

CHAPTER 4

ISSUES LEADING TO DISPUTES

Sector analysis

**Appeals of PSU banks referred
to COD**

Case studies

Recommendations

Chapter 4 Issues leading to disputes

Lack of clarity in the provisions of the Act introduces subjectivity in the assessments, which leads to disputes. Deviations from prescribed procedures by the AOs also contribute to disputes.

4.1 In our study on shipping sector⁴⁴, we found that ambiguity and inconsistency on issues relating to port trusts, had led to tax dispute amounting to Rs. 756 crore.

The income of port trusts was previously exempt from income tax as they were deemed to be local authorities. Since 2003-04, there is no consistency on the status of the port trusts. The issue of quantifying the written down value (WDV) of assets purchased and put to use prior to 2003-04 when port trusts were not taxable, led to most of the disputes, which were escalated by the Department. The Act was amended (2008) to clarify that WDV in the books of accounts would be the deemed depreciation that will be allowed for the purpose of income tax. However, no action had been taken by the Department to settle the past disputes despite such a large quantum of demands locked-up on this account.

4.2 We attempted a sectoral analysis to identify the provisions which are leading to disputes. The absence of a reliable database that captures appeals sectorally was a limitation. We analysed 517 pending appeals spread across 39 sectors with a total disputed tax of Rs. 3,392.9 crore. 155 appeals in Karnataka constituting 30 *per cent* of the appeals filed related to software industry; the disputed tax constituted 68 *per cent* of the total tax disputed. The main issues involved related to sections dealing with exemption on exports and business in free trade zones⁴⁵.

4.3 The data on appeals relating to PSU banks referred to the COD during three years (January 2004 to December 2007) provided a reference point (Table 4.1) for analysis. In three years, 118 references were made in respect of 10 banks, averaging to 3 disputes per bank every year. We selected a few banks for further analysis.

Table 4.1: Cases referred to COD

Bank	No of cases referred to COD
Andhra Bank	6
Bank of Baroda	8
Bank of India	12
Bank of Maharashtra	6
Syndicate Bank	24
Canara Bank	18
Dena Bank	12
Punjab National Bank	13
State Bank of India	11
UCO Bank	8

⁴⁴ Paragraph 1.10.3 of Report of the CAG on Union Government (Direct Taxes) No. PA 25 of 2009

⁴⁵ Under sections 10A, 10B, 80HHC and 80HHE

4.4 In Karnataka, the Department referred 42 disputes to COD relating to Syndicate Bank and Canara Bank in which a staggering amount of Rs. 5,435 crore was involved. The disputes occurred repeatedly on two main issues: chargeability of income tax on interest tax recovered from customers and interest on sticky loans treated as income. The COD denied permission in 12 cases relating to Syndicate Bank and in 6 cases of Canara Bank. But the cases rejected by COD, did go to CIT (A) straining the system at that level. In Delhi, 13 disputes (disputed tax: Rs. 480 crore) relating to Punjab National Bank were referred by the Department to COD, the main issue being additions made on income on account of disallowance of expenditure⁴⁶ incurred to earn income exempted from tax under the Act. Repeated disputes on the same issue, call for a sectoral analysis and decisive action to remove ambiguities.

4.4.1 The Ministry stated (July 2010) during the exit conference that a system is being developed internally by which a database would be created with details of the decisions of the COD, which would be accessible to the AOs.

4.5 Two case studies also illustrate the need for the Department to conduct an evaluation on the efficacy of the provisions in the light of their preponderance to being disputed and set aside at the first stage of appeal.

Case study I

We took a sample of 14 appeals against the penalties⁴⁷ (total: Rs. 322 crore) imposed by AOs in Delhi charge. The CIT (A) decided in favour of the taxpayer in 13 cases. The one appeal that was decided against the assessee, was contested by him in the ITAT which deleted the penalty, but the Department appealed to the HC against the ITAT order.

The Department filed appeals with the ITAT in nine⁴⁸ out of the 13 appeals. ITAT dismissed the appeals in five cases. The remaining four cases are pending. Department further appealed to the HC in three cases⁴⁹; the one case decided by the Court went in favour of the assessee. This too was contested by the Department in SC, on which a decision is awaited.

The Act grants considerable discretionary powers to the AO in deciding the incidence and the quantum of penalty. It is the subjectivity inherent in the exercise of this power that leads to appeals in which the penalty becomes unsustainable. The repeated failures in appeals did not deter the Department

⁴⁶ Under Section 14A

⁴⁷ Under section 271(1) (c)

⁴⁸ It did not contest the CIT(A) decision in 4 cases.

⁴⁹ It did not contest the ITAT decision in one case.

from further appeals without analysing the reasons for failure. The deterrent effect of penalty undoubtedly stands compromised in this situation.

The Ministry stated (July 2010) during the exit conference that the AOs are being given training at institutional level and the analysis of such cases is a continuous process.

Case Study II

15 appeals in Delhi charge were on additions made by AOs on income on account of disallowance of expenditure⁵⁰ (Rs. 254 crore) incurred to earn income exempted from tax under the Act. CIT (A) deleted additions of Rs. 237 crore in ten cases. The Department went in appeal before the ITAT in eight cases involving addition of Rs. 202 crore. The ITAT too decided four cases in favour of the assessee deleting the additions of Rs. 13 crore; the remaining cases were yet to be decided. The Department filed appeals in two cases⁵¹ to the HC which further deleted the amount. Thus out of the total additions amounting to Rs. 254 crore, additions amounting to Rs. 250 crore were deleted in different stages of appeals.

The methodology for computing the additions on exempted income has not been laid down on an objective basis. The subjectivity in the process makes such cases unsustainable in appeals. Yet, the Department opts for repeated appeals.

4.6 We found that technical lapses by the AOs also lead to appeals. 17 appeals in our sample involving tax of Rs. 447.8 crore occurred because of these lapses.

Charge: CIT-LTU, Mumbai, Maharashtra; AYs: 1992-93 to 1994-95
Assessee: Industrial Development Bank of India Limited

The assessments for the three years were revised/re-assessed after the prescribed time limit in the Act. The assessee appealed against the orders with ITAT, which quashed the orders on account of time barring. The tax revenue involved in this case was Rs. 307.9 crore. The Department further escalated the dispute on two appeals to the HC.

The Ministry stated (July 2010) that reopening was quashed on legal issue and not due to time barring. However, the orders of ITAT clearly mention time barring as the reason for quashing the reopening.

Charge: CIT-3, Mumbai, Maharashtra; AY: 1996-97
Assessee: ICICI Bank Limited

⁵⁰ Under section 14A

⁵¹ Department did not contest the deletion of additions by the ITAT amounting to Rs. 13.41 crore in two cases.

The CIT revised⁵² (March 2003) the assessment, which was given effect by the AO by raising a demand for Rs. 158.1 crore. The ITAT, without going into the merits of the case, quashed (September 2008) the order on the ground that it was barred by limitation, based on which the amount was refunded.

4.7 Recommendations

We recommend a sectoral analysis of disputes to identify frequently disputed provisions of the Act. This can serve as a template while finalising the provisions of DTC.

The Ministry stated (July 2010) that the Central Appeal Registry and National Judicial Reference System will facilitate such analysis.

There is a need to remove ambiguities in the provisions of the Act to reduce the use of discretion by the AOs. The penal provisions of the Act, for instance, require a re-look, since the deterrent edge to these provisions is being blunted due to inability to sustain the penalty orders in appeals.

The Ministry stated (July 2010) that these are discussed at various forums towards a cohesive approach.

A databank of cases in which permission is not granted by COD containing details on the disputed provisions of the Act may be created so that similar cases are not pursued or referred to COD.

The Ministry stated (July 2010) that such a database will also form part of National Judicial Reference System.

Responsibility must be fixed on AOs for technical or procedural lapses that drag the Department to needless litigation.

The Ministry stated (July 2010) that responsibility is fixed and necessary action taken, wherever needed.

The DTC seeks to change the very basis of exemptions. After its operationalisation, the only purpose behind continuation with the disputes could be the realisation of revenue as no substantial clarification on law would be necessary. Hence it may be useful if a process of plea bargaining [in the form of Kar Vivad Samadhan Scheme] is considered.

The Ministry accepted (July 2010) the recommendation.

⁵² Under section 263 of the Act.