

CHAPTER II
AUDIT IMPACT

Chapter Summary

- ◆ The Department recovered ₹ 311,7 crore in cases pointed out by us in 2010-11.
(Paragraph 2.2)
- ◆ We detected errors in 20,130 assessments completed by the Department having a tax effect of ₹ 14,475,4 crore. Incidence of errors in scrutiny assessments completed by the Department in 2009-10 was 5.6 *per cent*. Tax effect of such erroneous demands was ₹ 12,815,7 crore, which would impact the total tax demand raised by the Department by 17.5 *per cent*.
(Paragraph 2.3 and Appendix 6)
- ◆ This report contains 464 high value cases. Ministry/Department has accepted 46 *per cent* of them.
(Paragraph 2.3.3)
- ◆ We noticed that 7,942 cases were rendered time-barred due to delay in taking timely action on erroneous cases resulting in loss of revenue of ₹ 5,334,5 crore.
(Paragraph 2.4.2)
- ◆ The Department did not produce 11.5 *per cent* of the records requisitioned by us during 2010-11.
(Paragraph 2.5.1)

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.

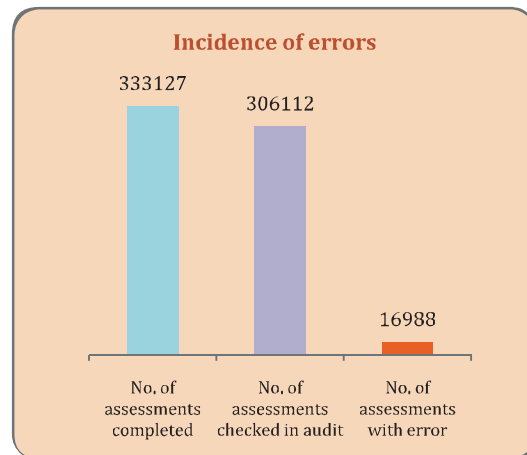
2.2 RECOVERY AT THE INSTANCE OF AUDIT

The Department recovered ₹ 2,605,1 crore in the last five years from demands raised to rectify the errors in assessments pointed out by us. This includes ₹ 311,7 crore recovered in 2010-11.

2.3 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 completed during 2009-10 averaged to 5,6 per cent. The revenue impact of these errors works out to 17,5 per cent of the total demand raised by the Department (*Appendix-6*).

Chart 2,1 Incidence of errors



2.3.1 The tax effect of errors during 2010-11 was ₹ 14,475.4 crore as shown below:

Sl. No	Category	No. of cases	Tax effect
1	Corporation tax & Income tax	18,711	14,397.8
2	Wealth tax	801	20.1
3	Other Direct taxes	618	57.5
	Total	20,130²⁶	14,475.4

2.3.2 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:-

Sl. No.	Category	No. of cases	Tax effect
1	Errors/ omissions in computation	4,823	2,566.2
2	Ineligible concessions given to assesseees	8,190	7,842.5
3	Income not assessed	2,169	2,023.9
4	Others	3,289	1,461.6
	Total	18,471	13,894.2

Out of 18,711 cases with tax effect of ₹ 14,397.8 crore, 240 cases with tax effect of ₹ 503.5 crore related to over assessments,

2.3.3 High value and important cases among the errors detected in local audit are included in the Audit Report. The present Audit Report contains 464 cases reported to the Ministry of Finance. While 192 of these cases, which were accepted by the Ministry, have been included in this Chapter²⁷, remaining cases have been discussed in detail in Chapters III and IV of this Report. In respect of five of these 464 cases, provisions of the Act were open to interpretation, while in all the other cases, the AOs issued erroneous assessment orders despite clear provisions, 'Errors/Omissions in computation' accounted for 41.9 per cent of the tax effect of the errors whereas 26.5 per cent of the tax effect (sub-categories have been given at *Appendix-8*) was due to 'Ineligible concessions given to assesseees' as detailed below in Table 2.3,

²⁶ No. of assessments with errors as shown in Chart No. 2.1 relates to scrutiny assessments completed during 2009-10 and audited during 2010-11, 20,130 cases shown in Table 2.2 relates to all cases audited during 2010-11 which includes assessments completed during earlier years also.

²⁷ Paragraphs 2.4.4, 2.4.5 and 2.4.6, Appendices - 11, 12 and 13

Table no. 2.3: Category-wise details of errors of high value cases

Sl. No.	Category	No. of cases	Tax effect (₹ in crore)	Percentage of tax effect of errors
1	Errors/ omissions in computation	113	1,525.5	41.9
2	Ineligible concessions given to assessees	230	964.9	26.5
3	Income/Wealth not assessed	53	323.4	8.9
4	Others	68	827.9	22.7
	Total	464	3,641.7	100.0

2.4 RESPONSE TO AUDIT

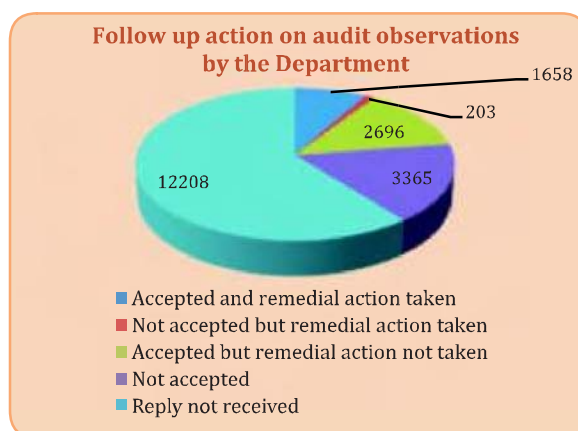
We elicit response from the audited entities at different stages of audit. On completion of field audit, we issue the local audit report (LAR) to the Department for comments. Important and high value cases are referred to the Ministry for comments before inclusion in the Audit Report.

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 becomes time barred leading to loss of revenue.

2.4.1 RESPONSE: INITIAL AUDIT

We received replies in respect of 39 per cent of the cases issued this year (2010-11). The Department accepted 21.6 per cent of the issued cases and remedial action was completed²⁸ in 9 per cent cases. The Department did not reply to 61 per cent of the cases. This issue needs to be followed up by the Department,

Chart 2.2 Follow up action on audit observations



²⁸ 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.

Chart 2.3 Position of acceptance of observations

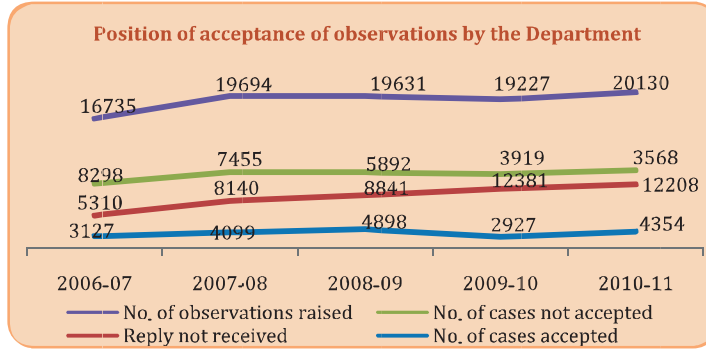


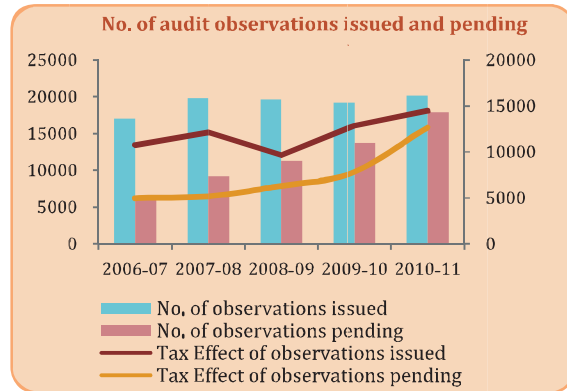
Chart No. 2,3 depicts the position of acceptance at the end of each of the last five years (Appendix-9) over the period 2006-07 to 2010-11. Responsiveness of Department to the audit observations

has deteriorated over the years.

2.4.2 REMEDIAL ACTION TIME BARRED

Chart 2.4 No. of audit observations issued and pending

The accretion in pendency in replies to audit findings each year has resulted in pile-up of 72,020 cases involving revenue effect of ₹ 43,751 crore as of 31 March 2011. Chart 2.4 depicts the increasing trend of pendency of observations.

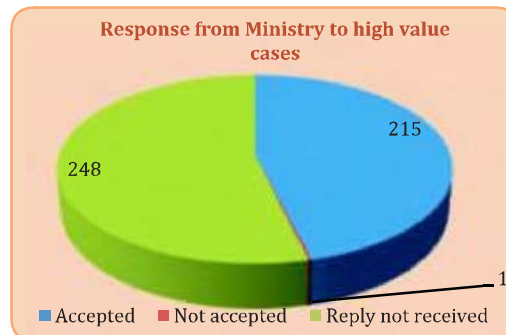


We conducted a review of the above pending cases and found that 7,942 cases with tax effect of ₹ 5,334.5 crore have become time barred for remedial action as on 31 March 2011. Details are given in Appendix-10.

2.4.3 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. Out of the 464 Draft Paragraphs for current Report, the Ministry accepted 46 per cent of the cases; in 53 per cent cases, we were yet to receive the response as of December 2011 and one case has not been accepted.

Chart 2.5 Response to high value cases



2.4.4 In 13 cases with tax effect of ₹ 3,1 crore the Ministry accepted the observations, completed the remedial action and recovered the amount. Details are at *Appendix-11*. One case is illustrated below:

Charge : CIT Bangalore-I, Karnataka, AY: 2007-08

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 scrutiny assessment of **L & T Valdel Engineering Pvt. Ltd.**, the refund of ₹ 71.45 lakh already made during processing²⁹ of the return was not taken into account resulting in short computation of demand of ₹ 0,8 crore.

2.4.5 The Ministry accepted 140 observations with tax effect of ₹ 453,6 crore. Remedial action had also been taken by the Department in these cases. Details are at *Appendix-12*. Two cases are illustrated below:

A. Charge: CIT Madurai-I, Tamil Nadu, AY: 2006-07

Under section 32(2) prior to 1 April 2002, unabsorbed depreciation allowance shall be carried forward to the following assessment years not being more than eight assessment years immediately succeeding the assessment year for which the said allowance was first computed and be set off against business income.

In the case of **Tamil Nadu State Transport Corporation (Madurai) Ltd.** unabsorbed depreciation of ₹ 123,0 crore up to assessment year 1998-99 was quantified and allowed to be set off even though it was more than eight years old. This resulted in potential short levy of tax of ₹ 41,4 crore. The Department accepted the observation and took remedial

action under section 154 of the Act.

²⁹ 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.

B. Charge: CIT LTU Chennai Tamil Nadu, AY: 2002-03

Under section 143 (3), the Assessing Officer, while completing the assessment after scrutiny, shall make a correct assessment of the total income of the assessee including the set-off of brought forward losses of earlier years and determine the correct amount of tax payable by the assessee.

In the case of **United India Insurance Company Ltd.** the total income of ₹ 132,5 crore was determined after setting off of unabsorbed loss of ₹ 34,4 crore relating to

assessment year 2001-02. The loss of ₹ 34,4 crore for assessment year 2001-02 was converted into positive income on revision. Thus there was no loss to be set off. The mistake resulted in short computation of business income by ₹ 34,4 crore involving short levy of tax of ₹ 20,4 crore. The Department accepted the observation and took remedial action under section 154 of the Act.

2.4.6 The Ministry accepted 39 observations with tax effect of ₹ 831,0 crore and remedial action had been initiated by the Department. Details are at *Appendix-13*. Two cases are illustrated below:

A. Charge: CIT Trichy, Tamil Nadu, AY 2007-08

Section 36(1)(vii)(a) provides for a deduction not exceeding ten per cent of the aggregate average advances made by the rural branches of a scheduled bank.

Thiruchirapalli District Central Co-operative Bank Ltd. had claimed and was allowed deduction of ₹ 36,6 crore by aggregating 10 per cent of the loans and advances pertaining to rural branches and 5 per cent of the profits. As the assessee had no rural branches, it was eligible for deduction of 7,5 per cent of the income only. The mistake resulted in

underassessment of income of ₹ 17,9 crore and excess carry forward of loss of ₹ 15,7 crore involving positive tax effect of ₹ 5,5 crore and potential tax effect of ₹ 4,8 crore. The Department accepted the observation and initiated remedial action by setting aside the assessment under section 263 of the Act,

B. Charge: CIT Mumbai-X, Maharashtra, AY 2006-07

As per Section 36(1)(vii) read with section 36(2)(v), where any bad debt relates to advances made by an assessee to which clause (vii) of subsection (1) of section 36 applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part thereof in that previous year to the provision for bad and doubtful debts account made under that clause. In other words, deduction for bad debts can be allowed in the computation only when there is no balance available in the provisions for bad and doubtful debt account created as per the provisions of Section 36(1)(vii).

Bank of Maharashtra claimed and was allowed write off of bad debt of ₹ 42.2 crore in violation of the proviso to section 36(1)(vii) as the bad debt of ₹ 155.1 crore written off by the assessee during the relevant previous year was less than the opening provision of ₹ 233.5 crore for bad and doubtful debts. The Department accepted the observation and initiated remedial action under section 263 of the Act.

2.4.7 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 437 cases, representing 5 *per cent* of the cases included, were yet to be received as of December 2011. In addition, 201 cases with tax effect of ₹ 1272.9 crore, included in the Audit Reports during 1999-2006 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-V, Delhi, AY. 2003-04

Provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions do not qualify for deduction.

PNB Guilts Ltd. had reduced ₹ 36.9 crore as provision for diminution in market value of stock from closing stock in trading income. As the loss was notional and had not actually arisen, it could not be claimed as deduction and should have been added back to the taxable income of the assessee. The omission resulted in under assessment of income by ₹ 36.9 crore involving short levy of tax of ₹ 13.5 crore.

B. Charge: CIT Chennai-I, Tamil Nadu, AY. 2001-02 & 2002-03

Provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions do not qualify for deduction.

HTL Ltd. had provided an estimated amount of ₹ 1,4 crore for assessment year 2001-02 and ₹ 3,5 crore for assessment year 2002-03 towards non moving inventories. As this amount was only a provision towards a future contingent liability, the same was required to be disallowed. Omission to do so resulted in

short computation of income by ₹ 1.4 crore involving short levy of tax of ₹ 64,9 lakh for assessment year 2001-02 and excess determination of loss of ₹ 3.5 crore with potential tax effect of ₹ 1.3 crore for assessment year 2002-03,

2.5 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,

2.5.1 Out of 6,35,862 records requisitioned during 2010-11, 73,412 cases (11.5 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,

Sl. No.	State	No. of records not produced
1	Andhra Pradesh	197
2	Jharkhand	4
3	Karnataka	60
4	Madhya Pradesh	47
5	Odisha	159
6	Tamil Nadu	15
7	Maharashtra	6
	Total	488