

Chapter Summary

Income tax constituted 39.38 percent of the total collection from direct taxes in 2003-04. There were 2.88 crore assessees as on 31 March 2004, which represented an increase of 2.49 per cent over the previous year.

(Para 4.1 & 4.2)

Audit issued 174 observations with a tax effect of Rs.37.33 crore involving various irregularities, omissions and mistakes to the Ministry of Finance.

(Para 4.4)

Assessees had availed unentitled benefits in summary assessments in 29 cases involving tax effect of Rs.4.91 crore.

(Para 4.24)

In addition, assessing officers committed mistakes in:

- ◆ adoption of correct figures, applying correct rate of tax and levy of surcharge in 35 cases involving tax effect of Rs.8.35 crore.

(Para 4.6, 4.7 & 4.8)

- ◆ computation of business income and assessment of firm in 16 cases involving tax effect of Rs.2.06 crore

(Para 4.9 to 4.12 and 4.14)

- ◆ computation of capital gains, carry forward and set off of losses, implementation of appellate orders and allowed income to escape assessment in 18 cases involving tax effect of Rs.4.90 crore

(Para 4.13 & 4.15 to 4.17)

- ◆ allowing reliefs and exemptions under chapter VIA in 14 cases involving tax effect of Rs.4.78 crore,

(Para 4.18, 4.19)

- ◆ levy of interest in 42 cases involving tax effect of Rs.8.70 crore

(Para 4.21)

- allowing refund and interest thereon, not making assessment within the prescribed period in 6 cases involving tax effect of Rs.1.83 crore.

(Para 4.20,4.22)

- overcharge of tax in 8 cases involving tax effect of Rs.1.17 crore

(Para 4.25).

CHAPTER IV: INCOME TAX

Number of assessees	4.1 The number of assessees (other than companies) borne on the books of the Income tax department as on 31 March of 2003 and 2004 was 2.81 crore and 2.88 crore respectively as given in Table 2.7 of Chapter II of this Report.
Receipts from income tax	4.2 During 2003-2004, income tax receipts were Rs.41,387 crore compared to Rs.36,866 crore in 2002-2003. Table 2.4 of Chapter II of this report has the details.
Status of assessments	4.3 Table 2 of Appendix 5 of this Report contains particulars of assessments due for disposal, assessments completed and pending. Details of demands remaining uncollected during the last five years are given in Table 2.13 of this Report.
Results of audit	<p>4.4 Audit issued 166 draft paragraphs involving undercharge of tax of Rs.36.16 crore and 8 draft paragraphs involving overcharge of tax of Rs.1.17 crore to the Ministry of Finance between March 2004 and October 2004 for comments.</p> <p>Out of these 174 draft paragraphs, internal audit of the department had seen 20 cases, but the mistakes were not detected.</p> <p>Out of 174 draft paragraphs issued to Ministry, 160 cases, involving under charge of Rs.35.53 crore and 8 cases involving over charge of Rs.1.17 crore are indicated in the succeeding paragraphs. 29 observations with tax effect of Rs.4.91 crore related to summary assessments whereas 139 observations with tax effect of Rs.31.79 crore related to scrutiny, best judgment and block assessment.</p> <p>Paragraphs with money value of over Rs. 1 crore in each case are illustrated while those between Rs.10 lakh and Rs. 1 crore in each case are shown in the Appendices. Those with money value less than Rs.10 lakh in each case are clubbed together indicating consolidated figures of tax effect.</p>
Status of replies received from Ministry of Finance	4.5 Out of 168 cases included in this chapter, the Ministry of Finance have accepted audit observations in 14 cases involving tax effect of Rs.4.11 crore . In one case the Ministry have not accepted the audit observation. In the remaining 153 cases, the Ministry's replies are awaited.
Mistakes in adoption of correct figures	4.6 Non adherence to provisions of the Act Assessing officers are required to determine and assess the income correctly in scrutiny assessments. The Board have issued instructions to assessing officers and their supervisory officers to ensure that mistakes in assessments do not occur.

Audit noticed that assessing officers had adopted incorrect figures, not added back inadmissible claims and committed mistakes in computation as well as arithmetical errors in calculation of total income resulting in short levy of tax totalling **Rs.3.01 crore** in **17 cases** in Bihar, Gujarat, Haryana, Jharkhand, Maharashtra, Madhya Pradesh, Punjab, and West Bengal. **Eight cases** each involving tax effect of more than Rs.10 lakh but less than Rs. one crore are indicated in **Appendix 18**.

4.7 Incorrect application of rates of tax

Application of incorrect rate of tax

Under the Income Tax Act, 1961, 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 under the relevant Finance Act. Further, a firm assessed as such is chargeable to income tax at the rate of forty percent for the assessment year 1995-96.

One case involving tax effect of more than Rs.1 crore is illustrated below.

4.7.1 In Bihar, Patna Central charge, assessment of a firm, **M/s Chhotanagpur Cattlefood Supply Co. Ranchi** for the assessment year 1995-96 was completed originally after scrutiny at a total income of Rs.15.44 crore in March 1998 which was modified subsequently from time to time and finally rectified in September 2002 at a total income of Rs.15.33 crore. Audit scrutiny revealed that income tax was chargeable in the above case at the rate of forty percent whereas tax was charged by the department at thirty five percent. Incorrect application of rate of tax resulted in short charge of tax including interest aggregating Rs.2.36 crore. The department accepted the observation and initiated remedial action.

4.8 Surcharge

Surcharge not levied

Income tax including surcharge is charged at the rates prescribed in the relevant Finance Act.

Assessing officers did not levy surcharge at the rate prescribed in the Finance Acts resulting in short demand of **Rs.2.98 crore** in **17 cases** in Andhra Pradesh, Bihar, Delhi, Gujarat, Jharkhand, Madhya Pradesh, Maharashtra, Rajasthan, and West Bengal. **Eight cases** each involving tax effect of more than Rs.10 lakh but less than Rs. one crore are indicated in **Appendix 19**.

4.9 Liabilities not disallowed

Incorrect allowance of liabilities

Certain deductions being 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. are deductible on actual payment basis. It is further provided that only if the payment is made before the due date of filing of the return, such expenditure would be allowable.

Assessing officers allowed liabilities without expenditure being incurred resulting in short levy of tax of **Rs.73.26 lakh** in **five cases** in Gujarat and Maharashtra. **Two cases** involving tax effect of more than Rs.10 lakh are indicated at serial numbers **1 and 2 of Appendix 20**.

4.10 Payments exceeding Rs.20,000/- made otherwise than by cheque or bank draft.

Payments made otherwise than by cheque or bank draft

Under the Income Tax Act, 1961 where the assessee incurs any expenditure in respect of which payment exceeding twenty thousand rupees is made other wise than by a crossed cheque or by a bank draft, twenty percent of such expenditure shall not be allowed as a deduction.

Assessing officers did not observe these provisions in **two cases** involving tax effect of **Rs.66.32 lakh** in Himachal Pradesh and Gujarat charges. Details of these **two cases** are given at serial numbers **3 and 4 of Appendix 20**.

4.11 Underassessment of sale

Underassessment of sale

Under the Income Tax Act, 1961, all income accruing or arising to an assessee in a previous year relevant to the assessment year is included in the total income.

The assessing officer did not add the receipts by way of sales in **two cases** involving tax effect of **Rs.16.60 lakh** in Delhi and Gujarat charges.

4.12 Mistakes in computation of business income

Mistakes in computation of business income

Under the Income Tax Act, 1961, in a scrutiny assessment, the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment.

Income under the head “profits and gains of business or profession” is computed in accordance with the method of accounting regularly employed by the assessee.

Assessing officers committed mistakes in computing business income resulting in short levy of tax totalling **Rs.41.04 lakh** in **6 cases** in Gujarat, Karnataka, Rajasthan and West Bengal. **Two cases** each involving tax effect of more than Rs.10 lakh are indicated at serial numbers **5 and 6 of Appendix 20**.

4.13 Incorrect computation of capital gains

Irregularities in computation of capital gains

The method of computation of income chargeable to tax under the head ‘capital gains’ is described in **para 3.13** of this report.

Audit noticed instances of incorrect computation of capital gains and irregular exemption even where required conditions were not fulfilled, leading to short levy of tax totalling **Rs.1.52 crore** in **nine cases** in Gujarat, Haryana, Kerala, Maharashtra and Tamil Nadu. **Two cases** involving tax effect of more than Rs.10 lakh are indicated at serial numbers **7 and 8 of Appendix 20.**

4.14 Omission to include the income paid to partners in the assessment of firms

Mistakes in assessment of firms and partners

Under the Income Tax Act, 1961 income of a firm, assessed for each of the previous years falling within the block period shall be the income determined before allowing deduction of salary, interest, commission bonus or remuneration by whatever name called, provided that the income of the firm so determined shall not be chargeable to tax in the hands of the partners, whether on allocation of shares or on account of enhancement of income

Audit noticed that **one case** involving tax effect of **Rs.8.85 lakh** in Uttar Pradesh where the assessing officer while computing undisclosed income of the firm had omitted to include the amount of interest and remuneration paid to its partners in the assessment.

4.15 Income not assessed

Income escaping assessment

Income tax shall be charged for every assessment year in respect of total income of the previous year of every person. The term 'income' has an inclusive definition under the Act and includes capital gains, unexplained investment and so on.

Audit noticed short levy of tax totalling **Rs.2.83 crore** in **six cases** in Andhra Pradesh, Gujarat, Kerala, Rajasthan and Tamil Nadu as the assessing officers had not assessed all income to tax. One case involving tax effect of more than Rs. one crore is illustrated below. **Another case** involving tax effect of more than Rs.10 lakh but less than Rs.1crore is indicated at serial number **9 of Appendix 20.**

4.15.1 In Tamil Nadu, Central-II, Chennai charge, the income tax assessment of an individual, **Ms. Susila Ramasamy**, for the assessment year 1996-97 was completed after scrutiny in March 2003, determining the taxable income at Rs.80.77 lakh. Audit scrutiny revealed that while converting US dollars 6,25,000 into Indian Rupees, the conversion rate was erroneously applied as Rs.3 per US dollar instead of adopting the applicable rate of Rs.30 to a dollar. The mistake resulted in under assessment of income of Rs.168.75 lakh involving tax of Rs.250.53 lakh including interest. Department accepted the observation and completed remedial action by raising demand of Rs.250.53 lakh.

4.16 Incorrect computation, carry forward and set off of losses

Incorrect set off of losses

The method of computation, carry forward and set off of losses is described in **para 3.14** of this report.

Audit noticed short levy of tax totalling **Rs.50.77 lakh** in **two cases** in Delhi as the assessing officers did not apply the above provisions correctly. These cases are mentioned at serial numbers **10 and 11 of Appendix 20**.

4.17 Mistakes in assessments while giving effect to appeal orders

Mistakes in implementation of appellate orders

Under the Income Tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income Tax (Appeals) against an order of assessment made by the assessing officer and the later shall comply with the directions given in the appellate orders.

Audit noticed short levy of tax of **Rs.4.04 lakh** in **one case** in Haryana wherein while giving effect to the appellate order, the assessing officer omitted to charge interest for seven months of delay in filing of return.

4.18 Mistakes in computation of export profits

Incorrect allowance of deduction in respect of export profits

The method of allowance of deduction in respect of export profits has been described in **para 3.17** of this report.

Audit noticed mistakes in computation of export profits resulting in short levy of tax totalling **Rs. two crore** in **11 cases** in Andhra Pradesh, Delhi, Kerala, Maharashtra, Rajasthan, Tamil Nadu and Uttar Pradesh. **Three cases** each involving tax effect of more than Rs.10 lakh are indicated at serial numbers **1 to 5 of Appendix 21**.

4.19 Incorrect allowance of deduction in respect of income of co-operative societies.

Incorrect allowance of deduction in respect of income of co-operative societies

Under the Income Tax Act, 1961, where the gross total income of a Co-operative Society includes any income from the purchase of agricultural implements, seeds or other articles intended for agriculture for the purpose of supplying them to its members, deduction shall be allowed on the whole amount of such income. Proportionate expenses would have to disallowed in case the assessee earns income which is not to be included in the total income under the provisions of the Act.

Audit noticed mistakes in allowance of the deduction resulting in short levy of tax of **Rs.2.78 crore** in three **cases** in Haryana, Rajasthan and Orissa. One case involving tax effect of more than Rs. one crore is illustrated below. **Two cases**

each involving tax effect of more than Rs.10 lakh but less than Rs. one crore are indicated at serial numbers **6 and 7 of Appendix 21**.

4.19.1 In Haryana, Panchkula charge, the assessment of a co-operative society, **M/s. Haryana State Co-operative Supply and Marketing Federation, Ltd**, for the assessment year 1989-1990 was completed after scrutiny in March 2002 after allowing a deduction of Rs.2025.31 lakh.

Audit scrutiny revealed that deduction of Rs.517.70 lakh relating to non taxable income of “input” division was allowed without making a reduction on account of proportionate administrative and overhead expenses which worked out to Rs.138.87 lakh. This mistake resulted in excess allowance of deduction of Rs.138.87 lakh leading to under-assessment of income by an identical amount involving tax effect of Rs.219.50 lakh including interest. The department rectified the mistake and raised demand of Rs.228.98 lakh including interest.

4.20 Irregular refunds

Irregular refunds

Under the Income Tax Act, 1961, 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, the assessing officer may grant the refund or adjust or set off the refund against outstanding dues of the assessee for any assessment year.

Audit noticed that the assessing officer had allowed refund in **two cases** in Delhi and Kerala involving tax effect of **Rs.25.02 lakh**. **One case** involving tax effect of more than Rs.10 lakh is given at serial number **1 of Appendix 22**.

4.21 Mistakes in levy of interest

Non levy/short levy of interest

The provisions regarding levy of interest for delays in filing return of income, payment of advance tax and default in payment of demand have been described in **para 3.23** of this report.

Audit noticed short levy of interest for delays in filing return of income, payment of advance tax and default in payment of demand totalling **Rs.8.70 crore** in **42 cases** in Andhra Pradesh, Bihar, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Two cases** involving tax effect of more than Rs. 1 crore are illustrated below. Thirteen **cases** each involving tax effect of more than Rs.10 lakh but less than Rs. one crore are indicated in **Appendix 22**.

4.21.1 In Maharashtra Mumbai City-XXI charge, the assessment of an individual assessee, **Shri Mohanlal K. Shah** (HUF), for the assessment year 1997-98 was completed after scrutiny in March 2003 at a total taxable income of Rs.755.69 lakh. The assessment was based on a return filed by the assessee on 23 April

2002 with reference to a notice under section 148 issued by the department on 19 March 2002 and the tax payable was determined at Rs.151.13 lakh. Audit scrutiny revealed that interest for late filing of return was levied for only two months whereas it was to be levied for 58 months from 1 July 1997 to 23 April 2002, i.e., from the due date of filing of return till the actual date of filing the return. The omission resulted in short levy of interest of Rs.140.94 lakh. The department accepted the audit observation and rectified the mistake.

4.21.2 In Andhra Pradesh, Central, Hyderabad charge, the assessment of an individual, **Sri. K.Venkateshwara Rao**, for the block period 1990-91 to 1999-2000 and from 1 April 2000 to 4 January 2001, was completed in January 2003 at an income of Rs.774.77 lakh. Audit scrutiny revealed that as the assessee had not filed the return of income, interest of Rs.129.17 lakh was leviable. This was not levied while determining the tax payable which resulted in short demand of tax of Rs.129.17 lakh. The department took remedial action and raised demand of Rs.129.17 lakh subsequent to the audit observation.

4.22 Avoidable payment of interest by government

Avoidable payment of interest by government

Under the Income Tax Act, 1961 a refund due to an assessee as a result of an order may be withheld on valid grounds with the prior approval of the competent authority till such time as such authority may determine. The Board directed in January 1977 and reiterated in August 2004 that refunds should be granted within a month of date of appellate orders and while rectifying the assessment for giving effect to appellate orders, the amount refundable should be determined after adjustment of refund granted earlier.

Three cases of non observance of the provision in Gujarat and Uttar Pradesh resulted in avoidable payment of interest of **Rs.9.98 lakh**.

4.23 Loss of revenue

Loss of revenue

Under the Income Tax Act, 1961, where any search is conducted or books of accounts or other documents or any assets are requisitioned on or after 1 January 1997 and the undisclosed income belongs to any person other than the person in respect of whom search was made or books of accounts etc were requisitioned, then the assessing officer, having jurisdiction over such other person, shall serve a notice requiring him to file return of income in the prescribed form disclosing his total income including undisclosed income for the block period and pass an order of assessment for the block period, within two years from the end of the month in which such notice was served on such other person.

In Rajasthan, Jaipur-I charge, in the case of **Shri Radha Mohan Sharma and 8 others**, a search was conducted on 1 October 1997, and the first notice for furnishing return of income in the prescribed form, was served to nine persons on 23 July 1998 followed by another notice on 26 May 1999 to three of the above

nine persons and on 24 September 1999 to the remaining six persons. The assessments for the block period from 1987-88 to 1996-97 and up to 1 October 1997, which were required to be made before the end of July 2000 with reference to the first valid notice issued on 23 July 1998, were however completed only on 28 September 2001. The assessee preferred appeal and all the block assessment orders were annulled in appeal on the ground that these were not passed within the limitation period of two years. Non-completion of assessments within period of limitation resulted in loss of revenue of Rs.1.48 crore.

4.24 Mistakes in summary assessments made after June 1999

**Assessee
availing
unentitled
benefits in
summary**

Absence of uniformity amongst assessing officers in taking remedial action on mistakes emanating from summary assessments from 1 June 1999 has been referred to in **para 3.27** of this report with reference to mistakes noticed in assessments of companies.

During test check of income tax assessments of other than companies, audit detected mistakes in **29 cases** of summary assessments involving tax effect of **Rs.4.91 crore** in Andhra Pradesh, Haryana, Himachal Pradesh, Gujarat, Karnataka, Maharashtra, Madhya Pradesh, Orissa, Punjab, Rajasthan, Tamil Nadu Uttar Pradesh and West Bengal. **Ten cases** involving tax effect of more than Rs.10 lakh each are indicated in **Appendix 23**.

4.25 Cases of over assessment or overcharge due to negligence on the part of assessing officer

**Cases of over
assessment/
overcharge**

Audit noticed avoidable mistakes attributable to negligence on the part of the assessing officers resulting in over charge of tax totalling **Rs.1.17 crore** in **8 cases** in Bihar, Haryana, Gujarat, Madhya Pradesh, Rajasthan, Tamil Nadu and West Bengal. **Three cases**, each involving tax effect of more than Rs.10 lakh but less than Rs. one crore are indicated in **Appendix 24**.