

CHAPTER II

AUDIT IMPACT

Chapter Summary

- ◆ In the last five years, the Government introduced five legislative amendments to correct the anomalies pointed out by us. In addition, a provision has also been incorporated in Direct Tax Code.

(Paragraph 2.2)

- ◆ In 2009-10, the Department recovered ₹ 449.3 crore in cases pointed out by us.

(Paragraph 2.3)

- ◆ We detected errors in 19,230 assessments completed by the Department having a tax effect of ₹ 12,842.7 crore. Incidence of errors in scrutiny assessments completed by the Department in 2008-09 was 4.5 *per cent*. Tax effect of such erroneous demands was ₹ 12,369.8 crore, which would impact the total tax demand raised by the Department by 22 *per cent*.

(Paragraph 2.4 and Appendix-5)

- ◆ Delay in taking timely action on erroneous cases led to loss of revenue of ₹ 2,868.3 crore in 5,643 cases seen by us which were rendered time-barred.

(Paragraph 2.5.2)

- ◆ The Department did not produce 13.5 *per cent* of the records requisitioned by us during 2009-10.

(Paragraph 2.6.1)

CHAPTER II

AUDIT IMPACT

2.1 STATUTORY AUDIT

Our audit involves examination of individual assessments in field offices of the Income Tax Department to seek an assurance on:

- Accuracy in tax demands and;
- Efficacy and adequacy of systems and procedures in tax administration.

2.2 LEGISLATIVE IMPACT

In the last five years, the Government introduced five legislative amendments to correct the anomalies pointed out by us. One amendment made in Finance Act 2009 is mentioned below along with the provision incorporated in Direct Tax Code Bill 2010.

Our Report on IT audit of e-TDS system of Income Tax Department pointed out that there is a need to specify the time limit for processing of e-TDS returns. In the absence of such a provision, the e-TDS returns were not being processed by the Department leading to loss of revenue. The Income Tax Act was amended through Finance Act 2009. Section 200A effective from 1.4.2010 specifies that no intimation specifying the sum determined to be payable by or the amount of refund due to the deductor shall be sent after the expiry of one year from the end of the financial year in which the statement of TDS is filed.

Our Report No. PA 25 of 2009 on 'Exemptions, deductions and allowances to shipping and related sectors' pointed out that though there is specific mention of taxability of freight charges paid for goods shipped from a port in India (i.e. exports) with the mechanism for implementation of the same being explained in section 172, there is no specific mention regarding the taxation of income contained in the freight charges paid for goods brought to a port in India (i.e. imports). A provision for taxing the same has been included in the Direct Tax Code Bill 2010.

2.3 RECOVERY AT THE INSTANCE OF AUDIT

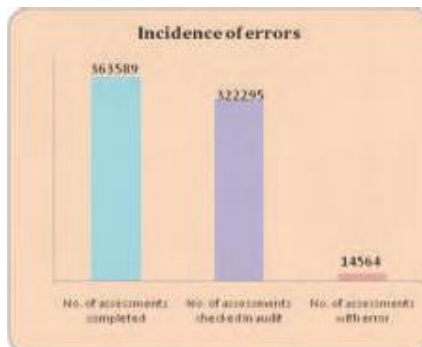
The Department recovered ₹ 2,599.1 crore in the last five years from demands raised to rectify the errors in assessments pointed out by us. This includes ₹ 449.3 crore recovered in 2009-10.

2.4 INCIDENCE OF ERRORS

It was our attempt to audit all scrutiny assessments completed by assessment units that fall in the audit sample selected for field audit on the basis of pre-defined parameters of risk analysis. We found that the incidence of errors in the scrutiny assessments

The establishment cost of our audit in 2009-10 is 0.02 per cent of the tax effect of cases pointed out by us. Further, the cost would be 1.5 per cent of the total demand raised on our findings (details at Appendix-6).

Chart 2.1: Incidence of errors



completed during 2008-09 averaged to 4.5 per cent. The revenue impact of these errors works out to 22.0 per cent of the total demand raised by the Department (Appendix-5).

2.4.1 The tax effect of errors was ₹ 12,842.7 crore as shown below:

Table no. 2.1: Tax wise details of errors

Sl. No.	Category	No. of cases	Tax effect (₹ in crore)
1	Corporation tax & Income tax	17,717	12,773.4
2	Wealth tax	798	20.8
3	Other Direct taxes	715	48.5
Total		19,230	12,842.7

2.4.2 The category-wise details of underassessment (sub-categories have been given in Appendix-7) in respect of Income tax and Corporation tax are given below:-

Table no. 2.2: Category-wise details of errors

Sl. No.	Category	No. of cases	Tax effect (₹ in crore)
1	Arithmetical errors	5,348	2,646.3
2	Ineligible concessions given to assesseees	6,779	3,751.1
3	Income/ not assessed	2,279	570.9
4	Others	3,119	5,359.8
Total		17,525	12,328.1

Out of 17,717 cases with tax effect of ₹ 12,773.4 crore, 192 cases with tax effect of ₹ 445.3 crore related to over assessments.

2.4.3 High value and important cases among the errors detected in local audit are included in the Audit Report. The present Audit Report contains 453 cases reported to the Ministry of Finance. While 166 of these cases, which were accepted by the Ministry, have been included in this Chapter¹⁶, remaining cases have been discussed in detail in Chapters III and IV of this Report. In respect of 9 of these 453 cases, provisions of the Act were open to interpretation, while in all the other cases, the AOs issued erroneous assessment orders despite clear provisions. 'Ineligible concessions given to assesseees' accounted for 33 *per cent* of the tax effect of the errors whereas 64 *per cent* of the tax effect (sub-categories have been given at Appendix-8) was due to 'arithmetical errors' as detailed below in Table 2.3.

Sl. No.	Category	No. of cases	Tax effect (₹ in crore)	Percentage of tax effect of errors
1	Arithmetical errors	76	3,784.0	64.0
2	Ineligible concessions given to assesseees	253	1,957.1	33.1
3	Income/Wealth not assessed	82	42.6	0.7
4	Others	42	127.1	2.2
	Total	453	5,910.8	100.0

2.5 RESPONSE TO AUDIT

We elicit response from the audited entities at different stages of audit. On completion of field audit, we issue the local audit report (LAR) to the Department for comments. Important and high value cases are referred to the Ministry for comments before inclusion in the Audit Report.

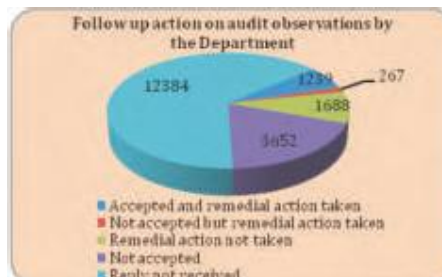
The Board issued instructions (2006) that replies to LARs should be provided within six weeks. The assessing officers are required to initiate remedial action within two months of receipt of a LAR to correct errors in demands lest the case should become time barred leading to loss of revenue.

¹⁶ Paragraphs 2.5.4, 2.5.5 and 2.5.6, Appendices-11, 12 and 13

2.5.1 RESPONSE : INITIAL AUDIT

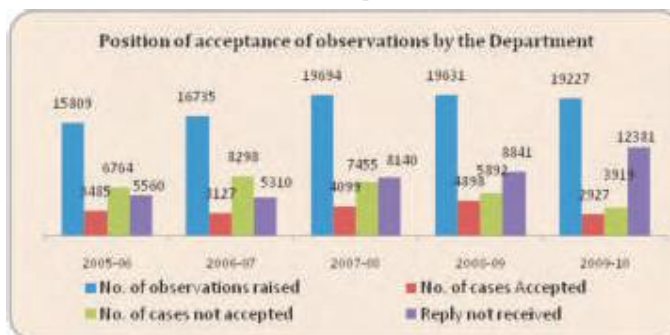
We received replies to 36 per cent of the cases included in LARs issued this year (2009-10). Of these cases, 18 per cent were accepted by the Department and remedial action was completed¹⁷ in 22 per cent of the cases. As compared to 2008-09, the cases in which the Department did not reply rose from 45 per cent to 64 per cent. This issue needs to be followed up by the Department especially in the light of the displeasure expressed by the Public Accounts Committee.

Chart 2.2: Follow up action on audit observations



The position of acceptance at the end of each of the last five years has been given in Appendix-9.

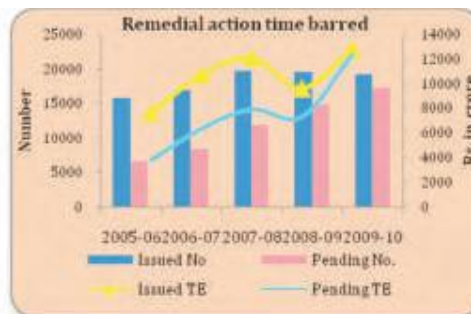
Chart 2.3: Position of acceptance of observations



2.5.2 REMEDIAL ACTION TIME BARRED

The accretion in pendency in replies to audit findings each year has resulted in a mounting pile-up of 85,359 cases involving revenue effect of ₹ 47,263 crore as of 31 March 2010. The Chart 2.4 depicts the increasing trend of pendency of observations.

Chart 2.4: Remedial action time barred



¹⁷ The Assessing Officer (AO) initiates remedial action by issuing a notice to the assessee, who is then given an opportunity to present his case. After considering all the facts, the AO issues a rectificatory order raising the rectified demand for tax/refund, whichever be the case. At this stage, remedial action is said to have been taken.

We conducted a review of the above pending cases and found that 5,643 cases with tax effect of ₹ 2,868.3 crore have become time barred for remedial action. Details are given in Appendix-10.

2.5.3 RESPONSE: HIGH VALUE CASES

We give six weeks to the Ministry to offer their comments on high value cases before their inclusion in the Audit Report. The Ministry accepted 38 per cent of the cases; in 59 per cent cases, we were yet to receive the response as of December 2010 and the remaining have not been accepted.

Chart 2.5: Response to high value cases



2.5.4 The Ministry accepted 15 observations with tax effect of ₹ 34 crore. Remedial action had been taken by the Department and the amount recovered in these cases. Details are at Appendix-11. One case is illustrated below:

Charge : CIT Kolkata-II, West Bengal, AY: 2005-06

In an assessment made under section 143(3), the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct amount of tax or refund as the case may be.

During the scrutiny assessment of **The West Bengal Industrial Development Corporation Ltd.**, the refund already made during processing¹⁸ of the return was not taken into account resulting in short levy of tax of ₹ 1.3 crore.

2.5.5 The Ministry accepted 133 observations with tax effect of ₹ 281.7 crore. Remedial action had been taken by the Department in these cases. Details are at Appendix-12. Two cases are illustrated below:

¹⁸ Returns received by the IT Department are initially processed under section 143(1) towards making prima facie adjustments to the income. Thereafter in selected cases, detailed examination is undertaken through scrutiny assessment.

A. Charge: CIT Coimbatore-I, Tamil Nadu, AY: 2002-03 to 2004-05

Section 36(1)(iv) provides that any sum paid by the assessee as an employer by way of contribution towards a recognized provident fund is an allowable deduction.

Tamil Nadu State Transport Corporation Ltd. was allowed expenditure of ₹ 35.4 crore towards pension contribution although necessary approval for the pension fund had not been obtained from the Income tax authorities. This resulted in short levy of tax of ₹ 12.8 crore.

B. Charge: CIT Ludhiana-I, Punjab, AY: 2006-07

Section 72(1) provides for loss under the head 'profits and gains of business or profession' that could not be or is not wholly set off against income under any other head of income of the relevant year to be carried forward to the following assessment year(s) to be set off against 'profits and gains of business or profession'.

Industrial Organics Ltd. was allowed to carry forward loss of ₹ 32 crore as against the available loss of ₹ 7.9 crore. This resulted in excess carry forward of loss of ₹ 24.1 crore involving tax effect of

₹ 8.1 crore.

2.5.6 The Ministry accepted 18 observations with tax effect of ₹ 19.1 crore and remedial action had been initiated by the Department. Details are at Appendix-13. Two cases are illustrated below:

A. Charge: CIT Mumbai-X, Maharashtra, AY 2005-06

Section 36(1)(viii) provides for a deduction in respect of any special reserve created and maintained by a public company formed and registered in India with the main object of carrying on the business of providing long term finance for construction or purchase of houses in India for residential purposes.

ICICI Home Finance Co. Ltd. had discontinued the business of giving home loans from November 2001. Still for the assessment year 2005-06, deduction under section 36(1)(viii) was allowed which resulted in underassessment of income of ₹ 10.9 crore with consequent short levy of tax of ₹ 5.3 crore.

B. Charge: CIT Kolkata-XIX, West Bengal, AY 2003-04

In an assessment made under section 143(3), an assessee is not entitled to claim deduction on any capital expenditure.

Price Water House Ltd., a firm claimed and was allowed deduction of ₹ 3.5 crore as expenses on PWC Global Services charges paid to Price

Water House Coopers International Ltd. towards utilizing their brand name. As the payment was made for acquiring monopoly right of the brand name, the amount was to be treated as capital expenditure and was to be disallowed. The omission resulted in under assessment of ₹ 3.5 crore involving tax effect of ₹ 1.3 crore.

2.5.7 RESPONSE: AUDIT REPORT

The Audit Report once presented in the Parliament, stands referred to the Public Accounts Committee. The Ministry intimates to us the status of these cases, through Action Taken Notes (ATN). Replies on 940 cases, representing 11 *per cent* of the cases included, were yet to be received as of December 2010. In addition, 400 cases with tax effect of ₹ 2,830.5 crore, included in the Audit Reports during 1999-2005 on which no replies were received/no remedial action was taken, would have become time barred by now. Two cases are given below:

A. Charge: CIT Delhi-VI, Delhi, AY. 2002-03

Section 43B provides that any amount payable by an assessee as employer by way of contribution to any pension fund or payable to an employee is deductible on actual payment basis.

Oriental Insurance Company Ltd. was allowed deduction of ₹ 95.9 crore even though the employer's contribution to pension fund was not actually deposited within due date. The mistake resulted in over assessment of loss by ₹ 95.9 crore involving potential tax effect of ₹ 34.2 crore.

B. Charge: CIT Mumbai-II, Maharashtra, AY. 1997-98

Section 72 provides that where, in any assessment year, unabsorbed depreciation under the head 'Profits and gains of business or profession' cannot be set off against any other income of the relevant assessment year, such unabsorbed depreciation shall be carried forward for subsequent year and shall be set off only against profits and gains from any business or profession and not against other income.

JK Chemicals Ltd. was allowed set-off of unabsorbed depreciation of ₹ 6.2 crore brought forward from earlier years against the income arising out of capital gains and income from other sources. This resulted in underassessment of income of ₹ 6.2 crore involving short levy of tax of ₹ 5.8 crore.

2.6 NON-PRODUCTION OF RECORDS

Under section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971, assessment records are scrutinized in revenue audit with a view to securing an effective check on the assessment, collection and proper allocation of taxes and examining that regulations and procedures are being observed. As per section 18 of the same Act, it is incumbent on the Department to expeditiously produce records and furnish relevant information to audit.

2.6.1 Out of 9,96,788 records requisitioned during 2009-10, 1,34,173 cases (13.5 *per cent*) were not produced to audit. The Table 2.4 below contains State-wise details where records were not produced to audit in three or more consecutive audit cycles.

Table :2.4 Records not produced to audit in three or more audit cycles		
Sl. No.	State	No. of records not produced
1	Andhra Pradesh	292
2	Jharkhand	4
3	Karnataka	62
4	Madhya Pradesh	15
5	Orissa	269
6	UT Chandigarh	54
7	Tamil Nadu	14
8	Maharashtra	165
9	West Bengal	19
	Total	894