

Chapter III

Review on assessments relating to infrastructure development (Deductions under section 80IA of the Income Tax Act)

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Highlights

Audit reviewed the assessment records of the assessee engaged in infrastructure development and claiming deduction under section 80IA of the Income Tax Act completed during the financial years 2003-04 to 2006-07 (upto the date of audit) with a view to (i) determine the extent of underassessment/loss of revenue due to mistakes in assessment, (ii) determine the degree of compliance by the specified undertakings or enterprises with the provisions of the Act, and (iii) derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/rules.

During the review audit test checked 685 assessments in company and non company circles involved in the specified infrastructure activity for verifying the claims of deduction under section 80IA of the Act. Audit observed mistakes in 91 cases having a value of Rs. 2037.22 crore and revenue impact of Rs. 932.29 crore.

(Paragraph 3.6.1)

Deduction under section 80IA was allowed without taking into account all losses and depreciation relating to the eligible units involving revenue impact of Rs. 581.89 crore. In the case of **M/s Bharat Sanchar Nigam Limited**, unabsorbed depreciation had not been taken into account while allowing deduction under section 80IA involving a revenue impact of Rs. 318.17 crore.

(Paragraphs 3.6.3.4 and 3.6.3.5)

Benefit of deduction under section 80IA was allowed in respect of incomes not relatable to the eligible undertaking with a revenue impact of Rs. 96.92 crore. In the case of **M/s Gujarat Powergen Energy Corporation** interest income was not disallowed while computing deduction under section 80IA with a revenue impact of Rs. 81.50 crore.

(Paragraphs 3.6.9.1 to 3.6.9.8)

Incorrect apportionment of expenses relating to eligible undertakings resulted in inflation of eligible profits and consequent deduction involving a revenue impact of Rs. 101.38 crore. In the case of **M/s Nuclear Power Corporation of India Ltd**, this resulted in excess deduction involving a revenue impact of Rs. 67.87 crore.

(Paragraphs 3.6.4.2 and 3.6.4.3)

Benefit of deduction under section 80IA had been availed of by ineligible assessee involving a revenue impact of Rs. 40.20 crore. In the case of **M/s Kirloskar Brothers Limited** the deduction under section 80IA was allowed though the assessee was ineligible for the same, with a revenue impact of Rs. 12.35 crore.

(Paragraphs 3.6.2.3 to 3.6.2.13)

There were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

(Paragraphs 3.6.6.1 to 3.6.6.13)

Major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under loss or were being assessed under the special provisions of the Act which does not take into account deductions under section 80IA.

(Paragraph 3.6.11.7)

Audit recommends that:

- The Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.

(Paragraph 3.7.1.1)

- The Ministry may consider making it mandatory for the assessee availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.

(Paragraph 3.7.3.1)

- The Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10CCB specifies the basis of apportionment/ allocation of common expenses especially with regard to composite business where assessee have both eligible and ineligible units.

(Paragraph 3.7.4.1)

- The Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.

(Paragraph 3.7.5.1)

- The Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfil the criteria for the selection of cases for scrutiny.

(Paragraph 3.7.7.1)

- The Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.

(Paragraph 3.7.8.1)

**Review on assessments relating to infrastructure development
(Deductions under section 80IA of the Income Tax Act)**

3.1 Introduction

3.1.1 The provision of efficient infrastructure services is essential to realise the full potential of growth in the economy. The infrastructure sector includes power, telecommunication, roads, and industrial parks as well as power generation, distribution and transmission. It has been recognised that government alone cannot fulfill all the requirements of providing infrastructure and that the private sector also needs to be actively engaged in the process by providing an appropriate policy framework which gives them adequate confidence and incentives to invest on a large scale, while simultaneously preserving adequate checks and balances through transparency, competition and regulation¹.

3.1.2 Tax incentives can be defined as any incentive that reduces the tax burden of enterprises in order to induce them to invest in particular projects or sectors or geographical areas. Tax incentives or tax preferences include reduced rates of taxes on profits, tax holiday, accelerated depreciation, deferrals, credits, etc. In developing an incentive system, the government needs to clearly list and analyse the deficiencies in the system that the incentives are designed to reduce. The costs of granting incentives can then be compared to the benefits of removing or reducing such deficiencies. Periodic review of the incentive system would help to plug revenue leakage as also appropriately modify the incentive scheme.

3.2 Objective of the review

The review seeks to examine the benefit of deduction under section 80IA of the Act in respect of industrial undertakings or enterprises with a view to:

- i) determine the extent of underassessment/loss of revenue and other irregularities due to mistakes in assessment
- ii) determine the degree of compliance by the specified undertakings or enterprises with the provisions of the Act
- iii) derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/Rules.

3.3 Law and procedure

3.3.1 Background of section 80IA

Section 80IA of the Income Tax Act (Act) provides the extent and scope of deductions available to undertakings involved in the business of infrastructure development. The Finance Act, 1999 substituted section 80IA with a new section

¹ Chapter 9 of the Economic Survey 2006-07

80IA and section 80IB. Section 80IA as it originally stood in the Act provided for deductions in respect of profits and gains of industrial undertaking in certain cases. With effect from 1 April 2000, deduction under section 80IA is available to the following business carried on by an undertaking:

- Provision of infrastructure facility which includes roads, highway projects, water supply, water treatment projects, sanitation and sewerage systems, solid waste management systems and ports including airport, inland waterway or inland port
- Telecommunication services
- Industrial parks
- Power generation, transmission and distribution.

3.3.2 The eligible profits have to be taken as if they are the only source of income and computed accordingly. The deduction is admissible only if the accounts of the undertaking have been audited by a chartered accountant and the tax audit report in Form no. 10CCB duly signed and verified by such accountant is furnished along with the return of income.

3.4 Scope of review

3.4.1 The review was conducted on both summary and scrutiny assessments completed during the financial years 2003-04 to 2006-07 (upto the date of audit). Audit test checked assessment records of 685 assesseees in company and non company circles involved in the specified infrastructure activity for verifying claims of deduction under section 80IA of the Act.

3.4.2 Audit methodology

A list of undertakings engaged in the eligible business were collected from various sources including State Government authorities, Electricity Boards, the Ministry of Telecommunications and the Department of Industrial Policy and Promotion Council (DIPP) to identify assesseees who were likely to claim deduction under section 80IA. In addition, the assessment records and also the list of assesseees furnished by the Director General of Income Tax (Systems), New Delhi and Regional Computer Centres of the respective states were scrutinised to identify assesseees who had availed of deduction under section 80IA.

3.4.3 Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/ Commissioners of Income Tax by the Director General of Audit/Pr. Director of Audit/Pr. Accountants General/ Accountants General during the period from June 2007 to July 2007.

3.5 Acknowledgement

Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review was issued to the Ministry in November 2007. An exit conference was held in December 2007 with the Board to discuss the results of this review. The views expressed by them in the exit conference have been appropriately incorporated in this report.

3.6 Audit findings

3.6.1 Audit of assessment records of 685 assesseees in company and non company circles in the review revealed mistakes in 91 cases with a revenue impact of Rs. 2,037.22 crore, of which Rs. 932.29 crore relates to short levy of tax and Rs. 1,104.93 crore relates to other issues which have potential impact on levy of tax such as non restriction of deduction to reasonable profits, non preparation of separate accounts etc., in the states of Andhra Pradesh, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

System issues

3.6.2 Benefit of deduction availed by ineligible assesseees

Audit noticed in 16 cases that the benefit of deduction under section 80IA had been allowed to ineligible assesseees as detailed in paragraphs below:

Infrastructure sector

3.6.2.1 The benefit of deduction under section 80IA is available to an Indian company or a consortium of such companies which develops infrastructure. For being considered a developer of an infrastructure project, an assessee needs to execute the project on a build-operate-transfer (BOT), build-operate-own-transfer (BOOT) or build-operate-lease-transfer (BOLT) basis and the assessee has to invest his own funds in the infrastructure project. The enterprise has to enter into an agreement with a government entity (viz. Central Government, State Government or local authority or any other statutory body). In cases where the assessee is operating and maintaining an infrastructure facility, the assessee needs to secure an operation as well as maintenance contract and the concerned asset has to be transferred to the assessee for such purpose. It has been judicially² held that the intention behind this provision was to give a “fillip of deduction against the total income of the assessee derived from the infrastructure project as the entire cost of the infrastructure was being borne by the assessee”.

² Ayush Ajay Construction Ltd vs Income-Tax Officer {79 ITD 213}

3.6.2.2 This implies that deduction under section 80IA is not available to a company which does not develop the infrastructure but merely constructs them on contract basis. The Finance Act, 2007 inserted an explanation retrospectively that nothing contained in section 80IA would apply to a person who executes a work on contract basis. It has been judicially³ held that the explanation must be read into the main provision with effect from the time that the main provision came into force.

3.6.2.3 In Maharashtra, CIT 1, Pune charge, the assessments of a company, **M/s Kirloskar Brothers Limited**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in March 2006 and December 2006 respectively. The assessee had claimed deduction of Rs. 5.49 crore and Rs. 28.24 crore in the assessment years 2003-04 and 2004-05 respectively on profits derived from the work carried out by the assessee for M/s Sardar Sarovar Narmada Nigam Ltd. which consisted of design and supply of equipment and a second contract for erection, commissioning, operating and maintaining the equipment for a limited period. The assessee was not entitled for deduction as it was merely carrying out the work on works contract basis and it had not developed any infrastructure facility. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction was irregular. The omission to do so resulted in loss of revenue of Rs. 1.97 crore and Rs. 10.38 crore in assessment years 2003-04 and 2004-05 respectively.

3.6.2.4 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company, **M/s Larsen and Toubro Limited**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and December 2006 respectively after allowing a deduction of Rs. 13.12 crore and Rs. 9.60 crore under section 80IA. Audit examination revealed that the income on which deduction has been allowed related to contract works executed by the assessee. Neither was the work carried out on BOT, BOOT or BOLT basis nor was any agreement with the government entity filed with the Department. Hence deduction under section 80IA should have been disallowed, which was not done. This resulted in incorrect allowance of deduction aggregating to Rs. 22.72 crore involving revenue impact of Rs. 8.26 crore.

3.6.2.5 In Maharashtra, CIT Central 3, Mumbai charge, assessment of a company, **M/s ABG Heavy Industries**, for the assessment year 2003-04 was completed after scrutiny in December 2005. The assessee had supplied cargo handling equipments to the Jawaharlal Nehru Port (JNPT) for which JNPT was paying lease rentals to the assessee. The assessee had supplied only cranes as per the JNPT's requirements, which could not be construed as having developed, maintained or operated an infrastructure facility namely, 'port'. Though the Department had disallowed the deduction in assessment years 1998-99 and 1999-2000, it was allowed in the assessment year 2003-04. The omission to disallow it resulted in

³ Supreme Court Judgment in case no. Appeal (Civil) 351-355 of 2005 Sedco Forex International Drill. Inc. & Others vs CIT, Dehradun & Anr dated 17 November 2005

underassessment of income of Rs. 18.06 crore involving revenue impact of Rs. 6.64 crore.

3.6.2.6 The Department has accepted (March 2007) the observation.

3.6.2.7 In Maharashtra, CIT 24, Mumbai charge, assessment of a company, **M/s Patel KNR JV**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in December 2005 and December 2006 respectively after allowing a deduction of Rs. 0.79 crore and Rs. 9.89 crore under section 80IA. Audit examination revealed that the assessee was executing widening and rehabilitation of carriageway (Krishna Vaniyambadi section) as a contractor engaged by the National Highway Authority of India (NHAI), which was the developer in this project. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction aggregating to Rs. 10.68 crore was irregular involving revenue impact of Rs. 3.84 crore.

3.6.2.8 In Maharashtra, CIT 24, Mumbai charge, the assessments of a company, **M/s KNR Patel JV**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in December 2005 and December 2006 respectively, after allowing a deduction of Rs. 4.84 crore and Rs. 4.76 crore under section 80IA. Audit examination revealed that the assessee was executing widening and rehabilitation of carriageway (Nellore Kavali section) as a contractor engaged by the NHAI, which was the developer in this project. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction aggregating to Rs. 9.60 crore was irregular involving revenue impact of Rs. 3.49 crore.

3.6.2.9 In Maharashtra, CIT 10, Mumbai charge, assessment of a company, **M/s Petron Civil Engineering Pvt. Ltd.**, for the assessment year 2003-04 was completed after scrutiny in January 2006, after allowing a deduction of Rs. 4.45 crore under section 80IA. Audit examination revealed that the assessee was executing various works in the capacity of a contractor engaged by government bodies such as Maharashtra Sewerage Board, Bangalore Water Supply and Sewerage Board, Gujarat Water Supply and Sewerage Board, etc. Since the assessee was not a developer of the project as specified under section 80IA the allowance of deduction of Rs. 4.45 crore was irregular involving revenue impact of Rs. 1.64 crore.

3.6.2.10 In Maharashtra, CIT 2, Pune charge, the assessments of a firm, which was a partnership between **M/s Shree Satav Construction Pvt. Ltd.** and **M/s Dena Rahsaz JV**, for the assessment years 2002-03 and 2003-04, were completed in summary (February 2003) and scrutiny (March 2006) manner respectively. As seen from the balance sheet, the assessee was a partnership firm consisting of a company and another partner Dena Rahsaz JV, which was not a company as defined under section 2(17) of the Act. As the firm was not a consortium of companies, it was not entitled to deduction under section 80IA. Further, the

assessee's profits were derived from providing services as a works contractor, which was not eligible for deduction. Incorrect allowance of deduction of Rs. 1.61 crore and Rs. 2.57 crore in the assessment years 2002-03 and 2003-04 respectively, resulted in revenue impact aggregating to Rs. 1.52 crore.

3.6.2.11 Similarly, in Maharashtra, CIT 2, Pune charge, the assessment of a firm which was a partnership between **M/s Shree Satav Construction Pvt. Ltd. JV** and another partner **M/s Shree Kumar & Co.**, for the assessment year 2004-05 was completed after scrutiny in November 2006. A perusal of the balance sheet revealed that M/s Shree Kumar & Co. was not a company as defined in section 2(17) of the Act. As the firm was not a consortium of companies, it was not entitled to deduction under section 80IA. Further, the assessee's profits were derived from providing services as a works contractor, which was not eligible for deduction. Incorrect allowance of deduction of Rs. 2.46 crore resulted in revenue impact of Rs. 0.88 crore.

3.6.2.12 In Rajasthan, CIT I, Jaipur charge, assessments of a company, **M/s Om Metal Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in March 2006 and May 2006 respectively after allowing a deduction of Rs. 94.39 lakh and Rs. 138.27 lakh under section 80IA. Audit examination revealed that assessee was executing works on behalf of a government undertaking in Maharashtra and the scope of work included manufacture and installation of dam gates. As the assessee was not involved in any infrastructure activity specified under section 80IA, the deduction allowed was irregular. This resulted in irregular allowance of deduction of Rs. 2.32 crore involving revenue impact of Rs. 1.09 crore including interest.

3.6.2.13 In Madhya Pradesh, CIT, Ujjain charge, the assessment of a company, **M/s Indermal Samarathmal Infrastructure (P) Ltd.**, for assessment year 2002-03 was completed under section 143 (3) read with section 147 in March 2006 determining 'nil' income after allowing deduction under section 80IA of Rs. 1.76 crore and at Rs. 1.84 crore under special provisions of the Act. Audit examination revealed that since all the rights of the assessee under the BOT agreement on which deduction under section 80IA had been allowed had been cancelled by the Government, the assessee was not entitled for deduction under section 80IA. The omission to disallow it resulted in incorrect allowance of deduction of Rs. 1.76 crore involving a revenue impact of Rs. 48.72 lakh.

3.6.2.14 Six other cases, where deduction had been allowed to works contractors are given in **Table no. 3.1** below:

(Rs. in lakh)

Table no. 3.1: Irregular allowance of deduction to works contract

Sl. no.	Name of the assessee/CIT charge	Nature of business	Assessment Year(s)	Type/date of assessment	Deduction allowed	Revenue impact
1	M/s VA Tech Wabag Ltd. CIT I, Chennai	Execution of water/waste water treatment plant projects	2002-03	Summary February 2003	276.47	98.70
2	M/s Supreme Infrastructure (India) Pvt. Ltd. CIT I, Pune	Civil contractor for local bodies	2003-04	Scrutiny November 2005	22.00	58.00
			2004-05	Scrutiny December 2006	140.00	
3	M/s SJR Infrastructure (P) Ltd. CIT III, Bangalore	Civil contractor for local bodies	2003-04	Scrutiny March 2006	13.60	29.22
			2004-05	Scrutiny March 2006	34.45	
			2005-06	Summary November 2006	19.11	
4	M/s Ajwani Infrastructure P Ltd. CIT 10, Mumbai	Civil contractor for local bodies	2003-04	Scrutiny January 2006	41.00	29.00
			2003-04	Scrutiny December 2006	39.00	
5	M/s CES ONYX P Ltd. CIT I, Chennai	Sweeping, collection and transportation of the municipal solid waste	2004-05	Scrutiny November 2006	28.06	9.00
6	M/s Anthony Motors Ltd. CIT 10, Mumbai	Contract from the solid waste management division of Municipal Corporation of Greater Mumbai for cleaning	2004-05	Scrutiny March 2005	23.00	8.25

Note: In respect of Sl. no. 1, the Department revised the assessment in December 2006. In respect of Sl no. 3 the Department has accepted the audit objection and initiated remedial action (July 2007). In respect of Sl. no. 5 Department has initiated remedial action (August 2007).

3.6.2.15 Audit examination thus revealed that, the benefit of deduction under section 80IA had been irregularly extended to works contractors although they could not be deemed to be engaged in developing or maintaining an infrastructure facility within the meaning of section 80IA.

3.6.2.16 *Audit recommends that the Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.*

3.6.2.17 In the exit conference, the Board agreed to examine the issue.

Telecommunication services

3.6.2.18 In order to attract huge investments and encourage a large number of commercial enterprises to engage in these services, the benefit of deduction under section 80IA was extended to the telecommunication sector⁴. Any undertaking which starts providing telecommunication services as provided in the Act on or after 1 April 1995 shall be eligible for deduction under section 80IA. The deduction is provided in the Act to basic service providers to encourage more providers to come into the field. Such deductions may not be found necessary to be extended for secondary players in the sector, as the tariff rates enjoyed by them (through increased competition) would by itself take care of the need of incentives⁵.

3.6.2.19 In Maharashtra, CIT 5, Mumbai charge, the assessments of a company, **M/s Millenium Telecom Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in October 2005 and September 2006. The assessee had claimed deduction under section 80IA as a provider of internet services of Rs. 1.10 crore and Rs. 78.53 lakh. Audit examination of the records revealed that the profits for which the deduction was claimed were derived mainly from providing e-tendering services to M/s MTNL and not from providing internet services. The assessee had not made any investment in infrastructure and was, in fact, using the internet infrastructure of MTNL by paying rent and ISP management charges. Incorrect allowance of deduction resulted in short levy of tax of Rs. 40.55 lakh and Rs. 28.17 lakh for the assessment years 2002-03 and 2004-05 respectively.

3.6.2.20 Three other cases, where franchisees were being allowed deduction are given in **Table no. 3.2** below:

(Rs. in lakh)

Table no. 3.2: Deduction allowed to ineligible assesseees

Sl. no.	Name of the assessee/CIT charge	Assessment Year	Type of assessment(s)	Nature of business	Incorrect allowance of deduction	Revenue impact
1	M/s EKNOCOM CIT X, Chennai	2001-02 to 2006-07	Summary (except 2003- 04 which was under scrutiny)	Franchisee for operating EPABX system	75.88	27.43
2	M/s United Telelinks Pvt. Ltd. CIT III, Bangalore	2003-04 2004-05	Scrutiny Summary	Franchisee for operating EPABX system	47.95	21.57
3	A. Jayalakshmi CIT I, Trichy	1999-2000 to 2006-07	Summary (except 2003- 04 which was under scrutiny)	Franchisee for operating EPABX system	44.02	12.35

Note: In respect of Sl. no. 2, the Department has initiated remedial action (July 2007).

⁴ The Finance Act, 1997

⁵ ITAT, Special Bench, Mumbai in ITA no. 840/Mum/2003 in the case of VSNL, Mumbai vs CIT

3.6.2.21 The legal instruments granting tax incentives are required to be carefully drafted so that they achieve the policy objectives with minimum leakage of tax revenue. They are to be expressed as precisely as possible to avoid ambiguity in implementation.

3.6.2.22 *Audit recommends that the Ministry may consider suitably clarifying the provisions of section 80IA so as to prevent misuse of the incentive by ineligible assesseees.*

3.6.3 Incorrect allowance of deduction without adjustment of losses and depreciation relating to eligible units

3.6.3.1 To safeguard against the possibility of suppression of expenditure and inflation of profits of eligible units by diverting the same to existing (taxable) units, the Act provides that the profits and gains from the eligible business shall be computed as if such eligible business was the only source of income of the assessee during the previous year. A separate report is to be furnished by each undertaking claiming deduction and shall be accompanied by the profit and loss account and balance sheet as if the undertaking were a distinct entity. The deduction under section 80IA is available for any ten consecutive assessment years out of fifteen years beginning from the year in which the assessee commences the eligible activity.

3.6.3.2 For computing the deduction under chapter VIA, the Act provides that the amount of income derived by the assessee and included in his total income has to be computed under the provisions of the Act, *interalia*, taking into account the carried forward losses and unabsorbed depreciation of the earlier years. Further, it has been judicially held⁶ that for the purposes of determining the quantum of deduction under chapter VIA (and thus section 80IA), depreciation and other expenditure falling within sections 28 to 44D will have to be taken into consideration whether it is claimed by the assessee or not.

3.6.3.3 Audit examination revealed that the assesseees were not preparing separate accounts from the date of commencement of business but were preparing separate accounts only from the year from which they were claiming exemption. However, in respect of assesseees' engaged in both eligible and non eligible activities the unabsorbed losses, unabsorbed depreciation, etc. relating to the eligible undertaking are to be notionally taken into account in determining the quantum of deduction even though these may actually have been set off against the profit of the assessee

⁶ Pandian Chemicals Ltd. vs CIT (2003) {262 ITR 278} (SC)
Nahar Exports Ltd. vs CIT 156 Taxman 305 (2006) (P & H)
Cambay Electric Supply Industrial Co. Ltd. vs CIT (1978) {113 ITR 84} (SC)
Power Finance Corporation. Ltd. vs CIT (2006) {100 TTJ 114}
Varindra Agro Chem Ltd. vs DCIT (2006) {100 TTJ 114} (CHD)

from other sources⁷. The omission to do so resulted not only in reduction of taxable income of the non eligible units but also inflated profits to the eligible units.

3.6.3.4 Audit noticed that in 29 cases the benefit of deduction under section 80IA had been allowed without taking into consideration the losses and depreciation relating to the eligible undertakings which resulted in excess allowance of deduction as detailed in the paragraphs below:

3.6.3.5 In Delhi CIT I charge, assessment of a company, **M/s Bharat Sanchar Nigam Limited**, audit examination of the assessment concluded after scrutiny in December 2006 for the assessment year 2004-05 revealed that 80IA deduction had been allowed incorrectly. The assessee had an unabsorbed depreciation of Rs. 1176.09 crore relating to the earlier assessment year viz. 2003-04. It was seen that deduction under section 80IA for assessment year 2004-05 had been allowed without setting off this unabsorbed depreciation of Rs. 1176.09 crore, which resulted in excess allowance of deduction to the extent of Rs. 887 crore involving revenue impact of Rs. 318.17 crore.

3.6.3.6 The Department has accepted the audit observation and rectified the assessment (April 2007).

3.6.3.7 In Gujarat, CIT II, Ahmedabad charge, audit examination of the assessment records of a company, **M/s Gujarat Powergen Energy Corporation Ltd.**, for the assessment year 2002-03 revealed that as per the notes forming parts of the accounts, assessee had not claimed depreciation of Rs. 490.17 crore for the assessment years 1997-98 to 2001-02 and deduction under section 80IA was allowed without reducing the amount of depreciation which resulted in revenue impact of Rs. 171.56 crore.

3.6.3.8 The Department has agreed to examine the issue (April 2007).

3.6.3.9 In Karnataka, CIT I Bangalore charge, the assessment of a company, **M/s KPC Ltd.**, for the assessment year 2004-05 was completed under scrutiny during December 2006 determining an income of Rs. 97.10 crore after allowing deduction of Rs. 173.67 crore under section 80IA. Audit examination revealed that three out of six eligible power generating units had earned profit of Rs. 173.67 crore during the year. The other three units had accumulated and brought forward loss of Rs. 99.80 crore, which was not set off while computing the profit of eligible business for claiming deduction. The omission resulted in excess deduction of Rs. 99.80 crore with revenue impact of Rs. 46.39 crore including interest.

3.6.3.10 The Department has accepted the audit observation (July 2007).

3.6.3.11 In Karnataka, CIT I, Bangalore charge, assessment of a company **M/s KPC Ltd.**, for the assessment year 2002-03 was completed under scrutiny

⁷ CIT vs Kotagiri Industrial Coperative Tea Factory Ltd., 1997 {224 ITR 604} (SC)

during February 2005 determining 'nil' income after allowing deduction of Rs. 80.56 crore under section 80IA and setting off Rs. 247.24 crore being unabsorbed depreciation relating to earlier years. The balance of unabsorbed depreciation of Rs. 205.09 crore was allowed to be carried forward. Audit examination of the assessment records revealed that deduction under section 80IA had been allowed before setting off unabsorbed depreciation. After setting off of unabsorbed depreciation of earlier years no income was available for claiming deduction. This resulted in incorrect allowance of deduction and excess carry forward of unabsorbed depreciation of Rs. 80.56 crore with potential revenue impact of Rs. 28.76 crore.

3.6.3.12 The Department has accepted the audit observation (July 2007).

3.6.3.13 In Tamil Nadu, CIT I, Chennai charge, a company **M/s Tamil Nadu Newsprints & Paper Ltd.**, engaged in the business of manufacture and sale of paper also derived income from generation of power through wind mills that commenced operation in the financial year 1993-94 (assessment year 1994-95).

3.6.3.14 The assessee claimed deduction under section 80IA from the assessment year 2003-04 being the initial year and maintained separate profit and loss account for the eligible business from 2003-04 onwards. The profit of the eligible business was computed and deduction of Rs. 9.24 crore and Rs. 2.65 crore was allowed for the assessment year 2003-04 and 2004-05 respectively. However, it was noticed that the assessee had claimed depreciation on assets used for generation of power of Rs. 72.97 crore from assessment year 1994-95 to the assessment year 2002-03 which was not reduced from profits of eligible business for the assessment year 2003-04 and 2004-05 before working out the deduction allowable under section 80IA. This has resulted in incorrect allowance of deduction of Rs. 9.24 crore and Rs. 2.65 crore with consequential revenue impact of Rs. 4.67 crore and Rs. 1.27 crore for the assessment years 2003-04 and 2004-05 respectively.

3.6.3.15 The Department initiated remedial action (April 2007).

3.6.3.16 In Tamil Nadu, CIT I, Chennai charge, an assessee company **M/s EID Parry (I) Ltd.**, had adjusted the loss relating to power generation business as per section 80IA(5) and the accumulated loss of Rs. 19.17 crore was carried forward to the assessment year 2004-05. In the assessment year 2004-05 the assessee company had claimed deduction under section 80IA of Rs. 16.40 crore after adjusting a carry forward loss of Rs. 6.93 crore instead of the actual accumulated loss of Rs. 19.17 crore. This resulted in excess claim of deduction of Rs. 12.24 crore involving revenue impact of Rs. 5.27 crore.

3.6.3.17 The Department has initiated remedial action (August 2007).

3.6.3.18 In Karnataka, CIT I, Bangalore charge, the assessment of a company, **M/s Jindal Aluminium (P) Limited**, for assessment years 2003-04 and 2004-05

were completed after scrutiny during March 2006 and December 2006 respectively determining 'nil' income under normal provisions after allowing deductions under section 80IA and at Rs. 4.17 crore under special provisions of the Act and tax levied thereon. Audit examination revealed that the assessee had incurred a net loss of Rs. 17.98 crore and Rs. 2.15 crore during the relevant previous years in three units engaged in power generation. However, while allowing deduction, only profit earned by Unit I was reckoned without setting off the loss sustained by Unit II and III. This omission resulted in short computation of income by Rs. 1.48 crore and Rs. 8.89 crore during assessment years 2003-04 and 2004-05 respectively, involving revenue impact aggregating to Rs. 2.60 crore including interest.

3.6.3.19 The Department has accepted the audit observation (July 2007).

3.6.3.20 In Gujarat, CIT IV, Ahmedabad charge, the assessment of **M/s Sadbhav Engineering Ltd.**, was completed after scrutiny for the assessment year 2004-05. Audit examination revealed that while working out the deduction under section 80IA, losses of Rs. 6.75 crore determined in the earlier assessment year were not adjusted against positive income determined for assessment year 2004-05 in respect of three eligible units. This irregular deduction resulted in underassessment of Rs. 4.49 crore with consequent short levy of tax of Rs. 1.81 crore including interest.

3.6.3.21 The Department has agreed to review the case (March 2007).

3.6.3.22 In Madhya Pradesh, CIT, Bhopal charge, the assessment of **M/s HEG Ltd.**, for the assessment year 2002-03 was completed after scrutiny in March 2005 wherein the assessing officer had restricted the deduction claimed by the assessee. On appeal by the assessee, deduction was allowed by CIT (A) and assessee was allowed a deduction under section 80IA aggregating to Rs. 20.24 crore on power generation division located at Durg, Tawa and Rishabdev. Audit examination, however, revealed that the assessee had sustained a loss in Tawa Division which was not considered while computing the deduction under section 80IA. This resulted in excess deduction of Rs. 3.03 crore involving potential revenue impact of Rs. 1.08 crore.

3.6.3.23 Similarly, in the assessment year 2003-04, in the scrutiny assessment concluded in March 2007, a deduction under section 80IA of Rs. 7.23 crore was allowed to the power division at Tawa. As the assessee had unabsorbed loss of Rs. 66.50 lakh in power division at Tawa, it had to be set off before working out the deduction under section 80IA, which was not done. The omission resulted in excess allowance of deduction to the extent of Rs. 66.50 lakh involving revenue impact of Rs. 32.27 lakh including interest.

3.6.3.24 The Department accepted the audit observation (June 2007).

3.6.3.25 Six other cases, where brought forward loss or unabsorbed depreciation were not adjusted before computing deduction under section 80IA, are given in the

Table no. 3.3 below and 15 cases involving a revenue impact of Rs. 3.15 crore are brought out at **Appendix 14**.

(Rs. in lakh)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type of assessment	Incorrect allowance of deduction	Revenue impact
1	M/s. Servalakshmi Paper Boards (P) Ltd. CIT I, Coimbatore	2004-05	Scrutiny	193.14	92.32
2	M/s. Rain Calcining Ltd. CIT III, Hyderabad	2004-05	Scrutiny	238	85.27
3	M/s. Easun Reyrolle Ltd. CIT-I, Chennai	2000-01 and 2005-06 2001-02 and 2004-05	Summary Scrutiny	196.09	73.27
4	Sagar Power Ltd. CIT III, Hyderabad	2003-04	Scrutiny	126	61.00
5	M/s. Ketan Construction Ltd., CIT I, Rajkot	2004-05	Scrutiny	127.78	56.84
6	GVG Paper Mills Ltd. CIT-III, Coimbatore	2004-05 2005-06	Scrutiny Summary	84.47	56.36

Note: In respect of Sl. no. 1 and 4, the Department accepted (April 2007) the audit observation. In respect of Sl. no. 3 the Department has initiated remedial action (August 2007)

3.6.3.26 Audit examination thus revealed that in cases where the assessee had both eligible and non eligible units, separate accounts were not being prepared from the date of commencement of business, but were being prepared only from the year from which they were claiming exemption. As a result of this, deduction under section 80IA was being allowed without taking into account all losses and depreciation relating to the eligible units treating them as distinct entity.

3.6.3.27 *Audit recommends that the Ministry may consider making it mandatory for the assessee availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.*

3.6.3.28 In the exit conference, the Board agreed to examine the issue.

3.6.4 Incorrect apportioning of expenses resulting in excess deduction

3.6.4.1 Subsection (10) of section 80IA provides that where it appears to the assessing officer that owing to the close connection between the assessee carrying on the eligible business and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, the assessing officer shall in computing the profits

and gains of such eligible business for the purposes of this section, take the amount of profit as may be reasonably deemed to have been derived from the business.

3.6.4.2 In Maharashtra, CIT 3, Mumbai charge, the assessments of a company, **M/s Nuclear Power Corporation of India Ltd.**, for the assessment years 2002-03 and 2005-06 were completed after scrutiny in December 2004 and January 2007 respectively. The assessee had not debited the proportionate expenses i.e. administrative and other expenses shown in the consolidated profit and loss account to the units claiming deduction under section 80IA. This resulted in inflating the profit of the units claiming 80IA deduction resulting in excess deduction of Rs. 43.53 crore and Rs. 185.47 crore involving revenue impact of Rs. 15.54 crore and Rs. 67.87 crore for the assessment years 2002-03 and 2005-06 respectively.

3.6.4.3 In Tamil Nadu, CIT I Central charge, an assessee company, **M/s TCP Ltd.**, for the assessment years 2001-02 to 2004-05 while allocating the common indirect expenses such as administrative expenses, selling overheads, etc., out of total indirect expenditure of Rs. 137.19 crore, expenditure of Rs. 47.19 crore only was allocated to the power division. The basis of allocation was not available on record. However, the proportionate expenditure as calculated by audit based on the turnover of the eligible undertaking worked out to Rs. 92.19 crore. The incorrect allocation of indirect expenditure reduced the profits of ineligible business resulting in excess allowance of deduction of Rs. 45 crore under section 80IA involving revenue impact of Rs. 17.97 crore.

3.6.4.4 In Tamil Nadu, CIT I, Central Chennai charge, a company, **M/s A.S. Shipping Agencies (P) Ltd.**, engaged in the business of Steamer Agents and Container Freight Station (CFS) operators for assessment years 2002-03 and 2003-04 had been allowed deduction of Rs. 49.26 lakh and Rs. 145.90 lakh respectively. Audit examination revealed that the assessee had income from bonded warehousing, leasing out of canteen and miscellaneous income of Rs. 42.54 lakh and Rs. 43.45 lakh for the assessment years 2002-03 and 2003-04 respectively which was not eligible for computing the deduction. Further, the expenditure of Rs. 22.64 lakh and Rs. 6.93 lakh for the assessment years 2002-03 and 2003-04 of maintenance of the plot relating to eligible 80IA unit were omitted to be included in that business. This incorrect apportionment of income and expenditure between eligible business and ineligible business resulted in excess allowance of deduction of Rs. 49.26 lakh and Rs. 73.92 lakh for the above assessment years involving an aggregate revenue impact of Rs. 52.63 lakh.

3.6.4.5 Though the Department replied (March 2007) that the assessing officer was aware of the mistake, no rectificatory proceedings had been initiated to rectify it.

3.6.4.6 Four other cases, where incorrect deduction was allowed due to non apportionment of pro-rata expenditure are given in the **Table no. 3.4** below:

(Rs. in crore)

Table no. 3.4: Incorrect deduction due to non apportionment of pro-rata expenditure

Sl. no.	Name of assessee/ CIT charge	Assessment year	Type of assessment	Nature of mistake	Incorrect deduction	Revenue impact
1	Tata Chemicals CIT 2, Mumbai	2002-03	Scrutiny	Did not apportion depreciation correctly to the unit eligible for deduction	9.72	3.47
		2003-04	Scrutiny		7.44	2.73
		2004-05	Scrutiny		5.63	2.02
2	M/s Larsen and Tubro Ltd. CIT 2, Mumbai	2003-04	Scrutiny	Did not apportion interest and the administrative expenses to the eligible business	12.00	2.74
		2004-05	Scrutiny		7.45	4.30
3	M/s Servalakshmi Paper Boards (P) Ltd. CIT I, Coimbatore	2004-05	Scrutiny	Did not apportion managerial remuneration	0.53	0.25
4	M/s Rajshree Sugars and Chemicals Ltd. CIT II, Coimbatore.	2004-05	Scrutiny	Did not apportion interest payments	Not quantified	
		2005-06	Summary			

3.6.4.7 Audit examination thus revealed that the assessing officers were not apportioning the expenses relating to eligible undertakings correctly, which resulted in inflation of eligible profits and, thereby, the deduction.

3.6.4.8 *Audit recommends that the Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10 CCB specifies the basis of apportionment/allocation of common expenses especially with regard to composite business where assessees have both eligible and ineligible units.*

3.6.4.9 In the exit conference, the Board agreed to examine the issue.

3.6.5 Allowance of deduction without proper auditor's report/certificate

3.6.5.1 Subsection (7) of section 80IA provides that deduction under this section shall not be admissible unless the accounts of the undertaking relevant to the assessment year for which the deduction claimed have been audited by an accountant. Rule 18 BBB further ordains that the assessee shall furnish along with his return of income, the report of such audit in the prescribed Form no. 10 CCB duly signed and verified by a chartered accountant which shall be accompanied by the profit and loss account and balance sheet of the eligible undertaking as if the undertaking were a distinct entity. In the case of CIT vs Shivanand Electronics [1994] {209 ITR 63} (Bombay), it was held that no duty is cast on the assessing officer to ask an assessee who has failed to file the audit report, to do so before rejecting his claim for relief.

3.6.5.2 In Haryana, Hisar charge, the assessment of a company, **M/s Jindal Steel and Power Limited**, for the assessment year 2003-04 was completed after scrutiny in March 2006. Deduction of Rs. 65.94 crore was allowed on power generation units under section 80IA under normal provisions and by charging tax of Rs. 14.09 crore on book profits under special provisions of the Act. Audit examination revealed that deduction under section 80IA was allowed without obtaining the separate accounts for eligible undertakings as required under Rule 18 BBB of the Income Tax Rules. In the absence of separate accounts, audit was unable to verify correctness of the allowed deduction of Rs. 65.94 crore involving revenue impact of Rs. 24.23 crore.

3.6.5.3 The Department stated (September 2006) that the requisite information was already available on record in the shape of prescribed audit report in Form no. 10 CCB. Reply of the Department is not tenable as separate account was to be compulsorily filed failing which deduction was not admissible.

3.6.5.4 In Tamil Nadu, CIT I, Chennai charge, a company, **M/s TIDEL Park Ltd.**, which was allowed deduction under section 80IA of Rs. 3.09 crore, did not file the mandatory audit certificate in Form no. 10CCB as prescribed under Rule 18BBB of the Income Tax Rules along with the return of income for the assessment year 2003-04. Besides, as per column 26 of Form no. 3CD, the section wise details of deduction admissible under chapter VIA was reported as 'nil' by the company tax auditor. In the absence of the requisite audit certificate in Form no. 10CCB, the assessee was not eligible for deduction under section 80IA of Rs. 3.09 crore. The omission to disallow it resulted in revenue impact of Rs. 1.13 crore.

3.6.5.5 The Department has initiated remedial action (April 2007).

3.6.5.6 In West Bengal, CIT IV, Kolkata charge, assessments of a company **M/s APM Industries Ltd.**, for the assessment years 2002-03 and 2003-04 were completed in scrutiny manner in March 2005 and January 2006 after allowing deduction under section 80IA of Rs. 75.32 lakh and Rs. 1.83 crore respectively. Audit examination revealed that the assessee had not submitted the audit certificate in Form no. 10CCB and hence no deduction was allowable under section 80IA of the Act. The omission to disallow it resulted in irregular allowance of deduction involving revenue impact of Rs. 26.89 lakh and Rs. 90.89 lakh respectively.

3.6.5.7 In its reply the Department stated (May 2007) that for a procedural defect, admissible statutory deduction should not be disallowed. The Department referred to a Board circular which states that refund or deductions omitted to be claimed by the assessee are allowable in assessments. The reply is not tenable as submission of Form no. 10CCB is mandatory for allowance of deduction under section 80IA. Further, the Board circular cited is also not relevant to the instant case.

3.6.5.8 In Andhra Pradesh, CIT Central, Hyderabad charge, assessment of a company **M/s Sree Rayalaseema Green Energy Ltd.**, for the assessment year

2004-05 was completed after scrutiny. Audit examination revealed that no audit certificate had been enclosed with the return of income. Further, it was also seen that the assessee had been wrongly allowed deduction under section 80IA in respect of the receipts from the sale of sugarcane and sugar which were not part of the eligible unit. The omission to disallow the deduction without auditor's certificate and properly examine the computation of eligible profits resulted in short computation of income of Rs. 1.87 crore with consequential revenue impact of Rs. 81.99 lakh including interest.

3.6.5.9 In Andhra Pradesh, CIT, Rajahmundry charge, assessment of a company **M/s Gowthami Bio-Energies Ltd.**, for the assessment year 2003-04 was completed after scrutiny in December 2005. Audit examination revealed that the audit certificate in Form no. 10CCB enclosed with the return of income issued by the chartered accountant was incomplete and defective in as much as that the deduction admissible was not certified therein. In the absence of correct and complete statutory certificate, the deduction under section 80IA of Rs. 1.07 crore was not allowable. The omission to do so resulted in short computation of income of Rs. 1.07 crore with consequential revenue impact of Rs. 53.10 lakh including interest. On this being pointed out the Department initiated remedial measures.

3.6.5.10 In Maharashtra, CIT 10, Mumbai charge, the assessments of a company **M/s E. A. Infrastructure Pvt. Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in August 2005 and December 2006 respectively. The assessee had not furnished the audit report in Form no. 10 CCB along with the return. Hence, the deduction under section 80IA was not admissible. The omission to disallow it resulted in incorrect allowance of deduction of Rs. 95.37 lakh and Rs. 38.89 lakh involving revenue impact aggregating to Rs. 49 lakh for both the assessment years.

3.6.5.11 Audit examination thus revealed that deduction under section 80IA was being allowed even though the assessee were not filing the required audit report/certificates along with the profit and loss account and balance sheet relating to the eligible undertaking treating it as a distinct entity.

3.6.5.12 *Audit recommends that the Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.*

3.6.5.13 In the exit conference, the Board accepted the audit recommendation.

3.6.6 Incorrect computation of deduction

Power generation and distribution

3.6.6.1 In order to meet the growing need of power, investments are encouraged in power generation and distribution including captive power plants by providing them with incentives, one of them being deduction under section 80IA.

3.6.6.2 Though it has been judicially held⁸ that one cannot do business with oneself, the benefits of deduction under section 80IA were extended to captive power plants (CPP) on the reasoning that CPP operators would draw less electricity from the electricity boards, thereby lessening the load on the grid. The Board, while clarifying⁹ the availability of benefits to CPPs stated that the deduction would be subject to the following:

- The CPP set up by an undertaking is distinct and separate and there is an element of commercial profits or gains by the power generating undertaking from the industrial user
- The assessing officer through examination shall ensure that the transactions between CPP and its undertaking is at arms length
- The grant of deduction shall not be taken to legitimise something not permissible under the provisions of Electricity Supply Act and related laws
- The user undertaking shall not debit the expenses incurred by the CPP in its own profit and loss account.

3.6.6.3 The Indian Electricity Act 2003 provides the basic framework for the regulation of the electricity industry in India. The Central Government has set up independent and autonomous regulatory bodies' viz. Central Electricity Regulatory Commission (CERC) and the State Electricity Regulatory Commissions (SERCs). CERC is empowered to regulate and frame guidelines on matters relating to electricity tariff covering generation, transmission and distribution of electricity.

3.6.6.4 Tariff structures, both for the 'public sector' and 'independent power producers' (IPPs), was determined on 'cost plus profit basis'. For IPPs the 'return on equity' is computed on the capital¹⁰ relatable to the generating unit at the rate of 16 percent as has been laid down in a notification¹¹ issued by the Ministry of Power. The notification also states that while fixing the tariff, an element of income tax (corporate tax) paid by the power producer is also to be taken into account.

3.6.6.5 This notification read in consonance with the condition that profits and gains of eligible undertakings would be on a reasonable basis (subsection 10 under section 80IA) implies that profits arising to undertakings in the power sector entitled for deduction shall not exceed 16 percent on their equity relatable to the power project. Given the imperative of allowing the deduction on a reasonable basis, audit sought to examine the procedures and practice in the Department for computing profits of captive power plants on a reasonable basis which would

⁸ [1979] {119 ITR 303} (Gujarat High Court) CIT vs Rasiklal Balabhai B.J. Divan, CJ. and B.K. Mehta

⁹ Letter issued to the Secretary General, Indian Merchants Chamber, Mumbai in File no. 178/28/2001-ITA I dated 3 October 2001

¹⁰ Capital for the purpose of computing the return on equity includes paid up capital, premium raised by the generating company while issuing share capital and investment or internal resources created out of free reserve of the existing company, if any, for the funding of the project, for the purpose of computing the return on equity

¹¹ Notification no. SO 251(E) dated 30 March 1992

safeguard against any artificial inflation of profits arising to the eligible unit, thereby increasing the amount of deduction available as detailed below:

Excess allowance of benefit due to non-restriction of deduction to reasonable profit derived from electricity

3.6.6.6 Under section 80IA of the Act, where it appears to the assessing officer that, owing to the close connection between the assessee carrying on the eligible business and any other person, or the course of business of an assessee is so arranged that the business transacted produces more than ordinary profits which might be expected to arise, the assessing officer can recompute the profits arising from such arrangements and the deduction available to the assessee.

3.6.6.7 Audit examination revealed that there were inconsistencies in the methodology adopted for computing reasonable profits allowable as deduction under section 80IA. A perusal of the assessment records of M/s Tata Power Co Ltd., Mumbai for the assessment year 2004-05 completed after scrutiny revealed that revenue attributable to the power plants for the purposes of deduction under section 80IA had been arrived at based on the 'clear profit and reasonable return on capital base as per the Electricity Supply Act¹²'. In the case of Hindustan Petroleum Corporation Ltd, Mumbai for the assessment year 2004-05 completed after scrutiny, lower deduction under section 80IA had been allowed based on the market rate of electricity minus fifteen percent.

3.6.6.8 No such exercise was done to restrict the claims of assessee who had claimed deduction in excess of profits allowable under Electricity Act or to apply a consistent and acceptable standard as highlighted in the following paragraphs.

3.6.6.9 In Maharashtra, CIT I, Mumbai charge, assessments of **M/s Reliance Energy Ltd. (REL)**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny in January 2005, March 2005 and March 2006 respectively. The assessee was engaged in the business of generation and distribution of electricity and was allowed deduction under section 80IA for the eligible business of generation of electricity at Rs. 385.97 crore, Rs. 261.96 crore and Rs. 474.95 crore for the assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.6.10 The Maharashtra Electricity Regulatory Commission (MERC) had quantified the profits at the rate of 16 percent arising to the composite business of generation and distribution of REL¹³ for the financial years relevant to the assessment years 2002-03, 2003-04 and 2004-05 at Rs. 235 crore, Rs. 249 crore and Rs. 290 crore. Audit examination revealed that the assessing officer had not worked out the pro rata deduction for computing the profits attributable to the eligible unit of generation of electricity while allowing deduction under section

¹² Taken from the balance sheet

¹³ vide tariff order issued in case no. 18 of 2003 dated 1 July 2004

80IA. This resulted in excess allowance of deduction aggregating to Rs. 636.89 crore involving a revenue impact of Rs. 229.04 crore as detailed in **Table no. 3.5** below:

(Rs. in crore)

Table no. 3.5: Excess allowance of benefit due to non-restriction of deduction to reasonable profit derived from electricity

Sl. no.	Details	Assessment year		
		2002-03	2003-04	2004-05
1	Profit determined by MERC for both generation and distribution	235	249.00	290.00
2	Power sale from eligible generating station (million Kwh)	3442	3546.00	4084.00
3	Total power sales (million Kwh)	5676	5880.00	6126.00
4	Pro rata profits eligible for deduction under section 80IA computed as (1) * (2) / (3)	142.50	150.16	193.33
5	80IA deduction allowed	385.97	261.96	474.95
6	Excess 80IA deduction allowed (5)-(4)	243.47	111.80	281.62
Revenue impact		86.92	41.09	101.03

3.6.6.11 In Maharashtra, CIT 6, Mumbai charge, the assessments of a company, **M/s Hindalco Industries Ltd.**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny in February 2004, January 2005 and March 2006 respectively. It was seen that the assessee had computed the profit derived from supply of electricity for captive consumption, which worked out to an average of 92.75 percent return on investment per annum as against 16 percent prescribed in the notification of March 1992. Further, it was seen that assessee did not apportion all the expenses to its captive power plant and hence was able to show more than normal profits. The omission to recompute profits of the assessee from captive power plant as provided under section 80IA and limit it to a reasonable quantum as prescribed in notification of the Ministry of Power resulted in inflation of profits eligible for deduction under section 80IA. This resulted in excess deduction of Rs. 492.13 crore, Rs. 372.41 crore and Rs. 262.27 crore in the three assessment years resulting in revenue impact of Rs. 175.69 crore, Rs. 136.86 crore and Rs. 94.09 crore respectively.

3.6.6.12 Six other cases, where the claim of deduction under section 80IA was not restricted as per guidelines of the Ministry of Power are given in **Table no. 3.6** below:

(Rs. in crore)

Table no. 3.6: Excess computation of profit on captive power plants

Sl. no.	Name of the assessee/CIT charge	Assessment Year(s)	Type of assessment	Excess deduction*	Revenue impact
1	M/s Reliance Industries Ltd. CIT 3, Mumbai	2002-03	Scrutiny	223.00	79.61
		2003-04	Scrutiny	320.02	117.60
		2004-05	Scrutiny	266.59	95.64
2	M/s Gujarat Ambuja Cement Ltd. CIT 3, Mumbai	2002-03	Scrutiny	97.90	34.95
		2003-04	Scrutiny	90.62	33.30
		2004-05	Scrutiny	91.18	32.71

Sl. no.	Name of the assessee/CIT charge	Assessment Year(s)	Type of assessment	Excess deduction*	Revenue impact
3	M/s Larsen and Tubro Ltd. CIT 2, Mumbai	2002-03	Scrutiny	36.52	13.04
		2003-04	Scrutiny	24.94	9.17
4	M/s Atul Limited CIT I, Ahmedabad	2002-03	Scrutiny	13.65	6.84
		2003-04	Scrutiny	14.49	7.32
5	M/s Sterlite Industries (I) Ltd. CIT III, Chennai	2004-05	Scrutiny	6.00	2.86
6	M/s Thiagarajar Mills Ltd. CIT I, Madurai	2000-01 to	Scrutiny	5.76	2.14
		2004-05			
		2005-06	Summary		

**Excess deduction has been computed as deduction allowed minus deduction allowable [@ 16%]
In respect of Sl. no. 5, the Department has accepted (September 2007) the audit observation and agreed to initiate remedial action.*

3.6.6.13 Audit examination thus revealed that there were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

3.6.6.14 *Audit recommends that the Ministry should take appropriate measures to ensure that the interest of revenue is protected while allowing deduction to captive power plants.*

3.6.6.15 In the exit conference, the Board agreed to examine the issue in view of the wide variations noticed.

3.6.7 Non selection of 80IA cases for scrutiny

3.6.7.1 As per the scrutiny guidelines issued by the Board annually, the cases where chapter VIA- deduction exceeds Rs. 25 lakh, are to be compulsorily selected for scrutiny for the financial years 2003-04, 2004-05 and 2005-06. Non compliance of the above instructions were noticed in the following cases:

3.6.7.2 In Uttar Pradesh, CIT II, Kanpur charge, an assessee **M/s UP State Industrial Development Corporation**, filed its return of income for the assessment year 2003-04 declaring 'nil' income in May 2005 as against the due date of October 2003 (extended up to November 2003).

3.6.7.3 No notice had been issued to regularise the belated filing of return or to examine the veracity of the deductions/exemptions claimed by the assessee. The audit examination revealed that assessee had derived income from three units, out of which only one was entitled to avail of deduction under section 80IA. During the earlier assessment year (viz. assessment year 2002-03), expenditure of Rs. 5.52 crore (relating to group gratuity schemes, prior period expenses, diminution in value of shares, etc) had been made in respect of the ineligible units. Since the assessee had claimed deduction exceeding Rs. 25 lakh under section 80IA in his return of income, the return ought to have been selected for scrutiny as per scrutiny guidelines issued by the Board. Audit noticed that disallowances of similar nature

were to be carried out during the assessment year 2003-04 also, which could not be done as no action was taken on the return filed by the assessee. The omission to select the case for scrutiny resulted in underassessment of income of Rs. 12.89 crore involving revenue impact of Rs. 4.74 crore.

3.6.7.4 The Department agreed (May 2007) to take remedial action.

3.6.7.5 In Maharashtra, CIT 6, Mumbai charge, the assessment of a company **M/s IRB Infrastructure Limited**, for the assessment year 2002-03 was done in summary manner wherein profits arising from income on toll fees were claimed as deduction under section 80IA. Though the deduction claimed was in excess of limits prescribed by the Board, the case was not selected for scrutiny. The audit examination revealed that the deduction under section 80IA on toll fees had been disallowed during the assessment year 2001-02. The omission to select the case for scrutiny resulted in incorrect allowance of deduction of Rs. 1.52 crore involving revenue impact of Rs. 54 lakh.

3.6.7.6 In Delhi, CIT I charge, the assessment of a company, **M/s Jagson International Ltd.**, for the assessment years 2004-05 was processed in summary manner in March 2005 after allowing the deduction under section 80IA of Rs. 48.48 lakh. Audit examination revealed that for the assessment year 2004-05, as the assessee had claimed a deduction of Rs. 48.48 lakh, which was more than Rs. 25 lakh, this case fell under compulsory scrutiny. However, it was not selected for scrutiny.

3.6.7.7 On this being pointed out, the Department initiated action to select the case for scrutiny (August 2007).

3.6.7.8 Four other instances, where cases were not selected for scrutiny are given in **Table no. 3.7** below:

(Rs. in crore)

Table no. 3.7: Non selection of 80IA cases for scrutiny				
Sl. no.	Name of the assessee/ CIT charge	Assessment year/type of assessment	Deduction claimed under section 80IA	Reasons furnished by the Department for non-selection for scrutiny
1	M/s Gayathri Agro Industrial Power Ltd. CIT VI, Hyderabad	2003-04 Summary	1.17	The assessing officer replied (June 2007) that as this case was processed in summary manner during March 2004, the return was not selected for scrutiny. The reply is not tenable as the instructions of the Board were not complied with.
2	MSK Infrastructure & Toll Bridge Pvt Ltd. CIT II, Vadodara	2005-06 Summary	1.17	The assessing officer replied (May 2007) that the above case had not been selected for scrutiny through CASS ¹⁴ . Manual selection was prohibited and hence, no action could be taken in this case.

¹⁴ Computer assisted scrutiny system

Sl. no.	Name of the assessee/ CIT charge	Assessment year/type of assessment	Deduction claimed under section 80IA	Reasons furnished by the Department for non-selection for scrutiny
3	M/s Trident Power Systems Ltd. CIT II, Hyderabad	2005-06 Summary	1.02	The assessing officer replied (May 2007) that scrutiny guidelines are not applicable as the resultant income would be nil after setoff of losses. However, the reply is not correct as the case should have been selected for scrutiny to disallow the claim under section 80IA.
4	M/s City Online Services Ltd. CIT I, Hyderabad	2004-05 Summary	0.47	The assessing officer replied (November 2006) that the above case had not been picked up for scrutiny through CASS. Manual selection was prohibited and hence, no action could be taken.

3.6.7.9 Audit examination thus revealed that cases were not being selected for scrutiny even though they fulfilled the criteria. The CASS was also not aiding in the identification of assessees for compulsory scrutiny as per the criteria prescribed by the Board.

3.6.7.10 *Audit recommends that the Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfill the criteria for the selection of cases for scrutiny.*

3.6.7.11 In the exit conference, the Board accepted the recommendation and stated that this aspect is being taken care of in the new CASS for selection of cases for scrutiny during 2007-08.

Compliance issues

3.6.8 Incorrect allowance of deduction on notional value of steam

3.6.8.1 Sub section (8) of section 80IA provides that where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of the deduction, the profits and gains of such eligible business shall be computed as if the transfer had been made at the market value of such goods or services. In exceptional circumstances, the assessing officer may compute such profits and gains on a reasonable basis.

3.6.8.2 Section 80IA of the Act, provides for deduction of hundred percent of the profits from the generation or generation and distribution of power. It has been

judicially held¹⁵ that non-mention of the word ‘electricity’ in section 80IA was only because the Legislature wanted to give the term ‘power’ a wider meaning. The word ‘power’ has to be given a meaning which in common parlance means ‘energy’ and can be of any form-mechanical, electrical, wind or thermal. Thus, steam produced by the assessee would be termed as power and qualify for the deductions under section 80IA. Steam is a transient product without shelf life. Under the circumstances notional computation of value of steam on the basis of cost of production could inflate the amount of deduction allowable.

3.6.8.3 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company **M/s Tata Chemicals Ltd.**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed in scrutiny manner in January 2005, February 2006 and December 2006 respectively. The company had been allowed deduction under section 80IA for captive power plants. Audit examination revealed that the deduction was computed after taking into account sale of electricity and steam generated by the eligible units. While working out the sale value for computing the profit the assessee had adopted the value for electricity based on the rates of Gujarat Electricity Board treating it as fair market value. The ‘Notes to Accounts’ appended to return of income stated that steam is not a marketable product and, therefore, the sale could not be recorded at fair market value. Profits on sale of steam had been taken as the cost of production. As the cost of production of steam equals the sale value no profit can be attributed to this transaction.

3.6.8.4 Thus, as the determination of profit on production of steam was on a notional basis, the deduction allowed was incorrect. This resulted in incorrect allowance of deduction of Rs. 53.04 crore, Rs. 51.28 crore and Rs. 39.74 crore and short levy of tax of Rs. 18.94 crore, Rs. 18.84 crore and Rs. 14.26 crore for assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.8.5 Three other cases, where the deduction under section 80IA was allowed on the basis of notional value of steam are given in the **Table no. 3.8** below:

(Rs. in crore)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type/date of assessment	Value of steam included for 80IA deduction	Revenue impact
1	M/s. Hindalco Industries Ltd. CIT 6, Mumbai	2002-03	Scrutiny / February 2004	8.54	3.05
		2003-04	Scrutiny / January 2005	13.03	4.79
		2004-05	Scrutiny / March 2006	24.34	8.73
2	M/s Hindustan Petroleum Corporation Ltd. CIT 1, Mumbai	2002-03	Scrutiny / March 2005	29.95	0.31
		2003-04	Scrutiny / December 2005	35.05	3.57
		2004-05	Scrutiny / November 2006	40.19	1.38
3	M/s. Shri Krishna Khandsari Sugar Mills, CIT 1, Nashik	2003-04	Scrutiny / December 2005	0.35	0.13

¹⁵ Sial SBEC Bioenergy Ltd vs CIT [2004] {83 TTJ (Delhi) 866}

3.6.8.6 In its reply, the Department stated (July 2007) in the case of M/s Hindalco Industries Ltd. that, merely because steam was not marketable the value could not be considered as 'nil'. The Department drew an analogy to the valuation of 'work in progress' in the processing industry.

3.6.8.7 In case of M/s Shri Krishna Khandasari Sugar Mills Ltd., the Department stated (February 2007) that the eligible units derive income from two elements viz. from sale of electricity and from sale of steam.

3.6.8.8 Reply of the Department is not tenable in both the cases as no profit can be attributed to a transaction where the sale value has been equated with the cost of production.

3.6.8.9 In the exit conference the Board accepted the audit observation and stated that benefit of deduction under section 80IA to sale of steam as an intermediate product is not admissible.

3.6.9 Incorrect allowance of deduction on other income

3.6.9.1 It has been judicially held that the word 'derived from' cannot have a wide import so as to include any income which can in some manner be attributed to the business. The derivation of the income must be directly connected with the business and generated there from. Interest income is not considered to be directly derived from eligible industrial undertaking and is also not to be considered for deduction as per various judicial pronouncements¹⁶.

3.6.9.2 In Gujarat, CIT II, Ahmedabad charge, assessment of a company, **M/s Gujarat Powergen Energy Corporation**, for the assessment year 2004-05 was completed after scrutiny. The assessee was allowed a deduction of Rs. 217.61 crore under section 80IA on interest income relying on a judicial pronouncement by the High Court of Gujarat¹⁷. Audit examination however revealed that the said judgment had not been accepted by the Department and a special leave petition against this decision had been filed and it had been admitted by the Supreme Court. Thus, the interest income was required to be excluded to keep the issue alive and ensure consistency. However, interest income was not disallowed while computing deduction under section 80IA which resulted in revenue impact of Rs. 81.50 crore including interest.

3.6.9.3 The Department agreed to take remedial action (April 2007).

¹⁶ CIT vs Cochin Refineries Ltd [1982] {135 ITR 278} (Ker.)
CIT vs Cement Distributors Ltd [1994] {208 ITR 355} (Delhi)
CIT vs Cambay Electric Supply Industrial Company Ltd (1978) {113 ITR 84} (SC)
CIT vs Sterling Foods(1999) {237 ITR 579} (SC)
CIT vs Pandian Chemicals Ltd. {262 ITR 278} (SC)

¹⁷ In the case of Nirma Ltd.

3.6.9.4 In Andhra Pradesh, CIT II, Hyderabad charge, assessment of a company, **M/s GMR Energy Ltd.**, for the assessment year 2004-05 was completed after scrutiny in October 2006 determining the tax of Rs. 6.29 crore (at the rate of seven and one-half percent of Rs. 81.85 crore) under special provisions of the Act viz. 115JB which was more than the tax of Rs. 58.88 lakh under normal provisions of the Act leviable at the rate of 35 percent. Audit examination revealed that a deduction of Rs. 37.26 crore was allowed under section 80IA while computing taxable income under normal provisions of the Act. However, other income of Rs. 25.80 crore (being interest on deposits, foreign fluctuation gain, etc.) had not been reduced while allowing the 80IA deduction. After disallowing 'other income', the tax leviable under normal provisions would be more than that under special provisions. The omission to disallow other income resulted in excess allowance of deduction of Rs. 25.80 crore with a consequential revenue impact of Rs. 4.05 crore.

3.6.9.5 In Gujarat, CIT I, Rajkot charge, assessment of a company, **M/s Ketan Construction**, for the assessment years 2002-03, 2003-04 and 2004-05 was completed after scrutiny. Audit examination revealed that deduction under section 80IA had been computed taking into account insurance claim, commission and other income aggregating to Rs. 8.48 crore (Rs. 73.26 lakh, Rs. 588.48 lakh and Rs. 186.42 lakh) which was not eligible for deduction. The omission to disallow this resulted in incorrect allowance of deduction of Rs. 8.48 crore involving revenue impact of Rs. 3.13 crore.

3.6.9.6 In Maharashtra, CIT 2, Mumbai charge, assessments of a company, **M/s Nhava Sheva International Container Terminals Pvt. Ltd.**, for the assessment years 2002-03 and 2003-04 were completed after scrutiny in January 2005 and March 2006 respectively. The assessee had included 'other income' of Rs. 1.45 crore and Rs. 2.84 crore in the assessment years 2002-03 and 2003-04 respectively while computing the deduction allowable under section 80IA. As this was not derived from eligible business activity, it had to be disallowed for the purposes of computing deduction. The omission to do so resulted in incorrect grant of deduction which resulted in revenue impact aggregating to Rs. 1.56 crore.

3.6.9.7 In Gujarat, CIT I, Rajkot charge, assessments of a company, **M/s Backbone Enterprise**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny. Audit examination revealed that the deduction under section 80IA had been computed taking into account other income aggregating to Rs. 326.45 lakh (Rs. 82.42 lakh and Rs. 244.03 lakh) from interest on deposits which was not eligible for deduction. The omission to disallow this resulted in incorrect allowance of deduction of Rs. 3.26 crore involving revenue impact of Rs. 1.35 crore.

3.6.9.8 Proviso to sub section 4 of section 92C provides that where an arm's length price is determined by the assessing officer for international transaction, the assessing officer may compute the total income of the assessee having regard to the

arm's length price so determined and no deduction under chapter VIA 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 this subsection.

3.6.9.9 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company, **M/s Nhava Sheva International Container Terminals Pvt. Ltd.**, for the assessment year 2003-04 and 2004-05 were completed after scrutiny on March 2006 and December 2006 respectively. An addition of Rs. 3.29 crore and Rs. 3.30 crore was made under section 92C(3). Audit examination revealed that the assessing officer included the above addition for computing the profits for deduction under section 80IA which resulted in incorrect allowance of deduction aggregating to Rs. 6.59 crore involving an aggregate revenue impact of Rs. 2.39 crore (Rs. 1.21 crore and Rs. 1.18 crore for assessment years 2003-04 and 2004-05 respectively).

3.6.9.10 Five other cases, where income not derived from eligible activity had been considered for allowing deduction are given in **Table no. 3.9** below:

(Rs. in lakh)

Table no. 3.9: Incorrect allowance of deduction on other income

Sl. no.	Name of the assessee/CIT charge	Assessment year(s) /Type of assessment	Other income on which deduction incorrectly allowed under section 80IA		Revenue impact
			Nature	Amount	
1	M/s Rajkamal Builders Infrastructure (P) Ltd. CIT IV, Ahmedabad	2002-03/ Scrutiny	Interest on	58.66	93.94
		2003-04/ Scrutiny	deposits	77.58	
		2004-05/ Scrutiny		53.45	
2	M/s Gayathri Agro Industries Power Ltd., Suryapet CIT VI, Hyderabad	2002-03/ Summary	Interest on	20.09	24.15
		2003-04/ Summary	deposits	40.26	
		2004-05/ Scrutiny		22.90	
		2005-06/ Scrutiny		12.75	
3	M/s Bharuch Enviro Infrastructure Ltd CIT III, Vadodara	2004-05/ Scrutiny	Interest on deposits	48.13	22.96
4	M/s TIDEL Park Ltd CIT I, Chennai	2003-04/ Scrutiny	Income from lease	34.54	17.92
5	M/s R.V.K.Energy (P) Limited CIT III, Hyderabad	2003-04/ Scrutiny	Interest on deposits	29.75	10.93

Note: In respect of Sl. no. 5, the Department has accepted the audit observation (October 2006).

3.6.10 Other issues

3.6.10.1 In Tamil Nadu, CIT I, Chennai charge, a company, **M/s Terra Energy Ltd.**, incorporated on March 1995 with the object of generation of power had neither transacted any business nor acquired any fixed assets till the transfer of two co-generation plants from M/s Thiru Arooran Sugars Ltd., as slump sale under a scheme of arrangement approved by the High Court of Madras in August 2000. As this was a transfer of a business already in existence, the new unit formed was not

eligible for deduction under section 80IA. The incorrect allowance of deduction under section 80IA resulted in revenue impact of Rs. 2.80 crore for the assessment year 2001-02.

3.6.10.2 The Department has initiated remedial action (April 2007).

3.6.10.3 In Maharashtra, CIT Central Circle IV charge, assessment of a company **M/s All Cargo Movers (India) Pvt. Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006 wherein deduction was allowed on profits derived from a 'container station'. A container station does not fall within the definition of eligible infrastructure. The port authorities also did not issue any certificate that the said structure formed part of the port. The omission to disallow the claim of deduction resulted in incorrect allowance of deduction of Rs. 1.22 crore involving a revenue impact of Rs. 44 lakh.

3.6.10.4 In Tamil Nadu, CIT III, Coimbatore charge, a company assessee **M/s Armstrong Knitting Mills (P) Ltd.**, after purchasing windmills during the assessment year 2002-03 had sold these to its sister concern and later leased back the same assets and claimed deduction on the income generated from windmills for the assessment year 2004-05. As no industrial undertaking was setup by the assessee claiming deduction (since the assets were only leased and not owned) and the machinery was also previously used in the business, the assessee was not eligible for deduction under section 80IA. This resulted in irregular allowance of deduction of Rs. 48.89 lakh involving revenue impact of Rs. 17.54 lakh.

3.6.10.5 The Department agreed to examine the issue (May 2007).

3.6.10.6 Proviso to sub section 4(c) of section 80IA provides that where an infrastructure facility is transferred after 1 April 1999 to another enterprise for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with a government entity, the provisions of the section shall apply to the transferee for the unexpired period as if the transfer had not taken place.

3.6.10.7 In Maharashtra, CIT 8, Mumbai charge, the assessments of **M/s Ideal Toll Roads Investment & Operations Pvt. Ltd.**, for the assessment year 2002-03 was processed in summary manner (December 2002) and for the assessment years 2003-04 and 2004-05 after scrutiny (in January 2006 and December 2006 respectively). The assessee was allowed deduction under section 80IA on the profits generated on account of the toll collected for a road (Udaipur Bypass Project) located in the state of Rajasthan. The road was constructed by M/s Atlanta Construction (I) Limited (later known as Atlanta Infrastructure Ltd.) by a tripartite BOT agreement in July 1996 with the Government of India and the Government of Rajasthan. There was no provision in this agreement to transfer or assign the maintenance and operation of the road or to assign the rights to collect the toll to a third party. M/s Atlanta Infrastructure Ltd. assigned its rights to recover toll to the

assessee company for Rs. 10.10 crore. As the transfer was not in accordance with the agreement, the assessee was not entitled to deduction under section 80IA. Incorrect grant of deduction resulted in underassessment of income of Rs. 5.79 crore, Rs. 6.20 crore and Rs. 5.05 crore with consequent revenue impact of Rs. 2.07 crore, Rs. 2.28 crore and Rs. 1.81 crore for assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.11 Tax expenditure

3.6.11.1 Tax expenditures are provisions in the Act, such as exclusions, deductions, credits, exemptions and other incentives that are designed to encourage certain kinds of activities or to aid taxpayers in special circumstances and reflect the policy choices of the government. They reduce the amount of tax revenues that may be collected and can be considered as direct government expenditure.

3.6.11.2 The steps involved in framing a tax incentive policy broadly include the design of tax incentives, implementation of the scheme and follow up in terms of compliance with the provisions of the Act and policy objectives. The benefit arising out of such tax incentives must also be periodically evaluated so as to derive an assurance that the policy and its implementation methods are indeed benefiting the beneficiaries. In order to do this effectively, it is necessary that the Department is in possession of real time and reasonable data relating to the major issues involved such as details of companies availing of deduction, nature of the activities for which the deductions are being allowed, sectors availing of the deduction, impact of the deduction on the various sectors, amount of revenue foregone, etc. Such data would assist in streamlining the Income Tax Act as well as in fine tuning the conditionality built into the section with actual developments in the sector.

3.6.11.3 Quantification of revenue foregone

A tax expenditure statement was laid before Parliament during Budget 2005-06 and 2006-07¹⁸ providing data on the revenue foregone¹⁹ on account various exemptions and deductions. The budget estimate of tax expenditure on account of each incentive has been broadly based on the probable revenue realisations by the exchequer in case the tax incentive was removed. In this exercise, the Ministry collected tax related information relating to 1689 companies from different sectors from the field formations of the Income tax Department in respect of the financial year 2003-04 (assessment year 2004-05). This exercise revealed that the highest tax expenditure was on account of deduction provided to profits of undertakings involved in development of infrastructure facilities, telecommunication services, power generation transmission and distribution as defined under section 80 IA.

¹⁸ Annex 12 to Receipts Budget 2005-06 and 2006-07

¹⁹ The tax forgone on each tax concession claimed by the companies has been estimated by applying corporate tax rate of 36.59 percent on the amount of deduction.

3.6.11.4 At the time of carrying out the audit review, no separate database of assessee availing of exemption under section 80IA was available with the Department. Audit identified 685 cases using collateral sources as specified in paragraph 3.4.1 above and test checked the assessments pertaining to the assessment year 2004-05 so as to be able to compare the estimates of revenue foregone with those stated in the tax expenditure statement of the Receipts Budget 2006-07, results of which are indicated in **Table no. 3.10** below:

(Rs. in crore)

	2004-2005
Deduction allowed as per the 166 assessment records seen by audit	16341.48
Tax expenditure @ 36.59 percent	5979
Tax expenditure @ 36.59 percent as quantified in the budget for 1689 companies	5832
Difference	147

3.6.11.5 In order to provide an impetus to undertakings to invest in the telecommunication sector, deduction under section 80IA was extended to undertakings providing telecommunication services. There has been an exponential growth in the telecom sector during the past decade. Audit examined the income tax assessments of major undertakings providing telecommunication services in order to examine the extent to which they had availed of the benefit of exemptions under section 80IA.

3.6.11.6 Status of deduction availed by telecommunication companies under section 80IA

The market share of various players in the telecom sector under GSM and CDMA along with the deduction allowed to them under section 80IA in the assessments is brought out in **Table no. 3.11** below:

(Rs. in crore)

Sl. no.	Name of operator	Market share in percent*	Details of deductions claimed/allowed under section 80IA for the assessment years			
			2002-03	2003-04	2004-05	2005-06
1	Bharti	22.00	Assessed under section 115JB#	Assessed under section 115JB#	Not claimed	Not claimed
2	BSNL	19.89	Not claimed	Not claimed	Assessed under section 115JB#	Assessed under section 115JB#
3	Reliance	19.51	Not claimed	Not claimed	Not claimed	Not claimed
4	Idea	8.31	Not claimed	Not claimed	Not claimed	Not claimed
5	Tata Teleservices	5.46	Not claimed	Not claimed	Not claimed	Not claimed
6	Spice Telecom (Now Spice Communication Pvt Ltd)	2.17	Not claimed	Not claimed	Not claimed	Not claimed

* Source: TRAI Annual Report 2005-06
 # Tax levied under special provisions, hence deduction under section 80IA has not been taken into account.

3.6.11.7 Audit examination thus revealed that major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under losses or were being assessed under special provisions of the Act which does not take in to account deductions under section 80IA (details at **Appendix 15**).

3.6.11.8 *Audit recommends that the Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.*

3.6.11.9 In the exit conference, the Board agreed to examine the issue.

3.7 Conclusions and summary of recommendations

3.7.1 The benefit of deduction under section 80IA had been irregularly extended to works contractors although they could not be deemed to be engaged in developing or maintaining an infrastructure facility within the meaning of section 80IA.

3.7.1.1 *Audit recommends that the Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.*

3.7.1.2 In the exit conference, the Board agreed to examine the issue.

3.7.2 The legal instruments granting tax incentives are required to be carefully drafted so that they achieve the policy objectives with minimum leakage of tax revenue. They are to be expressed as precisely as possible to avoid ambiguity in implementation.

3.7.2.1 *Audit recommends that the Ministry may consider suitably clarifying the provisions of section 80IA so as to prevent misuse of the incentive by ineligible assesseees.*

3.7.3 Assesseees deriving income from both eligible and non eligible units were not preparing separate accounts from the date of commencement of business, but were preparing it only from the year from which they were claiming exemption. As a result of this, deduction under section 80IA was being allowed without taking into account all losses and depreciation relating to eligible units treating them as a distinct entity.

3.7.3.1 *Audit recommends that the Ministry may consider making it mandatory for the assesseees availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment*

orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.

3.7.3.2 In the exit conference, the Board agreed to examine the issue.

3.7.4 The assessing officers were not apportioning the expenses relating to the eligible undertakings correctly which resulted in inflation of eligible profits and, thereby, deduction.

3.7.4.1 *Audit recommends that the Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10CCB specifies the basis of apportionment/ allocation of common expenses especially with regard to composite business where assesseees have both eligible and ineligible units.*

3.7.4.2 In the exit conference, the Board agreed to examine the issue.

3.7.5 Deduction under section 80IA was being allowed even though the assesseees were not filing the required audit report/certificates along with the profit and loss account and balance sheet relating to the eligible undertaking treating it as a distinct entity.

3.7.5.1 *Audit recommends that the Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.*

3.7.5.2 In the exit conference, the Board accepted the audit recommendation.

3.7.6 There were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

3.7.6.1 *Audit recommends that the Ministry should take appropriate measures to ensure that the interest of revenue is protected while allowing deduction to captive power plants.*

3.7.6.2 In the exit conference, the Board agreed to examine the issue.

3.7.7 Cases were not being selected for scrutiny even though they fulfilled the criteria. The CASS was also not aiding in identification of assesseees for compulsory scrutiny as per the criteria prescribed by the Board.

3.7.7.1 *Audit recommends that the Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfill the criteria for the selection of cases for scrutiny.*

3.7.7.2 In the exit conference, the Board accepted the audit recommendation.

3.7.8 Major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under losses or were being assessed under special provisions of the Act which does not take into account deductions under section 80IA.

3.7.8.1 *Audit recommends that the Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.*

3.7.8.2 In the exit conference, the Board agreed to examine the issue.

New Delhi
Dated:

(SUDHA KRISHNAN)
Principal Director of Receipt Audit
(Direct Taxes)

Countersigned

New Delhi
Dated:

(VIJAYENDRA N. KAUL)
Comptroller and Auditor General of India