

# **CHAPTER I**

## **TAX ADMINISTRATION**

## Chapter Summary

- ◆ Direct taxes collections increased from Rs. 2,30,181 crore in 2006-07 to Rs. 3,33,818 crore in 2008-09 at an average annual rate of growth of 27.3 *per cent*.

**(Paragraph 1.3)**

- ◆ For every unit growth in GDP, direct taxes grew by 0.6 *per cent* only in 2008-09 reversing the trend of buoyancy in excess of one in earlier years. The deceleration in tax collection was thus sharper than that of GDP.

**(Paragraph 1.3.1)**

- ◆ The total number of direct tax assessees declined by 3 *per cent* in 2008-09 as compared to an increase by 7.6 *per cent* in 2007-08, with the decline being sharper for corporate assessees. Inability to retain the existing tax base was a matter of concern.

**(Paragraph 1.4)**

- ◆ 84 *per cent* of the collections came in by way of voluntary compliance, thus moving towards international practice of greater reliance on self-assessment in tax administration.

**(Paragraph 1.6)**

- ◆ The department achieved greater efficiency in completion of scrutiny assessments cases, bringing down pendency from 54 *per cent* in 2006-07 to 44 *per cent* in 2008-09.

**(Paragraph 1.7)**

- ◆ Cost of collection rose from 0.6 *per cent* in 2007-08 to 0.7 *per cent* in 2008-09 because of deceleration in tax collection and increase in establishment cost.

**(Paragraph 1.10)**

- ◆ 84 *per cent* of the targeted audits were completed by Internal Audit. Mistakes detected in the assessments previously checked in Internal Audit indicate a need for improvement in the quality of Internal Audit. Departmental response to Internal Audit was clearly inadequate.

**(Paragraph 1.13)**

## CHAPTER I

### TAX ADMINISTRATION

#### 1.1 INTRODUCTION

Direct taxes levied by Parliament mainly comprise:

- **Corporation tax** on companies which constitutes 64 per cent<sup>1</sup> of direct tax collection. The corporates also pay **wealth tax** on the assets owned by them. In addition, tax is payable on **capital gains** made on the sale of assets.
- **Personal Income tax** which is required to be paid if the income level reaches above Rs. 1.50 lakh<sup>2</sup>.

**1.1.1** Other direct taxes include **Fringe Benefit tax**<sup>3</sup> and **Securities Transactions Tax**<sup>4</sup>.

**1.2** The organizational structure of the Income-tax Department is at Appendix-1. Table 1.1 provides a snapshot of tax administration.

**Table 1.1: Tax Administration**

| <b>1. Collection<sup>5</sup> (Rs. in crore)</b>      | <b>2006-07</b> | <b>2007-08</b> | <b>2008-09</b> |
|--|----------------|----------------|----------------|
| i) Corporation Tax                                   | 1,74,935       | 2,23,941       | 2,42,304       |
| ii) Income Tax                                       | 81,697         | 1,12,910       | 1,16,225       |
| iii) Other Taxes                                     | 10,784         | 16,647         | 14,386         |
| iv) Total Gross Collection                           | 2,67,416       | 3,53,498       | 3,72,915       |
| v) Refunds   | 37,235         | 41,285         | 39,097         |
| vi) Net Collection                                   | 2,30,181       | 3,12,213       | 3,33,818       |
| Refunds as % of gross collection                     | 14             | 12             | 10             |
| Tax-GDP Ratio  | 5.6            | 6.6            | 6.3            |
| Buoyancy <sup>6</sup>                                | 2.6            | 2.5            | 0.6            |
| <b>2. Assessee profile<sup>7</sup> (No. in lakh)</b> |                |                |                |
| i) Non-corporate assessees                           | 308.9          | 331.7          | 323.2          |
| ii) Corporate assessees                              | 4.0            | 4.9            | 3.3            |
| <b>Total</b>   | <b>312.9</b>   | <b>336.6</b>   | <b>326.5</b>   |

<sup>1</sup> for the financial year 2008-09

<sup>2</sup> The base above which income tax is payable is revised from time to time. It is Rs. 1.5 lakh for the assessment year 2009-10

<sup>3</sup> Tax on the value of certain benefits offered by the employers to their employees. Fringe Benefit Tax will be abolished from the assessment year 2010-11 onwards.

<sup>4</sup> Tax on the value of taxable securities purchased and sold through a recognized stock exchange in India

<sup>5</sup> Source: Tax collection figures – Pr. CCA, CBDT, New Delhi.

GDP – CSO, Press release dated 29 May 2009.

<sup>6</sup> Tax buoyancy is measured by the ratio of percentage change in tax revenues to percentage change in GDP

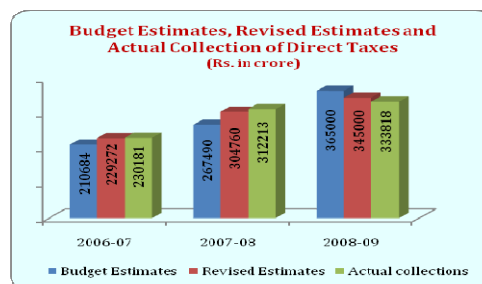
<sup>7</sup> Source : Directorate of Income Tax (Legal & Research), Research & Statistics Wing

|  |                     |                     |                     |
|--|---------------------|---------------------|---------------------|
| <b>3. Filing gap<sup>8</sup></b>                                       |                     |                     |                     |
| i) No. of PAN card holders <sup>9</sup>                                | 519.5               | 648.5               | 807.9               |
| ii) No. filing returns   | 313.0               | 336.6               | 326.5               |
| iii) Filing gap  | 206.5               | 311.9               | 481.4               |
| <b>4. Stages of collection (Rs. in crore)</b>                          |                     |                     |                     |
| <b>Pre-assessment</b>  |                     |                     |                     |
| i) Tax deducted at source  | 70,689              | 1,04,741            | 1,28,230            |
| ii) Advance tax  | 1,21,227            | 1,58,120            | 1,43,332            |
| iii) Self assessment tax   | 13,825              | 21,125              | 30,779              |
| <b>Total pre-assessment collection</b>                                 | <b>2,05,741</b>     | <b>2,83,986</b>     | <b>3,02,341</b>     |
| <b>Post-assessment collection</b>                                      |                     |                     |                     |
| Regular assessment   | 30,396              | 25,720              | 21,337              |
| Other receipts   | 20,495              | 27,145              | 34,851              |
| <b>Total post-assessment collection</b>                                | <b>50,891</b>       | <b>52,865</b>       | <b>56,188</b>       |
| <b>Pre-assessment as % of total gross collection(minus Wealth tax)</b> | <b>80.2</b>         | <b>84.3</b>         | <b>84.3</b>         |
| <b>5. Position of scrutiny assessments (Number)</b>                    | <b>2006-07</b>      | <b>2007-08</b>      | <b>2008-09</b>      |
| i) Assessments due for disposal  | 5,27,005            | 9,97,813            | 9,53,767            |
| ii) Assessments completed (%)  | 2,41,983<br>(45.9)  | 4,07,239<br>(40.8)  | 5,38,505<br>(56.5)  |
| iii) No. of officers deployed for assessment duty                      | 3954                | 3218                | 3106                |
| <b>6. Efficiency of collection<sup>10</sup> (Rs. in crore)</b>         |                     |                     |                     |
| i) Demand of earlier year's pending collection                         | 86,203              | 86,859              | 93,344              |
| ii) Current year's pending demand                                      | 31,167              | 37,415              | 1,07,932            |
| <b>Total</b>   | <b>1,17,370</b>     | <b>1,24,274</b>     | <b>2,01,276</b>     |
| Actual collection  | 2,30,181            | 3,12,213            | 3,33,818            |
| <b>7. Tax Recovery Officers</b>  |                     |                     |                     |
| <b>i) Total certified demand (Rs. in crore)</b>                        | <b>35,225.26</b>    | <b>36,057.56</b>    | <b>31,496.82</b>    |
| ii) Certified demand recovered (%)                                     | 8,521.40<br>(24.2)  | 8,612.62.<br>(23.9) | 4,035.80<br>(12.8)  |
| iii) Certified Demand pending (%)                                      | 26,703.86<br>(75.8) | 27,444.94<br>(76.1) | 27,461.02<br>(87.2) |
| <b>8. Cost of collection (Rs. in crore)</b>                            |                     |                     |                     |
| <b>i) Total direct tax collection</b>                                  | <b>2,30,181</b>     | <b>3,12,213</b>     | <b>3,33,818</b>     |
| <b>ii) Total cost of collection (%)</b>                                | <b>1,343 (0.6)</b>  | <b>1,713 (0.6)</b>  | <b>2,268 (0.7)</b>  |

### 1.3 GROWTH IN COLLECTION

There has been a robust growth in collection of direct taxes in the last three years, as it increased from Rs. 2,30,181 crore in 2006-07 to Rs. 3,33,818 crore<sup>11</sup> in 2008-09 at an average annual rate of growth of 27.3 per cent. Global

Chart 1.1: Growth in collection



<sup>8</sup> Every individual or Hindu undivided family or an association of person or body of individuals, if their total income exceeded Rs. 1,50,000 for the assessment year 2009-10 shall furnish the return of their income. In case of every company or firm shall furnish return of income or loss for every previous year.

<sup>9</sup> Source: Directorate of Income Tax (Systems), New Delhi

<sup>10</sup> Source: CAPI Demand & Collection Statement along with Analysis for the month of March 2009

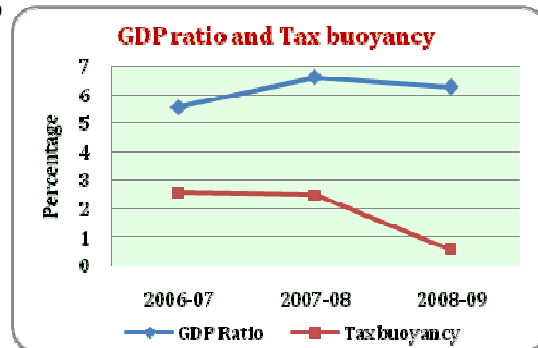
<sup>11</sup> Head wise/State/UT wise break up of direct tax collection is given in Appendix-2

recession and economic slowdown in 2008-09 had an impact on actual collections which were lower (by 8.5 *per cent*) than the budget estimates. This bucked the trend in earlier years (2006-08) when the collections exceeded the budget projections (Chart 1.1).

### 1.3.1 TAX-GDP-RATIO AND TAX BUOYANCY

Tax-Gross Domestic Product (GDP) ratio in 2008-09 also reduced from 6.6 *per cent* in 2007-08 to 6.3 *per cent* in 2008-09. For every unit growth in GDP, direct taxes grew by 0.6 *per cent* only in 2008-09 (Chart 1.2) reversing the trend of buoyancy<sup>12</sup> in excess of one in earlier years. The deceleration in tax collection was thus sharper than that of GDP.

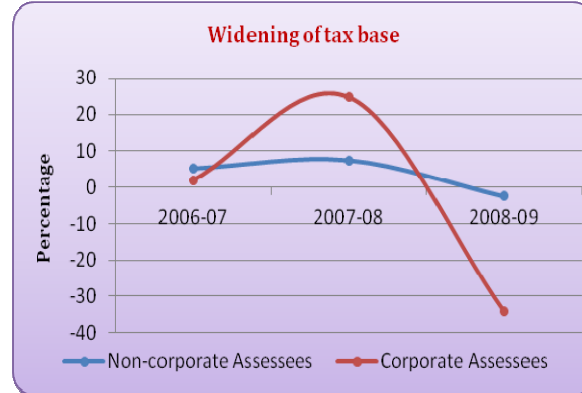
Chart 1.2: GDP ratio and Tax buoyancy



### 1.4 WIDENING OF TAX BASE

The taxpayer base grew over the last five years from 271.8 lakh taxpayers in 2004-05 to 326.5 lakh taxpayers in 2008-09 at the rate of 20.2 *per cent*. But, in 2008-09, the number of assessees declined by 3.0 *per cent* as compared to an increase by 7.6 *per cent* in 2007-08. The decline

Chart 1.3: Widening of tax base



was sharper among corporate assesseees (Chart 1.3), indicating, *inter alia*, stop-filing, which would need to be reviewed by the Board.

The decline was at variance from the accepted notion that simple tax laws and lower tax rates promote better tax compliance. It is a matter of concern that the Department which is otherwise aiming towards widening the tax base had not managed to retain the existing tax base. Evidently, the department is not utilizing the mechanisms available to widen the tax base. These include inspection and survey, information sharing with other tax departments and third party

<sup>12</sup> Buoyancy is measured by the ratio of percentage change in tax revenues to percentage change in GDP.

information available in annual information return. Automation also facilitates greater cross linking<sup>13</sup>.

#### 1.4.1 FILING GAP

Filing Rate and Non-Filing Rate<sup>14</sup>, being assessed in modern tax administrations, has not yet been done in India.

The Permanent Account Number (PAN) allotted<sup>15</sup> to a taxpayer, is the unique identification number that helps track individual tax compliance. There were 807.9 lakh PAN cardholders as on 31 March 2009, of whom only 326.5 lakh assesseees had filed their return of income relevant to the financial year 2008-09. This gap of 481.4 lakh assesseees was considerably higher than the corresponding figure (by 10 lakh assesseees) in 2007-08. The Board should identify the reasons for large-scale stop-filing or non-filing.

1.4.2 There were 7.5 lakh working<sup>16</sup> companies in the country registered with Registrar of Companies (ROC) as on 31 March 2009. However, the corporate assesseees on the Income-tax department's records are only 3.3 lakh, leaving an un-reconciled list of 4.2 lakh companies. The Ministry intimated (January 2009) that this gap could be because the "non-filers" had not started their business or because they did not have any income during the said period. It added that the Board would be advised to reconcile the discrepancy for accurate assessment of the filing gap.

#### 1.4.3 RELATIVE SHARE IN COLLECTION

The three major States (Chart 1.4) of Maharashtra, Karnataka and Delhi had contributed more than 3/4<sup>th</sup> of total direct tax collection in 2008-09; in 2007-08, their contribution was 2/3<sup>rd</sup> of the total collection. The increase in their relative share was because of robust buoyancy in tax collection (9.2 *per cent*) recorded in Karnataka. On the other hand, Delhi registered 23 *per cent* decline in collection in 2008-09 over the previous year.

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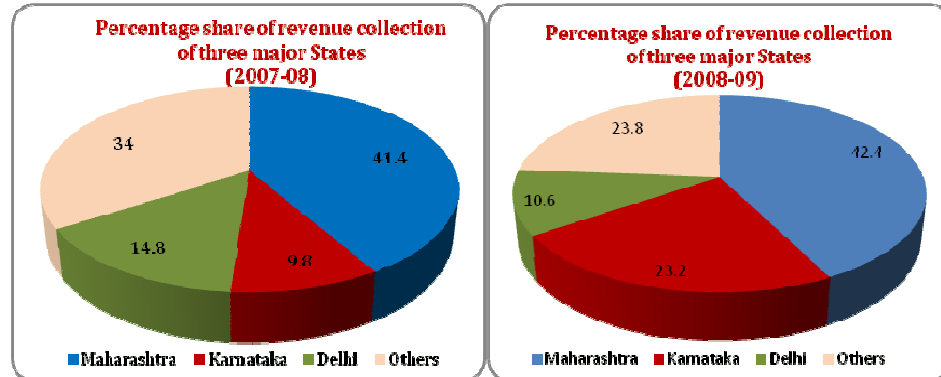
<sup>13</sup> Information about non-filers of TDS returns from e-TDS, Annual comparative figures of TDS deposited by big corporate & non-corporate deductors, Linking TAN data in order to ensure better compliance from them, linking tax returns with the PAN data base and linking return submitted by deductors on TDS deductions with the returns of the deductee.

<sup>14</sup> defined as the percentage of the taxpayer population with a filing requirement that filed timely returns and the amount of unpaid taxes due from delinquent and non-filed returns respectively.

<sup>15</sup> PAN is issued by the department, but the front-end of the process has been outsourced to UTI Technology Services Ltd. (UTITSL) and the National Securities Depository Ltd. (NSDL) with effect from 1 July 2003.

<sup>16</sup> Out of a total of 7.8 lakh companies, 0.3 lakh were reported to have gone into liquidation, leaving a balance of 7.5 lakh working companies

Chart 1.4: Relative-share in collection



Growth in collection was unevenly spread across the country. Only 7 states<sup>17</sup> have had positive growth in tax collection in 2008-09 vis-a-vis 2007-08. Karnataka and West Bengal (details in Appendix-2A) had a growth of more than 100 *per cent* as compared to that of the previous year. The reason(s) for growth of more than 100 *per cent* in respect of these two states needs to be examined since it could well be due to change in the accounting methodology. The issue is especially significant in view of the negative growth in Direct Taxes collections in the other states during the same period.

## 1.5 EFFECTIVE RATE OF TAXATION

The effective tax rate for companies<sup>18</sup> was 22.2 *per cent* in 2007-08<sup>19</sup> which was substantially lower than the statutory tax rate of 33.9 *per cent*. 190 companies with profits before taxes (PBT) of Rs. 500 crore and above accounted for 54.9 *per cent* of the total PBT and 54 *per cent* of the total corporate tax payable. However, their effective tax rate was only 21.9 *per cent* while the effective tax rate was 24.1 *per cent* for companies having PBT of upto Rs. one crore. This shows that tax concessions are being availed of mainly by large companies.

The effective tax rate of public sector companies (PSUs) in 2007-08 was 25.7 *per cent* as against 21.3 *per cent* for private companies. It is evident that the public companies bear a larger tax burden than their private counterparts (Table 1.2). Thus, the private sector enjoys much larger tax concessions from the Government as compared to public sector. The gap of effective rate of taxation between the private sector and public sector undertakings needs to be reviewed at the Board level.

<sup>17</sup> Arunachal Pradesh, Karnataka, Maharashtra, Tripura, West Bengal, A&N Islands and Puducherry

<sup>18</sup> Source: Receipts Budget 2009-2010

<sup>19</sup> The effective tax rate was 20.60 *per cent* in 2006-07.

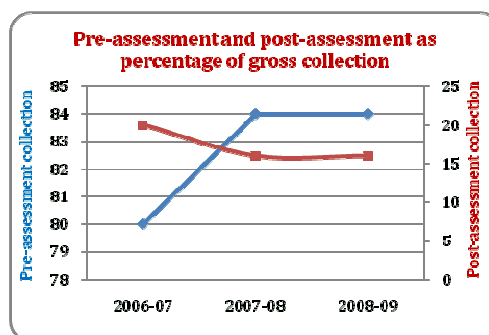
**Table 1.2<sup>20</sup> : Analysis of total taxable profits and effective rate of tax**

| Sector       | Number        | Share in total profits (in %) | Share in total tax payable (in %) | Effective rate of tax (in %) |
|--------------|---------------|-------------------------------|-----------------------------------|------------------------------|
| Private      | 407765        | 78.4                          | 75.1                              | 21.3                         |
| Public       | 1808          | 21.6                          | 24.9                              | 25.7                         |
| <b>Total</b> | <b>409573</b> | <b>100.00</b>                 | <b>100.00</b>                     | <b>22.2</b>                  |

## 1.6 EXTENT OF VOLUNTARY COMPLIANCE

84 *per cent* of the gross collections in 2008-09 were by way of voluntary compliance by assesseees (pre-assessment stage). Most developed countries aim to maximize the amount of tax collected through voluntary compliance; the compliance rates ranging<sup>21</sup> from 95 *per cent* in Sweden to 89 *per cent* in United Kingdom.

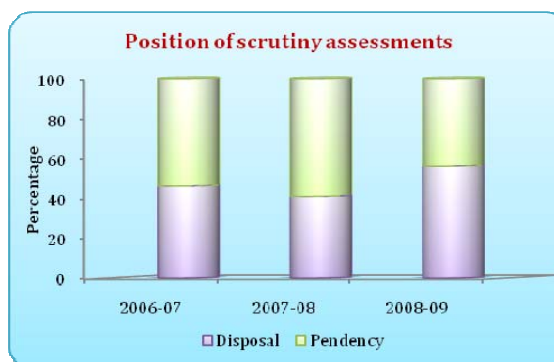
**Chart 1.5: Extent of voluntary compliance**



## 1.7 POSITION OF ASSESSMENT

High-risk tax returns are selected and examined with reference to collateral data by the assessing officers (AOs) in scrutiny assessments. Out of the total 9.5 lakh scrutiny assessments cases for disposal (Chart 1.6), the department had disposed off 5.4 lakh (56 *per cent*) cases in 2008-

**Chart 1.6: Position of assessment**



09. This was an improvement over the 46 *per cent* disposal achieved in 2006-07 and 41 *per cent* in 2007-08. As a result, the pendency came down from 54 *per cent* in 2006-07 to 44 *per cent* in 2008-09.

Working norms of officers deployed for assessment and non-assessment duty needs to be framed up so that qualitative content of the tax scrutiny can be improved alongwith improving the pendency status of cases. Based on the data made available to audit, 47 *per cent*

<sup>20</sup> Data collated from the income tax returns.

<sup>21</sup> Source: Report on Organisation for Economic Co-operation and Development (OECD)

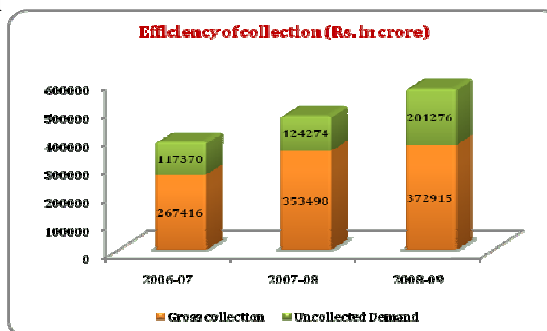


of the working strength of officers<sup>22</sup> was deployed on assessment duty and rest of officers were on other administrative duties.

### 1.8 EFFICIENCY OF COLLECTION

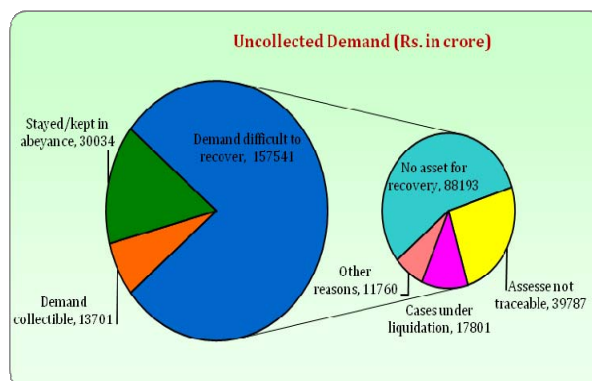
Gross tax collection as a percentage of the total demands raised in assessments (Chart 1.7) had shown an increasing trend from 69 per cent in 2006-07 to 74 per cent in 2007-08. In 2008-09, however, there was a decline to 65 per cent and Rs. 2 lakh crore remained uncollected. This comprised demand of Rs. 0.9 lakh crore of earlier years and current demand (2008-09) of Rs. 1.1 lakh crore. One group (Hasan Ali) alone accounted for Rs. 71,874 crore of uncollected demand.

Chart 1.7: Efficiency of collection



Various reasons contributed to the uncollected demand (Chart 1.8). 53 per cent was because there was no asset for recovery or the companies were under liquidation.

Chart 1.8: Details of uncollected demand



Defaults in payment of tax are referred to the Tax Recovery Officers (TROs) who draw up a certificate specifying the amount of arrears due from the assessee and proceed to recover the amount. The recovery mechanism is inefficient as 87 per cent of the certified demand has remained uncollected in 2008-09; the figure stood at 76 per cent in 2006-07 and 2007-08.

Board should frame up a time bound action plan for recovery of current and arrears demands by fixing target for each assessing officer.

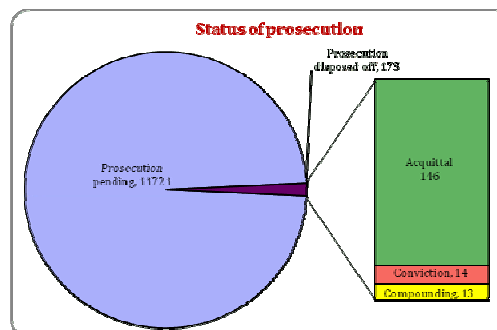
<sup>22</sup> against the working strength of 6,679 officers in the cadres of Addl. CIT/Addl DIT/Joint CIT/Joint DIT, Dy. CIT/Dy. DIT/Assistant CIT/Assistant DIT and ITOs, only 3,106 officers (47 per cent) of these cadres were deployed on assessment duty.

When tax demands remain irrecoverable for a longer period inspite of exercise of the powers of recovery conferred under the Act, write off of such arrears should be considered as per instructions laid down on the subject. Recovery proceedings can be made effective by increasing the accountability of the TROs and incentivizing achievements.

### 1.9 STATUS OF PROSECUTION

The department had launched prosecutions in 11,894 cases of evasion upto 2008-09. Only 173 cases (1.5 per cent of the total cases) were disposed off, of which 146 cases resulted in acquittal (Chart 1.9). The high rate of acquittal needs to be analysed to ensure greater effectiveness of prosecution as a deterrent.

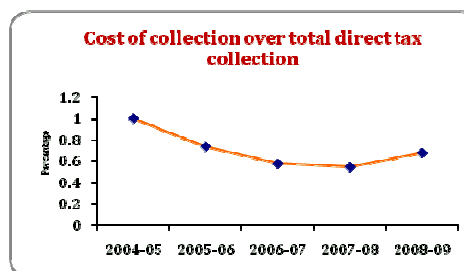
Chart 1.9: Status of prosecution



### 1.10 COST OF COLLECTION OF TAXES

Total cost of direct tax collection (Chart 1.10) showed a decreasing trend from 1.00 per cent in 2004-05 to 0.6 per cent in 2007-08. In 2008-09, the costs rose because of deceleration in tax collection and increase in establishment cost.

Chart 1.10: Cost of collection of taxes



### 1.11 REFUNDS CASES AND INTEREST PAID ON REFUNDS

Where the amount of tax paid exceeds the amount of tax payable, the assessee is entitled to a refund of the excess amount. Simple interest at the prescribed rate<sup>23</sup> is payable on the amount of such refund. Refund is also admissible (alongwith interest) as a result of any order passed in appeal or other proceedings. 'Refunds' have been examined separately and our findings have been featured in the Performance Audit Report No. 7 of 2009-10.

<sup>23</sup> Fifteen per cent per annum on the amount of refund due from the date immediately following the expiry of the period of three months aforesaid to the date on which the refund is granted.

### 1.12 APPEALS, REVISION PETITION AND WRITS

If the assessee is not satisfied with the assessment or refund order, he can file an appeal with the Commissioner (Appeals) and thereafter with the Income Tax Appellate Tribunal (ITAT). On any question of law arising out of such order, the assessee can also appeal to the High Court and Supreme Court. The Act prescribes the time limits also for disposal of an appeal. The appeal process is a subject matter of another study being conducted by us and will, therefore, be dealt with in a separate report.

### 1.13 INTERNAL AUDIT

Internal audit is an important part of the departmental control that provides the assurance that demands/refunds are processed accurately by correct application of the provisions of the Act.

Internal audit wing had planned 1,51,800 cases for audit during 2008-09 based on the working strength of wing. 84 *per cent* of the target was achieved. However, we detected numerous observations in the assessments previously audited by Internal Audit. This indicates a need for improvement in the quality of Internal Audit.

Internal audit had raised 24,165 observations in the audited assessments with money value of Rs. 3,738.62 crore. Based on the reply from assessment units, the internal audit had settled 2,866 cases (12 *per cent*) with money value of Rs. 334.48 crore.

In 342 draft paragraphs cases issued to the Ministry in 2008-09, only 17 cases (4.9 *per cent*) were seen by internal audit and no mistakes were detected by them, which indicates need for improvement in quality of audit.

Departmental response to internal audit needs improvement. Remedial action was being taken only on current year's findings. Only 10.4 *per cent* of the major findings raised by internal audit were acted upon by the assessing officers. The total pendency of 21,299 cases had tax effect of Rs. 340.2 crore.