

Highlights

The Comptroller and Auditor General of India conducts the audit of receipts of the Union Government under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. This Report primarily discusses compliance to the provisions of the Income Tax Act, 1961 and the associated rules, procedures, directives etc. as applied to all aspects related to the administration of direct taxes. The report is organised into six chapters, the highlights of which are described below:

Chapter I: Direct Taxes Administration

Direct taxes receipts of Union Government in financial year (FY) 2018-19 amounting to ₹ 11,37,718 crore grew by 13.5 *per cent* over the FY 2017-18 (₹ 10,02,738 crore). Direct Taxes represented 6.0 *per cent* of the gross domestic products (GDP) in FY 2018-19. Share of direct taxes in gross tax revenue increased to 54.7 *per cent* in FY 2018-19 from 52.2 *per cent* in FY 2017-18.

Of the two major components of direct taxes, collections from Corporation Tax increased by 16.2 *per cent*, from ₹ 5.71 lakh crore in FY 2017-18 to ₹ 6.64 lakh crore in FY 2018-19. Collections from Income Tax increased to 13.1 *per cent* from ₹ 4.08 lakh crore in FY 2017-18 to ₹ 4.62 lakh crore in FY 2018-19. Voluntary compliance by assesseees (pre-assessment stage) accounted for 82.6 *per cent* of the total collections of Corporation and Income Tax in FY 2018-19.

The number of non-corporate assesseees increased from 5.38 crore in FY 2017-18 to 6.20 crore in FY 2018-19, registering an increase of 15.2 *per cent*. The number of corporate assesseees increased from 7.99 lakh in FY 2017-18 to 8.46 lakh in FY 2018-19, registering an increase of 5.9 *per cent*.

In last three financial years more than 40 *per cent* of Corporation Tax collection in first quarter as well as the total refund amount was refunded against the previous years' collection in the first quarters of FYs.

The arrears of demand increased from ₹ 11.1 lakh crore in FY 2017-18 to ₹ 12.3 lakh crore in FY 2018-19. However, the net collectible demand decreased to ₹ 14,593 crore in FY 2018-19 as compared to ₹ 20,159 crore in FY 2017-18 due to increase in demand difficult to recover. The Department indicated that more than 98.8 *per cent* of uncollected demand would be difficult to recover.

The number of appeals pending with CIT (Appeals) increased from 3.0 lakh in FY 2017-18 to 3.4 lakh in FY 2018-19. The amount locked up in these cases was ₹ 5.6 lakh crore in FY 2018-19. The total cases pending at higher levels (ITATs/High Courts/Supreme Court) increased from 0.82 lakh cases in FY 2017-18 to 1.35 lakh in FY 2018-19.

Chapter II: Audit Mandate, Products and Impact

During FY 2017-18, the Income Tax Department (ITD) had completed 2.99 lakh scrutiny assessments in the units audited as per the audit plan of FY 2018-19, out of which we checked 2.72 lakh cases. Apart from this, we have also audited 0.60 lakh cases out of 1.59 lakh scrutiny assessments completed in the earlier financial years, during FY 2018-19. The incidence of errors in assessments checked in audit during FY 2018-19 was 5.95 *per cent* (19,768 cases), as against 6.45 *per cent* last year.

There have been persistent and pervasive irregularities in respect of Corporation Tax and Income Tax assessments cases over the years. Recurrence of such irregularities, despite being pointed out repeatedly in the earlier Audit Reports point to structural weaknesses on the part of Department as well as the absence of appropriate institutional mechanisms to address this. Such irregularities were particularly noticeable in the assessment charges in Maharashtra.

We have included 393 high value cases reported to the Ministry in Chapter III and IV of this Report. Of these, we received replies in respect of 190 cases as on 30 June 2020, of which, 174 cases (91.5 *per cent*) were accepted and 16 cases not accepted. In remaining 203 cases the Ministry/ ITD did not furnish replies. Besides, Chapter V brings out our report on a subject specific compliance audit on 'Interest under sections 234A, 234B, 234C and 244A of the Act'. The Chapter points out that the interest was wrongly computed either due to systemic deficiencies in Assessment Information System (AST) or due to incorrect interventions/ computation by the assessing officers (AOs). Availability of facility for manual intervention in AST was misused by AOs by way of modifying the interest at excess amount which led to blockade of refund to the assessee. The system deficiency with respect to calculation of interest still persisted in the new application, i.e. 'Income Tax Business Application'. In addition, one long draft paragraph viz. 'Long Term Capital Gain on Penny Stocks' has been separately included in Chapter VI of this Report.

In the last three years, the ITD recovered ₹ 657.94 crore from demands raised to rectify the errors in assessments that we had pointed out. There are 53,117 cases involving revenue effect of ₹ 1.20 lakh crore pointed out in audit which remained unsettled as of 31 March 2019 for want of replies from the ITD.

During FY 2018-19, 1,961 cases with tax effect of ₹ 2,237.05 crore became time-barred for initiating any remedial action.

During last three years, more than 82 *per cent* individual taxpayers faced the TDS mismatch problem due to the difference in the amount available in Form 26AS and that claimed by the assesseees through their ITR, majority being salaried taxpayers.

The possible reasons for mismatch of TDS amount may be – the deductor did not deposit TDS or file the quarterly TDS return on time, entered incorrect amount in the TDS return, quoted incorrect PAN, the deductor's TAN wrongly entered in ITR, mistake in selecting assessment year. As a result, ITD did not allow credit for TDS which resulted into either raising demand or not releasing refunds, causing harassment to the assesseees.

We tried to attempt an Audit to examine the reasons for TDS mismatches, status of their resolution, mode of the resolution, efforts of the department, as well as correctness and completeness of information shared by ITD etc.

However, we could not conduct the audit as the assessment records were not available with the jurisdictional assessing officers as these were not pushed to them by the CPC-Bengaluru, even after two years of the assessment year.

Inability of the department to furnish relevant information to complete the audit has prevented the C&AG from fulfilling his constitutional mandate.

The ITD needs to ascertain whether the mismatches were due to the IT systems or the failure of deductors in furnishing correct returns/ information. In cases of failure of the deductors, necessary action may be taken against the defaulting deductors under the Act by ITD. It also needs to be ascertained in how many cases the ITD raised demand from the taxpayers because of the mismatch, as such causing harassment to the taxpayer. ITD also needs to examine the mismatch to ensure that no tax is levied on the persons who are not required to pay tax.

Chapter III: Corporation Tax

We pointed out 316 high value cases pertaining to corporation tax with tax effect of ₹ 8,210.43 crore. We classified these cases in four broad categories viz.

- (a) Quality of assessments involving tax effect of ₹ 1,477.60 crore (51 cases);
- (b) Administration of tax concessions/exemptions/deductions involving tax effect of ₹ 5,456.76 crore (176 cases);
- (c) Income escaping assessment due to errors involving tax effect of ₹ 1,043.41 crore (77 cases) and
- (d) Over-charge of tax/interest involving ₹ 232.66 crore (12 cases).

Chapter IV: Income Tax

We pointed out 77 high value cases of income tax with tax effect of ₹ 170.36 crore. We classified these cases in four broad categories as follows:

- (a) Quality of assessments involving tax effect of ₹ 19.05 crore (29 cases);
- (b) Administration of tax concessions/exemptions/deductions involving tax effect of ₹ 121.72 crore (30 cases);
- (c) Income escaping assessments due to errors involving tax effect of ₹ 26.27 crore (17 cases); and
- (d) Over charge of tax/interest involving ₹ 3.32 crore (one case).

Assessing Officers (AOs) committed errors in the assessments ignoring clear provisions of the Act. The cases of incorrect assessments involving arithmetical errors in computation of income and tax are difficult to accept as mere errors, in the days of calculators and computers. Further, application of incorrect rates of tax and surcharge, errors in levy of interest, excess or irregular refunds etc. point to either incompetence, or mischief, as well as weaknesses in the internal controls in ITD which need to be addressed. The existing scrutiny assessment procedure is opaque.

While the Ministry has taken action to initiate correction in these cases, it may be pointed out that these are only a few illustrative cases. In the entire universe of all assessments, including non-scrutiny assessments, there is every likelihood of such errors, of omission or commission, in many more cases. The CBDT not only needs to revisit its assessments, but also put in place a fool proof IT system and internal control mechanism to eradicate, so-called “errors”.

In view of repetitive nature of the errors, ITD should take remedial steps to prevent recurrence.

It is recommended that the CBDT may examine whether the instances of "errors" noticed are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.

Chapter V: Interest under section 234A, 234B, 234C and 244A of the Act

We audited 6,217 assessment cases which were processed/completed through AST module/system and examined the correctness of interest, calculated through the system and modified by AOs with respect to sections 234A, 234B, 234C and 244A of the Income Tax Act. We found that interest was calculated incorrectly through the AST system in 70.51 *per cent* cases. Incorrect amount of interest was calculated through the system despite the fact that the system was designed, inter alia, to undertake assessment functions of calculation of interest under various sections of Income Tax Act.

The audit findings are as under:

- a) The interest was wrongly computed by ITD, in 76.68 *per cent*¹ of cases of the sample of 6,217 selected out of a population of 8,35,727 records, either due to systemic deficiencies or due to incorrect interventions by the AOs.
- b) Input of the other ITD module was not being captured properly in the AST system leading to incorrect computation of interest in number of cases which has an impact on final tax collection and refund.
- c) AOs did not take any step to rectify the incorrect interest, under sections 234A, 234B, 234C and 244A of the Act, calculated through the system even though AST system allowed the AOs to modify the value of interest in accordance with the provisions of the Act, thereby leading to either short levy/payment or excess levy/payment of interest.
- d) AOs modified the interest under sections 234A, 234B, 234C and 244A of the Act against the incorrect interest calculated through the system in some cases. However, not all these cases were modified at correct amount, which resulted in either short levy/payment or excess levy/payment of interest.
- e) AOs manually modified the interest amount which was not warranted in instances where correct amount of interest was calculated through the system, leading to either short levy/payment or excess levy/payment of interest causing hardship and harassment to taxpayers.

1 4,767 assessment cases out of 6,217 assessment cases which were audited

It is not clear why manual modification is permitted, that too apparently without a protocol for seeking senior level clearances if, in exceptional cases, manual intervention is required. In fact, if manual intervention at every level is needed, or continued, it either points to an ill designed IT System, or a deliberate attempt to retain discretion, for no apparent good reason.

- f) Incorrect levy of interest (excess levy) by AOs using modification feature of AST led to blockade of refunds due to the assessee. This was not only violation of provisions of law but also resulted in non-fulfilment of Citizen's Charter. On the one hand the efficiency of the department was affected and on the other there was undue harassment to the assessee.
- g) All Income Tax Returns (ITRs) are first summarily processed under section 143(1) at Centralized Processing Centre (CPC), Bengaluru. Processing of ITRs by CPC is supposed to be completely automated. However, refunds of the assessee's were blocked by modifying the interest amount even in cases processed in summary manner through CPC.
- h) The net collection of taxes is computed by allowing for the refunds². Blockade of refunds, therefore, have the result of inflating the net tax collection. Further, unreasonable tax demand from the assessee, by way of excess levy of interest, results in disputes and further snowballs into large arrears. Thus, the blockade of refund and excess demand would have consequent effect on the revenue collection of the Government.

It is recommended that

- a) *CBDT may institute appropriate checks and balances in Income Tax Business Application (ITBA) to prevent recurrence of error in computation of tax and interest.*
- b) *The IT system for direct taxes needs to be designed in such a way that it should ensure zero or minimal physical interface between the assessee and the tax officers. The Government may consider the IT System for direct taxes being placed at arms length from CBDT, with an independent governmental body or organisation.*

2 Para 7.2.2. of CBDT Accounts Manual

- c) *AST module allows manual modification of interest amount which resulted in errors in computation of interest. ITD needs to inquire into the reasons for errors in computation of interest through AST and reasons for allowing manual modification to co-exist with IT system.*
- d) *The system should be designed to provide audit trail for modifications, if any, being carried out by AOs. All justifications for modification by AO must be available on the system.*
- e) *CBDT may examine whether the instances of “errors” noticed are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.*
- f) *The IT Department may fix accountability on the part of the AOs to ensure that the risk of recurrences of similar types of irregularities are minimised.*
- g) *CBDT may ensure that the refund due to the assessee is released in prescribed time limit, upholding its commitment through the citizen charter, rather than to withhold/block it by manual intervention.*
- h) *AO’s action regarding blockade of refund as well as under charging of interest may be investigated upon.*
- i) *While audit carried out test check of a sample of cases, CBDT should examine all the cases where modifications were carried out in AST to identify instances of omission and commission and take necessary action as per law.*

Chapter VI: Long term capital gain on Penny Stocks

We observed that the ITRs of the assesseees who traded in the shares of penny stock companies were neither selected for scrutiny nor reopened for scrutiny despite the ITD having information of claiming LTCG. The ITD failed to issue notices for filing ITRs, to the assesseees who were involved in trading penny stocks, but have not filed their ITRs. Even Non-filers Monitoring System had not been utilized effectively to identify such non-filers. The AOs had no uniformity in making additions of exempt LTCG, despite the fact that the grounds of additions were same. In some cases, AOs did not make any addition for claimed exempted LTCG, for which no justification was given in the assessment orders. Further, the AOs had made additions at different percentage where the assesseees traded in shares of same penny stock companies. The ITD did not have any systemic approach to deal with cases of beneficiaries traded in penny stock as in some cases entire sales consideration was disallowed whereas in some cases only claimed LTCG was disallowed. There is also variation in disallowance of commission received by entry and exit provider from beneficiary of penny stock.

It is recommended that

- (i) the ITD may design CASS parameters in such a way that all the relevant information with ITD, whether from ITR or other sources, may be used to select the cases for scrutiny.*
- (ii) the method of selection for scrutiny under CASS may be shared with the C&AG as was pointed out in the Audit Report No. 9 of 2019 of C&AG so that audit may see whether the selection of cases for scrutiny is as per CASS parameters.*
- (iii) the ITD may examine whether the errors in assessment of cases where LTCG on penny stock was claimed, are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.*