

CHAPTER 2



Incidence of refunds

Incidence of refunds as measured by 'refunds as a percentage of gross tax collections' showed a decreasing trend over the period indicating a positive shift towards streamlining of tax assessment. It was higher in respect of company cases as compared to non-company cases. However, the differential gap between the two categories (in terms of *per cent*) was reducing. We found that the tendency to pay excess advance tax especially among PSUs persisted in the department. This continuing trend points to a risk that assessing officers may resort to collection of excess advance tax to meet their targets and subsequently refund the excess. Despite automation, the pendency in processing of refund cases exhibited an increasing trend with a six months backlog from 2008-09. Our analysis showed that increase in interest outflows on refunds was mainly on account of delays in processing than due to increase in volume of refunds.

2.1 We made the following assumptions in the analysis of incidence of refunds:

- ❑ A taxpayer will ordinarily pay tax closest to what is due and would not like to pay more than due;
- ❑ In a refined tax administration, a taxpayer can calculate the tax due with greater accuracy because of either clarity in tax provisions or consistent application of provisions by assessing officers in past assessments;
- ❑ In an emerging economy as new types of businesses open, some amount of over-payment of tax leading to refunds is unavoidable.

Hence, reduction in the incidence of refunds as measured by refunds as a percentage of gross collections would indicate refinement in tax assessment.

2.2 Over the years 2005-09, quantum of refunds has increased by 30 *per cent*, but the incidence of refunds has come down (Table 2.1). Interest payments as a percentage of refund showed a fluctuating trend (Chart 2.1). Nearly one-eighth of the gross collections were refunded to the assesseees during this period, which is substantially lower than its share in pre-2000s when one-fourth of the gross collections were refunded. The decreasing trend is a pointer to the streamlining of tax assessment process.

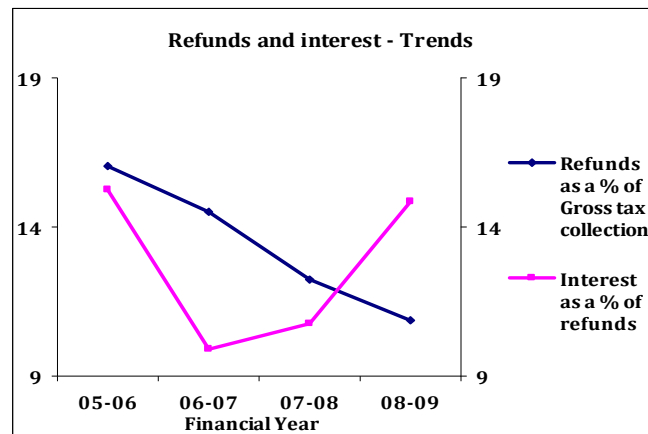


Chart 2.1: Incidence of refunds

2.3 Interest on refunds showed a progressive increase during 2006-09 at a pace that was higher than that of refunds (Table 2.1). In 2008-09, refunds registered a dip as compared to the previous year but interest payments rose by 32 *per cent*. This shows that increase in interest payments were mainly on account of delays in processing refunds than due to increase in volume of refunds.

Table 2. 1: Volume of refunds

Financial year	Gross tax collection	Refunds	(Rs. in '000 crore)	
			Interest on refunds	Net Tax Collection
2005-06	187	25.4	4.6	157
2006-07	257	33.3	3.7	220
2007-08	337	36.6	4.4	296
2008-09	359	33.2	5.8	320

Incidence of corporate refunds

2.4 There is a wide variation between refunds relating to corporate and non-corporate assessees. On an average, 14.9 *per cent* of gross collections were refunded to companies as compared to 9.0 *per cent* in non-company cases. This indicates a greater tendency among corporates to deposit higher tax. It was much higher in pre-2000s when 23.4 *per cent* of gross collections were refunded to companies and 10.5 *per cent* to assessees other than companies.

2.5 55th Report of the PAC had also noted the disturbing tendency, particularly among Public Sector Undertakings (PSUs), of making excess advance tax payments and thus being the highest claimants to refunds. The Ministry in its reply stated that to dissuade the claimants from doing so, the interest rate on refunds was reduced from 8 *per cent* to 6 *per cent* in 2003. We found that the tendency to pay excess advance tax persisted although to a lesser extent. There were 21 corporates in 6⁸ States, who paid excess advance tax of Rs. 436 crore, especially at the year end. Of this, Rs. 403 crore, representing 92 *per cent* of excess tax, was paid by 9 PSUs. Department⁹ replied that they have no control if assessees paid advance tax in excess of the amount due.

2.6 The PAC had directed the Department to study the trends in the payment of advance tax to identify the factors that gave rise to huge refunds as also the major claimants of refunds. We noted that refund amount higher than pre-determined levels is a parameter used in selection of cases for scrutiny assessment.

2.7 Excess payment of advance taxes also distorts the performance evaluation of assessing officers (AO) against the targets for tax collection. This trend is fraught with the risk of encouraging the AOs to collect excess advance tax to fulfill their targets which is subsequently refunded.

⁸ Jharkhand, Delhi, Madhya Pradesh, Punjab, Tamil Nadu and Uttar Pradesh

⁹ DCIT Range I Lucknow

Quarterly trends

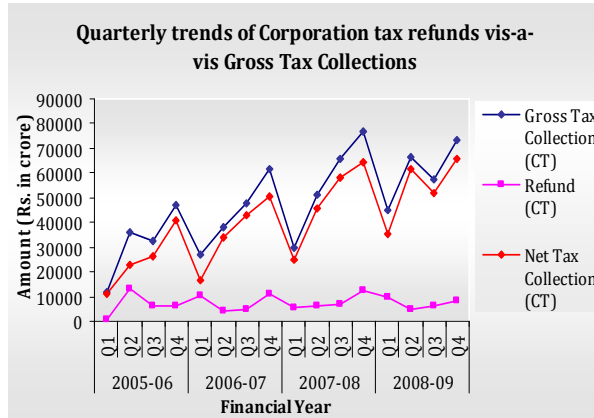


Chart 2.2: Quarterly trends

2.8 Chart 2.2 shows that collections pick up momentum in the second quarter of the year and peak in the fourth quarter; first quarter collections averaged around 1/7th of total collection. Similarly average refunds also peak in the fourth quarter, with the result that the net collections show a quantum jump in the second quarter to peak in the fourth quarter.

Pendency rate

2.9 Kelkar Committee concluded that the public inconvenience with regard to refunds was partly due to the Department's inability to promptly process the increasing number of returns and partly due to the cumbersome process of issuing of refunds, which was sought to be corrected through IT initiatives. However, IT efforts are yet to make a substantial impact on the Department's ability to process the refund claims (Graph 2.3). The pendency rate of refund claims (claims pending over total received) has shown an upward trend (Table 2.2) ranging 22.5 per cent to 37 per cent each year. The Department needs to identify the bottlenecks that are impeding its goals of reducing the pendency of claims.

Chart 2.3: Status of refund cases

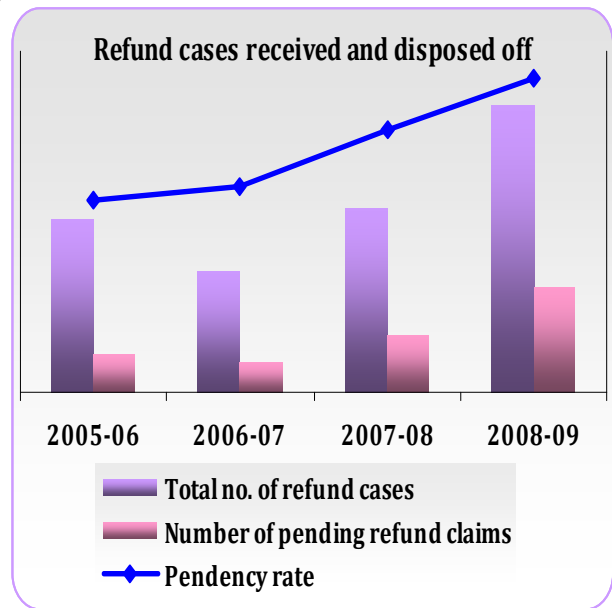


Table: 2.2 Refund cases received and processed

Year	Opening balance	No. received	Total	(in lakhs)		
				No. processed	No. pending	Pendency rate
2005-06	5.2	20.1	25.3	19.6	5.7	22.5
2006-07	5.7	12.3*	18.0	13.6	4.4	24.4
2007-08	4.4	22.8	27.2	18.8	8.4	30.9
2008-09	8.4	33.8	42.2	26.7	15.6 ¹⁰	37.0


* The figures provided by the department appear to be erroneous

¹⁰ This translates into a backlog of six months in the year 2008-09.


2.10 A BPR study conducted by the Department (2007) found that handling of multiple jobs by the AOs, mixing routine jobs with other specialized activities, was leading to high taxpayer grievances. An initiative to streamline the processing of returns was creation of the Central Processing Centre (CPC) at Bengaluru. The CPC would process all the e-filed returns in the country and paper returns filed in Karnataka and Goa summarily, thus separating this activity from the regular scrutiny assessments by the AOs. It will enable the Department to process the returns and issue refunds expeditiously and encourage more taxpayers to resort to electronic filing of returns.

2.11 Meanwhile, efforts for centralized processing in jurisdictional areas are yet to bear fruit. For instance, DT01 charge, Mumbai¹¹ could process (August 2009) only 111 cases of the 1.8 lakh refund returns received upto July 2008.

2.12 Recommendations

 *We recommend that the Ministry may conduct an analysis of high value refunds to identify pockets of high incidence.*

The Ministry stated (March 2010) during the exit conference that the generic causes could be identified. For instance, higher incidence of refunds in respect of PSUs could be on account of refund of tax deducted at source on payments received by loss making PSUs. A detailed analysis could throw up the specific causes.

 *Ministry may review the gaps in automation which are impeding the clearance of refund claims.*

The Ministry stated (March 2010) during the exit conference that they were not oblivious to the gaps but were hampered by resource constraints. Efforts are being made to overcome the problems in the existing AST software and replace it with a new software.

¹¹ Centralised processing centre Direct Tax 01 (DT01) under CIT 29 Mumbai, where all salary returns are being processed