

## EXECUTIVE SUMMARY – CHAPTER - III

<b>Unrealistic BEs</b>	Significant variations were noticed persistently between budget estimates and actual receipts.
<b>Results of audit</b>	<p>In 2011-12, 32 units relating to agricultural income tax were test checked and found underassessment of tax and other irregularities involving ₹ 24.98 crore in 13 cases.</p> <p>The Department accepted underassessment and other deficiencies of ₹ 6.21 lakh in seven cases.</p>
<b>Very low recovery by the Department</b>	During the period 2007-08 to 2010-11, inadmissible expenses, income escaping assessment, incorrect computation of income etc. with revenue impact of ₹ 54.99 crore were pointed out in 208 paragraphs. Of these, the Department accepted audit observation in 50 cases involving ₹ 1.52 crore but recovered only ₹ 0.23 crore in 26 cases.
<b>What is highlighted in this Chapter</b>	<p>In this Chapter illustrative cases of selected observations noticed during test check of records relating to Agricultural Income Tax Office are brought out. It was found that the provisions of the Act/Rules were not observed.</p> <p>It is a matter of concern that similar omissions have been pointed out repeatedly in the Audit Reports for the past several years, but the irregularities persist, and remain undetected.</p>
<b>Conclusion</b>	<p>It is recommended that internal audit may be operationalised immediately. Further, the Department needs to improve the internal control system so that weaknesses in the system are addressed and omissions of the nature detected by us are avoided in future.</p> <p>It also needs to initiate immediate action to recover the inadmissible expenses, income escaping assessment, incorrect computation of income etc. pointed out by us, more so in those cases where it has accepted our contention.</p>

## CHAPTER - III : TAXES ON AGRICULTURAL INCOME

### 3.1 Tax administration

The levy and collection of taxes on agricultural income is governed by The Kerala Agricultural Income Tax (KAIT) Act 1991 and is administered by Commissioner of Commercial Tax (CCT). The assessment, levy and collection are looked after by Inspecting Assistant Commissioners, Agricultural Income Tax and Commercial Tax Officers. The Department of Commercial Taxes is under the control of the Secretary to Government (Taxes) at the Government level.

Companies and persons, who derive agricultural income within the State are liable to KAIT. In respect of Companies tax at the rates prescribed in the Schedule to the Act shall be charged. From April 2000, persons holding landed property upto 500 hectares may opt to pay tax at compounded rate. No tax is payable on first five hectares.

### 3.2 Trend of receipts

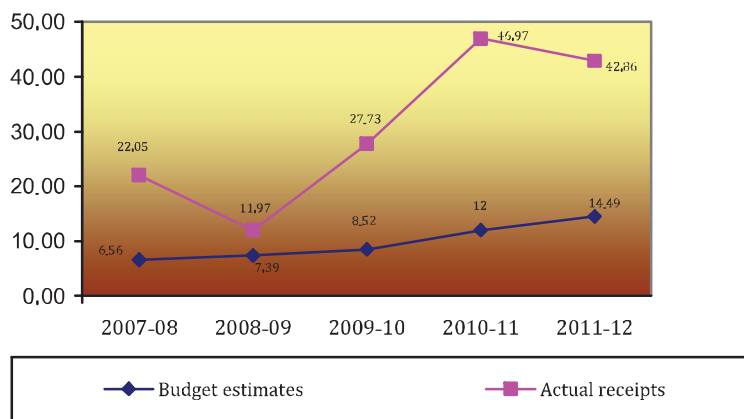
Actual receipts (AR) from agricultural income tax during the last five years (2007-08 to 2011-12) along with the budget estimates (BEs) during the same period are exhibited in the following table and graph.

(₹ in crore)

Year	Budget Estimates	Actual Receipts	Variation	Percentage of variation	Total tax receipts of the State	Percentage of actual receipts vis-à-vis total tax receipts	Percentage of growth rate
2007-08	6.56	22.05	(+) 15.49	(+) 236.13	13,668.95	0.16	128.97
2008-09	7.39	11.97	(+) 4.58	(+) 61.98	15,990.18	0.07	(-) 45.71
2009-10	8.52	27.73	(+) 19.21	(+) 225.47	17,625.02	0.16	131.67
2010-11	12.00	46.97	(+) 34.97	(+) 291.41	21,721.69	0.22	69.38
2011-12	14.49	42.86	(+) 28.37	(+) 195.79	25,718.60	0.16	(-) 8.75

Source : Finance Account of relevant year

**Budget estimates and Actual receipts**



It was noticed in Audit that during 2011-12 the Department could not maintain the growth rate achieved during the previous year. Department may streamline its budgeting process to make the budget estimates realistic as significant variations were noticed persistently between budget estimates and actual receipts.

### **3.3 Arrears in AIT assessment**

The Department furnished the position of arrears under agricultural income tax which is as shown below :

Opening balance	7,050
Addition during 2011-12 including remanded cases	2,757
<b>Total</b>	<b>9,807</b>
No. of assessments completed	5,067
Arrear cases – 4,005	
Current cases – 1,059	
Remanded cases – 3	
Closing balance	<b>4,740</b>

The table above shows that the Department completed 5,067 assessments which was 51.67 per cent of the arrears outstanding.

### 3.4 Impact of Audit

#### Revenue Impact

During the last four years, cases of inadmissible expenses, income escaping assessment, incorrect computation of income, underassessment due to assignment of incorrect status etc., with revenue implication of ₹ 54.99 crore in 208 paragraphs were pointed out. Of these, the Department/Government accepted audit observations involving ₹ 1.52 crore and had since recovered ₹ 0.23 crore. The details are shown in the following table:

(₹ in crore)

Year of Audit Report	Paragraphs included		Paragraphs accepted		Amount recovered	
	No.	Amount	No.	Amount	No.	Amount
2007-08	43	3.69	17	0.35	10	-
2008-09 Vol. I	67	28.66	9	0.12	4	0.11
2009-10	39	5.57	19	0.95	11	0.12
2010-11	59	17.07	5	0.10	1	-
<b>Total</b>	<b>208</b>	<b>54.99</b>	<b>50</b>	<b>1.52</b>	<b>26</b>	<b>0.23</b>

The recovery of cases vis-à-vis the amount accepted was negligible.

### 3.5 Working of Internal Audit Wing

As the Department did not furnish detailed information on internal audit, Audit was unable to comment on the performance of the Internal Audit Wing (IAW).

### 3.6 Results of audit

In 2011-12 Audit test checked records of 32 units relating to agricultural income tax. Under assessment of tax and other irregularities involving ₹ 24.98 crore in 13 cases were noticed in audit which fall under the following categories:

(₹ in crore)

Sl. No.	Categories	No. of cases	Amount
1.	Income escaping assessment	4	23.11
2.	Incorrect computation of tax	3	0.03
3.	Inadmissible expenses	2	0.54
4.	Others	4	1.30
<b>Total</b>		<b>13</b>	<b>24.98</b>

During the course of the year, the Department accepted underassessment and other deficiencies of ₹ 6.21 lakh in 7 cases out of which one case involving ₹ 7,158 was pointed out in audit during the year 2011-12. The Department realised an amount of ₹ 6.21 lakh in seven cases during the year 2011-12.

A few illustrative audit observations involving ₹ 5.45 crore are mentioned in the succeeding paragraphs.

### **3.7 Audit observations**

*Scrutiny of the assessment records of agricultural income tax in Commercial Taxes Department revealed several cases of non-observance of provisions of Act/Rules, incorrect determination of income/interest, grant of inadmissible expenses/allowances and other cases as mentioned in the succeeding paragraphs in this chapter. These cases are illustrative and are based on a test check carried out in audit. Such omissions on the part of the Assessing Authorities (AAs) are pointed out in audit each year but not only do the irregularities persist, but these also remain undetected till an audit is conducted. There is need for the Government to improve the internal control system including strengthening of the internal audit.*

### **3.8 Non-observance of provisions of Act/Rules**

*Under the KAIT Act and Rules made thereunder, for completing assessments the following aspects should be observed:*

- i) tax shall be levied at the prescribed rate on the agricultural income derived by the assessee;*
- ii) deductions shall be allowed on income derived subject to certain conditions; and*
- iii) interest shall be levied on the balance tax payable.*

*It was noticed that while finalising the assessment, the AAs did not observe some provisions which resulted in short levy of tax and interest of ₹ 5.45 crore as mentioned in the paragraphs 3.8.1 to 3.8.3.*

#### **3.8.1 Incorrect determination of taxable income**

(IAC(AIT), Kottayam; March 2012)

The Kerala Agricultural Income Tax Act, 1991 stipulates that where an allowance or deduction is made in the assessment for any year in respect of loss or expenditure and if the assessee obtained any amount in lieu of such loss, the amount so obtained shall be deemed to be agricultural income.

It was noticed (December 2010) from the assessment records of KFDC Ltd.<sup>1</sup> for the assessment year 2008-09 that as per balance sheet an amount of ₹ 3.64 crore received as subsidy by the assessee as a compensation for selling timber at reduced price was neither shown as income in the assessment return filed by the assessee nor was it assessed by the AIT officer though it was an agricultural income. The omission resulted in non-levy of tax of ₹ 1.82 crore.

After this being pointed to the Department and the Government in March 2012, the Government stated (September 2012) that the subsidy received by the

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<sup>1</sup> Kerala Forest Development Corporation Limited.

corporation from the Government was an allowance intended for the compensation of loss happened by fall in price of timber and hence not agricultural income. The reply is not acceptable as the subsidy received was towards fall in price and as such was part of total agricultural income since there was no fall in price of timber and the amount received had to be reckoned as part of sale price.

### 3.8.2 Incorrect allowance of expenses

- (IAC(AIT), Kottayam; March 2012)

Section 5 of the KAIT Act enumerates the deductions allowable from the agricultural income. Cost of failed plantation and prior period expenditure are not included in the list of the items on which deduction is allowable under the Act.

It was noticed that while finalising the assessment (December 2010) of a public sector company (KFDC Ltd.) for the assessment year 2008-09 the assessing officer

allowed an amount of ₹ 3.04 crore being the cost of failed plantations. This resulted in escape of income of ₹ 3.04 crore with tax effect of ₹ 1.52 crore.

After the matter was pointed out to the Department and to the Government in June 2012, the Government stated (September 2012) that the corporation was raising plantations solely for felling and sale of wood and income out of this sale was subjected to tax and hence cost of raising it ought to have been allowed for deduction. Further, failure of plantation is a universal phenomenon and certain percentage of the seedlings would perish before attaining maturity.

It is clear from the reply that the plants had perished when plants were in the immature stage and in view of the provision in the Act that expenditure incurred for the cultivation, upkeep or maintenance of immature plants from which no agricultural income is derived during the previous year shall not be allowed.

- (IAC(AIT), Kottayam; January 2012)

It was noticed that while finalising the assessment (October 2010) of a public limited company (KFDC Ltd) for the year 2008-09 the assessing officer allowed prior period expenditure of ₹ 33.59 lakh being expenditure incurred by the assessee towards various expenditure during earlier years. This resulted in escape of income of ₹ 33.59 lakh with consequent tax effect of ₹ 16.80 lakh.

After the matter was pointed out to the Department in January 2012 and reported to Government in March 2012, the Government stated (September 2012) that certain income and expenditure which relate to previous years are accounted by the corporation under the head 'Prior period income' and 'Prior period expenditure' in their books of accounts but they were actually derived and incurred in the current year itself. The reply is not tenable since the Act does not allow the adjustment of expenditure incurred in previous year against income in subsequent year.

### 3.8.3 Incorrect exemption of income led to income escaping assessment

#### 3.8.3.1 (IAC(AIT&CT), Mattancherry)

Section 2(1)(a) of KAIT Act 1991 stipulates that any rent or revenue derived from land which is used for agricultural purposes is agricultural income. The agricultural income derived from cultivation of pine apple is exempt from levy of agricultural income tax; however, lease rent is not exempted from agricultural income tax.

It was noticed that while finalising the provisional assessment of a domestic company (Harrison Malayalam Ltd.) for the years 2006-07 and 2007-08 the assessing authority exempted the income of ₹ 1.45 crore and ₹ 1.42 crore received respectively by the company on account of lease rent/licence fee for inter crop cultivation of pineapple in the rubber division and tea division instead of levying tax on the income received by the assessee. The omission to assess the aggregate income of ₹ 2.87 crore resulted in non-levy of tax of ₹ 1.44 crore.

After the matter was pointed out to the Department in October 2010 and to the Government in December 2010, the Government stated (October 2011) that the agricultural income derived from cultivation of pineapple was not taxable and hence the lease rent/licence fee could not be assessed to agricultural income tax. The reply is not tenable as only agricultural income derived by pineapple cultivation is exempt, the rent received from land used for agricultural purposes is taxable irrespective of the fact that source is taxable or not and that the cause of income by the tax payer, i.e. the assessee, is lease.

#### 3.8.3.2 (IAC(AIT), Kottayam)

The KAIT Act, 1991 stipulates that agricultural income means any income derived from land by sale by the cultivator or received by him in respect of which no process has been performed. The forest development tariff is the amount collected by the assessee at five *per cent* of the value of invoice raised during the year for timber and timber growth retained by him. As this is an additional source of revenue for the assessee, the same will form part of his agricultural income. From April 2005 onwards agricultural income tax leviable in the case of domestic company having total agricultural income exceeding rupees three lakh is 50 *per cent* of the total agricultural income.

It was noticed that while finalising the assessment of a public limited company (KFDC Ltd.) (October 2010) in IAC Kottayam, the assessing officer did not include forest development tariff of ₹ 66.58 lakh collected by the assessee in his income. This resulted in escape of income of ₹ 66.58 lakh with resultant short levy of tax of ₹ 33.29 lakh.

After the case was pointed out to the Department (January 2012) and reported to the Government (March 2012), Government stated (August 2012) that as per a tribunal decision<sup>2</sup>, forest development tariff is a separate levy and cannot be treated as part of sale value and does not form part of income. The reply is not correct since tax and development tariff are different. The tax paid is an allowable deduction whereas the forest development tariff is collected by the assessee from the purchasers of forest produce which is retained by them and hence form part of agricultural income under the KAIT Act. Tribunal decision cited is about forest development tax and not development tariff. Further report has not been received (December 2012).

### 3.8.3.3 (IAC(AIT), Kottayam)

The KAIT Act, 1991 allows deduction of expenditure not being in the nature of capital expenditure or personal expenses of the assessee expended wholly and exclusively for the purpose of deriving agricultural income.

It was noticed that while finalising the assessment of a public limited company (KFDC Ltd.) for the year 2008-09, the assessing officer allowed deduction of an amount of ₹ 34.35 lakh on

account of property written off and shown as expenditure in the Profit & Loss account. Since no agricultural income was derived from the property written off no deduction was admissible. The incorrect deduction resulted in escape of income of ₹ 34.35 lakh with short levy of tax of ₹ 17.17 lakh.

The matter was pointed out to the Department in January 2012; reply has not been received (December 2012).

The matter was reported to the Government in March 2012; their reply has not been received (December 2012).

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<sup>2</sup> 12 KTR 62