

Executive Summary

Direct tax collections, amounting to ₹ 4.35 lakh crore accounted for three-fourth of revenue receipts of the Government of India in 2009-10. At the same time the uncollected portion of tax demand was ₹ 2.29 lakh crore in March 2010 equivalent to 54 *per cent* of total direct tax collections. The arrears of demand also registered a steep hike in last five years.

This 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. The main objectives of our audit were to seek an assurance that the Department: has an effective internal control mechanism and monitoring system and has made all efforts provided in the Act for expeditious recovery of arrears of tax demand; has complied with the instructions issued by the Central Board of Direct Taxes from time to time; is diligently pursuing the disposal of appeals by Appellate Authorities; is liaising with the Settlement Commission for early disposal of cases involving high tax demand.

We employed two tier sampling for selection of assessment units and tax recovery wards and for identification of cases within those units. We also analyzed high value arrear demand cases of ₹ 10 crore and above available with the Directorate of Income Tax (Recovery).

An overview of our audit findings and key recommendations included in this Report is given below:

Inventory of Arrears (Chapter 2)

Data being maintained by different wings of the Income Tax Department (Department) are widely divergent. The controls are scattered to that extent as different sets of data are being monitored within the different functional wings of the Department.

We analyzed 1369 high value cases involving arrear demand of ₹ 1,96,092.07 crore for the quarter ending September 2010. Individuals/ HUF accounted for 60 *per cent* of the demand while the companies accounted for another 34 *per cent*. The demand against individuals is highly skewed with just 12 individuals accounting for 90 *per cent* of the outstanding demand. Further, 84.3 *per cent* of the arrear demand amounting to ₹ 1,65,337.42 crore is categorized as unrealizable demand by the Department. Age wise analysis revealed that 31 per cent of the demand was between 2 to 5 years old and 23 per cent was more than five years old. Analysis of the demand locked in appeals at various stages revealed that most of the cases were pending in appeal with the departmental appellate authorities. The demand pending before CIT (Appeals) accounted for 91.91 *per cent* and 70.73 *per cent* of total demand locked up in appeals in 2008-09 and 2009-10 respectively.

Key Audit Recommendations

We recommend that

- ❖ *The Department may ensure preparation of a robust and reliable data base of arrear demand by reconciling the data maintained by different wings of the Department, towards effective monitoring and follow up of arrears*

Tax Recovery Mechanism and Internal Controls (Chapter 3)

Despite the Tax Recovery Officer being the most important functionary involved in monitoring and recovery of arrear demand, the Department is not maintaining a centralized database of the sanctioned strength vis-à-vis deployment of Tax Recovery Officers. Thus vacancy position in this important cadre is not being monitored exclusively and is being done as part of the overall cadre of Income Tax Officers.

Tax Recovery Mechanism involves intimation of arrears by Assessing Officer to TRO, drawal of Tax Recovery Certificates (TRC) and finally disposal of TRCs. The flow of information from Assessing Officers to the TROs is far from satisfactory. We noticed 1,54,198 cases involving outstanding demand of ₹ 4,543.83 crore where the demand was not transferred to the TROs inspite of non-recovery for more than one year. There was difference in figures of arrear demand in the books of AOs versus TROs due to lack of co-ordination between them. In 338 cases involving demand of ₹ 11.86 crore the AOs did not provide information sought by the TROs. The Tax Recovery Registers of the TROs did not provide an assurance that Tax Recovery Certificates (TRCs) had been drawn up in all the cases. The annual disposal of recovery certificates by the TROs is far below the annual norm of disposal of 1200 certificates fixed by the Board. There were 1,17,403 TRCs involving arrear demand of ₹ 1,57,053.72 crore pending for disposal in November 2010.

Departmental mechanism to monitor the progress of assessment work and collection through Demand and Collection Register (D&CR) and Arrear Demand and Collection Register (ADCR) maintained at the level of AOs was weak. Dossier Reports had not been prepared in 5,167 cases. Cases are not being properly transferred to the ADCRs. Such omissions result in weakening of internal control mechanism and may lead to non-recovery of arrears. We found that in several TRO units the registers prescribed for facilitating monitoring and control over the tax arrears and their disposal were not being maintained at all. In spite of specific provisions for internal audit, TROs escaped internal audit.

Key Audit Recommendations

We recommend that

- ❖ *A reasonable time may be made mandatory for the drawal of Recovery Certificates by the TROs.*

- ❖ *The target for drawing up of Recovery Certificates by the TROs may be revisited and an appropriate norm may be fixed on the basis of the actual work load in different charges instead of the existing norm of 1200 certificates to be disposed annually.*
- ❖ *Ministry may consider working out appropriate modalities for liaison between AOs and TROs under supervision of the higher authorities to ensure better co-ordination and speedy disposal of cases.*
- ❖ *Ministry may consider strengthening Internal Audit of the post assessment collection process to effectively monitor the recovery of tax arrears by prescribing minimum number of TROs to be covered by Internal Audit every year.*

Issues leading to arrears (Chapter 4)

The inventory of demand is piling up as a result of compromise with the established procedures and controls. We found that the increase in arrears was mainly due to reasons such as inaction and protracted delays on part of the AOs in referring the arrear cases to the TROs, lack of co-ordination between the AOs and TROs subsequent to the referral, lack of adequate efforts to collect the demand, failure to recover undisputed demand, failure to invoke special powers for recovery by TROs and disputed cases pending in appeals. Despite the Department having an all encompassing computerised package in the form of 'ITD systems', the data contained therein is not being reconciled to ensure reliability. Adequate efforts are not being made to trace the defaulting assessees. Analysis of high value demand cases revealed that the irrecoverability of demand was caused by delay in liquidation/ insolvency proceedings, no assets for recovery, assessee not being traceable, demand covered by stay etc.

Key Audit Recommendations

We recommend that

- ❖ *The Department may ensure correct and timely credit of TDS/TCS to the assessee by introducing reconciliation with concerned agencies to avoid mismatches resulting in creation of wrong demand.*
- ❖ *As mentioned in our Study on the Appeals Process, reasons for low disposal of appeals by CsIT(A) need to be analysed. Wherever pendency is due to lower efficiency, strict administrative measures may need to be taken.*
- ❖ *Department needs to effectively pursue the cases locked up in litigation at the ITAT and higher formations.*

Follow up and disposal of arrears (Chapter 5)

Follow up and disposal of cases in arrears is less than the prescribed targets. Majority of the cases were disposed off while giving effect to Appellate orders. The Tax Recovery Officers sparingly exercised the special powers towards recovery of the demand. Refunds were issued

without adjusting the demand. Despite provisions such as issue of notice under section 220(1), granting extended time period for payment of arrears to the assessee under section 225(1), attachment of the bank accounts of the assessee under section 226(3), attachment and sale of movable and immovable property under section 222(1), adjustment of refund arising in subsequent years against arrear demand and levy of penalty under section 221, it was seen that there were lapses in collection of undisputed amount.

Key Audit Recommendations

We recommend that:

- ❖ *The provisions of adjustments of arrear demand while granting refunds should strictly be followed. The system may provide for fixing responsibility in such cases.*
- ❖ *The information collected through Annual Information Returns by the Central Information Branch (CIB) particularly about the properties owned by the assessee should be accessible to the TROs also.*
- ❖ *The write off proposals in justifiable cases may be pursued and such irrecoverable demand may be considered for write off after following due administrative procedure.*
- ❖ *The mechanism of Regional Economic Intelligence Committee (REIC) needs to be strengthened to facilitate sharing of information among different revenue collecting agencies.*