

CHAPTER 5

Mistakes in assessments

**Allowance of cost of production/
acquisition of distribution rights of
films**

Other mistakes in assessment

Recommendation

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Mistakes in assessments

There were 257 cases of errors in assessment involving ₹ 350.81 crore due to wrong application of provisions of the Act.

The provisions of the Income Tax Act regarding allowance of cost of production of films and acquisition of distribution rights of films were not being invoked properly. There were also errors in assessment involving other provisions of the Act.

I Allowance of cost of production/acquisition of distribution rights of films

Rule 9A of the Income Tax Rules, 1962 regulates deduction of expenditure on production of a film and Rule 9B, expenditure on acquisition of distribution rights of the film. We found mistakes in 32 cases involving tax impact of ₹ 22.32 crore. Few cases are illustrated below:

5.1 Irregularities in allowance of cost of production of film

Charge: CIT-11, Mumbai, Maharashtra; AY 2006-07

Assessee: Ms. Smitha Thackeray

Rule 9A (5) provides that deduction for cost of production of a feature film, certified for release by the Censor Board shall be allowed when the producer exhibits the film on commercial basis or sells rights of exhibition; and the realization from it is credited in his books of accounts.

The assessee had not commercially released the film 'Hum Do Hamara Ek/Double Trouble' and realization there from was not credited in the books of accounts. However, the Department allowed the cost of production of the film ₹ 4.39 crore, resulting in short levy of tax of ₹ 62.32 lakh (including interest) and potential tax impact of ₹ 96.24 lakh.

5.2 Irregularities in allowance of cost of acquisition of distribution rights

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05

Assessee: M/s. Allu Entertainment (P) Ltd.

Rule 9B (5) provides that deduction in respect of cost of acquisition of distribution rights of a feature film shall not be allowed unless the film distributor exhibits the film on commercial basis or sales rights of exhibition; and realization there from is credited in his books of accounts.

The assessee had not offered any income through exhibition and selling of distribution rights, but the Department allowed

deduction of ₹ 5.84 crore towards cost of film lease rights, cost of positive print and publicity for two feature films, resulting in short levy of tax of ₹ 2.55 crore.

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05
Assessee: M/s. Gemini Industries & Imaging Limited

The Department allowed entire cost of ₹ 4.55 crore on production of feature films. The Department further allowed expenditure of ₹ 2.33 crore under Rule 9B in the revision order, based on the revised return of the assessee. This ₹ 2.33 crore was already included in ₹ 4.55 crore, allowed during original assessment. The excess allowance of expenditure resulted in short levy of tax of ₹ 83.34 lakh.

II Other mistakes in assessments

We found mistakes in 225 cases having tax effect of ₹ 328.49 crore. Summarised position is given in Table 3 below.

Error category	No. of cases	Tax effect (₹ in crore)
Income not assessed or incorrect computation of business income	49	97.02
Incorrect carry forward and set off of losses	17	21.35
Mistake in allowing depreciation	6	4.10
Incorrect allowance of capital expenditure	4	6.51
Non levy of Fringe Benefit Tax	6	0.71
Others	143	198.80

Few cases are illustrated below:

5.3 Irregular allowance of bad debts

Charge: CIT-11, Mumbai, Maharashtra; AY 2006-07
Assessee: M/s. Zee Entertainment Enterprises Ltd.

As per section 36(1)(vii) read with section 36(2) of the Act, any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is an allowable deduction.

The assessee debited advances of ₹ 6.61 crore to the profit and loss account as bad debts. These were not written off from the books of accounts. The Department, however, allowed these advances as bad debts. This resulted in short levy of tax of ₹ 2.22 crore.

5.4 Income not assessed

Charge: CIT-11, Mumbai, Maharashtra; AY 2005-06

Assessee: M/s. B. R. Films

Under the mercantile system of accounting any income or expenditure is accounted for on accrual basis irrespective of the fact whether it is received or paid during the relevant previous year.

The assessee spread over the consideration of ₹ 2.28 crore, received for sale of satellite rights of old films for five years. Since the sale was finalised in the previous year relevant to the current assessment year, entire amount of consideration should have been assessed in the current assessment year. However, the assessing officer allowed the spreading over of income. This resulted in under assessment of income by ₹ 2.28 crore involving tax effect of ₹ 71.51 lakh.

5.5 Irregular allowance of capital expenditure

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2003-04 to 2005-06

Assessee: M/s. Gemini TV Pvt. Ltd.

Expenditure of capital nature are not allowable under the provisions of section 37(1) of the Act while computing the taxable income chargeable under the head 'profit and gains of business or profession'.

The Department allowed expenditure of ₹ 6.42 crore on laying of cables for transmission of TV signals during assessment years 2003-04 to 2005-06 as deductions during these years. This has resulted in excess allowance of expenditure by ₹ 6.42 crore and short levy of tax of ₹ 2.92 crore.

After being pointed out by us, the Department rectified the assessments for assessment years 2003-04 and 2005-06 under section 147.

5.6 Non-capitalisation of intangible assets

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05 and 2005-06

Assessee: M/s. Sun TV Network Ltd.

Under section 32(1)(ii), intangible assets viz. know-how, patents, trade marks, copy rights, licences, franchises or any other business or commercial rights of similar nature should be capitalized and depreciation be allowed at 25 per cent under Part B of the Depreciation Schedule.

The assessee claimed and the Department allowed entire expenditure of ₹ 105.54 crore on purchase of rights of feature films and TV serials as deduction for the current assessment year, whereas it should have been capitalized and depreciation be allowed. Non-capitalizing of the intangible assets of feature films and TV serials rights resulted in short-levy of tax of ₹ 23.64 crore (including interest).

Reply of the Department that film rights do not fall under any of the categories of intangible assets is not tenable. Such rights are to be treated under Copyrights or Licences against Explanation 3 to Section 32(1).

5.7 Incorrect exemption under section 11

Charge: CIT, Kochi, Kerala; AY 2005-06 and 2007-08

Assessee: M/s KP Issac & Sons Charitable Trust

Under section 13(1), if any part of income or any property of the trust or the institution is applied or used directly or indirectly for the benefit of any person specified in section 13(3), income of such trust/institution will not be eligible for exemption u/s 11.

The assessee's only business is running three cinema theatres taken on lease owned by a firm -M/s. KP Issac & Sons, in which all the trustees are partners. The assessee claimed the entire excess of income over expenditure of ₹ 0.70 lakh and ₹ 27.50 lakh for AY 2005-06 and 2007-08 respectively as exempt u/s 11. We observed that ₹ 16.43 lakh and ₹ 40.39 lakh was due to the trust from the Firm as on March 2005 and March 2007 respectively. As the income received by the trust was applied directly or indirectly for the benefit of persons referred to in Section 13(3), the assessee was not entitled to get exemption under section 11 and the status of the assessee should be considered as 'Association of Persons'.

Further, exemption allowed to the Firm – K P Issac & Sons for donation and charity to the Trust of ₹ 19.83 lakh and ₹ 3.97 lakh for AYs 2005-06 and 2007-08 respectively should have also been disallowed. This has tax effect of ₹ 9.21 lakh for AY 2005-06 and of ₹ 12.64 lakh for AY 2007-08.

5.8 Unexplained deposits not taxed as deemed income

Charge: CIT-11, Mumbai, Maharashtra AY 2006-07

Assessee: Shri Gautam Adhikari

Where any sum is found credited in the books of an assessee and no explanation/satisfactory explanation is offered to the assessing officer with regard to its nature or source, the same may be charged to income tax as the income of the assessee of that previous year under section 68.

The assessee during the relevant previous year 2005-06 purchased house property for consideration of ₹ 8.87 crore. In February 2006, the said property was let out to M/s. Rock Star Properties Ltd. for a deposit of ₹ 24.31 crore and rent of ₹ 48,000 per annum (all inclusive) which in turn had given it back to the assessee to occupy. We observed that the amount of deposit was not recorded in the leave and licence agreement. The tax auditor in clause 24(a) of Form 3CD had categorically omitted to testify the aforesaid transaction. The assessee also failed to

furnish the documentary evidence to prove that the money was received through normal banking channels. Cognizance of such vital aspect was not taken into account while finalizing the assessment. The omission had resulted in unexplained deposit of ₹ 24.31 crore escaping assessment involving tax effect of ₹ 10.88 crore (including interest).

Recommendation

5.9 *We recommend that responsibility for material errors in assessment may be fixed to reduce their incidence.*

While noting the suggestion for consideration the CBDT stated (February 2011) that the new system of review of assessments by the CIT has been introduced in November 2008 for reducing such instances and responsibility is fixed in cases found appropriate.

**New Delhi
Dated**

**(MEENAKSHI GUPTA)
Director General (Direct Taxes)**

Countersigned

**New Delhi
Dated**

**(VINOD RAI)
Comptroller and Auditor General of India**