

Highlights

- Audit reviewed the administration and implementation of six types of deductions and allowances granted under sections 32, 35, 80-HHD, 80-HHF, 80-IA and 80-IB of the Income Tax Act with a view to examining the adequacy of law, rules and procedures to safeguard the interests of revenue.

(Para 2.1.6)

- Audit test checked around 1.3 lakh assessments spread over three assessment years and found mistakes in 760 cases involving a tax effect of Rs.624 crore. 452 of these were summary assessments where tax effect involved was Rs.341 crore representing around 52 percent of total tax effect.

(Para 2.12.1)

- Assessing officers committed mistakes in 308 scrutiny assessments that involved tax effect of Rs.283 crore.

(Para 2.12.1)

- In addition , lacunae in law such as not defining ‘tourist’, ‘plant’, ‘loose tools’, ‘manufacture and production’, not disallowing ‘duty drawback’ receipts before granting deduction for export of software and so on involved a revenue of Rs.35 crore in 33 cases.

(Para 2.21.2 to Para 2.26.3)

- Test check of assessments of selected companies in 11,615 cases revealed that depreciation granted under the Income Tax Act was greater than that available under the Companies Act which involved a tax effect of Rs.7282 crore.

(Para 2.31.2)

- Review revealed that administration and implementation of the selected deductions and allowances under the Act may not have effectively helped in achievement of any of their principal objectives and ended up in litigation and loss of revenue. There was no mechanism available in the department to objectively assess the performance of the selected provisions of the Act vis-à-vis their objectives.

(Para 2.33.1)



Efficiency and effectiveness of administration and implementation of selected deductions and allowances under Income Tax Act

2.1. Introduction

2.1.1 Government of India (the Government) have amended the Income tax Act (the Act) through successive Finance Acts over the years. Such amendments mainly attempt to introduce welfare measures, rationalise and simplify tax laws, modify or introduce measures to accelerate economic development, provide certain incentives to selected sectors of the economy, stimulate investment for industrial growth besides bringing in tax payer friendly measures. The Act therefore allows several kinds of exemptions, allowances, deductions, rebates/reliefs and concessions to tax payers in pursuance of the above objectives.

2.1.2 Incomes exempt, either full or in part, from tax can be categorized as 'Exemptions' while incomes subjected to tax but entitled to rebate or relief at an average rate of tax in certain circumstances come under 'Rebates' or 'Reliefs'. Likewise, deductions are those specifically provided under Chapter VIA of the Act and applied, after arriving at the gross total income, at the rates prescribed under the relevant sections subject to fulfilment of the conditions prescribed therein. These can be allowed only if there is positive income after setting off previous losses, if any. The Act provided for certain allowances/incentives such as depreciation, investment allowance, expenditure on scientific research etc. with a view to compensating the assessee from losses incurred during the course of business or for upgradation of technology.

2.1.3 The Shome Advisory group on Tax policy and Administration for the 10th Plan devoted a chapter on Reform of Direct Taxes and interalia dealt with sections 80 IA and 80 IB of the Act in its Report submitted in 2002. The group had not minced any words in declaring that tax incentives under sections 80 IA and 80 IB ***".....are in the nature of subsidies and since most developing countries do not account for these tax expenditures, they escape closer scrutiny of its effect. Tax incentives are, therefore inefficient, inequitous, impose greater tax payer compliance burden and administrative burden, result in revenue loss and contributed to complexity of the tax laws and encourage tax avoidance. These should be discouraged and wherever necessary political environment created to purge the tax statute of such incentives"***. The Group's Report noted that tax incentives had been subjected to abuse and that in spite of them, development in backward areas was yet to take off. Comptroller and Auditor General of India's Report No.12 of 1998 was referred to, for instances of abuse. The Report further pointed out that the problem was of basic infrastructural bottlenecks and these could not be taken care of by tax incentives.

2.1.4 The Kelkar Report concentrated on all aspects of direct taxes. With reference to incentives, it has more or less echoed the views of the Shome Advisory Group. The abuse, adverse impact of and increase in litigation due to the tax incentives have been decried. It stated that ***'the die is now cast for deleting***

other (i.e. other than export) incentives’. Depreciation has especially been dealt with and it questioned the rates prescribed as well as the situation where a group of assets were charged depreciation at the same rate. The rate of depreciation for plant and machinery of 25 percent was considered appropriate when the corporate tax rate was very high. With rationalization of corporate tax rates, it was suggested that the rate would need to be brought down to 15 percent bringing it in line with the rate prescribed in the Companies Act, which would pre-empt tax avoidance through manipulation of depreciation.

2.1.5 Operation of Export incentives (Section 80HHC) was reviewed in the Audit Report 12 of 1999, which was placed before the thirteenth Lok Sabha. The Public Accounts Committee (PAC) had, in their report numbers 34 and 41 of 2003 recommended that these provisions had outlived their usefulness and be abolished or drastically rationalized. The Act has since been amended to phase out the export incentives.

2.1.6 Keeping in view the recommendations of the Shome Advisory Group, the Kelkar Report, the PAC mentioned above, the scope for misuse/abuse, litigation and complexities involved, the effectiveness and efficiency of administration and implementation of the following deductions and allowances were examined in audit through this ‘review’ or systems appraisal: -

- Section 32 – Depreciation
- Section 35 – Expenditure on Scientific Research
- Section 80HHD – Deduction in respect of business of a hotel or an approved tour operator
- Section 80HHF – Deduction in respect of profits and gains from export or transfer of film software/T.V.software
- Section 80IA – Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development
- Section 80IB – Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings

2.1.7 The Government have modified each of the selected allowances/deductions introduced at various times subsequently in order to cater to the growing and changing needs, re-assessment of importance of the affected sectors of the economy or the demands of categories of tax payers. Accordingly, the Government specified their objectives in the relevant Budget Speeches and/or explanatory memoranda to the concerned Budgets.

2.2. Objective of the review

2.2.1 Based on a test check of selected assessment and other records of the department, the review seeks to

- ascertain the instances and extent of abuse or misuse of the selected allowances/deductions and areas of litigation attributable to complexity of laws and quantify the impact of deficiencies in implementation,

- identify lacunae, if any, in law,
- examine whether the stated purposes of various amendments to the selected sections have been achieved, and
- identify the effect on the tax liability of the selected companies occasioned due to application of different rates of depreciation in the Companies and the Income Tax Act.

2.3 Audit methodology and sample selection

2.3.1 The review covered assessments not only of companies for examination of application of sections 80IA, 80IB and 32 in particular but also non company assesseees for examination of administration of sections 35, 80HHD and 80HHF of the Act. The companies included top companies in terms of strategic sectors and top tax payers in the assessing units.

2.3.2 For section 32, all assessment cases in the selected units were scrutinised for review from the database of “top” companies compiled by field audit formations. For sections 35, 80HHD, 80HHF, 80IA and 80IB, assessments were examined in accordance with the methodology mentioned in **Table 1** below:

Table 1: Quantum of audit

Field formations	Selection of units		Assessments records for selection	
			Scrutiny	Summary
1	2		3	4
Delhi, Mumbai, Tamil Nadu, West Bengal, Karnataka, and Gujarat	CITs with Company cases/charges	50%		
	<u>Under the selected CITs</u>			
	JCIT/Additional CIT carrying out assessment functions	100%	100%	10%*
	DCIT/ACIT	100%	50%*	10%*
	ITOs	25%*	50%*	10%*
Other offices	CITs with Company cases/charges	100%		
	<u>Under the selected CITs</u>			
	JCIT/Additional CIT carrying out assessment functions	100%	100%	10%*
	DCIT/ACIT	100%	50%*	10%*
	ITOs	25%*	50%*	10%*

* denotes selection randomly made

2.3.3 Besides, in respect of assessees incurring expenditure on scientific research and availing deduction under section 35 and those availing deduction under sections 80 IA and 80 IB, details were obtained from Department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India in February 2004. Similarly, in respect of assessees availing deduction under Section 80-HHD covering hotels and tour operators, details were obtained from the Department of Tourism, Ministry of Tourism and Culture, Government of India, also in February 2004.

2.3.4 In all, 16 Accountants General, Principal Director of Audit, Central, Mumbai, Principal Director of Audit, Central, Kolkata and Director General of Audit, Central Revenues, New Delhi conducted the review in the assessment units pertaining to their charges and draft review reports were furnished to the respective Chief/Commissioners of Income Tax between August and October 2004. The Accountants General, Principal Directors, Director General also held exit conferences with their counter parts in October-November 2004. This was followed up with an Exit Conference with the Board on 10 February 2005.

2.3.5 Audit requisitioned the assessments completed in the financial years 2001-02, 2002-03 and 2003-04 till the date of audit. Wherever necessary, past records were also linked for conducting a purposeful examination in audit.

2.4 Law and procedure

2.5 Depreciation-Section 32

2.5.1 Depreciation means diminution in value that occurs gradually over the useful life of a business asset due to wear and tear and is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance. Fixed assets viz; buildings, machinery, plant or furniture, being tangible assets are eligible for depreciation. Knowhow, patents, copyrights, trademark, licences, franchises or any other business or commercial rights of similar nature, are intangible assets and are entitled to depreciation if these are acquired on or after 1 April 1998.

2.5.2 The Act provides for depreciation subject to fulfilment of three **main** conditions that the asset in respect of which depreciation is claimed should be (a) owned wholly or partly by the assessee (b) used for the purpose of business or profession and (c) used during the relevant previous year.

2.5.3 Appendix I and IA to Income Tax Rules, 1962 contain the rates at which depreciation is admissible. Depreciation at 50 percent of the normal rate is admissible in case a newly acquired asset is put to use for the purpose of business or profession for a period of less than 180 days in the year in which it is acquired. Depreciation is not allowed under specific circumstances mentioned in the Act.

2.5.4 Significant amendments made to law: -

- Finance Acts of 1966, 1967, 1974, 1975 and 1980 provided for additional depreciation and “extra shift” depreciation allowance in addition to normal depreciation. With a view to rationalizing the rate structure, providing higher depreciation for facilitating modernization and simplifying the calculation of depreciation, the Taxation Laws (Amendment and miscellaneous provisions) Act 1986 applicable from 1 April 1988 introduced the concept of “Block of Assets”.
- The Finance Act 1966 provided for full depreciation of the entire cost of plant and machinery exceeding Rs.750, which was enhanced to Rs.5000 in Finance Act 1983. As this proved to be a cause of much dispute, a proviso to section 32(1) was inserted with effect from 1 April 1996 withdrawing this allowance.
- Depreciation was allowed for fractional ownership of assets purchased on or after 1 April 1996.
- In the case of amalgamation, proportionate depreciation was allowed, to amalgamating and amalgamated companies as well as in the case of succession to the predecessor and successor and the demerged and resulting company in the case of a demerger.
- Depreciation was allowed on intangible assets acquired on or after 1 April 1998 in lieu of deductions allowed under section 35A/35AB earlier.
- With effect from 1 April 1998, the Act provided for separate rates of depreciation for machinery engaged in generation and generation and distribution of power.
- Foreign motorcars, acquired on or after 1 April 2001, were allowed depreciation.
- From 1 April 2002, the Act made mandatory for assesseees to claim depreciation whether details of assets in their returns are furnished or not.
- From assessment year 2003-04, the Act provided for additional depreciation at 15 percent (7.5 percent if used for less than 180 days) on plant and machinery acquired and installed after 31 March 2002 subject to fulfilment of certain conditions.
- Depreciation relating to assessment year 1997-98 and onwards, can be set off against any income from assessment year 2003-04 without any limit of time. Earlier depreciation relating to assessment year 1995-96 and 1996-97 was allowed to be carried forward for set off only for eight assessment years.

2.6 Expenditure on scientific research –Section 35

2.6.1 Section 35 of the Act provided an incentive in the form of deduction at the rate of 100 percent or 125 percent of the expenditure incurred for promotion of scientific research in India, by an industrial undertaking on its own or through any approved scientific research association or through any notified university, college or other institution subject to fulfilment of certain conditions.

2.6.2 Significant amendments made to law

- Under Section 35(1) payment made to an approved university or college or institution for the use of research for social science or statistical research related to the business of the assessee is eligible for deduction.
- Section 35(2) was amended with effect from 1 April 1984 to exclude expenditure *on land* from the deduction provided for capital expenditure incurred by assessee which itself carries on scientific research after 31 March 1967.
- With effect from 1 April 1997, section 35(2AB) allowed 150 percent deduction on capital expenditure *excluding both land and buildings*.

2.7 Deduction in respect of business of hotel or an approved tour operator Section-80HHD

2.7.1 In order to boost the foreign exchange earnings for the nation, the Act provided for deduction under section 80 HHD with effect from assessment year 1989-90 onwards at prescribed percentage in respect of business of hotels or tour operators, approved by the Director General of Tourism, Government of India, or a travel agent, from the profits derived in foreign exchange from the services provided to foreign tourists subject to fulfilment of certain conditions and production of certificates in Form 10-CCAD and 10-CCAE.

2.7.2 Eligible profit for computing the deduction shall be computed by multiplying profits and gains of business or profession with net foreign exchange receipts from services provided to foreign tourists and then dividing the result by total receipts of the business.

2.7.3 Significant changes made to law

2.7.4 From assessment year 1999-2000, deduction allowed under this section shall not qualify for deduction under any other sections of Chapter VIA and in no case shall exceed the profit and gains of such business.

2.7.5 From June 1999, the Government empowered the assessing officer to amend the order of assessment within four years from the end of the previous year in which the qualifying amount was brought in India within the prescribed time limit or extended period, with the approval of Reserve Bank of India where any deduction had been denied only on the ground that income otherwise qualifying for deduction had not been received in India and such income was so received in or brought into India at a subsequent date.

2.7.6 From assessment year 2001-02, the Government decided to phase out the deduction in the prescribed manner with the intent that deduction is not allowed in assessment year 2005-06 and subsequent years.

2.7.7 The method of computation, quantum of deduction allowable and the conditions for claiming deduction have been separately prescribed in the Act.

2.8 Deduction in respect of profits and gains from export or transfer of film software/TV software – Section-80HHF

2.8.1 The Act provided for deduction under section 80HHF, with effect from 1 April 2000, to an Indian company or a resident non corporate assessee engaged in the business of export or transfer; by any means, out of India, of any film software, television software, music software, television news software including telecast right and referred to as software or software rights.

2.8.2 The terms competent authority, convertible foreign exchange, export turnover, film software, music software, telecast right, television software and total turnover are defined in explanatory clauses (a) to (e) and (g) to (i) below the section 'ibid'. Profits of the business shall be reckoned in the manner specified in explanation (f) to the section itself.

2.8.3 Furnishing of a report of a Chartered Accountant in Form 10-CCAI certifying the correctness of the claim was made a pre-requisite for claiming the deduction. The quantum of deduction and other requisite conditions have also been provided in the section itself.

2.8.4 Significant amendments to Law

2.8.5 From the assessment year 2001-02, the Government amended section 80HHD in order to phase out the deduction over a period of 5 years by allowing a deduction of 80 per cent for assessment year 2001-02, 70 per cent for the assessment year 2002-03, 50 per cent for the assessment year 2003-04 and 30 per cent for assessment year 2004-05. No deduction shall be allowed from the assessment year 2005-06 onwards.

2.9 Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development – Section –80IA

2.9.1 From April 1991, section 80 I, with slight modifications, was replaced by a new section 80 IA which was originally made applicable to new industrial undertakings commencing manufacture, production, operation of ship, hotel, cold storage during the period 1 April 1991 to 31 March 1995. These provisions were extended to industrial undertakings commencing manufacture/production during the period 1 April 1993 to 31 March 1994 in specified industrially backward states allowing tax holiday benefits to the units, set up in industrially backward districts for infrastructure development, and also to the units, engaged in the generation and distribution of power. From April 2000, the deduction was restricted to units engaged in infrastructure development only.

2.9.2 Appendix 16 gives, at a glance, the details of deductions available under section 80IA viz: date of commencement of production, amount of deduction admissible and the period upto which deduction is admissible.

2.9.3 Other conditions for availing the benefit of deduction, inter alia, included production of Chartered Accountant's report in Form 10CCB alongwith the return of income certifying that the deduction has been correctly claimed.

2.10 Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertaking – Section 80IB

2.10.1 With effect from 1 April 2000, section 80IB provided for deduction to industrial undertakings/industrial undertaking in backward areas/ships/hotels/business of building, owning and operating of multiplex theatres/convention centres/company carrying on scientific research and undertakings carrying out housing projects/undertakings setting up and operating a cold chain facility for agricultural produce and undertakings doing the integrated business of handling storage and transportation of food grains.

2.10.2 Relevant sections, eligible business, period of availability together with other conditions of eligibility are discussed in **Appendix 21**. Besides, the undertaking should neither have been formed by the splitting up or reconstruction of an already existing business nor use previously used machinery. It should also employ 10 or more workers if operating with the aid of power and 20 or more if no power is used.

2.11 Constraints

2.11.1 The department has no database or records or registers in respect of the assesseees who are availing various deductions under the Income Tax Act. Although such information was intended to be available technically with the department, it has not been accessed or used in any meaningful way. In the absence of such comprehensive information with the department, limited information gathered by audit from other sources was relied upon for identification of cases. Further, restructuring of the department involving mass transfer of files from one circle/range/ward to another rendered accessibility of files/records difficult.

2.11.2 Non production of records

Non production of records by the assessing officers of the department in different charges was a significant constraint which varied from 3.54 percent in Punjab charge to 48.79 percent in Kerala charge, of the requisitioned records. **Table 2** below has the details. Restructuring of the department or the files pending with higher authorities were generally cited as reasons for non production. No reason was adduced for non-production of records in most of the cases.

AG/PD	Total No. of cases requisitioned	No. of cases not produced	Percentage of non production over total requisitioned
Andhra Pradesh	28614	2986	10.44
Bihar	1020	49	4.80
Delhi	7544	2688	35.63
Gujarat	2091	320	15.30
Haryana	1124	108	9.61
Jharkhand	2044	230	11.25
Kerala	2320	1132	48.79
Orissa	874	292	33.41
Punjab&UT	1185	42	3.54
Rajasthan	881	95	10.78
Tamil Nadu	905	320	13.99
Uttar Pradesh	2517	334	13.27
West Bengal	3589	995	27.72
Total	54708	9591	17.5

2.12 Audit findings

2.12.1 A total number of 1,37,899 cases covering selected sections of the Act were taken up for review. Excess/irregular deductions involving revenue effect of Rs.659 crore were noticed in 793 cases (including cases where lacunae in law were noticed). While 469 summary assessment cases involved a tax effect of Rs.347 crore, 324 scrutiny assessments involved a tax effect of Rs.313 crore relating to administration of the provisions of the Act selected for this review.

2.12.2 Audit noticed maximum number of mistakes relating to section 32 where revenue involved was Rs.320.50 crore in 499 cases followed by Rs.164.95 crore in 104 cases under section 80IA. A total number of 111 cases pointing out mistakes under section 80-IB involved revenue of Rs.81.21 crore.

2.12.3 Details of important and significant audit findings are presented in the following paragraphs corresponding to the objectives of this review mentioned in para 2.2 above.

2.13 OBJECTIVE I Abuse/Misuse/Complexity in law and Quantification of Deficiencies in Implementation

2.14 SECTION-32

2.14.1 Depreciation claimed and allowed on assets not owned by the assessee

2.14.2 In Bihar, Gujarat and Maharashtra charges, depreciation was incorrectly claimed and allowed in **three cases** on such assets which were not owned by the assessee. The mistakes resulted in excess allowance of depreciation involving tax effect of **Rs.1.39 crore**. One case involving tax effect of more than Rs.1 crore of Maharashtra charge is shown in the **Table 3** below. Remaining two cases are shown at **Sl. Nos 1 and 2 of Appendix 18**.

(Rs. in crore)

Table 3: Inadmissible claims of depreciation on assets not owned by the assessee

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Nature of mistake	Excess claim	Tax effect
1	M/s Antop Hill Warehousing Company Ltd City VI Mumbai	2000-01 Summary	Ware houses	Depreciation was erroneously claimed and allowed on warehouses which were not owned by the assessee.	3.46	1.33

2.14.3 Assets not used in the business

2.14.4 In Andhra Pradesh, Chandigarh, Gujarat, Himachal Pradesh, Maharashtra, New Delhi, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal charges, depreciation was erroneously allowed on the assets which were not put to use in relevant previous year owing to cessation of business/lock out/strikes/non-installation etc. The omissions led to short levy of tax of **Rs.4.80 crore** in **35 cases**. Four cases each involving tax effect of more than Rs.25 lakh but less Rs.1 crore are indicated at **Sl. Nos 1 to 4 of Appendix 19**.

2.14.5 Depreciation cannot be allowed on assets income from which is computed under the head 'income from house property'. Depreciation incorrectly allowed against income from let out property which was assessed under the head, 'income from house property' in **two cases** in Tamil Nadu charge as shown at **Sl. Nos 3 and 4 of Appendix 18** resulted in short levy of tax of **Rs.14 lakh**.

2.14.6 Sale and lease back transactions

2.14.7 This is a special category of transaction where both the vital conditions of ownership and use are violated. Assets are sold only on paper and the buyer leases the same assets back to the seller. The buyer claims depreciation as the owner even though the original seller is using the assets. Board issued Instruction 1978 in December 1999 containing detailed guidelines to the assessing officers on treatment of such transactions. Audit scrutiny revealed that depreciation was still being allowed in violation of the law and guidelines on the issue.

2.14.8 Depreciation allowed in "Sale and Leaseback" cases in violation of the conditions of ownership and usage resulted in short levy of tax of **Rs.14.17 crore** in **8 cases** in Tamil Nadu and Uttar Pradesh charges. One case involving tax effect of Rs.11.78 crore of Uttar Pradesh charge is illustrated below. Four cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos 5 to 8 of Appendix 18**.

2.14.9 In Uttar Pradesh charge, the assessment of M/s Indo Gulf Fertilizers and Chemicals, for the assessment year 1996-97 was completed after scrutiny in March 2002, after allowing depreciation of Rs.16.65 crore on addition of pollution

control equipments costing Rs.33.30 crore purchased under a “sale cum lease” arrangement from M/s Mangalore Refinery and Petro Chemical Ltd (MRPCL). The equipment was installed and used by MRPCL and not by the assessee. Depreciation was however, wrongly allowed to the assessee. The mistake resulted in underassessment of income of Rs.16.65 crore involving revenue effect of Rs.11.78 crore including interest.

2.14.10 Irregular claim of depreciation against income fully exempt from tax

2.14.11 No depreciation is admissible against the income exempt from tax.

2.14.12 In Delhi III charge, assessments of M/s Central Warehousing Corporation for the assessment years 2000-01 and 2002-03 were completed in summary manner disallowing exemption to income from warehousing activities but allowing depreciation claimed on warehouses. On appeal, income from warehousing activities was, however, exempted. Since depreciation on assets contributing to exempt income, is not admissible, it should have been disallowed. The mistake resulted in aggregate underassessment of income of Rs.31.82 crore involving tax effect of Rs.11.72 crore.

2.14.13 The department did not accept the audit observation, as it was a summary assessment. The reply is not tenable as mistakes arising from summary assessments conferring otherwise unentitled benefit on the assessee, prejudicial to the interests of revenue could be rectified under the powers available to assessing officers under the Act.

2.14.14 Mistakes in determination of actual cost or written down value of assets

2.14.15 Written down value means, in the case of assets acquired in the previous year, the actual cost to the assessee and in the case of the assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed under the Act.

2.14.16 In the case of any block of assets, written down value means, in respect of any previous year relevant to the assessment year commencing on 1 April 1988, the aggregate of the written down values of all the assets falling within that block of assets and, in respect of any previous year relevant to the assessment year commencing on 1 April 1989, the written down value of that block of assets in the immediately preceding year as reduced by the depreciation actually allowed in respect of that block of assets in relation to the said preceding previous year subject to certain adjustments prescribed in the Act.

2.14.17 In the case of succession in business or profession, the written down value of any asset or any block of assets shall be the amount which would have been taken as its written down value if the assessment had been made directly on the person succeeded to.

2.14.18 Incorrect application of the above provisions resulted in short levy of tax of **Rs.54.40 crore** in **54 cases** in Andhra Pradesh, Bihar, Gujarat, Haryana, Jharkhand, Kerala, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal charges. Six cases each involving tax effect of more than Rs.1 crore are shown in the **Table 4** below. Seven cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos 1 to 7 of Appendix 20.**

(Rs.in crore)

Table 4: Excess depreciation due to mistakes in written down values etc.

Sl No.	Name of the assessee/CIT charge	Assessmentyear/ Nature of Assessment	Nature of asset	Excess claim of depreciation	Tax effect
1.	M/s MCCPTA India Corporation Ltd Kolkata IV	2001-02 Summary	Fixed asset	32.88	13.00
2.	M/s DHBVNL Hissar (Haryana)	2000-01 Summary	-do-	28.43	10.94
3.	M/s UHBVNL Panchkula (Haryana)	2001-02 Summary	-do-	23.90	9.45
4.	M/s DHBVNL, Hissar	2001-02 Summary	-do-	21.39	8.46
5.	M/s S T BSES Coal Washeries Ltd City I Mumbai	2000-01 to 2002-03 Summary	Plant & Machinery	16.04	6.17
6.	M/s Chennai Bottling Company Chennai I	1996-97 Scrutiny	Business assets	1.91	1.61

2.14.19 Capital investment subsidies not deducted from cost. Where a part of the cost of an asset has been met directly or indirectly by the Central Government or State Government in the form of a subsidy, then such subsidy shall not be included in the actual cost of the asset.

2.14.20 Non-compliance with the above provision resulted in inflation of actual cost and excess allowance of depreciation involving tax effect of **Rs.2.38 crore** in **6 cases** in Assam charge. One case involving tax effect of Rs.1.60 crore is shown in the **Table 5** below. Two cases involving tax effect of Rs.34.53 lakh and Rs.28.39 lakh respectively are indicated at **Sl. Nos 9 and 10 of Appendix 18.**

(Rs. in crore)

Table 5: Excess depreciation allowed due to inflation of cost of assests

Sl. No.	Name of the assessee/CIT charge	Assessment year	Nature of asset	Nature of mistake	Under assessment	Tax effect
1.	M/s Virgo Cement Ltd. Guwahati II	2001-02 Scrutiny	Business asset	Capital investment subsidy not deducted from cost	4.56	1.60

2.14.21 Depreciation allowed on assets disposed off. Written down Value (WDV) in the case of any block of assets means the aggregate of WDV's of all assets falling within that block of assets at the end of the previous year increased

by the value of assets acquired and decreased by the value of assets sold or destroyed or discarded.

2.14.22 Incorrect allowance of depreciation without reducing the value of assets sold/disposed of, discarded or destroyed resulted in short levy of tax of **Rs.1.44** crore in **5 cases** in Gujarat charge. One case involving tax effect of Rs.1.24 crore is shown in the **Table 6** below. Two cases involving tax effect of Rs.8.93 lakh and Rs.8.43 lakh respectively are indicated at **Sl.Nos 11 and 12 of Appendix 18**.

(Rs. in crore)

Table 6: Depreciation allowed on assets disposed off

Sl. No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of Mistake	Under-assessment	Tax effect
1.	M/s Gujarat Electricity Board Baroda I	2001-02 Scrutiny	Loss of assets was considered as capital in nature but depreciation was allowed without reducing the value thereof from WDV	3.14	1.24

2.14.23 Adoption of incorrect rates of depreciation

2.14.24 Depreciation on any block of assets shall be calculated at the rate specified in **Appendix I and IA** to the Income Tax Rules 1962.

2.14.25 Mistake in application of correct rate of depreciation resulted in short levy of tax of **Rs.40.57** crore in **120 cases** (134 assessments) in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Haryana, Jharkhand, Karnataka, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu charges. Six cases each involving tax effect of more than Rs.1 crore are shown in the **Table 7** below. 11 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos 1 to 11 of Appendix 21**.

(Rs. in crore)

Table 7: Adoption of incorrect rates of depreciation

Sl No.	Name of assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Rate of depreciation		Excess claim	Tax effect
				Admissible	allowed		
1	M/s Airport Authority of India Delhi I	1994-95 2000-01 Scrutiny	Security fencing Vehicles	10%	25%	0.77	1.71
				10%	25%	2.46	
				20%	25%	0.50	
				20%	25%	3.31	
2	M/s SREI International Finance Ltd, Delhi I	2003-04 Summary	Vehicles	20%	40%	4.06	1.49
3	M/s ZIP Telecom Ltd Hyderabad-3	2000-01 Summary	'ZIP Fone' instruments	25%	60%	3.35	1.29

4	M/s Prax Air India Ltd. Bangalore III	1999-00 Scrutiny 2000-01 2001-02 Summary	Gas Cylinder	25%	100%	8.34 5.33 6.29	7.46
5	M/s Airport Authority of India Delhi	1994-95 2000-01 Scrutiny 2002-03 Summary	Terminal Building	10%	25%	43.57	15.56
6	M/s State Bank of Bikaner & Jaipur Jaipur II	2000-01 2001-02 Scrutiny	Leased assets Computers Motor Cars	25% -	100%	8.62	4.31

2.14.26 Excess allowance of depreciation on assets used for less than 180 days.

2.14.27 Mistakes in application of 50 percent of prescribed rate of depreciation on assets used for less than 180 days resulted in short levy of tax of **Rs.6.62 crore** in **33 cases** in Andhra Pradesh, Chandigarh, Delhi, Gujarat, Himachal Pradesh, Jharkhand, Kerala, Maharashtra, Punjab and West Bengal charges. Three cases each involving tax effect of more than Rs.1 crore are given in the **Table 8** below. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl. Nos.12 to 14 of Appendix 21.**

(Rs. in crore)

Table 8: Excess allowance of depreciation on assets used for less than 180 days

Sl No.	Name of assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Rate of depreciation		Excess claim	Tax effect
				Admissible	Allowed		
1.	M/s ABN Amro Bank N.V Kolkata	2000-01 Appeal revision	Intangible asset	12.5%	25%	4.13	1.98
2	M/s Bhima SSK Ltd. Pune-I	2001-02 Scrutiny	Plant & Machinery	12.5%	25%	4.30	1.70
3	M/s Ispat Profiles India Ltd. Kolkata I	1996-97 Scrutiny	Machinery	12.5%	25%	2.20	1.01

2.14.28 Mistakes in carry forward /set off of depreciation

2.14.29 Where for any assessment year, unabsorbed depreciation can not be set off against any other income in the relevant previous year, it shall be carried forward to the following assessment year and set off against profit and gains of that assessment year. It can be carried forward for eight assessment years. However, in doing so, business loss of earlier years has to be first set off followed by unabsorbed depreciation. The law has been amended with effect from 1 April 2004 enabling unabsorbed depreciation to be carried forward, indefinitely.

2.14.30 Mistakes in setting off unabsorbed depreciation resulted in short levy of tax of **Rs.40.10 crore** in **54 cases** (66 assessments) in Andhra Pradesh, Bihar, Delhi, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal charges. 11 cases each involving tax effect of Rs.1 crore or more are given in **Table 9** below. 12 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 12 of Appendix 22**.

(Rs. in crore)

Sl No.	Name of the assessee/CIT Charge	Assessment year	Excess set off	Tax effect
1.	M/s Samcor Glass Ltd. Delhi III	1999-00 & 2000-01 Scrutiny	20.81	8.01
2.	M/s Shree Cement Ltd. Ajmer	2002-03 & 2003-04 Summary	4.10 1.20	4.54
3.	M/s Shriram City Union Finance Ltd, Chennai III	2002-03 Summary	4.35	3.83
4.	M/s Ipisteel Ltd. Cuttack	1995-96 to 2000-01 Scrutiny 2001-02 to 2003-04 Summary	4.48	2.48(P)
5.	M/s Tuticorin Alkali chemicals Chennai I	1996-97 to 1998-99 Scrutiny	2.40 0.62	2.18
6.	M/s Samtel Color Ltd, Delhi III	2001-2002, Scrutiny	3.71	2.12
7.	M/s Tamil Nadu Cement Corporation Ltd, Chennai I	1997-98 Scrutiny	4.74	2.04
8.	M/s Rajasthan State Mineral Development Corporation Ltd, Jaipur II	2000-01 Scrutiny	2.87	1.97
9.	M/s Textool Company Ltd. Coimbatore II	2001-02 Summary	3.43	1.73
10.	M/s Avery Cycle Industries Ltd. Ludhiana Central	2000-01 Scrutiny	2.89	1.11
11.	M/s Rajasthan Texchem. Ltd. Mumbai IV	2001-02 Scrutiny	2.52	1.00

2.14.31 Mistakes in grant of additional depreciation

2.14.32 With a view to encouraging modernization and investment in the economy, incentive in the form of additional depreciation was introduced with effect from assessment year 2003-04. Additional depreciation shall be allowed subject to the conditions that either a new industrial undertaking should begin manufacture after 1 April 2002 or an existing industrial undertaking should substantially expand its installed capacity by at least 25 percent.

2.14.33 Additional depreciation was allowed even when prescribed conditions were not fulfilled or detailed information in Form 3AA was not filed, in **7 cases** in Haryana, Kerala, Orissa and Uttar Pradesh charges resulting in short levy of tax of

Rs.15.60 crore. One case involving tax effect of Rs.14.90 crore of Orissa charge is discussed in **Table 10** below. Two cases involving tax effect of Rs.36.85 lakh and Rs.18.33 lakh respectively are indicated at **Sl.Nos 13 and 14 of Appendix 18.**

(Rs. in crore)

Table 10: Mistakes in grant of additional depreciation

Sl No	Name of the assessee/ CIT charge	Assessment year	Nature of asset	Nature of objection	Additional depreciation allowed incorrectly	Tax effect
1.	M/s National Aluminium Company Ltd. Bhubaneswar	2003-04 Summary	Plant and Machinery	Plant and Machinery was acquired before 1 April 2002 and its expansion was below 25 per cent.	40.56	14.90

2.14.34 Depreciation claim allowed on ineligible items

2.14.35 Items, whether tangible or intangible, which have been included in Appendix I to the Income Tax Rules 1962, are eligible for deduction at the rates prescribed therein. It has been judicially held* that roads do not qualify for depreciation as “building” unless a road is laid for providing approach to factory/business premises.

2.14.36 Irregular allowance of deduction on the items not included in Appendix I to the Income Tax Rules 1962 resulted in short levy of tax of **Rs.5.11 crore in 16 cases** in Andhra Pradesh, Bihar, Gujarat, Karnataka and West Bengal charges. One case involving tax effect of Rs.4.27 crore of Karnataka charge is given in the **Table 11** below. Two cases involving tax effect of Rs.40.95 lakh and Rs.20.69 lakh respectively are indicated at **Sl. Nos 15 and 16 of Appendix 18.**

(Rs.in crore)

Table 11: Depreciation claim allowed on ineligible items

Sl. No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Nature of asset	Nature of mistake	Tax effect
1.	M/s Nandi Highway Developers Ltd. Bangalore III	2001-02 2002-03 Summary	Road built on BOT basis and not owned by the assessee	Depreciation was claimed and allowed on roads constructed on ‘BOT’ basis which was not an eligible item included in Appendix I to the Income Tax Rules	4.27

* M/s Indore Municipal Corporation Vs CIT (247 ITR 808 – SC)

2.14.37 Mistakes in adoption of correct figures and errors in computation

2.14.38 Under the Act, an assessment may be completed in a summary manner, inter alia, after rectifying any arithmetical error in the return, accounts and accompanying documents. 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. Despite this and instructions issued by the Board from time to time, mistakes including incorrect adoption of figures, arithmetical errors, double allowance of claims, failure to add back the claims originally disallowed by the assessing officer etc. continue to occur suggesting the need for better vigilance and highlighting the fact that internal control mechanism needed to be strengthened urgently and effectively.

2.14.39 Mistakes in adoption of correct figures and errors in computation of deduction resulted in short levy of tax of **Rs.38.98 crore** in **57 cases** in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Jharkhand, Himachal Pradesh, Karnataka, Maharashtra, Punjab, Tamil Nadu and West Bengal charges. Three cases involving tax effect more than Rs.1 crore each are given in **Table 12** below. 5 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 4 of Appendix 23**.

(Rs. in crore)

Table 12: Mistakes in adoption of correct figures and errors in computation

Sl No.	Name of the assessee/CIT charge	Assessment year/ Nature of assessment	Excess deduction allowed	Tax effect
1.	M/s AIR India Ltd, Mumbai	2000-01, Scrutiny	79.32	30.54
2.	M/s ITC Ltd, Kolkata III	2001-02, Scrutiny	5.90	2.33
3.	M/s Information Technologies (I) Ltd Delhi IV	2000-01 Scrutiny	2.08	1.19

2.14.40 Other miscellaneous mistakes

2.14.41 Assessing officers had committed mistakes of miscellaneous nature in **12 cases** involving tax effect of **Rs.10.04 crore** in Andhra Pradesh, Assam, Delhi, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal charges. One case involving tax effect of Rs.6.80 crore is given in **Table 13** below. Remaining cases are indicated at **Sl Nos 1 to 11 of Appendix 24**.

(Rs in crore)

Table 13: Other miscellaneous mistakes

Sl No.	Name of the Assessee/CIT charge	Assessment year/Nature of assessment	Nature of observation	Under assessment	Tax effect
1.	M/s India Polyfibers Ltd Lucknow II	2002-03 Summary	Depreciation pertaining to past assessment years (1996-97 to 2001-02) was incorrectly claimed and allowed	19.05	6.80

2.15 SECTION- 35

2.15.1 Irregular allowance of deduction on scientific research under section 35(1) and section 35(2AB) without approval of prescribed authority

2.15.2 For the purpose of claiming the deduction in respect of expenditure towards scientific research under sections 35(1) and 35(2AB), approval of prescribed authority is required which, under the provisions of the Act, shall be the Secretary, Department of Scientific and Industrial Research, Government of India.

2.15.3 Irregular allowance of deduction under the above provisions without approval of prescribed authority resulted in short levy of tax of **Rs.27.66 crore in 14 cases** in Bihar, Delhi, Gujarat, Jharkhand, Maharashtra, Orissa and Tamil Nadu charges. Five cases each involving tax effect of more than Rs.1 crore are given in **Table 14** below. 3 cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 3 of Appendix 25**.

(Rs. in crore)

Table 14: Irregular allowance of deduction under section 35(1) and section 35(2AB)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Excess deduction allowed	Tax effect
1.	M/s Lupin Ltd Mumbai X	2002-03, Summary 2001-02, Scrutiny	20.06 12.52	12.88
2.	M/s CIPLA Ltd, Mumbai II	2002-03, Summary	10.74	4.25
3.	M/s Cipla Ltd, Mumbai II	2003-04, Summary	11.82	4.22
4.	M/s National Aluminium Company Ltd. Bhubaneswar	2000-01, Scrutiny 2001-02 to 2003-04 Summary	7.03	2.62
5.	M/s Nicholas Piramal India Ltd, Mumbai	2002-03 Summary	4.76	1.88

2.15.4 Incorrect allowance of deduction together with depreciation

2.15.5 Where deduction is allowed for any previous year under section 35 in respect of expenditure represented wholly or partly by an asset, no deduction shall be allowed under section 32 for the same or any other previous year in respect of that asset.

2.15.6 Non-compliance with above provision resulted in excess allowance of deduction involving tax effect of **Rs.1.40 crore in 4 cases** in Andhra Pradesh, Bihar and West Bengal charges. Two cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 4 and 5 of Appendix 25**.

2.15.7 Other mistakes

2.15.8 Different types of mistakes in allowance of deduction towards expenditure on scientific research under Section 35 resulted in short levy of tax of **Rs.2.06 crore in 8 cases** in Gujarat, Maharashtra, Tamil Nadu and Uttar Pradesh

charges. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 3 of Appendix 26.**

2.16 SECTION- 80 HHD

2.16.1 Irregular allowance of deduction without approval of prescribed authority

2.16.2 For claiming deduction under section 80HHD the business of hotel or of a tour operator should have been approved by the Director General, Director General of Tourism, Government of India.

2.16.3 In the following cases, the business of hotel was not approved by the prescribed authority which resulted in irregular allowance of deduction under section 80HHD involving short levy of tax of **Rs.19.31 lakh in 3 cases** in Delhi, Karnataka and Kerala charges. Details of these cases are indicated at **Sl.Nos 6 to 8 of Appendix 25.**

2.16.4 Irregular/non-utilisation of reserve

2.16.5 For allowing deduction under section 80HHD, an amount equal to the percentage of deduction is debited to the profit and loss account of the previous year in respect of which the deduction is allowed and credited to a reserve account to be utilized for the purposes of the business of the assessee in the prescribed manner.

2.16.6 Irregular transfer of entire amount of foreign exchange reserve to the profit and loss account without using it for the specified purposes, resulted in short levy of tax of **Rs.37.57 crore in 10 cases** in Maharashtra, Tamil Nadu, Orissa and West Bengal charges. Four cases each involving tax effect of more than Rs.1 crore are given in **Table 15** below. Three cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 9 to 11 of Appendix 25.**

(Rs. in crore)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Irregular deduction allowed	Tax effect
1.	M/s East India Hotel Ltd Kolkata III	2001-02 Scrutiny	35.80	14.16
2.	M/s East India Hotel Ltd. Kolkata III	1999-00 Scrutiny	34.70	12.14
3.	M/s Hotel Leela Venture Ltd. Mumbai VIII	1998-99 Scrutiny	24.00	8.40
4.	M/s Travel Corporation of India Mumbai IV	2000-01 Scrutiny 2001-02 Scrutiny	3.28 0.85	1.60

2.16.7 Mistake in computation of eligible profit/deduction

2.16.8 Under the provisions of the Act, the eligible profits for the purpose of deduction under section 80HHD are to be reckoned with regard to total turnover only.

2.16.9 Mistake in computation of eligible profit/deduction resulted in short levy of tax of **Rs.81.14 lakh** in **2 cases** in Delhi and Tamil Nadu charges. Details of these cases are indicated at **Sl.Nos 12 and 13 of Appendix 25**.

2.16.10 Incorrect allowance of deduction against ineligible business resulted in short levy of tax of **Rs.1.31 crore** in **6 cases** in Delhi, Karnataka, Kerala, Maharashtra and Tamil Nadu charges. One case involving tax effect of Rs.60.99 lakh of Maharashtra charge is indicated at **Sl.No 4 of Appendix 26**.

2.16.11 Irregular allowance of deduction without setting off brought forward loss

2.16.12 Under the provisions of the Income Tax Act, 1961, deduction under chapter VIA shall be allowed only after brought forward losses of earlier years are set off.

2.16.13 Irregular allowance of deduction without setting off brought forward loss resulted in short levy of tax of **Rs.43.32 lakh** in **2 cases** in Kerala and Tamil Nadu charges as indicated at **Sl.Nos 14 and 15 of Appendix 25**.

2.16.14 Other mistakes

2.16.15 While computing deduction under Section 80HHD, the assessing officers committed different types of mistakes which resulted in excess allowance of deduction involving short levy of tax of **Rs.63.42 lakh** in **9 cases** in Karnataka, Kerala, Maharashtra, Orissa, Rajasthan and Tamil Nadu charges. Two cases involving tax effect of Rs.17.06 lakh and 14.05 lakh are indicated at **Sl. Nos 16 and 17 of Appendix 25**.

2.17 SECTION- 80HHF

2.17.1 Irregular allowance of double deductions

2.17.2 Sub section (5) of section 80 HHF stipulates that where a deduction under this section is claimed and allowed for any assessment year, no deduction shall be allowed in relation to such profits under any other provisions of the Act.

2.17.3 In violation of the above provision, assesseees were allowed deductions under other sections of the Act in addition to deduction under section 80-HHF which resulted in excess allowance of deduction resulting in short levy of tax of **Rs.22.15 lakh** in **2 cases** in Maharashtra charge as indicated at **Sl Nos 5 and 6 of Appendix 26**.

2.17.4 Mistakes in adoption of correct figures and errors in computation

2.17.5 Mistakes in adoption of correct figures and errors in computation of deduction were noticed in 4 cases involving revenue effect of **Rs.1.98 crore** in **5 cases** in Maharashtra charge. One case involving tax effect of Rs.1.36 crore is shown in **Table 16** below. Another case involving tax effect of Rs.44.63 lakh is indicated at **SI No 7 of Appendix 26**.

(Rs. in crore)

Table 16: Avoidable mistakes and errors in computation

SI No.	Name of the assessee/ CIT charge	Assessment year/Nature of assessment	Nature of mistake	Excess deduction allowed under section 80HHF	Tax effect
1.	M/s Nimbus Communications Ltd City XI Mumbai	2000-01 Scrutiny	Amount of total turnover was incorrectly adopted.	2.37	1.36

2.17.6 Other miscellaneous mistakes

2.17.7 Different types of mistakes in application of provisions of sections 80HHF resulted in excess allowance of deduction involving short levy of tax of **Rs.88.21 lakh** in **4 cases** in Andhra Pradesh, Maharashtra, Tamil Nadu and West Bengal charges as indicated at **SI Nos 8 to 11 of Appendix 26**.

2.18 SECTION-80IA**2.18.1 Irregular deduction allowed on ineligible business/other income not relating to manufacture/industrial/infrastructure activities**

2.18.2 Deduction was incorrectly allowed on other income not relating to manufacture/industrial/infrastructure activities which resulted in short levy of **Rs.136.42 crore** in **61 cases** in Andhra Pradesh, Bihar, Chandigarh, Delhi, Gujarat, Haryana, Jharkhand, Karanataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and West Bengal charges. Four cases each involving tax effect of more than Rs.1 crore are given in **Table 17** below. Four cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **SI.Nos.1 to 4 of Appendix 27**.

(Rs. in crore)

Table 17: Irregular deduction under section 80IA against other income

SI No.	Name of the assessee/CIT charge	Assessment year/Nature of assessment	Nature of income to be excluded	Irregular deduction allowed	Tax effect
1.	M/s Orissa Power Generation Corporation Ltd. Bhubaneswar	2001-02 to 2003-04 Summary	Other income. Excess set off of brought forward depreciation and non-filing of prescribed audit certificate was also noticed	394.30	125.52
2.	M/s Rungta Irrigation Ltd, Delhi V	1999-00 Scrutiny	Other income	4.63	2.47

3.	M/s Kochi Refinery Ltd, Kochi	1998-99 Scrutiny	Income from investment and other sources	4.44	1.60
4.	M/s Vesuvius India Ltd. Kolkata IV	1999-00 2002-03 Summary 2000-01 2001-02 Scrutiny	Other income credited towards 'provisions no longer required and exchange gain'	2.92	1.57

2.18.3 Non-deduction of proportionate corporate expenses

2.18.4 Where any assessee has more than one unit of manufacture and all of them are not eligible for deduction under section 80IA, it is often noticed that the expenses of the eligible unit are debited to the non eligible unit so that the taxable profits go down and the non taxable profits go up.

2.18.5 In West Bengal III charge, audit examination of the assessment of M/s Tide Water Oil Co. (I) Ltd for the assessment year 1998-99 completed after scrutiny revealed that while claiming deduction under section 80IA, the assessee did not reduce the proportionate expenses having direct nexus with the exempted unit. These expenses were debited against income from non eligible units to reduce the taxable income. The mistake resulted in under assessment of income of Rs.1.75 crore involving short levy of tax of Rs.61.51 lakh. At the instance of audit, assessment was reopened under section 263 and set aside against which assessee preferred appeal to ITAT, where appeal was decided in favour of the department.

2.18.6 Incorrect allowance of double deduction

2.18.7 If deduction under section 80IA is claimed for any assessment year, deduction to the extent of such profits and gains shall not be allowed under any other provisions of Chapter VIA from the profit and gains of same business.

2.18.8 Incorrect allowance of deduction towards export profits on the same amount of profits and gains in violation of the above provision resulted in excess allowance of deduction involving short levy of tax of **Rs.9.71 crore in 15 cases** in Maharashtra, Gujarat, Tamil Nadu and West Bengal charges. One case involving tax effect of Rs.4.36 crore is illustrated below. Four cases each involving tax effect of more than Rs.50 lakh but less than Rs.1 crore are indicated at **Sl.Nos 1 to 4 of Appendix 28**.

2.18.9 In West Bengal, Kolkata III charge, in the assessments of M/s East India Hotel Ltd. for the assessment years 1999-00 to 2001-02 completed after scrutiny, the assessee was allowed deduction under section 80IA though it had already claimed deduction under section 80HHD. The irregularity resulted in short levy of tax of Rs.4.36 crore.

2.18.10 Incorrect allowance of deduction in respect of ‘prior period’ income

2.18.11 Deduction under section 80IA is admissible only from the date the industrial undertaking starts manufacturing activities as provided in the Act.

2.18.12 In Kerala, Kochi charge, the assessment of M/s Kochi Refinery Ltd. for the assessment year 1997-98, completed after scrutiny in March 2000 was revised in June 2001 at a total income of Rs.168.11 crore allowing a deduction of Rs.20.51 crore in respect of a new unit commissioned in December 1994. Audit scrutiny revealed that the profit derived from the eligible unit included Rs.12.88 crore being the amount received on account of increase in costs of margin from oil co-ordination committee for the period prior to the commissioning of the new unit in December 1994. The mistake resulted in allowance of an excess deduction of Rs.3.86 crore involving short levy of tax of Rs.2.77 crore including interest.

2.18.13 Inadmissible claims for want of audit certificate

2.18.14 Deduction under this section shall not be admissible unless an accountant audits the accounts of the assessee of the relevant previous year and the assessee furnishes along with the return of income, the report of such audit in the prescribed Form No.10CCB duly signed and verified by such accountant.

2.18.15 Irregular allowance of deduction in the absence of requisite audit certificate resulted in short levy of tax of **Rs.1.16 crore in 12 cases** in Bihar, Gujarat, Haryana, Himachal Pradesh and Tamil Nadu charges. One case involving tax effect of Rs.39.31 lakh is indicated at **Sl.No 5 of Appendix 28**.

2.18.16 Irregular deduction in respect of units formed by splitting existing units

2.18.17 Deduction under section 80IA is allowed, inter alia, subject to two conditions, viz: the undertaking is not formed by the splitting up or reconstruction of a business already in existence or the transfer of machinery from an old business. Further, in the event of transfer, the total value of the machinery transferred should be less than twenty per cent of the total value of the machinery used in the new business.

2.18.18 In Assam, Shillong charge, in the case of M/s Eastern Mining and Allied Industries Ltd. Rs.1.88 crore worth of machinery out of a total value of machinery of Rs.3 crore claimed to have been used in the business was found to be fictitious and depreciation disallowed for assessment years 1993-94 to 1995-96. However, deduction under section 80IA of Rs.6.3 crore and Rs.3.54 crore was allowed for assessment years 1995-96 and 1996-97 respectively. This was in spite of the fact that major part of the machinery was found fictitious and no manufacture could have been done with fictitious machinery. Also, the value of old and previously used machinery, transferred to the business, was more than 20

percent of the total value of the plant machinery. Thus, the deduction allowed was not in order. Omission to disallow deduction resulted in underassessment of income of Rs.9.84 crore involving short levy of tax of Rs.5.94 crore.

2.18.19 Non-furnishing of separate accounts for separate units/divisions

2.18.20 For the purpose of computing quantum of deduction under section 80IA, profit and gains of the eligible business of the assessee shall be computed for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year as if such eligible business were the only source of income during the relevant previous year.

2.18.21 Non furnishing of separate accounts for separate units resulted in short levy of tax of **Rs.1.18 crore** in **3 cases** in Bihar and Uttar Pradesh charges. Two cases involving tax effect of Rs.72.32 lakh and Rs.41.28 lakh respectively are indicated at **Sl.Nos 6 and 7 of Appendix 28.**

2.18.22 Incorrect adjustment of loss

2.18.23 Under the provisions of section 80IA(5), the profits eligible for deduction have to be computed as if the new industrial undertaking is a separate unit and provisions of the Act have to be applied accordingly.

2.18.24 In Maharashtra charge, in the assessment of M/s Anurang Engineering Company Pvt Ltd., for the assessment years 2001-02 and 2002-03, the loss of a unit eligible for deduction under section 80IA was adjusted against the income from its other businesses in violation of the above provision. In the same charge, similar situation was observed in another case of M/s Endurance System Pvt. Ltd. The mistakes resulted in aggregate short levy of tax of Rs.2.97 crore in two cases.

2.18.25 Other miscellaneous mistakes

2.18.26 The assessing officers also committed different types of mistakes which resulted in short levy of tax of **Rs.8.37 lakh** in **2 cases** in Chandigarh and Kerala charges as indicated at **Sl Nos 12 and 13 of Appendix 30.** Besides, deduction was erroneously allowed without setting off brought forward losses/unabsorbed depreciation in four cases involving short levy of tax of Rs.90.49 lakh in Delhi and Tamil Nadu charges. Two cases involving tax effect of Rs.47.26 lakh and Rs.24.65 lakh respectively are indicated at **Sl Nos 8 and 9 of Appendix 28.**

2.19 SECTION-80 IB.

2.19.1 Irregular allowance of deduction on incomes not relating to manufacture/industrial activities

2.19.2 One of the conditions for availing deduction under section 80IB is that the income eligible for deduction should be derived from the eligible business as defined.

2.19.3 Deduction under section 80IB was incorrectly allowed against the income derived from other sources resulting in short levy of tax of **Rs.37.42 crore** in **73 cases** in Assam, Chandigarh, Delhi, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu and Uttar Pradesh charges. Two cases each involving tax effect of more than Rs.1 crore are given in **Table 18** below. Eight cases each involving tax effect of more than Rs.25 lakh but less than Rs.1 crore are indicated at **Sl.Nos 5 to 12 of Appendix 27**.

(Rs. in crore)

Sl No.	Name of the assessee/ CIT charge	Assessment year/Nature of assessment	Nature of income to be excluded	Irregular deduction allowed	Tax effect
1.	M/s Himachal Futuristic Communication Ltd, Delhi I	2001-02 Scrutiny	Manufacture of software	70.28	27.79
2.	M/s NIIT GAS Ltd. Delhi V	2001-02 Scrutiny 2003-04 Summary	Manufacture of software	7.45	3.02

2.19.4 Special provisions for small-scale industrial undertakings

2.19.5 Section 80IB prohibits deduction in respect of income from the manufacture of any item listed in the Eleventh Schedule of the Income Tax Act except in the case of small scale industrial undertakings having total investment in plant and machinery of less than Rs.one crore.

2.19.6 Violation of the above stipulation resulted in short levy of tax of **Rs.1.98 crore** in **two cases** in Rajasthan and Tamil Nadu charges. One case involving tax effect of Rs.1.49 crore is illustrated below. Remaining case is indicated at **Sl.No 14 of Appendix 26**.

2.19.7 In Rajasthan, Jaipur Central charge, audit scrutiny of the summary assessment records of **M/s. Dinesh Pouches Ltd.** for the assessment year 2003-04 allowing deduction of Rs.3.72 crore under section 80IB revealed that the cost of plant and machinery was more than Rs.one crore. Hence the assessee was not a small scale industrial undertaking entitled to deduction in respect of income from manufacture of items included in Eleventh Schedule of the Income Tax Act. Irregular allowance of deduction resulted in short levy of tax of Rs.1.49 crore.

2.19.8 Non-maintenance of separate accounts

2.19.9 The provisions of this section do not allow the adjustment of any income/loss of the unit eligible for deduction against income/loss from any other unit or business of the assessee. For this purpose, separate accounts also have to be mandatorily maintained for each unit/ business claiming deduction.

2.19.10 Non-maintenance of separate accounts for different units resulted in short levy of tax of **Rs.1.30 crore** in **two cases** in respect of M/s Aksh Optifibre Ltd. (Haryana charge) and M/s Alkem Laboratories Ltd. (Bihar charge) for assessment years 2001-02 (Summary) and 2000-01 (Scrutiny) respectively.

2.19.11 Claims allowed without audit certificate

2.19.12 Deduction under this section shall not be admissible unless an accountant audits the accounts of the assessee for the relevant previous year and the assessee furnishes along with his return of income, the report of such audit in the prescribed Form No.10CCB duly signed and verified by such accountant.

2.19.13 Incorrect allowance of deduction in the absence of requisite audit certificate resulted in short levy of tax of **Rs.35.04 crore** in **12 cases** in Bihar, Himachal Pradesh, Jharkhand, Kerala and Tamil Nadu charges. Three cases each involving tax effect of rupees one crore and above are given in **Table 19** below. Two cases involving tax effect of Rs.16.85 lakh and Rs.8.66 lakh respectively are indicated at **Sl.Nos 10 to 11 of Appendix 28**.

(Rs. in crore)

Table 19: Inadmissible claims for want of audit certificates

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Inadmissible deduction	Tax effect
1.	M/s Kochi Refinery Ltd. and six Others Kochi and Kottayam	2003-04 Summary	68.21	28.24
2.	M/s Saluja Exim Ltd. Himachal Pradesh	2002-03 Summary	14.68	5.24
3.	Shri D.H.Desai Patna II, Bihar	2001-02 Scrutiny	2.30	1.17

2.19.14 Irregular deduction to business not located in approved backward areas

2.19.15 Audit scrutiny revealed that deduction was allowed to businesses not located in approved backward areas. The irregularity resulted in short levy of tax of **Rs.1.36 crore** in **five cases** in Chandigarh and Uttar Pradesh charges. One case involving tax effect of Rs.1.02 crore of Uttar Pradesh charge is given in **Table 20** below. Two cases involving tax effect of Rs.16.92 lakh and Rs.13.03 lakh respectively are indicated at **Sl.Nos 15 and 16 of Appendix 26**.

(Rs. in crore)

Table 20: Deduction allowed to business not located in approved backward areas

Sl No.	Name of assessee	Assessment year/ Nature of assessment	Location of business	Excess claim	Tax effect
1.	M/s Rahul Detergent Pvt. Ltd Kanpur II	2001-02 Scrutiny	Delhi	1.95	1.02

2.19.16 Double deduction

2.19.17 Where any amount of profits and gains of an undertaking or of an enterprise of an assessee is claimed and allowed under section 80IB for any assessment year, deduction to the extent of such profits and gains shall not be allowed under any other provisions of Chapter VIA of the Act.

2.19.18 Incorrect of allowance of deduction in violation of the above provision resulted in short levy of tax of **Rs.77.87 lakh** in **four cases** in Delhi and Kerala charges. One case involving tax effect of Rs.34.39 lakh is indicated at **Sl.No 17 of Appendix 26**.

2.19.19 Other miscellaneous mistakes

2.19.20 The assessing officers also committed different types of mistakes which resulted in short levy of tax of **Rs.53.62 lakh** in **six cases** as indicated at **Sl Nos 18 to 23 of Appendix 26**.

2.20 OBJECTIVE II: Lacunae in law**2.21 SECTION-32****2.21.1 Definition and categorization of loose tools**

2.21.2 In the absence of specific definition and categorization of ‘loose tools’ and ‘moulds’ as assets or “stores and spares” there was no consistency in treatment of depreciation by different assessing officers. Depreciation was being allowed at 25 percent treating these as plant and machinery by some assessing officers or entirely allowed as revenue expenditure by others.

2.21.3 Inconsistency in the treatment of “loose tools” and “moulds” as plant and machinery for the purpose of depreciation by assessing officers resulted in short levy of tax of **Rs.3.07 crore** in **five cases** (seven assessments) in Madhya Pradesh and Tamil Nadu charges. One case involving tax effect of Rs.2.69 crore relating to Tamil Nadu charge is given in **Table 21** below. Two cases involving tax effect of Rs.13.39 lakh and Rs.12.68 lakh are indicated at **Sl.Nos 17 and 18 of Appendix 18**.

(Rs.in crore)

Table 21: Expenditure on loose tools erroneously treated as revenue

Sl No.	Name of the assessee/ CIT Charge	Assessment year	Nature of asset	Tax effect
1.	M/s Neyveli Lignite Corporation Chennai III	2001-02 (Scrutiny)	Loose tools treated as assets and 25% depreciation granted in earlier years but erroneously fully allowed as revenue expenditure.	2.69

2.21.4 Definition of plant

2.21.5 The term plant has been defined in the Act to include ships, vehicles, books, scientific apparatus and surgical equipment. However, audit scrutiny revealed that depreciation was being claimed on the dictionary meaning of plant even in respect of agricultural/ horticultural plants. One interesting case is illustrated below.

2.21.6 In Karnataka, Bangalore III charge, audit scrutiny revealed that M/s SPA Agro Ltd., for the assessment year 2002-03, where assessment was completed in summary manner, claimed and was allowed depreciation aggregating Rs.27.89 lakh on Rose and Carnation plantations. As these items were not eligible items specified in Appendix I to Rule 5, depreciation granted thereon was required to be withdrawn. The omission resulted in short levy of tax of Rs.8.89 lakh.

2.21.7 It was judicially held¹ that theatre or hotel building equipped for business purposes are still buildings and therefore are not entitled to depreciation at the rate applicable to plant.

2.21.8 Non compliance with above judicial pronouncement occasioned due to complexity in definition of plant resulted in short levy of tax of **Rs.92.45 lakh** in **Three cases** in Madhya Pradesh charge. Two cases involving tax effect of Rs.61.78 lakh and Rs.27.49 lakh respectively are indicated at **Sl.Nos 18 and 19 of Appendix 25**.

2.21.9 Verification of actual cost

2.21.10 Where assets acquired by the assessee are “second hand” assets, the actual cost thereof has to be determined by the assessing officer. In the absence of a specific statutory provision requiring assessees to furnish details of the assets in these cases in Audit Report in Form 3CD, there is no safeguard available to restrict the allowance to bonafide and correct cases, especially when more than 95 percent cases are completed in summary manner.

2.21.11 In Karnataka, Bangalore III charge, in the assessment of M/s Praxair India Pvt. Ltd for the assessment year 1999-2000 completed after scrutiny, the assessee claimed and was allowed depreciation of Rs.21.99 crore on the transfer of fixed assets of value of Rs.30.22 crore acquired by the assessee from four other companies during the relevant previous year. The transferred fixed assets being second hand assets, deduction towards expenditure thereon should have been allowed in scrutiny assessment only after verifying the cost to be adopted under section 43(1) which was not done. Similarly, in the case of M/s Wipro Fluid Power Ltd for the assessment year 2002-03, assessment completed in summary

¹ CIT Vs. Anand Theaters (244 ITR 192 - SC)

manner in the same charge, depreciation of Rs.36.50 lakh was claimed and allowed without verification of the actual cost of the second hand assets. The mistakes involved tax effect of Rs.7.83 crore.

2.22 SECTION-35

2.22.1 Lacuna in section 35(2AB) when read with section 35(2)

2.22.2 Section 35 (2AB) of the Act provides for grant of weighted deduction of 150 per cent of the expenditure incurred including capital and revenue, related to “in house” research and development facility of certain businesses **excluding the cost of land or building** whereas section 35 (2) of the Act provides for grant of 100 per cent deduction of the expenditure incurred (both capital and revenue) for own business **excluding only the cost of land.**

2.22.3 Section 35(2) has been drafted in such a manner that it excludes only the expenditure on land so that the expenditure on building can be claimed under it, while section 35(2AB) simultaneously enables an assessee to claim weighted deduction on expenditure excluding land and building. The rationale for the difference is not clear. Departmental Circular No.387 issued in July 1984 explained that land, not being a depreciable asset, had been excluded from the purview of section 35(2). The reason for excluding both land and building from the purview of section 35(2AB) had not been spelt out. Not making the two clauses mutually exclusive is inexplicable especially since section 35(2AB) is applicable only for specified businesses and section 35(2) is generally applicable. Consequently, assessee end up claiming the benefit not available in one section under the other section leading to an avoidable anomaly and loss of revenue.

2.22.4 Audit scrutiny revealed that double allowance of deductions under both sections 35 (2) and 35 (2AB) resulted in tax effect of **Rs.15.59 crore** in **six cases** in Maharashtra charge. Two cases involving tax effect of more than Rs.1 crore are given in **Table 22** below. Two more cases involving tax effect of Rs.34.45 lakh and Rs.21.17 lakh respectively are indicated at **Sl.Nos 20 and 21 of Appendix 25.**

(Rs. in crore)

Table 22: Irregular allowance of deduction towards cost of building under section 35(2)

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Tax effect
1.	M/s Lupin Ltd Mumbai X	2002-03 Summary 2001-02 Scrutiny	10.42
2.	M/s Glenmark Pharmaceuticals Pvt Ltd CC-XXXIII Mumbai	2001-02 Scrutiny 2003-04 Summary	4.49

2.23 SECTION 80 HHD

2.23.1 ‘Services’ to tourist not defined

2.23.2 Deduction under section 80HHD is admissible only if the assessee is engaged in the business of a hotel or of a tour operator, approved by the prescribed authority in this behalf or of a travel agent and is providing “services” to tourists.

2.23.3 However, the term ‘tourist’ is not defined in the section and various judicial decisions have only complicated the situation for assessing officers leading to inconsistent treatment and potential loss of revenue.

2.23.4 The ITAT, Mumbai recently held² in February 2004 that tax could not be levied on payments received by hotels from crew of Foreign Airlines Companies. However, the assessing officer was of the view that crew of Foreign Airlines were not tourists. They were in India for job requirements and hence the hotels which were paid advance for their accommodation in Indian rupees for the permanent booking of rooms for the crew could not be allowed deduction under section 80HHD. However ITAT Mumbai overruled this on the plea that such crew members had been listed as “tourists” by the department of the tourism effective from 1989 and Directorate General of Tourism is the prescribed authority under rule 18BBA(5) for approval of hotels. This litigation occurred essentially due to absence of specific definition of the term ‘tourists’ in section 80HHD itself. The response of the department to the said ITAT decision is awaited. This is a matter with substantial revenue effect as noticed by audit in the cases of M/s Hotel Leela Venture and M/s Indian Hotel Company Limited assessed in Mumbai charge where aggregate deduction of Rs.1.52 crore was granted to the foreign exchange earnings from the crew of foreign airlines.

2.24 SECTION-80HHF

2.24.1 Section 80HHF providing for deduction specifically for the export of software was modelled on the lines of original section 80HHC providing export incentives. While computing deductions under section 80HHC, 90 percent of export incentive, duty drawback, cash compensatory support etc covered under clauses (iiia), (iiib) and (iiic) of section 28 are deducted from the export profits whereas this condition is not prescribed for working out deduction under section 80HHF inserted later. This would appear to be a lacuna in the Act which allows additional deduction under section 80HHF compared to that contemplated in the original section 80HHC, available to other exports.

2.24.2 Instances of deduction allowed on “duty drawback” involving potential tax effect of **Rs.32.89 lakh in two cases** in Maharashtra charge are indicated at **Sl Nos 24 and 25 of Appendix 26.**

² M/s Sun-n-Sand Hotels (P) Ltd Vs Dy CIT (ITA No.2488Mumbai/1997)

2.25 SECTION-80IA

2.25.1 'Production' and 'manufacture' not defined

2.25.2 The words 'production' and 'manufacture' are not defined in the Act and their meanings are subject to judicial interpretations and pronouncements. A whole spectrum of judicial decisions is available with varying interpretations.

2.25.3 It has been judicially held³ that crushing of dolomite lumps into chips and powder does not bring about new commercial commodity. As such, income earned from such 'crushing' will not constitute income derived from a manufacturing or industrial undertaking.

2.25.4 It has also been judicially held⁴ that formation of chicks is a natural biological process on which the assessee has no control and as such profits derived from such business are not eligible for deduction under section 80IA.

2.25.5 Non application of these judicial decisions resulted in short levy of tax of **Rs.3.20 crore** in **3 cases** in West Bengal and Orissa charges. Two cases each involving tax effect of rupees one crore or more are given in **Table 23** below. One case involving tax effect of Rs.52.36 lakh is indicated at **Sl.No 12 of Appendix 28**.

(Rs. in crore)

Table 23: Inconsistent application of judicial decisions

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Under assessment	Tax effect
1.	M/s Amrit Feeds Ltd. Kolkata I	1998-99 1999-00 Summary	3.60	1.68
2.	M/s Bansapani Iron Ltd. Sambalpur	1999-00 2001-02 Scrutiny	0.82 0.91	1.00

2.26 SECTION-80IB

2.26.1 Depreciation not being mandatory leading to misuse

2.26.2 Prior to 1 April 2002, it was not mandatory for the assesseees to claim depreciation. This resulted in claims of depreciation being ignored and income became available for deduction under section 80IB (Chapter VIA), which would have otherwise lapsed. Depreciation can be claimed in later years whereas such deductions cannot.

2.26.3 Incorrect grant of deductions under section 80IB without considering depreciation/past losses resulted in short levy of tax of **Rs.2.78 crore** in **seven cases** in Assam, Kerala and Maharashtra charges. Four cases involving tax effect

³ DDC Sales Tax and Others Vs. M/s Bherha Ghat Minerals Industries (246 ITR 230-SC)

⁴ CIT Vs M/s Venkateshwara Hatcheries Pvt. Ltd (103 Taxman 503 SC-2001 & 237 ITR 174-SC)

of more than Rs.25 lakh but less than Rs.one crore are indicated at **Sl.Nos 22 to 25 of Appendix 25.**

2.27 Objective III: Purpose of Amendments not served

2.28 SECTION-32

2.28.1 Amendment removing obligation to file depreciation schedule (w.e.f.1.4.88)

2.28.2 Verification of ownership and use of assets are important aspects to be examined before allowing depreciation. Assessee were required to file details of ownership and use under section 34(1) of the Act. Consequent to the introduction of the concept of block of assets from 1 April 1988, this section was abolished. Presently, there is no requirement of furnishing details of ownership and use except for broad details regarding the full block of assets to be given in the Audit Report in Form No. 3CD which are not always provided. With 95 percent of cases being accepted in summary manner there is no mechanism available with the department nor any specific responsibility fixed on the assessee to ensure that depreciation is claimed in each case correctly and in accordance with the requirements of law.

2.28.3 Depreciation was irregularly claimed and allowed in the absence of depreciation schedule in **18 cases** involving tax liability of **Rs.5.71 crore** in Himachal Pradesh, Jharkhand, Madhya Pradesh and Orissa charges where the details of ownership and use of assets were not verifiable. One such case with substantial tax effect of Rs.3.31 crore is illustrated below. Two cases involving tax effect of more than Rs.25 lakh but less than Rs.one crore are indicated at **Sl.Nos 26 and 27 of Appendix 25.**

2.28.4 In Karnataka, Bangalore-I charge, the assessments of M/s ICICI Venture Fund Management Company Ltd. for the assessment years 1999-00 and 2000-01 were accepted in summary manner and completed after scrutiny respectively. Audit scrutiny revealed that depreciation aggregating Rs.9.01 crore on leased equipment "Boiler" was allowed at 100 percent during relevant previous years based on audit report in form 3CD. Particulars to substantiate the ownership and use were not available either in the Form 3CD or assessment records accompanying the return. Depreciation claimed should have been disallowed. Omission to do so resulted in short levy of tax of Rs.3.31 crore.

2.29 Amendments for carry forward of unabsorbed depreciation and mandatory charging of depreciation

2.29.1 Prior to 1 April 2002, it was not mandatory for the assessee to claim depreciation. With effect from 1.4.1998 depreciation was allowed to be carried forward indefinitely. This led to a situation where assessee were not claiming depreciation but claiming other deductions under Chapter.VIA, which would not

have been available to them, had depreciation been required to be mandatorily claimed. Depreciation was carried forward and claimed when convenient for the assessee.

2.29.2 It was only after the Supreme Court ruling⁵ that depreciation is not mandatory that the onus for claiming depreciation was put back on the assessee through an amendment made with effect from 1 April 2002 making the charging of depreciation, mandatory. The decision came on 15 March 2000 but the Act was amended only after two years.

2.29.3 The loophole pointed out above has been exploited by the assesseees with unquantifiable and unascertainable revenue effect. Audit scrutiny revealed that depreciation was not allowed before allowing deduction resulting in allowance of deduction involving tax effect of **Rs.9.15 crore** merely in **16 cases** in Maharashtra and Gujarat charges. Five cases each involving tax effect of around Rs.one crore or more are given in the **Table 24** below. Four cases each involving tax effect of more than Rs.25 lakh but less than Rs.one crore are indicated at **Sl.Nos 13 to 16 of Appendix 28**

(Rs in crore)

Table 24: Non adjustment of depreciation before allowing deduction under section 80IA

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Tax effect
1	M/s Wim Plast Ltd Mumbai Central III	1996-97 1999-00 Scrutiny	2.18
2.	M/s Medispray Laboratories Pvt Ltd CC I Mumbai	1999-00 2000-01 Scrutiny	1.20
3.	M/s Okasa Pvt Ltd CC I Mumbai	2000-01 Scrutiny	1.00
4.	M/S Tancom Electronics Mumbai XX	1998-99 Scrutiny	1.00
5.	M/s. Historic Resort Hotel Ltd, Jaipur II	2000-01 Scrutiny	0.91

2.30 Amendment providing for depreciation on intangible assets with effect from 1 April 1999

2.30.1 From 1 April 1999, depreciation was to be allowed on intangible assets which included copy rights, patents, technical knowhow, franchise charges and any other commercial rights. Intangible assets therefore cannot include goodwill, stock exchange membership fees, intellectual property rights or investment in shares. Inclusion of the concept of “intangible asset” has opened the door for a number of ambiguities. This is leading to misuse or defective implementation of the provisions as detailed below.

⁵ M/s Mahindra Mills Vs CIT (243 ITR 56)

2.30.2 As per accounting standards, ‘goodwill’ was not considered as an intangible asset for the purpose of amortisation. Further ‘goodwill’ cannot be considered as any other business or commercial right and depreciation cannot be allowed. It has been judicially held⁶ that goodwill is not a capital asset. Further, the cost of goodwill cannot ordinarily be ascertained and the date of acquisition also cannot be fixed. It follows, therefore, that depreciation cannot be charged on goodwill.

2.30.3 Depreciation was incorrectly allowed on ‘goodwill’ treating it as an intangible asset involving tax effect of **Rs.35.87 crore** in **three cases** in Tamil Nadu charge. One case involving tax effect of Rs.35.78 crore is given in **Table 25** below. Remaining two cases are indicated at **Sl.Nos 19 and 20 of Appendix 18**.

(Rs. in crore)

Sl No.	Name of the assessee/ CIT charge	Assessment year	Nature of expenses	Depreciation irregularly allowed	Tax effect
1.	M/s Penta Soft Technology Central Chennai	2001-02 Scrutiny	Goodwill	90.47	35.78

2.30.4 Allowance of depreciation on investment in shares and stock exchange membership fee resulted in short levy of tax of **Rs.6.99 crore** in **two cases** of Madhya Pradesh and Rajasthan charges. One case involving tax effect of Rs.6.97 crore is given below. The remaining case is illustrated at **Sl.No 21 of Appendix-18**.

2.30.5 In Rajasthan, Udaipur charge, examination in audit of the summary assessment records of **M/s. Hindustan Zinc Ltd.** for the assessment year 2002-03 revealed that the assessee invested in shares of M/s Andhra Pradesh Gas Power Corporation Ltd. during the relevant previous year and claimed and was allowed depreciation of Rs.18.17 crore treating the shares as “intangible” assets. This was not in order as shares were not intangible assets. The omission resulted in excess allowance of depreciation of Rs. 18.17 crore involving tax effect for Rs.6.97 crore. One more case where depreciation was allowed in a summary assessment on Intellectual Property Rights (IPR) is indicated in **Table 26** below.

(Rs in crore)

Sl No.	Name of the assessee/ CIT Charge	Assessment year	Gross value of intangible asset	Irregular depreciation allowed	Tax effect
1.	M/s Financial Technologies India (P) Ltd. Mumbai VIII	2001-02 Scrutiny	18.01 (Intellectual property right)	4.50	1.78

⁶ M/s B.Srinivasa Shetty Vs CIT (128 ITR 294-SC)

2.31 OBJECTIVE IV Effect of Different Rates of Depreciation as per Income Tax Act and Companies Act

2.31.1 While discussing corporate tax reforms, the Kelkar Task Force observed that the adequacy of the rate of depreciation depends on the presumed period of the useful life of the asset, the mode of granting depreciation whether by ‘diminishing balance method’ or by ‘straight line method and expected rates of growth of prices of capital goods. The Task Force recommended reduction of depreciation rates for the general category of plant and machinery from 25 percent to 15 percent and appropriate lower rates for other categories of block of assets. The revised rates of depreciation were to minimize the divergence between the depreciation charged to the profit and loss account in accordance with the provisions of the Companies Act and depreciation claimed for tax purposes and also remove the problem of depreciation being charged on inflated “written down values (WDV)” as per the Companies Act.

2.31.2 An analysis in audit of depreciation calculated as per Companies Act and that being claimed and allowed under the Income Tax Act revealed the results as shown in **Table 27** below:

(Rs. in crore)

Jurisdictional charge	No. of assessees	Depreciation claimed as per Income Tax Act	Depreciation claimed as per Companies Act	Difference (3-4)	Tax effect with reference to the amount in Col.5
1	2	3	4	5	6
Assam	419	2854.99	1121.05	1733.94	606.94
Andhra Pradesh	909	639.40	267.81	371.59	139.91
Bihar	209	84.08	48.31	35.77	13.05
Delhi	294	1319.56	1096.53	223.03	85.87
Gujarat	2243	4849.37	4332.87	516.50	227.31
Haryana	158	2441.99	1090.35	1351.64	496.79
Himachal Pradesh	266	241.58	92.51	149.07	56.31
Jharkhand	138	826.35	630.03	196.32	73.57
Karnataka	124	1790.14	946.69	843.45	316.50
Kerala	114	1266.68	710.69	555.99	207.44
Madhya Pradesh	1142	551.29	392.39	158.90	63.01
Maharashtra	560	3466.37	1810.32	1656.05	618.45
Orissa	153	2910.39	2530.93	379.46	130.89
Punjab	639	1153.22	762.59	390.63	144.83
Punjab&UT	322	343.34	208.45	134.89	51.72
Rajasthan	496	1578.98	940.03	638.95	239.64
Tamil Nadu	1079	17496.14	12925.26	4570.88	1607.41
Uttar Pradesh	156	552.71	215.66	337.05	117.97
West Bengal	2194	9900.35	3850.85	6049.50	2084.64
Total	11615	54266.93	33973.32	20297.61	7282.25

2.31.3 It can be seen from the above that the difference in rates involved additional deprecation of Rs.20,297.61 crore in the selected sample of **11,615 cases** which in terms of tax effect would be **Rs.7282.25 crore**. Audit could not verify as how Ministry was able to ascertain the corresponding benefits in terms of increased investment in assets or corresponding increase in production.

2.32 Irregular claim of depreciation on the written down value (WDV) under Companies Act instead of Income Tax Act

2.32.1 The difference in rates of depreciation as per the Companies Act and the Income Tax Act has also led to peculiar and anomalous situation involving substantial effect on revenues. Audit scrutiny revealed that assessee were claiming and being allowed depreciation on the WDV of assets under the Companies Act (which would always be a higher figure because of lower rates of depreciation) whereas depreciation should have been allowed on WDV as per the Income Tax Act.

2.32.2 There was a short levy of tax of **Rs.1.62 crore** in only **six cases** in Orissa and Rajasthan charges. One case involving tax effect of Rs.1.26 crore pertaining to Orissa charge is shown in the **Table 28** below. One case involving tax effect of Rs.29.40 lakh is indicated at **Sl.No 28 of Appendix 25**.

(Rs. in crore)

Table 28: Irregular claim of depreciation based on WDV under Companies Act instead of Income Tax Act

Sl No.	Name of the assessee/ CIT charge	Assessment year/ Nature of assessment	Under assessment	Tax effect
1	M/s Orissa Mining Corporation Bhubaneshwar	2002-03 (Summary)	3.54	1.26

2.33 Conclusion and recommendations

2.33.1 With more than 95 percent assessments being accepted in summary manner where the assessing officers cannot exercise elementary and basic checks, there was substantial loss of revenue because of excess claims of deductions and allowances, in general. *Audit recommends that a well defined risk assessment and effective procedure for selection of cases for scrutiny may be introduced to act as a deterrent against exploitation of summary assessments by unscrupulous assesseees.*

2.33.2 Assessing officers have not been exercising important checks and calling for crucial and relevant information from assesseees before allowing their claims even in scrutiny assessments. *Audit recommends that responsibility be fixed for glaring omissions especially in scrutiny assessments contributing to loss of revenue besides conducting focussed and well targeted training programmes to upgrade the skills of the assessing officers on a continuing basis.*

2.33.3 Anomalies and ambiguities in law and often conflicting judicial decisions on similar issues are not being sorted out or clarified promptly and properly enough to facilitate consistent treatment by assessing officers and safeguard interests of revenue. *Audit recommends that judicial decisions concerning significant and important provisions of the Act be evaluated promptly in the Board by devising an effective procedure of reporting and coordination with the field offices.*

2.33.4 Lacunae in law such as not defining ‘tourist’, ‘plant’, ‘loose tools’, ‘services to tourist’, ‘manufacture’ and ‘production’ etc in the Act, not disallowing ‘duty drawback’ receipts before granting deduction for export of software and so on as discussed in paragraphs 2.21.2 to 2.26.3 of this Report led to inconsistent treatment of similar issues by the assessing officers. *Audit recommends that these ‘terms’ be defined comprehensively so as to prevent inconsistent treatment and exploitation by assessees to the detriment of revenue.*

2.33.5 The department has no database or records or registers containing details of assessees availing various deductions under the Income Tax Act. Although such information is intended to be available technically, it has not been accessed or used in any meaningful way. *Audit recommends that the department derive full potential of the software already available and maintain proper records of all exemptions, allowances and deductions allowed which would help in assessing and reviewing their impact, from time to time.*

2.33.6 The Shome Advisory Group and the Kelkar Task Force recommended, inter alia, reduction of depreciation rates for the general category of plant and machinery from 25 percent to 15 percent and appropriate lower rate for other categories of block of assets so that divergence between depreciation charged to profit and loss account and depreciation permissible under Income Tax Act is eliminated. This difference in rates of depreciation involved Rs.7,282.55 crore in selected sample of 11,615 cases in terms of tax effect. *Audit recommends that the rates of depreciation under the Income Tax Act be aligned with those in the Companies Act and due consideration given to the recommendations of the Shome Advisory Group and the Kelkar Task Force.*

2.34 In the Exit Conference held in February 2005, the Board agreed to separately examine all the recommendations made.