

CHAPTER 6

OMISSION IN ASSESSMENTS

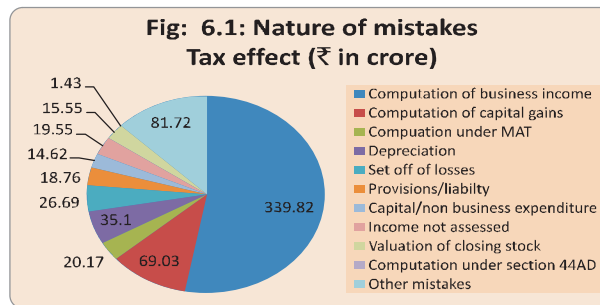
- **Mistakes in computation of business income**
- **Mistakes in computation of capital gains**
- **Mistakes in computation of income under MAT provision**
- **Mistakes in computation, set off and carry forward of depreciation**
- **Mistakes in carry forward and set off losses**
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CHAPTER 6

OMISSIONS IN ASSESSMENTS

We noticed mistakes relating to computation of business income, capital gain, income under MAT provisions, incorrect allowance of depreciation and set off of past losses, incorrect allowance of capital expenditure/non business expenditure and incorrect valuation of closing stock etc.

6.1 As the provisions of the Act were not followed correctly, we noticed 675 cases relating to mistakes with a tax effect of ₹ 642.44 crore. Categorywise details are depicted in pie chart and illustrations are given below:



6.2 Mistakes in computation of business income

We noticed 118 cases of mistakes in computation of business income involving tax effect of ₹ 339.82 crore. Five cases are illustrated below:

6.2.1 Charge: CIT-IV, Kolkata, AY 2007-08

M/s. Hindustan Steelworks Construction Ltd received a specific grant of ₹ 164.03 crore from Government of India in March 2007 for the purpose of payment of old income tax liability for the assessment year 2000-01. However, assessee did not include this specific grant as its income though it should have been treated as revenue receipt. Omission resulted in over assessment of loss by ₹ 71.82 crore and underassessment of income by ₹ 92.21 crore with revenue impact of ₹ 55.21 crore.

6.2.2 Charge: CIT-II Jaipur, AY 2005-06

In the assessments of **M/s Rajasthan Housing Board Corporation Ltd**, income of ₹ 60.50 crore on account of sale of plots was not included in total income. Instead the expenditure on cost of land, cost of construction etc were debited to expenditure on properties (works) and amount received out of sale of residential houses, shop and plots was reduced there from. The remaining balances have been shown in balance sheet. Thus revenue receipt of ₹ 60.50 crore was not accounted for in revenue account involving tax effect of ₹ 24.85 crore.

6.2.3 Charge: CIT-I Delhi, AY 2007-08

M/s Anant Raj Industries Ltd.²³ engaged in the business of Sale/Purchase of Land, Building and Structures etc had forfeited the Earnest Deposit/Advance Money received from the sale of roof rights of the building and shown under the head 'Sale of Investment' in the Profit and Loss account and the same was reduced from the computation of income. We observed that the money/benefit arisen to the assessee pertained to trading/business activity and therefore, it was a trading receipt and should have been taxed accordingly. The mistake resulted in under assessment of income of ₹ 45 crore, involving short levy of tax of ₹ 20.14 crore including interest.

6.2.4 Charge: CIT-IV Delhi, AYS 2005-06 and 2007-08

Expenditure in the nature of capital is disallowable under section 37 of the Act. Further, Section 32 of the Act provides for depreciation on technical knowhow being an intangible asset.

We noticed that in the AY 2005-06, **M/s Ircon International Ltd.**²⁴ debited ₹ 8.27 crore to profit and loss account as technical know-how which being capital in nature (intangible asset) should have been disallowed (after

allowing depreciation @ 25 per cent). The mistake resulted in underassessment of income of ₹ 6.20 crore. Further, amounts of ₹ 16 crore and ₹ 11.17 crore shown on account of Foreign Projects Reserve were not utilised by the assessee and in the AY 2007-08, interest of ₹ 1.91 crore under section 234D was not charged by the Department on refund amount. These mistakes involved aggregate tax effect of ₹ 17.71 crore including interest.

6.2.5 Charge: CIT-I Patna, AY 2005-06

M/s Aparna Housing Construction Pvt. Ltd, invested ₹ 75 lakh on account of purchase of land which was not included in determining the income. Further, the closing stock of goods in transit (vehicle & spares) amounting to ₹ 1.60 crore shown in balance sheet under the head inventories was not shown in P&L account. Both mistakes resulted in short levy of tax of ₹ 1.15 crore.

6.3 Mistakes in computation of capital gains

As per section 2(47)(ii) and (v) of the Act, transfer, in relation to a capital asset includes the extinguishment of any rights therein, or any transaction allowing possession of any immovable property to be taken or retained by any other person in part performance of a contract, of the nature referred to in Section 53A of the Transfer of Property Act, would attract Capital Gains.

We noticed 30 cases involving tax effect of ₹ 69.03 crore where capital gain was not offered to tax. Two Illustrations are given below:

²³ Scrutiny assessment was completed in December 2009 determining income of Rs.92.02 crore.

²⁴ Scrutiny assessments were completed in December 2007 & 2009 respectively.

6.3.1 Charge: CIT-III Chennai, AY 2006-07

Shri Sheriff Dyan & Sherdan Games Parks and Holidays Pvt. Ltd received built up area worth ₹ 40.30 crore and ₹ 30.65 crore respectively in lieu of the land transferred. No capital gain was offered on the above transactions involving tax effect of ₹ 23.91 crore.

6.3.2 Charge: CIT-II Coimbatore, AYs 2006-07 & 2007-08

M/s Prime Textiles²⁵ allowed possession and take over of immovable property to M/s Prime Developers, a Partnership Firm, for a consideration involving capital gain of ₹ 32.86 crore. However, no tax on capital gain was offered which had a revenue impact of ₹ 10.83 crore.

6.4 Mistakes in Computation of Income under MAT provision

Section 115 JB provides for levy of MAT at the rate of 7.5 per cent of the book profit if the tax payable on total income under the normal provisions is less than 7.5 per cent of the book profit arrived at after certain additions and deletions as prescribed.

We found incorrect /non application of MAT provisions in 10 cases involving tax effect of ₹ 20.17 crore. An illustration is given below:

6.4.1 Charge: CIT-X, Mumbai, AY 2007-08

Department did not consider revised return filed by the **M/s Shivshahi Punarvasan Prakash Ltd** while computing the income under MAT provision of the Act which resulted in underassessment of income by ₹ 13.68 crore involving non levy of tax of ₹ 1.54 crore.

Department has accepted the objection (March 2010).

6.5 Mistakes in computation, set off and carry forward of depreciation

Section 32 provides for depreciation on the cost or written down value of assets if such assets are owned by the assessee and used for the purpose of business during relevant previous year.

We noticed 69 cases in which mistakes were committed in allowance of depreciation/set off of and carry forward of losses involving revenue impact of ₹ 35.10 crore. An illustration is given below:

²⁵ Assessment was completed after scrutiny (December 2008).

6.5.1 Charge: CIT, Central, Hyderabad, AYs 2006-07 & 2007-08

M/s Madhucon Projects (P) Limited was allowed depreciation on vehicles @ 25 percent instead of allowable rate of 15 percent which resulted in excess claim of ₹ 1.86 crore in AY 2006-07. Further, due to incorrect adoption of WDV, depreciation was allowed in excess of ₹ 19.24 crore in AY 2007-08. This resulted in under assessment of income of ₹ 21.10 crore involving aggregate tax effect of ₹ 9.38 crore.

6.6 Mistakes in carry forward and set off of losses

Section 43A provides for deduction of loss on account of fluctuation in the rate of exchange of foreign currency, provided that the loss arrived at is backed by actual remittance.

We noticed 13 cases involving tax effect of ₹ 26.69 crore due to mistakes in carry forward and set off of losses. An illustration is given below:

6.6.1 Charge: CIT- V, Delhi, AY 2007-08

M/s National Building Construction Corporation Ltd debited to its profit and loss accounts foreign exchange fluctuation loss of ₹ 42.35 crore. The AO allowed the loss although it was not backed by actual remittance. This resulted in short levy of tax of ₹ 18.66 crore.

6.7 Incorrect allowance of provision/liability

Section 43B of the Act provides for certain deductions against the payments (i.e. tax, duty, cess, bonus, leave-encashment etc.) in the year in which the payments are actually made by the assessee. Further, the Act does not provide for deduction against any provision made in the accounts though fixed liabilities are allowed as deduction.

We noticed 37 cases involving short levy of ₹ 18.76 crore having mistakes in allowance of provision/liability. One case is illustrated below:

6.7.1 Charge: CIT -I, Lucknow, AY 2006-07,

M/s Jai Prakash Enterprises debited ₹ 36.28 crore towards employee's remuneration and benefits in profit and loss account. In the balance sheet an amount of ₹ 2.89 crore towards provision for gratuity and ₹ 1.50 crore towards leave encashment was shown under the head "provisions", which was not incurred during the year as mentioned in Auditor's Report. Further, ₹ 1.38 crore towards bonus and ₹ 1.37 crore towards incentive was not paid up to the date of filing the return. Thus allowance of inadmissible expenses of ₹ 6.84 crore resulted in short levy of ₹ 3.06 crore.

6.8 Incorrect allowance of Capital/non business expenditure

Section 37(1) of the Act provides that any expenditure not being expenditure of the nature prescribed in section 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the head "profits and gains of business or profession.

We noticed 18 cases involving tax effect of ₹ 14.62 crore of mistakes in allowance of capital/ non business expenditure. One case is illustrated below:

6.8.1. Charge: CIT- X, Mumbai, AYs 2005-6 & 2007-08

M/s Shivshahi Punarvasan Prkalp Ltd claimed and was allowed deduction of ₹ 18.50 crore and ₹ 8.52 crore during AY 2005-06 and 2007-08 respectively on account of 'Interest on a Project' under 'One time settlement scheme (OTS)'. As these expenditures were related to work in progress of a specific project, the same were required to be capitalised. Omission to disallow capital expenditures resulted in underassessment of income by ₹ 27.02 crore in respective years involving short levy of tax of ₹ 9.66 crore.

6.9 Income not assessed

Section 5 of the Act provides that if the assessee follows the mercantile system of accounting, the income received, accrued or is deemed to accrue or arise to the assessee in any previous year is to be included in the income of the assessee in such year.

We found 72 cases involving tax effect of ₹ 19.55 crore where income was not offered to tax. An illustration is given below:

6.9.1 Charge: CIT-I, Lucknow, AY 2006-07

M/s Uttar Pradesh Rajkiya Nirman Nigam followed mercantile system of accounting and had shown in the balance sheet under current assets ₹ 3.08 crore on account of income accrued but not received. The same was required to be included in the total income of the assessee. Further, an amount of ₹ 53.75 lakh was debited to profit and loss account towards leave encashment and again reduced ₹ 5.45 crore towards leave encashment at the time of computation. The mistake resulted in under assessment of income of ₹ 8.53 crore involving short levy of tax of ₹ 3.82 crore.

The Department (November 2010) accepted the observation partly.

6.10 Valuation of work-in-progress

Section 145 A prescribes that the valuation of inventory for the purpose of determining the income chargeable under the head "Profits and gains of business or profession" shall be in accordance with the method of accounting regularly employed by the assessee. The closing stock exhibited in the Profit and Loss Account include value of work- in- progress, besides value of raw materials, finished products etc.

We noticed 77 cases involving tax effect of ₹ 15.55 crore where value of work in progress/closing stock was not adopted correctly. An illustration is given below:

6.10.1 Charge: CIT- 1, Lucknow, AY 2007-08

M/s Bhola Singh Jai Prakash Construction Ltd had shown value of ₹ 10.83 lakh in profit and loss account as against ₹ 6.62 crore in balance sheet. Besides, closing stock of work in progress was taken at ₹ 10.83 lakh as against actual amount of ₹ 14.83 lakh as stated by the Auditor in its report. Thus, short accountal of inventories and work in progress resulted in short computation of income of ₹ 6.56 crore involving short levy of tax of ₹ 2.74 crore.

6.11 Conditions for computation of income under section 44AD

As per Section 44AD, an assessee whose gross receipts from business of civil construction does not exceed ₹ 40 lakh, income is to be adopted at 8 percent of the gross receipts paid or payable to an assessee. If the gross contract receipt of an assessee exceeds ₹ 40 lakh, the assessee is required to get his accounts audited and furnish an audit report in the prescribed form under section 44AB of the Income Tax Act.

We noticed 29 cases involving tax effect of ₹ 1.43 crore where the said provision was not complied with. One illustration is given below:

6.11.1 Charge: CIT-I, Bangalore, AYs 2004-05 & 2005-06

The assessments of a firm, **M/s. Mahima Developers**, were completed under summary in August 2006 determining income on estimate basis at 8 percent of gross receipt. We observed from the receipt/payment statement attached with the return that the firm received gross contract receipt of ₹ 3.94 crore and ₹ 3.23 crore but neither maintained and kept accounts as required under section 44AA nor got the accounts audited as required under section 44AB. The Department, however, accepted the return without audited accounts irregularly as the provision of section 44AD declaring 8 percent income on estimate basis applies where the gross receipt does not exceed ₹ 40 lakh.

Department accepted the observation stating that the penalty under section 271A would be levied.

6.12 Other cases

6.12.1 We also noticed various types of mistakes such as incorrect adoption of figures, short /non levy of interest, mistake in estimation of gross receipts, incorrect allowance of deduction against house property & over assessment of income etc in 203 cases involving tax effect of ₹ 81.72 crore.

6.13 Recommendations

We recommend that

- *The CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with. Wherever it is felt necessary the Department may also explore the possibility of capacity building for reducing the incidence of mistakes.*

(Para nos. 6.1 to 6.12)

CBDT accepted (June 2011) the occurrence of omissions/mistakes in assessments. They stated that implementation of their Central Action Plan for the year 2011-12 and monitoring by supervisory officers would improve the quality of assessments.

New Delhi
Dated



(MEENAKSHI GUPTA)
Director General (Direct Taxes)

Countersigned

New Delhi
Dated



(VINOD RAI)
Comptroller and Auditor General of India