

# **CHAPTER I**

## **TAX ADMINISTRATION**

## Chapter Summary

- ◆ Direct tax collections increased from ₹ 1,65,216 crore in 2005-06 to ₹ 3,78,063 crore in 2009-10 at an average annual rate of growth of 32.2 *per cent*.

**(Paragraph 1.3)**

- ◆ In 2009-10, for every unit growth in GDP, direct taxes grew by 0.8 *per cent* only. Thus, the acceleration in tax collection was less sharper than that of GDP in 2009-10. The buoyancy improved as compared to 2008-09 when it was 0.5 *per cent*.

**(Paragraph 1.3.1)**

- ◆ The total number of direct tax assessees increased by 14.4 *per cent* in 2009-10 to 340.9 lakh as compared to 297.9 lakh taxpayers in 2005-06. The growth path has been fluctuating as it registered a decline of 3 *per cent* in 2008-09, with the decline being sharper for corporate assessees. However, in 2009-10 there has been a marginal increase of 4 *per cent*.

**(Paragraph 1.4)**

- ◆ 82.8 *per cent* of the collections came in by way of voluntary compliance in 2009-10.

**(Paragraph 1.6)**

- ◆ The pendency of scrutiny assessment cases increased from 45.7 *per cent* in 2005-06 to 50.7 *per cent* in 2009-10.

**(Paragraph 1.7)**

- ◆ Cost of collection rose to 0.73 *per cent* in 2009-10 from 0.55 *per cent* in 2007-08.

**(Paragraph 1.10)**

- ◆ Internal Audit completed 69.8 *per cent* of the targeted audits. Only 12.6 *per cent* of major findings raised by Internal Audit were acted upon by the assessing officers in 2009-10. Departmental response to Internal Audit was clearly inadequate.

**(Paragraph 1.13)**

## CHAPTER I

## TAX ADMINISTRATION

## 1.1 INTRODUCTION

## 1.1.1 Direct taxes levied by the Parliament mainly comprise:

- **Corporation tax** on companies which constitutes 64.7 per cent of direct tax collection<sup>1</sup>. 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 ₹ 1.60 lakh<sup>2</sup>.

1.1.2 Other direct taxes include **Fringe Benefit tax**<sup>3</sup>, **Securities Transactions tax**<sup>4</sup> and **Wealth tax**<sup>5</sup> etc.

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

	2005-06	2006-07	2007-08	2008-09	2009-10 (₹ in crore)
1. Gross Collection	1,95,248	2,67,416	3,53,498	3,72,915	4,35,164
2. Refunds	30,032	37,235	41,285	39,097	57,101
3. Net Collection	1,65,216	2,30,181	3,12,213	3,33,818	3,78,063
4. Tax-GDP Ratio	4.6	5.6	6.6	6.3	6.1
5. Buoyancy <sup>6</sup>	1.7	2.5	2.6	0.5	0.8
6. No. of assesseees (in lakh)	297.9	312.9	336.6	326.5	340.9
7. No. of PAN card holders (in lakh)	440.0	519.5	648.5	807.9	958.0
8. Returns filed (in lakh)	297.9	312.9	336.6	326.5	340.9
9. Pre-assessment collection	1,50,208	2,05,741	2,83,986	3,02,341	3,51,660
10. Post-assessment collection	37,086	50,891	52,865	56,188	73,053
11. No. of scrutiny assessments due for disposal	4,25,225	5,27,005	9,97,813	9,53,767	8,70,620
12. No. of scrutiny assessments completed	2,30,698	2,41,983	4,07,239	5,38,505	4,29,585
13. No. of officers deployed for assessment duty	3,801	3,954	3,218	3,106	3,605
14. Direct refund claims pending (in lakh)	5.7	4.4	8.3	15.5	19.4
15. Interest on refunds	4,575	3,693	4,444	5,778	12,951
16. Demand pending	95,387	1,17,370	1,24,274	2,01,276	2,29,032
17. No. of appeals pending with CIT(A)	64,125	1,07,841	1,30,358	1,58,031	1,80,991
18. Certified demand recovered	4,433.0	8,521.4	8,612.6	4,035.8	3,322.3
19. Certified demand pending	27,209.4	26,703.9	27,444.9	27,461.0	95,122.4
20. Cost of collection	1,240	1,343	1,713	2,286	2,774

The details of tax administration are given in Appendix-2.

<sup>1</sup> for the financial year 2009-10

<sup>2</sup> The base above which income tax is payable is revised from time to time. It is ₹ 1.6 lakh for the AY 2010-11 (₹ 1.9 lakh in case of resident women and ₹ 2.4 lakh in case of resident sr. citizens).

<sup>3</sup> Tax on the value of certain benefits offered by the employers to their employees. Fringe Benefit Tax is 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.

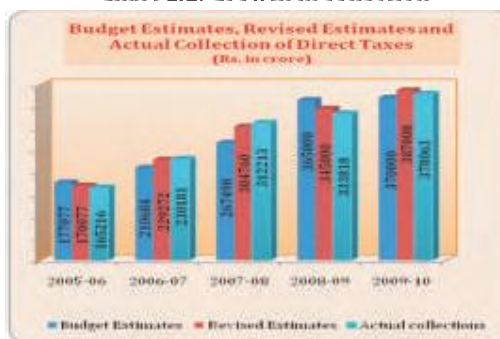
<sup>5</sup> Tax chargeable on the net wealth comprises certain assets specified under section 2(ea) of the Wealth Tax Act.

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

### 1.3 GROWTH IN COLLECTION

There has been a robust growth in collection of direct taxes in the last five years, as it increased from ₹ 1,65,216 crore in 2005-06 to ₹ 3,78,063 crore<sup>7</sup> in 2009-10 at an average annual rate of growth of 32.2 per cent. The collections exceeded the

Chart 1.1: Growth in collection

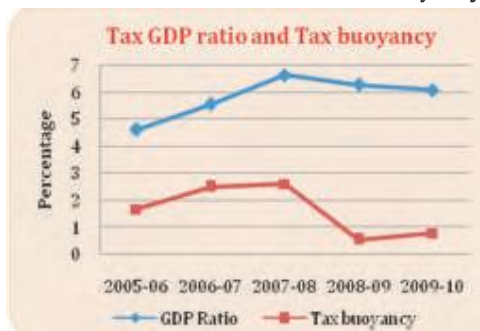


budget estimates during the period except 2005-06 and 2008-09. (Chart 1.1). The rate of growth of tax collection has decelerated particularly in 2008-09 and has since marginally improved in 2009-10. There was deviation in actual collections with reference to budget estimates during 2006-07 to 2008-09 as the actual collection deviated by 8.5 per cent to 16.7 per cent of the budget estimates. However, revised estimates were found realistic during the period 2005-06 to 2009-10 as the collection was within 3.2 per cent of the revised estimates.

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

Tax-Gross Domestic Product (GDP) ratio increased from 4.6 per cent in 2005-06 to 6.1 per cent in 2009-10. However, there was a slight decline as compared to 6.6 per cent in 2007-08. For every unit growth in GDP, direct taxes grew from 1.7 per cent in 2005-06 to 2.6 per cent in 2007-08. However, the trend of buoyancy slowed down steeply to 0.8 per cent in 2009-10 through 0.5 per cent in 2008-09 (Chart 1.2). Buoyancy value less than 1 is not a healthy indicator given the overall growth in the GDP. The sharp decline in buoyancy is a matter of concern.

Chart 1.2: Tax GDP ratio and Tax buoyancy



1.3.2 The total direct tax collection has increased by 128.8 per cent from ₹ 1,65,216 crore in 2005-06 to ₹ 3,78,063 crore in 2009-10 whereas total GDP has increased by 74.0 per cent from ₹ 35,80,344 crore in 2005-06 to ₹ 62,31,171 crore in 2009-10 indicating a significantly higher growth rate of tax collection over five years period. However, in the recent past i.e. 2008-09 and 2009-10 the

<sup>7</sup> Head wise/State/UT wise break up of direct tax collection is given in Appendix-3.

rate of growth of tax collection has decelerated particularly in 2008-09 and thereafter marginally improved in 2009-10. At the same time, revenue foregone<sup>8</sup> on account of tax exemptions has increased by 150.1 *per cent* from ₹ 48,168 crore in 2005-06 to ₹ 1,20,483 crore in 2009-10 impacting the growth of tax collection.

#### 1.4 CONSOLIDATING THE TAX BASE

Analysis of the tax base is essential to establish that all the assesses are in the tax net and that the tax due is deposited by these assesses.

##### 1.4.1 WIDENING OF TAX BASE

The assessee base grew over the last five years from 297.9 lakh taxpayers in 2005-06 to 340.9 lakh taxpayers in 2009-10 at the rate of 14.4 *per cent* (Chart 1.3).

Chart 1.3: Widening of tax base



The Department has different mechanisms available to enhance the assessee base which include inspection and survey, information sharing with other tax departments and third party information available in annual information returns. Automation also facilitates greater cross linking<sup>9</sup>. Most of these mechanisms are available at the level of the assessing officers. The Department needs to holistically harness these mechanisms at macro level to analyse the gaps in the assessee base.

Permanent Account Numbers (PANs)<sup>10</sup> issued upto March 2009 and March 2010 were 807.9 lakh and 958 lakh respectively. The returns filed in 2008-09 and 2009-10 were 326.5 lakh and 340.9 lakh respectively. The gap between PANs and the number of returns filed was 617.1 lakh in 2009-10. The Board needs to identify the reasons for the gap and use this information for appropriately enhancing the assessee base. The gap may be due to issuance of duplicate PAN cards and death of some PAN card holders. The Department needs to put in place appropriate controls to weed out the duplicate PANs and also update the position in respect of deceased assesses. It is significant to

<sup>8</sup> Tax incentives to promote savings by individuals and various incentives/exemptions to corporate as well as non-corporate sectors.

<sup>9</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>10</sup> The Permanent Account Number (PAN) allotted to a taxpayer, is the unique identification number that helps track individual tax compliance. It 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.

note that the number of PAN card holders has increased by 117.7 *per cent* between 2005-06 to 2009-10 whereas the number of returns filed in the same period has increased by 14.4 *per cent* only.

The total direct tax collection has increased by 128.8 *per cent* during the period 2005-06 to 2009-10. The increase in tax collection was around nine times as compared to increase in the assessee base. It should be the constant endeavour of the Department to ensure that the entire assessee base, once correctly identified is duly meeting the entire tax liability. However, no assurance could be obtained that the tax liability on the assesses is being assessed and collected properly. This comment is corroborated in para 2.4.1 of Chapter 2 of this report where we have mentioned about our detection of undercharge of tax amounting to ₹ 12,842.7 crore in 19,230 cases audited during 2008-09. However, given the fact that ours is a test audit, Department needs to take firm steps towards strengthening the controls available on the existing statutes towards deriving an assurance on the tax collections.

#### **1.4.2 RECONCILIATION OF CORPORATE ASSESSEES**

There were 8.4 lakh working companies<sup>11</sup> in the country registered with Registrar of Companies (ROC) as on 31 March 2010. However, the corporate assesseees on the Income-Tax Department's records are only 3.7 lakh, leaving an un-reconciled list of 4.7 lakh companies. The difference has increased from 3.4 lakh in 2005-06. It had been marginally reconciled in 2007-08 (2.8 lakh). The Board should reconcile the discrepancy for accurate assessment of the filing gap.

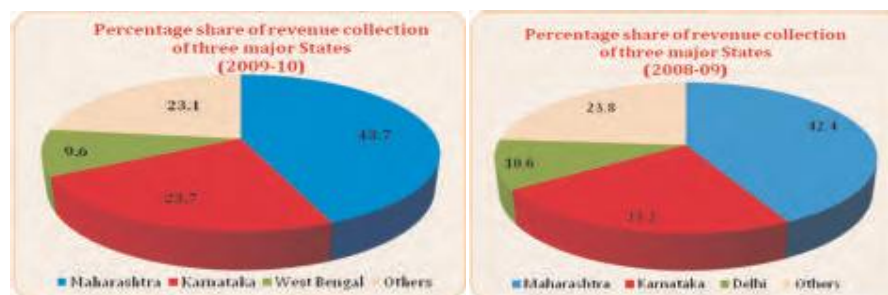
#### **1.5 RELATIVE SHARE IN COLLECTION**

The three major States (Chart 1.4) of Maharashtra, Karnataka and West Bengal had contributed more than 3/4<sup>th</sup> of total direct tax collection in 2009-10; in 2008-09, the three major states who had contributed more than 3/4<sup>th</sup> of total direct tax collection were Maharashtra, Karnataka and Delhi. West Bengal registered increase of 31.5 *per cent* in collection while Maharashtra and Karnataka registered increase of around 16 *per cent* in collection over the previous year. On the other hand Delhi registered 15.3 *per cent* decline in collection in 2009-10 over the previous year. The reasons for decline in collection need to be examined.

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<sup>11</sup> Source: Ministry of Corporate Affairs (R&A Division).

Chart 1.4: Relative-share in collection



Growth in collection was unevenly spread across the country. Positive growth in tax collection was reported in 16 states<sup>12</sup> in 2009-10 vis-a-vis 2008-09. Assam, Chhattisgarh, Manipur, Mizoram and Uttarakhand (details in Appendix-4) 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 five states needs to be examined. The issue is especially significant in view of the negative growth in Direct Tax collections in other 16 states during the same period.

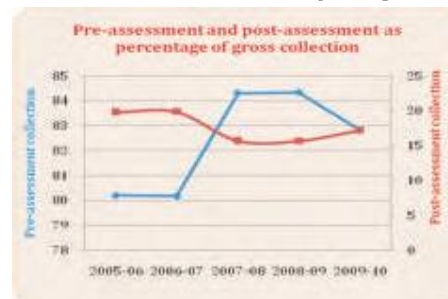
### 1.6 EFFECTIVE RATE OF TAXATION

The effective tax rate for companies<sup>13</sup> was 22.8 per cent in 2008-09<sup>14</sup> which was substantially lower than the statutory tax rate of 33.9 per cent. We found that 179 companies with profits before taxes (PBT) of ₹ 500 crore and above accounted for 57.5 per cent of the total PBT and 55.7 per cent of the total corporate tax payable. However, their effective tax rate was only 22.1 per cent while the effective tax rate was 25.5 per cent for companies having PBT of upto ₹ one crore. This shows that tax concessions are being availed of mainly by large companies.

### 1.7 EXTENT OF VOLUNTARY COMPLIANCE

Voluntary compliance by assesseees (pre-assessment stage) accounted for 82.8 per cent of the gross collections in 2009-10. The collection by way of voluntary compliance was higher than 2005-06 and 2006-07 but marginally lower than 2007-08 and 2008-09.

Chart 1.5: Extent of voluntary compliance



<sup>12</sup> Andhra Pradesh, Assam, Bihar, Chattisgarh, Gujarat, Jammu & Kashmir, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Mizoram, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttaranchal and West Bengal

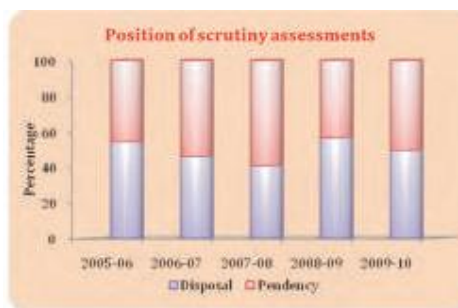
<sup>13</sup> Source: Receipts Budget 2010-11

<sup>14</sup> The effective tax rate was 22.24 per cent in 2007-08.

### 1.8 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 8.7 lakh scrutiny assessment cases for disposal (Chart 1.6), the Department had disposed off 4.3 lakh (49.3 per cent) cases in 2009-10. This was higher than the scrutiny assessments completed in 2006-07 and 2007-08. However, despite the increase in the number of officers involved in assessment duty, number of scrutiny assessments came down in 2009-10 as compared to 2008-09. This is to be seen in the perspective that the very base of scrutiny assessments due had been reduced from 9.5 lakh in 2008-09 to 8.7 lakh in 2009-10. The pendency of scrutiny assessments increased from 45.7 per cent in 2005-06 to 50.7 per cent in 2009-10.

Chart 1.6: Position of assessment



Working norms of officers deployed for assessment and non-assessment functions need to be framed up so that qualitative content of the tax scrutiny can be improved alongwith improving the pendency status of cases.

### 1.9 EFFICIENCY OF COLLECTION

In 2009-10, only 65 per cent of the total demands cumulatively raised in assessments upto that year had been collected (Chart 1.7). The performance was identical as in 2005-06 and 2008-09. However, there was a decline as compared to collection of 74 per cent for 2007-08. At the end of 2009-10, as much as ₹ 2.3 lakh crore remained uncollected. This comprised demand of ₹ 1.8 lakh crore of earlier years and current demand (2009-10) of ₹ 0.5 lakh crore. However, in 2008-09, earlier years pending demand was ₹ 0.9 lakh crore and current demand was of ₹ 1.1 lakh crore. Out of which, one group namely Hassan Ali alone accounted for ₹ 71,784 crore of uncollected demand (refer paragraph 1.8 of Audit Report No. 4 of 2009-10). However, this matter is pending in appeal before ITAT.

Chart 1.7: Efficiency of collection

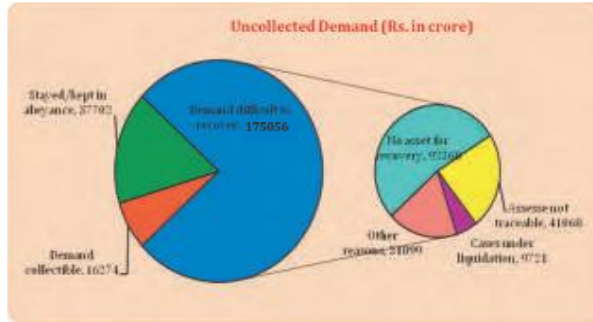




The uncollected demand is rising despite clear provisions in the Act to enforce collection and recovery of outstanding demand viz. attachment and sale of assessee's movable and immovable property, appointment of a receiver for the management of assessee's properties and imprisonment.

Chart 1.8: Details of uncollected demand

The Department intimated that various factors (Chart 1.8) contributed to the uncollected demand. ₹ One lakh crore (44.6 per cent) remained uncollected as there were no assets for recovery or the companies were under liquidation/BIFR.



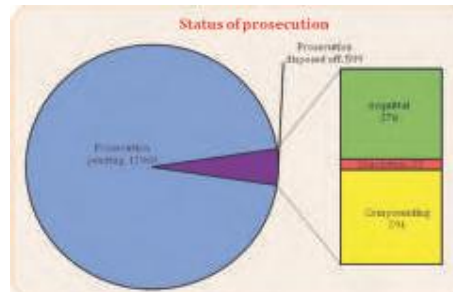
Defaults in payment of tax are referred to the Tax Recovery Officers (TROs) who draw up a certificate specifying the amount of arrears due from the assessee and proceed to recover the amount. The recovery mechanism is inefficient as certified demand remaining uncollected increased to ₹ 95,122.4 crore (96.6 per cent) 2009-10 from ₹ 27,209 crore (86 per cent) in 2005-06. It registered a three fold growth in the last year itself as compared to ₹ 27,461 crore in 2008-09.

Board should frame up a time bound action plan for recovery of current and arrear demands by fixing targets for each assessing officer. Recovery proceedings can be made effective by increasing the accountability of the TROs and incentivizing achievements.

**1.10 STATUS OF PROSECUTION**

The Department had launched prosecution in 12,060 cases of tax evasion upto 2009-10. Only 599 cases (5 per cent of the total cases) were disposed off, of which 276 cases resulted in acquittal (Chart 1.9). The Board needs to analyse the reasons for slow pace of disposal. The high rate of acquittal also needs to be analysed to ensure greater effectiveness of prosecution as a deterrent.

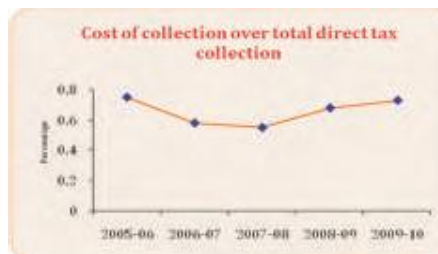
Chart 1.9: Status of prosecution



### 1.11 COST OF COLLECTION OF TAXES

Total cost of direct tax collection (Chart 1.10) showed a decreasing trend from 0.75 per cent in 2005-06 to 0.55 per cent in 2007-08. In 2008-09 and 2009-10, there was rise in cost mainly due to increase in establishment cost.

Chart 1.10: Cost of collection of taxes



### 1.12 REFUND 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 is payable on the amount of such refund. Refund is also admissible (along with interest) as a result of any order passed in appeal or other proceedings. Pendency of direct refund claims results in outflow of revenue from Government by way of interest.

Out of total 48 lakh direct refund claims, the Department had disposed off 28.6 lakh (59.6 per cent) claims in 2009-10. The pendency rate has increased to 40.4 per cent in 2009-10 from 22.5 per cent in 2005-06.

The Government has refunded ₹ 57,101 crore which includes interest of ₹ 12,951 crore (22.7 per cent) from gross collection of Corporation Tax and Income Tax of ₹ 4,24,713 crore in 2009-10. The interest paid on refunds in 2008-09 was ₹ 5,778 crore (14.8 per cent of ₹ 39,097 crore, the amount refunded) out of the gross collection of ₹ 3,58,529 crore. The interest on refunds also needs to be seen in the perspective of pendency of direct refund cases which increased from 5.7 lakh in 2005-06 to 19.4 lakh in 2009-10 registering an increase of 240 per cent.

#### 1.12.1 INCORRECT ACCOUNTING OF INTEREST ON REFUNDS

We had earlier commented<sup>15</sup> 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 budget provision for 'interest on refund' was made in the Budget Estimates for 2009-10 and the expenditure on interest on refunds amounting to ₹ 12,950.8 crore was treated as reduction in

<sup>15</sup> in Audit Reports of 2004, 2005, 2006, 2007, 2008, 2009 and 2009-10

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 ₹ 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 practice is still being followed and needs to be rectified. In response the Department stated that this is a policy decision taken at the highest level.

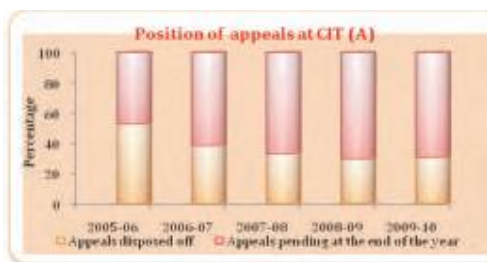
### 1.13 APPEAL CASES

An aggrieved tax payer has the right to dispute a tax demand with the Income Tax Department through the Commissioner of Income Tax (Appeals). Second appeal against the orders of CIT(A) lies in the Income Tax Appellate Tribunal (ITAT) which functions under the Ministry of Law. On any question of law arising out of an order of ITAT, a taxpayer may appeal progressively to the High Court and the Supreme Court. Analogous right to appeal is also available to the Department against the orders of CIT (A) and onwards.

#### 1.13.1 APPEALS PENDING BEFORE CIT(A)

As per the instructions of the Board, each CIT(Appeal) is required to dispose off a minimum of 60 appeals per month, and a total of 720 appeals annually. Thus, 1.1 lakh appeals could have been disposed off during the year on the basis of the working strength of 151 CIT (Appeals). CIT(A) were required to dispose off 2,60,700 cases during 2009-10. Out of this only 0.8 lakh appeals (30.6 per cent) were disposed off (Chart 1.11) and the average annual disposal per CIT(A) during 2009-10 was only 528 appeals. The amount locked up in appeal cases with CIT(A) was ₹ 2.2 lakh crore in 2009-10 which is equivalent to 66.9 per cent of the revised revenue deficit of Government of India.

Chart 1.11: Appeals disposed off and pending



1.13.2 Further, the amount locked up in appeals at higher levels (ITAT/High Court/Supreme Court) was ₹ 91,087 crore in 60,246 cases as on 31 March 2010.

#### **1.14 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.

The Department introduced a new Internal Audit System w.e.f. June 2007 to have an effective and objective set up of Internal Audit wherein the assessment functions and audit functions are assigned to separate specialized wings. Under each CIT(Audit) there shall be one Addl. CIT who would be responsible for internal audit of high value cases and supervision of the audit work of special audit party (SAP) headed by Dy./Asstt. CsIT and the internal audit party (IAP) headed by ITOs. The minimum number of cases to be audited by each Addl. CIT, SAP and IAP in a year shall be 50, 300 and 1,300 (600 corporate cases and 700 non-corporate cases) respectively.

Internal audit wing had planned 2,53,300 cases for audit during 2009-10 based on the working strength of wing. Out of which, 1,76,840 were completed thereby achieving 69.8 *per cent* of the target.

Internal audit had raised 14,577 observations in the audited assessments with money value of ₹ 1,224.8 crore during the year 2009-10. Based on the reply from assessment units, the internal audit had settled 6,434 cases with money value of ₹ 657.6 crore.

However, we detected numerous observations in the assessments previously audited by Internal Audit. We noticed that internal audit had audited 2,142 assessments in 2009-10, where we pointed out the mistakes but the same were not detected by them.

Out of 453 draft paragraphs included in this report, only 52 cases (11.5 *per cent*) were seen by internal audit and no mistakes were detected by them, which indicates need for improvement in quality of internal audit.

Departmental response to internal audit also needs improvement. Only 12.6 *per cent* of the major findings raised by internal audit were acted upon by the assessing officers in 2009-10. The total pendency increased from 21,299 cases having tax effect of ₹ 3,404.2 crore in 2008-09 to 29,442 cases having tax effect of ₹ 3,971.4 crore in 2009-10.