

Chapter Summary

Comptroller and Auditor General of India conducts audit of revenues from direct taxes of the Union Government under section 16 of the Comptroller and Auditor's General of India (Duties, Powers and Conditions of Service) Act, 1971 through test check of assessment and other records maintained by the Income Tax Department and Ministry of Finance. He examines the systems and procedures laid down by the department/government in critical areas of tax administration to assess the effectiveness of their working and evaluates the degree of compliance with tax laws, rules and judicial pronouncements in the assessment, demand and collection of tax revenues from various assesseees. This report has been prepared after considering the response of the Ministry of Finance to the audit observations, wherever received.

(Para 1.1, 1.2, 1.5 & 1.6)

Field offices under the Comptroller and Auditor General of India issued 14460 audit observations on underassessment involving tax effect of Rs.4838.76 crore and 2386 cases of over assessment involving tax effect of Rs.469.12 crore during 2003-04 to the assessing officers of the department relating to corporation tax, income tax and other direct taxes. A total of 931 cases with tax effect of Rs.1852.65 crore were issued to the Ministry as individual draft paragraphs out of which 885 cases involving tax effect of Rs.1761.12 crore are included in this report.

(Para 1.3, 1.7 & 1.8)

Although the manpower made available for internal audit had increased by 1079 percent after introduction of the chain system of internal audit the percentage shortfall with reference to the total auditable cases was 62.47. Audit could not ascertain as to how the department was monitoring improvement in quality of internal audit in the absence of any evaluation of the work.

(Para 1.12)

Out of 35,858 records requisitioned and not produced during 2002-03, 70.35 percent of records were not produced to audit in 2003-04, when requisitioned again.

(Para 1.14)

CHAPTER I: INTRODUCTION

General

1.1 Direct taxes levied by Parliament comprise:

- **Corporation tax**
- **Income tax**
- **Wealth tax**
- **Gift tax**
- **Interest tax and**
- **Expenditure tax**

Laws relating to direct taxes are administered by the Central Board of Direct Taxes (hereinafter called 'the Board'). The Board is under the overall control of Department of Revenue, Ministry of Finance. Revenue from direct taxes during 2003-04 was Rs.1,05,087.76 crore. Time series data on revenue from various direct taxes and other related statistical information on tax administration are presented in Chapter II.

Statutory Audit

1.2 Audit of direct taxes by the Comptroller and Auditor General of India is carried out under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. Audit covers the field offices and the Board and involves examination of-

- (a) assessments through test check;
- (b) rationale for issue of instructions and circulars;
- (c) decisions taken in particular cases, and
- (d) efficacy and adequacy of systems and procedure of tax collection, appeals, and overall tax administration.

Audit observations are initially communicated to field offices and important findings are forwarded to the Board and Ministry of Finance. Finally, the Audit Report on direct taxes is forwarded to Parliament through the President of India.

Present Report

1.3 The preface describes the arrangement of this report. The Ministry's response, where furnished is indicated in each case. Where the reply of the Ministry is not acceptable, the reasons therefor have been mentioned along with the gist of the reply of the Ministry.

The present report contains 885 out of 931 audit observations referred to Ministry of Finance. Table 1.1 below contains the details of draft paragraphs¹ issued to Ministry and included in the report.

¹ It is an audit observation issued to the Ministry seeking their comments

(Rs. in crore)

Category of tax	Number of Draft Paras issued to Ministry	Tax effect	Number of Draft Paras included in the Report	Tax effect
1	2	3	4	5
Corporation Tax	574	1785.28	536	1694.38
Income Tax	174	37.33	168	36.70
Wealth Tax	83	5.82	83	5.82
Gift Tax	5	0.82	5	0.82
Interest Tax	92	23.28	90	23.28
Expenditure Tax	3	0.12	3	0.12
Total	931	1852.65	885	1761.12

Four hundred and eighty one observations involving tax effect of Rs.723.26 crore had arisen out of local audit conducted during 2003-04 and 450 observations involving tax effect of Rs.1,129.39 crore were noticed during local audit conducted in earlier years.

A limited test check in audit to assess the status and adequacy of follow up action in selected post VDIS 1997 assessments based on the comments in Audit Report No.12A of 2000, revealed short levy of tax of Rs.228.55 crore in only 1081 cases.

1.4 A separate Report 13 of 2005 containing the results of reviews or system appraisals has been prepared on the following subjects which dealt with examination in audit of

- (i) status of improvement of efficiency through the 'Restructuring' of the Income Tax department,
- (ii) efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act,
- (iii) some aspect of non-resident taxation with reference to Double Taxation Avoidance Agreements (DTAA).

Non-receipt of Board's comments on draft paragraphs

1.5 Cases with substantial tax effect are brought to the notice of Income Tax Department and the Ministry in the form of 'draft paragraphs'. Sufficient time is allowed thereafter for their response so that these could be considered before finalisation of this report. However, despite Board's instructions that all 'draft paragraphs' cases should receive the personal attention of the Commissioners of Income Tax (CITs) for expeditious action, inordinate delays continue to occur in receipt of departmental responses.

1.6 Table 1.2 below contains the position of replies received from the Ministry till the finalisation of the Audit Report.

TABLE 1.2: DRAFT PARAS ISSUED TO MINISTRY AND THEIR ACCEPTANCE

Year of Report	Number of draft paragraphs issued	Replies received before finalisation of Audit Report	Percentage of cases in which replies were received	No. of cases accepted by Ministry	Percentage of cases accepted by Ministry with reference to column 3
1	2	3	4	5	6
2000-01	1,123	141	13	125	89
2001-02	918	134	15	112	84
2002-03	980	178	18	170	95
2003-04	931	96	10	74	77

1.7 After completion of audit of each assessment unit, audit observations are conveyed to the department through a local audit report. In the case of important observations, a statement of facts is issued to the department for verification of facts and obtaining their comments.

Results of test audit in general

1.8 Audit of assessments conducted between 1 April 2003 to 31 March 2004 revealed 14460 cases of under assessment and 2386 cases of over assessment involving revenue effect of Rs.4,838.76 crore and Rs.469.12 crore respectively. Assessing officers accepted 3306 audit observations (22.86 %), did not accept 4,883 observations (33.77 %) and did not respond to 6271 observations (43.37%) involving tax effect of Rs.661.56 crore, Rs.1,716.47 crore and Rs.2,460.73 crore respectively of under assessment.

Corporation tax and Income tax

1.8.1 A total of 13,785 observations pertain to corporation and income tax and involved tax effect of Rs.4,687.43 crore. Table 1.3 below contains an analysis of these observations in terms of nature of mistakes and other omissions that audit noticed in assessments.

(Rs. in crore)

TABLE 1.3: CATEGORIES OF OMISSIONS IN INCOME TAX/CORPORATION TAX

		No. of cases	Tax effect
1.	Avoidable mistakes in computation of income and tax	1219	241.57
2.	Failure to observe the provisions of the Finance Acts	345	150.08
3.	Incorrect status adopted in assessments	20	2.36
4.	Incorrect computation of salary income	341	5.23
5.	Incorrect computation of income from house property	242	5.32
6.	Incorrect computation of business income	3644	1574.04
7.	Irregularities in allowing depreciation	780	185.37
8.	Irregular computation of capital gains	229	96.14
9.	Mistakes in assessments of firm	177	2.91
10.	Omission to club the income of spouse/minor child etc.	7	0.21
11.	Income not assessed	1090	336.63
12.	Irregular set-off of losses	392	224.16
13.	Mistakes in assessments while giving effect to appellate orders	54	7.69
14.	Irregular exemptions and excess relief given	1467	392.33

TABLE 1.3: CATEGORIES OF OMISSIONS IN INCOME TAX/CORPORATION TAX

		No. of cases	Tax effect
15.	Excess or irregular refunds	540	29.83
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1587	901.94
17.	Avoidable or incorrect payment of interest by Government	234	30.55
18.	Omission/short levy of penalty	414	110.13
19.	Other topics of interest (miscellaneous cases)	484	340.03
20.	Under-assessment of surtax	519	50.91
	Total	13785	4687.43

Wealth tax

1.8.2 Similarly, 542 observations relating to wealth tax were issued involving tax effect of Rs.126.11 crore. Table 1.4 below contains an analysis of omissions in terms of nature of irregularities.

(Rs. in crore)

TABLE 1.4: CATEGORIES OF OMISSIONS IN WEALTH TAX

		No. of Cases	Amount
1	2	3	4
1.	Wealth not assessed	381	7.27
2.	Incorrect valuation of assets	35	0.42
3.	Mistakes in computation of net wealth	31	0.24
4.	Incorrect status adopted	12	0.11
5.	Mistakes in calculation of tax	8	0.09
6.	Non-levy or incorrect levy of additional wealth tax	9	0.09
7.	Non-levy or incorrect levy of penalty and non-levy of interest	39	0.54
8.	Miscellaneous	27	117.35
	Total	542	126.11

Other Direct Taxes

1.8.3 One hundred and thirty four observations relating to other direct taxes i.e. gift tax, interest tax etc were issued involving tax effect of Rs.25.23 crore as mentioned in Table 1.5 below.

(Rs. in crore)

TABLE 1.5: OTHER DIRECT TAXES

S. No.	Category of tax	No. of cases	Tax effect
1	Gift tax	11	0.60
2	Interest tax	115	24.35
3	Expenditure tax	8	0.28
	Total	134	25.23

Outstanding statutory audit observations

1.9 According to departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee

(Ninth Lok Sabha) in their 20th Report underscored the fact that responsibility for settlement of audit observations rests with the department and it cannot remain content merely with sending replies to audit observations. In their Action Taken Note, the Ministry of Finance had stated that they would endeavour to see that targets for settlement of audit observations were achieved. However, large number of audit observations made in 2003-04 and earlier years are still to be settled.

1.9.1 As on 31 March 2004, 77,211 observations involving revenue effect of Rs.19,869.73 crore were pending. This does not include the audit observations communicated between 1 April 2003 to 31 March 2004. The year-wise particulars of the pendency are given in Table 1.6.

(Rs. in crore)

TABLE 1.6: OBSERVATIONS PENDING WITH DEPARTMENT FOR FINAL ACTION

Year	Income Tax and Corporation Tax		Other Direct Taxes (Wealth Tax, Gift Tax, Interest Tax, Expenditure Tax and Estate Duty)		Total	
	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
1	2		3		4	
Upto 2000-01	50954	11680.14	6406	286.95	57360	11967.09
2001-02	9136	3388.77	701	57.49	9837	3446.26
2002-03	9365	4429.30	649	27.08	10014	4456.38
Total	69455	19498.21	7756	371.52	77211	19869.73

1.9.2 A total of 9,071 audit observations relating to income tax and corporation tax were pending as on 31 March 2004 with revenue effect of Rs.13873.82 crore (as against 9,153 cases with a revenue effect of Rs.14,490.64 crore in 2002-03) where income tax involved in each individual case exceeded Rs.10 lakh. Cases in respect of different charges are shown below in Table 1.7.

(Rs. in crore)

TABLE 1.7: PENDING IT/CT CASES

Sl. No.	Name of charge	Items	Amount
1	2	3	4
1.	Andhra Pradesh	135	120.40
2.	Assam	200	368.26
3	Bihar	91	166.22
	Jharkhand	105	87.67
4.	Gujarat	504	603.58
5	Haryana	100	82.85
6	Himachal Pradesh	28	19.76
7.	Jammu & Kashmir	29	20.84

Sl. No.	Name of charge	Items	Amount
8.	Karnataka	344	315.76
9.	Kerala	420	372.45
10.	Madhya Pradesh Chhattisgarh	276 55	240.10 36.33
11.	Orissa	118	149.96
12.	Punjab	297	293.70
13.	UT Chandigarh	51	90.79
14.	Rajasthan	175	422.67
15.	Tamil Nadu	766	193.22
16.	Uttar Pradesh & Uttaranchal	435	438.20
17.	Delhi	1271	1222.18
18.	Maharashtra	2954	7314.09
19.	West Bengal	717	1314.79
	Total	9071	13873.82

1.9.3 Table 1.8 contains audit observations pending in other direct taxes where the tax involved in each case exceeded Rs.5 lakh.

(Rs. in crore)

TABLE 1.8: PENDING CASES OF OTHER DIRECT TAXES

Sl. No.	Category of tax	Number of audit observations	Tax effect
1	2	3	4
1.	Wealth tax	320	82.65
2.	Gift tax	67	52.01
3.	Interest tax	89	32.62
4.	Expenditure tax	5	1.17
5.	Estate Duty	9	7.17
	Total	490	175.62

1.9.4 Nine thousand five hundred and sixty one (12.38 percent) observations accounted for Rs.14049.44 (70.71 percent) of revenue effect of the total pending cases. Department needs to assign priority to settle observations of higher tax effect.

1.10 The action plan of the department for 2003-04 provided for 90 percent disposal of all outstanding major audit observations, and 80 percent for current major audit observations. In respect of pending statutory major audit observations up to 31 March 2003, 90 percent of the cases were to be settled. However the actual achievement was only 20 percent and 30 percent respectively of the targets fixed.

1.10.1 Table 1.9 below indicates targets for settlement of major statutory audit observations for the year 2003-04 according to action plan and actual achievements:

TABLE 1.9: ACTION PLAN & ACTUAL ACHIEVEMENTS OF THE DEPARTMENT					
Audit observations					
	For disposal	To be settled as per targets fixed	Settled	Targets (percent)	Achievements with reference to the targets fixed (percent)
1	2	3	4	5	6
Current	4869 (1595.67)	3895 (1276.54)	789 (302.82)	80	.20
Arrear	14996 (4146.30)	13496 (3731.67)	4088 (765.90)	90	30
(Figures in brackets represent money value in crore of rupees)					

The achievements were, therefore, short of targets.

Remedial action time barred

1.11 The Board have issued specific instructions for taking timely action on audit observations so as to avoid cases becoming barred by limitation of time and leading to loss of revenue. The Public Accounts Committee (150th Report-Eighth Lok Sabha) had also recommended that the Board review old outstanding observations in consultation with Audit.

1.11.1 In some charges where the status of audit observations issued between 1978-79 and 1996-97 was reviewed in 2003-04, cases where remedial action had become time barred were noticed. Details of these cases have been forwarded to the respective Commissioners. Table 1.10 contains the number of such cases along with tax effect.

TABLE 1.10: REMEDIAL ACTION BECOMING TIME BARRED			
(Rs. in crore)			
Sl. No.	Name of the State	Income Tax	
1	2	3	
1.	Andhra Pradesh	397	15.47
2.	Bihar	116	11.97
	Jharkhand	87	9.19
3.	Gujarat	325	0.36
4.	Harayana	76	1.82
5.	Kerala	8	0.06
6.	U.T.Chandigarh	90	7.17
7.	Madhya Pradesh & Chhatisgarh	414	59.61
8.	Orissa	154	2.93
9.	Punjab	6	0.02
10.	Rajasthan	53	0.23
11.	Tamilnadu	29	0.69
	Total	1755	109.52

Internal Audit

1.12 The Board have introduced a new 'chain' system of internal audit in 2001, which involved 5,397 officials drawn from all ranges and assessing offices as against only around 500 designated officials entrusted with the exclusive responsibility for internal audit earlier.

1.12.1 All auditable cases where assessments are completed during a month are to be audited in internal audit by the end of following month. Thus the disposal for year ending 31 March 2004 should have been of all cases where assessments had been completed by 28 February 2004. Department determined the number of auditable cases in 2003-04 as 18.41 lakh. An analysis of the performance is given in Table 1.11.

Table 1.11: Performance of Internal Audit

Financial Year	Total auditable cases	Target for disposal	Total cases audited	Shortfall with reference to total auditable cases	
				No.	Percentage
2000-01	4,16,791	1,98,000	1,90,774	2,26,017	54.22
2001-02	4,84,263	4,84,263	41,837	4,42,426	91.37
2002-03	15,57,231	15,57,231	3,60,748	11,96,483	76.83
2003-04	18,40,561	18,40,561	6,90,841	11,49,720	62.47

1.12.2 The number of cases audited had increased more than sixteen fold in 2003-04 compared to the position in 2001-02 when there was 91 percent shortfall in coverage. It is pertinent to note that the manpower made available for internal audit had increased by 1079 percent in 2003-04 in new chain system. Audit could not ascertain as to how the department was monitoring improvement in quality of internal audit in the absence of any evaluation of the work.

1.12.3 The number of observations raised in internal audit ranged from 1,364 in 2001-02, 5,827 in 2002-03 and 6876 in 2003-04 involving money value of Rs.63.76 crore, Rs.169.38 and Rs.159.23 crore respectively. Details of internal audit observations accepted by assessing officers, amendments in law suggested, if any, to strengthen the tax administration or recoveries made as a result of internal audit during the period are not readily available with the department.

Outstanding audit observations of internal audit

1.13 According to departmental instructions, internal audit observations are to be attended to by the assessing officer within three months. However, as on 31 March 2004, 11,951 audit observations of internal audit involving a tax effect of Rs.1,682.51 crore were pending settlement. This included 6,876 observations with money value of Rs.159.23 crore made during 2003-04.

1.13.1 Table 1.12 below contains information on major observations of internal audit and their settlement.

TABLE 1.12: PERFORMANCE OF IAD IN RESPECT OF MAJOR OBJECTIONS

Financial year	No. of cases for disposal	No. of cases settled	Percentage of total cases disposed	No. of pending cases
1	2	3	4	5
1999-00	22943(1708.08)	8823(537.36)	38	14120(1170.72)
2000-01	21364(5975.68)	7738(576.59)	36	13626(5399.09)
2001-02	5375(814.84)	1111(216.79)	21	4264(598.05)
2002-03	6635(1430.33)	2348(452.13)	35	4287(978.20)
2003-04	5151(1936.90)	1466(275.63)	28	3685(1661.27)

(figures in brackets indicate money value of rupees in crore)

1.13.2 The major cases settled during 2003-04 were only 1,466 (28 percent) as compared to 2348 (35 percent) in 2002-03. Further opening balance for 2001-02 to 2003-04 do not tally with the closing balance for 2000-01 to 2002-03, which were still under reconciliation in the department. Actual settlement achieved is thus likely to be much lower.

1.13.3 The Public Accounts Committee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that observations of internal audit be analysed with reference to the year of assessment apart from the year in which these were raised, so that greater attention could be given to the settlement of observations relating to earlier years, before the cases become time-barred for re-opening. The Ministry of Finance (Department of Revenue) in their action taken note had stated that assessment year-wise and age-wise classification was being made so that greater attention could be paid to settlement of older and revenue significant objections. Since the normal period available for re-opening of cases is four years, all observations pertaining to 1998-99 and earlier years should have been settled by March 2002. However, this did not happen as shown in Table 1.13, which gives age-wise analysis of the pending items at the end of 2003-04 and revenue effect involved:

TABLE 1.13: PENDING INTERNAL AUDIT OBJECTIONS

Year in which objection raised	No. of cases	Revenue Effect (Rs. in crore)
1	2	3
2000-01 and earlier years	2245	1465.80
2001-02	396	27.74
2002-03	216	40.22
2003-04	828	127.51
Total	3685	1661.27

Action on observations of internal audit

TABLE 1.14: TARGET & ACTUAL SETTLEMENT OF INTERNAL AUDIT OBJECTIONS

Audit observations					
	For disposal	To be settled as per targets fixed	Settled	Target (percent)	Achieved (percent)
1	2	3	4	5	
Current	1142(141.12)	1142(141.12)	314(13.62)	100	27.50
Arrears	4009(1795.78)	4009(1795.78)	1152(262.01)	100	28.74

Figures in brackets indicate value Rs. in crore

Achievements, thus fell short of the targets fixed.

Records not produced to audit

1.14 With a view to securing an effective check on the assessment, collection and proper allocation of taxes and examining that regulations and procedures are being observed, assessment records are scrutinised in revenue audit. It is incumbent on the Department to expeditiously produce records and furnish relevant information to audit.

Appendix 1 contains details of records not produced to audit in previous audit cycles. These records were again requisitioned in 2003-04, and not produced to audit. An analysis of the information reveals that 70.35 percent of cases not produced during earlier audits and requisitioned again in 2003-04, were not produced to audit even after the lapse of the period of more than two years of re-organisation of the department. Consequently, audit of such cases could not be carried out.

Table 1.15 contains state wise details where records were not produced to audit in 3 or more consecutive audit cycles. Consequently, audit of such cases also could not be carried out.

TABLE 1.15 RECORDS NOT PRODUCED TO AUDIT IN 3 OR MORE AUDIT CYCLES

S.No.	State	Number of records not produced		
		IT/CT	W.T.	Total
1	2	3	4	5
1	Andhra Pradesh	26	3	29
2	Karnataka	5	16	21
3	Madhya Pradesh	5	-	5
4	Orissa	8	-	8
5	Tamilnadu	2	-	2
6	Maharashtra	-	4	4
	Total	46	23	69