Chapter Summary

Corporation tax constituted 62.27 percent of the total collection from direct taxes in 2004-05. There were 3.80 lakh assessees as on 31 March 2005, which represented an increase of 1.95 per cent over the previous year.

(Para 3.1 & 3.2)

Audit issued **486** observations to the Ministry of Finance involving tax effect of **Rs.3,434.65 crore** highlighting various irregularities, omissions and mistakes, for comments. Ministry accepted 17 observations involving tax effect of Rs.8.27 crore till preparation of this report.

(Para 3.4 & 3.5)

Assessing officers committed mistakes in:

- adoption of correct figures, applying correct rate of tax and levy of surcharge in 50 cases involving tax effect of Rs.450.76 crore.

  (Para 3.6 to 3.7)

- computation of business income in 51 cases involving tax effect of Rs.517.06 crore

  (Para 3.8)

- allowing unentitled expenditure or provision, liability and claims and depreciation in 122 cases involving tax effect of Rs.536.87 crore

  (Para 3.9 to 3.12)

- computation of capital gains, carry forward and set off of losses in 36 cases involving tax effect of Rs.1,560.38 crore

  (Para 3.13 & 3.14)

- allowing reliefs and exemptions under chapter VIA and in computation of income under special provisions of the Act in 106 cases involving tax effect of Rs.117.47 crore

  (Para 3.16 to 3.20)

- levy of interest in 70 cases involving tax effect of Rs.75.76 crore

  (Para 3.23 & 3.24)

CHAPTER III: CORPORATION TAX

Number of companies vis-à-vis company assessees

3.1 According to the records of Ministry of Finance, Department of Company Affairs, there were 6,61,371 companies limited by shares at work as on 31 October 2004, which included 5,83,618 private limited companies and 77,753 public limited companies. As per the records of the Income Tax Department, the number of company assessees as on 31 March 2005 was 3,79,752 as compared to 3,72,482 as on 31 March 2004.

Receipts from corporate tax

3.2 During 2004-2005, corporation tax receipts were Rs.82,680 crore as against Rs.63,562 crore in 2003-04. Table 2.4 of this Report contains the details.

Status of assessments

3.3 Table 2.11 (Appendix 5) of this report contains particulars of assessments due for disposal, assessments completed and assessments pending.

Results of audit

3.4 Audit issued 472 draft paragraphs involving undercharge of tax of Rs.3,393.66 crore and 14 draft paragraphs involving overcharge of tax of Rs.40.99 crore to the Ministry of Finance between May 2005 and December 2005 for eliciting their comments.

Out of 486 draft paragraphs issued to the Ministry, internal audit of the department had seen 48 cases in which mistakes could not be detected. Internal audit had not seen 438 cases at all.

Out of 486 draft paragraphs issued to the Ministry, 470 cases involving under charge of Rs.3,392.89 crore and 14 cases involving overcharge of Rs.40.99 crore are indicated in the succeeding paragraphs

Each paragraph indicates a particular category of mistake and starts with a suitable preamble followed by combined/consolidated tax effect of all observations of similar nature. Cases with money value of more than Rs.10 crore each are illustrated while those of more than Rs.1 crore but below Rs.10 crore each are given in a tabular form in Appendices.

Status of replies received from Ministry of Finance

3.5 Of 484 cases included in this chapter, Ministry of Finance accepted audit observations in 17 cases involving tax effect totalling Rs.8.27 crore. Observations in respect of two cases involving tax effect of Rs.6.32 crore were not accepted. In the remaining cases, Ministry's replies are awaited.

Mistakes in adoption of correct figures/ arithmetical errors

3.6 Assessing officers have to determine and assess the income correctly in 'scrutiny' assessments. Accounts, claims, records and all documents are to be examined in scrutiny assessments. The Board have issued instructions to assessing officers and their supervising officers to ensure that mistakes in assessments do not occur.

Audit noticed that assessing officers had adopted incorrect figures, committed arithmetical errors, allowed claims twice, and had not added back inadmissible claims to income and had thus short levied tax by **Rs.389.91 crore** in **44** cases in Andhra Pradesh, Delhi, Gujarat, Haryana, Jammu & Kashmir, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu and West Bengal. **Five** cases involving short levy of tax of more than Rs. 10 crore each are illustrated below and **10** cases involving tax effect of more than Rs.1 crore each are indicated at serial number **1 to 10** of **Appendix 7.**

3.6.1 In Delhi IV charge, the assessment of a company, **M/s Engineering Project India Ltd.**, for the assessment year 2001-02 was completed after scrutiny in January 2004 at a loss of Rs.444.88 crore. Audit scrutiny revealed that the assessee had filed his return at an income of Rs.2.48 crore and shown brought forward losses of Rs.447.36 crore. After adjustment of brought forward losses of Rs.447.36 crore relating to earlier years to the extent of available income of Rs.2.48 crore, the income for the assessment year 2001-02 should have been assessed at 'nil' instead of loss of Rs.444.88 crore. The mistake resulted in over assessment of loss of Rs. 444.88 crore involving potential tax effect of Rs.175.95 crore.

3.6.2 In Maharashtra, City I Mumbai charge, the assessment of a company, **M/s. Maharashtra State Electricity Board,** for the assessment year 2001-02 was completed after scrutiny in November 2003 at a loss of Rs.1,142.23 crore. Audit scrutiny revealed that the assessee returned loss of Rs.2,814.99 crore after adding back depreciation of Rs.1,355.75 crore as per the Companies Act and deducting depreciation of Rs.1,621.93 crore as per the Income Tax Act. The assessing officer, while making the assessment, again added back the depreciation as per the Companies Act and allowed the depreciation as per the Income Tax Act from the returned loss, which had already been done by the assessee. In doing so assessee was allowed undue benefit of depreciation of Rs.266.16 crore and excess carry forward of loss of the same amount which involved potential short levy to the extent of Rs.105.27 crore. The department accepted the audit observation and initiated remedial action.

3.6.3 In Maharashtra, City-II Mumbai charge, the assessment of a company, **M/s. Dena Bank Ltd.,** for the assessment year 2000-01 was completed after scrutiny in March 2003 at taxable income of Rs.207.98 crore. Audit scrutiny revealed that while discussing assessment order, the assessing officer decided on tax appreciation in the current investment amounting to Rs.27.57 crore on protective basis but while computing the taxable income, this amount was not added back. Further, profit of Rs.21.68 crore, earned by the assessee on sale of investments, was also not considered while computing the taxable income. These mistakes resulted in under assessment of income of Rs.49.25 crore involving short levy of tax of Rs.28.16 crore including interest. The department took remedial action.

3.6.4 In Haryana, Faridabad charge, the assessment of a company, **M/s National Hydro Electric Power Corporation Ltd.**, for the assessment year 2000-01 was completed after scrutiny in March 2003 allowing carry forward of unabsorbed depreciation of Rs.1,269.12 crore relating to assessment years 1995-96 to 1999-2000. The assessment was subsequently rectified in October 2003. Audit scrutiny revealed that the unabsorbed depreciation was incorrectly adopted as Rs.1,346.17 crore in the rectificatory order instead of Rs.1,269.12 crore. The omission resulted in over computation of carry forward of unabsorbed depreciation by Rs.77.05 crore. There was also a totalling mistake of Rs.0.06 crore in this order as the net loss was worked out at Rs.1,337.50 crore instead of Rs.1,337.56 crore. Thus loss of Rs.76.99 crore was over computed, which involves potential tax effect of Rs.26.95 crore.

3.6.5 In Delhi Central II charge, the assessment of a company, **M/s Tosha International Ltd.**, for assessment year 2001-02 was completed after scrutiny in March 2004. Audit scrutiny revealed that the assessee filed return of positive income of Rs.7.90 crore but the assessing officer erroneously adopted the same as loss of Rs.29.74 crore. The mistake resulted in incorrect carry forward of loss of Rs.37.64 crore involving potential tax effect of Rs.14.89 crore.

Incorrect rate of tax and surcharge

3.7 As per Finance Act 2000, the rate of dividend tax payable on distributed profits of a domestic company during the period from June 2000 to May 2001 was 20 percent. Surcharge at the rate of 10 percent was also leviable in respect of the dividend tax.

Surcharge is levied at prescribed rates in addition to the tax in the case of a domestic company whose income exceeds the prescribed limit.

Audit noticed short levy of dividend tax and surcharge in **6** cases in Delhi, Kerala and Maharashtra involving tax effect of **Rs.60.85 crore. One** case involving tax effect of Rs.10 crore or more is illustrated below and **one** case involving tax effect of more than Rs.1 crore but less than Rs.10 crore is indicated at serial number **11 of Appendix 7.**

3.7.1 In Maharashtra, City I Mumbai charge, the assessments of a company, **M/s Life Insurance Corporation of India Ltd.**, for the assessment years 1999-2000 and 2000-01 were completed under section 115Q read with section 115 in February 2001 and February 2003 charging the distributed profits of Rs.267.96 crore and Rs.319.71 crore as on 30 March 2000 and 29 March 2001 respectively. Audit scrutiny revealed that in assessment year 1999-2000, surcharge at the rate of 10 percent payable on tax of Rs.26.80 crore was not levied. In assessment year 2000-01, tax was computed incorrectly at the rate of 10 percent as against the applicable rate of 20 percent on the distributed profits of Rs.319.71 crore and surcharge at the rate of 10 percent was also not levied. The mistake resulted in total short levy of tax of Rs.58.07 crore. The department accepted the audit observation and initiated remedial action.

Mistake in computation of business income

3.8 Total income of a person for any previous year includes income from whatever source derived which is received or deemed to be received or which accrues or arises during such previous year unless it is specifically exempt from tax by other provisions of the Act. It has been **judicially** held that

(i) income derived from investment in government securities could not be regarded as an essential part of the assessee's banking activities in as much as the same did not form part of its stock-in-trade or working/circulating capital. Hence the interest on Government securities placed with the SBI/RBI could not qualify for exemption[1]**,**

(ii) in order to claim exemption under the relevant provisions of the Act, the business must have a direct or proximate connection with or nexus to earnings[2],

(iii) if an amount is received in the course of trading transaction, even though it is not taxable in the year of receipt as being of revenue character, the amount changes its character when the amount becomes assessee's own money because of limitation or by any other statutory or contractual right. When such an event happens, the amount should be treated as income of the assessee[3];

(iv) the receipt will be subject to tax only in the year in which the right to receive accrues or arises to the assessee and cannot be spread over to future years[4]

(v) the advance money received and income accrued during the year is taxable as income[5]

Income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly adopted by the assessee. Where the assessee follows the mercantile system of accounting, the profits and gains are worked out on due or accrued basis.

Valuation of purchase and sale of goods and inventory for the purposes of determining the income of an assessee shall be in accordance with the method of accounting regularly adopted by the assessee and adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.517.06 crore** in **51 cases** in Andhra Pradesh, Bihar, Delhi, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu and West Bengal. **Five** cases involving short levy of tax of Rs.10 crore or more is illustrated below and **nine** cases, each involving tax effect of more than Rs.1 crore but less than Rs.10 crore are indicated at serial number **1 to 9** in **Appendix 8**.

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[1] MP CooP Bank Vs Addl. CIT 218 ITR 438 (SC)
[2] Gujarat State Coop Bank Vs. CIT 250 ITR 229 (Guj HC) 2000-
[3] CIT Vs T.V. Sundaram Iyengar and sons 222.ITR 344 (SC)
[4] EID Parry (I) Ltd., 258 ITR 404 (Madras)
[5] CIT Vs Sheik Md Rowther Shipping & Agencies (P) Ltd.

3.8.1 In Tamil Nadu, Chennai-I charge, the income tax assessments of a non-life insurance company, namely, **M/s. United India Insurance Company,** for the assessment years 1995-96 to 1999-2000 and eight other non-life insurance companies **(M/s. National Insurance Company,** Kolkata, **M/s. Oriental Insurance Co.**, New Delhi, **M/s. General Insurance Co. of India,** Mumbai, **M./s New India Assurance Co. Ltd.**, Mumbai, **M/s. Reliance General Insurance Co. Ltd.**, Mumbai, **M/s. Bajaj Allianz General Insurance Co. Ltd.**, Mumbai, **M./s. ICICI Lombard,** Mumbai and **M/s. HDFC CHUBB General Insurance Co.**, Mumbai,) in Kolkata, Mumbai, and Delhi charges, for the assessment years 2001-02 to 2003-04 were completed between 2001 to 2004.

Audit scrutiny of the income tax assessments of above non-life insurance companies in Chennai, Kolkata, Mumbai and Delhi, for the assessment years 1995-96 to 2003-04, revealed that the companies have been earning profits on realization of investments/sale of shares of companies and redemption of such investments, which are directly taken to the General Reserve Account in the Balance Sheet, without crediting it to the Profit & Loss Account of the respective assessment years. Though interest earned by such companies on loans and debentures is chargeable to tax, profits made by the companies on realization of investment/sale and redemption of investment are possibly escaping assessment as they are not considered to be taxable owing to omission of Rule 5(b) of first schedule to the Income Tax Act with effect from the assessment year 1989-90. Audit scrutiny further revealed that no uniform policy has been adopted by the assessing officers with regard to bringing such profits to tax.

Profits earned by these companies on account of sale of investment in shares of companies are taxable by virtue of the following statutory provisions/conditions which are, otherwise, applicable to such companies:

i) The assessee companies carry on insurance business in the usual course of business. Besides, they also act as a public financial institution under Section 4A of the Companies Act. Transaction in shares and securities is one of the normal business activities of the assessee company. Profit on sale of such investment is thus liable to tax.

ii) If any part of the profits and gains is not attributable to the insurance business, there cannot be a valid cause for taking profits and gains attributable to such part to the Balance Sheet and therefore the same is liable to tax.

iii) The companies are entitled to avail benefit of provisions of section 43 D of the Income Tax Act with regard to income recognition and also section 36(1)(viia) of the Income Tax Act with regard to provision for bad and doubtful debts. The functions of the assessee company have been bifurcated into two distinct activities viz. one of insurance business and the other as public financial institution. As per RBI guidelines, income from non-banking activities of a financial institution has to be recognized as income. Hence profit realized on sale of investment should

be considered as business income of the public financial institution and not that of the insurance business to warrant exemption on the ground that Rule 5(b) of the First Schedule dealing with determination of income of insurance business is not in the statute with effect from 1 April1988.

iv) The profits arising out of sale of investments form part of the activities of a public financial institution similar to that of the interest earned on debentures and

v) Investments in securities or shares being non obligatory, can not be considered as a part of legitimate insurance business.

Audit scrutiny further revealed that these companies had earned profit to the tune of Rs.1,163.66 crore during the assessment years 1995-96 to 2003-04, but the income escaped assessment possibly due to lacuna in the Act and also due to different stand taken by the assessing officers in this regard, resulting in revenue loss of Rs.407.28 crore to the government. If suitable measures are not taken timely, revenue losses on this score are likely to multiply. The department accepted audit observation and took remedial action in the case of M/s. United Insurance Company Ltd (Chennai-I) and M/s. National Insurance Company (Kolkata) for the assessment year 1995-96.

3.8.2 In Delhi CIT-III charge, the assessment of a company, **M/s Shyam Telelink Ltd.,** for assessment year 2000-2001 was completed after scrutiny in March 2003 determining income of Rs.37.33 lakh. Audit scrutiny revealed that assessee had created a capital reserve of Rs.63.93 crore during the previous year relevant to assessment year 2000-01. The amount of Rs.63.93 crore accrued to assessee on waiver of loan, discharge of bank guarantee and payment of demurrage charges as a result of termination of settlement already arrived at by the assessee company with another company. Since the amount had accrued to assessee in the course of business, it should have been taxed as business income. Omission to do so resulted in under assessment of income of Rs.63.93 crore involving undercharge of tax of Rs.36.55 crore. The department has taken remedial action.

3.8.3 In Tamil Nadu, Chennai III charge, the assessment of a company, **M/s Sterling Holiday Resorts (I) Ltd.**, for the assessment years 1997-98, 1998-99 and 2000-01 were completed after scrutiny in March 2000, March 2001 and March 2003 respectively on a loss of Rs.35.26 crore, Rs.18.42 crore and Rs.13.58 crore. The assessment for the assessment year 1997-98 was revised in September 2002 on a loss of Rs.35.37 crore. Audit scrutiny revealed that the assessee, engaged in selling of time share units and providing holiday facilities to members for a specific period, had collected membership fee totalling Rs.45.84 crore for the assessment years 1997-98, 1998-99 and 2000-01 on a deferred payment basis. Out of the total membership fee, relevant portion reasonably attributable towards direct cost was taken into account as income in the year in which the purchaser became the member. The balance amount was treated as "avoidable subscription

towards customer facilities" and accounted for as time share income equally spread over a period of 99 years. As the right to receive membership fee had accrued during the year of receipt of such fees and the income could not be spread over to future year, the entire receipt totalling Rs.45.84 crore should have been brought to tax. Omission to do so resulted in income of Rs.45.84 crore escaping assessment with consequential under assessment of income for the assessment year 1997-98 and reduction of loss for assessment years 1998-99 and 2000-01 involving a tax effect of Rs.1.75 crore (including interest) for the assessment years 1997-98 and potential tax effect of Rs.17.93 crore for the assessment years 1997-98, 1998-99 and 2000-01. Total tax effect aggregated to Rs.19.68 crore.

3.8.4 In Tamil Nadu, Chennai III charge, assessment of a company, **M/s Mahindra Holiday Resorts India Ltd.**, for the assessment year 1998-99 originally completed after scrutiny in March 2001 at a loss of Rs.1.88 crore and subsequently revised in February 2002 to give effect to appellate order, at a loss of Rs.3.91 crore. The income tax assessments for the assessment years 1999-2000 and 2000-01, processed in summary manner in January 2000 and February 2002, were revised in March 2002 and July 2002 at a loss of Rs.10.29 crore and Rs.15.64 crore respectively. For the assessment year 2001-02 the assessment was processed in summary manner in May 2002 at a loss of Rs.17.37 crore. Audit scrutiny revealed that the assessee, engaged in selling of time share units and providing holiday facilities to members for a specific period, had collected membership fee in full or on a deferred payment basis. Out of total membership fee, relevant portion reasonably attributable to direct cost involved in selling the time share units was taken into account as income in the year in which the purchaser became a member and the balance representing "Advance towards members facilities" was being accounted for as time share income equally over a period of 33 years. As the right to receive membership fee had accrued during the year of receipt of such fees and also in the absence of specific provisions in the Act, the income could not be spread over to future years. As such the entire receipt towards fees amounting to Rs.107.09 crore should have been brought to tax instead of the net amount of Rs.54.76 crore offered to tax by the assessee for the assessment years 1998-99 to 2001-02. Omission to do so resulted in income totalling Rs.52.33 crore escaping assessment with consequential under assessment of income for assessment years 1998-99 to 2000-01 and reduction of loss for assessment year 2001-02 by a like sum involving positive tax effect of Rs.5.47 crore (excluding interest for short payment of advance tax) and potential tax effect of Rs.13.83 crore. Total tax effect aggregated Rs.19.30 crore for the assessment years 1998-99 to 2001-02.

3.8.5 In Delhi, CIT-III charge, the assessment of a company, **M/s. Steel Authority of India,** for the assessment year 2000-01 was completed after scrutiny in March 2003. Audit scrutiny revealed that the assessee debited Rs.26.82 crore to the profit and loss account on account of adjustments pertaining to earlier years. Since these expenses pertained to earlier years, these were required to be disallowed. Omission to do so resulted in over-assessment of loss by Rs.26.82

crore involving potential tax effect of Rs.10.32 crore. The department accepted the audit observation and initiated remedial action.

3.9 Incorrect allowance of capital and non business expenditure

Incorrect allowance of inadmissible expenditure/ claims/ provisions

Any expenditure, not being in the nature of capital expenditure, laid out wholly or exclusively for the purpose of business, is allowable as deduction in computation of income chargeable under the head 'profits and gains of business or profession'. It has been **judicially**[*] held that the expenditure on raising capital by issue of shares by a finance company is of a capital nature. Interest and finance charges, incurred during construction period of a project, are a capital disbursement.

No deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of total income under the Act.

Assessing officers incorrectly allowed capital and non-business expenditure which resulted in short levy of tax totalling **Rs.266.33 crore** in **35** cases in Delhi, Gujarat, Karnataka, Maharashtra, Tamil Nadu, Uttaranchal and West Bengal. **Two** cases involving short levy of tax of more than Rs.10 crore are illustrated below and **seven** cases, over Rs.1 crore but below Rs.10 crore each, are indicated at serial numbers **10 to 16** in **Appendix 8.**

3.9.1 In Maharashtra, City I Mumbai charge**,** the assessments of a company, **M/s Maharashtra State Electricity Board,** for the assessment years 1999-2000 and 2000-01 were completed after scrutiny in January 2000 at taxable income of Rs.189.64 crore and Rs.683 crore respectively. Audit scrutiny revealed that assessee company was allowed deduction of Rs.247 crore and Rs.237.87 crore during the relevant previous years respectively towards interest and finance charges capitalised in the accounts which was not in order as the said expenses were in respect of assets at construction stage and as such being in the nature of capital expenditure. Further, the assessee was allowed depreciation aggregating Rs.114.87 crore on the said interest expenses which was capitalised in the books of accounts. The depreciation allowed was also not in order as the assets against which interest expenses were capitalised were still at construction stage and were not put to use for the purpose of business. Incorrect allowance of deduction as well as depreciation resulted in excess carry forward of losses to that extent involving potential tax effect of Rs.220.22 crore.

3.9.2 In Tamil Nadu Chennai-III charge, assessment of a company, **M/s. Sterling Holiday Resorts Ltd.** for the assessment year 1997-98 was completed after scrutiny in March 2000 at a loss of Rs.35.26 crore and subsequently revised in September 2002 at a loss of Rs.35.37 crore. The assessee was allowed deduction of Rs.6.64 crore, Rs.6.64 crore and Rs.20.96 crore towards 'market development expenses', 'new project expenses' and 'administrative and

[*] Metro General Credits Ltd. Vs CIT 221 ITR 99 (Madras)

other expenses charged under Resort construction' respectively. In the assessment for the assessment year 1999-2000 also, completed in a summary manner in September 2000 at a loss of Rs.30.63 crore, deduction of Rs.2.43 crore, Rs.15.67 crore and Rs.1.77 crore towards 'market development expenses', 'new project expenses' and 'administrative and other expenses charged under Resort construction' respectively were allowed. Audit scrutiny revealed that in the assessments for the assessment years 1998-99 and 2000-01, the expenditure was disallowed treating the same as capital expenditure. The expenditure, allowed in the assessment years 1997-98 and 1999-2000 should also have been disallowed on similar lines. Omission to do so resulted in excess computation of loss of Rs.34.25 crore and Rs.19.87 crore in assessment years 1997-98 and 1999-2000 respectively involving potential tax effect aggregating to Rs.21.68 crore.

3.10 Incorrect allowance of preliminary expenses

Admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with extension of an industrial undertaking is limited to 5 per cent of the cost of the project or capital employed at the option of the assessee and is allowed in equal instalments spread over 5 years.

Audit noticed that assessing officers had incorrectly allowed preliminary expenses which resulted in short levy of tax totalling **Rs.1.39 crore** in **two** cases in Karnataka and Tamil Nadu. **One** case involving tax effect of more than Rs.1 crore but less than Rs.10 crore is indicated at serial number **17** of **Appendix 8**.

3.11 Incorrect allowance of provisions/ liabilities/ expenditures

A provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions do not qualify for deduction under the Act. It has been **judicially**[*] held that in order for a loss to be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur.

No deduction in respect of any provision for gratuity on retirement or on termination of employment for any reason shall be allowed unless it is by way of contribution towards an approved fund or for payment of gratuity that has become payable during the previous year.

The amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable as deduction in computing the income chargeable to tax under the head 'profits and gains of business or profession'. In the case of a bank where provision made for bad and doubtful debts is admissible, the amount of deduction shall be limited to the

[*] CIT V/s Indian Overseas Bank 151 ITR 466 (Madras)

amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts accounts made under the Act. No deduction for a bad debt or part thereof shall be allowed unless the assessee has debited the amount of such debt or part of debt in the previous year to the provision for bad and doubtful debts account. Besides, bad debts written off shall not include any provision for bad and doubtful debts made in the books. No deduction towards write off of bad debt shall be allowed unless such debts represent money lent in the ordinary course of the business of banking or money lending which is carried on by the assessee.

Deductions on account of cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc., or any sum payable to an employee as bonus or commission for services rendered or any sum payable as interest on any loan from any public financial institution are allowable on actual payment basis. No deduction in respect of contribution to the above funds is however, allowable unless such sum has actually been paid before the stipulated due date as specified under the relevant statute governing the funds.

Financial corporations engaged in providing long term finance for industrial or agricultural development in India, are entitled to special deduction of an amount transferred by them out of their profits to special reserve account, up to an amount not exceeding 40 percent of the profits derived from such business of providing long term finance as computed under the head "Profits and gains of business or profession" before making this deduction and any other deduction under Chapter VI A. Any expenditure including that of capital nature laid out, expended or incurred on scientific research related to the business carried on by the assessee shall be allowed as deduction.

With effect from 1 April 2001, where an assessee incurs any expenditure by way of payment of any sum to an employee at the time of his retirement, one fifth of the amount so paid shall be deducted in computing the profit and gains of the business and the balance shall be deducted in equal instalments for each of the four immediately succeeding years.

Actual interest tax liability of an assessee is allowable from the profits and gains of his business or profession for that assessment year.

Audit noticed that the assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.254 crore** in **64** cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu and West Bengal. **Six** cases, involving tax effect of more than Rs.10 crore each are illustrated below and **12** cases with tax effect over Rs.1 crore but below Rs.10 crore each are shown at serial numbers **18 to 29** in **Appendix 8.**

3.11.1 In Maharashtra, City-III Mumbai charge, assessment of a company, **M/s ICICI Bank Ltd.**, for assessment year 1996-97, completed after scrutiny in March 1999, was revised in February 2000 at total income of Rs.223.56 crore. Audit scrutiny revealed that the assessee was allowed deduction of Rs.300.69 crore on account of bad debts written off which interalia included provision for doubtful debts of Rs.16 crore and provision for bad and doubtful debts of earlier years of Rs.142 crore appropriated through special reserve account which required to be disallowed. Further, the assessee was also allowed deduction of Rs.11.77 crore on account of provision for bad & doubtful debts admissible to banks which also required to be withdrawn as bad debts written off allowed as deduction was in excess of the provisions admissible to the bank under the Act. The omission resulted in incorrect allowance of deduction aggregating Rs.169.77 crore involving under assessment of income to that extent and thereby short levy of tax of Rs.78.10 crore.

3.11.2 In Maharashtra, City-I Mumbai charge, the assessments of a company, **M/s. Life Insurance Corporation of India**, for the assessment years 1999-2000 and 2000-01 was completed after scrutiny in January 2001 and January 2003 respectively. Audit scrutiny revealed that the assessee was allowed deductions towards additional interest tax liabilities of Rs.60 crore pertaining to assessment year 1995-96 and Rs.260 crore pertaining to assessment years 1993-94 to 1996-97 which had already been refunded to the assessee in pursuance of ITAT's decision in favour of the assessee. The assessee was also allowed excess deduction of interest tax liability aggregating Rs.12.79 crore for assessment years 1999-2000 and 2000-01. Omission to add back the excess deductions so allowed resulted in under assessment of income of Rs.332.79 crore involving short levy of tax of Rs.45 crore.

3.11.3 In Delhi-VI charge, the assessment of company, **M/s. Oriental Insurance Co.**, for the assessment year 2002-03 was completed after scrutiny in March 2004 determining a loss of Rs.187.51 crore. Audit scrutiny revealed that the employer's contribution to the pension fund of Rs.95.91crore was deposited after the due date. As the provisions of the Act do not provide for allowing late payment of superannuation fund dues, Rs.95.91 crore should have been disallowed. The omission to do so resulted in over assessment of loss by Rs.95.91 crore involving potential tax effect of Rs.34.24 crore.

3.11.4 In Delhi-II charge, the assessment of a company, **M/s Mahanagar Telephone Nigam Ltd.**, for the assessment year 1997-98 was completed after scrutiny in December 1999 determining income of Rs.1,514.45 crore. Audit scrutiny revealed that as per notes to account, the assessee has made provision of Rs.40.40 crore against likely liability on revision of pay and the assessing officer has allowed the same. The provision not being an ascertained expenditure should not have been allowed and should have been added to the income of the assessee. Omission to do so resulted in under assessment of income of Rs.40.40 crore with short levy of tax of Rs.28.23 crore.

3.11.5 In Maharashtra, City V Mumbai charge, the assessment of a company, **M/s. Air India Ltd.,** for the assessment year 2000-01 was completed after scrutiny in March 2003. Audit scrutiny revealed that the assessee was allowed provision of Rs.31.68 crore, made in the accounts for bad and doubtful debts and advances. Since the provision for this purpose is not an allowable deduction, the amount should have been disallowed and added back. Omission to do so resulted in excess carry forward of loss of Rs.31.68 crore involving potential tax effect of Rs.12.20 crore.

3.11.6 In Maharashtra, City III Mumbai charge, the assessment of a company, **M/s. IDBI Bank Ltd.,** for the assessment year 1997-98 was completed after scrutiny in February 2000 determining taxable income of Rs.1,326.62 crore. The taxable income was redetermined at Rs.1241.34 crore in June 2001 after giving effect to an appellate order passed in March 2001. Audit scrutiny revealed that while giving effect to appellate order, the assessing officer allowed deduction of Rs.86.39 crore towards provision for bad and doubtful debts. This deduction was required to be restricted to the credit balance of Rs.70.46 crore in the reserve created for the purpose by debiting the Profit and Loss Account. Omission to do so resulted in excess allowance of deduction of Rs.15.93 crore involving short levy of tax of Rs.11.34 crore including interest.

Incorrect allowance of depreciation

3.12 In computing the business income of an assessee, a deduction on account of depreciation on the cost or written down value of building, plant and machinery, furniture, fixtures etc, is admissible at the rates prescribed in the Income Tax Rules, 1962 provided the assets are owned by the assessee and used for the purpose of the business. Depreciation on land is not admissible. It has been **judicially**[*] held that depreciation has to be mandatorily charged before the deductions are calculated.

Where in any assessment year full effect cannot be given to any depreciation allowance owing to there being no or less profits or gains under the head ‘profits and gains of business or profession’, such unabsorbed depreciation shall be carried forward for subsequent year/years and shall be set off against profits and gains from any business or profession for that year/years.

Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction on account of depreciation shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the assets comprising such block.

The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.15.15 crore** in **21** cases in Delhi, Gujarat,

[*] CIT Vs Mahindra Mills 243 ITR 56 (S.C.)

Karnataka, Kerala, Maharashtra, Orissa, Rajasthan, Tamil Nadu and West Bengal. **Four** cases involving tax effect of more than Rs.1 crore but below Rs.10 crore each are shown at serial number **1 to 4** in **Appendix 9.**

Incorrect computation of capital gains

3.13 Any profit and gains arising from the transfer of a capital asset shall be chargeable to income tax under the head 'capital gains' and is taxable in the year in which the transfer took place. The mode of computation of capital gains in respect of long-term capital asset provides for deduction, from the consideration received, of the cost of acquisition of assets and the cost of any improvement thereto and of expenditure incurred wholly and exclusively in connection with such transfer. From the assessment year 1993-94, 'indexed cost of acquisition' and 'indexed cost of improvement' would apply in the case of transfer of long term capital asset.

Long term capital asset means a capital asset which is not a short term capital asset and short-term capital asset means a capital asset held by an assessee for not more than 36 months. An assessee is eligible for exemption in cases where the capital gain arises from the transfer of long term capital asset and the assessee had within a period of six months after the date of such transfer invested the whole or any part of net consideration in any of the bonds, debentures, shares of a public company or units of any mutual fund specified by the Board. Capital gain arising out of transfer from a short-term capital asset is charged at maximum marginal rate applicable as per relevant Finance Act.

The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.10.78 crore in six** cases in Delhi, Karnataka and Maharashtra. **Two** cases involving tax effect of more than one crore but less than Rs.10 crore are given in **Appendix 9** at serial number **5** & **6.**

Incorrect computation/ carry forward/ set off of losses

3.14 Where the net result of computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the profits and gains of business or profession of those years.

No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined. Further, no loss can be carried forward for set off unless the assessee has filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer. If the return filed by an assessee is defective and the defect is not rectified within the period granted by the assessing officer, the return shall be treated as an invalid return.

Where there has been an amalgamation of a company owning an industrial undertaking with another company, the accumulated loss shall be deemed to be

the loss of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Act shall apply accordingly subject to certain conditions.

The assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.1,549.60 crore** in **30** cases in Bihar, Delhi, Gujarat, Haryana, Karnataka, Kerala, Maharashatra, Orissa, Rajasthan, Tamil Nadu and West Bengal. **Two** cases involving tax effect of more than Rs.10 crore each are illustrated below and **eight** cases of tax effect of over Rs.1 crore but below Rs.10 crore each are indicated against serial numbers **1 to 8** of **Appendix 10.**

3.14.1 In Tamil Nadu, Chennai-I charge, the assessment of a company, **M/s Tamil Nadu Electricity Board**, for the assessment year 2002-03 was filed in October 2002 claiming a loss of Rs.2,375.56 crore. Audit scrutiny revealed that the return filed by the assessee was treated as defective and declared invalid in December 2002 for not filing the prescribed audit certificate along with the return. The appeal filed by the assessee against the above order was dismissed in December 2003. The assessee subsequently filed a revised return in February 2004 claiming a business loss of Rs.4,190.13 crore and unabsorbed depreciation of Rs.903.32 crore which was processed in March 2004 on the income as returned by the assessee. As the return filed by the assessee in October 2002 was a defective return and the same was declared as invalid, the return filed in February 2004 should have been treated as a belated return and business loss of Rs.4,190.13 crore should have been disallowed. Omission to do so resulted in incorrect allowance of business loss of Rs.4,190.13 crore involving potential tax effect of Rs.1495.88 crore. Though formal reply has not been received, it was found on local verification that the department has taken remedial action as per audit observation.

3.14.2 In Karnataka, Mangalore charge, the assessment of a company, **M/s Syndicate Bank Ltd,** for assessment year 2001-02 was completed after scrutiny in March 2004, determining total income at Rs.271.37 crore under special provisions and 'nil' under normal provisions of the Income Tax Act. Audit scrutiny revealed that the computation of income under normal provisions had become 'nil' after adjusting brought forward losses of earlier assessment years. Further, the unabsorbed loss of Rs.90.89 crore relating to the assessment year 1997-98 was allowed to be carried forward. Scrutiny revealed that the unabsorbed loss carried forward from the assessment year 1997-98 was Rs.18.97 crore only and not Rs.90.89 crore as allowed by the assessing officer. The mistake resulted in excess carry forward of loss of Rs.71.92 crore involving potential tax effect of Rs.28.44 crore including surcharge. The department accepted the audit observation and rectified the assessment.

Mistakes in implementation of appellate orders

3.15 An aggrieved assessee can appeal to the Commissioner of Income Tax (Appeals) against the order of an assessing officer who shall comply with the

directions given in the appellate order. Further appeal is also permitted to be made on questions of fact and law to ITAT* and on the questions of law alone to the High Court and the Supreme Court thereafter. Any mistake committed while giving effect to appellate order will result in under assessment/over assessment of income.

The assessing officers did not implement the appellate orders correctly, which resulted in short levy of tax totalling **Rs.17.97 crore** in **nine** cases in Andhra Pradesh, Gujarat, Kerala, Orissa, Rajasthan, Tamil Nadu and West Bengal. **Four** cases involving tax effect of more than Rs.1 crore but less than Rs.10 crore each are indicated at serial number **1 to 4** of **Appendix 11.**

Irregular reliefs and exemptions under Chapter VIA of the Income Tax Act

3.16 Under the Income Tax Act 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the total income chargeable to tax. The overriding condition is that the total deduction under Chapter VIA should not exceed the gross total income of the assessee. 'Gross total income' has been defined as the total income computed in accordance with the provisions of the Act but before making the deductions under Chapter VIA.

The assessing officers did not comply with the above provision, which resulted in short levy of tax totaling **Rs.13.05 crore** in **five** cases in Delhi and West Bengal. **Two** cases involving tax effect of more than Rs.1 crore but less than Rs.10 crore each are indicated at serial number **1 & 2** of **Appendix 12.**

3.17 Incorrect allowance of deduction in respect of profits for export business

An assessee being an Indian company or other assessee, resident in India, engaged in the business of export is entitled to a deduction equal to the profits derived from the export of goods or merchandise if the sale proceeds are received in convertible foreign exchange. Where the export out of India is of goods or merchandise manufactured or processed by the assessee and also of trading goods, the profits derived from such export shall, in respect of goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turn over of the business carried on by the assessee and in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods. The profit so arrived at shall be further increased by ninety percent of profit on sale of licenses and export incentives, if any. The export and total turnover shall not, however, include freight or insurance attributable to the transport of the goods or merchandise beyond the custom station. Further, deduction in respect of export profits shall not be admissible unless the assessee furnished along with the return of income, the report of an accountant certifying that the deduction was correctly claimed in accordance with the provisions of

* Income Tax Appellate Tribunal

section 80HHC. Profits on sale of DEPB credits are not eligible for deduction under section 80 HHC.

Where an amount of profits and gains of an industrial undertaking is allowed as deduction under 80 IA, the profit to that extent shall not qualify for deduction for any assessment year under any other provision of Chapter VIA.

Incorrect application of the above provisions resulted in short levy of tax totalling **Rs.22.33 crore** in **57** cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan and Tamil Nadu. **Five** cases, each involving tax effect of more than Rs.1 crore are indicated at serial numbers **3 to 7** of **Appendix 12**.

3.18 Incorrect allowance of deduction in respect of profits from export of computer software

An assessee being an Indian company or a person engaged in the business of export out of India of any computer software or its transmission from India to a place outside India, is entitled to a deduction equal to the extent of profits derived from the export of any computer software or its transmission from India to a place outside India, if sale proceeds thereof are received in convertible foreign exchange.

Incorrect application of the above provision resulted in short levy of tax totalling **Rs.2.87 crore** in **three** cases in Maharashtra and Tamil Nadu. **One** case involving tax effect of more than Rs.1 crore is indicated at serial number **8** of **Appendix 12.**

3.19 Incorrect allowance of deduction in respect of profits from industrial undertakings

Where the gross total income of an assessee includes any profits and gains derived from a newly established industrial undertaking, which goes into production after 31 March 1991, the assessee is entitled to a deduction of 30 percent of profits provided the industrial undertaking does not manufacture or produce article or thing specified in the Eleventh Schedule. One of the conditions to allow deductions is that the business is not formed by splitting up or the reconstruction of a business already in existence and that the value of old machinery or plant or part transferred to such new business does not exceed twenty percent of total value of the machinery or plant or part used in the business. It has been judicially held that the use of the term “derived from” in the relevant provisions of the Act indicates the restricted meaning given by the legislature to cover only the profits and gains directly accruing from the conduct of the business or undertaking.

Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking engaged in infrastructure development etc., including generation or generation and distribution of power, the assessee is

entitled to a deduction from such profits and gains of an amount equal to hundred percent for the first five assessment years and thereafter thirty percent (in case of a company) for further five assessment years. Sub-section 5 of section 80-IA provides that for the purpose of determining the quantum of deductions, the profits and gains of the eligible business shall be computed as if such profits and gains were the only source of income of the assesses during the previous year. Further, the losses of eligible units, that have been set off against positive income of other units, have to be considered before allowing the deduction.

Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.4.14 crore** in **six** cases in Delhi, Gujarat, Madhya Pradesh, Maharashtra, Punjab and Tamil Nadu. **Three** cases involving tax effect of more than Rs.1 crore are indicated at serial numbers **9 to 11** of **Appendix 12.**

Incorrect computation of income under special provisions of the Act

3.20 Under section 115 JA of the Income Tax Act, 1961, where in the case of an assessee being an Indian company the total income as computed under this Act in respect of any previous year is less than 30 percent of its book profit, the total income of such assessee chargeable to tax shall be deemed to be an amount equal to thirty percent of such profit. For this purpose, book profit means the net profit as per the profit and loss account subject to certain additions/deletions. Further, the amount carried to any reserve by whatever name called is to be added to net profit. Brought forward loss or unabsorbed depreciation, whichever is less, would be reduced in arriving at the book profit. Determination of deemed income under the special provisions shall not affect the determination of loss to be carried forward and set off in subsequent assessment years.

Where any amount of tax is paid under section 115 JA by an assessee, a credit in respect of tax so paid in excess over the tax under normal provisions of the Act, shall be allowed to be set off in a succeeding year only when tax becomes payable on the total income computed under the normal provisions of the Act but such set off shall not be allowed beyond the fifth year immediately succeeding the assessment year in which tax credit becomes allowable.

Under section 115 JB of the Income Tax Act, 1961, in the case of a company if the income tax payable on total income as computed under the normal provisions of the Act in respect of previous year relevant to assessment year commencing on or after 1 April 2001 is less than 7.5 per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income tax at the rate of 7.5 per cent.

Assessing officers did not apply the above provisions correctly, which resulted in short levy of tax totalling **Rs.75.08 crore** in **35 cases** in Andhra Pradesh, Assam, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Rajasthan, Tamil Nadu and West Bengal. **One** case involving tax effect of more than Rs.10 crore is illustrated

below and **12** cases of more than Rs. one crore but less than Rs.10 crore each are indicated against serial numbers **1 to 12** of **Appendix 13**.

3.20.1. In Maharashtra, City II Mumbai charge, the assessment of a company, **M/s. Larson & Toubro,** for the assessment year 2001-02 was completed in March 2004 under special provisions of the Act. Audit scrutiny revealed that the assessing officer worked out the tax payable under normal provisions of the Act at Rs.52.14 crore and under special provisions at Rs.22.52 crore. In finalising the assessment under special provisions, the assessing officer decided that after giving MAT[*] credit of Rs.29.62 crore and double taxation relief of Rs.38.14 lakh, tax under normal provisions would be less than the tax worked out under special provisions, which was not correct. The benefit of MAT credit or any prepaid taxes was required to be given only after working out the total tax liability. The assessee was required to be taxed under the normal provisions as the tax determined under those provisions was more instead of under special provisions. The mistake resulted in short levy of tax of Rs.36.93 crore. The department accepted the audit observation and took remedial action.

Excess or irregular refunds by Government

3.21 Where, as a result of any order passed in assessment, appeal, revision or any other proceedings under the Act, refund of any amount becomes due to the assessee, it may be granted in cash or adjusted or set off against outstanding dues of the assessee for any assessment year.

The assessing officers committed mistakes in grant of refunds viz. grant of excess refund of tax/non adjustment of refund which resulted in irregular refunds totalling **Rs.3.50 crore** in **two** cases in Gujarat and Maharashtra. **One** case of more than Rs. one crore but less than Rs.10 crore is indicated against serial number **1** of **Appendix 14.**

Incorrect payment of interest on refunds

3.22 An assessee is entitled to receive, in addition to the refund out of any advance tax paid including tax deducted at source, simple interest thereon at the rate of eight per cent per annum with effect from June 2002 (since reduced to six per cent from 8 September 2003). Interest is payable for every month or part thereof from the first day of April of the assessment year to the date on which the refund is granted. No interest will be payable, if the amount of refund is less than ten percent of tax determined.

Assessing officers made incorrect payment of interest totalling **Rs.37.32 crore** in **16** cases in Delhi, Gujarat, Jharkhand, Maharashtra, Rajasthan, Tamil Nadu and West Bengal. **Two** cases involving tax effect of more than Rs.10 crore are illustrated below and t**hree** cases involving tax effect of more than Rs.one crore but below Rs.10 crore each are shown against serial numbers **2 to 4** of **Appendix 14.**

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[*] Minimum Alternate Tax

3.22.1 In Maharashtra, Mumbai charge, the assessment of a company, **M/s State Bank of India,** for the assessment year 1999-2000 was completed after scrutiny in February 2002 raising tax demand of Rs.4.71 crore which was paid in full in March 2002. At the request of the assessee made in June 2003, the assessment was subsequently rectified in August 2003 allowing double taxation relief of Rs.30.51 crore and thereby issuing refund of Rs.43.37 crore. The refund included interest of Rs.12.86 crore which was calculated for the period from March 2002 till the date of refund. Audit scrutiny revealed that double taxation relief was claimed neither in the return nor during the scrutiny proceedings. The assessee claimed the relief only on 25 June 2003. Thus the delay in refund of Rs.30.51 crore was wholly attributable to the assessee and hence no interest on this refund was payable for the period prior to 25 June 2003. Interest payable for the period from 25 June 2003 till the date of refund worked out to Rs.61.06 lakh only. The mistake resulted in excess payment of interest of Rs.12.25 crore on refund. The department accepted the audit observation and remedial action was taken.

3.22.2 In Gujarat, Central I Ahmedabad charge, assessment of a company, **M/s Nirma Ltd., Co**., for the assessment year 1998-99 was completed after scrutiny in November 2000, determining the taxable income of Rs.113.17 crore. The assessee preferred an appeal against the assessment, which was decided in March 2002. While giving effect to appellate orders in May 2002, the taxable income was determined at Rs.1.34 crore. Audit scrutiny revealed that tax payable on the income of Rs.50.13 crore worked out to Rs.17.54 crore against which tax of Rs.18.87 crore was paid by the assessee by way of advance tax and TDS. Thus the refund amount worked out to Rs.1.33 crore only and not Rs.11.06 crore as granted by the department. Since the refudable amount of Rs.1.33 crore was less than ten percent of tax determined, no interest was payable on the refund amount. Besides allowing excess refund of Rs.9.73 crore, mistake also resulted in irregular payment of interest of Rs.62.39 lakh. Total tax effect aggregated to Rs.10.35 crore. Department accepted audit observation and remedial action was also taken.

Non levy of interest on excess grant of refunds

3.23 Where amount refunded in summary assessment exceeds amount refundable on regular assessment, the assessee shall be liable to pay simple interest at the rate of two-third per cent (one half per cent from 8 September 2003) on the excess amount so refunded for every month or part of the month comprised in the period from the date of grant of refund to the date of such regular assessment.

There is, however, a lacuna in the Act as there is no provision under which interest could be levied in the case of excess refunds made at the time of regular assessment/reassessments and any other subsequent assessment made thereafter to give appeal effect etc.

Audit noticed that lacuna in the Act and non-adherence of the above provision, regarding levying of interest on excess refund at the time of summary assessment, by the assessing officers resulted in short levy of tax totalling **Rs.36.71 crore** in

11 cases in Delhi, Karnataka and Maharashtra. **One** case involving tax effect of more than Rs.10 crore is illustrated below and **one** case involving tax effect of more than Rs. one crore but below Rs.10 crore is shown against serial number **5** of **Appendix 14.**

3.23.1 In Maharashtra, Mumbai II charge, the assessment of a company, **M/s. State Bank of India**, for the assessment years 1996-97 to 1998-99 was completed after scrutiny in March 2004 raising additional demands of Rs.118.69 crore, Rs.53.36 crore and Rs.76.29 crore respectively after adjustment of refunds made in regular assessments on earlier occasions. Audit scrutiny revealed that earlier the assessment for assessment year 1996-97 was revised to give effect to ITAT's order issued in June 2002 granting a refund of Rs.138.82 crore in April 2003. Similarly assessment for assessment year 1997-98 was revised in March 2002 granting a refund of Rs.25.90 crore in April 2002 followed by a further revision in March 2003 in compliance with ITAT's order allowing a refund of Rs.113.21 crore in April 2003. The same situation was met in the case of assessment year 1998-99 where the assessment was revised in March 2002 granting a refund of Rs.88.49 crore in April 2002. However there being no provision in the Act to levy interest on the excess refunds made earlier in regular assessments against the demands raised at later stage, there was a loss of revenue aggregating to Rs.28.17 crore by applying the rate of interest as prescribed under section 234D. Thus there is a lacuna in the Act, which needs to be addressed as was done in the case of excess refunds at summary assessment stage.

Non levy/short levy of interest for default in filing of return/ payment of advance tax/tax demand

3.24 If an assessee fails to file return within the specified due date or who is liable to pay advance tax, has failed to pay such tax or, where the advance tax paid by such assessee is less than ninety percent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two percent up to 31 May 1999, (one per cent from 8 September 2003) for every month. Interest shall be reckoned from 1 April next following such financial year to the date of determination of total income and where a regular assessment is made, to the date of such regular assessment. Interest is payable on the amount equal to the assessed tax or as the case may be, on the amount by which the advance tax paid falls short of the assessed tax. The Act further provides that self-assessment tax paid should include interest, if any, liable to be paid by the assessee under any provision of the Act. In the event of shortfall in the total of the tax and interest, the amount so paid shall first be adjusted towards interest payable and balance if any, is adjusted towards tax payable.

The assessee should pay any demand for tax within thirty days of service of notice of the relevant demand. Failure to do so attracts simple interest at one and one half percent (one per cent from 8 September 2003) for every month or part thereof from the date of default till actual payment.

Audit noticed non-compliance with the above provisions. Interest was short levied by **Rs.39.05 crore** in **59** cases in Andhra Pradesh, Assam, Bihar, Delhi, Gujarat,

Kerala, Maharashtra, Madhya Pradesh, Rajasthan, Tamil Nadu and West Bengal. **Nine** cases of tax effect over Rs.one crore but below Rs.10 crore, each, are shown against serial numbers **1 to 9** of **Appendix 15.**

Other topics of interest

3.25 In completing an assessment and determining the tax or refund, the assessing officer should take into account prepaid taxes paid by the assessee and refunds made to him.

Where in any financial year, the assessee has paid any interest which is payable outside India on which tax has not been paid or deducted, such amount should not be allowed as deduction while computing the income chargeable under the head "profits and gains of business or profession".

If any person, who is responsible for deducting tax at source, does not deduct or after deducting the tax fails to pay the tax, he shall be deemed to be an assessee in default in respect of the tax and shall be liable to pay simple interest at the rate of fifteen percent per annum on the amount of such tax from the date on which such tax was deductible to the date on which the tax is actually paid. Penalty is also leviable for the default.

Where an assessee incurs any expenditure in respect of which payment exceeding twenty thousand rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, twenty per cent of such expenditure shall not be allowed as deduction.

Where the assessing officer or the CIT (Appeals) is satisfied that any assessee has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct the assessee to pay by way of penalty in addition to the tax payable by him, a sum which is equal to but not more than three times of the tax sought to be evaded.

Audit noticed that the assessing officers did not adhere to the above provisions which resulted in short levy of tax totalling **Rs.75.80 crore** in **eight** cases in Andhra Pradesh, Delhi, Gujarat, Maharashtra and Tamil Nadu. **One** case involving tax effect of more than Rs.10 crore is illustrated below.

3.25.1 In Maharashtra, City II Mumbai charge, the assessment of a company, **M/s State Bank of India,** for the assessment year 1997-98 was completed after scrutiny in March 2004 at tax demand of Rs.53.36 crore, after adjustment of TDS, advance taxes paid and refunds granted earlier, which was paid by the assessee on 30 April 2004. Audit scrutiny revealed that the assessing officer had not given credit of DTA[*] relief of Rs.23.99 crore and advance tax of Rs.30 crore paid on 18 October 1999. Besides, TDS credit was given for Rs.516.22 crore only as against Rs.526.87 crore and refunds of Rs.25.89 crore and Rs.113.21 crore granted on 23

[*] Double Taxation Agreement

April 2002 and 24 April 2003 respectively were not added back. The total tax payable by the assessee thus worked out to Rs.127.82 crore as against Rs.53.36 crore worked out by the department. The mistake resulted in short levy of tax of Rs.74.46 crore. On being pointed out, the department accepted the audit observation and rectified the mistake.

Cases of over assessment or over charge

3.26 Cases of over assessment/over charge due to negligence on the part of assessing officers are being regularly featured in the reports of the Comptroller and Auditor General of India. During test check in audit during 2004-05, audit noticed over assessment of income in **14 cases** involving over charge of tax totalling **Rs.40.99 crore** in Delhi, Gujarat, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu and West Bengal. **One** case involving tax effect of Rs.10 crore or more is illustrated below and **three** cases involving tax effect of Rs.1 crore or more each are shown at serial numbers **1 to 3** in **Appendix 16.**

3.26.1 In West Bengal-II, Kolkata charge, the assessment of a company, **M/s U.C.O.Bank,** for the assessment year 2001-02 was completed after scrutiny in March 2004. Audit scrutiny revealed that an amount of Rs.14.47 crore, being the difference between 'broken period interest' of Rs.76.42 crore paid on purchase of securities and 'broken period interest' of Rs.61.95 crore earned from sale of securities, was considered to be added back to the total income of the assessee in the assessment order. While computing the business income, the assessing officer erroneously added Rs.76.42 crore instead of Rs.14.47 crore as discussed in the assessment order. The omission resulted in excess computation of income by Rs.61.95 crore. Since the entire assessed income was reduced to 'nil' after set off of business loss to the extent of profit available, there was excess set off of loss of Rs.61.95 crore. The mistake led to short allowance of further carry forward by an identical amount involving potential tax effect of Rs.24.50 crore.