# Chapter III

## Corporation Tax

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## Chapter Summary

Corporation tax constituted 61.30 percent of the total collection from direct taxes in 2005-06. There were 3.93 lakh assessees as on 31 March 2006, which represented an increase of 3.42 percent over the previous year.

**(Para 3.1 & 3.2)**

Audit issued 665 observations to the Ministry of Finance involving revenue impact of Rs. 1910.31 crore highlighting various irregularities, omissions and mistakes, for comments. Ministry accepted 248 observations involving revenue impact of Rs. 307.17 crore till preparation of this report.

**(Para 3.4 & 3.8)**

Assessees had availed unentitled benefit in summary assessments in 142 cases involving revenue impact of Rs. 92.06 crore.

**(Para 3.32.2)**

Assessing officers committed mistakes in:

- adoption of correct figures, applying correct rate of tax and levy of surcharge in 70 cases involving revenue impact of Rs. 123.60 crore.

  **(Para 3.9.1 & 3.10.3)**

- computation of business income in 45 cases involving revenue impact of Rs. 367.78 crore.

  **(Para 3.11.4)**

- allowing unentitled expenditure or provision, liability and claims and depreciation in 149 cases involving revenue impact of Rs. 476.73 crore.

  **(Para 3.12.4, 3.13.3, 3.14.8 & 3.15.4)**

- computation of capital gains, carry forward and set off of losses in 43 cases involving revenue impact of Rs. 441.98 crore.

  **(Para 3.16.2 & 3.17.4)**

- giving effect to appellate orders, allowing relief and exemptions under chapter VIA and in computation of income under special provisions of the Act in 91 cases involving revenue impact of Rs. 123.95 crore.

  **(Para 3.18.1, 3.19.1, 3.20.2, 3.21.3, 3.22.3, 3.23.3, 3.24.3 & 3.25.2)**

- levy of interest in 56 cases involving revenue impact of Rs. 42.15 crore.

  **(Para 3.28.1 & 3.29.2)**

# 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 7,12,435 companies limited by shares at work as on 30 November 2005, which included 6,33,089 private limited companies and 79,346 public limited companies. However, as per the records of the Income Tax Department, the number of company assessees as on 31 March 2006 was 3,92,573 as compared to 3,79,752 as on 31 March 2005.

**Receipts from corporate tax**

**3.2** During 2005-2006, corporation tax receipts were Rs. 1,01,277 crore as against Rs. 82,680 crore in 2004-05, constituting 61.30 percent of the total direct taxes collection. **Table 2.4** of **Chapter II** 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 assessments pending.

**Results of audit**

**3.4** Audit issued **653** draft paragraphs involving undercharge of tax of **Rs. 1893.21 crore** and **12** draft paragraphs involving overcharge of tax of **Rs. 17.10 crore** to the Ministry of Finance between May 2006 and October 2006 for eliciting their comments.

**3.5** Out of **665** draft paragraphs issued to the Ministry of Finance, internal audit of the department had seen **48 cases** in which mistakes could not be detected. Internal audit had not seen **616 cases** at all.

**3.6** Out of **665** draft paragraphs issued to the Ministry, **620** involving under charge of **Rs. 1697.76 crore** and **12 cases** involving overcharge of **Rs. 17.10 crore** are indicated in the succeeding paragraphs.

**3.7** Each paragraph indicates a particular category of mistake and starts with a suitable preamble followed by combined/consolidated revenue impact 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. one crore but below Rs. 10 crore each are given in a tabular form in appendices.

**Status of replies received from Ministry of Finance**

**3.8** Out of **632 cases** included in this chapter, the Ministry of Finance have accepted audit observations in **248 cases** involving revenue impact totalling **Rs. 307.17 crore.** Observations in respect of **102 cases** involving revenue impact of **Rs. 81.62 crore** have not been accepted. In the remaining cases, Ministry's replies are awaited. Replies of the Ministry have been examined and suitably incorporated wherever necessary.

**Mistakes in adoption of correct figures/ arithmetical errors/other avoidable mistakes**

**3.9** Assessing officers have to determine and assess the income correctly in 'scrutiny' assessments. Accounts, claims, records and all documents are to be examined in scrutiny assessments. The Board have issued instructions to assessing officers and their supervising officers to ensure that mistakes in assessments do not occur.

**3.9.1** 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. 123.08 crore** in **65 cases** in Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **17 cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 7** at **serial numbers 1 to 17. Four cases** involving short levy of tax of more than Rs. 10 crore each, are illustrated below:

**3.9.2** In Tamil Nadu, Chennai I charge, the assessment of a company, **M/s Indian Overseas Bank**, for the assessment year 2002-03 was processed in summary manner in March 2003 determining 'nil' income under the normal provisions and Rs. 180.40 crore under the special provisions of the Act and a refund of Rs. 22.98 crore including interest on refund of Rs. 1.72 crore was granted. The assessment was subsequently completed after scrutiny in March 2005 determining an income of Rs. 317.16 crore and a demand for Rs. 109.82 crore was raised. Audit scrutiny revealed that while computing the demand of Rs. 109.82 crore, refund of Rs. 22.98 crore granted earlier in March 2003 was not added back to the total demand. The mistake resulted in short computation of tax by Rs. 23.90 crore including interest on excess refund.

**3.9.3** Ministry have accepted the audit observation.

**3.9.4** In Delhi I charge, the assessment of a company, **M/s Airport Authority of India Ltd**, for the assessment year 2000-01 was completed after scrutiny in September 2002. The assessment was revised in September 2004 under section 250/143(3) and reassessed in March 2005 under section 148/143(3) determining an income of Rs. 394.80 crore. Audit scrutiny revealed that due to arithmetical error, the assessing officer levied surcharge of Rs. 2.76 crore instead of the correct amount of Rs. 13.82 crore. The mistake resulted in short levy of tax of Rs. 14.67 crore including interest.

**3.9.5** In Delhi V charge, the assessment of a company, **M/s RPG Paging Services Ltd**, for the assessment year 2001-02 was completed after scrutiny in March 2004 determining a loss of Rs. 33.18 crore. Audit scrutiny revealed that as per the computation sheet furnished by the assessee, the income for the year was assessed at 'nil', after adjusting the brought forward losses of Rs. 44.43 lakh. However, in the assessment order, the assessing officer incorrectly assessed a loss of Rs. 33.18 crore. The mistake resulted in overassessment of loss by Rs. 33.18 crore involving potential revenue impact of Rs. 13.12 crore.

**3.9.6** In Rajasthan, Jaipur II charge, the assessment of a company, **M/s Jaipur Vidyut Vitran Nigam Ltd,** for the assessment year 2002-03 was completed after scrutiny in September 2004 determining 'nil' income after set off of unabsorbed depreciation to the extent of profit. Audit scrutiny revealed that the assessing officer, during the scrutiny, made certain additions on account of EPF, CPF and GPF, prior period expenses, lease rental and interest payment on loan aggregating Rs. 55.75 crore to the income of the assessee. However, while computing the total income, he added a sum of Rs. 25.75 crore only. The mistake resulted in under computation of income by Rs. 30 crore involving potential revenue impact of Rs. 10.71 crore.

**3.9.7** Ministry have accepted the audit observation.

**Incorrect rate of tax and surcharge**

**3.10** 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.

**3.10.1** Where the total income of a foreign company includes any income by way of interest received from an Indian concern in foreign currency, the same is taxable at the rate of 20 percent.

**3.10.2** Income tax computed in accordance with section 113 of the Act shall in the case of a company be increased by a surcharge calculated at the rate of prescribed percentage.

**3.10.3** Audit noticed short levy of tax and surcharge in **five cases** in Gujarat, Maharashtra and Uttar Pradesh involving revenue impact of **Rs. 52.49 lakh.**

**Mistake in computation of business income**

**3.11** 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.

**3.11.1** Profits and gains of business of insurance shall be computed in accordance with the rules contained in the First Schedule. As per Rule 5 to First Schedule, the profits and gains of insurance other than life insurance shall be taken to be the balance of the profits disclosed in the annual accounts placed before the Controller of Insurance after adding back inadmissible expenditure. Under section 45 I (c)(ii) of RBI Act, the definition of financial institution includes any non-banking financial institution carrying on any class of insurance business and financial activities dealing in shares, securities etc. Section 4A of the Companies Act provides for declaration of any public company as a public financial institution.

**3.11.2** 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. Where the assessee follows the mercantile system of accounting, the

profits and gains are worked out on due or accrued basis. Only such expenses are allowable as deduction from previous year's income as are relevant to that year.

**3.11.3** Valuation of purchase and sale of goods and inventory for the purposes of determining the income of an assessee shall be in accordance with the method of accounting regularly adopted by the assessee and adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

**3.11.4** Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 367.78 crore** in **45 cases** in Andhra Pradesh, Assam, Delhi, Gujarat, Karnataka, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Eight cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 8** at **serial numbers 1 to 8.** **Two cases** involving short levy of tax of more than Rs. 10 crore are illustrated below:

**3.11.5** In Tamil Nadu, Chennai I Charge, the income tax assessment of a non life insurance company, **M/s United India Insurance Company Ltd.,** for the assessment year 2000-01 and **six other** non life insurance companies **(M/s Oriental Insurance Co., New Delhi, M/s National Insurance Co., Kolkata, M/s HDFC CHUBB General Insurance Co Ltd, Mumbai, M/s Bajaj Alliance General Insurance Co, Mumbai, M/s Reliance General Insurance, Mumbai, M/s ICICI Lombard, Mumbai**) in Kolkata, Mumbai, Delhi charges, for the assessment year 2004-05 were completed between 2003 to 2006**.** Audit scrutiny revealed that the assessee companies have been earning profits on realisation of investments/sale of shares of companies and redemption of such investments, which are directly taken to the General Reserve Account in the Balance Sheet, without crediting it to the Profit and Loss Account of the respective assessment years. Though interest earned by such company on loans and debentures is chargeable to tax, profits made by the company on realisation of investment/sale and redemption of investment are possibly escaping assessment as these are not considered to be taxable owing to omission of Rule 5(b) of first schedule to the Income Tax Act with effect from assessment year 1989-90. Audit scrutiny further revealed that no uniform policy has been adopted by the assessing officers with regard to bringing such profits to tax. Profits earned by these companies on account of sale of investment in shares of companies are taxable by virtue of the following statutory provisions/conditions which are, otherwise, applicable to such companies:

(i) The assessee companies carry on insurance business in the usual course of business. Besides, they also act as a public financial institution under section 4A of the Companies Act. Transaction in shares and securities is one of the normal business activities of the assessee company. Profit on sale of such investment is thus liable to tax.

(ii) If any part of the 'profits and gains' is not attributable to the insurance business, there cannot be a valid cause for taking 'profits and gains' attributable to such part to the Balance Sheet and therefore the same is liable to tax.

(iii) The companies are entitled to avail benefit of provisions of section 43D of the Income Tax Act with regard to income recognition and also section 36(1)(viia) of the Income Tax Act with regard to provision for bad and doubtful debts. The functions of the assessee company have been bifurcated into two distinct activities viz. one of the insurance business and the other as public financial institution. As per RBI guidelines, income from non-banking activities of a financial institution has to be recognised as income. Hence profit realised on sale of investment should be considered as business income of the public financial institution and not that of the insurance business to warrant exemption on the grounds that Rule 5(b) of the first schedule dealing with determination of income of the insurance business is not in the statute with effect from 1 April 1988.

(iv) The profit arising out of sale of investments from part of the activities of the public financial institution is similar to that of the interest earned on debentures and;

(v) Investments in securities or shares being non obligatory, cannot be considered as part of legitimate insurance business.

**3.11.6** Audit scrutiny further revealed that these companies had earned profit to the tune of Rs. 776.46 crore but the income escaped possibly due to lacunae in the Act and also due to the different stand taken by the assessing officers in this regard, resulting in revenue loss of Rs. 281.51 crore.

**3.11.7** Similar observation had also been pointed out in Audit Report No. 8 of 2006. If suitable measures are not taken early, revenue losses on this score are likely to increase.

**3.11.8** In Delhi V charge**,** the assessment of a company, **M/s National Thermal Power Corporation Ltd,** for the assessment year 2001-02 was completed after scrutiny in April 2003 determining income of Rs. 1603.49 crore. Audit scrutiny revealed that assessee adjusted pre-commissioning sale of Rs. 61.85 crore against pre-commissioning expenditure of Rs. 92.62 crore and the balance pre-commissioning expenditure of Rs. 30.77 crore was capitalised. The entire pre-commissioning expenses should have been capitalised and the pre-commissioning sale income of Rs. 61.85 crore taken as the income of the assessee and taxed accordingly. The omission resulted in underassessment of income of Rs. 61.85 crore involving revenue impact of Rs. 43.59 crore.

## 3.12 Incorrect allowance of capital/non business expenditure and expenditure on scientific research

**Incorrect allowance of inadmissible expenditure/ claims/ provisions**

**3.12.1** 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'. It has been judicially held that

(i) if bad debts debited to profit and loss account relate to any advances on capital account, they are not admissible as deduction as the loss is capital loss[1],

(ii) grant of technical aid and fees for setting up factory and right to sell the products as per collaboration agreement is not allowable as 100 percent revenue expenditure and is to be treated as 25 percent capital expenditure[2],

(iii) loss on repossessed hire purchase assets is not allowable deduction as it is basically a capital loss[3], and

(iv) cost of abandoned project is capital expenditure and not allowable as deduction[4].

**3.12.2** 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. It has been judicially held[5] that proportionate management expenses should be deducted from gross dividend for arriving at income from this source.

**3.12.3** Any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility , approved by the prescribed authority, shall be allowed as deduction equal to one and one-half times of expenditure so incurred. No deduction shall be allowed unless the assessee enters into an agreement with the prescribed authority for cooperation in such research and development facility and for audit of accounts maintained for that facility.

**3.12.4** Assessing officers incorrectly allowed capital expenditure, non-business expenditure and expenditure on scientific research which resulted in short levy of tax totalling **Rs. 108.05 crore** in **36 cases** in Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal. **11 cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are indicated in **Appendix 8** at **serial numbers 9 to 19.** **Two cases** involving short levy of tax of more than Rs. 10 crore each, are illustrated below:

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[1] Hasimara Industries and others Vs CIT (231 ITR 842) (SC)
[2] Southern Switchgear Ltd Vs CIT and others (232 ITR 359) (SC)
[3] Motor and General Sales (P) Ltd Vs CIT 9226 ITR 137) (SC)
[4] Kanoria Chemicals and Industries V CIT (78 Taxmann455) (Calcutta HC)
[5] CIT Vs United General Trust Ltd. (200 ITR 488) (SC)

**3.12.5** In Maharashtra, Mumbai City-II charge, the assessment of a company, **M/s Bank of India**, for assessment year 1998-99 was completed after scrutiny in March 2001 allowing interest of Rs. 6.59 crore earned on infrastructure lending, interest of Rs. 13.01 crore earned on tax free bonds and dividend of Rs. 136.47 crore as exempt from tax. Expenses attributable to earn the exempted income were required to be disallowed. Audit scrutiny revealed that the department disallowed the expenses attributable to interest earned on infrastructure bonds but expenses attributable to interest on tax free bonds and dividend income aggregating Rs. 79.72 crore was not disallowed. The omission resulted in underassessment of income of Rs. 79.72 crore involving short levy of tax of Rs. 44.92 crore.

**3.12.5.1** The Ministry has not accepted the observation stating that no expenses were found to be attributable to the interest on tax free bonds as assessee had sufficient fund in reserves and surplus from which the assessee has invested in the tax free bonds. Further, remedial action taken by the department in February 2004 was quashed by CIT (Appeals). The reply is not tenable as the assessing officer disallowed similar expenses incurred to earn interest on infrastructure lending under section 10(23G) but did not consider the expenses pointed out in audit which were also required to be disallowed. Further, the appellate order quashing the scrutiny order was passed under the provisions of section 14A which prohibits the assessing officer from reopening an assessment completed prior to April 2001, and no merit was applied.

**3.12.6** In Delhi-I charge**,** the assessments of a company, **M/s Central Warehousing Corporation,** for the assessment years 1995-96, 1996-97 and 1999-2000 were completed after scrutiny in March 2002 determining income aggregating Rs. 170.74 crore. The assessments were revised in January 2005 at a loss of Rs. 260.95 crore to give effect to appellate orders. Audit scrutiny revealed that the gross total income of the assessee included income from warehousing activities which was allowed as exempted from tax. However, the assessee was allowed depreciation of Rs. 35.23 crore on warehousing building. Since the expenditure relating to the exempted income is not allowable, the depreciation of Rs. 35.23 crore should have been disallowed while giving effect to the appellate orders in January 2005. The omission to do so resulted in incorrect carry forward of loss of Rs. 35.23 crore involving potential revenue impact of Rs. 14.87 crore.

### 3.13 Incorrect allowance of preliminary expenses/ expenditure incurred under voluntary retirement scheme

**3.13.1** Where any expenditure is incurred in connection with issue for public subscription of shares or debentures of the company being underwriting commission, brokerage and drafting charges for extension of industrial undertaking or setting up of a new industrial unit, a deduction of an amount equal to one tenth of such expenditure is allowed for each of the ten successive years. Where expenditure is incurred for the purpose of amalgamation or demerger, the

assessee shall be allowed a deduction equal to one fifth of such expenditure for five successive years beginning with the year in which amalgamation or demerger takes place.

**3.13.2** Where any expenditure is incurred in any previous year by way of payments of any sum to an employee at the time of his voluntary retirement, one-fifth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year and balance shall be deducted in equal instalments for each of the four immediately succeeding years.

**3.13.3** Audit noticed that assessing officers had incorrectly allowed above mentioned expenses which resulted in short levy of tax totalling **Rs. 7.64 crore** in **nine cases** in Delhi, Maharashtra, Tamil Nadu, Uttaranchal and West Bengal. **Three cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 8** at **serial number 20 to 22**.

### 3.14 Incorrect allowance of provisions/ liabilities/ expenditures

**3.14.1** 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 held[1] that in order for a loss to be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur.

**3.14.2** 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 fund or for payment of gratuity that has become payable during the previous year.

**3.14.3** 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. No deduction towards write off of bad debt shall be allowed unless such debts represent money lent in the ordinary course of the business of banking or money lending, which is carried

[1] CIT V/s Indian Overseas Bank 151 ITR 466 (Madras)

on by the assessee. Bad debts in respect of loans issued by foreign branches of a bank are not allowable deduction against Indian income.

**3.14.4** Deductions on account of 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 allowable on actual payment basis. No deduction in respect of contribution to the above funds is however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds.

**3.14.5** 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. Any expenditure including that of capital nature laid out, expended or incurred on scientific research related to the business carried on by the assessee shall be allowed as deduction.

**3.14.6** Where an allowance of deduction has been made in the assessment for any year in respect of loss, expenditure of trading liability incurred by the assessee and subsequently obtained whether in cash or benefit by way of remission or cessation of liability there of, the amount obtained shall be deemed to be profit and charged to tax as income of that relevant previous year.

**3.14.7** Actual interest tax liability of an assessee is allowable from the profits and gains of his business or profession for that assessment year.

**3.14.8** Audit noticed that the assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 296.03 crore** in **71 cases** in Delhi, Gujarat, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal. **15 cases** with revenue impact over Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 8** at **serial numbers 23 to 37. Four cases** involving revenue impact of more than Rs. 10 crore each are illustrated below:

**3.14.9** In Maharashtra, Mumbai City-II charge, the assessment of a company, **M/s Bank of Baroda**, for assessment year 1998-99 was completed after scrutiny in February 2001 determining an income of Rs. 892.35 crore and allowing deduction of Rs. 288.87 crore towards provision for non-performing assets, Rs. 78.02 crore written off out of contingency at foreign branches and Rs. 11.80 crore written off out of general ledger contingency at foreign branches. Audit scrutiny revealed that the amount of Rs. 288.87 crore allowed on account of

provision for non-performing assets constituted Rs. 39.80 crore on account of actual bad debts written off at branch offices, and Rs. 249.08 crore on account of prudential write off at head office and partial write off at foreign branches. The amount of Rs. 249.08 crore was not actually written off in the books of the bank and as such deduction thereagainst should have been disallowed. Further, deduction of Rs. 78.02 crore written off out of contingency at foreign branches and Rs. 11.80 crore written off out of general ledger contingency at foreign branches were also required to be disallowed in view of the appellate orders in the case of the same assessee in assessment year 1993-94 directing that the bad debts of the foreign branches should be ignored as they cannot be set off against income in India. The omission to disallow the above deductions resulted in underassessment of income of Rs. 338.89 crore involving short levy of tax of Rs. 189.19 crore.

**3.14.10** In Maharashtra, Mumbai City-III charge, the assessment of a company, **M/s ICICI Bank Ltd.**, for the assessment year 2001-02 was completed after scrutiny in February 2004 determining an income of Rs. 1263.02 crore. The assessee was allowed a deduction of Rs. 70 crore from the income of the business of providing long term finance against special reserve created to that extent. Audit scrutiny revealed that certain categories of income, viz. dividend income of Rs. 112.18 crore, credit on account of write-back of specific provision of Rs. 393.83 crore, interest on income tax refund and capital gain of Rs. 9.11 crore and other finance income of Rs. 220 crore, which were not derived from the business of providing long term finance were also taken into account in the computation of the deduction. The omission to exclude the above categories of income from the long term finance income resulted in incorrect allowance of deduction of Rs. 70 crore involving short levy of tax of Rs. 27.69 crore.

**3.14.11** In Delhi V charge, the assessment of a company, **M/s PNB Gilts Ltd.,** for the assessment year 2003-04 was completed after scrutiny in January 2005 determining an income of Rs. 151.56 crore. Audit scrutiny revealed that the assessee had reduced Rs. 36.85 crore as "Provision for diminution in market value of stock" from closing stock in trading income on the plea that it was following RBI guidelines in valuation of closing stock at cost or market price, whichever was less. As the loss was notional and had not actually arisen, the amount of Rs. 36.85 crore should have been added back to the taxable income of the assessee, as income was required to be computed according to provisions of the Income Tax Act. The omission to add back the amount to taxable income resulted in underassessment of income of Rs. 36.85 crore with consequent short levy of tax of Rs. 13.54 crore.

**3.14.12** In West Bengal, Kolkata CIT-IV charge, the assessment of a company, **M/s SKG Consolidated Ltd.**, for the assessment year 2002-03 was completed on best judgment assessment basis in March 2005 determining 'nil' income. Audit scrutiny revealed that Rs. 24.66 crore representing sales tax was not paid within the relevant previous year or within due date of submission of return. The

omission to add back the amount to the income had resulted in underassessment by an identical amount involving revenue impact of Rs. 12.37 crore including interest.

**3.14.13** The Ministry have accepted the audit observation.

**Incorrect allowance of depreciation**

**3.15** In computing the business income of an assessee, a deduction on account of depreciation on the cost or written down value of building, plant and machinery, furniture, fixtures etc, is admissible at the rates prescribed in the Income Tax Rules, 1962 provided the assets are owned by the assessee and used for the purpose of the business. Depreciation on land is not admissible. It has been judicially held[1] that depreciation has to be mandatorily charged before the deductions are calculated.

**3.15.1** Depreciation is also allowed on intangible assets which include copyrights, patents, technical know how, franchise charges and any other commercial rights. Intangible assets, therefore, cannot include goodwill, stock exchange membership fee, intellectual property rights or investment in shares. It has been judicially held[2] that goodwill is not a capital asset.

**3.15.2** Where in any assessment year full effect cannot be given to any depreciation allowance owing to there being no or less profits or gains under the head ‘profits and gains of business or profession’, such unabsorbed depreciation shall be carried forward for subsequent year/years and shall be set off against profits and gains from any business or profession for that year/years.

**3.15.3** Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction on account of depreciation shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the assets comprising such block.

**3.15.4** The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 65.01 crore** in **33 cases** in Andhra Pradesh, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Three cases** involving revenue impact of more than Rs. one crore but below Rs. 10 crore each, are shown in **Appendix 9** at **serial number 1 to 3.** **One case** involving revenue impact of more than Rs. 10 crore is illustrated below:

**3.15.5** In Delhi IV charge, the assessments of a company, **M/s Hindustan Coca Cola Beverages (P) Ltd.,** for the assessment years 2001-02 and 2002-03 were

[1] CIT Vs Mahindra Mills (243 ITR 56) (SC)
[2] B Srinivasa Shetty Vs CIT (128 ITR 294) (SC)

completed after scrutiny in March 2004 and March 2005 determining loss of Rs. 435.28 crore and Rs. 262.97 crore respectively. Audit scrutiny revealed that the assessee was allowed depreciation on goodwill aggregating Rs. 123.87 crore treating it as an intangible asset. This was not in order as goodwill is not an intangible asset on which depreciation was allowable. The mistake resulted in incorrect allowance of depreciation aggregating Rs. 123.87 crore involving potential revenue impact aggregating Rs. 46.94 crore.

**3.15.6** Ministry have accepted the audit observation.

**Incorrect computation of capital gains**

**3.16** 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.

**3.16.1** Where full value of consideration received or accruing as a result of transfer of any capital asset falling within a block of assets, on which depreciation has been allowed under the Act, exceeds the written down value of the block of assets at the beginning of the relevant previous year, the excess shall be deemed as capital gains arising from the transfer of short term asset.

**3.16.2** The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 19.50 crore** in **four cases** in Delhi, Maharashtra and West Bengal. **One case** involving revenue impact of more than Rs. 10 crore is illustrated below.

**3.16.3** In West Bengal, Kolkata IV charge, the assessment of a company, **M/s ICI India Ltd.,** for the assessment year 2000-01 was completed after scrutiny in March 2003 allowing set off of long term capital loss of Rs. 6.83 crore. Audit scrutiny revealed that the assessee sold certain depreciable assets within a block of assets but incorrectly computed long term capital loss owing to reduction of indexed cost of acquisition for each item from the net realisation of sales. As per the relevant provision of the Act ibid, the sale realisation was required to be reduced by the written down value of the assets in the relevant block. The net result in that event would have been a short term capital gain of Rs. 27.85 crore. Omission in this regard resulted in underassessment to an identical amount. Further, as certain items from the block of assets were sold at a value which was higher than the written down value of the entire block, no depreciation was admissible on the remaining items within the block. However, irregular depreciation was allowed thereto for Rs. 24.53 lakh. The mistakes resulted in cumulative underassessment of Rs. 28.10 crore and irregular set off of capital loss of Rs. 6.83 crore leading to undercharge of tax of Rs. 18.30 crore including interest.

**Incorrect computation/ carry forward/ set off of losses**

**3.17** 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 cannot 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.

**3.17.1** 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. If the return filed by an assessee is defective and the defect is not rectified within the period granted by the assessing officer, the return shall be treated as an invalid return.

**3.17.2** Where there has been an amalgamation of a company owning an industrial undertaking with another company, the accumulated loss shall be deemed to be the loss of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Act shall apply accordingly subject to certain conditions.

**3.17.3** Any income, arising from the transfer of a capital asset, being a unit of US 64, and where the transfer of such asset takes place on or after 1 April 2002, shall be exempt from tax. It has been judicially held[1] that if income from a particular source is exempt from tax, loss from such source cannot be set off against income from another source under the same head of income. It has also been judicially held[2] that loss from a source which is not taxable cannot be carried forward.

**3.17.4** The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 422.48 crore** in **39 cases** in Delhi, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Orissa, Rajasthan, Tamil Nadu and West Bengal. **Three cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 10** at **serial numbers 1 to 3. Three cases** involving revenue impact of more than Rs. 10 crore each, are illustrated below:

**3.17.5** In Maharashtra, Mumbai City II charge, the assessment of a company, **M/s Reliance Industries Ltd**., for assessment year 2002-03 was completed after scrutiny in March 2005 determining an income of Rs. 475.83 crore. The assessee was allowed a deduction of Rs. 1364.38 crore towards brought forward loss of another company, M/s Reliance Petroleum Limited, which merged with the assessee company from April 2001. The position of brought forward losses of the merging company was based on the assessment order for the assessment year

[1] CIT Vs S.S.Thiagrajan (129 ITR 115) (Madras HC)
[2] CIT Vs Harprasad & Co. (P) Ltd. (99 ITR 118) (SC)

2001-02 completed after scrutiny in January 2004. Audit scrutiny revealed that while giving effect to an appellate order in July 2004, the taxable income of the merging company was re-determined at 'nil' after setting off entire brought forward losses of previous years. No loss was carried forward for set off in the future assessments. The fact that the brought forward loss of Rs. 1364.38 crore of M/s Reliance Petroleum Limited had been fully set off in the revised assessment order of July 2004 was not taken into consideration while making the assessment of M/s Reliance Industries Ltd in March 2005. The mistake resulted in underassessment of income of Rs. 1364.38 crore with short levy of tax of Rs. 376.17 crore.

**3.17.6** In Maharashtra, Mumbai City VII charge, the assessment of a company, **M/s National Textile Corporation. Ltd.,** for assessment year 2002-03 was completed after best judgment in October 2004 determining total loss of Rs. 1033.74 crore including carry forward of accumulated loss of Rs. 945.18 crore of earlier assessment years. Audit scrutiny revealed that while computing total loss for assessment year 2002-03, the assessee was allowed carried forward loss of Rs. 82.37 crore pertaining to assessment year 1997-98 as against actual loss of Rs. 51.05 crore only. The mistake resulted in excess carry forward of loss of Rs. 31.32 crore involving potential revenue impact of Rs. 11.18 crore.

**3.17.7** Ministry have accepted the audit observation.

**3.17.8** In Delhi V charge, the assessment of a company, **M/s Oriental Bank of Commerce**, for the assessment year 2004-05 was completed after scrutiny in February 2005 determining income of Rs. 1194.99 crore. Audit scrutiny revealed that the assessee had long term capital loss of Rs. 53.52 crore from transfer of US-64 units. This was set off against long term capital gains of Rs. 12.77 crore arising from transfer of investment, and the balance loss of Rs. 40.75 crore was allowed to be carried forward for future set off. The set off and carry forward of loss was not admissible as income arising from the transfer of a capital asset being a unit of US 64 is exempt from tax and if income from a particular source is exempt from tax, loss from such source cannot be set off against income from another source. Accordingly, this should have been disallowed. The omission to do so resulted in underassessment of income of Rs. 12.77 crore and incorrect carry forward of loss of Rs. 40.75 crore involving revenue impact of Rs. 10.97 crore (Rs. 2.62 crore positive and Rs. 8.35 crore potential).

**Mistakes in implementation of appellate orders**

**3.18** 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 Income Tax Appellate Tribunal 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 underassessment/overassessment of income.

**3.18.1** The assessing officers did not implement the appellate orders correctly, which resulted in short levy of tax totalling **Rs. 42.12 crore** in **13 cases** in Andhra Pradesh, Delhi, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Orissa and Tamil Nadu. **One case** involving revenue impact of more than Rs. 10 crore is illustrated below.

**3.18.2** In Tamil Nadu, Chennai III charge, the assessment of a company, **M/s Southern Petrochemical Industries Corporation Ltd.,** for the assessment year 2000-01 was completed after scrutiny in March 2003 determining a loss of Rs. 44.02 crore under normal provisions of the Act. While computing the loss, depreciation of Rs. 85.86 crore was allowed by the assessing officer though it was not claimed by the assessee in the income tax return. An income of Rs. 6.12 crore was assessed to tax under the special provisions of the Act. The assessment was revised in January 2004 to give effect to the order of Commissioner of Income Tax (Appeals) determining loss of Rs. 51.80 crore. The assessment was again revised in November 2004 to give effect to the orders of the Income Tax Appellate Tribunal determining loss of Rs. 44.02 crore. Audit scrutiny revealed that the appeal by the assessee against the allowance of the depreciation by the assessing officer in the scrutiny assessment was allowed by the ITAT. However, this was not considered while giving effect to the orders of ITAT. Allowance of irregular depreciation of Rs. 85.86 crore resulted in underassessment of income of Rs. 41.83 crore and incorrect carry forward of loss of Rs. 44.02 crore involving revenue impact of Rs. 36.76 crore (Rs. 19.81 crore positive and Rs. 16.95 crore potential). It would also result in withdrawal of MAT credit of Rs. 2.36 crore since the income was to be assessed under the normal provisions of the Act. Aggregate revenue impact amounted to Rs. 39.13 crore.

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

**3.19** The Income Tax Act 1961, provides that certain deductions are admissible from the gross total income of an assessee in arriving at the total income chargeable to tax. The overriding condition is that the total deduction under Chapter VIA should not exceed the gross total income of the assessee. 'Gross total income' has been defined as the total income computed in accordance with the provisions of the Act but before making the deductions under Chapter VIA.

**3.19.1** The assessing officer did not comply with the above provision, which resulted in short levy of tax of **Rs. 31.96 lakh** in **one case** in Tamil Nadu.

### 3.20 Incorrect deduction of donations

**3.20.1** In computing the total income of an assessee, a deduction of an amount equal to fifty percent of the aggregate sum paid by the assessee as donation to certain specified funds, charitable institutions etc. is allowable. The aggregate sum shall not exceed 10 percent of the gross total income. The deduction is allowable only if the fund or institution is approved by the prescribed authority.

**3.20.2** The assessing officer did not comply with the above provisions, which resulted in short levy of tax totalling **Rs. 47.24 lakh** in **two cases** in Tamil Nadu and Maharashtra charges.

### 3.21 Incorrect allowance of deduction in respect of profits for export business

**Incorrect allowance of deduction in respect of profits for export business**

**3.21.1** 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 turnover 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.

**3.21.2** Where an amount of profits and gains of an industrial undertaking is allowed as deduction under 80 IA, the profit to that extent shall not qualify for deduction for any assessment year under any other provision of Chapter VIA.

**3.21.3** Incorrect application of the above provisions resulted in short levy of tax totalling **Rs. 6.56 crore** in **17 cases** in Delhi, Gujarat, Kerala, Maharashtra, Rajasthan and West Bengal. **One case** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore is shown in **Appendix 11** at **serial number 1**.

### 3.22 Incorrect allowance of deduction in respect of profits from housing project/export of computer software/export of film software

**3.22.1** An assessee deriving any profit or gains from the business of execution of a housing project awarded by the World Bank shall be allowed a deduction of an amount equal to fifty percent of the profits. Housing project means a project for the construction of any building, road, bridge or other structure in any part of India.

**3.22.2** An Indian company or a person engaged in the business of export out of India of any computer software or its transmission from India to a place outside India, is entitled to a deduction equal to the extent of profits derived from the export of any computer software or its transmission from India to a place outside India, if sale proceeds thereof are received in convertible foreign exchange. For computing the deduction, 90 percent of brokerage, commission, interest etc. is to be deducted from the profits and gains of the business.

**3.22.3** Incorrect application of the above provision resulted in short levy of tax totalling **Rs. 2.61 crore** in **six cases** in Karnataka, Maharashtra and West Bengal. **One case** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore is shown in **Appendix 11** at **serial number 2.**

### 3.23 Incorrect allowance of deduction in respect of profits from industrial undertakings

**3.23.1** 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 specified percentage of profits provided the industrial undertaking does not manufacture or produce article or thing specified in the Eleventh Schedule. One of the conditions for allowing deductions is that the business is not formed by splitting up or the reconstruction of a business already in existence and that the value of old machinery or plant or part transferred to such new business does not exceed twenty percent of total value of the machinery or plant or part used in the business. It has been judicially held[*] that the use of the term "derived from" in the relevant provisions of the Act indicates the restricted meaning given by the legislature to cover only the profits and gains directly accruing from the conduct of the business or undertaking.

**3.23.2** Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking engaged in infrastructure development etc., including generation or generation and distribution of power, the assessee is entitled to a deduction from such profits and gains of an amount equal to hundred percent for the first five assessment years and thereafter thirty percent (in case of a company) for further five assessment years. Sub-section 5 of section 80-IA provides that for the purpose of determining the quantum of deductions, the profits and gains of the eligible business shall be computed as if such profits and gains were the only source of income of the assessees during the previous year. Further, the losses of eligible units, which have been set off against positive income of other units, have to be considered before allowing the deduction.

[*] Cambay Electric Supply Industrial Co. Ltd. Vs. CIT {113 ITR 84 (SC)} and Sterling Foods Vs. CIT {237 ITR 579 (SC)}

**3.23.3** Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 16.41 crore** in **15 cases** in Delhi, Gujarat, Madhya Pradesh, Maharashtra and Tamil Nadu**. Four cases** involving revenue impact of more than Rs. one crore are indicated in **Appendix 11** at **serial numbers 3 to 6.**

**Incorrect computation of income under special provisions of the Act**

**3.24** The Income Tax Act, 1961, provides that 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. Further, 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. 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.

**3.24.1** Where any amount of tax is paid under section 115 JA by an assessee, a credit in respect of tax so paid in excess over the tax under normal provisions of the Act, shall be allowed to be set off in a succeeding year only when tax becomes payable on the total income computed under the normal provisions of the Act but such set off shall not be allowed beyond the fifth year immediately succeeding the assessment year in which tax credit becomes allowable. Tax credit cannot be treated at par with advance tax or TDS and cannot be deducted from the tax liability determined while calculating interest liability for various defaults.

**3.24.2** If the income tax payable on total income as computed under the normal provisions of the Act in respect of previous year relevant to assessment year commencing on or after 1 April 2001 is less than seven and one-half percent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income tax at the rate of seven and one-half percent.

**3.24.3** Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs. 52.76 crore** in **33 cases** in Andhra Pradesh, Assam, Delhi, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. **Seven cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 12** at **serial numbers 1 to 7**. **One** case involving revenue impact of more than Rs. 10 crore is illustrated below:

**3.24.4** In Tamil Nadu, Chennai I charge, the assessment of a company, **M/s Indian Overseas Bank**, for the assessment year 2000-2001 was completed after scrutiny in March 2003 determining an income of Rs. 15.71 crore under normal provisions of the Act. The net loss under section 115 JA was worked out

at Rs. 1.37 crore. Audit scrutiny revealed that the assessee company had debited to the Profit and Loss account, an aggregate amount of Rs. 123.31 crore towards provision for bad and doubtful debts, provision for investment depreciation fund, provision for standard assets and provision for contingencies towards frauds. As the above expenses were only provisions towards future contingent liabilities, the same were required to be disallowed**.** The omission to disallow the above provisions for computing the book profit and tax liability under special provisions resulted in short levy of tax of Rs. 14.24 crore.

### 3.25 Incorrect computation of tax on distributed profits

**3.25.1** For any assessment year, in addition to normal tax chargeable in respect of the total income of a domestic company, tax at the rate of 10 percent for the period from 1 June 1997 to 31 May 2000 and at the rate of 20 percent for the period from 1 June 2000 to 31 May 2001 is payable within 14 days from the date of declaration, distribution or payment of any amount by such company by way of dividend whether interim or otherwise. Failure to pay such tax within the specified period entails payment of simple interest at the prescribed rate from the date following the due date of payment to the date of actual payment.

**3.25.2** The assessing officers did not apply the above provisions which resulted in short levy of tax totalling **Rs. 2.70 crore** in **four cases** in Andhra Pradesh, Tamil Nadu and West Bengal. **One case** of more than Rs. one crore but less than Rs. 10 crore is shown in **Appendix 12** at **serial number 8.**

**Excess or irregular refunds by Government**

**3.26** 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.

**3.26.1** 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. 1.28 crore** in **six cases** in Karnataka, Maharashtra, Tamil Nadu and West Bengal.

**Incorrect payment of interest on refunds**

**3.27** An assessee is entitled to receive, in addition to the refund out of any advance tax paid including tax deducted at source, simple interest thereon at the prescribed percentage. Interest is payable for every month or part thereof from 1 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.

**3.27.1** Assessing officers made incorrect payment of interest totalling **Rs. 26.73 crore** in **11 cases** in Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu and West Bengal. **Two cases** involving revenue impact of more than Rs. one crore but below Rs. 10 crore each, are shown in **Appendix**

**13** at **serial numbers 1** and **2. One case** involving revenue impact of more than Rs. 10 crore is illustrated below:

**3.27.2** In Maharashtra, Mumbai City II charge, the assessment of a company, **M/s State Bank of India,** for assessment year 1996-97, completed after scrutiny in March 1999, was revised in February 2001. The assessment was further revised in March 2004 and March 2005 to give effect to the orders of CIT (Appeals) and ITAT respectively. The income was ultimately determined at Rs. 1349.24 crore in March 2005 allowing interest on refund from April 1996 onwards. Audit scrutiny revealed that the assessee claimed double taxation avoidance relief of Rs. 18.59 crore in February 2003 which was allowed in March 2005 for the first time. The issue regarding allowance of double taxation avoidance relief was not discussed in any of the assessment orders passed earlier even at the scrutiny stage. As the delay in claiming the refund against the said relief was attributable to the assessee, interest on refund was payable only from February 2003 as against April 1996 allowed by the department. The mistake resulted in excess payment of interest of Rs. 11.78 crore on refund.

**3.27.3** The Ministry have accepted the audit observation.

**Non levy of interest on excess grant of refunds**

**3.28** Where amount refunded in summary assessment exceeds amount refundable on regular assessment, the assessee shall be liable to pay simple interest at the rate of two-third percent (one-half percent from 8 September 2003) on the excess amount so refunded for every month or part of the month comprised in the period from the date of grant of refund to the date of such regular assessment.

**3.28.1** Audit noticed that non-adherence of the above provision, regarding levying of interest on excess refund at the time of summary assessment, by the assessing officers resulted in short levy of tax totalling **Rs. 2.57 crore** in **seven cases** in Kerala, Maharashtra, Punjab, Rajasthan and West Bengal.

**Non levy/short levy of interest for default in filing of return/ payment of advance tax/tax demand**

**3.29** If an assessee fails to file return within the specified due date or whoever 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 up to 31 May 1999 (one percent 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.

**3.29.1** The assessee should pay any demand for tax within thirty days of service of notice of the relevant demand. Failure to do so attracts simple interest at prescribed percentage for every month or part thereof from the date of default till actual payment.

**3.29.2** Audit noticed non-compliance with the above provisions. Interest was short levied by **Rs. 39.58 crore** in **49 cases** in Andhra Pradesh, Bihar, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, Rajasthan, Tamil Nadu, UT Chandigarh and West Bengal. **Six cases** of revenue impact over Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 14** at **serial numbers 1 to 6.**

### 3.30 Non/short levy of penalty

**Non/short levy of penalty**

**3.30.1** Where any assessee repays any deposit in excess of Rs. 20,000 other than by account payee cheque or bank draft, penalty of a sum equal to the sum of the deposit so repaid shall be leviable.

**3.30.2** Where there is concealment of particulars of income or furnishing of inaccurate particulars of income, penalty shall be levied at minimum of 100 percent of tax evaded subject to maximum of 300 percent.

**3.30.3** Audit noticed non-compliance of above provisions by assessing officers in **three cases** of Andhra Pradesh, Gujarat and Maharashtra involving revenue impact of **Rs. 53.91 lakh**.

### 3.31 Other topics of interest

**Other topics of interest**

**3.31.1** In completing an assessment and determining the tax or refund, the assessing officer should take into account prepaid taxes and refunds made to the assessee.

**3.31.2** Where an assessee incurs an expenditure in respect of which payment in excess of Rs. 20,000 is made otherwise than by a crossed cheque or crossed bank draft, twenty percent of such expenditure will not be allowable as deduction.

**3.31.3** Where in any financial year an assessee has incurred any expenditure but fails to offer any explanation about the source of such expenditure or part thereof or the explanation, if any, offered by the assessee is not satisfactory in the opinion of the assessing officer, the amount covered by such expenditure or a part of expenditure may be deemed to be the income of the assessee for such financial year.

**3.31.4** Audit noticed that the assessing officers did not adhere to the above provisions which resulted in short levy of tax totalling **Rs. 96.27 lakh** in **four cases** in Delhi, Karnataka and Madhya Pradesh.

### 3.32 Mistakes in summary assessment cases

**Mistakes in summary assessment cases**

**3.32.1** Consequent to the amendment of the Income Tax Act with effect from 1 June 1999 no prima facie adjustment can be made by assessing officer in an assessment completed in summary manner. However, unentitled benefits availed of by the assessees in summary assessments can be withdrawn and mistakes rectified under the powers separately available to the assessing officers under the Act. The Board have also issued instructions in August 1995 for initiating remedial action with regard to all audit observations.

**3.32.2** Out of **665 draft paragraphs** sent to Ministry during the year in respect of corporation tax, **161 draft paragraphs** involving revenue impact of **Rs. 284.46 crore** were related to summary assessments. **One hundred forty two cases** with a revenue impact of **Rs. 92.06 crore** relating to Andhra Pradesh, Assam, Delhi, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal have been included in this chapter. In **83 cases** involving revenue impact of **Rs. 46.69 crore** the assessing officers accepted audit observations and either initiated or completed remedial action. In **13 cases** involving revenue impact of **Rs. 4.30 crore** the observations were not accepted stating that the Act does not provide for such adjustments in summary assessments. In the remaining cases replies were awaited**. 11 cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 15** at **serial numbers 1 to 11. Two cases** involving revenue impact of more than Rs. 10 crore each, are illustrated below:

**3.32.3** In Tamil Nadu, Chennai III charge, the assessment of a company, **M/s Mahindra Holiday Resorts India Ltd.**, for the assessment years 2003-04 and 2004-05 were processed in summary manner in December 2003 and November 2004 determining 'nil' income and at a loss of Rs. 77.10 lakh respectively. Audit scrutiny revealed that the assessee company, engaged in selling time share units and providing holiday facilities to members for a specific period, collected membership fee in full or on a deferred payment basis. Out of the total membership fee, one portion was recognised as time share income in the year in which the purchaser became the member and the balance was being recognised as timeshare income equally over a period of 33 years. Audit scrutiny further revealed that out of the membership fees collected from the members only 40 percent was offered as income and the remaining 60 percent viz. Rs. 25.14 crore and Rs. 23.13 crore for the two assessment years was treated as advance for providing facilities to the members over a period of 33 years. The amount was taken to the Balance Sheet directly as advances for customers' facilities. As the right to receive membership fee accrues during the year of receipt of such fees and as the income could not be spread over to future years in the absence of specific provisions in the Act, the receipt should be brought to tax in the respective assessment years. The omission to do so resulted in escapement of income of Rs. 48.27 crore with consequential revenue impact of Rs. 18.15 crore (including potential revenue impact of Rs. 27.66 lakh) for the two assessment years.

**3.32.4** In Orissa, Cuttack charge, the assessment of a company, **M/s Orissa State Financial Corporation**, for assessment year 2003-2004 was processed in summary manner in January 2004. Audit scrutiny revealed that the assessee had a profit of Rs. 17.47 crore but while computing the income it was incorrectly mentioned as a loss. The mistake resulted in excess carry forward of loss of Rs. 34.95 crore involving potential revenue impact of Rs. 12.84 crore.

**Cases of over assessment or overcharge**

**3.33** Cases of overassessment/overcharge due to negligence on the part of assessing officers are being regularly featured in the reports of the Comptroller and Auditor General of India. During test check in audit during 2005-06, audit noticed overassessment of income in **12 cases** involving overcharge of tax totalling **Rs. 17.10 crore** in Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu and West Bengal. **Five cases** involving revenue impact of more than Rs. one crore but less than Rs. 10 crore each, are shown in **Appendix 16** at **serial numbers 1 to 5.**