not also make an entry of the provisional share income adopted in the register of cases of provisional share incomes. Failure to amend the partners' original assessments to adopt the correct share income resulted in short levy of tax of Rs. 1,33,327 for the assessment years 1978-79 to 1981-82.

The Ministry of Finance have accepted the mistake.

(d) The income-tax assessments of three partners of a registered firm for the assessment year1979-80 were completed in March 1982, provisionally adopting share income from the firm of each partner as Rs. 2,48,925. The Income-tax Officer received information in March 1983 that the correct share income of each of the partners for the same year was Rs. 2,88,652. This information was not made use of at the time of amending the three partners assessments in July 1983 to give effect to the orders of an appellate authority. The omission to do so resulted in non-levy of tax aggregating Rs. 82,236 in respect of the three partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(e) In the case of an assessee individual, the assessment for the assessment year 1978-79, earlier completed on provisional basis in March 1981 adopting the share income from a firm at Rs. 15,120 was not revised although the assessment of the firm for the assessment year 1978-79 had been completed subsequently in September 1981 allocating to the assessee a share income of Rs. 1,03,223. No note of the pending action was kept in the assessment records. The register of provisional share income was not also maintained. Non-revision of the assessment adopting the correct share income from the firm resulted in short levy of tax of Rs. 79,325 including interest for the belated filing of the return and short payment of advance tax.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(f) The instructions of the Central Board of Direct Taxes issued in July 1976 provide that the cases of partners of a firm should as far as possible be assessed in the same ward/circle where the firm is assessed so as to reduce the rectification work to the minimum.

The income-tax assessments of a partner in a registered firm for the assessment years 1979-80 and 1980-81 were completed in March 1982 and October 1982 adopting his share of loss provisionally as

Rs. 82,908 and Rs. 70,719 respectively. The assessing officer did not make an entry of the provisional share of losses adopted, in the register of cases of provisional share income. Audit scrutiny revealed that though the assessments of the firm for the assessment years 1979-80 and 1980-81 were completed in October 1981 and February 1983 by the same Income-tax Officer and the correct share of loss of the assessee (partner) had been determined as Rs. 37,600 and Rs. 6,237 respectively the assessing officer had not adopted the correct share of loss for the assessment year 1979-80 nor had amended the original assessment for the assessment year 1980-81. The mistakes resulted in short levy of tax aggregating Rs. 78,387 for the two assessment years.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(g) While completing (March 1982) the assessment of a specified Hindu undivided family for the assessment year 1980-81, the assessing officer adopted the share of income from a firm provisionally as Rs. 9,27,000. However, audit scrutiny of the assessment records of the firm assessed by the same assessing officer indicated that the assessment of the firm was completed in September 1983 determining the share income of the assessee's family as Rs. 10,26,962. The assessing officer had not, however, taken any action to revise the assessment of the Hindu undivided family. This resulted in under-assessment of income of Rs. 99,962 and a short levy of tax of Rs. 71,971.

The Ministry of Finance have initiated remedial action on the objection.

(h) The income of a firm with five equal partners was assessed in September 1983 for the assessment year 1980-81 as unregistered firm and the share of each partner was determined at Rs. 33,740. The case was subsequently revised in May 1984 as a result of appellate order and assessed as registered firm when share of each partner was determined at Rs. 24,208. The provisional share income of Rs. 23,010 was assessed in the hands of each partner. The income of the firm for the assessment year 1981-82 was assessed in August 1984 as registered firm and the share of each partner was determined at Rs. 39,365 as against the provisional share income of Rs. 23,600 assessed in their hands. The cases were not noted in the register of provisional share income although the firm and partners were assessed by the same assessing officer. Action was also not taken to revise the assessments of partners after completion of assessment of the firm. This resulted in under assessment of income of Rs. 1,198 and Rs. 15,765 in each of the five partners cases in assessment years 1980-81 and 1981-82 respectively with consequent aggregate short levy of tax of Rs. 54,680 including interest for shortfall in payment of advance tax.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The total income of an assessee firm for the assessment year 1981-82 was computed in May 1983 at Rs. 89,520 after allowing a loss of Rs. 3,14,653 towards difference in exchange rate for forward contract. The said loss was claimed by the assessee for the assessment year 1980-81 but the Income-tax Officer considering it as pertaining to the assessment year 1981-82, disallowed it in the assessment for 1980-81 made in March 1983. On an appeal preferred by the assessee against this disallowance, the Appellate Commissioner in his orders of November 1983 held loss to the extent of Rs. 3,05,378 as allowable in the assessment year 1980-81 and the balance Rs. 9,275 as allowable in the assessment year 1981-82. Accordingly the assessment for the year 1980-81 was revised in January 1984 by allowing loss of Rs. 3,05,378. But the assessment for 1981-82 already made in May 1983 allowing the entire loss of Rs. 3,14,653 was not correspondingly revised. The mistake resulted in excess allowance of loss of Rs. 3,05,378 in the assessment year 1981-82 leading to under-assessment of income by the same amount.

Further, in the assessment year 1981-82 a sum of Rs. 16,462 was treated as income towards cash assistance for export of leather goods. It was noticed from a letter of June 1983 from the Income-tax Officer that the assessee had actually received a sum of Rs. 83,570 on this account during the period corresponding to the assessment year 1981-82. As the assessment for 1981-82 was not revised on receipt of the said information there was further under assessment of income of Rs. 67,108 in this year. The mistakes resulted in total tax under charge of Rs. 1,68,451 in the hands of the firm and its four partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.21 Mistakes in assessment of firms

(i) Under the Income-tax Act, 1961 and the rules made thereunder applications for registration of firms are required to be signed personally by all the partners in the firm, but, if a partner is absent from India, or is a lunatic or an idiot, the application may be signed by any person duly authorised by him in this behalf or, as the case may be, by a person entitled under law to represent him. If these conditions are not fulfilled, the firm has to be treated as an unregistered

firm. It has been judicially held (1962) that when a partnership deed is not signed by all the partners the partnership is not a valid one (51 ITR 507). Further under the Act, income derived from house property is assessable as "income from house property" unless the property is used for any business or profession of the owner. It has also been judicially held (82 ITR 547 SC) that if an owner holds a property and receives from his tenants, rent including service charges like supplying fuel, cleaning the premises and rendering other services, the owner, would be assessed to tax, in respect of annual value of the property under 'income from house property' and entire receipts in respect of services undertaken, under 'business income'.

A firm dealing in the business of construction and letting out of buildings on composite lease by providing services of maintaining drainage, electrical installations, colour washing, was granted registration for the assessment years 1980-81 and 1981-82 and assessments were completed in December 1981. In the application form seeking registration for the assessment year 1980-81, due to change in the constitution of the firm on the death of one partner and admission of four new partners, in the fresh partnership deed, one of the partners had signed for two other partners. For the assessment year 1981-82, the application form seeking continuance of registration referred to in the assessment order, was also not on record. As a result of application of registration as well as the partnership deed having not been signed by all the partners, the firm was not entitled to registration for the assessment year 1980-81 as also the continuation of registration for the assessment year 1981-82 and as such was to be treated as unregistered firm.

Further the firm, during the assessment year 1980-81 let out a multi-storeyed building for office purposes on lease, providing services of maintenance of drainage, electrical installations including lift, colour washing etc. The assessments for the assessment years 1980-81 and 1981-82 were completed accepting the income returned as income from "business". As the service provided for by the assessee were only ordinary maintenance of the building, the entire income from the building would be assessed as income from "house property" and not as "business income". The above two mistakes resulted in a short demand of tax of Rs. 2,20.675 for the two assessment years 1980-81 and 1981-82.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The assessment of a registered firm for the assessment year 1981-82 was completed in September 1983 for a loss of Rs. 5,09,341 which represents unabsorbed depreciation. In computing the said unabsorbed depreciation the net profit at Rs. 73,265 earned by the assessee firm in that year was omitted to be considered for setting off the unabsorbed depreciation. The mistake resulted in the excess carry forward of unabsorbed depreciation of Rs. 73,265.

The Ministry of Finance have accepted the mistake.

(iii) The Income-tax Act, 1961, provides, that, in the particular event of a change in the constitution of the firm in any previous year by one or more of the existing partners retiring from the firm and|or one or more new partners being admitted into the firm, a single assessment should be made on the firm as it stood constituted at the time of making the assessment. However, in the event of a firm coming to an end by dissolution, assessment should be made on the firms as it existed upto the date of dissolution. A separate assessment is to be made on the successor firm from the date of its coming into existence.

It has been judicially held that in case where the partnership deed of firm did not provide that the firm shall not dissolve on the death of a partner, the firm stands automatically dissolved by operation of law on the happening of the event and the new firm taking over the business of first firm whether formed by some or all of the surviving partners of the first firm by themselves or in combination with new partners should be regarded as a firm succeeding the dissolved firm (110 ITR 468). Two separate assessments are to be made on these two firms for the respective periods of their existence. The judicial opinion also received statutory recognition in the Taxation Laws (Amendment) Act, 1984 with retrospective effect from 1 April 1975.

It was noticed in audit (January 1985) that in the case of a firm which stood dissolved on 22 May 1981 by operation of law on the death of a partner and succeeded to by a reconstituted firm formed by the surviving partners, a single return for the entire previous year was submitted by the assessee firm and accordingly the assessment was made by the department for the assessment year 1982-83 in April 1983 covering both the pre and post dissolution periods which was not in order. The single assessment incorrectly made resulted in a short demand of tax of Rs. 65,328 as a result of the loss of Rs. 2,51,953 suffered by the reconstituted firm having been set off

against the income of Rs. 5,30,272 earned by the dissolved firm.

The Ministry of Finance have stated that remedial action is being initiated.

(iv) Under the Income-tax Act, 1961 an application for registration of a firm is required to be made with evidence of an instrument of partnership specifying therein the individual shares of the partners.

For the assessment year 1980-81, a firm was granted registration and the assessment completed in July 1982 on a total income of Rs. 1,23,320. The net income after deduction of the firm's tax was allocated equally among its nine partners. Audit scrutiny of the partnership deed of the firm revealed that the profit should be allocated among its nine partners at the rate of eleven paise in a rupee and the balance one paise for charity. However, as per the records enclosed to the return for the assessment year 1980-81, the net profit of the previous year was found to have been allocated at the rate of 9.9 paise to each of its nine partners and an equal share to a reserve account and the remaining one per cent for charity. As the partnership deed did not include any specific provision for the transfer of profits to a reserve account and as the allocation of the net income made by the department among the partners in the assessment completed in July 1982, was not strictly in the manner specified in the deed of partnership, the grant of registration for the assessment year 1980-81 was not in order and resulted in short levy of tax of Rs. 57,715 by treating the firm as unregistered.

The assessment was checked by the Internal Audit Party of the department but the mistake was not detected.

The Ministry of Finance have stated that the assessment was revised in October 1984.

3.22 Omission to include income of spouse/minor child etc.

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

In the case of an assessee individual incomes of Rs. 51,098 and Rs. 58,710 of a minor son arising from his admission to the benefits of a partnership firm were not included in the assessee's total incomes for the assessment years 1978-79 and 1979-80 assessed in March 1981 and December 1981 respectively in accordance with the clubbing provisions of the Act. Further, in the assessment year 1980-81 (assessed in January 1983) surcharge on income-tax was incorrectly worked out at the rate of 7½ per cent instead of the correct rate of 20 per cent. The above mistakes resulted in total under charge of tax of Rs. 97,839 for the three assessment years.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the Act, income arising from assets transferred by an individual directly or indirectly to his son's wife or his son's minor children on or after 1 June 1973 otherwise than for adequate consideration was to be included in the income of the transferor and subjected to tax. It has been judicially held (May 1978) that the words "directly or indirectly" would cover cases of transfer through the medium of trusts also.

An assessee individual settled a sum of Rs. 10,000 in May 1980, on a trust for the benefit of her sons' eight minor children. The trust conducted business, and for the assessment years 1981-82 and 1982-83 its income from business was computed at Rs. 53,630 and Rs. 55,040 respectively. The income of the trust for these two years was also allocated to the beneficiaries in the specified proportions. Thus, though income arose to the sons 'minor children' through the medium of trust created by the assessee for their benefit, such income was, however, not included in the income of the assessee. The omission to do so resulted in short computation of income by Rs. 1,08,670 leading to aggregate short levy of tax of Rs. 56,353 including interest for the belated filing of return and short payment of advance tax.

The Ministry of Finance have stated that remedial action has been initited.

(iii) All income arising to any person by virtue of a revocable transfer of assets is chargeable to income-tax as the income of the transferor and is to be included in his total income. A transfer, under the Act is deemed to be revocable if it contains any provision for the retransfer directly or indirectly of the whole or any part of the income or assets to the transferor.

(a) A minor was the absolute owner of lands and other properties. Two trusts were created in August 1973 on behalf of the minor transferring the lands and other properties. According to the trust deeds, the minor, his wife as and when married and children as and when born were the beneficiaries of the income of the trust. According to the trust deeds, during the existence of the trust, their income could be either accumulated or applied for the benefit of any or all the beneficiaries. The trust would be terminated after completion of 15 years whereupon the assets would be distributed among the beneficiaries. The assessment of the trusts for the assessment years 1979-80 to 1981-82 were separately completed between February 1982 and January 1984. In respect of the individual income of the minor, separate assessments were made between February 1982 and January 1983 for the assessment years 1979-80 to 1981-82. As the trust deeds contained provision for the retransfer directly or indirectly of the whole or any part of the income or assets to the transferor, the income of the trusts for the assessment years 1979-80 to 1981-82 needed clubbing with the individual income of the minor. The omission to club the income resulted in short-levy of tax of Rs. 54,472 for the assessment years 1979-80 to 1981-82 in the hands of the minor (individual).

On being pointed out in audit in May 1984, the Inspecting Assistant Commissioner (Audit) stated (January 1985) that the two trusts were multi-beneficiary trusts; as the shares of the beneficiaries were indeterminate and unknown and under the provisions of the Income-tax Act, the income of the two trusts attarcted tax at the highest rates. The contention of the department, however, overlooks the fact that the law has specifically provided in case of re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor that the income from the trust is to be included in the total income of the transferor.

The comments of Ministry of Finance on the paragraph are awatited (January 1986).

(b) The karta of Hindu undivided family created a trust in March 1980 by settling on it, the share interest of the Hindu undivided family in a registered firm, for the benefit of (i) karta of Hindu undivided family consisting of himself, his wife and a minor daughter and (ii) the minor daughter, for the maintenance, education, and marriage expenses, and for safe-guarding the general health of the beneficiaries. The share of the beneficiaries in the corpus as well as the income was 70 per cent to the karta of the Hindu undivided family and 30 per cent to the minor daughter. Since the transferor got back a part of the assets|income, the trust was a revocable one. Hence the entire income of the trust was assessable to tax in the hands of the transferor *viz.*, the Hindu undivided family. However, the assessment of the Hindu undivided family for the assessment years 1980-81 and 1981-82 were made in September 1982 only upon its 70 per cent share excluding the 30 per cent share of Rs. 39,023 and Rs. 27,780 relating to minor daughter. The mistake resulted in short levy of tax of Rs. 51,533 including interest for the belated filing of the return and short payment of advance tax for the two assessment years.

On this being pointed out in November 1984, the Income-tax Officer contending that there was no mistake stated that only a partial partition was effected in the Hindu undivided family in respect of the interest of the Hindu undivided family in a firm, under which the unmarried daughter was allocated a share of 30 per cent thereof towards her maintenance, education marriage etc. The reply of the Income-tax Officer is contrary to the facts evidenced by the records. Further, there was no finding of the assessing officer regarding the partial partition and even if there be a partition it was not valid as under the law it had taken place beyond 31 December 1978.

The Ministry of Finance have accepted the mistake.

(iv) Under the provisions of the Income-tax Act, 1961, in computing the total income of an individual, all income that arises to his|her spouse by way of salary, commission, etc., from a concern in which such individual has a substantial interest has also to be included, except where such income is attributable solely to the application of the spouse's technical or professional knowledge and experience.

A lady individual owned a proprietary concern engaged mainly in the business of purchase and sale of cattle|poultry feed. The business was managed by her husband, who did not possess any technical or professional knowledge and experience in the field. During the previous year relevant to the assessment year 1979-80 (assessment completed in February 1982), he was paid a commission of Rs. 42,825 which was, however, not included in the assessee's total income for the assessment year under the clubbing provisions of the Act. Similar payment had also been made in earlier assessment year 1978-79 as well. The omissions to include the commission in the income of the spouse resulted in short levy of tax of Rs. 44,470 (including interest) for the two assessment years.

The Ministry of Finance have stated that remedial action has been taken.

3.23 **Income escaping assessment**

(i) Under the provisions of the Income-tax Act, 1961, any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

In the case of two individual assessees, interim dividends of Rs. 6,67,700 and Rs. 5,90,200 were received by them and the said sums were duly credited in their respective bank accounts during the previous year relevant to the assessment year 1981-82. In computing the total income of the assessees for the assessment year 1981-82 (assessed between January 1984 and February 1984) the assessing officer did not consider the said interim dividends as income, as claimed by the assessees, on the ground that till approval of the share holders in the annual general meeting, the interim dividends would not become unconditionally available to the share holders. The said interim dividend in question having been received by the assessees and duly credited in their respective bank accounts, the same should have been treated as having been unconditionally made available to them and should, therefore, be deemed to be income of the assessee for the relevant previous year. The omission to assess the dividend income of Rs. 12,57,900 to tax resulted in short levy of tax aggregating Rs. 10,33,260 including interest for short payment of advance tax and belated submission of return in the case of two assessees.

On the mistake being pointed out in December 1984, the department while not accepting the objection, stated that under the Company's Act, the power to declare any dividend rests on the shareholders of the company and the authority of the Board is only to the extent of recommending such dividends. However, interim dividend which the Board pays is always conditional upon the approval of the shareholders in the Annual General Meeting and the same becomes un-conditionally available to the share-holders at that time. The reply of the department is not acceptable, since the provision under Income-tax Act which covers normal dividends uses the word 'declared' but provision covering interim dividend is silent regarding 'declaration' which would imply that interim dividend becomes un-conditionally available to the share-hoders as soon as it is paid. Besides, in the instant case as the interim dividend was actually paid to the assessee (by way of the same having been credited in their respective bank accounts), it should be deemed to be their income during the previous year for having such dividends unconditionally made available by the company. The reply of the department, therefore, requires re-consideration.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the Act, where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article, and such money, bullion, jewellery or valuable article is not recorded in the books of accounts, if any, maintained, by him for any source of income, and the assessee offers no explanation about the nature and source of acquisitions of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Income-tax Officer, satisfactory, the money and the value of bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

An assessee Hindu undivided family's business consisted of trading in wire nails and diamonds. During the accounting year relevant to the assessment year 1979-80, the assessee exported diamonds worth Rs. 6,42,725 which were stated to be purchased from two parties. However, as a result of investigation by department it was found that the two parties from whom the diamonds were stated to be purchased were not dealing in diamonds but were only lending their name for the purpose of issue of purchase bills. As the source of purchase given by the assessee was incorrect and the assessee was not able to account for the diamond satisfactorily, the department added 2 per cent of the doubtful purchases and completed the assessment in March 1982.

The department having established that the parties from whom the purchases were stated to be made were bogus and that there was no genuine purchase, the assessee would be deemed to be the owner of the jewellery (i.e. diamonds) and the value thereof *i.e.* Rs. 6,42,725 was assessable as income of the assessee for the relevant assessment year, instead of adding a mere 2 per cent of the doubtful purchases. Omission to do so resulted in underassessment of income of Rs. 6,29,870 and short levy of tax of Rs. 4,17,370.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the provisions of the Income-tax Act, 1961, the various types of incomes chargeable to income-tax include profits and gains of business or profession. Business for this purpose includes not only trade, commerce or manufacture but also any adventure in the nature of trade. The term 'adventure'

in the nature of trade suggests that it is allied to transactions that constitute trade or business but may not be trade or business. It has been judicially held (November 1955) that adventure in the nature of trade is characterised by some of the essential features that make up trade or business but not by all of them and so even an isolated transaction can satisfy the description of an adventure in the nature of trade. It has further been held that in cases where the purchase has been made solely and exclusively with the intention to resell at a profit and the purchaser has no intention of holding the asset for himself or otherwise enjoying or using it, the transaction is an adventure in the nature of trade.

In the case of an assessee individual the total income for the assessment year 1981-82 was computed in March 1984 at Rs. 5,83,480 which included a short term capital gain of Rs. 4,93,000 derived from sale of National Defence Gold Bonds, 1980. On a representation made by the assessee that capital gain was not attracted on gold bonds under the Income-tax Act, the assessment was revised in April 1984 deleting the addition of Rs. 4,93,000. However, in the instant case, the purchase of bonds on 17|26 September 1980 at Rs. 10,10,000 and sale thereof only on 6 October 1980 at Rs. 15,03,000 indicated that the purchase had been made clearly with the intention to resell at a profit and not with a view to acquiring any capital investment. The nature of this transaction was, therefore, required to be treated, for income-tax purposes as an adventure in the nature of trade and the gain of Rs. 4,93,000 derived therefrom was assessable as business profit in computing the total income of the assessee. The omission to assess it so resulted in escapement of income of Rs. 4,93,000 with consequent tax undercharge of Rs. 3,24,857 in the assessment year 1981-82.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) The Income-tax Act, 1961, provides for an allowance or deduction in respect of expenditure or trading liability incurred for the purpose of business carried on by the assessee. Where on a subsequent date, the assessee obtains any benefit in respect of such expenditure or trading liability, whether in cash or in any other manner, the benefit so accrued shall be deemed to be profits and gains of business or profession and the same is chargeable to income-tax as the income of that previous year in which the benefit accrues, even if the business or profession is not in existence in that year.

An assessee firm defunct from 30 September 1970 engaged in executing Government civil contracts, hired a compressor from Government in April 1967 for use in the work of driving a tunnel. At the request of the firm, the Government ordered (January 1974) the retrospective sale of the compressor to the firm from the date it was hired out, for a consideration of Rs. 2,04,951 and adjustment of hire charges already recovered totalling Rs. 2,00,826 towards its cost. As the adjustment towards cost, giving effect to the sale of compressor made in March 1977, amounted to refund of the hire charges already allowed in the computation of the firm's total income, the profit arising to the firm therefrom was chargeable to tax in the assessment year 1977-78. On the omission being pointed out in audit in September 1981, the department completed the assessment for the assessment year 1977-78 in December 1983 raising an additional demand of Rs. 2,15,249 in the hands of the firm and its partners.

The Ministry of Finance have stated that necessary remedial action has been taken.

(v) Under the Income-tax Act, 1961, all income accruing or arising to an assessee in India in a previous year relevant to the assessment year is includible in the total income of that assessee.

(a) An assessee registered firm was paid Rs. 2,49,094 as interest by a Limited Company which pertained to the period from 1 April 1978 to 30 June 1979 as was evident from the certificate of deduction of tax issued by the company in Form 19-A and filed by the assessee with the return of income for the previous year ending June 1979 relevant to the assessment year 1980-81, assessment of which was completed in March 1983. As the assessee firm followed the mercantile system of accounting, the said income was neither returned for the assessment year 1980-81 nor assessed to tax. The income of Rs. 2,49,094 thus escaped assessment resulting in short levy of tax of Rs. 1,93,077 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) According to the balance sheet of an assessee, a minor, sums of Rs. 4,91,345, Rs. 6,97,893 and Rs. 7,11,816 were due to the assessee, from a proprietary concern run by his mother at the commencement of each previous year relevant to the assessment years 1978-79, 1979-80 and 1980-81 respectively but no income towards interest due thereon was returned on the plea that it was not charged. In the assessments for these years completed in January 1980, February 1981 and July 1982 on a taxable income of

Rs. 1,41,000, Rs. 1,48,690 and Rs. 1,90,660 respectively, the department did not also add any amount towards interest due from the proprietary concern of the assessee's mother and charge the same to tax as was done in respect of similar sums advanced by the assessee to his mother.

On the omission to charge interest being pointed out by audit in May 1983, the department reopened and completed the assessments in January 1985 demanding Rs. 1,81,665 in the aggregate consequent on the charging of interest.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(c) The income of a resident assessee includes all income from whatever source derived which accrues or arises to him outside India.

A resident assessee received regular payments from the Department of Health, Welfare and Education, United States of America. The amount received in the previous years relevant to assessment years 1980-81 to 1983-84 was Rs. 2,17,593 which was not assessed to tax even though it was neither casual nor non-recurring. The omission resulted in short levy of tax of Rs. 1,24,970.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(vi) Under the Income-tax Act, 1961, wherein a financial year immediately preceding the assessment year the assessee had made investments and the assessee offers no explanation about the nature and source of investments or the explanation offered by him is not satisfactory in the opinion of the Income-tax Officer, the value of the investments may be deemed to be the income of the assessee for such financial year.

In the course of assessment proceedings for the assessment year 1977-78 (assessment completed in 1983) of an association of persons deriving income from house property, the assessing officer noticed that the assessee had invested Rs. 1,62,100 in the house property during the accounting period relevant to the assessment year 1976-77 from undisclosed sources. However, the Income-tax Officer did not initiate action to complete the assessment for the assessment year 1976-77 charging investment from the undisclosed source and house property income of Rs. 17,334 to tax. The omission resulted in non-levy of tax of Rs. 1,14,720. Besides, penalty under the provisions of the Act was also leviable.

The Ministry of Finance have stated that action was pending due to administrative problems.

(vii) Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Income-tax Officer, satisfactory, the sum so credited is chargeable to income-tax as the assessee's income from undisclosed sources.

In the wealth tax assessment of an assessee individual for the assessment year 1979-80 completed in December 1983, the assessee's claim for deduction of liabilities amounting to Rs. 4,19,190 was disallowed by the assessing officer on the ground that the liabilities introduced in the name of the third parties were not genuine and were introduced so as to reduce the tax liability. However, the corresponding income-tax assessment made in January 1982 wherein the said fictitious loans of Rs. 4,19,190 were not treated as the assessee's income from undisclosed sources, was not rectified. The omission resulted in escapement of income of Rs. 4,19,190 leading to tax undercharge of Rs. 1,90,800 after taking into account the excess carry forward of loss of Rs. 1,08,005. The assessee was also liable to penalty for concealment of income.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(viii) In the case of a registered firm, the income-tax payable on the total income of the firm shall first be determined and the net income after deduction of the tax payable by the firm is apportioned among the partners for inclusion in their total income and assessment to tax.

A partner of a registered firm who was regularly assessed to income-tax for the assessment years 1971-72 to 1978-79 applied for extension of time for filing the returns of income for the assessment years 1979-80 and 1980-81 upto 31 March 1962 in July 1981. The assessment of the assessee for the assessment year 1979-80 was, however, closed as 'no proceedings' in January 1981. As per the returns filed by the firm in which the assessee was a partner, however, he had provisional share income of Rs. 1,09,866 and Rs. 91,362 respectively for the two assessment years. Upto the assessment year

1978-79, the assessee had also been assessed to income from house property and other sources. On the omission to call for the returns of income for the assessment years 1979-80 and 1980-81 and to complete the relevant assessments being pointed out by audit in August 1982 the department obtained the returns for the assessment years 1979-80 and 1980-81 and completed the assessments in July 1983 raising demand of Rs. 94,687.

The Ministry of Finance have accepted the mistake.

3.24 **Incorrect carry forward/set off of losses**

(i) Under the Income-tax Act, 1961, where for any assessment year, the loss under the head 'profits and gains of business or profession' cannot be set off against any other income, such loss is carried forward to the following assessment year and is set off against the profits or gains of any other business or profession. Similar provisions exist for carry forward and adjustment of depreciation and development rebate etc. No portion of the business loss| development rebate would be carried forward for more than eight assessment years immediately succeeding the assessment year in which the loss was first computed or machinery or plant had been installed. No such limit is applicable in the case of unabsorbed depreciation.

The assessment of a co-operative society for the assessment year 1981-82 (fianalised in February 1984) was computed at a loss of Rs. 29,83,800 and the assessee was also at the same time allowed the benefit of carry forward of loss of Rs. 3,17,82,106 pertaining to earlier assessment years as returned. For the purpose of carry forward of business loss, development rebate and depreciation etc. qualifying amounts are required to be computed separately so as to fall within the prescribed limitation period. This was, however, not done in this case. The correct amount of carry forward loss including unabsorbed depreciation commencing from the assessment year 1973-74 worked out to Rs. 2,53,61,184 as against Rs. 3,17,82,106 allowed by the department. As a result there was an incorrect allowance of carry forward of loss of Rs. 64,20,922.

The Ministry of Finance have accepted the mistake.

(ii) Under the provisions of the Income-tax Act, 1961, where the return of income filed by an assessee is not acceptable, the Income-tax Officer may call for the production of any accounts or documents as he may require or ask the assessee to furnish in writing and verified in the prescribed manner information in such form and on such points or matters or make such inquiry as he may consider necessary for the purpose of obtaining full information in respect of income or loss of any person, before making the assessment.

In the assessment of an assessee individual for the assessment year 1976-77 (assessment completed in March 1984) a loss of Rs. 3,72,057 in share dealing was set off against the income from winning Jackpot (horse racing) as per claim of the assessee. It was noticed in audit (May 1984) that the genuineness of the share-dealing could not be verified from the records of share brokers but the department allowed the loss on the basis of the records shown by the assessee without calling for any details in support of the claim of loss in the share dealings.

As the genuineness of the transaction could not be verified from the records of the share brokers, the said loss should have been disallowed in assessment. The omission to do so resulted in under assessment of income by Rs. 3,72,057 with consequent undercharge of tax of Rs. 2,86,484.

The department justified stating that the assessment was made on a protective basis. The fact that it was a protective assessment does not justify the allowance of a loss about the genuineness of which the Income-tax Officer was not satisfied.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the Income-tax Act, 1961, losses arising under the head 'profit and gains of business' which cannot be adjusted against other income arising in the same assessment year, are permitted to be carried forward to the following assessment year for set off against the profits and gains of business assessable for that assessment year provided that the business for which the loss was originally computed is continued to be carried on by the assessee in the previous year in which the loss carried forward is adjusted.

In the case of an assessee, body of individuals, in the assessments for the assessment years 1979-80 and 1980-81 completed in March 1981 and November 1982, the Income-tax Officer allowed the set off of their share of losses from two registered firms in respect of the assessment years 1973-74 and 1974-75 to the extent of Rs. 12,935 and Rs. 97,699 respectively. It was, however, noticed from the assessment

records (April 1984) that the two firms had discontinued the business, one in October 1974 and the other during the previous year relevant to the assessment year 1977-78. As the business for which the losses were originally computed was not carried on during the previous years relevant to the assessment years 1979-80 and 1980-81, the set off of losses allowed was irregular. This mistake resulted in short computation of income by Rs. 1,10,634 involving short levy of tax aggregating to Rs. 71,193.

The Ministry of Finance have accepted the mistake.

3.25 **Incorrect set off of unabsorbed depreciation**

Under the provisions of Income-tax Act, 1961, where in the assessment of the assessee (or if the assessee is registered firm, or an unregistered firm assessed as a registered firm, in the assessment of its partners) full effect cannot be given to depreciation allowance in any previous year owing to there being no profits or gains chargeable for that previous year, or owing to profits or gains chargeable being less than the allowance, then subject to other provisions of law, the allowance or part of the allowance to which effect has not been given shall be deemed to be part of the allowance for the following previous year and so on. It has been judicially held (August 1983) that in case of firm the partners alone are entitled to carry forward the unabsorbed depreciation allowance allocated to them.

In the case of an assessee firm, unabsorbed depreciation of Rs. 1,27,318 allocated to one of the partners at the end of assessment year 1980-81 was allowed to be carried forward and set off in the hands of the firm for the assessment year 1981-82 (assessed in November 1983). The incorrect carry forward and set off of the unabsorbed depreciation in the hands of the firm resulted in short computation of income by Rs. 1,27,318 involving short levy of tax of Rs. 81,350 in the hands of the firm and its partners.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.26 **Mistakes in giving effect to appellate orders**

(i) Under the provisions of Income-tax Act, 1961, where the original assessment is set aside or cancelled in appeal, fresh assessment has to be completed before the expiry of two years from the end of the financial year in which the order of the appellate authority is received or in which the order in revision is passed by the Commissioner of Income-tax. Failure to comply with the provisions within the prescribed time limit will render the assessment as time barred.

An assessee family trust created by a member belonging to an industrial house was assessed on an income of Rs. 26,79,570 for the assessment year 1974-75 in August 1977. But no tax demand was made as the income was directly assessed in sole beneficiary's hands in a representative capacity in September 1977. The assessment of the trust was set aside by the Commissioner (Appeals) in March 1979. Necessary rectification to give effect to the appellate order was made in March 1979 whereby the assessees' income was reduced to nil. Consequently, the assessment of the sole beneficiary was also rectified on 31 March 1979 reducing the income by Rs. 26,69,570.

In September 1980, a reassessment of the sole beneficiary's income from the trust was made under the revisionary proceedings of the Act, by bringing income of Rs. 7,520 to tax as declared, with the remarks that as the assessment in the case of the trust had been set aside, the reassessment in the case of the beneficiary was made subject to rectification. It was, however, noticed (December 1983) that no fresh assessment had been made of the trust within the prescribed time limit which expired in March 1981.

The omission to make reassessment of the trust within the prescribed time and to include the correct income therefrom in the hands of the beneficiary resulted in non-assessment of income of Rs. 26,72,050 and consequent loss of revenue of Rs. 25,68,229 due to operation of time bar.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The Income-tax Act, 1961, provides for a deduction of 20 per cent of profits and gains derived by an assessee from new industrial undertaking established in backward areas.

In the case of a registered firm, the assessment for the assessment year 1980-81 was completed in September 1983 determining the gross total income at Rs. 13,41,958. A deduction of Rs. 2,29,440 in respect of profits and gains derived by the firm from a new industrial undertaking established in a backward area was allowed and the net income was computed at Rs. 10,78,180. On an appeal by the assessee on various grounds, the appellate authority under the orders issued in February 1984 deleted additions totalling Rs. 5,02,590 made while determining the gross income. While giving effect (March 1984) to the appellate orders, the assessing officer straightway deducted the amount of relief allowed from the taxable income of Rs. 10,78,180 instead of deducting it first

from gross total income of Rs. 13,41,958 and thereafter revising the deduction already allowed on percentage basis in respect of industrial units set up in backward areas. The correct deduction admissible would work to Rs. 1,45,673 as against Rs. 2,29,440 allowed by the department. This, as also another minor computation mistake resulted in under assessment of firm's income by Rs. 88,798 and consequently led to short levy of tax of Rs. 78,206 including a tax calculations mistake, in the hands of the firm and its two partners.

The Ministry of Finance have accepted the mistake.

3.27 Incorrect allowance of relief in respect of newly established industrial undertaking

Under the Income-tax Act, 1961, as amended retrospectively with effect from 1 April 1972 by the Finance Act 1980, where the gross total income of an assessee included profits and gains derived from a newly established industrial undertaking which went into production before 1 April 1981 the assessee becomes entitled to tax relief in respect of such profits and gains upto six per cent per annum of the capital employed (7-1|2 per cent from 1 April 1976) in the industrial undertaking in the assessment year in which the undertaking began to manufacture or produce articles and also in each of the four succeeding assessment years.

(i) Under the rules prescribed for computing the capital employed the values of the assets as on the first day of the computation period as reduced by money and debts owned by the assessee on that day are to be considered. Where the profits and gains derived from the industrial undertaking fall short of the relevant amount of capital employed or where there are no profits and gains, the whole or balance of deficiency can be carried forward for adjustment upto the seventh assessment year reckoned from the end of the initial assessment year.

In the assessment of a firm for the assesment year 1981-82 made in February 1983 at a net loss of Rs. 3,07,820 the department computed the tax holiday relief at Rs. 76,934 in respect of newly established undertaking adopting the value of the assets as on the last day of the previous year and carried forward the same for adjustment in the succeeding assessment years. On the basis of the capital computed on the values of the assets and liabilities as on the first day of the relevant computation period relief of Rs. 1,289 only was allowable to the assessee.

Again, in respect of assessment year 1982-83 assessed in September 1983 as a loss case, the assessee was allowed the same amount of deduction as computed for the assessment year 1981-82 instead of the actual admissible deduction of Rs. 49,757 and accordingly carried forward for adjustment in the succeeding assessment years. The above mistakes resulted in excess carry forward of inadmissible deduction of Rs. 1,02,822 for the two assessment years.

The Ministry of Finance have accepted the mistake.

(ii) In respect of an industrial undertaking established in a backward area a deduction of 20 per cent of its profits is also allowed, in computing taxable income. These deductions are not admissible if the industrial undertaking is formed by splitting up, or the reconstruction of a business already in existence or if it is formed by the transfer to a new business of machinery or plant previously used for any purpose.

In the assessment of a registered firm, an industrial undertaking, for the assessment year 1982-83 completed in December 1982 in addition to the tax relief of Rs. 37,469 a deduction of Rs. 65,475 at 20 per cent of the profits of industrial undertaking established in backward area was also allowed. It was noticed in audit (August 83) that the assessee firm neither had a factory premises of its own nor owned any machinery but carried on business in the premises of a partner company using the latter's machinery. As the assessee firm was merely an offshoot of the company no 'new' industrial undertaking had come into being and as such the assessee firm was not entitled either to the tax holiday relief or deduction towards setting up an industrial undertaking in a backward area. The incorrect allowance resulted in short levy of tax aggregating Rs. 68,662 in the hands of the firm and its partners.

The Ministry of Finance have accepted the mistake.

(iii) For the purpose of arriving at the value of the capital employed, the aggregate of moneys borrowed or debt owned by the assessee should not be included in capital employed.

In the assessment of a registered firm for the assessment year 1980-81, assessed in January 1982, a set off of Rs. 45,450 being the tax holiday relief carried forward for the assessment year 1977-78 was allowed. An examination of the computation of capital employed for the assessment year 1977-78 revealed (December 1982) that this relief was calculated on capital which included Rs. 7,57,500, being loan taken

from the State Financial Corporation. Incorrect computation of capital employed resulted in incorrect set off of Rs. 45,450 involving short levy of tax of Rs. 61,645 including interest for short payment of advance tax in the hands of the firm and its partners.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

3.28 **Incorrect allowance of relief in respect of newly established industrial undertaking in backward areas**

Under the provisions of the Income-tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking which began production after 31 December 1970, in any backward area, a deduction from such profits and gains of an amount equal to twenty per cent thereof would be allowable.

(i) Where the new industrial undertaking was formed by the transfer of machinery or plant previously used for any purpose in any backward area, the total value of the machinery or plant or part so transferred should not exceed twenty per cent of the total value of the machinery or plant used in the business for allowing the deduction.

A registered firm, engaged in the production and export of semi-tanned skins in a backward area, started manufacture of finished leather from April 1976 since the Government discouraged the export of semi-tanned leather. The original assessments of the firm for the assessment years 1977-78 and 1978-79 were completed in July 1980 and March 1981 on a total income of Rs. 4,95,390 and Rs. 8,66,950 respectively after allowing deduction of Rs. 1,27,680 and Rs. 2,33,902 for the two years in respect of profits and gains from the new industrial undertaking. The assessments of the firm for these years were revised in March 1981 and September 1981 to give effect to appellate orders redetermining the relief admissible for each year as Rs. 2,06,589 and Rs. 4,63,538 respectively. According to the details furnished by the assessee, while completing the assessment of the assessment year 1977-78, it was noticed (July 1982) that the value of the machinery previouly used in the business of the assessee and transferred to the new business, however, exceeded 20 per cent of the total value of the machinery and hence the assessee was not eilgible for the deduction from the profits and gains of the new undertaking established in a backward area. The incorrect allowance resulted in an aggregate short levy of tax of Rs. 4,16,031 in the hands of the firm and its partners for the two assessment years.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) In case of a person other than a company or a co-opertive society, the deduction is not admissible unless the accounts of the industrial undertaking for the previous year relevant to the assessment year have been audited by an accountant and the assessee furnishes along with the return of income, the audit report in the prescribed form duly signed and verified by such accountant.

In the regular assessment of a registered firm, (a ginning factory) for the assessment year 1979-80 completed in April 1983, a deduction of Rs. 79,031 claimed by the assessee firm at twenty per cent of profits of the new industrial undertaking was disallowed on the grounds that no manufacturing activity was involved in ginning and processing of cotton. However, deduction was allowed in appeal and the assessment was revised in November 1983. The assessee firm had not, however, furnished the audit report prescribed in the Act in respect of the industrial undertaking. This factor was neither noticed at the time of assessment nor brought to the notice of the appellate authority. In the absence of the audit report, the assessee was not entitled to the deduction. This resulted in total short levy of tax of Rs. 61,292. In reply, the department justified stating (May 1985), that the audit point was against the orders of the appellate authority and that the audit objection has been brought to the notice of the appellate authority for necessary rectificatory action. The department's reply is not factually correct as omission pointed out in audit was not the subject matter of the appellate order.

The Ministry of Finance have accepted the mistake.

3.29 **Irregular exemptions and reliefs**

(i) Chapter VI A of the Income-tax Act, 1961 provides for certain deduction to be made from gross total income. The over-riding 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 deductions under Chapter VI A.

An assessee co-operative society was assessed in March 1983 at a loss of Rs. 1,02,972 for the assessment year 1980-81 after allowing a deduction of Rs. 1,40,692 towards relief on capital gains under

Chapter VI A *ibid*. As the gross total income of the assessee as assessed was only Rs. 37,720 the relief under Chapter VI A *ibid* should have been restricted to the extent of positive income. This resulted in incorrect computation of loss to the extent of Rs. 1,02,972 and its carry forward for adjustment against future years income.

The Ministry of Finance have accepted the mistake.

(ii) According to the notification of December 1950, issued by the Government of India under the provisions of Income-tax Act 1922, the income of the co-operative societies registered in Part B States is exempt from being taxed. Under a specific provision of the Income-tax Act, 1961 any agreement entered into, direction, instruction, notification, order issued under any provision of the Income-tax Act, 1922, shall continue to be in force. Similar provisions do not exist in the Act to allow the concession to any assessee co-operative society in an area which formed part of a Part 'A' State after merger.

A co-operative society was initially registered in October 1948 in a part 'A' State. Subsequently, the registration of the said society was cancelled and the said society bifurcated into five new societies and new registration to each one of them was granted in 1968. One of the bifurcated societies was granted complete exemption from being taxed in the assessment for the assessment year 1981-82 made in January 1984 ostensibly under the mistaken belief that the above provision of the Act would apply to the assessee. This had resulted in the assessee co-operative society being granted irregular exemption and consequent under assessment of income of Rs. 1,27,570 and short levy of tax of Rs. 51,730.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.30 **Non levy/short levy of interest**

(i) The Income-tax Act, 1961, provides that any demand for tax should be paid by an assessee within thirty five days of service of notice of the demand and failure to do so would attract simple interest at twelve per cent (fifteen per cent from 1 October 1984) per annum from the date of default.

(a) In April 1982, the Central Board of Direct Taxes clarified through executive instructions that in case where the original assessment is either varied or set aside by the appellate authority, but on appeal by the department, the original order of the Income-tax Officer is restored either in part or wholly, interest for non-payment of demand will be computed with reference to the date of service of the original demand notice on the tax finally determined.

The total income of an assessee for the assessment years 1974-75 and 1978-79 was determined at Rs. 6,00,000 each by the Income-tax Officer in a best judgement assessment completed on 20 February 1981 on the assessee's failure to furnish full details required for a regular assessment. On appeal, the Commissioner of Income-tax (Appeals) set aside the orders on 23 March 1981 and directed the Income-tax Officer to make fresh assessments. The department went in appeal to the Income-tax Appellate Tribunal and succeeded in getting the orders of the Commissioner of Income-tax (Appeals) reversed, restoring the original assessment order of 20 February 1981. Accordingly, fresh assessment orders were passed by the Income-tax Officer on 11 November 1983 determining the income at Rs. 6,00,000 each for both the assessment years as before.

As a result, therefore, interest for non-payment of demand, should have been levied for the period from 29 March 1981 to 10 November 1983 which was not done resulting in non-levy of interest amounting to Rs. 1,68,268 for the assessment year 1974-75 and Rs. 1,20,900 for the assessment year 1978-79.

The assessment was checked by the internal audit of the department but the mistake escaped their notice.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(b) Under the Income-tax Rules 1962 where the demand is not paid within the end of the financial year, interest is to be calculated upto the end of the financial year and a demand notice issued within a period of thirty days from the end of the financial year.

An individual was served with a notice of demand for Rs. 1,12,557 for the assessment year 1971-72 on 20 May 1972. The demand was reduced to Rs. 50,520 (revision in October 1975) which was partially adjusted to the extent of Rs. 11,242 on 31 January 1983 against the refund relating to assessment years 1972-73 and 1976-77. Demand for interest amounting to Rs. 66,447 for the period 1 July 1972 to 31 March

1984 for the belated payment of tax of arrears had not, however, been raised.

The assessment was checked by the Internal Audit Party of the department but the mistake escaped their notice.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the provisions of Income-tax Act, 1961, where the return for an assessment year is furnished after the specified date, the assessee is liable to pay interest at 12 per cent (15 per cent from 1 October 1984) per annum from the day immediately following the specified date to the date of furnishing the return on the amount of tax payable on the total income as determined on regular assessment as reduced by the advance tax paid, if any, and any tax deducted at source. Where any assessee has paid advance tax on his own estimate for any financial year and the advance tax so paid falls short of seventy five per cent of the tax determined on regular assessment interest at the prescribed rate is payable by the assessee on the amount by which the advance tax paid falls short of the assessed income from the first day of the next financial year to the date of regular assessment.

(a) An assessee, a co-operative society, filed its return of income in March 1983 i.e. after the expiry of 20 months from the due date. While computing the income-tax for the assessment year 1981-82 in January 1984, the tax chargeable as reduced by advance tax paid worked out to Rs. 5,74,132. For the delay in furnishing the return, the assessee was also liable to pay interest of Rs. 1,14,820 which was not levied by the department.

Again, for the assessment year 1982-83 assessed in March 1984, the tax determined as payable worked out to Rs. 26,61,806 against which the assessee had paid advance tax of Rs. 3,21,000 on own estimates. For short payment of advance tax the assessee was liable to interest which worked out to Rs. 5,32,294 as against the sum of Rs. 4,72,110 actually levied by the department. These omissions including a minor computation mistake resulted in total revenue effect of Rs. 1,75,884.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) An assessee trust filed the return of income for the assesment year 1972-73 in August 1979. The assessment was completed in March 1984 on the taxable income of Rs. 1,26,340 and a tax demand of Rs. 84,033 was raised. For the delay of 85 months in filing the return, the assessee was liable to pay interest of Rs. 71,400 which was omitted to be levied.

The assessment was checked by the Internal Audit Party of the department which did not detect the mistake.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) The Act provides that prior to the assessment year 1985-86, for calculation of interest in the case of a registered firm, the tax payable on the total income shall be the amount of tax which would have been payable on the total income if the firm had been assessed as an unregistered firm.

While finalising the assessment of a registered firm for the assessment years 1979-80 and 1981-82 in January 1984 the department levied interest for belated submission of return on the basis of tax paid by the registered firm instead of calculating the interest on the basis of tax payable as unregistered firm. This resulted in a total short levy of interest of Rs. 1,47,438.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Where on making regular assessment, the Income-tax Officer finds that any person has not sent a statement of advance tax payable by him computed in the manner laid down in the Act or has not sent an estimate of his current income and the advance tax payable by him on the current income if he has not been previously assessed, simple interest at the rate of 12 per cent per annum (15 per cent from 1 October 1984) from the first day of April next following the financial year upto the date of regular assessment, is payable by the assessee.

(a) An assessee trust having failed to furnish the return, its assessment for the assessment year 1975-76 was completed in March 1984 exparte. For failure to furnish the return, interest of Rs. 62,578 was payable by the assessee which was not levied by the department.

Again the assessee trust which had not been previously assessed by way of regular assessment for earlier assessment years failed to furnish an estimate of its own current income for the assessment year 1975-76 and to pay advance tax on that basis. Failure to do so rendered the assessee liable to interest of

Rs. 64,383 which was also not levied by the department. The mistakes in both these cases led to aggregate short levy of interest of Rs. 1,26,961.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) While completing the assessments of four partners of a firm for the assessment year 1981-82 in March 1984, the period from April 1981 to February 1984 for which the interest was charged for shortfall in advance tax was incorrectly taken as 16 months instead of 35 months and the period from August 1981 to August 1982 for which the interest was charged for belated filing of return was reckoned as 12 months instead of 13 months. The mistakes together with minor arithmetical errors led to an aggregate short demand of tax of Rs. 84,008.

The Ministry of Finance have accepted the mistake.

(c) Higher rates of tax are prescribed by the Finance Act in the case of every Hindu undivided family which at any time during the previous year has atleast one member whose total income of the previous years exceed the taxable limit.

In the assessment of a Hindu undivided family for the assessment year 1974-75, assessed in February 1984 on an income of Rs. 1,06,560 the tax was charged at the lower rates, as applicable to non specified Hindu undivided family, even though one of the coparceners had a taxable income of Rs. 38,601. Further, the interest chargeable for belated filing of return as also non payment of advance tax for the assessment years 1973-74 and 1974-75 was incorrectly levied. These mistakes resulted in undercharge of tax (including interest) aggregating Rs. 98,694.

The Ministry of Finance have stated that the assessments made ex parte have since been cancelled.

(d) In the assessment of an individual for the assessment year 1981-82 completed in February 1984 as best judgement assesment, the assessing officer omitted to levy interest of Rs. 60,656 for failure of the assessee to file statement of estimate and payment of advance tax.

The Ministry of Finance have accepted the mistake.

(v) Under the Income-tax Act, 1961 any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest, other than interest on securities shall at the time of credit of such interest to the account of the payee, deduct income-tax thereon at the rates in force and deposit the same to the credit of the Government. Failure to deduct tax at source renders the assessee liable to pay interest at the prescribed rates on the amount of such tax. The Board issued instructions in December 1980 that for the purpose of making deduction of tax at source, any interest payable to a creditor has to be taken as being credited to the account of the payee and the apparent nomenclature of the particular account in which the credit is made is not conclusive in the matter.

An assessee firm in its accounts for the year relevant to the assessment year 1982-83 debited a sum of Rs. 31,48,533 towards interest payable during the year. The said interest income, instead of being credited to the account of the payee, was credited to the interest payable account but no tax was deducted at source from the said amount. The failure to deduct the tax from the interest so paid rendered the assessee liable to interest of Rs. 22,085 (upto June 1984) which was not levied.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.31 **Avoidable payment of interest by Government**

(i) Under the provisions of Income-tax, Act, 1961, where the advance-tax paid by an assessee exceeds the amount of tax payable as determined on regular assessment, the Government is liable to pay interest on the amount of advance-tax paid in excess for the period from 1 April of the assessment year to the date of regular assessment. In case, however, any part of such excess has been refunded on the basis of provisional assessment, no interest is payable after the date of such provisional assessment. The Central Board of Direct Taxes had from time to time issued instructions making it obligatory on the Income-tax Officer to frame a provisional assessment for refund on the basis of return filed by the assessee, within a period of six months from the date of furnishing the return.

Two individuals (assessed in the same ward) who had paid advance tax of Rs. 7,17,640 and Rs. 5,31,520 for the financial year 1981-82 filed their returns of income for the assessment year 1982-83 on 30 August 1982 and 30 June 1982 declaring a total income of Rs. 3,76,860 and Rs. 2,77,273 respectively. As the refund became *prima facie* due on the basis of return, a provisional assessment was required to be made within the statutory period of six months under the provisions of the Act as well

as the Board's instructions. No action was, however, taken by the assessing officer to make provisional assessment to refund the tax paid in excess by the individuals. The regular assessments in both the cases were made in November 1983, and as a result the assessees were paid interest of Rs. 89,794 and Rs. 67,811 on account of excess payment of advance tax. Had provisional assessments been made within six months, as laid down in the Act, total payment of interest amountnig to Rs. 74,932 could have been avoided.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

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

The assessment of a registered firm for the assessment year 1966-67 was revised by the Income-tax Officer in April 1981 to give effect to certain orders passed in favour of the assessee by the appellate authorities in August 1972. The revision resulted in total refund of tax of Rs. 51,434 to the assessee firm and to its partners. As the appellate orders passed in August 1972 were given effect to by the department only in April 1981 in the case of firm and in August 1983 in the case of four partners, the department had to pay Rs. 62,079 towards interest on the refund. The payment of interest could have been avoided had timely action been taken as per the instructions issued by the Board.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

3.32 Omission to levy penalty

Under the Income-tax Act, 1961, if the assessing officer, in the course of any proceedings, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income he may direct that such person shall pay by way of penalty not less than the amount of tax sought to be evaded and not exceeding twice that amount. The Central Board of Direct Taxes issued instructions in July 1964 and further reiterated in September 1975, that in cases where the Income-tax Officer does not initiate penalty proceedings, he should record reasons for not doing so.

An assessee filed the return of his income for the assessment year 1977-78 on 26 September 1977 showing income of Rs. 49,900. The income was assessed at Rs. 1,56,000 exparte on 4 March 1980 in the status of unregistered firm. The assessment was reopened on 21 July 1980 at the instance of the assessee. The assessment was again made exparte on 1 March 1983 at Rs. 1,56,000 as the assessee did not attend in response to notice nor did he produce books of account. The minimum penalty of Rs. 66,154 for concealment of income was leviable. Proceedings were not started nor a note of satisfaction of the assessing officer for not initiating the proceeding was kept.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

3.33 Non-observance of the provisions of law relating to contractors

Under the Income-tax Act, 1961, and the rules framed thereunder, where any contractor enters into a contract with any other person for carrying out any work or the supply of goods or services in connection therewith, the value of which exceeds Rs. 50,000 he shall, within one month of entering into a contract, furnish to the assessing authority particulars of the contract in the prescribed form. In the event of failure to furnish such particulars, the Commissioner of Income-tax may impose a fine not exceeding Rs. 50 for every day of default, subject to a maximum of 25 per cent of the value of the contract.

The provision relating to fiiing of statutory statements has been enacted as an anti-tax evasion measure.

The omission or delays in rendering statutory statements of particulars by contractors and inaction on the part of the department to initiate penalty proceedings for such defaults were commented upon in paras 3.25 of the Audit Report, 1982-83 and 3.22 of Audit Report 1983-84. Further instances of omissions or delays in rendering statutory statements as well as inaction on the part of the department to ini-

tiate penal action have come to the notice of audit. The details are as under :—

Sr. No.	Commissioners' charge	No. of cases	Assessment years	Omission/ period of default of filing statutory statements	Maximum fine imposable (Rupees)	When brought to the notice of department by Audit
1.	A	18	1980-81 to 1983-84	Ranged from 576 to 1928 days	16,72,120	Between May 1983 and August 1984
2.	B	1	1980-81 to 1983-84	Not filed till June 1984	4,06,276	June 1984
3.	C	11	1978-79 to 1982-83	Ranged from 186 days to 935 days.	2,51,400	October, 1984
4.	B	1	1980-81 to 1982-83	Not filed till June 1984	1,68,657	June 1984
5.	D	1	1981-82	Not filed till May 1983	1,50,800	June 1983
6.	E	1	1981-82 to 1982-83	Not filed till March 1985	81,800	December 1983
7.	C	4	1981-82 1982-83	Ranged from 383 to 401 days	77,950	December, 1984

In all these cases no action had been initiated by the department either to call for the statutory statements or to invoke the penal provisions of the law. The maximum fine imposable in these cases as per scales laid down in the Act amounts to Rs. 28.09 lakhs.

The Ministry of Finance have accepted the mistake in one case; their comments in the remaining six cases are awaited (January-1986).

3.34 **Other topics of interest**

(i) *Grant of permission for change of previous year*

Under the provisions of the Income-tax Act, 1961, an assessee can change the hitherto followed previous year in respect of his business with the consent of the Income-tax Officer upon such conditions as the Income-tax Officer may impose. The Central Board of Direct Taxes have issued instructions in May 1971 and August 1976 requiring the Income-tax Officers to ensure that the assessee is not attempting to make use of the device of changing his previous year in a manner detrimental to revenue, including undue deferment of payment of advance tax. Where the application is made with the object of causing loss to revenue the orders of Commissioner of Income-tax should be obtained before granting permission to the assessee to change the previous year. The Board also specifically directed the Commissioners of Income-tax to cancel all permissions granted for change of previous year by the Income-tax Officers if they are found to be prejudicial to revenue.

A registered firm carrying on business in civil works contracts from 1 December 1971 was assessed to tax upto the assessment year 1979-80 on the income earned in the relevant previous years ending on 30 April. However, for the assessment year 1980-81, the firm sought and obtained the permission to change the previous year from that ending 30 April 1979 to that ending on 29 February 1980 on the plea that the change would facilitate the filing of the returns of wealth-tax of the partners of the firm, as another firm in which they had interest was closing its accounts on 29 February. On 6 February 1981 the firm sought permission of the Income-tax Officer to restore the previous year relevant to the assessment year 1981-82 to 30 April 1981 on the plea that the anticipated facility in the filing of the wealth-tax returns of the partners did not materialise as the associated firm had switched over to Diwali accounting year. This request of the firm for change of previous year with effect from assessment year 1981-82 was agreed to by the Income-tax Officer on 11 February 1981 on the condition that the income of 14 months from 1 March 1980 to 30 April 1981 is returned for the assessment year 1981-82. The assessee filed the return of income for assessment year 1981-82 on 27th July 1981 declaring income of Rs. 21,543 to be adjusted against investment allowance claim of Rs. 4,82,770, and the assessment was completed on 7 April 1983 computing the total income as 'nil' after allowing the investment allowance of Rs. 1,25,273 and depreciation of Rs. 8,68,984 on certain machinery purchased on 28 April 1981 and depreciation of Rs. 5,12,743 on five lorries purchased on 30 April 1981. The balance of unabsorbed investment allowance of Rs. 3,57,407 was allowed to be carried forward for set off in subsequent assessment years. Audit scrutiny of the assessment records revealed (May 1984/June 1985) the following omissions/errors detrimental to the revenue.

1. The assessee firm had received Rs. 20,33,833 on 1 August 1980 as arbitration award in respect of contracts executed by it in 1972 to 1974. As a result, the assessee was liable to file a statement of advance tax payable by it in the financial year on the basis of self assessment tax paid for the assessment year 1980-81. It was also liable to file an estimate/revised estimate of advance tax payable on the receipt of Rs. 20,33,833 on 1 August 1980 and

pay advance tax amounting to Rs. 3,78,250 in equal instalments on such of the dates as are applicable to the case. The assessee did not file the statement of estimate of advance towards tax for the financial year 1980-81 and also did not pay any amount towards advance tax during the financial year 1980-81. Failure to do so attracted interest amounting to Rs. 91,776 and also penalty.

2. The assessee firm had in November 1980 placed orders for supply of certain machinery costing Rs. 19,31,078 reserving the right to cancel the orders in the first week of February 1981 if the machinery was not supplied before 31 January 1981. This heavy expenditure on machinery was desired to be made by the assessee before 31 January 1981 apparently as a part of tax planning to reduce the incidence of tax on the heavy receipt of Rs. 20.33 lakhs by claiming depreciation and investment allowance by putting the machinery to use before the end of the previous year *i.e.* 28 February 1981. When its tax planning did not materialise due to non receipt of machinery by 31 January 1981 the assessee tried and succeeded in achieving the same purpose by obtaining an extension of the previous year to 30 April 1981 from the department on 11 February 1981, three weeks before the existing previous year was to close, on the plea, that reasons stated by him earlier for switching over to previous year ending 28 February did not materialise. The machinery was actually supplied to the firm at one station on 28 April 1981 and was moved to another station on 30 April 1981 and was hired out on both these days. The assessee firm also purchased five lorries for Rs. 12,81,982 on 30 April 1981, the last day of the extended previous year. Depreciation and investment allowance amounting to Rs. 15.07,000 was claimed by the assessee on the above machinery and lorries in the return for assessment year 1981-82 reducing the taxable income to 'nil'. Thus the assessee had made use of the device in the change of the previous year to avoid payment of tax on the receipt of Rs. 20,33,833 in the then previous year relevant to assessment year 1981-82.

3. The Inspecting Assistant Commissioner to whom the assessment order was referred for approval under the Act, also did not consider the above factors which were detrimental to revenue, but held that the change of previous year granted was in order.

4. The orders of the Commissioner of Income-tax as required under the instructions of the Board for the change of the previous year were not on record.

5. The grant of permission to change the previous year relevant to the assessment year 1981-82 within five days of the receipt of the request from the assessee without taking into consideration the default of the assessee in payment of advance tax had thus resulted in a short demand of tax of Rs. 11,50,840 (inclusive of interest of Rs. 91,776 for the non-payment of advance tax) in the hands of the firm and its partners for the assessment year 1981-82.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) *Incorrect computation in the case of foreign technician*

The Income-tax Act, 1961, allows under certain conditions, exemption from tax on certain portion of remuneration paid to foreign technicians in the employment of the Government or a local authority or a statutory corporation or for services in any business carried on in India. The term 'technician' as defined in the Act means an individual who is not a citizen of India and has specialised knowledge and experience in constructional or manufacturing operations or in mining or in generation of electricity or other form of power or in some other specified fields. The technician should for the purposes of the Act be employed in India in a capacity in which specialised knowledge and experience are actually utilised and the contract of service should be approved by the Government of India. In case, the foreign technician, is employed in an Indian concern the tax paid by the employer is treated as a perquisite in the hands of the technician and taxed on 'tax on tax basis'. According to Central Board of Direct Taxes instructions of February 1973, the approval given by the Government of India (in the Administrative Ministries) needs to be reviewed by the assessing authority if the technician had not actually been in possession of specialised knowledge and experience in constructional and manufacturing operations or in mining.

A foreigner who was employed by a foreign company (a foreign collaborator of a public sector Indian Iron Ore Company) in India as Manager, Operations Warehouse of the Indian Company was actually engaged in overall direction of warehouse facility of an Iron Ore Mine. For the assessment year 1980-81 and 1981-82 (assessments completed in March 1983 and February 1984 respectively), exemption from tax was allowed by the Income-tax Officer in respect of the remuneration paid treating the individual as a 'technician' on the basis of approval of the contract of service by the Ministry of

Steel and Mines in January 1979. It was observed that the individual did not possess the specialised knowledge and experience in the field specified in the Act, as his experience was in the field of accounting and inventories only and not in the operation of mining proper and hence the approval of the contract of service of the assessee as a technician was not in order for purposes of exemption from income-tax. The irregular exemption allowed in respect of remuneration upto Rs. 48,000 for assessment year 1980-81 and Rs. 26,000 for 1981-82 was, therefore, not in order. In addition, the tax to be borne by the employer on 'tax on tax' basis was Rs. 10,07,982 as against Rs. 2,47,674 actually borne and paid by it for assessment year 1980-81. For the assessment year 1981-82 the corresponding amounts are Rs. 3,89,194 (to be borne) and Rs. 1,15,165 (actually borne). Thus, short computation of income by Rs. 10,55,982 for the assessment year 1980-81 and by Rs. 4,15,914 for assessment year 1981-82 resulted in short levy of tax aggregating Rs. 10,34,337 and penal interest for non deduction of tax at source amounting to Rs. 90,416.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iii) *Invalid service of notices*

Under the Income-tax Act, 1961, where a firm or other association of persons is dissolved, notices under the Act, in respect of the income of the firm or association, may be served upon any person who was a partner (not being a minor) or a member of the association, as the case may be, immediately before its dissolution.

A firm engaged in the business of floating hundies was assessed for the assessment years 1961-62 to 1964-65 as an unregistered firm between September 1963 and February 1967. The firm was dissolved in 1969. On the basis of notices served between March 1970 and March 1973 on a person who was not a partner of the dissolved firm or by affixation, the Income-tax Officer re-opened the assessments *ex parte* to bring to tax certain cash credits which had escaped assessment in earlier years, and raised demand of Rs. 1,28,312 for the four assessment years. The Income-tax Appellate Tribunal, however, held in August 1975, that notices in assessment years 1961-62 to 1964-65 were not validly served upon the assessee and assessments framed were without jurisdiction.

Failure to serve notices of re-assessment on the proper person resulted in loss of revenue of Rs. 1,28,312.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(iv) *Procedural mistakes in the assessments of firms and partners*

According to the instructions issued by the Central Board of Direct Taxes in June 1979, all entries in the collection columns of the demand and collection register should be made by a Tax Assistant|Upper Division Clerk and checked by the Head Clerk|Supervisor, both of whom should initial each entry, the latter in a different ink. This is to ensure the accuracy of posting the collection columns. When an assessment is revised, the amount already refunded to the assessee at the time of the original assessment has to be added to the demand, as tax due from the assessee. Failure to follow these instructions in an income-tax ward led to the following mistakes in the assessment of a firm and its partners :

(1) While revising the assessment of a registered firm for the assessment year 1979-80, in February 1983, in pursuance of an appellate order (January 1983), an amount of Rs. 51,886, being the balance of tax demanded earlier for the assessment year 1979-80 and outstanding against the assessee, was wrongly taken as collected, based on an incorrect entry to that effect in the demand and collection register. This resulted in excess refund of Rs. 51,886, part of which (Rs. 26,876) was adjusted against the tax due from the partners, and refund order for the balance amount (Rs. 25,010) was issued in favour of the firm (which was, however, returned unencashed).

(2) While revising the assessments of three of the partners of the above firm for the assessment year 1979-80 in February 1983, following the revisions of the firm's assessment in pursuance of an appellate order of January 1983, sums of Rs. 20,417, Rs. 1,14,281 and Rs. 78,894 respectively refunded to the three partners at the time of original assessment in March 1982, were omitted to be taken into account. This resulted in short levy of tax totalling Rs. 2,13,592.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

CHAPTER 4

OTHER DIRECT TAXES

A—WEALTH TAX

4.01 Wealth-tax is levied for every assessment year in respect of the net wealth on the corresponding valuation date of every individual and Hindu undivided family according to the rates specified in the Schedule to the Act. Levy of wealth-tax on companies has been revived in a limited way from 1 April 1984.

In the financial years 1980-81 to 1984-85 wealth-tax receipts vis-a-vis the budget estimates were as given below :—

Year	Budget Estimates	Actuals
	(In crores of rupees)	
1980-81	65.00	67.37
1981-82	66.00	78.12
1982-83	80.00	90.37
1983-84	90.00	93.31
1984-85	97.00	107.58

4.02 Particulars of cases finalised, pending assessment and arrears of demand are given below :—

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of	Arrears of demand pending collection at the end of
			(In crores of rupees)
1980-81	3,50,583	4,99,903	217.11
1981-82	3,97,211	5,67,381	208.92
1982-83	4,27,483**	5,41,594**	182.29**
1983-84	4,65,487@	4,90,234@	197.29
1984-85	4,75,833	4,53,575	211.25

**Figures furnished by Ministry of Finance in March/April 1984 have been adopted.

@Figures furnished by Ministry of Finance in March 1985 have been adopted.

4.03 During the test audit of assessments made under the Wealth-tax Act, 1957, conducted during the period 1 April 1984 to 31 March 1985, the following types of mistakes were noticed :

(i) Wealth escaping assessment.

(ii) Incorrect valuation of assets.

(iii) Incorrect computation of net wealth.

(iv) Incorrect exemptions and deductions.

(v) Mistakes in application of rates of tax/avoidable mistakes.

(vi) Non-levy of additional wealth-tax.

(vii) Non-levy/short levy of penalty.

(viii) Miscellaneous.

A few important cases illustrating these mistakes are given in the following paragraphs.

4.04 **Wealth escaping assessment**

(i) Under the Wealth-tax Act, 1957, as amended with effect from 1 April 1982, moneys standing to the credit of a person resident outside India in a Non-resident (External) Account in any bank in India, the interest income of which is exempted from income-tax, shall not be taken into account, in computing the net wealth during the year ending on the valuation date. The Wealth-tax Act, 1957, further provides that in the case of an assessee being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who has returned to India with the intention of permanently residing in India, moneys and the value of assets brought by him into India and the value of assets acquired by him out of such moneys are exempt from wealth-tax for a period of seven successive assessment years commencing with the assessment year next following the date of return to India. As a consequence of exempting the moneys lying to the credit in the Non-resident (External) Account held by a person resident outside India from wealth-tax, the Central Board of Direct Taxes in their circular of February 1985 clarified that such moneys to the credit of Non-resident (External Account

would be exempt from wealth-tax for a period of seven successive assessment years after the return of an Indian citizen or a person of Indian origin hitherto ordinarily residing in a foreign country with the intention of permanently residing in India. This provision came into force from 1 April 1982 and will be applicable from assessment year 1982-83 and subsequent assessment years.

A resident Assistant Surgeon in the service of a State Government left India on 17 February 1976 for taking private employment in a foreign country and finally returned to India on 6 May 1979. While abroad he had been remitting money to India from time to time and the moneys were credited to his Non-resident (External) Account maintained in a bank in India and as on the valuation date relevant to the assessment year 1980-81, such deposits lying in the Non-resident (External) Account totalled to Rs. 33,00,000 (approximately). No wealth-tax assessment was, however, made for the assessment year 1980-81. It was pointed out in audit (April 1982) that as the assessee was not a person who could be said to be ordinarily residing in a foreign country, since the limited period of stay abroad is known to the assessee even before leaving India and the bank deposits did not also constitute moneys or assets brought by him into India on his leaving the foreign country, the bank deposits were not, therefore, exempt from wealth-tax. Under the Wealth-tax Act, 1957, the balance in the Non-resident (External) Account of a person resident outside India is excluded from the net wealth as well as exempted from net wealth for subsequent seven assessment years only from the assessment year 1982-83 and the assessment year in the case of the assessee being prior to this assessment year, the exemption is not, therefore, admissible.

Similar omission to assess the wealth of the assessee for the assessment year 1978-79 also was pointed out in audit.

On being pointed out in audit in April 1982, the department completed the assessments and raised (February 1984) demand of Rs. 2,63,967.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Net wealth of three assessees, for the assessment year 1975-76, was determined, in March 1980, at Rs. 8.98 lakhs, Rs. 8.21 lakhs and Rs. 6.27 lakhs, respectively. In addition, the assessee had also jointly owned urban land since the assessment year 1972-73. While completing the assessments of the assessees, for the assessment year 1976-77, in March 1981, the assessing authority had valued this land at Rs. 6,39,000 and added the value of each assessee's one-third share of Rs. 2,13,000 in his net wealth. However, neither the assessees had declared their one-third share in the value of this land nor the department included it in the assessments for the assessment year 1975-76. The value of this urban land was also omitted to be included by the department in the assessments, for the assessment years 1972-73 to 1974-75. This resulted in under-assessment of wealth of Rs. 25,56,000, for the assessment years 1972-73 to 1975-76.

Further, the department had not levied the additional wealth-tax, for the assessment years 1972-73 to 1975-76, even though the value of urban immovable assets of each assessee exceeded rupees five lakhs. The wealth-tax chargeable on the net wealth assessed, for the assessment year 1975-76, was also not worked out correctly.

These omissions resulted in short-levy of tax of Rs. 1,87,698, including mistake in tax calculations in the original assessment.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) As per the income-tax assessment records of an individual, during the previous year relevant to the assessment year 1974-75, an assessee had constructed a movie house at a cost of Rs. 4.34 lakhs on a site of 50 cents of land owned by him in a municipal town. Besides, he owned agricultural property in the form of one-fifth share in a Coffee Estate. The value of land appurtenant to the theatre, together with the agricultural property would be about Rs. 4.90 lakhs. Though the individual thus owned assets of such value as would well be above taxable limits, he was not enlisted for wealth-tax assessment.

The Ministry of Finance have stated (July 1985) that the audit objection was given effect to and assessments have been made on net wealth ranging between Rs. 6,38,800 for the assessment year 1974-75 and Rs. 11,46,100 for the assessment year 1980-81. The demand of Rs. 70,398 was raised by the department. The Ministry further stated that the assessee has filed appeals against these assessments.

(iv) An individual held fifty per cent share in a house property situated in a metropolitan city, the other half being vested in his mother as her life

interest as per 'will' of the testator (the father of the assessee). The total value of the house property was determined (March 1979) by the Departmental Valuation Officer at Rs. 11,49,840, as on 31 March 1973 and fifty per cent (Rs. 5,74,920) thereof was assessed in the hands of the assessee in each of the assessments, for the assessment years 1979-80 to 1981-82, completed in December 1981 and August 1982. The assessee's mother died in December 1978, i.e., prior to the valuation date relevant to the assessment year 1979-80. As such the entire property had devolved on the assessee on his mother's death as per the terms of the 'will' and the value of the entire property was includible in the net wealth of the assessee.

Further, the said property was sold by the assessee for Rs. 12,61,000, during the previous year relevant to the assessment year 1982-83 and the capital gains arising therefrom were offered for taxation. Therefore, the value of the entire property should have been considered in full in the wealth-tax assessments of the assessee for the assessment years mentioned above. Non-inclusion of the other half share in the net wealth of the assessee, thus, resulted in under-assessment of wealth of Rs. 17,24,760, with consequent short-levy of tax of Rs. 55,410.

The Ministry of Finance have accepted the mistake in principle.

(v) Under the Wealth-tax Act, 1957, the 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 him on the valuation date. The Central Board of Direct Taxes issued instructions (November 1973 and April 1979) emphasising the need for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to prevent cases of evasion of tax. Further, the Act also provides for the levy of penalty, *inter alia*, if an assessee has, without reasonable cause, failed to furnish the wealth-tax return within the prescribed time or concealed the particulars of any assets or furnished inaccurate particulars of any assets or debts.

(a) An assessee entered into an agreement with an individual, in June 1975, to sell 42.67 acres of land for Rs. 6,40,050. This fact was noticed in audit from the income-tax assessment records of the assessee and the buyer for the assessment year 1981-82. The aforesaid land was sold by the assessee in the previous year relevant to the assessment year 1981-82. As per agreement dated June 1975, it is seen that the assessee owned the aforesaid immovable property from the assessment years 1976-77 to 1981-82 and also had a cash amount of Rs. 6,40,050 (land sale proceeds) for the assessment years 1982-83 and 1983-84. But he did not file any returns of his net wealth for these assessment years nor did the department call for these wealth-tax returns though the income-tax assessment records indicated that the assessee was liable to wealth-tax. Taking the sale price of land as value of the property at Rs. 6,40,050, for assessment years 1976-77 to 1981-82 and cash equal to sale proceeds during the assessment years 1982-83 and 1983-84, wealth aggregating to Rs. 51,20,400 had escaped assessment due to omission by the assessing officer to correlate the income-tax assessment records of the assessee. This resulted in non-levy of wealth-tax of Rs. 62,050 (including additional wealth-tax). Further, penalty provisions for non-filing of the returns and concealment of wealth were also attracted.

The Ministry of Finance have accepted the mistake.

(b) The income-tax assessment records of a Hindu undivided family, for the assessment years 1979-80 to 1983-84, disclosed that the family owned an immovable property which was let out at the net annual rent of Rs. 77,109, Rs. 75,205, Rs. 73,965, Rs. 91,539 and Rs. 1,04,295, for the assessment years 1979-80, 1980-81, 1981-82, 1982-83 and 1983-84, respectively. Based on the value of the building on the 'income capitalisation method' and the value of the movable properties as shown in the balance-sheets submitted with the income-tax returns, the assessee had assessable wealth of Rs. 7,09,300, Rs. 6,03,200, Rs. 5,25,600, Rs. 6,91,700 and Rs. 9,16,400, respectively, during the aforesaid assessment years. The assessee did not, however, file the wealth-tax returns. The department also did not call for the wealth-tax returns. The omission resulted in non-levy of wealth-tax of Rs. 37,673. Further, penalties for the non-submission of returns and concealment of wealth were also leviable under the provisions of the Wealth-tax Act, 1957.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(c) The income-tax assessment records of an assessee, for the assessment years 1979-80 and 1980-81, disclosed rental income of Rs. 57,600, in

each assessment year in respect of two let out commercial immovable properties owned by her. Neither the assessee returned the value of these properties in her wealth-tax returns for the above two assessment years nor did the department assess the value of these properties while completing the wealth-tax assessments in October 1983. Based on the 'income capitalisation method', the value of the properties would work out to Rs. 6,91,200, for each of the assessment years 1979-80 and 1980-81.

Further, the assessee had one-half share in a let out theatre property. The assessee returned its value at Rs. 50,000 in her wealth-tax returns, for the assessment years 1979-80 and 1980-81, being the amount invested by her. The income-tax assessment records of the assessee, however, disclosed that the assessee and the another co-owner received a total rent of Rs. 48,000 of the theatre building in each of the above two assessment years. Adopting the 'income capitalisation method' and taking the capital value at 12 times of rent received, the value of whole building would work out to Rs. 5,76,000 and assessee's half share being Rs. 2,88,000. However, while completing the assessments, the Wealth-tax Officer adopted the value at Rs. 54,980 and Rs. 53,039, in each of the two assessment years, respectively.

The above mistakes resulted in under-assessment of wealth of Rs. 18,51,400, with consequent short-levy of tax of Rs. 36,278. Further, penalty provisions for the concealment of the properties were also leviable.

The Ministry of Finance have accepted the mistake.

(d) An individual assessee was appointed as executrix to an estate. The estate yielded rental income from a lease-hold property situated in a metropolitan city. The lease deed was executed in December 1966, for a period of twenty years, on a monthly rent of Rs. 10,200.

The income-tax assessments, for the assessment years 1976-77 to 1981-82, revealed that the income from the lease-hold property was assessed to income-tax. However, the value of the lease-hold property had neither been shown by the assessee as wealth nor assessed to tax by the department. No wealth-tax returns were filed by the assessee showing the value of the asset and the department had not also called for the same for determination of wealth by issuing notices to the assessee. The value of the property on the basis of unexpired portion of lease and expected return at 8 per cent would work out to Rs. 5,61,318, Rs. 8,15,815, Rs. 9,13,971 and Rs. 7,19,140, for the assessment years 1978-79 to 1981-82, respectively. Thus, there had been escapement of wealth mentioned above, which resulted in non-levy of tax of Rs. 34,509. In addition, minimum penalty for concealment of wealth amounting to Rs. 34,509 was also leviable, which was not levied.

The Ministry of Finance have accepted the mistake.

(e) Two individuals were assessed to wealth-tax, for the assessment year 1978-79, on their net wealth of Rs. 3,95,694 and Rs. 4,27,655, respectively. However, for the subsequent assessment years 1979-80 to 1983-84, both the individuals did not file the wealth-tax returns. The department also did not call for the returns. Based on the net wealth computed for the assessment year 1978-79, wealth escaping assessment, for the assessment years 1979-80 to 1983-84 would work out to Rs. 41,16,745, with consequent short-levy of tax of Rs. 28,345. Further, penalty provisions for non-filing of the returns were also attracted.

The Ministry of Finance have accepted the mistake.

(f) Certain assets belonging to Indian Nationals were seized by the Government of Pakistan during and after the Indo-Pakistan conflict of 1965. The Custodian of Enemy Property in India had issued a notice in 1971 asking the affected persons to file claims with him so that 25 per cent of the value of the verified claims might be paid to such affected persons against a bond to be executed by the recipients. The procedure laid down contemplates that after the claim is received, the Custodian verifies it and issues an order sanctioning the ex-gratia amount admissible. After acceptance of the amount and execution of the bond by the affected persons, the relief is disbursed to them by the Custodian. The Appellate Tribunal, Calcutta held (April 1980) that an assessee's claim for ex-gratia relief is converted into a legal right and then an asset, after the date of communication of the assessee's acceptance, either through a letter or by executing an Indemnity Bond. In other words, the legal right to the ex-gratia amount crystallises as soon as an assessee communicates his acceptance and the right, which is an asset, is chargeable to wealth-tax in the years, the valuation dates of which fall subsequent to the date of acceptance.

The Central Board of Direct Taxes, however, issued instructions in July 1984 that the ad hoc interim relief granted by the Government of India in the form of ex-gratia grant from the Consolidated Fund of India cannot be assessed to wealth-tax as there is no legally enforceable claim to such relief. These instructions of the Board run counter to the provisions of the Wealth-tax Act, which provides that the 'asset' includes property of every description. An assessee's right to receive ex-gratia compensation is an 'asset' and crystallises as soon as an assessee communicates his acceptance thereto. The Board was requested in audit, in November 1984, to reconsider these instructions in view of the provisions of the Wealth-tax Act and the decision of the Appellate Tribunal; otherwise it may lead to wealth escaping assessment. The Board is yet to communicate its decision in the matter (July 1985).

In a case the Custodian of the Enemy property for India communicated the sanction for payment of compensation of Rs. 12.5 lakhs, in March 1975, for the estate left behind by a Zamindar in East Bengal (now Bangladesh) on partition of India in 1947. The Zamindar died in 1968 and two of his five legal heirs also died in 1971. As such the compensation was actually inherited by the remaining three co-sharers (assessees) in equal proportions. The assessees had communicated their acceptance of the compensation by executing the Indemnity Bond, in March 1975. As the compensation mentioned above was ordered by the Custodian and accepted by the assessees, its value of Rs. 4,16,666, was required to be included in the net wealth of each of the above assessees, for the assessment year 1975-76. However, this was not done. This resulted in wealth of Rs. 12.5 lakhs escaping assessment, with consequent under-charge of tax of Rs. 23,729.

On the short-levy being pointed out in audit in February 1984, the Ministry of Finance stated in reply in October 1984 that the compensation amount had already been taxed and in view of the Board's instruction of July 1984, the tax already recovered would be refunded. Apart from the fact that the Ministry's reply that the compensation had already been taxed, was not factually correct, the Board's instructions of July 1984 are also not in accordance with the law.

The further comments of Ministry of Finance on the paragraph are awaited (January 1986).

(vi) In re-computing the net wealth of a Hindu undivided family, for the assessment year 1975-76, in February 1983, the assessing officer added back an amount of Rs. 4,60,000 (representing partitioned amount of Hindu undivided family) on the ground that the partition was invalid. However, similar additions were not made in the subsequent assessments, for the assessment years 1976-77 to 1978-79, completed between March 1981 and February 1983, though there was no finding of a valid partition having taken place subsequently. The omission to make similar additions resulted in under-assessment of wealth of Rs. 13,80,000, with consequent short-levy of wealth-tax of Rs. 40,530.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

4.05 **Incorrect valuation of assets**

A. *Immovable properties*

(i) Under the Wealth-tax Act, 1957, the value of any property shall be estimated to be the price which it would fetch if sold in the open market on the valuation date.

(a) It has been judicially (135 ITR 386) held (October 1981) that the assessee's own valuation report filed in respect of a property for subsequent years could be 'information' for re-opening the assessment of earlier years. While completing the wealth-tax assessments of an assessee, in April 1983, the department adopted the value of an urban plot at Rs. 3,77,000, Rs. 4,27,000, Rs. 4,78,000 and Rs. 20,00,000, for the assessment years 1979-80 to 1982-83, respectively.

However, in the wealth-tax return, for the assessment year 1983-84, filed in August 1983, the assessee had himself returned the value of the same plot at Rs. 39 lakhs on the basis of sale agreement of 1983, which was accepted by the department. In view of the considerable difference between the value adopted for earlier assessment years and the value declared by the assessee on the basis of his own sale transaction for the assessment year 1983-84, the Wealth-tax Officer should have re-opened the assessments for the earlier assessment years.

Assuming that the value of the urban land appreciated at about Rs. 5 lakhs every year, the under-assessment of wealth, for the assessment years 1979-80 to 1982-83, was Rs. 73,18,000, with consequent short-levy of tax of Rs. 2,45,767.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) In the case of an individual, assessments, for the assessment years 1973-74 to 1976-77, were completed in September 1978. These assessments were set-aside in appeal in March 1980. Fresh assessments were framed in March 1984, determining the net wealth at the same amount at which the assessments had been made originally at Rs. 4,63,700, Rs. 5,25,000, Rs. 5,15,100 and Rs. 5,54,000, for the respective assessment years 1973-74 to 1976-77. The assessee's wealth consisted of two urban immovable properties, one of which was under absolute ownership but not exclusively used for own residence and in the other, the assessee had one-fourth share. In the assessment, for each of the assessment years 1973-74 to 1976-77, the aggregate value of these properties had been taken at Rs. 5,57,200, before allowing admissible exemption of Rs. 1,00,000. However, according to the departmental valuation report of February 1981, the value of these properties worked out to Rs. 9,73,475, for the assessment years 1973-74 and 1974-75 and Rs. 10,24,800, for the assessment years 1975-76 and 1976-77. The valuation so made was overlooked in the assessments completed (March 1984) by the department much after the date of receipt of the valuation reports and consequently not only net wealth was computed short but additional wealth-tax on value of urban immovable properties exceeding Rs. 5,00,000 was also not charged.

The under-assessment of assessee's net wealth (after deducting current-tax liability) worked out to Rs. 16,58,900, with consequent short-levy of tax of Rs. 1,21,068 (including non-levy of additional wealth-tax of Rs. 79,830).

The Ministry of Finance stated that the assessment order to which the objections relate has been set aside by the Assistant Appellate Commissioner on the ground that enough opportunity was not given to assessee to explain his case.

(c) The Wealth-tax Act, 1957, provides that the Wealth-tax Officer may make a reference to the Departmental Valuation Officer for the valuation of the assets where the value as returned on the basis of valuation report of the registered valuer, in his opinion, is less than its fair market value and the fair market value of the asset exceeds, the value of the asset as returned by more than 33⅓ per cent of the value of asset as returned or by more than Rs. 50,000.

The wealth-tax assessments of a Hindu undivided family (specified), for the assessment years 1979-80 to 1983-84, were completed in January and September 1983. The family's net wealth, *inter alia*, included one-third share in an immovable property (consisting of land with buildings, godown and other construction thereon). The property had been let out to a company and a few other commercial companies. The value of the entire property for the assessment year 1975-76, was estimated by the registered valuer at Rs. 4,50,000. The assessee's share being one-third was returned at Rs. 1,50,000, for all the assessment years 1975-76 to 1982-83. The assessing officer accepted the value at Rs. 1,50,000, as assessment years 1975-76 to 1982-83. The assess- 1975-76 to 1979-80 and made an ad hoc increase of Rs. 45,000 in each of the assessment years 1980-81 to 1982-83. During the previous year relevant to the assessment year 1983-84, an additional godown was constructed on the vacant land in the property at a cost of Rs. 1,73,000. Taking into account the assessee's one-third share of this addition, the assessee returned the value of Rs. 2,52,667, for the assessment year 1983-84. The returned value was accepted by the assessing authority in the assessment for the assessment year 1983-84. The assessments for the assessment years 1979-80 to 1982-83 and for the assessment year 1983-84 were completed in January 1983 and September 1983, respectively.

The income-tax assessment records of the assessee disclosed that the assessee himself had returned the net annual rental income for his one-third share in the property, ranging between Rs. 26,653 and Rs. 83,903, in each of the five assessment years 1979-80 to 1983-84. But the property was never referred by the department to the valuation cell for ascertaining the market valuation.

Further, the movable and immovable properties belonging to the family were partitioned between the 'karta' (assessee) and his son in September and October 1980, respectively. According to the partition deed, (October 1980) the value of one-third share of the assessee in the same property had been shown at Rs. 5,99,000, as per the guidelines of the State Registration Department.

Even adopting the value of the property at Rs. 5,99,000, as valued by the assessee in the partition deed, for the assessment years 1979-80 to 1983-84, for which rental income was shown by the assessee in the income-tax assessments, the undervaluation of property would work out at Rs. 4,49,000,

in the assessment year 1979-80 and Rs. 4,04,000 in each of the assessment years 1980-81 to 1983-84. Thus, adoption of incorrect valuation of property resulted in under-assessment of wealth of Rs. 20,65,000, with consequent short-levy of tax of Rs. 79,169.

The Ministry of Finance have accepted the mistake.

(d) The net wealth of an individual, for the assessment years 1978-79 and 1979-80, included, immovable properties. While completing the wealth-tax assessments for these assessment years, on 14 March 1984, the department adopted the value of these immovable properties at Rs. 14,80,550 (including the value of self-occupied property at Rs. 3,35,250). The income-tax assessment of the assessee, for the assessment year 1981-82, completed in March 1984 also, disclosed that the properties valued at Rs. 11,45,300 (other than self-occupied) were sold during the previous year relevant to the assessment year 1981-82, for a consideration of Rs. 22,00,000, which was invested in Rural Development Bonds. This amount had also been returned under movables in the wealth-tax return, for the assessment year 1980-81. It would thus be seen that the sale consideration was nearly twice that was adopted in the wealth-tax assessments, for the assessment years 1978-79 and 1979-80. Assuming a reduction in the market value of the property at ten per cent for each of the assessment year from the sale value of Rs. 22,00,000, the market value of the properties as on the valuation date for each of the assessment years 1978-79 and 1979-80 would be Rs. 17,82,000 and Rs. 19,80,000, respectively, as against Rs. 11,45,000 adopted by the department. The incorrect adoption of valuation resulted in under-assessment of wealth of Rs. 14,71,400, with consequent short-levy of tax of Rs. 44,418.

The Ministry of Finance have accepted the mistake in principle.

(ii) The methods generally adopted to estimate the market value of any building are the 'land and building method' and 'income-capitalisation method'. It had been judicially held (100 ITR 621) that the 'income-capitalisation method' is ideally suited for valuation of commercial properties.

(a) Three individuals were partners in a registered firm, having one-eighth share each, during the assessment years 1978-79 and 1979-80. The firm's assets, inter alia, included a house property which was let out to the Government at a monthly rent of Rs. 1,12,340. The book value of the above house property was shown, in the balance-sheets of the firm as on March 1978 and 1979, at Rs. 12,43,701, in each of the year. However, under the 'income-capitalisation method', if the net maintainable rent is capitalised by the multiplier of 100/9 (and deduction of 10 per cent allowed therefrom for joint ownership) the fair market value of the property would be Rs. 93,44,290.

While completing the wealth-tax assessments of the above three individuals, for the assessment years 1978-79 and 1979-80, in July 1982, the assessing authority took the value of assessees shares in partnership firm at Rs. 1,55,463, being one-eighth of book value of the house property owned by the firm instead of Rs. 11,68,036, being the value of one-eighth share of market value of the property of Rs. 93,44,290, under the 'income capitalisation method'. The incorrect valuation of property thus resulted in under-assessment of wealth of Rs. 60,75,438, with consequent short-levy of wealth-tax of Rs. 1,12,974.

The Ministry of Finance have accepted the mistake.

(b) Three assessees (two individuals and one Hindu undivided family) were owners of separate house properties in a metropolitan city. The properties were entirely let out for commercial purposes at an annual net rent ranging between Rs. 26,207 and Rs. 42,592. The market value of these properties was determined by the approved valuer, as on 31 March 1981, at Rs. 1,18,000, Rs. 1,96,475 and Rs. 1,90,000, respectively, for each of the assessment years 1982-83 and 1983-84. The same value was returned by the assessees and assessed by the Wealth-tax Officer, between October 1982 and February 1984.

For valuation of properties let out for commercial purposes the proper method was to capitalise the net rental income. The fair market value of the properties on the basis of the capitalisation of the net rental income, even at the multiplier of 100/9 would be Rs. 10,78,888 and Rs. 11,85,521, for the assessment years 1982-83 and 1983-84, respectively. The non-adoption of the appropriate method of valuation resulted in under-valuation of properties of Rs. 12,55,459, with consequent short-levy of tax of Rs. 26,479.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) Under the Wealth-tax Act, 1957, in the case of valuation of house property belonging to an assessee and exclusively used by him for his residential purposes throughout the period of twelve months immediately preceding the valuation date may at the option of the assessee, be taken to be the price which it would fetch, if sold, in the open market on the valuation date next following the date on which he became the owner of the house or on the valuation date relevant to the assessment year commencing on the 1 April 1971, whichever valuation date is later.

(a) In the wealth-tax assessment of an individual, for the assessment year 1976-77, completed in March 1981, the value of a house property, on a site measuring 16.61 grounds in a metropolitan city, was adopted at Rs. 5,73,000, being the value fixed (June 1979) by the Commissioner of Income-tax (Appeals), for the assessment year 1971-72 and the same value was also adopted for each of the assessment years 1977-78 to 1979-80. However, the assessee, had deducted one-sixth of the annual value of the property as relating to "business", while computing the income under house property under the Inome-tax Act, 1961, which was also considered reasonable (January 1971) by the Appellate Assistant Commissioner. Further, the sale value of the aforesaid property was Rs. 24 lakhs as per the sale deed executed in August 1981.

As the house property was not exclusively used for residential purposes and was used for business purpose also, the fair market value as on the respective valuation dates was to be adopted for the assessment years 1976-77 to 1979-80 instead of Rs. 5,73,000 which was too low when compared to the value of Rs. 24 lakhs shown in the sale deed. Estimating an annual increase of twenty per cent, based on the sale value of Rs. 24 lakhs in August 1981, the value of the house property would be of Rs. 8,88,000, Rs. 10,66,000, Rs. 12,79,000 and Rs. 15,35,000, for the assessment years 1976-77 to 1979-80, respectively. The resultant total additional demand of wealth-tax would be Rs. 1,03,490.

The Ministry of Finance have accepted the mistake.

(b) The value of a house property owned by an assessee was taken, in the assessment years 1973-74 to 1978-79, at its market value on the valuation date relevant to the assessment year 1971-72, on the basis of certificates recorded in the wealth-tax returns of the relevant years to the effect that the said property was being used by him for his residence. The balance sheets and income and expenditure accounts filed with the income-tax returns, however, revealed that the assessee was not using the building for residence but was running the business of a hotel in the house since the assessment year 1973-74 and onwards. As the major portion of the house was being used for commercial purposes and the entire house was not used exclusively for self-residence the market value of the same on the relevant valuation dates was required to be adopted instead of restricting the same to its value as on 1 April 1971. The incorrect valuation of the house property adopted by the department resulted in under-computation of assessee's net wealth by Rs. 23,08,600, with consequent under-charge of tax of Rs. 85,935.

The Ministry of Finance have accepted the mistake.

(iv) An assessee was the owner of certain immovable properties (buildings, workshop, plot etc.). The assessing officer determined (March 1979) the value of these properties, for the assessment year 1974-75, at Rs. 5,08,500. This value was determined after adding five per cent increase in the value of these properties determined by the Departmental valuation Officer as on 31 March 1973, for the assessment year 1973-74. However, the value of these properties, for the assessment years 1975-76 to 1977-78, was assessed, in March 1981 and March 1982, lower than the valuation adopted for the assessment year 1974-75, by Rs. 1,59,566, Rs. 1,29,516 and Rs. 38,000, respectively, without assigning any reasons. Further, immovable properties valued at Rs. 80,600 and Rs. 1,51,516 and assessed in the past years were not returned and assessed in the assessment years 1975-76 and 1977-78, respectively.

The assessee had also investment of Rs. 1,92,200 in a company, which was not returned and assessed in each of the assessment years 1975-76 to 1977-78 though, in the earlier and subsequent years, it was included in net wealth. This resulted in total under-assessment of wealth by Rs. 11,35,798, with consequent short-levy of wealth-tax of Rs. 94,270, including additional wealth-tax.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(v) While computing (March 1984) the net wealth of a deceased assessee (individual), for the assessment years 1977-78 and 1978-79, the department had incorrectly taken the value of immovable property at

From the income-tax assessment records of the assessee, for the assessment year 1981-82, it was noticed that the assessee had sold some of the foreign assets in the accounting year 1980-81 (ending March 1981). In the income-tax return, the assessee had furnished the face value of the foreign assets sold, their value as on 1 January 1964 and the sale price received thereof in the accounting year 1980-81, for the purposes of calculating the quantum of capital gains arising out of the sale. From the above details it was seen that the face value of the foreign assets sold was £ 36,880 and the market value thereof was £ 1,05,496, even as far back as January 1964, i.e., nearly three times more than their face value. The sale price of £ 2,03,306 obtained in the year 1980-81 was 5½ times more than the face value of the foreign assets sold by the assessee.

Even if the increase of three times in the face value of the foreign assets as on 1 January 1964, as declared by the assessee himself, is taken into account, the assets owned by the assessee were under-valued by Rs. 1,51,29,500, Rs. 1,25,84,880, Rs. 1,42,39,000 and Rs. 1,22,27,510, in the assessment years 1975-76 to 1978-79, respectively. Thus, due to lack of proper co-ordination of the assessment records pertaining to different direct taxes, by the assessing officer, there was under-charge of tax of Rs. 28,28,640.

The Ministry of Finance have accepted the mistake.

(ii) Under the Wealth-tax Rules, 1957, the market value of unquoted equity shares of company is to be computed with reference to its balance-sheet drawn up on the relevant valuation date and where there is no such balance-sheet, the balance-sheet drawn up on a date immediately preceding the valuation date and in the absence of both, the balance-sheet drawn up on a date immediately after the valuation date.

Twelve assessees held 13,070 unquoted equity shares of a private limited company. All the assessees as also the company had 31 March each year as their valuation date and accounting year. The assessing officer in the assessments of these assessees, for the asessment year 1976-77, completed in March 1981, determined the market value of these shares, as on the valuation date 31 March 1976, at Rs. 2,003.05 per share, with reference to the balance-sheet of the company as on 31 March 1976. Similarly, in the assessments of these assessees, for the assessment year 1978-79, determined the market value of these shares, as on the valuation date 31 March 1978, at Rs. 2,246 per share.

The assessees returned the value of these shares, for the assessment year 1977-78, at Rs. 833 per share, as on the valuation date 31 March 1977. The returned value of these shares was adopted by the assessing authority in the assessments completed in March 1982. There was no income-tax assessment of the company for the assessment year 1977-78, as it had changed its accounting year from 31 March 1976 ending to a later date. The market value of its shares as on 31 March 1977 (valuation date of the assessees) was not ascertainable as there was no balance-sheet on that date. In such circumstances the assessing officer has to determine the market value of the shares on the basis of the balance-sheet drawn up immediately preceding the valuation date, viz., Rs. 2,003.05 per share as on 31 March 1976. Adoption of such a low value as Rs. 833 per share was also not justified in view of the rising trend of share value indicated by the value of Rs. 2,246 per share adopted by the assessing officer, for the assessment year 1978-79.

Taking the difference in value of Rs. 1,170 per share between the value of Rs. 2,003 per share determined with reference to the balance-sheet of the company as on 31 March 1976 and the value of Rs. 833 per share adopted by the assessing authority the under-assessment of wealth, for the assessment year 1977-78, worked out to Rs. 152.92 lakhs, with consequent under-charge of tax of Rs. 5,17,841.

The Ministry of Finance have accepted the mistake.

(iii) In the cases of six assessees, three individuals and three Hindu undivided families, holding shares in a private limited company, the wealth-tax assessments, for the assessment years 1977-78 to 1981-82, were completed between March 1983 and December 1983, adopting the value at Rs. 200 per share, based on the sale value of the shares by one of the individuals to a relative in December 1977. However, the wealth-tax assessment records of another individual (assessed in the same ward), holding shares in the same company, revealed that the value of the shares, determined by the assessing authority on the basis of break-up value, as prescribed under the Wealth-tax Rules, was Rs. 329.22, Rs. 296.57, Rs. 249.60, Rs. 288.96, Rs. 325.85 and Rs. 409.38 as on the valuation dates 31 March 1976, 30 June 1977, 30 June 1978, 30 June 1980,

30 June 1981 and 30 June 1982, respectively. The omission to adopt the value determined under the wealth-tax Rules in the assessments of the six assessees, resulted in under-assessment of wealth of Rs. 41,74,500, with consequent short-levy of wealth-tax of Rs. 1,42,520.

The Ministry of Finance have accepted the mistake.

(iv) Under the Wealth-tax Rules, 1957, the break-up value of unquoted equity shares is to be worked out without taking into account, reserves by whatever name called and contingent liabilities, depicted on the liability side of the balance sheet of a company.

While computing the net wealth of four individuals, for the assessment years 1976-77 to 1980-81, between March and October 1981, the value of unquoted equity shares of a company under the break-up method was adopted at Rs. 79.64, Rs. 22.26, Rs. 255.18, Rs. 274.45 and Rs. 178.12, respectively, as returned by assessees. In arriving at the break-up value of the shares for the respective assessment years liabilities, viz., excess provision for taxes, gratuity, bonus, and advance tax paid were deducted from the value of assets alongwith other admissible items shown on the liabilities side of the balance sheet of the company for the relevant previous years. Since the provisions for taxes, gratuity, bonus, etc., were in the nature of reserves, these items were not to be taken into account in determining the break-up value of equity shares of the company. Excluding these items; the market value of each equity share would be Rs. 320.36, Rs. 361.98, Rs. 357.24, Rs. 336.72 and Rs. 207.59, for the above assessment years, respectively (as worked out by the department in the revision of the assessments on being pointed out in audit). The incorrect valuation of shares, thus resulted in under-assessment of wealth of Rs. 37,26,710, with consequent short-levy of wealth-tax of Rs. 93,714.

The Ministry of Finance have accepted the mistake.

(v) The net wealth of an individual, for the assessment year 1982-83, included value of 5,624 unquoted equity shares in a private limited company, 2,812 being bonus shares, allotted to him by the company. The value of the shares was returned as Rs. 3,93,680 at Rs. 70 per share, based on yield method. While completing the wealth-tax assessment, in February 1984, the assessing officer arrived at the value of these shares at Rs. 334 per share by the break-up value method as prescribed under the Wealth-tax Rules and added back a sum of Rs. 7,42,368, representing the difference in value of 2,812 shares at Rs. 264 per share. The difference in the value of the other 2,812 bonus shares of an equal amount was, however, omitted to be added and assessment completed. The omissions resulted in under-assessment of wealth of Rs. 7,42,368, with consequent short-levy of wealth-tax of Rs. 28,700.

The Ministry of Finance have accepted the mistake.

C. *Partner's share interest in partnership firms*

(i) Under the provisions of the Wealth-tax Act, 1957, where an assessee is a partner in a firm, the value of his interest in the net assets of the firm is to be included in his net wealth.

(a) While completing the wealth-tax assessments of three assessees, who were partners in two partnership firms, for the assessment years 1977-78 to 1983-84, on various dates between March 1982 and March 1984, their shares in reserves on account of development rebate and investment allowance (shown in the balance sheets of the firms), were not included in their net wealth. The omission resulted in short-levy of tax of Rs. 78,288.

The Ministry of Finance have accepted the mistakes.

(b) A partnership firm disclosed the under-valuation of closing stock of Rs. 26,00,000, for the assessment year 1974-75. The department, however, assessed the under-valuation at Rs. 32,00,000 in January 1982, which was accepted by the firm. Consequently, the net wealth of one of the partners in the firm, having 25 per cent share interest in the firm, should have been enhanced by Rs. 8,00,000, for the assessment year 1974-75 and the subsequent assessment years. However, the assessee in his wealth-tax returns, for the assessment years 1974-75 to 1983-84, returned his share interest of Rs. 6,50,000 (25 per cent of Rs. 26,00,000). The department, while completing the assessments of these assessment years, in March 1984, added back Rs. 6,50,000 (being 25 per cent of the original disclosed amount of Rs. 26,00,000) as returned by the assessee, for the assessment years 1974-75 and 1979-80 to 1983-84 and Rs. 7,40,000, for the assessment years 1975-76 to 1978-79. The reason advanced for the addition of Rs. 7,40,000 was that the assessee's share came down to 15 per cent from

the assessment year 1975-76 and onwards. However, the addition of Rs. 7,40,000 was calculated by taking 25 per cent of Rs. 26,00,000, and 15 per cent of Rs. 6,00,000. Further, no reasons were given by the assessing authority for adding back again only Rs. 6,50,000, for the assessment years 1979-80 to 1983-84.

Since the partner's (assessee's) share interest in the firm, on the basis of assessed under-valuation of Rs. 32,00,000 of the firm, for the assessment year 1974-75, was Rs. 8,00,000, it should have been assessed to wealth-tax, for the assessment years 1974-75 to 1983-84, irrespective of any change in assessee's share in the firm, unless the relevant amount was shown to have been spent. Incorrect valuation of assessee's share interest in the firm adopted, resulted in under-assessment of wealth of Rs. 11,40,000, with consequent short-levy of tax of Rs. 42,847.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) An assessee was the sole legal heir of the properties consisting of bank deposits, shares in partnership firm, etc., left by a deceased. As per wealth-tax returns, for the assessment years 1977-78 and 1978-79, the assessee had returned the value of these assets at Rs. 88,294 and Rs. 40,286, respectively. But while completing the wealth-tax assessments for these assessment years, the Wealth-tax Officer adopted the value of these assets at Rs. 4,51,038, on the basis of balance-sheet filed by the assessee. However, for the subsequent assessment year 1979-80, the assessee returned the value of the above assets at Rs. 33,111. The returned value was adopted by the Wealth-tax Officer in the assessment made in October 1983. The adoption of incorrect value resulted in under-assessment of wealth of Rs. 4,17,927 for the assessment year 1979-80. This together with mistake in tax calculation resulted in short-levy of tax of Rs. 36,502.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

D. *Jewellery*

In the wealth-tax assessment of a Hindu undivided family (specified), for the assessment year 1979-80, completed in March 1984, the Wealth-tax Officer estimated the value of precious stones (included in the not wealth of the assessee) on the relevant valuation date, viz., 31 March 1979, at Rs. 8 lakhs as against Rs. 1,15,302, returned by the assessee on the basis of valuation of the asset for the assessment year 1968-69. The assessee had, returned the value of the asset at Rs. 1,35,630, for the earlier assessment years 1976-77 and 1977-78 and at Rs. 1,15,302 (after sale of asset to the extent of Rs. 20,320) for the assessment year 1978-79 and the value returned was accepted by the assessing officer in the assessments made, in March 1981, March 1982 and March 1983, respectively. As the value of the asset was increasing steadily from year to year and there was no sudden spurt in price only in the previous year relevant to the assessment year 1979-80, the valuations adopted in the assessment years 1976-77 to 1978-79 was very low when compared to the one adopted in assessment year 1979-80. Even at a low estimate of the price of the asset as Rs. 4,00,000, for the assessment year 1976-77 and Rs. 5,00,000, for each of the two assessment years 1977-78 and 1978-79, the total under valuation of the asset worked out to Rs. 14,00,000, involving short-levy of tax of Rs. 60,400.

The Ministry of Finance while not accepting the objection stated (July 1985) that the assessee had gone in appeal against the enhanced valuation of precious stones adopted by the department. They further stated that the valuation of precious stones is not like valuation of immovable property and the Income-tax Officer's action, for the assessment years 1976-77 to 1978-79, was justified.

The value of precious stones returned by the assessee and accepted by the department was on the basis of valuation of these assets for the assessment year 1968-69. As the market value of gold between the years 1968 and 1979 increased steadily from year to year it is untenable to maintain that the market value of precious stones during this period did not increase and there was sudden spurt in price only in the assessment year 1979-80.

4.06 **Incorrect computation of net wealth**

(i) Under the Wealth-tax Act, 1957, the 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 him on the valuation date.

(a) A debt is a sum of money which is payable or will become payable in future by reason of a present obligation. The obligation must have accrued and must be subsisting.

The net wealth of two individuals, for the assessment years 1977-78 to 1979-80, was arrived at after allowing deduction on account of estimated

land development expenditure of Rs. 15,92,133, to be incurred which the assessee claimed as liabilities, though in fact no such expenditure as claimed was incurred by the assessee. The incorrect allowance of deduction resulted in short-levy of tax of Rs. 1,06,781.

The Ministry of Finance have accepted the mistake.

(b) An assessee was engaged in three different activities, namely a stud farm, a poultry division and horse racing in his agricultural farm and estate, during the previous year relevant to the assessment year 1979-80. In addition, the assessee was also having personal assets and liabilities. The assessee maintained separate sets of accounts and balance-sheets for each of the above business and personal assets. Some of the assets (business/personal) were eligible for exemption from wealth-tax. As per the balance-sheets the assessee owned the taxable assets of Rs. 45,67,262 and non-taxable assets of Rs. 31,20,894, with corresponding liabilities of Rs. 16,63,222 and Rs. 44,19,542, respectively. While filing the return of net wealth, for the assessment year 1979-80, the assessee aggregated (Rs. 76,88,156) the above taxable and non-taxable assets on the one hand and the liabilities (Rs. 60,82,764) on the taxable assets and non-taxable assets on the other in respect of all the activities of the assessee. The total liabilities of Rs. 60,82,764 were apportioned by the assessee in the proportion which the total taxable assets (Rs. 45,67,262) bear to the total assets (Rs. 76,88,156). On this basis the assessee thus claimed a debt of Rs. 36,14,854, out of the total liabilities of Rs. 60,82,764, which was allowed by the assessing officer while completing the assessment in March 1984.

The liabilities incurred on the security of the non-taxable assets would not be entitled to deductions as per provisions of the Act. As the liabilities in relation to taxable and non-taxable assets were shown by the assessee separately, the liabilities of Rs. 16,63,222 relating to taxable assets only were entitled to deductions. The incorrect method adopted by the department in arriving at the deductible debts resulted in under-assessment of wealth of Rs. 19,51,632, with consequent short-levy of tax of Rs. 65,997.

The Ministry of Finance have accepted the mistake.

(c) It has been judicially held (110-ITR-305-April 1977) that unless a sum of money is payable by one person to another there can be no debt at all. Accordingly, where provision is made in the accounts of a Hindu undivided family to meet the marriage expenses of the daughters of a coparcener, such provision cannot be said to be a sum of money payable by a joint family to the daughters concerned and hence cannot be deducted in computing the net wealth of the family.

A Hindu undivided family had set apart Rs. 1,50,000 as reserve for family arrangement out of its net wealth in each of the previous years relevant to the assessment years 1973-74 and 1974-75 and Rs. 1,20,000, in each of the previous year relevant to the assessment years 1975-76 to 1979-80, for the marriage of family daughters and claimed these amounts as deduction from its wealth. While completing the assessments for these assessment years, in March 1983 and March 1984, the assessing officer incorrectly allowed the aforesaid claim of the assessee, though it did not constitute debt as clarified by the above judicial decision. The incorrect allowance, thus resulted in under-assessment of wealth of Rs. 9,00,000, with consequent short-levy of tax of Rs. 34,416.

The Ministry of Finance have accepted the mistake.

(ii) The wealth-tax assessments of a Hindu undivided family, for the assessment years 1973-74 and 1974-75, were revised, in January 1984, to give effect to appellate orders. While revising the assessment orders, for the allowance of outstanding tax liabilities, the assessing officer allowed deductions of income-tax and wealth-tax liabilities amounting to Rs. 18,19,364, in the assessment year 1973-74 and Rs. 13,96,235 in the assessment year 1974-75, as claimed by the assessee. In addition, the assessing authority also allowed deductions on account of current years wealth-tax liabilities of Rs. 18,52,777, for the assessment year 1973-74 and Rs. 8,46,152, for the assessment year 1974-75. However, the outstanding liabilities of Rs. 18,19,364 and Rs. 13,96,235 as aforesaid included the current years wealth-tax liabilities of Rs. 17,02,185 and Rs. 6,73,089, for the assessment years 1973-74 and 1974-75, respectively. As the full current years wealth-tax liabilities were allowed separately as stated above, deductions of Rs. 17,02,185 and Rs. 6,73,089 included in the outstanding tax liabilities were not in order. This resulted in under-assessment of wealth of Rs. 23,75,274, with consequent short-levy of tax of Rs. 1,75,500.

The Ministry of Finance have accepted the mistake.

(iii) Liability to wealth-tax is a debt to be allowed subject to it not being disputed before appellate authorities or not remaining unpaid for more than twelve months.

In the wealth-tax assessments of an assessee, for the assessment years 1976-77 and 1977-78, revised in January 1984 and the assessment, for the assessment year 1978-79, completed in March 1983, payments towards wealth-tax demands, for earlier years amounting to Rs. 2,06,991, Rs. 2,47,672 and Rs. 2,80,226 made before the respective valuation dates were wrongly deducted as debts, resulting in under-assessment of wealth of Rs. 7,34,889, with consequent short-levy of tax of Rs. 33,390.

The Ministry of Finance have accepted the mistake in principle.

(iv) In the wealth-tax assessment of an individual, for the assessment year 1982-83, completed in March 1984, the assessing authority allowed deduction of Rs. 5,54,116 representing tax liability as claimed by the assessee. But as per details of adjusted accounts filed by the assessee in connection with the assessment years 1977-78 and 1978-79 and as recorded by the assessing authority in the assessment order (January 1983), for the assessment year 1977-78, the entire tax liability was actually adjusted in accounts and no part of the liability remained outstanding beyond the assessment year 1978-79. The assessing authority did not also allow the said liability in the subsequent assessments for the assessment years 1979-80 and onwards. The incorrect allowance of deduction thus resulted in under-assessment of wealth of Rs. 5,54,116, with consequent short-levy of tax of Rs. 26,386.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

4.07 **Incorrect exemptions and deductions**

(i) In the case of an assessee, being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country returns to India with the intention of permanently residing therein, the Wealth-tax Act, 1957, exempts moneys and assets brought by him into India and the value of assets acquired by him out of such moneys, for a period of seven successive assessment years commencing with the assessment year next following the date on which such person returns to India. This exemption was made by the Finance Act, 1976, with effect from 1 April 1977. The Central Board of Direct Taxes also clarified (January 1980) that the above exemption would not be applicable to a person who returned to India before 1 April 1976.

(a) An assessee, a citizen of Indian origin, had returned to India in July 1973, after working abroad from January 1969, with the intention of permanently residing therein. The assessee received (between October 1975 and May 1978) an amount of Rs. 6,56,820 (81,825 dollars) which was earned abroad out of employment there (between July 1969 and July 1973) after arrival in India. He filed wealth-tax returns, for the assessment years 1981-82 to 1983-84, in December 1983 and claimed exemption in respect of investments which were made out of moneys brought by the assessee after his return to India, viz., Rs. 6,56,820. The exemption was allowed by the assessing authority treating the assessment year 1981-82 as the seventh succeeding assessment year reckoning from the assessment year 1974-75 (seventh succeeding assessment year from the assessment year 1974-75 was 1980-81 and not 1981-82).

As the assessee returned to India in July 1973, i.e., before 1 April 1976, the exemption was not available to him. Further, the assessee had not filed the wealth-tax returns for the assessment years 1974-75 to 1980-81, in respect of which he was liable to tax due to inapplicability of exemption. No action was also taken by the assessing officer to call for the returns for the assessment years 1974-75 to 1980-81. The above mistakes resulted in non-levy of wealth-tax of Rs. 39,249.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) While completing the wealth-tax assessments of three individuals, for the assessment years 1977-78 to 1981-82, between November 1977 and January 1982, the assessing authority allowed exemptions of Rs. 15,08,542 and $ 53,000 in respect of moneys brought by them from foreign countries and kept in deposits in India. The individuals were permanently settled in India and were either pensioners or persons who had rendered long service in India and had returned to India after having served abroad temporarily for some years. Thus, there was no question of their returning to India with the intention of permanently residing in India and the exemption allowed was not in order. This resulted in short-levy of tax of Rs. 26,154.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the Wealth-tax Act, 1957, where the net wealth of the assessee being a citizen of India, includes foreign assets, the assessee will be entitled to a rebate of wealth-tax calculated at 50 per cent of the prescribed rates, in the proportion of the foreign wealth to the total wealth.

A Hindu undivided family, had, according to the wealth-tax assessments, for the assessment years 1977-78 and 1978-79, completed in January 1982 and January 1983, foreign wealth of Rs. 61,92,996 and Rs. 57,44,615, respectively. The net wealth in India for these two assessment years was minus figures *viz.*, (—) Rs. 7,31,273 and (—) Rs. 9,85,426, respectively, as the debt in India exceeded the value of assets. The net wealth of Rs. 54,61,723 and Rs. 47,59,189 thus charged to tax for these two assessment years was only foreign wealth and there was no Indian wealth. The rebate of wealth-tax allowable could not, therefore, exceed 50 per cent of the chargeable wealth-tax calculated on the net wealth of Rs. 54,61,723 and Rs. 47,59,189, respectively. However, the rebate of wealth-tax allowable worked out to Rs. 87,180 and Rs. 75,100 on the net wealth chargeable to tax of Rs. 54,61,723 and Rs. 47,59,189, respectively, instead of Rs. 99,080 and Rs. 90,970, which was incorrectly calculated by the department on the total foreign wealth of Rs. 61,92,996 and Rs. 57,44,615, respectively, for the above two assessment years. This resulted in under-charge of tax of Rs. 26,838.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

4.08 **Mistakes in application of rates of tax/avoidable mistakes**

A. *Mistakes in application of rates of tax*

(i) From the assessment year 1974-75, the Schedule to the Wealth-tax Act, 1957, was amended to provide for a higher rate of tax for every Hindu undivided family (specified category) having at least one member with assessable net wealth exceeding rupees one lakh upto the assessment year 1979-80 and rupees one lakh and fifty thousands from the assessment year 1980-81 and subsequent years. Other cases of Hindu undivided family attract tax at lower rates.

In the assessments of ten such Hindu undivided families, assessed in seven wards, tax was found to have been levied at lower rates instead of at the higher rates prescribed for the specified category of Hindu undivided family, for the assessment years 1974-75 to 1983-84, completed between May 1979 and January 1984. The mistake resulted in aggregate short-levy of tax of Rs. 2,09,216.

The Ministry of Finance have accepted the mistake in all the ten cases.

(ii) The Schedule to the Wealth-tax Act, 1957, was amended by the Finance (No. 2) Act, 1977 and the rates of wealth-tax relevant to the assessment year 1977-78 were increased.

The net wealth of an individual, for the assessment year 1977-78, was revised in March 1984, at Rs. 54,11,416. While calculating the tax, the assessing officer incorrectly applied the lower rates of tax applicable to assessment year earlier to 1977-78 instead of the increased rate as amended by the Finance (No. 2) Act, 1977. The correct wealth-tax on the assessed net wealth worked out to Rs. 1,61,615 as against Rs. 1,17,785, levied by the department. This resulted in short-levy of tax of Rs. 43,830.

The Ministry of Finance have accepted the mistake.

B. *Avoidable mistakes*

In computing the net wealth of an assessee, for the assessment year 1978-79, in March 1983, his share (Rs.14,71,113) of wealth (in the form of jewellery) in the trust, was incorrectly taken at 15|70 as returned by the assessee instead of the correct share (Rs. 22,56,863) at 23|70 as adopted in previous assessment year 1977-78. The incorrect share adopted resulted in under-assessment of wealth of Rs. 7,85,750, with consequent short-levy of tax of Rs. 26,578.

The Ministry of Finance have accepted the mistake.

4.09 **Non-levy of additional wealth-tax**

Under the Wealth-tax Act, 1957, before its amendment by the Finance Act, 1976, where the net wealth of an individual or a Hindu undivided family included buildings or lands (other than business premises) or any rights therein, situated in an urban area additional wealth-tax was leviable on the value of such urban assets exceeding the prescribed limits.

The net wealth of five individuals and four Hindu undivided families, for the assessment years 1965-66 to 1976-77, assessed between July 1983 and March 1984, *inter alia,* included urban immovable properties valued at Rs. 188.47 lakhs on which additional wealth-tax was not levied by the department. This

resulted in under-charge of tax of Rs. 3,25,955 in these cases.

The Ministry of Finance have accepted the under-charge of tax in six cases involving revenue of Rs. 2,27,287; their reply to the remaining three cases is awaited (January 1986).

4.10 **Non-levy/short-levy of penalty**

(i) Under the Wealth-tax Act, 1957, penalty is leviable where the assessing officer is satisfied that an assessee has, without reasonable cause, failed to furnish the wealth-tax return within the prescribed time. Upto 31 March 1976, the penalty leviable was a sum, equal to one-half per cent of the net wealth assessed for every month, during which the default continued, as reduced by the amount of initial exemption but subject to a maximum of an amount equal to one hundered per cent of net wealth assessed. The Act was amended with effect from 1 April 1976, to provide that the penalty should be equal to two per cent of the assessed tax for every month during which the default continued. As regards cases where the default took place prior to the amendment and continued after the amendment, the Central Board of Direct Taxes issued instructions (February 1977) that such default being a continuous one, the penalty should be imposed for every month during which the default continued by applying the unamended provisions for the period prior to 1 April 1976 and the amended provisions thereafter. However, in April 1981, the Supreme Court held that—

(a) the default was not continuous but was a single default committed on the last date on which the return had to be filed, and

(b) the penalty should be imposed in accordance with the law in force on the date of default.

In view of the judgment, the aforesaid instructions of February 1977 were withdrawn by the Board in October 1981.

Two individuals, assessed in the same ward, filed their returns of net wealth, for the assessment year 1975-76, in March 1979 and January 1979 revised return in March 1979, respectively, much later than the due date (30 June 1975). The periods of delay in filing the returns were 44 months and 42 months, respectively. The assessing officer levied penalty of Rs. 10,465 and Rs. 14,058, in December 1981 and March 1982, respectively, for delay in filing the returns. The penalty of Rs. 10,465 levied in one case was incorrectly computed by reference to the assessed net wealth for the period from the due date of filing of return to 31 March 1976, under the law then in force and by reference to the assessed tax from 1 April 1976 to the date of filing the return. The penalty of Rs. 14,058 levied in another case was incorrectly computed by reference to the assessed tax from 1 April 1976 to the date of filing the return.

On the basis of the principle laid down by the Supreme Court in its decision of April 1981, the total penalty leviable in both the cases would work out to Rs. 77,385. The mistakes thus, resulted in short-levy of penalty of Rs. 52,862.

The Ministry of Finance have accepted the mistake.

(ii) The Wealth-tax Act, 1957, provides that where any tax is payable on the basis of any return, after taking into account the amount of tax, if any, already paid, the assessee shall be liable to pay such a tax before furnishing the return and the return shall be accompanied by proof of payment of such tax. If any assessee fails to pay the tax or any part thereof, the assessing authority may impose a penalty calculated at the rate of two per cent of such tax remaining unpaid for every month during which the default continued. The Central Board of Direct Taxes clarified, in March 1974, that in cases where penal action is not initiated the assessing officers should properly record the reasons in the order sheet or append a note to the assessment order giving reasons thereof.

A Karta of a specified Hindu undivided family filed his return of net wealth at Rs. 7,50,300, for the assessment year 1976-77, in October 1976. No wealth-tax calculated on the basis of returned wealth was paid by the assessee before filing the return. The assessee was required to pay wealth-tax of Rs. 25,012 on his returned wealth. The non-payment of tax attracted levy of penalty under the provisions of the Act.

While completing the assessment in March 1981, the assessing officer neither levied the penalty for non-payment of tax before filing the return nor record specific reasons for not levying the penalty.

The Ministry of Finance have accepted the mistake and stated (August 1985) that additional demand of Rs. 26,020 has been raised.

4.11 **Miscellaneous**

(i) *Erroneous rectification of mistake*

Under the Wealth-tax Act, 1957, the Wealth-tax Officer may amend an order of assessment with a view to rectifying any mistake apparent from the record,

within four years from the date of order sought to be amended.

The wealth-tax assessments of an assessee, for the assessment years 1971-72 to 1976-77, were completed in April 1977. The assessee did not claim any wealth-tax|income-tax liabilities in the returns. The income-tax liability claimed for the assessment year 1976-77 was rejected by the department for want of evidence. The assessee, however, filed an application in December 1983, claiming income-tax and wealth-tax liabilities of Rs. 18,00,716 as outstanding on the valuation dates relevant to the said assessment years. The Wealth-tax Officer rectified the assessments in March 1984 and granted refund of Rs. 2,38,028. The time-limit for passing rectificatory order had, however, expired in April 1981. The order passed in March 1984 was, therefore, time-barred.

Further, the current year's wealth-tax liability for each year was, however, allowed in the assessment order of April 1977 and the tax was levied after deduction of such liability. There was, therefore, no mistake apparent from record. The refund of Rs. 2,38,028 granted was thus erroneous.

The Ministry of Finance have accepted the mistake.

(ii) *Excess refund*

The wealth-tax assessments of an assessee, for the assessment years 1973-74 and 1974-75, were originally completed in March 1974. These assessments were set aside in appeal, in December 1980. In pursuance to the appellate orders, the assessing officer authorised a refund of Rs. 1,18,725, in February 1982, for both the assessment years without making any fresh assessments. While working out the said refund, payments of tax of Rs. 64,527, made in September/October 1979, were taken into account. However, while completing the set aside assessments, in March 1984, the department incorrectly again allowed the credit of Rs. 64,527, in working out the net demand, though the credits had already been given while working out the refund of Rs. 1,18,725, in February 1982. The double credit allowed, thus, resulted in under-charge of tax of Rs. 64,527.

The Ministry of Finance have accepted the facts of the case.

(iii) *Non-levy of interest*

Under the Wealth-tax Act, 1957, an assessee is deemed to be in default if the amount specified in the notice of demand is not paid within thirty-five days of its service and, for the period of default the assessee is liable to pay simple interest at twelve per cent per annum. According to executive instructions issued in April 1982 the interest payable would be with reference to the due date reckoned from the original demand notice and with reference to the tax finally determined in a revision, if any, upto the date of issue of a certificate to the Tax Recovery Officer.

(a) The wealth-tax assessments of an individual for the assessment years 1971-72 to 1974-75, were completed on 24 March 1979 and demand of Rs. 2,27,908, was raised on the same day. Demand notice was served on the assessee on 31 March 1979. The assessee appealed to the Appellate Assistant Commissioner on the valuation adopted by the assessing authority for a house property. Value of the house property of Rs. 8,06,000, for each of the assessment years 1971-72 to 1973-74 and Rs. 6,40,000, for the assessment year 1974-75, was returned by the assessee. Against the returned value of the house property, the assessing authority assessed the value of Rs 12,67,000, for each of the assessment years 1971-72 to 1973-74 and Rs. 11,41,000, for the assessment year 1974-75.

The Appellate Assistant Commissioner directed, in November 1980, that the value of the house property as returned by the assessee, for the assessment years 1971-72 to 1974-75, should be adopted. The Appellate Tribunal also upheld (April 1982) the orders of the Appellate Assistant Commissioner. The original assessment, completed in March 1979, were revised in January 1983, to give effect to the Appellate Tribunal's order of April 1982 and the total demand payable was determined at Rs. 74,433. The assessee paid a sum of Rs. 25,000, on various dates between December 1982 and November 1984. Interest for the delay in payment of the demand for the period from May 1979, as provided under the Act, was however, not charged. The interest payable by the assessee upto the end of March 1984 worked out to Rs. 41,678.

The Ministry of Finance have accepted the mistake.

(b) The wealth-tax assessments of a Hindu undivided family and an individual, for the assessment years 1976-77 to 1981-82, were completed between March 1980 and December 1982. Notices of demand to pay the tax of Rs. 2,26,377 were served on the assessee on various dates between April 1980 and December 1982. Demands of tax of Rs. 1,93,375 were paid by the assessees on various dates between April 1981 and January 1984, after the prescribed period of payments, leaving a balance demand of Rs. 33,002 unpaid by the Hindu undivided family as on 31 March 1984.

For the delay in payments the assessees were liable to pay interest of Rs. 43,553, which was, however, not levied by the department.

The Ministry of Finance have accepted the mistake in both the cases.

(iv) *Adoption of incorrect status*

(a) Under the Wealth-tax Act, 1957, wealth-tax payable by an individual, who is "not a citizen of India" and who is "not resident in India", in respect of any assessment year, computed in accordance with the rates specified in the Schedule, shall be reduced by an amount equal to 50 per cent thereof.

The wealth-tax assessments of an individual, for the assessment years 1979-80 to 1981-82, were completed, in November 1983 and tax was charged at the concessional rate of 50 per cent, treating the individual as "non-Indian citizen" and "non-resident". However, though as per the wealth-tax returns filed by the assessee for the above three assessmet years the individual was "not a citizen of India", her residential status was indicated as "not ordinarily resident in India." Therefore, the concessional rate of tax was not applicable in this case. This resulted in short-levy of wealth-tax of Rs. 39,967.

The Ministry of Finance have accepted the mistake.

(b) Under the Wealth-tax Act, 1957, the amount standing to the credit of an Hindu undivided family (unlike an individual) in any provident fund set up by the Central Government and notified by it in this behalf in the official gazette, is not exempt. It has been judicially (148 ITR 440) held (March 1983) that the marital bond between the husband and wife continued and was not snapped in spite of the maintenance share given to his wife. Therefore, the husband and wife were assessable as Hindu undivided family in respect of the family's property received by the assessee on partition.

An assessee partitioned the assets of his Hindu undivided family between himself and his son, after giving a share to his wife for her maintenance. For the assessment years 1977-78 to 1979-80, the assessee filed his wealth-tax returns in the status of Hindu undivided family. While completing the assessments, for these assessment years, in March 1984, the Wealth-tax Officer adopted his status as 'Individual' on the ground that the family stood disrupted on account of partition effected among its members and allotment of a share to his wife also.

As in this case the marital bond between the husband and wife continued and was not snapped, the correct status of the assessee would be Hindu undivided family. By treating the assessee as an individual instead of Hindu undivided family (in view of above judicai decision) balances of Rs. 1,39,300, Rs. 1,67,646 and Rs. 1,93,300, standing to the credit of the assessee, in the public provident fund, in the respective three assessment years, were exempted from wealth-tax. Further, though the assessee's wife had taxable wealth, for the assessment year 1978-79, the department applied lower rates of tax applicable to individual instead of the higher rates of tax applicable to the H.U.F. (specified).

The incorrect status adopted thus, resulted in under-assessment of wealth of Rs. 5,00,246, with consequent short-levy of tax of Rs. 27,671.

The Ministry of Finance have accepted the mistake.

(v) *Non-completion of assessments within time limit*

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

An individual filed his wealth-tax returns, for the assessment years 1966-67 to 1974-75, in October 1974, declaring his net wealth as between Rs. 4,77,780 and Rs. 5,17,540 during these years. The assessments for these assessment years were not, however, completed till October 1981 (date of audit). As the assessments were not completed before the expiry of the statutory limitation period, on 31 March 1979, wealth aggregating to Rs. 44,28,920 escaped assessment, resulting in loss of revenue of Rs. 28,946.

The Ministry of Finance have accepted the mistake in principle.

B—GIFT TAX

4.12 Gift-tax is levied on the aggregate value of all gifts made by a person during the relevant previous year. All transfers of property which are made without adequate consideration in money or money's worth are also liable to tax unless specially exempted by the Gift-tax Act, 1958. The term 'property' for the purpose of the Act connotes not only tangible movable and immovable property including agricultural land but also other valuable rights and interests.

4.13 In the financial years 1980-81 to 1984-85 gift-tax receipts vis-a-vis the budget estimates were as given below :—

Year	Budget Estimates	Actuals
	(In crores of rupees)	
1980-81	6.25	6.51
1981-82	6.25	7.74
1982-83	6.75	7.71
1983-84	8.50	8.84
1984-85	8.50	10.86

4.14 Particulars of cases finalised, pending assessment and arrears of demand are given below :

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of	Arrears of demand pending collection at the end of
		(In crores of rupees)	
1980-81	60,562	38,226	29. 52
1981-82	68,964	53,100	31.16
1982-83	74,163£	47,741£	21.90£
1983-84	82,450**	43,870**	27.21
1984-85	83,577	38,185	26.62

£Figures furnished by Ministry of Finance in March/April 1984 have been adopted.

**Figures furnished by Ministry of Finance in March 1985 have been adopted.

4.15 During the test audit of assessments made under the Gift-tax Act, 1958, conducted during the period 1 April 1984 to 31 March 1985, following types of mistakes were noticed :

(i) Gifts escaping assessment.

(ii) Non-levy of tax on deemed gifts.

(iii) Incorrect valuation of gifted properties and mistakes in computation of gifts.

(iv) Omission to aggregate gifts for purpose of calculation of tax.

(v) Miscellaneous.

A few important cases illustrating these mistakes are given in the following paragraphs :

4.16 **Gifts escaping assessment**

Under the Gift-tax Act, 1958, gift is a transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth. Further, under the Act *ibid* the term 'transfer of property' has been defined to mean any disposition, conveyance, assignment, settlement, delivery, payment or other alienation of property and includes, *inter alia*, the creation of a trust in a property.

An individual left India for foreign country, in February 1976, on employment, availing himself of leave without allowances for five years at home and finally returned to India in May 1979. While he was abroad and after his return, he made fixed deposits of Rs. 3,04,000 in the name of his wife (out of his earnings abroad), during the period September 1977 to November 1979. The income-tax assessment records of the individual, for the assessment year 1980-81, disclosed that the legal title to the money covered by the fixed deposits passed to the individual's wife as soon as the deposits were made in her name and as such the deposits had to be treated as gifts during the assessment years 1978-79 to 1980-81 and were chargeable to gift-tax. Neither the assessee filed any gift-tax return nor did the department initiate any gift-tax proceedings. The omission resulted is non-levy of gift-tax of Rs. 41,250.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

4.17 **Non-levy of tax on deemed gifts**

Under the Gift-tax Act, 1958, where property is transferred otherwise than for adequate consideration, the amount by which the market value of the property at the date of the transfer exceeds the value of the consideration, shall be deemed to be a gift made by the transferor and is chargeable to gift-tax. The Act further provides that the value of the property shall be estimated to be the price which it would fetch if sold in the open market on the date on which the gift was made.

(i) A trust was created by a deed of settlement drawn up on 2 May 1945. Subsequently, a supplementary deed was executed on 2 August 1945. As laid down in the trust deed, the trustees (assessee) had sold the property mentioned therein to an individual in February 1973, for a consideration of Rs. 8 lakhs.

For the purpose of gift-tax assessment adequacy of the consideration had to be judged, with reference to the market value of the property. The market value of the property which was sold (February 1973) by the assessee was valued (March 1981) at Rs. 76 lakhs by the departmental valuer in connec-

tion with the wealth-tax assessment of the trust for the period ending 31 March 1973. The same value was adopted by the department in the accounting year 1973-74 relevant to the assessment year 1974-75. As the property was transferred for inadequate consideration, the difference between the market value of the property on the date of transfer and the actual sale consideration received, *i.e.* Rs. 68 lakhs, should have been treated as deemed gift and gift-tax levied. Failure to do so resulted in non-levy of gift-tax of Rs. 43,16,355.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The partnership deeds of two partnership firms disclosed that five partners had transferred 56,000 shares in two limited companies held as stock-in-trade by them to the two firms on 8 May 1979 and 18 March 1981 as capital at their book value of Rs. 19.65 and Rs. 575 per share. However, the market value of these shares on the relevant dates of transfer, as per closing quotations of the shares of the above companies in the Bombay Stock Exchange, was Rs. 96 and Rs. 605 per share, respectively. The difference between the market value on the date of transfer and the value at which the shares were held as stock-in-trade on that date was not, however, treated deemed gift attracting gift-tax. The omission resulted in escapment of gift of Rs. 37,35,750, with consequent non-levy of gift-tax of Rs. 10,26,805, in the hands of the five partners, for the assessment years 1980-81 and 1981-82.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) A company purchased (February 1979) 6,000 shares of another company, a sister concern of the assessee, at Rs. 100 per share. The department did not ascertain the market value of the shares on the date of purchase. However. the income-tax assessment records of the assessee company revealed that due to accumulation of losses, the value of shares of the sister concern was almost 'nil', on the date the shares were purchased by the assessee company. Thus, the amount of Rs. 6,00,000 paid by the assessee company to its sister concern was without adequate consideration and constituted deemed gift in the hands of the assessee company, which escaped assessment, resulting in short-levy of gift-tax of Rs. 1,36,500.

The Ministry of Finance have accepted the mistake.

(iv) During the previous years relevant to the assessment years 1978-79 to 1980-81, an individual and three Hindu undivided families sold 5,872 shares held by them in a private limited company at Rs. 200 per share. In the case of another individual assessee assessed in the same ward, however, the value of shares held by him in the same company was adopted at Rs. 249.60 and Rs. 288.96 per share as on 30 June 1978 and 30 June 1980, respectively, for the purposes of wealth-tax assessments. This value was based on the book value of the assets with a deduction of fifteen per cent for non-declaration of dividends as contemplated under the Wealth-tax Rules, 1957.

In the absence of the market values of the assets, even if the value adopted for the wealth-tax purposes, disallowing the deduction of 15 per cent, had been adopted, the value of each share would work out to Rs. 293.64 as on 30 June 1978 and Rs. 339.95 as on 30 June 1980. The difference between the values as above and the sale consideration of Rs. 200 per share would amount to deemed gift, for the assessment years 1978-79 to 1980-81. The total amount of deemed gift would work to Rs. 6,43,280 and consequent non-levy of gift-tax of Rs. 1,18,750.

The Ministry of Finance have accepted the mistake.

(v) The income-tax assessment records of an assessee showed that he sold 340 shares of a private limited company, on 11 August 1977, for a declared consideration of Rs. 250 per share which was accepted by the department for levy of capital gains tax for the assessment year 1978-79. The assessee had gifted 160 shares of the same company on 6 August 1977 to his grand-daughter. While completing the gift-tax assessment, for the assessment year 1978-79, in February 1983, the department adopted the value of these gifted shares at Rs. 1,979 per share as per the break-up value method. Since the shares were sold at a declared consideration less than the value of shares adopted in the gift-tax assessment, *i.e.*, fair market value, the difference of Rs. 1,729 per share of 340 shares sold constituted deemed gift. No gift-tax proceedings were, however, initiated by the department. The omission resulted in escapement of taxable gift of Rs. 5,87,860, with consequent short-levy of tax of Rs. 71,965

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(vi) The wealth-tax assessment records of an individual disclosed that, in April 1977, *i.e.*, during the previous year relevant to the assessment year

1978-79, he transferred land and building which was let out and a vacant plot of land (valued Rs. 63,500) to a firm on consideration of which his capital account in the firm was credited by Rs. 1,25,000. The market value of the let out land and building on the date of transfer to the firm, would work out to Rs. 4,26,210, under the 'income capitalisation method'. Thus, the total market value of the above immovable properties was Rs. 4,89,710. The difference of Rs. 3,64,710 between the fair market value and the declared consideration for which it was transferred constituted deemed gift attracting gift-tax of Rs. 71,427, which was not levied by the department.

The Ministry of Finance have contended (December 1985) that the consideration for the transfer of an asset by a partner to a partnership firm cannot be evaluated at the time of formation of partnership. This position is, however, not maintainable in terms of law on the subject.

(vii) An assessee company sold in January 1976, an immovable property consisting of land, bungalow and garden to an individual, for a consideration of Rs. 2,00,000. In response to a reference made by the Inspecting Assistant Commissioner of Income-tax (Acquisition), the Departmental Valuation Officer valued (September 1976) the property as on the date of sale at Rs. 7,04,000, which included Rs. 2,45,349 being the value of improvements stated to have been made by the buyer between the date of agreement to sell (November 1973) and the actual date of sale (January 1976). The fair market value of the property, after taking into account the improvements made by the buyer himself, would be Rs. 4,58,651, on the date of sale. The difference between the sale price (Rs. 2,00,000) and the market value (Rs. 4,58,651) constituted deemed gift, attracting gift-tax of Rs. 45,000. However, the department had not initiated any gift-tax proceedings.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(viii) A firm, consisting of a mother and three daughters, was dissolved and reconstituted on 6 March 1980, with the retirement of one daughter and induction of husband and wife as partners. The daughter who retired took away one-third share of the land and buildings of the firm and the new partners brought with them a capital of Rs. 11.51 lakhs into the firm.

The reconstituted firm was dissolved on 19 May 1980 (after about two months of formation) and the entire business was taken over by the husband and wife, who were the ex-partners. Under the terms of the deed the other partners (mother and two daughters) were given Rs. 40,000 each as their share, while the husband and wife took over the immovable properties as well as a liability of Rs. 2.31 lakhs of the firm.

The Wealth-tax Officer, on 31 March 1981, valued the immovable properties at Rs. 17.20 lakhs, in the hands of the husband and wife as co-owners on 'rent capitalisation method'. Since the property fetched the same rent from December 1977, applying the same base, the value of the properties would be not less than Rs. 17.20 lakhs in May 1980.

Thus, the immovable properties valued at Rs. 17.20 lakhs were transferred for a consideration of Rs. 13.82 lakhs (capital brought in Rs. 11.51 lakhs plus liabilities taken over Rs. 2.31 lakhs) and accordingly the difference of Rs. 3.38 lakhs constituted deemed gift and was liable to gift-tax of Rs. 40,800.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ix) An individual converted his hotel business, run by him, into partnership firm with his two sons as partners. The shares of the sons in the firm were 30 per cent each and the assessee's share was 40 per cent. Entire assets and liabilities of the hotel, carried on by him, as on 31 March 1974, were thrown into the partnership firm. In computing the value of the assets over liabilities, the value of the building housing the hotel was taken at Rs. 5,98,635. Out of this net amount ascertained, Rs. 14,000 were taken as capital contribution by the assessee and the balance standing to the credit of the assessee was treated as a loan by him to the firm.

In the wealth-tax assessment of the assessee, for the assessment year 1974-75, the value of the above hotel building, as on 31 March 1974, was taken at Rs. 9,78,000. The building was thus under-valued by Rs. 3,79,365, at the time of conversion of hotel business into partnership firm as on 31 March 1974.

Leaving 40 per cent being the assessee's share, the transfer of the balance of 60 per cent of Rs. 3,79,365 (Rs. 9,78,000 minus Rs. 5,98,635) was without consideration and liable to gift-tax. However, neither the assessee filed gift-tax return nor did the department initiate gift-tax proceedings. This resulted in non-levy of gift-tax of Rs. 37,155 on the deemed gift of Rs. 2,27,620.

The Ministry of Finance have contended (December 1985) that the consideration for the transfer of an asset by a partner to a partnership firm can not be evaluated at the time of formation of partnership. This position is, however, not maintainable in terms of law on the subject.

(x) An assessee held 50 per cent and 25 per cent shares in two tea estates. The wealth-tax assessment of the assessee, for the assessment year 1979-80, completed in January 1980, *inter-alia,* included the values of the above shares, which were determined at Rs. 3,00,000 and Rs. 1,98,561, respectively. The assessee sold these shares to the sister concerns (two tea companies), in February 1980, at Rs. 1,20,000 and Rs. 1,60,000, respectively. Since the property was transferred at a declared consideration less than the value determined in the wealth-tax assessments in January 1980, the difference of Rs. 2,18,561 (Rs. 3,00,000 —Rs. 1,20,000 and Rs. 1,98,561—Rs. 1,60,000) was a deemed gift under the Gift-tax Act. No gift-tax proceedings were, however, initiated by the department. The omission resulted in escapement of taxable gift of Rs. 2,18,561, with consequent non-levy of gift-tax of Rs. 34,890.

The comments of Ministry of Finance on paragraph are awaited (January 1986).

(xi) Under the Gift-tax Act, 1958, the value of transactions such as release, discharge, surrender, forfeiture or abandonment of any debt, contract, an actionable claim or of any interest in property, if not bonafide, are deemed gift. 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 retirement of some of the partners or on admission of new partners or on conversion of a sole proprietorship into a partnership and the profit-sharing ratios of the partners are revised any interest surrendered or relinquished by one or more of such persons in favour of others (without adequate consideration in money or money's worth) would attract levy of gift-tax.

(a) A partnership firm had eight partners, having equal share in the profit and loss of the firm. Out of the eight partners, five partners retired from partnership from 1 March 1979. As per the Deed of Retirement executed in June 1979, the retired partners got back their capital balances as on 28 February 1979 and abandoned their claims to all assets of the firm including land and buildings in favour of the remaining three partners. The market value of the land and buildings, on the basis of the valuation adopted in the wealth-tax assessment of the partners, for the assessment years 1975-76 to 1979-80, worked out to Rs. 40,68,625, as on 1 March 1979. The excess of Rs. 39,51,691 on revaluation of the land and buildings, over the book value of Rs. 1,16,934, was required to be allocated amongst all the eight partners. The same not being allocated to the retiring partners, the share-interest in the firm was undervalued to the extent of Rs. 24,69,805 (5|8th of Rs. 39,51,691) and thus surrendered in favour of the continuing partners. The amount of Rs. 24,69,805 thus surrendered constituted deemed gift attracting levy of gift-tax. Neither the assessees filed any return of gift-tax nor did the department call for the same. The omission resulted in an aggregate non-levy of gift-tax of Rs. 5,18,700.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) The wealth-tax assessment records of an individual revealed that a proprietory business, including a hotel building owned by him was converted into a partnership firm in the previous year relevant to the assessment year 1976-77. The assessee retained one-third share in the new partnership firm, the remaining two-third having been given equally to his two sons. The departmental valuer estimated the market value of the property (hotel building) at Rs. 7,90,800 as on 31 March 1975. The newly constituted firm credited the capital account of the assessee with a sum of Rs. 2,31,112, being one-third share in the value of the property. Since the assessee had vested the said property in himself and his two sons without adequate consideration, he was liable to gift-tax on the deemed gift of property to the extent of Rs. 5,27,000, being two-third of property's value. The department did not, however, initiate any gift-tax proceeding. The omission resulted in escapement of gift of Rs. 5,27,000, with consequent non-levy of gift-tax of Rs. 1,13,160.

While not accepting the mistake, the Ministry of Finance have stated (August 1985) that the Wealth-tax Officer had already given an office note regarding gift-tax liability on the wealth-tax assessment order dated 13 June 1978. However, gift-tax proceedings were initiated only after the omission was pointed out in audit in August 1980.

(c) Certain immovable properties (three buildings and a vacant land), were owned by a firm consisting of a mother (10 per cent share) and her three daughters (30 per cent share each) as partners. On 6

March 1980, one of the daughters retired and she took away one-third share of the land and buildings. The mother-partner, though entitled to 10 per cent share, was not allocated any share in the value of the property. The balance-sheet drawn up, as on 6 March 1980, disclosed that the balance two-third of the property was valued at Rs. 13.50 lakhs and the amount credited to the accounts of the two daughters-partners. The relinquishment of the mother-partner in favour of the two daughters constituted a gift.

The Wealth-tax Officer had adopted the value of the two-third share of the immovable properties on 'rent capitalisation method', as on 31 March 1981, at Rs. 17.20 lakhs and as there was no change in rentals of the properties from December 1977 and if the same basis of valuation was adopted the value of the whole properties would be Rs. 25.80 lakhs as on 6 March 1980. Accordingly, the mother-partner's share of 10 per cent foregone would be Rs. 2.58 lakhs attracting gift-tax of Rs. 44,750

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(d) A firm was re-constituted during the previous year relevant to the assessment year 1977-78. Two out-going partners one major and other minor had surrendered their entire 54 per cent share interest and the three other continuing partners gave up two per cent each of their respective share interest in favour of other partners. As a consequence the existing partners concerned, who had given up their two per cent shares in favour of the other partners, had not received any consideration for surrendering their shares. Likewise the retiring partners have partly foregone the value of their share interest in the firm in favour of the continuing partners of the firm by receiving only their capital contribution, i.e., inadequate consideration. The value of share interest thus surrendered by the five partners, attracted levy of gift-tax. Neither the assessees filed any return of gift nor did the department call for the same.

On this under-assessment being pointed out in audit (April 1982), the department stated (November 1983) that gift-tax assessments in respect of four partners have been completed (October 1983) and additional demand of Rs. 30,244 raised.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

4.18 **Incorrect valuation of gifted properties and mistakes in computation of gifts**

(i) Under the gift-tax Act, 1958, the value of any property, other than cash, transferred by way of gift shall be the price which it would fetch if sold in the open market on the date on which the gift was made. Gifts made by any person to any institution established for a charitable purpose are exempt from gift-tax if donations made to such institution qualify for deduction under the Income-tax Act, 1961.

(a) An assessee gifted 1,662 and 400 unquoted equity shares of two public limited companies to three charitable institutions on 31 March 1982, relevant to the assessment year 1982-83. However, one of the above institution had not obtained the certificate of exemption from the Commissioner of Income-tax and the donation thus made did not qualify for deduction under the Income-tax Act, 1961 and was liable to gift-tax.

Further, the value of the shares was returned by the assessee at their face value of Rs. 100 per share instead of at their market value. The value of shares as returned by the assessee was accepted by the Gift-tax Officer in the assessment made in December 1983.

In the wealth-tax return, for the assessment year 1981-82, the assessee had shown the value of these shares of the above two companies at Rs. 279.92 and Rs. 154.32 per share, respectively. Even if the value of the shares as adopted for wealth-tax assessment was taken as the market value on the date of gift, in the absence of market value particulars, the under-assessment of gift would work out to Rs. 3,20,755.

The above mistake resulted in aggregate short-levy of gift-tax of Rs. 73,895.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(b) In August 1981 (relevant to the assessment year 1982-83), an assessee gifted a house property owned by her in a metropolitan city. The department while completing the gift-tax assessment, in June 1983, adopted the value of the gifted house property at Rs. 2,25,000, as mentioned in the deed of gift. But the value of the said property was determined at Rs. 3,20,000, in July 1976, by the Appellate Assistant Commissioner, for the assessment year 1973-74 and the same value was adopted in the assessee's wealth-tax assessments upto the assessment

year 1981-82. The wealth-tax assessment for the assessment year 1981-82 was completed in May 1983. The omission to adopt the value of Rs. 3,20,000, resulted in under-assessment of gift of Rs. 95,000, with consequent short-levy of tax of Rs. 23,750, for the assessment year 1982-83.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) The provisions of the Gift-tax Act, 1958, are pari-materia with those of Estate Duty Act, 1953, in regard to the valuation of unquoted equity shares. Thus, the instructions issued by the Central Board of Direct Taxes under the Estate Duty Act for valuation of shares, are equally applicable to cases under the Gift-tax Act. Under the Estate Duty Act the Board has issued instructions in May and July 1965 that the value of unquoted equity shares should be determined on the basis of market value and not the book value of assets of the company. The Board reiterated their instructions of May and July 1965 in October 1974 and May 1975.

The provisions relating to the valuation of shares under the Wealth-tax Act, 1957 and the Rules made thereunder are not applicable to valuation under the Gift-tax Act.

An assessee gifted 35,000 equity shares of a private limited company to another private limited company in the previous year relevant to the assessment year 1979-80. The assessee had worked out the value of the above shares at Rs. 15.34 per share. The computation of the value of the shares made in June 1978 revealed that for arriving at the break-up value of Rs. 15.34 per share a deduction of 15 per cent had been claimed by the assessee. The department had also accepted the discounted value of Rs. 15.34 per share for assessment purposes. However, the value of each share before the above deduction worked out to Rs. 18.05 per share.

The discounted value of Rs. 15.34 per share was worked out on the basis of Wealth-tax Rules, 1957. As the Wealth-tax Rules are not applicable for gift-tax purposes, the deduction of 15 per cent resulted in incorrect adoption of the value of shares of Rs. 94,850, with consequent short-levy of gift-tax of Rs. 28,455.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) In the case of an assessee, the gift-tax assessment, for the assessment year 1973-74, was made in March 1979, determining the taxable gift as Rs. 1,93,714. While bringing escaped gift to tax, in February 1984, by making additions to the gift already taxed, the Gift-tax Officer incorrectly took the gift already taxed as Rs. 97,300 (which related to the assessment year 1974-75) instead of Rs. 1,93,714. The mistake resulted in under-assessment of gift of Rs. 96,414, with consequent short-levy of gift-tax of Rs. 28,923.

The Ministry of Finance have accepted the mistake.

4.19 **Omission to aggregate gifts for purpose of calculation of tax**

Under the Gift-tax Act, 1958, as amended by the Taxation Laws (Amendment) Act, 1975, with effect from 1 April 1976, taxable gifts made by an assessee in a previous year are to be charged to tax after aggregating them with the taxable gifts, if any, made during the 'preceding four previous years' (excluding gifts made before 1 June 1973) at the rates of tax for the assessment year in hand. From the gift-tax so computed, gift-tax on the taxable gifts of the preceding four years reckoned at the same rate will be deducted and the balance would represent the gift-tax payable for the year.

While completing the wealth-tax assessments of three individuals, for the assessment year 1979-80, in a ward, in February 1984, the gifts of Rs. 50,000 made by each of them during the previous four years were not aggregated for rate purpose. This resulted in short-levy of gift-tax of Rs. 27,750.

The Ministry of Finance have accepted the mistake.

4.20 **Miscellaneous**

(i) *Omission to make gift-tax assessments*

Under the Gift-tax Act, 1958, gift-tax assessments from the assessment year 1975-76 shall be completed within four years from the end of the relevant assessment year in which the gift is first assessable or one year from the date of filing of a return or a revised return, whichever is later.

An individual filed his gift-tax return, for the assessment years 1976-77 and 1977-78, in October 1976 and December 1977, returning total gift of Rs. 95,000 and Rs. 1,00,000, respectively. The department failed to make gift-tax assessments by 31 March 1981 and 31 March 1982, as stipulated in the Act. This resulted in loss of revenue of Rs. 44,532, as remedial action is time-barred.

The Ministry of Finance have accepted the omission.

(ii) *Delay in completing gift-tax assessments*

An individual made remittances from abroad to his spouse who constructed a house valued at Rs. 1,52,000 and made investments for Rs. 1,74,000 during the previous years relevant to the assessment years 1974-75 and 1975-76, respectively. The department issued notices to the individual, in September 1979, calling for the returns and a reply was received from the individual in November 1979. Though notices were issued as early as in November 1982, fixing the date of hearing as 19 November 1982, no follow up action was taken by the department to complete the assessments till the date of audit (February 1984).

On this being pointed out, the Ministry stated in reply in July 1985 that the delay had not led to any loss of revenue and that the assessments were made in March 1984, raising a demand of tax of Rs. 36,350.

C—ESTATE DUTY

4.21 (a) The Estate Duty Act, 1953, imposes in the case of every person dying after 15 October 1953, levy of estate duty at prescribed rates upon the principal value of the estate as defined in the Act and which passes on death.

The levy of estate duty has ceased to apply in relation to properties on deaths occurring on or after 16 March 1985, by virtue of the Estate Duty (Amendment) Act, 1985.

(b) Receipts under the estate duty in the financial years 1980-81 to 1984-85 as compared with the Budget Estimates of these years, are as under :

Year	Budget Estimates	Actuals
	(In crores of rupees)	
1980-81	13.00	16.23
1981-82	15.00	20.31
1982-83	17.00	20.38
1983-84	19.00	26.46
1984-85	20.00	24.37*

*Provisional.

4.22 Partticulars of cases finalised, pending assessment and arrears of demand are given below :—

	Number of assessments completed during the year	No. of cases pending assessment	Arrears of demand pending collection (In crores of rupees)
1980-81	32,428	35,862	27.65
1981-82	35,257	36,581	30.73
1982-83	38,483	35,561**	34.31**
1983-84	37,688**	34,477	34.45
1984-85	36,856***	34,399	41.12

**Final figures revised by Ministry of Finance.

***Under verification by Ministry of Finance.

4.23 Under the Estate Duty Act 1953, no time-limit has been prescribed for the completion of assessment and re-assessment proceedings for the levy of estate duty. A case of inordinate delay in making a re-assessment involving considerable revenues is stated below :—

Under the Estate Duty Act where the Estate Duty Officer has reason to believe that by reason of the omission or failure on the part of the person accountable to submit an acount of the estate of the deceased or to disclose fully and truly all material facts necessary for assessment, any property chargeable to estate duty has escaped assessment, he may require the person accountable to submit an account and make a reassessment. Similarly, if the Estate Duty Officer has, in consequence of any information in his possession, reason to believe notwithstanding that there has not been such omission or failure of the assessee that any property chargeable to estate duty has escaped assessment, he can make a re-assessment after requiring the person accountable to submit an account. The Estate Duty Act also provides that in cases of such re-assessment, no proceedings shall be commenced after the expiration of three years from the date of assessment. The law does not, however, provide a time-limit for the completion of assessments.

In paragraph 105 of the Report of the Comptroller & Auditor General of India, Union Government (Civil) Revenue Receipts; Volume II; for the year 1975-76, a case of Estate Duty assessment of ex-ruler of a former princely State who expired in February

1967, had been reported. The accountable person filed a return in September 1967, declaring the principal value of the estate of the deceased at Rs. 1.73 crores. The final assessment was made in January 1973, determinig the value of the estate at Rs. 3.69 crores involving estate duty of Rs. 3.03 crores after making an addition of Rs. 1.96 crores to the value returned. The net principal value was, as a result of appellate decisions, reduced to Rs. 3,07,45,721 and the amount of revised demand stood at Rs. 2,51,05,862, out of which an amount of Rs. 42,17,446 is yet to be paid.

In January 1975, the Department issued a notice for re-assessment of the estate that escaped assessment. In February 1975, the Estate Duty Officer informed the legal representative that the re-assessment was necessitated to bring to charge the value of a palace owned by the ex-ruler. Between 1975 and July 1980, no further effective action was taken in the matter. In July 1980 and December 1980, the Department reminded the legal representative for furnishing the revised return. In December 1980, the legal representative requested for a week's time to furnish the particulars required by the Department. Thereafter, the matter was not further pursued, and a notice calling for details was issued to the legal representative in January 1985, viz., ten years after issue of notice for re-assessment. In the said para, a major item of short-levy of duty of Rs. 2.87 crores due to omission to include in the assessment made in January 1973, the value of properties settled on trusts which was subject to his power of disposition and which passed on his death, was pointed out. In January 1981, the Law Ministry, after discussions with the Ministry of Finance and Audit, upheld the validity of the audit objection. Further action to raise the additional demand is yet to be taken. Also in the same para, a number of audit objections pointing out short-levy of considerable amount of duty had been mentioned.

Though 19 years have elapsed after the death of the deceased and more than 10 years after the various omissions involving considerable revenue were pointed out to the Department by Audit, action remains to be taken to complete the re-assessment to bring the value of the palace to duty and also to rectify the mistakes pointed out in audit. The Department has again intimated to Audit in June 1985, that the reopened assessment proceedings are under process and that the proceedings would be completed in about 3 to 4 months' time. The non-prescription of a time-limit for the completion of re-assessment in the Estate Duty Act has led to this delay in making the re-assessment.

The Ministry of Finance have accepted the delay, and stated that there had been delay on account of various facts including non-cooperation and non-compliance on the part of the accountable person and the Attorney to file either the statement of accounts or other information relevant for assessment proceedings.

4.24 During the test audit of assessments made under the Estate Duty Act, 1953, conducted during the period from 1 April, 1983 to 31 March, 1984, the following types of mistakes resulting in under-assessment of duty were noticed :—

(i) Incorrect computation of principal value of estate ;

(a) lack of correlation amongst various assessment records ; and

(b) incorrect computation or under valuation of the principal value of estate

(ii) Estates escaping assessment.

(iii) Incorrect valuation of assets ;

(a) unquoted equity shares ; and

(b) immovable properties.

(iv) Incorrect grant of reliefs/deductions

(v) Non-levy of penalty.

(vi) Miscellaneous.

A few instances of these mistakes are given in the following paragraphs :

4.25 **Incorrect computation of principal value of estate**

(A) *Lack of correlation amongst various assessment records*

The matter regarding the necessity of correlation of assessments made under various direct taxes has been consistently stressed upon, and the need for maintaining a proper correlation amongst the various assessment records has been emphasized by the Public Accounts Committee (101st Report : Seventh Lok Sabha : 1981-82), as also by the Central Board of Direct Taxes vide their instructions issued in November, 1973 and April 1979, with a view to preventing cases of evasion of estate duty. Non-observance of these instructions in the following cases resulted in

incorrect computation of principal value of estates and under-charge of duty.

(i) A person who died in July 1968, held 1,19,633 shares of Rs. 10 each in a company where he was the chairman. The company took a loan of Rs. 1,00,14,145 from the Industrial Finance Corporation of India on the collateral security of its assets. The deceased as the chairman of the company, and another person who was the managing director of it, stood as guarantors in respect of the loan from the Finance Corporation. In terms of the "guarantee agreement" in February 1967, the deceased would not pledge, charge or otherwise encumber or dispose of his share-holding in the company during the currency of the loan agreement without prior consent and approval of the Finance Corporation.

While making the estate duty assessment in July, 1983, the assessing officer erroneously observed that the deceased, who was one of the guarantors, pledged the shares held by him in the company as collateral security and thus created a charge on those shares. The assessing officer, therefore, concluded that the title of the deceased in those shares was defective and accordingly took them at "nil" value in the assessment of the estate. It was, however, observed in audit (January, 1985) that the shares were quoted in the stock exchange and were valued by the accountable person in the first estate duty return at Rs. 5 per share as per market quotation on the date of death. The accountable person, however, revised the value at Rs. 4 per share in the second estate duty return. The Finance Corporation in a categorical reply to the company stated in February 1973, that the shares held by the deceased in the company were neither charged nor pledged as collateral security to the Corporation. Further, in the Wealth-tax assessment of the deceased for the assessment year 1968-69 (assessment completed in November, 1978) and also for the subsequent year (assessment completed in March, 1979), the value of those shares was taken at Rs. 5 per share. The omission to correlate the wealth-tax assessment records resulted in incorrect exclusion of the value of the shares by the assessing officer from the estate of the deceased leading to under-statement of the value of the estate by Rs. 5,98,165 and under-charge of duty of Rs. 5,08,440.

The final comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Estate duty assessments in respect of two persons (who died in November, 1973 and July, 1974 respectively) were completed in February, 1984 and November, 1983 without correlating those with the respective wealth-tax assessment records. Consequently, the following facts were left out in the estate duty assessments :

(a) in the case of the first deceased person (died in November 1973), a sum of Rs. 4,93,479 representing the value of eight items of immovable property—although disclosed in his wealth-tax assessments, was omitted to be included in the computation of the estate ; and

(b) in the case of other one (died in July 1974), the value of four items of immovable property (including excess liability allowed) adopted for purposes of estate duty assessment, was less by Rs. 6,41,707 as compared to the value adopted in his wealth-tax assessment.

Thus, the omission to correlate the wealth-tax assessment records at the time of estate duty assessments resulted in short computation of their estates by a total of Rs. 11,35,186 leading to a short-levy of duty of Rs. 2,82,097.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iii) In the estate duty assessment completed in July, 1983, in respect of the estate of a person who died in July 1968, the assessing officer took the value of the immovable property at Rs. 98,304, as returned by the accountable person although the value of the entire aforesaid property was taken at Rs. 4 lakhs in the wealth-tax assessments of the deceased for the assessment years 1957-58 to 1968-69.

The omission to correlate the wealth-tax assessment records at the time of estate duty assessment resulted in under-valuation of estate by Rs. 3,01,696 with consequent short-levy of duty for Rs. 2,56,442.

The final comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iv) While completing the wealth-tax assessment of an assessee for the assessment year 1977-78 in March 1982, the Wealth Tax Officer had information that the assessee expired in April, 1978. The Wealth Tax Officer did not, however, pass on the information to the Assistant Controller of Estate Duty. No proceedings were initiated under the Estate Duty Act and such proceedings became time-barred by April, 1983. The omission of the Wealth Tax Officer to communicate the information about the death of the assessee had resulted in a loss of revenue of Rs. 42,708.

The Ministry of Finance have accepted the mistake.

(v) The gift tax records of an assessee showed that the assessee died in September 1978, and that a gift of rupees one lakh was made by him within two years prior to his death. Neither the fact of death nor the disposition by way of gift was passed on to the Estate Duty Officer.

On the omission being pointed out by audit in April/May 1982, the department intimated (May 1984) that the acountable person filed a return on 1 January 1983 including therein the value of gift made in June, 1978, and the assessment was made in February, 1983 on a net principal value of Rs. 4,08,588 raising a demand of Rs. 38,217. The department contended that the Estate Duty Accounts were filed voluntarily though after audit had pointed out the omission, and hence it could not be said that the assessment was made at the instance of audit.

The fact remains that there was no attempt to utilise the information available in the assessment records for over a period of three years with a view to preventing escapement of duty from levy.

The Ministry of Finance have accepted the mistake in principle.

(B) *Incorrect computation of the principal value of estate*

A few cases where the principal value of the estate was incorrectly computed are given below :

(i) Under the provisions of the Estate Duty Act, 1953, gifts made within two years of death of the deceased are includible in the estate of the deceased. In the case of gifts to charitable institutions, only gifts made within six months of the death are includible. In respect of incomes accruing on the property gifted, the Act provides that the estate of the deceased shall include all income accrued upon property included therein down to and outstanding at the date of death of the deceased. It has been held by the Kerala, Bombay, Madhya Pradesh, Gujarat, Delhi and Allahabad High Courts that income accruing on the property gifted will include such income that arises naturally without the intervention of donee.

In the case of a deceased who died in May, 1980, the estate included 225 shares of a private limited company which were gifted by the deceased in May, 1979. The records showed that the company had issued bonus shares in the ratio of 1 : 1 (i.e. for every ordinary share held, one bonus share) on its own volition without any intervention by the donee. Under the law, the value of bonus shares was also includible in the estate. Omission to do so resulted in under assessment of estate by Rs. 2,49,750 involving short-levy of estate duty of Rs. 68,889.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) A "will" executed by a testator is to be probated, *i.e.*, it has to be officially proved as authentic or genuine as regards the value of personal property of the deceased testator and succession to such property in a court. The probate indicates the particulars of the properties and the value thereof together with the Court fees paid therefor.

In the estate duty assessment (March, 1983) of a deceased (died in March, 1966)—while computing the principal value of the estate, the value of compensation for land, accrued rent and jewellery taken together was taken at Rs. 88,170 instead of at Rs. 3,74,538 as shown in the probate issued by the Court.

The aforesaid under-valuation resulted in an aggregate short-assessment of estate by Rs. 2,86,368 with consequent duty effect of Rs. 63,015.

While accepting the mistake, Ministry of Finance have informed that the additional demand of Rs. 63,015 had been raised.

(iii) Under the Estate Duty Act, 1953, for the purpose of imposing estate duty on the estate of the deceased, the total value of the properties valuing each of them separately may first be determined, and thereafter, the properties—to the exent to which the exemption is to be given, will have to be taken out and the aggregate of the remaining should be divided as if at the time of death of the deceased, there was a notional partition and the share that would have fallen to the deceased determined, and the share so determined will be the share on which duty is to be levied under the Act. If the deceased left behind lineal descendants, the extent of the shares of such lineal descendants has to be aggregated to the share of the deceased in the property and the rate applicable to such aggregate value of the estate will have to be taken into account.

The estate of a deceased (died in February, 1979) comprised of his free estate and also four ninth share (4/9th share) in the H.U.F. property consisting of both

movable and immovable. In the estate duty assessment (completed on 30-4-1983) the value of immovable property to the extent of Rs. 1,57,760 representing deceased's four-ninth share in the H.U.F. property as well as an equal amount representing the lineal discendant's share was not included in the principal value. This mistake resulted in a short levy of estate duty to the extent of Rs. 51,156.

Although the case was checked by the special Internal Audit Party, the mistake was not pointed out. On being pointed out in audit, the aforesaid mistake was accepted by the Ministry of Finance and the assessment rectified (November 1985) raising the additional demand.

(iv) Under the Urban Land (Ceiling and Regulation) Act, 1976, the competent authority issues a Gazette Notification giving the particulars of the vacant land held by a person in excess of the ceiling limit and stating that such vacant land is to be acquired by the concerned State Government and the claim of all persons interested in such vacant land might be made to him. At any time after the publication of the notification, the competent authority may by another gazette notification declare that from a specified date the excess vacant land shall be deemed to have been acquired by the State Government. The Act prohibits transfer by way of sale, mortgage, gift, lease or otherwise of the excess land during the period commencing from the date of publication of the first gazette notification and ending with the date of declaration through the second notification. The Estate Duty Act, 1953 contemplates payment of Estate Duty on the principal value of the property passing on the death of a deceased and the value of any property is the price which it would fetch if sold in the open market at the time of the deceased's death.

In the Estate Duty assessment made in January 1984, of a person who died in August 1978, a house site measuring 14.6 grounds in metropolitan city was valued at Rs. 25,000 per ground for 6.9 grounds and at Rs. 2,400 per ground for the balance 7.7 grounds on the basis of the report of the registered valuer. The piece of land measuring 7.7 grounds was priced lower due to the fact that it was likely to be acquired by Government under the Urban Land (Ceiling and Regulation) Act, 1976. Till the date of death in August 1978, and even thereafter till the assessment was taken up in January 1984, the Government had not proposed acquisition of the vacant land in excess of the ceiling limit through a gazette notification. Nor had transfer of the land by way of sale, mortgage, gift etc. been prohibited by a gazette notification. Accordingly, the piece of land measuring 7.7 grounds also needed valuation at the enhanced market value of Rs. 25,000 per ground instead of at the lower valuation of Rs. 2,400 per ground. The mistake due to under-valuation of the estate led to short assessment of principal value of the estate by Rs. 1,74,400 involving short levy of estate duty of Rs. 52,200.

On being pointed out in October 1984, the Department justified the assessment stating that the threat of acquisition was more harmful and speculative than the acquisition itself. The reply of the Department has overlooked the fact of free transferability of land till a gazette notification was issued for the acquisition of the lands under the Urban Land (Ceiling and Regulation) Act, 1976. The attention of the department was again drawn to the under-valuation through the local Audit Report issued in February, 1985 and the statement of fact forwarded in April, 1985.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(v) Under the provisions of the Estate Duty Act, 1953, property which the deceased was competent to dispose of at the time of his death shall be deemed to pass on his death, and estate duty is leviable on the full value of such property. The fact that a child was in the womb of the widow at the time of death of the deceased and that child born subsequently happened to be a male child would make no difference in the passing of the property in entirety. The Supreme Court have held in November 1965, that the doctrine that under Hindu Law a son conceived or in his mother's womb is equal in many respects to a son actually in existence in the matter of inheritance, partition, survivorship and the right to impeach an alienation made by his father, is not one of universal application and it applies mainly for the purpose of determining rights to property and safeguarding such rights of the son. The Supreme Court ruled that the doctrine does not fit in with the scheme of Income-tax Act. For the same reasons the doctrine would have no application while making an assessment under the Estate Duty Act. If a male Hindu who—for the time being—is a sole suvivor coparcener of a Hindu Undivided Family governed by the Mitakshara School of Hindu Law dies, the whole of the common property of the family along with his separate property passes for levy of estate duty as he has power of disposition over these properties.

In the estate duty assessment of a sole coparcener of a Hindu Undivided Family who died in July 1978, only half the value of the property belonging to HUF instead of the whole property, was included in the principal value. While making the assessment in August, 1983 the Estate Duty Officer accepted the plea of the accountable person that a child was in the womb of the widow at the time of the death of the deceased and as the child in uterus was born subsequently as a male, the other half of the property belonging to that son could be included in the principal value of the estate only for rate purposes. The exclusion of half the value of the property which is not valid in law, resulted in short levy of estate duty of Rs. 51,781.

The mistake was pointed out in Audit in July 1984, and reply of the Depaprtment is awaited. However, a verification of the assessment records disclosed that the Estate Duty Officer had requested the Appellate Authority in May, 1985 to enhance the principal value of the estate by treating the entire property as passing on the death of the deceased while deciding some other points on which the accountable person had preferred an appeal. The result of the remedial action is awaited.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(vi) Under the provisions of the Estate Duty Act, 1953, estate duty is payable on the principal value of the property passing on the death of the deceased.

In the estate duty assessment (January, 1983) in respect of a person who died in September 1981, the net principal value of the estate was worked out to Rs. 8,75,921 instead of Rs. 8,89,831, leading to a short computation of the value of Rs. 13,910. Apart from this, a mistake was also made in the calculation of duty. Due to these mistakes, the duty leviable was worked out at Rs. 27,985 instead of Rs. 68,456 resulting in short levy of duty of Rs. 40,471. The department accepted the objection and rectified the assessment (December, 1984) raising an additional demand of Rs. 40,471.

The audit objection has since been accepted by the Ministry.

(vii) The Estate Duty Act, 1953 provides that value of one house or part thereof exclusively used by the deceased for his residence is exempt from duty subject to a maximum of Rs. 1 lakh. It has been held by the Andhra Pradesh High Court in February, 1983 that where the house used by the deceased for his residence belonged to a Hindu Undivided Family, the exemption should be applied to the value of the entire house and, thereafter, the proportionate share of the coparcener determined and included in the principal value of the deceased's other estate. The value of interest of other coparceners is also aggregated only for rate purpposes. If, however, the entire value of the joint-family-house is within the limit of exemption of Rs. 1 lakh, the question of aggregation for rate purposes will not arise.

In the estate duty assessment (made in December, 1983) of a deceased (died in September, 1980) in Andhra Pradesh, the value of the one-fourth coparcener's interest in the joint-family house, valued at Rs. 3,83,050, was determined at Rs. 95,763. The sum of Rs. 95,763, as it happened to be less than Rs. 1 lakh specified in the Act, was not included in the principal value of the estate; the shares of the other lineal descendants were also not aggregated for rate purposes as the value of each was less than Rs. 1 lakh mentioned in the Act. The procedure followed by the assessing officer was not in order. According to the judicial decision, the exemption of Rs. 1 lakh would have to be excluded from the value of Rs. 3,83,050 representing the value of the joint family property and the balance Rs. 2,83,050 divided amongst the four coparceners, i.e. Rs. 70,762 was includible in the assessment of the deceased. The incorrect procedure adopted by the assessing officer resulted in short-levy of estate duty of Rs. 38,798.

On being pointed out in audit in July 1984, the Department stated in reply in March 1985 that the assessment had been reopened and remedial action taken.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(viii) Under the provisions of the Estate Duty Act 1953, as amended by Estate Duty (Amendment) Act 1982, the value of residential house owned and used by the deceased before death, is to be taken as adopted in the wealth tax assessment in respect of his net wealth on the valuation date immediately preceding the date of his death.

In the estate duty assessment (25-3-1982) in respect of the estate of a person who died in September 1981, the principal value of the estate was determined at Rs. 4,42,634, which *inter alia* included value of a

residential house taken at Rs. 2,13,500 after granting allowable exemption of rupees one lakh. The value so adopted was based on a valuer's report valuing the property as on the date of death, *i.e.*, 25 September 1981. Subsequently, on an application made by the accountable person (October 1982), the value of the property was reduced to Rs. 80,000 after granting exemption of rupees one lakh and basing the recomputation on the wealth-tax assessment on the valuation date (31st May 1979).

The valuation date for wealth-tax assessment in the instant case immediately preceding the date of death would have been 31st May 1981. Hence in the absence of relevant wealth-tax assessment order and in the face of valuer's report valuing the property as on the date of death, the rectification of assessment and lowering the value of estate by Rs. 1,33,500 was not correct. The consequent duty short-levied in the case amounted to Rs. 29.539.

On the matter being pointed out in audit (November 1983) the department has accepted the mistake and has reported that the assessment has been rectified (July 1984) creating an additional demand of Rs. 30,313.

The comments of Ministry of Finance on the paragraph are awaited. (January 1986).

4.26 **Estates escaping assessment**

A few cases where estates escaped assessment thereby leading to under-charge of duty, are given below :—

(i) In computing the principal value of the estate of a deceased (died in September, 1981) the value of certain immovable non-agricultural properties worth Rs. 4,71,408 returned by the accountable person, was not included in the original as well as in the revised assessments completed in April 1983 and August 1983 respectively. This omission resulted in short levy of duty of Rs 4,01,834.

The special audit party of the revenue department checked the assessment records in February 1984, but did not notice the omission.

The Ministry of Finance have accepted the mistake.

(ii) The Estate Duty Act, 1953 provides for the levy of estate duty on the principal value of the property that passes or is deemed to pass on the death of the deceased; the value to be ascertained in accordance with the detailed provisions made thereto in the said Act.

A person who died in January 1971, had one-third share in an H.U.F. property. While making the estate duty assessment in April 1983, the assessing officer took half of the one-third share of the deceased in the aforesaid H.U.F. property. This led to under-assessment of the estate by Rs. 2,08,500.

Further, in the estate-duty assessment of deceased's husband who died earlier (in April 1970), the value of immovable properties, jewelleries and silver utensils of the HUF was taken at Rs. 11,34,502 but in the estate-duty assessment of the deceased these assets were valued at Rs. 7,79,066, leading to under-assessment of the estate (one-third share) by Rs. 1,18,479. The total under-assessment of estate by Rs. 3,26,979 led to under-charge of duty of Rs. 1,30,335.

While accepting the mistake the Ministry of Finance have informed that the additional demand of Rs. 1,41,764 had been raised.

(iii) Under the Estate Duty Act, 1953, property gifted away more than two years before death is not liable to estate duty; but where disposition by way of "gift" is not valid, the question of aforesaid relief does not arise.

A person who died in February 1979, made a gift of ornaments and jewelleries for Rs. 2,18,685 to her diverse relations and others by executing a 'will'. The said gift which was to take effect sometime in November and December 1976 as per will, was assessed to gift-tax for the assessment year 1977-78 in September 1981. However, the Gift-tax assessment was set aside by the Commissioner in September 1982 on grounds of legal validity of the gift, and also because of the doubt as to whether there was any gift at all. In conformity with the above stand, the department felt that the said jewelleries and ornaments belonged to the assessee and were liable to wealth-tax in the assessment years 1977-78 and 1978-79. The estate duty officer, however, accepted the gift as genuine in the estate duty assessment made in October 1983, and the gift having been made more than two years before death was excluded from the value of the estate. As both in the gift-tax and wealth-tax assessments the gift has not been accepted as valid gift, the value of the ornaments and jewelleries for Rs. 2,18,685 was required to be included in the net principal value of estate of the deceased. Further, the estate duty officer

also allowed relief of Rs. 39,478 on account or gift tax payments on the aforesaid gifts, and this was also not in order. The incorrect exclusion of assets and reilef allowed resulted in under-assessment of estate by Rs. 2,18,685 leading to under-charge of duty of Rs. 98,944.

The Department have accepted the audit objection in principle.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(iv) Under the Estate Duty Act, 1953, the interest of a coparcener in the common property of a Hindu Undivided Family, ceasing on his death, shall be deemed to pass on his death to the extent to which a benefit accrues or arises by cesser of his coparcenary interest in the joint family property governed under the Mitakshara School of Hindu law. The Act also provides that the interest of all the lineal descendants of the deceased in the joint family property or HUF property has to be aggregated so as to form one estate for determining the rate of estate duty to be levied in respect of the principal value thereof.

In one case, the Assistant Controller of Estate Duty determined the principal value of the individual estate of a deceased person (who died in October 1981) at Rs. 6,85,357 and omitted to include therein :

(a) the deceased's one-third share of the coparcenary interest amounting to Rs. 38,966; and

(b) for determining the rate of duty leviable two-third share of interest of lineal descendants amounting to Rs. 2,77,932.

The omission resulted in under-assessment of the principal value of the estate by Rs. 3,16,898 with consequent short levy of duty of Rs. 85,469 and also interest for late filing of the estate duty return amounting to Rs. 4,401.

The Ministry of Finince have accepted the Mistake.

(v) The estate-duty assessment made in July 1983, in respect of the estate of a person who died in July 1968, contained the following mistakes :

(a) A sum of Rs. 1,04,668 representing the value of net assets of tea company was includible in the estate of the deceased. The assessing officer apportioned the net value of the assets between agricultural and non-agricultural assets, and included in the estate Rs. 41,871 being the non-agricultural portion. The full value of the assets both agricultural and non-agricultural was includible, and the omission resulted in under-assessment of the estate by Rs. 62,797.

(b) The value of land and salvage value of the shed of a farm was considered in assessment, while the written-down value of the machinery in the said farm to the extent of Rs. 30,632 escaped assessment.

The above mistakes along with a minor mistake resulted in aggregate under assessment of estate by Rs. 95,553 with consequent duty effect of Rs. 81,203.

The final comments of Ministry of Finance on the paragraph are awaited (January 1986).

(vi) Under the provisions of the Estate Duty Act, 1953, the property which the deceased was at the time of his death competent to dispose of shall be deemed to pass on his death, and is liable to estate duty.

A male Hindu, who for the time-being is a sole surviving coparcener in a Hindu Undivided Family governed by the Mitakshara School of Hindu Law, is competent to alienate the coparcenary property in the same way and to the same extent as his separate property, and the alienation cannot be questioned by the female members of the family or by a son, if any, born or adopted by him subsequent to alienation. On the death of such sole surviving coparcener, the whole of his property including the coparcenary property passes by succession to his heirs, and as such, the whole of his estate is assessable to duty.

In the case of a deceased who died on 13th February 1981, and in whose case the estate duty assessment was finalised in July 1981, the assessing officer had taken one-half share of the deceased's cesser of interest in the H.U.F. property amounting to Rs. 3,27,708 out of the total value of H.U.F. property of Rs. 6,55,417 after allowing a deduction of Rs. 1 lakh towards marriage and maintenance of the unmarried daughter of the deceased. In this case the family consisted of the deceased, his wife, a major son and an unmarried daughter. In the year 1970, the major son got separated by filing a suit for partition of the family property. The residual family remained joint in which there was no other coparcener. As there was no other coparcener there was no question of a demand for partition in the family which would have necessitated a provision for maintenance of the unmarried daughter. Thus, the aforesaid deduction of Rs. 1,00,000 was not correct.

Moreover, after separation of the son, as the family remained joint, the share of the wife of the deceased in the family property was 1|3rd to which she was entitled consequent upon the suit for partition filed in the High Court by the major son. That share was her absolute property under the provision of the Hindu Succession Act of 1956. Therefore, in respect of 2|3rd share of interest in the joint family property, the deceased had aboslute powers of disposition. Hence, on his death, 2|3rd share of interest in the family property valuing Rs. 5,03,612 was to be subjected to estate duty and not fifty per cent of it as done by the assessing officer.

Consequently there was an under-assessment of estate by Rs. 1,75,904, resulting in short levy of duty of Rs. 65,202.

The mistake has been accepted by the department and the assessment rectified in May 1985. Particulars of the collection of the additional demand are awaited (July 1985).

The case was seen by Internal Audit.

The comments of Ministry of Finnance on the paragraph are awaited (January 1986).

(vii) Under the provisions of the Estate Duty Act, 1953, estate duty is payable on the principal value of the property passing on death of the deceased.

In the estate duty assessment (February 1984) in respect of a person who died in October 1981, the net principal value of the estate was worked out to Rs. 8,26,952.

The wife of the deceased who predeceased him intestate in January 1975, left an estate of the value of Rs. 3,99,979. The deceased and his son being the only legal heirs of the wife of the deceased, half the share of her property amounting to about Rs. 2,00,000 was omitted to be included in the estate duty assessment of the deceased. Thus, the estate was under-valued by Rs. 2,00,000 leading to a short-levy of duty of Rs. 60,000.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(viii) Under the Estate Duty Act, 1953, gifts made *inter vivos* within a period of two years before death of the deceased are deemed to pass on death of the deceased, and includible in his dutiable estate.

A person who died in November 1981, relinquished 25 per cent of his 50 per cent interest in a firm without any consideration (February 1981) in favour of his son from January 1981. The share in the firm thus relinquished by the deceased constituted "deemed gift" in favour of his son who become entitled to share, to the extent of 25 per cent, in the assets and liabilities including the profits and losses of the firm. While completing the estate duty assessment (May 1983|May 1984), the assessing officer did not include the following in the principal value of the estate of the deceased :

(a) The value of the "deemed gift" of Rs. 1,16,256 calculated on the basis of balance sheet of the firm as on January 1981; and

(b) The deceased's own share of 25 per cent in the assets of the firm at an enhanced value as per valuer's report as shown in the deceased's wealth-tax returns for assessment years 1978-79 to 1981-82 to the extent of Rs. 69,712.

The above omissions resulted in an aggregate escapement of assessment in respect of the estate of the deceased by Rs. 1,85,968 with consequent undercharge of duty of Rs. 55,790.

The comments of Ministry of Finance on the paragraph are awaited (January 1986)

(ix) According to the Estate Duty Act, 1953, movable properties situated outside India belonging to a deceased who was domiciled in India at the time of his death, are includible in the principal value of estate.

In the case of a deceased (died in November 1981) who was domiciled in India at the time of his death and was staying till his death in a foreign country on account of his service under the government of that country, his salary and gratuity of Rs. 1,27,752 due from the foreign government were not included in the principal value of the estate.

Further, the death-*cum*-retirement gratuity and G.P.F. account balances (aggregating to Rs. 42,316) due to him from the State Government and the amount of Rs. 11,288 receivable from the life Insurance Corporation of India, in respect of his life insurance policy were also not included in the value of the assets.

The omissions resulted in under-assessment of estate of Rs. 1,81,356 with a duty effect of Rs. 47,341.

While accepting the audit objection, the Ministry have informed the Audit that out of total demand of Rs. 47,341 a sum of Rs. 20,000 has since been collected (July 1985).

(x) Under the provisions of the Estate Duty Act, 1953, in order that any property may become liable to the charge of estate duty, there must be a cesser of interest on the death of the deceased and a benefit must accrue or arise therefrom. When the value of the benefit accruing from cesser of such an interest is to be computed, the essential requirement is that the interest must extend to the income of the property. An interest can be said to extend to the income from the property only when a person is entitled to the income from the said property. If this interest extends to the whole income of the property then the value of that interest will be the principal value of the said property.

A person who died in October 1979, was the sole recipient of income from the properties held under a trust which was created under a will in December 1969. As per the provisions of the will, the entire income and residential properties were, after the death of the deceased, payable to another person mentioned in the will itself by the testator. As the entire interest of the deceased in all the properties held under the aforesaid trust having ceased on her death, the principal value of those properties was liable to be included in the estate of the deceased.

In the estate duty assessment (completed in April 1984), the assessing officer took into consideration the movable assets and accrued income from the trust properties but omitted to include the value of the properties resulting in the under-statement of the estate by Rs. 3,12,212, with consequent undercharge of duty to the extent of Rs. 46,859.

While accepting the audit objection, the Ministry have informed the Audit that the assessment had been rectified on 8-2-1985 and the amount of additional demand of Rs. 46,859 raised.

(xi) Under the provisions of the Estate Duty Act 1953, a disposition made by a person within a period of two years prior to his death, is to be treated as property deemed to pass on death. As such, where on a partition of Hindu Undivided family, a deceased coparcener had taken less than his due share, there would be a disposition in favour of relatives to the extent of share less taken by the deceased.

A deceased Karta (died in December 1980) of a Hindu undivided family affected a partition of properties in April 1980 within two years prior to his death, taking a 'nil' share instead of his legal 1/4th share, (*i.e.*, Rs. 68,268). The share thus relinquished by the deceased was includible in his estate being deemed gift within two years prior to his death, but the same was not so included in the assessment.

The omission resulted in under assessment of the estate of the deceased by Rs. 68,268 with consequent short levy of duty of Rs. 16,938.

The Ministry of Finance have accepted the mistake.

4.27 **Incorrect valuation of assets**

(A) *Unquoted equity shares*

Under the provisions of the Estate Duty Act, 1953 and the instructions issued by the Central Board of Direct Taxes in October 1974 and May 1975, unquoted equity shares of a private company are to be valued on the basis of the market value of the assets including goodwill of the company as on the date of death. One of the established methods of computation of goodwill of a business is the super-profits method under which the average profits for a period of three to five years are capitalised at a number of years' purchase.

A person who died in May 1969 held 3800 equity shares in a private company on the date of death. The Estate Duty Officer estimated the value of each share in September 1982 at the rate of Rs. 215.91 under the break-up value method of valuing the assets. For this purpose, the value of goodwill was estimated at Rs. 25,000.

For the estate duty purposes, the market value of goodwill is includible in the principal estate. The value of goodwill computed under the super-profits method, taking average of the profits for the three years ending March 1967, March 1968 and March 1969, after allowing deduction towards the interest on capital at 9 per cent and applying a multiplier of "two" amounted to Rs. 19,57,312 and the value of each share amounted to Rs. 344.73 instead of Rs. 215.91 adopted in the assessment. The undervaluation resulted in under-assessment of estate by Rs. 4,89,516 involving short-levy of duty of Rs. 1,67,046.

The comments of the Ministry of Finance on the paragraph are awaited (January 1986).

(B) *Immovable properties*

(i) The Estate Duty Act, 1953 deems any property gifted within two years before the date of death of the deceased, as passing on the date of his death, and the value of such property is includible in the dutiable estate. The value of such property is estimated to be the price which it would fetch, if sold in the open market, at the time of the deceased's death.

In the estate duty assessment (completed in June 1983) in respect of the estate of a person who died in February 1980, the assessing officer included in the principal value of the estate of the deceased a sum of Rs. 1,24,457 representing the value of on the date of gift (*i.e.,* 16 April 1979), silver utensils/ articles and jewellery, whereas the market value of those properties (adopting the same basis followed by the assessing officer in respect of similar other assets) worked out to Rs. 1,97,522 as on the date of death of the deceased (*i.e.,* 19th February, 1980). Thus, the omission to adopt the market value of the gifted properties as on the date of death of the deceased, resulted in under-valuation of the estate by Rs. 73,065 leading to a short levy of duty of Rs. 26,919, including interest of Rs. 5,000 for the delay in submission of the "return".

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the provisions of Estate Duty Act, 1953, as amended from 1-3-1981 by the Estate Duty (Amendment) Act, 1982, the value of one residential house or part thereof owned and used by the deceased before his death, is to be taken as adopted in the wealth-tax assessment in respect of his "net wealth" on the valuation date immediately preceding the date of his death. Also, under the statutory rules framed under the Wealth-tax Act, 1957, the simple method of finding the valuation of a residential house is to multiply the 'gross annual rent' by a fair number of years' purchase.

A person who died in April 1981, was owner of a residential house property in a metropolitan city, seventy per cent of which was let out and thirty per cent of it was occupied by him for his own residence. In the estate duty assessment (made in November 1982), the value of the property was taken at Rs. 2,36,000 and exemption of Rs. 1,00,000 was allowed for the portion occupied for self-residence. But following the statutory rules framed under Wealth-tax Act, 1957, the value of the property would come to Rs. 3,19,950. Failure to value the house property as per statutory provisions led to under-assessment of estate by Rs. 87,965 with consequent duty-effect of Rs. 22,948.

The mistake has been accepted by the Ministry of Finance.

4.28 **Incorrect grant of reliefs/deductions**

(i) According to the provisions of the Estate Duty Act, 1953, where any property on which estate duty is payable, is transferred within a period of two years following the death of the deceased, a deduction is to be allowed from the estate duty payable by an accountable person of a proportionate amount of the income-tax on the capital gains arising out of the transfer of the said property, the proceeds of which have been utilised wholly or partly for the payment of estate duty.

In this context, the Central Board of iDrect Taxes issued necessary instructions (November 1965) laying down a formula for the calculation of the relief.

In the assessment of a deceased (died in May 1979) completed in November 1982, the relief allowable, according to the formula, worked out to Rs. 1,36,692 as against Rs. 1,89,254 actually allowed by the assessing officer resulting in excess relief to the extent of Rs. 52,562.

The mistake has been accepted by the Ministry of Finance.

(ii) The Estate Duty Act, 1953 provides, on the Central Board of Direct Taxes being satisfied, for grant of relief in the estate duty payable on any property passing upon the death of any person, where subsequently within five years of the death of the deceased, estate duty has again become payable on the same property or any part thereof, passing on the death of the person to whom the property passed on the first death. The quantum of relief in the amount of estate duty payable on the death of the second deceased person depends upon the period that passed between the two deaths, as provided in the Act.

While computing the principal value of the estate of a deceased person who died in September 1975, the assessing officer in his assessment made in January 1983 (revised in August 1983) allowed a deduction of Rs. 2,67,923 representing the estate duty liability (Rs. 2,07,227) and interest thereon Rs. 60,696 relating to a predeceased brother, who had died in July 1974.

In March 1984, the assessments of both the deceased person and his predeceased brother were revised to give effect to 'quick succession relief' allowed under the Board's orders. In this revision, the estate duty liability of the pre-deceased brother was revised to Rs. 2,25,658 (duty Rs. 1,74,937 and interest Rs. 50,721).

In the assessment of the deceased, instead of adopting the revised liability of Rs. 2,25,658 for the purpose of deduction from the estate of the deceased person, the assessing officer by mistake deducted the pre-revised liability of Rs. 2,67,923 leading to a short computation of the estate value to the extent of Rs. 42,265 and consequential short levy of duty of Rs. 29,413.

The Ministry of Finance have accepted the mistake.

(iii) According to the provisions of the Estate Duty Act, 1953 (the Act)—effective from 1st March 1981, no estate duty shall be payable in respect of any deposits with a co-operative housing society made by the deceased who was a member of the society and to whom a building or part thereof was allotted or leased under a house building scheme of the society where such deposits had been made under such scheme.

Further, the Act deems any property, even though *bona fide,* gifted within two years from the date of death, as passing on the date of death of the deceased person, and thus become includible in the dutiable estate of the deceased.

In the estate duty assessment (completed in March 1983 and revised in January 1984) in respect of a deceased person (died in December 1981), the deposits amounting to Rs. 1,00,030 made to a "Housing Board" towards allotment of flat under the self-financing scheme of the Board, was allowed as a deduction from the total value of the deceased's interest in the house properties. Out of the aforesaid deposits, a sum of Rs. 70,030 was contributed by the deceased herself during her life time, and the balance of Rs. 30,000 was deposited in February 1982, *i.e.* after death of the deceased.

Since the "Housing Board" was not a "co-operative housing society", the relevant provisions of the Act, which were applicable to deposits with "co-operative housing society", were not applicable to the deposits of Rs. 70,030. Also, as the flat was not handed over by the "Housing Board" to the deceased till the date of her death, the deposit of Rs. 30,000 made in February 1982 was not an allowable deduction.

Further, the payments amounting to Rs. 5,681 made in January 1981, by the deceased towards the L.I.C. premia on policies taken out in the names of other persons were to be treated as "gifts" made within two years and thus exigible to duty.

While accepting the mistake, the Ministry of Finance have informed that the additional demand of Rs. 26,436 had been raised.

4.29 **Non-levy of penalty**

Under the provisions of the Estate Duty Act, 1953, and Rules framed thereunder, every person accountable for the estate duty is required to submit the account for estate duty within six months from death of the deceased. The Controller of Estate Duty may extend the time-limit subject to payment of the interest by the accountable persons at the rate of 6 per cent per annum.

In the case of a person who died in July 1968 the department issued a notice to the accountable persons in July 1969, for submission of the account for estate duty by August 1969. On applications made by the accountable persons, the time-limit for submission of the account for estate duty was extended by the department up to the end of December 1969. The accountable persons actually submitted the accounts in January 1975.

In the estate duty assessment of the deceased completed in July 1983, the assessing officer, however, did not levy interest of Rs. 1,80,303 from 16 January, 1969 to 31 December, 1969 *i.e.*, 6 per cent paragraph are awaited (January 1986).

The final comments of Ministry of Finance on the paragraph are awaited. (January 1986).

4.30 **Miscellaneous**

(i) Under the Estate Duty Act, 1953 National Defence Gold Bonds, 1980 to the extent of the principal value of such bonds for an aggregate weight of 50 kgs. of gold, is exempt from levy of Estate Duty. The Gold Bonds Scheme provides that the bonds would be repaid in the form of gold on 27th October, 1980. Under the Estate Duty, Act, the property which the deceased was competent to dispose of is deemed to pass on his death and is includible in the principal value of the Estate.

In the estate duty assessment (assessment made in February 1984) in respect of a person who died in August 1982, the exemption was allowed on National Defence Gold Bonds, 1980, for 1376 gms. of gold.

The Bonds had become repayable on 27th October, 1980 and on the date of death it ceased to be bonds for which exemption was contemplated under the scheme. Merely because the deceased had not redeemed the bonds in exchange for gold, the scheme cannot be considered to have been continued and exemption afforded even after the due date for payment, namely, 27th October 1980. Hence, the value of 1376 gms. of gold valued at Rs. 2,26,352 was includible in the principal estate of the deceased. The omission to include the amount resulted in short levy of estate duty of Rs. 54,857.

The comments of Ministry of Finance on the paragraph are awaited (January 1986).

(ii) Under the provisions of the Estate Duty Act, 1953, no estate duty shall be payable in respect of one house or part thereof belonging to the deceased and exclusively used by him for his residence at the time of his death to the extent the principal value thereof does not exceed rupees one lakh, if such house is situated in a place with a population exceeding ten thousand, and the full principal value thereof in any other case. It has been judicially held that the benefit of exemption in respect of a property would be allowable only if the right of exclusive use thereof by the deceased existed, and not allowable in cases where only permissive use or use, otherwise than under a right, existed.

In the estate duty assessments of two individuals (dates of death 7-11-1977 and 8-1-1981) completed in August 1983 and March 1984 on principal values of Rs. 4,49,075 and Rs. 3,49,720 respectively, exemption of rupees one lakh was allowed in each case in respect of house property said to have been used by them for residence. The exemption claimed and allowed in both the cases was in respect of properties gifted away by the deceased persons within two years before their death wherein they had not retained any claim or title. It was noticed in audit (November|December 1984) that in both the cases the deceased persons had gifted away the properties transferring absolute right of ownership and possession to the donees concerned without reserving any right or interest for themselves in the property. The deed of settlement executed in the first case also indicated possession of the property had also been delivered to donee. Audit pointed out that the incorrect allowance of exemption of rupees one lakh in each case has resulted in under-charge of estate duty of an aggregate amount of about Rs. 52,425.

The Ministry of Finance have accepted the mistake.

New Delhi
The 28 APR 1986

(P. K. BANDOPADHYAY)
Director of Receipt Audit-II.

Countersigned

New Delhi
The 28 APR 1986

(T. N. CHATURVEDI)
Comptroller and Auditor General of India