

Chapter V: Internal Control Mechanism

5.1 Introduction

Internal control is necessary to improve policy formulation and implementation. An effective system of internal controls serves as a means to obtain reasonable assurance that the steps and action undertaken by the ITD meet their established goals and objectives. We have tried to highlight the control issues of the ITD relating to allowance of depreciation and amortisation in this Chapter.

There is no mechanism available in the ITD to verify the veracity of claim of the assesseees for depreciation in respect of additions made to the block of assets in previous year.

5.2 Non-availability of data relating to additions made to fixed assets during the relevant previous year

Section 44 AB of the Act requires the assessee to furnish Tax Audit Report (TAR) in Form No 3CD vide Rule 6G(2) of Income Tax Rules, 1962 by an accountant along with the return of income. Further, Clause 14(d) of TAR requires the assessee to furnish the details of additions to/deletions from the fixed assets during the previous year viz., the date of purchase, the date when it was put to use, subsidy/ grant/ reimbursement received thereon, change in rate of exchange of currency, etc. Verification of ownership and usage of assets are important aspects to be examined before allowing depreciation.

The requirement of furnishing details of ownership and usage of assets under Section 32(1) of the Act, along with the return of income, was removed with effect from 01 April 1988, with the introduction of the concept of block of assets. Further, in the present system of mandatory e-filing of returns, there is no provision for furnishing the details of ownership and usage of assets, except in respect of those cases which are selected for scrutiny assessments. Even in such cases, only the basic details of assets are required to be furnished in the TAR without attaching documentary evidence thereto.

We observed in Chhattisgarh, Karnataka, Madhya Pradesh and West Bengal charges, that 165 assesseees made additions of ₹ 1,038.92 crore to fixed assets during the relevant previous year but did not disclose in Form 3CD, Clause 14(d), inter alia, the relevant details such as the dates on which additions were made and the assets put to use for more / less than 180 days etc, which put a question mark on the correctness of the claim of the

assessee with regard to admissibility of depreciation at full/half rate, on the assets acquired, classification thereof under the correct block and determination of the cost thereof actually borne by the assessee (See Box 5.1).

Box 5.1: Illustrative cases on non-availability of data relating to additions to fixed assets made during the relevant previous year

a. In Madhya Pradesh, Indore charge, **M/s Sharda Solvent Ltd**, for AY 11, made additions of ₹ 26.12 crore and irregularly claimed and was allowed depreciation of ₹ 3.58 crore on new plant and machinery, the details thereof were not furnished at the time of assessment stating that it was under preparation.

b. In Chhattisgarh, Bilaspur charge, **M/s Mangal Sponge & Steel Pvt Ltd**, for AY 10, claimed and was allowed depreciation of ₹ 1.05 crore @ 100 per cent on electrostatic precipitator as per computation whereas in Annexure III forming part of 3CD report and Schedule 'E' of balance sheet, the depreciation worked out to ₹ 52.53 lakh @ 50 per cent and ₹ 40.44 lakh @ 15 per cent respectively. We observed that no evidence regarding purchase of the asset and putting the same to use was available in the assessment records. In the light of inconsistent claim of depreciation and in the absence of any evidence, the AO should have disallowed the entire depreciation.

In respect of cases pertaining to Karnataka charge, ITD stated that the required details were thoroughly verified during assessments. In one case, AO pointed out that the books of accounts, bills and vouchers maintained by the assessee often ran into large volume of data which was not practically possible to check and retain all the available data and as such the books of accounts/vouchers were returned to the assessee after a test check. The reply is not tenable for the reason that nothing was forthcoming from Form 3CD or available in the assessment records to indicate that the claims of depreciation had been regulated correctly after test check of the requisite details.

The majority of the cases are summarily processed and not selected for scrutiny by ITD. The TAR did not always provide or keep on record to indicate that the requisite details were called for at the time of assessment by AOs for verification of additions made to the block of assets during the relevant previous year. There is no mechanism available in ITD to verify the veracity of claim of the assessee for depreciation in respect of additions made to the block of assets irrespective of the fact that the case was selected for scrutiny or not.

In all assessment cases including those where the books of accounts, bills and vouchers maintained by the assessee are voluminous, AO should ensure that

the TAR in the prescribed format contains the requisite details and is brought on record. CBDT may consider modifying the e-filing of returns so that requisite information/records are available with ITD.

ITD does not have any mechanism/database or maintain register/records for keeping a watch over the correct status of unabsorbed depreciation carried forward for future set off despite CBDT's specific instruction issued in September 2007 in this regard.

5.3 Non-linking/availability of records relating to unabsorbed depreciation of earlier years

The Act provides for carry forward of unabsorbed depreciation for set off against the income of the following AYs. AST Module, being used by the ITD to fulfill the requirement of summary processing of cases, does not provide for automatically picking up data from earlier years to ensure the correctness of the claims for set off of unabsorbed depreciation. As regards scrutiny assessments, AOs verify the claim made by the assessee from the records available with them or accept the same without any verification.

CBDT has also issued instruction²¹ in this regard for the AOs to carry out necessary verifications at the time of scrutiny assessments with reference to physical records and link past assessment records so as to ensure the correctness of the claims of brought forward losses and depreciation. Audit has been regularly pointing out mistakes in allowing set-off of brought forward unabsorbed depreciation even then such mistakes persist.

We observed in Gujarat and West Bengal charges that the AOs allowed set off of unabsorbed depreciation in 8 cases without examining the genuineness of the assessee's claim for which assessee was not eligible at all or was eligible for comparatively more or less amount of unabsorbed depreciation (See Box 5.2). In this regard, paragraph 3.11 of this report may also be referred to.

Box 5.2: Illustrative cases on Non-linking/availability of records relating to unabsorbed depreciation of earlier years

- a. In West Bengal, CIT-I Kolkata charge, **M/s West Bengal State Electricity Distribution Co. Ltd**, for AY 10 and AY11, was allowed carry forward of depreciation aggregating ₹ 817.74 crore pertaining to AY 08 for future set off as per relevant TARs as against the actual amount of ₹ 222 crore available for carry forward from the AY 08 as per notification²² issued after restructuring of

²¹ Instruction.9/2007 dated 11 September 2007

²² Govt of West Bengal Notification 327-PO/O/III/3R-29/2006 dated 13 Oct 2008

West Bengal State Electricity Board into transmission and distribution companies. Thus, there was lack of internal control to verify the figures provided by the Chartered Accountants in respect of carry forward of unabsorbed depreciation of ₹ 595.74 crore involving potential tax effect of ₹ 202.49 crore.

b. In Gujarat, CIT I Vadodara charge, AO disallowed the claim of **M/s Chemstar Organics India Ltd** for depreciation of ₹1.66 crore for AY 11 stating that the company's operation had been suspended for the last 7 years due to bank and GIIC having taken adverse possession of the units and hence there was no business or manufacturing activities by the company. In doing so, the AO did not take any action in respect of the immediate previous six years. This resulted in excess allowance of carry forward of unabsorbed depreciation of ₹ 6.94 crore involving short levy of tax of ₹ 2.36 crore.

On the issue of availability of any mechanism/ register/ record regarding unabsorbed depreciation within the ITD, 35 AOs in respect of Delhi charge confirmed the fact that no mechanism/ register/ record was available in ITD to verify the genuineness of the claim of unabsorbed depreciation by the assessee in their return of income.

ITD does not have any mechanism/ database or maintain register/ records for keeping a watch over the correct status of unabsorbed depreciation carried forward for future set off despite CBDT's specific instruction issued in September 2007 in this regard. AO either rely on the information provided in the return of income or the past records, made available by the assessee itself. Similar is the situation in respect of unabsorbed depreciation in the case of amalgamation and demerger of a Company. ITD has no mechanism to validate the data on unabsorbed depreciation relating to earlier years, furnished by the assessee in its e-return or AST Module.

ITD may maintain the records of carry forward of unabsorbed depreciation for future set off in respect of each assessee including the amalgamation and demerger cases of companies, which would help in assessing and reviewing their impacts, from time to time to minimize mistakes in carry forward and set off of unabsorbed depreciation pertaining to earlier years at AO's level. This can be achieved if ITD introduces a section in Individual Running Ledger Account (IRLA) or in profile of assessee in ITD System to keep and maintain the data regarding unabsorbed depreciation or loss available to assessee which may be linked with the loss determined in the current AY so that the data is updated on real time basis and unabsorbed depreciation allowed set off correctly.

ITD may make it mandatory to all AOs to obtain a statement of unabsorbed depreciation assessment year-wise as per latest assessment order and make

it part of the assessment order after due verification at the time of finalizing the assessment.

ITD does not have any effective mechanism to ensure the correctness of WDV carried over for the purpose of allowance of depreciation or set off of unabsorbed depreciation thereon. In absence of this, AOs committed mistakes in carrying over the WDV.

5.4 Need for verification of Written Down Value

In the case of any block of assets, depreciation at prescribed rate is admissible on the closing written down value (WDV). Closing WDV, in the case of assets acquired before the previous year, means the actual cost to the assessee less all depreciation actually allowed to him under the Act which would naturally be the opening WDV of that block of asset for the next/current year and so on. The depreciation statement given in the TAR in Form 3CD does not take cognizance of change in WDV due to revision or appeal effect etc. Further, it is not mandatory for AOs to obtain the depreciation statement of earlier years and verify the WDV considering allowance and disallowance of depreciation in earlier years.

We noticed mistakes in carrying over the WDV in six cases in Andhra Pradesh, Bihar, Maharashtra and Tamil Nadu. In this regard, paragraph 3.7 of this report may also be referred to.

ITD does not have any effective mechanism to ensure the correctness of WDV carried over for the purpose of allowance of depreciation or set off of unabsorbed depreciation thereon.

An effective mechanism may be evolved to verify and ensure the correctness of written down value of the block of assets carried over.

Recommendations

We recommend that

- a. CBDT may consider modifying the e-filing of returns so that information relating to additions to fixed assets made during the relevant previous year is available with AOs at the time of assessment.

The Ministry stated (May 2014) that in the return of income of assesseees having business income (ITR – 4, 5 and 6) the income from business is computed in Schedule BP of such returns. Item no. 12 of schedule BP allows for deduction on account of depreciation u/s 32 of the Act. The computation of such depreciation as per the Act is provided in separate schedules DPM (Depreciation on Plant and Machinery), DOA (Depreciation on other Assets) and DEP (Summary of

Depreciation on Assets) of the return. Schedule DPM and schedule DOA under block of assets has separate columns for addition of fixed assets for a period of 180 days or more (column 4 in both the schedules) and for addition of fixed assets for a period of less than 180 days (column 7 in both the schedules) for the purpose of computation of depreciation. Thus, the information relating to addition to fixed assets made during the previous year is duly captured in the returns of income for each block of asset separately. In addition, for auditable cases, the audit report furnished by the Chartered Accountant has a detailed schedule of assets including additions if any, at an individual asset level. These audit reports are also e-filed and are available to AO.

Audit is of the view that despite capturing details of unabsorbed depreciation in e-filing, mistakes in assessments still persists. The Ministry may make efforts to minimize the mistakes in future.

The Ministry while reiterating its earlier stand, stated (June 2014) that the steps taken in annual Central Plan documents for error free assessment would reduce/minimize mistakes committed by AOs

- b.** CBDT may make it mandatory for all AOs to obtain a statement of unabsorbed depreciation assessment year-wise as per latest assessment order and make it a part of the assessment order after due verification at the time of finalizing the assessment.
- c.** CBDT may evolve an effective mechanism to verify and ensure the correctness of written down value of the block of assets carried over.

*In respect of recommendations **b** and **c** above, the Ministry stated (May 2014) that in cases subjected to detailed scrutiny, AOs are required to do in-depth examination of all relevant issues which have a bearing on the assessment being framed. Allowing proper set-off of unabsorbed depreciation, being brought forward from earlier assessment years or arriving at correct value of Written-down value are amongst the important issues which an AO is required to examine. In this regard, AO is expected to refer to documents of the taxpayer and more importantly, the records being maintained in the Department to arrive at correct figures. Further, the assessments being framed are subject to Review and Inspection (though not in all cases) by the supervisory authorities. In cases, where any loss of revenue due to lapses on part of AO is observed, remedial measures as per provisions of the Act are taken to safeguard the interest of revenue. Also, CBDT has been repeatedly laying emphasis on passing of 'zero error assessments' from audit point of view. Therefore, as the*

existing mechanism is largely satisfactory, no specific intervention is needed.

Audit is of the view that the instructions issued by the CBDT so far are not serving the purpose as mistakes in allowance of depreciation still continue to occur. Audit reiterates its stand for making a statement of unabsorbed depreciation and written down value of the block of assets carried over mandatory as part of latest assessment order after due verification. This may also be included in check list of Internal Audit Wing of ITD for effective monitoring.

New Delhi
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Countersigned

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