Chapter 4 – Compliance Issues with respect to other provisions of Income Tax Act availed by healthcare sector assessees

4.1 Audit findings on compliance issues

During the examination of assessment records in respect of Private Hospitals, Nursing Homes/Medical Clinics, Medical Colleges/Research Institutes, Diagnostic Centres, Pathological labs and other Medical supplies agencies/stores, audit noticed mistakes relating to deductions, quality of assessment, income escaping assessment etc. This chapter deals with audit issues relating to deficiencies in the application of provisions of the IT Act and relevant Rules/Judicial pronouncements by the Assessment Officers during assessment in respect of the aforesaid assessees.

Audit noticed that in 149 cases, the provisions of the Income Tax Act were not followed correctly, involving tax effect of ₹74.45 crore. The mistakes noticed in assessment and the corresponding tax effects are summarized in Table 4.1. Detailed audit findings in this regard are discussed in subsequent paragraphs.

Table 4.1: Types of mistakes noticed in assessment

Sl. no.	Nature of Mistakes and Para Number of the Report	Number of cases	Tax effect (₹ lakh)
1.	Irregular allowance of depreciation/ amortisation (Para 4.2.1& 4.2.2)	9	231.39
2.	Irregular allowance of business expenditure (Para 4.3)	23	361.56
3.	Non-deduction of tax deducted at source (TDS) (Para 4.4)	13	266.11
4.	Irregularities regarding Minimum Alternative Tax (MAT) (Para 4.5)	5	465.74
5.	Irregularities regarding set off of carried forward losses (Para 4.6)	8	1,561.95
6.	Non levy of penalty (Para 4.7)	7	217.65
7.	Incorrect computation of Capital Gains/Losses (Para 4.8)	8	296.26
8.	Income escaping assessment (Para 4.9)	22	279.73
9.	Other mistakes during assessment (Para 4.10)	26	1,441.99
10.	Irregular allowance of unlawful expenditure (Para 4.11)	28	2,322.25
Total		**149**	**7,444.63**

4.2 Irregular allowance of depreciation/amortisation

4.2.1 In eight cases of five states[99] (**Appendix-7**) depreciation was irregularly allowed under section 32 of the IT Act on assets (other than life-saving equipment - discussed in para 3.3.4) involving total tax effect of ₹2.06 crore. Three cases are discussed below (Box: 4.1)

Box 4.1: Illustrative cases on irregular allowance of depreciation (Other than life saving equipment)

a. Charge: PCIT-2, Guwahati, Assam
Assessee: GNRC Limited
Assessment Year: 2011-12
PAN: AAACG7527P

The scrutiny of the assessment was completed in March 2014 with assessed income of ₹4.93 crore. It was noticed from the Income Tax depreciation schedule attached to Tax Audit Report that the total allowable depreciation as per IT Act was ₹4.93 crore. However, in the assessment order, the Assessing Officer had allowed ₹6.78 crore towards depreciation. As such, there was excess allowance of depreciation of ₹1.85 crore and consequently, there was underassessment of income to that extent with tax effect of ₹83.48 lakh[100]. The ITD's reply was awaited (April 2017).

b. Charge: PCIT-2, Delhi
Assessee: M/s Noida Medicare Centre Limited
Assessment Year: 2012-13 and 2013-14
PAN: AAACN0980B

The scrutiny of the assessment for AY 2012-13 was completed in March 2015 with assessed income of ₹63.80 lakh and for AY 2013-14 in March 2016 at assessed income of ₹4.22 crore which was revised in May 2016 to ₹3.96 crore. Scrutiny revealed that the foreign exchange fluctuation due to exchange rate difference was booked on a deferred credit basis from the supplier of the capital equipment. As the payment for this exchange rate difference was not actually made by the assessee, the amount cannot be a part of the value of asset[101]. Hence the assessee was not eligible to claim depreciation on the exchange rate difference on addition of assets. The omission to disallow the depreciation resulted in under-assessment of

[99] Assam (1), Delhi (2) Tamil Nadu (3) and Uttar Pradesh (1).

[100] (Tax @33.2175 per cent on ₹184.80 lakh i.e. ₹61.39 lakh plus interest u/s 234B @36 per cent on ₹61.39 lakh i.e. ₹22.10 lakh)

[101] Section 43A of the Income Tax Act provides that if assessee acquires a depreciable asset from a country outside India for the purpose of business or profession and in consequences of a change in the rate of exchange during any previous year after the acquisition of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency *at the time of making payment*, the increase or reduction in the liability shall be deducted or added to the value of the depreciable asset.

income by ₹1.46 crore involving short levy of tax of ₹47.37 lakh relating to AYs 2012-13 and 2013-14. ITD's reply was awaited (April 2017).

c. **Charge: PCIT-1, Coimbatore, Tamil Nadu**
Assessee: M/s Vedanayagam Hospital Limited
Assessment Year: 2013-14
PAN: AAACV9940R

The scrutiny assessment of the assessee was completed in March 2016 with income of ₹2.95 crore after allowing depreciation of ₹2.52 crore which included ₹2.45 crore on plant & machinery. Audit scrutiny revealed that depreciation was allowable only to the tune of ₹1.48 crore. This resulted in excess allowance of depreciation of ₹1.05 crore involving tax effect of ₹33.96 lakh. The Department agreed to take remedial action in the case (October 2016).

4.2.2 Irregular allowance of amortisation of preliminary expenses

As per section 35D of the IT Act, certain preliminary expenses, incurred by an Indian company or a resident non-corporate assessee before the commencement of business, qualify for amortisation of one-fifth of such expenditure as deduction in each of the five successive years beginning with the year in which the business commences or, as the case may be, the previous year in which extension of industrial undertaking is completed, or the new industrial unit commences production or operation. In one case, as discussed below, entire preliminary expenditure was allowed as deduction instead of one-fifth of such expenditure.

Box 4.2: Irregular allowance of amortisation of preliminary expenses

a. **Charge: PCIT, Noida, Uttar Pradesh**
Assessee: M/s Jaypee Healthcare, Noida
Assessment Year: 2013-14
PAN: AACCJ9811D

Scrutiny of assessment records for the Assessment Year 2013-14 revealed that during assessment (February 2016), the assessee was allowed preliminary expenses of ₹1.01 crore before assessing the income at nil. However, it was found that the amount of ₹1.01 crore was the total preliminary expenses incurred by the assessee during FY 2012-13 whereas ₹20.27 lakh, being one-fifth of the said preliminary expenses, was only required to be allowed to the assessee. Hence, there was excess computation of loss of ₹81.10 lakh (₹101.37 lakh – ₹20.27 lakh) involving potential tax effect of ₹25.05 lakh. The Department stated that the matter would be looked into. Further development was not intimated to Audit (April 2017).

4.3 Irregular allowance of business expenditure

Section 37 of the IT Act allows deduction of expenditure which is of revenue nature and expended wholly and exclusively for the purpose of business or profession. Audit noticed that in 23 cases of 11 states[102] (**Appendix-8**), the AOs had allowed business expenditure in contravention of the laid down provisions involving a tax effect of ₹3.62 crore. Three cases are discussed below (see box 4.3).

Box 4.3: Illustrative cases on irregular allowance of business expenditure

a. Charge : PCIT-1, Kochi, Kerala
Assessee : Aster DM Healthcare (P) Limited
Assessment Year: 2012-13
PAN:AACCD7912K

The scrutiny assessment was completed in March 2015 at loss of ₹6.11 crore. It was observed that legal and professional expenses/business promotion expenses of ₹6.63 crore were incurred in connection with the acquisition of new investments (hospitals) and being capital in nature, was allowed during assessment. The irregular allowance has resulted in potential tax effect of ₹2.15 crore. ITD's reply was awaited (April 2017).

b. Charge : PCIT-2, Hyderabad, Andhra Pradesh & Telangana
Assessee : M/s Hyderabad Institute of Oncology Pvt. Ltd
Assessment Year: 2012-13
PAN:AACCH3376D

The assessment was completed in June 2014 at 'nil' income which was rectified under section 154 while arriving at the income of ₹4.62 crore under MAT. Loss on foreign exchange fluctuation towards purchase of capital goods of ₹1.34 crore was claimed and allowed as revenue expenditure. This has resulted in incorrect allowance of revenue expenditure of ₹80.33 lakh after deducting the allowable depreciation. The potential tax effect worked out to ₹24.82 lakh. The department rectified the assessment order under section 154 of the IT Act in September 1016.

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[102] Andhra Pradesh & Telangana (4), Assam (7), Delhi (2), Jharkhand (1), Kerala (2), Maharashtra (2), Rajasthan (1), Tamil Nadu (1), Uttar Pradesh (2) and West Bengal (1).

c. Charge: PCIT, Trivandrum, Kerala
Assessee: M/s PRS Hospital
Assessment Year: 2010-11
PAN:AADFP4651M

The assessment of M/s PRS Hospital was completed after scrutiny in March 2013 with assessed income of ₹2.98 crore after allowing prior period expenditure of ₹57.05 lakh which was not allowable under the provisions of the IT Act. This involved tax effect of ₹17.63 lakh. The Department rectified the mistake in March 2016.

4.4 Non-deduction of Tax at Source (TDS)

As per section 40(a)(ia), any interest, commission or brokerage (rent, royalty), fees for professional or technical services or amounts payable to a contractor or sub-contractor etc., as detailed therein, on which tax is deductible at source (TDS) and has not been deducted or, after deduction, has not been paid on or before the specified due date, shall not be allowed as expense in computing the income.

Audit noticed thirteen cases (**Appendix-9**) in nine states[103] in which the AO had allowed expenses on which TDS was not deducted, in violation of the laid down provisions, involving tax effect of ₹2.66 crore. Two cases are discussed below (Box 4.4).

Box 4.4: Illustrative cases on Non-deduction of TDS

a. Charge : PCIT-16, Mumbai, Maharashtra
Assessee: Shri Sudhansu S Bhattacharya
Assessment Year: 2012-13
PAN:AABPB4376R

The assessee, a medical professional, whose income was assessed at ₹18.56 crore after scrutiny in March 2015, had claimed and was allowed professional expenses of ₹42.55 lakh on which TDS was not deducted. This had led to underassessment of income to that extent with resultant short levy of tax of ₹13.15 lakh. ITD's reply was awaited (April 2017).

[103] Andhra Pradesh & Telangana(1), Bihar (1), Haryana(1), Jharkhand (1), Maharashtra (3), Uttar Pradesh (3) and West Bengal (2).

b. Charge : PCIT, Ranchi, Jharkhand
Assessee: The Chotanagpur Regional Handloom Weavers Corporation Union, IRBA, (Ranchi)
Assessment Year: 2013-14
PAN:AAAAT5001D

The assessment was completed in February 2015 at assessed income of ₹1.56 crore. The assessee, engaged in the business of hospital services, had paid ₹1.01 crore towards 'Labour charge' to M/s SSS Limited (a company) during the FY 2012-13 relating to the AY 2013-14, but the TDS was made against ₹30.78 lakh only. Thus, amount of ₹70.16 lakh (₹1.01 crore less ₹30.78 lakh) should have been disallowed under section 40(a)(ia), but the assessing officer had added back only ₹40.24 lakh to the income of the assessee, instead of ₹70.16 lakh. This omission resulted in irregular allowance of expenses of ₹29.92 lakh (₹70.16 lakh less ₹40.24 lakh) with consequent short levy of tax of ₹9.24 lakh. ITD's reply was awaited (April 2017).

4.5 Irregularities regarding Minimum Alternate Tax (MAT)

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

Audit noticed five cases (**Appendix-10**) in five states[104] where the AO had not assessed income under Section 115JB correctly, involving tax effect of ₹4.66 crore. Two cases are discussed below (see box 4.5).

Box 4.5 : Illustrative cases on irregularities regarding Minimum Alternate Tax (MAT)

a. Charge: PCIT-2, Bengalaru, Karnataka
Assessee: M/s Manipal Health Enterprises Pvt. Ltd
Assessment Year: 2013-14
PAN:AAGCM5933R

The assessee whose scrutiny assessment was completed in March 2016 with assessed income of ₹67.41 crore, had claimed an amount of ₹2.39 crore as MAT credit while computing the tax payable which was allowed in the assessment order. However, during the AYs 2011-12 and 2012-13, income of the assessee was assessed under normal provisions of the IT Act and the tax was calculated accordingly. As such there was no MAT credit available for the assessee to claim for the AY 2013-14. This resulted in irregular grant of MAT credit leading to short levy of tax of ₹3.25 crore. The department stated

[104] Andhra Pradesh & Telangana (1), Karnataka (1), Tamil Nadu (2) and West Bengal (1).

(August 2016) that the assessee had paid tax of ₹2.38 crore under MAT in the previous assessment year as tax payable under the normal provisions of the Act was only ₹33.84 lakh. Hence, ₹2.38 crore was lying as MAT credit to be adjusted. The reply is not acceptable as the department had adopted the computation statement of the assessee instead of the assessment order under section 143(3) relating to AYs 2011-12 and 2012-13.

b. Charge: PCIT-4,Chennai, Tamil Nadu
Assessee: M/s Medall Health Care Private Limited
Assessment Year: 2013-14
PAN: AABCP 9015E

The scrutiny assessment was completed during March 2016 at a loss of ₹11.51 crore. While arriving at income as per the normal provisions (not invoking section 115JB), disallowance of ₹2.33 crore was made under Section 14A of the IT Act in respect of expenditure relating to the exempted income. However, while arriving at the book profit under Section 115JB of the IT Act, the said expenditure was not considered. Further, while arriving at the book profit, brought forward loss of ₹2.64 crore was erroneously adjusted instead of the correct amount of ₹1.08 crore. These mistakes resulted in short computation of book profit by ₹3.89 crore and short levy of MAT by ₹1.06 crore including interest. The ITD's reply was awaited (April 2017).

4.6 Irregularities regarding set off of carried forward losses

Section 72 provides for carry forward of loss for set-off in the following AYs where the loss is not wholly set off against income under any head of the relevant year, to the extent it is not set off.

Audit noticed eight cases (**Appendix-11**) in six states[105] in which the AO had allowed set off of losses in contravention of the laid down provisions involving tax effect of ₹15.62 crore. Two cases in this regard are discussed below (see box 4.6).

Box 4.6: Illustrative cases on Irregularities regarding set off of carried forward losses

a. Charge: PCIT-1, Coimbatore, Tamil Nadu
Assessee: M/s Ganga Medical Centre and Hospital (P) Limited
Assessment Year: 2010-11
PAN:AABCG8283F

The assessment of the company was completed during March 2013 at assessed income of ₹0.65 crore after adopting the revised return of income and adjustment of brought forward loss of ₹3.57 crore. Audit scrutiny

[105] Gujarat (2), Karnataka (1), Maharashtra (1), Tamil Nadu (1), Uttar Pradesh (1) and West Bengal (1).

revealed that in the revised return of income, the assessee had unabsorbed depreciation of ₹2.22 crore which was deducted from the gross total income to arrive at the taxable income. Further, the brought forward loss of ₹3.57 crore was wrongly deducted from the total income although there was no brought forward loss available. This had resulted in excess set off of brought forward loss of ₹3.57 crore leading to short levy of tax of ₹1.21 crore.

b. Charge: PCIT(Central Circle), Bengalaru, Karnataka
Assessee: M/s. Sri Srinivasa Educational and Charitable Trust
Assessment Year: 2012-13
PAN: AAGCS0925B

Scrutiny of the assessment records revealed that while passing the assessment order in January 2016for the AY 2012-13 under section 153A[106] of the IT Act with an income of ₹43.74 crore, loss of ₹1.68 crore relating to AY 2011-12 was already set off. However, while passing the rectification order, the loss for ₹12.41 crore relating to AY 2011-12 was set off which again included the loss of ₹1.68 crore. This had the effect of setting off of loss of ₹1.68 crore twice which was irregular. This resulted in excess set off of loss of ₹1.68 crore with a potential short levy of tax of ₹54.38 lakh. ITD had initiated remedial action for rectification under section 154 in September 2016.

4.7 Non levy of penalty

Audit found seven cases (**Appendix-12**) in seven states[107] where penalty should have been levied under section 271C[108] and 271D[109] for violation of provision under section 269SS and 269T; non-levy of such penalty in these cases resulted in tax effect of ₹2.18 crore. Two of the cases are detailed below (Box 4.7):

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[106] Read with section 143(3) of the IT Act.

[107] Delhi (2), Gujarat (1), Maharashtra (1), Kerala (1), Rajasthan, Tamil Nadu (1) and West Bengal (1).

[108] Section 271C of Income Tax Act provides that if any person fails to deduct the whole or any part of tax as required by or under the provisions of chapter XVII-B or pay the whole or any part of the tax as required by or under sub-section (2) of section 115O or the second proviso to section 192B, then such person shall be liable to pay by way of penalty a sum equal to the amount of tax which such person failed to deduct or pay as aforesaid.

[109] Under section 269SS of the Income Tax Act, no person shall, take or accept from any other person, any loan or deposit otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account if the amount is ₹20,000 or more. Non-compliance to this will attract penalty equal to the amount under section 271D.

Box 4.7: Illustrative cases on Irregularities on Non levy of penalty

a. **Charge: PCIT-1 (Corporate), Kochi, Kerala**
   Assessee: M/s Molecule 7 Hospitals and Medical Institutions Pvt. Ltd.
   Assessment Year: 2012-13
   PAN:AACCD7912K

The scrutiny assessment of the assessee was completed in March 2015 with Nil income. During the previous year relevant to the assessment year, the assessee had accepted ₹80.69 lakh both in cash and bank and repaid ₹74.74 lakh both in cash and bank. Since, both the transactions were made otherwise than by account payee cheque or account payee bank draft (required as per Section 269SS and section 269T[110] respectively), penalties of ₹80.69 lakh under Section 271D and ₹74.74 lakh under Section 271E respectively were to be levied. However, the AO did not initiate to levy such penalties. ITD's reply was awaited (April 2017).

b. **Charge: CIT-4, Ahmedabad, Gujarat**
   Assessee: Satyamev Hospitals Pvt. Ltd.
   Assessment Year: 2013-14
   PAN: AAMCS4193B

The assessee, engaged in the business of running a private hospital, filed (October 2013) its return of income for AY 2013-14 declaring total loss of ₹1.97 crore. The income was assessed (February 2016) at loss of ₹1.71 crore under section 144 of the IT Act. It was observed from the Tax Audit Report that the assessee had repaid to a person the loan amount of ₹36.52 lakh[111] through a mode otherwise than by an account payee cheque or account payee draft. But no procedure for levy of penalty was initiated under section 269T[112] of the IT Act. Failure to do so resulted into non-levy of penalty of ₹36.52 lakh. ITD's reply was awaited (April 2017).

[110] Under section 269T of the Income Tax Act, no branch of a banking company or a co-operative bank and no other company or co-operative society and no firm or other person shall repay any loan or deposit made with it otherwise than by an account payee cheque or account payee bank draft drawn in the name of person who has made the loan or deposit or use of electronic clearing system through a bank account if the amount is ₹20,000 or more.

[111] Shri Jayesh Sandesara, Ahmedabad (PAN AKUPS3647M)

[112] As per section 269T of the IT Act read with section 271E if a person repays any loan in excess of ₹20,000 otherwise than by a crossed account payee cheque or demand draft it shall be liable to pay, by way of penalty, a sum equal to the amount of the loan or deposit so repaid.

4.8 Incorrect computation of Capital Gain/Loss

Section 45 of the Act provides that any profits or gains arising from the transfer of a capital asset shall be chargeable to income tax under the head capital gains. Section 50B of the Act provides that any profits or gains arising from slump sale[113] shall be chargeable to income tax as capital gains arising from the transfer of long term capital asset. Section 54F of the Act provides that capital gain on transfer of certain capital assets shall not be charged in case of investment in residential house.

Audit noticed eight cases (**Appendix-13**) in seven states[114] where income was not considered in accordance with the laid down provisions, involving tax effect of ₹2.96 crore. Three cases are discussed below (see box 4.8).

Box 4.8: Illustrative cases on Incorrect computation of Capital Gain/Loss

a. Charge: PCIT-21, Delhi
Assessee: Dr. Jawahar Lal Chakravarty
Assessment Year: 2012-13
PAN:AABPC8294M

In the instant case, the assessee whose assessment was completed in March 2016 at assessed income of ₹76.42 lakh, had sold unlisted securities and earned a capital gain of ₹6.95 crore. This capital gain was claimed and allowed as exemption under section 54F[115] of the IT Act as the assessee had purchased a residential property for ₹10.50 crore. The assessee was holding more than one property, one being his residence at New Delhi[116] and another property at Okhla[117]on which he was earning "Income from House Property". Hence, he was not eligible for claiming exemption under section 54F of the IT Act. The omission to disallow the same resulted in under assessment of capital gain of ₹6.95 crore involving short levy of tax and interest of ₹1.95 crore. ITD's reply was awaited (April 2017).

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[113] Under Indian Income tax Act, 1961, "slump sale" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Therefore transferor is not required to assign value to each "assets and liabilities" of "business undertaking" to be transferred.

[114] Andhra Pradesh & Telangana (1), Delhi (1), Karnataka (1), Maharashtra (1), Tamil Nadu (2) and West Bengal (2).

[115] Section 54F of the IT Act provides exemption to an individual or a HUF who transferred any long-term capital asset but other than residential house if assessee has purchased, within one year before the date of transfer or 2 years after the date of transfer or constructed within 3 years after the date of transfer one residential house. Assessee should not own on the date of transfer of the original asset more than one residential house (other than new house).

[116] 38/61, Punjabi Bagh, New Delhi

[117] D-170, Okhla

b. Charge: PCIT-16, Mumbai, Maharashtra
Assessee: Dr.Gautam N Allahbadia
Assessment Year: 2012-13
PAN:AAAPA9976F

The assessee whose income was assessed at ₹6.43 crore in March 2015, had a flat in Bandra, Mumbai worth ₹3.90 crore in June 2011 and claimed exemption of ₹2.09 crore under section 54 of the IT Act. Audit scrutiny revealed that the assessee had paid ₹1.25 crore as booking amount in June 2012 for purchase of another flat in Bandra at ₹6.60 crore and the builder had also allotted that flat to the assessee, though the agreement was not registered nor was the stamp duty paid. Since no new asset was purchased within two years from the sale of the old flat, the assessee was not eligible for exemption under section 54 of the IT Act. The omission to disallow the exemption claimed resulted in underassessment of 'Long Term Capital Gain' of ₹2.09 crore with consequent short levy of tax of ₹58.49 lakh including interest of ₹15.48 lakh under section 234B. ITD's reply was awaited (April 2017).

c. Charge: PCIT-8, Kolkata, West Bengal
Assessee: Purnendu Roy
Assessment Year: 2013-14
PAN: ADKPR4048L

In this case, the assessee who was assessed in March 2016 with an income of ₹1.33 crore, had made advance payment of ₹93.33 lakh up to FY 2011-12 for a property (flat) to 'Bengal Unitech Universal' but it was sold at ₹1.40 crore during FY 2012-13.As per schedule 5(Current Assets-Loans & Advances) of balance sheet, as on 31 March 2013, the assessee had made advance payment of ₹77.15 lakh upto 31 March 2012 for a flat from 'Bengal Unitech Universal'. However the flat was not included in the opening balance of "fixed assets schedule" and no additions were made in respect of the same under "fixed assets". This implied that the flat was not actually transferred to the assessee. However, long term capital gain was considered at ₹9,625/- (after indexation as per IT Act) in respect of the flat in the computation of total income. Therefore, the entire transaction was either a venture or trade of the assessee by booking a flat and selling the booking right before completion/delivery at a profit for making windfall gains and this transaction was allowable as a short term capital gain. In either of the cases, there was underassessment of income of ₹46.57 lakh[118] leading to undercharge of tax of ₹14.39 lakh. ITD's reply was awaited (April 2017).

[118] ₹1.40 crore less ₹93.33 lakh less ₹9,625.

4.9 Income escaping assessment

Section 5 of the IT Act provides that the total income of a person for any previous year includes all income, from whatever source derived, which is received or deemed to be received or which accrues or arises during such previous year, unless specifically exempted from tax under the provisions of the IT Act.

Audit noticed that in 22 cases (**Appendix-14**) in 11 states[119], income was not considered in accordance with the laid down provisions, involving tax effect of ₹2.80 crore. Two cases are discussed below (see box 4.9).

Box 4.9: Illustrative cases on Income escaping assessment

a. **Charge: PCIT-5, Chennai, Tamil Nadu**
 Assessee: M/s. Primex Scans and Labs Private Limited
 Assessment Year: 2013-14
 PAN:AAGCP2852F

The scrutiny assessment of the assessee, a closely held company, was completed in February 2016 at assessed loss of ₹2.94 crore. Audit examination revealed that the assessee had issued shares at a premium of ₹3.65crore. However, the fair market value of the shares as per the Valuation Report[120] was ₹2.41crore only. This had resulted in the issue of shares at premium in excess of the fair market value, in violation of provisions under Section 56(2) (viib) of the IT Act[121] by ₹1.24 crore resulting in potential tax effect of ₹38.23 lakh. The Department replied (June 2016) that the audit observation would be looked into.

b. **Charge: PCIT-7, Mumbai**
 Assessee: SRL Diagnostics Pvt. Ltd.,
 Assessment Year: 2013-14
 PAN: AAACT9117E

The assessment was completed at loss of ₹4.01 crore in March 2016. It was noticed from the assessment records that while computing the income, the assessee was disallowed an amount of ₹1.33 crore under section 14A[122] of the

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[119] Andhra Pradesh & Telangana (2), Assam (1), Bihar (1), Delhi (1),Haryana (1),Maharastra (7), Rajasthan (2), Tamil Nadu (1) , Uttar Pradesh (4) and West Bengal (1).

[120] Discounted cash flow method adopted by the assessee.

[121] As per Section 56(2) (viib) of the Income Tax Act, 1961 where a Company, not being a company in which the public are substantially interested, receives in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of share shall be chargeable to tax.

[122] Section 14A stipulates that no deduction shall be made in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act.

IT Act. However, it was seen that while computing the disallowance, the gross value of asset was adopted instead of the net value as per Rule 8D[123] of the Income Tax Rules. Consequently, the amount to be disallowed was ₹3.12 crore, resulting in short disallowance of ₹1.79 crore and short levy of tax of ₹35.80 lakh. ITD's reply was not received (April 2017).

4.10 Other mistakes during assessment

Audit also noticed 24 cases in ten states[124] (**Appendix-15**) of miscellaneous nature such as irregular allowance of interest expenditure, mistake in computation of income, allowance of provisional expenses, mistake in levy of interest, etc. involving tax effect ₹14.42 crore[125]. Three cases are illustrated below (see box 4.10).

Box 4.10: Illustrative cases on Other Mistakes during assessment.

a. Charge: CIT-4, Chennai, Tamil Nadu
Assessee: M/s Medall Health Care Private Limited
Assessment Year: 2013-14
PAN:AABCP9015E

The assessment was completed in March 2016 at loss of ₹11.51 crore. It was noticed that the assessee had given an amount of ₹54.46 crore as interest-free advance to its subsidiaries and step-down subsidiaries[126] whereas an amount of ₹8.46 crore was incurred as interest expenditure. Hence, the proportionate interest expenditure of ₹6.13 crore from the total finance cost of ₹13.29 crore had to be disallowed since the loan was not utilised for assets of the assessee company which resulted in short computation of business income to the tune of ₹6.13 crore. This resulted in potential tax loss of ₹1.90 crore. The Department replied (October 2016) that remedial action would be taken, if necessary.

b. Charge: PCIT-Exemptions, Bangaluru, Karnataka
Assessee: M/s Gokula Education Foundation (Medical)
Assessment Year: 2011-12
PAN:AAATG1779Q

The scrutiny assessment of the assessee was completed in March 2014 at income of ₹30.48 crore. It was noticed that as per Para 7.7 of the assessment order, ₹1.80 crore as expenditure incurred outside India was disallowed and

[123] Rule 8D provides the method of computation of expenditure pertaining to exempt income.
[124] Andhra Pradesh & Telangana (2), Bihar (1), Delhi (4), Haryana (1), Karnataka (1),Kerala (2), Maharashtra (1), Tamil Nadu (5), Uttar Pradesh (2) and West Bengal (3)
[125] Total understatement of tax ₹909.55 lakh and overcharge of tax ₹532.44 lakh.
[126] Step down subsidiaries means subsidiary company of a company which is subsidiary to another company.

added back to the total income. However, while concluding the assessment order, this was not considered for disallowance. Omission to disallow the same resulted in short computation of income and consequential short levy of tax of ₹66.22 lakh. The ITD accepted (March 2017) the audit observation.

c. Charge: PCIT-4, Kolkata
Assessee: Phoenix Cardio Care India Private Limited
Assessment Year: 2013-14
PAN: AABCE4709J

In the instant case, assessment was completed in March 2016 with assessed income of ₹39.40 lakh. It was observed that during the previous year of AY 2013-14, the assessee had issued 6300 shares @ ₹940 each (Face value: ₹10 plus Share premium: ₹930 per share). As against this, Audit had arrived[127] at fair market value of the shares at ₹205[128] per share resulting in excess of ₹735 per share ₹940 less ₹205) towards the fair market value of share premium**.** Therefore**,** ₹46.30 lakh (₹735 for 6,300 shares) was needed to be added back under section 56(2)(viib)[129] of the IT Act to the total income of the assessee. Omission to do so had resulted in under-assessment of income to the tune of ₹46.30 lakh involving total undercharge of tax of ₹19.46 lakh**.** ITD's reply was not received (April 2017).

d. Charge: PCIT(Central Circle), Bengalaru, Karnataka
Assessee: M/s. Anand Social & Educational trust
Assessment Year: 2009-10 to 2012-13
PAN: AAATA7392M

The assessee trust was running Dr. Ambedkar Medical and Hospital, whose assessment for the AYs 2009-10 to 2012-13 were concluded under section 153A/143(3) of the IT Act in March 2016 with assessed incomes of ₹12.68 crore, ₹14.85 crore, ₹22.74 crore and ₹27.86 crore respectively. While computing the tax liability, interest under section 234B of the IT Act was charged at ₹10.75 crore from the date of determination of the total income under section 143(1) of the IT Act, instead of correct amount of ₹15.16 crore, leviable for the period from the date commencing on the first day of April next following such FY and ending on the date of reassessment/re-

[127] As per Rule 11U and 11UA of Income Tax Rule 1962.

[128] Fair value=(Gross asset- Gross liability)/Total no. of Share issued=(`981.39 lakh less `669.37 lakh)/ `1.524 lakh.

[129] sub section 2(viib) of section 56 implies that the income shall be chargeable to the income Tax under the head "Income from other sources" namely "*….where a company not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of shares….*".

computation under section 147/153A of the IT Act, as required under section 234B(3)[130] of the IT Act. This has resulted in short levy of interest under section 234B(3) by ₹4.41 crore[131] respectively. The department in its reply (June 2016) stated that the issue would be examined.

4.11 Irregular allowance of unlawful expenditure

As per CBDT directive dated August 2012[132], claim for any expense incurred in providing freebies[133] to medical practitioners in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 shall be inadmissible under section 37(1) of the Income Tax Act, being an expense prohibited by the law. It has been judicially held[134] that any commission paid to private doctors for referring patients was prohibited by law and hence not to be allowed as business expenditure.

4.11.1 Audit noticed in 19 cases in eight states[135] (**Appendix-16A**) in which AO had allowed such expenditure in contravention to such provisions involving tax effect of ₹5.56 crore. Three cases are discussed below (see box 4.11).

Box 4.11: Illustrative cases on irregular allowance of unlawful expenditure

a. Charge : PCIT-4, Chennai, Tamil Nadu
Assessee: M/s Life Cell International Private Limited
Assessment Year: 2013-14
PAN: AAECA7997B

The scrutiny assessment of the assessee was completed in March 2016 at income of ₹35.59 crore. As per records, the assessee had claimed and was allowed exemption of ₹6.91 crore shown as referral fees under the head 'Other expenses'. As the said expenses were not allowable as per CBDT circular no. 5 of 2012, the same were required to be disallowed and added back to the taxable income. Omission to do so resulted in undercharge of income by ₹6.91 crore involving short levy of tax of ₹2.07 crore. ITD's reply was awaited (April 2017).

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[130] As per the amended section 234B(3) w.e.f 1.6.2015, where as a result of an order of reassessment or re-computation u/s 147/153A the amount on which interest was payable under sub section(1) is increased the assessee shall be liable to pay simple interest at the rate of 1 per cent of every month or part of it comprised in the period commencing on the first day of April next following such financial year and ending on the date of reassessment/re-computation under section 147/153A, on the amount by which the tax on total income determined on the basis of reassessment /re-computation exceeds the tax on the total income determined under subsection(1) of section 143 or on the basis of regular assessment as referred to in subsection(1) as the case may be.

[131] ₹70.17 lakh, ₹73.27 lakh, ₹178.77 lakh and ₹117.74 lakh for four years (AYs 2009-10 to 2012-13)

[132] circular No.5/2012 dated 01 August 2012

[133] Like gifts, travel facility, hospitality, cash or monetary grants.

[134] Hon'ble Punjab and Haryana High Court in CIT Vs KAP Scan and Diagnostic Centre Pvt. Ltd [2012] 344 ITR476 (Punjab & Haryana)

[135] Andhra Pradesh & Telangana (5), Bihar (1), Delhi (1), Kerala (2),Maharashtra (1), Tamil Nadu (3), West Bengal (6).

b. **Charge : PCIT-8, Kolkata, West Bengal**
Assessee: Debjit Ghosh
Assessment Year: 2012-13 and 2013-14
PAN:AGJPG7542C

The assessee engaged in trading of surgical and medical equipment had debited ₹1.09 crore in AY 2012-13 and ₹2.32 crore in AY 2013-14 in the Trading and Profit & Loss Account under the head 'Business Promotion'. As the business promotion expenditure made by the assessee was incurred mainly for giving freebies like gifts, travel facility, hospitality, cash or monetary grant to the medical practitioners, the expenditure was not an allowable expenditure. The incorrect allowance resulted in underassessment of income of ₹3.21 crore[136] involving tax effect of ₹99.31 lakh[137] (₹30.55 Lakh for AY 2012-13 and ₹68.76 lakh for AY 2013-14). ITD's reply was awaited (April 2017).

c. **Charge : PCIT-4, Kolkata, West Bengal**
Assessee: M/s Peerless Hospitex Hospital Research Centre Limited
Assessment Year: 2010-11 , 2011-12 and 2012-13
PAN:AABCP7225L

In the above case, payments of referral fees of ₹47.53 lakh, ₹51.77 lakh and ₹63.40 lakh were made to the doctors in AY 2010-11, AY 2011-12 and AY 2012-13 respectively. As the expenses were 'unlawful' in nature they were required to be disallowed and added back to the total income of the assessee in the relevant AYs. Omission to do so resulted in underassessment of income of ₹47.53 lakh, ₹51.77 lakh and ₹63.40 lakh in the AY 2010-11, AY 2011-12, and AY 2012-13 respectively with consequential total tax effect of ₹51.75 lakh[138]. ITD's reply was awaited (April 2017).

[136] ₹321.40 lakh =₹98.86 lakh (AY 2012-13) and ₹222.54 lakh (AY 2013-14)
[137] ₹30.55 lakh (AY 2012-13) + ₹68.76 lakh (AY 2013-14)
[138] ₹16.16 lakh, ₹16.00 lakh and ₹19.59 lakh in the AY 2010-11, AY 2011-12, and AY 2012-13 respectively.

4.11.2 Further, in nine cases (**Appendix-16B**) in Maharashtra, audit noticed that advertisement and business promotion expenses of ₹52.21 crore were allowed by the Department although advertising has been deemed as "unethical" practice as per Para 6[139] of the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulation, 2002 and Para 6(1)[140] of Homoeopathic Practitioners - (Professional Conduct, Etiquette & Code of Ethics) Regulations. This resulted in undercharge of tax of ₹16.93 crore in such cases. One case is illustrated below (see box 4.12):

Box 4.12: Illustrative case on irregular allowance of unlawful expenditure

Charge: PCIT-16, Mumbai, Maharashtra
Assessee: M/s Batra's Positive Health Clinic Private Limited
Assessment Years: 2012-13 & 2013-14
PAN: AABCD3857G

The scrutiny assessments of the assessee for AYs 2012-13 and 2013-14 were completed in March 2015 and March 2016 at income amounts of ₹9.75 crore and ₹8.48 crore respectively. Audit noticed that the assessee had claimed and was allowed expenditure of ₹23.84 crore and ₹27.83 crore incurred on account of advertisement and business promotion expenses in AYs 2012-13 and 2013-14 respectively. As such practices were declared "unethical" by the regulatory bodies, the expenditure incurred thereon was to be considered as "illegal" and hence added back under the provisions of Section 37. Omission to do so resulted in underassessment of incomes by ₹23.84 crore and ₹27.83 crore involving short levy of tax of ₹7.74 crore and ₹9.03 crore in AYs 2012-13 and 2013-14 respectively. ITD's reply was awaited (April 2017).

[139] Para 6 of the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulation,2002-**UNETHICAL ACTS :** A physician shall not aid or abet or commit any of the following acts which shall be construed as unethical - Advertising: Soliciting of patients directly or indirectly, by a physician, by a group of physicians or by institutions or organisations is unethical. A physician shall not make use of him / her (or his / her name) as subject of any form or manner of advertising or publicity through any mode either alone or in conjunction with others which is of such a character as to invite attention to him or to his professional position, skill, qualification, achievements, attainments, specialities, appointments, associations, affiliations or honours and/or of such character as would ordinarily result in his self advertisement or journals provided it shall be permissible for him to publish his name in connection with a prospectus or a director's or a technical expert's report.

[140] Para 6(1) of Homoeopathic Practitioners - (Professional Conduct, Etiquette & Code of Ethics) Regulations 1982 (As amended as per notification published in the Official Gazette dated July 12, 2014)-**Advertising:** Solicitation of patients directly or indirectly by a practitioner of Homoeopathy either personally or by advertisement in the newspapers, by placards or by the distribution of circular cards or handbills is unethical. A practitioner of Homoeopathy shall not make use of, or permit others to make use of, him or his name as a subject of any form or manner of advertising or publicity through lay channels which shall be of such a character as to invite attention to him or to his professional position or skill or as would ordinarily result in his self-aggrandisement (2)He shall further not advertise himself directly or indirectly through price lists or publicity materials of manufacturing firms or traders with whom he may be connected in any capacity, nor shall he publish cases, operations or letters of thanks from patients in non-professional newspapers.

In the Exit Conference, it was stated by the Department that clarification had already been issued in this regard (Circular No. 5 of 2012) and after that such instances had reduced. However, all the items, like referral fees, advertisement or business promotion expenditure etc. were not covered under the said clarification.

4.12 Summary of Findings

- The provisions relating to the depreciation on machinery and plants as well as depreciation on other assets and amortisation of preliminary expenses were allowed erroneously. Provisions relating to allowances of business expenditure, tax deducted at source, minimum alternate tax and set off of carry forward losses were not followed correctly by the ITD during assessment. The Assessing officers omitted to obtain details of cases where cash receipts and payments were made in contravention with sec. 269SS and 269T and also failed to initiate penalty proceedings. The computation and allowance of capital gains/losses were not carried out according to the provisions of the Act. In some cases, income of the assessees was not considered in accordance with the laid down provisions of the Act.
- The referral fees paid to the doctors by private hospitals, nursing homes, diagnostics centres etc. for referring patients and payments made on account of advertisement expenses by the medical practitioners were allowed, although such expenditure has been held as disallowable and "unethical" as per CBDT's directives and Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 read with Homoeopathic Practitioners - (Professional Conduct, Etiquette & Code of Ethics) Regulations respectively.

4.13 Recommendations

The CBDT may include the provision of disallowance of expenditure in respect of all kinds of freebies and referral fees paid to medical practitioners as well as advertisement and business promotion expenses within the purview of explanation under section 37 of Income Tax Act 1961 to create an additional deterrence against such unethical practices.

The CBDT replied (May 2017) that any legislative intervention in specific form of mentioning specific items as unallowable expenditure under section 37 of the Act will only dilute the wider ambit of explanation 1 to section 37. Thus according to CBDT, adequate legal provisions exist and necessary circulars have already been issued by CBDT in this regard. Hence no further intervention in the form of legislative enactment to the Act is required in this matter.