Report of the Comptroller and Auditor General of India

for the year ended March 2004

System Appraisals

UNION GOVERNMENT
(DIRECT TAXES)
NO. 13 OF 2005

Laid on the table of Lok Sabha/Rajya Sabha on _____

TABLE OF CONTENTS

PREFACE

The Report for the year ended March 2004 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts – Direct Taxes of the Union Government is conducted under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The Report presents the results of audit reviews and appraisals of receipts under direct taxes. This Report is arranged in the following order:-

(i) Chapter 1 is a broad based review on the status of improvement of efficiency through the 'Restructuring' of the Income Tax Department.

(ii) Chapter 2 highlights the efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act.

(iii) Chapter 3 deals with some aspects of non-resident taxation with reference to Double Taxation Avoidance Agreements (DTAA), and

The observations included in this Report have been selected from the findings of test audit conducted during 2003-2004.

Overview

Status of improvement of efficiency through the 'Restructuring' of the Income Tax Department

Audit examined the status of improvement of efficiency and productivity of the Income Tax Department consequent to the implementation of a proposal for its restructuring in August 2000 by the Union Cabinet.

Audit noticed that efficiency, productivity and the methodology of ascertaining immediate revenue gains indicated in the proposal to the Union Cabinet were not defined and there was no mechanism to monitor and assess the performance in a transparent and verifiable manner. Increase in revenues from direct taxes was contributed predominantly by pre-assessment collections, which did not test the assessment, investigation or recovery skills of the increased workforce. Specific supporting data reflecting efficiency and productivity after restructuring in areas such as increased revenue, faster disposal of pending cases, reduction in the number of stop filers, quicker disposal of appeals and reduction in delay in issue of refunds was not available. No details of costs relating and consequent to restructuring were maintained. Rs.4.25 crore was spent on outsourcing in only 43 CsIT charges. As many as 3750 posts, remained unfilled as on 1 April 2003 in nine States. Assessing officers had, on an average, completed only 45 scrutiny assessments after restructuring as against an average of 82 per year before restructuring. Department had the potential of completing around 6 lakh assessments per year after restructuring whereas around only 1.80 lakh were completed per year on an average. Percentage of uncollected demand increased from 36.73 in 1991-92 to 45.61 in 2003-04.

The average number of appeals disposed off by each Commissioner of Income Tax (Appeals) in a month came down to 27.53 during 2003-04 as against 43.12 during 1999-2000. The period of redressal of grievance at first appellate level did not come down to the promised level of six months. Interest as a percentage of refunds increased from 10.36 in 1999-2000 to 18.26 in 2003-04. Average delay in payment of refunds increased from about 8 months in 1996-97 to 10.36 months in 1999-2000 and further to 27.38 months in 2003-04. Despite introduction of new chain system of internal audit, percentage of shortfall with reference to target had increased after restructuring (2002-03 & 2003-04) as compared to the pre-restructuring period (1999-2000 & 2000-01).

Audit recommends that

- the IT System of the Department should generate a specific set of information which can help effectively monitor areas of improvement as visualized in restructuring proposals,

- working of chain system of internal audit be reviewed to ensure compliance with targets, and
- the criteria for working out the 'cost of collection', be critically reviewed after suitably factoring in 'pre assessment' collections, so as to present a transparent and correct picture of efficiency and productivity in this important area.

Review on efficiency and effectiveness of administration and implementation of selected deductions and allowances under the income Tax Act

Audit reviewed the administration and implementation of 'six' types of deductions and allowances granted under the Income Tax Act such as depreciation, deductions in respect of expenditure on scientific research, business of a hotel or an approved tour operator, profits and gains from export or transfer of film software/television software, profits and gains from industrial undertakings or enterprises engaged in infrastructure development and in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings. Its intention was to examine the adequacy of law, rules and procedures to safeguard the interests of revenue. Audit test checked around 1.3 lakh assessments spread over three assessment years and found mistakes in 760 cases involving tax effect of Rs.624 crore. In addition lacunae in law such as not defining 'tourist', 'plant', 'loose tools', 'manufacture and production', not disallowing 'duty drawback' receipts before granting deduction for export of software and so on involved revenue of Rs.35.34 crore in 33 cases. Besides, test check of assessments of selected companies in 11,615 cases revealed that depreciation granted under the Income Tax Act was greater than that available under the Companies Act which involved a tax effect of Rs.7282 crore.

Audit noticed maximum number of mistakes in availing depreciation allowance where revenue involved was Rs.320.50 crore in 499 cases followed by Rs.164.95 crore in 104 cases of incorrect deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development. A total number of 111 cases of mistakes in availing deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings involved revenue of Rs.81.21 crore.

Audit recommends that

- the department derive full potential of the software already available and maintain proper record of all exemptions, allowances and deductions allowed which would help in assessing and reviewing their impact, from time to time.
- a well defined risk assessment and effective procedure for selection of cases for scrutiny may be introduced which could act as a deterrence against exploitation of summary assessments by unscrupulous assessees.

Responsibilities would need to be fixed especially for glaring omissions in scrutiny assessments contributing to loss of revenue besides conducting focussed and well targeted training programmes to upgrade the skills of the assessing officers on a continuing basis,

- judicial decisions concerning significant and important provisions of the Act would need to be evaluated in the Board promptly and properly by devising an effective procedure of reporting and in coordination with the field offices,
- terms such as 'tourist', 'plant', 'loose tools', 'services to tourist', 'manufacture' and 'production' in the Act would need to be comprehensively defined so as to prevent inconsistent treatment and exploitation by assessees to the detriment of revenue and
- rates of depreciation under the Income Tax Act may be aligned with those in the Companies Act by giving due consideration to the recommendations of the Shome Advisory Group and the Kelkar Task Force.

Review on some aspects of non-resident taxation with reference to double taxation avoidance agreements

Audit reviewed the status of administration and implementation of double taxation avoidance agreements (DTAAs) with selected countries including areas such as mutual agreement procedure, exchange of information, assistance in tax collection and taxation of non-residents engaged in maritime business. Audit also examined adequacy of action taken by the assessing officers to determine effective place of management of Mauritius based entities before allowing tax relief on capital gains consequent to issue of Board's circular of February 2003 and the landmark decision of Supreme Court in October 2003.

Audit noticed that the Board did not institute and ensure an effective mechanism of monitoring the income of FIIs and their sub accounts in coordination with regulatory bodies like SEBI and RBI which would have helped in levying correct taxes on such entities operating in stock markets. Consequently, the 'tie breaker clause' in Indo Mauritius DTAA could not be applied proactively by assessing officers to determine the effective place of management in cases of entities claiming residence in more than one country including India.

Audit noticed that important provisions of DTAAs were being inadequately administered which had adverse impact on revenues. Implementation of provisions relating to mutual agreement procedure, exchange of information and assistance in recovery of taxes was weak and ineffective, thus jeopardizing the interests of revenue. Taxation of receipts on sale of software by non residents needed clarification as substantial revenues were found locked up in litigation. Revenue to the extent of Rs.1350 crore was involved in all these cases

Audit also noticed mistakes such as inconsistencies in application of provisions of DTAAs on the one hand and provisions of the Act on the other, leading to irregular grant of exemptions and income escaping tax which involved a short levy of tax of Rs.440 crore in 314 cases.

Audit recommends that

- a holistic study of DTAAs be conducted to ascertain the benefits accruing to the nation, especially as these are not placed before Parliament. A well-designed and periodical cost benefit analysis would also need to be put in place.

- Shortcomings in DTAAs, especially those relating to definition and operation of permanent establishment, limitation of treaty benefits and disallowing treaty shopping needed to be removed so as to curtail misplaced incentives and ensure that the benefits of DTAAs are availed by bonafide assessees. Taxation of income of non-residents from maritime business needed to be bestowed serious and urgent attention especially as the share of foreign vessels in overseas trade of India is 86 percent and assessments require correlation with applicable DTAAs. It needed to be ensured that the assessing officers did not treat issue of 'no objection certificates' to non residents or their agents, an end in itself.

Chapter I

Status of improvement of efficiency through the 'Restructuring' of the Income Tax Department

- Highlights
- Introduction
- Proposal
- Audit Objective
- Audit methodology
- Audit findings
  - Staff position
  - Cost implication
  - Computerisation efforts
  - Collection from direct taxes
  - Uncollected demands
  - Position of assessments
  - Outsourcing
  - Dealing with stop-filers
  - Position of appeals
  - Interest on refunds
  - Delay in implementation of the scheme
  - Transfer of records
  - Chain system of internal audit
  - Feedback from tax consultants
  - International comparison
- Conclusion & recommendations

Highlights

- Overall direct taxes collection increased but was contributed by increase in pre-assessment collections than post assessment collections, which did not test the assessment, investigation or recovery skills of the increased workforce of the department.

- The extent of increase in collection of taxes that was directly attributable to increase in efficiency and productivity after restructuring of the department was not possible to be ascertained, as specific and supporting data was not maintained.

(Para 1.16)

- Neither were the terms 'efficiency', 'productivity' and manner of measurement of 'immediate revenue gains' defined in the proposal to the Union Cabinet nor was any mechanism to monitor and assess the same specified by the Board in a transparent and verifiable manner.

(Para 1.1.1, 1.2.4 & 1.3.5)

- Details of monitoring and controlling system for implementation and assessment of results of restructuring were not made available. Commencement of implementation of the restructuring scheme took initially one year and removal of ambiguities in the jurisdiction order almost three years in West Bengal charge.

(Para 1.11 & 1.27)

- Status of fulfillment of conditions, laid down by the Union Cabinet while approving the scheme of restructuring, especially finalisation of 'MOU' between the Government and the Board in regard to increased revenue generation, was not made available.

(Para 1.6.4)

- Costs relating and consequent to restructuring were not available as no details were maintained for the purpose. In 43 CsIT charges alone, Rs.4.25 crore was incurred on outsourcing various items of work that was attributable to restructuring and post restructuring work.

(Para 1.13 & 1.22)

- In Andhra Pradesh, Delhi, Gujarat, Karnataka, Maharashtra, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal charges as many as 3,750 posts from Inspector and below had remained unfilled as on 1 April 2003. Not only were there vacancies in almost all cadres in tax recovery units but also the sanctioned strength itself had declined from 2,867 in 2001-02 to 2,498 in 2003-04.

(Para 1.12.5 & 1.19.3)

- The average number of scrutiny assessments completed by an assessing officer was hardly 45 per year after restructuring as against an average of around 82 before restructuring even though the number of assessing officers and supervisory officers had increased substantially. Increase in disposal of summary assessment cases was more due to processing of returns on AST software and outsourcing of data entry, costs of which were not projected in the proposal for restructuring.

(Para 1.23 & 1.21)

- Board did not lay down nor enforce a uniform policy for monitoring and reducing the number of stop filers and realizing the revenue due from them.

(Para 1.24)

- Percentage of uncollected demand increased from 36.73 in 1991-92 to 45.61 in 2003-04.

(Para 1.18)

- Board did not issue clear instructions for maintenance of statistics in respect of revenue involved in appeals filed and disposed off. The average number of appeals disposed off by each Commissioner of Income Tax (Appeals) in a month came down to 27.53 during 2003-04 as against 43.12 during 1999-2000. The period of redressal of grievance at first appellate level could not come down to the promised level of six months from 18 months.

(Para 1.25)

- The amount of interest paid on refunds increased by more than 300 percent between 1999-2000 and 2003-04. Interest as a percentage of refunds increased from 10.36 to 18.26 during this period. Average delay in payment of refunds increased from about 8 months in 1996-97 to 10.36 months in 1999-2000 and further to 27.38 months in 2003-04.

(Para 1.26)

- Despite introduction of new chain system of internal audit, percentage of shortfall with reference to target had increased after restructuring as compared to the pre-restructuring period.

(Para 1.29)

- Audit recommends that

➢ the IT System of the Department should generate a specific set of information which can help effectively monitor areas of improvement as visualized in restructuring proposals,

➢ working of chain system of internal audit be reviewed to ensure compliance with targets, and

- the criteria for working out the 'cost of collection', be critically reviewed after suitably factoring in 'pre assessment' collections, so as to present a transparent and correct picture of efficiency and productivity in this important area.
(Para 1.34)

Status of improvement of efficiency through the 'Restructuring' of the Income Tax Department

1.1 Introduction

1.1.1 Reform of tax administration is an integral part of tax reforms. With this background, the Central Board of Direct Taxes (the Board) proposed to the Union Cabinet in July 2000, a scheme of restructuring of the Income tax department to improve **efficiency** and **effectiveness** through induction of technology.

1.1.2 An exponential increase in volume of work over the years was considered to have led to problems such as

- increase in pendency of income tax assessments.
- increase in number of stop filers.
- increase in arrears of taxes.
- increase in the number of taxpayers per Commissioner of Income Tax (CIT).
- deterioration in span of control at other levels that undermined efficiency and effectiveness.
- increase in average delay in issue of refunds resulting in huge outgo of interest
- virtually inoperative existing manual system due to unprecedented growth in tax payers and large volumes of work breeding inefficiency, harassment to tax payers and corruption, and
- deteriorating career prospects of officers in the Indian Revenue Service at a fast pace making them lag behind other comparable Central Services.

1.2 Proposal

1.2.1 It was felt, after an 'in-house' exercise undertaken in the department (Mishra Committee Report, 1998), that any meaningful improvement in tax administration could come only through a 'comprehensive global solution' that provided for full-scale induction of information technology. This would improve taxpayer service, provide a user-friendly environment and enable handling of growing volumes of workload.

1.2.2 The proposal aimed, therefore, to restructure the department, retrain and reorient its personnel through

- functionalization, to increase productivity,
- increase in the number of officers rationalizing the span of control for better supervision, control and management of workload,
- improvement of tax payer services and

- reorientation, retraining and redeployment of surplus staff by increasing the levels of existing work norms and providing appropriate incentives like promotions commensurate with increased productivity.

1.2.3 Accordingly, the proposal involved creation/abolition of various posts in the department. Overall strength of the department, consisting of 57,989 posts before restructuring, was to be decreased to 55,234 after restructuring resulting in net decrease of 2,755 posts. The number of officers in higher cadres was increased whereas in the lower cadres, the number was decreased as shown in Table 1 below:

Table 1: Strength of Officers

Post	Strength before restructuring	Strength after restructuring	Increase in strength
CCIT	36	116	80
CIT	402	698	296
Addl CIT	339	469	130
JCIT	453	647	194
DCIT	1033	1240	207
ACIT	648	734	86
ITO	3261	4207	946
Total	6172	8111	1939

1.2.4 As the total number of tax payers had gone up from 160 lakh as on 1 April 1997 to 250 lakh as on 1 April 2000, the effective span of control would be over 1 lakh tax payers per CIT, 33,000 per Range and 6,600 per Ward. The proposal apparently recognized the fact that the number of employees need not increase continuously with increase in number of taxpayers and that the additional workload would be handled through greater computerization, increase in productivity and rationalization of work practices. Productivity per employee was proposed to be increased from 265 registered taxpayers as on 1 April 1997 to 400 on 1 April 2001, 600 as on 1 April 2004, 900 as on 1 April 2007 and 1,350 on 1 April 2010. Thus, the same number of employees was expected to provide quality service to a much larger number of taxpayers. The term 'productivity' and how to measure and verify the same were not defined or described in the proposal to the Cabinet.

1.2.5 Redressal time of grievances of tax payers at the first level of appeals viz. CIT (Appeals) was sought to be reduced from 18 months to 6 months in line with internationally accepted norms. It was projected that this would release substantial tax revenue locked in appeals and reduce uncertainty for taxpayers.

1.2.6 Besides strengthening and augmenting the representation of the department in each bench of ITAT°, addition of new Directorates, creation of additional posts of ministerial staff in areas of record management and reduction

° ITAT – Income Tax Appellate Tribunal

in posts of peons, it was proposed that internal work study norms for the long run would be recast based on cost of collection per registered tax payer and number of registered tax payers per employee.

1.2.7 Finally, direct tax laws, rules, administrative rules and guidelines were decided to be amended or relaxed as found necessary after following prescribed procedure in order to give full effect to the proposals.

1.3 Proposed impact or benefits of restructuring

1.3.1 **Standardization of Work norms**:- As work norms were to be standardized for all employees with reference to the number of tax payers, every employee was expected to assume ownership of organizational goals resulting in higher productivity and effectiveness. No mention was made in the proposal as to when and with respect to which data, the work norms would be standardized.

1.3.2 **Downsizing**:- There was to be downsizing of income tax bureaucracy by 4.75 percent. Stagnation was expected to be reduced at all levels, which was to improve employee morale and prepare the department for induction of technology.

1.3.3 **Cost Implications**:- By applying incremental cost method[*], a saving of Rs 3.05 crore in the short run, on salaries and wages under the 'current' rates of DA and rules for other perquisites as a result of the proposal was projected. Accordingly, no additional expenditure was provided under this head. It was also mentioned that by adopting the 'Mean Pay Method', based on mean pay in each scale for estimating the costs of creating new posts, the financial implication of restructuring was estimated at Rs. 42 crore. Vacancies were proposed to be filled by promotion and not by direct recruitment and, therefore, there was to be much less immediate financial impact. It was concluded that even if the proposal did result in an estimated financial burden of Rs. 42 crore under the 'Mean Pay method', this should be viewed as cost incidental to the process of modernization and induction of technology. Over a period of time, it was felt that there would be a marginal increase in expenditure, in relation to overall tax collection, incremental tax collection and the 'existing' wage bill. It was expected that consequent to modernization and computerization, average cost of collection would fall inspite of the estimated financial cost of restructuring. The mechanism of working out the cost of collection and the allocation of appropriate 'weightage' to pre assessment collection that did not exactly test the investigation or assessment or recovery skills of the officers of the department, were not spelt out in the proposal to the Cabinet.

[*] Incremental cost method:- pay drawn on promotion minus pay drawn immediately before promotion

1.3.4 **Productivity**:-Based on the workload relating to tax payers registered as on 1 April 1997, it was proposed that there would be an estimated 200 per cent increase in productivity at organizational level. Here also, the meaning of 'productivity', the method of monitoring or verifying the increase, if any, were not mentioned in the proposal to the Cabinet.

1.3.5 **Additional Revenue Gains**:- Consequent to restructuring, the Department was expected to be well placed to deal with key areas of non-compliance. This, in turn, was to have led to an '**immediate**' impact on revenues due to the enhanced ability to deal with 'stop-filers' estimated at Rs.2800 crore. Another Rs.6000 crore was estimated to be the additional impact on revenues from disposal of pending assessments. Increase in the number of first appellate authorities and Tax Recovery Officers (TRO) were expected to contribute an estimated Rs.7500 crore to the revenues. Interest burden on refunds was projected to come down by Rs.350 crore per annum with early issue of refunds. The long run impact in increased tax buoyancy was expected to be much more. The definition of 'immediate' impact on revenues was conspicuous by its absence in the proposal to the Cabinet.

1.3.6 **Chain System of Internal Audit**: A new chain system of internal audit was separately introduced in December 2001 by the Board in the field offices ostensibly with a view to strengthening the internal check of assessments and refunds besides expanding on coverage and involving personnel from all assessment circles. Prior to restructuring, the 'Internal Audit' set up, consisting of Internal Audit Parties (IAP) and Special Audit Parties (SAP) was a separate entity within the Department. New system of internal audit was introduced after approval of the scheme of restructuring by the Cabinet, under the administrative powers of the Board.

1.4 Conditions of approval

The Cabinet approved the proposal of the Board/Department of Revenue on 31 August 2000 subject to the following conditions:-

- An 'MOU' should be entered into between the Government and the Board in regard to increased revenue generation.
- In order to reduce public harassment and ensure accountability, specific steps needed to be taken to strengthen the vigilance and accounting machinery in the Board, and
- The redeployed manpower needed to be fully trained in computer technology within a period of five years so as to improve the tax administration.

1.5. Audit objectives

Audit undertook the review with a view to ascertaining

- the extent of achievement of promised 'immediate' revenue gains
- the status of fulfillment of conditions laid down by the Cabinet while according approval
- the extent of improvement in efficiency after restructuring in areas such as assessments, issue of refunds, disposal of appeals, increased revenue generation, quality of assessments, effectiveness of anti-tax evasion measures, widening of tax base, number of tax payers serviced/handled, tax payer grievances and so on,
- whether there were verifiable and documented means of ensuring that the achievements are objectively measured, recorded and internally verified,
- that all direct and indirect costs involved in implementation of the scheme of restructuring have been properly and adequately accounted for and all expenditure has been incurred with the sanction of the competent authority in accordance with the prescribed procedure, and
- the extent of improvement, consequent to the change in or augmentation of the system of internal control and monitoring mechanism.

1.6 Audit methodology

1.6.1 Consultation with Ministry/CBDT

The Secretary, Ministry of Finance, Department of Revenue and the Board were informed in December 2003 about the selected review **topics** for Audit Report 13 of 2005 of the Comptroller and Auditor General of India requesting them to issue suitable instructions to field formations in the Income Tax Department to produce relevant records to audit teams from the field offices for examination and study.

1.6.2 In February 2004, references were made to the Board to make available their relevant records relating to the scheme of restructuring for audit scrutiny. Comments of the Board were also sought (13 February 2004) on certain basic and essential aspects of the scheme. These aspects included

- status of implementation and monitoring of the scheme of restructuring,
- mechanism of monitoring progress and achievements,
- status of fulfillment of conditions subject to which Cabinet approved the scheme,
- status of realisation of immediate or short term benefits promised in the scheme,
- status of induction of technology,
- details of placement of manpower and training,
- details and position of improvement in efficiency and performance in various areas, and constraints faced in implementation of the scheme.

1.6.3 Reply was received from the Board in August 2004. It was stated that all activities of the department were being monitored by the respective Members of the Board within the sphere of their responsibilities. While giving details of status of implementation of the scheme, only overall and all India position regarding collection of taxes, arrear collections, refunds, appeals and status of induction of technology were given. These details have been analysed in the succeeding paras on related aspects. However, nothing was mentioned in the reply about the status of fulfillment of conditions laid down by the Cabinet and constraints faced by the department, if any, in implementing the scheme.

1.6.4 A reference was also made to the Secretary to Government of India, Ministry of Finance, Department of Revenue in August 2004 seeking the status of fulfillment of these conditions. Reply has not been received.

1.7 Offices selected for review

Nine field offices as detailed below, were selected for study and examination of the relevant and concerned records. The selection was done on the basis of their contribution to the total collections from direct taxes. In the financial year 2002-03, contribution from these states was Rs.73,765.89 crore and formed 89 per cent of the total collection of Rs.83,088.57 crore from direct taxes. The selected offices were:-

- Andhra Pradesh
- Delhi
- Gujarat
- Karnataka
- Madhya Pradesh
- Maharashtra
- Tamil Nadu
- Uttar Pradesh, and
- West Bengal

1.8 Period covered

Audit attempted to examine the relevant records of the department for the period 1999-2000 to 2003-04, i.e., two years prior to and two years after the restructuring, including the year of restructuring.

1.9 CsIT/Units selected for review

CsIT were selected on the basis of revenue collection. Within the selected CsIT, selection of DCIT/ACIT was 100 percent and that of ITO, one under each CIT was done on random basis as indicated in **Table 2** below:-

Table 2: Selection of units for review

States	Total CsIT	CsIT selected for review	CsIT who made available records	CsIT who did not respond	Total no. of units (DCIT/ ACIT/ITO/ TRO)	Total no. of units selected for review
Andhra Pradesh	30	14	14	-	252	68
Delhi	20	20	17	3	331	23
Gujarat	58	3	3	NIL	487	9
Karnataka	36	7	7	NIL	60	19
Madhya Pradesh	7	4	4	NIL	149	32
Maharashtra	46	27	22	-	690	50
Tamil Nadu	10	5	5	NIL	177	36
Uttar Pradesh	16	8	8	-	284	40
West Bengal	31	9	9	-	130	42

1.10 Cases selected not produced to audit

1.10.1 Records and returns identified for requisition were essentially monitoring reports, periodical returns to Board, assessment records and statistical data on recovery, appeals and refunds.

1.10.2 Records and returns of Income Tax offices in Ahmedabad, Allahabad/ Lucknow, Bangalore, Bhopal/Indore, Chennai, Delhi, Hyderabad, Kolkata/ Durgapur, Mumbai, Nagpur and Pune were selected for test check.

1.10.3 On an average, 50 percent of total scrutiny cases, 2 percent of total summary cases, 10 per cent of total appeal cases (minimum 100 cases) and 10 per cent of highest value refund cases were selected for test check and statistical data.

1.10.4 Details of cases selected for test check are given in Appendix 1.

1.10.5 In these selected states, 20,018 scrutiny, 46,856 summary, 6,567 appeal and 14,522 refund cases were selected and requisitioned for the purpose of review. The department did not produce 6,576 scrutiny cases, 16,015 summary cases, 1,331 appeal cases and 5,304 refund cases.

1.10.6 Audit also compared and analysed the data available in its earlier Audit Reports furnished by the Board with the current data made available by the Board for arriving at some indicators of its performance relating to both 'pre' and 'post' restructuring periods.

1.11 Meetings with departmental authorities

1.11.1 A number of meetings were held with departmental authorities at various levels in Delhi by the Principal Director/Director, Direct Taxes to ascertain the position regarding implementation of the restructuring scheme, monitoring and verification system worked out by the department to watch the results of the scheme, internal control and record management system developed by the department for the purpose and other related issues like production of records etc.

1.11.2 At the draft review report stage, an Exit Conference of Member (A&J) of the Board and Principal Director (Direct Taxes), office of the Comptroller and Auditor General of India was held to discuss the audit conclusions and recommendations proposed to be included in the Audit Report. The results of the discussion have been incorporated in this report at appropriate places.

1.11.3 In the initial meetings, the department could not provide information as to how implementation and results of the restructuring were being monitored and measured, who was the monitoring authority, what was the controlling system and other related issues. In one such meeting, it was reported that a three-member committee consisting of three CsIT, was formed to look after the implementation of the scheme of restructuring. Later this committee was stated to have been disbanded and all the records sent to Deputy Secretary, Ad VII section under Member (Personnel), of the Board. However, in a meeting with Ad VII section, only one main file (note portion and correspondence portion) regarding proposal of restructuring with related details and Cabinet approval was made available. No other files and records were stated to be available with Ad.VII section.

1.12 Audit findings

1.12.1 Staff position

One reason for restructuring of the department, as stated in the Cabinet Note, was poor career management and promotion prospects resulting in demoralization of officers in the Indian Revenue Service making them lag behind other comparable Central Services. At the same time, downsizing of the Income Tax bureaucracy was estimated at 4.75 percent. Accordingly, various posts were created/abolished in the department. Though, there was expected to be an overall decrease of 2,755 posts in the staff strength of the department, in real terms the sanctioned strength of the supervisory, assessing, appellate and recovery officers increased whereas in the lower cadres the sanctioned strength decreased. Details are given in **Appendix 2.**

1.12.2 As per the proposal submitted to the Union Cabinet, on an average, for every CCIT there should have been 6.02 CsIT and for every CIT, there should have been 10.45 Addl.CsIT/JCIT/ DCIT/ACIT/ITO.

1.12.3 Audit attempted to verify the position in selected charges. In Andhra Pradesh, Madhya Pradesh, Maharashtra and Uttar Pradesh charges, the number of CsIT per CCIT and the number of Addl.CsIT/JCIT/DCIT/ACIT/ITO per CIT were closer to the figures proposed to the Union Cabinet. However, these ratios were substantially different in the charges of Delhi (4 & 8.61), Gujarat (8.87 & 8.49), Karnataka (6 & 10.63) and West Bengal (6.4 & 8.5).

1.12.4 Above analysis indicates that as compared to the recommended figures, there were relatively larger number of CCsIT and CsIT in Delhi, larger number of CsIT in Gujarat, larger number of Addl.CsIT/JCIT/DCIT/ITOs in Karnataka and lesser number of Addl.CsIT/JCIT/DCIT/ITOs in West Bengal charges.

1.12.5 Position of sanctioned posts pre-restructuring (as on 1 April 2001) and post-restructuring (as on 1 April 2003) of the selected charges are given in **Appendix 3.**

1.12.6 Audit noticed that all posts sanctioned in pursuance of restructuring had not been filled up. In Andhra Pradesh, Delhi, Gujarat, Karnataka, Maharashtra, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal charges as many as 3,750 posts from Inspector and below had remained unfilled as on 1 April 2003. Details are given in **Appendix 4.**

1.12.7 In the charges of Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Tamil Nadu and West Bengal, the vacancies as a percentage of sanctioned strength were substantially high and ranged from 11.29 to 18.38.

1.12.8 In Delhi charge, the post restructuring working strength in the cadre of CIT/Addl CIT exceeded the sanctioned strength. No reasons for the excess working strength were given.

1.12.9 Reasons for vacancies were generally stated to be promotion to the higher grade, transfer to other regions and retirement/VRS/death of officers.

1.12.10 Audit could not ascertain as to how posts in large numbers could continue to remain unfilled for long periods of over three years. This indicated that these posts would be redundant and not necessary. Incidentally, according to the instructions of Ministry of Finance in O.M No7 (7)-E (Co-ord)/93 dated 3 May 1993, these posts would be deemed to have been abolished if they continued to remain unfilled for a period exceeding one year.

1.12.11 During 'Exit Conference' the Board stated that vacancies in various cadres were due to factors outside the control of the Board. There were Government of India's instructions for making no fresh recruitments. Staff Selection Commission had not held any examination for fresh recruitments. Judicial proceedings on seniority related issues also contributed to delays. Recruitment rules for all cadres were also being formulated.

1.13 Cost implication

1.13.1 No additional expenditure was specifically provided for implementation of the scheme of restructuring though financial implication, by adopting "Mean Pay Method" was estimated at Rs.42 crore.

1.13.2 Audit noticed that the department had not maintained separate accounts for expenditure relating to its restructuring. To analyse the impact of the restructuring on the expenditure of the department, various sub head wise details were called for. It was, however, intimated by the Board that details of expenditure on office furniture, accommodation, office building, telephone expenses, vehicles and other office expenses could not be provided as no such separate details were maintained.

1.13.3 The Board in their letter dated 20 August 2001 asked all the cadre controlling CCsIT to submit revised estimates of expenditure for budget of 2001-02 including additional funds required under different heads on account of restructuring. Detailed note was also required to be furnished showing the method adopted in working out the additional requirement.

1.13.4 The West Bengal charge in letter dated 18 September 2001 sent to the Board, made a budget proposal of Rs.16.66 crore under the head "office expenses" for the financial year 2001-02 including a sum of Rs.6.11 crore exclusively to meet expenditure relating to restructuring leaving the remaining amount of Rs.10.55 crore for "office expenses general". An amount of Rs.9.04 crore was sanctioned, without allocating any separate budget for restructuring, which was fully spent during the financial year 2001-02 under the head "office expenses". It was intimated that expenditure on restructuring was not exclusively monitored.

1.13.5 In CCsIT, Indore and Bhopal charges in Madhya Pradesh, the expenditure under the head 'office expenses' increased by 14.61 percent, 35.95 percent, 40.55 percent and 19.14 percent during financial years 2000-01, 2001-02, 2002-03 and 2003-04 respectively over the preceding financial years. This increase was due to booking of expenditure on "Modernisation and Technology" under the head "office expenses".

1.13.6 The Board, therefore, did not have a mechanism to monitor the progress of its promise of a saving of Rs.3.05 crore on salaries and wages consequent to upgradation of posts after restructuring.

1.14 Computerisation Efforts

1.14.1 The computerisation of Income Tax Department was started in 1994. A review on "Computerisation in the Income Tax Department" has already appeared in Audit Report No.12 of 2000, which remarked as follows:-

i) ***Computerisation programme suffered from lack of proper planning. None of the projected milestones could be achieved due to "ad hoc" changes made from time to time in the programme***

ii) ***Against the conventional practice, the hardware was procured well before framing of the software design document, leading to improper hardware sizing. Further, bottlenecks such as non-readiness of***

sites/terminal bank's delay in the implementation of software application systems and delayed acquisition of leased lines leading to non-connectivity of PCs with RCC/NCC[1] contributed to an overall slowdown in the implementation of the computerisation programme.

iii) ***While some progress was made in implementation of TAS[2] and PAN allotment, the progress in other areas like AIS[3], AST[4], IRLA[5], TDS, MIS, EFS[6] and MMS[7] etc. did not gather momentum despite the hardware and software facilities existing for this.***

1.14.2 The Board informed in September 2001 that two standing committees had been formed with Member of the Board as Chairman and CCsIT as members to achieve the implementation of application system. Progress in areas such as processing of returns on AST software, OLTAS[8], eTDS[9] etc., appear to have since taken place. The field of computerisation, being technical and a potential subject for separate review has been left out of the purview of the present study.

1.15 Results of promised benefits of restructuring

1.15.1 The department was expected to be well placed to deal with key areas of non-compliance consequent to restructuring, which in turn was to have 'immediate' impact on revenues. The term 'immediate' was not defined. Additional revenue gains of Rs.2,800 crore from dealing with stop filers, Rs.6000 crore from disposal of pending assessments, Rs.7500 crore by increasing the number of first appellate authorities and TROs and Rs.350 crore from reduced burden of interest on refunds were estimated.

1.15.2 Audit attempted an analysis of each area of such additional revenue gain from a test check of records produced by the department. Results of the analysis are given below.

1.16 Collection from direct taxes.

1.16.1 The Board intimated in August 2004 that the collection of Direct Tax revenue had increased from Rs.68,613 crore in 2001-02 to Rs.1,05,049 crore in 2003-04 which translated into an increase of Rs.36,436 crore (53 percent growth) over a period of three years after restructuring of the Department. While on the face of it, this is correct, a much deeper and careful analysis is required to appreciate the extent of improvement in efficiency that can be entirely attributed to the gains from restructuring. It also needs to be noted that pre assessment

[1] Regional Computer Centre/National Computer Centre
[2] Tax Accounting System
[3] Assessee Information System
[4] Assessment Information System
[5] Individual Running Ledger Account
[6] Enforcement Information System
[7] Manpower Management System
[8] Online Tax Accounting System
[9] Electronic Tax Deduction at Source

collections such as TDS, advance tax and self assessment tax contribute as much as 85 per cent of total collection which do not directly test either the investigative or assessment or recovery skills of the assessing or supervising or higher officers of the department. Audit attempted an analysis of these aspects despite various constraints as mentioned in paragraph 1.11 above.

1.16.2 Details of Direct Taxes collections for the period from 1991-92 to 2003-04 are given in **Table 3** below:

(Rs. in crore)

Table 3: Direct Taxes Collections

Year	Pre-assessment collections			Post assessment collections		Total collection	Refunds	Net collection
	TDS	Advance Tax	Self Asstt	Regular Asstt	Other Receipts			
1991-92	5976	8467	1177	1568	803	17990	3408	14582
1992-93	6209	9918	2038	2114	884	21164	3655	17509
1993-94	7283	11908	2407	3097	683	24566	5387	19179
1994-95	9604	14495	2414	3013	1011	30537	4686	25851
1995-96	13946	16349	2814	5769	1196	40073	7999	32074
1996-97	15334	19679	3289	5532	2528	46363	9562	36801
1997-98	13788	21061	4245	4954	1637	45685	8568	37117
1998-99	16258	24365	4736	6825	2841	55024	10255	44769
1999-00	18546	30849	4509	6766	7165	67835	11488	56347
2000-01	28213	32614	5841	8121	5420	80211	12751	67460
2001-02	32672	34094	5479	9492	4094	85833	17220	68613
2002-03	36568	49158	6414	10745	2184	105069	22031	83038
2003-04	42955	58713	9852	16015	3150	130685	25736	104949

1.16.3 Though collection from direct taxes have increased at a higher growth rate in the two years post restructuring, the department did not maintain any analysis of the reasons for this growth so as to establish or correlate the same entirely or at least substantially to the positive outcome of and improvement of efficiencies in assessment and collection functions consequent to the implementation of the scheme of restructuring.

1.16.4 In the 'Exit Conference', the Board accepted that such details were not available with the Board/Department. It was, however, stated that once the process of computerization was completed, such information would be available. It was also felt that the quality of scrutiny assessments had improved in so far as only sustainable additions were being made reducing infructuous demands. However, no data in support of Board's claim was made available.

1.16.5 Audit analysed the average growth of net collections from 1991-92 to 2003-04. During pre-restructuring period, i.e., 1991-92 to 2000-01, average annual rate of growth of net collection was 18.6 percent and for the period 2001-02 to 2003-04, i.e., post-restructuring period, it was 23.7 percent. The period 2000-01 to 2001-02 has not been considered for the analysis being a transitional

phase and as the growth rate was only 1.7 percent in 2001-02. Comparison of two figures of average rate of revenue growth in the pre and post restructuring periods shows that there was increase of about 5 percent after restructuring.

1.16.6 Analysis of collections from 1991-92 to 2003-04 revealed that pre assessment collection as a percentage of total collection during the period 1991-92 to 2003-04 fluctuated between 80 and 88 whereas post assessment collection as a percentage of total collection varied from 20 to 12. During the period 1999-2000 to 2003-04, the share of pre assessment collection in the total collection rose from 79.46 percent to 85.33 percent whereas that of post assessment collection declined from 20.54 percent to 14.67 percent during the same period. Details are given in **Table 4** below:-

Table 4: Pre-assessment/post assessment collections

Year	Pre assessment collection as a percentage of total collection	Post assessment collection as a percentage of total collection
1991-92	86.83	13.18
1992-93	85.83	14.17
1993-94	87.92	15.39
1994-95	86.82	13.18
1995-96	82.62	17.38
1996-97	82.61	17.38
1997-98	85.57	14.43
1998-99	82.43	17.57
1999-00	79.46	20.54
2000-01	83.12	16.88
2001-02	84.17	15.83
2002-03	87.69	12.31
2003-04	85.33	14.67

1.16.7 Although the total collections during the period 1999-2000 to 2003-04 had increased substantially, ***it was more due to the increase in pre assessment collection rather than post assessment collection. The growth in collection, therefore, cannot exactly be attributed to the special efforts of the Income Tax Department after restructuring especially in the fields of investigation, assessment or recovery.***

1.16.8 According to the Mishra Committee Report, that formed the basis of the proposal to the Union Cabinet, the post assessment collection at optimal level could be expected to be increased by an estimated Rs.4000 crore per year. The proposal to the Cabinet had estimated 'immediate' additional revenue gains of Rs.6000 crore due to disposal of pending assessments.

1.16.9 Audit attempted to verify the additional revenue gains as a result of disposal of pending assessments after restructuring. The Board, however, replied that the details only of total direct taxes collections could be provided. Details of additional demand raised through scrutiny assessments were not maintained and,

therefore, could not be provided. Consequently, percentage of additional revenue to gross collection was also not provided. Audit was not able to ascertain as to how in the absence of these vital data and statistical information on performance, the Board was assuring itself of improvement in efficiency from its field formations in a regular and transparently verifiable manner.

1.16.10 During 'Exit Conference', the Board stated that increase in revenue was due to increase in efficiency after the restructuring of the department, which in turn had enabled them to process more summary assessments resulting in higher revenues. However, no data in support of Board's claim was made available.

1.16.11 In the absence of the above data, audit attempted an analysis of the post assessment collections. Average annual growth rate of **post assessment** collection for the period 1991-92 to 2000-01 worked out to 21.4 percent whereas that for the period 2001-02 to 2003-04 worked out to 18.8 percent only. The growth rate of post assessment collection after restructuring period has, thus in fact, declined (**Table 3 refers**). The levels, indicated in the Mishra Committee Report or the proposal for restructuring, were, thus, not only not achieved but the levels had declined compared to the position prior to restructuring.

1.16.12 Details collected from selected charges of Delhi, Maharashtra, Tamil Nadu and West Bengal also revealed that the growth in collection of direct taxes continued to be predominantly due to tax paid by the assessees at the pre assessment stage. Position of these four states is given in **Appendix 5.**

1.17 Position of revenue collection in test checked cases

1.17.1 Audit made an attempt to analyse the position of revenue collection in test checked cases on the basis of income returned by assessees, additions made during assessments, total demand raised, pre-assessment payments, appeals filed with revenue effect and cases decided in favour of or against revenue at first appeal. The information on above lines could be collected only from selected offices in Hyderabad (Andhra Pradesh charge), Delhi, Mumbai, Pune, Nagpur, Nasik, and Thane (Maharashtra charge), Bhopal and Indore (Madhya Pradesh charge), Tamil Nadu and Kolkata region (West Bengal charge).

1.17.2 Audit test checked 8539 cases in above charges and noticed that

- against the total demand of Rs.14,548 crore raised in these cases, only Rs.2820 crore of additional demand (19.4 percent) was raised as a result of assessment and investigation by the assessing officers,
- pre-assessment collections amounted to Rs.11728.94 crore which represented 80.6 percent of the total demand raised,
- appeals were filed in 857 of these 8539 cases involving revenue of Rs.903 crore. Only 180 cases (21.0 percent of appealed cases) involving revenue of Rs.86.32 crore (9.6 percent of appealed revenue) were decided in favour of revenue at the first appellate stage. Remaining 677 cases (79 percent of

cases appealed against) involving revenue of Rs.816.83 crore (90.4 percent of revenue involved in these 857 cases) were either decided against the revenue or remained undecided. Details are given in **Appendix 6.**

1.18 Uncollected demands

1.18.1 Every year thousands of crores of rupees are collected from Direct Taxes and almost equal amount remain uncollected at the end of the year. After restructuring of the department, position of uncollected demands has not changed much as given in **Table 5** below.

(Rs in crore)

Table 5: Uncollected demands

Year	Tax collected	Tax remaining uncollected	Percentage of total tax demand remaining uncollected
1991-92	14574	8461	36.73
1992-93	16752	9211	35.48
1993-94	19183	10780	35.98
1994-95	25851	22699	46.75
1995-96	32074	28970	47.46
1996-97	36801	33585	47.72
1997-98	37116	41230	52.63
1998-99	44769	44143	49.65
1999-00	56347	52970	48.46
2000-01	67460	56431	45.55
2001-02	68613	90177	56.79
2002-03	83038	67638	44.89
2003-04	104949	88017	45.61

1.18.2 Percentage of uncollected demand had gone up to 56.79 in the year of restructuring of the Income Tax Department, i.e. 2001-02 from 45.55 in 2000-01. In 2002-03 and 2003-04, it came back to pre-restructuring level of about 45 percent.

1.18.3 With a view to further analyzing the position of collected and uncollected demands, records for 1999-00 to 2003-04 were 'test checked' in the nine selected field offices mentioned in para 1.7. Uncollected demand as a percentage of total demand in all the selected charges for this period was above the all India average implying that the percentage of total collection in these charges was below the all India average figures. Only exceptions noticed were Madhya Pradesh charge in 2000-01 and West Bengal charge in 2002-03. Details are given in **Appendix 7.**

1.19 Recoveries by TRO (All India position)

1.19.1 The administrative machinery of tax recovery was strengthened by allocating one TRO exclusively to each range consequent to the restructuring of the department. Collection unit in a range, headed by one TRO, has been made responsible for collection, recovery and refund of taxes. Accordingly, sanctioned

strength of TROs was increased from 204 as on 31 March 2001 to 472 after restructuring representing an increase of 131 percent. The sanctioned strength was further increased to 509 as on 31 March 2003 but decreased to 462 as on 31 March 2004.

1.19.2 The Board informed (August 2004) that cash collection out of arrear demand had increased from 6.85 percent as on 1 April 2001 to 7.4 percent as on 1 April 2003. There was stated to have been even greater improvement in the ratio of cash collection out of current demand, which was stated to have increased from 12.61 percent in 2001-02 to 24.55 percent in 2003-04.

1.19.3 Audit made an attempt to analyse the results of increased strength of TROs after restructuring on the revenue collections. Effective and efficient recovery of tax is possible if the tax recovery machinery is strong and fully equipped with the full strength of the sanctioned staff. Audit noticed that not only were there vacancies in almost all cadres of tax recovery machinery but also the sanctioned strength itself had declined from 2867 in 2001-02 to 2498 in 2003-04. The reasons for this decrease in sanctioned strength were not given. Position of staff as on 31 March 2002, 31 March 2003 and 31 March 2004 is given in Table 6 below.

Table 6: Man Power for Recovery

Cadre	2001-02		2002-03		2003-04	
	Sanctioned Strength	Number actually deployed (as percentage of sanctioned strength)	Sanctioned Strength	Number actually deployed (as percentage of sanctioned strength)	Sanctioned Strength	Number actually deployed (as percentage of sanctioned strength)
TROs	472	472	509	457	462	388
Inspectors/ Supervisors	1013	781	1080	793	753	615
UDCs	482	346	520	399	426	239
LDCs	238	119	251	164	199	92
Stenographers	207	125	237	131	251	124
Notice Servers	275	158	262	153	203	105
Peons	180	93	-	-	204	79
Total	2867	2094 (73.04)	2859	2097 (73.35)	2498	1642 (65.73)

1.19.4 According to Government of India, Ministry of Finance, OM No 7 (7)-E (Co-ord)/93 dated 3 May 1993, if a post remained unfilled for a period of one year or more it would be deemed to have been abolished. About 27 to 34 percent of the total sanctioned strength for recovery had remained unfilled during the period 2001-02 to 2003-04. These posts should be deemed to have been abolished. Since the department has been conducting its business despite these posts remaining unfilled, the actual requirement of these unfilled posts and their continued inclusion in the sanctioned strength, is questionable.

1.19.5 Details of demands certified to TROs and demands recovered for 1998-99 to 2003-04, pre and post restructuring are given in the Table 7 below:

(Rs. in crore)

Table 7: Tax demands certified to TRO and demand recovered

Year	Demand at the beginning of the year	Demand certified during the year	Total demand	Demand recovered during the year (as a percentage of total demand)	Balance at the end of the year	Recovery per TRO
1998-99	3,581.80	2,490.08	6,071.88	1,173.66 (19.33)	4,898.22	6.99
1999-00	4,898.22	2,647.77	7,545.99	986.85 (13.08)	6,559.14	6.80
2000-01	6,559.14	3,706.51	10,265.65	2,223.74 (21.66)	8,041.91	12.42
2001-02	8,041.91	7,885.96	15,927.87	2,229.48 (14.00)	13,698.39	4.72
2002-03	13698.39	6,752.72	20,451.11	4441.85 (21.72)	16,009.26	9.72
2003-04	16,009.26	5,320.28	21,329.54	4111.73 (19.28)	17,217.81	10.60

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

1.19.6 The position of demand recovered during the year remained at around 19 percent after restructuring, which was already achieved in 1998-99. Recovery made per TRO has, however, improved.

1.19.7 Position of collections by TRO was attempted to be test checked in selected field offices. Details/information for 1999-2000 were not available and those for 2000-01 were available in Andhra Pradesh only. In respect of Karnataka, information regarding demand certified was available and demand recovered was not available. Thus, comparison of the position between the pre and post restructuring periods could not be made. The percentage of demand recovered by TROs in the selected field offices of Andhra Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal ranged from 0.30 percent to 18.65 percent during 2001-02 to 2003-04, which was much below the all India average figures of 13.08 percent to 21.72 percent. The only exception was the demand recovered of Rs.0.24 crore out of certified demand of Rs.0.44 crore (55 percent) in selected cases of Uttar Pradesh charge in 2001-02. Details with percentage of recovery are given in **Appendix 8.**

1.20 Revenue collections from search and seizure cases

1.20.1 The Income Tax Department conducts searches every year and seizes assets from suspected defaulters. **Table 8** below summarizes the position of prosecutions launched, convictions obtained, offences compounded and acquittals allowed, which has also featured as para 2.13 of Audit Report 12 of 2005.

Table 8: Prosecutions Launched, Convictions obtained, Offences Compounded and Acquittals

Year	Number of prosecutions launched			Disposal of cases				Cases pending
	Opening balance	Additions	Total	Convictions (Percentage of total disposal of cases)	Compounding	Acquittals (Percentage of total disposal of cases)	Total (Percentage of total prosecutions launched)	Balance
1999-00	14,122	343	14,465	14 (0.87)	128	1,465 (91.16)	1,607 (11.11)	12,858
2000-01	12,858	235	13,093	20 (2.78)	279	419 (58.36)	718 (5.48)	12,375
2001-02	12,375	38	12,413	5 (2.36)	8	199 (93.87)	212 (1.71)	12,201
2002-03	12,201	102	12,303	18 (4.16)	11	404 (93.30)	433 (3.52)	11,870
2003-04	11,870	37	11,907	12 (10.43)	55	48 (41.74)	115 (0.96)	11,792

1.20.2 The total number of cases disposed off during the year had declined from 11.11 percent in 1999-2000 to 0.96 percent in 2003-04. Out of the total cases disposed off, only 10.43 percent of cases resulted in convictions in 2003-04. The proportion of acquittals or compounding was around 90 percent or more in all the years under consideration. The position of prosecutions launched, convictions obtained, offences compounded and acquittals allowed has, therefore, not changed for the better after restructuring of the Income Tax Department.

1.20.3 As regards final revenue collections from 'Search and Seizure' cases, Board had informed that details of collections from such cases were not maintained, and hence did not have any mechanism to assess, monitor and enhance the efficiency of this very important instrument of deterrence against tax evaders.

1.21 Position of assessments

1.21.1 In order to improve the functional efficiency of the department, certain rationalisation measures at a structural level were introduced. This included separation of the assessment, collection and record keeping functions. Three separate units each for assessment, collection and record keeping were introduced. The officer incharge of a circle or ward in the assessment unit in a range was required to do only assessment work. Collection unit in a range, headed by one TRO, was made responsible for collection, recovery and refund of taxes and Record keeping unit, headed by an office superintendent and assisted by tax assistants and daftaries had to manage the records for the entire range.

1.21.2 The Mishra Committee had observed that the number of scrutiny assessments both in absolute terms and as a proportion of the number of registered taxpayers had fallen considerably from approximately 60 percent in the late 1960s, to approximately 30 to 40 percent in the late 1970s and down to a little over 5 percent in the 1990s. It was also stated therein that there was no scope for further reducing the number of scrutiny assessments as a proportion of the number of registered taxpayers, given the international practice and significant realisation from scrutiny assessments implying low level of compliance.

1.21.3 Table 9 below gives the percentage of total assessments due, which were selected for scrutiny and also those completed after scrutiny during 1991-92 to 2003-04. The number of assessments due for disposal, completed and pending at the end of the year during the above period is given in Appendix 9 which also features as Table 2.11 of Audit Report 12 of 2005.

Table 9: Assessments selected/completed after scrutiny

Year	Assessments selected for scrutiny as a percentage of total assessments due	Assessments completed after scrutiny as a percentage of total assessments due
1991-92	6.65	3.81
1992-93	6.41	3.59
1993-94	5.56	3.76
1994-95	4.53	2.99
1995-96	4.29	2.84
1996-97	4.36	3.02
1997-98	8.00	6.64
1998-99	3.25	1.10
1999-00	2.02	1.15
2000-01	1.15	0.72
2001-02	0.59	0.46
2002-03	2.37	0.46
2003-04	1.42	0.72

1.21.4 As per Mishra Committee Report, about 6 lakh[1] scrutiny assessments should have been possible to be completed with the total posts of assessing officers that would be available after restructuring. In absolute terms, the number of scrutiny assessments completed ranged from 1.68 lakh in 2001-02 to 1.97 lakh in 2003-04 after restructuring as against a minimum of 2.01 lakh in 1998-99 and a maximum of 9.20 lakh in 1997-98 achieved before restructuring. After restructuring, the number of scrutiny assessments completed thus was short of figure visualized by Mishra Committee Report and also did not reach the levels achieved before even though the number of assessing officers and supervising officers had increased from 6172 during pre-restructuring period to 8111 after restructuring. The number of summary assessments completed, however, had increased substantially from 1.40 crore in 1999-2000 to 2.14 crore in 2003-04. In percentage terms, number of summary assessments completed reached around 80

[1] Based on number of officers on assessment duty in March 2004

per cent in 2003-04 from a level of around 52 per cent in 1999-2000. But this was more due to processing of returns on AST software and outsourcing of data entry/refund generation work rather than the direct efforts of the assessing officers.

1.21.5 Assessments selected for scrutiny as a percentage of total assessments due had declined steadily from 6.65 percent in 1991-92 to 0.59 percent in 2001-02 except for 1997-98 when this figure was 8 percent. In 2002-03, this figure rose to 2.37 percent and again fell to 1.42 percent 2003-04.

1.21.6 Assessments completed after scrutiny as a percentage of total assessments due was however much smaller than above and steadily declined from 3.81 percent in 1991-92 to 0.72 percent 2003-04. Significantly, this figure has been about 1 or less than 1 percent in the last 5 years (less than ½ percent in 2001-02 and 2002-03).

1.21.7 Figures of scrutiny assessments, due for disposal in 2003-04 were shown as 3.88 lakh whereas at the end of March 2003, 7.22 lakh scrutiny assessments had remained pending for disposal. Normally, assessments due for disposal for 2003-04 should have been higher than 7.22 lakh as it would include pending assessments of earlier year and additions made during the year. Reasons for the discrepancy were not ascertainable.

1.21.8 Audit attempted a 'test check' of the position of the assessments completed between 2000-01 to 2003-04 in the selected CCIT charges of Delhi, Maharashtra, Tamil Nadu and West Bengal with a view to assessing the position of assessments completed in summary manner as well as after scrutiny.

1.21.9 Audit noticed in the selected charges that in summary cases, the number of assessments due had increased from about 90 lakh in 2000-01 to about 1.1 crore in 2003-04. The disposal of summary cases had increased from 53.4 percent of cases due in 2000-01 to 73 percent in 2003-04. Details are given in **Appendix 10**. In case of scrutiny assessments in these selected charges, the number of assessments due had increased from about one lakh cases in 2000-01 to about 1.77 lakh cases in 2003-04. The completion of scrutiny assessments had decreased from 73.6 percent to 51.2 percent during the same period. Details are given in **Appendix 11**.

1.22 Outsourcing

Audit noticed that an expenditure of Rs.4.25 crore had been incurred in 43 CsIT charges test checked in Andhra Pradesh, Gujarat, Madhya Pradesh, Maharashtra, Tamil Nadu and Uttar Pradesh during 2001-02 to 2003-04 on outsourcing of work relating to processing of income tax returns, allotment of PAN upto June 2003, dispatch of refund orders and Tax Accounting System (TAS). These costs were not projected in the proposal submitted to the Union Cabinet for approval. The

increased number of summary assessments completed and refunds issued after restructuring would need to be viewed in the light of above position.

1.23 Productivity per Assessing Officer

Audit attempted to study the productivity of assessing officers in terms of the number of scrutiny assessments completed. The proposal made to the Union Cabinet by the Ministry/Board on 'restructuring of Income Tax Department' promised an estimated 200 percent increase in 'productivity' at organisational level. Neither did the proposal define 'productivity' nor did it state how to measure 'productivity'. This has to be viewed in conjunction with the fact that the number of scrutiny assessments selected depended upon the instructions issued centrally by the Board every year and CCsIT/CsIT had only a limited scope to add to the numbers. Mishra Committee Report envisaged that the Addl/Jt. Commissioner would be expected to do 25 scrutiny assessments per year and the Dy/Asstt Commissioner and ITOs would be expected to do 125 and 160 scrutiny assessments per year respectively.

1.23.1 The average number of scrutiny assessments completed by each assessing officer (AO) at all India level during the years 1999-2000 to 2003-04 is given in **Table 14** below. This number has declined from 82.31 per assessing officer in 1999-2000 to 44.50 per assessing officer in 2003-04. It remained stagnant around 38 per assessing officer during 2001-02 and 2002-03 and improved slightly in 2003-04 but was still below the pre-restructuring level.

Table 14: Average productivity per AO (All India)

Year	No. of Scrutiny assessments completed	No of Assessing officers	No. of scrutiny assessments completed per AO
1999-00	316223	3842	82.31
2000-01	225730	3842	58.75
2001-02	168010	4383	38.33
2002-03	172410	4436	38.87
2003-04	197390	4436	44.50

1.23.2 Scrutiny assessment is a full fledged and principal item of work of assessing officers and intended to act also as a deterrent against misuse of provisions of the Act and evasion of tax in subsequent assessments. Audit attempted a further analysis of "productivity" per assessing officer with reference only to scrutiny assessments completed in the selected states during 2000-01 to 2003-04. **Table 15** below has the details: -

Table 15: No of assessing officers and scrutiny assessments completed

Charge	Assessing officers		Scrutiny assessments completed (average per assessing officer)			
	Pre-restructuring	Post restructuring as on 31.3.2004	2000-01	2001-02	2002-03	2003-04
Andhra Pradesh	208	221	17517 (84)	8119 (38)	9886 (46)	13051 (59)
Delhi	267	244	34561 (129)	5083 (21)	17267 (71)	15957 (65)
Gujarat	288	306	18313 (64)	19594 (64)	14707 (48)	6039 (20)
Karnataka	188	208	10708 (57)	6377 (34)	9141 (45)	9433 (45)
Madhya Pradesh	82	93	5337 (65)	4351 (47)	2680 (29)	6041 (65)
Maharashtra	NA	588	9932 (NA)	23385 (45)	28389 (48)	42876 (73)
Tamil Nadu	263	325	12544 (39)	7688 (24)	9423 (29)	15800 (49)
Uttar Pradesh.	NA	240	25877 (NA)	6454 (27)	8338 (35)	12201 (51)
West Bengal	399	431	16058 (40)	15355 (36)	10412 (24)	16189 (38)

1.23.3 The number of scrutiny assessments completed in a year per assessing officer has either remained constant or improved slightly in Madhya Pradesh and Tamil Nadu during 2000-01 to 2003-04 while in the case of Andhra Pradesh, Delhi, Gujarat, Karnataka and West Bengal, this number declined. The above data was not available for Maharashtra and Uttar Pradesh charges for the pre-restructuring period. In none of the states, however, this number was close to the figure indicated in the proposal for restructuring based on Mishra Committee Report. An average of 45 scrutiny assessments completed per assessing officer in 2003-04 would indicate that each assessing officer would be completing less than 4 assessments per month. A large force of assessing officers did not appear to have been gainfully utilised for completing more scrutiny assessments, after restructuring.

1.23.4 The Board stated, during 'Exit Conference', that the reason for decline in the average number of scrutiny assessments completed by an assessing officer after restructuring was close monitoring by the CsIT.

1.24 Dealing with stop filers

1.24.1 An assessee is termed as 'stop filer' if he has not filed return in all of the preceding 3 years and as 'non filer' if return has not been filed in any of the preceding 3 years. Mishra Committee report estimated an immediate additional revenue gain of Rs.2800 crore as a result of enhanced ability to deal with 'stop filers' after restructuring.

1.24.2 Audit approached the Board/department to ascertain the number of stop filers, those brought back to tax net and additional revenue generated from them, as promised in the scheme. The Board intimated that the details of total number of assessees and stop filers identified could be provided but the number of stop filers brought back to tax net and additional revenue raised from such stop filers brought back to tax net were not available.

1.24.3 Audit subsequently made efforts to collect information on 'stop filers' by test checking the records of the Income Tax Department at field level. As shown in Table 16 below, some information regarding stop filers brought back to tax net was available in West Bengal, Maharashtra, Uttar Pradesh and Madhya Pradesh but additional revenue realised from these stop filers was available only in West Bengal, Maharashtra and Uttar Pradesh charges.

(Rs in crore)

Table 16: Position of stop filers - 2001-02 to 2003-04°.

AG	Total number of assessees	Number of stop filers identified by the department	Number of stop filers brought back to tax net	Additional revenue raised	Number of stop filers as percentage of total assessees	Percentage of stop filers brought back to tax net
Andhra Pradesh	5196974	1320186	NA	NA	25.40	-
Delhi	NA	NA	NA	NA	-	-
Gujarat	6551558	961856	NA	NA	14.68	-
Karnataka	4797516	1251139	NA	NA	26.08	-
Madhya Pradesh	3648829	351011	3723	NA	9.62	1.06
Maharashtra	4101058	161952	4711	10.93	3.95	2.91
Tamil Nadu	8058717	1412074	NA	NA	17.52	-
Uttar Pradesh	4785586	614670	84505	6.10	12.84	13.75
West Bengal	571743	33653	3023	0.06	5.89	8.98

1.24.4 In the states for which information was available, the number of stop filers as a percentage of total number of assessees varied from 3.95 in Maharashtra to 26.08 in Karnataka. The proportion of stop filers brought back to tax net varied from 0.11 percent to 13.75 percent.

1.24.5 Audit noticed that there was no clear policy in the department for monitoring and reducing the number of stop filers besides realizing the revenue due from them. Firstly, the basis on which the Mishra Committee report arrived at the figure of Rs.2800 crore as the additional revenue gain from bringing back the stop filers to tax net after restructuring was not ascertainable. Secondly, no data in

° a) Overall figures of stop-filers in West Bengal (WB) Region were not available. Figures given in above table are in respect of eight out of nine selected Csit. (b) In Delhi charge details were not available. (c) In Tamil Nadu, Gujarat, Karnataka and Andhra Pradesh charges, though number of stop filers was available with the department, they did not have any data for number of stop filers on whom notices were served, who were brought back to tax net and against whom additional demand was raised. (d) Information regarding number of stop filers brought back to tax net were available in MP, UP and selected CsIT of WB. However, information regarding additional revenue raised from these stop filers was available only in UP and at selected CsIT of WB.

this regard was being maintained by the Board, in the absence of which, it was not clear as to how the Board was monitoring the progress of the objective of bringing back the stop filers to tax net. Thirdly, in the charges where this data was being maintained, the progress was slower than what was promised in the proposal.

1.24.6 The Board stated during 'Exit Conference' that they were aware of the issue but they were preoccupied with more significant/important areas. This issue would be taken up in due course.

1.25 Position of appeals

1.25.1 One of the benefits promised in the proposal of restructuring was immediate additional revenue gain of Rs.7500 crore by increasing the number of first appellate authorities and TROs. Besides, period for redressal of grievance was to be reduced from 18 months to six months. The Board fixed 60 units (weightage of 2 units for company assessment and 5 units for search & enhancement cases) per month disposal norm for each CIT (A), which was increased to 75 units per month from June 2004.

1.25.2 As on 31 March 2004, 0.82 lakh appeals were pending disposal at the level of CIT(A). As far as maintenance of statistics in respect of revenue involved in appeals filed, disposed off and balance pending was concerned, the Board/department did not have uniform system. While information on revenue involved in appeals was furnished to audit in Andhra Pradesh, Karnataka and partly in Maharashtra charges, the same was not available in Delhi, Gujarat, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal charges. The Board informed that the department was not maintaining statistics in respect of revenue involved in appeals filed, disposed off and balance pending. The Board later furnished some data according to which out of the total amount of Rs.57,128 crore disputed/locked up in appeal with various appellate authorities as in January 2004, an amount of Rs.26,260 crore (46 percent) was pending with CsIT(A).

1.25.3 Since the department was not maintaining statistics on revenue figures involved in appeals filed, disposed off and balance at the end of the year, the basis on which additional revenue gains of Rs.7,500 crore by increasing the number of CsIT (A) and TROs had been promised in the proposal to the Union Cabinet was not ascertainable in audit.

1.25.4 The time series data on position of appeals at the level of CIT (A) is given in **Appendix 12.** Out of 1.68 lakh, 1.72 lakh and 1.97 lakh scrutiny assessments completed in each of the three years viz., 2001-02 to 2003-04, as many as 0.64 lakh (38 percent), 0.64 lakh (37.2 percent) and 0.73 lakh (37.1 percent) cases were appealed against by the assessees indicating that a large proportion of cases were being appealed against.

1.25.5 Number of appeals disposed off was 1.08 lakh in 1999-2000, which declined to 0.98 lakh in 2000-01 and further to 0.80 lakh in 2001-02 before increasing to 1.18 lakh in 2002-03 and further declining to 0.95 lakh in 2003-04. There has been a steady decline in the number of appeals pending at the end of the year from 1.90 lakh in 1999-2000 to 0.82 lakh in 2003-04 which was due to the fact that addition of appeal cases at the level of CIT (A) came down from 0.82 lakh in 1999-2000 to 0.73 lakh in 2003-04. This, in turn, was attributable to the fact that the number of scrutiny assessments completed during the year came down substantially from 3.16 lakh in 1999-2000 to 1.97 lakh in 2003-04.

1.25.6 Addition to the number of appeals at CIT (A) level during the year as a percentage of scrutiny assessments completed during the year increased from 26 in 1999-2000 to 37.02 in 2003-04 implying, that the proportion of scrutiny assessments with which the assessees were dissatisfied was increasing. The addition to appeals/writs/references at the ITAT level during the year as a proportion of number of cases disposed off by CIT (A) during that year increased steadily from 6.06 percent in 1999-2000 to 35.14 percent in 2003-04 implying that there was an increase in proportion of dissatisfied assessees whose appeals were disposed off by CIT (A).

1.25.7 The average number of appeals disposed off by each CIT (A) in a month during 1999-2000 was 43.12, which came down to 27.53 during 2003-04. At this rate, the number of months required to clear the appeals pending as at the end of 1999-2000 would be 21.14 and 10.36 for those pending at the end of 2003-04. From the above analysis, we can conclude that the period of redressal of grievance at first appellate level although reduced could not come down to the promised level.

1.25.8 Audit also made efforts to ascertain the position of appeal cases through a test check at selected field offices. Audit confined itself to the implementation part of the assurances given in the scheme of restructuring without going into the merits of the appeal orders. Results of audit analysis of some of the selected charges are given below:

- In Hyderabad (Andhra Pradesh) charge, about 23 percent of appeals involving about 21 percent of the locked up revenue, in Bhopal & Indore (Madhya Pradesh) charge about 14 percent of appeals involving about 19 percent of locked up revenue, in Tamil Nadu 47 percent of appeals involving about 24 percent of locked up revenue, in Mumbai, Pune, Nagpur, Nasik and Thane (Maharashtra) charge, about 6 percent of appeals involving about one percent of locked up revenue and in Kolkata (West Bengal) charge about 38 percent of appeals involving about 14 percent of the locked up revenue were decided in favour of revenue. Rest of the appeals were either undecided or decided against revenue. In Delhi charge, 82 appeal cases filed between 2001-02 to 2003-04 involving revenue effect of Rs.98.06 crore were still undecided.

- In Delhi charge, the number of CIT (A) had increased from 24 to 30 after restructuring. As on 31 March 2004, 1034 cases were pending for disposal. 186 cases were pending for more than 2 years, 240 cases for 1 to 2 years, 329 cases between 9 months to 12 months and 279 cases between 6 months to 9 months. Almost after three years of restructuring, 1034 cases were still pending disposal for more than 6 months.
- In Maharashtra, Mumbai region, number of CIT (A) had decreased from 46 to 33 after restructuring. As on 31 March 2004, 3,149 appeals were pending with CIT (A). 141 of the pending appeals were more than 5 years old, 266 between 3 to 5 years, 1135 between 12 months to 36 months and 1607 between 6 months to 12 months old. Reasons for pendency were attributed to non-submission of details by the assessees, delay in submission of details/replies by the assessing officers and frequent transfer of files from one CIT (A) charge to another CIT (A) charge.
- In Tamil Nadu charge, the number of CIT (A) had increased from 13 to 18 after restructuring. Data collected on appeal cases by audit from 6 selected offices of CsIT (A) situated at Chennai (CIT (A)-III, V, VII, IX & XI) revealed that out of total of 4351 cases disposed of during 2001-02 to 2003-04, 750 cases took more than 6 months for disposal and as many as 1138 cases were pending disposal as on 31 March 2004. Out of 1138 pending appeals, 2 cases were more than 8 years old, 1 case between 6-8 years, 14 between 4-6 years, 27 between 3-4 years, 91 between 2-3 years, 174 between 1-2 year, 190 cases between 6 months to 12 months and 639 cases up to 6 months old.
- In West Bengal charge, the number of CIT (A) had increased from 14 to 48 after restructuring. Out of 607 cases pending disposal in four selected CsIT (A), 155 (25.54 percent of the total cases) were more than 6 months old and had not been disposed of. 248 cases (61.23 percent of 405 disposed of cases) took more than 6 months for disposal.

1.25.9 The Board had not maintained records to segregate disposals made within 6 months, which was the period mentioned in the scheme of restructuring for disposal of appeal cases. Thus, the Board did not seem to have evolved the necessary control mechanism to ensure disposal of appeal cases within 6 months.

1.26 Interest on refunds

1.26.1 Where refund of any amount becomes due to the assessee under the Act, he is entitled to receive, in addition to the said amount, simple interest thereon calculated in the prescribed manner. One of the factors on which increase/ decrease in the amount of interest paid depends, is the speed with which the refund is paid.

1.26.2 As per the proposal on restructuring, the interest burden was expected to be reduced by Rs.350 crore per annum with reduction in average time taken in issue of refunds. Mishra Committee Report had estimated the average delay in issue of refunds during a year by dividing the total interest on refunds paid during the year by the product of the amount of refunds paid during that year and the rate

of interest on refunds during that year. Mishra Committee arrived at an estimate of an average delay of 8 months in payment of refunds during 1996-97 and predicted that after restructuring, the average delay in issue of refunds would be reduced to four months.

1.26.3 Table 17 below shows time series data on refunds during 1990-91 to 2002-03

(Rs. in crore)

Table 17: Refunds

Year	Refunds	Interest paid on refunds	Interest paid on refunds as a percentage of refunds	Average delay in payment of refunds in months*
1990-91	2773	94.58	3.41	3.51
1991-92	3408	148.93	4.37	4.37
1992-93	3655	142.01	3.89	3.89
1993-94	5387	383.47	7.12	7.12
1994-95	4686	432.13	9.22	9.22
1995-96	7999	989.36	12.37	12.37
1996-97	9562	729.97	7.63	7.63
1997-98	8568	902.93	10.54	10.54
1998-99	10255	1854.14	18.08	18.08
1999-00	11488	1189.65	10.36	10.36
2000-01	12751	2622.37	20.57	20.57
2001-02	17220	1922.88	11.17	14.89
2002-03	22031	6268.07	28.45	42.74
2003-04	25736	4701.16	18.26	27.38

1.26.4 From Rs.11,488 crore in 1999-2000, refunds paid had more than doubled to Rs.25,736 crore in 2003-04. Interest paid on refunds as a percentage of refunds has also increased from 10.36 to 18.26 during the same period. Applying the same method as adopted in the Mishra Committee Report, the average delay in payment of refunds has been worked out and shown in column 5 of the table above. From an average delay of about 8 months in payment of refunds in 1996-97, it increased to 10.36 months in 1999-2000 and further to 27.36 months in 2003-04. Neither had the amount of interest paid nor the average delay in payment of refund decreased as promised in the proposal for restructuring.

1.26.5 Audit also attempted to check the number of cases where refunds were issued on indemnity bonds so as to assess the extent of non-availability of returns and the mechanism in place to ensure correctness of claims of refunds in such cases. The Board intimated that details of interest paid on refunds and the details of number of cases where refund was paid on indemnity bond could not be provided since no such statistical data was maintained.

* Rate of interest on refunds has been taken as 1 percent per month during 1990-91 to 2000-01, ¾ percent per month during 2001-02 and 2/3 percent per month during 2002-03 and 2003-04 for calculating average delay.

1.26.6 Audit attempted to verify the position of refund cases in Delhi[1], Mumbai region and Uttar Pradesh[2] for 2001-02 to 2003-04. Uttar Pradesh charge could not provide the statistics for 2001-02. The position of refunds in these charges is given in Table 18 below:-

(Rs. in crore)

Table 18: Position of refunds in selected charges

Charge	No of cases where refund orders issued			Amount of refund paid			Interest paid on refunds (Percentage of refunds)			No. of cases where refund was paid on indemnity bonds		
	2001-02	2002-03	2003-04	2001-02	2002-03	2003-04	2001-02	2002-03	2003-04	2001-02	2002-03	2003-04
Mumbai Region	174047	562282	678705	1090.43	4945.78	7695.75	69.30 (6.35)	549.20 (11.10)	1123.86 (14.60)	81	186	269
Delhi	46328	100570	93855	23.44	337.81	558.30	3.09 (13.18)	52.35 (15.50)	65.28 (11.69)	271	635	800
U.P.	NA	239423	206297	NA	210.98	175.68	NA	18.97 (8.99)	12.54 (7.17)	NA	38	57

1.26.7 In Mumbai region, the amount of interest paid on refunds increased from 6.35 percent in 2001-02 to 14.60 percent in 2003-04. In Delhi charge, the percentage decreased from 13.18 in 2001-02 to 11.69 in 2003-04. In Uttar Pradesh charge, comparison with pre-restructuring period could not be made as these statistics were not maintained.

1.26.8 The Board issued instructions in August 2002 that all returns in which refunds were payable to the assessee should be processed first and in cases requiring administrative approval, the refund should be issued within 30 days from the date of its determination. All refund orders should be sent to assessees by 'Registered Post' with acknowledgement due within 7 days of the passing of the order resulting in the refund.

1.26.9 In one of the cases test checked in Mumbai CIT City-2 charge, the assessee M/s Bank of Baroda, had filed revised return for assessment year 2001-02 on 12 September 2002 claiming refund of Rs.230.10 crore. The assessment was not completed initially in summary manner. The return was assessed after scrutiny on 30 January 2004, determining refund of Rs.38.35 crore. An amount of Rs.2.06 crore was paid as interest on refund for the period 1 April 2003 to 30 January 2004. Similarly, in the case of M/s Tata Power Company Ltd., return for 2001-02 was not assessed in summary manner and on completion of assessment after scrutiny on 25 February 2004, refund of Rs.51.63 crore was issued. An amount of Rs.3.26 crore was paid as interest on refund from April 2003 to February 2004. In both these cases, interest amount could have been saved had the returns been processed within the specified period in summary manner.

[1] In case of Delhi, data covers 4 CsIT only out of 20 as other CsIT did not respond.
[2] CIT Aligarh and ACIT Bulandshahar of CIT Meerut did not provide the details

1.26.10 Audit also noticed that though the returns, in which refunds were payable, were attempted to be processed on priority, there were instances when the refunds were not issued in the specified time. Position in this respect in some charges is given below:

- In Mumbai City-2 charge, during financial year 2003-04 though refunds were determined in 85 cases involving an amount of Rs.31.26 lakh in October 2003, and November 2003, the same were not issued to the assessees till June 2004. There was also delay of 6 to 11 months in issuance of refund in 52 cases involving refund of Rs.167.22 lakh.
- Test check of 792 refund cases in selected units of Delhi charge revealed that refund of Rs.210.57 crore was issued including interest of Rs.11.61 crore for delays ranging between 4 to 30 months during 2001-02 to 2003-04.
- In Tamil Nadu, out of 854 refund cases test checked, refunds were issued belatedly with delays ranging from 1 to 5 years in 25 cases.

1.27 Delay in implementation of the scheme

1.27.1 Cabinet approved the scheme in August 2000. Revised jurisdictions were notified on 31 July 2001 for implementation by the department from 1 August 2001.

1.27.2 Audit, however, noticed that the scheme was implemented in West Bengal charge in what appeared to be three phases, commencing only after one year from 1 August 2001. The Board had forwarded the revised jurisdiction of all the CsIT of West Bengal charge to the Department on 31 July 2001. Before receipt of the Board's notification, the Department in West Bengal issued an order on 27 July 2001 for creation of ranges/circles/wards in West Bengal under the scheme of restructuring with effect from 1 August 2001. Revised jurisdiction of all CsIT and Ranges on the basis of special trade and pin codes indicating the cases/assessees was notified. The order was not completely in conformity with the orders of the Board. The Board did not accept the order which was cancelled only on 19 October 2001 as per the directions of the Board. The department informed the Board on 1 January 2002 certain difficulties faced in implementing the Board's instructions and submitted a draft modified jurisdiction order for Board's approval. This draft order included certain omissions stated to have been made by the Board in their original notification. The Board informed the CCIT on 18 April 2002 that the revised jurisdiction had not been acceded to. A draft proposal defining the new jurisdiction exclusively on the basis of pin codes and special trade/business was again sent to the Board on 18 June 2002. The Board directed the West Bengal Circle to ascertain the position of the workload of the CsIT as well as to inform the period required to implement the proposed revised jurisdiction. The Board finally issued a notification on 30 July 2002 amending its original notification. Thus, one year was spent in revising the original orders and in implementation of the scheme of restructuring.

1.27.3 CCIT, Kolkata informed the Board on 11 October 2002 that there were discrepancies in the revised order of July 2002 such as

- employees with Banks, some PSUs e.g. ONGC, IOC etc. had been omitted;
- employees with Railways and Non-Government Schools had been assigned simultaneously with CIT-VI and CIT-VIII, and
- no provision had been made for residuary cases whose names were either left out or not specifically mentioned.

1.27.4 Even after one year of the issue of the orders notifying the implementation of restructuring, instances of individual assessees having salary as one of the sources of income who were not able to file their returns due to ambiguities in the jurisdiction order, were noticed. The said ambiguities were set right by issuing an order dated 10 September 2003, i.e, after a lapse of two years from the implementation of the scheme in August 2001.

1.27.5 The office of the I.T.O Ward 3(4) under the Additional Commissioner of Income Tax, Range-III, Kolkata was holding concurrent jurisdiction with the assessment office at Andaman and Nicobar Islands and had no assessment record in its possession till 14 July 2004. The jurisdiction of assessing officers under Addl. CIT, Range-III was revised to create jurisdictional charge of ITO Ward 3(4) to include certain assessees of Kolkata, District Howrah and North and South 24 Paraganas vide order dated 9 July 2004, i.e., after a lapse of almost three years from the implementation of restructuring in August 2001.

1.27.6 During the period between the Board's first notification dated 31 July 2001 and the cancellation of the CCIT's order of 27 July 2001 on 19 October 2001, the assessments and other functions were carried out by the department. After the cancellation of the CCIT's order on 19 October 2001 till the Board's notification on 30 July 2002, no jurisdictional order in light of Board's earlier notification was issued. The assessments completed during this period could, therefore, be open to challenge by assessees on the ground that the assessing officers did not have the authority to carry out the assessment work during this period. In a reply department stated that the first order dated 27 July 2001 was an interim arrangement. However, no such scope was available in the scheme of restructuring. Audit could not quantify the adverse impact that could have arisen due to this peculiar situation in West Bengal charge.

1.28 Transfer of records

1.28.1 After restructuring, records were transferred 'en masse' from the erstwhile special ranges, company circles, wards and business circles to the newly created ranges, circles and wards on the basis of pin codes and alphabetical order. The Board informed that after restructuring, there was complete overhaul of the jurisdiction of various charges resulting in transfer of records from the old and abolished units to the newly created ranges and assessing officers. Considering

the urgency of the work, entire efforts were stated to have been directed towards ensuring the dismantling of old charges in 2001. It was, therefore, essential that the assessment and related records of all assessees and assessments were carefully, fully and properly transferred from the old to the new jurisdictions.

1.28.2 Audit attempted to ascertain the mechanism adopted by the Board and its field formations to ensure that all the records were properly accounted for and transferred so that interests of revenue are safeguarded adequately and arrear demand in particular was carried forward completely for pursuing recovery even after restructuring. The Board informed that dismantling work having been completed in 2001-02 and the old units abolished, it was unlikely that any details regarding the transfer of records as required by audit could be provided.

1.28.3 Audit made efforts to independently ascertain the position of transfer of records in selected offices. Information was available only partly in Delhi, UP and Madhya Pradesh charges and is shown in **Table 19** below:

Table 19: Transfer of records in selected offices

	Delhi (Only 3 CITs out of 20)	Uttar Pradesh (Only Muradabad)	Madhya Pradesh (Only Indore-II)
Number of files due from old units	74574	821	60610
Number of files received in new units	68496	799	3604
Number of files not traceable	NA	16	376
Other reasons for non transfer	NA	NA	NA

1.28.4 In Gujarat, Karnataka and West Bengal charges, no details regarding transfer of records were available with the department. In Chennai (Tamil Nadu), details were available only in respect of files received. No other details regarding files due from old units and files not traceable were available. No information was forthcoming whether all the arrear demand was correctly and promptly transferred and accounted for in the new revised jurisdictions.

1.29 Chain system of internal audit

1.29.1 As part of restructuring, the existing system of internal audit was replaced by a new chain system of internal audit in the field offices of the Income Tax Department ostensibly with a view to strengthening the internal check of assessments and refunds involving personnel from all assessment circles. The new system of internal audit was introduced from 6 December 2001, after the approval of the scheme of restructuring by the Cabinet, under the administrative powers of the Board.

1.29.2 In the new internal audit system, all auditable cases, where assessments were completed during a month were to be internally audited by the end of the following month. Audit of one range was to be conducted by another range. Audit functions were to be a continuous process and involvement of assessing officers for performing simultaneous audit functions was expected to not only ensure spread of workload but also not consume much time.

1.29.3 Prior to restructuring, 150 audit parties (both Internal Audit parties and Special Audit Parties), consisting around 500 designated officials, were entrusted with the exclusive responsibility for internal audit and each party was required to audit around 110 cases every month. After restructuring, 4626 officials, drawn from all ranges and assessing offices, were to be involved for the purpose.

1.29.4 An analysis of the all India performance of internal audit from 1999-2000 to 2003-04, including both pre-restructuring and post-restructuring periods, is given in **Table 20** below:

Table 20: Internal Audit

Financial Year	Total auditable cases	Target for disposal	Total cases Audited	Shortfall with reference to total auditable cases	
				No	Percentage
1999-2000	3,70,617	1,98,000	1,94,859	1,75,758	47.42
2000-01	4,16,791	1,98,000	1,90,774	2,26,017	54.22
2001-02	4,84,263	4,84,263	41,837	4,42,426	91.37
2002-03	15,57,231	15,57,231	3,60,748	11,96,483	76.83
2003-04	18,40,561	18,40,561	6,90,841	11,49,720	62.46

Although, the number of cases audited internally had increased in absolute terms during 2002-03 and 2003-04, the percentage of shortfall with reference to total auditable cases had increased under the new system of internal audit after restructuring as compared to the pre restructuring period implying that the internal controls of the department had weakend.

1.29.5 Position of internal audit in respect of Andhra Pradesh, Delhi, Gujarat, Madhya Pradesh, Uttar Pradesh and West Bengal charges is given in **Table 21** below. Information in respect of Karnataka for the year 2001-02 to 2003-04 and in respect of Tamil Nadu for 2001-02 and 2002-03 was not available.

Table 21: Internal Audit in selected charges

Year	Andhra Pradesh		Delhi		Gujarat		M.P.		U.P*		West Bengal**	
	Auditable cases	Audited cases (percentage target achieved)	Auditable cases	Audited cases (percentage target achieved)	Auditable cases	Audited cases (percentage target achieved)	Auditable cases	Audited cases (percentage target achieved)	Auditable cases	Audited cases (percentage target achieved)	Auditable cases	Audited cases (percentage target achieved)
2001-02	41332	4277 (10.34)	19679	4500 (22.87)	55130	11294 (20.49)	13599	Nil	4082	1279 (31.33)	2764	2214 (80.10)
2002-03	54460	5644 (10.36)	125799	17987 (14.30)	146733	44423 (30.27)	39570	6969 (17.61)	30324	4607 (15.19)	5760	3643 (63.24)
2003-04	136098	84100 (61.80)	127316	55371 (43.49)	139827	47112 (33.69)	46475	7220 (15.53)	16506	3534 (21.41)	6992	5320 (76.09)
Total	231890	94021 (40.54)	272794	77858 (28.54)	341690	102829 (30.09)	99644	14189 (14.24)	50912	9420 (18.50)	15516	11177 (72.03)

* The figures pertain to CsIT Bareilly, Muradabad, Lucknow-I, Ghaziabad and Circle I & II Meerut

** Overall figures were not available. Above figures are compiled from selected CsIT.

1.29.6 In terms of absolute numbers, the cases audited internally increased during 2003-04 as compared to 2001-02 in all the selected charges (Andhra Pradesh,

Delhi, Madhya Pradesh, Uttar Pradesh and West Bengal) for which information was available. However, number of cases internally audited as a percentage of auditable cases during the same period improved in the case of Andhra Pradesh and Delhi whereas it decreased in the case of Madhya Pradesh, Uttar Pradesh and West Bengal. All the selected charges except Gujarat and West Bengal could achieve only around 50 percent of auditable cases.

1.29.7 In the case of Madhya Pradesh and Uttar Pradesh, shortfall in achievement of target was consistently higher than the all India average in the post-restructuring period. The position of Uttar Pradesh was similar to the all India trend both in terms of absolute numbers as well as percentage of target achieved. In the case of Andhra Pradesh, Delhi, Madhya Pradesh and West Bengal, position was similar to all India position in terms of absolute number but dissimilar in terms of percentage of targets achieved.

1.30 Questionnaire feedback from tax consultants

1.30.1 Twenty Income Tax Consultants/Chartered Accountants were given a questionnaire (**Appendix 13**) in each of the charges of Delhi, Gujarat, Karnataka, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal, seeking their views on the status of facilities, efficiency, tax payers' assistance etc., in the department after restructuring.

1.30.2 Audit received **total 42** responses, which need to be interpreted with caution. Firstly, the sample size was very small and concentrated in larger cities only. Also, only some of the leading tax consultants were approached and feed back could involve some element of subjectivity.

1.30.3 Despite these limitations, the exercise had shown interesting results, which are given below:

- Three fourth of the respondents had good or satisfactory perception of the new organisational structure of the Income Tax Department.
- About 59 percent of respondents were satisfied with the stabilization of changed jurisdictional charges.
- Only about 38 percent of respondents were not satisfied due to problems faced in filing of returns whereas about 80 percent were not satisfied due to problems faced at the level of assessments.
- About 88 percent of the respondents felt that delay occurred at assessment level.
- About 76 percent of respondents were not satisfied with the position of refunds after restructuring whereas 83 percent of respondents felt that the situation of tracing the records was not satisfactory.
- Sixty two percent of the respondents felt that overall record management in the department after restructuring was not satisfactory.
- 71 percent of the respondents were satisfied with their experience at 1st appellate stage with reference to time taken for disposal.

- 69 percent of the respondents were satisfied with their experience at 2nd stage of appeal with reference to time taken.
- 69 percent of the respondents were not satisfied with the departments' efforts to trace tax evaders.
- 77 percent of the respondents were not satisfied with the position in respect of transactions generating incomes going unreported.
- About 66 percent of the respondents were satisfied with the department's decision of outsourcing of certain areas of department's work.

1.31 An international comparison

1.31.1 In the absence of definition of terms such as efficiency and productivity in the note of the Ministry to the Union Cabinet seeking approval to the scheme of restructuring and subsequent inability of the Board to provide details of performance in areas such as efficiency of collection, cost of collection, results of scrutiny assessments and search cases, tackling stop filers, speed in disposal of appeals, arrear demand and so on, Audit attempted a comparison of commonly developed and utilised performance indicators or parameters of efficiency of national tax bodies of some OECD countries and the **Income Tax Department of India**[1] as worked out from other available sources.

1.31.2 Audit is aware that such comparison between tax systems of different countries would need to be made with caution as significant differences exist in the respective tax systems, such as: -

- variation in the organisational set up and the degree of autonomy of the national tax bodies across different countries
- the national tax body in many countries is also responsible for customs administration and/or various other non-tax functions
- in many countries, employee tax payers are required to file annual income tax returns, while in many others, most employees are relieved of such a requirement owing to the special tax withholding arrangements
- tax burdens vary across different countries
- in some countries, the collection of social contributions has also been integrated into the tax administration arrangements, and
- the level of automation and computerisation may also vary.

1.32 Analysis of staff investment for compliance functions

1.32.1 The ratio of number of staff deployed for audit and other verification work to total number of staff of the national revenue agency of the selected countries expressed as a percentage has been compared. In the case of Income Tax Department of India, the ratio of staff engaged in scrutiny as well as summary

[1] Use of 'Tax Administration in OECD countries: Comparative Information series (2004)' prepared by Forum on Tax Administration Compliance Sub-group has been made for this purpose.

assessment functions to total sanctioned strength during 2000-01 has been taken for the above comparison.

1.32.2 The above ratio for the Income Tax Department of India was higher than that of national revenue agencies of USA and France but lower than that of revenue agencies of other selected countries. Details are given in **Appendix 14.**

1.33 Comparison of Gross and Net Tax Arrears

1.33.1 The ratios of gross and net tax arrears to the denominator of annual net revenue collections of taxes of the selected countries have been compared. A declining trend in the ratio is likely to indicate improved payment compliance and/or arrear collection effectiveness. The difference between gross and net arrears refers to tax debts, the collection of which is subject to objection, dispute and/or litigation. In addition, the size of a revenue body's reported volume of tax arrears will be affected by write off policies concerning uncollectible debts, which may vary substantially between member countries[1].

1.33.2 The ratios relating to the Income Tax Department of India in this regard were significantly higher as compared to those of the national revenue agencies of other selected countries. Collection of tax arrears thus seems to be a significant problem in many of these countries and an acute problem in India.

1.33.3 There is also a large difference between gross arrears and net arrears in India signifying that a large portion of arrears in India would fall in the category of 'arrears not fallen due, amounts claimed to have been paid pending verification, amounts for which instalments were granted and amounts stayed/kept in abeyance'. Details are given in **Appendix 15.**

1.33.4 Audit hopes that the above analysis would help the Ministry devise objective, practical and yet ambitious parameters and a transparent mechanism for measuring efficiency and increasing productivity of its workforce in relation to administration of direct taxes, in particular.

1.34 Conclusion and recommendations

1.34.1 There has been increase in revenue generation even though no MOU appears to have been signed with Ministry by the Board. However, to what extent this increase was directly attributable to efficiency and productivity improvement after restructuring was not ascertainable in audit.

[1] As per the OECD publication, ibid, annual reports of a number of countries (e.g., Australia and UK) indicate that fair amounts of tax are written off each year as uncollectible in accordance with standard government debt management policies. In other countries, action to write off uncollectible debts is fairly limited and is often only executed after very long periods of time have elapsed.

1.34.2 Large number of vacancies remained unfilled at various levels for a number of years indicating that these posts may not really be needed as the department's performance at 'macro level' in terms of overall revenues realized and summary assessments completed has apparently improved despite these 'vacancies'.

1.34.3 After restructuring the average number of scrutiny assessments completed by an assessing officer had declined.

1.34.4 In the absence of details of taxes collected as a result of scrutiny assessments that have stood the test at least at the first stage of appeal, improvement effected in the quality of scrutiny assessments was not ascertainable.

1.34.5 Efficiency in bringing stop filers back to the tax net and the accretion of revenues from this function was not ascertainable.

1.34.6 Almost 46 percent of outstanding arrear demand was locked up in appeals at the CIT(A) level. Pace of disposal of appeals at CIT(A) level was not according to the norms indicated by the Board and there was no mechanism to establish and relate the fact of release of tax demands for recovery to increase in the number of posts of CIT(A) after restructuring.

1.34.7 The increase in number of summary assessments disposed off annually after restructuring was almost entirely attributable to "outsourcing" of data entry and related functions rather than direct efficiency or productivity improvement after restructuring.

1.34.8 No separate account of the costs incidental to restructuring was maintained. Substantial expenditure consequent to and related to restructuring exercise had not been separately budgeted or projected as expenditure relating to restructuring.

1.34.9 In the absence of clear targets and well-designed, transparent and verifiable criteria of efficiency and productivity, monitoring has suffered. There was no dedicated or clearly identified Wing/Division in the Board to effectively monitor efficiency and productivity improvements consequent to restructuring.

1.34.10 Apart from introduction of new chain system of internal audit and new system of inspections, online tax accounting system and electronic filing of TDS returns, audit did not notice evidence of concerted efforts at rationalization of work norms or practices after restructuring. Despite the introduction of the chain system of internal audit, the internal control of the department had weakened after restructuring.

Audit recommends that the IT System of the Department should generate a specific set of information which can help effectively monitor areas of improvement as visualized in restructuring proposals.

Audit recommends that working of chain system of internal audit be reviewed to ensure compliance with targets.

Audit recommends that criteria for working out the 'cost of collection' be critically reviewed after suitably factoring in substantial 'pre assessment' collections, so as to present a transparent and correct picture of efficiency and productivity of the department in this important area.

1.35 During the Exit Conference, the Board accepted that there was no mechanism to monitor efficiency and productivity improvements in the manner sought by audit consequent to restructuring. The reason given was that the computerization of the department in different phases was in progress and once the computerization would be completed, a mechanism to monitor the efficiency and productivity improvements of the department would also come in place. Board intimated that the steps to rationalize the work norms or practices in the department were being taken. A separate Committee was preparing the duty lists for all the cadres after the restructuring. Coming to large scale vacancies, it was attributed to problems in finalising recruitment rules which were now stated to be ready except for 'two' cadres. The entire process of restructuring would take between 5 to 7 years to stabilize.

Chapter II

Efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act

- Highlights
- Introduction
- Constraints
- Audit Findings
  - Abuse/misuse/complexity in law and quantification of deficiencies in implementation
  - Lacuna in law
  - Purpose of amendments not served
  - Effect of different rates of depreciation as per Income Tax Act and Companies Act
- Conclusion and recommendations

Highlights

- Audit reviewed the administration and implementation of six types of deductions and allowances granted under sections 32, 35, 80-HHD, 80-HHF, 80-IA and 80-IB of the Income Tax Act with a view to examining the adequacy of law, rules and procedures to safeguard the interests of revenue.

  (Para 2.1.6)

- Audit test checked around 1.3 lakh assessments spread over three assessment years and found mistakes in 760 cases involving a tax effect of Rs.624 crore. 452 of these were summary assessments where tax effect involved was Rs.341 crore representing around 52 percent of total tax effect.

  (Para 2.12.1)

- Assessing officers committed mistakes in 308 scrutiny assessments that involved tax effect of Rs.283 crore.

  (Para 2.12.1)

- In addition , lacunae in law such as not defining 'tourist', 'plant', 'loose tools', 'manufacture and production', not disallowing 'duty drawback' receipts before granting deduction for export of software and so on involved a revenue of Rs.35 crore in 33 cases.

  (Para 2.21.2 to Para 2.26.3)

- Test check of assessments of selected companies in 11,615 cases revealed that depreciation granted under the Income Tax Act was greater than that available under the Companies Act which involved a tax effect of Rs.7282 crore.

  (Para 2.31.2)

- Review revealed that administration and implementation of the selected deductions and allowances under the Act may not have effectively helped in achievement of any of their principal objectives and ended up in litigation and loss of revenue. There was no mechanism available in the department to objectively assess the performance of the selected provisions of the Act vis-à-vis their objectives.

  (Para 2.33.1)

Efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act

2.1. Introduction

2.1.1 Governemnt of India (the Government) have amended the Income tax Act (the Act) through successive Finance Acts over the years. Such amendments mainly attempt to introduce welfare measures, rationalise and simplify tax laws, modify or introduce measures to accelerate economic development, provide certain incentives to selected sectors of the economy, stimulate investment for industrial growth besides bringing in tax payer friendly measures. The Act therefore allows several kinds of exemptions, allowances, deductions, rebates/reliefs and concessions to tax payers in pursuance of the above objectives.

2.1.2 Incomes exempt, either full or in part, from tax can be categorized as 'Exemptions' while incomes subjected to tax but entitled to rebate or relief at an average rate of tax in certain circumstances come under 'Rebates' or 'Reliefs'. Likewise, deductions are those specifically provided under Chapter VIA of the Act and applied, after arriving at the gross total income, at the rates prescribed under the relevant sections subject to fulfilment of the conditions prescribed therein. These can be allowed only if there is positive income after setting off previous losses, if any. The Act provided for certain allowances/incentives such as depreciation, investment allowance, expenditure on scientific research etc. with a view to compensating the assessees from losses incurred during the course of business or for upgradation of technology.

2.1.3 The Shome Advisory group on Tax policy and Administration for the 10th Plan devoted a chapter on Reform of Direct Taxes and interalia dealt with sections 80 IA and 80 IB of the Act in its Report submitted in 2002. The group had not minced any words in declaring that tax incentives under sections 80 IA and 80 IB ***".....are in the nature of subsidies and since most developing countries do not account for these tax expenditures, they escape closer scrutiny of its effect. Tax incentives are, therefore inefficient, inequitous, impose greater tax payer compliance burden and administrative burden, result in revenue loss and contributed to complexity of the tax laws and encourage tax avoidance. These should be discouraged and wherever necessary political environment created to purge the tax statute of such incentives".*** The Group's Report noted that tax incentives had been subjected to abuse and that in spite of them, development in backward areas was yet to take off. Comptroller and Auditor General of India's Report No.12 of 1998 was referred to, for instances of abuse. The Report further pointed out that the problem was of basic infrastructural bottlenecks and these could not be taken care of by tax incentives.

2.1.4 The Kelkar Report concentrated on all aspects of direct taxes. With reference to incentives, it has more or less echoed the views of the Shome Advisory Group. The abuse, adverse impact of and increase in litigation due to the tax incentives have been decried. It stated that ***'the die is now cast for deleting***

other (i.e. other than export) incentives'. Depreciation has especially been dealt with and it questioned the rates prescribed as well as the situation where a group of assets were charged depreciation at the same rate. The rate of depreciation for plant and machinery of 25 percent was considered appropriate when the corporate tax rate was very high. With rationalization of corporate tax rates, it was suggested that the rate would need to be brought down to 15 percent bringing it in line with the rate prescribed in the Companies Act, which would pre empt tax avoidance through manipulation of depreciation.

2.1.5 Operation of Export incentives (Section 80HHC) was reviewed in the Audit Report 12 of 1999, which was placed before the thirteenth Lok Sabha. The Public Accounts Committee (PAC) had, in their report numbers 34 and 41 of 2003 recommended that these provisions had outlived their usefulness and be abolished or drastically rationalized. The Act has since been amended to phase out the export incentives.

2.1.6 Keeping in view the recommendations of the Shome Advisory Group, the Kelkar Report, the PAC mentioned above, the scope for misuse/abuse, litigation and complexities involved, the effectiveness and efficiency of administration and implementation of the following deductions and allowances were examined in audit through this 'review' or systems appraisal: -

- Section 32 – Depreciation
- Section 35 – Expenditure on Scientific Research
- Section 80HHD – Deduction in respect of business of a hotel or an approved tour operator
- Section 80HHF – Deduction in respect of profits and gains from export or transfer of film software/T.V.software
- Section 80IA – Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development
- Section 80IB – Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings

2.1.7 The Government have modified each of the selected allowances/deductions introduced at various times subsequently in order to cater to the growing and changing needs, re-assessment of importance of the affected sectors of the economy or the demands of categories of tax payers. Accordingly, the Government specified their objectives in the relevant Budget Speeches and/or explanatory memoranda to the concerned Budgets.

2.2. Objective of the review

2.2.1 Based on a test check of selected assessment and other records of the department, the review seeks to

- ascertain the instances and extent of abuse or misuse of the selected allowances/deductions and areas of litigation attributable to complexity of laws and quantify the impact of deficiencies in implementation,

- identify lacunae, if any, in law,
- examine whether the stated purposes of various amendments to the selected sections have been achieved, and
- identify the effect on the tax liability of the selected companies occasioned due to application of different rates of depreciation in the Companies and the Income Tax Act.

2.3 Audit methodology and sample selection

2.3.1 The review covered assessments not only of companies for examination of application of sections 80IA, 80IB and 32 in particular but also non company assessees for examination of administration of sections 35, 80HHD and 80HHF of the Act. The companies included top companies in terms of strategic sectors and top tax payers in the assessing units.

2.3.2 For section 32, all assessment cases in the selected units were scrutinised for review from the database of "top" companies compiled by field audit formations. For sections 35, 80HHD, 80HHF, 80IA and 80IB, assessments were examined in accordance with the methodology mentioned in Table 1 below:

Table 1: Quantum of audit

Field formations	Selection of units		Assessments records for selection	
			Scrutiny	Summary
1	2		3	4
Delhi, Mumbai, Tamil Nadu, West Bengal, Karnataka, and Gujarat	CITs with Company cases/charges	50%		
	Under the selected CITs			
	JCIT/Additional CIT carrying out assessment functions	100%	100%	10%*
	DCIT/ACIT	100%	50%*	10%*
	ITOs	25%*	50%*	10%*
Other offices	CITs with Company cases/charges	100%		
	Under the selected CITs			
	JCIT/Additional CIT carrying out assessment functions	100%	100%	10%*
	DCIT/ACIT	100%	50%*	10%*
	ITOs	25%*	50%*	10%*
* denotes selection randomly made				

2.3.3 Besides, in respect of assessees incurring expenditure on scientific research and availing deduction under section 35 and those availing deduction under sections 80 IA and 80 IB, details were obtained from Department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India in February 2004. Similarly, in respect of assessees availing deduction under Section 80-HHD covering hotels and tour operators, details were obtained from the Department of Tourism, Ministry of Tourism and Culture, Government of India, also in February 2004.

2.3.4 In all, 16 Accountants General, Principal Director of Audit, Central, Mumbai, Principal Director of Audit, Central, Kolkata and Director General of Audit, Central Revenues, New Delhi conducted the review in the assessment units pertaining to their charges and draft review reports were furnished to the respective Chief/Commissioners of Income Tax between August and October 2004. The Accountants General, Principal Directors, Director General also held exit conferences with their counter parts in October-November 2004. This was followed up with an Exit Conference with the Board on 10 February 2005.

2.3.5 Audit requisitioned the assessments completed in the financial years 2001-02, 2002-03 and 2003-04 till the date of audit. Wherever necessary, past records were also linked for conducting a purposeful examination in audit.

2.4 Law and procedure

2.5 Depreciation-Section 32

2.5.1 Depreciation means diminution in value that occurs gradually over the useful life of a business asset due to wear and tear and is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance. Fixed assets viz; buildings, machinery, plant or furniture, being tangible assets are eligible for depreciation. Knowhow, patents, copyrights, trademark, licences, franchises or any other business or commercial rights of similar nature, are intangible assets and are entitled to depreciation if these are acquired on or after 1 April 1998.

2.5.2 The Act provides for depreciation subject to fulfilment of three **main** conditions that the asset in respect of which depreciation is claimed should be (a) owned wholly or partly by the assessee (b) used for the purpose of business or profession and (c) used during the relevant previous year.

2.5.3 Appendix I and IA to Income Tax Rules, 1962 contain the rates at which depreciation is admissible. Depreciation at 50 percent of the normal rate is admissible in case a newly acquired asset is put to use for the purpose of business or profession for a period of less than 180 days in the year in which it is acquired. Depreciation is not allowed under specific circumstances mentioned in the Act.

2.5.4 Significant amendments made to law: -

- Finance Acts of 1966, 1967, 1974, 1975 and 1980 provided for additional depreciation and "extra shift" depreciation allowance in addition to normal depreciation. With a view to rationalizing the rate structure, providing higher depreciation for facilitating modernization and simplifying the calculation of depreciation, the Taxation Laws (Amendment and miscellaneous provisions) Act 1986 applicable from 1 April 1988 introduced the concept of "Block of Assets".
- The Finance Act 1966 provided for full depreciation of the entire cost of plant and machinery exceeding Rs.750, which was enhanced to Rs.5000 in Finance Act 1983. As this proved to be a cause of much dispute, a proviso to section 32(1) was inserted with effect from 1 April 1996 withdrawing this allowance.
- Depreciation was allowed for fractional ownership of assets purchased on or after 1 April 1996.
- In the case of amalgamation, proportionate depreciation was allowed, to amalgamating and amalgamated companies as well as in the case of succession to the predessor and successor and the demerged and resulting company in the case of a demerger.
- Depreciation was allowed on intangible assets acquired on or after 1 April 1998 in lieu of deductions allowed under section 35A/35AB earlier.
- With effect from 1 April 1998, the Act provided for separate rates of depreciation for machinery engaged in generation and generation and distribution of power.
- Foreign motorcars, acquired on or after 1 April 2001, were allowed depreciation.
- From 1 April 2002, the Act made mandatory for assessees to claim depreciation whether details of assets in their returns are furnished or not.
- From assessment year 2003-04, the Act provided for additional depreciation at 15 percent (7.5 percent if used for less than 180 days) on plant and machinery acquired and installed after 31 March 2002 subject to fulfilment of certain conditions.
- Depreciation relating to assessment year 1997-98 and onwards, can be set off against any income from assessment year 2003-04 without any limit of time. Earlier depreciation relating to assessment year 1995-96 and 1996-97 was allowed to be carried forward for set off only for eight assessment years.

2.6 Expenditure on scientific research –Section 35

2.6.1 Section 35 of the Act provided an incentive in the form of deduction at the rate of 100 percent or 125 percent of the expenditure incurred for promotion of scientific research in India, by an industrial undertaking on its own or through any approved scientific research association or through any notified university, college or other institution subject to fulfilment of certain conditions.

2.6.2 Significant amendments made to law

- Under Section 35(1) payment made to an approved university or college or institution for the use of research for social science or statistical research related to the business of the assessee is eligible for deduction.
- Section 35(2) was amended with effect from 1 April 1984 to exclude expenditure ***on land*** from the deduction provided for capital expenditure incurred by assessee which itself carries on scientific research after 31 March 1967.
- With effect from 1 April 1997, section 35(2AB) allowed 150 percent deduction on capital expenditure ***excluding both land and buildings***.

2.7 Deduction in respect of business of hotel or an approved tour operator Section-80HHD

2.7.1 In order to boost the foreign exchange earnings for the nation, the Act provided for deduction under section 80 HHD with effect from assessment year 1989-90 onwards at prescribed percentage in respect of business of hotels or tour operators, approved by the Director General of Tourism, Government of India, or a travel agent, from the profits derived in foreign exchange from the services provided to foreign tourists subject to fulfilment of certain conditions and production of certificates in Form 10-CCAD and 10-CCAE.

2.7.2 Eligible profit for computing the deduction shall be computed by multiplying profits and gains of business or profession with net foreign exchange receipts from services provided to foreign tourists and then dividing the result by total receipts of the business.

2.7.3 Significant changes made to law

2.7.4 From assessment year 1999-2000, deduction allowed under this section shall not qualify for deduction under any other sections of Chapter VIA and in no case shall exceed the profit and gains of such business.

2.7.5 From June 1999, the Government empowered the assessing officer to amend the order of assessment within four years from the end of the previous year in which the qualifying amount was brought in India within the prescribed time limit or extended period, with the approval of Reserve Bank of India where any deduction had been denied only on the ground that income otherwise qualifying for deduction had not been received in India and such income was so received in or brought into India at a subsequent date.

2.7.6 From assessment year 2001-02, the Government decided to phase out the deduction in the prescribed manner with the intent that deduction is not allowed in assessment year 2005-06 and subsequent years.

2.7.7 The method of computation, quantum of deduction allowable and the conditions for claiming deduction have been separately prescribed in the Act.

2.8 Deduction in respect of profits and gains from export or transfer of film software/TV software – Section-80HHF

2.8.1 The Act provided for deduction under section 80HHF, with effect from 1 April 2000, to an Indian company or a resident non corporate assessee engaged in the business of export or transfer; by any means, out of India, of any film software, television software, music software, television news software including telecast right and referred to as software or software rights.

2.8.2 The terms competent authority, convertible foreign exchange, export turnover, film software, music software, telecast right, television software and total turnover are defined in explanatory clauses (a) to (e) and (g) to (i) below the section 'ibid'. Profits of the business shall be reckoned in the manner specified in explanation (f) to the section itself.

2.8.3 Furnishing of a report of a Chartered Accountant in Form 10-CCAI certifying the correctness of the claim was made a pre-requisite for claiming the deduction. The quantum of deduction and other requisite conditions have also been provided in the section itself.

2.8.4 Significant amendments to Law

2.8.5 From the assessment year 2001-02, the Government amended section 80HHD in order to phase out the deduction over a period of 5 years by allowing a deduction of 80 per cent for assessment year 2001-02, 70 per cent for the assessment year 2002-03, 50 per cent for the assessment year 2003-04 and 30 per cent for assessment year 2004-05. No deduction shall be allowed from the assessment year 2005-06 onwards.

2.9 Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development – Section –80IA

2.9.1 From April 1991, section 80 I, with slight modifications, was replaced by a new section 80 IA which was originally made applicable to new industrial undertakings commencing manufacture, production, operation of ship, hotel, cold storage during the period 1 April 1991 to 31 March 1995. These provisions were extended to industrial undertakings commencing manufacture/production during the period 1 April 1993 to 31 March 1994 in specified industrially backward states allowing tax holiday benefits to the units, set up in industrially backward districts for infrastructure development, and also to the units, engaged in the generation and distribution of power. From April 2000, the deduction was restricted to units engaged in infrastructure development only.

2.9.2 Appendix 16 gives, at a glance, the details of deductions available under section 80IA viz: date of commencement of production, amount of deduction admissible and the period upto which deduction is admissible.

2.9.3 Other conditions for availing the benefit of deduction, inter alia, included production of Chartered Accountant's report in Form 10CCB alongwith the return of income certifying that the deduction has been correctly claimed.

2.10 Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertaking – Section 80IB

2.10.1 With effect from 1 April 2000, section 80IB provided for deduction to industrial undertakings/industrial undertaking in backward areas/ships/hotels/ business of building, owning and operating of multiplex theatres/convention centres/company carrying on scientific research and undertakings carrying out housing projects/undertakings setting up and operating a cold chain facility for agricultural produce and undertakings doing the integrated business of handling storage and transportation of food grains.

2.10.2 Relevant sections, eligible business, period of availability together with other conditions of eligibility are discussed in Appendix 17. Besides, the undertaking should neither have been formed by the splitting up or reconstruction of an already existing business nor use previously used machinery. It should also employ 10 or more workers if operating with the aid of power and 20 or more if no power is used.

2.11 Constraints

2.11.1 The department has no database or records or registers in respect of the assessees who are availing various deductions under the Income Tax Act. Although such information was intended to be available technically with the department, it has not been accessed or used in any meaningful way. In the absence of such comprehensive information with the department, limited information gathered by audit from other sources was relied upon for identification of cases. Further, restructuring of the department involving mass transfer of files from one circle/range/ward to another rendered accessibility of files/records difficult.

2.11.2 Non production of records

Non production of records by the assessing officers of the department in different charges was a significant constraint which varied from 3.54 percent in Punjab charge to 48.79 percent in Kerala charge, of the requisitioned records. Table 2 below has the details. Restructuring of the department or the files pending with higher authorities were generally cited as reasons for non production. No reason was adduced for non-production of records in most of the cases.

Table 2: Non production of records

AG/PD	Total No. of cases requisitioned	No. of cases not produced	Percentage of non production over total requisitioned
Andhra Pradesh	28614	2986	10.44
Bihar	1020	49	4.80
Delhi	7544	2688	35.63
Gujarat	2091	320	15.30
Haryana	1124	108	9.61
Jharkhand	2044	230	11.25
Kerala	2320	1132	48.79
Orissa	874	292	33.41
Punjab&UT	1185	42	3.54
Rajasthan	881	95	10.78
Tamil Nadu	905	320	13.99
Uttar Pradesh	2517	334	13.27
West Bengal	3589	995	27.72
Total	**54708**	**9591**	**17.5**

2.12 Audit findings

2.12.1 A total number of 1,37,899 cases covering selected sections of the Act were taken up for review. Excess/irregular deductions involving revenue effect of Rs.659 crore were noticed in 793 cases (including cases where lacunae in law were noticed). While 469 summary assessment cases involved a tax effect of Rs.347 crore, 324 scrutiny assessments involved a tax effect of Rs.313 crore relating to administration of the provisions of the Act selected for this review.

2.12.2 Audit noticed maximum number of mistakes relating to section 32 where revenue involved was Rs.320.50 crore in 499 cases followed by Rs.164.95 crore in 104 cases under section 80IA. A total number of 111 cases pointing out mistakes under section 80-IB involved revenue of Rs.81.21 crore.

2.12.3 Details of important and significant audit findings are presented in the following paragraphs corresponding to the objectives of this review mentioned in para 2.2 above.

2.13 OBJECTIVE I Abuse/Misuse/Complexity in law and Quantification of Deficiencies in Implementation

2.14 SECTION-32

2.14.1 Depreciation claimed and allowed on assets not owned by the asseessee

2.14.2 In Bihar, Gujarat and Maharashtra charges, depreciation was incorrectly claimed and allowed in **three cases** on such assets which were not owned by the assessees. The mistakes resulted in excess allowance of depreciation involving tax effect of **Rs.1.39 crore.** One case involving tax effect of more than Rs.1 crore of Maharashtra charge is shown in the **Table 3** below. Remaining two cases are shown at **Sl. Nos 1 and 2 of Appendix 18.**

(Rs. in crore)

Table 3: Inadmissible claims of depreciation on assets not owned by the assessee

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Nature of mistake	Excess claim	Tax effect
1	M/s Antop Hill Warehousing Company Ltd City VI Mumbai	2000-01 Summary	Ware houses	Depreciation was erroneously claimed and allowed on warehouses which were not owned by the assessee.	3.46	1.33

2.14.3 Assets not used in the business

2.14.4 In Andhra Pradesh, Chandigarh, Gujarat, Himachal Pradesh, Maharashtra, New Delhi, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal charges, depreciation was erroneously allowed on the assets which were not put to use in relevant previous year owing to cessation of business/lock out/strikes/non-installation etc. The omissions led to short levy of tax of **Rs.4.80 crore** in **35 cases**. Four cases each involving tax effect of more than Rs.25 lakh but less Rs.1 crore are indicated at **Sl. Nos 1 to 4 of Appendix 19**.

2.14.5 Depreciation cannot be allowed on assets income from which is computed under the head 'income from house property'. Depreciation incorrectly allowed against income from let out property which was assessed under the head, 'income from house property' in **two cases** in Tamil Nadu charge as shown at **Sl. Nos 3 and 4 of Appendix 18** resulted in short levy of tax of **Rs.14 lakh**.

2.14.6 Sale and lease back transactions

2.14.7 This is a special category of transaction where both the vital conditions of ownership and use are violated. Assets are sold only on paper and the buyer leases the same assets back to the seller. The buyer claims depreciation as the owner even though the original seller is using the assets. Board issued Instruction 1978 in December 1999 containing detailed guidelines to the assessing officers on treatment of such transactions. Audit scrutiny revealed that depreciation was still being allowed in violation of the law and guidelines on the issue.

2.14.8 Depreciation allowed in "Sale and Leaseback" cases in violation of the conditions of ownership and usage resulted in short levy of tax of **Rs.14.17 crore** in **8 cases** in Tamil Nadu and Uttar Pradesh charges. One case involving tax effect of Rs.11.78 crore of Uttar Pradesh charge is illustrated below. Four cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at at **Sl. Nos 5 to 8 of Appendix 18.**

2.14.9 In Uttar Pradesh charge, the assessment of M/s Indo Gulf Fertilizers and Chemicals, for the assessment year 1996-97 was completed after scrutiny in March 2002, after allowing depreciation of Rs.16.65 crore on addition of pollution

control equipments costing Rs.33.30 crore purchased under a "sale cum lease" arrangement from M/s Mangalore Refinery and Petro Chemical Ltd (MRPCL). The equipment was installed and used by MRPCL and not by the assessee. Depreciation was however, wrongly allowed to the assessee. The mistake resulted in underassessment of income of Rs.16.65 crore involving revenue effect of Rs.11.78 crore including interest.

2.14.10 Irregular claim of depreciation against income fully exempt from tax

2.14.11 No depreciation is admissible against the income exempt from tax.

2.14.12 In Delhi III charge, assessments of M/s Central Warehousing Corporation for the assessment years 2000-01 and 2002-03 were completed in summary manner disallowing exemption to income from warehousing activities but allowing depreciation claimed on warehouses. On appeal, income from warehousing activities was, however, exempted. Since depreciation on assets contributing to exempt income, is not admissible, it should have been disallowed. The mistake resulted in aggregate underassessment of income of Rs.31.82 crore involving tax effect of Rs.11.72 crore.

2.14.13 The department did not accept the audit observation, as it was a summary assessment. The reply is not tenable as mistakes arising from summary assessments conferring otherwise unentitled benefit on the assessee, prejudicial to the interests of revenue could be rectified under the powers available to assessing officers under the Act.

2.14.14 Mistakes in determination of actual cost or written down value of assets

2.14.15 Written down value means, in the case of assets acquired in the previous year, the actual cost to the assessee and in the case of the assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed under the Act.

2.14.16 In the case of any block of assets, written down value means, in respect of any previous year relevant to the assessment year commencing on 1 April 1988, the aggregate of the written down values of all the assets falling within that block of assets and, in respect of any previous year relevant to the assessment year commencing on 1 April 1989, the written down value of that block of assets in the immediately preceding year as reduced by the depreciation actually allowed in respect of that block of assets in relation to the said preceding previous year subject to certain adjustments prescribed in the Act.

2.14.17 In the case of succession in business or profession, the written down value of any asset or any block of assets shall be the amount which would have been taken as its written down value if the assessment had been made directly on the person succeeded to.

2.14.18 Incorrect application of the above provisions resulted in short levy of tax of Rs.54.40 crore in 54 cases in Andhra Pradesh, Bihar, Gujarat, Haryana, Jharkhand, Kerala, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal charges. Six cases each involving tax effect of more than Rs.1 crore are shown in the Table 4 below. Seven cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at Sl. Nos 1 to 7 of Appendix 20.

(Rs.in crore)

Table 4: Excess depreciation due to mistakes in written down values etc.

Sl No.	Name of the assessee/CIT charge	Assessmentyear/ Nature of Assessment	Nature of asset	Excess claim of depreciation	Tax effect
1.	M/s MCCPTA India Corporation Ltd Kolkata IV	2001-02 Summary	Fixed asset	32.88	13.00
2.	M/s DHBVNL Hissar (Haryana)	2000-01 Summary	-do-	28.43	10.94
3.	M/s UHBVNL Panchkula (Haryana)	2001-02 Summary	-do-	23.90	9.45
4.	M/s DHBVNL, Hissar	2001-02 Summary	-do-	21.39	8.46
5.	M/s S T BSES Coal Washeries Ltd City I Mumbai	2000-01 to 2002-03 Summary	Plant & Machinery	16.04	6.17
6.	M/s Chennai Bottling Company Chennai I	1996-97 Scrutiny	Business assets	1.91	1.61

2.14.19 **Capital investment subsidies not deducted from cost.** Where a part of the cost of an asset has been met directly or indirectly by the Central Government or State Government in the form of a subsidy, then such subsidy shall not be included in the actual cost of the asset.

2.14.20 Non-compliance with the above provision resulted in inflation of actual cost and excess allowance of depreciation involving tax effect of Rs.2.38 crore in 6 cases in Assam charge. One case involving tax effect of Rs.1.60 crore is shown in the Table 5 below. Two cases involving tax effect of Rs.34.53 lakh and Rs.28.39 lakh respectively are indicated at Sl. Nos 9 and 10 of Appendix 18.

(Rs. in crore)

Table 5: Excess depreciation allowed due to inflation of cost of assests

Sl. No.	Name of the assessee/CIT charge	Assessment year	Nature of asset	Nature of mistake	Under assessment	Tax effect
1.	M/s Virgo Cement Ltd. Guwahati II	2001-02 Scrutiny	Business asset	Capital investment subsidy not deducted from cost	4.56	1.60

2.14.21 **Depreciation allowed on assets disposed off.** Written down Value (WDV) in the case of any block of assets means the aggregate of WDVs of all assets falling within that block of assets at the end of the previous year increased

by the value of assets acquired and decreased by the value of assets sold or destroyed or discarded.

2.14.22 Incorrect allowance of depreciation without reducing the value of assets sold/disposed of, discarded or destroyed resulted in short levy of tax of **Rs.1.44** crore in 5 cases in Gujarat charge. One case involving tax effect of Rs.1.24 crore is shown in the **Table 6** below. Two cases involving tax effect of Rs.8.93 lakh and Rs.8.43 lakh respectively are indicated at **Sl.Nos 11 and 12 of Appendix 18.**

(Rs. in crore)

Table 6: Depreciation allowed on assets disposed off

Sl. No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of Mistake	Under-assessment	Tax effect
1.	M/s Gujarat Electricity Board Baroda I	2001-02 Scrutiny	Loss of assets was considered as capital in nature but depreciation was allowed without reducing the value thereof from WDV	3.14	1.24

2.14.23 Adoption of incorrect rates of depreciation

2.14.24 Depreciation on any block of assets shall be calculated at the rate specified in **Appendix I and IA** to the Income Tax Rules 1962.

2.14.25 Mistake in application of correct rate of depreciation resulted in short levy of tax of **Rs.40.57** crore in **120 cases** (134 assessments) in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Haryana, Jharkhand, Karnataka, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu charges. Six cases each involving tax effect of more than Rs.1 crore are shown in the **Table 7** below. 11 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos 1 to 11 of Appendix 21.**

(Rs. in crore)

Table 7: Adoption of incorrect rates of depreciation

Sl No.	Name of assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Rate of depreciation		Excess claim	Tax effect
				Admissible	allowed		
1	M/s Airport Authority of India Delhi I	1994-95 2000-01 Scrutiny	Security fencing Vehicles	10% 10% 20% 20%	25% 25% 25% 25%	0.77 2.46 0.50 3.31	1.71
2	M/s SREI International Finance Ltd, Delhi I	2003-04 Summary	Vehicles	20%	40%	4.06	1.49
3	M/s ZIP Telecom Ltd Hyderabad-3	2000-01 Summary	'ZIP Fone' instruments	25%	60%	3.35	1.29

4	M/s Prax Air India Ltd. Bangalore III	1999-00 Scrutiny 2000-01 2001-02 Summary	Gas Cylinder	25%	100%	8.34 5.33 6.29	7.46
5	M/s Airport Authority of India Delhi	1994-95 2000-01 Scrutiny 2002-03 Summary	Terminal Building	10%	25%	43.57	15.56
6	M/s State Bank of Bikaner & Jaipur Jaipur II	2000-01 2001-02 Scrutiny	Leased assets Computers Motor Cars	25% -	100%	8.62	4.31

2.14.26 Excess allowance of depreciation on assets used for less than 180 days.

2.14.27 Mistakes in application of 50 percent of prescribed rate of depreciation on assets used for less than 180 days resulted in short levy of tax of **Rs.6.62 crore** in **33 cases** in Andhra Pradesh, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Jharkhand, Kerala, Maharashtra, Punjab and West Bengal charges. Three cases each involving tax effect of more than Rs.1 crore are given in the **Table 8** below. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos.12 to 14 of Appendix 21.**

(Rs. in crore)

Table 8: Excess allowance of depreciation on assets used for less than 180 days

Sl No.	Name of assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Rate of depreciation		Excess claim	Tax effect
				Admissible	Allowed		
1.	M/s ABN Amro Bank N.V Kolkata	2000-01 Appeal revision	Intangible asset	12.5%	25%	4.13	1.98
2	M/s Bhima SSK Ltd. Pune-I	2001-02 Scrutiny	Plant & Machinery	12.5%	25%	4.30	1.70
3	M/s Ispat Profiles India Ltd. Kolkata I	1996-97 Scrutiny	Machinery	12.5%	25%	2.20	1.01

2.14.28 Mistakes in carry forward /set off of depreciation

2.14.29 Where for any assessment year, unabsorbed depreciation can not be set off against any other income in the relevant previous year, it shall be carried forward to the following assessment year and set off against profit and gains of that assessment year. It can be carried forward for eight assessment years However, in doing so, business loss of earlier years has to be first set off followed by unabsorbed depreciation. The law has been amended with effect from 1 April 2004 enabling unabsorbed depreciation to be carried forward, indefinitely.

2.14.30 Mistakes in setting off unabsorbed depreciation resulted in short levy of tax of **Rs.40.10 crore** in **54 cases** (66 assessments) in Andhra Pradesh, Bihar, Delhi, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal charges. 11 cases each involving tax effect of Rs.1 crore or more are given in Table 9 below. 12 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 12 of Appendix 22.**

(Rs. in crore)

Table 9: Mistakes in carry forward/set off of depreciation

Sl No.	Name of the assessee/CIT Charge	Assessment year	Excess set off	Tax effect
1.	M/s Samcor Glass Ltd. Delhi III	1999-00 & 2000-01 Scrutiny	20.81	8.01
2.	M/s Shree Cement Ltd. Ajmer	2002-03 & 2003-04 Summary	4.10 1.20	4.54
3.	M/s Shriram City Union Finance Ltd, Chennai III	2002-03 Summary	4.35	3.83
4.	M/s Ipisteel Ltd. Cuttack	1995-96 to 2000-01 Scrutiny 2001-02 to 2003-04 Summary	4.48	2.48(P)
5.	M/s Tuticorin Alkali chemicals Chennai I	1996-97 to 1998-99 Scrutiny	2.40 0.62	2.18
6.	M/s Samtel Color Ltd, Delhi III	2001-2002, Scrutiny	3.71	2.12
7	M/s Tamil Nadu Cement Corporation Ltd, Chennai I	1997-98 Scrutiny	4.74	2.04
8.	M/s Rajasthan State Mineral Development Corporation Ltd, Jaipur II	2000-01 Scrutiny	2.87	1.97
9.	M/s Textool Company Ltd. Coimbatore II	2001-02 Summary	3.43	1.73
10	M/s Avery Cycle Industries Ltd. Ludhiana Central	2000-01 Scrutiny	2.89	1.11
11	M/s Rajasthan Texchem. Ltd. Mumbai IV	2001-02 Scrutiny	2.52	1.00

2.14.31 Mistakes in grant of additional depreciation

2.14.32 With a view to encouraging modernization and investment in the economy, incentive in the form of additional depreciation was introduced with effect from assessment year 2003-04. Additional depreciation shall be allowed subject to the conditions that either a new industrial undertaking should begin manufacture after 1 April 2002 or an existing indutrial undertaking should substantially expand its installed capacity by at least 25 percent.

2.14.33 Additional depreciation was allowed even when prescribed conditions were not fulfilled or detailed information in Form 3AA was not filed, in 7 cases in Haryana, Kerala, Orissa and Uttar Pradesh charges resulting in short levy of tax of

Rs.15.60 crore. One case involving tax effect of Rs.14.90 crore of Orissa charge is discussed in **Table 10** below. Two cases involving tax effect of Rs.36.85 lakh and Rs.18.33 lakh respectively are indicated at **Sl.Nos 13 and 14 of Appendix 18.**

(Rs. in crore)

Table 10: Mistakes in grant of additional depreciation

Sl No	Name of the assessee/ CIT charge	Assessment year	Nature of asset	Nature of objection	Additional depreciation allowed incorrectly	Tax effect
1.	M/s National Aluminium Company Ltd. Bhubaneshwar	2003-04 Summary	Plant and Machinery	Plant and Machinery was acquired before 1 April 2002 and its expansion was below 25 per cent.	40.56	14.90

2.14.34 Depreciation claim allowed on ineligible items

2.14.35 Items, whether tangible or intangible, which have been included in Appendix I to the Income Tax Rules 1962, are eligible for deduction at the rates prescribed therein. It has been judicially held° that roads do not qualify for depreciation as "building" unless a road is laid for providing approach to factory/business premises.

2.14.36 Irregular allowance of deduction on the items not included in Appendix I to the Income Tax Rules 1962 resulted in short levy of tax of **Rs.5.11 crore** in **16 cases** in Andhra Pradesh, Bihar, Gujarat, Karnataka and West Bengal charges. One case involving tax effect of Rs.4.27 crore of Karnataka charge is given in the **Table 11** below. Two cases involving tax effect of Rs.40.95 lakh and Rs.20.69 lakh respectively are indicated at **Sl. Nos 15 and 16 of Appendix 18.**

(Rs.in crore)

Table 11: Depreciation claim allowed on ineligible items

Sl. No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Nature of mistake	Tax effect
1.	M/s Nandi Highway Developers Ltd. Bangalore III	2001-02 2002-03 Summary	Road built on BOT basis and not owned by the assessee	Depreciation was claimed and allowed on roads constructed on 'BOT' basis which was not an eligible item included in Appendix I to the Income Tax Rules	4.27

° M/s Indore Municipal Corporation Vs CIT (247 ITR 808 – SC)

2.14.37 Mistakes in adoption of correct figures and errors in computation

2.14.38 Under the Act, an assessment may be completed in a summary manner, interalia, after rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment. Despite this and instructions issued by the Board from time to time, mistakes including incorrect adoption of figures, arithmetical errors, double allowance of claims, failure to add back the claims originally disallowed by the assesssing officer etc. continue to occur suggesting the need for better vigilance and highlighting the fact that internal control mechanism needed to be strengthened urgently and effectively.

2.14.39 Mistakes in adoption of correct figures and errors in computation of deduction resulted in short levy of tax of Rs.38.98 crore in 57 cases in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Jharkhand, Himachal Pradesh, Karnataka, Maharashtra, Punjab, Tamil Nadu and West Bengal charges. Three cases involving tax effect more than Rs.1 crore each are given in Table 12 below. 5 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at Sl.Nos 1 to 4 of Appendix 23.

(Rs. in crore)

Table 12: Mistakes in adoption of correct figures and errors in computation

Sl No.	Name of the assessee/CIT charge	Assessment year/ Nature of assessment	Excess deduction allowed	Tax effect
1.	M/s AIR India Ltd, Mumbai	2000-01, Scrutiny	79.32	30.54
2.	M/s ITC Ltd, Kolkata III	2001-02, Scrutiny	5.90	2.33
3.	M/s Information Technologies (I) Ltd Delhi IV	2000-01 Scrutiny	2.08	1.19

2.14.40 Other miscellaneous mistakes

2.14.41 Assessing officers had committed mistakes of miscellaneous nature in 12 cases involving tax effect of Rs.10.04 crore in Andhra Pradesh, Assam, Delhi, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal charges. One case involving tax effect of Rs.6.80 crore is given in Table 13 below. Remaining cases are indicated at Sl Nos 1 to 11 of Appendix 24.

(Rs in crore)

Table 13: Other miscellaneous mistakes

Sl No.	Name of the Assessee/CIT charge	Assessment year/Nature of assessment	Nature of observation	Under assessment	Tax effect
1.	M/s India Polyfibers Ltd Lucknow II	2002-03 Summary	Depreciation pertaining to past assessment years (1996-97 to 2001-02) was incorrectly claimed and allowed	19.05	6.80

2.15 SECTION- 35

2.15.1 Irregular allowance of deduction on scientific research under section 35(1) and section 35(2AB) without approval of prescribed authority

2.15.2 For the purpose of claiming the deduction in respect of expenditure towards scientific research under sections 35(1) and 35(2AB), approval of prescribed authority is required which, under the provisions of the Act, shall be the Secretary, Department of Scientific and Industrial Research, Government of India.

2.15.3 Irregular allowance of deduction under the above provisions without approval of prescribed authority resulted in short levy of tax of **Rs.27.66 crore** in **14 cases** in Bihar, Delhi, Gujarat, Jharkhand, Maharashtra, Orissa and Tamil Nadu charges. Five cases each involving tax effect of more than Rs.1 crore are given in **Table 14** below. 3 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 3 of Appendix 25**.

(Rs. in crore)

Table 14: Irregular allowance of deduction under section 35(1) and section 35(2AB)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Excess deduction allowed	Tax effect
1.	M/s Lupin Ltd Mumbai X	2002-03, Summary 2001-02, Scrutiny	20.06 12.52	12.88
2.	M/s CIPLA Ltd, Mumbai II	2002-03, Summary	10.74	4.25
3.	M/s Cipla Ltd, Mumbai II	2003-04, Summary	11.82	4.22
4.	M/s National Aluminium Company Ltd. Bhubaneswar	2000-01, Scrutiny 2001-02 to 2003-04 Summary	7.03	2.62
5.	M/s Nicholas Piramal India Ltd, Mumbai	2002-03 Summary	4.76	1.88

2.15.4 Incorrect allowance of deduction together with depreciation

2.15.5 Where deduction is allowed for any previous year under section 35 in respect of expenditure represented wholly or partly by an asset, no deduction shall be allowed under section 32 for the same or any other previous year in respect of that asset.

2.15.6 Non-compliance with above provision resulted in excess allowance of deduction involving tax effect of **Rs.1.40 crore in 4 cases** in Andhra Pradesh, Bihar and West Bengal charges. Two cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 4 and 5 of Appendix 25**.

2.15.7 Other mistakes

2.15.8 Different types of mistakes in allowance of deduction towards expenditure on scientific research under Section 35 resulted in short levy of tax of **Rs.2.06 crore in 8 cases** in Gujarat, Maharashtra, Tamil Nadu and Uttar Pradesh

charges. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at Sl.Nos 1 to 3 of Appendix 26.

2.16 SECTION- 80 HHD

2.16.1 Irregular allowance of deduction without approval of prescribed authority

2.16.2 For claiming deduction under section 80HHD the business of hotel or of a tour operator should have been approved by the Director General, Director General of Tourism, Government of India.

2.16.3 In the following cases, the business of hotel was not approved by the prescribed authority which resulted in irregular allowance of deduction under section 80HHD involving short levy of tax of Rs.19.31 lakh in 3 cases in Delhi, Karnataka and Kerala charges. Details of these cases are indicated at Sl.Nos 6 to 8 of Appendix 25.

2.16.4 Irregular/non-utilisation of reserve

2.16.5 For allowing deduction under section 80HHD, an amount equal to the percentage of deduction is debited to the profit and loss account of the previous year in respect of which the deduction is allowed and credited to a reserve account to be utilized for the purposes of the business of the assessee in the prescribed manner.

2.16.6 Irregular transfer of entire amount of foreign exchange reserve to the profit and loss account without using it for the specified purposes, resulted in short levy of tax of Rs.37.57 crore in 10 cases in Maharashtra, Tamil Nadu, Orissa and West Bengal charges. Four cases each involving tax effect of more than Rs.1 crore are given in Table 15 below. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at Sl.Nos 9 to 11 of Appendix 25.

(Rs. in crore)

Table 15: Irregular/non-utilisation of reserve

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Irregular deduction allowed	Tax effect
1.	M/s East India Hotel Ltd Kolkata III	2001-02 Scrutiny	35.80	14.16
2.	M/s East India Hotel Ltd. Kolkata III	1999-00 Scrutiny	34.70	12.14
3.	M/s Hotel Leela Venture Ltd. Mumbai VIII	1998-99 Scrutiny	24.00	8.40
4.	M/s Travel Corporation of India Mumbai IV	2000-01 Scrutiny 2001-02 Scrutiny	3.28 0.85	1.60

2.16.7 Mistake in computation of eligible profit/deduction

2.16.8 Under the provisions of the Act, the eligible profits for the purpose of deduction under section 80HHD are to be reckoned with regard to total turnover only.

2.16.9 Mistake in computation of eligible profit/deduction resulted in short levy of tax of **Rs.81.14 lakh** in **2 cases** in Delhi and Tamil Nadu charges. Details of these cases are indicated at **Sl.Nos 12 and 13 of Appendix 25**.

2.16.10 Incorrect allowance of deduction against ineligible business resulted in short levy of tax of **Rs.1.31 crore** in **6 cases** in Delhi, Karnataka, Kerala, Maharashtra and Tamil Nadu charges. One case involving tax effect of Rs.60.99 lakh of Maharashtra charge is indicated at **Sl.No 4 of Appendix 26.**

2.16.11 Irregular allowance of deduction without setting off brought forward loss

2.16.12 Under the provisions of the Income Tax Act, 1961, deduction under chapter VIA shall be allowed only after brought forward losses of earlier years are set off.

2.16.13 Irregular allowance of deduction without setting off brought forward loss resulted in short levy of tax of **Rs.43.32 lakh** in **2 cases** in Kerala and Tamil Nadu charges as indicated at **Sl.Nos 14 and 15 of Appendix 25**.

2.16.14 Other mistakes

2.16.15 While computing deduction under Section 80HHD, the assessing officers committed different types of mistakes which resulted in excess allowance of deduction involving short levy of tax of **Rs.63.42 lakh** in **9 cases** in Karnataka, Kerala, Maharashtra, Orissa, Rajasthan and Tamil Nadu charges. Two cases involving tax effect of Rs.17.06 lakh and 14.05 lakh are indicated at **Sl. Nos 16 and 17 of Appendix 25**.

2.17 SECTION- 80HHF

2.17.1 Irregular allowance of double deductions

2.17.2 Sub section (5) of section 80 HHF stipulates that where a deduction under this section is claimed and allowed for any assessment year, no deduction shall be allowed in relation to such profits under any other provisions of the Act.

2.17.3 In violation of the above provision, assessees were allowed deductions under other sections of the Act in addition to deduction under section 80-HHF which resulted in excess allowance of deduction resulting in short levy of tax of **Rs.22.15 lakh in 2 cases** in Maharashtra charge as indicated at **Sl Nos 5 and 6 of Appendix 26.**

2.17.4 Mistakes in adoption of correct figures and errors in computation

2.17.5 Mistakes in adoption of correct figures and errors in computation of deduction were noticed in 4 cases involving revenue effect of **Rs.1.98 crore** in **5 cases** in Maharashtra charge. One case involving tax effect of Rs.1.36 crore is shown in **Table 16** below. Another case involving tax effect of Rs.44.63 lakh is indicated at **Sl No 7 of Appendix 26.**

(Rs. in crore)

Table 16: Avoidable mistakes and errors in computation

Sl No.	Name of the assessee/ CIT charge	Assessment year/Nature of assessment	Nature of mistake	Excess deduction allowed under section 80HHF	Tax effect
1.	M/s Nimbus Communications Ltd City XI Mumbai	2000-01 Scrutiny	Amount of total turnover was incorrectly adopted.	2.37	1.36

2.17.6 Other miscellaneous mistakes

2.17.7 Different types of mistakes in application of provisions of sections 80HHF resulted in excess allowance of deduction involving short levy of tax of **Rs.88.21 lakh** in **4 cases** in Andhra Pradesh, Maharashtra, Tamil Nadu and West Bengal charges as indicated at **Sl Nos 8 to 11 of Appendix 26.**

2.18 SECTION-80IA

2.18.1 Irregular deduction allowed on ineligible business/other income not relating to manufacture/industrial/infrastructure activities

2.18.2 Deduction was incorrectly allowed on other income not relating to manufacture/industrial/infrastructure activities which resulted in short levy of **Rs.136.42 crore** in **61 cases** in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Haryana, Jharkhand, Karanataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal charges. Four cases each involving tax effect of more than Rs.1 crore are given in **Table 17** below. Four cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos.1 to 4 of Appendix 27**.

(Rs. in crore)

Table 17: Irregular deduction under section 80IA against other income

Sl No.	Name of the assessee/CIT charge	Assessment year/Nature of assessment	Nature of income to be excluded	Irregular deduction allowed	Tax effect
1.	M/s Orissa Power Generation Corporation Ltd. Bhubaneswar	2001-02 to 2003-04 Summary	Other income. Excess set off of brought forward depreciation and non-filing of prescribed audit certificate was also noticed	394.30	125.52
2.	M/s Rungta Irrigation Ltd, Delhi V	1999-00 Scrutiny	Other income	4.63	2.47

3.	M/s Kochi Refinery Ltd, Kochi	1998-99 Scrutiny	Income from investment and other sources	4.44	1.60
4.	M/s Vesuvius India Ltd. Kolkata IV	1999-00 2002-03 Summary 2000-01 2001-02 Scrutiny	Other income credited towards 'provisions no longer required and exchange gain'	2.92	1.57

2.18.3 Non-deduction of proportionate corporate expenses

2.18.4 Where any assessee has more than one unit of manufacture and all of them are not eligible for deduction under section 80IA, it is often noticed that the expenses of the eligible unit are debited to the non eligible unit so that the taxable profits go down and the non taxable profits go up.

2.18.5 In West Bengal III charge, audit examination of the assessment of M/s Tide Water Oil Co. (I) Ltd for the assessment year 1998-99 completed after scrutiny revealed that while claiming deduction under section 80IA, the assessee did not reduce the proportionate expenses having direct nexus with the exempted unit. These expenses were debited against income from non eligible units to reduce the taxable income. The mistake resulted in under assessment of income of Rs.1.75 crore involving short levy of tax of Rs.61.51 lakh. At the instance of audit, assessment was reopened under section 263 and set aside against which assessee preferred appeal to ITAT, where appeal was decided in favour of the department.

2.18.6 Incorrect allowance of double deduction

2.18.7 If deduction under section 80IA is claimed for any assessment year, deduction to the extent of such profits and gains shall not be allowed under any other provisions of Chapter VIA from the profit and gains of same business.

2.18.8 Incorrect allowance of deduction towards export profits on the same amount of profits and gains in violation of the above provision resulted in excess allowance of deduction involving short levy of tax of **Rs.9.71 crore** in **15 cases** in Maharashtra, Gujarat, Tamil Nadu and West Bengal charges. One case involving tax effect of Rs.4.36 crore is illustrated below. Four cases each involving tax effect of more than Rs.50 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 4 of Appendix 28**.

2.18.9 In West Bengal, Kolkata III charge, in the assessments of M/s East India Hotel Ltd. for the assessment years 1999-00 to 2001-02 completed after scrutiny, the assessee was allowed deduction under section 80IA though it had already claimed deduction under section 80HHD. The irregularity resulted in short levy of tax of Rs.4.36 crore.

2.18.10 Incorrect allowance of deduction in respect of 'prior period' income

2.18.11 Deduction under section 80IA is admissible only from the date the industrial undertaking starts manufacturing activities as provided in the Act.

2.18.12 In Kerala, Kochi charge, the assessment of M/s Kochi Refinery Ltd. for the assessment year 1997-98, completed after scrutiny in March 2000 was revised in June 2001 at a total income of Rs.168.11 crore allowing a deduction of Rs.20.51 crore in respect of a new unit commissioned in December 1994. Audit scrutiny revealed that the profit derived from the eligible unit included Rs.12.88 crore being the amount received on account of increase in costs of margin from oil co-ordination committee for the period prior to the commissioning of the new unit in December 1994. The mistake resulted in allowance of an excess deduction of Rs.3.86 crore involving short levy of tax of Rs.2.77 crore including interest.

2.18.13 Inadmissible claims for want of audit certificate

2.18.14 Deduction under this section shall not be admissible unless an accountant audits the accounts of the assessee of the relevant previous year and the assessee furnishes along with the return of income, the report of such audit in the prescribed Form No.10CCB duly signed and verified by such accountant.

2.18.15 Irregular allowance of deduction in the absence of requisite audit certificate resulted in short levy of tax of **Rs.1.16 crore** in **12 cases** in Bihar, Gujarat, Haryana, Himachal Pradesh and Tamil Nadu charges. One case involving tax effect of Rs.39.31 lakh is indicated at **Sl.No 5 of Appendix 28.**

2.18.16 Irregular deduction in respect of units formed by splitting existing units

2.18.17 Deduction under section 80IA is allowed, interalia, subject to two conditions, viz: the undertaking is not formed by the splitting up or reconstruction of a business already in existence or the transfer of machinery from an old business. Further, in the event of transfer, the total value of the machinery transferred should be less than twenty per cent of the total value of the machinery used in the new business.

2.18.18 In Assam, Shillong charge, in the case of M/s Eastern Mining and Allied Industries Ltd. Rs.1.88 crore worth of machinery out of a total value of machinery of Rs.3 crore claimed to have been used in the business was found to be fictitious and depreciation disallowed for assessment years 1993-94 to 1995-96. However, deduction under section 80IA of Rs.6.3 crore and Rs.3.54 crore was allowed for assessment years 1995-96 and 1996-97 respectively. This was inspite of the fact that major part of the machinery was found fictitious and no manufacture could have been done with fictitious machinery. Also, the value of old and previously used machinery, transferred to the business, was more than 20

percent of the total value of the plant machinery. Thus, the deduction allowed was not in order. Omission to disallow deduction resulted in underassessment of income of Rs.9.84 crore involving short levy of tax of Rs.5.94 crore.

2.18.19 Non-furnishing of separate accounts for separate units/divisions

2.18.20 For the purpose of computing quantum of deduction under section 80IA, profit and gains of the eligible business of the assessee shall be computed for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year as if such eligible business were the only source of income during the relevant previous year.

2.18.21 Non furnishing of separate accounts for separate units resulted in short levy of tax of **Rs.1.18 crore** in **3 cases** in Bihar and Uttar Pradesh charges. Two cases involving tax effect of Rs.72.32 lakh and Rs.41.28 lakh respectively are indicated at **Sl.Nos 6 and 7 of Appendix 28.**

2.18.22 Incorrect adjustment of loss

2.18.23 Under the provisions of section 80IA(5), the profits eligible for deduction have to be computed as if the new industrial undertaking is a separate unit and provisions of the Act have to be applied accordingly.

2.18.24 In Maharashtra charge, in the assessment of M/s Anurang Engineering Company Pvt Ltd., for the assessment years 2001-02 and 2002-03, the loss of a unit eligible for deduction under section 80IA was adjusted against the income from its other businesses in violation of the above provision. In the same charge, similar situation was observed in another case of M/s Endurance System Pvt. Ltd. The mistakes resulted in aggregate short levy of tax of Rs.2.97 crore in two cases.

2.18.25 Other miscellaneous mistakes

2.18.26 The assessing officers also committed different types of mistakes which resulted in short levy of tax of **Rs.8.37 lakh** in **2 cases** in Chandigarh and Kerala charges as indicated at **Sl Nos 12 and 13 of Appendix 30**. Besides, deduction was erroneously allowed without setting off brought forward losses/unabsorbed depreciation in four cases involving short levy of tax of Rs.90.49 lakh in Delhi and Tamil Nadu charges. Two cases involving tax effect of Rs.47.26 lakh and Rs.24.65 lakh respectively are indicated at **Sl Nos 8 and 9 of Appendix 28.**

2.19 SECTION-80 IB.

2.19.1 Irregular allowance of deduction on incomes not relating to manufacture/industrial activities

2.19.2 One of the conditions for availing deduction under section 80IB is that the income eligible for deduction should be derived from the eligible business as defined.

2.19.3 Deduction under section 80IB was incorrectly allowed against the income derived from other sources resulting in short levy of tax of **Rs.37.42 crore** in **73 cases** in Assam, Chandigarh, Delhi, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and Uttar Pradesh charges. Two cases each involving tax effect of more than Rs.1 crore are given in **Table 18** below. Eight cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 5 to 12 of Appendix 27.**

(Rs. in crore)

Table 18: Irregular deduction allowed under section 80IB against other income

Sl No.	Name of the assessee/ CIT charge	Assessment year/Nature of assessment	Nature of income to be excluded	Irregular deduction allowed	Tax effect
1.	M/s Himachal Futuristic Communication Ltd, Delhi I	2001-02 Scrutiny	Manufacture of software	70.28	27.79
2.	M/s NIIT GAS Ltd. Delhi V	2001-02 Scrutiny 2003-04 Summary	Manufacture of software	7.45	3.02

2.19.4 Special provisions for small-scale industrial undertakings

2.19.5 Section 80IB prohibits deduction in respect of income from the manufacture of any item listed in the Eleventh Schedule of the Income Tax Act except in the case of small scale industrial undertakings having total investment in plant and machinery of less than Rs.one crore.

2.19.6 Violation of the above stipulation resulted in short levy of tax of **Rs.1.98 crore** in **two cases** in Rajasthan and Tamil Nadu charges. One case involving tax effect of Rs.1.49 crore is illustrated below. Remaining case is indicated at **Sl.No 14 of Appendix 26.**

2.19.7 In Rajasthan, Jaipur Central charge, audit scrutiny of the summary assessment records of **M/s. Dinesh Pouches Ltd.** for the assessment year 2003-04 allowing deduction of Rs.3.72 crore under section 80IB revealed that the cost of plant and machinery was more than Rs.one crore. Hence the assessee was not a small scale industrial undertaking entitled to deduction in respect of income from manufacture of items included in Eleventh Schedule of the Income Tax Act. Irregular allowance of deduction resulted in short levy of tax of Rs.1.49 crore.

2.19.8 Non-maintenance of separate accounts

2.19.9 The provisions of this section do not allow the adjustment of any income/loss of the unit eligible for deduction against income/loss from any other unit or business of the assessee. For this purpose, separate accounts also have to be mandatorily maintained for each unit/ business claiming deduction.

2.19.10 Non-maintenance of separate accounts for different units resulted in short levy of tax of **Rs.1.30 crore** in **two cases** in respect of M/s Aksh Optifibre Ltd. (Haryana charge) and M/s Alkem Laboratories Ltd. (Bihar charge) for assessment years 2001-02 (Summary) and 2000-01 (Scrutiny) respectively.

2.19.11 Claims allowed without audit certificate

2.19.12 Deduction under this section shall not be admissible unless an accountant audits the accounts of the assessee for the relevant previous year and the assessee furnishes along with his return of income, the report of such audit in the prescribed Form No.10CCB duly signed and verified by such accountant.

2.19.13 Incorrect allowance of deduction in the absence of requisite audit certificate resulted in short levy of tax of **Rs.35.04 crore** in **12 cases** in Bihar, Himachal Pradesh, Jharkhand, Kerala and Tamil Nadu charges. Three cases each involving tax effect of rupees one crore and above are given in **Table 19** below. Two cases involving tax effect of Rs.16.85 lakh and Rs.8.66 lakh respectively are indicated at **Sl.Nos 10 to 11 of Appendix 28**.

(Rs. in crore)

Table 19: Inadmissible claims for want of audit certificates

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Inadmissible deduction	Tax effect
1.	M/s Kochi Refinery Ltd. and six Others Kochi and Kottayam	2003-04 Summary	68.21	28.24
2.	M/s Saluja Exim Ltd. Himachal Pradesh	2002-03 Summary	14.68	5.24
3.	Shri D.H.Desai Patna II, Bihar	2001-02 Scrutiny	2.30	1.17

2.19.14 Irregular deduction to business not located in approved backward areas

2.19.15 Audit scrutiny revealed that deduction was allowed to businesses not located in approved backward areas. The irregularity resulted in short levy of tax of **Rs.1.36 crore** in **five cases** in Chandigarh and Uttar Pradesh charges. One case involving tax effect of Rs.1.02 crore of Uttar Pradesh charge is given in **Table 20** below. Two cases involving tax effect of Rs.16.92 lakh and Rs.13.03 lakh respectively are indicated at **Sl.Nos 15 and 16 of Appendix 26**.

(Rs. in crore)

Table 20: Deduction allowed to business not located in approved backward areas

Sl No.	Name of assessee	Assessment year/ Nature of assessmnet	Location of busness	Excess claim	Tax effect
1.	M/s Rahul Detergent Pvt. Ltd Kanpur II	2001-02 Scrutiny	Delhi	1.95	1.02

2.19.16 Double deduction

2.19.17 Where any amount of profits and gains of an undertaking or of an enterprise of an assessee is claimed and allowed under section 80IB for any assessment year, deduction to the extent of such profits and gains shall not be allowed under any other provisions of Chapter VIA of the Act.

2.19.18 Incorrect of allowance of deduction in violation of the above provision resulted in short levy of tax of **Rs.77.87 lakh** in four cases in Delhi and Kerala charges. One case involving tax effect of Rs.34.39 lakh is indicated at **Sl.No 17 of Appendix 26.**

2.19.19 Other miscelleanous mistakes

2.19.20 The assessing officers also committed different types of mistakes which resulted in short levy of tax of **Rs.53.62 lakh** in six cases as indicated at **Sl Nos 18 to 23 of Appendix 26.**

2.20 OBJECTIVE II: Lacunae in law

2.21 SECTION-32

2.21.1 Definition and categorization of loose tools

2.21.2 In the absence of specific definition and categorization of 'loose tools' and 'moulds' as assets or "stores and spares" there was no consistency in treatment of depreciation by different assessing officers. Depreciation was being allowed at 25 percent treating these as plant and machinery by some assessing officers or entirely allowed as revenue expenditure by others.

2.21.3 Inconsistency in the treatment of "loose tools" and "moulds" as plant and machinery for the purpose of depreciation by assessing officers resulted in short levy of tax of **Rs.3.07 crore** in **five cases** (seven assessments) in Madhya Pradesh and Tamil Nadu charges. One case involving tax effect of Rs.2.69 crore relating to Tamil Nadu charge is given in **Table 21** below. Two cases involving tax effect of Rs.13.39 lakh and Rs.12.68 lakh are indicated at **Sl.Nos 17 and 18 of Appendix 18.**

(Rs.in crore)

Table 21: Expenditure on loose tools erroneously treated as revenue

Sl No.	Name of the assessee/ CIT Charge	Assessment year	Nature of asset	Tax effect
1.	M/s Neyveli Lignite Corporation Chennai III	2001-02 (Scrutiny)	Loose tools treated as assets and 25% depreciation granted in earlier years but erroneously fully allowed as revenue expenditure.	2.69

2.21.4 Definition of plant

2.21.5 The term plant has been defined in the Act to include ships, vehicles, books, scientific apparatus and surgical equipment. However, audit scrutiny revealed that depreciation was being claimed on the dictionary meaning of plant even in respect of agricultural/ horticultural plants. One interesting case is illustrated below.

2.21.6 In Karnataka, Bangalore III charge, audit scrutiny revealed that M/s SPA Agro Ltd., for the assessment year 2002-03, where assessment was completed in summary manner, claimed and was allowed depreciation aggregating Rs.27.89 lakh on Rose and Carnation plantations. As these items were not eligible items specified in Appendix I to Rule 5, depreciation granted thereon was required to be withdrawn. The omission resulted in short levy of tax of Rs.8.89 lakh.

2.21.7 It was judicially held[1] that theatre or hotel building equipped for business purposes are still buildings and therefore are not entitled to depreciation at the rate applicable to plant.

2.21.8 Non compliance with above judicial pronouncement occasioned due to complexity in definition of plant resulted in short levy of tax of **Rs.92.45 lakh** in **Three cases** in Madhya Pradesh charge. Two cases involving tax effect of Rs.61.78 lakh and Rs.27.49 lakh respectively are indicated at **Sl.Nos 18 and 19 of Appendix 25**.

2.21.9 Verification of actual cost

2.21.10 Where assets acquired by the assessee are "second hand" assets, the actual cost thereof has to be determined by the assessing officer. In the absence of a specific statutory provision requiring assessees to furnish details of the assets in these cases in Audit Report in Form 3CD, there is no safeguard available to restrict the allowance to bonafide and correct cases, especially when more than 95 percent cases are completed in summary manner.

2.21.11 In Karnataka, Bangalore III charge, in the assessment of M/s Praxair India Pvt. Ltd for the assessment year 1999-2000 completed after scrutiny, the assessee claimed and was allowed depreciation of Rs.21.99 crore on the transfer of fixed assets of value of Rs.30.22 crore acquired by the assessee from four other companies during the relevant previous year. The transferred fixed assets being second hand assets, deduction towards expenditure thereon should have been allowed in scrutiny assessment only after verifying the cost to be adopted under section 43(1) which was not done. Similarly, in the case of M/s Wipro Fluid Power Ltd for the assessment year 2002-03, assessment completed in summary

[1] CIT Vs. Anand Theaters (244 ITR 192 - SC)

manner in the same charge, depreciation of Rs.36.50 lakh was claimed and allowed without verification of the actual cost of the second hand assets. The mistakes involved tax effect of Rs.7.83 crore.

2.22 SECTION-35

2.22.1 Lacuna in section 35(2AB) when read with section 35(2)

2.22.2 Section 35 (2AB) of the Act provides for grant of weighted deduction of 150 per cent of the expenditure incurred including capital and revenue, related to "in house" research and development facility of certain businesses **excluding the cost of land or building** whereas section 35 (2) of the Act provides for grant of 100 per cent deduction of the expenditure incurred (both capital and revenue) for own business **excluding only the cost of land.**

2.22.3 Section 35(2) has been drafted in such a manner that it excludes only the expenditue on land so that the expenditure on building can be claimed under it, while section 35(2AB) simultaneously enables an assessee to claim weighted deduction on expenditure excluding land and building. The rationale for the difference is not clear. Departmental Circular No.387 issued in July 1984 explained that land, not being a depreciable asset, had been excluded from the purview of section 35(2). The reason for excluding both land and building from the purview of section 35(2AB) had not been spelt out. Not making the two clauses mutually exclusive is inexplicable especially since section 35(2AB) is applicable only for specified businesses and section 35(2) is generally applicable. Consequently, assessees end up claiming the benefit not available in one section under the other section leading to an avoidable anomaly and loss of revenue.

2.22.4 Audit scrutiny revealed that double allowance of deductions under both sections 35 (2) and 35 (2AB) resulted in tax effect of **Rs.15.59 crore** in **six cases** in Maharashtra charge. Two cases involving tax effect of more than Rs.1 crore are given in **Table 22** below. Two more cases involving tax effect of Rs.34.45 lakh and Rs.21.17 lakh respectively are indicated at **Sl.Nos 20 and 21 of Appendix 25.**

(Rs. in crore)

Table 22: Irregular allowance of deduction towards cost of building under section 35(2)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Tax effect
1.	M/s Lupin Ltd Mumbai X	2002-03 Summary 2001-02 Scrutiny	10.42
2.	M/s Glenmark Pharmaceuticals Pvt Ltd CC-XXXIII Mumbai	2001-02 Scrutiny 2003-04 Summary	4.49

2.23 SECTION 80 HHD

2.23.1 'Services' to tourist not defined

2.23.2 Deduction under section 80HHD is admissible only if the assessee is engaged in the business of a hotel or of a tour operator, approved by the prescribed authority in this behalf or of a travel agent and is providing "services" to tourists.

2.23.3 However, the term 'tourist' is not defined in the section and various judicial decisions have only complicated the situation for assessing officers leading to inconsistent treatment and potential loss of revenue.

2.23.4 The ITAT, Mumbai recently held[2] in February 2004 that tax could not be levied on payments received by hotels from crew of Foreign Airlines Companies. However, the assessing officer was of the view that crew of Foreign Airlines were not tourists. They were in India for job requirements and hence the hotels which were paid advance for their accommodation in Indian rupees for the permanent booking of rooms for the crew could not be allowed deduction under section 80HHD. However ITAT Mumbai overruled this on the plea that such crew members had been listed as "tourists" by the department of the tourism effective from 1989 and Directorate General of Tourism is the prescribed authority under rule 18BBA(5) for approval of hotels. This litigation occurred essentially due to absence of specific definition of the term 'tourists' in section 80HHD itself. The response of the department to the said ITAT decision is awaited. This is a matter with substantial revenue effect as noticed by audit in the cases of M/s Hotel Leela Venture and M/s Indian Hotel Company Limited assessed in Mumbai charge where aggregate deduction of Rs.1.52 crore was granted to the foreign exchange earnings from the crew of foreign airlines.

2.24 SECTION-80HHF

2.24.1 Section 80HHF providing for deduction specifically for the export of software was modelled on the lines of original section 80HHC providing export incentives. While computing deductions under section 80HHC, 90 percent of export incentive, duty drawback, cash compensatory support etc covered under clauses (iiia), (iiib) and (iiic) of section 28 are deducted from the export profits whereas this condition is not prescribed for working out deduction under section 80HHF inserted later. This would appear to be a lacuna in the Act which allows additional deduction under section 80HHF compared to that contemplated in the original section 80HHC, available to other exports.

2.24.2 Instances of deduction allowed on "duty drawback" involving potential tax effect of **Rs.32.89 lakh** in **two cases** in Maharashtra charge are indicated at **Sl Nos 24 and 25 of Appendix 26**.

[2] M/s Sun-n-Sand Hotels (P) Ltd Vs Dy CIT (ITA No.2488Mumbai/1997)

2.25 SECTION-80IA

2.25.1 'Production' and 'manufacture' not defined

2.25.2 The words 'production' and 'manufacture' are not defined in the Act and their meanings are subject to judicial interpretations and pronouncements. A whole spectrum of judicial decisions is available with varying interpretations.

2.25.3 It has been judicially held[3] that crushing of dolomite lumps into chips and powder does not bring about new commercial commodity. As such, income earned from such 'crushing' will not constitute income derived from a manufacturing or industrial undertaking.

2.25.4 It has also been judicially held[4] that formation of chicks is a natural biological process on which the assessee has no control and as such profits derived from such business are not eligible for deduction under section 80IA.

2.25.5 Non application of these judicial decisions resulted in short levy of tax of **Rs.3.20 crore** in **3 cases** in West Bengal and Orissa charges. Two cases each involving tax effect of rupees one crore or more are given in **Table 23** below. One case involving tax effect of Rs.52.36 lakh is indicated at **Sl.No 12 of Appendix 28.**

(Rs. in crore)

Table 23: Inconsistent application of judicial decisions

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Under assessment	Tax effect
1.	M/s Amrit Feeds Ltd. Kolkata I	1998-99 1999-00 Summary	3.60	1.68
2.	M/s Bansapani Iron Ltd. Sambalpur	1999-00 2001-02 Scrutiny	0.82 0.91	1.00

2.26 SECTION-80IB

2.26.1 Depreciation not being mandatory leading to misuse

2.26.2 Prior to 1 April 2002, it was not mandatory for the assessees to claim depreciation. This resulted in claims of depreciation being ignored and income became available for deduction under section 80IB (Chapter VIA), which would have otherwise lapsed. Depreciation can be claimed in later years whereas such deductions cannot.

2.26.3 Incorrect grant of deductions under section 80IB without considering depreciation/past losses resulted in short levy of tax of **Rs.2.78 crore** in **seven cases** in Assam, Kerala and Maharashtra charges. Four cases involving tax effect

[3] DDC Sales Tax and Others Vs. M/s Bherha Ghat Minerals Industries (246 ITR 230-SC)
[4] CIT Vs M/s Venkateshwara Hatcheries Pvt. Ltd (103 Taxman 503 SC-2001 & 237 ITR 174-SC)

of more than Rs.25 lakh but less than Rs.one crore are indicated at **Sl.Nos 22 to 25 of Appendix 25.**

2.27 Objective III: Purpose of Amendments not served

2.28 SECTION-32

2.28.1 Amendment removing obligation to file depreciation schedule (w.e.f.1.4.88)

2.28.2 Verification of ownership and use of assets are important aspects to be examined before allowing depreciation. Assessees were required to file details of ownership and use under section 34(1) of the Act. Consequent to the introduction of the concept of block of assets from 1 April 1988, this section was abolished. Presently, there is no requirement of furnishing details of ownership and use except for broad details regarding the full block of assets to be given in the Audit Report in Form No. 3CD which are not always provided. With 95 percent of cases being accepted in summary manner there is no mechanism available with the department nor any specific responsibility fixed on the assessee to ensure that depreciation is claimed in each case correctly and in accordance with the requirements of law.

2.28.3 Depreciation was irregularly claimed and allowed in the absence of depreciation schedule in **18 cases** involving tax liability of **Rs.5.71 crore** in Himachal Pradesh, Jharkhand, Madhya Pradesh and Orissa charges where the details of ownership and use of assets were not verifiable. One such case with substantial tax effect of Rs.3.31 crore is illustrated below. Two cases involving tax effect of more than Rs.25 lakh but less than Rs.one crore are indicated at **Sl.Nos 26 and 27 of Appendix 25.**

2.28.4 In Karnataka, Bangalore-I charge, the assessments of M/s ICICI Venture Fund Management Company Ltd. for the assessment years 1999-00 and 2000-01 were accepted in summary manner and completed after scrutiny respectively. Audit scrutiny revealed that depreciation aggregating Rs.9.01 crore on leased equipment "Boiler" was allowed at 100 percent during relevant previous years based on audit report in form 3CD. Particulars to substantiate the ownership and use were not available either in the Form 3CD or assessment records accompanying the return. Depreciation claimed should have been disallowed. Omission to do so resulted in short levy of tax of Rs.3.31 crore.

2.29 Amendments for carry forward of unabsorbed depreciation and mandatory charging of depreciation

2.29.1 Prior to 1 April 2002, it was not mandatory for the assessee to claim depreciation. With effect from 1.4.1998 depreciation was allowed to be carried forward indefinitely. This led to a situation where assessees were not claiming depreciation but claiming other deductions under Chapter.VIA, which would not

have been available to them, had depreciation been required to be mandatorily claimed. Depreciation was carried forward and claimed when convenient for the assessee.

2.29.2 It was only after the Supreme Court ruling[5] that depreciation is not mandatory that the onus for claiming depreciation was put back on the assessee through an amendment made with effect from 1 April 2002 making the charging of depreciation, mandatory. The decision came on 15 March 2000 but the Act was amended only after two years.

2.29.3 The loophole pointed out above has been exploited by the assessees with unquantifiable and unascertainable revenue effect. Audit scrutiny revealed that depreciation was not allowed before allowing deduction resulting in allowance of deduction involving tax effect of Rs.9.15 crore merely in 16 cases in Maharashtra and Gujarat charges. Five cases each involving tax effect of around Rs.one crore or more are given in the Table 24 below. Four cases cases each involving tax effect of more than Rs.25 lakh but less than Rs.one crore are indicated at Sl.Nos 13 to 16 of Appendix 28

(Rs in crore)

Table 24: Non adjustment of depreciation before allowing deduction under section 80IA

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Tax effect
1	M/s Wim Plast Ltd Mumbai Central III	1996-97 1999-00 Scrutiny	2.18
2.	M/s Medispray Laboratories Pvt Ltd CC I Mumbai	1999-00 2000-01 Scrutiny	1.20
3.	M/s Okasa Pvt Ltd CC I Mumbai	2000-01 Scrutiny	1.00
4.	M/S Tancom Electronics Mumbai XX	1998-99 Scrutiny	1.00
5.	M/s. Historic Resort Hotel Ltd, Jaipur II	2000-01 Scrutiny	0.91

2.30 Amendment providing for depreciation on intangible assets with effect from 1 April 1999

2.30.1 From 1 April 1999, depreciation was to be allowed on intangible assets which included copy rights, patents, technical knowhow, franchise charges and any other commercial rights. Intangible assets therefore cannot include goodwill, stock exchange membership fees, intellectual property rights or investment in shares. Inclusion of the concept of "intangible asset" has opened the door for a number of ambiguities. This is leading to misuse or defective implementation of the provisions as detailed below.

[5] M/s Mahindra Mills Vs CIT (243 ITR 56)

2.30.2 As per accounting standards, 'goodwill' was not considered as an intangible asset for the purpose of amortisation. Further 'goodwill' cannot be considered as any other business or commercial right and depreciation cannot be allowed. It has been judicially held[6] that goodwill is not a capital asset. Further, the cost of goodwill cannot ordinarily be ascertained and the date of acquisition also cannot be fixed. It follows, therefore, that depreciation cannot be charged on goodwill.

2.30.3 Depreciation was incorrectly allowed on 'goodwill' treating it as an intangible asset involving tax effect of **Rs.35.87 crore** in **three cases** in Tamil Nadu charge. One case involving tax effect of Rs.35.78 crore is given in **Table 25** below. Remaining two cases are indicated at **Sl.Nos 19 and 20 of Appendix 18.**

(Rs. in crore)

Table 25: Inadmissible depreciation claim on 'goodwill'

Sl No.	Name of the assessee/ CIT charge	Assessment year	Nature of expenses	Depreciation irregularly allowed	Tax effect
1.	M/s Penta Soft Technology Central Chennai	2001-02 Scrutiny	Goodwill	90.47	35.78

2.30.4 Allowance of depreciation on investment in shares and stock exchange membership fee resulted in short levy of tax of **Rs.6.99 crore** in **two cases** of Madhya Pradesh and Rajasthan charges. One case involving tax effect of Rs.6.97 crore is given below. The remaining case is illustrated at **Sl.No 21 of Appendix-18.**

2.30.5 In Rajasthan, Udaipur charge, examination in audit of the summary assessment records of **M/s. Hindustan Zinc Ltd.** for the assessment year 2002-03 revealed that the assessee invested in shares of M/s Andhra Pradesh Gas Power Corporation Ltd. during the relevant previous year and claimed and was allowed depreciation of Rs.18.17 crore treating the shares as "intangible" assets. This was not in order as shares were not intangible assets. The omission resulted in excess allowance of depreciation of Rs. 18.17 crore involving tax effect for Rs.6.97 crore. One more case where depreciation was allowed in a summary assessment on Intellectual Property Rights (IPR) is indicated in **Table 26** below.

(Rs in crore)

Table 26: Inadmissible depreciation on intellectual property rights

Sl No.	Name of the assessee/ CIT Charge	Assessment year	Gross value of intangible asset	Irregular depreciation allowed	Tax effect
1.	M/s Financial Technologies India (P) Ltd. Mumbai VIII	2001-02 Scrutiny	18.01 (Intellectual property right)	4.50	1.78

[6] M/s B.Srinivasa Shetty Vs CIT (128 ITR 294-SC)

2.31 OBJECTIVE IV Effect of Different Rates of Depreciation as per Income Tax Act and Companies Act

2.31.1 While discussing corporate tax reforms, the Kelkar Task Force observed that the adequacy of the rate of depreciation depends on the presumed period of the useful life of the asset, the mode of granting depreciation whether by 'diminishing balance method' or by 'straight line method and expected rates of growth of prices of capital goods. The Task Force recommended reduction of depreciation rates for the general category of plant and machinery from 25 percent to 15 percent and appropriate lower rates for other categories of block of assets. The revised rates of depreciation were to minimize the divergence between the depreciation charged to the profit and loss account in accordance with the provisions of the Companies Act and depreciation claimed for tax purposes and also remove the problem of depreciation being charged on inflated "written down values (WDV)" as per the Companies Act.

2.31.2 An analysis in audit of depreciation calculated as per Companies Act and that being claimed and allowed under the Income Tax Act revealed the results as shown in **Table 27** below:

(Rs. in crore)

Table 27: Depreciation claimed as per Income Tax Act versus Companies Act

Jurisdictional charge	No. of assessees	Depreciation claimed as per Income Tax Act	Depreciation claimed as per Companies Act	Difference (3-4)	Tax effect with reference to the amount in Col.5
1	2	3	4	5	6
Assam	419	2854.99	1121.05	1733.94	606.94
Andhra Pradesh	909	639.40	267.81	371.59	139.91
Bihar	209	84.08	48.31	35.77	13.05
Delhi	294	1319.56	1096.53	223.03	85.87
Gujarat	2243	4849.37	4332.87	516.50	227.31
Haryana	158	2441.99	1090.35	1351.64	496.79
Himachal Pradesh	266	241.58	92.51	149.07	56.31
Jharkhand	138	826.35	630.03	196.32	73.57
Karnataka	124	1790.14	946.69	843.45	316.50
Kerala	114	1266.68	710.69	555.99	207.44
Madhya Pradesh	1142	551.29	392.39	158.90	63.01
Maharashtra	560	3466.37	1810.32	1656.05	618.45
Orissa	153	2910.39	2530.93	379.46	130.89
Punjab	639	1153.22	762.59	390.63	144.83
Punjab&UT	322	343.34	208.45	134.89	51.72
Rajasthan	496	1578.98	940.03	638.95	239.64
Tamil Nadu	1079	17496.14	12925.26	4570.88	1607.41
Uttar Pradesh	156	552.71	215.66	337.05	117.97
West Bengal	2194	9900.35	3850.85	6049.50	2084.64
Total	**11615**	**54266.93**	**33973.32**	**20297.61**	**7282.25**

2.31.3 It can be seen from the above that the difference in rates involved additional deprecaition of Rs.20,297.61 crore in the selected sample of **11,615 cases** which in terms of tax effect would be **Rs.7282.25 crore**. Audit could not verify as how Ministry was able to ascertain the corresponding benefits in terms of increased investment in assets or corresponding increase in production.

2.32 Irregular claim of depreciation on the written down value (WDV) under Companies Act instead of Income Tax Act

2.32.1 The difference in rates of depreciation as per the Companies Act and the Income Tax Act has also led to peculiar and anomalous situation involving substantial effect on revenues. Audit scrutiny revealed that assessees were claiming and being allowed depreciation on the WDV of assets under the Companies Act (which would always be a higher figure because of lower rates of depreciation) whereas depreciation should have been allowed on WDV as per the Income Tax Act.

2.32.2 There was a short levy of tax of **Rs.1.62 crore** in only **six cases** in Orissa and Rajasthan charges. One case involving tax effect of Rs.1.26 crore pertaining to Orissa charge is shown in the **Table 28** below. One case involving tax effect of Rs.29.40 lakh is indicated at **Sl.No 28 of Appendix 25**.

(Rs. in crore)

Table 28: Irregular claim of depreciation based on WDV under Companies Act instead of Income Tax Act

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Under assessment	Tax effect
1	M/s Orissa Mining Corporation Bhubaneshwar	2002-03 (Summary)	3.54	1.26

2.33 Conclusion and recommendations

2.33.1 With more than 95 percent assessments being accepted in summary manner where the assessing officers cannot exercise elementary and basic checks, there was substantial loss of revenue because of excess claims of deductions and allowances, in general. *Audit recommends that a well defined risk assessment and effective procedure for selection of cases for scrutiny may be introduced to act as a deterrent against exploitation of summary assessments by unscrupulous assessees.*

2.33.2 Assessing officers have not been exercising important checks and calling for crucial and relevant information from assessees before allowing their claims even in scrutiny assessments. *Audit recommends that responsibility be fixed for glaring omissions especially in scrutiny assessments contributing to loss of revenue besides conducting focussed and well targeted training programmes to upgrade the skills of the assessing officers on a continuing basis.*

2.33.3 Anomalies and ambiguities in law and often conflicting judicial decisions on similar issues are not being sorted out or clarified promptly and properly enough to facilitate consistent treatment by assessing officers and safeguard interests of revenue. *Audit recommends that judicial decisions concerning significant and important provisions of the Act be evaluated promptly in the Board by devising an effective procedure of reporting and coordination with the field offices.*

2.33.4 Lacunae in law such as not defining 'tourist', 'plant', 'loose tools', 'sevices to tourist', 'manufacture' and 'production' etc in the Act, not disallowing 'duty drawback' receipts before granting deduction for export of software and so on as discussed in paragraphs 2.21.2 to 2.26.3 of this Report led to inconsistent treatment of similar issues by the assessing officers. *Audit recommends that these 'terms' be defined comprehensively so as to prevent inconsistent treatment and exploitation by assessees to the detriment of revenue.*

2.33.5 The department has no database or records or registers containing details of assessees availing various deductions under the Income Tax Act. Although such information is intended to be available technically, it has not been accessed or used in any meaningful way. *Audit recommends that the department derive full potential of the software already available and maintain proper records of all exemptions, allowances and deductions allowed which would help in assessing and reviewing their impact, from time to time.*

2.33.6 The Shome Advisory Group and the Kelkar Task Force recommended, interalia, reduction of depreciation rates for the general category of plant and machinery from 25 percent to 15 percent and appropriate lower rate for other categories of block of assets so that divergence between depreciation charged to profit and loss account and depreciation permissible under Income Tax Act is eliminated. This difference in rates of depreciation involved Rs.7,282.55 crore in selected sample of 11,615 cases in terms of tax effect. *Audit recommends that the rates of depreciation under the Income Tax Act be aligned with those in the Companies Act and due consideration given to the recommendations of the Shome Advisory Group and the Kelkar Task Force.*

2.34 In the Exit Conference held in February 2005, the Board agreed to separately examine all the recommendations made.

Chapter III

Some aspects of non-resident taxation with reference to double taxation avoidance agreements

- **Highlights**
- **Introduction**
- **Audit Objective**
- **Audit findings**
  - **Adequacy of follow up action involving Indo-Mauritius DTAA**
  - **Revenue foregone due to exemption under DTAAs**
  - **Comparative analysis of selective DTAAs**
  - **Mutual agreement procedure**
  - **Exchange of information**
  - **Mistakes in application of DTAA provisions**
  - **Income escaping assessment**
  - **Allowance of credit for taxes paid abroad**
  - **Mistakes in taxation of maritime business of non residents**
  - **Mistakes in application of various provisions of the Act**
- **Conclusion & recommendations**

Highlights

- Audit reviewed some aspects of administration and implementation of double taxation avoidance agreements (DTAAs) with selected countries and taxation of non-residents including maritime business in particular as well as other issues like mutual agreement procedure, exchange of information and assistance in tax collection.

(Para 3.3)

- Audit also examined adequacy of action taken by the assessing officers to determine effective place of management of Mauritius based companies before allowing tax relief on capital gains consequent to Supreme court decision in October 2003.

(Para 3.7)

- A comparative study of 12 selected DTAAs revealed that there was no uniformity or consistency in defining the existence of a Permanent Establishment (PE) based on the minimum threshold period of existence. Expenditure incurred by the PE towards royalty and fee for technical services would consequently become an allowable expenditure, thereby reducing the taxable income leading to loss of revenue. Audit could not quantify loss of revenue on this score, as the field offices of the department did not have any specific mechanism or procedure designed to watch and prevent the same.

(Para 3.8)

- Provisions for assistance for recovery of taxes existed in DTAAs with some countries like South Africa, Belgium and Denmark and did not exist in DTAAs concluded with USA, UK and Singapore. Recovery of demands aggregating Rs.2.68 crore relating to three assessees belonging to USA and Singapore could not be enforced in the absence of provisions for assistance of recovery in DTAAs.

(Para 3.8.10)

- When a lower rate of tax or benefit of restriction of scope of taxation was extended to one OECD country, the same was automatically required to be extended to other OECD countries as well, without any corresponding benefit or reciprocity to India.

(Para 3.8.12)

- Audit noticed that benefit of exemption on capital gain tax of Rs.8.40 crore under Indo-Mauritius DTAA was allowed subsequent to issue of Board's circular of April 2000 even though it was established ab-initio that effective place of management was in third countries.

(Para 3.7.10)

- Test check of mutual agreement procedure (MAP) cases revealed that there was inadequate co-ordination between the Board and the assessing officers resulting in appellate authorities taking contrary views on resolutions arrived at by competent authorities.

(Para 3.9.10)

- Thirteen cases were pending resolution for periods ranging from two to five years resulting in blockade of revenue of Rs.425.42 crore. Non implementation of the resolution arrived in four MAP cases in favour of revenue resulted in non levy of tax of Rs.102.50 crore.

(Para 3.9.4 to 3.9.12)

- Test check of "exchange of information" cases sought from foreign governments revealed that there was inadequate co-ordination between the competent authorities in the Board and assessing officers with regard to utilization of this important mechanism for safeguarding interests of revenue amounting to Rs.73.69 crore.

(Para 3.10.9)

- Test check of taxation of maritime business of non-residents revealed inconsistencies in issue of NOCs to non resident companies without obtaining necessary details and allowing relief. Audit noticed irregular grant of DTAA relief amounting to Rs.16.42 crore in 340 cases in Gujarat.

(Para 3.12.1)

- Test check of application of the provisions of the Act in taxation of non-residents revealed that tax was levied short amounting to Rs.109.48 crore on various counts in 28 cases.

(Para 3.13.11)

Some aspects of non-resident taxation with reference to double taxation avoidance agreements

3.1. Introduction

3.1.1 Developing nations look to the developed ones for better technology, large capital and specific expertise in various fields and sectors of economy. Similarly, the developed nations are interested in the markets, investment opportunities, increased and profitable use of their capital and technology in the developing nations. Liberalization and opening up of the economy since 1990s has rendered India one of the attractive destinations for foreign investments. A comparative position of foreign investment since 1990-91 is detailed in Table 1 below:

Table 1: Foreign investment inflows

Year	Direct investment		Portfolio investment		Total	
	Rs. in crore	US $ Million	Rs. in crore	US $ Million	Rs. in crore	US $ Million
1990-91	174	97	11	6	185	103
1991-92	316	129	10	4	326	133
1992-93	965	315	748	244	1713	559
1993-94	1838	586	11188	3567	13026	4153
1994-95	4126	1314	12007	3824	16133	5138
1995-96	7172	2144	9192	2748	16364	4892
1996-97	10015	2821	11758	3312	21773	6133
1997-98	13220	3557	6696	1828	19916	5385
1998-99	10358	2462	(-) 257	(-) 61	10101	2401
1999-00	9338	2155	13112	3026	22450	5181
2000-01	18406	4029	12609	2760	31015	6789
2001-02	29240	6131	9639	2021	38879	8152
2002-03	22552	4660	4738	979	27290	5639
2003-04	21482	4675	52279	11377	73761	16052

Source: Handbook of Statistics on the Indian Economy 2003-04, RBI Publication

3.1.2 Mauritius was topping foreign direct investment in India during the last four years. (Table 2)

US $ Million

Table 2: Country wise foreign direct investment in India*

Country	2000-01	2001-02	2002-03	2003-04 (Prov.)
Mauritius	843	1863	534	381
USA	320	364	268	297
UK	61	45	224	157
Germany	113	74	103	69
Netherlands	76	68	94	197
Japan	156	143	66	67
France	93	88	53	34
South Korea	24	3	15	22
Others	224	340	301	238

Source: RBI Annual Reports

* Data exclude FDI inflows under the NRI direct investment route through RBI and inflows due to acquisition of shares under Section 5 of the FEMA 1999.

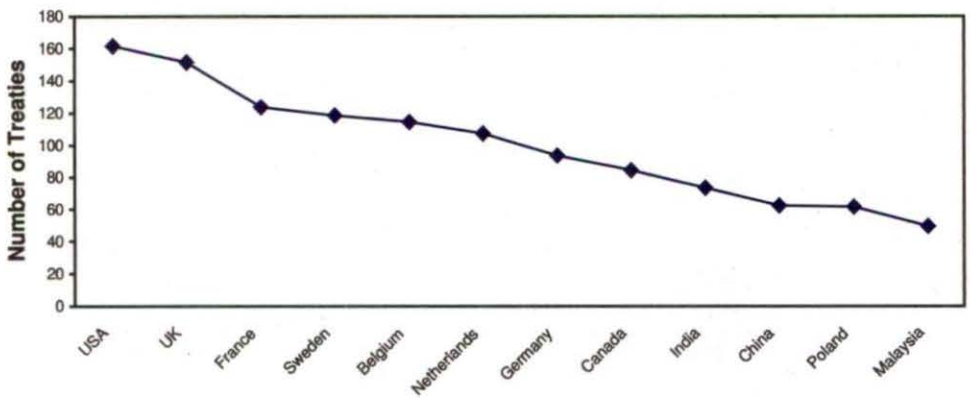
3.1.3 Globalization and increased transnational investment and trade imply a potential conflict of tax jurisdictions. Central to the question of jurisdictional conflict is the issue of sovereign right of two or more jurisdictions to levy tax on one and the same event or one and the same taxpayer. Where there are mismatches between national tax laws, the jurisdictional conflict can get aggravated by improper conduct by taxpayers. Jurisdictional conflicts can be resolved unilaterally under national tax laws, or bilaterally and even multilaterally under "tax treaties" or "Double taxation avoidance agreements" (DTAA).

3.1.4 The paramount issue underlying all international tax considerations is how to appropriately allocate income and equitably divide or share the revenues between host and home countries. The resolution of this issue is the main purpose of DTAAs, which seek, inter-alia, to set out detailed allocation rules between the "source" and "resident" countries for different categories of income.

3.1.5 DTAAs are generally expected to fulfill the following objectives.

- Facilitate investment and trade flow
- Prevent discrimination between taxpayers
- Provide fiscal certainty to cross border transactions and
- Contribute to attainment of national development goals.

The following graph gives the comparative position of DTAAs among countries, with USA leading the block.



Source : UNCTAD database

3.1.6 There are 'two' models popularly known as, the United Nations model (UN) and Organisation for Economic Cooperation and Development model (OECD), which are widely followed by the countries while entering into DTAAs. OECD model is generally regarded as being geared to the interests of developed countries and recognizes the priority of the country of residence to tax income. On the other hand, the UN model appreciates the needs of the developing countries and reserves the right of tax to the country of its source. India has comprehensive DTAAs with more than 65 countries and limited DTAAs covering income from airlines and merchant shipping business with more than 10 countries.

3.1.7 In pursuance of Section 90 of the Income Tax Act (the Act), the Government of India through the Central Board of Direct Taxes (the Board) have entered into DTAAs with various countries for

- granting relief in respect of income on which tax has been paid under the Income Tax Act of both the countries; or
- the avoidance of double taxation of income under the Act, and under the corresponding law in force in that country; or
- exchange of information for the prevention of evasion or avoidance of income tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance; or
- recovery of income tax under the Act, and under the corresponding law in the other country in respect of the income, profits or gains; or
- promoting mutual economic relations, trade and investment **(clause inserted with effect from April 2004).**

3.1.8 Issues relating to Indo-Mauritius DTAA

DTAAs being country specific, the contours of taxation and concessions granted vary based on the comparative advantage that India enjoys with them. In this context Indo-Mauritius DTAA has been of considerable concern. A study of the articles dealing with residency and taxation of capital gains reveals that special consideration was bestowed to business entities of Mauritius in view, perhaps of the fact that Mauritius was a less developed country than India and has had longstanding special relationship with India. Coinciding with the liberalization of Indian economy, the Government of Mauritius promulgated the Mauritius Offshore Business Activities Act 1992(MOBAA) to regulate the offshore business in that country. A body corporate registered under the laws in Mauritius would be a resident in Mauritius and thus "subject to taxation" as a resident. Income Tax Act of Mauritius provided that offshore companies were liable to pay 'zero percent' tax. Thus, by bringing an offshore company within the definition of resident, not only was the benefit of offshore company extended to it but also the benefits of residency allowable under DTAA bestowed on it. This led to establishment of conduit companies in Mauritius through which investors of third countries routed their investment, which led to concern among tax authorities in India about the loss of rightful revenue. In effect, the whole exercise of avoidance of double taxation turned out to be avoidance of taxation altogether.

3.1.9 Follow up action on Joint Parliamentary Committee's recommendation on Stock Market Scam

Foreign institutional investors (FIIs), realizing the opportunity, also channelised their investment into India through the Mauritius route. A few stockbrokers were considered to have exploited the same and contributed to huge inflow of monies to create undue fluctuations in the stock markets, which was identified as one of the causants of the securities scam, which was investigated by the "Joint

Parliamentary Committee" (JPC). The Board in its action taken note on the report of JPC informed that, MOBAA, which restricted the exchange of information between India and Mauritius, had been repealed in November* 2001. Further, it was also stated that a Memorandum of Understanding with the Financial Services Commission of Mauritius was contemplated for exchange of information as a safeguard against the practices of money laundering.

3.1.10 The JPC had noted in its 'Report on the stock market scam' presented to Parliament on 21 December 2003, that the 'Special Cell' constituted to examine the role of industrial houses with respect to the stock scam and the close nexus between industrial houses, banks and stockbrokers was not effectively functioning. The Director General (Investigation) of Income Tax Department in Mumbai, who headed the Special Cell had noted that 'each of the organizations (i.e. RBI, SEBI, CBI, DCA, CBDT, etc) had already a mass of information and what was required was a sifting to establish the wrong doings if any'.

3.1.11 The JPC in its observation on the Indo-Mauritius DTAA had noted that RBI did not have information on FII inflows country wise. The External Affairs Ministry deposing before the JPC had brought out that there were similar problems pertaining to taxation of long-term capital gains with 17 other countries, to which the Ministry of Finance also agreed. Based on the deposition by various Ministries, the Committee had observed, "there could be substantial revenue loss due to the 'residency clause' in the Indo-Mauritius DTAA". It, therefore, recommended that Companies investing in India through Mauritius should be required to file a declaration of ownership with RBI, to the effect that all the Directors and effective management was in Mauritius.

3.1.12 Adequacy and status of action taken by the Board to streamline procedures for assessments and allowing benefits under Indo-Mauritius DTAA following the JPC recommendations was identified as a priority area for examination in audit.

3.1.13 Landmark Judgement of Supreme Court on Indo-Mauritius DTAA

The tax authorities in India, recognizing the need to curtail the 'abuse' of the Indo-Mauritius treaty denied the benefit of the treaty (March 2000) to some offshore business companies (OBC) registered in Mauritius that had claimed exemption from tax under the Income Tax Act, by rejecting the certificate of residence furnished by them. Such OBCs were claiming exemption of capital gains from stock market operations, which gave the right of taxation of such capital gains to Mauritius.

3.1.14 At around the same time, there were fluctuations in the stock markets and general perception that the action of the department denying the benefit of Mauritius residency to some Mauritius based FIIs was the root cause for such fluctuations. It was projected that this would have or had resulted in huge

* replaced by Financial Services Development Act promulgated with effect from 1 December 2001

outflows of foreign investment from India. To clear the doubts, as also clarify the intent of the Indo-Mauritius DTAA, the Board issued Circular 789 dated 13 April 2000, inter alia, requiring the assessing officer to accept the certificate of residence granted under the local legislation of Mauritius to OBCs operating from third countries including India.

3.1.15 Considering a 'public interest litigation' (PIL), Delhi High Court quashed the above circular as bad in law on the grounds that the income tax officer was entitled to lift the corporate veil in order to ascertain whether a company was actually resident of Mauritius or not in exercise of his quasi-judicial powers and any attempt by the Board to interfere with this would be contrary to the intendment of the Act.

3.1.16 However, the honourable Supreme Court in their judgment in the case of Azadi Bachao Andolan on 7 October 2003 upholding the issue of circular by the Board as also the Indo-Mauritius DTAA, held that

- ***Indo-Mauritius DTAC[ϕ] (1983) is not 'ultra vires' of the powers of the Central Government under section 90, on account of its susceptibility to "treaty shopping[*]".***
- ***Circular 789 of April 2000 issued by the Board falls within the parameters of the powers exercisable by the Board under section 119. The circular does not in any way crib, cabin or confine the powers of the assessing officer with regard to any assessment. It merely formulates guidelines to be applied in the matters of assessment of assessees covered by the provisions of Indo-Mauritius DTAA.***
- ***Merely because, at a given time there may be an exemption from income tax in respect of particular head of income, it is not correct to say that the taxable entity is not liable to taxation.***

3.1.17 During the pendency of the proceedings before the Supreme Court, the Board issued a circular on 10 February 2003 clarifying that where an assessing officer finds and is satisfied that an entity is resident of both India and Mauritius, he would be free to proceed to determine the residential status under the DTAA by invoking what is otherwise also known as the 'tie-breaker' clause. It further stated that where it was found that the company had its place of effective management in India, then, notwithstanding it being incorporated in Mauritius, ***it would be taxed under the DTAA in India***. Adequacy and consistency of action taken by the assessing officers to safeguard interests of revenue in pursuance of the above developments in relation to Indo-Mauritius DTAA was an important issue for examination in audit.

[ϕ]Double taxation avoidance agreements are also known as 'double taxation avoidance conventions' or 'double taxation avoidance treaties'.

[*] Treaty shopping means the advantage taken of a DTAA between two countries by a resident of a third country.

3.1.18 Assessment of income from maritime business of non-residents

Maritime transport is a critical infrastructure for the social and economic development of a country. There are 12 major ports in the country, which handled a total traffic of 344.55 million tones of traffic during 2003-04 as against 313.53 million tones during 2002-03*. The share of Indian ships in total overseas trade was around 16 percent during 2002-03; the remaining 84 percent being handled by foreign vessels. Thus, overseas trade of India was a major source of revenue to foreign vessels. Audit sought to examine the adequacy of rules and procedures for taxation of income accruing to non residents on account of shipping business as this had to be examined carefully by the assessing officer with reference to applicable DTAAs.

3.1.19 As a related subject, other important aspects of administration and implementation of DTAAs in general, such as mutual agreement procedure (MAP) and exchange of information were chosen for examination.

3.1.20 Audit also decided to scrutinise whether any 'cost benefit' analysis was conducted in respect of various DTAAs and also whether there were adequate reasons for bestowing different treatment to similar issues in various DTAAs, through a limited study of selected DTAAs, with special interest to India.

3.1.21 Role of regulatory bodies

Securities & Exchange Board of India (SEBI) has been empowered to register and issue licenses to foreign institutional investors (FIIs) who intend to invest in the Indian stock market and fulfill the laid down conditions. One such condition, which is intended to safeguard the interest of revenue, is nomination of an agent including a person who may be treated as an agent under section 163 of the Income Tax Act. Section 115AD is the charging section for taxation of income arising to FIIs from securities or shares. Press Note of March 1994, issued by Department of Economic Affairs under Ministry of Finance clarifies the issue of taxation of FIIs. Adequacy of arrangements to discharge the above requirements and their enforcement/utilization by the Income Tax Department for taxation of non-residents were also considered for scrutiny in audit.

3.2 Law and Procedure

3.2.1 Sections 90 and 91 under Chapter IX of the Act deal with powers of the Central Government to enter into agreement with foreign countries for granting relief for doubly taxed income. Section 172 deals with taxation of non-residents from occasional shipping business. Chapter XII A details the 'special provisions relating to certain incomes of non-residents under sections 115 C to 115 I'.

* Annual Report 2003-04 of Ministry of Shipping, Government of India

3.2.2 Provisions on taxation of maritime business

Section 172 of the Act, provides for levy and recovery of tax in case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped from a port in India. The master of the ship shall furnish a return of the amount paid or payable on account of such carriage before departure from any port in India. The assessing officer may, however allow the ship to depart by issuing 'no objection certificate' (NOC), if the master of the ship makes satisfactory arrangement for filing of the return within 30 days of the departure of the ship and payment of tax. The assessing officer shall assess the income and determine the tax payable, if any, as envisaged in the Act.

3.2.3 The Board vide instruction 838 dated 3 June 1975 laid down that where it was not possible for the master of the ship to furnish the return before the departure of ship, arrangements could be made in the form of suitable bond or bank guarantee to safeguard the interest of revenue.

3.2.4 The Board vide circular 732 dated 20 December 1995 laid down that the assessing officer may issue annual NOC where ships are owned by an enterprise belonging to a country with which India has entered into DTAA and the agreement provides for taxation of shipping profits only in that country of which the enterprise is resident and no tax is payable by them at the Indian ports. The assessing officer is required to ensure before issue of NOC that all the requisite documents or evidence such as proof of residence, details of loading port and discharge port, freight payable as per charter agreement, have been submitted.

3.2.5 DTAA provisions on taxation of maritime business

DTAAs provide that profits derived by an enterprise of a contracting state from the operation of ships in international traffic shall be taxable only in that state. DTAAs concluded with Netherlands, Mauritius and Sri Lanka provide that profit from the operation of ship in international traffic shall be taxable only in the contracting state in which the effective management of enterprise is situated. DTAAs concluded with Japan, Jordan and Kenya, however, provide that profits may be taxed in the other contracting State also, but the tax so charged shall not exceed 50 percent of tax otherwise imposed by the internal law of that state, subject to the conditions provided therein.

3.3 Objectives of the review

The review seeks through a limited and selective test check of records in the Board and assessments in the selected field offices, to

- derive an assurance of adequacy of measures and procedures in the income tax department for ensuring effective co-ordination with the regulatory bodies like SEBI and RBI for utilizing the information available with them on FIIs in particular and safeguard interests of revenue,

- assess adequacy of action in cases involving Indo-Mauritius DTAA consequent to JPC recommendations, Board's circular of February 2003 , landmark judgment of Supreme Court in the case of Azadi Bachao Andolan in October 2003 and amendment to section 90 of the Act,
- attempt a comparative analysis of provisions of DTAA with selected countries with reference to criteria for determining "permanent establishment" (PE) and taxation of business profits, with a view to identifying areas of inconsistency, if any, and seeking an assurance that an adequate mechanism exists to ensure that costs did not outweigh benefits,
- examine adequacy of the mechanism for monitoring and implementation of significant provisions of DTAA like mutual agreement procedure (MAP) and exchange of information etc.,
- examine adequacy of systems and procedures and correctness of allowance of DTAA relief in respect of taxation of shipping business to non-residents, and related aspects of taxation of non-residents and
- examine the extent of uniformity in application of various articles in the DTAAs and identify ambiguity, if any, so that there is no loss of revenue to the exchequer

3.4 Audit methodology

3.4.1 Scope of the Review:

DTAAs of 12 countries viz. USA, UK, Japan, Germany, Kenya, Mauritius, Malayasia, Oman, South Africa, Singapore, UAE and Uzbekistan were selected to examine the consistency or otherwise and effectiveness of their execution and implementation in respect of Permanent Establishment, Business profit, Dividend, Interest, Royalties and Fees for technical services, Capital gains, Shipping and Air transport, Anti treaty-shopping provision, exchange of information, Mutual Agreement Procedure, Treaty limitation and so on. Assessments involving DTAAs with a few other countries like Sri Lanka and Greece were also checked.

3.4.2 Audit coverage

Review covered assessments concluded during the financial years 1999-2000 to 2003-04 and up to July 2004.

3.5 Sample Size

The review covered all scrutiny assessments and 50% summary assessments selected on random basis concluded under the Director of Income tax (DIT) (International Taxation) charges in Bangalore, Chennai, Delhi, Kolkata and Mumbai[†] and other charges in Andhra Pradesh, Gujarat, Kerala and Uttaranchal which had preponderance of cases of non-residents. Audit examined 1732 assessments completed after scrutiny and 12,937 summary assessments in 130 assessing units.

[†] Selection percentage being 20 percent for summary assessments

3.6 Audit findings

Audit noticed mistakes in 314 cases involving non-levy or short levy of tax of Rs.440 crore. Mistakes related to irregular exemption of capital gains under Indo-Mauritius DTAA and incorrect application of provisions of DTAA as well as provisions of the Act. Also, irregular grant of relief to maritime business of non-residents in 405 cases resulted in non-levy or short levy of tax of Rs.18.54 crore.

Apart from inadequate coordination by departmental authorities with regulatory bodies like SEBI and RBI with regard to monitoring the tax liabilities of FIIs, audit also noticed instances of loss of rightful revenue due to treaty shopping by residents of third countries, unquantifiable tax expenditure due to exemptions under DTAAs, blockade of revenue due to delay in processing/finalizing MAP cases, ambiguities with relation to taxation of software payments and so on in 63 cases involving tax revenue of Rs.1350 crore.

Audit findings are described in detail in the following paragraphs.

3.6.1 Adequacy of institutional arrangements for taxation of nonresidents

SEBI is the nodal authority for registering and monitoring the activities of the FIIs and their sub accounts[◊]. There are more than 600 FIIs registered with SEBI and over 4000 sub accounts relating to the same, which are active in the Indian stock market[‡]. FIIs registered with SEBI are automatically recognized for the purposes of section 115 AD of the Act and can avail concessional rate of taxation. Since, no deduction of tax shall be made from any income by way of capital gains arising from the transfer of securities by such FIIs, the Ministry of Finance in their press note of 1994 had stated that nomination of an agent, who could be held responsible under section 163 of the Act in India, was a prerequisite for granting registration. Further, FIIs were required to file the details of their transactions in the stock markets, periodically with SEBI. It is, therefore essential that the income tax department have the details of representative assessees of all FIIs operating in India so as to safeguard the interests of revenue.

3.6.2 Audit examined whether FIIs were specifying an agent and whether the department was monitoring and pursuing taxation of such income/agents through a well designed, coordinated and effective strategy and action plan. Audit noticed that the department was not having any centralized or alternate effective mechanism to correlate or utilize the details available with SEBI relating to inflows and outflows of FIIs. Audit was given to understand from SEBI that application for registration did not have details of an agent as provided under section 163 of the Act and no details such as local address were available relating

◊ Sub account includes foreign corporate or foreign individuals and those institutions established or incorporated outside India and those funds or portfolios established outside India, whether incorporated or not, on whose behalf investments are proposed to be made in India by an FII

‡ Source :SEBI Data

to FIIs. SEBI have also informed that neither had any information been periodically furnished to the department nor was it called for.

3.6.3 An impression was sought to be created that denial of DTAA relief to some Mauritius based entities by rejecting residency certificate had led to flight of capital and investment from India. However, an appraisal of the transactions in the capital markets during November 1999 to October 2000 as highlighted in the Annual Reports of SEBI indicated that there were 'inflows' with respect to FIIs in this period (Column 2 of Table 3 below). During January 2000 to March 2000, when returns in some cases were being processed by the departmental officers in Mumbai for denial of relief under Indo-Mauritius DTAA, there was a net increase in investment. Subsequent to the issue of circular there was, in fact, a net outflow of investment (Column 4, ibid). Thus, there was neither substantial decrease in investment consequent to denial of benefits to a few third country based companies investing through Mauritius nor marked increase after issue of Circular 789 in April 2000 as shown in **Table 3**.

(Rs. in crore)

Table 3: Inflows/Outflows through FIIs

Month	Gross purchases (Column 2)	Gross sales (Column 3)	Net investment (Column 4)
November 1999	3934.47	2705.44	1229.03
December 1999	4556.19	2938.57	1617.62
January 2000	6129.73	5933.16	196.57
February 2000	9761.57	6677.47	3084.10
March 2000	9890.07	8691	1198.83
April 2000	8354.50	5767.80	2586.70
May 2000	6307.4	6054.70	252.70
June 2000	5398.80	6333.60	(-) 934.80
July 2000	5857.60	7259.40	(-) 1401.80
August 2000	5134.00	3875.20	1258.90
September 2000	7149.60	6931.30	218.30
October 2000	4440.70	4659.30	(-) 218.50

3.6.4 Operations by FIIs in Indian stock markets can be through 'sub-accounts' as approved and registered by SEBI who would be held responsible as representative assessees under section 163 of the Act. Whether this arrangement would constitute a 'permanent establishment' under the treaty needed to be clarified by the Board, as more than 4000 sub-accounts were operating on behalf of about 600 FIIs.

3.6.5 Revenue foregone on account of exemptions under domestic law

Section 10 of the Act, inter alia, details the exemptions available to non-residents on income arising or accruing to them in India. The Working Group of the Board (January 2003) in its 'Report on Non-resident Taxation' had recommended, withdrawal of such exemptions granted to non residents.

3.6.6 Department did not conduct any study to ascertain the extent of revenue foregone by the Government by exempting incomes of non residents under section 10 of the Act. Test check of assessments in **Mumbai DIT (IT)** charge revealed that revenue foregone on account of exemptions allowed in only 'seven' cases aggregated **Rs.1.48 crore** as detailed in **Table 4** below.

(Rs. in crore)

Table 4: Revenue foregone under section 10

Sl No	No of cases	Category of income	Section involved	Tax foregone
1	2	Fees for technical services	10 (6A)	0.20
2	5	Aircraft lease payments	10 (6BB)	1.29
Total				**1.48**

3.6.7 Ministry may initiate measures to assess the budgetary or revenue sacrifice as also the real benefits flowing from these exemptions so that incentives granted to non-residents actually accrue to them instead of the exchequer of the other contracting State.

3.7 Adequacy of follow up action involving Indo-Mauritius DTAA

3.7.1 Irregular exemption of capital gains under Indo – Mauritius DTAA

The peculiar problems associated with administration of Indo-Mauritius DTAA and the background of related issues have been mentioned in paragraphs **3.1.8 to 3.1.17** above. Audit scrutiny of assessments of entities that were stated to have been incorporated in Mauritius and deriving income from capital gains on sale of shares in India revealed that the benefit of exemption under Article 13 of Indo-Mauritius DTAA was allowed based on incomplete data.

3.7.2 In **Mumbai DIT (IT)** charge, assessment of **M/s. Pathfinder Investment Ltd.** (owned by Shri Dhananjay Agarwal) for the assessment year 2001-02 was completed after scrutiny in March 2004 denying the benefit of exemption of capital gains as the assessee could not prove that the effective place of management was in Mauritius. Further, the tax residency certificates furnished by the assessee related to a different company (i.e. Lloyds Securities Overseas Ltd).

3.7.3 Similar benefit was not denied in respect of similarly placed two other assessees **(M/s. Discover Investment Ltd. & M/s. Euro Discovery Tech. Ventures Ltd)** who had produced tax residency certificates of Mauritius, which did not relate to them. Exempting capital gains of Rs.222.31 crore for assessment years 2000-01 and 2001-02 entailing a tax levy of **Rs.29.59** crore without examining effective place of management was irregular.

3.7.4 Board may also, in this connection, for ensuring consistency in assessments, like to clarify to its assessing officers as to whether profits arising to FIIs would be assessable as business profits or capital gains, as FIIs are investment companies. This would ensure that interests of revenue are safeguarded.

3.7.5 Loss of revenue due to misuse of Indo-Mauritius treaty by residents of third countries

JPC in their report in December 2003 on the stock market scam had observed that though the exact amount of revenue loss due to 'residency clause' of the Indo-Mauritius treaty could not be quantified, but taking into account the huge inflows/outflows, it could be assumed to be substantial. They had concluded that the problem with the Indo-Mauritius treaty was not as much with residents engaging in 'round tripping'*, routing their investments through Mauritius, but with residents of third countries exploiting the favourable dispensation sought to be granted to 'bonafide' residents of Mauritius through 'post box companies'.

3.7.6 The Committee had, therefore, recommended that in order that the benefits of Indo-Mauritius treaty were available only to bonafide residents, 'companies' investing in India through Mauritius should file details of 'ownership' with RBI and furnish a declaration that effective place of management was in Mauritius. Board's circular of February 2003 clarified taxability of Indian companies involved in 'round tripping' through Mauritius. However, similar action was not taken with reference to residents of third countries availing the benefits.

3.7.7 It is interesting to note that the Ministry in July 1995 had opined ***"for Indian investors to be globally competitive, facilities available to foreign investors to use the relative advantages of Mauritius should also be available to Indian investors"***. However, Board's circular of February 2003 negated the above advantage by providing that 'tie breaker' clause for deciding the residence, would be applicable only in respect of resident Indians investing through Mauritius. Reasons that prompted the Ministry to exclude residents from India availing the benefits of DTAA while simultaneously allowing residents of third countries to avail the same, were not ascertainable.

3.7.8 It is also relevant to note that the Ministry in its submission to JPC had stated that there were problems in DTAAs with 17 other countries as well pertaining to taxation of long-term capital gains. Whether, exempting capital gains from taxation in India was a conscious policy of the Ministry as reflected in the Indo-Mauritius DTAA or the Ministry have been caught totally unawares of the adverse implications of changes in domestic laws in Mauritius on the Indian tax situation was not verifiable in Audit. The admission of the Ministry before the JPC, mentioned at paragraph **3.1.11** indicates, that the situation had become one of 'fait accompli' and progress, if any, to remedy the situation has been slow.

3.7.9 Audit noticed that the department did not have any proactive strategy or action plan to identify investors belonging to third countries routing their transactions/investments through Mauritius for the sole purpose of enjoying treaty benefits, to the detriment of revenues. Audit also found that relief claimed by

* wherein domestic companies take money out of the country and then bring it back as overseas contribution to equity.

assessees under Indo-Mauritius DTAA was being allowed by assessing officers without proper scrutiny.

3.7.10 Audit noticed that in **Mumbai DIT (IT)** charge, in six cases, relating to assessment year 1997-98, the assessing officers had denied exemption to capital gains on the grounds that effective place of management or the actual control of management was not in Mauritius but in third countries. However, consequent to issue of circular 789 in April 2000 by the Board which was, perhaps, construed to mean that the assessing officer had no choice but to accept the residency certificate granted by Mauritius even when the actual control was exercised from outside Mauritius, the assessments were, subsequently revised in favour of the assessees under section 264 of the Act nullifying the tax demand of **Rs.8.40 crore**.

3.7.11 The Supreme Court in their judgement in October 2003 had clearly decided that circular 789 of April 2000 did not in any way crib, cabin or confine the powers of the assessing officer with regard to any assessment. The assessing officers ought to have examined the assessment/revision orders 'denovo' in these cases especially as it was already established 'ab initio' that the effective place of management of these companies was not in Mauritius. Ministry may like to initiate action to get the assessments and the issue of effective place of management examined in case of all FIIs and their sub accounts in respect of Mauritius based units so as to safeguard interests of revenue

3.7.12 Audit noticed an instance of Indo-Mauritius DTAA being availed by a non-resident of a third country, USA. In **Mumbai DIT (IT)** charge, **Vodafone International Inc (VII), USA** had divested its share holding in favour of two Indian companies through its 100% subsidiary, M/s Air Touch International Mauritius Ltd. (AIML) in Mauritius. AIML earned long-term capital gain amounting to Rs.79.59 crore and short-term capital gain of Rs.42.69 crore for the assessment year 2001-02 from the above transaction. AIML claimed exemption from capital gain tax under Indo-Mauritius DTAA, which was allowed after scrutiny in January 2004. Thus, VII, by divesting through Mauritius saved capital gain tax of **Rs.20.77 crore** by taking shelter of Indo-Mauritius DTAA. Had the shares been directly sold by VII USA, the entire capital gain would have been subjected to tax in India under Indo-US DTAA.

3.7.13 Ministry may, therefore, have to put in place an effective mechanism to ensure that the benefit of residency and taxation of capital gains are availed of only by bonafide residents of the countries with which DTAAs have been concluded and not extended to residents of third countries as a matter of course in a routine manner. Ministry may undertake a transparent cost benefit analysis of extension of such benefits through 'treaty shopping' so that it would become a recognized and clearly thought out policy of the Government to permit the same. Ministry may also take urgent action to include specific clause for enforcing 'limitation of treaty benefits' in all identified 'problem DTAAs' so that the consequential benefits are not availed by default.

3.7.14 Revenue forgone due to exemption under DTAAs

Audit attempted to quantify the tax expenditure or indirect subsidy granted to FIIs resident in UAE under the Indo-UAE DTAA and enjoying exemption from capital gains tax as available in Indo-Mauritius DTAA. Details of 10 companies at random, to which Indo-Mauritius and Indo-UAE DTAAs applied were obtained from SEBI to quantify the possible tax expenditure to the Indian exchequer on account of favorable dispensation granted to them with regard to taxation of long term capital gains. In the absence of specific data, the calculations were based on details of sale of equity furnished by SEBI. Tax has been worked out on the premise that all sales had resulted in long-term capital gains attracting a levy of 10%. Long-term capital losses incurred if any, are assumed to be offset by the fact that short-term capital gains are not being factored into the estimate. Revenue foregone in respect of Mauritius and UAE for 10 companies would amount to **Rs.76.14 crore** and **Rs.532.63 crore** respectively during the years 2001-02 to 2003-04 as detailed in **Table 5** below.

(Rs. in crore)

Table 5: Equity Investment : Mauritius (Sales)

Sl No	Name of FII	2001-02	2002-03	2003-04	Total
1	India Capital Management Inc	Nil	Nil	97.6	97.6
2	Maxwell (Mauritius) Pvt Ltd	Nil	Nil	94.4	94.4
3	BNP Paribas South Asia Investment Co. Ltd	42.4	52.7	114.6	209.7
4	South Asia Regional Fund	Nil	17.8	Nil	17.8
5	JF India Fund	Nil	127.7	204.8	332.5
6	CDC Financial Services (Mauritius)	Nil	Nil	9.4	9.4
	Total	**42.4**	**198.2**	**520.8**	**761.4**
	Equity Investment : United Arab Emirates (Sales)				
1	Citicorp Banking Corporation	Nil	Nil	8.9	8.9
2	HSBC Financial Services (Middle East) Ltd	Nil	131.9	1424.6	1556.5
3	Abu Dhabi Investment Authority	903.2	940.5	1603.5	3447.2
4	TAIB Bank E.C.	77.2	115.5	121	313.7
	Total	**980.4**	**1187.9**	**3158**	**5326.3**

3.7.15 Incorrect carry forward of capital losses

As Indo-Mauritius DTAA provides that capital gains arising to Mauritius based FIIs are assessable to tax only in Mauritius, losses on account of the same are similarly to be adjusted or claimed only in Mauritius. In **Mumbai, DIT (IT)** charge, audit noticed assessing officers had accepted the claims of carry forward of capital losses of six companies amounting to **Rs.478.95 crore** arising from sale of shares by Mauritius based FIIs though losses were not assessable in India which would have entailed a potential tax levy of **Rs.48 crore.**

3.7.16 Loss of revenue due to non-selection of cases for scrutiny

In **Mumbai DIT (IT)** charge, assessments of **M/s. Empire International Holdings Ltd. and M/s. Lotus India Investments Ltd.** for the assessment year

2001-02 were completed in summary manner allowing the benefit of exemption of capital gains under Indo-Mauritius treaty without production of tax residency certificate or other document evidencing effective management in Mauritius. M/s. Lotus India Investments Ltd was allowed exemption of tax on capital gains of Rs.3.99 crore involving a potential tax levy of **Rs.0.34 crore** which was irregular, while in the case of M/s. Empire International Holdings Ltd, no details of capital gain were mentioned. In view of the incomplete information in the returns, the cases should have been selected for scrutiny to ensure that exemption was correctly availed by the assessees.

3.7.17 In **Mumbai DIT (IT)** charge, the assessments of **M/s. Abacus International Pvt Ltd**, for the assessment years 2001-02 to 2003-04 were completed in summary manner accepting 'nil' income. Audit scrutiny for the assessment year 1999-2000 revealed that the assessing officer in his scrutiny order of March 2002 did not accept the claim of exemption under Article 5. It was held that income of the assessee was taxable as business income under Article 7 of Indo-Singapore DTAA. For ensuring consistency in denial of exemption, the returns of income for the subsequent years should have been selected for scrutiny. Omission to do so, resulted in loss of revenue of **Rs.1.15 crore**

3.8 Comparative analysis of selected DTAAs

3.8.1 Permanent Establishment (PE)

PE is defined as a "fixed place through which the business of an enterprise is wholly or partly carried on". A building site or construction or installation project, or any structure used for exploration or development of natural resources constitutes a PE if it lasts more than 12 months as per OECD Model and 6 months as per UN Model. India generally follows UN Model.

3.8.2 A comparative study of articles on PE in respect of 12 selected DTAAs (**USA, U.K., Japan, Germany, Kenya, Mauritius, Malaysia, Oman, South Africa, Singapore, UAE and Uzbekistan**) revealed that there is no uniformity or consistency in defining the existence of a PE based on the minimum threshold period of existence as given in **Table 6** below:

Table 6: Period for reckoning PE in DTAAs

Name of the country	Building site installation or structure	Supervisory activity	Finishing services	Exploration of natural resources
USA	120 days	120 days	90 days	120 days
UK	6 months	6 months	90 days	Not mentioned
Uzbekistan	Not mentioned	Not mentioned	Not mentioned	Not mentioned
Germany	6 months	6 months	Not mentioned	Not mentioned
Japan	6 months	6 months	6 months	6 months
Singapore	183 days	183 days	183 days	183 days
Mauritius	9 months	9 months	Not mentioned	Not mentioned
South Africa	6 months	6 months	Not mentioned	Not mentioned
UAE	9 months	9 months	9 months	Not mentioned

3.8.3 Audit noticed that in DTAA with USA, the period adopted is 120 days instead of 6 months. Reasons for adopting different periods in DTAAs with Mauritius, Singapore and UAE were not ascertainable in audit, as no supporting records were made available. Revenue implications were thus not known.

3.8.4 Business Profits

UN Model convention, inter alia, states that in the determination of profits of a PE, no deduction shall be allowed for amounts paid (otherwise than towards reimbursement of actual expenses) by the PE to the head office of the enterprise or any of its other offices by way of royalties, fees or other similar payments in return for the use of patents or commission for specific services performed.

3.8.5 Audit noticed that except in respect of DTAAs with USA and UK, above provision of UN Model convention has not been considered in any other DTAA. Consequently, in respect of at least 10 DTAAs scrutinized in audit, expenditure incurred by the PE towards royalty, fee for technical services would become an allowable expenditure, thereby reducing the taxable income leading to loss of revenue. Audit could not quantify loss of revenue on this score, as the field offices of the department did not have any specific mechanism or procedure designed to watch and prevent the same.

3.8.6 Income from dividends, interest, royalty and technical fees

India generally follows UN Model for taxation of various sources of income like dividends, interest, royalty, and technical fee. Rates of taxes, which may be withheld from dividends, interest, royalty are to be negotiated bilaterally, unlike the OECD Model which specifies the maximum rate. However, where a DTAA provides for a particular mode of computation of income, the same shall be followed irrespective of the provisions of the Act.

3.8.7 Benefits accruing to India by agreeing to different rates of taxation and cost involved or opportunities foregone were not ascertainable in audit. With new trade arrangements coming into force on account of WTO obligations, it becomes imperative that the DTAAs that India had entered into are also appropriately revised in consonance with the comparative advantage arising there from. A conscious and well planned cost benefit analysis would need to be attempted to quantify revenue foregone on account of taxation rights conceded to other contracting states and exemptions granted by way of preferential tax treatments accorded to non residents, especially as DTAAs are not being placed before Parliament.

3.8.8 Taxation of receipts on sale of software by non residents

Computer software means a computer programme recorded on an information storage device containing instructions to the computer. It would contain a source code and an object code, the authorship of which is protected by copyright. The

transfer of software may involve mixed contracts wherein the ratio between various heads of income like capital gains or business or royalty need to be carefully determined so that interest of revenue is safeguarded.

3.8.9 Examination in audit revealed that while in the case of DTAAs with Russia and Morocco, payment for transfer of computer software is treated as 'royalty', in the case of other DTAAs especially Indo-US DTAA there is no such specific mention. Audit examined assessments of 10 companies in the charge of **DIT (IT) Bangalore** to which the Indo-US DTAA applied, relating to the assessment years 1999-2000 to 2003-04. The assessees had preferred an appeal against the assessments, which sought to tax the payments for computer software as 'royalty', on the ground that the DTAA did not clearly specify that payment should be categorized as royalty. The aggregate tax demand involved in these 10 cases was **Rs.54.78 crore** which could have been realized if the Indo-US DTAA had contained specific provisions on the lines of other DTAAs or an amendment was proposed and effected to the DTAA safeguarding interests of revenue.

3.8.10 Assistance for recovery

One of the purposes for entering into DTAAs is providing assistance for recovery of taxes under the respective statutes of the contracting states. While specific provisions exist in DTAAs with South Africa, Belgium and Denmark, these are conspicuous by their absence in DTAAs concluded with USA, UK and Singapore.

3.8.11 In **Delhi, DIT (IT) and CIT XII** charge, recovery of demands aggregating **Rs.1.53 crore** pertaining to non-residents belonging to USA (**Mr. Eugene Theroux and Mr. Vikram Vadhera**) could not be enforced in the absence of provisions of assistance of recovery in Indo-US DTAA. Similarly, in another case **(M/s. Classic Enterprises)** under **DIT(IT) Bangalore** charge, tax demand of **Rs.1.15 crore** could not be realized due to absence of the required provisions in Indo-Singapore DTAA. Ministry may consider effecting an amendment to the DTAAs for safeguarding interests of revenue.

3.8.12 DTAAs with OECD countries

Audit scrutiny of Indo-Belgium DTAA revealed that if India limits its taxation on royalties or fees for technical services to a rate lower or a scope more restricted in the DTAA with a third state which is a member of the OECD, then the benefit of such limitation /rate would automatically apply to Indo-Belgium DTAA. Similar provision exists in DTAAs with Netherlands and France.

3.8.13 Audit noticed that similar or corresponding privilege or benefit is not automatically available to India from the OECD countries. With the prospect of entry of new countries into OECD, Ministry will have to take utmost care in negotiating rates of tax, as these will have multi lateral implications affecting the existing DTAA with OECD countries.

3.8.14 Precautions will also have to be taken after conducting a transparent cost benefit analysis even in cases of countries (with which India has already concluded DTAA), becoming members of OECD subsequently, which could claim the benefit of lower rates or preferential treatment available to existing OECD countries. Even the converse may apply, as existing OECD countries could claim lower rates that India might confer to the other country that would become member of OECD, subsequently. Ministry may review the practice of extending preferential tax treatment to all OECD member countries automatically especially in the absence of corresponding provisions and reciprocity available to us.

3.8.15 Relief under the Act and DTAA simultaneously allowed.

As per the Act, where the Central Government has entered into a DTAA, then in relation to the assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.

In **DIT (IT) Mumbai** charge, assessment of **M/s Abu Dhabi Investment Authority** for the assessment year 2001-02 was completed in summary manner. Income returned by the assessee comprised capital gains, which were claimed exempt under Indo-UAE DTAA and dividend income of Rs.19.69 crore which was claimed exempt under the Act.

3.8.16 When the assessee had opted for assessment under the provisions of the treaty, exempting dividends under the provisions of the Act, would become irregular. Audit scrutiny revealed that dividends would be taxable at the rate of 15 percent under the Indo-UAE DTAA and tax of **Rs.2.94 crore** was leviable. In this context, Ministry may need to clarify whether provisions of the Act and the treaty would apply simultaneously during the same assessment year and assessee could toggle between them for each item of income, as DTAA is an not an exercise in tax avoidance but avoidance of double taxation.

3.8.17 Irregular grant of exemption under DTAA

In case of a non resident engaged in the business of providing facilities or plant and machinery on hire for prospecting for or extraction of mineral oil, a sum equal to ten percent of aggregate amounts paid or payable whether in or out of India to the assessee shall be deemed to be income chargeable to tax. Board Instruction 1767 of July 1987 had laid down that ten percent of income on work done in India and one percent of all activities outside India relating to the above activities be adopted as income for three years beginning from assessment year 1987-88.

3.8.18 In **Uttaranchal, Dehradun** charge, the assessment of **M/s. Hyundai Heavy Industries Company Ltd.** for the assessment year 1999-00 was completed after scrutiny in March 2002. Audit scrutiny revealed that income from sources outside India was computed at one percent of gross receipts as per Board's instruction, which was applicable only for three years from assessment

year 1987-88 as against ten percent provided in the Act. This resulted in income of Rs.64.02 crore escaping tax involving a short levy of tax of Rs.46.86 crore.

3.8.19 The Ministry replied that income was computed under the Indo-Korea DTAA and the assessing officer had estimated the profits at one percent of the gross receipts from abroad. The reply is not tenable, as DTAA only specified the jurisdiction which would be competent to tax the profits arising to the PE, and not the quantum of profit, whereas it is the Act, which specifies the quantum of income chargeable to tax. Further, as the income arising abroad to the assessee has been attributed to the PE in India, computation of income chargeable to tax at one percent instead of ten percent of gross receipts was irregular.

3.9 Mutual Agreement Procedure

DTAAs lay down a mutual agreement procedure (MAP) for resolving disputes arising out of their application. The taxpayer may approach the competent authority of the contracting state of which he is a resident where he feels that the assessment to be made or order passed is not in accordance with the terms of the DTAA. The competent authority shall endeavor to resolve the dispute by mutual agreement with the competent authority of the other country. MAP is an additional mechanism for settling tax disputes and shall be given effect to notwithstanding any time limits under the domestic law of the contracting states.

3.9.1 The Board, vide instruction of November 2002, laid down the following procedure for giving the effect to the resolution of dispute under MAP.

- applicant shall be required to give an acceptance to the decision arrived at under MAP and that he will forego any right to appeal on the same issue.
- where the issue is under appeal, the assessing officer shall also obtain an undertaking from the assessee regarding withdrawal of appeal on the issue.
- where the appeal has been decided by the CIT (A) but the appeal is pending with the ITAT, MAP decision will be implemented only after the assessee withdraws his appeal from the ITAT. And where department has filed an appeal before the ITAT, the same shall also be withdrawn on the points on which the decision has been arrived at under MAP.

3.9.2 The Board issued instructions in April 2003 and March 2004 to the effect that the assessing officer shall keep the enforcement of collection of outstanding taxes in abeyance in respect of tax payers resident in the USA and UK who had furnished bank guarantee for the amount of tax under dispute in respect of whom MAP had been activated. Where no resolution is possible, intimation to this effect shall be given to the assessing officer who shall be entitled to conclude the assessment as per law in force and also invoke the guarantee in case the assessee fails to pay the demand.

3.9.3 Non production of MAP cases

In April 2004, audit requisioned details of all MAP cases, which were pending with or resolved during the period 1999-2000 to 2003-04 by the competent authority[§]. The Board in June 2004 stated that they did not have any record or details of action being taken by the assessing officers during the pendency of the issue or after the case was resolved under MAP. Audit called for further details of 36 MAP cases (October 2004) collected by the audit team from the list given by the Board. However, neither details of all the cases nor the connected records like correspondence with other competent authorities, reminders issued and reports were made available to audit despite repeated request. The Board in December 2004 forwarded the same list of 36 MAP cases without giving details of action taken. Audit attempted to selectively and independently examine the status of MAP cases in terms of cases resolved and cases under appeal from the assessing officers. Audit could examine only 28 cases.

3.9.4 Outstanding MAP cases

Audit noticed that MAP cases being pursued by the Board were pending resolution for periods ranging from two to five years as given in **Table 7** below.

(Rs. in crore)

Table 7: Outstanding MAP cases

No of MAP cases	Countries involved	Assessment Year involved	Status of cases	Revenue involved
5	USA	1996-97 to 2002-03	Two cases were pending from 1999, two from 2002 and one from 2003	88.48
2	UK	1996-97 to 2002-03	One case was pending from 1999 and other case from 2000	112.27
3	Japan	1997-98 to 2002-03	One case was pending from 2000 and two cases from 2001 &2002	176.98
1	Belgium	1999-2000	Pending from 2000	3.82
1	Sweden	1997-98	Pending from 2002	43.53
1	Spain	1996-97	Pending from 2003	0.34
Total				**425.42**

3.9.5 Further scrutiny of the above cases revealed the following:

- These cases were being simultaneously processed in appeal of which the appellate authorities were unaware.
- The assessing officers had not obtained requisite bank guarantees in three cases (**M/s Clifford Chance and M/s Link Laters and M/s INMARSAT, UK**), In one case, bank guarantee was obtained for Rs. 0.90 crore against demand of **Rs.1.99 crore** (**M/s Herbal Life International of America, USA**). In 6 other cases relating to Japan, Belgium, Sweden and Spain, no measures like obtaining bank guarantees, were taken to safeguard the interest of revenue.

[§]Joint Secretary(JS), Foreign Tax Division (FTD) in the Board

- Pendency of cases had resulted in not only blockade of revenue to the tune of **Rs.425.42 crore** but also could result in avoidable payment of interest on refunds due to delay in completion of MAP proceedings.

3.9.6 Inadequacy in implementing MAP resolutions

Audit noticed inadequacies in implementation of MAP resolution as indicated in the following paragraphs.

3.9.7 The assessing officer in the case of **M/s Delta Air Lines, USA** under the charge of **DIT (IT), Mumbai** sought to tax the income derived from servicing other airlines and providing personnel and equipment in India under article 5 of Indo-US DTAA for the assessment years 1992-93 to 1997-98. The assessee went in appeal against the above order in March 2000. Simultaneously, the assessee preferred an application in January 2001 to resolve the issue under MAP, which was accepted and taken up by the Board. In February 2002, MAP case was resolved in favour of revenue and the Board informed the assessing officer that the activity was rightly taxable in India. In the meantime, CIT (A) on 5 March 2002 issued a contrary decision favouring the assessee and a refund of **Rs.3.15 crore** was granted to the assessee.

3.9.8 In the case of **M/s Motorola, USA** under the charge of **DIT (IT), Delhi,** the issue under consideration was allocation of profits attributable to sales by Indian PE *vis a vis* global profits and taxability of certain payments as royalty. When Department sought to tax the same, the assessee sought relief by activating MAP. In December 2003, the competent authorities agreed that the receipts of the assessee were taxable in India. The resolution under MAP was yet to be given effect to by the assessing officer. In the meantime, assessee preferred an appeal with CIT (A), which is pending. Tax demands for the assessment years 1998-99 to 2001-02 amounting to **Rs.98.75 crore** were pending recovery.

3.9.9 In the case of **M/s Badger Energy, USA, {CIT (IT) Bangalore}**, the assessing officer concluded assessment for the assessment year 1997-98 determining a total tax of **Rs.0.49** crore treating certain expenditure incurred outside India as head office expenses. The assessee contested the above action before CIT (A). Simultaneously, the assessee sought redressal by activating MAP in May 2001, which was accepted and taken up by the Board. In the meantime, CIT (A) ruled in favour of the assessee. Department filed second appeal with ITAT, which was pending. Though the MAP case was resolved in favour of revenue in December 2003, no such communication was available with the assessing officer (July 2004). Non-availability of communication from the Board with the assessing officer regarding the resolution resulted in appellate authority taking a contrary view in favour of the assessee to the detriment of revenue.

3.9.10 Audit scrutiny revealed that in the above cases, when the competent authorities of the other states had agreed that certain streams of income were

indeed taxable in India, a contrary decision by the appellate authorities could have been avoided by better coordination amongst various authorities in the department which would have prevented loss of revenue. This not only indicated lack of coordination between the departmental officers and the appellate authorities on the one hand but also lack of effective monitoring by the Board.

3.9.11 Further, DTAAs being contractual in nature, the scope of taxation as negotiated by competent authorities in the contracting states shall be final, and the scope of such taxation may not be amenable to further interpretation or dispute before the appellate authorities. Thus, in so far as taxability of income arising from specific activities is concerned, the understanding of the competent authorities shall have precedence and such decisions arrived at after prolonged negotiations may, perhaps, be beyond the jurisdiction of departmental appellate authorities. Further, as the non residents paying tax in India have the option of availing credits in their home countries, any relief contemplated by appellate authorities may only result in shifting of tax base out of India. Hence, the mechanism of MAP needs to be appropriately redesigned to not only prevent double taxation but also collect revenue, which rightfully belongs to India.

3.9.12 Delay in implementation of MAP resolution

In **Delhi DIT (IT)** charge, the case of **VISA Service International Association, USA,** was taken up under MAP in 1999 to resolve the issue of taxability of receipts accruing to permanent establishment (PE) from business activities in India for assessment years 1997-98 and 1998-99. The competent authorities resolved in September 2003 that certain streams of income were indeed taxable in India, which was communicated to the assessing officer with instructions to give effect to the resolution within 90 days (i.e. by December 2003). The resolution which resulted in a refund was however, given effect to only in March 2004, after a delay of three months resulting in avoidable payment of interest on refund aggregating **Rs.11.23 lakh.**

3.9.13 Closure of MAP cases without any resolution

In **Delhi DIT (IT)** charge, cases pertaining to **M/s Galileo International, and American Airlines Inc USA** (of **M/s SABRE Group)** for the assessment years 1996-97 to 2001-02 involving a tax revenue of **Rs.36.23 crore and Rs.17.99 crore, respectively,** were closed without a mutually acceptable settlement. Assessees had preferred appeal under domestic law and demands were stayed. In the absence of specific clause for assistance for recovery of taxes in the Indo-US DTAA, bank guarantees ought to have been obtained. Failure to do so had jeopardized the interests of revenue to the extent of **Rs.54.22 crore**.

3.9.14 Deficiencies and inconsistencies in MAP

Audit noticed the following deficiencies and inconsistencies.

- There is no prescribed time limit within which the MAP cases are to be resolved leading to prolonged negotiations and blockade of revenue
- There are no instructions on the action to be taken by the assessing officer when the case is being simultaneously processed under MAP and appeal
- Except in the case of UK and USA, there are no instructions to obtain bank guarantee to safeguard the interest of revenue for disputed demands.
- The option given to the assessee for accepting or rejecting the resolution, has rendered the dispute resolution mechanism totally ineffective, as the assessee would still have the option of taking up the case under normal appellate channels in spite of resolution by competent authorities being in favour of revenue.
- Incidentally, Ministry may like to note that the Revenue Procedure 2002-52 of Inland Revenue Service (IRS) of USA, specifically provides for coordination between the appellate authorities and IRS. The US competent authority will not, without the consent of appellate authorities accept or continue to consider a taxpayer's request for assistance if the matter is already agitated in the Courts. Further, in case of simultaneous process under MAP and appeal, the concerned representatives will consult each other so that the terms of resolution and the principles and facts upon which it is based are compatible with the position that the competent authority intends to present to the foreign competent authority with respect to the issue. However, in India, no such procedure has been adopted.

3.10 Exchange of Information

3.10.1 DTAAs provide that competent authorities of contracting states shall exchange such information as is necessary for applying the provisions of DTAAs or of domestic laws of the contracting states.

3.10.2 Audit made efforts to examine the system of exchange of information in the Board, with a view to analyzing whether the information sought from foreign countries were received promptly and 'follow up' action being taken by the assessing officers was being monitored. Board did not make available the relevant records and only furnished a list of 123 cases of "exchange of information" processed between January 2000 and March 2004 which indicated that 61 were finalized and 62 were pending.

3.10.3 Only a few cases could be examined as complete details like assessment years, tax implications and details of the representation received from the field offices were not made available by the Board. Audit noticed that there was no monitoring of the action taken by the assessing officers in respect of the cases where information had been received. Details of pursuance with the corresponding authorities in these countries were not available for verification in audit. A perusal of records with the assessing officers revealed the following.

3.10.4 In **Kerala, Ernakulam** charge, information was sought to verify the genuineness of gifts received by an assessee, **Mr. John George Vettath** and his family members from a non-resident, (Mr. John Paulose Vettath). The information called for from four countries (Malaysia, UAE, Indonesia, and Singapore) in July 1998 was yet to be received. Audit scrutiny revealed that the assessment was concluded in October 2003 without disallowing gift of Rs.90 lakh involving tax effect of **Rs.60.58 lakh**. Thus, efforts at exchange of information proved unfruitful.

3.10.5 In **Gujarat, Ahmedabad-I** charge, an assessee **(Shri Kamal Galani, Mumbai)** had made investments out of foreign remittance of Rs.3.78 crore. The assessing officer had made a reference to the Board in October 2002 who, however, forwarded the same to the UAE authorities only in January 2004 after more than one year of receipt of reference from the assessing officer. The assessment was finalized in July 2004 pending receipt of information from the Board without disallowing or adding back the amount of Rs.3.78 crore involving a tax effect of **Rs.2.45 crore**. Here also, the efforts of utilizing the facility of exchange of information proved unsuccessful.

3.10.6 In **Gujarat, Ahmedabad, DIT (Investigation)** charge, two assessees **(Shri Atul Sheth & Mukesh Sheth, Rajkot)**, had received gift of Rs.4.70 crore from non-residents in UAE. The assessing officer had made a reference to the Board on 25 November 2002 who in turn forwarded the same to UAE authorities in December 2002. No information had been received so far. The assessment was concluded without adding the above amount of Rs.4.70 crore jeopardizing the interest of revenue involving a tax effect of **Rs.3.05 crore**.

3.10.7 In **Gujarat, Ahmedabad DIT (Investigation)** charge, **Shri Chitra Publicity Company, Ahmedabad** & its managing partners had received gifts of more than Rs.2.17 crore from non -residents in USA. The assessing officer had made a reference to the Board in November 2002 reply to which was received in May 2004. In the meantime, assessing officer concluded the assessment in December 2003, adding bogus gift involving tax revenue of Rs.1.15 crore. Assessee went in appeal. Audit scrutiny revealed that the information received in May 2004 confirming the apprehension of revenue that it was a case of bogus gift was not conveyed to CIT (Appeal) resulting in appellate authority deleting the additions made in the assessment on account of bogus gifts in July 2004. The department filed further appeal to ITAT. The department could have collected tax of **Rs.0.46 crore** (at the rate of 40 percent of Rs.1.15 crore) and saved the effort of appealing in ITAT, if the information confirming the bogus gift received in May 2004 was promptly and properly produced before CIT (Appeals).

3.10.8 In **Andhra Pradesh, Hyderabad** charge, information sought from the Board in five cases **(Lanco Group, United Exports, Oil Country Tubular Ltd, Harmahendar Singh Bagga & KGR Exports, Vizag)** from foreign countries was pending for periods ranging from one to three years. Assessments were concluded without adding back the amounts involving tax levy of **Rs.67.13 crore**

3.10.9 In the above cases, the assessing officers had suspected the bonafides of certain transactions involving substantial revenue implication. Verification through the Board however was not forthcoming in time and assessing officers had to complete the assessments without having been satisfied regarding the genuineness of investments or expenditure in order, perhaps to meet the deadline of limitation of time of completion of assessments. Tax involved in the above test checked cases aggregated **Rs.73.69 crore**.

3.11 Mistakes in application of DTAA provisions

3.11.1 Incorrect allowance of loss relating to Branch operations outside India

Indo-USA DTAA provides that income/loss of the branch office is assessable in USA and to that extent the same shall not be considered for taxation in India.

In **Karnataka, Bangalore-I** charge, the assessment of M/s **Aditi Technologies (P) Ltd** for the assessment year 2001-02 was completed in summary manner in October 2002 at 'nil' income after allowing deductions in respect of losses pertaining to branch operations in U.S.A. The assessee incorrectly claimed the loss of Rs.17.52 crore of U.S.A. branch operations in India, despite stating in enclosures to the return of income, that the loss pertaining to USA branch office was not considered for claiming deductions. This resulted in excess allowance of deduction amounting to Rs.17.52 crore involving short levy of tax **Rs.6.13 crore**.

3.11.2 Business profits taxed as royalty

DTAAs provide that where fees for technical services and interest are paid to a non-resident, tax shall be withheld at the prescribed rates on gross basis*. In case, the payments of the nature referred to above are related or connected to a PE, then such income is taxable as 'Business profits' at rates specified in the Act.

In **Andhra Pradesh, Hyderabad** charge, the assessment of **M/s Louis Berger International Inc USA**, for the assessment year 2002-2003 was completed in summary manner in March 2003 accepting the income returned. The assessee provided engineering consultancy for infrastructure projects in India through a PE. Hence income accruing to the assessee was taxable as 'business profit' at the rate of 20 percent as prescribed in the Act, as against 15 percent paid by the assessee. Incorrect application of provisions of DTAA resulted in short levy of tax of **Rs.1.12 crore** including interest.

3.11.3 Incorrect allowance of Double Taxation relief

Under the Act, a person resident in India is entitled to relief on his foreign income taxed both in India and in a foreign country. The quantum of relief is governed by DTAA entered into by the two countries.

* Gross basis means total receipts without allowing for any expenditure.

In **Karnataka, Bangalore-I,** charge, the assessment of M/s **Infosys Technologies Ltd**. for the assessment year 2001-02 was completed after scrutiny in March 2004. Audit scrutiny revealed that while allowing double taxation relief of Rs.17.99 lakh, lower figures of total turnover as available in the original return of income were adopted instead of revised and higher total turnover worked out in the assessment order. Actual relief worked out to Rs.11.65 lakh. This resulted in excess grant of double taxation relief of Rs.6.34 lakh involving short levy of tax of **Rs.12.38 lakh** including interest.

3.11.4 Incorrect exemption of interest income under DTAA

As per Article 8 of Indo-US DTAA, where an enterprise derives profits from operation of ships or aircraft in international traffic or interest on funds connected with such operations, the same shall be taxed in the contracting state. However, interest arising to an enterprise from any other source shall be taxed in the contracting state in which interest arises, at 15 percent of gross amount.

In **Mumbai, DIT (IT)** charge, assessment of **M/s Delta Airlines**, a foreign company, for the assessment year 2003-04 was completed in summary manner in February 2004. The assessee had claimed exemption of interest of Rs.70.38 lakh under Article 8 of Indo- US DTAA. Audit scrutiny revealed that interest income comprised interest on income tax refund of Rs.60.96 lakh and interest on fixed deposit of Rs.9.43 lakh. Interest received on refund and fixed deposit cannot be considered as part of profits derived from the operation of aircraft in international traffic eligible for exemption under Article 8 of the Indo-US DTAA. Assessee had also claimed similar exemption for assessment year 2001-02 which was allowed while processing the return in summary manner in January 2003. Incorrect allowance of exemption resulted in short levy of tax aggregating **Rs.13.12 lakh**.

3.11.5 Incorrect taxation of income from royalty and fees from technical services under DTAA provisions

Tax is leviable on interest, royalty and fees for technical services on gross basis. Income arising on account of the above in a contracting state and paid to resident of the other contracting state may be taxed in either of the contracting states subject to conditions specified in the DTAAs. In **DIT (IT) Mumbai** charge, audit noticed that in seven cases there was short levy of tax of **Rs.1.95 crore** as royalty was not taxed on gross basis. Details are shown in **Appendix 29 at Sl. No. 1 to 7.**

3.11.6 Non-levy of surcharge

DTAAs concluded with several countries like USA and UK while defining taxes covered under the treaty mention not only income tax but also surcharge levied thereon. In respect of payment made towards royalty, fees for technical services and interest by a resident to foreign companies, the Finance Acts 2002 and 2003,

provided for levy of surcharge at the rate of 5 percent and 2.5 percent respectively, on tax deducted at source.

Test check of the assessments of non-residents revealed that surcharge was not being levied. Loss of revenue due to inconsistency in levy of surcharge in 97 cases amounted to Rs.1.32 crore as indicated in Table 8 below:

(Rs. in crore)

Table 8: Non levy of surcharge

Name of charge	No. of cases	Assessment year	Tax effect
DIT(IT), Bangalore	35	2002-03	0.53
--do--	41	2003-04	0.37
DIT(IT), Chennai	95	2003-04/2004-05	0.42
Total			1.32

3.11.7 Board during Exit Conference (February 2005) did not accept the audit observation on the ground that the rates prescribed by DTAA were inclusive of surcharge and treaty law overrode domestic law. Board's view is not acceptable as DTAAs provide that taxes covered in India are income tax 'including' any surcharge thereon. Further, 'relief from double taxation' as enshrined in DTAA affords credit for income tax as well as surcharge levied thereon. Assessees can also claim credit for surcharge paid in the country of residence, where return of income is filed. The Working group on non-resident taxation in its report of January 2003 had also highlighted the need for clarification by the Board on levy of surcharge.

3.11.8 Mistakes in application of minimum alternate tax provisions (MAT)

It has been held** by Authority for advance rulings (AAR) that the MAT provisions under section 115JA/115JB of the Act are also applicable to foreign companies. Double taxation relief will be allowable under normal provisions of the Act and not under MAT provisions.

In Mumbai, DIT (IT) charge, audit noticed mistakes in four cases involving tax effect of Rs. 5.49 crore where double taxation relief was allowed on tax payable under MAT. Details are shown in Appendix 29 at Sl No. 8 to 11.

3.11.9 Income escaping assessment

As per DTAAs, income of foreign companies having PE in India would be assessed to tax in accordance with normal provisions of the Act. Audit examination revealed that there was short levy of tax of Rs.33.20 crore as such income was not taxed under the Act. Few instances are detailed below and the remaining are highlighted in Appendix 29 at Sl. No. 12 to 24.

3.11.10 In Chennai, DIT (IT) charge, a foreign company, M/s Kier International, incorporated in UK set up a project office at Chennai to execute marine works. For the assessment year 2000-01, the assessee returned a loss of

** 234 ITR 335 & 234 ITR 828

Rs.18.69 crore which was accepted after scrutiny. Audit scrutiny revealed that the assessee had not offered an income of Rs.18.34 crore to tax which had accrued on account of activities by the project office in India, but received directly by the Head Office in UK. Omission to include income of Rs.18.34 crore resulted in short assessment involving tax effect of **Rs.8.80 crore.**

3.11.11 In **Chennai, DIT (IT)** charge, the promoters of an Indian company **M/s ST CMS Electric Company Pvt. Ltd** were from USA and Netherlands. The company was incorporated to build, own and operate a thermal power plant in Neyveli, Tamil Nadu and hence it had a PE in India. The company had made payments in foreign currency to entities abroad towards engineering, design, equipment supply, civil and infrastructure services during the assessment years 2000-01 to 2002-03 totalling Rs.60.37 crore without deducting tax of **Rs.9.06 crore** at source.

3.11.12 In **Kolkata, DIT (IT)** charge, the assessment of **M/s Price Waterhouse Coopers Ltd, USA**, for the assessment year. 2000-01 was completed in summary manner in March 2003 at a total income of Rs.85.35 lakh. The assessee had received Rs.1.95 crore from M/s. Reliance Industries Ltd. (RIL) Mumbai on account of consultancy work carried out in India. This amount was remitted directly by RIL to the assessees' principal in USA on the basis of 'no objection certificate' obtained from the department in Mumbai without withholding required tax. This income was not offered to tax by the assessee, leading to underassessment of income of Rs.1.95 crore involving short levy of tax of **Rs.0.59 crore**.

3.11.13 In **Kolkata, DIT (IT)** charge, an assessee company, **Leonhardt Andra Und Partner GMBH** registered in West Germany, had entered into a contract in July 1974 with Hoogly River Bridge Commissioners (HRBC), West Bengal in connection with the design and supervision of construction of the bridge. Payments made by HRBC to the assessee on the above activities were taxed. On appeal by the assessee, CIT (A) set the assessments aside and allowed relief for the assessment years 1983-84 to 1991-92. Department approached ITAT which also favoured the assessee. On further appeal by the department, Kolkata High Court held that supervision charges being in the nature of technical services were taxable in India as provided in Indo-German DTAA. However, department failed to act upon the judgement of the High Court.

3.11.14 Audit scrutiny revealed that the assessee had received a sum of Rs.7.91 crore for the said assessment years as supervision charges (excluding 1988-89). Failure to give effect to High Court order resulted in non-levy of tax of **Rs.0.79 crore**. Department stated that the copy of the High Court order dated 12 December 2000 had not been received. The reply is not tenable as the judgement was widely available including in the Income Tax Reports (ITRs).

3.11.15 In **Mumbai, DIT (IT)** charge, the assessment of **M/s. A.P. Moller**, a partnership firm resident in Denmark, for the assessment year .2001-02 was

completed after scrutiny in March 2004. Income from shipping business was computed at 7.5 percent of gross receipts of Rs.1382.80 crore at Rs 103.71 crore under section 44 B of the Act. It was noticed that an amount of Rs.9.85 crore towards rebate was deducted from the gross receipts, which was irregular. This resulted in short computation of income of Rs.73.86 lakh (7.5 percent of Rs.9.85 crore) involving short levy of tax of **Rs.41.69 lakh** including interest.

3.11.16 Mistake in allowing credit for taxes paid abroad

Relief from double taxation shall be provided through the exemption method or the credit method. In the former method, income from the country of source is treated as fully exempt in the country of residence whereas in the latter, the country of residence grants a credit of tax paid in the country of source against the tax chargeable under its own laws.

3.11.17 Audit noticed that assessees from India having operation in foreign countries with which India has DTAAs have been declaring losses from operation in such foreign countries under the Indian Income Tax Act in addition to availing incentives under section 10A/10B of the Act. Tax credits had been claimed even when there was a loss from business activities abroad in addition to claiming disproportionate tax credits. Further, audit noticed inconsistencies in affording credit to taxes paid abroad due to variation in definition of assessment years as also instances where refund had been granted in India though corresponding tax had been deducted at source abroad. These irregularities resulted in short levy of tax of **Rs.20.19 crore** in 7 cases. Few instances are highlighted below, other cases being noted in **Appendix 29 at Sl No 25 to 27.**

3.11.18 In **Andhra Pradesh, Hyderabad** charge **M/s Satyam Computer Services Company Limited (SCSCL)** claimed credit of tax of Rs.44.72 crore paid in USA in the assessment year 2003-04 on its income of Rs.108.32 crore from USA Branch office and the rate of tax worked out to 41.28 percent. As per Article 25 of Indo-US DTAA, the credit for taxes paid in USA shall not exceed that part of income tax, which is attributable to the income, which may be taxed in USA. However, it was seen from the returns for the assessment years 1998, 1999 and 2000 filed in USA, that the rate of tax applicable was 34 percent. Hence the credit of tax had to be restricted to 34 percent instead of 41.28 percent. The excess tax credit worked out to **Rs.7.88 crore**. In this context, it may be pointed out that as per US tax laws, losses arising abroad shall be set off only when there is taxable income from foreign sources.

3.11.19 In the case of the same assessee, for the assessment years 1998-99 to 2003-04, interest on account of default in payment of advance tax on the income returned in India was worked out treating taxes paid abroad as advance tax. There is no provision in the DTAAs to treat the tax paid in USA or any other country as advance tax. Hence, interest on account of default in payment of advance tax is to be worked out and levied before giving credit to taxes paid abroad. Failure to do

so resulted in short levy of interest of **Rs.6.55 crore** for the assessment years 1998-99 to 2003-04 apart from non-levy of interest for deferment of advance tax of **Rs.4.80 crore** for the assessment year 2003-04.

3.11.20 The same assessee (SCSCL) filed return of income for the assessment year 2003-04 in November 2003, which included a loss of Rs.1.04 crore from its Australian branch and claimed credit of Rs.47.69 lakh being tax paid in Australia. When the assessee had returned loss from Australian Branch, the credit of tax paid in Australia was not to be allowed, as there was no double taxation of the same income. Further, as per Indo-Australia DTAA, credit for tax on income arising in Australia shall not exceed the proportion of Indian tax, which such income bears to the entire income chargeable to tax in India. Incorrect allowance of tax credit resulted in short demand of **Rs.47.69 lakh**.

3.11.21 SCSCL also claimed tax credit of Rs.1.59 crore on its UK Branch income of Rs.1.28 crore which works out to **124 per cent** of taxable income for the assessment year 2003-04. Similarly, the assessee paid tax of Rs.27.64 lakh on its Canada Branch income of Rs.10.74 lakh, which works out to **257 per cent** of taxable income. Although, the credit of taxes claimed was abnormally high, the same was allowed by the assessing officer without proper examination.

3.11.22 Inadequacies in allowing tax credit

Audit examination revealed that the following issues would need to be clarified by the Board to ensure that the assessing officers adopt a consistent practice in allowing tax credits.

- Method and quantum of tax credit allowable when there is difference between tax assessment year in the foreign country and India.
- Documents necessary for claiming tax credits, such as, proof of return filed in foreign country, non claiming of refund of foreign taxes paid etc.,
- Stage at which credit is to be allowed in assessments i.e. as advance tax or TDS or self-assessment tax, etc.
- Tax credit allowable where incomes are not liable to tax in India as per DTAA or as per domestic law such as income exempt u/s 10A and
- Tax credit allowable to companies, which are taxable under special provisions of the Act (MAT).

3.11.23 Some assessees were declaring losses from operations of branches set up abroad, which were being carried forward for adjustment in subsequent years under the Indian Income Tax Act and were also given credit for taxes paid abroad through these branches. Ministry may examine the rationale for bestowing such multiple benefits to the same assessee and consider a review of the existing practice so that excessive and misplaced claims of relief are not allowed.

3.12 Mistakes in taxation of maritime business of non-residents

Provisions relating to taxation of shipping business of non-residents have been described in paragraphs 3.2.2 to 3.2.5 above.

Audit noticed inconsistencies in issue of 'no objection certificate' (NOC) and instances of allowance of DTAA relief where there were no agreements but exemption was allowed to Indian ships. In some cases, tax relief was allowed invoking provisions of inapplicable DTAAs, which was irregular. These mistakes resulted in short levy of tax of **Rs.18.53 crore**. Few instances are illustrated below while the remaining are noted in **Appendix 30.**

3.12.1 NOCs were to be issued and DTAA relief allowed only after verifying the eligibility criteria of non-residents, which, inter alia, included scrutiny of non-resident's nationality, charter party agreements, nomination of agent, freight movement particulars and ownership of the ship. In **Gujarat, Jamnagar, Ahmedabad, Surat and Baroda** charges in 235 cases, tax relief aggregating **Rs.10.95 crore** had been granted without due scrutiny of requisite details which was irregular. Further, in **Jamnagar** charge, relief of **Rs.5.47 crore** had been granted in 105 cases without confirming authenticity of agent's particulars. Thus, it was not clear as to how the assessing officers had satisfied themselves that NOCs were issued only in bonafide cases.

3.12.2 In 17 cases in **Goa, Madgaon and Andhra Pradesh Kakinada** charge, tax of **Rs.96 lakh** was not levied on shipping profits by incorrectly invoking DTAA applicable to nationality of owner of the ship as against the DTAA applicable to nationality of freight beneficiary.

3.12.3 In 9 cases in **Ahmedabad, Madgaon and Kakinada** charges relief of **Rs.66.45 lakh** was irregularly allowed to non-residents of countries with which there were no agreements by invoking DTAAs of third countries where shipping profits were exempt.

3.12.4 Default in filing /non-assessment of returns filed by non-residents

Though subsequent to obtaining NOCs a prescribed return was to be filed and duly assessed by the assessing officer, adequate attention was not being bestowed for ensuring the same. Audit attempted an analysis of the effectiveness of the procedure adopted and the promptness of the assessment completed under section 172(4) of the Act in the CIT charges of Goa, Mumbai and Gujarat. Audit noticed that the returns were either not filed or were filed after the prescribed time limit and no follow up action was initiated by the assessing officer as envisaged in Board instruction of June 1975, as detailed in **Table 9** below:

Table 9: Default in filing of returns and non completion of assessments of returns filed

Charge	Period	Number of NOCs issued	Number of returns filed	Number of assessments made	Percentage of returns filed	Percentage of assessments completed
Goa, Madgaon	2000-01 to 2003-04	1328	Not indicated in records	688	Not known	52
Gujarat, Jamnagar Ahmedabad Surat & Baroda	-do-	9846	5341	2133	54	40
Mumbai DIT(IT)	2001-02 to 2003-04	4032	3672	76	91	2

3.12.5 There was thus, a substantial short fall in the number of returns filed in comparison to NOCs issued. The position of final assessments made under section 172(4) was rather alarming as only around 2 percent of the returns filed were assessed in Mumbai and 52 percent and 40 percent in Goa and Gujarat charges respectively. Audit could not assure itself that required seriousness was being bestowed by assessing officers on monitoring receipt and more importantly on completing assessments promptly. The Board could have ensured this by prescribing periodical reports from assessing officers regarding disposal of returns filed by nonresidents involved in shipping business. In none of the previous five years had assessments been concluded under section 172 (4) of the Act, by selecting the same for scrutiny in accordance with instructions issued by the Board. It would appear that essential responsibility of assessing officers for safeguarding interests of revenue was not being discharged and the department ended up considering issue of NOCs as an end in itself. The loss of revenue if any, on this score is completely unascertainable as monitoring mechanism left much to be desired.

3.12.6 Inadequacies in law in respect of taxation of shipping business by non residents

Audit examination revealed that there were several inadequacies in monitoring mechanism and lacunae in the Act in respect of taxation of shipping business of non-residents, which would have adverse implication on revenue.

3.12.7 Since there is neither any return under section 139 nor any assessment year involved where an assessment is made under section 172, neither can reassessment proceedings under section 147* nor rectificatory proceedings under section 154@ be initiated. For similar reasons, the CIT is barred from reopening the assessment under section 263 of the Act. Further no interest is leviable in cases of default in payment of taxes or non-filing of returns as available under

* [1995] 215 ITR 103 (Pune AT) South India Corporation (A) Ltd.
@ [1991] 371 ITD 356 (AHD) MV Belstar

sections 234A and 234B of the Act. These ambiguities need to be rectified by suitable amendment to safeguard interests of revenue especially as required seriousness is not being bestowed by assessing officers for completing assessments

3.12.8 Board's circular of June 1975 states that if the non-resident makes suitable arrangement for filing of returns and payment of taxes, and assessing officer is satisfied of the same, he will advise all the jurisdictional income tax officers dealing with ports, to grant 'port clearance' to ships during the financial year. Though the system of issuing multiple NOCs to the same ship was sought to be curbed, it was only during December 1995 the Board issued another circular after a lapse of 20 years.

3.12.9 Board's circular of December 1995 states that annual NOCs shall be issued after obtaining an undertaking from the shipping company to the effect that during the period of currency of NOC, no ship belonging to it will be engaged in any traffic other than international traffic. Annual certificates were being issued by applying DTAA based on nationality of owner. However, no mechanism is available to monitor activities of such ships when nationals of other countries were chartering the same and where shipping profits were taxable in India.

3.12.10 The system of taxation under section 172 was intended for occasional shippers. Occasional* or casual means accidental or fortuitous, suggesting absence of any entertained object or intention. Ministry may, under the circumstances, like to review as to how entities that were engaged in regular shipping business could be allowed the benefit of section 172.

3.13 Mistakes in application of various provisions of the Act

Examination of assessments of non-residents or assessments involving payments to non-residents, which were taxable in India, revealed various mistakes such as excess allowance of deduction in respect of head office expenditure, incorrect deduction in respect of provision for bad and doubtful debts and for payments made outside India without deducting tax at source, incorrect deduction of receipts for services rendered in India, incorrect taxation of capital gains, irregularities in deduction of tax at source and completion of assessment proceedings, incorrect application of exchange rates while computing taxable income and non levy of applicable interest for default in filing of returns or for shortfall in payment of advance tax as also deferment in payment of advance tax. Instances involving short levy of tax in excess of Rs.25 lakh each are highlighted below.

* Ramanathan Chettiar Vs CIT (1967) 63 ITR 458 (SC)

3.13.1 Excess allowance of deduction in respect of head office expenditure

Under section 44 C of the Act, an assessee, being a non-resident, is entitled to a deduction on account of head office expenditure to the extent of five per cent of the adjusted total income or actual expenditure whichever is less.
In **DIT (IT) Mumbai** charge, audit noticed that in four cases, assessee's claims for deduction of head office expenditure were incorrectly allowed involving short levy of tax of **Rs.6.37 crore** as shown in **Appendix 29 at Sl No. 28 to 31.**

3.13.2 Incorrect deduction in respect of provision for bad and doubtful debts

A bank incorporated outside India is entitled to deduction on account of provision for bad and doubtful debts at five per cent of total income before making any deduction under Chapter VI. The deduction allowable in respect of bad debts written off in such cases is to be restricted to the amount, which is in excess of the credit balance in the provision of doubtful debts account.

In **DIT (IT) Mumbai** charge, audit noticed that in five cases, assessee's claims for deduction on account of bad debts written off were allowed without considering balance in provisions for bad and doubtful debts involving tax effect of **Rs.4.53 crore**. Details are shown in **Appendix No. 29 at Sl. No. 32 to 36.**

3.13.3 Incorrect deduction for payments made outside India without TDS

Where, in any financial year, assessee has paid interest, royalty, fees for technical services or other sum chargeable to tax, which is payable outside India, on which tax has not been paid or deducted at source as specified in the Act, such amounts shall not be deducted in computing the income chargeable to tax.

The assessment of **M/s. Standard Chartered Bank (Mumbai City 1 charge)** and **M/s. H.C.C. Pati Joint Venture (Mumabi City 23 charge)** for the assessment years 1999-00 and 2002-03 had been completed after scrutiny and in summary manner respectively, without disallowing payments, which had been made abroad on which tax had not been deducted at source. This resulted in under assessment of income involving a short levy of tax of **Rs.58.89 lakh**.

3.13.4 Incorrect deduction on receipts for services rendered in India

Where the total income of an assessee includes any income by way of commission or other similar payment received in convertible foreign exchange from a foreign enterprise and brought into India within specified period, a deduction equal to fifty percent of such income is allowed. The income qualifying for exemption shall include amounts on account of services rendered from India but shall not include services rendered in India.

In **Mumbai City II** charge, the assessment of **M/s Heartly and Gresham (I) Ltd** for the assessment year 1997-98 was completed after scrutiny in November 1999 after allowing deduction of Rs.63.97 lakh towards income from foreign enterprise. Audit scrutiny revealed that the assessee was not entitled to deduction, as service charges from the foreign enterprise were for supply of information regarding market conditions in India and for collecting strategic information to secure sales orders in India. Incorrect allowance of deduction of Rs.63.97 lakh resulted in short levy of tax of **Rs.43.49 lakh** including interest.

3.13.5 Incorrect taxation of capital gains

Long-term capital gain and short-term capital gain are to be considered as distinct sources of income and taxed at rate of 10 percent and 30 percent respectively (upto 1 October 2004).

In **Mumbai DIT (IT)** charge, the assessment of **M/s. Morgan Stanley Dean Witter Investment Management Inc.** for the assessment year 2001-02 was completed after scrutiny in February 2004. Short term capital gain of Rs.2.14 crore taxable at the rate of 30 percent was set off against long term capital loss which was not permitted under the Act. In the process, the assessing officer ended up applying lower rate of taxation involving short levy of tax of **Rs.42.86 lakh.**

3.13.6 In **Mumbai DIT (IT)** charge, two instances of application of incorrect rate of tax on long term capital gains involving short levy of tax of **Rs.27.20 crore** were also noticed details of which are noted in **Appendix 29 at Sl. No. 37 and 38.**

3.13.7 Issue of notice for assessment under an inapplicable provision

In **West Bengal, DIT** charge, the six non-resident companies were doing business in India through their Indian agent, **M/s. PILCOM**. No returns were initially submitted either by non-resident companies or by their agent for income taxable in India, for the assessment year 1996-97. The department issued notice on 30 March 1999 under section 148 of the Act directly to the non-resident companies whereas assessment was concluded in the name of Indian agent in March 2002 creating a demand of Rs.7.35 crore. On appeal by the assessee, CIT appeal set-aside the assessment since notice under section 148 was irregularly issued to the foreign companies, which should instead have been issued to their agent in India under section 163 of the Act. Departmental appeal in ITAT was also set aside on similar grounds. The Department have preferred an appeal in High Court of Kolkata which is pending. Failure of the department in following the correct procedure in issuing notice resulted in blockade of revenue of **Rs.7.35 crore,** which could turn into a loss of revenue, as well.

3.13.8 Irregularities in deduction of tax at source

Section 195 of Income Tax Act provides that tax shall be deducted at source on payments to non-residents. In **Chennai DIT (IT)** charge, the assessee **(M/s Satyam Infoway Ltd)** incurred an expenditure of Rs.77.44 crore in foreign currency towards share issue expenses, legal and professional charges, royalties and other related expenses for assessment years 2000-01 to 2003-04.

Tax had not been deducted at source on the above payments except for assessment year 2001-02. Audit scrutiny revealed that expenses incurred towards legal and professional charges, share issue expenses, etc were taxable as "fee for technical services" in the hands of recipients (non-resident). However, neither had the non-resident filed any return of income nor any assessment concluded on the assessee in representative capacity. The total short levy of tax on payments made to non-resident amount to **Rs.11.35 crore**.

3.13.9 In **Andhra Pradesh, Hyderabad** charge, returns of income of **M/s Nippon Koei Company Limited, Japan** for the assessment years 1999-2000 and 2000-01 were filed by the representative assessee viz. the Superintending Engineer (SE) Kurnool beyond the specified date in January 2003. Returns were treated as *non est* and the assessee was informed in March 2004. However, no assessment proceedings were initiated.

Audit scrutiny revealed that SE did not file annual return of TDS and remitted the entire TDS of Rs.1.50 crore in lump sum for the assessment years 1999-2000 and 2000-01 in January 2003. Since the representative assessee had filed the necessary returns beyond due date, he was liable to pay interest which was not levied. Further assessee's claim for deduction of head office expenses was not restricted as provided in the Act. Aggregate short levy of tax worked out to **Rs.96.88 lakh.**

3.13.10 In **Chennai, DIT (IT)** charge, tax had been deducted at source on payments made to non-residents at lower rates by applying incorrect provisions of the Act. This resulted in short deduction of tax of **Rs.31.51 crore** in addition to non levy of interest of **Rs.19.87 crore** as detailed in **Appendix 29 at Sl. No. 39 to 44**. In the same charge, in four other cases, tax of **Rs.1.54 crore** was not deducted at source on payments made to non-residents as detailed in **Appendix 29 at Sl. No.45 to 48**.

3.13.11 Other mistakes

Audit noticed in Delhi, Mumbai, Hyderabad and Kerala charges mistakes in computation of taxable income due to incorrect application of exchange rates, non levy of applicable interest for default in payment of advance tax and deferment of payment of advance tax as also taxation of income of non residents

at lower rates involving a short levy of **Rs.109.48 crore** as detailed in **Appendix 29 at Sl. No. 49 to 76.**

3.13.12 Miscellaneous

In **DIT (IT) Chennai, Mumbai and Karnataka** charges, audit noticed mistakes in 35 cases involving short levy of tax of amounting to **Rs.16.48 crore** due to errors in totalling of tax and incorrect computation of income under various provisions of Act.

3.14 Conclusion and recommendations

While audit realizes that revenue consideration is perhaps not the sole factor determining the contents of a DTAA and promotion of friendly relations and special interests with certain countries do play a significant role, limited examination of some of the important issues concerning the administration and implementation of DTAAs and taxation of non residents engaged in maritime business revealed shortcomings and inadequacies which needed to be removed and procedures strengthened.

3.14.1 A well-directed and clear strategy was not in place to remove inconsistencies and shortcomings in DTAAs especially those relating to definition of permanent establishment, limitation of treaty benefits, disallowing or consciously allowing 'treaty shopping', amendment of DTAAs and enforcing exchange of information clauses effectively. Cost benefit analysis of DTAAs had not been conducted. *Audit recommends that DTAAs may be examined critically through a phased and well monitored programme so that interests of revenue are safeguarded and one sided concessions are avoided. Audit recommends that the Board may assess the costs and benefits from each DTAA transparently and objectively, especially as DTAAs are not placed before Parliament.*

3.14.2 Monitoring and co-ordination of all aspects relating to mutual agreement procedure (MAP) cases, exchange of information (EOI) and assistance in tax recovery both in the Board and the field offices of the department, were not effective enough to safeguard interests of revenue and derive the optimum advantage from various DTAAs. *Audit recommends that procedures relating to MAP, EOI and recovery of tax be suitably codified and implementation monitored so that there is consistency and clarity in action being taken by assessing officers.*

3.14.3 A proactive action plan was not evolved to investigate cases of FIIs/sub accounts claiming residence in Mauritius so that effective place of management was investigated and determined in fulfilment of the spirit and intention of Indo-Mauritius DTAA. Ministry did not put in place a strategy to identify cases which attracted the 'tie breaker' clause to determine taxability of income in the case of India based entities claiming residence in Mauritius and prevent 'treaty shopping' in the case of entities based in third countries but availing the benefits under Indo-

Mauritius DTAA. Similar vigil was warranted but absent in respect of non residents claiming residence of Malta, Cyprus, UAE, Tanzania and other similarly placed DTAAs. This would have ensured that the Ministry was not caught in a state of *'fait accompli'* as had happened in relation to Indo-Mauritius DTAA with regard to taxation of capital gains from stock market operations. *Audit recommends that Board ensure that a database of FIIs and sub accounts relating to all entities operating in India is prepared and their liability to tax examined critically so that benefits of DTAA are availed only by assessees actually and rightfully entitled to the same.*

3.14.4 Income of FIIs/sub accounts engaged in the business of investment in stock markets was not being taxed under the specific provisions (section 115 AD) available in the Act or by treating them as business profits under DTAAs, which was detrimental to the interests of revenue. Though income of FIIs/sub accounts was to be treated as business profit and taxed accordingly, it was being erroneously categorized as capital gains and being exempted from tax by routinely invoking DTAAs. *Audit recommends that the Board may issue necessary clarification to ensure correct and proper taxation of income arising to FIIs/sub accounts.*

3.14.5 A proactive strategy for utilizing the information in respect of non resident's business activities available with regulatory bodies like SEBI and RBI was not evolved in the department. *Audit recommends that the Board strengthen the mechanism of coordination with regulatory bodies so that vital information relating to the income of FIIs/sub accounts is obtained regularly and acted upon promptly by assessing officers with a view to bringing the same to tax, if necessary by bringing in a suitable amendment to the Act*

3.14.6 Taxation of income of non residents from maritime business was not being bestowed serious attention especially in completion of regular assessments which require intelligent application of correct DTAAs and assessing officers were resting content only with issue of 'NOCs' to agents/shipping companies concerned. *Audit recommends that clear procedures be introduced and implementation monitored so that regular assessments of income from maritime business are seriously made and assessing officers do not treat issue of NOCs as an end in itself.*

3.14.7 Benefits were being allowed both under the Act and the DTAA separately for parts of income, as convenient to the assessee. Board may need to clarify that the Act or DTAA alone would need to be applied to all sources of income in a particular year. *Audit recommends that the Board unambiguously clarify issues such as incidence of surcharge and the option of availing concession under DTAA and the Act simultaneously, for the same assessment year for different sources of income, so as to ensure consistency in assessments and prevent loss of revenue.*

3.14.8 Assessees were availing multiple benefits under the Indian Income Tax Act with regard to income and taxes paid in foreign countries jeopardizing the interests of revenue. *Audit recommends that the Board may issue guidelines for regulating credit to taxes paid abroad and specifying the manner of treatment of tax credit, so that assessments are consistently made and interests of revenue are safeguarded.*

3.14.9 An Exit Conference was held with Member (A&J) in the Board in February 2005 to discuss audit conclusions and recommendations. The Board agreed to examine the same separately.

New Delhi
Dated: 12 April 2005

(P. SESHKUMAR)
Principal Director of Receipt Audit
(Direct Taxes)

Countersigned

New Delhi
Dated: 12 April 2005

(VIJAYENDRA N. KAUL)
Comptroller and Auditor General of India

Appendices

Appendix 1

Chapter-1
Status of improvement of efficiency through the 'Restructuring' of the Income Tax Department

Details of cases produced to Audit
(Reference in para 1.10.4)

States	Total no of cases				Cases selected for review				Cases not produced to audit			
	Scrutiny	Summary	Appeal	Refund	Scrutiny	Summary	Appeal	Refund	Scrutiny	Summary	Appeal	Refund
Andhra Pradesh	5104	39952	9293	NA	2552	799	929	414	673	32	723	-
Delhi**	1407	98074	-	-	661	2925	108	802	40	236	26	10
Gujarat	1977	434349	NA	NA	197	8686	NA	NA	130	8482	-	-
Karnataka	2008	200081	3932	36094	1012	3877	394	3624	436	2347	158	1767
Madhya Pradesh	18409	3755360	18355	421147	2407	3217	191	3229	NIL	NIL	NIL	NIL
Maharashtra	7676	138966	2479	16414	4138	3018	246	2003	3273	2093	220	1720
Tamil Nadu	3375	208612	15798	7047	1776	4372	4351	854	NIL	NIL	NIL	NIL
Uttar Pradesh	5556	693814	NIL	Nil	2778	15063	NIL	NIL	NIL	NIL	NIL	NIL
West Bengal	8897	239481	2335	35444	4497	4899	348	3596	2024	2825	204	1807
Total (Percentage of cases not reduced over cases selected for review.	54409	5808689	52192	516146	20018	46856	6567	14522	6576 (33%)	16015 (34%)	1331 (20%)	5304 (36%)

** Data pertaining to post restructuring period only was provided. Appeal and Refund case figures included in scrutiny and summary cases.

Appendix 2
Composition of officers and staff at different levels in the Income Tax Department
(Reference in para 1.12.1)

Sl. No.	Post (pre-restructuring)	Re-designated Post	Sanctioned strength (pre restructuring)	Sanctioned strength (post restructuring)	Increase in sanctioned strength	Decrease in sanctioned strength
1.	CCIT	CCIT	36	116	80	-
2.	CIT	CIT	402	698	296	-
3.	Addl.CIT	Addl. CIT	339	469	130	-
4.	JCIT	JCIT	453	647	194	-
5.	DCIT	DCIT	1033	1240	207	-
6.	ACIT	ACIT	648	734	86	-
7.	ITO	ITO	3261	4207	946	-
8.	ITI	ITI	8106	9490	1384	-
9.	Supr – 1	Sr.AO	5	5	-	-
10.	Supr – 1	AO-II	35	35	-	-
11.	Supr – 1	AO-III	280	774	494	-
12.	Supr-II	Office Supdt.	710	2468	1758	-
13.	HC/Asstt	Sr. Tax Asstt	2240	8030	5790	-
14.	TA	-	5609	-	-	5609
15.	UDC	Tax Asstt	9408	8931	-	477
16.	LDC	LDC	6947	311	-	6636
17.	RC	RC	223	-	-	223
18.	Sr. PA	Sr. PA	364	814	450	-
19.	Steno-I	Steno-I	1255	1000	-	255
20.	Steno-II	Steno-II	2510	2002	-	508
21	Steno-III	Steno-III	2511	2002	-	509
22.	DPA Gr B	DPA Gr B	55	55	-	-
23.	DPA Gr A	DPA Gr A	81	104	23	-
24.	DEO Gr D	-	23	-	-	23
25.	DEO Gr C	Sr. Tax Asstt	35	35	-	-
26.	DEO Gr B	Sr. Tax Asstt.	264	264	-	-
27.	DEO Gr A	Tax Asstt	394	394	-	-
28.	NS	NS	3172	3172	-	-
29.	GES.OPR	GES.OPR	23	23	-	-
30.	Jamedar	Jamedar	144	144	-	-
31.	Daftry	Daftry	695	3108	2413	-
32.	Peon	Peon	6692	3968	-	2724
33.	Watchman	Watchman	2322	2322	-	-
34.	Sweeper	Sweeper	435	435	-	-
35.	Farash	Farash	276	276	-	-
36.	Mali	Mali	45	45	-	-
37.	Others	Others	62	62	-	-

Appendix 3
Position of Sanctioned Strength of selected charges
(Reference para 1.12.5)

Designation	Andhra Pradesh			Delhi			Gujarat			Karnataka		
	Pre	Post	+/-	Pre	Post	+/-	Pre	Post	+/-	Pre	Post	+/-
CCIT/DGIT	1	5	4	8	20	12	3	8	5	2	6	4
CIT/DIT	12	30	18	64	80	16	35	71	36	18	36	18
Ad CIT/JCIT	30	52	22	119	121	2	61	85	24	33	57	24
DCIT/ACIT	68	98	30	242	212	-30	140	150	10	79	105	26
ITO	180	230	50	271	356	85	287	368	81	164	221	57
Inspector	433	504	71	626	746	120	753	863	110	396	476	80
Tax Assistant	684	825	141	1430	1345	-85	455	662	207	311	320	9
Others	1573	1208	-365	2472	2072	-400	3165	2523	-642	1381	1247	-134
Total	2981	2952	-29	5232	4952	-280	4899	4730	-169	2384	2468	84

Designation	Madhya Pradesh			Mumbai Region			Chennai			Uttar Pradesh			West Bengal		
	Pre	Post	+/-	Pre	Post	+/-	Pre	Post	+/-	Pre	Post	+/-	Pre	Post	+/-
CCIT/DGIT	1	3	2	4	15	11	3	10	7	3	7	4	5	15	10
CIT/DIT	11	20	9	81	101	20	32	60	28	26	44	18	41	96	55
Ad CIT/JCIT	18	32	14	143	153	10	66	100	34	58	81	23	91	126	35
DCIT/ACIT	42	53	11	273	249	-24	153	178	25	123	130	7	187	216	29
ITO	82	107	25	466	559	93	266	356	90	240	340	100	383	474	91
Inspector	244	277	33	NA	NA	NA	600	727	127	708	833	125	1062	1191	137
Tax Assistant	141	263	122	NA	NA	NA	377	0	-377	850	642	-208	889	1717	828
Others	1206	962	-244	NA	NA	NA	3174	3236	62	3145	2849	-296	6671	5076	-1595
Total	1745	1717	-28	967	1077	110	4671	4667	-4	5153	4926	-227	9329	8911	-418

Appendix 4
Vacancies in Field Offices of Income Tax Department
(Reference para 1.12.6)

Designation	West Bengal			Chennai			Delhi			Karnataka		
	S.S	W.S	+/-	S.S	W.S	+/-	S.S	W.S	+/-	S.S	W.S	+/-
CCIT/DGIT	15	12	-3	10	9	-1	20	20	0	6	5	-1
CIT/DIT	96	67	-29	60	52	-8	80	90	10	36	32	-4
Ad CIT/JCIT	126	101	-25	100	98	-2	121	146	25	57	53	-4
DCIT/ACIT	216	187	-29	178	128	-50	212	160	-52	105	86	-19
ITO	474	472	-2	356	352	-4	356	354	-2	221	221	0
Inspector	1191	1004	-187	727	683	-44	746	686	-60	476	458	-18
Tax Asstt	1717	1649	-68	0	0	0	1345	1251	-94	320	278	-42
Others	5076	4340	-736	3236	2818	-418	2072	1780	-292	1247	1049	-198
Total	8911	7832	-1079	4667	4140	-527	4952	4487	-465	2468	2182	-286
Vacancies as a percentage of Sanctioned strength			12.10			11.29			9.39			11.59

Designation	Madhya Pradesh			Andhra Pradesh			Uttar Pradesh			Gujarat		
	S.S	W.S	+/-	S.S	W.S	+/-	S.S	W.S	+/-	S.S	W.S	+/-
CCIT/DGIT	3	3	0	5	4	-1	7	7	0	8	7	-1
CIT/DIT	20	19	-1	30	30	-	44	44	0	71	58	-13
Ad CIT/JCIT	32	20	-12	52	52	-	81	77	-4	85	89	+4
DCIT/ACIT	53	41	-12	98	78	-20	130	100	-30	150	119	-31
ITO	107	107	0	230	229	-1	340	320	-20	368	368	-
Inspector	277	254	-23	504	479	-25	833	785	-48	863	754	-109
Tax Asstt	263	217	-46	825	765	-60	642	650	8	662	471	-191
Others	962	741	-221	1208	1164	-44	2849	2324	-525	2523	2230	-293
Total	1717	1402	-315	2952	2801	-151	4926	4307	-619	4730	4096	-634
Vacancies as a percentage of Sanctioned strength			18.34			5.11			12.56			13.40

(Note: S.S denotes Sanctioned Strength and W.S. denotes Working Strength)

Appendix 5
(Reference in para 1.16.12)

(Rs in crore)

Details of pre-assessment and post assessment collections in selected charges of Delhi*					
Financial Year	**Pre assessment collections**	**Post assessment collections**	**Total collections**	**Percentage of pre assessment collections over total collections**	**Percentage of post assessment collections over total collections**
1	2	3	4	5	6
2001-02	46.23	130.95	177.18	26.10	73.90
2002-03	432.64	172.09	604.73	71.54	28.46
2003-04	439.15	352.97	792.12	55.43	44.57

(Rs in crore)

Details of pre-assessment and post assessment collections in selected charges of Maharashtra					
Financial Year	**Pre assessment collections**	**Post assessment collections**	**Total collections**	**Percentage of pre assessment collections over total collections**	**Percentage of post assessment collections over total collections**
1	2	3	4	5	6
1999-00	1296.07	52.80	1348.87	96.09	3.91
2000-01	1615.23	125.73	1740.96	92.78	7.22
2001-02	17371.79	3107.38	20479.17	84.83	15.17
2002-03	39567.10	5962.19	45529.29	86.90	13.10
2003-04	39024.67	7257.06	46281.73	84.32	15.68

(Rs in crore)

Details of pre-assessment and post assessment collections in selected charges of Tamil Nadu					
Financial Year	**Pre assessment collections**	**Post assessment collections**	**Total collections**	**Percentage of pre assessment collections over total collections**	**Percentage of post assessment collections over total collections**
1	2	3	4	5	6
1999-00	3909	467	4376	89.33	10.67
2000-01	4705	562	5267	89.33	10.67
2001-02	4839	464	5303	91.25	8.75
2002-03	5902	469	6371	92.64	7.36
2003-04	6821	576	7397	92.21	7.79

* Figures for 1999-2000 and 2000-01 were not available

(Rs in crore)

Details of pre-assessment and post assessment collections in selected charges of West Bengal					
Financial Year	Pre assessment collections	Post assessment collections	Total collections	Percentage of pre assessment collections over total collections	Percentage of post assessment collections over total collections
1	2	3	4	5	6
1999-00	2926.22	385.99	3312.21	88.35	11.65
2000-01	3756.57	351.66	4108.23	91.44	8.56
2001-02	3873.92	412.86	4286.78	90.37	9.63
2002-03	4624.20	303.97	4928.17	93.83	6.17
2003-04	5659.51	437.97	6097.48	92.82	7.18

Appendix 6
(Reference in para 1.17.2)

(Rs in crore)

Charge	Total cases test checked	Returned income	Assessed income	Total demand raised	Pre assessment collections	Pre assessment collection as a percentage of total demand	Net demand after deducting pre assessment collections	Post asst collection as percentage of total demand	Cases where appeals were filed		Appeals decided in favour of revenue at 1st stage	
									Cases	Amount	Cases	Amount
Andhra Pradesh	2646	2143.52	2456.99	799.35	673.21	84.2	126.14	15.8	206	64.52	48	13.74
Delhi	621	6732.72	7514.25	3936.36	3513.84	89.3	422.51	10.7	82	98.06		
Maharastra	672	4605.79	10498.53	5734.57	4546.6	79.3	1187.97	20.7	34	364.83	2	2.79
Madhya Pradesh	325	91.22	289.75	122.69	57.51	46.9	66.39	54.1	209	44.1	29	3.9
Tamil Nadu	1776	547.57	3316.43	1487.57	1072.36	72.1	415.21	27.9	62	74.73	29	18.32
W Bengal	2473	3350.45	5787.82	2564.18	1910.39	74.5	653.79	25.5	295	354.10	111	47.57
Total	**8513**	**17471.27**	**29863.77**	**14644.72**	**11773.91**	**80.4**	**2872.01**	19.6	**888**	**1000.44**	**219**	**86.32**

(Rs. in crore)

Position of revenue collection in test checked cases of Hyderabad (Andhra Pradesh)										
Year	**Total cases test checked**	**Returned income**	**Assessed income**	**Total demand raised**	**Pre-assessment collections (percentage of total demand)**	**Net demand after deducting pre-assessment collections**	**Cases where appeals were filed with revenue effect**		**Appeals decided in favour of revenue 1st stage**	
	Cases	**Amount**	**Amount**	**Amount**	**Amount**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
1	2	3	4	5	6	7	8	9	10	11
1999-00	26	5.63	5.75	2.64	2.29 (86.74)	0.35	-	-	-	-
2000-01	71	4.04	5.23	2.06	1.12 (54.37)	0.94	9	8.43	4	0.05
2001-02	320	206.10	228.10	80.53	34.98 (43.44)	45.55	27	6.64	13	5.08
2002-03	816	859.57	1060.17	340.64	307.19 (90.18)	33.45	56	48.94	27	8.55
2003-04	1413	1068.18	1157.74	373.48	327.63 (87.72)	45.85	114	0.51	4	0.06
Total	2646	2143.52	2456.99	799.35	673.21 (84.22)	126.14	206	64.52	48°	13.74

° Remaining 158 cases involving revenue of Rs.50.78 crore were decided against revenue

(Rs. in crore)

Position of revenue collection in test checked cases of Delhi										
Year	**Total cases test checked**	**Returned income**	**Assessed income**	**Total demand raised**	**Pre-assessment collections(percentage of total demand)**	**Net demand after deducting pre-assessment collections**	**Cases where appeals were filed with revenue effect**		**Appeals decided in favour of revenue 1st stage**	
	Cases	**Amount**	**Amount**	**Amount**	**Amount**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
1	2	3	4	5	6	7	8	9	10	11
2001-02	73	5610.07	6062.44	3398.53	3044.78 (89.59)	353.74	11	67.33	Nil	Nil
2002-03	190	208.03	258.69	131.15	86.98 (66.32)	44.17	30	7.10	Nil	Nil
2003-04	358	914.62	1193.11	406.68	382.08 (93.95)	25.60	41	23.63	Nil	Nil
Total	621	6732.72	7514.25	3936.36	3513.84 (89.27)	422.51	82	98.06	Nil°	Nil

Details for the period 1999-2000 and 2000-01 were not available.
No appeal case was found decided in the cases test checked.

° No appeal case was found decided in these test checked cases

(Rs. in crore)

Position of revenue collection in test checked cases of Mumbai, Pune, Nagpur, Nasik and Thane (Maharashtra)										
Year	**Total cases test checked**	**Returned income**	**Assessed income**	**Total demand raised**	**Pre-assessment collections (percentage of total demand)**	**Net demand after deducting pre-assessment collections**	**Cases where appeals were filed with revenue effect**		**Appeals decided in favour of revenue 1st stage**	
	Cases	**Amount**	**Amount**	**Amount**	**Amount**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
1	2	3	4	5	6	7	8	9	10	11
2001-02	83	1028.01	2512.75	1891.39	1209.67 (63.96)	681.72	4	47.00	1	0.005
2002-03	134	127.19	1182.73	726.65	395.57 (54.44)	331.08	16	14.43	-	-
2003-04	455	3450.59	6803.05	3116.53	2941.36 (94.38)	175.17	14	303.40	1	2.79
Total	672	4605.79	10498.53	5734.57	4546.60 (79.28)	1187.97	34	364.83	2	2.79

Details for the period 1999-2000 and 2000-01 were not available.

(Rs. in crore)

Position of revenue collection in test checked cases of Bhopal and Indore (Madhya Pradesh)										
Year	Total cases test checked	Returned income	Assessed income	Total demand raised	Pre-assessment collections (percentage of total demand)	Net demand after deducting pre-assessment collections	Cases where appeals were filed with revenue effect		Appeals decided in favour of revenue 1st stage	
	Cases	Amount	Amount	Amount	Amount	Amount	Cases	Amount	Cases	Amount
1	2	3	4	5	6	7	8	9	10	11
1999-00	13	6.40	11.10	5.74	3.71 (65.00)	2.03	9	1.80	4	0.98
2000-01	9	5.38	9.43	4.88	2.78 (56.97)	2.10	9	2.10	1	0.50
2001-02	127	40.27	73.28	39.55	11.22 (28.37)	28.33	90	24.14	16	1.72
2002-03	103	24.22	104.98	42.22	25.22 (59.73)	17.20	57	6.00	8	0.70
2003-04	73	11.70	90.96	30.30	14.58 (48.00)	16.73	44	10.06	NA	NA
Total	325	91.22	289.75	122.69	57.51 (46.87)	66.39	209	44.10	29*	3.90

* Remaining 180 cases involving revenue of Rs.40.20 crore were decided against revenue

(Rs. in crore)

Position of revenue collection in test checked cases of Tamil Nadu charge										
Year	**Total cases test checked**	**Returned income**	**Assessed income**	**Total demand raised**	**Pre-assessment collections (percentage of total demand)**	**Net demand after deducting pre-assessment collections**	**Cases where appeals were filed with revenue effect**		**Appeals decided in favour of revenue 1st stage**	
	Cases	**Amount**	**Amount**	**Amount**	**Amount**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
1	2	3	4	5	6	7	8	9	10	11
2001-02	314	366.20	768.17	342.38	166.97 (48.76)	175.41 (51.23)	28	61.34	10	10.71
2002-03	528	-154.61	759.54	445.51	367.25 (82.43)	78.26 (17.56)	22	8.50	16	7.41
2003-04	934	335.98	1788.72	699.68	538.14 (76.91)	161.54 (23.08)	12	4.89	3	0.20
Total	1776	547.57	3316.43	1487.57	1072.36 (72.09)	415.21 (27.91)	62	74.73	29	18.32

(Rs. in crore)

Position of revenue collection in test checked cases of Kolkata (West Bengal)										
Year	**Total cases test checked**	**Returned income**	**Assessed income**	**Total demand raised**	**Pre-assessment collections (percentage of total demand)**	**Net demand after deducting pre-assessment collections**	**Cases where appeals were filed with revenue effect**		**Appeals decided in favour of revenue 1st stage**	
	Cases	**Amount**	**Amount**	**Amount**	**Amount**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
1	2	3	4	5	6	7	8	9	10	11
1999-00	315	-36.20	564.18	248.81	186.50 (74.96)	62.30	62	64.53	27	16.04
2000-01	374	503.94	1203.60	536.07	211.41 (39.44)	224.67	62	49.93	27	5.07
2001-02	413	707.09	1367.12	626.60	431.01 (68.79)	195.59	61	123.26	15	18.78
2002-03	583	93.14	390.59	247.22	184.93 (74.80)	62.29	91	114.10	33	7.67
2003-04	788	2082.48	2262.33	905.48	896.54 (99.01)	8.94	19	2.28	9	.01
Total	2473	3350.45	5787.82	2564.18	1910.39 (74.50)	653.79	295	354.10	111	47.57

Appendix 7

(Reference para 1.18.3)

(Rs in crore)

Position of uncollected demand of selected charges

Year	A.P		Delhi		Gujarat		Karnataka		Maharashtra	
	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)
1999-00	154.55	1141.15 (88.07)	-	-	2650.94	3691.87 (58.20)	722.53	1270.56 (63.75)	148.69	411.63 (73.46)
2000-01	138.81	1027.62 (88.10)	3799.00	4171.00 (52.33)	2839.26	3532.11 (55.44)	858.64	957.24 (52.71)	166.27	720.79 (81.26)
2001-02	214.04	1131.07 (84.09)	4399.00	4800.00 (52.18)	2476.27	3878.49 (61.03)	620.36	1490.90 (70.62)	8510.31	25453.29 (74.94)
2002-03	277.34	1356.82 (83.03)	4509.00	5481.00 (54.86)	4453.32	3725.64 (45.55)	756.06	1735.92 (69.66)	20552.01	60804.49 (74.74)
2003-04	286.82	1513.28 (84.07)	6439.00	6686.00 (50.94)	2114.56	3294.73 (60.91)	794.71	2063.40 (72.19)	19505.33	92039.00 (82.51)

(Rs in crore)

Year	Madhya Pradesh		Tamil Nadu		Uttar Pradesh		West Bengal	
	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)	Collected	Uncollected (Uncollected demand as a percentage of total demand)
1999-00	-	-	261.00	2389.00 (90.15)	501.94	1824.37 (78.42)	3610.65	4743.95 (56.78)
2000-01	861.29	494.69 (36.48)	330.00	2364.00 (87.75)	659.50	2317.10 (77.84)	4387.55	6082.94 (58.10)
2001-02	774.31	2102.70 (73.09)	164.00	2716.00 (94.30)	160.02	974.67 (85.90)	3400.06	4867.62 (58.87)
2002-03	2620.94	3335.32 (56.00)	324.00	2729.00 (89.39)	297.44	913.21 (75.43)	6038.09	4642.96 (43.47)
2003-04	1903.84	4891.12 (71.98)	340.00	3554.00 (91.27)	204.69	861.10 (80.79)	4471.75	4725.84 (51.38)

Appendix 8
Details with percentage of recovery in selected charge
(Reference para No.1.19.7)

(Rs in crore)

Year	Andhra Pradesh		Karnataka		Madhya Pradesh		Maharashtra	
	Demand certified	Demand recovered	Demand certified	Demand recovered	Demand certified	Demand recovered	Demand certified	Demand recovered
1999-00	NA	NA	NA	NA	NA	NA	NA	NA°
2000-01	176.60	3.46 (1.96)	NA	NA	524.37	NA	NA	NA
2001-02	326.44	10.65 (3.26)	15.55	1.91 (12.28)	541.60	8.20 (1.51)	724.25	2.84 (0.39)
2002-03	447.76	25.38 (5.67)	19.30	1.71 (8.86)	2609.12	9.98 (0.38)	1037.92	44.43 (4.28)
2003-04	524.20	24.27 (5.28)	18.60	1.04 (5.59)	3372.39	9.98 (0.30)	1445.60	83.59 (5.78)

Year	Tamil Nadu		Uttar Pradesh		West Bengal	
	Demand certified	Demand recovered	Demand certified	Demand recovered	Demand certified	Demand recovered
1999-00	NA	NA	NA	NA	NA	NA
2000-01	NA	NA	NA	NA	NA	NA
2001-02	606.00	110.00 (18.15)	0.44	0.24 (54.54)	11.03	0.96 (8.70)
2002-03	724.00	135.00 (18.65)	3.38	0.32 (9.47)	18.10	1.08 (5.97)
2003-04	1093.00	140.64 (12.87)	7.82	0.32 (4.09)	20.38	2.95 (14.47)

(MP data is excluding TRO for CIT Jabalpur I & II, Gwalior and Ujjain,
UP figures pertain to only TRO Range-II, Allahabad)
WB figures for test checked units only).

° Not available

Appendix 9
Position of assessments
(Reference para 1.21.3)

Year	Assessments for disposal			Assessments completed			Assessments pending			Percentage of assessments completed		
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Scrutiny	Summary	Total
1991-92	534174	7500631	8034805	306495	6406919	6713414	227679	1093712	1321391	57.38	85.42	83.55
1992-93	509406	7443737	7953143	285867	6217076	6502943	223539	1226661	1450200	56.12	83.52	81.77
1993-94	498327	8465578	8963905	336894	7086282	7423176	161403	1379296	1540699	67.61	83.71	82.81
1994-95	453353	9551857	10005210	298669	7294097	7592766	154684	2257760	2412444	65.88	76.36	75.89
1995-96	455446	10166080	10621526	301534	7998319	8299853	153912	2167761	2321673	66.21	78.68	78.14
1996-97	528154	11583285	12111439	366329	10082930	10449259	161825	1500355	1662180	69.36	87.05	86.28
1997-98	1108764	12751169	13859933	920701	10354926	11275627	188063	2396243	2584306	83.04	81.21	81.35
1998-99	598076	17832219	18430295	201849	8352299	8554148	396227	9479920	9876147	33.75	46.84	46.41
1999-00	553637	26846956	27401593	316223	14043850	14360073	237414	12804106	13041520	57.12	52.31	52.41
2000-01	360141	31046331	31406472	225730	18633110	18858840	134411	12413221	12547632	62.68	60.02	60.05
2001-02	217540	36508234	36725774	168010	19958558	20126568	49530	16549676	16599206	77.23	54.67	54.80
2002-03	894415	36900040	37794455	172410	33792795	33965205	722005	3107245	3829250	19.28	91.58	89.87
2003-04	388275	26978376	27366651	197390	21380490	21577880	190885	5597886	5788771	50.83	79.25	78.84

Appendix 10
(Reference para 1.21.9)

Position of summary assessments in selected charges

Charge	2000-01			2001-02			2002-03			2003-04		
	Due	Completed	Balance	Due	Completed	Balance	Due	Completed	Balance	Due	Completed	Balance
Delhi	1980326	933271	1047055	2229912	1132472	1097440	2776368	2645557	130811	1777576	1416945	360631
Maharashtra	1496960	1071110	425850	6460290	3598494	2861796	7041804	6511630	530174	4673362	3329390	1343972
Tamil Nadu	1608273	1218187	390086	2473338	1276626	1196712	2988976	2800602	188374	1758251	1474422	283829
West Bengal	3900505	1577267	2323238	4267470	2282855	1984615	3770428	3168035	602393	2530083	1622097	907986
Total	8986064	4799835	4186229	15431010	8290447	7140563	16577576	15125824	1451752	10739272	7842854	2896418
Percentage completion		53.4			53.7			91.2			73.0	

Appendix 11
(Reference para 1.21.9)

Position of scrutiny assessments in selected charges

Charge	2000-01			2001-02			2002-03			2003-04		
	Due	Completed	Balance	Due	Completed	Balance	Due	Completed	Balance	Due	Completed	Balance
Delhi	38553	34561	3992	8215	5083	3132	34409	17267	17142	27676	15957	1719
Maharashtra	13196	9932	3264	31745	23385	8360	69259	28389	40870	75666	42876	32790
Tamil Nadu	20712	12544	8168	15778	7688	8090	24799	9423	15376	31878	15800	16078
West Bengal	26806	16058	10748	24484	15355	9129	28558	10412	18146	42117	16189	25928
Total	99267	73095	26172	80222	51511	28711	157025	65491	91534	177337	90822	76515
Percentage completion		73.6			64.2			41.7			51.2	

Appendix 12
Position of Appeals at CIT (A) level
(Reference para 1.25.4)

Year	Total for disposal	Disposed off	Balance	Addition during the year CIT/ DCIT (A)°	Scrutiny asst. completed	Addition as a percentage of scrutiny asst completed during the year (Col.5 / Col.6 * 100)	Addition to ITAT appeals/writs /ref. during the year	Addition to ITAT appeals/writs /ref as a percentage of disposal by CIT (A) (Col.8/Col.3* 100)	Number of CIT (A)	Average disposal per CIT (A) per month	Number of months required to clear the balance at current rate
1	2	3	4	5	6	7	8	9	10	11	12
1991-92	388404	141955	246449		306495						
1992-93	363400	141034	222366	116951	285867	40.91					
1993-94	412421	145739	266682	190055	336894	56.41					
1994-95	405582	148010	257572	138900	298669	46.51	16986	11.48			
1995-96	367775	137039	230736	110203	301534	36.55	15480	11.30			
1996-97	330953	115640	215313	100217	366329	27.36	8017	6.93			
1997-98	296544	86536	210008	81231	920701	8.82	8213	9.49			
1998-99	298837	83841	214996	88829	201849	44.01	-4621	-5.51			
1999-00	297225	107624	189601	82229	316223	26.00	6527	6.06	208	43.12	21.14
2000-01	270537	98568	171969	80936	225730	35.86	7052	7.15	207	39.68	20.94
2001-02	235763	79902	155861	63794	168010	37.97	14740	18.45	207	32.17	23.41
2002-03	219966	118743	101223	64105	172410	37.18	36435	30.68	289	34.24	10.23
2003-04	174298	92152	82146	73075	197390	37.02	33440	35.14	288	27.53	10.36

° Deputy Commissioner of Income Tax (Appeals) (DCIT (A)) was the first appellate authority till 1 October 1998, after which this post has been abolished and CIT (A) is the first appellate authority.

Appendix 13
(Reference para 1.30.1)

Feed back from tax consultants

Name of the Tax consultant firm

Name of the person/s responding to the questionnaire

Questions	Response
What is your overall perception of the organizational structure as it prevails now?	
Has the changed jurisdictions of charges stabilised and if not, what are the exact problems in locating charges of assessments?	
What are the problems faced at different levels by tax practitioners- Filling of returns Assessment level	
Where specifically do delays occur at the assessment level and rectification proceedings?	
What is the position of refunds after restructuring? Is there delay in issuing refunds to assessees? Is there any problem in tracing the assessment records which result in delay of refunds?	
How is overall record management of the department? Where are problems in this area?	
What is the experience at 1st appellate stage with reference to the time taken for disposal?	
What is the experience at 2nd appellate stage with reference to time taken?	
Are the department's efforts to trace tax-evaders adequate? Do many transactions generating income go unreported? If so, can some examples be quoted?	
What are your comments on decisions of outsourcing of certain areas of the department's work?	

Appendix 14
Analysis of Staff Investments for Compliance Functions
(Reference para 1.32.2)

Country	Total staffing (FTE's)	Total staffing: audit and other verification	
		No.	% of total
Australia	19,177	6,475	33.8
Canada	38,381	10,415[2]	27.1
France	75,046	16,666	22.2
Germany	122,278		
Japan	56,315	38,110[1]	67.7
Sweden	9,030	3,106	34.4
UK – IRD	66,674	16,704	25.1
USA	100,229	15,224	15.2
India – ITD	**61,093**	**14,668[2]**	**24.0**
Source: Tax Administration in OECD Countries: Comparative Information Series (2004)			

[1] Number includes an unknown level of staff time devoted to tax payer service functions
[2] Includes staff for scrutiny as well as summary assessment functions in 2000-01. source: Mishra Committee Report on 'Restructuring of the Income Tax administration for increased effectiveness- a report, 1997-98'.

Appendix 15
Comparison of Year-end Gross and Net Tax Arrears (all years' debt)
(Reference para 1.33.3)

Country	Reported gross tax arrears/net tax collections (%)			Reported net tax arrears/net tax collections (%)		
	2000	2001	2002	2000	2001	2002
Australia	6.4	8.5	9.3	3.2	5.6	6.5
Canada	7.3	7.5	8.4	5.8	5.9	6.8
France	15.9	15.7	16.1			
Germany	2.5	2.6	2.6	1.4	1.4	1.5
Japan	5.2	4.6	4.9			
Sweden	2.0	2.3	1.9	0.8	0.2	0.4
UK – IRD[1]	18.3	18.6	17.2	3.4	5.2	6.2
USA	13.9	14.7	16.1	3.4	3.6	4.4
India[2] – ITD	**82.6**	**130.3**	**81.4**	**6.9**	**43.5**	**17.2**

Source: Tax Administration in OECD Countries: Comparative Information Series (2004)

[1] Arrears data used for computation relate to aggregate receivables as end – October for each year indicated, compared with annual net revenue collections for fiscal year.

[2] Net arrears in India comprise gross arrears minus arrears not fallen due, amounts claimed to have been paid pending verification, amounts for which instalment were granted and amount stayed/kept in abeyance. The figures have been taken from Audit Reports of Comptroller and Auditor General of India

Appendix 16
(Refer Para No.2.9.2)

Chapter-2
Efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act

Deduction in respect of industries in infrastructure development [Sec. 80IA]

Nature of Undertaking	Period of commencement of production		Quantum of deduction		Period of admissibility
	From	To	Company	Others	
1	2	3	4	5	6
1. Infrastructure facilities	1/04/95	Open ended	100%	100%	For 10 years out of first 15 years
2. Telecommunication services: Domestic Satelite Services	1/04/95	31/03/04	100% 30%	Not eligible	For initial 5 years Balance period of 5 years
(b) Other services viz. radio, paging, basic or cellular networking of trunking & Electronic data Interchange Service	1/04/95	31/03/04	100% 30%	100% 25%	For initial 5 years Balance period of 5 years
3. Industrial Park or special economic Zone	1/04/97	31/03/06	100%	100%	For 10 years out of 15 years
4. Power sector engaged in Generation or generation & distribution of power	1/04/93	31/03/06	100%	100%	For 10 years out of 15 years
b) Transmission or distribution of power	1/04//99	31/03/06	100%	100%	For 10 years out of 15 years

Appendix 17
(Refer Para No.2.10.2)

Eligible business/period/conditions of eligibility under section 80IB

Nature of Undertaking	Commences production during the period		Quantum of deduction		Period of admissibility
	From	To	Company	Others	
Manufactures/produces articles or things in areas specified in the Eighth Schedule					
If located in back-ward states No deduction w.e.f. AY 2004-05	01/04//93	31/03/04	100% 30%	100% 25%	For initial 5 years Balance period of 5 years (For Co-op. Society 7 years)
(b) If located in North –Eastern Region					
No deduction w.e.f. AY 2004-05	01/04//93	31/03/04	100%	100%	For 10 years
I A SSI undertaking:					
Located in back-ward districts –					
Category A	01/04//93	31/03/04	100% 30%	100% 25%	For initial 5 years Balance period of 5 years (For Co-op. Society 7 years)
Category B	01/10/94	31/03/04	100% 30%	100% 25%	For initial 3 years Balance period of 5 years (For Co-op. Society 9 years)
(ii) Located elsewhere	01/04/95	31/03/04	30%	25%	For 10 years (Co-op Society-12 years)
2. Manufactures/produces articles or things in areas other than those specified in eighth Schedule					
Only if located in backward States	01/04/93	31/03/04	100% 30%	100% 25%	For initial 5 years Balance period of 5 years (For Co-op. Society 7 years)
(b) A SSI undertaking: Located in backward districts: -					
Category A	01/10/94	31/03/04	100% 30%	100% 25%	For initial 5 years Balance period of 5 years (For Co-op. Society 7 years)
Category B	01/10/04	31/03/04	100% 30%	100% 25%	For initial 3 years Balance period of 5 years (For Co-op. Society 9 years)
(ii) Located elsewhere	01/04/95	31/03/02	30%	25%	For 10 years (For Co-op. Society 12 years)
An industrial Undertaking which is not a SSI, located in backward					

districts Category A	01/10/94	31/03/02	100% 30%	100% 25%	For initial 5 years Balance period of 5 years (For Co-op. Society 7 years)
Category B	01/10/94	31/03/02	100% 30%	100% 25%	For initial 3 years Balance period of 5 years (For Co-op. Society 9 years)
3. Cold storage plant					
(a) Located in backward districts-	01/04/93	31/03/04	100% 30%	100% 25%	For initial 5 years balance period of 5 years (For Co-op. Society 7 years)
(b) Located in backward districts-Category A	01/10/94	31/03/04	100% 25%	100% 25%	For initial 5 years balance period of 5 years (For Co-op. Society 7 years)
Category B	01/10/94	31/03/04	100% 30%	100% 25%	For initial 3 years balance period of 5 years (For Co-op. Society 9 years)
© Located elsewhere (only for SSI)	01/04/95	31/03/02	30%	25%	For 10 years (For Co-op. Society 12 years)
4. Hotel – in Specified Areas	01/04/97	31/03/01	50%	Not eligible	For initial 10 years
In Non-specified Areas	01/04/97	31/03/01	30%	Not eligible	For initial 10 years
5. Scientific Research & Development	01/04/00	31/03/04	100%	Not eligible	For initial 5 years
6.Mineral Oil: Commercial Production Located in North Eastern Region	Prior to 01/04/97	Open ended	100%	100%	For initial 7 years
(ii) Located elsewhere	01/04/97	Open ended	100%	100%	For initial 7 years
(b) Refining	01/10/98	Open ended	100%	100%	For initial 7 years
7. Construction & development of Housing project	01/10/98	31/03/05	100%	--	Till 31/03/2001
8. Operating cold storage facility for agricultural produce	01/04/99	31/03/04	100% 30%	100% 25%	For initial 5 years Next 5 years (Co-op society 7 years)
9. Handling, Storage and Transportation of Food Grains	01/04/01	Open ended	100% 30%	100% 25%	First 5 Years For next 5 years
10. Multiplex Theatre	01/04/02	31/03/05	50%	50%	For initial 5 years
11. Convention Centre	01/04/02	31/03/05	50%	50%	For initial 5 years

Appendix 18

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Nature of mistake	Excess claim of depreciation	Tax effect
Refer Para No.2.14.2: Depreciation on assets not owned by the asseessee						
1.	M/s Bhardwaj Construction Company Pvt. Ltd Hazari Bagh	2003-04 Summary	Business assets	Depreciation was claimed and allowed on assets not taken over by the assessee.	14.51	5.33
2.	M/s Apexa Software Pvt. Ltd Gandhi Nagar	2002-03 Summary	Car	Asset not owned by the assessee	0.59	0.19
Refer Para No.2.14.5: Depreciation against let out house property						
3.	M/s FFE Minerals Ltd, Chennai I	1999-00 Scrutiny 2000-01 Summary	Let out property	Incorrect allowance of depreciation against income from house property.	9.24 9.73	8.68
4.	M/s Meco Tronics Pvt. Ltd. Chennai III	1999-00 2000-01 Summary	Let out property	Incorrect allowance of depreciation against income from house property.	9.73 10.81	5.32
Refer Para No.2.14.8: Depreciation on sale and lease back transactions						
5.	M/s Thirunindra Narayanan Finance Pvt. Ltd. Chennai I	1999-00 Scrutiny 2000-01 Summary	Leased assets	Depreciation allowed on leased out assets.	189.02	72.13
6.	M/s Trident Finance Chennai I	1997-98 Scrutiny	-do-	-do-	132.89	57.14
7.	M/s Ind. Bank Merchant Banking Ltd. Chennai I	1997-98 Scrutiny	-do-	-do-	81.90	35.22
8.	M/s Kenzes foundation Chennai I	1997-98 Scrutiny	-do-	Depreciation allowed incorrectly in a sale and lease back transaction.	41.50	25.28
Refer Para No.2.14.20: Capital investment subsidies not deducted from cost						
9.	M/s R.K.B Cements Pvt. Ltd. and 5 others[1] Guwahati II	2000-01 to 2002-03 Summary/ Scrutiny	Business asset	Capital investment subsidies not deducted from cost	97.84	34.53
10.	M/s Satyam Steels and Alloys	2000-01 Summary/Sc	Business asset	Capital investment subsidies not deducted	81.13	28.39

1

Sl. No.	Name of the assessee	Assessment year	Tax effect
1.	M/s Borak Valley Alloys Pvt. Ltd.	2000-01 and 2001-02	2.72
2.	M/s Assam State Warehousing Corporation Ltd.	2001-02	12.88
3.	M/s Assam Air Products Pvt. Ltd.	2000-01	1.64
4.	M/s Assam Roofing Ltd.	2001-02	0.63
5.	M/s North East Gasess Pvt. Ltd.	2001-02	0.87

	Pvt. Ltd, Shillong	rutiny		from cost		
Refer Para No.2.14.22: Depreciation allowed on assets disposed off						
11.	M/s Kothari Beverages Pvt. Ltd, Baroda I	2002-03 Summary	Plant and machinery	Depreciation was allowed on plant and machinery disposed of	25.01	8.93
12.	M/s Gujarat Electricity Board Baroda I	2003-04 Summary	Building and vehicles	Depreciation allowed on Building and vehicles disposed of	22.94	8.43
Refer Para No.2.14.33: Mistakes in grant of additional depreciation						
13.	M/s Sree Mataliks Ltd. Bhubaneshwar	2003-04 Summary	Mini Blast Furnace	Expansion to Mini Blast Furnace acquired before 1 April 2002 was below 25 per cent.	90.85	36.85
14.	M/s Jalan Jee Polytax Ltd Gorakhpur	2003-04 Summary	Plant and machinery	Requisite Form 3AA not furnished	49.88	18.33
Refer Para No.2.14.36: Depreciation claim allowed on ineligible items						
15.	M/s Advanced Medicare & Research Institute Ltd Kolkata IV	1999-2000 to 2002-03 Summary	Leasehold land	Ineligible item	108.78	40.95
16.	M/s Ambuja Cement Eastern Ltd Kolkata IV	2000-01 Scrutiny 2001-02 2002-03 Summary	Leasehold land and surface right	Ineligible item	55.75	20.69
Refer Para No.2.21.3: Inconsistency in the treatment of "loose tools" and "moulds						
17.	M/s Thompson Consumer Electronics Chennai I	1996-97 Scrutiny	Loose tools	Depreciation claimed at 100 per cent was not restricted to 25 per cent treating the assets as plant and machinery in the year of consumption	14.54	13.39
18.	M/s Fennor India Ltd. Madurai I	2002-03 2003-04 Summary	Replacement of moulds	Depreciation claimed at 100 per cent was not restricted to 25 per cent treating the assets as plant and machinery in the year of consumption	6.63 28.68	12.68
Refer Para No.2.30.3: Depreciation incorrectly allowed on 'goodwill'						
19.	M/s Radam Media Pvt. Ltd. Chennai IV	2002-03 Summary	Goodwill	Depreciation was incorrectly allowed on goodwill treating as 'non competitive fee'.	28.33	5.53
20.	M/s Meltrek India Pvt. Ltd. Chennai III	2000-01 Summary	Goodwill	Depreciation was incorrectly allowed on goodwill treating as 'trade mark knowhow'.	8.50	3.28
Refer Para No.2.30.4: Depreciation on investment in shares and stock exchange membership fee						
21.	M/s Vinayak Equity Brokers India Pvt. Ltd. Indore I	2000-01 to 2002-03 Summary	M.P.Stock Exchange Membership Fee	Depreciation was incorrectly allowed.	4.63	2.04

Appendix 19
(Refer Para 2.14.4)
Assets not used in business

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year	Depreciation irregularly allowed	Tax effect
1.	M/s Bilaspur Castings Ltd Kolkata I	1997-98 to 2003-04 Summary	216.78	82.65
2.	M/s Tex Tools Ltd. Coimbatore II	2003-04 Summary	188.18	69.16
3.	M/s Galaxy Multimedia Pvt. Ltd. Mumbai-VIII	2001-02 Scrutiny	158.99	62.88
4.	M/s Utkal Moulders Ltd. Bhubaneswar	2000-01 Summary	69.47	34.78

Appendix 20
(Refer Para 2.14.18)
Mistakes in determination of actual cost or written down value of assets

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of Assessment	Nature of asset	Nature of mistake	Tax effect
1.	M/s SBI Home Finance Ltd. Kolkata III	1999-2000 to 2002-03 Summary	Different assets	Opening WDV was taken as Rs.4.97 crore instead of Rs.2.01 crore.	54.61
2.	M/s Roofit Inds. Pvt. Ltd. Central I Mumbai	1998-99 1999-00 Scrutiny	Buildings, Plant & Machinery, Equipments & Furniture	WDV of the asset was adopted as Rs.1704.38 lakh instead of Rs.1360.17 lakh	46.63
3.	M/s Hunter Snacks Pvt. Ltd, Chennai I	2001-02 Summary	Business assets	Opening WDV was incorrectly adopted.	38.11
4.	M/s Sarvaraya Sugars Ltd Central Hyderabad	2000-01 Scrutiny	Plant & machinery	WDV was not correctly adopted.	35.88
5.	M/s Black Thunder Theme Park, Chennai I	2000-01 Summary	Business assets	Opening WDV was incorrectly adopted.	33.79
6.	M/s Texprint Overseas Ltd. Kolkata III	2000-01 2001-02 2002-03 Summary	Plant & machinery	Additional amount of depreciation due to variation in exchange rate was calculated on the net book value instead of WDV.	32.23
7.	M/s Modern Denim Ltd, Jaipur II	1995-96 Scrutiny	Business assets	Incorrect adoption of written down value	27.10

Appendix 21

(Rs. in lakh)

Sl. No	Name of assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Rate of depreciation		Excess claim	Tax effect
				Admissible	allowed		
Refer Para No.2.14.25: Adoption of incorrect rates of depreciation							
1.	M/s Bank of Maharashtra Ltd, Pune-I	2001-02 Scrutiny	Electric Installation	10%	25%	215.13	85.08
2.	M/s Prax Air Carbondioxide Pvt. Ltd. Bangalore III	1999-00 Scrutiny 2000-01 2001-02 Summary	Gas Cylinder	25%	100%	62.83 45.08 34.50	52.99
3.	M/s Mardia Steel Pvt. Ltd. Ahmedabad Central	1997-98 Scrutiny	DCARC furnace	25%	More than 25%	114.34	45.94
4.	M/s Infrastructure Development Corporation Ltd, Chennai I	1999-00 2000-01 Scrutiny	Residential Building	5%	10%	101.27	45.26
5.	M/s Ashok Leyland Ltd. Chennai I	1998-99 Scrutiny	Building	5%	10%	115.72	38.57
6.	M/s L&T Western India Toll Bridge, Chennai I	2002-03 Summary	Buildings	10%	25%	45.49	37.15
7.	M/s DCM Financial Services Ltd, Delhi I	1996-97 Scrutiny	Buses/ Trucks in leasing finance	25%	40%	73.13	33.64
8.	M/s Gujarat Hotels Pvt. Ltd. Jabalpur	2000-01 Scrutiny 2001-02 Summary	Plant and Machinery	25%	More than 25%	68.71	33.04
9.	M/s Sayaji Hotels Ltd. Baroda III	2003-04 Summary	Hotel Building	10%	20%	81.35	29.90
10.	M/s Shri Satpuda Tapi Parisar SSK Ltd. Nasik I	1995-96 Scrutiny	Non-factory building used for residential purpose	5%	25%	31.59	27.48
11.	M/s Mysore Sales International Ltd. Bangalore III	1999-00 Scrutiny	Improvement to buildings on lease hold land	10%	100%	49.04	26.17
Refer Para No.2.14.27: Depreciation on assets used for less than 180 days							
12.	M/s Indapur Sahakari Sakahar Karkhana Ltd. Pune-I	2001-02 Scrutiny	Plant & Machinery	12.5%	25%	149.63	59.18
13	M/s Lloyd Engineering Ltd, Delhi II	2000-01 Scrutiny	Plants & Machinery	12.5%	25%	49.55	27.38
14	M/s Sadhu Singh Hamdard Trust Jalandhar	2000-01 2001-02 Scrutiny	Business assets	81.96	163.90	81.96	26.51

Appendix 22
(Refer Para No.2.14.30)
Excess carry forward of losses/unabsorbed depreciation

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT Charge	Assessment year	Excess set off	Tax effect
1.	M/s East Coast Breweries and Distilleries Cuttack	1995-96 to 1997-98 Scrutiny	57.73	81.90
2.	M/s Shriram chits & Investments Chennai Central I	2002-03 & 2003-04 Summary	--	80.21
3.	M/s Rajasthan Small Industries Corporation Ltd. Jaipur II	1996-97 Scrutiny	70.11	47.65
4.	M/s Milton Plastics Ltd. Mumbai II	1997-98 to 2000-01	159.00	57.55
5.	M/s Gujarat Inject Ltd Baroda I	1989-90 Best judgement	41.72	56.71
6.	M/s Om Oil & Flour Mills Ltd. Cuttack	2002-03 & 2003-04 Summary	74.74 74.66	54.12
7.	M/s Thiru Arooran Sugars Chennai III	1992-93 Scrutiny	64.02	47.71
8.	M/s. Orissa Extrusions Ltd, Cuttack	1998-99 Scrutiny	133.99	46.90
9.	M/s Varun Shipping Company Ltd. Mumbai V	1999-00 Scrutiny	521.00	43.35
10.	M/s Rayalaseema Hi-strength Hypo Ltd Hyderabad III	1999-2000 Scrutiny	106.83	37.39
11.	M/s Parental Drugs India Pvt. Ltd. Mumbai VII	2001-02 Scrutiny	56.14	30.64
12.	M/s Shree Rajasthan Syntex Ltd. Udaipur	2003-04 Summary	76.47	31.39

Appendix 23
(Refer Para No.2.14.39)
Mistakes in adoption of correct figures and errors in computation

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Excess deduction allowed	Tax effect
1.	M/s Madura Coats Ltd. Madurai I	1997-98 & 1999-00 Scrutiny	110.17 62.42	98.05
2.	M/s TVS Motor Company Chennai I	1999-00 scrutiny	78.64	53.48
3.	M/s Earnest Health Care Ltd Indore I	2000-01 Summary	106.95	41.17
4.	M/s Kapoor Rice and General Mills Moga (Punjab)	2002-03 Summary	75.07	26.80

Appendix 24
(Refer Para No.2.14.41)
Other miscellaneous mistakes

(Rs in lakh)

Sl No.	Name of the Assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of observation	Under assessment	Tax effect
1.	M/s R.D.B. Industries Ltd. CIT-Kolkata-I	2000-01 Summary	Depreciation relating to prior period was not added back	254.39	97.94
2.	M/s Shoppers Investment and Finance Co. Chennai	1991-92 to 1994-95 (Scrutiny and appeal revision)	CIT(A)'s directions for disallowing depreciation on assets acquired on "hire purchase" were not carried out.	170.13	97.83
3.	M/s AFCON Pauliny (India) Ltd, City VIII Mumbai	2001-02 Scrutiny	Book depreciation not added back correctly	51.72	29.25
4.	M/s State Bank of Travancore	1993-94 Scrutiny	Claim of depreciation on permanent security disallowed in original order incorrectly allowed in revision order	20.15	25.60
5.	M/s Bharat Hotels (P) Ltd Delhi I	2001-02	Depreciation incorrectly allowed on 'motor car' manufactured out of India and acquired by the assessee before 1 April 2001.	39.89	22.72
6.	M/s Kamal Packaging (P) Ltd, Kolkata-II	2002-03 Summary	Depreciation of earlier year was incorrectly claimed and allowed	59.41	21.21
7.	M/s Maharashtra State Oil Seeds Commercial and Industries Corporation Ltd. City I Mumbai	1990-91 Scrutiny r.w.s 250	Book depreciation not added back correctly	31.80	17.17
8.	M/s Pancharatna Cements (P) Ltd Jorhat (Assam)	2002-03/ Summary	Book profit worked out after adjusting depreciation as per Income Tax Act instead of Companies Act.	13.60	5.43
9.	M/s Artose Breweries Ltd Rajamundry (AP)	2000-01 Summary	Book depreciation not added back correctly	9.73	3.75
10.	M/s HTE Enterprises (P) Ltd, Moradabad	2003-04 Summary	Assessee claimed arrear depreciation of Rs.4.86 lakh.	4.86	1.79
11.	M/s Rajasthan State Handloom Development Corporation Ltd. Jaipur-I	2003-04 Summary	Depreciation as per Income Tax Act was allowed without adding back depreciation as per Companies Act	3.78	1.32

Appendix 25

(Rs in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Under assessment	Tax effect
Refer Para No.2.15.3: Irregular allowance of deduction on scientific research				
1.	M/s Soft Beverages Chennai III	2001-02 to 2003-04 Summary	63.35 43.52 16.69	60.93
2.	M/s Amoli Organics Ltd. Valsad (Gujarat)	2001-02 Scrutiny 2003-04 Summary	32.19 51.14	31.52
3.	M/s Shyam Telecom Ltd. Delhi	2000-01 Scrutiny	47.57	27.19
Refer Para No.2.15.6: Incorrect allowance of deduction together with depreciation				
4.	M/s I.T.C Ltd. Kolkata III	2000-01 & 2001-02 Scrutiny	236.52	92.35
5.	M/s Vera Laboratories Ltd. Hyderabad III	1998-99 to 2000-01 Summary	74.86	27.03
Refer Para No.2.16.3: Deduction without approval of prescribed authority				
6.	M/s Narula Corner House Delhi V	2001-02 Scrutiny 2002-03 & 2003-04 Summary	28.89	10.53
7.	M/s Nilgiri Dairy Farm Ltd. Bangalore III	1999-00 to 2002-03 Summary	13.90	5.27
8.	M/s Southern paper Products Pvt. Ltd. and two others[2], Ernakulam Central	1999-00 & 2001-02 Scrutiny	6.90	3.51
Refer Para No.2.16.6: Irregular/non-utilisation of reserve				
9.	M/s New Kenilworth Hotel Ltd. Kolkata III	2001-02 & 2003-04 Scrutiny 2002-03 Summary	102.93	38.08
10.	M/s Parikh Inn Pvt. Ltd. Kolkata III	1999-00, 2000-01 & 2001-02 Summary	70.92	34.05
11.	M/s Thomas Cook India Ltd. Mumbai-I	2001-02 Scrutiny	78.79	31.16
Refer Para No.2.16.9: Mistake in computation of eligible profit/deduction				
12.	M/s EIH Hotels Ltd. Chennai I	1996-97 & 1997-98 Scrutiny	31.80 140.04	76.7 6
13.	M/s Paradise Holidays Delhi V	2001-02 Scrutiny 2003-04 Summary	6.69 1.47	4.38

2

1.	M/s Air Travel Enterprises India Ltd. Trivandrum	2000-01 2001-02 Scrutiny
2.	M/s Avenue Hotel and Resorts Kochi	2001-02 Summary

Refer Para No.2.16.13: Deduction without setting off brought forward loss				
14.	M/s Hotel and Allied Traders Pvt. Ltd. Kochi	2002-03, & 2003-04 Summary	97.71	35.44
15.	M/s Sangu Chakra Hotels Pvt. Ltd. Trichy	2001-02 & 2002-03 Summary	12.51	7.88
Refer Para No.2.16.15: Other mistakes under section 80HHD				
16.	M/s Marudhar Hotels Pvt. Ltd. Jodhpur I	1997-98 Scrutiny	39.67	17.06
17.	M/s Hotel Leela Venture Ltd. Mumbai VIII	1996-97 Scrutiny	30.55	14.05
Refer Para No.2.21.8: Non compliance with judicial pronouncement				
18.	M/s Jabalpur Hatcheries Pvt. Ltd. Jabalpur I	2002-03 & 2003-04 Summary	93.11 77.65	61.78
19.	Shri V.N.Dubey Jabalpur I	2000-01 to 2003-04 Summary	33.48 35.03	27.49
Refer Para No.2.22.4: Double allowance of deductions under sections 35 (2) and 35 (2AB)				
20.	M/s Cipla Ltd. Mumbai-II	2003-04 Summary	93.74	34.45
21.	M/s USV Ltd. CC-XXXII Mumbai	2003-04 Summary	38.41	21.17
Refer Para No.2.26.3: Deductions under Chapter VIA without considering past depreciation				
22.	M/s Hotels and Allied Traders Pvt. Ltd Kochi	2002-03 & 2003-04 Summary	247.36	89.83
23.	M/s Sourth India Corporation Ltd. Kochi	2002-03 2003-04 Summary	88.55 131.12	81.98
24.	M/s Atco Research & Development Ltd Mumbai VI	2000-01, Summary 2001-02, Scrutiny 2002-03, Summary	75.09 56.32 42.24	66.26
25.	M/s Red Rose Textiles Industries Ltd Mumbai IV	2000-01 2001-02 Scrutiny	139.68 107.89	25.45
Refer para No.2.28.3: Irregular grant of depreciation without depreciation schedule				
26.	M/s Ores India Pvt.Ltd. Cuttack	2002-03 2003-04 Summary	160.99 134.59	119.72
27.	M/s Zen global Finance Ltd. Chennai	1998-99, Scrutiny 2000-01, Summary	128.82 36.38	57.82
Refer para No.2.32.2: Depreciation on WDV under Companies Act instead of Income Tax Act				
28.	M/s Orissa Tourism Development Corporation Bhubaneshwar	2000-01 2001-02 Summary	70.13	29.40

Appendix 26

(Rs in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of mistake	Irregular deduction allowed	Tax effect
Refer Para No.2.15.8: Other mistakes under section 35					
1.	M/s Ashapura Minechem Pune-I	2001-02 Scrutiny	Incorrect allowance of capital expenditure without verification by the auditor	161.57	63.90
2.	M/s Dhara Vegetable Oil and Foods Company Ltd. Baroda I	2003-04 Summary	Incorrect allowance of deduction u/s 35(I)(i), 35(I)(ii), 35(2)(ia) and 35(I)(iv) without fulfilling the prescribed conditions therein.	160.79	59.08
3.	M/s Teledata Informative Ltd. Chennai III	1998-99 to 2000-01 Summary	Assessee's business being software development, capital expenditure was incorrectly allowed as deduction on scientific research	431.17	50.86
Refer Para No.2.16.10: Deduction against ineligible business					
4.	M/s Thomas Cook (India) Ltd. Mumbai I	2000-01 Scrutiny 2001-02 Scrutiny	Money changing business was incorrectly treated as service provided to foreign tourists for allowing deduction u/s 80HHD.	60.78 83.29	60.99
Refer Para No.2.17.3: Irregular allowance of double deductions					
5.	M/s Venus Continental Pvt Ltd, City XI Mumbai	2000-01 Summary	While computing deduction under section 80HHF, profit and export turnover taken under section 80 HHC were not deducted.	49.59	19.09
6.	Ms. Puja Bhaganani City XI Mumbai	2000-01 Scrutiny	While computing deduction under section 80HHF, profits taken for deduction under section 80 I were not deducted.	8.74	3.06
Refer Para No.2.17.5: Mistakes in adoption of correct figures and errors in computation					
7.	M/s Mukta Art Ltd Central II Mumbai	2001-02 Scrutiny	Miscellaneous income and equipment hire charges of Rs.7.14 crore received by the assessee were not reduced from profits.	112.85	44.63
Refer Para No.2.17.7: Other miscellaneous mistakes under section 80HHF					
8	M/s M.V Exports Ltd. Chennai	2000-01 Scrutiny	Deduction was allowed under section 80-HHC instead of section 80-HHF, in the absence of requisite audit certificate	122.52	47.17
9.	Shri Chandrakant A. Mehta, Mumbai-I	1996-97 Summary	Deduction was allowed under section 80-HHF instead of section 80-HHC	42.93	27.69
10.	M/s PCM Sports India Pvt Ltd Hyderabad	2000-01 Summary	Deduction was allowed even though it did not involve any export or transfer out of India, of film software.	25.09	11.18
11.	Shri Budhadev Dasgupta Kolkata XIX	2001-02 Summary	Deduction was incorrectly allowed to an individual against the certificate meant for industrial undertaking	6.19	2.17

Refer Para No.2.18.26: Other miscellaneous mistakes under section 80IA					
12.	M/s Media Tronix Pvt. Ltd; Kochi	2003-04 Summary	Company did not use power in manufacturing process and employed only 18 workers instead of 20 workers as required.	16.04	6.63
13.	M/s Avon Meters Pvt. Ltd Chandigarh	2003-04 Summary	Commencement of production beyond specified period.	4.73	1.74
Refer Para No.2.19.6: Special provisions for small-scale industrial undertakings					
14.	M/s Schuing Selter India Pvt. Ltd. Chennai III	2000-01 to 2002-03 Scrutiny	Assessee was not an eligible small scale industrial undertaking for deduction	131.91	49.42
Refer Para No.2.19.15: Irregular deduction to business not located in approved backward areas					
15.	M/s Raghuraji Agro Industries Pvt. Ltd Faizabad	2001-02 Scrutiny	Location of business at Ambedkar Nagar was not in approved area	29.16	16.92
16.	M/s Kanpur Detergent & Chemicals Ltd Kanpur II	2001-02 Scrutiny	Location of business at Delhi was not in approved area	24.78	13.03
Refer Para No.2.19.18: Double deduction					
17.	M/s Kanam Latex Industries Pvt. Ltd Kottayam	2002-03 2003-04 Summary	Deduction under section 80IB was not reduced while computing deduction towards export profits.	86.19	34.39
Refer Para No.2.19.20: Other miscellaneous mistakes under section 80IB					
18.	M/s Malayala Manorama Company Ltd. Kottayam	2000-01 Summary	Inflation of eligible profits due to wrong apportionment of expenses. Besides, figures of deduction were not adopted correctly.	62.03	27.94
19.	M/s K.P Issac & Sons Kochi	2000-01 Summary	Hotel business was not approved by the prescribed authority	20.09	10.33
20.	M/s Utkal Asbestos Ltd, Bhubaneswar	2002-03 Summary	Inflation of eligible profits due to wrong apportionment of expenses	25.20	9.72
21.	M/s R.V.Nirman Pvt. Ltd, Hyderabad	2002-03 Summary	Production commenced before prescribed date of October 1998.	--	3.70
22.	M/s Spectrum Projects Pvt. Ltd, Bhubaneswar	2000-01 Summary	- do -	3.31	1.50
23.	M/s Him Metal Processing Pvt. Ltd. Himachal Pradesh	2003-04 Summary	Deduction was incorrectly allowed beyond the tax holiday period of 10 years	1.39	0.43
Refer Para No.2.24.2: Deduction on "duty drawback"					
24.	M/s Venus Continental (P) Ltd City XI Mumbai	2000-01 Summary	Duty drawback, sale of licenses etc. were not reduced from export profits.	72.35	27.86
25.	M/s C A Films Pvt Ltd City XI Mumbai	2000-01 Summary	Duty drawback was not reduced from export profits.	12.73	5.03

Appendix 27

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/Nature of assessment	Nature of income to be excluded	Irregular deduction allowed	Tax effect
Refer Para No.2.18.2: Irregular deduction allowed on ineligible business/other income					
1.	M/s Northern Strips Ltd. Delhi V	2001-02 Summary	Ineligible business of cutting and slitting of polyster film	218.18	86.22
2.	M/s Elastrex Polymers Ltd. Bangalore I	2000-01 2001-02 Summary	Income from manufacturing 'ruffer chappel' not an eligible business	165.18	64.36
3.	M/s Meghmani Organics Ltd. Ahmedabad II	2000-01 Scrutiny 2002-03 Summary	DEPB benefit of eligible unit	129.28	59.90
4.	M/s Regency Exports Pvt. Ltd/ Mumbai City-III	1996-97 Scrutiny	Income from designing production and export of cotton made ups and trading of goods manufactured by others	40.83	32.31
Refer Para No.2.19.3: Irregular allowance of deduction on other income to be excluded					
5.	M/s Kanam Latex Industries Pvt. Ltd, Kottayam	2002-03 Summary	Other income	--	55.95
6.	Jawand Sons Udey Complex Ludhiana III	2001-02 Scrutiny 2002-03 2003-04 Summary	Export incentive	111.35	46.22
7.	M/s Malayala Manorma Company Ltd, Kottayam	2003-04 Summary	Income relating to ineligible period where production started after prescribed date of 31 March of 1995.	118.13	45.80
8.	M/s Merck Limited Mumbai VI	2000-01 Scrutiny	Sale proceeds of DEPB	71.72	40.66
9.	(i) M/s N Sahewalla and Co. Ltd. Dibrugarh (ii) Dr. S.S.Malpani Jorhat	1997-98 1998-99 Scrutiny 1999-00 to 2001-02 Summary 1999-00 to 2000-01 Summary	Income from ineligible business of application of X-ray and ultrasonic machinery in medical clinic.	60.88	34.42
10.	M/s Himson Textile Engg. Ind. Ltd, Surat I	2003-04 Summary	Interest, rent and dividend not excluded	91.46	33.61
11	M/s Rohit Soap & Detergent Pvt. Ltd, Kanpur II	2000-01 2001-02 Scrutiny	Income from ineligible business	58.89	32.56
12.	Sh Tilak Raj Bedi Prop M/s Puneet Exports Inds Ludhiana III	2001-02 Scrutiny 2002-03 2003-04 Summary	Export incentive and Interest	71.71	30.33

Appendix 28

(Rs. in lakh)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Irregular deduction allowed	Tax effect
Refer Para No.2.18.8: Incorrect allowance of double deduction				
1.	M/s Metrochem Industries Ltd Ahmedabad I	1999-2000 Scrutiny	358.56	82.11
2.	M/s Sri Lakshmi Saraswathi Mills Ltd. Chennai III	1999-00 & 2000-01 Summary	153.85	73.55
3.	M/s Brakes India Ltd. Chennai I	2000-01 & 2002-03 Summary	167.64	61.85
4.	M/s Pioneer Niaggi Chemicals Madurai I	2002-03 & 2003-04 Summary	171.35	61.71
Refer Para No.2.18.15: Claims allowed without audit certificate				
5.	M/s Bajaj Motors Ltd Gurgaon	2001-02 2002-03 Summary	40.81 64.92	39.31
Refer Para No.2.18.21 Non-furnishing of separate accounts for separate units/divisions				
6.	M/s Bhagwati Rubber & Allied Products Ltd, Kanpur	2000-01 & 2001-02 Scrutiny	131.70	72.32
7.	M/s Alkem Labortories Ltd. Patna I	1997-98 & 1999-00 Scrutiny	108.06	41.28
Refer Para No.2.18.26: Other miscellaneous mistakes under section 80IA				
8.	M/s Magnum Power Generation Ltd. Delhi II	2001-02 Scrutiny	119.50	47.26
9.	M/s Sundaram Brake Linings Ltd Chennai III	1999-2000 Scrutiny	59.18	24.65
Refer Para No.2.19.13: Claims allowed without audit certificate under section 80IB				
10.	M/s P.K.Re-rolling Mills Pvt. Ltd. Kozhikode	2000-01 Summary	47.20	16.85
11.	M/s DSP Precision Products Ltd. Himachal Pradesh	2001-02 2002-03 Summary	14.53 8.16	8.66
Refer Para No.2.25.5: Inconsistent application of judicial decisions				
12.	M/s Patnaik Minerals Pvt. Ltd. Sambalpur	1997-98 1999-00 2000-01 2001-02 Scrutiny	44.84 23.90 20.34 28.76	52.36
Refer Para No.2.29.3: Non adjustment of depreciation before allowing deduction under section 80IA				
13.	M/s Reliance Industries Ltd Mumbai III	2001-02 Scrutiny	219.20	86.69
14.	M/s Cello Writing Instruments & Containers Pvt. Ltd, CC III Mumbai	1999-00 Scrutiny	167.04	51.49
15	M/s Cello Home Products CC III Mumbai	1999-00 Scrutiny	124.24	43.48
16.	M/s Diamond Cables Ltd. Baroda I	2001-02 & 2002-03 Scrutiny & Summary	98.97	40.49

Appendix 29

Chapter 3
Some aspects of non-resident taxation with reference to double taxation avoidance agreements

(Rs. in crore)

Sl. No.	Name of the assessee and charge	Astt Year & nature of assessment	Gist of observation	Tax Effect
Incorrect levy of tax on royalty income/fees from technical services (Para 3.11.5)				
1	M/s. Mazagaon Dock Ltd. as agent of Sudmash Russia DIT(IT) Mumbai	1998-99 Scrutiny	Technical fee was incorrectly taken at Rs.45.33 lakh instead of Rs.148.38 lakh as shown in TDS certificate.	0.67
2	M/s Adem Opel AG Germany DIT(IT) Mumbai	1999-00 to 2003-04 Scrutiny and Summary	-do-	0.31
3	M/s. Castrol Limited, U.K. DIT(IT) Mumbai	2001-02 Scrutiny	-do-	0.31
4	M/s. Drover International Belgium DIT(IT) Mumbai	2001-02 Scrutiny	Royalty was not taxed on gross basis.	0.22
5	M/s. Aditya Vikram Global Trading House Mauritius DIT(IT) Mumbai	2001-02 Scrutiny	-do-	0.18
6	M/s Unilever PLC DIT(IT) Mumbai	1996-97 Scrutiny	Tax was not levied on the gross interest receipt of Rs.1224.51 lakh.	0.14
7	M/s. Ciba Speciality Chemical Inc. Basle DIT(IT) Mumbai	2001-02 Scrutiny	Royalty of Rs.240.10 lakh received in November 1997 was offered to tax in assessment year 2001-02. This postponement resulted in loss of revenue, as reduced rate of 15% was levied instead of 20% applicable during the year when this income arose as per Indo-Swiss treaty	0.12
Incorrect application of MAT (Para 3.11.8)				
8	M/s. Larsen & Toubro Ltd. DIT(IT) Mumbai	1997-98 Scrutiny	DTAA relief of Rs.67.18 lakh was allowed from tax computed on income under section 115JA, which was not in order. Refund worked out to more than 10% of assessed tax and interest on refund was also incorrectly allowed	2.82
9	M/s. Hollandsche Aanneming Maatschappij BV (HAM) DIT(IT) Mumbai	1999-00 Scrutiny	Interest for defaults in payment of advance tax u/s 234B and for deferment of advance tax u/s 234C was allowed after considering MAT credit, which was not in order. This resulted in short levy of interest.	2.50
10	M/s. J P Morgan Chase Bank as successor of the Morgan Guarantee Trust of	2000-01 Summary	Provisions of section 115JA were not invoked and income was incorrectly computed at Rs.159.58 lakh under	0.09

	New York DIT(IT) Mumbai		normal provisions as per revised return instead of Rs.174.54 lakh under special provisions resulting in underassessment of income of Rs.14.96 lakh.	
11	M/s. Tecnimont SPA India Project DIT(IT) Mumbai	2003-04 Summary	Book profit under section 115JB was computed at 'nil' after allowing brought forward depreciation and business loss instead of allowing the lower of the two from the net profit of Rs.103.14 lakh. The resultant understatement of book profit was Rs.102.12 lakh	0.08
Incorrect computation of income (Para 3.11.9)				
12	Ballast HAM Dredging DIT(IT) Mumbai,	2001-02 Scrutiny)	Assessing officer disallowed hire rentals in respect of the vessel 'Sagar Manthan' paid to the Dutch principals as the same was inflated and was not made on the basis of arms length. However disallowance in respect of two other vessels, 'HAM 219' & 'HAM 309' having similar features and similar conditions was not made resulting in underassessment of income of Rs.11.21 crore	5.38
13	M/s. Boskalis International-Dredging International DIT(IT) Mumbai	2003-04 Summary	Credit for TDS of Rs.126 lakh was availed, whereas the related contract revenue was not offered to tax	1.26
14	Airline Rotables Ltd. (U.K.) DIT(IT) Mumbai	2000-01 Scrutiny	Taxable profits were calculated at 7.67% of gross receipts instead of 15% as discussed in the assessment order. This resulted in underassessment of income of Rs.263.09 lakh.	1.26
15	M/s. Haskoning Royal Dutch Consulting Engineers & Architects DIT(IT) Chennai,	1998-99 1999-00 Summary	Fee for technical services relatable to PE was not treated as business income	1.10
16	M/s Yamazen Corporation DIT(IT) Chennai	2000-01 to 2003-04 Summary and Scrutiny	Reimbursement of actual expenses incurred by assessee and reimbursed by their principals was not offered for taxation	0.94
17	C. Rajendran DIT (IT), Chennai	2000-01 Summary	Foreign currency income claimed irregularly as exempt.	0.91
18	M/s. American Express Bank DIT(IT) Mumbai,	1998-99 Scrutiny	Income of Rs.1.01 crore arising from sale of shares, which was held as 'stock in trade', was incorrectly taxed as long-term capital gain instead of business income.	0.89
19	M/s. Asia Today DIT(IT) Mumbai	2001-02 Scrutiny)	Assessee did not offer Rs.533.10 lakh being subscription revenues from April to June 2000, to tax.	0.80

20	M/s. International Nederlanden Bank, NV DIT(IT) Mumbai,	1997-98 Scrutiny	While setting of brought forward business loss of assessment year 1996-97 from the business income of assessment year 1997-98, loss of Rs.32.30 lakh under the head "capital gains" was incorrectly allowed in contravention of the provisions	0.38
21	Heat and Control Pty Limited DIT(IT) Chennai	1999-2000 to 2001-02 Summary and Scrutiny	Reimbursement of actual expenses incurred by assessee and reimbursed by their principals was not offered for taxation	0.31
22	M/s Royal Jordanian Airlines DIT(IT) Delhi	2000-01 Scrutiny	Interest on income tax refund not offered to tax.	0.15
23	M/s Foster Wheeler Pyro Power Inc DIT(IT) Chennai	1998-99 to 2000-01 Scrutiny and Summary	Reimbursement of actual expenses incurred by assessee and reimbursed by their principals was not offered for taxation	0.08
24	M/s Siemens Information and Communication Networks DIT(IT) Delhi	1999-00 Scrutiny	Revenue earned by assessee from imparting training at its facilities outside India was not offered to tax.	0.08
Mistakes in allowing credit for taxes paid abroad (Para 3.11.17)				
25	M/s Satyam Computer Services Company Ltd Hyderabad	1999-2000	Credit allowable on tax paid in USA worked out to Rs.2.24 crore (i.e. tax paid during last three quarters of calendar year 1998 and first part of calendar year 1999) as per procedure followed by the assessing officer during earlier and subsequent years as against Rs.2.48 crore allowed.	0.23
26	M/s Ficthner Consulting Equipment (I) Pvt Ltd Chennai I	2000-01 Summary	Refund was granted though tax was deducted in Japan	0.23
27	M/s Sri Lankan Airlines DIT(IT) Chennai	2000-01 Summary	Credits were afforded by the assessing officer though corresponding income was taxable only in Sri Lanka	0.02
Excess allowance of deduction in respect of head office expenditure (Para 3.13.1)				
28	M/s. Bank of Tokyo Mitsubishi Ltd. DIT(IT) Mumbai,	2001-02 Scrutiny	Deduction of head office expenses was allowed twice resulting in under-assessment of income of Rs.355.14 lakh.	2.46
29	City Bank NA DIT(IT) Mumbai,	2001-02 Scrutiny	Deduction u/s 44C for Head office expenses was allowed at Rs.3432.54 lakh instead of Rs.2990.63 lakh actually debited to the profit and loss account resulting in underassessment of income of Rs.441.91 lakh.	2.12
30	M/s. American Express Bank DIT(IT) Mumbai,	1999-00 Scrutiny	While rectifying the scrutiny assessment, though total income was reduced, deduction of head office expenditure was not proportionately reduced resulting in under assessment of income of Rs.224.47 lakh.	1.61

31	M/s. State Bank of Mauritius DIT(IT) Mumbai,	2003-04 Summary	The assessee's claim for deduction of Head office expenditure of Rs.122.24 lakh was allowed without restricting the same to Rs.78.77 lakh being 5% of total income resulting in underassessment of income of Rs.43.47 lakh.	0.18
Incorrect allowance of deduction in respect of bad and doubtful debts (Para 3.13.2)				
32	The Bank of Bahrain & Kuwait B.S.C DIT(IT) Mumbai,	2001-02, Scrutiny	Deduction on account of bad debts written off was allowed without considering balance of Rs.2.24 crore in provisions for bad and doubtful debts allowed resulting in under assessment of income.	1.54
33	M/s. American Express Bank DIT(IT) Mumbai,	1999-00, Scrutiny	While rectifying the scrutiny assessment, though total income was reduced, deduction on account of provision for bad and doubtful debts was not proportionately reduced resulting in underassessment of income of Rs.1.97 crore.	1.42
34	M/s. Dresdner Bank AG DIT (IT) Mumbai	2001-02 Scrutiny	Deduction on account of bad debts written off was allowed without considering balance of Rs.1.71 crore in provisions for bad and doubtful debts resulting in over assessment of loss of similar amount.	0.81
35	M/s.Bank of Nova Scotia, DIT(IT) Mumbai,	2001-02 Scrutiny	Deduction on account of bad debts written off was allowed by considering incorrect in provision for bad and doubtful debts resulting in underassessment of Rs.48.80 lakh.	0.65
36	Oman International Bank DIT (IT) Mumbai	2000-01 Order giving effect to appellate order	While allowing deduction for bad debts as directed in the appellate order, deduction of Rs.21.86 lakh allowed in the A.Y.1998-99 was not considered thereby resulting in excess deduction of bad debts.	0.11
Incorrect taxation of capital gains (Para 3.13.6)				
37	M/s May and Baker Ltd DIT(IT) Mumbai	2001-02 Scrutiny	Long term capital gains of Rs 49.66 crore taxed at 10 percent instead of applicable rate of 20 percent	20.05
38	M/s Hoechst A.G. Germany DIT(IT) Mumbai	2001-02 Scrutiny	Long term capital gains of Rs 142.86 crore taxed at 10 percent instead of applicable rate of 20 percent	7.15
Irregularities in deduction of TDS (Para 3.13.10)				
39	M/s PT Sambar Mitra Jaya DIT(IT) Chennai	2001-02 to 2003-04 Summary	TDS affected at lower rates applicable to resident assessees' instead of rates applicable to non residents resulting in short levy of tax and interest.	22.12
40	M/s Secit SPA Societa Ecologica Italiana DIT(IT) Chennai	1998-99 to 2001-02 Summary and Scrutiny	-Do-	16.55

41	M/s Kier International Ltd. DIT(IT) Chennai	1999-00 Scrutiny	-Do-	5.90
42	M/s Equipment Consultant Inc. DIT(IT) Chennai	1997-98 to 1999-00 Scrutiny and Summary	-Do-	4.62
43	M/s Seclat SA Project Office DIT(IT) Chennai	2002-03 to 2003-04 Summary	-Do-	1.75
44	M/s Sinar Jermih SDN DIT(IT) Chennai	2002-03 to 2003-04 Summary	-Do-	0.44
45	M/s Secit SPA Societa Ecologica Italiana DIT(IT) Chennai	1998-99 to 2001-02 Summary and Scrutiny	-Do-	1.32
46	M/s Haskoning Royal Dutch Consulting Engineers & Architect DIT(IT) Chennai	2000-01 to 2001-02 Summary	-Do-	0.15
47	M/s VSL Singapore (P) Ltd. DIT(IT) Chennai	2000-01 to 2001-02 Summary	Tax not deducted at source	0.04
48	M/s Kier International Ltd. DIT(IT) Chennai	2001-02 Summary	-Do-	0.03
Defaults in payment of advance tax (Para 3.13.11)				
49	M/s. Master Card International Inc , DIT (IT) Delhi	1997-98 and 1998-99 Scrutiny	Interest u/s 234B on short payment of advance tax was not levied.	1.14
50	The Hong Kong & Shanghai Banking Corporation Ltd. DIT (IT) Mumbai	2000-01 Scrutiny	Interest u/s 234C on deferment of advance tax was not levied.	1.08
51	M/s. Development Bank of Singapore Ltd. DIT (IT) Mumbai	1996-97 Scrutiny	While giving effect to appellate order of January 2003, interest u/s 234 B of Rs.20.97 lakh leviable up to the date of regular assessment was not levied	0.21
52	M/s. Galileo International DIT(IT) Delhi	2000-01 Scrutiny	-Do-	0.17
53	M/s. Lufthansa German Airlines DIT(IT) Delhi	2000-01 Scrutiny	-Do-	0.11
Mistakes in application of rate of tax in respect of foreign company				
54	Master Card International Inc DIT(IT) Delhi	1996-97 Scrutiny)	Tax levied at the rate of 48 percent instead of applicable rate of 55 percent	2.51
55	M/s. Doosan Heavy Industries & Constructions Co. Ltd. DIT (IT) Mumbai,	2001-02 Scrutiny	Income from turnkey project approved by Central Government computed at Rs.170.24 lakh u/s 44BBB was taxed at 15% instead of applicable rate of 48%.	0.75
56	M/s. State Bank of Mauritius DIT (IT) Mumbai,	2003-04 Summary	Business income taxed at rate applicable to Indian companies (35%) instead of the rates applicable to foreign companies (42%)	0.26

57	M/s Pirelli Cavie Systemi SPA, Italy, Hyderabad charge	2001-02 Scrutiny	Business income taxed at rate applicable to Indian companies (35%) instead of rates applicable to foreign companies (42%)	0.18
58	Dayanand V. Kamath, Mrs. Narmada Kamath and. George Andrews Ernakulam & Trivandrum	1999-2000 to 2003-04 Summary	Concessional rate of tax of 20% was levied on investment income, as against normal rates of 30%.	0.18
59	M/s Honeywell International Asia Pacific Inc DIT (IT) Delhi	1996-97 Scrutiny	Business income taxed at rate applicable to Indian companies (48%) instead of rate applicable to foreign companies (55%)	0.14
60	M/s. C.T. Environment Ltd. DIT (IT) Mumbai,	2001-02 Scrutiny	Profits and gains from business were taxed at 15% instead of applicable rate of 48%	0.14
61	M/s. Foster Wheeler Energy Ltd. DIT (IT) Mumbai,	2003-04 Summary	Surcharge was levied at 2.5 % instead of applicable rate of 5%.	0.07
62	Mrs. K.Mohammed DIT (IT) Mumbai	1996-97 & 1997-98 Scrutiny {143(3) rws 147}	In the reassessments completed for both the assessment years, DTAA benefits were not allowed to the assessee. However income was taxed at reduced rate as per the treaty instead of being taxed at normal rates.	0.06
Non-levy of interest for default in filing of return				
63	M/s Lotus Development Asia Pacific Pvt. Ltd. DIT(IT) Delhi	1999-2000 & 2000-01 Best Judgement	Interest not levied though return of income was filed beyond due date	73.24
64	M/s. Siemens Information and Communication Network DIT(IT) Delhi	1999-00 Summary	-Do-	2.76
65	M/s. Sheraton International Inc. DIT(IT) Delhi	1995-96 1996-97 1999-00 2000-01 Summary and Scrutiny	-Do-	2.45
66	M/s. Master Card International DIT(IT) Delhi	1998-99 Summary	-Do-	2.21
67	M/s. Ericsson Radio Systems AB DIT(IT) Delhi	1999-00 Summary	-Do-	1.83
68	M/s. Visa Services International Association DIT(IT) Delhi	1995-96 Summary	-Do-	1.12
69	M/s. Shin Satellite Public Co. Ltd. DIT(IT) Delhi	1998-99 1999-00 2001-02 Summary and Scrutiny	-Do-	0.95
70	M/s. Lucent Technologies International Inc. DIT(IT) Delhi	2000-01 Summary	-Do-	0.40

71	M/s. Sabre Inc. DIT(IT) Delhi	2000-01 Scrutiny	-Do-	0.39
72	M/s. United Airlines Inc. DIT(IT) Delhi	1999-00 2000-01 Summary	-Do-	0.38
73	M/s. GraceMac Corporation DIT(IT) Delhi	2001-02 Summary	-Do-	0.28
Incorrect application of exchange rates				
74	Lotus Development Asia Pacific Pvt. Ltd. DIT(IT) Delhi	1999-2000 & 2000-01 Best Judgement	Application of incorrect exchange rate and mistake in totaling.	12.59
75	Lucent Technologies International Inc. DIT(IT) Delhi	2000-01 Scrutiny	Application of incorrect exchange rate while computing taxable income.	3.04
76	Nokia Corporation DIT(IT) Delhi	2000-01 Scrutiny	Application of incorrect exchange rate while computing taxable income.	0.84

Ms Nandini Sr Ao.

Appendix 30

Mistakes in taxation of maritime business of non-residents (Para 3.12)

Rs in lakh

Sl No	Charge	No of cases	Nature of mistake	Tax effect
1	Kakinada and Vishakapatnam, Andhra Pradesh	11	Relief under Indo-Greece DTAA was erroneously allowed at the time of issue of NOC though the same was to be allowed only when assessees claimed in regular assessments under 172(7) of the Act.	23.66
2	Bhavnagar, Gujarat	20	Assessees were denied the benefit of tax relief by assessing officers under the charge of DIT(IT), Mumbai in March 2003, subsequent to which NOCs were being issued only after obtaining bank guarantees. However, the same was not being done in Bhavnagar, Gujarat charge which was irregular.	13.34
3	Madgaon, Goa	3	Demands relating to NOCs issued during 1999-2000 were still outstanding	6.06
4	Jamnagar, Gujarat	3	Tax levied based on tonnage indicated in charter agreements as against actuals carried by the assessee	2.88
5	Madgaon, Goa	1	Tax not levied though shipping profits were taxable in India	2.04
6	Jamnagar, Gujarat	1	DTAA relief incorrectly allowed for carriage of goods in coastal traffic	1.32