

CHAPTER 3

INTERNAL CONTROLS

- **Database of assessees and the Central Information Branch**
- **Selection for scrutiny**
- **Incorrect Certification by Chartered Accountants**
- **Recommendations**

CHAPTER 3

INTERNAL CONTROLS

- Department does not have proper database of the assessee engaged in the business of civil construction. Business codes appearing in the central AST database of taxpayers maintained by the DGIT (System) are often captured incorrectly.
- We could not identify non filers by cross linking the records of the Department as PAN details of the contractors registered with the works departments were not available.
- Information collected by the CIB from third party sources were not being collated and disseminated to users defeating the very purpose of the scheme.
- We noticed a number of cases which were not selected for compulsory scrutiny as per CBDT norms.
- We found that the Department was not initiating action against the erring statutory auditors for incorrect certification in their tax audit report.

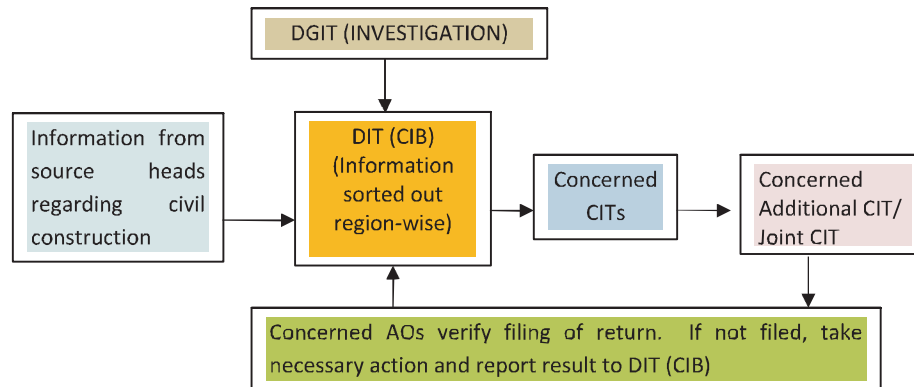
3.1 The primary role of tax administration is to ensure that all entities that are due to pay tax under extant legislation are adequately covered under the tax net, and assessee filing returns are offering correct income to tax. In a tax system which is increasingly reliant on voluntary compliance through self assessments, it is imperative for the Department to put in place proper control mechanisms to ensure collection of information on transactions made by the concerned entities from third party sources, and on organising and dissemination of this information to enable follow up action by concerned Assessing Officers (AOs). The Department should also ensure adequate controls on the scrutiny process for efficient and effective tax administration.

3.2 Database of assessee and the Central Information Branch

3.2.1 With a view to identifying potential taxpayers, the CBDT had made it mandatory for every person to quote PAN in all documents pertaining to sale or purchase of any immovable property valued at ₹ 5 lakh or more. As per CBDT instructions, the Central Information Branch (CIB) functioning under DGIT (Inv) would collect information from specified source heads in appropriate formats on a regular basis. Sec 285BA of the Act, effective from 1st April 2005 requires certain specified persons/entities to file an annual information report (AIR) on specified financial transactions with the Director General (CIB). For instance, information on immovable properties valued ₹ 30 lakh or more and registered on or after 1st April 2004 is to be furnished by the Registrar/Sub Registrar appointed under the Registration Act 1908, as per form 61A. Further, internal instructions of the Department

require collection of information relating to immovable property from the records of Urban Development Authority, Municipal Authorities, Panchayats etc in appropriate formats enabling comparison with data on returns. After collection of information, all the data for the whole year are sorted by the CIB address wise and range wise. The sorted CIB data is transmitted annually to the jurisdictional assessing officers to facilitate identification of non-filers and taking necessary action.

A flow chart depicting the process on information transfer is given below:



3.2.2 As per procedure, where information from source heads contains PAN, the sorted output is uploaded on the Income Tax Department (ITD) application and sent directly to the AO having jurisdiction over the PAN holder. When PAN information is unavailable, the transaction information is sorted as per address and sent to jurisdictional additional CIT/JCIT. The DIT(CIB) informed that the information collected under the relevant source code¹² from builders, contractors, housing cooperative societies was being uploaded on the Regional Computer Centre (RCC) server.

3.2.3 Adequacy of data

We found in audit that basic data on assessee engaged in civil construction was not available with the concerned CITs. To examine the validity and completeness of information on construction entities available with the Department, we obtained data on entities engaged in construction from the Works Departments, Municipal Corporations and Sub Registry Offices etc. We found that the registration particulars of the contractors/firms available with the agencies did not carry PAN details in most cases. The information, therefore, could not be cross linked with the records of the Department to identify non filers. Moreover, the Department could not match the names of the contractors vis-a-vis records available with them. The finding echoed a similar observation made by us in our earlier report of 2004 on the Sector.

¹² Code No. 018 & 019 in the Revised source codes

3.2.4 Dissemination of Information by the CIB

We also ascertained from various charges that the extent of dissemination of information available with CIB was low. We found in Delhi and Kolkata that data available with CIB was not being properly collated and information was being sent only on cases selected for scrutiny. Uploading of data on the system had been initiated only in February 2010. In Mumbai, the DIT (CIB) stated that substantial information¹³ relating to assessment years 2005-06 to 2008-09 collected/received by the DIT (CIB) Mumbai could not be disseminated to the assessment charges due to technical problems. This invariably resulted in non identification of non filers by the AOs defeating very purpose of the exercise.

3.2.5 Use of AIR data

Data from third party sources would have been useful in verifying declarations made by individual assesses. We found that for the data disseminated, no formal monitoring mechanism had been established to ascertain the extent of use of this data by the AOs.

3.2.6 Business codes in AST database

Section 44AB of the Income Tax Act¹⁴, 1961 requires every assessee engaged in business activities to furnish a statement of particulars in prescribed format (Form 3CD) which, inter alia, includes declaration on method of accounting, valuation of closing stock, amounts not credited to profit and loss account and nature of business as per specified codes. In case of construction entities separate codes (viz. 0401, 0402, 0403, 0501 etc) are prescribed as per classification of business as Builder, Property developer, Civil Contractor and Estate agent. Such information is obtained to facilitate sectoral analysis of assesseees.

3.2.6.1 Our analysis of the central AST database maintained by the DGIT (Systems) for the assessment years 2006-07 to 2009-10 revealed inaccuracies¹⁵ in the business codes and actual business of the assesseees. In Delhi, we found nine construction entities filing returns who were not figuring in the AST database at all. Further, we noticed assesseees engaged in businesses other than civil construction had filed income tax returns under codes meant for construction entities. A test check of records in Goa revealed that out of 4131 assesseees engaged in construction, business codes in 164 cases were not filled in correctly. We found that the correctness of codes mentioned by the assesseees in the 3CD Form was not being ascertained by the Department. The discrepancies in codes impeded sectoral analysis on tax and raised questions about the authenticity of the data.

¹³ 10.45 crore pieces of information was collected by/ received at CIB Mumbai between 2005-06 and 2008-09.

¹⁴ Part B of the Annexure I of Form 3CD

¹⁵ Appendix -1

3.3 Selection for scrutiny

The CBDT issues instructions every year which lay down the procedure for selection of assessments for compulsory scrutiny under various categories. As per the Board's norms for compulsory scrutiny and Computer Aided Selection for Scrutiny (CASS) norms, the returns of all the builders following project completion method are required to be selected for compulsory scrutiny. Besides, wherever an assessee claimed deduction under section 80 IA or 80IB of the Act for the first time or the deduction claimed by the assessee under Chapter VI A of the Act exceeded a threshold limit, the case has to be selected for scrutiny. Further, in case of corporate assessees, where turnover exceeded ₹ 2 crore, and net profits shown were below 5 percent the case had to be selected for scrutiny.

Out of the sample of summary assessments made available for scrutiny we noticed 58 cases which were not selected for compulsory scrutiny in deviation from prescribed norms. Out of these, 28 cases involved tax effect of ₹ 5.55 crore that went unnoticed. An illustration is given below:

3.3.1 Charge: CIT-IV, Kolkata, AY 2005-06

M/s SENBO Engineering Ltd¹⁶ was allowed a deduction of ₹ 6.76 crore under section 80IA. We noticed that in the previous year, i.e for the assessment year 2004-05, no deduction under section 80IA was allowed by the Department as the assessee was a works contractor. Although the status of the assessee remained unchanged in assessment year 2005-06, due to non-selection of the case for scrutiny, the assessee was allowed inadmissible deduction under Section 80IA having a revenue impact of ₹ 2.01 crore. The Department stated in reply that a notice under section 148 had already been issued to the assessee on 30 April 2010 for reopening the case.

3.4 Incorrect Certification by Chartered Accountants:

As per Rule 18 BBB of Income Tax Rules, 1962 deductions under Sections 80IA, 80IB and 80IC shall not be admissible unless the accounts for which the deduction claimed have been audited and audit report in the prescribed Form No.10 CCB duly signed and verified by a chartered accountant, along with the profit and loss account and balance sheet is enclosed with the return. Further, Section 142A(3) of the Act provides that the AO may require a Valuation officer to make an estimate of such value and report the same to him. On receipt of the same from the Valuation officer, AO may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment.

We found significant inconsistencies in expenses shown in accounts and deductions claimed as certified by chartered accountants as compared to valuations made by Departmental valuation Officers (DVO) when cases were referred to them. An illustration is given below:

¹⁶ The case was completed after summary in January 2007.

3.4.1 In Pune and Thane charges, 32 cases¹⁷ involving deduction claims of ₹ 24.55 crore under section 80IB(10) were referred by the concerned AOs to the DVOs. The DVOs found the claims of assesses to be inadmissible in 25 cases and were so treated by the AOs. In 15 of them, the claimants had exceeded the maximum area permissible for claiming deductions and the concerned statutory auditors had wrongly certified that the claims of deductions of ₹ 6.83 crore under section 80IB(10) were allowable. As the facts certified by the statutory auditors were found to be incorrect, the said auditors attracted action under the provisions of the Act. However, the Department had not initiated any action against the erring statutory auditors.

3.4.2 We also checked 84 other cases involving claims of ₹ 1023 crore which were admitted by the AOs without referring them to the DVOs. Given the propensity of incorrect certification by statutory auditors there was high probability of ineligible deduction claims being allowed.

3.5 Recommendations

We recommend that

- *The Department may devise proper controls to ensure that the data received by CIB is sorted and disseminated promptly, enabling effective scrutiny and widening of the tax net. Further, a feedback mechanism may be evolved to determine the extent of use of this data by the AOs while making assessments.*

(Para 3.2.4)

The CBDT stated (June 2011) that data uploading on the system has been initiated only in February 2010. There would be improvement in the system as it gains experience. The recommendation has been accepted.

- *In view of incorrect certification by statutory auditors of deduction claims of assesses engaged in civil construction, the Department may consider putting provision for sample verification of claims by Departmental Valuation Officers.*

(Para 3.4)

The CBDT stated (June 2011) that the AO has necessary powers to refer cases to the valuation cell during the course of assessment proceedings and therefore no further provision is required to be brought in the statute in this regard. As regards incorrect certification also necessary provisions are there for disciplinary action.

We are of the opinion that CBDT needs to ensure compliance with the existing rules/instructions.

¹⁷ Appendix 2