REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR ENDED 31 MARCH 1992

NO. 5 OF 1993

UNION GOVERNMENT
(REVENUE RECEIPTS - DIRECT TAXES)

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TABLE OF CONTENTS

CHAPTER 2 - SYSTEM APPRAISALS

CHAPTER 3 - CORPORATION TAX

Incorrect computation of business income

Incorrect exemption and excess reliefs

Non-levy or incorrect levy of interest

Irregular Exemptions and Excess Reliefs

Non-levy or Incorrect levy of Interest

Other topics of Interest

CHAPTER 5 - OTHER DIRECT TAXES

A. WEALTH-TAX

B. GIFT-TAX

C. ESTATE DUTY

PREFATORY REMARKS

The Audit Report on Revenue Receeipts - Direct Taxes of the Union Government (Civil) presents the results of audit of receipts under Direct Taxes comprising income tax, wealth tax, gift tax, estate duty and hotel receipts tax. The Report is arranged in the following order:-

(i) Chapter 1 incorporates the statistical information regarding the working results of the tax administration and audit;

(ii) Chapter 2 includes three system appraisals on Scheme of Depreciation Allowance, Assessment of religious and charitable trusts and Computerisation in the Income Tax Department.

(iii) Chapter 3 mentions the results of audit of corporation tax;

(iv) Chapter 4 deals, similarly with the points that arose in the audit of income tax;

(v) Chapter 5 covers points that arose in audit of wealth tax, gift tax, estate duty and hotel receipts tax.

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

OVERVIEW

1. This Report of the Comptroller and Auditor General of India presents the results of test audit of assessments relating to direct taxes. During the financial year 1991-92, 3577 units were audited. Some of the important audit findings form part of this Audit Report.

2. There has been substantial increase in gross receipts from direct taxes, as compared to the previous year. The actual collection for the year was Rs.15342.36 crores against the budget estimates of Rs.13892.30 crores, representing a rise of 39.11 percent over last year's collection of Rs.11028.94 crores. However, there was only a marginal increase in the number of assessees, which rose from 75.28 lakhs to 77.95 lakhs, an increase of about 3.55 per cent.

3. In the collection of all direct taxes, the expenditure incurred was to the tune of Rs.256.46 crores against Rs.230.18 crores incurred in the previous year. As a percentage of total collections this came to 1.7 per cent (against 2.1 per cent in 1990-91).Gross pre-assessment collections of Income tax and Corporation tax during the year by way of tax deduction at source, advance tax and self-assessment tax, before adjustment of refunds, were Rs.16422.36 crores which accounted for 91.28 per cent of the total gross collections before adjustment of refunds. The cost of collection in respect of Income tax and Corporation tax alone as a percentage of post assessment collections of these taxes was 16.35 per cent (against 13.6 per cent in 1990-91).

4. Overall pendency of assessments increased to 13.21 lakhs as on 31 March 1992 (from 12.82 lakhs as on 31 March 1991). The rise mainly related to scrutiny assessments (from 1.77 lakhs to 2.27 lakhs); there was a marginal decrease in pendency of summary assessments. This was despite a larger number of officers (2456) having been deployed on assessment duty currently than the number (2176) deployed in the previous year.

5. Arrears of tax have also shown an increasing tendency. Cumulative arrears for corporation tax and income tax rose from Rs.6694.54 crores last year to Rs.8460.98

crores during the period ending 31st March 1992. Of these, in 4139 cases alone, the arrears amounted to Rs.5105.19 crores, each of these cases having an arrear of more than Rs.25 lakhs. Inspite of regular monitoring of this area through Action plans, arrears continue to mount. Incidentally, the Action Plan for 1991-92 had envisaged an overall reduction of 10% in the aggregate demand as compared to the previous year. This remains an area of concern.

6. During the course of test audit, 16049 objections involving under assessment of Rs.1184.88 crores were raised. Of these, 362 cases involving substantial tax effect (Rs.391.19 crores), and carrying important observations, feature in this Report. Besides the following system appraisals also stand included in this Report:

(i) Scheme of depreciation allowance

(ii) Assessment of Religious and Charitable Trusts.

(iii) Computerisation in the Income Tax Department.

7. System Appraisal

Salient Audit findings

Scheme of Depreciation Allowance

(a) In order to enable assessees engaged in business or profession to generate funds internally for renewal, replacement and modernisation of assets, the Income Tax Act allows a deduction on account of depreciation on capital assets used in business. A review of the scheme revealed the following:

(i) There is no provision seeking to ensure retention or ploughing back of funds made available through tax concessions in the business, though the Choksi committee (1978) had brought out the desirability thereof. **[Para 2.01.6]**

(ii) The quantum of depreciation allowance is dependent on the actual cost of the machinery or plant and buildings which should not include any element of adjustment due to fluctuations in rate of exchange of foreign borrowings except on actual repayment of the foreign currency loan. However, in many cases depreciation was being erroneously allowed on cost of assets as enhanced by fluctuations in rate of exchange. Likewise, capital subsidy

provided by Government should be deducted while computing the cost of assets. Though divergent opinions were expressed in courts over the treatment of capital subsidy, the legal position is yet to be established through the judicial process or by suitable amendment of the law. **[Para 2.01.12]**

(iii) Extra shift depreciation allowance was admissible upto a maximum of one half of the normal depreciation allowance where the concern had worked double shift and a maximum of an amount equal to the normal allowance where the concern had worked triple shift. The Ministry of Law opined that if in any particular year, any particular machine or plant was not used at all even for a day, the normal depreciation allowance was not admissible and as a corollary thereto extra shift depreciation would not be admissible. Inspite of this advice, the Board did not modify their instruction stating that where a concern has worked double 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 for which each machine had actually worked.This resulted in substantial under-assessment of tax. **[Para 2.01.17(i)]**

(iv) A number of cases have been brought out where depreciation, initial depreciation and additional depreciation have been allowed without observing the conditions of ownership and usage, without particulars of assets having been furnished and without restricting depreciation allowance to the extent of cost of assets. In addition,there were mistakes in carry forward and set off of unabsorbed depreciation allowance and in application of rates of depreciation etc. The overall revenue effect of these mistakes (in 788 cases)was over Rs.93.00 crores.**[Para 2.01.7, 8,9,15,16,18,19]**

Assessment of Religious and Charitable trusts

(b) Income of trusts and institutions created for charitable or religious purposes, when derived from property held under trust and applied for charitable and religious purposes, is exempt from income tax subject to certain conditions. Wealth tax is also not charged on property held under trust, or other legal obligations, for public purposes of a religious and charitable nature. Donors are given relief from income tax and gift tax

in respect of donations paid to institutions established in India for charitable purposes. A review of the scheme revealed mistakes in assessment, involving tax effect of Rs.11.46 crores in 232 cases. Some of the important observations are:

(i) Though the Income Tax Act allows a specific exemption for specified income of professional bodies engaged in the control, supervision, regulation or encouragement of the professions of law, medicine, accountancy, engineering etc., the Board has allowed a general exemption, granting further benefits to certain professional associations.**[Para 2.02.8(ii)]**

(ii) Trusts can get statutory exemptions of its income only on fulfilment of certain conditions. In assessments done summarily there is no scope to the assessing authorities to examine the various conditionalities. However, most of the trusts are being assessed in the summary manner. **[Para 2.02.8(iii)]**

(iii) Trusts which are absolutely exempted are not required to file their return of income. This makes the monitoring of such cases difficult.**[Para 2.02.8(i)]**

(iv) With a view to prevent abuse in the application and investment of trust funds, there are provisions which disentitle a trust from exemption, if its funds are used for the benefit of `interested persons' or invested otherwise than in specified modes. In several cases, recourse was not taken to these provisions.**[Para 2.02.9]**

(v) In many cases, contributions made for earmarked funds were treated as corpus funds despite the absence of direction to that effect and such contributions were erroneously excluded from the total income of the trust. In 81 such cases, there was short levy of Rs.423.03 lakhs.**[Para 2.02.10,12]**

(vi) No exemption is available under the Wealth Tax Act if the trust forfeits exemption under Income Tax Act for any infringement of its provisions. In a number of cases where the trusts had forfeited exemption under the Income Tax Act, the properties held by such trusts were not assessed for wealth tax.**[Para 2.02.19]**

Computerisation in the Income tax Department

(c)The Income Tax Department has decided, in principle, to computerise certain areas of work. Accordingly, computerisation was undertaken in a phased manner. The first phase commenced from October 1985. However,even after seven years, computerisation plans of the department are still to reach the operational stage. Although more than Rs.9.08 crores has been spent towards computerisation, the coverage has been very limited. Of the ten areas identified application software packages have been developed for six areas only. But implementation remains further limited to just four areas. The switchover to computer processing in these four areas was intermittent and computerised working coexisted with manual processing. Defects in assessments and refunds, processed through computers, continue to be observed. In implementing the plans, the department has been facing constraints on account of inadequacy of hardware capacity, shortage of trained staff and also staff resistance. The net result has been that computerisation, in the real sense, failed to take off.

8. Draft paragraphs

Significant audit points

1022 draft paragraphs involving a total tax effect of Rs.468.73 crores were issued to the Ministry of Finance for comments. Ministry's replies have not been received in 328 of these cases involving tax effect of Rs.93.79 crores. Selected 362 draft paragraphs involving revenue effect of Rs.391.19 crores have been included in this Report. Of these, the Ministry have so far accepted the observations in 144 cases with tax effect of Rs.132.82 crores. Internal Audit of the Income tax Department had failed to point out the mistakes in 31 cases involving tax effect of Rs.32.10 crores.

Corporation tax

9.(a) Avoidable mistakes

(i) In Delhi charge, while computing the total income of a company, provisions for store and spares etc were adopted at a figure of Rs.4758.91 lakhs instead of Rs.4942.89 lakhs leading to excess computation of loss

of Rs.183.98 lakhs involving potential tax effect of Rs.91.99 lakhs **[Para 3.07-A 1(i)].**

(ii) In Madhya Pradesh charge, instead of adopting profit of Rs.160.35 lakhs as per profit and loss account, loss of Rs.211.57 lakhs was adopted resulting in excess computation of loss of Rs.371.92 lakhs involving short levy of tax of Rs.204.56 lakhs. **[Para No.3.07.B.1].**

(b) Incorrect computation of business income

(i) In Maharashtra charge, interest included in the price of securities purchased during the year was not disallowed though it was capital expenditure. This led to under assessment of income of Rs.151.00 lakhs in the case of a public sector banking company involving short levy of tax of Rs.87.36 lakhs **[Para 3.10 A.1(i)].**

(ii) In West Bengal and Rajasthan charges, while computing the total income of two banking companies, deduction towards bad debt was allowed, though the debt was neither written off nor restricted to the amount by which the same exceeded the amount allowed as provision for bad debt. In another case of Delhi charge, the amount of bad debt written off was less than the available provision. This led to aggregate under assessment of income of Rs.14.20 crores involving short levy of tax of Rs.8.90 crores **[Para 3.11 A.1(i), (ii) & B]**

(iii) In West Bengal charge, in one case of a tea company, actual remittance of foreign currency was not there and yet loss on account of fluctuations in rate of exchange was allowed. This led to underassessment of income by Rs.44.85 lakhs involving short levy of tax of Rs.42.37 lakhs.**[Para 3.13.A]**

(iv) Provisions made in the accounts otherwise than for accrued or ascertained liabilities are not allowable as business expenditure. Incorrect allowance of unascertained liabilities towards provisions for doubtful dues from customers, doubtful debts and provision for wage revision of employees in three companies cases, assessed in Delhi and Madhya Pradesh charges, aggregating Rs.37.40 crores, led to potential short levy of tax of Rs.19.99 crores **[Para 3.14 A.1(i), (ii) and B (i)].**

(v) Any sum payable by way of taxes, contribution to an approved provident fund, superannuation fund, gratuity or any other fund for the welfare of the employees is not allowed as business expenditure unless actually paid in the previous year. In the cases of two companies, allowance of unpaid taxes, duties and contribution to various funds aggregating Rs.171.09 lakhs resulted in short levy of tax of Rs.92.46 lakhs in West Bengal charge **[Para 3.15A.1(i) &(iv)]**

(vi) In Gujarat charge, an amount of Rs.58.20 lakhs being sales tax, octroi etc.though initially disallowed, was subsequently allowed by the appellate authority. The original assessment was revised to give effect to the appellate decision, but the subsequent year's assessment was not revised to withdraw deduction of the same amount which was allowed on payment basis. This resulting in under assessment of an identical amount involving short levy of tax of Rs.40.87 lakhs **[Para 3.15 A.3(i)]**

(c) Other mistakes

(i) In West Bengal charge, while computing total income of an investment company, excess allowance of interest on renewal subscriptions led to under assessment of Rs.183.70 lakhs involving short levy of tax of Rs.188.78 lakhs including interest. **[Para 3.17 A.1(i)].**

(ii) In Maharashtra charge, in one case, additions on account of loss on sale of assets of Rs.5.79 lakhs was made, instead of Rs.189.93 lakhs leading to underassessment of income of Rs.184.14 lakhs, involving short levy of tax of Rs.127.74 lakhs.**[Para 3.17 A.1(ii)].**

(iii) In Delhi charge, while disallowing prior period expenses, amounts pertaining to earlier years on account of repairs and maintenance which were already allowed in the respective years were not disallowed leading to excess computation of loss of Rs.143.36 lakhs involving potential tax effect of Rs.71.68 lakhs.**[Para 3.17A.2(i)].**

(iv) In Gujarat charge, in the case of three closely held companies, the entire interest liability on the cost of machinery acquired on deferred payment basis was allowed instead

of allowing only that relatable to the relevent previous years, resulting in under assessment of income of Rs.298.02 lakhs involving short levy of tax of Rs.191.62 lakhs.**[Para 3.17 A.3]**

(v) In Delhi charge, in two cases prior period expenses of Rs.30.25 crores were allowed, even though the assessees were following the mercantile system of accounting, resulting in under assessment of identical amounts involving potential tax effect of Rs.18.39 crores **[Para 3.17.B.1(i) and (ii)]**

(d) Investment allowance

(i) In Gujarat charge, grant of depreciation, additional depreciation, extra shift allowance and investment allowance on pre-production expenditure of Rs.628.68 lakhs allocable against assets not entitled to the same led to under assessment of income of Rs.265.28 lakhs involving potential tax effect of Rs.153.20 lakhs.**[Para 3.18.A.2]**

(ii) In Maharashtra charge, excess carry forward and set off of investment allowance of Rs.21.06 crores led to under assessment of the like amount involving short levy of tax of Rs.13.27 crores. **[Para 3.18.B.1(i)]**

(e) Income not assessed

In West Bengal charge, in the case of a public sector electricity company,an income of Rs.292.71 lakhs accruing out of increase in the rate of tariff that became effective, was not included in the assessment leading to excess carry forward of loss of Rs.292.71 lakhs involving potential tax effect of Rs.153.67 lakhs.**[Para 3.19.A.1(i)]**

(f) Set off and carry forward of losses

(i) In the case of a public limited company (Bihar charge) due to incorrect working of the amount of loss to be carried forward, set off of loss beyond the prescribed period and failure to follow the prescribed order of priority, there was an excess carry forward of loss and unabsorbed depreciation aggregating Rs.113.89 crores involving potential tax effect of Rs.61.50 crores. **[Para 3.20.A.1].**

(ii) In Gujarat charge, in one case, income was assessed at `Nil' after adjusting carried forward business loss of Rs.4.47 crores and unabsorbed depreciation of Rs.1.14 crores. Audit scrutiny revealed that income was assessable at Rs.3.28 crores after setting off of unabsorbed allowances, which were only Rs.2.33 crores. The mistake resulted in underassessment of income of Rs.3.28 crores involving short levy of tax of Rs.1.94 crores **[Para 3.20.A.2(i)].**

(iii) In West Bengal charge, in the case of a private limited company, carry forward of excess amount of loss and unabsorbed depreciation of Rs.207.29 lakhs was allowed erroneously involving potential tax effect of Rs.114.01 lakhs **[Para 3.20 A.3(i)]**

(iv) A public limited company was erroneously allowed carry forward of losses of Rs.905.56 lakhs relating to an earlier year in respect of which the total loss assessed was only Rs.373.07 lakhs. There was thus excess carry forward of loss of Rs.532.49 lakhs involving potential tax effect of Rs.335.47 lakhs. Though the summary assessment scheme requires adjustment to be made on account of brought forward losses/allowances, reference to previous records, which is required for that purpose, is barred. The instant assessment was made summarily **[Para 3.20 B(1)(i)]**

(v) In West Bengal charge, a Government company, two public limited companies,and two other companies in Delhi charge were allowed to carry forward and set off losses of Rs.73.53 crores for assessment years 1988-89 and 1989-90 despite late filing of returns of income. This led to excess carry forward of business loss of Rs.37.38 crores, involving potential tax effect of Rs.19.64 crores.**[Para 3.20.B.2(1)].**

(g) Deduction under chapter VI-A Exemptions and reliefs

(i) In Andhra Pradesh charge, two private limited companies were allowed deductions on account of export of computer software and technology for the assessment years 1989-90 and 1990-91. However the provisions for such deduction was brought on the statute book only from assessment year 1991-92. This led

to under assessment of income of Rs.32.39 lakhs involving short levy of tax of Rs.20.85 lakhs. **[Para 3.23 A].**

(ii) In Maharashtra charge, a domestic company was wrongly allowed a deduction of Rs.46.82 lakhs towards inter-corporate dividend in respect of which the correct amount was Rs.8.55 lakhs. This led to under assessment of income of Rs.38.27 lakhs involving short levy of tax of Rs.30.25 lakhs **[Para 3.26.A]**

(iii) In West Bengal charge, a deduction of Rs.73.99 lakhs was allowed on the basis of gross receipts in foreign currencies instead of the correct amount of Rs.8.98 lakhs, alowable on net receipts, in the assessment of a company receiving fees in foreign currency for services rendered outside India. Consequently after invoking the provisions for minimum tax, income was computed at Rs.30.57 lakhs instead of Rs.65.51 lakhs. This led to under assessment of income of Rs.34.95 lakhs involving short levy of tax of Rs.26.71 lakhs.**[Para 3.27.B.1(i)]**

(iv) In the case of two non resident companies, resident of Japan, assessed in West Bengal charge, double taxation relief amounting to Rs.238.48 lakhs, being 50 percent of the Indian income tax, was allowed, though the companies had incurred world losses and therefore did not suffer any tax in Japan. This led to under assessment of tax of Rs.342.05 lakhs including interest. **[Para 3.28 A.1]**

(h)Minimum tax

(i) In Madhya Pradesh charge, in the case of a public sector company total income was computed at `Nil'.In doing so, deductions allowable were not restricted to 70 per cent of the book profits as required under the provisions of the Act resulting in short levy of tax of Rs.7.47 crores **[Para 3.29].**

(ii) In West Bengal charge, a widely held banking company was assessed at `Nil' income, though there was a book profit of Rs.862.81 lakhs. Failure to bring to tax 30 per cent of the book profits, as required under provisions of the Act, led to under-assessment of income of Rs.258.84 lakhs

involving short levy of tax of Rs.203.84 lakhs **[Para 3.30 B.1]**

(iii) In Maharashtra charge, in the case of a public sector banking company, the assessment was framed at a loss of Rs.122.06 crores. However, as per provisions regarding minimum tax, thirty per cent of the book profits should have been brought to tax. Omission to do so resulted in under assessment of Rs.204.13 crores involving short levy of tax of Rs.145.44 crores **[Para 3.30.B.2]**

(j) Irregular refund

In West Bengal charge, while revising the assessment of a closely held non-resident company, refund of Rs.14.79 lakhs was allowed instead of raising an additional demand of Rs.10.01 lakhs leading to excess refund of Rs.24.80 lakhs **[Para 3.31.(i)]**

(k) Interest

(i) In Maharashtra charge, in one case though directions were recorded by the assessing officer for levying interest on account of short payment of advance tax, such interest was not levied. Consequently there was non-levy of interest of Rs.49.08 lakhs **[Para 3.33]**

(ii) In West Bengal charge, though demand of Rs.954.38 lakhs for three assessment years was paid belatedly in 8 instalments by a widely held banking company, interest was not levied for such late payment. There was thus non-levy of interest of Rs.97.20 lakhs **[Para 3.34.1(i)]**

(iii) In West Bengal charge, in one case, though tax of Rs.614.09 lakhs was deducted from the interest on bonds issued by the assessee, the same was not credited to Government account within the prescribed time. However, penal interest of Rs.111.21 lakhs was not levied, **[Para 3.35]**

Surtax

10.(i) In Delhi and Tamil Nadu charges, omission to make timely surtax assessments for the assessment years 1983-84 to 1987-88 inspite of the directions of the Board for finalisation of the same within a month of the income tax assessment led to non-levy of surtax of Rs.1.59 crores in 3 cases **[Para 3.38.1(i) and (ii)].**

(ii) Incorrect computation of capital, while framing the surtax assessment, led to excess grant of statutory deduction of Rs.61.56 lakhs involving short levy of surtax of Rs.27.70 lakhs **[Para 3.38.3].**

Income tax other than corporation tax

11.(i) Mistake in computation of additional tax at Rs.2.06 lakhs instead of Rs.20.64 lakhs in an individual case assessed in Maharashtra charge led to short levy of additional tax of Rs.18.58 lakhs **[Para 4.06.B.1]**

(ii) Incorrect adoption of loss of Rs.7.66 lakhs in place of profit in the case of a co-operative society assessed in Karnataka charge led to under assessment of income of Rs.15.32 lakhs involving short levy of tax of Rs.7.67 lakhs **[Para 4.06.B.2].**

(iii) In West Bengal charge, in one case sales from branches was considered as Rs.82.67 lakhs instead of the correct figure of Rs.130.22 lakhs which led to under assessment of Rs.47.55 lakhs involving short levy of tax of Rs.34.79 lakhs **[Para 4.09.A.(ii)]**

(iv) Failure to disallow unpaid entry tax, being a statutory liability remaining unpaid, in the case of a registered firm assessed in West Bengal charge, led to under assessment of income of Rs.72.02 lakhs involving short levy of tax of Rs.47.10 lakhs **[Para 4.11.B.(i)]**

(v) In Maharashtra charge, in the case of a co-operative sugar mill, the assessing officer allowed depreciation of Rs.364.49 lakhs instead of Rs.123.49 lakhs in respect of one unit. Further, unabsorbed depreciation allowed to be brought forward was taken at Rs.45.98 lakhs instead of Rs.30.32 lakhs. The two mistakes led to excess computation of loss of Rs.224.88 lakhs and excess allowance of carry forward of unabsorbed depreciation of Rs.15.67 lakhs,involving potential tax effect of Rs.100.99 lakhs **[Para 4.14.2].**

(vi) While computing capital gain in the case of an individual assessed in Maharashtra charge, incorrect allowance of the prescribed deductions before applying the provisions relating to exemptions on account of sale of

a residential property, led to under assessment of income by Rs.29.81 lakhs involving short levy of tax of Rs.21.71 lakhs **[Para 4.17.1].**

(vii) Instructions issued by the Board require the Assessing officers to revise the share income of partners, wherever the income of a firm undergoes a revision. In Delhi, Gujarat, Haryana, Karnataka, Punjab, Tamil Nadu and Uttar Pradesh charges, though the firm and partners were assessed in the same wards, non-revision of share income of partners in 149 cases led to under assessment of income of Rs.2.40 crores involving short levy of tax of Rs.1.13 crores. Similarly, non revision of assessments was noticed in case of 36 partners of 9 firms assessed in different words, resulting in aggregate under assessment of income of Rs.96.90 lakhs involving short levy of tax of Rs.47.93 lakhs.**[Para 4.19.2(ii)& iii]**

(viii) In Tamil Nadu charge, in the case of a co-operative society, allowance of the relief in respect of a newly established industrial undertaking beyond the prescribed seven years led to under assessment of income of Rs.65.09 lakhs involving short levy of tax of Rs.47.02 lakhs **[Para 4.24.1].**

Other Direct Taxes

Wealth tax

12.(i) In Gujarat charge, in the cases of two assessees, substantial additions were made to their income, following discovery of undisclosed cash/income in search operations. However, the wealth tax returns did not include the assets that generated this income. There was consequent non-levy of wealth tax of Rs.16.54 lakhs **[Para 5.04.2].**

(ii) In the case of an individual assessed in Tamil Nadu charge, omission to adopt the Departmental valuer's valuation, as given in another case of similar house property built on an adjacent plot, led to under charge of wealth tax of Rs.10.23 lakhs **[Para 5.05.2(i)].**

(iii) In Tamil Nadu charge, non-levy of wealth tax on a company having taxable assets like buildings, led to short levy of wealth tax of Rs.13.60 lakhs over three years **[Para 5.09.1(a)(i)].**

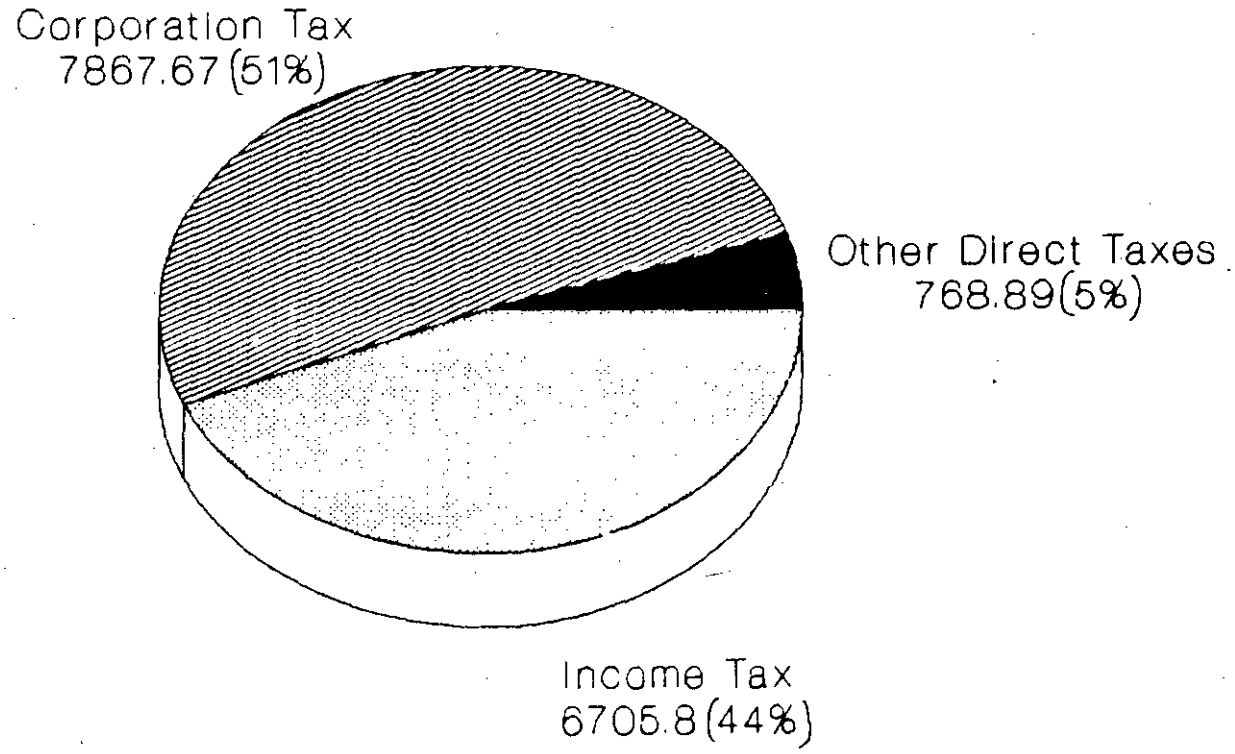
Other Direct Taxes

Gift tax

13.(i) In the case of an individual, assessed in Delhi charge, the market price of a plot of land was taken as Rs.5.47 lakhs although as per rates prescribed by the Ministry of Urban Development, the plot should have been valued at Rs.70.75 lakhs. This led to non assessment of deemed gift of Rs.65.28 lakhs involving non levy of gift tax of Rs.19.59 lakhs.**[Para 5.14.1(i)]**

(ii) In Gujarat charge,an assessee company sold immovable property to its subsdiary company for a consideration which was lower than the value of the property as per wealth tax assessment by Rs.34.99 lakhs. However, gift tax proceedings were not initiated for the deemed gift. This resulted in non-levy of gift tax of Rs.18.27 lakhs **[Para 5.14.2]**

INCOME TAX COLLECTIONS
(1991-92)



(Figures in crores of rupees)

CHAPTER 1

GENERAL

Receipts under various Direct Taxes

1.01 (i) The total proceeds from Direct Taxes for the year 1991-92* amounted to Rs.15,342.36 crores out of which a sum of Rs.5,104.32 crores was assigned to the States. The figures for the three years 1989-90, 1990-91 and 1991-92 are given below:

(In crores of Rupees)

		1989-90	1990-91	1991-92*
0020	Corporation Tax	4728.92	5335.27	7867.67
0021	Taxes on income other than Corporation tax	5008.98	5375.34	6705.80
0023	Hotel Receipts Tax	3.46	1.30	1.24
0024	Interest Tax	3.94	(-) 0.86	305.04
0028	Other Taxes on Income and Expenditure	71.63	80.27	144.38
0031	Estate Duty	4.27	3.07	2.86
0032	Taxes on wealth	178.51	231.17	306.93
0033	Gift tax	8.07	3.38	8.44
	Gross Total	10007.78	11028.94	15342.36
	Less share of net proceeds assigned to the States:			
	Income Tax Estate Duty Hotel Receipts Tax	3921.15	4.119.24	5,104.32
	Total	3,921.15	4.119.24	5,104.32
	Net Receipts	6,086.63	6,909.70	10,238.04

The gross receipts under Direct Taxes during 1991-92 went up by Rs.4,313.42 crores compared with the receipts during 1990-91 against an increase of

* Figures furnished by the Controller General of Accounts are provisional

Rs.1021.16 crores in 1990-91 over those for 1989-90. Receipts under Corporation Tax registered an increase of Rs.2,532.40 crores while receipts under "Taxes on Income other than Corporation-tax" accounted for an increase of Rs1330.46 crores.

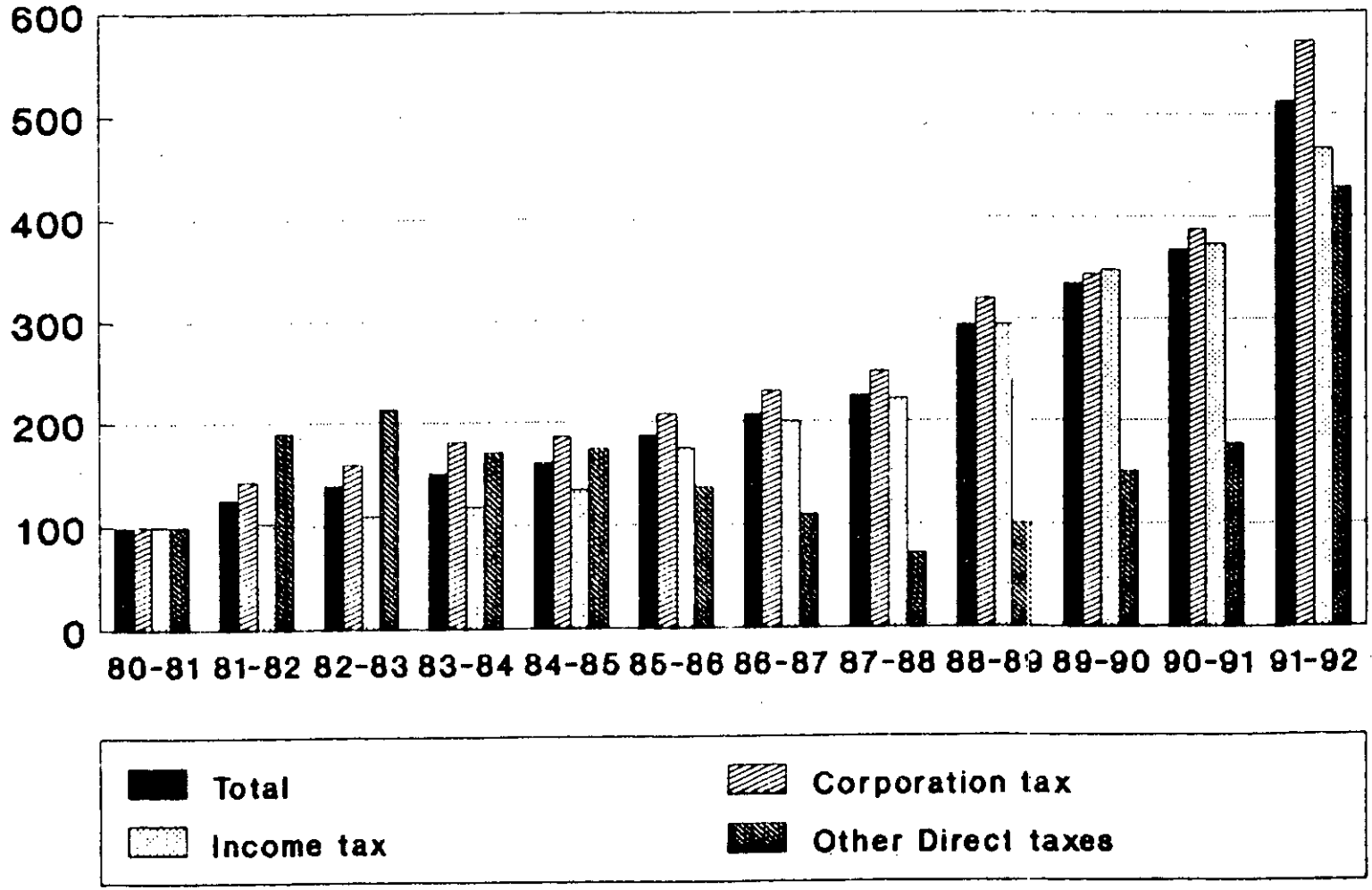
(ii) The trend in collection of Direct Taxes since 1980-81 has been as under:

Year	Collection (in crores of rupees)				Index taking 1980-81 as base			
	Corporation tax	Income Tax other than Corporation Tax	Other Direct Taxes	Total	Corporation tax	Income Tax other than Corporation tax	Other Direct Taxes	Total
1980-81	1377.45	1439.93	179.75	2997.13	100	100	100	100
1981-82	1969.96	1475.50	340.16	3785.62	143.0	102.5	189.2	126.3
1982-83	2184.51	1569.51	384.21	4138.23	158.6	109.0	213.7	138.1
1983-84	2492.73	1699.13	306.52	4498.38	181.0	118.0	170.5	150.1
1984-85	2555.89	1927.75	313.69	4797.33	185.6	133.9	174.5	160.1
1985-86	2865.08	2511.29	245.46	5621.83	208.0	174.4	136.6	187.6
1986-87	3159.96	2878.97	197.53	6236.46	229.4	199.9	109.9	208.1
1987-88	3432.92	3192.43	131.83	6757.18	249.4	221.7	72.2	225.5
1988-89	4407.21	4241.24	180.31	8828.76	320.0	294.6	100.3	294.6
1989-90	4728.92	5008.98	269.88	10007.78	343.3	347.8	150.1	333.9
1990-91	5335.27	5375.34	318.33	11028.94	387.3	373.3	177.1	367.9
1991-92	7867.67	6705.80	768.89	15,342.36	571.2	465.7	427.7	511.9

(iii)** Corporation Tax and income tax collections since 1980-81 shown as percentage of

** Figures are under reconciliation

TREND IN COLLECTION OF DIRECT TAXES OVER THE YEARS 1980-81 to 1991-92



(BASE YEAR 1980-81 - 100)

the Gross Domestic Product is as follows:

Year	Corporation tax	Income Tax other than Corporation-Tax	G.D.P. at factor cost (current prices)**	Corporation Tax as percent of G.D.P.	Income Tax as percent of G.D.P.
(1)	(2)	(3)	(4)	(5)	(6)
			(Rupees in crores)		
1980-81	1377.45	1439.93	1,22,427	1.1	1.2
1981-82	1969.96	1475.50	1,43,216	1.4	1.0
1982-83	2184.51	1569.51	1,59,395	1.4	1.0
1983-84	2492.73	1699.13	1,86,723	1.3	0.9
1984-85	2555.89	1927.75	2,08,577	1.2	0.9
1985-86	2865.08	2511.29	2,33,476	1.2	1.1
1986-87	3159.96	2878.97	2,59,055	1.2	1.1
1987-88	3432.92	3192.43	2,94,266	1.2	1.1
1988-89	4407.21	4241.24	3,51.724	1.3	1.2
1989-90	4728.92	5008.98	3,95,143	1.2	1.3
1990-91	5335.27	5375.34	4,72,660	1.1	1.2
1991-92*	7867.67	6705.80	5,41,888	1.5	1.2

Variation between Budget estimates and Actuals

1.02.1 The Actuals for the year 1991-92 under the Major heads 0020-Corporation-tax and 0021 Taxes on Income other than Corporation tax exceeded the Budget Estimates.

The figures for the years from 1987-88 to 1991-92 under the different heads are given below:

** GDP Figures collected from National Accounts Statistics Organisation, Ministry of Planning. GDP figures for 1991-92 are as per estimates of NASO

* Figures furnished by the Controller General of Accounts are provisional

Year	Budget Estimates	Actuals	Variation	Percentage of of variation
			(In crores of Rupees)	
0020-Corporation Tax				
1987-88	3,452.00	3,432.92	(-)19.08	(-)0.55
1988-89	4,050.00	4,407.21	357.21	8.82
1989-90	4,500.00	4,728.92	228.92	5.08
1990-91	5,289.00	5,335.27	46.27	0.87
1991-92*	6,704.00	7,867.67	1163.67	17.35
0021-Taxes on Income other than Corporation Tax				
1987-88	2,845.00	3,192.43	347.43	12.21
1988-89	3,650.00	4,241.24	591.24	16.20
1989-90	4,000.00	5,008.98	1008.98	25.22
1990-91	5,676.00	5,375.34	(-)300.66	(-)5.30
1991-92*	6,152.00	6,705.80	553.80	9.00
Other Direct Taxes##				
1987-88	141.00	126.13	(-)14.87	(-)10.54
1988-89	133.25	137.99	4.74	3.55
1989-90	132.60	194.79	62.19	46.90
1990-91	187.50	236.76	49.26	26.27
1991-92*	801.30	623.27	(-)178.03	(-)22.21

2*. The details of variation under the heads subordinate to the Major Heads 0020 and 0021 for the year 1991-92 are given below:

		Budget	Actuals	(In crores of Rupees) Increase(+) Shortfall(-)	Percentage of variation
0020-Corporation Tax					
(i)	Income Tax on companies	5891.00	7290.65	(+)1399.65	23.75
(ii)	Surtax	9.00	2.81	(-)6.19	(-)68.77
(iii)	Surcharge	788.00	493.84	(-)294.16	(-)37.32
(iv)	Receipts awaiting transfer to other minor heads	-	-	-	-

* Figures furnished by Ministry of Finance are provisional and under reconciliation

##includes Interest Tax, Estate Duty, Wealth Tax, Gift Tax. Details are given in Appendix I.

(v)	Other receipts	16.00	80.37	(+)64.37	402.31
	Total	6,704.00	7867.67	(+)1163.67	17.35
0021-Taxes on Income Tax other than Corporation Tax					
(i)	Income tax	5742.00	6470.97	(+)728.97	12.69
(ii)	Surcharge	373.00	146.14	(-)226.86	(-)60.82
(iii)	Receipts awaiting transfer to other minor heads	-	-	-	-
(iv)	Other receipts	37.00	88.69	(+)51.69	139.70
(v)	Deduct share of proceeds assignedto States	(-)4,564.91	(-)5104.32	(+)539.41	11.81
	Total	1587.09	1601.48	(+)14.93	0.90

Analysis of collection

1.03* 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 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.

1 (i) The break up of total collections of Corporation-tax, Surtax and Interest Tax from companies and taxes on income other than orporation Tax from non-companies, at pre-assessment and post-assessment stages, during the year 1991-92 as furnished by the Ministry of Finance is given below:

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* Figures furnished by the Ministry of Finance are provisional and under reconciliation

1.03 COLLECTION ANALYSIS

	Company				Non-company	
					(Amount in crores of rupees)	
	Corporation tax	Surtax	Interest tax	Total	Income tax	Total
Tax deducted at source	2348.13	-	-	2348.13	3627.80	5975.93
Advance Tax	5962.38	-	-	5962.38	2504.81	8467.19
Self-assessment	455.31	-	-	455.31	721.32	1176.63
Regular assessment	1153.75	-	-	1153.75	414.33	1568.08
Other receipts including surcharge	543.56	3.34	-	546.90	255.71	802.61
Total collections	10463.13	3.34	-	10466.47	7523.97	17990.44
Refunds	2613.14	0.53	-	2613.67	794.79	3408.46
Net collections	7849.99	2.81	-	7852.80	6729.18	14581.98

(ii) The sub-head wise break up total income tax collections for companies, non companies and total thereof for the years 1987-88 to 1991-92, as furnished by the Ministry of Finance, is as follows:

Tax collection (In crores of rupees)

Year	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds	Net collection
Company								
1987-88	830.90	2,446.24	195.06	633.81	31.13	4,137.14	704.23	3,432.91
1988-89	841.12	3,347.50	337.10	501.92	123.67	5,151.31	744.75	4,406.56
1989-90	1,684.89	3,017.30	364.31	1,029.75	80.19	6,176.44	1,462.25	4,714.19
1990-91	1,499.58	4,085.01	355.98	1,127.67	207.17	7,275.41	1,944.79	5,330.62
1991-92*	2.348.13	5,962.38	455.31	1157.09	543.56	10,466.47	2613.67	7,852.80
Non-company								
1987-88	1,446.03	1,465.83	418.24	207.55	28.75	3,566.40	374.30	3,192.10
1988-89	1,862.79	2,085.00	454.60	195.02	45.69	4,643.10	404.94	4,238.16
1989-90	2,665.67	1,967.21	535.94	326.90	81.83	5,577.55	569.26	5,008.29
1990-91	2,583.36	2,227.64	639.30	562.18	175.89	6,188.37	827.74	5,360.63
1991-92*	3,627.80	2,504.81	721.32	414.33	255.71	7,523.97	794.79	6,729.18
Total								
1987-88	2,276.93	3,912.07	613.30	841.36	59.88	7,703.54	1,078.53	6,625.01
1988-89	2,703.91	5,432.50	791.70	696.94	169.36	9,794.41	1,149.69	8,644.72
1989-90	4,305.56	4,984.51	900.25	1,356.65	162.02	11,753.99	2,031.51	9,722.48
1990-91	4,082.94	6,312.65	995.28	1,689.85	383.06	13,463.78	2,772.53	10,691.25
1991-92*	5,975.93	8,467.19	1,176.63	1,568.08	802.61	17,990.44	3,408.46	14,581.98

* Figures furnished by Ministry of Finance are provisional

2* The details of tax collections from Government companies, Corporations (including nationalised banks) and foreign companies out of the company assessees in sub-para '1' above, during the year 1991-92 as furnished by the Ministry of Finance are as under:

(In crores of rupees)

	Government companies and Corporations	Foreign companies	Others	Total
Advance Tax	1573.99	208.52	2777.16	4559.67
Self-assessment	79.38	8.59	531.64	619.61
Regular assessment	290.31	13.87	611.02	915.20
Surtax	0.42	--	1.01	1.43
Interest Tax	88.25	19.08	187.80	295.13
Total	2032.35	250.06	4108.63	6,391.04

3.(i) The details of tax deduction at source during the year 1991-92 under broad categories are as under:

	Amount(in crores of rupees)
Salaries	1600.54
Interest on securities	1422.89
Dividends	391.27
Interest	778.80
Winnings from lottery or cross word puzzles	46.56
Winnings from horse races	10.09
Payments to contractors and sub-contractors	995.46
Insurance commission	119.08
Payment to non-residents and others	611.24
Total*	5,975.93

(ii)*. The details of tax deducted at source, the number of statements of tax deducted at source received and the tax actually remitted to Government account for the year 1991-92 under broad categories are as under:

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

1.03 COLLECTION ANALYSIS

(Rupees in crores)

Income	No. of statements received	Tax deducted as per statements	Tax remitted to Govt. Account	Balance due for remittance	
				For the year	Upto the end of the year
(a)Salary	1.14.184	928.58	927.69	0.89	0.89
(b)Interest	1,86,056	307.36	307.32	0.04	0.04
(c)Contractors/sub contractors	32,439	338.17	338.16	0.01	0.01
(d)Others**	16,421	482.76	482.21	0.11	0.06
Total*	3,49,100	2,056.47	2,055.38	1.05	1.20

Advance Tax

4.* Tax payable and collected by way of advance-tax during the year 1991-92 is as under:

(In crores of rupees)

	Company				Non-company	
	Corporation tax	Surtax	Interest tax	Total	Income tax	Total
1. Arrear demand	66.76	0.02	-	66.78	8.27	75.05
2. Current demand	985.29	-	41.15	1026.44	1012.09	2038.53
3.Collections:						
(a) Out of arrear demand	2.52	-	-	2.52	3.20	5.72
(b) Out of current demand	1469.61	-	21.76	1491.37	1280.91	2772.28
(c) Total	1472.13	-	21.76	1493.89	1284.11	2778.00
4. Balance demand						
(a) Arrear	64.24	0.02	-	64.26	5.07	69.33
(b) Current	(-)484.31	-	19.38	(-)464.93	(-)268.82	(-)773.75
(c) Total	(-)420.07	0.02	19.38	(-)400.67	(-)263.75	(-)664.42

** includes interest on securities, dividends, etc.
For details see Appendix II.

* Figures furnished by Ministry of Finance are provisional and under reconciliation.

Cost of collection

1.04.1 The total expenditure incurred during the year 1991-92 and earlier three years in collecting the direct taxes are as under:

(In crores of Rupees)

Year	Collection	Expenditure	Percentage
1988-89	8,828.76	187.28	2.12
1989-90	10,007.78	210.39	2.10
1990-91	11,028.94	230.18	2.09
1991-92*	15,342.36	256.46	1.67

1.04.2* The expenditure incurred during the year 1991-92 in collecting Corporation Tax, Taxes on Income other than Corporation Tax and Other Direct Taxes together with the corresponding figures for the preceding three years, is as under:

	Collection (In crores of Rupees)	Expenditure on collection	Percentage
0020-Corporation Tax			
1988-89	4,407.21	20.56	0.47
1989-90	4,728.92	25.24	0.53
1990-91	5335.27	27.62	0.52
1991-92*	7867.67	30.77	0.39
0021-Taxes on income etc.			
1988-89	4,241.24	148.42	3.50
1989-90	5,008.98	164.10	3.28
1990-91	5,375.34	179.53	3.33
1991-92*	6,705.80	200.02	2.98
Other Direct Taxes#			
1988-89	180.15	18.30	10.15
1989-90	266.42	21.05	7.90
1990-91	317.03	23.03	7.26
1991-92*	767.65	25.67	3.34

* Figures furnished by the Controller of Accounts, are provisional and under reconciliation.

Includes interest tax, expenditure tax estate duty, wealth tax and gift tax.
For details, see Appendix III

Number of assessees

Income tax

1.05.1 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 1991-92 no income tax was payable on a total income not exceeding Rs.22,000 except in the case of specified Hindu undivided family, registered firms, co-operative society, local authority and company where a lower limit is applicable.

(i) The total number of assessees in the books of the department was 77,95,186 as on 31st March 1992* as against 75,28,269 as on 31 March 1991. The break up of the assessees on the said two dates was as under:

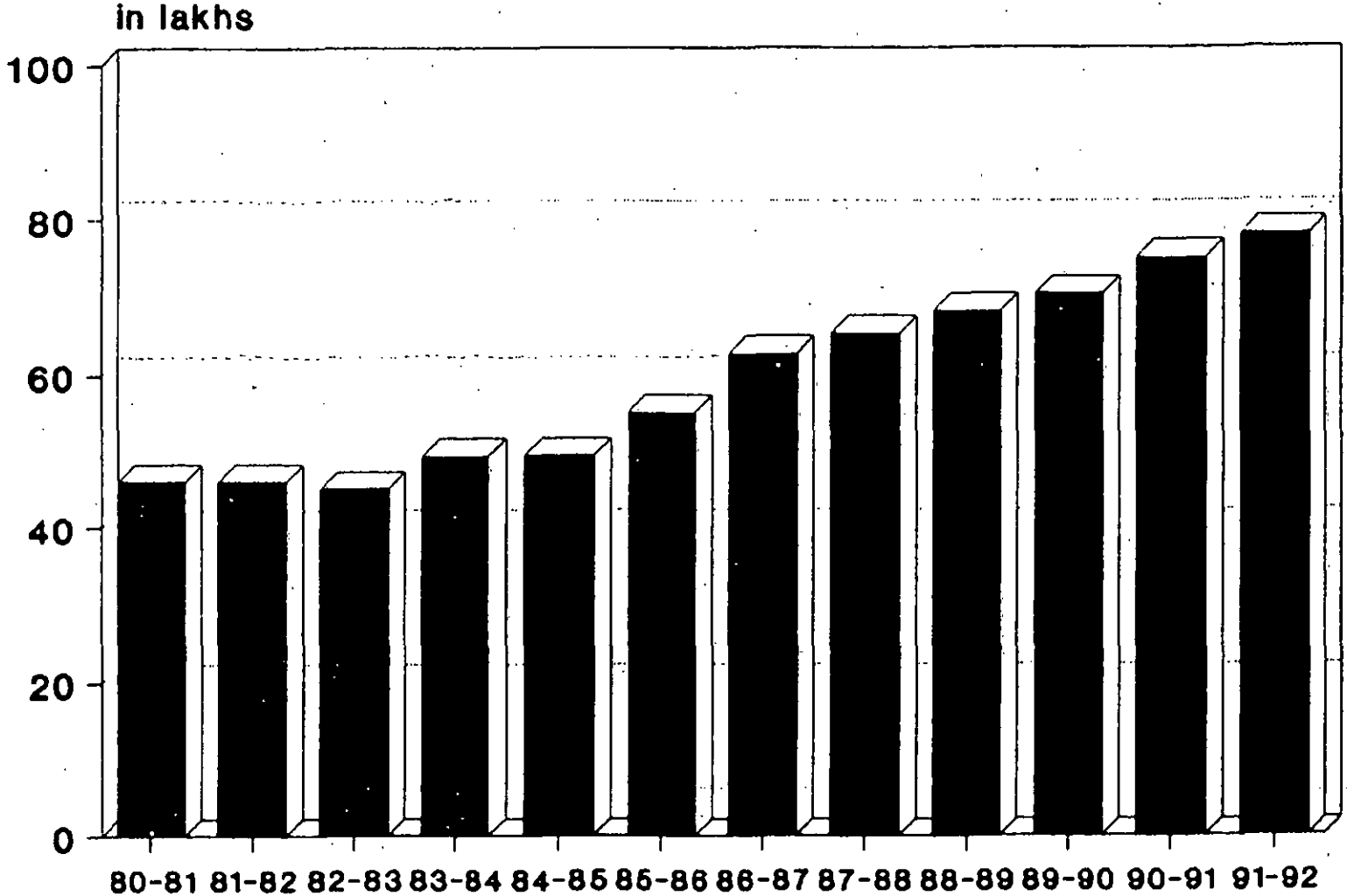
	As on 31 March 1991	As On 31 March 1992*
Individuals	57.55.998	58,78,404
Hindu undivided families	3,80,680	4,19,908
Firms	11,82,977	12,96.063
Companies	1,24,402	1.34.779
Trusts	43,531	41.049
Others	40.681	31,080
Total	75,28,269	77,95,186

(ii)* The following table indicates the break up of assessees according to slabs of income:

	Individuals	Hindu undivided families	Firms	Companies	Others (including Trusts)	Total
(i) Below taxable limit	7,59,152	64,417	1,66,283	37,505	39,485	10,16,842*
(ii) Above taxable limit but upto Rs.1,00,000	48,77,669	3,27,292	10,09,824	55,478	27,454	62,97,106*
(iii) Rs.1,00,001 to Rs.5,00,000	2,33,109	27,450	1,61,747	21,828	4,321	4,48,455
(iv) Above Rs.5,00,000	8,474	749	8,209	14,482	869	32,783
Total	58,78,404	4,19,908	12,96,06	1,34,779	72,129	77,95,186

*. Figures furnished by the Ministry of Finance are provisional and under reconciliation

Total number of Assessees



Surtax

2. 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 15 percent (from 1st April 1977) of the capital of the company or Rs. two lakhs, whichever is greater.

The number of surtax assessees in the books of the department as furnished by the Ministry of Finance for the last three years was as under:

Year ending	No. of assessees
31st March 1990	2,375
31st March 1991	1,860
31st March 1992*	1,391

Interest Tax

3. The number of assessees for Interest tax in the books of the department as furnished by the Ministry of Finance for the last three years was as under:

Year ending	No. of assessees
31st March 1990	63
31st March 1991	52
31st March 1992*	152

Wealth Tax

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

For the assessment year 1991-92 no wealth tax was payable where the net wealth is less than Rs.2.50 lakhs.

(i) The number of wealth tax assessees in the books of the department as on 31st March 1991 and 31 March 1992 were as follows:

	As on 31st March 1991	As on 31st March 1992*
Individuals	5,70,599	5,91,681
Hindu undivided family	75,314	78,021
Companies	14,292	15,205
Others	88	502
Total	6,60,293	6,85,409

* Figures furnished by Ministry of Finance are provisional and under reconciliation

(ii)* The following table indicates the break up of assessees according to slabs of income:

	Individuals	Hindu undivided families	Companies	Others	Total
(i) Below taxable limit	79,284	13,669	2,016	210	95,179
(ii) Above taxable limit but upto Rs.5,00,000	3,62,958	47,107	10,111	149	4,20,325
(iii) Rs.5,00,001 to Rs.10,00,000	1,16,676	13,574	2,166	65	1,32,481
(iv) Rs.10,00,001 to Rs.15,00,000	23,435	2,548	522	37	26,542
(v) Above Rs.15,00,000	9,328	1,123	390	41	10,882
Total	5,91,681	78,021	15,205	502	6,85,409

Gift Tax

5. 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 1991-92 no gift tax was payable where the value of taxable gifts did not exceed Rs.20,000.

The number of gift tax assessment cases for disposal for the years 1990-91 and 1991-92 were as follows:

1990-91	62,572
1991-92*	52,859

* Figures furnished by the Ministry of Finance are provisional

Estate Duty

6. 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 was levied upon the principal value of the estate comprising all property settled or not settled including agricultural land, which passes on death.

No estate duty is leviable in respect of estate passing on death occuring on or after 16 March 1985.

The number of estate duty assessment cases for the years 1990-91 and 1991-92 was as follows:

1990-91	2,008
1991-92*	1,671

Arrears of assessment

1.06 The limitation period for completion of assessment is 2 years in the case of income tax, wealth tax and gift tax

1. Sanctioned and working strengh of officers on assessment duty as on 31st March 1991 and 31 March 1992 were as under:

	Nature of Posts	As on 31st March 1991		As on 31st March 1992*	
		Sanctioned strength	Working strength	Sanctioned Strength	Working strength
(a)	Income Tax Officers on assessment duty	2,131	1,876	2,410	2,175
(b)	Deputy Commissioner (Assessment)	266	255	253	253
(c)	Asstt. Controllers of Estate Duty	45	45	36	28
	Total	2,442	2,176	2,699	2,456

2. Income Tax including Corporation Tax

(i) The number of assessments completed during the five years was as under:

*Figures furnished by the Ministry of Finance are provisional.

Financial year	Number of assessments for disposal			Number of assessments completed			
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Percentge
1987-88	5,29,761	70,43,560	75,73,321	3,41,570	61,23,953	64,65,523	85.37
1988-89	4,31,343	66,95,326	71,26,669	2,92,790	58,80,475	61,73,265	86.54
1989-90@	4,44,724	64,42,103	68,84,856	2,97,543	54,01,950	56,98,310	82.76
1990-91*	4,41,797	72,28,910	76,70,707	2,60,722	61,27,783	63,88,505	83.28
1991-92*	5,34,174	75,00,631	80,34,805	3,06,495	64,06,919	67,13,414	83.55

Number of assessments pending at the end of the year

	Scrutiny	Summary	Total
1987-88	1,88,191 (16.98 %)	9,19,607 (83.02%)	11,07,798
1988-89	1,38,553 (14.53 %)	8,14,851 (85.47%)	9,53,404
1989-90	1,47,181 (12.40 %)	10,40,153 (87.60%)	11,86,546
1990-91*	1,77,766 (13.86%)	11,04,436 (86.14%)	12,82,202
1991-92	2,27,679 (17.23%)	10,93,712 (82.77%)	13,21,391

It would be seen from the above table that percentage of pending scrutiny cases has continued to remain very high, ranging from 16.98 per cent in 1987-88 to 17.23 per cent in 1991-92.

(ii) Status-wise break up of income tax assessments completed during the year 1990-91 and 1991-92 was as under:

		1990-91	1991-92*
(i)	Individuals	48,84,380	51,85,928
(ii)	Hindu undivided families	3,15,008	3,15,439
(iii)	Firms	10,22,155	10,22,250
(iv)	Companies	1,19,265	1,46,998
(v)	Association of persons	47,697	42,799
	Total	63,88,505*	67,13,414

@ Figures are under reconciliation by Ministry of Finance

* Figures are provisional and under reconciliation by Ministry of Finance

(iii)* Status-wise and income range-wise break up of pendency of assessments as on 31 March 1992 was as under:

Sr. No.	Status	No. of pending assessments with income			
		Upto Rs.1,00,000	Rs.1,00,001 to Rs.5,00,000	Over Rs.5,00,000	Total
1.	Companies	32,083	13,820	20,458	66,361
2.	Firms	1,38,240	53,105	8,573	1,99,918
3.	Individuals	9,07,979	72,647	6,065	9,86,691
4.	Hindu undivided families	47,211	6,790	1,040	55,041
5.	Others	11,099	1,690	591	13,380
	Total	11,36,612	1,48,052	36,727	13,21,391

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

	As on 31st March 1991	As on 31st March 1992
1987-88 and earlier years	10,782	5,965
1988-89	42,697	5,629
1989-90	2,18,493	15,653
1990-91	10,10.230	2,33,369
1991-92	--	10,60,775
Total*	12,82,202	13,21,391

(v)* Status-wise and year-wise break up of pendency of income tax assessments as on 31st March 1992 was as under:

* Figures furnished by Ministry of Finance are provisional and under reconciliation

1.06 ARREAR OF ASSESSMENT

	Status	1987-88 and earlier years	1988-89	1989-90	1990-91	1991-92	Total
(a)	Company assessments						
(i)	Regular	147	237	1,133	14,178	46,154	61,849
(ii)	Reopened/ set aside	1,025	485	754	482	1,766	4,512
(b)	Non-company assessments						
(i)	Regular	885	2,311	10,797	2,05,784	9,96,229	12,16,006
(ii)	Reopened/ set aside	3,908	2,596	2,969	12,925	16,626	29,024
	Total	5,965	5,629	15,653	2,33,369	10,60,775	13,21,391

The number of assessments pending as on 31st March 1992 was 13,21,391 as compared to 12,82,202 as on 31st March 1991 and 11,86,546 on 31st March 1990.

Wealth Tax, Gift Tax and Estate Duty

1.WEALTH TAX

3.(i)* The number of wealth tax assessments completed during the year 1991-92 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
10,15,199	6,87,158	68	3,28,041

(ii)* Status-wise break up of the wealth tax assessments completed during the years 1990-91 and 1991-92 were as under:

	Status	No. of assessments completed during 1990-91	1991-92
(i)	Individuals	5,21,279	6,02,885
(ii)	Hindu undivided families	61,201	67,347
(iii)	Companies	13,779	16,608
(iv)	Others	152	318
	Total	5,96,411	6,87,158

* Figures furnished by Ministry of Finance are provisional

(iii)* Assessment year-wise position of pendency of assessments at the end of 1991-92 was as under:

Year	No. of assessments		Total
	Regular	Reopened	
1987-88	1,773	1,346	3,119
1988-89	3,285	526	3,811
1989-90	8,880	759	9,639
1990-91	83,526	737	84,263
1991-92	2,26,496	713	2,27,209
Total	3,23,960	4,081	3,28,041

(iv)* Status-wise and wealth range-wise break up of pendency of wealth tax assessments at the end of 1991-92 was as under:

Taxable Wealth-range	Number of pending assessments				
	Status				
	Individual	HUFs	Companies	Others	Total
Up to Rs.2,50,000	37,208	5,363	3,815	114	46,500
Rs.2,50,001 to Rs.5,00,000	1,54,386	18,448	3,285	66	1,76,185
Rs.5,00,001 to Rs.10,00,000	73,906	9,059	1,913	29	86,907**
Rs.10,00,001 to Rs.15,00,000	10,797	1,180	241	20	12,238
Over Rs.15,00,000	5,263	545	394	9	6,211
Total	2,83,560	34,595	9,648	238	3,28,041

2. GIFT TAX (i)* The number of gift tax assessments completed during the year 1991-92 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
52,859	42,176	80	10,683

(ii)* Assessment year-wise position of pendency of assessments at the end of 1990-91 was as under:

Year	Number of assessments		Total
	Regular	Reopened	
1987-88 and earlier years	101	82	183
1988-89	102	24	126
1989-90	863	158	1,021
1990-91	2,801	3	2,804
1991-92	6,534	15	6,549
Total	10,401	282	10,683

* Figures furnished by the Ministry of Finance are provisional

3. ESTATE DUTY (i)* The number of estate duty assessments completed during the year 1991-92 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
1,671	651	39	1020

(ii)* The number of assessments completed according to range of principal value of estate was as under:

Principal value of estate	Number of assessments completed
Up to Rs.5,00,000	520
Rs.5,00,001 to Rs.10,00,000	87
Rs.10,00,001 to Rs.15,00,000	29
Above Rs.15,00,000	15
Total	651

(iii)* Assessment year-wise position of pendency of assessments at the end of the year 1991-92 was as under:

Assessment Year	Number of assessments		
	Regular	Reopened/ set aside	Total
1987-88 and earlier years	647	168	815
1988-89	40	22	62
1989-90	50	17	67
1990-91	39	1	40
1991=92	28	8	36
Total	804	216	1,020

(iv)* Estate value-wise pendency of assessments at the end of the year 1991-92 was as under:

Principal value of estate	Number of assessments
Up to Rs.5,00,000	469
Rs.5,00,001 to Rs.10,00,000	416
Rs.10,00,001 to Rs.15,00,000	77
Above Rs.15,00,000	58
Total	1020

* Figures furnished by the Ministry of Finance are provisional

4. SURTAX (i)*The number of surtax assessments completed during the year 1991-92 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
2085	326	16	1759

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1991-92 was as under:-

Assessment year	Number of assessments
1987-88 and earlier years	1,275
1988-89	137
1989-90	104
1990-91	101
1991-92	142
Total	1,759

5.INTEREST TAX (i)* The number of interest tax assessments completed during the year 1990-91 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
48	3	6	45

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1991-92 was as under:

Assessment year	Number of assessments
1987-88 and earlier years	25
1988-89	1
1989-90	-
1990-91	4
1991-92	15
Total	45

*Figures furnished by Ministry of Finance are provisional

Arrears of Tax Demands

1.07.1 The Income Tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 30 days unless the time for payment is extended by the 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 as per return has been paid before filing the appeal.

Corporation Tax (including surtax) and Income Tax

(i)(a)* The total demand of tax raised and remaining uncollected as on 31st March 1992 was Rs.8,460.98 crores, out of which arrears of Rs.5038.33 crores related to companies. The arrears included Rs.3,618.44 crores in respect of which the permissible period of 30 days had not expired as on 31st March 1992, Rs.139.52 crores claimed to have been paid but remaining to be verified/adjusted, Rs.2,089.92 crores stayed/kept in abeyance and Rs.107.31 crores for which instalments had been granted and instalments not fallen due.

(b)* The details of demands of Income tax (including corporation-tax) stayed/kept in abeyance as on 31 March 1992 were as under:

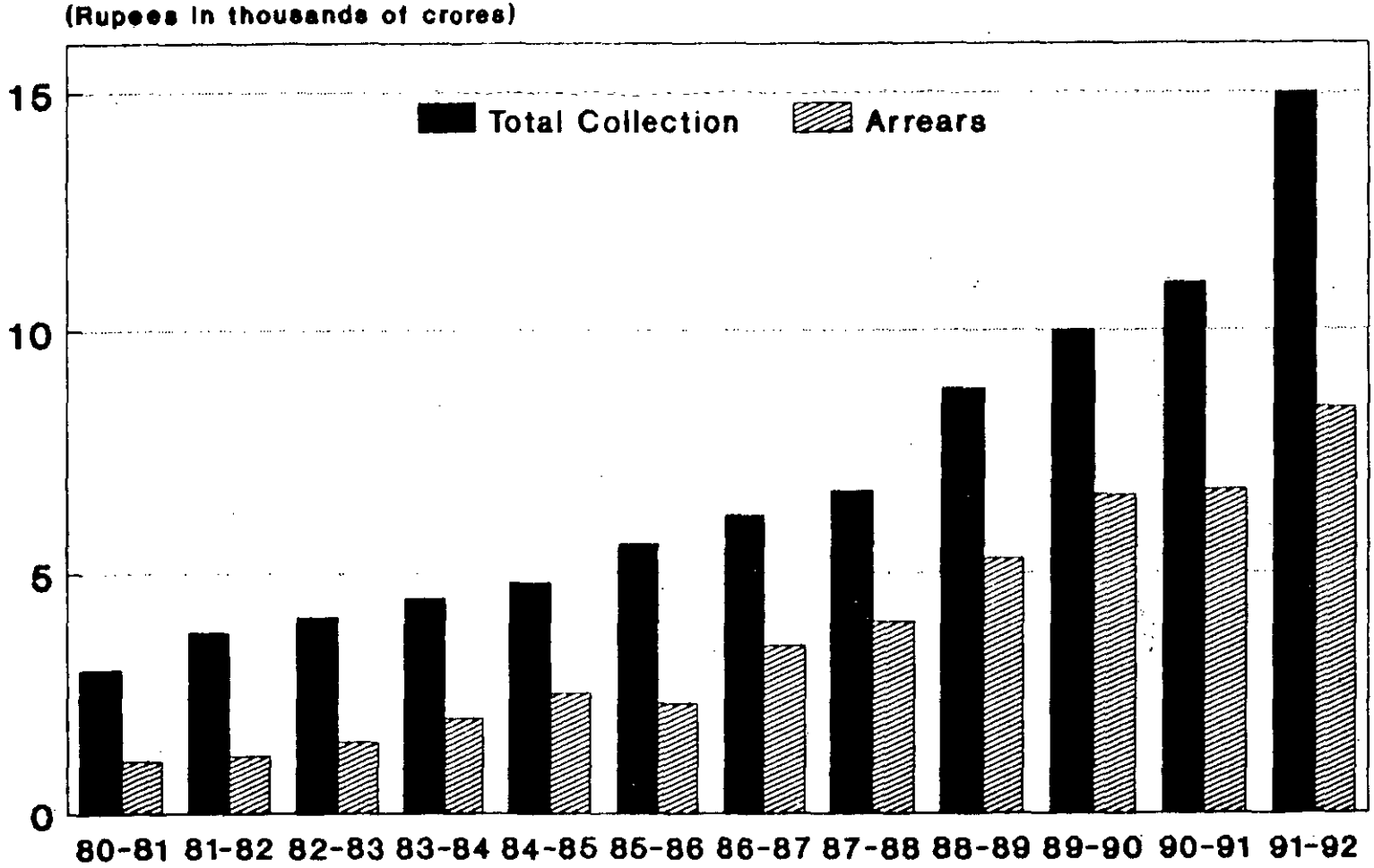
(In crores of rupees)

(1)	By courts	252.01
(2)	Under Section 245(F)(2) (Application to Settlement Commission)	82.56
(3)	By Tribunals	113.37
(4)	By Income tax authorities due to	
	(i) Appeals and revisions	723.34
	(ii) Double Income Tax claims	0.66
	(iii) Restriction of remmittances Sec.220(7)	3.58
	(iv) Other reasons	914.40
	Total	2.089,92

* Figures furnished by the Ministry of Finance are provisional

ARREARS OF INCOME TAX

JUXTA POSITIONED AGAINST COLLECTION



(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:

(In crores of rupees)

	Corporation Tax	Income Tax	Interest	Penalty	Total
1987-88 and earlier years	236.51	316.96	324.38	158.38	1,036.23
1988-89	108.40	102.15	128.76	53.57	392.88
1989-90	269.77	173.46	252.35	86.44	782.02
1990-91	399.56	327,70	399.41	173.07	1299.74
1991-92	2,056.30	1,478.43	1,240.20	175.18	4,950.11
Total	3,070.54	2,398.70	2,345.10	646.64	8460.98

(d)* The following table gives the break up of the gross arrears of Rs.8,460.98 crores by certain slabs of income.

(Rupees.in crores)

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Upto Rs.1 lakh in each cases	87961	503.13	212.06	3574379	1156.62	526.06	3662340	1659.65	738.12
Over Rs.1 lakh to Rs.5 lakhs in each case	7995	189.36	93.45	22765	366.78	193.58	30760	556.14	287.03
Over Rs.5 lakhs to Rs.10 lakhs in each case	2462	183.15	93.75	6582	225.05	116.08	9044	408.20	209.83
Over Rs.10 lakhs to Rs.25 lakhs in each case	1617	371.74	108.89	2824	360.06	137.12	4441	731.80	246.01
Over Rs.25 lakhs in each case	1936	3769.66	664.62	2203	1335.53	360.19	4139	5105.19	1024.81
Total	1,06,971	5017.04	1172.77	3608753	3443.94	1333.03	3710724	8460.98	2505.80

Note:Net arrears represent gross arrears as reduced by demand not yet due, amounts claimed to have been paid but still to be verified,demand stayed and instalments granted but which have not fallen due.

(e)* Classification of tax in arrears (Gross)

		Amount(in crores of rupees) Arrears	Current	Total
1(a)	Amount due from companies in liquidation			
	(i) Pending consideration of write-off/ scaling down petitions	21.72	1.73	23.45
	(ii) Others	36.55	52.52	89.07
	(iii) Total	58.27	54.25	112.52
(b)	Amounts due from non-company assessees involved in insolvency proceedings			
	(i) Pending consideration of scaling down petitions/write off	2.34	-	2.34
	(ii) Others	13.86	32.97	46.83
	(iii) Total	16.20	32.97	49.17
(c)	Total of (a) (iii)and (b)(iii)	74.47	87.22	161.69
2(a)	Amounts due from assessees who have left India and who have no known assets	1.10	-	1.10
(b)	Amount due from assessees who are not traceable and or who have no known assets			
	(i) Pending consideration of write off/ scaling down petitions	12.80	-	12.80
	(ii) Others	10.29	1.22	11.51
	(iii) Total	23.09	1.22	24.31
(c)	Total (a) and (b)(iii)	24.19	1.22	25.41

		Arrears	Current	Total
3.	Amounts due from undertakings which have been nationalised or taken over by the Government where the erstwhile owners do not have enough assets to pay the tax			
(i)	Pending consideration of scaling down petitions/write off	0.59	-	0.59
(ii)	Others	21.40	1.75	23.15
(iii)	Total	21.99	1.75	23.74
4.	All other amounts in arrears			
(i)	Pending consideration of scaling down petitions/write off	3.32	0.14	3.46
(ii)	Which are not being realised for various reasons for genuine hardship	434.77	551.64	986.41
(iii)	Balance being the realisable amount	2,952.13	4,308.14	7,260.27
(iv)	Total	3,390.22	4,859.92	8,250.14
(v)	Total of 1(c), 2(c), 3(iii) and 4(iv)	3,510.87	4,950.11	8,460.98

* Figures furnished by the Ministry of Finance are provisional

(ii)* The amounts of interest tax in arrears and the year-wise break up thereof are given below:-

	No. of cases	Amount (In crores of rupees)
1987-88 and earlier years	-	-
1988-89	44	0.10
1989-90	7	9.76
1990-91	-	-
1991-92	7	0.93
Total	58	10.79

(iii)* Other Direct Taxes (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 31st March 1992.

(Amounts in crores of rupees)

	Wealth Tax		Gift Tax		Estate Duty	
	Number	Amount	Number	Amount	Number	Amount
1987-88 and earlier years	1,56,742	136.48	27,152	9.79	19813	20.42
1988-89	48,290	68.60	7,601	2.38	2,346	4.76
1989-90	66,771	58.90	9,891	7.60	895	3.18
1990-91	94.241	83.23	11,206	7.48	738	1.39
1991-92	1,33,754	126.07	14,508	10.61	360	1.99
Total	4,99,798	473.28	70,358	37.86	24,152	31.74

2. Under the provisions of the Income Tax Act, 1961 every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty days of the service of notice of demand. On the default of an assessee in this respect, the Income Tax Officer may forward a certificate specifying the demand of arrears to the Tax Recovery Officer for recovery of demand. The Tax

* Figures furnished by the Ministry of Finance are provisional

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 1.5 percent per month or part of month (from 1 April 1989) on the outstandings till the date of recovery by one or more of the following modes.

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

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

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

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

(i)* The number of officers engaged in tax recovery work during 1991-92 was as follows:

Particulars	Sanctioned strength	Working strength
Commissioners (Recovery)	9	9
Tax Recovery Officers	169	150

(ii)* The tax demands certified to the Tax Recovery Officers and the progress of recovery to end of 1991-92 are given in the following table:

(In crores of rupees)

	Demand certified			Demand recovered	Balance at the
	At the beginning of the year	During the year	Total	during the year	end of year
1987-88	747.28	315.21	1062.49	289.50	772.97
1988-89	772.97	507.13	1280.10	197.05	983.05
1989-90*	1077.98	227.04	1305.02	407.61	897.41
1990-91*	903.05	317.23	1220.28	367.12	853.16
1991-92*	671.92	371.67	1043.59	323.73	719.86

(iii)* Year-wise break up of certificates pending on 31 March 1992 and amount of demand:

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

Year of receipt of recovery certificates	No. of certificates	Amount involved
		(In crores of rupees)
1987-88	8,25,640	253.12
1988-89	1,16,745	89.84
1989-90	1,04,350	99.78
1990-91	35,975	122.98
1991-92	40.428	201.36
Total	11,23,138	767.08

(iv)* Tax-wise and amount-wise analysis of pending certificates:

(In crores of rupees)

	Range of demand	Corporation Tax		Income Tax		Wealth Tax	
		No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	1,07,692	21.18	7,66,745	79.17	98,582	12.68
(b)	Over Rs.10,000 and below Rs.1,00,000	8,588	9.47	89,939	73.06	12,587	11.98
(c)	Over Rs.1 lakh	2,292	136.08	14,307	391.08	737	25.29
	Total	1,18,572	166.73	8,70,991	543.31	1,11,906	49.95

	Range of demand	Gift Tax		Estate Duty		Interest Tax		Total	
		No.	Amount	No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	18837	2.54	1,650	0.62	-	-	9,93,506	116.19
(b)	Over Rs.10,000 and below Rs. 1 lakh	808	1.31	138	0.09	-	-	1,12,060	95.88
(c)	Over Rs.1 lakh	38	1.05	6	0.88	192	0.65	17,572	555.01
	Total	19,683	4.90	1,794	1.59	192	0.65	11,23,138	767.08

(v)* year-wise disposal and pendency of attached property

Year	No. of cases at the begining of the year		No. added during the year		Total	
	Movable	Immovable	Movable	Immovable	Movable	Immovable
1987-88	2,355	2.866	461	346	2,816	3,212
1988-89	2,468	3,139	639	1,134	3,107	4,273
1989-90	2,694	4,131	547	683	3,241	4,814
1990-91	2,539	4,157	1,031	675	3,570	4,832
1991-92*	2,227	3,122	636	495	2,863	3,617

Year	No. actually disposed of		No. pending at the close of the year	
	Movable	Immovable	Movable	Immovable
1987-88	348	73	2,468	3,139
1988-89	413	142	2,694	4,131
1989-90	702	657	2,539	4,157
1990-91	1,343	1,710	2,227	3,122
1991-92	355	427	2,508	3,190

3. Disposal of attached property - year-wise details of attached properties awaiting disposal at the end of 1991-92 as furnished by the Ministry of Finance were as under:

Year	Number of cases				Total		Appointment of Receiver for management of properties (Amount in crores of Rupees)	
	Movable		Immovable					
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
1987-88	462	2.58	688	17.87	1150	20.45	-	-
1988-89	96	10.40	391	9.52	487	19.92	-	-
1989-90	195	30.76	814	27.95	1009	58.71	-	-
1990-91	993	10.35	801	40.12	1794	50.47	4	43
1991-92	762	6.31	496	63.55	1258	69.86	4	43
Total	2,508	60.40	3190	159.01	5698	219.41	8	86

* Figures furnished by Ministry of Finance are provisional and under reconciliation

Appeals, Revision Petitions and Writs

1.08.1 Under the provisions of the Income Tax Act, 1961 if an assessee is not satisfied with an assessment, a refund order etc. he can file an appeal to the Appellate Assistant Commissioner(now Deputy Commissioner (Appeal). 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, 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.

(1)* Income tax,including Corporation tax.

(a) Particulars of Income tax appeals and revision petitions pending as on 31 March 1992 were as under:

(i)	No. of income tax appeals pending with	
	(a) Appellate Assistant Commissioner [Since redesignated as Deputy Commissioner (Appeals)]	1,26,464
	(b) Commissioner of Income tax (Appeals)	1,51,647
(ii)	No. of income tax revision petitions pending	14,234
	Total	2,92,345

(b)(i) Year-wise details of appeals pending with Deputy Commissioner(Appeals) for the five years ending 1987-88 to 1991-92 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1987-88 and earlier years	1,33,405	75,962	1,01,017	1,08,350
1988-89	1,07,612	75,781	79,970	1,03,423
1989-90	1,03,423	68,609	59,609	1,12,423
1990-91	1,11,451	92,020	76,012	1,27,459
1991-92*	1,27,459	70,752	71,747	1,26,464

(ii)* Year-wise break up of high demand (more than 1 lakh) appeals pending with Deputy Commissioner (Appeals) at the end of the year 1991-92 with reference to their year of institution was as under:

Year of Institution	Number pending
1987-88 and earlier years	300
1988-89	290
1989-90	537
1990-91	839
1991-92	1823
Total	3789

(c)(i)* Year-wise details of appeals pending with Commissioners of Income Tax (Appeals) for the five years ending 1987-88 to 1991-92 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1987-88	1,09,070	72,980	67,032	1,14,044
1988-89	1,14,414	75,962	83,042	1,07,334
1989-90	1,07,334	84,876	81,822	1,10,388
1990-91	1,10,388	97,203	84,935	1,22,569
1991-92*	1,22,569	1,17,198	88,120	1,51,647

(ii)* Year-wise break up of high demand (more than 1 lakh) appeals pending with Commissioners of Income Tax (Appeals) at the end of the year 1991-92 with reference to their year of institution was as under:

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

Year of Institution	Number pending
1987-88 and earlier years	753
1988-89	1,190
1989-90	2,850
1990-91	7,596
1991-92	24,857
Total	37,246

(d)(i) Particulars of revision petitions for the five years ending 1987-88 to 1991-92 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1987-88	17,534	9,247	9,907	16,874
1988-89*	17,311	8,748	8,679	17,380
1989-90	17,380	6,740	6,532	17,588
1990-91	17,588	6,578	8,255	15,911
1991-92*	15,897	7,612	9,275	14,234

(ii)* Year-wise break up of revision petitions pending at the end of the year 1991-92 with reference to their year of institution was as under:

Year of Institution	Number pending
1987-88 and earlier years	3,581
1988-89	1,779
1989-90	1,854
1990-91	2,540
1991-92	4,480
Total	14,234

(2) Other Direct Taxes

(a)* Particulars of Wealth Tax, Gift Tax and Estate duty appeals and revision petitions pending as on 31st March 1992 were as under:

* Figures furnished by Ministry of Finance are provisional and under reconciliation

No. of appeals pending with		Wealth Tax	Gift Tax	Estate Duty
(i)	Deputy Commissioner(Appeals)	40,870	1,626	327
(ii)	Commissioner of Income tax (Appeals)	22,033	670	1,604
(iii)	No. of revision petitions pending	2,270	91	-
	Total	65,173	2,387	1,931

(b) Particulars of appeal cases with Deputy Commissioner(Appeals) and Commissioner (Appeals) and revisions petitions with Commissioners for the year 1991-92 were as under:

	Pending at the beginning of the year	Added during the year	Total	No. disposed of during the year	No. pending at the end of the year
(i)* With Deputy Commissioner (Appeals)**					
Wealth Tax	42,963	15,741	58,704	17,834	40,870
Gift Tax	1,927	533	2,460	834	1,626
Estate duty	498	84	582	255	327
Super profits tax/Surtax	50	16	66	41	25
Interest Tax	8	17	25	14	11
Total	45,446	16,391	61,837	18,978	42,859
(ii)* With Commissioner of Income Tax (Appeals)					
Wealth Tax	16,338	15,492	31,830	9,797	22,033
Gift Tax	702	414	1,116	446	670
Estate duty	2,089	504	2,593	989	1,604
Super profits tax/Surtax	620	169	789	399	390
Interest Tax	78	34	112	53	59
Total	19,827	16,613	36,440	11,684	24,756
(iii)*Revision petitions with Commissioners					
Wealth Tax	2,839	605	3,444	1,174	2,270
Gift Tax	99	30	129	38	91
Estate duty	-		-	-	-
Super profits tax Sur Tax	36	6	42	7	35
Interest Tax	-	-	-		-
Total	2,974	641	3,615	1,219	2,396

* Figures furnished by the Ministry of Finance are provisional

(c)* Year-wise break up of pendency of high demand (more than Rs.50,000) appeals at the end of the year 1991-92 with reference to their year of institution was as under:

(i) With Deputy Commissioner (Appeals)

Year of institution	Wealth tax	Gift tax	Estate duty	Interest tax	Super profit tax/Surtax	Total
1987-88	225	27	-	-	-	252
1988-89	76	-	6	-	-	82
1989-90	100	2	-	-	-	102
1990-91	247	8	-	-	-	255
1991-92	211	13	3	-	-	227
Total	859	50	9	-	-	918

(ii)* With Commissioners of Income Tax (Appeals)

1987-88	309	8	150	-	11	478
1988-89	277	5	33	-	-	315
1989-90	558	9	42	3	3	615
1990-91	1,151	66	45	8	36	1,306**
1991-92	2,338	58	51	2	53	2,502
Total	4,633	146	321	13	103	5,216

(d)* Year-wise pendency of revision petition with Commissioners:

Year of filing of petition	Number pending
1987-88 and earlier years	600
1988-89	250
1989-90	214
1990-91	513
1991-92	819
Total	2,396

(e)* Writ petitions pending:

		In Supreme Court	In High Court	Total
(i)	On 31 March 1992	4,491	7,950	12,441
(ii)	Out of (i) above			
Pending for:				
	Over 5 years	529	2,228	2,757
	3 to 5 years	923	1,188	2,111
	1 to 3 years	1,212	2,366	3,578
	Upto 1 year	1,827	2,168	3,995
	Total	4,491	7,950	12,441

* Figures furnished by Ministry of Finance are provisional

(f)* Cases pending with Judicial Courts:

		In Supreme Court	In High Court	Total
(i)	On 31 March 1992	3,131	25,336	28,467
(ii)	Out of (i) above Pending for:			
	Over 5 years	711	5,064	5,775
	3 to 5 years	373	6,235	6,608
	1 to 3 years	1,361	8,128	9,489
	Upto 1 year	686	5,909	6,595
	Total	3,131	25,336	28,467

Reliefs and refunds

1.09.1* Where the amount of tax paid exceeds the amount of tax payable the assessee is entitled to a refund of the excess. If the refund is not granted by the department within three months from the end of the month in which the claim is made, simple interest at the prescribed rate becomes payable to the assessee on the amount of such refund (vide Section 237 read with Section 243 of the Income Tax Act).

(i)(a) The particulars of cases of direct refunds on which claims were made during 1987-88 to 1991-92 were as under:

Financial year	Opening Balance	Claims received during the year	Total	No. of refunds	Balance oustanding**
1987-88	25,731	84,064	1,10,795	98,327	12,468
1988-89	12,468	1,03,136	1,15,604	98,808	16,796
1989-90	16,796	84,611	1,01,407	76,620	24,787
1990-91	24,787	74,668	99,455	83,638	15,817
1991-92	15,817	92,114	1,07,931	96,414	11,517

(b)* Year-wise analysis of the outstanding direct refunds claims as on 31 March 1992.

Financial year in which application was made	No. of cases pending
1987-88 and earlier years	-
1988-89	-
1989-90	18
1990-91	69
1991-92	11,430
Total	11,517

* Figures furnished by the Ministry of Finance are provisional

(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 on that behalf. Simple interest at the prescribed rate is payable to the assessee in such cases too.

Cases resulting in refund as a result of appellate orders and revision orders etc., during each of the five years ending 1991-92 were as under:

Financial year	Opening Balance	Additions	Disposal	Balance
1987-88	1,957	22,660	22,599	2,018
1988-89	2,018	20,863	21,638	1,243
1989-90	1,243	22,099	21,465	1,877
1990-91	1,877	19,193	19,971	1,099
1991-92	1,099	18,444	18,654	889

(b)* Year-wise analysis of balance as on 31 March 1992 was as under:

Financial year	No. of cases pending*
1987-88	-
1988-89	78
1989-90	90
1990-91	155
1991-92	566
Total	889

Interest

1.10 The Act provides for payment of interest by the assessee 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 to pay interest.

The particulars of interest paid on refunds by Government under the different provisions of the Act during the years 1989-90 1990-91 and 1991-92 are given below:

* Figures furnished by the MInistry of Finance are provisional

(Amount in crores of rupees)

Section of Income Tax Act under which interest paid	1989-90		1990-91		1991-92*	
	No. of assess-ments	Amount	No. of assess-ments	Amount	No. of assess-ments	Amount
214	89,609	21.17	49,569	13.04	22,201	34.01
243	9	0.06	466	0.28	293	4.81
244	74,727	69.36	2,64,312	73.88	4,20,539	111.07

Cases settled by Settlement Commission

1.11 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 last five years was as under:

(i) Income Tax*

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	No. of cases pending
1987-88	1,824	244	13.38	1,580
1988-89	1,897	243	12.81	1,654
1989-90	1,993	355	17.81	1,638
1990-91	2,000	480	24.00	1,520
1991-92*	2,014	457	22.69	1.557

(ii) Wealth Tax*

Financial year	No. of cases for disposal@	No. of cases disposed of	Percentage	No. of cases pending@
1987-88	620	84	13.55	536
1988-89	590	97	16.44	493
1989-90	537	92	17.13	445
1990-91	538	136	25.28	402
1991-92*	479	166	34.66	313

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

* Figures furnished by Ministry of Finance and under reconciliation

Financial year	Income Tax		Wealth Tax	
		(In lakhs of rupees)		
	Addl. tax collected/ collectable on admission of applications	Gross demand created in respect of cases settled	Addl.tax collected/ collectable on admission of applications	Gross demand created in respect of cases settled
1988-89	155.62	512.16	1.47	612.20
1989-90	582.37	940.72	16.56	51.24
1990-91	764.62	938.41	4.71	55.73
1991-92	864.17[&]	1284.78	18.70	59.35

(iv)* No. of cases pending for admission before Settlement Commission 798

(v)* No. of cases held up with Settlement Commission for want of comments of the department 446

Penalties and prosecutions

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

(i) Income Tax and Corporation Tax

(a) Penalty proceedings inititated, disposed of and pending for each of the three years ending 1991-92 were as under:

Year	Cases pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1989-90	4,24,435	2,71,538	6,95,973	3,14,613	3,81,360
1990-91	3,81,360	1,98,314	5,79,674	3,13,175	2,66,499
1991-92*	2,66,499	1,02,731	3,69,230	1,35,876	2,33,354

(b) Prosecutions, launched, convicted/compounded and cases pending in the Courts for the three years ending 1991-92 were as under:

[&] includes W.T. demand for Calcutta charge, Figures for Bombay charge not supplied by Ministry of Finance

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

Year	Pending at the beginning of the year	Complaints filed during the year	Total	Convicted	No. of cases disposed of: Compounded	Acquitted	Total	Total Pending
1989-90	24,028	8,998	33,026	1,906	169	538	2,613	30,413
1990-91	30,672	3,762	34,434	1,030	452	1,561	3,043	31,391
1991-92*	31,391	2,615	34,006	166	154	135	455	33,551

(c) Penalty and composition money levied, collected and pending for the three years 1989-90 to 1991-92 were as under:

(Amount in crores of Rs.)

Year	Opening Balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1989-90	205.95	1.64	85.72	2.89	45.83	1.51	24.58	3.03
1990-91	255.04	3.02	172.36	9.71	7.12	7.41	35.61	5.32
1991-92*	356.18	5.32	157.52	18.34	8.35	15.56	43.01	8.10

Other Direct Taxes

(ii)(a) Penalty proceedings initiated, disposed of and pending for each of the three years ending 1991-92 are given below:

Year	Cases pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1989-90	79,742	33,901	1,13,643	38,296	75,347
1990-91	76,242	43,539	1,19,781	50,153	69,628
1991-92*	69,628	27,660	97,288	32,634	64,654

(b) Prosecutions launched, convicted/compounded and cases pending in the Courts for the three years ending 1991-92 are given below:

Year	Pending at the beginning of the year	Complaints filed during the year	Total	Convicted	No. of cases disposed of: Compounded	Acquitted	Total	Cases pending
1989-90	832	65	897	4	-	8	12	885
1990-91	910	172	1,082	3	6	46	55	981
1991-92*	981	205	1,186	25	1	8	34	1,152

(c) Penalty and composition money levied, collected and pending for the three years 1989-90 to 1991-92 is as follows:

* Figures are provisional and under reconciliation by Ministry of Finance

(Amount in crores of Rupees)

Year	Opening Balance outstanding		Levied during the year		Collected during the year		Balance	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1989-90	13.06	0.06	8.60	0.15	2.70	0.12	18.96	0.09
1990-91	18.76	0.09	5.66	0.01	6.81	0.01	17.81	0.09
1991-92*	17.81	0.09	5.93	0.03	6.23	0.02	17.51	0.09

Searches and Seizures

1.13 Sections 132, 132-A and 132-B of the Income Tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director of Income Tax, Commissioner of Income Tax or a specified Deputy Director of Income Tax or a Deputy Commissioner of Income Tax. Where any money, bullion, jewellery or other valuable article or thing is seized, the Assessing Officer has after necessary investigations, to make an order with the approval of the Deputy Commissioner of Income Tax within 120 days of the seizures, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability, and retain in his custody such assets as are, in his opinion, sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the persons from whose custody they were seized. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approved of the retention for longer period.

(i)* The number of cases in which searches and seizures were conducted for the three years ending 1989-90 to 1991-92 was as under:

Year	No. of cases where cash jewellery etc., assets were seized		No. of cases where no assets were seized
	No.	Value (in crores of Rupees)	
1989-90	1,653	111.85	1,413
1990-91	2,072	626.20	1,393
1991-92*	1,520	159.67	725

* Figures furnished by Ministry of Finance are provisional and under reconciliation

(ii)(a) Particulars of orders under Section 132(5) passed during the three years ending 1991-92 were as under:

Year	Opening balance of cases	Search cases during the year	Total	No. of cases where orders were passed during the year	No. of cases pending at the end of the year
1989-90	1,766	1,900	3,686	2,717	969
1990-91	969	2,332	3,301	2,283	1018
1991-92*	1,018	1,681	2,699	1,765	934

(b) Particulars of income determined in the orders under Section 132(5), tax involved therein, assets retained and assets returned over the three years ending 1991-92 were as under:

Year	No. of cases where orders were passed	Income determined in the orders	Tax involved therein	Value of assets retained	Value of assets returned
		(Amount in crores of Rupees)			
1989-90	2,642	246.70	225.31	922.79	297.10
1990-91	2,268	343.62	233.51	92.96	20.22
1991-92*	1,518	232.33	241.06	64.71	12.46

(iii)(a) The number of search cases out of (ii)(b) where final assessments were completed and pending for the three years ending 1991-92 was as under:

Year	Opening balance of orders U/s 132(5)	Order U/s 132(5)passed during the year	Total	No. of cases where final assessments were completed			
				Where concealed income was found	With No concealed income	Total	Balance cases
1989-90	2,056	1,477	3,533	1,107	595	1,702	1,831
1990-91	1,831	1,639	3,470	1,135	653	1,788	1,682
1991-92	1,682	1,044	2,726	689	364	1,053	1,673

(b)* Year-wise particulars of pendency of orders under Section 132(5) where final assessments were pending as on 31 March 1992 were as under:

Year in which summary assessments were made (1)	No. of cases where final assessments were pending (2)	Out of (2) No. of cases with Settlement Commission (3)
1989-90	695	74
1990-91	537	41
1991-92	1,048	15

* Figures furnished by the Ministry of Finance are provisional

(c)* Particulars of income determined, tax levied, balance-tax outstanding after adjustment of value of assets retained on final assessment for the three years ending 1991-92 were as under:

(Rupees in Crores)

Year	No.of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery		
			Tax	Penalty	Total		Tax	Penalty	Total
1989-90	4,240	282.04	146.80	9.74	156.54	15.33	131.50	9.71	141.21
1990-91	4,936	298.27	147.43	8.58	156.01	12.83	135.51	7.67	143.18
1991-92	3,165	374.56	195.81	9.18	204.99	46.22	151.39	7.38	158.77

(d)* The number of cases of prosecutions launched, compounded and convictions obtained for the three years ending 1991-92 was as under:

Year	No.of prosecutions launched			No.of cases compounded	No.of cases in which convictions were obtained	No. of cases pending
	Opening balance	During the year	Total			
1989-90	12,883	4,421	17,304	214	19	17,090
1990-91	17,090	1,569	18,659	2,865	11	15,794
1991-92	15,794	739	16,533	146	8	16,387

(e)* Particulars of cases of assets returned, interest paid and cases pending for three years ending 1991-92 were as under:

Year	No. of cases where assets were due for return			No. of cases where assets returned	No. of cases where interest paid during the year	Balance cases pending
	Opening balance	Added during the year	Total			
1989-90	400	389	789	260	6	529
1990-91	529	1,122	1,651	184	-	1467
1991-92	1,467	403	1,870	1,107	-	763

Survey

1.14.1 Number of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the three years ending 1991-92 is as follows:

* Figures furnished by Ministry of Finance are provisional

Year	No. of premises surveyed
1989-90	8,620
1990-91	3,242
1991-92*	2,260

2. Number of cases where evidence about ostentatious expenditure was collected under Section 133A(5).

Year	No. of cases
1989-90	221
1990-91	544
1991-92*	324

Acquisition of Immovable Properties

1.15.1 Acquisition proceeding 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 objective of evading tax. The scope of these provisions had been extended through the Income Tax (Amendment) Act, 1981 with effect from 1 July 1982 to cover:

(a) transfer 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 *de facto* 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 recommendations 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 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.

2. Acquisition proceedings under these provisions could be initiated where an immovable property of fair market value exceeding Rs.25,000 (Rs.1 lakh with effect from 1 June 1984) was transferred for any apparent monetary

consideration which was less than the fair market value by more than 15 percent of the apparent monetary consideration. The compensation payable on acquisition is the amount of the monetary consideration shown in the transfer document plus 15 percent 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 between the then Ministry of Works and Housing and 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 after all formalities relating to appeal etc. provided under the law had been completed. Accordingly the Central Board of Direct Taxes issued instructions in May 1977.

3. With effect from 1 October 1986, the provisions of Chapter XXA of the Income Tax Act, 1961 do not apply to or in relation to the transfer of any immovable property made after the 30 September 1986 (Section 269 RR).

(i) The number of Deputy Commissioners of Income Tax engaged on the residual work for the year 1991-92 is:

	Sanctioned strength	Working strength
At the commencement of the year	12	8
At the close of the year	11	7

(ii) The number of intimations in Form 37-G received from the Registering Authorities during the three years ending 1991-92 was as under:

Year	No. of intimation received
1989-90	13,115
1990-91	5,537
1991-92	4,318

(iii)(a) The number of notices issued, dropped, acquisition orders passed and notices pending for three years ending 1991-92 was as follows:

Year	Opening balance	No. of notices issued during the year	Total	No. of notices dropped during the year	No. of cases where orders were passed	No. pending
1989-90	1,652	81	1,733	756	7	970
1990-91	970	28	998	214	-	784
1991-92*	784	-	784	160	5	619

(b)* Year-wise particulars of pendency as on 31 March 1992 were as under:

Year of institution	No. of notices pending
1989-90 and earlier years	513
1990-91	15
1991-92	91
Total	619

(iv) The number of cases where acquisition orders were passed, properties acquired and the balance pending for the three years ending 1991-92 was as under:

Year	No. of cases where orders were passed			No. of cases where properties were actually taken over	Balance Number
	Opening balance	During the year	Total		
1989-90	702	(-)1	701	-	698**
1990-91	698	(-)86	612	-	612
1991-92*	612	(-)198	414	-	414

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

1.16 With a view to countering tax evasion and to curb the circulation of black money in real estate transactions, a new Chapter XXC was inserted in the Income Tax Act, 1961, with effect from 1st October, 1986 empowering the Central Government to purchase immovable properties in certain cases of transfer. To begin with, these provisions were made applicable to properties proposed to be transferred for an apparent consideration exceeding Rs.10 lakhs in each case in the metropolitan cities of Bombay, Calcutta, Delhi and Madras. It has been extended to 24 more cities from 1st October 1987, 1st June 1989 and 1st April 1991.

During the financial year ended March 1992 details of properties purchased by the Central Government were as under:

* Figures furnished by Ministry of Finance are provisional

** Difference is due to 3 cases set aside in Gujarat Region

	Calcutta	Madras	Ahmedabad	Delhi	Bombay	Total
(i) No. of statments received in Form 37-I	105	391	124	397	1948	2965
(ii) No. of properties purchased	4	8	5	10	47	74
(iii) Value of properties purchased (Rs. in lakhs)	118	211	334	748	3149	4560
(iv) No. of properties where consideration exceeds Rs.50.lakhs	1	1	4	6	18	30

Functioning of Valuation Cells

1.17.1 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 valuation units	No. of valuation districts
1987-88	71	13
1988-89	71	13
1989-90	70	13
1990-91	70	13
1991-92	70	13

(ii) No. of cases referred to valuation cells, disposed of and pending at the end of the each of three years ending 1991-92

	Year	No. for disposal at the beginning of the year	No. of cases referred during the year	Disposed of during the year	Pending at the end of year
(a) Income Tax	1989-90	927	6,346	6,314	959
	1990-91	682@	5,696	5,623	755
	1991-92*	755	6,602	6,516	841
(b) Other Direct Taxes#	1989-90	4,109	9,022	10,033	3,098
	1990-91	3,098	7,440	8,713	1,825
	1991-92	1,825	5,713	6,152	1,386

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

includes Wealth tax, gift tax and Estate Duty, Details are in Appendix IV

Revenue demands written off by the department

1.18* A demand of Rs.1331.04 lakhs in 1,05,495 cases was written off by the department during the year 1991-92. Details are given below category-wise:

1. Income tax

(Amount in lakhs of Rupees)

		Company		Non-company		Total	
		No.	Amount	No.	Amount	No.	Amount
I.	(a) Assessees having died leaving behind no assets or have become insolvent or gone into liquidation	-	-	1,387	60.65	1,387	60.65
	(b) Assessees who have gone into liquidation or are defunct	8	37.41	-	-	8	37.41
	Total	8	37.41	1,387	60.65	1395	98.06
II.	Assessees being untraceable	12	40.00	24,718	498.24	24,730	538.24
III.	Assessees having left India	-	-	1,881	34.59	1,881	34.59
IV.	Other reasons:						
	(a) Assessees having no attachable assets	2	17.86	2,555	80.72	2,557	98.58
	(b) Amount being petty, etc.	20	13.45	34,647	110.30	34,667	123.75
	(c) Amount written off as a result of scaling down of demand	6	231.08	40,259	206.74	40,265	237.82
	Total	28	262.39	77,461	397.76	77,489	660.15
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	48	339.80	1,05,447	991.24	1,05,495	1331.04

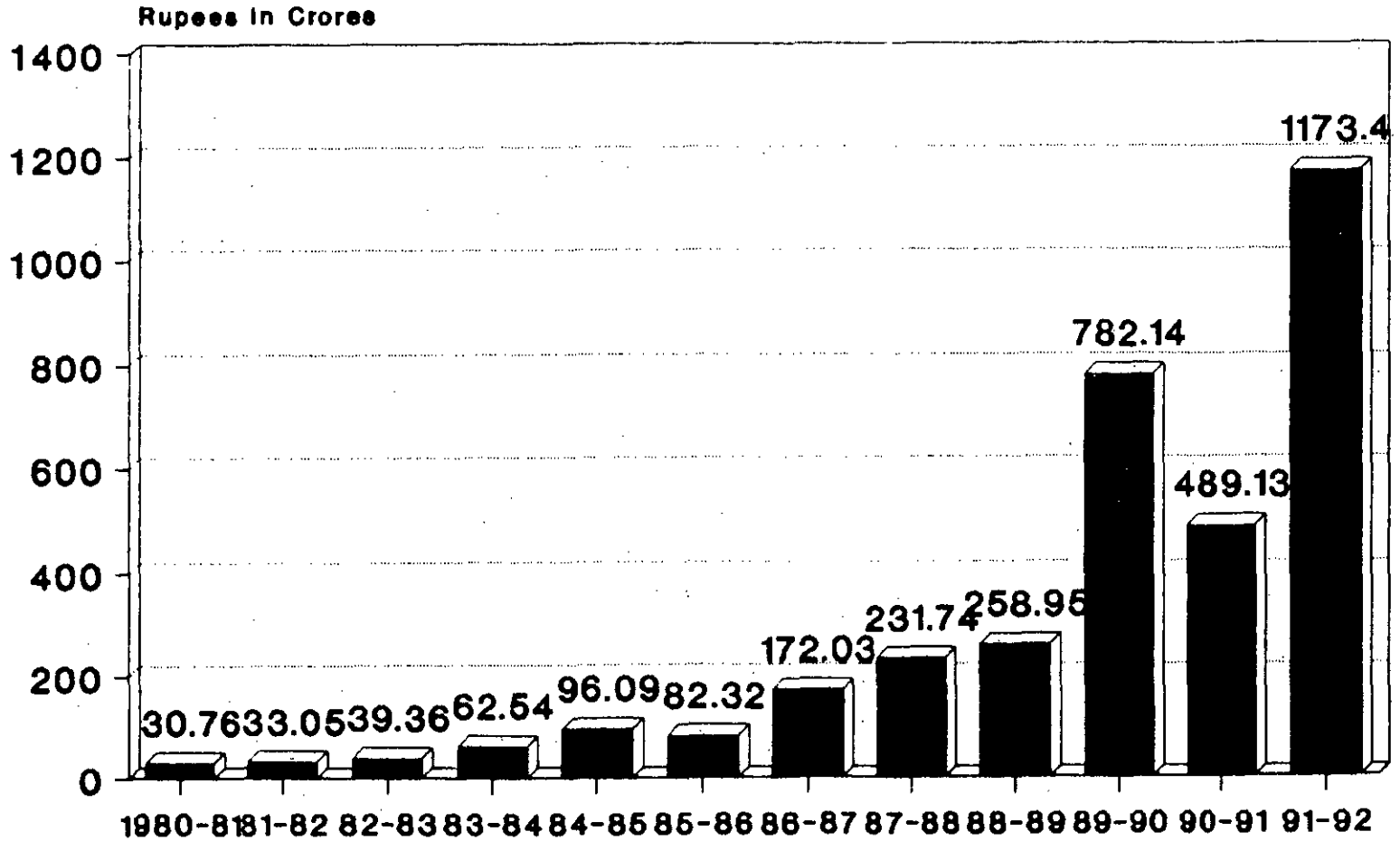
2.* Wealth Tax, Gift Tax and Estate Duty demands written off by the department during the year 1991-92 due to untraceability of assessee are given below:

(Amount in lakhs of Rupees)

Wealth tax		Gift tax		Estate Duty	
No.	Amount	No.	Amount	No.	Amount
5	0.59	9	0.03	-	-

* Figures furnished by the Ministry of Finance are provisional and under reconciliation

INCOME TAX
UNDER-ASSESSMENT



Results of Test Audit in general

1.19 During the period 1st April 1991 to 31 March 1992 in the course of test audit of the assessments completed by the Income tax Department, 16049 cases of under-assessment involving a total revenue effect of Rs 1184 .88 crores were noticed. A resume of the deficiencies noticed is given below:

(i) Corporation Tax and Income Tax

During the period under report, test audit brought to light total underassessment of tax of Rs.1173.40 crores in 14500 cases. Of the total 14500 cases of underassessment, short levy of tax of Rs.1151.92 crores was noticed in 6849 major audit observations. The remaining 7651 cases accounted for underassessment of tax of Rs.21.48 crores.

The underassessment of tax of Rs.1173.40 crores arose due to mistakes which could broadly be categorised under the following heads:

		No. of cases	Amount (Rupees in crores)
1.	Avoidable mistakes in computation of income and tax	878	88.57
2.	Failure to observe the provisions of the Finance Acts	817	60.93
3.	Incorrect status adopted in assessments	172	3.11
4.	Incorrect computation of income	227	2.78
5.	Incorrect computation of income from house property	171	1.23
6.	Incorrect computation of business income	3.473	289.99
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1,417	305.67
8.	Irregular computation of capital gains	218	12.50
9.	Mistakes in assessments of firms and partners	655	5.40
10.	Omission to club the income of spouse/minor child etc.	45	0.68
11.	Income not assessed	1,439	105.25
12.	Irregular set off of losses	339	103.46
13.	Mistakes in assessments while giving effect to appellate orders	56	0.59
14.	Irregular exemptions and excess reliefs given	1,349	97.84
15.	Excess or irregular refunds	191	5.08
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	802	10.59
17.	Avoidable or incorrect payment of interest by Government	87	0.96
18.	Omission/short levy of penalty	742	9.55
19.	Other topics of interest (Miscellaneous cases)	1,291	59.38
20.	Under-assessment of surtax	131	9.84
	Total	14.500	1173.40

It will be noticed that in terms of both the number of audit objections and the amount, the categories under serial numbers 1,6,7,11,12 and 14

are heavy and call for special attention from the department.

(ii) Wealth Tax

During test-audit of assessments made under Wealth Tax Act, 1957, short levy of Rs.6.42 crores was noticed in 1324 cases.

The underassessment of tax of Rs.6.42 crores was due to mistakes categorised under the following heads:

		No. of cases	Amount (in crores of rupees)
1.	Wealth not assessed	385	2.37
2.	Incorrect valuation of assets	390	2.41
3.	Mistakes in computation of net wealth	133	0.57
4.	Incorrect status adopted in assessments	29	0.05
5.	Irregular/excessive allowances and exemption	139	0.27
6.	Mistakes in calculation of tax	100	0.20
7.	Non-levy or incorrect levy of additional wealth tax	14	0.25
8.	Non-levy or incorrect levy of penalty and non-levy of interest	87	0.12
9.	Miscellaneous	47	0.18
	Total	1324	6.42

(iii) Gift Tax

During the test audit of gift tax assessments it was noticed that in 206 cases there was short levy of Rs.4.92 crores.

(iv) Estate Duty

In the course of test audit of estate duty assessments it was noticed that in 19 cases there was short levy of estate duty of Rs.0.14 crores.

State-wise Analaysis

While deficiencies and mistakes were generally noticed in all circles, maximum underassessment of tax was noticed in Delhi, Maharashtra, West Bengal, Bihar, Uttar Pradesh, Tamil Nadu and Madhya Pradesh in that order. In terms of the numbers of cases noticed, Maharashtra had the highest number followed by Tamil Nadu, Madhya Pradesh, West Bengal, Delhi, Uttar Pradesh and Bihar.

Outstanding audit objections

1.20 Assessments completed by the Income Tax department are subjected to audit by the Department's own Internal Audit and test checked by the Indian Audit and Accounts Department (Statutory Audit) under the Comptroller and Auditor General of India. While the former conducts 100 percent audit of all immediate cases, the audit by I.A. & A.D. is carried out through test checks, designed to verify the adequacy and efficiency of systems and procedures. According to the Departmental instructions, objections raised by Internal Audit Department are to be attended to by the assessing officers within a period of three months, whereas audit observations of statutory audit are to be replied to within a period of six weeks.

During 1991-92, the total number of observations made by the Internal Audit Department was 13,882 with money value of Rs.239.22 crores while the number of observations of statutory audit came to 16049 with money value of Rs.1184.88 crores.

As on 31 March 1992, a total number of 1,12,370 audit objections pointed out by both the Internal Audit and Statutory Audit, was pending for settlement. Of these, 11,466 major cases (with tax effect of Rs.10,000 and above under the Income tax and Rs.1,000 and above under the other direct taxes) accounting for Rs.366.11 crores and 22,986 minor objections involving revenue effect of Rs.3.08 crores are of the Internal Audit. The remaining 77,918 cases relate to statutory audit involving Rs.1,923.39 crores.

(i) Internal Audit

As per the information furnished by the Directorate of Income tax (Audit) of the Department, the number of major objections of the Internal Audit disposed of during the four year period of 1988-89 to 1991-92 and the number pending as at the end of these years are given below:

Financial year	No. of cases for disposal and amount (in crores of rupees)	No. of cases disposed of and amount (in crores of rupees)	Percentage of disposal to total number of cases for disposal	No. of pending cases and amount (in crores of rupees)
1.	2.	3.	4.	5.
1988-89	18,840	7,974	42	10,866
	(411.75)	(200.89)	(49)	(210.86)
1989-90	18,578	8,907	48	9,671
	(479.25)	(156.39)	(33)	(322.86)
1990-91	20,698	10,044	49	10,654
	(1017.36)	(318.25)	(31)	(699.11)
1991-92	18,625	7,159	38	11,466
	(936.61)	(570.50)	63	(366.11)

Age-wise analysis of the pending items at the end of 1991-92 and revenue effect involved are given below:

Year in which objection raised	No. of cases	Revenue effect (Amount in crores of rupees)
1987-88 and earlier years	206	3.07
1988-89	513	12.19
1989-90	1931	44.85
1990-91	3077	98.41
1991-92	5739	207.59
Total	11,466	366.11

The Public Accounts Commitee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that internal audit objections should also be analysed with reference to the year of assessment apart from the year in which the objections were raised, so that greater attention could be given to the settlement of objections relating to earlier years, before they became time-barred for re-opening. Since the normal period available for re-opening of cases is four years, all objections pertaining to 1988-89 and earlier years should have been settled by March 1992, which is not the case as shown above.

(ii) Statutory Audit

As on 31st March 1992, 77,918 objections involving a revenue of Rs.1,923.39 crores, are pending for final action. The year-wise particulars of the pendency are as follows:

(a) Statement showing year-wise particulars of pendency of objections, as compared to the position as on 31 March 1991.

	Income Tax		Other Direct Taxes (Wealth Tax, Gift Tax and Estate Duty)		Total	
					(Revenue effect in crores of Rupees)	
Year	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
1.	2.		3.	4. 5.	6.	7.
Up to 1988-89 and earlier	41,757	418.11	8,463	38.73	50,220	456.84
years	(48,100)	(480.46)	(10,285)	(43.28)	(58,385)	(523.74)
1989-90	12,042	714.43	1,051	6.25	13,093	720.68
	(15,632)	(800.53)	(1,570)	(8.74)	(17,202)	(809.27)
1990-91	13,173	734.86	1,432	11.01	14,605	745.87
Total	66,972	1,867.40	10,946	55.99	77,918	1923.39
	(63,732)	(1,280.99)	(11,855)	(52.02)	(75,587)	(1333.01)

Note: The figures in brackets indicate the position as on 31 March 1991.

During the year 1991-92 there was an increase in the number of outstanding objections by 2,331(3.08 percent) items, and the revenue effect of the outstanding objections had increased by Rs.590.38 crores (44.36 percent) over that of the earlier year.

(b) There were 1514 cases (as against 975 in earlier year) where the income tax involved in each individual case exceeded Rs.10 lakhs. The charge-wise break up of these cases are:

S.No.	Name of charge	Items	Amount (in lakhs of rupees)
1.	Andhra Pradesh	17	343.45
2.	Assam	30	1,537.07
3.	Bihar	23	2,869.09
4.	Delhi	176	34,417.56
5.	Gujarat	94	3,513.53
6.	Haryana	5	63.89
7.	Karnataka	54	4,688.34
8.	Kerala	23	646.20
9.	Madhya Pradesh	127	12,491.33
10.	Maharashtra	488	58,614.45
11.	Orissa	12	260.65
12.	Punjab	6	112.31
13.	Rajasthan	21	308.86
14.	Tamil Nadu	155	6,187.18
15.	Uttar Pradesh	32	1,564.07
16.	West Bengal	251	15,322.38
	Total	1,514	1,42,940.36

(c) The particulars of the number of cases where the wealth tax involved in each case exceeded Rs.5 lakhs are as under:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Andhra Pradesh	1	10.56
2.	Delhi	3	40.41
3.	Gujarat	7	119.64
4.	Karnataka	1	7.37
5.	Madhya Pradesh	9	650.36
6.	Maharashtra	7	83.62
7.	Punjab	2	19.13
8.	Tamil Nadu	8	155.19
9.	Uttar Pradesh	1	8.24
10.	West Bengal	9	153.40
	Total	48	1,247.92

(d) The particulars of the number of cases where the total gift tax involved in each case exceeded Rs.5 lakhs are given below:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Delhi	1	15.74
2.	Gujarat	12	212.98
3.	Haryana	1	32.98
4.	Karnataka	2	66.02
5.	Kerala	1	21.39
6.	Maharashtra	9	475.49
7.	Orissa	1	184.97
8.	Tamil Nadu	11	246.47
9.	West Bengal	5	151.78
	Total	43	1407.82

(e) The particulars of the number of cases where the estate duty invovled in each case exceeded Rs.5 lakhs are shown below:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Andhra Pradesh	6	701.62
2.	Karnataka	2	12.82
3.	Kerala	1	10.08
4.	Rajasthan	3	10.64
5.	Tamil Nadu	1	6.94
6.	West Bengal	2	11.30
	Total	15	753.40

Out of a total pendency of 77,918 cases involving a revenue effect of Rs.1,923.39 crores, 1620 cases (2.10 per cent) accounted for a revenue effect of Rs.1,463.50 crores (76.08 per cent). The data given called for attention to cases involving larger revenue effect by assigning priority in the matter of their settlement.

(iii) Steps taken to settle objections

The Action Plan Target of the department for 1991-92 provided for disposal of 100 percent of all arrear major audit objections. In respect of current objections raised by statutory audit upto 31 December 1991, replies are to be sent in 90 percent of the cases while the target fixed for major internal audit objections is 50 per cent.

(a) According to information furnished by the department in October 1992 relating to internal audit objections and Quarterly Reviews of Internal Audit and Receipt Audit Major objections of the Directorate of Income Tax (Income Tax and Audit), for the quarter ending March 1992, the position of Action Plan Target and achievement for the clearance of the major internal and statutory audit objections for the year 1991-92 was as under:

	Number for disposal (Amount in crores of rupees)	Number to be settled as per targets fixed	Number settled (Amount in crores of rupees)	Shortfall in targets	Shortfall percentage to target	Percentage of settlment to total number for disposal	Balance pending (Amount in crores of rupees)	Percentage of pendency
	1.	2.	3.	4.	5.	6.	7.	8.
A. Internal Audit Objections								
Current	7,971	3986	2,232	1754	44	28	5739	72
	(237.49)	(50%)	(29.90)				(207.59)	(87.41)
Arrear	10,654	10,654	4,927	5,727	53.75	46.25	5727	53.75
	(699.12)	(100%)	(540.60)				(158.52)	(22.67)
B. Receipt Audit Objections								
Current	9980	8982	2634	6348	70.68	26.39	7341*	73.61
	(1265.98)	(90%)	(438.78)				(827.20)	(65.34)
Arrear	26,607	26,607	7097	19,510	73.33	26.67	19,510*	73.33
	(1133.12)	(100%)	(282.15)				(850.97)	(75.10)

* Including 1,234 and 11,916 current and arrear objections respectively not accepted by the department but yet to be dropped by the Receipt Audit.

The above data show that achievements were well short of targets

(b) Remedial action barred by time.

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

In a few charges reviewed during the year 1991-92, a number of cases where remedial action became barred by limitation was noticed. The number noticed as a result of review of such cases alongwith tax effect involved in selected charges are as under :

Sl.No.	Charge	Income Tax		Other Direct Taxes	
		No.of objections	Tax effect (in lakhs of rupees)	No.of objections	Tax effect (in lakhs of rupees)
1.	Andhra Pradesh	151	5.03	--	--
2.	Haryana	49	12.52	26	2.12
3.	Maharashtra	1773	96.23	--	--
4.	Gujarat	852	87.02	190	9.51

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

Under the existing arrangement, sufficient time (about 7-8 months) is made available to the Income tax department for dealing with all important audit observations, having substantial tax effect so that the Department's comments and Ministry's remarks could be incorporated in the Audit Report, while reporting such cases. However, despite Board's instructions that all draft paragraph cases should receive the personal attention of the Commissioners of Income tax for expeditious action, inordinate delays continue to occur in the receipt of Department's replies.

The position regarding receipt of replies to draft paragraphs from the Ministry for the last 3 Audit Reports are as follows:

Report	Period of issue	Total Number sent	Replies received in the respective year	Position (as on 12th February '93)
1989-90	January - July 1990	1,903	356(November 1990)	1,438
1990-91	January-July 1991	1,319	535(January 1992)	973
1991-92	March-July 1992	1,022	694 (As on 12th February 1993)	

Chapter 2

System Appraisal

2.01 Scheme of Depreciation Allowance

Introductory

2.01.1 In every business, apart from current costs, the cost of capital assets employed in the business has to be recouped over the period of productive use of the assets. Accordingly, to provide for the gradual wastage of the assets employed in the business, depreciation is charged before computing the profits for the year. However, while the historical cost of an asset can be recovered over the life-span of productive use of the same, this amount may not be adequate for the purpose of replacement of the assests due to cost inflation etc. In this context, to facilitate replacement of wasted assets and to boost investments, the Income Tax Act has traditionally included certain additional benefits under depreciation in addition to normal depreciation.

The Law

2.01.2 As a standard measure, depreciation is allowed year by year calculated on the basis of the actual cost and the depreciation provided in the past. In addition, there have been provisions for additional depreciation, initial depreciation, terminal allowance and extra shift allowance. These have been introduced from different dates subject to specified conditions. Additional depreciation and initial depreciation, limited to the specified assets and at different rates, allowed extra depreciation, but was available only in the year of installation of the eligible assets. Terminal allowance allowed the difference between the written down value and the sale price of an asset at the end of its useful life. In addition, there was an extra shift allowance in respect of machinery working double or triple shifts. Thus, while additional and initial depreciation operated to boost investments, the extra shift allowance provided for faster wastage of assets when subjected to more intensive use. The scheme of things as briefly narrated continued up to 31 March 1988. The procedure, however, was full of complexities as it required detailed book-keeping by assessee in

respect of each particular asset and laborious checking thereof by the Income Tax Department.

Following the recommendations of the Economic Administration Reforms Commission 1978, the provisions for depreciation under Income Tax law were rationalised with effect from 1st April, 1988. The modifications made retained only one item for depreciation, abolishing the provisions in respect of additional depreciation, initial depreciation, terminal depreciation and extra shift allowances. The concept of `block of assets' was also introduced as the basis of depreciation and the general rate of depreciation for plant and machinery was fixed at 33.33 per cent, with some specified departures. Presumably the rationalised provisons have been considered adequate from the economic angle, since at 33.33 per cent the accumulated depreciation would be close to double the historical cost of the assets in about 10 years. It can, thus, be held that there would be sufficient generation of internal funds for replacement of the assets and for renewal/modernisation of the same. Subsequently, from 1 April 1992, the general rate of depreciation has been reduced to 25 per cent. The other aspects remain as before. The position of law is thus as below:

(a) Up to 31 March 1988:

(i) Depreciation was available at different rates on individual assets, the basic rate for plant and machinery being 15 per cent with effect from 2 April 1983.

(ii) Extra shift allowance was available. For double shift working, it was 50 per cent of the normal rate of depreciation and for triple shift working, it was equal to the depreciation.

(iii) Initial depreciation was granted at different rates for specified assets during the year of installation.

(iv) Additional depreciation was allowed for specified assets, again during the year of installation.

(v) Terminal allowance was admissible being the difference between the written down

value and the sale price.

The basis of calculation was the actual cost of each individual asset, reduced by the depreciation already allowed.

(b) From 1st April 1988

Only depreciation allowance, based on blocks of assets, was admissible. For plant and machinery, the general rate was liberalised to 33.33 per cent, though different rates existed in specified cases.

(c) From 1st April 1992

The basic rate of depreciation for plant and machinery was brought down to 25 per cent. Otherwise, the general scheme of things remains as at (b) above.

Magnitude of the allowance

2.01.3 According to statistics compiled and published by the Directorate of Income Tax (Research, Statistics, Publications and Public Relations) in All India Income tax Statistics', the deductions allowed on depreciation were as shown below:

Assessment year	Depreciation allowance	Tax effect
	(In lakhs of rupees)	
1985-86	15984.34	6902.91
1986-87	16028.87	7100.28
1987-88	34506.61	11036.26

Figures have not been compiled by the Directorate beyond the assessment year 1987-88. Thus, not to speak of careful watch, review and evaluation of the end-result of the concessionel provisions, particularly after the wide changes effected from 1 April 1988, even basic data are not readily available.

Scope of the review

2.01.4 This review attempts a general evaluation of the scheme of depreciation and in particular, of the degree of compliance of law and procedural requirements, alongwith the manner of implementation of the scheme by the Income Tax department. In so doing, errors and omissions in the application of law and rules and other procedural lapses noticed have been highlighted in the report. In the process of the review, mistakes were

noticed in 788 cases, involving tax effect of nearly Rs.93 crores out of which 121 cases were completed under summary assessment scheme with tax effect of Rs.19 crores. Ministry of Finance have so far accepted the audit observations in 40 cases involving tax effect of Rs.10.40 crores. The review covered assessments up to 1990-91. It, however, does not include summary assessment cases where **prima facie** adjustments were not permissible; 54 such cases with mistakes involving under-assessment of Rs.22.51 crores and short levy of tax of Rs.11.80 crores were noticed.

Highlights

2.01.5(i) In order to enable assessees engaged in business or profession to generate funds internally for renewal, replacement and modernisation the Income Tax Act allows deduction on account of depreciation on capital assets used in business at rates higher than those adequate to enable recoupment of the historical costs of the assets over their life span. However, there is no provision seeking to ensure retention or ploughing back of funds thus made available through tax concessions in the business, though the Choksi Committee (1978) had brought out the desirablity thereof. In Audit, instances have come to notice where the funds thus generated appears to have been distributed as dividend. Even after rationalisation of the provisions from 1 April 1988, no review/evaluation has been attempted. In fact, even the quantum of the tax concessions allowed has not been compiled beyond the assessment year 1987-88.[Para 2.01.6]

(ii) The conditions attached to the grant of depreciation allowance required verification of certain particulars such as whether the asset acquired was new or second-hand, the date of its installation and period of use during the year, whether initial depreciation and additional depreciation were allowed or not, the date on which the assets were sold or discarded etc. Test review revealed that in 29 cases, though the prescribed particulars were not furnished, depreciation was allowed, with tax effect of Rs.457.96 lakhs.[Para 2.01.17(iii) & 2.01.21]

(iii) Depreciation allowance was not admissible unless the assets were owned and used in the business. The audit review has

brought out 21 cases where depreciation allowance was allowed on leased assets or on assets acquired under hire- purchase agreements involving tax effect of Rs.110.43 lakhs.[Para 2.01.9(i)(b) and 9(ii)]

(iv) Adjustment in the actual cost of assets acquired from abroad is permissible on account of change in the repayment liability due to variation in rate of exchange, but only at the time of actual repayment of the foreign currency loan. It was however observed in 25 cases that depreciation was erroneously allowed on enhanced capital cost of assets, even though there was no remittance in repayment. Consequently, there was short levy of tax of Rs.476.59 lakhs. [Para 2.01.10]

(v) Depreciation allowance is to be calculated on the actual cost of the asset which does not include that portion of the cost which has been met directly or indirectly by any other person or authority. In 1976, the Board clarified that the amount of subsidy received under the 10 per cent `Central outright grant of subsidy scheme 1971' for industrial units would be deducted in computing the cost of the assets for purposes of depreciation. Karnataka, Andhra Pradesh, Madhya Pradesh, Gujarat and Kerala High Courts have, however, held that though the subsidy is quantified at a percentage of the cost of the fixed capital asset, the subsidy schemes did not treat the subsidy as granted for the specific purpose of meeting a portion of the cost of the asset and it is granted more as a compensation for the hardship and inconvenience caused to the entrepreneur. On the other hand, the Punjab and Haryana High Court has taken the view that the subsidy is deductible in the computation of actual cost. Inspite of the legal controversy, Government did not clarify the position or expound the intention behind the legislation leading to avoidable litigation This review features 43 such cases, involving tax effect of Rs.129.75 lakhs.[Para 2.01.12]

(vi) Extra shift depreciation allowance was admissible up to a maximum of one-half of the normal depreciation allowance where the concern had worked double shift and upto a maximum of an amount equal to the normal

allowance where the concern had worked triple shift. The Ministry of Law opined 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. Inspite of this advice, the Board did not modify their instruction stating that where a concern has worked double 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 for which each machine had actually worked double or triple shift during the relevant previous year. 31 such cases, involving tax effect of Rs.1646.02 lakhs, form part of this review. [Para 2.01.17(i)

(vii) The review has also pointed out a case of undue benefit, whereby in certain situations of belated filing of returns, income escapes assessment. In one such case, accrued income of Rs.6.19 crores before depreciation escasped assessment.[Para 2.01.24]

(viii) In the course of the review, in 453 cases, mistakes were noticed in regard to conditions regarding owning the assets and putting them into use, allowance of initial and additional depreciation, failure to restrict depreciation allowance to the extent of cost of asset, mistake in carry-forward and set-off of unabsorbed depreciation allowance, application of incorrect rates of depreciation etc., involving tax effect of Rs.3910.49 lakhs. [Para 2.01.7, 2.01.8, 2.01.9(i)(a) and (c), 2.01.15, 2.01.16, 2.01.18, 2.01.21(i)]

Review/ Evaluation of the general scheme

2.01.6 The depreciation allowance allowed under the Income Tax Act, is significantly higher than the depreciation usually charged to profit and loss account by business organisations to recoup the historical cost of wasting assets employed in the business. Presumably, the liberalisation is in the interest of national economy which would gain from fresh investments and renewal/ replacement of productive assets. This, however, would call for measures to ensure that the revenue foregone by way of higher depreciation allowance is in fact retained

and reinvested in the business. The Choksi Committee (1978) had considered this aspect and noted that the depreciation permitted under the Act went beyond charging the capital expenditure incurred on depreciable assets over the useful life of the same and was aimed at working as an incentive measure affecting the cash flow of the enterprise and generation of internal resources for replacement of assets. The Committee had said that the tax incentive allowed should not be permitted to be frittered away but should be retained within the business for further development. Accordingly, the Committee had recommended that the higher rates of depreciation provided in the Income Tax Act should be considered the maximum permissible and should be allowed only where the quantum of depreciation claimed for Income Tax purposes was actually debited to the profit and loss account of the relevant previous year. Such a provision, however, does not exist in the statute. There is no requirement on the business to retain or reinvest the higher depreciation allowance allowed as tax incentive for the purpose of business, rather than being distributed as dividend. During the course of audit, it was found that two companies (Calcutta) had over the last 3 years in one case and 7 years in the other, distributed dividends of Rs.3069.38 lakhs against their aggregate post tax profit of Rs.4112.95 lakhs. If the liberalised provisions were not there, the post-tax profit available in these companies over the same period would have been Rs.2,128.84 lakhs. Thus, apparently part of tax incentive stood distributed as dividend. While it is difficult to come to a definite conclusion in regard to similar diversion of funds as a general issue in view of the flexibility available to corporations to determine the level of dividend to be declared or the quantum of profit to be transferred to/ withdrawn from reserve, the level of dividend declaration could well have been lower in many cases but for the tax incentives provided in the Income Tax Law under depreciation.

A full evaluation of the incentive with reference to its objective is thus desirable. However, even the figures relating to the extent of the concession allowed are not readily available with the Directorate of

Research, Statistics, Publications and Public Relations of the Board.

Application of incorrect rates

2.01.7 Deduction of depreciation is granted at specified percentages of the actual cost/written down value prescribed in Income-tax Rules. The prescribed rates range from 5 per cent to 100 per cent depending on the nature and class of the asset specified. Application of incorrect rate was noticed in 205 cases of 16 charges (Andhra Pradesh, Assam, Bihar, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Kerala, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal) in respect of assessment years 1979-80 to 1990-91 resulting in excess allowance of depreciation of Rs.1726.61 lakhs involving tax effect of Rs.1071.18 lakhs (including potential tax effect of Rs.278.43 lakhs in 13 cases). This includes 60 cases (tax effect Rs.110.44 lakhs) which were completed under summary assessment scheme.

Allowance of depreciation though assets not used for business

2.01.8 The deduction towards depreciation is admissible if the asset belonging to an assessee is used for the purpose of business or profession which is carried on by him. It has been held judicially1 that the expression

1 Liquidation of Pursa Ltd. Vs. CIT (1954) 25 ITR (SC) Central Proview Manganese Ore company Limited (1937) 5 ITR 734 (Nag) CIT Vs. Express Newspaper Limited (1964) 53 ITR 250 (SC) CIT Vs. Moon Mills Ltd. (1967) 65 ITR 630 (SC)

`used for the purposes of the business' means that the assets must be used by the owner for the purpose of carrying on the business and earning profits therefrom. In other words, the assets must be used for the purpose of that very business which is carried on by the assessee, the profits of which are assessable under section 28 of Income Tax Act 1961. If the assets have not been used at all for any part of the accounting year, no depreciation allowance is admissible.

In the assessments of 51 assessees in 12 charges (Assam, Andhra Pradesh, Bombay, Calcutta, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Punjab, Tamil Nadu and Uttar Pradesh), for assessment years 1981-82 to 1990-91, the assessing officers allowed depreciation on machinery and plant which were not used in business due to (a) no manufacture or business having been carried on during the accounting year or (b) assets being under construction and installation. The mistakes resulted in under-assessment of income of Rs.1,628.55 lakhs involving short levy of tax of Rs.586.20 lakhs (inclusive of potential tax effect of Rs.545.79 lakhs in 11 cases). This includes 14 cases which were completed in summary assessment scheme (tax effect of Rs.394.97 lakhs).

Allowance of depreciation without ownership of assets

2.01.9 For depreciation on plant and machinery or other assets to be admissible, the assets are to be owned by the assessee and used for the purpose of his business during the relevant previous year.

(i) It has been judicially2 held that when there is no registered deed conveying immovable property to the assessee, there is no transfer of ownership of the property to the assessee and, accordingly, the assessee would not be entitled to depreciation.

(a) In the assessments of eight assessee companies (Assam, Andhra Pradesh, Bombay, Karnataka and Uttar Pradesh charges), for the assessment years 1986-87 to 1990-91, the assessing officers allowed depreciation on buildings in respect of which the registration of sale deeds had not been executed by the vendors concerned. The companies were, thus, not the legal owners of the buildings and were, therefore, not entitled to depreciation thereon. The mistake resulted in under-assessment of income of Rs.48.18 lakhs and short levy of tax of Rs.27.75 lakhs (inclusive of potential tax effect of Rs.7.78 lakhs in 5 cases). These include 2 cases which were completed under summary assessment scheme (tax effect of Rs.9.74 lakhs).

(b) In respect of 16 assessee companies, (Andhra Pradesh, Assam, Chandigarh, Gujarat, Madhya Pradesh, Punjab, Tamil Nadu and Bombay charges) depreciation was allowed for assessment years 1978-79 to 1980-81 and 1985-86 to 1990-91 on machinery purchased under the hire-purchase scheme. As the basic conditions of ownership had not been satisfied till completion of the instalment payments, the assessees were not eligible for depreciation thereon. The incorrect allowance resulted in under-assessment of income of Rs.148.38 lakhs and short levy of tax of Rs.91.36 lakhs. This includes 3 cases which were completed in summary manner (tax effect of Rs.40.31 lakhs). An illustrative case is given below:

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2 CIT Vs. Hindustan cold Storage and Refrigeration Pvt. Limited (1976) 103 ITR 455 (Delhi) Mir Osman Ali Khan (Late Nawab Sir) Vs. CWT (1986) 162 ITR 888(SC) a case under Wealth Tax Act interpreting the words "belonging to the assessee".

In the previous year relevant to the assessment year 1990-91, an assessee company (i) held plant and machinery costing Rs.84.79 lakhs, purchased under a hire-purchase agreement in the previous year and (ii) made additions to plant and machinery and other assets, financed under hire-purchase agreements, to the extent of Rs.38.87 lakhs and Rs.6.12 lakhs respectively. The assessing officer, while completing the assessment in March 1991, allowed depreciation allowance of Rs.45.65 lakhs at the rate of 33.33 per cent on the cost of the assets as claimed by the assessee. Since the assessee was not the owner of the assets, the amount of depreciation allowed was not in order. The mistake resulted in excess carry forward of loss by Rs.45.65 lakhs with potential tax effect of Rs.27.11 lakhs.

(c) In the assessments of 14 other companies (Andhra Pradesh, Bombay, Delhi, Madhya Pradesh, Tamil Nadu and Uttar Pradesh charges), depreciation for assessment years 1987-88 to 1990-91 was allowed to the assessee companies on machineries which were not owned by them. This resulted in under assessment of income of Rs.843.37 lakhs and short levy of tax of Rs.356.12 lakhs (inclusive of potential tax effect of Rs.288.86 lakhs in 4 cases).These include 3 cases completed under summary assessment scheme(tax effect Rs.337.91 lakhs).

(ii) It has been judicially3 held that a lessee who carries on business, having taken on lease buildings, land appurtenant to the business premises, machinery and plant is not entitled to any depreciation allowance as he is not the owner of the assets taken on lease. The interest in the property which an assessee must possess in order to obtain the benefit of the depreciation allowance has necessarily to be full ownership of property. In the assessments of 5 companies(Assam, Calcutta, Punjab and Tamil Nadu charges) for the assessment years 1986-87 to 1989-90, the assessing officers allowed depreciation on machinery and plant which were taken on lease, resulting in under-assessment of income of Rs.33.47 lakhs involving short levy of tax of Rs.19.07 lakhs.

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3 Golcha Properties (P) Ltd. Vs. CIT (1987) 166 ITR 259 (Raj), 1988(177 ITR 47 (Raj), 1988 171 ITR 47(Raj); (1988) 169 ITR 525 (Raj) CIT Vs. Monga O.P.(1986) 162 ITR 224 (Bombay)

Erroneous allowance of depreciation on fluctuations in exchange rates

2.01.10 Under the provisions of the Income Tax Act 1961, where an assessee has acquired any asset from a country outside India for the purpose of his business or profession, and in consequence of change in the rate of exchange at any time after the acquisition of such asset, there is an increase or decrease in the liability as expressed in Indian currency for making payment towards the whole or a part of the cost of the asset, the amount by which the liability is so increased or decreased during the previous year shall be added to, or as the case may be, deducted from the actual cost of the asset. It has been clarified (October, 1984) by the Ministry of Law that the benefit of addition to actual cost of assets on change in the rate of exchange of currency is admissible only at the time of actual repayment of the foreign currency loans. Any intermediate fluctuation in the rate of exchange not backed by actual remittance would not be relevant for this purpose. It was, however, observed that the department had allowed depreciation allowance on such enhanced cost of assets, leading to underassessment of Rs.752.50 lakhs which involved short levy of tax of Rs.476.59 lakhs in 25 cases(Assam, Calcutta,Delhi, Gujarat, Orissa and Uttar Pradesh charges) for the assessment years 1967-68 to 1990-91 (inclusive of potential tax effect of Rs.222.74 lakhs in 14 cases). It includes one case completed under summary assessment scheme (tax effect Rs.16.06 lakhs).

Wrong adoption of written down value

2.01.11 Written down value has been defined as the actual cost of the assets to the assessee in the case of new assets acquired during the previous year and in case of assets acquired in earlier years, the actual cost less the depreciation (both normal and additional) allowed under the Act, and also sale proceeds of machinery, if any.. The Act further provides that from the assessment year 1984-85, the amount of initial depreciation will be deducted in determining the written down value. It was observed that in respect of 96 companies (Andhra Pradesh, Bihar, Bombay, Calcutta, Chandigarh, Delhi, Karnataka, Kerala, Madhya Pradesh, Punjab and Tamil Nadu charges) the written down value adopted was wrong. The assessing officers did not deduct the additional or the extra shift

allowance or the initial depreciation for arriving at the correct written down value nor deducted the sale proceeds of machinery sold as required. This resulted in under-assessment of Rs.1,378.61 lakhs with consequent short levy of tax of Rs.811.12 lakhs (inclusive of potential tax effect of Rs.438.52 lakhs in 17 cases) over the assessment years 1982-83 to 1990-91. These include 9 assessments which were completed under summary assessment scheme (tax effect Rs.20.03 lakhs).

Actual Cost

2.01.12 Under the provisions of the Income Tax Act, 1961, the term `actual cost' for the purpose of allowance of depreciation means the actual cost of the assets to the assessee as reduced by that portion of the cost thereof, 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 amount of subsidy received under `10 per cent Central outright grant of subsidy scheme 1971' for industrial units to be set up in selected backward areas, constituted capital receipts in the hands of the recipient and, accordingly, is to be deducted from the cost of assets for the purpose of allowing depreciation on such assets.The Punjab and Haryana High Court4 also held the same view. However, 5 other High Courts (Karnataka, Andhra Pradesh, Madhya Pradesh, Gujarat and Kerala) differed and concluded that though the subsidy was quantified as a percentage of the cost of the fixed asset, it was granted more as compensation for the hardship/inconvenience suffered by the entrepreneur, and not for the specific purpose of meeting a part of the cost of the asset. The issue has, however, not been reviewed further by the Ministry even after the divergence in court decisions.

In the assessments of 43 companies completed under scrutiny (Assam, Haryana Himachal Pradesh, Bihar, Bombay, Calcutta, Delhi, Orissa, Tamil Nadu, and U.P. charges), for assessment years 1989-90 to 1990-91, omission to reduce the actual cost of plant and machinery by the amount of cash subsidy and

4 CIT Vs. Jindal Bros Rice Mills (1989) 179 ITR 470 (P&H)
CIT V. Grace Paper Industries Pvt. Ltd. 91990) 183 ITR 591(Guj)
CIT Vs. Relish Foods (1989) 180 ITR 454 (Ker)
CIT Vs. Steel Ingots (P) Ltd.(1990) 181 ITR 42 (MP)

public contributions while computing the allowable depreciation, led to excess allowance of depreciation of Rs.500.45 lakhs involving short levy of tax of Rs.129.75 lakhs

Depreciation on capitalised interest

2.01.13 Under the Income Tax Act 1961, as amended with retrospective effect from 1 April 1974, where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of the amount as is relatable to any period after such asset is put to use shall not be included in the actual cost for the purpose of depreciation allowance.

(i) In the assessment of 5 companies (Calcutta, Gujarat and Tamil Nadu charges), over the assessment years 1982-83 to 1987-88, interest of Rs.244.08 lakhs in respect of deferred payments was capitalised and included in the actual cost of plant and machinery and depreciation of Rs.104.56 lakhs was allowed on such capitalised interest. The said interest related to the post commissioning period of the asset and was, therefore, not eligible to be considered as part of the `actual cost'. Erroneous treatment of interest led to excess allowance of depreciation of Rs.104.56 lakhs with consequential short levy of tax of Rs.61.60 lakhs. An illustrative case is given below:

The assessment of a private company for the assesment year 1987-88 was completed in March 1989. The assessee recalculated the written down value of plant and machinery in the previous year relevant to assessment year 1987-88 after reducing the written down value by the amount of interest capitalised. It had capitalised interest amounting to Rs.97.56 lakhs due to future payments under deferred payment scheme for purchase of plant and machinery etc. and added it to the cost of the machinery during the assessment years 1983-84 to 1985-86. Accordingly, it was allowed depreciation and extra shift allowance as under:

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[4] CIT Vs.Steel Tube of India Ltd.(1990) 181 ITR 90(MP)
CIT Vs.Godawari Plywoods Ltd.(1987) 168 ITR 632 (AP)
CIT Vs.Bhandari capacitors Pvt.Ltd.(1987)168 ITR 647(MP)
CIT Vs.Diamond Dies Mfg.Corpn.Ltd.(1988) 172 ITR (Karn)

Assessment Year	Amount of interest capitalised (Rs. in lakhs)	Amount of depreciation
1983-84	Rs.48.34	Rs.14.50
1984-85	Rs. 2.24	Rs.10.82
1985-86	Rs.46.98	Rs.21.67
1986-87	--------	Rs.15.17
	Rs.97.56	Rs.62.16

The assessee was required to withdraw the depreciation allowance claimed during the assessment years 1983-84 to 1986-87, as per the provisions of the Act. Failure to withdraw the depreciation of the earlier assessment years resulted in allowance of excess depreciation of Rs.62.17 lakhs involving short levy of tax of Rs.38.14 lakhs (positive).

(ii) Interest capitalised, i.e., interest paid before the asset is put to use, is to be treated as part of the `actual cost' of the asset and would, therefore, not qualify as revenue expenditure. In the assessment of a public limited comapny (Calcutta charge), completed under section 143(3), interest of Rs.172.53 lakhs and Rs.147.49 lakhs for assessment years 1983-84 and 1984-85 respectively, being capitalised interest on borrowed money paid or payable for acquiring plant and machinery under the head `capital work in progress' was allowed as revenue expenditure in the respective assessments. It was also seen that the said plant and machinery was not put to use in the previous years relevant to assessment years 1983-84 and 1984-85. The incorrect allowance of interest paid as revenue expenditure resulted in under assessment of income of Rs.172.53 lakhs in assessment year 1983-84 and excess carry forward of business loss of Rs.147.59 lakhs in assessment year 1984-85, resulting in under-charge of tax of Rs.182.44 lakhs (inclusive of potential tax of Rs.85.17 lakhs).

(iii) In the assessment of a widely held company (Calcutta charge) for the assessment year 1989-90, completed in a summary manner (June 1990), interest of Rs.245.42 lakhs was capitalised and included in the actual cost of the asset of Rs.2119.01 lakhs. The said interest was also allowed as revenue

expenditure. The plant and machinery however,was put to use on 31st March 1989, i.e. the last day of the previous year relevant to assessment year 1989-90. The capitalised interest of Rs.245.42 lakhs, being not relatable to the period after the asset was put to use, cannot be allowed as revenue expenditure. The deduction of Rs.245.42 lakhs was, thus, irregular and led to excess carry forward of business loss of Rs.122.71 lakhs after allowing depreciation, involving potential tax effect of Rs.64.43 lakhs and short levy of additional tax of Rs.12.89 lakhs.

Revaluation of Asset.

2.01.14 In computing the business income of an assessee, a deduction on account of depreciation is admissible in respect of buildings, plant , machinery and other assets owned by the assessee and used for the purpose of his business.The Act 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 and the assessing officer is satisfied that the transfer of such assets was mainly for the reduction of the liability to income tax, the actual cost to the assessee shall be such an amount as may be determined by the assessing officer with prior approval of the Deputy Commissioner of Income Tax, having regard to all circumstances of the case.

During the previous year relevant to assessment year 1985-86, a registered firm (Gujarat), on its dissolution with effect from 31st December 1983 was converted into a closely held company. All the share holders were partners of the dissolved firm. The assets of the firm, having a written down value of Rs.84.95 lakhs, were valued to Rs.146.39 lakhs by the company though the takeover was without any consideration. The adoption of higher value for the machinery resulted in allowance of excess depreciation of Rs.22.44 lakhs in the assessments for assessment years 1985-86 and 1986-87 completed under section 143(3) leading to short levy of tax of Rs.13.88 lakhs.

Additional Depreciation

2.01.15 Under the provisions of the Income Tax Act 1961, as amended by the Finance (No.2) Act 1980, a deduction was allowed by way of additional depreciation in respect of

new plant and machinery installed after 31st March 1980 but before 1st April 1985, the additional sum being equal to one-half of the normal depreciation in respect of the previous year in which such plant and machinery is installed, or if the plant and machinery is first put to use in the immediately succeeding previous year, then in respect of that previous year. The additional depreciation was not admissible in respect of office appliances, machinery and plant installed in office premises, buildings and road transport vehicles.

(i) It was observed that in the assessment of 5 assessee companies (Calcutta, Haryana and Uttar Pradesh charges), for assessment years 1986-87, 1987-88 and 1990-91, completed under scrutiny, additional depreciation was erroneously allowed on machinery which was installed after 31st March 1985. The mistake resulted in under-assessment of income of Rs.30.01 lakhs in one case and in excess computation of loss by Rs.56.24 lakhs in the 4 others involving short levy of tax of Rs.48.32 lakhs (inclusive of notional tax effect of Rs.25.48 lakhs).

(ii) In the assessment of 8 companies (one case completed under the summary assessment scheme) of Tamil Nadu charge for the assessment years 1983-84 to 1985-86, additional depreciation of Rs.35.72 lakhs was allowed on road transport vehicles and machinery installed in office premises which was not in order. The mistakes resulted in under-assessment of income of Rs.35.72 lakhs and short levy of tax of Rs.21.86 lakhs.

(iii) The assessment of a closely held company (Tamil Nadu Charge), for the assessment year 1983-84, was completed under scrutiny in January 1987 (revised in December 1987) allowing additional depreciation of Rs.15.12 lakhs at 22.5 per cent on the additions of Rs.67.21 lakhs. The previous year for the assessment year 1983-84 was of 18 months. Though the assessee company had claimed depreciation at 45 per cent and additional depreciation at 22.5 per cent in respect of TSI Anodes, the assessing officer allowed normal depreciation at 22.5 per cent for a period of 18 months but failed to reduce the rate of additional depreciation to 11.25 percent i.e. 50 per cent of normal

depreciation. The mistake led to under-assessment of income by Rs.7.56 lakhs and short levy of tax of Rs.5.81 lakhs inclusive of surtax.

Excess carry forward and set off of unabsorbed depreciation

2.01.16 When for any assessment year, unabsorbed depreciation under the head 'profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed depreciation is to be carried forward to the subsequent assessment year(s) and is to be set off against profits and gains of business and profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year(s) for set off.

(i) In the assessments of 136 companies (Bombay, Calcutta, Gujarat, Karnataka, Madhya Pradesh, Orissa and Tamil Nadu charges), for the assessment years 1983-84, 1985-86 to 1990-91, an aggregate sum of Rs.2693.35 lakhs, purportedly being unabsorbed depreciation pertaining to earlier assessment years, was allowed to be set off. However, it was observed that there were no such unabsorbed amount to be carried forward in the earlier years. In fact, the depreciation allowance had been denied by the assessing officers or had been varied in subsequent revisional orders or the depreciation allowance originally allowed had been reduced in appeals. The incorrect carry forward and set off resulted in under-charge of tax of Rs.1609.48 lakhs (inclusive of potential tax effect of Rs.517.88 lakhs in 12 cases). These include 11 cases of summary assessment involving tax effect of Rs.846.11 lakhs. An illustrative case is given below.

In the assessment of a company for assessment year 1990-91, completed under the summary assessment scheme and subsequently rectified under section 154, the assessee claimed and the department allowed set off of excess carried forward unabsorbed depreciation of Rs.941.83 lakhs relating to assessment year 1989-90. As per assessment order of assessment year 1989-90, there was no unabsorbed depreciation to be carried forward. This resulted in under-assessment of Rs.941.83 lakhs involving short levy of tax Rs.508.58 lakhs and additional tax of Rs.101.71 lakhs.

(ii) Under the provisions of the Income Tax Act 1961, where in the assessment of the assessee, full effect cannot be given to depreciation allowance in any previous year owing to there being no profits or gains chargeable for the previous year or 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 year and so on. It has been judicially5 held that in the case of firms, depreciation should be adjusted against business income and against other heads of income of the firm and that portion, if any, which remains unabsorbed would be apportioned to the partners for adjustment against the business and other income of each of the partners. If full effect cannot still be given to the depreciation allowance of the assessee firm by the above process in the hands of its partners and some amount still remains unadjusted, the assessee firm would carry it forward to the succeeding assessment years.

Two registered firms(Bombay charges) returned losses of Rs.47.55 lakhs for the assessment years 1981-82 to 1989-90. One of the firms was assessed under summary assessment scheme and the other under scrutiny. The losses were on account of unabsorbed depreciation and were apportioned among the partners. In the absence of any positive income in the hands of partners, the unabsorbed depreciation reverted back to the registered firm and was required to be carried forward in the hands of the firm only. Incorrect allocation of unabsorbed depreciation resulted in short levy of tax of Rs.26.06 lakhs (potential) in the hands of partners.

Extra shift allowance

2.01.17 Under the Income Tax Rules, 1962, extra shift depreciation allowance shall be allowed upto a maximum of one half of the normal depreciation allowance where the concern had worked double shift and up to a maximum of an amount equal to the normal

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5 CIT Vs.Trivedi Sons RJ (1990) 183 ITR 420 (AP)
Pearl Wollen Mills Vs.CIT (1989) ITR 368 (P&H)
CIT Vs.Srinivasa Sugar Factory (1988) 174 ITR 178 (AP)
CIT V.Madras Wire Products (1979) 119 ITR 454 (Mad)
Ballarpur collerics Co.Vs.CIT (1973) 92 ITR 219(Bombay)

allowance where the concern had worked triple shift. The Rules further prescribe that the extra shift depreciation on plant and machinery of a non-seasonal factory is to be allowed at such proportion of the normal depreciation as the number of days for which the concern actually worked extra shift bears to the normal number of working days of the concern during the previous year. The normal number of working days in a previous year is deemed to be the actual number of days the factory works or 240 days, whichever is greater. This provision was operative up to 31st March 1988.

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. In September 1970, the Board revised its view, and issued instructions stating that where a concern had worked double shift or triple shift, extra shift allowance should be allowed in respect of the entire plant and machinery used by the concern without making any attempt to determine the number of days for which each machine had actually worked double or triple shift during the relevant previous year. The Ministry of Law subsequently opined (February, 1978) that if in any particular year any particular machine or plant was not used at all even for a day, the normal depreciation allowance was not admissible and as a corollary thereto, extra shift depreciation would also not be admissible and suggested that the Board's Instruction of September 1970 be modified.

In February 1985, the Board issued instructions directing the assessing 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 had worked. The instructions further provided that where a concern had more than one factory, the extra shift allowance would be regulated for each factory in the above manner.

(i) In the assessments of 31 assessees (Chandigarh, Delhi, Gujarat, Himachal Pradesh, Kerala, Orissa, Tamil Nadu, and

Uttar Pradesh charges), completed under scrutiny, extra shift allowance was allowed for assessment years 1984-85 to 1987-88. It was revealed that though the concerns had worked only for 40 days, 91 days, 128 days and 180 days, extra shift allowance was allowed equivalent to the normal depreciation without restricting the same to the proportionate number of working days. This resulted in under assessment of income of Rs.2,827.94 lakhs and short levy of tax of Rs.1,646.02 lakhs (including potential tax effect of Rs.89.82 lakhs in 5 cases).

(ii) The Income Tax Rules, 1962 prohibit extra shift depreciation allowance for multiple shift in respect of machinery and plant, against which the letters `NESA' appear in the depreciation schedule of the Rules. In the assessment of 30 companies (Andhra Pradesh, Assam, Calcutta, Gujarat, Kerala and Tamil Nadu), for the assessment years 1978-79 to 1980-81 and 1984-85 to 1987-88, completed under scrutiny, extra shift allowance on machinery of the prohibited category including barges, electric installation. cold storage, technical know-how etc. was allowed. As no extra shift allowance was admissible,there was under assessment of income of Rs.297.26 lakhs resulting in short levy of tax of Rs.199.00 lakhs.

(iii) The Income Tax Rules, 1962 provide for grant of extra shift depreciation for extra shift working of plant and machinery depending on the number of days of double and triple shift working of the concern. For claiming the deduction, the assesee has to furnish the particulars prescribed in the Rules. In the case of 13 companies (Andhra Pradesh,Bihar, Kerala and Tamil Nadu), completed under scrutiny, there was no evidence that the machinery had worked extra shift during the previous year relevant to the assessment years 1983-84 to 1987-88 and the assessees had also not furnished the prescribed particulars to establish the claim. The department, however, allowed the extra shift allowance on triple shift. The incorrect allowance resulted in under-assessment of income of Rs.200.71 lakhs and short levy of tax of Rs.165.28 lakhs, (including potential tax effect of Rs.76.56 lakhs in 1 case). An illustrative case is

given below:

In the assessment for assessment year 1987-88, the assessee was allowed a deduction on account of extra shift allowance to the tune of Rs.153.02 lakhs without enclosing any details. This resulted in excess deduction on account of triple shift allowance to the tune of Rs.153.02 lakhs with consequent excess carry forward of investment allowance of the same amount (current year Rs.134.12 lakhs and Rs.18.89 lakhs relating to the previous assessment year 1986-87). The tax effect is Rs.76.56 lakhs (potential).

(iv) The rates of depreciation were revised with effect from 2nd April 1987 applicable to the assessment year 1988-89 and onwards. No extra shift allowance was allowable thereafter. In the assessment of 5 companies (Bombay, Calcutta, Delhi and Karnataka charges), for the assessment years 1988-89 and 1989-90, triple shift allowance equal to the normal depreciation was incorrectly allowed. Since no extra shift allowance was allowable from the assessment year 1988-89 onwards, there was under-assessment of income of Rs.510.80 lakhs involving short levy of tax of Rs.269.05 lakhs (inclusive of potential tax effect of Rs.52.68 lakhs in 3 cases). Of these, 4 assessments involving tax effect of Rs.42.98 lakhs were completed under the summary assessment scheme. An illustrative case is given below:

In the case of a company, assessed in Karnataka charge, extra shift allowance of Rs.408.10 lakhs for triple shift working was allowed for assessment year 1988-89, although there was no provision under the law applicable to the assessment year 1988-89 and onwards. This resulted in short levy of tax of Rs.214.25 lakhs (potential).

Initial depreciation

2.01.18 Under the provisions of the Income Tax Act, 1961 as it stood prior to its amendment with effect from 1st April 1988, an assessee was entitled, subject to fulfilment of certain conditions, to initial depreciation at the rate of 20 per cent of the actual cost of the machinery or plant in respect of the previous year in which the machinery/plant is acquired/installed, or if it is first put to use in the immediately

Other mistakes

succeeding previous year, then in respect of that previous year. This provision stands withdrawn with effect from 1st April 1988.

(i) The Act provides that the aggregate of all deductions in respect of depreciation viz. normal depreciation, extra shift allowance, initial depreciation etc., should not exceed the actual cost of the assets in respect of which the depreciation was allowed. It was observed that in 17 cases (Punjab and Tamil Nadu charges), completed under scrutiny, initial depreciation of Rs.135.84 lakhs was not taken into account for restricting the total depreciation allowance admissible. This resulted in under-assessment of income of Rs.116.35 lakhs for assesment years 1983-84 to 1987-88 and short levy of tax of Rs.68.56 lakhs.

(ii) Though the allowance of initial depreciation has been withdrawn with effect from assessment year 1988-89, it was observed that initial depreciation of Rs.50.71 lakhs was allowed to 2 assessees (Tamil Nadu and Uttar Pradesh charges) in the assessment for the assessment year 1988-89 completed under scrutiny. This resulted in under-assessment of income of Rs.50.92 lakhs (including under assessment on account of another mistake in allowance of depreciation on carpets) involving short levy of tax of Rs.27.72 lakhs (inclusive of potential tax effect of Rs.5.99 lakhs).

Non furnishing of prescribed particulars of assets

2.01.19 Depreciation allowance is admissible only on the particulars of depreciable assets used for the purposes of business being furnished by the assessee. Upto the assessment year 1987-88, these particulars had to be furnished in the form prescribed under Rule 5AA of the Income Tax Rules 1962. With effect from the assessment year 1988-89, the particulars of assets are required to be given alongwith the return of income. It has also been judicially6 held that where the particulars of the assets are not furnished by the assessee, depreciation allowance cannot be allowed. In the assessment of 16 cases (Assam, Madhya

6 191 ITR 477 (Patna) Jitan Ram Vs. CIT
112-ITR-9 (Kerala) CIT Vs.Fagoomal Lakshmi Chand

Pradesh, Orissa and Rajasthan charges), for the assessment years 1985-86 to 1988-89 and 1990-91, depreciation was allowed without the particulars having been furnished by the assessee. This resulted in under assessment income of Rs.496.34 lakhs with consequent short levy of tax of Rs.292.68 lakhs inclusive of interest. Of these, 10 cases involving tax effect of Rs.120.65 lakhs were completed under the summary assessment scheme. An illustrative case is given below:

An assessee purchased, in the previous year relevant to assessment year 1987-88, machinery worth Rs.1808.54 lakhs on which depreciation amounting to Rs.242.64 lakhs was allowed, even though the prescribed particulars of the machinery were not furnished by the assessee. Incorrect allowance of depreciation resulted in undercharge of tax of Rs.97.06 lakhs including interest of Rs.55.81 lakhs.

Depreciation on capital expenditure on scientific research and technical know-how

2.01.20 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. In respect of expenditure incurred on acquiring any know-how for use for the purposes of business, one-sixth of the amount so paid is deductible in computing the taxable income for that year, and the balance in equal instalments for each of the five immediately succeeding previous years. In such cases, the assessee will not be entitled to any separate depreciation in respect of the capital expenditure on scientific research represented by any asset either in the same or in any subsequent previous year. It has also been held judicially[7] that depreciation is not allowable on the price paid for the acquisition of technical data/know-how.

(i) While computing the income of seven assessing companies (Calcutta and Uttar Pradesh) for the assessment years 1985-86 to 1989-90, expenditure on scientific

7 CIT Vs.Premier Automobile Ltd. 190 ITR 155 (Bombay)

expenditure was allowed in toto. In addition, depreciation to the extent of 66.87 lakhs was also allowed. As no depreciation was allowable separately, the entire cost having already been allowed as deduction, there was under-assessment of income of Rs.66.87 lakhs. Short levy of tax amounted to Rs.45.55 lakhs (inclusive of potential tax effect of Rs.4.89 lakhs in one case). Of these, one case involving tax effect of Rs.4.93 lakhs was completed under summary assessment scheme.

(ii) While completing assessments of 6 cases (Madhya Pradesh, Bombay, Chandigarh U.T.) for the assessment years 1986-87 to 1990-91, the capital expenditure incurred on the acquisition of technical know-how was allowed as deduction. In addition, depreciation of Rs.18.23 lakhs was also allowed on the same assets which resulted in under-assessment of income of an identical amount and short levy of tax of Rs.11.74 lakhs. Of these, one case involving tax effect of Rs.1.39 lakhs was completed under summary assessment scheme.

Depreciation for transitional period related to change over to uniform previous year

2.01.21. In computing the business income of an assessee, a deduction on account of depreciation is admissible at the prescribed rates on plant and machinery and other assets, provided they are owned by the assessee and used for the purpose of his business during the relevant previous year. From 1st April 1989, the financial year uniformly became the relevant previous year. For the assessment year 1989-90, as a transitional arrangement, it was provided that depreciation can be proportionately increased if income under the head `profits and gains of business or profession' included in the total income is for a period of thirteen months or more. This increase is, however, not admissible where 100 per cent depreciation is allowed on any block of assets as per the rates schedule.

(i) In respect of the assessment year 1989-90, four assessee companies, whose assessments were completed in summary manner (Bombay, Karnataka and Tamil Nadu charges), had a previous year ranging from 15 months to 23 months. The companies made additions to plant and machinery costing Rs.327.90 lakhs during the previous year for which

depreciation at the rate of 100 per cent has been prescribed in the Rules. It was observed that the assessees claimed proportionate increase in the amount of depreciation in respect of this block of assets also, even though the depreciation thereby exceeded the cost of assets and this was allowed. The mistake resulted in under-assessment of income of Rs.96.50 lakhs and short levy of tax of Rs.61.43 lakhs (inclusive of potential tax effect of Rs.1.53 lakhs in one case).

(ii) In the assessments of a widely held company (Calcutta charge) for the assessment year 1989-90, a loss of Rs.259.44 lakhs was determined after allowing deduction towards depreciation of Rs.281.57 lakhs on the basis of a revised return of income filed by the assessee company on 30 March 1990. The assessment was subsequently revised in July 1991 determining loss of Rs.248.25 lakhs on the basis of a second revised return of income filed on 7th January 1991. It was seen that in the original return filed on 29 December 1989, the depreciation allowance of Rs.160.90 lakhs, calculated at the rate applicable to the assets in question for 21 months, being the previous year relevant to the assessment year 1989-90, was correctly claimed by the assessee company . In the revised return of income filed on 30 March 1990, however, depreciation was wrongly claimed at Rs.281.57 lakhs by assuming that the original figure of Rs.160.90 lakhs represented depreciation for 12 months. The same was allowed in the assessment completed in a summary manner in July 1991. The mistake resulted in excess allowance of depreciation of Rs.120.67 lakhs with consequential excess carry forward of unabsorbed depreciation of a like amount involving potential tax effect of Rs.63.35 lakhs and short levy of additional tax of Rs.12.67 lakhs for the assessment year 1989-90.

(iii) The Central Board of Direct Taxes had issued instructions in May 1971 and August 1976 requiring the assessing Officer to ensure that the assessees did not make use of the device of changing their previous year in a manner prejudicial to the interest of revenue including under-payment of advance tax. Where an application is made with the object of causing loss to revenue, orders of the Commissioners were required to be

obtained before granting permission for changing 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 assessing officers, if found prejudicial to revenue.

One public limited company (Gujarat circle), with previous year ending on 31 December upto the assessment year 1987-88, sought permission for change in the accounting year and to have the next accounting year covering a period of 15 months from 1 January 1987 to 31 March 1988. The change was proposed on the grounds of continued recessionary trends in the textile industry and workers' strike for three months in that year and also to fall in line with the proposal of the Govt., of India to have a uniform financial year (April to March) for all assesses. The change was allowed by the assessing officer. In this case,a new unit was started on 29th March 1988. In the total assessed business loss of Rs.2.19 crores, the new unit at Dharwar alone accounted for depreciation of Rs.1.68 crores. No separate income and expenditure in respect of the latter unit was furnished, nor was any separate set of accounts of that unit produced to the statutory auditors. The change of accounting year had no relation to recession in industry or adoption of a uniform previous year and was ostensibly aimed at tax evasion. It resulted in irregular carry forward of depreciation of Rs.1.68 crores involving potential tax effect of Rs.88.20 lakhs.

(iv) The intention of Rule 5 of the 10th schedule to the Income Tax Act is to remove hardship faced by tax payers for compulsory change-over of previous year and, accordingly, assets in use for 13 months or more in the relevant previous year would get the benefit of proportionally higher depreciation, and those in use for less than 13 months, the benefit would be restricted to 12 months only.

In three cases of Calcutta charge, the assessments for the assessment year 1989-90 were completed for two periods i.e. 1st July 1987 to 30th June 1988 and 1st July 1988 to 31 March 1989. In doing so, depreciation for 21 months was allowed even on assets which were added during the extended previous year,

resulting in excess allowance of depreciation of Rs.282 lakhs and short levy of tax of Rs.177.57 lakhs (inclusive of potential tax effect of Rs.7.34 lakhs in one case). Of these, 2 cases involving tax effect of Rs.171.52 lakhs were completed in summary manner.

Mistakes in assessment while giving effect to appellate orders

2.01.22 For the purpose of depreciation, the term `written down value' means, in the case of assets acquired before the previous year, the actual cost to the assessee as reduced by depreciation actually allowed (including extra shift allowance) under the Act.

(i) In the case of a company (Bihar charge) in which public are substantially interested, although extra shift allowance of Rs.9.56 and Rs.12.57 lakhs was allowed in the assessment years 1980-81 and 1984-85 as per the appellate orders in March 1991, the same was not taken into account in determining the written down value of the assets in the succeeding assessment years. The mistake resulted in excess allowance of depreciation of Rs.7.87 lakhs for assessment years 1981-82, 1982-83 and 1985-86 alone leading to total under-assessment of an identical amount involving short levy of tax of Rs.4.40 lakhs in aggregate.

(ii) While computing the income of a widely held company (Karnataka charge), for the assessment years 1986-87 to 1988-89, expenditure of Rs.3.31 lakhs, Rs.1.16 lakhs and Rs.2.96 lakhs for the assessment years 1986-87, 1987-88 and 1988-89 respectively was treated as capital expenditure and depreciation of Rs.0.99 lakhs, Rs.1.04 lakhs and Rs.1.80 lakhs were allowed. On appeal by the company, the Commissioner (Appeals) held (June 1990) that the expenditure was to be treated as revenue expenditure. While treating the expenditure as revenue exependiture, the depreciation allowed was not withdrawn. This resulted in excess allowance of depreciation of Rs.3.83 lakhs with consequential short levy of tax of Rs.2.13 lakhs.

Roads, culverts and buildings

2.01.23 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. It has been judicially8 held that roads are to be treated as buildings and not as plant and machinery.

In the assessments of an assessee, a petro-chemical company, (Assam circle), for the assessment years 1989-90 and 1990-91, completed under scrutiny, depreciation at the rate of 15 per cent which was applicable to plant and machinery was allowed, as claimed by the assessee, in respect of roads within the factory against the admissible rate of 5 percent. The depreciation disallowable worked out to Rs.29.09 lakhs involving tax effect of Rs.12.11 lakhs.

Undue benefit

2.01.24 Under the provisions of the Income Tax Act, 1961 as it stood prior to 1st April 1991, a return of income below the maximum amount which is not chargeable to tax shall be deemed never to have been furnished, and treated as nonest except in certain specified circumstances such as a return of loss to be carried forward, a return in support of a claim for refund etc.

An assessee company (Tamil Nadu charge) filed returns of loss for the assessment years 1986-87 and 1987-88 on 30th December 1986 and 9 June 1988 respectively. The assessing officer filed the returns, treating them as **non est.** For the assessment year 1988-89, the assessee filed a return of loss of Rs.2.94 crores within time. The assessment was completed under scrutiny and revised after appellate order, at loss of Rs.3.52 crores. The assessing officer recomputed the depreciation by taking the written down value as on 1st April 1985 i.e. with reference to the last completed assessment, ignoring the returns for the assessment years 1986-87 and 1987-88 which were not acted upon. While the assessee was not put to any loss by way of depreciation, the income accruing to the assessee for the assessment years amounting to Rs.6.19 crores before depreciation,escaped assessment, involving substantial tax effect.

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8 CIT Vs.Sandirk Asia Ltd. 144-ITR-585 (Bombay)
CIT Vs.Gwalior Rayon silk Mfg Co.Ltd.(1992)-108 Taxation 360(SC)

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

(i) In the assessments of 6 companies, one co-operative society and one registered firm (Calcutta ,Haryana, Punjab and Bombay charges), for the assessment years 1987-88 to 1990-91, completed under scrutiny, the assessing officers allowed depreciation of Rs.183.90 lakhs as admissible under the Act, but did not add back Rs.272.45 lakhs already charged as depreciation in the profit and loss account. The omission resulted in under-assessment of income by Rs.272.45 lakhs involving tax effect of Rs.123.41 lakhs (including potential tax effect of Rs.106.73 lakhs in 3 cases). An illustrative case is given below:

In the assessment of a limited company for the assessment year 1987-88, completed in September 1989, the assessing officer allowed depreciation of Rs.171.19 lakhs as admissible under the Act but did not add back Rs.57.87 lakhs already charged as depreciation in the profit and loss account. The omission resulted in over-assessment of loss amounting to Rs.57.87 lakhs having potential tax effect of Rs.28.94 lakhs.

(ii) In the assessment of 16 assessees(Delhi, Bombay, Calcutta and Rajasthan charges), for assessment years 1986-87, 1988-89 and 1990-91, while disallowing the difference between the depreciation claimed and depreciation allowed, the assessing officer allowed excess depreciation to the extent of Rs.203.82 lakhs involving short levy of tax of Rs.104.80 lakhs (including potential tax effect of Rs.44.05 lakhs in 2 cases). Of these, 1 case involving tax effect of Rs.1.50 lakhs was assessed in a summary manner

(iii) In the assessment of a public limited company (Gujarat charge), for assessment years 1985-86 and 1986-87, completed under scrutiny, depreciation of Rs.59.10 lakhs on plant and machinery was disallowed, on the ground that proof of

purchase was not produced. While allowing depreciation in the subsequent year, however, depreciation was allowed separately on the disallowed items. In doing so, depreciation was allowed twice,resulting in excess depreciation of Rs.15.66 lakhs and short levy of tax of Rs.8.19 lakhs

2.02 Review on assessment of religious and charitable trusts

Introductory

2.02.1 The State has always recognised and sought to encourage the laudable role of private philanthropy in relieving distress and in helping to meet the socio-economic, cultural and religious needs of the society. Such an encouragement has been a feature of the Indian taxation system. Income of trusts and institutions created for charitable or religious purposes, when derived from property held under trust or received through donations to the corpus of the trust, and applied for such charitable and religious purposes, is exempt from income Tax subject to certain conditions. Wealth tax is also not charged on property held under trust or other legal obligations for public purposes of a religious and charitable nature. Donors are given relief from income tax and gift tax in respect of donations paid to institutions established in India for charitable purposes.

Law and Procedure

2.02.2(1) The Income Tax Act does not define a religious and charitable trust.However, the Indian Trust Act defines a trust `as an obligation annexed to the ownership of the property and arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner' (Section 3). The person who reposes or declares the confidence is called the author of the trust, the person who accepts the confidence is called the trustee, and the person for whose benefit the confidence is accepted is called the beneficiary. The subject matter of the trust is called trust property.

The essentials of a valid trust are as follows:

(i) It must be created for a lawful purpose[1]. The purpose is lawful unless (a) it is forbidden by law, or (b) it is of such a nature that, if permitted, it would defeat the provisions of any law, or (c) it is fradulent, or (d) it involves or implies injury to the person or property of another or (e) the court regards it as immoral or opposed to public policy.

(ii) If it relates to immovable property, it must be declared by a non-testamentary instrument in writing, signed by the author of the trust or the trustee and registered, or by the will of the author of the trust or of the trustee. If it relates to movable property it must be declared as in the case of immovable property or alternatively, the ownership of the property must be transferred to the trustee (in which case a written declaration is not necessary)[2].

(iii) The author of the trust must indicate with reasonable certainty by any words or acts,

(a) an intention on his part to create thereby a trust;

(b) the purpose of the trust,

(c) the beneficiary and

(d) the trust property[3].

(iv) Unless the trust is declared by will or the author of the trust is himself to be the trustee, the trust property must be transferred to the trustee[4].

(v) The subject matter of a trust must be property transferable to the beneficiary and not merely a beneficial interest under a subsisting trust[5].

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1 Sec.4 of Indian Trust Act 1882

2.Sec.5 ibid

3 Section 6 of Indian Trust Act 1882

4 Section 8 ibid

5 Sections 7,9 and 10 ibid

(vi) The author of a trust, the trustee and the beneficiary must all be competent persons[5]. A trust may be created by any person competent to contract. Section 11 of the Contract Act provides that every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject. A competent trustee is one who is capable of holding property, but where the trust involves the exercise of discretion, he will not be entitled to execute it unless he is competent to contract. The beneficiary may be any person capable of holding property. He may be minor or an alien. A trustee may also be a beneficiary but he cannot be the sole beneficiary, since no trust can exist where the entire property is vested in one person and rights and duties are exercised by one person.

2.02.3 The Income Tax Act gives an inclusive definition of the term `charitable purpose', classifying it under four heads, viz., `relief of the poor, education, medical relief and the advancement of any other object of general public utility. The first head `relief of the poor' has always been recognised as a charitable purpose. However, if under a trust created or established after 1st April 1962, a relative obtains any benefit even by way of preference, the trust would be regarded as non-charitable and the whole income of the trust would be includible in the total income [S.13(1)(c)].Examples of the second head `education' are establishing schools where free education is imparted, establishing professional chairs, lectureships, scholarships, fellowships and readership and grants in respect of research, academic rewards, extending financial assistance to poor and deserving students by way of loans, scholarships, grant for purpose of books, etc. As regards the third head `medical relief', this should be by way of bounty and not by way of bargain. The fact that some of the beneficiaries pay for the benefits they get from a medical institute would not be fatal to charitable character of the institution. The fourth head comprises all objects of general public utility which will include all purposes which are useful or

beneficial to the general public. It would exclude the object of private gain. The question whether a particular object is of general utility or not is to be tested, not by the views and the considerations of the founder or the author of the trust, but by the principles applicable to such cases in a court of law and by finding out whether a court would regard the trust as a charity, applying the standard of customary law and opinion common amongst the community to which the parties belong.

2.02.4 Religious purposes must be determined by the personal law of the parties and would include the advancement, support or propagation of a religion and its tenets. The exemption granted under the Act is confined to public religious trusts and does not extend to private religious trusts which do not enure for the public benefit6.

2.02.5 Thus, a valid trust for charitable or religious purposes would involve having the public as the beneficiary and the specification of objects on which or for which income from the property is to be spent or applied, besides specification of the property and the dedication of property. The Supreme Court has, in a recent decision[7], held as follows:

> "The crux of the statutory exemption under section 11(1)(a) of the Act is not the income earned from property held under trust but the actual application of the said income for religious and charitable purposes. It is, therefore, necessary to indicate in the trust deed the broad objectives for which the income derived from the property is to be utilised."

Sections 11 and 13 of the Income Tax Act, 1961 deal with exemptions available to income held for charitable or religious purposes on fulfilment of certain conditions regarding application, setting apart and investment of such income. Donations to such trusts are partially exempt in the hands of the donors from the levy of income tax and fully exempt from the levy of gift tax under Gift Tax Act, 1958. No wealth tax is leviable under Wealth

6 Official Trustees Vs. CIT, 67-ITR-218

tax Act 1957 on the wealth of the trusts which enjoy income tax exemption.

Besides exemption under Section 11, the Central Government has statutorily and absolutely exempted under various sub-sections of Section 10 some specific trusts, associations or institution as also certain types of income having regard to their objects and importance. Section 10, unlike section 11, does not contemplate that income should be applied during the year itself. Incomes falling under Section 10 do not form part of the total income. The position is similar to incomes assessable under section 11 to 13. However section 139(4A) provides for mandatory filing of a return in the latter cases provided the total income without giving effect to the provisions of Sections 11 and 12 is above the maximum amount which is not chargeable to income tax. It has been judicially held[8] that the provisions of section 10 and sections 11 to 13 are not mutually exclusive8. Thus, income, which are not eligible for exemption under section 10, can be considered for exemption under Sections 11 to 13, provided the conditionalities attached are observed.

Scope of Audit

2.02.6 Since concessions granted to charitable and religious institutions involve sacrifice of considerable revenue, it is essential that the tax privileges are not abused. This review is intended to evaluate as to how far the provisions of Income Tax Act, Wealth Tax Act and Gift Tax Act are being correctly applied, and whether there is any deficiency in the laws and their practice which may be taken advantage of to avoid tax liability through the device of trusts.

A test check of the assessment records of 6133 public charitable and religious trusts was conducted over assess-ment years 1986-87 to 1990-91, to examine the grant of registration for income tax purposes, the quantum and the manner in which income has been derived, applied, accumulated and invested vis-a-vis the provisions of Income Tax Act, 1961, and their liability to wealth

7 Gangabai Charities Vs.CIT 196-ITR-30(ST)(SC)

8 CIT Vs. Bar Council of Maharashtra, 130-ITR-28(SC)

tax and gift tax if any.Errors were noticed in 232 trusts cases (either scrutiny assessments or summary assessments involving prescribed adjustments) with tax effect of Rs.1146 lakhs, out of which selected cases are reported in the following paragraphs. However, 374 cases of summary assessments where mistakes not involving prescribed adjustments were noticed (tax effect Rs.3977 lakhs) have not been included in the review.

Highlights

2.02.7(i) The useful and supplementary role of private philanthropy in relieving distress and meeting economic, social, cultural and religious needs of the society has been recognised by the State in extending to charitable entities the benefit of exemption of tax on property and on income from such property held in trust. The crux of the statutory exemption is that the said income and property are actually applied or intended to be applied for public purposes of religious and charitable nature. Tax laws contain various safeguards to prevent abuse of the concessions and to secure the application of income and property for the declared objectives of the trust.

(ii) Exemption is allowed to an instutition, trust or fund created for charitable or religious purposes.This exemption is available under Section 10 and Section 11 of the Income Tax Act. However, whereas Section 139(4A) makes the filing of a return mandatory in case the income is above taxable limits for assessees claiming exemption under Section 11, there is no such requirement for assessees granted exemption under Section 10 and hence monitoring of such cases is difficult [Para 2.02.8(i)].

(iii) The Income Tax Act provides a separate exemption under Section 10(23A) for specified income of professional bodies engaged in the control, supervision, regulation or encouragement of professions of law, medicine, accountancy, engineering, architecture etc. It has been observed that inspite of this specific provision, the Board has been allowing a general exemption under section 10(23) (c)(iv) granting a further benefit to certain professional associations [Para 2.02.8(ii)].

(iv) Trust assessments, by and large, are being completed in a summary manner, accepting the returned income except for making some prescribed prima facie adjustments to it. Trusts can get statutory exemption of its income only on fulfilment of certain conditions,but assessments done summarily leave no scope to the assessing authorities to examine the various conditionalities. As a result, assessee trusts may abuse the exemption of income which might otherwise be taxable [Para 2.02.8(iii)].

(v) Donations specifically made towards the corpus of trusts created for charitable or religious purposes are not included in its total income. If such trust subsequently becomes non-functional or defunct, money standing in the corpus of the trust will escape tax liability without ever being applied to religious or charitable purposes in the absence of any enabling provision under the Act. In one case that came to notice, a trust collected donations towards its corpus which stood at Rs.0.82 lakhs as on 31st March 1983 but did not at all utilise the income derived therefrom nor carried out any activity related to the objectives of the trusts during the following years [Para 2.02.8(iv)].

(vi) Income of a hospital or other institution for treatment, convalescence or rehabilitation of persons requiring medical attention is exempt from tax if it exists solely for philanthropic purposes and not for purposes of profit.Exemption of income of a medical institution which was charging nearly 90 per cent of the patients like any other private nursing home resulted in non-levy of tax of Rs.57.96 lakhs [Para 2.02.16].

(vii) One of the conditions for claiming exemption from tax is that the recipient of such income should make an application in the prescribed manner for registration of the trust before the expiry of one year from the date of creation of the trust. Delay in making an application, if not condoned by the competent authority, will result in grant of registration from a date later than the date of creation of the trust, that is from the first day of the financial year in which the application is made. In the cases of 9

assessees involving tax effect of Rs.42.20 lakhs, the registrations were granted from dates later than the dates of creation of the trusts or not granted at all, yet incomes for the period prior to registration were not brought to tax [Para 2.02.11].

(viii)Income from property held under trust is to be computed on accrual/due basis. If a trust is unable to apply 75 per cent of its total income to charitable or religious puposes as required, due to non-receipt of accrued income, it can opt in the prescribed manner to have it treated as deemed application of income in the year in which it is derived but not actually received. In the case of 5 trusts which did not exercise any such option, accrued income amounting to Rs.26.79 lakhs was excluded with consequent short levy of tax of Rs.24.94 lakhs [Para 2.02.15].

(ix) With a view to preventing abuse in the application and investment of trust funds, there are stringent provisions in the Income Tax Act which disentitle a trust for exemption if its funds are used for the benefit of `interested persons' such as authors and managers of the trust or trustees or their close relatives or if its surplus funds are invested otherwise than in specified modes such as Government securities, deposits in post office or scheduled banks etc. In the case of 20 assessees, trust funds were found to have been applied for the benefit of `prohibited persons' and surplus funds invested in non-prescribed modes, but the trusts were not subjected to tax despite disentitlement to exemption leading to non-levy of tax of Rs.81.26 lakhs [Para 2.02.9 &2.02.13].

(x) Voluntary contributions not made with a specific direction that they would form part of the corpus of the trust and contribution towards earmarked funds without such specific direction are includible in the total income of the trust which is required to be applied for the objectives of the trust. Any surplus income in excess of 25 per cent of the total income, which could not be applied for the objectives of the trust in a financial year, is liable to be taxed. Provisions, however, exist in the Income Tax Act which permit the accumulation of such surplus income for

specified purposes and for specified periods not exceeding 10 years, if a proper notice is given within the prescribed time limit by the recipient of such income and such accumulated income is spent on the specified objective within that period. Cases were noticed where the contributions made for earmarked funds such as building fund, scholarship funds etc., were treated as corpus funds despite the absence of direction to that effect and were excluded from the total income of the trust leading to shortfall in application of income. In a number of cases test checked, either timely notice was not given or the set apart income was not applied to the specified objectives within the time limit, but the income in question was not subjected to tax as required. Test check in audit revealed undercharge of tax of Rs.423.03 lakhs in the cases of 81 assessees [Paras 2.02.10 & 2.02.12].

(xi) Properties held under trust or other legal obligations for any charitable or religious purposes for the benefit of general public is also exempt from levy of wealth tax. However, no exemption is available under Wealth tax Act if the trust forfeits exemption under Income Tax Act for any infringement of its provisions. In the case of 62 assessees, though the trusts had forfeited income tax exemptions for the reason that the trust funds were applied for the benefit of interested persons' or that surplus funds were invested in non-prescribed modes, the properties held by such defaulting trusts were not brought to wealth tax. This resulted in non-levy of wealth tax of Rs.102.14 lakhs.[Para 2.02.19]

(xii) Income of a trust by way of profits and gains of business is exempted only if the work of the trust is carried on mainly by the beneficiaries for charitable purposes and the business is of an approved kind. The trust is required to maintain separate books of account for such business. The non-inclusion of the taxable business income of Rs.31.58 lakhs in the cases of 4 assessee trusts resulted in the non-levy of tax of Rs.17.40 lakhs [Para 2.02.14].

Detailed Review

The results of test check conducted are summarised in the following paragraphs:

General observations

2.02.8(i) The income of an institution, trust or a fund created for charitable or religious purposes can be exempted under Section 10(23)(c)(iv) and (v) or Section 11 of Income Tax Act. Some of the conditionalities in the two sections are common; but while sub-section 4A of Section 139 prescribed mandatory filing of return if the total income of the assessee exempt under Section 11 is taxable without taking into account the provisions of that section, filing of return in the case of assessees exempted under section 10(23)(iv)and (v) would not be necessary since the income does not form part of the total income. In such a situation the Department would have no opportunity to examine whether the conditionalities have been observed and whether the continuance of exemption is justified.

(ii) Under the provisions of clause 23A of Section 10 of the Income Tax Act, specified income of an association or institution established in India for the control, supervision, regulation or encouragement of the profession of accountancy, law, medicines, engineering etc. as the Central Government may notify, is not to be included in computing the total income in a previous year. Similarly any income received by a person on behalf of any fund or institution established for charitable purposes which may be notified by Central Government having regard to the objects of the fund or institution is also not liable to be included in total income under sub-clause 23 C (iv) of Section 10. Grant of exemption under the provisions of Section 10(23C) (iv) instead of under the specific provisions of sub-section 23A of Section 10 would result in non-assessment of certain income such as income from house property, income by way of interest or dividend derived from investments and income for rendering specific services. Further there is no clear uniformity in the matter. While eight professional bodies are known to have been covered under section 10(23c)(iv), some others have remained under section 10(23A).

(iii) In West Bengal charge, assessments completed during assessment years 1989-90 and 1990-91 under summary assessment scheme numbered 2513 and 4371 as against 282 and 328 done under scruinty. The percentage of

scrutiny assessment was 7.6% in the assessment year 1989-90 and 5.75% in the assessment year 1990-91. In other words, the bulk of the assessments (93 to 95 percent) was completed in a summmary manner under section 143(i) of Income Tax Act. It may be stated that assessment of trusts, hitherto done as scruinty cases under section 143(3) have been brought under the purview of Summary assessment Scheme (without any monetary restrications) from April 1988. Trust assessments differ from the assessment of other entitites.Statuotry preconditions for application/accumulation or setting apart of income laid down under section 11 for enjoying exemption, taxability of voluntary contributions under section 12 and compliance of provisions of section 12A for registration vis-a-vis notification of trusts in official Gazettee for permanent exemption under certain sub-sections of section 10 as also compliance of provisions to avoid forfeiture of exemption under section 13 of Income Tax Act, are necessarily to be examined by the assessing authorities so as to ensure that the legislative intent in giving tax relief to the public trusts, are not abused. However, the department has, by and large, been processing the trust assessments in a summary manner accepting the returned income without independently applying the provisions of Sections 11,12 and 13 of the Act, to the public religious and charitable trusts or institutions. Since trusts can get immunity from taxation only on fulfilment of certain statutory conditions, assessments done under the summary scheme leave no scope for the assessing authorities to examine these aspects. Cases processed under section 143(1) were found to have been re-opened very sparingly for scrutiny.

(iv) Under the provisions of Income Tax Act, income received by a religious or charitable trust is exempt from levy of tax, if it is spent on the avowed objects of the trust. The Act further provides that donations received by the trust with specific directions that they shall form part of the corpus of the trust shall not be treated as its income for the purpose of levy of tax. Tax concessions are also available to the donors. The inherent intention of exemption/concessions in tax is that the amounts received by a trust as donation should be utilised for

chartiable and religious purposes in India. However, no time-limit has been prescribed in law for utilisation of funds received by way of donations for the corpus of the trust. In the absence of a time-limit, while benefits of tax concessions are enjoyed both by the donor and the donee trust, the corpus funds may remain unutilised for religious and charitable purposes indefinitely. If any of these trusts subsequently become defunct, the amount standing in the corpus of the trust will escape tax liability without ever being applied to religious or charitable purposes in the absence of any enabling provision under the Act.

In Uttar Pradesh charge, a charitable trust was created on 31st March 1978 with an initial donation of Rs.45,000 with the object of constructing a hospital to give free medical relief to the general public. Subsequently also, it received contributions. The hospital was not constructed till the end of previous year relevant to the assessment year 1983-84. The entire balance of Rs.82,670 as on 31st March 1983 was lying unspent.

Irregularities in the application of trust properties and income

2.02.9 Income derived from property held under trust wholly for charitable or religious purposes is exempt to the extent to which such income is applied for these purposes in India. The crux of the statutory exemption under the Act is not the income earned from property held under trust but the actual application of revenue to charitable or religious purposes*.

Under the Act, the entire income of the trust is liable to tax if part or whole of its income or property is directly or indirectly applied or used or such income enures for the benefit of a certain category of persons such as author/founder of the trust/institution, any trustee or manager or substantial contributors etc. or any specified relative of the aforesaid persons. Such use or application is deemed to have occurred if any part of income or property is lent to this category of persons without adequate

* Gangabai Charities Vs. CIT, 196-ITR-ST 30(SC)

security/interest or if any land or building is made available without charging adequate rent or other compensation or if any amount is paid in excess of what may reasonably be paid by way of salary, allowance or otherwise to such person or if any services are rendered without adequate remuneration or other compensation or if any funds are invested in any concern in which such a person has a substantial interest etc.

The exemption is also not available to a trust/institution created or established for charitable purposes if the benefit is restricted to any particular religious community or caste or to the employees or members of a trust/institution or substantial donor. Where the income of any year is applied to a purpose other than the charitable objects for which the trust is founded, or is spent on non permissible purposes, tax will be levied on such amounts. This is beacuse aplication of the trust funds to a purpose outside the objects of the trust, though to a charitable object, would constitute breach of trust.

A test check of assessment records for the assessment years ranging from 1981-82 to 1990-91 revealed that in the case of 11 assessees(A.P.,Assam, Delhi, Gujarat, Kerala, Orissa, Tamil Nadu, U.P. charges), properties held under trust or trust funds were used or utilised for the benefit of prohibited category of persons or their relatives or the benefits were restricted to a particular religious community or caste. The infringement of the provisions of the Act disentitled the trust/ institution from enjoying the benefit of statutory exemption from tax of their income amounting to Rs.70.11 lakhs involving revenue of Rs.34.11 lakhs in 20 assessments (4 of which were completed under the summary assessment scheme involving under-assessment of income of Rs.3.87 lakhs with tax effect of Rs.3.52 lakhs). The department accepted the audit observations in 8 cases.

An illustrative case is given below:

In Assam charge, a religious trust was constituted, for promoting religious activities in the States of Nagaland, Manipur and Meghalaya. Donations and gifts to schools

etc., were not among the objects of the trust as per the deed of trust.It was observed that the trust spent Rs.11.73 lakhs and Rs.13.39 lakhs for religious purposes and an amount of Rs.32.60 lakhs was given as donations and gifts for schools and other buildings during the previous years relevant to assessment years 1984-85 and 1985-86 (Rs.14.08 lakhs and Rs.18.52 lakhs, respectively).Donations and gifts, which were not the objects of the trust, are not eligible for exemption. Even after allowing a deduction of 50 per cent of the qualifying amount in respect of the donations (in the absence of the objects of such donations on record), the short levy of tax due to incorrect allowance of full exemption of the donations and gifts worked out to Rs.10.03 lakhs. The objection was accepted by the department.

Voluntary contribution, not made with a specific direction towards the corpus, excluded from total income

2.02.10 Any voluntary contribution received by a charitable or religious trust, not being contribution made with a specific direction that it shall form part of its corpus, is deemed to be income of the trust. Donations towards earmarked funds such as building fund, scholarships fund etc., cannot be taken to be towards the corpus funds, but are merely appropriation of income for a specific purpose and are, therefore, includible in the total income. In case a trust intends to utilise such funds in future and seeks exemptions from tax for the current year, it is required to file form No.10 seeking permission for exemption from being considered as income and for future application, investing such set apart funds in the prescribed modes.

In the case of 15 assessee trusts (Assam,Delhi,Maharashtra, Orissa and Rajsthan charges), the exclusion from total income of donations to earmarked funds or voluntary contributions or of grants without specific direction of the donors to treat them as corpus funds resulted in non- assessment of income amounting to Rs.290 lakhs having tax effect of Rs.231 lakhs in 22 assessments over the assessment years 1978-79 to 1989-90. The department accepted the audit observation in six cases.

Irregularities relating to registration of trust

2.02.11 One of the conditions for claiming exemption of income from tax is that the recipient of trust income shall make an application for registration of the trust or institution in the prescribed form (Form 10A) and manner to the Chief Commissioner or Commissioner before 1st July 1973 or before the expiry of one year from the date of creation of the trust or institution, whichever is later. In case an application is made after expiry of the aforesaid period, the delay may be condoned by Chief Commissioner or Commissioner on reasonable grounds and in that case the exemption will be available from the date of creation of the trust or institution. In case the delay is not condoned, the exemption is available only from the first day of the financial year in which the application is made. If registration is not granted by the concerned authority, the benefit of exemption is not admissible.The Board, in their circulars of August 1984 and January 1987, had emphasised the need for the assessing officers to ascertain, through examination of accounts or annual reports of the past years, that the trust continued to spend its income on its stated objectives and had not diverted its income for non-charitable purposes. The Board had also advised that the renewal of registration of a dormant trust or one acting as a fund collecting agency would not be justified.

Test check revealed that 9 assessees (Gujarat, Kerala, Madhya Pradesh, Orissa, Uttar Pradesh charges) were either not registered with the Income tax Department or their applications for registration were pending with it, or they were granted registration from a date later than that applied for. In four of these cases, there was no evidence available on record regarding the grant of registration to them. In one case, the registration was granted from a later date, one application was pending and in 3 cases, registration was not granted.Yet their assessments were completed treating them as registered charitable or religious trusts. The irregular exemption of trusts resulted in under assessment of income of Rs.71.77 lakhs with tax effect of Rs.42.20 lakhs in 14 assessments, (10 of which were completed under the summary assessment scheme,involving under assessment of income

of Rs.47.45 lakhs with tax effect of Rs.26.98 lakhs) over the assessment years 1988-89 to 1991-92. The department accepted the audit observations in two cases.

Some illustrative cases are given below:

(i) In Gujarat Charge, a charitable trust which was created on 22nd March 1981 with the object, among other things, of providing medical relief, construction and maintenance of hospital etc., claimed complete exemption of its income as a hospital or medical institution for the assessment year 1989-90. This claim was rejected by the assessing officer on the ground that the assessee trust itself did not run a hospital or medical institution. However, exemption was granted to the assessee under Section 11 as a charitable trust and the assessment was finalised accordingly in a scrutiny manner, in July 1990 (rectified in January 1991). Though the trust was created on 22nd March 1981 it applied for registration only on 17th October 1990 after a lapse of more than 8 years and the registration was granted by the Commissioner of Income Tax effective from the date of filing of application for registration i.e., 17th October 1990. The assessee trust was, thus, not eligible for exemption of its income for the assessment year 1989-90. The incorrect grant of exemption resulted in under-assessment of income of Rs.14.24 lakhs and non-levy of tax of Rs.10.16 lakhs including interest for default in payment of advance tax. Wealth Tax payable by this trust worked out to Rs.1.31lakhs on its net wealth of Rs.65.95 lakhs for the assessment year 1989-90.

The audit observations were not accepted by the department stating that the Commissioner of Income Tax has condoned the delay of more than 8 years in filing the application, which was factually not correct.

(ii) In Orissa charge, a trust was created under the Societies Registration Act, 1860 on 30th December 1986 with the following objects:

a) To initiate young people to development work.

b) To conduct leadership courses for

school youth or college students in order to make them understand their role in the society.

c) To revitalise and promote co-operative work etc.

d) To provide training in development work etc.

The society had applied for registration under the Income Tax Act on 23rd February 1988. It had not been granted registration up to April 1992. During the period ending 31st December 1987 and 31st March 1989 relevant to the assessment years 1988-89 and 1989-90, the total receipts of the institution amounted to Rs.1.51 lakhs and Rs.25.58 lakhs respectively. The trust did not file the income tax return for the assessment year 1988-89 and no notice was issued calling for the return and consequently no assessment was made for that year, notwithstanding the fact that the trust had exercised an option to set apart Rs.1.04 lakhs for accumulation and future utilisation. The assessment for the assessment year 1989-90 was completed as scrutiny assessment on 19th February 1990 computing the total income as nil and allowing the trust to accumulate Rs.6.06 lakhs for future utilisation. Since the trust was not granted registration as a charitable trust, exemption of income from tax was not in order. Non-assessment of income of Rs.7.10 lakhs for the assessment years1988-89 and 1989-90 resulted in non-levy of tax of Rs.3.73 lakhs in the aggregate.

Non fulfilment of condition for accumulation of income

2.02.12 Under the provisions of Income Tax Act, income derived from property held under trust wholly for charitable or religious purposes is exempt from levy of tax to the extent such income is applied for such purposes during the year together with any income not exceeding twenty five per cent of its total income, accumulated or set apart from such purposes. However, a trust is permitted to accumulate more than twenty five per cent of its income, provided notice is given in writing to the assessing officer before the expiry of time allowed for furnishing the return of income in the prescribed manner specifying the purpose for which income is being accumulated and the period (which in no case should exceed ten

years) for which the same is being accumulated and the money so set apart is invested or deposited in the prescribed modes such as Central or State Government securities, scheduled bank deposits etc.

If the aforesaid accumulated income is not applied for the specified purpose within the prescribed period or ceases to remain invested in the prescribed modes, then such income is deemed to be the income of the trust or institution in the previous year in which the default occurs or in the previous year immediately following the expiry of the aforesaid period.

In the case of 66 trusts (Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerla, Madya Pradesh, Maharashtra,Punjab and Uttar Pradesh charges), the prescribed procedure for the accumulation of more than twenty five per cent of the total income for prescribed periods and for specified purposes was not followed, or the accumulated income was not utilised for specified purposes within the permitted time limit. The omission to tax the assessable income of Rs.354.21 lakhs in 78 assessments ranging over assessment years 1989-90 to 1991-92 led to under-charge of tax of Rs.191.98 lakhs (38 assessments of these were completed in a summary manner involving under-assessment of income of Rs.242.82 lakhs with tax effect of Rs.154.01 lakhs). The department accepted the objection in four cases.

Irregularities in the investment of trust funds

2.02.13 The Income Tax Act stipulates that if any funds of a charitable or religious trust are invested or deposited after 28th February 1983 in any mode other than those specified or if funds invested before 1st March 1983 in the non specified manner continue to be so invested or deposited after 30th November 1983, no exemption would be available to the trust and tax becomes leviable on its income at the maximum marginal rates. The specified modes are: Government savings certificates, deposit in post office saving banks, deposits with any scheduled bank or cooperative bank, investments in Central or State Government securities or units of the Unit Trust of India or in debentures guaranteed by the Central or State Government, deposit with any

public sector company, Industrial Development Bank or investment in immovable property etc.

In the case of nine assessee trusts,(Gujarat, Madhya Pradesh, Maharashtra, Punjab and West Bengal Charges)trust funds were invested in non-prescribed modes of investments resulting in under assessment of income of Rs.52.57 lakhs with tax effect of Rs.37.76 lakhs and non levy of wealth tax of Rs.5.48 lakhs in 15 assessments (14 of which were done in a summary manner involving under assessment of income of Rs.52.29 lakhs with tax effect of Rs.37.65 lakhs) over the assessment years ranging from 1989-90 to 1991-92. The department has accepted the audit observations in seven cases.

An illustrative example is given below:

In the case of a trust assessed in Gujarat charge, it was revealed from audit reports of the Chartered Accountants on the accounts of the previous year, relevant to assessment year 1989-90 and 1990-91, that the trust had some investments otherwise than in the prescribed forms and modes. Further, trust funds were used contrary to the scheme and rules framed thereunder.

In view of these violations pointed out in the audit report, the trust was not eligible for exemption and its entire income was required to be brought to tax. Wealth tax was also leviable on the market value of its assets/ property. Failure to do so resulted in under-assessment of total income of Rs.37 lakhs and non-levy of income tax aggregating Rs.23.43 lakhs. Wealth tax aggregating Rs.5.48 lakhs was also leviable on the net wealth of Rs.217.74 lakhs for the two years.

Business income not brought to tax

2.02.14 Exemption from levy of tax in respect of income by way of profits and gains of business of a trust is available with effect from assessment year 1984-85, only if the work is mainly carried on by the beneficiaries of the trust/ institution wholly for charitable purposes or the business consists of printing and publication of books or is of a kind notified by the Central Government which is carried on by a trust wholly for public religious purposes.

In both cases the trust or institution is required to maintain separate books of accounts in respect of such business.

In the case of 4 assessee trusts, (Gujarat and Punjab Charges), assessed income by way of profits and gains of business undertakings was not brought to tax, though the business did not consist of the permitted kind or was not being carried on by the beneficiaries of the trust. Separate books of accounts were also not being maintained in these cases. The omission to bring to tax the business income in 8 assessments for the assessment years 1984-85 to 1990-91 completed under scrutiny, led to under-assessment of income by Rs.31.58 lakhs with tax effect of Rs.17.40 lakhs.

An illustrative case is given below:

In Punjab charge, a trust created for advancement of language and culture of the State, was registered as a charitable trust in November 1979. It was observed that during the previous years relevant to assessment years 1984-85 and 1986-87, the trust had business income of Rs.8.78 lakhs and Rs.4.04 lakhs respectively from publications and sale of newspapers. Against this income, the amount applied for charitable purposes was only Rs.11,153 and Rs.9,655, respectively in the two years. Thus, the predominant object of the activity of the trust was profit earning, and its business income of Rs.12.82 lakhs in the two years was liable to tax of Rs.7.95 lakhs. The assessee had also invested its funds in the business instead of specified investments.

Income escaping assessment

2.02.15 Under the provisions of the Income Tax Act, income from property held under trust wholly for religious or charitable purposes has to be computed on accrual/due basis. Accordingly, interest accrued on investment and capital gain not utilised for acquiring new capital asset are to be included in the total income of the assessees. Further, the Act provides that where any sum is found credited in the books of accounts or any investment made is not shown therein and if the assessee offers no explanation about the nature and source of such credit or investment, such an amount will be deemed to be the income of the assessee.

In the case of 5 assessee trusts (Delhi,Gujarat, Punjab and Tamil Nadu Charges), the exclusion of accrued interest on investments, capital gain on sale of capital assets not utilised for acquiring new capital assets and unexplained credit/ investment in the books of accounts amounting to Rs.26.79 lakhs resulted in under-charge of tax of Rs.24.94 lakhs in 10 assessments completed in a scrutiny manner over the assessment years 1981-82 to 1990-91.

Incorrect exclusion from total income.

2.02.16 The income of a trust or institution may be absolutely exempt from the levy of income tax under the provisions of Income Tax Act, if it is established for charitable purposes and is notified by the Central Government having regard to its objects and importance or if it is established wholly for public religious purposes or wholly for religious and charitable purposes and is notified by the Central Govt., having regard to the manner in which its funds are administered to ensure the proper application thereof to its declared objectives. Also exempted is the income of a hospital or other institution for the reception, treatment, convalescence or rehabilitation of persons requiring medical attention and which are existing solely for philanthropic purposes and not for purposes of profit.

In Tamil Nadu charge, a public charitable trust formed with the main object of providing medical relief to the poor and needy in and around a metropolitan city had sponsored a medical institution for the treatment of cardio- vascular diseases. The institution provided treatment to both poor and rich patients and the number of poor patients who were provided treatment either free or at a concessional rate was on an average 10 per cent of the total number of patients treated in a year. During the previous years relevant to the assessment years 1988-89 and 1989-90, only 19 and 143 poor patients were treated. The cost of treatment given to the poor patients during the previous year relevant to 1989-90 was reported to be Rs.19.15 lakhs as against the total collection of Rs.342.43 lakhs vide the statement accompanying the annual reports and accounts of the trust. The hospital provided four grades of accommodation i.e, ordinary,

semi-private, deluxe and super deluxe to patients in the hospital charging different rates. The charges for treatment including surgery, medicines and other services also varied with reference to the class of accommodation availed by the patients. Till the assessment year 1987-88, the assessments were completed after allowing exemption of its income under section 11 and 12. For the assessment years 1988-89 and 1989-90, the entire income of the trust was treated as exempt under section 10(22A) and the assessments completed accordingly.

Section 10(22A) provides for exemption of any income of a hospital/medical institution established solely for philanthropic purposes and not for purposes of profit. `Philanthropic' activities imply those related to affection for mankind. Since the assessee had been collecting fixed charges at different rates according to an approved printed tariff for schedule services rendered, it cannot be considered as a hospital established solely for philanthropic purposes. On the other hand, the institution was run on a commercial basis collecting heavy charges from the patients like any other private nursing home. As such, the income of the assessee trust could not be excluded under section 10(22A). Further, as the conditions regarding application and accumulation of its income as laid down under section 11(1)(a) and 11(2) were not satisfied and in the absence of a report of audit of its accounts as required under section 12A(b), the income of the trust could not also be exempted under sections 11 and 12. Tax due on the income of the assessee after making necessary adjustments of expenditure on depreciation and difference in foreign exchange rate, works out to Rs.57.96 lakhs, for the assessment years 1988-89 and 1989-90.

Other mistakes

2.02.17(i) Mistakes in computation of trust income

(a) Deduction on account of depreciation is not allowable in the computation of trust income, except in the case of business undertakings held under trust for public charitable or religious purposes. This is so, because where the trust does not carry out any business, the benefit of depreciation also cannot be allowed, treating it as actual

application of trust income. In the case of 8 assessee trusts (Delhi, M.P., Rajasthan and U.P. charges), depreciation was allowed. This,together with non-filing of audit certificate and non application of 75 per cent of its income in one case (Madhya Pradesh charge), resulted under assessment of income of Rs.103.95 lakhs with short levy of tax of Rs.54.34 lakhs in 17 assessments over the assessment years 1981-82 to 1991-92 (of these 5 were completed under summary assessment scheme involving under-assessment of income of Rs.88.98 lakhs with tax effect of Rs.45.43 lakhs). Objections were accepted in 7 cases.

(b) The incorrect adoption of income of Rs.24.23 lakhs as Rs.(-)7.93 lakhs in one case assessed summarily for the assessment year 1990-91 in Bombay charge and non-consideration of income of Rs.67.39 lakhs (out of which Rs.21.94 lakhs was offered by the assessee itself and the remaining Rs.45.44 lakhs for infringement of condition of investment in prescribed modes) in another case assessed under scrutiny for the assessment year 1989-90, in West Bengal charge, resulted in short levy of tax of Rs.69.04 lakhs in aggregate.

(ii) Non-filing/late filing of Income tax Return

The Act provides that every person in receipt of income derived from property held under trust wholly for charitable or religious purposes shall furnish a return of such income, if the total income, without giving effect to the provisions of Sections 11 and 12, exceeds the maximum of the amount which is not chargeable to income tax.

It was noticed in audit that in 3 cases assessable in Kerala and Karnataka charges involving 13 assessment years, there was evidence available with the department that the trusts had assessable income, and yet they were either not furnishing their returns or their income had not been correctly assessed. The department did not take any action to call for the returns/revised return. In the absence of any such returns, it could not be ensured that the trusts had been correctly assessed to tax. In case of non-filing and late filing of returns, the

Act provides for levy of penalty also.

In Karnataka charge, a society established in 1980 with the only object of forming residential layouts for the benefit of its members from the Defence and Government establishments was registered by the Commissioner of Income Tax in 1980 as a public charitable trust. The income of the Society was treated as exempt from tax up to the assessment year 1987-88 on the ground that it was registered as a public charitable trust.In February 1991, the Commissioner of Income tax, observed that the society was not engaged in any charitable activities. This has further been established by assessing officer while concluding the assessment for the assessment year 1988-89. Even so,steps were not taken to reopen the assessments of the earlier years where the income was treated as exempt nor were the wealth tax returns called for. This resulted in non-levy of tax aggregating Rs.3.86 lakhs in the assessment years 1985-86 to 1987-88.

(iii)Failure to file audit report

One of the conditions for claiming exemption from the levy of tax under Income Tax Act and Wealth tax Act is that where the total income of the trust or institution exceeds twenty five thousand rupees in any year, the accounts for that year are audited by a chartered accountant and the report of the accountant in the prescribed form No.10B, duly signed and verified by him and setting forth the prescribed particulars, is furnished alongwith the return of income. In the absence of audit reports, the income of the trust is taxable at the rate applicable to association of persons.

In the case of 36 assessees (A.P, Bihar, Delhi, Gujarat, Karnataka, Madhya Pradesh, Rajasthan and West Bengal charges), test check revealed that the audit reports of the chartered accountant, in the prescribed form, were not filed alongwith the returns of income for different assessment years ranging from 1989-90 to 1991-92 in 60 cases. Nevertheless, exemption was granted, resulting in under-assessment of income of Rs.464.81 lakhs with non-levy of tax of Rs.269.55 lakhs. (41 of these were completed under summary assessment scheme involving

under assessment of income of Rs.325.81 lakhs with tax effect of Rs.193 lakhs).

(iv) Non-maintenance of `Register of accumulation of income by trusts and utilisation thereof.

With a view to ensuring that the assessing officer maintains a check on the fulfilment of the provisions of the Act, the Central Board of Direct Taxes has prescribed (April 1984) the maintenance of `Register of accumulation of income by the trusts and utilisation thereof'. The register was, however, not maintained in any of the wards test checked in Punjab, Delhi and the Union Territory of Chandigarh.

Gift Escaping Assessment

2.02.18 Under the Gift Tax Act 1958, donations made by any person to any charitable institution or fund which is not exempted under the provisions of the Income Tax Act, are liable to gift tax.

In Tamil Nadu charge, a trust received from a political party, a sum of Rs.4 lakhs towards its corpus during the previous year relevant to assessment year 1985-86, the assessment of which was completed in March 1988 under scrutiny. Audit scrutiny of the relevant income tax records of the trust revealed that the sum was utilised by the trust for setting off earlier years' losses and for replacement of loans in connection with the printing press and not for any charitable purpose. The contributions were not exempted under the provisions of the Income Tax Act. In the above circumstances the sum of Rs.4 lakhs should have been treated as gift and charged to gift tax in the hands of the donor. The omission to do so resulted in the escapement of gift of Rs.4 lakhs leading to a non-levy of gift tax of Rs.80,250 for assessment year 1985-86. The assessing officer of the trust has intimated the Income Tax Officer assessing the donor about this escapement who in turn has issued notice to the donor calling for the return of gift (March 1990).

Wealth of trust escaping assessment

2.02.19 Property held under trust or other legal obligation for any public purpose of charitable or religious nature in India is exempt from levy of wealth tax. The exemption is, however, not available if the trust

forfeits exemption under the Income Tax Act inter alia for the following reasons :

(i) Any part of income or property of the trust has been applied for the benefit of the author, or the manager of the trust, any trustee or any of their specified relatives.

(ii) Trust funds have been invested in modes not prescribed under the provisions of the Act.

In such cases, wealth tax is chargeable at the maximum marginal rate without excluding the value of any asset exempted under Wealth Tax Act.

In the case of 62 assessee (Andhra Pradesh, Delhi, Gujarat, Karnataka, Mahrashtra, Punjab, Tamil Nadu and West Bengal charges), it was noticed that exemption of income from the property held under trust for income tax purposes was not available for income tax purpose for one or more of the reasons stated above and as such the properties in question constituted the wealth of the assessees, exigible to wealth tax. Except in the case of 20 assesses, no return of wealth had been filed nor was any notice calling for the wealth tax return issued by the department. In the cases in which wealth tax returns were filed, erroneous deduction on account of exemption of certain assets was noticed with consequent non-levy of tax at the maximum marginal rates. The mistakes resulted in non-levy of wealth tax amounting to Rs.102.14 lakhs in 188 assessments (20 of which were completed in a summary manner) completed for assessment years ranging from 1981-82 to 1991-92. In the case of 18 assessees, the department had agreed to take action while in 43 others, final replies have not been received. The one case in which the department did not accept the objection is as under:

In Gujarat Charge, an assessee trust was exclusively engaged in the business of construction of residential flats and letting the same out on rent to the members of a particular community. The income received from renting the properties had been assessed to income tax, but no action was taken to bring the market value of the assets relating

to assessment years 1981-82 to 1990-91 to wealth tax. This resulted in non-levy of wealth tax of Rs.30.32 lakhs and penalty of Rs.25.30 lakhs for non filing of returns of wealth. The department did not accept the objection stating that it was not correct to hold that the trust was not a charitable trust since the blocks were rented to the poor members of at particular community. However, since no exemption was allowed under the Income Tax Act for income from these properties, these were liable to wealth tax also.

2.03 Computerisation in the Income Tax Department

Introductory

2.03.1 The introduction of computers in the Income Tax Department in a phased manner was approved by the Ministry of Finance in March, 1976. A Systems Development Team started functioning from 1st September, 1977 and its report got clearance from the department of Electronics. However, in March 1979, the Ministry of Finance reversed its decision on computerisation. In June 1980, the scheme was revived for limited implementation with approval of the Finance Minister in respect of compilation of statistics and verification of annual salary returns. The scope of computerisation was extended in June 1982, again with the approval of Finance Minister, to areas which could be identified by the Board from time to time; simultaneously creation of additional posts for its implementation and an expert study in consultation with the National Informatics Centre were approved. For the purpose, a feasibility study was conducted by M/s. C.M.C. in March 1983.

The first phase of computerisation in the Department started in Madras in October 1985 with the installation of a mini computer system S.N.23 which was upgraded to the system SN 73 in August 1986. The upgraded system was also installed at Bombay, Calcutta and Delhi during 1987-88 and at thirty two other centres later on.

The total capital expenditure incurred during the years 1984-85 to 1991-92 on installation

of the system at the thirty six centres was Rs.702.57 lakhs and other expenditure amounted to Rs.205.48 lakhs.

Areas of Application

2.03.2 With installation of the system at the 36 centres, the department identified the following 10 areas for computerisation in April, 1987:

(i) Allotment of Permanent Account Number (PAN)

(ii) Challan Processing System(Phase I)

(iii) Summary Assessment System

(iv) Pay Roll System

(v) Tax deduction at source-Salary System

(vi) Challan Processing System (Phase II)

(vii) Judicial Reference System

(viii) Monitoring grievances of tax payers

(ix) Filing of tax returns of non-business income

(x) Data bank and matching of information.

Out of the 10 areas identified, application software packages have so far been developed for 6 areas at serial number (i) to (vi) above. Of these, only 4 systems at serial number (i) to (iv) above have been implemented at all centres upto March 1992.

Targets

2.03.3 Hundred per cent (100 %) computerisation was aimed at for the first time in 1989-90 in the following three areas:

(i) Allotment of Permanent Account Number (PAN)

(ii) Processing of Challans/Refunds (Phase I)

(iii) Summary Assessment Cases

No targets have been fixed for the other areas of computerisation (March 1992).

Allotment of Permanent Account Number

2.03.4(a) The software package for allotment of PAN had allotted 85.23 lakhs PANs against 77.95 lakhs assessees on the books of the department as on 31 March 1992. There were several shortcomings mainly in the nature of multiple PANs assigned to the same assessee in different CIT's charges and even in the same ward/circle;non-intimation of PAN allotment to the assessee, non-availability of provision for immediate retrieval/ allotment of PAN and non-preparation of up-to-dated PAN directory and non-printing of addendum etc. At five centres in Maharashtra circle, in many cases of allotment, the names which were longer than 40 characters (including Mr,Mrs, Dr.etc.) were abbreviated arbitrarily.There was no consistency in the order of entering names. Sometimes the name began with the last name, sometimes with the middle and sometimes with the first name.Hand written names and addresses were often not correctly entered. At Bombay centre, the problem of multiple PAN numbers to the same assessee in a large number of cases resulted in the return of 1 lakh PAN cards to the department. Test check similarly revealed cases of assignment of duplicate or multiple PANs to the same assessees at Calcutta, Ahmedabad, Baroda, Surat, Rajkot, Bhopal and Jabalpur Centres. In Uttar Pradesh cirle also, under four CIT charges, as against 4.46 lakhs assessees 6.30 lakhs PANs were allotted leading to excess allotment of 1.84 lakhs PANs incorrectly. Thus, a system for entry of error-free data into the computers and allotment of correct PAN numbers is not so far in place.

(b) The Director of Income tax(Systems) had issued guidelines in February 1990 to eliminate duplicate PANs manually by assessing officers and for this purpose alphabetical PAN Directories were sent to assessing officers. During test check at Delhi and Calcutta centres, audit found that the revised package had not been implemented.

Challan Processing System

2.03.5(a) Targets were also not achieved by the challan processing system. Audit scrutiny revealed that against an estimated receipt of 421.80 lakhs challans (140.60 lakhs per year) by the department during the three years 1989-90 to 1991-92, only 152.11 lakhs challans were processed through the computer. The shortfall approximated to 70.34 percent.

Further, the percentage of shortfall ranged from 56.47 percent to 75.02 percent in different centres.

(b) The switchover to computer processing was intermittent and coexisted with manual processing. For instance, at Delhi centre computerised processing was introduced in December 1989 and was suspended in April 1990.In Andhra Pradesh, challan processing was done manually in all field offices except at Hyderabad and Vishakhpatnam. The prescribed procedure of challan processing was not followed at all in Bombay.

(c) A test check of 11 centres revealed that important registers such as the daily collection register, register of missing/surplus challans , daily tally register, record keeper register and bank scroll register were not kept current and were not maintained in the manner prescribed.This made monitoring and correct accounting difficult.

A few illustrative cases of defects noticed in audit are listed below:

(i) At Jabalpur and Bhopal centres, daily collection register was not maintained year-wise and tax-wise.Relevant columns of daily collection register were not filled in. Reconciliation statements were not prepared. In one instance, credit was afforded to assessees on the basis of their challans and not on the basis of daily collection register. Some cases were transferred to other wards/ circles but collections were still being reported to the incorrect wards by the computer centre. Similarily, entries in the daily collection register pertaining to other wards/circles were not reported back to the computer centre in the prescribed form. It was noticed that acceptance of challans in a form other than that prescribed resulted in misclassification in four transactions in two cases involving payment of Rs.5.23 lakhs.

(ii) During test check of records in five wards in Delhi centre, it was noticed that credit for collection of tax was being generally given on the basis of the copies of the challans filed by the assessees without verifying the receipt from official records.

It was also seen that entries regarding collection of advance tax/regular demand were not posted in the daily collection register.

(iii)At two centres in Kerala, the prescribed procedure of processing of challans was not followed . The entries in the daily collection register did not pertain to concerned assessing officers and wrong classifications were also not intimated to the computer centres.

(d) Several cases of delay in reconciliation of amounts were detected. At Jabalpur centre, the figure of arrear demand as on 1st April 1991 was shown as Rs.77.21 lakhs in the collection register generated by the computer while Rs.53.53 lakhs was indicated in manuscript form register as per yearwise break-up. Similarily the figures were Rs.52.00 lakhs as per reconciliation statement and Rs.55.04 lakhs in monthly progress report (March 1991). The differences between the four sets of figure for the same head have not been reconciled till January 1992. At Bhopal and Jabalpur centres , the huge differences of Rs.543.47 lakhs , Rs.255.95 lakhs and Rs.24.46 lakhs for the months of March 1990, March and October 1991 between major headwise account and detailed account were not reconciled till March 1992. In Rajasthan circle, the difference between the collection as per Bank scrolls under different major heads and the monthly detailed account prepared by the computer unit amounted to Rs.3.66 lakhs in January 1992 at Jodhpur centre and Rs.31.56 lakhs in December 1991 at Jaipur centre. These were not reconciled. In Tamil Nadu at three centres,the annual difference of Rs.107.94 crores between the computer figures and the Zonal Accounts Office figures for the years 1990-91 and 1991-92 was not analysed under different headings due to missing/surplus challans or refund vouchers, excess or short credits/payments.

(e) Periodical audit of the working of the computer centres by the Internal Audit Parties of the department, as contemplated in the CBDT instructions of September 1989, was not carried out since inception of the centres.The department has stated that they have not yet devised any system of checking of computerised challan processing by

Internal Audit.

Summary assessment System

2.03.6(a) Time-frame for achieving targets for summary assessment system seems to be slipping away. A test check at the 36 centres revealed that there has been a steep decline in the processing of assessments from the year 1988-89 when the system was introduced. The percentage of cases processed through computer fell from 24.85 percent in 1988-89 to 7.74 percent in 1990-91.

(b) The processing of summary assessments through computers was not implemented at Jaipur, Bhubaneswar, Vishakapatnam, Cochin and Trivandrum centres. At Patna centre , though the computer was installed in December 1988, the process had not commenced from 1989-90. Similarly the scheme was not implemented after 1988-89 in Calcutta. At all the four centres of the Gujarat circle,after an initial achievement of 47.61 per cent, no returns were processed on computer from the year 1990-91.

(c) Many other irregularities and errors related to refunds being issued where actually tax was due, erroneous issue of refunds, wrong calculation of interest payable, demands being raised in cases of pre-paid taxes, reckoning of loss as income and assesssing income for the wrong amount etc., were detected and rectified manually by the department. A few instances are given below:

(i) In Gujarat circle, at the four centres , a test check of 3026 cases in 17 wards under 5 Commissioners' charges revealed that in 13 cases loss was taken as income, in 19 cases incorrect status was adopted, in 38 cases credit for prepaid taxes was given wrongly and 31 cases were assessed for wrong amounts. A few illustrative cases are given below:

(1) Income of three assessees for the assessment years 1987-88 and 1988-89 was incorrectly determined at Rs.7.74 lakhs in October 1988, December 1988 and March 1989 instead of Rs.1.72 lakhs returned by the assessees .

(2) The returned loss of Rs.1.66 lakhs of an assessee for assessment year 1988-89

was assessed as income resulting in raising of incorrect demand of Rs. 69,629.

(ii) At Kanpur centre, the following points were noticed.

(1) In two cases of a ward, the computer worked out a refund of Rs.1.20 crores instead of the actual refund due of Rs.1033 only.

(2) In one case, interest under Sections 234B and 234C of Income Tax Act was worked out to Rs.62,925 and demand of Rs.58,675 was computed by the computer, while actual demand worked out to Rs.564 only.

(iii) At Pune centre, it was seen that

(1) in one case as against `nil' demand after payment of prepaid tax of Rs.68,476, a demand of Rs.54,578 was wrongly raised; and

(2) in two cases as against the refund of Rs.1,355 due to the assessees, the computer showed a demand of Rs.16,155.

Pay Roll System

2.03.7 Audit scrutiny of the Pay Roll System revealed that its adoption was not uniform. In the Tamil Nadu circle, at Madras centre the system has been partially implemented and restricted to preparation of monthly salary bills only (including recovery). In Gujarat circle, the system has not been implemented at three centres out of four as no data were received in the computer centre due to resistance from staff. At Baroda centre, pay roll package was implemented from May, 1990 to September, 1990 only. Thereafter, it was discontinued.In Bihar, though the software package was available at Patna centre since 3 December 1988, the operation was not taken up.At Calcutta, Bhubaneshwar and Jabalpur centres, the software package for pay roll system has not been implemented . In Punjab circle, the package was implemented partly at two centres out of three.

Constraints

2.03.8 Major areas of difficulty/ constraints in computerisation have been hardware, inadequacy of trained staff and staff resistance as seen from the below:

(a) The present system SN-73 and its design does not have sufficient storage capacity for processing the voluminous data. At Delhi and Bombay centres, the system has only 2 MB main memory and 168 MB hard disc with 300 MB removable disc which were insufficient to cover the whole cycle of tax accounting system. At Calcutta Centre, the 300 MB movable disc pack (RMO V) was inoperative since installation.The storage capacity upto May 1991 was only 168 MB. In May 1991, a non-removable disc pack of 182 MB, upgraded to 337 MB from 30 October 1991, was also installed. Further enhancement of disc capacity was considered necessary to implement some more packages in addition to challan and PAN. At Coimbatore and Madurai centres, the capacity provided for the system proved inadequate. The storage capacity of the computer at all the centres in Uttar Pradesh circle has also been reported to be inadequate to cope up with all areas of application in respect of approximately 6.37 lakhs assessees.

(b) The maintenance support was not assured and the specific local problems in hardware were not easily resolved which resulted in poor quality of service and indefinite down time. Non availability and inadequacies in the power supply system was also noticed in 17 centres. This had adverse effect and resulted in wastage of data entered in the computer due to power fluctuations.

(c) There was huge shortage of technical staff.The shortage was to the extent of 20.24 percent, 54.55 percent, 55.10 percent, 81.25 percent and 75 percent in the cadres of Data Entry Operator, Control Operator, Programmer, Assistant Director(Computer) and Computer Manager respectively. The deployment of manpower was arbitrary.

(d) The process of computerisation has also encountered persistent staff resistance.The process is officially opposed by the Group `B' and Group `C' Staff Associations. Out of the ten areas identified as priority, opposition from the staff is primarily against computerisation of assessment functions. Such opposition is officially on the grounds of possible retrenchment and loss of job and promotion prospects. Negotiations have not been conclusive. The Board has also

not issued any fresh instructions in the recent past in this matter.

Conclusions

2.03.9 To sum up, a variety of factors such as limited capacity of hardware and slow pace of development of software, coupled with shortage of trained staff and staff resistance in general and non-fixation of targets in all areas of application has contributed to the tardy implementation of computerisation in the department.

CHAPTER 3

CORPORATION TAX

3.01 **According to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, there were 2,53,390 companies as on 31 March 1992. These included 507 foreign companies and 2,192 associations functioning `not for profit' but registered as companies limited by guarantee and 330 companies with unlimited liability. The remaining 2,50,361 companies with limited liability comprised 1,180 Government companies and 2,49,181 non-Government companies with paid up capital of Rs.56,481.4 crores and Rs.22,415.30 crores respectively. Among non-Government companies, over 88.26 percent (2,19,950) were private limited companies with a paid up capital of Rs.4,606.30 crores.

3.02 The number of companies on the books of the Income Tax Department during the last five years was as follows:

As on 31 March	Number
1988	87,985
1989	96,176
1990	1,10,514
1991	1,24,402
1992*	1,34,779

* Provisional figures as furnished by the Ministry of Finance.

** Figures furnished by the Ministry of Industry, Department of Company Affairs.

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

Year	No. of assessments completed	Receipts (In crores of rupees)	Per capita contribution (in lakhs of rupees)	Gross collection (In croresof rupees)	Percentage of collection to gross collection
1987-88	89,778	3432.92	3.82	6757.18	50.80
1988-89	1,21,595	4407.21	3.62	8828.76	49.91
1989-90	1,04,572	4728.92	4.52	10,007.78	47.25
1990-91	1,19,265	5335.26	4.47	11,028.93	48.37
1991-92*	1,46,998	7,867.67	5.35	15,342.36	51.28

* Figures furnished by the Ministry of Finance/Controller General of Accounts are provisional

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

Year	No. of assessment completed during the year	Pending at the close of the year	Percentage	Amount of demands Collected during the year	In arrears at the close of the year	Per cent age
				(In crores of rupees)		
1987-88	89,778	54,196	60.36	3432.92	1425.93	41.54
1988-89	1,21,595	41,421	34.06	4407.21	2169.41	49.22
1989-90	1,04,572	50,286	48.08	4728.92	2951.69	62.41
1990-91	1,19,265	57,073	47.85	5335.26	2590.22	48.54
1991-92*	1,46,998	66,361	45.14	7,867.67	3070.54	39.02

3.05 The Action Plan of the Income-tax Department for 1991-92 envisaged that the total income tax demand (Arrear plus current) to be carried forward as on 1 April 1992 should be ten percent less than the arrear demand brought forward as on 1 April 1991.

3.06 A total number of 632 draft paragraphs involving tax effect of Rs.447.94 crores were issued to the Ministry of Finance for comments during March 1992 to July 1992. The Ministry of Finance have accepted the observations in 265 cases involving tax effect of Rs.140.16 crores. 135 illustrative cases involving tax effect of Rs 352.80 crores are given in the following paragraphs. Out of these the Ministry of Finance have accepted the observations in 54 cases involving tax effect of Rs.118.35 crores. 15 of these cases were checked by the internal Audit but the mistakes were not detected by it. In a number of these cases assessment work had been done by Deputy Commissioners of Income tax (Assessment). The audit observations in respect of scrutiny and summary assessment cases have been included separately under these heads. The repetitive nature of the mistakes committed by the assessing officers indicates that adequate attention is not being given even to assessments involving substantial revenue.

Avoidable mistakes in computation of income and tax

3.07 Mistakes in the computation of total income and in the determination of tax payable, involving substantial revenue are being reported year after year in the audit reports. The extent of such mistakes noticed during test audit of the assessments completed by the tax officers during the last five years was as under:

Year	No. of items	Amounts of tax underassessed (in lakhs of rupees)
1987-88	796	291.84
1988-89	679	1,121.38
1989-90	880	960.63
1990-91	1,153	1135.00
1991-92	878	8857.00

The types of mistakes noticed are :

(i) Incorrect adoption of figures

(ii) Arithmetical errors

(iii) Calculation errors and other omissions/mistakes

Some important cases noticed in test check are given below :

A- Scrutiny Assessment

1(i) In the assessment of a government company for the assessment year 1987-88, completed in March 1990, the assessing officer disallowed Rs.4,758.91 lakhs on account of provisions made for store and spares, inventories, sundry debtors, loans and advances and other provisions etc. instead of the correct amount of Rs.4942.89 lakhs being the net effect of the provisions created. The mistake resulted in excess computation of loss by Rs.183.98 lakhs involving potential tax effect of Rs.91.99 lakhs.

(ii) The assessment of a government company, for the assessment year 1987-88, was completed in January 1990 determining business loss at Rs.1762.96 lakhs after making disallowances of Rs.8489.65 lakhs. It was noticed in audit that the aggregate of such disallowances worked out to Rs.8513.22 lakhs. The mistake resulted in excess computation of loss by Rs.23.57 lakhs involving potential tax effect of Rs.11.79 lakhs.

Ministry of Finance have accepted the audit observation.

2. While computing the income of an assessee, the assessing officer normally proceeds with the income as computed by the assessee as the starting point and then makes necessary adjustments by way of additions and deletions, in accordance with the provisions of the Act and Rules, to arrive at the total taxable income.

While completing the assessment of a Government company for the assessment year 1988-89 in January 1990, the assessing officer erroneously added back an amount of Rs.8895.69 lakhs on account of certain disallowances as against the actual amount of Rs.8939.03 lakhs. The mistake resulted in excess computation of loss by Rs.43.34 lakhs involving potential tax effect of Rs.22.76 lakhs.

The department has accepted the audit observation.

3. Under the provisions of the Income Tax Act, 1961 as applicable from the assessment year 1984-85, in computing the business income of an assessee, a deduction for any sum payable by the assessee by way of tax/duty under any law for the time being in force or for any sum payable by him as an employer by way of contribution to any provident fund or superannuation or any other fund for the welfare of the employees will be allowed out of income of the previous year in which such sum is actually paid, irrespective of the method of accounting employed by the assessee. In other words, these deductions are allowable on actual payment and not on accrual basis.

The assessment of a company for the assessment year 1988-89 was completed in March 1991. As per the discussion in the assessment order an amount of Rs.1067.51 lakhs was allowable to the assessee towards statutory liability which was disallowed in earlier assessment years. However, in the actual computation, an amount of Rs.1087.32 lakhs was allowed. The mistake resulted in excess computation of loss of Rs.19.81 lakhs leading to notional short levy of tax of Rs.10.40 lakhs.

Ministry of Finance have accepted the audit observation.

B-Summary Assessment

1. The assessment of a company for the assessment year 1989-90 was completed summarily in March 1990, accepting the loss returned at

Rs.6,712.61 lakhs. The accounting period for the assessment year 1989-90 was of twenty one months from 1 July 1987 to 31 March, 1989. Audit scrutiny revealed that the above loss was computed by the assessee by taking the loss at Rs.211.57 lakhs for the accounting period ending 31 March 1989. However as per profit and loss account for the period ending 31 March 1989, there was a profit of Rs.160.35 lakhs as follows:-

Loss for the year	Rs.211.57 lakhs
Less: Adjustment relating to the prior years	Rs.371.92 lakhs
Profit for the year	Rs.160.35 lakhs

Further, the amount of Rs.371.92 lakhs referred to above as prior years adjustment, was actually revenue receipts and written back expenses forming part of the profit and loss account. The assessing officer should have therefore computed the income at Rs.160.35 lakhs instead of accepting the loss at Rs.211.57 lakhs as returned by the assessee. The mistake resulted in excess computation of loss by Rs.371.92 lakhs with consequential notional short levy of tax of Rs.204.56 lakhs.

2. For the assessment year 1990-91, a company returned a loss of Rs.131.63 lakhs. The returned loss was accepted in the assessment completed in February 1991 under the summary assessment scheme. It was seen in audit that while computing the loss, the assessee company did not add back to the net loss of Rs.161.97 lakhs, the investment allowance reserve of Rs.41.28 lakhs debited to the accounts of the previous year relevant to assessment year 1990-91. The assessee company also did not claim any investment allowance in the assessment year 1990-91. The omission to add back the investment allowance reserve of Rs.41.28 lakhs resulted in excess computation of loss by an identical amount, involving potential short levy of tax of Rs.24.52 lakhs. Further, additional tax of Rs.4.90 lakhs was also required to be levied.

Ministry of Finance have accepted the audit observation.

Incorrect status adopted in assessment

3.08 Under the provisions of Income Tax Act, 1961, a company is deemed to be a company in which the public are substantially interested if, inter-alia, it fulfils the condition that the shares in the company were, as on the last day of the previous year, listed in a recognised stock

excahange in India or shares carrying not less than fifty per cent of voting power throughout the previous year were beneficially held by Government or a Corporation established by Central, State or Provincial Act, or any other company including a hundred per cent subsidiary of such a company. The incidence of tax is lower in respect of a company in which the public are substantially interested.

In the assessment of a limited company for the assessment year 1987-88, completed in March 1990, the assessing officer treated the company as one in which the public were substantilly interested and levied tax at the rate of 50 per cent. Audit scrutiny, however, revealed that the shares of the company were not registered with the stock exchange and it should have been treated as a non-industrial company in which public were not substantially interested and accordingly taxed at the rate of 60 percent. The mistake resulted in short levy of tax of Rs.11.95 lakhs (including interest of Rs.3.64 lakhs for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

Incorrect computation of business income

Incorrect allowance of deduction for technical know-how

3.09 Under the Income Tax Act, 1961, with effect from the assessment year 1986-87, where an assessee has paid in any previous year any lump sum consideration for acquiring any know-how for use for the purpose of business, one sixth of the amount paid shall be deducted in computing the profits and gains of business and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years.

A- Scrutiny Assessment

1(i) A closely held assessee company debited royalty of Rs.31.26 lakhs payable outside India in its profit and loss account for the previous year relevant to the assessment year 1989-90. In the assessment for the assessment year 1989-90 completed in March 1991, the above amount was allowed as deduction in computing the income of the assessee company, although no tax was deducted or paid therefrom in the relevant previous year. As such, the amount of royalty of Rs.31.26 lakhs was required to be disallowed. Omission to do so resulted in under assessment of income of Rs.31.26 lakhs involving undercharge of tax of Rs.26.72 lakhs (including interest for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

(ii) The assessment of a company for the assessment year 1988-89 was completed in March 1991. The company had debited in its profit and loss account an amount of Rs.31.54 lakhs towards payment made on account of technical know-how, which was allowed by the assessing officer. Audit scrutiny revealed that the total payment made towards technical know-how fees during the relevant previous year was Rs.88.38 lakhs. Accordingly the deduction allowable for computing the income was Rs.14.73 lakhs only, being one sixth of the total payment made instead of Rs.31.54 lakhs, as allowed by the department. The mistake resulted in under assessment of income of Rs.16.81 lakhs leading to short levy of tax of Rs.12.68 lakhs (including interest leviable for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

Incorrect allowance of capital expenditure

3.10 Under the provisions of the Income Tax Act, 1961, any expenditure, not being of a capital nature or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business, is allowable as deduction in computing income chargeable under the head `profits and gains of business'. It has also been judicially held* that where an assessee purchases securities at a price determined with reference to their actual value as well as the interest accrued thereon till the date of purchase, the entire price paid for them would be in the nature of capital outlay and no part of it can be set off as an expenditure against the income by way of interest received on such securities.

A- Scrutiny Assessment

1(i) The assessment of a public sector banking comapny for the assessment year 1984-85 was completed in May 1987. While computing its income, the bank claimed deduction of Rs.151 lakhs towards payment made in respect of interest element included in the price of securities purchased during the year. As the payment is of capital nature it should have been disallowed. Failure to do so resulted in under assessment of income of Rs.151 lakhs leading to short levy of tax of Rs.87.36 lakhs.

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* Vijaya Bank Ltd. Vs. Addl. CIT (187-ITR-541 SC)

(ii) In its profit and loss account for the previous year relevant to the assessment year 1988-89, an assessee company debited a sum of Rs.22.40 lakhs towards `expenditure on civil works during contruction' pending allocation between capital and revenue . This was allowed by the assessing officer while completing the assessment in December 1990. However, as the entire expenditure is capital in nature, no part of it could be allocated to revenue. Further, the amount debited to revenue account was adhoc and not based on actuals. In the circumstances, the deduction claimed and allowed was irregular. The omission resulted in short levy of tax of Rs.11.76 lakhs.

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

The assessment of a company for the assessment year 1989-90 was completed in February 1990 under the summary assessment scheme, accepting the loss returned. It was seen in audit that the miscellaneous expenses' debited in the accounts of the relevant previous year included expenses towards erection of computer, debenture issue and technical know-how fees aggregating Rs.48.25 lakhs. The expenses being capital in nature should have been disallowed while computing the taxable income. The omission to do so resulted in excess computation of loss of Rs.48.25 lakhs leading to notional short levy of tax of Rs.25.37 lakhs. Additional tax of Rs.5.07 lakhs was also required to be levied.

Incorrect allowance of bad debts

3.11 Under the Income Tax Act, 1961, as amended from 1 April 1989, the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing income chargeable to tax under the head `Profits and gains of business or profession'. However, in the case of a bank to which provision for bad and doubtful debts is allowable, the amount of deduction relating to any such debt or part thereof shall be limited to the amount by which such debts or part thereof exceeds the credit balance in the `provision for bad and doubtful debts account' made under the Act.

A-Scrutiny Assessment

1(i) In the assessment of a banking company for the assessment year 1989-90, completed in August 1990, the Deputy Commissioner of Income tax allowed deduction towards provisions for bad and

doubtful debts and bad debts aggregating Rs.10.01 crores (bad debts Rs.5.93 crores and provisions for bad and doubtful debts Rs.4.08 crores). As per provisions of the Act, the deduction allowed in respect of `bad debts' of Rs.5.93 crores should have been limited to the amount by which the same exceeded the amount allowed for provisions for bad and doubtful debts of Rs.4.08 crores, which in assessee's case works out to Rs.1.85 crores. Thus the assessee was entitled for deduction of bad debts to the extent of Rs.1.85 crores instead of Rs.5.93 crores allowed by the department. Failure to restrict the deduction for bad debts accordingly resulted in excess allowance of `bad debts' by Rs.4.08 crores involving short levy of tax of Rs.2.53 crores (inclusive of excess interest of Rs.0.39 crores paid on refunds).

(ii) In the assessment of a public sector bank for the assessment year 1989-90, completed in March 1990, the assessing officer allowed deduction of Rs.76.41 lakhs on account of bad debts despite the fact that the provision of Rs.247.58 lakhs towards bad and doubtful debts was available in the accounts of the relevant previous year. As the amount of bad debts written off was less than the available provision, no further deduction on account of bad debts was admissible. This mistake resulted in underassessment of income by Rs.76.41 lakhs involving short levy of tax of Rs.47.34 lakhs (including interest of Rs.7.22 lakhs paid to the assessee).

Ministry of Finance have accepted the audit observation.

B-Summary Assessment

The assessment of a widely held banking company for the assessment year 1989-90 was completed in a summary manner in June 1990. the assessee had a taxable income of Rs.236.32 lakhs in the assessment year 1989-90 but after adjusting a part of the carried forward loss of Rs.2598.18 lakhs relating to earlier years, the income for the year was assessed at Nil and the balance unadjusted loss of Rs.2361.86 lakhs was allowed to be carried forward. In the assessment, deduction on account of bad debt amounting to Rs.935.54 lakhs was allowed, although the same was not actually written-off in the relevant accounts. The deduction was, therefore, irregular and led to excess-carry forward of loss of Rs.935.54 lakhs, involving potential undercharge of tax of Rs.491.16 lakhs. Additional tax of Rs.98.23 lakhs was also required to be levied.

Incorrect computation of the income of financial corporation

3.12 Under the Income Tax Act, 1961, financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to a special deduction of an amount transferred by them out of their profits to a special reserve account, upto an amount not exceeding 40 percent of their total income as computed before making any deduction under chapter VI-A of the Act. The deduction is to be limited to the amount of the special reserve actually created in the accounts of the relevant previous year.

A- Scrutiny Assessment

1(i) In the assessment of a state-owned financial corporation for the assessment year 1986-87, completed by the Deputy Commissioner of Income tax (Assessment) in March 1989, a special deduction of Rs.34.17 lakhs was allowed. It was noticed in audit that in the accounts for the previous year relevant to the assessment year 1986-87, the company did not transfer any amount out of its profits to a special reserve account which was a pre-condition for the admissibility of the aforesaid deduction. The deduction of Rs.34.17 lakhs, therefore, was not admissible. The incorrect allowance was not withdrawn even at the time of revising the assessment in May 1990. The mistake led to under assessment of income of Rs.34.17 lakhs involving short levy of tax of Rs.17.94 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) In the assessments for the assessment years 1987-88 and 1988-89, completed in January and February 1989 and subsequently revised in November 1989 and March 1990, a state owned industrial investment company was allowed the aforesaid special deduction at Rs.32.45 lakhs and Rs.147 lakhs respectively. However in the accounts of the previous years relevant to the assessment years 1987-88 and 1988-89, the company had actually created special reserve of only Rs.19.46 lakhs and Rs.136 lakhs respectively. The deductions should have been restricted to the amounts of the reserve actually created. Besides, in the assessment year 1987-88, the company was erroneously allowed deduction of entertainment expenses in excess by Rs.0.37 lakhs. These omissions led to excess deductions aggregating Rs.24.23 lakhs involving total short levy of tax of Rs.14.86 lakhs (inclusive of excess interest of Rs.2.47 lakhs on advance tax and refunds).

Ministry of Finance have accepted the audit observation.

Incorrect deduction of loss on account of fluctuation in the rate of exchange

3.13 The Ministry of Law clarified in October 1984, that exchange loss arrived at on the basis of fluctuations in the rate of exchange and not backed by actual remittance, cannot be allowed as deduction in computing the total income under the Income Tax Act.

A- Scrutiny Assessment

During the previous year relevant to the assessment year 1988-89, an assessee tea company debited to its accounts Rs.112.12 lakhs towards `difference in exchange' due to fluctuation in the rate of exchange and it was allowed as deduction in the assessment for the assessment year 1988-89 completed by the Deputy Commissioner (Special Range) in March 1991. Since there was no actual remittance of foreign currency during the previous year and the loss arose due to intermediary fluctuations in the rate of exchange, the allowance of exchange loss as deduction in the computation of business income was not in order. The mistake resulted in underassessment of income by Rs.44.85 lakhs (40 percent of Rs.112.12 lakhs, the assessee being a tea company) involving undercharge of tax of Rs.42.37 lakhs (including interest of Rs.18.82 lakhs for short payment of advance tax).

B-Summary Assessment

During the previous year relevant to the assessment year 1989-90, an assessee company debited to its accounts a sum of Rs.61.61 lakhs towards `difference in exchange' due to fluctuation in the rate of exchange and it was allowed as deduction in the assessment for the assessment year 1989-90 completed in June 1990 in the summary manner. Since there was no actual remittance of foreign currency during the previous year and the loss had arisen due to intermediary fluctuations in the rate of exchange, the allowance of exchange loss as deduction in the computation of business income was not in order. The mistake resulted in underassessment of income by Rs.24.64 lakhs (40 percent of Rs.61.61 lakhs, the assessee being a tea company) leading to undercharge of tax of Rs.15.53 lakhs (including additional tax of Rs.2.59 lakhs).

Incorrect allowance of provision

3.14 Under the Income Tax Act, 1961, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for deduction.

A- Scrutiny Assessment

1(i) An assessee company, engaged in the generation and distribution of electricity, had shown in its accounts for the previous year relevant to assessment year 1986-87 an amount of Rs.213.02 crores receivable against supply of power. Out of this, a sum of Rs.26.52 crores was deducted and kept under `Provision for doubtful dues from customers'. The assessing officer, while completing the assessment in March, 1991 did not add back the sum of Rs.26.52 crores, though the amount represented only a provision and was not an accrued or ascertained liability and was not, therefore, an admissible deduction. The incorrect allowance of deduction of Rs.26.52 crores resulted in potential short levy of tax of Rs.13.92 crores.

Ministry of Finance have accepted the audit observation.

(ii) In the assessment of a Government company for the assessment year 1989-90, completed in March 1991, the assessing officer allowed a deduction of Rs.606.87 lakhs being provision for doubtful debts. As the provision of Rs.606.87 lakhs was not an ascertained liability, it was not an allowable deduction. The mistake resulted in excess computation of loss by Rs.606.87 lakhs involving potential tax effect of Rs.318.61 lakhs.

Ministry of Finance have accepted the audit observation.

2. The Act also provides that any sum paid or payable to an employee as bonus is allowable as deduction in computing the business income.

(i) The assessment of a widely held banking company for the assessment year 1988-89 was completed in December 1990 at a total income of Rs.3669.16 lakhs. In the assessment, an amount of Rs.250 lakhs was allowed as estimated bonus. However, the Tax Audit Report of the next previous year indicated that the actual payment of bonus of the previous year relating to the assessment year 1988-89 was Rs.140.39 lakhs. Therefore, the balance amount of Rs.109.61 lakhs represented only an estimated provision for bonus and not an ascertained liability and was not allowable as deduction. Incorrect allowance of deduction resulted in underassessment of Rs.109.61 lakhs with consequent undercharge of tax of Rs.82 lakhs (including short levy of interests of Rs.0.72 lakhs for belated submission of return and Rs.23.74 lakhs for short payment of advance tax).

(ii) An assessee company debited in its profit and loss account for the previous year relevant to the assessment year 1989-90 an amount of Rs.112.06 lakhs being `provision for obsolescence of materials'. While computing the taxable income for the assessment year 1989-90, the assessing officer allowed the provision as deduction. As the amount represented merely a provision and not an ascertained liability, the same was not an allowable deduction. The mistake resulted in excess carry forward of loss by Rs.112.06 lakhs involving potential tax effect of Rs.58.83 lakhs.

(iii) During the previous year relevant to assessment year 1985-86, an assessee company had made a provision of Rs.9.72 lakhs in its accounts towards engineering fees payable to its collaborators. In the assessment completed in January 1989, the department allowed this provision as deduction. Audit scrutiny, however, revealed that the agreement for execution of the project had not been entered into and approval of the Central Government under the Companies Act 1956 had also not been obtained. Therefore the amount represented only a provision and was not an accrued liability as the legal obligation for making payment to collaborators had not arisen during the relevant previous year. The deduction was therefore not allowable. The mistake resulted in under assessment of income by Rs.9.72 lakhs involving short levy of tax of Rs.11.02 lakhs (including interest of Rs.5.40 lakhs).

B-Summary Assessment

(i) A Government company debited in its profit and loss account for the previous year relevant to the assessment year 1989-90, an amount of Rs.481.54 lakhs being `provisions for wage revision of employees' and the assessing officer, while completing the assessment in the summary manner in February 1990 and revising it in August 1990, allowed the entire provision as deduction. As the amount was merely a provision for a possible payment at a future date and not an ascertained liability, it was not an allowable deduction. The mistake which was apparent from the information available in return, accounts and documents of the assessee, resulted in over-computation of loss by the like amount involving potential tax effect of Rs.240.77 lakhs and additional tax of Rs.48.15 lakhs.

(ii) A public limited company changed its method of accounting in respect of certain specified items in respect of the previous year relevant to the assessment year 1989-90 and claimed a

deduction of Rs.84.66 lakhs in the assessment, completed under summary assessment scheme, on account of provision for payments due to workers and supervisory staff, pending settlement of pay structures effective from October 1986 and August 1987, though no such settlement was actually made during the previous year. The liability was not an ascertained one, nor had it accrued during the previous year and hence was, prima-facie, inadmissible. However, no adjustment to disallow the inadmissible deduction was made by the assessing officer while accepting the returned loss of the assessee. The omission resulted in potential short levy of tax of Rs.44.13 lakhs and non-levy of additional tax of Rs.8.83 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of a company for the assessment year 1989-90, completed under the summary assessment scheme in July 1990, an amount of Rs.33.96 lakhs debited in accounts towards `provision for diminution in the value of investments' was allowed as a deduction while computing taxable income. As the provision debited in accounts was towards a contingent liability and not an ascertained liability nor an actually sustained loss, it should have been disallowed. Failure to do so resulted in excess computation of loss by Rs.33.96 lakhs leading to notional short levy of tax of Rs.19.61 lakhs. Additional tax of Rs.3.92 lakhs was also required to be levied.

Incorrect allowance of liabilities

3.15 Under the provisions of the Income Tax Act, 1961, as applicable with effect from the assessment year 1984-85, a deduction otherwise allowable under the Act in respect of any sum payable by the assessee by way of tax or duty under any law for the time being in force, or any sum payable by him as an employer by way of contribution to any provident fund or superannuation or gratuity or any other fund for the welfare of the employees, shall be allowed in computing the business income of that previous year in which such sum is actually paid and not merely on the basis of accrual of the liability. The Act was amended with effect from 1 April 1988 to provide that taxes and duties etc., if paid on or before the due date of submission of return of income for the relevant previous year in which the liability to pay such amounts was incurred, will

also be allowed as deduction. It has been held* by the Supreme Court that the amount of Sales-tax collected by a trader in the course of business constitutes his trading or business receipts and is liable to be included in his business income. It has also been judicially held** that if a receipt is a trading receipt, the fact that it is not so shown in the books of accounts of the assessee would not prevent the assessing authority from treating it as such.

A-Scrutiny Assessment

1(i) The assessment of a public limited company for the assessment year 1987-88 was completed in March 1990 computing total income at Rs.Nil after setting off of unabsorbed depreciation pertaining to the assessment year 1985-86 to the extent of Rs.624.88 lakhs. A further sum of Rs.561.25 lakhs was carried forward for future set off. In the computation of total income, the assessing officer disallowed a sum of Rs.292.87 lakhs on account of unpaid liabilities in respect of taxes, duties and contribution to various funds. The balance sheet of the relevant previous year (i.e. as on 30 June 1986), however, indicated an increase aggregating Rs.450.17 lakhs over the balance of such unpaid liabilities as on 30 June 1985. Accordingly the entire sum of Rs.450.17 lakhs should have been added back in the computation of income in place of Rs.292.87 lakhs. The incorrect disallowance led to under assessment of income of Rs.157.30 lakhs with identical excess carry forward of unabsorbed depreciation involving a potential undercharge of tax of Rs.78.65 akhs in assessment year 1987-88.

(ii) While completing the assessment of a public sector undertaking for the assessment year 1984-85 in March 1987, the assessing officer erroneously allowed deduction amounting to Rs.20.57 lakhs in respect of unpaid liabilities on account of contributory provident fund (Rs.7.37 lakhs) and gratuity fund (Rs.13.20 lakhs), which were outstanding in the balance sheet as unpaid liability at the end of the relevant previous year. The omission to add back the unpaid liability resulted in under assessment of income of Rs.20.57 lakhs involving a tax effect of Rs.17.87 lakhs (including interest of Rs.0.58 lakhs for late filing of return and Rs.5.02 lakhs for short payment of advance tax).

The department has accepted the audit observation.

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* Sinclare Murrey & Co.Pvt.Ltd. Vs.CIT Calcutta (97-ITR-615 SC)

**Chowrangheee Sales Bureau Pvt.Ltd. Vs. CIT W.B. (87-ITR-542)

(iii) The assessment of a public limited company for the assessment year 1988-89 was completed in March 1991 at a loss of Rs.5.24 lakhs. Audit scrutiny revealed that sales tax of Rs.27.54 lakhs collected from the customers had not been passed through the relevant profit and loss account and the amount remaining unpaid was shown as liability in the balance sheet. The amount could not also be allowed as deduction since it was not paid during the relevant previous year. The omission to treat the trading receipts as income resulted in under assessment of income of Rs.27.54 lakhs involving under charge of tax aggregating Rs.14.46 lakhs (including potential tax of Rs.2.75 lakhs) in the assessment year 1988-89.

(iv) The assessment of a closely held company for the assessment year 1986-87 was completed in March 1990 at an income of Rs.41.29 lakhs by adding a net sum of Rs.2.78 lakhs towards unpaid liability. The sum was arrived at by deducting from unpaid statutory liability of the assessment year amounting to Rs.16.63 lakhs, the disallowed liability of earlier years paid during the previous year relevant to that assessment year amounting to Rs.13.85 lakhs. The amount of Rs.13.85 lakhs included sales tax of Rs.13.80 lakhs paid during the year. The records of the assessment of the assessment years 1984-85 and 1985-86 however showed that only a sum of Rs.0.03 lakhs was disallowed in the assessment year 1984-85 out of which Rs.0.02 lakhs was allowed on payment basis in the assessment year 1985-86. Thus the amount of sales tax remaining disallowed was Rs.0.01 lakhs and not Rs.13.80 lakhs as allowed in the assessment. Hence, there was irregular allowance of deduction of Rs.13.79 lakhs. This led to under assessment of the same amount with undercharge of tax of Rs.8.69 lakhs. It was also noticed that tax was calculated on the income originally assessed in March 1990, at fifty-five percent plus surcharge. The records indicated that the assessee is a trading company, its main business being sale of cars on commission. In earlier assessment years also the company was treated as a non-industrial company. Consequently, tax was leviable at sixty percent plus surcharge. The mistake in this regard led to further undercharge of tax of Rs.2.17 lakhs. Thus there was total undercharge of tax aggregating Rs.13.81 lakhs (including short levy of interest of Rs.2.95 lakhs for filing of belated return).

Ministry of Finance have accepted the audit observation.

2. In regard to cases where the payment of sales tax is deferment under the deferred scheme provided by the State government, the Central Board of Direct Taxes, in consultation with the Law Ministry, clarified that if the state government made an amendment in the Sales Tax Act to the effect that the sales tax deferred under the scheme shall be treated as actually paid, such a deeming provision would meet the requirements of Section 43-B.

In the assessments of a widely held company for the assessment years 1984-85, 1985-86 and 1986-87, assessed between February 1988 and May 1988, the assessing officer erroneously allowed deduction towards the unpaid sales tax to the extent of Rs.14.88 lakhs, Rs.26.15 lakhs and Rs.4.18 lakhs respectively on the ground that the payment of sales tax was deferred upto 1990 as per State Government Scheme for promotion of industrial development in backward areas. Scrutiny of assessment records revealed that the certificate from State sales tax authorities for the allowance of such deduction was also not furnished by the assessee company, as required under the rules. As such the deduction allowed for the three assessment years was irregular. The omission to add back the unpaid liabilities resulted in under assessment of income aggregating Rs.45.22 lakhs involving short levy of tax of Rs.24.52 lakhs for the three assessment years 1984-85 to 1986-87.

Ministry of Finance have accepted the audit observation.

3. An assessee who is aggrieved can appeal to the Commissioner of Income tax (Appeals) against an order of assessment made by the assessing officer and the latter shall comply with the directions given by the former.

(i) The assessment of a widely held company for the assessment year 1986-87, completed in July 1988 at an income of Rs.315.64 lakhs, was revised in September 1988 to allow deduction of Rs.58.20 lakhs representing sales-tax, provident fund dues, octroi, municipal and house tax, etc. relating to the assessment year 1985-86 which were actually paid during the assessment year 1986-87. This amount was earlier disallowed in the assessment for the assessment year 1985-86 on the ground that the payments had not been made in that year, but

the assessee had preferred an appeal which was upheld by the Commissioner of Income tax (Appeals) in September 1990. Scrutiny of records in audit revealed (November 1990) that though the rectification giving effect to the order of the Commissioner of Income tax (Appeals) was made in November 1990 by reducing the income originally assessed for the assessment year 1985-86, no action was taken to withdraw the deduction of the same amount allowed for the assessment year 1986-87. Omission to revise the assessment for the assesment year 1986-87 resulted in short computation of income by Rs.58.20 lakhs with consequential short levy of tax of Rs.40.87 lakhs (including interest for short payment of advance tax).

(ii) In the assessment for the assessment year 1988-89, completed in January 1991, a company was allowed deduction of Rs.32.96 lakhs being undischarged liability disallowed in the assessment for the earlier assessment year 1987-88. It was seen in audit that for the assessment year 1987-88, on an appeal, the Commissioner of Income tax (Appeal) had allowed an amount of Rs.28.54 lakhs out of Rs.32.96 lakhs. The assessing officer had also given effect to the appellate order in February 1991. Therefore, the deduction already allowed in the assessment year 1988-89 should have been withdrawn to the extent of Rs.28.54 lakhs, which was not done. Consequently, there was under assessment of income by an identical amount involving short levy of tax of Rs.16.48 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of a widely held company for the assessment year 1983-84 which was completed in November 1986, the assessing officer allowed Rs.31.44 lakhs as Central Excise duty payable at differential rates as claimed by the assessee without making any provision therefore in the accounts. Tax Audit Report indicated that the claim was in dispute. Audit scrutiny revealed that the assessee had disputed the higher rate of levy which was upheld by the departmental appellate authority. On reference, Central Government issued a show-cause notice and held in abeyance the orders of the appellate authority. On a writ petition before the Hon'ble High Court at Calcutta, the assessee was allowed certain reliefs and permitted to act on the basis of the departmental appellate order till passing of final

orders by the Court. Further, in a departmental circular issued in January 1982 by the Commissioner of Income tax, it was directed that demand raised as per show cause notice could not be legally enforced without passing a regular adjudication order. The assessee company was, however, claiming liability for excess duty at higher rate although the interim order of the Court put a bar on demand of duty at the higher rate and the departmental circular also rendered the demand at higher rate unenforceable. Therefore, the claim of Rs.31.44 lakhs representing excise duty at differential rate was not ascertained nor known liability, and the allowance thereof was irregular. The mistake resulted in excess computation and carry forward of loss of Rs.31.44 lakhs involving potential tax effect of Rs.17.72 lakhs.

Ministry of Finance have accepted the audit observation.

B-Summary Assessment

1(i) The assessments of a widely held company for the assessment years 1989-90 and 1990-91 were completed in a summary manner in June 1990 and March 1991 respectively. It was noticed from the tax audit report and accounts submitted with the return of income that the amounts of Rs.6.79 lakhs and Rs.38.68 lakhs, debited to profit and loss accounts as taxes and duties for the previous year relevant to the assessment years 1989-90 and 1990-91 respectively, were not paid within the relevant previous year or within the due date allowed for furnishing the return of income. These amounts should have been added back to the income of the assessee company in the respective assessment years. Omission to do so resulted in under assessment of income by identical amounts with aggregate potential undercharge of tax of Rs.24.45 lakhs and non-levy of additional tax of Rs.4.89 lakhs in the two assessment years 1989-90 and 1990-91.

(ii) The assessment of a widely held company for the assessment year 1989-90 was made in a summary manner in April 1990, at loss of Rs.148.53 lakhs. In the assessment, the assessing officer disallowed, interalia, outstanding liability for provident fund amounting to Rs.13.89 lakhs out of the total unpaid liability on this account amounting to Rs.24.31 lakhs as indicated in the tax audit report. The balance unpaid liability amounting to Rs.10.42 lakhs was however not disallowed by the assessing officer. Further, the unpaid sales tax liability of Rs.18.56 lakhs was

also not disallowed. As these amounts stood debited to the relevant profit and loss accounts but remained unpaid even upto the due date of furnishing the relevant return of income, these were disallowable under the Act. Omission to do so led to excess computation and carry forward of loss of Rs.28.98 lakhs, involving potential tax effect of Rs.15.21 lakhs.

(iii) During the previous year relevant to the assessment year 1989-90, an assessee, a widely held company, had collected sales tax amounting to Rs.32.37 lakhs but the same remained payable. Since the amount was not paid during the relevant previous year it should have been added back to the income of the assessee treating it as trading receipt. Failure to do so in the assessment for the assessment year 1989-90, completed in June 1990 in a summary manner, resulted in excess carry forward of business loss of Rs.32.37 lakhs involving a potential undercharge of tax of Rs.16.99 lakhs and non levy of additional tax of Rs.3.40 lakhs.

2. The Finance Act, 1988 has, with effect from 1 April 1989, brought within the ambit of the aforesaid provision of allowability of certain sums only on actual payment, any sum payable by the assessee as interest on any loan or borrowing from any public financial institution.

In the assessment of five companies for the assessment year 1989-90, assessed between February 1990 to March 1991 in a summary manner, interest aggregating Rs.216.01 lakhs payable to different central financial institutions, was allowed as deduction. Audit scrutiny of the accounts and documents accompanying the returns of income revealed that the assessee companies had not paid the above interest during the relevant previous year or by the due date of submission of returns of income for that previous year. Thus, the amount of unpaid interest should have been disallowed. Omission to do so resulted in under assessment/excess carry forward of loss amounting to Rs.216.01 lakhs involving potential tax effect of Rs.104.68 lakhs and positive tax effect of Rs.13.95 lakhs and non levy of additional tax of Rs.22.67 lakhs.

Ministry of Finance have accepted the audit observation in one case.

Incorrect valuation of closing stock

3.16 According to accounting principles, the value of closing stock shown at the end of the previous year, is exhibited as the value of opening stock of the immediately succeeding previous year.

In the assessment of a tea company for the assessment year 1987-88, completed in March 1990, the value of closing stock of tea was determined at Rs.402.84 lakhs against Rs.245.03 lakhs shown by the assessee and net addition of income of Rs.15.30 lakhs was made after deducting Rs.142.51 lakhs for revaluation of closing stock for assessment year 1986-87. On an appeal, the appellate authority deleted the additions of Rs.142.51 lakhs made in the closing stock of assessment year 1986-87 which was given effect to in August 1990. However, no adjustment was made in the value of opening stock of the assessment year 1987-88 consequent on revision of assessment for the assessment year 1986-87, which resulted in underassessment of income of Rs.57.00 lakhs. It resulted in under charge of tax of Rs.41.68 lakhs (including interest of Rs.71,251 for belated submission of return and interest of Rs.12.47 lakhs for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

Other mistakes in the computation of business income

3.17 While computing the income of an assessee, the assessing officer normally proceeds with the net profit as per profit and loss account as the starting point and then makes necessary adjustments by way of additions or deletions in accordance with the provisions of the Act and rules to arrive at the total income.

A- Scrutiny Assessment

1(i) During the previous year relevant to the assessment year 1983-84 an investment company received renewal subscriptions of Rs.5779.34 lakhs from the public against Welfare Endowment Certificates issued to the certificate holders in earlier years. The assessee company credited interest at a flat rate of 10 per cent per annum on the accumulated balance in the Welfare Endowment Certificate Fund Account at the end of the financial year and raised an indentical debit in the relevant profit and loss account. As renewal subscriptions were received on different dates during the previous year and all of them were not one-year old by the end of the previous year, there was excess credit of interest in the Fund Account and corresponding excess debit of interest in the relevant profit and loss account.

The assessment was completed under scrutiny in March 1987 on the basis of the claim of interest on renewal subscriptions as per accounts. The irregularity was brought to the notice of the assessing officer in September 1987. Consequent to audit observations, the assessing officer got the accounts of the assessee company audited as provided under the Act and obtained a report of such audit. On the basis of the report, the department made several revisions and, inter alia, disallowed a sum of Rs.183.70 lakhs against interest on renewal subscriptions in the assessment reframed in September 1991. The excess allowance of interest of Rs.183.70 lakhs in the original assessment had thus led to identical under assessment of income in the assessment year 1983-84 with short levy of tax of Rs.188.78 lakhs, including interest of Rs.66.39 lakhs for short payment of advance tax.

(ii) In the case of a public sector company for the assessment year 1987-88, it was seen from the notes forming part of the accounts that the company had debited in the accounts of the relevant previous year an amount of Rs.189.93 lakhs on account of loss on sale of assets. While completing the assessment in August 1989, the assessing officer added to the net profit an amount of Rs.5.79 lakhs only instead of Rs.189.93 lakhs debited to the accounts. The allowability of the deduction on account of loss on sale of assets was not discussed in the assessment order. The omission resulted in under assessment of income of Rs.184.14 lakhs involving short levy of tax of Rs.127.74 lakhs including short levy of interest for late filing of return and for short payment of advance tax.

2. Under the provisions of Income Tax Act, 1961, only such expenses are allowable as deduction from a previous year's income as are relevant to that year.

(i) While completing the assessment of a Government company for the assessment year 1987-88 in January 1990, the assessing officer disallowed prior period expenses of Rs.431.85 lakhs as against actual amount of Rs.575.21 lakhs which should have been disallowed. The amount of Rs.575.21 lakhs included a sum of Rs.143.36 lakhs pertaining to repairs and maintenance and was already allowed as expenditure in earlier years. The omission resulted in excess computation of loss by Rs.143.36 lakhs involving potential tax effect of Rs.71.68 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) In the assessment of a Government company for the assessment year 1988-89, completed in January 1990, the assessing officer disallowed prior period expenses of Rs.2029.83 lakhs as against the actual amount of Rs.2056.92 lakhs. The disallowed amount of Rs.2029.83 lakhs was arrived at after reducing Rs.27.09 lakhs pertaining to repairs and maintenance. This amount was already allowed as expenditure in earlier years and was not, therefore, allowable. The omission resulted in excess computation of loss of Rs.27.09 lakhs involving potential tax effect of Rs.14.22 lakhs.

3. Under the provisions of Income-tax Act, 1961, interest paid or payable in connection with the acquisition of capital assets relatable to the period after such asset are first put to use is allowable as deduction in the computation of business income. Since the income is computed in respect of an accounting period, the expenditure allowable against such income would be what was incurred during that accounting period. It was held by the Supreme Court* in 1975 that interest on money borrowed for acquisition of a capital asset relating to the period upto the date on which such asset was put to use would form part of the actual cost of the asset. Three closely held companies claimed, for assessment years 1984-85 to 1986-87, deduction of interest liability amounting to Rs.298.02 lakhs which represented interest on the cost of machinery acquired on deferred payment basis and related to the periods beyond the relevant accounting year. The assessees claimed these deductions for the entire period of currency of the loan in one lump sum in the year in which the contract with the financing agency i.e., Industrial Development Bank of India (IDBI) was signed. The claim was accepted by the assessing officer and allowed in the assessments. It

* 98-ITR-167

waspointed out in audit that only that portion of interest which accrued and fell due for payment during the relevant accounting year could be allowed as deduction against the income of the particular year and not the total amount of interest which would fall due for the entire period of the agreement. The department contended that the claim was rightly allowed, since the entire amount of interest expenditure was incurred during the year as per the ratio of a Gujarat High Court decision* wherein the Hon'ble High court had held that `interest on deferred payment formed part of the `actual cost' of plant and machinery. However perusal of the court decision would reveal that the case related to whether interest could form part of the cost of acquisition for the purpose of allowing depreciation and development rebate. The question of allowing the deduction of interest as revenue expenditure was not covered by this decision. Moreover, in view of the clarificatory amendment introduced by the Finance Act 1986 retrospectively from 1.4.1974, the ratio of the aforesaid decision no longer holds good.

The irregular allowance of interest that did not fall due as an enforceable legal liability during the relevant previous year aggregated Rs.298.02 lakhs in three cases (pertaining to assessment years 1984-85, 1985-86 and 1986-87) and involved short levy of tax of Rs.191.62 lakhs.

4. Under the provisions of the Income-tax Act, 1961, income under the head `profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment.

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* 104-ITR-581

(i) In the case of an assessee, a public sector undertaking, for the previous year relevant to assessment year 1986-87, the assessee had debited a sum of Rs.1.37 crores to its accounts as contribution towards employees education and welfare scheme. Audit scrutiny revealed that out of this amount, Rs.88.70 lakhs pertained to the previous years relevant to the assessment years 1984-85 and 1985-86 and the balance amount of Rs.48.71 lakhs to the previous year relevant to assessment year 1986-87. However, the department, while completing the assessment in March 1989, disallowed the sum of R.48.71 lakhs but allowed the other sum of Rs.88.70 lakhs even though this sum also was not allowable in the previous year relevant to the assessment year 1986-87 as the liability did not accrue during the relevant accounting year. Thus there was under assessment of income Rs.88.70 lakhs involving short levy of tax of Rs.51.23 lakhs.

(ii) In the assessment of a Government company for the assessment year 1985-86, completed in March 1988, the assessing officer erroneously allowed deduction of Rs.28.16 lakhs on account of expenditure for earlier previous years not relevant to assessment year 1985-86. As the assessee was following mercantile system of accounting, it should have been disallowed and added back while determining the taxable income of the assessee. The omission to do so resulted in over-assessment of loss by Rs.28.16 lakhs involving potential tax effect of Rs.16.26 lakhs.

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

1(i) A Government company, following the mercantile system of accounting, debited a sum of Rs.2233.45 lakhs in its accounts for the year ended 31 March 1989 relevant to the assessment year 1989-90 towards prior period expenses. The assessing officer, while completing the assessment in the summary manner in February 1990, allowed the deduction for the same amount. Since prior period expenses did not pertain to the year under consideration, the assessing officer should have disallowed the amount. The omission to do so, though the mistake was apparent from the accounts, documents and return filed by the assessee, led to over computation of loss by a like amount involving potential tax effect of Rs.1340.07 lakhs (including additional tax of Rs.223.34 lakhs).

Ministry of Finance have accepted the audit observation.

(ii) In the assessment of a company for the assessment year 1989-90, completed in March 1990 in the summary manner, the assessing officer erroneously allowed deduction of Rs.791.24 lakhs on account of expenditure of earlier previous years not relevant to the assessment year 1989-90. As the assessee was following mercantile system of accounting, this amount should have been disallowed and added back while determining taxable income of the assessee. Omission to do so resulted in over-assessment of loss by Rs.791.24 lakhs involving potential tax effect of Rs.498.48 lakhs (including additional tax of Rs.83.08 lakhs).

Ministry have not accepted the audit observation stating that the question involves scrutiny of claims and allowances/disallowances to be determined which is a step not contemplated by provisions of Section 143(1)(a). The reply is not tenable as the aforesaid deductions were, on the basis of information availablle in accounts and return, prima facie inadmissible and should have been disallowed.

Mistake in grant of investment allowance/ carry forward and set off of unabsorbed investment allowance

3.18 Under the Income Tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction by way of investment allowance, shall be allowed in the previous year of installation or in the previous year of first usagae of a sum equal to 25 percent of the actual cost of the machinery. The Act further lays down that where any amount is paid or payable as interest in connection with the

acquisition of asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included in the actual cost of the asset.

A- Scrutiny Assessment

1. In the assessment of a widely held company for the assessment year 1982-83, completed/revised by the Deputy Commissioner in March 1985/February 1987, unabsorbed investment allowance of Rs.105.35 lakhs, computed after reducing from the cost of plant and machinery a sum of Rs.22.11 lakhs, being the interest capitalised, was allowed to be carried forward for set off against the income of subsequent assessment year(s). It was however noticed during audit (September 1990) that the correct amount of interest capitalised as per the revised depreciation statement filed by the assessee worked out to Rs.182.21 lakhs. Accordingly the correct amount of unabsorbed investment allowance to be carried forward worked out only to Rs.65.33 lakhs as against Rs.105.35 lakhs determined in the assessment. The mistake resulted in an excess carry forward of investment allowance of Rs.40.03 lakhs involving a potential tax effect of Rs.21.01 lakhs.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income Tax Act 1961 and the accepted principles of accountancy, cost of fixed assets includes all expenditure necessary to bring such assets into place and to put them in working condition. The pre-production expenditure of a new industry can be allocated to the various capital assets and the total cost of each item is accepted for allowing depreciation, extra shift allowance and investment allowance under the Income Tax Act.

In the assessment of a company for the assessment year 1984-85, completed by the Deputy Commissioner of Income Tax on 30 March 1987, an amount of Rs.1952.09 lakhs representing expenditure incurred by the assessee prior to commencement of business was capitalised. The entire expenditure was allocated only against assets entitled to depreciation, extra shift allowance and investment allowance. As the pre-production expenditure are general administrative and establishment expenditure, a rational method of allocation would be to apportion it amongst all assets including assets not entitled to depreciation or investment allowance such as land, furniture and fittings, etc. in proportion to their cost or alternatively

to the recorded expenditure on the various assets at the commencement of production. On such allocation of the pre-production expenditure, depreciation, additional depreciation, extra shift allowance and investment allowance would not be admissible on Rs.628.68 lakhs allocable against land, furniture and fixtures, vehicles etc. However, on this sum, the assessee was incorrectly allowed depreciation (on land only), additional depreciation, extra shift allowance and investment allowance to the extent of Rs.265.28 lakhs. The incorrect allowance resulted in under-assessment of income of Rs.265.28 lakhs involving potential short levy of tax of Rs.153.20 lakhs.

3. Under the Income Tax Act 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction by way of investment allowance shall be allowed in the previous year of installation or in the previous year of first usage, of a sum equal to 25 percent (20 percent from the assessment year 1989-90 and onwards) of the actual cost of the machinery to the assessee. As per the opinion given by the Ministry of Law, Department of Legal Affairs, no investment allowance is admissible to an assessee who has transferred his eligible assets to somebody else on hire/mortgage basis, whether as a solitary case or as a business activity.

Assessment of a company in which public are substantially interested, for the assessment year 1987-88, was completed in February 1990 allowing investment allowance of Rs.96.14 lakhs to be carried forward alongwith the investment allowance of Rs.9.40 lakhs and Rs.66.27 lakhs pertaining to the assessment years 1985-86 and 1986-87 respectively. In the assessment order, it was indicated that this would be allowed subject to creation of reserve. It was seen in audit that the assessee company was engaged in the business of purchasing medical equipment and givng the same on lease and did not engage itself in any manufacturing activity.Thus the grant of investment allowance, subject to creation of reserve, on the leased out machinery was incorrect and it resulted in aggregate potential short levy of tax of Rs.85.90 lakhs.

Ministry of Finance have accepted the audit observation.

4. Under the Income Tax Act,1961, in respect of machinery owned by the assessee and used for the

purpose of business carried on by him, a deduction shall be allowed by way of investment allowance in the previous year of installation or in the previous year of first usage, of a sum equal to 25 per cent of the actual cost of the machinery to the assessee.The investment allowance is allowed subject to the condition that an amount equal to seventy five 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.

In the assessment of a company for the assessment year 1986-87, completed by the Deputy Commissioner of Income tax in March 1989, the assessing officer allowed investment allowance of Rs.333.71 lakhs.It was seen in audit that even though there was enough profit, the assessee company had created investment allowance reserve of Rs.187.00 lakhs. Therefore investment allowance of Rs.249.33 lakhs only was allowable as against Rs.333.71 lakhs allowed. The grant of excess investment allowance of Rs.84.38 lakhs resulted in short levy of tax of Rs.63.68 lakhs (including interest for short payment of advance tax).

5. Under the Income Tax Act,1961, as amended with retrospective effect from 1 April 1974, where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after the asset is first put to use shall not be included in the actual cost of the asset for the propose of allowance of depreciation and investment allowance.

The assessment of a widely held company for the assessment year 1985-86 was completed by the Deputy Commissioner of Income tax (Assessment) in February 1988.Audit scrutiny in January 1990, revealed that the company had purchased certain machinery on deferred payment basis during the previous year relevant to the assessment year 1977-78, had capitalised the interest of Rs.458.23 lakhs due on future payments under deferred payment scheme over the period 1977-78 to 1985-86 and had added the same to the cost of machinery.The department had also allowed depreciation and extra shift allowance aggregating Rs.181.79 lakhs and investment allowance of Rs.79.69 lakhs for the assessment years 1977-78 to 1985-86 on the amount of interest so added to the capital cost.The mistake in allowance of investment allowance alone resulted in an aggregate short levy of tax of Rs.46.00 lakhs.In

the absence of full particulars of the interest payment which fell due during the relevant previous years, the year-wise underassessment and the short-levy of tax on account of the mistake on depreciation could not be worked out.

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

Under the Income Tax Act,1961, where for any assessment year unabsorbed investment allowance under the head 'profit and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed investment allowance shall be carried forward to the following assessment year, and shall be set off against profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off upto a maximum of eight assessment years immediately succeeding the assessment year for which loss was first computed. Further, under the amended provisions of the summary assessment scheme applicable with effect from 1 April 1989, adjustments shall be made to the income of the assessees inter alia, in regard to any loss carry forward, deduction allowance or relief which is prima facie admissible or inadmissible. Though the provisions of the Act required adjustments to be made on account of brought forward losses and allowances which need reference to previous years' assessment records, these could not carried out on account of executive instructions issued by the Board in Instruction No.1814 dated 4 April 1989 which barred such reference to earlier records.

1(i) The assessment for the assessment year 1989-90 in respect of a public limited company was completed under the summary assessment scheme in January 1990 accepting the income at Rs.25.43 crores as returned by the assessee.While completing the assessment, the assessee was allowed to avail a deduction of Rs.29.49 crores on account of unabsorbed investment allowance comprising Rs.3.84 crores, Rs.11.19 crores and Rs.14.46 crores for the assessment years 1984-85, 1986-87 and 1987-88 respectively.It was, however, seen that the deduction on account of investment allowance for the assessment years 1984-85 and 1986-87 was already allowed in full in these respective assessment years in the assessments completed in January 1987 and March 1989 respectively. In respect of assessment year 1987-88, a balance of only Rs.8.43 crores as unabsorbed

investment allowance remained to be set off against future years' profits.The mistake resulted in excess allowance of deduction of Rs.21.06 crores leading to short levy of tax of Rs.13.27 crores(including additional tax of Rs.2.21 crores).

(ii) In the assessment of a company for the assessment year 1990-91 completed in January 1991 under the summary assessment scheme, set off of unabsorbed investment allowance of Rs.65.42 lakhs relating to the earlier assessment years was allowed as claimed. It was seen in audit that in the assessment order for the earlier assessment year 1989-90, the assessing officer had recorded that all brought forward losses including depreciation and investment allowance were absorbed in that year and no loss remained to be carried forward for future set off.Thus the set off of investment allowance of Rs.65.42 lakhs in the assessment year 1990-91 was not in order.The incorrect set off resulted in under assessment of income by an identical amount involving short levy of tax of Rs.35.32 lakhs.

(iii) In the assessment for the assessment year 1990-91 completed in February 1991 in the summary manner, a company claimed unabsorbed investment allowance of Rs.48.53 lakhs in respect of the assessment year 1989-90. It was seen from the assessment order for the assessment year 1989-90 that there was no unabsorbed investment allowance to be carried forward to the subsequent assessment years.The incorrect allowance of the investment allowance resulted in under assessment of income of Rs.48.53 lakhs leading to short levy of tax of Rs.31.45 lakhs (including additional tax).

2. Under the Income Tax Act, 1961, as amended by Direct Tax Laws (Amendment) Act, 1989, with effect from 1 April 1989 in respect of machinery owned by the assessee and used for the purpose of the business of manufacture or production of any article or thing, a deduction by way of investment allowance shall be allowed in the previous year of installation or in the previous year of first usage of a sum equal to 20 percent of the actual cost of the machinery to the assessee.

(i) While completing the assessment of a Government company for the assessment year 1989-90 under the summary assessment scheme in February 1990(revised in August 1990), the assessing officer erroneously allowed a deduction of

Rs.494.21 lakhs by way of investment allowance at the rate of 25 percent of the actual cost of machinery of Rs.1976.86 lakhs as against the admissible rate of 20 percent. The excess grant of investment allowance resulted in over-computation of loss by Rs.98.84 lakhs involving potential tax effect of Rs.59.31 lakhs (including additional tax of Rs.9.88 lakhs).

(ii) The assessment of widely held company for the assessment year 1989-90 was originally completed in August 1990 under the summary assessment procedure and later revised in January 1991, determining the loss at Rs.1795.25 lakhs which was allowed to be carried forward for future set-off. While admitting the claim for investment allowance on plant and machinery worth Rs.719.84 lakhs installed during the previous year ended 31 March 1989, the assessing officer allowed the deduction at Rs.179.96 lakhs at 25 per cent of the cost thereof, as claimed in the return of income, instead of Rs.143.97 lakhs admissible at the rate of 20 per cent of the cost. The application of incorrect rate led to under assessment of income of Rs.35.99 lakhs, with identical excess carry forward of loss involving a potential tax-effect of Rs.22.67 lakhs, including Rs.3.78 lakhs by way of short levy of additional income tax.

Income not assessed

3.19 Under the Income Tax Act, 1961 the total income of a person, for any previous year includes all income, from whatever sources derived, which is received or is deemed to be received or which accrues or arises during such previous year, unless specifically exempted from tax by the provisions of the Act. 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 system of accounting, the net profit or loss is calculated after taking into account all the income actually received or accrued or deemed to have accrued as well as expenditure incurred and liabilities relating to the period, regardless of their actual receipt or payment. It has been judicially* held that income is accrued when the assessee has acquired a right to receive it.

A- Scrutiny Assessment

1(i) The assessment of a public sector company, for the assessment year 1988-89, originally made in March 1991, was revised in December 1991

* CIT Gujarat Vs. Ashokbhai chimanbhai (561 ITR 42-SC)

determining loss of Rs.2208.05 lakhs and the loss representing unabsorbed depreciation was allowed to be carried forward for future set-off. The total income was, however, determined at Rs.1148.44 lakhs, as returned by the assessee, being 30 percent of book profit under the special provisions of the Act relating to companies. During the previous year, as revealed from a note to the Balance Sheet as at 31 March 1988, the assessee had accrued income of Rs.292.71 lakhs from power sales to a State Electricity Board on account of increased rate of tariff effected from 1 December 1982. The unilateral increase in the rate of tariff by the assessee company, originally disputed by the State Electricity Board, was finally accepted, through a memorandum of agreement between the parties on 7 September 1987, to be effective from August, 1985. As the claim was admitted through the execution of an agreement made during the relevant previous year bestowing upon the assessee the right to receive the income during that year, the non-inclusion of the income on accrual basis resulted in under-computation of income by Rs.292.71 lakhs. There was consequent excess carry-forward of loss of Rs.292.71 lakhs with potential tax effect of Rs.153.67 lakhs in the assessment year 1988-89.

Ministry of Finance have accepted the audit observation.

(ii) The assessment of a widely held company for the assessment year 1987-88 was made in March 1991 at loss of Rs.323.61 lakhs. The computation included interest income of Rs.19.65 lakhs only, under the head `other income'. Audit scrutiny, however, revealed that the department, consequent upon completion of the assessment for the assessment year 1982-83 in March 1986, determined a sum of Rs.126.56 lakhs as refundable to the assessee which included interest of Rs.42.88 lakhs payable to him for excess payment of advance tax. The refund was paid by adjustment against the demand for the assessment year 1980-81 on 17 April 1986. Accordingly, the interest of Rs.42.88 lakhs accruing to the assessee in April 1986 would be the income of the assessee for the assessment year 1987-88. This was not included in the computation of income for the assessment year 1987-88. There was thus excess determination and carry forward of loss to that extent with potential tax effect of Rs.22.51 lakhs.

(iii) In the assessment of a non-resident company for the assessment year 1987-88, completed

in March 1990, a sum of Rs.62.92 lakhs received from other sources was not considered in the computation of business income. The omission resulted in under-charge of tax of Rs.18.88 lakhs.

Ministry of Finance have accepted the audit observation.

2. It was seen (February, 1991) in audit of the assessment records of a public limited company that the assessing officer had received an intimation in February 1987 from another officer of the department to the effect that the assessee had received a refund of Rs.32.77 lakhs on account of sales tax during the previous year relevant to the assessment year 1988-89. However, this amount was not credited to the profit and loss account in the relevant accounting period, nor was it brought to tax in the assessment completed in March 1989. Omission on the part of the assessing officer to bring it to tax resulted in the escapement of income of Rs.32.77 lakhs for the assessment year 1988-89 leading to short levy of tax of Rs.17.20 lakhs.

3. In the previous years relevant to the assessment years 1986-87 and 1987-88, a private limited company following mercantile system of accounting had accrued income from interest and carrying charges aggregating Rs.59.76 lakhs from two companies following the same method of accounting. In the assessments of the paying companies, interest and carrying charges debited to the respective profit and loss accounts were allowed on accrual basis as provided under the Act. However, income from interest and carrying charges was not assessed in the relevant previous years in respect of the assessee company on accrual basis. The omission to do so in the assessments of the assessee company completed in March 1989 and March 1990 resulted in aggregate under-assessment of income of Rs.59.76 lakhs in the assessment years 1986-87 and 1987-88 involving a potential undercharge of tax of Rs.36.71 lakhs.

Ministry of Finance have accepted the audit observation.

B-Summary Assessment

1. It has been judicially* held that taxes forming part of sale consideration of goods sold in the course of business constitute trading receipts and is to be included in the total

* Chowringhee Sales Bureau Pvt.Ltd. Vs.CIT W.B.(87-ITR-542)

income. If and when the assessee pays the amount so collected to the Government or refunds the same to the customers, the assessee would be entitled to claim deduction of the sum so paid or refunded.

The assessment of a widely held company for the assessment year 1986-87 was completed under the summary scheme in March 1989 accepting the loss of Rs.337.64 lakhs as computed by the assessee. It was, however, noticed (July 1990) in audit that the amount of sales turnover credited to profit and loss account of Rs.17.07 crores was exclusive of excise. This was irregular and it resulted in potential short levy of Rs.26.37 lakhs.

The department has accepted the audit observation.

2. Under the provisions of the Income Tax Act, 1961, cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India is taxable under the head `Profits and gains of business or profession' from the assessment year 1967-68.

During the previous year relevant to the assessment year 1989-90, an assessee company received an amount of Rs.26.85 lakhs towards cash compensatory support from government against export which was deducted from total receipt of the company while computing profits, on the ground that it was a capital receipt. The receipts towards cash compensatory support was required to be included in the total income of the assessee as export incentives are taxable under the head profits and gains of business as per provisions of the Act. Omission to do so resulted in under assessment of income of Rs.26.85 lakhs involving potentital short levy of tax of Rs.14.10 lakhs. Further, additional tax of Rs.2.82 lakhs was also required to be levied.

3. Under the provisions of the Income Tax Act, 1961, the profit and gains of any business or profession which is carried on by an assessee at any time during the relevant year is chargeable to tax under the head `profits and gains of business or profession.

In the previous year relevant to the assessment year 1990-91, a private limited company received payments aggregating Rs.70.55 lakhs on account of execution of contracts as per certificate of deduction of tax at source. Against this, receipts amounting to Rs.52.85 lakhs only were accounted

for while framing assessment in the summary manner in March 1991. This resulted in short accountal of income by Rs.17.70 lakhs with consequent under assessment of tax by Rs.13.02 lakhs. Further, additional tax of Rs.2.60 lakhs was also required to be levied.

Incorrect set off of carry forward of loss

3.20 Under the provisions of the Income Tax Act, 1961, the amount of business loss including depreciation, which has been determined in assessment can be carried forward to be set off against future income.

A- Scrutiny Assessment

1. In the assessment of a public limited company for the assessment year 1988-89, completed in March 1991, the assessing officer allowed set off of business loss of Rs.5.89 crores relating to the assessment year 1980-81 and allowed carry forward of unabsorbed business loss of Rs.29.86 crores relating to the same assessment year. This loss was set off before set off of current depreciation allowance of Rs.129.79 crores. As there was no income left after set off of current depreciation, the unabsrobed loss relating to the assessment year 1980-81 was not admissible for set off in the assessment year 1988-89 and the same became barred by limitation for set off beyond the assessment year 1988-89. Further, the assessing officer allowed an aggregate carry forward of earlier year's losses (inclusive of unabsorbed depreciation) of Rs.790.21 crores and current year's unabsorbed depreciation of Rs.129.79 crores, as claimed by the assessee in its return of income. However, on verification of the assessment records of the earlier assessment years, the correct brought forward loss was found to be Rs.682.21 crores only. Thus excess loss of Rs.108.00 crores was allowed to be carried forward. Moreover, profit of Rs.5.89 crores was determined for the assessment year 1988-89 before allowance of depreciation and as such, unabsorbed depreciation of Rs.123.90 crores only (Rs.129.79 crores - Rs.5.89 crores) for the current year could be carried forward. The consequent carry forward of incorrect amount of loss and unabsorbed depreciation, aggregating Rs.113.89 crores involved potential tax effect of Rs.61.50 crores.

Ministry of Finance have accepted the audit observation.

2. No loss under the head `Profits and gains of business or profession' is allowed to be carried forward from 1 April 1985 for set off unless the

assessee had filed the return of loss voluntarily within the due date or within such further time as may be allowed by the Income tax Officer.

(i) The regular assessment of a widely held company for the assessment year 1982-83 was completed in March 1985, determining the taxable income as `Nil' after adjusting carried forward business loss of Rs.4.47 crores and unabsorbed depreciation of Rs.1.14 crores relating to assessment years 1980-81 and 1981-82. The assessment was modified in June 1987, but there was no change in the computation of income or set off already allowed in the original assessment in March 1985. Scrutiny of the assessment records of assessment years 1980-81 and 1981-82 revealed that in the assessments for these two years made in September 1983 and September 1984 respectively, no business loss was assessed in either of these years to be carried forward for set off. Thus the set off of business loss of Rs.4.47 crores allowed in the assessment year 1982-83 was not in order. However, in the assessment year 1981-82 unabsorbed depreciation of Rs.1.56 crores was allowed to be carried forward for set off in the assessment year 1982-83 and in addition, there was a balance amount of Rs.77.37 lakhs available, on account of unabsorbed investment allowance and relief in respect of newly established business undertaking which could have been set off in the assessment year 1982-83. The income of the assessee for the assessment year 1982-83 should, therefore, have been assessed at Rs.3.28

crores after setting off the above unabsorbed allowances of Rs.1.56 crores and Rs.77.37 lakhs. The mistake resulted in under-assessment of income of Rs.3.28 crores involving short levy of tax of Rs.1.94 crores.

The department has accepted the audit observation.

(ii) The assessment of a public limited company for the assessment year 1986-87 was completed in March 1989 at a total loss of Rs.200.57 lakhs (unabsorbed depreciation of Rs.24.54 lakhs and business loss of Rs.176.03 lakhs) which was allowed to be carried forward. Scrutiny of the assessment records revealed(March 1990) that the return of income was filed late on 28 July 1987 as against the due date of 31 July 1986. Since the return of income was not filed within the prescribed time, the benefit of carry forward of business loss (included in the total assessed loss) was not available to the assessee. Incorrect

carry forward of loss of Rs.176.03 lakhs resulted in potential short levy of tax of Rs.92.41 lakhs.

3. Under the Income Tax Act, 1961, where for any assessment year, the net result of computation under the head `Profits and gains of business and profession' is a loss to the assessee, not being a loss sustained in speculation business, and such loss cannot be or is not wholly set off against income under any head, so much of the loss as has not been set off shall, subject to other provisions of the Act, be carried forward for adjustment in 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 private limited company for the assessment year 1987-88 was completed at a business loss of Rs.243.06 lakhs and unabsorbed depreciation Rs.47.70 lakhs in March 1990. In the assessment, the assessing officer allowed carry forward of unabsorbed business loss and depreciation of Rs.239.81 lakhs for the earlier assessment years 1984-85 and 1985-86 for set off in the subsequent years. Audit scrutiny revealed (December 1991) that out of the above carried forward loss for the assessment year 1984-85 and 1985-86, a sum of Rs.207.29 lakhs including a portion of unabsorbed depreciation, was set off in June 1989 against the positive income of the assessment year 1986-87. Thus, unabsorbed depreciation of Rs.32.52 lakhs only was available for carry forward and set off in the subsequent years in place of Rs.239.81 lakhs actually carried forward by the department. Thus, the sum of Rs.207.29 lakhs, was wrongly allowed to be carried forward for set off against future profits involving a potential tax effect of Rs.114.01 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The assessment of a closely held company, for the assessment year 1990-91 was processed in a summary manner in March 1991 and was later assessed after scrutiny in September 1991, computing a loss of Rs.265.94 lakhs, which was allowed to be carried forward. This included carry forward of loss of Rs.249.17 lakhs (including unabsorbed depreciation of Rs.6.03 lakhs). Audit scrutiny revealed(January 1992) that the said carried forward loss of Rs.249.17 lakhs included

unabsorbed business loss of Rs.243.14 lakhs, of which loss of Rs.119.42 lakhs pertained to the assessment years 1974-75 to 1982-83, the carry forward of which had lapsed in the assessment year 1990-91. As such further carry forward of the said loss beyond the assessment year 1990-91 was irregular. There was thus excess carry forward of loss of Rs.119.42 lakhs with consequent potential tax effect of Rs.70.93 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) The assessment of a company for the assessment year 1988-89 was completed in February 1991, computing taxable income at Rs.49.19 lakhs under the special provisions of the Act. While computing the income under the normal provisions of the Act, the company was allowed unabsorbed loss and depreciation of earlier years aggregating Rs.583.30 lakhs. It was seen in audit that the total of unabsorbed depreciation and losses allowed by the department correctly worked out to Rs.533.30 lakhs only. The excess set off resulted in erroneous carry forward of unabsorbed losses of Rs.50.00 lakhs leading to notional short levy of tax of Rs.26.25 lakhs.

Ministry of Finance have accepted the audit observation.

(iv) In the assessment of a company for the assessment year 1986-87, completed in February 1991, the assessing officer computed the losses to be carried forward at Rs.87.15 lakhs which comprised unabsorbed depreciation of Rs.54.70 lakhs and business loss of Rs.32.45 lakhs. However, in the assessment order, besides the unabsorbed depreciation of Rs.54.70 lakhs, an amount of Rs.66.87 lakhs was allowed to be carried forward as business loss instead of Rs.32.45 lakhs. The excess carry forward of losses of Rs.34.42 lakhs resulted in potential short levy of tax of Rs.18.93 lakhs.

Ministry of Finance have accepted the audit observation.

(v) In its assessment for the assessment year 1986-87 a private limited company claimed set off of a loss of Rs.7.83 lakhs suffered from forest business against the net income of Rs.6.10 lakhs arrived at after considering a deduction of Rs.2.03 lakhs under section 80I of the Income Tax Act, 1961, against the income of Rs.8.14 lakhs

from industrial undertaking and disclosed loss of Rs.1.72 lakhs in the assessment return. The set off was also allowed by the assessing officer. During the course of Audit scrutiny of assessment records in April 1990, it was noticed that the loss related to the assessment year 1985-86 as the fire in the forest causing the loss had broken out on 29 March 1985 and therefore its set off was not allowable during assessment year 1986-87. The assessee had not claimed such loss for the assessment year 1985-86 and as such it was not entitled to claim its set off during the following year. The omission led to under charge of tax of Rs.2.86 lakhs.

Ministry of Finance have accepted the audit observation.

4. Under the provisions of Income Tax Act, 1961, as amended by the Finance Act 1978 with effect from assessment year 1978-79, where there has been an amalgamation of company owning an industrial undertaking with another company and the Central Government, on the recommendation of the specified authority, is satisfied that certain conditions specified in this behalf are fulfilled, it may make a declaration to that effect and thereupon the accumulated loss or unabsorbed depreciation of the amalgamating company should be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which amalgamation was effected and other provisions of the Act relating to carry forward and set off of loss and allowance for depreciation would apply accordingly.

A sick unit engaged in the manufacture of electronic insulators was amalgamated with a closely held company in June 1985. The assessment of the amalgamated company for the assessment year 1987-88 was completed in March 1990 on a taxable income of Rs.12.29 lakhs. In the assessment, the loss of Rs.30.04 lakhs relating to the amalgamating company was allowed as deduction. Audit scrutiny revealed (June 1990) that the declaration of the Central Government on the recommendation of the specified authority approving the scheme of amalgamation had not been received. The set off was therefore incorrect and it resulted in short levy of tax of Rs.25.91 lakhs (including interest for non-filing of estimate for advance tax).

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

1. Under the provisions of Income Tax Act, 1961, where for any assessment year the net result of computation under the head `Profits and gains of business or profession' is a loss to the assessee, not being a loss sustained in speculation business, and such loss cannot be or is not wholly set-off against income under any head of income, so much of the loss as has not been set-off shall, subject to other provisions of the Income Tax Act, be carried forward for adjustment in the following assessment year. The amended provision of the Summary assessment scheme were applicable with effect from 1 April 1989. Under the amended provisions, adjustments shall be made to the income of the assesses inter-alia in regard to any loss, carry forward, deduction allowance or relief which is prima facie admissible or inadmissible. Though the provisions of the Act required adjustments to be made on account of brought forward losses and allowances which need reference to assessment records of earlier years', these could not carried out on account of executive instructions issued by the Board in Instruction No.1814 dated 4 April 1989 which barred such reference to earlier records.

(i) The assessment of a public limited company for the assessment year 1989-90, originally completed in September 1990 in a summary manner, was revised in March 1991 at a total loss of Rs.3467.90 lakhs including past year's business losses and unabsorbed depreciation. Out of total brought forward losses including unabsorbed depreciation, a sum of Rs.905.56 lakhs relating to assessment year 1987-88 was claimed and allowed to be carried forward in the above assessment year. Assessment records for the assessment year 1987-88 however, indicated that total loss assessed for that year in the assessment completed in March 1989 in a summary manner was only Rs.373.07 lakhs. There was thus excess computation and carry forward of loss of Rs.532.49 lakhs in the assessment year 1989-90 which was not withdrawn even in the assessment as revised subsequently in March 1991, This led to potential revenue effect of Rs.279.56 lakhs. Further, additional tax of Rs.55.91 lakhs was also required to be levied.

(ii) A widely held company filed its return of income for the assessment year 1990-91 admitting a loss of Rs.1536.80 lakhs and claiming carry forward of unabsorbed losses of earlier years aggregating Rs.4,392.62 lakhs. This was accepted under the summary assessment scheme and an intimation sent in February 1991. Audit scrutiny

revealed that the carried forward losses claimed included, inter alia, an aggregate sum of Rs.184.17 lakhs towards unabsorbed business loss, investment allowance and development rebate relating to the assessment years 1973-74, 1974-75 and 1981-82 which had already lapsed due to time limit. It should therefore have been disallowed as a prima facie inadmissible item on the basis of the information filed by the assessee with the return. Omission to do so resulted in an excess carry forward of loss of a like amount involving a potential tax effect by Rs.99.45 lakhs. Further, additional tax of Rs.19.89 lakhs was also require to be levied.

The department has accepted the audit observation.

(iii) In the assessment of a company for the assessment year 1990-91, completed in March 1991 under the summary assessment scheme, the assessee company was allowed to carry forward unabsorbed depreciation of Rs.1683 lakhs, investment allowance of Rs.416 lakhs, and business loss of Rs.54 lakhs, relating to the earlier assessment years as claimed. It was seen from the assessment order for the assessment year 1989-90, completed in March 1991, that the assessee company was entitled to carry forward unabsorbed depreciation of Rs.1621 lakhs and investment allowance of Rs.389 lakhs only. The incorrect allowance resulted in excess carry forward of unabsorbed depreciation of Rs.62 lakhs, unabsorbed investment allowance of Rs.27 lakhs and unabsorbed business loss of Rs.54 lakhs involving potential short levy of tax of Rs.77.00 lakhs. Further, additional tax of Rs.15.40 lakhs was also required to be levied.

(iv) The assessment of a public limited company, for the assessment year 1989-90, was completed in a summary manner in August 1990, at a loss of Rs.3601.71 lakhs, against the returned loss of Rs.3613.99 lakhs, which was allowed to be carried forward. The above loss, **inter-alia,** included brought forward unabsorbed business loss and investment allowance of Rs.133.86 lakhs and Rs.7.36 lakhs respectively relating to assessment year 1981-82. The unabsorbed business loss of Rs.133.86 lakhs and unabsorbed investment allowance of Rs.7.36 lakhs had already lapsed at the end of the assessment year 1989-90, being the last year for set off. Therefore, the total loss computed for the assessment year 1989-90 for being carried forward for set off against future profits should have been reduced by the aforesaid sums. Failure to do so resulted in excess computation of

loss of Rs.141.22 lakhs involving potential tax effect of Rs.74.14 lakhs. Further, additional tax of Rs.14.83 lakhs was also required to be levied.

(v) The total income of a public limited company for the assessment year 1989-90 was computed in a summary manner in June 1990 at a loss of Rs.329.86 lakhs as per return, which included brought forward losses of Rs.216.98 lakhs comprising unabsorbed business loss of Rs.95.95 lakhs, Rs.7.22 lakhs and Rs.56.24 lakhs for assessment years 1985-86, 1987-88 and 1988-89 respectively and also unabsorbed depreciation of Rs.35.57 lakhs and Rs.22 lakhs for the assessment years 1987-88 and 1988-89 respectively. It was noticed from the assessment order for assessment year 1988-89 (dated 14 February 1991) that the total income was computed at a loss of Rs.16.36 lakhs representing unabsorbed depreciation and the same alongwith the unabsorbed business loss of Rs.44.59 lakhs only for the assessment year 1985-86 was allowed to be carried forward. Therefore, the assessee company was entitled to carry forward business loss aggregating to Rs.60.95 lakhs and not Rs.216.98 lakhs as claimed in the return of income for assessment year 1989-90. The assessment for the assessment year 1989-90 should, therefore, have been revised after completion of assessment for the assessment year 1988-89 in February 1991 and the assessed loss for the assessment year 1989-90 should have been reduced accordingly. But this was not done even when the assessment for the assessment year 1989-90 was revised in April 1991. The omission led to excess computation of loss by Rs.156.03 lakhs, with consequent excess carry forward of losses by identical amount in the assessment year 1989-90 involving potential tax effect of Rs.81.91 lakhs. Further, additional tax of Rs.16.38 lakhs was also required to be levied.

(vi) The assessment of closely held company for the assessment year 1989-90 was completed in a summary manner in June 1990 computing net income at Rs.59.79 lakhs as per assessees' computation, out of which a sum of Rs.8.78 lakhs was taxed as 30 percent of adjusted book profit of Rs.29.27 lakhs. The balance income of Rs.51.01 lakhs was set off against unabsorbed losses of a company since amalgamated with the assessee company. Further losses aggregating Rs.73.73 lakhs including loss of Rs.10.36 lakhs suffered by the assessee company itself in the assessment year 1988-89 was carried forward. It was, however, noticed from the assessment order for the assessment years 1986-87 to 1988-89 that the

assessee company's claim for set off of losses of the amalgamating company out of the income of those assessment years was disallowed by the assessing officer as formal notification to that effect, as required under the provisions of the Act, had not been issued by the Central Government. Consequently in the absence of such notification even in the previous year relevant to the assessment year 1989-90, the set-off of Rs.51.01 lakhs allowed in respect of the loss of the amalgamated company was not in order. Hence, instead of being levied minimum tax on book profit and allowed set-off of unabsorbed losses of the amalgamating unit, the assessee company was required to be assessed on a total income of Rs.49.43 lakhs after allowing a set-off of Rs.10.36 lakhs in respect of the carried forward loss of its own business pertaining to the assessment year 1988-89. The incorrect set-off led to under assessment of income of Rs.40.65 lakhs and undercharge of tax of Rs.34.74 lakhs (including additional tax of Rs.4.70 lakhs for under statement of income in the return filed and interest of Rs.6.57 lakhs for short payment of advance tax). Similarly the irregular carry forward of loss of Rs.73.73 lakhs in the assessment order for 1989-90 had a potential tax effect of Rs.42.58 lakhs.

(vii) The assessment of a company for the assessment year 1989-90 was completed in June 1990 under summary assessment scheme accepting the returned loss of Rs.63.47 lakhs which included brought forward unabsorbed depreciation and business loss aggregating Rs.59.02 lakhs pertaining to the assessment years 1987-88 and 1988-89. However, it was seen from the assessment orders of the assessment years 1987-88 and 1988-89 that unabsorbed depreciation to the extent of Rs.4.11 lakhs only remained to be carried forward to the subsequent assessment years. The excess allowance resulted in excess computation of loss of Rs.54.91 lakhs leading to notional short levy of tax of Rs.34.59 lakhs. Further, additional tax of Rs.6.92 lakhs was also required to be levied.

(viii) The assessment of a public limited company for the assessment year 1989-90 was completed in the summary manner in June 1990 at a loss of Rs.23.78 crores which included brought forward unabsorbed losses relating to earlier assessment years from 1981-82 to 1988-89. It was noticed that out of the assessed loss of Rs.23.78 crores, losses of Rs.2.10 crores and Rs.2.43 crores related to assessment year 1987-88 and

1988-89 respectively. However, for the assessment years 1987-88 and 1988-89, the assessee company was assessed at losses of Rs.2.09 crores and Rs.2.04 crores respectively instead of Rs.2.10 crores and Rs.2.43 crores as claimed by the assessee company and brought forward in the assessment year 1989-90. The mistake resulted in excess computation of loss Rs.40.27 lakhs with consequent excess carry forward of losses by identical amount in the assessment year 1989-90 involving potential tax effect of Rs.21.14 lakhs. Further, additional tax of Rs.4.23 lakhs was also required to be levied.

2. No loss under the head `Profit and gains of business or profession' is allowed to be carried forward for set off unless the assessee has filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer.

(i) In the assessments of five companies, for the assessment year 1988-89 and 1989-90 completed in a summary manner in February 1989, June 1989, February 1990 and March 1990, loss of Rs.7353.30 lakhs was allowed to be carried forward for set off. It was noticed in audit that the returns of loss for the relevant assessment year were filed by the companies on November 1988, March 1989 and January 1990 instead of stipulated dates 30 June 1988, 31 July 1988 and 31 December 1989. The assessee companies did not apply for/were not allowed any extension of time or they did not apply for an extension of a time for filing of the return of loss for the assessment year 1988-89 and 1989-90. Since the returns of loss were not filed within the prescribed time, the benefit of carry forward of business loss was not available to the assessee companies. Thus there was excess carry forward of business loss of Rs.3737.86 lakhs involving potential undercharge of tax of Rs.1964.48 lakhs.

(ii) A private limited company filed a return of loss on 27 September 1988 for the assessment year 1988-89. The assessing officer assessed the loss at Rs.19.74 lakhs on 27 March 1991 and allowed it to be carried forward and set off from future profits. In the assessment for the assessment year 1989-90, out of the above sum of Rs.19.74 lakhs, a sum of Rs.18.64 lakhs was set off against the profit of the year. As the return for the assessment year 1988-89 was filed beyond the prescribed date, the benefit of carry forward of loss was not admissible to the assessee company.

The mistake resulted in erroneous carry forward of loss involving potential tax effect of Rs.15.93 lakhs (inclusive of non-levy of interest for non payment of advance tax).

(iii) The return of income for the assessment year 1988-89 filed by a private limited company in June 1988 was defective in as much as the statements of accounts for the relevant previous year had not been enclosed On the omission being pointed out by the assessing officer in February 1989, the assessee furnished (July 1989) copies of statements of accounts relating to the previous year 1988-89 instead of the previous year 1987-88. The return of income for the assessment year 1988-89, therefore, continued to be defective. Nevertheless, the assessing officer concluded a summary assessment (August 1989) accepting the claim of the assessee to carry forward the returned business loss of Rs.12.17 lakhs, unabsorbed depreciation allowance of Rs.7.42 lakhs and unabsorbed investment allowance of Rs.30.15 lakhs. As the return of income itself was defective, no assessment could be concluded and consequently the carry forward of amounts aggregating Rs.49.73 lakhs was irregular, involving a potential tax effect of Rs.28.72 lakhs. Further additional tax of Rs.5.74 lakhs was also required to be levied.

Ministry of Finance have accepted the audit observation.

Mistakes in assessments while giving effect to appellate orders

3.21 The assessment of a widely held company for the assessment years 1968-69 and 1969-70 were completed in March 1972 on taxable incomes of Rs.64.54 lakhs and Rs.28.76 lakhs respectively. In the reopened assessments, completed in March 1974 and March 1975, anticipated loss on exchange of Rs.9.20 lakhs and Rs.4.32 lakhs was disallowed. However, the assessments were revised in February 1975 and October 1977 with reference to the orders of the Appellate Tribunal allowing the deductions of Rs.9.20 lakhs and Rs.4.32 lakhs. The Tribunals decision was subsequently reversed by the High Court in April 1984. Audit scrutiny, however,revealed (July 1991) that no action was taken to revise the assessments to give effect to the orders of the High Court. The omission resulted in under assessment of tax of Rs.19.42 lakhs.

Incorrect exemptions and excess reliefs

Mistakes in allowing deduction under Chapter VI A

3.22 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 overriding condition is that the total deduction should not exceed the gross total income of the assessee. `Gross total income' has been defined in the Act as the total income computed in accordance with the provisions in the Act before making the deductions under Chapter VI-A. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to `nil' or to a loss, no deduction under Chapter VIA is admissible. Further with effect from the assessment year 1984-85, the aggregate amount of specified deductions in the case of companies is to be restricted to 70 percent of `pre-incentive total income' before allowing any specified deduction.

1(i) The assessments of a public limited company for the assessment years 1984-85 (modified) and 1987-88 were made in March 1988 and March 1989, determining pre-incentive income of Rs.38.72 lakhs and Rs.36.24 lakhs respectively. The assessee company was eligible for deduction of Rs.49.96 lakhs and Rs.65.81 lakhs towards investment allowance, donations, profits from newly established undertakings and export turnover. These deductions were limited to Rs.27.11 lakhs and Rs.25.37 lakhs being 70 percent of the pre-incentive total income and the taxable income was computed at Rs.11.62 lakhs and Rs.10.87 lakhs respectively. The company was also allowed to carry forward of unadjusted balance of the aforesaid deductions amounting to Rs.19.30 lakhs and Rs.40.44 lakhs respectively. Audit scrutiny (January 1990) revealed that after limiting the aforesaid deductions to the gross total income of Rs.38.72 lakhs and Rs.36.24 lakhs, the maximum amount that could be allowed to be carried forward was Rs.11.62 lakhs and Rs.10.87 lakhs as against Rs.19.30 lakhs and Rs.40.44 lakhs allowed by the assessing officer. The mistake resulted in excess carry forward of Rs.37.25 lakhs involving aggregate potential tax effect of Rs.19.22 lakhs for the two years.

Ministry of Finance have accepted the audit observation.

(ii) In the revised assessment of a public limited company for the assessment year 1986-87, completed in August 1989, the assessing officer allowed deductions totalling Rs.25.89 lakhs under Chapter VI-A of the Act out of the income of Rs.57.47 lakhs computed before the adjustment of unabsorbed depreciation and investment allowance of earlier assessment years amounting to Rs.3.20 crores, determined the taxable income as nil and allowed the balance of unabsorbed depreciation and investment allowance of Rs.2.88 crores to be carried forward. The procedure adopted by the assessing officer was not in order as the unabsorbed depreciation and investment allowance of earlier years should have been adjusted first to determine the gross toal income and thereafter only, deductions under Chapter VI-A should have been allowed. In this case the gross total income after partial adjustment of unabsorbed depreciation and investment allowance aggregating Rs.3.20 crores would work out to `nil' and thus no deductions under Chapter VI-A were admissible. The incorrect allowance of deduction of Rs.25.89 lakhs under Chapter VI-A thus resulted in incorrect carry forward of unabsorbed depreciation and investment allowance to the same extent involving potential tax effect of Rs.13.59 lakhs.

Ministry of Finance have accepted the audit observation.

Incorrect allowance of relief in respect of export turnover

3.23 Under the Income Tax Act, 1961, with effect from the assessment year 1991-92 and onwards, an assessee being an Indian company or other assessee resident in India engaged in the export business of computer software and technology, is entitled to a deduction in the computation of taxable income of an amount equal to the profits derived by the assessee from the export of such computer software and technology. Similar deduction was already available in respect of export turnover of other goods or merchandise with effect from 1983-84. The intention of the new section 80 HHE is explained in the Explanatory Notes to the Finance Act, 1991, indicating that the new section confers benefits, hitherto available for export of goods and merchandise, on export of computer software and technology also with effect from the assessment year 1991-92.

A- Scrutiny Assessment

Assessment of two companies in which public were not substantially interested, engaged in the business of export of computer software and technology, for the assessment years 1989-90 and 1990-91, were completed in March, 1991 with income

of Rs.1.20 lakhs and Rs.5.32 lakhs respectively. It was, however, noticed in audit that these companies had claimed deduction of Rs.21.56 lakhs and Rs.10.83 lakhs respectively representing profits on export turnover of computer software and technology under section 80 HHC. As the provision for grant of deduction on export turnover of computer software and technology came into effect from the assessment year 1991-92, deduction for the earlier assessment years 1989-90 and 1990-91 was not admissible. The incorrect deduction resulted in aggregate short demand of tax of Rs.20.85 lakhs.

B- Summary Assessment

Under the Income Tax Act, 1961, an assessee, being an Indian Company or other assessee resident in India, engaged in the export business is entitled to a deduction in the computation of taxable income of the profit derived from the export of all goods and merchandise other than those specified in the Act, if the sale proceeds thereof were receivable in convertible foreign exchange. For this purpose, in a case where the business carried on by the assessee does not consist exclusively of export out of India of goods and merchandise, the profits derived from export of such goods and merchandise shall be the amount which bears to the profits of the assessee as computed under the head 'profit and gains of business or profession' the same proportion as the amount of export turnover bears to the total turnover of the business carried on by the assessee.

In the assessment of a public limited company for the assessment year 1989-90, completed in a summary manner in September 1990, the assessee was allowed a deduction of Rs.172.25 lakhs in respect of export profits as per computation filed by the assessee. From the computation it appeared that the assessee derived a business income of Rs.72.36 crores from the total turnover of Rs.2249.10 crores which included export turnover of Rs.53.54 crores. But the credit side of the trading accounts of the company relevant to the assessment year 1989-90 showed, besides sales figure of Rs.2249.10 crores (total turnover), an item of other income of Rs.18.98 crores comprising miscellaneous income of Rs.9.35 crores and income of Rs.9.63 crores from investment. While income from investment of Rs.9.63 crores was deducted from business income for separate consideration,

the miscellaneous income of Rs.9.35 crores stood included in the business income of Rs.72.36 crores. Since the miscellaneous income of Rs.9.35 crores had no relation with the profit derived from export turnover, the same should have been deducted from business income before calculating the proportionate income from export turnover. Thus in determining the export incentive deduction, the business income derived from total turnover of Rs.2249.10 crores should have been taken at Rs.63.01 crores instead of Rs.72.36 crores. The allowable deduction on account of profits from export turnover of Rs.53.54 crores would thus work out to Rs.150 lakhs instead of Rs.172.25 lakhs allowed by the assessing officer. The mistake resulted in excess allowance of deduction of Rs.22.25 lakhs leading to under-assessment of income by the identical amount involving undercharge of tax of Rs.11.68 lakhs and additional tax of Rs.2.34 lakhs for under statement of income in the assessment year 1989-90.

Ministry of Finance have not accepted the audit observation stating that the assessment was completed under Summary Assessment Scheme. Since the correct deduction could have been worked out from the documents & accounts attached to the return of income, this is a case of failure to carry out the prescribed adjustment.

Incorrect deduction in respect of profits from new industrial undertaking established after 31 March 1981.

3.24 Under section 80-I of the Income Tax Act, 1961, where the gross total income of an assessee, being a company, includes any profits and gains derived from an industrial undertaking which goes into production within a period of nine years next following 31 march 1981, the assessee is entitled to a deduction of twenty five percent of such profits and gains for a period of eight years including the year in which the assessee begins to manufacture or produce articles or things. Where the assessee is also entitled to deduction under section 80-HH in respect of profits and gains from newly established industrial undertaking in backward areas in addition to the above mentioned deduction, deduction under section 80-I is to be computed after reducing the deduction allowed under section 80HH.

In the assessments of a closely held company for the assessment years 1988-89 to 1990-91, deductions were allowed to the tune of Rs.6.28 lakhs, Rs.57.89 lakhs and Rs.64.64 lakhs respectively in respect of profits and gains from new industrial undertaking established after 31

March 1981. The assessee was also allowed deduction in respect of profits and gains from newly established industrial undertaking in backward areas. As the assessee was entitled to both the deductions, deduction in respect of profits and gains from new industrial undertaking established after 31 March 1981 was to be allowed on the gross total income as reduced by the deduction in respect of profits and gains from newly established industrial undertaking in backward areas. Accordingly, the assessee was entitled to the deduction of Rs.5.02 lakhs, Rs.46.31 lakhs and Rs.51.71 lakhs as against Rs.6.28 lakhs, Rs.57.89 lakhs and Rs.64.64 lakhs allowed by the department. The mistake resulted in excess allowance of deductions aggregating Rs.25.77 lakhs involving short levy of tax of Rs.18.28 lakhs (including additional income tax of Rs.2.87 lakhs and interest for short payment of advance tax for the assessment year 1988-89).

Incorrect allowance of deduction in respect of profits from newly established Industrial Undertaking (prior to 31 March 1981)

3.25 Under the provisions of the Income Tax Act, 1961, prior to its amendment by Fianance Act, 1980 with effect from assessment year 1981-82, where the gross total income of an assessee included any profits and gains derived from a newly established industrial undertaking which went into production before 1 April 1981, the assessee becomes entitled to tax relief in respect of such profits and gains upto 6 per cent per annum (7.5 per cent from 1st April 1976) of the capital employed in the undertaking, in the assessment year in which the undertaking began to manufacture or produce articles and in each of the four succeeding assessment years. Where, however, such profits and gains fall short of the relevant amount of the capital employed during the previous year, the amount of such shortfall or deficiency was to be carried forward and set off against future profits upto the seventh assessment year reckoned from the end of the initial assessment year.

A- Scrutiny Assessment

In the assessment of a public limited company, engaged in the business of manufacture and production of priority items, for the assessment years 1987-88 and 1988-89 completed in June 1989, the assessee claimed and was allowed the carry forward of the deficiency of tax holiday relief at the rate of six percent of the capital employed in the assessment years 1982-83 to 1984-85 amounting to Rs.18.87 lakhs, out of which, relief of Rs.4.94 lakhs was claimed for the previous year relevant to the assessment year 1984-85. This relief was allowed to be carried forward for set off against

the income of subsequent years. It was, however, noticed (August 1990) in audit that the assessee comapny was allowed this relief for the first time in the previous year relevant to the assessment year 1979-80. Under the provisions of the Act, it was not admissible beyond the assessment year 1983-84 and the relief could not be carried forward beyond the assessment year 1986-87. Thus the relief of Rs.4.94 lakhs was incorrectly allowed and the entire relief of Rs.18.87 lakhs including Rs.4.94 lakhs was incorrectly allowed to be carried forward in assessment years 1987-88 and 1988-89 Besides, the assessee was allowed a deduction of Rs.9 lakhs towards newly established industrial undertaking in backward areas in precedence to carried forward unabsorbed depreciation and investment allowance. After adjustment of unabsorbed depreciation allowance etc., no income was left for adjustment, and as such no depreciation on this account was admissible. There was further mistake of Rs.0.75 lakhs in allowing terminal depreciation and donations also. These mistakes resulted in excessive carry forward of relief and loss to the extent of Rs.28.62 lakhs involving potential short levy of tax of Rs.14.42 lakhs (including positive tax effect of Rs.11,250).

Ministry of Finance have partly accepted the audit observation.

B-Summary Assessment

The assessment of an Indian company for the assessment year 1989-90 was completed in March 1990 at a loss of Rs.637.46 lakhs. Audit scrutiny revealed (October 1990) that the loss included Rs.27.29 lakhs being unabsorbed deficiency of new industrial undertaking for the assessment years 1980-81 to 1984-85, which could have been carried forward only upto assessment year 1987-88. The mistake resulted in excess computation of loss by Rs.27.29 lakhs involving potential tax effect of Rs.14.33 lakhs. Further, additional tax of Rs.2.87 lakhs was also required to be levied.

Incorrect allowance of deduction in respect of inter-corporate dividend

3.26 Under the Income Tax Act, 1961, in the case of a domestic company where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed a deduction at sixty percent of such income. However, the deduction shall not in any case exceed the gross total income of the assessee.

A- Scrutiny Assessment

During the previous year relevant to the assessment year 1987-88, a domestic company received dividend income of Rs.14.25 lakhs from the Unit Trust of India and claimed deduction of Rs.8.55 lakhs (being 60 percent of Rs.14.25 lakhs). However, in the assessment completed in March 1990, the assessing officer wrongly allowed deduction of Rs.46.82 lakhs in respect of dividends. As deduction of Rs.8.55 lakhs only was allowable, the mistake resulted in under assessment of income of Rs.38.27 lakhs involving short levy of tax of Rs.30.25 lakhs (including Rs.9.20 lakhs leviable for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

A widely held company was assessed in a summary manner for the assessment year 1989-90 in April 1990 at a loss of Rs.129.53 lakhs. The company had incurred a business loss of Rs.153.86 lakhs and earned a dividend income of Rs.60.16 lakhs during the relevant previous year. The loss of Rs.129.53 lakhs was arrived at after allowing an incentive deduction of Rs.36.10 lakhs (being 60 percent of the dividend income of Rs.60.16 lakhs), from the business loss alongwith certain other adjustments. The incentive deduction was allowed although the assessee company had no positive income. Since the gross total income of the assessee company was `Nil' even after setting off the whole of the dividend income of Rs.60.16 lakhs, the allowance of incentive deduction of Rs.36.10 lakhs was irregular. The mistake resulted in excess carry forward of business loss by an identical amount involving a potential undercharge of tax of Rs.18.95 lakhs and consequent non levy of additional tax of Rs.3.79 lakhs. Refund of Rs.30.01 lakhs made to the assessee company for excess payment of taxes, including interest of Rs.4.20 lakhs, was also required to be limited to Rs.26.22 lakhs (Rs.30.01 lakhs minus Rs.3.79 lakhs only after adjustment of above additional tax).

Ministry of Finance have accepted the audit observation.

Deduction in respect of royalties etc. from certain foreign enterprises

3.27 Under the Income Tax Act, 1961, where the gross total income of an assessee, being an Indian company, includes any income by way of royalty, fee or any similar payment received from the government of a foreign state or a foreign enterprises in consideration for the use outside India of any patent, invention, model, design,

copy right secret formula or process or similar property right or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided to such government or enterprises by the assessee, or in consideration of technical services rendered or agreed to be rendered outside India to such government or enterprises by the assessee under an agreement approved in that behalf and such income is finally received in covertible foreign exchange in India in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange, a deduction of an amount equal to fifty percent of the income so received in, or brought into India is allowable in computing the total income of the assessee. The deduction allowable is determined with reference to the net income and not on the gross income from such receipts.

B- Summary Assessment

1(i) A private limited company filed its return of income for the assessment year 1989-90 showing total income at Rs.Nil after adjustment of a deduction of Rs.73.99 lakhs claimed in respect of fees received in foreign currencies from services rendered outside India. The assessee calculated the deduction admissible as Rs.286.74 lakhs being 50 percent of gross receipt of Rs.573.49 lakhs, but limited the deduction to Rs.73.99 lakhs, his total income. The assessing officer did not consider the computation of the deduction claimed and completed the assessment in a summary manner in January 1990 invoking the provision of the Act relating to levy of minimum tax on 30 percent of book profit. Consequently tax of Rs.17.65 lakhs was levied on Rs.30.57 lakhs (30 percent of book profit of Rs.101.89 lakhs) and a sum of Rs.19.18 lakhs was refunded to the assessee including interest of Rs.2.49 lakhs. The details of computation, however, revealed that the assessee company had worked out the deduction on the basis of gross receipts in foreign currencies (Rs.573.49 lakhs) in place of net receipts. The net receipt would come to Rs.16.96 lakhs after adjustment of proportionate expenses (Rs.556.53 lakhs) debited to the profit and loss account against such receipts (Rs.573.49 lakhs). Accordingly a sum of Rs.8.48 lakhs (50 percent of Rs.16.96 lakhs) only was available as deduction in place of Rs.73.99 lakhs. Hence, instead of invoking the provision relating to levy of minimum tax on book profits, the total income was computable at Rs.65.51 lakhs (Rs.73.99 lakhs- Rs.8.48 lakhs). As total income

was computed at Rs.30.57 lakhs, there was underassessment of income of Rs.34.95 lskhs involving short levy of tax of Rs.20.18 lakhs. Interest of Rs.2.49 lakhs allowed on the refundable sum determined earlier was also irregular. Further, additional tax of Rs.4.04 lakhs was also required to be levied.

(ii) An assessee company computed its total income at Rs.19.90 lakhs under the normal provisions of the Act for the assessment year 1989-90. As the amount calculated at 30 percent of the book profit was Rs.23.28 lakhs, the assessee offered it for taxation as provided in the Act. The assessment was completed in February 1990 under the summary assessment scheme. While computing the income under the normal provisions of the Act, the assessee company had claimed a deduction of Rs.43.15 lakhs towards income earned from foreign enterprises. It was seen in audit that the company had worked out the expenditure incurred for earning the income from foreign enterprises as Rs.155 lakhs instead of the correct amount of Rs.198 lakhs. The incorrect computation resulted in claiming excess deduction by Rs.21.32 lakhs. The correct amount of income under normal provisions of the Act thus worked out to Rs.41.22 lakhs, against Rs.23.28 lakhs offered for taxation under the special provisions of the Act. Consequently there was under assessment of income of Rs.17.94 lakhs involving short levy of tax of Rs.12.43 lakhs (including additional tax of Rs.2.07 lakhs).

Ministry of Finance have accepted the audit observation.

Irregular allowance of double taxation relief

3.28 Under the Double Taxation Avoidance agreement between India and Japan, where a resident enterprise of Japan derives profit through shipping operation in India, the tax leviable on such profit in India shall be reduced by an amount equal to 50 percent thereof provided the income so charged to tax in India is also charged to tax in Japan. The agreement further provides that the amount of tax paid in Indian income shall be allowed credit against tax payable in Japan. Further, it has been judicially* held that in order to get the benefit of double taxation, income assessed to tax in one country is required to be assessed in the other country as well.

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* CIT Bombay Vs. New Citizen Bank (58-ITR-468)
CIT Madras Vs. Indian Bank Ltd. (61-ITR-631)

A. Scrutiny Assessment

In the assessment of two non-resident shipping companies for the assessment years 1986-87 to 1989-90, completed/revised between September 1989 and November 1990 and January 1991, deductions aggregating Rs.238.48 lakhs, being 50 percent of the income tax levied in India on Indian income, were allowed as per the Double Taxation Avoidance agreement exisitng between the two countries. Audit scrutinty revealed that the companies, incurred world losses for all these assessment years and as such, were not taxed in Japan, As the Companies suffered world losses in the respective assessment years, the Indian income of the relevant years also did not suffer any tax in Japan. There was, thus no double taxation of the same income and granting of 50 percent deduction from Indian income tax as per Double Taxation Avoidance Agreement was irregular. The mistake led to undercharge of tax of Rs.342.05 lakhs (including interest for short payment of advance tax and non filing of estimate of advance tax).

Ministry of Finance have accepted the audit observation in one case.

Non levy of minimum tax due to omission to restrict certain deductions in the case of companies

3.29 Under the Income Tax Act, 1961, as applicable to the assessment years 1984-85 to 1987-88, where in the case of a company the aggregate amount of deductions admissible under certain specified provisions of the Act exceeds seventy percent of the amount of the total income, the amount to be deducted is restricted to seventy percent of the total income.

In the assessment of a company for the assessment year 1986-87, completed in March 1991, the income was computed at `nil' after first allowing a deductions of Rs.107.37 crores in respect of current depreciation and Rs.37.07 crores on account of investment allowance for the current year and then allowing set off of carried forward unabsorbed depreciation allowance of earlier assessment years to the extent of profit of Rs.44.94 crores. However as per provision in the Act, after considering the current depreciation of Rs.107.37 crores and allowing set off of carried forward depreciation of 44.06 crores pertaining to earlier years, the deduction should have been restricted to seventy percent of total income of Rs.37.95 crores. This was not done and minimum tax on thirty percent of the pre-incentive income of Rs.37.95 crores was not levied. The omission resulted in non-levy of minimum tax of Rs.5.98 crores and interest of Rs.1.49 crores for delay in furnishing return.

Ministry of Finance have accepted the audit observation.

Mistake in the levy of minimum tax on book profits of companies

3.30 Under the Income Tax Act, 1961, where in the case of a company, other than a company engaged in the business of generation of electricity, the total income as computed under the Act in respect of any previous year relevant to the assessment years 1988-89 to 1990-91 is less than thirty percent of `book profit', the total income of such company chargeable to tax shall be deemed to be an amount equal to thirty percent of such `book profit'. This restriction is applicable even to cases where the computation of income under the normal provisions in the Act results in loss. In the computation of book profit, carried forward loss or unabsorbed depreciation of earlier years, whichever is less, is allowed to be set off.

B- Summary Assessment

1. The assessment of a widely held banking company for the assessment year 1989-90 was completed in a summary manner in June 1990 at `Nil' income and a carry forward of loss of Rs.2361.86 lakhs was allowed for set off in subsequent years' assessment. Assessment records indicated that the company had an adjusted book profit of Rs.862.81 lakhs, thirty percent of which was the minimum income chargeable to tax. The assessing officer failed to bring to tax the minimum income of Rs.258.84 lakhs (thirty percent of Rs.862.81 lakhs) which led to under assessment to that extent with consequent undercharge of tax of Rs.176.66 lakhs (including interest of Rs.40.76 lakhs for non payment of advance tax). Further, additional tax of Rs.27.18 lakhs was also required to be levied.

Ministry of Finance have accepted the audit observation.

2. The assessment of a public sector banking company for the assessment year 1989-90 was completed in January 1990 under the summary assessment scheme. As the income computed under the normal provisions of the Act resulted in a loss of Rs.122.06 crores, the bank computed the taxable income as Rs.204.13 crores as provided in the Act. However, instead of offering the amount of Rs.204.13 crores for taxation, the bank returned the loss of Rs.122.06 crores and the assessing officer accepted the returned loss. As the amount of Rs.204.13 crores was required to be brought to tax, the omission to do so resulted in under assessment of income of Rs.204.13 crores

leading to short levy of tax of Rs.145.44 crores (including interest of Rs.16.84 crores paid in excess for excess payment of advance tax and additional tax of Rs.21.44 crores).

3. Book profit has been explained in the Act as the net profit as shown in the profit and loss account for the relevant previous year as increased by the amount or amounts set aside for provisions made for meeting liabilities other than ascertained liabilities.

(i) The assessment of a nationalised bank for the assessment year 1990-91 was completed in March, 1991 in the summary manner computing income of Rs.1617.15 lakhs under the special provisions of the Act, being 30 percent of book profit of Rs.5390.50 lakhs. The income computed under the normal provisions of the Act was Rs.1399.42 lakhs. It was seen in audit that while computing the book profit, a provision made towards depreciation on investments amounting to Rs.200.00 lakhs and debited to the accounts was not added to the net profit as required under the Act. The omission resulted in under assessment of income of Rs.60.00 lakhs leading to short levy of tax of Rs.46.66 lakhs (including additional tax of Rs.7.78 lakhs).

(ii) The assessment of a public limited company for the assessment year 1989-90, completed in September 1990 in a summary manner, was revised in November 1990 at a total income of Rs.726.69 lakhs being 30 percent of book profit of Rs.2422.32 lakhs by applying the special provisions. Scrutiny of the assessment records revealed that the net profit of Rs.2422.32 lakhs was arrived at after providing for an aggregate amount of Rs.172.45 lakhs comprising provisions of Rs.10 lakhs for doubtful advances, Rs.2.29 lakhs for doubtful debts, Rs.122.28 lakhs for estimated loss on slow-moving/non-moving/non-usable stores and Rs.37.88 lakhs for gratuity. It was however seen from the statement of income that the assessee company, while computing the gross income before application of the special provisions, had added back the above provisions which confirmed that these were not ascertained liabilities. Hence the net profit of Rs.2422.32 lakhs should have been increased by Rs.172.45 lakhs in computing income under the special provisions. Omission to do so resulted in short computation of book profit by an identical amount involving under assessment of income of Rs.51.73 lakhs, being 30 percent of the above amount, with consequent underchrage of tax of Rs.27.16 lakhs. Further, additional tax of

Rs.5.43 lakhs was also required to be levied.

4. A private limited investment company, returned an income of Rs.1.20 lakhs under the special provisions of the Act for the assessment year 1990-91 and while completing the assessment in summary manner in March, 1991 the assessing officer accepted the same. It was seen during audit that the assessee had income from the long term capital gain on account of sale of shares to the extent of Rs.56.78 lakhs. The sale proceeds of the shares were invested in capital gain units of the Unit Trust of India (Rs.79.89 lakhs) and hence there was no liability in respect of the capital gain tax as the entire capital gain was exempt from taxation. However, the income derived from the sale of shares was not credited to the profit and loss account but was instead credited to the reserves and surplus. This resulted in under estimation of the book profit, to the extent the of Rs.56.78 lakhs. Omission to compute the correct book profit resulted in underassessment of income of Rs.17.03 lakhs (being 30 percent of Rs.56.78 lakhs) leading to short levy of tax of Rs.13.24 lakhs (including additional tax of Rs.2.21 lakhs).

Ministry of Finance have accepted the audit observation.

5. In the assessment of a company for the assessment year 1990-91, completed under the summary assessment scheme, the assessing officer, while determining the book profit, erroneously allowed reduction of the amount of Rs.52.68 lakhs on account of unabsorbed depreciation, although there were no brought forward losses. This was apparent from the accounts, records and returns filed by the assessee. The mistake resulted in under-assessment of income of Rs.15.80 lakhs (30 percent of Rs.52.68 lakhs) involving tax effect of Rs.10.51 lakhs (including interest and additional tax).

Excess refund

3.31 Under the Income Tax Act, 1961, where as a result of any order passed in appeal, revision or any other proceedings under the Act, refund of any account becomes due to the asssessee, the assessing officer may grant the refund in cash or adjust or set off the refund against outstanding dues of the assessee.

(i) In the assessment of a closely held non resident company for the assessment year 1987-88 in January 1989, the assessing officer determined a refund of Rs.131.06 lakhs due to the assessee.

The entire refund, initially adjusted against the income tax demand for the assessment year 1986-87 in February 1989, was subsequently adjusted against the income tax demand for the assessment years 1985-86 and 1986-87 (Rs.24.80 lakhs and Rs.106.26 lakhs respectively) in March 1989 in pursuance of a revision order for the assessment year 1986-87. It was, however, noticed that the assessment for the assessment year 1987-88 itself was revised in March 1991 determining the refund at Rs.121.05 lakhs instead of Rs.131.06 lakhs as originally determined. Accordingly, additional demand of Rs.10.01 lakhs was required to be raised by the department for the assessment year 1987-88. But the assessing officer made a refund of Rs.14.79 lakhs instead of raising additional demand of Rs.10.01 lakhs. The mistake resulted in excess refund of Rs.24.80 lakhs in the assessment year 1987-88.

(ii) In the last revision made in the assessment of a public limited company for the assessment year 1988-89 in November 1990, a sum of Rs.12.67 lakhs was determined as refundable on account of excess payment of advance-tax. The amount refundable was finally worked out to Rs.58.96 lakhs with the addition of another refund of Rs.46.29 lakhs due for the assessment year 1989-90. It was, however, noticed from the orders of the assessing officer for the assessment year 1988-89 and the register of refund for the assessment year 1990-91 that two adjustment refunds were made for the sums of Rs.7.06 lakhs and Rs.9.32 lakhs in September 1990 against outstanding demands for the assessment years 1985-86 and 1986-87 respectively. As the net refundable sum was determined at Rs.58.96 lakhs after adjustment of all dues, payments and refunds etc. relating to the aforesaid assessment years, the sums of Rs.7.06 lakhs and Rs.9.32 lakhs were required to be deducted from the said net refund. Omission to do so resulted in excess determination of refund of Rs.16.38 lakhs pertaining to the assessment years 1988-89 and 1989-90.

Non levy or incorrect levy of interest

Interest for delay in filing of return.

3.32 Under the Income Tax Act 1961, where the return of income for an assessment year is furnished after the specified due date, the assessee shall be liable to pay simple interest at 15 percent (from 1 October 1984) per annum from the date immediately following the specified due date to the date of filing the return, or where no return is furnished, to the date of completion of

regular assessment, on the amount of tax determined in the regular assessment as reduced by the advance tax, if any, paid and tax deducted at source.

The return for the assessment year 1988-89 was submitted by an assessee company on 25 January 1990, in response to a notice by the assessing officer issued on 10 January 1990. The assessment was completed on 27 February 1991 at Rs.142.52 lakhs with tax of Rs.82.30 lakhs The specified due date for submission of the return was 30 June 1988. The assessee was, therefore, in default as regards submission of the return for the period from July 1988 to Decemeber 1989 and was liable to pay interest in accordance with the aforesaid provision. The assessing officer, however, did not levy any interest. which resulted non levy of interest of Rs.15.26 lakhs.

Ministry of Finance have accepted the audit observation.

Interest for short payment of advance tax

3.33 Under the Income Tax Act, 1961, where an assessee has paid advance tax for any financial year on the basis of his own estimate and the advance tax so paid falls short of eighty three and one third per cent of the tax determined on regular assessment, interest at twelve per cent (fifteen per cent from 1 October 1984) per annum is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax, from the first day of the next financial year to the date of regular assessment.

The assessment of a company for the assessment year 1988-89 was completed in March 1991 determining taxable income of Rs.223.10 lakhs against the returned income of Rs.28.83 lakhs.It was seen in audit that even though the assessing officer had given direction while framing the assessment order that interest be charged for short payment of advance tax, it was not levied. The omission resulted in non-levy of interest of Rs.49.08 lakhs.

Interest for delay in payment of tax demand

3.34.1 Under the Income Tax Act, 1961, any demand for tax should be paid by an assessee within thirty five days (thirty days from 1 April 1989) of service of notice of the relevant demand. Failure to do so attracts simple interest at 12 percent (15 percent with effect from 1 October 1984) per annum from the date of default or one and a half percent on the amount of default for every month or part thereof of the period

commencing from the day immediately following the end of the period of thirty five days or thirty days mentioned above and ending with the day on which the amount is paid. The Act also provides that where due to any rectificatory order, the amount of tax payable has been reduced, the interest payable shall also be reduced accordingly. In other words, the interest would be leviable for the same period of default, but on the reduced tax liability. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demand. In April 1982, the Board issued instructions clarifying that the interest is to 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 any appellate authority but restored either partly or wholly on further appeal and the fact that during the intervening period there was no tax payable by the assessee under any operative order would make no difference to the position.

(i) The assessments of a widely held banking company for the assessment years 1984-85, 1985-86 and 1987-88 were originally completed in February 1987, March 1988 and January 1990 and later revised in July 1990 and April 1990 with revised tax demands of Rs.315.88 lakhs, Rs.77.27 lakhs and Rs.561.23 lakhs as against the original demands of Rs.300.18 lakhs, 77.27 lakhs and 934.32 lakhs. The demand notices were served on 17 February 1987, 25 July 1990 and 20 March 1990. The assessee paid the demand in four instalments, of Rs.21.55 lakhs on 16 September 1987, Rs.278.64 lakhs on 22 March 1988, Rs.2.13 lakhs on 17 April 1989 and Rs.15.70 lakhs in December 1990 (for assessment year 1984-85) and Rs.27.27 lakhs on 20 December 1990 (for assessment year 1985-86) and in three instalments in July 1990 Rs.18.30 lakhs in September 1990 of Rs.187.86 lakhs and in October 1990 of Rs.355.06 lakhs (for assessment year 1987-88). The assessee was, therefore, in default in respect of the tax demand in full/part to the extent mentioned above. The aggregate interest leviable was Rs.97.20 lakhs (Rs.40.37 lakhs, Rs.4.64 lakhs and Rs.52.19 lakhs, for the assessment years 1984-85, 1985-86 and 1987-88 respectively) which was not levied.

(ii) The assessment of a widely held company for the assessment year 1977-78 was originally completed in March 1978 determining the taxable

income and the tax thereon at Rs.270.76 lakhs and Rs.148.92 lakhs respectively. the income was computed after setting off unabsorbed deficiency of the deductions in respect of the profits and gains from newly established industrial undertakings prior to 31 March 1981 amounting to Rs.462.96 lakhs relating to assessment years 1971-72 to 1975-76. The deduction for the above assessment years was computed by the assessing officer by excluding the borrowed funds from the capital.The assessee went in appeal against such computation and succeeded in the Tribunal.The assessments for the respective years were revised increasing the quantum of the deduction. Consequential changes in the assessments for assessment year 1977-78 was made in Feburary 1981 and a refund of Rs.71.97 lakhs granted to the assessee company in March 1981.

The department filed miscellaneous petitions before the Tribunal for the assessment years 1972-73 to 1975-76 against its earlier orders on the strength of the retrospective amendment of the provisions with effect from 1 April 1972 to exclude borrowed funds in computing the capital. Thereupon the Tribunal restored (May 1981) the matter to the Commissioner of Income tax (Appeals) with a direction to dispose of the case in the light of the decision to be given by the Supreme court on this issue.Based on the directions of the Tribunal, the Commissioner of Income Tax (Appeals) upheld in March 1985 the computation of the assessing officer as being in conformity with the decisions of the Supreme court upholding the validity of the restrospective amendment to the Act. Accordingly the assessments for assessment years 1972-73 to 1975-76 were revised by the department in March 1985 as per directions of the Commissioner of Income tax (Appeal) and consequent revision was also made for assessment year 1977-78 in March 1985, determining the net income at Rs.726.72 lakhs after set off of the unabsorbed deficiency of Rs.6.89 lakhs and raising a net additional demand of Rs.306.64 lakhs which was paid by the assessee company in March 1985. Audit scrutiny in March 1988 revealed that though the refund of Rs.71.97 lakhs originally determined was converted into a demand thereby attracting interest under the Board's circular of April 1982, no action was taken to levy the interest. The interest leviable aggregated Rs.30.71 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) The assessment of a company for the assessment year 1979-80, completed by the Assistant Commissioner in September 1982, was subsequently revised in March 1984 in pursuance of an appeal order. The re-assessment was completed in March 1988 in pursuance of an order of the Commissioner of Income tax at a total income of Rs.17.17 lakhs with a tax demand of Rs.14.58 lakhs. The assessee company was liable to pay tax by 26 October 1982 as the original demand notice was served on 22 September 1982, but till October 1991, no tax was paid by the assessee. The omission led to non-levy of interest to the extent of Rs.18.45 lakhs (calculated upto the end of the financial year 1990-91).

Ministry of Finance have accepted the audit observation.

Interest for failure to deposit tax deducted at source

3.35 The Income Tax Act,1961, provides that if a person responsible for deducting tax at source under the provisions of the Act does not deduct such tax or after deducting it, fails to pay the same as required under the Act, he is liable to pay interest at 12 percent (15 per cent from 1 October 1984) per annum on the amount of tax from the date on which such tax was deductible or deducted to the date on which tax is actually paid.

The assessments of an assessee for the asessment years 1983-84 and 1984-85, completed in September 1986 and March 1987 respectively, indicated that the assessee had debited to the accounts of the respective previous years, interest on bonds issued by the assessee to the extent of Rs.2164.93 lakhs and Rs2499.02 lakhs. The interest amounts so debited were correspondingly credited to the individual accounts of the bond holders. In terms of Central Board of Direct Taxes Circular of December 1980 tax is to be deducted at source as soon as interest is credited to the accounts of the recipient.The assessee accordingly deducted the required tax at the time of credit during April 1982 to March 1983(assessment year 1983-84) and April 1983 to March 1984(assessment year 1984-85) amounting to 261.61 lakhs and Rs.352.48 lakhs respectively. The assessee, however, deposited the tax so deducted after expiry of the time specified in the Act on 31 January 1984 and 30 March 1985 respectively. The failure to make timely payment of the tax to Government account attracted levy of penal interest for the periods 1 April 1982 to 31 January 1984 (assessment year

1983-84) and 1 April 1983 to 30 March 1985 assessment year 1984-85). The aggregate interest leviable for the two assessment years works out to Rs.111.21 lakhs, which was not levied by the Department.

The department has accepted the audit observation.

Avoidable payment of interest by Government

3.36 Under the Income Tax Act,1961, where the advance tax paid by an assessee during any financial year exceeds the amount of tax payable on regular assessment, the Government is liable to pay interest at the prescribed rates on the amount of advance tax paid from 1 April next following the said financial year to the date of regular assessment. The Act also provides for provisional assessment (upto assessment year 1988-89) and grant of refund of excess advance tax paid on the basis of such provisional assessment. The Board also issued instructions in 1971 and 1972 that provisional assessment should be made in all cases whether the assessee had specifically claimed a refund or not in the return where regular assessment is likely to be delayed beyond six months of the receipt of return.

A-Scrutiny Assessment

A widely held company filed its return of income for the assessment year 1986-87 in August 1986 admitting an income of Rs.244.86 lakhs. The assessment was completed in March 1989 determining an income of Rs.235.83 lakhs, resulting in a refund of Rs.120.14 lakhs. Interest payable by the Government was granted to the assessee company in July 1989 amounting to Rs.52.56 lakhs for the period from April 1986 to February 1989. A further interest of Rs.6.01 lakhs was also granted from March 1989 to June 1989 on the basis of appellate orders in March 1990. Audit scrutiny revealed that the provisional assessment as required to be made under the Act was not made, resulting in avoidable payment of interest of Rs.36.04 lakhs for the period March 1987 to February 1989. Further, the omission to issue the refund order of Rs.120.14 lakhs simultaneously with the assessment order in March 1989 led to the payment of additional interest of Rs.6.01 lakhs by Government.

The department while admitting the procedural lapse in not making the provisional assessment, stated that the delay in completion of regular assessment was due to administrative difficulties. It was further stated that though the assessment was delayed, the funds of the assessee remained with the Government and hence there was no loss of

revenue on this account. The reply is not tenable in as much as the mistake pointed out is non-compliance with the statutory requirement of making a provisional assessment which resulted in avoidable payment of interest by Government.

Ministry of Finance have accepted the audit observation in principle.

B- Summary Assessment

A company filed returns of income for the assessment years 1985-86, 1986-87 and 1987-88 on 28 June 1985, 30 June 1986 and 30 June 1987 claiming refund of Rs.33.02 lakhs, Rs.26.09 lakhs and Rs.4.60 lakhs respectively, based on the excess of advance tax paid over the tax payable on the returned income in each of the assessment years. The asessee also specifically requested the assessing officer to conclude provisional assessments and allow the refunds due. But no provisional assessment was made for any of these assessment years. The regular assessments were concluded in March 1988, November 1988 and March 1990 for the assessment years 1985-86,1986-87 and 1987-88 respectively allowing a total refund of Rs.63.71 lakhs on account of tax paid in excess together with interest thereon aggregating Rs.26.57 lakhs. Had provisional assessments been made within six months from the dates of filing of returns payment of interest aggregating Rs.19.40 lakhs could have been avoided.

Ministry of Finance have accepted the audit observation.

Omission to levy penalty

3.37 Under the Income Tax Act, 1961, as amended from the assessment year 1985-86, every assessee whose total sales-turnover or gross receipts in business exceed forty lakh rupees in any previous year, should get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain report of such audit in the prescribed form within the specified date. Failure to get the accounts audited and to obtain the audit report within the specified date renders the assessee liable to a penalty equivalent to one half percent of the turnover or one lakh rupees, whichever is lower. The Central Board of Direct Taxes also issued instructions in July 1964 and again in September 1975 that where the Income Tax Officer did not initiate penal proceedings in any case, he should record the reasons for not doing so.

(i) Ten assesses, seven companies and three registered firms, had filed their returns of

income for the assessment years 1985-86, 1987-88 and 1988-89 along with the prescribed audit reports of chartered accountants after the expiry of the specified dates. Accordingly, the assesses were liable for penalty for the delay. The assessing officer, however, did not initiate any penalty proceedings nor keep a note of the reasons for not doing so while completing the assessments under scrutiny during March 1988 and March 1991. Penalty leviable in these cases aggregated Rs.10.88 lakhs for the assessment years 1985-86, 1987-88 and 1988-89.

(ii) In the case of another corporate assessee, turnover for the previous years relevant to assessment years 1986-87 to 1988-89 exceeded forty lakh rupees. The statutory audit reports were neither attached with the returns nor insisted upon by the assessing officer. For failure to observe the statutory provisions the assessee was liable to pay a penalty of Rs.3 lakhs which was not imposed.

The department has accepted the audit observation in three cases.

SURTAX

Omission to make surtax assessment and incorrect computation of capital

3.38.1 Under the Companies (Profit) Surtax Act,1964, there is no statutory time limit for completion of surtax assessments. However, pursuant to the recommendations of the Public Accounts Committee in para 6.7 of its 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 assessment.The Board further laid down that the surtax asessment should not be kept pending on the ground that the additions in the income tax assessment were disputed in appeal and that the time lag between the dates of completion of income tax and surtax assessments should not ordinarily exceed one month unless there were special reasons to justify the delay.

(i) The income tax assessment of two limited companies for the assessment years 1983-84 and 1987-88 were completed by the assessing officer in February 1990 and March 1991. The surtax assessment proceedings were, however, not initiated till the date of audit (March and September 1991) resulting in non-levy of surtax amounting to Rs.109.31 lakhs including interest of Rs.40.77 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The income tax assessments of a closely held company for the assessment years 1984-85, 1985-86,1986-87 and 1987-88 were completed/revised between March 1988 and March 1990 determining its income at Rs.43.60 lakhs,Rs.123.59 lakhs, Rs.91.22 lakhs and Rs.199.98 lakhs on the basis of which the net chargeable profits for the levy of surtax worked out to Rs.4.50 lakhs,Rs.34.85 lakhs,Rs.21.28 lakhs and Rs.70.18 lakhs respectively.Audit scrutiny(July 1990) however, revealed that the surtax assessment for none of these years was completed.The total amount of surtax leviable over these years came to Rs.49.42 lakhs.

Ministry of Finance have accepted the audit observation.

2. 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 rupees two lakhs, whichever is greater.Capital for this purpose includes the paid up share capital and reserves.

The assessment of a widely held company for the assessment year 1987-88 was completed in March 1990 on a total income of Rs.203.64 lakhs.The assessee had submitted a return for surtax for the assessment year in September 1987.The chargeable profit in excess of the amount of statutory deduction was Rs.39.38 lakhs.The assessee was therefore liable to pay surtax of Rs.12.70 lakhs and interest of Rs.3.81 lakhs for non payment of advance tax. It was, however, noticed in audit that the assessing officer had not initiated surtax proceeding till the date of audit (August 1991).The omission resulted in non-realisation of surtax of Rs.16.51 lakhs.

3. As per the Surtax Act, any amount standing to the credit of any account in the books of a company which is in the nature of a liability or provision shall not be regarded as a reserve for the purpose of computation of capital.

In the surtax assessment of a widely held tea company for the assessment year 1986-87, completed in November 1990, the assessing officer computed the aggregate of capital and reserves and

surpluses at Rs.1727.54 lakhs on the basis of the figures as on 30 June 1985 i.e. the last day of the relevant previous year. Based on this figure, and taking note of the liabilities of Central taxes, the statutory deduction allowable was calculated at Rs.114.02 lakhs on the capital base of Rs.760.12 lakhs.Under the rules, however, the capital of the company was required to be computed at Rs.794.82 lakhs, being the aggregate of capital and reserves and surpluses as on 1 July 1984 i.e. the first day of the relevant previous year, on the basis of which, the capital worked out to Rs.349.72 lakhs and the statutory deduction allowable thereon was Rs.52.46 lakhs only.The incorrect computation of capital led to excess grant of statutory deduction of Rs.61.56 lakhs and consequent under-assessment of net chargeable profit by an identical amount with short levy of surtax of Rs.27.70 lakhs.

Ministry of Finance have accepted the audit observation.

4. Further, under the Act the chargeable profits of any year are computed with reference to total income assessed for levy of income tax for that year after making certain prescribed adjustments. 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. Under the Companies Deposits (Surcharge on Income tax) Scheme, 1984 and 1985, surcharge which is levied on income tax is not payable by a company, if the company deposits with the Government an amount equal to the surcharge.

The surtax assessments of a widely held tea company for the assessment years 1985-86 and 1986-87 were completed in December 1990 and November 1990, computing the net chargeable profits at Rs.194.52 lakhs and Rs.161.44 lakhs after allowing tax liabilities at Rs.312.20 lakhs and Rs.304.90 lakhs which included surcharge on income tax of Rs.14.87 lakhs and Rs.14.52 lakhs respectively. Audit scrutiny, however, revealed (September 1991) that surcharge leviable on income tax was adjusted in full against the deposits made by the company with the Government under the Companies Deposits (Surcharge on Income tax) Scheme, 1976. As no surcharge on income tax was payable as per income tax assessments, the allowance of Rs.14.87 lakhs

and Rs.14.52 lakhs while computing chargeable profits in the surtax assessments was irregular. This led to under assessment of net chargeable profit by the identical sums in the assessment years 1985-86 and 1986-87 respectively.

Further, although balancing charge, representing excess of sale proceeds over written down value of an asset, to the extent of depreciation actually allowed, was required to be excluded from the computation of chargeable profit, there is no provision in the relevant rules to deduct proportionate tax liability on such profit from the total income tax liability allowable in computing chargeable profit. As income tax liability of Rs.0.26 lakhs in respect of balancing charge of Rs.0.47 lakhs was deducted from the total income tax liability allowable for the assessment year 1985-86, there was over assessment of net chargeable profit by Rs.0.26 lakhs in that assessment year. The consequent aggregate under assessment of net chargeable profit by Rs.29.13 lakhs comprising Rs.14.61 lakhs in the assessment year 1985-86 and Rs.14.52 lakhs in the assessment year 1986-87 led to short levy of surtax of Rs.11.65 lakhs in the two assessment years.

CHAPTER 4

INCOME TAX

4.01 Income Tax collected from persons other than companies is booked under the Major Head '0021 Taxes on income other than corporation tax'. Eighty five percent of the net proceeds of this tax, except in so far as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States in accordance with the recommendations of the Finance Commission.

4.02 The trend of receipts from income tax during the last five years was as follows:

Year	Total collection of all Direct Taxes	Amount of Income tax	Percentage of Income tax to total collection
	(In crores of rupees)		
1987-88	6,757.18	3,192.43	47.25
1988-89	8,828.76	4,241.24	48.04
1989-90	10,007.78	5,008.98	50.05
1990-91	11,028.94	5,375.34	48.74
1991-92*	15,324.07	6,729.18	44.56

4.03 The number of assessees (other than companies) borne on the books of the Income Tax department during the last five years was as follows:

As on 31 March	Number	Average collection of taxes (per capita) (in thousands of rupees)
1988	64,37,826	4.95
1989	67,15,127	6.31
1990	69,16,640	7.24
1991	73,22,010	7.34
1992*	77,60,407	8.66

* Provisional

4.04 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		Percentage of pendency to total cases due for disposal	Amount of demand		Percentage of arrears to total collection
	Completed during the year	Pending at the close of the year		Collected during the year (In crores of rupees)	In arrears at the close of the year	
1987-88	63,75,745	10,53,602	14.18	3,192.43	987.79	30.94
1988-89	60,51,670	9,11,983	13.10	4,241.24	1,178.67	27.79
1989-90	55,93,738	11,36,260	16.88	5,008.98	1,409.99	28.15
1990-91	62,68,326	12,28,905	16.39	5,375.34	1,534.59	28.55
1991-92*	65,66,416	12,55,030	16.05	6,729.18	2,398.70	35.65

4.05 A total number of 280 draft paragraphs involving tax effect of Rs.18.32 crores were issued to the Ministry of Finance for comments during March 1992 to July 1992. The Ministry of Finance have accepted the observations in 124 cases involving tax effect of Rs.5.59 crores.102 illustrative cases involving tax effect of Rs.11.90 crores are given in the following paragraphs. Out of these, the Ministry of Finance have accepted the observations in 31 cases involving tax effect of Rs.3.18 crores. Out of these 12 cases were checked by the Internal Audit but the mistakes were not detected by it.

Avoidable mistakes in computation of income and tax

4.06 Underassessments of tax of substantial amounts on account of avoidable mistakes, attributable to negligence on the part of assessing officers were reported in the Audit Reports year after year. Despite this and despite issue of repeated instructions by the Government, such mistakes continue to occur. 7 representative cases involving short levy of tax of Rs.63.90 lakhs are given below:

Sr. No.	State/ Commissioner's charge/ Assessee	Assessment year	Nature of mistake	Tax effect/ Financial implication (In lakhs of rupees)
A.Scrutiny Assessment				
01.	Bhubaneshwar/ Individuals	1987-88	While computing total income the assessing officer added an amount of Rs.9.18 lakhs instead of Rs.18.36 lakhs.	13.05 (including interest)
02.	Ahmedabad/ Unregistered firm	1985-86	While computing total income, addition of Rs. 10.67 lakhs in respect of three items which were discussed in the assessment order was not made	9.87 (including interest)
03	Bombay/ Individual	1986-87	While computing the taxable income the assessing officer added an amount of Rs.32.94 lakhs instead of Rs.42.55 lakhs as discussed in the assessment order. The omission resulted in under-assessment of income of Rs.9.65 lakhs.	8.93 (including interest)
04.	Hyderabad/ Individual	1988-89	The net profit on the turnover of Rs.50 lakhs was to be estimated at 10 percent. This was wrongly worked out as Rs.0.5 lakh. This resulted in short computation of income of Rs.4.50 lakhs.	3.43 (including interest)
05.	Kanpur/ Registered firm	1989-90	While giving effect to the order of CIT (Appeal), tax on income of Rs.67.85 lakhs was levied incorrectly at Rs.15.04 lakhs against the correct amount of Rs.16.95 lakhs	2.37 (including interest)

The department has accepted the audit observation in two cases. Ministry of Finance have accepted the audit observation in another two cases.

B.-Summary assessment

01	Bombay/ Individual	1990-91	The assessing officer made an addition of Rs.191.10 lakhs to the income of Rs.157.28 lakhs returned by the assessee and arrived at a taxable income of Rs.348.38 lakhs. Additional tax was leviable at Rs.20.64 lakhs but was levied at Rs.2.06 lakhs	18.58
02.	Bangalore/ Co-operative Society	1989-90	An arithmetical error was committed by the assessee whereby the positive figure of Rs.7.66 lakhs was erroenously taken at a negative figure for the same amount. The assessing officer failed to notice the mistake resulting in undercharge of income by Rs.15.32 lakhs.	7.67 (including additional tax of Rs.1.28 lakhs)

Ministry of Finance have accepted the audit observation in the above two cases.

Application of incorrect rate of tax

4.07 Under the provisions of Income Tax Act, 1961, tax shall be charged on the total income of an association of persons at the maximum marginal rate where the individual shares of the members of the association of person in whole or any part of the income of such association of persons are indeterminate or unknown. Maximum marginal rate of income tax means the rate of income tax (including surcharge on income tax, if any) applicable in relation to the highest slab of income in case of an association of persons as specified in the Finance Act of the relevant assessment year.

In the assessments of three assessees (association of persons), for the assessment years 1985-86 to 1989-90, the assessments for which were completed between December 1990 and February 1991, the assessing officer decided to levy tax at the maximum marginal rates as the shares of the members of the association of persons were indeterminate. However, while calculating tax, the assessees were charged to tax at ordinary rates. The mistake resulted in under charge of tax of Rs.2.48 lakhs in the case of the three assessees.

4.07-4.09 Incorrect Rate of Interest-Expenditure On Advertisement Etc.

The department has accepted the audit observation.

Failure to observe the provisions of the Finance Acts

4.08 Under the provisions of the Income Tax Act, 1961, for determination of income in the case of an assessee, being a person other than a public sector company, obtaining in any sale by way of auction, tender or any other mode conducted by any other person any goods in the nature of alcoholic liquor for human consumption (other than Indian made foreign liquor) or any forest produce, a sum equal to the percentage specified in the Act of the amount paid or payable by the buyer as the purchase price in respect of such goods shall be deemed to be the profits and gains of the buyer from the business of trading in such goods chargeable to tax under the head 'profits and gains of business or profession'. This provision is, however, not applicable where the goods purchased by the buyer are utilised for the purpose of manufacturing, processing or production of any article or thing.

In the assessments of four individual assessees, engaged in the business of purchase and sale of Tendu leaves, for the assessment year 1989-90, completed in the summmary manner between August 1989 and January 1990, the total income was determined by the assessing officer as shown in the returns which was below the percentage of profit specified in the Act. Failure to recompute the profits as per the provisions of the Act resulted in short computation of income by Rs.7.49 lakhs with consequent short levy of tax and interest of Rs.3.83 lakhs.

Incorrect computation of business income

Omission to disallow excess expenditure on advertise-ment, publicity and sales promotion

4.09 Under the provisions of Income Tax Act, 1961, as applicable from 1 April 1984 to 31 March 1986, where the aggregate expenditure incurred by an assessee on advertisement, publicity and sales promotion, running and maintenance of air craft or motor cars and payments made to hotels exceeds Rs. 1 lakh, twenty percent of such excess was not allowable as deduction in computing the business income of the assessee.

Scrutiny assessment

(i) In the assessment of an unregistered firm, completed in March 1988, while

computing the business income for the assessment year 1985-86, the assessing officer allowed full expenditure of Rs.40.92 lakhs incurred during the relevant previous year on advertisement, running of motor car, payments to hotels and sale promotion without disallowing twenty percent of the expenditure in excess of Rs.1 lakh. The omission resulted in allowance of excess expenditure of Rs.7.98 lakhs leading to short levy of tax of Rs.4.94 lakhs.

The department has accepted the audit observation.

(ii) The assessment of a registered firm (dealing in raw jute) for the assessment year 1989-90, was completed in September 1990, on a taxable income of Rs.1.69 lakhs. From the profit and loss account of the firm, covering a period of 21 months for the previous year relevant to the assessment year 1989-90, it was seen that out the total sales of raw jute of Rs.90.29 lakhs, sales amounting to Rs.7.62 lakhs were effected from the Head office and Rs.82.67 lakhs from the separate branches of the firm.Audit scrutiny of the relevant assessment records revealed that total sales of the two branches made to different parties amounted to Rs.130.22 lakhs and not Rs.82.67 lakhs as computed in the assessment and the sales made to parties were also confirmed by them. The omission to consider the correct amount of sales in the assessment resulted in under assessment of income of Rs.47.55 lakhs, involving short levy of tax of Rs.16.63 lakhs, including non-levy of interest for belated filing of the return and for short payment of advance tax, in the hands of the firm.There was also consequential undercharge of tax of Rs.18.16 lakhs in the hands of three partners.Thus, the aggregate undercharge of tax worked out to Rs.34.80 lakhs in the assessment year 1989-90.

The department has accepted the audit observation.

(iii) The assessment of an individual for the assessment year 1988-89 was finalised in March 1991. The assessee did not claim an amount of Rs.2.19 lakhs which was a liability on account of supplies made by other parties.The assessing officer decided to add 10 per cent of the liability being the

profits earned but not returned by the assessee. It was pointed out in audit that instead of adding 10 per cent of the amount, the entire unclaimed liability Rs.2.19 lakhs was to be treated as undisclosed profit and added to the taxable income.Omission to do so resulted in under assessment of income of Rs.1.97 lakhs and short levy of tax of Rs.2.98 lakhs including interest leviable under the provisions of the Income Tax Act, 1961.

Ministry of Finance have accepted the audit observation.

Mistake in computation of business income.

4.10 Under the provisions of Income Tax Act, 1961, the income under the head 'profits and gains of business or profession' is computed, based on the method of accounting regularly employed by the assessee. Under the mercantile system of accounting, the annual profits are worked out on due or accrual basis, after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due.

A- Scrutiny Assessment

(i) In the assessment of a registered firm, for the assessment year 1987-88, completed in October 1989, the tax liability was determined at Rs.727 and after allowing for a credit of Rs.66,906 (towards tax deducted at source) refund of Rs.66,179 was allowed. From the certificates furnished with the return, it was noticed that though the assessee had received interest of Rs.6.69 lakhs on the running account of the firm for the period from 31 December 1986 to 31 March 1987, the interest amount was not accounted for as income of the relevant previous year. Omission to add back the amount to the total income resulted in under assessment of income of Rs.6.69 lakhs with resultant short levy of tax of Rs.3.81 lakhs in the hands of the firm and its partners.

Ministry of Finance have accepted the audit observation.

(ii) An assessee, a co-operative sugar mill, which was maintaining accounts under the mercantile system, debited Rs.2.86 lakhs in its profit and loss account relevant to the assessment year 1981-82 in respect of interest payment for the assessment year 1978-79 and short credited accrued interest

of Rs.69,166 on fixed deposit. Audit scrutiny revealed (November 1989) that while completing the assessment after giving appeal effect in January 1989, the assessing officer had not disallowed the interest payment of earlier year nor added back the accrued interest. Omission to do so resulted in under assessment of income of Rs.3.55 lakhs leading to under charge of tax and interest of Rs.2.81 lakhs.

The department has accepted the audit observation.

B- Summary Assessment

The assessment of an assessee, a registered firm, for the assessment year 1989-90, was completed in March 1990 in the summary manner. It was noticed in audit that the assessee who was following the mercantile system of accounting, had exhibited Rs.6.63 lakhs representing miscellaneous bills as assets in the balance sheet as on 31 March 1989. The amount of Rs.6.63 lakhs, being income accrued but not received, should have been included as income. Omission to do so resulted in underassessment of income of Rs.6.63 lakhs with short levy of tax of Rs.3.33 lakhs in the hands of firm and its partners.

Incorrect allowance of liabilities

4.11 Under the provisions of the Income Tax Act, 1961, as amended by the Finance Act 1983, with effect from the assessment year 1984-85, in computing the business income of an assessee, a deduction allowable in respect of any sum payable by way of tax or duty or any sum, payable as an employer by way of contribution to any provident fund, superannuation fund etc. will be allowed out of the income of the previous year in which such sum is actually paid, irrespective of the method of accounting employed by the assessee. However, deduction in respect of tax or duty will be allowed if it is actually paid on or before the due date for furnishing the returns of income.

A- Scrutiny Assessment

In the assessment of an assessee registered firm for the assessment year 1989-90, completed in February 1991, the assessing officer had allowed deductions of Rs.38.41 lakhs on account of unpaid statutory liabilities such as Employees State Insurance, Employees Provident Fund, central sales tax and local sales tax. As the amount

of Rs.38.41 lakhs was not actually paid on or before the due date for furnishing the return of income for the previous year relevant to the assessment year 1989-90, it should have been added back to the income of the assessee firm. Failure to do so resulted in underassessment of income of Rs.38.41 lakhs with consequent under charge of tax of Rs.24.77 lakhs in the hands of the firm and its partners.

The department has accepted the audit observation.

B. Summary Assessment

(i) The assessments of a registered firm for the assessment years 1989-90 and 1990-91 were completed in a summary manner in March 1990 and August 1990 on total incomes of Rs.41.70 lakhs and Rs.59.16 lakhs respectively.The records indicated that Rs.25.72 lakhs and Rs.46.34 lakhs were debited to the relevant profit and loss accounts being accrued liabilities on 'entry tax'. The relevant balance sheets indicated that the accrued liabilities of Rs.25.71 lakhs and Rs.46.31 lakhs out of the above debits remained unpaid during the relevant previous years. The unpaid liabilities should, therefore, have been disallowed which was not done.The omission led to under assessment of income of Rs.25.71 lakhs and Rs.46.31 lakhs for the assessment years 1989-90 and 1990-91 respectively with consequent tax under charge aggregating Rs.18.48 lakhs for the two years in the hands of firm alone.The corresponding short charge in the hands of partners worked out to Rs.28.62 lakhs in aggregate for the two years. The total revenue effect thus amounted to Rs.47.10 lakhs.

(ii) In the assessment of five assessees (three co-operative societies and two registered firms) for the assessment years 1989-90 and 1990-91, completed between November 1989 and February 1991 in the summary manner, an amount of Rs.58.60 lakhs shown as liability on account of sales tax, purchase tax, provident fund, contribution to Employees State Insurance, excise duty, cess and interest payable to public financial institutions was not disallowed and added back to the income. Omission to disallow the unpaid amounts of such liabilities led to undercharge of tax of Rs.28.19 lakhs

(including additional tax), of which a sum of Rs.19.19 lakhs was potential.

(iii) The income of Rs.3.65 lakhs returned by a society for the assessment year 1989-90 was accepted by the assessing officer under the summary assessment scheme without carrying out any adjustments and an intimation was sent to the assessee in January 1990. Audit scrutiny revealed (June 1991) that the deductions claimed by the assessee included inter-alia, Rs.1.50 lakhs towards provision for bad and doubtful debts, Rs.5.52 lakhs being sales tax payable and Rs.74,112 being bonus payable to employees. In the latter two cases, there was no indication of the liability having been discharged before the due date for filing the return. These deductions were thus **prima-facie** inadmissible and should have been disallowed which was not done. The omission to disallow these amounts aggregating Rs.7.76 lakhs resulted in short levy of tax of Rs.3.89 lakhs (including additional tax).

Ministry of Finance have accepted the audit observation.

Incorrect computation of income/loss

4.12 If an item included in the total income/loss determined in any assessment order required modification as a result of an appellate order or otherwise, the revision is generally carried out by excluding such item from the total income/loss and then by including the modified figure. If a new item not included initially has to be considered, the question of first excluding the item from the income/loss already determined would not arise.

The assessments of a registered firm for the assessment years 1979-80, 1980-81 and 1982-83, concluded between March 1982 and February 1985, were revised by the assessing officer in January 1991 to consider a new item of rental income of Rs.1.99 lakhs offered by the assessee subsequently through revised returns under the 'Amnesty Scheme'. While computing the revised total income for each of the three assessment years, the assessing officer first increased the loss determined earlier by Rs.1.99 lakhs and then included the same under the head 'income from house property' after disallowing certain expenses claimed by

the assessee. As the rental income was an additional item not included in the original assessment, the question of first increasing the loss determined by the additional income, would not arise. The mistake thus resulted in excess determination of loss by Rs.1.99 lakhs for each of the assessment years 1979-80 and 1980-81 involving a total potential tax effect of Rs.1.89 lakhs (for both the firm and its partners), and under assessment of income by Rs.1.99 lakhs for the assessment year 1982-83 with consequent short levy of tax of Rs.1.16 lakhs (on the firm and its partners).

Ministry of Finance have accepted the audit observation.

Incorrect valuation of closing stock

4.13 In order to determine the profits from businees, 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 held1 and later confirmed by Supreme Court2 and the Ministry of Law that the previlege of valuing the closing stock in a consistent manner would not be adopted where a business comes to an end when stock on hand would be valued at the market rate in order to determine the true profits of the business on the date of closure of business.

(i) An individual converted his business into a partnership firm with effect from 1 April 1984 by admitting his two major sons as partners and two minor sons to the benefits of partnership. It was noticed (May 1987) in audit that in the assessment of the firm for the assessment year 1985-86, completed in January 1987, the stock held by the assessee was transferred to the firm at the book value of Rs.40.08 lakhs as on 31 March 1984. As the sole proprietory business run by the assessee was taken over on 31 March 1984, the closing stock held by him should have been valued at market rates in his hands. Further, in the absence of details of market value, adopting the rate of gross profit (15 percent as the basis for valuation), the addition to be made in his hands amounted to Rs.6.01 lakhs.

1 CIT Vs. A.L.A. firm (102 ITR 622-Madras)

2 ALA firm Vs. CIT (189 ITR 285 (SC)]

Omission to do so resulted in short levy of tax of Rs.3.83 lakhs for assessment year 1984-85.

(ii) During the previous year relevant to the assessment year 1985-86,a partnership firm was dissolved on 13th May 1984, and its business taken over by two of the three partners in their individual capacity. While completing the assessment of the firm for the assessment year1985-86 in March 1986, the assessing officer adopted the value of the closing stock at Rs.32.98 lakhs, as returned by the assessee, without ascertaining its market value. It was pointed out in audit that the market value of the closing stock, arrived at on the basis of the gross profit returned by the assessee, would be considerably higher, and that the omission to adopt the market value in computing the profits from business had resulted in short-levy of tax of Rs.1.65 lakhs in the hands of the firm alone.

Ministry of Finance have accepted the audit observation.

Mistake in allowance of investment allowance

4.14 Under the provisions of the Income Tax Act, 1961, no deduction on account of investment allowance is allowable in respect of road transport vehicles. It has been judicially held3 that dumpers are road transport vehicles.

1(i) In the assessment of a registered firm of a building contractors, for the assessment year 1985-86, completed in March 1988 and revised in February 1989, certain machineries like dumpers, loaders etc. were treated as road transport vehicles as they were registered as such and also on the basis of judicial decision in another case[3]. However, investment allowance of Rs.36.34 lakhs as claimed by the assessee was allowed by the assessing officer. The mistake resulted in short levy of tax of Rs.26.23 lakhs in the hands of the firm and partners.

(ii) In the assessment of an assessee firm, engaged in the contract work of transporting blasted over-burden, it was noticed that

3 CIT Vs. Shiv Construction [165 ITR 159 (Guj)]

during the previous year relevant to the assessment year 1989-90, the assessee firm had purchased various road transport vehicles, including dumpers, costing Rs.34.79 lakhs on which investment allowance of Rs.6.96 lakhs was claimed and allowed. As the dumpers etc. purchased by the assessee are road transport vehicles, the assessee was not entitled to investment allowance.

Incorrect allowance of investment allowance thus resulted in underassessment of Rs.6.95 lakhs with short levy of tax of Rs.3.82 lakhs.

2. A co-operative sugar mill, which was running a paper plant unit also, was assessed in the status of an 'Association of persons' for the assessment year 1988-89 and the assessment was completed in July 1989, determining a loss of Rs.224.88 lakhs. The loss was allowed to be carried forward for set off against the income of future assessment years. The income of the sugar mill for the year was arrived at by the assessing officer at Rs.235.26 lakhs. The paper plant unit had, however, incurred loss and the loss was determined by the assessing officer at Rs.469.13 lakhs after allowing depreciation of Rs.364.49 lakhs. In the assessment, the loss of Rs.224.88 lakhs was worked out after setting off the income of Rs.235.26 lakhs from the sugar mill against the loss of Rs.469.13 lakhs from the paper unit. It was seen from the computation of loss of the paper plant unit that the department had incorrectly allowed depreciation of Rs.364.49 lakhs against the correct amount of Rs.123.49 lakhs by inadvertantly adopting the written down value of the assets as depreciation allowance. This resulted in excess allowance of depreciation of Rs.240.54 lakhs and computation of excess loss from paper plant unit to that extent. Thus the assessment should have resulted in positive income of Rs.15.67 lakhs instead of loss of Rs.224.88 lakhs as determined in July 1989. Further, as per the rectified assessment for the assessment year 1987-88, completed in April 1990, the assessee was allowed to carry forward unabsorbed depreciation of Rs.45.98 lakhs pertaining to the assessment year 1985-86. After set-off of the positive income of Rs.15.67 lakhs against the brought forward depreciation of the

assessment year 1985-86, the unabsorbed depreciation to be allowed to be carried forward would be Rs.30.32 lakhs. The mistake thus resulted in incorrect computation of carry forward loss for the assessment year 1988-89 of Rs.224.88 lakhs and excess allowance of carry forward of unabsorbed depreciation of Rs.15.67 lakhs involving potential tax effect of Rs.100.99 lakhs.

Ministry of Finance have accepted the audit observation.

Omission to withdraw investment allowance

4.15 Under the provisions of Income Tax Act, 1961, if any machinery on which investment allowance 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 investment allowance so granted shall be deemed to have been wrongly allowed and the assessing officer should recompute the income of the assessee for the relevant previous year and make necessary amendment. It has been judicially held4 that conversion of proprietory business into partnership involves transfer of assets necessiating withdrawal of investment allowance.

A proprietorship firm was converted into a private limited company during the previous year relevant to the assessment year 1990-91. The proprietorship firm had been allowed investment allowance amounting to Rs.1.31 lakhs during assessment year 1984-85 and Rs.3.70 lakhs in the assessment year 1986-87. As the conversion of proprietorship firm into a private limited company amounted to 'transfer' and the transfer had taken place within eight years of the acquisition of the machinery, the assessing officer was required to withdraw the investment allowance already allowed to the proprietorship firm, which was not done. The omission to withdraw the amount of investment allowance totalling Rs.5.01 lakhs resulted in short levy of tax of Rs.2.79 lakhs inclusive of interest for belated filing of return and default in payment of advance tax.

Ministry of Finance have accepted the audit observation.

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4 CIT Vs. Rangnathji Desai [163 ITR 295(Guj.)]

Incorrect grant of deduction in respect of investment deposit account

4.16 Under the Income Tax Act, 1961, in the case of a tax payer whose total income includes income under the head 'Profits and gains of business or profession' and who has out of such income, deposited any amount in the deposit account maintained by him with Development Bank within a period of six months from the end of the previous year or before furnishing the return of his income whichever is earlier or has utilised any amount during the previous year for the purchase of any new ship, new aircraft, new machinery or plant without depositing any amount in a deposit account, is allowed a deduction equal to the amounts deposited and/or any amount so utilised. The amount of deduction is, however, limited to 20 percent of the profits of eligible business or profession as per audited accounts.

A- Scrutiny Assessment

In the assessment of a co-operative sugar mill for the assessment year 1988-89, deduction towards the investment deposit account was allowed at Rs.30.18 lakhs, consisting of Rs.28.44 lakhs expended on purchase of plant and machinery and Rs.1.74 lakhs towards deposit with the Development Bank. Audit scrutiny revealed (October 1991) that out of the total amount of Rs.30.16 lakhs (claim restricted to Rs.28.44 lakhs) utilised for the purchase of machinery, Rs.15.45 lakhs related to payments made prior to the commencement of the previous year relevant to the assessment year by way of advance payment/final settlement of bills. As the amount of Rs.15.45 lakhs utilised was not out of the income chargeable to tax, the deduction allowed on this amount was not in order and deduction of only Rs.14.71 lakhs on account of purchase of plant and machinery was not permissible against Rs.28.44 lakhs allowed. The mistake resulted in excess deduction of Rs.13.73 lakhs and potential tax effect of Rs.5.73 lakhs.

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

For the assessment year 1990-91, an assessee registered firm had claimed a deduction of Rs.5.99 lakhs on account of investment deposit account and the claim was allowed by the assessing officer under the summary assessment scheme. From the statement submitted alongwith the return, it was seen

in audit that the assessee had utilised the amount of Rs.5.99 lakhs for the purchase of office appliances such as telephone system and electronic typewriters and this amount should have been disallowed as a prima-facie inadmissible deduction. Failure to do so resulted in under-assessment of income of Rs.5.99 lakhs and aggregate short levy of tax of Rs.4.02 lakhs in the hands of the firm and its partners.

Ministry of Finance have accepted the audit observation.

Incorrect computation of capital gains

4.17.1 Under the provisions of the Income Tax Act, 1961, any profits and gains, arising from the transfer of a capital asset is chargeable to income tax under the head 'capital gains' and is taxable in the year in which the transfer took place. The mode of computation of capital gains in respect of long term capital asset provides for deduction, from the consideration received, of the cost of the asset and the cost of its improvement. In addition, the Act provides for a deduction of Rs.10,000 plus a percentage of the excess over Rs.10,000 depending upon the class of the asset. Further, the Act provides for exemptions from capital gains tax in respect of certain modes of dispensation of the sale consideration in certain types of cases. The Central Board of Direct Taxes has clarified that the provisions relating to the exemptions will have to be applied first and the deduction of Rs.10,000 plus a percentage of the excess over Rs.10,000 will be applied on the remaining part of the capital gains.

An assessee individual sold a residential property in the previous year relevant to the assessment year 1989-90 for a consideration of Rs.160.00 lakhs. The cost of the property was Rs.10.05 lakhs. The entire capital gain of Rs.149.95 lakhs was claimed as deduction and exemptions and the same was allowed by the assessing officer in the assessment completed in June 1990. The assessee had computed the taxable capital gain at 'NIL' by claiming the deduction of Rs.10,000 plus percentage of the excess over Rs.10,000 first and then claiming the balance amount as exempted under other provisions of the Act. This was not correct. The exemptions were to

be allowed first and on the balance only the deduction of Rs.10,000 plus percentage in excess of Rs.10,000 was allowable. The taxable capital gain would correctly work out to Rs.29.81 lakhs as against 'NIL' amount brought to tax. The mistake resulted in under assessment of income of Rs.29.81 lakhs involving short levy of tax of Rs.21.71 lakhs (including additional tax of Rs.3.13 lakhs and interest of Rs.2.93 lakhs paid to the assessee on excess payment of advance tax).

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income Tax Act,1961, long term capital gain arising from the transfer of a residential house is exempt from tax to the extent mentioned therein, if the assessee has, within a period of one year before or two years after the date on which the transfer took place, purchased or has within a period of three years after that date constructed a residential house.The Act further provides that for purposes of computation of capital gains, the cost of acquisition of an existing property on 1 April 1974 shall be taken to be the cost of acquisition to the assessee or the fair market value of the asset on 1 April 1974, at the option of the asessee.

(i) In April 1988, an assessee individual purchased a house property for Rs.11 lakhs out of the advance money received in respect of the sale of her existing house which was sold for Rs.40 lakhs in April 1990. The assessee claimed proportionate exemption from capital gains in respect of the investment in purchase of the house. Further, in computing the capital gains, the assessee took the cost of acquisition at Rs.13.50 lakhs being the fair market value as on 1 April 1974. The assessment was completed in January 1991 accepting the assessee's computation. However, since the assessee did not purchase the new asset within one year before the date of sale of her old asset, she was not eligible for the exemption claimed. Secondly, the market value of the old house was Rs.3 lakhs as per wealth tax records for the assessment year 1976-77 as against Rs.13.50 lakhs taken into consideration for the computation of capital gains. These mistakes resulted in under-assessment of income of

Rs.8.73 lakhs involving short levy of tax of Rs.5.27 lakhs (including Rs.55,840 for default in payment of advance tax).

(ii) An assessee individual sold, during the previous year relevant to the assessment year 1988-89, a residential house for Rs.40 lakhs and claimed exemption of Rs.18.38 lakhs from capital gains tax. The exemption was allowed by the assessing officer in the assessment completed in January 1990 on the ground that the assessee had made a deed of purchase agreement in December 1987 to invest the capital gain of Rs.18.38 lakhs on a new house property. Since the purchase had not been completed and there was no provision in the Act to exempt capital gain from tax on the basis of purchase agreement, the capital gain of Rs.18.38 lakhs should have been taxed. The incorrect exemption thus resulted in under assessment of capital gain of Rs.9.19 lakhs involving a short levy of tax of Rs.4.83 lakhs in the assessment year 1988-89.

Ministry of Finance have accepted the audit observation.

3. Where the full value of consideration received does not exceed Rs.2 lakhs, no capital gains is chargeable to tax, and if it exceeds Rs.2 lakhs so much of the capital gains as bears to the whole of capital gain, the same proportion as the amount of Rs.2 lakhs bears to the amount of consideration, is not charged to tax.

An individual filed his return of income for the assessment year 1985-86 in February 1990 disclosing capital gain of Rs.7.50 lakhs arising out of the sale of a residential house for Rs.10.50 lakhs. The initial cost (as on 1 April 1974) of the house was shown at Rs.3.00 lakhs.The assessee claimed deduction of Rs.1.43 lakhs and offered a net taxable income of Rs.39,310 after claiming other statutory deductions.The assessing officer concluded the assessment accepting the net income as computed by the assessee.

Audit scrutiny of some of the available income tax records of the individual for the earlier assessment years revealed that the assessee owned two other residential properties and there was nothing on record to indicate that he had subsequently disposed

them of by sale or otherwise.Further, copies of documents enclosed to the return of income for assessment year 1985-86 indicated that the deduction of Rs.5.37 lakhs claimed by the assessee was only towards an advance made to a building contractor who had offered to construct and allot a residential flat on a future date.Deduction is admissible only if the house has actually been purchased or constructed within the stipulated time and in the case of the assessee, the asset was yet to come into existence and the transaction was still in preliminary stages. The deductions claimed on both the accounts viz., Rs.1.43 lakhs and Rs.5.37 lakhs were, therefore, irregular and led to under-assessment of income by Rs.4.08 lakhs involving short levy of tax of Rs.4.18 lakhs including interest for belated filing of return.

4. Upto the assessment year 1987-88, the Act provided for deductions in respect of long-term capital gains. 'Long term capital gains' means capital gains arising from the transfer of a capital asset held by an assessee for more than thirty six months immediately preceding the date of transfer.

An assessee firm dealing in immovable properties was formed with effect from 1 April 1985, by taking over the assets and liabilities of an erstwhile partnership firm which was dissolved with effect from 31 March 1985, with three of the existing partners and three new partners.In the return for the assessment year 1987-88(assessment completed in July,1989) the assessee returned long term capital gains of Rs.5.01 lakhs in respect of the sale of flats and undivided share of land and claimed the deduction in respect of long term capital gains amounting to Rs.2.56 lakhs. The claim was allowed by the assessing officer.Audit scrutiny in September 1991 revealed that since the new firm came into being only from 1 April 1985, the assets which were transferred had been held by the assessee for less than thirty six months and the capital gains relating to the transfer should, therefore, have been treated as short term capital gains. It was further observed that the cost of acquisition for the purpose of computation of capital gains was taken as Rs.10.55 lakhs as against Rs.9.55 lakhs, as per the clearance certificate issued by the

assessing officer to the registering authority. The incorrect computation of capital gains and the incorrect allowance of deduction resulted in short computation of income by Rs.3.56 lakhs with short levy of tax of Rs.2.03 lakhs in the hands of the firm and its partners.

Omission to levy tax on capital gains

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

Audit scrutiny of Income Tax records of an individual assessee revealed that the assessee had transferred, by way of gift, 70,644 equity shares of a public limited company to another company in March 1984 alongwith the liability of Rs.28.86 lakhs on account of loans raised by the assessee against the security of these shares. It was seen that value of these shares amounted to Rs.30.38 lakhs and a sum of Rs.1.52 lakhs was (offered for assessment and) assessed to gift tax by the gift tax officer for the assessment year 1984-85 in September 1984. As the cost price of these shares gifted to the assessee was Rs.7.19 lakhs and the deemed consideration for the said transfer was Rs.28.86 lakhs there was a long term capital gain of Rs.21.67 lakhs to the assessee for which he was liable to tax for the assessment year 1984-85 after considering certain deductions admissible under the provisions specified in the Act. This income from the capital gains which worked out to Rs.8.65 lakhs was not offered by the assessee for taxation nor were any proceedings initiated.

The department has accepted the audit observation and rectified the mistake creating additional demand of Rs.5.83 lakhs.

Mistake in assessment of firms and partners

4.19.1 The Income Tax Act,1961,provides that the Income tax officer may treat an unregistered firm as a registered firm, if the aggregate amount of the tax payable by the firm and its partners, if it were assessed as a registered firm, would be greater than the aggregate amount of the tax payable by the firm and its partners as an unregistered firm.

For the assessment years 1988-89 and 1989-90, a firm was assessed at total incomes of Rs.15.75 lakhs and Rs.25.68 lakhs respectively as an unregistered firm in February 1991 and tax including interest aggregating Rs.37.52 lakhs on the firm and its partners was levied accordingly. Had the firm been treated as registered, the aggregate amount of tax payable by the firm and its partners would have worked out to Rs.43.59 lakhs including interest which was higher than the amount of tax and interest actually levied. The mistake in not assessing the firm as a registered one resulted in total short levy of tax of Rs.6.07 lakhs including interest for non-filing of return and short payment of advance tax for the assessment years 1988-89 and 1989-90.

2. Under the provisions of the Income Tax Act 1961, if the assessment of the firm has not been completed, the share income from the firm is included in the assessments of the partners on provisional basis and the assessments are revised later to include the final share income on completion of the assessment of the firm. For this purpose, the Income tax Officer is required , under the instructions issued by the Central Board of Direct Taxes in March 1973 , to maintain a 'Register of cases of provisional share income' so that rectification of these cases is not lost sight of. No revision of the asssessment of a partner can, however, be made 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.

The Central Board of Direct Taxes issued instructions in November 1981 that where the firm and its partners are assessed in different wards, the Income tax Officer assessing the firm should communicate the share income of each partner to the Income tax Officer having jurisdiction to assess such partners immediately after completion of the assessment of the firm and should insist on its acknowledgement by the other Income tax Officer. The latter is required to revise the assessments of the partner within three months of receipt of intimation of the final share income. These instructions were issued to ensure that the correct share incomes are assessed in the hands of the partners

promptly and the tax due to the Government is assessed and demand raised without loss of time.

Pursuant to the recommendations of Public Accounts Committee made in 85th Report (Seventh Lok Sabha, 1981-82), the department issued fresh instructions in April 1983 for proper maintenance of provisional share income registers and adequate checking of the registers by Range Inspecting Assistant Commissioners and departmental audit parties. Reiterating the earlier instructions, the Board in their instructions issued in October 1984 also stated that there should be co-ordination between the assessing officers of the firm and of the partners in the matter of ascertaining the correct share income of partners and taking rectificatory action based on it. The Board issued clarificatory orders in February 1988 specifying that even for the assessments of partners completed in summary manner, remedial measures to rectify the mistakes could be taken.

Inspite of these instructions, cases of failure to revise the share income of the partners consequent upon the completion of the assessments of the firms continue.

During test check in 28 Commissioners' charges for the assessment years 1978-79 and 1980-81 to 1990-91, in respect of 809 registered firms involving 3621 partners, under assessment of Rs.11.60 crores was noticed with tax effect of Rs.5.06 crores due to omission to revise the assessments of partners within the stipulated period. Some of the mistakes/irregularities identified in audit are indicated below:

(i) In the case of 315 partners of 97 registered firms (Andhra Pradesh, West Bengal, Chandigarh, Gujarat, Madhya Pradesh, and Rajasthan charges) there was delay ranging from 4 to 49 months beyond the stipulated period in carrying out ractification of partners' share income on completion of the firms' assessments which delayed raising of tax demands of Rs.40.77 lakhs. In these cases, the firms and the partners were assessed in the same wards.

(ii) Assessments were not revised after completion of the firms' assessments in the

cases of 149 partners of 55 registered firms (Delhi, Gujarat, Karnataka, Punjab Tamil Nadu and Uttar Pradesh charges) though the firms and their partners were assessed in the same wards. This includes three partners in Karnataka charge where assessments were made in summary manner for the assessment year 1988-89. Due to non adoption of the correct share income of Rs.4.19 crores after the completion of assessments of the firms for the assessment years 1978-79 to 1982-83, 1984-85 to 1989-90, there was under assessment of income of Rs.2.40 crores with consequent short levy of tax aggregating Rs.1.13 crores, including interest for belated filing of returns and short payment of advance tax.

(iii) Non-revision of assessment was also noticed in case of partners assessed in different wards, after completion of assessments of the firms,in the charges of Commissioners of Haryana and Karnataka and Tamil Nadu. It was seen from the assessment records of 36 partners of 9 firms for the assessment years 1978-79 to 1982=83, 1984-85 to 1988-89, the assessments of which were completed between March 1989 and January 1990,that the aggregate provisional share income from the firms at Rs.47.38 lakhs was adopted instead of the correct share income of Rs.144.30 lakhs,resulting in aggregate under assessment of income of Rs.96.90 lakhs involving short levy of tax of Rs.47.93 lakhs including interest for belated filing of returns and short payment of advance tax.

It was further seen that the correct share income of 3 partners in a firm assessed in summary manner in the Karnataka charge was not communicated to the assessing officers who had jurisdiction over their assessments leading to delay in creation of demand of Rs.5.27 lakhs.

(iv) In the case of 75 partners of 18 firms (Chandigarh, Kerala and Punjab charges), the assessing officers of the firms had not sent intimation of the share incomes of the partners even after expiry of the period of 4 to 20 months from the dates of completion of the assessments of the firms to the assessing officers of the partners located in different wards. This resulted in underassessment of income of Rs.37.60 lakhs

with tax effect of Rs.12.65 lakhs.

(v) Test check also revealed that the cases of 135 partners of 31 registered firms (West Bengal, Chandigarh, Gujarat, Kerala and Madhya Pradesh charges), had become time barred as the assessments were not revised/rectified within the time limit of 4 years from the end of financial year in which the firms' assessments were completed resulting in non-levy of tax of Rs.7.95 lakhs.

(vi) Apart from non-maintenance of the prescribed register in some charges , there were many defects where it was maintained and this impaired proper coordination in effecting revision of partners' assessments. The defects noticed included failure to carry over outstanding entries to the subsequent year, absence of entries regarding completion of partners' assessments of provisional share income, lack of internal control and supervision etc.

Income not assessed

4.20 Under the Income Tax Act, 1961, all income accruing or arising to an assessee in a previous year relevant to the assessment year is includible in his total income.

A- Scrutiny Assessment

1(i) The assessment of an assessee individual for the assessment year 1987-88 was completed in March,1990 at a taxable income of Rs.3.90 lakhs, being the share income from three firms.It was noticed in audit that for the earlier assessment year 1986-87, the assessee had admitted an amount of Rs.200.00 lakhs as unexplained investment in about 70 benami accounts in banks and had offered it as income.However, for the assessment year 1987-88, no interest income from these banks deposits was returned by the assessee nor was it considered by the assessing officer while completing the assessment. Even at the rate of 10 per cent per annum, accrued interest escaping assessment would be Rs.20.00 lakhs, resulting in a short levy of tax of Rs.16.80 lakhs, which included interest for late filing of return of income and non filing of the statement of advance tax.

(ii) In the assessment for the assessment year 1988-89 in respect of an individual assessee, completed in March,1991, credit for

tax deducted at source amounting to Rs.3,919 was allowed from total contract receipts of Rs.19.18 lakhs. Scrutiny of the profit and loss accounts revealed that total receipts from contract and manufacturing jobs were credited at Rs.10.53 lakhs and total value of work in progress was shown at Rs.21.03 lakhs. Further, contract receipts aggregating Rs.3.86 lakhs received from two concerns during the relevant previous year were included neither in total contract receipts nor in the total work in progress.As all the expenditure in securing contract receipts had been claimed and allowed and credit for the entire tax deducted at source was allowed, the above receipts of Rs.3.86 lakhs should have been included in the total receipts, for ascertaining the correct business income of the assessee.This having not been done, income of the assessee was under assessed to the extent of Rs.3.86 lakhs with consequent undercharge of tax of Rs.2.87 lakhs including interest for delay in filing of return and short payment of advance tax.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of the Income Tax Act, 1961,the total income of any previous year of a person, inter alia, includes all income from whatever source derived which is received or is deemed to be received in India in such year or accrues or arises or is deemed to accrue or arise to him in India during such year. On the basis of judicial decision5 (January 1982) the Central Board of Direct Taxes issued instructions in February 1986 stating that the cash compensatory support given to exporters is taxable as trading receipts.The Finance Act 1990 also introduced an amendment to the Income Tax Act with retrospective effect from the assessment year 1967-68 that export incentives given to exporters by way of cash compensatory support or any other subsidy received by them for export would be included in the definition of income and taxed under the head profits and gains of business or profession.

An assessee, a registered firm, which was in receipt of cash compensatory support and Central excise rebates of Rs.10.88 lakhs in

5 Jeevanlal (1929) Ltd. Vs.CIT Central Circle II, Calcutta-848

the previous year relevant to the assessment year 1989-90 had offered to tax a sum of Rs.83,204 only. The difference of Rs.10.05 lakhs, being revenue receipts and thus taxable, was not offered to tax by the assessee.This omission led to short levy of tax of Rs.6.86 lakhs in the hands of the firm and its partners including interest for default in payment of advance tax, besides attracting penalty for concealment of income.

3. The Act specifically provides that any interim dividend shall be deemed to be 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.

Assessment of two individual assessees for the assessment year 1986-87 was completed in March 1989. Audit scrutiny of the assessment records revealed (November 1989) that a sum of Rs.11.25 lakhs, being interim dividend paid to the assessee shareholders during the previous year relevant to the assessment year 1986-87, was kept out of computation of income assessed at Rs.28.11 lakhs. It was further seen that though interim dividend was to be paid to the members who were entitled to it, it was paid subject to its confirmation by the shareholder as final dividend.The dividend paid to the members is thus assessable as income of the relevant previous year. Omission to do so resulted in under assessment of income of Rs.11.25 lakhs and under charge of tax of Rs.6.44 lakhs including interest for delayed submission of return and short payment of advance tax in the two cases.

The department has accepted the audit observation.

4. Under the Income Tax Act, 1961, where in any financial year, the assessee has made investments which are not recorded in the books of account, if any, maintained by him, and the assessee offers no explanation about the source of investment or the explanation offered is not, in the opinion of the assessing officer satisfactory, the value of the investment is deemed to be the income of the financial year.

In the assessment of a firm for the

assessment year 1989-90, completed in March 1991, the total income was assessed at Rs.2.83 lakhs after making an addition of Rs.46,000 to the returned income of Rs.2.37 lakhs and refund of excess advance tax of Rs.34,730 together with interest of Rs.11,970 was allowed to the assessee.

Scrutiny of case records of the assessee revealed that survey was carried out in the premises of the assessee in January 1989 when investment of Rs.3.00 lakhs in stock-in-trade was not found recorded in the assessee's books.The assessee agreed to surrender the value of Rs.2.50 lakhs of investment in stock-in-trade and sought 15 days' time to reconcile the further difference.Advance tax of Rs.38,000 was also paid in respect of the said income in March 1989. However the assessing officer did not make addition of the unexplained investment of Rs.3.00 lakhs to the total income during assessment proceedings. The omission resulted in escapement of income of Rs.3 lakhs and short levy of tax of Rs.1.93 lakhs in the case of the firm and its partners. The failure also resulted in non levy of penalty of Rs.1.58 lakhs for concealment of particulars of income by the assessee.Thus there was total underassessment of Rs.3.51 lakhs. The refund of Rs.46,700 allowed to the assessee was also irregular.

B- Summary Assessment

1. Any subsidy granted by the Government to recoup revenue expenditure is deemed to be a revenue receipt in the hands of the assessee.

A cooperative society, engaged in the business of collection of milk from milk producers through village societies, received from the State Government transport subsidy of Rs.14.87 lakhs and Rs.12.87 lakhs in respect of the assessment years 1989-90 and 1990-91, in recoupment of the expenditure on transport already incurred by the assessee.The receipt was not shown in the profit and loss account of either year but loss of each year shown in the balance sheet was reduced by the amount of the subsidy. The subsidy, being revenue receipt, was required to be credited to the profit and loss account. By not doing so, the loss as per profit and loss account was claimed in excess to the extent of the amount of the subsidy.

In the assessments made in September 1990 and November 1990 in the summary manner, the assessing officer allowed the claim of excess carry forward of loss of Rs.14.87 lakhs and Rs.12.87 lakhs in respect of the assessment years 1989-90 and 1990-91. This resulted in aggregate potential short levy of tax of Rs.11.72 lakhs and non-levy of aggregate additional income tax of Rs.2.34 lakhs over the two years.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income Tax Act, 1961, any tax deducted at source shall be treated as a payment of tax on behalf of the person from whose income the deduction was made and credit shall be given to him for the amount so deducted in respect of the assessment year for which such income is assessable. The related receipt from which the tax was deducted has to be taken into account in computing the assessee's total income.

In the assessment of an individual assessee for the assessment year 1988-89, completed in a summary manner in March 1989, in determining the quantum of tax payable, credit was given for a sum of Rs.92,100 towards tax deducted at source from interest of Rs.9.24 lakhs received on debentures.However, out of the receipt of Rs.9.24 lakhs from which the tax had been deducted, a sum of Rs.1.24 lakhs only was assessed to tax. The omission resulted in under assessment of income of Rs.8.00 lakhs and consequential undercharge of tax of Rs.4.66 lakhs including interest for short payment of advance tax in the assessment year 1988-89.

The department has accepted the audit observation.

Incorrect set off and carry forward of losses

4.21.1 Under the Income Tax Act, 1961, the assessing officer shall give due effect to the allowance, inter alia, of unabsorbed depreciation, unabsorbed investment allowance and business loss carried forward in the regular assessment, if any, for earlier assessment year or years while completing the assessment after scrutiny of the accounts and hearing the assessee.

In the case of assessment of an assessee firm for the assessment year 1988-89, completed under scrutiny in March 1991, it was noticed (June 1991) in audit that unabsorbed depreciation and investment allowance aggregating Rs.32.16 lakhs was allowed to be carried forward, while unabsorbed investment allowance of Rs.1.76 lakhs only was to be carried forward from the assessment year 1988-89 as per the assessment records. The incorrect determination of carry forward of unabsorbed depreciation and investment allowance amounting to Rs.32.16 lakhs in the original assessment order of March,1991 involved a potential tax effect of Rs.8.17 lakhs. The department has since passed a rectificatory order (May 1992) determining that no amount was required to be carried forward.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income Tax Act, 1961, where the net result of the computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss cannot be wholly set off against income under any other head of income of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year to be set off against the profits and gains of business or profession of those years.

The assessment of an individual for the assessment year 1987-88 was completed in March 1990 determining 'Nil' income after setting off the assessee's share of the unabsorbed business loss for assessment year 1986-87, of Rs.12.22 lakhs relating to a firm wherein he was a partner. Audit scrutiny revealed (September 1990) that the entire income of the assessee for the previous year relevant to the assessment year 1987-88 consisted only of income from property/other sources and therefore the setting off of the assessee's share of business loss carried forward from earlier years against such income was not regular. The mistake resulted in a short levy of tax of Rs.5.90 lakhs.

Ministry of Finance have accepted the audit observation.

Mistake while giving effect to appellate orders

4.22.1 The assessment of a firm for the assessment year 1985-86, concluded in October 1987, was revised in January 1991 to give effect to an appellate order, determining a business loss of Rs.9.20 lakhs and unabsorbed investment allowance of Rs.8.22 lakhs. The entire amount of Rs.17.42 lakhs was, however, allocated by the assessing officer among the partners of the firm instead of only the business loss of Rs.9.20 lakhs. This resulted in incorrect allocation of loss of Rs.8.22 lakhs among the partners involving potential short levy of tax of Rs.4.52 lakhs in the hands of partners of the firm.

Ministry of Finance have accepted the audit observation.

2. The assessments of a registered firm, engaged in construction and renting of building, for the assessment years 1982-83 and 1984-85 to 1987-88, were completed by the assessing officer treating the entire rental income as falling under the head income from house property'. On appeal, the Appellate Authority in his orders issued in August and November 1989, directed the assessing officer to treat 75 per cent of the rental income as 'Income from house property' and the balance 25 per cent as 'income from other sources' and to allow deduction of all the expenses shown in the profit and loss account for computing the 'Income from other sources' excluding those that were to be allocated as deduction while computing the income under the head ' income from house property'. The assessing officer revised the assessments in February 1990, allowing one-sixth of the annual value considered for computing the portion of income under the head ' Income from house property'. It was seen in audit that in computing the income under the head ' Income from other sources'. the assessing officer had again allowed expenditure aggregating Rs.9.77 lakhs debited to the profit and loss accounts towards 'Building Maintenance' which had to be disallowed as that had been considered separately while computing the income under the head 'Income from house property'. The mistake resulted in short levy of tax of Rs.3.92 lakhs in the hands of the firm and its partners, for the five assessment years.

Ministry of Finance have accepted the audit observation.

Incorrect exemptions and excess reliefs

Mistake in allowing deductions under Chapter VIA

4.23 Under the provisions of Chapter VIA of the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax.The overriding condition is that the total deduction should not exceed the gross total income of the assessee. 'Gross total income' had been defined in the Act as the total income computed in accordance with the provisions of the Act before making the deductions under chapter VIA. Where set off of unabsorbed loss, depreciation investment allowance etc. of earlier years results in reducing the total income to 'nil' or to a loss, no deduction under chapter VIA is admissible. Under the revised procedure of summary assessment introduced with effect from assessment year 1989-90, the assessing officer is required to disallow deduction, allowance or relief which are prima facie inadmissible and also levy additional income tax at the rate of twenty per cent of the tax payable on such excess amount.

The return of 'nil' income of a cooperative sugar mill for the assessment year 1989-90 was accepted by the assessing officer and an intimation was sent under the summary scheme in March 1991. In the statement of income computed, the income was worked out as Rs.62.96 lakhs for income tax purposes.Audit scrutiny (December 1991) revealed that deductions under chapter VI A were allowed first to the extent of Rs.25.58 lakhs and the balance was set off against the carried forward loss of Rs.191.04 lakhs, which was irregular.The incorrect deduction resulted in excess carry forward of loss of Rs.25.58 lakhs with potential tax effect of Rs.10.70 lakhs and non levy of additional income tax of Rs.2.14 lakhs.

Ministry of Finance have accepted the audit observation.

Incorrect relief in respect of profits from newly established industrial undertaking (prior to 31 March 1981)

4.24 Under the provisions of the Income Tax Act, 1961, prior to its amendment by the Finance Act, 1980, 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 (7.5 percent from 1 April 1976) of the capital employed 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 (six in the case of a co-operative society) succeeding assessment years. Where, however, such profits and gains fell short of the relevant amount of capital employed during the previous year, the amount of such shortfall or deficiency was to be carried forward and set off against future profits upto the seventh assessment year reckoned from the end of the initial assessment year.

1. The Income Tax assessment of a cooperative sugar mills for the assessment year 1989-90 was completed in March 1991 determining the total income at Rs.1.72 crores after allowing relief in respect of the newly established industrial undertaking amounting to Rs.65.09 lakhs.Audit scrutiny(December 1991) revealed that the assessee started commercial production of sugar during the previous year relevant to the assessment year 1982-83. As such it was entitled to the relief upto the assessment year 1988-89 only and no relief was allowable for the assessment year 1989-90. The assessee itself had not claimed the relief. The incorrect grant of relief of Rs.65.09 lakhs resulted in undercharge of tax of Rs.47.02 lakhs including interest for belated filing of return of income and for default in payment of advance tax.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income Tax Act 1961, where the assessee is a person other than a company or a co-operative society, the deduction from profits and gains derived from an industrial undertaking equal to twenty percent thereof shall not be admissible unless the accounts of the industrial

undertaking for the previous year relevant to the assessment year for which the deduction is claimed have been audited by an accountant and the assessee has furnished, alongwith his return of income, the report of such audit in the prescribed form duly signed and verified by such accountant. The deduction shall be allowed for seven assessment years beginning with the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture.

While completing the assessments of an assessee firm for the assessment years 1987-88 to 1989-90 between March 1989 and April 1990, the assessing officer allowed deductions amounting to Rs.1.27 lakhs, Rs.1.23 lakhs and Rs.2.47 lakhs on account of profits and gains derived from an industrial undertaking. Scrutiny in audit, however, revealed that the assessee firm had not furnished alongwith the returns, the prescribed reports of audit by an accountant. The deductions allowed were as such, not, admissible. The mistake resulted in under-assessment of income by Rs.4.98 lakhs involving tax of Rs.2.97 lakhs for the assessment years 1987-88 to 1989-90 in the case of the firm and its partners.

The department has accepted the audit observation.

Incorrect deduction in respect of profits from new industrial undertaking established after 31 March 1981.

4.25 Under the provisions of the Income Tax Act 1961, as amended by the Finance No.(2) Act, 1980, with effect from 1 April 1981, an assessee whose income includes any profits and gains derived from an industrial undertaking which goes into production within a period of nine years next following 31 March 1981, is entitled to a deduction of twenty per cent of such profits and gains from the income assessable to tax for a period of eight years including the year in which the assessee begins to manufacture.

The assessment of a registered firm for the assessment year 1989-90 was completed in July 1990 in the summary manner allowing a deduction of Rs.17.75 lakhs in respect of the profits and gains of new industrial undertaking. Audit scrutiny revealed (October 1991) that the profits of the new industrial undertaking were determined at Rs.48.74 lakhs and the deduction would, therefore, work out

to Rs.9.75 lakhs. The excess deduction of Rs.8 lakhs resulted in short levy of tax of Rs.5.56 lakhs (including additional income tax) in the hands of the firm and its partners.

Incorrect allowance of relief in respect of export turnover

4.26 Under the provisions of the Income Tax Act, 1961, as applicable for the assessment years 1987-88 and 1988-89, an assessee being an Indian company or a person other than a company resident in India, engaged in the business of export out of India of any goods or merchandise during the previous year, shall be allowed, in computing the total income, a deduction equal to the aggregate of 4 per cent of net foreign exchange realisation and 50 per cent of so much of the profits derived from the exports of such goods or merchandise as exceeded 4 per cent of the foreign exchange realisation. With effect from the assessment year 1989-90, an assessee being an Indian company or other assessee resident in India and engaged in export business is entitled to a deduction of the whole of the profits derived from such business. In a case where the business carried on by the assessee does not consist exclusively of export out of India of goods or merchandise (other than mineral oil and mineral ores), the profits derived from exports of goods or merchandise shall be the amount which bears to the profits of the assessee as computed under the head 'profits and gains of business or profession' the same proportion as the amount of export turnover bears to the total turnover of the business carried on by the assessee. The aggregate deduction allowable however would not exceed the export profits.

A - Scrutiny Assessment

(i) It was revealed in audit that an assessee firm, engaged in the business of export of goods out of India as well as sale within India, claimed and was allowed, for the assessment years 1987-88 to 1990-91, deductions of Rs.77.91 lakhs as against admissible deductions of Rs.66.42 lakhs. This resulted in excess allowance of deductions of Rs.11.49 lakhs involving short levy of tax of Rs.7.40 lakhs in the hands of the firm and its partners.

Ministry of Finance have accepted the audit observation.

(ii) The Act provides that the deduction should not exceed the profits derived by the assessee from the export of goods or merchandise and the amount of deduction has to be worked out with reference to the net amount of such income included in the gross total income of the assessee. It has also been clarified that for the purpose of determining the profits derived from the export of goods, 'export turnover' should not include freight or insurance.

In the assessment of an assessee individual for the assessment year 1988-89, completed in September 1988, the assessing officer allowed a deduction of Rs.24.29 lakhs as claimed by the assessee. Audit scrutiny revealed that in determining the profits derived by the assessee from the export of goods, the deduction of Rs.3.90 lakhs allowed towards Investment Deposit Account in computing the assessee's business income was not taken into account. Further, freight amounting to Rs.4.79 lakhs was also not deducted from the export turnover. These mistakes resulted in allowance of excess deduction of Rs.3.33 lakhs and under assesment of tax of Rs.1.65 lakhs.

Ministry of Finance have accepted the audit observation.

B- Summary Assessment

In the return of income of a registered firm for the assessment year 1989-90, processed under the summary assessment procedure, the assessee worked out the deduction in respect of export turnover as Rs.49,589 at four per cent of the profits and gains of its business.Audit scrutiny revealed(November 1991) that the assessee had worked out the profit on export turnover after deducting the export incentive of Rs.9.79 lakhs from the total business profit and then claimed the entire export incentives of Rs.9.79 lakhs along with the relief of Rs.49,589 on account of profit on export turnover as deduction. Correctly computed, the deduction would work out to Rs.88,550 as against Rs.10.28 lakhs allowed.The excess allowance resulted in short computation of income of Rs.9.40 lakhs with consequent undercharge of Rs.5.14 lakhs in the hands of the firm and partners(including additional income tax).

Non levy/ Incorrect levy of interest

Delay in payment of tax demand

4.27.1 Under the Income Tax Act, 1961, as amended from 1 April 1989, 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 levy of simple interest at fifteen percent per annum (one and one-half percent for every month or part thereof from 1 April 1989) from the date of default till the actual date of payment of demand.

The assessment of a co-operative sugar mills for the assessment year 1986-87 was completed in February 1990 on a total income of Rs.125.53 lakhs and tax demand of Rs.50.17 lakhs was raised.The due date for payment of demand expired in May 1990.A further demand of Rs.4,604 was raised based on the revised total income of Rs.125.65 lakhs assessed in September 1990.The assessee paid only Rs.50.17 lakhs in two instalments, one of Rs.10 lakhs in October 1990 and another of Rs.40.17 lakhs in February 1991. The assessing officer charged interest amounting to Rs.3.61 lakhs for the belated payment of tax demand.Audit scrutiny (December 1991) revealed that the assessing officer had computed the interest as if the assessee had paid the demand in five equal instalments of Rs.10 lakhs each over the period August 1990 to December 1990 and Rs.21,266 in January 1991, (as against Rs.50.17 lakhs paid). He had also calculated the interest at fifteen per cent.Thus non-payment of Rs.4,604 alongwith calculation errors resulted in the undercharge amounting to Rs.3.31 lakhs.

Ministry of Finance have accepted the audit observation.

2. Any person who has not been assessed previously has to send to the Income tax officer, in each financial year, before the date on which the last instalment of advance tax is due, an estimate of his total income for the relevant previous year and pay advance tax accordingly.Failure to file the estimate and to pay the tax within the due date renders the assessee liable to pay interest at the prescribed rates from 1 April next following the financial year in which advance tax was payable upto the date of regular assessment.

Two foreign technicians were assessed for the first time in April 1988 with total income of Rs.12.38 lakhs and Rs.5.57 lakhs against NIL income returned by them for the assessment year 1986-87. The assessees did not file any estimate of their current income nor pay advance-tax except self-assessment tax of Rs.0.02 lakh paid by one of them.Consequently, the individuals were liable for levy of interest aggregating Rs.2.56 lakhs calculated at 15 per cent from 1 April 1986 to 31 March 1988.Interest was not, however, levied.

The department has accepted the audit observation.

Non-filing of annual returns for tax deducted at source.

4.28 Under the provisions of the Income Tax Act, 1961, the prescribed person in the case of every office of Government, the principal officer in the case of every company, the prescribed person in the case of every local authority or other public body or association, every other private employer and every other person responsible for deducting tax under the Act shall, within the prescribed time after the end of such financial year, prepare and deliver or cause to be delivered to the prescribed income tax authority, such returns in such form and verified in such manner and setting forth such particulars as may be prescribed. Failure to file the prescribed return within the due date renders the person responsible liable to penalty of not less than one hundred rupees. which may extend to two hundred rupees, for every day during which the failure continues.

Audit scrutiny of annual returns for the financial years 1988-89 and 1989-90 in respect of salary income drawn and disbursed to the employees revealed that twenty five Drawing and Disbursing officers assigned to deduct tax at source had filed returns belately, with delays ranging from 179 to 791 days. The department, however, did not initiate any penalty proceedings. The minimum penalty not levied in these cases amounted to Rs.9.95 lakhs.

Omission to levy penalty.

4.29.1 Under the provisions of Income Tax Act, 1961, where in the course of the search operation the assessee is found to be the owner of any money, bullion, jewellery or

other valuables and the assessee claims that such assets have been acquired by utilising his own income, then notwithstanding the fact that such income is declared by him in any return of income furnished on or after the date of the search, he should, for the purpose of imposition of penalty for concealment of income, be deemed to have concealed the particulars of income.

In the case of an assessee individual, after the search operation conducted on 29th January 1988, an income of Rs.9.63 lakhs was returned for the previous year relevant to the assessment year 1988-89 on 29th May 1989, as against the due date of 31 July 1988. The assessee also paid tax of Rs.54,449 and Rs.1.39 lakhs on 29 May 1989 and 28 November 1989 respectively against the assessed tax of Rs.4.89 lakhs. It was noticed in audit that a minimum penalty of Rs.4.84 lakhs was leviable for concealment of income of Rs.9.63 lakhs. The penalty was however not levied on the ground that conditions for grant of immunity from levy of penalty as prescribed under the provisions specified in the Act were satisfied. As the return was not filed on the due date and taxes/interest thereon were also not paid on such due date, the waiver of penalty was irregular.

2. The Income Tax Act, 1961, as amended from the assessment year 1985-86 and onwards, has made it obligatory for every assessee whose total sales, turnover or gross receipts in business exceed forty lakh rupees in any previous year to get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain report of such audit in the prescribed form within the due date. The due date for filing the return for business cases has been prescribed as 30 June or 31 July of the assessment year according to the date of closing of the accounts of the assessee. Failure to get the accounts audited and to obtain the audit report within the due dates renders the assessee liable to a penalty equivalent to one half per cent of the turnover or one lakh rupees, whichever is lower.The Central Board of Direct Taxes had issued instructions in July 1964 and again in September 1975 that where the Income tax Officer did not initiate penalty proceedings in any case, he should record the reasons for

not doing so.

A -Scrutiny Assessment

(i) Audit scrutiny of the assessment records of nine assessees(seven registered firms and one association of persons and one individual), for the assessment years 1985-86 to 1988-89, revealed that though the total turnover of each of the assessees had exceeded Rs.40 lakhs, the statutory audit reports had not been furnished alongwith the returns of income. It was seen that the assessing officer did not insist upon submission of the report, nor initiate proceedings for levy of penalty which aggregated Rs.8.68 lakhs. Further, in the case of two more assessees, which were registered firms, the prescribed audit reports for the assessment year 1987-88 and 1988-89 were filed after expiry of the stipulated dates, entailing levy of penalty amounting to Rs.1.71 lakhs.

The department has accepted the audit observation in nine cases.

(ii) An assessee, a co-operative society, filed the return of income for the assessment years 1985-86 to 1988-89 in January 1989 alongwith audited accounts signed by the authorised accountant on 9 June 1987, 3 October 1989 and 4 December 1990 for assessment years 1985-86,1986-87 and 1987-88 respectively. In respect of assessment year 1988-89, the assessment was made on the basis of unaudited accounts, no audit report having been submitted. In the assessment for these years completed in March 1991, the assessing officer did not initiate any penalty proceedings nor keep a note of the reasons for not doing so. At the rate of one-half per cent of the turnover or one lakh rupees whichever is lower, the penalty leviable but not levied aggregated Rs.4 lakhs.

(iii) Two assessees filed their returns of income alongwith the prescribed audit reports of chartered accountants on 31 July 1987, 14 October 1987 and 14 October 1988 after the prescribed due dates i.e. 31 July 1986, 31 July 1987 and 31 August 1988 for the assessment years 1986-87, 1987-88 and 1988-89 respectively and as such they were liable for penalty. No such penalty was, however, levied. The omission resulted in non-levy of penalty amounting to Rs.3 lakhs.

The department has accepted the mistake in one case and levied penalty of Rs.1 lakh.

B.-Summary assessment

(i) In the case of two assessee co-operative societies, the assessments for the assessment year 1989-90 were completed on 25th January 1990 and 20th March 1990 under the summary assessment procedure. It was observed in audit that the assessees had sales in excess of Rs. forty lakhs each. As such the accounts were required to be audited by an accountant and the report of such audit was to be submitted before the specified date viz. 31 October 1989 which was not done.Omission to do so attracted levy of penalty of one half percent of total sales on Rs.49.02 crores including consignment sales of Rs.3.52 lakhs for the period 1 July 1987 to 31 March 1989.The sales for 12 months worked out to Rs.28.02 crores.Thus penalty amounting to Rs.14 lakhs limited to to Rs.2 lakhs has to be levied.

There was no mention in writing either in the order sheet or on the body of intimation sheet under section 143(1) about the reasons for non-initiation of penalty proceedings.

Ministry of Finance have accepted the audit observation.

(ii) The assessments of three registered firms for the assessment years 1985-86 to 1988-89 were completed in the summary manner between January 1989 and March 1990. Audit scrutiny revealed (May,1990) that the gross turnover in all the three cases as per the Trading and Profit and Loss Account of each year exceeded Rs.40 lakhs.The audit reports contemplated under the Act were however filed by the assessee firms after the specified date for all the assessment years, the delay ranging from 5 to 32 months.No penalty was levied for the default. The aggregate penalty leviable in the three cases worked out to Rs.4.69 lakhs.

Ministry of Finance have accepted the audit observation.

3. Under the provisions of Income Tax Act, 1961, no person shall after 30 June 1984, take or accept from any other person any loan or deposit of Rs.10,000 (Rs.20,000 from 1 April 1989) or more otherwise than by account

payee cheque or bank draft subject to certain exceptions. Similarly no person shall repay in cash to any person any deposit or deposit with interest if the amount is Rs.10,000 or more. Any person contravening these provisions without reasonable cause is liable to pay a fine equal to the amount of such loan or deposit. The Central Board of Direct Taxes has also directed that in cases where the Income tax Officer does not initiate proceedings, he should record the reasons for not doing so.

(i) In the assessment of an assessee individual for the assessment year 1989-90, completed in March 1990 in a summary manner, it was seen in audit that the assessee had accepted deposits in cash amounting to Rs.5.54 lakhs from eleven private parties as evidenced from the audit report filed with the returns. As the aggregate amount accepted from each person was more than Rs.10,000 penalty was to be levied. It was further seen that, repayment of deposit in cash amounting to Rs.95,800 was also effected in contravention of the provisions of the Act. The total fine leviable worked out to Rs.6.50 lakhs, which was not levied. Reasons for not doing so were not recorded.

(ii) The assessments of two assessee individuals for the previous years relevant to the assessment years 1987-88 and 1990-91 were completed in February 1989 and March 1991 in the summary manner. From the prescribed audit reports filed with the return of income it was seen that the assesses had accepted/paid in cash loans/deposits amounting to Rs.3.61 lakhs, each in excess of the limit prescribed. The assessing officers did not initiate penalty proceedings, nor record any reasons for not doing so. The total fine/penalty leviable in these cases worked out to Rs.3.61 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of an assessee registered firm for the assessment year 1988-89, completed in October 1988 in a summary manner, the assessee had repaid a sum of Rs.2 lakhs in cash to another person, as evidenced from the tax audit report. Audit scrutiny revealed that the assessing officer did not

initiate any action to levy penalty nor record the reasons for not doing so. Fine leviable in the case worked out to Rs.2.00 lakhs.

Other topics of interest

Failure to observe the provisions relating to contractors

4.30 Under the provisions of Income Tax Act, 1961, and the rules framed thereunder, where any contractor enters into a contract with any person for carrying out any work or for 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 the contract, furnish to the assessing authority the particulars of the contract in the prescribed form. In the event of failure to furnish the particulars, the Commissioner of Income tax may impose a fine not exceeding fifty rupees for every day of default subject to the maximum of twenty five percent of the value of the contract. The provisions relating to filing of the statutory statements have been enacted with a view to counter evasion of tax.

In the assessment of four assessees (two registered firms, one AOP and one individual) for the assessment years 1986-87 and 1987-88, completed between March 1989 and May 1991, it was noticed that though the assessees had entered into contract with other persons for carrying out works and for supply of goods exceeding Rs.50,000 each, they had failed to furnish particulars of contracts in the prescribed forms. However no action was initiated by the department to call for the statutory statements or to invoke the penal provisions of law. The maximum fines imposable in these cases amounted to Rs.9.41 lakhs.

Non-disallowance of expenditure in excess of Rs.2,500/ Rs.10,000, paid otherwise than by crossed cheque/draft

4.31 The Income Tax Act, 1961, provides for disallowance of expenditure incurred in business or profession for which payment is made for any amount exceeding Rs.2,500 (Rs.10,000 with effect from 1 April 1989) otherwise than by crossed cheque or crossed bank draft.This provision was designed to counter evasion of tax through claim for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the department as to the identity of the payee and the reasonableness of the amount. Some cases and circumstances

in which exemption from this requirement can be claimed have been provided in the Rules.A residuary provision made in this regard states that exemption can be allowed where the assessee satisfies the Income tax Officer not only about the genuineness of the payment and identity of the payee but also on the fact that the payment could not be made by a crossed cheque/draft due to exceptional or unavoidable circumstances, or to the impracticability of payment or to avoid causing genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof.

It has been juducially held6 that to claim the benefit of the provision of this Rule, it is not sufficient to establish the genuineness of purchases and identity of the payee. The assessee should also be further required to prove that the circumstances mentioned in the Rule existed and the required conditions were satisfied, and in the absence of such evidence such payments are not deductible in the computation of income.

Under the Act as made applicable from the assessment year 1985-86, assessees carrying on business or profession, if their total sales, turnover or gross receipts exceeded the specified limit, should file in respect of their accounts for a previous year, an audit report furnished by a chartered accountant in the prescribed form to facilitate the assessing officer in allowing the claim for deduction.The form of Audit Report provides for the auditor to list out payments in excess of Rs.2,500 made otherwise than by crossed cheque/bank draft.

(i) In the case of an assessee registered firm, engaged in the business of labour job for dyeing and printing on contract basis, payments aggregating Rs.12.78 lakhs were made otherwise than by crossed cheque or crossed bank draft.The payments were allowed merely on the basis of certificate of the chartered accountant that the identity of the person

6 Nahgi Lal Vs. CIT (167-ITR-139)

were established and hence these cases were covered by the exceptions provided under the Income tax Rules 1962. Scrutiny of the records revealed that the payments were made to parties established in business in a city well served by banking facilities.It was also noticed that no exceptional or unavoidable circumstances for making payments in cash or the difficulties that would otherwise be caused were proved.Moreover, the assessing officer had not recorded his satisfaction as to the circumstances for extending the benefit of the Rule. As such, payments should have been disallowed in the computation of income.Failure to do so resulted in under assessment of income of Rs.12.78 lakhs and short levy of tax of Rs.9.02 lakhs.

The department has accepted the audit observation.

(ii) In the case of an assessee registered firm for the assessment year 1987-88, the chartered accountant had certified that in 113 cases, involving payments aggregating Rs.12.35 lakhs (each exceeding Rs.2500), payment had been made otherwise than by crossed cheques/drafts and the payments were also not covered by any of the items eligible for exemptions as listed in the Income tax Rules. Further, these payments were made to firms, companies and individuals located in places where cheque drawing facilities were available and the assessee had also not furnished any explanation for the extraneous circumstances that existed for making such payments. As such, payments aggregating Rs.12.35 lakhs should have been disallowed. It was seen in audit that in the assessment completed in March 1990, the assessing

officer had allowed the entire expenditure without assigning any reason for this deviation in effecting payments in cash. The omission resulted in short computation of income of Rs.9.88 lakhs (after adjustment of the assessed loss of Rs.2.47 lakhs) with consequent short levy of tax of Rs.5.18 lakhs (both firms and partners) apart from potential tax effect of Rs.59,215 due to incorrect carry forward of loss.

Ministry of Finance have accepted the audit observation.

Loss of revenue due to non-completion of set aside assessment within the prescribed time limit

4.32 Under the provisions of the Income Tax Act, 1961, an order of fresh assessment in pursuance of an order passed by the Commissioner of Income tax (Appeals) setting aside or cancelling an assessment may be made at any time before the expiry of two years from the end of the financial year in which the order is reviewed by the Commissioner.

In the assessments for assessment years 1979-80 and 1980-81 completed in April 1983, the demand payable by a firm was determined as Rs.85,917 for assessment year 1979-80 and Rs.1.75 lakhs for assessment year 1980-81. On appeal by the asessee regarding jurisdiction, the Commissioner of Income tax (Appeals) set aside the said assessments in October 1983 with the direction that the assessments be redone in accordance with law after settling the issue of jurisdiction. When the assessing officer informed (January 1984) the assessee that he would complete the assessments, the assessee firm again challenged his jurisdiction. The assessing officer solicited instructions of the Commissioner of Income tax on the question of jurisdiction. In November 1984, the Commissioner informed the Income Tax Officer that the assessee had no

objection to the assessment being completed by the latter. It was, however, observed (June 1988)in audit that no action had been taken to complete the above assessments which resulted, due to time bar, in loss of revenue of Rs.2.61 lakhs in the hands of the firm for assessment years 1979-80 and 1980-81 and Rs.62,300 in the hands of the partners for the assessment year 1979-80 as per the assessments set aside.

Ministry of Finance have accepted the audit observation.

CHAPTER 5

A WEALTH TAX

5.01 In the financial years 1987-88 to 1991-92, wealth tax receipts as against budget estimates were as given below:

Year	Budget Estimates	Actuals	Variation	Percentage
		(In crores of rupees)		
1987-88	120.00	100.58	(-)19.42	(-)16.18
1988-89	120.00	122.48	02.48	02.06
1989-90	120.00	178.51	58.51	48.75
1990-91	175.00	231.17	56.17	32.09
1991-92*	255.00	306.93	51.93	20.36

*Provisional

5.02 Particulars of cases finalised, assessments pending and demand in arrears for the five years ending 31 March 1992 are as given below:

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of the year	Arrears of demand pending collection at the end of the year (In crores of rupees)
1987-88	09,23,182	3,78,499	283.22
1988-89	06,95,326	3,19,267	406.78
1989-90	05,23,897	3,55,756	402.26
1990-91	05,96,411	3,61,114	429.52
1991-92*	06,87,158	3,28,041	473.28

* Provisional

5.03 During the test audit of assessments completed under the Wealth Tax Act,1957, conducted during the period 1 April 1991 to 31 March 1992, short levy of wealth tax of Rs.6.42 crores was noticed in 1324 cases.

A total number of 83 draft paragraphs involving tax effect of Rs.169.38 lakhs were issued to the Ministry of Finance for comments during March 1992 to July 1992. The Ministry of Finance have accepted the observations in 44 cases involving tax effect of Rs.77.33 lakhs. 27 illustrative cases

involving tax effect of Rs.116.95 lakhs are given in the following paragraphs. While Paras 5.04 to 5.08 are on wealth tax on assessees other than companies, para 5.09 relate to company cases. Out of these, the Ministry of Finance have accepted the observations in 12 cases involving tax effect of Rs.52.60 lakhs . 3 cases involving tax effect of Rs.8.85 lakhs were checked by the Internal Audit of the department but the mistakes were not detected by them.

Wealth tax on assessees other than companies

5.04 Under the Wealth Tax Act,1957, wealth tax on assessees other than companies is chargeable in respect of each assessment year on the net wealth of the assessees as on the valuation date relevant to that assessment year at the rates prescribed in the Schedule to the Act. Net wealth means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date.

Wealth not assessed

1(i) An assessee individual was a partner in a firm which was discontinued in April 1975 and thereafter one of the partners was stated to have become the sole owner of the property. But the assessee continued to claim fifty per cent ownership in the property. For the assessment year 1987-88, the property was valued by the Valuation Cell at Rs.110.87 lakhs as on 31 March 1987. Accepting the assessee's plea of 50 per cent ownership, the assessing officer valued the share of assessee's property at Rs.49.89 lakhs in respect of the assessment for the assessment year 1986-87, after deducting 10 per cent from the value of the property towards escalation for the subsequent year. Audit scrutiny however revealed (October 1991) that the assessee's share in the property was not assessed to wealth tax for the assessment years 1983-84 to 1985-86. Adopting the same rate of escalation of 10 per cent per annum, the value of the assessee's share in the property would be Rs.37.48 lakhs, Rs.41.23 lakhs and Rs.45.35 lakhs for the assessment years 1983-84, 1984-85 and 1985-86 respectively. Omission to assess the wealth to tax in these years resulted in aggregate short levy of tax of Rs.5.52 lakhs.

(ii) An individual was assessed to wealth tax in June 1990 for the first time for the

assessment year 1986-87. Audit scrutiny (May 1991) revealed that the assessee was in possession of taxable wealth right from assessment year 1982-83 onwards comprising a vacant house site measuring 4 grounds (approx) in a metropolitan city and a lodge building with the aggregate value of these properties ranging from Rs.21.84 lakhs to Rs.25.50 lakhs (approx) for the assessment years 1982-83 to 1985-86. Omission to complete the wealth tax asessments for these assessment years, on the basis of the above particulars, resulted in aggregate short levy of wealth tax of Rs.2.73 lakhs(approx).

2. The Public Accounts Committee has repeatedly emphasised the need for proper co-ordination amongst the assessment records pertaining to different direct taxes to ensure overall improvement in the administration of these taxes. The Central Board of Direct Taxes have also issued instructions (November 1973, April 1979 and September 1984) reiterating the necessity for greater co-ordination with a view to bring to tax cases of evasion of tax.

The income tax assessments of two individual assessees, for the assessment year 1983-84, were completed in March 1988 and March 1989. The assessment records revealed that as a result of search and seizure operations the assessing officer had included an amount of Rs.52.03 lakhs towards interest, rental income and unexplained cash protectively in the income of the assessees. This amount was subsequently reduced to Rs.28.16 lakhs by the Commissioner of Income tax (Appeals). In the case of one assessee the share was taken as Rs.18.44 lakhs (two third of the seized income) and in the case of the other assessee, the share was taken as Rs.9.22 lakhs. The amount of Rs.18.44 lakhs consisted of undisclosed income of Rs.13.44 lakhs and unexplaned cash of Rs.5.00 lakhs. Similarly the amount of Rs.9.22 lakhs consisted of undisclosed interest income of Rs.6.72 lakhs and unexplained cash of Rs.2.50 lakhs.

Audit scrutiny of the wealth tax assessments for the assessment years 1983-84 to 1986-87, completed between March 1988 and December 1989, revealed (January/February 1991) that returns of the assessees did not include the assets that generated this income.

Considering a rate of return of 20 per cent, the value of wealth which earned the interest and rental income works out to Rs.110.02 lakhs in the assessment year 1983-84 and Rs.100.80 lakhs each in the assessment years 1984-85 to 1986-87 in aggregate of two assessees. Non-inclusion of aggregate additional wealth of Rs.412.42 lakhs in the net wealth of the two assessees resulted in short levy of wealth tax aggregating Rs.16.54 lakhs.

Ministry of Finance have accepted the audit observation in one case.

3. The Act ibid further provides that where the assets chargeable to tax are held by an association of persons other than a company or a co-operative society and the individual shares of the members of the said association in the income or assets or both are indeterminate or unknown, wealth tax shall be levied as in the case of an individual at the rates specified in Part I of Schedule I of the Wealth Tax Act or at three per cent, whichever would be more beneficial to revenue.

The income tax assessment of an association of persons, for the assessment year 1987-88, was completed in March 1990 on a total income of Rs.1.45 lakhs. Audit scrutiny of the accounts of the assessee revealed (April 1990) that no wealth tax return was filed by the assessee, nor did the department take any action to assess the net wealth of the assessee. The omission resulted in non-assessment of wealth of Rs.52.23 lakhs with consequent non-levy of wealth tax of Rs.1.52 lakhs.

Ministry of Finance have accepted the audit observation.

Incorrect valuation of assets

A-Scrutiny Assessment

5.05(a) Immovable properties.

1. Under the Wealth Tax Act,1957, the Wealth tax Officer shall estimate the value of any asset (other than cash) to be the price which, in his opinion, it would fetch, if sold in the open market on the valuation date.

(i) In the wealth tax assessments of two Hindu undivided families of the specified

category, for the assessment years 1987-88 to 1989-90, completed between September 1988 and August 1990, the value of land owned by the assessees in a metropolitan city measuring 7 grounds 1664 sq. feet and 6 grounds 2074 sq. feet was adopted at Rs.2 lakhs per ground. Audit scrutiny revealed (June 1991) that as per the records of the Appropriate Authority, the rate prevailing in the vicinity during August 1988 to August 1989 ranged between Rs.7.57 lakhs and Rs.11.25 lakhs per ground.If the rate of Rs.9.58 lakhs per ground as per the instance of sale recorded near about the valuation date for assessment year 1989-90 was adopted and an allowance of 33.33 per cent given thereon for earlier assessment years towards price escalation, the market value of the two pieces of land would work out to Rs.32.77 lakhs and Rs.29.24 lakhs for assessment year 1987-88, Rs.49.16 lakhs and Rs.41.86 lakhs for assessment year 1988-89 and Rs.73.70 lakhs and Rs.65.76 lakhs for assessment year 1989-90. The under valuation of immovable properties in the assessments resulted in aggregate under assessment of wealth of Rs.230.49 lakhs leading to aggregate undercharge of tax of Rs.6.86 lakhs for the three assessment years.

The department has not accepted the audit observation in view of the value of the ground at Rs.2.50 lakhs each upto 31 March 1990 and at Rs.6.50 lakhs each with effect from 1 April 1990 as per Sub-Registrar's office. The reply was not acceptable as the value of the Sub-Registrar's office was different from the value assessed for wealth tax purposes. Moreover, the objection was based on the rates prevailing on the relevant dates in the vicinity of the concerned properties as per records of the Appropriate Authority of Income Tax Department.

(ii) An individual received Rs.11 lakhs in March 1980 from a State Government as advance towards compensation for acquiring an immovable property in December 1979 in a metropolitan city.The assessee declared the compensation money of Rs.11 lakhs in her wealth tax return for the assessment years 1980-81 to 1983-84 and Rs.9 lakhs for the assessment year 1984-85 which was adopted as such by the Department in the assessments completed between March 1985 and March 1989. Audit scrutiny revealed (August 1990) that

the amount of compensation was finally determined (May 1986) in a Court of Law at Rs.33.72 lakhs.The assessing officer, however, did not re-open the wealth tax assessments of the assessee for the assessment years 1980-81 and 1981-82 to adopt the full amount of compensation awarded by Court nor consider the correct value in the wealth tax assessments for the assessment years 1982-83 to 1984-85 completed subsequently.The omission resulted in under-assessment of wealth of Rs.115.62 lakhs with consequent aggregate undercharge of tax of Rs.4.91 lakhs for the five assessment years.

The department has accepted the audit observation.

2. The Act further provides that the Wealth Tax Officer may make a reference to the Departmental Valuation Officer for valuation of an asset where, in his opinion, the value returned by the assessee is less than the fair market value and the value so fixed by the Departmental Valuation Officer shall be adopted in the assessments.

(i) In the wealth tax assessments of an individual assessee, owning a building with 986 square meters of built up area in 18-19 grounds in a metropolitan city, for the assessment years 1982-83 to 1987-88 completed in January 1989, the value was fixed at Rs.30,000 per ground as on 31 December 1979 which was increased to Rs.45,000 per ground for the subsequent assessment years, upto assessment year 1987-88. Audit scrutiny revealed(August 1989) that in respect of another assessee having a similar house property in the adjacent plot, the ground value was taken as Rs.2 lakhs per ground as on 31 December 1982, Rs.2.4 lakhs as on 31 December 1983 and Rs.2.88 lakhs as on 31 December 1984, based on the Departmental Valuer's valuation. Omission to adopt the correct value in this case resulted in short levy of wealth tax of Rs.10.23 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The wealth tax assessments of two individuals for the assessment year 1985-86 were completed in March 1990 on net wealth of Rs.45 lakhs and Rs.51.98 lakhs.The assessees

were having 14/44 and 16/44 share interest in a firm which owns land and several buildings, while the remaining 14/44 share interest was held by a third partner.The entire property was valued by the departmental valuation cell at Rs.122.16 lakhs as on 31 March 1983 and the shares of the assessees at this rate worked out to Rs.38.87 lakhs and Rs.44.42 lakhs, which were adopted in the wealth tax assessment for assessment year 1985-86 by the assessing officer. Audit scrutiny revealed (July 1991) that the third partner retired from the partnership in November 1984 receiving in consideration thereof, a portion of the above property bearing certain buildings and an area of 11.31 grounds of land.The valuation cell of the department in its report of March 1991, had valued the property, excluding the portion allotted to the retiring partner, at Rs.138.23 lakhs and the share of the two assessees who were holding 50 per cent each in the firm as on the valuation date 31 March 1985, worked out to Rs.69.12 lakhs.Though the wealth tax assessments for the assessment year 1986-87 were completed in March 1991 adopting this value, the assessments for assessment year 1985-86 were not revised to consider the enhanced value (allocating 50 per cent share to each of the two partners) as per the department's valuation report.The omission led to under-assessment of wealth of Rs.30.25 lakhs and Rs.24.69 lakhs respectively involving a short levy of wealth tax aggregating Rs.2.62 lakhs (approx.).

3. As per instructions issued by the Central Board of Direct Taxes in June 1970 where the value of a property in respect of any assessment year is shown at a figure exceeding the declared consideration in respect of an earlier year by more than 25 per cent, the assessment of the earlier years should be re-opened for revaluation even though the higher valuation in the subsequent years was attributable to the adoption of a different basis for valuation.

In the wealth tax assessments of an individual, for the assessment years 1985-86 to 1987-88, completed in March 1990, the value of a self-occupied property with total land-area of 6 acres and 34 cents and comprising a building in about 29 cents, was adopted at Rs.3.35 lakhs while the value of

another property, being vacant site measuring 26 grounds, leased to an Educational Trust for 25 years, was adopted at Rs.2.35 lakhs as returned by the assessee in the returns. Audit scrutiny revealed (November 1991) that in the wealth tax assessments for the assessment years 1988-89 and 1989-90, completed in March 1991, the value of the building in the self-occupied property was adopted at Rs.3.35 lakhs as returned by the assessee and in addition to it, the value of the vacant land in the same property which was not separately included in the wealth tax assessments of earlier years was estimated by the assessing officer at Rs.27.30 lakhs and so adopted in the assessments. Similarly for the vacant site, the value was adopted at Rs.68.25 lakhs in the assessment for the assessment year 1989-90. Omission to re-open the assessments of the assessment years 1985-86 to 1987-88 having regard to the assessments completed for the later assessment years of 1988-89 and 1989-90 resulted in approximate underassessment of wealth of Rs.67.29 lakhs, Rs.75.03 lakhs and Rs.83.64 lakhs for the assessment years 1985-86 to 1987-88 respectively. This resulted in non-levy of wealth tax aggregating Rs.4.69 lakhs.

Ministry of Finance have accepted the audit observation.

4. It has been judicially held* that the assessee's own valuation report filed in respect of the properties for subsequent years could be `information' for re-opening of the assessment of earlier years.

Three individuals were co-owners having one-fourth share each in an immovable property. While framing assessments in the case of two of the assessees (assessments made between January 1986 and July 1987), the assessing officer adopted the value of the individual shares of the same property at Rs.1.33 lakhs for the assessment years 1980-81 to 1983-84, Rs.1.34 lakhs for assessment years 1984-85 to 1985-86 and at Rs.1.69 lakhs for the assessment year 1986-87. No wealth tax return was however, submitted by the third assessee for the assessment years prior to assessment year 1987-88. Audit scrutiny revealed

* Dr.Keki Hormusji Vs.WTO (1981),135 ITR 386 (Bombay H.C.)

(January 1991) that two of the assessees returned individual shares at Rs.15.16 lakhs each for the assessment year 1987-88 on the basis of the valuation made in February 1987 by a registered valuer and were assessed as such by the assessing officer while framing assessments in May 1989 for the assessment years 1987-88 and 1988-89. The third assessee filed wealth tax return for the first time for the assessment year 1987-88, also showing her individual share in the said immovable property at Rs.15.16 lakhs. Considering the substantial variation between the values adopted for earlier assessment years and the value declared by the assessee on their own valuation for the assessment years 1987-88 and 1988-89, the assessing officer should have re-opened the assessments for earlier assessment years, but it was not done. Assuming ten per cent appreciation in value each year, the underassessment of wealth for the earlier assessment years 1980-81 to 1986-87 amounted to Rs.128.26 lakhs in the case of two assessees (submitting wealth tax returns) with consequent total undercharge of tax of Rs.3.31 lakhs. Besides, net wealth aggregating Rs.73.81 lakhs escaped assessment in the case of the third assessee on which total chargeable tax of Rs.86,798 was not levied for the assessment years 1980-81 to 1986-87. Aggregate tax effect thus worked out to Rs.4.18 lakhs in the three cases.

B-Summary Assessment

The wealth tax assessment of an assessee individual, for the assessment year 1984-85, was completed in March 1989 in a summary manner, determining the net wealth as Rs.(-) 5.35 lakhs.During the assessment proceedings, the assessing officer had referred certain properties with total written down value of Rs.9.04 lakhs as on the valuation date to the Valuation Officer.The valuation report, which was received in March 1989 after completion of the assessment, showed the total value of the properties, as on the valuation date as Rs.47.18 lakhs.Hence, assessment for the aforesaid assessment year needed revision. This was not done.Further, the value of certain other immovable properties (non-business assets) was adopted as Rs.4.89 lakhs as returned by the assessee instead of the value of Rs.6.87 lakhs adopted in an earlier assessment year 1982-83 based on an appellate order. These omissions resulted in under-

assessment of wealth of Rs.34.77 lakhs with consequent non-levy of tax of Rs.1.22 lakhs.

Ministry of Finance have accepted the audit observation.

(b) Unquoted/quoted equity shares

Unquoted equity shares

1. The Wealth Tax Rules, 1957, prescribed the method of determination of market value of unquoted equity shares which is based mainly on the assets and liabilities of the company as shown in its balance sheet as on the valuation date.When there is no such balance sheet on the valuation date, the preceding balance sheet and in its absence, the succeeding balance sheet has to be taken into account.

The net wealth of two individuals, for the assessment year 1984-85, included, inter alia, 28 shares each of a private limited company.The value of the shares was declared by the assessees at Rs.49,559 per share and was accepted as such by the assessing officer in the assessments completed in February 1989. Audit scrutiny revealed (November 1989/October 1991)that there was nothing on record to indicate that the rate was based on the assets and liabilities of the company as exhibited in the balance sheet on the valuation date. However, the value of each share of the same company for the two earlier assessment years 1982-83 and 1983-84 had been worked out by the assessee at Rs.1.10 lakhs and Rs.1.43 lakhs respectively and for the succeeding assessment year 1985-86 at Rs.96,007. Even on the basis of the lowest value of Rs.96,007 per share as declared for the assessment year 1985-86 out of these three values, there was under valuation of shares of Rs.26.01 lakhs in the assessment year 1984-85 with consequent short levy of wealth tax of Rs.1.24 lakhs in the case of the two assessees.

Ministry of Finance have accepted the audit observation.

2. The Central Board of Direct Taxes issued instructions in March 1982 clarifying that in the case of a company which is a going concern and whose shares are not quoted on

the stock-exchange, the profit which the company is making and should be capable of making or in other words, the profit earning capacity of the company, would ordinarily determine the value of its share. The rate of capitalisation may be taken at 10 per cent of the maintainable profits in the case of investment companies other than those which derive the major part of their income from house property and 8.5 per cent in the case of investment companies which derive major part of their income from house property.

In the case of three individual assessees, who held shares of a private limited investment company, the valuation of shares for the assessment years 1982-83 to 1986-87 were made at Rs.1403, Rs.1425, Rs.846, Rs.501 and Rs.888 per share respectively by a registered valuer by adopting the yield method. The assessing officer had accepted these values of shares as returned by the assessees while completing the assessments in July 1986. This mode of valuation of shares was upheld by the appellate authorities and confirmed by the Tribunal in the case of some earlier assessments. Audit scrutiny revealed (July 1987) that while determining the value of shares by the yield method, the rate of capitalisation was taken at 15 per cent instead of 10 per cent as per the Board's instructions. This resulted in aggregate under-assessment of wealth by Rs.41.14 lakhs for the five years.

Besides, an exemption of Rs.1.09 lakhs on account of immovable property, in addition to the over-all exemption of Rs.5 lakhs, was incorrectly allowed in the case of one of the assessees for the assessment year 1986-87.

The effect of the above mistakes was total underassessment of wealth of Rs.42.23 lakhs leading to undercharge of wealth tax of Rs.1.35 lakhs in the five assessment years.

The department has accepted the audit observation.

Quoted equity shares

A-Scrutiny Assessment

According to the instructions issued by Central Board of Direct Taxes in September 1957, if an assessee is assessed within a

state in which there is a recognised Stock Exchange, the rate of shares quoted in that Stock Exchange should be adopted as the market value of such shares for the purpose of wealth tax assessments.

An individual(assessed in Calcutta charge) owned 7,300, 7,200 and 14,400 equity shares of a limited company during the assessment years 1987-88, 1989-90 and 1990-91. The assessee also owned 12,000 equity shares of another private limited company during the assessment year 1990-91. These shares were quoted per share at Rs.41, Rs.117, Rs.135.20 and Rs.4.75 at Delhi stock exchange and at Rs.119, Rs.280, Rs.143.20 and Rs.5.31 at Calcutta stock exchange as on the valuation dates relevant to the above assessment years. While completing the wealth tax assessments for the aforesaid assessment years between February 1989 and January 1991, the assessing officer incorrectly adopted the value of these shares quoted at Delhi stock exchange on the basis of values returned by the assessee. Since the state in which the assessee was assessed has a recognised stock exchange(Calcutta), the rate of shares quoted in that stock exchange should have been adopted for valuation of such shares. The mistake resulted in under-assessment of wealth of Rs.18.65 lakhs.

Further, for the assessment year 1989-90, the value of jewellery and silver utensils, which had been assessed at Rs.5.50 lakhs for the previous assessment year 1988-89, was assessed at Rs.4.59 lakhs as returned by assessee. This resulted in further under-assessment of wealth of Rs.90,683.

These omissions resulted in total under assessment of wealth of Rs.19.56 lakhs with consequent under charge of tax of Rs.1.06 lakhs (including penalty of Rs.53,043 for furnishing inaccurate particulars of wealth by the assessee).

B-Summary Assessment

1. In the case of quoted shares, the relevant quotation in the Stock Exchange represent the price the shares would fetch if sold in the open market on the valuation date.

(i) An individual assessee owned 5,760 quoted equity shares of a limited company

situated in a metropolitan city on the valuation date relevant to the assessment year 1988-89. Audit scrutiny revealed (May 1991) that in the assessment, completed in a summary manner in January 1991, the value of each equity share was adopted at Rs.388 as returned by the assessee against the market value of Rs.2962.50 on the valuation date, as quoted in the stock exchange of the city.Non-adoption of the correct market value of the shares resulted in underassessment of wealth of Rs.148.29 lakhs with consequent undercharge of wealth tax of Rs.7.37 lakhs (including non-levy of penalty of Rs.98,000 for belated submission of return and penalty of Rs.3.19 lakhs for furnishing inaccrurate value of quoted shares).

(ii) While computing the net wealth of an individual, for the assessment years 1984-85 to 1986-87 (valuation dates 31 March of 1984, 1985 and 1986) in December 1988, in a summary manner, the value of 14,177,15,477 and 18,077 shares held by the assessee in two private limited companies was worked out at Rs.20 and Rs.155.55 per share for assessment years 1984-85 and 1985-86 and Rs.20 and Rs.177.78 per share for assessment year 1986-87. It was however noticed that the value of these shares was quoted at Rs.35.25, Rs.34.50 and Rs.32.50 and Rs.224, Rs.430 and Rs.740 per share at the recognised stock exchange on the relevant valuation dates, i.e. 31 March 1984, 31 March 1985 and 31 March 1986. Non-adoption of the market value of the shares as quoted in the stock exchange resulted in under-assessment of wealth of Rs.5.24 lakhs, Rs.2.22 lakhs and Rs.4.45 lakhs involving aggregate short levy of wealth tax of Rs.3.06 lakhs for the assessment years 1984-85 to 1986-87.

Ministry of Finance have accepted the audit observation.

(c) Share interest in a trust

B- Summary Assessment

Under the provisions of the Wealth Tax Act, 1957, where an assessee is a beneficiary of a discretionary trust, the value of his interest in the net assets of the trust is to be included in his net wealth. The Rules framed under the Act further provide that where the market value of any asset exceeds its book-value by more than 20 per cent, the

market value is to be adopted in computation of the value of such asset.

An individual assessee was one of the beneficiaries (having 50 per cent share) of a private discretionary trust holding substantial equity shares of a limited company. The assessee also owned certain equity shares of the same limited company in his individual capacity. In the assessments for the assessment years 1984-85 to 1988-89, completed in the summary manner between February 1989 and March 1990, the market value of each share so held by the assessee in his individual status was taken at Rs.320.90, Rs.476.25, Rs.35.84, Rs.28.75 and Rs.19.00 respectively, but in determining assessee's share interest in the trust, the assessing officer erroneously adopted the book-value of the shares of the said company held by the trust instead of their market value. The mistake resulted in total under assessment of wealth of Rs.218.18 lakhs with consequent aggregate undercharge of tax of Rs.5.44 lakhs for the five assessment years.

Ministry of Finance have accepted the audit observation.

Incorrect computation of net wealth

5.06 In the wealth tax assessment of an assessee, for the assessment year 1984-85 completed in March 1989, the net wealth was erroneously computed at Rs.47.50 lakhs adopting the share of assessee in the estate of his father valued at Rs.661.50 lakhs in the ratio of 504/6912 instead of the correct figure of Rs.80.39 lakhs in the ratio of 840/6912. The incorrect adoption of ratio of assessee's share resulted in under assessment of wealth by Rs.32.89 lakhs involving short-levy of wealth tax of Rs.1.58 lakhs.

The department accepted the audit observation in principle and stated that rectification was not possible at that stage as additions made in the past by the assessing officer on account of assessee's share were deleted by the appellate authority and the department had gone in appeal to the Tribunal.

Non-levy of surcharge on wealth tax

5.07 Schedule I to Wealth Tax Act,1957, was amended by Finance Act, 1988, to provide for the levy of surcharge at the rate of ten per cent of wealth tax in respect of the assessment year 1988-89.

While calculating the tax in the assessments of two individuals and a Hindu undivided family, for the assessment year 1988-89, completed in December 1990, surcharge on wealth tax of Rs.22.51 lakhs was not levied by the department.The omission resulted in short levy of tax of Rs.2.21 lakhs.

Ministry of Finance have accepted the audit observation.

Incorrect waiver of interest

5.08 As per the instructions issued by Central Board of Direct Taxes in June 1988, under the `Scheme for special collection' which remained operative during the period between July 1988 and September 1988 and which was applicable to the demands of income tax only, the assessees, having paid in full the demands of income tax certificated upto 31 March 1986 together with fifty per cent of the interest payable thereon by 30 September 1988, were entitled to rebate of fifty percent on the amount of interest payable.

In the case of an assessee who had paid within the specified period the demands of income tax as well as wealth tax together with fifty per cent interest certificated upto 31 March 1986, the Commissioner of Income Tax waived (January 1989) the interest of Rs.8.12 lakhs (including interest of Rs.3.34 lakhs on wealth tax demands) being fifty per cent of the amount of interest payable on such demands. Since the scheme was applicable to demands of income tax only, the waiver of interest of Rs.3.34 lakhs payable on the demands of wealth tax was irregular.

The department has accepted the audit observation.

Wealth tax on companies

5.09.1 Under the provisions of Section 40 of Finance Act,1983,with effect from the assessment year 1984-85, companies, other than those in which the public are substantially interested, are liable to wealth tax at flat rate of 2 per cent in respect of the net wealth comprising the aggregate market value as on the valuation date, of the specified assets belonging to the company, including building or land appurtenant thereto other than building or part thereof used by the assessee as factory,

godowns, warehouse, hotel or office for the purposes of its business, reduced by the aggregate value of the debts owed by the company pertaining to such assets.

(a) Non-levy of wealth tax on companies

(i) The Central Board of Direct Taxes issued orders in November 1975 declaring the Madras Club a company for purposes of assessment under the Wealth Tax Act. Audit scrutiny however, revealed (July 1987) that the specified assets of the company, viz. buildings, which attracted wealth tax on its revival from assessment year 1984-85 were not assessed to wealth tax for the assessment years 1984-85 to 1986-87. This resulted in non-levy of wealth tax of Rs.13.60 lakhs for the three assessment years.

Ministry of Finance have accepted the audit observation.

(ii) The income tax assessment records of a closely held company for the assessment years 1984-85 to 1990-91 revealed that the company had let out on rent certain buildings owned by it (other than buildings used for own business). Although the value of these buildings constituted wealth of the company, it did not file its wealth tax returns nor did the assessing officer initiate action to call for the returns. Based on the net maintainable rent, wealth of the aggregate value of Rs.4.36 crores had escaped assessment leading to total non-levy of tax of Rs.8.64 lakhs for the assessment years 1984-85 to 1990-91.

(iii) Scrutiny in audit of the income tax assessment records of a closely held company for the assessment year 1987-88 revealed that though the assessee company owned property and motor cars which were liable to wealth tax, the assessee did not file the wealth tax returns from the assessment year 1987-88 onwards nor were these called for by the department. The omission resulted in under assessment of wealth of Rs.27.84 lakhs, Rs.30.01 lakhs, Rs.33.86 lakhs and Rs.32.71 lakhs for the assessment years 1987-88 to 1990-91 with consequent under-charge of wealth tax aggregating Rs.2.55 lakhs for the four years. Besides, penalty and interest were also leviable.

Ministry of Finance have accepted the audit observation.

(iv) The income tax assessment records of a closely held company for the assessment years 1984-85 to 1989-90 disclosed that it owned a building which was let out on rent for commercial use. The building yielded gross rent of Rs.48,759 for the assessment years 1984-85 and 1985-86, Rs.1.19 lakhs for the assessment year 1986-87, Rs.1.41 lakhs for the assessment years 1987-88 and 1988-89 and Rs.1.85 lakhs for the assessment year 1989-90. After allowing for reasonable outgoings like repairs in respect of the building, the net maintainable rent of the building amounted to Rs.40,633 for assessment years 1984-85 and 1985-86, Rs.99,393 for assessment year 1986-87, Rs.1.18 lakhs for assessment years 1987-88 and 1988-89 and Rs.1.57 lakhs for assessment year 1989-90. Capitalising rent by a multiplier of 100/9 for assessment years 1984-85 to 1988-89 under the Wealth Tax Rules and 12.5 for assessment year 1989-90 under Wealth Tax Act, the market value of the building worked out to Rs.4.51 lakhs for assessment years 1984-85 and 1985-86, Rs.11.04 lakhs for assessment year 1986-87, Rs.13.07 lakhs for assessment years 1987-88 and 1988-89 and Rs.19.61 lakhs for assessment year 1989-90. However, the assessee company did not file returns of wealth nor did the department initiate action to call for the same for the purposes of wealth tax. The omission resulted in non-assessment of wealth of Rs.65.82 lakhs with consequent non-levy of wealth tax of Rs.1.34 lakhs.

2. Building and land appurtenant thereto other than the building used by the assessee as factory, office etc, are specified assets. Thus a factory building under construction, or where production or manufacturing activity has not commenced, is a building not used as factory or office building and is as such, a specified asset for this purpose.

Five closely held companies possessed, on the valuation dates relevant to the assessment years 1984-85 to 1986-87, factory and office buildings and lands appurtenant thereto which were under construction or where production or manufacturing activity had not commenced.Thus these buildings were specified assets in respect of which wealth tax was

leviable.However, the assessee companies did not file returns of net wealth, nor did the assessing officer initiate any wealth tax proceedings.The omission resulted in escapement of wealth of Rs.91.98 lakhs (being the book value shown in the balance sheets of the relevant assessment years) and non-levy of wealth tax aggregating Rs.1.85 lakhs on the five companies.

Ministry of Finance have accepted the audit observation.

(b) Wealth not assessed

Summary Assessment

In the assessment of a closely held company for the assessment year 1988-89, completed in December 1988, the assessing officer did not add back Rs.59.08 lakhs declared as assets in the balance sheet as the value of the land and of factory building under construction. Since the asset was under construction, it could not be treated as factory building being used by the assessee in its business and therefore on the basis of information available in the records the amount was includible in the computation of wealth for tax. Omission to do so led to escapement of wealth of Rs.59.08 lakhs resulting in short levy of wealth tax of Rs.1.30 lakhs.

B- GIFT TAX

5.10 In the financial years 1987-88 to 1991-92, gift tax receipts vis-a-vis the budget estimates were as given below:

Year	Budget Estimates (in crores of rupees)	Actuals	Variation	Percentage
1987-88	11.00	8.23	(-)2.77	(-)25.18
1988-89	10.00	6.74	(-)3.26	(-)32.60
1989-90	9.50	8.07	(-)1.43	(-)15.05
1990-91	9.00	3.38	(-)5.62	(-)62.44
1991-92*	9.00	8.44	(-)0.56	(-) 6.22

*Provisional

5.11 Particulars of cases finalised, assessments pending and demands in arrears, for the five years 1987-88 to 1991-92 are as given below:

Year	No.of assessments completed during the year	No. of cases pending assessment at the end of the year	Arrears of demands pending collection at the end of the year (In crores of rupees)
1987-88	64,375	30,517	22.02
988-89	70,642	21,327	24.53
1989-90	52,560	18,683	62.61
1990-91	46,621	15,951	54.49
1991-92*	42,176	10,683	37.86

*Provisional

5.12 During the test audit of assessments made under the Gift Tax Act,1958, conducted during the period 1 April 1991 to 31 March 1992 short levy of gift tax of Rs.4.92 crores was noticed in 206 cases.

A total number of 20 draft paragraphs involving tax-effect of Rs.61.65 lakhs were issued to the Ministry of Finance for comments during March 1992 to July 1992. The Ministry of Finance have accepted the observations in 7 cases involving tax effect of Rs.27.69 lakhs. 10 illustrative cases involving tax effect of Rs.54.99 lakhs are given in the following paragraphs. Out of these, the Ministry of Finance have accepted the observations in 5 cases involving tax effect of Rs.26.22 lakhs. One case involving tax effect of Rs.1.34 lakhs was checked by the Internal Audit of the department but the mistake was not detected by it.

Gift not assessed.

5.13 Under the provisions of the Gift Tax Act, 1958, gift tax shall not be charged in respect of gifts made by any person to any institution or fund established or deemed to be established for a charitable purpose to which exemption under the provisions of the Income tax Act apply. The Act further provides that gift tax shall not be charged in respect of gift made by any person, being an employer, to any employee by way of bonus, gratuity or pension or to the dependents of a deceased employee to the extent to which the payment of such bonus, gratuity or pension is proved to the satisfaction of the assessing officer as being reasonable, having regard to the circumstances of the case, and is made solely in recognition of the services rendered by the employee. Instructions have

also been issued (November 1973, April 1979 and September 1984) for co-ordination amongst assessment records pertaining to different direct taxes with a view to bring to tax cases of evasion of tax.

(i) The income tax assessment of an assessee company for the assessment year 1990-91, completed in March 1991, indicated that the assessee company had, during the relevant previous year, donated sums aggregating Rs.6.89 lakhs of which a sum of Rs.1.43 lakhs only qualified for exemption under the provisions of Income Tax Act, 1961. Accordingly, the residual amount of donations of Rs.5.46 lakhs was not exempted under the Income tax Act. Furthermore, as the donations were made without consideration, these constituted `gift' under the Gift Tax Act attracting levy of gift tax. The assessee company however did not file any gift tax return, nor did the department initiate any gift tax proceedings. The omission led to gift of Rs.5.46 lakhs escaping assessment, resulting in non-levy of gift tax of Rs.1.58 lakhs.

The department did not accept the observation contending that as the amounts in question were paid by the company to its employees on marriage and other occasions, presentation donations of Rs.5.46 lakhs could not be treated as gift attracting gift tax. The department's contention was not tenable because the payments were not made as bonus, gratuity or pension to the employees of the assessee or to the dependents of any deceased employee, and hence the benefit of exemption contemplated in the Gift Tax Act was not available.

(ii) The wealth tax assessments of an assessee and his two sons, for the assessment year 1988-89, were completed in the status of individuals in December 1990. The assessment records indicated that the assessee had allowed his eldest son to construct the first floor over the roof of his house and his younger son to construct a house in the open space in the compound. This facility extended by the assessee to his two sons for constructing houses without any consideration thus constituted deemed gifts. On the basis of the value of the floor area of 366.5 sq.meters at half the rate of Rs.975 per

sq.meter, as fixed by the Departmental Valuation Officer as on 30 March 1988 and also taking the area of house constructed in the compound, in the absence of further details, as 200 sq.metres at Rs.975 per sq.metre, the deemed gifts would work out to Rs.1.78 lakhs and Rs.1.95 lakhs respectively. The omission to initiate gift tax proceedings thus resulted in non-assessment of deemed gift of Rs.3.73 lakhs with consequent non-levy of gift tax of Rs.1.06 lakhs.

Ministry of Finance have accepted the audit observation.

Non-levy of tax on deemed gift

5.14.1 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 on the date of transfer exceeds the value of the consideration shall be deemed to be gift made by the transferor. The Act further provides that the value of any asset, other than cash, 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) In the assessment of an individual, for the assessment year 1989-90, completed in March 1990, the value of land measuring 1965.34 sq.meters was accepted at the sale price of Rs.5.47 lakhs, against the market value of the land at Rs.70.75 lakhs as per the rates prescribed by the Ministry of Urban Development. The excess of the market value over the declared sale consideration of the land constituted deemed gift and gift tax was required to be levied thereon. It was seen in audit that the assessee had not filed gift tax return nor did the department initiate gift tax proceedings. The omission resulted in non-assessment of deemed gift of Rs.65.28 lakhs with consequent non-levy of gift tax of Rs.19.59 lakhs.

The department stated (January 1992) that the rate was reasonable as the land was situated at a far off place.The contention of the department was however, not tenable in view of the rates indicated by the Ministry of Urban Development.

(ii) In the assessment of a registered firm for the assessment year 1988-89, completed in January 1989, the assessing officer assessed

the value of two properties at the sale price of Rs.1.51 lakhs as against the market value of Rs.12.19 lakhs determined on the basis of rates prescribed by the Ministry of Urban Development. The omission led to escapement of deemed gift of Rs.10.68 lakhs resulting in non-levy of gift tax of Rs.3.14 lakhs.

The department stated (November 1990) that gift tax proceedings had been initiated.

(iii) In the previous year ended 31 March 1987, an individual assessee sold 15,994 shares of a private limited company at Rs.20 per share and returned capital loss of Rs.19,173 for the assessment year 1987-88. Audit scrutiny revealed (February 1989) that in the wealth tax assessment for assessment year 1986-87, completed in February 1988, the value of each share was adopted at Rs.49.17. The difference between the market value and sale consideration amounting to Rs.4.67 lakhs thus constituted deemed gift attracting levy of gift tax. However, the assessee did not file any gift tax return nor did the department initiate gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.1.34 lakhs.

Ministry of Finance have accepted the audit observation.

2. It has been judicially held* that if a capital asset is transferred for consideration below its market value, the difference between the market value and the consideration received would amount to a gift liable to gift tax.

An assessee, a closely held company, had sold immovable property situated in a metropolitan city for a net consideration of Rs.143.50 lakhs to its subsidiary company during the assessment year 1985-86. The market value of the property was determined at Rs.178.49 lakhs as on 31 March 1984 as per valuation certificate (dated 27 March 1989) of the Valuation Officer.The valuation was adopted in the wealth tax assessment of the transferor company for assessment year 1984-85 completed in March 1989. As the property was transferred at a declared consideration which was less than the fair market value

* K.P.Verghese Vs. ITO (1981) 131-ITR-597, 617 (SC)

adopted in the wealth tax assessment, the difference of Rs.34.99 lakhs constituted deemed gift under Gift Tax Act. No gift tax proceedings were, however, initiated by the department. The omission resulted in non-assessment of taxable gift of Rs.34.99 lakhs with consequent non-levy of gift tax of Rs.18.27 lakhs.

Ministry of Finance have accepted the audit observation.

3. Under the provisions of the Gift Tax Act,1958, where there is a release, discharge, surrender, forfeiture or abandonment of any debt, contract or other actionable claim or of any interest in property by any person, the value thereof, to the extent to which it has not been found to the satisfaction of the assessing officer to have been bonafide, shall be deemed to be a gift made by the person responsible therefor.

The income tax assessment records of a partnership firm for the assessment year 1985-86 disclosed that the firm was dissolved with effect from 13 May 1984 and its business was taken over by two of the three partners, in their individual capacity, and continued uninterruptedly under the same name and style. The third partner, a trust represented by the trustee, was paid the balance in its current account. Although the third partner had thus, in effect, surrendered its share in the goodwill of the firm for no consideration, no action was taken by the department to bring the deemed gift to tax. This resulted in escapement of deemed gift valued at Rs.12.13 lakhs from tax with consequent non-levy of gift tax of Rs.3.42 lakhs.

The department completed the gift tax assessment raising a demand of Rs.3.42 lakhs (February 1991).

4. Under the Gift Tax Act,1958, as amended from assessment year 1989-90, where a property is transferred otherwise than for adequate consideration, the amount by which the value of the property, as determined under the Welath-Tax Act, exceeds the value of the consideration shall be deemed to be a gift made by the transferor. Under the Wealth Tax Act, the value of let out immovable

property, being a building or land appurtenant thereto, shall be determined on the basis of the annual rent received or receivable by the owner.

Audit scrutiny of the income tax assessment records of a Hindu undivided family of the specified category revealed (February 1992) that the assessee had sold a godown building during the previous year relevant to the assessment year 1990-91 for a consideration of Rs.6.60 lakhs. It was also seen that the assessee was deriving a monthly rent of Rs.9,500 by letting it out on the basis of which, the value of the property as per the Wealth Tax Act worked out to Rs.12 lakhs. The difference of Rs.5.40 lakhs was thus assesable to gift tax as deemed gift. However, no gift tax return was filed by the assessee, nor did the department initiate any assessment proceedings. Omission to do so resulted in non-levy of gift tax of Rs.2.18 lakhs (including interest towards default in furnishing the return of gift).

Ministry of Finance have accepted the audit observation.

5. The Gift Tax Rules,1958,lay down that the value of unquoted equity shares in a private limited company should be ascertained with reference to the total assets of the company.

The income tax assessment records of a Hindu undivided family for the assessment year 1987-88 revealed that the assessee sold in the relevant previous year 15,850 unquoted equity shares of a private limited company for a consideration of Rs.80,125. The value of each share, however, worked out to Rs.28.09 as per the break-up value method under Rule 1-D of Wealth Tax Rules, 1957 and on this basis, the total value of 15,850 shares would work out to Rs.4.45 lakhs. The difference of Rs.3.65 lakhs between the sale consideration and the fair market value should have been treated as deemed gift, attracting levy of gift tax. However, the assessee did not file any gift tax return nor did the department initiate any gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.1.04 lakhs.

The department has accepted the audit

observation.

Omission to give effect to appellate orders

5.15 Under the Gift Tax Act,1958, any transaction entered into by a person with intent to diminish directly or indirectly the value of his own property and to increase the value of another shall be a deemed gift liable to gift tax. It has been held judicially* that where a transaction was neither an investment nor a case of dealing in shares, but was a transaction within the same group of persons, a gift was made in respect of the shares either when the price was paid for them at much more than they were worth or at the time they were sold, for much less than they were worth.

An assessee company was holding fifteen thousand redeemable non-cumulative preference shares of Rs.100 each, worth Rs.15 lakhs, of its sister concern. All the shares were sold in the previous year relevant to the assessment year 1986-87 for Rs.3 lakhs and Rs.12 lakhs were claimed as short term capital loss. The assessing officer applied the provisions of the Wealth Tax Rules and arrived at the value of the shares at Rs.11.25 lakhs at Rs.75 per share, allowed the loss of Rs.3.75 lakhs and disallowed the balance loss of Rs.8.25 lakhs as claimed by the assessee. In appeal, the Commissioner of Income Tax allowed the deduction of Rs.8.25 lakhs disallowed by the assessing officer but opined that Gift Tax provisions could be invoked.Though the income tax assessment for the assessment year 1986-87 was rectified in December 1989 to give effect to the Commissioner's order, gift tax proceedings were not initiated. Omission to do so resulted in non-levy of gift tax of Rs.3.37 lakhs.

Ministry of Finance have accepted the audit observation.

C-Estate Duty

The levy of Estate duty was discontinued by the Estate Duty (Amendment) Act, 1985, in respect of estate passing on death occuring on or after 16 March 1985.

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* South Asia Industries (P) Ltd. Cs. CIT Delhi (1985) 155-ITR-392 (Delhi H.C.)

5.16 Receipts from the estate duty during the financial years 1987-88 to 1991-92 vis-a-vis the Budget estimates were as under:

Year	Budget estimates	Actuals	Variation	Percentage
		(In crores of rupees)		
1987-88	10.00	8.02	(-)1.98	(-)19.80
1988-89	3.25	6.04	2.79	85.84
1989-90	3.10	4.27	1.17	37.74
1990-91	3.50	3.07	(-)0.43	(-)12.28
1991-92*	2.30	2.86	0.56	24.34

* Provisional

5.17 The particulars of assessments finalised, assessments pending and estate duty demands in arrears in respect of the years 1987-88 to 1991-92 are as given below:

Year	No. of assessments completed during the year	No. of assessments pending at the end of the year	Arrears of demand pending collection
			(In crores of rupees)
1987-88	11,704	3,095	399.73
1988-89	4,227	1,744	73.27
1989-90	2,188	1,269	24.18
1990-91	844	1,173	35.19
1991-92*	651	1,020	31.74

* Provisional

5.18 During test audit of assessments made under the Estate Duty Act, 1953, conducted during the period from 1 April 1991 to 31 March 1992, short levy of estate duty of Rs.14.48 lakhs was noticed in 19 cases.

A total number of 7 draft paragraphs involving tax-effect of Rs.16.33 lakhs were issued to the Ministry of Finance for comments during March 1992 to July 1992. The Ministry of Finance have accepted the observations in 4 cases involving tax effect of Rs.10.98 lakhs. Three illustrative cases involving tax effect of Rs.13.30 lakhs are given in the following paragraphs. Out of these, the Ministry of Finance have accepted the observations in 2 cases involving tax effect of Rs.9.72 lakhs.

Estate not assessed

5.19 The Estate Duty Act, 1953, before its discontinuance by the Estate Duty (Amendment)Act,1985, 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.

A person, who died in October 1984, was a partner in a firm, with profit-sharing ratio of 50 per cent upto 15 September 1981 and 20 per cent thereafter. In the estate duty assessment of the deceased, completed in March 1989 and revised in August 1989, in working out his share in the undistributed profits of the firm, the share in the profits of Rs.27.63 lakhs pertaining to the assessment year 1982-83 (previous year ended 27 October 1981) was taken at 20 per cent, although he was entitled to 50 per cent upto 15 September 1981 and 20 per cent thereafter. Further, the accountable person had requested the assessing officer to adjust income tax refunds due to the deceased, totalling Rs.3.99 lakhs in respect of the assessment years 1982-83 to 1985-86, against the estate duty arrears. However, the refunds due to the extent they related to payments made by the deceased before his death, were not included in the principal value of the estate. The mistakes resulted in escapement of estate of principal value of Rs.9.88 lakhs with consequent undercharge of estate duty of Rs.8.40 lakhs, excluding interest.

Ministry of Finance have accepted the audit observation.

Incorrect computation of principal value of estate

5.20.1 The Act ibid further provides that the property which the deceased, at the time of his death, was competent to dispose of shall be deemed to pass on his death. It has also been judicially* held that the value of a house property is includible in the estate of a deceased, if he had been enjoying the interest of the property, even though the title to that property was defective.

Three residential flats in a metropolitan city, belonging to a person(who died in April 1980), were let out on an annual rent of Rs.1.22 lakhs.The assessing officer, while completing the assessment in January 1987,

*Smt. Prakash Kaur Vs. Controller of Estate Duty (1981) 130 ITR 337(Orissa H.C.)

had taken Rs.2.57 lakhs representing the amount of advance paid for these flats in the estate of the deceased, as these were not registered in the name of the deceased. Moreover, the assessing officer had also allowed a deduction of Rs.2.03 lakhs, taken as security deposit from the tenants as liability of the estate. Audit scrutiny of income tax assessment records of the deceased, for the period prior to his death, revealed that the annual rental income was offered for taxation, though registration of the property was not made in his favour. It was also noticed that the deceased had been paying municipal taxes and other maintenance charges of the above flats. Hence, the value of flats, at the market value of Rs.10.65 lakhs, should have been included in the estate of the deceased. Omission to do so resulted in net under assessment of the value of the estate by Rs.8.08 lakhs with consequent short-levy of duty of Rs.3.58 lakhs.

The department did not accept the audit observation on the ground that the amount of advance was considered as movable asset in wealth tax assessment and income from the flats was assessed to income tax under 'other source'. The contention of the Department was not tenable, as the assessing officer was required to consider the market value of the property, as determinable under the estate duty assessment.

2. The value of a property included in the principal value of estate is estimated to be the price which, in the opinion of the controller,it would fetch if sold in the open market at the time of deceased's death.

The estate duty assessment of a deceased (date of death 28 December 1975) was completed in February 1985 on a principal value of Rs.1.98 lakhs adopting the value of one-fourth share of the properties of the Hindu undivided family consisting of the deceased and his three sons as returned by the accountable person.Audit scrutiny (August 1986) revealed that there were two partial partitions in July 1972 and June 1975, between the deceased and his sons, of both the properties inherited by the deceased from the bigger Hindu undivided family and the property purchased out of the Hindu undivided

family funds, leaving some properties undivided among the members of the family.As the properties that fell to the deceased's share as a result of the partitions belonged to the deceased in his individual capacity, the entire property should have been assessed to estate duty. This, with the one-fourth share of the undivided properties and personal jewellery amounted to Rs.7.92 lakhs. Further, the correct liability allowable worked out to Rs.53,115 only as against Rs.1.88 lakhs adopted in the assessment.The above mistakes resulted in under-assessment of the net principal value of the estate by Rs.5.40 lakhs involving short levy of estate duty of Rs.1.32 lakhs.

Ministry of Finance have accepted the audit observation.

New Delhi
The

13 APR 1993

(P.K.LAHIRI)
Principal Director of Receipt Audit
(Direct Taxes)

Countersigned

New Delhi
The

13 APR 1993

(C.G.SOMIAH)
Comptroller and Auditor General of India.

APPENDIX I

Variation between Budget estimates and actuals

Year	Budget Estimates	Actuals	Variation	Percentage of variation
			(In crores of Rupees)	
024-Interest Tax				
1987-88	----	9.30	9.30	---
1988-89	----	2.73	2.73	---
1989-90	----	3.94	3.94	---
1990-91	----	(-)0.86	(-)0.86	---
1991-92	535.00	305.04	(-)229.96	(-)42.98
0031-Estate Duty				
1987-88	10.00	8.02	(-)1.98	(-)19.80
1988-89	3.25	6.04	2.79	85.84
1989-90	3.10	4.27	1.17	37.74
1990-91	3.50	3.07	(-)0.43	(-)12.28
1991-92*	2.30	2.86	0.56	24.34
0032-Taxes on Wealth				
1987-88	120.00	100.58	(-)19.42	(-)16.18
1988-89	120.00	122.48	2.48	2.06
1989-90	120.00	178.51	58.51	48.75
1990-91	175.00	231.17	56.17	32.09
1991-92*	255.00	306.93	51.93	20.36
0033-Gift Tax				
1987-88	11.00	8.23	(-)2.77	(-)25.18
1988-89	10.00	6.74	(-)3.26	(-)32.60
1989-90	9.50	8.07	(-)1.43	(-)15.05
1990-91	9.00	3.38	(-)15.62	(-)62.44
1991-92	9.00	8.44	(-)0.56	(-)6.22

APPENDIX II

Tax deducted at source

(Rupees in crores)

Income	No. of statements received	Tax deducted as per statements	Tax remitted to Govt. Account	Balance due for remittance	
				For the year end	Upto the end of the year
(a) Interest on Securites	1.870	78.25	78.25		
(b) Dividends	6,067	99.56	99.51	0.05	0.05
(c) Lottery and Crossword Puzzles	187	17.87	17.87		
(d) Winnings from horse races	1,625	42.65	42.65		
(e) Insurance Commission	3,274	38.55	38.55		
(f) Payment to non-resident	3,398	205.48	205.38	0.06	0.01
Total	16,421	482.76	482.21	0.11	0.06

APPENDIX III

Cost of collection

	Collection (In crores of Rupees)	Expenditure on collection	Percentage
0024-Interest Tax			
1988-89	2.73	0.02	0.73
1989-90	3.94	0.02	0.50
1990-91	(-)0.86	0.02	0.02
1991-92	305.04	0.03	0.01
0028- Other taxes on income and expenditure			
1988-89	42.16	1.28	3.03
1989-90	71.63	1.47	2.05
1990-91	80.27	1.61	2.00
1991-92*	144.38	1.79	1.24
0031-Estate Duty			
1988-89	6.04	0.55	9.10
1989-90	4.27	0.63	14.75
1990-91	3.07	0.69	22.47
1991-92*	2.86	0.77	26.92
0032-Taxes on wealth			
1988-89	122.48	14.62	11.93
1989-90	178.51	16.83	9.42
1990-91	231.17	18.41	7.96
1991-92*	306.93	20.52	6.68
0033-Gift Tax			
1988-89	6.74	1.83	27.15
1989-90	8.07	2.10	26.02
1990-91	3.38	2.30	68.04
1991-92*	8.44	2.56	30.33

APPENDIX IV

Functioning of Valuation cells- Cases referred, disposed of and pendency in respect of other Direct Taxes

	Year	No. for disposal at the beginning of the year	No. of cases referred during the year	Disposed of during the year	Pending at the end of year
(b) Wealth Tax	1989-90	4,035	8,887	9,875	3,047
	1990-91	3,047	7,319	8,571	1,795
	1991-92*	1,795	5,644	6,067	1,372
(c) Gift Tax	1989-90	26	90	91	25
	1990-91	25	76	75	26
	1991-92*	26	53	67	12
(d) Estate duty	1989-90	48	45	67	26
	1990-91	26	45	67	4
	1991-92*	4	16	18	2

@ Figures are under reconciliation by Ministry of Finance

E R R A T A

Page	Para	Line	For	Read
xviii	(iii)	17th from top	8.98	8.48
95	2.02.09	12th from bottom	34.11	38.06
101	2.02.13	8th from top	37.76	37.72
114	2.03.6(b)	10th from top	47.61	26.55
173	3.29	9th from bottom	44.06	Rs.44.06
209	4.19.2	18th from bottom	5.06	5.16
252	5.11	Table	988-89	1988-89
258		Footnote	GS	VS