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Report of the Comptroller and Auditor General of India

Performance Audit

UNION GOVERNMENT (DIRECT TAXES) NO. PA 25 OF 2009

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for the year ended March 2008

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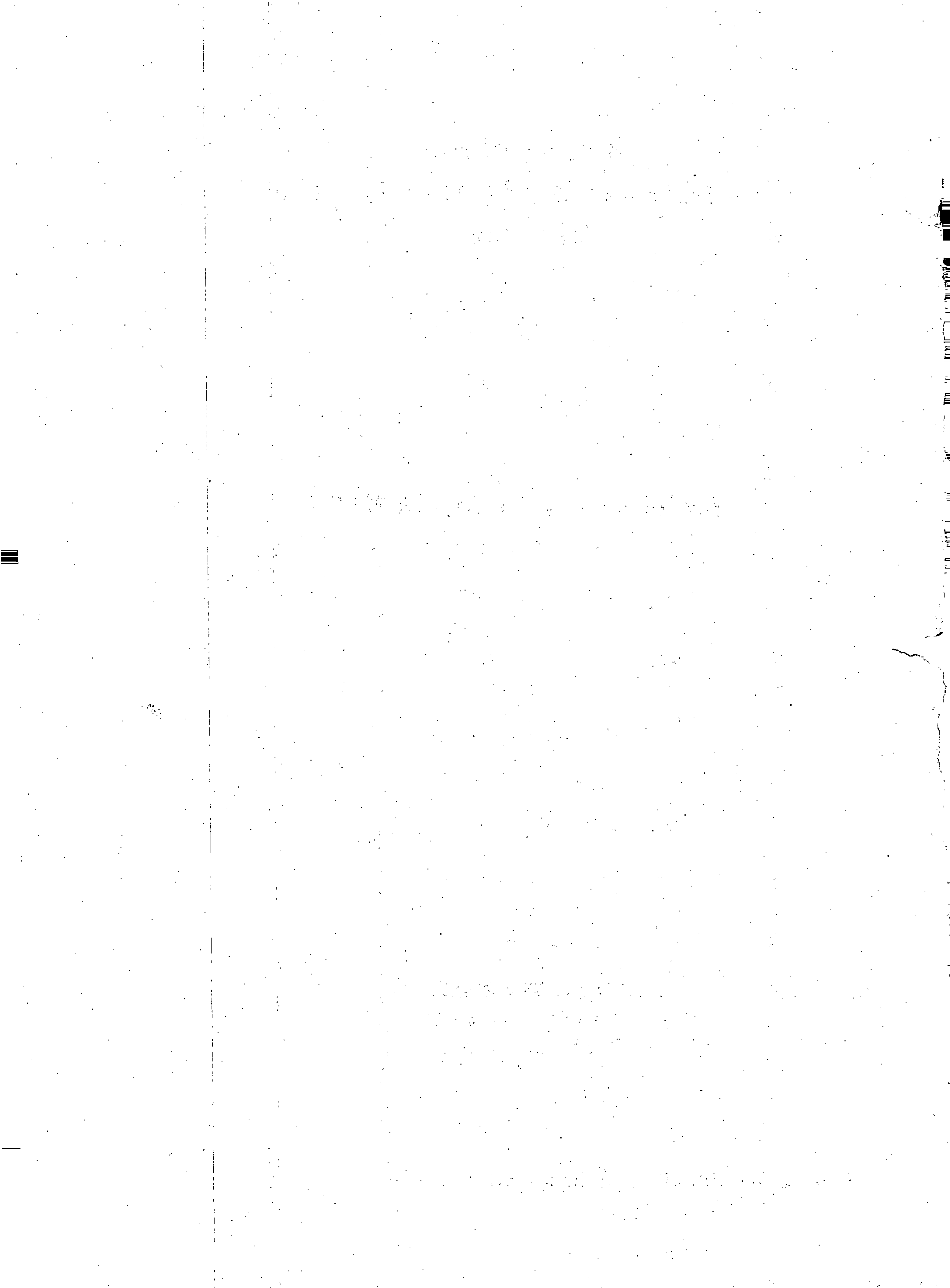

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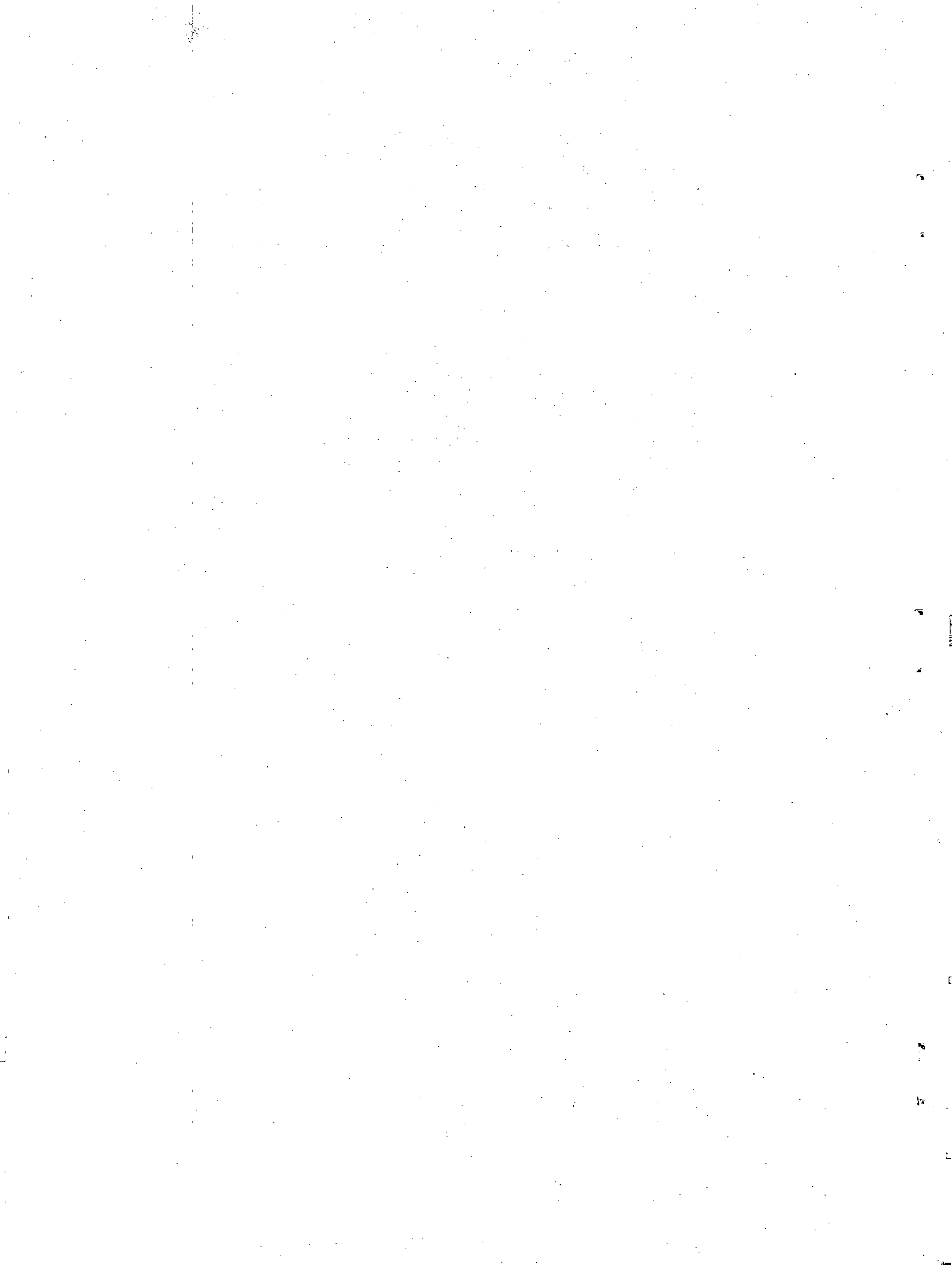


PREFACE

The report for the year ended March 2008 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

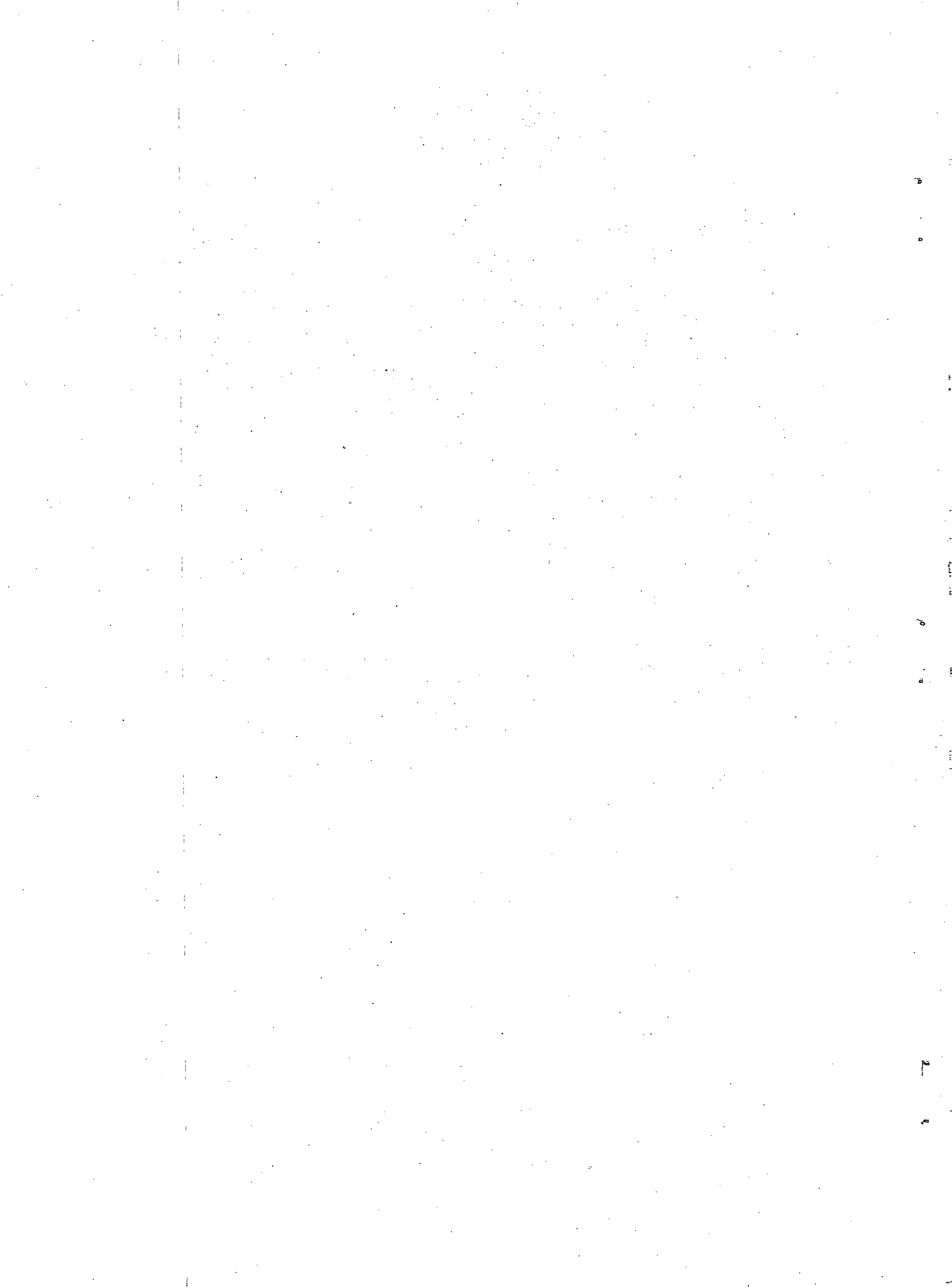
The audit of Revenue Receipts – Direct Taxes of the Union Government is conducted under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The report presents the results of audit reviews and appraisals of receipts under direct taxes. This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

(i) Chapter 1 contains results of the review on exemptions, deductions and allowances to shipping and related sectors.

(ii) Chapter 2 contains results of the review on deductions of profits and gain from certain undertakings other than infrastructure development undertakings (Deductions under section 80IB of the Income tax Act, 1961).

(iii) Chapter 3 contains results of the IT Audit of e-TDS system of Income Tax Department.

The observations included in this report have been selected from the findings of test audit conducted during 2007-2008 and in earlier years, which could not be covered in the previous reports.



Overview

I. Review on exemptions, deductions and allowances to shipping and related sectors

Audit carried out a review of the income tax assessments of assessees in shipping and related sectors relating to assessment years 2003-04 to 2006-07 and 2007-08, wherever available with a view to ascertain the adequacy of systems and procedures available and implemented. The review covered assessees engaged in shipping operations and related activities, such as shipping agents, clearing and forwarding agents etc, port trusts and non-residents deriving profits from maritime business availing relief under DTAAs or otherwise. The review revealed systemic and compliance issues with a revenue impact of Rs. 187.40 crore and Rs. 299.81 crore respectively.

The Department has not effectively monitored the shipping reserves created/utilised under different sections of the Act. Though there is an increase in the absolute number of ships and gross tonnage after the introduction of tonnage tax scheme, the position of overseas tonnage (as a percentage) remains constant. Audit observed that there was inconsistency in allowance of depreciation on assets owned by port trusts and there was no uniformity in the status of port trusts in the income tax assessments.

There was no follow up action after issue of NOC and lack of coordination with other government authorities viz. port trusts and customs authorities. There was no consistency in the taxation of shipping profits arising to residents of countries where there is no tax on shipping income under the domestic law of those countries. There was no mechanism in place to ensure that the freight earnings on imports received by the non-resident assessees involved in maritime business were assessed to tax. The coordination mechanism for taxation of coastal shipping of non-residents was inadequate.

Audit recommends that:

- The Ministry may like to ensure that the creation and utilisation of reserves is adequately monitored so that the intended purpose is not lost.
- The Ministry may consider instituting a mechanism so that relevant data from the customs authorities and port authorities are periodically obtained and reconciled with the port clearance certificates issued by the Department.
- The Ministry may like to prescribe an appropriate mechanism to ensure that all relevant documents and facts are verified before issue of NOCs.
- The Ministry may consider setting up a suitable mechanism for taxation of freight earnings from imports.
- The Ministry may like to institute a mechanism for ensuring coordination with Director General, Shipping so that income derived by non-residents from coastal shipping is brought to tax.

II. Review on Deductions of profit and gain from certain undertakings other than infrastructure development undertakings (Deduction under section 80IB of the Income Tax Act, 1961)

Audit reviewed the assessment records in respect of undertakings availing the benefit of deduction under section 80IB in order to seek assurance that systems and procedures are sufficient and in place to ensure compliance with the provisions of the Act/ Rules, evaluate the degree of compliance by the specified undertakings with the provisions of the Act, quantify the loss of revenue or underassessment and other irregularities due to mistakes in assessment, highlight lacunae or deficiencies, if any, in the administration, law or policy relating to this section.

Audit observed a total of 1,105 cases of irregularities involving a tax effect of Rs. 1,510.18 crore.

Audit observed cases where irregular deduction under section 80IB was allowed such as industrial unit not being a new industrial undertaking but formed out of reconstruction of a business already in existence; activities carried out by the industrial undertakings were not manufacturing activities; production activities were not commenced within the specified time limits as laid down in the Act; income was not derived from eligible business. Audit also observed inconsistent stand of the Department in the cases of refineries in allowing deductions in respect of marketing margin which has put a huge amount of revenue at risk besides potential revenue losses, in respect of other refineries in the country. In the Housing sector, audit observed that deductions were allowed though various conditions which have been laid down in the Act for availing deduction were not fulfilled by the assesses.

Audit recommends that:

- The Ministry may ensure that the status of an industrial undertaking is ascertained before deduction is allowed.
- The Ministry may reconcile the different stands taken by the Department in respect of deduction on marketing margin in the case of Indian Oil Corporation Limited (IOCL) and Hindustan Petroleum Corporation Limited (HPCL), and escalate the level of appeal to the highest level.
- The Ministry may ensure that judicial pronouncements in respect of manufacturing activities are applied to all similarly placed cases.
- The Ministry may consider issuing instructions so that assessing officers are vigilant in determining the eligibility of the assessee and the time period for applicability of deduction under section 80IB.
- The Ministry may evolve a suitable control mechanism to ensure the conditions as laid down for availing deduction in respect of Housing sector are complied with before allowing deduction in this regard.

- The Ministry may strengthen its control mechanism to ensure the compliance of various provisions and requirements of the Act before allowing deductions under section 80IB of the Act.

III. IT audit of e-TDS system of Income Tax Department

In this review, audit attempted to evaluate electronic filing of returns of Tax Deducted at Source with a view to ascertaining the fulfillment of the business requirements set down in the Income Tax Act, extent of utilisation of all the software features, the efficiency and accuracy of processing, adequacy of security measures and the level of data integrity.

Audit noticed cases of imperfect external interface with other (AIS, OLTAS and AST) related modules; interface with the users was not user friendly, automated solution not being provided for distinguishing already processed and unprocessed returns. Business rules were not being properly mapped. Audit also noticed that the data accuracy could not be ensured in the e-TDS system as the authorities entering the data are outside the control of the Department. Validation controls were lacking as there were instances of mistakes where the returns uploaded had errors in spite of File Validation Utility, manual returns were not properly digitized and important fields were not filled in. This resulted in the Department receiving returns with a large number of defaults which made the processing of returns difficult. Consequential non-processing of returns may result in possible revenue loss. Back-up of the data with the third party was not taken as per the terms of the MoU and the data backed up by the Department was not regularly tested for retrieval and there was lack of awareness of security measures within the Department. It was also noticed that there was delay in development of the e-TDS application and the networking system.

Audit recommends that:

- The Department should ensure better linkage with the various external interfaces.

- There is a need to fix the time limit for processing of e-TDS returns so that compliance to law is ensured and possible loss of revenue is minimised. An effective mechanism needs to be implemented to monitor the number of returns processed. The network also needs to be strengthened to enhance the processing of e-TDS returns.

- The accuracy of data has to be ensured so that it can be relied upon. Also validation controls should be constantly evaluated to ensure data integrity.

- The data backup should be taken and tested regularly for retrieval. The users should be made aware of the security issues.

Chapter I

Review on exemptions, deductions and allowances to shipping and related sectors

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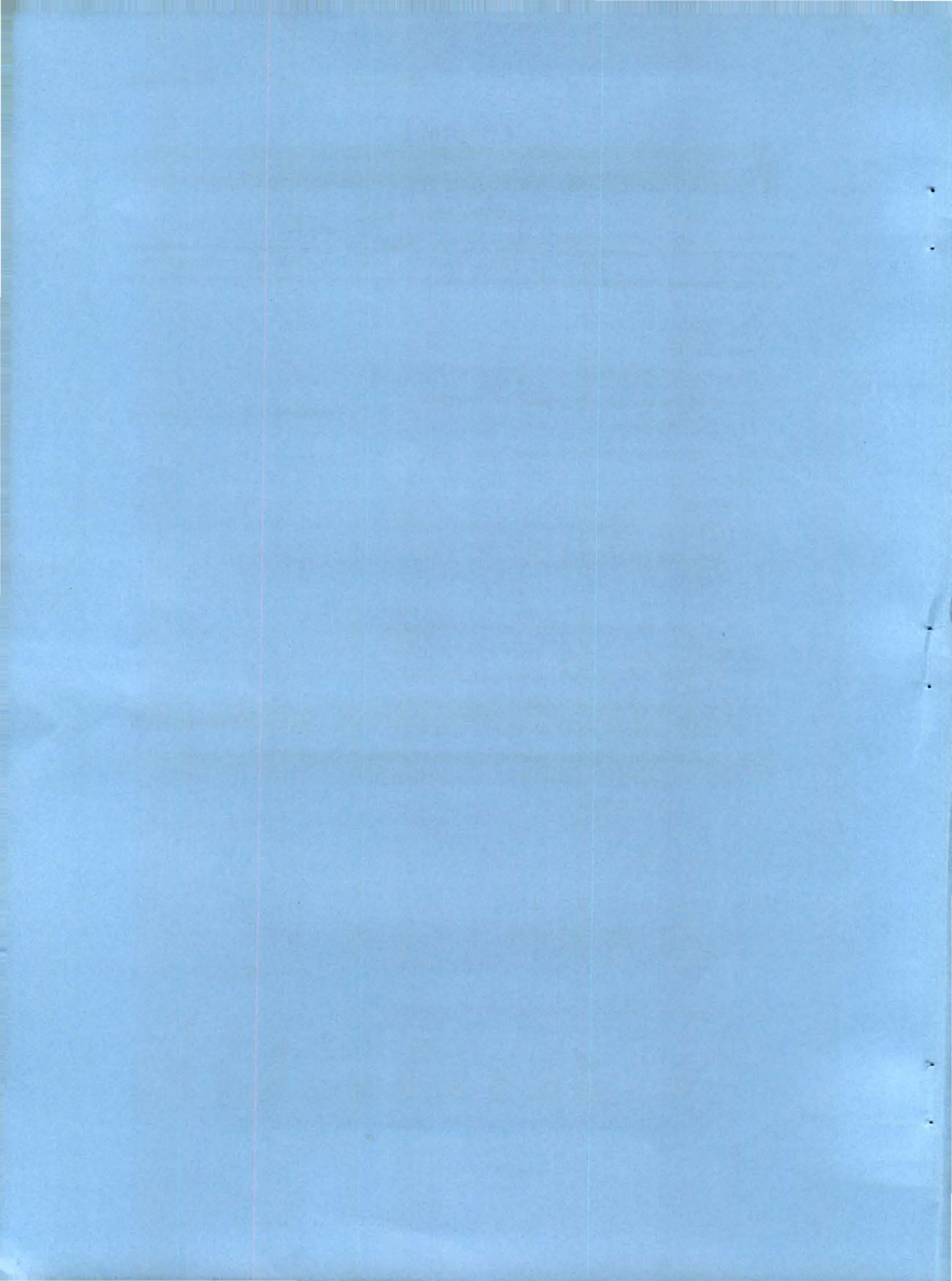


Highlights

Audit carried out a review of the income tax assessments of assessees in shipping and related sectors with a view to ascertain the adequacy of systems and procedures available and implemented. The review covered assessees engaged in shipping operations and related activities, such as shipping agents, clearing and forwarding agents, port trusts and non-residents deriving profits from maritime business availing relief under DTAAs or otherwise. All scrutiny assessments of major shipping companies and major port trusts were checked in audit. In addition 10 to 50 per cent of the port clearance certificates issued by the jurisdictional income tax officers were test checked. Ten per cent of the cases identified under related activities such as shipping agents, clearing and forwarding agents etc. were also test checked.

(Paragraphs 1.1, 1. 3 and 1.5)

Systemic deficiencies relate to creation and utilisation of reserves under section 32A and 33AC, tonnage tax, port trusts and assessment of income arising to non-residents engaged in maritime business. These issues involve a revenue impact of Rs. 187.40 crore. Compliance issues such as adoption of incorrect figures, incorrect deduction for payments made outside India without tax deduction at source, etc. with a revenue impact of Rs. 299.81 crore were noticed.

(Paragraph 1.6.3)

The reserves created under section 32A are still unutilised and no action has been taken on the same. There appears to be no monitoring mechanism for reserves created under section 33AC. Further, the safeguards for mis-utilisation/non-utilisation of reserve created under section 33AC are inadequate.

(Paragraph 1.7.5)

As envisaged in the TTS proposal, the share of Indian bottoms ferrying Indian trade increasing from 27-30 per cent to 50 per cent and that of coastal fleet to one million GRT has not been achieved.

(Paragraph 1.8.2.1)

Whereas in certain port trusts depreciation on port basin, wharves and break water, capital dredging and railway sidings was being allowed @ 25 per cent treating them as plant & machinery, in other port trusts depreciation thereon was being allowed @ 10 per cent as applicable to buildings. Excess allowance of depreciation resulted in underassessment of income involving a short levy of Rs. 84.18 crore.

(Paragraph 1.10.6)

There is no consistency in the taxation of shipping profits arising to residents of countries where there is no tax on shipping income under the domestic law of those countries. Further, there is no analysis available on the impact of these exemptions on revenue in India.

(Paragraph 1.15.3)

Two PSUs viz. BPCL and ONGC are deducting tax at source from payments to non-residents for import of crude; four PSUs viz. MRPL, HPCL, IOCL and SAIL are not deducting tax at source on import of crude/steel products. Taxation records of ships, belonging to countries with which there was no DTAA or where shipping income was taxable in India, revealed that freight payment of Rs. 2,271.76 crore during April 2005 to March 2007 had been made for imports on which tax of Rs. 71.02 crore was not levied.

(Paragraph 1.16)

In Goa, Gujarat, Karnataka and Tamil Nadu, returns filed under section 172 were processed, whereas in Andhra Pradesh, Maharashtra, Orissa and West Bengal these returns were not processed. It is improbable that all the returns filed from 1961 onwards would be assessed by 31.12.2008 as prescribed under section 172(4A). Even if these are processed, possibility of recovery of tax demand, if any, is remote.

(Paragraph 1.17)

DTAA relief of hundred per cent was being allowed to foreign ships involved in coastal shipping in contravention of the DTAAs. The coordination mechanism for taxation of coastal shipping of non-residents was inadequate

(Paragraph 1.19)

Audit recommends that:

- The Ministry may like to ensure that the creation and utilisation of reserves is adequately monitored so that the intended purpose is not lost.
- The Ministry may consider instituting a mechanism so that relevant data from the customs authorities and port authorities are periodically obtained and reconciled with the port clearance certificates issued by the Department.
- The Ministry may like to prescribe an appropriate mechanism to ensure that all relevant documents and facts are verified before issue of NOCs.
- The Ministry may consider setting up a suitable mechanism for taxation of freight earnings from imports.
- The Ministry may like to institute a mechanism for ensuring coordination with DG Shipping so that income derived by non-residents from coastal shipping is brought to tax.

Review on exemptions, deductions and allowances to shipping and related sectors

1.1 Introduction

Maritime transport is a critical infrastructure for the economic development of a country. It influences the pace, structure and pattern of development. The shipping policy of the Government is geared towards increasing the share of Indian fleet in sea borne trade. Investments in the shipping sector have been made by the State, mainly because of the large resources required, long gestation, uncertain returns and a number of externalities, associated with the infrastructure sector. Owing to the special requirements and cascading effect of the infrastructure sector on the economy, the Government has provided several fiscal incentives.

The Income Tax Act, 1961 (Act) apart from exemption and deductions available in general, provides for specific incentives to the maritime sector in the form of investment reserves, deduction under 80IB etc. From the assessment year 2005-06, the Government has introduced a new scheme, tonnage tax scheme (TTS) for the shipping industry to make it more competitive and to induce growth by encouraging capital investment. This scheme provides for presumptive taxation of income of qualifying ships based on the net tonnage and the period of its operation.

Audit carried out a review of the income tax assessments of assessees in shipping and related sectors with a view to ascertain the adequacy of systems and procedures available and implemented. Audit directed its efforts towards focused examination of contribution to revenue in the form of direct taxes by the assessees in the shipping and related sector.

1.2 Objective of the review

The review was conducted to:

- derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/Rules,
- analyse the allowance of exemptions and deductions to the shipping and related sectors under the Act,
- analyse the impact of the tonnage tax scheme,
- examine the allowance of relief under the Double Taxation Avoidance Agreements (DTAA) to non-residents engaged in maritime business.

1.3 Scope of the review and period of coverage

The review covered assessees engaged in shipping operations and related activities, such as shipping agents, clearing and forwarding agents etc, port trusts and non-residents deriving profits from maritime business availing relief under DTAAs or otherwise. The review covered assessments relating to the assessment years 2003-04 to 2006-07 and 2007-08, wherever available.

1.4 Law and procedure

In respect of residents, apart from the general provisions of the Act applicable to all business, specific provisions relating to shipping sector are covered under section 32A, 33AC and 80IB of the Act. TTS applicable from the assessment year 2005-06 is covered under section 115V to 115VZC.

Section 44B, section 172 and DTAAs concluded under section 90 and section 91 define the scope and extent of taxation of income/profits which arise/accrue to non-residents.

1.5 Audit methodology and sample size

In the absence of database of assessees engaged in shipping or related activities, audit adopted a multi pronged strategy for identifying assessees and for collection of data on the shipping sector. Analysis of the TTS and taxation of imports was carried out by utilizing data obtained from the Department of Shipping. Taxation of non-residents was examined utilizing the data obtained from the Director General of Shipping, Department of Central Excise, Customs and Service Tax and the jurisdictional Port Trusts.

Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/Commissioners of Income Tax/Director of Income Tax (International Taxation) by the Principal Directors of Audit/Principal Accountants General/Accountants General.

1.5.1 Sample size

All scrutiny assessments of major shipping companies and major port trusts were checked in audit. In addition 10 to 50 per cent of the port clearance certificates issued by the jurisdictional income tax officers were test checked. Ten per cent of the cases identified under related activities such as shipping agents, clearing and forwarding agents etc. were also test checked. Audit appraisal was carried out in the income tax jurisdictions covering the states of Andhra Pradesh, Delhi, Goa, Gujarat, Karnataka, Kerala, Maharashtra, Orissa, Tamil Nadu and West Bengal.

1.5.2 Acknowledgement

Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review report was issued to the Ministry in October 2008. An exit conference was held in December 2008 with the Central Board of Direct Taxes/Ministry of Finance to discuss the results of the reviews. The views expressed by them in the exit conference have been appropriately incorporated in this report.

1.6 Audit findings

Audit noticed that there were systemic deficiencies in the provisions and implementation thereof governing assessment of income arising to assessees relating to

the shipping sector. Audit findings have been broadly compiled under two heads residents and non-residents.

1.6.1 The issues relating to residents, *inter alia*, include:

- Creation and utilisation of shipping reserves,
- Tonnage tax scheme (TTS) and
- Port trusts.

1.6.2 The issues relating to non-residents, *inter alia,* include:

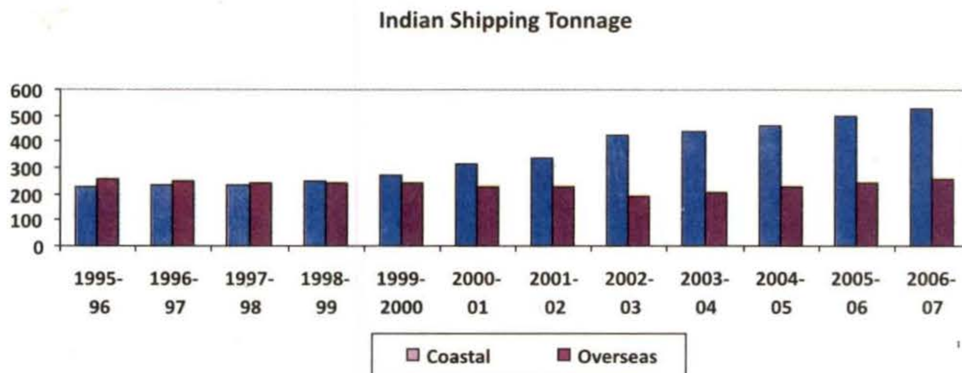
- Co-ordination with other Government authorities
- Issues relating to NOCs
- Allowance of relief under DTAAs
- Assessment of freight charges paid on imports
- Status of assessments of returns filed under section 172
- Filing of returns in respect of ships engaged in coastal trade

1.6.3 Systemic deficiencies relate to creation and utilisation of reserves under section 32A and 33AC, tonnage tax, port trusts and assessment of income arising to non-residents engaged in maritime business. These issues involve a revenue impact of Rs. 187.40 crore. Compliance issues such as adoption of incorrect figures, incorrect deduction for payments made outside India without tax deduction at source, etc. with a revenue impact of Rs. 299.81 crore were noticed.

ISSUES RELATING TO RESIDENTS

1.7 Creation and utilisation of shipping reserves

1.7.1 Shipping industry has an important linkage between economic growth and trade. It is estimated that about 70 per cent of India's overseas trade by value is carried by sea. The demand for shipping services has been steadily increasing as India's trade, post liberalization has increased phenomenally. The number of Indian ships carrying goods on coastal and overseas voyages is brought out in the diagram below:



Though there has been a steady increase in the share of Indian ships in coastal carriage, its share in the overseas sector is stagnant. The Government has time and again recognized the importance of shipping industry in overseas trade and has given fiscal incentives viz. higher rate of depreciation (section 32), investment allowance for acquisition of ships (section 32A), investment deposit account (section 32AB), shipping reserves (section 33AC) and the latest being TTS, introduced with effect from assessment year 2005-06.

1.7.2 Section 32A and 33AC

Acquisition and operation of ships being capital intensive, the government sought to provide an impetus to the shipping industry by giving fiscal incentives in the form of tax deductions. With a view to provide tax incentive to government and public companies engaged in the business of operation of ships for generation of resources internally to augment their fleet, section 32A and later section 33 AC were inserted (w.e.f. 01.04.1990) in the Act. Subsequently, the TTS was introduced w.e.f. 01.04.2005.

Section 32A introduced w.e.f. 01.04.1976, *inter alia*, provides that in respect of a ship which is owned by the assessee and is wholly used for the purpose of the business, an additional deduction of a sum by way of investment allowance equal to 25 per cent of the actual cost of the ship shall be allowed. The deduction shall be allowed only if an amount equal to 50 per cent of the investment allowance is debited in an 'investment allowance reserve account'. The investment allowance shall be utilised for acquisition of a new ship within a period of eight years immediately succeeding the assessment year in which the ship was acquired failing which the relevant amount would be added back to income. The scheme was withdrawn by Board Notification dated 19.03.1990 and no investment allowance is allowed to any ship acquired after 31.3.1990.

Consequent to withdrawal of section 32A, section 33AC, *inter alia*, provides that an assessee being a government company or a public company engaged in the business of operation of ships is entitled to a deduction of an amount not exceeding 50 per cent of the profits derived from the business of operation of ships and credited to a reserve account to be utilised for acquiring a new ship. The reserves were to be utilised within 8 years failing which the amount would be taxed as income. Pending acquisition of a ship, the accumulated reserves could be utilised for the purposes of the business of the assessee. To safeguard against mis-utilisation of the reserve, it has been provided that the reserve would be taxed as income in the year in which it is utilised for other purposes like distribution of dividends etc.

The TTS[1] provides that twenty per cent of the book profits derived from eligible shipping business, shall be transferred as 'tonnage tax reserve account' and be utilised within a period of 8 years. In case the reserve is not utilised or utilised for other purposes, the same would be brought to tax.

[1] Discussed in paragraph 1.8

1.7.3 Monitoring of shipping reserves

Common feature of sections 32A and 33AC, as also the newly inserted TTS, is the creation of specific purpose reserve account, utilisation of the reserve within a specified period and monitoring of the same by the Department. Audit sought to examine whether the reserves created under the schemes were being utilised and in case of mis-utilisation/non-utilisation, the same was brought to tax.

- **Section 32A**

  In Goa, CIT Panaji charge, test check of the records for the assessment year 2005-06 revealed that in four cases[2] investment allowance reserve created continued to be carried forward. Since the scheme was withdrawn with effect from 01.04.1990, the same should have been added back to the income of the assessee and brought to tax. Omission resulted in under assessment of income of Rs. 3.31 crore involving a short levy of tax of Rs. 1.18 crore.

- **Section 33AC**

  Test check by audit of the assessments of 13 companies **(Appendix 1)**, wherein deduction under section 33AC had been allowed revealed that huge balances amounting to Rs. 887.13 crore, Rs. 693.03 crore and Rs. 306.70 crore were outstanding under shipping reserve account during the years 2004-05, 2005-06 and 2006-07 respectively. A perusal of these assessment orders reveals that there was no specific mention of outstanding reserves under section 33AC, period to which they relate or when they would lapse. This data in the assessment order would have enabled the assessing officers to monitor the utilisation or otherwise of the reserve.

1.7.4 Inadequate safe guard to ensure utilisation of shipping reserve under section 33AC

Shipping reserve has to be utilised for the purchase of a new ship within a period of 8 years following the previous year in which the reserve was created. The effort to bring the unutilised shipping reserve to tax was not achieved as the assessees had brought forward business losses or unabsorbed depreciation which was set off against the additions. Section 155(4A), which is to safeguard against wrong utilisation of investment reserves created under section 32A, provides that the wrongly utilised reserve would be added back to the income of the assessee for the year in which the reserve was created and assessed to tax with consequential levy of interest to date.

In Maharastra, CIT City 5 Mumbai charge, audit scrutiny revealed that the following two companies which were allowed deduction under section 33 AC had not utilised the reserve at the end of eight years for acquisition of a new ship.

- The assessment of **M/s. Pranik Shipping and Services Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006. Audit scrutiny

[2] Unutilised investment allowance related to Chowgule & Co (Rs. 305.10 lakh), Srimanguesh Shipping Co. (Rs. 10.37 lakh), Nigel Ship Yard Pvt Ltd. (Rs. 13.29 lakh) and Aquarius Pvt Ltd (Rs. 1.79 lakh)

revealed that the assessee was allowed to adjust current and earlier years' unabsorbed depreciation and losses against the deemed profit of Rs. 5.92 crore arisen due to non-utilisation of reserve created during assessment year 1995-96. Had a deterrent provision been available in 33AC as available under section 155(4A) for section 32A, the tax leviable would be Rs. 8.45 crore.

- The assessment of **M/s. Garware Shipping Corporation Ltd.,** for the assessment years 2003-04, 2004-05 and 2005-06 was completed after scrutiny in December 2006, February 2005 and March 2007 respectively. Audit scrutiny revealed that the assessee had offered deemed income on account of non-utilisation of shipping reserve created in assessment years 1994-95, 1995-96 and 1996-97 of Rs. 53.81 lakh, Rs. 80.26 lakh and Rs. 1.98 crore respectively during the assessment years 2003-04, 2004-05 and 2005-06. The reserves were created out of profits relating to the assessment years 1994-95, 1995-96 and 1996-97 when the tax rate was 40 per cent plus surcharge as applicable but offered to tax during assessment years 2003-04, 2004-05 and 2005-06 when the rate of tax was 35 per cent plus applicable surcharge. If section 33AC had a deterrent provision as available under section 155(4A) for section 32A, the tax leviable would be Rs. 4.54 crore.

1.7.5 The reserves created under section 32A are still unutilised and no action has been taken on the same. There appears to be no monitoring mechanism for reserves created under section 33AC. Further, the safeguards for mis-utilisation/non-utilisation of reserve created under section 33AC are inadequate. Since the TTS also has provisions for creation and utilisation of 'reserves' it is necessary that a monitoring mechanism be put in place.

1.7.5.1 During the exit conference, the Ministry stated that the new system of 'internal audit' and the 'review and inspection' by Commissioners of Income Tax (CsIT) would address the monitoring issues raised by audit.

1.7.5.2 *The Ministry may like to ensure that the creation and utilisation of reserves is adequately monitored so that the intended purpose is not lost.*

Compliance issues

1.7.6 Incorrect allowance of deduction on income not derived from the operation of ships

1.7.6.1 In Maharastra, CIT City 5 Mumbai charge, the assessment of a company, **M/s. Arcadia Shipping Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006. Audit scrutiny revealed that the assessee was allowed deduction under section 33AC in respect of income not derived from operation of ships such as interest, vehicle hire charges, brokerage, rent, service charges etc. This resulted in underassessment of income of Rs. 1.56 crore with consequent short levy of tax of Rs. 74.47 lakh.

The Department has accepted the audit observation (October 2008).

1.7.6.2 In Maharashtra, CIT City 5 Mumbai charge, the assessment of a company, **M/s. Mercator Lines Ltd.**, for the assessment year 2003-04 was completed after scrutiny in December 2005. Audit scrutiny revealed that the assessee was allowed deduction under section 33AC in respect of insurance claim of Rs. 1.29 crore which was not derived from the business of operation of ships. This resulted in underassessment of income of the said amount with consequent short levy of tax of Rs. 47.44 lakh.

1.7.7 Non-assessment of reserve utilised for other purposes

1.7.7.1 In Andhra Pradesh, CIT-1 Visakhapatnam charge, the assessment of a company, **M/s. Dredging Corporation of India**, for the assessment year 2004-05 was completed after scrutiny in January 2006 determining an income of Rs. 188.46 crore. On appeal, the ITAT allowed relief to the assessee and order giving effect to appellate order was passed in March 2008 at an income of Rs. 8.21 crore after allowing relief of Rs. 180 crore under section 33AC.

During the year the assessee utilised Rs. 45 crore withdrawn from 'Reserve under section 33AC utilisation account' for distribution of dividends and transfer to general reserve. Audit scrutiny revealed that no new ships had been acquired during the assessment year as evidenced from the asset schedule. As Rs. 45 crore was not utilised for acquiring ships, the same was to be brought to tax. Omission resulted in under assessment of income of Rs. 45 crore with a consequential tax effect of Rs. 24.22 crore including interest.

The Department, while not accepting the objection, replied that the assessee purchased three dredgers worth Rs. 600 crore in assessment years 1999-2000 and 2000-01 and as such, applied the reserve well within time limits provided under section 33AC. However, the assessee made book entry in the accounting year 2003-04 relevant to assessment year 2004-05 for Rs. 45 crore.

The reply is not acceptable because if the reserve had been utilised during the assessment year 1999-2000 and 2000-01, the same ought to have been reflected in the books of accounts in the relevant year as per the provisions of the Companies Act. Further, the reserve would no longer exist in the balance sheet as on 31.3.2004 (assessment year 2004-05).

1.7.8 Incorrect computation of income under special provisions

For the purposes of special provisions viz., section 115JB, book profit means the net profit as shown in the profit and loss account as increased by the amounts carried to any reserves by whatever name called, other than the reserve specified under the section 33AC apart from other adjustments prescribed in the section.

1.7.8.1 In Maharastra, CIT City 5 Mumbai charge, the assessment of a company, **M/s. Mercator Lines Ltd.**, for the assessment year 2003-04 was completed after scrutiny in December 2005. Audit scrutiny revealed that as against a shipping reserve of Rs. 2.20 crore allowable under section 33AC, Rs. 3.50 crore was reduced from book profits. This

resulted in underassessment of income of Rs. 1.31 crore with consequent short levy of tax of Rs. 10.28 lakh.

1.7.8.2 In Maharastra, CIT City 5 Mumbai charge, the assessment of a company, **M/s. South East Asia Marine Engineering and Construction Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006. The assessment was completed under normal provisions levying a tax of Rs. 56.59 lakh (on an income of Rs. 1.47 crore) as it exceeded the tax payable under special provisions.

Audit scrutiny revealed that book profit had been computed after reducing Rs. 17 crore (being reserve created under section 33AC) instead of Rs. 15.15 crore (being deduction allowed under section 33AC). Consequently, the book profit works out to Rs. 8.27 crore with a tax of Rs. 63.57 lakh which is more than tax under normal provisions. Incorrect allowance of deduction under section 33AC while computing book profits resulted in short levy of tax of Rs. 14.52 lakh including interest.

The Department in not accepting the objection (June 2008), stated that, the words used in section 115JB are 'reserve specified under section 33AC' and not 'amount allowed as deduction under 33AC'. Reply is not tenable as the 'reserve created' and 'deduction allowed' cannot have different connotations under section 33AC and 115JB as otherwise creation of reserve would provide an opportunity for tax evasion. Incidentally, in the case of another assessee (M/s. Great Eastern Shipping Co Ltd - assessment year 2003-04- CIT Central, Mumbai) the Department while computing tax under section 115JB had restricted the deduction under section 33AC to amount actually allowed as against reserve created.

1.8 Tonnage Tax Scheme

The ownership of the world fleet is controlled by a select few countries viz. Greece, Japan, Germany, China and Norway with a market share of 53 per cent. India has a world market share of 1.52 per cent (2006-07). Recognising the vital role of shipping in the national economy and the need to provide a fiscal regime to enable Indian shipping to be internationally competitive, TTS was introduced by the Finance Act, 2004.

The proposal for TTS (mooted in November 2002) was not only to facilitate 'growth of Indian shipping tonnage' but also to spur fleet expansion and auxiliary activities in the shipping sector. TTS was to facilitate growth of Indian shipping tonnage; increase the share of Indian bottoms ferrying Indian trade from 27-30 per cent to at least 50 per cent in the next five years; and to augment the Indian coastal fleet to one million GRT in the next 2-3 years. As about 90 per cent of the Indian overseas tonnage requirements were being met by foreign ships, it was envisaged that the increased share of Indian overseas tonnage would result in substantial foreign exchange savings.

Chapter XII G of the Act, covering sections 115V to 115VZC, deals with the scope, application and implementation of the TTS. Tonnage income of a qualifying company shall be deemed to be the profits chargeable to tax under the head 'profits and gains of business or profession'. The TTS provides for computing income arising from the

operation of a ship on presumptive basis and is determined on the daily tonnage income of the qualifying ship. The tonnage income of an opting company for a previous year shall be the aggregate of the tonnage income of each qualifying ship and equal to daily tonnage income of each of such ship multiplied by the number of days in the previous year, or by the number of days the ship is operated. The income so arrived shall be taxed at rates prescribed under the Act. The tax payable under TTS was substantially less than that payable under normal provisions of the Act as the income was computed on notional basis.

1.8.1 Efficacy of the scheme

It is necessary that the tax concession allowed are evaluated periodically to ensure that they have the desired impact and are serving the purpose for which they were designed. Audit sought to examine the efficacy of the scheme and its impact by a study of the growth in the shipping sector involving the following parameters:

- Tonnage of Indian vessels
- Average age of Indian fleet
- Foreign exchange outgo

1.8.2 Tonnage of Indian vessels

The development of Indian Gross Registered Tonnage[3] (GRT) for the period from 1.04.2000 to 01.01.2008 (i.e. before and after introduction of TTS) is given in the table below:

('000 tonnes)

Table 1.1: Tonnage of Indian vessels

As on	Coastal		Overseas		Total	
	Ships	G.R.T.	Ships	G.R.T.	Ships	G.R.T.
Position prior to introduction of tonnage tax scheme						
1-04-2000	273	681.60	240	6,231.36	513	6,912.96
1-04-2001	316	697.24	230	6,119.35	546	6,816.59
1-04-2002	336	733.65	224	6,087.28	560	6,820.93
1-04-2003	425	805.26	191	5,372.29	616	6,177.55
1-04-2004	436	807.80	203	6,136.40	639	6,944.20
Position after introduction of tonnage tax scheme						
1-04-2005	458	810.59	228	7,202.36	686	8,012.95
1-04-2006	496	817.44	243	7,646.98	739	8,464.42
1-04-2007	530	842.03	257	7,753.15	787	8,595.18
1-01-2008	573	893.13	277	8,136.41	850	9,029.54

Source: Annual reports of Ministry of Shipping

1.8.2.1 Coastal shipping with 573 ships and GRT of 893.13 thousand tonnes constitutes 10 per cent of the total GRT while overseas shipping constitutes the remaining. India has a world market share of about 1.52 per cent (2006-07). Thus, though there is an

[3] GRT is a factor of the total volume of all enclosed spaced of the ship in cubic metres and is computed as provided under Rule 3 of The Merchant Shipping (Tonnage Measurement of Ships) Rules, 1987

increase in the absolute number of ships and gross tonnage, the position of overseas tonnage (as a percentage) remains constant. Thus, the share of Indian bottoms ferrying Indian trade increasing from 27-30 per cent to 50 per cent as envisaged in the proposal for TTS has not been achieved. Further, Indian coastal fleet has not achieved the target of one million GRT as envisaged in the TTS proposal.

1.8.2.2 A study of the ownership data of ships in India reveals that out of total 850 ships (as on 1 January 2008), 47 are owned by government departments or parastatals, 73 by port trusts and 16 of them are dredgers. These 136 vessels involving tonnage of 193.54 thousand tonnes GRT would not be available for commercial exploitation for carriage of goods.

1.8.3 Average age of Indian fleet

The average age of the fleet owned by India (as on 1 January 2007) vis-à-vis the average age of developing countries, developed countries and the world average is given in table below:

Table 1.2: Average age of Indian fleet vis-à-vis developing and developed countries

Sl. No.	Name of the country and world ranking	Age					Average age
		0 to 4 years	5 – 9 years	10 – 14 years	15 – 19 years	20 years and above	
1	India*	9.9	14.4	13.8	11.6	50.3	17.9
2	Developing countries#	24.6	18.9	17.1	11.8	27.7	12.4
3	Developed countries#	28.4	29.9	17.6	7.8	16.3	9.9
4	World#	25.1	21	16.7	10.9	26.2	12

*Indian National Ship Owners Association, Mumbai
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Thus, in spite of deductions to the shipping sector (over a period of 20 years) under sections 32A, 33AC and the favourable tax regime in the form of TTS, the average age of Indian fleet is higher than that of the industry average.

1.8.4 Foreign exchange outgo

The position of volume of maritime tonnage handled by foreign vessels for the financial years 2004-05 to 2006-07 is given in the table below:

('000 tonnes)

Table 1.3: Volume of maritime tonnage handled by foreign vessels

Financial Year	Loaded	Percentage to total loaded cargo	Unloaded	Percentage to total unloaded cargo	Total of loaded and unloaded	Percentage to total
2004-05	1,55,730	94.8	1,90,717	81.0	3,46,447	86.7
2005-06	1,71,770	95.2	2,14,253	80.3	3,86,023	86.3
2006-07	1,89,552	94.9	2,47,393	83.0	4,36,945	87.8

Given the fact that about 90 per cent of the India's maritime overseas shipping needs are being met by non-residents, there is considerable foreign exchange outgo to the owners/operators of ships registered abroad.

The expenditure incurred for transportation in foreign exchange[4] during the years 2004-05, 2005-06 and 2006-07 was Rs. 20,363 crore, Rs. 34,746 crore and Rs. 40,029 crore respectively. Approximately, 95 per cent of the country's trade by volume and 70 per cent[5] by value are moved by sea. Thus, the foreign exchange outgo on account of engaging the services of ships owned by the non-residents has not reduced even after the introduction of TTS.

1.8.5 Evaluation of tonnage tax scheme

The TTS was introduced to reduce the impact of taxes on eligible shipping companies. Audit sought to examine the revenue foregone on account of TTS and the number of assessees opting for the scheme.

In the absence of relevant data with the Department, audit obtained data on companies opting for TTS from the Ministry of Shipping. Data obtained from the Ministry revealed that of the 169 entities (excluding parastatals) owning ships, 25 companies had opted for the TTS during assessment year 2005-06. Audit sought to examine the impact of tax paid under the TTS vis a vis that under the normal provisions of the Act as also the tax paid by these companies during the pre tonnage tax period. Audit analysis of 18 assessees revealed that nine companies during assessment year 2003-04 and six companies during assessment year 2004-05, which were not paying taxes on account of availing the deduction under section 33AC, had to pay taxes under TTS. In respect of eight companies there has been a substantial reduction in taxes paid (**Appendix 2**).

1.8.6 The growth in Indian shipping tonnage subsequent to the introduction of the TTS has not kept pace with either the requirements of the Indian overseas shipping or the growth in maritime trade of India. The Ministry, during exit conference, stated that TTS is an internationally accepted best practice for taxing income from shipping. Apart from taxation the performance of the shipping industry is dependent on a host of other factors both domestic and international. The performance of shipping industry in this overall scenario cannot be a reason for modification in the taxation law.

1.8.6.1 *The Ministry may review the tonnage tax scheme.*

Compliance issues

1.9 Mistakes noticed in assessments of assessees other than port trusts are brought out in the following paragraphs:

[4] Reserve Bank of India annual reports
[5] Annual Report 2007-08, Department of Shipping, GOI

1.9.1 Non-qualifying income assessed under TTS

In Andhra Pradesh, CIT 2 Hyderabad charge, the assessment of a company, **M/s. Kei-Ross Maritime Ltd.**, for the assessment year 2005-06 was completed after scrutiny in March 2007 accepting the returned income including income of Rs. 0.91 lakh under TTS. The assessee owned four tugs and was accorded approval under TTS. Audit scrutiny however revealed that the assessee had computed income from seven tugs (four owned and three chartered) under TTS as against four tugs approved. Further, the assessee had not furnished a certificate issued by the DG, Shipping under the Merchant Shipping Act, 1958 as required under section 115VD and a certificate of minimum training requirement as required under section 115VU in respect of these three tugs. Hence, the income of Rs. 2.24 crore relating to these three tugs which should have been computed under normal provisions of the Act, was not done. This resulted in under assessment of income of Rs. 2.24 crore with a consequential tax effect of Rs. 1.13 crore.

The Department stated (October 2008) that all the qualifying ships need not be approved to be eligible for tonnage tax scheme and certificates required under section 115VU were available on record. The reply is not acceptable as the assessee, while applying for TTS, did not furnish the details, in the prescribed form[6], in respect of the three chartered ships, in accordance with the Rule 11P of the Income Tax Rules, 1962. The valid certificates available on record pertained to owned ships and not to the three chartered ships.

1.9.1.1 In Andhra Pradesh, CIT Hyderabad charge, mistakes in computing income under TTS were noticed in three other cases involving a short levy of Rs. 32.34 lakh.

1.9.2 Income not offered to tax

Assessing officers have to determine and assess the income correctly after verifying accounts, claims and records of the assessee.

In Tamil Nadu, CIT III Chennai charge, the assessment of a company, **M/s. Poompuhar Shipping Corporation Ltd.**, for the assessment years 2003-04 and 2004-05 was completed after scrutiny and in summary manner in February 2006 and March 2006 respectively. The assessee was allowed an expenditure of Rs. 13.46 crore and Rs. 6.51 crore for the assessment years 2003-04 and 2004-05 respectively from the freight income towards under performance of voyages on own vessels in pursuance of freight agreement with M/s. Tamil Nadu Electricity Board (TNEB).

Audit scrutiny revealed that there was no such condition for reduction of freight income owing to under performance of voyages of own vessels as per the freight agreement entered into with TNEB (original in 1978 and subsequent revisions till date). Therefore, the reduction made towards under performance of voyages from freight income for the above assessment years aggregating to Rs. 19.97 crore was irregular involving a short levy of Rs. 9.58 crore.

[6] Form No. 65

1.9.3 Implementation of appellate order

An aggrieved assessee can appeal to the Commissioner of Income Tax (Appeals) against the order of an assessing officer who shall comply with the directions given in the appellate order. Any mistake committed while giving effect to an appellate order results in underassessment/overassessment of income.

In Gujarat, CIT Gandhinagar charge, the assessment of **M/s. Gujarat Maritime Board** was completed after scrutiny in December 2006 determining an income of Rs. 1.16 crore as against 'nil' income returned by the assessee. On an appeal by the assessee, all the additions were deleted. Audit scrutiny of the order of April 2007 giving effect to appeal order revealed that instead of depicting the income of the assessee as 'nil' it was shown as loss of Rs. 28.46 crore. This resulted in incorrect computation of loss of Rs. 28.46 crore involving a potential tax effect of Rs. 8.54 crore.

1.9.4 Audit also noticed other mistakes in respect of 34 assessees involving tax effect of Rs. 24.16 crore of which 12 assessees involving tax effect of Rs. 20.26 crore are given in **Appendix 3**.

1.10 Port Trusts

1.10.1 Port trusts are parastatals set up under the Major Port Trusts Act, 1963 discharging the set of functions as prescribed under the Major Port Trust Act. The accounting standards to be followed have been laid down by the Department of Shipping and are based on the Indian Companies Act, 1956. The tariff fixations for various services rendered by the ports are based on orders of the Tariff Authority for Major Ports.

Indian port sector comprises 12 major ports and 200 minor ports. Eleven major ports are governed by the provisions of Major Port Trust Act, 1963 and the twelfth is the Ennore Port Limited, the first corporate major port. The remaining ports are under the administrative control of the respective maritime State Governments. The total volume of the traffic handled by all the Indian ports during 2007-08 was 649.38 million tonnes, of which 463.84 million tonnes (71 per cent) was handled by major ports and remaining 185.54 million tonnes by the non-major ports.

1.10.2 Status of port trusts

Till the assessment year 2002-03, the income of the port trusts were exempt under section 10(20) of the Act as they were deemed to be local authorities. Consequent to the amendment of section 10(20), the port trusts became taxable from the assessment year 2003-04 onwards. A study of the assessments of the port trusts revealed that there was no uniformity in the status accorded to port trusts in the income tax assessments as brought out in the table below:

Table 1.4: Status of port trusts

Sl No.	Name of the port trust	Status under which assessed as in assessment year 2005-06	Rate at which tax has been levied
1	Kolkata,	Local Authority	35 per cent
2	Mumbai, Paradip, Chennai, Kandla	Local Authority	30 per cent
3	Kochi (Cochin)	Artificial Juridical Person	35 per cent
4	Mormugao	Trust (Charitable Institution)	Exempted
5	Tuticorin	Association of Persons	30 per cent
6	Vishakhapatnam	Local Authority	30 per cent
7	New Mangalore	Local Authority	30 per cent
8	Jawaharlal Nehru (JNPT)	Local Authority	30 per cent

Sl. No.3: Based on order of ITAT, Kerala, assessee has been granted registration as 'charitable trust' as defined under section 12AA.
Sl. No.4: As held by ITAT, Panaji.
Sl. No.5: Assessee sought registration as 'trust' with CIT I, Madurai, Tamil Nadu which was rejected. Assessee has preferred an appeal before ITAT after obtaining approval from Committee of Disputes.
Sl. No.6: Based on order of ITAT, Hyderabad, assessee has been subsequently granted registration as 'charitable trust' as defined under section 12AA with retrospective effect.
Sl. No.7: Assessee's application for registration as 'trust' is pending in appeal (May 2008) with CIT(A).
Sl No 8 Assessee has been subsequently accorded the status of 'charitable trust'.

1.10.2.1 Given the fact that the port trusts are engaged in the same set of activities and are governed by the same set of rules and regulations, it becomes necessary that the status for assessment purposes under the Act is clarified to ensure consistency.

1.10.3 Assessments in appeal

A study of the assessments of the major port trusts and disputes arising thereon revealed that there are several appeals pending (October 2008) resulting in locking up of government revenue of Rs. 756.28 crore in litigation (**Appendix 4**).

A majority of the cases pertain to the written down value to be adopted for allowing depreciation on assets purchased and put to use prior to 2003-04 (when port trusts were not taxable). The Department, while allowing depreciation on these assets, had taken the stand that depreciation would deem to have been allowed notionally and written down value adopted accordingly in assessments after assessment year 2003-04. The assessees went in appeal on the above stand of the department and consequent disallowances. Subsequently, Finance Act, 2008[7] introduced an explanation under section 43(6) with retrospective effect from 01.04.2003.

Audit study revealed that no action had been taken by the Department to speed up the judicial process by filing necessary applications with the relevant authorities.

[7] Passed by Parliament in May 2008. The explanation clarified that where assessee was not required to compute his total income for the purpose of this Act during preceding years (as in the case of port trusts), then while arriving at w.d.v of assets, the depreciation provided in the books of accounts of the assessee shall be deemed to be the depreciation actually allowed under this Act.

1.10.4 Alternatives to assessment of port trusts

The Supreme Court has held[8] that income of an authority, even constituted by a notification under an Act enacted by the Legislature, is not the income of the Government and the Authority cannot claim exemption from Union taxation. The Prime Minister's Council on Trade and Industry in its recommendation on Ports under Infrastructure Development has recommended that *'to ensure that the port trusts start operating along more commercial lines, it is necessary to corporatise them'*. Further, section 5 of the Major Port Trust Act, 1963 provides that 'every Board constituted under this Act shall be a body corporate having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold or dispose of property and may by the name by which it is constituted, sue or be sued'. Further, the Ministry of Shipping[9] guidance note provides that *'the format of financial statements prescribed by the Indian Companies Act, 1956 has been used as the basis for developing the accounting format of port trusts together with the requirement of accounting standards'*.

1.10.4.1 The port trusts thus follow accrual system of accounting and the identification of revenue and expenditure is based on the principles contained in the Companies Act, 1956. Further, steps have already been taken for corporatisation of JNPT, New Mangalore and Tuticorin port trusts viz. registering with the jurisdictional Registrars of Companies.

1.10.4.2 In case port trusts are treated as 'companies', apart from providing clarity and consistency for assessment purposes, it would also be possible for the Department to collect additional revenue by levy of tax under special provisions (Minimum Alternate Tax).

1.10.5 Consequent to amendment to section 10(20), the port trusts became taxable from the assessment year 2003-04. Audit study of the assessments of the port trusts revealed that there was no uniformity in the status accorded to port trusts in the income tax assessments as also the levy of tax. Whereas, four port trusts had been accorded the status of 'charitable trusts' after repeated appeals, the application of two others are pending approval. Further, there have been moves to corporatise the port trusts. Not only is the contribution of port trusts to the exchequer in the form of income tax meagre, the tax demands raised are locked up in disputes.

1.10.5.1 While accepting the views of audit that 'ports trusts' were being assessed differently, the Ministry during exit conference stated that section 2 of the Act has been amended through Finance Act 2008 effective 01.04.2009, by which the term charitable purpose has been redefined to exclude activities in the nature of trade or business carried out for a fee or cess or any other consideration.

[8] Adityapur Industrial Area Development Authority *v.* Union of India (2006) 283 ITR 97
[9] Ministry of Shipping (Ports Wing) letter No PR-20021/2/98-PG dated 06.11.2002

1.10.6 Allowance of depreciation

Under section 32 of the Act, depreciation shall be allowed on assets owned by the assessee and used for the purposes of the business of the assessee at the rates prescribed in Rule 5 of the Income tax Rules. Wharves are fixed platforms which serve as interim storage areas intended to enable unloading and reloading vessels as quickly as possible. Breakwaters are structures constructed on coasts as part of coastal defence or to protect an anchorage from the effects of weather. Therefore, these structures are in the nature of buildings. Similarly, since capital dredging relates to creation of harbour berth or waterway or to deepen existing facilities in order to allow access to larger ships, it forms part of building. It has been judicially held[10] that railway track or rail road are 'roads' and hence are to be treated as buildings and depreciation allowed accordingly.

Audit scrutiny revealed that depreciation on port basin, wharves and break water; capital dredging and railway sidings was being allowed @ 25 per cent treating them as plant & machinery as against the allowable rate of 10 per cent as applicable to buildings as detailed in the following paragraphs:

1.10.6.1 Whereas in the assessment port trusts at Mumbai and Kandla depreciation on wharves and related structures had been allowed at the rate of 10 per cent, depreciation at M/s. Ennore Port Ltd. had been allowed at the rate of 25 per cent. This resulted in excess allowance of depreciation of Rs. 110.23 crore involving a short levy of Rs. 40.11 crore (**Appendix 5**).

1.10.6.2 Whereas in the assessment port trusts at Mumbai, Kochi, Tuticorin and Marmugao depreciation on capital dredging had been allowed at the rate of 10 per cent, depreciation at Visakhapatnam, Kakinada, New Mangalore and Chennai had been allowed at the rate of 25 per cent. This resulted in excess allowance of depreciation of Rs. 78.98 crore involving a short levy of Rs. 26.28 crore (**Appendix 5**).

1.10.6.3 Whereas in the assessment port trusts at Paradip and Kandla depreciation on railway sidings had been allowed at the rate of 10 per cent, depreciation at Visakhapatnam, Kakinada, Mumbai and JNPT had been allowed at the rate of 25 per cent. This resulted in excess allowance of depreciation of Rs. 42.30 crore involving a short levy of Rs. 17.79 crore (**Appendix 5**).

In respect of Kakinada, the Department inviting a reference to various judgements, replied that railway sidings and capital dredging are to be treated as plant and allowed depreciation accordingly. Reply of the Department may be viewed in the light of different treatments accorded to ports located elsewhere as also judicial pronouncement[11] pertaining to allowance of depreciation on similar assets.

1.10.6.4 *The Ministry should reconcile these differences so as to ensure consistency in treatment of assets and charge depreciation accordingly.*

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[10] Union of India v. Authority under Minimum Wages Act 1948 Naval Area [AIR 1969 Bom 310] [Bombay HC] and CIT v. Roongta Mines Pvt Ltd [1992] 183 ITR 570 (Cal)

[11] CIT v. Mazagaon Dock Ltd (1994) 206 ITR 260 (Bom.)

Compliance issues

1.10.7 Adoption of incorrect figures

In a scrutiny assessment, the income of the assessee shall be correctly computed after making the required adjustments as laid down in the Act.

In Maharashtra, CIT Thane charge, the assessment of **M/s. Jawaharlal Nehru Port Trust** for the assessment year 2005-06 was completed after scrutiny in December 2007 and rectified in March 2008. During the scrutiny assessment, capital loss of Rs. 23.21 crore was incorrectly treated as capital gains to arrive at the taxable income. The rectification order of March 2008 was passed to rectify this mistake. Audit scrutiny of the rectification order revealed that instead of reducing Rs. 23.21 crore, Rs. 46.41 crore was reduced. This resulted in underassessment of income of Rs. 23.21 crore involving a short levy of tax of Rs. 9.83 crore.

1.10.8 Other miscellaneous mistakes noticed in the assessments of port trusts in 10 cases involving tax effect of Rs. 13.27 crore are detailed in **Appendix 6**.

ISSUES RELATING TO NON-RESIDENTS

1.11 Maritime transport is a critical infrastructure for the social and economic development of a country. India's maritime needs are predominantly being fulfilled by foreign ships, as has been discussed earlier. The share of foreign ships in total overseas trade is about 80-95 per cent. The overseas trade of India is a major source of revenue to foreign vessels.

India's overseas trade of 497809 thousand tonnes is predominantly carried by foreign lines (95 per cent in exports and 83 per cent in imports)[12]. Audit sought to examine the adequacy of rules and procedures for taxation of income accruing to non-residents engaged in maritime business on account of carriage of goods from Indian ports.

1.11.1 Provisions for taxation

1.11.1.1 Sections 90 and 91 deal with powers of the Central Government to enter into agreement with foreign countries for granting relief to doubly taxed income. Generally DTAAs provide that profits derived by an enterprise of a contracting state from the operation of ships in international traffic shall be taxable only in that state.

1.11.1.2 Section 172(1) deals with taxation of non-residents from occasional shipping business and provides for levy and recovery of tax in case of any ship, belonging to or chartered by non-resident, which carries passengers, livestock, mail or goods shipped from a port in India. Section 172(3) provides that the master of the ship shall furnish a return of the tax amount paid/payable on account of such carriage before departure from any port in India. The assessing officer may, however allow the ship to depart by issuing 'no objection certificate' (NOC), if the master of the ship makes satisfactory

[12] Annual Report of Ministry of Shipping 2006-07

arrangement for filing of the return within 30 days of the departure of the ship and payment of tax. Under section 172(4), the assessing officer shall assess the income and determine the tax payable. Section 172(4A) introduced by Finance Act, 2007[13] provides that no order under section 172(3) shall be passed after nine months. Returns pending assessment shall be processed before 31.12.2008. Section 172(7) provides an option to the assessee to get his income assessed under other provisions of Income Tax Act. In such a case, the annual return filed by the assessee shall be assessed under section 143(3).

1.11.1.3 The Board laid[14] down that where it is not possible for the master of the ship to furnish the return before the departure of ship, arrangements could be made in the form of suitable bond or bank guarantee to safeguard the interest of revenue. It is further provided[15] that the assessing officer may issue annual NOC where ships are owned by an enterprise belonging to a country with which India has entered into DTAA and the agreement provides for taxation of shipping profits only in that country of which the enterprise is resident and no tax is payable by them in India. The assessing officer is to ensure before issue of NOCs that all the requisite documents or evidence such as proof of residence, details of loading port and discharge port, freight payable as per charter agreement, have been submitted. The NOCs are being issued by designated jurisdictions of the Department.

1.11.1.4 Section 44B details the special provisions for computing profits and gains of shipping business in the case of non-resident assessees. In section 44B, the incidence of tax is on a non-resident engaged in the business of operation of ships owned or chartered by him for carriage of passengers, livestock, mails or goods shipped from a port in India. This provision covers non-resident assessees engaged in regular shipping business.

1.12 Taxation of maritime business of non-residents

Audit noticed inconsistencies in issue of NOCs, incorrect issue of NOCs and allowance of DTAA relief where there were no agreements and irregular exemption allowed under DTAA to Indian ships. In some cases, tax relief was allowed invoking provisions of inapplicable DTAAs. Audit findings are brought out in the following paragraphs:

1.13 Co-ordination with other government authorities

Since port trusts are the nodal authorities for regulating the movement of ships, audit obtained data on foreign ships which have sailed out of ports and attempted to correlate it with the issuance of NOCs by the Department.

[13] w.e.f. 01.04.2007
[14] vide instruction 838 dated 3 June 1975
[15] vide circular 732 dated 20 December 1995

1.13.1 Port trusts

In Visakhapatnam Port, relatable to ITO (International Taxation) Visakhapatnam charge, Kandla Port, relatable to CIT I Rajkot charge, Mumbai Port, relatable to DIT International Taxation, Mumbai charge, and Paradip port relatable to CIT Cuttack charge differences were noticed between number of foreign ships sailing out of port and number of NOCs issued as detailed below:

Table 1.5: Number of foreign ships sailing out of port and number of NOCs issued

Assessment year	As per port trust				As per records of the Department			
	Number of ships which have embarked on international voyage				Number of applications received for issue of NOC for international voyage			
	Visakhapatnam	Kandla	Mumbai*	Paradip	Visakhapatnam	Kandla	Mumbai$	Paradip
2003-04	1,142	1,610	NA	556	513	2,064	NA	209
2004-05	1,327	1,630	4,784	664	639	1,886	1,008	302
2005-06	1,519	1,843	5,846	807	699	1,627	1,566	413
2006-07	1,490	1,926	5,464	821	558	1,185	2,314	476
2007-08	727	NA	5,276	936	727	NA	1,915	529
	6,205	**7,009**	**21,370**	**3,784**	**3,136**	**6,762**	**6,803**	**1,929**

* Vessels set sail for international voyage as per information received from Mumbai Port Trust and Jawaharlal Nehru Port Trust.
$ Data does not include NOCs issued by one charge viz. Range I DIT International Taxation Mumbai during 2004-05 and 2005-06.

The system of issuing NOC under section 172 and processing the return before a foreign ship left the Indian port on international voyage was conceived as a safeguard to ensure that the non-resident discharged his tax liability before leaving the Indian port. It appears that the Department has not made adequate attempts to coordinate with the port authorities to obtain data on foreign ships carrying cargo from Indian ports and reconcile the same with the port clearance certificates issued. Thus an effective tool for safeguarding the interests of revenue has been left untapped.

1.13.2 Customs Authorities

Returns filed under section 172 are to be carefully verified with the details filed by the assessee. Assessing officer has to call for the relevant documents and wherever necessary, 'voyage accounts' need to be summoned and examined to ensure that tax payable is correctly determined.

1.13.2.1 In Maharashtra, DIT International Taxation, Mumbai, four NOCs were issued for carriage of cargo totaling to 810 Teus[16]. Audit scrutiny revealed that the actual cargo carried was 4,827 Teus, far exceeding the load declared in the NOCs. Similarly, in two other cases, NOCs were issued for carriage of 8200 Metric tonnes but the actual cargo carried was 18,155 Metric tonnes. Thus, goods carried and taxes paid as per NOCs were far less than what was actually carried.

1.13.2.2 In Andhra Pradesh, Visakhapatnam Port Trust relatable to ITO (International Taxation), Visakhapatnam charge, audit obtained details of ships that have set on international traffic during 2003-04 to 2006-07 and the quantity of goods carried by

[16] Twenty equivalent units

them from the port of Visakhapatnam and correlated the same with data in the Income-tax Department. Audit scrutiny revealed that the quantity of goods actually carried was more than the quantity declared at the time of seeking NOCs and consequently, full freight charges was not brought to tax. Failure of the Department to implement a mechanism to cross verify and bring to tax full freight charges paid for exports resulted in loss of revenue of Rs. 15.01 lakh.

1.13.2.3 A correlation of records of Karwar Port relating to CIT Mangalore charge with the records of the Income-tax Department revealed that three ships carrying export cargo had neither applied for a NOC nor had filed returns of income under section 172(3). However, these ships were given clearance from the port and had embarked on international voyage.

Table 1.6: Ships which had neither applied for NOC nor had filed returns

Sl No	Name of vessel	Nationality	Date of sailing from the port	Nature of goods	Quantity in MTs
1	MT Uni Tank	Panama	05.03.2007	Molasses	10,223
2	MV Chiat	Not indicated	19.04.2007	Iron ore	37,700
3.	MV Morlera	Croatia	01.02.2008	Iron ore	54,261
There is no DTAA either with Panama or with Croatia and hence the income from freight earnings would necessarily be taxable in India.					

1.13.3 Lack of adequate follow up of action after issue of NOC and lack of coordination with the port trusts and customs authorities jeopardized the interest of revenue.

1.13.3.1 *The Ministry may consider instituting a mechanism so that relevant data from the customs authorities and port authorities are periodically obtained and reconciled with the port clearance certificates issued by the Department.*

1.13.3.2 While accepting the audit view during exit conference, the Ministry stated that the responsibility of ensuring payment of applicable taxes and verifying the port clearance certificate was with the Customs authorities [section 172 (6)]. The Ministry added that it will explore the possibility of establishing online mechanism for coordination with the Customs authorities.

1.14 Deficiencies in issue of NOCs

On receipt of an application from master of a ship or his agent, the assessing officer shall issue an NOC to the applicant after examining the necessary details. NOCs shall be issued after careful examination of nationality of freight recipient, DTAA applicable, proof of incorporation of the company, nature of business, port of discharge, residential proof, indemnity bond or bank guarantee to cover the tax on freight income, master bond by the master of the ship nominating an agent, etc. Audit examination revealed mistakes in issue of NOCs as given below:

Table 1.7: Deficiencies in issue of NOCs

Sl No	Charge and nature of mistake
1	**CIT Jamnagar Gujarat** • Of the 145 cases checked in audit, the date of issue was not indicated in 113 Master Bonds filed and were thus open ended and were to be treated as defective. No Master Bonds were available in 14 cases. Further, in respect of 18 cases, NOCs were issued prior to obtaining Master Bond. • In seven cases NOCs were issued to M/s. Venkatesh Carriers Ltd., Jamnagar who acted as agent in India for USL Shipping FZE UAE, wherein a tax of Rs. 35.87 lakh was payable for which cheques were issued to the Department between November 2003 and October 2005. These cheques were, however, not remitted to bank for realization and all the cheques had become time barred (May 2007) resulting in loss of revenue of Rs. 35.87 lakh. The Department accepted the audit observation and stated that remedial action taken by raising a demand of Rs. 35.87 lakh. • During the period 2003-04 to 2005-06, 87 NOCs had been issued to **M/s Atlantic Shipping Pvt Ltd.** (shipping agent) on behalf of various ships even though there was no challans or other proof (like indemnity bond) for payment of applicable taxes. The tax payable amounted to Rs. 50.29 lakh.
2	**CIT-I Rajkot Gujarat** • In 15 cases, Master's Certificate/authority (i.e. Master Bond) was not available on record and of these final returns were not filed in 10 cases. • In 21 cases, it was noticed that NOCs were issued after departure of the ship which defeated the very purpose of issue of NOCs. • In 17 cases, during the financial year 2007-08, NOCs were issued allowing 100 per cent tax relief, based on NOCs issued earlier by the Joint Director (International Transaction), Mumbai during financial year 2006-07 without de novo verifying the applicability of the treaty benefits resulting in irregular exemption of DTAA involving a tax effect of Rs. 6.37 lakh.
3	**CIT Panaji Goa** • During the period 2003-04 to 2006-07, 2160 NOCs were issued to non-resident shipping companies through the Indian agents on the basis of indemnity bonds filed by the agent without verifying the requisite details such as residential proof of owner or charterer responsible for paying the tax, freight payable as per charter agreement, the agreement between owner and the agents. Thus, verification of the authenticity of appointment of the agents was not complete. Audit could not ensure as to how the assessing officer had verified the eligibility or otherwise for allowing DTAA relief.

1.14.1 NOCs were thus being issued even where the applicants had not provided the relevant information and without proper examination of the facts to the detriment of revenue.

1.14.1.1 *The Ministry may like to prescribe an appropriate mechanism to ensure that all relevant documents and facts are verified before issue of NOCs.*

1.14.1.2 During the exit conference, the Ministry stated that the existing mechanism provides for verification of relevant facts. However, in view of the audit observations, the Ministry agreed to ensure that the facts were checked properly before issue of NOCs.

1.15 Incorrect allowance of relief under DTAAs

Relief under DTAA should be allowed based on the DTAAs relevant to the nationality of the freight beneficiary. Freight beneficiary may be owner or charterer of the ship. The commercial arrangements in shipping trade are complex and charter parties operate in a chain. This makes it difficult to identify the nature and purpose of the arrangement and the relationship between the ship owner, charterer, sub-charterer and shipper. This complicates the issue as to which party in the chain is liable to tax especially under section 172.

1.15.1 Audit study revealed that in the following cases DTAA relief had been incorrectly allowed:

(Rs. in lakh)

Table 1.8: Incorrect allowance of relief under DTAAs

<table>
<tr><th>Sl No</th><th>Provision of treaties</th><th>Details of audit observations</th><th>Tax effect</th></tr>
<tr><td rowspan="4">1</td><td rowspan="3">Indo Switzerland DTAA

There is no separate clause for taxation of income arising from maritime business. However, under article 7 relating to 'business profits' it has been stated that 'business profits of an enterprise of a Contracting State other than the profits from the operation of ships in international traffic shall be taxable only in that State'. Thus income from operation of ships in international traffic would be subject to tax in the other State but only so much of the profit as is directly or indirectly attributable to that State. Hence, the profit arising from carriage of goods from India would be liable to tax as provided under section 172 of the Act.</td><td>ITO (International Taxation) Visakhapatnam,
BHP Billiton Marketing Agency, Switzerland

Tax relief of Rs. 13.63 lakh on a freight income of Rs. 27.63 lakh (being 7.5 per cent of freight payment of Rs. 368.40 lakh) was allowed which was irregular.'</td><td>13.63</td></tr>
<tr><td>CIT I Rajkot

30 NOCs had been issued to freight beneficiaries belonging to Switzerland during the period 2005-06 to 2007-08 wherein tax relief of Rs. 219 lakh had been allowed, which was irregular.</td><td>219</td></tr>
<tr><td>CIT Kochi
Mediterranean Shipping Company, Switzerland

Tax relief of Rs. 2.84 lakh in respect of two NOCs had been allowed.</td><td>2.84</td></tr>
<tr><td colspan="2">The Department stated that a new article No. 22 was inserted w.e.f. 20.12.2000 in the DTAA which provides that the tax on income of a resident of a contracting state, wherever arising, not dealt with in the foregoing article of this agreement shall be taxable only in that state. Reply is not tenable as Article 22(1) is of a general nature and taxation of shipping profits is already covered under Article 7 of the Indo Swiss DTAA.</td><td></td></tr>
</table>

Sl No	Provision of treaties	Details of audit observations	Tax effect
2	**Indo South Korea DTAA** Article 9(2) of the DTAA read with Protocol of July 1985, profits derived from the operation of ships in international traffic may be taxed in the Contracting State in which such operation is carried on; but the tax so charged shall not exceed 90 *per cent* of the tax otherwise imposed by the internal law of the State.	**CIT Jamnagar,** **S.K. Shipping, Seoul** Tax on freight income of Rs. 24.38 lakh works out to Rs. 10.20 lakh. DTAA relief of Rs. 5.10 lakh (@ 50 per cent) was allowed and the NOC was issued after payment of remaining amount. Relief allowable under Indo-Korea (South) DTAA was only 10 per cent as against 50 per cent allowed.	4.08
	The Department accepted (April 2008) the audit observation.		
3	**Indo Greece DTAA** Article 6(1) of the Indo Greece DTAA provides that when a resident of Greece operating ships derives profits from India through such operations carried on in India such profits may be taxed in Greece as well as in India. But the tax so charged in India shall be reduced by 50 per cent thereof and the reduced amount of Indian tax payable shall be allowed as a credit against Greek tax charged. Article 6(4) provides that Article 6(1) shall not in the case of India affect the application of section 172(1) to 172(6) for the assessment of profits from occasional shipping i.e. the provisions of Article 6(1) shall apply only when an adjustment is made under section 172(7).	**CIT Kakinada** 15 NOCs had been issued during 2003-04 to 2007-08 wherein DTAA relief of 50 per cent had been allowed even though in none of the cases, assessees' had opted for regular assessment under section 172(7) either by exercising an option or filing a regular return of income. Thus as against a tax leviable of Rs. 115.85 lakh, only a tax of Rs. 46.64 had been levied resulting in excess relief of Rs. 69.21 lakh apart from interest of Rs. 13.46 lakh.	82.67
		CIT Mangalore In one case, NOC was issued without levying or collecting any tax.	3.78
4	**Indo Norway DTAA** Article 9 of Indo Norway DTAA provides that profits derived by an enterprise of a contracting state from the operation of ships in international traffic shall be taxable only in that state. Notwithstanding the above, such profits may be taxed in the contracting state in which such operation is carried on but the tax so charged should not exceed 50 per cent of the tax otherwise imposed by the internal law of that state. The amount of such profits subject to tax in India shall not exceed 7.5 per cent of the sums receivable in respect of the carriage of passengers or freight embarked in India.	**CIT Panaji, Goa** Returns filed by **M/s. Salgaokar Mining Industries (P) Ltd** in the capacity of an agent on behalf of entities belonging to Norway was processed under Indo-Norway DTAA after allowing DTAA relief @100 per cent. Audit scrutiny revealed that the relief allowable under Indo-Norway DTAA was only 50 per cent resulting in short levy of tax of Rs. 16.93 lakh.	16.93
	The Department agreed to examine the issue.		

Sl No	Provision of treaties	Details of audit observations	Tax effect
5	**Entities from Bermuda** As per Article 3(1) of the Indo UK DTAA read with Article II(1) of the limited DTAA, the term 'United Kingdom' means 'Great Britain including England, Wales and Scotland' and Northern Ireland. The DTAA shall not be applicable to other territories such as Channel Islands and Isle of Man.	**CIT, Jamnagar** NOCs had been issued in seven cases on the basis of Indo-UK DTAA to M/s. Interocean Shipping (I) Pvt. Ltd in respect of voyages by various ships. The freight beneficiary in these cases was M/s. Mansel Oil Limited of Hamilton, an enterprise based in Bermuda. As nationality of the freight beneficiary was Bermuda, Indo UK-DTAA would not be applicable. Hence, the NOCs granted without collection of tax of Rs. 73.32 lakh was irregular.	73.32
	The Department accepted the audit observation.		
6	**Entities from Liberia** India does not have a DTAA with Liberia.	**Addl. DIT International Taxation, Paradip, Orissa** Tax relief of Rs. 2.17 lakh was allowed in case of the ship MV EL Tango for the assessment year 2006-07 on the basis of Indo-Japan DTAA. Audit scrutiny revealed that the ship and the freight beneficiary belonged to Liberia, with which there is no DTAA and hence income would be taxable in India. Failure to invoke the DTAA based on nationality of the freight beneficiary who is located in Liberia resulted in incorrect allowance of relief of Rs. 2.17 lakh.	2.17
7	**Indo France DTAA** Article 9 provides that profit derived by an enterprise of a contracting state from the operation of ships in international traffic shall be taxable only in that contracting state. Notwithstanding the above, such profits may be taxed on other state from which they are derived, provided that, tax so charged shall not exceed during the first five fiscal years after the entry into force of this convention, 50 per cent and during the subsequent five years 25 per cent of the tax otherwise imposed by the internal law of that state. Article 30 of DTAA provides that this convention shall enter into force on the first day of the second month following	**CIT Panaji, Goa** **M/s. South India Corporation (Agencies) Ltd.** filed a return of income in the capacity of an agent on behalf of M/s. Setaf Saget Exploitation, belonging to France. The return related to freight income of Rs. 83.29 lakh earned during October 2004 and December 2004, was processed after allowing relief (@100 per cent) of Rs. 34.15 lakh by invoking the Indo France DTAA. Audit scrutiny however revealed that 25 per cent of the applicable taxes would be payable as against 'nil' tax assessed by the Department. This omission resulted in non-levy of tax of Rs 8.54 lakh.	8.54

Sl No	Provision of treaties	Details of audit observations	Tax effect
	the date of receipt of the letter of the notification and shall thereupon have effect in India in respect of income arising in any fiscal year beginning on or after the first day of April following the calendar year in which the convention enters into force. The DTAA was notified vide Notification No GSR 681(E) dated 07.09.1994 (calendar year 1994) and would be applicable to income arising on or after 01.04.1995 relevant to the financial year 1995-96.		
	The Department replied that as the DTAA came into force from 01.08.1994, the freight earnings received in December 2004 was ten years after the date of agreement and hence the assessee was eligible for 100 per cent exemption. Therefore, the assessment dated 28 February 2005 was in order. The Department's reply is not acceptable as Article 9 states that 100 per cent tax relief under DTAA agreement was available after 10 years after the entry into force of the convention. The date of reckoning is available in Article 30 which provides that 'the notification shall have effect in India in respect of income arising in any fiscal year beginning on or after the first day of April following the calendar year in which the convention enters into force'. Thus, the period of 100 per cent exemption was available from 1 April 2005 onwards.		
8	India does not have DTAA with Panama, Bahamas, Liberia and Marshall Islands	**CIT Mangalore Karnataka** DTAA relief of 100 per cent had been allowed in respect of 17 ships/voyages during the period from 2004-05 to 2007-08. The freight beneficiaries belonged to countries (Panama 7, Bahamas 3, Liberia 6 and Marshall Islands 1) with which India does not have a DTAA. Audit scrutiny revealed that 100 per cent tax relief had been allowed by the Department by invoking the nationality of the purchaser of goods as against the nationality of the freight beneficiary which was irregular.	259

1.15.1.1 Thus, port clearance certificates were being issued in a routine manner without actually examining the allowability or otherwise of DTAA relief. Given the complexity of the trade, NOCs are being obtained invoking the nationality of registry of the ship, or flag or shipper or charterer or sub charterer or owner where hundred per cent relief is available to shipping profits under DTAA.

1.15.1.2 *The Ministry may like to review the situation so as ensure clarity and reduce complexity in application of DTAA.*

1.15.1.3 While agreeing to the audit view, the Ministry during exit conference stated that the assessing officers concerned would be further sensitized on the clauses contained in DTAAs relating to taxation of maritime business.

1.15.2 DTAA relief to entities of countries where shipping income is exempt

A study of the provisions relating to taxation of shipping profits in Cyprus, Singapore, Malaysia and United Arab Emirates (UAE) reveals that no tax is leviable on ships belonging to these countries which are engaged in international maritime traffic.

1.15.2.1 Article 8 of the Indo-UAE DTAA provides that profits derived by an enterprise of a contracting state from the operation of ships by that enterprise in international traffic shall be taxable only in that State. UAE does not have any enforced Income Tax Legislation for general business. An Income Tax Decree has been enacted by each Emirate, but in practice the enforcement of these decrees is restricted to foreign banks and oil companies[17] only. Audit also observed from the certificates produced by the UAE freight beneficiaries that they were not liable to tax in the UAE. Thus, there is effectively no tax on shipping income derived from international maritime business of entities/ships of UAE.

Reference is invited to the ruling given by the Authority for Advance Rulings in the case of Cyril Eugene Pereira[18] holding that *'liability to pay tax both in India and the foreign country entitles a taxpayer to claim relief under rules laid down in the DTAA. If the taxpayer pays tax or is liable to pay tax under the laws in force in one country alone, he cannot claim any relief from a non-existent burden of double taxation. DTAA is meant only for the benefit of taxpayers who are liable to pay tax twice on the same income'.*

Applying this logic to the Indo-UAE DTAA implies that if shipping income is exempt in UAE, the assessee can not claim any deduction on that shipping income. However, the following was observed:

1.15.2.2 In Delhi, DIT IT charge, **M/s. Emirates Shipping Lines, FZE, UAE** had been issued an annual NOC by JDIT (OSD) International Taxation for the period 1.4.2006 to 31.03.2007 allowing 100 per cent relief. The assessee was required to submit an annual consolidated freight tax return under section 172. In view of the position detailed above, since no tax was payable in UAE, 100 per cent relief allowed to the assessee was irregular. This resulted in non-assessment of income of Rs. 16.88 crore (being 7.5 per cent of freight charges of Rs. 225.12 crore) involving short levy of tax of Rs. 7.13 crore.

In Andhra Pradesh in 21 cases relating to Kakinada Port, six cases relating to Visakahapatnam Port, in Kerala four cases relating to Kochi Port, in Karnataka five cases relating to Mangalore Port and in Gujarat two cases relating to Kandla port, Jamnagar charge freight beneficiaries of UAE were allowed tax relief of Rs. 1.94 crore, Rs. 20.23 lakh, Rs. 3.58 lakh, Rs. 18.33 lakh and Rs. 12.08 lakh respectively. The relief granted was

[17] Source *http://www.government.ae/gov/en/biz/business/taxes.jsp*
[18] 239 ITR 650 (AAR)

irregular as these entities would be taxable in India applying the ratio of the above ruling.

1.15.2.3 While the assessing officer at Kakinada jurisdiction replied that the audit observation would be examined, in Visakhapatnam the audit observation was not accepted on the ground that there is no pre-condition that, to enjoy relief under DTAA, the freight beneficiary should be taxable in the country of residence. In Jamnagar charge, the Department stated that the matter was referred to parties concerned for making the payment.

In Delhi, the Department stated that the Authority for Advance Rulings (AAR) was specific to the assessee and the applicability of the same cannot be extended to other assessees. While inviting a reference to the Supreme Court judgment in the case of Azadi Bachaon Andolan[19], it stated that there was no scope of denying the benefit of the tax treaty to a company which is incorporated in UAE. It added that if the contention of audit was accepted, it would lead to dishonouring international agreements which is against the spirit of Vienna Convention-Law of Treaties.

1.15.2.4 The reply is not acceptable in view of the following:

- The Supreme Court was dealing (in this case) with residency certificate, taxation of capital gains under Article 14 and treaty shopping especially in the context of Indo Mauritius DTAA and Board Circular No 789 wherein the Court has held the circular as valid.
- The issue in the current objection relates to taxation of shipping profits and no where has audit contested the residency or primacy of DTAAs over the Act.
- The Supreme Court neither set aside the principles enunciated by the AAR in the Cyril Eugene Pereira's case nor was it set aside when it took the view that though actual payment may not be necessary, it should be shown to be payable in other country.
- There is no corresponding law in UAE and exemption of shipping profits has not led to development of mutual economic relations, trade and investment as required in section 90(2). Discharge of fiscal obligations by non-residents on income earned in India can in no way be treated as violation of the sprit of Vienna Convention Law of Treaties.

1.15.3 There is no consistency in the taxation of shipping profits arising to residents of countries where there is no tax on shipping income under the domestic law of those countries. Further, there is no analysis available on the impact of these exemptions on revenue in India.

1.15.3.1 *The Ministry may like to conduct a study of the tax exemptions being extended to countries where income from shipping are exempted under domestic laws and the non-residents escape paying taxes both in India and abroad.*

[19] 263 ITR 706

1.15.3.2 The Ministry, during the exit conference, stated that DTAAs are intended not only to avoid double taxation but also for other economic interests of the country.

1.16 Non-assessment of freight charges paid on imports

Though there is specific mention of taxability of freight charges paid for goods shipped from a port in India (i.e. exports) and a mechanism for implementation of the same (viz., section 172), there is no specific mention regarding the taxation of income contained in the freight charges paid for goods brought to a port in India (i.e. imports). The Kolkata High Court in the case of Czechoslovak Ocean Shipping International Joint Stock Company and Another v. Income Tax Officer[20] *held that income earned on freight charges paid for import is liable to tax.*

1.16.1 The quantum of goods imported through various major ports during 2002-03 to 2005-06 was 1,68,565, 1,81,618, 2,00,795 and 2,27,640 thousand metric tonnes. Audit sought to examine the revenue implication with reference to freight income earned by non-residents engaged in the maritime business of carrying goods into India. Since a substantial portion of imports in India comprises crude and petroleum products (more than 75 per cent) and steel/iron ore, audit examined the payment of tax or otherwise of the freight charges paid for import of crude and steel products by public sector companies which revealed the following:

(Rs. in crore)

Table 1.9: Deduction of tax at source from payments to non-residents for import

Sl. No	Particulars	Financial year	Freight paid	Amount of TDS	Remarks
1.	Bharat Petroleum Corporation Ltd (BPCL)	2006-07	1.72	0.20	TDS effected @ 11.8 per cent
		2007-08	45.58	4.83	TDS effected ranged between 1.66 per cent to 11.8 per cent
2.	Mangalore Refinery and Petrochemicals Ltd. (MRPL)	2005-06	76.38	Nil	Freight charges in nine cases paid to residents of Liberia with which India does not have DTAA.
		2006-07	62.37	Nil	Freight charges in five cases paid to residents of Liberia with which India does not have DTAA.
		2007-08	69.65	Nil	Freight charges in seven cases and two cases paid to residents of Liberia and Marshall Islands with which India does not have DTAA.
3.	Oil & Natural Gas Commission Ltd. (ONGC)	2005-06	34.98	1.16	TDS affected on charter hirer charges paid to contractors.
		2006-07	33.99	1.08	
4.	Hindustan Petroleum Corporation Ltd. (HPCL)	2006-07	12.78	Nil	Freight charges in one case have been paid to resident of Monaco with which India does not have DTAA.
		2007-08	46.88	Nil	

[20] 81 ITR 162

Table 1.9: Deduction of tax at source from payments to non-residents for import

Sl. No	Particulars	Financial year	Freight paid	Amount of TDS	Remarks
5.	Indian Oil Corporation Ltd. (IOCL)	2007-08	76.71	Nil	Freight charges have been paid to residents of Liberia (45), Panama (6), Taiwan (5), Marshall Islands (1), Iran (4), Hong Kong (2), Kuwait (1), Monaco (13) and Bermuda (4) with which India does not have DTAA. Payments were also made to residents of Greece (11) and Korea (8) where India has DTAA and shipping income would be taxable in India
6.	Steel Authority of India Ltd. (SAIL)	2003-04	453.81	Nil	No tax has been deducted at source on freight charges
		2004-05	743.73	Nil	
		2005-06	961.90	Nil	
		2006-07	973.40	Nil	
		2007-08	1,648.90	Nil	

1.16.2 Whereas two Public Sector Undertakings (PSUs) importing crude viz. BPCL and ONGC are deducting tax at source from payments to non-residents for import of crude, four PSUs viz. MRPL, HPCL, IOCL and SAIL are not deducting tax at source on import of crude/steel products.

1.16.3 Audit requisitioned data on imports managed/arranged by the Chartering Wing in the Department of Shipping, Ministry of Shipping, Road Transport & Highways for the period from 1.4.2005 to 31.3.2007. The imports managed/arranged for by the Chartering Wing comprises 10 per cent (approx.) of the total imports by India. Audit study of taxation of ships belonging to countries with which there was no DTAA or where shipping income was taxable in India revealed that freight payment of Rs. 2,271.76 crore have been made for imports as given below:

(Rs. in crore)

Table 1.10: Non-assessment of freight charges paid on imports

Sl No.	States	Imports in MT	Freight Payment	Loss of revenue
1.	Andhra Pradesh	54,36,652	685.68	21.50
2.	Gujarat	29,98,000	366.95	11.00
3.	Karnataka	*	523.27	16.70
4.	Maharashtra	33,42,918	679.45	21.31
5.	Orissa	1,60,000	16.41	0.51
	Total		**2,271.76**	**71.02**

* Not quantifiable. The freight payments have been arrived at based on Import General Manifests furnished by the Customs Department at Karnataka.

1.16.4 Thus though provisions in the Act exist for taxation of both exports and imports, failure of the Department to implement a mechanism for taxation of income contained in freight charges paid for imports resulted in substantial loss of revenue.

1.16.5 While in Mangalore, Karnataka, the Department agreed to examine the audit point raised, in Kandla, Gujarat it stated that the taxability is determined on the basis of

residency of actual freight beneficiary and added that unless the ultimate freight beneficiary and its country of residence is ascertained, it cannot be said with certainty that loss of revenue has taken place.

1.16.6 There is no mechanism in place to ensure that the freight earnings on imports received by the non-resident assessees involved in maritime business were assessed to tax by the Department.

1.16.6.1 *The Ministry may consider setting up a suitable mechanism for taxation of freight earnings from imports.*

1.16.6.2 The Ministry, during the exit conference, stated that freight payments accruing or arising out of India are subject to taxation as per the Income Tax Act. It added that the individual cases would be examined.

1.17 Status of assessment of returns filed under section 172

On receipt of a return the assessing officer shall assess the income and determine the tax payable thereon at applicable rates. Section 172(1) gives a right to the ITO to levy and recover tax in case of any ship belonging to a non-resident in a 'summary manner' (ad hoc assessment) not withstanding anything contained in other provisions of the Act[21]. Since preliminary scrutiny of the taxability or otherwise of the freight income has already been carried out while issuing the NOC, the assessment scheme contemplated under section 172(3) is summary[22].

1.17.1 Audit examination revealed that jurisdictional offices at Goa, Gujarat, Karnataka and Tamil Nadu had processed the returns filed under section 172 and others had not processed the same as detailed below:

Table 1.11: Status of assessment of returns filed under section 172

Sl No	Jurisdiction	2003-04		2004-05		2005-06		2006-07		Total		
		Filed	Assd	Filed	Assd	Filed	Assd	Filed	Assd	Filed	Assd	Not assd
1.	Andhra Pradesh	648	Nil	814	Nil	953	Nil	887	Nil	3,302	Nil	3,302
2.	Karnataka	326	306	456	448	499	430	411	328	1,692	1,512	180
3.	Orissa	302	Nil	413	Nil	476	Nil	529	Nil	1,720	Nil	1,720
4.	West Bengal	3,526	Nil	5,457	Nil	7,089	Nil	8,640	Nil	24,712	Nil	24,712
5.	Maharashtra	NA	NA	1,008	Nil	1,566	Nil	2,314	Nil	4,888	Nil	4,888
6.	Gujarat	2,304	132	2,098	Nil	1,945	Nil	1,680	Nil	8,027	132	7,895
7.	Goa	458	458	469	444	364	26	873	639	2,164	1,567	597
8.	Tamilnadu*	7,852	7,852	6,264	6,264	8,384	8,384	11,758	11758	34,258	34,258	Nil

* Please see paragraph on Default in filing of returns

1.17.2 On the issue of non-processing of returns, the Department at Kerala, Maharashtra, Andhra Pradesh and Orissa has given varying replies such as no returns have been assessed; the units dealing with administration and implementation of

[21] A.S. Glittre D/S I/S Garonne v. ITO [1997] 91 Taxman 286/225 ITR 739 (SC).

[22] Union of India v. Gosalia Shipping Pvt Ltd (1978) 113 ITR 307 (SC)

section 172 were created in June 2003 and June 2004; no information is available in the Department regarding the number of non-resident assessees who defaulted to file return of income as required under section 172 and no internal audit was conducted in respect of NOCs issued and returns processed under section 172; there is no practice of processing returns under section 172 and that there was no time limit prescribed for processing of returns filed under section 172 prior to 2007.

1.17.3 The reply of the above offices needs to be viewed in the background of action taken and processing done by offices at Karnataka, Goa, Tamil Nadu and Gujarat where the returns filed under 172 have been processed. Section 172 clearly provides for assessment of returns filed and just because no time limits are specified does not mean that the returns are available for assessment indefinitely. The recourse to take shelter under the new section 172 (4A) and the reasoning that time is available till 31.12.2008 for all returns filed to date does not sustain, as it is improbable that all the returns filed from 1961 onwards would be assessed by 31.12.2008. Even if these are processed, possibility of recovery of tax demand, if any, is remote.

1.17.3.1 *The Ministry may like to review the situation since the issue involves non-residents involved in maritime business who do not have a permanent establishment in India.*

1.17.3.2 The Ministry, during the exit conference, agreed to ensure that all the returns are processed within the prescribed period.

Compliance issues

1.18 Default in filing of returns

In Tamil Nadu, DIT (IT) Chennai charge, 984 and 1118 port clearance certificates had been issued during the year 2005-06 and 2006-07 respectively. Pertaining to these PCCs, 16,046 and 14,476 returns were to be filed under section 172 (3). However, it was noticed that only 4,558 and 9,900 returns were received and assessed under section 172. In respect of the balance 11,488 and 4,576 returns for the financial years 2005-06 and 2006-07, respectively, neither the assessee filed the return as envisaged under section 172 (Board's circular of December 1995) nor the Department initiated any action to obtain the same.

On this being pointed out (August 2006 and August 2007), the Department replied that in the absence of any laid down procedure, the Income Tax Office would call for such returns telephonically, if required after going through the port clearance register.

Similarly, the position in respect of Karnataka and Maharashtra is as follows:

Table 1.12: Default in filing of returns

Sl no	Jurisdiction	Charge	Period	NOCs issued	Returns receivable	Returns not filed
1	Karnataka	ITO, Ward 1, Karwar	2003-04 to 2006-07	682	682	157
2	Maharashtra	DIT International Taxation, Mumbai	2007-08	11*	109	109
		Total		**682**	**791**	**1,473**

*NOCs issued to principal charterers who are responsible for filing returns in respect of all the slot charterers

1.19 Non-filing of returns by non-residents in respect of ships engaged in coastal trade

Section 407 of the Merchant Shipping Act, 1958 provides that a foreign ship entering a port in India may carry goods to other ports in India after obtaining approval from DG Shipping, Mumbai[23]. The profits earned from the operation of ships in coastal traffic between ports in India are taxable in India.

Audit sought to examine the procedures for coordination with DG Shipping, Mumbai for obtaining data on foreign ships engaged in coastal shipping so as to ensure that necessary returns were being filed and incomes assessed to tax. Audit study revealed inadequacies as detailed in the following paragraphs:

1.19.1 DTAAs with Japan, UAE and Singapore provide that profits derived from the operation of ships in international traffic carried on by an enterprise of a Contracting State shall be taxable only in that State. However, profits arising to non-residents out of carriage of goods within places situated in a contracting state shall be taxed in the contracting state in which income was derived. Board reiterated[24]the above position.

In Andhra Pradesh ITO (International Taxation), Visakhapatnam charge and Gujarat DIT International Taxation, Gandhidham charge audit scrutiny revealed that DTAA relief was incorrectly granted though voyages were between ports within India resulting in under-assessment of income of Rs. 1.05 crore with a tax effect of Rs. 48.50 lakh.

1.19.2 A test check of records of the New Mangalore Port Trust and the Department revealed that ships with foreign flags had operated in coastal trade. It was noticed that in 44 instances, between 2006 and 2008, ships with foreign flags had not filed returns under section 172 declaring their earnings on such voyages nor had they arranged for the same through their agents. The Department of Customs had also not insisted upon furnishing NOC from the Income-tax Department in terms of section 172(6) at the time of allowing these ships to set sail. In the absence of details of freight paid or payable to the ship owners/charterers, escapement of income and tax chargeable thereon could not be quantified.

The Department agreed to examine the audit observation.

[23] Shipping Development Circular No 2 of 2002 issued by DG, Shipping
[24] vide circular No 732 dated 20.12.1995

1.19.3 DTAA relief of hundred per cent was being allowed to foreign ships involved in coastal shipping in contravention of the DTAAs. The coordination mechanism for taxation of coastal shipping of non-residents was inadequate.

1.19.3.1 *The Ministry may like to institute a mechanism for ensuring coordination with Director General, Shipping so that income derived by non-residents from coastal shipping is brought to tax.*

1.19.3.2 The Ministry, during the exit conference, agreed with the audit recommendation.

Compliance issues

1.20. Incorrect adoption of tax rates

According to Circular No. 732 dated 20.12.1995 issued by CBDT, the income earned by ships belonging to non-residents engaged in international traffic shall be entitled to relief under DTAA provisions and in case they are engaged in coastal traffic the income earned thereon shall be taxable in India.

1.20.1 In Tamil Nadu, DIT International Taxation Chennai charge, royalty payments (charter hire payments) made by **M/s. Poompuhar Shipping Corporation Ltd. and M/s. SICAL Logistics Ltd.** to non-residents during the assessment years 2003-04 and 2004-05 were assessed to tax after treating the assessees in representative capacity.

1.20.2 Audit scrutiny revealed that the royalty payments made to non-residents were assessed to tax at lower rates of 10/15 per cent. As these ships were utilised only for coastal traffic i.e. for carriage of goods between ports in India and not in international traffic, the income arising to non-residents would be taxable under normal provisions of the Income Tax Act. Thus, the tax leviable would be @ 20 per cent as specified in section 115A. Omission to invoke 115A resulted in short levy of Rs. 14.36 crore.

Miscellaneous issues

1.21 Incorrect deduction for payments made outside India without TDS

Section 195 provides that any person responsible for paying to a non-resident any sum chargeable under the Act, shall deduct tax at source at the time crediting the payment. Section 9(vii) provides that income by way of fees for technical services payable to a non-resident is deemed to accrue or arise in India. Section 40(a) (i) provides that any interest, royalty, fee for technical services or other sum payable outside India or to a non-resident shall not be allowed as deduction in computing the business income, if tax is not deducted at source or after deducting it is not paid to Government account.

In the case of *West Asia Maritime Ltd. v. Income Tax Officer*[25] relating to the assessment year 2003-04, the ITAT held that hire charges paid by Indian charterers for hiring ships

[25] [2008] 297 ITR (AT) 202 (Chennai)

on Bare-Boat Charter-cum-Demise (BBCD) basis to a non-resident are taxable in India as 'royalty' and hence liable for TDS. Further, in the case of *Poompuhar Shipping Corporation Ltd. v. Income Tax Officer, International Taxation II*[26] (relating to the assessment year 2003-04), the ITAT held that payment on account of time charter agreement on 'ship' constituted 'payment for equipment' and is to be treated as 'royalty' and hence liable for TDS.

1.21.1. In Tamil Nadu, CIT III Chennai charge, the assessments of a company **M/s. Poompuhar Shipping Corporation Ltd.**, for the assessment year 2004-05 and 2005-06 were completed after scrutiny/summary in March 2006 and December 2007 respectively. Audit scrutiny revealed that the assessee had not deducted tax at source on foreign remittances towards charter hire charges of Rs. 48.42 crore and Rs. 108.10 crore paid during the assessment years 2004-05 and 2005-06 respectively. The omission resulted in underassessment of the said amounts with consequent short levy of tax of Rs. 19.46 crore and Rs. 53.42 crore respectively.

1.21.2 In Tamil Nadu, CIT I Chennai charge, the assessments of a company, **M/s. West Asia Maritime Ltd.**, for the assessment year 2003-04 and 2004-05 were completed after scrutiny in February 2006 (later revised in December 2006) and December 2006 respectively. Audit scrutiny revealed that the assessee had not deducted tax at source on foreign remittances towards charter hire charges of Rs. 20.65 crore and Rs. 62.80 crore paid during the assessment years 2003-04 and 2004-05 respectively. The omission resulted in underassessment of the said amounts with consequent short levy of tax of Rs. 10.34 crore and Rs. 29.96 crore respectively.

1.21.3 In Maharashtra, Mumbai City 5 charge, the assessment of a company, **M/s. Shipping Corporation of India Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006. Audit scrutiny revealed that the assessee had not deducted tax at source of Rs. 23.78 crore on foreign remittance of Rs. 92.81 crore towards bare-boat hire charges and, therefore, the foreign remittance of Rs. 92.81 crore should have been disallowed. Omission to do so resulted in underassessment of Rs. 92.81 crore involving a short levy of tax of Rs. 33.30 crore.

Further, it was seen that in the case of the same assessee, the Income Tax Officer (IT) (TDS), Range 2, Mumbai in an order passed in August 2007 under section 201 (1)/201(1A) had confirmed the demand of TDS.

1.21.4 Five similar cases relating to Kerala, Maharashtra and Tamil Nadu charge where foreign remittances had been made towards hire charges for BBCD without deduction of tax at source involving a short levy of Rs. 46.40 crore are given in **Appendix 7**.

[26] [2008] 297 ITR 219 (Chennai)

1.22 Conclusions and Summary of Recommendations

1.22.1 The reserves created under section 32A (withdrawn from 1.4.1990) are still unutilised and no action has been taken on the same. There appears to be no monitoring mechanism for reserves created under section 33AC. Further, the safeguards for mis-utilisation/non-utilisation of reserve created under section 33AC are inadequate. Since the TTS also has provisions for creation and utilisation of 'reserves', it is necessary that a monitoring mechanism be put in place.

1.22.1.1 During the exit conference, the Ministry stated that the new system of 'internal audit' and the 'review and inspection' by Commissioners of Income Tax would address the monitoring issues raised by audit.

1.22.1.2 *The Ministry may like to ensure that the creation and utilisation of reserves is adequately monitored so that the intended purpose is not lost.*

1.22.2 The growth in Indian shipping tonnage subsequent to the introduction of the TTS has not kept pace with either the requirements of the Indian overseas shipping or the growth in maritime trade of India. The Ministry, during exit conference, stated that TTS is an internationally accepted best practice for taxing income from shipping. Apart from taxation the performance of the shipping industry is dependent on a host of other factors both domestic and international. The performance of shipping industry in this overall scenario cannot be a reason for modification in the taxation law.

1.22.2.1 *The Ministry may review the tonnage tax scheme.*

1.22.3 Consequent to amendment to section 10(20), the port trusts became taxable from the assessment year 2003-04. Audit study of the assessments of the port trusts revealed that there was no uniformity in the status accorded to port trusts in the income tax assessments as also the levy of tax. Whereas four port trusts had been accorded the status of 'charitable trusts' after repeated appeals, the application of two others are pending approval. Further, there have been moves to corporatise the port trusts. Not only is the contribution of port trusts to the exchequer in the form of income tax is meager, the tax demands raised are locked up in disputes.

1.22.3.1 While accepting the views of audit that 'ports trusts' were being assessed differently, the Ministry, during the exit conference, stated that section 2 of the Act has been amended through Finance Act 2008 effective 01.04.2009, by which the term charitable purpose has been redefined to exclude activities in the nature of trade or business carried out for a fee or cess or any other consideration.

1.22.4 Lack of adequate follow up of action after issue of NOC and lack of coordination with the other government authorities viz., port trusts and customs authorities jeopardized the interest of revenue.

1.22.4.1 *The Ministry may consider instituting a mechanism so that relevant data from the customs authorities and port authorities are periodically obtained and reconciled with the port clearance certificates issued by the Department.*

1.22.4.2 While accepting the audit view during the exit conference, the Ministry stated that the responsibility of ensuring payment of applicable taxes and verifying the port clearance certificate was with the Customs authorities [section 172 (6)]. The Ministry added that it will explore the possibility of establishing online mechanism for coordination with the Customs authorities.

1.22.5 NOCs were being issued even where the applicants had not provided the relevant information and without proper examination of the facts to the detriment of revenue.

1.22.5.1 *The Ministry may like to prescribe an appropriate mechanism to ensure that all relevant documents and facts are verified before issue of NOCs.*

1.22.5.2 During the exit conference, the Ministry stated that the existing mechanism provides for verification of relevant facts. However, in view of the audit observations, the Ministry agreed to ensure that the facts were checked properly before issue of NOCs.

1.22.6 Port clearance certificates were being issued in a routine manner without actually examining the allowability or otherwise of DTAA relief. Given the complexity of the trade, NOCs are being obtained invoking the nationality of registry of the ship, or flag or shipper or charterer or sub charterer or owner where hundred per cent relief is available to shipping profits under DTAA.

1.22.6.1 *The Ministry may like to review the situation so as ensure clarity and reduce complexity in application of DTAA.*

1.22.6.2 While agreeing to the audit view, the Ministry, during the exit conference, stated that the assessing officers concerned would be further sensitized on the clauses contained in DTAAs relating to taxation of maritime business.

1.22.7 There is no consistency in the taxation of shipping profits arising to residents of countries where there is no tax on shipping income under the domestic law of those countries. Further, there is no analysis available on the impact of these exemptions on revenue in India.

1.22.7.1 *The Ministry may like to conduct a study of the tax exemptions being extended to countries where income from shipping are exempted under domestic laws and the non-residents escape paying taxes both in India and abroad.*

1.22.7.2 The Ministry, during the exit conference, stated that DTAAs are intended not only to avoid double taxation but also for other economic interests of the country.

1.22.8 The Ministry, during the exit conference, stated that freight payments accruing or arising out of India are subject to taxation as per the Income Tax Act. It added that the individual cases would be examined.

1.22.8.1 The *Ministry may consider setting up a suitable mechanism for taxation of freight earnings from imports.*

1.22.8.2 The Ministry, during the exit conference, stated that freight payments accruing or arising out of India are subject to taxation as per the Income Tax Act. It added that the individual cases would be examined.

1.22.9 It is improbable that all the returns, filed under section 172, from 1961 onwards would be assessed by 31.12.2008. Even if these are processed, possibility of recovery of tax demand, if any, is remote.

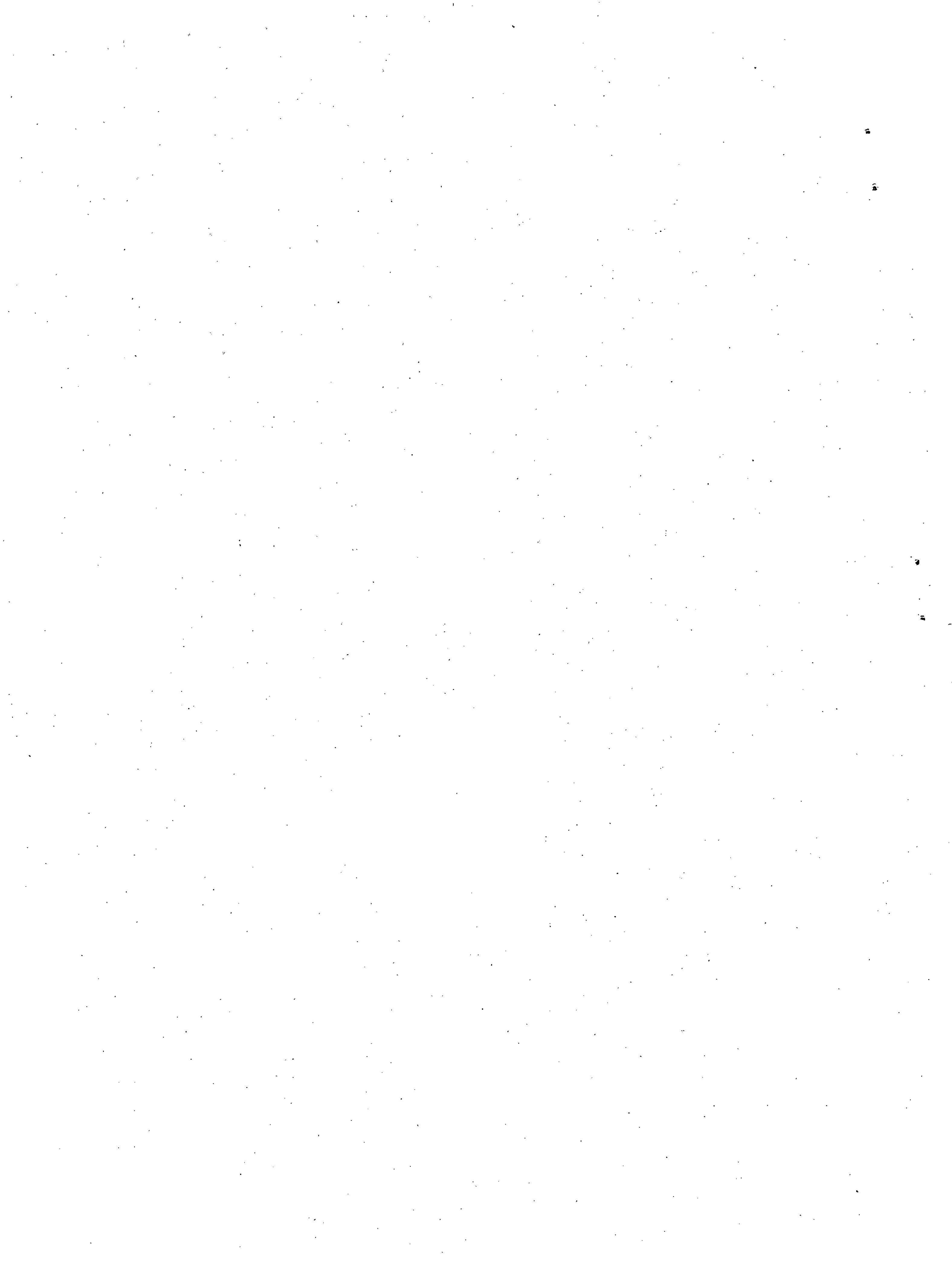
1.22.9.1 *The Ministry may like to review the situation since the issue relates to non-residents involved in maritime business who do not have a permanent establishment in India.*

1.22.9.2 The Ministry, during the exit conference, agreed to ensure that all the returns are processed within the prescribed period.

1.22.10 DTAA relief of hundred per cent was being allowed to foreign ships involved in coastal shipping in contravention of the DTAAs. The coordination mechanism for taxation of coastal shipping of non-residents was inadequate.

1.22.10.1 The *Ministry may like to institute a mechanism for ensuring coordination with Director General, Shipping so that income derived by non-residents from coastal shipping is brought to tax.*

1.22.10.2 The Ministry, during the exit conference, agreed with the audit recommendation.



Chapter II

Review on Deductions of profit and gain from certain undertakings other than infrastructure development undertakings (Deduction under section 80IB of the Income Tax Act, 1961)

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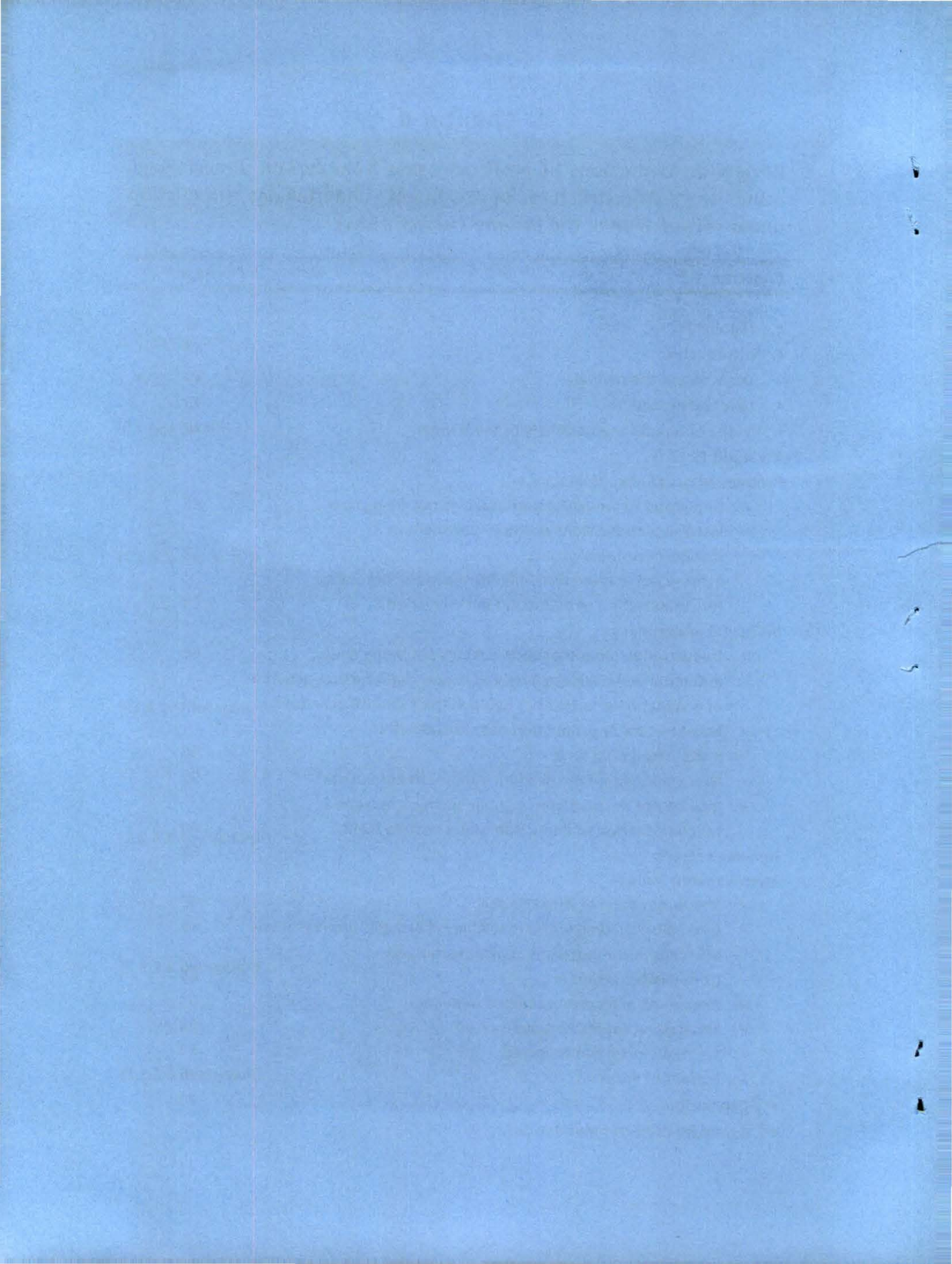


Highlights

The assessment records in respect of undertakings availing the benefit of deduction under section 80IB were examined in order to seek assurance that systems and procedures are sufficient and in place to ensure compliance with the provisions of the Act/ Rules, evaluate the degree of compliance by the specified undertakings with the provisions of the Act, quantify the loss of revenue or underassessment and other irregularities due to mistakes in assessment, highlight lacunae or deficiencies, if any, in the administration, law or policy relating to this section.

(Paragraph 2.2)

Audit of the selected 4,372 cases during the period of review revealed 1,105 cases of irregularities involving a revenue impact of Rs. 1,510.18 crore.

(Paragraph 2.6)

Audit noticed that in the case of M/s. Hindustan Petroleum Corporation Limited, a deduction of Rs. 1,591.51 crore was allowed to VREP II unit even though this unit was not a new industrial undertaking. Thus, the deduction allowed was irregular resulting in short levy of tax of Rs. 575.48 crore.

(Paragraph 2.7.1.2)

The inconsistent stand of the Department in the cases of Indian Oil Corporation Limited (IOCL) and Hindustan Petroleum Corporation Limited (HPCL), in allowing deductions in respect of marketing margin has put the revenue of Rs. 535.14 crore from IOCL at risk besides potential revenue losses which the Department could bear in subsequent years not only in these two refineries, but also in respect of other refineries in the country.

(Paragraph 2.7.2.12)

Audit observed 87 cases where the deduction under section 80IB was allowed even though activities carried out by the industrial undertakings were not manufacturing activities or were from the items listed in Eleventh Schedule of the Act. This resulted in underassessment of income having revenue impact of Rs. 22.94 crore.

(Paragraph 2.8.2.2)

Audit observed 125 cases where the deduction under section 80IB was allowed even though manufacture, production activities were not commenced within the specified time limits as laid down in the Act. This resulted in underassessment of income having revenue impact of Rs. 34.51 crore.

(Paragraph 2.8.3.2)

Audit observed 251 cases where the deduction under section 80IB was allowed even though income was not derived from eligible business. This resulted in underassessment of income having revenue impact of Rs. 47.72 crore.

(Paragraph 2.8.5.2)

In housing projects, audit observed that in 99 cases, deduction under section 80IB was allowed even though assessees were not eligible to claim deduction due to various reasons. This resulted in underassessment of income having revenue impact of Rs. 55.43 crore.

(Paragraph 2.9.2)

Audit observed 23 cases where there were mistakes in adoption of correct rates of deduction under section 80IB of the Act. This resulted in underassessment of income having revenue impact of Rs. 104.71 crore.

(Paragraph 2.13.2)

Audit recommends that:

- The Ministry may ensure that the status of an industrial undertaking is ascertained before deduction is allowed.
- The Ministry may reconcile the different stands taken by the Department in respect of deduction on marketing margin in the case of IOCL and HPCL, and escalate the level of appeal to the highest level.
- The Ministry may ensure that judicial pronouncements in respect of manufacturing activities are applied to all similarly placed cases.
- The Ministry may consider issuing instructions so that assessing officers are vigilant in determining the eligibility of the assessee and the time period for applicability of deduction under section 80IB.
- The Ministry may evolve a suitable control mechanism to ensure the conditions as laid down for availing deduction in respect of Housing sector are complied with before allowing deduction in this regard.
- The Ministry may strengthen its control mechanism to ensure the compliance of various provisions and requirements of the Act before allowing deductions under section 80IB of the Act.

Review on Deductions of profit and gain from certain undertakings other than infrastructure development undertakings (Deduction under section 80IB of the Income Tax Act, 1961)

2.1 Introduction

2.1.1 The Income tax Act, 1961 (the Act) has been amended (through successive Finance Acts over the years) mainly to introduce welfare measures, modify or introduce measures to accelerate economic development, provide for certain incentives to selected sectors of the economy and stimulate investment for industrial growth. The Act therefore allows several kinds of exemptions, allowances, deductions, rebates/relief and concessions to tax payers in pursuance of the above objectives. The deductions are those specifically provided under chapter VIA of the Act and applied after arriving at the gross total income, at the rates prescribed under the relevant sections, subject to fulfillment of the conditions prescribed therein. These can be allowed only if there is positive income after setting off losses, if any.

2.1.2 With effect from 1 April 1991, the existing section 80I was modified, and a new section 80IA was inserted which was made applicable to the new industrial undertakings commencing manufacture, production, operation of ship, hotel and cold storage during the period from 1 April 1991 to 31 March 1995. From 1 April 2000, the deduction under section 80IA was restricted to units engaged in infrastructure development, and a separate section 80IB was introduced to enable the assessees engaged in the business other than infrastructure development to claim deduction.

2.2 Objective of the review

The assessment records in respect of undertakings availing the benefit of deduction under section 80IB were examined in order to:

- seek assurance that systems and procedures are sufficient and in place to ensure compliance with the provisions of the Act/Rules.
- evaluate the degree of compliance by the specified undertakings with the provisions of the Act.
- quantify the loss of revenue or underassessment and other irregularities due to mistakes in assessment.
- highlight lacunae or deficiencies, if any, in the administration, law or policy relating to this section.

2.3 Law and procedure

Deductions in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings [Section 80IB]

2.3.1 The undertakings/sectors, to which the provisions of section 80IB are applicable, are as follows:

i. Industrial undertaking [80IB(3)]
ii. Industrial undertaking in an industrially backward state [80IB(4)]
iii. Industrial undertaking located in notified industrially backward districts 80IB(5)
iv. Owning and operation of ship by an Indian company [80IB(6)]
v. Hotel industry [80IB(7)]
vi. Multiplex theatre [80IB(7A)]
vii. Convention centre [80IB(7B)]
viii. Company carrying on scientific research and development [80IB(8)]
ix. Production or refining of mineral oil [80IB(9)]
x. Developing and building housing projects [80IB(10)]
xi. Setting up and operating cold chains facility for agriculture produce [80IB(11)]
xii. Handling, storage and transportation of food grains and processing, preservation and packaging of fruits and vegetables [80IB(11A)]
xiii. Operating and maintaining hospital in rural area [80IB(11B)]

2.3.2 A few important provisions of the Act in respect of the sectors, which have been highlighted during the course of audit, are discussed below:

2.3.3 Industrial undertaking

To claim benefit of deduction under section 80IB(3), 80IB(4), 80IB(5), an industrial undertaking must satisfy the following basic conditions:

Table no. 1: Conditions to claim benefit of deduction under section 80IB(3), 80IB(4) and 80IB(5)

Condition 1	It should be a new undertaking.
Condition 2	It should not be formed by transfer of old plant and machinery.
Condition 3	It should manufacture or produce articles other than items specified in the Eleventh Schedule.
Condition 4	Manufacture or production should be started within a stipulated time limit.
Condition 5	It should employ minimum number of employees as specified under various provisions of the Act.
Condition 6	Accounts of the undertaking have been audited by an accountant, and the audit report duly signed and verified by such accountant is furnished along with the return of income (Form no. 10CCB).

2.3.3.1 Amount of deduction

Rates of deduction and other conditions as laid down in the Act to claim the deduction are given in the **Appendix 8**.

2.3.4 Mineral oils

To claim benefit of deduction under section 80IB(9), an industrial undertaking must satisfy the following basic conditions:

1. It should be a new undertaking.
2. It should not be formed by transfer of machinery or plant previously used for any purpose.
3. It should employ minimum number of employees as specified under various provisions of the Act.
4. Accounts of the undertaking have been audited by an accountant, and the audit report duly signed and verified by such accountant is furnished along with the return of income (Form no. 10CCB).
5. It should commence commercial production as follows:

Table no. 2: Commencement of Commercial production

	Commencing production of mineral oil	Refining of mineral oil
Undertaking located in North-Eastern Region	Before April 1, 1997	-
Undertaking located anywhere in India	After March 31, 1997	After September 30, 1998

2.3.4.1 Amount of deduction

The amount of deduction to an undertaking which begins commercial production or refining of mineral oil shall be hundred per cent of the profits for a period of seven consecutive assessment years including the initial assessment year.

2.3.5 Developing and building housing projects

An undertaking engaged in development and building housing projects shall be eligible to claim deduction under section 80IB(10) subject to the following:

Table no. 3: Conditions to claim benefit of deduction under section 80IB(10)

Condition 1	The project should be approved by a local authority before March 31, 2007
Condition 2	The size of the plot of land should be minimum of one acre.
Condition 3	The undertaking commences development and construction of the housing project after September 30, 1998 and it should complete construction within 4 years from the end of financial year in which the housing project is first approved or before April 1, 2008, whichever is later.
Condition4	The built-up area of the shops and other commercial establishments included in the housing project shall not exceed 5 per cent of the aggregate built-up area of the housing project or 2000 sq. ft., whichever is less.
Condition 5	The built up area of each residential unit should be subject to the limit of 1000/1500 sq. ft.
Condition 6	Accounts of the undertaking have been audited by an accountant, and the audit report duly signed and verified by such accountant is furnished along with the return of income (Form no. 10CCB).

2.3.5.1 Amount of deduction

The amount of deduction in the case of an undertaking developing and building housing projects shall be hundred per cent of the profits derived in the previous year relevant to any assessment year from such housing project.

2.4 Scope and audit methodology of the review

2.4.1 Assessment records of both corporate and non corporate assesses along with the supporting audit reports/certificates as required under section 80IB and other sections of the Act were selected for examination. The review was conducted on both summary and scrutiny assessments completed during the financial years from 2004-05 to 2007-08 and till the date of audit. A total of 4,372 cases were examined during the period of review. The basis of selection of cases for audit is given in **Appendix 9**. The review covered all assessments whether completed after scrutiny or processed in summary manner in respect of industrial undertakings (corporate as well as non-corporate assessees) availing deduction under section 80IB.

2.4.2 Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/Commissioners of Income Tax by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from June 2008 to August 2008.

2.5 Acknowledgement

Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review was issued to the Ministry in October 2008. An exit conference was held in December 2008 with the Central Board of Direct Taxes (Board) to discuss the results of this review. The views expressed by them in the exit conference have been appropriately incorporated in this report. The Board accepted the audit recommendations and agreed to address the issues brought out in the review report. The Board stated that case specific replies would follow.

2.6 Audit findings

2.6.1 Audit of the selected 4,372 cases during the period of review revealed 1,105 cases of irregularities involving tax effect Rs. 1,510.18 crore including potential tax effect of Rs. 536.98 crore in the states of Andhra Pradesh, Assam, Bihar, Chandigarh (UT), Chhattisgarh, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

2.6.2 Audit observations with money value of Rs. one crore and above have been discussed either in the paragraphs of this report or highlighted in the appendices. Those below Rs. one crore have not been highlighted individually although their revenue impact has been included in the report.

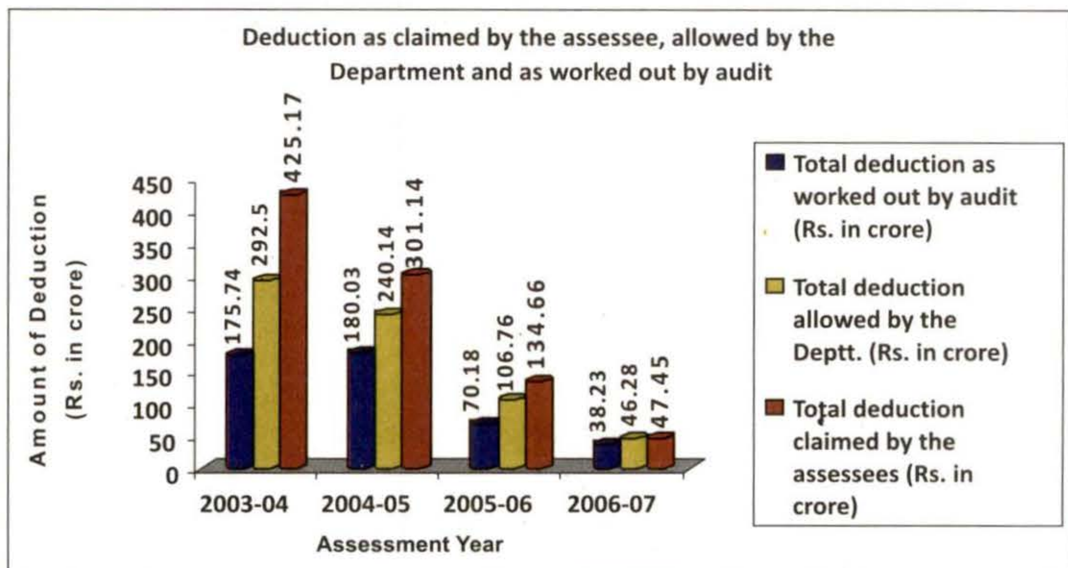
2.6.3 Status of deductions in Industrial Undertakings and Housing Sector

2.6.3.1 Audit study revealed that the number of irregularities in Industrial undertakings (section 80IB[3]) and Housing sector (section 80IB[10]) is more than other sectors under section 80IB. Therefore, audit analysed the figures of the total deduction under section 80IB claimed by the assessees, allowed by the Department and deductions as worked out by audit for the assessment years 2003-04, 2004-05, 2005-06 and 2006-07 in these two sectors which are given in Table below.

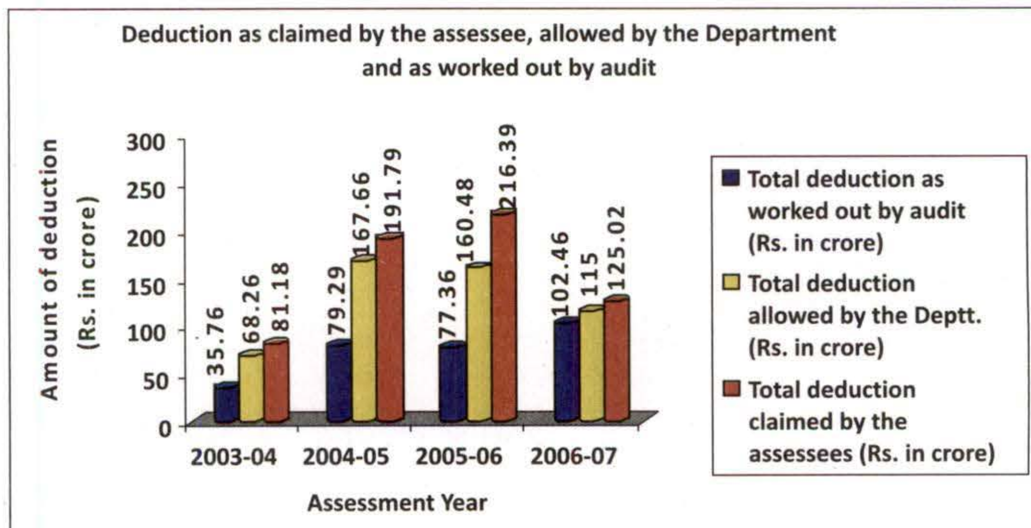
Table no. 4: Status of deductions in Industrial Undertakings and Housing Sector

Sector/ Section	A.Y.	No. of cases reviewed by audit	Total deduction claimed by the assessees (Rs. in lakh)	Total deduction allowed by the Deptt. (Rs. in lakh)	Total deduction as worked out by audit (Rs. in lakh)	Addition by the Deptt (col. 4-col. 5) (Rs. in lakh)	Potential addition as per audit (col. 4-col. 6) (Rs. in lakh)
1	2	3	4	5	6	7	8
Industrial Undertaking / 80IB(3)	2003-04	355	42,516.72	29,250.4	17,574.26	13,266.32	24,942.46
	2004-05	457	30,113.58	24,013.79	18,003.06	6,099.79	12,110.52
	2005-06	362	13,466.18	10,676.39	7,018.24	2,789.79	6,447.94
	2006-07	115	4,745.26	4,628.28	3,823.21	116.98	922.05
	Total	**1,289**	**90,841.74**	**68,568.86**	**46,418.77**	**22,272.88**	**44,422.97**
Housing Sector/ 80IB(10)	2003-04	44	8,117.73	6,826.41	3,575.91	1,291.32	4,541.82
	2004-05	95	19,179.45	16,765.66	7,929.06	2,413.79	11,250.39
	2005-06	128	21,639.47	16,047.86	7,736.14	5,591.61	13,903.33
	2006-07	67	12,501.69	11,500.32	10,245.62	1,001.37	2,256.07
	Total	**334**	**61,438.34**	**51,140.25**	**29,486.73**	**10,298.09**	**31,951.61**

Graph. 1: Status of deduction in Industrial Undertakings Sector



Graph. 2: Status of deduction in Housing Sector



2.6.3.2 Thus, it will be observed from the status of deductions claimed by the assessees, allowed by the Department and worked out by audit, that there is potential for further realisation of revenue.

2.6.4 Status of deductions in Refinery Sector

Audit examination of assessment records in respect of three oil companies namely Hindustan Petroleum Corporation Limited (HPCL) and Indian Oil Corporation Limited (IOCL) and Kochi Refineries Limited having oil refineries namely Visakh refinery, Panipat refinery, Gujarat refinery and Kochi refinery threw up issues having wide ramification. Deduction was being allowed to Visakh refinery (HPCL) even though the same was not a new industrial undertaking resulting in short levy of tax of Rs. 575.48 crore. Inconsistent stand in the cases of IOCL and HPCL in respect of deduction in respect of marketing margin has put the revenue of Rs. 535.14 crore from IOCL at risk. The impact may not be limited to only these two oil companies, but could have consequential effect on all such similarly placed units.

2.6.5 Analysis of mistakes in assessment

2.6.5.1 Out of 1104[1] cases of mistakes/irregularities noticed, 711 cases pertained to scrutiny assessment and 393 cases were processed in summary manner. Thus, 64 per cent of mistakes noticed were from scrutiny assessment.

Audit recommends that the Ministry may strengthen its internal control mechanism so as to ensure that the issues as brought out in this report are addressed during assessment proceedings.

[1] Total number of irregularities observed is 1105. However, one case pertains to the format of Form no. 10CCB which does not belong to assessment proceedings.

2.7 Production or refining of mineral oil

2.7.1 Deductions to industrial undertakings not being new

The amount of deduction to an undertaking which begins commercial production or refining of mineral oil, covered under section 80IB(9) shall be hundred per cent of profits for a period of seven consecutive assessment years subject to fulfillment of the prescribed conditions. The conditions, inter-alia, stipulate that the industrial under taking is not formed by splitting up or reconstruction of a business already in existence and by transfer to a new business of plant and machinery previously used for any purpose. However, if the value of the transferred assets does not exceed 20 per cent of the total value of the machinery or plant used in the business, the condition is deemed to have been satisfied.

Meaning of 'Formed'

The word 'formed' is intended to connote that the body of the company or its shape did not come up in consequence of transfer of machinery and plant used previously for business purposes.

'Splitting up of business'

The expression "splitting up of business already in existence" indicates a case where the integrity of business earlier in existence is broken up and different sections of the activities previously conducted are carried on independently.

'Reconstruction of a business'

There must be a emergence of a new physically separate unit which may exist on its own as a viable industrial unit. An undertaking is formed out of the existing business if the physical identity with the old unit is preserved. Further, the new industrial undertaking must be an integrated unit by itself.

2.7.1.1 Audit observed in one refinery that the deduction under section 80IB(9) was allowed for three assessment years even though no new industrial undertakings was formed. This resulted in underassessment of income having revenue impact of Rs. 575.48 crore in Maharashtra. The case is discussed below.

2.7.1.2 In Maharashtra, CIT 1 Mumbai charge, the assessments of a company, **M/s. Hindustan Petroleum Corporation Ltd.,** for the assessment years[2] 2002-03, 2004-05 and 2005-06 were completed after scrutiny in March 2005, November 2006 and December 2007 respectively after allowing a deduction of Rs. 133.12 crore, Rs. 793.88 crore and Rs. 664.51 crore under section 80IB. Audit examination revealed that Visakh Refinery was in operation since May 1957 and the VREP II was an expansion/reconstruction of the existing Visakh Refinery for the purpose of increasing the capacity from 4.5 Million Metric Tonnes Per Annum (MMTPA) to 7.5 MMTPA. The expanded unit was commissioned during financial year 1999-2000 and the commercial

[2] Records for the assessment year 2003-04 were not produced by the Department.

production commenced during financial year 2000-01. Audit noticed that no new or physically separate unit emerged as a result of expansion as is the requirement of the Act to claim deduction. Further, VREP II was not registered as a separate entity under the Factories Act, Central Excise and Sales Tax Acts, and the Indian Explosive Act. Even the storage facilities, in the pre-expansion and expanded units, were inseparably common and not identifiable separately. Thus, VREP II not being a physically separate independent industrial undertaking, but a unit formed by reconstruction of Visakh Refinery which was already in existence, and many of the facilities were being commonly shared, it was not eligible for claiming deduction under section 80IB. As such, deduction of Rs. 1,591.51 crore allowed was irregular which resulted in short levy of tax of Rs. 575.48 crore in these three assessment years besides the revenue loss which has already occurred during previous assessment years outside the scope of the review.

The Department in its reply (September and November 2008) stated that i) VREP II unit is a highly technically advanced unit and is capable of processing varieties of crude, and it consists of newly set up processing facilities, ii) VREP II unit is an independent unit which can process crude oil separately and manufacture petroleum products as processes are not dependent on the older process unit of the refinery, iii) the various parameters like non registration under Central Excise Act, Sales Tax Act, Indian Explosive Act, separate approval from the Ministry of Petroleum, common storage and dispatch of finished goods etc are not sufficient and strong reasons to outweigh the report of Engineers India Limited (EIL) wherein it was stated that the facilities provided under VREP-II were adequate to independently process crude oil at the rate of 3 MMTPA. Various parameters as noted by audit could be relevant for commercial purposes and not for deciding the technical issue whether the two refineries are independent of each other.

The Department's reply is not acceptable in view of the following:

The Department has emphasized in its reply that VREP II unit is an independent unit which can process crude oil separately and manufacture petroleum products as processes are not dependent on the older process unit of the refinery. This is, however, only one of the parameters to avail tax exemption. As per the conditions defined by the Supreme court in its judgement in the case of Textile Machinery Corporation Limited vs Commissioner of Income Tax (107 ITR 195), new industrial undertaking is not only required to be an integrated/independent unit by itself but also needs to be a separate and distinct entity. The physical identity of the new unit must not be preserved with the existing unit, and new industrial unit must be separate physically from the old one, the capital of which and the profits thereon are ascertainable. New undertaking can be carried on separately without complete absorption and losing their identity in the old business. Separate books of accounts are to be kept by the new undertaking. Audit, however, observed that VREP II was not a separate and distinct entity as explained in the following paragraphs.

1. Barring the capability of independent operation of the refinery process units, the two units are not physically separate as VREP II was not registered as a separate entity under the Factories Act, Central Excise and Sales Tax Acts, and the Indian Explosive Act. Existing license issued by various statutory authorities

for existing Visakh refinery were modified to accommodate the expanded capacity of the Visakh refinery.

2. VREP II unit does not generate its own sales invoice and sales are recorded for the Visakh refinery as a whole. VREP I unit is not eligible to claim tax exemption as its tax holiday period is already over. The sale of two units (one eligible, and one not eligible) is a combined one, thereby, indicating that the identity of the VREP II is yet linked to VREP I.
3. As per Annual Report of Hindustan Petroleum Corporation Limited for the year 2006-07, there are only two refineries viz Mumbai refinery (capacity of 5.5 MMTPA) and Visakh refinery (capacity of 7.5 MMTPA). The Department's plea that VREP I and VREP II are two refineries is not correct.
4. Crude intake lines and storage is common for VREP I and VREP II. Dispatch of finished products is also shared.
5. EIL in its report (August 2008) has stated that while constructing VREP II, various existing facilities/utilities were augmented and revamped indicating VREP II was not a new refinery.

Thus, it would be observed that VREP II is not a separate and distinct entity and is carrying out its operations while preserving its identity with VREP I in the old business in view of the facts explained above. There is only one refinery in Visakhapatnam known as Visakh refinery consisting of VREP I and VREP II units sharing many common facilities and utilities.

Audit recommends that the Ministry may ensure that the status of an industrial undertaking is correctly ascertained before deduction is allowed.

2.7.2 Inconsistent decisions of the Department in respect of refinery profits

Deduction under section 80IB(9) is to be allowed in respect profits and gains which have been derived out of refining of mineral/crude oil. Audit observed that in two refineries, Department has taken different stands on the issue as to whether marketing margin[3] is to be added or not to the refinery profit for the purpose of allowing deduction under this section. Marketing margin, if added to the refinery profit, will inflate the profits and result in higher amount of deduction under section 80IB. The issue has its impact on the entire refinery sector. The case highlighting the inconsistent decision of the Department on the said issue, is discussed below:

2.7.2.1 In Maharashtra, CIT 10 (1) Mumbai charge, the assessment of a company, **M/s. Indian Oil Corporation Limited,** for the assessment years 2004-05 and 2005-06 was completed after scrutiny in October 2006 and October 2007. Audit examination revealed that in the scrutiny assessments, the Department disallowed 80IB deductions to the extent of marketing margin as included in the profit of Panipat refinery and AU-V unit of Gujarat refinery. Total deduction disallowed was Rs. 1,469 crore crore in the two assessment years (assessment year 2004-05: Rs. 335.42 crore, assessment year 2005-06: Rs. 1,133.58 crore).

[3] Market margin is the profit derived by the marketing division of the assessee on the products manufactured by the refinery unit and transferred to the marketing division of the assessee at a fixed price.

2.7.2.2 The Department stated the following reasoning for disallowing the assessee's claim of deduction under section 80IB in respect of profit received from Marketing Division:

2.7.2.3 "While computing refinery profit, the sale price can be one which is fetched by any refinery when selling its products to any other oil marketing company or refinery. The market price of refined products can be taken as the one which any other refinery would fetch on the product concerned. It may be noted that IOCL has, apart from selling products of its refineries, purchased refined products from various other companies."

2.7.2.4 "The products from refineries of other companies are purchased by the assessee corporation (IOCL) at 'Refinery Transfer Price' (RTP) which is periodically agreed at by oil industry and is based on Import Parity Price (IPP). Even IOCL transfers its refined products to marketing or other divisions on RTP. And thus, it is clear that the market value for the purpose of 80IB deduction must be taken as RTP and so there is no case for inclusion of marketing profits in the refinery profit for 80IB deduction claim."

2.7.2.5 Thus, the claim of Rs. 335.42 crore (assessment year 2004-05) and Rs. 1,133.58 crore (assessment year 2005-06) being marketing margin/profit was rejected by the assessing officer, and added back to the assessee's income.

2.7.2.6 Audit, however, observed that the Department has allowed deduction under section 80IB in respect of marketing margin to M/s. Hindustan Petroleum Corporation Ltd., for the assessment year 2004-05. A paragraph in this regard on irregular consideration of marketing margin in the case of a Visakh Refinery for claiming 80IB deduction was printed in the Report of the Comptroller and Auditor General of India for the year ended March 2007 (PA 7 of 2008) as para no. 2.8.2.1 in Chapter II 'Review on Appreciation of Third Party Reporting/Certification in Assessment Proceedings'. Gist of the para is as follows:

2.7.2.7 In Maharashtra, CIT 1 Mumbai charge, the assessment of a company, **M/s. Hindustan Petroleum Corporation Ltd.**, for the assessment year 2004-05 was completed after scrutiny in November 2006. The assessee had claimed a deduction of Rs. 793.88 crore in respect of Vishakh Refinery – VREP II Project. During audit examination, it was observed that while working out the deduction under section 80IB, an amount of Rs. 279.55 crore on account of marketing margin pertaining to marketing division was also considered. As the marketing division is i) not an industrial undertaking under the definition of section 80IB and ii) is involved in trading activities (converting the bulk produced by the refinery into retailable lots and selling it in retail markets), the profit earned by the marketing division is only a trading profit and not a profit derived out of manufacturing activities.[4] Thus consideration of marketing margin for claiming deduction under section 80IB was irregular. However, this amount was not disallowed, resulting in excess deduction of Rs. 279.55 crore under section 80IB, involving short levy of tax of Rs. 110.82 crore.

[4] Profit derived by the refinery out of its refining activities was Rs. 514.33 crore i.e. 14 per cent of its cost of operations

2.7.2.8 The Ministry in its reply (August 2008) to the PAC had stated that transfer from one division of the company to another is not a sale under the Sales of Goods Act as no one can sell to himself. The book entries reflecting inter division transfer is at a fixed rate from refinery division to marketing division is an internal accounting/control mechanism of the assessee which cannot give rise to any profit. Profit arises only when goods are sold by the marketing division to outsiders. Therefore the entire profit on the products manufactured by the eligible refinery unit viz. Vishakh Refinery is admissible for computation of deduction under section 80IB. This was also the view of the Bombay High Court in the assessee's own case for the assessment year 1989-90 vide its order dated 24-07-2006 which has become final.

2.7.2.9 Further, in response to a PAC question as to what approach was being adopted by the Department in other refineries in respect of marketing margin while allowing deduction under section 80IB, the Ministry stated that the Department was following the judgement of the Bombay High Court in this regard.

2.7.2.10 The Ministry's reply is not tenable as it would be seen that in case of **M/s. Indian Oil Corporation Ltd.**, the Department had not allowed the deduction in respect of marketing margin. The Department had taken the same view as was taken by audit in the paragraph 2.7.2.7 cited above. Interestingly, assessments in the case of Indian Oil Corporation Ltd. were finalised after the date (24 July 2006) of Bombay High Court's judgement. This implies concurrence with the Audit's view that deduction is not to be allowed on marketing margin. It is also mentioned that the Board's instruction no. 2 dated 24 October 2005 stating that the escalation of level of appeal from the High Court to the Supreme Court where tax effect exceeds Rs. 10 lakh was also not followed even though the Department was itself convinced about the fact that marketing margin is not to be considered for allowing deduction as would be observed from subsequent developments explained in the paragraph below.

2.7.2.11 IOCL filed an appeal with the CIT(A) in November 2006 stating that the assessing officer had erred in excluding marketing margin from the profits eligible for deduction under section 80IB. In support of its claim, IOCL quoted the judgement of Bombay High Court dated 24 July 2006 in the case of HPCL. CIT (A) in its decision dated 24 March 2008 placing reliance on this judgement has stated, for assessment year 2004-05, that the company would be eligible for deduction under section 80IB on profit derived from products manufactured which stands included in the marketing margin. The Department has filed a second appeal with ITAT dated 26.5.2008. For assessment year 2005-06, the appeal to CIT(A) is pending.

2.7.2.12 Thus inconsistent stand of the Department in the cases of IOCL and HPCL, has put the revenue of Rs. 535.14 crore[5] from IOCL at risk for the two assessment years, besides potential revenue losses which the Department will bear in subsequent years not only in these two refineries but also in case of other refineries in the country.

[5] IT @ of 35 per cent + surcharge @ 2.5 per cent +Education cess @ 2 per cent on the total deductions disallowed by the Department for the assessment year 2004-05 and 2005-06.

Audit recommends that the Ministry may ensure that level of appeal is escalated to the highest level or the relevant provisions of the Act amended in cases having such wide ramification so as to have complete clarity leaving no scope for inconsistencies in the assessment proceedings.

2.7.2.13 In the exit conference, the Board stated that in view of different judgements of different jurisdictional High Courts, it was difficult to have a uniform decision by the assessing officers of the different states. Audit, however, pointed out that the issue raised in the audit observation pertained to the same state and same jurisdictional High Court. Board accepted the audit recommendation and stated that the issue would be resolved on finalisation of appeal in due process of law.

2.7.3 Income not derived from eligible business reckoned for computation of deduction under section 80IB

2.7.3.1 As per section 80IB, deductions under the section is admissible only in respect of the profits and gains derived by an assessee from the industrial undertaking which manufactures or produces articles or things. The deduction has to be strictly construed, and the language of the enactment prevents the extension of the benefits to income which is merely incidental or ancillary to the industrial undertaking but which does not arise from and out of it. In the case of composite business, relief is confined only to profits of industrial undertaking. Further, for determining the quantum of deduction, profit and gains of the eligible business shall be computed as if such profit and gains were the only source of income of the assessee during the relevant previous year.

2.7.3.2 Audit observed in one case in Kerala where the deduction under section 80IB was allowed even though income was not derived from eligible business. The case is discussed below:

2.7.3.3 In Kerala, CIT Kochi charge, the assessment of a company, **M/s. Kochi Refineries Ltd.,** (since transferred to CIT, Mumbai on 10.9.2007) for assessment year 2002-03 was completed after scrutiny in December 2004 determining the income at Rs. 111.83 crore after allowing a deduction of Rs. 12.44 crore under section 80IB. Consequent to an appellate order, the assessment was revised in October 2005 determining the income at Rs. 105.32 crore. Audit examination revealed that while allowing deduction, 'other income' aggregating to Rs. 11.43 crore (interest, miscellaneous receipts etc.) was considered. As the other income of Rs. 11.43 crore was not derived from industrial activity, the assessee was not eligible for deduction under 80IB to that extent. The inclusion of other income was therefore not in order and resulted in excess deduction of Rs. 3.43 crore with consequent tax effect of Rs. 2.16 crore including interest. The Department accepted and rectified the mistake in October 2007.

2.8 Industrial undertakings

2.8.1 Deductions to industrial undertakings not being new

Under section 80IB, where the gross total income of an assessee includes any profits and gains derived from any business as specified under this section, there shall be

allowed, in computing the total income of the assessee, a deduction from such profits and gains deduction in respect of profits and gains of an amount equal to such percentage and for such number of assessment years as specified under this section. This section applies to any industrial undertaking which is not formed by splitting up or the reconstruction of a business already in existence. Further, industrial undertaking should not be formed by transfer of old plant and machinery. However, if the value of the transferred assets does not exceed 20 per cent of the total value of the machinery or plant used in the business, the condition is deemed to have been satisfied.

2.8.1.1 Audit observed 26 cases where the deduction under section 80IB was allowed even though these were not new industrial undertakings. This resulted in underassessment of income having revenue impact of Rs. 19.58 crore in Andhra Pradesh, Assam, Jammu and Kashmir, Maharashtra, Punjab and West Bengal. Out of these, two cases are discussed below.

2.8.1.2 In Jammu and Kashmir, CIT J & K charge, assessment of a firm, **M/s. Sun Pharmaceutical Industries**, for the assessment year 2005-06 was completed after scrutiny in December 2007. Audit examination revealed that assessee was a partnership firm in which **M/s. Sun Pharmaceutical Industries Limited**, another company, was having 95 per cent share. Further, out of total value of plant and machinery amounting to Rs. 9.05 crore, plant and machinery valuing Rs. 7.26 crore, being 80 per cent of the total plant & machinery, was transferred from M/s. Sun Pharmaceuticals Industries Ltd. during the financial year 2003-04 and 2004-05. As the assessee firm was formed out of splitting up of an existing company (M/s. Sun Pharmaceutical Industries Limited), and the value of the transferred assets exceeded the limit of 20 per cent, assessee was not eligible for allowance of deduction under section 80IB of the Act. Omission resulted in short levy of tax of Rs. 8.63 crore.

2.8.1.3 In Maharashtra, CIT Central 1 Mumbai charge, assessments of an individual, **Smt. Madhu Gupta proprietor of M/s. Photo Film Industries**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny in March 2005, March 2006 and December 2006 respectively after allowing a deduction of Rs. 8.18 crore[6], Rs. 1.36 crore and Rs. 4.41 crore under section 80IB respectively in respect of the unit located at Pondichery. Audit observed the following in this regard:

2.8.1.4 The assessee had not filed the mandatory audit report in form no. 10CCB as prescribed under section 80IB and Rule 18BBB along with the return of income for the assessment years 2002-03, 2003-04 and 2004-05. Further, during the assessment for the assessment year 2002-03, the assessing officer denied the claim under section 80IB stating that the business of Photo Film Industries was a mere reconstruction of the business of M/s. G G Photo Ltd., which was already in existence. CIT (Appeal) also upheld (January 2006) the decision of assessing officer with regard to disallowance of deduction under section 80IB. However, on the assessee's appeal, the ITAT, Mumbai Bench allowed (May 2007) for the assessment year 2002-03, the claim in full.

[6] Relief was allowed by ITAT

2.8.1.5 Audit observed that as the mandatory audit report had not been furnished in respect of any of the three assessment years, the assessee was not eligible for deduction. As such, in audit's opinion, the department should have escalated the level of appeal against the decision of ITAT in view of the facts that (i) mandatory audit reports not furnished, (ii) revenue impact involved was Rs. 6.19 crore[7] including interest, and as per Board's instruction no. 2 dated 24 October 2005, where the tax effect involved is Rs. 4 lakh and above, the Department is to file an appeal with the High Court under section 260A of the Act, (iii) decision of assessing officer disallowing deduction was based on sound reasoning, and the same was also upheld by the CIT (Appeal).

2.8.1.6 The Department accepted (January 2008) the audit observation and stated that remedial action has already been taken for the assessment year 2004-05 by reopening the assessment under section 147 of the Act in respect of non submission of mandatory audit report, and remedial action for the assessment years 2002-03 and 2003-04 were being examined.

Thus, the basic conditions, for granting deductions under section 80IB to an industrial undertaking viz (i) it should be a new undertaking and not formed by splitting up, or the reconstruction, of a business already in existence, and (ii) it should not be formed by transfer of old plant and machinery beyond the limit of 20 per cent, have been violated in these cases.

Audit recommends that the Ministry may ensure that detailed examination to ascertain the status of an industrial undertaking is made before deduction is allowed.

2.8.2 Industrial undertakings involved in non-manufacture activities or production of articles as listed in the Eleventh Schedule

2.8.2.1 In order to claim deduction under section 80IB, an Industrial undertaking should manufacture or produce any article or thing (not being an article or thing specified in the list in the Eleventh Schedule).

Meaning of Manufacture

If by application of labour and skill an object is transformed to the extent that it is commercially known differently, manufacture has taken place. The moment there is a transformation into a new commodity having its own character, use and name, whether it be the result of one process or several processes, "manufacture" takes place.

2.8.2.2 Audit observed 87 cases where the deduction under section 80IB was allowed even though activities carried out by the industrial undertakings were not of manufacturing or were from the items as listed in Eleventh Schedule of the Act. This resulted in underassessment of income having revenue impact of Rs. 22.94 crore in Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Tamil Nadu and West Bengal. Out of these, three cases are discussed below and three cases are given in **Appendix 10.**

[7] Assessment year 2002-03 Rs. 3.51 crore, Assessment year 2003-04 Rs. 0.59 crore, Assessment year 2004-05 Rs. 2.09 crore

2.8.2.3 In Maharashtra, CIT 23 Mumbai charge, the assessments of a firm, **M/s. Marmo Classic**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in December 2005 after allowing a deduction of Rs. 5.34 crore and Rs. 10.58 crore respectively in respect of the industrial unit located at Silvassa. Audit examination revealed that the assessee was engaged in the activity of cutting of marble slabs and tiles. It has been judicially held[8] that mining of lime stone and marble blocks and cutting and sizing them are not manufacturing activity, and assessee was not entitled to special deduction. Since the assessee was not engaged in the activity of manufacture and production of articles or things, it was not eligible for deduction under section 80IB and the deduction allowed was incorrect. The irregular deduction aggregating Rs. 15.92 crore resulted in revenue impact of Rs. 7.23 crore including interest. The Department in its reply (October 2008) stated that the process involved in converting marble blocks into smaller pieces of marble slabs and tiles was cleaning with water , dressing manually and mechanically correcting of natural flaws by chemical analysis, polishing and sizing, which are necessary to make marble blocks into marketable commodity of small slabs and tiles. These end products are distinct and separate from the original marble blocks. Hence, the process amounted to manufacture and the deduction was correctly allowed. The reply is not tenable as the process described by the department is converting marble blocks into smaller pieces is only a treatment given to the product, and this does not amount to manufacture. This view is supported by Supreme Court and High Court as detailed below:

In the case of Lucky Minmat Pvt Ltd vs CIT [245 ITR 830], the Supreme Court held that If the assessee is engaged in the business of mining of limestone and marble blocks and thereafter cutting and sizing the same before being sold in the market, it does not amount to manufacture. The Supreme Court upheld the order of the Rajasthan High Court [226 ITR 245] which had clarified the word 'Manufacture' as under:

"The Manufacture implies a change, but every change is not manufacture although every change in the article is the result of the treatment, labour and manipulation. To bring about the change qualifying as manufacture some thing more is necessary and that something is transformation i.e. a new different article, having a distinct name, character or use, must emerge". In the assessee's case, from the first stage to the last stage the nature of article continues to be the same i.e. marble.

Audit also observed that in a similar case of M/s. Inani Marbles and Industries Ltd., assessed in CIT 2 Mumbai charge, the 80IB deduction for the assessment year 2004-05 was disallowed in December 2006 by the department on the same grounds.

2.8.2.4 In West Bengal, CIT Central I Kolkata charge, the assessments of a company, **M/s. J.L Morison Ltd.,** for the assessment years 2001-02 to 2006-07 were completed after scrutiny in March 2004, March 2005, March 2006, October 2006, March 2007 and March 2008 respectively. The assessee was engaged in manufacturing of cosmetics and dental care products which are listed in the Eleventh Schedule. Since the assessee was neither an undertaking located at backward State, nor a small scale industrial undertaking (SSI), the deduction was not admissible. Mistake in allowing deduction thus

[8] Lucky Minmat P Ltd vs CIT, 245 ITR 830 (SC)

resulted in cumulative underassessment of income of Rs. 5.31 crore involving undercharge of tax of Rs. 1.66 crore for assessment years 2001-02 to 2004-05, Rs. 32.51 lakh for assessment year 2005-06 and Rs. 46.12 lakh for assessment year 2006-07 leading to cumulative under charge of tax of Rs. 2.44 crore including interest in six years.

2.8.2.5 In Maharashtra, CIT 24 Mumbai charge, the assessments of a firm, **M/s. Silvasa Wooden Drums**, for the assessment years 2004-05 and 2005-06 were completed after scrutiny March 2006 and March 2007 respectively and the return for the assessment year 2006-07 was processed in summary manner in March 2008. A deduction of Rs. 78.00 lakh, Rs. 1.55 crore and Rs. 2.68 crore for the respective assessment year under section 80IB was allowed to the assessee in respect of its unit located at Silvasa. Audit examination revealed that the assessee was engaged in galvanizing steel tape and cold rolled coils/strips. It has been judicially[9] held that the process of galvanizing does not result in the manufacture or production of new goods as such and an assessee running the business of galvanizing was not entitled to deduction. Since the assessee was not engaged in manufacturing or producing articles the allowance of deduction aggregating to Rs. 5.01 crore was irregular involving revenue impact of Rs. 1.95 crore.

The Department in its reply (August 2008) stated that as the assessee was engaged in the business of manufacturing and galvanizing steel tapes and CR strips, and galvanizing was not done for outsiders but was done for regular business activities, deduction has been rightly allowed. The reply is not acceptable as the assessee's activity is decoiling cold rolled steel strips, cutting it to a smaller size and galvanizing it. The process of cutting CR strips to smaller size does not amount to manufacture as no new product different from its components has emerged.

Thus, deductions have been allowed to Industrial undertakings which were not carrying out manufacturing activities.

Audit recommends that the assessing officers ensure that judicial pronouncements in respect of manufacturing activities are applied to all similarly placed cases.

2.8.3 Manufacture or production not started within a stipulated time limit

2.8.3.1 To claim deduction under section 80IB, industrial undertaking should commence manufacture or production of article or things or operate cold storage plant or plants between April 1, 1991 and March 31, 1995.

2.8.3.2 Audit observed in 125 cases where the deduction under section 80IB was allowed even though manufacture or production activities were not commenced within the specified time limits as laid down in the Act. This resulted in underassessment of income having revenue impact of Rs. 34.51 crore in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Karnataka, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, two cases are discussed below and five cases are given in **Appendix 11.**

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[9] CIT vs. Hindustan Metal Refining Works (P) Ltd. 128-ITR-472 (Cal)

2.8.3.3 In Chandigarh, CIT I charge, assessment of a company, **M/s. Bhushan Limited**, for the assessment years 2003-04 and 2004-05 was completed after scrutiny in January 2005 and January 2006. Audit examination revealed that the assessee had claimed and was allowed deduction of Rs. 19.80 crore. Since the assessee had started production activity on 1 March 1985 well before 1 April 1991, it was not eligible for deduction. The irregular amount of deduction aggregating to Rs. 19.80 crore resulted in short levy of tax of Rs. 8.75 crore including interest.

2.8.3.4 In Delhi, CIT VI charge, assessment of a company, **M/s. Tina Overseas Limited**, for the assessment year 2004-05 and 2005-06 were completed after scrutiny in November 2006 and March 2007 after allowing deduction of Rs. 3.72 crore and Rs. 2.45 crore under section 80IB for its units at Panipat and Chennai respectively. Audit examination revealed that the assessee had claimed deduction in respect of Panipat unit (started its operation w.e.f. 1 August 2001) and Chennai unit (started w.e.f. 20 December 2000) respectively under section 80IB(4). Further, deduction under section 80IB (4) is available only if an industrial undertaking is located in industrially backward State specified in the Eighth Schedule of the Act. However, Panipat unit and Chennai unit come under the States of Haryana and Tamil Nadu which are not industrially backward States as per Schedule Eight of the Act. As such, assessee was not eligible to claim deduction under section 80IB(4). For units located in Panipat and Chennai, deduction can be availed under section 80IB(3) only, but, assessee was not even eligible to claim deduction under this section as the assessee had started its operations in December 2000 and August 2001 which was not within the period stipulated under this section viz 1 April 1991 to 31 March 1995. Thus, deduction of Rs. 3.72 crore and Rs. 2.45 crore were irregular resulting in short levy of tax of Rs. 2.87 crore including interest.

Thus deductions have been granted under section 80IB in respect of cases where manufacture or production has not started within the time limits as specified in the Act.

Audit recommends that the instructions may be issued in this regard so that assessing officers are vigilant in determining the time period for applicability of deduction under section 80IB.

2.8.4 Non employment of specified number of employees

2.8.4.1 To claim deduction under section 80IB industrial undertaking, Section 80IB of the Act provides that the undertaking employs 10 or more workers in a manufacturing process carried on with the aid of power, or employs 20 or more workers in a manufacturing process carried on without the aid of power.

2.8.4.2 Audit observed in 13 cases where the deduction under section 80IB was allowed even though specified number of employees was not employed. This resulted in underassessment of income having revenue impact of Rs. 5.97 crore in Bihar, Delhi, Gujarat, Jammu and Kashmir, Jharkhand and Uttar Pradesh. Out of these, two cases are discussed below.

2.8.4.3 In Delhi, CIT IV charge, assessment of a company, **M/s. Global Business India Pvt. Limited**, for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 1.37 crore after allowing a deduction of Rs. 7.25 crore under section 80IB of the Act. Audit examination revealed that 15 workers were employed in factory at Agartala. Further examination revealed that during the previous year (2002-03), the assessee had incurred an expenditure of Rs. 0.45 lakh under the head 'power and fuel expenses' against the total production of Rs. 35.65 crore (0.013 per cent of the production). Even during previous year (2001-02) relevant to assessment year 2002-03, the assessee had incurred almost the same amount of expenditure (Rs. 0.43 lakh) on power and fuel against the total production of Rs. 13.02 crore (0.03 per cent of the production). The analysis revealed that the expenses on power and fuel did not change/changed very marginally; whereas the production increased by 174 per cent over the same period which is indicative of the fact that power was not the requirement of manufacturing process. Since the company is not working with the aid of power and there are less than 20 workers, the deduction under section 80IB was not admissible. This resulted in incorrect allowance of deduction under section 80IB amounting to Rs. 7.25 crore involving tax effect of Rs. 3.66 crore including interest. Further, the assessee had not furnished the mandatory audit report in Form no. 10CCB. The Department while accepting the audit finding, stated in July 2007 that remedial action was being taken.

2.8.4.4 In Jammu and Kashmir, CIT J & K charge, assessment of an individual, **Shri Dhanji Bhai Anandji Bhai, proprietor of M/s. Makson Engineering Export,** for the assessment years 2005-06 and 2006-07 was completed after scrutiny in March 2007 and February 2008 after allowing a deduction of Rs. 2.89 crore and Rs. 2.22 crore respectively. Audit examination revealed that the assessee had employed 12 workers in the manufacturing process during the relevant previous years 2004-05 and 2005-06. However, as per Form no. 10CCB, assessee had conducted the manufacturing process without the aid of power, and therefore, he was not eligible for allowance of deduction as the assessee had employed only 12 workers instead of minimum 20 workers as per the above provisions of the Act. This resulted in inadmissible deduction of Rs. 2.89 crore and Rs. 2.22 crore with a corresponding tax effect of Rs. 97.19 lakh and Rs. 74.81 lakh for the aforesaid assessment years.

Thus, Department has allowed deduction under section 80IB even in cases where specified number of employees have not been employed.

The Ministry may ensure that as the information in respect of number of employees and use of power in manufacturing activities is given in the audit report, such information is utilised by the assessing officers and verified from the accounts of the assessee before allowing deductions under section 80IB.

2.8.5 Income not derived from eligible business reckoned for computation of deduction under section 80IB

2.8.5.1 As per section 80IB, deductions under the section is admissible only in respect of the profits and gains derived by an assessee from the industrial undertaking which manufactures or produces articles or things. The deduction has to be strictly construed,

and the language of the enactment prevents the extension of the benefits to income which is merely incidental or ancillary to the industrial undertaking but which does not arise from and out of it. In the case of composite business, relief is confined only to profits of industrial undertaking. Further, for determining the quantum of deduction, profit and gains of the eligible business shall be computed as if such profit and gains were the only source of income of the assessee during the relevant previous year.

2.8.5.2 Audit observed in 251 cases where the deduction under section 80IB was allowed even though income was not derived from eligible business. This resulted in underassessment of income having revenue impact of Rs. 47.72 crore in Andhra Pradesh, Bihar, Chandigarh, Chhattisgarh, Delhi, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, two cases are discussed below and five cases are given in **Appendix 12**.

2.8.5.3 In Maharashtra, CIT 2 Mumbai charge, the assessment of a company, **M/s. Tata Chemicals Ltd.,** for the assessment year 2002-03 was completed after scrutiny in January 2005 after allowing a deduction of Rs. 32.38 crore under section 80IB in respect of Babrala Fertiliser Division located at Badaun District in Uttar Pradesh. Audit examination revealed that the deduction under section 80IB had been computed after taking into account other income aggregating Rs. 241.10 crore from retention price subsidy (Rs. 143.92 crore), escalation subsidy (Rs. 60.89 crore), freight subsidy (Rs. 34.51 crore) and insurance claim (Rs. 1.78 crore) which was not eligible for deduction. After reducing the ineligible income, no balance profit was available for allowing deduction. The deduction of Rs. 32.38 crore allowed was, thus, incorrect resulting in revenue impact of Rs. 16.01 crore including interest.

The Department in its reply (October 2008) stated that the subsidies have a direct nexus to the business carried on by the assessee and therefore forms part of the business income eligible for deduction under section 80IB. The subsidies, though received from Government, are intended to compensate the assessee for the possible loss which the assessee may incur by selling different kinds of fertilizer at Government administrative prices. The reply is not acceptable as it was observed that in the scrutiny assessment for the subsequent assessment years 2003-04 and 2004-05 of the same assessee completed in February 2006 and December 2006 respectively, the 80IB claims in respect of price concession subsidy, product subsidy, sales tax remission were denied by the Department. Further, various court decisions[10] have emphasized that the income of these nature (subsidies from the Government) were to be treated as not derived from the industrial undertaking and hence not eligible for claiming deduction under section 80IB.

2.8.5.4 In Maharashtra, CIT 6 Mumbai charge, the assessment of a company, **M/s. Akruti Nirman Ltd.,** for the assessment year 2004-05 was completed after scrutiny in May 2005 after allowing a deduction of Rs. 8.33 crore under section 80IB. Audit examination revealed that the claim included Rs. 6.34 crore on account of rent received

[10] CIT vs Viswanathan & Co.(261 ITR 737 (Mad))
CIT vs Sterling Foods (237 ITR 579 (SC))
CIT vs Fenner India Ltd (239 ITR 480 (Mad))

which was not eligible for deduction. Omission to disallow Rs. 6.34 crore had a revenue impact of Rs. 2.59 crore including interest.

Thus, incomes which have not been derived from eligible business were reckoned for deduction.

Audit recommends that the Ministry may by appropriate directions ensure that the income, on which deduction is sought by the assessee, is critically analysed and only that portion of income is considered for deduction which has been derived from eligible sources.

2.9 Housing projects

2.9.1 The amount of deduction in the case of an undertaking covered under section 80IB(10), developing and building housing projects approved before, 31 March 2007 shall be hundred per cent of the profits derived from such housing project subject to fulfillment of all the prescribed conditions. The conditions, inter-alia, stipulate that the undertaking has commenced or commences development on or after after 1 October 1998 and completes such construction within 4 years from the end of financial year in which the housing project is first approved or before April 1, 2008, whichever is later. The completion certificate is mandatory for claiming deduction. The size of the plot of land should be of minimum one acre. The residential unit should have a maximum built up area of one thousand square feet in Mumbai or Delhi and one thousand five hundred square feet elsewhere. No shops and commercial establishments were permissible in the project up to assessment year 2004-05, and from assessment year 2005-06 onwards the built up area of shops/commercial establishments should not exceed five per cent of the aggregate built up area of the housing project or two thousand square feet which ever is less.

2.9.2 Audit observed that in 99 cases, deduction under section 80IB was allowed even though assessees were not eligible to claim deduction due to reasons such as i) commencing development/construction in the period other than as specified, ii) creating commercial establishments (not permissible up to assessment year 2004-05) or developing commercial area more than the stipulated norms (assessment year 2005-06 and onwards), iii) non submission of completion certificates, iv) area of the land of housing project being less than one acre, etc. This resulted in underassessment of income having revenue impact of Rs. 55.43 crore in Andhra Pradesh, Assam, Delhi, Gujarat, Haryana, Jharkhand, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu, and West Bengal. Out of these, six cases are discussed below and nine cases are given in **Appendix 13**.

2.9.3 In Maharashtra, CIT 3 Pune charge, the assessments of a company, **M/s. Runwal Multi Housing Pvt. Ltd.,** for the assessment years 2003-04, 2004-05 and 2005-06 were completed after scrutiny in March 2006, December 2006 and December 2007 respectively after allowing a deduction of Rs. 3.34 crore, Rs. 3.39 crore and Rs. 5.46 crore under section 80IB. It was observed from the audit report (Form no. 10CCB) that the project was under construction and the mandatory completion certificate from the

local authority was not furnished. Further, the project had commercial units measuring 3,982 square feet which was more than the maximum permissible limit of 2,000 square feet. Thus, the housing project was ineligible for deduction and the allowance of deduction aggregating Rs. 12.19 crore was irregular, having a revenue impact of Rs. 5.97 crore including interest.

2.9.4 In Maharashtra, CIT 1 Mumbai charge, the assessment of a firm, **M/s. Dosti Associates,** for the assessment year 2003-04 was completed after scrutiny in March 2006 after allowing a deduction of Rs. 11.49 crore under section 80IB. Audit examination revealed that the project had commercial shops. As the provision in respect of shops/commercial establishments was applicable with effect from the assessment year 2005-06 only, the assessee was not eligible to claim deduction prior to assessment year 2005-06. Thus, incorrect claim of deduction of Rs. 11.49 crore resulted in revenue impact of Rs. 4.22 crore.

2.9.5 In Maharashtra, CIT 2 Thane charge, the assessment of a firm, **M/s. Siddhi Real Estate Developers,** for the assessment year 2005-06, was completed after scrutiny in October 2007 after allowing a deduction of Rs. 8 crore under section 80IB. Audit examination revealed that the project was not completed and mandatory completion certificate of the project was not furnished. Due to non completion, the project was not eligible for deduction and the allowance of deduction on partially completed buildings was irregular. The incorrect allowance of deduction of Rs. 8 crore had a revenue impact of Rs. 3.83 crore including interest.

The Department in its reply (September 2008) stated that the housing project consisted of 19 buildings and 10 buildings had been completed/developed during the previous year, and hence profits from these buildings had been allowed under section 80IB. It was further stated that the entire project was completed before 31 March 2006. It also stated that the assessee might offer the profit/loss from a housing project either on 'year to year' basis or on 'project completion method'. However, due to the implication of section 5, the Department prefers to tax such assessees on 'year to year' basis rather than 'project completion method'. The reply is not acceptable in view of the following:

- Although the assessee has the option to offer the profit/loss from a housing project on annual basis or on project completion method in the normal course, as per the requirement of section 80IB(10), Rule 18BBB and Form no. 10CCB, the entire project has to be completed and mandatory completion certificate of the project is to be furnished along with the return for claiming deduction under section 80IB. Since entire project was not completed during the previous year 2004-05 relevant to the assessment year 2005-06, allowing of deduction was irregular.

- The Department has stated that the entire project was completed by March 2006. As such, deduction can be allowed only in the assessment year 2006-07 subject to submission of completion certificate.

2.9.6 In Maharashtra, CIT 21 Mumbai charge, the assessment of a firm, **M/s. Pathare and Associates,** for the assessment year 2004-05 was completed after scrutiny in December 2006 after allowing a deduction of Rs. 7.95 crore under section 80IB. Audit

examination revealed that the project had shops and commercial area measuring 3,974 square feet. As the provision in respect of shops/commercial establishments was applicable with effect from the assessment year 2005-06 only, claiming deduction for commercial establishments built prior to April 2005 was irregular and required to be disallowed. As such, project was not eligible for deduction and the incorrect allowance of deduction of Rs. 7.95 crore resulted in revenue impact of Rs. 3.79 crore including interest. The Department in its reply (August 2008) stated that the assessee's project consisted of residential units and shops. In the case of the assessee, the shops have been considered as a part of the housing project eligible for exemption under section 80IB(10). It was further stated that provisions of section 80IB have been amended by the Finance (No. 2) Act, 2004 w.e.f 1 April 2005. As such deduction had been correctly allowed. The Department's reply is not acceptable as the ITAT Mumbai 'C' Bench has observed in the case of M/s. Laukik Developers vs DCIT 3, Thane (105 ITD 657) that the construction of shops or commercial place cannot be considered a housing project for the purpose of application of the provisions of section 80IB(10) of the Act. The Tribunal in its order said, "we are unable to accept the argument off the ld. Counsel for the assessee that since the case pertains to pre-amendment period, the deduction under section 80IB(10) will be available to the assessee even if the shops and other commercial establishments are included in the housing project of the assessee. If this argument of the assessee is accepted, then it shall nullify the very object of introducing the provision of section 80IB(10) in the statute book for promotion of housing activity in the country since there shall be no limit of the total built-up area devoted to construction of shops and other commercial establishments in the housing project of the assessee".

2.9.7 In Andhra Pradesh, CIT III Hyderabad charge, assessment of a company, **M/s. Sainath Estates (P) Ltd.**, for the assessment year 2002-03 was completed after scrutiny in December 2006 after allowing a deduction of Rs. 6.71 crore under section 80IB (10). Audit examination revealed that the assessee company had not furnished the 'completion certificate'. In the absence of such certificate the deduction is inadmissible. Incorrect allowance of deduction resulted in short computation of income to the same extent involving a tax effect of Rs. 3.76 crore including interest.

2.9.8 In Maharashtra, CIT 3 Pune charge, the assessment of a company, **M/s. Runwal Erectors Pvt. Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in March 2006 and December 2006 respectively after allowing a deduction of Rs. 2.01 crore and Rs. 2.19 crore under section 80IB. Audit examination revealed that project had shops/commercial establishments. As the benefit of deduction, in respect of these units, was applicable with effect from the assessment year 2005-06 only, claiming deduction for such units built prior to April 2005, was irregular and required to be disallowed. The incorrect claim of deduction of Rs. 4.20 crore resulted in revenue impact of Rs. 2.06 crore including interest.

Thus, deductions have been allowed in cases where assessees were not eligible to claim the same.

Audit recommends that the suitable control mechanism may be evolved to ensure the conditions as laid down for availing deduction in respect of housing sector are complied with before allowing deduction in this regard.

Miscellaneous issues

2.10 Non submission of Audit Report

2.10.1 The deduction under section 80IB is admissible only if the accounts of the undertaking have been audited by an accountant, and the audit report duly signed and verified by such accountant is furnished along with the return of income (Form no. 10CCB).

2.10.2 Audit observed 237 cases where the deduction under section 80IB was allowed even though mandatory audit report was not furnished by the assessee along with the income tax return. This resulted in underassessment of income having revenue impact of Rs. 81.11 crore in Andhra Pradesh, Assam, Bihar, Chandigarh, Chhattisgarh, Delhi, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, three cases are discussed below, and nine cases are given in **Appendix 14.**

2.10.3 In Uttar Pradesh, CIT Central Kanpur charge, the assessment of a company, **M/s. Kothari Products Ltd.,** for the assessment years 2003-04 and 2004-05 were completed after scrutiny in June 2004 and May 2005 respectively. Audit examination revealed that the assessing officer had allowed deduction under section 80IB in the two assessment years amounting to Rs. 56.01 crore and Rs. 17.70 crore respectively. However, it was observed that the assessee had not submitted the Form no. 10CCB along with the income tax return in the two assessment years. As such, the assessee was not eligible to claim deduction under section 80IB. This involved a tax effect of Rs. 28.44 crore.

2.10.4 In Tamil Nadu, CIT VI Chennai charge, assessment of a firm, **M/s. R.K. Industries,** for the assessment years 2003-04 and 2004-05 was completed after scrutiny in January 2006 and December 2006 after allowing deduction of Rs. 6.92 crore and Rs. 6.99 crore under section 80IB respectively. Audit examination, however, revealed that the assessee had not filed the requisite mandatory audit certificate in Form no. 10CCB. Hence the assessee was not eligible to claim deduction under section 80IB. This involved a tax effect of Rs. 6.82 crore including interest.

2.10.5 In Maharashtra, CIT 5 Pune charge, the assessments of a company, **M/s. Daimler Chrysler Pvt. Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006. Audit examination revealed that the assessee had not claimed any deduction under section 80IB in the return of income. In the notes filed along with the returns of income, assessee had stated that he was eligible for deduction under section 80IB, but as there was no taxable income during the previous year, the deduction under section 80IB was 'nil'. Assessee further stated, "if during the assessment proceedings, assessee is determined to have positive income, then assessee submits its claim for deduction under section 80IB". The assessing officer, during

scrutiny assessment, allowed deduction of Rs. 8.53 crore which was subsequently reduced to Rs. 8.15 crore by a rectification order under section 154 of the Act.

Audit examination revealed that as the assessee had not submitted the requisite audit report in Form no. 10CCB before completion of assessment under section 143 (3), the deduction of Rs. 8.15 crore allowed under section 80IB was irregular. The omission had resulted in incorrect allowance of deduction of Rs. 8.15 crore involving tax effect of Rs. 3.89 crore including interest.

2.11 Deduction allowed without setting off brought forward losses

2.11.1 In terms of provision of chapter VIA of the Act, while computing the deduction, the amount of income derived by the assessee has to be computed after taking into account the carried forward losses and unabsorbed depreciation of the earlier years.

2.11.2 Audit observed in 22 cases where while computing the deduction, the amount of income derived by the assessee was computed without taking into account the carried forward losses and unabsorbed depreciation of the earlier years. This resulted in underassessment of income having revenue impact of Rs. 3.57 crore in Assam, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Rajasthan, Tamil Nadu and West Bengal. Out of these, one case is discussed below.

2.11.3 In Assam, CIT II Guwahati charge, the assessment of a company, **M/s. Vinay Cements Ltd.,** for the assessment year 2004-05 was completed after scrutiny in October 2006. Audit examination revealed that the assessee had claimed and was allowed deduction of Rs. 4.98 crore before set off of unabsorbed depreciation and losses of Rs. 22.37 crore to the extent of income available. This resulted in excess allowance of deduction of Rs. 4.98 crore with consequent tax effect (potential) of Rs. 1.49 crore.

2.12 Mistakes in computation of income derived from eligible business

2.12.1 Where the gross total income of an assessee includes any profits and gains derived from eligible business, there shall, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified.

2.12.2 Audit observed in 98 cases there was mistake in computation of income derived from eligible business under section 80IB of the Act. This resulted in underassessment of income having revenue impact of Rs. 21.86 crore in Assam, Bihar, Delhi, Gujarat, Haryana, Himachal Pradesh, Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, two cases are discussed below.

2.12.3 In Jammu and Kashmir, CIT J & K charge, assessment of a firm, **M/s. Sun Pharmaceutical Industries**, for the assessment year 2005-06 was completed after scrutiny in December 2007. Audit examination revealed that the assessing officer had disallowed deduction on interest income stating that the interest income could not be

said to have been derived from the industrial activity and as such did not qualify for deduction under section 80IB (4) of the Act. Accordingly, claim of assessee to the extent of profit attributable to interest income was disallowed and added to the returned income. However scrutiny of the records revealed that while computing the net taxable income, interest income of Rs. 8.39 crore relating to Dadra unit had not been added to the returned income of the assessee. This resulted in underassessment of income of Rs. 8.39 crore with a corresponding tax effect of Rs. 4.08 crore (including interest) and penalty of Rs. 3.07 crore under section 271(1)(c) of the Act.

2.12.4 In Tamil Nadu, CIT Pondicherry charge, assessment of a firm, **M/s. Vinbros and Company**, for the assessment year 2002-03 was completed after scrutiny in August 2007. Audit examination revealed that while computing business income the total income was taken as Rs. 31.16 lakh instead of Rs. 3.11 crore after disallowing deduction under section 80IB. This had resulted in short computation of income to the extent of Rs. 2.80 crore involving a tax effect of Rs. 1.69 crore including interest. The department accepted the audit observation and revised (April 2008) the assessment under section 154 of the Income tax Act.

2.13 Adoption of incorrect rates of deduction

2.13.1 Where the gross total income of an assessee includes any profits and gains derived from eligible business under sections 80IB, there shall, in accordance with and subject to the provisions of section 80IB, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified.

2.13.2 Audit observed in 23 cases there was mistake in adoption of correct rates of deduction under section 80IB of the Act. This resulted in underassessment of income having revenue impact of Rs. 104.71 crore in Andhra Pradesh, Gujarat, Himachal Pradesh, Jammu and Kashmir, Kerala, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, two cases are discussed below.

2.13.3 As per section 80IB(4), the amount of deduction in the case of industrial undertaking in an industrially backward State specified in the Eighth Schedule shall be 100 per cent of the profits and gains for five assessment years beginning with the initial assessment year and thereafter 25 per cent (or 30 per cent where the assessee is a company). Further, as per the provisions of section 80IB(14)(c), initial assessment year means the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things.

2.13.3.1 In Tamil Nadu, CIT III Chennai charge, assessment of a company, **M/s. Sterlite Industries (India) Ltd.,** for the assessment years 2002-03, 2003-04 and 2004-05 was completed after scrutiny in February 2005, March 2006 and December 2006 respectively. Audit examination revealed that according to Form no. 10CCB of Rakholi Unit[11], Silvassa, the date of commencement of operation by the undertaking was 18 March 1998 and the initial assessment year was 1998-99. Hence the fifth year for claim

[11] Located at Dadra and Nagar Haveli, an industrially backward union territory.

of deduction at 100 per cent under section 80IB was 'assessment year 2002-03'. From the assessment year 2003-04 onwards, the unit was eligible for deduction at 30 per cent only. However, the assessee company had incorrectly claimed deduction at 100 per cent for this unit during the assessment years 2003-04 and 2004-05. Similarly, in respect of Chinchpada unit[11a] the date of commencement of operation as per Form no. 10CCB was 7 June 1996 and the initial assessment year was 1997-98. Hence, the assessment year 2001-02 would be the fifth and final year to claim deduction at 100 per cent and thereafter the assessee was to claim deduction at 30 per cent only. However, the assessee had incorrectly claimed deduction during the assessment years 2002-03 and 2003-04 at 100 per cent instead of 30 per cent This had resulted in excess claim of deduction of Rs. 527.23 crore involving a tax effect of Rs. 100.57 crore, including interest The Department accepted (June 2008) the audit observation and agreed to initiate remedial action.

2.13.4 As per section 80IB(3), the amount of deduction would be 30 per cent (where the assessee is a company) of the profit or gain for a period of ten consecutive years beginning with the initial assessment years.

2.13.4.1 In West Bengal, CIT Central II, Kolkata charge, the assessment of a company, **M/s. BMW Industries Ltd.,** for the assessment year 2002-03 was completed after scrutiny in March 2005. Audit examination revealed that the assessee claimed hundred per cent deduction instead of admissible thirty per cent, which was allowed in the assessment. Mistake thus resulted in excess allowance of deduction of Rs. 4.29 crore leading to underassessment of income by an identical amount involving undercharge of tax of Rs. 2.45 crore including interest. In reply the Department accepted (June 2008) the observation and stated that remedial measure under section 147 was being taken.

2.14 Separate accounts not maintained

2.14.1 Section 80IB(13) of Income Tax Act, 1961 read with Rule 18 BBB of Income Tax Rule, provides that in order to claim deduction under section 80IB, a separate audit report is to be furnished by each undertaking or enterprise of the assessee claiming deduction under section 80IB and shall be accompanied by the profit and loss account and balance sheet of the undertaking or enterprise as if the undertaking or enterprise were a distinct entity.

2.14.2 Audit observed in 26 cases assesses had not furnished separate Profit and Loss Account and Balance Sheet in respect of each unit eligible for deduction as if it were a separate entity. In the absence of these accounts, audit could not verify the correctness of the deduction claimed in such cases in Andhra Pradesh, Delhi, Gujarat, Kerala, Punjab and Uttar Pradesh. Out of these, two cases are given below.

2.14.3 In Delhi, CIT III charge, assessment of a company, **M/s. Sudhir Genset Limited,** for the assessment year 2003-04, 2004-05 and 2005-06 was completed after scrutiny in March 2006, December 2006 and December 2007 after allowing deduction under section 80IB of Rs. 12.57 crore, Rs. 16.49 crore and Rs. 19.11 crore respectively. Audit

[11a] Located at Dadra and Nagar Haveli, an industrially backward union territory.

examination revealed that assessee has six units, out of which, four units were eligible for deduction under section 80IB. The assessee was required to furnish separate Profit and Loss account and Balance Sheet in respect of each unit eligible for deduction as if it were a separate entity. However, the assessee had not furnished the separate accounts. In the absence of separate profit and loss account and Balance Sheet, correctness of allowance of deduction under section 80IB amounting to Rs. 12.57 crore, Rs. 16.49 crore and Rs. 19.11 crore in these three assessment years, could not be verified.

2.14.4 The Department in its reply (July 2008) stated that relevant section did not provide for maintenance and furnishing separate Profit and Loss account and Balance Sheet. Reply of the Department is not acceptable as Section 80IA(7) read with Rule 18BBB of the Act stipulates that deduction shall not be admissible unless separate Profit and Loss account and Balance Sheet in respect of each unit eligible for deduction is submitted as if it were a separate entity along with the return of income.

2.14.5 In Kerala, CIT Kottayam charge, assessment of a company, **M/s. Malayala Manorama Co. Ltd.,** for the assessment year 2003-04 and 2004-05 was completed after scrutiny in February 2006 and December 2006 after allowing deduction under section 80IB of Rs. 1.98 crore and Rs. 2.19 crore respectively. Audit examination revealed that the assessee was required to furnish separate profit and loss Account and Balance Sheet in respect of each unit eligible for deduction as if it were a separate entity. However, the assessee had not furnished the separate accounts. Thus, in the absence of separate profit and loss account and Balance Sheet, correctness of allowance of deduction under section 80IB amounting to Rs. 1.98 crore and Rs. 2.19 crore in these two assessment years could not be verified.

Thus deductions have been allowed in the cases where (i) where assessee has not filed mandatory audit report in Form no. 10CCB, (ii) income had been computed incorrectly, (iii) separate accounts had not been furnished, (iv) brought forward losses have not been set off prior to the deduction. Besides, cases have been noticed where incorrect rates of deduction were adopted while allowing deduction.

Audit recommends that the Ministry may ensure that deduction under section 80IB is allowed only in those cases where mandatory audit report has been furnished by the assessees, and strengthen its control mechanism to ensure the compliance of various provisions and requirements of the Act before allowing deductions under section 80IB of the Act.

2.15 Scrutiny norms not followed

2.15.1 As per the scrutiny guidelines issued by the Board annually, the cases where Chapter VIA deduction exceeds the specified limit[12], are to be compulsorily selected for scrutiny for the financial years 2004-05, 2005-06 and 2006-07.

[12] Rs. 25 lakh or above in Delhi, Mumbai, Chennai, Kolkata, Pune, Hyderabad, Bangalore and Ahmedabad, and Rs. 10 lakh or above in other places.

2.15.2 Audit observed 91 cases which were to be assessed in scrutiny manner, but were, however, processed in summary manner. In the absence of scrutiny assessment, audit was unable to verify correctness of the allowed deduction in such cases. Details of 13 such cases as observed in Assam, Delhi, Haryana, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal are given in **Appendix 15**.

2.16 Format of Form no. 10CCB

2.16.1 Column 18 of the Form no. 10CCB is as follows:

18. Industrial undertakings engaged in manufacture or production or article or things or operation of cold storage plant:

(a)	Does the industrial undertaking manufacture or produce any article or thing specified in the Eleventh Schedule (Please specify the article or thing -----------)	☐Yes ☐No
(b)	If yes, does the manufacturing process use power	☐Yes ☐No

2.16.2 Column 18(b) above implies that the question whether the manufacturing process uses power is applicable only to the industrial undertaking manufacturing any article or thing specified in Eleventh schedule. As a result, a number of tax auditors are stating in column 18(b) "not applicable" whereas this is one of the essential conditions (the undertaking employs 10 or more workers in a manufacturing process carried on with the aid of power, or employs 20 or more workers in a manufacturing process without the aid of power) for claiming deduction under section 80IB where industrial undertaking manufacture or produce any article or thing other than specified in the Eleventh schedule.

The Ministry may consider this issue, and suitable changes in Form no. 10CCB be made to make it unambiguous.

Conclusion

Audit has noticed several cases where basic conditions for allowing deduction to industrial undertakings under section 80IB of the Act namely (i) it should be a new industrial undertaking not formed by splitting up or the reconstruction of a business already in existence, (ii) it should manufacture or produce articles, (iii) manufacture or production should be started within a stipulated time limit, (iv) it should employ minimum specified number of employees and (v) submission of mandatory audit report, have been violated. In the case of refineries, audit noticed inconsistent stand taken by the Department in allowing deduction in respect of marketing margin. In the Housing sector, audit observed that deductions were allowed though various conditions which have been laid down in the Act for availing deduction were not followed by the assessees. Audit also noticed cases where wrong rates of deduction were adopted. The

Ministry may consider ways to improve the adherence level of the various basic conditions of the Act and ensure greater compliance with the provisions of the Act before allowing tax holiday under section 80IB.

Summary of Recommendations

The Ministry may ensure that in-depth analysis is made to ascertain the status of an industrial undertaking before deduction is allowed.

The Ministry may reconcile the different stands taken by the Department in respect of allowing/disallowing deduction on marketing margin in the case of IOCL and HPCL, and escalate the level of appeal to the highest level. Alternatively, the relevant provisions of the Act may be amended.

The Ministry may ensure that judicial pronouncements in respect of manufacturing activities are applied to all similarly placed cases.

The Ministry may consider issuing instructions so that assessing officers are vigilant in determining the eligibility of the assessee and determining the time period for applicability of deduction under section 80IB.

The Ministry may ensure that as the information in respect of number of employees and use of power in manufacturing activities is given in the audit report, such information is utilised by the assessing officers and verified from the accounts of the assessee before allowing deductions under section 80IB.

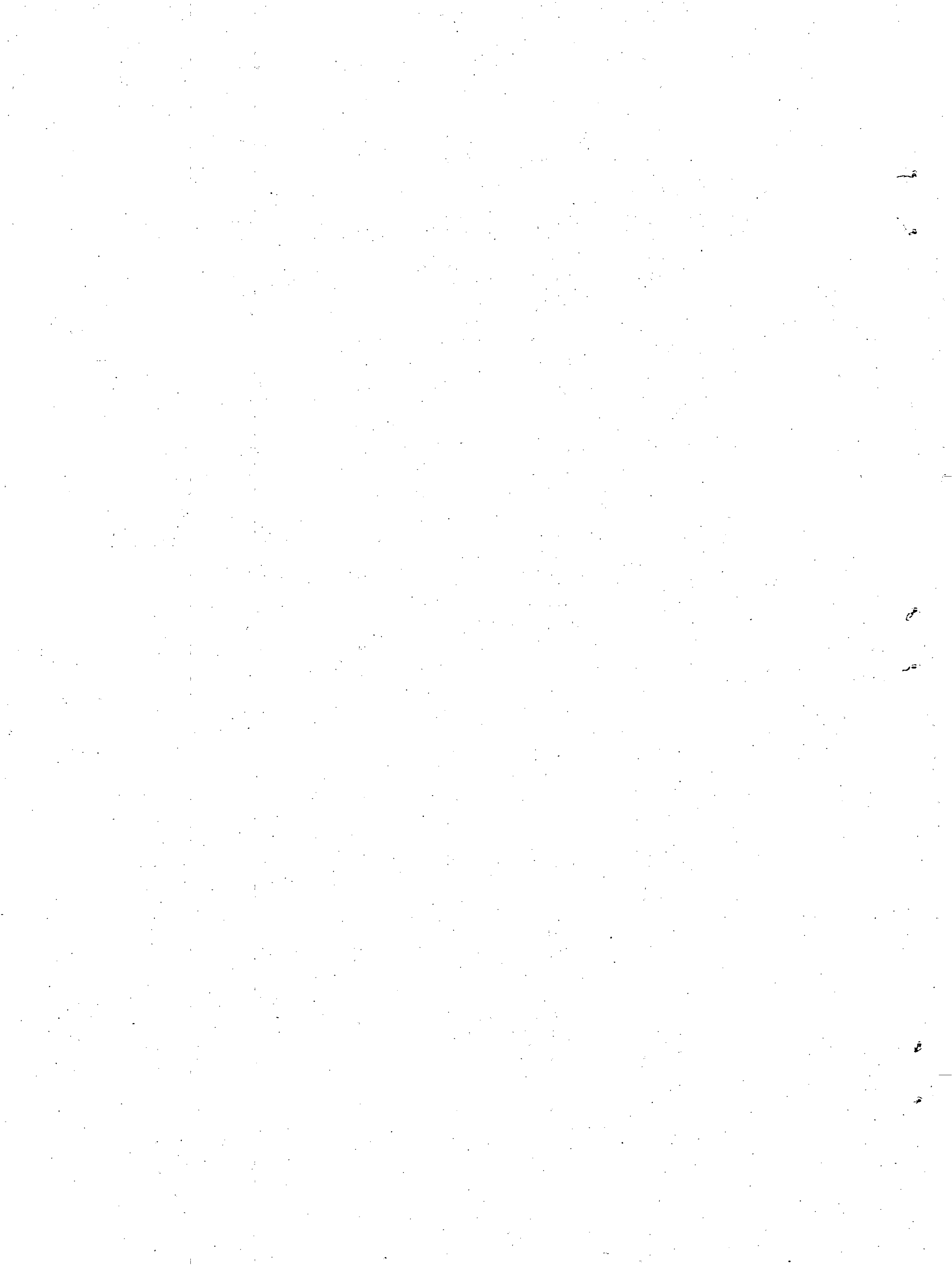
The Ministry may evolve a suitable control mechanism to ensure that the conditions as laid down for availing deduction in respect of Housing sector are complied with before allowing deduction in this regard.

The Ministry may ensure that deduction under section 80IB is allowed only in those cases where mandatory audit report has been furnished by the assessees.

The Ministry may strengthen its control mechanism to ensure compliance of various provisions and requirements of the Act before allowing deductions under section 80IB of the Act.

The Ministry may consider the suitable changes in the Form no. 10CCB so as to make it unambiguous.

In the exit conference, the Board accepted the audit recommendations and agreed to address the issues brought out in the review report.



Chapter III

IT audit of e-TDS system of Income Tax Department

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Highlights

Electronic filing of returns of Tax Deducted at Source has been evaluated with a view to ascertaining the fulfillment of the business requirements set down in the Income Tax Act, extent of utilisation of all the software features, efficiency and accuracy of processing, adequacy of security measure and the level of data integrity.

The external interface of the e-TDS module with AIS, OLTAS and AST modules was not perfect which resulted in creating avoidable workload in the Department besides hardship to the tax payers as notices were wrongly generated for incorrect quoting of PAN, challans could not be claimed from the OLTAS module and non-filers and new assessees could not be identified for AST module.

(Paragraphs 3.2.1.1 to 3.2.1.4)

The interface of the e-TDS system with the users was not user friendly. It did not provide automated solution for distinguishing already processed and the unprocessed returns. The users' manual was last updated in August 2005 making it difficult for the users' to find solutions to the problems.

(Paragraphs 3.2.2.1 to 3.2.2.3)

Business rules were not properly mapped as rate parameters were not fixed in the e-TDS system for certain sections while there were cases when amendments in the Act were not incorporated in the system. The system was not able to segregate cases where TDS was either deducted at lower rates or no TDS was deducted.

(Paragraphs 3.3.1.1 to 3.3.1.3)

The data accuracy could not be ensured in the e-TDS system as the authorities entering the data are outside the control of the Department. Validation controls were lacking as instances of mistakes were noticed where the returns uploaded had errors in spite of File Validation Utility. Manual returns were not properly digitized and important fields were not filled in. This has resulted in Department receiving returns with a large number of defaults which made the processing of returns difficult for the Department and the consequential non-processing of returns may result in possible revenue loss.

(Paragraphs 3.4.1.1.to 3.4.4.2)

The data with the third party was not taken back as per the terms of the MoU and the data backed up by the Department was not regularly tested for retrieval and there was lack of awareness of security measures within the Department.

(Paragraphs 3.4.6.1, 3.4.6.2 and 3.4.7)

There was delay in development of the e-TDS application and the networking system. The networking, which was envisaged to be completed in a period of four months in November 2002, has not been completed till September 2008. The payment to a third party was made at higher rates for the functions which had not commenced.

(Paragraphs 3.5.1 and 3.5.2)

Audit recommends that:

- The Department should ensure better linkage with the various external interfaces.
- There is a need to fix the time limit for processing of e-TDS returns so that compliance to law is ensured and possible loss of revenue is minimised. An effective mechanism needs to be implemented to monitor the number of returns processed. The network also needs to be strengthened to enhance the processing of e-TDS returns.
- The accuracy of data has to be ensured so that it can be relied upon. Also validation controls should be constantly evaluated to ensure data integrity.
- The data backup should be taken and tested regularly for retrieval. The users should be made aware of the security issues.

IT audit of e-TDS system of Income Tax Department

3.1 Audit Approach

3.1.1 Introduction

Tax Deduction at Source (TDS) is one of the important modes of collection of direct taxes under pre-assessment collections. The main objective of TDS is to collect tax at the time of income being earned so that the Government can have a regular inflow of cash resources, and prevent tax evasion. It also places a responsibility of deducting and depositing tax on the shoulders of persons other than the payees.

TDS module was one of the nine individual modules of Income Tax Department (ITD) applications conceived under the Comprehensive Computerisation Programme in 1994. It was accepted by the Department in June 2002 for implementation. The data entry process of this module was error prone and it was further re-fined (August 2003) into e-TDS application, designed to receive returns in electronic format with the option to process returns pertaining to the period 'before 2002-03'.

The objective of computerisation of TDS functions was to reduce the compliance cost by dispensing with the system of enclosing bulky returns with certificates, often difficult to handle. The purpose of dematerialisation of TDS certificates was to enable processing of all TDS returns through computer so that TDS credit could be verified on-line across the country and possibilities of fraudulent claims minimised.

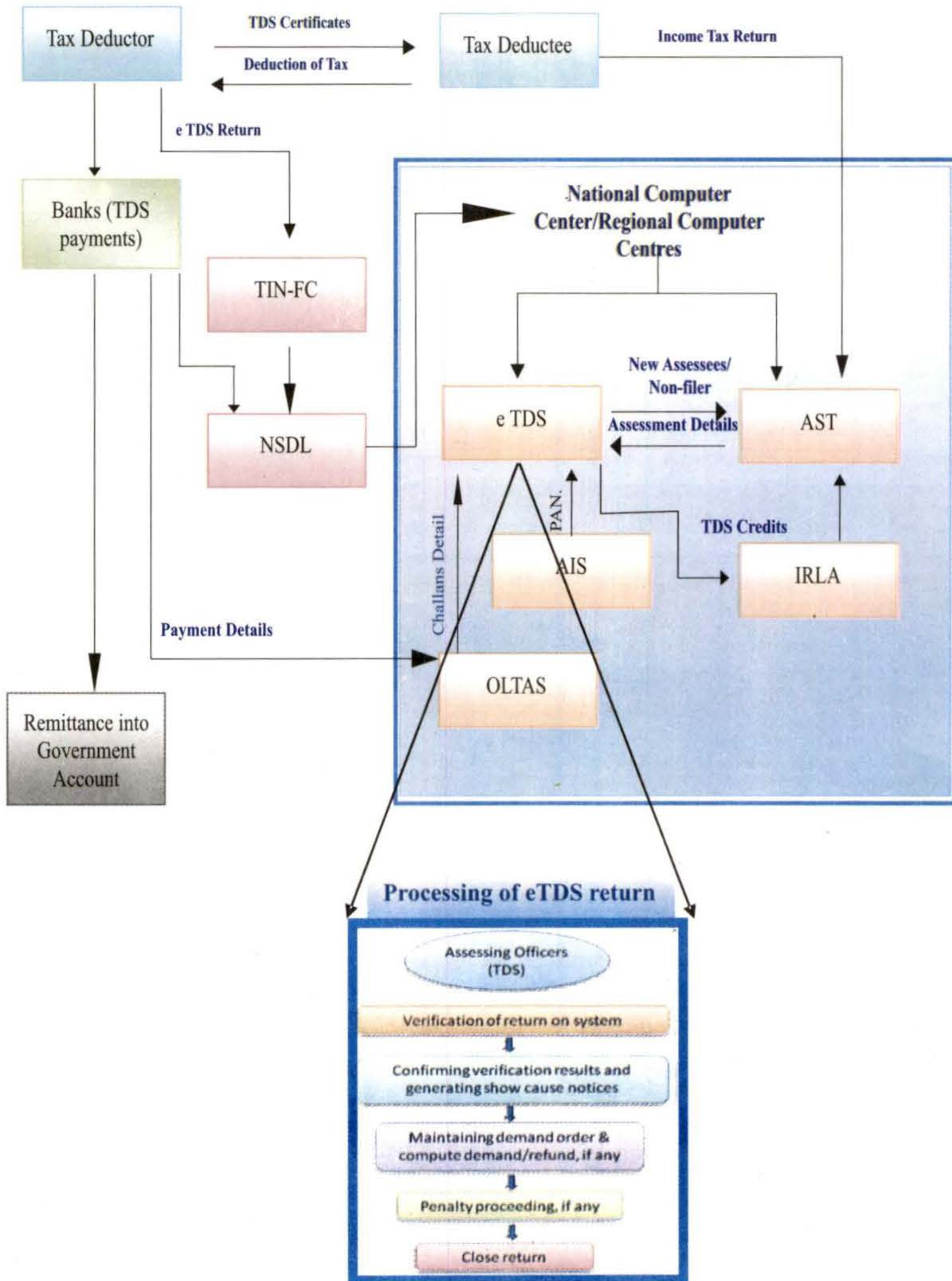
The Income Tax Department notified an "Electronic Filing of Returns of Tax deducted at Source Scheme 2003". For this purpose, Director General of Income Tax (Systems) has been designated as System Administrator and M/s. National Securities Depository Limited (NSDL) as e-intermediary, for receiving and uploading the returns/statements, both in the paper format and computer media, through front offices called as 'Tax Information Network-Facilitation Centre (TIN-FC)' at over 478 stations all over the country. NSDL uploads the TDS Returns flat files in the National Computer Center (NCC) data interchange server according to Regional Computer Centers (RCCs). The RCCs manually download their respective files as soon as the file becomes available on the NCC data interchange server.

The e-TDS system provides the following major functionalities:

- Entering the Returns and application of online validations for ensuring high degree of data accuracy.
- Verifying TDS Returns/statements for automatic detection of defaults related to demands and penalties and generation of show cause notices.
- Maintaining manually detected defaults and generation of show cause notices.
- Incorporating and monitoring adjustments made for short deduction of tax at show cause, demand creation and subsequent stages.

- Creating demands that are finalized during show cause hearings and posting them to IRLA (TDS). Generation of outputs like demand notices, challans and refund vouchers.
- Maintaining key information about demand and penalty as a result of subsequent proceedings viz. rectification, revision, appeal etc.
- Generating timely and accurate reports and querying data online.

The e-TDS module has also been designed to have adequate level of interface with other ITD modules like Assessee Information System (AIS), Assessment Information System (AST), Online Tax Accounting System (OLTAS) and Individual Running Ledger Account (IRLA) etc. During the processing of TDS returns, the e-TDS module verifies the payment details of individual deductor/deductee through challan details available in OLTAS. After confirmation of payments of individual challans, these are posted in to TDS IRLA, which is a Permanent Account Number (PAN) wise ledger account of individual deductee. These PAN-wise ledger accounts of individual deductee are designed to be utilised by the AST for giving TDS credit or refund during regular income tax assessment. This was designed to overcome the disadvantages of manual system of giving credit of TDS on the basis of physical TDS certificate issued by the deductor. The flow chart on the working of e-TDS is as follows:



Flow Chart on working of e-TDS System
Tax Deductor
TDS Certificates
Deduction of Tax
Tax Deductee
Income Tax Return
e TDS Return
Banks (TDS payments)
TIN-FC
NSDL
National Computer Center/Regional Computer Centres
e TDS
New Assessees/ Non-filer
Assessment Details
AST
PAN.
Challans Detail
AIS
TDS Credits
IRLA
Payment Details
OLTAS
Remittance into Government Account
Processing of eTDS return
Assessing Officers (TDS)
Verification of return on system
Confirming verification results and generating show cause notices
Maintaining demand order & compute demand/refund, if any
Penalty proceeding, if any
Close return

3.1.2 Audit scope and sampling

The study was conducted in the four metros of Delhi, Mumbai, Chennai and Kolkata and three states of Andhra Pradesh, Karnataka and Gujarat. TDS circles/wards were selected on random basis for the purpose of the study as under:

States/stations	Circles		Wards		RCC
	Number	Percentage	Number	Percentage	
Delhi	3	100	8	33	Delhi
Mumbai	6	100	15	33	Mumbai
Chennai	3	100	12	33	Chennai, Coimbatore and Madurai
Kolkata	11	100	6	33	Kolkata
Andhra Pradesh	5*	83	6	33	Hyderabad and Visakhapatnam
Karnataka	5	100	4	33	Bangalore
Gujarat	2	100	6	33	Ahmedabad, Baroda, Surat and Rajkot
* In Vijaywada circle there was no processing of e-TDS returns					

Audit evaluation of the performance of the system was made for the return financial years 2002-03 to 2007-08 in respect of selected units. Adequacy of general IT controls and application controls and effectiveness of the system with reference to defined objectives of computerization were also assessed.

Separate questionnaires were issued to the National Computer Centre and the Regional Computer Centres and the selected assessing officer/units and government deductors. The findings relating to these returns are discussed in subsequent paragraphs.

3.1.3 Audit objectives

The Information Technology (IT) audit was conducted with the following objectives:

- To evaluate the e-TDS software in relation to fulfilment of the business requirements set down in the IT Act.
- To ascertain the extent of utilisation of all the software features and to ensure that all the checks and controls to be exercised before processing e-TDS return are built into the software.
- To evaluate whether the processing is quick, efficient and correct.
- To evaluate whether security issues were adequately addressed and the data integrity assured.

3.1.4 Audit Methodology

The audit of e-TDS system was conducted using the CoBiT[1] framework of the IT Governance Institute, which has been adopted by the Comptroller and Auditor General

[1] Control objective for information and related technology

of India as the framework for conducting information technology audits. The framework provides a set of internationally accepted benchmarks against which the information technology activities of an organization can be evaluated.

Three domains and thirteen high-level control objectives as detailed in **Appendix 16** were selected in accordance with the audit objectives. The audit guidelines of the CoBiT framework were suitably adapted to the functioning of the e-TDS system. The audit of the System development including procurement of software, leased line connectivity etc., have also been carried out by reviewing the files available in the DIT (Systems)/ Regional Computer Centre at Delhi.

The Oracle dump files of e-TDS returns obtained from the DIT (Systems)/RCC were analysed using Computer Assisted Audit Technique[2] (CAAT). The results were further examined with reference to the TDS provisions of the Act.

3.1.5 Constraints

- The audit was not provided independent access to the system and in such a situation audit could not run test data for confirmation of audit findings
- The security policy of the department was not made available to audit.
- The data dump, wherever made available, was provided in July/August 2008, after the scheduled period of audit was over. In one charge[3], same has not been made available till date.
- Audit experienced that the network was mired in slow connectivity.
- The details of salary and non-salary returns uploaded and the year-wise expenditure thereon (in phase-II) were not made available to audit.
- The physical verification reports, asset/ stock registers of the hardware were not produced to the audit.

3.1.6 Acknowledgement

Indian Audit and Accounts Department acknowledges the cooperation of the Income Tax Department in providing the records and information for audit. The draft review was issued to the Ministry in November 2008. An exit conference was held in December 2008 with the Central Board of Direct Taxes (Board) to discuss the results of this review. The views expressed by them in the exit conference and the case specific replies have been appropriately incorporated in this report.

3.1.7 Audit Findings

The present e-TDS system is handling huge data in terms of the number of returns received every year, including the cases of large corporate deductors. The effort of the Department to improve the tax collection system with the facility to the deductors to file their returns from the comfort of their office/home is appreciable. The audit evaluation of the system has revealed that there is scope for further improvement of

[2] ORACLE and Interactive Data Extraction and Analysis (IDEA)
[3] Karnataka charge till November 2008

the whole process by addressing the problems faced in the interfaces within the various ITD modules and in the e-TDS module so that the objectives of ITD are met.

The audit findings on the above aspects relating to e-TDS module are given in the subsequent chapters/ paragraphs. The findings have been structured as:

1. Interface
    i. External interface
    ii. Interface with users
2. Business Rule Mapping
3. Data Management
    i. Data Accuracy
    ii. Data Safety
    iii. Data Security
    iv. Audit trail
4. Delivery and Support

3.2 Interface

External interface

3.2.1 In order to effectively discharge assessment functions in a fully computerized environment, it was envisaged in the System Design Document[4] (SDD) that e-TDS module will have interfaces with other modules as discussed in chapter 3.1.

Test check in audit at Delhi, Kolkata and Chennai charges relating to interface of e-TDS revealed the following:

3.2.1.1 The SDD of e-TDS module provides that the interface with OLTAS would give payment details of each deductor. It was observed that the e-TDS module was not functioning effectively as payment details claimed by deductors could not be verified due to incorrect/non-availability of TDS payment details in OLTAS. This has also resulted in large increase in suspense over the years as detailed in **Appendix 17**. Further, the dematerialisation of TDS certificate had to be postponed from 1 April 2005 to 1 April 2010 due to gradual stabilisation of OLTAS module which could not attain perfection as entries were not getting fully captured in OLTAS.

The Ministry in its reply stated (December 2008) that it is not correct to say that dematerialisation of TDS certificate has been deferred only because of non-stabilisation of OLTAS instead there were other reasons also *viz.* non-filing of TDS returns by all the deductors and that the national level information technology infrastructure of the Department was not yet operational. The reply of the Ministry confirms the audit observation.

3.2.1.2 The SDD of the e-TDS provides for interface with AIS for referring to Assessing Officer (AO) codes and PAN of the deductee. The system was, however, not verifying

[4]Paragraph 4.1.9)

the PAN from the All Indian PAN directory but only from the limited PAN relating to the regional database. As a result of this, notices of default for incorrect quoting of PAN under section 272B of the Income Tax Act were wrongly generated[5] creating avoidable workload in the Department besides hardship to the tax payers.

3.2.1.3 The SDD of e-TDS module also provides for identification and listing of non-filers and new assesses for its utilization in AST module. The interface between e-TDS and AST module was not able to identify and list non-filers and new assessees.

3.2.1.4 Non-processing/limited processing of e-TDS returns, entries not getting fully captured in OLTAS and large numbers of mismatches (as discussed in subsequent paragraphs) was resulting in credits becoming unavailable to assessees and these were given after manual verification[6] of original TDS certificates.

The verification of the PAN at National level is a paramount business requirement which is not satisfied due to an imperfect verification process. This increases the possibility of generation of defaults notices especially for those assessees whose PAN is correct but not available in the regional database.

The Ministry, while accepting the audit finding[7] relating to AIS module, stated (December 2008) that earlier e-TDS module used to verify the PAN from the All India PAN directory, but due to resource constraints the same had to be discontinued and verification restricted to PAN residing in RCC of the deductor. It was further stated (December 2008) that after migration to Primary Data Centre (PDC), the verification would commence again for which necessary modification was already underway and at the central level, inconsistency letters have been issued to the deductors who have made mistakes(inclusive of mistakes relating to invalid PANs and non-quoting of PANs) in their TDS returns.

As regards the AST module, the Ministry stated (December 2008) that data of PAN ledger which are created from TDS returns are being made/have been made available to the AST module for verification of TDS entries while processing of individual returns and this data would also act as the base data for creation of list of non-filers and for identification of new assessees in AST. It was further stated that centrally measures have been taken to further improve the data quality and compliance, especially with respect to utilizing the data available in AST for identifying defaulters vis-à-vis TDS provisions.

The fact remains that this imperfect interface with AST has not yielded the desired result of identifying non-filers and new filers. It has also resulted in giving tax credit or refunds on the basis of manual verification of physical TDS certificate, thus defeating the purpose of computerisation of e-TDS function.

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[5] In Chennai charge

[6] Reply to questionnaire issued to Regular Assessing Officers – 65 in Delhi and 5 in Mumbai charge

[7] In respect of Delhi charge.

Recommendations: The Department should revisit the issue of interface among various modules.

The recommendation of the audit was noted (December 2008) by the Ministry and it was stated that it is true that there is a need for a better interface between TDS and other modules and steps have been initiated to further strengthen the interface. It was further stated that it would be taken care of when the exercise of migration of application and consolidation of database is completed for which appropriate software would be developed.

Interface with users

3.2.2 The interface of the module with the users should be such that the processing of returns, right from the stage of initiation to the last stage of closing of the returns, is done by the system with minimum manual intervention. It was seen that the e-TDS system was not providing automated solutions for certain functions as discussed below:

3.2.2.1 The system[8] does not provide for any specific report/query for distinguishing the already processed and the unprocessed returns. The system generates a 'Return Status Report' which only shows status of the processing initiated or not, but it does not have a separate section to distinctly show the unprocessed and processed returns. The Assessing Officer (AO) before processing of return, has to go to the Return Receipt Registers (RRR) and check each RRR entry and confirm, entry by entry to ascertain whether a return has already been processed or not. The other alternative is that the AO manually records the RRR entry up to which the returns have been processed and starts processing from the next RRR entry.

The findings of audit were noted (December 2008) by the Ministry for taking appropriate action.

3.2.2.2 The system provides an option to view the returns, which are put on hold for errors. It was seen[9] that when the option is exercised, an error message (ORA-01722) appears on the screen. The RRR financial year shown in the report on deductee details differs[10] with that of RRR financial year in the check list generated.

While accepting the audit observation, the Ministry replied (December 2008) that data was being analysed and necessary steps would be taken to address the issue.

3.2.2.3 The back-up, restart & restore and trouble- shooting procedures, abnormal end, emergency fixes have not been incorporated in the user manual[11]. Changes have been incorporated into the system from time to time by applying patches to the e-TDS system but have not been incorporated in the user manual[12]. The present users' manual was last updated in August 2005. Non-updation of users' manual makes it difficult for the users to find solutions to the problems.

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[8] Seen in Chennai, Bangalore, Delhi, and Hyderabad charges.
[9] In Mumbai charge
[10] It was noticed in Chennai Charge
[11] As was observed in Mumbai, Chennai and Karnataka charges
[12] In Delhi charge

The Ministry in its reply stated (December 2008) that system is under migration and new user manual is under preparation and will be released in due course. It was further stated that so far as aspects relating to back-up etc, are concerned the same can not be incorporated in this manual since these are operating system related issues. However, no such operating manual was available with the RCCs[13].

3.2.2.4 A user friendly option of generating a report, containing the details of all deductees of that particular return as available in Form No. 26Q, is not available for Form Nos. 24, 24Q, 27, 27Q, 27E and 27EQ. Non-availability of this option in forms (including quarterly returns) other than Form No. 26Q makes verifying the entries in the forms a tardy process.

While accepting the audit observation it was stated (December 2008) by the Ministry that presently the Department is in the process of migrating the application and consolidating the database and once the exercise is over, steps will be taken to make appropriate changes in the ITD software.

Recommendation: It has to be ensured that processing of the returns entails minimum manual intervention and the user should be able to complete the processing easily.

3.3 Business Rule Mapping

3.3.1 Non-incorporation of requirements of the Income Tax Act and the procedures

The business rules need to be properly mapped for any manual system to be computerised. It was noticed that the e-TDS module was not able to meet all the procedures and requirements of the Act as there was no provision in the module for verification of the certificates where tax at lower rates was deducted or no tax was deducted, rate parameters were not fixed for certain sections etc. The cases are discussed below:

3.3.1.1 No provision for segregation of 'nil' and 'lower' tax cases

The deductor may, deduct TDS at lower rate or may not deduct it, on production of certificates as per provisions[14] of the Act by the deductee. The SDD of e-TDS application did not have the procedure for online verification of such certificates except for a check box to indicate cases of no deduction or deduction at lower rates, without segregating the two. As such this aspect has not been addressed while designing the system.

It was also noticed in audit[15] that the system generated wrong notices (which were issued) for short deduction but the deductor reported these cases as covered under provisions of the Act. The certificates were as such being manually verified.

[13] It was noticed for RCC Mumbai, Kolkata and Chennai.

[14] Section 197 or 197A

[15] in Mumbai charge, in two assessing units

The Ministry, while accepting the audit observation stated (December 2008) that appropriate changes are being planned in the TDS module so that such certificates are issued from the system which will make the verification possible.

3.3.1.2 Rates parameters not fixed in the system

Tax rate parameters for payments to non-residents[16] have not been fixed. This was evident from the fact that the e-TDS application was not detecting any case of short deduction of TDS for payments to non-residents[17]. Similarly, for payment of interest on securities, cases of short deduction of TDS under section 193 are not being detected[18] (In the mismatch report of returns for section 193, the system gives message 'Could not check for short deduction at prescribed rate, as tax rates have not been defined for section code 193') by the system.

Not addressing the issue of verification of certificates in the computerized environment and non-fixation of rate parameters are not only failures on the part of the Department while initiating the application software but also results in non-detection of cases where there is a delay in issue of the certificate or the tax has been deducted at lesser rates with consequent loss of revenue to Government.

The Ministry accepted the audit observation and stated (December 2008) that steps have been initiated to incorporate the appropriate changes in the ITD software.

3.3.1.3 Non-incorporation of amendments in the provisions of the Act

Every year, the Finance Act makes amendments in some of the existing provisions of the Act or new provisions are added. It was noticed that there were instances when the amendments made in the Act were not incorporated in the e-TDS system as would be evident from the following:

A new cess namely, 'secondary and higher education cess' was introduced in the Finance Act, 2007. Accordingly, the rates for TDS on payments made during the financial year 2007-08 were to include this new cess, which is being collected for a specific purpose and accounted for under relevant head of account.

It was noticed in audit[19] that there was no separate column for 'secondary and higher education cess' in the present module. Test check of database pertaining to Delhi charge revealed that one of its table[20] which contains the various components of tax deducted, namely, tax, surcharge, and education cess, had no separate column for 'secondary and higher education cess'. It was noticed that education cess and 'secondary and higher education cess' are clubbed together and shown in a single field.

[16] It was noticed in Delhi, Chennai and Karnataka charges

[17] TDS return for Non-resident in Form No. 27 and 27Q

[18] It was noticed in Delhi charge.

[19] In Chennai and Delhi charges. There were two cases in Chennai charge relating to the year 2005-06, one case under section 194-C and the other under section 194-I where education cess was not deducted.

[20] Table T_ TRANS

In absence of separate field for 'secondary and higher education cess' in the present module proper accounting is not possible.

Thus, the system is unable to check whether the total tax deducted is apportioned correctly against the relevant heads of account. Only mismatches due to short payment of tax or short deduction of tax with reference to the total tax deducted/deposited are being checked.

Similarly, the Department may not be able to include fields for entering any newly imposed cess/surcharge/tax etc.

It was stated (December 2008) by the Ministry that suggestion to make the system more dynamic has been noted.

Recommendation: The e-TDS system needs to be reengineered so that both present and future requirements of the Act and procedures are met.

3.4. Data Management

DATA ACCURACY

The system of filing the TDS returns is such that the corporate and government deductors have to file the e-TDS return and the individual assessee can file the manual return. The e-TDS return can be filed online at the website of NSDL or in magnetic media through Tax Information Network-Facilitation Centres (TIN-FCs) of NSDL. The department does not have any control over the data entry for e-TDS returns. So far as the manual returns are concerned the same are to be digitised by the TIN-FCs. It was noticed in audit that the returns received by the department have number of defaults[21] resulting in one by one processing of returns by the Assessing Officers and as a result very few returns are being processed. The reliability and accuracy of data entry has to be viewed in the background of the fact that delays[22] in deposit of tax of 34,945 days (96 years) and 32,874 days (90 years) and delays in furnishing the certificates of 19,358 days (53 years) and 14,221 days (39 years) are being displayed.

The Ministry in its reply stated (December 2008) that the issue is being analysed.

3.4.1 Lack of control on TIN-FCs

The Department is not having adequate control on the TIN-FCs as the checks for verifying the validity of the data entered in the pre-defined fields are not conducted as would be evident from the following:

[21] In the context of e-TDS returns, defaults mean mistakes.

[22] In Chennai charge

3.4.1.1 Mistakes carried in the returns uploaded inspite of File Validation Utility[23]

Instances[24] were found where challan number was zero with the result that the return goes in default because of mismatch. This could have been avoided if the FVU had been able to detect this as an error. Further, lower threshold limit[25] for quoting of PAN was not adhered to as in a sample case[26] where the number of deductees was 16, the PANs were not available in five cases; the return was accepted even though it was not within the threshold limit.

The Ministry stated (December 2008) that threshold limits for PAN quoting was first introduced from the second quarter of financial year 2007-08 whereas return was filed in July 2006. However, as per CBDT's circular dated 12 February 2008 till 30 September the threshold limit was 70 per cent whereas in this case the return was accepted even when the PAN quoting was less than 70 per cent (it was 68.75 per cent).

3.4.1.2 Manual returns not properly digitised

Test check of 20 manual returns which were digitised[27] revealed that while data was incorrectly entered in two digitised returns; six returns were not uploaded in the database.

The Ministry replied (December 2008) that incorrect digitisation may be due to the fact that the data in the paper return was not legible and as regards non-uploading of returns, the fact of same financial year and same form number re-occurring could be a possible reason. It is suggested that the matter may be further examined so that all returns for which the receipt has already been issued to the deductor are uploaded.

3.4.2 Lack of validation controls

Validation controls ensure the correctness and completeness of data entered into the system duly checking the same with respect to some other data/range available. These controls are essential in the context of Income Tax Department as it not only has financial impact on assessment and collection of tax but may also result in erroneous penalty and prosecution for defaults. Analysis of the e-TDS data provided by the Department revealed the following discrepancies.

[23] File Validation Utility (FVU) is a program developed by NSDL, which is used to ascertain whether the e-TDS/TCS return file contains any format level error(s). In case there are no errors in the e-TDS/TCS return file, error/response file will display the control totals otherwise the error/response file will display the error location and error code along with the error code description. In case any error is found the same can be rectified and e-TDS/TCS return file will again go through the FVU till an error-free file is prepared.

[24] In Mumbai charge

[25] No. 402/92/206-MC (10 of 2008) GOI/MOF Department of Revenue, CBDT dated 12 February 2008, the lower threshold limit for quoting of PAN in e-TDS returns by Deductors was 70 per cent for forms 26Q & 27Q and 90 per cent for 24Q till 30 September 2007 which was subsequently (for and from the quarter ending 31 March 2008) enhanced to 85 per cent and 95 per cent respectively

[26] (Form 26Q) (RRR No. 30070100111295, PAN No AAACV4791J, TAN No. HYDV00125G and Name of the Assessee M/s Vijaya Bank, MJ Road Branch, Hyderabad)

[27] In Mumbai charge, 20 manual returns were test checked with the digitised data.

3.4.2.1 AO Code not pertaining to TDS jurisdiction/correct jurisdiction

In respect of 94 returns[28] the range codes pertained to range codes other than the TDS ranges codes. Similarly, out of 6,384 TAN, 868 TAN[29] were assigned to the AOs to whose jurisdiction[30] these did not pertain.[31] Returns with incorrect Range/AO code may result in non-processing or delay in processing of these returns.

The Ministry in its reply stated (December 2008) that this is the responsibility of respective TDS charges and in all CCIT (CCA) regions, CIT (TDS) is in place and the mapping is likely to be completed.

3.4.2.2 Date of deduction not filled in

Date of deduction of tax is an important field of the TDS returns and compliance to the provisions of Act (e.g., date of deposit of tax into Government account) is dependent on this field. Non-quoting of these dates, besides receipt of incomplete returns affects the compliance to the Act. Analysis of data[32] revealed that that this field was not filled-in for 72,599, 47,392 and 16,475 cases in respect of Delhi, Mumbai and Chennai charges respectively.

The Ministry stated that (December 2008) the cases cited by audit may exist in cases of paper returns and date of deduction can also be NULL (nil) in cases where even though payment has been made but no tax has been deducted but the same has been mapped to challan through which tax has been deposited. However, in the case of Delhi all these cases are salary returns and 99.75 per cent of these cases pertain to electronic returns.

3.4.2.3 Incorrect amount of payment and section code

Analysis of data[33] revealed that the fields of 'amount of payment' and 'section code' were not filled in 9,639 and 13.30 lakh[34] records respectively. Similar analysis in another table[35] revealed that section code was not filled in 10436 records and in 1,683 records category code was not filled in.

There were records against which amount of payment was shown as '0', even then all other details like BSR code, challan voucher number, etc were available which shows inadequate validation controls.

The Ministry in its reply stated (December 2008) that validations have been subsequently incorporated to ensure that deductor can not prepare a return without

[28] Analysis of table T_Return for Return Financial Year 2002 to 2007 in Delhi charge having TDS ranges Range 49, 50 and 51was done.
[29] Test check was done in eight assessing units for one financial year in Delhi charge.
[30] AO-wise TAN directory in respect of three circle and 5 TDS wards, under the CIT (TDS), Delhi charge
[31] TDS returns are available to the AOs according to AO code, linked to alphabetic jurisdiction, in AO-wise Return Receipt Register. Whenever there is change due to re-organistaion, etc., the changes are required to be incorporated in the systems so as to maintain the correct jurisdiction of the assessment units.
[32] In table T_Chln_Brkup for Delhi and Mumbai charges and in T_TDS_TRANS table in Chennai charge.
[33] In table T_CHLN_VCHR_DTL for Delhi and Mumbai charges.
[34] For Delhi and Mumbai charges out of 55.32 lakh and 95.09 lakh records respectively
[35] In T_TDS_TRANS table in Chennai charge.

entering the amount of the payment and section code (FVU would allow only specified section codes). In this regard it is stated that the cases pointed by audit include returns[36] pertaining to return financial year 2007-08 and 95.64 per cent returns are electronic returns where section code was not mentioned and in 72 per cent cases[37] amount was not filled in electronic returns.

3.4.2.4 Inaccuracy in amount of payment and TDS amount

In TDS return the field 'amount paid/credited[38]' indicates the payment made on which the TDS is deductible at a certain percentage of the payment made and the tax deducted is recoded in field 'TDS[39]' and it is always much lesser than the former. It was noticed[40] in one of the returns that even if the amount in both the fields was same, the systems accepted the return without default. Further data analysis[41] revealed that in respect of 45,216 cases relating to Return Financial Years (RFYs) 2004-08 the amount of payment on which tax was deducted was equal or lower to the tax deposited. Similarly in 84,215 cases relating to RFYs 2004-08, the amount of tax deducted was equal to or greater than the amount of payment on which tax was deducted.

The Ministry in its reply stated (December 2008) that to improve the data quality, a validation in FVU has been introduced as per which the TDS can not be more than the amount paid.

3.4.2.5 Incorrect application of logical control

In several cases[42] in Chennai charge the system indicates 'Short deduction' even when the two factors i.e. 'the tax deducted and paid to Government account and 'the tax as calculated by the system' are equal or more.

In few cases[43], where the tax rate flag was "L" indicating deduction of tax at lower or nil rates, the system calculated tax deductible at a rate higher than the rates prescribed under the provisions of the Act. This indicates incorrect application of a vital logical control in the system.

The Ministry in its reply stated (December 2008) that in cases where the tax rate flag is 'L' indicating deduction of tax at lower or nil rate, as per the logic the tax rate is taken as mentioned by the deductor in the return. It was further stated that in case the deductor has shown the rate which is same as the rate as per the Act, that rate will be taken for the purpose of computing the TDS liability. The Ministry has not addressed the issue

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[36] In respect of Delhi charge.
[37] In respect of Delhi charge.
[38] Col no 419 Return form no. 26Q
[39] Col no 421 Return form no. 26Q
[40] In Chennai charge.
[41] In Chennai charge of i) PMNT_DDE : amount on which tax deducted ii)TAX_DPST : tax deposited , TDS_TCS_DDE : tax deducted in table T_TDS_TRANS
[42] In Chennai charge Analysis of data revealed that: T_TDS_TRANS table pertaining to the periods 2002 to 2008 the system had identified 10,52,812 records as short deducted. Among these in 2,700 cases, tax deducted tds_tcs_dde (tax deducted by deductor) was found to be in excess than the tax deductible tds_tcs_deductible (as calculated by the System) and in 3,038 cases tax deducted was equal to tax deductible.
[43] In Chennai charge

where the deductor has shown the rate higher than the rates prescribed in the Act. In such cases, the system should at least restrict the deductible amount as per the tax rates prescribed in the Act.

3.4.2.6 Non-adherence to standardised format

In the computerised system standardised format is provided for the numbers which are assigned for certain purposes. The Permanent Account Numbers (PAN) and Tax Deduction Account Numbers (TAN) are to be of the length of 10 alphanumeric numbers. The Challan Identification Number (CIN) has standardised fields. Following shortcomings were noticed:

a. The system accepts[44] the PAN/TAN[45] with length less than 10 digits without giving any error message indicating improper validation controls. This leads to generation of mismatch reports relating to Invalid PANs.

b. Standardised fields of CIN having Bank Branch code, challan voucher number and payment date were not adhered to and were accepted in the system despite being blank or invalid as per following details[46]:

Charge	Total number of records	Bank Branch Code		Challan Voucher No.		Payment Date	
		Blank	Invalid	Blank	Invalid	Blank	Invalid
Delhi	55,32,838	5,96,179	10,08,771	4,32,245	12,53,849	1,326	--
Mumbai	95,08,652	12,29,118	7,53,664	10,97,440	15,83,547	9,159	--
Andhra Pradesh	17,79,109	1,35,699	--	1,62,641	83,110	--	--

In Chennai charge query on database[47] in respect of CIN revealed that out of 3,37,87,546 records, the date of payment and date of deposit of tax were left blank in 19,642 and 5,38,790 cases respectively.

The Ministry replied (December 2008) that presently in case of PAN/TAN validations, the FVU does not allow preparation of returns without a 10 digit PAN/TAN. It was further stated that data (pertaining to CIN) may have been blank/invalid because the return may pertain to a period prior to April 2005. However, the cases[48] pointed out by audit include returns which pertain to the return financial year 2007-08.

3.4.3 Inconsistent processing

A computer system processes the data in a pre-determined manner. Audit noticed certain cases where the system was performing calculations on the given set of data in a

[44] Data analysis in Chennai charge of T_TDS_TRANS & T_F24_TDS_TRANS revealed these results.
[45], PAN/TAN were less than 10 digits in 12,560 cases out of 2,91,753 cases
[46] Analysis of table T_CHLN_VCHR_DTL revealed these results.
[47] T_TDS_TRANS
[48] In respect of Delhi charge

different manner than that of the other cases, which could be due to many reasons including undesirable manual intervention.

3.4.3.1 Incorrect dropping of cases of demand of more than Rs. 100

Keeping in view the large number of cases, where the total demand against a return is Rs. 100 or less and the high follow up cost of demand and defaults, the Board[49] decided to allow the AO to ignore such cases and drop demand/defaults up to Rs. 100 or less. The DIT (System)[50] modified e-TDS application for dropping such cases and the software was also tuned to drop such cases automatically, while running return mismatch or initiating bulk processing. In such cases warning letters were also to be issued by the AO to DDOs, to be careful in future so as to ensure that short deduction of tax did not become habitual.

It was noticed in audit[51] that the above functionality was not working properly as inconsistent results (as per details given in **Appendix 18**) were shown by the system. Demand was raised when the demand was less than Rs. 100 and demand was dropped when it was more than Rs. 100 and cases were also noticed where the system displayed message for dropping of demand when no demand existed. It was also noticed[52] that although the functionality existed in the e-TDS application, yet no warning letters were being issued by the assessing officers to the defaulting deductors.

Such inconsistency in incorrect dropping of demand cases of more than Rs. 100 has also resulted in loss of revenue to Government.

The Ministry noted the audit findings and stated (December 2008) that data was being analysed.

3.4.3.2 Surcharge not calculated

In respect of 150 assessees[53], for payments made under Sections 194A & 194D surcharge at two per cent on payment was not calculated by the system.

The Ministry noted the audit finding and stated (December 2008) that data would be analysed and if required, necessary modifications will be made in the software.

3.4.3.3 Inconsistency in 'list of invalid/missing PAN'

The deductors are required to fill the PAN of the deductees in the TDS return. It was noticed in audit[54] that there were returns in which, in place of PAN of the deductees the deductor had mentioned 'PANNOTAVBL'. The list of invalid/missing PAN did not include

[49] Vide Instruction no.1/2007 dated 18 December 2007
[50] Vide TDS instruction number 34 dated 11 March 2007
[51] in Chennai, Delhi and Mumbai charges
[52] in Delhi and Andhra Pradesh charges
[53] In Chennai charge
[54] In Delhi charge

cases where the PAN of the deductee was shown as "PANNOTAVBL" in the return filed by the deductor.

Further verification of this list with the database of PAN available in the AIS module at the RCC revealed that the PANs, which were shown as valid, were not found in AIS database whereas some of the invalid PANs were found in the AIS database as per details given in **Appendix 19.**

The Ministry in its reply stated (December 2008) that the list of invalid/missing PAN shows the 'PANNOTAVBL' records and such instances were not reported to it earlier. Further it was stated that since migration and consolidation has already commenced, corrective measures will be taken once the freeze on software modification is withdrawn.

3.4.4 Non-processing of returns

The e-TDS module was modified in January 2006[55] to provide for batch processing of TDS returns. The rationale behind the modification of e-TDS module was to segregate returns with no defaults from those with defaults (e.g., short deduction, late deduction, late deposit, non-quoting of PAN, etc) under the Act. The returns with defaults were to be made available in the systems to the Assessing Officer for initiating action. The returns without defaults[56] were to be closed.

3.4.4.1 It was seen that 1.62 lakh returns were initiated in Delhi[57] and Karnataka charges under bulk against total 4.72 lakh returns received during the period 2002-03 to 2007-08 (details in **Appendix 20**). Out of 1.62 lakh returns, defaults were noticed in 1.02 lakh returns (having the details of crores of assessees) which were to be individually processed.

Even returns without defaults are not being closed. Out of 71,347 returns without default in Chennai, Delhi and Karnataka charges only 437 returns were closed (details are available in **Appendix 21**).

Further, due to the magnitude of work involved in processing of returns with defaults, action is not even being taken by the AO for the returns with defaults resulting in non-issue of show cause notices & possible non-realization of demands. This fact is further corroborated by very low percentage of returns initiated as discussed in next paragraph.

3.4.4.2 The Income-tax Act, 1961 provides that the Assessing Officers[58] are required to process the TDS returns to identify cases of defaults like short deduction of tax, short deposit of tax and interest, late deposit of tax into government account, late filing of return, late furnishing of TDS certificates, non/incorrect quoting of PAN, etc., and

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[55] As per instruction no. 25 dated 27 January 2006

[56] TDS Instruction no.25 provides that if the mismatch process initiated through bulk processing does not detect any default these returns will be treated as processed

[57] On "Bulk Processing Status Screen" in 10 Assessing units in Delhi and 6 Assessing units in Bangalore

[58] TDS charge

initiate processing[59]. The main objective of computerisation of TDS functions was to enable processing of all TDS returns for verifying TDS claims online, through computer across the country to eliminate fraudulent TDS claims.

The details of year-wise numbers of e-TDS returns received and initiated for processing in stations/states selected for audit are given in the **Appendix 22**.

As would be seen from the Appendix, that out of 24.73 lakh returns received during the period of six years from 2002-03 to 2007-08 only 2.33 lakh returns were processed. During the year 2003-04 only 6,841 returns out of 1.90 lakh were processed. Maximum processing (as a percentage) took place in the year 2004-05 when 28,894 returns were processed out of 1.94 lakh returns. The main reason for non- processing was that there was high prevalence of defaults as mentioned in preceding paragraph. With such large number of defaults in the returns received it would be very difficult to process all the returns as the returns with defaults have to be verified one by one by the Assessing Officers.

Besides this, other reasons were poor connectivity, processing of returns not being user friendly[60], non-generation/difficulties in generation of mismatch reports, physical verification of the certificates for lower/no deduction of TDS, difficulties in claiming challans, lack of training[61] etc. As a result of non- processing, the Department is not able to ensure compliance to the provisions of the Act. Non-processing of returns may consequently result in possible loss of revenue to the Government due to action not being taken against the deductors for defaults although a part of these defaults could be attributable to data entry errors.

The audit worked out[62] the possible loss of revenue (which could have been avoided if the returns were processed) relating to defaults, such as short deduction of tax, short deposit of tax and interest, late deposit of tax into government account, late filing of return, late furnishing of TDS certificates, non/incorrect quoting of PAN, etc, for the total returns received/deductee details available in the returns (whether processed or not) as per details given below:

(i) Short deposit of tax

There were 1.29 crore cases in which the amount of tax deposited by the deductor was less than TDS deducted by the deductor, resulting in short deposit of tax of Rs. 2,999.99 crore which was subject to interest at the rate of one per cent per month and penalty equivalent to amount of short deposit (details are given in **Appendix-23**).

[59] Under sections 201, 206C of the Act

[60] as stated by the authorities concerned and noticed by audit

[61] In Chennai charge (Coimbatore) the Department attributed the reasons to technical difficulties, lack of training on e-TDS processing and system related problems.

[62] By running queries designed in audit software on the tables viz. T_Chln_brkup, T_TDS_TRANS, T_Returns of the database of the Department for some of the charges viz. Delhi, Mumbai, Chennai and Andhra Pradesh as per details given in the appendices 23 to 28.

(ii) Late filing of returns

Out of 18.61 lakh returns, in 9.96 lakh returns there were delays ranging between 1 to 1,516 days in filing the returns involving penalty of Rs. 483.60 crore (details are given in **Appendix 24**).

(iii) Delay in furnishing of certificates

Out of 5.57 crore deductee details, there was delay in furnishing of TDS certificate under various sections in 1.76 crore cases involving total penalty of Rs. 1800.78 crore (details are given in **Appendix 25**).

(iv) Non-levy of interest in cases of default for delayed deposit of TDS

Out of 95.27 lakh e-TDS Salary returns, in 11.15 lakh returns there was delay in deposit of tax into government account ranging between 1 to 27 months involving interest of Rs. 17.59 crore. Similarly in respect of non salary cases, out of 9.41 crore cases, in 1.27 crore cases there was delay in deposit of tax into government account ranging between 1 to 40 months involving interest of Rs. 86.70 crore (details are given in **Appendix 26**)

(v) Non-initiation of penalty for non-quoting of PAN

Under section 272 B read with section 139A (5) deductor is liable to penalty for non-quoting of PAN of the deductee. In 88.60 lakh cases PAN was not quoted and the minimum possible penalty worked out to Rs. 8,859.71 crore[63] (details are given in **Appendix 27**).

(vi) Non-initiation of penalty proceedings for returns with defaults

The year-wise percentage of cases where penalty needed to be initiated to cases where penalty action was initiated has also come down to 0.02 per cent in the year 2007-08[64] from 17 per cent in the year 2002-03 (the details are in **Appendix 28**).

The Ministry while noting the findings of the audit stated (December 2008) that wherever and to the extent possible, validations will be introduced in the system. It was further stated that processing of the TDS returns has been slow due to acute shortage of manpower and system resources and non working of the bulk processing system due to lack of resources. It was also assured by the Ministry that processing of TDS returns may speed up with the institution of CIT (TDS) and DIT (TDS) in place and commencement of the single national database when all the AOs will be on the network and it will be easier to monitor various aspects of the module. As regards possible loss of revenue pointed out by audit, considered as hypothetical by the Ministry, it is stated that it was not

[63] In Delhi charge 8,32,549 defaulters under the category of "PANNOTAVBL" and "PAN not quoted" have been summarized on individual deductee name and worked out to 2,68,757 cases involving penalty of Rs. 268.75 crore. In other charges penalty has been worked out without such summarisation.
[64] In Delhi charge in respect of 10 selected assessing units.

hypothetical as the provisions of the Act were kept in view while analysing the database and computing the loss. However, the main aim of the audit was to highlight the necessity of accelerating the processing of TDS returns to plug loopholes leading to loss of revenue.

Recommendations: The Department needs to:

a. *design a File Validation Utility which does not allow any error to go undetected;*
b. *ensure accuracy of data entry by deductors/ TIN-FCs;*
c. *ensure that the validation controls ensure data integrity and reliable outputs;*
d. *fix a time limit for processing of e-TDS returns so that compliance to law is ensured and possible loss of revenue is minimised;*
e. *monitor the number of returns processed within time so prescribed;*
f. *make the processing of returns smooth, speedy and user friendly by reviewing the infrastructure facilities.*

3.4.5 Non-generation/Inaccuracy in reports

The e-TDS module provides for generation of certain reports based on which decisions and action can be taken for better adherence to the provisions of the law and enhancement in the collection of revenue. Reports can be generated for Management Information System purposes also. It was observed that some of these are not being generated or there are inconsistencies in the generation of these reports, details of which are given below:

3.4.5.1 List of late filers

The purpose of this report was to identify the non-filers and late filers who used to be identified by the Blue Book in the manual system. It was observed in audit[65] that this report is not being generated in the respective AO charges. In one[66] of the charges the local formations were verifying the list of non-filers forwarded by the DIT (systems). In another charge[67] this report was generated at the RCC level but even this report had cases where the returns had already been filed in time. Non-generation/inconsistencies in generation of desired report amounted to non-fulfillment of business requirement and defaulters not being levied with penalty. The generation and use of this report could have contributed towards widening and deepening the tax base.

The Ministry while accepting the audit finding, attributed (December 2008) the non-generation of the report to action not being taken by the AOs despite the procedure being explained in training and user manual.

[65] In Chennai, Delhi, Karnataka, Kolkata and Mumbai charges
[66] In Kolkata charge
[67] In Chennai charge

3.4.5.2 Inaccuracy in generation of mismatch report

The system while generating[68] the mismatch report for short deduction under section 194A shows a message that 'Could not check for short deduction at prescribed rates as tax rates have not been defined for section code 194A' for the returns relating to financial year 2007-08. However, in the same report short deduction under section 194A was also computed. Further, the system computed[69] 'nil' interest for short deduction and short payment[70] for the financial year 2007-08 even for the cases where short deduction/short payment and interest was chargeable.

The Ministry noted the audit finding and stated (December 2008) that data will be analysed and if required, necessary modification will be made to the software.

3.4.5.3 Non-generation of report showing number of returns processed during a financial year

The system does not[71] generate report on the number of returns processed during a particular financial year at the AO level. The query on 'ITD-TDS-Query-Returns Statistics' in the system, generated only the updated figures of processed returns for the particular financial year as on the date of generation. Non-generation of such reports by the system results in performance not being evaluated. The system should have been designed in such a manner that this report could be generated from the data available centrally/regionally at NCC/RCC for performance evaluation and MIS purposes.

The Ministry accepted the audit observation and stated (December 2008) that based on feed back received from the field, necessary action has been initiated to display parameterised statistics.

Recommendations: The department needs to make use of the reports generated from the system, while ensuring that these are correctly generated.

DATA SAFETY

3.4.6 For receiving and uploading of the data, the Department is having a Memorandum of Understanding (MoU) with NSDL who is an e-intermediary. The data uploaded by NSDL is transferred to NCC and from NCC to various RCCs and from there it is sent to Assessing Officers. The Department is required to get the off line data from NSDL as per the terms of MoU and for the data available with the Department, proper back-up procedures need to be in place and should also be functional. The observations[72] of audit in this regard are given below:

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[68] It was noticed in Chennai charge.
[69] It was noticed in Chennai charge.
[70] under section 201(1A)
[71] In Delhi, Mumbai, Chennai and Karnataka charges.
[72] The observation regarding Off line data relates to Delhi charge.

3.4.6.1 Off line data with NSDL: As per the MOU the NSDL[73] is to retain the data on-line for a period of two years from the end of the financial year to which it pertains and off line for a further period of two years. The off line data is to be handed over to the Department after expiry of this period with proper indexing/retrieval facilities. Further, physical documents relating to PAN/TAN application/change request were required to be retained for a period of one year after allotment/renewal/effecting the change. Electronic data relating to TAN/PAN were required to be retained for a period of two years. NSDL has not provided off-line data (once due in March 2008) to the Department.

3.4.6.2 Data processed within the Department

In this regard following shortcomings[74] were noticed:

- The backups were not taken regularly. Instead of taking the backup fortnightly, on several occasions the backup was taken for 3-4 months. Certain other cases were noticed where the backup file could not be retrieved properly.
- The data taken as back up in magnetic tapes was not tested for retrieval.

It was stated by the Ministry (December 2008) that at present, the data is continuously being taken into the Department's database and that till date the entire data is available online and when MoU was entered into, real time transfer was not envisaged. It was further stated that with the completion of consolidation of database of the Department, the entire data will be available at the Business Continuity Site (BCS) as well as the Disaster Recovery Site (DRS) of the Department.

The Department, in the interest of security and for disaster management purposes, should continue to take over the data from NSDL as per the terms of MoU with NSDL till such time BCS and DRS do not come into place.

Recommendation: The Ministry should ensure that back-up procedures are implemented properly even when BCS and DRS come in to place.

DATA SECURITY

3.4.7 A well defined and documented password and security policy with proper implementation of the same is necessary for an organization to safeguard information from unauthorized access and tampering. Though the security policy was not made available to audit it was observed[75] that:

i) The system does not provide for password change at the time of initial login by the user; does not enforce any periodic change of password by the user and in many of the e-TDS wards user ID and passwords were the same;

ii) The Date and time of last access and number of unsuccessful attempts after last successful login attempt were not displayed on the screens of authorized users

[73] Para 7(v) (Obligation of NSDL) of Memorandum of Understanding between Income Tax Department (ITD) and NSDL (e-TDS intermediary).
[74] In Delhi, Karnataka and Mumbai charges.
[75] In Mumbai, Chennai, Andhra Pradesh and Kolkata charges

at the time of login; User ID was not suspended after a specified number of repeated unsuccessful log-on attempts;

iii) The assessing officers were given access to the e-TDS software by means of issuing passwords. However, the actual processing was done by the staff members with the passwords of the A.Os.

The Ministry in its reply stated (December 2008) that the department is in the process of migrating the application and consolidating databases and the security procedure that will be followed in the new system has also been addressed.

Recommendation: The Department should ensure that the security policy is strictly implemented.

AUDIT TRAIL

3.4.8 Computerised systems are designed in such a way that the audit trail of the processes undergone is maintained. However, the same was not maintained in Delhi charge as would be evident from the following:

The mismatch reports generated by the assessing officer of the selected TDS circles/wards were not saved for future references. Audit experienced that if required subsequently, generation of these reports, pertaining to large number of deductees, takes 2-3 hours. Often the system, while generating a report, gets logged-off after a pre defined idle time, as a security measure. This was also one of the reasons for processing of only those returns which were having less number of deductees pertaining to wards and non-processing of high value returns with larger number of transactions.

Recommendation: The Department should ensure that proper audit trail is maintained in the system.

The Ministry noted the audit findings and stated (December 2008) that necessary action will be taken where necessary.

3.5 Delivery and Support

THIRD PARTY SERVICES

3.5.1 Design and development of ITD application and Networking system

In order to improve the efficiency and effectiveness of Tax Administration and to ensure timely availability and utilisation of information, under Comprehensive Computerisation Programme, the Department decided to engage Tata Consultancy Services (TCS) in September 1994 as a software consultant. TCS was to analyse, design, develop and implement Applications Software at Delhi, Mumbai and Chennai at a cost of Rs. 72.12 lakh. The nine integrated applications, including TDS, were to be designed and developed within a period of 14 months which was later on extended to 24 months i.e. by September 1996. Against the original scheduled delivery time for all applications, the

TDS application was accepted by the Department on 19 June 2002 i.e. after a delay of 69 months.

For achieving a smoother, faster and flawless network it was decided in November 2002 to implement All India Income Tax Network Project (TAXNET) within a period of four months for establishment of a network[76] to provide end to end connectivity to the 751 locations spread across 510 cities. The work was awarded to Bharti Infotel Limited, at a cost of Rs.240 crore in October 2005, after a gap of three years from the approval of Cabinet (November 2002). The developer and designer of the application had highlighted the importance of a smooth, speedy and un-interrupted networking between NSDL, NCC, RCC, LBS[77] and the end-users for successful implementation of the ITD modules. Even then the scheduled period of completion of the TAXNET project was not adhered to.

The network, however, continues to be a hindrance for efficient working of the ITD applications (September 2008). Logs[78] of connectivity at Assessing Officers level were not made available to audit. It was, however, observed during audit that connectivity was not only slow but was also frequently interrupted. Lack of uninterrupted and speedy connectivity was also one of the reasons attributed by assessing officers[79] for not processing the returns, and connectivity to Servers at RCC, Mumbai was not available during the audit period.

The Ministry while accepting the audit observation stated (December 2008) that with the National Data Centre coming in place, this issue will be taken care of.

Recommendations: The Department should strengthen its communication network and ensure round-the-clock connectivity for enhancing the processing of e-TDS returns.

3.5.2 Payment to NSDL regarding Phase II of Tax Information Network (TIN)

The Department[80] decided[81] that the rates for various services during Phase II of the TIN, shall continue to be at the rates of Phase I[82], except in case of processing of TDS/TCS data pertaining to deductions from 1 April 2005 onwards. It was decided that the revised rate would be Rs. 1.30 per deductee record in respect of salary (up to 7.2 crore records) and Re. 0.75 per record thereafter. Similarly the rate for non-salary deductee was fixed at Rs. 1.30 per deductee records (up to 5 crore deductee records) and Re. 0.70 per record thereafter. The price fixed for above services in earlier MOU was Re. 0.75 per deductee record for salary and Re. 0.50 per deductee record (up to 2.40 crore deductee records) Re. 0.40 per deductee record thereafter for non-salary returns/statements. The rates for TDS/TCS returns were enhanced on the ground that

[76] MPLS Internet Protocol based Virtual Private Network (IP VPN)
[77] Local Building Server
[78] In respect of Mumbai charge these were not maintained.
[79] for Delhi charge
[80] In Delhi charge
[81] The Empowered Committee, on the recommendation of the Price Negotiation Group (PNG), in its 13th meeting held on 24 September, 2004 took the decision.
[82] Fixed under the MOU with NSDL dated 12 February 2004

there would be qualitative enhancements for processing of data pertaining to TDS/TCS returns in Phase II.

Audit observed that the services for which rates were enhanced were oriented to dematerialisation of TDS/TCS certificates which was originally planned to be implemented with effect from 1 April 2005. The implementation of dematerialisation has, however, been postponed up to 2009-10. Hence the payment to NSDL at higher rate for the functions which have not started/used (due to deferment of dematerialisation) was not justified as NSDL continued to render the same service and there was no qualitative enhancement in the services rendered by it.

The details of number of records for salary and non-salary returns uploaded and the year-wise expenditure on uploading the TDS/TCS returns paid to NSDL in phase-II were not made available to audit.

The Ministry in the exit conference stated (December 2008) that there are some major differences in the functionalities that were part of Phase I and Phase II and it was also stated that activities that NSDL is rendering has made the system completely ready for dematerialisation. While not disputing the additionalities mentioned by the Ministry, the fact remains that NSDL was unable to render all the services for Phase II, as specified in the Minutes of the 13th meeting of the Empowered Committee (10 September 2004). Moreover dematerialisation has been deferred.

3.5.3 Details for returns uploaded and returns not uploaded are not made available to Nodal Officer

The ITD needs to ensure that TIN-FCs are uploading all the returns received by them and no returns are pending to be uploaded. Such details would have facilitated the AO concerned about the non-filers. As per the directions of DIT (Systems),[83] Nodal Officers are to hand over electronic media and Form No. 27A received from the TIN-FCs to the Assessing Officers concerned and maintain a proper record of distribution. It was noticed[84] that the forms have not been handed over to the Assessing Officers concerned and in some cases[85] returns were not found to have been uploaded, although evidence of filing and quoting the RRR number were provided by the assessee.

The Ministry stated (December 2008) that detailed instructions have been issued to the TDS charges from time to time regarding the functions of Nodal Officers and various suggestions were also given.

3.5.4 Digitisation of bank challans

It was decided[86] by the Department in December 2005 to scan and digitise challans and scrolls, in 35 stations all over India, for the financial year 2004-05 and 2005-06 for

[83] letter No.Misc/2/3/2005/DIT(S)-20903-47 dated 28.02.2006
[84] In Mumbai charge
[85] It was noticed in Chennai charge
[86] On the basis of the recommendations of the committee, constituted by the Board, to look into the problems faced during the implementation of OLTAS, a decision was taken on the directions of the Empowered Committee.

ensuring accurate verification of payments. By the end of March 2007, the vendor could scan 35.38 lakh challans and the same were handed over to the Department in CDs and in hard disk for further action, at a total cost of Rs. 37.73 lakh out of which payment of Rs. 22.11 lakh had already been made.

As on the date of audit (July 2008), the CDs/Hard disc containing the challan data which were to be made available to 330 Assessing Officers (Delhi) for matching the OLTAS data for giving credit were lying (July 2008) at CIT (CO), while the regular income tax returns pertaining to financial year 2004-05 and 2005-06 have already been processed.

Thus, the expenditure incurred for the entire scheme of 'scanning and digitization of challans and scrolls' did not yield the intended results as there is now no scope for utilisation of the data.

Conclusion

The Department is handling huge data in terms of the number of returns received each year, including the cases of corporate deductors. For smooth functioning of e-TDS module efficient interfaces with other modules was a prerequisite. However, interfaces were not functioning properly. This was also one of the reasons for non stabilisation of the module and deferring the implementation. Further, the e-TDS system needs to be more user-friendly. The business rules have not been properly mapped. Certain amendments in the provisions of the Act have not been duly incorporated in the e-TDS system.

The Department is constrained in managing the data. The data accuracy could not be ensured as the authorities entering the data are outside the control of the Department. Further, the validation controls were also lacking as instances of mistakes were noticed where the returns uploaded had errors in spite of File Validation Utility, manual returns were not properly digitized, important fields were not filled in etc. This has resulted in Department receiving returns with large number of defaults which made the processing of returns difficult for the Department. Possible revenue loss can not be ruled out in such cases.

The data with the third party was not taken back as per the terms of MoU and the data backed up by the Department was not regularly tested for retrieval and there was lack of awareness of security measures within the Department. Further, there was delay in development of the e-TDS application and the networking system. The networking, which was envisaged to be completed in a period of four months in November 2002, has not been completed till September 2008.

The Ministry in its reply brought out the major initiatives taken up at the central level by the Directorate of Systems for improvement of the data quality, active follow up being taken up with the banks for better TDS compliance and sensitization of deductors by means of information dissemination through websites on TDS related provisions resulting in better tax collection.

While again appreciating the efforts of the Income Tax Department, Audit reiterates that there is scope for further improvement of the whole process and the highlighted problems need to be addressed.

Summary of Recommendations

The Department should ensure better linkage with the various external interfaces.

There is a need to fix the time limit for processing of e-TDS returns so that compliance to law is ensured and possible loss of revenue is minimised. An effective mechanism needs to be implemented to monitor the number of returns processed. The network also needs to be strengthened to enhance the processing of e-TDS returns.

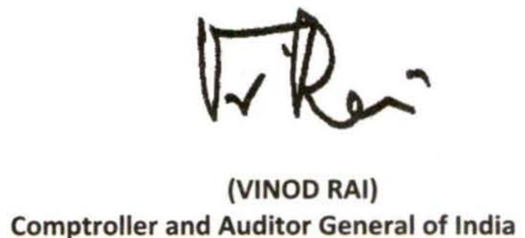
The accuracy of data has to be ensured so that it can be relied upon. Also validation controls should be constantly evaluated to ensure data integrity.

The data backup should be taken and tested regularly for retrieval. The users should be made aware of the security issues.

New Delhi
Dated: 20 MAY 2009

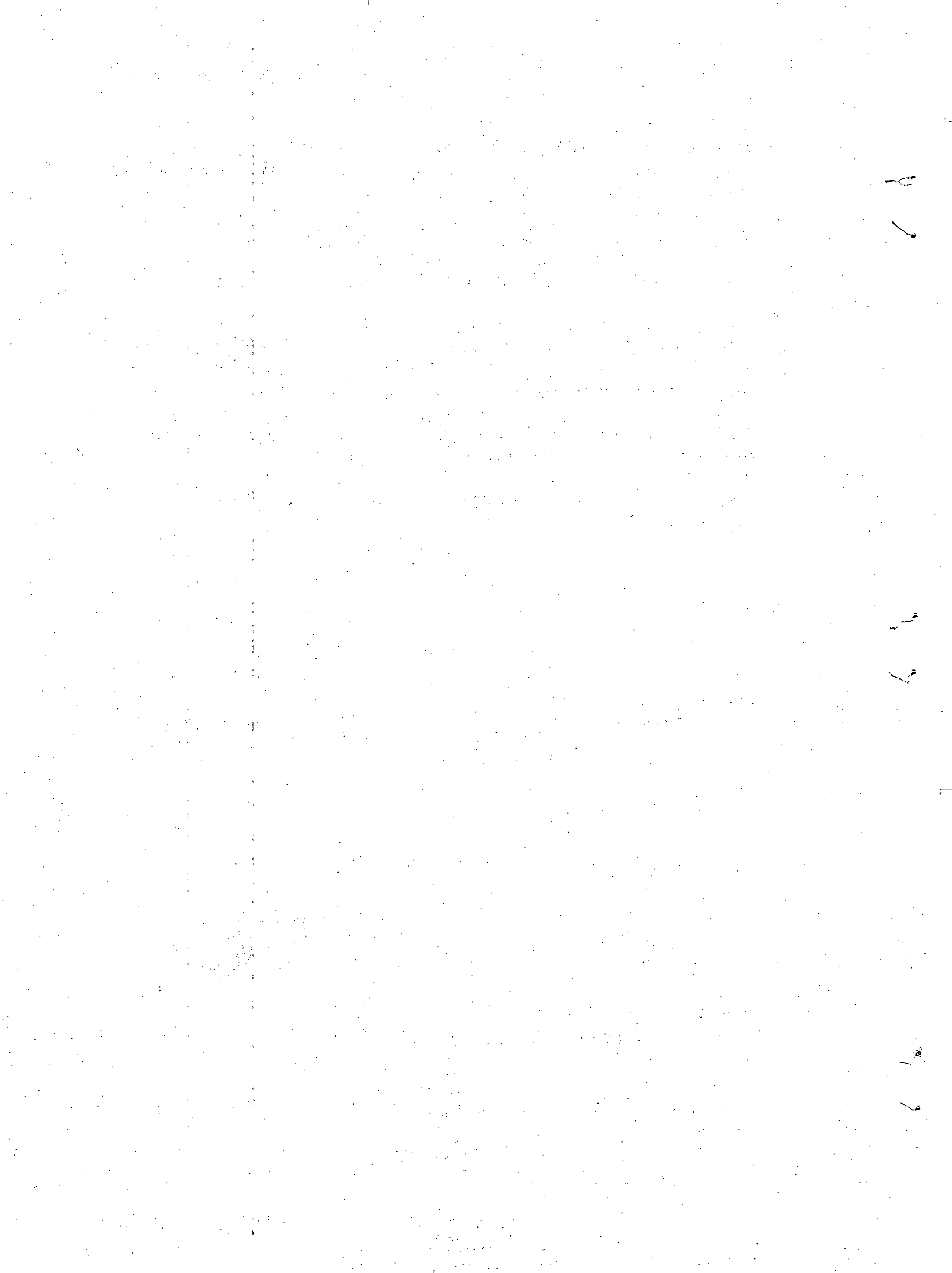
(MAHUA PAL)
Principal Director (Direct Taxes)

Countersigned



New Delhi
Dated: 20 MAY 2009

(VINOD RAI)
Comptroller and Auditor General of India



Appendices

Appendix 1

Paragraph 1.7.3

(Rs. in crore)

Sl. No	Name of the assessee	Balance of reserves in assessment year		
		2004-05	2005-06	2006-07
	Maharastra			
1	The Great Eastern Shipping Co. Ltd.	385	240	240
2.	Tolani Shipping Company Ltd.	46	0	0
	West Bengal			
3.	Surendra Overseas Ltd.	46.53	46.53	46.53
4	Asianol Shipping Ltd	1.35	1.35	1.35
5	Vivada Inlands	1.24	1.24	1.24
	Tamil Nadu			
6	TCI Seaways Lid	4.77	4.77	NA
7	Good Earth Maritime Ltd.	16.06	16.06	NA
8	West Asia Maritime Ltd	25.50	25.50	NA
	Kerala			
9	South India Corporation Ltd.	14.13	14.13	14.13
	Goa			
10	Sancoale Shipping	1.37	1.37	1.37
	Andhra Pradesh			
11	Dredging Corporation of India Ltd.	333.00	333.00	0
12	Kei-Rsos Maritime Ltd.	3.18	2.08	2.08
13	Ocean Sparkles Ltd.	9.00	7.00	NA
	Total	**887.13**	**693.03**	**306.7**

NA : Not available

Appendix 2
Paragraph 1.8.5

(Rs. in lakh)

Sl. No.	Name of assessee	2003-04	2004-05	2005-06	
				Normal#	Tax paid under TTS
1	Raj Shipping Ltd	0*	0*	189.92	0.27
2	South East Asia Maritime Engineering & Co	0*	0*	74.55	2.00
3	Pratibha Shipping	0*	0*	247.91	11.67
4	Shipping Corporation of India Ltd.	0*	0*	38990.26	609.30
5	Tolani Shipping company Ltd.	0*	0*	6984.93	29.25
6	Mercator Line	0*	0*	6201.15	114.68
7	Essar Shipping Ltd.	0*	76.29	11026.34	157.71
8	Varun Shipping Co. Ltd.	0*	24.66	2552.52	40.02
9	Garware Shipping Corporation Ltd.	0*	30.70	422.75	72.58
10	Kei-Ross Maritime Ltd.	22.16	27.08	241.57	3.97
11	Ocean Sparke Ltd.	54.09	240.59	90.60	0.37
12	Gati Ltd.	95.13	56.10	52.99	2.21
13	Sealion Sparkle Harbour Services Ltd.	9.44	10.03	4.29	0.06
14	The Great Eastern Shipping company Ltd.	257.01	2918.26	25340.35	357.59
15	KC Maritime	96.96	10.97	15.69	2.62
16	South India Corporation Ltd	53.83	916.06	745.30	6.21
17	Good Earth Maritime Ltd	15.85	49.05	2014.00	36.69
18	Sanmar Shipping Co Ltd	15.95	152.53	2582.76	266.58
	Total	**620.42**	**4512.32**	**97777.88**	**1713.78**

* After allowing deduction under section 33AC
# Notional income taxable under normal provisions had the companies not opted for TTS.
Sl. No. 1 to 9, 14 and 15 relate to Maharashtra; 10 to 13 relate to Andhra Pradesh; 16 relates to Kerala; 17 and 18 relate to Tamilnadu charges.

Appendix 3
Paragraph 1.9.4

(Rs. in crore)

Sl No	Assessee and CIT charge	Assessment year	Assessment details	Nature of mistake	Tax effect
1.	Poompuhar Shipping Corporation Ltd., CIT-III Chennai	2005-06	Scrutiny/ Sec. 154 December 2007/ February 2008	Unabsorbed depreciation to be carried forward upto the assessment year 2005-06 was determined at Rs. 17.62 crore instead of Rs. 4.36 crore. This resulted in excess carry forward of depreciation by Rs. 13.26 crore. Department accepted (January 2008) the audit observation and revised the assessment.	4.64
2.	Radiant Shipping Ltd Mumbai City 5	2004-05	Scrutiny December 2006	Assessee was allowed depreciation of Rs. 8.67 crore in contravention of section 43(6) on fleet which was sold during the relevant previous year and the entire block of fleets ceased to exist as on 31 March 2004. This resulted in excess carry forward of loss of Rs. 8.67 crore involving a potential short levy of tax of Rs. 3.11 crore. Department accepted the audit observation and rectified the mistake (November 2007).	3.11
3.	Abhiyan Cargo Pvt. Ltd Kolkata CIT-I	2005-06	Summary September 2006	As per the Tax Audit Report appended to the return of income, no tax had been deducted by the assessee on payment of Rs. 5.84 crore made to contractors which was in violation of provisions of section 194C. Omission to disallow the expenditure resulted in under assessment of income of Rs. 5.84 crore The Department has accepted the audit observation.	2.37
4.	SICAL Logistics Ltd CIT III Chennai	2003-04	Scrutiny March 2006	Assessee purchased (March 2002) a ship for Rs. 18.55 crore on borrowed capital and sold (April 2004) the same for Rs. 13.59 crore without actually putting it to use. Interest of Rs. 3.26 crore and Rs. 3.41 crore on borrowed capital was not disallowed as per proviso to section 36(1)(iii)	1.19
		2004-05	Scrutiny December 2006		1.23
5.	Cochin Shipyard Ltd CIT Kochi	2005-06	Scrutiny December 2007.	Provisions for obsolescence, non-usability and deterioration of inventory amounting to Rs. 4.88 crore was debited to the profit and loss account (Schedule 7) which was not an allowable expenditure. Omission to disallow the expenditure resulted in under assessment of income of Rs. 4.88 crore. The department stated that the stock against which the provision made would either be used in the future or written off as unusable.	2.38

Sl No	Assessee and CIT charge	Assessment year	Assessment details	Nature of mistake	Tax effect
6.	Surendra Overseas Ltd CIT (Cen) I, Kolkata	2003-04	Scrutiny February 2006	Assessment was concluded at a loss of Rs. 7.04 crore under normal provisions. However, assessee's book profits worked out to Rs. 6.14 crore, which was not taken into account while working out the tax payable under special provisions. Department accepted the audit observation (January 2008).	0.73
7.	South India Corporation Ltd CIT Kochi	2005-06	Scrutiny December 2007	Assessee was allowed a deduction of Rs. 2 crore on the combined profits derived from the business of shipping and wind energy generation. After setting off of brought forward losses the assessee had no profits from the eligible undertaking (i.e. wind mill) for allowing deduction under section 80IA.	0.97
8.	Dredging Corporation of India CIT I Visakhapatnam	2003-04	Scrutiny/ Revised February 2004/ April 2006	Interest of Rs. 77.75 lakh under section 234B was levied though assessee had paid advance tax and self assessment tax aggregating to more than 90 percent of tax payable Department accepted the audit observation and took remedial action (Oct/Nov 2007).	0.78
9.	V.S. & B Containers Pvt Ltd CIT I Chennai	2002-03	Scrutiny March 2005	Domestication expenses of Rs. 70.22 lakh and Rs. 122.38 lakh which was capital in nature was allowed in the assessments as revenue expenditure.	0.25
		2003-04	Summary March 2004		0.45
10.	AFL Pvt. Ltd. CIT Central I Mumbai	2005-06	Scrutiny December 2007	Assesse was allowed to carry forward a loss of Rs. 16.24 crore as against the actual loss of Rs. 14.13 crore resulting in excess carry forward of loss of Rs. 2.12 crore (PTE)	0.77
11.	ABG Shipyards Ltd CIT Cen. III Mumbai	2003-04	Scrutiny January 2006	Ninety percent of interest of Rs. 3.33 crore received was not reduced while computing deduction under 80HHC Department stated (August 2008) that remedial action under section 263 had been taken.	0.64
12.	Priyanshu Sea Foods (P) Limited CIT 1 Vishakhapatnam	2003-04	Summary March 2004	Depreciation of 86.06 lakh and Rs. 118. 00 lakh allowed in respect of two imported Deep Sea Fishing Vessels was irregular as assessee was not the owner of the vessels and no amount was paid for acquisition of the vessels by the assessee. Incidentally it was seen that the Department had disallowed the depreciation of Rs. 158 lakh in respect of these vessels during the assessment year 2004-05. Department accepted the audit observation and initiated remedial action.	0.32
		2005-06	Summary August 2006		0.43
Total					**20.26**

Appendix 4
Paragraph 1.10.3

(Rs. in crore)

Sl No	Port Trust Asst year	Appeal by and where pending	Issue in brief	Tax involved
1	**Jawaharlal Nehru**			
	2003-04	By assessee with CIT(A)	Interest on loan relating to periods upto 31.03.2002, W.D.V. to be adopted in assessment for assessment year 2003-04 on assets purchased and put to use prior to 2003-04 when port trusts were not taxable. Whether depreciation to be computed and reduced notionally while arriving at WDV, disallowance of contribution to approved gratuity and superannuation fund paid during current year but relating to earlier years, rental income from staff quarters treated as business income instead of treating it as income from house property, etc.	300.16
	2004-05	By assessee with CIT(A)	-do-	115.91
	2005-06	By assessee with CIT(A)	-do-	88.79
2	**Paradip**			
	2004-05	By Department in ITAT	Interest on loan and rate of depreciation on assets	0.18
	2005-06	-do-	-do-	55.89
3	**Visakhapatnam**			
	2004-05	By Department in ITAT	Disallowance of prior period expenses	6.91
	2005-06	-do-	Disallowance of excess depreciation	0.59
4	**Kochi (Cochin)**			
	2004-05	By Department in ITAT	Taxability of balance outstanding in provisions created for retirement benefits of employees	37.43
5	**Mormugao**			
	2005-06	By Department in ITAT	Written down value to be adopted in assessment for assessment year 2005-06 on assets purchased and put to use prior to 2003-04 when port trusts were not taxable. Whether depreciation has to be computed and reduced notionally while arriving at WDV.	3.93
6	**New Mangalore**			
	2003-04	By Department in High Court	Written down value to be adopted in assessment for assessment year 2003-04 on assets purchased and put to use prior to assessment year 2003-04 when port trusts were not taxable. Whether depreciation has to be computed and reduced notionally while arriving at WDV?	34.40
	2004-05	By Department in ITAT	-do-	27.87
	2005-06	By Department in ITAT	In addition to the above, taxation of unutilized grants in aid and disallowance under section 43B.	19.19

7	**Kandla**			
	2003-04	By Department in High Court	Written down value for allowing depreciation and classification of assets	45.84
	2004-05	By assessee in ITAT	Depreciation claimed on cost of assets, expenses towards productivity linked bonus and claim of expenditure on which tax was not deducted at source	10.75
	2005-06	By assessee with CIT(A)	Depreciation claimed on cost of assets and expenses for productivity linked bonus	8.44
	Total			**756.28**
Details of appeals in respect of port trusts at Chennai, Ennore and Tuticorin in Tamilnadu and Mumbai are not available.				

Appendix 5
Paragraph 1.10.6.1 to 1.10.6.3

(Rs. in crore)

Sl No	Name of assessee	Assessment year	Nature of assessment	Month of assessment	Excess allowance of depreciation	Tax effect	Total
	Wharves						
1.	Ennore Port Ltd	2003-04	Scrutiny	November 2005	110.23	40.11	40.11
	Capital Dredging						
2.	Visakhapatnam Port Trust	2003-04	Scrutiny	February 2005	1.58	0.50	
		2004-05	Scrutiny	November 2006	3.00	0.99	
		2005-06	Scrutiny	December 2007	2.70	0.99	
3.	Kakinada Sea Ports Limited	2005-06	Scrutiny	November 2007	0.16	0.06	
4	New Mangalore Port Trust	2003-04	Scrutiny	March 2006	31.27	10.32	
		2004-05	Scrutiny	December 2006	20.33	6.71	
		2005-06	Scrutiny	December 2007	12.43	4.18	
		2006-07	Scrutiny	March 2008	6.79	2.31	
5.	Chennai Port Trust	2003-04	Scrutiny	March 2006	0.72	0.22	26.28
	Railway sidings						
6	Visakhapatnam Port Trust	2003-04	Scrutiny	February 2005	3.13	1.62	
		2004-05	Scrutiny	November 2006	2.06	1.10	
		2006-07	Scrutiny	December 2007	0.78	0.44	
7	Kakinada Sea Ports Limited	2005-06	Scrutiny	November 2007	0.56	0.21	
8	Mumbai Port Trust	2003-04	Scrutiny	February 2006	4.72	1.49	
		2004-05	Scrutiny	December 2006	5.36	1.65	
		2005-06	Scrutiny	September 2007	3.39	1.05	
9.	Jawaharlal Nehru Port Trust	2003-04	Scrutiny	December 2007	10.89	5.39	
		2004-05	Scrutiny	July 2007	7.08	3.04	
		2005-06	Scrutiny	December 2007	4.33	1.80	17.79

Appendix 6
Paragraph 1.10.8

(Rs. in crore)

Sl. No.	Assessee and CIT charge	Assessment year	Assessment details	Nature of mistake	Tax effect with interest
1.	Jawaharlal Nehru Port Trust CIT II Thane charge	2003-04	Scrutiny/ Revised Dec 2007 Feb 2008	While rectifying the original assessment order, the assessing officer reduced the business income by Rs. 51.08 crore as against the correct amount of Rs. 64.08 crore. This resulted in over assessment of income of Rs. 13 crore.	4.10
2.	-do-	2004-05	Scrutiny July 2007/ Feb 2008	Loss of Rs. 721 lakh on sale of spares which were used for capital asset viz. bulk terminal, was allowed as revenue expenditure.	2.22
3.	New Mangalore Port Trust CIT Mangalore	2004-05	Scrutiny Dec 2006	Capital loss of Rs. 7.93 crore on conversion of units under US 64 scheme into tax free Government Securities had been allowed as revenue expenditure. Incidentally it may be pointed out that this amount had been disallowed in the scrutiny assessment of Mumbai Port Trust during assessment year 2004-05.	2.62
4.	Tuticorin Port Trust	2004-05	Scrutiny Dec 2006	Rs. 11.69 crore being exchange rate fluctuation was added to fixed assets and depreciation of Rs. 2.92 crore (@ 25 per cent) was allowed. However, as per Section 43 A the fluctuation in the foreign exchange rates can be capitalized only if the foreign exchange liability on the asset had been fully discharged. Since the liability had not been discharged capitalizing the expenditure and allowing depreciation thereon was incorrect	1.05
5.	New Mangalore Port Trust CIT Mangalore	2005-06	Scrutiny Dec 2007	As against an admissible deduction of Rs. 52.75 lakh (being one fifth of Rs. 2.64 crore) towards VRS expenses, a deduction of Rs. 4.75 crore had been allowed resulting in incorrect allowance of deduction of Rs. 4.22 crore involving a tax effect of Rs. 1.70 crore. Further, amount already refunded during summary assessment was adopted as Rs. 16.89 crore as against Rs. 15.87 crore resulting in an excess demand of Rs. 72 lakh.	0.98

6.	Paradip Port Trust CIT Cuttack	2004-05	Scrutiny/ Revised Jun 2005/ Apr 2007	The rectification order sought to rectify the erroneous allowance of depreciation of Rs. 203.86 crore as against Rs. 203.36 crore allowable. Audit scrutiny revealed that instead of adding, Rs. 50 lakh, the same was reduced from the taxable income.	0.60
7.	Kakinada Sea Ports Ltd CIT II Hyderabad	2005-06	Scrutiny Nov 2007	Assessment under special provisions was completed after allowing unabsorbed depreciation pertaining to assessment years 2000-01 to 2004-05. Audit scrutiny revealed that brought forward losses to be set off was Rs. 20.43 lakh as against Rs. 4.79 crore set off, which was irregular. Department, while accepting the audit observation, stated that necessary rectification had been carried out by raising an additional demand.	0.50
8.	Kolkata Port Trust CIT XII Kolkata	2004-05	Scrutiny Dec 2006	Depreciation on residential buildings was allowed at the rate of ten percent as against five percent allowable. Further, Rs. 3.21 crore allowed as depreciation on plant and machinery as against Rs. 2.70 crore allowable.	0.48
9.	Jawaharlal Nehru Port Trust CIT Thane	2004-05	Scrutiny/ Revised July 2007 Feb 2008	Income of Rs. 1.34 crore had been reduced from the total income as it related to prior period. However, in the rectification order the sum of Rs. 1.34 crore had been once again reduced.	0.41
10.	Mumbai Port Trust CIT City XII Mumbai	2003-04	Scrutiny Feb 2006	Revenue expenditure of Rs. 3.96 crore claimed by the assessee was disallowed treating it as capital and depreciation of Rs. 99 lakh was allowed. On an appeal by the assessee, the appellate authority restored status *quo ante*. In the order giving effect to appellate order (passed in May 2007) the depreciation of Rs. 99 lakh allowed in the original order was not added back to the income. Department took remedial action (August 2008).	0.31
Total					**13.27**

Appendix 7
Paragraph 1.21.4

(Rs. in crore)

Sl. No	Assessee and CIT charge	Assessment year	Nature of assessment	Month of assessment	Remittance on which tax not deducted	Tax effect
1	Sical Logistics Ltd. CIT III Chennai	2002-03	Scrutiny	March 2005	5.14	3.29
		2003-04	Scrutiny	March 2006	12.86	6.47
		2004-05	Scrutiny	December 2006	23.09	12.06
2	Goodearth Maritime Ltd CIT I Chennai	2003-04	Scrutiny	January 2006	12.88	4.73
		2004-05	Scrutiny	December 2006	18.46	6.62
3	Varun Shipping Co. Ltd CIT Mumbai City 5	2003-04	Scrutiny	March 2006	6.55	2.41
		2004-05	Scrutiny	December 2006	7.22	2.59
4	Radiant Shipping Ltd CIT Mumbai City 5	2003-04	Scrutiny	March 2006	12.32	4.53
		2004-05	Scrutiny	December 2006	4.09	1.47
5	Kinship Services (I) Pvt Ltd. CIT Ernakulam	2003-04	Scrutiny	February 2006	4.89	2.23
	Total					**46.4**

Appendix 8

Review on Deductions of profit and gain from certain undertakings other than infrastructure development undertakings (Deduction under section 80IB of the Income Tax Act, 1961)

(Referred to in paragraph 2.3.3.1)

Summary of deductions under section 80IB available to different sectors

	Small scale industrial undertaking	Industrial undertaking (including cold storage) set up in an industrial backward State (Eighth Schedule)	Industrial undertaking (including cold storage) set up in Category A notified backward district	Industrial undertaking (including cold storage) set up in Category B notified backward district	Cold chain facility for agricultural produce	Any other
1. Nature of articles to be produced	Any	Any (see Note 2)	Other than those given in Eleventh Schedule	Other than those given in Eleventh Schedule	Cold chain facility for agricultural produce	Other than given in Eleventh Schedule
2. Time limit for commencement of production or operation	Between April 1, 1995 and March 31, 2002	Between April 1, 1993 and March 31, 2004 (March 31, 2007 for an industrial undertaking in the State of Jammu & Kashmir)	Between October 1, 1994 and March 31, 2004	Between October 1, 1994 and March 31, 2004	Between April 1, 1999 and March 31, 2004	Between April 1, 1991 and March 31, 1995
3. Amount of deduction (period of deduction commences form initial assessment year)						
3.1 Owned by a company	30% for first 10 year	100% for first 5 year and 30% for next 5 year	100% for first 5 years and 30% for next 5 year	100% for first 3 years and 30% for next 5 year	100% for first 5 year and 30% for next 5 year	30% for first 10 years
3.2 Owned by a co-operative society	25% for first 12 years	100% for first 5 years and 25% for next 7 years	100% for first 5 years and 25% for next 7 years	100% for first 3 years and 25% for next 9 years	100% for first 5 years and 25% for next 7 years	25% for first 12 years
3.3 Owned by any other person	25% for first 10 years	100% for first 5 years and 25% for next 5 years	100% for first 5 years and 25% for next 5 years	100% for first 3 years and 25% for next 5 years	100% for first 5 years and 25% for next 5 years	25% for first 10 years

Note

1. No deduction will be available under section 80IB from the assessment year 2004-05 in respect of undertakings/ enterprises eligible for deduction under section 80IC.
2. From the assessment year 2005-06, an industrial undertaking in the state of Jammu and Kashmir should not manufacture or produce cigarette/ cigars, distilled and brewed alcoholic drinks, aerated branded beverages and their concentrates.

Appendix 9
(Referred to in paragraph 2.4.1)

Basis of selection cases where database was available from the Department

Charges	Industrial undertakings covered u/s 80 IB(3) and 80IB(5) viz industrial undertakings, small scale industries, industries in backward districts	Industrial undertakings other than the categories as mentioned in column (2)	Cases excluded from identified cases
(1)	(2)	(3)	(4)
All States wherever database from the department is available	50 percent of the identified cases subject to minimum of 250 cases. Once sample size as above is determined, following criterion was adopted for selecting the individual cases: 80 percent of sample size from top cases 20 percent of sample size from other cases on random sampling basis.	100 percent of identified cases	1. Loss cases 2. Cases of claim for deduction below Rs.5 lakh

Basis of selection cases where database was not available from the Department

Charges	Criterion for identifying the source of sample			Criterion for identifying the assessees availing deduction under section 80-IB	Cases excluded from identified cases
	Source area	Risk element attached	Basis of selection		
1	2	3	4	5	6
All States wherever database from the department is not available	Company circles → Non company circles →	High risk area → Low risk area →	60 percent of company circles 20 percent of non company circles	100 percent of the identified cases in the circles selected	1. Loss cases 2. Cases of claim for deduction below Rs.5 lakh

Appendix 10
(Referred to in paragraph 2.8.2.2)

(Rs. in lakh)

Industrial undertakings involved in non-manufacture activities or production of articles as listed in the Eleventh Schedule

Sl. no.	Name of the Assessee CIT charge	Assessment Year	Type of assessment / Date of assessment	Particulars	Revenue impact
1	M/s. Arambagh Hatcheries (P) Ltd. **CIT Cental III, Kolkata**	2001-02 2004-05	Scrutiny/ March 2004 Summary/ March 2006	The assessee was engaged in processing of meat. It has been judicially held[1] that meat processing is not a manufacturing activity. Thus, the assessee was not eligible for claiming deduction under section 80IB.	170.79
2	M/s. Arambagh Hatcheries (P) Ltd. **CIT Cental III, Kolkata**	2002-03	Scrutiny/ July 2004	The assessee was engaged in the processing of meat and poultry feed. Since meat and feed processing are not manufacturing activities as per judicial rulings the assessee was not eligible for claiming deduction under section 80IB.	139.41
3	M/s. Shalimar Pellet Feeds Ltd. **CIT Cental II, Kolkata**	2005-06	Scrutiny/ May 2007	The assessee was engaged in the processing of poultry feed. It has been judicially held[2] that poultry feed processing is not a manufacturing activity. Thus, the assessee was not eligible for claiming deduction under section 80IB	129.25

[1] CIT vs. Relish Food reported in 237 ITR 59(SC)
[2] Indian Poultry vs CIT (2001) 116 Taxman 493

Appendix 11
(Referred to in paragraph 2.8.3.2)

(Rs. in lakh)

Manufacture or production not started within a stipulated time limit					
Sl. no.	**Name of the Assessee CIT charge**	**Assessment Year**	**Type of assessment/ Date of assessment**	**Particulars**	**Revenue impact**
1	M/s Bry Air (asia) Pvt. Ltd. **CIT I, Delhi**	2003-04 2005-06	Scrutiny/ February 2006 November 2007	The undertaking started its operation in the previous year 1998-99 which was not within the period stipulated for claiming deduction under section 80IB. Further, the mandatory audit report in Form no. 10CCB was also not furnished for the two assessment years. Department in its reply (July 2008) stated that since the assessee was a Small Scale Industrial undertaking, and as such, date of commencement was as applicable to small scale industrial undertaking (SSI). It was further stated that filing of audit report was not mandatory. The reply is not acceptable as the total investment in Plant and Machinery on the last day of the previous year was more than one crore, and as such the industrial undertaking was not a SSI. Further, furnishing of audit report is mandatory as per Section 80IA(7) read with the rule 18BBB.	250.57
2	M/s Eltek SGS Ltd. **CIT IV, Delhi**	2003-04 2004-05	Scrutiny/ February 2006 Scrutiny December 2006	The industrial undertaking started the production on 15 March, 1997. It was further certified in Form 10CCB that it was not a small scale industrial undertaking (SSI). As the production had started beyond the stipulated time limit, the allowance of deduction of Rs.469.29 lakh was irregular. Department in its reply (July 2008) stated that since the assessee was a small scale industrial undertaking, the deduction was rightly claimed and allowed. The reply is not acceptable as the auditor in Form no. 10CCB has certified that the industrial undertaking was not a small scale industrial undertaking.	229.82
3	M/s Shah Originals **CIT XXIV,**	2004-05	Scrutiny/ December 2006	Deduction under section 80IB can be allowed for maximum number of 10 years. In the instant case, the assessee	179.00

	Mumbai			had commenced its operation in June 1992, and was eligible to claim deduction only up to the assessment year 2002-03 starting from the initial assessment year of 1993-94. However, assessee had claimed and was also allowed deduction in the assessment year 2004-05 which was irregular.	
4	M/s Delhi Press Patra Prakashan Ltd. **CIT 1, Delhi**	2004-05	Scrutiny December 2006	Deduction under section 80IB(3) is available for 10 years. In this case, the assessee had already availed deduction under section 80IB(3) for 10 years. However, assessee incorrectly claimed deduction for eleventh year, and the same was allowed by the Department. The Department has accepted the audit observation (August 2008)	112.40
5	M/s Indrayani Ferrocast Pvt. Ltd. **CIT 1, Pune**	2005-06	Scrutiny December 2007	Audit examination revealed that the benefit was granted to the assessee treating it as a small scale industry although the investment in plant and machinery exceeded the prescribed limit of rupees one crore. Since the undertaking ceased to be a small scale industry, it was not eligible for deduction under section 80IB.	112.00

Appendix 12
(Referred to in paragraph 2.8.5.2)

(Rs. in lakh)

Income not derived from eligible business reckoned for computation of deduction under section 80IB.

Sl. no.	Name of the Assessee CIT charge	Assessment Year	Type of assessment/ Date of assessment	Particulars	Revenue impact
1	Sri C Gopalan **CIT I, Bangalore**	2004-05	Scrutiny/ December 2006	The assessee while computing eligible profits did not exclude Rs. 5.41 crore on account of undivided interest in land paid to vendors/ land owners through developer and Rs. 57.27 lakh on account of miscellaneous income. On exclusion of these items the eligible profits would be 'nil'. Thus the allowance of deduction of Rs. 4.81 crore was irregular.	211.01
2	M/s. Gopalan Enterprises. **CIT I, Bangalore**	2004-05 2005-06	Scrutiny/ December 2006 Scrutiny/ December 2007	The assessee while computing eligible profits did not exclude the amount of miscellaneous income and undivided interest in land paid by individual flat owners to the vendors/ land owners. This resulted in irregular allowance of deduction of Rs. 1.34 crore and Rs. 2.74 crore in the assessment years 2004-05 and 2005-06 respectively.	196.34
3	M/s. Sterlite Industries (Ind) Ltd. **CIT III, Chennai**	2004-05	Scrutiny/ December 2006	The assessee, while computing eligible business profits for claiming deduction under section 80IB, had omitted to exclude Rs. 2.91 crore of interest income which was not derived from manufacturing activity.	139.00
4	M/s. Raj Homes (Pvt.) Ltd. **CIT, Bhopal**	2004-05	Scrutiny/ December 2006	The appreciation in profits by Rs. 1.99 crore was on account of change in the method of valuation of work in progress, as was certified in Form 3CD, and not on account of sale of flats. Further the completion certificate in respect of any of the projects had not been furnished. Thus the entire deduction of Rs. 2.85 crore was not allowable.	135.98
5	M/s. Shalimar Rexine Pvt. Ltd. **CIT 3, Pune**	2003-04, 2004-05 2005-06	Scrutiny/ March 2006 Scrutiny/ December 2006 Scrutiny/ December 2007	Benefit was granted to the assessee treating it as a small scale industry although the investment in plant and machinery exceeded the prescribed limit of rupees one crore. As such, the entire deduction of Rs. 2.09 crore was not allowable.	101.00

Appendix 13
(Referred to in paragraph 2.9.2)

(Rs. in lakh)

Benefit of deduction allowed to ineligible assessees in Housing projects					
Sl. no.	**Name of the Assessee CIT charge**	**Assessment Year**	**Type of assessment/ Date of assessment**	**Particulars**	**Revenue impact**
1	M/s. Sidharth Foundation and Housing Ltd. **CIT VI, Chennai**	2004-05	Scrutiny/ December 2006	Permission to develop the land for the purpose of building was granted by the local authority to Sri. Suresh Jain after collecting development charges and licence fee from him, and the completion certificates were issued to him for the purpose of obtaining power supply, water supply and service connection. Thus, in every respect, Sri. Suresh Jain was the developer of the housing project and the assessee was the contractor nominated by the developer/ultimate purchaser of the flats for the execution of civil construction work. As such, the deduction of Rs. 6.24 crore allowed to M/s. Sidharth Foundation and Housing Limited was irregular.	241.00
2	M/s A G Joshi and Co. **CIT I, Pune**	2004-05 2005-06	Scrutiny/ December 2006 Scrutiny/ December 2007	Built up area of shops and other commercial establishments exceeded the specified limit of 2000 sq. ft.	199.00
3	M/s Tungwa Developers **CIT XV, Mumbai**	2005-06	Scrutiny/ October 2007	As per Form 10CCB the project was still under construction. Therefore, the allowance of deduction of Rs. 3.54 crore was irregular.	170.00
4	M/s. Gemstar Construction Pvt. Ltd. **CIT 9, Mumbai**	2003-04 2004-05	Scrutiny March 2005	Audit examination revealed that the housing project had shops admeasuring 2361 square feet. As the provision in respect of shops/commercial establishments was applicable with effect from the assessment year 2005-06 only, claiming deduction for commercial shops/establishments built prior to April 2005 was irregular and required to be disallowed. As such, the project was not eligible for deduction and the allowance	166.00

				of deduction aggregating to Rs. 3.93 crore was irregular. The Department replied (December 2007) that as the housing project was approved by the local authority, the deduction was correctly allowed. The reply is not acceptable as the ITAT Mumbai C Bench has observed in the case of M/s. Laukik Developers Vs DCIT 3 Thane (105 ITD 657) that the construction of shops or commercial establishments cannot be considered a housing project for the purpose of application of the provisions of section 80IB(10) of the Act.	
5	M/s Calcutta Metropolitan Group Ltd. **CIT III, Kolkata**	2005-06	Scrutiny/ December 2006	Total commercial area of the entire project is more than the specified limit of 2000 sq. ft.	156.00
6	M/s B K Pate Enterprises **CIT I, Pune**	2005-06	Scrutiny/ December 2007	Plot size was less than the specified norm of one acre.	128.00
7	M/s Sabri Realtors **CIT XV, Mumbai**	2005-06 2006-07	Sc rutiny/ March 2007 Scrutiny/ March 2008	As per Form 10CCB the project was still under construction. Therefore, the allowance of deduction of Rs. 1.41 crore and Rs. 1.42 crore in the assessment years 2005-06 and 2006-07 respectively was irregular.	123.00
8	M/s Padmini Infrastructure Developers (India) Limited **CIT V, Delhi**	2003-04 2005-06	Scrutiny March 2005 Summary July 2006	Deduction under section 80IB(10) is available to Developer and Builder. In the instant case the assessee was a builder only and not the developer. Further, the mandatory audit report in Form no. 10CCB was also not furnished for the two assessment years. As such, assessee was not eligible to claim deduction. The Department in its reply (July 2008) stated that action has been taken under section 147 of the Act.	113.39
9	M/s Brahma Builders **CIT II, Pune**	2003-04 2004-05	Scrutiny/ March 2006 Scrutiny/ December 2006	Commercial units measuring 7831.08 sq.mts exceeded the specified limit of 2000 sq.ft. and built up area of residential units also exceeded the norm of 1500 sq/ft.	110.00

Appendix 14
(Referred to in paragraph 2.10.2)

(Rs. in lakh)

Audit Report not furnished

Sl. No.	Assessee/CIT Charge	Assessment Year	Type/date of assessment	Revenue impact
1	Autoliv IFB India (P) Ltd. **CIT IV, Kolkata**	2004-05	Scrutiny/ December 2006	348.33
2	M/s Ittinia Properties Ltd. and M/s Ittinia Housing Ltd. **CIT I, Bangalore**	2004-05	Scrutiny/ December 2006	319.00
3	M/s Raj Homes (Pvt.) Ltd. **CIT, Bhopal**	2005-06	Scrutiny/ December 2007	290.00
4	M/s. Nippo Batteries **CIT III, Chennai**	2003-04	Scrutiny/ March 2006	227.00
5	M/s. Bansapani Iron Ltd. **CIT, Sambalpur**	2003-04 2004-05	Scrutiny/ February 2005 Scrutiny/ December 2005	164.25
6	M/s Orissa State Warehousing Corporation **CIT, Bhubaneshwar**	2006-07	Summary/ March 2008	162.66
7	M/s Plastiblends India Ltd. **CIT VIII, Mumbai**	2003-04	Scrutiny/ August 2005	149.00
8	Hydro S&S Ind ustries .Ltd. **CIT I, Chennai**	2003-04 2004-05	Scrutiny/ March 2006 Scrutiny/ December 2006	140.78
9	M/s Tide Water Oil Co (India) Ltd. **CIT II, Kolkata**	2003-04	Scrutiny/ March 2006	122.00

Appendix 15
(Referred to in paragraph 2.15.2)

(Rs. in lakh)

Scrutiny norms not followed

Sl. no.	Name of the Assessee CIT charge	Assessment Year	Type of assessment/ Date of assessment	Amount of 80IB deduction claimed
1	M/s Ishan Techonologies (P) Ltd **CIT, Shilong**	2004-05	Summary/ October 2004	2754.37
2.	M/s. Finolex Cables Ltd[3]. **CIT V, Pune**	2006-07	Summary/ November 2006	513.43
3	M/s Rama Industries **CIT XV, Mumbai**	2006-07	Summary/ April 2007	334.00
4	M/s. Sonigara Construction Co[3]. **CIT V, Pune**	2006-07	Summary/ October 2007	314.62
5	M/s Khatri Fragrances **CIT II, Kanpur**	2005-06	Summary/ March 2007	301.93
6	M/s. Mehta Flex Pvt. Ltd. **CIT VIII, Mumbai**	2003-04	Summary/ November 2003	263.00
7	M/s Padmini Infrastructure Developers (I) Ltd. **CIT V, Delhi**	2005-06	Summary/ July 2006	255.00
8	M/s. Martin Burn Ltd. **CIT II, Kolkata**	2005-06	Summary July 2006	235.00
9	Smt. Pushpalata Agarwal **CIT XIV, Mumbai**	2005-06	Summary/ March 2007	195.89
10	M/s. Fancy Fittings Ltd. **CIT II, Mumbai**	2005-06	Summary/ March 2006	162.43
11	M/s. Sun Transtamp P. Ltd. **CIT IX, Mumbai**	2005-06	Summary/ November 2006	141.48
12	M/s. Aspee springs Ltd. **CIT I, Delhi**	2005-06	Summary/ February 2006	139.92
13	M/s. Wilhelm Textile (I) Pvt. Ltd. **CIT VI, Delhi**	2005-06	Summary/ September 2006	123.83

[3] On being pointed out by audit, these cases have since been selected for scrutiny and the assessments are in progress.

Appendix – 16

IT audit of e-TDS system of Income Tax Department

(Paragraph No. 3.1.4)

Domains/High Level Control Objectives Selected

Domain	High Level CoBiT Control Objectives
Acquisition and Implementation	Identify Automated Solutions
	Acquire and Maintain Application Software
	Develop and Maintain Procedures
	Manage Changes
Delivery and Support	Define Service Levels
	Manage Third Party Services
	Ensure Continuous Service
	Ensure Systems Security
	Educate and Train Users
	Manage Problems and Incidents
	Manage Data
	Managing Operations
Monitoring	Monitor the process

Appendix –17
(Paragraph No. 3.2.1.1)

(Rs. in lakh)

Details of amount in suspense						
Charge	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**
Delhi						
Total amount in suspense	15536.02	12073.39	13047.74	33047.74	68979.61	109260.17
Percentage of increase to base year 2002-03	100	(-) 22	(-) 16	113	344	603
Number of challans	15247	11557	22540	57505	81845	91556
Mumbai						
Total amount in suspense	17943.96	35330.77	184958.09	72901.92	86766.96	NA
Percentage of increase to base year 2002-03	100	97	931	306	384	NA
Number of challans	3969	4776	392610	124222	112795	NA
Karnataka*						
Total amount in suspense	NA	30.25	126713.81	20510.75	13390.64	10506.68
Percentage of increase to base year 2003-04	-	100	418789	67704	44167	34633
Tamil Nadu*						
Total amount in suspense	2329	2824	10000	16400	NA	NA
Percentage of increase to base year 2002-03	100	21	329	604	-	-
Gujarat*						
Total amount in suspense	NA	84.03	83.58	112.35	157.07	316.20
Percentage of increase to base year 2003-04	-	100	(-) 1	34	87	276
Andhra Pradesh						
Total amount in suspense	827.24	1156.08	892.87	7811.72	8514.83	20284.82
Percentage of increase to base year 2002-03	100	40	8	844	929	2352

* Year wise number of challans not provided

Appendix – 18
(Paragraph No. 3.4.3.1.)

Statement showing cases of incorrect dropping of cases of demand of Rs. 100 or more

Sl No.	Charge	Name of the deductor	RRR No.	TAN No.	Return Financial year	Form No and Periodicity
Cases where demand is more than Rs. 100 but System dropped the demand						
1	Delhi	Orient Ceramics & Industries Limited	10120100073775	DELO00049A	2007-08	26 Q Ist Qtr
2	Chennai	Sterling Holiday Resorts India	30040600060516	CHES01325C	2008-09	26Q 2nd Qtr
Cases where no demand exist but system displayed message for dropping of demand						
3	Chennai	Rayala Corporation Pvt. Ltd.	30041900091184	CHER06505C	2007-08	26Q Ist Qtr
Cases where demand is less than 100 and show cause notice generated						
4	Mumbai	Dewan Housing Finance Corporation Ltd.	30110200062644	MUMD09790E	2006-07	24Q 4th qr
5	Mumbai	Ford Credit Kotak Mahindra Ltd.	30200300053825	MUMF01743A	2006-07	26Q 2nd qr
6	Mumbai	Corporation Bank, Matunga	30510100104271	MUMC1119D	2006-07	27Q 4th qr

Appendix – 19
(Paragraph No. 3.4.3.3)

List of cases in which discrepancy in invalid/missing PAN report exists

Sl No	RRR No	Name of Deductee
Cases where PAN was not available and were not included in the list of invalid/missing PAN report		
Circle 51(1) RRR Financial year 2007-08		
1	10100500040610	Shubh Media , Raman Bhatia ,Ahmed Enterprises
Circle 51(1) RRR Financial year 2006-07		
2	10270200054671	Report not generated although default in PAN existed
3	10270300017250	- do-
4	12460100017536	- do-
5	11420100033333	- do-
6	10101300152296	- do-
7	10101300154890	Abhishek Marbles, Economy India, Jay Jalaram Cotton Ind.
8	12460100016490	Report not generated although default in PAN existed
9	10270300021645	Monika Arora
10	12460100017120	Report not generated although default in PAN existed
11	10270200056830	- do-
12	13470100008573	Amardeep Taxi Services
PAN shown as valid but not confirmed in Delhi's PAN database		
Circle 51(1) RRR Financial year 2007-08		
	10100500040610	V. Image Group(ABRPV6987F)
	10100500040610	Bihar Raffia Industries Ltd. (AABCB0710C)
	10100500040610	Blue Dart Express Ltd. (AAACB0446L)
Circle 51(1) RRR Financial year 2006-07		
	10101300154890	Green Carriers & Contactors (AADFG0296A)
	12460100016490	The Rajputana Stores Pvt Ltd (AABCT7041C)
	12460100016490	O P Bagla & Co. (AAAFD1030A)
	12460100016490	Meerut Packaging Indus (AABFM3369D)
	12460100016490	Priyanka Art Service (ABWBS3832M)
	12460100016490	Master Rajesh Art Service (ABWAS3833L)
	10270200056830	Dextrous Exim Service Pvt. (AABCD2566O)
	10270200056830	City Services (AAAFC5626O)
	10270200056830	Kaushik Brothers (AOUPS4028G)
	10270200056830	Ashok Kanodia (AABPK0752G)
	10270200056830	Pradeep Kanodia H.U.F. (AFSPK9367D)
	10270200056830	Securewell Conservency Services (AGLPK3472C)
	10270200056830	Associated Road Carriers (AACCA4861C)
	10270200056830	MS Tours and Travels (AXAPS2919R)
	10270200056830	DHL Express (I) Pvt Ltd (AABCD3611Q)
	10270200056830	Finishing Touch (AFCPS4002B)
	10270200056830	Prateek Roadways Pvt Ltd (AADCT8193P)
	10270200056830	Neural Systems (AABFN1324K)
	10270200056830	Sudhir Garg & Co. (ACFPG7932C)
	10270200056830	P K Katiyar (AADPK2753K)
	10270200056830	Wiptech Peripherals (AAACU5307K)
	10270200056830	Computer Touch (AAAFC6623R)
	10270200056830	Noida Ad Agency (AWTPS5769H)
	10270200056830	U L India Pvt Ltd (AAACU2468F)

	10270200056830	Wildnet Technologies (AAAFW7469F)
	13470100008573	Gordon Woodroff
	13470100008573	Dawar Tempo Service
Cases where PAN was available in deductee details and available in AIS (RCC Delhi) and wrongly included in the list of invalid/missing PAN Report		
	70461300046734	Ardee Housing P Ltd (AAACA3096K)
	70461300046734	Spectra Net Pvt Ltd (AABCS1618N)
	70461300046734	Skymark Trave India Pvt. Ltd. (AABCS7648L)
	70461300046734	JMD Maintenance Services Pvt. Ltd. (AABCJ1827A)
	70461300046734	Business News & Information Services Pvt. (AAACB5323J)
	70461300046734	Group 4 Securities Guarding Ltd. (AAACG1625Q)
	70461300046734	S S Enterprises (AAEFS5893F)
	70461300046734	Overseas Courier Servces India Pvt. Ltd. (AAACO0254D)
	70461300046734	Detective & Security Services (AABPL0555C)
	70461300046734	Premier International (AAHPB8434E)
	70461300046734	HCL Infinet Ltd. (AAACH7784H)
	70461300046734	Tetra Information Services Pvt. Ltd. (AAACT5118P)
	70461300046734	Mayur Batra & Co. (AEWPB7677N)
	70461300046734	Mira Mahubeni (AAQPM9410J)
	70461300046734	Heera Projects & Developers p Ltd. (AABCH6208B)
	70461300046734	Rani Sawhney (ABAPS6303B)

Appendix – 20
(Paragraph No. 3.4.4.1)

Statement showing details of returns initiated under bulk processing and returns under default in bulk processing							
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Total
e-returns received							
Delhi	10557	25510	26535	77651	87782	54292	282327
Karnataka	6999	15731	17049	51439	60647	37319	189184
Total e-returns received	17556	41241	43584	129090	148429	91611	471511
Returns initiated under bulk							
Delhi	2103	7261	9985	49519	45069	15904	129841
Karnataka	Nil	Nil	1416	6458	22046	1893	31813
Total returns initiated under bulk	2103	7261	11401	55977	67115	17797	161654
Returns with default under section 201 (1)/206C (7)							
Delhi	2055	6999	8596	39011	24220	3575	84456
Karnataka	N.A.	N.A.	1218	4795	11714	182	17909
Total returns with default	2055	6999	9814	43806	35934	3757	102365

Appendix - 21
(Paragraph No. 3.4.4.1)

Statement showing cases of non-closing of processed returns without defaults

Charge	e-TDS returns processed without any defaults under section 201(1)/206C and no default for penalty under section 272B/139(5B)	e-TDS return closed[1]	Percentage
Chennai	50481	259	0.51
Delhi	16450	178	1.08
Karnataka	4416	0	0.00
Total	**71347**	**437**	**0.66**

[1] Comparison of 'Query bulk processing status screen' with 'Return Status Report' for the respective RFY

Appendix – 22
(Paragraph No. 3.4.4.2)

Number of e-TDS returns received and processed by Assessing Officers

Charge	Years						Total
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	
Delhi							
e-Returns received	10557	25510	26535	77651	87782	54292	282327
e-Returns initiated for processing by AO	1083	2467	1343	201	5682	213	10989
Percentage of processing	10.26	9.67	5.06	0.26	6.47	0.39	3.89
Mumbai							
e-Returns received	33081	72751	78082	246285	306680	154621	891500
e-Returns initiated for processing by AO	4519	1944	332	9498	21806	678	38777
Percentage of processing	13.66	2.67	0.43	3.86	7.11	0.44	4.35
Chennai							
e-Returns received	10800	24150	29992	85844	103520	89351	343657
e-Returns initiated for processing by AO	118	935	25167	26846	41204	4548	98818
Percentage of processing	1.09	3.87	83.91	31.20	39.8	5.09	28.75
Kolkata							
e-Returns received	1656	41548	15523	70227	105038	99702	333694
e-Returns initiated for processing by AO	40	1225	475	6666	17354	22929	48689
Percentage of processing	2.42	2.95	3.06	9.49	16.52	23	14.59
Gujarat							
e-Returns received	NA	7587	23450	43273	69668	41800	185778
e-Returns initiated for processing by AO	NA	4	1328	4284	9509	01	15126
Percentage of processing		0.05	5.66	9.9	13.65	0.0	8.14
Andhra Pradesh							
e-Returns received	548	3248	3605	82106	99650	57795	246952
e-Returns initiated for processing by AO	0	266	249	181	6729	12829	20254
Percentage of processing	0	8.19	6.90	0.22	6.75	22.20	8.20
Karnataka							
e-Returns received	6999	15731	17049	51439	60647	37319	189184
e-Returns initiated for processing by AO	0	0	0	247	188	24	459
Percentage of processing			0.00	0.05	0.31	0.06	0.24
Total e-Returns received	**63641**	**190525**	**194236**	**656825**	**832985**	**534880**	**2473092**
Total e-Returns initiated for processing by AO	**5760**	**6841**	**28894**	**47923**	**102472**	**41222**	**233112**
Percentage	**9.05**	**3.59**	**14.88**	**7.30**	**12.30**	**7.71**	**9.43**

Appendix - 23
(Paragraph No. 3.4.4.2(i)

(Rs. in crore)

Statement of short deposit of tax into Government Accounts for the period 2002-03 to 2006-07

Charges	Total records	No. of records with Short deposit	Range of difference (Rs.)	Total Short Deposit
Salary returns[1]				
Delhi	2770903	40034	1 to 337484	15.86
Mumbai	6756187	4801	1 to 5177761	10.32
Andhra Pradesh	1920951	3432	1 to 678000	0.99
Chennai	2134826	8021	1 to 750900	6.97
Total	**13582867**	**56288**		**34.14**
Non-salary returns[2]				
Chennai	--	12881471	1 to 323262203	2965.85
Grand Total	**13582867**	**12937759**		**2999.99**

[1] Table : T_CHLN_BRKUP: Difference of cols. 'TDS' and 'TAX_ DEPT'
[2] Table : T_TDS_TRANS: Difference of cols. 'TDS_TCS_DDE' and 'TAX_DPST'

Appendix - 24
(Paragraph No. 3.4.4.2(ii))

(Rs. in crore)

Statement showing cases of non-levy of penalty on late filers identified from the table : T_RETURN

Charge	Total No of Returns	Returns on which default on late filing exist	Delay in days	Amount[1]
Delhi	613796	267245	1 to 1516	94.88
Mumbai	918255	546067	1 to 1346	248.26
Andhra Pradesh	50228	24421	1 to 1370	17.78
Chennai	278721	158747	1 to 1091	122.68
Total	**1861000**	**996480**		**483.60**

[1] At the rate of Rs. 100 per day subject to the maximum amount of TDS

Appendix - 25
(Paragraph No. 3.4.4.2(iii))

a) Delhi Charge

(Rs. in crore)

Statement showing cases of non-levy of penalty in case of defaults for delay in furnishing of TDS certificate identified from the table : T_TDS_TRANS

Return Financial Year	No of deductees			Number of records verified in which penalty exists	Penalty	Number of records not verified where penalty exists	Penalty	Total Penalty[1]
	Verified	Not verified	Total					
2002-03	283710	6010197	6293907	136743	15.05	2506541	251.01	266.07
2003-04	790378	9245619	10035997	427230	43.09	5089591	510.12	553.21
2004-05	1133723	9544119	10677842	714219	78.36	5551135	586.15	664.50
Total	2207811	24799935	27007746	1278192	136.50	13147267	1347.28	1483.78

b) Other charges

(Rs. in crore)

Charge	Total Records	No. of records with default	Penalty
Andhra Pradesh[2]	2899241	296760	35.15
Chennai	25793384	2836148	281.85
	28692625	3132908	317.00

[1] Under section 272A (2)(g) of Income Tax Act, 1961, penalty of sum of rupees one hundred for every day during which the failure continues.
[2] RCC Visakhapatnam

Appendix -26
(Paragraph No. 3.4.4.2(iv))

Statement showing cases of non-levy of interest in cases of default for delayed deposit of TDS

(Rs. in crore)

I) Salary cases[1]

Charge	Total No of Returns	Returns on which default on late deposit exist	Delay in months	Interest leviable[2]
Delhi	2770903	715219	1 to 26	10.18
Mumbai	6756187	399443	1 to 27	7.41
Total	**9527090**	**1114662**		**17.59**

(Rs. in crore)

II) Non salary cases[3]

a) Delhi Charge(Total no of cases 5.56 crore)

Return Financial year	Number of deductee where default for non-levy of interest exists	Number of records verified in which default exists	Interest leviable	Number of records not verified where penalty exists	Interest leviable	Total Interest leviable[2]
2002-03	994178	37407	0.31	956771	6.14	6.45
2003-04	1710851	122894	0.70	1587957	7.43	8.13
2004-05	1792864	172257	0.73	1620607	8.41	9.14
2005-06	1758265	1309313	6.70	448952	2.06	8.76
2006-07	3577708	572793	4.96	3004915	13.22	18.18
2007-08	565953	126834	0.74	439119	1.96	2.70
Total	**10399819**	**2341498**	**14.14**	**8058321**	**39.22**	**53.36**

(Rs. in crore)

b) Other charges

Charge	Total No of Returns	Returns on which default on late deposit exist	Delay in months	Interest leviable[2]
Andhra Pradesh[4]	2899241	285545	1 to 28	2.13
Chennai	33787546	207947	1 to 40	15.15
Gujarat	1832196	1832157	1 to 28	16.06
Total	**38518983**	**2325649**		**33.34**

[1] Table :T_chln_brkup
[2] Under section 201 (1A) of Income Tax Act, 1961
[3] Table:T_TDS_TRANS
[4] RCC Visakhapatnam

Appendix - 27
(Paragraph No. 3.4.4.2(v)

(Rs. in crore)

Statement showing cases of non-initiation of penalty for non-quoting of PAN

Charges[1]	Total cases	No. of cases "PANAPPLIED"	No. of cases "PANNOTAVBL"	No. of cases where PAN not quoted	Total Non quoting PAN (4+5)	Penalty[2] (in crore)
1	2	3	4	5	6	7
Delhi	2770903	93480	823318	231	268757[3]	268.75
Andhra Pradesh	1920951	153725	369240	731	369971	369.97
Mumbai	6756187	151134	3003167	2120	3005287	3005.29
Chennai[4]	-	-	-	43800	43800	43.80
Gujarat	12195215	255471	2574438	2597461	5171899	5171.90
Total	**23643256**	**653810**	**6770163**	**2644343**	**8859714**	**8859.71**

[1] Cases identified from table T_CHLN_BRKUP in respect of Delhi, Andhra Pradesh and Mumbai charges and table T_TDS TRANS and T_F24_TDS_TRANS in Chennai charge and table T_TDS_TRANS in Gujarat charge.
[2] Penalty of Rs. 10,000 for non-quoting of PAN under section 272B of the Income Tax Act, 1961
[3] 823549 cases were summarized to 268757 on individual deductees name
[4] 34029 cases in table T_TDS_TRANS and 9771 cases in T_F24_TDS_TRANS

Appendix - 28
(Paragraph No. 3.4.4.2(vi))

Statement showing cases of non-initiation of penalty proceedings

Return financial year	Total Number of Returns for which Penalty made to be initiated	Total Number of Returns in which Penalty Initiated	Percentage	No. of returns for which penalty has been imposed
2002-03	1526	264	17	NA
2003-04	4201	285	7	NA
2004-05	5319	10	0.19	NA
2005-06	37715	15	0.03	0
2006-07	29811	132	0.44	0
2007-08	8493	2	0.02	0
Total	**87065**	**708**	**0.81**	**0**

GLOSSARY

Review on exemptions, deductions and allowances to shipping and related sectors

BAREBOAT CHARTER: Hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship including the right to appoint the master and crew, and pay all running expenses.

BAREBOAT CHARTER CUM DEMISE: A bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered.

CHARTERER: A person or firm hiring a vessel for the carriage of goods or passengers or both

CHARTER PARTY: Shipowners do not always directly undertake to carry the goods of shippers on their vessel. They may simply charter their vessels to another party (the **charterer**) who will then enter into a Contract of Affreightment with the shipper. As between the shipowner and the charterer their rights and obligations will be governed by the **charter party.** The charter may either for a period of time known as Time Charter or Demise or Bareboat Charter or voyage Charter

CLEARING AND FORWARDING AGENTS : They are also known as custom house agents or CHAs. They have to obtain a licence under section 146 of the Customs Act, 1962 after passing a qualifying examination conducted by the Commissioner of Customs.

COST, INSURANCE AND FREIGHT (CIF): Cost, insurance and freight (CIF) is an international trade term of sale in which, for the quoted price the seller/exporter gets the goods cleared after the ship's rail at the port of shipment (not destination) i.e. the cost of clearance is borned by the seller.

Generally, importers prefer CIF terms when they have relatively little freight volume. It is simpler in that their suppliers are responsible for arranging freight and insurance details. The importer relinquishes control of choosing freight carriers, routing and other shipping specifics. Here convenience outweighs the need for enhanced shipment control and associated freight savings. As the number of overseas suppliers and overall freight volume increase problems can occur with obtaining accurate shipment information as overseas suppliers are not well positioned to handle service issues that develop in-transit.

DEADFREIGHT or DEAD FREIGHT: The space booked by a Broker or charterer to load cargo on a ship and for some reason or other it is not used.

DEADWEIGHT or DEADWEIGHT CAPACITY OR DEADWEIGHT TONNAGE: The total weight which a ship can carry , including cargo , provisions , fuel, stores , bunkers, crew , spares , etc ., up to her plimsoll line or marks. Alternatively DWT is the difference between light and loaded displacement.

DEMURRAGE: Amount of money paid to the ship owner by the charterer or shipper, for failing to complete loading and / or discharging within the time allowed in the voyage charter party.

FOC OR F.O.C.: Flag of Convenience.

FREE ON BOARD (FOB) – Free on board (FOB) is a trade term in which for the quoted price, the seller/exporter clears the goods for export and is responsible for the costs and risks of delivering the goods past the ship's rail at the port of delivery i.e. buyer bears the cost of clearance.

Buying Free On Board has two major benefits over CIF, more competitive freight rates and enhanced shipment control. When shipping CIF, overseas suppliers are inclined to mark up their freight cost for the extra service provided in arranging transport and insurance whereas in FOB, buyer can choose his transporter and insurance provider. By taking title to the goods as they cross the ship's rail at the overseas port of shipment, importers are better able to obtain accurate and timely shipment information by working with third party logistics provider of their choosing and are thus assured that their interests are safeguarded.

HOME PORT: The Port of Registry of a ship where the interests of the owners are.

LINER: A cargo - carrying ship which is operated between scheduled, advertised ports of loading and discharge, on a regular basis.

LOADED CARGO: Cargo which is loaded on to ship and intended to be transported by sea to different ports. Example export cargo.

MANIFEST: A document containing a full list of a ship's cargo, extracted from the bills of lading.

MASTER: Commander of a merchant ship responsible for navigation and management of the ship at sea. He has to give an account in the log Book, of all that happens during the voyage and at ports etc.

NATIONAL FLAG: The flag carried by a ship to show her nationality.

NET TONNAGE: The total of all enclosed spaces within a ship available for cargo, expressed in tons each of which is equivalent to 100 cubic feet N.T or N/T. Also termed Net Registered Tonnage NRT or N.R.T.

OUTWARD BILL OF LADING: This is a bill of lading, where goods are actually being exported to another country and not to a port of the same country.

PORT CLEARANCE: Customs permission for the master to take his vessel to sea

SHIPMASTER or SHIP'S MASTER: Commander of a merchant ship.

SHIPOWNER: A person or firm that owns one or more ships.

SHIP'S MANIFEST: One of the essentials for a commercial ship to have Clearance Inwards and Outwards. The manifest gives a clear picture of the various cargoes loaded for every port

SLOT CHARTERER: Since a ship can carry a large amount of cargo, the cargo space may be sold in the form of slots to various individuals or companies in which case the DTAA applicable to the slot charterer is invoked for allowing exemptions

STEVEDORES . The Indian agent appoints stevedores who are licensed by the concerned port authorities to organize the loading of export cargo and discharge of the imported cargo from the ship on to the jetties to the port premises.

SUB-CHARTERER: A person or company who charters a ship from a party who is not the owner but who , in turn , has chartered the ship .

TEU: Twenty Foot Equivalent Unit.

TIME CHARTER (TO): To hire a ship for a period of time. This may be said either of a shipowner , who hires his ship out to a charterer , or of a charterer who hires a ship from a shipowner .

TIME CHARTER PARTY: A document containing the terms and conditions of a contract between a charterer and a shipowner for the hire of a ship for a period of time. The owner undertakes for the period of the charter to make his vessel available to serve the commercial purposes of the charterer. The complexity of a time charter party derives from the fact that ownership and possession of the vessel, which remain in the owner, are separated from use of the vessel, which is granted to the charterer, and partly from the peculiar characteristics and hazards of carriage by sea.

A voyage charter is different to a time charter because under the former, it is the owner who is using the vessel to trade for his own account. He decides and controls what cargoes he will carry and bears the full commercial risk and expense and enjoys full benefit of the earnings. Under a time charter, the owner still has to bear the expense of maintaining the ship, the crew and insurance in return for the payment of hire. Only the right to exploit the earning capacity of the vessel is transferred to the time charterer.

TONNAGE: A quantity of cargo, normally expressed as a number of tonnes or tons. It can also be defined as the cubic capacity of a ship.

TUG or TUGBOAT: A comparatively small vessel with powerful engines and constructed in such a way as to be able to manoeuvre easily for towage and to assist in salvage operations. Also called Tow Boat.

UNLOADED CARGO: Cargo received from various ports unloaded from the ship. Example import cargo.

VOYAGE ACCOUNT: A statement of the costs and revenue of a voyage of a ship made after the voyage is completed when the income and all actual costs are known.

VOYAGE CHARTER: A contract of carriage in which the charterer pays for the use of a ship's cargo space for one, or sometimes more than one, voyage.

VOYAGE CHARTERER: A ship may be hired by a charterer for carriage of goods for a particular voyage in which case the DTAA applicable to the voyage charterer is invoked for allowing exemptions.