

## ***EXECUTIVE SUMMARY***

The construction industry has emerged as an important driver of India's economic growth – both in terms of its share of GDP and its contribution towards employment generation. A number of tax concessions are given to entities in this sector. An earlier performance audit conducted during the year 2002-03 by us revealed systemic and compliance deficiencies and several irregularities in assessment of entities in the sector.

The main objectives of our study were to ascertain whether the Income Tax Department has made significant efforts to widen and deepen the tax base in this potential area and ensured proper compliance of the provisions of the Act by the entities engaged in this sector.

An overview of the specific audit findings and key recommendations included in this Report is as follows:

### **Legal Framework (Chapter 2)**

#### **Audit Findings**

Although Section 80IB(10) was introduced to incentivize building of housing for low and middle income groups, the Act did not provide for the conditions defining the low and middle income groups. Our analysis in West Bengal and Tamil Nadu charges indicated that residential construction projects targeting HIGs were availing the tax incentive, thereby frustrating the legislative intent behind it.

We noticed that a number of entities assessed in construction business were registered as firms/AOP with their turnover and profits comparable to some companies in the same sector. However, the provisions of MAT being applicable only to Companies, favoured the firms who could get away by paying nil or minimal tax.

Builders/developers are using Transfer of Development Rights (TDRs) for constructing extra floor space index (FSI) or selling them to other developers. In absence of TDS provisions, the department could not levy TDS on TDR transactions.

Builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/mobilization advances. In absence of proper mechanism on these payments there was material risk of the related receipts not being offered to tax.

Section 80(IB) allows deduction of profits to undertakings engaged in developing and building housing projects. This Section, however, does not disallow claims on conditions of non-deduction of TDS on certain payments unlike Section 40(a)(ia). Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed under Section 80(IB).

We found lack of clarity/uniformity on deduction/treatment of certain elements of income and expenditure like interest towards borrowed fund, income derived from leasing of properties held in stock in trade, sale of parking space and allowing TDS credit on mobilization advances etc.

### **Key Audit recommendations**

*We recommend that*

- *A cap linked to Housing Pricing Index on the sale value of the flats constructed by the builders/contractors may be considered as a condition for claiming deduction under section 80IB(10) so that legislative intent of providing affordable housing is met.*
- *The purview of Section 115JB i.e MAT may be extended to Firms/AOP who are taking advantage of deductions available in the Act.*
- *CBDT may consider introducing suitable mechanism in the statute to reduce tax evasion in cases of TDR transactions and payments of compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/ mobilization advances to safeguard the interest of revenue.*
- *CBDT may issue necessary instructions for uniform treatment of income derived from leasing of properties held in stock in trade, income from sale of parking space and expenses on 'Interest on borrowed funds' and 'Directors' meeting fee/project management fee'.*

## Internal controls (Chapter 3)

### Audit Findings

The Department does not have a proper database of the assessees engaged in the business of civil construction. Non filers could not be identified by cross linking the records of the Department with that from third party sources as PAN details of the contractors engaged in the works departments were not available in most cases. The input controls on data capture of business codes in the central AST database of taxpayers were found to be weak, thereby hindering sectoral analysis and planning.

The bulk of the information collected by the CIB from third party sources were not being collated and disseminated to user levels. Further, there was no mechanism to ascertain the extent of use of disseminated data by the AOs.

We found that the Department was not initiating action against the erring statutory auditors for incorrect certification in their tax audit report.

### Key Audit recommendations

*We recommend that*

- *The Department may prepare a complete and accurate database of assessees in the sector. It may also ensure that the data received by CIB is sorted out and disseminated promptly, enabling effective scrutiny and widening of the tax net.*
- *CBDT may devise a system to monitor compliance with the existing rules/instructions so that the department may initiate action against the erring statutory auditors.*

## Information sharing and scrutiny (Chapter 4)

### Audit Findings

Information and records on related assessees were found to be rarely shared and cross verified by the concerned AOs. In 15 cases, in absence of cross verification of records available with the AOs, income of ₹ 49.26 crore escaped assessment.

We found 256 cases involving tax effect of ₹ 83.54 crore in which income in the hands of TDS deductees escaped assessment due to short/non accountal of contract receipts, in their profit and loss accounts.

We noticed 220 cases of inadmissible claims involving tax effect of ₹ 469.10 crore on which TDS was not deducted or where deducted, was not remitted to the Government.

### **Key Audit recommendations**

*We recommend that*

- *CBDT may issue necessary instructions for sharing of information regarding high value transactions among the concerned AOs to prevent leakage of revenue.*
- *CBDT may ensure that no TDS credits are allowed without quoting PAN of the deductee.*
- *CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with.*

## **Special provisions for civil construction (Chapter 5)**

### **Audit Findings**

Deductions admissible for housing projects under section 80IB(10) and for infrastructure development under section 80IA(4) were allowed even in cases where though the assesseees were not eligible to claim deductions as they were not fulfilling the conditions provided in the Act. We noticed mistakes in 142 cases involving tax effect of ₹ 326.38 crore indicating poor monitoring and lack of internal controls in assessments leading to inadmissible deductions.

Mistakes in assessments of Public Private Partnership projects were noticed in seven cases involving tax effect of ₹ 43.72 crore relating to depreciation on Government leased assets, expenses against exempt income, escapement of income for not following regular method of accounting.

We also noticed 67 cases involving tax effect of ₹ 140.59 crore where revenue was not recognized by applying the percentage completion method as Accounting Standard 7 as revised with effect from 2003.

### **Key Audit recommendations**

*We recommend that*

- *CBDT may issue necessary instructions to monitor the deductions allowed for housing and infrastructure projects by providing suitable checks through internal audit.*
- *Assessing Officers may ensure that accounting treatment for ongoing construction projects commenced after April 2003 conform to Accounting Standard 7 as revised*

## **Omissions in assessments (Chapter 6)**

### **Audit Findings**

We noticed mistakes relating to computation of business income, capital gains, income under MAT provisions, incorrect allowance of depreciation or setting off past losses, incorrect allowance of provision/liability, incorrect allowance of capital expenditure/non business expenditure, and incorrect valuation of closing stock etc. These mistakes involved aggregate tax effect of ₹ 642.44 crore in 675 cases.

### **Key Audit recommendations**

*We recommend that*

- *CBDT may devise an appropriate control mechanism with clearly defined responsibilities to ensure that provisions of the Act are complied with. Wherever it is felt necessary the Department may also explore the possibility of capacity building for reducing the incidence of mistakes.*