

## Highlights

In this review, 246 TDS units, 174 regular assessment units and 15 international taxation units were audited and 32630 cases test-checked. Audit noticed mistakes in 12814 cases involving revenue impact of Rs. 389.20 crore; of this penalty leviable was Rs. 63.23 crore. Cases relating to income escaping assessment, non/short deduction of TDS, involving possible revenue loss was of Rs. 52.90 crore. This was also inclusive of mistakes noticed in 82 cases of non-residents/foreign companies involving revenue impact of Rs. 204.19 crore.

In spite of the increase registered in the number of transactions that are covered under the TDS scheme and the overall growth in the economy, there had been a decline in the number of effective tax deductors over the years.

**(Para 2.9.1.4)**

Data collected by audit indicated large potential for TDS and TCS from insurance commission, reinsurance commission, payments to non-residents and sale of liquor.

**(Para 2.9.3 & 2.14.1)**

Mistakes relating to tax deduction at lower rates from income of non-residents by way of royalty and fees for technical services owing to incorrect determination of PE were noticed in nine cases involving a revenue impact of Rs. 58.97 crore.

**(Para 2.10.1)**

Failure to disallow expenditure in cases of non deduction of TDS in respect of payment made to NRI/foreign companies were noticed in 19 cases involving revenue impact of Rs. 93.13 crore.

**(Para 2.10.2)**

Audit noticed mistakes in 72 cases wherein income of Rs. 39.79 crore on which TDS had been deducted escaped assessment involving revenue loss of Rs. 14.97 crore.

**(Para 2.11.1)**

Mistakes relating to non/short deduction of TDS were noticed in 273 cases involving possible revenue impact of Rs. 77.04 crore including interest and penalty.

**(Para 2.11.2)**

Failure to remit TDS into government account in 34 cases indicated possible loss of revenue of Rs. 6.92 crore.

**(Para 2.11.3)**

Failure to disallow the expenditure on which tax had not been deducted or after deduction was not paid into Government account during the previous year within time prescribed was noticed in 332 cases involving revenue impact of Rs. 45.45 crore.

**(Para 2.11.5)**

10549 cases of late filing of returns were noticed with delays ranging from 1 day to 1406 days and the penalty leviable in these cases was Rs. 5.54 crore.

**(Para 2.11.7)**

TDS credits held in suspense showed an increasing trend over the period 2002-03 (Rs.799.37 crore) to 2005-06 (Rs.10011.49 crore) in 5 states.

**(Para 2.12.2)**

Review of e-TDS indicated that e-TDS returns filed remained unprocessed for the past three years largely due to software related problems and inadequacy of trained manpower. There was also no proper system for preservation and storage of records in magnetic media.

**(Para 2.13)**

Audit noticed mistakes relating to omission to collect tax at source in 16 cases involving a revenue impact of Rs. 3.90 crore.

**(Para 2.14.3)**

**Audit recommends that**

- Ministry may take necessary steps to bring in all tax deductors into the tax net and enforce recovery of TDS/TCS as required under the Act.
- Adequate enforcement mechanism be evolved to ensure consistency in assessment and prevent loss of revenue, particularly in the important area of international taxation. Coordination between TDS and regular assessment units as also internal audit mechanism should be strengthened.
- Problems relating to software and inadequacy in trained manpower are attended to urgently so that e-TDS returns are processed and revenues due to Government realised. Further, arrangements for ensuring storage and preservation of records in magnetic medium need to be ensured.
- A time limit for completion of TDS/TCS assessments may be prescribed so as to ensure early realisation of any revenues due to Government

## Review on implementation of TDS/TCS schemes

### 2.1 Introduction

Mobilisation of resources in direct taxes is carried out through levy of taxes mainly at two levels viz. pre-assessment and post assessment. Pre-assessment collections form a major portion of revenue collection in several countries as it is relatively easy to administer, cost effective, and reduces pressure on the revenue authorities as the onus for collection and deposit of taxes shifts to the persons responsible (tax deductors) for effecting payments. Post assessment collections on the other hand, requires the deployment of more resources on the part of revenue administration.

**2.1.1** Direct taxes collected prior to assessment may be classified as follows:

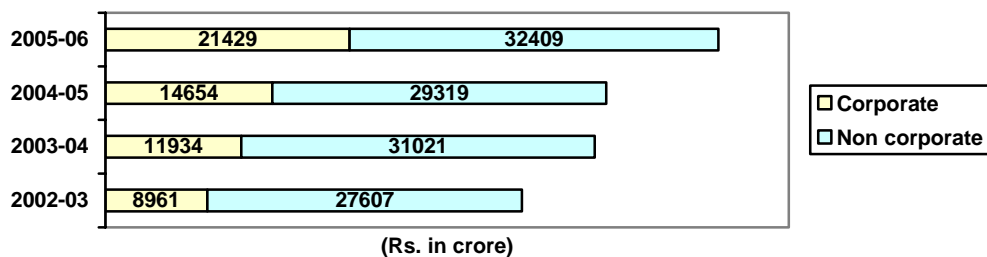
- (i) Tax deducted at source (TDS)
- (ii) Tax collected at source (TCS)
- (iii) Advance tax
- (iv) Self assessment tax

**2.1.2** TDS, also referred to as ‘withholding tax’ in the case of transactions involving non residents, gives the government the whole or part of the tax on the taxable income earned by an assessee even before the relevant income is received by him. Tax collection at source is resorted to where there is an identified risk of incomes liable to tax escaping assessment as also the non viability of collection of tax at the end due to large numbers such as in the case of liquor sales and forest produce.

### 2.2 Trends in tax deduction at source

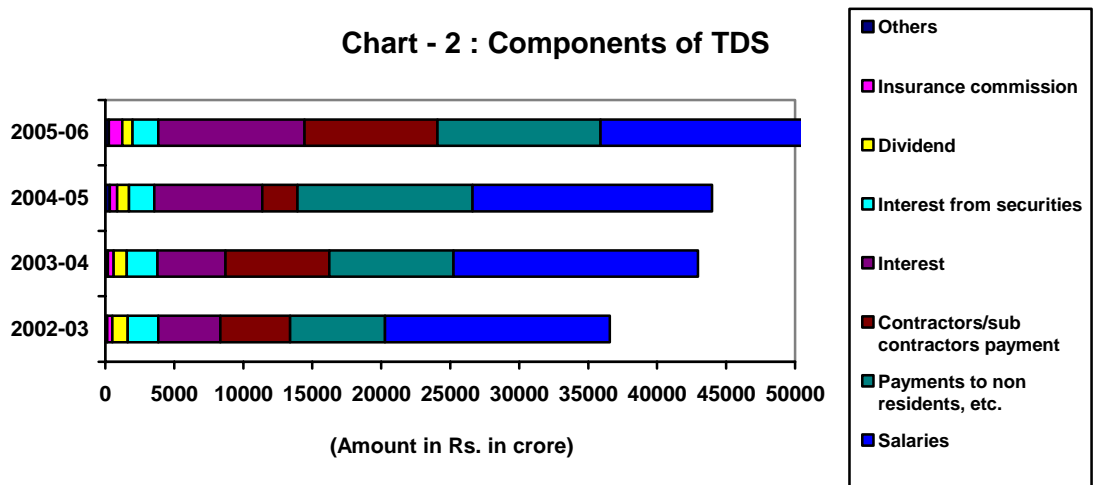
**2.2.1** Pre-assessment collection (2005-06) of direct taxes in India comprises 83 percent of the total direct tax collections, of which approximately 33 percent comes from TDS. TDS is the predominant mode of revenue realisation in respect of non corporate assessees, comprising almost 52 percent of their tax payments. Trends of tax deducted at source from corporate and non corporate assessees are indicated in Chart-1 below<sup>^</sup>.

**Chart - 1 : Tax deducted at source**



<sup>^</sup> Chapter II of Audit Reports on Direct taxes of the relevant years

**2.2.2** A study of the components and growth of TDS during the past four years shows a mixed trend as detailed in Chart-2.



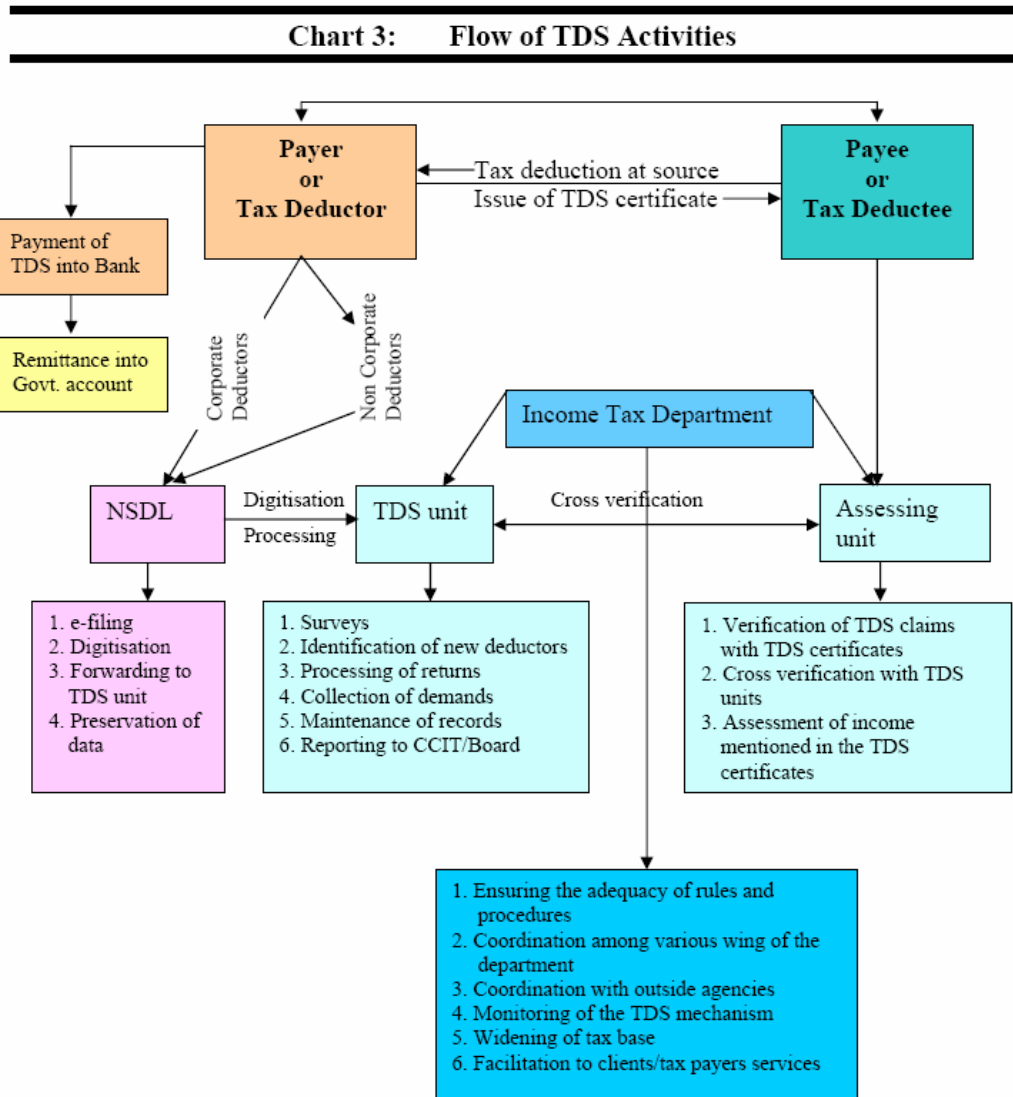
**2.2.3** During the period 2002-03 to 2005-06, major components of TDS were from salaries, payments to non residents, interest and payments to contractors and sub-contractors. These sources together contributed about 92 percent of total TDS collections.

(Rs. in crore)

	2002-03	2003-04	2004-05	2005-06
Salaries	16293	17712	17341	17941
Payments to non residents, etc.	6884	8996	12711	11834
Contractors/sub contractors payment	5056	7543	2535	9638
Interest	4485	4930	7833	10585
Interest from securities	2232	2214	1849	1871
Dividend	1098	950	852	752
Insurance commission	384	434	523	967
Others	136	176	329	250
<b>Total TDS collected</b>	<b>36568</b>	<b>42955</b>	<b>43973</b>	<b>53838</b>

## 2.3 Organisational set up and functions

**2.3.1** There is a dedicated set up in the ITD for administering TDS comprising of a CCIT supported by CsIT/Addl.CsIT/JCsIT/DCsIT/ACsIT/ITOs. The functions of TDS units include identifying new tax deductors through surveys, creation of database, identification of stop filers/non filers, allotment of TAN, ensuring prompt collections and remittances, processing of returns, coordination with assessing units etc. At the CBDT, Member (Revenue) monitors and coordinates the administration and implementation of TDS provisions. The flow of TDS activities in detail is as follows:



**2.3.2** In respect of non residents there is a Director General of International Taxation at New Delhi whose jurisdiction extends over the Director of Income Tax (International Taxation) located at New Delhi, Mumbai, Kolkata, Chennai, Bangalore and Hyderabad. All tax assessments including matters relating to TDS are processed by these officers. In other places the jurisdictional CCsIT exercise jurisdiction over non resident taxation matters.

**2.3.3** Director General of Income Tax (Systems) is in-charge of computerisation in the Department which includes acquisition of hardware and software apart from programme implementation, delivery and support to field formations. In so far as the TDS mechanism (including e-TDS/e-TCS) is concerned their functions include troubleshooting, facilitation and change management.

## 2.4 Law and procedure

Detailed procedure in regard to TDS and TCS is laid down in Chapter XVII – Collection and recovery of the Income Tax Act, 1961. Other related provisions include section 40(a)(i), 40(a)(ia), 44D, 90, 92, 115A and 195. No time limit has been prescribed under the Act for processing of TDS/TCS returns.

## 2.5 Objectives of the review

The following specific issues were examined in audit to verify:

- the extent of identification of potential deductors/activities liable to TDS/TCS;
- the application of the provisions of the Act relating to TDS/TCS with regard to both non residents and residents;
- the correctness of accounting procedures in TDS/TCS; and
- the implementation of e-TDS scheme.

## 2.6 Past study

The scheme of TDS was last reviewed in audit and reported in Chapter 3 of Report No. 12 of 1999 in respect of the implementation of the newly introduced sections 194C and 194E. The review revealed failures relating to non deduction of tax at source from payments to contractors/sub contractors and non resident sportsmen/sports associations involving revenue impact of Rs. 164.24 crore.

## 2.7 Audit methodology

### 2.7.1 Scope and coverage of the review

In the current study, records at both TDS units and assessment units were test checked. Records scrutinised included returns (both TDS and income tax returns), assessment records and related registers maintained in 246 TDS units, 174 assessment units and 15 international taxation units relating to the period 2002-03 to 2005-06.

### 2.7.2 Sample Size

The selection of TDS units for review was as per the criteria given below:

Sl. No.	Jurisdiction	No. of CIT charges selected (in percent)	No. of units to be selected*	Coverage (Percent)
1.	4 Metros, Karnataka and Gujarat	25	TDS Circle	100
			TDS Wards	50
2.	Other	30	TDS Circles	100
			TDS Wards	50

\* In selected unit sample size consisted of TDS/TCS returns of more than Rs.10 lakh (100 percent) and less than Rs.10 lakh (10 percent) subject to a minimum of 100 returns

## 2.8 Exit conference

An exit conference was held on 5 January 2007 wherein the audit findings and recommendations were discussed with the concerned officers in the Ministry. Ministry agreed to examine the issues raised in the audit study.

## 2.9 Audit findings

### Section A Identification of potential deductors/activities liable to TDS

Audit sought to examine the adequacy of the procedures in the Department for ensuring compliance by existing tax deductors as also to bring in new entities into the tax net. The result of audit examination is detailed below:

#### 2.9.1 Identification and registration of tax deductors

**2.9.1.1** With a view to identifying potential tax deductors within the ambit of the TDS/TCS scheme, audit independently attempted to estimate activities/entities who should have been registered as tax deductors. The data was compiled covering colleges, public sector undertakings, local bodies, cooperative societies, banks and other financial institutions, treasury officers, drawing and disbursing officers, etc. from generally available sources in the public domain including websites of statutory organisations (RBI, UGC, etc), yellow pages and economic surveys. Audit also collected data on the number of tax deductors available on the records of the Department from the various jurisdictions.

**2.9.1.2** In **Assam, Delhi, Gujarat, Goa, Kerala, Maharashtra, Punjab, Chandigarh (UT), Rajasthan and West Bengal** it was observed that there was a large gap in the number of tax deductors on the records of the Department as compared to those liable to be registered. As against 1.10 lakh\* deductors indicated by the Department, the audit exercise revealed potential for registering about 15 lakh tax deductors (**Appendix 5**).

**2.9.1.3** Further, audit compiled data on the number of tax deductors as available in the progress report of the Income Tax Department at the beginning and end of the year which is given in Table 3 below:

<b>Year</b>	<b>No. of tax deductors as on 1 April</b>	<b>No. of tax deductors as on 31 March</b>
2002-03	1026739	1101830
2003-04	653538	626055
2004-05	626055	577131
2005-06	577131	460277

\* Except **Andhra Pradesh, Chandigarh (UT) and Delhi** where the Department did not produce records

<sup>¥</sup> Source: Progress report of the Income Tax Department by Directorate of Research and Statistics

**2.9.1.4** The figures indicated that in spite of the increase registered in the number of transactions covered under the TDS scheme and the overall growth in the economy, there has been a decline in the number of effective tax deductors over the years. The number of deductors as on 31 March 2006 was 55 percent lower than as on 1 April 2002.

Ministry during exit conference while agreeing to examine the issue stated that the TAN database is being updated and cleaning of TAN master is under process to take care of redundant TAN.

## **2.9.2 Surveys by TDS units**

In order to ensure that all entities that are liable to deduct or collect tax at source are brought on the records of the Department, TDS units are required to examine the income tax assessments, connected records and conduct surveys. Survey reports prepared thereafter by the TDS units need to be followed up for compliance from the defaulters. This protocol needs to be proactive not only to identify new tax deductors/collectors but also to ensure the correctness and completeness of the returns filed by the existing tax deductors.

Audit scrutiny of records maintained in 246 TDS units indicated that in **Jharkhand, Assam and Orissa** no surveys had been carried out. In **Uttar Pradesh (Meerut charge)** surveys had been carried out but survey reports had not been finalised (June 2006) even after a lapse of 2 years. In **Madhya Pradesh (Bhopal and Indore charges)** audit could not derive an assurance that surveys had been carried out as the relevant records were not made available.

## **2.9.3 Identifying activities liable for deducting tax at source**

### **2.9.3.1 Deduction of tax at source from insurance business**

Audit sought to examine the adequacy of tax deducted at source in one growing sector viz., the insurance sector. There are 29 companies (8 public sector and 21 private sector) involved in insurance activities (14 life, 14 non life and 1 reinsurance)\*. Payments, commissions, rewards, etc for soliciting or processing insurance business (including for continuance, renewal or revival of policies), are liable for deduction of tax at source.

Data collected by audit indicates the potential for revenue collection (i.e. deduction of tax at source) of Rs. 1118.28 crore from regular insurance commission vis-à-vis the amount actually collected as brought out in Table 4 below:

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\* Annual Report 2004-05 of Insurance Regulatory and Development Authority (IRDA)



(Rs in crore)

SI No	Particulars	2001-02	2002-03	2003-04	2004-05
<b>1.</b>	<b>Commission payment by life insurers*</b>				
	Public Sector (LIC)	4519.32	5015.08	5742.92	6203.23
	Private Sector	49.09	153.03	415.42	854.73
<b>2</b>	<b>Commission payment by non life insurers*</b>				
	Public Sector	657.42	935.71	1092.29	1233.20
	Private Sector	5.92	42.56	109.65	228.20
	<b>Total</b>	<b>5231.75</b>	<b>6146.38</b>	<b>7360.28</b>	<b>8519.36</b>
3	Rate of TDS under section 194D (including surcharge)	10.2%	10.2%	10.2%	10.2%
<b>4</b>	<b>Tax deductible at source</b>	<b>533.64</b>	<b>626.93</b>	<b>750.74</b>	<b>868.97</b>
<b>5</b>	<b>Tax deducted by the Department<sup>#</sup></b>	<b>321</b>	<b>384</b>	<b>434</b>	<b>523</b>
<b>6</b>	<b>Revenue gap</b>	<b>212.64</b>	<b>242.93</b>	<b>316.74</b>	<b>345.97</b>

\* Annual Reports of Insurance Regulatory and Development Authority (IRDA)  
# Chapter II of Audit Reports on Direct taxes of the relevant years

### 2.9.3.2 Deduction of tax at source on reinsurance commission charges

Payments made towards reinsurance commission by insurance companies are liable for TDS as the payment is in the nature of commission. Audit scrutiny of annual reports of five insurance companies revealed that these companies in **Chennai, Delhi, Kolkata and Mumbai** had made payment towards reinsurance commission of Rs. 6189.66 crore during the period from 2001-02 to 2004-05 on which no tax had been deducted at source by the payers. The potential for revenue collection (i.e. deduction of tax at source) in this transaction worked out to Rs. 631.34 crore apart from applicable interest and penalty (Table 5):

(Rs in crore)

SI No	Particulars	2001-02	2002-03	2003-04	2004-05
1	General Insurance Corporation of India Ltd.	836.38	959.56	1116.82	1274.31
2	National Insurance Company Ltd.	69.72	27.55	25.87	19.31
3	The New India Assurance Co Ltd.	386.72	480.86	58.49	595.25
4	The Oriental Insurance Co Ltd.	76.65	36.47	33.53	28.35
5	United India Insurance Co Ltd.	74.84	39.05	35	14.93
<b>6</b>	<b>Total commission paid</b>	<b>1444.31</b>	<b>1543.49</b>	<b>1269.71</b>	<b>1932.15</b>
7	Rate of TDS under section 194D (including surcharge)	10.2%	10.2%	10.2%	10.2%
<b>8</b>	<b>Tax deductible at source</b>	<b>147.32</b>	<b>157.43</b>	<b>129.51</b>	<b>197.08</b>

\* Annual Reports of the concerned companies for the relevant years

On this being pointed out in audit in **Maharashtra, Mumbai charge**, in the case of **General Insurance Corporation of India Ltd**, the Department took remedial action and raised a demand of Rs. 466.77 crore (including interest) for the assessment years 2004-05 to 2006-07 (October 2006).

**2.9.3.3** Similarly, the above companies had also received payments towards reinsurance commission which is also liable for TDS as the payment is in the nature of commission. Audit study of annual reports of five insurance companies revealed that these companies in **Chennai, Delhi, Kolkata and Mumbai** had received reinsurance commission of Rs. 2820.47 crore during the period from 2001-02 to 2004-05 on which no tax had been deducted at source by the payers. The potential for revenue collection (i.e. deduction of tax at source) in this transaction worked out to Rs. 399.25 crore.

Ministry during exit conference agreed to examine the issue.

**2.9.3.4 Deduction of tax at source from payments to non-residents**

The quantum of outflows or payments to residents abroad on account of payments such as salaries, commission, royalties, dividends etc. which are liable for tax deduction at source subject to the conditions specified in the Act indicates the potential for revenue collection in this area (i.e. deduction of tax at source) as brought out in the following Table 6 :

(Rs. in crore)

<b>Table 6 Payments to non-residents</b>				
<b>Sl. No.</b>	<b>Particulars</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
1.	Total (Services*, transfers <sup>\$</sup> and income <sup>&amp;</sup> )	122574	120575	184222
2.	Rate of TDS (considered at lowest slab)	15%	15%	15%
<b>3.</b>	<b>Tax deductible at source</b>	<b>18386.10</b>	<b>18086.25</b>	<b>27633.30</b>
<b>4.</b>	<b>Tax deducted as per Department<sup>#</sup></b>	<b>6884</b>	<b>8996</b>	<b>12711</b>
<b>5.</b>	<b>Revenue gap</b>	<b>11502.10</b>	<b>9090.25</b>	<b>14922.30</b>
<i>Source: RBI -INDIA'S OVERALL BALANCE OF PAYMENTS IN RUPEES</i> <i>* Software services, business services, financial services and communication services</i> <i>\$ Official, Private</i> <i>&amp; Investment income and compensation of employees</i> <i># Chapter II of Audit Reports on direct taxes of the relevant years</i>				

Ministry during exit conference agreed to examine the issue.

**2.9.3.5 Deduction of tax at source from fee for technical services (194 J)**

Any person making payment to a resident by way of fees for professional services or technical services is required to deduct tax @ five percent of such sum, at source along with surcharge and education cess wherever applicable.

The Reserve Bank of India had authorised setting up of 43 centres to be managed by 13 public sector banks\* for providing cheque clearing facility. Customer banks availing of these services were to pay magnetic ink character recognition (MICR) charges at the prescribed rates fixed by RBI and to deduct tax at source from these payments.

\* Andhra Bank, Bank of Baroda, Bank of India, Canara Bank, Central Bank of India, Corporation Bank, Oriental Bank of Commerce, Punjab National Bank, State Bank of India, State Bank of Indore, State Bank of Travancore, State Bank of Hyderabad and Union Bank of India

In Gujarat, Orissa, Uttar Pradesh and Chandigarh (UT), State Bank of India (SBI), Bank of Baroda (BoB) and Punjab National Bank (PNB) had been authorised to run MICR centres. Test check by audit revealed that customer banks were paying MICR charges to SBI, BoB and PNB without deducting tax at source in 227 cases (221 cases in Gujarat, one case in Orissa, four cases in Uttar Pradesh and one case in Chandigarh) involving revenue impact of Rs. 5.46 crore of which two cases are given below.

(Rs. in lakh)

**Table 7 MICR**

Sl. No	State	Name of the Bank	Tax due	Interest due	Penalty leviable	Revenue impact
1.	Uttar Pradesh	Punjab National Bank	79.59	20.79	79.59	179.97
2.	Gujarat	Bank of Baroda	5.28	0.94	5.28	11.50

On this being pointed out in audit, Department agreed to take necessary action in Gujarat (and recovered Rs. 3.16 lakh in Vadodara) and Chandigarh (UT).

## **Section B Application of TDS provisions : Non residents**

### **2.10 Domestic and Treaty Law**

Two main principles underlie the basis of taxation of non residents' viz. the source and residence principle. Under the source principle, a country taxes all income earned from sources within its territorial jurisdiction whereas under the residence principle, a country taxes the world wide income of persons residing within its territorial jurisdiction. India combines both the source and residence principle for taxing incomes/payments made out of India. Determination of existence or otherwise of a permanent establishment (PE) decides the applicability and leviability of tax. Where there is a regular PE in India, then the non resident is expected to file a return on incomes derived on account of activities in India. Lower rates of taxation available under Double Taxation Avoidance Agreement (DTAA) are applicable only when royalty and fees for technical services are earned other than through a PE. In other cases, taxes are deducted at source, which in the case of payments to non residents is termed as withholding tax. To safeguard against non deduction of tax, expenditure on payments made to non residents without deducting tax at source is disallowed in the assessment of the assessee (payer).

DTAAs also provide for assistance for recovery of taxes due from non residents who have left India. However, such clauses for assistance in recovery of taxes are not available in DTAAs with some countries such as USA, Australia and Singapore. Hence, there is a risk of loss of revenue to the Government in case TDS is not effected upfront at the time of making payments to non residents. Audit sought to examine the adequacy of the controls in place not only for enforcing TDS on payments to non residents but also the disallowance of expenditure where such taxes had not been deducted so as to safeguard the interests of revenue.

Audit scrutiny of records to verify the applications of TDS and related provisions revealed mistakes relating to short deduction of tax at source owing to ambiguities in determination of income relating to permanent establishment, failure to disallow expenditure (payments made to non residents) on which tax has not been deducted at source, etc. in **82 cases** involving a revenue impact of **Rs. 209.21 crore** of which penalty was **Rs. 5.02 crore**.

#### **2.10.1 Ambiguities in determination of income relating to permanent establishment resulting in short deduction of tax at source**

The definition of the term “permanent establishment (PE)” is critical in fixing the tax rates applicable to an assessee. Though the term “PE” ordinarily denotes a place of business or management, it also includes other activities such as facilities, installations, and oil wells etc. The existence of PE depends on a range of criteria which inter alia include period of stay, nature of activities and nature of contract. Whereas incomes attributable to PEs are taxable at higher rates, lower rates are applicable to cases where no PE exists.

In **Delhi DIT (IT) charge**, audit scrutiny of **nine cases** revealed mistakes relating to tax deduction at lower rates from income of non-residents by way of royalty and fees for technical services owing to incorrect determination of PE involving a revenue impact of **Rs. 58.97 crore**. **Two cases** involving revenue impact of more than Rs. five crore are illustrated below while **four cases** involving revenue impact between Rs. 50 lakh and Rs. five crore are indicated in Table 8 and cases less than Rs. 50 lakh have been shown in **Appendix 6**.

**2.10.1.1** The assessment of a company, M/s Ericsson AB (based in Sweden), for the assessment year 2002-03 was completed after scrutiny in March 2005 wherein the assessing officer held that the assessee has permanent establishment in India by way of fixed place of business. Income arising to the assessee in India from royalty and technical fee was charged to tax at ten percent. Audit scrutiny of the DTAA between India and Sweden revealed that where an assessee is earning royalty or technical fee through a permanent establishment situated in other State, such income is taxable as business income in accordance with the domestic provisions of the State of source. Hence the income from royalty and technical fee was to be charged at the rate of thirty percent under section 115A (as the agreement for the instant transaction was entered into after July 1996) and not ten percent as done by the assessing officer. Failure to do so resulted in short levy of tax of Rs. 42.72 crore including interest.

**2.10.1.2** The assessment of a company, M/s Oracle Corporation for the assessment year 2002-03 was completed after scrutiny in March 2005 determining an income of Rs. 103.17 crore. Audit scrutiny revealed that in the assessment order, the assessing officer had held the Indian subsidiary of the assessee as the permanent establishment of the parent foreign company and during the previous year assessee had earned royalty income of Rs. 74.61 crore. This income was charged to tax at

the rate of 15 percent as per provisions of DTAA instead of 20 percent as per the Act. The mistake resulted in short levy of tax of Rs. 5.23 crore including interest.

In its reply the Department stated that in the assessment order the assessing officer had not found royalty income to be effectively connected with the permanent establishment. Reply of the Department is not tenable as in the assessment order the assessing officer has neither discussed this issue, nor specified any reasons as to why the royalty income was not connected to the permanent establishment.

(Rs. in crore)

**Table 8 Ambiguities in determination of income relating to permanent establishment**

Sl No	Name of assessee	Asst Year	Asst. u/s	Nature of mistake	Revenue impact
1	UOPP Inter American Inc	2002-03	143 (3)	TDS affected @ 20 percent instead of 30 percent.	3.56
2	Mc Donalds Corporation	1997-98 to 2001-02	143 (3)	TDS was affected @ 15 percent on income from royalty as against 30 percent applicable for incomes attributable to PE	3.26
3	World Sport Nimbus Pvt Ltd	2002-03	143 (3)	Income from royalty and technical fees taxable @ 15 percent and 20 percent respectively was not effected	2.68
4	Electricite de France	2003-04	143 (3)	TDS was affected @ 10 percent on income from royalty and fee from technical services as against 20 percent applicable for incomes attributable to PE	0.68
<b>Total</b>					<b>10.18</b>

### 2.10.2 Non deduction of tax at source in respect of payment made to non residents – failure to disallow expenditure

Audit scrutiny in **Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu** revealed that payments made to non residents on which tax has not been deducted at source were not disallowed by the assessing officer. Audit noticed mistakes in **19 cases** involving revenue impact of **Rs. 93.13 crore**. **One case** involving a revenue impact of **Rs. 75.68 crore** is illustrated below. **Five cases** involving revenue impact of more than Rs. one crore are indicated in Table 9 while **eight cases** involving revenue impact between Rs. 10 lakh and Rs. one crore are shown in **Appendix 7**.

**2.10.2.1 In DIT (IT) Mumbai charge**, scrutiny of assessment records of an assessee, M/s Ballast Nedam Dredging revealed that for the assessment years 2001-02 and 2002-03, payments of Rs. 111.65 crore and Rs. 46.02 crore had been made to the Indian project office of a foreign company engaged in contract for dredging work on which no tax had been deducted at source. Since the income related to activities in India, these amounts were chargeable to tax in India and hence liable for TDS. Audit scrutiny however revealed that these payments had not been

disallowed in the hands of the assessee for not deducting tax at source. Failure to disallow the expenditure resulted in non levy of tax of Rs. 75.68 crore.

(Rs. in crore)

Sl. No.	CIT Charge	Name of the assessee	AY	Nature of Mistake	Tax Effect
1.	Chennai	India Additives (P) Ltd.	2000-01 & 2001-02	Assessee had paid Rs. 2.65 crore as royalty and Rs. 0.89 crore as fee for technical services without deducting tax at source.	4.22
2	CIT I, Chennai	M/s. Asia net communication Ltd., Chennai	2001-02	A sum of Rs. 7.64 crore was paid to a foreign company as transponder hire charges which are in the nature of technical know-how charges without deducting tax at source.	3.91
3	CIT I, Chennai	M/s. Hanil Lear India (P) Ltd Thiruvellur	2003-04	Expenditure of Rs. 5.18 crore towards technical fee paid to foreign companies was allowed though the chartered accountant has certified in Form 3 CD that TDS has been recovered but was not remitted to Government account during the previous year.	2.27
4.	CIT-III, Chennai	M/s Polaris Software Lab Ltd.	2002-03 and 2003-04	Payment of Rs. 112.08 lakh and Rs. 293.80 lakh respectively were made by the assessee company towards professional charges in foreign currency for which no tax was deducted or paid.	2.04
5	CIT I, Chennai	M/s. Indo National Ltd. Chennai 34	2001-02	The assessee paid Rs. 311.36 lakh towards technical fee to a foreign company and failed to deduct tax at source.	1.11

### 2.10.3 Other observations

Where a person responsible for deducting tax at source fails to deduct it or after deducting fails to pay the amount of tax in the Government account he shall be liable to pay interest for delays in remittance apart from penalty for default.

**2.10.3.1 In DIT (IT), Mumbai charge,** M/s Star Television Entertainment Ltd (STAR), a non-resident assessee, belatedly filed the return for assessment year 2003-04 in August 2004 (as against October 2003) indicating 'nil' income. No TDS certificate had been enclosed to the return. Assessee had contended that the telecasting advertisement revenue received by it was not chargeable to tax in India. However the payer of advertisement charges issued a TDS certificate to the assessee (STAR) in March 2006. Audit scrutiny revealed that instead of holding the assessee to be in default and levying interest for delay in payment of tax, the assessing officer allowed credit for the TDS certificate produced by the assessee and treated it as if tax was deducted and paid in time. This resulted in short levy of interest of Rs. 35.82 crore (u/s 234A and 234B) on STAR apart from levy of interest and penalty (u/s 201A) on the tax deductor for delay in remittance into Government account. The Department accepted the observation and initiated remedial action.

**2.10.3.2 In DIT (IT) Mumbai charge,** audit scrutiny of the records of a company M/s Reliance Industries Ltd., for the year 2002-03 and M/s Reliance Infocomm, Mumbai for the years 2002-03 to 2003-04 revealed that tax of Rs. 2.87 crore and Rs. 1.99 crore had not been deducted at source on payments made to non residents based in USA. This resulted in short collection of Rs. 4.86 crore apart from applicable interest and penalty of Rs. 6.91 crore.

**2.10.3.3 In DIT (IT) Mumbai charge,** M/s Rabo India Finance Pvt. Ltd. had filed TDS return for FY 2002-03 in April 2003 depicting a remittance of Rs. 30.30 lakh as TDS on gross payments of Rs. 1.80 crore. Audit scrutiny of the document (challans) enclosed with the return revealed that assessee had also made a remittance of Rs. 2.78 crore which was not indicated in the TDS return. Department had not initiated any action to verify the unexplained credit or rectify the return filed by the assessee.

**2.10.3.4 In DIT (IT) Mumbai charge** in three cases there were delays ranging from 2 months to 6 months in remittance of tax deducted at source, on which interest of Rs. 46.83 lakh was not levied. On this being pointed out in audit, the Department accepted the audit contention and initiated remedial action.

**2.10.3.5 In Gujarat, CCIT Ahmedabad charge,** audit scrutiny of the records of a company M/s Gujarat State Petroleum Ltd, Gandhinagar revealed that remittances had been made to non resident individuals and companies (as technical fee) without deducting taxes or by applying lower rates of tax. This resulted in short deduction of tax of Rs. 3.28 crore apart from interest of Rs. 39.44 lakh. Department agreed to take remedial action.

**2.10.3.6 In Kerala, Kochi charge** whereas DTAA with Poland, provided for tax rates at 15 percent for dividend and interest and 22.5 percent for royalty and fee for technical services, audit scrutiny of the returns filed by an assessee (M/s Cochin Shipyard Ltd) in Form 27 revealed that TDS had been effected at a lower rate of 4.2 percent as against the lowest applicable rate of 15 percent on the payments made to a non-resident based in Poland. Records made available to audit did not show that the deductor/ deductee had made any application to the assessing officer for deduction at a lower rate or on a lower income. Short deduction of tax worked out to Rs. 13.40 lakh apart from interest of Rs. 5.83 lakh.

**2.10.3.7** Further in the same charge, audit scrutiny revealed that though DTAA rates were in the range of 10-15 percent for payments to non residents based in Singapore, TDS effected on payments to an assessee from June 2002 to September 2003 ranged from 20-27 percent. No reasons were forthcoming from the records as to why different rates of deduction had been applied.

**2.10.3.8 In Kerala, Kochi charge** in 14 cases involving a remittance of Rs. 15.30 crore, the correctness of the rates of TDS could not be verified in audit as residency particulars of the payee were not mentioned by the assessee and the same were also not called for by the Department. Thus audit could not derive an assurance on the correctness of the tax deducted at source.

**2.10.3.9** In **Bangalore, Chennai and Delhi** charges audit noticed that in **six cases** payments had been made to non-residents without deducting tax or had been short deducted involving a revenue impact of **Rs. 1.11 crore** including interest and penalty.

## **2.11 Application of TDS provisions : Resident**

During audit scrutiny of assessment records mistakes relating to income escaping assessment, non/short deduction of tax, allowance of business expenditure, credits allowed without TDS certificates, non/short levy of interest and penalty, failure to remit TDS collections/belated remittances in Government account, non levy of surcharge/education cess and other omissions were noticed in TDS units in **12,673 cases** involving revenue impact of **Rs. 170.81 crore**, of which penalty leviable was **Rs. 55.34 crore**.

### **2.11.1 Income escaping assessment**

A crucial check to be exercised by the assessing officers before allowing credit for TDS certificates is to see whether the corresponding incomes had been offered to tax by the assessee.

In **Andhra Pradesh, Delhi, Jharkhand, Karnataka, Tamil Nadu, Uttar Pradesh and West Bengal charges**, in **72 cases** though tax credit as claimed by the assessee had been allowed in the income tax assessments, assessing officers had not ensured that the corresponding income was offered to tax. Income of **Rs. 39.79 crore** had not been offered to tax with a revenue impact of **Rs. 14.97 crore**. **Four cases** with revenue impact of more than Rs. 50 lakh are indicated in Table 10 while **23 cases** with revenue impact between Rs. 10 lakh and Rs. 50 lakh are shown in **Appendix 8**.

(Rs. in crore)

**Table 10 : Income escaping assessment**

<b>Sl. No.</b>	<b>CIT charge</b>	<b>Name of the assessee</b>	<b>Nature of asst /Asst Year</b>	<b>Amount</b>	<b>Tax effect</b>
1.	CIT-III, Chennai	M/s PSEGPPN Operations (P) Ltd.	2002-03 143(1)	11.96	3.41
	CIT-VIII, Chennai	Streamline Forwarders	2002-03 & 2003-04 143(1)	3.17	1.16
	CIT-I, Chennai	APL Logistics Pvt. Ltd.	2001-02 143(3)	1.20	0.68
2.	CIT Delhi	M/s Lear Seating (P) Ltd	2001-02 143 (3)	2.19	1.33
	CIT Delhi	M/s. Krishna Engineering Works	2003-04 143 (3)	2.12	0.90
3	CIT-Muzaffarnagar	M/s Doaba Rolling Mills Pvt. Ltd.	2004-05 143(1)	2.26	0.89
4	CIT-V Hyderabad	M/s B. Ramachandraiah & Sons	2002-03 143(3)	1.08	0.54
<b>Total</b>				<b>23.98</b>	<b>8.91</b>



### 2.11.2 Non/short deduction of TDS

If any person responsible for deducting tax at source does not deduct the whole or part of the tax or after deducting the tax fails to remit the same into Government account, he shall be deemed to be an assessee in default and subject to penalty which may be the sum equal to the amount of tax which he failed to deduct. Further, he shall also be liable to pay simple interest at the prescribed rates.

During audit scrutiny of records mistakes relating to non/short deduction of TDS were noticed in **273 cases** in **Andhra Pradesh, Assam, Delhi, Gujarat, Goa, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Maharashtra, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttaranchal and West Bengal** involving possible revenue impact of **Rs. 77.04 crore** (of which TDS not effected was **Rs. 37.93 crore**, interest and penalty for not effecting TDS was **Rs. 3.73 crore** and **Rs. 35.38 crore** respectively). **Twenty eight cases** with revenue impact of more than Rs. 10 lakh but less than Rs. one crore have been shown in **Appendix 9**. **Nine cases** with revenue impact of more than Rs. one crore are indicated in Table 11 below:

(Rs in crore)

Sl. No.	State	Tax deductor	F.Y	TDS due	Interest	Penalty	Total
1.	Haryana	Haryana Roadways Engineering Corp Ltd	2002-03 & 2003-04	4.65	1.45	4.65	10.75
2.	Maharashtra	Ultra Entertainment Solutions Pvt. Ltd.	2002-03	2.88	0.60	2.88	6.36
3.	Madhya Pradesh	IDBI Bank Ltd (New)	2002-03 & 2003-04	1.10	0	1.10	2.20
4.	Andhra Pradesh	Sports Authority of Andhra Pradesh	2001-02 to 2004-05	0.73	0.34	0.73	1.80
5.	Haryana	Kaithal Co-op Sugar Mills Ltd.	2002-03 to 2004-05	0.77	0.18	0.77	1.72
6.	Kerala	Kerala Sports Council	2002-03 to 2004-05	0.65	0.29	0.65	1.59
7.	Assam	ONGC, Jorhat	2001-02 to 2002-03	0.65	0.24	0.65	1.54
8.	Tamil Nadu	Inspector General of Registrations, Government of Tamil Nadu	2000-01 to 2004-05	0.51	0.18	0.51	1.20
9.	Orissa	NTPC Kaniha	2001-02 to 2002-03	0.43	0.22	0.43	1.08
		<b>Total</b>		<b>12.37</b>	<b>3.5</b>	<b>12.37</b>	<b>28.24</b>

The Department accepted audit observations in cases at serial number **1, 2, 5** and **6** above.

### 2.11.3 Failure to remit TDS into Government account

Every person having deducted tax at source shall remit the same into Government account failing which he is liable to pay interest for the period of delay apart from penalty.

Audit scrutiny of TDS returns processed in selected units revealed that in **34 cases** in **Andhra Pradesh, Delhi, Gujarat, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal charges**, tax deducted at source of **Rs. 6.92 crore** was not remitted into Government account. Failure to remit TDS into government account indicated possible loss of revenue of Rs. 6.92 crore. Besides, it also called for levy of interest and penalty involving a total revenue impact of Rs. 14.83 crore. **Eight cases** involving revenue impact of more than Rs. 10 lakh but less than Rs. one crore are shown in **Appendix 10**. **Four cases** involving revenue impact of more than Rs. one crore are indicated in Table 12 below:

(Rs in crore)

**Table 12 : Failure to remit TDS into government account**

Sl. No.	Tax Deductor/ CIT charge	Financial year	TDS deducted	Interest	Penalty	Total
1.	M/s. Briggs Trading Co. Pvt. Ltd. Mumbai	2002-03	3.11	0.21	3.11	6.44
2.	M/s. Roofit Industries Ltd Mumbai	2001-02	1.25	0.14	1.25	2.64
3.	LMZ Energy India Ltd. Delhi	2001-02	0.57	0.25	0.57	1.40
4.	Boston Education and Software Ltd. Mumbai	2001-02	0.55	0.09	0.55	1.19
<b>Total</b>			<b>5.48</b>	<b>0.69</b>	<b>5.48</b>	<b>11.67</b>
Department stated that remedial action has been initiated in respect of cases noted at Sl. No 2 & 4.						

#### 2.11.4 Belated remittances of TDS into Government account

The person deducting tax at source shall pay the sum so deducted to the credit of Central Government within the prescribed time limit. Failure to do so attracts levy of interest.

In **Assam, Bihar, Gujarat, Karnataka, Maharashtra, Punjab, Rajasthan, Orissa, Tamil Nadu, Uttar Pradesh, Uttaranchal and West Bengal charges** audit noticed delays ranging from 1 month to 27 months in remitting TDS into Government account in **186 cases** on which interest of **Rs. 3.13 crore** was not levied. In **Bihar, Gujarat, Karnataka and West Bengal charges**, the audit observations were accepted by the Department and remedial action initiated.

#### 2.11.5 Incorrect allowance of business expenditure

Section 40(a)(ia) with effect from 1 April 2004 provides that any payment to a resident in the nature of interest, commission, brokerage, fees for professional or technical services or amounts payable to a contractor/subcontractor on which tax is deductible at source and such tax has not been deducted or after deduction has not been paid during the previous year within the time prescribed, shall not be allowed as a deduction in computing the income chargeable to tax.

Audit scrutiny of assessment records in Gujarat and Karnataka revealed that in **332 cases** TDS had not been remitted into Government account. Failure of the Department to disallow the corresponding payments/expenditure resulted in short levy of tax of **Rs. 45.45 crore**. **Thirty two cases** involving revenue impact of more than Rs. 25 lakh but less than Rs. one crore have been shown in **Appendix 11**. **Seven cases** involving revenue impact of more than Rs. one crore are indicated in Table 13 below:

(Rs. in crore)

**Table 13 : Incorrect allowance of business expenditure**

Sl. No.	CCIT Charge	Name of Company (Deductor)	Payment to be disallowed	Tax effect
1.	Vadodara	Indian Petro Chemicals Ltd	28.94	10.59
2.	Vadodara	Gujarat Electricity Board (GBPS) Utran	12.59	4.61
3.	Vadodara	Rajasthan Rajya Vidyut Utpadan Nigam Ltd. (RRVUNL)	10.73	3.93
4.	Ahmedabad	Gujarat Gas Company Ltd	10.26	3.75
5.	Vadodara	Gujarat Industries Power Co. Ltd.	6.79	2.48
6.	Vadodara	GSEC Ltd.(Duvaran)	4.67	1.71
7.	Surat	Gujarat Narmada Fertilizer Corporation	3.41	1.25

#### 2.11.6 TDS credits allowed without certificates

While making assessments after arriving at gross demand tax deducted at source as evidenced by TDS certificates, shall be deducted from the gross demand. Where the assessee has not furnished the TDS certificates the credit therefor will not be allowed.

In **Delhi charge**, in the case of M/s. Water and Power Consultancy Services (India) Ltd. for the assessment year 2003-04, TDS credit of Rs. 11.07 lakh was erroneously allowed in assessment without production of relevant TDS certificates. On this being pointed out in audit, Department accepted and rectified the mistake (February 2005).

#### 2.11.7 Late filing of TDS returns

Every person responsible for deducting tax at source shall after the end of each financial year submit annual returns to the jurisdictional TDS unit. Failure or delay in filing these returns would attract penalty at the rate of Rs. 100 for each day of delay subject to the maximum amount of tax deductible.

However no provision is available for levy of interest for non filing of TAN returns by tax deductors as available under section 234A for non filing or belated filing of income/corporate tax returns by the assessees.

Test check by audit revealed **10549 cases** of late filing of returns in **Assam, Tamil Nadu, Delhi, Gujarat, Haryana, Himachal Pradesh Jharkhand, Orissa, Rajasthan, Uttaranchal and West Bengal** with delays ranging from 1 day to 1406

days. Penalty leviable of **Rs. 5.54 crore** was not levied by the Department. In **Gujarat**, the Department agreed to take remedial action at the time of processing the return.

### 2.11.8 Failure to ensure completeness of TDS returns and certificates

Every deductor of tax is required to obtain a tax account number (TAN) which is unique to the deductor and which is to be quoted in all transactions relating to tax deduction at source. The Department must ensure that details in the TDS certificates like TAN, PAN, GIR, TDS amount, rate of TDS, etc are accurately and completely filled up. This is to enable the Department to correlate the tax credits availed by the payees (i.e. deductees) in their income tax assessments with those claimed to have been remitted by deductors.

Audit noticed several mistakes as a result of which correlation of tax credits with income tax assessments of deductors was not possible. Neither were the mistakes identified and rectified by the Department nor were the applicable penalties (@ Rs. 10,000) levied as detailed in Table 14 below.

(Rs. in lakh)

<b>Table 14 : Failure to ensure completeness of TDS returns and certificates</b>					
<b>Sl No</b>	<b>Charge</b>	<b>Nature of return</b>	<b>No of returns</b>	<b>Defects noticed</b>	<b>Penalty leviable</b>
1	Delhi	TDS	158 TAN returns	In 1750 TDS certificates issued by these deductors PAN/ GIR numbers were not recorded	175.00
2	Uttar Pradesh	TDS	178 TAN returns	TAN not recorded	17.80
		Income Tax returns	28 Tax deductors	In 801 TDS certificates issued by these deductors PAN/ GIR numbers were not recorded	80.10
3	Himachal Pradesh	TDS	301 TAN returns	TAN not recorded	30.10
4.	Gujarat	TDS	285 TDS certificates	PAN not recorded	28.50
		Income Tax returns	1 assessee (Vishal Exports Overseas Ltd)	TDS credit allowed on 15 defective TDS certificates	43.27
<b>Total</b>					<b>374.77</b>
Department accepted the audit observation in case of M/s Vishal Exports Overseas Ltd.					

### 2.11.9 Processing of TDS returns

No specific provision is available prescribing time limitation for processing and assessment of TDS returns filed by the tax deductors. Further, in accordance with the powers vested with the Board under section 119 of the Act, the Board has been prescribing selection criteria for picking up cases for scrutiny by the assessing officers of assessing units to ensure the correctness of the returns as also the availment of various concessions under the Act.

However no selection criteria have been prescribed so far by the Board, in any of the financial years for verification of TDS returns.

Ministry in their reply of January 2007 stated that suitable procedure is under consideration, which will specify time limit as well as procedure of verification of TDS/TCS returns.

#### **2.11.10 Internal audit**

As per the new system of internal audit (chain system), a prescribed percentage of all cases, were to be audited by the end of the following month. The percentage of TDS returns to be test checked in internal audit is specified in Board's instruction of December 2001.

In **Chandigarh (UT), Delhi, Gujarat, Jharkhand, Madhya Pradesh, Rajasthan, Uttar Pradesh, and West Bengal**, audit study revealed that no internal audit of TDS wards/circles was conducted during the period from 2002-03 to 2005-06.

**2.11.10.1** In TDS unit at **Uttar Pradesh (Meerut charge)** it was stated that internal audit was held during 2002-03 and 2004-05 but these reports were not made available to audit.

#### **2.11.11 Lack of coordination between assessing and TDS units**

The Board in September 1990 laid down that a percentage of TDS certificates enclosed with the return of income was required to be cross checked by the assessing officer with the concerned TDS unit before giving credit in order to safeguard against wrong and bogus claims. The percentage of certificates to be cross verified was to be decided by the jurisdictional CCIT/CIT.

In the units test checked in **Delhi, Jharkhand, Rajasthan and Uttar Pradesh** it was noticed that such cross verification was neither prescribed by the CCIT/CIT nor was any such verification carried out by the assessing officers. In **Karnataka charge** only three cases were reported for cross verification by assessing officers to TDS units.

Thus audit could not derive an assurance that the mechanism prescribed to safeguard the exchequer against wrong and bogus claims was functioning effectively.

#### **2.11.12 Miscellaneous observations**

**2.11.12.1** In **Orissa, Bhubaneswar charge** audit noticed that the tax deductor (Executive Engineer, Division II, Bhubaneswar Development Authority) had deducted a sum of Rs. 0.25 lakh only at source from the gross amount of Rs. 12.31 lakh paid to a contractor for executing works during the financial year 2002-03. However the TDS certificate was issued for a sum of Rs. 0.49 lakh.

### 2.11.12.2 Non levy of surcharge

While deducting tax at source, the tax deductor is also required to deduct surcharge/education cess as prescribed under the Finance Acts for the relevant period. In **Assam, Gujarat, Jharkhand, Maharashtra, Uttar Pradesh and West Bengal charges**, audit noticed **67 cases** where surcharge was either not deducted or short deducted involving revenue impact of **Rs. 1.76 crore**. In **18 cases** education cess was not deducted involving revenue impact of **Rs. 3.77 lakh**. One case is illustrated below:

In **Gujarat charge**, after detecting short deduction of TDS by the National Highway Authority of India while making payments to a foreign company during financial years 2002-03 and 2003-04, the Department raised the additional demand of tax but did not levy surcharge at prescribed rates in both these years. This resulted in short levy of surcharge of Rs. 31.61 lakh and the total revenue impact was Rs. 38.31 lakh inclusive of interest. On this being pointed out in audit, the Department accepted the observations and initiated remedial action.

## 2.12 Section C Issues in accounting

### 2.12.1 Misclassification of income tax and surcharge

In the challans prescribed for remittance of TDS into Government account, separate columns for tax and surcharge are given to enable the Zonal Accounts Officer to account for surcharge separately as the same forms part of Consolidated Fund of India and is not available for allocation to the States\*.

Audit scrutiny of challans appended to returns filed in TDS units revealed that surcharge of **Rs. 18.68 crore** had been classified under income tax in **3,269 cases** in **Assam, Chandigarh (UT), Delhi, Himachal Pradesh, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal (Appendix 12)**. In **West Bengal** it was stated that appropriate measures were under process.

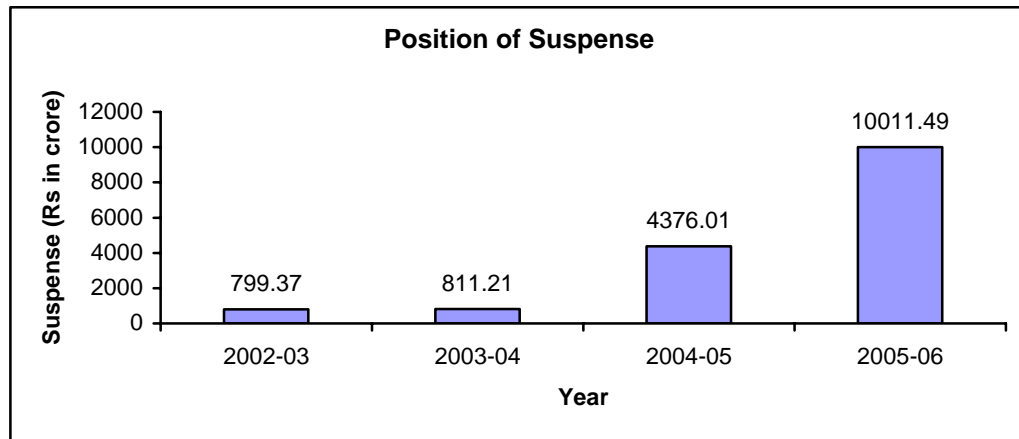
### 2.12.2 Position of suspense

Consequent to implementation of OLTAS, the bank at which tax remittances were being made had to enter the data contained in the challans such as TAN, date and amount of remittance. Failure to enter the TAN data or incorporation of incorrect data would result in credit of the amount under suspense. These amounts can be cleared while processing the e-TDS returns by the TDS units.

Audit scrutiny of TDS credits held in suspense in **Delhi, Karnataka, Maharashtra (except Nagpur), Punjab and Tamil Nadu** showed an increasing trend over the period 2002-03 to 2005-06 as depicted in Chart 4 below:

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\* Article 271 of the Constitution

**Chart 4**

The above table indicates that the amount of suspense is on an increasing trend. The suspense during year 2004-05 had increased by almost 500 percent over the balance in 2003-04 and by 229 percent in 2005-06 compared to the previous year.

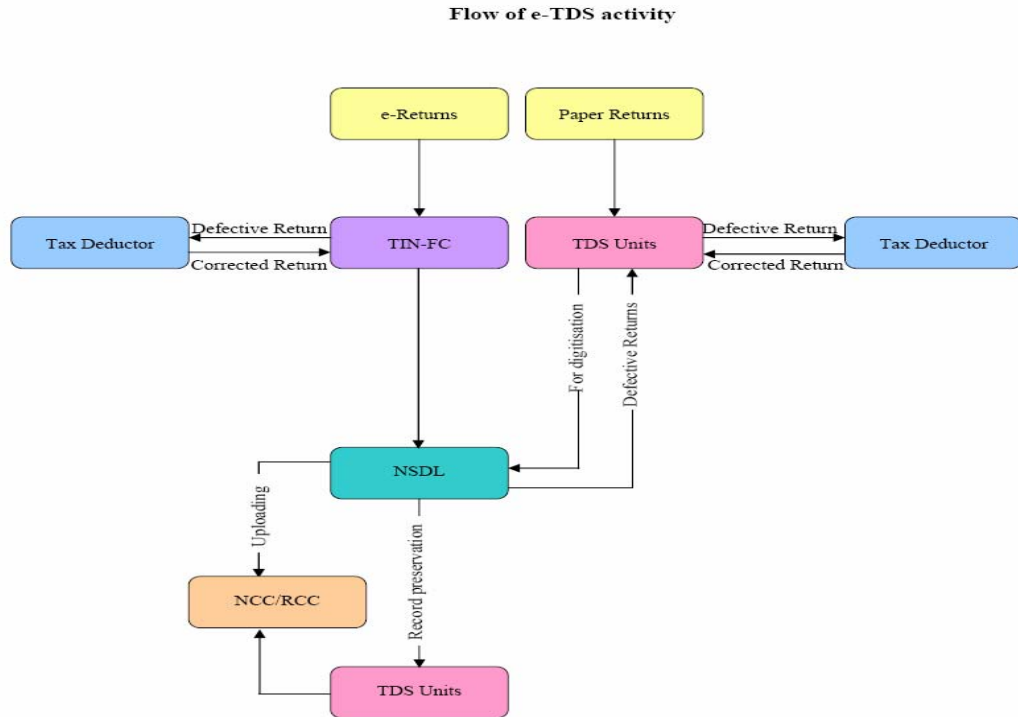
Ministry in their reply (January 2007) stated that efforts were being undertaken to improve the data quality in OLTAS which would result in reduction of the amount under suspense.

## **Section D Evaluation of e-TDS system**

### **2.13 e-TDS**

The 'Electronic filing of Tax Deducted at Source Scheme, 2003' was notified by CBDT with the objective of cutting down compliance cost for deductors and to correlate deduction of taxes made by deductors with the deposit of tax in the Government account, as also to correlate deduction of tax by the deductors with corresponding credits claimed by the deductees. Details of activities involved in the e-TDS process are given in the Chart 5 below:

**Chart 5**  
**Flow chart of the activities involved in filing and processing of e-TDS returns**



In view of the changed, reporting and compliance requirements both on the part of the clients (tax deductors and tax deductees) and the Department, audit sought to examine the adequacy of the systems and preparedness of the Department to enforce compliance. Audit also attempted to evaluate the facilitation mechanism to clients including clarity of rules and procedures.

### Electronic filing of returns

The Director General of Income Tax (Systems) was appointed as e-TDS Administrator and M/s National Securities Depository Limited (NSDL), which is also the agency hosting Tax Information Network (TIN), had been appointed as the Registrar for processing applications for registration as e-Return intermediary. NSDL opened their front offices called 'Tax Information Network - Facilitation Centers (TIN-FCs)' at 139 stations all over the country to receive the e-TDS returns. Furnishing of TDS return in electronic form was made mandatory for corporate deductors with effect from 1 June 2003 and for other offices of Government and non corporate deductors with effect from 1 April 2005 and 1 July 2005 respectively. NSDL was to digitise the returns and upload them onto the National Computer Center (NCC)/Regional Computer Centers (RCCs) of the Department.



The jurisdictional TDS authorities were required to access the RCC/NCC servers for processing of e-TDS returns to ascertain its compliance with the various provisions of the Act and the correctness of payment of requisite taxes by correlating the data available on this module with OLTAS<sup>€</sup>. Hence for processing of e-TDS returns availability of computers and connectivity with the server at RCC/NCC was a prerequisite. Audit scrutiny of the digitisation of paper returns and coordination with NSDL revealed the following:

### **2.13.1 Non availability of forms/inadequate ground work**

The e-TDS scheme was made operational from 01 June 2003, but the new forms of e-TDS returns and the procedure for e-filing were notified only in July 2003 and August 2003 respectively. The facilities (TIN-FCs) for receipt of e-TDS returns in the new form also became functional in January 2004. As a result of this, tax deductors continued to file returns in paper form, which could not be digitised and were declared invalid/defective. Tax deductors who had filed paper TDS returns between June 2003 and January 2004 were asked to file their e-TDS returns again, indicating lack of adequate preparation by the Department.

In **Maharashtra, Mumbai charge**, NSDL had provided a list of filers, who had not complied with the above instruction of filing TDS returns in new forms to the ITD (August 2004). Audit scrutiny revealed that no action had been taken on these non filers.

### **2.13.2 Trained manpower for e-TDS system**

The changed environment required a formal assessment of training needs for different categories of users and development of focused training modules for them. Hence comprehensive training programme with continuous monitoring and course correction was to be implemented. Audit sought to examine the adequacy of the mechanism for imparting training to its officers and staff for discharging their duties.

In **Tamil Nadu Chennai charge**, test check of records made available to audit revealed that only a few employees (51) in 2004-05 had been trained on the e-TDS module. In **Delhi charge** no records relating to training on the e-TDS module were made available to audit. In **Uttar Pradesh** it was noticed that no proper training had been imparted to the staff of e-TDS units. In **Karnataka, Bangalore charge**, it was stated that the officers who were holding charge of the TDS units currently had not been trained in processing of TDS returns in computer media. In **Jharkhand, Ranchi charge** and in five charges\* at **Punjab** the Department stated that the staff posted on e-TDS functions had not been trained.

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<sup>€</sup> Online Tax Accounting System is a system through which banks upload tax collection information for the tax collected at all their designated branches.

\* Two ranges each at Amritsar and Ludhiana and one range at Moga, Jagraon.

Ministry in their reply (January 2007) stated that 512 officers/officials of the Department had been trained in eTDS operation. However, in view of the responses received by audit indicating inadequate training and the low volume of processing of eTDS returns (para 2.13.5 refers), Ministry may like to review the implementation of its training programme.

### **2.13.3 Digitisation of paper returns**

The paper TDS returns for the FY 2002-03 and onwards filed with ITD were required to be sent to NSDL for digitisation and uploading by June 2004. Defective returns sent back by NSDL were to be set right by the ITD from the filer and the same resent for digitisation.

#### **2.13.3.1 Returns not sent for digitisation**

It was noticed in **Delhi, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Mumbai and Uttar Pradesh** that 1.27 lakh paper returns identified for digitisation had not been sent to NSDL for digitisation during the period of review.

#### **2.13.3.2 Returns pending with NSDL**

It was noticed in **Bihar, Delhi, Karnataka, Kerala, Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, and West Bengal** that of the returns sent by the Department for digitisation, 50831 returns were yet to be acted upon by NSDL. It was also observed in **Delhi** that not a single paper return relating to the financial year 2002-03 had been digitised by NSDL (May 2006).

On this being pointed out in audit, Ministry stated (January 2007) that in Delhi charge 4687 returns relating to 2002-03 had been digitised and uploaded as on 30 November 2006.

### **2.13.4 Inadequacies in monitoring**

In **Tamil Nadu, Chennai charge** out of 1.58 lakh TDS returns received by NSDL only 1.52 lakh returns had been uploaded into RCC, Chennai. In **Kerala, Kochi and Thiruvananthapuram charge**, it was observed that the total number of TDS returns shown as uploaded to these charges from NSDL were 32382, whereas only 11500 e-TDS returns were available online for access by the jurisdictional wards. In **Bihar, Patna charge**, it was observed that 21 TDS returns were misplaced by NSDL.

Ministry while providing the updated figures for Kerala in January 2007 stated that e-TDS returns can be tracked in the system and all e-TDS returns filed are uploaded into the income tax department's system. However, the updated figures in respect of Kerala continue to show a gap of 9,491 returns. The issue of misplaced returns in Patna also needs to be addressed by the Ministry.

### 2.13.5 Processing of e-TDS returns

TDS units were to check the tax due and tax deducted, timely remittances, correctness and bonafide of TDS certificates, leviability of interest and penalty wherever applicable, etc.

**2.13.5.1** In three ranges of CIT (TDS) **Delhi charge**, data relating to the number of e-returns received and processed revealed that during the financial years 2002-03 to 2004-05 on an average less than 2 percent of the returns had been processed by the Department as detailed in Table 15 below:

<b>Financial year</b>	<b>e-Return received</b>	<b>e-Return processed</b>	<b>Unprocessed e-Return</b>
2002-03	5605	20	5585
2003-04	33772	1332	32440
2004-05	60820	739	60081
2005-06	49649	969	48680

On this being pointed out in audit, the Department stated (September 2006) that non processing was due to software problems, connectivity and inadequacy of manpower.

**2.13.5.2** In **Tamil Nadu, Chennai charge**, Department stated that processing of returns through computer was not done since all the trial runs made to process returns resulted in demands as credit details were not available in respect of deductees whose PAN was not quoted. In spite of repeated instructions by DIT (Systems), none of the returns had been processed through computer (August 2006). Further, 25 stations in Tamil Nadu were not connected with the RCCs and hence assessing officers were not in a position to process the returns.

**2.13.5.3** In **Maharashtra, Mumbai charge**, the Department processed only 2531 e-TDS returns out of 17158 returns (14.75%) received during the financial year 2002-03 to 2005-06. It was also reported that processing of e-TDS returns could not be done properly mainly due to software problems and inadequacy of trained manpower.

**2.13.5.4** Test check in **Karnataka, Bangalore charge** revealed that processing of returns had not been undertaken fully as the package relating to e-TDS processing was not functioning through AST. There were also connectivity issues and inadequate trained manpower. Audit also noticed that in the case of e-TDS return relating to a company (M/s. BPL Telecom Ltd. for the assessment year 2003-04), TINFC had pointed out deficiencies in respect of several deductees (2656 deductees out of total number of 3257) (December 2004). However, neither the assessee nor the Department has taken any action to rectify these deficiencies (June 2006). Audit also noticed that the computer system was not provided to assessing officers outside Bangalore, which hampered the processing of e-TDS returns (June 2006).

**2.13.5.5 In Orissa charge** it was seen that only 26 e-TDS returns out of 3696 returns (0.70%) received pertaining to financial year 2003-04 to 2005-06 had been processed.

**2.13.5.6 In Jharkhand, Ranchi and Dhanbad charges** it was observed from records made available to audit that none of the e-TDS returns for the years 2003-04 to 2005-06 had been checked to ascertain the correctness of tax deduction at source and credit into Government account. It was further stated by the assessing officers that they were holding additional charge of the TDS units and were not aware of scrutiny, if any, done by earlier officers in-charge of the units.

**2.13.5.7 In Uttar Pradesh, Meerut charge,** audit observed that there were no computers in the TDS units. In **Kanpur charge,** the computers had become non functional whereas in **Agra charge,** they were partially functional. In **Himachal Pradesh, Solan, Mandi and Palampur charges** it was observed that there were no computers with online connectivity to enable the assessing officers to process the returns.

Ministry in their reply (January 2007) provided the updated details of returns received and processed as detailed below.

<b>Returns received during the financial year 2005-06</b>				
<b>Sl. No.</b>	<b>RCC</b>	<b>No. of returns available for processing</b>	<b>No. of returns processed</b>	<b>Percentage of column 4 to column 3</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1.	Delhi	2,13,491	38,823	18
2.	Bangalore	1,34,615	6,398	4
3.	Trivandrum	14,514	398	3
4.	Cochin	26,338	511	2
5.	Chennai	87,834	1,675	2
6.	Pune	49,273	471	1
7.	Mumbai	2,23,498	5,912	2
8.	Kolhapur	8,693	462	5
9.	Patiala	35,832	2,100	6
10.	Baroda	24,053	1,099	5
11.	Ahmedabad	41,921	462	1

Ministry also stated that certain changes have been made in the TDS software recently to enable faster processing of e-TDS returns. In view of the large numbers of e-TDS returns not being processed, Ministry may like to review the position so as to safeguard the interests of Government revenue.

### **2.13.6 Issues relating to TDS software**

e-TDS software was envisaged as a self contained mechanism which would enable the Department to identify stop filers and non filers; match tax remittance data in the return with the data available in OLTAS; compute interest for delayed remittance of tax at the applicable rates; generate demand notices and apply the system fed interest and surcharge rates applicable for various categories of

assesseees during a particular assessment year as also for different assessment years. Audit scrutiny of the functioning of the software revealed the following:

**2.13.6.1 In Maharashtra, Mumbai charge,** the Department had encountered problems relating to non correlation between unique return filers and the TAN allotted to tax deductors; problems with mismatching of remittance data between e-TDS return and OLTAS such as differences in date of challan (tendering and clearing date), difference in amount of tax due to exclusion of interest, non availability of validation in OLTAS thereby marking returns without TAN as defective, etc. It was seen that these anomalies continued even after two years of implementation of e-TDS scheme.

Ministry in their reply (January 2007) stated that the issue of unique e-TDS return filers and TAN allotted to deductors is being addressed and the problem of matching of remittance data between the e-TDS returns and OLTAS has been resolved to a large extent by the latest changes made to the e-TDS software.

**2.13.6.2 Test check in Karnataka, Bangalore charge** revealed that identification of jurisdiction which was decided upon the quantum of deduction availed was dysfunctional and did not provide for transfer of records in bulk which was one of the key advantages to be realised out of computerised processing of returns. It was also found that where a particular return pertains to a financial year and payments have been made corresponding to this in the next financial year, though the system provides for making changes in the ledger account, corrections were not allowed to be carried out due to problem in periodicity key. It was also found that the system did not allow generation of sorted data, though the data was available in consolidated form in Return Receipt Register (RRR).

Ministry in their reply of January 2007 stated that since different jurisdictional patterns are followed, generalised software was developed. Ministry also stated no problem has been found in the periodicity key and the system could generate reports in any sorted order. However, responses received from the field indicated practical problems at the field level which are required to be addressed.

**2.13.6.3** The e-TDS software defines non-filer as a deductor, who has obtained TAN, but, did not file a return. It was noticed that the e-TDS software was not provided with a suitable validation check for linking challan entries quoted in OLTAS module with TAN returns to ensure that all deductors who had remitted tax had indeed filed the requisite returns.

Ministry in their reply (January 2007) stated that changes will be carried out in the software to link OLTAS challan entries to e-TDS software to identify deductors who have remitted tax but not filed their TDS returns.

### **2.13.7 Mechanism for checking and storage of soft copies of e-returns**

Under e-TDS scheme, returns received in electronic media such as floppies, CDs, etc. from the e-intermediary are required to be preserved as records for future reference. For proper account of returns received the Department had prescribed specific procedure for maintaining 'Stock Register for Magnetic Media'.

It was observed in **Delhi charge** that no stock register of floppies/CDs was maintained during financial year 2002-03 to 2005-06 nor is there a system for checking the same. Receiving returns in floppies/CDs without ensuring their content and validity as also non availability of a proper system of storage and preservation of records in magnetic media defeated the purpose of storing the same for future reference.

Ministry during the exit conference agreed to reiterate the instructions for preservation and storage of records in magnetic media.

## **Section E Tax collection at source**

### **2.14 Introduction**

The mandate for collecting tax at source (TCS) is provided by the Introduction of "**Part-BB-Collection at source**" in **Chapter XVII** of the Income Tax Act 1961, by the Finance Act 1988 with effect from 1 June 1988 which has been amended through successive Finance Acts.

The scope of "Part BB" earlier covered the business of trading in alcoholic liquors, forest produce, tendu leaves, scrap and timber which was later amended to include contract or license or lease of parking lots, toll plazas and mining and quarrying by the Finance Act 2004 with effect from 1 October 2004. Further rates of tax which were originally ranging from five to fifteen percent had been reduced to one percent to two percent.

Audit of TCS returns and related records were taken up simultaneously along with scrutiny of TDS records in 246 TDS units for the period from 2002-03 to 2005-06, till date of audit and observations thereon are detailed below:

#### **2.14.1 Revenue gap in collection of tax at source**

Owing to the nature of the trade and ease of collection, income tax on profits and gains from the business of trading in alcoholic liquor is collected at source. Every person shall at the time of sale of alcoholic liquor for human consumption, collect from the buyer a sum equal to one percent of the sale price with effect from 8 September 2003 (prior to this date the rate of collection of tax was 10 percent).

A study of the Finance Accounts of eight selected states of **Andhra Pradesh, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Tamil Nadu and West Bengal** revealed that the revenues accruing to the state Government on account of sale of alcoholic liquor for human consumption showed an increasing trend. However, the collection of taxes at source is not in proportion to the excise revenues of the state Governments as detailed below:

(Rs. in crore)

**Table 16 : Value of liquor sold\***

States	2002-03	2003-04	2004-05
Maharashtra	1753.57	2056.13	1979.76
Tamil Nadu	2061.42	1613.20	2512.19
West Bengal	565.09	616.67	507.93
Madhya Pradesh	816.52	1001.05	1159.35
Punjab	1284.58	1398.29	1465.23
Andhra Pradesh	1797.74	1856.98	2036.44
Karnataka	1921.53	2201.42	2698.15
Haryana	823.89	865.68	922.22
<b>Total</b>	<b>11024.34</b>	<b>11609.42</b>	<b>13281.27</b>

(Rs. in crore)

**Table 17 : Tax collectible at source**

Year	Rate of tax deduction	Amount	Amount of TCS as per CGA*
2002-03	@ 10%	<b>1102.43</b>	<b>57.76</b>
2003-04**	@ 10% on half of the collections	<b>580.47</b>	<b>125.97</b>
	@ 1% on half of the collections	<b>58.04</b>	
2004-05	@ 1% for the year	<b>132.81</b>	<b>211.90</b>
	<b>Total</b>	<b>1873.75</b>	<b>395.63</b>

\* Controller General of Accounts

\*\* The rate of tax to be deducted at source was reduced from ten percent to one percent w.e.f. 08.09.2003 and hence TCS computed at differential rates.

The wide discrepancies between tax collectible at source and that shown as actually collected in respect of sale of liquor requires to be examined by the Department.

Ministry during the exit conference agreed to examine the issue.

### 2.14.2 Application of TCS provisions

Audit noticed mistakes such as non levy of surcharge/interest/penalty; non filing, belated filing of returns, defective TCS certificates, etc. in 38 cases relating to **Bihar, Haryana, Karnataka, Maharashtra, Orissa, Rajasthan and Uttar Pradesh charges** involving a revenue impact of Rs. 3.97 crore which includes tax of Rs. 81.48 lakh and interest and penalty of Rs. 3.16 crore.

\* Total turnover of liquor is conservatively estimated equivalent to the State Excise duty collections under the Major Head 0039 covering the Minor Heads 101 – Country spirits, 102 – Country fermented liquors, 103 – Malt liquor, 104 – Liquor and 105 – Foreign liquors & spirits which relate to excise duty collected on liquor for human consumption as depicted in the Finance accounts of the concerned States for the relevant year.

### 2.14.3 Omission to collect tax at source

Audit noticed mistakes relating to omission to collect tax at source in 16 cases involving a revenue impact of Rs. 3.90 crore of which **two cases** are illustrated below.

**2.14.3.1 In Maharashtra Mumbai charge**, M/s Shipping Corporation of India had derived income of Rs. 39.68 crore and Rs. 146.41 crore during the financial years 2003-04 and 2004-05 on account of sale of scrap. Audit scrutiny revealed that neither had the assessee collected tax at source nor did the Department initiate necessary proceedings. Failure to do so resulted in non-collection of tax at source of Rs. 1.94 crore including surcharge and education cess apart from interest of Rs. 45.37 lakh. On this being pointed out by audit, Department agreed to examine the issue.

**2.14.3.2 In Maharashtra Mumbai charge**, M/s ONGC had sold scrap amounting to Rs. 8.77 crore during the period from April 2003 to December 2003. Audit scrutiny revealed that neither had the assessee collected tax at source nor did the Department initiate necessary proceedings. Failure to do so resulted in non-collection of tax at source of Rs. 50.62 lakh including surcharge and education cess apart from interest of Rs. 14.68 lakh. On this being pointed out by audit, Department agreed to examine the issue.

### 2.14.4 Income escaping assessment

In **Jharkhand, Dhanbad charge** it was noticed that in assessment year 2004-05 four assessee debited purchases of liquor in excess of purchase value shown in the relevant TCS certificates resulting in income of Rs. 3.52 crore escaping assessment involving a revenue impact of Rs. 1.31 crore. The audit observations were accepted by the Department.

### 2.14.5 Processing of TCS returns

No specific provision is available prescribing time limitation for processing and assessment of TCS returns filed by tax deductors. In **Delhi charge**, audit scrutiny in nine selected units, revealed that for the financial years 2002-03 to 2005-06, no TCS return was processed as against 440 returns filed during these years. In **Bihar, Haryana, Karnataka, Maharashtra, Tamil Nadu and West Bengal (Kolkata charges)** also TCS returns had not been processed.

Further, in accordance with the powers vested with the Board under section 119 of the Act, the Board has been prescribing selection criteria for picking up cases for scrutiny by the assessing officers of assessing units to ensure the correctness of the returns as also the avilment of various concessions under the Act.



However no such selection criteria has been so far prescribed by the Board in any of the financial years for selection of TCS returns for scrutiny by the officers of TDS units. In **Delhi charge** TDS units were unable to explain the selection criteria adopted for processing of TCS returns.

Ministry in their reply of January 2007 stated that suitable procedure is under consideration, which will specify time limit as well as procedure of verification of TDS/TCS returns.

## **2.15 Conclusion and recommendations**

**2.15.1** A wide gap was noticed between the potential for TDS and TCS in certain sectors apart from non deduction/collection of tax at source. A declining trend in the number of effective tax deductors was observed. Surveys were either not being conducted or the reports of surveys were not finalised in a number of cases. *Audit recommends that Ministry may take necessary steps to bring all tax deductors/collectors into the tax net and enforce recovery as required under the Act.*

During the exit conference, Board while agreeing to examine the issue stated that the TDS administration is being strengthened by additional manpower. Board also stated that the database of tax deductors is being updated to reduce redundancy.

**2.15.2** Several mistakes relating to implementation of provisions relating to TDS/TCS were observed in respect of residents and non residents. *Audit recommends that adequate enforcement mechanism be evolved to ensure consistency in assessment and prevent loss of revenue, particularly in the important area of international taxation. Coordination between TDS and regular assessment units as also internal audit mechanism should be strengthened.*

During the exit conference, Board agreed to look into the issues raised by audit especially in the area of international taxation, and also stated that revamping of the internal audit mechanism in the department was under process.

**2.15.3** Review of e-TDS indicated that e-TDS returns filed remained unprocessed for the past three years largely due to software related problems and inadequacy of trained manpower. There was also no proper system for preservation and storage of records in magnetic media. *Audit recommends that these problems be attended to urgently so that the e-TDS returns are processed and revenues due to government realised. Further, arrangements for ensuring storage and preservation of records in magnetic media are ensured.*

During the exit conference, Board stated that certain changes have been made in the TDS software recently to enable faster processing of e-TDS returns. Board also agreed to reiterate the instructions for preservation and storage of records in magnetic media.

**2.15.4** The Income Tax Act does not prescribe any time limit to process the TDS/TCS returns unlike regular assessments. *Audit recommends that a time limit for completion of TDS/TCS assessments may be prescribed so as to ensure early realisation of any revenues due to government.*

During the exit conference, Board stated that a suitable process is under consideration, which will specify time limit as well as procedure for verification of TDS/TCS returns.

**2.15.5** Misclassifications in accounting were noticed as also large balances under 'suspense'. *Audit recommends that Ministry may look into this aspect and take steps to reconcile the differences.*

During the exit conference, Board agreed to examine the issue in detail and intimated that measures to reduce the suspense are underway.