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Report of the Comptroller and Auditor General of India

for the year ended March 1997

Union Government

(Direct Taxes)

No.12 of 1998

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for the year ended March 1997

UNION GOVERNMENT

(DIRECT TAXES)

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Prefatory Remarks

This Report for the year ended 31 March 1997 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's (Duties, Powers and Conditions of Service) Act, 1971. The Report presents the results of audit of receipts under direct taxes comprising corporation tax, income tax, wealth tax, gift tax etc. The Report is arranged in the following order:-

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

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

(iii) **Chapter 3 includes three system appraisals on Functioning of Internal audit, Method of accounting of revenue collections and refunds-Functioning of Central Treasury Unit, Zonal Accounts Office and Computer Cell and Deductions in respect of profits and gains from newly established industrial undertakings after a certain date.**

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

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

The observations included in this Report have been selected from the findings of the test audit conducted during 1996-97 as well as in earlier years but which could not be covered in the previous Reports.

Overview

Audit of Direct Taxes and Results of Audit

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

2. The tax effect of 275 audit observations and the three system appraisals featured in this report is Rs. 1104.71 crore and that of 25 cases of overassessment is Rs. 5.39 crore.

During the course of local test audit conducted in 1996-97, 15149 audit observations on underassessment involving tax effect of Rs.3392.51 crore and 44 cases of overassessment involving tax effect of Rs. 6.18 crore have been intimated to the department on Corporation tax, Income tax and Other Direct taxes. Out of these, 660 cases with tax effect of Rs. 698.16 crore and 25 cases of overassessment involving revenue effect of Rs. 5.39 crore have been issued to the Ministry as individual draft paragraphs. Out of the cases issued to the Ministry, 300 draft paragraphs with tax effect of Rs.650.28 crore (including potential tax effect of Rs.421.53 crore) have been included in this Report. Thus a very small fraction of audit findings have been included in this Report. Some cases noticed in earlier years have also featured as also few cases of overassessment of tax. The cases reported herein are those which either have substantial tax effect or have certain important/interesting features which in the perception of audit, should be reported. Of the cases featured in this Report, 135 cases involving revenue of Rs.136.05 crore (including potential tax effect of Rs.82.07 crore) have been accepted by the Ministry and remedial measures have been initiated.

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

-Functioning of Internal Audit in Income Tax Department.

-Method of accounting of revenue collections and refunds-functioning of central treasury units, zonal accounts office and computer cell.

-Deduction in respect of profits and gains from newly established industrial undertakings after a certain date.

3 (a) This Report has been prepared after considering the response of the Ministry of Finance to the audit observations, wherever received. However, the receipt of replies to individual draft paragraph cases this year has only been 59 percent against 81 percent last year. For the system appraisal of the scheme of 'allowing deductions to newly established industrial undertakings after a certain date' the concerned policy file of the Ministry was not made available. Besides, certain information regarding number of sur tax assessees for last three years and number of cases in which search and seizures conducted have not been furnished. Non-receipt of replies in large number of cases, relevant information and policy file on specific tax schemes, adversely affected the preparation of this Report.

[Paras 2.7.5, 2.16(i) and 3.3.5]

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

Revenues from direct taxes and Administration of Direct Taxes

4. The actual collections of direct taxes increased from Rs.33559.28 crore in 1995-96 to Rs.38,895.08 crore in 1996-97 constituting an increase of 15.90 percent over the previous year. The ratio of Direct Taxes in the Gross Domestic Product was 3.4 percent. The average buoyancy of direct taxes during 1996-97 was 0.03 which came down by 0.02 percent compared to the previous year.

[Para 2.2(a), 2.3(ii)(iii)]

While the collections of direct taxes increased by 15.90 percent the cumulative arrears of direct taxes also increased from Rs.28,969.59 crore in 1995-96 to Rs.33,585.12 crore representing an increase of 15.93 percent. The net arrears of direct taxes, however, came down from Rs.8,287.20 crore in 1995-96 to Rs.6,055.69 crore in 1996-97, a decrease of 26.92 percent over the previous year. Further, 55.65 percent of the net arrears outstanding as on 31 March 1997 was constituted by high demand cases of Rs.10 lakh and above which showed a decrease of 13.05 percent over the previous year.

[Para 2.9(i)(a)&(e)]

5. The expenditure incurred in collection of all direct taxes during 1996-97 was 1.27 percent of the total collections. The pre-assessment collections of direct taxes by way of tax deducted at source, advance tax and self assessment tax were 82.6 percent of the total collections.

[Para 2.5(i)&2.6.1]

6. During the year the number of assessees increased by 9.79 lakh and there were 1.16 crore assessees as on 31 March 1997. Pendency of assessments continued to remain an area of concern as the percentage of pending scrutiny and summary cases remained high at 30.64 and 12.95 percent respectively.

[Para 2.7.1(i)&2.8.1(i)]

The Department could dispose only 3 percent of its total workload of assessments after scrutiny and thus the bulk of the workload was disposed under the summary assessment scheme. Even in the high income category of cases the department could not dispose more than 22 percent cases after scrutiny.

[Para 2.8.1(iii)(a)&(b)]

7. Cases pending with appellate authorities have a perceptible impact on the assessments and collections of direct taxes. There were 1.46 lakh cases pending with Commissioners (Appeals) and 69,585 cases with Dy.Commissioner (Appeals) as on 31 March 1997. 17.6 percent of cases pending with the Commissioners were high demand cases. Besides, 1.90 lakh cases were pending with the Supreme Court, High Courts and Income Tax Appellate Tribunals.

While the arrears of direct taxes which remained uncollected as a result of stay/kept in abeyance by appellate authorities on 31 March

1997 was Rs.15,798 crore, Rs.11,280 crore was due to the stay and abeyance granted by the departmental appellate authorities.

[Para 2.9(i)(c)&2.11]

System Appraisals

8. (a) Functioning of internal audit in Income Tax Department

(i) The objectives of internal audit to play a corrective role and to exercise vigilance against mistakes leading to improvement in the quality of assessment has not been achieved. There were 4224 cases involving revenue effect of Rs.292.96 crore in which omissions and mistakes not detected by internal audit were noticed in statutory audit.

[Para 3.1.1& 3.1.13]

(ii) The absence of advance audit planning and programming and lack of proper coordination with assessment units on the one hand and statutory revenue audit on the other adversely effected the efficiency and effectiveness of scarce audit resources available. The shortfall in audit of auditable immediate and priority cases in 475 representative wards test checked during the years 1993-94 to 1995-96 ranged from 54 to 70 percent. The overall achievement of the targets fixed for audit fell short by 20 to 44 percent during the corresponding period.

[Para 3.1.7(a)& 3.1.8(b) and (d)]

8.(b) Method of accounting of revenue collections and refunds-functioning of Central Treasury Units, Zonal Accounts Office and Computer Cell.

(i) Delays in dispatch of daily collection register/daily refund register alongwith challans and refund advices to assessing officers ranged from 7 days to 31 months which would lead to delayed credits/refunds to assessees.

[Para 3.2.6(vii)]

(ii) Delays in crediting the receipts of Rs.12.44 crore by banks to government accounts ranged from a day to more than 200 days in as many as 1530 cases which involved levy of penal interest of Rs.39.55 lakh. Against it only Rs.9.69 lakh was levied and Rs.1.20 lakh collected.

[Para 3.2.8(iii)]

(iii) Misclassification of receipts and payments was noticed in 1508 cases apart from failure to segregate surcharge from tax in many cases leading to incorrect figure of net divisible proceeds under income tax allocable to States.

[Para 3.2.6(viii),7(iv)& 8 (ii)]

(iv) Large differences in the figures of tax receipts and refunds between the CTU/Zonal Accounts Officer were noticed which remained unreconciled for long period.

[Para 3.2.8(iv)]

8. (c) Deduction in respect of profits and gains from newly established industrial undertaking after a certain date.

(i) Irregular relief allowed to ineligible undertakings not complying with the condition under which relief was admissible resulted in undercharge of tax of Rs.62.82 crore in 64 cases.

[Para 3.3.8, 12, 13, 14, &18]

(ii) Deduction was allowed beyond the prescribed period of eligibility in 56 cases involving tax effect of Rs.8.52 crore.

[Para 3.3.9]

(iii) In 20 cases deduction involving tax effect of Rs.16.31 crore was allowed in excess of gross total income in violation of the overriding condition to limit the deduction by it .

[Para 3.3.15]

(iv) Incorrect computation of profits of eligible industrial undertakings by way of inclusion of other incomes not derived from it or by not setting off past years' unabsorbed depreciation or investment allowance led to undercharge of tax of Rs.49.42 crore in 215 cases.

[Para 3.3. 16 & 17]

Audit observations on Corporation Tax

9 (i) Corporation tax constitutes approximately 48 percent of the collections from direct taxes. 445 audit observations involving tax effect of Rs.670.71 crore on various irregularities/omissions/mistakes in the corporate tax assessments were issued to the Ministry of Finance for their comments.

[Para 4.3 & 4.5]

(ii) A substantial portion of underassessment was noticed in audit on account of avoidable mistakes in computation of income and tax, incorrect computation of business income, irregularities in allowance of depreciation and investment allowance, incorrect deductions under Chapter VIA and non-levy/short levy of interest.

Avoidable mistakes in computation of income and tax due to incorrect adoption of figures, arithmetical errors and application of incorrect rate of tax etc. led to undercharge of tax of Rs. 8875.47 lakh (including potential tax effect of Rs.7416.98 lakh) in 26 cases and overcharge of tax of Rs.402.39 lakh (including potential tax effect of Rs.21.44 lakh) in 17 cases in different CIT charges.

[Para 4.6 and 4.7]

(iii) In Delhi II charge, irregular allowance of Rs.287.20 lakh towards payment to a rival dealer to ward off competition by treating the same as revenue expenditure instead of capital expenditure resulted in excess computation of loss involving potential tax effect of Rs.148.63 lakh.

[Para 4.8.1]

(iv) In 8 cases in different CIT's charges, irregular deductions allowed in respect of provisions for liabilities other than accrued or ascertained liabilities resulted in short levy of tax aggregating Rs.362.91 lakh.

[Para 4.10]

(v) In West Bengal IV charge, omission to disallow provision of Rs.578.96 lakh towards payments to persons retiring under `selective voluntary scheme' on future dates resulted in undercharge of tax of Rs.515.33 lakh.

[Para 4.15.1(i)]

(vi) In Mumbai City III charge, incorrect allowance of depreciation at 100 percent instead of at normal rates on gas cylinders manufactured/purchased in bulk on the ground that the cost of each cylinder was less than Rs.5000 led to excess allowance of depreciation of Rs.112.79 lakh with consequent short levy of tax of Rs.111.55 lakh (including interest).

[Para 4.16.2(i)]

(vii)In Mumbai City XI charge, irregular set off of Rs.141.73 lakh on account of unabsorbed depreciation of earlier years even though there was no amount available to be set off resulted in

underassessment of income by a like amount involving short levy of tax of Rs.140.18 lakh.

[Para 4.16.5(i)(a)]

(viii) In Gujarat I, Ahmedabad charge, irregular set off of unabsorbed investment allowance of Rs.1395.68 lakh pertaining to earlier years in which no manufacturing or production activity was carried out led to short levy of tax of Rs.1104.26 lakh (including interest).

[Para 4.17.1(i)]

(ix) In West Bengal I charge, failure to add back Rs.1216.77 lakh being employees' contribution etc. to the contributory provident fund which was not credited to the fund account during the relevant previous year led to excess computation of loss involving potential tax effect of Rs.629.68 lakh and additional income tax of Rs.125.94 lakh.

[Para 4.20.1(i)]

(x) In Madhya Pradesh, Jabalpur charge, non-accountal of bills on account of interest payable by customers for delayed payments even though the assessee was following mercantile system of accounting and consistently charging interest payable on the basis of both receipt/debit advices, resulted in short computation of income by Rs.1244.24 lakh involving potential tax effect of Rs.643.89 lakh.

[Para 4.20.2(i)]

(xi) In Karnataka I, Bangalore charge, irregular set off of business losses of Rs.4824.47 lakh of earlier years which had already been set off resulted in potential undercharge of tax of Rs.2496.66 lakh.

[Para 4.21.1(i)]

(xii) In West Bengal III charge, failure to revise the assessment and withdraw the excess carryforward of loss consequent upon completion of the assessment for the earlier assessment year after scrutiny resulted in excess carryforward of loss of Rs.51206 lakh involving potential tax effect of Rs.26499 lakh. [Para 4.21.2(i)]

(xiii) In Mumbai City III charge, incorrect set off of short term capital loss against business income of the assessee resulted in underassessment of income by Rs.236.07 lakh with consequent short levy of tax of Rs.257.78 lakh (including interest).

[Para 4.21.3(i)]

(xiv) In Gujarat, Baroda charge, failure to withdraw depreciation and investment allowance allowed on capitalised interest on debentures, consequent upon the orders of appellate authority treating the expenditure as revenue instead of capital resulted in excess computation of loss by Rs.2296.20 lakh involving potential tax effect of Rs.1239.94 lakh.

[Para 4.22]

(xv) In West Bengal V charge, irregular allowance of chapter VIA deductions despite the fact that the gross total income worked out to a negative figure resulted in excess carryforward of loss of Rs.1904.04 lakh involving potential tax effect of Rs.875.86 lakh apart from non levy of additional income tax of Rs.175.17 lakh.

[Para 4.23(i)]

(xvi) In West Bengal II charge, irregular deduction of Rs.35.05 lakh towards profits and gains from an industrial undertaking in backward area to an ineligibile assessee company resulted in short levy of tax of Rs.30.83 lakh (including interest).

[Para 4.24]

(xvii) In Delhi II charge, irregular deduction towards profits and gains from projects outside India in the absence of remittance in foreign exchange of the profits derived therefrom within the stipulated period and inclusion of dividend income for the purpose of computing the above deduction resulted in underassessment of income aggregating Rs.83.47 lakh with consequent short levy of tax of Rs.44.12 lakh (including interest).

[Para 4.26]

(xviii) In West Bengal III charge, incorrect deduction towards export profits without considering the loss sustained by the assessee from export of trading goods resulted in underassessment of income by Rs.3329 lakh involving tax effect of Rs.1955.84 lakh (including additional income tax).

[Para 4.27.1(i)]

(xix) In West Bengal VI charge, irregular proportionate deduction for export turnover with reference to total composite income instead of forty percent of the income liable to income tax in the case of a tea company resulted in excess allowance of relief of Rs.127.89 lakh with consequent short levy of tax of Rs.86.70 lakh (including interest and additional income tax).

[Para 4..27.2]

(xx) In Mumbai City XII charge, non-inclusion of central excise duty in the total turnover resulted in excess allowance of deduction for export relief by Rs.379 lakh with consequent short levy of tax of Rs.329.50 lakh (including interest).

[Para 4.27.3(i)]

(xxi) In Karnataka I, Bangalore charge, irregular deduction of export profits for export of 'calcined petroleum coke', a non eligible item being residue of petroleum resulted in underassessment of income by Rs.74.90 lakh with resultant short levy of tax of Rs.47.79 lakh (including excess refunds).

[Para 4.27.4]

(xxii) In West Bengal III charge, grant of deduction of Rs.5480.97 lakh as against the correct amount of Rs.1445.24 lakh on account of profit derived for services rendered to foreign tourists resulted in underassessment of income by Rs.4035.73 lakh involving tax effect of Rs.2058.43 lakh.

[Para 4.28]

(xxiii) In North East Region,Shillong charge, omission to determine the net dividend income resulted in excess allowance of deduction in respect of inter-corporate dividend of Rs.610.74 lakh with consequent short levy of tax of Rs.441.87 lakh (including interest).

[Para 4.31.1(i)]

(xxiv) In Mumbai City I charge, irregular deduction towards royalties etc. received from foreign enterprises granted on income derived from rendering courier services not falling within the scope of technical or professional services resulted in underassessment of income by Rs.228.82 lakh with resultant short levy of tax of Rs.131.57 lakh.

[Para 4.32(i)]

(xxv) In Madhya Pradesh, Jabalpur charge, incorrect computation of book profit for the purpose of levying minimum tax resulted in underassessment of income by Rs.673.51 lakh involving short levy of tax of Rs.625.55 lakh (including interest).

[Para 4.33.(i)]

(xxvi) In West Bengal II charge, while computing the net demand, omission to consider the refund of Rs.86.87 lakh already made to the assessee at summary assessment stage resulted in irregular refund of Rs.86.87 lakh.

[Para 4.34]

(xxvii) In Tamil Nadu II, Chennai charge, failure to refund tax paid by way of TDS at the time of processing the return even though the assessee had returned huge loss for the current assessment year and had also unabsorbed losses of earlier years resulted in avoidable payment of interest of Rs.81.06 lakh.

[Para 4.36(i)]

(xxviii) In Mumbai City I charge, even though the assessee had obtained and repaid deposits exceeding the prescribed monetary limits otherwise than by means of account payee cheques/ bank drafts, penalty proceedings were not initiated for levy of penalty of Rs.38.86 lakh.

[Para 4.37]

Audit observations on income tax other than corporation tax.

10.(i) Income tax constitutes approximately 47 percent of the collections from Direct Taxes. 150 audit observations involving tax effect of Rs.150.07 crore on various irregularities/omissions/ mistakes in the Income tax assessments were issued to the Ministry of Finance for their comments.

(ii) Avoidable mistakes like incorrect adoption of figures, non-levy of surcharge and mistakes in computation of income and tax led to overcharge of tax of Rs.131.31 lakh in 6 cases and undercharge of tax of Rs.124.61 lakh (including potential tax effect of Rs.36.20 lakh) in 7 cases in different CIT's charges.

[Para 5.6(1)&(II)]

(iii) In Gujarat, Baroda charge, allowance of depreciation at the rate of 33.33 percent instead of admissible rate of 25 percent led to excess carry forward of depreciation of Rs.464 lakh involving potential tax effect of Rs.182 lakh.

[Para 5.11.1(i)]

(iv) In Maharashtra, Pune charge, the incorrect set off of unabsorbed investment allowance of earlier years amounting to Rs.94.84 lakh in the case of a firm engaged in construction business led to undercharge of tax of Rs.73.08 lakh (including interest).

[Para 5.12]

(v)In Mumbai City IX charge, incorrect exemption of income of a sports club attributable to a class of members not covered by the principle of mutuality led to underassessment of income of Rs.157.36 lakh involving tax effect of Rs.70.50 lakh.

[Para 5.14]

(vi) Failure to reduce the direct and indirect cost of export from export turnover and 90 percent of the gross other receipts from the profits of the business and incorrect allowance of relief in 4 cases led to excess export relief of Rs.563.02 lakh involving tax effect of Rs.542.87 lakh (including interest) in different CIT's charges.

[Para 5.18(i),(ii)&(iv)(Sl.No.1&2]

(vii) In Mumbai City III charge, incorrect exemption of interest income from investment in government and other securities in the case of a cooperative society led to underassessment of income of Rs.211.51 lakh involving tax effect of Rs.110.76 lakh (including interest).

[Para 5.19]

(viii) In West Bengal VIII charge, incorrect allocation of expenses relatable to receipt from foreign enterprise led to underassessment of income by Rs.41.45 lakh involving tax effect of Rs.20.79 lakh (including interest).

[Para 5.20]

(ix) In West Bengal Central II charge, short levy of interest for delay in filing the returns in the case of an individual amounted to Rs.32.58 lakh.

[Para 5.21.1(i)]

(x) In Maharashtra, Pune charge, non-initiation of penalty proceedings for concealment of income by way of suppression of the quantity of production involved minimum penalty of Rs.49.16 lakh.

[Para 5.22.1(i)]

Audit Observations on Wealth Tax

11. (i) In Delhi III charge, application of incorrect rate of tax resulted in overcharge of tax of Rs.4.60 lakh

[Para 6.4.1]

(ii) In Tamil Nadu III charge, omission to include certain immovable and movable properties owned by an individual assessee and seized during search operation in his net wealth resulted in non-assessment of net wealth ranging between Rs. 3.97 crore to Rs.4.07 crore with consequent non levy of tax of Rs.97.73 lakh (including interest) in the aggregate.

[Para 6.5.1(i)]

(iii) Erroneous adoption of lower average value of quoted equity shares in the case of 12 individuals and a Hindu Undivided Family without complying with the statutory requirement of furnishing a certificate of valuation by an accountant resulted in underassessment of wealth of Rs.1105.38 lakh with consequent short levy of tax of Rs.24.90 lakh (including interest) in different CIT's charges.

[Para 6.9]

(iv) Non-inclusion of specified assets in the net wealth of 7 closely held companies led to underassessment of net wealth of Rs.682.41 lakh involving non levy of wealth tax of Rs.17.39 lakh in different CIT's charges.

[Para 6.12]

Audit observations on Gift Tax

12. (i) In Karnataka II, Bangalore charge, omission to bring to tax the difference between the market value and declared sale consideration of equity shares as inadequate consideration resulted in non-levy of gift tax of Rs.10.84 lakh on the deemed gift of Rs.36.33 lakh.

[Para 6.18(i)]

(ii) In Mumbai City XI charge, failure to reckon the value of gifted property as adopted for wealth tax purposes led to non levy of gift tax of Rs.6.78 lakh on the deemed gift of Rs.22.80 lakh.

[Para 6.18(iii)]

Audit observations on Interest Tax

13. (i) In Tamil Nadu I, Chennai charge, non-inclusion of income received from bill discount, commercial papers and interest on certificate of deposits amounting to Rs.3783.01 lakh in the chargeable interest resulted in short levy of interest tax of Rs.164.89 lakh (including interest).

[Para 6.23.1(i)]

(ii) In Tamil Nadu, Chennai Central I charge, non-reckoning of Rs.2286.60 lakh received on account of interest and service charges as chargeable interest for interest tax purpose led to non-levy of interest tax of Rs.167.89 lakh (including interest).

[Para 6.23.1(ii)]

Audit observation on Expenditure Tax

14. In West Bengal Central II charge, mistake in application of rate of expenditure tax on chargeable expenditure in the case of two closely held companies resulted in short levy of expenditure tax aggregating Rs.77.91 lakh.

[Para 6.26]

Chapter 1

Introduction

General

1.1 The Direct Taxes levied by the Union Government comprise:

— **Corporation Tax** (taxes on income paid by companies, corporations etc.)
— **Income Tax**
— **Wealth Tax**
— **Gift Tax**
— **Interest Tax**
— **Expenditure Tax**

The various laws relating to Direct Taxes are administered by the Department of Revenue, Ministry of Finance through the Central Board of Direct Taxes (hereinafter called 'the Board'). The revenue from Direct Taxes during 1996-97 amounted to Rs.38,895.08 crore. Time series data on the different components of the revenue from Direct Taxes and other important statistical information on working of the tax administration machinery are given in Chapter 2 of this Report.

Statutory Audit

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

The audit of Direct Taxes is conducted through test check of assessments and other records of the department maintained in its various field offices. For examination of policy issues, introduction of particular amendments to the Income Tax Act or for examination of any background material behind the issue of circulars, instructions and decisions taken in particular cases, the records of the Central Board of Direct Taxes are also examined by the office of the Comptroller and Auditor General of India. Various prescribed checks are applied to ensure that the taxes due from assessees have been worked out in accordance with the provisions of law and levied. Reliance is placed on law as interpreted by the judicial authorities

including appellate tribunals. The thrust of statutory audit is to verify whether the systems and procedures prevalent in the department for administration of Direct Tax Laws are satisfactory for the levy and collection of taxes and to that extent, the objective is to lay emphasis on 'general' than on 'particular'. With this end in view, certain topics are selected for conducting 'System Appraisals' every year, in order to selectively review the implementation of particular provisions of the Act, schemes introduced by the government or the working of any particular wing of the tax administration.

The findings of audit in the form of audit observations are brought to the notice of the field Commissioners of Income Tax through local audit reports by the field offices of the Accountants General/Principal Directors of Audit. Important audit observations are then again subjected to technical scrutiny by the office of the Comptroller and Auditor General of India and thereafter issued to the Ministry of Finance for their comments.

Present Report

1.3 The arrangement of this Report has been mentioned in the prefatory remarks. In each case appearing in subsequent sections of this Report, the response of Ministry, to the extent available, has been indicated. Where the reply of the Ministry has not been found acceptable, the reasons therefor have been mentioned alongwith the reply of the Ministry.

A total of 15,149 audit observations on Corporation Tax, Income Tax and other Direct Taxes involving underassessment of tax of Rs.3,392.51 crore and 44 audit observations involving overassessment of tax of Rs.6.18 crore as noticed during test check of assessment records in 1996-97 were referred to the department. Out of the above, 660 cases involving underassessment of tax of Rs.698.16 crore (including potential tax of Rs.463.28 crore) and 25 cases of overassessment involving revenue effect of Rs.5.39 crore (including potential tax of Rs.0.21 crore) were issued to the Ministry of Finance as **draft paragraphs**. Only a small fraction of these cases has been featured in this Report. The selection of cases featured is based on either their monetary significance or which, in the perception of Audit, require the attention of the Parliament. The present Report contains 275 audit observations pertaining to corporation tax, surtax, income tax, wealth tax, gift tax, interest tax and expenditure tax. The revenue effect of these cases amounts to Rs.644.89 crore (including potential tax of Rs.421.32 crore in 44 cases). Besides these individual audit observations, the Report also contains system reviews on three topics viz., Functioning of Internal Audit in income tax department, Method of accounting of revenue collections and refunds-Functioning of

Central Treasury Units, Zonal Accounts Office and Computer Cell, Deductions in respect of profits and gains from newly established industrial undertakings after a certain date, the total tax effect of which is Rs.459.82 crore. 25 cases on overassessment of tax amounting to Rs.5.39 crore (including 1 case with potential tax effect of Rs. 0.21 crore) have also been featured in the Report.

Audit observations in 137 individual cases with tax effect of Rs.136.11 crore (including 21 cases involving potential tax effect of Rs. 82.07 crore) have been accepted by the Ministry. Of the cases referred to the Ministry those in which the Ministry have accepted the audit observations and have also taken remedial action including raising and collection of additional demand, have not been included in the Report unless the tax effect is very large or the case has some special features.

Of the total 15149 audit observations involving underassessment referred to earlier as resulting from test check, 1832 cases with tax effect of Rs.72.10 crore have so far been accepted by the department.

Non-receipt of Board's comments on draft paragraphs

1.4 Cases with substantial tax effect are brought to the notice of the Income Tax Department and the Ministry in the form of 'draft paragraphs'. Sufficient time is allowed thereafter to them for their response so that these could be considered before finalising this Report. However, it is disheartening to note that despite Board's instructions that all draft paragraph cases should receive the personal attention of the Commissioners of Income Tax for expeditious action, there is a steady decline in the percentage of replies received from 86.5 percent to 59 percent over last four years as indicated below:

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

Year of Report	Number of draft paragraphs issued	Replies received before finalisation of Audit Report	Percentage of cases in which replies were received	No. of cases accepted by Ministry	Percentage of cases in which Ministry accepted
1992-93	889	629	70.8	477	75.8
1993-94	620	536	86.5	427	79.7
1994-95	796	668	84	549	82.2
1995-96	831	673	81	565	84
1996-97	685	405	59	295	73

Local Audit Reports

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

Results of Test Audit in general

1.5.1 Test audit conducted between 1 April 1996 and 31 March 1997 of the assessments completed by the Income Tax Department revealed 15149 cases of underassessment involving a total revenue effect of Rs.3392.51 crore and 44 overassessment cases involving a total revenue effect of Rs. 6.18 crore, which were referred to the department. A resume of the deficiencies noticed is given below:

Corporation Tax and Income Tax

(i) During the period under report, 14345 cases involving a tax effect of Rs. 3379.84 crore were referred to the department. Of these cases, major audit observations were raised in 7888 cases involving short levy of tax of Rs.3369.85 crore. The remaining 6457 cases accounted for underassessment of tax of Rs.9.99 crore.

The underassessment of tax of Rs. 3379.84 crore (including Potential Tax) arose due to omission/irregularities and mistakes which can broadly be categorised under the following heads:

		No. of cases	Amount (Rs. in crore)
1.	Avoidable mistakes in computation of income and tax	1,450	418.34
2.	Failure to observe the provisions of the Finance Acts	553	74.12
3.	Incorrect status adopted in assessments	194	31.62
4.	Incorrect computation of income	299	11.82
5.	Incorrect computation of income from house property	136	5.88
6.	Incorrect computation of business income	3,301	1,248.97
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1,245	1,109.27
8.	Irregular computation of capital gains	320	26.09
9.	Mistakes in assessments of firm and partners	350	5.07
10.	Income not assessed	1,010	56.42
11.	Irregular set-off of losses	592	108.47
12.	Irregular exemptions and excess reliefs given	1,074	111.52
13.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1,779	96.48
14.	Avoidable or incorrect payment of interest by Government	137	8.55
15.	Omission/short levy of penalty	445	11.27
16.	Other topics of interest (Miscellaneous)	1,460	55.95
	Total	14,345	3,379.84

Wealth Tax

(ii) During test audit of assessments made under Wealth Tax Act, 1957, short levy of Rs.6.99 crore was referred to the department in 573 cases. The omissions/irregularities and mistakes can be categorised under the following heads:

		No. of cases	Amount (Rs. in crore)
1.	Wealth not assessed	246	4.07
2.	Incorrect valuation of assets	65	1.08
3.	Mistakes in computation of net wealth	30	0.05
4.	Incorrect status adopted in assessments	25	0.06
5.	Irregular/ excessive allowances and exemptions	31	0.17
6.	Mistakes in calculation of tax	65	0.78
7.	Non-levy or incorrect levy of additional wealth tax	12	0.22
8.	Non-levy or incorrect levy of penalty and non-levy of interest	64	0.30
9.	Miscellaneous	35	0.26
	Total	573	6.99

Gift Tax

(iii) During test check of gift tax assessments, 139 cases involving short levy of Rs. 3.16 crore were referred to the department.

Interest Tax

(iv) In the course of test audit of Interest Tax assessments it was noticed that in 81 cases there was short levy of interest tax of Rs. 1.27 crore.

Expenditure Tax

(v) During test check of Expenditure tax assessments, 11 cases involving short levy of Rs.1.25 crore were referred to the department.

Outstanding audit observations

1.5.2 According to the departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee (Ninth Lok Sabha) in their 20th Report recommended that the responsibility for the settlement of audit observations rests with the department and it cannot be contented merely with sending replies to audit observations. In their Action Taken Note, the Ministry of Finance had stated that they would endeavour to see that the targets for settlement of audit observations were achieved. However, large number of audit observations made in 1996-97 and earlier years are still to be settled. The details are mentioned below:

(a) On 31 March 1997, 70673 observations involving a revenue effect of Rs.5123.70 crore were pending for final action. This does not include the audit observations communicated during 1 April 1996

to 31 March 1997. The year-wise particulars of the pendency are as follows:

(Rs. in crore)

Year	Income Tax		Other Direct Taxes (Wealth Tax, Gift Tax and Estate Duty)		Total	
	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
1993-94 & before	42,597	2,919.42	7,153	68.41	49,750	2,987.83
1994-95	8,154	812.77	978	8.54	9,132	821.31
1995-96	10,646	1,298.95	1,145	15.61	11,791	1,314.56
Total	61,397	5,031.14	9,276	92.56	70,673	5,123.70

(b) There were 4064 pending audit observations as on 31 March 1997 with a revenue effect of Rs.3823.99 crore (as against 2678 in earlier year) where the income tax involved in each individual case exceeded Rs.10 lakh. The break-up of such cases in respect of a few charges where number of outstanding items are 50 or more is shown below:

Sl. No.	Name of charge	Items	Amount (Rs. in crore)
1.	Assam	75	54.16
2.	Bihar	74	137.23
3.	Delhi	1094	587.22
4.	Gujarat	204	183.38
5.	Kerala	93	39.04
6.	Madhya Pradesh	297	743.13
7.	Maharashtra	679	1,061.87
8.	Orissa	61	32.43
9.	Punjab	78	62.03
10.	Rajasthan	74	33.40
11.	Tamil Nadu	367	237.55
12.	Uttar Pradesh	148	66.46
13.	West Bengal	727	486.30

(c) There were 212 pending audit observations with a revenue effect of Rs. 17.27 crore where the wealth tax involved in each case exceeded Rs.5 lakh.

(d) There were 61 pending audit observations with a revenue effect of Rs.16.92 crore where the total gift tax involved in each case exceeded Rs. 5 lakh.

(e) There were 4 pending audit observations with revenue effect of Rs.1.15 crore where the total interest tax in each case exceeded Rs.5 lakh.

Of the 70673 pending cases with revenue effect of Rs.5123.70 crore, 4,193 cases (5.9 percent) of high tax effect accounted for Rs.3,792.87 crore (74 percent). This underlines the need to assign priority to the settlement of observations with high money value.

Steps taken to settle audit observations

1.5.3 The Action Plan of the department for 1996-97 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of statutory audit upto 31 December 1996 (i.e. period of report being 1996-97), replies are to be sent in 80 percent of the cases.

The targets for settlement of the major statutory audit observations for the year 1996-97 according to Action Plan and actual achievements were as under:

	Audit observations				
	For disposal (Rs. in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Shortfall	
				cases	Percentage
Current	9585 (2293.46)	7668 (80%)	3263 (358.11)	4405	57.45
Arrear	19101 (2245.52)	17191 (90%)	6278 (624.32)	10,913	63.48

The achievements were, therefore, well short of targets set.

Remedial action barred by time

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

In a few charges reviewed during the year 1996-97, a number of audit objections issued during the period 1981-82 to 1991-92 where remedial action became barred by limitation were noticed. Details of these cases have been forwarded to the respective Commissioners. The number of such cases alongwith tax effect are mentioned below:

Sl. No.	Charge	Corporation Tax and Income Tax	
		No. of observations	Amount (Rs. in crore)
1.	Gujarat	26	0.74
2.	Punjab	46	0.48

Internal Audit

1.6 In addition to the statutory audit, the department also has an Internal Audit Department (IAD) which is required to conduct 100 percent and 50 percent audit of all immediate and priority assessment cases respectively (as defined under departmental instructions of September 1990). Based on this, the department had determined the number of auditable cases by their IAD during 1996-97 as 3.90 lakh. However, the target was fixed at a much lower level based on 150 audit parties working during the period from 1 April 1996 to 31 March 1997 and each party being required to audit 110 cases every month. An analysis of their performance is given below:

Total auditable cases	Targets for disposal	Total cases audited	Shortfall
3,90,027	1,98,000	1,78,024	19,976

Thus achievement fell short of the targets set by 10.09 percent. The short fall in achievements has thus decreased from 21.41 percent as on 31 March 1996 to 10.09 percent as on 31 March 1997. No reasons have been furnished for shortfall in targets.

Outstanding observations of Internal Audit

1.6.1 According to the departmental instructions, observations of Internal Audit Department are to be attended to by the assessing officers within three months. However, this did not happen as seen from the fact that as on 31 March 1997, 34906 audit observations made by the Internal Audit involving a tax effect of Rs.963.71 crore were pending settlement. This included 12950 observations with money value of Rs.340.48 crore made during 1996-97.

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

Financial year	No. of cases for disposal and amount (Rs. in crore)	No. of cases settled and amount (Rs.in crore)	Percentage of total cases disposed	No. of pending cases and amount (Rs.in crore)
1993-94	18,006 (786.17)	7,752 (259.57)	43	10,254 (526.60)
1994-95	18,465 (976.34)	6,357 (261.30)	34	12,108 (715.04)
1995-96	18,990 (1,229.17)	6,286 (250.30)	33	12,704 (978.87)
1996-97	19,881 (1,314.28)	8,080 (363.33)	41	11,801 (950.95)

The Public Accounts Committee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that observations of Internal Audit should be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases became time-barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken note had stated that assessment- yearwise and agewise classification was being made so that greater attention could be paid to settlement of older and revenue significant objections. Since the normal period available for re-opening of cases is four years, all observations pertaining to 1993-94 and earlier years should have been settled by March 1997. However, this did not happen as shown in the following table which gives age-wise analysis of the pending items at the end of 1996-97 and revenue effect involved:

Year of the observation	No. of cases	Revenue effect (Rs. in crore)
1993-94 & before	17,303	325.35
1994-95	4,464	116.15
1995-96	5,009	283.01
1996-97	8,130	239.20
Total	34,906	963.71

Action on observations of Internal Audit

1.6.2 The Action Plan of the department for 1996-97 provided for 90 percent disposal of all pending major audit observations. In respect of current observations of Internal Audit upto 31 December 1996 (i.e. period of reporting being 1996-97), replies were to be sent in 80 percent of the cases.

The targets according to Action Plan and actual achievement in settlement of the major internal audit observations for the year 1996-97 were as under:

	Audit observations				
	For disposal (Rs in crore)	To be settled as per targets fixed	Settled (Rs. in crore)	Shortfall	
				Cases	Percentage
Current	7177 (335.41)	5742 (80%)	3023 (100.27)	2719	47.35
Arrear	12704 (978.87)	11,434 (90%)	5057 (263.06)	6377	55.77

The achievements were, therefore, below the targets set.

Chapter 2

Administration of Direct Taxes

Administration of Direct Taxes

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

The Board consists of a Chairman and five members, and have several attached and subordinate offices throughout the country. The attached offices function under three Directors General of Income Tax viz. Director General of Income Tax (Admn.), Director General of Income Tax (Exemption) and Director General of Income Tax (Training). There are 25 Chief Commissioners of Income Tax, who oversee the work of assessment and collection of direct taxes at regional levels. Besides, there are 5 Directors General of Investigation who are in overall charge of the investigation machinery on a regional basis to curb tax evasion and to unearth black money. The Chief Commissioners of Income Tax/Directors General of Income Tax oversee the work of the Commissioners/Directors of Income Tax in their respective charges and have also been given certain powers under the Income Tax Act, regarding discovery, production of evidence by any person, to requisition books of account, call for information etc., whereby they can issue summons. They are also empowered to authorise search and seizure operations.

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

A Settlement Commission constituted under the Income Tax Act with effect from April 1, 1976 provides a statutory remedy for avoiding protracted litigation between the assessee and the department. The

Commission deals with the settlement of Income Tax and Wealth Tax cases on applications being made by the assessees declaring their intention to pay tax on undisclosed income discovered by the department. The Commission has four benches at Delhi, Bombay, Calcutta and Madras.

Receipts under various Direct Taxes

2.2(a) The total collections from Direct Taxes for the year 1996-97 amounted to Rs.38,895.08 crore out of which Rs.13,515.94 crore was assigned to the States. The collections for the three years 1994-95, 1995-96 and 1996-97 as furnished by the Ministry of Finance are given below:

(Rs. in crore)

Head of account	Category of tax	1994-95	1995-96	1996-97	Increase in 1996-97 over the previous year
0020	Corporation Tax	13,820.96	16,487.13	18,566.69	2,079.56
0021	Taxes on income other than Corporation-tax	12,030.12	15,587.17	18,233.99	2,646.82
0023	Hotel Receipts Tax	0.16	0.91	0.98	0.07
0024	Interest Tax	801.40	1,170.05	1,712.39	542.34
0028	Other Taxes on Income and Expenditure	196.87	228.07	293.23	65.16
0031	Estate Duty	1.52	0.39	0.06	(-)0.33
0032	Taxes on wealth	104.87	74.16	77.44	3.28
0033	Gift Tax	14.98	11.40	10.30	(-)1.10
	Gross Receipts	26,970.88	33,559.28	38,895.08	5,335.80
	Less share of net proceeds assigned to the States:				
	Income Tax	8559.88	11288.32	13,515.94	
	Net Receipts	18411.00	22270.96	25,379.14	

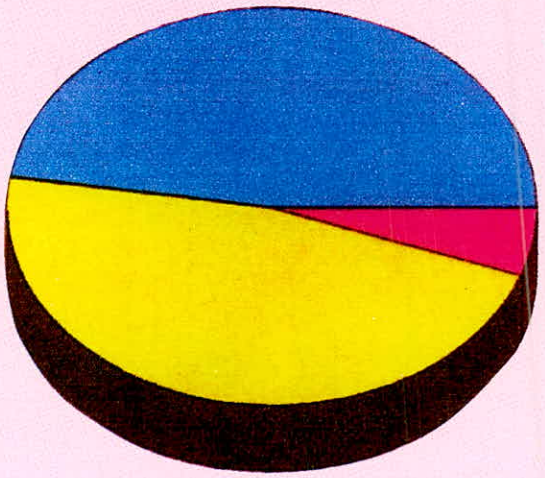
The above data reveal the following :

(i) While the Direct Taxes collections increased by 15.9 percent over the previous year as compared to 24.4 percent in 1995-96, the two important components namely Corporation Tax and Income Tax increased by 12.6 percent and 17 percent respectively as compared to 19.3 percent and 29.5 percent respectively in 1995-96.

(ii) The increase of Rs.542.34 crore in collections of interest tax over the previous year could be attributed to the increase in the number of assessees by 845 over the previous year and also increase in the "interest income" chargeable to interest tax.

2.2(b) The State/U.T. wise break-up of collections of direct taxes are given below:

Collection of Direct Taxes (1996-97)



Corporation Tax :	Rs. 18,566.69	crore
Income Tax :	Rs. 18,233.99	crore
Other Direct Tax :	Rs. 2094.40	crore

States	0020	0021	0023	0024	0028	0031	0032	0033	Total
	Corporation tax	Income Tax	Hotel Receipts Tax	Interest Tax	Expenditure Tax	Estate Duty	Wealth Tax	Gift Tax	
				(Rs. in crore)					
Andhra Pradesh	424.57	691.17	0.00	18.98	2.74	-0.23	1.11	0.39	1,138.73
Arunachal Pradesh	0.00	3.99	0.00	0.00	0.00	0.00	0.00	0.00	3.99
Assam	153.94	140.24	0.00	0.11	0.00	0.00	0.36	0.07	294.72
Bihar	32.47	370.71	0.00	0.00	0.00	-0.01	0.09	0.11	403.37
Goa	60.24	82.74	0.00	0.01	0.55	0.00	0.52	0.07	144.13
Gujarat	706.57	1,208.76	0.00	2.46	1.89	0.00	2.82	0.34	1,922.84
Haryana	59.45	221.84	0.00	0.07	0.00	-0.01	0.18	0.08	281.61
Himachal Pradesh	5.78	59.36	0.00	0.49	0.00	0.00	0.06	0.00	65.69
Jammu & Kashmir	25.43	32.35	0.00	0.52	0.00	0.00	0.12	0.00	58.42
Karnataka	522.89	1,175.42	0.00	157.18	23.71	0.01	4.12	0.78	1,884.11
Kerala	187.16	411.81	0.22	49.23	1.63	0.02	2.22	0.82	653.11
Madhya Pradesh	601.13	491.23	0.00	14.58	0.21	0.06	0.96	0.12	1,108.29
Maharashtra	8,556.20	5,853.89	0.00	1,014.25	109.46	-0.12	39.32	3.37	15,576.37
Manipur	0.05	5.25	0.00	0.00	0.00	0.00	0.00	0.00	5.30
Meghalaya	1.28	11.36	0.00	0.06	0.00	0.00	0.04	0.05	12.79
Mizoram	0.00	0.30	0.00	0.00	0.00	0.00	0.00	0.00	0.30
Nagaland	0.02	7.75	0.00	0.00	0.00	0.00	0.00	0.00	7.77
New Delhi	2,915.97	2,601.36	0.00	210.52	68.04	-0.02	7.31	1.32	5,804.50
Orissa	151.90	162.55	0.00	1.50	0.00	0.00	0.07	0.02	316.04
Punjab	99.82	404.47	0.00	17.26	0.00	-0.01	0.94	0.18	522.66
Rajasthan	159.10	341.96	0.00	17.63	5.83	0.00	0.75	0.19	525.46
Sikkim	0.03	0.23	0.00	0.00	0.00	0.00	0.00	0.00	0.26
Tamil Nadu	766.64	1,474.28	0.76	131.08	14.38	0.12	8.29	1.30	2,396.85
Tripura	0,.08	8.41	0.00	0.00	0.00	0.00	0.01	0.04	8.54
Uttar Pradesh	664.07	819.52	0.00	8.00	1.52	0.00	2.00	0.31	1,495.42
West Bengal	1,106.00	951.96	0.00	66.40	63.27	0.25	5.95	0.73	2,194.56
Union Territories									
Andaman Nicobar	3.11	5.22	0.00	0.00	0.00	0.00	0.00	0.00	8.33
Chandigarh	88.17	142.04	0.00	1.69	0.00	0.00	0.11	0.00	232.01
Daman	0.09	0.79	0.00	0.00	0.00	0.00	0.00	0.00	0.88
Diu	0.00	0.06	0.00	0.00	0.00	0.00	0.00	0.00	0.06
Dadar N. Haveli	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Pondicherry	3.17	17.01	0.00	0.37	0.00	0.00	0.09	0.01	20.65
Laxadweep	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
Silvasa	0.01	0.66	0.00	0.00	0.00	0.00	0.00	0.00	0.67
Total	17,295.34	17,698.70	0.98	1,712.39	293.23	0.06	77.44	10.30	37,088.44
CTDS	1,271.35	535.29	0.00	0.00	0.00	0.00	0.00	0.00	1,806.64
Grand Total	18,566.69	18,233.99	0.98	1,712.39	293.23	0.06	77.44	10.30	38,895.08

Thus, Maharashtra had the largest collections of Direct Taxes comprising 40 percent of the total collections, followed by Delhi, Tamil Nadu, West Bengal and Gujarat.

Trend of collection

2.3(i) The trend in collection of Direct Taxes since 1992-93 is shown below:

Year	Corporation Tax	Income Tax other than Corporation Tax	Other Direct Taxes	Total	Corporation Tax	Income Tax other than Corporation Tax	Other Direct Taxes	Total
1992-93	8,889.24	7,863.49	1,344.56	18,097.29	100 (Base)	100 (Base)	100 (Base)	100 (Base)
1993-94	10,060.06	9,122.62	1,115.56	20,298.24	113.1	116	82.9	112.1
1994-95	13,820.96	12,030.12	1,119.80	26,970.88	155.5	153	83.2	149
1995-96	16,487.13	15,587.17	1,484.98	33,559.28	185.4	198.2	110.4	185.4
1996-97	18,566.69	18,233.99	2,094.40	38,895.08	208.9	231.9	155.7	214.9

Direct Taxes - GDP Ratio

(ii) Direct Taxes collections since 1992-93 are shown below as percentage of the Gross Domestic Product:

Year	Direct Taxes	Corporation Tax	Income Tax other than Corporation tax	G.D.P at factor cost (current prices)*	Direct Taxes	Corporation Tax	Income Tax other than Corporation Tax
1992-93	18,097.29	8,889.24	7,863.49	6,27,913	2.8	1.4	1.2
1993-94	20,298.24	10,060.06	9,122.62	7,07,145	2.9	1.4	1.3
1994-95	26,970.88	13,820.96	12,030.12	8,54,103	3.1	1.6	1.4
1995-96	33,559.28	16,487.13	15,587.17	9,85,787	3.4	1.7	1.6
1996-97	38,895.08	18,566.69	18,233.99	11,49,215	3.4	1.6	1.6

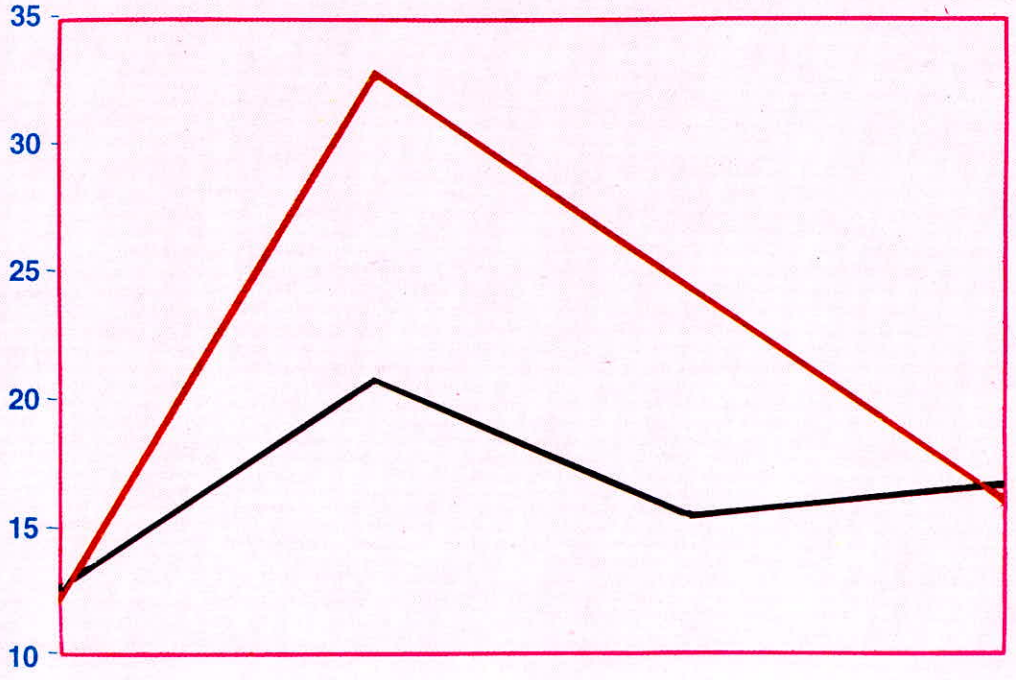
Direct Taxes as a percentage of GDP in some Asian countries with 1994-1996 figures as data base is given below:

Countries	Percentage of Direct Taxes to GDP**
Indonesia	8.6
Korea	6.0
Malaysia	9.2

* G D P figures collected from National Accounts Statistics Organisation, Ministry of Planning. The figures for 1996-97 are as per their estimates.

** Source International Monetary Fund, Government Finance Statistics and International Financial Statistics.

GDP AND TAX BUOYANCY



FIGURE

Figure in percentage	1993-94	1994-95	1995-96	1996-97
Change in revenue %	12.16	32.87	24.43	15.99
Change in GDP %	12.61	20.78	15.41	16.58

Pakistan	3.1
Philippines	5.4
Singapore	6.7
Sri Lanka	2.5
Thailand	5.7

(iii) Buoyancy or income elasticity of tax is measured by the ratio of change in tax revenues to change in GDP at current prices. This would be a reliable indicator of whether the tax administration have taken full advantage of the growth in GDP to optimise the resources mobilised through tax collections. As the following table shows, the buoyancy of tax has picked up upto the year 1995-96 but has come down in 1996-97.

Year	Change in revenue over previous year		Change in GDP over previous year		Buoyancy
	Amount (Rs.in crore)	Percent	Amount (Rs. in crore)	Percent	
1992-93	2,755	17.95	86,025	15.87	0.03
1993-94	2,201	12.16	79,232	12.61	0.02
1994-95	6,673	32.87	1,46,958	20.78	0.04
1995-96	6,588	24.43	1,31,684	15.41	0.05
1996-97	5,336	15.99	1,63,428	16.58	0.03

Variation between budget estimates and actual receipts

2.4(i) The comparative position of actual receipts vis-a-vis the budget estimates under the different heads for the years 1992-93 to 1996-97 are as follows:

Year	Budget Estimates	Actuals (Rs. in crore)	Variation	Percentage of variation
0020- Corporation Tax				
1992-93	8,125.00	8,889.24	764.24	9.41
1993-94	10,500.00	10,060.06	(-) 439.94	(-) 4.19
1994-95	12,480.00	13,820.96	1340.96	10.74
1995-96	15,500.00	16,487.13	987.13	6.37
1996-97	18,688.00	18,566.69	(-)121.31	(-)0.64

0021- Taxes on income other than Corporation Tax				
1992-93	7,870.00	7,863.49	(-) 6.51	(-) 0.08
1993-94	9,500.00	9,122.62	(-) 377.38	(-) 3.97
1994-95	10,925.00	12,030.12	1105.12	10.11
1995-96	13,500.00	15,587.17	2087.17	15.46
1996-97	17,843.00	18,233.99	390.99	2.19

Other Direct Taxes*				
1992-93	1,158.00	1,344.56	186.56	16.11
1993-94	1,260.00	1,115.56	(-) 144.44	(-) 11.46
1994-95	1,385.00	1,119.80	(-) 265.20	(-) 19.15
1995-96	1,276.00	1,484.98	208.98	16.38
1996-97	1,561.00	2,094.40	533.40	34.16

(ii) The details of variation under the heads subordinate to the Major heads 0020 and 0021 and under Major head 0024 - Interest Tax for the year 1996-97 are as follows:

	Head of revenue	Budget Estimates	Actuals	Variation	Percentage
		(Rs. in crore)			of variation
	0020-Corporation Tax				
(i)	Income Tax on companies	16,264.00	17,948.59	1,684.59	10.36
(ii)	Surtax	1.00	0.26	(-)0.74	(-)74.0
(iii)	Surcharge	2,351.00	459.99	(-)1,891.01	(-)80.43
(iv)	Other receipts	72.00	157.85	85.85	119.23
	Total	18,688.00	18,566.69	(-)121.31	(-)0.64
	0021 - Taxes on income other than Corporation Tax				
(i)	Income tax	17,557.00	17,587.46	30.46	0.17
(ii)	Surcharge	143.00	536.95	393.95	275.49
(iii)	Other receipts	143.00	109.58	(-)33.42	(-)23.37
(iv)	Total	17,843.00	18,233.99	390.99	2.19
(v)	Deduct share of proceeds assigned to States	13,023.53	13,515.94	492.41	3.78
	Net Collection	4,819.47	4,718.05	(-)101.42	2.10

0024 - Interest Tax			
1,250.00	1,712.39	462.39	36.99

Analysis of collection

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

(i) The sub-head wise break-up of total income tax collections for companies, non-companies at pre-assessment and post-assessment stages

* includes Interest Tax, Estate Duty, Wealth Tax and Gift Tax.

for the years 1992-93 to 1996-97, as furnished by the Ministry of Finance, are given below:

(Rs in crore)

Year	Tax collections							
	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds	Net Collections
Company								
1992-93	2,321.19	6,886.67	1032.48	1,437.88	424.86	12,103.08	2,489.04	9,614.04
1993-94	2,772.27	7,303.43	1,250.58	2,382.51	397.46	14,106.25	4,045.96	10,060.29
1994-95	3,810.91	9,770.02	952.84	2,030.36	614.59	17,178.72	3,357.76	13,820.96
1995-96	5,096.71	11,477.04	1,112.19	4,598.40	665.27	22,949.61	6,462.48	16,487.13
1996-97	5,138.94	14,206.80	1,260.57	4,234.06	1,480.31	26,320.68	7,753.99	18,566.69
Non-company								
1992-93	3,888.34	3,030.98	1005.38	676.60	459.49	9,060.79	1165.44	7,895.35
1993-94	4,510.31	3,794.34	1156.06	714.19	285.17	10460.07	1340.96	9,119.11
1994-95	5,792.84	4,725.06	1,461.62	982.73	396.14	13,358.39	1,328.29	12,030.10
1995-96	8,849.02	4,871.94	1,701.16	1,170.16	530.49	17,123.23	1,536.06	15,587.17
1996-97	10,195.39	5,472.08	2,028.43	1,298.37	1,048.21	20,042.48	1,808.49	18,233.99
Total								
1992-93	6,209.53	9,917.65	2037.86	2,114.48	884.35	21,163.87	3,654.48	17,509.39
1993-94	7,282.58	11,907.77	2,406.64	3,096.70	682.63	24,566.32	5,386.92	19,179.40
1994-95	9,603.75	14,495.08	2,414.46	3,013.09	1,010.73	30,537.11	4,686.05	25,851.06
1995-96	13,945.73	16,348.98	2,813.81	5,768.56	1,195.76	40,072.84	7,998.54	32,074.30
1996-97	15,334.33	19,678.88	3,289.00	5,532.43	2,528.52	46,363.16	9,562.48	36,800.68

Thus 82.6 percent of the collections were made at the pre-assessment stage with the balance being collected after assessment. Further, 78.3 percent of the collections in company cases and 88.3 percent in non-company cases in 1996-97 were made at pre-assessment stage.

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

	Amount (Rs in crore)
Salaries	6,026.13
Interest on securities	2,044.20
Dividends	1,022.72
Interest	2,811.86
Winnings from lottery or cross word puzzles	57.30
Winnings from horse races	47.87
Payments to contractors and sub-contractors	2,233.28
Insurance commission	130.53
Payment to non-residents and others	960.44
Total	15,334.33

(iii) The following details of statements of tax deducted at source for the year 1996-97 indicate a shortfall in the returns received from tax deductors:

1.	**No. of tax deductors as on 1 April 1996**	**4,95,869**
2.	**Adjustment/progressive additions upto 31 March 1997**	**1,84,043**
3.	**Effective tax deductors (1+2)**	**6,79,912**
4.	**No. of returns required to be filed by tax deductions at 3**	**6,79,912**
5.	**Returns received upto 31 March 1997**	**5,91,729**
6.	**Balance 4-5**	**88,183**

Cost of collection

2.6.1 The total expenditure incurred during the years 1992-97 in collecting the direct taxes was as under:

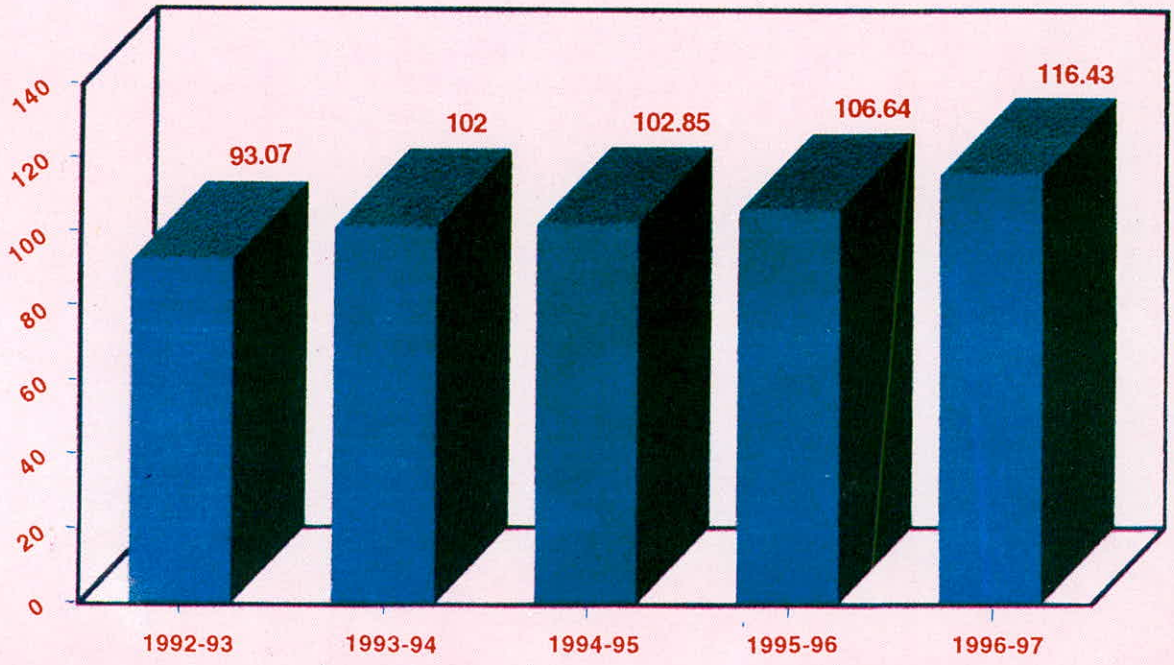
Year	Collection	Expenditure	Percentage
	(Rs. in crore)		
1992-93	18,097.29	296.48	1.63
1993-94	20,298.24	335.43	1.65
1994-95	26,970.88	388.27	1.44
1995-96	33,559.28	492.24	1.47
1996-97	38,895.08	494.15	1.27

The cost of collection has been showing a declining trend as the department's work force and as a consequence its expenditure, have remained more or less static.

However, as 82.6 percent of the collections was made at the pre-assessment stage, the cost of collection as a percentage of post assessmnt collection on account of corporation tax and taxes on income other than corporation tax which could be attributed to departmental efforts shows slight increase over last year as shown below:

Year	Collection on regular assessment	Expenditure on collection	Percentage
	(Rs. in crore)		
1992-93	2114.48	265.87	12.57
1993-94	3096.70	300.67	9.71
1994-95	3013.09	349.35	11.59
1995-96	5768.56	450.61	7.81
1996-97	5532.43	444.57	8.04

Number of assessees (1992-93 to 1996-97)



No. of assessees (in lakh)

2.6.2 The expenditure incurred during the year 1996-97 in collecting other direct taxes together with the corresponding figures for the preceding five years, is as follows:

Year	Collection	Expenditure on collection	Percentage
	(Rs.in crore)		
1992-93	1,344.56	30.61	2.27
1993-94	1,115.56	34.76	3.12
1994-95	1,119.80	38.92	3.47
1995-96	1,484.98	39.22	2.64
1996-97	2,094.40	49.58	2.37

Number of assessees

2.7 Under the provisions of the Income Tax Act, 1961, tax is chargeable on the total income of the previous year of every person. The term 'person' includes an individual, a Hindu undivided family, a company, a firm, an association of persons, or a body of individuals, a local authority and an artificial juridical person.

Income Tax

2.7.1 For the assessment year 1996-97, no income tax was payable on a total income not exceeding Rs.40,000 in case of individuals non-specified Hindu undivided families, association of persons and body of individuals. For specified Hindu undivided family, firms, co-operative society and local authority, lower limits were applicable. Corporate assessees are required to pay taxes at specified rates on their income.

(i) The department brought 9,79,029 additional assessees on its books during 1996-97, bringing the total number of assessees as on 31 March 1997 to 1.16 crore. The comparative break-up of the number of assessees as on 31 March 1996 and 31 March 1997 is given below:

	31 March 1996	31 March 1997
Individuals	87,98,212	97,61,426
Hindu undivided families	4,06,456	4,12,470
Firms	11,92,193	11,58,319
Companies	1,87,574	2,27,228
Trusts	42,769	49,629
Others	37,310	34,471
Total	1,06,64,514	1,16,43,543

(ii) The following table indicates the category wise break-up of assessees as on 31 March 1997:

Category	Individuals	Hindu undivided families	Firms	Companies	Others (including Trusts)	Total
(i) Category 'A'[1]	94,43,293	3,92,243	10,91,502	1,28,137	74,953	1,11,30,128
(ii) Category 'B' (Lower)[1]	2,40,262	12,162	41,946	43,622	6,545	3,44,537
(iii) Category 'B' (Higher)[2]	40,964	3,696	12,474	25,277	813	83,224
(iv) Category C'[3]	19,149	2,321	7,860	26,951	1,645	57,926
(v) Category 'D'[4]	17,758	2,048	4,537	3,241	144	27,728
Total	97,61,426	4,12,470	11,58,319	2,27,228	84,100	1,16,43,543

The above table shows that 98.5 percent assessees are from lower categories i.e with income below Rs.5 lakh, whereas only 1.5 percent of the assessees were from the higher income categories i.e. with income of Rs.5 lakh and above.

Wealth Tax

2.7.2 Under the provisions of the Wealth Tax Act, 1957, wealth tax is levied for every assessment year on the net wealth of every individual and Hindu undivided family according to the rates specified in the schedule to the Act. No wealth tax was levied on companies with effect from 1 April 1960. However, levy of wealth tax on companies has been revived in a limited way with effect from 1 April 1984. For the assessment year 1996-97, no wealth tax was payable where the net wealth was less than Rs.15 lakh.

The number of wealth tax assessees in the books of the department as on 31 March 1996 and 31 March 1997 were as follows:

---

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

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

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

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

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

	31 March 1996	31 March 1997
Individuals	3,35,954	2,55,136
Hindu undivided families	42,194	33,141
Companies	12,441	11,631
Total	3,90,589	2,99,908

Thus the number of wealth tax assessees as on 31 March 1997 has decreased by 90,681 as compared to 31 March 1996.

Gift Tax

2.7.3 Under the provisions of the Gift Tax Act, 1958, gift tax is levied according to the rates specified in the schedule for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including Hindu undivided family) or a company or an association of persons or body of individuals (whether incorporated or not) during the previous year. During the assessment year 1996-97 no gift tax was payable where the value of taxable gifts did not exceed Rs.30,000.

The number of gift tax assessees in the books of the department as on 31 March 1996 and 31 March 1997 were as follows:

	31 March 1996	31 March 1997
Individuals	47,872	45,777
Hindu undivided families	1,146	1,246
Companies	152	124
Firms	22	18
Others	755	199
Total	49,947	47,364

Thus the number of gift tax assessees as on 31 March 1997 has decreased by 2,583 as compared to 31 March 1996.

Interest Tax

2.7.4 Under the Interest Tax Act, 1974, as reintroduced with effect from 1 October 1991, by the Finance (No.2) Act, 1991, interest tax is leviable on the chargeable interest income of 'Credit Institutions'. Such credit institutions, inter alia, included co-operative societies engaged in the business of banking, not being co-operative societies which provide credit facilities to farmers or village artisans, for the assessment year 1993-94. The interest income chargeable to tax includes interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange.

The number of assessees for interest tax in the books of the department as furnished by the Ministry of Finance for the last two years were as under:

Year ending	No. of assessees
31 March 1996	3,117
31 March 1997	3,962

Sur Tax

2.7.5 Under the Companies (Profits) Surtax Act, 1964, surtax is levied on the chargeable profits of a company insofar as they exceed the statutory deductions, which is equal to 15 percent (from 1 April 1977) of the capital of the company or Rs. two lakh, which ever is greater.

The number of surtax assessees in the books of the department has not been furnished by the Ministry of Finance for the last three years.

Arrears of assessments

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

Working strength of officers for the last three years was as under:

Nature of posts	1994-95		1995-96		1996-97	
	Assessment Duty	Non-Assessment Duty	Assessment Duty	Non-assessment Duty	Assessment Duty	Non-assessment Duty
Addl.Commissioners/ Dy.Commissioners	224	268	236	250	213	225
Asstt. Commissioners	880	165	948	180	922	128
Income Tax Officers	1,778	415	2,054	420	2,034	408
Total	2,882	848	3,238	850	3,169	761

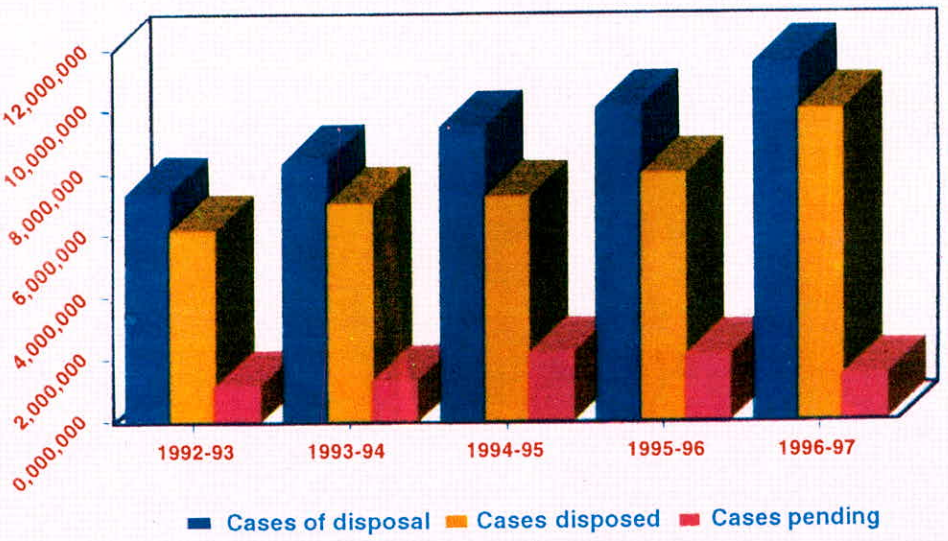
Income Tax (including Corporation Tax)

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

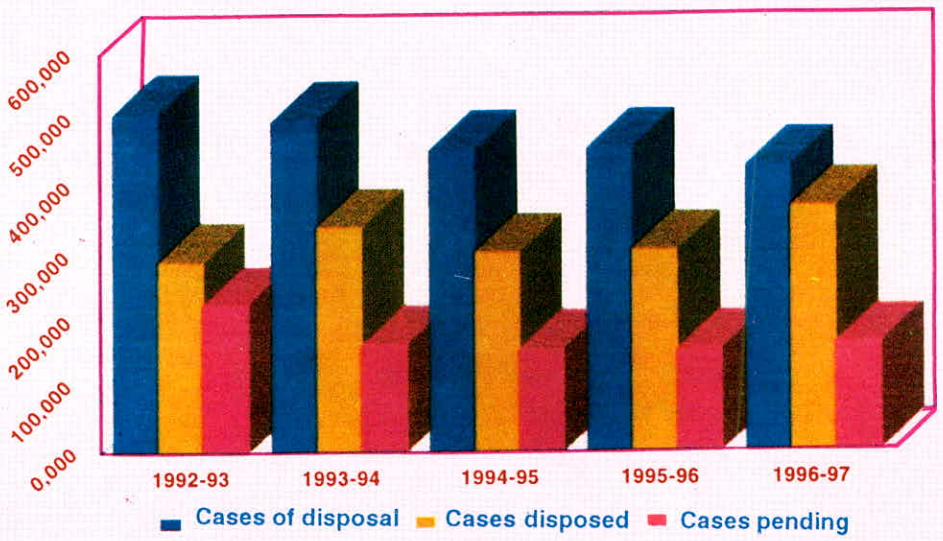
Financial Year	Number of assessments for disposal			Number of assessments completed			Percentage of disposal
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1994-95	4,53,353	95,51,857	1,00,05,210	2,98,669	72,94,097	75,92,766	75.89
1995-96	4,55,446	1,01,66,080	1,06,21,526	3,01,534	79,98,319	82,99,853	78.14
1996-97	5,28,154	1,15,83,285	1,21,11,439	3,66,329	1,00,82,930	1,04,49,259	86.27

The break-up of assessments pending at the end of the years 1994-95 to 1996-97 is given below:

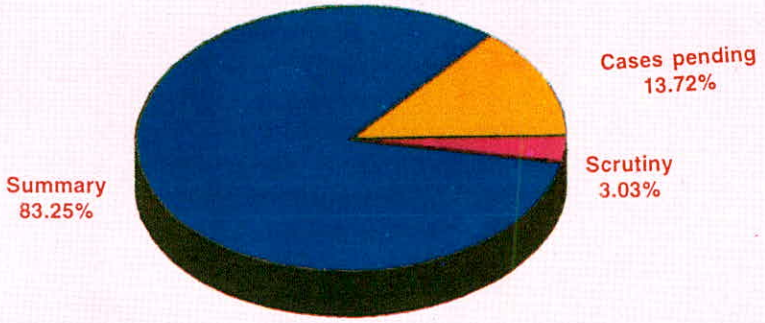
Disposal of summary assessment cases (1992-93 to 1996-97)



Disposal of scrutiny assessment cases (1992-93 to 1996-97)



Disposal of cases (1996-97)



Year	Scrutiny	Summary	Total
1994-95	1,54,684 (34.12)	22,57,760 (23.64)	24,12,444
1995-96	1,53,912 (33.79)	21,67,761 (21.32)	23,21,673
1996-97	1,61,825 (30.64)	15,00,355 (12.95)	16,62,180

(Figures in parentheses denote percentage of pendency with reference to the number of assessments for disposal)

It would be seen from the preceding table that though the overall pendency of cases decreased over the previous year yet the percentages of pending scrutiny and summary assessment cases was high though the Board had issued instructions for according priority to increasing disposal of both summary and scrutiny assessments.

(ii) Status-wise break-up of income tax assessments completed during the years 1994-95 to 1996-97 were as under:

		1994-95	1995-96	1996-97
(a)	Individuals	62,28,273	68,91,794	88,26,523
(b)	Hindu undivided families	3,01,731	2,92,996	3,63,574
(c)	Firms	8,17,282	8,55,645	9,56,127
(d)	Companies	1,86,938	1,99,086	2,35,385
(e)	Others	58,542	60,332	67,650
	Total	75,92,766	82,99,853	1,04,49,259

(iii) Status-wise and category-wise break-up of work load, disposals and pendency of assessments as on 31 March 1997 was as under:

			Workload		Disposal		Balance	
			Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny	Scrutiny	Non-Scrutiny
1.	Category 'A' Assessments	Company	22,598	1,38,194	14,813	1,04,797	7,785	33,397
		Non-Company	3,53,788	1,13,12,482	2,51,137	96,04,032	1,02,651	17,08,450
2.	Category 'B' (lower) Assessments	Company	20,096	62,512	12,096	50,523	8,000	11,989
		Non-Company	48,957	2,65,178	31,333	2,08,538	17,624	56,640
3.	Category 'B' (higher) Assessments	Company	6,119	13,681	3,208	11,599	2,911	2,082
		Non-Company	13,966	49,775	9,566	39,365	4,400	10,410

4.	Category 'C' Assessments	Company	24,554	33,435	12,598	22,938	11,956	10,497
		Non-Company	16,349	31,137	8,964	23,175	7,385	7,962
5.	Category 'D' Assessments	Company	3,865	497	2,485	328	1,380	169
		Non-Company	23,009	9,047	14,685	8,307	8,324	740
6.	Total	Company	77,232	2,48,319	45,200	1,90,185	32,032	58,134
		Non-Company	4,50,922	1,13,34,966	3,21,129	98,92,745	1,29,793	14,42,221

(a) The department could dispose 3 percent of its total workload of assessment cases by scrutiny assessments.

(b) In the higher income category of cases i.e. 'B higher' and 'C', the disposal of scrutiny cases was 16.2 and 21.7 percent in company cases and 15.0 and 18.9 percent in non-company cases.

Thus bulk of the workload has been disposed by summary assessment cases and even in the higher income category of cases the department could only complete 22 percent of cases in a scrutiny manner.

(iv) Status-wise and year-wise break-up of pendency of income tax assessments as on 31 March 1997 is as under:

	Status	1992-93 and earlier years	1993-94	1994-95	1995-96	1996-97	Total
	(a) Company assessments						
(i)	Regular	76	70	884	24,762	62,419	88,211
(ii)	Reopened/set side	680	325	307	408	235	1,955

	(b) Non-company assessments (c)						
(i)	Regular	26,937	1,845	20,334	3,32,448	11,68,007	15,49,571
(ii)	Reopened/set aside	3,331	1,732	3,487	4,347	9,546	22,443

The number of assessments pending as on 31 March 1997 was 16,62,180 as compared to 23,21,673 as on 31 March 1996 and 24,124,44 on 31 March 1995.

Other Direct Taxes
(A) Wealth Tax

2.8.2 Status-wise number of wealth tax assessments due for disposal, completed and pending for the years 1994-95 to 1996-97 were as follows:

Assessments	Year	Individuals	Hindu Undivided families	Companies	Total
Due for disposal	1994-95	2,60,006	34,876	11,407	3,06,289
	1995-96	1,53,915	22,979	8,516	1,85,410
	1996-97	1,25,818	18,327	9,516	1,53,661
Completed	1994-95	2,05,495	25,278	6,952	2,37,725
	1995-96	72,263	9,270	3,851	85,384
	1996-97	62,710	8,083	3,930	74,723
Pendency at the end of the year (percentage in parentheses)	1994-95	54,511 (20.96)	9,598 (27.52)	4,455 (39.05)	68,564 (22.38)
	1995-96	81,652 (53.05)	13,709 (59.66)	4,665 (54,78)	1,00,026 (53.95)
	1996-97	63,108 (50.15)	10,244 (55.89)	5,586 (58.70)	78,938 (51.37)

(B) Gift Tax

Status-wise number of gift tax assessments due for disposal, completed and pending for the years 1994-95 to 1996-97 were as under:

Assessments	Year	Individuals	HUFs	Companies	Firms	Others	Total
Due for disposal	1994-95	29,806	753	90	15	3264	33,928
	1995-96	30,457	894	148	19	219	31,737
	1996-97	31,344	931	159	16	43	32,493
Completed	1994-95	24,625	609	44	3	2864	28,145
	1995-96	23,230	596	83	9	191	24,109
	1996-97	27,017	571	60	9	33	27,690
Pendency at the end of the year (Percentage in parentheses)	1994-95	5,181 (17.38)	144 (19.12)	46 (51.11)	12 (80.00)	400 (12.25)	5,783 (17.04)
	1995-96	7,227 (23.73)	298 (33.33)	65 (43.92)	10 (52.63)	28 (12.78)	7,628 (24.04)
	1996-97	4,327 (13.80)	360 (38.67)	99 (62.26)	7 (43.75)	10 (23.25)	4,803 (14.78)

(C) Sur Tax and Interest Tax

The number of surtax and interest tax assessments due for disposal, completed and pending for the years 1994-95 to 1996-97 were as follows:

Assessments	Year	Surtax	Interest Tax
Due for disposal	1994-95	1,649	6,704
	1995-96	929	7,189
	1996-97	684	12,378
Completed	1994-95	499	1,810
	1995-96	73	2,864
	1996-97	68	5,374
Pendency at the end of the year	1994-95	1,150	4,894
(Percentage in parentheses)		(69.73)	(73.00)
	1995-96	856	4,325
		(92.14)	(60.16)
	1996-97	616	7,004
		(90.06)	(56.58)

Arrears of demands

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

Corporation Tax (including surtax) and Income Tax

(i)(a) Details of uncollected tax for the years 1994-95 to 1996-97 are given below:

	1994-95 (Rs. in crore)	1995-96 (Rs.in crore)	1996-97 (Rs.in crore)
Total amount of tax remaining uncollected as on 31 March	22,698.64	28,969.59	33,585.12
Arrears not fallen due as on 31 March	11,014.43	7,598.32	9,365.96
Amount claimed to have been paid but remaining to be verified/adjusted	658.47	3,167.56	2,054.98
Amount stayed/kept in abeyance	4,530.25	9,698.16	15,798.52
Amount for which installments had been granted but had not fallen due	157.78	218.34	309.96

Thus, the arrears remaining uncollected increased by Rs. 4,615.53 crore constituting 15.9 percent over the previous year.

(b) The year-wise position of arrears remaining uncollected in company and non-company cases for the years 1994-95 to 1996-97 is given below:

	1994-95 (Rs.in crore)	1995-96 (Rs.in crore)	1996-97 (Rs.in crore)
Companies	**9,890.12**	**12,433.53**	**15,432.64**
Non-companies	**12,808.52**	**16,536.06**	**18,152.48**
Total	**22,698.64**	**28,969.59**	**33,585.12**

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

(c) The details of demands of income tax (including corporation tax) stayed/kept in abeyance as on 31 March 1995 to 31 March 1997 were as follows:

		31 March 1995 (Rs.in crore)	31 March 1996 (Rs.in crore)	31 March 1997 (Rs.in crore)
(1)	**By courts**	**998.57**	**779.44**	**3,830.15**
(2)	**Under Section 245 F (2) (Application to Settlement Commission)**	**130.31**	**136.85**	**306.48**
(3)	**By Tribunals**	**214.79**	**386.49**	**381.63**
(4)	**By Income tax authorities due to**			
	(i) Appeals and revisions	**840.70**	**1,002.52**	**5,723.03**
	(ii) Double income tax claims	**32.66**	**30.28**	**31.46**
	(iii) Restriction on remittance Sec.220 (7)	**4.58**	**18.91**	**6.20**
	(iv) Other reasons	**2,308.64**	**7,343.67**	**5,519.57**
	Total	**4,530.25**	**9,698.16**	**15,798.52**

(d) The total outstanding demand remaining uncollected as on 31 March 1997 of Rs.33,585.12 crore comprised arrear demand of Rs.19,643.18 crore of earlier years. The age wise analysis of the arrear demand of corporation tax, income tax, interest and penalty is given below:

(Rs. in crore)

		Corporation Tax	Income Tax	Interest	Others	Total
1.	Over 1 year but less than two years	1,297.60	3,747.19	5,597.84	273.55	10,916.18
2.	Over 2 years but less than 5 years	928.58	2,401.87	3,088.50	304.63	6,723.58
3.	Over 5 years but less than 10 years	898.87	268.42	305.24	139.94	1,612.47
4.	Over 10 years	94.83	145.38	102.74	48.00	390.95
Total		3,219.88	6,562.86	9,094.32	766.12	19,643.18

(e) The following table gives the break-up of the gross arrears of Rs. 33,585.12 crore by certain slabs of income:

(Rs. in crore)

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Upto Rs.1 lakh in each case	2,89,924	2,588.76	781.36	45,50,714	2,248.56	926.43	48,40,638	4,837.32	1,707.79
Over Rs.1 lakh to Rs.10 lakh in each case	18,755	1,373.53	417.31	92,828	1,081.68	560.43	1,11,583	2,455.21	977.74
Over Rs.10 lakh to Rs.1 crore in each case	4,410	1,996.28	620.83	6,131	1,482.93	681.35	10,541	3,479.21	1,302.18
Over Rs. 1 crore in each case	1,235	9,474.07	1,423.38	840	13,339.31	644.60	2,075	22,813.38	2,067.98
Total	3,14,324	15,432.64	3,242.88	46,50,513	18,152.48	2,812.81	49,64,837	33,585.12	6,055.69*

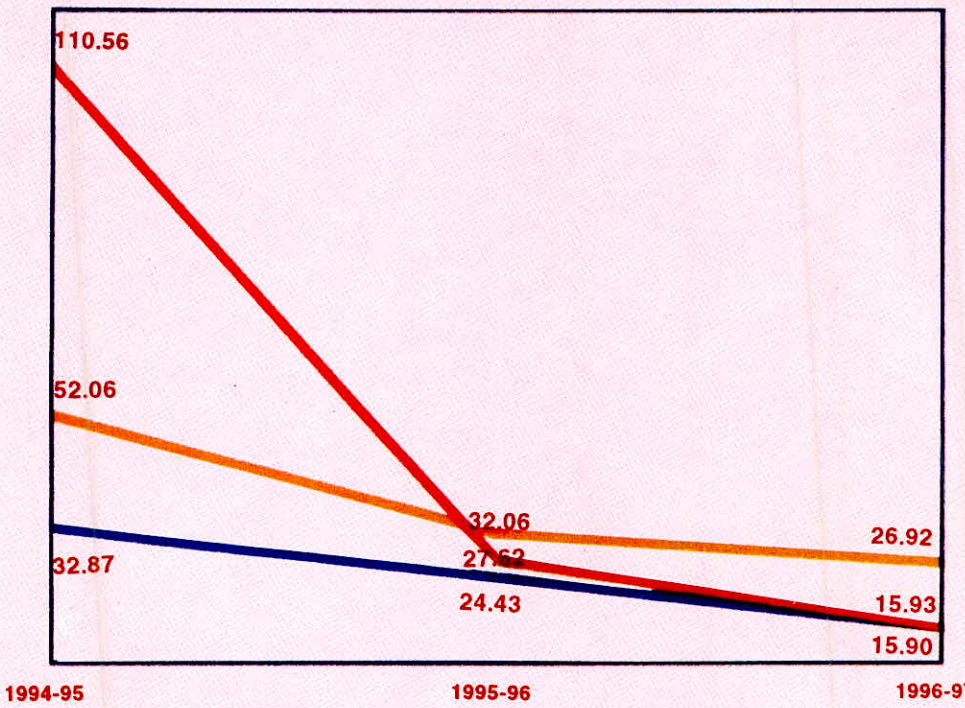
Thus 55.6 percent of the total net arrears of Rs.6,055.69 crore outstanding on 31 March 1997 was constituted by high demand cases of Rs.10 lakh and above. The department needs to accord priority for recovering these arrears.

Other Direct Taxes

The following table gives the year-wise arrears of demands outstanding under Wealth Tax, Gift Tax and Interest Tax as on 31 March 1997.

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

Growth in collection and arrears (1994-95 to 1996-97)



Percentage growth in revenue

Percentage growth in gross arrears

Percentage growth in net arrears

(Rs. in crore)

	Wealth tax	Gift Tax	Interest Tax
Over one year but less than two years	473.23	13.51	220.37
Over two years but less than five years	216.53	11.48	11.94
Over five years but less than ten years	84.12	5.41	1.22
Over ten years	34.56	3.35	0.93
Total	808.44	33.75	234.46

The above data reveals that the arrears of wealth tax are alarmingly high as they were 10.4 times of the collections of wealth tax as on 31 March 1997.

Tax Recovery Machinery

2.10 Under the provisions of the Income Tax Act, 1961, every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty days of the service of notice of demand. On the default of an assessee in this respect, the assessing officer may forward a certificate specifying the demand of arrears to the Tax Recovery Officer for recovery of demand. The latter will serve a notice on the defaulter requiring him to pay the demand within fifteen days. If the amount mentioned in the notice is not paid within the time specified therein or within such further time as the Tax Recovery Officer may grant in his discretion, he shall proceed to realise the amount together with interest at the rate of 1.5 percent per month or part of month (from 1 April 1989) on the outstandings till the date of recovery by one or more of the following modes:

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

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

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

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

(i) The number of Tax Recovery Officers engaged in tax recovery work during 1994-95 to 1996-97 was as follows:

Year	Sanctioned Strength	Working Strength
1994-95	240	185
1995-96	192	157
1996-97	163	139

(ii) The tax demands certified to the Tax Recovery Officer and the progress of recovery during 1994-95 to 1996-97 are given in the following table:

(Rs. in crore)					
Year	**At the beginning of the year**	**Demand certified during the year**	**Total**	**Demand recovered during the year**	**Balance at the end of the year**
1994-95	1654.56	414.24	2068.80	697.01	1371.79
1995-96	1371.79	753.54	2125.33	730.49	1394.84
1996-97	1394.84	1,098.60	2,493.44	742.60	1,750.84

Thus, the balance of arrears certified to the Tax Recovery Officers for recovery did not show any perceptible decline.

(iii) Year-wise break-up of certificates pending as on 31 March 1997 and amount of demand:

Year	**No. of Certificates**	**Amount**
		(Rs. in crore)
1992-93 and earlier years	6,61,491	458.31
1993-94	26,533	164.18
1994-95	39,490	224.50
1995-96	47,748	267.67
1996-97	35,613	636.18
Total	8,10,875	1,750.84

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

(Rs. in crore)							
	Range of Demand	**Corporation Tax**		**Income Tax**		**Wealth Tax**	
		No.	**Amount**	**No.**	**Amount**	**No.**	**Amount**
(a)	Upto Rs.10,000	44,036	14.82	5,31,521	154.42	76,310	8.54
(b)	Over Rs.10,000 and below Rs.1 lakh	7,500	18.45	1,00,774	117.20	9,420	8.89
(c)	Over Rs.1 lakh to Rs.5 lakh	1,784	34.61	11,671	197.64	737	8.83
(d)	Over Rs.5 lakh to Rs.10 lakh	753	30.25	3,451	150.09	138	5.13
(e)	Over Rs.10 lakh	646	176.06	3,187	799.96	136	13.84
Total		54,719	274.19	6,50,604	1,419.31	86,741	45.23

(Rs. in crore)									
	Range of Demand	Gift Tax		Sur Tax		Others		Total	
		No.	Amount	No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	16,258	1.75	202	0.06	610	0.17	6,68,937	179.76
(b)	Over Rs.10,000 and below Rs. 1 lakh	1,204	1.29	267	0.31	73	0.37	1,19,238	146.51
(c)	Over Rs.1 lakh to Rs.5 lakh	91	0.51	40	0.04	21	0.31	14,344	241.94
(d)	Over Rs.5 lakh to Rs.10 lakh	11	0.20	-	-	14	0.32	4,367	186.00
(e)	Over Rs.10 lakh	6	0.54	2	0.45	12	5.79	3,989	996.63
	Total	17,570	4.29	511	0.86	730	6.96	8,10,875	1,750.84

(v) Details of disposal and pendency of attached property are indicated below:

Particulars	Movable properties			Immovable properties		
	No.of cases	No.of properties	Approximate value (Rs. in crore)	No.of cases	No.of properties	Approximate value (Rs.in crore)
Properties attached	2,405	-	133.17	3,364	4,848	514.36
Sales conducted	9	16	0.09	11	12	0.20
Not sold over six months	224	-	1.80	-	-	-
Not sold over one year	-	-	-	739	1,035	76.83
Not sold over three years	-	-	-	1,029	1,547	131.68

	Number	Amount (Rs.in crore)
Cases in which receiver appointed	34	12.86
Defaulters against whom arrest proceedings initiated	206	3.80

Appeals, Revision petitions and Writs

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

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

A taxpayer can approach the Commissioner of Income Tax to revise an order passed by an assessing officer or by an Appellate Assistant Commissioner within one year from the date of such orders. The Commissioner can also take up for revision an order which, in his view, is prejudicial to the interest of revenue.
The number of Commissioners and Deputy Commissioners (Appeals) during 1996-97 was as follows:

Commissioners	**177**
Deputy Commissioners	**45**

Pendency position of appeals as on 31 March 1997

(i) Pending with Commissioners (Appeals)

	Total appeals	High demand appeals	With demand of Rs.10-25 lakh	With demand above Rs.25 lakh
Appeals for disposal	**2,28,559**	**50,870**	**5,087**	**5,216**
Completed	**82,831**	**25,196**	**3,060**	**3,142**
Pending	**1,45,728**	**25,674**	**2,027**	**2,074**

(ii) Pending with Deputy Commissioners (Appeals)

	Total Appeals	High demand
Appeals for disposal	**1,02,394**	**4,686**
Completed	**32,809**	**1,914**
Pending	**69,585**	**2,772**

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

	Supreme Court	High Court	Income Tax Appellate Tribunal
Appeals, references and writs for disposal	**7,926**	**57,320**	**1,38,952**
Completed	**160**	**2,000**	**11,919**
Pending	**7,766**	**55,320**	**1,27,033**

Reliefs and Refunds

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

The particulars of cases of direct refunds for which claims were made during the years 1994-95 to 1996-97 were as under:

Financial year	Opening balance	Claims received during the year	Total	No. of claims disposed off	Balance outstanding
1994-95	11,075	87,377	98,452	81,730	16,722
1995-96	16,722	1,22,592	1,39,314	1,04,362	34,952
1996-97	34,952	1,22,760	1,57,712	1,07,782	49,930

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

(a) Details of cases resulting in refund as a result of appellate order and revision orders etc. as on 31 March 1997 were as under:

Financial Year	Opening Balance	Addition	Disposal	Closing Balance
1996-97	3,280	37,924	37,031	4,173

(b) The yearwise analysis of the closing balance was as under:

Financial Year in which application was made	Number of cases pending
1992-93 and earlier years	275
1993-94	333
1994-95	416
1995-96	644
1996-97	2,505
Total	4,173

Interest

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

Details relating to interest paid on refunds by Government under certain relevant sections of the Income Tax Act, 1961, for the years 1994-95 to 1996-97 were as under:

(Rs.in crore)

Section under which interest paid	1994-95		1995-96		1996-97	
	No.of assessments	Amount	No. of assessments	Amount	No. of assessments	Amount
214	19,183	7.30	22,067	7.79	20,864	7.42
243	1,345	0.14	1,274	6.64	9	0.01
244	9,21,769	172.32	9,83,633	305.57	1,66,629	100.41
244A	3,27,569	252.37	2,99,749	669.36	15,31,464	622.13

Cases settled by Settlement Commission

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

(i) The number of cases settled by the Settlement Commission during the years 1994-95 to 1996-97 were as under:

Income Tax				
Financial year	No. of cases for disposal	No. of cases settled	Percentage of cases settled	No. of cases pending
1994-95	2,553	450	17.63	2,103
1995-96	2,631	485	18.43	2,146
1996-97	2,617	472	18.03	2,145

Wealth Tax				
Financial Year	No. of cases for disposal	No. of cases settled	Percentage of cases settled	No. of cases pending
1994-95	386	59	15.28	327
1995-96	356	98	27.53	258
1996-97	307	109	35.50	198

(ii) The number of cases pending for admission/held up with Settlement Commission as on 31 March 1997 were as under:

Cases pending for admission before Settlement Commission	**519**
Cases held up with Settlement Commission for want of comments of the department.	**120**

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

Financial Year	Income Tax		Wealth Tax	
	(Rs. in lakh)			
	Additional tax collected/collectable on admission of applications	Gross demand created in respect of cases settled	Additional tax collected/collectable on admission of application	Gross demand created in respect of cases settled
1994-95	3,089.39	2,412.73	36.49	34.00
1995-96	2,814.74	4,726.89	189.66	119.30
1996-97	4,245.36	5,179.99	30.68	122.54

Penalties and prosecutions

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

Income Tax (including Corporation Tax)

(i)(a) Penalty proceedings initiated, disposed of and pending for for the years 1994-95 to 1996-97 were as under:

Year	Opening balance	Additions	Total	Disposal	Closing balance
1994-95	2,32,161	72,282	3,04,443	85,217	2,19,226
1995-96	2,19,226	64,144	2,83,370	67,923	2,15,447
1996-97	2,15,447	75,335	2,90,782	67,720	2,23,062

(b) Details regarding prosecutions launched, convictions/compoundings and acquittals for the years 1994-95 to 1996-97 were as under:

Year	Complaints filed during the year	Convictions	Compounding	Acquittal	Total
1994-95	327	47	106	98	251
1995-96	288	79	1,592	487	2,158
1996-97	393	20	643	637	1,300

(c) Details relating to penalty cases such as work load, disposal, pendency and penalties imposed for the year 1996-97 are as follows:

Nature of penalty	Work load	Disposal	Balance
For Concealment	1,47,989	26,396	1,21,593
Others	1,42,793	41,324	1,01,469
Total	2,90,782	67,720	2,23,062

Analysis of pendency particulars	Less than 6 months	More than 6 months
For concealment	29,729	91,864
Others	29,671	71,798

Penalties imposed (Rs. in crore)		
Particulars	No. of cases	Amount
For concealment	11,832	264.61
Others	21,351	83.13

(d) Details of pendency of penalty and composition money levied, collected and pending for the years 1994-95 to 1996-97 were as under:

(Rs.in crore)

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	penalty	composition money	penalty	composition money	penalty	composition money	penalty	composition money
1994-95	284.27	67.72	97.85	91.88	72.47	19.41	309.65	140.19
1995-96	309.65	140.19	152.89	68.71	53.05	18.09	409.49	190.81
1996-97	434.73	197.84	110.32	117.74	112.99	67.78	432.06	247.80

Other Direct Taxes

(ii) (a) Penalty proceedings initiated, disposed of and pending for the years 1994-95 to 1996-97 are given below:

Year	Opening balance	Additions	Disposal	Closing balance
1994-95	53,519	8,178	12,984	48,713
1995-96	48,713	922	10,836	38,799
1996-97	38,799	2,662	9,126	32,335

(b) Details of pendency of penalty and composition money levied, collected and pending for the years 1994-95 to 1996-97 were as under:

(Rs. in crore)

Year	Opening balance		Levied during the year		Collected during the year		Balance outstanding	
	penalty	composition money	penalty	composition money	penalty	composition money	penalty	composition money
1994-95	10.62	3.18	4.58	0.14	0.91	0.44	14.29	2.88
1995-96	14.29	2.89	2.42	0.30	1.67	0.28	15.04	2.91
1996-97	15.69	2.91	0.66	1.98	1.02	0.99	15.33	3.90

Searches and seizures

2.16 Sections 132, 132A and 132B of the Income Tax Act, 1961, provide for search and seizure operations. A search has to be authorised by a Director/Commissioner of Income Tax or a specified Deputy Director or a Deputy Commissioner of Income Tax. Where as a result of search before 1 July 1995, any money, bullion, jewellery or other valuable article or thing is seized, the assessing officer after necessary investigations, has to make an order with the approval of the Deputy Commissioner of Income Tax within 120 days of the seizure, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability, and retain in his custody such assets as are, in his opinion, sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the persons from whose custody they were seized. From 1 July 1995 assessment of search cases are governed by Chapter XIV-B of the Income Tax Act. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approves of the retention for longer period.

(i) The number of cases in which searches and seizures were conducted for the three years 1994-95 to 1996-97 were as under:

Year	Total No. of searches and seizures conducted	Value of assets seized (Rs. in crore)
1994-95	4830	381.43
1995-96	4612	458.14
1996-97	information not furnished by Ministry	

(ii) (a) Particulars of income determined, tax levied, balance tax outstanding after adjustment of value of assets retained on final assessment for the year 1996-97 were as follows:

(Rs.in crore)

No. of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery		
		Tax	Penalty	Total		Tax	Penalty	Total
14,392	7,861.67	6,541.30	15.01	6,556.31	1,011.11	5,530.94	14.26	5,545.20

(b) The number of cases of prosecutions launched, compounded and convictions obtained for the years 1994-95 to 1996-97 were as under:

Year	No. of prosecutions launched			Disposal of cases		
	Opening balance	During the year	Total	No. of cases compounded	No. of cases in which convictions were obtained	No. of cases pending
1994-95	17,647	327	17,974	106	47	17,821
1995-96	17,821	288	18,109	1,592	79	16,438
1996-97	16,438	393	16,831	643	20	16,168

(c) Particulars of cases of assets returned, interest paid and cases pending for the year 1996-97 were as under:

No. of cases where assets were due for return			No. of cases where assets were returned	No. of cases where interest was paid during the year	Balance cases pending
Opening balance	Added during the year	Total			
1,184	2,032	3,216	1,784	26	1,432

Survey

2.17 (i) Number of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the years 1994-95 to 1996-97 were as under:

Year	No. of premises surveyed	
	under section 133A(1)	under section 133B
1994-95	10,237	7,81,307
1995-96	8,277	7,74,595
1996-97	9,073	8,09,523

(ii) The number of cases where evidence about ostentatious expenditure was collected under Section 133A(5) of Income Tax Act, 1961, for the years 1994-95 to 1996-97 were as under:

Year	No. of cases
1994-95	462
1995-96	not furnished by Ministry
1996-97	386

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

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

(i) Details of properties purchased by the Central Government during the financial year ended 31 March 1997 were as under:

	Calcutta	Chennai	Ahmedabad	Delhi	Mumbai	Total
(i) No. of statements received in form 37-I	116	332	547	922	708	2,625
(ii) No. of properties purchased	1	1	1	3	4	10
(iii) Value of properties purchased (Rs. in crore)	0.32	0.35	2.40	6.01	6.43	15.51
(iv) No. of properties where consideration exceeds Rs.50 lakh	-	-	1	2	4	7

(ii) The disposal of acquired properties and those awaiting disposal (for entire country) during 1996-97 is given below:

No. of properties sold	Sale value	Properties awaiting disposal	Amount
	(Rs. in crore)		
18*	20.39*	74**	55.42**

Revenue demands written off by the department

2.19(a) Details regarding amount written off for the year 1996-97 as furnished by the Ministry of Finance, are as under:

No. of cases identified involving arrear demand of Rs.10,000 and below where recovery certificates were isued upto 31 March 1979			Details of cases considered for write off during the year			Details of cases written off during the year			Details of balance of cases to be written - off		
No. of assessees	No. of entries	Total amount involved (Rs. '000)	No. of asses sees	No. of entries	Total amount involved (Rs. '000)	No. of assessees	No. of entries	Total amount written-off (Rs. '000)	No. of assessees (1-7)	No. of entries (2-8)	Total amount to be written off (Rs. '000) (3-9)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
63,215	75,510	69,520	41,029	52,754	28,398	51,962	64,801	24,402	11,253	10,709	45,118

(b) Category-wise details of revenue demands written off by the Department during 1996-97 were as under:

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

(i) Income Tax (including Corporation Tax)

(Rs.in crore)

Category	Company		Non-company		Total	
	No.	Amount	No.	Amount	No.	Amount
Assessees having died leaving behind no assets or have become insolvent or gone into liquidation.	-	-	447	1.11	447	1.11
Assessees who have gone into liquidation or are defunct	-	-	16	0.01	16	0.01
Total of (a) and (b)	-	-	463	1.12	463	1.12
Assessees being untraceable.	51	0.01	24,621	2.53	24,672	2.54
Assessees having left India	-	-	1,435	0.09	1,435	0.09
Other reasons:						
Assessees who are alive but have no attachable assets.	3	0.60	1,402	0.37	1,405	0.97
Amount being petty etc.	38	0.01	53,829	4.71	53,867	4.72
Amounts written off as a result of scaling down of demand.	-	-	14,622	0.82	14,622	0.82
Total	41	0.61	69,853	5.90	69,894	6.51
Amount written off on grounds of equity or as a matter of international courtesy, or where time, labour and expense involved in legal remedies for realisation are considered disproportionate to the recovery.	--	--	175	0.01	175	0.01
Grand Total:	92	0.62	96,547	9.65	96,639	10.27

(ii) Other Direct Taxes

(Rs.in lakh)

Amount written off due to untraceability of assessees	Wealth Tax		Gift Tax	
	No.	Amount	No.	Amount
	34	0.09	58	0.16

Chapter 3

System Appraisals

3 .1 Review on the functioning of internal audit in income tax department

Introductory

3.1.1 Internal audit was introduced in 1954 in the Income Tax Department with a view to provide a second check over the arithmetical accuracy of assessments made by the Assessing Officers. With the entrustment of audit of Direct Taxes to the Comptroller and Auditor General of India in 1960, the scope of duties of Internal Audit was made co-extensive with that of statutory audit in pointing out errors, omissions and mistakes, if any, committed during assessment and having mistakes remedied without loss of time. Though initially only income tax cases were subjected to scrutiny by Internal Audit, subsequently wealth tax, gift tax and estate duty cases have also been included. Internal Audit is also given a free hand to enlarge its scope of scrutiny to bring out new and interesting points that may come to light.

The Internal Audit set up in the Income Tax Department works under the overall control of the Member (Revenue and Audit) in the CBDT. Below him at the apex level is the Director of Income Tax (Audit) who co-ordinates the functions of the Internal Audit formations under different Chief Commissioners of Income Tax/Commissioners of Income Tax. The Commissioner of Income Tax is primarily responsible for all Internal Audit work relating to functioning of the Department's Audit Organisation. Under each CCIT/CIT there is Addl.CIT (Audit)/Dy.CIT (Audit) who plan, organise and direct the actual audit work through Special Audit Parties (SAP)/Internal Audit Parties (IAP). Each SAP is headed by an Asstt. Commissioner of Income Tax and assisted by two Inspectors, one Tax Assistant/UDC and one Stenographer. An IAP is headed by an Income Tax Officer and is assisted by one Inspector, three Tax Assistants/UDCs and one LDC.

The main objectives of Internal Audit are:

(i) to play a corrective role of pointing out mistakes committed during assessments and taking remedial action;

(ii) to exercise vigilance for prevention of mistakes having both deterrent as well as reformative effect;

(iii) to improve the quality of assessments, reduce errors and omissions which are subsequently detected by Revenue Audit.

Procedure

3.1.2 The Internal Audit Manual of the Income Tax Department regulates the functioning of Internal Audit and its various agencies. The auditable assessment cases have been classified into three categories .

(i) Immediate (to be checked by Special Audit Parties)
(ii) Priority (to be checked by Internal Audit Parties)
(iii) Residual (to be checked by Internal Audit Parties)

Immediate cases:

(i) All assessment falling in category C* & D**

(ii) All cases of Trusts and Charitable institutions in which the corpus of the trust exceeds Rs.10 lakh.

(iii) All refund cases where refund is Rs.50,000 and above in income tax and Rs.25,000 and above in other direct taxes.

(iv) In respect of other direct taxes cases, the same would fall in category of Immediate cases, if the assessed wealth/assessed value of taxable gifts/principle value of estate exceeds the limit specified below:-

Wealth Tax-	Twenty lakh
Gift Tax-	Five lakh
Estate Duty-	Five lakh

(v) All surtax assessments in which the surtax assessed is Rs.50,000 and above.

Priority Cases:

(i) All company cases with income/loss from Rs.50,000 to Rs. 5 lakh.
(ii) All non-company assessments with income/loss from Rs.2 lakh to Rs.5 lakh.

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* C-Company and non-company assessments with income/loss of Rs. 10 lakh and above.
**D-Search and Seizure assessments

(iii) All cases of Trusts and Charitable institutions where the corpus of the trust exceeds Rs. 5 lakh

(iv) All refund cases in which the refund is Rs.10,000 and above, but less than Rs.50,000 in income tax and Rs.10,000 and above but less than Rs.25,000 in all other direct taxes.

(v) All Wealth Tax, Gift Tax and Estate Duty assessments in which the assessed net wealth/assessed value of taxable gift/principal value of Estate exceeds the limit specified below:

(a) Wealth Tax Rs.5 lakh to Rs. 20 lakh
(b) Gift Tax Rs.50,000 to Rs. 5 lakh
(c) Estate Duty Rs.2 lakh to Rs.5 lakh

(vi) All surtax assessments in which the surtax is less than Rs.50,000 including no demand cases.

Category*	Scrutiny	Non-scrutiny
A	10%	2%
B	100%	10%
C	100%	100%
D	100%	100%

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

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

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

Category `C' assessees-Company and non-company assessments with income/loss of Rs.10 lakh and above.
Category `D' assessees-Search and Seizure assessments.

Scope of Audit Review

3.1.3 A review of the functioning of Internal Audit Organisation of Income Tax Department was conducted for the years 1993-94 to 1995-96 with a view to evaluate the extent to which the objectives behind setting up of this wing had been fulfilled. The working of this wing had earlier also been reviewed in Audit and incorporated in Audit Report of the Comptroller and Auditor General for the year 1989-90. The current review does not show any improvement in the working of Internal Audit over the last review. The results of the review on test check basis are summarised in the following paragraphs.

Constraints

3.1.4 In Maharashtra, Mumbai charge, the Internal Audit Organisation was re-organised from 1 January 1995. Records prior to 1 January 1995, i.e. before reorganisation of audit set up was not available with the Internal Audit. Hence data for the years 1993-94 and 1994-95 in respect of Mumbai charge could not be included in the review.

Highlights

3.1.5(i) The objectives of internal audit are to play a corrective role and to exercise vigilance against mistakes leading to improvement in the quality of assessment. Test check has revealed that the objectives have not been achieved as is evident from the Audit findings.

[Para 3.1.1]

(ii) The absence of advance audit planning and programming and lack of proper coordination with assessment units on the one hand and statutory revenue audit on the other adversely affected the efficiency and effectiveness of scarce audit resources available.

[Para 3.1.7(a)]

(iii) The shortfall in the audit of auditable immediate and priority cases in 475 representative wards test checked during the financial years 1993-94 to 1995-96 ranged from 54 percent to 70 percent. The overall achievement of the targets fixed for auditing the auditable cases also fell short by 20 percent to 44 percent during the corresponding period.

[Para 3.1.8(b) and (d)]

(iv) Except issuing audit notes in individual cases, no Internal Audit Reports in respect of an assessment unit was being issued in any of the charges test checked.

[Para 3.1.10(i)]

(v)The follow-up action on internal audit observations was lacking as is reflected in their large pendency ranging from 69 percent to 77 percent during the years 1993-94 to 1995-96. Meetings or discussions with assessing officers for the settlement is not in vouge. Despite PAC's recommendation that audit observations should also be analysed with reference to the year of assessment apart from the year in which these were raised with a view to concentrate on settlement of observations before these getting time barred, 201 observations involving tax effect of Rs.12.03 crore got time barred.

[Para 3.1.11 (a)(i),(ii), (b) and (d)]

(vi) The quality of checks exercised by Internal Audit is reflected by non-detection of omission and mistakes in 4224 cases involving revenue effect of Rs.292.96 crore which were noticed by statutory Audit.

[Para 3.1. 13]

(vii) Similar observations were pointed out in the earlier review also which featured in Audit Report 1989-90 but no improvement in the functioning of internal audit was noticeable.

[Para 3.1.14]

Man management

3.1.6(a) Shortfall in the staff strength

The Commissioner of Income Tax being head of the `Audit Wing' is primarily responsible for all Internal Audit parties and is required to ensure that the vacancies in the audit set up are filled promptly. But it has been seen that the shortfall in the set up of Internal Audit is persistent indicating that the `Internal Audit' has not been given due importance by the department. The position of the sanctioned and operated strength of the audit parties is given below:

Year	Sanctioned strength		Operated strength		Shortfall	
	IAPs	SAPs	IAPs	SAPs	IAPs	SAPs
1993-94	110	40	101	40	9	-
1994-95	110	40	101	40	9	-
1995-96	110	40	101	40	9	-

In addition of shortfall in the total strength of the parties, the operated strength of audit parties are not properly and adequately manned. Audit scrutiny in Orissa, West Bengal, Uttar Pradesh, Delhi, Madhya Pradesh and Bihar charges revealed that there existed shortage of manpower in working strength of IAPs/SAPs in almost every cadre. In some cases the positions were vacant for periods ranging from two months to two and half years. These are despite the fact that the total auditable cases (as per the Ministry's figures) increased from 2,93,099 in 1993-94 to 3,31,636 in 1995-96.

To illustrate, in Delhi charge the position of some cadres are given below:-

Designation	1993-94			1994-95			1996-97		
	Sanctioned Strength	Working Strength	Short-fall	Sanctioned Strength	Working Strength	Short-fall	Sanctioned Strength	Working Strength	Short-fall
DC/ Addl. CIT	6	3	(-)3	6	5	(-)1	6	3	(-)3
ACIT	4	2	(-)2	4	3	(-)1	4	3	(-)1
ITO	7	3	(-)4	7	3	(-)4	7	5	(-)2

(b) Frequent transfer of staff

Provisions of Internal Audit Manual envisages that staff should be continuously in audit for a tenure of two/three years. In Rajasthan, Andhra Pradesh, Orissa, Uttar Pradesh, Maharashtra, Delhi, Madhya Pradesh and Bihar charges audit scrutiny revealed that senior officers like DC (Audit)/Addl.CIT (Audit) were frequently transferred. The period of tenure held by these officers ranged from 1 month to 15 months. In Andhra Pradesh, Guntur charge no regular DC(Audit)/ACIT was posted for 19 months from July 1994 to March 1996. Frequent changes and too short tenures even in senior cadres like DCIT/Addl.CIT(Audit) would tend to adversely effect the working efficiency of Internal Audit Wing.

Programming and planning of audit

3.1.7(a) Absence of advance planning

Audit scrutiny revealed that concept of advance planning as per their own norms was absent in Internal Audit wing. As a practice the internal audit framed its programme for checking only those assessment units as selected and intimated by the Comptroller and Auditor General of India under statutory audit.

For instance in Tamil Nadu charge, audit scrutiny revealed that the AC(SAP) had addressed the assessing officers calling for the assessment files quoting date of audit by Receipt audit. Absence of proper planning has resulted in coinciding of Internal Audit with Receipt Audit in 31 units in Tamil Nadu, Uttar Pradesh and Assam charges. In Orissa and Uttar Pradesh charges Receipt Audit preceded the Internal Audit in respect of 26 units . Audit programming at random had left 13 DC (Special Range) in West Bengal charge unaudited during 1993-94 to 1995-96.

The Internal Audit Manual envisages that the work of audit parties should be properly planned by the ITO (IAP) and AC(SAP). The wards and circles should be selected for audit keeping in view their revenue importance, pendency of auditable cases issues like the occasion when the ward/circle was last audited and when in the Revenue Audit expected to take the audit work.

(b) Absence of correlation between Internal Audit and Assessment Unit

Audit Planning is an important tool for optimising the use of scarce audit resources. In it's absence the efficiency of the entire audit process is blunted.

A test check of records of selected Income Tax charges revealed lack of proper planning and programming of internal audit. In Andhra Pradesh, Orissa, Uttar Pradesh, Kerala, Haryana (UT), Madhya Pradesh and Bihar charges audit scrutiny has revealed that no consolidated list of auditable Immediate and Priority cases was sent to Internal Audit Wing. In Tamil Nadu, Haryana, Assam, Maharashtra, Delhi, Punjab, Gujarat and Rajasthan charges, though list was furnished belatedly in a small number of wards/circles it was not verified by the audit parties with reference to Demand and Collection Registers. In West Bengal charge, the list in respect of Immediate cases was sent, no such list was ever sent in respect of Priority cases. IAP select the priority cases from Demand and Collection Register.

(c) No concept of cross linking of auditable cases reported by Assessing Officers and those depicted in other records

While the primary responsibility for correct and timely reporting of Immediate and Priority cases is that of assessing officers, the Internal Audit Party should themselves verify the correctness of lists with reference to Demand and Collection Registers.

Audit scrutiny of Maharashtra and Delhi charges has revealed large variation between auditable Immediate and Priority cases depicted in the CAP-II (Central Action Plan), Demand and Collection register and cases reported by assessing authorities.

The details are as under:-

Maharashtra

Jurisdiction	Audit charge	Auditable cases as per Monthly Progress Reports for 1995-96	Auditable cases as per D&C Registers of DC Spl. Range
CCIT I Mumbai	DC(Au) I	732	1182
CCIT II Mumbai	DC(Au) V	426	1082
	DC(Au) VI	659	1147
CCIT III Mumbai	DC(Au) III	793	1279
	IV	761	866

Delhi

Year	No. of cases (as per CAP II statement)		No. of auditable cases (reported by assessing authority)	
	Immediate	Priority	Immediate	Priority
1993-94	9,599	27,234	7,552	16,076
1994-95	15,643	40,185	8,225	15,343
1995-96	16,254	35,213	7,834	14,525

Hence the arrear position communicated to Directorate of Income Tax year after year on the basis of Monthly Progress Reports did not reflect the true state of affairs.

Timeliness and coverage of audit and auditable cases

3.1.8(a) Shortfall in audit coverage

Based on the number of Immediate and Priority cases to be audited by Internal Audit, the number of assessment units to be covered by Internal Audit was examined (on test check basis) with reference those actually audited. Audit scrutiny revealed that Internal Audit was not ensuring timeliness of audit as envisaged, nor was the coverage of audit and auditable cases maintained. The shortfall of Internal Audit in the area of audit covered in respect of some representative wards of some charges is given below:

	No. of assessment wards to be audited			Actually audited			Short fall		
	1993-94	1994-95	1995-96	1993-94	1994-95	1995-96	1993-94	1994-95	1995-96
AP	151	158	169	89	109	105	62	49	64
Delhi	250	270	282	143	131	151	107	139	131
Haryana	44	49	56	36	37	38	8	12	18
MP	93	93	97	49	57	50	44	36	47
Karnataka	146	173	171	63	71	68	83	102	103
Punjab	152	163	188	92	121	110	60	42	78
Gujarat	262	268	295	176	169	207	86	99	88
Assam	60	60	60	41	47	39	19	13	21
Bihar	74	74	80	38	44	48	36	30	32
WB	503	492	501	198	182	227	305	310	274
Haryana (UT)	20	21	21	10	10	14	10	11	7
UP	224	228	231	95	90	96	129	138	135
Rajasthan	70	70	70	6	26	26	64	44	44
TN	312	278	313	258	228	264	54	50	49
Orissa	41	41	41	6	7	5	35	34	36

(b) Shortfall in audit of Immediate and Priority cases

All immediate cases are to be audited within a period of one month from the date of order of assessments and at least 50 percent of the priority cases are to be audited as early as possible but well before the audit is taken up by the Revenue Audit.

Audit scrutiny revealed shortfall in the audit of Immediate and Priority cases in 475 representative wards of Andhra Pradesh, Delhi, Haryana, Haryana (UT), Madhya Pradesh, Himachal Pradesh, Gujarat, Assam, West Bengal, Uttar Pradesh and Rajasthan charges as per details below:

Year	Immediate cases			Priority cases		
	To be audited	Actually audited	Shortfall (percentage)	To be audited	Actually audited	Shortfall (percentage)
1993-94	19,675	5,901	13,774 (70.0)	31,785	9,908	21,877 (68.8)
1994-95	28,463	12,332	16,131 (56.7)	37,239	12,517	24,722 (66.4)
1995-96	27,419	11,489	15,930 (58.1)	39,400	16,958	21,442 (54.4)

(c) Wealth Tax and Gift Tax cases not audited

Wealth Tax and Gift Tax cases are also subject to scrutiny by the Internal Audit.

Audit scrutiny of Bihar charge has revealed that audit of the wealth tax and gift tax cases is not being done. In Punjab and West Bengal charge only a small number of wealth tax and gift tax cases were being audited. For example in West Bengal charge, out of 274, 206 and 164 Immediate cases and 118, 36 and 27 Priority cases of wealth tax for 1993-94, 1994-95 and 1995-96 respectively only one Immediate case was checked during 1994-95.

(d) Overall performance of Internal Audit Wing

The Directorate of Income Tax fixes targets for disposal of auditable cases for Internal Audit Wing for each year. Audit scrutiny has, however, revealed that the set targets are not achieved by the Internal Audit leaving a large number of cases unaudited. The table below gives the overall performance of Internal Audit for 1993-94 to 1995-96.

Year	Total auditable cases	Targets for disposal	Total cases audited	Shortfall (percentage)
1993-94	2,93,099	2,93,099	1,63,385	1,29,714 (44.3)
1994-95	3,07,865	1,98,000	1,58,052	39,948 (20.2)
1995-96	3,31,636	1,98,000	1,55,603	42,397 (21.4)

Since the achievement fell short of the targets set by the department itself it appeared that the targets set were based on inadequate appreciation of constraints and available resources.

Failures of various functionaries in performing audit duties

3.1.9 The Internal Audit Manual specifies the functions of various officers of Internal Audit. Audit scrutiny revealed lack of planning, monitoring and failure to perform duties cast on the important functionaries of Internal Audit.

(a) Commissioner of Income Tax

(i) As per instructions laid down in Internal Audit Manual, the Commissioner of Income Tax is required to procure the list of immediate cases assessed during the month from the assessing officers in their charge and furnish a consolidated list by the 15th of the following month to the concerned Additional Commissioner of Income Tax (Audit). Audit scrutiny as brought in para 3.1.7(b) has revealed that such lists are not being furnished to the Internal Audit Wing.

(ii) In view of importance attached to the disposal of audit objections by the Board, the Commissioners of Income Tax are required to make monthly/quarterly review of disposal of major/minor objections by I.T.Os/ACs/DCs under their jurisdiction in order to locate the Circles in which the pendency is high and take immediate remedial action. Audit scrutiny has revealed that such instructions were not being followed as evidenced by the pendency position of major internal audit observations in respect of some charges given below:

Charge	Number of cases	Revenue effect (Rs.in crore)
Tamil Nadu	2,557	222.38
Delhi	1,298	216.37
Maharashtra	1,818	124.92
Karnataka	424	108.54
West Bengal	868	55.20

(iii) The Commissioners of Income Tax are also required to maintain Ledger cards and arrange for maintenance of Compliance cards. Ledger cards are required to be maintained in the prescribed form for each assessing officer recording mistakes accepted by the department, involving tax effect of more than Rs.1,000 in respect of Internal Audit and Receipt Audit objections. Compliance cards are required to be maintained as a ready visual record of cases with tax effect over Rs.10,000 in which objections have been remedied and are also required to indicate cases where action is pending. A separate card has to be maintained for each assessee which may be in use for five years. Ledger cards gives details of mistakes committed by assessing officers and

compliance cards serve as a ready record to watch if any remedial action is pending.

Audit scrutiny of records of Tamil Nadu, Delhi, Punjab and Bihar charges revealed that the Ledger cards and the Compliance cards were not being maintained.

(b) Additional Commissioner of Income Tax (Au)/ Dy.Commissioner of Income Tax (Au)

(i) The Addl.CIT/DC (Audit) are required to personally check all direct refund cases involving refund of Rs.50,000, refunds out of rectification, appeal effect, Tax Credit Certificate etc. exceeding Rs.50,000, correctness of appeal effect in cases involving reduction in income exceeding Rs.50,000, all cases involving tax liability of foreign collaborators and all cases having income more than Rs.10 lakh/25 lakh/50 lakh.

A review of the records revealed that the personal check actually performed by Addl./DC (Audit) was very low as compared to fixed targets. Instances from Delhi, Karnataka and Andhra Pradesh illustrate the extent of shortfall as under:

Years	1993-94			1994-95			1995-96		
Particulars	**Delhi**	**Karnataka**	**Andhra Pradesh**	**Delhi**	**Karnataka**	**Andhra Pradesh**	**Delhi**	**Karnataka**	**Andhra Pradesh**
Total number of cases required to be checked	1,833	651	688	1,783	628	734	1,733	588	736
Number of cases actually checked	549	19	95	719	29	155	672	51	278
Shortfall (percentage)	1,284 (70.0)	632 (97.1)	593 (86.2)	1,064 (59.7)	599 (95.4)	579 (78.9)	1,061 (61.2)	537 (91.3)	458 (62.2)

(ii) One of the functions of Additional/Deputy Commissioner of Income Tax (Audit) is planning of audit, by taking into account the work load and determining overall performance targets. No performance target was fixed by Additional/Deputy Commissioners of Income Tax (Audit) in planning of audit by taking into account the work load and determining overall performance targets. Test check of records in the audit wings, as brought

out in para 3.1.8, showed that there was delay in completion of audit by internal audit and also shortfall in audit coverage which indicates that there was no effective planning.

Audit reporting - issue of local audit reports

3.1.10 Non-issue of Local Audit Reports

(i) After the completion of audit, the IAPs/SAPs are not only required to prepare and forward to the assessing officer concerned audit notes on individual cases to be placed on the respective files, but are required to prepare Internal Audit Report similar to Receipt Audit's Local Audit Report.

Audit scrutiny of Delhi, Madhya Pradesh, Maharashtra, Gujarat, Punjab, Assam, Bihar, West Bengal, Uttar Pradesh and Rajasthan charges has revealed that no Internal Audit Report similar to Receipt Audit's Local Audit Report was issued. Objection memos were being issued as and when objections were noticed leading to inadequate monitoring mechanism .

(ii) Internal Audit Reports are also required to indicate the position of recovery of demand in Receipt Audit objections which has been treated as settled on raising of demand. Audit test check of Gujarat, Orissa and Tamil Nadu charges has revealed that while observations were pursued/watched till the remedial action was initiated, there was no watch for the recovery of demands.

(iii) Internal Audit is also required to prepare Annual Audit Report highlighting most vulnerable areas where mistakes have generally occurred and their revenue implications, interesting/new types of objections which need to be brought to the notice of entire audit set up to alert them to look for such mistakes and typical mistakes which are recurring year after year. Audit scrutiny of Punjab, Bihar and Rajasthan charges has revealed that no such Annual Reports were being prepared. The role of Internal Audit Wing as a reformative and deterrent body would have been aided to a great extent by preparation of such a Report.

Follow-up action on internal audit observations

3.1.11(a) Pursuance, settlement and pendency of internal audit observations

(i) A time limit of three months has been laid down for taking remedial action in respect of objections raised by Internal Audit. The review has

revealed that the time limit is not being adhered to by the assessing officers as a result of which many old observations are still pending. There appears to be no organised efforts to pursue these Internal Audit observations. The details of the Internal audit observations, their settlement and pendency position for 1993-94 to 1995-96 are given below:

Year	Number of cases for disposal and amount (Rs.in crore)	Number of cases settled and amount (Rs.in crore)	Number of pending cases and amount (Rs.in crore)	Percentage of pending cases
1993-94	46,056 (797.40)	11,507 (263.93)	34,549 (533.47)	75.0
1994-95	47,654 (985.63)	14,437 (263.82)	33,217 (721.81)	69.7
1995-96	45,848 (1240.50)	10,266 (251.81)	35,582 (988.69)	77.6

(Figures furnished by the Directorate of Income Tax).

Out of above, the details of major Internal audit observations, their settlement and pendency position for 1993-94 to 1995-96 are given below:

Year	Number of cases for disposal and amount (Rs.in crore)	Number of cases settled and amount (Rs.in crore)	Number of pending cases and amount (Rs.in crore)	Percentage of pending cases
1993-94	18,006 (786.17)	7,752 (259.57)	10,254 (526.60)	56.9
1994-95	18,465 (976.34)	6,357 (261.30)	12,108 (715.04)	65.6
1995-96	18,990 (1,229.17)	6,286 (250.30)	12,704 (978.87)	66.9

(ii) The PAC in their 150th Report (Eighth Lok Sabha), had recommended that observations of Internal Audit should be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases become time barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken notes had informed that assessment yearwise and agewise classification was being made so that greater

attention could be paid to settlement of older and revenue significant objections.

The review has, however, revealed that no effective steps were taken for the settlement of these outstanding internal audit observations. The following table which gives age-wise analysis of the pending items at the end of the year 1995-96 reveals that out of total revenue effect of Rs.988.69 crore, as much as 28.44 percent pertains to the year 1992-93 and earlier years.

Year of the observation	Number of cases	Revenue effect (Rs.in crore)
1992-93 and earlier years	15,179	281.27
1993-94	4,979	99.15
1994-95	6,145	167.73
1995-96	9,279	440.54
Total	35,582	988.69

(iii) The Action Plans of the department provide for disposal of 90 percent of all pending major audit observations and 80 percent of current audit observations (90 percent of current audit observations also for 1993-94). The department has failed to achieve the targets fixed under the Action Plan. The details of shortfalls for the years 1993-94 to 1995-96 are given below:

	1993-94		1994-95		1995-96	
	Arrear	Current	Arrear	Current	Arrear	Current
For disposal (amount in crore)	11,816 (498.13)	6,190 (288.04)	10,254 (526.61)	8,211 (449.74)	12,108 (715.04)	6,882 (514.13)
To be settled as per targets fixed	10,634 (90%)	5,571 (90%)	9,229 (90%)	6,569 (80%)	10,897 (90%)	5,506 (80%)
Settled (Rs. in crore)	5,326 (179.28)	2,426 (80.29)	3,859 (196.63)	2,498 (64.67)	4,162 (172.80)	2,124 (77.50)
Shortfall (percentage)	5,308 (49.92)	3,145 (56.45)	5,370 (58.19)	4,071 (61.97)	6,735 (61.81)	3,382 (61.42)

(b) Pursuance & settlement of audit observations through meetings/discussions

Meetings and discussions with the assessing officers are effective means to pursue and settle pending Internal Audit Observations. Audit scrutiny of

Bihar, Tamil Nadu, Karnataka, Assam and West Bengal charges has revealed that there was no evidence of any such discussion/meeting between Internal Audit and the assessing officers for settlement of audit observations.

(c) Settling Audit objections without proper reply

Internal Audit objections are to be settled after the receipt of convincing reply or remedial action taken by the Assessing Officers. Audit scrutiny of Maharashtra and West Bengal charges has revealed that observations in respect of 75 cases were closed without proper reply/recording details of rectificatory action. Two cases from Maharashtra charge are given below:

(i) D.C.(A) Central Circle, Mumbai raised an objection on an assessment made under section 143(1)(a) for the assessment year 1992-93 on grounds that since the total turnover of the assessee exceeded Rs.40 lakh, the accounts of the assessee should have been audited as required under section 44 AB of the Income Tax Act. Hence penalty of Rs.1 lakh under section 271 B should have been levied. Internal Audit closed the objection based on the assessing officer's reply that penalty would be initiated as regular assessment proceedings have commenced.

Since audit objection is of prima facie nature on assessment under section 143(1)(a), the closure of the objection by Internal Audit based on the reply of Assessing Officer was incorrect without completion of remedial action.

(ii) In another case, Internal Audit had raised an objection on an assessment made under section 143(1)(a) for the assessment year 1992-93 that since the assessee has not filed his return of income within specified time, the assessee's claim for carry forward of speculation loss of Rs.2.73 lakh should have been disallowed. The omission had resulted in notional short levy of tax of Rs.99,462. Based on the assessing officer's reply, that though the loss had been allowed to be carried forward, it had not been actually set off, the Internal Audit accepted the reply and settled the objection.

Since the issue raised by Internal Audit was a prima facie objection in a summary assessment, the assessing officer should have rectified the assessment as pointed out by the Internal Audit. It's settlement by Internal Audit was thus improper.

(d) Time barred cases

Internal Audit is required to send a list of all objections getting time barred

leading to loss of revenue in near future to the concerned assessing officers. However, the primary responsibility to ensure that the remedial action does not get time barred would rest on the assessing officer.

Audit scrutiny of records of Andhra Pradesh, Tamil Nadu, Kerala, Haryana, Assam and Delhi charges revealed revenue loss of Rs.1,903.54 lakh in 201 cases as the remedial action was not taken in time and the action had become time barred. Non/ improper maintenance of Internal Audit Register-7 (which contain details of major and minor audit objections) as mentioned in para 3.1.12 would have contributed to this revenue loss due to time barring.

Maintenance of registers

3.1.12 A number of control registers have been prescribed to organise, watch, monitor and control the programming of audit, auditable cases and audit observations. Audit scrutiny has revealed that many prescribed registers were either not being maintained or wherever maintained, were not properly maintained. The position of non-maintenance/incomplete maintenance in some charges is as under:

Register	Purpose in brief	Charges where not maintained	Charges where not maintained properly	Brief omission
Internal Audit Register-1	Register of Priority cases for checking	Tamil Nadu, Orissa, West Bengal, Uttar Pradesh (1993-94 & 1994-95), Haryana (UT-1993-94), Maharashtra, Punjab, Madhya Pradesh and Bihar	Haryana, Haryana (UT-1994-95 & 1995-96), Delhi and Rajasthan	Not maintained in prescribed form, total number of cases not given, all columns not filled in, Register not closed and submitted to supervising authoriy.
Internal Audit Register-2	Register of Immediate cases for checking	Tamil Nadu, Orissa, Uttar Pradesh, Haryana (UT-93-94), Maharashtra, Punjab, Madhya Pradesh, Bihar and Rajasthan	Haryana, Haryana (UT-94-95 & 95-96) and Delhi	-do-
Internal Audit Register-3	Register showing cases checked by SAP/IAP during the month	Orissa (93-94 & 94-95), Uttar Pradesh (93-94 & 94-95), Haryana, Haryana (UT 93-94), Punjab (except Patiala) and Rajasthan	Orissa (95-96), Haryana (UT 94-95 & 95-96) and Delhi	-do-
Internal Audit Register-4	Register regarding cases for test check/re-check/ vetting by ITO (IAP)/AC (SAP)	Orissa (93-94 & 94-95), Uttar Pradesh, Haryana, Punjab, (93-94 except Amritsar), Madhya Pradesh, Bihar, West Bengal and Rajasthan	Orissa (95-96), Haryana (UT-94-95 & 95-96) Punjab (1994-95 and (1995-96) and Delhi	-do-

Internal Audit Register-5	**Register showing cases for personal checking by ITO(IAP)/ AC (SAP)**	**Orissa (93-94 &94-95), West Bengal, Uttar Pradesh, Haryana, Punjab, Madhya Pradesh (Jabalpur), Bihar and Rajasthan**	**Orissa (95-96), Haryana (UT) and Delhi**	**-do-**
Internal Audit Register-6	**Register showing cases for personal checking/re-checking by DC(Audit)**	**Tamil Nadu, Orissa (93-94 & 94-95), West Bengal, Haryana, Madhya Pradesh (Jabalpur), Bihar and Rajasthan**	**Haryana (UT) and Delhi**	**-do-**
Internal Audit Register-7	**Internal Audit Objections Registers/ Major and Minor objections**	**Uttar Pradesh, Kerala, Haryana (UT-93-94), Assam, Madhya Pradesh, Gujarat and Rajasthan**	**Tamil Nadu, Orissa, West Bengal, Haryana (UT- 94-95 & 95-96), Delhi and Bihar**	**Not in prescribed form, all columns not filled in, gist of objections not given, whether accepted or not accepted not mentioned**
Internal Audit Register-8	**Register of Internal Audit Objections settled during the month, major/minor objections**	**Orissa, Uttar Pradesh, Haryana (UT-93-94), Madhya Pradesh, Bihar, Gujarat and Rajasthan**	**Tamil Nadu, West Bengal, Haryana (UT-94-95) and Delhi.**	**-do- Communication regarding dropping the objections not recorded**

As the registers are an important aid for control purposes which give details of Immediate and Priority cases for checking/re-checking/test checking and details of Internal Audit Observations, their settlement, their non-maintenance or improper maintenance adversely affects the performance of Internal Audit.

Failure of internal audit to detect mistakes in assessments

3.1.13 One of the objectives for setting up of Internal Audit was to improve the quality of assessments and thus of reducing errors and omissions which are subsequently detected by Revenue Audit. While the assessing officers should ensure that their assessments are free of any mistakes of law or facts, Internal Audit should see that their checks are exhaustive and there is no occasion for Receipt Audit to detect any mistake in the cases audited by them. Nevertheless, substantial audit objections are being noticed year after year by Receipt Audit in the assessments checked by the Internal Audit.

Audit scrutiny of Rajasthan, Karnataka, Himachal Pradesh, Gujarat, Tamil Nadu, Kerala, Uttar Pradesh, Haryana, Haryana (UT), Assam, Maharashtra, Punjab, Madhya Pradesh and Bihar charges has revealed

that 4224 cases involving revenue effect of Rs.292.96 crore were checked by the Internal Audit between 1993-94 to 1995-96 but omissions/mistakes committed by assessing officers escaped their notice and were subsequently detected by Receipt Audit.

Some illustrative cases noticed during the period of review are given below:

(i) Avoidable mistake in computation of income

While computing the income of an assessee the assessing officer normally proceeds either from the net profits or loss as per profit and loss account or the income or loss as computed by the assessee as the starting point and adds back inadmissible expenses and the amount of depreciation actually charged in the accounts. The amount of depreciation admissible under the Income Tax Act, 1961, and Rules framed thereunder is thereafter allowed as a deduction.

In Madhya Pradesh, Bhopal charge, the assessment of a public sector corporation for the assessment year 1993-94 was completed after scrutiny in November 1995 allowing depreciation of Rs.12.21 lakh. Audit scrutiny revealed that the assessing officer while computing the loss of Rs.609.80 lakh incorrectly added the amount of depreciation of Rs.12.74 lakh already charged to the accounts, instead of deducting the same from the returned loss. The mistake resulted in overassessment of loss by Rs.25.48 lakh involving potential tax effect of Rs.13.18 lakh. This mistake had not been detected by Internal Audit.

(ii) Incorrect allowance of liabilities

Under the Income Tax Act, 1961, any tax or duty actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income shall be allowed as deduction.

In Haryana (UT) Chandigarh charge, in the assessment of a widely held company for the assessment year 1994-95, completed after scrutiny in January 1996, deduction of Rs.81.38 lakh being customs duty payable (include in total expenses payable of Rs.162.63 lakh) was allowed. Scrutiny of assessment records revealed that the assessee had not furnished proof in support of payment of customs duty having been made before the due date of filing of the return. In the absence of proof the deduction was to be disallowed. Omission to do so resulted in

underassessment of Rs.81.38 lakh involving potential tax effect of Rs.42.11 lakh. This observation of Receipt Audit was based on assessment records already seen by Internal Audit but the mistake could not be detected by them.

(iii) Non levy of interest for delay in payment of tax demand

Under the Income Tax Act, 1961, any demand for tax should be paid by an assessee within 30 days of service of notice of the relevant demand and failure do so attracts levy of simple interest at one and one-half percent for every month or part thereof from the date of default till the actual date of payment of demand.

In Haryana (UT) Chandigarh charge, in the assessment of a co-operative society for the assessment year 1992-93, completed after scrutiny manner in March 1995, demand payable was determined at Rs.781.32 lakh and notice of demand was served on the assessee on 23 March 1995. The assessment of the assessee was subsequently revised as a result of appellate order in November 1995 and demand payable was reduced to Rs.376.26 lakh. Since the assessee had paid this demand after the admissible period he was liable to pay interest for late payment of demand amounting to Rs.46.53 lakh. The assessing officer failed to charge interest. Omission to do so resulted in non-levy of interest of Rs.46.53 lakh. This issue also remained to be detected by Internal Audit.

Weaknesses persist despite ministry's reply to earlier audit review

3.1.14 The system weaknesses of Internal Audit pointed out in the preceding paras were also reported in the review on the Internal Audit conducted for the Report of the Comptroller and Auditor General of India for the year 1989-90. Though the Ministry in their reply had stated that efforts were being made to augment the strength of the Internal Audit Wing and that directions had been issued to the Director of Inspection (Audit)/Field offices for taking necessary action, however, Audit scrutiny belies the Ministry's stand. The weaknesses enunciated in the preceding paragraphs continue to dog the Internal Audit Organisation. No concrete steps seem to have been taken to overcome weaknesses which had been identified by Audit in it's earlier Audit Report.

Other observations

3.1.15(i) A study on the working of Internal Audit Organisation in the Income Tax Department was carried out by the Directorate of Organisation and Management Studies of Income Tax Department which gave it's report in March 1994. The Committee while admitting the failures of Internal Audit on both qualitative as well as quantitative

fronts, has recommended various administrative and organisational changes in the Audit set-up and modifications in it's procedures. No action has been taken on the recommendations so far.

(ii) Internal Audit Manual regulates the functions of the Internal Audit Organisation and it's various functionaries. The latest Internal Audit Manual available with the department is of 1987 edition. Though there has been various changes in the norms and functions of Internal Audit the Manual has not been revised.

The review was referred to the Ministry in November, 1997. The Ministry's reply has not been received (December 1997).

3.2 Review on method of accounting of revenue collections and refunds-functioning of central treasury units, zonal accounts office and computer cell

Introductory

3.2.1 A proper system of accounting of revenue collections and refunds is a sine-qua-non for an efficient tax administration. It is also essential in our federal system of governance for ensuring proper allocation of revenues between the Union and the States.

With the departmentalisation of accounts with effect from 1 April 1977, all work relating to administration and accountal of receipts from Direct Taxes became the responsibility of the Central Board of Direct Taxes (CBDT) which it discharged through the Commissioners of Income Tax (CITs) located in different parts of the country. For this purpose, the office of the Chief Controller of Accounts (CCA) was created at the Board level. Under it (CCA) Zonal accounts offices (ZAOs) were located all over the country, each having specified jurisdiction covering one or more Commissioners of Income Tax. It was the responsibility of the ZAO to prepare monthly accounts of Direct Taxes Collections in his area of jurisdiction and submit them to the Chief Controller of Accounts, New Delhi for consolidation and submission to Central Board of Direct Taxes/Government.

Prescribed procedure

3.2.2 Prior to 1 April 1992, a link branch of a particular bank was responsible for sending the scrolls and challans received from the various branches of the same bank to the Focal Point Branch. This Focal Point Branch, which was a specified branch of the Reserve Bank of India or State Bank of India would in turn send the scrolls and challans to the Income Tax Department. Later, in order to avoid the delays in crediting

the amounts to Central Government Account, the system was modified with effect from 1 April 1992 and the concept of Focal Point Branch was eliminated.

Under the new system the accounting functions of receipts and refunds are carried out by four agencies:-

(1) The Reserve Bank of India and the branches of authorised Nationalised Banks.

(2) Departmental Treasury Units consisting of the Central Treasury Units and Computer Cells under the control of a Designated Officer.

(3) Zonal Accounts Offices located all over the country with each having specified jurisdiction covering one or more Commissioners of Income Tax.

(4) The Assessing Officers in the assessment units.

Under this procedure, Direct Tax payments are made by the Tax payers at the authorised branches of nationalised banks using the prescribed challans. Refunds of Direct Taxes are also made by the authorised banks on the basis of refund advices issued by the Income Tax Department. All the challans/refund vouchers contain one counterfoil to the Zonal Accounts Office, one for the Income Tax Department and one/two for the tax payer for retention with him and for submission alongwith the return of income. The banks prepare daily scrolls separately for each major head of account and one copy of these scrolls alongwith the relevant challans/refund vouchers are sent to the Designated Officer of the Income Tax Department in-charge of the Central Treasury Unit and another copy of these scrolls and challans/refund vouchers are forwarded to the Zonal Accounts Officer.

The Designated Officer on receipt of scrolls and connected challans/refund advices from banks, tallies the challans with the entries in the scrolls of the receiving branches and ensures the accuracy of the total collections made by different banks each day under each Major head of account. In this process the missing refund advices, short remittances, if any, are identified and the matter taken up with the respective banks. Then the challan/refund vouchers are processed in the Computer with the help of Software Package developed by the Central Board of Direct Taxes. The Daily Collection Register (DCR) and the Daily Refund

Register (DRR) are prepared Assessing Officer wise by the Computer Cell after tallying the day's total collections with the bank Scrolls and challans/refund vouchers. The collection as per the missing challans will be kept in the suspense Account till they are subsequently received from banks. Then these Daily Collection and Refund Registers alongwith the relevant challans/refund vouchers are to be distributed to the respective assessing officers for giving credit to the assessees for payments made by them under each major head of account. The Designated Officer will send a major head-wise simple account of all the transactions to Zonal Accounts Officer by the 8th of the following month. A detailed account showing the details of collection received during the month, major and minor headwise, shall also be forwarded to the Zonal Accounts Officer in the prescribed proforma by the 14th of the following month. The monthly figures of receipts and refunds are reconciled at all levels viz. the Central Treasury Unit, Zonal Accounts Office, Nationalised Bank and the Reserve Bank of India, Central Accounts Section (CAS) Nagpur, regularly with reference to the monthly statement prepared by the banks on the basis of the daily main scrolls of receipts and refunds separately for each Major Head.

The Internal Audit Organisation under the Control of the Chief Controller of Accounts, Central Board of Direct Taxes, also seeks to ensure by test check that the challans/refund advices have been properly accounted for with correct classification and the total collections/refunds as per the Zonal Accounts Officer and the Designated Officer tally each month.

Objectives

3.2.3 The objective of the review is to examine whether the internal procedures and controls adequately provide for and secure regular accounting of collection, allocation of revenue and their credit to Government accounts and also to assess that such regulations and procedures are actually being carried out. The review attempts to examine the method of accountal of revenues with reference to the new method introduced with effect from 1 April 1992.

Scope of review

3.2.4 For the purpose of conducting the review records of the CTUs, computer cells, ZAOs and 20 percent of the assessing officers in the Income Tax Department for one selected month for each of the three years 1993-94 to 1995-96 were scrutinized to find out whether the procedure prescribed by the CBDT for accounting of tax receipts and refunds were being followed scrupulously.

Highlights

3.2.5(i) The accounting procedure prescribes maintenance of Control registers to ensure complete and correct accounting of tax and refunds, including clearance in suspense accounts and correction of misclassifications. The review indicated that some important records were either not maintained at all or were not maintained properly in the prescribed form. Various irregularities mentioned in the following subparagraphs showed inadequate attention paid for proper upkeep of requisite records.

[Paras 3.2.6 (i)(iii) (iv) (v),7(iii), 8(vi),9(vii)]

(ii) Inordinate delays in preparation and despatch of the Daily Collection Register alongwith challans/refund advices from CTU's to the assessing officers were noticed which would lead to delayed/wrong credits/refunds to the assessees.

[Para 3.2.6(vii)]

(iii) The existing procedure provides for levy of penal interest at prescribed rates for delay in crediting the receipts by banks to Government account. Test check revealed delays of one day to more than 200 days in as many as 1530 cases involving the receipts of Rs.12.44 crore. As against the leviable penal interest of Rs.39.55 lakh interest amounting to Rs.9.69 lakh only was levied, of which Rs.1.20 lakh could be recovered.

[Para 3.2.8(iii)]

(iv) Ensuring correct classification of receipt under different head of direct taxes is an important function of accounting authorities specially in view of the fact that net receipt under income tax (excluding surcharge) alone is allocated to state. Test check revealed 1508 cases of misclassification of tax receipts apart from failure to segregate surcharge from income tax.

[Para 3.2.6 (viii), 7 (iv),8(ii)]

(v) Test check disclosed delays in accounting of challans/refund advices for substantial amount, omissions and delays in distribution of large number of challans and large pendency in suspense account for long periods leading to delayed credits to the assessees for the paid tax and incompleteness of the accounts.

[Para 3.2.6 (ii),(vii),(xi)]

(vi) The system also provides for reconciliation of the figures of tax receipts and refunds between the C.T.U./Zonal Accounts Officer. Test check in Audit revealed large differences which remained un-reconciled for long periods. This suggested that the existing system for promptly reconciling the difference was inadequate.

[Para 3.2. 8(iv)]

(vii) The periodical audit of the correctness of the accounting by the Internal Audit parties under the Director of Income Tax (Audit) as contemplated by the accounting system was not carried out in many C.T.Us and Zonal Accounts Offices. [Para 3.2.11]

Working of the Central Treasury Units

3.2.6 Irregularities in the maintenance of records by the Central Treasury Unit (CTU)

Improper maintenance of revised bank scroll register

As per instructions mentioned in the guidelines of revised procedure for processing of challans with the help of computer, the CTU was required to maintain revised bank scroll register in a prescribed form in fourteen columns. The scrolls and challans received from nodal branches of the banks for tax deposited by assessees, were to be entered in the above register. Separate register was required to be maintained for each bank and separate pages were required to be allotted for each major head of account. After that the challans and scrolls were required to be coded in the manner prescribed in the procedure and then sent to the Computer Cell for processing.

Audit scrutiny revealed that the revised bank scroll register was not being maintained in the prescribed form by the CTUs in Rajasthan, Karnataka, Andhra Pradesh, Assam, Gujarat, Uttar Pradesh, Delhi and Tamil Nadu charges.

The following deficiencies were noticed:

(a) Registers were not maintained in revised prescribed form.

(b) Col.7 to 14 of the prescribed form which contain vital information like number of challans actually present, number of missing/excess challans etc. were not provided in the register maintained and therefore not filled in. Consequently the very purpose of the Register as a tool for monitoring collection was defeated.

(c) No separate pages were kept for each head of account.

(d) Monthly totals were not struck.

(e) Progressive monthly totals were not arrived at.

(f) In Delhi charge, main scrolls received from each bank were kept in a bundle which served as bank scroll register.

In the absence of maintenance of the scroll register in the prescribed form, the delay in the receipt of challans and refund vouchers from banks till their final despatch to assessing officers and the errors in the scrolls could not be verified. The reconciliation of figures with those of the banks could also not be done.

Some other deficiencies noticed were:

(a) In Madhya Pradesh, Jabalpur charge, the notings of bank scrolls in the bank scroll register was not being done promptly and there were delays ranging between 5 days to 123 days in this regard. This will have a chain effect on the entire accounting system.

(b) In Gujarat charge, audit scrutiny revealed that instead of 7 digits 6 digits batch coding have been adopted by all CTUs. Since first digit denotes the bank, the second digit denotes the month, the third and fourth digits denote the date and the last three digits denote the running serial number of the scroll for a day given by the CTU, by adopting six digits, particulars of any one of these would be missing. It does not fit the computer programme developed for control purpose and the whole exercise at 6 digit defeats the purpose.

(c) In Orissa and Uttar Pradesh (Agra) charges, coding was not being done. However, AOs code is given on challan and scrolls by the Computer Cell in Orissa charge.

(ii) Delay in sending challans/refunds advices to computer Centre

Audit scrutiny revealed that the CTUs in Uttar Pradesh, Madhya Pradesh, Karnataka, Assam and Tamil Nadu charges took 4 days to 180 days in sending the scrolls/challans to the computer cell. For instance delays in sending the scrolls/challans by the CTUs to the computer cell which ultimately resulted in delay in giving credit to the assessee ranged between

4 to 23 days in Uttar Pradesh, 9 to 180 days in Madhya Pradesh, 8 to 44 days in Karnataka, 10 to 87 days in Assam and 16 to 40 days in Tamil Nadu charges. In many charges, the CTUs did not maintain any record indicating date of sending the challans to Computer Centre in the absence of which such delays could not be ascertained.

(iii) Non-authentication of entries of control sheet

As per revised procedure for processing of challans with the help of computer, after completion of data entry, an intermediate sheet called control sheet was to be brought out on a prescribed form by the computer centre and sent to CTU alongwith challans for manual checking. Entries of control sheet exceeding Rs.50,000 and Rs.1,00,000 were required to be physically verified and authenticated by the Head clerk/Supervisor/Inspector and ITO/AO (system) respectively who has to sign it as a token of check.

Audit scrutiny revealed that in Gujarat, Orissa, Uttar Pradesh (1 unit), Karnataka and Rajasthan charges, the requisite control sheets were not being generated. In the absence of such control sheets it could not be verified whether the prescribed procedure of checking of entries in the control sheets was being followed. In other charges like 1 unit in Tamil Nadu, 1 each in Jaipur, Assam, Delhi, Haryana, Andhra Pradesh, West Bengal though the control sheets were being maintained by the CTUs, the entries therein above Rs.50,000 and Rs.1,00,000 were not physically verified and signed by the designated persons.

(iv) Non-maintenance of register of collection sheets received from other charges

CTU was required to maintain a register in prescribed form for recording the daily collection sheets received from other charges and distributing it to Assessing Officers separately.

In Orissa, Karnataka, Punjab and Uttar Pradesh charges, the above register was not being maintained properly. In Haryana charge, in 6 cases involving a tax effect of Rs.19.72 lakh, though the challans pertained to other charges, these were accounted in Haryana charge and not transferred to the respective charges.

In Rajasthan charge, the collection sheets received from other charges were not entered by Central Treasury Unit of both the charges in the

register in the prescribed form. These were not distributed in time. In 4 cases involving an amount of Rs.2.41 crore, the delay ranged from over 1 month to 6 months which ultimately resulted in delay in giving credit to the assessees or giving credit on the basis of the assessee's copy of the challan.

(v) Non-maintenance of Register of Missing/ Surplus challans

The CTU is required to maintain a separate register for "Missing/surplus challans and lack of continuity of main scroll" to follow up with the nodal banks. On receipt of scrolls and challans from the nodal bank the CTU is required to tally all supporting challans/ refund advices as mentioned in daily bank scroll and to identify the missing/surplus challans. The challans not pertaining to direct taxes are to be sent back.

In Orissa, 4 CTUs in Uttar Pradesh, Delhi, Karnataka, Gujarat, U.T. chandigarh and Rajasthan charges, the register of missing/surplus challans was not being maintained by the CTUs though a large number of challans were found missing. In the absence of this register, follow up action in respect of missing challans and pendency at the end of the year could not be checked.

In some charges (1 Unit each in U.P. and Andhra Pradesh and all units in Maharashtra),the above register was not being maintained in the proper format as the number of challans missing or surplus was not mentioned, columns relating to date of intimation to bank were found blank and entries in the register were not authenticated by the Head clerk/ITO/AC(System). The register also revealed that a number of challans were not received from the bank alongwith the scrolls for which no follow up action had been taken by the department. One illustrative case is mentioned below:

In Uttar Pradesh charge, the challans for the full amount were not received alongwith the scrolls of Rs.3,46,451 received by the CTU from the State Bank of India during July 1995 to March 1996. No follow up action was found to have been taken by the concerned CTU.

(vi) Non-verification of monthly statements received from ZAO

The guidelines of revised procedure for processing of challans with the help of computer provides that the CTU would receive from ZAO a monthly statement called Annexure-C in a prescribed form, of scrolls received from the nodal banks (major headwise). The CTU would verify

this with reference to its registers and return it to the ZAO within 3 days alongwith the prescribed forwarding letter called Annexure-E and the difference/discrepancies, if any, reconciled monthly. Any delay in this regard would result in delay in reconciliation of figures under various heads of accounts in the books of ZAO which are ultimately taken as final figures in Government account.

Certain deficiencies were noticed during the course of audit in Uttar Pradesh, Maharashtra, Haryana, Madhya Pradesh, Tamil Nadu, Andhra Pradesh, Karnataka, Assam and West Bengal charges.

Six illustrative cases are given below:

(a) In Uttar Pradesh charge, it was seen that no such record was maintained by CTU Agra to verify whether such statements were received from the ZAO and returned by the CTU after verification. CTU Allahabad took one to three months in verifying the statement while CTUs Kanpur, Lucknow and Meerut did not return the statements received from ZAO, after verification.

(b) In Maharashtra, Mumbai charge, the net collection during the years 1994-95 and 1995-96 as per CTU were Rs.18,236.24 crore while as per ZAO it was Rs.18,235.80 crore leading to the discrepancy of Rs.0.44 crore. Similarly, in Pune charge, the net collection as per CTU during 1993-94 to 1995-96 was Rs.2858.77 crore against Rs.2704.78 crore shown by the ZAO leaving a discrepancy of Rs.153.99 crore unreconciled.

(c) In Haryana charge, as per records of ZAO (for the year 1993-94) net collections under all the heads of accounts of direct taxes inclusive of TDS of Rs.14.71 crore were Rs.145.29 crore. Against this the Central Treasury Unit/Computer Centre submitted the detailed accounts for the year 1993-94 amounting to Rs.131.59 crore. After adding the T.D.S. this amount works out to Rs.146.31 crore resulting in a difference of Rs.1.02 crore which needed reconciliation. As per information, the reconciliation is not possible as the relevant records have since been destroyed in floods during the year 1995.

(d) In Madhya Pradesh, Jabalpur charge, abnormal delays ranging between 30 days to 182 days was noticed in verifying the monthly statements of bank scrolls for 5 months. Consequently, considerable delays in reconciliation of differences of net collection as per CTUs and those of ZAOs were noticed.

(e) In Andhra Pradesh charge, at CTU, Hyderabad, the difference between ZAO and CTU figures ranged from Rs.1.89 lakh to Rs.376.41 lakh in 1993-94, from Rs. Nil to Rs.(-) 1503.40 lakh in 1994-95 and Rs.10 to Rs. (-)1.83 lakh in 1995-96 which were not reconciled. At CTU Vijayawada, reconciliation was not done for 8 months from April 1993 to October 1993 and March 1994 during 1993-94, 6 months from July 1995 to March 1995 and January 1996 during 1995-96. At CTU Visakhapatnam, no reconciliation was done during the years 1994-95 and 1995-96. The unreconciled difference between ZAO and CTU figures ranged from (-) Rs.80.92 lakh to Rs.8.02 lakh.

(f) In Assam charge, test check of CTU revealed discrepancies leading to excess figure of Rs.31.67 crore in ZAO account in booking the figures which remained unreconciled.

(vii) Delay in despatch of daily collection register/daily refund register alongwith challans and refund advices to assessing officers

Daily collection register and daily refund register alongwith the challans and refund advices are required to be despatched to assessing officers weekly in bunches by the CTU. Delay in despatch of the above registers alongwith the challans/refund advices would lead to delayed/wrong credits/refunds to the assessees.

Audit scrutiny revealed delays ranging from 10 days to 31 months in Uttar Pradesh, 17 days to 60 days in Rajasthan, 2 to 4 months in Karnataka, 2 months to 8 months in Maharashtra, 7 days to 103 days in Madhya Pradesh, 4 months to 12 months in Bihar, upto 5 months in Gujarat charges in sending the daily collection registers and challans to the assessing officers. These resulted in giving delayed credits to the assessees and also considerable delays in the issuance of refund orders resulting in payment of huge amount of interest by the government to the assessee.

For instance, in Madhya Pradesh charge, 58318 challans and 5511 refund advices pertaining to the month of March 1996 involving collection of Rs.80.51 crore and refund of 6.33 crore were sent to the respective assessing officers after a delay of 316 days (11 months).

(viii) Errors in classification

The Tax-Payers sometimes use incorrect Form of challans which result in erroneous classification of tax payment in the accounting statement. According to the Central Board of Direct Taxes instructions necessary changes should be made in the major/minor headwise classification at the time of posting in the Daily Collection Register pertaining to the concerned assessing officer. Such changes should be noted in the Register of changes in classification from day to day and at the end of the month, the relevant column should be totalled and a report sent to the designated officer. Similarly, the CTU would also maintain a record of consolidation and ultimately send a monthly report to the concerned Zonal Accounts Officer alongwith the detailed accounts for carrying out necessary rectification. However, this prescribed procedure was not being followed by the CTUs in Delhi, Haryana, West Bengal, Punjab, Gujarat, Rajasthan and Tamil Nadu charges as the challans pertaining to one major head were booked in another major head leading to misclassification of Direct Taxes payments from "0020 Corporatio tax" to "0021 Income Tax other than Corporation Tax" and vice versa. Some examples of such lapses are given in the table below:

Sl. No.	Name of the charge	Period Reserve Bank date	No.of cases involved	Amount (Rs.in lakh)	Wrongly booked in	To be booked in the correct major head	Remarks
1.	Delhi	11/95 to 12/95	7	1438.52	0020 & 0021	0020,0021, 0024 and 0032	
2.	Haryana	-	76 54	47.71 124.90	0021	0020	surcharge was not accounted for separately
3.	West Bengal	-	-	13,053	-	-	TDS cheque and schedule of the AG(A&E) indicated the whole amount of TDS instead of classifying the challans under relevant major heads 0020 and 0021.
4.	Punjab	-	776	4109.66	0021	0020	
5.	Gujarat	-	259	1730.00	0021	0020	
6.	Rajasthan	-	336	3422.00	0021	0020	

Refunds: similarly the refunds made by the assessing officers to the assessees were wrongly classified by them. A few such instances are given below:-

1.	Punjab	-	135	560.20	0021	0020	
2.	Rajasthan	-	41	521.00	0021	0024	The assessing officers were issuing refunds to the assessees
3.	Delhi	-	12	5.04	not found recorded		
4.	Haryana		290	1298.75	0021	0020	

(ix) Non-submission/delayed submission of major headwise account by the CTU to ZAO

As per paragraph 33 (A) of the guidelines issued by the Director of Income Tax (System) New Delhi Vide D.O.letter No.35/2/89/DIT/(S)/2314 dated 29 October 1993, CTU/Computer Centre was required to submit major headwise accounts to ZAO in the prescribed from by 8th of the following month.

Test check in audit revealed in-ordinate delays in Orissa, Uttar Pradesh, Andhra Pradesh, Madhya Pradesh, Delhi and Tamil Nadu charges in the submission of major head wise accounts by the CTUs to the ZAOs. For instance the delay in submission of Major Headwise accounts to the ZAOs ranged upto 17 days in Orissa, 19 days to 7 months in Uttar Pradesh, 1 month to six months in Andhra Pradesh, 5 days to 90 days in Madhya Pradesh charges. In Tamil Nadu charge, the CTUs/Computer Cell did not submit such major head wise accounts to ZAO.

(x) Delay in submission of simple and detailed accounts by CTU to the ZAO

A monthly statement in the prescribed form is to be prepared by the ZAO recording all the receipts and payments of all the banks for onward transmission to the Central Treasury Unit during the first week of the following month for confirmation and submission of detailed account by him. This monthly statement of scrolls received from ZAO was required to be reconciled with Central Treasury Unit Records within three days of receipt from the ZAO. The detailed account showing the details of collections received during the month major/minor headwise was also to be forwarded to the ZAO in the prescribed proforma by the 14th of the following month.

Test check of the selected CTUs revealed that in Maharashtra, Karnataka, Uttar Pradesh, Rajasthan, Haryana, Gujarat, Assam and Tamil Nadu charges, there were inordinate delays in despatch of simple and detailed

accounts by the CTUs to the ZAOs. Delays ranged from 40 days to 180 days in Maharashtra, 6 to 112 days in Karnataka, 22 days to 5 months in Uttar Pradesh, 7 days to 143 days in Rajasthan, 10 days to 156 days in Haryana, upto 3 months in Gujarat, upto 33 days in Assam and 5 days to 76 days in Tamil Nadu.

(xi) Large amounts outstanding under suspense account

Challans/refund vouchers which do not contain particulars of the Assessing Officer and hence could not be sent to the concerned Ward/Circle/Range, were required to be kept in the suspense account. The Directorate of O&M Services (Income Tax) had issued a circular in June 1978 stressing the importance of clearing the challans lying in the suspense account. With a view to ensuring that the numbers of uncleared challans lying in the suspense register was reduced to the minimum, a feed back report to the Board was prescribed in the said circular.

The following discrepancies were noticed in audit:

(a) In CTUs/Computer Cells in Uttar pradesh, Andhra Pradesh, Karnataka, Orissa, Maharashtra charges, no suspense account/ suspense files were opened though such amounts were included in the total collection.

(b) In Tamil Nadu charge, the huge amounts as shown below in respect of missing challans were kept in the suspense A/C but no efforts were made to clear them:-

Chennai	Years	No. of challans	Amount (Rs.)	No.of refund vouchers	Amount (Rs.)
Code No 010099		-			-
	1994-95	-	54.60 crore	-	10.35 crore
	1995-96	21084	24.28 crore	337	98.38 lakh
Code No. 010091					
	1995-96	4546	22.23 crore	30	21.51 lakh
Coimbatore	1993-94	945	25.16 lakh	94	2.19 lakh
	1994-95	1083	69.38 lakh	93	4.76 lakh
	1995-96	3634	2.76 crore	94	5.86 lakh

There was no procedure in the system for watching the progress in the clearance of these suspense accounts.

Working of the Computer Cell

3.2.7(i) Non-generation of letters to banks/ZAO for reconciliation

The computer centre was required to generate letters to Bank/ZAO for reconciliation in respect of cases where there were differences between the figures as shown by bank and those arrived at by the department and sent to CTU for further correspondence.

Test check in Audit revealed that the computer centres in Orissa, Karnataka, Rajasthan and Andhra Pradesh charges did not generate any letter for reconciliation of figures shown by each Bank and figures arrived at by totalling the daily challans and scroll amount received by the CTU. In Uttar Pradesh charge it was seen that no records were maintained so as to indicate that such letters were generated by the computer centre.

(ii) Deficiencies in the daily collection register (DCR)

Daily collection registers are required to be prepared in the prescribed format giving the dates, assessing officers continuity number (AOCON) (continuous number for the whole year), each entries arranged alphabetically major head wise, corresponding serial number of the control sheet, total collection for each day, running total for the whole year etc.

While reviewing the records the following deficiencies were found:-

(a) In Uttar Pradesh and Assam charges, the DCR was not being maintained properly. The address of the assessees and their PAN were not noted. No Column existed for noting the date of receipt of challans/refund advices in the CTU as provided in the prescribed form. Further, the entries of DCR were not authenticated by designated officer in these charges and Karnataka charge.

(b) In Rajasthan charge, daily collection register of one assessing officer for the year 1995-96 revealed that the continuity number (AOCON) was not maintained and a fresh series was started from 26 December 1995.

(iii) Non-maintenance of daily tally register

The computer centre was required to maintain daily tally register in the prescribed form indicating the total No. of challans and missing challans, total collection and also how they had been distributed. In the absence of such a register the computer cell would not be able to ascertain the number of missing/surplus challans. Test check in audit revealed that the daily tally

registers were not being maintained in Bihar, Orissa, UT Chandigarh, Punjab, Karnataka, Madhya Pradesh and Delhi charges.

In Andhra Pradesh charge, the daily tally register was improperly maintained as it did not show any missing challans and the amount involved, distribution of challans etc.

(iv) Surcharge

As per paragraph 33D (vii) of the revised guidelines issued by the Director of Income Tax (Systems) New Delhi in October 1993, computer cell was required to ensure that the surcharge on various categories of Income Tax, viz., advance tax, self assessment tax, etc. had been worked out correctly upto the prescribed percentage.

Test check of the selected computer units in Maharashtra, Karnataka, Gujarat, Orissa, Uttar pradesh, Rajasthan, UT Chandigarh and Punjab charges revealed that the computer centres were not ensuring that surcharge on various categories of tax was worked out correctly upto the prescribed percentage.

For instance, in Punjab charge, surcharge of Rs.4555.65 lakh (Jalandhar Rs.865.85 lakh, Amritsar Rs.162.81 lakh and Patiala Rs.3526.99 lakh) in the cases finalised by 25 assessing officers was booked as tax as the assessees had not shown surcharge separately on the challans.

Functioning of the Zonal Accounts Office

3.2.8 Verification of scrolls and challans

In the Zonal Accounts Office, on receipt of one copy of scrolls alongwith the challans/refund vouchers from the nodal bank, they are entered in a register major headwise and datewise separately for each bank. Later, the monthly total collections and total refunds are compared with the monthly statements received from each bank and discrepancies, if any, are reconciled.

After entering in the bankwise scroll register, the Zonal Accounts Office physically tallies all the supporting challans/refund vouchers, as mentioned in the daily main scroll, identifies the missing/surplus challans and refund vouchers, checks the continuity of serial numbers of the main scroll, and excess/short remittances, if any, are also reported to bank for reconciliation.

While conducting cross-verification of challans/refund vouchers at Central Treasury Unit/Zonal Accounts Office and assessing officer's level, the following deficiencies were noticed:-

(i) Inadequate attention paid to fraudulent refunds

In Delhi charge, fraudulent refunds in the Income Tax Department in 417 cases of Rs.25.88 lakh in the year 1993-94 and in 458 cases amounting to Rs.27.86 lakh in 1994-95 were noticed from the records (Details of accounts at a glance) of the Z.A.O. Complete details of such fraudulent refunds were however not available with ZAO, thereby disclosing inadequate attention being paid towards this important area.

(ii) Misclassification

It is the responsibility of the Zonal Accounts Officer to see whether the receipts/payments have been properly classified and accounted for major/sub-headwise.

(a) Several cases of misclassification of receipts and payments were noticed during the course of test check. A few instances of such misclassification are given in the table below:

Sl. No.	Name of the charge	Period/ No.of cases involved	Amount (Rs.in lakh)	Amount wrongly classi-fied under the Major Head	Amount to be classi-fied under the correct head of account	Remarks
1.	Maharashtra (Mumbai)	2 8	1400.00 17.00	0021 Income Tax	0024 Interest Tax	Wrong challan forms were used by the assessees
2.	Rajasthan	December 95 18 3	 68.08 64.30	 0021 0021	 0020 Corp.Tax 0024 Int.Tax	
3.	Madhya Pradesh	1994-95, 1995-96 34	 118.00	 0021	 0020	
4.	Karnataka	268	3159.00	between 0021 and 0020 and other heads		
5.	Uttar Pradesh	Dec.94 & June 95 3	 133.62	 0021	 0020 & 0024	

(b) Misclassification of Surcharge

1.	Rajasthan	-	12	9.36	-	Amount of surcharge not shown separately in challans issued by the department.
2.	Karnataka	-	-	1524.00	-	Element of surcharge was not segregated separately but was booked as a lump sum amount under "0021"
3.	Uttar Pradesh	-	15	186.56	-	Though the amount of tax and surcharge were shown separately in the challan but the total amount was booked under the major head.

Similarly, in Maharashtra and Bihar charges, surcharge was not shown separately.

It was seen that ZAO usually adopted classification of challans done by bank with the result that large amount of challans of Corporation Tax, Interest Tax, Expenditure Tax were classified under head 0021 Income Tax other than Corporation Tax, because assessees as well as income tax office used incorrect form of challans. Similarly refunds were issued to Corporations by the department on forms meant for refund of income tax. This also resulted in misclassification of amount under head 0021 Income Tax.

(iii) Non-payment of penal interest by Banks

As per the procedure which existed prior to 14 February 1996, collections of direct taxes at the receiving branches should be transferred to the concerned nationalised banks for credit to Government account within three to seven days (3 days for local branches and 7 days for outstation branches) from the date of receipt. In January 1996, the Reserve Bank of India had enhanced the permissible transit period from three to five days in the case of local branches and nine days for outstation branches. With effect from 1 April 1985, a provision existed for payment of interest by the banks at the rate of five percent per annum on delayed remittances beyond one month and above Rs.1 crore.

Later, with a view to remove the lacunae, the provision was amended with effect from 14 February 1996 empowering the ZAO to charge penal interest from the banks in respect of all cases of delayed remittances irrespective of the amount involved. Audit scrutiny, however, revealed that despite the amendment non levying the penal interest on a number of occasions the bank had not paid the amount. A few such cases are given in the table below:

Sl. No.	Charge	No.of cases	Amount delayed (Rs.in lakh)	Period of delay	Amount of interest (Rs.in lakh)	Remarks
1.	Maharashtra Mumbai Pune Nagpur	- 475 294	6.00 696.98 86.50	31 days to 182 days - -	0.16 13.55 1.77	Interest not levied
2.	Punjab	71	-	more than 30 days	1.74	-do-
3.	Karnataka	-	-	30 days to 203 days	5.89	-do-
4.	Rajasthan	161	137.00	-	2.12	Though interest demand was raised by ZAO but not deposited by the banks till date
5.	Delhi	123	63.76	-	6.44	Interest not levied
6.	West Bengal	-	-	1 to 92 days	0.31	-do-
7.	Tamil Nadu	406	254.00	-	7.57	Out of this Rs.1.20 lakh only could be collected.

(iv) Reconciliation of revenue collections and refunds as per major/minor headwise account (Detailed accounts) of designated officer with those of zonal accounts officer's figures

Huge amounts booked under suspense head RAT

As per para 5.5 of booklet on "Departmentalised Accounting System for Direct Tax Receipts and Refunds" and the circular issued by the Principal Controller of Accounts, Central Board of Direct Taxes, New Delhi vide No.101/ 92/88/CCA/557-591 dated 18.8.1988, the major headwise account of receipts and refunds proposed by the Zonal Accounts Officer on the basis of the main scrolls were to be reconciled with the major/minor headwise account received from the Central Treasury Unit (CTU). Any difference in the major headwise account should be got reconciled and the Account tallied each month. Pending receipt of detailed account for the full amount for each month from Central Treasury Unit, the difference was to be kept under the suspense account as "Receipt Awaiting Transfer (RAT)". Monthly and progressive figures (under each major head of account) under RAT were to be drawn by the Zonal Accounts Officer. Later, on receipt of detailed account for the balance amount from Central Treasury Unit, the suspense head RAT was to be cleared by deduct(-) credit to the detailed head under the respective major head. At the end of the year i.e. in the account of March the suspense head was to be fully cleared and total amount of receipt and payments during the year was to be booked finally under the respective

major head of account which was then communicated to the Central Board of Direct Taxes by the Z.A.O.

In Maharashtra, Karnataka, Uttar Pradesh, Rajasthan, Orissa, Karnataka, Andhra Pradesh and Tamil Nadu charges, audit scrutiny revealed discrepancies in the reconciliation procedure. Three instances are listed below:-

(a) In Uttar Pradesh, Rajasthan and Orissa charges, no reconciliation of figures between CTU & ZAO were done.

(b) In Karnataka charge, audit scrutiny revealed that RAT at the end of 1993-94 amounting to Rs.81.65 lakh was cleared by transferring it to "Advance Tax" without any detailed accounts from the CTU which was irregular. Similarly amounts of Rs.257.78 lakh and Rs.58.86 lakh for 1994-95 and 1995-96 outstanding as RAT after journal entry batch I(94-95) and 3/96 (supplementary) were cleared "as per statements of accounts submitted by the CTU." However, no reconciliation statements were enclosed with these accounts and it was not known as to how these amounts were cleared.

(c) In Tamil Nadu charge, though the CTU Chennai pointed out a number of mistakes from August 1995 to January 1996 like main scroll totalling errors etc., yet these mistakes were not noted in the error/wanting scroll register maintained by the ZAO.

(v) Non-reconciliation with Banks and Reserve Bank of India/Central Accounts Section, Nagpur

As per the revised memorandum of instructions with effect from 1.10.1988 issued by the Reserve Bank of India for collection and accounting of income tax and other Direct Taxes and payments of Income Tax refund orders by the branches of Public Sector Banks, each nationalised bank was responsible for collection of taxes by their branches at all stages till the amounts were credited to Government account. For the purpose of monthly reconciliation the nationalised banks were to prepare in the first week of the following month, a Zonal Accounts Office-wise monthly statements in quadruplicate (separately for receipts and payments) indicating datewise position reported to Zonal Accounts Officers through daily main scrolls and settled with the Reserve Bank of India, Central Accounts Section, Nagpur through their link cells at Nagpur in the previous month.

Similarly the Central Accounts Section, Reserve Bank of India, Nagpur (CAS) also would generate monthly put through statement and furnish the same to all the Zonal Accounts Officers and the Link Cells by the 20th of the following month indicating major headwise receipts/refunds etc.

As per the instructions issued by the Reserve Bank of India in September 1995 each nationalised bank was required to send monthly certificate to the Zonal Accounts Officer to the effect that all amounts of direct taxes collected in a particular month by all its receiving branches had been remitted to Government account.

This reconciliation of monthly Accounts with Banks, Reserve Bank of India, Central Accounts Section was not being done regularly in many charges in Maharashtra, Karnataka, Andhra Pradesh, Delhi and Tamil Nadu.

Two instances are illustrated below:

(a) In Maharashtra charge, the monthly reconciliation with many banks was not being done after March 1996 and in some cases it was not done after October 1988 onwards. None of the nationalised banks were furnishing the requisite certificate to ZAO to the effect that all the amounts of direct taxes collected in a particular month by all its receiving branches had been remitted to the Government account.

(b) In Delhi charge, audit scrutiny revealed that since 1988-89 till 1996-97 a sum of Rs.71.36 crore was required to be transferred to Government account by various banks. This represented the total progressive difference between the figures of the ZAO (as reported by the bank)and CAS Nagpur (as transferred to Government account). There existed a huge difference of Rs.334.83 crore in the figures of net amount as per the accounts (aggregating Rs.10,848.14 crore) and net amount as reported by the ZAO to be transferred to the Government account (totalling Rs.10,513.31 crore) during a period of 3 years 1993-94 to 1995-96.

(vi) Non-maintenance of Register by the ZAO

As per the procedure contained in "Departmental accounting system of Direct Taxes Receipts and Refunds" the following registers are required to be maintained in the ZAO office.

(i) Register of watching receipt or wanting scrolls

(ii) Register relating to reconciliation with bank

Audit scrutiny revealed that in many ZAO offices in Uttar Pradesh, Rajasthan, Karnataka and Delhi charges these registers were not being maintained. In Maharashtra, the Zonal Accounts Officers were either not maintaining any missing challan register or even if maintained, they were not monitoring the pending items properly.

In the absence of these registers the delay in sending scrolls/challans by bank to ZAO and the position of reconciliation with the bank could not be ascertained.

Working of the Assessing Officer

3.2.9(i) Prescribed checks not exercised by assessing officers

On receipt of daily collection register (DCR) alongwith challans and daily refund register (DRR) alongwith refund advices from the CTU the assessing officer was required to check running AOCON, page number, entry number and total collection.

While conducting cross verification of challans/refund vouchers of the assessing officers level, test check revealed that the above procedure of checking by assessing officers (AOs) was not being done by 54 AOs in Uttar Pradesh, 32 AOs in Karnataka, 3 AOs out of 5 in UT Chandigarh, 33 AOs out of 34 in Punjab, 10 AOs in Tamil Nadu and none of the assessing officers test checked in Madhya Pradesh, Maharshtra, Orissa, Assam and West Bengal charges.

Thus the assessing officers were not in a position to ascertain that there were no omission in the receipt of daily collection registers as well as challans/refunds vouchers from the CTU.

(ii) Cross Referencing not done

On receipt of DCR from the CTUs the assessing officer was required to enter the regular demand in the Demand and Collection Register (D&CR) making appropriate cross references in both the demand and collection register and daily collection register. A suitable entry in the order sheet was to be made indicating collections.

During the course of review of records of assessing officers in Uttar Pradesh, Rajasthan, Madhya Pradesh, Gujarat, Orissa, Andhra Pradesh Maharashtra, Karanataka, Punjab, Assam, West Bengal, Haryana and Tamil Nadu audit scrutiny revealed that in most of the charges assessing officers were not following the above procedure. In Delhi charge, even the bundles of DCR/DRR alongwith challans and refund advices were lying unopened. Regular demands were not being entered in the D&CR and thus no cross references were made in the DCRs.

Due to non-maintenance/improper maintenance of the D&CR registers and lack of cross referencing therein, the possibility of delayed/wrong credits to the assessees cannot be eliminated. A few instances of lapses of the above procedure are given below:

(a) In Uttar Pradesh charge in 431 cases involving a sum of Rs.68.53 lakh of regular demand, no cross references were noted by the assessing officers concerned.

(b) In Gujarat charge, an amount of Rs.1.38 crore and Rs.50 lakh were shown as outstanding as on 31 March 96 as arrear demand by the assessing officers. Audit scrutiny revealed that taxes collected as per the DCR have not been entered in the relevant accounting register which has resulted in excess exhibition under arrear demand.

(c) In Bihar charge, several challans noted from assessment records could not be traced in the DCRs. For instance 17 challans amounting Rs. 1 crore could not be traced in DCR by audit. It could not be ascertained as to whether DCRs for the challans were despatched by the respective CTUs or were misplaced by the assessing officer or these were the bogus challans.

(iii) Non-Reconciliation by assessing officer

At the bottom of DCR for each day in respect of regular demand, advance tax and self assessment tax a reconciliation statement was required to be given duly signed by the dealing assistant in the office of assessing officer. This would include particulars of number of entries transferred to the demand and collection register, number of entries not transferred because they did not pertain to the assessing officer, number of correcting entries that need not be transferred, number of entries though pertaining to him but were wrongly classified and totalled.

During test check in audit it was noticed that in the years 1993-94 to 1995-96 the aforesaid reconciliation statements were not recorded by many assessing officers in Maharashtra, Assam, Andhra Pradesh, Karnataka, Haryana, Gujarat, Orissa, Madhya Pradesh, West Bengal and 37 assessing officers in Tamil Nadu charges. This resulted in not sending any list to the respective CTUs informing the cases which do not pertain to them or were wrongly classified. Some such illustrative cases are given below:

Sl. No.	Charge	No.of cases	Amount involved (Rs.in lakh)	Remarks
1.	Haryana	316	1003.38	Challans received directly from various AOs instead of through CTU/Computers.
2.	Karnataka	268	3159.00	Misclassified between 0020 (Corp.tax) and 0021(Income Tax) and other heads in the daily collection register of AO and were not noticed by the CTU, the Computer Centre, ZAO and the AOs.
3.	Orissa	18	-	Refund voucher and advices did not indicate tax wise amount and interest separately. In 14 cases of refund Rs.2.63 lakh pertained to interest and in 4 cases, Rs.26.34 lakh pertained to 0020 Corp.tax and not to 0021 Income Tax.
4.	Haryana	441	450.91	Surcharge element was not bifurcated by assessees/department.
5.	Karnataka	713	3507.59	-do-
6.	Tamil Nadu	23 185 5	2796.00 1146.00 8.68	-do- In 5 CITs collection and refunds respectively were misclassified in DCRs/DRRs of AOs. This was not brought to the notice of Computer Centres.
7.	Assam	142	-	As per assessment order surcharge of Rs.140.56 lakh was leviable against which surcharge of Rs.48.71 lakh was accounted for on the basis of classification on challans in respect of advance tax and self assessment tax.

In Andhra Pradesh charge, a test check of daily collection registers/refund scrolls revealed that no such reconciliation statements were recorded in daily collection register/refund scrolls relating to 19 officers.

(iv) Challans not returned

On receipt of DCR/DRR along with challans/refund advices the assessing officer was required to prepare a list of items that did not belong to him or which were wrongly classified and sent back to computer centre/CTU in a

prescribed form by making suitable entries in the daily collection register/daily refund register.

Audit scrutiny revealed that many assessing officers in Uttar Pradesh, Karnataka, Rajasthan, Maharashtra, Punjab, Madhya Pradesh, Orissa, Gujarat and UT Chandigarh charges, were not following the above procedure. They were not preparing the list of items which did not pertain to them. Though a number of challans pertaining to other assessing officers were lying with them, the assessing officers were neither sending these challans back to the CTUs nor sending them to the concerned assessing officers. Some of the instances are cited in the table below:-

Sl.No.	Name of the charge	No.of challans	Amount involved (Rs.in lakh)
1.	Orissa	-	0.33
2.	Uttar Pradesh	199	11.10
3.	Rajasthan	38	37.59
4.	Punjab	268	395.13
5.	Madhya Pradesh	69	2.89
6.	Karnataka	5	31.23

Since the challans pertaining to other assessing officers were neither sent back to CTU nor passed on to the concerned assessing officers, this resulted in irregular credit to assessees by the assessing officers.

(v) Irregular credit given on the basis of assessee's copies of challans

As per instruction contained in the orders issued by the CBDT, credit of deposit of tax was to be given only on the basis of original challans received from the CTUs and not on the basis of assessee's copy of challans.

Audit scrutiny of the records of the assessing officers in Marahashtra, Uttar Pradesh, Rajasthan, Karnataka, Haryana, U.T Chandigarh, Punjab, Madhya Pradesh, Andhra Pradesh, Bihar, Gujarat and Orissa charges, revealed that in most of the charges credit of deposit of tax was invariably being given on the basis of assessee's copy of the challans and not on the basis of original copy of the challans received from the CTU. There existed a possiblity of giving wrong credits/refunds. Total number of such cases noticed in audit are tabulated below:-

Sl. No.	Charge	No. of cases	Amount involved (Rs.in lakh)	Remarks
1.	Uttar Pradesh	736	140.06	
2.	Karnataka	1,502	24,400.24	
3.	Haryana	2,747 935	7,504.23 2,031.47	Refund Vrs not placed in asstt.files.
4.	Punjab	664	1,766.16	
5.	Assam	204	554.85	Credit for tax paid in respect of advance tax and self assessment tax were allowed on the basis of assessee's copy of challan .
6.	West Bengal	percentage of cases varied from 100% to 80% in 27 wards,80% to 51% in 17 wards,10% to 1% in 10 wards		
7.	Tamil Nadu	109	2557.00	
8.	Gujarat			44 out of 59 Assessing Officers challans not placed in the respective files
9.	Delhi	230	-	

Some illustrative cases are given below:-

(a) In Karnataka charge, assessments were concluded giving credit without documentary evidence in 7 cases involving Rs.889.95 lakh.

(b) In Gujarat charge, refund of Rs.10.22 lakh, Rs.75.82 lakh and Rs.235.80 lakh were issued to 3 assessees in the years 1993-94 to 1995-96 respectively, on the basis of the copies of the assessee's challan and not on the basis of original challans from the CTU.

(c) In West Bengal charge, an assessee was allowed a credit of Rs.10 lakh towards Advance Tax on the basis of the fourth copy of the challan. Audit scrutiny revealed that the bank had acknowledged receipt of Rs.10,000 only. The CTU Calcutta on the contrary prepared a distribution memo for Rs.1 lakh.

(vi) Non-submission of monthly certificate by the assessing officer to his next higher officer

Every assessing officer is required to submit a monthly certificate to his next higher officer on a prescribed form that the revised procedure for the processing of challans with the help of computer was being followed by him.

Audit scrutiny of records of the assessing officers in Maharashtra, Karnataka, Gujarat, Orissa, Uttar Pradesh, U.T.Chandigarh, Punjab, Madhya Pradesh, Assam, Tamil Nadu and Delhi charges, test checked, revealed that in almost all the charges, neither did the assessing officers furnish the requisite certificates nor were these ever asked by their higher officers.

(vii) Non-maintenance of records of daily collection register (DCR)/daily refund register (DRR)

No records/registers for making entries of daily collection register/ daily refund register alongwith challans and refund advices received from CTUs was found maintained in Haryana, Madhya Pradesh, Gujarat, Rajasthan, Karnataka and Bihar charges. These records were also not kept properly by AOs. The challans/refund advices received from CTUs were also not placed in the assessment files. Thus it was not possible to ascertain whether DCR/DRR were being received regularly by the assessing officers from CTUs. Some instances are given below:-

(a) Madhya Pradesh

The Daily Collection Register/Refund scrolls received from CTU were not found bunched properly in the 11 assessing officers, out of the 13 assessing officers under Bhopal charge test checked in audit. Similarly these were not found bunched properly in all the 9 assessing officers test checked in audit under Jabalpur charge.

(b) Gujarat

In the case of 50, out of 59 A.Os. the DCRs have not been bunched and kept properly.

(c) Rajasthan

In 15 out of 16 assessing officers whose records were checked, the challans had not been placed in files. These were lying in bundles with daily collection register in loose condition.

(d) Karnataka

(i) In an assessment concluded in a summary manner credit was given considering the challan of the subsequent year and a refund of Rs.12.58 lakh was wrongly issued to the assessee. On being pointed out in audit (May 1997), the department is yet to give a reply (June 1997).

(ii) Three challans of Rs.11.35 lakh and one refund voucher of Rs.28,208 with no bank seal on them were noticed during test check. Two refund orders with no amount mentioned on them and one of them without name of assessee were noticed. In four refund orders involving Rs.2.94 lakh, the signature of the assessing officer was missing.

Functioning of the Designated Banks

3.2.10 Audit scrutiny of records available with the assessing officers, Zonal Accounts Offices and Central Treasury Units in Mumbai, Karnataka and Uttar Pradesh charges revealed several deficiencies in the functioning by Designated Banks. These are illustrated below:

(i) Acceptance of incomplete challans by banks

As per para 12-A-1 of Accounting System for Direct Taxes (issued by Reserve Bank of India), the receiving branch of the Bank while accepting the challan is required to scrutinise the challan form to ensure that the name and address of the assessee, assessment year, ITO ward or circle where he is assessed or assessable etc. have been properly written.

Some illustrative cases noticed during test check where the above instructions were not followed are given below:

(a) In Mumbai charge, three assessees had paid advance tax amounting to Rs.90,000 for the assessment year 1996-97 on 15.12.95. Though there was no cheque number and date in the challan, while scrolling, the bank had taken this amount as "Cheque Payment". Similarly, in another case in Uttar Pradesh charge the Bank accepted a challan dated 27.10.94 which did not contain the name of the assessee and the amount of tax deposited.

(b) In another case in the same charge, State Bank of India accepted advance tax amounting to Rs.19.50 crore by cheque even though the details of cheque number and date were not mentioned in the challan.

(c) In Bihar charge, the bank accepted a refund advice order of Rs.4100 on which the signature of the issuing authority was missing.

(ii) Variation in amount shown in challan and the amount shown in bank scroll

Audit scrutiny in Mumbai charge, revealed discrepancies in amounts shown in figures and amounts shown in words in the challans submitted to banks. The banks had however accepted the higher figures.

(iii) Acceptance of Incorrect Forms

Audit scrutiny in Uttar Pradesh charge, revealed that in 10 cases, sums aggregating Rs.31,773 were deposited by the assessees during June 1995, October 1995 and January 1996 using forms prescribed for the deposit of state receipts. These were however accepted by the Banks.

Internal Audit

3.2.11 The Handbook on "Departmentalised Accounting System for Direct Taxes Receipts and Payments" envisages an Internal Audit Organisation under the Chief Controller of Accounts for ensuring the correctness of all receipts and refunds and account records and other subsidiary registers maintained by the Zonal Accounts Offices and Central Treasury Unit. It was however observed that the prescribed audit of the accounting system in Delhi, Orissa, Rajasthan, Kerala (Kochi), Uttar Pradesh (Meerut), Tamil Nadu and Maharashtra (ZAO Nagpur) charges was not done.

Audit scrutiny revealed that wherever Internal Audit was conducted in Maharashtra and Uttar Pradesh (Agra, Allahabad, Kanpur and Lucknow) charges, the major observations revealed to delay in despatch of simple and Detailed accounts, delay in distribution of Daily Collection Registers/Daily Refund Registers, delay in Remittances by banks etc.

Despite the above observations the internal audit could not bring about positive results and the irregularities are continuing.

The review was referred to the Ministry in November 1997. The Ministry's reply has not been received (December 1997).

3.3 Deduction in respect of profits and gains from newly established industrial undertakings after a certain date

Introduction

3.3.1 Tax holiday scheme has been introduced by the Government in order to fulfill a number of policy objectives.

Under Section 80 J, the tax holiday was allowed with effect from assessment year 1968-69 to units commencing manufacture, etc. prior to 1 April 1981 and the deduction was as a percentage of capital employed in the business. With effect from 1 April 1981, a new Section 80 I was introduced by the Finance (No.2) Act, 1980. This Section was broadly on the lines of Section 80 J with the only significant change being that the deduction was to be calculated equal to a percentage of profits from the eligible undertakings, etc. The deduction under the provisions of Section 80 I ceased to operate in respect of the eligible business, etc. starting operation after 31 March 1991.

Law and procedure-Scope of the incentive

3.3.2(i) The businesses to which the concession is available, i.e. deduction available as percentage of profits of business, and the period for which the deduction is available are indicated in the following table:

Nature of Business	Category of the assessee	Period of commencement of business, etc.	Percentage of deduction	Number of years of deduction (including year of commencement of business etc.
A- New industrial undertakings which begins to manufacture/ produce articles/ things, or operates cold storage plant, or Ship which is brought into use, or Hotel which starts functioning	Company	1 April 1981 to 31 March 1990	25	08
		1 April 1990 to 31 March 1991	30	10
	Co-operative Society	1 April 1981 to 31 March 1990	20	10
		1 April 1990 to 31 March 1991	25	12
	Others	1 April 1981 to 31 March 1990	20	08
		1 April 1990 to 31 March 1991	25	10
B- Industrial undertaking carrying on the business of repairs to oceangoing vessels or other power craft:	Company	1 April 1983 to 31 March 1988	20	05

Conditions of eligibility

(ii)(a) New industrial undertaking

The Act provides for certain conditions to be fulfilled before the deduction is admissible. For instance, it should not have been formed by splitting up

or reconstruction of a business already in existence. It should not be formed by transfer to a new business, of machinery or plant previously used for any purpose, and it should manufacture any article or thing, not being an article or thing specified in XIth Schedule to Income Tax Act or operate one or more cold storage plants anywhere in India. However, a small scale industrial undertaking can manufacture an article or thing mentioned in the XIth Schedule. Further, it should employ 10 or more workers in a manufacturing process carried on with the aid of power, or should employ 20 or more workers in a manufacturing process carried on without the aid of power.

(b) Hotel

Similar conditions regarding formation by way of splitting up or reconstruction etc. exist for a hotel business. Moreover, such a hotel besides being approved by the Government, should be owned and the business is carried on by a company registered in India with share capital of Rs.5 lakh or more.

(c) Repairs to ocean-going vessel or other power craft

The condition regarding non-formation by splitting up or reconstruction of a business already in existence apply to this category also.

(d) Ship

A ship in order to be eligible for this deduction should be owned and wholly used for the purpose of business by the Indian company. Further, it should not have been owned or used in Indian territorial waters by a person resident in India prior to its acquisition by the Indian company

Objective of the review

3.3.3 The implementation of the scheme has been reviewed with a view to assess and evaluate the impact of the concession on the total revenue collection, overall efficiency of the department in identifying the eligible undertakings and the degree of compliance with the law and procedural requirements. It was also to examine whether the concessions had been granted as per the provisions of the Act and with due compliance to the judicial pronouncements. The results of the review conducted through a test check of the assessments completed during the years 1991-92 to 1995-96 are given in the succeeding paragraphs.

Scope of the review-sample size

3.3.4 For the purpose of review, out of 1874 assessment wards/ranges (inclusive of special ranges and circles) under the charges of various Commissioners of Income Tax, returns/assessments in 859 wards/circles/ranges (46 percent) were test checked.

Constraints

3.3.5 The Ministry's policy file regarding the scheme which would have indicated the complete objectives of the scheme, the expectations regarding revenue to be foregone and the desired results had been called for by Audit for examination. The file was stated to be untraceable. Since this record is a primary one for conducting a system study, in its absence, the overall efficacy of the scheme could not be judged.

Highlights

3.3.6(i) Deduction in respect of profits and gains from newly established industrial undertakings was provided under the Income Tax Law with the object of encouraging industrialisation process and combating un-employment. Despite this tax holiday provision being on the statute for over ten years, no review/study has ever been undertaken nor any system developed by the department to evaluate its impact on the said objective vis-a-vis the revenue foregone on this account. The authenticity of the figures maintained by the department regarding the deductions allowed under this provision was questionable since no reporting system existed for monitoring such deductions and test check by Audit had revealed a different set of figures. **[Para 3.3. 7]**

(ii) Irregular relief allowed to ineligible industrial undertakings which did not start commercial production within the prescribed dates, nor fulfilled the prescribed employment requirement or were engaged in specified prohibited industries or were formed by splitting up or reconstruction of a business already in existence or were non-manufacturing units resulted in under charge of tax of Rs.6281.91 lakh in 64 cases .

[Paras 3.3.8,12,13,14 and 18]

(iii) In 56 cases, the deductions were irregularly allowed beyond the prescribed period of eligibility involving tax effect of Rs.851.86 lakh.

[Para 3.3.9]

(iv) In 20 cases, deductions were erroneously allowed in excess of gross total income in violation of the overriding condition to limit the deduction by it. These resulted in short levy of tax of Rs.1630.96 lakh.

[Para 3.3.15]

(v) Incorrect computation of profits from an industrial undertaking due to inclusion of other incomes not derived from it for computation purposes or not setting off of unabsorbed depreciation and investment allowance of earlier years pertaining to the industrial undertaking in question against such profits led to under charge of tax of Rs.4942.40 lakh in 215 cases.

[Paras 3.3.16 and 17]

Impact of the scheme

3.3.7 The following table shows the amount of deductions granted during the years 1991-92 to 1994-95.

Assessment year	Amount of deductions granted (Rs.in crore)
1991-92	314.72
1992-93	355.62
1993-94	393.80
1994-95	438.77

While the above figures were collected from All India Income Tax Statistics for the years 1991-92 to 1994-95, the department did not possess any information system to give complete details of the number of beneficiaries, the amount of deduction claimed/allowed, number of units which availed of these concessions and then closed down etc. Since the reporting formats of the Income Tax Department do not facilitate the identification and quantification of deductions allowed under section 80 I (or any other deduction under Chapter VIA of the Income Tax Act), the above figures are not reliable. This becomes more apparent from the fact that test check in audit revealed that in 3052 cases alone, deductions amounting to Rs. 2379.79 crore were granted for the years 1991-92 to 1995-96.

Although the declared objective behind introduction of this provision was to encourage industrialisation, there were no reliable statistics available to indicate the extent to which the goals had been achieved. There is no indication that the Government had carried out a review to evaluate the impact of the scheme or to judge whether the revenue foregone was justifiable.

Activity commenced prior to/after specified dates

3.3.8 Under the Act, the deduction is allowed only if the industrial undertaking commences commercial production after 31 March 1981 and on or before 31 March 1991. Audit scrutiny revealed that

in 7 cases in Assam,. Gujarat, Orissa, Uttar Pradesh and Delhi charges, the deductions were allowed in contravention of the provisions. The irregular grant of deduction aggregated Rs.318.93 lakh resulting in short levy of tax of Rs.258.63 lakh.

These cases are listed below:

(a) In Delhi III charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in October 1994 and September 1995 and those for the assessment years 1994-95 and 1995-96 in summary manner in February 1995 and March 1996 allowing a total deduction of Rs.285.95 lakh. Audit scrutiny revealed that since the assessee had started manufacturing activity only after 31 March 1991 it was not eligible for the deduction. The irregular allowance of deduction of Rs. 285.95 lakh resulted in short levy of tax of Rs.236.27 lakh.

(b) Other cases:

SL. No.	Status	Commissioner's charge	Assessment year	Date of commencement of production	Deduction allowed (Rs. in lakh)	Tax effect (Rs.in lakh)
1.	Registered firm	Ahmedabad I	1992-93/ 1993-94	Prior to 1 April 1981	16.40	11.46
2.	Company	Surat	1993-94	Prior to 1 April 1981	9.67	5.56
3.	Registered firm	Orissa	1989-90 to 1991-92	4 March 1981	2.03	0.90
4.	Registered firm	Orissa	1993-94	Prior to 1 April 1981	0.32	0.16
5.	Individual	Agra, Uttar Pradesh	1992-93	October 1991	1.75	2.42
6.	Company	Shillong	1995-96	after 31 March 1991	2.81	1.86

Grant of concession beyond the period of eligibility

3.3.9 Under the Act, the deduction is available for a period of 10-12 years in the case of a co-operative society and 8-10 years in the case of a company or any other assessee. This would include the year of commencement of business and would depend on the date of commencement of business etc. It was noticed during audit that, in contravention to these provisions, concessions were granted for the assessment years beyond the period of eligibility. In 56 cases, in Assam, Bihar, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh. Orissa,

Punjab, Rajasthan, Uttar Pradesh, Tamil Nadu, West Bengal and Maharashtra charges, there occurred a short levy of tax aggregating Rs.851.86 lakh.

Three instances are discussed below:

(a) In Patiala, Punjab charge, the assessments of a company for the assessment years 1994-95 and 1995-96 were completed in a summary manner in September 1995 and August 1995 respectively in allowing a deduction of Rs.1061.19 lakh. Audit scrutiny revealed that similar claim of the assessee for the earlier assessment years 1991-92 to 1993-94 were disallowed by the assessing officer while completing the assessment for these years under scrutiny on the plea that the undertaking had commenced production before the year 1987-88 and the business was only expanded from time to time. Omission to disallow the relief in the assessment years 1994-95 and 1995-96 thus resulted in short levy of tax of Rs.519.60 lakh.

(b) In Tamil Nadu IV charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in March 1996 allowing a deduction of Rs.116.09 lakh. Audit scrutiny revealed that the assessee, having started manufacturing activity in the previous year relevant to the assessment year 1987-88, was not eligible for deduction for the assessment year 1995-96, being the ninth year. The irregular allowance of deduction, thus resulted in short levy of tax of Rs.68.18 lakh.

(c) In Karnataka I charge, a company started manufacturing activity in the previous year relevant to the assessment year 1984-85 and hence was eligible for the deduction upto and including the assessment year 1991-92. Audit scrutiny, however, revealed that deductions aggregating Rs.83.36 lakh were granted for the assessment years 1992-93 and 1993-94 completed after scrutiny in July 1994 and October 1995 and for the assessment years 1994-95 and 1995-96 completed in summary manner in February 1995 and February 1996. The irregular grant of deduction resulted in short levy of tax aggregating Rs.50.87 lakh.

Application of incorrect rate of deduction

3.3.10 The deduction is allowed at the rate of 25 percent or 30 percent in the case of companies if the period of commencement of business etc. was between 1 April 1981 and 31 March 1990 or between 1 April 1990 and 31 March 1991 respectively. In respect of other assessees, the deduction is allowed at the rate of 20 percent or 25 percent depending upon the date of commencement of business etc. between the above periods. Audit scrutiny

revealed that in 10 cases in Bihar, Gujarat, Karnataka and Uttar Pradesh charges, deductions were allowed at higher rates eventhough the assessees were eligible for the deduction at lower rates. The application of incorrect rate of deduction in these cases resulted in short levy of tax of Rs.24.89 lakh.

Two illustrative cases are indicated below:

Sl. No	Status	Commissioner's Charge	Assessment year	Rate of deduction allowed	Eligible rate	Excess deduction (Rs.in lakh)	Tax effect (Rs. in lakh)
1	Individual	Agra, Uttar Pradesh	1991-92 to 1993-94	25 percent	20 percent	4.12	8.63
2.	Company	Gujarat I	1994-95	30 percent	25 percent	9.09	6.77

Grant of deduction in the absence of auditor's report

3.3.11 In a case where the assessee is a person other than a company or a co-operative society, the deduction is admissible only if the return is accompanied by the audit report in the prescribed form duly signed and verified by an Accountant. Audit scrutiny in Karnataka, Madhya Pradesh and Rajasthan charges revealed that in 5 cases, grant of deduction in the absence of such reports resulted in short levy of tax of Rs.7.30 lakh.

Grant of deduction ignoring employment requirement

3.3.12 Under the Act, the deduction is admissible only if the industrial undertaking employs 10 or more workers in the manufacturing process carried on with the aid of power or employs 20 or more workers where the manufacturing process is carried on without the aid of power. Audit scrutiny in Himachal Pradesh, Delhi and Maharashtra charges revealed that deductions were allowed by the assessing officers without verifying the fulfillment of this condition. In 5 cases, such irregular deduction resulted in short levy of tax of Rs.172.83 lakh.

Two cases are illustrated below:

(a) In City I, Mumbai charge, the assessments of a company for the assessment years 1991-92 to 1995-96 were completed after scrutiny/in summary manner between April 1993 and March 1996. Audit scrutiny revealed that during the previous years relevant to the above assessment years, the assessee employed less than 10 workers in each of the eligible units and hence was not entitled to the deduction. The irregular grant of deduction resulted in short levy of tax of Rs.82.83 lakh.

(b) In Delhi IV charge, the assessments of a firm for the assessment years 1991-92 to 1993-94 were completed after scrutiny between September 1992 and March 1996 and those for the assessment years 1994-95 and 1995-96 in summary manner in October 1995 and August 1996 respectively allowing a deduction of Rs.128.74 lakh. Audit scrutiny revealed that all the workers employed were only on casual basis. As the casual workers and workers employed by outside parties were not to be treated as employees for the purpose of determining the eligibility criteria, the deduction granted was irregular. The mistake resulted in underassessment of income of Rs.128.74 lakh involving short levy of tax of Rs.78.72 lakh.

Irregular grant of deduction in respect of profits and gains from ineligible industries

3.3.13 Under the Act, the deduction is allowable to an undertaking which manufactures/produces any article/thing not being the one specified in the eleventh schedule. However, the above condition shall not apply in relation to a small-scale industrial undertaking. Audit scrutiny revealed that in 9 cases in Bihar, Haryana, Uttar Pradesh and Maharashtra charges, irregular deductions allowed to industrial undertakings engaged in the manufacturing of ineligible items resulted in an aggregate short levy of tax of Rs.4522.91 lakh (including potential tax effect of Rs.0.91 lakh).

Two instances are given below:

(a) In Meerut, Uttar Pradesh charge, the assessments of a company for the assessment years 1991-92 and 1992-93 were completed after scrutiny and those for assessment years 1993-94 to 1995-96 in a summary manner between March 1994 to December 1995 allowing an aggregate deduction of Rs.5562.78 lakh. Audit scrutiny revealed that the assessee was engaged in the manufacture of Xerox machines which being office apparatus are included in the eleventh schedule. As such, the assessee was not eligible for the deduction. The irregular grant of deduction thus resulted in underassessment of an income of Rs.5562.78 lakh with consequent short levy of tax of Rs.3880.98 lakh apart from non-levy of additional tax of Rs.481.91 lakh.

(b) In City III, Mumbai charge, the assessments of a company for assessment years 1992-93 to 1995-96 were completed after scrutiny/ in a summary manner allowing a deduction of Rs.50.89 lakh. Audit scrutiny revealed that the assessee was engaged in the manufacture of liquid hairdye which was listed in the eleventh schedule. Hence, it was not entitled to the deduction. The mistake resulted in irregular deduction of Rs.50.89 lakh with consequent short levy of tax of Rs.25.83 lakh.

Irregular allowance of deduction to non-manufacturing units

3.3.14 Under the provisions, the concession is allowed only to an industrial undertaking which manufactures or produces any articles or things. The expression manufacture or production applies to a case which bring into existence something different from its components* . Audit scrutiny in Assam, Gujarat, Haryana, Chandigarh, Karnataka, Madhya Pradesh, Punjab, Tamil Nadu, West Bengal and Maharashtra charges revealed that in 17 cases, deductions were allowed even though the assessees were not engaged in any eligible manufacturing activity. This resulted in a total undercharge of tax of Rs.216.09 lakh (including potential tax effect of Rs.1.90 lakh).

Two cases are detailed below:

(a) In City III, Mumbai charge, the assessments of a company for the assessment years 1989-90 to 1993-94 and 1995-96 were completed allowing deductions aggregating Rs.165.16 lakh. Audit scrutiny revealed that the assessee was engaged in the running of poultry farm and manufacturing of poultry products. As per the judicial decision** the business of poultry farm could not be treated as an industrial undertaking engaged in the manufacture of article, the decisive text being 'bringing into existence new goods'. Thus, the assessee was not entitled for the deduction. The irregular allowance resulted in underassessment of income of Rs.165.16 lakh involving a tax effect of Rs.90.45 lakh.

(b) In North East Region, Shillong charge, the assessments of a company for the assessment years 1991-92 to 1993-94 initially processed in a summary manner were completed after scrutiny between December 1993 and March 1996 allowing deductions aggregating Rs.19.14 lakh. Audit scrutiny revealed that the assessee derived its income from sale of extracted coal, white clay, construction of deep tube wells etc. and based on decision of Supreme Court*** was not engaged in any manufacturing activity. Therefore, the assessee was not entitled to the deduction. The irregular deduction resulted in underassessment of income of Rs.19.14 lakh in aggregate involving tax effect of Rs.17.72 lakh (including additional tax of Rs.1.90 lakh).

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* CIT V Tata Locomotive & Engineering Co. Ltd : 68 ITR 325 (Bombay)
** CIT V Deejay Hatcheries : 211 ITR 652 (Bombay)
*** CIT V N.C. Budharaja & Co. : 204 ITR 412 (SC)

Deduction granted in excess of gross total income

3.3.15 As per provisions of Chapter VIA of the Act, the deductions are allowed from the gross total income of an assessee to arrive at the net income chargeable to tax. The overriding condition is that the total deductions should not exceed the gross total income which has been defined as the total income computed in accordance with the provisions of the Act before making any deduction under Chapter VIA but after setting off of unabsorbed losses, depreciation investment allowance etc. of earlier years. Where the set off of unabsorbed losses, depreciation, investment allowance of earlier years results in reducing the total income to 'nil' or to a loss, no deduction under Chapter VIA is admissible. Audit scrutiny revealed that in 20 cases in Assam, Bihar, Gujarat, Rajasthan, Uttar Pradesh and West Bengal charges, non-observance of the above provisions resulted in short levy of tax of Rs.1630.96 lakh (including potential tax effect of Rs.1513.70 lakh).

Three cases are illustrated below:

(a) In West Bengal IV charge, the assessments of a widely held company for the assessment years 1991-92 and 1992-93 were completed in October 1994 and March 1995 and that of the assessment year 1993-94 in summary manner in July 1995 allowing deductions aggregating Rs.879.90 lakh each towards industrial undertaking established after 31 March 1981 and new industrial undertaking established in a backward area. Audit scrutiny revealed that after adjustment of the unabsorbed depreciation and investment allowance totalling to Rs.4885.68 lakh brought forward from the earlier assessment years, the gross total income of the assessee for the three years would be negative and thus no deductions under Chapter VIA were allowable. The irregular allowance of deductions resulted in excess carry forward of losses aggregating Rs.1759.80 lakh involving potential tax effect of Rs.910.22 lakh besides non-levy of additional income tax of Rs.74.78 lakh for the assessment year 1993-94.

(b) In West Bengal III charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 allowing an aggregate deduction of Rs.1192.75 lakh under various provisions of Chapter VIA (including deduction towards industrial undertaking established after 31 March 1981) interalia, setting off the unabsorbed depreciation of Rs.33.53 lakh brought forward from earlier years. Audit scrutiny revealed that while revising the assessment for the assessment year 1992-93 in June 1996, the unabsorbed depreciation of Rs.1275.84 lakh relating to earlier years was allowed to be carried forward. However, the assessment for the assessment year 1993-94 was not rectified

to set off the depreciation allowed to be carried forward. Had this been done, the deductions under Chapter VIA would be Rs.153.34 lakh and not Rs.1192.75 lakh allowed. The mistake resulted in excess allowance of deduction of Rs.1039.41 lakh with resultant excess carry forward of loss of Rs.836.52 lakh involving potential short levy of tax of Rs.432.90 lakh.

(c) In Meerut, Uttar Pradesh charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed in a summary manner in February 1993 and March 1995 allowing an aggregate deduction of Rs.118.77 lakh. Audit scrutiny revealed that the assessee had returned losses for both the assessment years and hence was not eligible for the deduction under the provisions of the Act. The incorrect allowance of deduction resulted in excess carry forward of losses aggregating Rs.118.77 lakh involving a potential short levy of tax of Rs.61.48 lakhs. Further, additional income tax of Rs.12.30 lakh leviable was not levied.

Irregular computation of deduction

3.3.16 Under the Act, the losses, unabsorbed depreciation and investment allowance of earlier years in respect of the industrial undertaking will have to be taken into account for the purpose of determining the profits of the unit for the relevant year eventhough the same might have been set off in earlier years against other incomes of the assessee. Audit scrutiny revealed that in 62 cases in Andhra Pradesh, Gujarat, Karnataka, Kerala, Madhya Pradesh, Uttar Pradesh, Tamil Nadu, Delhi, West Bengal and Maharashtra charges, non-observance of the above provisions resulted in short levy of tax of Rs.606.51 lakh (including potential tax effect of Rs.24.88 lakh).

A few cases are given below:

(a) In City II, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny allowing a deduction of Rs.791.09 lakh. Audit scrutiny revealed that unabsorbed investment allowance of Rs.361.23 lakh relating to earlier years had not been adjusted against the profits. Had this adjustment been done, the admissible deduction would work out to Rs.591.86 lakh as against Rs.791.09 lakh allowed by the department. The omission resulted in underassessment of income by Rs.199.23 lakh involving short levy of tax of Rs.103.05 lakh.

(b) In Jabalpur, Madhya Pradesh charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in April 1995 allowing a deduction of Rs.121.40 lakh. Audit scrutiny revealed that unabsorbed losses and depreciation amounting to Rs.389.87 lakh were not

reduced while computing the profits of the eligible unit. This mistake resulted in excess allowance of deduction of Rs.97.47 lakh leading to underassessment of income by like amount with consequent short levy of tax of Rs.75.66 lakh.

(c) In Coimbatore, Tamil Nadu charge, the assessments of a company for the assessment years 1994-95 and 1995-96 were completed after scrutiny in March 1996 allowing an aggregate deduction of Rs.122.07 lakh in respect of profits derived from one unit. Audit scrutiny revealed that while computing the deduction, the losses incurred by the unit in earlier years amounting to Rs.312.44 lakh were not adjusted. Had these losses been adjusted, the allowable deduction would work out to Rs.28.34 lakh as against Rs.122.07 lakh allowed by the department. The mistake resulted in underassessment of income by Rs.93.73 lakh with consequent short levy of tax of Rs.64.57 lakh.

(d) In West Bengal III charge, the assessment of a widely held company for the assessment year 1990-91 originally completed after scrutiny in March 1993 was rectified in March 1997, interalia, allowing a deduction of Rs.369.32 lakh in respect of one of its units. Audit scrutiny revealed that while a deduction of investment deposit account was made in computing the profits and gains of the business as a whole, no such deduction was effected from the profits and gains of the new unit for the purpose of computing the deduction. This omission led to excess allowance of deduction of Rs.73.86 lakh in respect of the unit resulting in short levy of tax of Rs.39.89 lakh.

Irregular allowance of deduction on `other incomes'

3.3.17 It has been judicially held* that the use of the term `derived from' in the relevant provisions of the Act indicates the restricted meaning given by the legislature to cover only the profits and gains directly accruing from conduct of the business undertaking. Thus, the deduction is not allowable on incomes having no nexus with the conduct of business of the assessee. Audit scrutiny revealed that in Andhra Pradesh, Assam, Bihar, Gujarat, Chandigarh, Haryana, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh, Delhi, West Bengal and Maharashtra charges, in contravention to the above, irregular deductions were allowed on other incomes such as trading receipts, job works, sale of REP license, interest on fixed deposits, dividend incomes etc., in 153 cases, resulting in an aggregate short levy of tax of Rs.4335.89 lakh (including potential tax effect of Rs.1.23 lakh).

* Cambay Electric Supply Industrial Co.Ltd.Vs. CIT Gujarat II;113 ITR 84(SC).

Few cases are given below:

(a) In Delhi VII charge, the assessments of a cooperative Society for the assessment years 1992-93 and 1993-94 were completed after scrutiny in March 1995 (revised in November 1995) and December 1995 (revised in March 1996) respectively allowing an aggregate deduction of Rs.4897.52 lakh. Audit scrutiny revealed that the income on which the deduction was allowed comprised of subsidy received, dividend income and other income not derived from the conduct of business undertaking. Hence, these receipts were required to be deducted while computing the deduction. Omission to do so resulted in underassessment of income of Rs.4897.52 lakh involving short levy of tax of Rs.2975.72 lakh (including interest).

(b) In Delhi IX Charge, the assessments of a co-operative society for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and February 1997 respectively after allowing deductions aggregating Rs.9810.43 lakh. Audit scrutiny revealed that the income on which the deduction was allowed included interest income received by the assessee on its deposits made with co-operative banks which was not eligible for the deduction. Omission to deduct the above interest income in computing the deduction resulted in underassessment of income of Rs.581.93 lakh with resultant short levy of tax of Rs.203.60 lakh.

(c) In Kanpur (Central), Uttar Pradesh charge, the assessments of a company for the assessment years 1990-91 and 1991-92 originally completed respectively in March 1993 and March 1994 were rectified in November 1994 allowing a deduction of Rs.247.19 lakh. Audit scrutiny revealed that current depreciation, investment deposit account and non-business receipts aggregating Rs.270.60 lakh were not deducted from the profits while determining the quantum of deduction. Had this amount been considered, the admissible deduction would work out to Rs.179.54 lakh as against Rs.247.19 lakh allowed by the department. The omission, thus, resulted in underassessment of income of Rs.67.65 lakh with consequent short levy of tax of Rs.136.11 lakh (including interest).

(d) In Bhopal, Madhya Pradesh charge, the assessment of a company for the assessment years 1991-92 and 1992-93 were completed after scrutiny in March 1994 and March 1995 respectively allowing a deduction of Rs. 30.87 lakh. Audit scrutiny revealed that the deductions were irregularly allowed on incomes towards computer job services, CCS export, premium on import license and profit on sale of investments which did not qualify

for the deduction. The mistake resulted in underassessment of income of Rs.30.87 lakh with consequent short levy of tax of Rs.26.91 lakh.

Irregular grant of deduction to undertakings etc., formed from reconstruction/ splitting up

3.3.18 As per provisions of the Act, the deduction is allowed to an industrial undertaking subject to the conditions that the new undertaking is not formed by splitting up or reconstruction of a business already in existence or is not formed by transfer to the new undertaking of machinery or plant used for any purpose. Audit scrutiny revealed that in Bihar, Gujarat, Chandigarh, Karnataka, Madhya Pradesh, Punjab, Rajasthan, Tamil Nadu, Delhi, West Bengal and Maharashtra charges, in 26 cases, irregular deductions were allowed due to non-observance of above provisions of the Act, which resulted in an aggregate short levy of tax of Rs.1111.45 lakh. Few cases are given below:

(a) In West Bengal IV charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 and those for the assessment years 1994-95 and 1995-96 were completed in summary manner in July 1995 and October 1996 respectively allowing an aggregate deduction of Rs.390.01 lakh, the deduction having been allowed for the first time for the assessment year 1993-94. Audit scrutiny revealed that the undertaking started its business in the previous year relevant to the assessment year 1989-90 by taking over the assets of another company. As the value of the transferred plant and machinery was more than 20 percent of the total value of the plant and machinery, the assessee was not eligible for this deduction. The irregular allowance of deduction thus, resulted in underassessment of income aggregating Rs.390.01 lakh with consequent short levy of tax of Rs.249.71 lakh (including interest).

(b) In City III, Mumbai charge, the assessments of a company for the assessment years 1991-92 to 1995-96 were completed after scrutiny/ in summary manner allowing deductions aggregating Rs.263.78 lakh. Audit scrutiny revealed that the undertaking was formed by purchasing a running concern from a proprietary firm and continued to manufacture the same products as of the erstwhile proprietary firm. As the new industrial undertaking was in effect formed by reconstruction of the existing business of the proprietary firm, it was not eligible for the deductions. The irregular deduction resulted in underassessment of income of Rs.263.78 lakh with consequent short levy of tax of Rs.213.94 lakh (including interest).

(c) In Jabalpur, Madhya Pradesh charge, the assessments of a company for the assessment years 1991-92 to 1993-94 were completed after allowing deduction totalling to Rs.242.63 lakh in respect of two of its units. Audit

scrutiny revealed that the assessee established the undertaking in January 1979 by taking over the existing business of an Indian branch of a foreign company and expanded the same during 1979 to 1993. During the previous year relevant to the assessment year 1990-91, the assessee started its services at two new sites (in Visakhapatnam and Durgapur) by deploying its mobile machinery from the existing work sites. As the establishment of the new sites by deployment of mobile machinery from the existing site was only splitting up of the existing business, the new units being the part of the existing business, the deduction allowed was irregular. The irregular deduction resulted in underassessment of income of Rs.242.63 lakh with consequent short levy of tax of Rs.213.05 lakh (including interest).

(d) In Karnataka I charge, the assessments of a company for the assessment years 1990-91 to 1992-93 were completed after scrutiny between March 1992 and March 1994 and those for the assessment years 1993-94 to 1995-96 in a summary manner between September 1994 and November 1995 allowing deduction aggregating Rs.177.65 lakh from the profit and gains of its new unit. Audit scrutiny revealed that the above unit was formed in the assessment year 1990-91 at the old site with addition of new machinery worth Rs.42.99 lakh to the existing machinery valued at Rs.5.25 lakh and continued to manufacture the same product. As no new undertaking had been formed the new unit being only an expansion of the existing business, the deduction granted was not in order. The mistake resulted in underassessment of income by Rs.177.65 lakh involving a tax effect of Rs.113.85 lakh (including interest).

Lacunae in the Act

3.3.19.1 Under the provisions of the Act, various deductions from the profits and gains derived by industrial undertakings are allowed subject to fulfilling certain requirements specified under the relevant sections. The total deductions under Chapter VI A of the Act are however restricted to the gross total income in respect of the industrial undertaking as a whole. However, such a restriction is not laid down in respect of income of each unit/division of the undertaking. Due to this lacunae in the Act, the industrial undertaking becomes eligible for more than 100 percent of deduction on eligible income. Three instances noticed in audit in Tamil Nadu, Delhi and West Bengal charges involving revenue loss of Rs.335.93 lakh on this account are illustrated below:

(a) In West Bengal III charge, the assessment of a company engaged in hotel business for the assessment year 1994-95 was completed after scrutiny in December 1996. Audit scrutiny revealed that the assessee was inter alia allowed a deduction of Rs.1455.99 lakh being 100 percent

deduction in respect of earnings in foreign exchange from the business income of Rs.3318.56 lakh of a hotel set up in Mumbai. The assessee was also granted a deduction of Rs.829.64 lakh towards priority industry on the same business income of Rs.3318.56 lakh. As the amount of Rs.1455.99 lakh on which 100 percent deduction was allowed was included in the total business income of Rs.3318.56 lakh, a further deduction of 25 percent towards priority industry resulted in undue benefit to the assessee by way of additional deduction of Rs.364 lakh (25 percent of Rs.1455.99 lakh). While the law is silent on this issue, the additional deduction resulted in an undue benefit of tax of Rs.312.69 lakh (including interest) to the assessee.

(b) In Tamil Nadu I charge, the assessments of a company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and in a summary manner in November 1995 in which deductions of Rs.35.67 lakh (97.85 percent of the profits) and Rs.58.14 lakh (95.75 percent of the profits) respectively were granted towards export profits under section 80 HHC. Audit scrutiny revealed that the assessee was also granted deductions (at the rate of 25 percent) of Rs.12.27 lakh and Rs.15.17 lakh during the two assessment years towards eligible industry. As the profits of the business on which deductions under section 80 HHC were already included in the business income, a further deduction of 25 percent towards eligible industry resulted in total deductions having exceeded the total profits by 22.85 percent and 20.75 percent for the two assessment years. Due to absence of an enabling provision, the assessee could derive an undue benefit and the exchequer was deprived of tax of Rs.23.24 lakh.

(c) In Delhi charge, the assessment of a cooperative-society for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1996 and February 1997 respectively. Audit scrutiny revealed that the assessee was allowed 100 percent deduction of Rs.2909.65 lakh under section 80P(2) being interest income derived from deposits. Due to lack of enabling provisions in the Act, a further deduction of 20 percent of the above amount was granted under section 80 I resulting in an undue benefit to the assessee.

Non maintenance of separate accounts

3.3.19.2 For determining the quantum of deduction, the profits and gains of the industrial undertaking shall be computed as if such profits and gains were the only source of income of the assessee during the previous year relevant to the assessment year and every subsequent assessment year upto and including the assessment year to which the determination was to be made. Audit scrutiny revealed that separate accounts had not been maintained by some assessees in respect of the eligible units. In the absence

of separate accounts, it was not possible to determine the quantum of profits and gains of the eligible units which qualify for the deduction. In test check in Karnataka, Kerala, Tamil Nadu and Maharashtra charges, in 23 cases, due to non-maintenance of separate accounts, the correctness or otherwise of the aggregate deductions of Rs.3631.95 lakh could not be ascertained. Of the above, in 18 cases, the short levy of tax had amounted to Rs.428.22 lakh.

Two cases are given below:

(a) In City I, Mumbai charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny allowing an aggregate deduction of Rs.213.87 lakh. In the absence of separate account in respect of the eligible unit, the assessing officer allowed the deduction after allocating the expenses deductible from the sales turnover in respect of the eligible unit to that of the total turnover of the company at 68 percent and 77.05 percent for the two years respectively. Audit scrutiny revealed that the eligible unit had, however, returned losses and hence the deduction was not admissible. The irregular deduction resulted in short levy of tax of Rs.110.68 lakh.

(b) In Coimbatore, Tamil Nadu charge, the assessments of a company for the assessment years 1991-92 to 1995-96 in respect of one unit and for the assessment years 1994-95 and 1995-96 in respect of another unit were completed after allowing deductions totalling to Rs.173.96 lakh. As no separate accounts were furnished alongwith the returns, the deductions allowed were not quantifiable and hence were irregular. This resulted in a total short levy of tax of Rs.89.13 lakh.

Absence of information in Returns regarding fulfillment/non-fulfillment of prescribed conditions

3.3.19.3 As per the provisions of the Act, among other things, an industrial undertaking becomes eligible for the deduction for a specified number of years from the date of commencement of manufacturing activity, and if the undertaking employed 10 or more workers in the manufacturing activity conducted with the aid of power or 20 or more workers in the activity conducted without the aid of power. Audit scrutiny in most of the cases test checked revealed that the serial number of the year to which the assessment pertained or the number of workers employed in the undertaking had not been mentioned by the assessee in the returns submitted by them. The department had also not maintained any records to ascertain such information. Thus, it was not possible to confirm whether the above eligibility conditions have been fulfilled or not in respect of the undertakings to which the concession had been granted. For proper

monitoring of the scheme, the provisions should provide that return contain such information.

Other topics of interest

3.3.20 During test check in review in Gujarat, Karnataka, Kerala, Rajasthan, Uttar Pradesh, Tamil Nadu, Delhi, West Bengal and Maharashtra charges, it was noticed that other irregularities committed in allowance of the deductions resulted in short levy of tax of Rs.276.82 lakh in 46 cases.

Few cases are given below:

(a) Under the provisions of sub-section 5 of section 80HHE of the Income tax Act, 1961, when any deduction under the section is claimed and allowed in respect of business of export out of India of computer software or its transmission from India to a place outside India by any means, and providing technical services outside India in connection with the development or production of computer software, no deduction shall be allowed in relation to such profits under any other provisions of the Income Tax Act.

In Pune, Maharashtra charge, the assessment of a company (engaged in the manufacture of computers, completed process and management systems and component elements) for the assessment year 1993-94 was completed after scrutiny and for the assessment years for 1994-95 and 1995-96 in a summary manner. Audit scrutiny revealed that deductions aggregating Rs.265.79 lakh were granted under section 80 I to the assessee based on profits on which deduction under section 80 HHE had already been allowed. The irregular allowance of deduction resulted in underassessment of income by Rs.213.30 lakh with consequent short levy of tax of Rs.105.79 lakh.

(b) Under the provisions of the Act, where due to close connection of business between the assessee and any other person, if for any other reason, the business transacted produces more than ordinary profit which might be expected to arise in the business of the industrial undertaking, the assessing officer may determine the profit as may be reasonably deemed to be derived.

In West Bengal I charge, the assessment of a company which had units manufacturing switchgears, furnaces, motors etc. for the assessment year 1992-93 was completed after scrutiny in March 1995 allowing a deduction of Rs.88.26 lakh from profits of Rs.353.04 lakh derived from sales of switchgears by one of its new units. Audit scrutiny of records revealed that as per report of the Board of Directors the profit of switchgear unit was adversely effected while in other divisions there was a steady growth in sales and profits. It was further revealed that the percentage of income derived

by the undertaking from the sales of its products was 2.27 whereas in respect of the eligible units (i.e. switchgear unit), it was as high as 28.64 under the reported adverse circumstances. Even after applying the same rate of percentage of profit to the total sales of switchgears of Rs.3903.30 lakh, the profit from switchgear would alone work out to Rs.1117.91 lakh as against the total income of Rs.503.74 lakh derived by the assessee. Thus, it appeared that the profit of the eligible unit was inflated to get higher deduction. However, the assessing officer did not examine this aspect. Further, it was revealed that based on proportionate allocation of general expenses (on the basis of sales), the miscellaneous expenses in respect of the eligible unit would be Rs.366.82 lakh as against Rs.208.67 lakh exhibited by the unit. Thus, due to booking a lower amount of expenses the profit was inflated by Rs.158.15 lakh. The mistake resulted in excess deduction of Rs.39.54 lakh involving short levy of tax of Rs.20.46 lakh.

(c) In West Bengal III charge, the assessment of a company engaged in hotel business for the assessment year 1994-95 was completed after scrutiny in December 1996 allowing a deduction of Rs.829.64 lakh on profits of its new hotel at Mumbai. Taxable income of the new hotel was computed after adding back book depreciation of Rs.177.10 lakh and after deduction of Rs.175.99 lakh from the book profits. Audit scrutiny revealed that as on 31 March 1994, the net block of assets of the new hotel represented about 20 percent of the net block of assets of the whole business and the book depreciation of the new hotel was 1.77 percent of the net block of assets thereof as against 1.80 percent of the net block of assets in respect of the whole business. However, in the case of income tax depreciation, the same represented only 1.75 percent of the net block of assets in the case of new hotel whereas it was 3.25 percent of net block of assets in the case of whole business. Further, the income tax depreciation represented only 99.37 percent of the book depreciation for the new hotel whereas the percentage was as high on 180 percent in respect of the whole business. Thus, it was evident that lesser amount of depreciation was debited to the new hotel to avail higher deduction. Had depreciation been correctly charged for the new hotel at the overall percentage of 3.25 of the net block of assets of the new hotel, the same would work out to Rs.326.11 lakh as against Rs.175.99 lakh provided. Lesser amount of depreciation of Rs.150.12 lakh resulted in excess allowance of deduction of Rs.37.53 lakh involving short levy of tax of Rs.19.42 lakh.

The review was referred to the Ministry in November 1997. The Ministry's reply has not been received (December 1997).

Chapter 4

Corporation Tax

Number of companies

4.1 According to the Ministry of Finance (Department of Company Affairs), the number of companies under various categories and the paid-up capital in the case of limited companies, as on 31 March 1997 are given below:

Sl. No.	Category	No. of Companies	Paid-up capital (Rs. in crore)
1.	Foreign companies as defined under Section 591 of the Companies Act, 1956	772	not available
2.	Associations `not for profit' but registered as companies	2578	not available
3.	Unlimited companies	419	not available
4.	Limited companies:		
a.	Government companies	1220	79,735.31
b.	Non-Government companies-		
	Private limited companies	3,86,230	25,156.60
	Public limited companies	63,500	79,650.89
	Total :	4,54,719	1,84,542.80

Number of assessees

4.2 The number of company assessees on the records of the Income Tax Department during the last five years was as follows:

As on 31 March	Number
1993	1,55,418
1994	1,71,419
1995	1,76,594
1996	1,87,574
1997	2,27,228

Trend of receipts

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

Year	Receipts from Corporation tax	Gross collection of all direct taxes	Percentage of Corporation tax to gross collection
	(Rs. in crore)		
1992-93	8,889.24	18,097.29	49.12
1993-94	10,060.06	20,298.24	49.56
1994-95	13,820.96	26,970.88	51.24
1995-96	16,487.13	33,559.28	49.13
1996-97	18,566.69	38,895.08	47.73

Status of assessments

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

Year	Number of assessments				Total Demand		
	For disposal	Completed during the year	Pending at the close of the year	Percentage of pendency to total cases for disposal	Demand for collection	Collection during the year	Percentage of collection to total demand
1992-93	2,26,665	1,51,913	74,752	32.98	13088.96	8889.24	67.91
1993-94	2,55,344	1,81,130	74,214	29.06	16686.69	10060.06	60.29
1994-95	2,58,059	1,86,938	71,121	27.56	23711.08	13820.96	58.29
1995-96	2,85,161	1,99,086	86,075	30.18	28920.66	16487.13	57.01
1996-97	3,25,551	2,35,385	90,166	27.70	33999.33	18566.69	54.61

Results of Audit

4.5 A total number of 428 draft paragraphs involving undercharge of tax of Rs. 666.69 crore and 17 draft paragraphs involving overcharge of tax of Rs. 4.02 crore have been issued to the Ministry of Finance during March 1997 to October 1997 for their comments. The Ministry have accepted 186 cases involving tax effect of Rs. 136.51 crore and 12 cases of over charge of tax involving Rs.2.05 crore.

Of the total 445 cases issued to the Ministry, 181 number of illustrative cases with aggregate undercharge of tax of Rs.619.07 crore relating to various categories and 17 cases of overcharge of tax involving Rs.4.02 crore are indicated in the succeeding paragraphs. Out of these, the Ministry have accepted the observations in 84 cases involving tax effect of Rs. 125.76 crore. Replies are awaited in respect of 79 cases. Of the cases included, 31 cases involving tax effect of Rs.41.66 crore have been checked by the Internal Audit Wing of the department but the mistakes remained undetected by it. The repetitive nature of the mistakes noticed during test check by Audit indicates the inadequate attention given by the assessing officers in the assessments of even those involving substantial revenue.

Avoidable mistakes in computation of income and tax

4.6 Under the Income Tax Act, 1961, an assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer shall make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or

refundable to him on the basis of such assessment. In all these assessments, the tax or refund shall be determined after taking into account the prepaid taxes and refunds made. Underassessment of tax of substantial amounts and overcharge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and issue of instructions by the Government from time to time, such mistakes continue to occur suggesting the need for close supervision and control. The various types of mistakes noticed included, inter alia, incorrect adoption of figures, arithmetical errors, double allowance, non-levy of surcharge etc. The extent of such mistakes noticed during test check of the assessments completed by the assessing officers during last five years was as under:

Year	No. of items	Amount of tax underassessed (Rs. in crore)
1992-93	907	14.70
1993-94	1,104	21.01
1994-95	1,503	35.04
1995-96	1,643	105.81
1996-97	1,450	418.34

1.Overassessment of income and tax

Mistakes by the assessing officers resulted in overcharge of income and tax from some assessees. Of the many cases noticed during test check in audit, a few major cases are mentioned below:-

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	City XI, Mumbai	1993-94 March 1996	143(3)	Due to totalling mistake and application of incorrect rate of tax, Rs.385.75 lakh was charged as tax instead of the correct amount of Rs.296.73 lakh	89.02
2.	Central I, Mumbai	1982-83 March 1995	143(3) read with 147	While reassessing short term capital gains of Rs.59.96 lakh, the same was added to the income of Rs.276.81 lakh as per order giving effect to appellate order of February 1987 instead of the income of Rs.186.59 lakh arrived at while giving effect to the Tribunal's final order dated September 1989 resulting in overassessment of income of Rs.90.22 lakh.	50.86

3.	WB I, Calcutta	1991-92	143(3)	Business loss of Rs.18.30 lakh was erroneously added instead of deducting the same from the total income. Further, the total income was computed in excess by Rs.10,000 due to arithmetical error. These mistakes resulted in overassessment of income by Rs.36.70 lakh.	37.22
4.	Bhubaneswar, Orissa	1991-92 1992-93 November 1993	143(3)	Tax was incorrectly levied at a higher rate of 50 percent as against correct rates of 40 percent and 45 percent in respect of the two assessment years 1991-92 and 1992-93 respectively.	27.31
5.	WB III, Calcutta	1993-94 March 1996	143(3)	As against the correct rate of 45 percent applicable to a domestic company in which public are substantially interested, tax was levied at a higher rate of 50 percent.	22.76
6.	City II, Mumbai	1991-92 February 1994	143(3)	Rs.23.31 lakh being profit on sale of depreciable assets was inadvertently reduced from the depreciation claimed by the assessee instead of from the profits where the amount was credited. This resulted in overassessment of income by Rs.46.62 lakh.	21.44 (P)
7.	City II, Mumbai	1993-94 March 1996	143(3)	As against the correct amount of interest chargeable of Rs.75.04 lakh towards short payment of advance tax Rs.96.35 lakh were actually charged.	21.31
8.	WB V, Calcutta	1993-94 March 1996	143(3)	Eventhough the advance tax paid by the assessee was more than 90 percent of assessed tax, yet interest of Rs.21 lakh was levied towards short payment of advance tax.	21.00
9.	Jodhpur, Rajasthan	1993-94 March 1995	144	In the assessment, the income was computed at a loss of Rs.4.94 lakh instead of the correct amount of loss of Rs.44.34 lakh which resulted in under computation of loss of Rs.39.40 lakh.	20.39
10.	WB I, Calcutta	1993-94 March 1996	143(3)	As against the correct amount of interest aggregating Rs.86.76 lakh leviable for short payment of advance tax and deferment of advance tax, interest of Rs.104.17 lakh was levied.	17.41
11.	Gujarat I, Ahmedabad	1993-94 March 1996	143(3)	While calculating interest leviable for short payment of advance tax, amount of Rs.21.94 lakh paid by the assessee towards advance tax was omitted to have been taken.	15.79

12.	City I, Mumbai	1995-96 March 1996	143(1)	Instead of the correct rate of 30 percent, tax was levied at a higher rate of 40 percent on the long term capital gains returned by the assessee.	13.29
13.	AP I, Hyderabad	1993-94 March 1996	143(3)	While computing the tax payable, interest of Rs. 68.07 lakh was levied for default in payment of advance tax as against the correct amount of Rs.55.43 lakh.	12.64
14.	City XI, Mumbai	1993-94 March 1996	143(3)	The business income was computed erroneously at Rs.12.27 lakh as against the correct amount of Rs.2.27 lakh which resulted in overassessment of income of Rs.10 lakh.	9.89
15.	WB I, Calcutta	1993-94 March 1996	143(3)	As against the correct amount of admissible refund of Rs.34.76 lakh, a refund of Rs.25.24 lakh only was determined resulting in short refund of Rs.9.52 lakh.	9.52
16.	AP I, Hyderabad	1993-94 March 1996	143(3)	Interest for default in payment of advance tax was levied erroneously at Rs.64.43 lakh as against Rs.58.06 lakh correctly leviable.	6.37
17.	TN I, Chennai	1993-94 March 1996	143(3)	As against the correct demand of Rs.11.74 lakh including interest and additional tax, demand of Rs.17.91 lakh was raised resulting in excess demand of tax.	6.17

The Ministry have accepted the audit observations at Sl. Nos. 3,5 to 8,10 to 13,15 to 17. Their response to the remaining cases has not been received.

(2) Underassessment of income and tax

(i) Incorrect adoption of figures

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	Patna, Bihar	1993-94 September 1995	143(3)	Eventhough the assessee returned a loss of Rs.8339 lakh, the assessment was completed at a loss of Rs.20377 lakh resulting in excess computation of loss by Rs.12038 lakh.	6229.00 (P)

2.	Pune, Maharashtra	1994-95 November 1995 (revised in February 1996)	143(1)	While revising the assessment in February 1996 for deletion of additional tax levied earlier, loss of Rs.2712.61 lakh as returned by the assessee was adopted instead of the assessed amount of loss of Rs.1431.66 lakh on the basis of which the additional tax was originally levied. This resulted in excess computation of loss by Rs.1280.95 lakh.	662.89 (P)
3.	WB I, Calcutta	1993-94 February 1996	143(3)	Though it was decided to add back Rs.3025.30 lakh towards accrued amount on account of increased rate of tariff realisable from two State Electricity Boards, only Rs.2357.14 lakh were added back while computing the income. This mistake resulted in excess computation of loss by Rs. 668.16 lakh.	345.77 (P)
4.	Surat, Gujarat	1988-89 March 1992 (revised in March 1995)	143(3)	Eventhough it was discussed in the revision order regarding addition of 10 percent of turnover as against 20 percent added in the original assessment, the addition was not considered while computing the income. The omission resulted in underassessment of income of Rs.89.55 lakh (after adjusting income already charged).	96.39
5.	Pune, Maharashtra	1995-96 February 1996	143(1)	While computing the taxable income, depreciation of Rs.16.22 lakh was added by the assessee instead of the correct amount of Rs.162.18 lakh debited to the profit and loss account. Though the mistake was prima facie apparent from the records, the same was not rectified while processing the return. The omission led to underassessment of income by Rs.145.96 lakh.	67.14 (P) 13.43 (AT) 1.11 (interest)

6.	TN I, Chennai	1989-90 February 1990 revised finally in March 1996	143(3)	Additional tax was not levied during final revision made in March 1996 on the ground that tax was levied on Rs.587.43 lakh during the revision made in September 1992. However, the above assessment was further revised in June 1994 reducing the income to Rs.482.85 lakh and a refund was allowed to the assessee. This fact was not considered and the omission resulted in short levy of tax of Rs.67.37 lakh.	67.37
7.	TN I, Chennai	1993-94 January 1996	143(3)	Rs.120.22 lakh was erroneously adjusted towards dividend income overlooking the fact that the assessee had returned his income after adjusting the same. This mistake resulted in excess carry forward of loss by Rs.120.22 lakh.	62.21 (P)
8.	Delhi I	1989-90 March 1996	143(3)	The business income of Rs.147.56 lakh was erroneously adopted as Rs.47.56 lakh which led to underassessment of income by Rs.100 lakh.	57.75
9.	Patiala, Punjab	1989-90 July 1990	143(1)	Depreciation of Rs.6106.23 lakh was incorrectly added back instead of the correct amount of Rs.6193.80 lakh which resulted in excess determination of loss by Rs.87.57 lakh.	49.97 (P) 9.99 (AT)
10.	WB IV, Calcutta	1993-94 March 1996	143(3)	Instead of adding Rs.26.16 lakh being aggregate of disallowed items of expenditure, the same was deducted from the net profits which resulted in underassessment of income of Rs.52.32 lakh.	46.58
11.	Delhi I	1993-94 March 1996	143(3)	While computing the taxable income, the dividend income of Rs.43.85 lakh was omitted to be taken into account which led to underassessment of income by a like amount.	43.37
12.	Delhi II	1993-94 March 1996	143(3)	Eventhough the assessment was completed at an income of Rs.42.21 lakh, no tax and interest	41.70

				thereon were levied by the assessing officer.	
13.	WB II, Calcutta	1993-94 March 1996	143(3)	Rs.79.05 lakh towards intercorporate dividend was deducted from the gross total income for separate consideration but the same was omitted to have been included in the computation of total income which resulted in underassessment of income by a like amount.	40.91
14.	City I, Mumbai	1992-93 October 1994	143(3)	Eventhough the provision for doubtful debts created in the account was added by the assessee, the same was omitted to be included while computing the taxable income.	20.28
15.	Cochin, Kerala	1993-94 March 1996	143(3)	While computing deduction towards export profits, the total turnover and adjusted total turnover were erroneously adopted as Rs.1282 lakh and Rs.985 lakh respectively as against the correct figures of Rs.4245 lakh and Rs.3947 lakh. This resulted in excess allowance of deduction of Rs.20.78 lakh.	18.93
16.	NE Region, Shillong	1995-96, March 1996	143(1)	As against the correct amount of Rs.27.79 lakh to be added back, Rs.2,779 only was added back which led to underassessment of income of Rs.27.76 lakh.	18.39
17.	City III, Mumbai	1992-93 September 1995	143(3)	Rs.16.42 lakh towards entertainment expenditure was disallowed but a further amount of Rs.26.44 lakh on the same account remained to be disallowed which resulted in underassessment of income by Rs.26.44 lakh.	17.19
18.	WB IV, Calcutta	1991-92 March 1994 (revised in December 1994 and August 1995)	143(3)	While revising the assessment, instead of deducting Rs.17.74 lakh on account of excess allowance of relief on export profits, the same was added to the aggregate deductions which led to underassessment of income by Rs.35.48 lakh.	16.32

The Ministry have accepted the audit observations at Sl. Nos. 2,3,5 to 8,10,12 to 15 and 17. Their response to the remaining cases has not been received.

(ii) Arithmetical errors

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB III, Calcutta	1993-94 March 1996	143(3)	Due to a totalling mistake, the aggregate amount of deduction was arrived at Rs.1671 lakh instead of the correct figure of Rs.1080 lakh leading to underassessment of income by Rs.591 lakh.	661.00
2.	Patiala, Punjab	1994-95 January 1995	143(1)	Refund of Rs.927.51 lakh was authorised due to arithmetical error instead of the correct amount of Rs.917.51 lakh which led to excess refund of Rs.10 lakh.	10.00

The Ministry have accepted both the audit observations.

Application of incorrect rate of tax

4.7 Under the Finance Act, a domestic company is chargeable to tax at specified rates depending on whether it is a company in which public are substantially interested and if not, whether it is an industrial company or trading and investment company or any other company. Further, under the provisions of the Income Tax Act, 1961, a company is deemed to be a company in which public are substantially interested if, inter alia, it fulfills the condition that the shares in the company were, as on the last day of the previous year, listed in a recognised stock exchange in India or the shares carrying not less than 50 percent of the voting power throughout the previous year were beneficially held by Government or a corporation established by a Central, State or Provincial Act or any company in which the public are substantially interested or a hundred percent subsidiary company of such company. The incidence of tax is lower in respect of a company in which the public are substantially interested. It has been judicially held* that private companies changing status under the Companies Act as deemed public companies should also satisfy the conditions under the Income Tax Act to be eligible for the lower rate of

* CIT Vs Lucas TVS; 14 ITR 700 (Madras)

tax. A few such cases, involving significant revenue, as noticed in test check in audit are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB IV, Calcutta	1993-94 March 1996	143(3)	Tax was levied at a lower rate of 45 percent instead of 50 percent prescribed for domestic companies in which public are not substantially interested. This together with arithmetical mistake resulted in an aggregate short levy of tax of Rs.57.25 lakh.	57.25
2.	City V, Mumbai	1993-94 October 1995	143(3)	Eventhough 60 percent shares of the assessee company were held by another company in which public were not substantially interested, tax was levied at lower rate treating the assessee as the one in which public were substantially interested.	56.65
3.	TN I, Chennai	1993-94 March 1996	143(3)	Though the assessee's status was determined as one in which public were not substantially interested, tax was levied at a lower rate of 45 percent instead of 50 percent applicable.	49.31
4.	Central I, Calcutta	1993-94 March 1996 (rectified in May 1996)	143(3)	Eventhough the assessee's income exceeded Rs.75000, surcharge at the rate of 15 percent on the tax was not levied under the provisions of Finance Act, 1993. This, together with short levy of interest resulted in short demand of tax and interest of Rs.46.50 lakh.	46.50
5.	City I, Mumbai	1991-92 February 1994 and 1992-93 December 1994	143(3) 143(3)	Even though more than 50 percent of the share capital of the assessee company was held by a closely held domestic company, tax was levied at lower rate applicable to one in which public were substantially interested.	43.60
6.	Lucknow, Uttar Pradesh	1993-94 January 1996	143(3)	Tax was levied at a lower rate of 40 percent instead of at the correct rate of 45 percent.	24.47

The Ministry have accepted the audit observations at Sl.Nos.1 to 5.

Their response to the remaining case has not been received.

Incorrect allowance of non-business expenditure

4.8.1 Under the Income Tax Act, 1961, any expenditure not being expenditure of capital nature or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of business, is allowable as deduction in computation of income chargeable to tax under the head "Profits and gains of business". It has been judicially held* that payment made to rival dealer to ward off competition would constitute capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time.

In Delhi II charge, the assessments of a company for the assessment years 1991-92 and 1992-93 were completed after scrutiny in November 1993 and October 1994 respectively. Audit scrutiny revealed that the assessee claimed and was allowed an aggregate expenditure of Rs.287.20 lakh as revenue expenditure towards payments made to a rival dealer to ward off competition during the relevant previous years. As the expenditure was of capital nature it should have been disallowed.

Omission to do so resulted in excess computation of loss of Rs.287.20 lakh involving potential tax effect of Rs.148.63 lakh.

The Ministry have accepted the audit observation.

4.8.2 It has been judicially held** that where an assessee purchases securities at a price determined with reference to their actual value as well as the interest accrued thereon till the date of purchase the entire price paid for them would be in the nature of capital outlay and no part of it can be set off as an expenditure against the income accruing on their securities.

In Tamil Nadu V, Chennai charge, the assessments of two banking companies for the assessment years 1991-92 to 1993-94 were completed after scrutiny/revised in March 1995, October 1995, December 1995 and March 1996. Audit scrutiny revealed that the assessees while offering the net interest received on securities, had debited in their accounts of the relevant previous years, sums of Rs.56.45 lakh, Rs.75.81 lakh, Rs.43.16 lakh and Rs.30.01 lakh respectively being interest paid on securities upto the date of purchase. Since the interest paid on securities upto the date of purchase is of capital nature, it was not an allowable deduction. The mistake resulted in underassessment of income aggregating Rs.197.32 lakh

* CIT V Coal Shipments P. Ltd. 82 ITR 902 (SC)
** Vijaya Bank Ltd. V CIT (Addl); 187 ITR 541 (SC)

(after allowing deduction of Rs.8.11 lakh in respect of provision for bad and doubtful debts) involving short levy of tax of Rs.148.97 lakh.

While the Ministry have accepted the audit observation on the same issue in one case, they have not accepted it in the other case stating that the Supreme court judgment quoted by audit related to assessment year 1968-69 where a separate head for computation of interest on securities existed. With the abolition of this head of income the income of a bank from interest on securities which are stock in trade is regarded as business income and correspondingly interest paid to a seller should be allowed as a revenue expenditure. The reply is not tenable as abolition of the head of income does not alter the principle enunciated in the Supreme court judgment. The judgment held that whatever be the consideration to purchase a security, the price paid was in the nature of a capital outlay and no part of it could be set off against interest income.

4.8.3 Under the Income Tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee on maintenance of any residential accommodation in the nature of guest house. The Act further provides that any accommodation by whatever name called, maintained, hired, reserved or otherwise arranged by the assessee for the purpose of providing lodging or boarding to any person on tour or visit to the place at which such accommodation is situated, is accommodation in the nature of guest house.

In Ranchi, Bihar charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in December 1995 and revised in January 1996. Audit scrutiny revealed that expenditure of Rs.162.25 lakh which was incurred by the assessee on maintenance of guest houses and transit camps was allowed by the assessing officer. The expenditure being in the nature of maintenance of guest house was not an admissible deduction. As the mistake was apparent from the records, it should have been disallowed as a prime facie adjustment. Omission to do so resulted in underassessment of income by Rs.162.25 lakh involving potential tax effect of Rs.74.64 lakh and non-levy of additional tax of Rs.14.93 lakh.

The Ministry have not accepted the audit observation stating that while processing a case in a summary manner only apparent mistakes are required to be rectified and prima facie not admissible is to be disallowed. They have further stated that the assessee company had given a detailed reason in the return of income as to why it had claimed deduction of

expenditure on guest house. The reply is not tenable in view of a clear provision in the Act which disallows expenditure on a guest house irrespective of its usage.

4.8.4 In City I, Mumbai charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that out of a sum of Rs.35090.84 lakh debited to the profit and loss account towards spares parts, consumable stores and tools, spares parts amounting to Rs.82.20 lakh were returned to the supplier but were not taken into account. The assessing officer also did not add back the aforesaid amount though it was pointed out by the statutory auditor. The omission resulted in underassessment of income by Rs.82.20 lakh involving tax effect of Rs.37.81 lakh.

The reply of the Ministry to the audit observation has not been received.

4.8.5 In Tamil Nadu I, Chennai charge, the assessments of a company for the assessment years 1991-92 and 1992-93 were completed in October 1993 and January 1995 after scrutiny allowing deductions of Rs.24.52 lakh and Rs.24.53 lakh respectively towards actual payment under voluntary retirement scheme. The assessee had adopted the accounting policy of capitalising the compensation amount paid every year and writing off one-seventh thereof in its accounts. Audit scrutiny revealed that besides the actual expenditure, the amount of Rs.24.52 lakh and Rs.24.53 lakh written off in the accounts by the assessee in these two years were also allowed as deductions. As the actual payment made under the scheme was already allowed as deduction, the share of expenditure capitalized and debited in the accounts should have been disallowed. Omission to do so resulted in aggregate underassessment of income by Rs.49.05 lakh involving tax effect of Rs.32.61 lakh.

The Ministry have accepted the audit observation.

Incorrect allowance of provision for bad and doubtful debts in respect of advances made by rural branches of bank

4.9.1 The Income Tax Act, 1961, as amended by the Finance Act, 1986, with effect from April 1987, provided that in respect of any provision for bad and doubtful debts made by a scheduled or non-scheduled bank, an amount not exceeding five percent of its total income (computed before making any deduction under this provision and Chapter VIA) and an amount not exceeding two percent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, shall be allowed as deduction while computing the business income of the assessee. Rural branch' for this purpose has been defined as a branch of a scheduled or a non-scheduled

bank situated in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

In Cochin, Kerala charge, the assessment of a banking company for the assessment year 1993-94 was completed after scrutiny in March 1996 allowing a deduction of Rs.353.75 lakh towards provision made in respect of bad and doubtful debts of rural branches of the bank. Audit scrutiny revealed that fourteen of the branches for which the deduction was allowed were situated in places with a population exceeding ten thousand according to the last census. As such, those branches did not qualify as rural branches and were not entitled to the deduction. The mistake in allowing deduction resulted in underassessment of income by Rs.31.15 lakh, with consequent short levy of tax of Rs.27.72 lakh (including interest).

The Ministry have not accepted the audit observation on the grounds that the Bank is governed by the guidelines issued by the Reserve Bank of India for terming rural and urban branches. The reply is not tenable as under the Income Tax Act deduction is not allowable for rural branches in a place which has a population exceeding ten thousand according to the last preceding census. Incidentally, the Ministry had accepted similar audit observation which appeared as para 4.11.2 of the Report of the C&AG of India for the year ended 31 March 1995.

4.9.2 Under the Income Tax Act, 1961, in the case of a bank, the amount of deduction relating to any bad debt or part thereof which is written off as irrecoverable in the accounts for the previous year, shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provisions for bad and doubtful debts made under the Act. Public Financial Institutions, State Financial Corporations and State Industrial Investment Corporations were also allowed deduction from April 1992 in respect of any provision made for bad and doubtful debt at an amount not exceeding five percent of the total income. However, the proviso of limitation when the bad debts are actually written off as irrecoverable in the accounts, were not made applicable to Financial Institutions and Corporations. This lacuna in the Act has enabled these assessees to avail deduction on account of bad and doubtful debts twice i.e. once while making provision for such debts and again when the bad and doubtful debts are actually written off as irrecoverable in the accounts of the assessee.

In Jaipur, Rajasthan charge, the assessment of a State Industrial Development and Investment Corporation for the assessment year 1993-94 was completed after scrutiny in January 1996. Audit scrutiny revealed that the assessing officer allowed a deduction of Rs.32.93 lakh on account of provision for bad and doubtful debts. The assessee was also allowed deduction of Rs.215.40 lakh on account of bad and doubtful debts written off as irrecoverable in its books of accounts. Had the above proviso of limitation been applicable to the assessee, the deduction would have been allowed at Rs.182.47 lakh (Rs.215.40 lakh-Rs.32.93 lakh) only. The lacuna in the law enabled the assessee to avail excess deduction resulting in underassessment of income by Rs.32.93 lakh involving tax effect of Rs.17.04 lakh.

The reply of the Ministry to the audit observation has not been received

Incorrect allowance of provisions

4.10 Under the Income Tax Act, 1961, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for deduction. It has been judicially held* that in order a loss be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur in future. A few cases noticed during test check are given below:

Sl. No	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB V, Calcutta	1993-94 March 1996 1994-95 November 1995	143(3) 143(1)	Provisions aggregating Rs.150 lakh were allowed on account of doubtful debts debited to the accounts.	77.63 (P) 10.35 (AT)
2.	WB III, Calcutta	1993-94 September 1994	143(1)	Provision of Rs.141.64 lakh towards doubtful debts was not disallowed eventhough it was apparent from the statements/ documents accompanying the return.	73.30 (P) 14.66 (AT)
3.	Karnataka I, Bangalore	1992-93 June 1993	143(1)	Even though the pension scheme was not approved by the Government, provisions of Rs.50.87 lakh each being employees' and employer's contribution towards pension scheme were allowed erroneously despite the fact that the same was	52.65 (P) 10.53 (AT)

* CIT Vs Indian Overseas Bank 151 ITR 446 (Madras)

				apparent from the records accompanying the return which resulted in underassessment of income of Rs.101.74 lakh.	
4.	WB VI, Calcutta	1992-93 February 1995	143(3)	Provisions for doubtful debts/ loans and advances, doubtful deposits and loss on reduction of finished goods aggregating Rs.100.39 lakh were allowed resulting in excess carry forward of losses.	51.95 (P)
5.	Delhi IV	1993-94 March 1996	143(3)	Rs.23.21 lakh being provision for warranty on the basis of technical evaluation was allowed as deduction leading to underassessment of income.	20.66
6.	TN I, Chennai	1990-91 February 1993	143(3)	Of the provision of Rs.21.75 lakh, Rs.4.16 lakh only was spent during the year and hence the unspent balance being liability not actually accrued should have been disallowed. Omission to do so resulted in underassessment of income by Rs.17.59 lakh.	17.41
7	Allahabad, Uttar Pradesh	1992-93, 1993-94, March 1995	143(3)	Provisions aggregating Rs.46.26 lakh towards trade commission payable on closing stock of tobacco and shown as outstanding liability in the balance sheets were incorrectly allowed as deduction which resulted in underassessment of income.	17.21
8	Central, Mumbai	1993-94 March 1996 1994-95 February 1995	143(3) 143(1)	Rs.24.08 lakh being a provision for doubtful debts/loans and advances, though apparent from the records accompanying the return, was erroneously allowed as deduction which resulted in underassessment of income.	16.56

The Ministry have accepted the audit observations at Sl.Nos.4,5 and 7. Their response to the remaining cases has not been received except at serial number 3 where the Ministry have not accepted the audit observation stating that this issue cannot be decided in a summary assessment where no details etc. can be called for. Further a similar disallowance was deleted by CIT(A) in a scrutiny assessment for the assessment year 1992-93. The reply is not tenable as the amount was for a mere provision and not ascertained liability. Incidentally, the Ministry

have accepted similar audit observation which appeared as paras 3.13.2(ii) and 4.11(ii) in the Reports of the C&AG of India on Union Government (Civil) Revenue Receipts Direct Taxes for the year 1992-93 and 1993-94 respectively. Further, the Ministry's reliance on the CIT(A)'s order is misplaced as the said order is based on the issue of allowance of deduction of bad debts in respect of which provision for bad debts has been made in earlier years, which is not relevant to this issue.

Incorrect allowance of liability

4.11.1 Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment on types of expenditure specified under section 43 (B) of the Act. From 1 April 1988, tax or duty actually paid by the assessee on or before due date applicable in his case for furnishing the return of income shall be allowed as deduction. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are also deductible on actual payment basis. No deduction in respect of contribution to the above funds is, however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds.

(i) In West Bengal I, Calcutta charge, the assessment of a non-resident company for the assessment year 1989-90 consisting of 21 months, originally completed in summary manner in April 1990 was revised in July 1990. Audit scrutiny revealed that the sums of Rs.110.67 lakh and Rs.91.88 lakh representing tax, contribution to provident fund, Employees' State Insurance etc. debited to the profit and loss account of the relevant previous year were allowed by the assessing officer. Since the amounts were not actually paid either in the relevant previous year or before the due date for filing the return, the same should have been added back as the mistake was apparent from the records and documents accompanying the return of income. Omission to do so resulted in excess carry forward of loss by Rs.202.55 lakh involving potential tax effect of Rs.132.66 lakh and additional tax of Rs.26.33 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) In Delhi II charge, the assessment of a company for the assessment years 1990-91 to 1992-93 were completed after scrutiny between July

1992 to September 1994 and for the year 1993-94 in a summary manner in November 1995. Audit scrutiny of various annexures accompanying the accounts revealed that provident fund contributions aggregating Rs.142.09 lakh debited to the profit and loss accounts pertaining to the previous years relevant to the above assessment years were not paid before the due dates. The amounts, being prima facie disallowable were, therefore, required to be disallowed. Omission to do so resulted in excess carry forward of losses by Rs.142.09 lakh involving potential tax effect of Rs.72.71 lakh.

The Ministry have accepted the audit observation.

4.11.2 Some more important cases of the above nature noticed during test check in audit are given below:-

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	WB III, Calcutta	1989-90 March 1992	143(3)	Sales tax of Rs.30.37 lakh collected but not paid to the Government account was not added back to income leading to underassessment of income.	13.51 9.68 (P)
2.	WB IV, Calcutta	1992-93 July 1993	143(1)	As per Tax Audit Report accompanying the return, out of the amount debited to profit and loss account, Rs.28.12 lakh were not paid towards municipal tax, entry tax, water tax and bonus, yet the same was allowed leading to underassessment of income.	17.46 (including additional tax)
3.	Orissa	1990-91 March 1993 1992-93 February 1995	143(3) 143(3)	Deductions of Rs.13.61 lakh and Rs.6.44 lakh were allowed eventhough the contributions on account of provident fund, Employees' state Insurance Scheme and Superannuation fund remained unpaid within the dates stipulated which resulted in underassessment of income aggregating Rs.20.05 lakh.	15.38

The Ministry have accepted all the three audit observations.

4.11.3 Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, a deduction otherwise allowable under the Act in respect of any sum payable by the assessee by way of tax or duty under any law for the time being in force, shall be allowed in computing the business income of that previous year in which such sum is actually paid irrespective of the method of accounting adopted by the assessee. Several State Governments have introduced `Sales tax deferment Scheme' under which eligible units are permitted to collect sales tax on sale of their products and retain the same for a prescribed period. The Central Board of Direct Taxes clarified in January 1987 that where the State Governments make an amendment in the Sales Tax Act to the effect that the sales tax deferred under the scheme shall be treated as actually paid, the statutory liability shall be treated as discharged. A further clarification has been made in December 1993, covering cases where instead of amendment in the Act, the State Governments have issued orders notifying schemes under which sales tax is deemed to have been collected and disbursed as loans and providing that entries shall be made in Government accounts giving effect to demand collections by crediting the appropriate receipt heads to sales-tax collections and debiting the heads relating to such loans. The Board stated in their circular that such schemes notified through Government orders also meet the requirements of earlier circular and the amount of sales tax liability converted into loans may be allowed as deduction in the assessment of the previous year in which such conversion has been permitted.

(i) In West Bengal VI, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed in March 1995 after scrutiny. Audit scrutiny revealed that sales tax amounting to Rs.223.57 lakh collected by the assessee company from its customers was shown as a liability in the balance sheet. Since the amount was not paid to the government account during the relevant previous year or before the due date of filing the return of income, it should have been treated as trading receipt and taxed. Omission to do so resulted in underassessment of income by Rs.223.57 lakh leading to excess carry forward of loss by an identical amount involving potential tax effect of Rs.115.70 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) In Ranchi, Bihar charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in May 1995 allowing deferred sales tax of Rs.47.20 lakh. Audit scrutiny revealed that

no amendment has been made in Bihar Sales Tax Laws to the effect that the deferred sales tax would be treated as actually paid nor had the `sales tax deferred payment scheme' been notified by the Government of Bihar for treating the deferred sales tax as collected and disbursed as loan. Thus the allowance of deduction was irregular and should have been disallowed. Omission to do so resulted in underassessment of income by Rs.47.20 lakh with consequent under charge of tax of Rs.35.83 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

Incorrect computation of income from tea business.

4.12 Under the Income Tax Rules, 1962, only 40 percent of income derived from the sale of tea grown and manufactured by a seller in India is deemed to be income derived from manufacturing and selling operation of the assessee and liable to income tax, the remaining 60 percent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to tax. This rule regarding apportionment of income applies only to income from tea business.

In West Bengal VI, Calcutta charge, the assessment of a widely held company (engaged in the business of growing and manufacturing tea) for the assessment year 1992-93 was completed in December 1994 after scrutiny. Audit scrutiny revealed that during the relevant previous year, the assessee company received Rs.154.82 lakh on account of sale of scrips and licence which was included in the tea growing income of two divisions of the assessee company and consequently only forty percent of the same was taxed. As the amount of receipt from sale of scrips and licence was not in the nature of income from sale of tea grown and manufactured by the assessee, such income would be fully taxable under the normal provisions of the Act, instead of bringing only forty percent of the amount to tax. The mistake resulted in underassessment of income by Rs.92.89 lakh (60 percent of Rs.154.82 lakh) involving short levy of tax of Rs.79.80 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

Incorrect allowance of deduction in respect of deposit under tea development account

4.13 Under the Income Tax Act, 1961, where an assessee carrying on business of growing and manufacturing tea in India has, before the expiry of six months from the end of the previous year or before furnishing the return of his income, whichever is earlier, deposited with a nationalised bank any amount or amounts in an account maintained by the assessee with that bank for the specified purposes approved by the Tea Board, the

assessee shall, subject to other provisions of the Act be allowed a deduction of a sum equal to the amount or the aggregate of the amounts so deposited or a sum equal to twenty percent of the profits of such business (computed under the head `profits and gains of business or profession' before making any deduction under this section), whichever is less. As such , the income which is attributable to the business of manufacturing tea from tea leaves purchased from outside is not eligible for deduction.

In West Bengal II, Calcutta charge, the assessment of a widely held company engaged in the business of growing and manufacturing of tea for the assessment year 1993-94 was completed after scrutiny in March 1996 allowing a deduction of Rs.36.36 lakh on account of deposit under tea development account on the income from packet tea division. Audit scrutiny revealed that the income from packet tea division was derived by the assessee company from manufacturing of tea which was treated as 100 percent taxable in the assessment. As the profit from the packet tea division was related only to manufacturing of tea, and not to growing and manufacturing tea, deduction in respect of deposit under tea development accounts was not allowable. The mistake resulted in irregular deduction of Rs.36.36 lakh involving short levy of tax of Rs.18.82 lakh and consequent excess allowance of interest of Rs.5.27 lakh.

The reply of the Ministry to the audit observation has not been received

Incorrect computation of business income

4.14 Under the Income Tax Act, 1961, the total income of an assessee for any previous year includes all income from whatever sources derived which is received or deemed to be received or which accrues or arises or is deemed to accrue or arise during such previous year unless specifically exempted from tax by the provisions of the Act.

In West Bengal III, Calcutta charge, the assessment of a Banking company for the assessment year 1989-90 was completed after scrutiny in March 1992. Audit scrutiny revealed that the assessing officer, while completing the assessment, considered interest on sticky loan of Rs.11435 lakh at the rate of fifteen percent at Rs.1715 lakh, not declared by the assessee, and included in the total income. It was, however, seen from Director's report that all lending rates were subjected to a floor rate of sixteen percent. Omission to apply the correct rate resulted in underassessment of income by Rs.114 lakh (Rs.1829 lakh less Rs.1715 lakh) involving short levy of tax of Rs.59.85 lakh.

The reply of the Ministry to the audit observation has not been received.

Prior period expenses

4.15.1 Under the Income Tax Act, 1961, income under the head `profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment. Only such expenses are allowable as deduction from a previous year's income as are relevant to that year.

(i) In West Bengal IV, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that a sum of Rs.578.96 lakh which was debited to the profit and loss account for the previous year relevant to the assessment year 1993-94 under the head `other expenditure (Sundries)' for making payment to those who would retire under `Selective Voluntary Scheme' on future dates was allowed as deduction. It was further revealed that selective voluntary scheme involved, inter alia, payment on specified dates of such amounts accruing and becoming due on those specified dates and no interest, right or claim would arise in respect of those future payments until they accrued and fell due. Therefore such expense was a contingent one and as the assessee was following mercantile system of accounting, the expenses which were not relevant to the relevant previous year were required to be disallowed. Omission to do so resulted in underassessment of income by Rs.578.96 lakh involving tax effect of Rs.515.33 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Tamil Nadu I, Chennai charge, the assessments of an insurance company for the assessment years 1989-90 and 1990-91 were completed after scrutiny. Audit scrutiny revealed that as per the notes on accounts, the assessee company had not credited in the accounts of the respective previous years, amounts of Rs.316 lakh and Rs.322.13 lakh being interest on loans and debentures where recovery of interest was deferred and remained outstanding for more than a year. As the assessee was regularly adopting mercantile system of accounting, interest on such loans and debentures should have been included in the total income on accrual basis. Omission to do so resulted in underassessment of income aggregating Rs.638.13 lakh involving under charge of tax of Rs.339.85 lakh.

The Ministry have accepted the audit observation.

(iii) In City I, Mumbai charge, the assessments of a closely held company for the assessment years 1992-93 and 1994-95 were completed after scrutiny in March 1994 and January 1996, inter alia, allowing interest liability of Rs.127.95 lakh and Rs.187.33 lakh respectively. Audit scrutiny revealed that the interest liability which was allowed related to letter of credit and bills of exchange which the assessee had drawn on another company for supply of certain material as the latter company became a BIFR company, the banks lodged their claim against the assessee for principal and interest which was disputed by the assessee. As the liability to pay interest would accrue only on finalisation of the suit, provision was a contingent one and should have been disallowed. Omission to do so resulted in underassessment of income aggregating Rs.315.28 lakh involving total short levy of tax of Rs.181.28 lakh (including potential tax effect of Rs.29.80 lakh for assessment year 1992-93) .

The reply of the Ministry to the audit observation has not been received.

(iv) In Delhi III charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in September 1994 allowing a deduction for interest amounting to Rs.283.94 lakh. Audit scrutiny revealed that as per compromise settlement arrived with the bank, a sum of Rs.499 lakh was only payable to them in full and final payment of their claim including principal and interest which was to start from the year 1992-93. As the interest expenditure had neither accrued nor paid during the previous year relevant to the assessment year, the entire interest debited to the profit and loss account, which in fact was a mere provision, should have been disallowed and added to the taxable income. Omission to do so resulted in excess carry forward of loss of Rs.283.56 lakh involving potential tax effect of Rs.163.05 lakh (including surcharge) and underassessment of positive income of Rs.0.38 lakh involving under charge of tax of Rs.0.22 lakh.

The Ministry have accepted the audit observation.

(v) In Andhra Pradesh II charge, the assessment of a company for the assessment year 1990-91 was completed in March 1993 after scrutiny. Audit scrutiny revealed that the assessee claimed and was allowed prior period expenses of Rs.103.41 lakh incurred by him. As the assessee was following mercantile system of accounting the deduction was incorrectly allowed. The mistake resulted in underassessment of income by Rs.103.41 lakh involving potential tax effect of Rs.55.84 lakh.

The reply of the Ministry to the audit observation has not been received.

(vi) In Delhi II charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in May 1994 allowing expenses of Rs.49.04 lakh relating to assessment year 1992-93. Audit scrutiny revealed that since these prior period expenses were already allowed by the assessing officer in earlier year, the same should have been disallowed. Omission to do so resulted in underassessment of income by Rs.24.06 lakh involving under charge of tax of Rs.17.33 lakh (including interest) and irregular carry forward of loss of Rs.24.98 lakh involving potential tax effect of Rs.14.36 lakh.

The reply of the Ministry to the audit observation has not been received.

Payments outside India

4.15.2 Under the Income Tax Act, 1961, where in any financial year the assessee has paid any interest, royalty or fees for technical services or other sum chargeable under this Act, which is payable outside India on which tax has not been paid or deducted such amounts (payable outside India) shall not be deducted in computing the income chargeable under the head `profits and gains of business or profession'.

In Central I (now West Bengal II), Calcutta charge, the assessment of a widely held company for the assessment year 1990-91 was completed after scrutiny in January 1993. Audit scrutiny revealed that deductions of Rs.45.57 lakh and Rs.9.17 lakh towards royalty payable to two different foreign companies were allowed without deduction of tax at source. The mistake resulted in underassessment of income by Rs.54.74 lakh involving under charge of tax of Rs.49.66 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

Incorrect allowance of capital expenditure

4.15.3 Under the provisions of Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure laid out or expended wholly or exclusively for the purpose of business is allowable as deduction in computing income chargeable under the head `profits and gains of business or profession'. It has been judicially held* that the expenditure on raising capital by issue of shares by a finance company is of a capital nature.

In Central I, Chennai charge, the assessment of a widely held finance company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that the assessing officer allowed a deduction of Rs.35.15 lakh towards share issue expenses for

* Metro General Credits Ltd. V CIT 221 ITR 99 (Madras)

raising additional share capital. In view of the jurisdictional High Court's decision, the share issue expenses should have been treated as of capital nature and disallowed. Omission to do so resulted in under assessment of income by Rs.35.15 lakh with consequent short levy of tax of Rs.24.65 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect valuation of closing stock

4.15.4(i) The method of valuation of closing stock as per generally accepted accounting principle is cost or market price whichever is less. This method of valuation, if followed consistently, is accepted in respect of a going concern. But in case of discontinued business, in the event of dissolution or amalgamation etc., to ascertain true profit, valuation of closing stock should be done at average sale price or market price.

In North Eastern Region, Shillong charge, the assessment of a widely held tea company for the assessment year 1993-94 was completed in March 1996 after scrutiny. Audit scrutiny revealed that the assessee company was amalgamated with a multinational company with effect from 1 January 1993 and accounts of the company were closed on 31 December 1992 disclosing closing stock of finished tea of 6,90,603 kg. It was further revealed that the stock was valued at cost or realisable value whichever was less. As the assessee company had ceased to exist for all practical purposes on amalgamation with another company, valuation of closing stock was required to be done at average sale price to ascertain true profit. Neither did the assessee value the closing stock correctly nor was it done by the assessing officer. The omission resulted in under-valuation of closing stock by Rs.81.08 lakh (based on sale price per kg as disclosed in the accounts) (Rs.11.74 x 6,90,603) and consequential under assessment of income by Rs.28.05 lakh with consequent short levy of tax of Rs.24.97 lakh (including interest).

The Ministry have not accepted the audit observation on the grounds that the assessing officer had adopted the method of valuation being cost or market value whichever was lower. This method was followed regularly by the assessee and the fact of amalgamation of the company with another was irrelevant for the purpose of closing stock valuation. Further, the Ministry is of the opion that there is no obligation to adopt any other method of valuation and that stock valuation at the time of amalgamation had been approved by the High Courts at Calcutta and Gauhati. Moreover since this stock was taken into account in the amalgamated company, there was no loss of revenue. The reply is not

tenable since it has been judicially confirmed by the Supreme Court and the Ministry of Law that the privelege of valuing closing stock at cost or market value could not be adopted by a business which comes to an end. In such a case, stock in hand should be valued only at market value to determine the true profits of the business. The approval of the High Courts is only for the purposes of amalgamation and not for income tax purposes where the Supreme Court judgment shall apply. The issue of there being no loss of revenue is not relevant as each assessment is independent and the fact that the value of the closing stock would be reflected in the amalgamated company is not relevant. Incidentally, the Ministry have accepted a similar para featured vide para 5.9.4(i)(a) of the Report of the Comptroller and Auditor General of India for the year ended 31 March 1995.

(ii) It has been judicially held* that any system of accounting which excludes for the valuation of stock in trade all costs other than the cost of raw materials is likely to result in a distorted picture of the true state of business, for the purpose of computing its chargeable income. The Board clarified in 1981 that central excise/customs duties, if any, payable by the manufacturer/trader should go into calculation of production cost and the closing inventory should include an element of such duty to represent such cost.

(a) In Maharashtra, West Bengal and Karnataka charges, the assessments of seven companies for the assessment years 1992-93 and 1993-94 were completed after scrutiny between August 1994 and March 1996 respectively. Audit scrutiny revealed that excise duty/customs duty aggregating Rs.955.35 lakh payable on finished goods had not been included in the value of closing stock. The excise duty and customs duty payable should have been debited to the profit and loss account on accrual basis. As customs and excise duty were deductible on actual payment basis, the said amount not paid to government account should have been added to arrive at the total income of the assessee. Omission to do so resulted in underassessment of income aggregating Rs.955.35 lakh involving short levy of tax of Rs.761.16 lakh (including interest and potential tax effect of Rs.24.82 lakh in one case).
The reply of the Ministry to the audit observation has not been received

(b) In West Bengal VI, Calcutta charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that customs duty of Rs.19.06

* CIT V British Paints India Ltd.; 188 ITR 44 (SC)

lakh payable on imported raw materials held in the bonded warehouse was not included in the value of closing stock. The customs duty payable should have been debited to profit and loss account on accrual basis. As customs duty was deductible on actual payment basis, the said amount not paid to government account should have been added to arrive at the total income of the assessee. Omission to do so resulted in underassessment of income by Rs.19.06 lakh involving short levy of tax of Rs.15.08 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of income of a financial corporation

4.15.5 Under the Income Tax Act, 1961, as amended from 1 April 1992, a deduction in respect of any provision for bad and doubtful debts made by a public financial institution or a State financial corporation or a State industrial investment corporation of an amount not exceeding five percent of the total income (computed before making this deduction and deduction under Chapter VI A of the Act) is allowed in computing the income chargeable under the head 'profits and gains of business or profession'. Further, financial corporation engaged in providing long term finance for industrial or agricultural development in India are entitled to a special deduction of an amount transferred by them out of their profits to a special reserve account upto an amount not exceeding 40 percent of their total income before making any deduction under Chapter VI A of the Act.

In Tamil Nadu II, Chennai charge, the assessments of a company engaged in promotion of industries for the assessment years 1992-93 and 1993-94 were completed after scrutiny in February 1995 and November 1995 respectively. Audit scrutiny revealed that the assessing officer allowed provision for bad and doubtful debts for Rs.9.88 lakh and Rs.17.18 lakh against the actual provision of Rs.8.23 lakh and Rs.12.28 lakh created by the assessee. Similarly, the special deduction for reserves created by the assessee for providing long term finance for industrial development of the country was allowed at Rs.75.11 lakh and Rs.130.54 lakh as against the actual reserve of Rs.65.81 lakh and Rs.98.27 lakh. The mistakes resulted in underassessment of income aggregating Rs.48.11 lakh involving short levy of tax of Rs.41.18 lakh (including interest).

The Ministry have accepted the audit observation.

Irregular allowance of depreciation

4.16.1(i) Under the provisions of the Income Tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on buildings, plant and machinery, furniture and fittings and ships is admissible at the prescribed rates provided these are owned by the assessee and used for the purposes of his business during the relevant previous year. Depreciation is not admissible on land on which the building stands or which is appurtenant to buildings. The Act, with effect from assessment year 1992-93, further provides that if any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purposes of business for a period less than 180 days in that previous year, depreciation on such assets will be allowed at 50 percent of the depreciation allowable according to percentage prescribed.

In Coimbatore, Tamil Nadu charge, in the assessment of a company for the assessment year 1993-94 completed after scrutiny in March 1996 on a total income of Rs.84.50 lakh, depreciation of Rs.165.66 lakh was allowed which included depreciation of Rs.111.90 lakh in respect of a particular division the new assets of which were stated to be installed on or before 30 September 1992. Audit scrutiny of the report in annual accounts revealed that the said division commenced its operation in December 1992. As such the assets were put to use only for less than 180 days in the relevant previous year and therefore fifty percent of normal depreciation was admissible. The excess allowance of depreciation resulted in underassessment of income by Rs.55.88 lakh with consequent short levy of tax of Rs.49.74 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of capital expenditure and depreciation

(ii) Under the Income Tax Act, 1961, any expenditure not being in the nature of capital expenditure laid out or expended wholly or exclusively for the purpose of the business is allowable as deduction in computing income chargeable under the head "Profits and gains of business or profession". It has been judicially held* that where only minor parts of the machinery in a textile mill are replaced that would constitute revenue expenditure. Where the expenditure incurred brings into existence a new asset or where the cost of replaced parts constitute substantial value (20

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* CIT V Mahalaxmi Textiles: 66 ITR 710 (SC)
CIT V Salem Coop. Spinners: 148 ITR 716 (Madras)
CIT V Madras Spinners: 177 ITR 495 (Kerala)
CIT V Ballimal Navalkishore: 90 Taxmann 402 (SC)
Hindusthan Pilkington V CIT: 73 Taxmann 631 (Calcutta)

percent) of the old machinery, the expenditure incurred would constitute capital expenditure. It has also been judicially held that the expenditure incurred on replacement of plant and machinery would be capital expenditure. Under the Income Tax Rules, 1962, different rates of depreciation have been prescribed for specified block of assets.

In Coimbatore, Tamil Nadu charge, the assessment of a company for the assessment year 1994-95 originally completed after scrutiny in March 1995 was revised in February 1996 allowing certain expenditure aggregating Rs.255.49 lakh on replacement of certain items of machinery as revenue expenditure. Audit scrutiny revealed that the expenditure was incurred for replacement of old, worn out machinery and not parts of machinery by way of repairs. Hence it constituted capital expenditure in view of several judicial decisions and the relevant assets were eligible for normal depreciation only. The eligible rate was 25 percent only and since the machinery were put to use for less than 180 days during the relevant previous year, the deduction was to be restricted to fifty percent of the amount calculated at the percentage prescribed in the case of block of assets comprising such asset. The mistake resulted in underassessment of income of Rs.223.55 lakh involving short levy of tax of Rs.153.12 lakh (including interest).

The Ministry have accepted the audit observation.

(iii) Under the provisions of the Income Tax Act, 1961, as amended by Finance Act, 1988, any profits and gains derived by an assessee from a hundred per cent export oriented undertaking shall not be included in the total income of the assessee in respect of any five consecutive assessment years falling within a period of eight years beginning with the year of commencement of manufacture or production of articles. The provisions of the Income Tax Act, 1961, governing the deductions and allowances admissible in computing the profits and gains of business are applicable only to such business the profits and gains of which are chargeable to tax as per the relevant provisions of the Income Tax Act. Consequently, in respect of the profits and gains of hundred per cent export oriented undertaking which is not included in the total income of the assessee, no further deductions or allowances are admissible.

In Tamil Nadu II, Chennai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 on a total income of Rs.423.84 lakh which, inter alia, included business income of Rs.372.47 lakh. While arriving at the business income, the assessee

claimed the profits and gains of a hundred per cent export oriented unit to the extent of Rs.943.91 lakh as exempt. Audit scrutiny revealed that the assessee was allowed depreciation of Rs.167.25 lakh on the assets of the hundred per cent export oriented undertaking which was inadmissible. The mistake resulted in underassessment of income of Rs.163.56 lakh (after allowing further deduction of Rs.3.69 lakh towards export turnover) involving tax effect of Rs.127.01 lakh (including interest).

The Ministry have accepted the audit observation.

4.16.2 Where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof shall be allowed as deduction in respect of the previous year in which such machinery or plant is first put to use by the assessee for the purpose of his business or profession. It has been judicially held* that where containers are handled only in bulk, each container cannot be treated as single plant for the purpose of 100 percent depreciation. Depreciation is to be allowed at normal rate on cumulative value of entire lot of the containers.

(i) In City III, Mumbai charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995 allowing 100 percent depreciation of Rs.150.39 lakh on gas cylinders on the ground that cost of each cylinder was less than Rs.5000. Audit scrutiny revealed that the cylinders were manufactured/purchased in bulk and leased out in bulk. Thus it was not correct to treat each cylinder as a separate plant in order to claim 100 percent deduction. Therefore the entire bulk purchased/manufactured and leased out should have been treated as single plant/unit and normal rate of depreciation allowed. The incorrect application of rates resulted in excess allowance of depreciation of Rs.112.79 lakh with consequent short levy of tax of Rs.111.55 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

(ii) In Visakhapatnam, Andhra Pradesh charge, the assessments of a company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1994 and March 1996 respectively. Audit scrutiny revealed that depreciation allowance was allowed at hundred percent on the entire cost of steel shuttering material worth Rs.52.99 lakh and Rs.90.25 lakh on the ground that each ballie and plank would

* Pathange Poultry V CIT; 210 ITR 668 (Karnataka)
ITO V First Leasing Co.; 20 ITD 449 (ITAT, Chennai)

cost less than Rs.5,000. Since each ballie and plank would not constitute a self contained plant which is necessary to perform the function of holding the ceiling, depreciation should have been allowed at the rate of 25 percent as applicable to general items of plant and machinery instead of at the rate of 100 percent. The mistake resulted in excess allowance of depreciation aggregating Rs.107.43 lakh with consequent short demand of tax of Rs.74.03 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

4.16.3 Taxation Laws (Amendment) Act, 1991, provided that for the assessment year 1991-92, depreciation for any block of assets in the case of a company was to be restricted to seventy five percent of the amount calculated at the prescribed percentage of normal allowance.

(i) In Jaipur, Rajasthan charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1996. Audit scrutiny revealed that the assessee was allowed depreciation amounting to Rs.336.15 lakh (being 75 percent of normal depreciation of Rs.448.20 lakh) and balance amount of Rs.112.05 lakh was allowed to be carried forward for further set off. Since there is no provision under the Act to allow carry forward of such balance amount of depreciation, the irregularity resulted in incorrect carry forward of depreciation by Rs.112.05 lakh involving potential tax effect of Rs.51.54 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) In North East Region, Shillong charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1996 allowing depreciation of Rs.37.10 lakh. Audit scrutiny revealed that depreciation on block of assets had not been restricted to 75 percent of the amount calculated as per provisions of the Act. The mistake resulted in excess allowance of depreciation of Rs.9.28 lakh and underassessment of income of equivalent amount with consequent short levy of tax of Rs.11.17 lakh (including interest).

The Ministry have accepted the audit observation.

Excess allowance of depreciation due to failure to revise assessment

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

during the relevant previous year. Depreciation is calculated on the cost or written down value of the assets according to the rates prescribed in the Income Tax Rules, 1962.

In Delhi I charge, the assessment of a Government company for the assessment year 1993-94 was completed after scrutiny in February 1996 at income of Rs.10,667.39 lakh after allowing depreciation of Rs.865.98 lakh. Audit scrutiny revealed that the assessment for the assessment year 1992-93 was revised in June 1996 giving effect to the appellate orders of May 1996, which led to additional allowance of depreciation of Rs.811.94 lakh. Hence, the assessment for the assessment year 1993-94 should have also been revised accordingly by adopting the opening written down value reduced by the amount of additional depreciation of Rs.811.94 lakh allowed for the assessment year 1992-93 while giving effect to appellate orders. Omission to do so resulted in excess allowance of depreciation of Rs.81.19 lakh leading to underassessment of income by an identical amount with consequent short levy of tax of Rs.42.02 lakh.

The Ministry have accepted the audit observation.

Excess/Irregular set off of unabsorbed depreciation

4.16.5(i) Under the Income Tax Act, 1961, where for any assessment year unabsorbed depreciation under the head 'profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year and shall be set off against profits and gains of business or profession' of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off.

(a) In City XI, Mumbai charge, the assessments of a company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in March 1995 and March 1996 respectively allowing set off of unabsorbed depreciation of the previous assessment years aggregating Rs.141.73 lakh. Audit scrutiny revealed that there was no unabsorbed depreciation available for set off in the assessment years 1992-93 and 1993-94. The incorrect set off resulted in underassessment of income aggregating Rs.141.73 lakh involving short levy of tax aggregating Rs.140.18 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

(b) In City III, Mumbai charge, the assessments of a company for the assessment years 1991-92 and 1992-93 were completed between March 1994 and March 1995 allowing set off of unabsorbed depreciation of Rs.437.93 lakh. Audit scrutiny revealed that there was carried forward unabsorbed depreciation of Rs.380.10 lakh only available for set off. The mistake resulted in excess set off of unabsorbed depreciation and underassessment of income of Rs.57.83 lakh involving tax effect of Rs.29.93 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) Under the Income Tax Act, 1961, in computing the profits and gains of business of a domestic company in relation to the previous year relevant to the assessment year commencing on the first day of April 1992, where effect is to be given to the unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before the first day of April 1991, the deduction shall be restricted to two-third of such allowance or allowances.

In Pune, Maharashtra charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995 allowing set off of unabsorbed depreciation relating to earlier years, aggregating Rs.57.03 lakh. Audit scrutiny revealed that the above amount was not restricted to Rs.38.02 lakh, being two-third of the amount as required under the Act. The mistake resulted in underassessment of income of Rs.19.01 lakh involving short levy of tax of Rs.18.80 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of investment allowance

4.17.1(i) Under the Income Tax Act, 1961, a deduction by way of investment allowance is allowed in the case of an industrial undertaking, not being a small scale undertaking, in respect of machinery or plant installed or put to use in the previous year for the purpose of business of construction, manufacture or production of any article or thing not being an article of thing specified in the Eleventh Schedule.

In Gujarat I, Ahmedabad charge, the assessment of a company engaged in the activity of mining of lignite, etc. for the assessment year 1991-92 was completed after scrutiny in March 1994 after setting off unabsorbed investment allowance of Rs.1395.68 lakh pertaining to assessment years

1989-90 and 1990-91. Audit scrutiny revealed that the assessee was not carrying on any manufacturing or production activity during these assessment years. Hence, grant of investment allowance was not in order. Moreover, assessee's claim for deduction under section 80 I was also disallowed by the appellate authority on the above grounds. The mistake resulted in underassessment of income by Rs.1395.68 lakh with consequent short levy of tax of Rs.1104.26 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that only set off of unabsorbed investment allowance brought forward from earlier years was allowed in the assessment year 1991-92 and no investment allowance was granted during the year. The Ministry's reply is not relevant to the audit observation as the assessee was not carrying on any manufacturing activity during the assessment years 1989-90 and 1990-91 (to which unabsorbed investment allowance related) and was thus not entitled to investment allowance deduction/set off of unabsorbed investment allowance relating to those years. The audit stand is also evidenced by the CIT(Appeals) order disallowing 80I deduction to the assessee on similar grounds.

(ii) Under the Income Tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction by way of investment allowance shall be allowed in the previous year of installation or in the previous year of first usage, of a sum equal to 25 percent upto assessment year 1988-89 and 20 percent thereafter, of the actual cost of the machinery.

In Orissa charge, the assessment of a company for the assessment year 1993-94 was completed in February 1996 allowing adjustment of unabsorbed investment allowance pertaining to assessment years 1988-89 and 1990-91 of Rs.533.47 lakh and carry forward of balance of Rs.177.78 lakh. Audit scrutiny revealed that the brought forward unabsorbed investment allowance included an amount of Rs.558.75 lakh for the assessment year 1990-91 which was computed on application of an incorrect rate of 25 percent of the cost of the plant and machinery installed instead of the prescribed rate of 20 percent applicable to assessment year 1990-91. The erroneous grant of deduction resulted in excess carry forward of investment allowance of Rs.111.75 lakh involving potential tax effect of Rs.57.83 lakh.

The Ministry have accepted the audit observation.

Erroneous carry forward of unabsorbed investment allowance

4.17.2 Under the Income Tax Act, 1961, no investment allowance is admissible on machinery or plant which are not used in an industrial undertaking for the purpose of the business of manufacture or production of any article or thing. The Board has clarified in January 1986 that investment allowance is not admissible to a hotel as no manufacture or processing of goods is involved.

In Delhi III charge, the assessment of a limited company for the assessment year 1995-96 was completed in March 1996 in a summary manner allowing carry forward of investment allowance of Rs.730 lakh relating to assessment year 1989-90 to be set off in the subsequent years. Audit scrutiny revealed that assessee company was engaged in the hotel business and as such was not entitled to get a deduction towards investment allowance. The mistake in allowing carry forward of the inadmissible investment allowance of Rs.730 lakh resulted in erroneous carry forward of loss by the like amount involving potential tax effect of Rs.335.80 lakh.

The Ministry have not accepted the audit observation on the plea that there is no scope to refer to past records to ascertain the correctness of figures of brought forward losses/ unabsorbed depreciation/investment allowance of earlier years in a summary assessment case. Further, the allowance of Investment Allowance to the hotel industry, being a debatable issue is not covered under summary assessment. The Ministry's reply is not tenable as the Board has categorically clarified in January 1986 that hotel business cannot qualify for investment allowance. The Board's instructions are binding on an assessing officer. Further, the fact that the assessee had a hotel business was apparent from the return itself and there was no need to refer to past records.

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

(i) In Ranchi, Bihar charge, the assessment of a widely held company for the assessment year 1993-94, was completed after scrutiny in May 1995 allowing set off of unabsorbed investment allowance of Rs.163.20 lakh and carry forward of balance amount of Rs.410.20 lakh in respect of plant and machinery installed and first put to use in the previous year relevant to the assessment year 1985-86. Audit scrutiny revealed that

investment allowance was neither claimed by the assessee in respect of previous year in which the plant and machinery was installed and put to use nor allowed by the assessing officer. The assessee was, therefore, not entitled to carry forward of investment allowance to the assessment year 1993-94. The mistake resulted in irregular set off of unabsorbed investment allowance of Rs.163.20 lakh with consequent under charge of tax of Rs.126.81 lakh (including interest) and carry forward of unabsorbed investment allowance of Rs.410.20 lakh involving potential tax effect of Rs.212.28 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) In City III, Mumbai charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in October 1995, allowing set off of unabsorbed depreciation of Rs.283.27 lakh for the assessment year 1991-92 and unabsorbed investment allowance of Rs.444.77 lakh for the assessment year 1985-86 and carry forward of balance unabsorbed investment allowance of assessment year 1985-86 amounting to Rs.372.42 lakh. As no investment allowance can be carried forward beyond eight succeeding assessment years from the initial assessment year in which it was allowed, the carry forward of unabsorbed investment allowance of Rs.372.42 lakh beyond assessment year 1993-94 was incorrect. The incorrect allowance of carry forward resulted in potential tax effect of Rs.192.73 lakh.

The reply of the Ministry to the audit observation has not been received

(iii) In Ludhiana, Punjab charge, the assessments of a domestic company for the assessment years 1992-93 and 1993-94 were completed in February 1995 and March 1996 allowing investment allowance aggregating Rs.136.32 lakh pertaining to assessment years 1988-89 to 1990-91. Audit scrutiny of assessment records revealed that neither did the assessee claim investment allowance during the years 1988-89 to 1990-91 nor was the same allowed to be carried forward for set off against future income. The irregular deduction of investment allowance resulted in underassessment of income of Rs.136.32 lakh with consequent short levy of tax of Rs.70.55 lakh.

The reply of the Ministry to the audit observation has not been received

(iv) In West Bengal I, Calcutta charge, the assessment of a company for the assessment year 1989-90 initially completed after scrutiny in March

1992 was revised in June 1992, allowing set off of unabsorbed investment allowance of Rs.141.12 lakh pertaining to the assessment years 1980-81 to 1987-88. Audit scrutiny revealed that the unabsorbed allowance of Rs.141.12 lakh included unabsorbed investment allowance of Rs.62.14 lakh pertaining to the assessment year 1980-81. As the unabsorbed investment allowance for the assessment year 1980-81 could not be set off beyond the assessment year 1988-89, the set off of unabsorbed investment allowance of Rs.62.14 lakh in the assessment year 1989-90 was irregular and resulted in underassessment of income of Rs.62.14 lakh with consequent short levy of tax of Rs.56.11 lakh (including interest).

The Ministry have accepted the audit observation.

Non-restriction of investment allowance

4.17.4 Under the Income Tax Act, 1961, as applicable for the assessment year 1992-93, where effect is to be given to the unabsorbed depreciation or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before the first day of April 1991, the deduction shall be restricted to two-third of such allowance or allowances.

In Tamil Nadu I, Chennai charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in January 1995 after setting off Rs.302.39 lakh being two-third of the unabsorbed depreciation and investment allowance of earlier years. Audit scrutiny revealed that the unabsorbed investment allowance of assessment year 1989-90 was taken as Rs.103.16 lakh as against the actual amount of Rs.82.56 lakh. Omission to take the correct figure resulted in excess set off of unabsorbed investment allowance of Rs.13.75 lakh (being two-third of the difference between Rs.103.16 lakh and Rs.82.56 lakh) with consequent short levy of tax of Rs.11.96 lakh (including interest) besides potential tax effect of Rs.3.56 lakh.

The Ministry have accepted the audit observation.

Incorrect/Excess set off of unabsorbed depreciation and investment allowance

4.18 Under the special provisions inserted with effect from 1 April 1992 by the Finance Act, 1992, in computing the profits and gains of business of a domestic company in relation to the previous year relevant to the assessment year commencing on the 1st day of April 1992, where effect is to be given to the unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before 1st day of April 1991, the deduction shall be restricted to two-third of such

allowance or allowances and the balance carried forward to subsequent year in the manner provided in the said special provisions. The Act further provides that in respect of plant and machinery installed in a industrial undertaking investment allowance of 25 percent of the actual cost (20 percent from assessment year 1989-90) is allowable in the year of installation or in the year of first usage subject to the condition that seventy five percent of the allowance is debited to the profit and loss account and credited to a reserve account to be utilised for acquiring new assets within a period of ten years.

(i) In Tamil Nadu II, Chennai charge, in the assessment of a public company for the assessment year 1992-93 completed after scrutiny in March 1995 set off of unabsorbed depreciation of Rs.121.75 lakh and unabsorbed investment allowance of Rs.355.40 lakh relating to earlier years and carry forward of balance unabsorbed depreciation of Rs.200.08 lakh was allowed. Audit scrutiny revealed that set off of Rs.355.40 lakh being unabsorbed investment allowance relating to assessment year 1990-91 in preference to unabsorbed depreciation of Rs.321.83 lakh was not in order. It also revealed that the assessee had not created any reserve for the investment allowance. Since the statutory condition was not satisfied, the assessee was not eligible for any investment allowance. Further, the restriction regarding set off of unabsorbed allowances applicable to assessment year 1992-93, was also not applied. The assessee was actually entitled to set off of only two-third of unabsorbed depreciation of Rs.214.55 lakh. The mistakes resulted in underassessment of income of Rs.262.59 lakh and excess carry forward of unabsorbed depreciation of Rs.92.80 lakh with consequent short levy of tax of Rs.233.73 lakh (including interest) besides potential tax effect of Rs.48.03 lakh.

The Ministry have accepted the audit observation.

(ii) In City III, Mumbai charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in March 1994 allowing set off of unabsorbed depreciation and unabsorbed investment allowance aggregating Rs.126.02 lakh. Audit scrutiny revealed that the amount was not restricted to the two-third of the total unabsorbed amount. Omission to apply restrictive provisions has resulted in underassessment of income by Rs.42 lakh involving short levy of tax of Rs.32.17 lakh (including interest).

The reply of the Ministry to the audit observation has not been received

Non-levy of capital gains tax

4.19.1 Under the Income Tax Act, 1961, as applicable from 1 April 1988, where full value of consideration received or accruing as a result of transfer of any capital asset falling within a block of assets on which depreciation has been allowed under the Act during the previous year, exceed the aggregate amount of (i) the expenditure incurred wholly and exclusively in connection with such transfer, (ii) the written down value of the block of assets at the beginning of the relevant previous year and (iii) the actual cost of any asset falling within that block of assets acquired during the year, such excess shall be deemed as capital gains arising from the transfer of short term capital assets.

In West Bengal IV, Calcutta charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995. Audit scrutiny, however, revealed that the short term capital gains of Rs.40.32 lakh derived from sale of air pollution control dust collector system/cyclonic scrubbers and energy saving devices was not brought to tax. Omission to do so resulted in under charge of tax of Rs.20.86 lakh.

The Ministry have accepted the audit observation.

Incorrect computation of capital gains

4.19.2 Under the Income Tax Act, 1961, any profits and gains, arising from the transfer of a capital asset is chargeable to income tax under the head `capital gains' and is taxable in the year in which the transfer took place. The Act further provides that where the assessing officer is of opinion that the value claimed is less than its fair market value, he may refer the valuation of capital asset to a valuation officer.

In Surat, Gujarat charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in March 1994. Audit scrutiny revealed that the sale proceeds received by the assessee on sale of building was taken as Rs.230.50 lakh whereas the value of the asset ascertained by the valuation officer was Rs.255.54 lakh. Thus, there was a discrepancy of Rs.25.04 lakh in the value shown in the statement of income for assessment. The mistake resulted in underassessment of capital gain by Rs.25.04 lakh with consequent short levy of tax of Rs.23.82 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect treatment of income as capital gains

4.19.3 Under the Income Tax Act, 1961, any profits or gains arising from the transfer of a capital asset are chargeable to income tax under the head `capital gains'. Capital asset is defined in the Act as a property

of any kind held by an assessee, whether or not connected with his business or profession but does not include stock in trade.

In Gujarat II, Ahmedabad charge, the assessments of eleven closely held companies for the assessment years 1990-91 and 1991-92 were completed after scrutiny between August 1992 and March 1993. Audit scrutiny revealed that the assessee companies were engaged in the sale and purchase of silver and the investments were held as stock in trade. As these companies were trading and investment companies and also assessed as such, the profits on the sale of silver constituted their normal "profits and gains" of business and should have been assessed as such. Treating the profits as capital gains was thus irregular which resulted in underassessment of income of Rs.50.13 lakh with consequent short levy of tax of Rs.53.57 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Income not assessed

4.20.1 Under the Income Tax Act, 1961, the total income of a person for any previous year includes income from whatever sources derived which is received or deemed to be received or which accrues or arises during such previous year unless specifically exempted from tax by the provision of the Act. It has been provided by the Finance Act, 1987 that from the assessment year 1988-89, income includes, interalia, any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any other fund set up for the welfare of such employees. However, a deduction in respect of any such sum shall be allowed to the assessee if the same is credited to the account of the employee in the relevant fund on or before the due date prescribed under the Act governing the fund.

(i) In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed in a summary manner in October 1995 at a loss of Rs.12,146.46 lakh. Audit scrutiny of statutory auditor's tax audit report revealed that a sum of Rs.1,216.77 lakh received by the assessee from the employees as contributions to and recoveries of advances from the contributory provident fund was debited to the relevant profit and loss account but not paid to the fund account during the previous year relevant to the assessment year 1994-95. There was also no evidence in support of the deposit of the said sum within the due date as prescribed under the relevant Act. The sum of Rs.1,216.77 lakh was therefore, required to be added back as income of the assessee for the assessment year 1994-95. Omission to do so resulted in excess computation

of loss by Rs.1,216.77 lakh involving potential under charge of tax of Rs.629.68 lakh and non levy of additional income tax of Rs.125.94 lakh.

The Ministry have not accepted the audit observation on the ground that entire amount of contribution was paid before the due date of filing of return of income. Ministry's reply is not tenable because as per explanation below clause (va) of sub section (1) of section 36 of Income Tax Act deduction in respect of sum received by the assessee from his employees as contribution to Provident Fund is allowed if the same is credited to the Account of the employees in the relevant fund on or before due date prescribed under the Act governing the Fund. Since the due date of payment in this case is on or before 15th of the following month and the amount was not credited to fund within due date, this amount should have been treated as income of the assessee and added back.

(ii) In West Bengal VI, Calcutta charge, the assessment of a widely held company for the assessment year 1989-90 was completed after scrutiny in February 1995 at a loss of Rs.4484.80 lakh. Audit scrutiny revealed that a sum of Rs.150 lakh received from the Government of Bihar towards Rehabilitation Programme undertaken in the unit "R.B.H.M." during the relevant previous year and accounted for in the balance sheet was not included in the taxable income. The omission resulted in underassessment of income of Rs.150 lakh leading to an excess carry forward of loss by the identical amount involving potential tax effect of Rs.78.75 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In West Bengal I, Calcutta charge, the assessment of a closely held company for the assessment year 1990-91 was completed after scrutiny in March 1993 at a total income of Rs.76.52 lakh. Audit scrutiny revealed that during the previous year relevant to the assessment year 1990-91, the assessee company received Rs.30.13 lakh from the Central Excise Department as refund by virtue of an interim order issued by the Hon'ble Calcutta High Court. This amount was not credited to the relevant profit and loss account and was shown under the head "other liabilities" in the relevant balance sheet. As the sum of Rs.30.13 lakh was received by the assessee in the previous year relevant to the assessment year 1990-91 it should have been brought to tax. Omission to do so resulted in underassessment of income by a like amount with consequent short levy of tax of Rs.30.79 lakh (including interest).

The Ministry have accepted the audit observation.

4.20.2 Under the Income Tax Act, 1961, income under the head "profits and gains of business and profession" is computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment. It has been judicially held* that income is accrued when the assessee has acquired a right to receive it.

(i) In Jabalpur, Madhya Pradesh charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in February 1996 at nil income. Audit scrutiny revealed that bills amounting to Rs.1244.24 lakh on account of interest raised on customers for delayed payments were not accounted for in the accounts pending acceptance of the same by the customers till 31 March 1993, on the ground that there was no scope to get the same. As the assessee company was following mercantile system of accounting and had been consistently charging interest payable on the basis of bills received/debit advices without verification of the adequacy/correctness of interest liability against the current years profits, the non inclusion of interest recoverable led to short computation of income by Rs.1244.24 lakh involving potential tax effect of Rs.643.89 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in March 1994 and subsequently rectified in June 1994. Audit scrutiny revealed that the assessee had claimed and was allowed credit for tax deducted at source of Rs.52,615 against income from contract job amounting to Rs.39.78 lakh. However, the income from contract job was neither credited to the profit and loss account relevant for the assessment year 1991-92 nor considered in the original or revised assessment leading to underassessment of income by Rs.39.78 lakh. Further, credit of Rs.1.62 lakh for tax deducted at source was allowed in the rectification assessment though certificates for tax deduction at source of Rs.96,681 were not available with the assessment records and the assessee too did

* CIT Vs Ashokbhai Chimanbhai (1965); 56 ITR 42 (SC)

not claim the credit. These mistakes resulted in aggregate under charge of tax of Rs.32.44 lakh (including interest).

The Ministry have accepted the audit observation.

4.20.3(i) Under the Income Tax Act, 1961, income of every kind which is not to be excluded from the total income under this Act shall be charged to income tax under the head "income from other sources". It has been judicially held* that interest received during proportion period out of investment made from surplus fund should be treated as income from other source and charged to tax accordingly. It has also been judicially held** that interest earned on short term investment of funds borrowed for setting up of factory during construction of factory before commencement of business has to be assessed as income from other source and it cannot be said that interest income is not taxable on ground that it would go to reduce interest on borrowed amount which would be capitalised.

In North East Region, Shillong charge, the assessments of a widely held company for the assessment years 1992-93 and 1993-94 were completed after scrutiny in March 1995 and March 1996 determining `Nil' income. Audit scrutiny revealed that the company apportioned the net interest (after deducting interest received) expenditure between profit and loss account and construction account. As the interest income was earned by the assessee out of investment from surplus fund and had no bearing with administrative overheads during construction, the income was to be assessed as "Income from Other Sources", as per judicial decision. Omission to do so resulted in underassessment of income of Rs.144.43 lakh and excess carry forward of loss of equivalent amount involving potential tax effect of Rs.74.74 lakh.

The reply of the Ministry to the audit observation has not been received

(ii) Under the Income Tax Act, 1961, the annual value of the property of which the assessee is the owner and the property is not used for carrying on his business or profession shall be charged under the head `income from house property'.

In City VI, Mumbai charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that rental income of Rs.27.56 lakh as decided by

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* Challapalli Sugars Ltd. Vs CIT; 98 ITR 167 (SC)

** Tuticorin Alkali Chemicals and Fertilisers Ltd. Vs CIT; 93 Taxman 502 (SC)

the assessing officer was remained to be added to the taxable income in computation. The omission to add back Rs.27.56 lakh as decided has resulted in underassessment of income by Rs.22.05 lakh (after allowing one-fifth for repairs) with consequent short levy of tax of Rs.19.63 lakh.

The Ministry have accepted the audit observation.

4.20.4 Under the Income Tax Act, 1961, interest paid by Government on the amount of refund due to an assessee constitutes income of the assessee and is chargeable to tax in the assessment year relevant to the previous year in which it is paid.

In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in March 1995. Audit scrutiny of assessment records for the assessment year 1990-91 processed in a summary manner in March 1991 revealed that assessee was paid a refund of Rs.574.91 lakh including interest of Rs.87.70 lakh in April 1991. The interest amount was subsequently reduced to Rs.81.36 lakh. This amount which was chargeable to tax in the assessment year 1992-93 was not brought to tax. The omission resulted in non-assessment of income by Rs.81.36 lakh with consequent short levy of tax of Rs.42.10 lakh.

The reply of the Ministry to the audit observation has not been received.

4.20.5 Under the Income Tax Act, 1961, any expenditure or trading liability incurred for the purpose of business carried on by the assessee is allowed as a deduction in the computation of business income. Where on a subsequent date , the assessee obtained any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof, the benefit that accrues thereby, shall be deemed to be profits and gains of business or profession to be charged to tax as the income of the previous year in which such remission or cessation takes place.

In Gujarat I, Ahmedabad charge, the assessment of a closely held company for the assessment year 1992-93 was completed after scrutiny in March 1995 and revised in November 1995. Audit scrutiny revealed that an amount of Rs.35.41 lakh representing sale proceeds of pads, pattis and crates, etc. purchased during the previous year relevant to the assessment year 1989-90 which was allowed as revenue expenditure by the appellate authority, was treated as capital receipt. Since the expenditure had been allowed as revenue expenditure the receipt on its sale should have been treated as

revenue receipt and taxed. This together with non restriction of unabsorbed depreciation to be set off resulted in underassessment of income by Rs.39.07 lakh with consequent short levy of tax of Rs.41.34 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that there was no mistake in the assessment order dated 31 March 1995 since the amount became taxable only after the Commissioner of Income Tax (Appeals) allowed it as a revenue expense vide order dated 20 June 1995. The reply is not tenable since the audit observation is based on the revised order dated 6 November 1995 passed subsequent to the orders of CIT (Appeals) dated 20 June 1995. Since the order of the CIT (Appeals) was in the knowledge of the assessing officer at the time of revised return, he was required to tax the amount.

Incorrect carry forward and set off of losses

4.21.1 Under the Income Tax Act, 1961, where the net result of the computation under the head `Profits and gains of business or profession' is a loss to the assessee and such loss cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those years. No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined.

(i) In Karnataka I, Bangalore charge, in the assessment of a company for the assessment year 1993-94 completed after scrutiny in December 1995, the income was computed at nil after setting off of unabsorbed business loss of Rs.4824.47 lakh pertaining to the assessment year 1987-88. Audit scrutiny revealed that this unabsorbed loss was adjusted against the income for the assessment years 1991-92 (Rs.1571.34 lakh) and 1992-93 (Rs.3253.13 lakh) in the assessments concluded in August 1994 and July 1994 respectively leaving no amount for further adjustment. The mistake resulted in incorrect set off of loss of Rs.4824.47 lakh involving potential tax effect of Rs.2496.66 lakh.

The Ministry have accepted the audit observation.

(ii) In Delhi I charge, the assessment of a company for the assessment year 1995-96 was completed in a summary manner in December 1995 at a loss of Rs.44829 lakh including loss relating to earlier years. Audit scrutiny revealed that the assessing officer determined the losses relating to earlier years as Rs.38165 lakh instead of Rs.35279 lakh as returned by the assessee

company. The mistake resulted in excess determination and carry forward of loss by Rs.2886 lakh involving potential tax effect of Rs.1328 lakh.

The Ministry have accepted the audit observation.

(iii) In Central I , Delhi charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 at income of Rs.102.59 lakh after setting off unabsorbed losses of Rs.229.96 lakh pertaining to assessment year 1989-90. Audit scrutiny revealed that there were no unabsorbed losses for previous year pending for adjustment as the same had already been set off up to the assessment year 1992-93. It was further observed from the assessment record for the assessment year 1992-93 that the assessing officer adjusted/set off brought forward loss of Rs.459.92 lakh instead of Rs.385.92 lakh thereby resulting in excess set off of loss amounting to Rs.74 lakh. The mistakes resulted in excess set off of losses aggregating Rs.303.96 lakh leading to underassessment of income by an identical amount with consequent short levy of tax of Rs.383.32 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iv) Few more cases of incorrect carry forward and set off of losses are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	Tamil Nadu III, Chennai	1994-95 February 1996	143(3)	As against the correct amount of loss of Rs.39.11 lakh to be carried forward , Rs.332.56 lakh was erroneously allowed to be carried forward for set off.	168.73 (P)
2.	WB VI, Calcutta	1992-93 March 1995	143(3)	Loss of Rs.452.34 lakh was allowed to be carried forward for set off as against the correct amount of Rs.266.37 lakh.	96.24 (P)
3.	Delhi III	1993-94 March 1996	143(3)	As against Rs.67.47 lakh of unabsorbed losses of previous years, Rs.175.36 lakh was allowed set off leading to underassessment of income by Rs.107.89 lakh.	90.69

4.	City II, Mumbai	1991-92 March 1994 (revised in August 1994)	143(3)	Instead of limiting the unabsorbed loss/depreciation brought forward from previous years to the amount of business income of Rs.389.53 lakh, the same was allowed set off against the short term capital gain also. This resulted in underassessment of income by Rs.90.36 lakh.	88.32
5.	Tamil Nadu I, Chennai	1992-93 December 1994 1993-94 February 1996	143(3) 143(3)	Eventhough Rs.321.65 lakh were already set off in the earlier assessment years leaving a balance of Rs.25.45 lakh, losses aggregating Rs.129.22 lakh were erroneously allowed set off in the two years.	81.28
6.	City III, Mumbai	1992-93 February 1995	143(3)	Set off of Rs.78.92 lakh was allowed towards brought forward unabsorbed losses eventhough no such losses were available to be set off.	69.43
7.	City III, Mumbai	1988-89 1989-90 March 1992 (revised in Jaunary 1995, May 1995)	143(3)	As against correct amount of losses aggregating Rs.1867.93 lakh to be set off, Rs.1931.54 lakh was allowed set off. Further, the loss was irregularly set off in 1988-89 against income from other sources and also deduction towards donation was not correctly restricted. These mistakes resulted in aggregating underassessment of income by Rs.63.61 lakh.	63.11
8.	Tamil Nadu I, Chennai	1993-94 March 1996	143(3)	Against the correct amount of Rs.968.42 lakh, an amount of Rs.1083.55 lakh was allowed set off towards brought forward unabsorbed losses.	59.58 (P)
9.	WB XI, Calcutta	1992-93 March 1994	143(1)	Eventhough the unabsorbed business loss of earlier year was adjusted in the accounts of the relevant year as prior period expenses due to change in the method of accounting with retrospective effect from 1983-84, set off of Rs.82.97 lakh was allowed towards brought	1.99, 46.26 (P), 9.25 (AT)

				forward unabsorbed loss leading to underassessment of income by Rs.2.53 lakh and excess carry forward of loss of Rs.80.45 lakh.	
10.	**Kerala**	**1992-93 January 1995**	**143(3)**	**As against correct amount of Rs.149.09 lakh allowable, Rs.187.76 lakh was allowed set off towards unabsorbed losses brought forward from earlier years.**	**34.27**
11.	**Gujarat Central, Ahmedabad**	**1992-93 March 1995 1993-94 March 1996**	**143(3) 143(3)**	**Against correct amount of unabsorbed depreciation of Rs.21.19 lakh set off of Rs.54.70 lakh was allowed.**	**33.14**
12.	**Bhopal, Madhya Pradesh**	**1993-94 February 1996**	**143(3)**	**Rs.87.64 lakh was allowed set off as against the correct amount of Rs.54.64 lakh.**	**32.26**

The Ministry have accepted the audit observations at Sl.Nos.1,3,4,5,7 to 11.Their response to the remaining cases has not been received.

Incorrect carry forward of losses

4.21.2 Under the Income Tax Act, 1961, as applicable from the assessment year 1989-90, where, as a result of an order of scrutiny assessment or best judgment assessment or revision, rectification or on settlement relating to any earlier assessment year and passed subsequent to the filing of the return of income processed under the summary assessment scheme for any subsequent year, there is any variation in the carry forward of loss, deduction, allowance or relief claimed in the return and as a result of that if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable and such intimation shall be deemed to be a notice of demand and all the provisions of the Act shall apply accordingly and if a refund is due, it shall be granted to the assessee. In case of loss, omission to rectify the carry forward of loss figures has the inherent risk, of the incorrect carry forward figures remaining undetected and unrectified.

(i) In West Bengal III, Calcutta charge, in the assessment of a nationalised banking company for the assessment year 1994-95, completed in a summary manner in November 1995, loss was determined at Rs.80271 lakh including Rs.60023 lakh pertaining to the assessment year 1993-94 and the loss was allowed to be carried forward for set off against future profits. Audit scrutiny revealed that in the scrutiny assessment for the assessment year 1993-94 made subsequently in March

1996, loss was determined at Rs.8817 lakh. Since the scrutiny assessment for the assessment year 1993-94 was completed after the date of filing of return of income for the assessment year 1994-95 in November 1994 the order allowing carry forward of loss of Rs.60023 lakh processed as per return for the assessment year 1994-95 was required to be revised to withdraw excess carry forward of loss and fresh intimation sent under the provisions of the Act. Omission to do so resulted in excess carry forward of loss by Rs.51206 lakh involving a potential tax effect of Rs.26499 lakh.

The Ministry have not accepted the audit observation on the ground that the assessments were completed in a summary manner. The reply is not tenable as the revision of summary assessments of subsequent assessment years was consequential action of scrutiny assessment of an earlier assessment year and hence a case of rectification of mistake apparent from records covered under section 154. Further, section 143(1)(b) provides for an intimation to be sent to the assessee if there is any variation in carried forward loss, deduction, allowance and relief in such circumstances.

(ii) In West Bengal I, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed in a summary manner in October 1995 determining total income of Rs.346.51 lakh after allowing set off of carried forward loss of Rs.635.36 lakh pertaining to earlier assessment year. Audit scrutiny revealed that the assessment for the assessment year 1993-94 was subsequently completed after scrutiny in March 1996 and loss allowed to be carried forward was reduced to Rs.104.05 lakh. Accordingly assessment for the assessment year 1994-95 was required to be revised allowing set off of loss of Rs.104.05 lakh and a revised intimation required to be issued on the demand payable. Omission to do so resulted in underassessment of income by Rs.531.31 lakh involving short levy of tax of Rs.379.44 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that the assessments were completed in a summary manner. The reply is not tenable as the revision of summary assessments of subsequent assessment years was consequential action of scrutiny assessment of an earlier assessment year and hence a case of rectification of mistake apparent from records covered under section 154. Further, section 143(1)(b) provides for an intimation to be sent to the assessee if there is any variation in carried forward loss, deduction, allowance and relief in such circumstances.

(iii) In Karnataka I, Bangalore charge, the assessment of a company for the assessment year 1994-95 was completed in January 1995 in a summary manner allowing set off of unabsorbed depreciation and investment allowance aggregating Rs.148.01 lakh pertaining to assessment years 1992-93 and 1993-94. Audit scrutiny revealed that assessments for the assessment years 1992-93 and 1993-94 were completed after scrutiny in December 1994 and January 1996 respectively pursuant to which there were no unabsorbed losses remaining to be set off. Consequently, assessment for the year 1994-95 was required to be revised and omission to do so resulted in underassessment of income by Rs.148.01 lakh involving short levy of tax of Rs.97.66 lakh (including interest).

The Ministry have accepted the audit observation.

Few more cases are given below:

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistakes	Tax effect (Rs.in lakh)
1.	WB V, Calcutta	1994-95 November 1995	143(1)	The assessment order was not revised eventhough the set off amount of unabsorbed loss of Rs.323.48 lakh allowed was reduced to Rs.151.13 lakh due to completion of scrutiny assessment of earlier year.	89.19 (P)
2.	Bhopal, Madhya Pradesh	1992-93 February 1994	143(1)	Eventhough the carry forward loss was reduced to nil due to best judgment assessment of earlier year, intimation of summary assessment was not revised for 1992-93 resulting in incorrect carry forward of loss by Rs.145.60 lakh.	83.72 (P)
3.	WB I, Calcutta	1994-95 October 1995	143(1)	Eventhough carried forward unabsorbed investment allowance of earlier year 1993-94 was determined at Rs.104.05 lakh in the scrutiny assessment, the summary assessment for	18.58

				1994-95 was not revised reducing the relief in respect of newly established industrial undertaking taking into account the above. This resulted in underassessment of income of Rs.26.01 lakh.	

The replies of the Ministry to the audit observations have not been received except for serial number 1 where the Ministry have not accepted the audit observation on the ground that the assessments were completed in a summary manner. The reply is not tenable as the revision of summary assessments of subsequent assessment years was consequential action of scrutiny assessment of an earlier assessment year and hence a case of rectification of mistake apparent from records covered under section 154. Further, section 143(1)(b) provides for an intimation to be sent to the assessee if there is any variation in carried forward loss, deduction, allowance and relief in such circumstances.

Incorrect set off of capital loss

4.21.3 Under the Income Tax Act, 1961, with effect from 1 April 1992, capital loss will be set off only against income under capital gain and not against any other head of income in the same assessment year.

(i) In City III, Mumbai Charge, the assessment of a non-resident banking company for the assessment year 1992-93 was completed after scrutiny in January 1995. Audit scrutiny revealed that during the previous year relevant to assessment year 1992-93, the company had incurred short term capital loss of Rs.236.07 lakh on account of loss on sale of investments which was allowed to be set off against business income of the assessee. The incorrect set off resulted in underassessment of income by Rs.236.07 lakh with consequent short levy of tax of Rs.257.78 lakh (including interest)

The reply of the Ministry to the audit observation has not been received.

(ii) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in March 1996 at a total income of Rs.276.94 lakh. Audit scrutiny revealed that the assessee derived income of Rs.181.02 lakh by investing in a fund placed with a scheduled bank under its Portfolio Management Scheme and showed the above income as speculation profit in its computation of income. The assessing officer, while completing the assessment, allowed

to set off speculation loss of Rs.140.61 lakh carried forward from assessment year 1992-93 against the speculation profit of Rs.181.02 lakh. Audit scrutiny of the assessment records for the assessment year 1992-93 revealed that the assessee company suffered loss of Rs.140.61 lakh on purchase and sale of units of Unit Trust of India. The assessing officer computed the aforesaid loss as short term capital loss and allowed it to be carried forward for future set off. As the loss was short term capital loss and assessed and allowed to be carried forward as such, terming it as `speculation loss in assessment year 1993-94 was irregular and also, the same cannot be set off against income under any head except capital gains. The irregular set off thus resulted in underassessment of income by Rs.98.42 lakh involving short levy of tax of Rs.50.93 lakh for the assessment year 1993-94, after considering the short term capital gain of Rs.42.19 lakh against which the short term capital loss could be set off.

The Ministry have accepted the audit observation.

(iii) In North East Region, Shillong charge, the assessment of a widely held company for the assessment year 1995-96 was completed in a summary manner in March 1996 determining Nil income as returned by the assessee. Audit scrutiny revealed that the assessee in computing income from profits and gains of business, deducted Rs.121.36 lakh being long term capital loss on dealing in shares. However, the mistake in set off of long term capital loss being apparent from records was not added back in assessment as prescribed adjustment. Omission to do so resulted in underassessment of income by Rs.38.10 lakh (after setting off of past losses of Rs.7.92 lakh and allowing further deduction of Rs.75.34 lakh for dividend income) with consequent short levy of tax of Rs.28.69 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In Delhi V charge, the assessment of a widely held company for the assessment year 1993-94 was completed after scrutiny in February 1996 at an income of Rs.255.67 lakh. Audit scrutiny revealed that assessee company had suffered loss on sale of investments amounting to Rs.18.30 lakh, under the head "capital gains". Instead of carrying it forward to the next assessment year for set off against further capital gains, it was incorrectly set off against the business income. The mistake resulted in underassessment of business income by Rs.18.30 lakh involving short levy of tax of Rs.16.10 lakh (including interest).

The Ministry have accepted the audit observation.

Mistake in assessment while giving effect to appellate orders

4.22 Under the Income Tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and latter shall comply with the direction given in the appellate order. Underassessment of tax of substantial amounts and over charge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Reports of the Comptroller and Auditor General of India suggesting the need for close supervision and control. Despite this and issue of repeated instructions by the Government, such mistakes continue to occur suggesting the need for close supervision and control.

(i) In Baroda, Gujarat charge, the assessment of a company for the assessment year 1990-91 was completed in March 1993 after scrutiny. Interest of Rs.7979.85 lakh on debenture was treated as capital in nature and depreciation and investment allowance aggregating Rs.2296.20 lakh was allowed by the assessing officer. On appeal, the Commissioner of Income Tax (A) allowed the expenditure as revenue expenditure. Audit scrutiny revealed that depreciation and investment allowance allowed was not withdrawn. The omission resulted in excess computation of loss of Rs.2296.20 lakh involving potential tax effect of Rs.1239.94 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Tamil Nadu I, Chennai charge, the assessment of an insurance company for the assessment year 1989-90 was revised in July 1992 to give effect to appellate orders. Audit scrutiny revealed that a sum of Rs.71.97 lakh originally disallowed towards amount written off in respect of depreciation on investment was allowed as relief given by the appellate authority. Since there being no specific direction for deletion of the amount was given in the appellate orders, the relief allowed was incorrect. The incorrect deduction resulted in underassessment of income by Rs.71.97 lakh with consequent short levy of tax of Rs.37.78 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In Delhi I charge, the assessment of a Government undertaking for the assessment year 1993-94 was completed after scrutiny in February 1996 at taxable income of Rs.10,667.39 lakh after allowing deduction of Rs.72.28 lakh towards departmental charges recoverable from clients on the plea that the said income had already been taxed in the preceding

assessment year 1992-93. Audit scrutiny revealed that the assessment of the preceding year 1992-93 was revised in June 1996 to give effect to appellate order giving relief to the assessee amounting to Rs.89.32 lakh on account of departmental charges. Keeping in view of the above appeal effect given and revision of the assessment for the preceding assessment year 1992-93 accordingly, the assessment for the assessment year 1993-94 should have been revised to withdraw the deduction of Rs.72.28 lakh allowed. Omission to do so resulted in underassessment of income by Rs.72.28 lakh with consequent short levy of tax of Rs.37.41 lakh.

The Ministry have accepted the audit observation.

(iv) In Patna, Bihar charge, the assessment of a state owned financial corporation for the assessment year 1986-87 originally completed after scrutiny in March 1992 was revised in March 1995 to give effect to orders of an appellate authority disallowing interest on sticky loans added by the assessing officer on accrual basis. Audit scrutiny revealed that in the original assessment, accrued interest of Rs.169 lakh was added back to the total income of the assessee company and the amount of Rs.27.84 lakh realised during the relevant accounting year in respect of accrued interest on sticky loans and offered for taxation by the company was deducted from the total income. However, while giving appeal effect, the addition of Rs.169 lakh was deleted by the assessing officer but the deduction of Rs.27.84 lakh allowed in the original assessment was, not withdrawn. Thus, the interest income on sticky loans amounting to Rs.27.84 lakh escaped assessment with consequent short levy of tax of Rs.14.62 lakh.

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deductions under Chapter VIA

4.23 Under the provisions of Chapter VIA of the Income Tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. Gross total income has been defined in the Act as the total income computed in accordance with the provisions of the Act before making the deductions under Chapter VIA. Where the set off of unabsorbed loss, depreciation, investment allowance etc. of earlier years results in reducing the total income to nil' or loss, no deduction under Chapter VIA is admissible.

(i) In West Bengal V, Calcutta charge, the assessment of a widely held company for the assessment year 1995-96 originally assessed in a summary manner in March 1996 was subsequently rectified in March 1996 determining a loss of Rs.4034.99 lakh which was allowed to be carried forward to be set off against future profits. Audit scrutiny revealed that in computing the aforesaid loss, the assessing officer allowed deductions aggregating Rs.1904.04 lakh under Chapter VIA as claimed by the assessee. As the gross total income of the assessee before allowing the above deduction under Chapter VIA worked out to a negative figure of Rs.2130.95 lakh, the assessee was not eligible for the deduction under Chapter VIA and the above information was available in the return and accompanying accounts and documents, the deductions should have been disallowed. Omission to do so resulted in excess computation and carry forward of loss of Rs.1904.04 lakh involving a potential tax effect of Rs.875.86 lakh, besides non levy of additional income tax of Rs.175.17 lakh.

The Ministry have accepted the audit observation.

(ii) In West Bengal IV, Calcutta charge, the assessment of a widely held company for the assessment years 1991-92 to 1993-94 were completed after scrutiny between March 1994 and July 1995 at an aggregate income of Rs.4397.49 lakh after adjustment of relevant year's depreciation and allowing therefrom deductions aggregating Rs.1759.80 lakh under the provisions of Chapter VI A. Audit scrutiny revealed that after set off of brought forward unabsorbed depreciation and unabsorbed investment allowance of Rs.4885.67 lakh of earlier year, no income would have been left in the three assessment years 1991-92 to 1993-94 for allowing deductions under Chapter VIA. The incorrect allowance of deduction, thus resulted in underassessment of income/excess carry forward of loss aggregating Rs.1759.80 lakh involving potential tax effect of Rs.910.70 lakh.

The Ministry have accepted the audit observation.

(iii) In Meerut, Uttar Pradesh charge, the assessment of a company for the assessment year 1994-95 was completed in summary manner in August 1995 determining a loss of Rs.30,434 lakh, interalia, allowing deduction of Rs.104.35 lakh under Chapter VIA and the loss was allowed to be carried forward. Audit scrutiny revealed that after setting off the loss of earlier years, the gross total income worked out to a loss and as such the deductions under Chapter VIA were prima facie

inadmissible. The incorrect allowance resulted in excess carry forward of loss to the extent of Rs.104.35 lakh involving potential tax effect of Rs.54 lakh, besides non-levy of additional income tax of Rs.10.80 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1994-95 was completed in a summary manner in October 1995 at a `nil' income after allowing deduction of Rs.179.24 lakh under Chapter VIA. Audit scrutiny revealed that the gross total income included long term capital gains of Rs.34.03 lakh and as such as per provisions of the Act, the gross total income would be Rs.145.21 lakh after adjustment of the capital gains and the allowable deduction under Chapter VIA would be Rs.145.21 lakh only. As it was apparent from the records accompanying the return of income, the deduction under Chapter VIA was required to have been adjusted under the prescribed adjustment as envisaged in the Act and capital gain of Rs.34.03 lakh should have been brought to tax. Omission to do so resulted in underassessment of income by Rs.34.03 lakh with consequent short levy of tax of Rs.21.87 lakh (including additional income tax and interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect deduction in respect of profits and gains from newly established industrial undertaking in backward areas.

4.24 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from newly established industrial undertaking in a backward area, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to twenty percent of such profits and gains. The Act further states that nothing contained in the said provision shall apply in relation to any undertaking engaged in mining.

In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in February 1995, allowing a deduction of Rs.35.05 lakh towards profits and gains from newly established industrial undertaking in backward areas. Audit scrutiny revealed that the assessee company did not fulfil requisite conditions for grant of such claim and the assessing officer had disallowed such claim in the assessment for the earlier assessment year 1991-92. Further, since the company was engaged in the business of mining activity, the above provisions were not applicable and it was not entitled to the deduction.

The incorrect allowance of deduction of Rs.35.05 lakh resulted in short levy of tax of Rs.30.83 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deductions in respect of profits and gains from newly established small scale industrial undertaking in certain areas.

4.25 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a small scale industrial undertaking a deduction from such profits and gains of an amount equal to twenty percent thereof is allowed. For this purpose, an industrial undertaking is deemed as a small scale industrial undertaking, if the aggregate value of the machinery and plant installed for the purpose of the business does not exceed Rs.35 lakh as on the last day of the previous year and the value of any machinery or plant shall be the actual cost thereof to the assessee.

(i) In Ahmedabad I, Gujarat charge, in the assessments of a closely held company for the assessment years 1991-92 and 1992-93 completed in a summary manner in June 1992 and March 1993 respectively, deductions of Rs.15.25 lakh and Rs.11.50 lakh were allowed in respect of the profits from newly established industrial undertaking treating the company as a small scale industrial undertaking adopting the value of plant and machinery at Rs.34.79 lakh as returned. Audit scrutiny revealed that the assessee did not include in the cost of plant and machinery the value of DMA Cylinders worth Rs.3.61 lakh which were purchased in the relevant previous years on which depreciation at the rate of 100 percent was allowed. Considering the value of the cylinders, the cost of plant and machinery on the last day of the relevant previous years exceeded Rs.35 lakh and as such the company was not a small scale industrial undertaking and hence not entitled to the deduction. The mistake resulted in underassessment of income aggregating Rs.26.75 lakh with consequent short levy of tax of Rs.20.85 lakh (including additional income tax and interest).

The Ministry have not accepted the audit observation stating that the DMA cylinders in question were used as containers and packing materials to bring gas to the assessee's plant and hence did not form part of plant and machinery. The reply is not tenable as cylinders alongwith valves and regulators form part of plant and machinery in terms of item G(v) of depreciation rates prescribed vide Rule 5 of Income Tax Rules, 1962. Accordingly these were included in the block of assets of plant and machinery in the year 1989-90 and 100 percent depreciation was claimed by the assessee and allowed by the assessing officer. The character of

DMA cylinders cannot change in the subsequent assessment years 1991-92 and 1992-93 and what was to be included towards value of plant and machinery was the actual cost and not the written down value as per provisions of section 80HHA. Further, the information regarding purchase of DMA cylinders and allowance of depreciation on the same was available with the returns and accompanying documents and thus the deduction was primafacie inadmissible.

(ii) In West Bengal IV, Calcutta charge, the assessments of a widely held company for the assessment years 1993-94 and 1994-95 were completed after scrutiny and in a summary manner in December 1995 and September 1995 respectively allowing deduction aggregating Rs.21.80 lakh in respect of newly established small scale industrial undertaking. Audit scrutiny of the assessment records revealed that the aggregate value of plant and machinery on the last day of the previous years exceeded Rs.35 lakh and as such, the company was not a small scale industrial undertaking and hence was not entitled to the deduction. The irregular allowance of deduction resulted in underassessment of income of Rs.21.80 lakh with consequent short levy of tax of Rs.16.91 lakh in aggregate (including interest for the two assessment years and additional income tax of Rs.1.21 lakh for the assessment year 1994-95).

The reply of the Ministry to the audit observation has not been received.

Irregular allowance of deduction in respect of profits and gains derived from project outside India

4.26 Under the provisions of the Income Tax Act, 1961, where an assessee being an Indian company or a person other than company, resident in India, derives any profits and gains from the business of execution of a project under any contract executed by the assessee with the Government of a foreign State or any statutory or other public authority or agency in a foreign State or with a foreign enterprise, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to fifty percent of such profits and gains remitted by the assessee into India, in foreign exchange, within a period of six months from the end of relevant previous year.

In Delhi II charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in October 1993 allowing deductions of Rs.53.30 lakh and Rs.1302.25 lakh towards profits and gains derived from project outside India and towards export profits respectively. Audit scrutiny revealed that the assessee had not remitted into India, in foreign exchange, the profits derived by it within six months from the end of the relevant financial year nor any extension was granted by the department. Thus no deduction was allowable to the assessee.

Further, the business profits on which the deduction towards export profits was allowed included a dividend income of Rs.333 lakh which not being business income was not to be taken for the purpose of allowing deduction. After considering the above towards export profits, the allowable deduction would work out to Rs.1272.08 lakh instead of Rs.1302.25 lakh allowed by the department. The two mistakes resulted in underassessment of income aggregating Rs.83.47 lakh with consequent short levy of tax of Rs.44.12 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of relief in respect of export profits

4.27.1 Under the Income Tax Act, 1961, as applicable from the assessment year 1992-93, an assessee being an Indian company or other assessee, resident in India, engaged in the business of export is entitled to a deduction equal to the profits derived from the export of goods or merchandise if the sale proceeds thereof are received in convertible foreign exchange. Where the export out of India is of goods or merchandise manufactured or processed by the assessee and also of trading goods, the profit derived from such export shall be aggregate of the adjusted profits in proportion to the export turnover in relation with the manufacturing/processing of goods and in relation to the trading activity, the amount arrived after deducting the direct and indirect costs of the trading from the export turnover of the activity. The profit so arrived at shall be further increased by ninety percent profit on sale of licenses and export incentives in the ratio of export turnover to total turnover.

(i) In West Bengal III, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in February 1995 and for the assessment year 1994-95 completed in a summary manner in September 1996, interalia, allowing a deduction aggregating Rs.3329 lakh toward export profits on the basis of Tax Audit Report. Audit scrutiny revealed that while allowing the above deduction, the assessing officer had taken into consideration only profits of Rs.3329 lakh derived from export of manufactured goods but omitted to consider the loss of Rs.7833.32 lakh sustained by the assessee from export of trading goods during the two assessment years. Had the loss, which was apparent from records, been taken into account, the resultant amount would be negative and thus no deduction would be admissible. Omission to consider the loss from export of trading goods resulted in underassessment of income by Rs.3329 lakh involving tax effect of Rs.1955.84 lakh in aggregate (including additional income tax of Rs.233.08 lakh for the assessment year 1994-95).

The reply of the Ministry to the audit observation has not been received.

(ii) In Pune, Maharashtra charge, the assessment of a company for the assessment year 1993-94 originally completed after scrutiny in March 1996 was rectified in June 1996 allowing a deduction of Rs.102.74 lakh in respect of export turnover. Audit scrutiny revealed that while computing the above deduction, the assessing officer had taken into consideration only the profit of Rs.102.74 lakh derived from manufactured goods but omitted to consider the loss of Rs.335.33 lakh sustained by the assessee on trading goods. Had the loss, which was apparent from records been taken into account, the resultant amount would be negative and thus no deduction would be admissible. Omission to consider the loss from export of trading goods resulted in underassessment of income of Rs.102.74 lakh with consequent short levy of tax of Rs.59.07 lakh.

The Ministry have accepted the audit observation.

(iii) In City I, Mumbai charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in December 1994 allowing a deduction of Rs.470.22 lakh towards export profits. Audit scrutiny revealed that the assessing officer had erroneously applied the provisions applicable upto assessment year 1991-92 instead of those applicable for the assessment year 1992-93. The deduction admissible as per the provisions applicable to assessment year 1992-93 would work out to Rs.423.70 lakh as against Rs.470.22 lakh allowed. Omission to apply correct provisions resulted in excess allowance of deduction of Rs.46.52 lakh resulting in underassessment of the like amount involving short levy of tax of Rs.24.03 lakh.

The Ministry have accepted the audit observation.

(iv) In West Bengal II, Calcutta charge, in the assessment of a widely held company engaged in the business of export of processed goods as well as trading goods for the assessment year 1993-94 was completed after scrutiny in March 1996 allowing a deduction of Rs.44.20 lakh in respect of export profit. Audit scrutiny revealed that the assessing officer, while computing the profit in respect of export of own processed goods at Rs.71.39 lakh, had taken into account the entire export turnover of Rs.1271.12 lakh instead of adjusted export turnover of Rs.473.71 lakh. Considering the above, the correct amount of export profit in respect of export of own processed goods would work out to

Rs.26.65 lakh as against Rs.71.39 lakh worked out by the department and the aggregate of the above three items would be a negative figure. As such, the assessee was not entitled to any deduction in respect of export profit. The incorrect allowance of deduction resulted in underassessment of income of Rs.44.20 lakh with consequent short levy of tax of Rs.22.87 lakh.

The reply of the Ministry to the audit observation has not been received.

(v) In Rohtak, Haryana charge, the assessment of a widely held company for the assessment year 1992-93, was completed after scrutiny in December 1994 allowing a deduction of Rs.24.97 lakh towards profit derived from the export of eligible goods. Audit scrutiny revealed that the deduction was not admissible as the profit from the export business was negative i.e. loss. Omission to disallow the deduction, thus, resulted in underassessment of income of Rs.24.97 lakh with consequent short levy of tax of Rs.21.45 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(vi) In Kanpur, Uttar Pradesh charge, the assessments of a company for the assessment years 1994-95 and 1995-96 were completed after scrutiny and in a summary manner respectively in February 1996 allowing a deduction aggregating Rs.174.53 lakh towards relief on export turnover. Audit scrutiny revealed that as per the report of the accountant and other documents accompanying the returns, the admissible deduction worked out to Rs.137.80 lakh. Omission to compute the admissible deduction correctly, resulted in excess allowance of deduction of Rs.36.73 lakh and underassessment of income by a like amount involving short levy of tax of Rs.20.02 lakh (including additional income tax of Rs.2.70 lakh for the assessment year 1995-96).

The reply of the Ministry to the audit observation has not been received.

(vii) In Coimbatore, Tamil Nadu charge, the assessment of a closely held company for the assessment year 1992-93 was completed in a summary manner in February 1993 determining `nil' income after allowing deduction of Rs.20.62 lakh for export profits. Audit scrutiny revealed that the adjusted profits on export of manufactured goods worked out to Rs.(-) 34.27 lakh which was adopted incorrectly as `nil' in the computation of the deduction. Had the correct figure of Rs.(-) 34.27 lakh been adopted, the aggregate of export profits would have been a

negative figure and the deduction to be allowed for export profits would be `nil' as against Rs.20.62 lakh actually allowed. This mistake resulted in incorrect allowance of deduction of Rs.20.62 lakh resulting in underassessment of income by a like amount with consequent short levy of tax of Rs.16.84 lakh (including interest and additional income tax).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of relief in respect of export turnover from tea business

4.27.2 In the case of tax payers engaged in the business of growing and manufacturing tea, for computing the income chargeable to tax from the sale of tea grown and manufactured in India, the composite income is first determined as if it were income derived from business and forty percent of such income is deemed to be the income liable to tax. The Central Board of Direct Taxes clarified in May 1991, that in case of tea companies, export incentive deduction should be allowed after the income chargeable to tax under the head profits and gains of business or profession has been computed under Rule 8 of the Income Tax Rules, 1962.

In West Bengal VI, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 was completed in a summary manner in March 1994 allowing a deduction of Rs.386.38 lakh in respect of export turnover in the tea division. Audit scrutiny revealed that the proportionate deduction in export turnover was calculated with reference to the total composite income of Rs.1941.17 lakh instead of Rs.776.47 lakh being forty percent of the income liable to income tax. The deduction for export turnover would correctly work out to Rs.258.49 lakh as against Rs.386.38 lakh actually allowed. The mistake resulted in excess allowance of deduction of Rs.127.89 lakh with consequent short levy of tax of Rs.86.70 lakh (including interest and additional income tax).

The reply of the Ministry to the audit observation has not been received.

Incorrect computation of turnover

4.27.3 The Act also provides that the profits of the business shall take into account ninety percent of profits on sale of an import licence, cash assistance against export or duty drawback and any brokerage, commission, interest, rent charges or any other receipt of similar nature. It has been judicially held* that the amount of sales tax and central excise duty collected by a trader in the course of business constituting his trading receipts are liable to be included in total turnover.

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* McDowell and Co.Ltd. Vs. CIT; 154-ITR-148(SC)

(i) In City XII, Mumbai charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in January 1995 allowing a deduction of Rs.545.13 lakh in respect of export profits. Audit scrutiny revealed that central excise duty of Rs.3230.83 lakh was not included in the total turnover of the business. Considering the above, the deduction allowable would work out to Rs.166.13 lakh as against Rs.545.13 lakh allowed. The incorrect allowance of deduction resulted in underassessment of income by Rs.379 lakh with consequent short levy of tax of Rs.329.50 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In City II, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in January 1996 allowing a deduction of Rs.346 lakh towards export profits. Audit scrutiny revealed that while allowing the deduction, the assessing officer has not reduced the profits by Rs.101.58 lakh being 90 percent of the interest income received by the assessee during the relevant previous year. Further, an amount of Rs.429.20 lakh on account of scrap sales and excise refund has not been added to the total turnover. Considering the above, the allowable deduction would work out to Rs.109.48 lakh as against Rs.346 lakh allowed. The excess allowance resulted in underassessment of income by Rs.236.52 lakh with consequent short levy of tax of Rs.176.25 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In West Bengal IV, Calcutta charge, the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in December 1994 allowing a deduction of Rs.78 lakh towards relief on account of export profits. Audit scrutiny revealed that for computation of the above deduction, the assessing officer has incorrectly adopted the unadjusted amounts of export turnover, total turnover and business profits instead of the adjusted amounts thereof. Further, the loss of Rs.79.18 lakh incurred by the assessee in export of trading goods was not considered. Taking into account the above, the allowable deduction would work out to Rs.5 lakh as against Rs.78 lakh allowed by the department. Further, in respect of the assessment year 1993-94 completed in a summary manner in September 1994, a loss of Rs.30.77 lakh incurred by the assessee in export of trading goods has not been

considered while computing the deduction. In addition, an amount of Rs.309.33 lakh being central excise duty collected has not been included and another amount of Rs.35.67 lakh towards sale of import licence has not been reduced from the total turnover. Considering the above, the allowable deduction would work out to Rs.1.41 lakh as against Rs.34.17 lakh allowed by the department. The above omissions resulted in total underassessment of income by Rs.105.76 lakh during the two assessment years with an aggregate short levy of tax of Rs.89.15 lakh (including interest and additional income tax for the assessment year 1993-94).

The reply of the Ministry to the audit observation has not been received.

(iv) In City II, Mumbai charge, the assessment of a company for the assessment year 1991-92 was completed after scrutiny in February 1994 allowing a deduction of Rs.207.89 lakh from the profits retained for export business. Audit scrutiny revealed that while computing the deduction, unabsorbed investment allowance of Rs.349.51 lakh of earlier years was not set off from the profits of the business. Further, an amount of Rs.1708 lakh on account of excise duty and processing charges was not included in the total turnover. After effecting the aforesaid adjustments, the allowable deduction worked out to Rs.118.88 lakh as against Rs.207.89 lakh allowed. The mistakes resulted in underassessment of income by Rs.89.01 lakh with consequent short levy of tax of Rs.69.61 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(v) In City II, Mumbai charge, the assessment of a widely held company for the assessment year 1993-94 was completed in a summary manner in July 1994 allowing a deduction of Rs.323.55 lakh towards export profits. Audit scrutiny revealed that while computing the deduction allowable, the assessee company had not included an amount of Rs.48.79 lakh being sales tax/excise duty collected, in the total turnover of the business. Further, an amount of Rs.134.55 lakh being technical service fees received from foreign company, was not reduced from the profits, eventhough deduction allowable for such income was claimed separately. After considering these prima facie adjustments, the allowable deduction would work out to Rs.243.78 lakh as against Rs.323.55 lakh allowed by the department. The mistake resulted in underassessment of income by Rs.79.77 lakh with consequent short levy of tax of Rs.60.80 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that the observation related to the assessment done in a summary manner without making any adjustments under section 80 HHC of the Income Tax Act. The reply is not tenable as the mistake was apparent from the documents accompanying the return and the observation was based on Supreme Court judgement which becomes a law for all purposes/ assessments whether completed after scrutiny or in a summary manner.

(vi) In Pune, Maharashtra charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in March 1995 after allowing a deduction of Rs.55.11 lakh towards export profits. Audit scrutiny revealed that while computing the above deduction, the assessing officer had taken into consideration only Rs.55.11 lakh being the proportionate export incentives but omitted to consider the loss of Rs.20.67 lakh and Rs. 33.38 lakh in respect of trading and manufactured goods respectively. Had these losses been taken into account, the amount of deduction allowable would be Rs.0.97 lakh as against Rs.55.11 lakh allowed. Failure to consider the losses under trading and manufactured goods resulted in underassessment of income by Rs.54.14 lakh with consequent short levy of tax of Rs.48.18 lakh (including interest).

The Ministry have accepted the audit observation.

(vii) In West Bengal II, Calcutta charge, the assessment for the assessment year 1992-93 of a widely held company engaged in the business of export of the manufactured as well as trading goods was completed after scrutiny in March 1995 on a total income of Rs.2573.29 lakh after allowing deduction of Rs.50.82 lakh towards export profits. Audit scrutiny revealed that the total turnover of Rs.69643.11 lakh of the assessee's income considered for computing the deduction did not include sales tax amounting to Rs.4269.20 lakh which was collected and paid by the assessee and included in total sale value of the goods. Considering the total turnover including the sales tax, the allowable aggregate deduction would work out to Rs.24.74 lakh. Further, for the trading activity of the assessee the adjusted profits as per the formula was a negative figure which was not reduced while determining the 80 HHC benefit. Had this negative figure been taken into account, the resultant figure would be negative rendering the assessee ineligible for deduction towards export turnover. The omissions of not considering sales tax in total turnover and the negative figure under export of trading goods resulted in an incorrect allowance of deduction of Rs.50.82 lakh leading to underassessment of income by an identical amount involving short levy of tax of Rs.45.76 lakh (including interest).

The Ministry have accepted the audit observation.

4.27.4 Under the Income Tax Act, 1961, mineral oil and minerals and ores other than those specified in the twelfth schedule are not eligible for the export incentive deduction from 1 April 1991.

In Karnataka I, Bangalore charge, the assessments of a widely held company for the assessment years 1993-94 to 1995-96 were completed after scrutiny and in a summary manner between March 1995 and January 1996 allowing deductions aggregating Rs.74.90 lakh for export of "calcined petroleum coke". Audit scrutiny revealed that " calcined petroleum coke" is a residue obtained from cracking/distillation of petroleum. Petroleum is a mineral oil and even the Income Tax Act has recognised this definition (Sections 42, 44 BB and 293A of the Act). Further, even under the Central Excise Act, Petroleum Coke whether green coke or calcined coke has not only been classified under the category of residues of mineral oils but has also been defined as residue resulting from the cracking or destructive distillation of petroleum. Therefore, `calcined coke' being a residue of petroleum is therefore a residue of a mineral oil and mineral oils are not eligible for the export incentive deduction. The incorrect allowance of deduction has thus resulted in underassessment of income by Rs.74.90 lakh involving tax effect of Rs.47.79 lakh (including excess refunds during assessment years 1993-94, 1994-95 and interest for assessment year 1995-96).

The Ministry have not accepted the audit observation on the ground that the assessee was not exporting `mineral or mineral oil' but an item other than one which falls under this category as the calcined petroleum coke is obtained by calcination process of raw petroleum coke which is a byproduct of crude oil. The Ministry have further stated that petroleum coke is not a product got by mining but is obtained by processing. The reply, however, is not tenable as it ignores the reasons stated in the para above.

4.27.5 Under the Income Tax Act, 1961, `supporting manufacturer' means a person being an Indian company or a person (other than company) resident in India manufacturing (including processing) goods or merchandise and selling such goods or merchandise to an exporting house or a trading house for the purposes of export.

In Jaipur, Rajasthan charge, the assessment of a company for the assessment year 1992-93 was completed in March 1995 after scrutiny

allowing a deduction of Rs.47.02 lakh towards export profits. Audit scrutiny revealed that out of the total turnover, an amount of Rs.155 lakh did not qualify for the deduction as the assessee purchased cut diamonds from other parties and sold/supplied them to export house without carrying out any manufacturing/processing activity and thus did not qualify to be a supporting manufacturer. Taking into account the above, the admissible deduction would work out to Rs.0.38 lakh as against Rs.47.02 lakh allowed resulting in underassessment of income by Rs.46.64 lakh involving short levy of tax of Rs.46.13 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Mistake in allowance of deduction of profits derived from services provided to foreign tourists

4.28 Under the provisions of the Income Tax Act, 1961, with effect from the assessment year 1989-90, where an assessee being an Indian company or other person resident in India engaged in the business of hotel or of a tour operator approved by the prescribed authority, there shall be allowed in computing the total income of the assessee, a sum equal to the aggregate of 50 percent of the profit derived from services provided to foreign tourists and so much of the amount out of remaining profits derived as such as is debited to profit and loss account and credited to a reserve account to be utilised by the assessee for the purpose of his business under the conditions prescribed in the Act. For this purpose, the profits derived from services provided to foreign tourists shall be the amount which bears to the profits of the business (as computed under the head `profits and gains of business or profession') the same proportion as the receipts in relation to services for foreign tourists received in convertible foreign exchange bears to the total receipts of the business.

In West Bengal III, Calcutta charge, the assessments of a widely held company engaged in business of manufacturing, trading as well as hotel business for the assessment years 1991-92 to 1993-94 were completed after scrutiny and for the assessment year 1994-95 was completed in a summary manner between March 1994 and September 1996, allowing deduction aggregating Rs.5480.97 lakh on account of profit derived from services provided to foreign tourists. Audit scrutiny revealed that as per provisions of the Act, the admissible deduction correctly worked out to Rs.1445.24 lakh only as against Rs.5480.97 lakh allowed by the department. The excess allowance, thus, resulted in underassessment of income by Rs.4035.73 lakh involving tax effect of Rs.2058.43 lakh in aggregate.

The reply of the Ministry to the audit observation has not been received.

Incorrect deduction in respect of profits from new industrial undertaking started functioning after 1 April 1991.

4.29 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a newly established industrial undertaking which goes into production after 1 April 1991, the assessee is entitled to a deduction of 25 percent (30 percent in the case of a company) of such profits provided the industrial undertaking does not manufacture or produce any article or thing specified in the eleventh schedule.

In West Bengal II, Calcutta charge, in the assessment of a widely held company for the assessment year 1992-93 completed after scrutiny in February 1995, a deduction of Rs.20.43 lakh was allowed in respect of one of its units under the above provisions of section 80 IA. Audit scrutiny revealed that as per the assessing officer's observation in respect of assessment year 1991-92, the said unit had in fact started functioning prior to 1 April 1991. Thus, the deduction under section 80 IA was not admissible, as the same is admissible to units which started functioning after 1 April 1991. The incorrect allowance thus resulted in underassessment of income by Rs.20.43 lakh with consequent short levy of tax of Rs.17.97 lakh (including interest).

The Ministry have accepted the audit observation.

Irregular grant of relief in respect of profits and gains from newly established industrial undertaking before 1 April 1981

4.30 Under the Income Tax Act, 1961, prior to its amendment by Finance Act, 1980, with effect from assessment year 1981-82, where the gross total income of an assessee included any profits and gains derived from a newly established industrial undertaking which went into production before 1 April 1981, the assessee was entitled to tax relief in respect of such profits and gains upto 6 percent per annum of the capital employed in the undertaking, in the assessment year in which the undertaking began to manufacture or produce articles and in each of the four succeeding assessment years. Where, however, such profits and gains fall short of the relevant amount of the capital employed during the previous year, the amount of such shortfall or deficiency was to be carried forward and set off against future profits upto the seventh assessment year reckoned from the end of the initial assessment year. Further, where the net result of the computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any other head of the relevant year, so much of the loss as had not been set off shall be carried forward to the following assessment year to be set off against the profits and gains of business or profession of those years.

In Visakhapatnam, Andhra Pradesh charge, the assessment of a closely held company for the assessment year 1993-94 was completed after scrutiny in March 1996 at `nil' income after set off of Rs.12.71 lakh towards unabsorbed investment allowance and depreciation and Rs.4.26 lakh towards deduction under section 80 J relating to assessment year 1989-90. Audit scrutiny revealed that the assessee company commenced production after 1 April 1981 and hence was not entitled to the deduction under section 80 J. Further, excess set off was allowed in respect of unabsorbed depreciation and investment allowance. The mistakes resulted in underassessment of income by Rs.10.82 lakh with consequent short levy of tax of Rs.10.70 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of inter-corporate dividends

4.31.1 Under the provisions of the Income Tax Act, 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from other domestic company, there shall be allowed in computing the total income, a deduction of an amount equal to so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the former company on or before the due date. The Act further provides that deduction on account of inter-corporate dividends is to be allowed with reference to the net dividend income as computed in accordance with the provisions of the Act and not on the gross amount of dividends.

(i) In North East Region, Shillong charge, the assessment of a widely held company for the assessment years 1991-92 and 1993-94 were completed after scrutiny in March 1994 and March 1996 allowing deduction of Rs.448 lakh in each year, to the extent of dividend declared by the company. Audit scrutiny of the printed accounts as well as discussion in the assessment orders for the assessment years 1990-91 to 1993-94 revealed that the amount of loan of Rs.11851.88 lakh obtained in November 1989 for augmenting working capital was not utilised for the said purpose but an amount of Rs.3442.93 lakh stood invested in Units and balance in tax free Bonds till the assessment year 1993-94. The proportionate interest payment on loan so invested in units would be Rs.304.73 lakh and Rs.485.04 lakh in the aforesaid years and thus, the net dividend income allowable for deduction after deducting the interest expenditure from out of the investments of Rs.450 lakh and Rs.625 lakh would be Rs.145.30 lakh and Rs.139.96 lakh in the assessment years 1991-92 and 1993-94 respectively. The omission to determine net

dividend income resulted in excess allowance of deduction of Rs.302.70 lakh and Rs.308.04 lakh in the aforesaid assessment years and consequent underassessment of income by Rs.610.74 lakh in aggregate involving short levy of tax of Rs.441.87 lakh (including interest for short payment of advance tax in 1993-94 and excess payment of interest by the Government in 1991-92).

The reply of the Ministry to the audit observation has not been received.

(ii) In City I, Mumbai charge, the assessment of a company for the assessment year 1992-93 originally completed after scrutiny in January 1995 was subsequently rectified in March 1995 allowing deduction for dividend distributed amounting to Rs.171.11 lakh. Audit scrutiny of the assessment records revealed that out of total dividend which was to be distributed, an amount of Rs.147.95 lakh was not available for distribution pending realisation of portion of sales value not realised. In view of this, the amount allowable for deduction would be Rs.68.74 lakh as against Rs.171.11 lakh allowed by the department. The omission to restrict the allowance to Rs.68.74 lakh resulted in underassessment of income by Rs.102.37 lakh involving short levy of tax of Rs.89 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

4.31.2 Under the provisions of Income Tax Act, 1961, in the case of a domestic company, being a scheduled bank or a public financial institution or a State financial corporation or a company registered under Section 25 of the Companies Act, where gross total income includes any income by way of dividends from another domestic company there shall be allowed in computing the total income a deduction of an amount equal to sixty percent of the income by way of dividends from another domestic company.

In Tamil Nadu I, Chennai charge, the assessments of a nationalised bank for the assessment years 1990-91 and 1993-94 were completed after scrutiny in March 1996 and January 1996 respectively, allowing deductions of Rs.37.03 lakh and Rs.562.04 lakh on account of inter-corporate dividends. Audit scrutiny revealed that instead of limiting the net dividends received to sixty percent, the entire amount of dividend was allowed as deduction. After limiting the dividends to the admissible sixty percent, the allowable deduction would work out only to Rs.380.85 lakh in aggregate. The excess deduction of Rs.218.22 lakh

resulted in underassessment of income by a like amount with consequent short levy of tax of Rs.126.97 lakh (including withdrawal of interest granted on the refund).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of royalties etc. received from foreign enterprises

4.32 Under the provisions of the Income Tax Act, 1961, where the gross total income of an assessee includes any income by way of royalty, commission, fees or any similar payment received by him in convertible foreign exchange from a foreign government enterprises, inter alia, in consideration of technical services to such government or enterprise, a deduction equal to fifty percent of such income is allowed in computing the total income of the assessee. The Board have clarified that the technical services for the purposes of section 80-O should only relate to the productive fields and services such as those relating to management, organisation etc. would not qualify for the purpose.

(i) In City I, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed after scrutiny in February 1996 allowing a deduction of Rs.228.82 lakh towards royalties etc. received from foreign enterprises. Audit scrutiny revealed that the deduction claimed by the assessee was for the income received by him for the courier services rendered to five international locations. As the activity of the assessee which was courier business would not fall within the scope of technical or professional services under the provisions of the Act, the deduction allowed was not proper. The irregular allowance of deduction resulted in underassessment of income by Rs.228.82 lakh with resultant short levy of tax of Rs.131.57 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Delhi I charge, the assessment of a company for the assessment year 1992-93 originally completed in February 1995 was revised in December 1995 and that for the assessment year 1994-95 was completed in a summary manner in June 1995 allowing an aggregate deduction of Rs.65.08 lakh towards consultancy fee received from foreign enterprises. Audit scrutiny revealed that the assessing officer allowed the deduction on gross income of consultancy fee of Rs.130.15 lakh instead of on the net income of Rs.36.29 lakh. The mistake resulted in underassessment of income of Rs.46.93 lakh

with consequent short levy of tax of Rs.28.22 lakh (including additional income tax of Rs. 1.23 lakh for the assessment year 1994-95).

The reply of the Ministry to the audit observation has not been received.

(iii) In City IV, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in September 1995 allowing a deduction of Rs.27.74 lakh in respect of fees, commission etc. from certain foreign enterprises. Audit scrutiny revealed that the assessee derived income mainly by providing services in India to foreign enterprises in terms of an agreement and the services provided as per an agreement included, inter alia, organising the travel mission and meetings in India, promoting product services of foreign enterprises in India, reporting regularly on any information and progress of the concerned projects, and advising the foreign enterprise on suitability of promotional material in India. As the above services were rendered in India, the deduction claimed by the assessee company and allowed by the department was not correct. The incorrect allowance of deduction resulted in underassessment of income by Rs.27.74 lakh involving short levy of tax of Rs.25.52 lakh (including interest).

The Ministry have not accepted the audit observation stating that no detailed examination was possible under section 143(1)(a) and as such the issue raised by Audit could not be verified. The reply is not tenable as the audit observation was based on section 143(3) order and on the basis of information available with the return and the accompanying documents.

Incorrect computation of book profit and deemed income to levy minimum tax

4.33 Under the special provisions of the Income Tax Act, 1961, where the total income computed under the normal provisions of the Act, in the case of a company (other than a company engaged in the business of generation and distribution of electricity) is less than 30 percent of its book profit, the total income of such assessee chargeable to tax shall be deemed to be an amount equal to 30 percent of such book profit. This provision is required to be invoked even in cases where computation of income under normal provisions of the Act results in nil income or loss. For this purpose, book profit means the net profit as shown in the profit and loss account for the relevant previous year prepared in accordance with the provisions of the Companies Act, 1956, subject to certain additions and deductions. Brought forward loss or unabsorbed depreciation whichever is less would be reduced in arriving at the book profit.

(i) In Jabalpur, Madhya Pradesh charge, the assessment of a company, for the assessment year 1990-91, was completed after scrutiny in March 1993 determining the deemed loss of Rs.661.51 lakh under the special provisions of the Act. Audit scrutiny revealed that the assessing officer while working out the deemed loss of Rs.661.51 lakh allowed depreciation of Rs.2906.55 lakh for developing mines which was neither debited to the profit and loss account nor allocated to the concerned block of assets. As per 'accounting policy' followed by the assessee company, the expenditure incurred on developing mines is grouped under capital work-in-progress till the mines are brought to revenue account. Since unabsorbed business loss in the above assessment year was nil, no deduction on account of unabsorbed depreciation was to be allowed for computing the book profit. Thus, book profit worked out to Rs.2245.04 lakh and the deemed income at 30 percent thereof would be Rs.673.51 lakh as against loss of Rs.661.51 lakh assessed by the department. The incorrect computation of book profit resulted in underassessment of income by Rs.673.51 lakh with consequent short levy of tax of Rs.625.55 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Maharashtra charge, the assessment of a banking company for the assessment year 1988-89 was completed after scrutiny in March 1992 at an income of Rs.2757.48 lakh which was subsequently reduced to 'nil' in May 1995 after giving effect to appellate orders and allowing relief and set off of brought forward losses of previous years. Audit scrutiny revealed that the assessee had a book profit of Rs.3666.47 lakh and as such 30 percent thereof should have been brought to tax under the special provisions of the Act. Omission to do so resulted in underassessment of income of Rs.1099.94 lakh involving short levy of tax of Rs.577.47 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In Maharashtra charge, the assessment of a company for the assessment year 1990-91 was completed after scrutiny in December 1990 and subsequently revised in November 1994 and December 1995 at an income of Rs.148.26 lakh as deemed income under the special provisions of the Act. Audit scrutiny revealed that the company had provided depreciation on the 'sum of digits' method instead of the methods allowed as per provisions of the Companies Act. The irregular method

resulted in excess provision of depreciation of Rs.411.42 lakh. Since the book profit is to be computed as per Companies Act, the excess provision of depreciation of Rs.411.42 lakh in the accounts in contravention of Companies Act was required to be added to the profits to arrive at deemed income to levy minimum tax. Omission to do so resulted in underassessment of income by Rs.123.43 lakh involving short levy of tax of Rs.66.65 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In Karnataka II, Bangalore charge, in the assessment of a company for the assessment year 1990-91 completed after scrutiny in March 1994, the taxable income was arrived at `nil' after adjusting brought forward losses of earlier years. Audit scrutiny revealed that the assessee company had an amount of Rs.34.10 lakh as book profit after adjusting the unabsorbed business loss of Rs.9.99 lakh. Failure to apply the special provisions resulted in escapement of income of Rs.10.23 lakh being 30 percent of the above book profit with consequent short levy of tax of Rs.16.65 lakh (including interest).

The Ministry have accepted the audit observation.

(v) In Cochin, Kerala charge, the assessment of a banking company for the assessment year 1989-90 originally completed after scrutiny in March 1992 was revised in February 1996 determining the income at Rs.30.15 lakh under special provisions. Audit scrutiny revealed that though government securities held by the assessee were in the nature of stock in trade, an amount of Rs.72.54 lakh being net profit on revaluation of such securities for the year was not credited to the profit and loss account prepared under the Companies Act, thereby scaling down `book profit' by that extent. Since the securities held by the assessee were treated as stock in trade in its accounts, the profits on their revaluation should have been credited to the profit and loss account. Omission to do so resulted in short computation of deemed income by Rs.21.76 lakh (30 percent of Rs.72.54 lakh) involving a short levy of tax of Rs.14.39 lakh (including interest).

The Ministry have not accepted the audit observation stating that in the case of banking companies, the profit on revaluation of government securities cannot be considered as real profits and that the department ignored both the loss as well as profit on revaluation for the purpose of assessing the profits of the banking companies. The reply is not

acceptable as it is not based on correct facts. Audit scrutiny has revealed that the government securities were treated as `stock in trade' and the assessee's claim that the loss on their revaluation was an allowable deduction was upheld by the CIT(Appeals) for the assessment year 1990-91.

Excess/irregular Refund

4.34 Under the Income Tax Act, 1961, where as a result of any order passed in assessment, appeal, revision or any other proceedings under the Act, refund of any amount becomes due to the assessee, the assessing officer may grant the refund in cash or adjust or set off the refund against outstanding dues of the assessee.

In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1993-94 originally completed in a summary manner in February 1994 was completed after scrutiny in March 1996. Audit scrutiny revealed that while computing the net demand in the scrutiny assessment, the assessing officer omitted to take into account the refund of Rs.86.87 lakh already made to the assessee at the summary assessment stage. The mistake resulted in irregular refund of Rs.86.87 lakh.

The Ministry have accepted the audit observation.

Non-levy/ incorrect levy of interest for delay in filing the return

4.35.1 Under the Income Tax Act, 1961, where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two percent per month or part thereof from 1 April 1989, from the date immediately following the specified due date to the date of filing the return or where no return is furnished to the date of completion of regular assessment on the amount of tax determined on regular assessment as reduced by the advance tax if any, paid and any tax deducted at source.

In City I, Mumbai charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in December 1995 at a total income of Rs.116.62 lakh and an assessed tax of Rs.67.06 lakh. Audit scrutiny revealed that the assessee furnished the return of income on 24 March 1995, though the specified due date for furnishing the return was 31 December 1993. The assessee was, therefore, liable to pay interest of Rs.20.12 lakh for default in furnishing the return of income in time as against the interest of Rs.2.01 lakh which was levied by the department. The mistake resulted in short levy of interest of Rs.18.11 lakh.

The Ministry have accepted the audit observation.

Short/Non-levy of interest for Short payment/ Non payment of advance tax.

4.35.2 Under the Income Tax Act, 1961, where in any financial year, an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part thereof reckoned from 1 April next following such financial year to the date of determination of total income by processing the return of income and where a regular assessment is made, to the date of such regular assessment on the amount equal to the assessed tax or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax.

(i) In West Bengal V, Calcutta charge, the assessments of a widely held company for the assessment years 1990-91 and 1991-92 were completed after scrutiny between March 1993 and March 1994 at a total income of Rs.182.91 lakh determining tax at Rs.22.06 lakh instead of correct amount of Rs.23.10 lakh for assessment year 1990-91 and Rs.65.14 lakh for assessment year 1991-92. Audit scrutiny revealed that the assessee company paid Rs.22.56 lakh by way of advance tax. Since the advance tax paid fell short of ninety percent of the assessed tax, the assessee company was liable to pay interest aggregating Rs.46.71 lakh for 36 months as against Rs.18.32 lakh levied by the department for assessment year 1991-92. These mistakes resulted in non-levy of interest aggregating Rs.29.43 lakh (including short levy of tax of Rs.1.04 lakh).

The Ministry have accepted the audit observation.

(ii) In West Bengal II, Calcutta charge, the assessment of a closely held company for the assessment year 1992-93 was completed after scrutiny in March 1995 at a total income of Rs.50.72 lakh determining tax at Rs.29.17 lakh. Audit scrutiny revealed that the assessee company paid a sum of Rs.74,304 only by way of tax deducted at source. Since the assessee did not pay any advance tax, it was liable to pay interest of Rs.20.47 lakh calculated at the rate of 2 percent per month for 36 months from 1 April 1992 to 31 March 1995 as against Rs.2.05 lakh actually levied by the department. The omission resulted in short levy of interest of Rs.18.42 lakh.

The Ministry have accepted the audit observation.

Non-levy of interest for delay in payment of tax demand

4.35.3 Under the Income Tax Act, 1961, as amended from 1 April 1989, any demand of tax should be paid by an assessee within thirty days (thirty five days prior to assessment year 1989-90) of service of notice of

demand. Failure to do so attracts simple interest at one and one half percent per month or part thereof (fifteen percent per annum prior to assessment year 1989-90) from the date of default till the date of actual payment.

(i) In West Bengal II, Calcutta charge, the assessment of a widely held company for the assessment year 1985-86 originally completed in March 1988 was revised in February 1992 with reduced demand of Rs.492.33 lakh. Audit scrutiny revealed that the original demand notice was served on 29 March 1988 and assessee paid Rs.41.72 lakh on 21 September 1994 by way of adjustment of refund relating to assessment year 1981-82. As the demand was not paid within the permissible period of 35 days from the date of service of demand notice, the assessee company was liable to pay interest of Rs.47.04 lakh which however was not levied.

The Ministry have accepted the audit observation.

(ii) In Jalandhar, Punjab charge, in the assessment of a domestic company for the assessment year 1992-93, a demand of Rs.151.96 lakh was recoverable by 5th April 1995. Audit scrutiny revealed that the assessee company paid Rs.24.02 lakh by way of adjustment of refunds for the assessment years 1991-92 and 1995-96 in January 1996 and further Rs.54.79 lakh was collected in March 1996. As the demand was paid beyond the permissible period of 30 days from the date of service of demand notice, the assessee company was liable to pay interest aggregating Rs.13.46 lakh between the period from April 1995 to March 1996 on the demand of Rs.24.02 lakh and Rs.54.79 lakh respectively which were not levied by the department.

The reply of the Ministry to the audit observation has not been received.

Incorrect payment of interest by government to the assessee-Section 244(A)(1)

4.36 Under the Income Tax Act, 1961, as applicable from assessment year 1989-90 onwards, where any refund is due to an assessee out of any advance tax (including the tax deducted at source), he shall be entitled to receive in addition to the said amount, simple interest thereon at the rate of one percent per month, from 1 October 1991 (one and half per cent upto 30 September 1991), for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted. No interest shall be payable if the amount of refund is less than ten per cent of the tax determined under summary or regular assessment.

(i) In Tamil Nadu II, Chennai charge, a public company filed its return of income for the assessment year 1993-94 on 30 December 1993, the

assessment of which was initially completed in a summary manner in July 1995 at a loss of Rs.98254 lakh. Subsequently, the assessment was completed after scrutiny on the basis of revised return in March 1996 determining a loss of Rs.28130 lakh and refund of TDS amount of Rs.270.20 lakh alongwith interest of Rs.108.08 lakh was made in July 1996. Audit scrutiny revealed that though the company returned huge loss for the current assessment year and that the company had huge unabsorbed losses of earlier years also no refund was made on account of TDS effected at the time of processing of return in July 1995. The return filed in December 1993 within time should have been processed soon after the filing of the return of income and the refund issued so as to avoid payment of interest. Thus the TDS amount of Rs.270.20 lakh was refunded after delay of thirty months of the filing of the return of income. The delay in granting the refund resulted in avoidable payment of interest of Rs.81.06 lakh.

The Ministry have not accepted the audit observation on the ground that there is no statutory provision or instruction to provide for expeditious processing of returns. The Ministry's reply is not acceptable as the observation was based on the CBDT circular No. 549 dated 31 October 1989 which contained clear-cut instruction in this regard.

(ii) In Delhi I charge, the assessment of a company for the assessment year 1993-94 was completed after scrutiny in March 1996 at a total income of Rs.5324.86 lakh and tax payable at Rs.2961.47 lakh. Audit scrutiny revealed that after adjustment of tax deducted at source and advance tax, the assessee was granted refund of Rs.315.62 lakh including interest of Rs.38.76 lakh. Since the amount of refund was less than ten percent of the tax determined in the assessment, no interest on excess amount paid was admissible as per provisions of the Act. The mistake resulted in irregular payment of interest amounting to Rs.38.76 lakh to the assessee.

The Ministry have accepted the audit observation.

(iii) In West Bengal III, Calcutta charge, the assessment of a widely held company for the assessment year 1990-91 originally completed after scrutiny in March 1993 was revised in August 1993. Audit scrutiny revealed that the assessee was allowed interest on refund amounting to Rs.36 lakh. Since the amount of refund was less than ten percent of tax determined in assessment, interest of Rs.36 lakh was not admissible under the provisions of the Act. The mistake thus, resulted in irregular payment of interest of Rs.36 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In Cochin, Kerala charge, the assessment of a widely held company for the assessment year 1989-90 was completed after scrutiny in September 1991 on `no profit no loss' basis as the assessee had failed to furnish audited accounts and audit certificate required under the provisions of the Income Tax Act despite issue of a notice for rectification of defects. Audit scrutiny revealed that the assessee having paid advance tax of Rs.105 lakh was granted a refund of Rs.152.25 lakh inclusive of interest of Rs.47.25 lakh for the period from 1 April 1989 to 30 September 1991. Since the delay beyond the date of filing of return in December 1989 was attributable to the assessee the interest paid for the period from January 1990 to September 1991 was not in order. This resulted in excess grant of interest of Rs.33.08 lakh.

The Ministry have accepted the audit observation.

(v) In Meerut, Uttar Pradesh charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in October 1993. Audit scrutiny revealed that the assessee was entitled to interest on refund amounting to Rs.70.79 lakh as against Rs.53.56 lakh granted by the department. The mistake resulted in short payment of interest of Rs.17.23 lakh.

Non-levy of penalty

4.37 Under the Income Tax Act, 1961, no person shall after 30 June 1984, take or accept from any other person any loan or deposit of Rs.20,000 (Rs.10,000 upto March 1989) or more otherwise than by account payee cheque or bank draft subject to certain exceptions. Similarly, no person shall repay in cash to any person any deposit or deposit with interest if the amount is Rs.10,000 or more. Any person contravening these provisions shall be liable to pay a fine equal to the amount of such loan or deposit accepted or repaid. The Central Board of Direct Taxes have also directed that in cases where the Income Tax Officer does not initiate penalty proceedings, he should record the reasons for not doing so.

In City I, Mumbai charge, the assessment of a company for the assessment year 1994-95 was completed in a summary manner in March 1995. Audit scrutiny of the Tax Audit Report revealed that the assessee company had obtained deposits from two parties aggregating Rs. 23.43 lakh and repaid Rs.15.43 lakh in cash. As such, the assessee company violated the above provisions and was therefore liable for penalty

prescribed under the Act. Omission to levy penalty on the basis of material available along with the return resulted in non-levy of penalty of Rs.38.86 lakh.

The reply of the Ministry to the audit observation has not been received.

Short levy of additional income tax

4.38 Under the Income Tax Act, 1961, as applicable from 1 April 1989 where as a result of adjustments, the returned income of the assessee is increased or loss decreased by any amount, the assessing officer shall increase the amount of tax payable by the assessee by an amount of additional income tax calculated at the rate of twenty per cent of tax payable on such excess amount.

In West Bengal III, Calcutta charge, the assessment of a nationalised bank for the assessment year 1994-95 was completed in November 1995 in a summary manner at a loss of Rs.80270.98 lakh after disallowing loss of Rs.36473.24 lakh at the time of processing the return by way of prescribed adjustments to the returned loss of Rs.116744.22 lakh. Audit scrutiny revealed that though an additional income tax of Rs.3774.98 lakh was required to be levied, the assessing officer levied additional income tax of Rs.3282.59 lakh. The mistake resulted in short levy of additional income tax of Rs.492.39 lakh.

The Ministry have accepted the audit observation.

Omission to deduct and pay tax at source

4.39 Under the Income Tax Act, 1961, if a person responsible for deducting tax at source fails to deduct or after deducting fails to pay to the credit of the Central Government, he will be deemed to be an assessee in default and shall be liable to pay penalty which shall not exceed the arrears of tax. Besides, he shall also be liable to pay simple interest at 15 percent per annum on the amount of such tax from the date on which such tax was deductible to the date on which the tax is actually paid.

In Gujarat I, Ahmedabad charge, the assessment of a company for the assessment year 1992-93 was completed after scrutiny in February 1995. Audit scrutiny revealed that the statutory auditor in the audit report had stated that the assessee had not deducted tax at source (Rs.4.76 lakh) from the interest payment made to two companies, and tax deducted at source amounting to Rs.3.83 lakh relating to the relevant previous year and earlier was not paid to the credit of the Central Government. The assessing officer was required to intimate the default to the I.T.O.(TDS)

for initiating interest/penalty proceedings, which was not done. Failure to do so has resulted in non-levy of penalty and interest aggregating Rs.18.30 lakh.

The reply of the Ministry to the audit observation has not been received.

Omission to revise surtax assessment

4.40 Under the Companies (Profits) Surtax Act, 1964, there was no statutory time limit for completion of surtax assessments. Pursuant to the recommendations of the Public Accounts Committee in Para 6.7 of their 128th Report (Fifth Lok Sabha), the Board issued instructions in October 1974 that surtax assessment proceedings should be initiated alongwith the income tax assessments. The Board further laid down that the surtax assessment should not be kept pending on the ground that the additions made in the income tax assessments were disputed in appeal and the time lag between the date of completion of income tax assessments and surtax assessments should not ordinarily exceed a month, unless there were special reasons justifying the delay.

In Tamil Nadu I, Chennai charge, the surtax assessment of a company for the assessment year 1987-88 originally completed in February 1990 was revised in November 1990. Audit scrutiny revealed that though the income was recomputed in February 1996, the surtax assessment was not revised. Omission to do so has resulted in short levy of surtax of Rs.12.77 lakh.

The Ministry have accepted the audit observation.

Chapter 5

Income Tax

General

5.1 Income Tax collected from persons other than companies is booked under the major head 0021 Taxes on income other than corporation tax'. 77.5 percent of the net proceeds of this tax, except insofar as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States in accordance with the recommendations of the Finance Commission.

Receipts from income tax

5.2 The trend of receipts from income tax during the last five years is shown below:

Year	Total Collection of all Direct Taxes	Amount of Income Tax	Percentage of Income Tax to total collection
	(In crore of rupees)		
1992-93	18,097.29	7,863.49	43.45
1993-94	20,298.24	9,122.62	44.94
1994-95	26,970.88	12,030.12	44.60
1995-96	33,559.28	15,587.17	46.44
1996-97	38,895.08	18,233.99	46.88

Number of assessees

5.3 The number of assessees (other than companies) borne on the books of the Income Tax Department during the last five years was as follows:

As on 31 March	Number of assessees
1993	82,32,350
1994	100,28,974
1995	101,08,012
1996	104,76,940
1997	114,16,315

Status of assessment

5.4 The following table indicates the progress in the completion of assessments and collection of demand under income tax (excluding corporation tax) during the last five years:

Year	No. of assessments				Total demand		
	For disposal	Completed during the year	Pending at the close of the year	Percen-tage of pend-ency to total cases	Demand for collection (In	Collected during the year crore of	Percen-tage of collection rupees)
1992-93	77,28,312	63,51,030	13,77,282	17.82	9,922.87	7,863.49	79.24
1993-94	85,10,569	72,42,046	12,68,523	14.90	12,403.40	9,122.62	73.55
1994-95	97,47,151	74,05,828	23,41,323	24.02	24,838.64	12,030.12	48.43
1995-96	103,36,365	81,00,767	22,35,598	21.62	32,123.23	5,587.17	48.52
1996-97	1,17,85,888	102,13,874	15,72,014	13.33	36,386.47	18,233.99	50.11

Results of audit

5.5 A total number of 144 audit observations involving undercharge of tax of Rs.23.76 crore (including potential tax effect of Rs.3.78 crore) and 6 audit observations involving overcharge of tax of Rs.1.31 crore were issued to the Ministry of Finance for comments. The Ministry have accepted the observations in 64 cases involving tax effect of Rs.8.67 crore (including potential tax effect of Rs.3.04 crore in 11 cases). 57 illustrative cases involving tax effect of Rs.20.06 crore (including potential tax effect of Rs.2.68 crore) are given in the following paragraphs. Out of these, the Ministry have so far accepted the observations in 24 cases involving tax effect of Rs.6.58 crore. Of the cases accepted by the Ministry, 1 case involving tax effect of Rs.9 lakh was checked by Internal Audit Wing of the Department but the mistake remained undetected. Replies are awaited in respect of 25 cases.

Avoidable mistakes in computation of income and tax

5.6 Underassessment of tax of substantial amounts and overcharge of tax in a few cases on account of avoidable mistakes attributable to negligence on the part of assessing officers have been mentioned year after year in the Reports of the Comptroller and Auditor General of India. Despite this and issue of instructions by Government from time to time, such mistakes continue to occur suggesting the need for close supervision and control. The various types of mistakes noticed included, inter-alia, incorrect adoption of figures, non-levy of surcharges, mistakes in computation etc. Some important cases of each type noticed in test check are given below:

(I) Overassessment of Income and Tax

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	CityIX Mumbai	1991-92 March 1996	143(3)	Interest for late filing of return and non-payment of advance tax incorrectly calculated.	47.51
2.	Tamil Nadu V Chennai	1987-88 Feb.1992 March 1994	143(3)	Carried forward unabsorbed deduction under section 80J from the earlier assessment year not set off leading to excess demand of tax	34.37
3.	West Bengal IX Calcutta	1988-89 March 1996	143(3)	Incorrect levy of interest for non-furnishing of estimate of advance tax and delay in filing the return resulted in excess demand	24.64
4.	Maharashtra Pune	1993-94 Feb.1996	143(3)	Deduction of Rs.5.79 lakh instead of the correct amount of Rs.50.79 lakh was erroneously made leading to overassessment of income	17.60
5.	Gujarat Surat	1994-95 Jan.1995	143(3)	Refund of income tax was added to the income instead of being deducted	4.07
6.	Gujarat Ahmedabad I	1992-93 March 1995	143(3)	Tax was incorrectly worked out at Rs.26.49 lakh instead of the correct amount of Rs.24.65 lakh	3.12 (including interest)

The Ministry have accepted the audit observations at serial number 1,2,4 and 6. Their response to the remaining cases has not been received.

(II) Underassessment of Income and Tax

1.	Madhya Pradesh Bhopal	1993-94 Feb.1996	143(3)	Disallowances amounting to Rs.46.23 lakh were deducted instead of being added to the net profit leading to underassessment of income of Rs.92.46 lakh	36.20(P)
2.	Mumbai Central I	1993-94 March 1996	143(3)	Non-inclusion of voluntary disclosed income of Rs.26 lakh and adoption of income from other sources less by Rs.1 lakh led to undercharge of tax	24.68 (including interest)
3.	Mumbai Central III	1993-94 March 1996	143(3)	Additions of Rs.27.18 lakh, though proposed, were omitted to be included in the total income	20.95 (including interest)

4.	Karnataka II Bangalore	1993-94 March 1996	143(3)	Surcharge on tax was not levied	14.96 (including interest)
5.	Maharashtra Nagpur	1991-92 March 1996	144	Unexplained investments of Rs.10.70 lakh were not included in the total income	11.08 (including interest)
6.	Bihar Ranchi	1992-93 March 1996	143(3)	Surcharge on tax not levied	8.78 (including interest)
7.	Andhra Pradesh Bangalore Central	1989-90 1990-91 March 1996	143(3)	Non-inclusion of share income and dividend income amounting to Rs.2.89 lakh and short levy of interest led to undercharge of tax	7.96 (including interest)

The Ministry have accepted the audit observations at serial number 1 to 6. Their response to the remaining case has not been received.

Application of incorrect rate of tax

5.7 Under the provisions of the Income Tax Act, 1961, income tax is chargeable for every assessment year in respect of the total income of the previous year, of a person according to the rates prescribed under the relevant Finance Act. Where the total taxable income includes long term capital gains, income tax will be levied on taxable income as reduced by long term capital gains at the rates specified in the annual Finance Act. The long term capital gain (and not short term) will be subjected to flat rate of 30 percent in case of a resident association of persons/body of individuals/trust.

In Maharashtra, Mumbai City Central III charge, the assessment of an assessee trust for the assessment year 1995-96 was completed in a summary manner in January 1996. Audit scrutiny revealed that the total income (long term capital gain) was taxed at twenty percent after allowing basic exemption of Rs.35000 as against the flat rate of thirty percent applicable to long term capital gain for the assessment year 1995-96. The application of incorrect rate of tax was apparent from records and constituted a prima facie adjustment. The mistake resulted in short levy of tax of Rs.15.17 lakh.

The reply of the Ministry to the audit observation has not been received.

Mistake in computation of trust income

5.8 Under the provisions of the Income Tax Act, 1961, the income from property held under trust wholly for charitable or religious purposes is exempt to the extent to which the income is applied for such purposes. It

has been judicially held* that the crux of statutory exemption under section 11(i)(a) of the Income Tax Act, 1961 is not the income earned from the property held under trust, but the actual application of the said income for religious and charitable purposes.

In Karnataka II, Bangalore charge, in the assessment of an association of persons (Public Charitable Trust) for the assessment years 1990-91 and 1991-92, completed after scrutiny in March 1992 and January 1993 respectively rental income aggregating Rs.23.73 lakh was exempted on the ground that the income was set apart for the fulfillment of the objects of the trust. Audit scrutiny revealed that though the object of the trust, interalia, was to establish a Kalyanamanatapa in the city which would be let out free of cost to general public, it had constructed an office-cum-shopping complex on the plot earmarked for the purpose. Further, the rent received was utilised for repayment of loan borrowed for its construction. As the income had not been applied for the charitable purposes it was not eligible for any exemption. Failure to disallow the exemption of rental income resulted in underassessment of income of Rs.23.73 lakh with consequent short levy of tax of Rs.18.34 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of liability

5.9 Under the Income Tax Act, 1961, as applicable from the assessment year 1984-85, certain deductions are allowable only on actual payment for types of expenditure specified under section 43B of the Act. From 1 April 1988, tax or duty actually paid by the assessee on or before due date applicable in his case for furnishing the return of income shall also be allowed as deduction. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are also deductible on actual payment basis. No deduction in respect of contribution to the above funds is, however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the fund.

(i) In Uttar Pradesh, Lucknow charge, the assessment of a Co-operative Sugar Mill for the assessment year 1993-94 was completed after scrutiny in February 1996. Audit scrutiny revealed that the assessing officer omitted to disallow a sum of Rs.32.99 lakh on account of unpaid interest

* Gangabai Charities V CIT (197-ITR-416-SC)

to financial institutions though in his assessment order he had rightly decided to add back the amount but did not give effect to this in the computation. Omission to do so resulted in short computation of income by Rs.32.99 lakh involving tax effect of Rs.9.54 lakh (including interest) and potential tax effect of Rs.7.35 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Uttar Pradesh, Lucknow charge, the assessment of a Co-operative Sugar Mills for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that the assessing officer allowed a deduction of Rs.28.86 lakh on account of liability towards deferred purchase tax but not actually paid during the relevant previous year. Omission to disallow the statutory liability not actually discharged resulted in underassessment of income by Rs.28.86 lakh involving tax effect of Rs.11.27 lakh.

The Ministry have accepted the audit observation.

(iii) In Delhi IX charge, the assessment of a registered firm for the assessment years 1991-92 and 1992-93 were completed after scrutiny in March 1996. Audit scrutiny revealed that assessing officer erroneously allowed deductions aggregating Rs.15 lakh in respect of unpaid liabilities on account of sales tax pertaining to the relevant previous years which were not paid before the respective due dates. Omission to add back the unpaid liability resulted in underassessment of income of Rs.15 lakh involving under charge of tax of Rs.7.93 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect computation of business income

5.10 Under the Income Tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee on maintenance of any residential accommodation in the nature of guest house. The Act further provides that residential accommodation in the nature of a guest house shall include accommodation hired or reserved by the assessee in a hotel for a period exceeding 182 days during the previous year and the expenditure incurred on the maintenance of a guest house shall in a case where the residential accommodation had been hired by the assessee, include also rent paid in respect of such accommodation. It is also provided that where the assessee incurs any expenditure in respect of which payment is made in a sum exceeding Rs.10,000 otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as a deduction.

In Mumbai, City II charge, the assessment of a firm for the assessment year 1994-95 was completed in a summary manner in August 1995. Audit scrutiny revealed that the assessee had incurred an expenditure of Rs.70.77 lakh in hotels booked for a period exceeding 182 days and had also incurred an expenditure of Rs.17.05 lakh towards food stuff, vehicle maintenance and payments to sub-contractors, the payments of which were made in sums exceeding Rs.10,000 otherwise than by a crossed cheque or a crossed bank draft. Since the amounts and their nature were apparent from the records and report of the Chartered Accountant furnished with the return of income, the same should have been disallowed as prima facie adjustment. Omission to do so resulted in excess carry forward of loss of Rs.87.82 lakh involving potential tax effect of Rs.39.34 lakh and non levy of additional income tax of Rs.7.86 lakh.

The reply of the Ministry to the audit observation has not been received.

Mistake in allowance of depreciation

5.11.1 Under the provisions of Income Tax Act, 1961, in computing business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the rate prescribed in Income Tax Rules, 1962, provided these are owned by the assessee and used for the purpose of his business during the relevant previous year.

(i) In Gujarat, Baroda charge, the assessment of a co-operative society for the assessment year 1992-93 was completed after scrutiny in February 1995 allowing depreciation on plant and machinery at the rate of 33.33 percent instead of admissible rate of 25 percent. The mistake resulted in excess carry forward of depreciation of Rs.464 lakh involving potential tax effect of Rs.182 lakh.

The Ministry have accepted the audit observation.

5.11.2 Under the Income Tax Act, 1961, where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof is allowed deduction as depreciation in respect of the previous year in which such machinery or plant is first put to use. It has been judicially held* that for any article or thing, component or object to be termed plant by itself so as to qualify for depreciation allowance at 100 percent these must be used by the assessee as a self contained unit and not as a part of attachment of bigger unit.

* Pathange Poultry Farm V CIT 210 ITR 668 (Karnataka)

In Andhra Pradesh, Visakhapatnam charge, the assessment of a registered firm for the assessment year 1993-94 was completed after scrutiny in February 1996 determining an income of Rs.16.45 lakh. Audit scrutiny revealed that depreciation allowance was allowed at 100 percent on the entire cost of steel shuttering material worth Rs.11.87 lakh acquired during the year, on the ground that each ballie and plank would cost less than Rs.5,000. Since each ballie and plank would not constitute a self contained plant which is necessary to perform the function of holding the ceiling, depreciation should have been allowed at 25 percent as applicable to general items of plant and machinery instead of at 100 percent. The mistake resulted in excess allowance of depreciation of Rs.9.81 lakh with a consequential short demand of Rs.6.03 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect investment allowance

5.12 Under the Income Tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction by way of investment allowance, shall be allowed in the previous year of installation or in the previous year of first usage of a sum equal to 25 percent of the actual cost of the machinery. It has been judicially held[@] that a company engaged in the construction of dams, bridges, roads or canal or similar other construction is not entitled for investment allowance.

In Maharashtra, Pune charge, the assessment of a firm for the assessment year 1993-94 was completed after scrutiny in March 1996 at Nil income after setting off unabsorbed investment allowance of earlier years to the extent of Rs.94.84 lakh. Audit scrutiny revealed that the assessee was engaged in the business of construction and was, therefore, not entitled for investment allowance and for the set off in view of the decision of the Supreme Court. The mistake resulted in underassessment of income of Rs.94.84 lakh involving short levy of tax of Rs.73.08 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Omission to levy tax on capital gains

5.13.1 Under the Income Tax Act, 1961, any profits and gains arising from the transfer of a capital asset are chargeable to tax under the head "Capital gains" and is taxable in the year in which the transfer takes place. The Act further provides that while computing gains in case of depreciable assets, the written down value of the asset at the beginning of the previous year is to be considered as the cost of acquisition of the assets for arriving at the

[@] NC Budhiraja V CIT 204 ITR 412 (SC)

capital gains and such gains are to be treated as short term capital gain. It has been judicially held[$] that in the case of sale of a going concern the balance of surplus is required to be apportioned between gain attributable to long term capital asset and short term capital asset.

(i) In Tamil Nadu, Coimbatore charge, in the assessment of an individual, for the assessment year 1993-94 completed in March 1994 after scrutiny the total income computed, inter alia, included capital gain of Rs.1.60 lakh realised on the sale of land and building. Audit scrutiny revealed that the assessee had transferred his 100 percent export oriented business in granites to a closely held company for Rs.222.90 lakh and was allotted shares for the above consideration. But short term capital gain of Rs.71.43 lakh on the transfer of depreciable assets was not assessed to tax. The above omission resulted in short demand of tax of Rs.41.60 lakh (including interest).

The Ministry have accepted the audit observation.

(ii) In Mumbai, City XII charge, in the assessment of an unregistered firm, engaged in the business of civil construction, engineering and property development, for the assessment year 1988-89 completed in November 1995 after scrutiny, profit from sale of a plot of land of Rs.19.32 lakh was charged to capital gains tax, after allowing a deduction of Rs.19.42 lakh, as offered by the assessee. Audit scrutiny of the earlier years' assessment records revealed that the said plot of land along with standing structure thereon was purchased by the assessee for the purpose of development which was the business of the assessee for all the preceding assessment years. As the assessee was engaged in the business of development, this plot of land should have been treated as stock-in-trade instead of treating it as investment in capital asset. Since the profit arising from the sale of trading assets is chargeable to tax under the head profits and gains of business or profession, it was not entitled to deduction admissible on transfer of long term capital asset. The incorrect computation of income under the head `capital gains' thus resulted in underassessment of income of Rs.19.42 lakh with consequent short levy of tax of Rs.28.93 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that the property was leased out and rental income therefrom was being returned by the assessee. Further, the property was not developed and was sold in its original form. Reply is not tenable as the assessee was all along engaged

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[$] Dasaprakash Bottling Co. V CIT 159 ITR 690 (Madras)

in business of civil construction, engineering and property development and the property in question had been purchased for the purposes of development. The fact that the said property was ultimately not developed does not alter the nature of asset which was held through out its possession with the assessee as business asset, that is, its stock-in-trade and not as capital asset. The income arising from its sale should therefore, have been brought to tax as business income and not as capital gains.

5.13.2 The mode of computation of capital gains in respect of long term capital asset provides for deduction from the consideration received the cost of asset and the cost of any improvement thereto and expenditure incurred wholly and exclusively in connection with its transfer. In the case of an assessee other than a company, a further deduction of Rs.10,000 (Rs.15,000 from the assessment year 1992-93) plus 50 percent of the amount in excess of Rs.10,000/Rs.15,000 is allowed depending upon the class of the asset. The Act also provides for the exemption of long term capital gains if the assessee has, within a period of six months after the date of transfer, invested or deposited the whole or any part of the net consideration in any specified asset. The Act further provides that where the capital asset became the property of the assessee on any distribution of assets on the liquidation of a company, the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

(i) In West Bengal VI, Calcutta charge, the assessment of an individual for the assessment year 1992-93 was completed after scrutiny in December 1994. Audit scrutiny revealed that during the previous year relevant to the assessment year 1992-93 the assessee who had earned a profit of Rs.460.92 lakh on shares sold was erroneously allowed exemption of Rs.178.16 lakh on long term capital gains as claimed on account of investment of Rs.222.88 lakh in Industrial Development Bank of India capital bonds as against the correct amount of Rs.116.57 lakh actually allowable. The incorrect exemption from capital gains resulted in underassessment of income of Rs.24.61 lakh involving short levy of tax of Rs.24.78 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Tamil Nadu II, Chennai charge, the assessment of an individual for the assessment year 1993-94 was completed in a summary manner in November 1995 on the total income of Rs.36.30 lakh. Audit scrutiny

revealed that the assessee while computing the long term capital gains of Rs.36.30 lakh in respect of two plots sold, deducted a sum of Rs.27 lakh towards mortgage loan due to a bank from the total sale consideration of Rs.149.65 lakh. Since this deduction was prima facie inadmissible it should have been disallowed. Omission to do so even though it was apparent from records resulted in underassessment of capital gains by a like amount with consequent short levy of tax of Rs.10.37 lakh (including interest).

The Ministry have not accepted the audit observation on the ground that it is outside the scope of section 143 (1)(a) and that the ITAT Madras bench had held in a case that the mortgage loan was deductible from sale consideration . The reply is not tenable as there is no provision for such deduction under section 48 which provides for computation of capital gains for income tax purposes. As the said deduction was not covered by any provision of the Act it was covered by prima facie adjustment. Further, the decision of appellate tribunal cannot be relied upon for allowance in a summary assessment.

Income not assessed

5.14 In the case of mutual benefit funds or societies, the identity of the source of income with the recepient of such income prevents any question of profit arising as no one can make profit out of oneself. The essence of mutuality lies in the return of what one has contributed to a common fund and unless there is such complete identity between the contributors and the participators in a common fund the principle of mutuality and exemption on that grounds will not be attracted* It has been judicially held** that surplus attributable to receipts of a mutual concern from such members as are entitled to participate in the beneficial interest of the concern is only covered by the principle of mutuality.

In Maharashtra, Mumbai City IX charge, the assessment of an association of persons for the assessment year 1993-94 was completed after scrutiny in October 1995 allowing exemption of receipts by way of entrance fee on the principle of mutuality based on the Commissioner of Income Tax (Appeal)'s order dated 8 December 1993 in the case of the assessee in respect of the assessment years 1988-89 to 1990-91. Audit scrutiny revealed that in the case of the assessee there were two classes of members (i) life/founder/ordinary and supernumerary members who had voting rights and were entitled to share the surplus of the club on its winding up; and (ii) remaining categories of Gymkhana/temporary/corporate and short

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* CIT V Kumbakonam Mutual Benefit Fund Ltd. 53 ITR 241 (SC)

** CIT V Ranchi Club Ltd. 196 ITR 137, affirmed by Supreme Court in the case of CIT V Bankipur Club Ltd. 226 ITR 97

term members who were not eligible to participate and vote in the general meetings and not entitled for the beneficial interest in the property of the club on its winding up. The surplus receipts attributable to second class of members were therefore not covered by the principle of mutuality. Further, since the association of persons has not been notified by the Government for availing the exemption under the provisions of the Act and part of its income was not covered by the principle of mutuality it should have been brought to tax. The omission resulted in underassessment of income of Rs.157.36 lakh with consequent short levy of tax of Rs. 70.50 lakh.

The reply of the Ministry to the audit observation has not been received.

Mistakes in the assessment of firms and partners

5.15.1. Under the provisions of the Income Tax Act, 1961, upto assessment year 1992-93 if the assessment of the firm has not been completed, the share income from the firm is to be included in the assessments of the partners on provisional basis and revised later to include the final share income on completion of the assessment of firm. For this purpose, the assessing officer is required under the instruction issued by the Central Board of Direct Taxes in March 1973 to maintain a register of cases of provisional share income so that these cases are not omitted to be rectified. No revision of assessment of partner can, however, be made under the Act, after the expiry of four years from the end of the financial year in which the final order was passed in the case of the firm.

The Central Board of Direct Taxes issued instructions in November 1981, that where the firm and its partners are assessed in different wards, the assessing officer assessing the firm should communicate the share income of each partner to the officer having jurisdiction to assess such partner immediately after completion of the assessment of the firm and should insist for its acknowledgment by the other assessing officer. The latter was also required to revise the assessments of the partners within three months on receipt of intimation of share income. These instructions were issued to ensure that the correct share incomes are assessed in the hands of the partners promptly and correct tax due to the Government is assessed and demand raised without loss of time.

Pursuant to the recommendations of Public Accounts Committee made in 85th Report (7th Lok Sabha 1981-82), the department issued fresh instructions in April 1983 for proper maintenance of provisional share income registers and adequate checking of the registers by Range-Inspecting Assistant Commissioners and departmental audit parties. Reiterating the earlier instructions, the Board in their instructions issued in

October 1984 also stated that there should be co-ordination between the assessing officers of the firm and the partners in the matter of ascertaining of correct share income of partners and taking corrective action based on it. The Board issued clarificatory orders in February 1988 specifying that even in the assessment of partner completed in summary manner the remedial measure to rectify the mistakes could be taken. Inspite of these instructions, the cases of failure to revise the share income of the partner consequent upon the completion of the assessments of the firm continues.

In Gujarat Central, Surat and Ahmedabad I and III charges, the assessments of 9 registered firms for the assessment years 1989-90 to 1992-93 were completed in a scrutiny manner between February 1992 to March 1995. Audit scrutiny revealed that due to non-maintenance or improper maintenance of the prescribed register in many cases the assessments of partners were not revised after completion of assessments of firms though the firms and partners were assessed in the same wards. Where different wards were involved the requisite intimations were not sent to those wards where the partners were assessed to tax to enable the concerned assessing officers to do the needful. The omission resulted in underassessment of income of Rs.245.29 lakh with consequent short levy of tax aggregating Rs.133.25 lakh.

The reply of the Ministry to the audit observation has not been received.

5.15.2 Under the provisions of Income Tax Act, 1961, as applicable upto assessment year 1992-93, in the case of a registered firm, the income tax payable by the firm itself shall be determined after assessing its total income and the share of each partner in the income of the firm shall be included in his total income and assessed to tax accordingly.

In Maharashtra, Pune charge, the assessment of an assessee `registered firm' for the assessment year 1990-91 was completed after scrutiny in March 1995 at a taxable income of Rs.35.35 lakhs as against income of Rs.97810 determined in summary manner in December 1990. Audit scrutiny revealed that though additions made under scrutiny were confirmed by the CIT(A) in February 1996, the share of income to be taxed in the hands of the partners were not revised. Non-adoption of the correct share of income of Rs.26.34 lakh instead of Rs.87,364 resulted in underassessment of income of Rs.25.47 lakh with consequent short levy of tax of Rs.13.37 lakh in the hands of the partners.

The Ministry have accepted the audit observation.

Carry forward and set off of losses

5.16 Under the Income Tax Act, 1961, where the net result of the computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those year(s).

In Karnataka II, Bangalore charge, the assessment of an individual for the assessment year 1984-85, originally completed after scrutiny in March 1987 was first rectified in June 1988 and subsequently revised to give effect in March 1996 to the orders of the Appellate Tribunal. Audit scrutiny revealed that the total loss had been erroneously determined at Rs.23.10 lakh instead of Rs.3.59 lakh resulting in excess carry forward of loss of Rs.19.51 lakh. Further, in the assessment for the year 1992-93 the loss of Rs.14.81 lakh determined originally in March 1987 in respect of assessment year 1984-85 was allowed as set off against income of that year resulting in excess set off of Rs.11.22 lakh. These mistakes resulted in short levy of tax of Rs.10.37 lakh (including interest).

The Ministry have accepted the audit observation.

Incorrect allowance of deduction in respect of profits and gains from newly established small scale industrial undertaking in certain areas

5.17 Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a small scale industrial undertaking in certain areas, a deduction from such profits and gains of an amount equal to twenty percent thereof is allowed. For this purpose, an industrial undertaking is deemed as a small scale industrial undertaking, if the aggregate value of the machinery and plant installed for the purposes of the business does not exceed Rs.35 lakh as on the last day of the previous year and for this purpose the value of any machinery or plant shall be the actual cost thereof to the assessee.

(i) In Gujarat, Surat charge, in the assessment of a registered firm for the assessment year 1992-93 completed after scrutiny in March 1993 and revised in June 1993, deduction of Rs.31.68 lakh was allowed in respect of the newly established industrial undertaking in a rural area. Audit scrutiny revealed that since the aggregate value of plant and machinery on the last day of the relevant previous year exceeded Rs.35 lakh, the benefit of deduction for small scale industrial undertaking was not available to the assessee. Moreover, the location of the industrial undertaking was not in a rural area covered by the provisions of the Act. The mistake resulted in underassessment of income of Rs.31.68 lakh

with consequent short levy of tax of Rs.20.55 lakh in the hands of firm and its partners and interest chargeable on it.

The Ministry have accepted the audit observation.

(ii) In Gujarat, Surat charge, the assessment of a registered firm for the assessment year 1991-92, was completed after scrutiny in June 1992, and deduction of Rs.13.87 lakh was allowed in respect of the newly established small scale industrial undertaking. Audit scrutiny revealed that the aggregate value of the plant and machinery on the last day of the relevant previous year exceeded Rs.35 lakh and as such the benefit of deduction for small scale industrial undertaking was not available to the assessee. The mistake resulted in underassessment of income of Rs.13.87 lakh with consequent short levy of tax of Rs.9.00 lakh in the hands of firm and its partners.

The Ministry have accepted the audit observation.

Incorrect allowance of relief in respect of export turnover

5.18 Under the Income Tax Act, 1961, an assessee being an Indian company or other assessee resident in India and engaged in the business of export is entitled to a deduction of the profits derived from the export of eligible goods, if the sale proceeds thereof are received in convertible foreign exchange. The benefit was extended to the export of processed minerals and ores specified in the Twelfth Schedule from 1 April 1991. While the business of the assessee does not consist exclusively of export of goods and merchandise, the profit derived from export of manufactured goods shall be the amount which bears to the profits of the business, the same proportion as export turnover bears to the total turnover. For this purpose the profits of the business means the profit as computed under the head 'profits and gains of business or profession'.and as reduced by 90 percent of specified receipts. Such profits are further to be increased by an amount which bears to 90 percent of the export incentives the same proportion as the export turnover bears to the total turnover. From assessment year 1992-93, the profits derived from export of goods not manufactured or processed by the assessee (i.e. trading goods) will be the export turnover in respect of such trading goods as reduced by the direct cost and indirect cost attributable to the export of such trading goods.

(i) In West Bengal IV, Calcutta charge, the assessment of a registered firm for the assessment year 1992-93 was completed after scrutiny in

March 1995 allowing a deduction of Rs.525.57 lakh towards export profits of trading goods as claimed. Audit scrutiny revealed that the assessing officer had failed to reduce the direct and indirect cost amounting to Rs.6817.44 lakh and Rs.53.80 lakh respectively from the export turnover of Rs.6734.82 lakh as required under the provisions of the Act. The deduction was thus erroneously allowed at Rs.525.57 lakh instead of the correct amount of Rs.185.40 lakh. The mistake resulted in underassessment of income by Rs.340.17 lakh with consequent short levy of tax of Rs.379.55 lakh (including interest) .

The reply of the Ministry to the audit observation has not been received.

(ii) In Tamil Nadu, Madurai charge, the assessment of an assessee, unregistered firm for the assessment year 1990-91 was completed in a summary manner in August 1991 allowing a deduction of Rs.11.75 lakh in respect of export of garnet sand. As the goods exported were not covered by the provisions, the assessee was not prima facie eligible for the deduction. Similarly, in the assessment for the assessment year 1993-94 completed after scrutiny in March 1995 a deduction of Rs.127.60 lakh was allowed towards export of garnet. Audit scrutiny revealed that as the assessee did not pulverise or micronise garnet but only segregated the garnet from excavated mineral ore, no deduction was allowable for the export of such unprocessed mineral. The incorrect allowance of export relief resulted in underassessment of income by Rs.139.35 lakh involving tax effect of Rs.92.94 lakh for both the years (including interest).

The Ministry have accepted the audit observation.

(iii) In Maharastra, Mumbai City IX charge, the assessment of an assessee individual for the assessment year 1995-96 was completed in a summary manner in March 1996 at a taxable income of Rs.42.51 lakh, as returned by the assessee, after allowing a deduction of Rs.10 crore in respect of export turnover. Audit scrutiny of the documents accompanying the return revealed that the Chartered Accountant had quantified the amount of deduction in respect of export turnover at Rs.8.26 crore and the assessee had further claimed an amount of Rs.1.74 crore being ninety percent of the export incentives. As the export turnover and total turnover varied, the ninety percent of the export incentives was required to be allowed in the same proportion as export turnover bore to the total turnover and so the assessee was eligible for aggregate deduction of Rs.8.99 crore only. As the mistake was apparent

from the records, the assessing officer should have allowed the deduction only to the extent as provided in the provisions. Failure to make the prima facie adjustments resulted in underassessment of income of Rs.1.01 crore with consequent short levy of tax of Rs.48.47 lakh (including additional income tax).

The reply of the Ministry to the audit observation has not been received.

(IV) Other important cases of incorrect export relief are given below:-

Sl. No.	Commissioner's charge	Assessment year and date of assessment	Section under which assessed	Nature of mistake	Tax effect (Rs.in lakh)
1.	Gujarat Ahmedabad Central	1992-93 March 1995	143(3)	90% of gross other receipt amounting to Rs.67.44 lakh was not reduced from the profits of the business leading to excess relief of Rs.37.72 lakh	36.33 (including interest)
2.	City VIII Mumbai	1993-94 Dec.1995	143(3)	Non-reduction of 90% of gross labour charges of Rs.51.22 lakh from the profits of the business led to excess export relief of Rs.45.78 lakh	34.05 (including interest)
3.	Karnataka I Bangalore	1992-93 & 1993-94 Nov.1994 & Nov.1995	143(3)	90% of the receipts like truck lease income machinery income, service charges, despatch money and interest on income tax refund aggregating Rs.73.93 lakh were not reduced from the profits of the business leading to excess allowance of Rs.27.64 lakh	20.58 (including interest)
4.	Tamil Nadu II Chennai	1994-95 Feb.1996	143(3)	Export profits in respect of trading goods was incorrectly worked out leading to inadmissible deduction of Rs.46.63 lakh	20.40 (including interest)
5.	City VII Mumbai	1993-94 Oct.1994	143(1) (a)	Aggregate of export loss and export incentives being negative figure of Rs.3.25 lakh, no export relief was allowable. This led to underassessment of income of Rs.29.65 lakh	20.49 (including interest)
6.	Kerala Thiruvanantha-puram	1992-93 March 1995	143(3)	90% of processing charges and interest was not reduced from the profits of the business leading to underassessment of income of Rs.17.02 lakh	15.36 (including interest)

7.	West Bengal VIII Calcutta	1992-93 & 1993-94 March 1995 November 1994	143(3)/ 143(1) (a)	Erroneous allowance of total profits of business as deduction instead of the aggregate of export profits in respect of trading goods and export incentives led to underassessment of income of Rs.16.89 lakh	14.49 (including additional tax and interest)
8.	Delhi IV	1993-94 Jan.1996	143(3)	Incorrect computation of profits of the business without taking into account the allowable depreciation led to excess export relief of Rs.23.44 lakh	10.50
9.	Tamil Nadu IV Chennai	1993-94 Dec.1994	143(1) (a)	Incorrect allowance of export relief in respect of grant of exhibition rights of films for fixed period led to underassessment of income by Rs.16.33 lakh	10.10 (including additional tax and interest)
10.	Kerala Cochin	1992-93 March 1995	143(3)	Incorrect computation of adimissible deduction led to excess relief of Rs.11.62 lakh	9.98 (including interest)

The Ministry have accepted the audit observation at serial number 10.

They have not accepted the audit observation at serial number 4 on the ground that indirect cost having no nexus with the export of trading goods cannot enter the computation of export profits of trading goods. The reply is not tenable as the indirect cost referred to in section 80 HHC (3)(c)(ii) has been defined by explanation (f) thereunder as costs, not being direct cost, allocated in the ratio of export turnover in respect of trading goods to the total turnover.' The definition does not speak of any nexus to be established between the indirect cost and export of trading goods for ascertaining the export profits therefrom and clearly lays down the method of computation of indirect costs. The audit observation at serial number 5 has not been accepted on the ground that the return of income was only processed under section 143(1)(a) and the prima facie adjustments prescribed under it do not cover the disallowance of export relief as per Board's instructions. Further, the profits for the purpose of section 80 HHC are overall profits of the unit and not that of only export activity since the assessee effected both export and domestic sales. The reply is not tenable, as the information that the export relief had not been claimed in accordance with the prescribed formula was apparent from Audit Report in form 3 CAB accompanying the return of income and was therefore covered by prima facie adjustments. Further, Audit had pointed out the incorrect

computation of profits derived from export business which should have been the aggregate of export profits, whether positive or negative and export incentives and not that of profits of the business. The audit observation at serial number 6 has not been accepted on the ground that 90 percent of processing charges need not be deducted as it forms part of the assessee's `turnover'. The reply is not tenable as the term `charges or any other receipt of a similar nature' used in explanation (baa) under section 80 HHC would include `processing charges' which has the nature of similar other income. Such inclusion would be in consonance with the rule of " ejusdem generis" used in the interpretation of statutes." They have also not accepted the audit observation at serial number 9 on the ground that the assessment was completed in summary manner. The reply is not tenable as the fact that assessee was only exporting film exhibition rights and not any goods or merchandise was apparent from records and thus covered under prima facie adjustments.

Their response in remaining cases has not been received.

Incorrect allowance of deduction in respect of income of co-operative societies

5.19 Under the Income Tax Act, 1961, a co-operative society engaged in carrying on the business of banking or providing credit facilities to its members, is entitled to a deduction of the whole of the amount of profits and gains attributable to such activity, in computing its total income. It has been judicially held* that investment in government securities which cannot be easily encashed and which can be utilised only on arising of certain contingencies cannot be regarded as its circulating capital or stock-in-trade and hence income derived from them cannot be attributed to banking activity entitled for deduction.

In Maharashtra, Mumbai III charge, the assessment of a co-operative society for the assessment year 1993-94 was completed after scrutiny in July 1995 at a taxable income of Rs.11.46 lakh after allowing a deduction of Rs.620.15 lakh in respect of income of co-operative society. Audit scrutiny revealed that the gross total income of the assessee included Rs.211.51 lakh on account of interest from investment in Government and other securities. As this income could not be regarded as income of the assessee from its banking activity as these investments did not form part of stock-in-trade/working capital of the assessee, the deduction of Rs.211.51 lakh in respect of income of co-operative society was not in order. The incorrect deduction resulted in underassessment

* M.P.Cooporative Bank Ltd. Vs.Addl. CIT-218-ITR-438 (SC).

of income by similar amount with consequent short levy of tax of Rs.110.76 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of deduction in respect of royalty, commission, etc. from a foreign enterprise

5.20 Under the Income Tax Act, 1961, an assessee who is either an Indian company or a person other than a company resident in India is entitled to a deduction, from the gross total income, of an amount equal to fifty percent of the income received by way of royalty, commission, fees etc. from a foreign enterprise including Government of Foreign State in consideration of technical services or professional services rendered outside India if the income is received in convertible foreign exchange within India or brought into India within stipulated time. The deduction allowable is determined with reference to the net income and not on the gross income from such receipts.

In West Bengal VIII charge, the assessments of a firm for the assessment years 1993-94 and 1994-95 were completed after scrutiny and in summary manner in January 1996 and November 1995 respectively after allowing a deduction of Rs.46.23 lakh under the above provisions of the Act. Audit scrutiny revealed that while determining the percentage of total expenses to the total receipts (in order to allocate pro-rata the expenses between the receipts from foreign enterprise and other income)only the direct expenses were considered from the total expenses debited to the relevant profit and loss accounts. After considering the total expenses, the admissible deductions for the two assessment years 1993-94 and 1994-95 worked out to Rs.2.25 lakh and Rs.2.52 lakh respectively. The incorrect allowance of deduction in respect of fees received from foreign enterprise resulted in underassessment of income of Rs.41.45 lakh in the aggregate involving tax effect of Rs.20.79 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Short levy of interest for delay in filing of return and short payment of advance tax

5.21 Under the Income Tax Act, 1961, where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two percent per month or part thereof from 1 April 1989, from the date immediately following the specified due date to the date of filing the return or where no return is furnished, to the date of completion of regular assessment on the amount of tax determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source.

(i) In West Bengal, Central II charge, the assessments of an individual for the assessment years 1989-90, 1990-91 and 1991-92 were completed after scrutiny in March 1996 and February 1996. Audit scrutiny revealed that as against the specified due dates for submission of the returns 31 August 1989, 31 August 1990 and 31 August 1991 respectively, the returns were filed on 31 March 1994. As such the assessee was liable to pay interest aggregating Rs.33.24 lakh for three assessment years against which the department levied Rs.65,766 only. The omission resulted in short levy of interest of Rs.32.58 lakh.

The reply of the Ministry to the audit observation has not been received.

(ii) In Mumbai Central II charge, the assessments of an individual for the assessment years 1989-90 and 1990-91 were completed after scrutiny in February 1996. Audit scrutiny revealed that the assessee filed the original returns for the assessment years 1989-90 & 1990-91 on 19 March & 29 October 1990 as against the due dates of 31 August 1989 and 31 August 1990 respectively and the assessments were originally completed in a summary manner in March 1990 and February 1991 respectively. Further, since the assessee had furnished the revised returns for these assessment years beyond the period of thirty days specified in the notice for re-opening of the assessments, he was also liable to pay interest for delay in filing the revised returns. The interest leviable worked out to Rs.70.50 lakh for the two assessment years as against Rs.58.56 lakh levied by the assessing officer. The mistake resulted in short levy of interest aggregating Rs.11.94 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In Madhya Pradesh, Bhopal charge, the assessment of an assessee individual for the assessment year 1989-90 was completed in March 1996 on best judgment assessment basis. Audit scrutiny revealed that return filed by the assessee for the assessment year 1989-90 on 21 March 1992 was treated as invalid being time barred. Moreover the assessee had failed to file a return in response to notice issued under section 148. The assessee was, therefore, in default as regards submission of the return and was liable to pay interest. However, interest amounting to Rs.2.24 lakh was charged as against Rs.7.50 lakh leviable. The mistake resulted in short levy of interest of Rs.5.26 lakh.

The reply of the Ministry to the audit observation has not been received.

Non-levy of interest for short payment of advance tax

5.21.2 Under the Income Tax Act, 1961, where an assessee who is liable to pay advance tax for any financial year on the basis of his own estimate has failed to pay such tax or where the advance tax so paid falls short of ninety percent of the tax determined on regular assessment, interest at the rate of two percent for every month or part of a month is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax from the first day of the next financial year to the date of determination of total income in a summary manner or regular assessment.

(i) In Gujarat, Baroda charge, the assessment of an assessee co-operative society for the assessment year 1993-94 was completed after scrutiny in December 1995. Audit scrutiny revealed that the advance tax required to be paid by the assessee was not paid and interest was not charged by the assessing officer. Omission to do so led to non-levy of interest of Rs.15.74 lakh.

The Ministry have accepted the audit observation.

(ii) In Delhi City VIII charge, the assessment of an individual for the assessment year 1992-93 was completed after scrutiny in March 1995. Audit scrutiny revealed that interest for short payment of advance tax was leviable at Rs.20.39 lakh as against Rs.9.18 lakh actually charged by the department. The mistake resulted in under charge of interest of Rs.11.21 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In Gujarat, Baroda charge, the assessment of an assessee firm for the assessment year 1989-90 was completed after scrutiny in March 1996. Audit scrutiny revealed that though the advance tax paid by the assessee fell short of ninety percent of the assessed tax no interest for the period of default was levied. Omission to do so led to short levy of interest of Rs.10.13 lakh.

The Ministry have accepted the audit observation.

Non-levy of interest on arrears of demand

5.21.3 Under the Income Tax Act, 1961, any demand for tax should be paid by an assessee within thirty five days (thirty days with effect from 1 April 1989) of service of notice of the relevant demand and failure to do so would attract interest at the rate of fifteen percent per annum with effect from 1 October 1984 and one and one half per cent for every month

or a part thereof from 1 April 1989 from the date of default till the actual date of payment of demands. The Central Board of Direct Taxes (CBDT) issued instructions in November 1974 that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of tax demand. The CBDT in their instructions issued in June 1991 has further emphasised that the assessing officer should calculate such interest at the end of each financial year even if the amount of tax etc. in respect of which interest is payable has not been paid in full before the end of any such financial year and issue the demand notice accordingly.

In Mumbai City III charge, the assessments of a family trust for the assessment years 1984-85 to 1986-87 and 1989-90 were completed in March 1987, March 1988, December 1988 and October 1991 respectively. Audit scrutiny revealed that in August 1993 the assessing officer intimated the Tax Recovery Officer, the total demand of Rs.23.50 lakh for all the above assessment years outstanding against the assessee without including the interest leviable for non-payment of tax demand. The omission resulted in non-levy of interest of Rs.10.01 lakh.

The Ministry have accepted the audit observation.

Omission to levy penalty

5.22 Under the Income Tax Act, 1961, if the assessing officer in the course of any proceedings under the Act, is satisfied that any person has concealed the particulars of income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty, in addition to any tax payable by him, a sum which shall not be less than, but not exceeding thrice, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or furnishing of inaccurate particulars of such income. The Board has also directed that in cases where the assessing officer does not initiate penalty proceedings, he should record reasons for not doing so. Explanation 5 under section 271 provides that, if an assessee during the course of the search makes a statement that valuables found in his possession has been acquired out of the income which has not been disclosed so far in his return of income to be furnished before the expiry of stipulated time and also specifies the manner in which such income has been derived and pays the tax together with interest thereon then no penalty for concealment of income is leviable.

(i) In Maharashtra, Pune charge, the assessment of an assessee individual for the assessment year 1992-93 was completed after scrutiny in March 1995 at a taxable income of Rs.89.93 lakh as against returned income of Rs.2.14 lakh. Audit scrutiny revealed that an addition of Rs.87.79 lakh was made on account of suppression of the quantity of production. The assessing officer was satisfied that there was concealment of income on account of suppression of the quantity of production and hence the assessee was liable to pay penalty. However no penalty proceedings were initiated by the assessing officer nor any reasons for not doing so recorded by him. The omission resulted in non-levy of minimum penalty of Rs.49.16 lakh.

The Ministry have not accepted the audit observation on the ground that it was not a fit case for penalty proceedings in absence of any specific instance of suppression of production in the production register and books of accounts. The reply is not convincing since the assessing officer made addition of Rs.87.79 lakh on account of suppression of figures of production in books. As such, under the Act, penalty should have been levied or waived off by recording reasons thereof.

(ii) In Madhya Pradesh, Bhopal charge, the assessment of an assessee firm for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that though the assessed income of Rs.25.19 lakh included Rs.21 lakh declared under section 132(4) of the Act in the course of search operation carried out in August 1993 the assessee did not pay tax and interest due thereon at the time of making statement. Hence penalty was leviable under the provisions of the Act. But the assessing officer while passing the assessment order in March 1996 did not propose to initiate proceedings to levy penalty nor did he record any reasons for not doing so. The mistake resulted in non-levy of penalty of Rs.9.41 lakh (at minimum rates).

The reply of the Ministry to the audit observation has not been received.

Other topics of interest

Omission to make revision of summary assessments

5.23 Under the Income Tax Act, 1961, with effect from 1 April 1989, where as a result of any order of assessment/re-assessment/ revision or settlement under the provisions of the Act relating to any earlier assessment year and passed subsequent to the filing of the return of income, there is any variation in the carried farward loss, deduction, allowances or relief claimed in the return and as a result of which, if any tax or interest, is found payable an intimation specifying the sum so

payable shall be sent and if any refund is due it shall be granted to the assessee.

In Tamil Nadu, Coimbatore charge, the assessments of a firm for the assessment years 1994-95 and 1995-96 were completed in a summary manner in July 1994 and October 1995 at a loss of Rs.10.29 lakh and 8.45 lakh respectively taking into account unabsorbed losses of Rs.20.98 lakh relating to the assessment year 1993-94. Audit scrutiny revealed that the assessment for the assessment year 1993-94 was completed in November 1995 after scrutiny at an income of Rs.1.22 lakh and thus there was no loss to be carried forward to subsequent years. Therefore the summary assessments for assessment years 1994-95 and 1995-96 were required to be rectified. Omission to rectify the intimation relating to the assessment year 1994-95 and 1995-96 resulted in short levy of tax of Rs.5.52 lakh besides potential tax effect of Rs.3.38 lakh.

The Ministry have not accepted the audit observation on the ground that the assessments were completed in a summary manner. The reply is not tenable as the revision of summary assessment of subsequent assessment years was consequential action of scrutiny assessment of an earlier assessment year and hence a case of rectification of mistake apparent from records covered under section 154. Further, section 143(1)(b) provides for an intimation to be sent to the assessee if there is any variation in carried forward loss, deduction, allowance and relief in such circumstances.

Chapter 6

Other Direct Taxes

A-Wealth Tax

Revenue from wealth tax

6.1 The following table gives a time series analysis of wealth tax receipts as against budget estimates during 1992-93 to 1996-97.

Year	Budget estimates	Actuals	Variation	Percentage variation
		(Rs. in crore)		
1992-93	300.00	467.27	167.27	55.7
1993-94	200.00	153.98	(-)46.02	(-)23.0
1994-95	125.00	104.87	(-)20.13	(-)16.1
1995-96	90.00	74.16	(-)15.84	(-)17.6
1996-97	110.00	77.44	(-)32.56	(-)29.6

The rather large variations between the budget and actual figures indicate the need to put the budgetary estimation on a realistic basis.

The drop in revenues in 1993-94 to 1996-97 with reference to preceding years was apparently due to the fact that with effect from assessment year 1993-94, net wealth upto Rs.15 lakh became exempt from wealth tax and a flat rate of 1 percent was imposed for net wealth exceeding Rs.15 lakh for all categories of assessees.

Status of assessments

6.2 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1997 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrear of demands at the end of the year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1992-93*	10,05,524	6,57,971	3,47,553	34.6	480.55
1993-94	6,13,751	4,32,574	1,81,177	29.5	423.28
1994-95	3,06,289	2,37,725	68,564	22.4	425.21
1995-96	1,85,410	85,384	1,00,026	53.9	806.23
1996-97	1,53,661	74,723	78,938	51.3	808.44

* The revised figures for 1992-93 furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally and incorporated in Report of the Comptroller and Auditor General of India on Union Government-Direct Taxes for that year.

There was a steep fall in the number of assessments for disposal in 1993-94 to 1996-97 as with effect from 1 April 1993 net wealth below Rs.15 lakh was exempted from levy of wealth tax.

Although there was reduction in the work load, the department could complete 0.75 lakh assessments in 1996-97 against 2.38 lakh assessments completed in 1994-95 and 0.85 lakh in 1995-96. This resulted in the pendency position improving only marginally from 22.4 percent in 1995-96 to 53.1 percent in 1996-97. The arrears continued to mount despite direction of the Board for according priority to reduction of arrear demand.

Results of audit

6.3 During the test audit of assessments completed under the Wealth Tax Act, 1957, conducted during the period 1 April 1996 to 31 March 1997, short levy of wealth tax of Rs.6.99 crore was noticed in 573 cases.

A total number of 57 audit observations involving tax effect of Rs.250.44 lakh and 2 audit observations involving over charge of tax of Rs.5.96 lakh were issued to the Ministry of Finance for comments during March 1997 to October 1997. Out of these, the Ministry of Finance have accepted the observations in 21 cases involving tax effect of Rs.158.55 lakh in respect of non-company assessments and 8 cases with tax effect of Rs.17 lakh in respect of company assessments and over charge of Rs.5.96 lakh in respect 1 non-company assessment and 1 company assessment. The categorywise break up of the audit observations issued to the Ministry of Finance is given below:

Sl.No.	Category	Draft paragraphs issued to the Ministry	
	Overassessment	**Nos.**	**Tax effect (Rs.in lakh)**
1.	Excess levy of wealth tax	1	1.36
2.	Mistake in application of rate of tax	1	4.60
	Total	2	5.96
	Underassessment		
1.	Wealth not assessed	13	127.29
2.	Non levy of wealth tax on companies	9	21.36
3.	Incorrect valuation of assets	17	65.65
4.	Incorrect computation of net wealth	4	18.35
5.	Incorrect calculation of tax	2	2.03
6.	Mistake in application of rate of tax	2	5.41

7.	Incorrect computation of liability	3	2.57
8.	Non/short levy of interest	5	6.02
9.	Omission to levy of penalty	2	1.76
	Total	57	250.44

25 illustrative cases with tax effect of Rs.206.89 lakh and 2 cases of overassessments involving overcharge of tax of Rs.5.96 lakh are discussed in the succeeding paragraphs to highlight the important audit observations. Paragraphs 6.5.1 to 6.11 are on wealth tax on assessees other than companies and paragraphs 6.12 to 6.14 relate to company cases. Out of these, the Ministry of Finance have so far accepted the observations in 13 cases involving tax effect of Rs.159.96 lakh and 2 cases of overcharge of tax of Rs.5.96 lakh. Replies are awaited in respect of 10 cases. Of the cases included, 6 cases involving tax effect of Rs.27.18 lakh were checked by the Internal Audit Wing of the department but the mistakes were not detected by them.

Excess levy of wealth tax

6.4.1 Under the Wealth Tax Act, 1957, from the assessment year 1993-94, where net wealth of an individual exceeds Rs.15 lakh, tax leviable is one percent of the amount by which net wealth exceeds Rs.15 lakh.

In Delhi III charge, the wealth tax assessments of two individuals for the assessment year 1993-94 were completed after scrutiny in March 1996 at net wealth of Rs.482.74 lakh and wealth tax of Rs.9.13 lakh was levied. Audit scrutiny revealed that tax was leviable at lower rate of one percent which worked out to Rs.4.53 lakh. The mistake in application of correct rate of tax resulted in over charge of tax of Rs.4.60 lakh.

The Ministry have accepted the audit observation.

2. Under the Wealth Tax Act, 1957, in a scrutiny assessment, the assessing officer shall make a correct assessment of taxable wealth of the assessee and determine the correct tax payable by him or refundable to him on the basis of such assessment. The Central Board of Direct taxes, from time to time, issued instructions stressing the necessity for ensuring accuracy in the computation of income/wealth and tax etc.

In Tamil Nadu Central I, Chennai charge, the wealth tax assessment of a company for the assessment year 1992-93 was completed on best judgment assessment basis in March 1996 at taxable wealth of Rs.483.50 lakh. Audit scrutiny revealed that wealth tax on the taxable wealth was

incorrectly levied at Rs.18.57 lakh instead of correct amount of Rs.17.21 lakh. The mistake resulted in excess levy of wealth tax of Rs.1.36 lakh.

The Ministry have accepted the audit observation.

Assessees other than companies

Wealth not assessed

6.5.1 Under the Wealth Tax Act, 1957, prior to 1 April 1993, wealth tax on assessees other than companies is chargeable in respect of each assessment year on the net wealth of the assessees as on the valuation date relevant to that assessment year at the rates prescribed in the schedule to the Act. From the assessment year 1993-94, where net wealth of an individual, Hindu undivided family and a company exceeds Rs.15 lakh, tax leviable is one percent of the amount by which net wealth exceeds Rs.15 lakh. Net wealth means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date. The Central Board of Direct Taxes issued instructions (November 1973, April 1979 and September 1984) for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to bringing to tax cases of evasion of tax.

(i) In Tamil Nadu III, Chennai charge, audit scrutiny of the income tax assessment records of an individual for the assessment years 1986-87 to 1988-89 revealed that certain immovable and movable properties owned by the assessee together with a huge cash balance were seized during search operations conducted between September 1990 and February 1991 and brought to income tax. These items constituted wealth of the assessee attracting levy of wealth tax. However, the assessee did not file return of wealth for any of the assessment years nor did the department initiate any wealth tax proceedings. On the omission being pointed out in audit, the department completed wealth tax assessments for assessment years 1986-87 to 1993-94 at net wealth ranging between Rs.3.97 crore to Rs.4.07 crore involving tax demand of Rs.97.73 lakh (including interest).

The Ministry have accepted the audit observation.

(ii) In Karnataka II, Bangalore charge, the wealth tax assessments of three individuals who were co-owners of a building in a city, in equal shares, for the assessment year 1991-92 were completed after scrutiny in February 1993/March 1993. Audit scrutiny of the relevant income tax assessment records of the assessees revealed that they received aggregate

rent of Rs.5.28 lakh in the relevant previous year from the building based on which the value of the building worked out to Rs.253.18 lakh which constituted wealth of the assessees attracting levy of wealth tax. However, the assessees did not return this wealth nor did the department bring it to wealth tax. The omission resulted in wealth of Rs.253.18 lakh escaping assessment with consequent non levy of wealth tax of Rs.5.04 lakh (including interest).

The Ministry have not accepted the audit observation on the grounds that during the year the building was partly let out and since it was still under construction, valuation as per Schedule III of the Wealth Tax Act does not arise. Further, the assessees had received rent for four months only from 1 December 1990 during the relevant previous year.

The Ministry's reply is not tenable since it was immaterial that the construction of the whole building was completed or not. The portion of the building for which rental income was received by the assessees constituted an asset owned by the assessees for wealth tax purposes justifying its valuation under the valuation provisions laid down vide explanation 1(b) below Rule 5 of Schedule III to the Wealth Tax Act which provides for valuation of the building even when it is let out for part of the previous year.

(iii) In Central II, Mumbai charge, the income tax assessment of an individual for the assessment year 1990-91 completed after scrutiny in March 1993 was subsequently revised in January 1996 determining the taxable income on the basis of the assets and concealed income seized during the search operations conducted in the premises of the assessee in March 1992 and the concealed income amounting to Rs.2.38 crore was decided to be treated as concealed wealth of the assessee for the assessment year 1990-91. However, the wealth tax assessment for the assessment year 1990-91 was not re-opened to bring to tax the concealed wealth though it was taxed in the subsequent assessment years 1991-92 and 1992-93. The omission resulted in wealth of Rs.2.38 crore escaping assessment with consequent short levy of wealth tax of Rs.4.67 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In Madhya Pradesh, Bhopal charge, the wealth tax assessment of two individuals for the assessment year 1990-91 were completed after scrutiny in March 1993 including their share in H.U.F. property

amounting to Rs.11.27 lakh in each case. Audit scrutiny revealed that the value of the property of the H.U.F. to be distributed among three co-parceners was determined at Rs.616.95 lakh after allowing the appeal effect fifty percent of one-third share of each of the assessees in the total value of the building which was to be included in wealth worked out to Rs.205.65 lakh as against Rs.22.54 lakh actually added by the assessing officer. The omission resulted in under assessment of wealth aggregating Rs.183.11 lakh involving short levy of tax of Rs.3.83 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

2. Under the Wealth Tax Act, 1957, as amended from 1 April 1993 `assets', inter alia, include urban land. The Act, further provides that urban land means land situated in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) but does not include land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or the land occupied by any building which has been constructed with the approval of the appropriate authority.

(i) In Maharashtra, Nagpur charge, the wealth tax assessment of an individual and a Hindu undivided family for the assessment year 1993-94 were completed ex parte in March 1996 at a net wealth of Rs.11.21 lakh and at `nil' respectively. Audit scrutiny revealed that the two assessees jointly owned a plot of land valuing Rs. 4 crore in a town in the ratio of four and one respectively on which they claimed and were allowed the exemption from the wealth tax on the ground that on a part of the land a building was constructed with the approval of appropriate authority and therefore the same fell outside the purview of the definition of urban land. The exemption allowed was not in order as remaining part of total land was still lying unused and as such was chargeable to wealth tax. The omission resulted in wealth escaping assessment to that extent with consequent short levy of tax of Rs.6.04 lakh.

The Ministry have accepted the audit observation.

(ii) In Bihar, audit scrutiny of the income tax assessment records of a company (Patna charge) for the assessment year 1994-95 and of three individuals (Ranchi charge) for the assessment year 1995-96 revealed that

the assessees owned taxable wealth consisting of house properties, urban lands and motor cars worth Rs.273.20 lakh attracting levy of wealth tax. However, the assessees did not furnish wealth tax returns nor did the department initiate any wealth tax proceedings. The omission resulted in aggregate wealth valued at Rs.273.20 lakh escaping assessment with consequent non-levy of wealth tax of Rs.2.28 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Incorrect allowance of wealth tax liabilities

6.6 Under the Wealth Tax Act, 1957, net wealth means the aggregate value of all assets wherever located, belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date.

In Karnataka I, Bangalore charge, the wealth tax assessment of a Hindu undivided family for the assessment year 1992-93 was completed after scrutiny in March 1995, computing the net wealth at Rs.92.87 crore after allowing wealth tax liability of Rs.301.62 lakh pertaining to the assessment year 1991-92. Audit scrutiny revealed that while giving effect to appellate orders for the assessment year 1991-92 the wealth tax liability was reduced to Rs.12.14 lakh in April 1995 which was further reduced to Rs.9.17 lakh in the rectificatory order of November 1995 but the wealth tax assessment for the assessment year 1992-93 was not revised adopting the allowable wealth tax liability of Rs.9.17 lakhs. The mistake resulted in short computation of wealth of Rs.292.45 lakh involving short levy of tax of Rs.11.32 lakh (including interest).

The Ministry have accepted the audit observation.

Mistake in application of rate of tax

6.7 From the assessment year 1974-75, the Schedule I to the Wealth Tax Act, 1957, was amended to provide for a higher rate of tax for every Hindu undivided family of the specified category having at least one member with assessable net wealth exceeding Rs.1 lakh upto assessment year 1979-80, Rs.1.50 lakh from the assessment year 1980-81 to 1992-93. Other cases of Hindu undivided family attract tax at lower rates.

In Andhra Pradesh I, Hyderabad charge, the wealth tax assessments of a Hindu undivided family (specified) for the assessment years 1989-90 to 1992-93 were completed after scrutiny in March 1995 on a net wealth of Rs.81.34 lakh, Rs.79.45 lakh, Rs.71.03 lakh and Rs.37.11 lakh respectively with an aggregate wealth tax demand of Rs.7.09 lakh treating its status as unspecified. Audit scrutiny revealed that the status of the

assessee being HUF (Specified) the tax was leviable at higher rate of 3 percent which worked out to Rs.11.92 lakh as against the sum of Rs.7.09 lakh levied. The mistake resulted in short levy of tax of Rs.4.83 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

A. Immovable properties

Incorrect valuation of assets

6.8.1 Under the Wealth Tax Act, 1957, from 1 April 1989, the value of any asset other than cash, shall be its value as on the valuation date, determined in the manner laid down in Schedule III to the Act. Under the rules provided for in the schedule, the value of any immovable property, being building or land appurtenant there to, shall be the amount arrived at by multiplying the net maintainable rent by the figure 12.5.

In Tamil Nadu IV, Chennai charge, the wealth tax assessments of an individual for the assessment years 1989-90 to 1992-93 were completed after scrutiny in February 1996 on a taxable wealth of Rs.8.66 lakh, Rs.13.77 lakh, Rs.15.52 lakh and Rs.18.60 lakh respectively adopting the value of a house property at Rs.7.49 lakh, Rs.11.29 lakh, Rs.13.49 lakh and Rs.13.68 lakh during the relevant previous years respectively as returned. Audit scrutiny of the income tax assessment records of the assessee for the assessment years 1989-90 to 1992-93 revealed that the house property was let out and the assessee received rent of Rs.4.88 lakh, Rs.4.88 lakh, Rs.4.88 lakh and Rs.6.63 lakh respectively during the relevant previous years. Considering rent capitalisation method the assessable value of the said property would work out to Rs.69.42 lakh, Rs.62.70 lakh, Rs.58.91 lakh and Rs.78.97 lakh respectively which was required to be adopted. The omission resulted in aggregate under assessment of wealth of Rs.224.06 lakh with consequent short levy of tax aggregating Rs.6.99 lakh (including interest).

The Ministry have accepted the audit observation.

2. Under the provisions of Wealth Tax Act, for the purpose of making an assessment, the assessing officer may refer the valuation of any asset to a valuation officer for determining the market value in accordance with the provisions of the Act and also under rules in Schedule III if he is of the opinion that the fair market value of the asset exceeds the value of the asset as returned, by more than the prescribed percentage and the value so estimated by the valuation officer shall be binding on the assessing officer.

In Tamil Nadu III, Chennai charge, the wealth tax assessments of an individual for the assessment years 1993-94 and 1994-95 were completed/revised after scrutiny in March 1996 and November 1995 on a net wealth of Rs.121.60 lakh and Rs.70.65 lakh respectively. In these assessments the share of the deceased spouse of the assessee was clubbed with the assessee's wealth and wealth tax demand raised in the hands of the assessee. Audit scrutiny revealed that the assessee owned aggregate share of 57.5/115 of a property situated in the heart of a metropolitan city (her individual share being 7.5/115 and deceased husband's share being 50/115). As per departmental valuation report the value of the property was Rs.552.03 lakh and assessee's share therefore was Rs.276.02 lakh being 57.5/115 of the value of the property. However, for assessment year 1993-94, the assessing officer considered Rs.35.87 lakh for inclusion in the value of the asset referred for valuation being the difference in value of 7.5/115 share (her share only) and omitted to include her deceased spouse's share of 50/115 valuing at Rs.239.16 lakh. Similarly, for assessment year 1994-95 while revising the intimation the value of the property was computed at Rs.97,066 instead of Rs.293.72 lakh as per valuation report. The omission resulted in underassessment of wealth aggregating Rs.531.91 lakh with consequent short levy of tax of Rs.5.32 lakh.

The Ministry have accepted the audit observation.

B. Quoted equity shares

6.9 Under the Wealth Tax Act, 1957, from 1 April 1989, the value of any asset other than cash, shall be its value, as on the valuation date, determined in the manner laid down in Schedule III to the Act. This schedule specifies that the value of an equity share in any company which is a quoted share shall be taken as the value quoted in respect of such share on the valuation date. Further, the value of an equity share in any company which is a quoted share, may at the option of the assessee or a company, be taken on the basis of the average of the value quoted on the 31 of March immediately preceding the assessment year and the values quoted in respect of such share on the said dates in relation to each of the immediately preceding nine assessment years provided where the assessee opts for the average of the values so quoted, he shall get such value certified by the accountant and attach the certificate along with the return.

In Andhra Pradesh I, Hyderabad, Vijaywada and West Bengal V and VIII, Calcutta charges, the wealth tax assessments of 11 individuals and

one Hindu undivided family for the assessment year 1992-93 were completed after scrutiny (best judgement assessment in one case) in August 1994 , December 1994, February 1995, January and March 1995 and of one individual in November 1994 in a summary manner. Audit scrutiny revealed that the value of a large number of quoted equity shares of several companies, owned by the assessees was adopted at average quoted value under the special valuation provisions of schedule III to the Act as opted and returned by the assessees. For adoption of such value, the assessees were required to get a certificate of valuation by an accountant and submit it with the return which was not done. Since the statutory requirement of furnishing the certificate of an accountant was not fulfilled by the assessees to substantiate their claims, the value of shares should have been adopted at quoted rates of shares on the respective valuation date i.e. 31 March 1992. Omission to do so resulted in underassessment of wealth aggregating Rs.1105.38 lakh with consequent short levy of tax of Rs.24.90 lakh (including interest).

The Ministry have accepted the audit observation in eight cases of Andhra Pradesh I, Hyaderabad, West Bengal I and Vijaywada charges. In Vijaywada charge, the Ministry have not accepted the audit observation in one case (out of identical audit observation raised in three cases of Vijaywada charge) on the ground that the point raised by audit is only a technical mistake.

The reply of the Ministry is not tenable in view of the specific provisions laid down in Rule 9A of Schedule III of the Wealth Tax Act,1957 under which where the assessee opts for the average of the values so quoted, he shall get such a value certified by an accountant and attach the same alongwith the return which being a statutory obligation was not complied with by the assessee at the time of filing the return in November 1992. Further, even at the time of assessment completed in March 1995 and date of audit (August 1995) the accountant's certificate was not furnished in support of claiming opted value of quoted equity shares. Incidentally, Ministry have accepted the similar audit observation raised in respect of other two assessees in the same draft paragraph.

The reply of the Ministry to the audit observations in the remaining cases have not been received.

C. Unquoted equity shares of investment companies

6.10 Under Schedule III to the Wealth Tax Act, 1957, the value of an unquoted equity share in an investment company shall be determined by deducting the value of all liabilities as shown in the balance sheet of such company from the value of all its assets shown in that balance sheet and the net amount so arrived at shall be divided by the total paid up equity share capital of the company as shown in the balance sheet and the result multiplied by the paid up value of each share shall be the value of the unquoted equity share. For this purpose the value of the asset disclosed in the balance sheet of the company whose shares are being valued shall be in accordance with the rules as applicable to that particular asset and in this regard the value of an equity share of any company shall be its quoted value on the valuation date.

In Central I, Chennai charge, the wealth tax assessments of five individuals for the assessment year 1992-93 were completed/revised after scrutiny between March 1995 and March 1996 on net wealth ranging from Rs.73.57 lakh to Rs.274.60 lakh which, inter alia, included unquoted shares in three closely held investment companies held by the assessees. The value of the unquoted shares was adopted at Rs.33,609, Rs.1.59 lakh and Rs.1.08 lakh respectively in respect of their share holdings. Audit scrutiny revealed that the value of quoted shares held by the above investment companies was adopted at book value instead of their value quoted as on the valuation date 31 March 1992 for arriving at the break up value of the assessees share in the investment companies under the mandatory valuation provisions. The omission resulted in under assessment of wealth aggregating Rs.249.26 lakh with consequent short levy of tax of Rs.7.43 lakh.

The Ministry have accepted the audit observation.

Short levy of interest for delay in filing the return

6.11 Under the Wealth Tax Act, 1957, where the return of net wealth for any assessment year is furnished after the specified due date, the assessee shall be liable to pay simple interest at the rate of two percent for every month or part of a month from the date immediately following the due date to the date of furnishing the return, on the amount of tax determined in regular assessment. An assessment made for the first time in respect of escaped wealth shall be regarded as a regular assessment for the purpose of charging interest.

In West Bengal, Central II, Calcutta charge, the wealth tax assessment of an individual for three assessment years 1989-90 to 1991-92 were completed after scrutiny in March 1996 for the first time on the basis of the returns submitted after the due dates, in response to the notices issued for assessment of wealth which escaped assessment. Audit scrutiny revealed that while charging interest for belated filing of return, the assessing officer calculated the period of delay from the expiry of the date of the notices instead of the specified due dates of filing the return. This resulted in short levy of interest aggregating Rs.2.20 lakh.

The reply of the Ministry to the audit observation has not been received.

Company cases

Non-levy of wealth tax

6.12 Under the provisions of Section 40 of Finance Act, 1983, with effect from the assessment year 1984-85, companies other than those in which the public are substantially interested are liable to wealth tax at a flat rate of 2 percent (plus 10 percent surcharge for the assessment year 1988-89 only) of the net wealth comprising the aggregate market value upto the assessment year 1991-92 and for assessment year 1992-93 either value determined in the manner laid down in Schedule III to the Act or value disclosed in balance sheet of the company on the valuation date, whichever is higher, of the specified assets belonging to the company reduced by the debts owed by the company pertaining to such assets on the valuation date.

In Kerala, Chandigarh, Maharashtra, Tamil Nadu and West Bengal charges, audit scrutiny of the income tax assessment records of 7 closely held companies for the assessment years 1984-85 to 1992-93 revealed that the companies owned specified assets which were chargeable to wealth tax. However, neither did the assessee companies file their return of net wealth nor did the department initiate any wealth tax proceedings. The omission resulted in aggregate wealth of Rs.682.41 lakh escaping assessment with consequent non-levy of wealth tax of Rs.17.39 lakh. Brief particulars of these cases are given below:

(Rs.in lakhs)

Sl.No.	Commissioner's charge	Assessment year	Type of assets owned	Aggregate value of assets escaping assessment	Tax effect
1.	Cochin and Trivandrum	1986-87 to 1992-93	buildings	170.18	3.96
2.	Patiala	1984-85 to 1991-92	building and land	60.90	3.93 (including interest)
3.	City XII, Mumbai	1992-93	buildings	152.21	2.98
4.	Central II, Mumbai	1992-93	leasehold land	121.35	2.34
5.	West Bengal, Calcutta	1984-85 to 1992-93	Motor Cars and house properties	113.86	2.11
6.	Tamil Nadu V	1992-93	building	63.91	2.07 (including interest)

The Ministry have accepted the audit observation at Sl.Nos.2 and 6. The Ministry have not accepted the audit observation at Sl.No.4 on the ground that the asset in question being lease hold land is not at all includible in the list of specified assets.

The Ministry's reply is not tenable in view of the list of the specified assets under Section 40(3) of Finance Act, 1983 which clearly indicate that the assets include land other than agricultural land vide sub-clause (V) of Section 40(3) of Finance Act, 1983. Further, the definition of specified assets owned by the company does not differentiate between lease hold land and other types of land. Incidentally, Ministry have accepted similar audit observation included as para 6.8.1(iii) in the Report of the Comptroller and Auditor General of India for the year ended 31 March 1994 on Union Government, Revenue Receipts-Direct Taxes. In the remaining cases the reply of the Ministry have not been received.

Incorrect computation of net wealth

6.13 Under the provisions of section 40 of the Finance Act, 1983, as it stood prior to the assessment year 1993-94, where any debt secured on any asset is incurred for, or ensures to, the benefit of any other person, or is not represented by an asset belonging to the assessee the value of such debt shall not be taken into account in computing the net wealth of the assessee.

In West Bengal, Central I charge, the wealth tax assessments of a private

limited company for the assessment years 1990-91 and 1992-93 were completed after scrutiny in March 1995. Audit scrutiny revealed that the company owned residential house property during the previous year relevant to the assessment year 1990-91 and its market value of Rs.40 lakh, being specified asset was includible in its net wealth. However, during assessment, the same was omitted to be included in the net wealth of the assessee. Besides, the said company was allowed a deduction toward debt of Rs.90 lakh from the value of its assets in each of assessment year 1990-91 and 1992-93 which was not in order as the debt was secured against an asset which was not included in the net wealth for any of the above two assessment years. The omission resulted in under assessment of wealth aggregating Rs.2.20 crore with consequent undercharge of wealth tax of Rs.5.15 lakh (including interest).

The Ministry have accepted the audit observation.

Short levy of interest for delay in filing the return

6.14 Under the Wealth Tax Act, 1957, where the return of net wealth for an assessment year is furnished after specified due date, the assessee shall be liable to pay simple interest at two percent per month or part of a month from the date immediately following the specified due date to the date of furnishing of the return, on the amount of tax determined in regular assessment.

In Punjab, Patiala charge, the wealth tax assessment of a company for the assessment year 1990-91 was completed after scrutiny in February 1996 determining net wealth and tax at Rs.4420 lakh and Rs.88.41 lakh respectively. Audit scrutiny revealed that the assessee filed return of net wealth in June 1995 instead of the specified due date for filing the return on 31 December 1990. The assessee was, therefore, liable to pay interest of Rs.95.48 lakh instead of Rs.93.71 lakh for delayed filing of return by 54 months. The mistake resulted in short levy of interest of Rs.1.77 lakh.

The Ministry have accepted the audit observation.

B-GIFT TAX

Revenue from gift tax

6.15 In the financial years 1992-93 to 1996-97, gift tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget estimates	Actuals	Variation	Percentage variation
	(Rs. in crore)			
1992-93	5.00	9.27	4.27	85.4
1993-94	10.00	4.99	(-) 5.01	(-) 50.1
1994-95	5.00	14.98	9.98	200.0
1995-96	10.00	11.40	1.40	14.0
1996-97	10.00	10.30	0.30	0.3

The large variation between the budget estimates and actuals in the years 1992-93 to 1994-95 indicates the necessity to put budget estimation on a realistic basis.

Status of assessments

6.16 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1997 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrearof demands at the end of year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1992-93	45,667	34,447	11,220	24.6	35.26
1993-94	36,478	28,489	7,989	21.9	31.81
1994-95	33,928	28,145	5,783	17.1	30.70
1995-96	31,737	24,109	7,628	24.0	30.51
1996-97	32,493	27,690	4,803	14.8	33.75

The above figures indicate that though the number of cases for disposal have been consistently declining during the years 1992-93 to 1995-96 (slightly increase in the year 1996-97 comparative to the cases for 1995-96), finalisation of assessments have also been declining and consequently the percentage of pendency has ranged between 14.8 to 24.0.

Results of audit

6.17 During the test audit of assessments made under the Gift Tax Act, 1958, conducted during the period 1 April 1996 to 31 March 1997, short levy of gift tax of Rs.3.16 crore was noticed in 139 cases. A total number of 8 audit observations involving tax effect of Rs.37.06 lakh were issued to the Ministry of Finance for comments during March to October 1997. Out of these, the Ministry of Finance have so far accepted the observations in 2 cases involving tax effect of Rs.5.91 lakh. 6 cases involving tax effect of Rs.34.12 lakh are discussed below. Replies are awaited in respect of 3 cases.

Non-levy of tax on deemed gift

6.18 Under the Gift Tax Act, 1958, prior to 1 April 1992 where property is transferred otherwise than for adequate consideration, the amount by

* The above revised figures for 1992-93 furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally and incorrporated in the Report of the Comptroller and Auditor General of India on Union government-Direct Taxes for that year.

which the market value of the property on the date of transfer exceeds the value of the consideration shall be deemed to be a gift made by the transferor. From 1 April 1992, the value of the property as on the date of the transfer and determined in the manner laid down in Schedule II to the Act which exceeds the value of the consideration shall be deemed to be a gift made by the transferor. As per Schedule II, the value of the gifted property shall be determined in accordance with the valuation provisions of various types of assets of Schedule III to the Wealth Tax Act.

(i) In Karnataka II, Bangalore charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1989-90 revealed that the assessee sold 2074 equity shares of a closely held company to an individual at Rs.964.32 each for a total consideration of Rs.20 lakh in July 1988, and on the same date another person had sold 1841 equity shares of the same company to the same purchaser at the rate of Rs.2,715.92 each. Thus there was a transfer of shares for inadequate consideration. The difference between two values constituted deemed gift of Rs.36.33 lakh attracting levy of gift tax. However, the assessee did not file return of gift nor did the department initiate gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.10.84 lakh, besides levy of interest.

The reply of the Ministry to the audit observation has not been received.

(ii) In City IX, Mumbai charge, audit scrutiny of income tax assessment records of a registered firm for the assessment year 1989-90 completed in February 1992 revealed that the assessee had sold two flats having built up area of 4060 square feet for a total consideration of Rs.6.10 lakh to a person who was husband of one of the partners of the firm. It was further revealed that the assessee had sold another flat having area of 1965 square feet in the same building for a consideration of Rs.15.53 lakh to another person during the assessment year 1987-88. As the value of the two flats sold in assessment year 1989-90 should not be less than Rs.32.10 lakh, the difference of Rs.26 lakh between the market value and value at which the property was sold constituted deemed gift attracting levy of gift tax. However, neither did the assessee file any gift tax return nor did the department initiate gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.7.74 lakh.

The reply of the Ministry to the audit observation has not been received.

(iii) In City XI, Mumbai charge, audit scrutiny of the income tax assessment records of an individual for the assessment year 1992-93

revealed that the assessee had sold during the relevant previous year, Bombay Stock Exchange card for a consideration of Rs.30 lakh. It was further revealed that the assessing officer had adopted the value of aforesaid asset at Rs.52.80 lakh in the wealth tax assessment of other assessees for assessment year 1992-93. As the value of the said property for wealth tax purposes was adopted at Rs.52.80 lakh the same should have been reckoned for gift tax purposes. As such, the difference of Rs.22.80 lakh between the value of the asset adopted in wealth tax assessment of other assessees for assessment year 1992-93 and the value at which the property was sold constituted deemed gift attracting levy of gift tax. However, the assessee did not file any gift tax return nor did the department initiate any gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.6.78 lakh.

The reply of the Ministry to the audit observation has not been received.

(iv) In Karnataka I, Bangalore charge, audit scrutiny of the income tax assessment records of a closely held company for the assessment year 1992-93 revealed that the assessee sold 1,37,000 shares of a company for a total consideration of Rs.16.80 lakh as against the market value of Rs.32.57 lakh as quoted in Bangalore Stock Exchange. Thus the difference of Rs.15.77 lakh constituted deemed gift attracting levy of gift tax. However, the assessee did not file any gift tax return nor did the department initiate any gift tax proceedings. The omission resulted in non levy of gift tax of Rs.4.67 lakh.

The Ministry have accepted the audit observation.

(v) In Tamil Nadu, Coimbatore charge, the wealth tax assessments of two Hindu undivided families for the assessment years 1988-89 and 1989-90 completed after scrutiny in March 1992 adopting the value of a vacant site owned by them at Rs.150 per sq.ft. which was subsequently reduced to Rs.50 per sq.ft. at the direction of appellate authority in August 1992. Audit scrutiny of the relevant income tax assessment records revealed that out of the said land, the assessees sold 16365 sq.ft. for Rs.2.28 lakh and 5892 sq.ft. for Rs.95,063 during the relevant previous years. The difference aggregating Rs.7.90 lakh between the sale value and the value adopted in the revised assessment constituted deemed gift attracting levy of gift tax. However, assessees did not file any gift tax returns nor did the department initiate any gift tax proceedings. The omission resulted in non-levy of gift tax of Rs.2.85 lakh (including interest).

The Ministry have not accepted the audit observation on the grounds that after revision of gift tax assessments the assessments were cancelled by the appellate authorities. They have further stated that department's appeal before ITAT is pending. The reply of the Ministry is not tenable in view of the fact that the department have completed gift tax assessments accepting the audit view. Further, they have not accepted the decision of the appellate authorities and have filed appeal before ITAT which is pending. Audit observation stands till the issue is decided by the ITAT.

Non-levy of interest for belated filing of return

6.19 Under the Gift Tax Act, 1958, every assessable person shall furnish a return of gift on or before 30 June of the corresponding assessment year. Further, where a return of gift for any assessment year is not furnished within the due date, the assessee is liable to pay simple interest at the rate of two percent for every month or part of a month of default comprised in the period commencing on the 1 July of the assessment year and ending on the date of furnishing return.

In Tamil Nadu, Coimbatore charge, the gift tax assessments of a Hindu undivided family for the assessment years 1991-92 and 1992-93 were completed after scrutiny in March 1996 on a taxable gift of Rs.3.80 lakh and Rs.3.55 lakh. Audit scrutiny revealed that the assessee filed its gift tax returns in April 1994 as against the due dates of 30 June 1991 and 30 June 1992 respectively but no interest was levied for the belated filing of returns. Omission to levy interest resulted in short demand of tax aggregating Rs.1.24 lakh.

The Ministry have accepted the audit observation.

C-Interest Tax

Revenue from interest tax

6.20 In the financial years 1992-93 to 1996-97, interest tax receipts vis-à-vis the budget estimates were as given below:

Year	Budget Estimates	Actuals	Variation	Percentage variation
	(Rs. in crore)			
1992-93	800.00	714.70	(-) 85.30	(-)10.6
1993-94	900.00	727.58	(-)172.42	(-)19.3
1994-95	1044.00	801.40	(-)242.60	(-)23.2
1995-96	1000.00	1170.05	(+)170.05	(+)17.0
1996-97	1250.00	1712.39	(+)462.39	(+) 37.0

The large variation between the budget estimates and actual indicates the necessity to put budget estimation on realistic basis.

Status of assessments

6.21 Particulars of assessments completed, assessments pending and demands in arrear for the last five years ending 31 March 1997 were as given below:

Year	Number of assessments			Percentage of total cases pending	Arrear of demands at the end of the year (Rs. in crore)
	Due for disposal	Completed during the year	Pending at the end of the year		
1992-93*	972	77	895	92.1	0.96
1993-94	2,381	395	1,986	83.4	0.62
1994-95	6,704	1,810	4,894	73.0	0.60
1995-96	7,189	2,864	4,325	60.1	102.82
1996-97	12,378	5,374	7,004	56.6	234.46

Results of audit

6.22 During the test audit of assessments made under the Interest Tax Act, 1974 conducted during the period 1 April 1996 to 31 March 1997 short levy of interest tax of Rs. 1.27 crore was noticed in 81 cases.

A total number of 21 audit observations involving tax effect of Rs.396.44 lakh were issued to the Ministry of Finance for comments during March to October 1997.

11 illustrative cases involving tax effect of Rs. 387.92 lakh are given in the following paragraphs to highlight the important audit observations. Replies are awaited in respect of all the 11 cases. Of the cases included, one case involving tax effect of Rs.164.89 lakh was checked by the Internal Audit Wing of the department but the mistake was not detected by it.

Under assessment of chargeable interest/omission to make assessment of interest tax.

6.23.1 Under the Interest Tax Act, 1974, as reintroduced with effect from 1 October, 1991 by the Finance (No.2)Act, 1991, interest tax is leviable on the chargeable interest income of 'credit institutions'. Such credit institutions, inter alia, included Co-operative Societies engaged in the business of banking , not being Co-operative Societies which provide credit facilities to farmers or village artisans, for the assessment year

* The above revised figures for 1992-93 relating to pendency in completion of assessments furnished by Ministry of Finance in February 1994 are different from those furnished by the Ministry provisionally incorporated in the Report of the Comptroller and Auditor General of India on Union Government-Direct Taxes for the year.

1992-93. The interest income chargeable to tax includes interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange. The returns of chargeable interest are required to be filed by 31 December of the relevant assessment year.

(i) In Tamil Nadu I, Chennai charge, the interest tax assessments for the assessment years 1992-93 and 1993-94 of an insurance company were completed in March 1995 and February 1996 on a chargeable interest of Rs.3683.95 lakh and Rs.10,493.46 lakh respectively. Audit scrutiny revealed that a sum of Rs.1572.67 lakh (50 percent of Rs.3145.35 lakh as the Act reintroduced from 1 October 1991) and Rs.2210.34 lakh relating to assessment years 1992-93 and 1993-94 respectively and representing amounts of income received from bill discount, commercial papers and interest on certificate of deposits were not included in the chargeable interest. The omission resulted in underassessment of chargeable interest by similar amounts with consequent short levy of interest tax of Rs.164.89 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Chennai, Central I charge, the income tax assessments of a finance company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in March 1994 and in a summary manner in August 1995 respectively. Audit scrutiny revealed that the assessee had received a sum of Rs.1083.63 lakh and Rs.1202.97 lakh as interest and service charges during the financial years relevant to assessment years 1993-94 and 1994-95 but neither did the assessee file interest tax returns nor did the assessing officer call for the same for these assessment years. Omission to do so resulted in non-levy of interest tax of Rs.167.89 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In Kerala, Cochin charge, the income tax assessment records of two co-operative societies, engaged in banking business for the assessment year 1992-93 revealed that the assessees had received Rs.113.60 lakh and Rs.83.47 lakh towards interest income during the periods covering 1 July 1991 to 30 June 1992 and 1 April 1991 to 31 March 1992 respectively. Since details of interest income in respect of six months from 1 October to 31 March 1992 (to which provisions of Interest Tax apply) were not available, a sum of Rs.98.53 lakh in aggregate could be taken to be chargeable to interest tax during the relevant period on proportionate

basis. However, neither did the assessees file any return of chargeable interest nor did the assessing officer initiate any action for their assessment. The omission resulted in non-assessment of chargeable interest of Rs.98.53 lakh in aggregate involving tax effect of Rs.8.59 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iv) In Chennai, Tamil Nadu IV charge, the income tax assessments of a closely held company for the assessment years 1993-94 and 1994-95 were completed in a summary manner. Audit scrutiny revealed that the total income included interest income of Rs.23.86 lakh and Rs.56.05 lakh respectively, by way of interest on jewel loans, house mortgage loans and interest on various deposits. It was further revealed that neither did the assessee file any interest tax return nor did the department initiate proceedings in this regard though it was prima facie apparent from record. Omission to do so resulted in interest income of Rs.23.86 lakh and 56.05 lakh respectively escaping assessment with consequent non-levy of interest tax aggregating Rs.5.18 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(v) In Chennai , Central I charge, the interest tax assessments of a company for the assessment years 1993-94 to 1995-96 were completed between January to March 1996. Audit scrutiny revealed that overdue charges which are in the nature of interest on delayed payment of loans and advances amounting to Rs.33.77 lakh, Rs.28.40 lakh and Rs.13.73 lakh received during the previous years relevant to the assessment years 1993-94 to 1995-96 respectively were not assessed to tax. The omission resulted in short levy of interest tax of Rs.3.45 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(vi) In Chennai, Tamil Nadu IV charge, the interest tax assessments of a finance company for the assessment years 1993-94 and 1994-95 were completed in December 1995 on a chargeable interest of Rs.94.64 lakh and Rs.146.14 lakh respectively. Audit scrutiny revealed that the assessee had received a sum of Rs.6.06 lakh and Rs.70.29 lakh as bill discounting charges during the assessment years 1993-94 and 1994-95 respectively and also Rs.1.42 lakh as interest on loans and deposits during the assessment year 1993-94. However, these receipts were not assessed to interest tax. Omission to do so has resulted in short levy of interest tax of Rs.3.37 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

2. The Board clarified in March 1996 that the finance charges accruing or arising to Hire purchase Finance Companies are in the nature of interest chargeable to interest tax.

(i) In Kerala, Cochin charge, the interest tax assessment of a finance and hire purchase company for the assessment year 1993-94 was completed in March 1996 accepting the returned chargeable interest of Rs.11.88 lakh. Audit scrutiny revealed that a sum of Rs.276.92 lakh credited in the profit and loss account as income by way of finance and service charges was not included in the total amount of chargeable interest. Omission to assess the aforesaid interest resulted in underassessment of chargeable interest of Rs.276.92 lakh with consequent under-charge of interest tax of Rs.16.28 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(ii) In Tamil Nadu, Coimbatore charge, the income tax assessments of two finance companies for the assessment years 1992-93 to 1994-95 were completed between March 1993 and January 1996. Audit scrutiny revealed that neither did the assessee companies file the returns of interest tax nor were these called for by the department though the assessees received interest and finance charges amounting to Rs.45.85 lakh and Rs.22.95 lakh during the relevant previous years. Omission to do so resulted in non-levy of interest tax of Rs.3.97 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

(iii) In Tamil Nadu, Coimbatore charge, assessment of a finance company for the assessment year 1993-94 was completed after scrutiny in March 1996. Audit scrutiny revealed that though the assessee had received finance charges of Rs.41.60 lakh and interest of Rs.4.74 lakh during the previous year no return for interest tax was called for by the assessing officer. Omission to do so resulted in chargeable interest of Rs.46.34 lakh escaping assessment with consequent non levy of interest tax of Rs.3.36 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.

Avoidable mistakes in computation of income and tax

6.24 Underassessment of tax of substantial amounts on account of avoidable mistakes attributable to negligence on the part of assessing officers have been repeatedly mentioned in the Reports of the Comptroller and Auditor General of India. Despite this and issue of instructions by Government from time to time, such mistakes continue to occur suggesting the need for close supervision and control.

In City III, Mumbai charge, the interest tax assessment of a company for the assessment year 1993-94 was completed in February 1996. Audit scrutiny revealed that while finalising the assessment though the assessing officer had rejected the claim of the assessee for non-inclusion of Rs.147 lakh (being interest on government securities) from the interest chargeable to tax, the same remained to be added in the computation of chargeable interest. Omission to add Rs.147 lakh resulted in underassessment of interest chargeable to tax involving short levy of interest tax of Rs.4.41 lakh.

The reply of the Ministry to the audit observation has not been received.

Non -levy of interest for delay in filing of return and short payment of advance tax

6.25 Under the Interest Tax Act, 1974, where the return for any assessment year is furnished after the specified due date, the assessee shall be liable to pay interest at two percent per month or part thereof from the date immediately following the specified due date to the date of filing the return or where no return is furnished, to the date of completion of interest tax assessment on the amount of tax determined as reduced by the advance tax, if any, paid. The Act also provides that where an assessee who is liable to pay advance tax for any financial year has failed to pay such tax or where the advance tax so paid falls short of ninety percent of the tax determined on interest tax assessment, interest at the rate of two percent for every month or part of a month is payable by the assessee on the amount by which the advance tax paid falls short of the assessed interest tax from the first day of the next financial year to the date of determination of chargeable interest.

In Karnataka Central, Bangalore charge, the interest tax assessment of a company for the assessment year 1992-93 was completed in March 1995. Audit scrutiny revealed that though the return of interest income was filed by the assessee belatedly and no advance tax was also paid on the returned interest income, no interest was levied by the department. The omission resulted in non-levy of interest aggregating Rs.6.53 lakh.

The reply of the Ministry to the audit observation has not been received.

D- Expenditure Tax

Mistake in application of rate of expenditure tax

6.26 The Expenditure Tax Act, 1987, provides for levy of expenditure tax at twenty percent with effect from 1 June 1989 on the expenditure incurred in a hotel wherein the room charges for any of the residential accommodation at the time of incurring such expenditure, exceeds Rs.400 (Rs.1200 or more with effect from 1 June 1992) per day per individual.

In Central II, West Bengal charge, the expenditure tax assessments of two closely held companies running a hotel, for the assessment years 1990-91 and 1991-92 were completed/revised after scrutiny between March 1995 and March 1996 at chargeable expenditure aggregating Rs.832.93 lakh and the tax levied aggregated Rs.83.29 lakh. Audit scrutiny revealed that expenditure tax was incorrectly charged at 10 percent instead of 20 percent of the chargeable expenditure. The mistake resulted in short levy of tax aggregating Rs.77.91 lakh.

The reply of the Ministry to the audit observation has not been received.

(MUKESH ARYA)
Principal Director of Receipt Audit
(Direct Taxes)

New Delhi
The 8 May 1998

Countersigned

(V.K. SHUNGLU)
Comptroller and Auditor General of India

New Delhi
The 8 May 1998

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