

CHAPTER 1

INTRODUCTION

Tax disputes: Process and impact

Goals of appeals

Why we chose the topic

Objectives of audit

Scope of audit

Acknowledgement

CHAPTER 1 Introduction

Tax disputes: Process and impact

1.1 There can be no levy of tax without the taxpayer being given the right to dispute it. The right to appeal is an indispensable part of the federal tax administration system.

1.2 It is universally accepted that litigation is not only costly and time consuming but also destructive of cooperative relationships between the tax department and the taxpayer. Large amounts of assessee's monies and departmental revenues get locked up in litigation for long periods. The dispute resolution process strains the departmental resources. The budgeting of receipts is also rendered awry when a substantial portion of the Government's projected revenues end up in appeal. Repeated references on issues to the judicial authorities make it difficult for the Department to firm up its practices which, in turn, affects assessments.

Avenues of dispute resolution for taxpayers in India

* **Appeals** by which the taxpayer can approach Commissioner of Income Tax (Appeals)-CIT (A).

* Before resorting to the Appellate mechanism, an assessee can apply¹ to the Commissioner for **revision of an order** within one year. Taxpayers do not find this avenue attractive since the next appeal lies with the High Court, thus excluding ITAT as an option.

* **Settlement Commission**² that allows errant taxpayers to make a clean breast of their affairs through a compromise settlement. But the Income Tax Act, 1961 (Act) does not prescribe time limits for disposal of cases by the Commission and our past studies³ showed that delays marred its effectiveness in reducing escalation of disputes.

* **Authority for Advance Rulings (AAR)**⁴ mainly for non-residents (and also specified categories of residents) on applications from taxpayers for rulings on impending taxable transactions. The rulings are binding on the taxpayer (and the Department) and the first appeal lies with High Court, which makes corporates shy away from AAR.

* A new section 144C⁵ introduced in the Act in 2009 seeks to set up a **Dispute Resolution Panel**. The assessing officer can approach the Panel for a draft order that will be issued to the taxpayer who can then present his case with the Panel. The final order will be binding on the Department although the taxpayer can appeal against the decision before the ITAT.

¹ Under section 264 of the Act

² Incorporated in Chapter XIX-A of the Income-tax Act

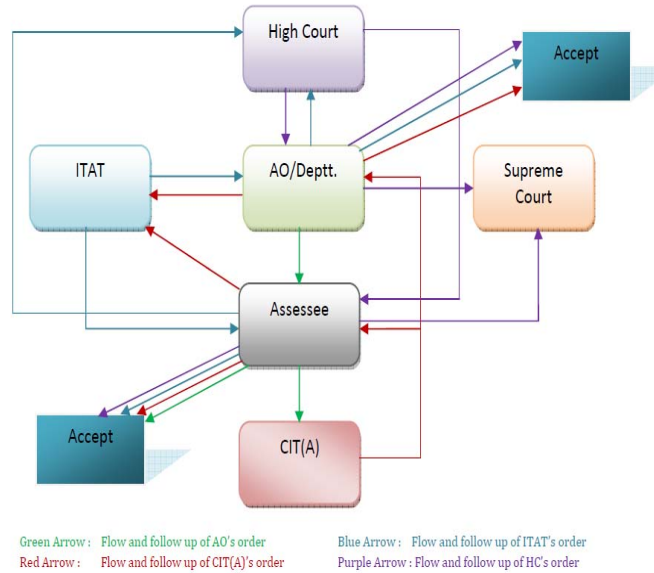
³ Report of the CAG on Union Government (Direct Taxes) No. 12A of 2001

⁴ AAR (Procedure) Rules, 1996 provide detailed procedure for obtaining advance rulings.

⁵ Inserted by the Finance (No. 2) Act, 2009, w.e.f. 1 April 2009. Income Tax (Dispute Resolution Panel) Rules, 2009 govern the panel.

1.3 Chapter XX of the Act confers the right on an aggrieved taxpayer to initiate the appellate mechanism from within the Income Tax Department (Department) i.e., Commissioner of Income Tax (Appeals)-CIT (A). Second appeal against the orders of CIT (A) lies to the Income Tax Appellate Tribunal (ITAT) which functions under the Ministry of Law. On any question of law arising out of an order of ITAT, a taxpayer may appeal progressively to the High Court (HC) and the Supreme Court (SC). Analogous right to appeal is also available to the Department against the orders of CIT (A) and onwards. The appellate level of HC was sought to be replaced by the National Tax Tribunal (NTT) through the National Tax Tribunal Act, 2005. Since NTTs are yet to be established, appeals against the ITAT order are still being instituted in the HC.

Chart 1.1: Flow and follow up of appeals at different levels



1.4 The system places the primary onus of implementing the appellate orders on the assessing officer (AO). The administrative Commissioners (CsIT) monitor their implementation by AOs under his charge. The decision on second appeal is taken with the approval of CsIT. The judicial wing under each CIT maintains records to monitor filing and pendency of appeal as well as of implementation of appellate orders.

1.5 The departmental judicial system in the country is divided into four geographical zones, each headed by the CIT (Judicial). CsIT (J) are required to highlight contradictory judicial pronouncements of HC that need harmonisation, for which they maintain a centralised database of cases that are referred to HC and above.

Goals of appeals

1.6 The appeals play a vital role in tax administration. But the Department has not enunciated the goals for appeals or laid down the performance indicators for its evaluation. We were constrained by the absence of identified benchmarks for evaluation. For the purpose of our study, we assumed that the goals of appeals would be to:

Ensure that the appeal process provides equitable and fair play to the taxpayers and at the same time rightful dues of the Department do not remain uncollected;

Harness the departmental resources optimally for timely and cost effective settlement of appeals;

Provide to the AOs a greater certainty with regard to the tax provisions and thus reduce inventory of disputes in the long run;

Enhance the assessee's satisfaction, which in turn would promote voluntary compliance and public confidence in the Department's integrity and efficiency.

We evaluated the performance of appeals on the above assumptions.

Why we chose the topic

1.7 The performance in the area of appeals is an important parameter to evaluate the Department on its functional efficiency. The impact of the disputes is substantial as would be evident⁶ from the following data for the period 2006-09:

48 per cent of the demands raised by AOs remains uncollected;

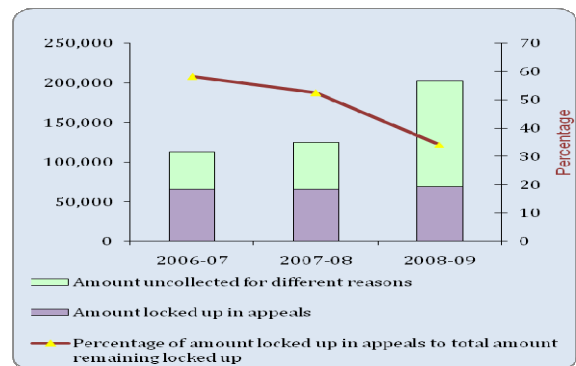
Disputes account for 45 per cent of the uncollected demands;

22 per cent of the demands raised in assessments are disputed by the taxpayers;

Incidence of appeals as a percentage of scrutiny assessments has reduced substantially from 46 per cent in 2006-07 to 17 per cent in 2008-09;

The total amount locked up in appeal at various levels is a staggering Rs. 2.2 lakh crore which is 87 per cent of the revenue deficit in 2008-09.

Chart 1.2: Percentage of amount locked up in appeals to total amount remaining locked up



This we felt, merited a performance evaluation. This is the first time we have attempted a holistic study of appeals. The topic was also suggested by the Central Board of Direct Taxes (Board) during our consultations on areas of concern in the Department.

⁶ The first three bullets are based on the demand and collection report (CAP -I) of Directorate of Income Tax (O & M S). The fourth & fifth bullets are based on the information provided by DGIT (L & R).

Objectives of audit

- 1.8** The objectives of our audit were to seek an assurance that:
- The Department has been able to contain the inventory of appeals to a manageable level through rationalising the workload of its officers at different levels enabling speedy resolution of disputes;
 - The provisions in the Act that lead to disputes are identified and the ambiguities are removed to reduce the incidence of disputes;
 - The decisions for escalation of disputes to higher levels of appellate hierarchy are based on a fair assessment of cost-benefit;
 - The appeals are filed by the Department within the prescribed timeframe to avoid dismissal due to limitation;
 - The appellate orders are implemented accurately and timely to avoid inconvenience to the taxpayer and avoidable payment of interest;

Scope of audit

1.9 The assessments which went in appeal or were decided at various appellate levels viz. CIT (A), ITAT, HC and SC during the years 2006-07 to 2008-09 were the subject of our study. We selected all HC and SC cases during these years in respect of each CIT charge.

1.10 We stood hampered in selection of appellate orders decided by CIT (A) and ITAT due to absence of a centralised database⁷ on appeals at the State level. We, therefore, had to examine individual assessment records for the selection, which considerably strained our audit plan. Cases involving tax effect below Rs. 5 lakh were excluded from sample selection. The details of the cases requisitioned and cases produced to audit are given in **Appendix I**.

1.11 Our work was hampered due to other constraints as well. Poor maintenance of records (commented in detail in chapter 5) especially those relating to appeal registers with AOs and in the judicial wings of the Department, is an area of concern. **Non-production of records by certain charges despite repeated requests was a serious constraint as well as a matter of concern. The Department produced only 5 per cent records in the case of Delhi, 49 per cent in case of Orissa, 46 per cent in case of Punjab and 52 per cent in case of Uttarakhand office.**

1.11.1 The Ministry assured (July 2010) during the exit conference that action would be taken against the concerned officers for non-production of records.

⁷ Database was available only in the Union Territory, Chandigarh and Punjab charges. In some charges indicative lists of cases were provided by the Department.

Acknowledgement

1.12 An entry conference was held on the 31 March 2009, with the Member (Audit & Judicial) and other senior officers of the Board, in which we explained to them the audit objectives, scope and methodology. Audit was conducted in the respective field formations of the Department.

1.13 The exit conference was held (July 2010) with the Ministry/Board wherein the report was discussed. The views expressed by the Ministry/Board in the exit conference have been suitably incorporated in this report. Replies received (July 2010) from the Ministry have also been suitably incorporated.