CHAPTER 5

MISTAKES IN ASSESSMENTS

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Recommendations

CHAPTER 5

Mistakes in assessment

The provisions of DTAA were not being properly invoked or interpreted while assessing non-residents. There were also errors in assessments involving other provisions of the Act.

I Relief under DTAA

Double Taxation Avoidance Agreements entail tax benefits to assesses of other countries. This needs to be weighed against the principle of reciprocity. Several instances of incorrect allowance of the benefits under DTAA by the Department have come to light during audit.

5.1 Relief to entities that are not taxed in the resident country

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2006-07
Assessee: Chiron Behring Gmbh & Company KG

DTAA is meant only for the benefit of taxpayers who are liable to pay tax twice on the same income. A taxpayer cannot claim relief under DTAA if he is not liable for taxation in the country of residence

The assessee was a limited partnership firm which was not liable to tax in Germany. In AY 2005-06, the AO denied the benefit of Indo-German DTAA relief to the assessee on this ground and taxed royalty income. However this principle was not followed in AY 2006-07 resulting in short levy of tax of ₹ 48 lakh.

Charge: CIT I, Chennai, Tamilnadu; AY: 2005-06
Assessee: West Asia Maritime Ltd.

The assessee paid ₹ 193.3 crore to Emirates Trading LLC UAE, for chartering vessels on which tax was not deducted at source. Payments towards charter hire charges partake the character of royalty under Section 9. Further, Emirates Trading Agency LLC, UAE is a company incorporated in UAE. There is effectively no tax on shipping income derived from shipping business in UAE. Tax deductible at source along with interest worked out to ₹ 59.8 crore.

5.2 Treatment of companies with a PE

Charge: DIT (IT), Chennai, Tamilnadu; AY: 2003-04
Assessee: Qualcom India Inc

Article 7 of the Indo-US DTAA provides that profits attributable to a PE in India will be taxed in accordance with the Indian tax laws. Under the Income Tax Act, a foreign company with a PE in India will be taxed on a presumptive basis on its gross receipts.

The assessee did not offer any business income, but debited expenditure relating to engineering and technical services in the accounts. Instead of being taxed on a

presumptive basis on the gross receipts, the assessment was completed by invoking the normal provisions of the Income Tax Act and the assessee was allowed to carry forward business loss of ₹ 3.1 crore. This led to potential undercharge of ₹ 1.3 crore.

Charge: CIT I, Chennai, Tamilnadu; AY: 2003-04 to 2006-07
Assessee: CEX ONYX India Pvt. Ltd

Section 44DA of the Act provides for assessing income being fees for technical services as Business Income.

The assessee had remitted fees for technical services to Onyx Asia Services Ltd Singapore, a foreign company on which tax was deducted (@20/10%). But as this income arose from a PE, the income should have been assessed as business income under Section 44DA and taxed (@ 40%). Short levy worked out to ₹ 1.7 crore.

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2005-06
Assessee: J. Mcdermott Eastern Hemisphere Ltd

Article 5 of Indo Mauritius DTAA provides that PE includes a mine or gas well and a site of assembly or supervisory activities. Section 44BB of the Income Tax Act provides that where a non-resident is engaged in the business of providing services or facilities used in the business of extraction or production of mineral oils then 10 *per cent* of the amounts received by it shall be liable for tax.

The assessee was in exploration business and its income was brought to tax in earlier AYs on the ground that it had a PE in the country. In AY 2005-06, its income was exempted from tax on the ground that income earned from execution of contracts was exempt from tax under Indo-Mauritius DTAA. This resulted in short levy of tax of ₹ 5.7 crore. Department initiated remedial action after we raised the issue.

5.3 Computation of capital gains

Charge: DIT (IT), Kolkata, West Bengal; AY: 2005-06
Assessee: Century Enka Ltd

Article 13 of Indo Netherlands DTAA provides for taxation on capital gains of a Dutch Company in India if the gains were made from transfer of shares in India. While computing the capital gains arising to a non-resident from transfer such shares, the benefit of indexation is not allowable.

Accordis Overseas Investment BV, Netherlands derived long term capital gains of ₹ 57.9 crore on buyback of shares by Century Enka Ltd. Assessee had made the remittance to the non resident after deducting tax of ₹ 12.1 crore at source. We found that the capital gains had been worked out by allowing cost of indexation which was against the provisions of section 48. The mistake resulted in short levy of tax of ₹ 8 crore.

5.4 Exemption from tax

Charge: DIT (IT), Chennai, Tamilnadu; AY: 2005-06
Assessee: Caterpillar India Pvt Ltd

Income Tax Act provides that the 'fees for technical services' received by foreign companies shall be taxed at 10 *per cent*. Reimbursement of payments to technical staff also forms fees for technical services. Article 23 of DTAA with USA & UK provides that incomes not covered under the articles of DTAA, will be charged under the head 'other income'

The assessee made payments to technical and non-resident staff belonging to Hong Kong, China, USA and UK without deduction of tax at source. Though these payments partake the nature of technical services[61], no tax was withheld on the basis of an exemption certificate from the ITD. The tax deductible was ₹ 1 crore. The department held that it is not possible to revoke an exemption order; hence no remedial action was possible. We are of the opinion that exemption certificate is only an interim measure and is subject to final assessment.

II Other Mistakes in Assessment

We found mistakes in 87 cases involving short levy/non levy of tax amounting to ₹ 250.8 crore. A few are illustrated below:

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2004-05
Assessee: Unilever HPC Finance Services Inc. USA

The case of Vodafone, established the principle that even if the financial transactions occur abroad, if they relate to assets in India, they will be taxed in India.

The assessee purchased shares of an Indian company, Hindustan Lever Ltd from Conopco Inc. USA ₹ 1018.5 crore. The consideration was paid directly in USA by Unilever Finance Services Inc. USA to Conopco Inc. USA without deducting tax at source. This has resulted in non compliance of TDS provisions. Failure of the department to take cognizance of this fact resulted in non levy of tax recoverable of ₹ 181.6 crore including interest under section 201(IA) of ₹ 76.9 crore. On this being pointed out by audit, department issued notice to the assessee (March 2009).

[61] AAR in the case of AT & S India Pvt. Ltd.(2006) 157 Taxmann 198

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2003-04
Assessee: Reliance Industries Ltd (RIL)

Section 10(15) of the Income Tax Act provides that interest payment is exempt from tax if (a)the loan is taken by an industrial undertaking in India, (b) the money is borrowed in foreign currency from sources outside India and (c) under a loan agreement approved by the Central Government

The assessee had, in the capacity of an agent of Deutsche Bank made interest payments to foreign financial institutions. An earlier exemption from income tax on such interest payments, was withdrawn (2002) by ITD owing to non fulfillment of conditions of section 10(15). Yet, the TDS deducted from the interest payments was quantified as refundable to RIL. When we raised the issue, ITD expressed its inability to rectify the assessment of RIL on the ground that it was only an agent. It instead reopened the assessment of the branch office of Deutsche Bank. Instead of taxing the payments afresh, ITD gave the credit for the TDS deducted by RIL without taking into account the fact that the TDS credit of ₹ 10.9 crore was allowed as credit to RIL. This has resulted in undercharge of tax of ₹ 10.9 crore.

Similarly in two other instances, the assessee (in the capacity of an agent of D.B Services and Credit Lyonnais) claimed the interest payments to foreign financial institutions as exempt under section 10(15) and claimed refund of ₹ 29.3 crore. The claim was accepted in the summary assessments. On being pointed out ITD reopened the assessments of the branch offices of D.B Services Tennesse Inc and Credit Lyonnais.

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2003-04 to 2004-05
Assessee: B4U International Holdings Ltd

Section 72 allows carry forward and set off of business losses pertaining to an assessment year to the subsequent assessment years.

The assessee was allowed carry forward of ₹ 42.5 crore as unabsorbed loss of AYs 2001-02 and 2002-03. We found that there were no losses to be carried forward for these AYs. Of the total carried forward loss, ₹ 17.7 crore was set-off against profits of AYs 2003-04 and 2004-05 and the unadjusted loss of ₹ 24.9 crore was allowed to be carried forward. This led to short levy of tax of ₹ 20.0 crore including potential under-charge of ₹ 10.2 crore. Department rectified the assessment in July 2008.

Charge: DIT (IT); Mumbai, Maharashtra; AY: 2004-05 to 2005-06
Assessee: M. Fabrikant and Sons INC, Mumbai

Section 14A of the Act seeks to tax expenditure incurred on earning exempted income

The business expenses incurred in earning income that is exempt from income tax, is not deductible. However, the expenses were not disallowed resulting in excess carry forward of loss of ₹ 5.4 crore involving potential short levy of tax of ₹ 2.3 crore. Department accepted and rectified both the assessments in March 2009.

Recommendation

- *We recommend that responsibility for material errors in assessments should be clearly fixed to reduce their incidence;*

  The CBDT stated that the ITD has been making sincere efforts for proper training and skill development of its personnel to reduce incidence of mistakes.

New Delhi **(MEENAKSHI GUPTA)**

Dated **Director General (Direct Taxes)**

Countersigned

New Delhi **(VINOD RAI)**

Dated **Comptroller and Auditor General of India**