**CHAPTER 3**

Refunds Process and Internal Controls

The refund process starts with the submission of claim by the assessee in annual income tax returns. The AO determines the refund amount and dispatches the refund voucher through authorised banks. Benefits of the controls available in the ITD applications towards referencing and reconciliation of information prior to making refunds are not being utilised appropriately. The controls provided by automation are compromised because of glitches in the flow of data across the system. The AOs have not integrated automated controls in their regular work. In the meanwhile, manual procedures are falling into disuse, thereby creating additional risks. Exercise of supervisory controls provided in checking the accuracy of refunds and by way of administrative approvals in high value refunds, is inadequate. Interest on belated refunds of excess tax is being incorrectly accounted as reduction of revenue instead of being correctly budgeted as an expenditure item. The incorrect accounting practice also leads to interest payments escaping legislative scrutiny despite being a charge on the Consolidated Fund of India and needs to be rectified.

3.1   Chart 3.1 outlines the processes involved in refund.

Chart 3.1: Flow of refund to the assessee
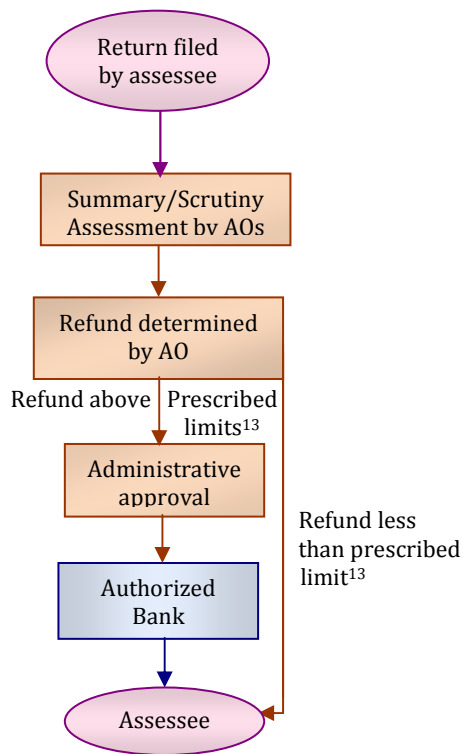
Tips for individual assessees claiming refund

• Correct particulars including PAN, bank account details etc. should be filled up.

• Work out the income and tax correctly for the relevant assessment year. In case of any difficulty, the tax payer should take the help of a Tax Return Preparer (TRP).

• Furnish correct PAN to the deductor and verify the tax deposited to the government on the website (https://www.tin-nsdl.com/).

• Keep the bank and the income tax department informed about any change of any particulars.

• Submit the return in time (normally, last date of filing of return is 31 July).

• The advance tax should be paid in time[12].

• Check status of refund on website (https://tin.tin.nsdl.com/oltas/refundstatuslogin.html).

• Refund cheque received should be submitted to the bank immediately to avoid expiry.

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[12] 30 *per cent* upto 15 June, 60 *per cent* upto 15 December and & 100 *per cent* upto March of the financial year immediately preceding the relevant AY. Concept of AY and previous year are proposed to be done away with in the new Draft Tax Code.

[13] The limits for administrative approval of supervisory officers as decided by the CCIT/DGIT as per paragraph 1 (iv) of instruction of August 1999.

3.2   The goals of timely issue of accurate refunds can be achieved if the Department has a robust internal control mechanism that alerts it to problems on time to enable it to take timely measures to redress them. We divided internal controls in three categories: controls on cash flow; controls on timely issue of refunds; and controls that ensure accuracy in refund advice.

Controls on cash flow

3.3   One of the most important financial controls to mitigate frauds is regular bank reconciliation of cheques encashed with cheques issued. The manual system of reconciliation was cumbersome and was rendered impossible with mounting volume of transactions. On-line tax accounting through OLTAS[14] greatly facilitates the reconciliation. The details of the refunds encashed by the assessee at various banks, is communicated by the Reserve Bank of India (RBI) daily as part of the payment scrolls. The account is required to be reconciled with the respective Zonal Accounts Offices.

3.4   On receipt of the reconciled accounts, a Daily Refund Register (DRR) is prepared electronically at/by Regional Computer Centres (RCCs) and dispatched to the concerned Ranges for distribution among AOs. The AOs are required to tally the amount paid with the office copy of the refund vouchers and note the date of encashment in the space provided in the office copy of the voucher and in the Demand and Collection Register (DCR). Such reconciliation at various levels constitute an important check to detect encashment of bogus refunds.

3.5   However, the controls exercised through the online system have not been optimized because of large amounts lying in OLTAS suspense[15]. Invalid PANs are a major cause for transactions that remain unreconciled. For our study on timeliness of refunds (refer to paragraph 4.4), we requested for details of the encashment of 9737 refund vouchers. The Department confirmed payment in 4291 cases. It informed that 177 cases remained unpaid and could not confirm payment for 5269 cases (representing 54 *per cent* of the sample) as 'no data was found' with them. Evidently, reconciliation is rendered difficult in such a milieu. Regular reconciliation at the head-end of the chain, ZAO-NSDL[16], is a vital artery to its flow down to the level of the AO, which is impaired in this framework thus constituting high risk.

3.6   The automated system has clearly not stabilized and till such time it does, continuing with the manual systems of control becomes inevitable. We found that at the field level, office copies of the refund vouchers are not being maintained properly in

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[14] The Department has an Online Tax Accounting System (OLTAS) which allows check of refunds encashed by the taxpayers through the data uploaded by payee banks.

[15] The tax deposited by an assessee and credited to government account is put in a suspense head if it is not matched to the assessee's Permanent Account Number (PAN). Further details are at paragraph 3.22

[16] The accounting of both expenditure and revenue (Direct Taxes) on monthly basis is done through the Zonal Accounts Officers (ZAOs). National Securities Depository Limited (NSDL) hosts the Tax Information Network (TIN). ZAOs have been provided with the facility to access the NSDL site through which they can view the challans/scrolls uploaded to TIN and take up the matter with Banks/ITD if data loaded to TIN does not match the details reported to them through challans or scrolls.

many offices[17]. In some offices where they were being maintained, their maintenance was not proper. We also found that the DRR is either not maintained or, where it was kept, its maintenance was tardy[18].

3.7   Refund vouchers, duly filled and signed by the AO but not issued for any reason should be cancelled or revalidated in order to prevent its misuse under the signature of issuing authority. These instructions were not being followed in some offices[19].

6008 refund cheques issued in 24 circles/wards of CCsIT Jaipur, Udaipur and Jodhpur during 2005-06 to 2008-09 were returned due to wrong address or non-availability of assessee. We found that in most of the cases envelopes were not opened and refunds were lying without cancellation under the signature of AO. Register of refund cheques received back were also not maintained in these circles /wards.

In DCIT Circle-1, CIT Jamshedpur charge, we found that a few refund vouchers, duly filled and signed by the issuing authority but not issued, were kept without cancellation – a situation fraught with high risk.

3.8   In order to prevent the misuse of refund vouchers, a proper record of issue and utilization of refund book is required to be maintained. The refund book itself containing used or blank refund vouchers must be kept in safe custody. Proper handing over of the refund book should be ensured at the time of the change of incumbency of an office. We found that in 31 units in Rajasthan, stock register of refund voucher was not found maintained.

3.9   The Board issued (1989) instructions for quarterly verification from the office copies of advice notes as well as from the relevant entries in the Demand and Collection Register to find out the cases of paid foils not received within six months of the issue of the refund voucher in order to ensure that there was no fraudulent payment. We found that the verification process is largely in disuse[20].

3.10   We had earlier commented[21] that the government was following an incorrect procedure of accounting for interest paid on refunds. Interest payment is a charge on the Consolidated Fund of India and is, therefore, payable through a proper budgetary mechanism. Accordingly, Minor Head "interest on refunds" is to be operated under the Major Head "2020-Collection of Taxes on Income and Expenditure". However, no

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[17] Andhra Pradesh, Bihar (19 cases), Chandigarh UT, Jharkhand, Orissa (212 cases), Punjab, Rajasthan, Tamil Nadu and West Bengal (out of 211 cases not properly maintained in most of the cases).

[18] in Chandigarh (UT), Haryana, Jammu & Kashmir, Jharkhand, Maharashtra (Out of the selected 132 circles/wards, 21 circles/wards confirmed that the daily refund register were not maintained, 94 circles/wards did not produce the said register and 17 circles/wards not properly maintained the above register), Orissa, Rajasthan and Uttar Pradesh except West Bengal charges

[19] In Jharkhand and Rajasthan

[20] There was no quarterly verification in the circles/wards selected for review in Andhra Pradesh, Bihar {except ITO Ward 2(2)}, Chandigarh UT, Gujarat (in 16 units out of 18 units), Haryana (except ACIT and ITO ward I Rohtak), Jammu & Kashmir, Jharkhand (records not furnished except CIT Dhanbad), Maharashtra (not done in 49 units and records not produced by 59 units), Orissa (records from 10 circles/wards not furnished), Punjab, Rajasthan, Tamil Nadu and West Bengal (in 10 units maintained records out of 51 units) charges.

[21] in Audit Reports of 2004, 2005, 2006, 2007, 2008 and 2009

budget provision for 'interest on refund' was made in the budget estimates for 2008-09 and the expenditure on interest on refunds amounting to Rs. 5,785 crore was treated as reduction in revenue. Accounting of interest on refund as reduction in revenue is incorrect as this interest was never collected in the first instance. Interest on belated refunds of excess tax should be budgeted as an expenditure item which, in fact, was done in the Budget Estimates 2001-02 when Rs. 92 crore was provided in the demand of 'Direct Taxes' under the Major Head '2020 – Collection of taxes on Income & Expenditure' towards interest on belated refund of excess tax. However, subsequently at the Revised Estimates stage the earlier practice of showing the interest on excess refund as deduct receipt was reverted to. The incorrect accounting practice which also results in interest payment escaping legislative scrutiny despite being a charge on the Consolidated Fund of India is still being followed and needs to be rectified.

Controls to stem delays

I   At the level of the Board

3.11   The Department assured the PAC that it would stem the delays by fixing targets in CAP and by monitoring the adherence to targets through monthly reports from field formations. The standards for time were actually relaxed from 4 months to six months (refer to paragraph 4.1). The delays we found in the process reflect adversely on the effectiveness of the monitoring mechanisms.

3.12   The monthly reports capture the delays from the stage of processing and do not track delays in processing itself. There is a need to watch the number of refund applications received and the time taken in processing of these cases in addition to the number of returns processed, refunds determined, refunds dispatched and refunds pending during the month as mentioned in the monthly report on refunds (MRR) for better monitoring of delays in disposal of refund applications.

II   In the field

3.13   In the manual system, various registers were maintained in order to exercise controls. Register of refund applications records the receipt and disposal of claims while the Demand & Collection Register is a master database used for recording all the details of the assessee with the details of the tax credits; demands due from him and the refunds issued to him. We found that the above registers that provided the controls were not being maintained in some offices[22].

3.14   An important step in curbing discretion of AOs, is that refunds claims must be taken up for processing chronologically from the date of filing returns. Such a system would be transparent and inspire the confidence of taxpayers, especially the small

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[22] Audit noticed in selected circles/wards in Bihar (in most of the units), Orissa and Rajasthan (in 33 out of 39 units) that the register of refund application was not maintained and in Chandigarh UT, Haryana, Orissa (10 units) and Rajasthan relevant entries were not made in the demand and collection register.

taxpayers. For not issuing refunds chronologically, various reasons were cited by AOs like shortage of space, invalid PANs delaying the processing of some returns, physical verification of TDS certificates where credits could not be found in OLTAS etc. It was also stated that refunds were being issued by and large chronologically except in those claims in which correlation is rendered difficult, which are then pushed to the end of the queue.

Controls on accuracy of advice

3.15   Refund vouchers prepared by a tax assistant are required to be checked by a supervisor before they are submitted to the AO for final checking and signature. But we found vouchers in Chandigarh and Jharkhand which did not have the signatures of the cheque writing person or of the supervisor.

3.16   Accuracy in refund advice is to be ensured by the AO by applying the following checks:

- Credits for the tax claimed to have been paid by the assessee[23] are verified;
- Refunds already issued have been considered;
- Verification of arrears and outstanding demands, if any, and
- Other details like period of interest, rates of tax etc. have been correctly computed and applied.

3.17   These checks when conducted manually were cumbersome and led to mounting pendency. With the processing of tax returns in the integrated computerized system of the Department, it was hoped that not only would the process be faster but also it would ensure accuracy since it would be system-driven. In 2004, electronic filing of income tax returns was introduced to obviate the need for data entry and thus further accelerate the processing of refund claims.

Risks during transition

3.18   During the transition stage after introduction of electronic filing in 2004, the assessee[24] was filing returns of income electronically through authorized e-return intermediaries. The intermediaries were to digitize the data in such returns and transmit the same electronically to the e-filing server. On successful validation of data structure and PAN, the Department would issue an on-line acknowledgement of the return. Signed paper return was also submitted to the AO affixing a printout of the online acknowledgement within 15 days. The Department made it mandatory to furnish the income tax return electronically for the corporate taxpayers (companies and firms requiring statutory audit) after 24.7.2006. Thus, during the transition period,

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[23] TDS data i.e. the base income on which TDS was deducted and the TDS remitted would also need to be captured so as to ensure that the income on which TDS credit is given has been offered for tax.
[24] any person, except Association Of Persons/Body of Individuals, who had been allotted a PAN

assessee was filing both electronic and paper returns. We noticed a few cases of double refunds.

Charge: CIT Thrissur, Kerala: AY: 2006-07

LFC Hire Purchase Co. Ltd. filed a manual return which was processed by ACIT, Circle (1), Palakkad, summarily to issue refund of Rs. 2.8 lakh in October 2006. In November 2006, the assessee filed the tax return electronically which was processed by ACIT, Range 2, Kochi to issue a refund, <u>once again</u>, in March 2008.

3.19   In Mumbai charge, double refund was issued in six cases, all of which came to notice when one of these assessees reported it[25]. The mistake occurred because the refund was first processed on AST and later issued through the refund banker scheme.

3.20   Although we did not find preponderance of double claims in our audit sample of refunds, the above instances are a pointer to the risks that the system was exposed to during transition. The computerized systems are yet to stabilize. The next big transition will be the centralised processing of returns after consolidating all 36 regional databases into a single database in the CPC (refer to paragraph 2.10) which will also issue refunds.

3.21   The shift of responsibilities from AOs to the CPC, bulk movement of records and dual methods of filing - manual and electronic filing, create risks which the Department must first identify to lay down clear instructions for mitigation.

Verification of credits

3.22   Banks upload the data relating to taxes through OLTAS. OLTAS provides details on challan number, nature of tax as well as the date of deposit; details that help the AO to verify the tax deposit claimed by the assessee in his refund claim. Several problems like inability to match the PAN[26] uploaded by the banks with the PAN database of the Department have led to a surge in tax credits lying in suspense accounts. OLTAS suspense as of March 2009 stood at Rs. 2762.8 crore[27]. This has considerably compromised the control that the AO could have exercised in the automated system. We did not get access to the system for checking this aspect. The AOs also could not provide an assurance on credits citing system difficulties that render confirmation of credits difficult.

3.23   During 2008-09, 42.4 *per cent* of the tax deposits at the pre-assessment stage was through Tax deducted at Source (TDS) by third party deductors, identified by the

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[25] Thereafter, the department had issued letters to all the 54 assessees whose returns were processed on AST and refund vouchers were generated by refund banker. Six assessees returned refund cheques that had been issued twice. The Department verified and found that 41 assessees had intimated non-receipt of double refund. However, the position in remaining seven cases could not ensured in audit.

[26] Each tax payer is identified through the Permanent Account Number (PAN) allotted by the Department. The PAN database resides in the Assessee Information System (AIS) module.

[27] The department is working towards putting in place a mechanism to facilitate greater compliance with regard to submission of returns by deductor as also to improve the tax details in the assessment records.

system through Tax deduction Account Number (TAN). TDS deductions are credited to the assessee's PAN account after the TDS returns submitted by the deductor (TAN) are processed through the e-TDS module.

3.24   In our audit of e-TDS (2008), we found that only 9.4 *per cent* of the TDS returns could be processed by the Department in Andhra Pradesh, Chennai, Delhi, Gujarat, Karnataka, Kolkata and Mumbai charges. The reasons were many but mainly because PAN of the deductees was either wrongly quoted by deductor in the TDS return or was not quoted at all[28]. The problem was compounded further by the incidence of invalid/ incorrect TAN/PAN quoted by assessee in the return. In such a scenario, the AO processing a refund claim cannot verify a TDS credit in the system and would have no other alternative but to call for the original TDS certificates[29] from the taxpayer, thus delaying the process, diluting the controls and causing inconvenience to the assessee.

Use of TDS certificates

3.25   We found that the controls required to be exercised while accepting TDS certificates were given a go-by. In 53 cases[30], TDS certificates ineligible for admission were accepted for processing refund of Rs. 30.2 crore. The practice exposed the Department to the risk of generation of inaccurate refunds as well as the risk of granting ineligible refunds.

3.26   Where an assessee claims refund on the basis of duplicate TDS certificate, the Department obtains an indemnity bond. This is to mitigate the risk of double claim of TDS credit. We found 15 cases[31] of refunds amounting to Rs. 23.5 crore where TDS credits were granted on duplicate copies of certificates without obtaining indemnity bonds. The practice is fraught with the risk of double claims.

Adjustment of refunds and demands

3.27   Excess refund granted is deemed to be tax payable by the assessee, to be recovered from him by way of adjustment or otherwise alongwith interest under Section 234D. The AOs are also instructed to ensure that all outstanding demands are first adjusted against the refund while determining the amount to be refunded. Section 245 requires that the assessee must be given a written intimation before adjusting his refund with outstanding demand.

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[28] TDS returns are accepted by the system if the threshold limit for PAN quoting (of deductees) was adhered to by the deductor. Threshold limit for and from quarter ending 31 March 2008 was 95 *per cent* for form no. 24Q

[29] TDS certificates are prepared by the deductor in triplicate: for the taxpayer, for the deductor himself and one for the AO. The AO calls for the original certificate from the tax payer to mitigate the risk of double claims.

[30] The refunds were inadmissible due to variety of reasons such as TDS certificates not in the favour of the assessee; they were defective such as challan number and TAN of the deductor not mentioned; relevant income not offered for tax; challan and TDS certificates not related to the assessment year etc. These were detected in Assam, Chandigarh UT, Chattisgarh, Haryana, Himachal Pradesh, Jammu & Kashmir, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and Uttarakhand charges.

[31] Bihar, Delhi, Himachal Pradesh, Jammu & Kashmir, Madhya Pradesh, Punjab and Rajasthan

3.28   The annual returns submitted by the taxpayer are processed in the module, Assessment Information System (AST). AST was designed to assist the AO in carrying out all assessment and related functions at various stages viz., assessments, re-assessments, rectification, penalty as well as monitor progress and post results in appeal, revision, in settlement commission and in prosecution. The results of such assessments would then flow to Individual Running Ledger Account (IRLA), another module that generates a comprehensive ledger covering assessment year-wise data on demands, collections and refunds for each assessee (PAN). Thus, the AO can use IRLA to verify past refunds and arrears in demands, if any, while processing a refund in AST.

Chart 3.1: Flow of Information in ITD
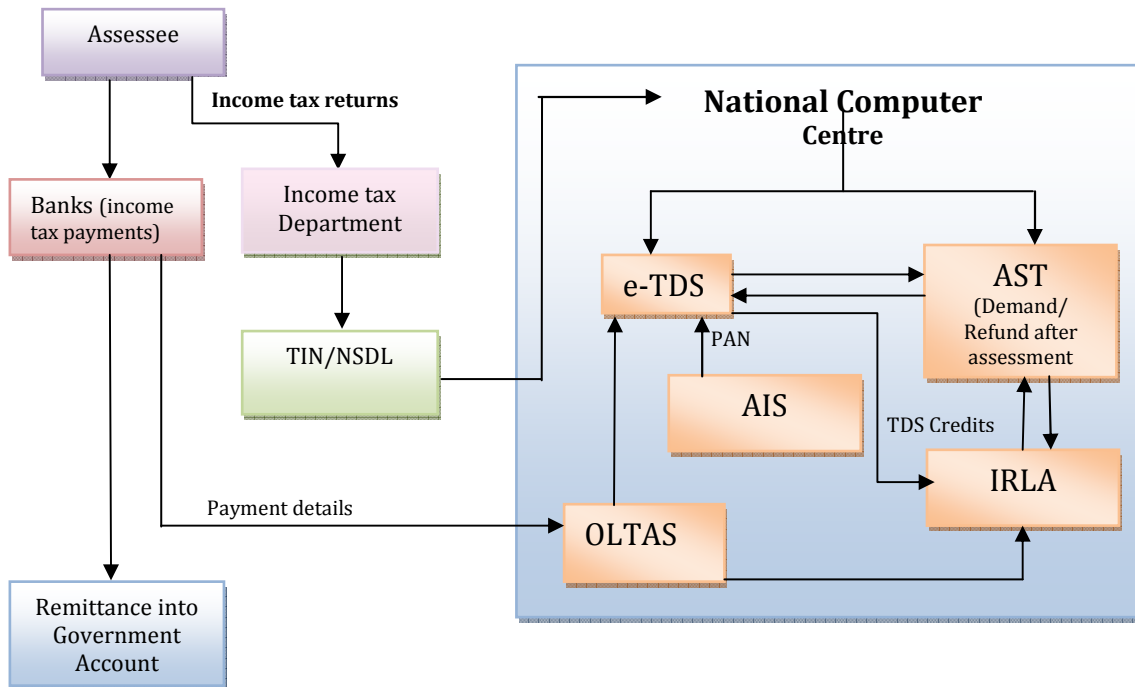
3.29   We found that AST is currently being used mainly for processing of returns under summary and issue of refunds flowing from such assessment. It, therefore, does not capture events that occur subsequently viz. demand/refund determined under scrutiny assessment (if selected), appeals, revision etc. The AOs are not currently feeding the results of post-assessment stage in AST either. Such data is unavailable in IRLA also, as it would be uploaded to IRLA through AST only. Thus, verification of arrear demands/refunds flowing from summary assessment alone would be available to the AO while processing refunds.

3.30 We found that the system controls were not utilised to ensure that refunds granted through summary assessments were adjusted while processing subsequent refunds (refer paragraph 5.1). The fact that the details available in AST were either not complete or used while processing refunds, show that the AOs by and large are working outside the system, thus compromising the controls therein.

3.31 All large refunds[32] are required to be approved by the CIT before issue. One of the checks exercised by the CsIT is that there are no high demand scrutiny assessments in the refund case that can be adjusted against the refunds. Each CCIT/DGIT has been delegated the power to fix the monetary ceiling above which the approval of JCIT/Addl. CIT shall be taken by the AO before the issue of refund, in their respective regions. Where administrative approval is necessary, the refund should be issued within thirty days from the date of its determination.

3.31.1 We found 85 cases involving refund of Rs. 1101.4 crore[33] which were issued either without obtaining the necessary administrative approval of the appropriate authorities or before obtaining such approval, though in each case approval was required to be obtained before issue of the refund from the competent authority.

3.32 The Board has fixed norms[34] for selection of cases for compulsory scrutiny for corporate and non-corporate assessees where high value refunds were issued during 2005-08. We found 140 cases[35] involving refund of Rs. 15.8 crore which met the norms fixed for selection, but were not selected for compulsory scrutiny. The selection for scrutiny has moved from traditional, manual selection to a risk-based system-driven process through the Computer Assisted Scrutiny System (CASS) module. Further selection out of the large sample is yet to be made transparent and is guided by discretion and judgment.

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[32] As per Central Action Plans 2005-09, approvals are to be taken in respect of issue of refund of Rs. 1.0 crore and above in the case of Delhi, Mumbai, Chennai, Kolkata, Bangalore, Hyderabad, Ahmedabad and Pune and Rs. 25.0 lakh above for other stations

[33] in Bihar, Chandigarh UT, Delhi, Gujarat, Himachal Pradesh, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu charges

[34]

F. Y.	Corporate	Non-Corporate
2005-06	all returns (except cases of foreign companies*) where refund claimed is Rs. 50.00 lakh or above in cities** and Rs. 20.00 lakh or above in other places.	all returns (except cases of non-residents*) where refund claimed is Rs. 10.00 lakh or above in cities** and Rs. 5.00 lakh or above in other places.
2006-07	All returns (except cases of foreign companies*) where refund claimed is Rs. 5.00 lakhs or above.	All returns (except cases of non-residents*) where refund claimed is Rs. 5.00 lakhs or above.
2007-08	All returns where refund claimed is Rs. 5.00 lakhs or above.	
*limit for selection would be decided by the DGIT(International Taxation).		
** Delhi, Mumbai, Chennai, Kolkata, Pune, Hyderabad, Bangalore and Ahmedabad		

[35] In Andhra Pradesh, Bihar, Chattisgarh, Chandigarh, Gujarat, Haryana, Jharkhand, Madhya Pradesh and Orissa

3.33 Recommendations

We recommend that the controls effected in the manual system may not be lost in automation. This will strengthen the MIS also.

The Ministry stated (March 2010) during the exit conference that the controls had been provided in the automation but were not being used by the AOs currently. Better advocacy, capacity building and change of mindset among the AOs, would result in greater usage of controls in the automated system.

Since automation captures the flow of income tax return since the time it is received, the automation system should be able to generate jurisdiction-wise report of pending refunds in order to have an effective control.

The Ministry accepted the recommendation.

In order to enhance transparency, refund claims should be processed in chronological order. The process can be made more transparent by displaying the status of the claim in terms of stage at which it is pending on the departmental website.

The Ministry stated (March 2010) during the exit conference that instructions existed for chronological processing. However, as on date, majority of the returns were being received manually. Due to acute shortage of manpower, data entry was hampered. The huge backlog of refunds had a dominoes effect on disposal of fresh refund claims. The CPC would address these issues and take care of the need for transparency.

The Ministry may ensure that for every cheque issued, an online auto-reconciliation is done by the system.

The Ministry stated (March 2010) during the exit conference that since the introduction of the Three tier system with a Primary Data Centre at Delhi, the mechanism of auto-reconciliation of refunds issued by AO vis-à-vis refunds encashed is already in place in the ITD system. The auto-reconciliation is being done through the Refund Banker and in non-refund banker cases where returns have been processed on AST. The OLTAS database has encashment details of all the IT refunds which is also available to the AO for reconciliation. However, in case of refunds arising out of rectification of assessment, appeal effect etc. auto-reconciliation was not facilitated.

The Ministry may identify the risks during migration and the steps that would be needed to mitigate the risks.

The Ministry stated (March 2010) during the exit conference that they were aware of the risks. The fact remains that the risks needed to be documented as

this would have an institutional follow-up potential instead of being of isolated concern to individuals.

- *The Ministry may provide budget provision for 'interest on refunds' as an expenditure item in the budget estimates.*

The Ministry stated (March 2010) during the exit conference that this was a policy decision taken at the highest level.

- *The Department may consider clearance of legacy data and improving the fidelity of the data on priority basis. This will also encourage the AOs to use the system and thus promote the integration of automation into regular assessment proceedings.*

The Ministry stated (March 2010) during the exit conference that the current year was the first year of three tier environment wherein the ITD has a centralized database at the Primary Data Centre at Delhi. However, it is difficult to automate the clearance of legacy data which remains in the suspense account. While processing the claims on AST, the AOs can query the system and match the credits to the best fit and clear the OLTAS suspense. The clearance of the unmatched data at an aggregate level will need to be compiled.

- *Pending full use of AST for all the assessment work, it may be made mandatory that results of all types of assessments viz., summary, scrutiny, rectification, revision etc. should be posted in the AST module. This will help the AOs to verify the arrears of demand and refunds issued earlier.*

The Ministry stated (March 2010) during the exit conference that IRLA had a software limitation and piecemeal entry of data (i.e. at any stage viz. scrutiny, reassessment, appeal effect etc.) in AST was not possible. The software would accept data only if the system had complete details relating to earlier stages. However, CPC would take care of this limitation.