

**OFFICE OF THE COMPTROLLER AND AUDITOR GENERAL OF  
INDIA**

New Delhi  
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**Audit Report on Assessment of Co-operative Societies & Co-operative Banks  
presented**

Performance Audit Report No. 16 of The Comptroller & Auditor General of India on '**Assessment of Co-operative Societies and Co-operative Banks**' was laid on the floor of the Parliament here today. The PA was carried out from March 2019 to September 2019 and findings were discussed with the Central Board of Direct Taxes (CBDT) in July 2020.

**Introduction**

This topic was selected for performance audit with a view to examine the extent of Coverage of Co-operative Societies in Income Tax net; Widening and deepening of the tax base; and Compliance of the statutory provisions. The performance audit covered the assessments of Co-operative Societies and Co-operative Banks completed by Income Tax Department (ITD) during the financial years 2014-15 to 2018-19.

**Summary of audit findings**

- Audit noticed that the number of Co-operative Societies and Co-operative Banks as per records of respective States/ Regional regulatory authorities/ Registering authorities was much higher as compared to the numbers as per ITD indicating that many Co-operative Societies and Banks were not in the tax net of ITD.

(Paragraph 2.1.1)

- ITD does not have a mechanism to map the information on Co-operative Societies/ Banks with the registering authorities in order to be able to verify the status of filing of income tax returns. There is no mechanism to seed the PAN in the databases of the Registrar of Co-operative Societies, and to check any change of declared registration status by the assessee, which is a major impediment in institutional and structured sharing of information with ITD.

(Paragraph 2.1.1)

- There was no evidence of action initiated against the non-filers/ stop-filers of Income Tax returns. ITD did not utilize the tools available with it through

conduct of survey and search & seizure operations to identify and bring into tax net the non-filers and stop filers of income tax returns.

(Paragraph 2.5.1, 2.2)

- While Co-operative Societies/ Co-operative Banks are supposed to be classified as Association of Persons (AOP), audit noticed that assessees classified as Firms, Body of Individuals (BOIs), Companies, Local authorities etc., were irregularly availing deductions meant for Co-operative Societies/ Co-operative Banks. This also has potential of providing inaccurate information pertaining to the assesseees involved in Co-operative Sector activities.

(Paragraph 2.3, 3.1)

- Audit noticed instances of inconsistencies and errors in the amounts of incomes and claims or deductions as per the data sets furnished by the DGIT(Systems) vis-à-vis the information available in assessment records. The mismatch in assessment data as furnished by the DGIT(Systems) and data as per the assessment records is not only indicative of poor coordination and control over data updation but also a reflection on accuracy of information.

(Paragraph 2.4.2)

- Audit noticed instances where appropriate form viz. ITR 5 was not used by assesseees in cases of Co-operative Sector for filing the Income Tax Return.

(Paragraph 2.5.2)

- Audit noticed that the verification of registration of the entity as Co-operative Societies/ Co-operative Banks was inadequate and evidential proof of a certificate of registration by Registrar as well as the details of members of the societies was either not available in the assessment records or not verified by the Assessing Officers. Thus, in such cases, it could not be confirmed by audit whether the deductions were availed by genuine assesseees.

(Paragraph 2.6.1, 2.6.2, 2.6.3)

- Accounts of the Co-operative Societies/ Co-operative Banks were required to be audited by an empanelled auditor and the details were to be collected through ITR-5. Audit noticed that this essential requirement was not complied with. Thus, the reliability of the accounts could not be confirmed.

(Paragraph 2.6.4.1, 2.6.4.2)

- The ITD assessed entities as Co-operative Banks that did not have a valid licence from Reserve Bank of India to operate as a Bank thereby allowing deductions to ineligible assesseees available for the Co-operative Banks.

(Paragraph 2.6.5)

- There were instances of irregular allowance of deductions under sections 36(1)(vii), 36(1)(viii), 36(1)(xvii) of the Act and various subsections of section

80P of the Act., where, conditions specified under the said provisions were not fulfilled, involving tax effect of ` 694.50 crore in 649 cases.

(Paragraph 3.1 to 3.7, 3.10, 3.11, 3.12)

- There was, relatively, higher propensity of irregular claims of deduction in respect of assessees engaged in banking, credit and financial services, accounting for 68.7 *per cent* of the total number of irregularities identified.

(Paragraph 3.1)

- While conducting scrutiny assessments, the Assessing Officers did not duly examine the parameters specified by the ITD for selection of cases for scrutiny viz. 'Large deductions claimed under section 80P' of the Act, in 274 cases, resulting in irregular allowance of deduction.

(Paragraph 3.1)

- Among the various sub sections under which a Co-operative Society/ Co-operative Bank could avail of deductions, it was seen that there was, relatively, higher risk of non-compliance under the sub-sections 80P(2)(d), 36(1)(viiia) and 80P(2)(a)(i) of the Act, being 56.55 *per cent*, 18.18 *per cent* and 17.72 *per cent* of the total number of irregularities identified during audit, respectively.

(Paragraph 3.1)

- Verification by the Assessing Officers was inadequate in determining adherence to the principles of mutuality. The Assessing Officers were taking differential stand in assessing similar cases of claims for deduction under section 80P of the Act. This impacted the quality of assessments of Co-operative Societies and Co-operative Banks.

(Paragraph 3.2.3)

- The major reasons for disallowance of claim of deduction were on account of assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of provisions applicable to Co-operative Societies.

(Paragraph 3.8)

- The Assessing Officers are adopting differential approach in allowance of deduction claimed under section 80P of the Act while completing assessments of assessees categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks.

(Paragraph 3.9)

- There is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the information in respect of sub-sections of 80P of the Act under which the assessee claims deduction under section 80P of the Act.

(Paragraph 3.10.1)

- Distinct and actual claim of deduction made under section 36(1)(viiia) of the Act is not getting captured in the existing format of ITR.

(Paragraph 3.11)

- Audit noticed instances of non-compliance to provisions laid down in the Act with respect to allowances of deductions/ expenses/ set-off and carry forward of losses, mistakes in computation of tax and interest, non-deduction of TDS, non-levy of penalty etc. involving tax effect of `12,328.40 crore, in 858 cases. It is pertinent to note that the assessment is being completed through ITD systems and applications. This is indicative of there being weaknesses in assessment procedure and internal controls of ITD which need to be addressed.

(Paragraph 4.1, 4.2, 4.3, 4.14)

- Audit noticed that 20.7 *per cent* cases (151 observations) relate to entities which were not registered as AOPs. In absence of uniformity in PAN registration category of similar class of assessee, in this case registered as Co-operative Society, the ITD would not be in position to derive meaningful information from data available with itself.

(Paragraph 4.1)

- Adequate examination of cases during scrutiny was not done. In 131 cases out of scrutiny assessment cases, where the criteria for selection was 'Large Deductions under chapter VIA of the Income Tax Act' that includes section 80P, the same was not adequately examined.

(Paragraph 4.1)

- Audit noticed instances of raising of demand in cases where returned income was equal to the assessed income at different stages of assessment viz. electronic processing of ITR, rectification, reassessment etc. Audit noticed several reasons for raising these demands such as, accounting of pre-paid taxes at processing of ITR stage, advance tax deposited under wrong head not considered as payment by CPC Bengaluru etc. Such cases point to the fact that claims, payments data are not reconciled at the time of assessment.

(Paragraph 4.12)

- Audit examined cases involving high value additions made during assessment and noticed instances where deduction claimed under section 80P(4) of the Act was disallowed on the pretext that the Co-operative Society was engaged in banking business. The existing activity codes do not differentiate the Co-operative Banks from Primary Agricultural Credit Societies (PACS). ITD should assign codes as per the nature of business or activity for effective monitoring.

(Paragraph 4.13)

#### **Audit's Recommendations:**

- *The CBDT may consider requesting the Central and State level registering bodies and regulatory authorities governing the Co-operative Societies and Co-operative Banks for instituting the seeding of PAN in their databases and facilitate a structured and institutional sharing of information. A process may be devised to track and monitor any change in the status of the assessee.*

(Paragraph 2.1.1)

- *Appropriate action as per provisions of the Act may be initiated against the non-filers/stop filers to detect the tax evasions. Survey may be utilised to identify Co-operative Societies/ Banks still outside tax net and bring them within the tax net.*

(Paragraph 2.2.1, 2.2.2)

- *The CBDT may ensure that the ITD checks for the actual status of the applicant vis-a-vis its name and activity carried out while allotting PAN to Co-operative Societies. In order to enable easy identification and monitoring of exemptions availed by the assessees, ITD may consider affixing fourth letter as 'A' to the PAN of Co-operative Society. It may also ensure that the change in status of assessees is adequately examined.*

(Paragraph 2.3, 3.1)

- *Evidential proof of a certificate of registration of Co-operative Societies/ Co-operative Banks by Registrar and details of members is essential for completion of assessments. ITD may issue necessary instructions to the Assessing Officers as well as strengthen the internal control mechanisms to ensure that provisions of the Act are being complied with.*

(Paragraph 2.6.1, 2.6.2, 2.6.3)

- *The CBDT may instruct Assessing Officers that the accounts of the Co-operative Societies/ Banks may be accepted by them only when their audit was found to have been conducted by empanelled auditors. Further, the instances of non-compliance to this regulatory requirement may be reported to the concerned regulatory authorities (ROCS, RBI etc.).*

*(Paragraph 2.6.1, 2.6.2, 2.6.3)*

- *The CBDT may inquire into the reasons for mismatch between data as per assessment records and as recorded in ITD systems with a view to eliminate weaknesses in the system. Necessary corrective action may be completed in a time bound manner.*

*(Paragraph 2.4)*

- *The CBDT may examine the action initiated in cases where incorrect ITR forms were filed by assessees in the Co-operative Sector and ensure that such returns are treated as invalid at ITR processing stage at CPC Bengaluru. Further, the claim of deductions allowed as Co-operative Societies/Co-operative Banks, if any, may be disallowed in such cases.*

*(Paragraph 2.5.2)*

- *The CBDT may consider devising a Standard Operating Procedure (SOP) for testing the principles of mutuality during scrutiny assessments of Co-operative Societies. It may also consider adopting a consistent approach for assessment of Co-operative Societies to address the practice of registering nominal and associate members with unequal rights as regular members, which defeat the principle of mutuality.*

*(Paragraph 3.2.3)*

- *The CBDT may devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies/ Banks to ensure allowance of claim to eligible assessees only.*

*(Paragraph 3.8)*

- *To ensure allowance of deduction to eligible assessees only, minimise possibility of ineligible claims and for effective monitoring of claims, the activity code and status code of assessee may be linked with the sub-sections of 80P and 36(1) of the Act under which deduction is claimed at the stage of filing of income tax return. The instances where deductions claimed by assessees engaged in ineligible activities was disallowed during assessment may be used used to identify activities, sector(s) and assessees to accord priority in selection for scrutiny in subsequent years. The same may also be reported to the concerned regulatory authorities (ROCS, RBI etc.).*

*(Paragraph 3.10)*

- *The actual claim of deduction made under section 36(1)(viiia) of the Act may be captured alongwith distinct figures/ details of deduction claimed on total income and rural advances in the relevant schedule of ITR forms for effective*

*monitoring, better MIS and assessment of impact of deduction as the actual claim is not getting captured in the existing format.*

*(Paragraph 3.11.2)*

- *Class of assessee and sections of the act under which the possibility of irregular allowance of claims were higher may be identified and monitored. ITD may devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance of deductions.*

*(Paragraph 3.1 to 3.7)*

- *The CBDT may examine the reasons for wide variations in the applicability of same law under similar conditions and issue directions, if required, to ensure consistency and uniformity in assessment of similar class of assessee engaged in similar activities in Co-operative sector. CBDT may also co-ordinate with regulatory bodies to align the assessment of such assessee in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies. The instances of ineligible assessee claiming deductions admissible to Co-operative Societies and engaged in commercial banking business noticed during assessment procedure may be reported to the regulatory authorities (RBI, ROCS etc.)*

*(Paragraph 3.9)*

- *The CBDT may issue SOP for assessment of claims made by sugar manufacturing Co-operative Societies under section 36(1)(xvii) to ensure that the allowance of deduction is in accordance with Government policies with respect to pricing of sugar at Central and State level.*

*(Paragraph 3.13)*

- *The CBDT may revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for errors and put in place a robust IT system and internal control mechanism to eliminate possibility of avoidable errors and to ensure compliance to provisions and conditions laid down under the Income Tax Act by the Assessing Officers. CBDT may like to introduce a quality assurance mechanism to ensure that errors in computations of tax are minimized.*

*(Paragraph 4.2 to 4.10)*

- *The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite there being clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity of irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular*

allowance.

(Paragraph 4.4)

- *The CBDT may ascertain whether the errors/ irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.*

(Paragraph 4.2 to 4.10)

- *The CBDT may ensure that the ITD should focus on reconciliation of claims, through CPC-Bengaluru, actively, to resolve the differences in claims and payments and evolve means to avoid possibilities of non-matching of the same.*

(Paragraph 4.12)

- *The CBDT may consider assigning/ updating codes as per the nature of business or activity ascertained during assessment for effective monitoring of the claims of deduction as per the nature of activities undertaken by Co-operative Societies and Co-operative Banks.*

(Paragraph 4.11)

- *ITR-5 may capture list of all Members of a Co-operative Society, along with their PAN, for the previous year relevant to the Assessment Year of filing of return. Quoting of PAN may be made mandatory for deposits received above a threshold amount by Co-operative Societies. Further, the CBDT may consider reporting instances involving significant quantum of unexplained cash credits to the regulatory authorities (RBI, ROCS etc.) to facilitate monitoring of probable financial irregularities.*

(Paragraph 4.9)

Department's response to audit observations and recommendations is discussed in the audit report along with further comments of Audit.

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