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(i). Audit Impact and its Follow Up

Introductory

Audit constitutes a crucial component of accountability and governance mechanism. By virtue of its suggestions and recommendations, it plays a significant role in providing an aid to the Government and Management. Acceptance of audit observations and action taken by the Government by bringing about amendment in rules and regulations is the manifestation of the impact of audit.

Some audit observations raised during previous Performance Audits, Subject Specific Compliance Audits and other Long Draft Paras (Topic based) are enumerated below for guidance. PAC recommendations wherever received have been included along with suggestive Audit Checks to be applied. Audit Checks are indicative and not exhaustive.

1. Performance Audit on 'Assessment of Firms' (CAG Report No. 7 of 2014)

1.1 **Partnership** is the relationship between persons who have agreed to share the profits of a business carried on by all or any of them. Persons who have entered into 'Partnership' with one another are called 'Partners' individually and a 'Firm' collectively.

C&AG had carried out a Performance Audit on **Assessment of Firms** under the Income Tax Act, 1961 (Act) and audit observations and recommendations featured in its Report No. 7 of 2014 are as follows:

1.2 Issues and Recommendations

S. No.	Issue(s)	Recommendation(s)
1	ITD does not have any system of maintaining complete database of Firms and their partners.	The Ministry may maintain complete database of Firms and devise a suitable mechanism to keep track of unregistered Firms and ensure filing of their ITRs.
2	ITD is not co-relating the assessment records of the Firms and their partners which resulted in short levy of tax.	The Ministry may consider linking the returns of Partners and their Firm so that AOs are able to verify the transactions. The Ministry may also make it compulsory for the Firms to declare their partners' name and PAN in the ITR.

3	ITD does not have any system of monitoring the partnership deed of the Firms in order to regulate the claims and collecting information from Registrar of Firms for effective control.	The Ministry may devise a software module to monitor receipts of first partnership deed and revised partnership deed in order to regulate the claims in regard to salary/ remuneration/ profit sharing/ rate of interest on Partners' Capital. The Ministry may also collect information regarding any change from the Registrar of Firms (to whom such changes are required to be reported as per the Partnership Act) so as to have effective control over assessment of Firms.
4	Partners of Firm avail excess exemption due to ambiguity in the Act.	The Ministry may amplify the explanation to section 10(2A) so as to give proper meaning of total income of the Firm to be divided among the partners in the cases where the total income is reduced due to deduction/ exemption.
5	The Act is not clear about admissibility of non-legal entities such as Firms, BOIs and AOPs as partners in a Firm.	The Ministry may clarify whether the non-legal entities can be partners in a Firm in order to avoid inconsistencies in composition of the partners.
6	AOs are not applying Section 14(A) of the act consistently on Partner's share of profit received from a Firm which is exempted under section 10(2A) of the Act. Also, AOs are unable to apply Section 14(A) read with rule 8D of the act relating to Partnership Firms on the exempted income in absence of previous year's details of income.	The Ministry may clarify on the consistent and harmonious application of Section 14A with reference to exempt income specified under Section 10(2A). The Ministry may also consider making it mandatory for the Firm to prepare Financial Statements incorporating current year as well as previous year's figures so as to facilitate application of provision.

1.3 Impact of Audit

CBDT under the Ministry of Finance vide Circular No.12/2019 accepted the recommendations and issued a set of guidelines for Assessing Officers in order to improve the quality of assessments and also to reduce the scope for committing errors. A copy of the circular is exhibited in **Annexure-I**.

1.4 Audit Checks

1. Whether the Assessing Officer (AO) had adhered to CBDT's circular no 12/2019 dated 19/6/2019.
2. Whether the AO had called for a copy of partnership deed during the course of assessment proceedings? To check whether authorization, limit of the remuneration etc. paid to the partners are as per the partnership deed. Similar checks to be exercised for interest paid on capital to partners.
3. Whether remuneration was paid to only working partner?
4. Whether interest on debit balance due to drawing is charged for interest as per partnership deed?
5. While computing remuneration payable to working partners, the remuneration should not exceed a particular aggregate amount which is based on the figure of "book profit" and whether book profit has been arrived as per explanation 3 to section 40(b) of the Act?
6. While computing book profit for the purposes of section 40(b)(v), whether incomes such as capital gain, interest, income from house property, income from other sources etc. have been excluded?
7. Whether while framing assessment of Firms, a cross-verification of remuneration and interest paid to the partners with income-tax return of Firm's partner has been made?
8. Whether in the case of changes in the constitution of Firm, carry forward and set-off of losses was allowed as per provision of section 78?
9. In case the share of profit received by the partners from the Firm and claimed exemption u/s 10(2A), the expenditure claimed by the partners has been disallowed u/s 14A read with Rule 8D of Income Tax Rules, 1962?
10. Whether the tax liability including penalty as per provision has been shown properly in case of dissolution of Firms?

11. Whether all assets & liabilities relating to the business of the Firm immediately before succession become the assets & liabilities of the company?
12. Whether partners of the Firm receive any consideration or benefit directly or indirectly in any form or manner other than by way of allotment of shares in the company?
13. Whether the aggregate of the shareholding of the partners in the company is not less than 50 percent of total voting power in the company?
14. Whether in the case of firms claiming deduction u/s 80IA, the AO has called for all payment of remuneration, salary, interest etc to partners for verification of expenses and profit of the eligible business after excluding the profit of related activity/business.
15. Whether AO has verified that the interest to partner is in accordance with the partnership deed and the amount calculated at the rate is not in excess of 12% simple interest per annum or below, if decided in the partnership deed.
16. In addition to the above, the General Checks given at the end may also be applied.

2. Performance Audit on Assessment of Assesseees in Pharmaceuticals Sector (CAG Report No. 5 of 2015)

2.1 Government provides support to **Pharmaceutical Sector** by way of various area-based tax exemptions, weighted deductions on expenses towards Research and Development (R&D) and other deductions against business profits in the Income Tax Act 1961 (Act), concessional rate of excise duties, State VAT etc. It is important to ensure that such fiscal incentives given to this sector under the Act are allowed as per prescribed conditions and seek assurance that proper machinery, to exercise necessary checks/ controls in the area of probable misuse of these provisions relating to tax concessions, exists and operates effectively.

C&AG had carried out a Performance Audit on **Assessment of Assesseees in Pharmaceuticals Sector** under the Income Tax Act, 1961 (Act) with objectives of-

(a) the exemptions and deductions allowable to Pharmaceutical Sector have been allowed as per entitlement

(b) the administrative and procedural adequacy for taxation of pharmaceutical sector exists

(c) the allowance of deduction of Research and Development expenditure to the assesseees in Pharmaceuticals Sector has contributed to the growth in industry as well as in tax revenues.

Audit observations and recommendations featured in the Report No. 5 of 2015 are as follows:

2.2 Issues and Recommendations

S.N.	Issues	Recommendations
1	ITD did not maintain data of incentives given to the Pharmaceutical Sector, hence audit was not able to assess the impact of revenue foregone in growth of the industry and finally in the fulfilment of objectives behind the incentive.	<p>i. CBDT may issue instruction to clarify the nature of expenses to be treated as freebies including physician's samples. Further, a suitable mechanism may be devised for the assesseees claiming deduction of such expenses, to provide details of expenses in the nature of freebies from the sales promotion expenses.</p> <p>ii. CBDT may clearly specify the effective date of disallowance of expenses towards freebies to put the disputed and varied interpretations in this regard to rest.</p> <p>iii. The Ministry may introduce a standard form, to be filed either with return or with the assessment records, indicating allocation of all common expenses or weighted</p>
2	ITD does not have complete sector wise data of assesseees of Pharmaceuticals Sector.	
3	ITD allowed weighted deduction on R&D under Section 35 (2AB) of the Act before receipt of approval from DSIR, who is the approving authority.	
4	ITD allowed weighted deduction on R&D expenses under Section 35(2AB) of the Act without verifying the details of expenditure approved by Department of Scientific and Industrial Research in Form 3CL/3CM.	
5	Pharmaceutical companies avoided deducting TDS on payments made to contract manufacturers by taking advantage of exclusion clause in Section 194C of the Act.	
6	Assesseees take advantage of ambiguous provision related to salary and interest payment	

	to Partners in the Firm to take undue benefit of 80IC deduction.	deductions along with the basis and working of such allocation. iv. The Ministry may adhere to the conditions of the DSIR in general and submission of audited accounts of the R&D facility with the return filed by the assessee in particular at the time of assessment to see the eligibility of R&D expenses and quantification thereof.
7	ITD does not have any mechanism to correlate & verify carried forward losses / depreciation especially of losses / depreciation of the unit availing 80IC deduction.	
8	ITD does not have any mechanism to correlate & verify the turnover declared in Income Tax with turnover declared in Central Excise which is part of the same Ministry of Finance.	

2.3 Impact of Audit

2.3.1 Action Taken by Ministry

Finance Act 2022 amended Section 37 of the IT Act to disallow expenditure incurred by an assessee for any purpose which is an offence, or which is prohibited by law,

- which shall also include expenditure incurred *to provide any benefit or perquisite provided to a person and acceptance of such benefit or perquisite by such person which is in violation of any law or rule or regulation or guidelines governing the conduct of such person.*

2.3.2 PAC Recommendations (2018-19 & 2019-20)

Some of the important PAC observations/ recommendations are enumerated below. For full details, the Committee Reports may be consulted.

1. The Committee recommended that henceforth a comprehensive data of pharmaceuticals sector be maintained not only for helping in tax planning and making sector specific policy but also for proper accounting and collection of the taxes from this sector. The Committee also desired the Department of Scientific and

Industrial Research and National Pharmaceutical Pricing Authority to capture PAN details of the sector to facilitate its linking with ITRs.

2. The Committee had to be apprised of the action taken against the assessing officers who allowed weighted deduction on expenses towards R&D without verifying the claims from the Form 3CL/3CM issued by DSIR in the cases pointed out in Audit Report.
3. The Committee recommended that the Ministry should take legal advice on the matter and amend the Section 194C of the IT Act, if required, at the earliest besides issuing clear instructions to ensure that the pharmaceutical companies deduct the TDS on payments to contract manufacturers.

Audit Checks

1. Whether the weighted deduction towards R&D expenses claimed by the assessee has been verified by the assessing officer by verifying the Form 3CL/CM issued by the DSIR. *Also*, whether department has allowed any excess deduction other than weighted deduction towards R&D expenses allowed by DSIR.
2. Whether the assessing officer had called for details of the contract manufacturers *or other service providing contractors* of the assessee company and verified deduction of TDS u/s 194C.
3. Whether the assessing officer has called for excise/GST returns and compared the turnover with respect to that declared in the ITR.
4. Whether the assessing officer had called for details of sales promotion expenses to verify whether freebies such as gifts, travel facilities, hospitality etc given to medical practitioners have been debited since such expenses are disallowed u/s 37(1).
5. Whether the expenses related to free samples given to physicians have been disallowed by the AO.
6. Whether the common/R&D expenses allocated between eligible and non-eligible units have been verified by the AO before allowing weighted expenses on the same.
7. Whether in the case of Pharmaceutical firms claiming deduction u/s 80IC, the AO has called for partnership deed to verify whether it provides for payment of remuneration and interest to partners or claimed deduction of the same.
8. In addition to the above, the General Checks given at the end may also be applied.

3. Bogus Purchases (CAG Report No. 2 of 2017)

3.1 **Fake/Accommodation Invoices** have been used by businesses to reduce profits by inflating the expenses and thereby lower the outgo of direct tax. It also helps them to take Input tax credit based on such fake invoices and reduce the outgo of VAT/GST. Fake invoices also enable to syphon money from their concerns for personal expenses.

The business concern approaches an accommodation entry provider for invoice for sale without obtaining any goods from them and pays the amount of the invoice by account payee cheque. The accommodation entry provider will encash the cheque and after retaining a small amount as commission return the balance amount in cash to the person who has given the cheque (Beneficiary).

The Maharashtra Sales Tax Department (MSDT) had introduced a system of matching of sales and purchases on an annual basis in which the total sales made by the taxpayer were compared with the Input tax Credit taken by the purchasers. They identified 2059 accommodation entry providers who were only issuing invoices without any supply of goods.

This data of MSTD was taken as the basis to find out how the Income Tax Department was dealing with cases of accommodation entry providers and the beneficiaries.

A detailed audit was carried in income tax department in Mumbai jurisdiction and a long paragraph was included in the CAG report of Direct Taxes (Report no. 2 of 2017). Audit observations and recommendations featured in the report are as follows:

3.2 Issues and Recommendations

S.N.	Issues	Recommendations
1	Few of the accommodation providers identified by the MSTD were selected for scrutiny. It was seen that accommodation entry providers scrutinised by the ITD got away lightly by mere addition of 0.5 percent to 5 percent of the turnover of the accommodation invoices in its taxable income. In many cases, the accommodation entry providers did not file their returns and no action was taken.	(i) The Assessing Officer shall take cognizance of report of the investigation wing and other such institutions of State Government in identifying fictitious / bogus transactions.

2	ITD did not disseminate the information of the purchases/beneficiaries, available in the accommodation entry providers case file, to the jurisdiction assessing officers resulting in beneficiaries who used the fake invoices went scot-free.	(ii) ITD may adopt a uniform mechanism for disallowance / addition as the AOs are allowing or disallowing amounts pertaining to bogus transactions arbitrarily.
3	845 cases of beneficiaries were analysed who had obtained bogus invoices aggregating ₹ 1167.11 crore against which addition of ₹ 210.55 crore at an average of 18.04 per cent of the bogus purchases was made to the return. The method of disallowance involved ad-hoc percentage, gross profit margin or peak credit method without applying any logical pattern pertaining to a particular type of industry or nature of operation.	
4	It has been concluded that the current provision has not acted as a deterrent as there are no disincentive for giving and receiving accommodation entries. Established companies have also resorted to practice of obtaining bogus purchases which shows that present system of gathering evidence and acting thereon was ineffective. The information received by the department is not complete and the information is being used selectively and many assessments scot-free without any action from the department. The present system of making ad hoc disallowance would only lead to generation of black money through such fictitious sales and purchases.	

3.3 Impact of Audit

The Finance Act 2020 introduced new section 271AAD to impose penalty of 100 percent of the fake invoices issued and accepted. The Sub Section (1) of Section 271AAD reads as follows

“Without prejudice to any other provisions of this Act, if during any proceeding under this Act, it is found that in the books of account maintained by any person there is—

- (i) a false entry; or
- (ii) an omission of any entry which is relevant for computation of total income of such person, to evade tax liability, the Assessing Officer may direct that such person shall pay by way of penalty a sum equal to the aggregate amount of such false or omitted entry.”

Audit Checks

1. The Assessing Officer has taken cognizance of report of the investigation wing and other such institutions of State Government in identifying fictitious / bogus transactions.
2. A uniform mechanism for disallowance / addition has been adopted by the AOs while allowing or disallowing amounts pertaining to bogus transactions.
3. In addition to the above, the General Checks given at the end may also be applied.

4. Long Para on Exempt Long Term Capital Gain through BSE Listed Penny Stocks (CAG Report No. 11 of 2020)

4.1 **Penny stocks** are stocks, that trade at a very low price, have very low market capitalization, are mostly illiquid, and are usually listed on a smaller stock exchange. These stocks are very speculative in nature and are considered highly risky because of lack of liquidity, smaller number of shareholders and limited disclosure of information.

Section 10(38) of the Income tax Act, 1961 (the ‘Act’) exempted long term capital gains (LTCG) arising from transfer of listed equity shares. The operators in the share market carry on circular trading in consent with each other to artificially increase the price of these penny stocks and show sales at the higher. The gains are shown as long-term capital gains which are exempt under Income Tax. Once this transaction is complete, the market price of

these penny stock falls drastically and the person who has bought it at a higher price will book losses and set it off against other capital gains.

A long Para on Penny Stock was forwarded by Mumbai Office and the audit observations included in CAG Report No 11 of 2020 is as follows:

4.2 Issues and Recommendations

S. No.	Issues	Recommendations
1	The ITD failed to issue notices to the assesseees who were involved in trading penny stocks but have not filed their ITRs.	(i) The ITD may design parameters in such a way that all the relevant information with ITD, whether from ITR or other sources, may be used to select the cases for scrutiny. (ii) The method of selection for scrutiny may be shared with the C&AG as was pointed out in the Audit Report No. 9 of 2019 of C&AG so that audit may see whether the selection of cases for scrutiny is as per parameters. (iii) The ITD may examine whether the errors in assessment of cases where LTCG on penny stock was claimed, are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.
2	Even Non-filers Monitoring System had not been utilized effectively to identify such non-filers.	
3	The AOs had no uniformity in making additions of exempt LTCG, despite the fact that the grounds of additions were same.	
4	In some cases, AOs did not make any addition for claimed exempted LTCG, for which no justification was given in the assessment orders.	
5	The ITD did not have any systemic approach to deal with cases of beneficiaries traded in penny stock as in some cases entire sales consideration was disallowed whereas in some cases only claimed LTCG was disallowed.	
6	There was also variation in disallowance of commission received by entry and exit provider from beneficiary of penny stock.	

4.3 Audit Checks

1. Whether uniformity is maintained where additions were made on similar grounds in the assessment orders passed by the Assessing Officer.
2. Whether the veracity of transactions have been verified where DIT(Investigation) Report is available. It is also important that the Assessing Officer not only follows the investigation in cases where information has been received, but also to see all the cases of LTCG/LTCL from the point of view of identifying the new bogus penny stock/ scrips.
3. In addition to the above, the General Checks given at the end may also be applied.

5. Performance Audit on “Assessment of Co-operative Societies and Co-operative Banks” (CAG Report No. 16 of 2020)

5.1 The Co-operative Societies can be defined as an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically-controlled enterprise. Co-operatives are legally established associations or business enterprises owned and controlled by the members that they also serve. Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity.

A Performance Audit on Assessment of Co-operative Societies and Co-operative Banks was taken up and the audit observations featured in the Report are as follows:

5.2 Issues and Recommendations

S.N.	Issues	Recommendations
1	Mismatch between Data Provided by DGIT(System) and Data collected from Assessment Record e.g. mismatch in data provided by DGIT(System) in respect of Returned Income, Assessed Income, Demand raised etc. and data	i) The CBDT may revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for errors and put in place a robust IT system and internal control mechanism to

	available in assessment folders maintained in assessment charges.	<p>eliminate possibility of avoidable errors and to ensure compliance to provisions and conditions laid down under the Income Tax Act by the Assessing Officers. The CBDT may like to introduce a quality assurance mechanism to ensure that errors in computations of tax are minimized.</p> <p>ii) The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite there being clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity of irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance.</p> <p>iii) The CBDT may ascertain whether the errors/ irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.</p> <p>iv) The CBDT may ensure that the ITD should focus on reconciliation of claims, through CPC-Bengaluru, actively, to resolve the differences in claims and payments and evolve means to avoid possibilities of non-matching of the same.</p>
2	Non utilization of investigative tools for strengthening the tax base e.g. The department did not seem to utilize the survey and search & seizure tools available with it to identify and bring into tax net the non-filers and stop filers of income tax returns.	
3	Non-verification of essential conditions of Acts and Provisions e.g. Audit noticed that the verification of registration of the entity as Co-operative Societies/ Co-operative Banks was inadequate and evidential proof of a certificate of registration by Registrar as well as the details of members of the societies was either not available in the assessment records or not verified by the Assessing Officers.	
4	Mistakes in computation of income, tax, surcharge etc.	
5	Mistakes in levy of interest / penalty etc.	
6	Irregular allowance of expenditure, deductions etc.	
7	Incorrect allowance of depreciation.	

		<p>v) The CBDT may consider assigning/ updating codes as per the nature of business or activity ascertained during assessment for effective monitoring of the claims of deduction as per the nature of activities undertaken by Co-operative Societies and Co-operative Banks.</p> <p>vi) ITR-5 may capture list of all Members of a Co-operative Society, along with their PAN, for the previous year relevant to the Assessment Year of filing of return. Quoting of PAN may be made mandatory for deposits received above a threshold amount by Co-operative Societies. Further, the CBDT may consider reporting instances involving significant quantum of unexplained cash credits to the regulatory authorities (RBI, ROCS etc.) to facilitate monitoring of probable financial irregularities.</p>
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5.3 Impact of Audit

CBDT (ITA Division) has issued guidelines vide Circular dated 23.10.2021 to address the issues flagged by the CAG vide Report No. 16 of 2020. It has been mentioned in the guideline that a detailed SOP is being issued shortly with respect to Assessment of Co-operative Societies and Co-operative Banks. (It will be circulated after issuance by CBDT.)

5.4 Audit Checks

1. Whether the classification of co-operative society was made by the Registrar and available in the document (Certificate of Registration by Registrar and Form 49A)

submitted to the Income Tax Department.

2. Whether verification of registration status was done by the Income Tax Department.
3. Whether the details of Members in ITR was verified from the Register of Members (being maintained by Registrar) containing particulars of members, admission and cessation details, shareholding details etc.
4. Whether the annual accounts/ financial statements of co-operative society were audited by Auditor from empaneled list.
5. Whether the amount of debt or part thereof allowed as deduction under section 36(1)(vii) had been taken into account while computing income of the assessee of previous year or earlier previous year and represented money lent in ordinary course of business of banking or money lending carried on by assessee.
6. Whether the amount of deduction allowed under section 36(1)(viii) was as per the conditions laid out in the Act.
7. In addition to the above, the General Checks given at the end may also be applied.

6. Performance Audit on Search and Seizure (CAG Report No. 14 of 2020)

6.1 **Search and Seizure** is a very powerful tool available to Income Tax Department to unearth any concealed income or valuables and to check the tendencies of tax evasion thereby mitigating the generation of black money. The Income Tax Department resorts to search and seizure only in cases where there is sufficient reason to believe that the person concerned would not disclose the true picture of his income in the normal course of filing of return and regular assessment.

The Performance audit on search and seizure assessments in Income Tax Department was carried out with the objective to examine

- (i) the extent of compliance with the existing provisions of the Act/Rules /Circular/Instructions in making such assessments and also to point out systemic deficiency, if any, in these assessments; and
- (ii) the efforts made by the department in coordinating with other Government agencies/different wings of the department to disseminate information during

the course of assessment, regarding undisclosed income detected during search and seizure operations.

Audit observations and recommendations featured in the Report No. 16 of 2020 are as follows:

6.2 Issues and Recommendations

S.N.	Issues	Recommendations
1	Audit noticed that the department did not centralise all cases in respect of certain groups for assessments due to which issues relating to the assessee pointed out in Appraisal Report could not be addressed.	i. The CBDT may introduce suitable provision for not allowing set-off of losses of previous years/earlier years assessed in regular assessments against the undisclosed income detected during search and seizure.
2	Audit noticed cases where AOs, while finalizing the assessments, did not take uniform stand in making additions on account of bogus purchases, accommodation entries and in adoption of figures of assessed income/revised income. The additions were made arbitrarily either on lump sum amount basis or different percentage ranging from five per cent to 50 per cent under similar circumstances without proper justification.	ii. Audit reiterates that the CBDT may introduce a time limit for issuing notices under amended section 153A/153C. iii. the CBDT may examine whether these are errors of omission or commission and take necessary action as per law in that regard.
3	Audit noticed cases where AO while finalizing the search assessments, did not assess unexplained credit, levied tax on normal provisions instead of leviable under special provisions of section 115JB of the Act, computed short demand, charged tax at a rate less than the prescribed rate, short levied interest, surcharge and did not	iv. ITD may strengthen the mechanism for monitoring of compliance of existing instructions of CBDT regarding centralisation of all the search cases in central circles, so that all the issues pointed out in Appraisal Report could be addressed and assessment made more effective.

	disallow expenditure related to exempt income, allowed incorrect MAT credit etc.	
4	Audit noticed cases where AO did not comply with the provisions such as non-referring of cases to Transfer Pricing Officer (TPO), Action on offence committed by Chartered Accountant in IT Act, Delay in action on Entry provider, Assessment without filing of IT Return, Prior approval of Joint Commissioner not taken before passing assessment order, etc. during search assessments.	
5	Audit observed delay ranging from one month to 14 months in handing over of Appraisal Report along with seized material to the AO. This inordinate delay in handing over seized materials may result in less time for assessment which has attendant risk of human error for hasty completion of assessment thus affecting the quality of assessments.	
6	Audit noticed cases where AO did not verify the source/genuineness of the transaction pointed out in Appraisal Report and did not add undisclosed income recommended in the Appraisal Report, unsecured loan/advance received from entry provider, entire undisclosed income pointed out in Appraisal Report was not assessed, expenditure was not added back to the income of the assessee for want of evidence of TDS, action was not initiated by the department despite receipt of search	<p>v. the Department may like to ensure that the search warrants are issued after proper examination of the information available, research and due diligence in a manner which is above suspicion as search and seizure involves lot of harassment to the assesseees and their families. The possibility of role of judicial body may also be explored. The CBDT may also analyse the reasons for low sustainability and fix the responsibility of the concerned officers.</p> <p>vi. the CBDT may examine the reasons for wide variations in the applicability of the same law under similar conditions and find a solution to ensure consistency in making assessments. The CBDT may also investigate whether these are errors of omission or commission and take necessary action as per law in that regard.</p> <p>vii. CBDT may put in place a mechanism so as to ensure that Appraisal Report along with seized material be handed over to assessment wing within stipulated time so that AO could have sufficient time to examine all the</p>

	folders and materials. Though the department was required to coordinate with other wings of ITD viz Investigation wing, TDS circle etc. in these cases and resolve the issues before finalization of the assessments but the same was not done.	issues pointed out in Appraisal Report.
7	Audit noticed cases where AO had not made addition of undisclosed income admitted by the assessee or disallowed the expenditure based on the statement made on oath during the course of search and also had not resolved the matter with the Investigation Wing.	<p>viii. the CBDT may put in place a mechanism so as to ensure that the issues pointed out in Appraisal Report are duly addressed during assessment.</p> <p>ix. ITD may strengthen its assessment procedure to make effective use of provision 132(4) of the Act.</p> <p>x. ITD may strengthen the mechanism of sharing of information amongst different wings of the Department as well as with other Government agencies and ensure its timeliness for effective assessments and prevent undue benefit to the assesseees.</p>
8	Audit noticed cases where other government agencies i.e. REIC and CBEC did not share information with ITD. As a result, AO could not address the issues like removal of stocks without payment of excise duty, purchases in cash without invoices/bills and genuineness of sources of investment etc. either in search assessments or finalized assessment without examining the requisite information which may be prejudicial to the interest of revenue.	<p>xi. the CBDT may fix responsibility where Action Note/Separate Narrative Report is not prepared and further appropriate action be taken so that objective of search and seizure operations is not defeated.</p>
9	Audit observed that the information relating to advancing of loans to the paper companies, wrong claim of PSI subsidy/sales tax subsidy was not shared by ITD with other government agencies/authorities either directly or through REIC.	<p>xii. ITD may devise a system to track the new assesseees added in the tax net consequent upon search operations/assessments and also to watch that these assesseees are tax compliant.</p>
10	Audit observed in certain Groups where Action Notes based on comprehensive and	

	<p>methodical examination of seized material, were not prepared by the AO. Audit also observed that Separate Narrative Reports were not prepared and sent to the Member (Investigations).</p> <p>Audit noticed cases that though the information relating to sellers of land/flat/commodities had been pointed out in the respective Appraisal Report, who could be potential assessees. Yet Department did not initiate any action in this regard. The department also did not confirm whether these sellers were in the tax net of the department and regularly filing the return.</p>	
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6.3 Impact of Audit

Finance Act, 2022 introduced following amendments to IT Act-

1. Insertion of a new Section 79A which provides that no set off any loss, whether brought forward or otherwise, or unabsorbed depreciation, shall be allowed to assessee against undisclosed income consequent to a search or a requisition or a survey other than under sub-section (2A) of the Income Tax Act.
2. Insertion of section 153(f) in explanation 1 (xii) in the Act which provides that the appraisal report along with seized material be handed over to assessment wing within a period not exceeding one hundred and eighty days after the end of search and seizure.
3. Insertion of a new sub- section (1A) in section 149 of the Act. Earlier assessment or reassessment was restricted to six prior years in search and seizure cases. Now it is inserted in the Act that where the income chargeable to tax represented in the form of an asset or expenditure escaped the assessment and the investment in such asset or expenditure in relation to such event or occasion has been made or incurred, in more than one previous years relevant to the assessment years, a notice under section 148 shall be issued for every such assessment year for assessment, reassessment or re-computation, as the case may be.

6.4 Audit Checks

1. Whether uniformity has been maintained while making additions during assessment where additions were maintained on similar grounds.
2. Whether CBDT's instructions/orders in respect of assessment of Search and Seizure cases are adhered to.
3. Whether the figures were correctly adopted where assessment has already been finalized u/s 143(3) while finalizing the search assessment, in response to the notice issued u/s 153A/153C of the Act for computation of income.
4. Whether Penalty @ 100 per cent (up to maximum 300 per cent) has been levied where in the course of search-initiated u/s 132 of the Act, the assessee has not declared any income, shall be deemed to have concealed the particulars of his income or furnished inaccurate particulars of income.
5. In addition to the above, the General Checks given at the end may also be applied.

7. Performance Audit on Exemptions to Charitable Trusts and Institutions (Report No 20 of 2013)

7.1 The Income Tax Act, 1961 (the Act) provides for tax exemptions to various entities including Government funded **entities engaged in objects which are charitable in nature** in order to encourage and fulfil social objectives in areas such as charity, religion, medical and education etc. These entities receive donations, voluntary contributions and have other incomes from activities which are charitable in nature. The receipts of such entities are required to be applied for the purposes for which these have been set up. Income tax Department (ITD) ensures that income of genuine and eligible trusts and institutions only are exempted from levy of income tax and correct amount of tax is paid by them.

7.2 Performance Audit on Exemptions to Charitable Trusts and Institutions was taken up initially in the year 2012 and was included in **CAG Report No 20 of 2013**. Public Accounts Committee (PAC) examined the Report in 2015 and submitted their Report. In 2018 PAC again submitted a report on the Action Taken by the Government on the observations and Recommendations contained in the Report No 20 of 2013 and desired that the Comptroller & Auditor General submit a report on the violations of the Public Charitable Trusts and make recommendations on how to remedy the gaps and prevent such recurrences in future.. A Follow up Audit of Exemptions to Charitable Trusts and Institutions was thereafter taken

up and the same was printed in Audit Report No 9 of 2019. In 2020-21, PA has been conducted and the Report is under Draft Stage at HQ level.

The objectives of the PA was to check a) Whether the CBDT ensures in an effective manner that the Charitable Trusts and Institutions, which are availing the benefits under sections 10(23C), 11, 12, 13, 80G(5) of the IT Act, are working towards achieving the objectives for which they are formed; b) Whether the ITD is efficient in granting the exemptions to the Charitable Trusts and Institutions under above provisions of the Act and such exemptions are given to the eligible entities accurately and in a timely manner.

Audit observations and recommendations featured in the above Reports are as follows:

7.3 Issues and Recommendations

Sr. No	Issue	Recommendations
1	In more than 300 cases, ITD granted approvals / registrations in the absence of certified copy of the Trust Deed or prescribed copies of the audited accounts etc.	The Ministry may review the exemptions granted to the assessee and also evolve a system so that no registration is granted to trust without calling for prescribed documents such as copy of trust deed, copies of audited accounts etc.
2	In more than 450 cases, ITD granted approvals / registrations in which there was no dissolution clause in the Trust Deed.	The Ministry should insist upon inclusion of 'Dissolution Clause' in the Trust Deed in all the states whether local legislation exists or not.
3	Irregular exemption to Trusts which were not charitable in nature.	The Ministry may issue suitable instructions that AO should allow exemption to Trust who have application of Income only for charitable purposes covered u/s 2(15) of the Act.
4	Delay in granting registration / approval	The Ministry may ensure that time limit for passing order u/s 10(23C), 12A and 80G of the Act is adhered invariably in all the case; otherwise responsibility may be fixed for delay in granting approval so that eligible trusts are allowed exemption
5	Exemption allowed u/s 80G though prescribed conditions were not fulfilled	The Ministry may reiterate suitable instructions for effective monitoring to minimize such type of mistake.

6	Exemption granted without submission of Audit Report	The Ministry may consider incorporating gist of Audit Report in ITR-7 to be processed electronically so that in no case exemption would be granted without having the accounts audited.
7	Diversion of income/property to related group trusts/institutions considered as application of income	NIL
8	Exemptions to assessees whose activities were not 'charitable' in nature	
9	Allowance of expenditure and accumulation where exemption was denied.	
10	Lack of monitoring the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act.	
11	Exemptions granted to trust on application of funds given to foreign universities.	
12	Exemption to assessee where voluntary contribution including foreign currency donation was considered as corpus fund without specific direction of donor.	
13	Non cancellation of registration where activities of the Trusts and Institutions are not in accordance with the provisions of the Act.	
14	Failure of the Assessment Information System (AST) to levy surcharge.	

7.4 Impact of Audit

Amendment in ITR 7 (ITR form for Trusts), changes in registration process (Re-registration for all trusts with validity of five years and after five years again fresh registration).

PAC Recommendations (2015-16 & 2018-19)

Some of the important PAC observations/ recommendations are enumerated below. For full details, the Committee Reports may be consulted.

1. Some of the provisions for exemptions to charitable trusts and institutions viz. section 11(1)(c) from on or after 1.4.1952, section 13(1)(d)(iii) after 30 November 1983, proviso to section 13(1)(d)(iii) from 1.6.1973 are from specific dates and apply to different trusts differently thereby not providing a level playing field. CBDT may consider bringing in a level playing field by inserting a sunset clause for such provisions applicable to those Trusts that have retained the benefit on ground of actions, having been taken earlier though these are prohibited now. A sunset clause for such provisions would ensure that benefits not available now are not available to anyone, and thus all types of Trusts and Institutions are treated on similar lines. This will reduce the difficulties in assessing Trusts, when different trusts have to be treated differently, and reduce the “errors” in assessments. CBDT may consider giving a period of say three years to the affected trusts to comply with the new provisions.
2. CBDT may consider amending the provision to make prior approval a pre-condition for foreign donation by a charitable trust or institution. The CBDT may also specify a limit say, 5 to 10 per cent of income for such donations.
3. CBDT may consider including a provision to make the trustee also liable in case where the provisions of the Act are not complied with.
4. Since the issues pointed out in the earlier Audit Report no. 20 of 2013 are continuing, ITD is advised to review all the trust cases without exception and ensure that exemptions and concessions allowed to them are as per the provisions of the Act and registration of trusts not fulfilling the prescribed conditions are reviewed.

7.5 Audit Checks

1. Whether certified copy of the Trust Deed or prescribed copies of the audited accounts is available on record.
2. Whether there is a delay in granting registration / approval.
3. Whether the exemptions allowable with reference to its activities have been allowed correctly and the accumulated funds have been utilized rightly within the time frame in subsequent years and whether any record of utilization of the fund in future has been maintained.
4. Whether depreciation is being claimed on assets whose cost has already been claimed as application of income? Application of income can be allowed but not depreciation.
5. Whether approval for exemptions was granted by the appropriate authority.

6. Whether exemption was allowed for the period for which approval/registration was granted.
7. When income exceeds the maximum amount which is not chargeable to income tax whether audit report in Form 10B is filed or not.
8. Applying the proviso to section 2(15) if the objects of the trust are not found to be charitable, whether computation of total income has been made as per the normal provisions of the Act.
9. Whether any contribution received without any specific direction from donors and held under corpus have been treated as income of trust/institution.
10. Whether at least 85% of the income from property held under trust for charitable or religious purposes has been applied for the purposes of the trust? If not, whether Form 10 has been filed.
11. Whether the income from business activity has been applied on charitable purpose to claim exemption? If not, whether the short fall of such application has been made taxable income.
12. Whether the property from which income is derived, is held by the trust and whether it is held wholly for charitable purposes only.
13. Whether any income not received in the previous year in which it was derived was taken as income in the following year or not.
14. Whether separate books of accounts have been maintained in respect of income from business activity to claim exemption? In a case where assessed income of such business undertaking exceeds the income reflected in the books of accounts, whether the exemption has been limited to the extent of income reflected in the books of accounts.
15. Whether the department is charging tax on anonymous donations as per provision of section 115BBC.
16. Whether any donation received by the organization notified under Section 80G(2) (d) has been utilized for the purposes other than providing relief to the victims.
17. Whether the assessee is allowed depreciation on assets in spite of claiming the whole amount of expense under application of income in the year of expense.

18. Whether the dual benefit has been taken of borrowed fund; one by including it in application of income under the head of addition to fixed assets and another at the time of repayment of loan.
19. Whether department has ensured compliance to the existing mechanism to ascertain the verification done by competent authorities i.e. DGIT-E/CCIT/CIT/DIT-E in requisite documents as specified in Act for approval of registration of Trusts.
20. Whether any column for PAN No in Form No 10 A has been inserted along with suitable changes in Rule 17A of the Income Tax Rules which makes PAN a pre-requisite condition for registration.
21. Whether any database of registered trusts/institutions has been maintained by the department and provided to AOs to have co-ordination between Approving Authorities and other related AOs for examination the issue of exemption of trust and their allied activities.
22. Whether the Assessing Officer adhere to the time limitation for passing order u/s 10(23C), 12A and 80G of IT Act
23. Whether the department has any appropriate control mechanism due to which Trusts are not allowed accumulations consistently through strict monitoring of Form 10 and also ensure utilization of accumulated funds over a period of time.
24. Whether any mechanism exist for withdrawal of exemption/cancellation of registrations/approvals u/s 12A / 10(23C) of Act in case of violation of provisions 8 of section 13 of Act. In some cases, though department has cancelled the registration, however, it is observed that the cancellation / withdrawal is being restored by hon'ble appellate authority/judicial High Court.
25. Whether any mechanism exists for accumulations of income by Trusts that are used in specified mode, specified time and for specific purposes.
26. Whether any instruction issued by CBDT to verify information of major donations received u/s 80G during scrutiny cases to ensure proper accounting of donations/transactions in the accounts of donors.
27. Whether the AO has adhered the issue pertaining to "substantially financed" to clarify provisions of section 10(23C) of IT Act.
28. Whether any mechanism for provisions for TDS compliance claimed by Trusts have been properly disclosed in the Audit Reports.

29. In addition to the above, the following Checks given at the end may also be applied.

8. Performance Audit on “Assessment of Entities Engaged in Health and Allied Sector” (Report No 27 of 2017)

8.1 Indian Healthcare Sector, one of the fastest growing service areas has witnessed significant growth in terms of revenue and employment generation in recent years. The healthcare sector in India comprises both private and public sectors. The private sector in India has a dominant presence in medical education and training, hospital infrastructure and ancillary service areas such as medical technology and diagnostics and provides nearly 80 per cent of outpatient care and about 60 per cent of inpatient care. The private health care sector comprises organizations that operate both on profit and not-for-profit basis. The “not-for-profit” organizations include healthcare service providers such as Non-Government Organizations (NGO’s), charitable institutions, Trusts, etc. The assessee engaged in the business of Private Hospitals, Nursing Homes/Medical clinics, Medical Colleges/Research Institutes, Diagnostic Centres, Pathological labs, medical supplies agencies/stores etc. are governed by all the provisions of the Income Tax Act that are generally applicable to the different class of assessee viz. Companies, Firms, Trusts, Charity firms, Association of Persons, Hindu Undivided families, Individuals etc. Further, the Income Tax Act provides specific tax incentives to hospitals viz five-year tax holiday in respect of profits derived from the business of operating and maintaining hospitals located anywhere in India other than the excluded areas, besides deduction of capital expenditure incurred in connection with setting up of new hospitals, subject to certain conditions. It also allows higher rate of depreciation on medical equipment to incentivize the hospitals to upgrade their healthcare infrastructure and to provide access to patients to the latest technology.

The performance audit of assessment of Private Hospitals, Nursing Homes/Medical Clinics, Medical Colleges/Research Institutes, Diagnostic Centres, Pathological labs and other medical supplies agencies/ stores etc. of the Department of Revenue was conducted in 2016.

8.2 Issues and Recommendations

S. N.	Audit Findings	Recommendations
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1	<p>Despite the availability of systems viz. Income Taxpayer Data Management System (ITDMS), Non-filers Monitoring System (NMS), Project Insight and other versatile tools for analyzing data collected from external sources for widening of tax base, audit noticed that these have not been effectively utilized/ implemented for strengthening the tax base in private healthcare sector and for identifying the stop-filers and non-filers. The existing tools could not be used to cross-verify whether medical professionals and medical companies/healthcare facilities registered with other registering agencies were effectively covered in the income tax net. Absence of any system of such cross-verification points to the possibility of potential assessee remaining outside the tax net.</p>	<ul style="list-style-type: none"> i. requesting the registering bodies/ agencies through their administrative Ministries/Departments making it mandatory to provide the PAN details by private hospitals, nursing homes/ medical clinics, medical colleges/ research institutes, diagnostic centres, pathological labs, medical supplies stores etc. at the time of registration. ii. modifying its existing mechanism to identify non-filer/ stop-filer private companies and registered medical professionals in healthcare sector to widen its tax base.
2	<p>businesses under healthcare sector like medical clinics, diagnostic centres, pathological labs and other medical supplies agencies/stores under the existing allocation of codes based on the nature of business with respect to healthcare assessee were not codified. This negatively impacts monitoring and vigilance of the healthcare sector as well as collection and sharing of relevant information on sector-specific issues.</p>	<ul style="list-style-type: none"> iii. leveraging survey operations more effectively to strengthen the tax base of assessee related to the healthcare sector. iv. allocating specific codifications to different businesses in the healthcare sector that are not captured presently (viz. Medical Clinics, Diagnostic Centres, Pathological labs and other medical supplies agencies/stores) under the existing
3	<p>The Income Tax Act does not prescribe any measurable parameters to assess the extent of charitable activities being</p>	

	undertaken by any hospital trust availing the benefit of exemptions under the Act. This gives rise to a possibility of assessee availing exemption without performing any charitable function.	codes specific to healthcare sector.
	no provision in the ITD module to enable validation of section 80G certificates by Assessing Officers as in done in the case of TDS certificates under TRACES.	v. introducing provision for generating sector specific data in NMS module.
4	The provision under section 35AD of the Act does not specify the allowability of deduction on capital investments in cases where the value of land and building were not separable, resulting in allowance of excess deduction and loss of revenue.	vi. The CBDT may consider prescribing measurable parameters for assessment of charitable activities undertaken by private hospital trusts as a precondition for granting exemptions under the Income Tax Act, and amend the Act for this purpose if necessary
5	Audit noticed instances where exemptions were allowed to ineligible assessee engaged in trading/commercial activities, as well as instances of incorrect allowance of accelerated depreciation on items not classified under life-saving medical equipment, incorrect allowance of deduction under section 80IB of the IT Act on incomes from non-hospital activities and irregular allowance of deduction on provisioning rather than on actual capitalization under section 35AD of the Act.	vii. The CBDT may clarify how to assess value of land for admissibility of deduction under section 35AD of the Income Tax Act in cases where the value of land is not separately determinable from the value of the building.
6	Provisions relating to allowances of business expenditure, tax deducted at source (TDS), minimum alternate tax (MAT) and set off of carry forward losses were	viii. The CBDT may consider the possibility of introducing automated generation of 80G certificates above a certain threshold.

	not followed correctly by the ITD during assessment.	ix. The CBDT may issue a clarification for disallowance of expenditure in respect of all kinds of freebies and referral fees paid to medical practitioners as well as advertisement and business promotion expenses within the purview of explanation under section 37 of Income Tax Act 1961 to create an additional deterrence against such unethical practices.
7	The “referral fees” paid to the doctors by the private hospitals, nursing homes, diagnostic centres etc. for referring patients and payments made on account of “advertisement expenses” by the medical practitioners were allowed, although such expenditure has been held as disallowable and “unethical” as per CBDT’s directives and laws of regulatory bodies.	

8.3 Audit Impact

PAC Recommendations (2018-19)

Some of the important PAC observations/ recommendations are enumerated below. For full details, the Committee Reports may be consulted.

1. The Income Tax Payer Data Management System (ITDMS), Non-filers Monitoring System (NMS), Project Insight have not been effectively utilized/ implemented for identifying the stop-filers and non-filers and to cross-verify whether medical professionals and medical companies/healthcare facilities registered with other registering agencies were effectively covered in the income tax net. an advanced analytical solution is being rolled out wherein it will be possible to select matching PAN by applying various PAN imputation rules desire that the same may be implemented at the earliest
2. The data available with agencies like Central Council of Indian Medicine and other registering agencies for medical professionals engaged in the practice of alternate medicines be also analysed to identify the non-filers. Since the demand for alternative medicines has increased, that tax incentives be given to only those manufacturers who comply with quality control standards.
3. The entities seeking exemption under the health sector may be given a sub code to analyze the revenue impact of the tax incentives.

4. Implementing a new measure to fix measurable parameters, on the lines of BPT Act, for charitable activities to justify the exemptions given to the Trusts/ Hospitals and install a robust mechanism for verifying the charitable activities carried out by any Trust/ Hospital.

5. As per section 10(23C), the income of certain funds, Universities, educational institutions, hospitals, etc., that deal with philanthropy works are not to be included in the total income and Section 11 of the Act governs the grant of exemption to income of a charitable trust or institution.

- The Committee further noted that Section 10(23C) and section 11 of the Income Tax Act, 1961 are overlapping in nature and cover the same purposes (philanthropy or charity) leaving scope for confusion and varying interpretations that allows the assesses to take unfair advantage of excluding the income or claiming exemption utilising one of these two provisions that suits them.
- To eliminate possibility of misuse by permitting an assessee to claim similar benefits under both the sections, specific instructions may be issued/ reiterated.

6. In order to ensure transparency in the business activities, expenses related to promotion of business, be allowed to be incurred from the profits after tax of the hospitals/pharmaceutical and allied industries and similarly, these may be made taxable in the hands of the beneficiaries.

7. The provision under section 35AD of the Act does not specify the allowability of deduction on capital investments in cases where the value of land and building are not separable, resulting in allowance of excess deduction and loss of revenue. DG (Exemptions) may be given the responsibility for making assessment of cases where construction has been done only on a very small portion of the land.

8.4 Audit Checks

1. Whether the assessing officer has called for excise/GST returns and compared the turnover with respect to that declared in the ITR.
2. Whether the assessing officer had called for details of sales promotion expenses to verify whether freebies such as gifts, travel facilities, hospitality etc. given to medical practitioners have been debited since such expenses are disallowed u/s 37(1).
3. Whether the expenses related to free samples given to physicians have been disallowed by the AO.
4. Whether the common/R&D expenses allocated between eligible and non-eligible units have been verified by the AO before allowing weighted expenses on the same.

5. Whether the MAT has been correctly calculated and rightly set off in future years and whether any records of MAT allowed to be set off in future has been maintained.
6. Whether assessee is taking the benefit of Section 11 and Section 10(23C) of the Act.
7. while claiming deductions under section 35AD, the conditions mentioned under the provisions have been fulfilled.
8. Whether deductions claimed under Section 35 and Section 35(2AB) of the IT Act for expenses on scientific research has rightly allowed.
9. whether deductions claimed under section 37 of the Act is expended wholly and exclusively for the purposes of business.

9. SSCA on ‘Interest u/s 234 a/234B/234C/244A’ (CAG Report No. 11 of 2020)

9.1 C&AG had carried out a SSCA on ‘Interest u/s 234 a/234B/234C/244A’ under the Income Tax Act, 1961 (Act) and audit observations and recommendations featured in its Report No. 11 of 2020 are as follows:

9.2 Issues and Recommendations

S. No.	Issues	Recommendations
1	Incorrect calculation of interest by System AST and Income Tax Business Application (ITBA)	CBDT may institute appropriate checks and balances in Income Tax Business Application (ITBA) to prevent recurrence of error in computation of tax and interest.
2	The interest was wrongly computed by either due to systematic deficiencies or due to incorrect interventions by A.O.	The IT system for direct taxes needs to be designed in such a way that it should ensure zero or minimal physical interface between the assessee and the tax officers. The Government may consider the IT System for direct taxes being placed at arm’s length from CBDT, with an independent governmental body or organisation.
3	AOs modified the interest under sections 234A, 234B, 234C and 244A of the Act against the incorrect interest calculated through the system in some cases and all	AST module allows manual modification of interest amount which resulted in errors in computation of interest. ITD needs to inquire into the reasons for errors in computation of

	these cases were not modified at correct amount, which resulted in either short levy/payment or excess levy/payment of interest.	interest through AST and reasons for allowing manual modification to co-exist with IT system..
	The interest was wrongly computed by ITD in 76.68 per cent of cases of the sample selected The interest was wrongly computed by either due to systematic deficiencies or due to incorrect interventions by A.O.	The system should be designed to provide Audit trail for modification carried out by AO. All justification for modification must be available on system.
4	Input of other ITD module was not being captured properly in the AST system leading to incorrect computation of interest in number of cases which has an impact on final tax collection and refund.	CBDT may examine whether the instances of “errors” noticed are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.
5	AOs did not take any step to rectify the incorrect interest, under section u/s 234A, 234B, 234C and 244A of the Act, calculated through the system even though AST system allowed the AOs to modify the value of interest in accordance with the provisions of the Act, thereby leading to either short levy/payment or excess levy/payment of interest.	The IT Department may fix accountability on the part of the AOs to ensure that the risk of recurrences of similar types of irregularities are minimised.
6	All Income Tax Returns (ITRs) are first summarily processed under section 143(1) at Centralized Processing Centre (CPC), Bengaluru. Which is supposed to completely automated. However, refunds of the assesses were blocked by modifying the interest amount even in cases processed in summary manner through CPC	CBDT may ensure that the refund due to the assessee is released in prescribed time limit, upholding its commitment through the citizen charter, rather than to withhold/block it by manual intervention.
		AO’s action regarding blockade of refund as well as under charging of interest may be investigated upon.
	The interest was wrongly computed by ITD in 76.68 per cent of cases of the sample selected The interest was wrongly computed by either due to systematic deficiencies or due to incorrect interventions by A.O.	While audit carried out test check of a sample of cases, CBDT should examine all the cases where modifications were carried out in AST to identify instances of omission and commission and take necessary action as per law.

9.3 Impact of Audit

CBDT under the Ministry of Finance accepted the recommendations and replied as given below:

1. ITBA application is created for the AOs and the training on the change to system is updated on the ITBA portal and instructions issued.
2. As the CPC and ITBA system needs to cater to all the changes as per the provisions of the Income tax Act, 1961 and Income Tax Rules and other procedures of the Department, there are chances that AO may inadvertently overlook the changes imposed on the system. Such changes can cause the impact on the taxpayers. Such mistakes are rectified as soon as the same are noticed on the system in a simpler manner and all the decisions taken are recorded digitally for audits.
3. The training and announcement of changes in the ITBA/CPC systems will be shared with the AOs more frequently and system level checks also will be revisited by adding appropriate indicators and alerts while initiating the records on the system.
4. Safeguard mechanism like recording or reasons for modifications in interest and prior approval of Higher Authority have been implemented in Legacy AST system and in ITBA.

10. ASSESSMENTS RELATING TO AGRICULTURAL INCOME (CAG Report No. 9 of 2019)

10.1 Article 366(1) of the Constitution provides that the expression ‘**Agricultural Income**’ in the Constitution means agricultural income as defined for the purpose of enactments relating to Indian Income Tax. As per section 2(1A) of the Income Tax Act, 1961 (the Act) ‘agricultural income’ means (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes; (b) Any income derived from such land by agricultural operations including processing of agricultural produce so as to render it fit for market or sale of such produce; (c) Any income attributable to a farm house subject to fulfillment of conditions specified in the Act; and (d) Any income derived from saplings or seedlings grown in a nursery. As per section 10(1) of the Income Tax Act, 1961, agricultural income is exempted from tax. Taxes on agricultural income falls under Entry 46 in “State List” under the Constitution of India. Thus, only the State Governments are competent to enact legislations for taxation of agricultural income. The Central Government cannot levy income tax on agricultural income. However, agricultural income is considered for rate

purposes while determining the income tax liability viz. the rate of tax applicable to other taxable income of Individuals, Hindu Undivided Families (HUF), Association of Persons (AOP), Bodies of individuals (BOI) and artificial juridical persons. Exemption under the Income Tax law may be claimed as agricultural income, income from sale of agriculture land, income earned as compensation received from government for acquiring the agriculture land etc.

C&AG had carried out a SSCA on **Assessment relating to Agricultural Income** under the Income tax Act, 1961 (Act) and audit observations and recommendations featured in its Report No. 9 of 2019 are as follows:

10.2 Issues and Recommendations

S. No.	Issues	Recommendations
1	Audit observed that there are no instructions from CBDT specific to scrutiny of agricultural income exemption claims. It has been held by the Apex Court in CIT Vs R. Venkataswamy Naidu that the onus lies on the assessee who claims exemption to establish it. While determining the taxable income and tax payable, the AO should insist upon production of material evidence for the exemption claimed on account of Agricultural income. Failure to adopt a system of establishing the veracity of the claim would result in excess allowance of exemptions and under-assessment of taxable income.	<p>i) ITD carry out a 100 per cent check of all cases, in all Commissionerates, where agricultural income claimed is above a certain threshold, say 10 lakh or more and examine and ensure that the exemption has been allowed only to eligible assessees, and is based on appropriate documents and verification.</p> <p>ii) ITD needs to tighten its system to allow exemption of income as agricultural income, as currently the system is porous and open to misuse, as brought out by audit in its test audit. Due diligence in verification of records and appropriate documents needs to be ensured. I</p> <p>iii) ITD needs to inquire into the reasons for mismatch between assessment amount and amounts as recorded in AST to rule out mala fide. If the errors are bona-fide, then the</p>
2	Audit noticed instances where exemption on account of agricultural income was allowed without taking into account/verifying the expenditure incurred to earn the agricultural income, which could also be a potential undesirable avenue for bringing unaccounted income/black money into the financial system in the garb of agricultural income. Audit noticed cases where rent or revenue derived from agricultural land was allowed as exemption without proper verification of records. Audit also noticed cases where exemption was allowed inconsistently with respect to different assessment years. Thus, assessees were allowed exemption for agricultural income without verifying the	

	ownership/rights over the agricultural land, cost of cultivation, Cash book and/or Bank statements of the assessee, details of receipts and expenditure claimed by assessee.	weakness in the system needs to be eliminated, as the two records must, under all circumstances, match. In fact, ITD needs to examine why, when returns are filed electronically, assessments are not carried out on the same electronic system/returns, and why a manual process is allowed to co-exist with an IT system. ITD should work towards elimination of actual interface with the assessee or his/her representative altogether.
3	Audit observed instances where there was a mismatch between the exemptions allowed in the assessment order vis-à-vis that reflected in the ITD database. Exemption allowed for agricultural income during scrutiny assessments had not been reflected correctly in the ITD database. The agricultural income in the ITD database continued to reflect the agricultural income as returned by the assessee or depicted irrelevant figures in cases where agricultural income allowed was different from that claimed by the assessee.	
4	Of 136 PCsIT selected by audit where status reports furnished to DGIT (systems) were sought, only 26 PCsIT in ten states furnished status reports to audit. As per the Status Report furnished to audit by the PCsIT in respect of 327 cases in Bihar & Jharkhand, Gujarat, Rajasthan, Kerala, Northeastern Region, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim as forwarded to the DGIT(Systems), there was a difference in amount of agricultural income as per the ITR filed by the assessee and the amount entered in AST system due to errors at data entry level in 36 cases. As per field verification (January 2019) the data entry errors remained to be corrected in 12 cases out of 36 cases. Audit noticed that the status reports are yet to be furnished by the selected Pr. CITs in Andhra Pradesh & Telangana, Karnataka & Goa, Madhya Pradesh & Chhattisgarh, Maharashtra, New Delhi, Northwestern Region and Odisha (November 2018).	CBDT may initiate action to institute checks for ensuring the correctness of data entered vis-à-vis the data furnished by the assessee to avoid such errors.

10.3 Impact of Audit

PAC Recommendations (2021-22)

Some of the important PAC observations/ recommendations are enumerated below. For full details, the Committee Reports may be consulted.

1. The Committee, in this regard, feel that the Ministry needs to seek the assistance of other Ministries concerned for integrating data acquired through computerization of land records as well as other sources so that requisite information may be easily available and accessible for verification at the time of scrutiny of claims, inclusive of such cases where the documentation is observed to be lacking or incomplete.
2. The Committee, therefore, desire that necessary action be initiated to identify the reasons for such lapses, and if warranted, responsibility fixed. Further, since the ITBA is an online platform, the Ministry may consider developing a module where the status report of action taken in respect of pending cases is generated and is shared with Supervisory Officers at regular intervals of time so as to facilitate monitoring within the Ministry.
3. The Committee, accordingly, desire that a detailed account of reasons for providing Status Reports in respect of only 26 PCsIT of the 136 PCsIT selected by Audit be furnished, explaining inter alia the position with regard to remaining 110 Commissionerates.
4. The Committee desire that issues relating to interpretation of definition of agricultural income can be clarified to the AOs by regularly updating the 'case laws' in the compendium, as recommended so that AOs may get access to all updated information necessary for assessment of agricultural income in a single digital compilation.

10.4 Audit Checks

1. Section 2 (IA)(a) of the Act: Rent or Revenue derived from Land

- Whether the rent received either in Cash or in kind has been treated as agricultural income, only if condition regarding location of land has been satisfied; the rent or revenue has been treated as agricultural income only if the Land has been situated in India.
- Whether the assessee has in fact derived the income from the land and has not for instance, as a merchant made an income through a trading operation such as by resale of a purchased standing crop. Whether the revenue has been treated as agricultural

income, only if, it has been derived from such land which is effective and immediate source of income. Therefore, there must be direct nexus between the land and agricultural income from which the revenue has been derived.

- In a case involving claim by original tenant, whether the rent received by an original tenant from sub-tenant in respect of agricultural land has been treated as agricultural income, only if, proper sub-lease has been entered between the original tenant and sub-tenant.
- Whether the assessee has claimed dividend amount (as AI) received from an agriculture-based company. Dividend paid by a company out of its agricultural income cannot be treated as revenue derived from land, as effective and immediate source of income is shareholding and not the land – *Bacha F. Guzdar v. CIT (1955) 27 ITR 1 (SC)*.
- Whether the assessee has incorrectly claimed any allowance paid by Government concerning land of which the assessee has been dispossessed as per requirement of the law of the land. Malikana allowance paid by the Government under legal obligation to an owner, dispossessed of his land, is not revenue derived from land, as the immediate source of income is the Government's legal obligation to pay compensation and not the land – *Pratap Singh v. Province of Bihar (Bihar) 17 ITR 202 (Pat.)*.
- Whether a surplus arising on transfer of agricultural land in urban area has been treated as revenue derived from land (refer Explanation to Section 2(1A)).
- Whether the land in respect of which AI exemption has been claimed has been assessed to land revenue or subject to a local rate assessed by Government or else the land is not situated within the prescribed jurisdiction of a municipality to allow the exemption under section 10(1).
- Whether the AI exemption claimed was correct where land or part thereof from which AI was derived fell outside the concerned State.

2. Section 2(IA) (b) of the Act: Income derived from agricultural land by agricultural operations

- Whether as regards the income for which exemption has been granted as agriculture income, the same income was derived by using the agricultural Land for “agricultural purposes”.
- Whether the income derived from marketing process qualifies for exemption as agricultural income, through an activity enhancing the value of the product by performing

such process to make the raw product fit to market. For example, tobacco leaves are ordinarily dried to make them suitable for sale. Therefore, the income from the ordinary process employed to dry the tobacco leaves to make them fit to be taken to market, is agricultural income.

- whether income from sale of seeds for contract farming through farmers has been incorrectly taken as Agricultural income (Karnataka High Court in M/s Namdhari Seeds Vs CIT(A) 341 ITR 432 (KAR) 2012)
- Whether income from sale of forest trees, fruits etc. growing naturally has been taken as AI. (Mustafa Ali Khan s CIT 16 ITR 330 (PC))
- Whether income from sale of forest trees, fruits etc. growing naturally has been taken as AI. (Mustafa Ali Khan s CIT 16 ITR 330 (PC))
- Whether income earned through other activities such as supply of water by assessee from tank in its agricultural land has been taken as AI. (Shri Ranga Vilas Ginning and Oil Mills Vs CIT)
- Whether income from today tapping has been taken as AI incorrectly.
- Whether remuneration received by a managing agent at a fixed percentage of net profit from a company having agricultural income has been incorrectly taken as AI. (Premier Construction Co. Ltd Vs CIT)
- Whether income from growing hybrid /germ plasm seeds after conducting agricultural research has not been taken as AI incorrectly.

3. Section 2(IA) (c) of the Act: Income from Farm building

- Whether the AI claimed as exemption is not actually bona fide annual value of a house property taxable under section 22.
- Whether receipt of TV shooting serial in farmhouse has been incorrectly taken as agricultural income

4. Section 10(1)

- Whether the rent or revenue was derived from land assessed to land revenue or subject to a local rate assessed by Government.
- If no, whether the land is situated outside the jurisdiction of a municipality.
- Whether the income claimed as exempt was derived by agricultural process.
- In case where the agricultural produces were processed before selling, whether the process was secondary and substantially different from what was required just to make the produces fit to be taken to market.

- Whether the farmhouses are located on or in the immediate vicinity of agricultural land.
- Whether the farm houses are used by the assessee as a dwelling house, storehouse or an out-building in connection with the land.

5. Partly Agriculture Income

In cases of partly agricultural income such as Rubber, Coffee and tea, audit may examine the apportionment of the agriculture income at the prescribed percentage to allow exemption. Audit may also examine whether the AO independently verified the yield to satisfy himself about the genuineness and correctness of the claim on agriculture income.

6. Absence or Inadequacy of internal controls

Based on the above and other checks as may be applicable in the particular circumstances of an assessee etc., audit observations are to be made wherever the records indicate that the exemption for AI was allowed by AO though unwarranted/ incorrect etc. However, this should also be correlated with absence or any inadequacy in system /mechanism to ensure that exemption is not allowed in ineligible claims.

Commonly applied audit checks

(Reference – Paragraph 6.6 of DT-RAM)

General Audit Checks

1. Whether there are any arithmetical inaccuracies and transcription errors?
2. Whether the rate of tax has been applied correctly?
3. Whether surcharge/education cess and penalty, if leviable, has been added to the tax on the total income determined on assessment (including a case of Block assessment)?
4. Has mandatory interest under sections 234A, 234B, 234C and 234D been charged correctly with reference to a period of default?
5. Whether all the disallowances discussed in the body of the assessment order have been taken into account in the computation of total income?
6. Whether total amounts proposed to be considered separately in the body of the assessment order have been added back to the returned income in the computation of total income?
7. Whether incomes earned from all sources have been considered and incomes under all heads e.g. Salary, Business Income, Capital Gain, House Property & Other Sources have been computed correctly with reference to the provisions of the Act?
8. Whether, in a case of reassessment or re-computation of income u/s 147/153A, interest u/s 234A and 234B has been calculated up to the date of reassessment or re-computation?
9. Whether residential status of the assessee has been correctly determined and the total income of the assessee has been computed correctly having regard to residential status?
10. Whether brought forward losses u/s 70 to 80 of the Act have been correctly assessed and allowed and whether any record of losses to be allowed to set off in future has been maintained?
11. Whether Refunds including interest has been correctly assessed and allowed and whether it has been issued promptly?
12. Whether interest on refund, if any, received in the previous year is shown in the taxable income?
13. While computing taxable income whether disallowance of unascertained liabilities was taken care of?
14. Whether the amortized expenditures (e.g. u/s 35DD, 35D etc.) have been correctly allowed?
In the case of claim u/s 35D whether the total expenses is restricted to 5 *per cent* of cost of the project or 5 *per cent* of the capital employed, whichever is more, in the case of corporate assessee and 5 *per cent* of cost of project in the case of noncorporate assessee.
15. Whether the admissible expenditure claimed in the computation of taxable income is actually forming part of the profit and loss account?

- a. Expenditure incurred for strengthening the capital structure of a company is capital in nature.
- b. Whether share issue expenses, not eligible for amortization u/s 35D, have been allowed as revenue.
16. Whether the exemptions/deductions under various sections have been correctly computed and allowed?
17. Whether all expenditure including the Capital or Revenue Expenditures have been correctly classified and allowed?
18. Whether payments otherwise than through crossed cheque have been verified for disallowance u/s 40A(3)?
19. Whether disallowances, deductions under various provisions of the Act, brought forward losses and its set-off against current taxable income and claim of statutory expenditure u/s 43B etc., as qualified in the Auditor Report [Form 3CD] was taken care of?
20. Whether the incomes of other persons have been considered as per section 60 to 61 of the Act?
21. Whether the provisions relating to Tax Deducted at Source have been followed and the expenditures have been correctly regulated where TDS has not been deducted or after deduction, not paid to the Govt. account in due time (there should be effective correlation between TAN & PAN and the AO should obtain required information from TDS certificates)?
22. Whether the gross receipts as shown in the TDS certificates were considered for taxable purposes and the correct claim of tax credit was allowed?
23. Whether the MAT has been correctly calculated and rightly set off in future years (wherever applicable) and whether any records of MAT allowed to be set off in future has been maintained?
24. Whether the accounts have been audited, wherever necessary, and actions have been taken for any non-compliance there to?
25. Whether the information contained in the Auditors Certificates/ Tax Audit Reports required for claiming different deductions has been duly considered?
26. Whether the return of income/loss has been signed by the authorized person as per section 140?
27. Whether the orders of the Appellate Authorities and Settlement Commission have been correctly effected to?
28. Whether the remuneration to the partners and interest on capital employed have been correctly allowed with reference to the provisions of the Act as well as the partnership deed (In case of AOP and BOI, the same are not allowable deductions)?
29. Whether in respect of Co-operative Societies, apart from the points mentioned above as applicable, the deductions allowed u/s 80P was examined?
30. In respect of Trust, apart from the points mentioned above as applicable, it is to be examined whether the exemptions allowable with reference to its activities have been allowed correctly and the accumulated funds have been utilized rightly within the time

frame in subsequent years and whether any record of utilization of the fund in future has been maintained?

31. Whether the assessment has been seen by IAP/SAP of the Department?

32. Whether any disallowance offered by the assessee in the computation sheet while filling his return of income/loss has been omitted by the Assessing Officer (AO) in the computation sheet of the assessment order?

33. Whether the return of loss is filed within the time limit permitted u/s 139(1).

34. Whether income from undisclosed sources has been brought to tax u/s 68 and 69?

35. Whether the Residential Status of the assessee has been correctly assessed?

36. To link up past records and see if any addition/disallowance is required to be made on account of any of the following situation:

a. Addition made in the past requiring similar action in the current year;

b. Method of valuation not accepted in the past requiring adjustment of values of opening stock and closing stock;

c. Brought forward losses, allowances and depreciation not correctly shown in the return;

d. Admissibility of deductions u/s 80 HH, 80 I, 80 IA on the basis of past records.

37. To compute the capital gain, benefit of cost of indexation is to be given only in cases of Long Term Capital Assets.

38. As per the provisions of the section 50 of the Act, if depreciation has been allowed on any fixed asset than the capital gain/loss arising on the disposal of this asset is always treated as short term capital gain/loss irrespective of the period of holding of this capital asset by the assessee.

39. If the return of income/loss has been revised by the assessee under section 139(5), then it is permissible only if the assessee has filed original return of income within the time limit as stipulated under section 139(1). Belated return can't be revised.

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40. Whether any deductions are allowed on actual payment basis in accordance with relaxation u/s 43(B), vide amendments from 01.04.2006.

41. If return is submitted belated, deduction under Section 10A and 10B will not be allowed.

42. Whether deductions under chapter VIA were restricted to gross total income after setting-off brought forward losses etc?

43. Whether claims under various sections of chapter VI are in accordance with section 80AB viz. that deductions are claimed on net income (after expenses) and not on gross income?

44. Whether the TDS has been deducted at the prescribed rate from all the payments as per the provisions of the Act and after deduction of the same has been deposited into Government account within due date?

Annexure-I

Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

North Block, New Delhi, the 19 of June, 2019

Subject: 'Assessment of Firms'-some of the important issues to be kept under consideration by the Assessing Officers while framing assessment-reg.

C&AG had carried out a Performance Audit regarding 'Assessment of Firms under the Income tax Act, 1961 (Act) and in its Report No. 7 of 2014, has made certain suggestions so that in future, assessments in these cases are handled in a more effective manner by the Assessing Officers (AOS). Various recommendations made by the C&AG in its Report have been duly considered by the Board. In order to improve the quality of assessments being framed in these cases and also to reduce the scope for committing errors, the Board desires that Assessing Officers should duly take into consideration the following issues while making assessments case of firms:

(i) Expenses in the hands of the firm such as interest on capital paid to the partners, remuneration payable to the working partners etc. are taxable in the hands of respective partners. Therefore, while framing assessment in case of firms, a cross-verification of such amounts with income-tax return of firm's partner will be desirable and any discrepancy between the tax return of a firm and its partners should be dealt with as per provisions of the Act. Further, AOs should invariably call for a copy of the partnership deed during the course of assessment proceedings and examine it carefully so that instances of payment of remuneration to any non-working partner or remuneration payment for period prior to the date of partnership deed but claimed as deductible are identified and cognizance of these are duly taken in assessment.

(ii) Section 40(b)(iv) stipulates following three conditions for allowability of interest to the

partners of a firm:

- a) the payment should be in accordance with the terms of the partnership deed; and
- b) it should relate to any period falling after the date of such partnership deed; and

c) it should not exceed the amount calculated at the rate of twelve percent simple interest per annum.

Instances have been noticed where the interest in the partnership deed was stated to be below twelve percent, yet, the same was allowed at the rate of twelve percent by the AO. Such mistakes should be avoided. Further, in case the rate prescribed in the partnership deed is in excess of twelve percent, the excess should be disallowed in assessment. The AO is also required to ascertain whether payment of interest is duly authorized by the partnership deed or not. Further, while calculating interest payable to the partners for purposes of section 40(b)(iv) of the Act, AOs are taking different yardsticks for calculating Interest viz. opening balance of capital, closing balance of capital, fixed capital or current capital etc. In this regard, section 40(b)(iv) of the Act prescribes that payment of interest to partners should be authorized by and be in accordance with the partnership deed. Therefore, while framing assessment, AOs should refer to the terms of the partnership deed for purpose of computation of interest on capital payable to a partner.

(iii) Clause (i) and (v) of section 40(b) of the Act lays down that payment of remuneration to a working partner should be authorized by the partnership deed, be in accordance with the terms of the partnership deed, should relate to a period after the partnership deed and should also not exceed the maximum amounts prescribed therein. However, it has been noticed that in some assessments, AOS had allowed expenditure on remuneration to the working partners though the same was either not authorized by the partnership deed or was in excess of the amount specified therein. In order to prevent recurrence of mistakes and allowing the expenditure strictly as per provisions of the Act, the AOS should ensure that claim under section 40(b)(v) of the Act is allowed only after a thorough verification of the partnership deed. Further, while computing remuneration which is allowable to a working partner under section 40(b)(v) of the Act, the term '*in accordance with the terms of the partnership deed*' in clauses (ii) and (v) of section 40(b) of the Act implies that remuneration should not be undetermined or undecided. Hence, in all situations, partnership deed should form the basis for determination of remuneration payable to the working partners. Furthermore, in situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v) of the Act, it would be restricted to the figure computed on the basis of the partnership deed.

(iv) While computing remuneration payable to the working partners under section 40(b)(v) of the Act, the remuneration should not exceed a particular aggregate amount which is based upon the figure of "book profit. The Explanation 3 to section 40(b) of the Act contains definition of "book profit for the purposes of determination of remuneration of the partners and provides that "book profit" shall mean the net profit, as shown in the profit & loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while calculating the net profit. Therefore, while computing 'book profit' for purposes of section 40(b)(v) of the Act, all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'profit or gain of business or profession', should be excluded.

(v) AOS are advised to apply the provisions of Chapter XVI of the Act in assessment of firms whenever required. It should be taken into consideration that under section 185 of the Act, any non-compliance by the firm or its partners with provisions of section 184 of the Act may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.

(vi) It has also come to notice that some firms try to Inflate the profits eligible for deduction under section 801A of the Act by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners. In such situations, Assessing Officers may examine these transactions in light of provisions of sub-section (10) of section 80IA of the Act which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.

(vii) While framing assessments in case of firms claiming carry forward and set off of losses, Assessing Officers are requested to verify such claims taking into consideration provisions of section 78 of the Act which disallow such a carry forward and set off in case of change in constitution of the firm or on succession.

(viii) Regarding the issue concerning possible action against the tax auditor for furnishing incomplete information in the Tax-Audit Report and effective utilization of information in the Tax Audit Report by the Assessing Officers, it is reiterated that directions given earlier viz. Instruction No. 09/2008 dated 31.07.2008 of CBDT should be followed scrupulously by the field authorities.

2. It is hereby clarified that this circular would also be applicable to limited scrutiny cases if the assessee is a registered firm.

3. This Circular may be brought to the notice of all concerned.
4. Hindi version to follow.

(Rajarajeswari R.)

Under-Secretary (ITA.II), CBDT

(F.No. 225/54/2014/ITA.II)

Copy to:

1. Chairman, CBDT and all Members, CBDT
2. All Pr. CCSIT/Pr. DSGIT
3. All JS/CSIT, CBDT
4. Addl. CIT, Data base Cell for uploading on Departmental Website
5. Web manager for uploading on incometaxindia.gov.in & placing in public domain
6. ITCC, Central Board of Direct Taxes (3 copies)

(Rajarajeswarl R.)

Under-Secretary (ITA.II), CBDT

(ii). PAC Recommendations and associated Audit Findings

1. EXEMPTIONS TO CHARITABLE TRUSTS AND INSTITUTIONS		
PAC Re- port 27 / Recom- mendation No.	PAC Recommendations (PAC Report No. 27 of 2015-16)	Associated Audit Findings (CAG's Report No. 20 of 2013)
3	The Committee, therefore, desire that as and when such cases of procedural mistakes in granting registrations/approvals/notifications are noticed, suitable punitive action should invariably be taken expeditiously against the officers including those involved in aforesaid 72 cases mentioned by Audit so as to inculcate a sense of responsibility and discipline among all and to save consequential loss to the exchequer.	Para 2.36 allowed exemptions in 72 cases irregularly involving tax effect of 8.88 crore despite rejection of registrations/approvals by the competent authority
4	The Committee are of the view that in order to ensure that in case of dissolution of a trust, its net assets are utilized for the purpose for which the trust was originally founded and not benefit the founders of the trust or his/her family Member relatives etc. the Ministry should henceforth insist on inclusion of 'Dissolution Clause' in the Trust Deed compulsorily while registering trusts under Section 12 AA uniformly all over India. The Ministry may also consider incorporating the suitable provisions in the Income Tax Act 1961 so as to ensure the same.	Para 2.8 non-inclusion of dissolution clause in the Trust Deed in 457 cases
5	The Committee cannot understand as to why the exemption was granted in this case u/s 11 of the Act when separate provisions exists in the Income Tax Act for the research institutions for availing exemption. As granting exemptions to the Trusts which were not charitable in nature is a serious issue which deprives the genuine Trusts/Institutions for availing the same, the Committee impress upon the Ministry to take stringent action against the Assessing Officers concerned for granting such irregular exemptions to those Trusts which were rendering services in relation to trade, commerce and do not come under the purview of charitable purpose. Besides, the Ministry may also take necessary	Para 2.15 irregular exemption to trusts in 60 cases whose objects were not charitable in nature

	<p>action within a stipulated time frame to cancel the registration of those Trusts which do not exist for charitable purpose. Under no circumstances they should be allowed to enjoy the benefits of exemption, in case they are working purely on commercial lines with the main motive of making profits. The tax amount of ` 87.33 crore so short-levied in the aforesaid 60 cases may also be recovered at the earliest and the Committee be apprised of the same.</p>	
6	<p>The Committee are perturbed to find that Income Tax Act is not explicit about the consequences/remedies available in case an application for ineligible trusts is not processed with six months. The Committee are not inclined to accept the contention of the Ministry that the delay has taken place in exceptional cases as delays noticed in granting approval in 594 cases may not be exceptional. These might have been either due to procedural lapses or deficient internal control on the part of AOs for not adequately applying the provisions of the Act deliberately. The way deemed approvals have been granted by the Department in all these 594 cases make the Committee feel that there is certainly something amiss in the working of the ITD which drastically needs to be streamlined. Therefore, they also desire that application seeking registration for trusts must be disposed of expeditiously. Further, there are no reasons as to why provisions to this effect cannot be incorporated in the Act. The Committee, therefore, desire that a serious thought needs to be given by CBDT in this regard. All cases where exemptions have been granted wrongly/illegally need to be probed with a view to fixing responsibility. The Committee have now been informed that restructuring of exemption Directorate would result in specialization on exemption matters with better control and monitoring. Further, proposal to make time barring limit uniform in respect of Section 12AA and 80 G applications by allowing extended time for completion in respect of Section 12AA applications by excluding time taken by applicants to comply with Commissioner's directions as available presently u/s 80 G is stated to be under examination of CBDT. The Committee have further been informed that</p>	<p>Para 2.28 delay of more than 6 months to 24 months beyond stipulated period in granting approvals/registrations/notifications in 594 cases</p>

	<p>the feasibility of introducing web based interactive platform for applying for registration, submitting soft copy of necessary documents and communicating with each other thus making the whole process faster, smoother, transparent and less time consuming is under discussion in CBDT. The Committee would like the Ministry to undertake these proposed measures expeditiously with a view to avoid delay in granting registration/approval/notification.</p>	
9	<p>The Assessing Officers concerned who were in connivance with the Trusts, should be awarded exemplary punishment. The Committee also desire that a survey of all the educational trusts be conducted in a time bound manner so as to verify whether they are misusing the provisions of 'Charitable Trusts' in the Income Tax Act considering the huge profits generated and surpluses accumulated by most of these trusts. The Committee would like to be intimated about the precise steps taken in this direction.</p>	<p>Para 3.3 The Committee note that 22 education institutions in Delhi, Mumbai, Pune Chennai, Coimbatore, Kolkata and Odisha had huge excess of income over expenditure of 819.40 crore during AY 07 and AY 11 and accumulated these surpluses ranging from 35.7 to 84.8 percent of their total income.</p>
11	<p>The Committee are unable to understand as to why such explanations of AOs were not called earlier before being pointed out by the Committee. This implies that such mistakes were neither noticed by the AOs during the scrutiny assessment of these cases nor the same had been detected by the Internal Audit Wing of the ITD, while as per existing mechanism the scrutiny assessments made by the AOs are subject to Internal Audit. The Committee, also, note that no penalty has been provided under the Act in case trusts violated the above mentioned provisions except to tax the trusts for that year in which default occurs. They therefore, desire that suitable provisions therefor be incorporated in the Act.</p>	<p>Para 3.9 The Committee find the 14 Trusts cases involving tax effect of 1090.03 crore where accumulation arising from capital gains were not either invested in specified mode or computed correctly.</p>
12	<p>The Committee would like to take stringent action against those Assessing Officers who are involved in assessment of such cases. It may also be ensured by the ITD that such cases of contrary and arbitrary decisions in similar cases do not recur and a mechanism may be created within the assessment procedures that such mistakes are caught during the process of assessment itself. Further, proper training may be imparted to all the Assessing Officers at regular intervals so as to keep</p>	<p>Para 3.30 allowed exemption in four similar cases for the income received from TV rights from BCCI in cases of Saurashtra Cricket Association, Baroda Cricket Association, Kerala Cricket Association and Maharashtra Cricket Association resulting in short levy of tax of 37.23 crore.</p>

	them updated about the correct application of relevant provisions of the Income Tax Act.	In Gujarat, CIT – II Rajkot, Saurashtra Cricket Association received TV subsidy of 8.02 crore, 13.81 crore and 13.34 crore from BCCI during AY 08, AY 10 and AY 11 respectively on organizing various tournaments
13	The Committee, therefore, feel that a strong deterrent mechanism is required to be formulated within the specific time frame to make Assessing Officers and their superiors accountable, for wastage of time and resources of the Department by making frivolous assessments which ultimately resulted into piling of appeals at various levels. The Committee also recommend that an online database of assessment precedents may also be created which could be accessed by all Assessing Officers and through which assessments made in similar cases can be shared to prevent inconsistent decision making.	Para 3.47 allowed exemptions irregularly in 11 cases involving tax effect of 99.63 crore despite assessee losing charitable character Box 3.12 AO allowed irregular exemption under section 11 and 10 (23 EA) simultaneously of 123.7 crore involving tax effect of 41.01 crore to Stock Exchange Investor Protection Fund & National Stock Exchange Investor Protection Fund, during AY 08 to AY 10. Since the nature of the funds was more of a business facilitator of the Stock Exchange and non-charitable in nature.
16	The Committee, therefore, do not understand as to how in the absence of scrutiny of such a vital information provided in Form 10, correct assessment of income tax involved in a large number of assessments is possible. What further dismay the Committee is the fact that even no responsibility has been fixed for this act of omission despite asking the Commissioners of Income Tax (Exemptions) to call for explanation of the Assessing Officers wherever Audit objections are accepted. Further, as regards the recovery of ` 106.10 crore irregularly exempted the Ministry intimated that the assessments are pending in re-opened cases. The Committee are not happy over the tardy progress made in finalization of such cases. They also deplore the callous attitude of the Assessing Officers which resulted in such wrong assessments and consequential loss of revenue. The Committee would expect the officers to be more vigilant in future and also desire that the assessments in re-opened case should be completed expeditiously and	Para 4.2 Audit noticed 120 cases involving tax effect of 106.10 crore where Trusts were availing exemptions u/s 11(2) even in scrutiny cases for accumulated amounts without filing Form 10 or filing it belatedly. Details of investments and amounts accumulated in the last 11 years were not in the Schedules I and K specified in the returns. Audit observed that ITD did not monitor accumulation of income, forms of investment in specified mode and subsequent application of accumulation after specified period as the registers were not maintained properly and updated.

	the total tax recovered from these cases should also be intimated to the Committee within three months of the presentation of this Report.	
20	The Committee express their displeasure over the fact that in all these cases the Assessing Officers had not followed the instructions of their own Department which caused huge amount of revenue loss to the exchequer. The Committee, therefore desire to know about the fixing of responsibility against the Assessing Officers concerned for violating those instructions. The Committee also feel that the possibility of nexus between AOs and the Trust cannot be ruled out. Thus, the Ministry should enquire into all these cases with a view to fixing responsibility of the AOs concerned so as to avoid such lapses in future.	Box 4.4 In ADIT-E, Ahmedabad and the data collected from the website of MHA that 73 assessee-trusts who received FC to the tune of 272.35 crore, during the FY 07 to FY 09 were not selected for scrutiny.
2. ASSESSMENT OF ASSESSEES IN PHARMACEUTICAL SECTOR		
PAC Report 136 / Recommendation No.	PAC Recommendations (PAC Report No. 136 of 2018-19)	Audit Findings (CAG's Report No. 5 of 2015)
3	The Committee would like to be apprised of the present status of commissioning of this project and recommend that henceforth a comprehensive data of Pharmaceuticals sector be maintained not only for helping in tax planning and making sector specific policy but also for proper accounting and collection of the taxes from this sector. The Committee, also desire the Department of Scientific and Industrial Research and National Pharmaceutical Pricing Authority to capture PAN details of the sector to facilitate its linking with ITRs.	Para 2.3 Sector wise data in the ITD - ITD does not have complete sector wise data of assessees of Pharmaceuticals Sector.
4	<i>On being asked as to why the industrialists are keen to take tax incentives in case of R&D sector, the representative of the Ministry replied during evidence that they have to phase out those deductions and from 2021 it would be actual expenditure, which is done on that particular item.</i> The Committee trust that Government would make an in-depth study before phasing out these deductions from 2021 and take further measures, legal or procedural as might be necessary to effectively deal with this issue. The Committee would also like to be apprised	Para 2.4 Allowance of R&D expenditure awaiting approval from DSIR - ITD allowed weighted deduction on R&D under Section 35 (2AB) of the Act before receipt of approval from DSIR who is the approving authority.

	of the action taken against the assessing officers who allowed weighted deduction on expenses towards R&D without verifying the claims from the Form 3CL/3CM issued by DSIR in the aforesaid 22 cases resulting in loss to the exchequer to the tune of 570.59 crore.	
5	The Committee are distressed to note that despite being pointed out the issue by the C&AG way back in 2015, no concrete steps have been taken thus far by the Ministry in this direction. Since a large number of potential tax payers can be identified in the Pharmaceutical sector, non-deduction of TDS in these cases resulted into huge revenue loss to the exchequer. Since the case pointed out by the Audit are only test checked and only tip of the iceberg, the net tax effect would be much detailed audit examination is done. The Committee, therefore, recommend that the Ministry should take legal advice on the matter and amend the Section 194C of the IT Act, if required, at the earliest besides issuing clear instructions to ensure that the Pharmaceutical companies deduct the TDS on payments to contract manufacturers.	Para 2.6 Deduction of TDS in respect of contract entered by assessee company with a manufacturing company for manufacture of products - Pharmaceutical companies avoided deducting TDS on payments made to contract manufacturers by taking advantage of exclusion clause in Section 194C of the Act.
6	The Committee are dismayed at this unfortunate state of affairs in the Department entrusted with the responsibility of collecting due tax revenue from the assessees. However, the Committee have been apprised that an MOU was entered into with CBEC on 30.11.2015 on exchange of information. The details of ER-4 are now being obtained from CBEC, wherever required the Excise turnover as per ER-4 and turnover as per profit and loss account of Income-Tax return are being compared. While welcoming the steps taken in this direction by the Ministry, the Committee hope that these steps will ensure in deepening the tax base of pharmaceutical sector. The Committee would like to be apprised of the outcome of such steps initiated by the IT Department way back in the year 2015.	Para 2.9 Mechanism for cross-verification of turnover declared in Income Tax Return with the turnover declared in Excise Return - ITD does not have any mechanism to correlate & verify the turnover declared in Income Tax with turnover declared in Central Excise which is part of the same Ministry of Finance.
7	The Committee are failed to find any specific reasons for allowing such expenses for tax deduction. The Committee have been informed that directions have been issued to the Chief Commissioners of Income Tax to issue advisory to the officers concerned in suitable	Para 3.1.1 Allowance of expenditure towards gifts, freebies etc. to Medical Professionals - AOs allowed expenditure on gifts, travel facilities, hospitality,

	<p>cases. However, the Committee find that no penal action was initiated against any of these officers who have failed in their duty. From the information made available to the Committee it is seen that the disciplinary actions are proposed to be taken against the AOs only. The Ministry have not offered any explanation on the role of delinquent senior officers. The Committee desire that the Ministry should initiate exemplary disciplinary action against the junior as well as senior officers connected with the lapses so that the principles of accountability and responsibility are applied in letter and spirit. Further, the Committee are of the opinion that the assesseees would not have succeeded in their efforts in defrauding the Government without the connivance of certain departmental officers. While deploring such an unhealthy practice in the Income Tax Department, the Committee recommend that not only the cases highlighted by the Audit but also similar such cases in the field should be thoroughly inquired into so as to find out as to how and why such lapses occurred, to what extent they were bonafide mistakes and exemplary stern action taken against the officers concerned. The Committee are perturbed to note that the AOs are taking divergent views for disallowance of expenses in the nature of freebies as CBDT has not clearly specified in its circular the effective date of disallowance of such expenses. Since the failure to mention the effective date in the circular by the CBDT led to divergent views of the AOs on a same issue result in litigation and finally to loss of revenue, the Committee desire that the Ministry should take immediate corrective action in this regard</p>	<p>cash or monetary grant despite being made irregular by the Act, Medical Council of India, CBDT/Judicial pronouncement.</p>
8	<p>The Committee exhort the Ministry to look into the reasons for failure on the part of the Internal Audit Wing for detecting such lapses leading to huge revenue loss to the exchequer and take suitable steps so as to ensure that this Wing perform efficiently in exercising effective control to find out mistakes in assessment and thereby to prevent leakage of revenue. The Committee would, therefore, like to be apprised of the action taken by the Ministry in this regard within 6 months of the presentation of this report.</p>	<p>Para 3.2.2 Allowance of concessions/deduction/rebate/relief Para 3.2.3 Setting off /carry forward of depreciation/business loss/ capital loss Para 3.2.4 Allowance of business expenditure Para 3.2.5 Allowance of R&D expenses</p>

		<p>Para 3.2.6 Mistake in allowing expenses on which TDS was not deducted / deposited</p> <p>Para 3.2.7 Inconsistency in assessment</p> <p>Para 3.2.8 Arithmetical errors in computation of income and tax</p> <p>Para 3.2.9 Assessment of Income under special provision</p> <p>Para 3.2.10 Assessment of Income under normal provision</p> <p>Para 3.2.11 Classification and computation of capital gains</p>
ASSESSMENTS RELATING TO AGRICULTURAL INCOME		
PAC Report 49 / Recommendation No.	PAC Recommendations (PAC Report No. 49 of 2021-22)	Audit Findings (CAG's Report No. 9 of 2019)
1	The Committee, in this regard, feel that the Ministry needs to seek the assistance of other Ministries concerned for integrating data acquired through computerization of land records as well as other sources so that requisite information may be easily available and accessible for verification at the time of scrutiny of claims, inclusive of such cases where the documentation is observed to be lacking or incomplete.	Para 5.9.2 Exemption without verification of supporting documents
2	The Committee, therefore, desire that necessary action be initiated to identify the reasons for such lapses, and if warranted, responsibility fixed. Further, since the ITBA is an online platform, the Ministry may consider developing a module where the status report of action taken in respect of pending cases is generated and is shared with Supervisory Officers at regular intervals of time so as to facilitate monitoring within the Ministry.	Para 5.9.3 Incorrect reflection of agricultural income in ITD Database

3	The Committee, accordingly, desire that a detailed account of reasons for providing Status Reports in respect of only 26 PCsIT of the 136 PCsIT selected by Audit be furnished, explaining inter a/ia the position with regard to remaining 110 Commissionerates.	Para 5.9.4 Status of Verification by the department
4	The Committee desire that issues relating to interpretation of definition of agricultural income can be clarified to the AOs by regularly updating the 'case laws' in the compendium, as recommended so that AOs may get access to all updated information necessary for assessment of agricultural income in a single digital compilation.	Para 5.9.5 Compliance issues - Mistakes in Assessments