

CHAPTER 1

Introduction

1.1 Direct tax collections constitute a dominant component of revenue receipts of the Union Government. In 2009-10, Direct Taxes collection of ₹ 4.35 lakh crore¹ accounted for 75.97 per cent of revenue receipts of Union Government and 6.9 per cent of GDP at market prices. The effectiveness of the functioning of the Revenue Department can be measured with reference to the tax collection, assessment, raising of demand and arrears thereof. The collection of tax demand is a critical responsibility of the Income Tax Department (Department). The tax collection is at two stages namely pre-assessment i.e. Tax Deduction at Source, Payment of Advance Tax, Payment of Self Assessment Tax and post assessment which is based on completion of assessment by the Assessing Officer.

1.2 In 2009-10, the pre-assessment collection was ₹ 3.52 lakh crore and the post assessment collection was ₹ 0.73 lakh crore. As compared to the post assessment collections, the total demand pending collection as on 31 March 2010 was ₹ 2.29 lakh crore. The tax recovery process is an important function of the Department. Accordingly, it has instituted a specialized mechanism for tax recovery by allocating one Tax Recovery Officer exclusively for each range. Several provisions are provided in the Income Tax Act (Act) and instructions have also been issued by the Board from time to time regarding reduction of arrears of tax demand. Despite this, the arrears have gone up manifold. This is a matter of great concern.

Why we chose the topic

1.3 We had conducted a performance evaluation of arrears of direct tax in 2001-02. Our major findings highlighted that an amount of ₹ 39,632 crore was outstanding as arrears of tax demand in 3993 cases that were made available to audit. The main reasons for huge build-up of arrears were filing of appeals by taxpayers and stay granted by Appellate Authorities, issue of refunds despite there being outstanding demand, inaction/delay on the part of the Department to follow up the recovery proceedings and lack of co-ordination between AOs and TROs.

1.4 Since then, the arrears of tax demand² have risen from ₹ 92,082 crore in 2005-06 to ₹ 2,29,032 crore in the year 2009-10.

¹ As per the Central Action Plan-1(CAP-1) statement of CBDT, the gross collection of Direct taxes of ₹ 4,35,164 crore consists of collections of ₹ 2,88,162 crore on account of Corporation tax, ₹ 1,36,551 crore on account of Income tax and ₹ 10,451 crore on account of other Direct taxes. The Pre-assessment and post assessment collection figures are in respect of Corporation tax and Income tax.

² The total tax demand pending comprised of demand of earlier years' pending collection and current year's demand pending collection. In 2005-06 the total demand pending of ₹ 92,082 crore consisted of earlier years' demand of ₹ 77,216 crore and current year's demand of ₹ 14,866 crore whereas in 2009-10 the total demand pending of ₹ 2,29,032 crore consisted of earlier years' demand of ₹ 1,81,612 crore and current year's demand of ₹ 47,420 crore.

1.5 The current review was undertaken to evaluate the reasons for huge build-up of income tax arrears and the measures being taken by the Department to liquidate arrears.

Objectives of the review

1.6 The objective of our audit was to seek an assurance that the Department:

- has an effective internal control mechanism, monitoring system and adequate manpower to ensure that its guidelines regarding collection and recovery of arrears of tax demand are adhered to.
- has taken all possible action provided in the Act for expeditious recovery of arrears of tax demand.
- has complied with the instructions given by the Central Board of Direct Taxes (Board) from time to time to reduce the arrears of tax demand.
- is effectively pursuing the recovery of installments granted to the assessee for payment of the tax demand.
- is diligently pursuing the disposal of appeals by the Appellate Authorities.

Legal Provisions

1.7 Chapter XVII-D consisting of Sections 220 to 232 and Schedule II of the Income Tax Act, 1961 relate to collection and recovery of tax. The major provisions are detailed below:

Sections	Provisions
220(1)	An assessee is required to pay the demand within 30 days pursuant to the service of demand notice or the time limit as specified by the AO.
220(2), 221(1)	Levy of interest and penalty in case of delayed payments.
222(1)	Special powers for initiating coercive measures to effect recovery of arrears are provided to TROs.
226(2), 226(3), 226(4), 226(5)	The AOs and TROs can effect recovery with the help of enforcement measures such as deduction from salary by the employer, payment by person indebted to defaulter, payment by money in Court's custody and by distraint (seizure of goods) or sale of movable property respectively.
179	Recovery of arrears of tax in case of private company may be effected from Director of the company during the year who shall be jointly and severally liable for payment of such tax.
188A	Partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant.
189(3)	Every person who was at the time of dissolution or discontinuance of business, a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm.
133A	The survey mechanism also may be used for recovery of tax demand.

Scope and methodology of audit

1.8 The arrear demand in respect of assessments completed during the financial years 2007-08 to 2010-11 (up to November 2010) but pending recovery up to the date of audit was the subject of our study.

1.9 Two tier sampling was employed while conducting the review. At level-1, the assessment units were selected using stratified random sampling. At level-2, selection of records to be analyzed for identification of cases was made using stratified random sampling. Details are provided in Appendix-1.

1.10 In 1,550 selected TROs and assessment units 66,350 cases of arrear demand were selected. Out of this, 60,324 cases representing 90.92 *per cent* were produced to audit. Details are provided in Appendix-2.

1.11 The focus of the audit was on follow up and collection of arrear demand. The arrear demand cases were identified from the records and data maintained by the Department. Records were requisitioned from the Assessing Officers and the Tax Recovery Officers and examined to assess the reasons for pendency and follow up action taken for reduction of arrear demand.

Acknowledgement

1.12 The Indian Audit and Accounts Department acknowledges the cooperation of the Income Tax Department in providing the necessary records and information for audit.

1.13 An entry conference was held with CBDT in January 2011. The audit objectives, scope of audit and the main areas of audit examination were explained in the meeting.

1.14 The exit conference was held with the CBDT in November 2011 to discuss the findings and recommendations included in this report.