

Chapter 1: Introduction

1.1 Introduction

The Income Tax Act, 1961 (Act) proposes imposition of penalty on an assessee, if the Assessing Officer (AO)/Commissioner of Income Tax-Appeals/Commissioner of Income Tax (CIT) is satisfied that there has been non-compliance with or violation of law and there is no reasonable cause for failure. The maximum penalty under the present laws is levying of penalty up to three times the tax proposed to be evaded with or without prosecution of the offender. The provisions also provide for AO or any other authority to waive/drop any proceedings initiated subject to fulfillment of conditions.

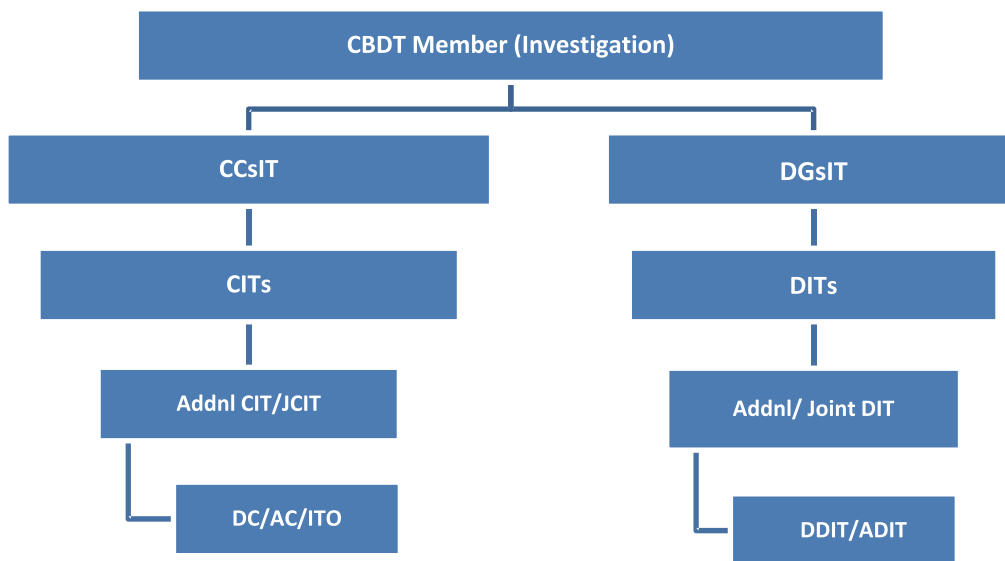
The Prosecution provisions contained in Chapter XXII of the Act, declares certain acts of omission and/or commission as punishable offences. Offences and Prosecution under the Act are read in conjunction with other laws such as Indian Penal Code (IPC), Code of Criminal Procedure (Cr PC) and Indian Evidence Act (IEA).

1.2 Organizational set up

The Central Board of Direct Taxes (CBDT) is the apex body in Department of Revenue (DoR) under Ministry of Finance (Ministry) charged with the administration of Direct Taxes. Member (Investigation) in the CBDT is responsible for technical and administrative matters relating to prevention and detection of tax evasion, including all matters falling under Chapter XXI of the Act and corresponding provisions of other Direct Tax Acts.

Income Tax Department (ITD) which functions under supervision and control of CBDT is divided into regions, and each region is headed by a Chief Commissioner of Income Tax (CCIT) or a Director General of Income Tax (DGIT). Commissioners/Directors of Income Tax (CIT/DIT) head the assessment functions which are carried out through the Additional CIT/DIT, JCIT/JDIT and DDIT/DC/ADIT/AC/ITO. Officers carrying out assessment functions and those other authorities specified in the Act can levy penalties for acts of omission or commission by assesseees. The organogram of ITD for administration and levy of penalty is as follows:

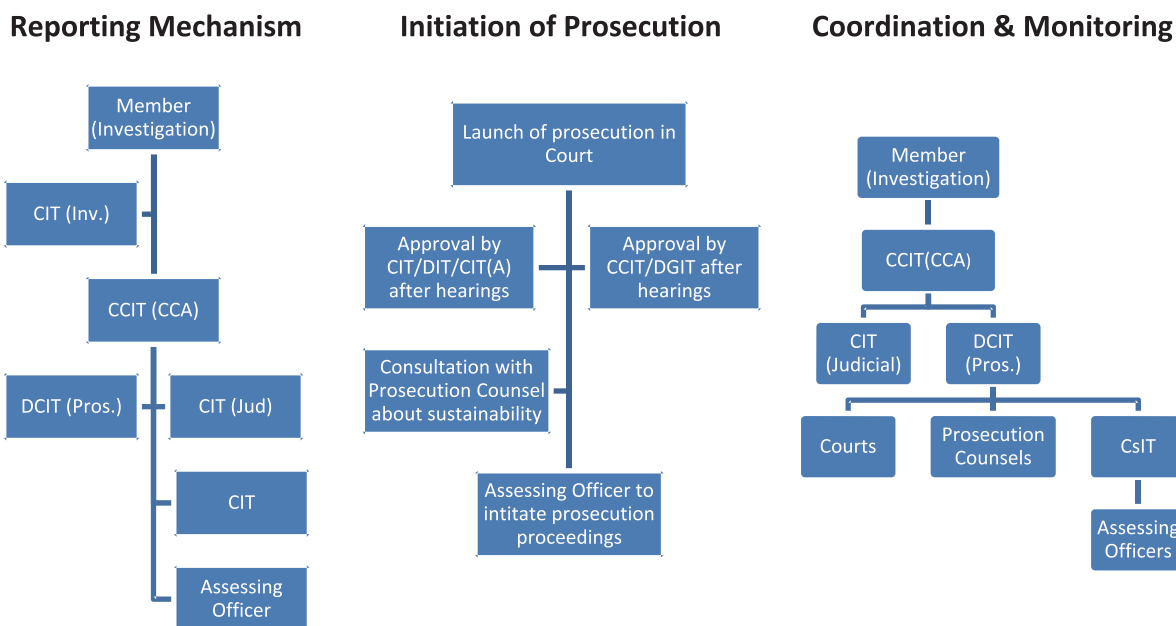
Chart 1.1 : Organogram of Penalty



Member (Investigation) in the CBDT has the overall charge of prosecution work in the ITD. He is assisted by CIT (Inv), Director (Inv) and DDIT (Prosecution). This set up handles the MIS reports, monitoring and functioning of the prosecution in the ITD.

The prosecution wing in the field functions under CCsIT with CIT (Judicial) as the Controlling Authority. DCIT (Prosecution) under CIT (Judicial) assisted by Inspectors and other staff is the Nodal Officer to attend to the day to day functions. The organogram of the prosecution work in CBDT and field formation of ITD is as follows:

Chart 1.2 : Organogram of Prosecution



1.3 Why we chose this topic

The Wanchoo Committee report of 1975 recommended that ITD needs to evolve vigorous prosecution policies and pursue it. It also stated that monetary penalties may always not be enough. The White Paper on Black Money of May 2012 published by Ministry of Finance described that taxpayers may be willing to take a calculated risk of tax evasion and may even justify it as a 'commercial risk'. Such calculated risk taking may be more effectively deterred by effective prosecution. A committee headed by the Chairman of CBDT constituted in May 2011 for examining ways to strengthen laws to curb the generation of black money in the country, its legal transfer abroad and its recovery recommended *inter alia* establishment of special judicial set up within the existing framework as also amendments to various fiscal statutes so that they become stronger. ITD has also taken several efforts to streamline and strengthen the deterrence mechanisms against tax evasion in general and income tax in particular.

As penalty and prosecution are important deterrent mechanisms, we felt it necessary to examine the administration and implementation of penalty and prosecution machinery, by the CBDT and its field formations for combating tax evasion. We sought to achieve this by examining current structures, its utilization and effectiveness.

The status of penalty proceedings during the last five years is indicated below:

Table 1.1: Status of penalty proceedings (in numbers)

Particulars	FY 09	FY 10	FY 11	FY 12
1. Total scrutiny assessments done	5,38,505	4,29,585	4,55,212	3,69,320
2. Total penalty proceedings pending	2,28,696	2,49,071	2,34,795	2,56,414
3. Disposal of penalty proceedings	69,692	81,208	1,46,337	85,661
4. Balance of penalty proceedings	1,59,004	1,67,863	1,67,314	1,70,753

Source: Central Board of Direct Taxes

The table data indicates that penal provisions are being invoked almost in fifty *percent* of the assessments carried out in scrutiny cases done every year. Cases are selected for scrutiny assessments based on pre determined parameters where there is a preponderance of escapement of income from tax.

The status of prosecutions is as follows:

Table 1.2: Status of Prosecution cases

Financial Year	Prosecution launched	Cases decided	Convictions	Compounded	Acquitted
FY 08	263	280	11	13	256
FY 09	162	146	14	13	119
FY 10	312	599	32	291	276
FY 11	244	356	51	83	222
FY 12	209	593	14	397	182
Total number of cases pending as of March 2013:				3,088	
Total number of complaints as of March 2012:				10,538	

Source: Central Board of Direct Taxes

The above table shows that acquittals in prosecution cases are high.

Timeliness and adequacy for disposal of prosecution cases are important. Supreme Court underlining the need for timely disposal of cases has stated:

A suit often drags on for years and it is undesirable that a criminal prosecution should wait till everybody concerned has forgotten all about the crime. The public interests demand that criminal justice should be swift and sure; that the guilty should be punished while the events are still fresh in the public mind and that the innocent should be absolved as early as is consistent with a fair and impartial trial. Another reason is that it is undesirable to let things slide till memories have grown too dim to trust¹.

In this back ground, we felt that a performance study of the working of deterrent mechanisms on tax manipulation and evasion seemed to be in order.

1.4 Objectives of the Review

The objectives of our audit were as follows: -

A In respect of Penalty

- a. Whether the mechanism for administration and implementation of penalties for various defaults existed and are functional,
- b. Whether penalty proceedings indeed have the deterrent effect on tax evaders as measured by the incidence of penalty.

¹ Radheyshyam Kejriwal vs. State Of West Bengal (Criminal Appeal No. 1097 of 2003) 18.02.2011 Supreme Court.

B In respect of Prosecution

- a. Whether the tool of prosecution has been used only in the rarest of rare cases,
- b. Whether functional efficiency of the prosecutions mechanism at various levels exists,
- c. Whether prosecutions have had the necessary impact in curbing tax evasion.

1.5 Scope and methodology of audit

In this Performance Audit, we studied whether the provisions on the Penalty and Prosecution have been appropriately deployed and judiciously operated to effect tax deterrence. We audited all the 18 CCsIT (CCA) regions covering all the States.

We examined prosecution procedures with focus on administrative and implementation mechanisms and their effectiveness. The review envisaged examination of assessments concluded during FY 10, FY 11 and FY 12 for penalty proceedings. As regards prosecution, we examined all cases which were decided by way of conviction, acquittal, compounding during FY 10, FY 11 and FY 12. In respect of live cases, we examined fifty *per cent* of the cases.

We examined the records available with the jurisdictional AOs and Offices handling prosecution under the CCsIT (CCA). In a few cases, we also correlated with the jurisdictional Courts where cases were purported to be pending. Certain records and reports were also examined in the CBDT to correlate the data being sent by jurisdictional officers, as per monitoring mechanisms laid out.

1.6 Discretionary power

Unlike the levy of interest which is compensatory in nature, imposition of a penalty does not follow ipso facto on the commission of a default. As per the Act, competent authority has the discretion not to levy the penalty if the assessee can show reasonable cause. It is implicit that when the statute confers a power, it is to be exercised in a reasonable manner for the purpose for which it was conferred. Penalty proceedings may be initiated by the Assessing Officer (AO) only on his satisfaction which should be absolute and based on definite information.

1.7 Legal provisions

Chapter XXI and XXII of the Act detail the powers of ITD for imposition of penalty and institution of prosecution for a variety of defaults/offences committed by the assessee. Various circulars issued by the CBDT from time to time also prescribe modalities for prosecution. Sections 271 to 272BBB deal with levy of penalty for different defaults committed, whereas Sections 275A to 280 relate to offences and prosecution. (See **Annex A** for details).

1.8 Acknowledgement

We held an entry conference with the Member (Audit & Judicial) in November 2012 in which we explained the audit objectives, scope, methodology and thrust areas of audit examination. The Indian Audit and Accounts Department acknowledges the cooperation of ITD in facilitating the audit.

We held the Exit Conference in October 2013 with the Ministry/CBDT wherein we discussed our findings and recommendations. We have incorporated the views expressed by the Ministry/CBDT in the Report.