

Chapter IV: Assessment of Firms

4.1 Introduction

We noticed mistakes relating to incorrect allowance of exemption/deduction, capital gains, carry forward and set off of losses, computation of income, incorrect allowance of depreciation etc in the assessments of Firms made by the ITD.

Several sections of the Act dealing with generic issues in the context of revenue collection have been incorporated in this chapter. We noticed 287 cases relating to mistakes, where the provisions of the Act were not followed correctly, with a tax effect of ₹ 244.57 crore. Category wise details of mistakes in assessment are shown in Table 4.1.

Table 4.1: Nature of mistakes with its tax effect

Nature of Mistakes	Cases	Tax effect (₹ in crore)
1. Income not assessed	56	44.13
2. Incorrect allowance of exemption/deduction	40	59.60
3. Mistakes in computation of Income	28	19.64
4. Depreciation/Set off of losses	44	25.00
5. Incorrect allowance of expenditure/provision	24	9.19
6. Capital gains	15	27.26
7. Other cases	80	59.75
Total	287	244.57

Assessing Officers did not assess income of the 56 Firms which resulted in short levy of tax of ₹ 44.13 crore.

4.2 Income not assessed

Section 5 of Act provides that 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.

We found 56 cases in 13 states²¹ involving ₹ 44.13 crore where income was not offered to tax (see Box 4.1).

Box 4.1: Illustrative cases on income not assessed

- a. In Andhra Pradesh, CIT-III Hyderabad charge, AO completed the assessment of **M/s. Dream Resorts** for AY 09 after scrutiny where the assessee received total amount of ₹ 14.85 crore towards settlement of bank dues. However, the assessee offered only ₹ 5.77 crore as income and hence, balance amount of ₹ 9.08 crore escaped assessment leading to short levy of tax of ₹ 3.90 crore including interest.

²¹ Maharashtra, Tamil Nadu, Rajasthan, Punjab, Haryana, Assam, Karnataka, Andhra Pradesh, Madhya Pradesh, Uttar Pradesh, Bihar, West Bengal and Chhattisgarh.

b. In Tamil Nadu, CIT-I Madurai charge, AO completed the assessment of **M/s. LPL Sons Roadlines** for AY 10 at nil income. We noticed that the assessee had shown total amount of ₹ 9.62 crore received towards lorry freight, hire charges and commission in the Income & Expenditure Accounts although assessee had actually received a total amount of ₹ 20.01 crore for the same during the year. Hence, the amount of ₹ 10.39 crore escaped income which resulted in short levy of tax of ₹ 3.50 crore.

Assessing Officers allowed incorrect exemption/deduction of 40 Firms resulting in short levy of tax of ₹ 59.60 crore.

4.3 Incorrect allowance of exemption/deduction

Chapter VIA and section 10 of the Act provide for certain deduction/exemptions in computing total income of an assessee subject to fulfillment of conditions specified therein.

We noticed 40 cases of incorrect allowance of exemption/deduction in 13 states²² involving tax effect of ₹ 59.60 crore (see Box 4.2).

Box 4.2: Illustrative cases on incorrect allowance of exemption/deduction

a. In Tamil Nadu, CIT-I Chennai charge, AO while completing the assessment of **M/s. Plaza Realities** for AY 10 under scrutiny, allowed deduction under section 80IB(10) for a sum of ₹ 13.46 crore. We noticed that the assessee entered into the contract with the land owner for the construction and therefore as per explanation inserted to the Act by Finance (No.2) Act, 2009, the assessee, being a contractor, should not have been allowed deduction under section 80IB of the Act. Mistake in allowing ineligible deduction resulted in short levy of tax of ₹ 6.59 crore.

b. As per section 10B(2)(iii) of the Act, if the new unit is formed by transfer of any plant and machinery previously used for any purposes, the unit is not entitled to claim any deduction under section 10B. In Tamil Nadu, CIT-VIII Chennai charge, AO completed the assessment of **M/s. Indira Industries** for AY 09 under scrutiny and allowed deduction of ₹ 7.86 crore under section 10B of the Act even though the assessee had installed the machinery which had already been previously used. The mistake resulted in under assessment of income by an equal amount involving short levy of tax of ₹ 3.73 crore.

²² Maharashtra, Tamil Nadu, Gujarat, Rajasthan, Punjab, Haryana, Himachal Pradesh, J&K, Jharkhand, Assam, Karnataka, Andhra Pradesh and Madhya Pradesh.

Assessing Officers committed mistakes in computation of income in 28 cases involving tax effect of ₹ 19.64 crore.

4.4 Mistakes in computation of Income

Section 143(3) of the Act provides that AOs have to determine and assess the income correctly. Different types of claims together with accounts, records and all documents enclosed with the return are required to be examined in detail in scrutiny assessments. CBDT has also issued instructions from time to time in this regard.

We noticed 28 cases of mistakes in computation of Income in eight states²³ involving tax effect of ₹ 19.64 crore (see Box 4.3).

Box 4.3: Illustrative cases on mistakes in computation of income

- a. In Andhra Pradesh, CIT-III Hyderabad charge, AO completed the assessment of **M/s. Edelvalue Partners**²⁴ for AY 11 after scrutiny at a loss of ₹ 26.69 crore as declared by the assessee. Audit noticed that the assessee deducted gross unrealized gain²⁵ of ₹ 30.17 crore instead of net unrealized gain of ₹ 7.58 crore from the net profit. The mistake resulted in under assessment of income of ₹ 22.59 crore involving potential tax effect of ₹ 6.83 crore. The ITD did not accept (May 2013) the audit observation stating that net unrealized gain was arrived at by adopting Accounting Standard-30 and the same needs to be deducted from the net profit. The reply itself confirms that the net unrealized gain should have been deducted from the net profit.
- b. In Karnataka, DGIT (Investigation) Bangalore charge, AO completed the assessment of **M/s Devi Enterprises** for AY 11 under section 153(c)/144 of the Act at an income of ₹ 49.12 crore. We observed that AO had adopted the advance tax at ₹ 450 lakh instead of correct amount of ₹ 460 lakh and levied surcharge on tax which was not applicable for the relevant AY. The mistake resulted in excess levy of tax of ₹ 1.60 crore. The ITD rectified the mistake under section 154 of the Act (June 2013).
- c. In Maharashtra, CIT-XV Mumbai charge, AO while completing the assessment of **M/s. Siddhivinayak Developers** for AY 08 after scrutiny in December 2009, considered the value of opening stock in the Profit & Loss Account at ₹ 32.08 lakh instead of correct amount of ₹ 184.08 lakh. The mistake resulted in under assessment of income of ₹ 152 lakh involving short levy of tax of ₹ 68.05 lakh.

²³ Maharashtra, Punjab, Karnataka, Andhra Pradesh, Madhya Pradesh, Delhi, Odisha and Uttar Pradesh.

²⁴ Engaged in business of trading in derivatives, securities and commodities.

²⁵ Included under income from treasury operations in Profit & Loss Account.

Assessing Officers committed mistakes in allowance of depreciation/set off of losses in 44 cases involving tax effect of ₹ 25 crore.

4.5 Depreciation/set off of losses

Section 32 of the Act provides for allowance of depreciation at the rates prescribed in the Act subject to fulfillment of certain conditions. Further, section 72 provides for carry forward and set-off of net loss of an AY against profits and gains of the following eight AYs.

We found mistakes in allowance of depreciation/set off of losses in 44 cases in 12 states²⁶ involving tax effect of ₹ 25 crore (see Box 4.4).

Box 4.4: Illustrative cases on depreciation/set off of losses

- a. In Gujarat, CIT I Rajkot charge, AO completed the assessment of **M/s. P. C. Patel & Company** for AY 11 at an income of ₹ 7.88 crore. We observed that AO allowed depreciation on tipper and dumper @ 30 per cent instead of applicable rate of 15 percent on the tipper/dumper as the assessee was engaged as a contractor. The mistake resulted in under assessment of income of ₹ 3.27 crore involving short levy of tax of ₹ 1.37 crore including interest. ITD replied (May 2013) that assessee had executed agreement of hiring of heavy earthmoving machinery for excavation work and hence, assessee was eligible for higher depreciation. Reply of the ITD is not tenable as the assessee had used tipper/dumper for the execution of contract work and not for the purpose of routine business activity.
- b. In Maharashtra, CIT-XX Mumbai charge, AO completed the assessment of **M/s. Punit Creation** for AY 11 after scrutiny in December 2012 at a loss of ₹ 2.44 crore and allowed brought forward losses of AY 07 and AY 08 amounting to ₹ 3.45 crore which were already adjusted against the income of AY 10. The mistake resulted in excess allowance of carry forward of losses by an equal amount involving potential tax effect of ₹ 1.06 crore.

Assessing Officers committed mistakes in allowance of expenditure/provisions in 24 cases resulting in short levy of tax of ₹ 9.19 crore.

4.6 Incorrect allowance of expenditure/provision

Provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions do not qualify for deduction. Further, Section 37(1) of the Act stipulates that any expenditure incurred wholly and exclusively for the purpose of business or profession is allowed in computing the business income of the assessee.

²⁶ Maharashtra, Tamil Nadu, Gujarat, Rajasthan, Punjab, Karnataka, Andhra Pradesh, Kerala, Delhi, West Bengal, Goa and Uttar Pradesh.

We noticed 24 cases in nine states²⁷ involving short levy of tax of ₹ 9.19 crore having mistakes in allowance of expenditure/ provisions (see Box 4.5).

Box 4.5: Illustrative cases on incorrect allowance of expenditure/provision

- a. In Assam, CIT-II Guwahati charge, AO while completing the assessment of **M/s. Brahmaputra Rolling Mills** for AY 10 after scrutiny at a loss of ₹ 4.80 crore, allowed expenses amounting to ₹ 13.45 crore on account of trial operation expenses. Since the amount expended for trial production was incurred before the commencement of commercial production, it should have been disallowed treating it as a capital expenditure. This omission resulted in underassessment of income of ₹ 13.45 crore involving potential tax effect of ₹ 2.05 crore.
- b. In Tamil Nadu, CIT-I Chennai charge, AO while completing the assessment of **M/s. Kunnam Granite & Works** for AY 10 allowed an expense of ₹ 5.46 crore towards foreign currency fluctuation loss which was speculative in nature. The mistake in allowing speculative loss as business expenditure resulted in under assessment of income by an equal amount involving tax effect of ₹ 1.86 crore.

Assessing Officers did not consider capital gains for tax in 15 cases resulting in short levy of tax of ₹ 27.26 crore.

4.7 Capital gains

Section 45 of the Act provides that any profit or gain arising from the sale or transfer of a capital asset is chargeable to tax under the head “capital gains” and shall be deemed to be the income of the previous year in which the transfer took place.

We noticed 15 cases in four states²⁸ involving tax effect of ₹ 27.26 crore where capital gain was not offered to tax (see Box 4.6).

Box 4.6: Illustrative case on capital gains

Section 50C of the Act provides that where the consideration received as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed by stamp valuation authority for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed be deemed to be the full value of the consideration received or accruing as a result of such transfer.

²⁷ Maharashtra, Tamil Nadu, Karnataka, Kerala, West Bengal, Uttar Pradesh, Assam, Odisha and Madhya Pradesh.
²⁸ Maharashtra, Tamil Nadu, Gujarat and Haryana.

In Maharashtra, CIT-XII Mumbai charge, AO completed scrutiny assessment of **M/s. Kohli Associates** for AY 07 at an income of ₹ 123.39 lakh. We observed that assessee had received sale consideration of ₹ 153.60 lakh on sale of old structure and construction of new project, however, the value of constructed project for the purpose of stamp duty was ₹ 255.80 lakh. The incorrect adoption of sale value of asset resulted in under assessment of long term capital gain at ₹ 103.20 lakh involving tax effect of ₹ 23.16 lakh. ITD took remedial action by way of passing order under section 263 of the Act (December 2011).

4.8 Other cases

We also noticed various types of mistakes in 15 states²⁹ such as short/non levy of interest, incorrect classification of income, failure to comply with TDS/TCS provisions etc. in 80 cases involving tax effect ₹ 59.75 crore (see Box 4.7).

Box: 4.7: Illustrative cases on miscellaneous mistakes

- a. In Delhi, DIT (International Taxation)-I, AO while finalizing assessment of **M/s. ESS Distribution (Mauritius)** for AY 08 after scrutiny in October 2011 at and income of US\$ 3.12 crore, did not levy interest under section 234B of ₹ 9.56 crore. ITD rectified the mistake under section 154 of the Act (October 2012).
- b. In Maharashtra, CIT-XXII Mumbai charge, AO while completing the assessment of **M/s. Rajesh Builders** for AY 08 under section 143(3) read with section 147 in March 2013 levied interest under section 234B for ₹ 2.81 crore instead of correct amount of ₹ 5.59 crore resulting in short levy of interest of ₹ 2.78 crore.
- c. Section 234B(3) provides that where, as a result of an order of re-assessment under section 147 of the Act, the amount on which interest is payable is increased, the assessee shall be liable to pay simple interest at the rate of one per cent 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 the tax on the total income determined on the basis of re-assessment exceeds the tax on total income determined in regular assessment. In Karnataka, CIT-III, Bengaluru charge, AO completed the assessment of **M/s Annapurneshwari Investments** for AY 06 after scrutiny at an income of ₹ 61.29 crore. Subsequently, case was reassessed under section 147 of the Act determining income of ₹ 26.63 crore. We observed that interest under section 234B (3) was levied at ₹ 1.87 crore instead of correct amount of ₹ 2.92 crore resulting in short levy of interest of ₹ 1.05 crore. ITD accepted and initiated action under section 154 of the Act (April 2013).

²⁹ Maharashtra, Tamil Nadu, Gujarat, Rajasthan, Punjab, Haryana, Jharkhand, Karnataka, Andhra Pradesh, Uttar Pradesh, Odisha, Delhi, Chhattisgarh, Madhya Pradesh and Bihar.

4.9 Recommendation

We recommend that CBDT may devise a mechanism to improve the quality of assessments and explore the possibility of capacity building for Assessing Officers for reducing the incidence of mistakes.

The Ministry in its reply (February 2014) elaborated on the steps taken by CBDT to improve the quality of assessment. CBDT has laid emphasis on improving quality of scrutiny assessment in their Central Action Plan. Post assessment, field offices, from FY 12 onwards, forward analysis of 50 quality assessments for suggesting improvement of assessments which are published annually. CBDT has also instructed supervisory offices to play an effective role and to bring matter of omission/commission on part of AOs to the Competent Authority for administrative action. CBDT also uses the system of review and inspection as an effective tool to monitor the quality of scrutiny assessments. A lot of emphasis is being laid on capacity building of Assessing Officer(s) which is achieved through regular training and interaction with Commissioner (Appeals) and Commissioners posted in Income Tax Appellate Tribunal at regular intervals.