

Chapter V

Other Direct Taxes

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Chapter Summary

This chapter consists of two parts A and B containing audit observations on assessments in respect of wealth tax and interest tax respectively.

The numbers of wealth tax assessees reduced from 1.52 lakh in 2001-02 to only 99,694 in 2005-06 though no major amendments have been made in the Wealth tax law.

(Para 5.2)

Audit issued 56 observations (42 and 14 observations relating to wealth tax and interest tax respectively) to the Ministry of Finance involving revenue impact of Rs. 5.17 crore (Rs. 2.65 crore in wealth tax and Rs. 2.52 crore in interest tax) highlighting various irregularities, omissions and mistakes for comments. Ministry accepted 27 observations (17 in wealth tax and 10 in interest tax) involving revenue impact of Rs. 2.34 crore (Rs. 1.73 crore in wealth tax and Rs. 61 lakh in interest tax) till preparation of this report.

(Para 5.4, 5.12 & 5.14)

The assessing officers did not

- ◆ ensure correct valuation of assets and inclusion of taxable assets in the net wealth resulting in short levy of wealth tax of Rs. 14.90 lakh in four cases.
(Para 5.5.3)
- ◆ include taxable assets in net wealth of the assessee resulting in short levy of tax of Rs. 48.10 lakh in 11 cases
(Para 5.6.2)
- ◆ correlate income tax assessment records with the records of wealth tax assessments resulting in non/short-levy of interest aggregating Rs. 45.84 lakh in 20 cases.
(Para 5.7.3)
- ◆ levy interest correctly for various defaults resulting in short levy of interest of Rs. 1.55 crore in six cases.
(Para 5.8.3)
- ◆ levy interest tax of Rs. 2.24 crore correctly in four cases.
(Para 5.15.5)

CHAPTER V: OTHER DIRECT TAXES

A-Wealth tax

Revenue from wealth tax

5.1 The following table gives the position of budget estimates and actual collections compared to total arrears of wealth tax demand between 2001-02 and 2005-06.

(Rs. in crore)

TABLE 5.1: BUDGET ESTIMATES, ACTUAL WEALTH TAX COLLECTION & ARREARS OF WEALTH TAX DEMAND

Year	Budget estimates	Actual collection	Arrears of wealth tax demand	Percentage of actual collection to the arrears of wealth tax demand
1	2	3	4	5
2001-02	145.00	135.36	1,361.04	9.9
2002-03	145.00	153.88	2,122.17	7.3
2003-04	145.00	135.83	1,397.88	9.7
2004-05	145.00	145.36	1,147.70	12.7
2005-06	265.00	250.35	9,490.87	2.6

5.1.1 Arrears of wealth tax demand for the year 2005-06 increased by 727 percent compared to year 2004-05 to Rs. 9490.87 crore (which includes Rs. 9209.38 crore where demand in arrear was more than Rs. one crore in individual cases) from Rs. 1147.70 crore.

Status of assesseees and assessments

5.1.2 The following table gives the comparative position of the number of wealth tax assesseees and number of wealth tax assessments due for disposal and actually completed between 2001-02 and 2005-06:

TABLE 5.2: WEALTH TAX (WT) ASSESSEES, ASSESSMENTS DUE FOR DISPOSAL AND COMPLETED

Year	No. of WT assesseees	No. of WT assessments due for disposal	No. of WT assessments completed	No. of WT assessments pending	Percentage of pending WT assessments to total assessments due for disposal
1	2	3	4	5	6
2001-02	1,51,676	1,18,530	78,982	39,548	33
2002-03	1,27,766	1,28,186	1,03,976	24,210	19
2003-04	1,35,085	1,09,777	82,702	27,075	25
2004-05	1,01,801	57,475	32,310	25,165	44
2005-06	99,694	76,670	52,859	23,811	31

5.2 The number of wealth tax assesseees has reduced from 1,51,676 in the year 2001-02 to 99,694 in the year 2005-06 although there has been no major change in the law since 1993-94. The department needs to investigate the reason for progressive decline in the number of assesseees, so that there is commensurate

widening of tax base for wealth tax assesseees vis-a-vis growth in number of income tax assesseees¹.

5.2.1 However, the number of wealth tax assessments completed decreased from 78,982 in 2001-02 to 52,859 in 2005-06. The percentage of pending wealth tax assessments to total assessments due for disposal also remains high at around 30 percent.

Results of audit

5.3 Audit issued 42 draft paragraphs involving undercharge of wealth tax of Rs. 2.65 crore between May 2006 and October 2006 to Ministry of Finance for their comments. Internal audit of the department had seen only eight of these cases but did not notice mistakes.

5.3.1 All the 42 draft paragraphs involving revenue impact of Rs. 2.65 crore have been included in this chapter. Each paragraph indicates a particular category of mistake and starts with a suitable preamble followed by combined/consolidated revenue impact of all observations of similar nature. Cases with money value of Rs. 10 lakh or more have been illustrated in the related category. Cases with money value of Rs. five lakh or more but less than Rs. 10 lakh each are given in a tabular form in **Appendix 18**.

Status of Ministry's replies

5.4 Out of 42 cases included in this Chapter, Ministry of Finance accepted the audit observations in 17 cases involving aggregate revenue impact of Rs. 1.73 crore. In five cases the Ministry have not accepted the audit observation. In remaining cases, replies are awaited. Replies of the Ministry have been examined and suitably incorporated wherever necessary.

5.5 Mistakes in valuation of assets

Mistakes in valuation of assets

5.5.1 The Wealth Tax Act, 1957, provides that the value of any asset other than cash is determined on the valuation date in the manner laid down in Schedule III to the Act. However, for the purpose of making an assessment, the assessing officer may refer the valuation of any asset to a valuation officer for determining its market value in accordance with the provisions of the Act, if he is of the opinion that the fair market value of the asset exceeds the value of the asset returned. The assessing officer is required to adopt the value so estimated by the valuation officer.

5.5.2 As per Rule 3 of this Schedule, the value of any property which is constructed on leasehold land and where the unexpired period of the lease of such land is less than fifty years is arrived at by multiplying the net maintainable rent by the figure eight. However, as per Rule 8, this valuation will not apply if the lease expires within fifteen years from the relevant valuation date and the deed of lease does not give an option to the lessee for the renewal of the lease.

¹ As per chapter 2 of Audit Report No. 8 of 2007, the number of income tax assesseees increased from 259 lakh in the year 2001-02 to 297.88 lakh in 2005-06.

5.5.3 The assessing officers did not adopt correct value of assets resulting in under valuation of Rs. 2.02 crore involving short levy of wealth tax of **Rs. 14.90 lakh** (including interest) in **four cases** in Karnataka, Kerala and West Bengal charges. **One case** involving revenue impact of Rs. 12.20 lakh is illustrated below:

5.5.4 In Karnataka, Bangalore I charge, the income tax assessments of a company, **M/s Canara Leasing Limited**, for the assessment years 1997-98 and 1998-99 revealed that the assessee had received rental income of Rs. 43.13 lakh and Rs. 31.39 lakh from the property constructed on leasehold land. The capitalised values of these properties were Rs. 3.04 crore and Rs. 2.61 crore which constituted wealth attracting levy of wealth tax. However, the assessing officer, in March 2002, had recorded in the assessment for the assessment year 1997-98 completed after scrutiny that the provision of Rule 3 was not applicable to the assessee as the lease expires within a period of 15 years.

5.5.5 Audit scrutiny revealed that though the leasehold rights of the assessee expired within fifteen years, the deed of lease provided an option to the assessee for a fresh lease of ten years and as such valuation as per Schedule 3 should have been done. The omission to do so resulted in underassessment of net wealth aggregating Rs. 5.65 crore for the above mentioned two assessment years and consequent non-levy of wealth tax of Rs. 12.20 lakh including interest.

5.5.6 Ministry have accepted the audit observation.

5.6 Wealth escaping assessment

Non inclusion of taxable assets in the net wealth

5.6.1 The Wealth Tax Act, 1957, provides that from assessment year 1993-94, 'assets' inter alia include guest house and all residential buildings, urban land, motor cars other than those used in the business of running them on hire or as stock in trade. As regards urban land it means land situated in any area which is within the jurisdiction of a municipality or cantonment board and which has a population of not less than ten thousand but does not include any unused land held by the assessee for industrial purposes for a period of two years from the date of acquisition by him.

5.6.2 The assessing officers did not include such taxable assets in **11 cases** in Assam, Jharkhand, Karnataka, Kerala, Maharashtra, Tamil Nadu and West Bengal charges resulting in short levy of tax aggregating **Rs. 48.10 lakh**. **Two cases** involving revenue impact of more than Rs. five lakh but less than Rs. 10 lakh each are indicated in **Appendix 18** at **serial number 1 to 2**. **One case** involving revenue impact of Rs. 19.34 lakh is illustrated below:

5.6.3 In Tamil Nadu, Chennai I charge, the assessment of a company **M/s Tamil Nadu Newsprint and Papers Ltd.** for the assessment year 1999-2000 was completed after scrutiny in January 2002 followed by a revision in June 2002 on a

taxable wealth of Rs. 12.49 crore. Further, the wealth tax return for the assessment years 2001-02 and 2002-03 were processed in a summary manner in March 2003 on a taxable wealth of Rs. 6.34 crore and Rs. 58 lakh respectively. Audit scrutiny revealed that the assessee company was in possession of industrial land since December 1996 at Ambattur, Chennai which was valued at Rs. 5.66 crore, Rs. 6.71 crore and Rs. 6.97 crore as on the relevant valuation dates for three assessment years respectively. As the land remained vacant for more than two years the value of urban land should be treated as wealth for the purpose of wealth tax. The omission to do so resulted in wealth of Rs. 19.34 crore escaping assessment with consequential revenue impact of Rs. 19.34 lakh.

5.7 Non correlation of assessment records

Wealth not assessed due to non-correlation of records of different direct taxes

5.7.1 The Board has issued instructions (November 1973, April 1979 and September 1984) to the assessing officers for ensuring proper co-ordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and wealth tax assessment cases so that there is no evasion of tax.

5.7.2 The net wealth chargeable to tax comprises certain assets specified² under section 2(ea) of the Act subject to adjustment of any debt owed by the assessee in relation to any of the specified assets on the valuation date.

5.7.3 Non correlation of income tax assessment records with the other taxes resulted in non levy of wealth tax aggregating **Rs. 45.84 lakh in 20 cases** in Andhra Pradesh, Himachal Pradesh, Gujarat, Tamil Nadu, Chandigarh (UT) and West Bengal charges. **One case** involving revenue impact of Rs. 16.01 lakh is illustrated below:

5.7.4 In Tamil Nadu, Coimbatore I charge, the income tax assessment of a company **M/s The Nanco Rubber and Plastic Ltd.**, for the assessment year 2002-03 was completed after scrutiny in November 2004 determining a loss of Rs. 29.48 lakh. Audit scrutiny revealed that the assessee was in possession of a piece of land which was valued at Rs. 5.75 crore by an approved valuer as shown

² The specified assets include following items :

- ◆ Any building or land appurtenant thereto whether used for residential purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty-five kilometers from local limits of any Municipality or a Cantonment Board,
- ◆ Motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade),
- ◆ Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals,
- ◆ Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes),
- ◆ Urban land and
- ◆ Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

in schedule of fixed assets enclosed to the annual accounts. However, neither did the assessee file its Wealth Tax return nor the department initiate any action to assess the wealth tax. This resulted in net wealth of Rs. 5.60 crore escaping assessment with consequent short levy of tax of Rs. 16.01 lakh (including interest).

5.8 Mistakes in levy of interest

Non/short levy of interest

5.8.1 The Wealth Tax Act, 1957, provides that where return of net wealth for any assessment year is furnished after the specified due date or is not furnished, the assessee shall be liable to pay simple interest at the rate of one percent (two percent upto May 1999, one and one-half percent upto May 2001 and one and one-fourth percent upto 7 September 2003) for every month or part of the month from the date immediately following the due date to the date of filing the return or where no return is furnished, to the date of completion of regular assessment on the amount of tax determined in regular assessment.

5.8.2 Demand of tax should be paid by an assessee within the time specified in the Act. Failure to do so would attract interest at the rate of one percent for every month or a part thereof from the date of default till the actual date of payment of demand. Interest for belated payment of tax was required to be calculated and charged within a week of the date of final payment of tax demand.

5.8.3 The assessing officers did not comply with the above provisions or applied them incorrectly resulting in short levy of interest aggregating **Rs. 1.55 crore** in **six** cases in Delhi, Maharashtra and Tamil Nadu charges. **One case** involving revenue impact of Rs. 5.81 lakh is indicated in **Appendix 18** at **serial number 3**. **Two cases** involving revenue impact of Rs. 1.44 crore are discussed below:

5.8.4 In Delhi, CIT I charge, the wealth tax assessments of a company, **M/s A.B. Hotels Limited** for the assessment year 1997-98 and 1998-99 were completed after scrutiny in March 2005. Audit scrutiny revealed that the interest for non-filing of return was levied at Rs. 21.32 lakh instead of the correct amount of Rs. 1.49 crore. This mistake resulted in short levy of interest of Rs. 1.28 crore.

5.8.5 Ministry have accepted the audit observation.

5.8.6 In Maharashtra, Mumbai CIT Central III charge, the assessments of a company **M/s Mars Hotel and Resort Pvt. Ltd**, for the assessment years 1998-99 to 2002-03 were completed in March 2005 on best judgment basis. Audit scrutiny revealed that the assessee did not file the wealth tax returns even after issue of notice by the department. Audit further noticed that the department levied the interest under section 17 B from 1 May 2004 i.e. one month after the date of issue of notice as against the applicable due date of 1 November of the respective assessment years. This resulted in short levy of interest of Rs. 15.41 lakh.

5.9 Application of incorrect rate of tax

Mistakes in application of rates of tax

5.9.1 The Wealth Tax Act, 1957, provides that wealth tax, in respect of the net wealth on the corresponding valuation date of every year, on individual, Hindu undivided family and company shall be charged at the rate of one percent of the amount by which the net wealth exceeds fifteen lakh rupees.

5.9.2 The assessing officers did not comply with the above provisions or applied them incorrectly resulting in short levy of tax of **Rs. 1.34 lakh** in **one** case in Tamil Nadu.

B-Interest Tax

General

5.10 The Finance Act, 2000 abolished the Interest Tax Act, 1974 with effect from 1 April 2000. Interest tax is, therefore, not chargeable in respect of any chargeable interest accruing or arising after 31 March 2000. No budget estimate for revenues from interest tax has been made from the financial year 2000-01. However, pending interest tax assessments needed to be completed without delay.

Results of audit

5.11 During the test check of assessments completed under the Interest Tax Act, 1974, conducted between 1 April 2005 and 31 March 2006, audit noticed short levy of interest tax of Rs. 2.93 crore in 15 cases.

5.12 Audit issued 14 draft paragraphs involving revenue impact of Rs. 2.52 crore from May 2006 to October 2006 to the Ministry of Finance for comments. Internal audit of the department had seen only four of these cases but did not notice the mistake.

5.13 All the 14 draft paragraphs issued to Ministry have been included in this chapter. Each paragraph indicates a particular category of mistake and starts with a suitable preamble followed by combined/consolidated revenue impact of all the observations of similar nature. Cases with money value of more than Rs. 10 lakh are illustrated and those with money value of Rs. five lakh or more but less than Rs. 10 lakh each, are given in tabular form in **Appendix 18**.

Status of replies received from Ministry of Finance

5.14 Out of 14 cases included in this chapter, the Ministry of Finance accepted the audit observations in 10 cases involving revenue impact of Rs. 61 lakh. In the remaining four cases, replies are awaited. Replies of the Ministry have been examined and suitably incorporated wherever necessary.

5.15 Mistakes in assessment of chargeable interest

Mistakes in assessment/ under assessment of chargeable interest

5.15.1 The Interest Tax Act, 1974, provides that credit institutions including banking company/public financial institution were chargeable to interest tax on their interest income from assessment year 1992-93 till assessment year 2001-02. Interest income chargeable to tax included interest on loans and advances, commitment charges on unutilised portion of any credit sanctioned and discount on promissory notes and bills of exchange. The return of chargeable interest was required to be filed by 31 December of the relevant assessment year.

5.15.2 The interest tax payable by the credit institution for any assessment year shall be deducted from income under the respective heads assessable for that assessment year. No such deduction was admissible from the interest income chargeable under the Interest Tax Act.

5.15.3 The Board issued instructions in 1995 clarifying that interest tax was to be levied on interest on debentures, bonds and securities etc.

5.15.4 Interest Tax Act did not permit setting off of interest receipt against interest payable.

5.15.5 The assessing officers did not apply the above provisions correctly resulting in short levy of interest tax aggregating **Rs. 2.24 crore** in **four cases** in Maharashtra and Tamil Nadu. **Three cases** involving revenue impact of more than Rs. 10 lakh are discussed below:

5.15.6 In Maharashtra, Mumbai City II charge, the interest tax assessment of a banking company, **M/s Bank of India** for the assessment year 2000-01 was completed in March 2003. Audit scrutiny revealed that the assessee had income of Rs. 28.91 crore from finance lease which was chargeable to interest tax. However, the said amount of finance lease was not considered for interest tax computation. Further, the assessing officer restricted the assessee's claim for bad debt to Rs. 250.02 crore as against the claim of Rs. 372.71 crore in the income tax assessment for the year 2000-01. In the interest tax computation, the assessee claimed the proportionate interest element of those debts, being bad, as deduction. Since the quantum of deduction of bad debt was reduced in income tax assessment, the claim of proportionate interest on the disallowed part of bad debt was also required to be disallowed in the interest tax assessment. The allowable bad debt element for the purpose of interest tax assessment worked out to Rs. 34.11 crore against which assessee claimed and was allowed bad debt of Rs. 50.84 crore. The above omissions resulted in total underassessment of taxable interest of Rs. 45.64 crore involving short levy of interest tax of Rs. 1.19 crore including interest.

5.15.7 In Maharashtra, Mumbai City III charge, the interest tax assessment of a company, **M/s ICICI Bank** for the assessment year 1997-98 was completed after

scrutiny in March 2005 determining a chargeable interest of Rs. 123.92 crore. The said assessment was earlier rectified in July 2001 determining chargeable interest at Rs. 109.13 crore and further rectified in April 2002 for a taxable interest of Rs. 115.63 crore. Audit scrutiny revealed that while computing the chargeable interest in the assessment completed in March 2005 the department considered the taxable interest of Rs. 109.13 crore assessed in the assessment order of July 2001 instead of Rs. 115.63 crore assessed as per the assessment order of April 2002. The omission resulted in underassessment of chargeable interest of Rs. 6.49 crore involving short levy of tax of Rs. 67.97 lakh including interest.

5.15.8 In Tamil Nadu, Trichy I charge, the assessment of a company, **M/s Lakshmi Vilas Bank** for assessment year 2000-2001 was completed as best judgment in March 2003 on a chargeable interest of Rs. 132.47 crore. Subsequently, the assessment was revised in October 2003 determining a chargeable interest of Rs. 112.28 crore. Audit scrutiny revealed that the assessee had deducted a sum of Rs. 9.54 crore being interest paid to a financial institution towards refinance, from the chargeable interest. As per Act, such interest towards refinance was not an allowable deduction from the chargeable interest. The incorrect allowance of deduction of Rs. 9.54 crore had resulted in underassessment of chargeable interest to that extent with revenue impact of Rs. 32.82 lakh.

5.15.9 Ministry have accepted the audit observation.

5.16 Incorrect application of rate of tax

Mistakes in applying correct rate of tax

5.16.1 The Interest Tax Act, 1974, provides that interest tax was leviable at three percent from assessment year 1992-93 to 1997-98 and at two percent thereafter, on the chargeable interest income of credit institutions.

5.16.2 The assessing officers did not apply correct rate of tax leading to short levy of tax of **Rs. 7.02 lakh** in **two cases** in Tamil Nadu.

5.17 Non correlation of records

Chargeable interest not assessed due to non-correlation of records of different direct taxes

5.17.1 The Board issued instructions (November 1973, April 1979 and September 1984) for ensuring proper co-ordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and different direct tax assessments viz., wealth tax, gift tax, interest tax etc., so that there was no evasion of tax.

5.17.2 The Board clarified in March 1996 that 'finance' charges accruing or arising to hire purchase finance companies are in the nature of interest chargeable to interest tax. The Board had further clarified in 1998 that if the transactions are in substance in the nature of financing transactions, hire charges should be treated as interest subject to interest tax.

5.17.3 The assessing officers did not comply with the instructions of the Board resulting in non-levy of tax totalling **Rs. 10.13 lakh** in **three cases** in Karnataka, Maharashtra, and Rajasthan. **One case** involving revenue impact of more than Rs. five lakh but less than Rs. 10 lakh is indicated in **Appendix 18** at **serial number 4**.

5.18 Mistakes in levy of interest

**Non/short levy
of interest**

5.18.1 The Interest Tax Act, 1974, provides that interest for default and deficiency in interest tax payments in advance, delays in paying demand raised and defaults/delays in filing return are leviable in the same manner and at the same rates as for the defaults of similar nature under the Income Tax Act.

5.18.2 Incorrect application of the above provisions resulted in non levy and short levy, totalling **Rs. 11.86 lakh** in **five cases** in Rajasthan. and Tamil Nadu. **One case** with money value of more than Rs. five lakh but less than Rs. 10 lakh is indicated in **Appendix 18** at **serial number 5**.

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Dated:

(SUDHA KRISHNAN)

**Principal Director of Receipt Audit
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Countersigned

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Dated:

(VIJAYENDRA N. KAUL)

Comptroller and Auditor General of India