

EXECUTIVE SUMMARY

Increase in tax collection	<p>In 2010-11 the collection of tax from AIT was 291.41 <i>per cent</i> of the budget estimate and 69.38 <i>per cent</i> higher than the collections of earlier year. While we acknowledge the healthy growth rate in revenue collection, we consider that the Department needs to streamline its budgeting process as significant variations between budget estimates and actual receipts were noticed persistently.</p>
Internal audit and outstanding assessments	<p>The internal audit of AIT was not conducted last year. Out of 9020 assessments outstanding, the Department had completed only 1970 assessments (21.84 <i>per cent</i>) leaving 7050 assessments as arrears.</p>
Very low recovery by the Department	<p>During the period 2006-07 to 2009-10 we pointed out inadmissible expenses, income escaping assessment, incorrect computation of income etc. with revenue impact of ₹ 42.53 crore in 199 paragraphs. Of these, the Department accepted audit observation in 74 cases involving ₹ 3.14 crore but recovered only ₹ 0.47 crore in 33 cases.</p>
Results of audit	<p>In 2010-11 we test checked 23 units relating to agricultural income tax and found underassessment of tax and other irregularities involving ₹ 17.07 crore in 59 cases.</p> <p>The Department accepted underassessment and other deficiencies of ₹ two lakh in four cases out of which one case involving ₹ 0.03 lakh was pointed out in audit during the year 2010-11.</p>
What we have highlighted in this Chapter	<p>In this Chapter we present illustrative cases of ₹ 7.54 crore selected from observations noticed during our test check of records relating to Agricultural Income Tax Office, where we found that the provisions of the Act/Rules were not observed.</p> <p>It is a matter of concern that similar omissions have been pointed out by us repeatedly in the Audit Reports for the past several years, but not only do the irregularities persist, these remain undetected till an audit is conducted.</p>
Our conclusion	<p>We recommend that internal audit may be operationalised immediately. Further, the Department needs to improve the internal control system so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future.</p> <p>It also needs to initiate immediate action to recover the inadmissible expenses, income escaping assessment, incorrect computation of income etc. pointed out by us, more so in those cases where it has accepted our contention.</p>

CHAPTER - III : TAXES ON AGRICULTURAL INCOME

3.1 Tax administration

The Department of Commercial Taxes is under the control of the Secretary to Government, Taxes at the Government level and collection of tax under the Kerala Agricultural Income Tax (KAIT) Act, 1991 is administered by the Commissioner of Commercial Taxes (CCT). The KAIT Act, 1991 governs the levy and collection of tax on agricultural income. The assessment, levy and collection are done by Inspecting Assistant Commissioners, Agricultural Income Tax and Commercial Tax Officers.

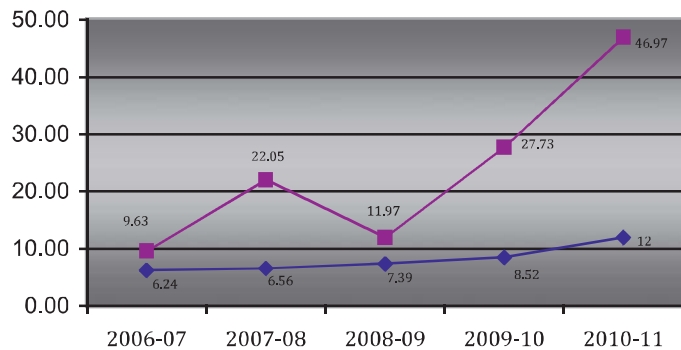
3.2 Trend of receipts

Actual receipts from agricultural income tax during the last five years (2006-07 to 2010-11) along with the budget estimates during the same period is exhibited in the following table and graph.

(₹ in crore)

Year	Budget estimates	Actual receipts	Variation	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts	Percentage of growth rate
2006-07	6.24	9.63	(+) 3.39	(+) 54.33	11,941.82	0.08	56.58
2007-08	6.56	22.05	(+) 15.49	(+) 236.13	13,668.95	0.16	128.97
2008-09	7.39	11.97	(+) 4.58	(+) 61.98	15,990.18	0.07	(-) 45.71
2009-10	8.52	27.73	(+) 19.21	(+) 225.47	17,625.02	0.16	131.67
2010-11	12.00	46.97	(+) 34.97	(+) 291.41	21,721.69	0.22	69.38

Budget estimates and actual receipts



We noticed that the Department was able to achieve a healthy growth rate of 69.38 per cent during 2010-11. We, however, feels that the Department needs to streamline their budgeting process to make the budget estimates realistic as significant variations were noticed persistently between budget estimates and actual receipts.

3.3 Arrears in AIT assessment

The Department furnished the position of arrears under agricultural income tax which is as shown below :

Opening balance	6,314
Addition during 2010-11 including remanded cases	2,706
Total	9,020
No. of assessments completed	1,970
Arrear cases – 1,913	
Current cases – 57	
Closing balance	7,050

The above table shows that the Department completed 1,970 assessments which was only 21.84 per cent of the cases due to be assessed.

3.4 Impact of audit

Revenue impact

During the last four years, we pointed out inadmissible expenses, income escaping assessment, incorrect computation of income, underassessment due to assignment of incorrect status etc., with revenue implication of ₹ 42.53 crore in 199 paragraphs. Of these, the Department/Government accepted audit observations involving ₹ 3.14 crore and had since recovered ₹ 0.47 crore. The details are shown in the following table:

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	No.	Amount	No.	Amount	No.	Amount
2006-07	50	4.61	29	1.72	8	0.24
2007-08	43	3.69	17	0.35	10	-
2008-09 Vol. I	67	28.66	9	0.12	4	0.11
2009-10	39	5.57	19	0.95	11	0.12
Total	199	42.53	74	3.14	33	0.47

The recovery of cases vis-a-vis the accepted paragraphs was almost negligible.

3.5 Working of internal audit wing

As internal audit was not conducted, we were unable to comment on the performance of the internal audit wing.

3.6 Results of audit

In 2010-11, we test checked the records of 23 units relating to agricultural income tax and noticed underassessment of tax and other irregularities involving ₹ 17.07 crore in 59 cases which fall under the following categories:

(₹ in crore)

Sl. No.	Categories	No. of cases	Amount
1.	Income escaping assessment	13	11.03
2.	Incorrect computation of income	03	0.15
3.	Incorrect computation of tax	08	0.16
4.	Inadmissible expenses	07	1.42
5.	Others	28	4.31
Total		59	17.07

During the course of the year, the Department accepted underassessment and other deficiencies of ₹ two lakh in four cases out of which one case involving ₹ 0.03 lakh was pointed out in audit during the year 2010-11. The Department realised an amount of ₹ 0.03 lakh in one case during the year 2010-11.

A few illustrative audit observations involving ₹ 7.54 crore are mentioned in the succeeding paragraphs.

3.7 Audit observations

We scrutinised the assessment records of agricultural income tax in the Commercial Taxes Department and found several cases of non-observance of the provisions of the Act/Rules, incorrect determination of income/interest, grant of inadmissible expenses/allowances and other cases as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and are based on a test check carried out in audit. Such omissions on the part of the Assessing Authorities (AAs) are pointed out by us each year but not only do the irregularities persist; these remain undetected till an audit is conducted. There is need for the Government to improve the internal control system including strengthening of the internal audit.

3.8 Non-observance of provisions of Act/Rules

The KAIT Act and Rules made thereunder provide for completing assessments observing the following aspects:

- i) levy of tax at the prescribed rate on the agricultural income derived by the assessee;*
- ii) allowance of deductions on income derived subject to certain conditions; and*
- iii) levy of interest on the balance tax payable.*

We observed that the AAs, while finalising the assessments, did not observe some of the provisions of the Act/Rules resulting in short levy of tax and interest of ₹ 7.54 crore as mentioned in the paragraphs 3.8.1. to 3.8.3.

3.8.1 Income escaped assessment

3.8.1.1 (IAC(AIT&CT), Mattancherry; October 2010).

Under the first proviso to Section 39(6) of the KAIT Act, 1991, in the case of assessment of agricultural income derived from manufactured tea, if the assessment under Income Tax Act 1961 is not completed when the agricultural income tax officer (AITO) proceeds to complete the assessment, he may provisionally accept agricultural income as per the return filed by him and revise such assessment in accordance with the order of the income tax authority. The limitation fixed under any of the provisions of the Act shall not apply for such revision, in respect of tea income.

We noticed that the assessment of a domestic company for the year 2001-02 was provisionally finalised (December 2003) accepting the loss of ₹ 6.13 crore from manufactured tea returned by the assessee. Even though the composite loss on manufactured tea was assessed at ₹ 54.03 lakh in the income tax assessment in February 2004, the AITO did not revise the assessment reckoning

the loss as ₹ 32.42 lakh (60 *per cent* of ₹ 54.03 lakh) in place of ₹ 6.13 crore computed in the AIT provisional assessment. The omission to revise the assessment resulted in excess carry forward of loss of ₹ 5.81 crore.

After we pointed out the case in October 2010 the assessing authority stated that even after revising the assessment, there would be loss and hence tax would not be payable for the assessment year. The reply is not tenable as the assessee was allowed to carry forward more loss than eligible and this was not allowable.

We pointed out the matter to the Department in November 2010 and to the Government in December 2010. We reminded the Government in September 2011. We have not received any further information from them (December 2011).

3.8.1.2 (AIT&CT, Kottayam; March 2011)

Section 5 of the KAIT Act enumerates the deductions allowable from the agricultural income. Further, expenditure on the upkeep and maintenance of immature plantations is not allowable deduction as per clause (p) of Section 5.

We noticed that while finalising the assessment (December 2009) of a public sector company for the assessment year 2007-08 in IAC Kottayam, the assessing officer allowed an amount of ₹ 1.53 crore being the cost of

the failed plantations. As the cost of raising failed plantations is a capital loss, this will not qualify for deduction under Section 5 of the KAIT Act. The irregular deductions resulted in escape of income of ₹ 1.53 crore with tax effect of ₹ 76.57 lakh.

After we pointed out the matter to the Department in March 2011 and reported to the Government in May 2011, the Government stated (August 2011) that the corporation is raising plantations solely for felling and sale of wood and income out of this sale was subjected to tax and hence cost of raising it ought to have been allowed for deduction. Further, failure of plantation is very common and 10 to 20 *per cent* plantations will perish when they attain maturity. It is clear from the reply that the plants had perished when plants were in the immature stage and in view of the provisions in the Act that expenditure incurred for the cultivation, upkeep or maintenance of immature plants from which no agricultural income is derived during the previous year shall not be allowed.

3.8.1.3 (AIT&CT, Kottayam; March 2011)

We noticed that while finalising the assessment (December 2009) of a public sector company for the assessment year 2007-08, an amount of ₹ 31.83 lakh being the amount of development of property (cost of raising tea, coffee and cashew plantation till the commercially yielding stage) written off was wrongly allowed as deduction under Section 5 of the KAIT Act. This resulted in escapement of income of ₹ 31.83 lakh with consequent tax effect of ₹ 15.92 lakh.

We pointed out the case to the Department in March 2011 and reported to the Government (May 2011). The assessing authority stated that the case would be examined.

3.8.1.4 (IAC, Kottayam; March 2011)

The KAIT Act stipulates that agricultural income means any income derived from land by sale by the cultivator or received by him in respect of which no process has been performed. The forest development tariff is the amount collected by the assessee at the rate of five *per cent* of the value of invoice raised during the year for timber and timber growth retained by them.

We noticed that while finalising the assessment for the year 2007-08 of a public limited company (December 2009) the assessing officer did not add forest development tariff of ₹ 36.16 lakh collected by the assessee as shown in the comments in the Profit and Loss account of the company

submitted alongwith the AIT return. This resulted in escapement of income of ₹ 36.16 lakh with resultant short levy of tax of ₹ 18.08 lakh.

After the case was pointed out to the Department in April 2011 and reported to Government in May 2011, the Government stated (August 2011) that forest development tariff would not form part of income as in the case of forest development tax. The reply is not correct since tax and development tariff are different.

3.8.1.5 (IAC(AIT&CT), Mattancherry; October 2010)

Income derived from sale of manufactured tea by a seller shall be computed as if it were liable to tax. The High Court of Kerala¹ had ruled that levy of tax under the AIT Act can relate only to sixty *per cent* of the income derived from sale of manufactured tea. Income from sale of green tea leaves is an agricultural income chargeable exclusively under agricultural income tax.

We noticed that in the case of a domestic company who had income from both manufactured tea and green tea leaf, the assessing authority finalised the assessment for the year 2007-08 in November 2009

assessing only sixty *per cent* of the income of ₹ 39.34 lakh derived from the sale of green tea leaves as returned by the company. The omission to assess the entire income of green tea leaves resulted in underassessment of income of ₹ 15.74 lakh leading to short levy of tax of ₹ 7.99 lakh.

After we pointed out the case (November 2010) the Department stated that the assessment completed was provisional which was subject to modification on completion of assessment by the income tax authorities and the assessee had sufficient loss carried forward from previous years which was sufficient to set off

¹ 184 ITR 561 Ker

the additional income pointed out. The reply of the assessing authority is not tenable as the assessment order is provisional only in respect of income relating to manufactured tea. Further, the contention that there is sufficient loss carried forward from previous years is no justification for assessing income incorrectly.

The case was reported to the Government in February 2011, their reply has not been received (December 2011).

3.8.1.6 (AIT & CT, Nedumkandam; February 2011)

Under the KAIT Act, agricultural income means an income derived from land by sale of agricultural produce. Agricultural income chargeable to tax shall be computed in accordance with the method of accounting regularly employed by the assessee. Cash system of book-keeping envisages accounting of actual cash receipts and cash payments as they occur.

We noticed that while finalising the assessment for the year 2009-10 of an assessee following cash system of accounting (September 2009) the assessing authority did not add an amount of ₹ 19.48 lakh realised from sundry debtors of the previous year by the assessee. This resulted in escapement of ₹ 19.48 lakh with

consequent tax effect of ₹ 5.84 lakh. The actual short levy after adjusting carried forward loss would come to ₹ 4.43 lakh.

We pointed out the case to the Department in February 2011 and to the Government in May 2011. The assessing authority stated that the case would be examined. Further report is awaited.

3.8.2 Irregular adjustment of loss

3.8.2.1 (IAC(AIT&CT), Mattancherry; October 2010).

Under the KAIT Act, the total agricultural income of the previous year of any person comprises of all agricultural income derived from land situated within or outside the State. Under Section 12 of the Act, where any person sustains a loss as a result of computation of agricultural income for any year, the loss shall be carried forward to the following year and set off against the agricultural income of that year and if it cannot be wholly set off, shall be carried forward to the following year and so on but no loss shall be carried forward for more than eight years.

We noticed that the assessing authority while finalising (November 2009) the assessment of a domestic company for the assessment year 2007-08, accepted adjustment of income of ₹ 49.47 lakh derived during the year against the loss of ₹ 16.70 crore carried forward from assessment year 1998-99 onwards. Adjusting loss relating to 1998-99 against the income earned in 2007-08 resulted in escapement of income of ₹ 49.47 lakh having potential tax effect of ₹ 24.73 lakh.

We pointed out the matter in October 2010. The assessing authority stated that the assessment completed was provisional and subject to revision on finalisation of Central Income Tax assessment and further, the assessee had sufficient carry forward loss from 1999-00. We consider that the reply of the assessing authority is not proper as the provisional assessment relates only to income from manufactured tea and assessment of income from other sources was final. Further, loss cannot be carried forward for more than eight years and the carried loss has a potential tax impact.

We pointed out the matter to Government in December 2010. We have reiterated our stand to the Department in September 2011.

3.8.2.2 (AIT & CT, Kottayam; March 2011)

We noticed that while finalising the assessment of a company for the assessment year 2005-06 in March 2010 the assessing authority fixed the net income at ₹ 46.66 lakh and recorded that this would be adjusted against the losses carried forward from the previous year. As per the assessment order for the year 2004-05, the balance of loss to be carried forward was ₹ 27.12 lakh only. Hence there was a taxable income of ₹ 19.54 lakh which was not assessed. This resulted in excess set off loss of ₹ 19.54 lakh with consequent tax effect of ₹ 9.77 lakh. Further while arriving the taxable income, the assessing authority had deducted ₹ 1.90 lakh being excess expenditure disallowed, which should have been added. This resulted in escapement of income of ₹ 3.81 lakh and consequent short levy of tax of ₹ 1.90 lakh. The total short levy works out to ₹ 11.67 lakh.

We pointed out the case to the Department in March 2011. The assessing authority stated that a reply would be furnished after examining the case. Further developments have not been reported (December 2011).

The case was reported to the Government in May 2011. Their reply has not been received. (December 2011).

3.8.3 Grant of inadmissible expenses

3.8.3.1 (IAC, Wayanad; December 2009)

The KAIT Act 1991 allows deduction of expenditure not being in the nature of capital expenditure or personal expenses of the assessee expended wholly and exclusively for the purpose of deriving the agricultural income. Repairs of residential building is not an expenditure incurred wholly and exclusively for the purpose of deriving agricultural income.

We noticed that while finalising the assessment of an assessee for the assessment years 2004-05 and 2005-06 in February 2007 and 2006-07 in October 2008 respectively, the assessing officer allowed expenses of ₹ 15.94 lakh incurred for the repairs of residential building. The incorrect allowance of expenditure resulted in excess carry forward of loss of ₹ 15.94 lakh having potential tax effect of ₹ 7.97 lakh.

We pointed out (December 2009) the case to the Department. The Department replied (August 2010) that the assessment orders have been revised by disallowing the expenses. We have not received any further information from them (December 2011).

The case was reported to the Government in May 2011. Their reply has not been received (December 2011).

3.8.3.2 (IAC, Kottayam; March 2011)

Section 5 of the KAIT Act provides that expenditure incurred during the relevant previous year for the production of agricultural income is an allowable expenditure.

We noticed that while finalising the assessment (December 2009) of a public limited company for the year 2007-08, the assessing officer allowed expenditure of ₹ 12.07 lakh being

expenditure incurred by the assessee towards repairs and maintenance and sale of tea and eucalyptus relating to the period prior to the relevant previous year 2006-07. This resulted in escapement of income of ₹ 12.07 lakh with consequent tax effect of ₹ 6.04 lakh.

After we pointed out the matter to the Department in March 2011 and reported to the Government in May 2011, the Government stated (August 2011) that certain income and expenditure related to the previous year are derived and incurred in the current year which was allowed as per the order of the AIT Tribunal. The remark of the Government is not correct as the AIT Tribunal order requires prior period income and expenditure to be assessed in accordance with law and the Act does not allow expenses incurred in a year to be adjusted against income in subsequent assessment years.