

**Overview**

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**I. Review on Assessments of Banks**

Audit reviewed the assessments of 89 banks including public sector, private and foreign banks for the assessment years 2002-03, 2003-04, 2004-05 and 2005-06 completed after scrutiny up to March 2007 with a view to (i) evaluating compliance with the law and procedural requirements of Income Tax Act, 1961 (ii) to quantify the extent of irregularities, mistakes and omissions in the assessment of banks and (iii) examine if there is any lacuna in the Act.

Audit noticed 318 mistakes in 165 scrutiny assessments involving tax effect of Rs. 2781.38 crore. Audit observed areas with high revenue impact on account of systemic issues such as incorrect allowance of bad debts written off, incorrect allowance of provision for bad and doubtful debts, incorrect depreciation on valuation of investments made by banks etc. Audit also observed cases with potential impact on levy of tax such as non correlation of figures of bad and doubtful debts, deductions towards advances given by rural branches etc. Besides, other irregularities of non-compliance such as incorrect allowance of expense towards exempt income, deductions, income not offered to tax and incorrect set off of losses were noticed.

**Audit recommends that:**

- The Ministry may strengthen its internal controls such as ensuring regular review of assessments of banks at an appropriate level, that all such cases are checked by internal audit etc.
- The Ministry may prescribe a checklist for the assessing officers requiring them to check that the bad debts to be written off have been debited to the provision for bad and doubtful debt account and that the credit balance of provision for bad and doubtful debt account of earlier years have been considered before allowing the same.
- The Ministry may also consider devising a system where the assessing officer can take cognizance of the credit balance available in the provision for bad and doubtful debt account pertaining to earlier years in respect of banks.
- The Ministry may strengthen its internal controls so that deductions to rural branches of banks are allowed only after suitable verification by the assessing officer so as to safeguard the interests of revenue.
- The Ministry may consider introducing a suitable provision in the statute relating to valuation of investments by banks.

## **II. Review on Appreciation of Third Party Reporting/Certification in Assessment Proceedings**

Audit reviewed the assessment records of corporate and non corporate assesseees (excluding who are salaried) completed during the period from 2004-05 to 2006-07 with a view to (i) ensure that the tax audit reports were complete in themselves to provide sufficient and requisite information to the assessing officer, thereby aiding him in completing the assessment as required under the Act, (ii) determine the extent to which the assessing officers have evaluated and utilised information provided in prescribed reports while completing assessments, and (iii) determine the effectiveness of the Department's internal control mechanism in ensuring that the objective of obtaining a report from a third party (the accountant) is fulfilled.

Audit observed a total of 2874 cases of irregularities having a value of Rs. 849.16 crore with revenue impact of Rs. 665.67 crore (including penalty of Rs. 41.52 crore).

Audit observed cases where action was not taken in terms of the provisions of the Act for furnishing of inadequate information in the tax audit reports. Audit also observed cases where the assessing officers did not take action to make additions or disallowances although there were omissions in the tax audit reports. Further, cases were noticed where the assessing officers did not utilise the information available in the tax audit reports/certificates while finalising assessments.

Audit observed that the internal control mechanism in the Department to ensure that (i) the audit reports/certificates were complete and provided sufficient and requisite information to the assessing officer, (ii) information which is provided in the audit reports is being effectively utilised by the assessing officers and (iii) cases are selected for scrutiny assessment on the basis of tax audit reports, is not effective.

### **Audit recommends that:**

- The Ministry may ensure taking of action in terms of instruction no.1959 and section 288 of the Act, in cases where inadequate/inaccurate information have been furnished in the tax audit reports
- The Ministry may issue instructions to ensure that assessing officers critically examine the tax audit reports along with the connected records and other available evidence so as to make an independent assessment in each case.
- The Ministry may ensure that information as available from the tax audit reports/certificates is effectively utilised in finalising the assessments.
- The Ministry needs to strengthen its internal control and monitoring mechanism to ensure compliance with the instructions, rules, circulars and provisions of the Income Tax Act, 1961.

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

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.

Audit observed areas with high revenue impact on account of systemic issues such as incorrect allowance of deduction without adjustment of losses and depreciation relating to eligible units, incorrect allowance of deduction on other income, benefit of deduction allowed to ineligible assessee, etc. Audit also observed cases with potential impact on levy of tax such as excess deduction due to non restriction of profits to the reasonable profit derived from captive power plants, etc. Audit study also 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 into account deductions under section 80IA.

#### **Audit recommends that:**

- The Ministry may consider making it mandatory for the assessee availing of 80IA deduction to furnish separate accounts and audit report from the first year of commissioning of the eligible project even for those years in which the deduction was not claimed. Assessment orders should clearly specify the details of losses to be carried forward for set off in future years for the eligible and ineligible units separately.
- 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.
- 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.
- 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.