

Highlights

Audit reviewed the assessments of 909, 1001 and 1050 companies relating to the assessment years 2002-03, 2003-04 and 2004-05 belonging to selected sectors of computer software, automobiles and ancillaries, steel and trading to examine the application of the provisions of Income Tax Act, 1961 and to quantify the effective rate of tax and tax expenditure as well as voluntary tax compliance by the selected companies of these sectors.

(Para 1.5.1)

The effective rate of tax of the selected companies assessed under the normal provisions of the Act were estimated as 20 percent, 27 percent, 17 percent during the assessment years 2002-03, 2003-04 and 2004-05 respectively.

(Para 1.5.4)

Tax expenditures in respect of all the benefits allowed under the Act for the selected companies assessed under the normal provisions for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively.

(Para 1.5.5)

Voluntary compliance by the selected companies, which were assessed under the normal provisions of the Act, has improved during the period under consideration. Further, voluntary compliance is higher in respect of companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

(Para 1.5.11)

Incorrect allowance of depreciation and set off of losses in 65 cases resulted in short levy of tax of Rs. 369.03 crore. In a single case, incorrect allowance of depreciation and set off of losses allowed to **M/s Tata Motors Ltd.** resulted in short levy of tax of Rs. 261.13 crore.

(Para 1.5.32 & 1.5.32.1)

Irregular exemption allowed u/s 10A & 10B in 73 cases resulted in short levy of tax of Rs. 278.75 crore. In a single case, irregular exemption allowed to a software company, **M/s GTL Ltd.** resulted in short levy of tax of Rs. 104.84 crore.

(Para 1.5.19 & 1.5.20.1)

Mistakes in computation of book profit under special provisions of the Act in 35 cases resulted in short levy of tax of Rs. 200.03 crore. In a single case, irregular tax credit under the special provisions of the Act was given to **M/s Tata Steel Ltd.** resulting in tax effect of Rs. 69.64 crore.

(Para 1.5.30 & 1.5.30.2)

Mistakes in computation of business income in 95 cases resulted in short levy of tax of Rs. 148.12 crore. Mistakes in computation of income in case of **M/s Ispat Industries Ltd.** resulted in short levy of tax of Rs. 41.41 crore.

(Para 1.5.27 & 1.5.27.1)

Incorrect deduction of expenditure allowed under Chapter VIA of the Act in 47 cases resulted in short levy of tax of Rs. 167.75 crore. Incorrect allowance of chapter VI A deduction in case of **M/s Jindal Steel and Power Ltd.** resulted in short levy of tax of Rs. 19.90 crore.

(Para 1.5.26 & 1.5.26.3)

Incorrect allowance of provisions and liabilities in 76 cases resulted in short levy of tax of Rs. 165.48 crore. In a single case of **M/s Data Access (India) Ltd.**, incorrect allowance of unascertained liabilities resulted in short levy of tax of Rs. 61.48 crore.

(Para 1.5.28 & 1.5.28.1)

Audit recommends that variations in profit pattern of companies/assessment under the special provisions of the Act could be given a higher weightage while selecting cases for scrutiny.

(Para 1.6.7)

Taking all the four selected sectors together maximum tax effect has been noticed in incorrect allowance of depreciation and set off of losses. Audit recommends that the claims related to depreciation and set off of losses should be linked with last available assessment records so as to ensure correctness of set off.

(Para 1.6.12)

Keeping in mind the quantum of revenue loss to the government audit recommends that the internal control mechanism of the department be strengthened so as to have better monitoring and linking of records, improved coordination among assessing officers and higher quality assessments.

(Para 1.6.13)

Review on assessment of selected companies in the selected sectors-Computer Software, Automobiles and ancillaries, Steel and Trading

1.1 Introduction

With a view to focus audit efforts towards examination of important contributions to revenue in the form of direct taxes, corporate tax assessments of companies relating to four sectors (detailed below) which play an important role in the national economy were selected for audit scrutiny:-

- Computer software (large, medium/small)
- Automobiles (LCVs/HCVs, cars, mopeds, scooters, tractors) including ancillaries (sheet metal, axle, breaks, wheels gears and shock absorbers)
- Steel (large, medium/small)
- Trading (large, medium/small)

The above sectors had been identified on the basis of significant growth registered in terms of sales turnover, net profit, dividend declared and tax paid during the year 2004 by utilising the database (Capitaline Plus).

1.2 Law and procedure

Income tax is an annual tax on income of previous year charged in the next following assessment year at the tax rates applicable for the assessment year. The annual Finance Act prescribes the tax rates. No specific provision has been prescribed in the Income Tax Act, 1961 (the Act) or the Wealth Tax Act, 1957 for assessment of companies within the selected sectors and all provisions of the acts *ibid.* are applicable to those entities. Some provisions of the Act, considering their applicability are mentioned below:

1.2.1 Exemption under section 10A and 10B

Exemption under section 10A relates to a deduction of such profits and gains as are derived by an undertaking in free trade zone etc., from the export of articles or things or computer software and exemption under section 10B relates to a deduction of such profits and gains as are derived by a hundred percent export oriented undertaking from the export of articles or things or computer software. These provisions provide for complete tax exemption for a consecutive period of 10 years beginning from the assessment year (AY) during which manufacture/production starts.

1.2.2 The dates from which the exemptions in respect of profits and gains derived by an industrial undertaking, which began or begins to manufacture/produce an article or thing or computer software are given below:

Location	Effective from
Free Trade Zone	AY 1981-82 or subsequent AY
Electronic Hardware/Software Technology Park	AY 1994-95 or subsequent AY
Special Economic Zone	AY 2001-02 or subsequent AY

1.2.3 In respect of profits and gains derived by 100 percent EOU (export oriented unit)- an undertaking has to be approved as 100 percent EOU under section 14 of Industries (Development & Regulation) Act, 1951 and rules made thereunder.

- Exemption u/s 10A & 10B are available from AY 2001-02 only if it is supported by a certificate in form 56F from a chartered accountant along with the audit report certifying correctness of the claim.
- For the assessment year 2003-04 the exemption would be limited to 90 percent of profit.
- No deduction would be available in respect of same profit under any other provision of the Act for the same assessment year or any other assessment year.
- Deductions/exemptions under sections 80IA, 80IB would not be applicable either during period of tax holiday or after tax holiday.
- Unabsorbed depreciation, unabsorbed capital expenditure on scientific research and losses u/s 72(1), 74(1) or 74(3) pertaining to assessment year 2000-01 or earlier assessment years are not allowed to be carried forward and set off.
- In case of transfer of ownership or change of beneficial ownership, no benefit u/s 10A or 10B would be available from the assessment year of such change.
- The benefit u/s 10A or 10B is optional; however, the assessee had to opt out of 10A or 10B during initial assessment year where the assessee intends not to avail the benefit.

1.2.4 Chapter VIA deductions

Deductions under sections 80A to 80U are contained in Chapter VIA of the Act.

1.2.5 Exemption of profit from export of computer software under section 80HHE

These provisions provide for exemption of profit derived from export of computer software or its transmission or providing technical services outside India in connection with development or production of computer software.

- 100 percent of profit upto assessment year 2000-01; 80 percent for assessment year 2001-02; 70 percent for assessment year 2002-03.; 50 percent for assessment year 2003-04.; 30 percent for assessment year 2004-05 and 0 percent from assessment year 2005-06.
- “Export turnover” would be the amount of convertible foreign exchange received in India within the time limit as reduced by the amount of freight, telecommunication charge, or insurance attributable to delivery of computer service outside India and of the expenses incurred in foreign currency in providing the technical service outside India.

- Deduction under 80HHE would be allowed only if supported by a certificate in form 10CCAF from a chartered accountant along with the audit report.
- No deduction would be allowed in respect of such profit under any other provision of the Act for the same or any other assessment year.

1.2.6 Deduction under section 80HHC

Special deduction is available to exporters of specified goods or merchandise according to specific formula.

- Deduction would be: (i) 100 percent of profit up to assessment year 2000-01, (ii) 80 percent for assessment year 2001-02, (iii) 70 percent for assessment year 2002-03, (iv) 50 percent for assessment year 2003-04 and (v) 30 percent for assessment year 2004-05.
- From assessment year 2005-06 there would be no deduction under the section.
- Deduction is not available unless accompanied by the auditor's certificate in form 10CCAC.

1.2.7 Deduction under section 80 IB

Section 80IB provides for 30 percent deduction of profit and gains of the industrial undertaking engaged in manufacture/ production of article or things which are not specified in Eleventh Schedule provided it is a new undertaking and not formed by splitting up or reconstruction of business or by transfer of used plant or machinery and the new undertaking begins to manufacture article or things during the period 1 April 1991 and 31 March 1995. The deduction is for a period of 10 years beginning from the assessment year during which production or manufacture begins.

1.2.8 Depreciation under section 32

Depreciation at prescribed rate on tangible asset / intangible asset, know-how, patents, copyrights, trademark, license, franchises or any other business or commercial rights of similar nature acquired on or after 1 April 1998 is admissible on fulfilment of condition that the asset is owned wholly or partly by the assessee, used for the purpose of business and used during the relevant previous year.

- Depreciation on intangible asset is admissible in lieu of deduction under section 35A/35AB.
- From 1 April 2002 claim and allowance of depreciation is mandatory.

1.2.9 Section 36

The section provides for deduction of various expenses on account of bonus to employee, insurance of stock/stores, contribution to approved gratuity fund,

recognised provident fund, interest on capital borrowed for the purpose of business. Admissibility of the deduction is subject to fulfillment of conditions mentioned in section 43B.

1.2.10 Section 115 JB

With effect from assessment year 2001-02, when income tax payable on total income of a company as computed under normal provisions of the Act in respect of the relevant previous year, is less than 7.5 per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable on such total income shall be the amount of income tax calculated at the rate of 7.5 percent of the book profit or total income. Book profit means the net profit as shown in the profit and loss account, prepared as per the provisions of Part II and III of Schedule VI to the Companies Act, 1956 after making certain adjustments as prescribed in the Act.

1.3 Objective of the review

1.3.1 The review seeks to examine

- The correctness of application of the provisions of the Act.
- The extent of loss of revenue or under assessment due to omissions and mistakes in the assessments of the selected companies in the above sectors.

1.3.2 An attempt has also been made to

- Quantify the effective rate of tax and tax expenditure in respect of the companies selected for the review.
- Indicate the extent of voluntary tax compliance by the selected companies of the above sectors.

1.4 Audit methodology and audit coverage

1.4.1 A database, namely 'Capitaline-Plus' was acquired from the market and was used for the purpose of this review. Out of 313 sectors having about 12,000 companies, 50 sectors were short listed on the basis of high value of gross sales during the year 2004. Out of these 50 sectors, four sectors namely computer software, automobile including ancillaries, steel and trading were short listed based on value of additional fields of rate of growth of sales, dividend annualized, the rate of growth of profit before tax and rate of growth of tax during the year 2004. A list of 529 companies with profit before tax exceeding Rs. 25 lakh during the year 2004 in the above four sectors was prepared, whose assessments were examined by field audit offices during the review. Apart from the above companies, assessments of other companies with sales turnover not less than Rs. 5 crore, including those with loss/nil income in the above four sectors were also selected for the purpose of the review.

1.4.2 Income tax assessments of companies for the assessment years 2002-03 to 2004-05 completed upto March 2006 have been covered under the review. Wherever cases of irregularities have been noticed, the assessment records of preceding years have also been examined, as made available.

1.4.3 Copies of the draft review report containing observations were issued to the respective Chief Commissioners of Income Tax / Director General of Income Tax (Investigation) by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from July 2006 to August 2006.

1.4.4 The consolidated draft review report was issued to the Ministry in November 2006. An exit conference between the office of the C & A G of India and the Board was held in January 2007.

1.5 Audit findings

1.5.1 Effective rate of tax and tax expenditures: Assessment records of 909 companies, 1001 companies and 1050 companies relating to assessment years 2002-03, 2003-04 and 2004-05 respectively and belonging to selected sectors of computer software, automobile and its ancillaries, steel and trading were examined by audit during the review. Total tax demand as per the department relating to these companies belonging to all the four sectors were Rs. 1671.85 crore, Rs. 3685.06 crore and Rs. 3824.37 crore during assessment years 2002-03, 2003-04 and 2004-05 respectively. Total tax demand of these companies as a percentage of total corporate tax collections in India in the relevant previous years were 4.57, 7.98 and 6.02 for assessment years 2002-03, 2003-04 and 2004-05 respectively. Details are given in **Appendix 1**.

1.5.2 Audit devised a proforma and collected data in respect of the selected companies relating to the above sectors while conducting the review (**Appendix 2**). The gap between the net profit of the companies as per the profit and loss account and their taxable income as determined by audit has been treated as total deductions availed by the selected companies under the Act. This amount multiplied by the corporate tax rate has been treated as 'tax expenditure' or the revenue forgone by the government as a result of granting these concessions to these companies under the Act. The actual tax payable as a percentage of net profit as per the profit and loss account has been treated as effective rate of tax in respect of these companies in the above four sectors. This analysis has been limited to the profit-making companies in these sectors whose incomes have been assessed under the normal provisions of the Act. For this analysis, figures relating to companies with nil income or loss or which were assessed under the special provisions of the Act and the amounts relating to penal interest or penalty etc from the audit's tax calculations were removed from the data.

1.5.3 A total of 664 companies, 775 companies and 852 companies of the selected companies belonging to all the four selected sectors with profits in any or all the years under consideration were assessed under the normal provisions of the

Act. The remaining companies were either nil income or loss-making companies or were assessed under the special provisions of the Act. Details are given in **Appendix 2**.

1.5.4 These companies have reported Rs. 7836.4 crore, Rs. 9489.7 crore and Rs. 17712.5 crore as net profit before tax and the department has assessed their taxable incomes as Rs. 4709.2 crore, Rs. 6856.0 crore and Rs. 8684.6 crore in the assessment years 2002-03, 2003-04 and 2004-05 respectively. The taxable incomes of these companies as determined by audit were Rs. 5221.3 crore, Rs. 7293.3 crore and Rs. 11176.4 crore in these assessment years respectively. Considering tax demand as per department as the numerator, the effective rates of tax* of the above companies of all the four selected sectors were estimated as 20 percent, 27 percent and 17 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 23 percent, 28 percent and 21 percent during the same period respectively.

1.5.5 Tax expenditure in respect of all the provisions of the Act for these companies for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively. Tax expenditure in respect of deductions relating to chapter VI A of the Act for these companies were Rs. 235.6 crore, Rs. 228.7 crore and Rs. 302.7 crore during the same period respectively. Tax expenditure in respect of deductions other than chapter VI A deductions of the Act for the selected companies during the same period were Rs. 679.7 crore, Rs. 540.0 crore and Rs. 1984.9 crore respectively.

1.5.6 A total of 400 companies had declared profits in all the years under consideration and were assessed under the normal provisions of the Act. Considering tax demand as per department as the numerator, the effective rates of tax of the above companies of all the four selected sectors were estimated as 23 percent, 30 percent and 25 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 24 percent, 32 percent and 25 percent during the same period respectively.

1.5.7 A total of 264 companies, 375 companies and 452 companies of the selected companies belonging to all the four selected sectors with profits in any one or two years under consideration were assessed under the normal provisions of the Act. In other year(s), these companies had either shown loss/nil income or had been assessed under the special provisions of the Act. Considering tax demand as per department as the numerator, the effective rates of tax of the above companies of all the four selected sectors were estimated as 16 percent, 23 percent and 11 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 22 percent, 23 percent

* Please see notes below appendix 2 (in four pages).

and 18 percent during the same period respectively. For the purpose of this analysis the data of the companies with loss in any of the three years have been removed from those years.

1.5.8 The above analysis, therefore, indicates that in the four selected sectors the companies showing profits and assessed under the normal provisions of the Act in all the three years under consideration have paid a higher effective tax rate than the companies who have shown profits and were assessed under the normal provisions in only one or two of the three years under consideration.

1.5.9 Additions made by the department and voluntary compliance: Figures on total income returned by all the selected companies of four selected sectors with profits and assessed under the normal provisions of the Act for assessment years 2002-03, 2003-04 and 2004-05 are given in Table 1 below along with total income assessed by the department as well as total income as worked out by audit.

(Rs. in crore)

A.Y.	Sector	Number of profit-making companies assessed under the normal provisions of the Act	Total income returned by the companies	Total income assessed by the department	Total income as worked out by audit	Addition by dept (cl 5-cl 4)	Potential additions (cl 6-cl 4)	Potential not realized as a percentage of total income (as per audit) (cl 8- cl 7 /cl 6x100)	Non-compliance by the companies at filing of the return stage (in percentage) (cl 8 as a per cent of cl 4)
1	2	3	4	5	6	7	8	9	10
2002-03	Automobile	118	1881.08	2543.3	2571.1	662.22	690.02	1.08	27
	Software	126	473.99	1129.9	1499.8	655.87	1025.85	24.67	68
	Steel	143	143.58	303.3	362.1	159.75	218.52	16.23	60
	Trading	277	599.29	732.7	788.3	133.37	189.01	7.06	24
	Total	664	3097.9	4709.2	5221.3	1611.21	2123.39	9.81	41
2003-04	Automobile	131	3106.5	3383.2	3416.2	276.65	309.73	0.97	9
	Software	162	2021.44	2066.1	2386.8	44.68	365.39	13.44	15
	Steel	173	186.94	310.5	308.3	123.53	121.38	(-)0.70	39
	Trading	309	973.31	1096.2	1181.9	122.94	208.60	7.25	18
	Total	775	6288.2	6856.0	7293.3	567.81	1005.10	6.00	14
2004-05	Automobile	146	5065.7	5150.9	6373.1	85.15	1307.3	19.18	21
	Software	173	3018.73	1312.6	2476.5	(-)1706.1	(-)542.22	47.00	.22
	Steel	199	431.20	492.9	546.8	61.67	115.59	9.86	21
	Trading	334	1666.16	1728.2	1780.0	62.05	113.85	2.91	6
	Total	852	10181.8	8684.6	11176.4	(-)1497.2	994.53	22.29	9

1.5.10 The difference between total income assessed by the department and that as returned by the companies gives us the additions made as a result of assessment efforts made by the department. Additions made by the department in respect of selected companies during assessment years 2002-03 and 2003-04 were Rs. 1611.21 crore and Rs. 567.81 crore respectively. During the assessment year 2004-05 total income as assessed by the department was less than that returned by the companies by Rs. 1497.2 crore. Column 8 of the table showing the difference between total income as worked out by audit and that as returned by the companies can be viewed as a measure of total potential additions that the department could

have made during the assessments. The difference between column 8 and column 7 will give the potential additions not realized by the department during its assessments. The potential-additions gap as a percent of total income (as worked out by audit) is given in column 9 of the table. The figure was 9.81 percent in assessment year 2002-03, which improved to 6.0 percent in assessment year 2003-04 and again deteriorated to 22.29 percent during assessment year 2004-05.

1.5.11 Column 8 of the table above also shows the amounts by which the companies are reporting their taxable incomes short. Column 8 as a percentage of total income returned by the companies (column 4) will give us a measure of non-compliance at the filing of return stage by the companies. This percentage for the assessment years 2002-03, 2003-04 and 2004-05 were 41, 14 and 9 respectively, implying thereby that non-compliance by the above companies at the filing of return stage has decreased during the period. Therefore, the data suggests that voluntary compliance by the above companies in four selected sectors has improved. This analysis in respect of companies showing profits in all the years under consideration and those with profits in only one or two of the three years under consideration and assessed under the normal provisions of the Act is given in **Appendix 3**. The data suggests that voluntary compliance in the selected sectors is more by those companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

1.5.12 Mistakes in assessments: Audit noticed 559 mistakes of various types involving tax effect of Rs. 1508.83 crore in the assessments of all the selected companies in the four selected sectors, whether assessed under the normal provisions or the special provisions of the Act. Department have replied in 196 cases involving tax effect of Rs 969.05 crore. Of these, department have accepted audit observations in 102 cases involving tax effect of Rs 448.24 crore and not accepted 94 cases involving tax effect of Rs 520.81 crore. Replies are awaited in respect of remaining 363 cases involving tax effect of Rs 539.78 crore. The replies of the department have been suitably incorporated in the report at appropriate places. These audit observations, category wise and sector wise, are depicted in Table 2 below.

(Rs. in crore)

Nature of mistake	Computer Software (large, medium/small)		Automobiles including ancillaries		Steel (large, medium/small)		Trading (large, medium/small)		Total tax effect	
	No	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect
Irregular/excess exemption in respect of section 10A/10B	71	266.73	1	11.18	0	0	1	0.84	73	278.75
Irregular deduction of expenditure in Chapter VI A	17	135.41	13	4.75	10	23.90	7	3.69	47	167.75
Incorrect computation of business income	23	45.51	18	17.46	23	62.16	31	22.99	95	148.12
Incorrect allowance of provisions and liabilities	22	88.83	26	36.97	14	15.87	14	23.81	76	165.48
Incorrect allowance of capital expenditure and non business expenditure	15	16.90	27	22.23	9	21.19	7	0.79	58	61.11
Incorrect computation of income under special provision of the Act	10	5.90	10	102.38	11	91.6	4	0.15	35	200.03
Incorrect computation of capital gains	0	0	3	29.57	0	0	0	0	3	29.57
Incorrect allowance of depreciation and set off of losses	12	30.86	16	266.23	17	29.74	20	42.20	65	369.03
Undervaluation of closing stock	0	0	4	18.57	2	14.81	0	0	6	33.38
Incorrect valuation of sales tax liability	0	0	0	0	1	3.26	0	0	1	3.26
Incorrect computation of assets after amalgamation	3	16.59	0	0	0	0	1	13.28	4	29.87
Suppression of production and sales	0	0	1	5.11	1	1.83	0	0	2	6.94
Irregularities in tax deduction at source	0	0	1	1.69	0	0	4	3.33	5	5.02
Other mistakes such as mistakes in adoption of figures, incorrect rates, default in interest etc,	28	5.96	11	1.21	22	1.99	28	1.36	89	10.52
Total	201	612.69	131	517.35	110	266.35	117	112.44	559	1508.83

1.5.13 Computer software sector: In computer software sector, audit noticed 201 mistakes involving tax effect of Rs.612.69 crore. Seventy one audit observations with tax effect of Rs.266.73 crore were noticed in respect of exemptions being granted under section 10 A/10 B. Number of mistakes in respect of deductions under chapter VI A, allowance of provisions and liability and computation of business income were 17, 22 and 23 respectively, with tax effect of Rs. 135.41 crore, Rs. 88.83 crore and Rs. 45.51 crore.

1.5.14 Automobile including ancillaries: In automobile including ancillaries sector, audit noticed 131 mistakes involving tax effect of Rs. 517.35 crore. Sixteen audit observations with tax effect of Rs. 266.23 crore were noticed in respect of incorrect allowance of depreciation and set off of losses. Number of mistakes in respect of computation of income under special provisions of the Act and allowance of provisions and liabilities were 10 and 26 respectively with tax effect of Rs. 102.38 crore and Rs. 36.97 crore.

1.5.15 Steel sector: In steel sector, audit noticed 110 mistakes involving tax effect of Rs. 266.35 crore. Eleven audit observations with tax effect of Rs. 91.60 crore were noticed in respect of computation of income under special provisions of the Act. Number of mistakes in respect of computation of business income and allowance of depreciation and set off of losses were 23 and 17 respectively with tax effect of Rs. 62.16 crore and Rs. 29.74 crore.

1.5.16 Trading sector: In trading sector, audit noticed 117 mistakes involving tax effect of Rs. 112.44 crore. Thirty one audit observations with tax effect of Rs. 22.99 crore were noticed in respect of computation of business income, while 20 and 14 audit observations with tax effect of Rs. 42.20 crore and Rs. 23.81 crore were noticed in respect of allowance of depreciation and set off of losses and allowance of provisions and liabilities respectively.

1.5.17 These audit observations are discussed, category wise, in subsequent paragraphs. The audit observations with tax effect of Rs. 25 crore and above have been discussed individually in the paragraphs, whereas those with tax effect between Rs. two crore and Rs. 25 crore have been shown in the tables in the body of the review. The audit observations with tax effect between Rs. 50 lakh and Rs. two crore have been shown in the **Appendix 4**. The tax effect of other audit observations with money value of less than Rs. 50 lakh have been included in the review, although these have not been individually highlighted. Some audit observations with smaller money value but dealing with interesting issues have also been highlighted in the review.

1.5.18 The cases relating to tax deducted at source as mentioned in para numbers 1.5.28 (serial number 3 of table 10) and 1.5.37 with tax implication of Rs. 3.47 crore are also featured in the review “Implementation of TDS/TCS schemes”.

1.5.19 Irregular /excess exemption in respect of section 10A/10B

Audit noticed 73 mistakes involving tax effect of Rs. 278.75 crore where exemption under section 10A/10B have been allowed by the assessing officer though the assessee did not comply with the necessary conditions to be eligible to get the exemption as shown in paragraph 1.5.20 to 1.5.25.

1.5.20 Irregular/excess exemption u/s 10A & 10B during transfer of ownership/beneficial interest

Sub section (9) of section 10A / 10B provides that where in any previous year the ownership or the beneficial interest in the undertaking is transferred by any means, the deduction during the period from 1 April 2001 to 31 March 2004 shall not be allowed to the assessee. Further, where on the last day of any previous year, the shares of the company carrying not less than fifty one percent of the voting power are not beneficially held by persons who held the shares of the company carrying not less than fifty one percent of the voting power on the last day of the previous year in which the undertaking was set up, the company shall be presumed to have transferred its ownership or the beneficial interest in the undertaking. In other words the persons who held 51 percent of shares at the time of setting up of the undertaking shall have to be continued to hold not less than 51 percent of shares in order to get the benefit under this section.

Audit noticed that exemption has been allowed ignoring the transfer or ownership of beneficial interest of the assessee in following cases:

1.5.20.1 In City 2 Mumbai charge, the assessments of a company **M/s. GTL Ltd.** for assessment years 2002-03, 2003-04 and 2004-05 were completed in summary manner in March 2003, March 2004 and February 2005 respectively and the assessment for only assessment year 2004-05 was selected for scrutiny. Audit scrutiny revealed that the assessee company previously known as M/s Global Tele Systems Ltd (GTSL) changed its name to **M/s GTL Ltd** with effect from 14 September 2001 consequent to merger of M/s. Global Electronic Commerce Services Ltd (GECS) from 01 January 2000. M/s GTL Ltd formerly known as M/s GTSL had set up an export-oriented unit (EOU) on 07 July 1999 in assessment year 2000-01 and the paid up share capital of the company as on the last day of the assessment year in which EOU was set up, was Rs. 43.41 crore. In the above share capital, the percent of shares of promoters (20.99 percent) together with FIIS (20.50 percent) and NRI's/ foreign corporation/ OCBs (14.79 percent) was 56.28 percent which came down to 39.49 percent as on the last day of the assessment year 2002-03 (promoters : 25.70 percent, FII'S : 5.63 percent and NRI's/foreign corporation/ OCBs : 8.16 percent). As such, in accordance with the above quoted provision the beneficial ownership would be deemed to have been transferred in assessment year 2002-03 and the exemption under section 10B was not allowable to the assessee for assessment year 2002-03 and subsequent assessment years. Omission to disallow the same resulted in underassessment of income of Rs. 215.89 crore for the assessment year 2002-03 to 2004-05 leading to short levy of tax of Rs.104.84 crore including interest.

Department raised demand of Rs.50.66 crore in respect of assessment years 2002-03 and 2004-05. The assessment for the assessment year 2003-04 was also being reopened.

1.5.20.2 Other two similar cases are shown in Table 3 below:

(Rs. in crore)

Table 3 : Irregular/excess exemption u/s 10A & 10B during transfer of ownership/ beneficial interest

Sl No / Name of assessee and charge	Assessment year & type of assessment	Nature of mistake	Tax effect
Software sector			
1. M/s. W.N.S. Global, City 10 Mumbai	2003-04 143(3)	The company, a wholly owned subsidiary of M/s British Airways Pvt. Ltd, UK, was claiming deduction of resultant profits u/s 10A. In May 2002, M/s WNS (Mauritius) Ltd acquired the entire share capital of the company from M/s British Airways and still the company claimed deduction of Rs. 30.75 crore u/s 10A which was allowed by the department irregularly.	16.41
Automobile including ancillaries sector			
2. M/s Igarishi Motors India Ltd, Chennai I	2001-02 2002-03 2003-04 143(3)	The assessee company was incorporated in 1992 with seven shareholders who held more than 51% of the shares. It was seen from the ninth annual report for the year 2000-01 that out of the seven original shareholders, only four were still with the company and their shareholding was less than 51% of the voting power. Thus the ownership was changed due to the issue of shares on private placement basis. Therefore deduction of Rs. 6.62 crore, Rs. 10.36 crore and Rs. 5.58 crore allowed u/s 10 A during these years was irregular.	11.18

1.5.21 Incorrect exemption u/s 10A & 10B due to incorrect computation of total income

Sub sections 6(ii) of 10A and 10B provide that no loss pertaining to the newly established undertakings in free trade zones or to the newly established hundred percent export oriented undertakings shall be carried forward or set off where such loss relates to any of the relevant assessment years ending before the 1 April 2001. It implies that, losses if pertaining to assessment year commencing on or after 1 April 2001 of the undertaking covered under section 10 A/10 B shall be set off or carried forward for set off. However, such losses may be carried forward or set off against those profits of the undertaking, which are covered under section 10 A/10 B only and not against those which are not covered under section 10 A/10 B, as according to provision of section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to the income which does not form part of the total income under the Act.

Sub section (5) of 80 HHE provides that where a deduction is allowed for any assessment year, the deduction shall not be granted in relation to such profit under any other provisions of the Act, for the same year and any other assessment year. Further, sub section 8 of 10A & 10B also provide that where the assessee, before the due date for furnishing the return of income under sub-section (1) of section 139, furnishes to the assessing officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of the section shall not apply to him for any of the relevant assessment years.

Audit noticed mistakes in 12 cases involving tax effect of Rs. 23.01 crore where above provisions were not adhered to correctly while allowing exemption of income u/s 10A & 10B. Four such cases are illustrated below:

(Rs. in crore)

Table 4 Incorrect exemption u/s 10A & 10B due to incorrect computation of total income

Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Computer Science Corporation India (P) Ltd, Indore, MP	2002-03 143(1) 2003-04 143(3)	The assessee was allowed exemption of Rs. 17.66 crore incorrectly u/s 10A in respect of Indore unit as the exemption was allowed u/s 80HHE in earlier years and change in option to claim exemption from section 80HHE to section 10A was not allowable. It was also noticed that the loss sustained in Noida unit was not set off against the profit of Indore unit. The omission to allow incorrect exemption as well as carry forward & set off of loss of Rs. 46.71 lakh resulted in under assessment of income of Rs. 18.13 crore.	8.23
2. M/s. Cognizant Technology Solutions India Ltd. Chennai I	2003-04 143(3)	The assessee had losses in three STP units and profits in five other STP* units for which exemption was claimed u/s 10B. The assessee claimed set off of losses of three units against the taxable profits of the year which was rejected by the assessing officer, in the assessment order, but the same was allowed at computation stage thereby resulting in underassessment of income of Rs. 9.39 crore.	3.45
3. M/s. Penta Media Graphics Ltd, Chennai-III	2002-03 143(3)	The interest income of Rs. 10.39 crore was not reduced from the business income for the purpose of exemption u/s 10B. The non-exclusion of interest income has resulted in excess allowance of exemption u/s 10B to the extent of Rs. 5.08 crore.	2.52
4. M/s Computech International Limited, Kolkata -I	2001-02 143(3)	Deduction u/s 10A was computed on the basis of total export turnover of Rs. 62.09 crore instead of Rs. 25.55 crore being sale proceeds brought into India in convertible foreign exchange within the stipulated period.	2.07

Seven similar cases are given at **serial number 1 to 7 of Appendix 4.**

1.5.22 Excess exemption u/s 10A & 10B due to incorrect computation of turnover

The profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

The export turnover has been defined as consideration in respect of export received in convertible foreign exchange, but does not include the expenses incurred towards insurance, freight communication if any, and expenses incurred in foreign exchange in providing the technical services outside India.

* Software technology park

Audit noticed mistakes in 48 cases involving tax effect of Rs. 106.75 crore where exemption under section 10A & 10B was allowed without making adjustment of the expenses incurred in foreign exchange or incorrect computation of turnover adopted thereby resulting in excess deduction. One case is illustrated below:

1.5.22.1 In City 2 Mumbai charge, the assessments of a software company **M/s Mahindra British Telecom Ltd**, for the assessment years 2002-03 and 2003-04 were completed after scrutiny in November 2004, December 2005 respectively and for assessment year 2004-05 in summary manner in February 2005. Audit scrutiny revealed that while working out the amount of exemption u/s10A, expenditure incurred in foreign currency for providing technical services was reduced from export turnover as well as from total turnover. However, the Act provides for reducing this amount only from the export turnover. Reducing the same from total turnover was not in order, which resulted in excess exemption of Rs. 144.62 crore with consequent short levy of tax of Rs. 52.27 crore.

1.5.22.2 Eight similar audit observations are shown in Table 5 below:

(Rs. in crore)

Table 5 : Excess exemption u/s 10A & 10B due to incorrect computation of turnover			
Sl No./ Name of assessee and charge	Assess-ment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s. Aftack Infosys Ltd., City 6 Mumbai	2003-04 2004-05 143(3)	The assessee had incurred the expenses in foreign currency towards installation service, testing etc. of Rs. 26.38 lakh and Rs. 41.51 crore. This was not reduced from the export turnover while computing exemption u/s 10B. Department has accepted the audit observation.	9.91
2. M/s Mphasis BFL Ltd, Bangalore III	2002-03 143(3)	In allowing the deduction u/s 10B, telecommunication charges attributable to export software outside India at Rs. 3.74 crore and the expenditure incurred in foreign currency for providing technical services outside India at Rs. 69.97 crore were incorrectly reduced from the total turnover. Department has accepted the audit observation.	9.84
3. M/s. Micro Technologies India Ltd., City 8 Mumbai	2002-03 143(3) 2003-04 2004-05 143(1)	The assessee had not received export sale proceeds in India but utilized them in purchase of equities in foreign companies with necessary permission of the RBI. This can not be taken as permission to consider the said proceeds as deemed to have been received in India for the purpose of exemption u/s 10A. This resulted in under assessment of income of Rs. 10.45 core.	5.27
4. M/s Micro Technologies India, City 8 Mumbai	2002-03 143(1)	The assessee had total profit of Rs. 5.73 crore from both STP and non STP units against which profit of Rs. 5.60 crore (98 percent) of total profit (was claimed as exempt u/s 10A). However, the assessee had debited 85 percent of total expenditure towards non STP units which was not in proportion of profit attributable to non STP units.	4.65
5. M/s Axes Technology India P Ltd., Bangalore -I	2002-03 143(1)	The assessee adopted Rs. 79.13 crore as export turnover whereas it had received only Rs. 58.84 crore in convertible foreign exchange within the prescribed time limit. Further, the data communication expenses at Rs. 39.02 lakh debited in the accounts was not reduced from export turnover. The above omissions resulted in excess deduction u/s 10A to the extent of Rs. 9.69 crore. Department has accepted the audit observation.	3.98

6. M/s Cognizant Technology Solutions India (P) Ltd, Chennai -I	2002-03 143(3)	The assessee in computing deduction u/s 10A had excluded the expenditure in foreign currency from the export turnover as well as from the total turnover though exclusion was to be done from export turnover only. Further, a sum of Rs. 12.70 crore was debited towards telecommunication charges but only a portion amounting to Rs. 5.45 crore was excluded from the export turnover. In the scrutiny assessment for the year 2003-04, the assessing officer has excluded 75 percent of the remaining sum, apart from the amount excluded from the export turnover as expenditure incurred in India attributable to delivery of software outside India. However, similar disallowance of Rs. 5.44 (75 percent of remaining Rs. 7.25 crore) was not considered for assessment year 2002-03.	3.94
7. M/s. Covansys (India) Pvt Ltd, Chennai I	2002-03 143(3)	While computing the exemption u/s 10B, telecommunication charges and expenditure incurred in foreign currency of Rs. 11.59 crore were reduced from the total turnover. These items were to be excluded from export turnover only. Incorrect computation of total turnover resulted in an excess allowance of exemption of Rs. 4.73 crore.	2.29
8. M/s Oracle Solutions services (I) Ltd., Bangalore -III	2002-03 143(3)	In allowing the deduction u/s.10A, the total turnover was adopted at Rs. 41.80 crore as against Rs. 51.29 crore as shown in the profit and loss account. The above omission resulted in excess deduction u/s.10A at Rs. 4.12 crore. Department has accepted the audit observation.	2.02

Seven similar cases are featured at **serial number 8 to 14 of Appendix 4.**

1.5.23 Incorrect exemption u/s 10A & 10B in respect of reconstitution/ splitting up of undertakings

No exemption is admissible to the assessee if company/undertaking is formed by splitting up or the reconstruction of business already in existence or by the transfer to a new business of machinery or plant previously used for any purpose.

Audit noticed mistakes in two cases involving tax effect of Rs. 7.88 crore where exemption u/s 10A & 10B was allowed irregularly ignoring the splitting up or the reconstruction of business of the undertakings. One such case is shown in Table 6 below:

(Rs. in crore)

Table 6 : Incorrect exemption u/s 10A & 10B in respect of reconstitution/ splitting up of undertakings			
Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Computech International Limited Kolkata -I	2001-02 2002-03 2003-04 143(3)	The assessee was allowed irregular exemption of Rs. 12.99 crore u/s 10A in respect of an STP/software unit in these assessment years which had been reconstructed in March 2000 with used plant and machinery of existing IT division in respect of which deduction u/s 80IB had been availed by the assessee up to assessment year 2000-01.	7.32

One similar case is featured at **serial number 15 of Appendix 4.**

1.5.24 Excess exemption u/s 10A & 10B allowed due to non adjustment of arm length price

Under section 92C of the Act, no exemption u/s10A & 10B or under chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under the section. Where any person has entered into an international transaction in previous year, the assessing officer may refer the computation of arm length price to the transfer pricing officer.

Audit noticed mistakes in 2 cases involving tax effect of Rs. 0.72 crore where above provisions were not followed. One of these cases is given at **serial number 16 of Appendix 4.**

1.5.25 Irregular exemption u/s 10A & 10B without furnishing certificate/accountant's report

Sub section (5) of sections 10A /10B provides that exemption shall not be allowed for any assessment year beginning on or after 1 April 2001, unless the assessee furnishes a certificate in the prescribed form, along with the return of income, the report of an accountant in accordance with the provisions of the sections.

Audit noticed mistakes in 3 cases involving tax effect of Rs. 7.96 crore where exemption u/s 10A & 10B was allowed without furnishing the report of accountant by the assessees. One such case is shown in Table 7 below:

(Rs. in crore)

Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
M/s Gavs Information Services Ltd, Chennai I	2002-03 & 2004-05 143(1) 2003-04 143(3)	The assessee was allowed exemption u/s 10B of Rs. 7.46 crore, Rs. 5.48 crore & Rs. 2.47 crore in these years though he had not filed report of the accountant along with the return of income.	6.90

One similar case is featured at **serial number 17 of Appendix 4.**

1.5.26 Incorrect deduction under Chapter VI-A

A deduction under section 80HHE of the Act, on account of the profits derived from export of computer software shall be the amount which bears to the profits of the business, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

As per section 10A of the Act, income includes amount received from rendering technical services outside India but excludes expenditure in foreign currency in providing technical services from export turnover. However, the profits from technical service rendered outside India is specifically provided for under section 80HHE of the Act and therefore said profit is eligible for deduction under 80HHE instead of 10A of the Act.

Audit noticed mistakes in 47 cases involving tax effect of Rs. 167.75 crore while allowing deduction under sections 80HHE, 80HHC, 80IA, 80IB, 80JJAA etc under Chapter VI A. Two such cases are discussed below:

1.5.26.1 In City 2 Mumbai charge, the assessment of a company **M/s. Tata Sons Ltd.** for the assessment year 2002-03 was completed after scrutiny in March 2005. Audit scrutiny revealed that the assessee was allowed exemption of Rs.362.94 crore under section 10A and deduction of Rs.539.13 crore under section 80HHE. While computing the deduction u/s 80HHE, the assessing officer had taken the total turnover at Rs.2881.67 crore as against Rs.4120.40 crore. As per provision contained u/s 80HHE, total turnover of the business as against total turnover of the undertaking is required to be considered. Adoption of the incorrect total turnover resulted in under assessment of income of Rs. 162.08 crore involving tax effect of Rs.57.86 crore.

The department in its reply stated that the turnover referred to in section 80HHE implies turnover of the business of the assessee and hence the turnover of units availing exemption under section 10A can not be included while computing the total turnover of the assessee. The department's reply is not tenable as total turnover should include turnover of all the activities whether under section 10A or under section 80HHE. Further, the department, in the assessment for the assessment year 2003-04, had allowed deduction under section 80HHE on total turnover including turnover of units availing exemption under section 10A.

1.5.26.2 The assessment of a company **M/s. Tata Sons Ltd.** for the assessment year 2001-02 was completed u/s 250 in October 2005. Audit scrutiny revealed that the department has allowed exemption u/s 10A amounting to Rs. 664.29 crore and deduction u/s 80HHE of Rs. 115.19 crore. The deduction u/s 80HHE was calculated on business income of Rs. 856.14 crore, which included the profit from 10A units amounting to Rs. 664.29 crore. The non-exclusion of the amount of exemption u/s 10A from the business income while calculating deduction under section 80HHE resulted in excess allowance of deduction u/s 80HHE amounting to Rs. 89.37 crore there by leading to short levy of tax of Rs. 35.34 crore.

1.5.26.3 Seven similar cases are shown in Table 8 below:

(Rs. in crore)

Table 8 : Incorrect deduction under Chapter VI-A			
Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s. Tata Sons Ltd City 2 Mumbai	2002-03 143(3) rws 263	While working out the qualifying business profit for arriving at deduction u/s 80HHE, an amount of Rs. 365.94 crore was reduced as deduction under section 10A instead of Rs. 435.29 crore actually allowed in giving affect to CIT order u/s 263 of the Act. This has resulted in excess allowance of deduction u/s 80HHE amounting to Rs. 43.08 crore.	23.48

2. M/s IGate global Solutions Ltd, Bangalore-I	2002-03 2003-04 143(3)	While determining the export turnover for calculating deduction under section 10 A, expenditure incurred in foreign exchange inter-alia including travel expenditure incurred in foreign currency at Rs. 3.42 crore & Rs. 128.89 crore respectively in these assessment years were treated as expenditure incurred in rendering technical services abroad and reduced from export turnover. The deduction relating to profits from rendering technical services abroad should have been allowed under section 80HHE and the said profit should be reduced to arrive at the deduction under section 10A. However the profits relating to rendering technical services abroad have not been reduced from the profits eligible for deduction u/s 10A. This resulted in excess allowance of deduction aggregating Rs. 5.18 crore.	3.66
3. M/s Mahindra British Telecom Ltd City 2 Mumbai	2002-03 2003-04 143(3)	Non-reduction of exempted income u/s 10A from the profit for working out deduction u/s 80HHE resulted in excess allowance of deduction to the extent of Rs. 7.96 crore.	2.86
4. M/s NIIT GIS Ltd, Delhi V	2002-03 143(1)	The assessee was engaged in manufacture of software which was not an article or thing and did not form an industrial undertaking. Secondly, the assessee had not furnished mandatory audit report in prescribed form along with the return for claiming deduction under section 80IB. So, deduction of Rs. 5.86 crore allowed u/s 80IB was irregular.	2.38
5. DSL Software Ltd, Bangalore-I	2003-04 143(3)	Similar excess allowance under section 10A, as in case of sl no. 2 above.	2.01
Steel sector			
6. M/s Jindal Steel and Power Limited, Hissar	2002-03 143(3)	Deduction of Rs. 52.0 crore and Rs. 3.74 crore was allowed on power generation units under sections 80IA and 80IB respectively under normal provisions and by charging tax of Rs. 9.38 crore on book profits under section 115JB. Audit scrutiny revealed that deductions under sections 80IA and 80IB were allowed without obtaining the unit-wise accounts of all the units as required under the Income Tax Rule 18 BBB (2). In the absence of this, allocation of head office expenses, financial expenses and other miscellaneous expenses to all units could not be ascertained and therefore, correctness of the deductions allowed is not verifiable.	19.90
Trading sector			
7. M/s Hyderabad Chemical Supplies Ltd, CIT II Hyderabad	2005-06 143(1)	Under section 80IA (5) the loss can be carried forward and set off against the profits earned by the same unit only in subsequent years. However, loss of Rs. 5.87 crore from the unit was set off against the profits of non eligible unit incorrectly.	2.42

Ten similar cases are featured at **serial number 18 to 27** of **Appendix 4**.

1.5.27 Incorrect computation of business income

Under the Act, the total income of any person for any previous year includes income from whatever source derived which is received or deemed to have been received or which accrues or arises during such previous year unless it is specifically exempted from tax by other provisions of the Act.

Fees paid for acquiring industrial information and technique likely to assist the assessee in manufacture and processing of goods form part of technical know how which qualify for depreciation under the block of intangible assets.

Any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business (non-compete fee) shall be chargeable to income tax under the head 'profits and gains of business or profession'.

Any sum received by the assessee from employees to which the provisions of sub-clause (x) of clause (24) of section 2 apply, are allowable as deduction only if such sum is credited to the employees' account on the relevant fund or funds on or before the 'due date'.

It has been judicially held* that, if any subsidy has been paid to the assessee for assisting him in carrying out the business operations after start of production/business, such subsidy should be treated as assistance for the purpose of the trade and classified as a revenue receipt.

Audit noticed mistakes in 95 cases involving tax effect of Rs. 148.12 crore due to failure to adhere to the above provisions. Mistakes noticed in respect of one assessee are given below:

1.5.27.1 In Kolkata I charge, assessments of a company **M/s Ispat Industries Limited**, for the assessment years 2001-02, 2002-03 and 2004-05 were completed after scrutiny and for assessment year 2003-04 was completed in summary manner at loss of Rs. 548.31 crore, Rs. 649.85 crore, Rs. 322.25 crore and Rs. 413.47 crore respectively. Audit scrutiny revealed the following inaccuracies in computation of income resulting in under assessment of income involving aggregate tax effect of Rs. 41.41 crore as shown below:

- As per the fixed assets schedule of the assessee for the year ending 31 March 2004, deferred revenue expenditure (DRE) available for set off was Rs. 122.23 crore, whereas DRE allowed was Rs. 143.02 crore. Further, depreciation allowed on fixed assets was in excess by Rs. 2.74 crore. Thus the over assessment of loss worked out to Rs. 23.53 crore having potential tax effect of Rs. 8.62 crore. In reply the assessing officer stated that the amount had not been claimed by the assessee. The contention is not tenable as an amount of Rs. 122.23 crore of DRE after adjustment and transfer was allowable as against an amount of Rs. 143.02 crore actually allowed.
- In the assessment year 2003-04, the assessee was allowed a separate deduction of Rs. 14.24 crore on account of difference in interest liability arising out of restructuring package. It was irregular as there was no credit of such amount in the profit and loss account during the previous years.

* 228 ITR 253, Sahney Steel and Press Works Ltd v/s CIT -- 1997

This resulted in potential tax effect of Rs. 5.08 crore. In reply, the assessing officer stated that the amount had been duly credited to the profit and loss account on the basis of the notes on accounts. The contention is not acceptable as it was reversal of previous year's accounting of restructuring package of loan.

- The assessee had written off Rs. 35.78 crore on account of “bills discounted being bills receivable” and claimed the amount as bad debt. It was noticed that it was neither a bad debt nor represented a loan/advance or banking business. The assessing officer has admitted that the amount was an investment and also the fact that the amount had not been taken into account in computing the income of the previous years. Thus, allowance of written off amount as bad debt resulted in over assessment of loss. This resulted in potential tax effect of Rs. 13.15 crore. In reply, the assessing officer has admitted that the amount in question was an investment towards earning discounting charges and has stated that the assessee can claim the same as a bad debt in the event of it being rendered irrecoverable. The contention is not acceptable as the same is to be treated as a capital loss and not a business loss.
- The assessee during the previous year converted a piece of freehold land into “stock- in- trade” for the purpose of commercial development. A sum of Rs. 174.35 crore was debited in the profit and loss account on account of such conversion but the land was valued at Rs. 105 crore as a part of closing stock, thus showing a loss of Rs. 69.35 crore. The loss was claimed as capital loss which was irregular as land is not subject to depreciation excepting in the event of natural calamity and capital expenditure in commercial development of land could not have any fall in value. This resulted in potential tax effect of Rs. 14.56 crore. The assessing officer in reply has stated that the claim for capital loss has not been allowed in the assessment. The same is not tenable as the assessee has computed the loss in the year of conversion and deferred the claim to the year of transfer and the irregular computation of capital loss was not rejected in the scrutiny assessment.

1.5.27.2 Twelve similar cases are given in Table 9 below:

(Rs. in crore)

Table 9 : Incorrect computation of business income			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Penta Media Graphics Ltd, Chennai III	2003-04 143(3)	Number of additions were made in the scrutiny assessment and income from business was increased from Rs. 4.60 crore to Rs. 73.14 crore but corresponding exemption u/s 10-B was not allowed on the additions. This resulted in over assessment of income of Rs. 29.74 crore.	15.01 Over charge

2. M/s National Informatics Centre Services Incorporation Delhi V	2002-03 2003-04 143(3) 2004-05 143(1)	In the assessment year 2003-04, as per 'Notes to Accounts', the amount of fees derived from services provided or rendered was Rs. 19.34 crore whereas the profit and loss account showed Rs. 8.99 crore as service and support receipts. Thus an amount of Rs. 10.35 crore has escaped assessment. Similar issues were also noticed in the assessment year 2002-03 and 2004-05 resulting in underassessment of income of Rs. 6.12 crore and Rs. 7.73 crore respectively. The above mistakes resulted in underassessment of income of Rs. 24.20 crore.	8.77
3. M/s Penta Media Graphics Ltd, Chennai III	2004-05 143(1)	The assessee had debited a sum of Rs. 37.31 crore in the profit and loss account towards "Depreciation as per Companies Act". From Form 3 CD filed along with return of income, it was noticed that the assessee company was not eligible for claiming depreciation as per the Act as per the Auditor's certificate. While computing taxable income depreciation as per Company's Act was not added back. The department has initiated remedial action.	8.11
4. M/s Satyam Computer Services Limited, Hyderabad Central	2004-05 143(1)	While calculating total tax payable, interest of Rs. 7.21 crore leviable for default in payment of advance tax was not levied. Non-levy of interest was due to the fact that taxes paid outside India amounting to Rs. 59.90 crore were considered as advance tax in arriving at total tax payable. As there is no specific provision in the Act to treat taxes paid outside India as advance tax, interest under section 234B is to be calculated without taking into account the taxes paid outside India as advance tax.	7.22
Automobile including ancillaries sector			
5. M/s Tata Motors Ltd, City 2 Mumbai	2001-02 2004-05 143(3)	In the assessment year 2001-02, unutilized central excise value added credit of Rs. 13.66 crore was not added back while computing the taxable income. In the assessment year 2004-05, the assessee had received interest u/s 244-A of Rs. 21.69 crore out of which the assessee had offered only Rs. 15.84 crore for taxation and the balance amount of Rs. 5.85 crore was not offered contending that the department had filed an appeal to ITAT. The assessee was however liable to pay tax on the entire amount of Rs. 21.69 crore and not on Rs. 15.84 crore.	5.79 (P) 1.70
6. Honda Motor Cycle and Scooter India (P) Ltd, Haryana, Gurgaon	2002-03 2003-04 143(3)	<p>In the assessment year 2002-03, expenditure of Rs. 4.59 crore on account of technical assistance; royalty and depreciation on technical know-how paid to foreign company was allowed as deduction though tax at source was not deducted. Such expenditure ought to have been disallowed. Besides, land development expenses of Rs. 41.11 lakh were included in the cost of building on which depreciation of Rs. 4.11 lakh was incorrectly allowed. The omissions resulted in over computation of loss of Rs. 4.63 crore.</p> <p>In the assessment year 2003-04, the assessee claimed deduction of Rs. 3.72 crore on account of royalty and of Rs. 2.90 crore on account of technical assistance fee treating the same as revenue expenditure. The assessing officer disallowed Rs. 2.49 crore for non deduction of tax at source and Rs. 4.14 crore was allowed as deduction. Since the technical assistance and royalty is paid for industrial information and technique likely to assist in manufacture or processing of goods, it forms part of intangible assets qualifying for depreciation of Rs. 62.53 lakh. Moreover, these payments were made to the holding company. Thus, deduction of Rs. 3.51 crore was allowed in excess. Besides, depreciation of Rs. 45.79 lakh on technical know how was</p>	3.04(P)

		allowed as deduction. Audit scrutiny revealed that it was accounted for in books in March 2003 and therefore, half of the normal depreciation was admissible being asset used for less than 180 days. Thus, depreciation on technical know-how was excess allowed by Rs. 22.89 lakh. Further, excess depreciation of Rs. 3.70 lakh on land development expenses needed to be withdrawn. The omissions resulted in over computation of loss by Rs. 3.78 crore.	
7. M/s Eicher Motor Ltd, Indore	1992-93 143(3) 147/154 February 2006	Provisions provided u/s 34A relating to quantum of set off of unabsorbed depreciation/investment allowances equal to 2/3 rd of positive income of assessment year was not observed and unabsorbed depreciation was taken at Rs. 2.96 crore instead of Rs. 1.40 crore as per appellate order of a subsequent date of 2002. Department has accepted the audit observation.	2.81
Steel sector			
8. M/s Steel Authority of India Ltd, Delhi III	2004-05 143(1)	The assessee had deposited Rs. 29.36 crore on account of employees' contribution to provident fund after the stipulated due date in respect of Bokaro Steel Ltd. This should have been added back to the income of the assessee. The omission to do so resulted in underassessment of income of Rs. 29.36 crore involving potential tax effect of Rs. 10.53 crore.	10.53
9. M/s Shobhagya Steels Ltd., Chennai – III	2004-05 143(1)	The assessee had filed its return of income for the assessment year 2004-05 admitting a loss of Rs. 5.59 lakh. While processing the return in summary manner, the returned loss was taken as Rs. 20.85 crore (including carry forward loss) erroneously.	7.46 (P)
Trading sector			
10. M/s. Indian Potash Ltd, Chennai I	2004-05 143(1)	The assessee had incorrectly claimed expenditure towards discount amounting to Rs. 9.04 crore included under "Schedule-17- other expenses", relating to previous year. The foreign currency balances of creditors, debtors and loans from banks as on 31 March 2004, were restated at the average exchange rate instead of the closing exchange rate prevailing as on 31 March 2004 which resulted in under statement of profit to the extent of Rs. 8.80 crore.	7.80
11. M/s Mahendra Inter Trade Ltd City 2 Mumbai	2002-03 143(1)	The assessee had debited Rs. 7.31 crore on account of "bad debts & advances written off" to the profit and loss account and the entire amount was allowed as business loss though the conditions such as the assessee should satisfy that writing off of the loan in the books of account and proving genuineness of irrecoverability, were not fulfilled.	2.61
12. M/s. Sembcorp Logistics India(P) Ltd., Chennai-III	2002-03 143(1)	The assessee company had claimed a sum of Rs. 6.90 crore relating to adjustments pertaining to earlier period. As these items have been incurred in earlier years, the same cannot be allowed as a deduction in subsequent years and required to be disallowed.	2.46 (P)

Fourteen similar cases are featured at **serial number 28 to 41** of **Appendix 4**.

1.5.28 Incorrect allowance of provisions and liabilities

Under the Act, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for the deduction. It has been judicially held[†] that for a loss to be deductible, it must have

[†] CIT vs Indian Overseas Bank {151 ITR 446} (Madras)

actually arisen and incurred and not merely anticipated as certain to occur in future. It has also been judicially held[‡] that only such expenditure that accrues in a year under mercantile system of accounting is allowable from the profits of the same year.

Audit noticed mistakes in giving effect to the above provisions in 76 cases involving tax effect of Rs. 165.48 crore. One such case is discussed below:

1.5.28.1 In Delhi IV charge, the assessment of **M/s Data Access (India) Ltd.** for the assessment year 2004-05 was processed in summary manner in April 2005 determining a loss of Rs. 107.62 crore. Audit scrutiny revealed that the assessee had made a provision for expenses amounting to Rs. 183.77 crore and showed it in the balance sheet under the head “current liabilities and provisions”. As per the note given below the details of the above head, the assessee had declared that provisions for expenses included liability of Rs. 171.36 crore which was not based on actual bills. Thus, it was an unascertained liability and should have been added back to the taxable income, which was not done in the instant case. The mistake resulted in underassessment of income of Rs. 171.36 crore involving tax effect of Rs. 61.48 crore. Reply is awaited.

1.5.28.2 Thirteen similar cases are shown in Table 10 below:

(Rs. in crore)

Table 10 : Incorrect allowance of provisions and liabilities			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Penta Media Graphics P Ltd, Chennai III	2002-03 143(3)/263	The assessee had made advance of Rs. 126.33 crore to its subsidiary companies for which no interest was charged. Assessee had paid interest on loans but made advances to its subsidiaries without charging interest. Hence, a proportionate interest and finance charge was required to be disallowed which was not done.	5.56
2. M/s Data Access (India) Ltd, Delhi IV	2003-04 144	The assessee had received interest income of Rs. 9.07 crore which should have been taxed under the head ‘income from other sources’. As income from other sources cannot be set off against brought forward business losses, it should have been taxed.	4.57
3. M/s Polaris Software Lab Ltd Chennai III	2002-03 2003-04 143(3)	A sum of Rs. 4.79 crore and Rs. 2.71 crore in respect of 10A units and 80 HHE units towards ‘provision for performance award’ disallowed in the previous years were now claimed on payment basis in the current year and ‘provision for estimated loss on incomplete contracts written back’. However no such disallowance of above payment were found in the records of earlier years and no details were found in the record regarding the above claims preferred during the current year. Further, no TDS was deducted on payment of Rs. 1.12 crore and Rs. 2.93 crore made towards expenditure on professional charges in foreign currency.	4.09

[‡] 82 ITR 364 Kedarnath Jute Manufacturing Co Ltd versus CIT. (Supreme Court)

4. M/s Moser Baer India Ltd, Delhi II	2003-04 143(3)	The assessee was not eligible for deduction u/s 35AB as from the assessment year 1999-2000, only depreciation @ 25 percent was allowable on such intangible assets viz. technical know how, patents, copyrights etc. Hence, the assessee was eligible for deduction of Rs. 2.05 crore only as depreciation (on intangible asset of Rs. 8.21 crore) instead of the deduction of Rs. 9.58 crore allowed.	3.13
Automobile including ancillaries sector			
5. M/s Ford India Ltd, Chennai I	2002-03 143(3)	The assessee had incurred expenditure of Rs. 26.59 crore in foreign currency towards interest on Foreign Currency Non Resident loans. As the assessee had not deducted tax at source, the expenditure was not allowable. This resulted in over assessment of loss involving a potential demand of Rs. 9.49 crore. Further, omission to deduct tax at source u/s 195 resulted in non levy of tax of Rs. 5.32 crore besides penalty leviable u/s 271C for failure to deduct tax @ 100% of the tax omitted to be deducted. The assessee was also liable for TDS interest of Rs. 2.88 crore u/s 201 (1A) and penalty of the amount of tax was required to be deducted.	9.49 (P) 8.19
6. M/s Yamaha Motors India Ltd, Delhi VI	2003-04 143(3)	The assessee had made provisions towards gratuity, superannuation, pension, after-sale services and warranties amounting to Rs.14.97 crore. As the amount was merely a provision and not an ascertained liability, it was not an allowable expenditure and should have been added back.	5.50
7. M/s Tata Motors Ltd, City 2 Mumbai	2001-02 143(3)	Provisions for staff welfare scheme amounting to Rs.13.16 crore debited in the profit and loss account was not added back while computing the taxable income resulting in under assessment.	5.20 (P)
Steel sector			
8. M/s Haryana Roadways Engineering Corporation Ltd, Gurgaon	2002-03 143(3) 2003-04 143(1)	The assessee company, following mercantile system of accounting, had not credited Rs. 2.80 crore on account of interest receivable stating that it was payable to scheduled banks and public financial institutions on borrowings. The Act provides that income accrued is chargeable to tax and deduction of interest payable on actual payment. In the assessment year 2003-04, interest of Rs. 2.34 crore payable to scheduled banks and public financial institutions was not disallowed although the same was not paid before the due date of filing of return.	2.46
9. M/s Usha Martin Ltd, Jharkhand Ranchi	2003-04 143(3) 2004-05 143(1)	While computing total income under section 115JB, the assessing officer omitted to add provisions of taxes amounting to Rs. 5.13 crore. Further, in the computation of income for the assessment year 2004-05, provision of taxes amounting to Rs. 7.75 crore was also omitted to be added back.	3.28
10. M/s Sandesh Springs P Ltd, Ludhiana Central	2002-03 153A /144	The assessing officer incorrectly raised the demand of Rs. 2.94 crore instead of Rs. 7.65 crore, resulting in short demand of Rs. 4.71 crore. Rectification action has been initiated after being pointing out by the audit.	4.71
Trading sector			
11. M/s State Trading Corporation of India Ltd, Delhi VI	2004-05 143(1)	Prior period expenses of Rs. 12.06 crore were charged to the 'Profit and Loss Account' but not added back. The mistake resulted in underassessment of income.	5.06

12. MMTC Ltd, Delhi II	2002-03 2003-04 2004-05 143(3)	Incorrect allowance of provision for advances of Rs. 13.07 crore being un ascertained liability and prior period expenditure of Rs. 7.15 crore resulted in underassessment of income. Further, short levy of interest of Rs. 21.0 lakh was also noticed.	9.88
13. M/s Global Infrastructure & Technologies Ltd City 1 Pune	2003-04 143(3)	The assessee claimed deduction of Rs. 8.30 crore on account of interest payable but not provided in the books of accounts and same was allowed by the department. Further note 12 to the accounts clarifies that these were provisions with reference to interest on secured loans/bonds. Since the above provisions were not booked in the accounts, the same were not admissible expenditure in view of the provisions contained in section 43-B. Department has accepted the audit observation.	3.05

Twenty four similar cases are featured at **serial number 42 to 65** of **Appendix 4**.

1.5.29 Incorrect allowance of capital and non business expenditure

Any expenditure not being in the nature of capital expenditure, laid down and expended wholly and exclusively for the purpose of business or profession is allowable as deduction. It has been judicially held[@] that expenditure incurred by the assessee by way of technical know-how to its foreign collaborator under an agreement is to be treated as capital.

Audit noticed mistakes in giving effect to the above provisions in 58 cases involving tax effect of Rs. 61.11 crore. Ten such cases are given in Table 11 below:

(Rs. in crore)

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Afteck Infosys Ltd City 6 Mumbai	2003-04 143(3) 2004-05 143(1)	A deduction of Rs. 3.90 crore and Rs. 16.61 crore in assessment years 2003-04 & 2004-05 respectively was allowed towards software development expenses. The benefit to be derived from the said expenses was of enduring nature and same was required to be treated as capital in nature and depreciation @ 60 percent was allowable. The mistake resulted in under assessment of income of Rs. 8.20 crore. Department has accepted the observation.	2.96
2. M/s Orbitech Solutions Ltd City 8 Mumbai	2003-04 143(3)	A deduction of Rs. 6.14 crore on account of product development expenses during the year was allowed. As this was in nature of capital, the same was not allowable as business expenses. Department has accepted the observation.	2.25
3. M/s Siemens Information Systems Ltd City 7 Mumbai	2002-03 143(3)	A deduction of Rs. 14.99 crore on account of cost of software and cost of hardware was allowed as revenue expenditure. As these items would be giving the benefit of enduring nature to the assessee, the said expenses should have been treated as capital expenditure. This has resulted in under assessment of income of Rs. 5.99 crore after allowing depreciation at the rate of 60 percent.	2.14

[@] 23 Taxmann 66 (SC) – Scientific Engineering Home (P) Ltd. Vs CIT

4. M/s Oracle India (P) Ltd, Delhi V	2003-04 143(3)	An expenditure of Rs. 4.85 crore on account of fixed assets written off in the profit and loss account was allowed incorrectly as the same is of capital nature.	2.44
Automobile including ancillaries sector			
5. M/s Tata Motors Ltd, City 2 Mumbai	2000-01 143(3)	The assessee had claimed and was allowed a deduction of Rs. 23.02 crore on account of expenditure incurred towards development of software called SAP [§] programme. Since the benefit from this programme was of enduring nature and the asset was of depreciable nature, the expenditure was required to be treated as capital expenditure and depreciation at the rate of forty percent was to be allowed. Incorrect treatment of the same as revenue expenditure and allowance of deduction resulted in under assessment of income of Rs. 13.81 crore. Department replied that the expenditure was revenue in nature. Department's reply is not tenable in view of the fact that similar expenditure in the case of two other assesseees during the assessment year 2001-02, had been considered as capital.	5.32 (P)
6. M/s Hyundai Motor India Ltd, Chennai – I	2003-04 143(3)	The assessee had debited Rs. 126.55 crore towards a technical transfer fee under "Royalty" which included a sum of Rs. 9.63 crore towards "technical know-how" paid to M/s. Hyundai Motor Company, Korea, the holding company, in pursuance of the Technology and Royalty agreement entered into in September 2002. It is observed that though royalty payment made from time to time at specified percentage on the net selling price of the products sold by the assessee was an allowable expenditure, the lump sum payment on account of technical know-how, however was required to be capitalized duly allowing appropriate depreciation in view of the judicial decision cited above. The irregular allowance of payment on technical know how resulted in under assessment of income to an extent of Rs. 7.07 crore.	2.91
7. M/s Jamna Auto Industries Ltd, Haryana Yamunanagar	2003-04 143(3)	Interest of Rs. 5.71 crore converted into loan by banks and public financial institutions was incorrectly allowed as deduction treating it as deemed to have actually been paid. The omission resulted in over computation of loss by Rs. 5.71 crore.	2.09
Steel sector			
8. M/s Steel Authority of India Ltd, Delhi III	2003-04 143(3)	As per the 'Notes on Accounts' the assessee had paid Rs.44.37 crore on account of surcharge for delayed payment for electricity and fuel bills to M/s Damodar Valley Corporation. The assessing officer had added back Rs.14.09 crore only out of Rs.44.37 crore as an adjustment relating to earlier years. The balance amount of Rs.30.28 crore was also to be added back as the nature of expenditure was penalty. Department did not accept the audit observation stating that late payment of surcharge was in the nature of compensation and not a penalty. The reply is not tenable as any payment over and above the actual charges on account of failure to pay the actual charges within stipulated time is deemed to be penalty in nature. Department, however, did not explain as to why only Rs.14.09 crore was disallowed.	11.11
9. M/s Southern Iron & Steel Co. Ltd, Coimbatore I	2002-03 143(1)	The assessee had claimed a sum of Rs.11.46 crore as deduction u/s 43-B towards interest on term loan, which was disallowed in the assessment year 2001-02. The assessee claimed the same on the ground that when interest payable to the banks was converted into loan, the interest due is deemed to have been paid. Conversion of	4.09 (P)

[§] M/s SAP Asia Systems

		the interest due into loan by funding the interest does not tantamount to payment made by the assessee. Once it is converted into a loan, it ceases to be revenue expenditure and is not deductible u/s 36 or 37 of the Act. Department has accepted the audit observation.	
10. M/s Steel Authority of India Ltd, Delhi-III	2004-05 143(1)	The assessee had debited Rs. 34.67 crore to the profit and loss account as prior period expenditure (after netting out prior period expenditure of Rs. 59.90 crore and prior period income of Rs. 25.23 crore). Out of the prior period expenditure of Rs. 59.90 crore, only Rs. 51.79 crore was added back in the computation of income. Failure to add back the remaining amount of Rs. 8.11 crore resulted in underassessment of income.	2.91

Fifteen similar cases are featured at **serial number 66 to 80** of **Appendix 4**.

1.5.30 Incorrect computation of income under special provisions of the Act

As per provisions of section 115-JB of the Act, where the income tax payable on the total income as computed under the normal provisions of the Act in respect of any previous year relevant to the assessment year commencing on or after 1 April 2001, is less than 7.5 percent of the book profit, such book profit shall be deemed to be the total income of the assessee and the assessee is liable to pay income tax @ 7.5 percent on such total income.

Audit noticed mistakes in 35 cases involving tax effect of Rs. 200.03 crore due to incorrect computation of book profits and non-adherence of the above provisions of the Act. Two such cases are discussed below:

1.5.30.1 In City 2 Mumbai charge, the assessments of an automobile company, **M/s. Tata Motors Ltd**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and in summary manner in July 2005 respectively. The tax was paid u/s.115-JB of the Act. Audit scrutiny revealed the following inaccuracies:

While working out the book profit, deferred tax amounting to Rs.576.55 crore, provisions for staff welfare schemes amounting to Rs.10.58 crore, provision for diminution in the value of investments of Rs.74.30 crore, provision for pension of Rs.14.87 crore, provision for bad and doubtful debts of Rs.97.94 crore and provision for loss on quantities of Rs.69 lakh were not considered for addition. As these amounts debited to the profit and loss account were merely provisions and not ascertained liabilities, these were required to be added to the book profit. The book profit was also reduced on account of profits eligible for deduction u/s.80-HHC amounting to Rs.14.22 crore and brought forward losses of Rs.152.97 crore, though deduction u/s.80-HHC was not allowed in computation under normal provisions of the Act as there was no profit available. There was also no loss in the books of account of the current year. These omissions resulted in under assessment of book profit of Rs.972.12 crore with consequent short levy of tax of Rs.86.18 crore including withdrawal of interest of Rs.7.38 crore u/s 244-A.

Department stated that the assessee is required to provide for all the liabilities which are legally and contractually due. However, the assessment has been reopened under section 148. The reply is not acceptable as the provisions are not ascertained liabilities but contingent in nature and therefore not allowable in view of the Supreme Court decision **.

1.5.30.2 In City 2 Mumbai charge, the assessments of M/s. Tata Steel Ltd for the assessment years 2002-03 and 2003-04 were completed after scrutiny in February 2005 and in March 2006 respectively. The rectification order was passed in January 2006 in respect of assessment year 2002-03. Audit scrutiny revealed that the department while determining tax demand allowed credit of Rs. 53.83 crore and Rs. 126.92 crore u/s 115JAA respectively before charging interest u/s.234-B. In accordance with the provisions of section 234B, interest for default in payment of advance tax should be calculated after giving credit of advance tax/TDS only. There is no provision in the Act to treat MAT credit in the nature of an advance tax or prepaid tax. The omission resulted in short levy of interest of Rs. 69.64 crore.

Five similar cases are given in Table 12 below:

(Rs. in crore)

Table 12 : Incorrect computation of income under special provisions of the Act			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Dusk Valley Technologies Ltd, Delhi IV	2002-03 143(3)	The income was computed at Rs. 4.81 crore and Rs. 1.69 crore under normal and special provisions of the Act with tax liability of Rs. 2.41 crore and Rs. 12.93 lakh respectively. Thus, the assessee was to pay tax under normal provision as it was on the higher side, but instead the assessee paid tax under special provision.	2.28
Steel sector			
2. M/s. Tata Iron & Steel Co. Ltd, City 2 Mumbai	2002-03 143(3)	The assessee had returned income of Rs. 132.12 crore u/s 115-JB but the return was processed u/s 143(1) and income was adopted as 'Nil' and the entire prepaid taxes along with interest amounting to Rs. 17.18 crore was granted and paid to the assessee in March, 2004. This mistake was rectified by raising a demand of Rs. 10.44 crore in March 2005. However the assessing officer did not consider the refund of Rs. 17.18 crore paid to the assessee which resulted in short levy of interest including interest u/s 234D.	18.21
3. M/s. Tata Steel Ltd City 2 Mumbai	2003-04 143 (3)	The assessing officer allowed MAT credit of Rs. 126.92 crore u/s 115JAA for the assessment year 1998-99, 1999-00 and 2000-01 instead of Rs. 123.89 crore allowable. This resulted in excess credit of Rs. 3.02 crore.	3.31
Automobile including ancillaries sector			
4.M/s Tata Motors Ltd, city 2 Mumbai	2000-01 143(3)	The assessee had filed revised return in February 2002 due to increase in capital gains to Rs.253.24 crore from Rs.150.14 crore on account of sale of its assets at Jamshedpur and Pune division as slump sale. The transaction was not routed through profit and loss account as a result of which the net profit was worked out to a smaller figure. This further resulted in under computation of book profit.	11.90

** Bharat Earth Movers Ltd Vs. CIT (245 ITR 428)

5. M/s. Premier Automobiles Ltd, City 10, Mumbai	2001-02 143(3)	While working out the book profit u/s 115-JB, provision for diminution in the value of investment amounting to Rs. 40.86 crore and provision for bad and doubtful debts amounting to Rs. 37.97 lakh were not considered for addition. Omission to do so resulted in under assessment of book profit of Rs. 41.24 crore. Department stated that in accordance with the Supreme Court judgment in the case of M/s Apollo Tyres, no adjustment can be made to the computation under section 115JB as provided by the assessee. Reply is not tenable as the Supreme Court judgment does not prohibit making adjustments provided in the Act. The above liabilities are contingent in nature and covered under section 115JB (2), which are required to be added while computing book profit.	3.49
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Two similar cases are featured at **serial number 81 to 82 of Appendix 4.**

1.5.31 Incorrect computation of capital gains

Any profit and gains arising from the transfer of a capital asset shall be chargeable to income tax under the head 'capital gains' and is taxable in the year in which the transfer took place. The mode of computation of capital gains in respect of long-term asset provides for deduction of cost of acquisition and expenditure incurred wholly and exclusively in connection with such transfer.

The assessing officer did not apply the above provisions correctly in the three cases, resulting in tax effect of Rs. 29.57 crore. One case is illustrated below:

In City II, Mumbai charge, the assessment of a company **M/s. Tata Motors Ltd** for the assessment year 2000-01 was completed after scrutiny in March 2003. Audit scrutiny revealed that the assessee had an income of Rs. 55.53 crore under the head 'long term capital gains'. However, in computation of income from long-term capital gains, an amount of Rs. 5.53 crore only was considered. Thus income to the extent of Rs. 50.00 crore was underassessed. Further, the assessee had entered into a share sales agreement with M/s. Lucent Technologies International Inc. USA in March, 2000. The assessing officer, while computing the capital gains on sale of such shares, considered only initial payment received by the assessee. The subsequent consideration received was not taken into account despite the fact that a letter was submitted by the assessee to this effect in November 2004. This resulted in under assessment of income of Rs. 21.84 crore. The above omissions resulted in short levy of tax of Rs. 27.65 crore (potential). On this being pointed out by audit the department has rectified the assessment in January 2006.

Two similar cases are featured at **serial number 83 to 84 of Appendix 4.**

1.5.32 Incorrect allowance of depreciation and set off of losses

Depreciation is allowable on know how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1 April 1998, owned wholly or partly by the assessee and used for the purpose of the business or profession, at the applicable

rates prescribed. If there is no positive income in the current year, losses can be carried forward to the subsequent year for set off. Loss under the capital gains can be set off only against income from capital gains in the same year and in subsequent years. For availing the benefit of section 10A/10B, loss relating to the business of the undertaking shall not be carried forward or set off, where such loss relates to any of assessment years prior to assessment year 2000-01.

Audit noticed mistakes relating to non adherence of above provisions in 65 cases involving tax effect of Rs. 369.03 crore. Four such cases are given below:

1.5.32.1 In City 2 Mumbai charge, the assessments of a company **M/s. Tata Motors Ltd** for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and in summary manner in July 2005 respectively. Audit scrutiny revealed that the assessee had paid tax U/s.115-JB. The income under normal provisions of the Act was computed at Rs. 118.73 crore after setting-off the brought forward business loss and depreciation of Rs. 1149.62 crore whereas the available brought forward business loss and depreciation was Rs. 472.35 crore only. Had the correct amount of brought forward loss and depreciation been set off, the tax payable under the normal provisions of the Act would have been higher than that under the special provisions, and hence should have been taxed as such. The omission resulted in under assessment of income of Rs. 677.27 crore with consequent short levy of tax of Rs. 261.13 crore. Department has accepted the audit observation and taken remedial action.

1.5.32.2 In City 7 Mumbai charge, the assessments of a trading company, **M/s. Procter and Gamble House Products Ltd**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny and in summary manner in March 2005, March 2006 and January 2005 respectively. Audit scrutiny revealed that the assessing officer allowed set off of brought forward losses of Rs. 75.83 crore pertaining to the years 1998-99 and 1999-2000 during the years 2002-03, 2003-04 and 2004-05 whereas brought forward losses available for the said assessment years to be set off were Rs. 6.93 crore only. It was noticed that the figures of losses had been adopted from the assessee's statement furnished along with the return for the assessment year 2002-03. Thus, the brought forward sets off of losses have been exceeded by Rs. 68.90 crore. Further, the assessee was also allowed to set off long term capital loss of Rs. 91.65 lakh from the business income incorrectly during the assessment year 2002-03. The above omissions resulted in under assessment of income totalling Rs. 69.82 crore and consequent short levy of tax of Rs. 33.64 crore.

1.5.32.3 In City 2 Mumbai charge, the assessments of a company, **M/s. Tata Motors Ltd**, for the assessment year 2003-04 were completed after scrutiny in March 2006. Audit scrutiny revealed that the assessee had business income of Rs. 518.65 crore. The brought forward depreciation including that of assessment year 2002-03 worked out to Rs. 820.65 crore. After allowing the above business income to set-off against the brought forward depreciation, the balance amount of depreciation allowed to be carried forward works out to Rs. 302.00 crore

whereas the department allowed the amount of depreciation to be carried forward at Rs. 378.67 crore resulting in excess allowance of depreciation of Rs. 76.67 crore with consequent short levy of tax of Rs. 28.17 crore. Department accepted the observation and stated that necessary remedial action would be taken.

1.5.32.4 In City 7 Mumbai charge, the assessment of a software company **M/s. Siemens Information Systems Ltd** for the assessment year 2002-03 was completed after scrutiny in February 2005. Audit scrutiny revealed that the assessing officer allowed exemption u/s.10A of Rs. 72.76 crore as against the business income of Rs. 45.22 crore resulting in net loss of Rs. 27.54 crore. The resultant loss was allowed to be carried forward. Audit noticed that business loss of Rs. 20.02 crore and unabsorbed depreciation of Rs. 33.06 crore pertaining to the period from assessment year 1994-95 to 2001-02 was also allowed to be carried forward. This resulted in incorrect allowance of carry forward of losses of Rs. 80.62 crore with consequent short levy of tax of Rs. 28.78 crore (Potential).

One similar case is shown in Table 13 below:

(Rs. in crore)

SI No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Trading sector			
1. M/s National Mineral Development Corporation Ltd, Hyderabad IV	2002-03 to 2004-05 143(3) 2005-06 143(1)	The assessee was allowed depreciation debited to profit and loss account as per Company's Act. However, instead of depreciation of Rs. 39.91 crore, Rs. 42.27 crore, Rs. 53.98 crore and Rs. 63.84 crore which stood debited to the profit and loss account, amounts of Rs. 35.60 crore, Rs. 37.35 crore, Rs. 52.92 crore and Rs. 63.33 crore were added back towards depreciation as per Company's Act on the assets of both production unit and head office for assessment years 2002-03 to 2005-06 respectively. Thus omission to add back the correct depreciation resulted in excess allowance of an aggregate depreciation of Rs. 10.80 crore for these years.	3.91

Five similar cases are featured at **serial number 85 to 89** of **Appendix 4**.

1.5.33 Under valuation of closing stock

Under section 145A of the Act, effective from 1.4.99, the valuation of inventories for the purpose of determining the income chargeable under the head "Profits and gains of business or profession" shall be adjusted to include the taxes actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation. Under section 4 of Central Excise Act, central excise duty is levied on 'transaction value' even though sales are effected at varying prices to different customers/buyers. The 'transaction value' is meant to include any amount, which is paid or payable by the buyer on account of sale of goods.

Audit noticed that the above provisions were not followed correctly in valuation of closing stock in six cases involving tax effect of Rs. 33.38 crore. Three of these cases are shown in Table 14 below:

(Rs. in crore)

Table 14 : Under valuation of closing stock			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Automobile including ancillaries sector			
1. M/s Exide Industries Ltd, Kolkata I	2002-03 2003-04 143(3)	The closing stock including excise duty was incorrectly valued at Rs. 57.51 crore and Rs. 62.56 crore instead of Rs. 74.24 crore and Rs. 99.97 crore in these years respectively. The omission resulted in short computation of profit of the year and consequent under assessment of income. The assessing officer contended that some of the assessee's main products were exempted from levy of excise duty. The reply is not tenable as audit had not taken into account the value of exempted products.	13.57
2. M/s Exide Industries Ltd, Kolkata I	2001-02 2002-03 2003-04 143(3)	The assessee in computation of income followed the practice of claiming separate deduction of excise duty under section 43B and added back the same amount for tax during next assessment year though the amount of excise duty was debited in the profit and loss account. The separate deduction on that account amounted to double deduction for the respective year. Though the amount was added back during next assessment year, the assessee (i) availed excess deduction in each year, (ii) deferred levy and payment of tax and (iii) availed exemption of payment of interest u/s 220(2).	2.99
Steel sector			
3. M/s Jindal India Ltd, Kolkata I charge	2004-05 143(3)	Finished goods valued at Rs. 342.64 crore were removed from factory and were sold. The value represented the 'transaction value' of the goods sold during the year. But the assessee accounted for Rs. 305.48 crore only towards sale price of the finished goods removed from the factory. Omission to account the transaction value as sale price of goods sold during the year resulted in under assessment of income by Rs. 37.15 crore. The department has initiated rectification action.	13.33

Three similar cases are featured at **serial number 90 to 92** of **Appendix 4**.

1.5.34 Incorrect allowance of sales tax liability

Sales tax is a trading receipt as well as a trading liability to be deposited in Government account and maintaining a separate account of sales tax for receipt and payment of sales tax does not alter the nature of receipt.

Audit noticed mistake in one case during the review which is given in Table 15 below:

(Rs. in crore)

Table 15 : Incorrect allowance of sales tax liability

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Steel sector			
1. M/s. Ispat Industries Ltd Kolkata I charge	2004-05 143(3)	The assessee debited a sum of Rs. 9.09 crore in P&L account as a prior period expense on account of sales tax and claimed it as deduction subject to provisions of section 43B. Since the assessee maintained separate account of receipt and payment of sales tax and did not credit the corresponding amount in P&L accounts as receipt of the business, the debit of Rs. 9.09 crore in P&L accounts as prior period expense on account of sales tax was irregular. In case of non-payment, the amount was to be included in outstanding liability u/s 43B and the amount was to be added back in computation of taxable income as it was debited in the P&L accounts. However, the assessing officer while computing the income has added this amount in the outstanding liability u/s 43B but he omitted to include in the income to nullify the debit entry of the P&L accounts. This resulted in under assessment of income.	3.26(P)

1.5.35 Incorrect computation of assets after amalgamation

Audit noticed mistakes in four cases where the benefit received from the scheme of amalgamation (being excess of fair value of net assets taken over by the assessee company over the paid up value of equity shares to be allotted) was not assessed by the assessing officer correctly resulting in escapement of income and tax effect of Rs. 29.87 crore. Two such cases are given in Table 16 below:

(Rs. in crore)

Table 16 : Incorrect computation of assets after amalgamation

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Quintegra Solutions Ltd, Chennai III	2003-04 143(3)	Pursuant to a scheme of amalgamation by the Madras High Court's order dated August 2003, M/s. Transys Technologies Pvt. Ltd. was amalgamated with the assessee with effect from July 2002. After adjusting for the assets and liabilities of the transferor company, the excess of Rs. 35.98 crore over the net asset value acquired was accounted for as goodwill of the amalgamated company. As per the terms of the High Court order, the assets and liabilities of the transferor company from the appointed date stood transferred to the assessee and were hence assessable under section 28(iv) in the hands of the assessee. However, taxability of the same was not considered. Omission to do so has resulted in escapement of income.	15.74
Trading sector			
2. M/s Spencer & Co Ltd, Chennai III	2002-03 143(1)	M/s Spencer Industrial Fund Ltd was amalgamated with effect from April 2001 with the assessee as per the scheme of amalgamation sanctioned by the Madras High Court order dated 25 October 2002. In accordance with the said scheme the assets and liabilities, rights and obligations were vested in the assessee	13.28

		<p>company, and were recorded at their respective fair values. Fair value of net assets taken over by the assessee in excess of the paid-up value of equity shares to be allotted was computed at Rs. 28.99 crore and the same was transferred to general reserve. As the assessee company had received the benefit of Rs. 28.99 crore from the scheme of amalgamations, the same was required to be treated as business income and brought to tax, which was not done.</p>	
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One similar case is featured at **serial number 93** of **Appendix 4**.

1.5.36 Income escaping due to suppression of production and sales

Audit noticed two cases of suppression of production, sales and receipts by the assessee as illustrated below:

1.5.36.1 In Karnataka, Mysore charge, the assessments of a company, **M/s. Automotive Axles Ltd**, for assessment years 2002-03 and 2003-04 were completed in summary and after scrutiny in April 2003 and December 2005 respectively on the income returned by the assessee. A comparison of total turnover of the assessee company with that of purchases made by another company [M/s Meritor HVS (India) Ltd. assessed at Mysore] belonging to the same group during the previous year relevant to assessment year 2002-03 and 2003-04 by audit revealed that M/s Meritor HVS (India) Ltd was purchasing the products manufactured by the assessee company and marketing the same and the purchases made by it from the assessee company were in excess of the sales as shown in the profit and loss account of the assessee company. The excess of purchases made by the group company over the sales of the assessee company was Rs. 4.72 crore and Rs. 6.59 crore respectively for assessment years 2002-03 and 2003-04 implying thereby that the assessee company had suppressed sales to that extent for two assessment years.

The omission to exhibit correct sales by the assessee company resulted in escapement of income by like amount with short levy of tax and interest for short payment of advance tax aggregating at Rs. 5.11 crore for both the assessment years.

1.5.36.2 In Uttaranchal, Haridwar charge, based on the yield of several companies in steel sector, ACIT, Haridwar circle had observed that yield in cases of induction furnaces should be around 92.5 % of the raw material used. Audit noticed that while some of the units have shown yield ranging between 94 to 95 %, other units of **M/s Kotdwar Steels Ltd, M/s Charu Steel Ltd and M/s Amrit Varsha Udyog** for the assessment years 2002-03 and 2004-05 have shown production below 92.5% .The respective assessing officer, however, accepted the yield and completed the assessment in the same circle without giving cognizance to the aspect of yield. Thus non-existence of a uniform rate of yield in the circle resulted in short computation of production and thereby short charge of tax. Taking 92.5 % as standard yield observed by the department the short production shown by the above companies resulted in short charge of tax of Rs. 1.83 crore.

1.5.37 Irregularities in tax deducted at source

Audit noticed that the provisions relating to tax deducted at source were not followed correctly in five cases involving tax effect of Rs. 5.02 crore. Three such cases are featured at **serial number 94 to 96** of **Appendix-4**.

1.5.38 Other cases

Audit noticed 89 other mistakes such as mistakes in adoption of figures, incorrect rates, defaulting interest, under assessment of wealth, etc involving tax effect of Rs. 10.52 crore. One such case is shown below:

1.5.38.1 Underassessment of wealth

Under the Wealth Tax Act, 1957, where the net wealth of a company exceeds Rs. 15 lakh, tax is levied at one percent of the amount by which the net wealth exceeds Rs. 15 lakh. Net wealth means value of all 'assets' *interalia*, including immovable properties, motor cars, jewellery, aircrafts, urban lands and cash in hand not recorded in the books of accounts provided that where any of the assets is used by the assessee as stock in trade, such asset shall be excluded.

In Kolkata I charge, **M/s. Ispat Industries Limited**, acquired urban land situated at Peddar Road Bombay prior to 31 March 2000 at a value of Rs. 108.90 crore and held it for industrial purpose (treated as freehold land under fixed asset) for 2 years without utilization as on 31 March 2002. Under provision of Wealth Tax Act, landed property was required to be treated as 'asset' for levy of wealth tax during assessment year 2002-03. However, no wealth tax was levied. The omission resulted in non-levy of wealth tax of Rs. 1.09 crore. The assessing officer has not accepted the audit observation on the grounds that the land had been converted to stock-in-trade during assessment year 2003-04 and the same was being used for business purpose. However as per audit, wealth tax would be leviable for the assessment year 2002-03 i.e. prior to conversion and also on account of the fact that the land was being commercially developed as mentioned in the notes to accounts.

1.5.38.2 Three cases relating to short levy of interest, incorrect rate of income tax and mistakes in adoption of figures are featured at **serial number 97 to 99** of **Appendix 4**.

1.6 Conclusions and recommendations

1.6.1 Effective rate of tax in respect of selected companies in selected sectors, which were assessed under the normal provisions of the Act before audit by CAG were estimated as 20 percent, 27 percent and 17 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively.

1.6.2 Effective rate of tax in respect of selected companies in selected sectors which were assessed under the normal provisions of the Act after audit by CAG were estimated as 23 percent, 28 percent and 21 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively.

1.6.3 In the four selected sectors the companies showing profits and assessed under the normal provisions of the Act in all the three years under consideration have paid a higher effective tax rate than the companies who have shown profits and were assessed under the normal provisions in only one or two of the three years under consideration.

1.6.4 Tax expenditure in respect of all the provisions of the Act for all the selected companies in the four selected sectors for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively.

1.6.5 Tax expenditure in respect of deductions relating to Chapter VIA of the Act for all the selected companies in the four selected sectors for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 235.6 crore, Rs. 228.7 crore and Rs. 302.7 crore respectively.

1.6.6 The potential additions made by the department as a result of its assessment functions in respect of selected companies of the four selected sectors, which were assessed under the normal provisions of the Act improved during assessment year 2003-04 as compared to that in assessment year 2002-03 but decreased during assessment year 2004-05.

1.6.7 Voluntary compliance by the selected companies of the four selected sectors, which were assessed under the normal provisions of the Act has improved during the period under consideration. Further voluntary compliance in the selected sectors is more by those companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

Audit recommends that variations in profit pattern of companies/assessment under the special provisions of the Act could be given a higher weightage while selecting the cases for scrutiny.

In the exit conference, Board accepted the recommendation and informed that this aspect is likely to be taken care of in the new method of computer-assisted selection (CAS) of cases for scrutiny by the department.

1.6.8 For the computer sector, the areas where more irregularities have been noticed were exemptions under section 10 A/10 B, deductions under Chapter VIA, allowance of provisions and liability and computation of business income.

1.6.9 For the automobile including ancillaries sector, the areas where more irregularities have been noticed were allowance of depreciation and set off of losses, computation of income under special provisions of the Act and allowance of provisions and liability.

1.6.10 For the steel sector, the areas where more irregularities have been noticed were computation of income under special provisions of the Act, computation of business income and allowance of depreciation and set off of losses.

1.6.11 For the trading sector, the areas where more irregularities have been noticed were allowance of depreciation and set off of losses and allowance of provisions and liabilities.

1.6.12 Taking all the four selected sectors together maximum tax effect has been noticed in incorrect allowance of depreciation and set off of losses. The reasons for these omissions have been depreciation as per Companies Act not being added back or depreciation on account of irregular valuation of assets having been allowed etc. and incorrect set off of previous losses.

Audit recommends that the claims related to depreciation and set off of losses should be linked with last available assessment records so as to ensure correctness of set off.

In the exit conference, Board accepted the recommendation and stated that the possibility of creating database in this respect will be examined. Till such time, instructions will be issued to field formations for carrying out the necessary verification at the time of assessment with reference to physical records.

1.6.13 Another area of irregularities noticed in respect of the four selected sectors pertain to sections 10A, 10B and deductions under chapter VIA such as 80HHE, 80IA, 80IB etc especially in respect of computer software.

- Several instances were noticed, where expenditure having been incurred in respect of freight, telecommunication charges or insurance and technical services outside India have been reduced from total turnover for calculating deductions under sections 10A and 10B although it should be excluded from the export turnover only.
- Instances were also noticed, where the assessee were changing their options of availing deductions under section 10A/10B in one assessment year and under section 80HHE in subsequent assessment years or vice versa though it is not allowed in the Act.
- Instances have also been noticed, where losses of undertakings availing benefits under section 10A/10B were set off against taxable income of undertakings not covered under section 10A/10B belonging to the same assessee.
- Another area of misuse noticed is incorrect computation of income under special provisions of the Act especially in the automobiles and ancillaries and steel sectors.

Audit recommends that the government may consider issuing explicit guidelines on these issues so as to ensure greater clarity. Keeping in mind the quantum of revenue loss to the Government audit recommends that the internal control mechanism of the Department be strengthened so as to have better monitoring and linking of records, improved coordination among assessing officers and higher quality assessments.

During the exit conference, Board accepted the recommendations and stated that the process of reorganisation of the internal audit of the department was already on.