

Overview

Status of improvement of efficiency through the ‘Restructuring’ of the Income Tax Department

Audit examined the status of improvement of efficiency and productivity of the Income Tax Department consequent to the implementation of a proposal for its restructuring in August 2000 by the Union Cabinet.

Audit noticed that efficiency, productivity and the methodology of ascertaining immediate revenue gains indicated in the proposal to the Union Cabinet were not defined and there was no mechanism to monitor and assess the performance in a transparent and verifiable manner. Increase in revenues from direct taxes was contributed predominantly by pre-assessment collections, which did not test the assessment, investigation or recovery skills of the increased workforce. Specific supporting data reflecting efficiency and productivity after restructuring in areas such as increased revenue, faster disposal of pending cases, reduction in the number of stop filers, quicker disposal of appeals and reduction in delay in issue of refunds was not available. No details of costs relating and consequent to restructuring were maintained. Rs.4.25 crore was spent on outsourcing in only 43 CsIT charges. As many as 3750 posts, remained unfilled as on 1 April 2003 in nine States. Assessing officers had, on an average, completed only 45 scrutiny assessments after restructuring as against an average of 82 per year before restructuring. Department had the potential of completing around 6 lakh assessments per year after restructuring whereas around only 1.80 lakh were completed per year on an average. Percentage of uncollected demand increased from 36.73 in 1991-92 to 45.61 in 2003-04.

The average number of appeals disposed off by each Commissioner of Income Tax (Appeals) in a month came down to 27.53 during 2003-04 as against 43.12 during 1999-2000. The period of redressal of grievance at first appellate level did not come down to the promised level of six months. Interest as a percentage of refunds increased from 10.36 in 1999-2000 to 18.26 in 2003-04. Average delay in payment of refunds increased from about 8 months in 1996-97 to 10.36 months in 1999-2000 and further to 27.38 months in 2003-04. Despite introduction of new chain system of internal audit, percentage of shortfall with reference to target had increased after restructuring (2002-03 & 2003-04) as compared to the pre-restructuring period (1999-2000 & 2000-01).

Audit recommends that

- the IT System of the Department should generate a specific set of information which can help effectively monitor areas of improvement as visualized in restructuring proposals,

- working of chain system of internal audit be reviewed to ensure compliance with targets, and
- the criteria for working out the 'cost of collection', be critically reviewed after suitably factoring in 'pre assessment' collections, so as to present a transparent and correct picture of efficiency and productivity in this important area.

Review on efficiency and effectiveness of administration and implementation of selected deductions and allowances under the income Tax Act

Audit reviewed the administration and implementation of 'six' types of deductions and allowances granted under the Income Tax Act such as depreciation, deductions in respect of expenditure on scientific research, business of a hotel or an approved tour operator, profits and gains from export or transfer of film software/television software, profits and gains from industrial undertakings or enterprises engaged in infrastructure development and in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings. Its intention was to examine the adequacy of law, rules and procedures to safeguard the interests of revenue. Audit test checked around 1.3 lakh assessments spread over three assessment years and found mistakes in 760 cases involving tax effect of Rs.624 crore. 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 revenue of Rs.35.34 crore in 33 cases. Besides, 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.

Audit noticed maximum number of mistakes in availing depreciation allowance where revenue involved was Rs.320.50 crore in 499 cases followed by Rs.164.95 crore in 104 cases of incorrect deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development. A total number of 111 cases of mistakes in availing deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings involved revenue of Rs.81.21 crore.

Audit recommends that

- the department derive full potential of the software already available and maintain proper record of all exemptions, allowances and deductions allowed which would help in assessing and reviewing their impact, from time to time.
- a well defined risk assessment and effective procedure for selection of cases for scrutiny may be introduced which could act as a deterrence against exploitation of summary assessments by unscrupulous assesseees.

Responsibilities would need to be fixed especially for glaring omissions 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,

- judicial decisions concerning significant and important provisions of the Act would need to be evaluated in the Board promptly and properly by devising an effective procedure of reporting and in coordination with the field offices,
- terms such as ‘tourist’, ‘plant’, ‘loose tools’, ‘services to tourist’, ‘manufacture’ and ‘production’ in the Act would need to be comprehensively defined so as to prevent inconsistent treatment and exploitation by assesseees to the detriment of revenue and
- rates of depreciation under the Income Tax Act may be aligned with those in the Companies Act by giving due consideration to the recommendations of the Shome Advisory Group and the Kelkar Task Force.

Review on some aspects of non-resident taxation with reference to double taxation avoidance agreements

Audit reviewed the status of administration and implementation of double taxation avoidance agreements (DTAAs) with selected countries including areas such as mutual agreement procedure, exchange of information, assistance in tax collection and taxation of non-residents engaged in maritime business. Audit also examined adequacy of action taken by the assessing officers to determine effective place of management of Mauritius based entities before allowing tax relief on capital gains consequent to issue of Board’s circular of February 2003 and the landmark decision of Supreme Court in October 2003.

Audit noticed that the Board did not institute and ensure an effective mechanism of monitoring the income of FIIs and their sub accounts in coordination with regulatory bodies like SEBI and RBI which would have helped in levying correct taxes on such entities operating in stock markets. Consequently, the ‘tie breaker clause’ in Indo Mauritius DTAA could not be applied proactively by assessing officers to determine the effective place of management in cases of entities claiming residence in more than one country including India.

Audit noticed that important provisions of DTAAs were being inadequately administered which had adverse impact on revenues. Implementation of provisions relating to mutual agreement procedure, exchange of information and assistance in recovery of taxes was weak and ineffective, thus jeopardizing the interests of revenue. Taxation of receipts on sale of software by non residents needed clarification as substantial revenues were found locked up in litigation. Revenue to the extent of Rs.1350 crore was involved in all these cases

Audit also noticed mistakes such as inconsistencies in application of provisions of DTAA's on the one hand and provisions of the Act on the other, leading to irregular grant of exemptions and income escaping tax which involved a short levy of tax of Rs.440 crore in 314 cases.

Audit recommends that

- a holistic study of DTAA's be conducted to ascertain the benefits accruing to the nation, especially as these are not placed before Parliament. A well-designed and periodical cost benefit analysis would also need to be put in place.
- Shortcomings in DTAA's, especially those relating to definition and operation of permanent establishment, limitation of treaty benefits and disallowing treaty shopping needed to be removed so as to curtail misplaced incentives and ensure that the benefits of DTAA's are availed by bonafide assessee's. Taxation of income of non-residents from maritime business needed to be bestowed serious and urgent attention especially as the share of foreign vessels in overseas trade of India is 86 percent and assessments require correlation with applicable DTAA's. It needed to be ensured that the assessing officers did not treat issue of 'no objection certificates' to non residents or their agents, an end in itself.