

## **CHAPTER IV**

### **PART A – INCOME TAX**

### **PART B – FRINGE BENEFIT TAX**

### **PART C – WEALTH TAX**

## Chapter Summary

This Report includes 162 cases pertaining to Income Tax, Fringe Benefit Tax and Wealth Tax with tax effect of ₹ 93.3 crore issued to the Ministry of Finance during August and October 2011 eliciting their comments. The Ministry has accepted 67 observations involving revenue impact of ₹ 49.1 crore.

### (Paragraphs 4.1, 4.6 and 4.8)

These cases of incorrect assessment point towards weaknesses in the internal controls on the assessment process being exercised by the Income Tax Department. The major mistakes in assessments were on account of:

- Errors and omissions in computation of income and tax, application of incorrect rates of tax and surcharge and levy of interest in 18 cases involving tax effect of ₹ 7.8 crore.

### (Paragraphs 4.2.1, 4.2.2 and 4.2.3)

- Incorrect allowance of business expenditure in 16 cases involving short levy of tax of ₹ 5.8 crore.

### (Paragraph 4.3.1)

- Irregular allowance of exemptions and deductions to trusts/firms and societies in 15 cases involving short levy of tax of ₹ 14.5 crore.

### (Paragraph 4.3.2)

- Irregular allowance of depreciation and business/capital losses in 10 cases involving short levy of tax of ₹ 2.3 crore.

### (Paragraph 4.3.3)

- Income not assessed in 12 cases involving short levy of tax of ₹ 3.2 crore.

### (Paragraph 4.4)

- Mistake in computation of fringe benefit in 12 cases involving short levy of Fringe Benefit Tax of ₹ 9 crore.

### (Paragraph 4.7)

## CHAPTER IV

### A – INCOME TAX

#### 4.1 RESULTS OF AUDIT

**4.1.1** This report includes 122 cases involving tax effect of ₹ 82.9 crore issued to the Ministry of Finance during August 2011 to October 2011 to elicit their comments.

**4.1.2** The Ministry/Department has replied in respect of 46 cases (37.7 per cent) accepting our observations involving aggregate revenue impact of ₹ 48 crore as of 15 December 2011. Out of these, the Department effected recovery of ₹ 83.6 lakh in three cases, completed remedial action in 35 cases involving tax effect of ₹ 33.6 crore and initiated remedial action in eight other cases involving tax effect of ₹ 13.6 crore. These 46 cases have been featured in paragraphs 2.4.4, 2.4.5 and 2.4.6 of Chapter II of this Report. Replies of the Ministry wherever received, have been examined and suitably incorporated in the report.

**4.1.3** This chapter discusses 76 cases, of which 73 cases involve undercharge of ₹ 31.9 crore and three cases involve overcharge of ₹ 3 crore. The errors in most of the assessments were committed despite clear provisions in the Act. These cases of incorrect assessment point towards weaknesses in the internal controls on the assessment process being exercised by the Income Tax Department.

**4.1.4** The categories of mistakes have been broadly classified as follows:

- Errors and omissions in computation
- Ineligible concessions given to assesseees
- Income not assessed/under assessed
- Others

**Chart 4.1 : Categories of mistakes**



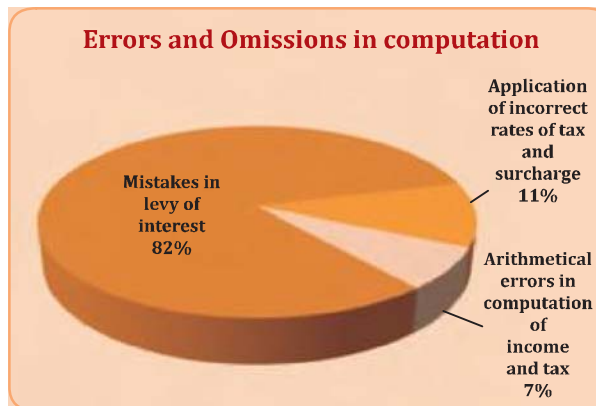
The category wise details (based on tax effect) are depicted in Chart 4.1. In terms of tax effect 65 per cent of the mistakes pertained to 'Ineligible concessions given to assesseees'. In the subsequent sections of this chapter, the first paragraph in each category indicates the nature of mistakes made by the Assessing Officer (AO). The four categories are further sub-divided and the sub-category wise description is also given. Interesting cases are illustrated in the subsequent paragraphs of this Chapter.

## 4.2 ERRORS/OMISSIONS IN COMPUTATION

The AO is required to make a correct assessment of the total income or loss of the assessee and determine correct amount of tax or refunds, as the case may be.

Chart 4.2: Errors and Omissions in computation

We found that there were cases where the AOs adopted incorrect figures, committed arithmetical errors, applied incorrect rates of tax and surcharge and levy of interest in 18 cases involving tax effect of ₹ 7.8 crore in Delhi, Gujarat, Himachal Pradesh, Jharkhand, Maharashtra,



Odisha, Punjab, Uttar Pradesh and West Bengal. Out of these 18 cases, there was short levy of tax of ₹ 4.8 crore in 16 cases and overcharge of tax of ₹ 3.0 crore in two cases. The sub-category wise details (based on tax effect) are depicted in Chart 4.2. Three sub-categories are discussed below:

### 4.2.1 ARITHMETICAL ERRORS IN COMPUTATION OF INCOME AND TAX

We found arithmetical errors in computation of income and tax in five cases involving tax effect of ₹ 55.3 lakh in Delhi, Gujarat and Jharkhand. Details of these cases have been sent to the Ministry.

### 4.2.2 APPLICATION OF INCORRECT RATE OF TAX AND SURCHARGE

We found mistakes relating to incorrect application of rates of tax and surcharge in four cases involving tax effect of ₹ 84.3 lakh in Gujarat, Maharashtra and Punjab. There were three cases of short levy of tax of ₹ 58.2 lakh and one case of overcharge of tax of ₹ 26.1 lakh. One case is illustrated below:

#### CHARGE: CIT- IV, AHMEDABAD, GUJARAT; AY 2007-08

Income tax including surcharge shall be charged at the rates prescribed in the relevant Finance Act.

In case of **Ashish Navnitlal**<sup>65</sup>, an Individual, the assessing officer treated the short term capital gain as business income but charged tax

<sup>65</sup> Assessment was completed under section 143(3) r.w.s. 147 in December 2009 at income ₹ 197.83 lakh & ₹ 275.55 lakh respectively.

@ 10 per cent on ₹ 81.8 lakh instead of 30 per cent applicable to business income. The mistake resulted in short levy of tax of ₹ 24.4 lakh including interest. **The Department rectified the mistake under section 154 of the Act in October 2010.**

#### 4.2.3 MISTAKES IN LEVY OF INTEREST

We found eight cases involving short levy of tax of ₹ 3.7 crore and one case involving overcharge of tax of ₹ 2.7 crore relating to mistakes in levy of interest for delay in submission of return, delay in payment of tax etc. in Gujarat, Himachal Pradesh, Maharashtra, Odisha, Punjab, Uttar Pradesh and West Bengal. Two cases are illustrated below:

##### A. CHARGE: CIT-II, SURAT, GUJARAT; BLOCK PERIOD 1.4.1992 to 17.4.2001

As per explanation 3 below section 234A(1), where the return of income is not furnished and the assessment is made for the first time under section 147 or section 153A, the assessment so made shall be regarded as regular assessment, the assessee is liable to pay interest at the specified rate for every month or part of a month comprised in the period commencing on the date immediately following the due date for filing the return and ending on the date of completion of assessment under section 144.

**Jitendra H Modi<sup>66</sup>**, an Individual, did not file the original return of income under section 139(1) even after issue of notices under various sections and final show cause notice issued in December 2008. However, interest of ₹ 65.5 lakh leviable

for the period November 1992 to December 2008 was not levied. **The Department rectified the mistake under section 154 of the Act in May 2010.**

##### B. CHARGE: CIT-CUTTACK, ODISHA; AY 2005-06

Section 234B(3) provides that where, as a result of an order of re-assessment under section 147, the amount on which interest is payable is increased, the assessee shall be liable to pay simple interest at the rate of one percent for every month or part thereof commencing on the day following the regular assessment till the date of re-assessment on the amount by which tax on the total income determined on the basis of re-assessment exceeds the tax on total income determined in regular assessment.

In case of **Paradeep Port Trust<sup>67</sup>**, tax of ₹ 48 crore levied in the original assessment was raised to ₹ 54.2 crore as a result of re-assessment in December 2009.

<sup>66</sup> Income of ₹ 36.67 lakh was assessed for block period 1.4.1992 to 17.4.2001 u/s 158BD in December 2008.

<sup>67</sup> Income of ₹ 1.53 crore assessed in January 2008.

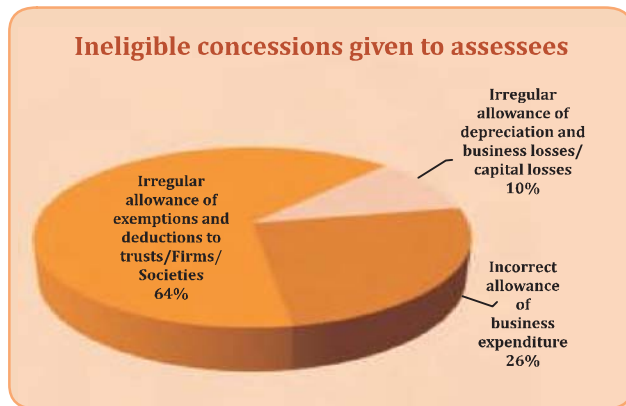
Interest under section 234B on increased tax from the date of original assessment to the date of revised assessment was not levied. Omission resulted in short levy of ₹ 2 crore. **The Department rectified the mistake under section 143(3)/147 of the Act in December 2009.**

### 4.3 INELIGIBLE CONCESSIONS GIVEN TO ASSESSEES

An assessee can claim deductions under Chapter VIA of the Act and for certain categories of expenditure under relevant provisions of the Act.

Ineligible concessions and deductions were given to assesseees in 41 cases with a tax effect of ₹ 22.6 crore in Andhra Pradesh, Delhi, Gujarat, Haryana, Himachal Pradesh, Karnataka, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The sub-category wise details (based on tax effect) are depicted in Chart 4.3. Three sub-categories are discussed below:

**Chart 4.3 : Ineligible concessions given to assesseees**



#### 4.3.1 INCORRECT ALLOWANCE OF BUSINESS EXPENDITURE

We noticed mistakes in allowance of business expenditure in 16 cases resulting in short levy of tax of ₹ 5.8 crore in Andhra Pradesh, Delhi, Gujarat, Himachal Pradesh, Maharashtra, Punjab, Uttar Pradesh and West Bengal. Two such cases are illustrated below:

##### A. CHARGE: CIT-XIII, DELHI; AY 2005-06 & 2006-07

Section 40A(2) provides for disallowance of so much of the expenditure in the form of payment to any person as defined in clause (b) thereof which in the opinion of the assessing officer is excessive or unreasonable having regard to the fair market value of goods, services for facilities for which payment is made.

**Remfry & Sagar<sup>68</sup>**, a firm, made payments of ₹ 1.7 crore and ₹ 1.5 crore to IPSS (India) Pvt. Ltd. for secretarial, accounting and other support services besides payment for furnished accommodation. As per the partnership deed, IPSS (India) Pvt. Ltd. was required to provide the

<sup>68</sup> Income of ₹ 47.9 lakh assessed in January 2007.

furnished accommodation at no cost. Therefore, expenditure in this regard was required to be added back. Omission to do so resulted in underassessment of income involving short levy of tax of ₹ 1.5 crore. ***The Department has taken remedial action under section 147/148 of the Act in December 2010.***

#### **B CHARGE: CIT-SHIMLA, HIMACHAL PRADESH; AY 2005-06**

Section 40(a)(ia) provides that any amounts payable to a contractor or sub contractor shall not be deducted in computing the income on which tax is deductible at source under chapter XVII-B of the Act and such tax has not been deducted.

**Sarabjit Singh**<sup>69</sup>, an individual, was allowed expenses of ₹ 1.5 crore on account of freight paid to truck owners on which tax at source was not deducted as required under section 40(a)(ia) of the Act. Consequently the above expenses of ₹ 1.5 crore was not allowable in computing the

income of the assessee. Omission to do so resulted in short levy of tax of ₹ 69.4 lakh. ***The Department rectified the mistake under section 143(3)/263 of the Act in December 2010.***

#### **4.3.2 IRREGULAR ALLOWANCE OF EXEMPTIONS AND DEDUCTIONS TO TRUSTS/FIRMS/SOCIETIES**

Irregular allowance of exemptions under sections 10(20), 10(23B) and 11 of the Act and incorrect allowance of deductions under sections 43B, 80IA, 80IB and 80HHC of the Act resulted in short levy of tax of ₹ 14.5 crore in 15 cases in Gujarat, Haryana, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. One such case is illustrated below:

#### **CHARGE: CIT-I, NAGPUR, MAHARASHTRA; AY 2005-06**

Section 43B provides that any sum payable by the assessee by way of tax, duty, cess or fee shall be allowed only in computing the income of that previous year in which sum is actually paid by him.

In case of **Nagpur Improvement Trust**<sup>70</sup>, income on account of premium of plots and from sale of shops amounting to ₹ 9.0 crore and ₹ 3.3 crore respectively were treated as capital receipts though the

corresponding expenditure on development works amounting to ₹ 2.5 crore was treated as revenue expenditure. As these incomes

<sup>69</sup> Assessment was completed in December 2007 under section 144/145(3).

<sup>70</sup> Best judgment was completed in December 2007 at a income of ₹ 75.46 lakh and rectified in January 2008 at a loss of ₹ 158.57 lakh.



were derived from commercial activity, these should have been treated as revenue receipts. Further, ₹ 1.1 crore on account of property tax against statutory contribution, though unpaid, was allowed in computing taxable income. The omissions resulted in underassessment of income aggregating to ₹ 13.5 crore with consequent short levy of tax of ₹ 5.8 crore. ***The Department rectified the mistake under section 143(3) read with section 263 of the Act in December 2010.***

#### **4.3.3 IRREGULAR ALLOWANCE OF DEPRECIATION AND BUSINESS LOSSES/ CAPITAL LOSSES**

Irregular allowance of depreciation and business losses/capital losses in 10 cases resulted in short levy of tax of ₹ 2.3 crore in Gujarat, Rajasthan, Maharashtra, Karnataka and West Bengal. Two cases are illustrated below:

##### **A. CHARGE: CIT-(C) II MUMBAI, MAHARASHTRA; AY 2004-05**

Under sections 80 and 139, a person claiming carry forward of loss under the head 'Capital Gains' is required to file return of income within the due date.

**Noshir D Talati**<sup>71</sup>, an individual, was allowed long term capital loss of ₹ 4.4 crore to be carried forward to next year. As the assessee had filed the return in August 2005 i.e. after the extended due date of 31.10.2004 he was not eligible for carry forward of loss. This resulted

in potential tax effect of ₹ 48 lakh. ***The Department rectified the mistake under section 154 of the Act in August 2010.***

##### **B. CHARGE: CIT-I, BARODA, GUJARAT; AY 2007-08**

Section 32 provides for depreciation at the rate of 15 percent of written down value on 'vehicle'. However, 'commercial vehicle' is eligible for higher rate of depreciation.

**Kalpesh S Patel**<sup>72</sup>, an individual, was allowed depreciation of ₹ 1.3 crore on various assets which included depreciation of ₹ 1.1 crore at higher rate

on commercial vehicles. Assessee was eligible for depreciation on vehicle at normal rate as he was in business of civil construction and not running the vehicles on hire. Thus excess allowance of depreciation of ₹ 69.4 lakh resulted in under assessment of income and short levy of tax of ₹ 31.1 lakh. ***The Department rectified the mistake under section 154 of the Act in November 2010.***

<sup>71</sup> Income of ₹ 88.50 lakh assessed in November 2006.

<sup>72</sup> Income of ₹ 3.10 crore assessed in December 2009.

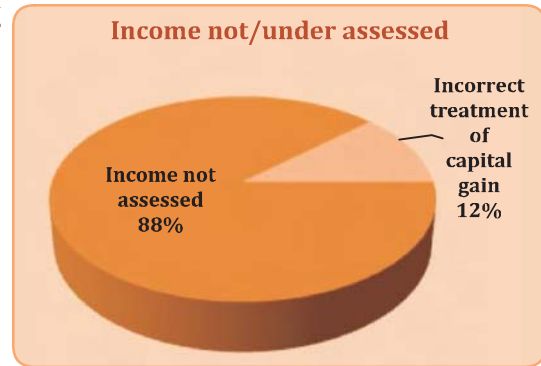


#### 4.4 INCOME NOT/UNDER ASSESSED

The total income of a person for any previous year shall include all incomes from whatever source derived; actually received or accrued or deemed to be received or accrued.

Income was under assessed in 12 cases involving tax effect of ₹ 3.2 crore in Andhra Pradesh, Bihar, Delhi, Gujarat, Maharashtra, Madhya Pradesh, Punjab, Tamil Nadu and West Bengal. The sub-category wise details (based on tax effect) are depicted in Chart 4.4. One sub-category is discussed below:

Chart 4.4: Income not/under assessed



##### 4.4.1 INCOME NOT ASSESSED

We noticed five cases where income was not assessed resulting in short levy of tax of ₹ 2.1 crore in Delhi, Gujarat, Madhya Pradesh, Punjab and Tamil Nadu. One case is illustrated below:

##### CHARGE: CIT-IX, DELHI; AY 2006-07

Under section 143(3), the AO is required to make a correct assessment of the total income or loss of the assessee and determine correct amount of tax or refunds, as the case may be.

In case of **Superior Crafts**,<sup>73</sup> a firm, the AO, while computing the income, did not consider an addition of ₹ 54.6 lakh made by the assessee in its computation of income. The mistake resulted in overassessment of

loss of ₹ 54.6 lakh involving potential tax effect of ₹ 18.38 lakh.

##### 4.4.2 INCORRECT TREATMENT OF CAPITAL GAIN

The AOs committed mistakes in computation of income in seven cases resulting in short levy of tax of ₹ 1.1 crore in Andhra Pradesh, Bihar, Maharashtra, Tamil Nadu and West Bengal. One case is illustrated below:

<sup>73</sup> Assessment was completed after scrutiny determining a loss of ₹ 3.31 crore in June 2008.

## CHARGE: CIT II, MUMBAI, MAHARASTHRA; AY 2006-07

Section 48 provides for computation of capital gains by deducting indexed cost of acquisition of the asset and indexed cost of any improvement from the full value of consideration received as a result of transfer of capital asset. However, this benefit is not allowable in case of computation of business income.

In case of **Bharat Khatiwala**<sup>74</sup>, an individual, the AO treated the Long term capital gain on sale of flat as business income. However, indexation benefit on cost of land, cost of improvement and cost

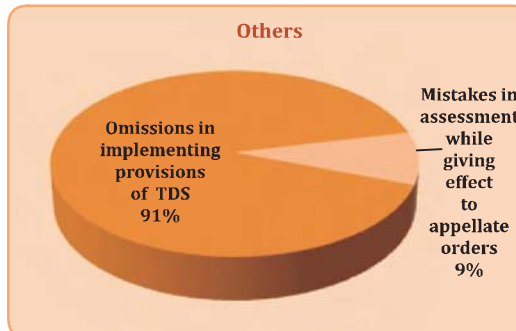
of construction of flat was not withdrawn. Omission resulted in under assessment of income of ₹ 26.3 lakh involving short levy of tax of ₹ 12.2 lakh.

### 4.5 OTHERS

The issues relating to mistakes in assessments while giving effect to appellate orders and omissions in implementing provisions are discussed in this category.

Other mistakes namely, mistake in assessment while giving effect to the appellate order and mistake in implementation of provisions of tax deduction at source (TDS) resulted in short levy of tax of ₹ 1.3 crore in five cases in Maharashtra, Gujarat, and West Bengal. The sub-category wise details (based on tax effect) are depicted in Chart 4.5. One case is discussed below:

Chart 4.5 : Others



#### 4.5.1 OMISSIONS IN IMPLEMENTING PROVISIONS OF TDS

## CHARGE: CIT-X, AHMEDABAD, GUJARAT; AY 2006-07

Section 199 provides that the credit of Tax Deducted at Source (TDS) is to be given in the assessment year in which the income from which the tax deducted at source is assessable.

**Jyoti Plastic Industries**<sup>75</sup>, a firm, was allowed credit of TDS of ₹ 1.83 lakh for job work. In the profit and loss account, assessee did not offer any income on account of job work. Since the credit of TDS was

<sup>74</sup> Income of ₹ 157.18 lakh was assessed after scrutiny in December 2008.

<sup>75</sup> Income of ₹ 13.51 lakh assessed in December 2008.

allowed on the basis of TDS certificate, omission to account for the related income resulted in underassessment of income of ₹ 1.5 crore involving short levy of tax of ₹ 65.9 lakh including interest. **The Department took remedial action under section 143(3) read with section 147 of the Act in December 2010.**

## B - FRINGE BENEFIT TAX

### 4.6 RESULTS OF AUDIT

**4.6.1** We reported 23 cases involving tax effect of ₹ 9.7 crore to the Ministry during August 2011 to October 2011 to elicit their comments.

**4.6.2** The Ministry/Department has replied in respect of 11 cases (48 per cent) accepting our observations involving aggregate revenue impact of ₹ 68 lakh. The Department effected recovery of ₹ 4 lakh in two cases and completed remedial action in nine cases involving revenue impact of ₹ 64 lakh. These 11 cases have been featured in paragraphs in 2.4.4 and 2.4.5 of Chapter II of this report.

**4.6.3** Twelve other cases involving short levy of Fringe Benefit Tax (FBT) of ₹ 9.0 crore have been included in this chapter.

### 4.7 MISTAKES IN COMPUTATION OF FRINGE BENEFIT

Non-compliance with the provisions related to FBT resulted in fringe benefit escaping assessment and under valuation of Fringe Benefits aggregating ₹ 9.0 crore in 12 cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Maharashtra, Tamil Nadu and West Bengal. Two cases are illustrated below:

#### A. CHARGE: CIT -I, TRICHY, TAMIL NADU; AY 2006-07

Under section 115WB(1)(c), fringe benefits, inter alia, include any consideration for employment provided by way of any contribution by the employer to an approved superannuation fund of employees.

**The Karur Vysya Bank Ltd<sup>76</sup>** was allowed a deduction of ₹ 9.6 crore towards contribution to approved superannuation fund for employees. However, as per FBT return the assessee had offered only

₹ 1.2 crore towards contribution to pension fund as fringe benefit as against the actual contribution of ₹ 9.6 crore. This resulted in fringe benefit of ₹ 8.4 crore escaping assessment with consequential tax effect of ₹ 2.8 crore.

<sup>76</sup> Fringe Benefit determined as ₹ 2.87 crore in September 2007 and further revised in August 2008.

## B. CHARGE: CIT -III, DELHI; AY 2006-07

Under section 115WB(2)(D) and 115WA(1), fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession incurred any expenses on, or made any payment for sales promotion.

**Seagram Distilleries Pvt. Ltd.**<sup>77</sup> was allowed deduction of ₹ 19.9 crore under the head 'Advertising, Sales and Rebates'. However, as per FBT return the assessee had offered only

₹ 5.4 crore for FBT as against the total expenditure of ₹ 19.9 crore allowed. This resulted in under assessment of expenditure of ₹ 2.9 crore<sup>78</sup> for the purpose of FBT involving short levy of tax of ₹ 1.3 crore including interest. ***The Department has taken remedial action under section 154 of the Act in April 2011.***

## C - WEALTH TAX

### 4.8 RESULTS OF AUDIT

**4.8.1** We reported 17 cases involving tax effect of ₹ 71.6 lakh to the Ministry during August 2011 to October 2011 to elicit their comments.

**4.8.2** The Ministry/Department has replied in respect of 10 cases (59 per cent) accepting all these cases involving aggregate revenue impact of ₹ 45.9 lakh. Out of these 10 cases, the Department effected recovery of ₹ 13.2 lakh in four cases and completed remedial action in five cases involving tax effect of ₹ 31.6 lakh. The Department has initiated remedial action in one case involving tax effect of ₹ 1.1 lakh. These 10 cases have been featured in paragraphs 2.4.4, 2.4.5 and 2.4.6 of Chapter II of this report.

**4.8.3** Out of 17 cases issued to the Ministry, seven cases involving revenue impact of ₹ 25.7 lakh have been included in this chapter.

### 4.9 NON-CORRELATION OF ASSESSMENT RECORDS

Non-compliance with the Board's instructions<sup>79</sup> resulted in non-levy of wealth tax aggregating ₹ 25.7 lakh in seven cases in Delhi, Gujarat, Maharashtra and Tamil Nadu. One case is illustrated below.

<sup>77</sup> Fringe Benefit determined as ₹ 1.61 crore in December 2009.

<sup>78</sup> 20 per cent of difference (₹ 19.9 crore - ₹ 5.4 crore)

<sup>79</sup> CBDT's instructions issued to the AOs in November 1973, April 1979 and September 1984.


**CHARGE: CIT-III, AHMEDABAD, GUJARAT; AY 2005-06**

The Board issued instructions to the AOs to ensure coordination between assessments pertaining to different direct taxes and for simultaneous disposal of wealth tax and income tax assessment cases to prevent tax evasion. The charge of the wealth tax is on the assets net of liabilities.

**Rasna Processors Private Ltd.<sup>80</sup>**, a company, received rental income of ₹ 2.0 crore during the year on property which attracted the provisions of the wealth tax. However, neither did the assessee file the return of wealth tax nor did the Department initiate

any action to call for the same. The omission resulted in non-levy of wealth tax of ₹ 16.1 lakh including interest. ***The Department has taken remedial action under section 16(5) of the Act in December 2010.***

New Delhi  
Dated: 21 March, 2012

  
(MEENAKSHI GUPTA)  
Director General (Direct Taxes)

**Countersigned**

New Delhi  
Dated: 21 March, 2012

  
(VINOD RAI)  
Comptroller and Auditor General of India

<sup>80</sup> The returned income of ₹ 17.67 lakh was accepted after scrutiny in December 2007.