

Chapter 3 : Mistake in assessments

3.1 Introduction

Compliance to provisions of the Act both by the assessee and the AOs is essential and hence highlighting deviations to the Act/Rule provisions forms an integral part of the performance audit. Such comments may help the department to make rectifications/revisions resulting in collection of revenue and avoidance of recurrence of mistakes as well. During this performance audit, we came across several issues that were non-compliant to the provisions of the Act/ Rules.

Category wise details of mistakes in assessment are briefly shown in Table 3.1 below:

Para No.	Table 3.1 : Nature of Mistakes	Cases	Tax effect (₹ in crore)
3.2	Allowance of deduction despite belated filing of returns	11	80.49
3.3	Deduction allowed beyond permissible periods	6	859.47
3.4	Incorrect apportionment of expenses	15	224.47
3.5	Consequences of Demerger/Amalgamation	7	376.10
3.6	Mistakes in computation of eligible profits	43	143.65
3.7	Transaction with related parties not done at market price	6	15.10
3.8	Deduction allowed on old Plant and Machinery/pre-existing infrastructure facility/ splitting up of business already in existence	11	40.51
3.9	Allowance of deduction on TP adjustment	4	15.11
3.10	Deduction against income from other sources	27	227.87
3.11	Other mistakes	15	170.28
3.12	Deduction allowed without creation of special reserve	1	0
Total		146	2153.05

3.2 Allowance of deduction despite belated filing of returns

As per section 80AC, deduction under section 80IA is not available unless it is claimed in the return of income and the return of income is filed within the due date as prescribed under section 139(1) of the relevant assessment year.

We found in 11 cases in 6 states²⁸ that ITD did not disallow the deduction despite belated filing of return, which resulted in underassessment of income involving tax effect of ₹ 80.49 crore (**Appendix 12**).

Box 3.1: Illustrative cases on allowance of deduction despite belated filing of return

a. Charge : CIT VI, Delhi
Assessee : M/s. Monnet Ispat & Energy Ltd.
Assessment Year : 2010-11
PAN : AAACM0501D

The AO allowed deduction of ₹ 177.75 crore for generation of power. We found that the assessee had filed return of income after due date of filing of return on 29 January 2011. As such, the deduction allowed was not in order. Incorrect allowance of deduction by the AO has resulted in under assessment of income of ₹ 177.75 crore involving tax effect of ₹ 60.41 crore including interest. Reply was awaited (November 2015).

b. Charge : CIT II Surat
Assessee : M/s. Saurashtra Enviro Project Pvt. Ltd.
Assessment Year : 2012-13
PAN : AACCV1967G

The AO allowed deduction of ₹ 18.94 crore to the assessee. We observed that the assessee had filed the return of income for A.Y. 2012-13 on 26 October 2012 as against the due date of 30 September 2012. As such the assessee was not eligible for deduction. AO's failure to disallow the claim resulted in underassessment of income of ₹ 18.94 crore involving short levy of tax of ₹ 8.41 crore. The ITD agreed to examine the issue (August 2015).

c. Charge : CI Central 2, Chennai
Assessee : St. John Freight Systems Pvt. Ltd.
Assessment Year : 2007-08 to 2010-11
PAN: AAACS 4697N

The AO allowed deduction of ₹ 1.32 crore, ₹ 1.79 crore, ₹ 2.43 crore and ₹ 1.50 crore to the assessee in AYs 2007-08, 2008-09, 2009-10 and 2010-11 respectively. We found that the assessee had filed the return of income belatedly on 7 February 2008, 20 January 2009, 30 November 2009 and 22 October 2011 for the AYs 2007-08, 2008-09, 2009-10 and 2010-11 respectively. AO's omission to disallow the claim of the assessee resulted in under assessment of income of ₹ 7.04 crore involving tax effect of ₹ 2.39 crore. Reply from ITD was awaited.

3.3 Deduction allowed beyond permissible periods

Deduction under section 80IA is required to be claimed for any 10 consecutive assessment years out of 15 years (20 years in the case of Road, Highway and Water Projects). For this purpose, from AY 2000-01, the initial assessment year would be the assessment year as specified by the assessee

²⁸ Andhra Pradesh(2), Delhi(1), Gujarat(1), Maharashtra(1), Tamil Nadu(5) and Uttar Pradesh(1)

at his option, beginning from the year in which the undertaking or the enterprise begins to operate or maintain the infrastructure facility. Prior to AY 2000-01, provision for exercising option for the purpose of initial assessment year was not available in the Act.

We observed in six cases in four states²⁹ that deductions were allowed for the period beyond the permissible limit of 10 consecutive assessment years, starting from the declared initial assessment year. Incorrect allowance of deductions involved tax effect of ₹ 859.47 crore (**Appendix 13**).

Box 3.2: Illustrative cases on deduction allowed beyond permissible periods

a. Charge: Pr. CIT-14, Mumbai
Assessee: M/s. Idea Cellular Limited
Assessment Year: 2009-10, 2011-12 and 2012-13
PAN: AAACB 2100P

The AO allowed deduction aggregating ₹ 2253.02 crore to the assessee for the AYs 2009-10, 2011-12 and 2012-13. We observed that the assessee engaged in the telecommunication services started its operation prior to 1 April 2000 i.e. between 3 October 1996 and 31 July 1997, and as such the initial assessment years being 1997-98 and 1998-99, the assessee was eligible for the deduction only up to AY 2007-08 and 2008-09. However, the assessee, on the grounds of large amount of brought forward business losses and unabsorbed depreciation, did not claim the deduction during these years. However, the AO allowed the deduction from AY 2009-10 onwards as there being positive income which was not in order as the eligibility period for the deduction had already elapsed with the end of AY 2008-09. Incidentally, in the case of a similarly placed assessee M/s. Vodafone India Limited having commenced its business during 1995-96, the ITD disallowed the deduction claimed by the assessee on the above ground. Irregular allowance of deduction after the permissible period by the AO has resulted in underassessment of income of ₹ 2253.02 crore involving tax effect of ₹ 807.60 crore. Reply from ITD was awaited.

b. Charge : Pr. CIT-14, Mumbai
Assessee: M/s. Reliance Infrastructure Limited
Assessment Years: 2009-10, 2011-12 and 2012-13
PAN: AACCR7446Q

The AO allowed deduction of ₹ 114.12 crore in the income to the assessee for AY 2009-10. We observed that the assessee commenced operations in Dahanu Power Units from the year relevant to AY 1995-96 and 1996-97 prior to 1 April 2000 for which option for initial assessment year for claiming the deduction was not available. Consequently, the 10 year limit of the period, eligible for deduction was over by the AY 2004-05 and AY 2005-06 for Unit-1 and Unit-2 respectively. Similarly, deduction of ₹ 32.20 crore allowed to the assessee in respect of wind mill for AYs 2009-10 to 2012-13 was not in order as the 10 year limit of the eligible period was over by the AY 2008-09. Irregular allowance of deduction beyond permissible period resulted in under assessment of income of ₹ 146.32 crore involving short

²⁹ Chandigarh(1), Delhi(1), Gujarat(1) and Maharashtra(3)

levy of tax of ₹ 49.56 crore. The Department did not accept the observation stating that the amended provisions of 1 April 2000 was equally applicable to the assessee which started operation before 1 April 2000. Hence, the deduction claimed was rightly allowed. The reply was not tenable as the amended provisions did not have retrospective effect. Hence, the allowance of benefits to units started operations before 1 April 2000 was not in order. Further, the Department also had taken the same stand in the case of M/s. Vodafone India Limited assessed in a different charge and disallowed the deduction.

3.4 Incorrect apportionment of expenses

Section 80IA(10) provides for re-computation of profits by the AO, owing to the close connection between the assessee carrying on the eligible business and any other person when the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business.

The indirect expenses such as administrative expenses, director's remuneration, head office expenses, establishment expenses, deduction under section 35(1)(ii), Royalty payment etc., which are common to eligible and non eligible business are to be apportioned between them. Audit noticed that the assessees were taking into account only the direct operational expenses while computing the business profits in respect of eligible business. This resulted in enhancing the profit of the eligible business with a consequential effect of higher claim of deduction under section 80IA.

We found in 15 cases in eight states³⁰ that deduction under section 80IA was allowed without properly apportioning the common expenses between eligible and non eligible units, which resulted in excess allowance of deduction involving tax effect of ₹ 224.47 crore (**Appendix 14**).

Box 3.3: Illustrative cases on incorrect apportionment of expenses

a. **Charge:** CIT VI, Delhi
Assessee: M/s. NTPC Ltd.
Assessment Year: 2010-11, 2011-12 and 2012-13
PAN: AAACN0255D

The AO allowed deduction of ₹ 1661.45 crore, ₹ 2034.90 crore and ₹ 2680.74 crore to the assessee for AY 2010-11 to 2012-13 for generation of power from the eligible units respectively. Audit observed from the separate accounts that sums of ₹ 106.57 crore, ₹ 159.09 crore and ₹ 179.08 crore towards corporate expenses were debited to profit and

³⁰ Andhra Pradesh(3), Delhi(1), Gujarat(2), Karnataka(2), Maharashtra(3), Rajasthan (2), Tamil Nadu(1) and Uttar Pradesh(1)

loss account to arrive at the profits of each of the eligible units. However, while computing the profits for the purposes of claiming deduction u/s 80IA, the same was added back, which resulted in enhancing the eligible profits. The assessee could not adopt two treatments – one for his accounts purposes and a different one for arriving at the profits for claiming higher deduction. The incorrect computation has resulted in excess claim/allowance of deduction of ₹ 444.72 crore for the AYs 2010-11, 2011-12 and 2012-13 respectively, involving an aggregate tax effect of ₹ 147.16 crore. Reply from ITD was awaited.

b. Charge: PCIT 14, Mumbai
Assessee: M/s. Reliance Infrastructure Limited
Assessment Year: 2010-11, 2011-12 and 2012-13
PAN: AACCR7446Q

The AO allowed deduction of ₹ 223.47 crore to the assessee for above three assessment years. Audit observed that the assessee had deducted ₹ 568.33 crore, ₹ 461.97 crore and ₹ 254.14 crore in computation of income as regulatory income on account of tariff adjustment account as unbilled revenue though the same was credited in profit and loss account. The regulatory income having been deducted from the income received by the assessee distribution from electricity and not apportioned to all eligible undertakings, resulted in inflation of profit of eligible units and thereby excess allowance of deduction under section 80IA resulted in under assessment of ₹ 155.61 crore involving tax effect of ₹ 51.88 crore. The Department replied that the regulatory income did not pertain to Goa and Samalkot units and hence, the reason for apportionment did not arise. The reply was not tenable as ITD did not provide the supporting documents in support of the claim that the regulatory income did not pertain to Goa and Samalkot units. Also the Department did not take into consideration the admissibility of deduction of Regulatory income as a whole.

c. Charge: CIT-I, Hyderabad
Assessee: M/s. AP Power Generation Corporation Ltd., Hyderabad
Assessment Year: 2011-12
PAN: AACCA2734J

The assessee company debited loss of ₹ 13.08 crore on account of floods from SLBHES, Srisailem unit (80-IA Unit) to the consolidated Profit and Loss accounts of the Company. However, no such expense was booked in the separate profit and loss account of the eligible specific unit for which 80-IA deduction was claimed. Consequently there was excess claim of deduction of ₹ 13.08 crore under section 80-IA involving tax effect of ₹ 5.91 crore. ITD agreed to look into the matter.

3.5 Consequences of Demerger/Amalgamation

As per Section 80 IA(12A), the benefit of deduction is not allowable to an enterprise or undertaking which was transferred in a scheme of amalgamation/ demerger on or after 1 April 2007.

We found in seven cases in four states³¹ incorrect allowance of deduction in respect of the profits related to the enterprises or undertaking which were transferred in a scheme of amalgamation/demerger, even though such amalgamation/ demerger was effected on or after 01.04.2007. Incorrect allowance of deduction resulted in underassessment of income of ₹ 1157.05 crore involving tax effect of ₹ 376.10 crore (**Appendix 15**).

Box 3.4: Illustrative cases on consequences of demerger/amalgamation

a. Charge: Pr. CIT (Central) 4, Mumbai
Assessee: M/s. JSW Energy Limited
Assessment Year: 2010-11 and 2011-12
PAN: AAACJ8109N

The AO allowed assessee deduction of ₹ 416.06 crore and ₹ 597.92 crore for AYs 2010-11 and 2011-12 in respect of SBU II unit which was originally a separate entity belonging to M/s. JSW (Vijayanagar) Ltd., and later on merged with the assessee company in a scheme of amalgamation effective from 01.04.2008. Since the merger happened after the cut-off date of 01.04.2007, the deduction in respect of SBU II was required to be disallowed. Irregular allowance of deduction by the AO has resulted in underassessment of income of ₹ 1013.98 crore involving tax effect of ₹ 340.03 crore. Reply from ITD was awaited.

b. Charge: CIT Valsad
Assessee: M/s. Devang Paper Mills Pvt. Ltd.
Assessment Year: 2011-12 and 2012-13
PAN: AADCD 7232R

The AO allowed deduction of ₹ 2.72 crore to the assessee. We observed that the assessee company was formed in a scheme of demerger of non-pharma division of Biodeal Laboratories Pvt. Ltd. with effect from 1 April 2010. As the demerger took place after 01.04.2007, the deduction should have been disallowed. AO's omission to disallow the deduction has resulted in underassessment of income involving short levy of tax of ₹ 1.09 crore. Reply from ITD was awaited.

3.6 Mistakes in computation of eligible profits

For computing the deduction under chapter VIA, the Act provides that the amount of income derived by the assessee and included in his total income has to be computed under the provisions of the Act, inter alia, taking into account the carried forward losses and unabsorbed depreciation of the earlier years. It has been judicially held that gross total income must be determined by setting-off against the income, business loss of earlier years before allowing deduction under Chapter VIA and if the resultant income is 'nil', the assessee cannot claim deduction under Chapter VIA.

³¹ Delhi(2), Gujarat(1), Maharashtra(3) and Tamil Nadu(1)

We observed in 43 cases in 10 states³² incorrect allowance of deduction due to mistake in calculation of income/tax, depreciation, double deduction allowed, deduction allowed on other head of income etc, which involved tax effect of ₹ 143.65 crore (**Appendix 16**).

Box 3.5: Illustrative cases on mistakes in computation of eligible profits

a. Charge : Pr. CIT Central, Kanpur
Assessee: M/s. Eldeco Sidcul Industrial Park Ltd.
Assessment Year: 2007-08 and 2008-09
PAN: AABCE 6152 D

The AO while computing the tax liability of the assessee, incorrectly levied tax at lower rate of 10 *per cent*, the rate applicable under MAT provisions as against at the rate of 30 *per cent*, leviable under normal provisions of the Act. The mistake committed by the AO has resulted in short levy of tax of ₹ 20.63 crore for both the AYs. The ITD rectified the mistake under section 154 of the Act (March 2015).

b. Charge: CIT-IV, Hyderabad
Assessee: M/s. NSL Renewable Power Pvt. Ltd., Hyderabad
Assessment Year: 2012-13
PAN: AABCN 6009L

The AO allowed deduction of ₹ 17.73 crore u/s 80IA to the assessee. The assessee was engaged in generation of power from windmill and biomass. We observed that the said deduction was also allowed on incomes from other heads of accounts viz., House Property, Short term Capital Gain and Dividend Income, etc. apart from income from eligible business (Power Generation) instead of restricting it to business income of ₹ 8 crore. AO's omission to disallow the deduction resulted in irregular allowance of deduction of ₹ 9.73 crore involving tax effect of ₹ 3.90 crore. The ITD took remedial action by passing order under section 154 (August 2015).

c. Charge : CIT charge IV, Delhi
Assessee: M/s. Gujarat Guardian Ltd.
Assessment Year: 2010-11
PAN: AAACG 1622K

The AO, while finalising the assessment, disallowed deduction of ₹ 18.35 crore under section 80IA for generating power, claimed in original return of income (ROI) instead of ₹ 22.77 crore claimed in the revised ROI by assessee. Thus, AO has failed to disallow the deduction which has resulted in incorrect allowance of deduction of ₹ 4.42 crore involving tax effect of ₹ 2.36 crore. The ITD accepted the audit observation.

³² Andhra Pradesh(10), Chandigarh(1), Delhi(1), Gujarat(1), Karnataka(5), Madhya Pradesh(1), Maharashtra(12), Rajasthan(1), Tamil Nadu(9) and Uttar Pradesh(2)

d. Charge : Pr. CIT V, Bengaluru
Assessee: Sri Ramamurthy Praveen Chandra
Assessment Year: 2010-11 to 2012-13
PAN: AAKPC 0482C

The assessee while computing total income reduced the income of ₹ 3.49 crore for all the three AYs from power generation through wind mills, and the same amount was again claimed and allowed as deduction under section 80IA also. Thus, the failure of the AO to disallow the deduction has resulted in double deduction, involving short levy of tax of ₹ 1.18 crore. Reply was awaited. (November 2015).

3.7 Transaction with related parties not done at market price

Section 80-IA (8) provides that if the consideration received for transacting goods & services between eligible and other business of the assessee does not correspond to the market value, profit shall be recomputed for the purpose of deduction as if the transaction was done at the prevailing market rate. It has been judicially³³ held that the assessee is allowed to charge unit price at the rate being charged by State Electricity Boards reducing therefrom the electricity duty, cess, taxes etc.

We observed in six cases in four states³⁴ that in the case of captive consumption of electricity, the assessee claimed excess deduction by adopting a rate higher than the market rate. The AOs also did not invoke the provisions of section 80IA(8) to arrive at the correct amounts of eligible deduction. Thus, it has resulted in excess allowance of deduction involving tax effect of ₹ 15.10 crore (**Appendix 17**).

Box 3.6: Illustrative cases on transaction with related parties not done at market price

a. Charge : Pr. CIT-2, Kolkata
Assessee: M/s. J K Lakshmi Cement Limited
Assessment Year: 2010-11
PAN: AAACJ6715G

The AO allowed deduction of ₹ 24.80 crore to the assessee for their profit/gain derived from its captive power plant at Jaykaypuram, Sirohi (Rajasthan). As per Form 10CCB, they had total sales of ₹ 113.19 crore comprising 2375.84 lakh units of power transferred to its own cement plant @ ₹ 4.69 per unit which included electricity duty of ₹ 0.40 which was required to be reduced as per ITAT decision. AO's failure to do so resulted in excess computation of profits and consequent higher claim of deduction of ₹ 9.50 crore involving potential tax effect of ₹ 3.23 crore by way of excess carry forward of MAT credit. Reply from ITD was awaited.

³³ DCIT vs. ITC (ITA No. 18 Kolkata 2006) ITAT B Bench Kolkata

³⁴ Madhya Pradesh(1), Maharashtra(2), Uttarakhand(1) and West Bengal(2)

b. Charge : PCIT - Dehradun
Assessee: M/s. Oil and Natural Gas Corporation Ltd.
Assessment Year: 2010-11
PAN: AAACO1598A

The AO allowed deduction of ₹ 60.26 crore for AY 2010-11 to the assessee company. We observed that the assessee company was engaged in generation of electricity. Yet it adopted the rate of ₹ 5.58 per unit applied by Maharashtra State Electricity Board (MSEB) to the end consumers, for the purpose of deduction whereas the assessee sold electricity to MSEB at the rate of ₹ 3.86 per unit. The sale price of the assessee to MSEB i.e. ₹ 3.86 per unit at least should have been the market price for the captive consumption of the assessee as per the above mentioned provisions and the same should also have been adopted for the purpose of deduction under section 80IA. The incorrect adoption of market price resulted in excess claim of deduction of ₹ 18.79 crore involving tax effect of ₹ 8.56 crore. ITD did not accept the observation stating that addition on this point was made for the first time during A.Y. 2011-12. Reply is not tenable as similar claim was disallowed by the AO in subsequent assessment for AY2012-13 also.

3.8 Deduction allowed on old Plant and Machinery/pre-existing infrastructure facility/splitting up of business already in existence

One of the conditions prescribed for claiming deduction of 80 IA was that the undertaking was not formed by the transfer to a new business of machinery or plant previously used for any purpose. The deduction was allowable if value of the used machinery did not exceed 20 *per cent* of the total value of Plant & Machinery. Machinery used outside India and imported by assessee claiming deduction was to be treated as new provided no deduction on account of depreciation on such machinery or plant had been allowed or was allowable in computing the total income of any person for any period prior to the date of installation. Further, the undertaking claiming deduction should not be formed by splitting up, or the reconstruction, of a business already in existence except in case of rehabilitation/ reconstruction u/s 33B and in the case of transfer of plant or machinery previously used by a State electricity Board.

CBDT has clarified³⁵ that widening of existing road by constructing additional lanes as a part of Highway Project is to be treated as new "Infrastructure Facility". Simply relaying of an existing road would not be classified as new infrastructure facility for this section.

³⁵ CBDT Circular No. 4/2010 dated 18th May 2010

We noticed in 11 cases in six states³⁶ where the assesseees were allowed deduction of ₹ 170.35 crore though the plant and machinery being used were old or a pre-existing infrastructure facility or undertakings being formed by splitting up of business already in existence. Irregular allowance of deduction resulted involved tax effect of ₹ 40.51 crore (**Appendix 18**).

Box 3.7: Illustrative cases on deduction allowed on old Plant and Machinery/pre-existing infrastructure facility/splitting up of business already in existence

a. Charge : CIT V, Hyderabad
Assessee: M/s. Vijayawada Tollway Pvt. Ltd., Hyderabad
Assessment Year: 2010-11
PAN: AACCV7296A

The AO allowed deduction of ₹ 48.95 crore under section 80IA to the assessee. The assessee entered into agreement with NHAI (2009) for developing the existing 4 lane way into 6 lane road in the state of Andhra Pradesh on a build, operate and transfer basis as part of National Highways Development programme Phase V. Audit observed that the assessee claimed and was allowed deduction on an already existing infrastructure (4 way road), which was not in order in view of clarification issued by the CBDT vide Circular No. 4/2010 on 18th May 2010. Irregular allowance of deduction resulted in underassessment to income of ₹ 48.95 crore involving tax effect of ₹ 16.64 crore. Reply from ITD was awaited.

b. Charge: Pr. CIT 3, Mumbai
Assessee: M/s. Redi Port Limited
Assessment Year: 2010-11 to 2012-13
PAN: AADCR 6980N

The AO allowed deduction of ₹ 79.08 lakh, ₹ 3.61 crore and ₹ 20.02 crore to the assessee for AYs 2010-11 to 2012-13 respectively. The company entered into agreement on 25 February 2009 with Maharashtra Maritime Board (MMB) whereby the MMB granted license for 50 years to build a multipurpose common user port on build, own, operate, share and transfer (BOOST) basis. MMB transferred all the government assets and existing facilities to the assessee for set up of modern multipurpose, common user port and also granted the right to design, collect and retain user charges during the license period of 50 years. As the assessee was engaged in operation of existing facilities and not yet developed new infrastructure facilities, deduction should have been disallowed. Thus, AO's failure to disallow the deduction has resulted in incorrect allowance of deduction of ₹ 24.42 crore involving tax effect of ₹ 10.40 crore for the three years.

ITD did not accept the observation stating that the assessee had fulfilled all the criteria laid down in Section 80IA as with effect from 1 April 2002, the deduction was allowable to an enterprise for operating and maintaining any infrastructure whereas the assessee company got registered under the Companies Act 1956. The reply was not tenable as the department interpreted the meaning of "it is owned by the company" as "assessee company registered under the Companies Act-1956", which was not correct. Phrase "it is owned by the company" used under section 80IA(1) is meant for "infrastructure development owned by

³⁶ Andhra Pradesh(1), Gujarat(2),Karnataka(2), Maharashtra(3), Rajasthan(1) and Tamil Nadu(2)

the company". Further, ITD saying that operating and maintaining of any infrastructure was eligible business for deduction u/s 80IA, was also not correct. Under section 80IA(4)(b), assessee was required to operate and maintain new infrastructure facility. In the instant case, assessee made lease deed agreement with MMB on 18th December 2009 for transfer of existing facility of PORT for their modernization but the assessee company started to claim the deduction under section 80IA from the same assessment year A.Y-2010-11 onwards without modernising the existing facilities.

c. Charge : CIT-2 Jaipur

Assessee: M/s. Murarilal Agarwal Contractor Pvt. Ltd.

Assessment Year: 2010-11, 2011-12 and 2013-14

PAN: AAECM1948A

The allowed deduction of ₹ 8.34 crore for the AYs 2011-12 and 2013-14 processed in summary manner and for AY 2010-11 completed after scrutiny. We observed that the assessee engaged in the business of widening, strengthening and improvement of road including leveling course/surface correction and increased thickness of cement concrete pavement, which was not eligible for the deduction. Irregular allowance of deduction has, thus, resulted in under assessment of income involving tax effect of ₹ 3.33 crore including interest. ITD did not accept the observation stating that widening and strengthening results in a new structure. The Reply was not tenable since leveling course/surface corrections and increased thickness of cement concrete pavements etc were not classifiable as a new infrastructure facility.

d. Charge : CIT Valsad

Assessee: M/s. Team Ferro Alloys Pvt. Ltd.

Assessment Year: 2010-11 and 2012-13

PAN : AAAC8925A

The AO allowed deduction of ₹ 3.50 crore (₹ 2.53 crore for AY 2010-11 and ₹ 97.30 lakh for AY 2012-13) under section 80IA to the assessee. Audit scrutiny of profit and loss account, Form 10CCB, computation of income and notes attached to auditor's report revealed that the assessee acquired the power unit at lump sum price. As the undertaking was formed by reconstruction of business already in existence, the deduction should have been disallowed. AO's omission to disallow the deduction resulted in irregular allowance of deduction of ₹ 3.50 crore involving tax effect of ₹ 1.46 crore. ITD did not accept the observation stating that the provisions of section 80IA did not explicitly deny a transfer of an undertaking per se by an existing assessee to another assessee. Sale of an undertaking is also one of the mode of transfer of an undertaking which is widely and popularly used by a person to transfer its assets. The reply was not tenable in view of clearcut provision of section 80IA(3)(ii), which stated that the undertaking should not have been formed by the transfer to a new business of machinery or plant previously used for any purpose.

3.9 Allowance of deduction on transfer pricing (TP) adjustment

Section 92CA(4) provides that no deduction under Chapter VIA, including deduction under section 80IA shall be allowed in respect of the amount of income by which the total income is enhanced after determination of Arms Length Price by the Transfer Pricing Officer

We noticed in four cases in three states³⁷ where deductions were allowed on the adjustments made while determining the Arms Length Price under section 92CA(4) involving tax effect of ₹ 15.11 crore (**Appendix 19**).

Box 3.8: Illustrative cases on allowance of deduction on TP adjustment

a. Charge : PCIT (Central) 3, Mumbai
Assessee: M/s. BT Global Communications India Private Limited
Assessment Year: 2011-12
PAN:AAACG1534A

The AO allow deduction of ₹ 21.64 crore on an addition made to that extent suo-moto by the assessee towards transfer pricing adjustment, which was not in order. Irregular allowance of deduction resulted in underassessment of income of ₹ 21.64 crore involving short levy of tax of ₹ 7.19 crore. The ITD has accepted the observation.

b. Charge : Pr. CIT-III Kolkata
Assessee: M/s. Vodafone East Ltd.
Assessment Year: 2011-12
PAN : AAACU3796J

The AO allowed deduction of ₹ 10.61 crore @ 30 per cent of ₹ 35.36 crore, the amount of upward adjustment over and above arms length price attributable to international transactions under section 92CA(3) which was in contravention of the proviso to section 92CA(4). AO's failure to disallow the deduction resulted in excess allowance of deduction of ₹ 10.61 crore involving tax effect of ₹ 5.22 crore. Reply from ITD was awaited.

3.10 Deduction against income from other sources

The word 'derived from' cannot have a wide import so as to include any income which can in some manner be attributed to the business. The derivation of the income must be directly connected with the business and generated there from.

It has been judicially held³⁸ that section 80IA/80IB is profit linked incentives in respect of the income derived by the eligible business. Interest income, duty drawback receipts and DEPB benefits, freight subsidy/ transport subsidy received from government, commission, insurance claim etc. are not

³⁷ Andhra Pradesh(1), Maharashtra(2) and West Bengal(1)

³⁸ Cambay Electrical Supply Co. Ltd. 113 ITR 84 (SC), Sterling Foods 237 ITR 53 (SC), Pandian Chemicals Ltd. 262 ITR 278(SC)., LIBERTY INDIA - [2009] 317 ITR 218 (SC), ORCHEV PHARMA P. LTD.- [2013] 354 ITR 227 (SC), CIT v. Kothari Products Ltd. [2007] 295 ITR 223/[2008] 168 Taxman 236 (All.), KOHINOOR FOODS LTD - [2013] 353 ITR 264 (Del), KIRAN ENTERPRISES - [2010] 327 ITR 520 (HP), SHARAVATHY STEEL PRODUCTS P. LTD. - [2012] 347 ITR 371 (Kar), M. M. FORGINGS LTD. - [2012] 349 ITR 673 (Mad), LIBERTY SHOES LTD - [2007] 293 ITR 478 (P&H), CIT v. Maharani Packaging (P) Ltd. (2011) 55 DTR 340 (HP)(High Court), Kinfra Exports Promotion Industrial Parks Ltd. v. DCIT (2013) 59 SOT 57(URO) (Cochin)(Trib.), Essar Power Ltd. v. Addl. CIT (2013) 142 ITD 251 (Mum.)(Trib.), CIT v. Gangothri Textiles Ltd. (2014) 221 Taxman 28 (Mad.)(HC)

considered to be directly derived from eligible industrial undertaking and is also not to be considered for deduction.

We noticed in 27 cases in 12 states³⁹ that deduction under section 80IA was allowed on interest receipts, sale of import license, insurance claim etc. that, inter alia, included the profit of the eligible business. Excess allowance of deduction attracted tax effect aggregating ₹ 227.87 crore (**Appendix 20**).

Box 3.9: Illustrative cases on deduction against income from other sources

- a. Charge: Pr. CIT II, Bhopal**
Assessee: M/s. Narmada Hydroelectric Development Corporation Ltd.
Assessment Year: 2010-11 to 2012-13
PAN: AABCN 1732 G

The assessee company earned interest and other income of ₹ 110.58 crore, ₹ 107.35 crore and ₹ 184.87 crore for AYs 2010-11 to 2012-13 respectively which were not attributable to direct income of the undertaking earned on its hydro electric power generation activity. AO's failure to exclude the above income from the business profits has resulted in excess allowance of deduction of ₹ 402.80 crore involving tax effect of ₹ 133.23 crore. The department agreed to examine the issue.

- b. Charge: PCIT-I, Patna**
Assessee: M/s. Bihar State Road Development Corporation Ltd.
Assessment Year: 2012-13
PAN: AADCB 7567M

The AO allowed deduction of ₹ 66.47 crore from other income to the assessee. We observed that the AO allowed deduction on interest income of ₹ 71.91 crore which was not derived from the eligible business. It is also noticed that the similar deductions were disallowed by the department during AYs 2010-11 and 2011-12. Incorrect allowance of deduction of ₹ 66.47 crore pertaining to other income has resulted in non-levy of tax of ₹ 23.05 crore. The ITD agreed to take remedial action (July 2015).

- c. Charge: CIT 4 Chennai**
Assessee: M/s. L&T Transportation Infrastructure Ltd.
Assessment Year: 2010-11 to 2012-13
PAN: AAACL1912F

The AO allowed deduction of ₹ 36.05 crore to the assessee for three assessment years above. We observed that the income against which deduction for AY 2010-11 was claimed, included interest income of ₹ 16.48 crore on Inter Corporate Deposits (ICDs), not eligible for deduction. Further, the assessee inflated the income of the eligible business by excluding the interest expenditure of ₹ 13.33 crore and ₹ 13.90 crore for AYs 2011-12 and 2012-13. Though the interest expenditure was related to the eligible business, this was adjusted

³⁹ Andhra Pradesh(4), Bihar (1), Chandigarh(1), Chhattisgarh(1), Delhi(1), Gujarat(2), Karnataka(6), Madhya Pradesh(1), Maharashtra(1), Rajasthan(2), Tamil Nadu(6) and Uttarakhand(1)

against income from 'other source'. The incorrect computation of income has resulted in excess allowance of deduction of ₹ 36.05 crore involving tax effect of ₹ 12 crore. For AY 2010-11, the ITD replied that the assessee did not claim deduction in respect of interest income. Reply was not tenable, as the computation of income statement and the assessment order clearly showed that the assessee had claimed deduction as pointed out by audit. For AYs 2011-12 and 2012-13, reply from ITD was awaited.

d. Charge: Pr. CIT, Dehradun
Assessee: M/s. SIDCUL
Assessment Year: 2010-11 and 2011-12
PAN: AAHCS 7324R

The AO allowed deduction of ₹ 11.33 crore and ₹ 14.44 crore to the assessee for above assessment years respectively. We observed that the assessee received interest income of ₹ 27.99 crore on installments of land premium receipts which was not derived from the eligible business. Incorrect allowance of deduction resulted in short levy of tax of ₹ 11.33 crore including interest. The ITD accepted the observation and agreed to take remedial action (October 2015).

3.11 Other mistakes

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

We noticed 15 cases⁴⁰ where the AO allowed deduction committing different types of mistakes while completing the assessments. Excess allowance of deduction involved tax effect of ₹ 170.28 crore (**Appendix 21**).

Box 3.10: Illustrative cases within the cases covered under other mistakes

a. Charge: PCIT (Central) 3, Mumbai
Assessee : M/s. Marathon Nextgen Realty Ltd.
Assessment Year : 2010-11 to 2012-13
PAN : AAACP8032B

The assessee claimed deduction of ₹ 280.70 crore for the above AYs against the income from house property, other sources, long term capital gain and short term capital gain. We observed that the assessee had shown business losses aggregating ₹ 22.43 crore from its activities in original return, prepared on the basis of accounts approved in Annual General Meeting of the Shareholders. Later on, the assessee reduced the sale price of the fixed assets of one of its projects as shown in the original return, by converting fixed assets into stock in trade and adopting the lower rate of the assets instead of rate shown in the books of

⁴⁰ Andhra Pradesh (1), Maharashtra(13) and Uttar Pradesh(1)

accounts thereby causing substantial reduction in LTCG and increase in STCG vis a vis converting business losses as shown in original return to business income of ₹ 142.88 crore against which deduction was allowed to that extent which was not in order. While claiming the revised computation, consequent reduction in LTCG and increase in STCG was not rectified in the Annual Accounts and the same was also not approved by the share holders in the special AGM. The revised audited Profit & Loss account, Balance Sheet were also not submitted with the revised return. Irregular allowance of deduction by the AO has had the tax impact of ₹ 47.60 crore for the three years. Reply from ITD was awaited.

b. Charge: Pr. CIT 2, Mumbai
Assessee: M/s. Tata Power Company Limited
Assessment Year: 2010-11
PAN : AAAC0054A

The AO allowed deduction of ₹ 248.91 crore to the assessee before arriving at the correct income. Audit observed that the losses on account of Tax free US 64 bonds were not added back to arrive at the taxable profit. AO's failure to do so resulted in excess allowance of deduction of ₹ 108.83 crore involving short levy of tax of ₹ 36.99 crore. Reply from ITD was awaited.

c. Charge: Pr.CIT 5, Mumbai
Assessee : M/s. Mhaikar Infrastructure Private Limited
Assessment Year : 2012-13
PAN : AADCM9396D

The AO allowed amortization to the extent of ₹ 79.94 crore towards toll collection rights as intangible asset instead of ₹ 91.13 crore being one-fifteenth of total value of toll collection rights of ₹ 1366.91 crore over concessional period of 15 years. Further, while computing book profit, AO deducted the provision of ₹ 54.97 crore for diminution in value (mentioned in the profit and loss account as reversal of provision of MTM) from the net profit of ₹ 127.48 crore whereas in the normal provision the AO did not disallow the same for the purpose of computing business income. The mistake resulted in excess allowance of deduction of ₹ 66.16 crore involving tax effect of ₹ 21.47 crore. Reply from ITD was awaited.

3.12 Deduction allowed without creation of special reserve

Section 80IA(6) provides that where housing or other activities are an integral part of the highway project and the profits of which are computed on such basis and manner as may be prescribed, such profit shall not be liable to tax when the profit has been transferred to a special reserve account and the same is actually utilised for the highway project excluding housing and other activities before the expiry of three years following the year in which such amount was transferred to the reserve account; and the amount remaining unutilised shall be chargeable to tax as income of the year in which such transfer to reserve account took place.

Box 3.11: Illustrative case on deduction allowed without creation of special reserve

Charge: PCIT – Noida

Assessee: M/s. Jaypee Infratech Ltd.

Assessment Year: 2009-10

PAN: AABCJ9042R

The AO allowed deduction of ₹ 284.87 crore to the assessee company. The assessee was engaged in the business of development, operation and maintenance of Yamuna Expressway alongwith associated structures and sale/development of lease hold land along the expressway. Further, CIT Noida reviewed the original assessment and disallowed the said deduction stating that the assessee was eligible for deduction under section 80IA(6) read with Explanation (b) to section 80IA(4)(i) and not with Explanation (a) to section 80IA(4)(i). On appeal, ITAT restored the deduction holding (April 2015) that “the development of the toll road with controlled access and exit points and right to collect toll from the users clearly put the Expressway within the ambit of road which is a toll road. Further, the development of the Expressway between Noida and Agra and development of five land parcels adjacent to Expressway were inseparable and integral part of one project and hence deduction to assessee could not be denied by wrongly putting the case of the assessee in clause (b) of Explanation to section 80IA (4)(i) of the Act”. In compliance to the ITAT order, order under section 254/263/143(3) was passed (July 2015) by allowing the deduction of entire amount.

The stand of CIT, Noida and the ITAT being contradictory to each other on the treatment of expressway whether a highway or a toll road, there is a need to modify the provisions in the Act for definition of road including toll road’ and ‘highway project’ covered under Explanation (a) and (b) below sub section (4)(i) of section 80IA.

The omissions and mistakes of AOs as illustrated above indicated that provisions/conditions laid down in section 80 IA of the Act were not duly complied with by the AOs, before allowing the deduction to the assessees engaged in the business of infrastructure development.

Recommendations

The CBDT may ensure that mistakes in assessments pointed out by Audit have been duly taken care of with a view to avoiding the loss of revenue.