

Chapter Summary

Corporation tax constituted 60 percent of the total collection from direct taxes in 2003-04. There were 3.72 lakh assessees as on 31 March 2004, which represented an increase of 2.02 per cent over the previous year.

(Para 3.1 & 3.2)

Audit issued **574** observations to the Ministry of Finance involving tax effect of **Rs.1785.28 crore** highlighting various irregularities, omissions and mistakes, for comments. Ministry accepted 43 observations involving tax effect of Rs.54.86 crore till preparation of this report.

(Para 3.4 & 3.5)

Assessees had availed unentitled benefits in summary assessments in 136 cases involving tax effect of Rs.205.46 crore.

(Para 3.27)

Assessing officers committed mistakes in:

- ◆ adoption of correct figures, applying correct rate of tax and levy of surcharge in 43 cases involving tax effect of Rs.64.47 crore.

(Para 3.6 to 3.8)

- ◆ computation of business income in 94 cases involving tax effect of Rs.286.81 crore

(Para 3.9)

- ◆ allowing unentitled expenditure or provision, liability and claims in 66 cases involving tax effect of Rs.341.43 crore

(Para 3.10 to 3.12)

- ◆ computation of capital gains, carry forward and set off of losses in 23 cases involving tax effect of Rs.263.08 crore

(Para 3.13 & 3.14)

- ◆ allowing reliefs and exemptions under chapter VIA and in computation of income under special provisions of the Act in 42 cases involving tax effect of Rs.58.86 crore.

(Para 3.16 to 3.19)

- ◆ levy of interest in 66 cases involving tax effect of Rs.404.13 crore

(Para 3.23)

CHAPTER III: CORPORATION TAX

Number of companies vis-à-vis company assessees

3.1 According to the records of Ministry of Finance, Department of Company Affairs, there were 6,41,498 companies limited by shares at work as on 1 April 2004, which included 5,64,118 private limited companies and 77,380 public limited companies. However, as per the records of the Income Tax Department, the number of company assessees as on 31 March 2004 was 3,72,482 as compared to 3,65,124 as on 31 March 2003.

Receipts from corporate tax

3.2 During 2003-2004, corporation tax receipts were Rs.63,561 crore as against Rs.46,172 crore in 2002-03. Table 2.4 of this Report contains the details.

Status of assessments

3.3 Table 2.11 (Appendix 5) of this report contains particulars of assessments due for disposal, assessments completed and pending.

Results of audit

3.4 Audit issued 559 draft paragraphs involving undercharge of tax of Rs.1,769.97 crore and 15 draft paragraphs involving overcharge of tax of Rs.15.31 crore to the Ministry of Finance between May 2004 and November 2004 for eliciting their comments.

Out of 574 draft paragraphs issued to the Ministry, internal audit of the department had seen 54 cases in which mistakes could not be detected. Internal audit had not seen 520 cases at all. Out of 141 cases pertaining to Delhi, audit could not establish in 95 cases as to whether they were seen by internal audit or not, as these details were not available in the departmental records.

Out of 574 draft paragraphs issued to the Ministry, 521 cases involving under charge of Rs.1,679.07 crore and 15 cases involving overcharge of Rs.15.31 crore are indicated in the succeeding paragraphs. 136 draft paragraphs related to summary assessments and involved under charge of tax of Rs.205.46 crore while 400 draft paragraphs related to scrutiny, best judgment and block assessments involving under charge of tax of Rs.1,488.60 crore.

Each paragraph indicates a particular category of mistakes and starts with a suitable preamble followed by combined/consolidated tax effect of all observations of similar nature. Cases with money value of more than Rs.10 crore each are illustrated while those of more than Rs.1 crore but below Rs.10 crore each are given in a tabular form in Appendices.

Status of replies received from Ministry of Finance

3.5 Of 536 cases included in this chapter, Ministry of Finance accepted audit observations in 43 **cases** involving tax effect totalling **Rs.54.86 crore**. In respect of 20 observations not accepted, gist of reasons for Ministry's non-acceptance has been included in the related paragraph itself along with suitable rebuttal. In the remaining cases, Ministry's replies are awaited.

Mistakes in adoption of correct figures/ Arithmetical error

3.6 An assessment can be completed in a ‘summary manner’ without requiring the presence of the assessee or examination of accounts and documents accompanying the return of income. Only arithmetical errors are rectified in summary assessment. Accounts, claims, records and all documents are examined only in ‘scrutiny’ assessments. Assessing officers have thus to determine and assess the income correctly in scrutiny assessments. The Board have issued instructions to assessing officers and their supervising officers to ensure that mistakes in assessments do not occur.

Audit noticed that assessing officers had adopted incorrect figures, committed arithmetical errors, allowed claims twice, and had not added back inadmissible claims to income and had thus short levied tax by **Rs.53.76 crore** in **24 cases** in Delhi, Maharashtra, and Uttar Pradesh. **Two** cases involving short levy of tax of more than Rs. 10 crore each are illustrated below and **11** cases involving tax effect of more than Rs.1 crore each are shown in **Appendix 7**.

3.6.1 In Maharashtra, City VII Mumbai charge, the assessment of a company, **M/s. Hotel Leelaventure Ltd.**, for the assessment year 2000-01 was completed after scrutiny in March 2003 at a loss of Rs.42.76 crore. Audit scrutiny revealed that the computation was incorrect as, while adding back Rs.23.76 crore to business loss of Rs.4.28 crore, the department arrived at a loss of Rs.19.48 crore instead of correctly arriving at an income of Rs.19.48 crore. Consequently, after allowing the admissible depreciation and making the other necessary adjustments the department arrived at a total loss of Rs.42.76 crore as against the correct figure of loss of Rs.3.80 crore. Incorrect computation resulted in excess carry forward of loss of Rs.38.96 crore involving potential short levy of tax of **Rs.15 crore**.

3.6.2 In Maharashtra, Mumbai City-II charge, the assessment of a nationalized bank, **M/s. Bank of India** for the assessment year 1991-92, was completed after scrutiny in March 1994 at an income of Rs.222.17 crore. It was revised at an income of Rs.107.43 crore in March 1998 and subsequently rectified at an income of Rs.86.81 crore while giving effect to an appellate order in June 1999. Audit scrutiny of the re-assessment order passed in March 1998 revealed that while computing the total income, “Income from House Property” of Rs.6.58 lakh and “Income from other Sources” of Rs.13.71 crore, respectively, were erroneously deducted from total income instead of adding back thereto. This mistake persisted even while issuing consequential effect to the appellate order in June 1999 resulting in under assessment of income of Rs.27.54 crore involving short levy of tax of **Rs.12.67 crore**. The department initiated remedial action in March 2004.

Incorrect rate of tax

3.7 Income tax is chargeable for every assessment year in respect of the total income of the previous year of an assessee according to the rates prescribed in the relevant Finance Act.

A domestic company is charged tax at specified rates depending on whether it is a company in which public are substantially interested, and if not, whether it is an

industrial company or trading and investment company or any other company. Incidence of tax is lower in respect of a company in which public are substantially interested.

Assessing officers levied tax short by **Rs.1.57 crore** in **four cases** in Gujarat, Karnataka, Maharashtra and West Bengal. **One** case involving tax effect of more than Rs.1 crore is indicated at serial number **one of Appendix 8**.

Surcharge not levied or incorrectly levied

3.8 Surcharge is levied at prescribed rates in addition to tax in the case of a domestic company whose income exceeds Rs.75,000.

Audit noticed that either surcharge was not levied or levied short in **15 cases** in Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Tamil Nadu, and West Bengal involving tax effect of **Rs.9.14 crore**. **Three** cases each involving tax effect of more than Rs.1 crore but less than Rs.10 crore are indicated at serial numbers **2 to 4 of Appendix 8**.

Mistake in computation of business income

3.9 Total income of a person for any previous year includes income from whatever source derived which is received or deemed to be received or which accrues or arises during such previous year unless it is specifically exempt from tax by other provisions of the Act.

The Act provides that in the case of an assessee being non resident, engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of mineral oils, a sum equal to ten per cent of the total amount paid, or payable (whether in or out of India) to the assessee, or to any person on his behalf shall be deemed to be the profit and gains of such business chargeable to tax under the head 'profit and gains of business or profession'.

Income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly adopted by the assessee. Any stock-in-trade held by the assessee for the purpose of business or profession does not constitute capital asset of the assessee.

Valuation of closing stock is a vital factor in determining the taxable income from business, as correct profit of the assessee cannot be ascertained unless the opening and closing stock are valued correctly. Valuation of closing stock of finished goods is to be made at the cost or market price, whichever is less.

Any interest (not being interest on loan issued for public subscription), royalty, fees for technical services and any sum paid on account of wealth tax shall not be deducted in computing the income chargeable under the head 'Profits and gains of business or profession'.

It has judicially been held¹ that mercantile system of accounting was relevant only to determine the point of time at which liability was attracted. It could not determine the range of taxable income or the ambit of taxation. It was further held that any receipt would be subject to tax only in the relevant year in which the right to receive accrued or arose to the assessee, but could not be spread over to future years.

Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.286.81 crore** in **94 cases** in Andhra Pradesh, Bihar, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttaranchal, Uttar Pradesh and West Bengal. **One** case involving short levy of tax of Rs.10 crore or more is illustrated below and **18** cases each involving tax effect of more than Rs.1 crore but less than Rs.10 crore are indicated in **Appendix 9**.

3.9.1 In Tamil Nadu, Central-II, Chennai charge, the income tax assessment of a company, **M/s. Essar Investment Ltd.**, for the assessment year 1994-95 was completed after scrutiny in March 1997 at 'Nil' income. Audit scrutiny revealed that the assessee transferred 400 lakh share warrants to its wholly owned subsidiary at Rs.240 crore. As the cost of share warrants was 'nil', the company claimed exemption on the profit realised on the transfer of asset. The normal business of the assessee company was purchase and sale of shares in bulk quantities regularly. Hence the transfer of share warrants which were held for a short period were nothing but sale of business assets i.e. (stock in trade) and therefore taxable under the head business income. Omission to assess the sale proceeds amounting to Rs.240 crore as "business income" resulted in under assessment of a like sum involving a tax effect of **Rs.210.75** crore including interest for short payment of advance tax. On this being pointed out in March 1997, the department replied that remedial action was taken in March 2001 and additional demand of Rs.254.45 crore was raised.

3.10 Capital and non-business expenditure incorrectly allowed

Incorrect allowance of inadmissible expenditure/claims

Any expenditure, not being in the nature of capital expenditure, laid out wholly or exclusively for the purpose of business, is allowable as deduction in computation of income chargeable under the head 'profits and gains of business or profession'. No deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of total income under the Act.

Assessing officers incorrectly allowed capital and non-business expenditure which resulted in short levy of tax totalling **Rs.48.77 crore** in **19 cases** in Delhi, Kerala, Maharashtra, Uttar Pradesh. **Two** cases involving short levy of tax of more than

¹ CIT Vs. Motor Credit (P) Ltd. {127 ITR 572 (MAD)}
EID Parry (I) Ltd. Vs DCIT (46 ITR 391 (MAD))

Rs.10 crore are illustrated below and **three** cases over Rs.1 crore but below Rs.10 crore each are indicated at serial numbers **1 to 3** of **Appendix 10**.

3.10.1 In Maharashtra, City-III, Mumbai charge, the assessment of a company, **M/s. Silvassa Industries (P) Ltd.**, for the assessment year 1996-97, initially completed in summary manner in November 1996 was revised in January 1999, followed by a further revision made after scrutiny in January 1999. Audit scrutiny revealed that the assessee issued 18 percent cumulative secured fully convertible debentures in November 1993 for Rs.300 crore, which were fully subscribed by Reliance Industries Ltd. in March 1994 who, after a period of 24 months and in terms of issue of these debentures, surrendered these debentures to the assessee for repurchase in March 1996 and was paid Rs.50 crores as loyalty payment in addition to the value of debentures of Rs.300 crores. The expenditure on payment of Rs.50 crores by the assessee was claimed and allowed as deduction from the taxable income, which was not in order. Since the debentures were issued to raise funds for a project, which was not completed till the date of repurchase of debentures, the loyalty payment made was in the nature of financial charges/pre-operative expenditure and hence it should have been capitalized. Incorrect treatment of the same as revenue expenditure and allowance of deduction from the "Income from other sources" resulted in under assessment of Rs.50 crore involving short levy of tax of **Rs.23 crore**. On local verification of records, it was seen that the department had rectified the assessment under section 147 in March 2004.

3.10.2 In Uttar Pradesh, Lucknow-I charge, the assessment of a company, **M/s. Indo Gulf Corporation Ltd**, for the assessment year 1997-98 was completed after scrutiny in February 2000. Audit scrutiny revealed that the assessee had claimed an expenditure of Rs.24.52 crore towards replacement of catalyst and catalyst tube of their existing plant and machinery. Though the expenditure was capital in nature, it was allowed as revenue expenditure by the assessing officer, which was in contravention of the provisions of the Act. After allowing depreciation of Rs.6.13 crore (25% of Rs.24.52 crore) the amount of capital expenditure treated as revenue expenditure comes to Rs.18.39 crore. The incorrect allowance of capital expenditure of Rs.18.39 crore resulted in short computation of income by an identical amount and short levy of tax of **Rs.11.98 crore** including interest. On being pointed out in November 2000, the department accepted the audit observation and rectified the mistake. The assessee has already paid a sum of Rs.5 crore against the demand.

3.11 Preliminary and prior period expenses incorrectly allowed

Admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with extension of an industrial undertaking is limited to 2.5 per cent (5 per cent w.e.f. 1 January 1999) of the cost of the project or capital employed at the option of the assessee and is allowed in equal instalments spread over 10 years.

Audit noticed that assessing officers had incorrectly allowed preliminary and “prior period” expenses which resulted in short levy of tax totalling **Rs.4.42 crore** in **eight cases** in Delhi, and Maharashtra. **One** case involving tax effect of more than Rs.1 crore but less than Rs.10 crore is indicated at serial number **4** of **Appendix 10**.

3.12 Incorrect allowance of provisions

Provisions incorrectly allowed

A provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions do not qualify for deduction under the Act. It has been judicially held² that in order for a loss to be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur.

No deduction in respect of any provision for gratuity on retirement or on termination of employment for any reason shall be allowed unless it is by way of contribution towards an approved gratuity fund or for payment of gratuity that has become payable during the previous year.

Where sales tax payable by a registered dealer has been deferred under the specific sales tax deferment scheme of a state government and the tax so deferred is deemed to have been paid in the year in which the liability thereof has arisen, the dealer would be entitled to claim in the relevant assessment year, the amount of tax deemed to have been paid in the relevant previous year.

The amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing the income chargeable to tax under the head ‘profits and gains of business or profession’. In the case of a bank where provision made for bad and doubtful debts is admissible, the amount of deduction shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts accounts made under the Act. No deduction for a bad debt or part thereof shall be allowed unless the assessee has debited the amount of such debt or part of debt in the previous year to the provision for bad and doubtful debts account. Besides, bad debts written off shall not include any provision for bad and doubtful debts made in the books.

With effect from the assessment year 1984-85, certain deductions as specified in the Act, are allowable only on actual payment basis. From 1 April 1989, cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc., or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are also deductible on actual payment basis. No deduction in respect of contribution to the above funds

² CIT Vs Indian Overseas Bank 151 ITR 446 (Madras High Court)

is however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds.

Under the Income Tax Act, 1961, financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to special deduction of an amount transferred by them out of their profits to special reserve account, up to an amount not exceeding 40 percent of the profits derived from such business of providing long term finance as computed under the head "Profits and gains of business or profession" before making this deduction and any other deduction under Chapter VI A.

Audit noticed that the assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.288.24 crore** in **39 cases** in Delhi, Gujarat, Kerala, Maharashtra, Tamil Nadu and West Bengal. **Four cases**, involving tax effect of more than Rs.10 crore each are illustrated below and **14 cases** with tax effect over Rs.1 crore but below Rs.10 crore each, are shown in **Appendix 11**.

3.12.1 In Maharashtra, City-II Mumbai charge, the assessment of a nationalized bank, **M/s. Bank of India**, for the assessment year 1999-2000 was completed after scrutiny in March 2002 at an income of Rs.562.32 crore, after allowing a deduction of Rs.346.12 crore on account of "bad debts written off". Audit scrutiny revealed that the amount written off constituted Rs.23.67 crore on account of actual bad debts written off at branches, Rs.322.45 crore on account of prudential write off at Head office and partial write off at foreign branches. Prudential and partial write off of debts of Rs.322.45 crore in the accounts of head office/foreign branches was required to be disallowed in the absence of any details regarding the debt becoming actually irrecoverable or the debt having been actually written off from the books of account. However, it was not done. The omission resulted in under assessment of income of Rs.322.45 crore involving short levy of tax of **Rs.172.12 crore** including interest. On being pointed out, the department initiated remedial action under section 147 of the Act.

3.12.2 In Delhi-III charge, the assessment of company, **M/s. Steel Authority of India Ltd.**, for the assessment year 2000-01 was completed after scrutiny in March 2003. Audit scrutiny revealed that the long-term agreement for revision of employees' salaries and wages had expired on 31 December 1996 and fresh agreement was pending settlement. However, "ad-hoc" adjustable advance/interim relief to the employees amounting to Rs.84.60 crore, against actual revision of salaries and wages was provided in the accounts. As it was only an unascertained liability, it was required to be disallowed. Omission to do so resulted in incorrect carrying forward of loss of Rs.84.60 crore involving potential tax effect of **Rs.32.58 crore**. On this being pointed out, the department accepted the audit observation.

3.12.3 In Delhi-I charge, the assessment of a company, **M/s. Airport Authority of India**, for the assessment year 2000-01 was completed after scrutiny in September 2002 at an income of Rs.394.66 crore. Audit scrutiny revealed that the assessee had made provisions of Rs.72.87 crore on account of 'Wage revision'. The provision not being actual expenditure should have been disallowed. The omission resulted in under assessment of income of Rs.72.87 crore with short levy of tax of **Rs.28.05 crore** including interest. On being pointed out in September 2003, the department accepted the audit observation and initiated remedial action by issuing notice under section 148 of the Act.

3.12.4 In Tamil Nadu, Chennai, Central-I charge, the income tax assessment of a company, **M/s. NEPC India Ltd.**, for the assessment year 1998-99 was completed after scrutiny in February 2002 at an income of Rs.77.28 crore. Audit scrutiny revealed that the assessee had claimed an expenditure of Rs.17.48 crore towards unpaid interest on secured loans obtained from financial institutions. As this amount represented interest liability that was not actually discharged during the previous year, it was required to be disallowed by the assessing officer. Omission to disallow unpaid interest liability resulted in under assessment of income of Rs.17.48 crore with consequential short levy of tax of **Rs.10.72 crore** including interest for short payment of advance tax. On this being pointed out in May 2002, the department intimated (March 2003) that the unpaid interest of Rs.17.48 crore had since been included in the income and additional tax demand raised.

Incorrect computation of capital gains

3.13 Any profit and gains arising from the transfer of a capital asset shall be chargeable to income tax under the head 'capital gains' and is taxable in the year in which the transfer took place. The mode of computation of capital gains in respect of long-term capital asset provides for deduction, from the consideration received, of the cost of acquisition of assets and the cost of any improvement thereto and of expenditure incurred wholly and exclusively in connection with such transfer. From the assessment year 1993-94, indexed cost of acquisition and indexed cost of improvement would apply in the case of transfer of long-term capital assets. However, from the assessment year 1998-99 these provisions are not applicable to bonds or debentures other than capital indexed bonds issued by the government.

The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.42.81 crore** in **five** cases in Delhi and Maharashtra. **Two** case involving tax effect of more than Rs.10 crore are illustrated below:

3.13.1 In Maharashtra, City-V, Mumbai charge, the income tax assessment of a company, **M/s. Air India Ltd.**, for the assessment year 2000-01 was completed after scrutiny in March 2003, at a loss of Rs.237.92 crore. Audit scrutiny revealed that while computing income, the assessing officer, inter alia, reduced short term capital gain of Rs.54.71 crore representing net profit on sale of investment and

dividend income of Rs.98.36 lakh from business loss of Rs.240.57 crore, as returned by the assessee, for being taken into account separately and taxed. However, both the short term capital gain of Rs.54.71 crore from net profit on sale of investment and dividend income of Rs.98.36 lakh were not brought to tax at all, even though the same were reduced from the computation of income, for separate consideration. The omission resulted in excess carry forward of loss by Rs.55.69 crore involving potential short levy of tax of **Rs.21.44 crore**.

3.13.2 In Delhi-IV charge, the assessment of a company, **M/s. Indrama Investment Ltd.**, for the assessment year 2000-01 was completed in June 2002 after scrutiny at an income of Rs.6.29 lakh after allowing an exemption of Rs.107.50 crore under section 54EA of the Act. Audit scrutiny revealed that out of total investment of Rs.109.40 crore stated to have been made in specified securities, a sum of Rs.59.64 crore was invested in the units of some mutual funds, which were not referred to in clause (23D) of Section 10 as specified by the Board in this behalf. Thus capital gains amounting to Rs.59.64 crore invested in units of unspecified mutual funds should not have been exempted from tax. The incorrect exemption resulted in underassessment of income of Rs.59.64 crore involving short levy of tax of **Rs.19.55 crore** including interest and withdrawal of interest allowed.

Incorrect computation, carry forward and set off of losses

3.14 Where the net result of computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss including depreciation can not be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those years.

No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined. Further, no loss can be carried forward for set off unless the assessee has filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer.

Loss under the head 'capital gains' can be set off only against income from capital gains in subsequent years.

The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.220.27 crore** in **18 cases** in Delhi, Himachal Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Two** cases each involving tax effect of more than Rs 10 crore are illustrated below and **four** cases of tax effect of over Rs.1 crore but below Rs.10 crore, each, are indicated against serial Nos **1 to 4 of Appendix 12**.

3.14.1 In Delhi-III charge, the income tax assessment of a company, **M/s. Samsung India Electronics Ltd.**, for the assessment year 2000-01 was completed after scrutiny in March 2003 at an income of Rs.34.75 crore after adjusting brought forward losses of Rs.27.10 crore for the assessment year 1999-2000. Audit scrutiny of the assessment for the assessment year 1999-2000 revealed that loss of Rs.6.74 crore was only left to be carried forward. The excess set off of loss of Rs.20.36 crore (Rs.27.10 crore – Rs.6.74 crore) resulted in underassessment of income of a like sum with consequent short levy of tax of **Rs.11.64 crore** including interest. On this being pointed out, the Ministry accepted the audit observation.

3.14.2 In West Bengal-II, Kolkata charge, the assessment of a banking company, **M/s. UCO Bank**, for the assessment year 2000-01 was completed after scrutiny in March 2003 at 'nil' income after setting off unabsorbed business loss to the extent of Rs.221.08 crore and allowing, inter alia, further carry forward of remaining business loss of Rs.373.97 crore pertaining to the assessment year 1993-94, for future set off. Audit scrutiny revealed that the assessment for the assessment year 1993-94 initially processed in a summary manner was subsequently completed after scrutiny in March 1996 determining loss for the year at Rs.88.17 crore. Consequently, the assessee was required to be allowed set off of Rs.88.17 crore only and not Rs.221.08 crore as allowed. This mistake resulted in excess set off of loss of Rs.132.91 crore involving undercharge of tax of Rs.51.17 crore. Moreover, further carry forward of business loss of Rs.373.97 crore for the assessment year 1993-94 was also incorrect. This irregular carry forward involved potential tax effect of Rs.143.98 crore. The total tax effect worked out to **Rs.195.15 crore** including potential tax effect of Rs.143.98 crore. The audit observation communicated to the department in August 2003, was accepted in February 2004.

Mistakes in implementation of appellate orders

3.15 An aggrieved assessee can appeal to the Commissioner of Income Tax (Appeals) against the order of an assessing officer who shall comply with the directions given in the appellate order. Further appeal is also permitted to be made on questions of fact and law to ITAT³ and on the questions of law alone to the High Court and the Supreme Court thereafter. Any mistake committed while giving effect to appellate order will result in under assessment/over assessment of income.

The assessing officers did not implement the appellate orders correctly, which resulted in short levy of tax totalling **Rs.3.54 crore** in **nine cases** in Delhi, Gujarat, Maharashtra, Rajasthan and Tamil Nadu and Uttar Pradesh and West Bengal. **One** case involving tax effect of Rs.1 crore or more is indicated at serial number **five of Appendix 12**.

³ Income tax appellate tribunal

**Irregular reliefs
and exemptions
under Chapter
VIA of the
Income Tax Act**

3.16 Excess allowance of deduction towards inter-corporate dividends

Under the Income Tax Act 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed, in computing the total income, a deduction of an amount equal to so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the former domestic company on or before the due date. The Act further provides that deduction on account of inter-corporate dividends is to be allowed with reference to the net dividend income as computed in accordance with provisions of the Act and not on the gross amount of dividends.

Non-adherence to above provisions by the assessing officer resulted in excess allowance of deduction towards inter-corporate dividend amounting to **Rs.11.10 crore** in one case in Maharashtra, which is illustrated below.

3.16.1 In Maharashtra, City-II, Mumbai charge, the assessment of a banking company, **M/s. State Bank of India**, for the assessment year 1996-97 completed after scrutiny in March 1999 at a total income of Rs.1355.82 crore was revised in February 2001 at an income of Rs.1550.13 crore, inter-alia allowing deduction of Rs.29.92 crore towards inter corporate dividend, being sixty percent of the gross dividend of Rs.49.87 crore. Audit scrutiny revealed that while revising the total income in February 2001, dividend for the purpose of deduction under Section 80 M for intercorporate dividends, inter alia, was not restricted to Rs.15.72 crore i.e. 'net' of expenditure of Rs.34.15 crore incurred for earning such dividend. Mistake in adoption of net dividend income for the purpose of allowing deduction under Section 80 M resulted in underassessment of income of Rs.20.49 crore (29.92 minus 9.43). The net underassessment was Rs.19.47 crore after allowing exemption to dividend earned from investment in UTI. There was, therefore, a short levy of tax of **Rs.11.10 crore** including interest. On being pointed out in January 2002, the department rectified the mistake in March 2004.

3.17 Incorrect allowance of deduction in respect of export profits

An assessee being an Indian company or other assessee, resident in India, engaged in the business of export is entitled to a deduction equal to the profits derived from the export of goods or merchandise if the sale proceeds are received in convertible foreign exchange. Where the export out of India is of goods or merchandise manufactured or processed by the assessee and also of trading goods, the profits derived from such export shall, in respect of goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turn over of the business carried on by the assessee and in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods. The profit so arrived at shall be further increased by ninety

percent of profit on sale of licenses and export incentives, if any. The export and total turnover shall not, however, include freight or insurance attributable to the transport of the goods or merchandise beyond the custom station. Further, deduction in respect of export profits shall not be admissible unless the assessee furnished along with the return of income, the report of an accountant certifying that the deduction was correctly claimed in accordance with the provisions of section 80HHC.

Incorrect application of the above provisions resulted in short levy of tax totalling **Rs.17.62 crore** in **23 cases** in Andhra Pradesh, Delhi, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Punjab and Tamil Nadu. **Seven** cases, each involving tax effect of more than Rs.1 crore are indicated at serial numbers **one to seven of Appendix 13**.

3.18 Incorrect allowance of deduction in respect of profits derived from new industrial undertaking established after 31 March 1991

Where the gross total income of an assessee includes any profits and gains derived from a newly established industrial undertaking, which goes into production after 31 March 1991, the assessee is entitled to a deduction of 30 percent of profits. The deduction is subject to fulfilment of certain conditions one of which is that it is not formed by splitting up or reconstruction of a business already in existence and it is not formed by the transfer to a new business of machinery or plant previously used for any purpose. For determining the quantum of deduction, profits and gains of the eligible business shall be computed as if such profits and gains were the only source of income of the assessee during the relevant previous year.

Assessing officers did not apply the above provisions correctly which resulted in short levy of tax totalling **Rs.94.60 lakh** in **four** cases in Andhra Pradesh, Maharashtra, and Tamil Nadu.

3.19 Incorrect computation of income under special provisions of the Act

Under Section 115 JA of the Income Tax Act, 1961, where in the case of an assessee being an Indian company the total income as computed under this Act in respect of any previous year is less than 30 percent of its book profit, the total income of such assessee chargeable to tax shall be deemed to be an amount equal to thirty percent of such profit. For this purpose, book profit means the net profit as per the profit and loss account subject to certain additions/deletions. According to explanation 9(b) to sub-section 2 of Section 115JA, the amount carried to any reserve by whatever name called is to be added to net profit. Brought forward loss or unabsorbed depreciation, whichever is less, would be reduced in arriving at the book profit. Under the Act, determination of deemed income under the special

provisions shall not affect the determination of loss to be carried forward and set off in subsequent assessment years.

Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.29.20 crore** in **14** cases in Delhi, Gujarat, Karnataka, Madhya Pradesh and Maharashtra. **One** case involving tax effect of more than Rs.10 crore is illustrated below and **two** cases of more than Rs. one crore but less than Rs.10 crore each are indicated against serial numbers **one and two** of **Appendix 14**.

3.19.1. In Maharashtra, in different Commissioners charges, **24 assessments of 19 companies**, pertaining to the assessment years 1999-2000 to 2001-02 were finalized between March 2002 and October 2003 either after scrutiny or in summary manner or as best judgement assessment under the special provisions of the Act. Audit scrutiny revealed that in all these cases, the assessees claimed and were allowed MAT credit from the total tax liability before charging interest for default in furnishing return of income or interest for default in payment of advance tax or interest for deferment of payment of advance tax, though the same was required to be given after charging the said interest. Further, interest on refunds was allowed on such credit. In one case, MAT credit was allowed even though no such credit was available. The mistakes resulted in short levy of interest totalling **Rs.24.15 crore**. On being pointed out, the department accepted the audit observations in four assessments and initiated remedial action under section 154. In sixteen assessments, the department replied that the tax collected under MAT had to be treated as tax collected under Chapter XVII of the Act. Reply is not tenable as setting off tax credit ahead of advance tax and tax deducted at source could result in the assessee being paid interest on tax credit, which is otherwise not admissible under the Act. A suitable clarification from the Board to assessing officers to allow tax credit strictly in accordance with the spirit behind special provisions would prevent inconsistent approach from being adopted by assessing officers and loss of revenue.

Excess or irregular refunds by Government

3.20 Where, as a result of any order passed in assessment, appeal, revision or any other proceedings under the Act, refund of any amount becomes due to the assessee, it may be granted in cash or adjusted or set off against outstanding dues of the assessee for any assessment year.

The assessing officers committed mistakes in grant of refunds viz. grant of excess refund of tax non adjustment of refund which resulted in irregular refunds totalling **Rs.3.14 crore** in **four cases** in Andhra Pradesh, Orissa and Maharashtra. **One** case of more than Rs. one crore but less than Rs.10 crore is indicated against serial number **three** of **Appendix 14**.

Incorrect payment of interest on irregular refunds

3.21 An assessee is entitled to receive, in addition to the refund out of any advance tax paid including the tax deducted at source, simple interest thereon at the rate of 8 per cent per annum with effect from June 2002 (since reduced to

6 per cent from 8 September 2003). Interest is payable for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted. No interest will be payable, if the amount of refund is less than ten percent of tax determined in summary or on regular assessment.

Assessing officers made incorrect payment of interest totalling **Rs.10.84 crore** in **17 cases** in Delhi, Gujarat, Jharkhand, Karnataka, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Two** cases involving excess payment of interest of more than Rs. one crore each are shown against serial numbers **four and five** of **Appendix 14**.

3.22 Loss of Revenue due to delay in issue of Notice u/s 148:

Under the Income Tax Act, 1961 before making the assessment, reassessment or recomputation, the assessing officer shall serve on the assessee a notice requiring him to furnish within such period as may be specified in the notice, a return of his income in the prescribed form and setting forth such other particulars as may be prescribed and the provisions of the Act shall be applied as if such return were a return required to be furnished u/s 139.

Audit noticed that the assessing officers did not adhere to the above provisions, which resulted in short levy of tax totalling **Rs.29.71 crore** in **three** cases in Delhi and Rajasthan. **One** case involving tax effect of more than Rs.10 crore is illustrated below.

3.22.1 In Delhi V charge, the assessment of a banking company, **M/s. Punjab National Bank**, for the assessment years 1993-94 completed after scrutiny in March 1996 at an income of Rs.108.03 crore while for the assessment year 1994-95 the assessment was completed at a loss of Rs.57.32 crore. The cases were reopened by issuing notice under section 148 on 30 May 2001. The assessments were completed in February 2002. Audit scrutiny revealed that the assessee went in appeal and the appellate authority held that notice under section 148 could not have been issued after 11 May 2001 and deleted the additions. The department could not file the second appeal as notice under section 148 was served after the specified date. The delay in issue of notice after the specified date resulted in under assessment of income of Rs.19.26 crore with consequent short charge of tax of **Rs.17.14 crore** including interest for the assessment year 1993-04 and deletion of Rs.23.75 crore involving potential tax effect of **Rs.12.29 crore** for the assessment year 1994-95. This was a case of loss of revenue caused solely by non-adherence to the basic requirement of serving the statutory notice before the due date, which was well known to the assessing officer.

**Non levy/short
levy of interest**

3.23 If an assessee fails to file return within the specified due date or who is liable to pay advance tax, has failed to pay such tax or, where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent upto 31 May 1999,

(one per cent from 8 September 2003) for every month. Interest shall be reckoned from 1 April next following such financial year to the date of determination of total income and where a regular assessment is made, to the date of such regular assessment. Interest is payable on the amount equal to the assessed tax or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax. The Act further provides that self-assessment tax paid should include interest, if any, liable to be paid by the assessee under any provision of the Act. In the event of shortfall in the total of the tax and interest, the amount so paid shall first be adjusted towards interest payable and balance if any, is adjusted towards tax payable.

The assessee should pay any demand for tax within thirty days of service of notice of the relevant demand. Failure to do so would attract levy of simple interest at one and one half percent (one per cent from 8 September 2003) for every month or part thereof from the date of default till actual payment.

Audit noticed non-compliance with the above provisions. Interest was short levied by **Rs.404.13 crore** in **66 cases** in Assam, Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Two** cases involving tax effect of more than Rs.10 crore are illustrated below and **nine** cases of tax effect over Rs.one crore but below Rs.10 crore, each, are shown against serial numbers 1 to 9 of **Appendix 15**.

3.23.1 In Madhya Pradesh, Jabalpur-II charge, the income tax assessments of a company, **M/s. Northern Coal Fields Ltd.**, for the assessment years 1995-96 and 1996-97 were completed after scrutiny in March 2002 at an income of Rs.792.62 crore and Rs.8.34 crore respectively. Audit scrutiny revealed that the interest for short payment of advance tax was incorrectly charged till the date of summary assessment as against the date of regular assessment. The mistake resulted in short levy of interest of **Rs.355.60 crore** for both the assessment years. On this being pointed out in November 2002, the department accepted the audit observations and informed that the assessment for the assessment year 1995-96 had been revised under section 154 in March 2003, raising an additional demand. However, remedial action for the assessment year 1996-97 is yet to be taken.

3.23.2 In Delhi, V charge, the assessment of a company, **M/s. Okara Agro Industries Ltd.**, for the assessment year 1997-98 was originally completed after scrutiny in March 2000 at an income of Rs.55.74 crore with tax demand of Rs.40.00 crore. The assessment was set aside in March 2001 and finally completed in March 2002 at the same income. Audit scrutiny revealed that the original demand notice was served in March 2000 and the assessee was liable to pay demand by April 2000. As the demand was not paid within the prescribed time, the assessee was liable to pay interest of Rs.13.39 crore from April 2000 to March 2002. The department, however, did not levy any interest, which resulted

in non-levy of interest of **Rs.13.39 crore**. On this being pointed out, the Ministry accepted the audit observation.

Other topics of interest

3.24 Non-deduction of tax at source/non-remittance of tax to government

If a person responsible for deducting tax at source does not deduct such tax or after deducting fails to pay tax to the credit of the Central Government, such person is liable to pay interest at 15 per cent per annum (12 per cent per annum from 8 September 2003) on the amount of tax from the date on which such tax was deductible, to the date on which tax is actually paid.

Audit noticed that the assessing officers did not adhere to the above provisions which resulted in short levy of interest totalling **Rs.5.50 crore in 12 cases** in Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Punjab and West Bengal. **One** case involving tax effect of more than Rs.1 crore is indicated against serial no.10 of **Appendix 15**.

3.25 Unexplained expenditure/undisclosed income

Where any sum is found credited in the books of an assessee and the assessee offers no explanation about the nature and source thereof, or explanation offered by him is not found to be satisfactory, the sum credited may be charged to income tax as income of the assessee of that previous year.

Audit noticed mistakes in assessments viz. unexplained credit, investments and expenditure were incorrectly excluded in income, resulting in short levy of tax totalling **Rs.1.05 crore in four cases** in Delhi, Gujarat, and Himachal Pradesh.

3.26 Incorrect deduction in respect of interest tax liability

Under the Interest Tax Act, 1974, interest tax payable by the assessee for any assessment year shall be deductible from the profits and gains assessable for that assessment year. If the interest tax assessment is revised resulting in increase/decrease of the interest tax payable, the income tax assessment also needs to be revised simultaneously for computing the revised income. No time limit is prescribed in the Interest Tax Act for completion of interest tax assessment. The Board issued instructions in (November 1973, April 1979 and September 1984) for ensuring proper coordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and different direct tax assessments, so that there was no evasion of tax.

Audit noticed that omission to restrict the deduction towards interest tax liability to actual payment resulted in short levy of tax totalling **Rs.1.06 crore in two cases** in Kerala charge.

**Special
comments on
summary
assessments
made from
June 1999
onwards**

3.27 Around 90 per cent of total assessments are being completed in summary manner on an average during the years 2000-01 to 2002-03 in the case of companies. Consequent to the amendment of Income Tax Act, 1961, w.e.f. 1 June 1999, no prima facie adjustments can be made by the assessing officer in an assessment completed in summary manner. However, unentitled benefits availed of by the assessee in summary assessments can be withdrawn and mistakes rectified under the powers separately available to the assessing officers under the Income Tax Act. The department does not have an effective mechanism to identify and take corrective measures in respect of mistakes arising out of assessments made in summary manner. Audit noticed inconsistency in the stand taken by assessing officers regarding remedial action to be taken to safeguard interests of revenue. Table 3.1 contains the details of action taken or not taken on the mistakes in summary assessments pointed out in audit:-

S.No	Response of the department	No. of cases
1	Audit observation accepted and remedial action taken	24
2	Audit observation simply accepted	7
3	Remedial action taken	20
4	Remedial action taken while not accepting the audit observation	5
5	Agreed to initiate remedial action	15
6	Not accepted on the plea that it being a debatable issue, remedial action can not be taken	21
7	Reply awaited from the department	44
Total		136

During test check, Audit observed that in **136 cases** of summary assessment completed after 1 June 1999 involving tax effect totalling **Rs.205.46 crore** in Andhra Pradesh, Assam, Delhi, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal, assessing officers of the department have been inconsistent on taking follow up remedial action in mistakes noticed in summary assessments as is evident from Table 3.1. **Six** cases, each involving tax effect of more than Rs.10 crore are illustrated below and **29** cases each with tax effect over Rs. one crore but below Rs.10 crore are shown in **Appendix 16**.

3.27.1 Tamil Nadu, Chennai-I charge, the income tax assessment of a company, **M/s Alstom Ltd.**, for the assessment year 1999-2000, processed in summary manner in March 2000 was revised in June 2001 at a loss of Rs.55.04 crore. Audit scrutiny revealed that the assessee sold its low voltage component business as a going concern to M/s G.E. Electric Distribution and Control (India) Pvt. Ltd. in June 1998. The total consideration for sale of the business was Rs.78.58 crore. The sale was required to be regarded, as a “slump sale” since no portion of the consideration was allocable to any specific asset. The profit of Rs.48.76 crore out

of such sale was neither offered to tax by the assessee nor brought to tax by the assessing officer. Omission to tax the profit of Rs.48.76 crore on sale of business resulted in non-assessment of capital gain of like amount with consequential reduction in loss by Rs.48.76 crore and potential tax effect of **Rs.17.07** crore for the assessment year 1999-2000.

3.27.2 In West Bengal-I Kolkata charge, the assessment of a company, **M/s. Burn Standard Co. Ltd.**, for the assessment year 1999-2000 was completed in a summary manner in April 2001 at 'Nil' income after setting off unabsorbed business loss of Rs.308.98 crore. Audit scrutiny revealed that the loss of Rs.308.98 crore included, inter alia, business loss of Rs.93.70 crore as against the correct amount of Rs.62.80 crore and Rs.96.65 crore instead of the correct amount of Rs.91.91 crore for the assessment years 1994-95 and 1995-96 respectively. Allowance of incorrect amounts by the assessing officer, based on the claim of the assessee resulted in excess 'set off' of losses totalling Rs.35.65 crore for the assessment years 1994-95 and 1995-96 involving potential tax effect of **Rs.12.48 crore**. Though the assessing officer did not accept the audit observation on the ground that it was a summary assessment, local verification revealed that an order for rectification of the omission had been issued in March 2004.

3.27.3 In Delhi-IV charge, the assessment of a company, **M/s. Hexacom India Ltd**, for the assessment year 2002-03 was completed in summary manner at 'Nil' income in February 2003 after set off of losses of Rs.10 crore. Audit scrutiny revealed that losses amounting to Rs.74.08 crore were incorrectly allowed to be carried forward for future set off against the correct amount of Rs.40.63 crore. The mistake resulted in excess allowance of carry forward of loss by Rs.33.46 crore with consequent potential effect of **Rs.11.94 crore**.

3.27.4 In Delhi-V charge, the assessment of a company, **M/s. Oriental Bank of Commerce**, for the assessment year 2001-02 was processed in a summary manner in February 2003 at an income of Rs.262.03 crore after allowing exemption of Rs.139.76 crore towards dividend income and income relating to tax free bonds and investments in infrastructure capital funds. Audit scrutiny revealed that proportionate administrative expenses attributable to the exempted income were not disallowed from the total administrative expenditure claimed. After deduction of proportionate administrative expenses of Rs.115.09 crore, allowable deduction worked out to Rs.24.67 crore as against Rs.139.76 crore allowed. The mistake resulted in underassessment of income of Rs.115.09 crore with consequential short levy of tax of Rs.54.80 crore including interest. The department replied (February 2004) that the audit observation would be taken care of in scrutiny assessment. It was however, observed that while making scrutiny assessment, no addition was made towards the shortfall in disallowance of proportionate expenses to earn the remaining tax free income of Rs.107.12 crore pertaining to tax free bonds and investment in infrastructure capital funds. Omission to make the addition resulted in under assessment of income of Rs.18.56 crore with consequent short levy of tax of **Rs.10.68 crore** including interest.

3.27.5 In West Bengal-I, Kolkata charge, the assessment of a company, **M/s. Westinghouse Saxby Farmer Ltd**, for the assessment year 2001-02 was processed in summary manner in February 2003 at 'loss' and the same was allowed to be carried forward. Audit scrutiny revealed that the assessee submitted the return of loss on 28 December 2001 as against the due date of submission of 30 November 2001. Since loss determined on belated return is not admissible for being carried forward for future set off, the mistake resulted in irregular carry forward of business loss of Rs.25.96 crore involving potential tax effect of **Rs.10.27 crore**. Though the department did not accept the audit observation on the ground that it was a 'summary assessment, local verification revealed that, in the interest of revenue, a notice under section 148 had been issued in November 2003 to consider reassessment.

3.27.6 In Delhi-III charge, the income tax assessments of a company, **M/s. Steel Authority of India Ltd**, for the assessments years 1999-2000 and 2000-01 were completed in summary manner in March 2000 and after scrutiny in March 2003 at a loss of Rs.3220.13 crore and Rs.2218.61 crore respectively. Audit scrutiny revealed that provident fund dues amounting to Rs.35.58 crore were paid late, but only Rs.8.17 crore was added back in computation of the income. The remaining amount of Rs.27.41 crore was claimed on the plea that the appellate authorities had been allowing the expenses as long as these were incurred within the financial year. As the Act did not provide for allowing late payment of provident fund dues, Rs.27.41 crore paid late should have been disallowed. Omission do so resulted in over-assessment of loss by Rs.27.41 crore involving potential tax effect of **Rs.10.11 crore**. For the assessment year 2000-01, the department accepted the audit observation. For the assessment year 1999-2000, though the department did not accept the audit observation yet remedial action had been taken.

**Cases of over
assessment
or over
charge**

3.28 Cases of over assessment/over charge due to negligence on the part of assessing officers are being featured in the reports of the Comptroller and Auditor General of India year after year. During test check in audit during 2003- 04, audit noticed over assessment of income in **15 cases** involving over charge of tax totalling **Rs.15.31 crore** in Haryana, Karnataka, Kerala, Maharashtra, Orissa, Tamil Nadu and West Bengal. **Three** cases involving tax effect of Rs.1 crore or more each are shown in **Appendix 17**.