

**Report of the
Comptroller and Auditor General
of India
for the year ended March 2010**

**Performance Audit
of
Business of Civil Construction**

**UNION GOVERNMENT
(DIRECT TAXES)
NO. 12 OF 2011-12**

Laid on the table of Lok Sabha/Rajya Sabha on 2 June 2011



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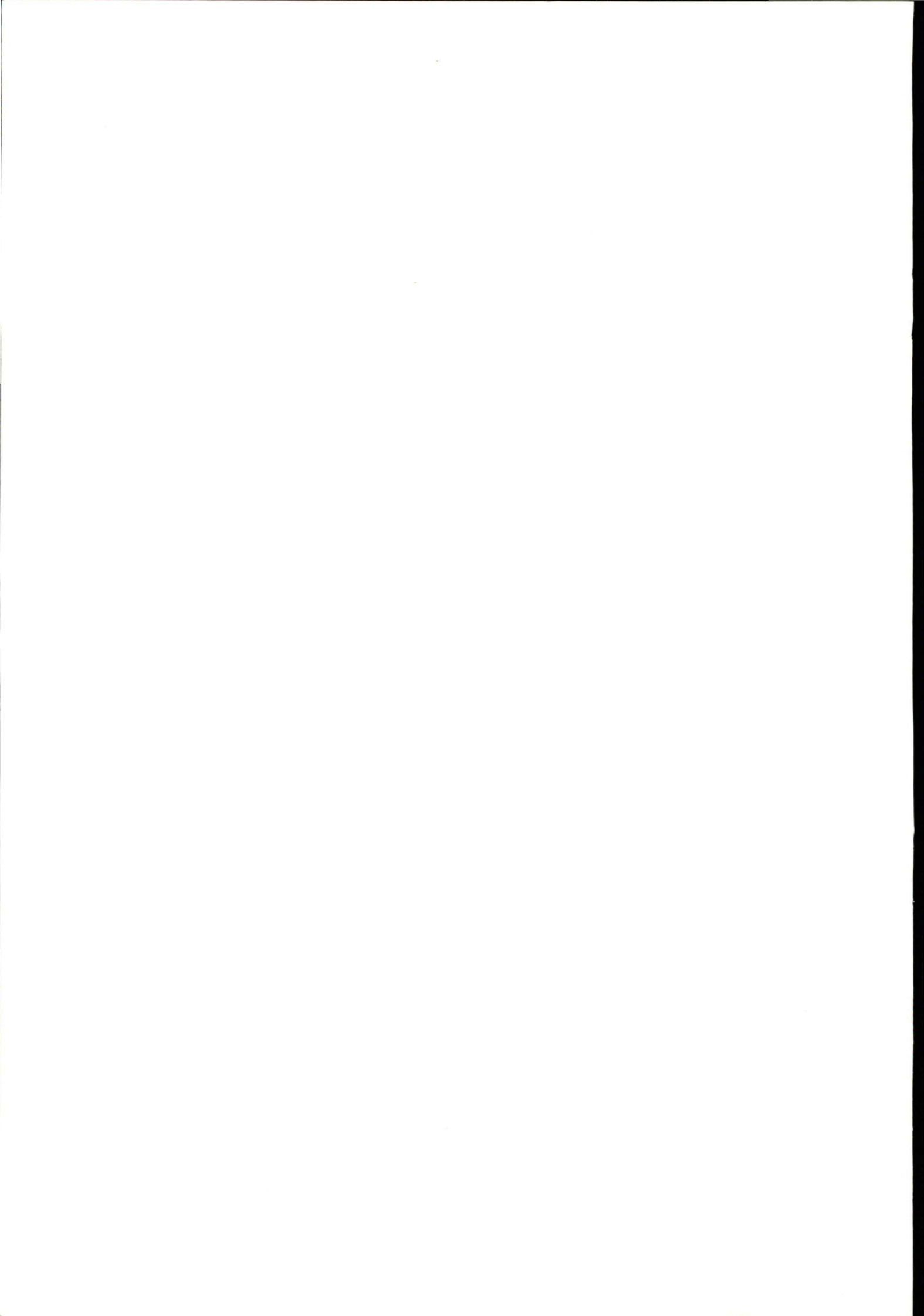


PREFACE

The Report for the year ended March 2010 containing the results of the performance audit of business of civil construction 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.

Our findings are based on mainly test audit conducted during the year 2010. Some findings of audit conducted in earlier years, but could not be covered in previous reports, have also been included.



Executive summary

EXECUTIVE SUMMARY

The construction industry has emerged as an important driver of India's economic growth – both in terms of its share of GDP and its contribution towards employment generation. A number of tax concessions are given to entities in this sector. An earlier performance audit conducted during the year 2002-03 by us revealed systemic and compliance deficiencies and several irregularities in assessment of entities in the sector.

The main objectives of our study were to ascertain whether the Income Tax Department has made significant efforts to widen and deepen the tax base in this potential area and ensured proper compliance of the provisions of the Act by the entities engaged in this sector.

An overview of the specific audit findings and key recommendations included in this Report is as follows:

Legal Framework (Chapter 2)

Audit Findings

Although Section 80IB(10) was introduced to incentivize building of housing for low and middle income groups, the Act did not provide for the conditions defining the low and middle income groups. Our analysis in West Bengal and Tamil Nadu charges indicated that residential construction projects targeting HIGs were availing the tax incentive, thereby frustrating the legislative intent behind it.

We noticed that a number of entities assessed in construction business were registered as firms/AOP with their turnover and profits comparable to some companies in the same sector. However, the provisions of MAT being applicable only to Companies, favoured the firms who could get away by paying nil or minimal tax.

Builders/developers are using Transfer of Development Rights (TDRs) for constructing extra floor space index (FSI) or selling them to other developers. In absence of TDS provisions, the department could not levy TDS on TDR transactions.

Builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/mobilization advances. In absence of proper mechanism on these payments there was material risk of the related receipts not being offered to tax.

Section 80(IB) allows deduction of profits to undertakings engaged in developing and building housing projects. This Section, however, does not disallow claims on conditions of non-deduction of TDS on certain payments unlike Section 40(a)(ia). Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed under Section 80(IB).

We found lack of clarity/uniformity on deduction/treatment of certain elements of income and expenditure like interest towards borrowed fund, income derived from leasing of properties held in stock in trade, sale of parking space and allowing TDS credit on mobilization advances etc.

Key Audit recommendations

We recommend that

- *A cap linked to Housing Pricing Index on the sale value of the flats constructed by the builders/contractors may be considered as a condition for claiming deduction under section 80IB(10) so that legislative intent of providing affordable housing is met.*
- *The purview of Section 115JB i.e MAT may be extended to Firms/AOP who are taking advantage of deductions available in the Act.*
- *CBDT may consider introducing suitable mechanism in the statute to reduce tax evasion in cases of TDR transactions and payments of compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/ mobilization advances to safeguard the interest of revenue.*
- *CBDT may issue necessary instructions for uniform treatment of income derived from leasing of properties held in stock in trade, income from sale of parking space and expenses on 'Interest on borrowed funds' and 'Directors' meeting fee/project management fee'.*

Internal controls (Chapter 3)

Audit Findings

The Department does not have a proper database of the assessee engaged in the business of civil construction. Non filers could not be identified by cross linking the records of the Department with that from third party sources as PAN details of the contractors engaged in the works departments were not available in most cases. The input controls on data capture of business codes in the central AST database of taxpayers were found to be weak, thereby hindering sectoral analysis and planning.

The bulk of the information collected by the CIB from third party sources were not being collated and disseminated to user levels. Further, there was no mechanism to ascertain the extent of use of disseminated data by the AOs.

We found that the Department was not initiating action against the erring statutory auditors for incorrect certification in their tax audit report.

Key Audit recommendations

We recommend that

- *The Department may prepare a complete and accurate database of assessee in the sector. It may also ensure that the data received by CIB is sorted out and disseminated promptly, enabling effective scrutiny and widening of the tax net.*
- *CBDT may devise a system to monitor compliance with the existing rules/instructions so that the department may initiate action against the erring statutory auditors.*

Information sharing and scrutiny (Chapter 4)

Audit Findings

Information and records on related assessee were found to be rarely shared and cross verified by the concerned AOs. In 15 cases, in absence of cross verification of records available with the AOs, income of ₹ 49.26 crore escaped assessment.

We found 256 cases involving tax effect of ₹ 83.54 crore in which income in the hands of TDS deductees escaped assessment due to short/non accountal of contract receipts, in their profit and loss accounts.

We noticed 220 cases of inadmissible claims involving tax effect of ₹ 469.10 crore on which TDS was not deducted or where deducted, was not remitted to the Government.

Key Audit recommendations

We recommend that

- *CBDT may issue necessary instructions for sharing of information regarding high value transactions among the concerned AOs to prevent leakage of revenue.*
- *CBDT may ensure that no TDS credits are allowed without quoting PAN of the deductee.*
- *CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with.*

Special provisions for civil construction (Chapter 5)

Audit Findings

Deductions admissible for housing projects under section 80IB(10) and for infrastructure development under section 80IA(4) were allowed even in cases where though the assesseees were not eligible to claim deductions as they were not fulfilling the conditions provided in the Act. We noticed mistakes in 142 cases involving tax effect of ₹ 326.38 crore indicating poor monitoring and lack of internal controls in assessments leading to inadmissible deductions.

Mistakes in assessments of Public Private Partnership projects were noticed in seven cases involving tax effect of ₹ 43.72 crore relating to depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting.

We also noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognized by applying the percentage completion method as Accounting Standard 7 as revised with effect from 2003.

Key Audit recommendations

We recommend that

- *CBDT may issue necessary instructions to monitor the deductions allowed for housing and infrastructure projects by providing suitable checks through internal audit.*
- *Assessing Officers may ensure that accounting treatment for ongoing construction projects commenced after April 2003 conform to Accounting Standard 7 as revised*

Omissions in assessments (Chapter 6)

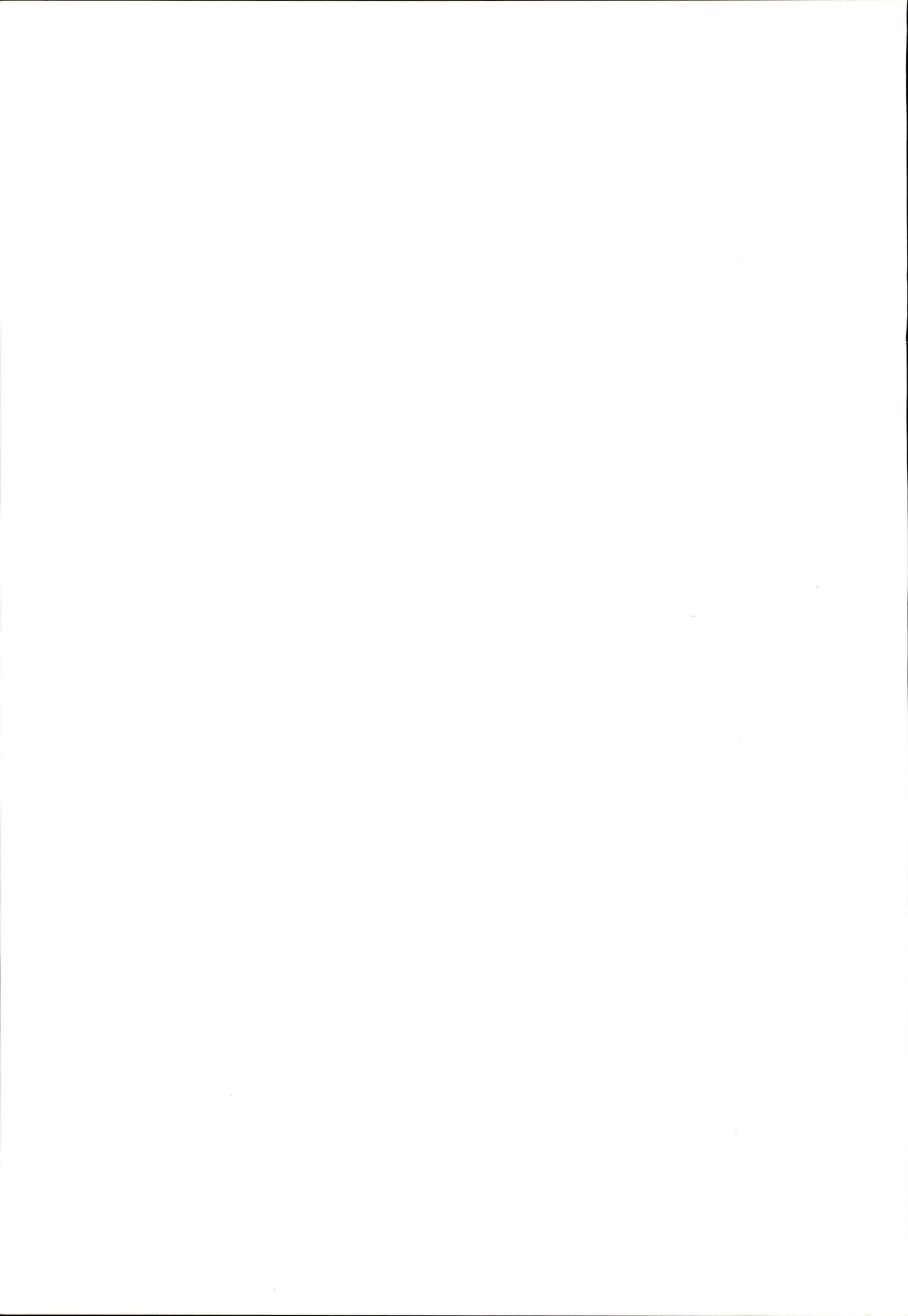
Audit Findings

We noticed mistakes relating to computation of business income, capital gains, income under MAT provisions, incorrect allowance of depreciation or setting off past losses, incorrect allowance of provision/liability, incorrect allowance of capital expenditure/non business expenditure, and incorrect valuation of closing stock etc. These mistakes involved aggregate tax effect of ₹ 642.44 crore in 675 cases.

Key Audit recommendations

We recommend that

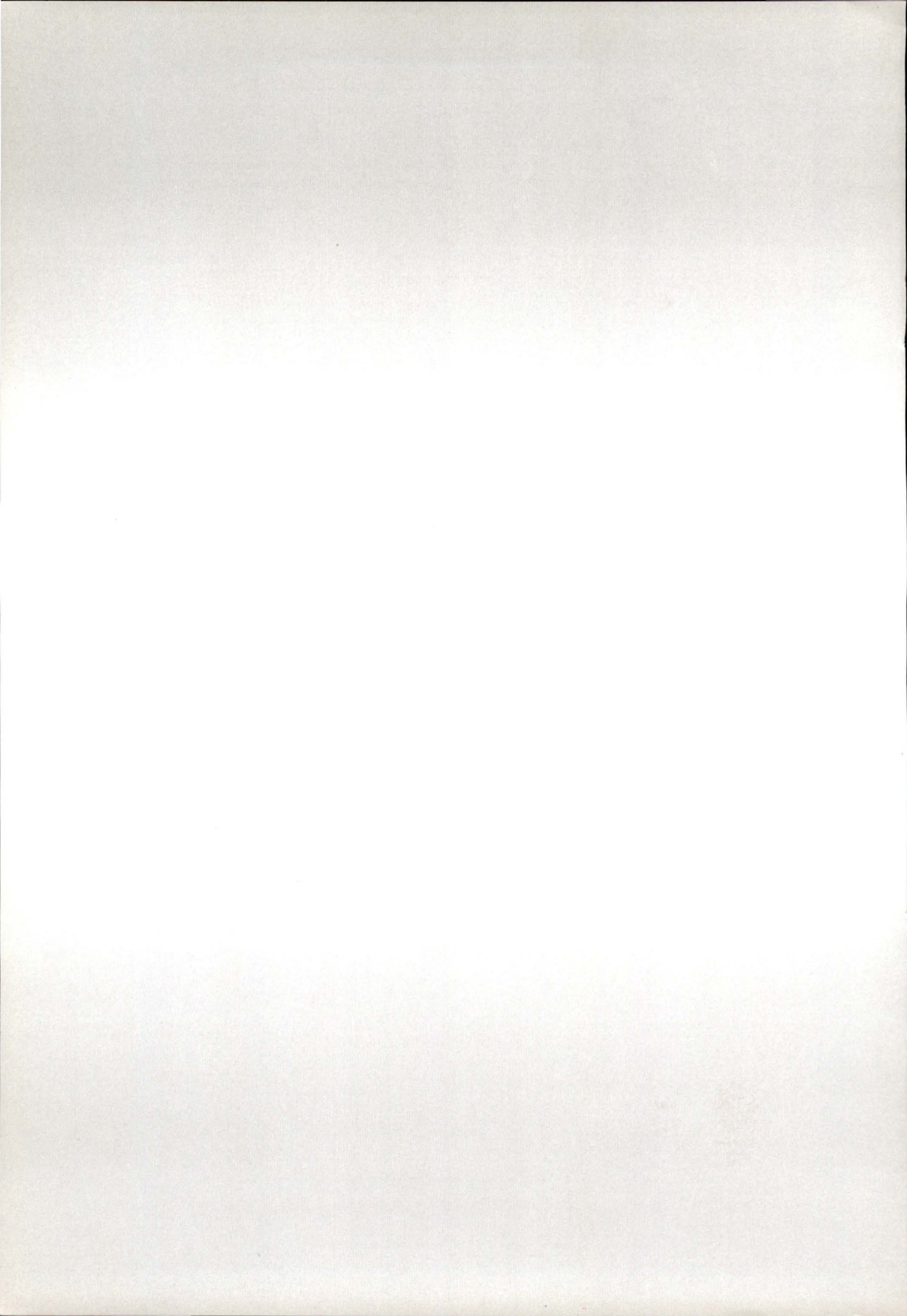
- *CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with. Wherever it is felt necessary the Department may also explore the possibility of capacity building for reducing the incidence of mistakes.*



CHAPTER 1

INTRODUCTION

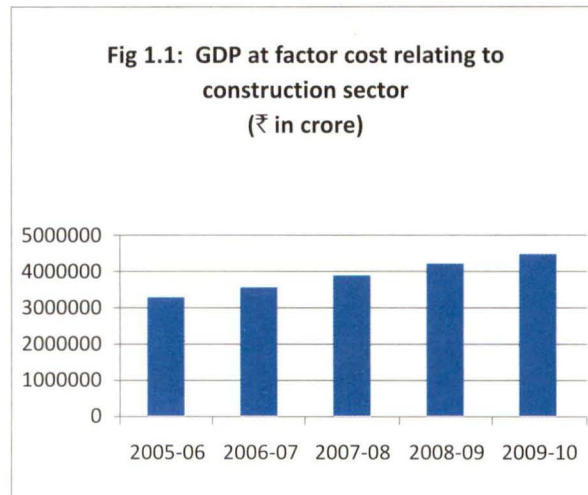
- **Why we chose the topic**
- **Legal Provisions**
- **Objectives of the review**
- **Scope of audit**
- **Acknowledgement**



CHAPTER 1

INTRODUCTION

1.1 India has emerged as the second fastest growing economy in the world.¹ The civil construction industry is not only an integral part of the economy but also a powerful engine of growth influencing the development path. It is poised for growth on account of industrialization, urbanization, economic development and people's rising expectations for improved quality of living. In India, construction is the second largest economic activity² after agriculture in terms of employment generation. The Eleventh Plan



document set the investment target on construction to nine percent of GDP by the end of the plan period. The total turnover in residential, commercial and infrastructure construction sector increased³ from ₹ 32,49,130 crore during 2005-06 to ₹ 44,64,081 crore during 2009-10 registering compound annual growth rate of seven per cent over the period.

1.2 Why we chose the topic

- There has been steady growth in construction activity since 2005-06 in spite of a brief slowdown in the housing sector in 2008-09.
- A number of tax concessions are given to entities in this sector.
- An earlier performance audit conducted by us for the year ending March 2003 highlighted absence of data base of civil contractors, the ineffective use of surveys to broaden the tax base, deficiencies in the 'Project Completion Method' of accounting adopted by the construction entities and several irregularities in assessments of civil contractors and builders. Since the review, the sector has grown manifold and much of the concerns pointed out by us continue to exist.
- There has been a rapid urbanization in India and upgradation of city infrastructure by regional and local governments.

Thus, the subject merited a performance evaluation.

¹ Finance Minister's Budget Speech 2009.

² Source: Report of the Working Group on construction, 11th Five Year Plan

³ Centre for monitoring of Indian Economy

1.3 Legal Provisions

Income tax assessment of entities engaged in civil construction are governed by general provisions for computation of income from business and specific provisions relating to deductions/ exemptions etc as laid out in the Income Tax Act 1961. The relevant provisions are summarized in Table 1 below:

Table:1 Relevant sections of the Income Tax Act			
General Provisions		Provisions specific to civil construction	
Section	Brief	Section	Brief
28 to 32	Computation of income from profits and gains of business or profession.	44AD	Special provision for computing profits and gains of business of civil construction etc.
36 & 37	Allowable deductions.	44AB	Audit of accounts of certain persons carrying on business or profession
40(a)(ia)	Amounts not deductible	80IA(4)	Deduction in respect of profits and gains from industrial undertaking or enterprises engaged in infrastructure development
40A(3)	Expenses or payments not deductible in certain circumstances	80IAB	Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of Special Economic Zone
50C	Special provision for full value of consideration in certain cases	80IB(10)	Deduction in respect of profits and gains from industrial undertaking or enterprises engaged in developing and building housing projects

1.4 Objectives of the review

The objectives of the review were to seek an assurance that:-

- All registered contractors including builders, who are liable to pay taxes are on the records of the Income Tax Department.
- The Income Tax Department has made significant efforts to widen and deepen the tax base in this potential area specifically to examine the effective utilization of information collected from transaction returns like the Annual Information Returns that are filed separately with the Department by different agencies.
- The Department has ensured proper compliance of the provisions of the Income Tax Act by the contractors/ builders/developers.
- The Department has been able to identify and plug lacunae or deficiencies in the administration of law or policy related to the above subject.

1.5 Scope of audit

1.5.1 Coverage

The review covered the assessments completed between financial years 2006-07 and 2009-10 and up to June 2010.

1.5.2 Sample

For audit coverage we selected 50 percent of the assessment units which are company circles and 30 percent of units other than Company Circles in metro charges. In non-Metro charges, we chose 30 percent of the company circles and 10 percent of other assessment units for audit scrutiny. Within a selected unit, all cases of scrutiny assessments were selected for examination. In case of assessments completed in a summary manner five percent of these were selected in audit at Metro charges and 10 percent in non Metro charges. In absence of assessment charge-wise database, we identified assesses engaged in the business of civil construction from the (Assessment Information System) AST⁴ data maintained by the DG (Systems) of the Department by selecting the relevant codes. We requisitioned 15,045 assessment records from the assessment units of the Department located all over India. However, the Department could produce 11,476 assessment records to us.

1.5.3 Constraints

The Department failed to provide 3,569 assessment records which were about 24 percent of records requisitioned by audit. The level of non production ranged from 31 percent to 51 percent in Uttar Pradesh, Orissa, Jammu & Kashmir and Maharashtra charges. Thus, our selection of assesses for study remained confined to the limited assessee data. Non production of records by certain charges despite repeated requests was a matter of concern.

1.6 Acknowledgment

1.6.1 An entry conference was held with CBDT on 19 March 2010. The audit objectives, scope and the main focus areas of audit examination were explained in the meeting. The Indian Audit and Accounts Department acknowledges the cooperation of the Income Tax Department in facilitating the audit.

1.6.2 The exit conference was held (June 2011) with the Ministry/Board wherein the Report was discussed. The views expressed by the Ministry/Board in the exit conference have been suitably incorporated in this Report.

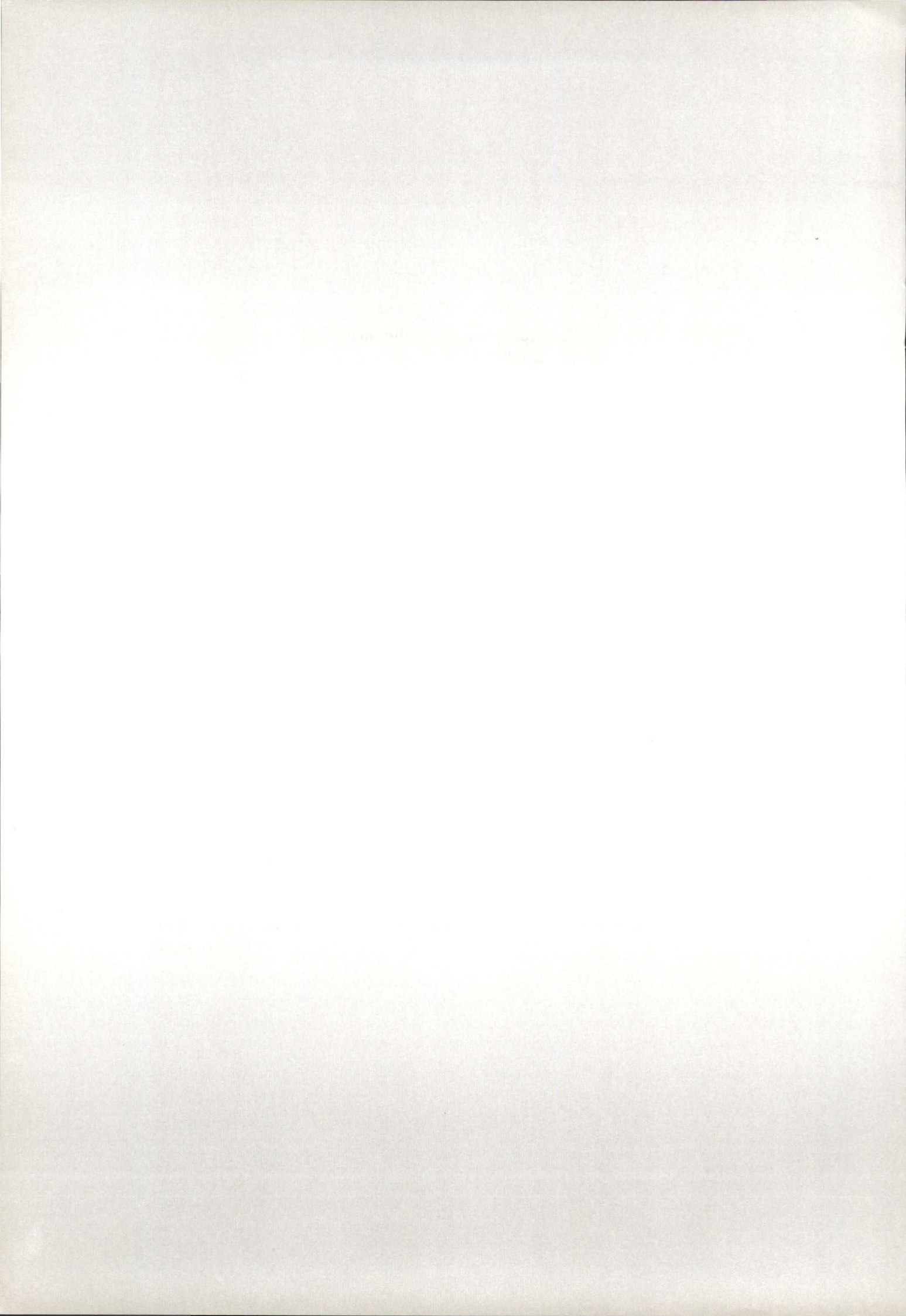
⁴ One of the modules of the applications software used by the IT department for assessment of income tax returns of assessee. The process starts with entering the returns received from assesses into the system.



CHAPTER 2

LEGAL FRAMEWORK

- **Admissibility of fiscal incentives**
- **Non applicability of MAT on Firms/AOPs**
- **Absence of TDS provision on compensation paid**
- **Transfer of Development Rights (TDR)**
- **TDS on payment of mobilization advances**
- **Inconsistency in provisions**
- **Lack of clarity in provisions**
- **Assessment of Housing Development Authorities/
Boards**
- **Recommendations**



CHAPTER 2

LEGAL FRAMEWORK

Following inconsistencies in the Act have been discussed in this chapter.

- The objective of introduction of the benefits under section 80IB(10) was to build housing for low and middle income groups. The Act did not provide for the conditions defining the low and middle income groups for the purpose of allowing the deduction under section 80IB(10). We observed that in West Bengal charge, in three housing projects, more than 50 percent units were earmarked for HIG whereas in Tamil Nadu charge, in four projects, around 50 percent flats measuring less than 1500 square feet were sold for ₹ 40 lakh or more. Thus, the legislative intent behind introduction of the scheme has not been achieved.
- MAT was introduced to ensure that the registered companies earning huge profits and declaring substantial dividends to its shareholders but not contributing to the Government by way of corporate tax, pay at least certain percentage of book profit as MAT. We noticed that a number of entities assessed in construction business were registered as firms/AOP with their turnover and profits being comparable to some companies in the same sector got away by paying nil or minimal tax as MAT provisions are not applicable to them.
- Builders/developers are using Transfer of Development Rights (TDRs) for constructing extra Floor Space Index (FSI)⁵ or selling these TDRs to any other persons. In absence of TDS provisions, the department could not levy TDS on TDR transactions.
- Builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/payment of mobilization advances. There is no provision in the Act to collect TDS on these payments leaving the risk of the related receipt not being offered to tax.
- Section 80(IB) allows deduction of profits to undertakings engaged in developing and building housing projects. This Section, however, does not provide for any disallowance of corresponding amount that is disallowed under Section 40(a)(ia) when TDS is not deducted against certain payments. Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed

⁵ Ratio of the total floor area of buildings to the size of the land.

under Section 80(IB), thereby defeating the purpose of the introduction of the former section.

- We found lack of clarity on deduction/treatment of certain elements of income and expenditure like interest towards Borrowed Fund, income derived from leasing of properties held in stock in trade, sale of parking space & allowing TDS credit on mobilization advances etc.
- Exemption allowed to Housing Development Authorities under section 10(20A) was withdrawn with effect from 1 April 2003. We noticed that these entities were trying to avoid tax by claiming exemptions incorrectly.

2.1 It is essential that the legal framework governing the computation of income and eligibility for deductions/exemptions from business of civil construction ensures that correct income from business is brought to tax. The Income Tax Act lays down certain responsibilities in terms of declarations and audited statements that are to be submitted by the assessee along with the returns. During the course of the review, we found certain gaps and inconsistencies in the legal framework that needed to be addressed to ensure that income from business of civil construction is properly brought to tax. These inconsistencies have been discussed in this Chapter.

2.2 Admissibility of fiscal incentives

The objective of introduction of the benefits under section 80IB(10) in 1999 was to build housing stock for low and middle income groups. While conditions for admissibility of special deductions from income assessed were laid down in terms of size of built up property, proportion of commercial area, size of plot etc., the Act, however, did not provide for the conditions defining the low and middle income groups for the purpose of allowing the deduction under section 80IB(10).

Our small sample analysis revealed that in West Bengal charge, in three housing projects that availed of tax benefits, more than 50 percent units were earmarked for HIG whereas in Tamil Nadu charge, in four projects, around 50 percent flats measuring less than 1500 square feet were sold for ₹ 40 lakh or more. Thus, the legislative intent behind introduction of the special provisions was not being met.

2.3 Non applicability of MAT on Firms/AOPs

2.3.1 The concept of MAT was introduced under section 115JB of the Income Tax Act to ensure that companies having huge profits and declaring substantial dividends to its shareholders but not contributing to the Government by way of corporate tax by taking advantage of various exemptions and deductions provided in the Act, pay at least certain

percentage of book profit as MAT. However, the said provision is not applicable for Firms/AOPs.

2.3.2 We noticed that a number of construction entities were registered as firms⁶/ AOPs and the turnover and profits of some of these entities were comparable to Companies of similar size. However, the MAT provisions being inapplicable to these entities, the revenue collected from their business was low. A comparison between the firms and Companies test checked in Mumbai is given in Table 2 below:

(₹ in crore)

Table:2 Cases of non applicability of MAT on Firms

Firm				Company			
Name / AY	Net profit as per P&L account	Tax paid Under normal provision	Tax that would have been due as per MAT	Name/ AY	Net profit as per P&L account	Tax due as per normal provision	Tax paid as per MAT
M/s Dosti Associates 2007-08	14.60	0	1.64	M/s Lavina Estates Pvt Ltd 2007-08	15.37	0	1.75
M/s Jain Associates 2007-08	10.74	0.08	1.20	M/s Emerald Realtors Pvt Ltd 2007-08	8.69	0	0.97

2.3.3 We found in Mumbai charge that deductions under section 80IB(10) aggregating ₹ 295.37 crore were allowed in case of assessments of 66 partnership firms/AOP (Joint Ventures). As these deductions formed a major portion of taxable income of these firms, they got away by paying nil or minimal tax and Government could not collect revenue from them despite comparable profits from their business. The revenue implication of non applicability of MAT provisions to firms amounted to ₹ 24.87 crore.

2.4 Absence of TDS provision on compensation paid

Under TDS provisions, collection of tax is effected at source when income arises or accrues. The builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract. Such compensation is paid over and above refunds of any money paid by the concerned allottees/tenants, etc in view of more lucrative propositions. There is no provision in the Act to collect TDS on these payments leaving the risk of the related receipt not being offered to tax.

⁶ Section 4 of The Indian Partnership Act 1932 defines 'partnership' in a commercial entity. It has limited legal identity for the purpose of tax law.

We noticed 12 cases of the above nature during test check of records at various charges. These included seven cases in Mumbai where compensation of ₹ 445.52 crore was paid on account of redevelopment. In absence of TDS provision on these transactions potential tax of ₹ 46.18 crore could not be realized. An illustration is given below:

2.4.1 Charge: CIT-IX Mumbai, AY 2007-08

M/s Agromach Spares Corporation booked commercial premises on part payment of ₹ 3.05 crore in a building proposed to be developed by M/s Axis Realty Pvt. Ltd. The developer, in view of a better offer by a different party requested the assessee Company to surrender its allotment rights in the said property. As per agreement (January 2006), the assessee agreed to surrender its rights in the above property and the developer M/s Axis Realty Pvt. Ltd paid ₹ 3.60 crore to the assessee as compensation over and above the refund of booking amount as per agreement. We verified the records of the assessee, M/s Agromach Spares Corporation and found that the commercial compensation received from M/s Axis Realty was not accounted for in its accounts resulting in escapement of income involving tax effect of ₹ 1.21 crore.

2.5 Transfer of Development Rights (TDR)

When land is acquired for public amenities like roads, gardens, schools, markets, etc. by Municipal Corporations, the owner of the land is often granted a Development Rights Certificate (DRC) instead of monetary compensation. This DRC is transferable and can be sold in the market and such transactions are commonly referred to as TDR⁷. The plot where TDR is created is called the 'originating plot' and the plot where the TDR is actually used is called the 'receivable plot'. It indicates the FSI credit in square meter of the built-up area to which the owner or lessee of the reserved plot is entitled, the place and user zone in which the development rights are earned, and the areas in which they may be utilised. TDR can be utilised by the original recipients or transferred to any other person. When the DRC holder intends to transfer it to another individual, he must submit the DRC to the Municipal Commissioner with an appropriate application for endorsement of the new holder's name on the certificate, without such an endorsement, the transfer will be invalid and the certificate will continue to be in the name of the original holder. A TDR transaction is entered into by the concerned parties at a mutually agreed price. Presently, there is no provision of TDS on TDR transactions.

⁷ Under a transfer development rights system, a landowner whose property is restricted to open space is assigned development rights in proportion to some overall desirable density for the jurisdiction. The landowner may either utilize the rights or sell them in the open market to landowners in other locations who are allowed to develop their properties. The rights may be used to develop additional structures on the unrestricted properties. In this way, restricted areas may be maintained as open space without completely destroying the development value of the properties.

The builders/developers are using TDRs for constructing extra floor space index (FSI)⁸. However, the state authorities (sub-registrars) have refrained till date from determining the fair market value of TDR units. As no ready reckoner rates (division wise) were available, the genuineness of values declared on TDR transactions could not be ascertained.

It was also difficult to know whether the corresponding income was being offered by the TDR transferor/seller as there was no provision for TDS on TDR transaction.

2.5.1 We noticed eight cases in Mumbai charge where expenditure aggregating ₹ 128.93 crore on account of TDR was allowed. The department could not levy TDS⁹ of ₹ 2.57 crore in absence of TDS provision for TDR Transaction. An illustration is given below:

2.5.2 Charge: CIT, Central II, Mumbai, AY 2007-08

M/s K. Raheja Corporation Pvt. Ltd. was allowed expenditure of ₹ 76.45 crore on account of cost of TDR. Due to absence of provision of TDS on TDR, tax of ₹ 1.53 crore (calculated at the minimum TDS rate of 2%) in the hands of the transferors of development rights could not be realized.

2.6 TDS on payment of mobilization advances

The Board¹⁰ had prescribed that credit of tax deducted at source from advance rent will be allowed in proportion in which such income is offered for taxation for different assessment years based on a single certificate furnished for tax deduction. However no such clarification has been issued for similar transaction of tax deducted on mobilization advances¹¹ given to contractors. Tax credit shall not be given on mobilization advances as these do not form part of income. We noticed 3 cases of incorrect credit allowed for mobilization advances involving tax effect of ₹ 16.12 crore.

An illustration is given below:

2.6.1 Charge: CIT V Mumbai, AYs 2005-06 to 2007-08

M/s Essar Construction Ltd claimed and was allowed TDS credit of ₹ 14.33 crore on mobilization advance/progressive payments incorrectly as the corresponding income was not offered to tax during the assessment years under consideration. Further, interest of ₹ 0.75 crore granted on above TDS credit was also not in order. This resulted in tax effect of ₹ 15.08 crore.

⁸ Ratio of the total floor area of buildings to the size of the land.

⁹ TDS has been worked out at the minimum rate of 2%.

¹⁰ Circular No.5 dated 2 March 2001

¹¹ Advances given to contractors to make arrangements for mobilization of men, material and machinery at the project site.

2.7 Inconsistency in provisions

As per Section 40(a)(ia) of the Act, certain payments, in respect of which TDS was not deducted/remitted, shall not be allowed as deduction when computing the income chargeable under the head 'profits and gains of business or profession'. Section 80(IB) of the Act, on the other hand, allows hundred per cent deduction of profits to undertakings engaged in developing and building housing projects under certain conditions. This Section, however, does not provide for any disallowance of corresponding amount that is disallowed under section 40(a)(ia) when TDS is not deducted against certain payments. Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed under section 80(IB), thereby defeating the purpose of the introduction of the former section.

We noticed two cases relating to this inconsistency in provisions mentioned above involving tax effect of ₹ 8.50 crore. An illustration is given below:

2.7.1 Charge: CIT III, Chennai AY 2006-07

In the assessment of **M/s. Shriram Properties Ltd.**, we found out that ₹ 23.79 crore was disallowed under section 40a(ia) and added back to the income. Deduction under section 80 IB (10) was, however, allowed to the corresponding extent of ₹ 23.79 crore involving potential revenue impact of ₹ 8.01 crore.

2.8 Lack of clarity in provisions

We noticed that there was lack of clarity in instructions relating to treatment of certain elements of income and expenditure for the purpose of allowing deductions/exemptions. As a result we found similar issues being treated differently by Assessing Officers.

2.8.1 Income derived from leasing of properties held in stock in trade

The properties held in stock in trade by the builders and developers were being given on rent and rental income was being classified under the head income from house property to get benefit of additional deduction of 30 per cent. The treatment was incorrect as the income was being derived from properties held in stock in trade, a business asset and resulted in excess allowance of deduction of 30 per cent.

We noticed four cases in Mumbai charge of the above nature with consequent underassessment of income of ₹ 8.52 crore with tax effect of ₹ 2.98 crore. Two illustrations indicating divergent views taken by the department are given below:

2.8.1.1 Charge: CIT (Central) II, Mumbai, AYs 2005-06 to 2008-09

M/s K. Raheja Pvt Ltd offered income from leasing of buildings constructed by him and shown in the closing stock as income from house property and claimed 30 per cent deduction available under provisions of house property income. Lease rent from stock in trade properties was not treated as business income resulting in underassessment of income of ₹ 4.35 crore involving short levy of tax of ₹ 1.53 crore.

2.8.1.2 Charge: CIT (Central) II, Mumbai, AY 2007-08

M/s Rockfort Estate Development offered income from leasing of buildings constructed by him and shown in the closing stock, as income from house property and claimed 30 per cent deduction available under provisions of house property income. The Department assessed the income as income from business. However, in earlier year, said income was assessed as income from house property. This resulted in underassessment of income of ₹ 1.82 crore involving short levy of tax of ₹ 0.64 crore.

2.8.2 Income from sale of parking space

Parking space does not form part of either the maximum built up area of the residential unit or the permissible commercial establishment for allowing prescribed condition for allowing deduction under section 80IB(10).

The Act is silent on the allowance or disallowance of this deduction towards sale of parking space.

2.8.2.1 We noticed seven cases in Goa, Mumbai, Pune and Thane charges where AOs allowed deduction in four cases and disallowed in remaining three cases against sale of parking space. Thus, there was no uniformity in treatment of such income. An illustration is given below:

2.8.2.2 Charge: CIT Goa, AY 2007-08

M/s Devashri Real Estate Developers was allowed deduction of ₹ 67.90 lakh under section 80IB(10) towards sale of space for car parking. Since the sale of car parking with profit motive amounts to commercial activities, deduction allowed under section 80IB (10) was incorrect involving short levy of tax of ₹ 0.23 crore.

2.8.3 Treatment of certain expenses

Due to lack of clarity on treatment of expenses on 'Interest towards the Borrowed Fund' and 'Directors' Meeting Fee', we found different treatment of claims of the same assessee in Delhi charge in two consecutive assessment years. Two cases are illustrated below:

2.8.3.1 Charge: CIT Central-I Delhi, AY 2007-08

In the assessment of **M/s Ansal Properties and Infrastructure Ltd.**, the expenses on 'Interest towards the Borrowed Fund' and 'Directors' Meeting Fee' were proportionately disallowed and debited to the Profit and Loss account of the project eligible for deduction u/s 80IB(10). This reduced the profit eligible for deduction. However, this treatment was not followed in the earlier assessment year 2006-07, for the same assessee.

2.8.3.2 Charge: CIT IV Delhi, AY 2007-08

The instructions on treatment of project management fees were found to be ambiguous resulting in different treatment by AOs.

In the assessment of **M/s Gulab Farms Pvt. Ltd.**, the AO disallowed ₹ 1.59 crore booked as 'Project Management Fees', treating it as expenditure of capital nature. We

found that the expenditure under same head with same contents was allowed by another Assessing Officer of Circle-7(1) under CIT III charge, in the case of **M/s Sweet Peas Farms Pvt. Ltd.**, in the same assessment year.

2.9 Assessments of Housing Development Authorities/Boards

Exemption allowed to an Authority constituted for the purpose of providing housing accommodation or for the purpose of planning, development or improvement of cities, towns under section 10(20A) was withdrawn with effect from 1 April 2003. One of the major implications of this amendment was that all entities covered under the erstwhile Section 10(20A) would be required not only to pay Income Tax but also to file returns, be subject to tax audit u/s 44AB and to maintain proper books of accounts as stipulated in Section 44AA.

Test check of 22 cases of Housing Developing Authorities/Boards revealed that there was no uniformity in the assessments of Housing Development Authorities. Four illustrations are given in Table 3 below:

(₹ in crore)

Sl. No.	Name of Housing Authority/ CIT charge	AY	Status of exemption claim after withdrawal of admissibility under section 10(20) with effect from 2003.	Audit comments	Tax effect
1	Delhi Development Authority Trust Circle II Delhi	2003-04 to 2007-08	Assessee applied for exemption as a charitable trust in March 2003 which was denied by DIT (Exemption) but on appeal before ITAT, the same was allowed in January 2006 with	Department neither went in for further appeal against ITAT decision nor finalized assessment proceeding. In December 2008, the department sought a	N A

			retrospective effect from 01 April 2002.	special audit of the accounts of the DDA under section 142(2A) of the Act due to complexities of accounts. The High Court issued a stay order.	
2	Chandigarh Housing Board Chandigarh I	2004-05 to 2008-09	The assessee claimed exemption under Section 10(20) but AO denied the status of local authority as per present provision and assessed income as AOP.	AO did not levy surcharge correctly	38.40
3	Varanasi Development Authority Varanasi	2007-08	Exemption claimed as trust and was incorrectly granted by AO.	The entity did not fulfill the necessary condition for grant of exemption and therefore certificate was not issued by CIT. Besides incorrect exemption, the assessee had shown ₹. 9.10 crore as accrued income against stamp fees in the Balance Sheet under "Sundry Debtors" which was not taken as income.	3.84
4	Silchar Development Authority Shillong	2006-07 to 2009-10	Exemption granted under Section 10(20) contrary to the provisions of the Act	The AO (ACIT, TDS Silchar) in May 2010 accepted incorrect exemption granted	0.05

2.10 Recommendations

We recommend that

- A cap linked to Housing Pricing Index on the sale value of the flats constructed by the builders/contractors may be considered as a condition for claiming deduction under section 80IB(10) so that legislative intent of providing affordable housing is met.

(Para no. 2.2)

The CBDT stated (June 2011) that the provisions of section 80IB(10) are being phased out as the last date for approval for housing projects have expired on 31.03.2008 and no further extension has been granted to the same in the latest Finance Bill 2011.

- The purview of section 115JB ie MAT may be extended to Firms/AOP who are taking advantage of deduction or incentive available in the Act.

(Para no. 2.3)

The CBDT stated (June 2011) that Limited Liability Partnerships (LLPs), which are business entities similar to partnership firms have been recently proposed to be brought under the purview of alternate minimum tax (similar to MAT for corporate) through the insertion of a new Chapter in the Income Tax Act, vide Finance Bill 2011. The issue will be further examined for including other entities while finalizing the DTC. However, as majority of Firms/AOPs are in the unorganized and Small/Medium Enterprise Sector, imposing MAT may hamper this sector.

- *Suitable provisions for assessment and collection of tax on TDR transactions and payment of compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/mobilization advances may be introduced to safeguard the interest of revenue.*

(Para nos. 2.4, 2.5 and 2.6)

The CBDT stated (June 2011) that as the sale and purchase of TDR and surrender of premises takes place between organized entities, there is negligible chance of non reporting of transactions by the concerned parties and introduction of TDS provision for such transaction will only increase the compliance burden on the tax payers. CBDT accepted the recommendation on payment of TDS on mobilization advances.

We are of the view that in case the TDS provisions are not feasible in respect of sale & purchase of TDR and surrender of premises, CBDT may consider introducing other suitable mechanism to reduce tax evasion in such cases.

- *The inconsistency between Section 80(IB) and Section 40a(ia) may be removed by making admissibility of deductions under Section 80(IB) conditional to admissibility under section 40a(ia).*

(Para no. 2.7)

The CBDT stated (June 2011) that in view of the DTC Bill providing for phasing out of profit linked incentives, no further action seems necessary on the issue.

- *CBDT may issue necessary instructions for uniform treatment of income derived from leasing of properties held in stock in trade, income from sale of parking space and expenses on 'Interest on borrowed funds' and 'Directors' meeting fee/project management fee'.*

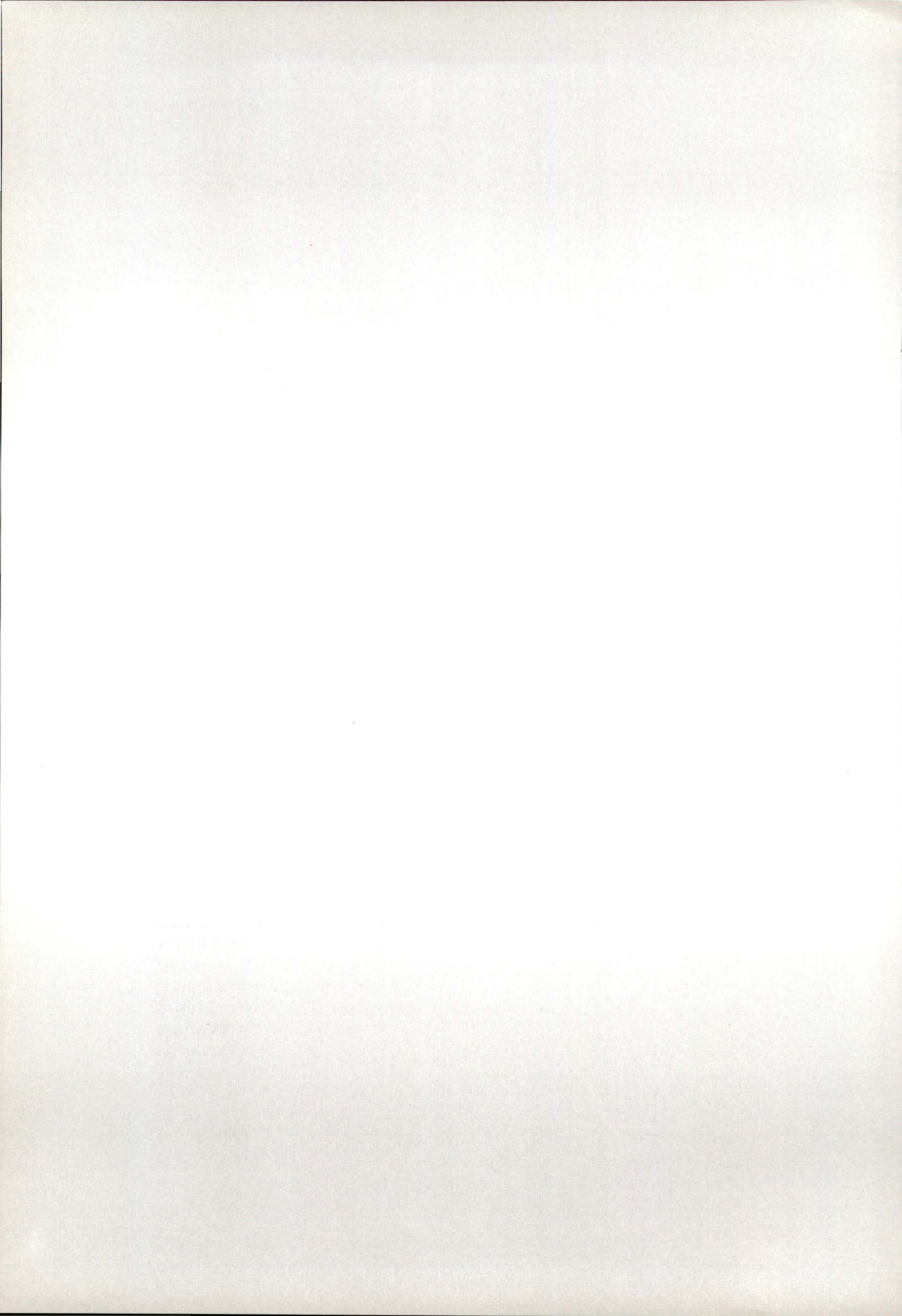
(Para nos. 2.8 & 2.9)

The CBDT (June 2011) accepted the recommendation.

CHAPTER 3

INTERNAL CONTROLS

- **Database of assessees and the Central Information Branch**
- **Selection for scrutiny**
- **Incorrect Certification by Chartered Accountants**
- **Recommendations**



CHAPTER 3

INTERNAL CONTROLS

- Department does not have proper database of the assessee engaged in the business of civil construction. Business codes appearing in the central AST database of taxpayers maintained by the DGIT (System) are often captured incorrectly.
- We could not identify non filers by cross linking the records of the Department as PAN details of the contractors registered with the works departments were not available.
- Information collected by the CIB from third party sources were not being collated and disseminated to users defeating the very purpose of the scheme.
- We noticed a number of cases which were not selected for compulsory scrutiny as per CBDT norms.
- We found that the Department was not initiating action against the erring statutory auditors for incorrect certification in their tax audit report.

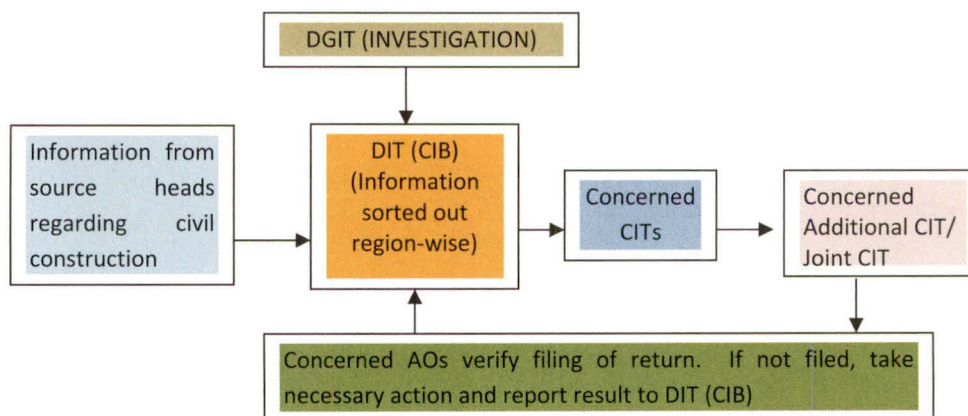
3.1 The primary role of tax administration is to ensure that all entities that are due to pay tax under extant legislation are adequately covered under the tax net, and assessee filing returns are offering correct income to tax. In a tax system which is increasingly reliant on voluntary compliance through self assessments, it is imperative for the Department to put in place proper control mechanisms to ensure collection of information on transactions made by the concerned entities from third party sources, and on organising and dissemination of this information to enable follow up action by concerned Assessing Officers (AOs). The Department should also ensure adequate controls on the scrutiny process for efficient and effective tax administration.

3.2 Database of assessee and the Central Information Branch

3.2.1 With a view to identifying potential taxpayers, the CBDT had made it mandatory for every person to quote PAN in all documents pertaining to sale or purchase of any immovable property valued at ₹ 5 lakh or more. As per CBDT instructions, the Central Information Branch (CIB) functioning under DGIT (Inv) would collect information from specified source heads in appropriate formats on a regular basis. Sec 285BA of the Act, effective from 1st April 2005 requires certain specified persons/entities to file an annual information report (AIR) on specified financial transactions with the Director General (CIB). For instance, information on immovable properties valued ₹ 30 lakh or more and registered on or after 1st April 2004 is to be furnished by the Registrar/Sub Registrar appointed under the Registration Act 1908, as per form 61A. Further, internal instructions of the Department

require collection of information relating to immovable property from the records of Urban Development Authority, Municipal Authorities, Panchayats etc in appropriate formats enabling comparison with data on returns. After collection of information, all the data for the whole year are sorted by the CIB address wise and range wise. The sorted CIB data is transmitted annually to the jurisdictional assessing officers to facilitate identification of non-filers and taking necessary action.

A flow chart depicting the process on information transfer is given below:



3.2.2 As per procedure, where information from source heads contains PAN, the sorted output is uploaded on the Income Tax Department (ITD) application and sent directly to the AO having jurisdiction over the PAN holder. When PAN information is unavailable, the transaction information is sorted as per address and sent to jurisdictional additional CIT/JCIT. The DIT(CIB) informed that the information collected under the relevant source code¹² from builders, contractors, housing cooperative societies was being uploaded on the Regional Computer Centre (RCC) server.

3.2.3 Adequacy of data

We found in audit that basic data on assessee engaged in civil construction was not available with the concerned CITs. To examine the validity and completeness of information on construction entities available with the Department, we obtained data on entities engaged in construction from the Works Departments, Municipal Corporations and Sub Registry Offices etc. We found that the registration particulars of the contractors/firms available with the agencies did not carry PAN details in most cases. The information, therefore, could not be cross linked with the records of the Department to identify non filers. Moreover, the Department could not match the names of the contractors vis-a-vis records available with them. The finding echoed a similar observation made by us in our earlier report of 2004 on the Sector.

¹² Code No. 018 & 019 in the Revised source codes

3.2.4 Dissemination of Information by the CIB

We also ascertained from various charges that the extent of dissemination of information available with CIB was low. We found in Delhi and Kolkata that data available with CIB was not being properly collated and information was being sent only on cases selected for scrutiny. Uploading of data on the system had been initiated only in February 2010. In Mumbai, the DIT (CIB) stated that substantial information¹³ relating to assessment years 2005-06 to 2008-09 collected/received by the DIT (CIB) Mumbai could not be disseminated to the assessment charges due to technical problems. This invariably resulted in non identification of non filers by the AOs defeating very purpose of the exercise.

3.2.5 Use of AIR data

Data from third party sources would have been useful in verifying declarations made by individual assesses. We found that for the data disseminated, no formal monitoring mechanism had been established to ascertain the extent of use of this data by the AOs.

3.2.6 Business codes in AST database

Section 44AB of the Income Tax Act¹⁴, 1961 requires every assessee engaged in business activities to furnish a statement of particulars in prescribed format (Form 3CD) which, inter alia, includes declaration on method of accounting, valuation of closing stock, amounts not credited to profit and loss account and nature of business as per specified codes. In case of construction entities separate codes (viz. 0401, 0402, 0403, 0501 etc) are prescribed as per classification of business as Builder, Property developer, Civil Contractor and Estate agent. Such information is obtained to facilitate sectoral analysis of assesseees.

3.2.6.1 Our analysis of the central AST database maintained by the DGIT (Systems) for the assessment years 2006-07 to 2009-10 revealed inaccuracies¹⁵ in the business codes and actual business of the assesseees. In Delhi, we found nine construction entities filing returns who were not figuring in the AST database at all. Further, we noticed assesseees engaged in businesses other than civil construction had filed income tax returns under codes meant for construction entities. A test check of records in Goa revealed that out of 4131 assesseees engaged in construction, business codes in 164 cases were not filled in correctly. We found that the correctness of codes mentioned by the assesseees in the 3CD Form was not being ascertained by the Department. The discrepancies in codes impeded sectoral analysis on tax and raised questions about the authenticity of the data.

¹³ 10.45 crore pieces of information was collected by/ received at CIB Mumbai between 2005-06 and 2008-09.

¹⁴ Part B of the Annexure I of Form 3CD

¹⁵ Appendix -1

3.3 Selection for scrutiny

The CBDT issues instructions every year which lay down the procedure for selection of assessments for compulsory scrutiny under various categories. As per the Board's norms for compulsory scrutiny and Computer Aided Selection for Scrutiny (CASS) norms, the returns of all the builders following project completion method are required to be selected for compulsory scrutiny. Besides, wherever an assessee claimed deduction under section 80 IA or 80IB of the Act for the first time or the deduction claimed by the assessee under Chapter VI A of the Act exceeded a threshold limit, the case has to be selected for scrutiny. Further, in case of corporate assessees, where turnover exceeded ₹ 2 crore, and net profits shown were below 5 percent the case had to be selected for scrutiny.

Out of the sample of summary assessments made available for scrutiny we noticed 58 cases which were not selected for compulsory scrutiny in deviation from prescribed norms. Out of these, 28 cases involved tax effect of ₹ 5.55 crore that went unnoticed. An illustration is given below:

3.3.1 Charge: CIT-IV, Kolkata, AY 2005-06

M/s SENBO Engineering Ltd¹⁶ was allowed a deduction of ₹ 6.76 crore under section 80IA. We noticed that in the previous year, i.e for the assessment year 2004-05, no deduction under section 80IA was allowed by the Department as the assessee was a works contractor. Although the status of the assessee remained unchanged in assessment year 2005-06, due to non-selection of the case for scrutiny, the assessee was allowed inadmissible deduction under Section 80IA having a revenue impact of ₹ 2.01 crore. The Department stated in reply that a notice under section 148 had already been issued to the assessee on 30 April 2010 for reopening the case.

3.4 Incorrect Certification by Chartered Accountants:

As per Rule 18 BBB of Income Tax Rules, 1962 deductions under Sections 80IA, 80IB and 80IC shall not be admissible unless the accounts for which the deduction claimed have been audited and audit report in the prescribed Form No.10 CCB duly signed and verified by a chartered accountant, along with the profit and loss account and balance sheet is enclosed with the return. Further, Section 142A(3) of the Act provides that the AO may require a Valuation officer to make an estimate of such value and report the same to him. On receipt of the same from the Valuation officer, AO may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment.

We found significant inconsistencies in expenses shown in accounts and deductions claimed as certified by chartered accountants as compared to valuations made by Departmental valuation Officers (DVO) when cases were referred to them. An illustration is given below:

¹⁶ The case was completed after summary in January 2007.

3.4.1 In Pune and Thane charges, 32 cases¹⁷ involving deduction claims of ₹ 24.55 crore under section 80IB(10) were referred by the concerned AOs to the DVOs. The DVOs found the claims of assesses to be inadmissible in 25 cases and were so treated by the AOs. In 15 of them, the claimants had exceeded the maximum area permissible for claiming deductions and the concerned statutory auditors had wrongly certified that the claims of deductions of ₹ 6.83 crore under section 80IB(10) were allowable. As the facts certified by the statutory auditors were found to be incorrect, the said auditors attracted action under the provisions of the Act. However, the Department had not initiated any action against the erring statutory auditors.

3.4.2 We also checked 84 other cases involving claims of ₹ 1023 crore which were admitted by the AOs without referring them to the DVOs. Given the propensity of incorrect certification by statutory auditors there was high probability of ineligible deduction claims being allowed.

3.5 Recommendations

We recommend that

- *The Department may devise proper controls to ensure that the data received by CIB is sorted and disseminated promptly, enabling effective scrutiny and widening of the tax net. Further, a feedback mechanism may be evolved to determine the extent of use of this data by the AOs while making assessments.*

(Para 3.2.4)

The CBDT stated (June 2011) that data uploading on the system has been initiated only in February 2010. There would be improvement in the system as it gains experience. The recommendation has been accepted.

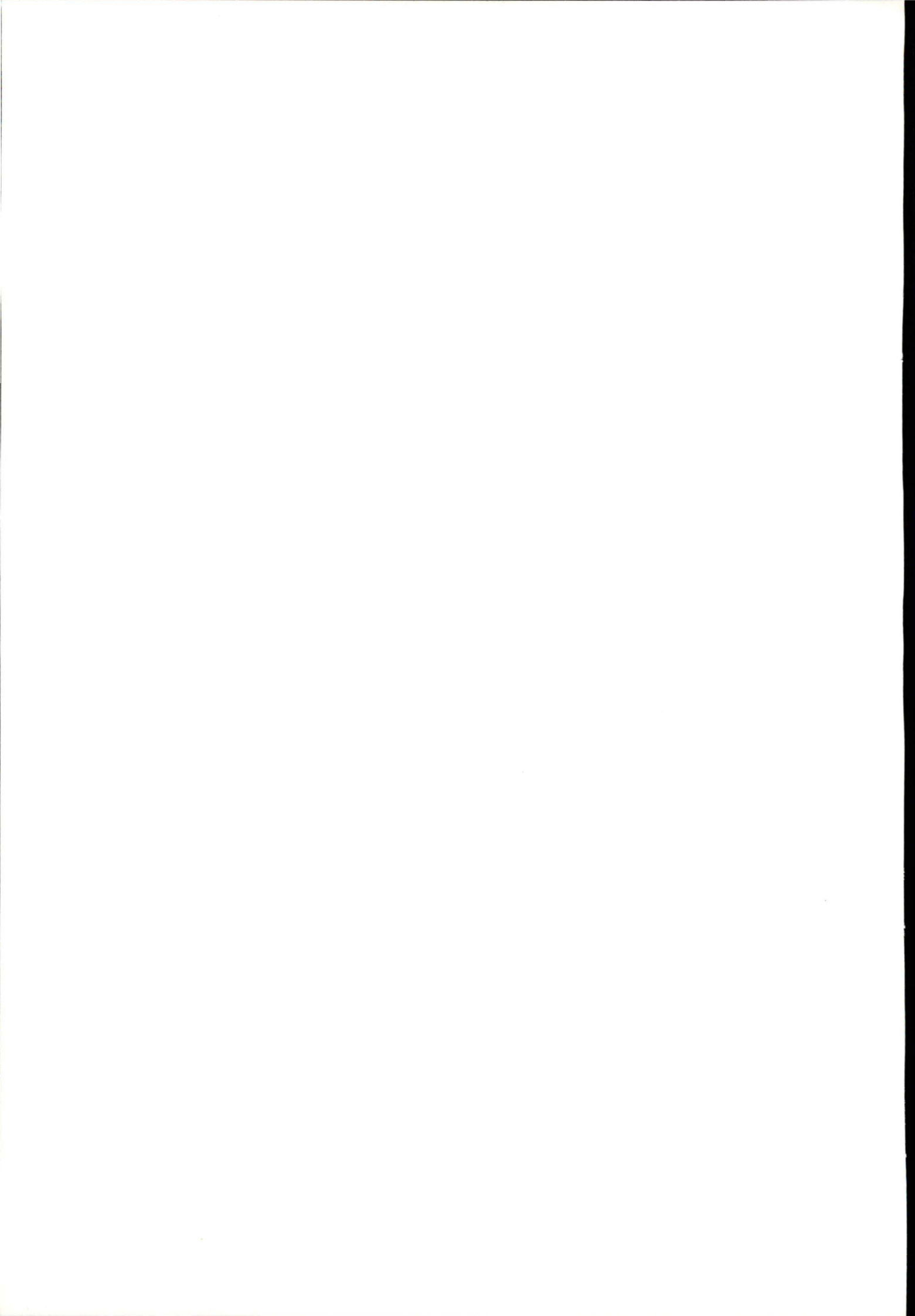
- *In view of incorrect certification by statutory auditors of deduction claims of assessee engaged in civil construction, the Department may consider putting provision for sample verification of claims by Departmental Valuation Officers.*

(Para 3.4)

The CBDT stated (June 2011) that the AO has necessary powers to refer cases to the valuation cell during the course of assessment proceedings and therefore no further provision is required to be brought in the statute in this regard. As regards incorrect certification also necessary provisions are there for disciplinary action.

We are of the opinion that CBDT needs to ensure compliance with the existing rules/instructions.

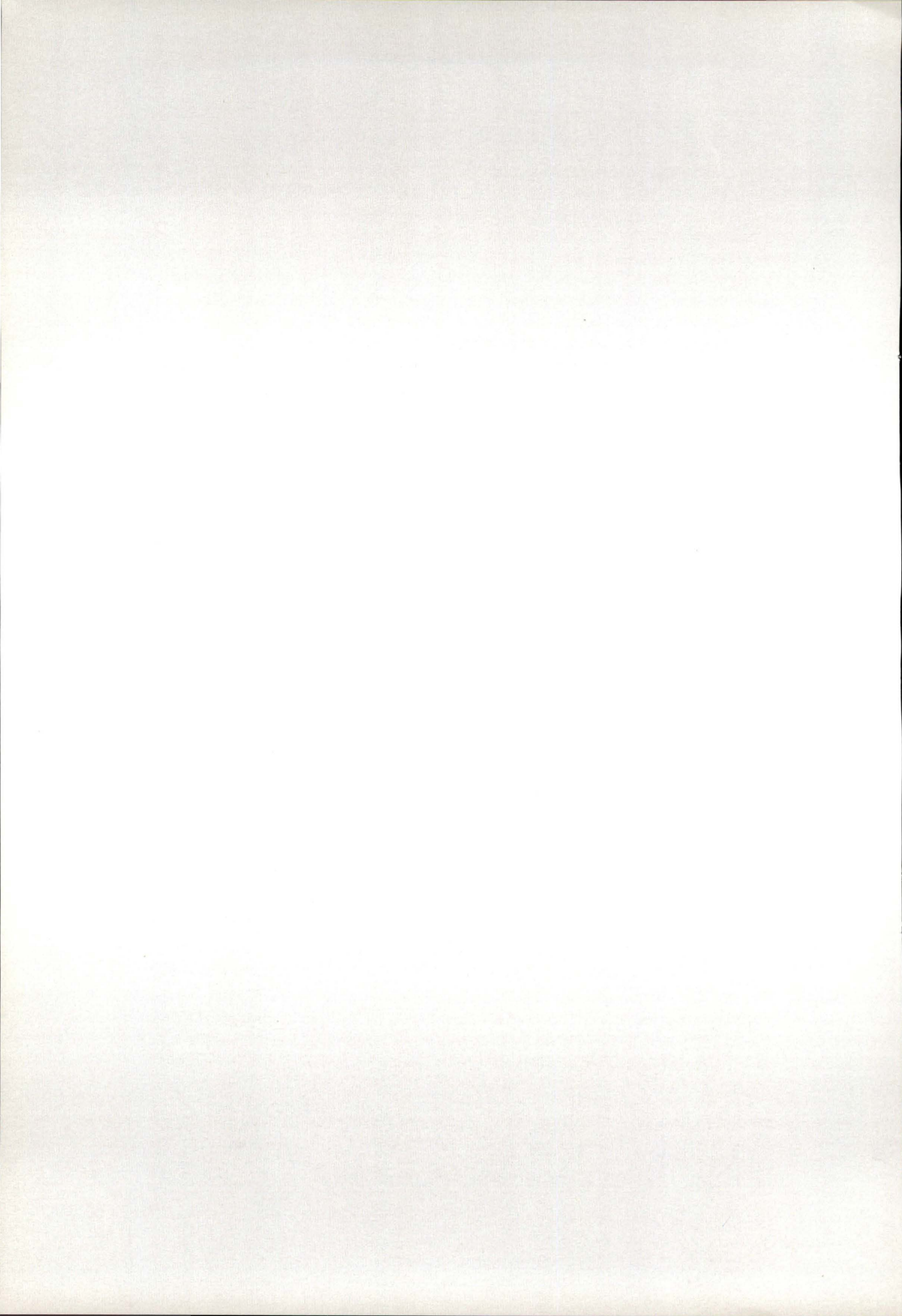
¹⁷ Appendix 2



CHAPTER 4

INFORMATION SHARING AND SCRUTINY

- **Information sharing and cross verification**
- **Lack of cross verification**
- **Recommendations**



CHAPTER 4

INFORMATION SHARING AND SCRUTINY

- Information and records on related assessees were found to be rarely shared and cross verified by the concerned AOs. We found that income of ₹ 49.26 crore in 15 cases escaped assessment due to lack of cross verification of records available with the AOs.
- We found 256 cases involving tax effect of ₹ 83.54 crore in which income escaped assessment due to short/non accountal of contract receipts, in profit and loss account.
- We also noticed 220 cases involving tax effect of ₹ 469.10 crore of non deduction/remittance of TDS or delay in remittance of TDS to the Government.

4.1 Information sharing and cross verification:

The Act provides that the Assessing Officers shall complete the assessment correctly after verifying all the necessary records, documents and accounts of the assessee.

We noticed 15 cases in Mumbai, Chennai, Delhi, Kanpur and Rajahmundry charges involving revenue impact of ₹ 49.26 crore where income escaped assessment either due to non sharing of information among AOs or due to lack of cross verification of records available with the AOs. Five illustrations involving tax effect of ₹ 46.26 crore are given in Table 4 below:

(₹ in crore)

Table:4 Cases on information sharing and cross verification

S No.	Name of the assessee/ CIT charge	AY	Description	Tax effect
1.	M/s Abode Builders CIT-XX, Mumbai M/s Vaman Estate CIT-XXI Mumbai	2007-08	M/s Abode Builders and M/s Vaman Estate developed a project "Trans Residency" in joint venture. The AO disallowed the deduction under section 80IB(10) to the former for non-fulfillment of conditions prescribed. However, the latter was irregularly allowed the same due to non passing of the related information on breach of conditionality to the AO concerned. We verified that M/s Vaman Estate was irregularly allowed deduction of ₹ 34.20 crore.	15.38
2.	M/s EVP Group and M/s S&P Foundation Group CIT I Chennai	2004-05 to 2008-09	During assessment proceedings followed by search and seizure, the assessee accepted the actual sale considerations of developed properties along with 'on money payments' made to different parties for purchase of land that were not shown in their accounts and also paid related tax liability. We found that the actual sale consideration was mentioned in the sale agreements entered	18.67

			between the assessee and the sellers of the land. The information on the land transactions readily available with the department was not transmitted to the AOs having jurisdiction over the entities who had received the payments and were liable to pay taxes on the 'On money' received. The income escaping assessment involved revenue impact of ₹ 56.57 crore.	
3.	M/s Ansal Buildwell Ltd Central Circle I Delhi	2006-07	The assessee included project expenses of ₹ 82.74 crore in respect of work in progress of Sushant Lok-III transferred by Ansal Properties and Infrastructure Ltd. However, as per accounts of Ansal Properties and Infrastructure Ltd., the project cost of Sushant Lok- III was only ₹ 57.29 crore.	11.39
4.	M/s MCL-RSR (JV) CIT Rajahmundry Andhra Pradesh	2006-07	The assessee returned ₹ 43.90 lakh for sale of 9 flats as against ₹ 53.09 lakh as per records of Sub Registrar office thereby understating income of ₹ 9.19 lakh. Besides, assessee claimed sub contract payments of ₹ 11.86 crore to R. Subba Raju, Firm. We cross checked and found that it credited only ₹ 10.94 crore. AO failed to detect the irregularity though the firm's records were also available with him in the same charge.	0.32
5.	M/s Kanpur Development Authority CIT I Kanpur	2007-08	The assessee made payments of ₹ 1.48 crore to M/s Kanpur Electric Supply Co. and Shri Ram Kishan Kushvaha in Kanpur charge without quoting PAN. On cross verification we found that deductees neither offered the income for taxation nor claimed credit for TDS.	0.50

4.2 Lack of cross verification of TDS

In order to facilitate correct assessment by the AO, section 44AB provides a role to the tax auditor who would undertake verification of the accounts and records of the assessee to ensure compliance to TDS provisions. The tax auditor gives his report in the prescribed form (3CD). We noticed cases where the tax auditor, instead of making a detailed verification of compliance to TDS provisions gave qualified statements such as, "due to voluminous nature of transactions, the compliance with TDS provisions could not be verified but the same was done on test check basis". In such cases the Department neither disallowed the claims made by the assessee nor issued suitable instructions to the tax auditors. This resulted into allowing huge expenses without verifying compliance with TDS provision.

4.2.1 Escapement of income due to short accountal of TDS receipts

Section 199 of Income Tax Act, 1961 provides that any tax deducted at source shall be treated as payment of tax on behalf of the tax deductee and credit shall be given to him for the amount so deducted in respect of the assessment year for which income is assessable. The related receipt from which the tax was deducted has to be taken into account while computing the total income of the tax deductee.

We found 256 cases where the contract receipts on which TDS was made as shown in Form 16A were either not accounted for or short accounted by contractors (tax deductees) in their profit and loss account. These cases involved tax effect of ₹ 83.54 crore. Three illustrations are given below:

4.2.1.1 Charge: CIT-IV, Delhi, AY 2006-07

M/s IRCON International Ltd.¹⁸ had shown contract receipts of ₹ 1042.30 crore as against contract receipts of ₹ 1068.37 crore as per TDS certificates on which TDS was claimed by the assessee. Hence, contract receipts of ₹ 26.07 crore were short accounted by the assessee. Besides, the assessee also did not account for the receipts of ₹ 44.37 crore from countries covered under DTAA which were taxed in those countries but deducted the same from computation of the income. These mistakes resulted in short levy of tax of ₹ 32 crore including interest applicable.

4.2.1.2 Charge: CIT Bhubaneswar, AYs 2005-06 & 2006-07

M/s ARSS Infrastructure Projects Pvt Ltd had shown gross receipt of ₹ 29.58 crore and ₹ 60.25 crore in Profit and loss account during the above two AYs as against ₹ 29.77 crore and ₹ 65.76 crore shown in TDS certificates respectively. Hence, gross receipts of ₹ 5.70 crore were short accounted for by the assessee involving short levy of tax of ₹ 2.53 crore.

4.2.2 Allowing expenses without deducting/remitting TDS

Section 40(a)(ia) of the Act provides that any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work on which tax is deductible at source and such tax has not been deducted or after deduction, has not been paid within prescribed period then such amounts shall not be deducted in computing the income chargeable under the head "profit and gains of business or profession".

We noticed 220 cases of inadmissible expenditure on which TDS was not deducted or where deducted, was not remitted to the Government. The mistakes involved tax effect of ₹ 469.10 crore. Three cases are illustrated below:

4.2.2.1 Charge: CIT- VIII Mumbai, AY 2007-08

M/s Aamby Valley Ltd debited an expenditure of ₹ 648.11 crore in profit and loss account on account of interest which was payable after two years and TDS on it was not deducted. As such the same was required to be disallowed in view of provisions of section 40(a)(ia) of the Act. Besides, the assessee

¹⁸ Assessment was completed after scrutiny in December 2008

credited an amount of ₹ 190.92 crore from sales of plots and debited expenditure of ₹ 161.72 crore as cost of the sales. We noticed that the assessee had sold plots as well as villas for a consideration of ₹ 361.71 crore. Thus, the sale consideration was understated to the extent of ₹ 170.79 crore. These mistakes resulted in aggregate tax effect of ₹ 285.47 crore.

4.2.2.2 Charge: CIT-V, Mumbai, AYs 2006-07&2007-08

M/s. Maharashtra State Road Development Corporation Ltd was granted deduction towards interest of ₹ 155.56 crore accrued but not due on secured/unsecured loan. As the interest was not due for payment and TDS thereon was not deducted, deduction granted towards payment of interest of ₹ 155.56 crore was not in order and should have been disallowed. The mistake resulted in under assessment of income to that extent involving potential tax effect of ₹ 52.36 crore.

4.2.2.3 Charge: CIT-II Hyderabad, AY 2005-06

M/s IVRCL Infrastructures and Projects Ltd recovered TDS of ₹ 93.24 crore every month during the year in respect of sub contract payment but failed to remit the tax deducted at source within the prescribed period. The same was required to be disallowed in terms of provision of section 40(a)(ia). The omission involved tax effect of ₹ 42.65 crore.

4.3 Recommendations

We recommend that

- *CBDT may issue necessary instruction for sharing of information regarding high value transactions among the concerned AOs to prevent leakage of revenue.*

(Para no. 4.1)

CBDT stated (June 2011) that the AOs are expected to cross verify and counter check such transactions. They would issue instructions with a view to sensitize the AOs on the issue as also to tighten the monitoring mechanism to prevent such lapses.

- *CBDT may issue necessary instructions that no TDS credits shall be allowed without quoting PAN of the deductees.*

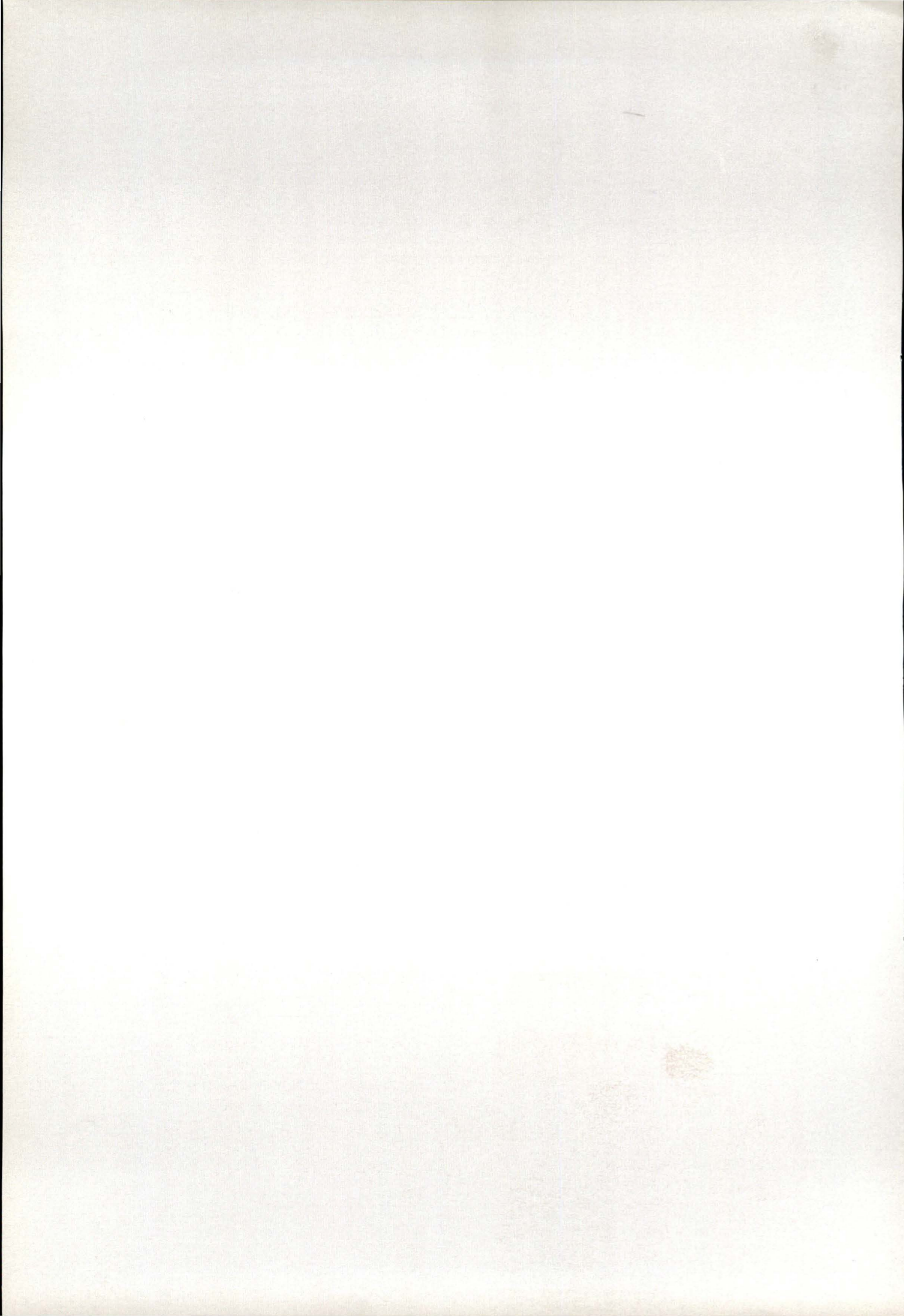
(Para no. 4.2)

CBDT stated (June 2011) that the issue has been addressed with the implementation of the New System of mandatory furnishing of PAN wef 01-04-2010 by the deductor of tax at source, which is required to be matched with the income tax return of the deductee.

CHAPTER 5

SPECIAL PROVISION FOR CIVIL CONSTRUCTION

- **Deductions for Housing / Infrastructure projects**
- **Deduction for developing housing projects under section 80 IB (10)**
- **Deduction for infrastructure development under section 80 IA**
- **Deduction for development of Special Economic Zone (SEZ)**
- **Mistakes in assessments of Public Private Partnership Projects**
- **Accounting issues**
- **Recommendations**



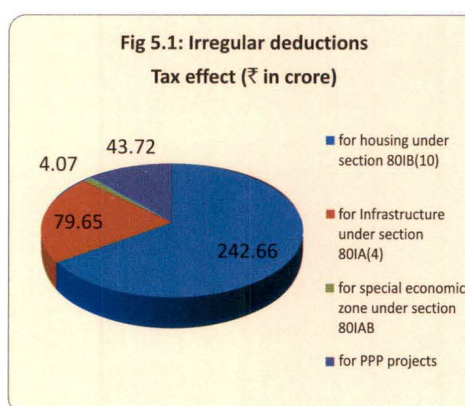
CHAPTER 5

SPECIAL PROVISIONS FOR CIVIL CONSTRUCTION

- Deductions admissible for housing projects under section 80 IB(10) and for infrastructure development under section 80IA(4) were allowed even though assesseees were not eligible to claim deductions as they did not fulfill the conditions provided in the Act. We noticed mistakes in 142 cases involving tax effect of ₹ 326.38 crore due to lack of proper monitoring of deductions granted for developing housing projects/ infrastructure.
- Mistakes in assessments of Public Private Partnership projects were noticed in seven cases involving tax effect of ₹ 43.72 crore relating to depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting.
- We noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognized by applying the percentage completion method as per Accounting Standard 7 as revised with effect from 2003.

5.1 Deductions for Housing/Infrastructure projects

The assesseees engaged in the business of civil construction availed irregular deductions falling in five major categories, namely; for development of housing projects under section 80IB(10) and infrastructure under section 80IA as well as for development of Special Economic Zone (SEZ) under section 80IAB and the deductions allowed in absence of audit report by the chartered accountant involving tax impact of ₹ 326.38 crore in 142 cases.



5.2 Deduction for developing housing projects under section 80IB(10)

The Act provides hundred per cent deduction to profits of an undertaking derived from the developing and building housing projects approved before, 31.03.2008 subject to fulfillment of certain conditions.

We observed 92 cases involving tax effect of ₹ 242.66 crore where deductions were allowed even though assesseees had not fulfilled either of the conditions as provided in the Act. Different categories of inadmissible deductions are discussed below:

5.2.1 Housing projects having excess commercial area

Charge: CIT-IV Delhi, AY 2007-08

As per conditions of admissibility, deduction under section 80IB(10) shall be admissible only if the built up area of the shops and other commercial establishments is not more than five per cent of the aggregate built up area of the housing project or 2000 square feet whichever is less.

M/s Eldeco Infrastructure and Properties Ltd. was allowed a deduction of ₹ 51.88 crore against a project with total built up commercial area of 15450 square feet¹⁹ in deviation of the condition stated above. The mistake resulted in short levy of tax of ₹ 23.23 crore.

5.2.2 Housing projects having excess built up area

Charge: CIT-II, Ahmedabad AYs 2006-07 & 2007-08

For claiming deduction under section 80IB(10), a residential unit must have built up area not exceeding 1000 square feet and 1500 square feet for Metro and non Metro cities respectively. Further, built up includes balconies and projections but does not include the common areas shared with other residential units.

M/s Ganesh Housing Corporation Ltd. (GHCL) was allowed deductions of ₹ 34.40 crore under section 80IB(10). Audit examination revealed that the built up residential area being 1677.76 sq feet exceeded the maximum permissible limit. Moreover, GHCL did not include the area of balconies and

projections including covered independent parking for working out the built up area. Thus, the deduction was inadmissible. The mistake resulted in short levy of tax of ₹ 14.55 crore. The Department has initiated action (July 2010) to reopen the assessments.

5.2.3 Filing return after due date

5.2.3.1 Charge: CIT-VI, Delhi, AY 2008-09

Section 80AC of Income Tax Act, 1961, provides that deduction under section 80IB shall not be allowed to an assessee unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139.

M/s Unitech Ltd.²⁰ was allowed deduction of ₹ 30.14 crore under section 80IB (10) which was not admissible at all as the assessee filed the return on 02 April 2009, i.e.

after due date of filing return on 30 September 2008. The mistake resulted in short levy of tax of ₹ 13.12 crore including interest.

¹⁹ Used in the name of shopping mall, Arcadia

²⁰ Assessment was completed under section 143(3) r.w.s. U/s 153A in December 2008

Department replied (February 2011) that the observation appeared to be correct and remedial action was being taken.

5.2.3.2 Charge: CIT- I, Hyderabad, AYs 2004-05 to 2008-09

Andhra Pradesh Housing Board, Hyderabad awarded work on a integrated township project with world class facilities²¹ to **M/s Cesma International Private Ltd**, at a project cost of ₹ 186.68 crore. The Return for 2005-06 was filed late. We found that AO did not charge the interest of ₹ 11.30 crore for delay in filing return of income. Besides, penalty of ₹ 1 lakh for delay in getting the accounts audited and delay in implementing the appellate orders by 9 months was also not levied.

5.3 Deduction for infrastructure development under section 80IA

Section 80IA(4) provides that where total income of an assessee includes profit and gains of an undertaking from eligible business, the assessee shall be eligible for specified deduction for specified period subject to fulfillment of certain conditions.

Mistakes in application of the above provision resulted in incorrect admission of deduction under section 80 IA (4) in 48 cases involving revenue impact of ₹ 79.65 crore. Different categories of inadmissible deductions are discussed below:

5.3.1 Irregular allowance of deduction under Section 80IA against works contract

Charge: CIT-I, Coimbatore, AYs 2004-05 &2005-06

Explanation below section 80IA(13) introduced by the Finance Act, 2007 in May 2007 with retrospective effect from 1 April 2000 provides that deduction under section 80-IA shall not be admissible to a contractor in respect of a works contract entered into with the undertaking or enterprise, as the case may be.

M/s Chettinadu Lignite Transport Services Ltd. was disallowed deduction of ₹ 12.03 crore under section 80IA for AY 2004-05 which was upheld by CIT(Appeal) but allowed by the ITAT in July 2007. Similarly deduction ₹ 12.26 crore for AY 2005-06, initially disallowed by

the AO, was allowed by CIT(Appeal) in March 2008, following the ITAT decision for the earlier AY. The assessee, being only a sub contractor executing a contract on behalf of others, was covered by the Explanation below section 80IA(13) introduced by Finance Act, 2007 in May 2007 and was not eligible for the said deduction. Non consideration of the Explanation brought out in the Act by the Finance Act 2007 resulted in irregular allowance

²¹ Named Singapore Sanskruthi Township at Pocharam village, Ghatkesar Mandal, RR District

of deduction aggregating ₹ 24.29 crore involving short levy of tax of ₹ 8.80 crore.

5.4 Deduction for development of Special Economic Zone (SEZ)

The section 80IAB provides that deduction at one hundred percent shall be admissible to an undertaking from any profits and gains derived from the business of developing a Special Economic Zone (SEZ), notified on or after 1 April, 2005 under the SEZ Act, 2005.

We found two cases involving tax effect of ₹ 4.07 crore as illustrated below:

5.4.1 Charge: CIT-II, Ahmedabad, AY 2007-08

M/s Mundra Port & Special Economic Zone Ltd. (MPSEZ) engaged in port operations and logistics had been allowed an expenditure of ₹ 120.39 crore which included a sum of ₹ 6.81 crore as a provision for “demurrage charges”, which were neither accrued nor known liabilities. Since the said provision was not laid out or expended wholly and exclusively for the purpose of business for the year under consideration, this was required to be added back for the purpose of computation of business income and chargeable to tax. This resulted in short levy of tax of ₹ 2.29 crore.

5.4.2 Charge: CIT-VI Mumbai, AYs 2006-07 & 2007-08

M/s. Mahindra Gesco Developers Ltd. was allowed deduction of ₹ 0.24 crore and ₹ 3.73 crore respectively under section 80IAB for developing an Export Processing Zone approved in September 2004, prior to April 2005 and hence, the deduction allowed was not in order. The mistake resulted in under assessment of income aggregating ₹ 3.97 crore involving short levy of tax amounting to ₹ 1.78 crore. Department stated in its reply that notice u/s 148 was issued to assessee in respect of assessment year 2006-07.

5.5 Mistakes In Assessments Of Public Private Partnership Projects

5.5.1 To encourage private investment in infrastructure, Governments have entered into PPP projects where a variety of fiscal concessions like tax incentives, revenue retention for a fixed lease period, etc. are being given. In order to identify revenue risks arising from assessments of incomes from these projects we test checked the assessment records pertaining to a few PPP projects. We found mistakes in the nature of depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting involving tax effect of ₹ 43.72 crore in seven cases.

5.5.2 Depreciation on Government leased assets

The Act provides that owner of the asset is entitled to depreciation if the asset is used in the business. However, accounting standard AS 19 effective from 2001 requires finance leases to be capitalised in the books of lessee. CBDT has clarified that AS 19 will have no implication on the allowance of depreciation under the Act. The lessee will capitalize and depreciate the asset for accounting purposes and legal owner will continue to avail depreciation u/s 32.

In Andhra Pradesh we found four cases where the assessee claimed depreciation on roads/ bridges/toll ways, developed under PPP mode. As the assets belong to

Government and no commercial operations were involved, allowing claims of depreciation on these assets were not correct. These omissions resulted in incorrect allowance of depreciation involving tax effect of ₹ 31.41 crore. An illustration is given below:

5.5.2.1 Charge: CIT-III, Hyderabad, AY 2005-06

M/s Swarna Tollway Pvt Limited claimed depreciation of ₹ 63.54 crore on leased Government assets developed under PPP mode. As the said assets belonged to the Government, claim of depreciation was not correct. Omission to disallow the same resulted in incorrect allowance of depreciation with a potential tax of ₹ 23.25 crore.

5.5.3 Expenses against exempt income.

Section 14A of the Act provides for disallowance of expenditure incurred in relation to income not includible in total income. Further, Section 115JB requires companies to prepare their profit and loss account in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956.

We found a case where Government entities were forming joint venture companies with private developers and certain expenses unrelated to total income offered for tax were being incorrectly allowed for

deduction as illustrated below:

5.5.3.1 Charge: CIT-II Hyderabad AY 2007-08

M/s EMAAR Hills Township Pvt Ltd (EHTPL), a special purpose vehicle formed by the Andhra Pradesh Industrial Infrastructure Corporation (APIIC), with Emaar Properties PJSC, Dubai for development of world class Golf course with integrated township projects was allotted land by APIIC on 66 years lease in AY 2007-08 in return of 26 percent equity holding. The agreement mentioned that the accounting for the project would be to the mutual satisfaction of both the parties. EHTPL entered into another development agreement with Emaar-MGF Land Holdings Pvt. Ltd, for construction of villas, luxurious apartments etc on the leased land without permission of

Government of Andhra Pradesh thereby, violating conditions of PPP agreement. Against total sales of ₹ 5.36 crore, EHTPL offered a total loss of ₹ 4.40 crore adjusting other expenses of ₹ 15.74 crore. As the project was not developed by EHTPL and was ultimately entrusted to another company, the entire income of ₹ 5.36 crore received from Emmar-MGF Land Holdings Pvt Ltd should have been treated as sales commission received from sub contractor and brought to tax by disallowing the expenses of ₹ 15.74 crore. The omission resulted in entire income of ₹ 5.36 crore escaping assessment involving tax effect of ₹ 1.80 crore.

5.5.4 Escapement of income

Income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly adopted by the assessee. Where the assessee follows the mercantile system of accounting, the profits and gains are worked out on due or accrued basis.

We found two cases of income escaping assessment involving tax effect of ₹ 12.74 crore as illustrated below:

5.5.4.1 Charges: CIT-IV Hyderabad & CIT-III Hyderabad, AY 2004-05

M/s **PVR Industries Ltd (PVRIL)** claimed ₹ 6.01 crore payable towards sub contract to M/s **Associated Engineering Enterprises (AEE)** whereas AEE admitted ₹ 3.82 crore as receivable from PVRIL for the same period which shows variation of ₹ 2.19 crore. Both the assessee had followed mercantile system of accounting. Hence, the difference, being excess claim of ₹ 2.19 crore needed to be disallowed. The mistake involved tax effect of ₹ 0.79 crore.

5.5.4.2 Charge: CIT- VI, Mumbai, AY 2007-08

M/s **Ideal Road Builders Pvt. Ltd** worked out surplus income of ₹ 26.70 crore pertaining to prior period after allowing certain deductions like amortization, maintenance expenses on Build Operate and Transfer (BOT) project. However, the Department did not consider the surplus as income. Omission resulted in underassessment of income by ₹ 26.70 crore with consequent short levy of tax of ₹ 11.95 crore.

5.6 Accounting issues:

The Section 145(2) of the Act provides that Central Government may notify accounting standards to be followed by any class of assesseees or in respect of any class of income. Since civil construction projects take time, the business transactions spill over many accounting periods, leading to accounting problems. Our earlier report pointed out that there was a tendency among the entities engaged in civil construction to misuse the 'Project Completion Method' of accounting by postponing account of profits and thereby taxes indefinitely. We recommended that the stage of project completion be

defined for identifying proportional completion and accounting. The Accounting Standard on construction contracts (AS-7) was revised in 2003 which laid down that revenue from such ongoing contracts shall be recognised year after year on the basis of Percentage of Completion of such contracts.

The assessing officer is empowered²² to reject the accounts of the assessee if the same have not been prepared in accordance with the prescribed accounting standards and may proceed to determine the income on best judgment basis.

We noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognised by applying the percentage completion method though advances were received from customers against sale of immovable properties as against work-in-progress/closing stock. Three cases are illustrated below:

5.6.1 Charge: CIT-III Kolkata, AYs 2006-07 & 2007-08

M/s Bengal Park Chambers Development Ltd commenced a housing project (Sunrise point) in August 2005 with likely completion by August 2008. Our analysis revealed that percentage of actual expenditure to estimated cost of the project was 18.27 and 51.51 upto March 2006 and March 2007 respectively. However the assessee did not recognize revenue as per AS 7. As a result, there was underassessment of income during above AYs having a revenue impact of ₹ 2.16 crore.

5.6.2 Charge: CIT-II Delhi, AYs 2004-05 & 2005-06

M/s Malibu Estates Pvt. Ltd. received full payment of ₹ 62.25 crore and ₹ 24.40 crore in the above AYs respectively against 392 and 234 properties ready for transfer in favour of customers. However, no revenue was recognised against these properties in the said assessment years. The omission to do so resulted in underassessment of income aggregating ₹ 86.65 crore involving short levy of tax of ₹ 41.49 crore.

5.6.3 Charge: CIT-IV Delhi, AYs 2005-06 & 2007-08

M/s DLF Commercial Developers Ltd. completed 66.74 per cent of its Hyderabad project under percentage completion method during 2007-08 and recognized revenue of ₹ 329.47 crore in the profit and loss account under the head 'Revenue from constructed properties'. The correct percentage of completion was 72.58 percent instead of 66.74 percent worked out by the assessee. In doing so, revenue of ₹ 28.83 crore from this project was short recognized as income of the assessee.

²² Section 145 (3) of the Act

Besides, the assessee purchased land valuing ₹ 185.77 crore and transferred land costing ₹ 68.69 crore to fixed assets. However, assessee claimed ₹ 144.97 crore expenses of land as against ₹ 117.08 crore. Further, during AY 2005-06, the assessee had shown ₹ 49.81 crore in transfer from work in progress as against closing stock of ₹ 43.83 crore during earlier assessment year. The mistakes involved tax aggregating ₹ 31.42 crore.

5.7 Recommendations

We recommend that

- *CBDT may issue necessary instructions to monitor the deductions allowed for housing and infrastructure projects by providing suitable checks through internal audit.*

(Para nos. 5.1 to 5.5)

CBDT stated (June 2011) that necessary instructions have been included in their Internal Audit Manual of 2011. They have assured further sensitization.

- *Assessing Officers may ensure that accounting treatment for ongoing construction projects commenced after April 2003 conform to Accounting Standard 7 as revised.*

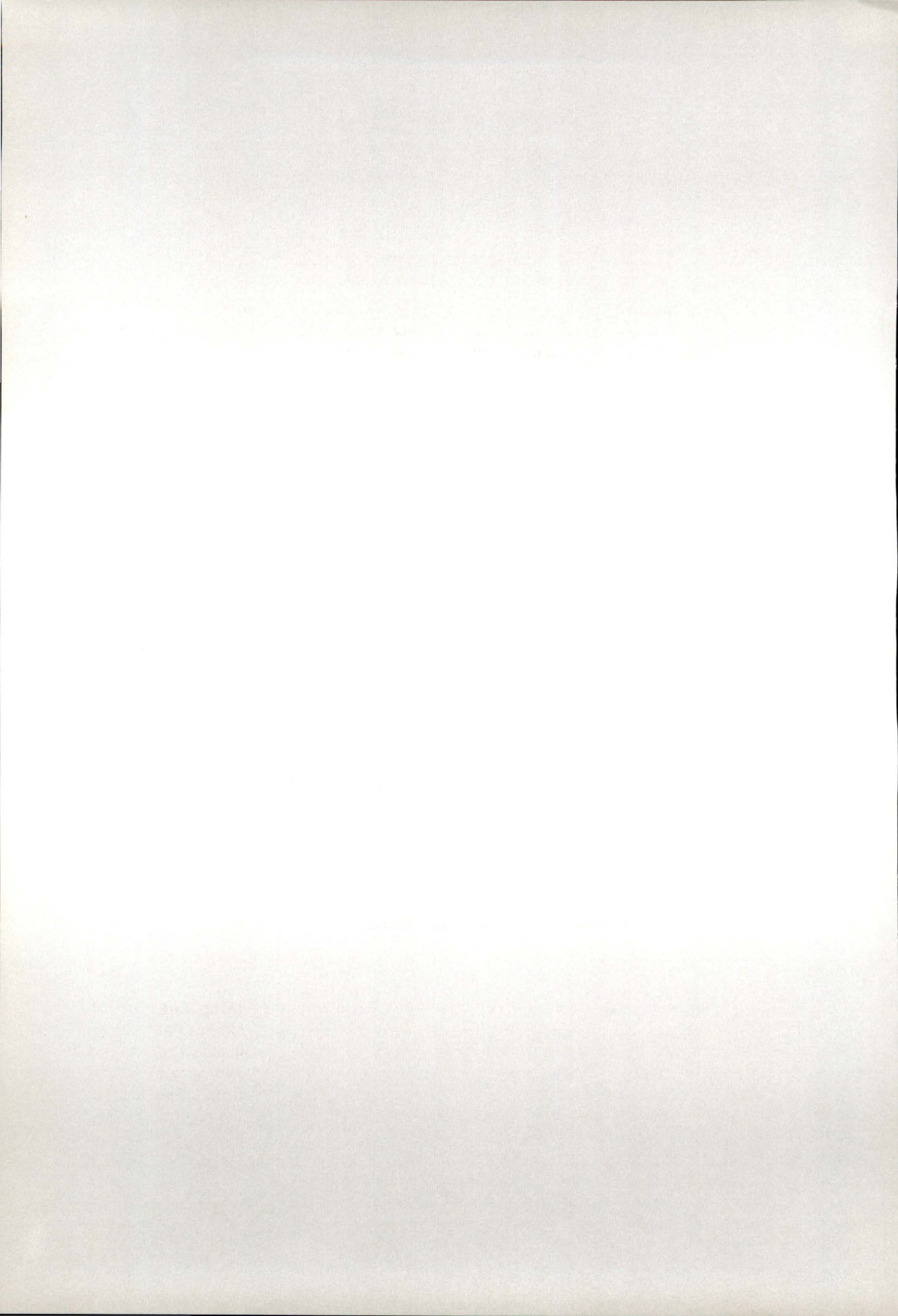
(Para no. 5.6)

CBDT accepted (June 2011) the recommendation.

CHAPTER 6

OMISSION IN ASSESSMENTS

- **Mistakes in computation of business income**
- **Mistakes in computation of capital gains**
- **Mistakes in computation of income under MAT provision**
- **Mistakes in computation, set off and carry forward of depreciation**
- **Mistakes in carry forward and set off losses**
- **Incorrect allowance of provision / liability**
- **Incorrect allowance of capital/non business expenditure**
- **Income not assessed**
- **Valuation of work in progress**
- **Conditions for computation of income under section 44 AD**
- **Recommendations**

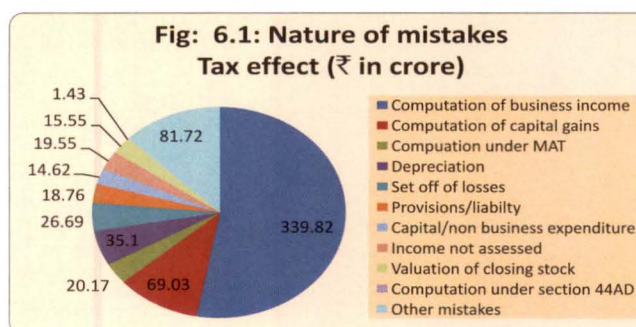


CHAPTER 6

OMISSIONS IN ASSESSMENTS

We noticed mistakes relating to computation of business income, capital gain, income under MAT provisions, incorrect allowance of depreciation and set off of past losses, incorrect allowance of capital expenditure/non business expenditure and incorrect valuation of closing stock etc.

6.1 As the provisions of the Act were not followed correctly, we noticed 675 cases relating to mistakes with a tax effect of ₹ 642.44 crore. Categorywise details are depicted in pie chart and illustrations are given below:



6.2 Mistakes in computation of business income

We noticed 118 cases of mistakes in computation of business income involving tax effect of ₹ 339.82 crore. Five cases are illustrated below:

6.2.1 Charge: CIT-IV, Kolkata, AY 2007-08

M/s. Hindustan Steelworks Construction Ltd received a specific grant of ₹ 164.03 crore from Government of India in March 2007 for the purpose of payment of old income tax liability for the assessment year 2000-01. However, assessee did not include this specific grant as its income though it should have been treated as revenue receipt. Omission resulted in over assessment of loss by ₹ 71.82 crore and underassessment of income by ₹ 92.21 crore with revenue impact of ₹ 55.21 crore.

6.2.2 Charge: CIT-II Jaipur, AY 2005-06

In the assessments of **M/s Rajasthan Housing Board Corporation Ltd**, income of ₹ 60.50 crore on account of sale of plots was not included in total income. Instead the expenditure on cost of land, cost of construction etc were debited to expenditure on properties (works) and amount received out of sale of residential houses, shop and plots was reduced there from. The remaining balances have been shown in balance sheet. Thus revenue receipt of ₹ 60.50 crore was not accounted for in revenue account involving tax effect of ₹ 24.85 crore.

6.2.3 Charge: CIT-I Delhi, AY 2007-08

M/s Anant Raj Industries Ltd.²³ engaged in the business of Sale/Purchase of Land, Building and Structures etc had forfeited the Earnest Deposit/Advance Money received from the sale of roof rights of the building and shown under the head 'Sale of Investment' in the Profit and Loss account and the same was reduced from the computation of income. We observed that the money/benefit arisen to the assessee pertained to trading/business activity and therefore, it was a trading receipt and should have been taxed accordingly. The mistake resulted in under assessment of income of ₹ 45 crore, involving short levy of tax of ₹ 20.14 crore including interest.

6.2.4 Charge: CIT-IV Delhi, AYs 2005-06 and 2007-08

Expenditure in the nature of capital is disallowable under section 37 of the Act. Further, Section 32 of the Act provides for depreciation on technical knowhow being an intangible asset.

We noticed that in the AY 2005-06, **M/s Ircan International Ltd.**²⁴ debited ₹ 8.27 crore to profit and loss account as technical know-how which being capital in nature (intangible asset) should have been disallowed (after

allowing depreciation @ 25 per cent). The mistake resulted in underassessment of income of ₹ 6.20 crore. Further, amounts of ₹ 16 crore and ₹ 11.17 crore shown on account of Foreign Projects Reserve were not utilised by the assessee and in the AY 2007-08, interest of ₹ 1.91 crore under section 234D was not charged by the Department on refund amount. These mistakes involved aggregate tax effect of ₹ 17.71 crore including interest.

6.2.5 Charge: CIT-I Patna, AY 2005-06

M/s Aparna Housing Construction Pvt. Ltd, invested ₹ 75 lakh on account of purchase of land which was not included in determining the income. Further, the closing stock of goods in transit (vehicle & spares) amounting to ₹ 1.60 crore shown in balance sheet under the head inventories was not shown in P&L account. Both mistakes resulted in short levy of tax of ₹ 1.15 crore.

6.3 Mistakes in computation of capital gains

As per section 2(47)(ii) and (v) of the Act, transfer, in relation to a capital asset includes the extinguishment of any rights therein, or any transaction allowing possession of any immovable property to be taken or retained by any other person in part performance of a contract, of the nature referred to in Section 53A of the Transfer of Property Act, would attract Capital Gains.

We noticed 30 cases involving tax effect of ₹ 69.03 crore where capital gain was not offered to tax. Two Illustrations are given below:

²³ Scrutiny assessment was completed in December 2009 determining income of Rs.92.02 crore.

²⁴ Scrutiny assessments were completed in December 2007 & 2009 respectively.

6.3.1 Charge: CIT-III Chennai, AY 2006-07

Shri Sheriff Dyan & Sherdan Games Parks and Holidays Pvt. Ltd received built up area worth ₹ 40.30 crore and ₹ 30.65 crore respectively in lieu of the land transferred. No capital gain was offered on the above transactions involving tax effect of ₹ 23.91 crore.

6.3.2 Charge: CIT-II Coimbatore, AYs 2006-07 & 2007-08

M/s Prime Textiles²⁵ allowed possession and take over of immovable property to M/s Prime Developers, a Partnership Firm, for a consideration involving capital gain of ₹ 32.86 crore. However, no tax on capital gain was offered which had a revenue impact of ₹ 10.83 crore.

6.4 Mistakes in Computation of Income under MAT provision

Section 115 JB provides for levy of MAT at the rate of 7.5 per cent of the book profit if the tax payable on total income under the normal provisions is less than 7.5 per cent of the book profit arrived at after certain additions and deletions as prescribed.

We found incorrect /non application of MAT provisions in 10 cases involving tax effect of ₹ 20.17 crore. An illustration is given below:

6.4.1 Charge: CIT-X, Mumbai, AY 2007-08

Department did not consider revised return filed by the **M/s Shivshahi Punarvasan Prakalp Ltd** while computing the income under MAT provision of the Act which resulted in underassessment of income by ₹ 13.68 crore involving non levy of tax of ₹ 1.54 crore.

Department has accepted the objection (March 2010).

6.5 Mistakes in computation, set off and carry forward of depreciation

Section 32 provides for depreciation on the cost or written down value of assets if such assets are owned by the assessee and used for the purpose of business during relevant previous year.

We noticed 69 cases in which mistakes were committed in allowance of depreciation/set off of and carry forward of losses involving revenue impact of ₹ 35.10 crore. An illustration is given below:

²⁵ Assessment was completed after scrutiny (December 2008).

6.5.1 Charge: CIT, Central, Hyderabad, AYs 2006-07 & 2007-08

M/s Madhucon Projects (P) Limited was allowed depreciation on vehicles @ 25 percent instead of allowable rate of 15 percent which resulted in excess claim of ₹ 1.86 crore in AY 2006-07. Further, due to incorrect adoption of WDV, depreciation was allowed in excess of ₹ 19.24 crore in AY 2007-08. This resulted in under assessment of income of ₹ 21.10 crore involving aggregate tax effect of ₹ 9.38 crore.

6.6 Mistakes in carry forward and set off of losses

Section 43A provides for deduction of loss on account of fluctuation in the rate of exchange of foreign currency, provided that the loss arrived at is backed by actual remittance.

We noticed 13 cases involving tax effect of ₹ 26.69 crore due to mistakes in carry forward and set off of losses. An illustration is given below:

6.6.1 Charge: CIT- V, Delhi, AY 2007-08

M/s National Building Construction Corporation Ltd debited to its profit and loss accounts foreign exchange fluctuation loss of ₹ 42.35 crore. The AO allowed the loss although it was not backed by actual remittance. This resulted in short levy of tax of ₹ 18.66 crore.

6.7 Incorrect allowance of provision/liability

Section 43B of the Act provides for certain deductions against the payments (i.e. tax, duty, cess, bonus, leave-encashment etc.) in the year in which the payments are actually made by the assessee. Further, the Act does not provide for deduction against any provision made in the accounts though fixed liabilities are allowed as deduction.

We noticed 37 cases involving short levy of ₹ 18.76 crore having mistakes in allowance of provision/liability. One case is illustrated below:

6.7.1 Charge: CIT -I, Lucknow, AY 2006-07,

M/s Jai Prakash Enterprises debited ₹ 36.28 crore towards employee's remuneration and benefits in profit and loss account. In the balance sheet an amount of ₹ 2.89 crore towards provision for gratuity and ₹ 1.50 crore towards leave encashment was shown under the head "provisions", which was not incurred during the year as mentioned in Auditor's Report. Further, ₹ 1.38 crore towards bonus and ₹ 1.37 crore towards incentive was not paid up to the date of filing the return. Thus allowance of inadmissible expenses of ₹ 6.84 crore resulted in short levy of ₹ 3.06 crore.

6.8 Incorrect allowance of Capital/non business expenditure

Section 37(1) of the Act provides that any expenditure not being expenditure of the nature prescribed in section 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the head "profits and gains of business or profession.

We noticed 18 cases involving tax effect of ₹ 14.62 crore of mistakes in allowance of capital/ non business expenditure. One case is illustrated below:

6.8.1. Charge: CIT- X, Mumbai, AYs 2005-6 & 2007-08

M/s Shivshahi Punarvasan Prkalp Ltd claimed and was allowed deduction of ₹ 18.50 crore and ₹ 8.52 crore during AY 2005-06 and 2007-08 respectively on account of 'Interest on a Project' under 'One time settlement scheme (OTS)'. As these expenditures were related to work in progress of a specific project, the same were required to be capitalised. Omission to disallow capital expenditures resulted in underassessment of income by ₹ 27.02 crore in respective years involving short levy of tax of ₹ 9.66 crore.

6.9 Income not assessed

Section 5 of the Act provides that if the assessee follows the mercantile system of accounting, the income received, accrued or is deemed to accrue or arise to the assessee in any previous year is to be included in the income of the assessee in such year.

We found 72 cases involving tax effect of ₹ 19.55 crore where income was not offered to tax. An illustration is given below:

6.9.1 Charge: CIT-I, Lucknow, AY 2006-07

M/s Uttar Pradesh Rajkiya Nirman Nigam followed mercantile system of accounting and had shown in the balance sheet under current assets ₹ 3.08 crore on account of income accrued but not received. The same was required to be included in the total income of the assessee. Further, an amount of ₹ 53.75 lakh was debited to profit and loss account towards leave encashment and again reduced ₹ 5.45 crore towards leave encashment at the time of computation. The mistake resulted in under assessment of income of ₹ 8.53 crore involving short levy of tax of ₹ 3.82 crore.

The Department (November 2010) accepted the observation partly.

6.10 Valuation of work-in-progress

Section 145 A prescribes that the valuation of inventory for the purpose of determining the income chargeable under the head "Profits and gains of business or profession" shall be in accordance with the method of accounting regularly employed by the assessee. The closing stock exhibited in the Profit and Loss Account include value of work-in-progress, besides value of raw materials, finished products etc.

We noticed 77 cases involving tax effect of ₹ 15.55 crore where value of work in progress/closing stock was not adopted correctly. An illustration is given below:

6.10.1 Charge: CIT- 1, Lucknow, AY 2007-08

M/s Bhol Singh Jai Prakash Construction Ltd had shown value of ₹ 10.83 lakh in profit and loss account as against ₹ 6.62 crore in balance sheet. Besides, closing stock of work in progress was taken at ₹ 10.83 lakh as against actual amount of ₹ 14.83 lakh as stated by the Auditor in its report. Thus, short accountal of inventories and work in progress resulted in short computation of income of ₹ 6.56 crore involving short levy of tax of ₹ 2.74 crore.

6.11 Conditions for computation of income under section 44AD

As per Section 44AD, an assessee whose gross receipts from business of civil construction does not exceed ₹ 40 lakh, income is to be adopted at 8 percent of the gross receipts paid or payable to an assessee. If the gross contract receipt of an assessee exceeds ₹ 40 lakh, the assessee is required to get his accounts audited and furnish an audit report in the prescribed form under section 44AB of the Income Tax Act.

We noticed 29 cases involving tax effect of ₹ 1.43 crore where the said provision was not complied with. One illustration is given below:

6.11.1 Charge: CIT-I, Bangalore, AYs 2004-05 & 2005-06

The assessments of a firm, **M/s. Mahima Developers**, were completed under summary in August 2006 determining income on estimate basis at 8 percent of gross receipt. We observed from the receipt/payment statement attached with the return that the firm received gross contract receipt of ₹ 3.94 crore and ₹ 3.23 crore but neither maintained and kept accounts as required under section 44AA nor got the accounts audited as required under section 44AB. The Department, however, accepted the return without audited accounts irregularly as the provision of section 44AD declaring 8 percent income on estimate basis applies where the gross receipt does not exceed ₹ 40 lakh.

Department accepted the observation stating that the penalty under section 271A would be levied.

6.12 Other cases

6.12.1 We also noticed various types of mistakes such as incorrect adoption of figures, short /non levy of interest, mistake in estimation of gross receipts, incorrect allowance of deduction against house property & over assessment of income etc in 203 cases involving tax effect of ₹ 81.72 crore.

6.13 Recommendations


We recommend that

- *The CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with. Wherever it is felt necessary the Department may also explore the possibility of capacity building for reducing the incidence of mistakes.*

(Para nos. 6.1 to 6.12)


CBDT accepted (June 2011) the occurrence of omissions/mistakes in assessments. They stated that implementation of their Central Action Plan for the year 2011-12 and monitoring by supervisory officers would improve the quality of assessments.

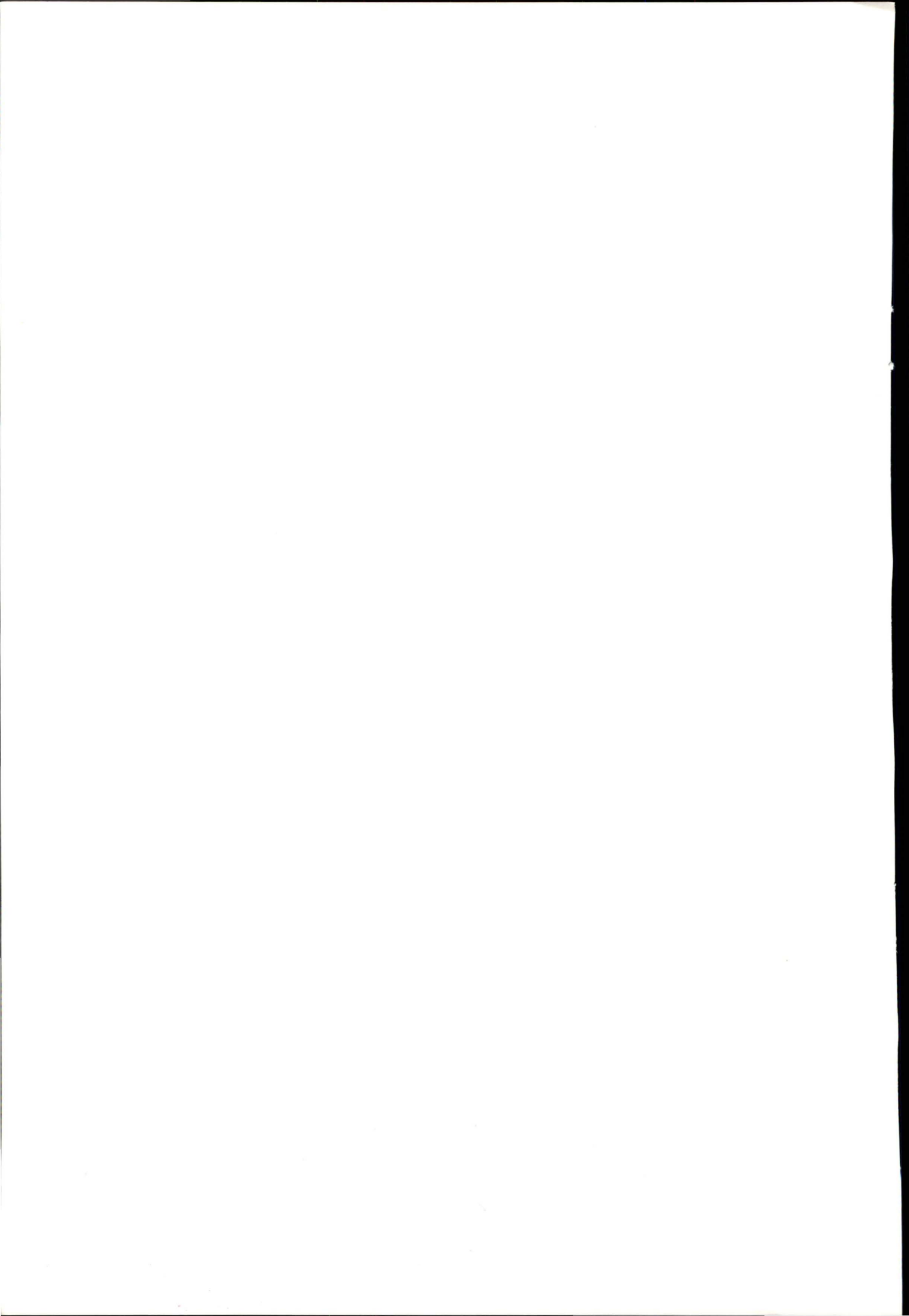
New Delhi
Dated: 1 August 2011


(MEENAKSHI GUPTA)
Director General (Direct Taxes)

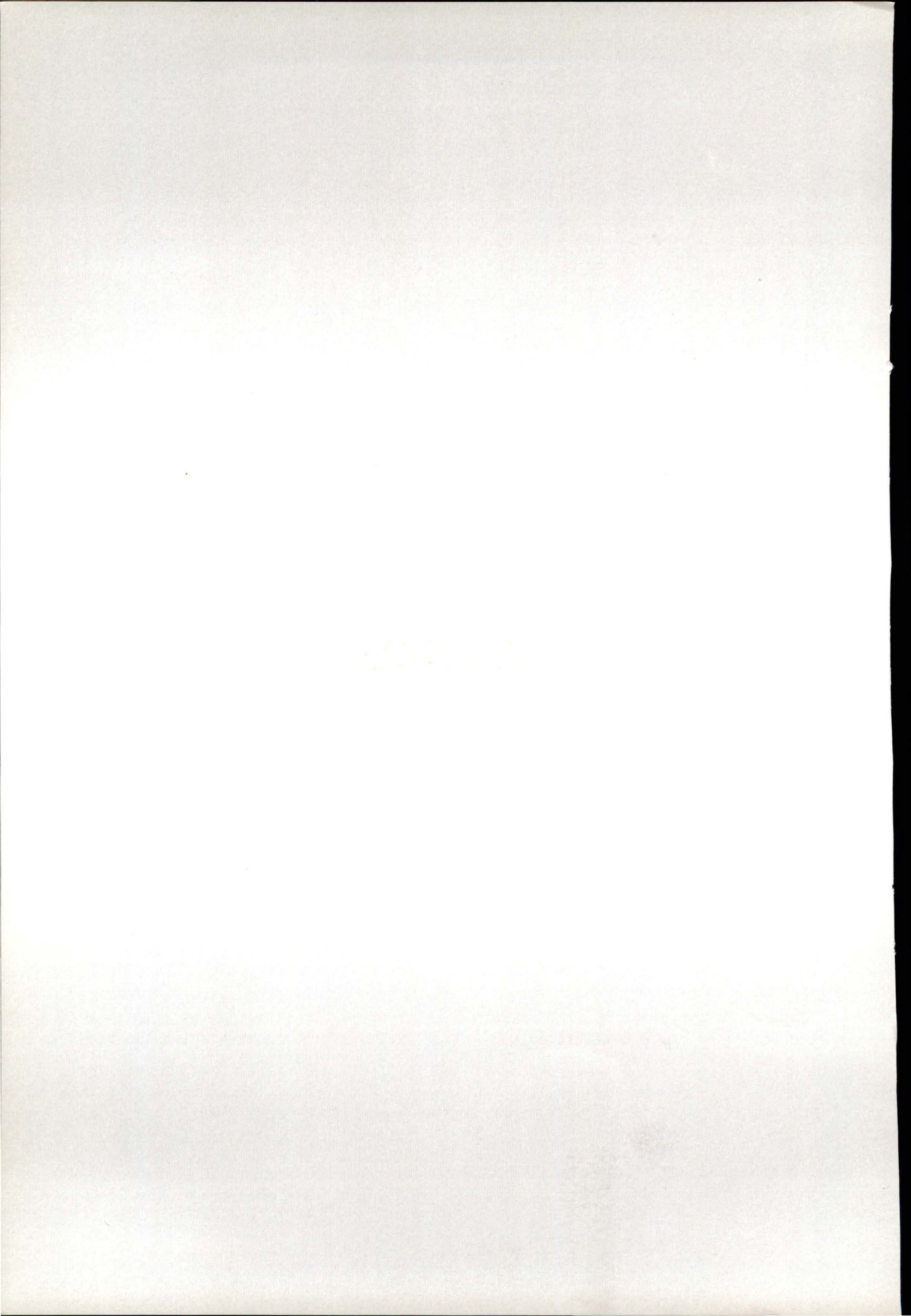
Countersigned

New Delhi
Dated: 1 August 2011


(VINOD RAI)
Comptroller and Auditor General of India



APPENDIX



Appendix 1
(Refer para no. 3.2.6.1)
Database of assessee showing business codes pertaining to civil construction

Sl No.	State	Assessee collected from different sources including DGIT (Systems)	Assessee confirmed by the Dept	Assessee not in the tax net of the Dept	Cases where codes were not filled in by the assessee	Cases where codes filled in incorrectly	Remarks
	Assam	688	0	24	0	0	24 contractors executing construction works under the Municipal Board, Silchar during financial years 2008-09 and 2009-10 were not in the taxnet.
2	Delhi	3542	0	9	0	1	9 companies did not figure in data base for AY 2009-10. In one case code was written as '505' different from business of civil construction.
3	Goa	2308	1270	0	0	164	164 cases were given incorrect codes
4	Gujarat	0	0	0	2	20	20 cases were given incorrect codes. In 2 cases no codes were filled in.
5	Maharashtra	0	0	0	3223	11	Codes left blank in 3223 cases in the list provided by DG (System). 11 assessee engaged in the business of civil construction were not included in that list. One banking company was given business code of civil construction.
6	Orissa	2939	2122	817	0	0	Out of 2939 assessee, executing construction work, identified by audit, department could furnish jurisdictional details of 2122 assessee only, though their addresses were provided.
7	West Bengal	0	0	0	0	2	Department could not arrest the codes of the assessee correctly. In two cases wrong codes were given in Form 3CD filed along with the return.

Note: In respect of remaining states, no database on business of civil construction was available.

Appendix 2
(Refer para no.3.4.1)
Incorrect certification by Chartered Accountants

Deduction under section 80IB(10) disallowed on the basis of reference made to Local Authority					
Sl. No.	Name of the assessee	CIT Charge	Assessment Year	Claim disallowed (Rs. in lakh)	Reasons on the basis of Report of DVO/Govt. approved valuer
1	M/s. Aaradya Developers	Pune V	2005-06	54.38	Exceeding the permissible limit
2	As above		2006-07	0.3	As above
3	M/s. J.K.Builders		2005-06	32.1	As above
4	As above		2006-07	124.08	As above
5	As above		2007-08	16.04	As above
6	M/s. Khandge Mehta Associates		2006-07	6.99	As above
7	As above		2007-08	18.09	As above
8	M/s. Pharande Developers		2004-05	2.24	Area is less then 1 acre
9	As above		2005-06	65.26	Exceeding the permissible limit
10	As above		2006-07	63.39	As above
11	M/s Namrata Developers		2007-08	51.61	As above
12	M/s Rohan Engineering Construction		2005-06	14.4	As above
13	As above		2006-07	28.06	As above
14	M/s D B S Developers & Promotors		2006-07	82.91	Commercial area is more than 1000 Sq Ft.
15	As above		2007-08	123.29	As above
16	M/s Sarjan Construction		2004-05	18.91	Plot of area is less than 1 acre
17	As above		2005-06	17.65	As above
18	As above		2006-07	28.7	As above
19	As above		2007-08	143.28	As above
20	M/s H A Developers		2003-04	125.21	As above
21	As above		2005-06	18	As above
22	As above		2006-07	330.32	As above
23	As above		2007-08	117.53	As above
24	M/s Kohli construction		2004-05	22.23	As above
25	As above		2005-06	9.74	As above
26	M/s Vikram Builders	Thane III	2006-07	28.37	All Buildings approved by local authority as a single plan. However, building "C" was not completed
27	As above		2005-06	33.35	As above
28	M/s Royal construction co.		2003-04	9.52	Project not completed on or before 31-3-08
29	As above		2004-05	12.68	As above
30	As above		2005-06	5.11	As above
31	M/s S B Developers		2006-07	215.86	As above
32	As above		2007-08	634.94	As above
	Grand total			2454.54	