



Report of the Comptroller and Auditor General of India



लोकहितार्थ सत्यनिष्ठा
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Performance Audit on Assessment of Co-operative Societies and Co-operative Banks

Union Government
Department of Revenue – Direct Taxes
Report No. 16 of 2020

**Report of the
Comptroller and Auditor General of India**

for the year ended March 2019

**Performance Audit on
Assessment of Co-operative Societies and
Co-operative Banks**

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Laid on the table of Lok Sabha/Rajya Sabha on _____

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Preface

This Report for the year ended March 2019 has been prepared for submission to the President under Article 151 of the Constitution of India.

The Report contains significant results of the performance audit of Assessment of Co-operative Societies and Co-operative Banks completed by the Income Tax Department, Department of Revenue of the Union Government during the financial years 2014-15 to 2018-19.

The instances mentioned in this Report are those, which came to notice in the course of audit conducted from March 2019 to September 2019.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Executive Summary

The Co-operative Sector witnessed a significant growth in terms of number of entities registered as Co-operative Societies and Co-operative Banks. During 2009-10 to 2016-17, Co-operative Societies registered a growth of 39.84 *per cent*. A Co-operative Society or Co-operative Bank registered under the Co-operative Societies Act (State or Central Act) is treated as an “assessee” liable to pay income tax and assessed under the provisions of the Income Tax Act, 1961 (the Act). This topic was selected for performance audit with a view to examine the extent of: Coverage of Co-operative Societies in Income Tax net; Widening and deepening of the tax base; and Compliance of the statutory provisions.

The objectives of the performance audit were to examine:

- i. whether all the entities in the Co-operative Sector are in the tax net and filing income tax returns and are being assessed for levy of due amount of tax;
- ii. the nature and extent of compliance to provisions specific to the assesseees of Co-operative Sector under the Income Tax Act, 1961; and
- iii. the nature and extent of compliance to the general provisions of the Act during assessment process.

The performance audit covered the assessments of Co-operative Societies and Co-operative Banks completed during the financial years 2014-15 to 2018-19. The sample was derived from the data provided by Income Tax Department (ITD) for period 2014-15 to 2016-17, as per risk assessment carried out by audit as well as cases identified from the list of Multi State Co-operative Societies (MSCS) available on the MSCS website. Audit had called for 9,282 sample case records (including 81 cases of MSCS) pertaining to Co-operative Societies and Co-operative Banks from 1,726 Assessment Charges for audit scrutiny. Out of chosen sample, 400 cases did not fall under the category of Co-operative Societies and Co-operative Banks and of remaining 8882 cases, 8470 cases (95.36 *per cent*) were produced to Audit.

Summary of audit findings is given below:

- Audit noticed that the number of Co-operative Societies and Co-operative Banks as per records of respective States/ Regional regulatory authorities/ Registering authorities was much higher as compared to the numbers as per ITD indicating that many Co-operative Societies and Banks were not in the tax net of ITD.

(Paragraph 2.1.1)

- ITD does not have a mechanism to map the information on Co-operative Societies/ Banks with the registering authorities in order to be able to verify the status of filing of income tax returns. There is no mechanism to seed the PAN in the databases of the Registrar of Co-operative Societies, and to check any change of declared registration status by the assessee, which is a major impediment in institutional and structured sharing of information with ITD.

(Paragraph 2.1.1)

- There was no evidence of action initiated against the non-filers/ stop-filers of Income Tax returns. ITD did not utilize the tools available with it through conduct of survey and search & seizure operations to identify and bring into tax net the non-filers and stop filers of income tax returns.

(Paragraph 2.5.1, 2.2)

- While Co-operative Societies/ Co-operative Banks are supposed to be classified as Association of Persons (AOP), audit noticed that assessees classified as Firms, Body of Individuals (BOIs), Companies, Local authorities etc., were irregularly availing deductions meant for Co-operative Societies/ Co-operative Banks. This also has potential of providing inaccurate information pertaining to the assessees involved in Co-operative Sector activities.

(Paragraph 2.3, 3.1)

- Audit noticed instances of inconsistencies and errors in the amounts of incomes and claims or deductions as per the data sets furnished by the DGIT(Systems) vis-à-vis the information available in assessment records. The mismatch in assessment data as furnished by the DGIT(Systems) and data as per the assessment records is not only indicative of poor coordination and control over data updation but also a reflection on accuracy of information.

(Paragraph 2.4.2)

- Audit noticed instances where appropriate form viz. ITR 5 was not used by assessees in cases of Co-operative Sector for filing the Income Tax Return.

(Paragraph 2.5.2)

- Audit noticed that the verification of registration of the entity as Co-operative Societies/ Co-operative Banks was inadequate and evidential proof of a certificate of registration by Registrar as well as the details of members of the societies was either not available in the assessment records or not verified by the Assessing Officers. Thus, in

such cases, it could not be confirmed by audit whether the deductions were availed by genuine assesseees.

(Paragraph 2.6.1, 2.6.2, 2.6.3)

- Accounts of the Co-operative Societies/ Co-operative Banks were required to be audited by an empanelled auditor and the details were to be collected through ITR-5. Audit noticed that this essential requirement was not complied with. Thus, the reliability of the accounts could not be confirmed.

(Paragraph 2.6.4.1, 2.6.4.2)

- The ITD assessed entities as Co-operative Banks that did not have a valid licence from Reserve Bank of India to operate as a Bank thereby allowing deductions to ineligible assesseees available for the Co-operative Banks.

(Paragraph 2.6.5)

- There were instances of irregular allowance of deductions under sections 36(1)(viiia), 36(1)(viii), 36(1)(xvii) of the Act and various subsections of section 80P of the Act., where, conditions specified under the said provisions were not fulfilled, involving tax effect of ₹ 694.50 crore in 649 cases.

(Paragraph 3.1 to 3.7, 3.10, 3.11, 3.12)

- There was, relatively, higher propensity of irregular claims of deduction in respect of assesseees engaged in banking, credit and financial services, accounting for 68.7 *per cent* of the total number of irregularities identified.

(Paragraph 3.1)

- While conducting scrutiny assessments, the Assessing Officers did not duly examine the parameters specified by the ITD for selection of cases for scrutiny viz. 'Large deductions claimed under section 80P' of the Act, in 274 cases, resulting in irregular allowance of deduction.

(Paragraph 3.1)

- Among the various sub sections under which a Co-operative Society/ Co-operative Bank could avail of deductions, it was seen that there was, relatively, higher risk of non-compliance under the sub-sections 80P(2)(d), 36(1)(viiia) and 80P(2)(a)(i) of the Act, being 56.55 *per cent*, 18.18 *per cent* and 17.72 *per cent* of the total number of irregularities identified during audit, respectively.

(Paragraph 3.1)

- Verification by the Assessing Officers was inadequate in determining adherence to the principles of mutuality. The Assessing Officers were taking differential stand in assessing similar cases of claims for deduction under section 80P of the Act. This impacted the quality of assessments of Co-operative Societies and Co-operative Banks.

(Paragraph 3.2.3)

- The major reasons for disallowance of claim of deduction were on account of assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of provisions applicable to Co-operative Societies.

(Paragraph 3.8)

- The Assessing Officers are adopting differential approach in allowance of deduction claimed under section 80P of the Act while completing assessments of assessee categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks.

(Paragraph 3.9)

- There is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the information in respect of sub-sections of 80P of the Act under which the assessee claims deduction under section 80P of the Act.

(Paragraph 3.10.1)

- Distinct and actual claim of deduction made under section 36(1)(viiia) of the Act is not getting captured in the existing format of ITR.

(Paragraph 3.11)

- Audit noticed instances of non-compliance to provisions laid down in the Act with respect to allowances of deductions/ expenses/ set-off and carry forward of losses, mistakes in computation of tax and interest, non-deduction of TDS, non-levy of penalty etc. involving tax effect of ₹12,328.40 crore, in 858 cases. It is pertinent to note that the assessment is being completed through ITD systems and applications. This is indicative of there being weaknesses in assessment procedure and internal controls of ITD which need to be addressed.

(Paragraph 4.1, 4.2, 4.3, 4.14)

- Audit noticed that 20.7 *per cent* cases (151 observations) relate to entities which were not registered as AOPs. In absence of uniformity in PAN registration category of similar class of assessees, in this case registered as Co-operative Society, the ITD would not be in position to derive meaningful information from data available with itself.
(Paragraph 4.1)
- Adequate examination of cases during scrutiny was not done. In 131 cases out of scrutiny assessment cases, where the criteria for selection was 'Large Deductions under chapter VIA of the Income Tax Act' that includes section 80P, the same was not adequately examined.
(Paragraph 4.1)
- Audit noticed instances of raising of demand in cases where returned income was equal to the assessed income at different stages of assessment viz. electronic processing of ITR, rectification, reassessment etc. Audit noticed several reasons for raising these demands such as, accounting of pre-paid taxes at processing of ITR stage, advance tax deposited under wrong head not considered as payment by CPC Bengaluru etc. Such cases point to the fact that claims, payments data are not reconciled at the time of assessment.
(Paragraph 4.12)
- Audit examined cases involving high value additions made during assessment and noticed instances where deduction claimed under section 80P(4) of the Act was disallowed on the pretext that the Co-operative Society was engaged in banking business. The existing activity codes do not differentiate the Co-operative Banks from Primary Agricultural Credit Societies (PACS). ITD should assign codes as per the nature of business or activity for effective monitoring.
(Paragraph 4.13)

Summary of Recommendations

Audit recommends that:

- *The CBDT may consider requesting the Central and State level registering bodies and regulatory authorities governing the Co-operative Societies and Co-operative Banks for instituting the seeding of PAN in their databases and facilitate a structured and institutional sharing of information. A process may be devised to track and monitor any change in the status of the assessee.*

(Paragraph 2.1.1)

- *Appropriate action as per provisions of the Act may be initiated against the non-filers/stop filers to detect the tax evasions. Survey may be utilised to identify Co-operative Societies/ Banks still outside tax net and bring them within the tax net.*

(Paragraph 2.2.1, 2.2.2)

- *The CBDT may ensure that the ITD checks for the actual status of the applicant vis-a-vis its name and activity carried out while allotting PAN to Co-operative Societies. In order to enable easy identification and monitoring of exemptions availed by the assessees, ITD may consider affixing fourth letter as 'A' to the PAN of Co-operative Society. It may also ensure that the change in status of assessees is adequately examined.*

(Paragraph 2.3, 3.1)

- *Evidential proof of a certificate of registration of Co-operative Societies/ Co-operative Banks by Registrar and details of members is essential for completion of assessments. ITD may issue necessary instructions to the Assessing Officers as well as strengthen the internal control mechanisms to ensure that provisions of the Act are being complied with.*

(Paragraph 2.6.1, 2.6.2, 2.6.3)

- *The CBDT may instruct Assessing Officers that the accounts of the Co-operative Societies/ Banks may be accepted by them only when their audit was found to have been conducted by empanelled auditors. Further, the instances of non-compliance to this regulatory requirement may be reported to the concerned regulatory authorities (ROCS, RBI etc.).*

(Paragraph 2.6.1, 2.6.2, 2.6.3)

- *The CBDT may inquire into the reasons for mismatch between data as per assessment records and as recorded in ITD systems with a view to eliminate weaknesses in the system. Necessary corrective action may be completed in a time bound manner.*

(Paragraph 2.4)

- *The CBDT may examine the action initiated in cases where incorrect ITR forms were filed by assessees in the Co-operative Sector and ensure that such returns are treated as invalid at ITR processing stage at CPC Bengaluru. Further, the claim of deductions allowed as Co-operative Societies/Co-operative Banks, if any, may be disallowed in such cases.*

(Paragraph 2.5.2)

- *The CBDT may consider devising a Standard Operating Procedure (SOP) for testing the principles of mutuality during scrutiny assessments of Co-operative Societies. It may also consider adopting a consistent approach for assessment of Co-operative Societies to address the practice of registering nominal and associate members with unequal rights as regular members, which defeat the principle of mutuality.*

(Paragraph 3.2.3)

- *The CBDT may devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies/ Banks to ensure allowance of claim to eligible assessees only.*

(Paragraph 3.8)

- *To ensure allowance of deduction to eligible assessees only, minimise possibility of ineligible claims and for effective monitoring of claims, the activity code and status code of assessee may be linked with the sub-sections of 80P and 36(1) of the Act under which deduction is claimed at the stage of filing of income tax return. The instances where deductions claimed by assessees engaged in ineligible activities was disallowed during assessment may be used used to identify activities, sector(s) and assessees to accord priority in selection for scrutiny in subsequent years. The same may also be reported to the concerned regulatory authorities (ROCS, RBI etc.).*

(Paragraph 3.10)

- *The actual claim of deduction made under section 36(1)(viiia) of the Act may be captured alongwith distinct figures/ details of deduction claimed on total income and rural advances in the relevant schedule of*

ITR forms for effective monitoring, better MIS and assessment of impact of deduction as the actual claim is not getting captured in the existing format.

(Paragraph 3.11.2)

- *Class of assessee and sections of the act under which the possibility of irregular allowance of claims were higher may be identified and monitored. ITD may devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance of deductions.*

(Paragraph 3.1 to 3.7)

- *The CBDT may examine the reasons for wide variations in the applicability of same law under similar conditions and issue directions, if required, to ensure consistency and uniformity in assessment of similar class of assessee engaged in similar activities in Co-operative sector. CBDT may also co-ordinate with regulatory bodies to align the assessment of such assessee in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies. The instances of ineligible assessee claiming deductions admissible to Co-operative Societies and engaged in commercial banking business noticed during assessment procedure may be reported to the regulatory authorities (RBI, ROCS etc.)*

(Paragraph 3.9)

- *The CBDT may issue SOP for assessment of claims made by sugar manufacturing Co-operative Societies under section 36(1)(xvii) to ensure that the allowance of deduction is in accordance with Government policies with respect to pricing of sugar at Central and State level.*

(Paragraph 3.13)

- *The CBDT may revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for errors and put in place a robust IT system and internal control mechanism to eliminate possibility of avoidable errors and to ensure compliance to provisions and conditions laid down under the Income Tax Act by the Assessing Officers. CBDT may like to introduce a quality assurance mechanism to ensure that errors in computations of tax are minimized.*

(Paragraph 4.2 to 4.10)

- *The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite there being clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity of irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance.*

(Paragraph 4.4)

- *The CBDT may ascertain whether the errors/ irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.*

(Paragraph 4.2 to 4.10)

- *The CBDT may ensure that the ITD should focus on reconciliation of claims, through CPC-Bengaluru, actively, to resolve the differences in claims and payments and evolve means to avoid possibilities of non-matching of the same.*

(Paragraph 4.12)

- *The CBDT may consider assigning/ updating codes as per the nature of business or activity ascertained during assessment for effective monitoring of the claims of deduction as per the nature of activities undertaken by Co-operative Societies and Co-operative Banks.*

(Paragraph 4.11)

- *ITR-5 may capture list of all Members of a Co-operative Society, along with their PAN, for the previous year relevant to the Assessment Year of filing of return. Quoting of PAN may be made mandatory for deposits received above a threshold amount by Co-operative Societies. Further, the CBDT may consider reporting instances involving significant quantum of unexplained cash credits to the regulatory authorities (RBI, ROCS etc.) to facilitate monitoring of probable financial irregularities.*

(Paragraph 4.9)

Income Tax Department's response to audit observations and recommendations is discussed in the audit report along with further comments of audit.

Chapter 1: Introduction

1.1 Overview

Co-operative Institutions

A Co-operative¹ is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise. Co-operatives are legally established associations or business enterprises owned and controlled by the members, that, they also serve. The basic feature differentiating Co-operatives from other forms of business ownership is that its primary motive is service to the members rather than making profits.

1.2 Co-operative Societies: Definition, Governing Acts

1.2.1 The formation and working of the Co-operative Societies in India is governed by the Co-operative Societies Act, 1912, a Central Act. Section 4 of the Act defines Co-operative Society as “a society which has in its objectives the promotion of economic interest of its members in accordance with Co-operative principles”. This Act facilitates the formation of Co-operative Societies for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means.

Subsequently, Part IXB was inserted into the Constitution of India by the Constitution (Ninety-seventh Amendment) Act, 2011. It defines the Co-operative Societies as ‘a society registered or deemed to be registered under any law relating to Co-operative Societies for the time being in force in any State’.

Co-operative Societies are further listed under the State List of the Seventh Schedule of the Indian Constitution². The State laws govern the incorporation, regulation and winding up of Co-operative Societies (other than the Multi-State Co-operative Societies that are operating in more than one State) based on the principles of voluntary formation, democratic member control, member-economic participation and autonomous functioning. The respective State Governments and the Registrar of Co-operative Societies (ROCS) appointed by the State monitor and regulate the Co-operative Societies in the States.

1 Source: United Nations website, www.un.org/development/desa/Co-operatives

2 Schedule VII, List II, Item 32 of Constitution of India

A Co-operative Society may be established and registered for the promotion of interest of members in accordance with the Co-operative principles. At least 10 members are required for registering a Co-operative Society. A certificate of registration signed by the Registrar shall be conclusive evidence that the society therein mentioned is duly registered unless it is proven that the registration of the society has been cancelled. The Registrar also classifies the society into classes and sub-classes of societies prescribed in the Governing Acts according to the principal object in the bye-laws.

1.2.2 The incorporation, regulation and winding up of Co-operative Societies operating in more than one state is governed by the Multi-State Co-operative Societies Act, 2002. The federal Co-operative Societies may be classified with reference to the nature of their activities. Not more than one federal Co-operative Society shall be registered in similar and identical objects in same area of operation.

1.3 Co-operative Banks: Definition, Governing Acts

1.3.1 A Co-operative Bank is a Co-operative Society registered or deemed to have been registered under any State or Central Act and is engaged in banking business. The Co-operative Banks are, thus, governed by Central or State regulatory laws governing Single State Co-operative Societies and Multi-State Co-operative Societies in addition to the regulatory laws governing 'Banking', listed as Central subject³ in the Constitution of India. The applicable laws governing the banking activities are:

- a) The Reserve Bank of India Act, 1934;
- b) Part V of the Banking Regulation Act, 1949 as applicable to Co-operative Banks;
- c) The Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004; and
- d) The Banking Laws (Application to Co-operative Societies) Act, 1965.

1.3.2 The Banking Regulation Act, 1949 was made applicable to Co-operative Banks in 1966 by incorporating Section 56 therein. The important provisions of Banking Regulation Act, 1949, which are applicable to Co-operative Banks, are:

- (a) The Act shall not apply to a Primary Agricultural Credit Society (PACS⁴) and a Co-operative Land Mortgage Bank.

³ List I, Item 45, Schedule VII of the Constitution of India.

⁴ Primary Agricultural Credit Society (PACS) is a rural Co-operative credit institution that operates at district or state level and is part of rural Co-operative Banking segment.

- (b) RBI can cancel a license granted to a Co-operative Bank if the bank closes banking business or the bank does not comply with any conditions imposed by RBI while issuing license.

1.4 Taxability of Co-operative Societies and Co-operative Banks

1.4.1 As per Section 2(19) of the Income Tax Act, 1961 (the Act) Co-operative Society means a Co-operative Society registered under the Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force in any State for the registration of Co-operative Societies. A Co-operative Society or Co-operative Bank registered under the Co-operative Societies Act (State or Central Act) is treated as an “assessee” liable to pay income tax under the provisions of the Act and every such Co-operative Society or Co-operative Bank is therefore governed by the provisions of the Act and liable to be assessed to income tax as per the provisions of the Act like any other assessee.

1.4.2 There is no threshold limit for taxability of income in case of Co-operative Society or Co-operative Bank. The incomes are liable to be taxed at slab rates prescribed in the Finance Acts applicable to Co-operative Societies in respective Assessment Years. A Co-operative Society or Co-operative Bank has to file return of income in Form ITR-5 by due date as notified by the Central Board of Direct Taxes (CBDT) for filing of Income Tax Return. Other compliance requirements for Co-operative Societies/ Co-operative Banks under the provisions of the Act include, inter alia, obtaining Permanent Account Number (PAN⁵) and Tax Deduction and Collection Account Number (TAN⁶) registration, payment of advance tax, Tax Deduction at Source provisions including filing of quarterly Tax Deducted at Source (TDS⁷) returns, maintenance of books of accounts and other documents prescribed under section 44AA of the Act; audit under section 44AB of the Act if receipts from business cross specified limits; levy of Alternate Minimum Tax (AMT⁸).

1.5 Why we chose the topic

The Co-operative Sector witnessed a significant growth in terms of number of entities registered as Co-operative Societies and Co-operative Banks as is evident from the graphs below.

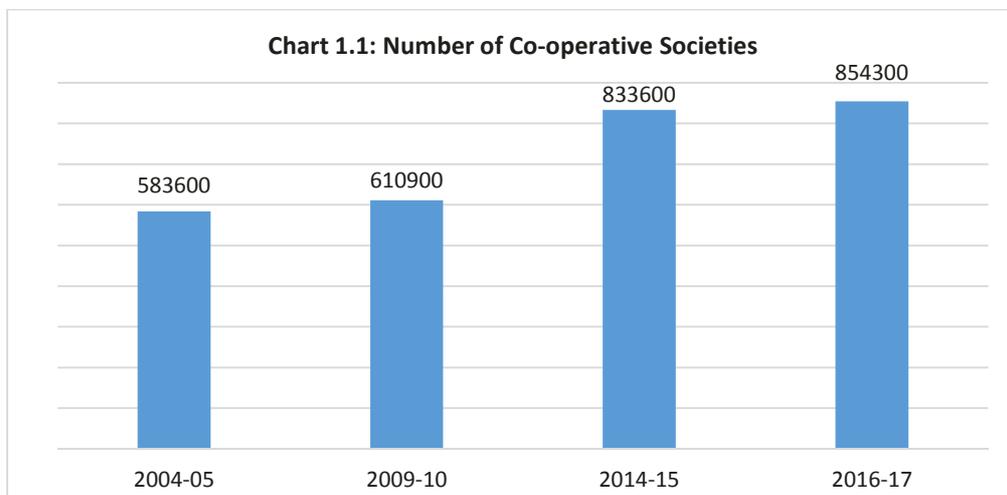
5 Permanent Account Number (PAN) is a unique ten digit alpha numeric number allotted by ITD to any “person” who applies for it.

6 TAN or Tax Deduction and Collection Account Number is a ten digit alpha numeric number required to be obtained by all persons who are responsible for deducting or collecting tax.

7 As per the Income Tax Act, a person (deductor) who is liable to make payment of specified nature to any other person (deductee) shall deduct tax at source and remit the same into the account of the Central Government.

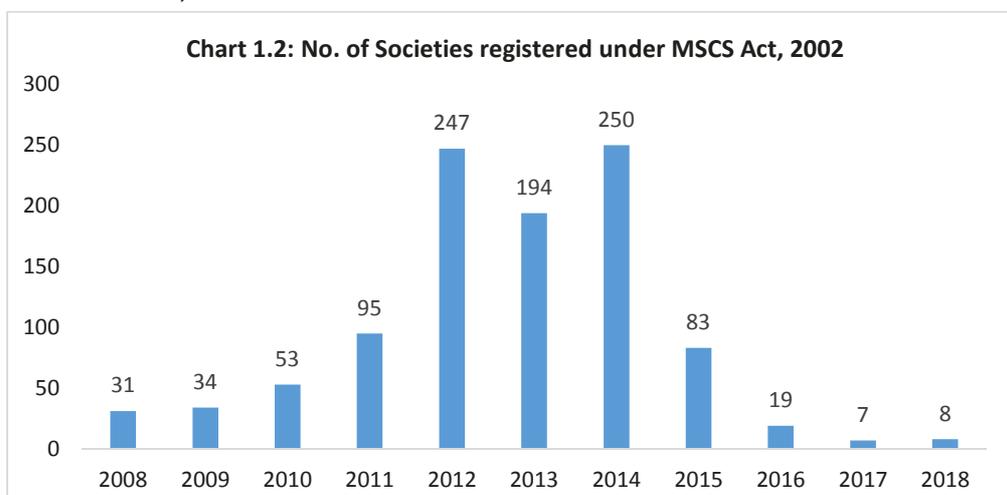
8 Alternate Minimum Tax is minimum tax that is leviable alternative to normal tax under section 115JC of the Act and is applicable to non-corporate taxpayers including Association of Persons (AOPs).

A. **Growth in respect of Co-operative Societies:** During 2009-10 to 2016-17, Co-operative Societies registered a growth of 39.84 per cent.



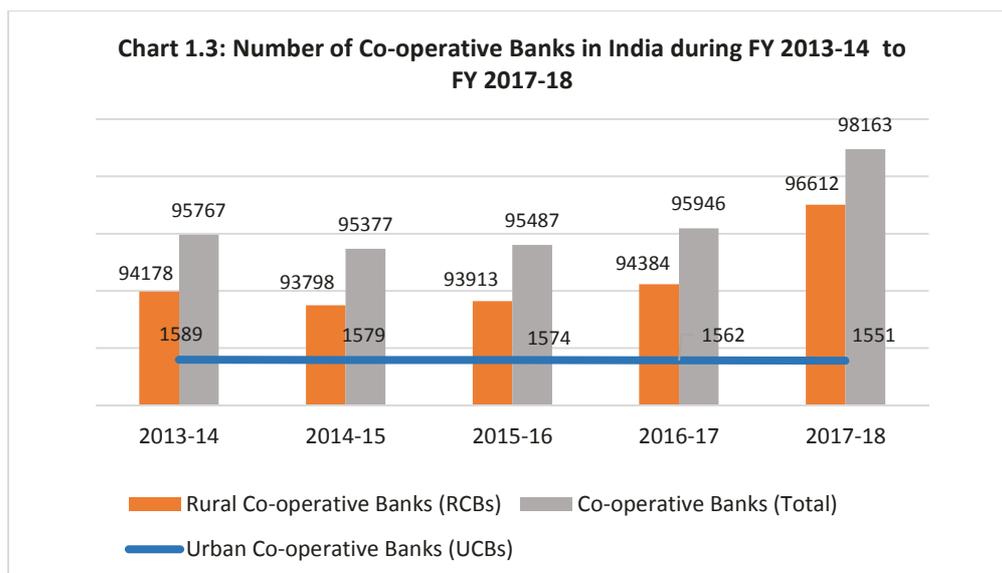
Source: NCUI, Statistical Profile 2018.

B. **Growth in respect of Multi-State Co-operative Societies:** The registration of Multi-State Co-operative Societies was, relatively, high during the years 2012 to 2014, as seen below:



Source: <https://mscs.dac.gov.in/ChartYear.aspx>

C. **Growth of Co-operative Banks:** There was a significant growth in the number of Co-operative Banks post 2014-15. The chart below shows the number of Co-operative Banks in the country during the period between FY 2013-14 to FY 2017-18:



Source: RBI

As mentioned above the Co-operative Sector has witnessed substantial growth both in the number of Co-operative Societies as well as Co-operative Banks. They are subject to tax as per the provisions referred to above. This topic was selected for performance audit with a view to examine the extent of:

- Coverage of Co-operative Societies in Income Tax net;
- Widening and deepening of the tax base; and
- Compliance of the statutory provisions.

1.6 Audit Objectives

The objectives of the performance audit are to examine:

- whether all the entities in the Co-operative Sector are in the tax net and filing income tax returns and are being assessed for levy of due amount of tax;
- the nature and extent of compliance to provisions specific to the assesseees of Co-operative Sector under the Income Tax Act, 1961; and
- the nature and extent of compliance to the general provisions of the Act during assessment process.

1.7 Scope of Audit

The database of returns in respect of the assesseees of Co-operative Sector to be covered in audit was called for from DGIT (Systems) for the FYs 2014-15 to 2017-18. DGIT (Systems) provided Assessing Officer-wise aggregate data and

assessee-wise data of Income Tax Returns (ITRs⁹) assessed during FYs 2014-15 to 2016-17¹⁰ with respect to Co-operative Societies, Co-operative Banks and non-banking finance companies (NBFCs) [2,36,997 records]. The cases having business code 807 (pertaining to NBFCs), exclusively, were excluded to arrive at a population of 1,97,898 records for sample selection of Co-operative Societies and Co-operative Banks. The DGIT(Systems) however, did not provide the status codes¹¹ of the cases shared with audit. The Financial Year (FY)-wise details of 1,97,898 records are given below:

Table 1.1: Details of records shared by DGIT(Systems) for FY 2014-15 to 2016-17

[Amount in ₹Crore]

FY	No of records	Returned Income	Assessed Income	Demand Raised	Amount of Bad and Doubtful Debts	Provision for Bad and Doubtful Debts	Deduction under Section 80P
2014-15	47241	7060.06	28883.23	9121.22	17.82	410.15	3301.36
2015-16	68330	22065.93	38128.69	6709.82	156.35	1387.11	8938.62
2016-17	82327	47267.70	65210.30	5678.52	331.81	2016.77	88495.51

Source: Data provided by DGIT (Systems), ITD

1,97,898 records were analysed and extractions based on audit parameters were segregated area-wise to arrive at a sample detailed in para 1.8 of this chapter.

1.8 Sample Selected and Audited

The sample for this performance audit was derived from the data provided by Income Tax Department (ITD) for period 2014-15 to 2016-17, as per risk assessment carried out by audit. The sample also comprised additional assessment cases finalised during 2017-18 and 2018-19 in respect of PANs selected from the sample derived from ITD data for 2014-15 to 2016-17 and Multi-State Co-operative Societies / Co-operative Banks cases identified from the list of Multi State Co-operative Societies available on the MSCS website.

9 Income Tax Return (ITR) is a form in which the taxpayers file information about his incomes earned and tax applicable to the Income Tax Department.

10 DGIT(Systems) furnished the aggregate data and assessee-wise data of ITRs pertaining to Co-operative Sector that were assessed during FY 2017-18, that was sought before commencement of field audit for planning purposes, towards completion of field audit (September 2019).

11 Status Code – Status codes are used by the Income Tax Department to identify the status of the taxpayer, being either Individual, Hindu Undivided Family (HUF), Firm, Local Authority, Co-operative Bank, Co-operative Society, Any other AOP or BOI, Public Company, Private Company or Others. Status Code for Co-operative Bank is 03 and Co-operative Society is 04.

Details of cases selected for audit in respect of all States/Regions¹² are tabulated below:

Table 1.2: Sample Selection

Sl. No.	Sample selected	No. of cases
1	Number of PCsIT/CsIT selected	291
2	Number of Assessment Charge selected	1726
3	Sample size	9282 ¹³
4	Number of cases not produced	412
5	Number of cases in data furnished by ITD which did not fall under the category of a Co-operative Society or Co-operative Bank.	400 ¹⁴
6	Total (4+5)	812
7	Number of cases covered in the Performance Audit (3-6)	8470

Apart from the above cases covered in the performance audit, 128 audit observations in respect of Co-operative Societies and Co-operative Banks noticed during the compliance audits have also been incorporated separately in Chapter 4 of this report.

1.9 Constraints/ Non-production of Records

Audit had called for 9,282 sample case records (including 81 cases of MSCS) pertaining to Co-operative Societies and Co-operative Banks from 1,726 Assessment Charges for audit scrutiny. Out of chosen sample, 412 (4.44 per cent) cases were not produced to Audit.

ITD has assigned specific Status Code to Co-operative Societies (04) and Co-operative Banks (03) for distinct classification and codification of the assessee pertaining to Co-operative Sector which is captured through ITRs filed by the assessee. The status code of the assessee-wise detailed data of Co-operative Societies and Co-operative Banks was not furnished to audit although the codes are required to be captured through ITD system. As such, focussed risk assessment for Co-operative Societies and Co-operative Banks, separately, could not be carried out. ITD has not furnished any reasons for not providing Status Code details in respect of assessee-wise detailed data of Co-operative Societies and Co-operative Banks (July 2020).

1.10 Profile of selected sample

The sample selected consisted of around 24.7 per cent of cases selected from the state/ region of Maharashtra. Other major states/ regions represented in

12 Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand, West Bengal

13 Includes 81 MSCS cases

14 These cases comprised assessments of assessee with PAN registration status of Company, Local Authority, Trust or AOP but not registered as Co-operative Society or Co-operative Banks.

the selection were Gujarat, Kerala, Karnataka and Uttar Pradesh & Uttarakhand constituting 9.8 *per cent*, 9.0 *per cent*, 7.9 *per cent* and 7.6 *per cent* of the sample respectively. Selections were made from all regions/ states. Region-wise/ state-wise distribution of audit sample is at Appendix 1.

Based on availability of details of nature of business/ activity as per the assessment records audit found that around 59.8 *per cent* of the assesseees in Co-operative Sector were engaged in banking, credit and financial services (including PACS) followed by trading (8.4 *per cent*), sugar (5 *per cent*) and housing (4.7 *per cent*). Details are in Appendix 2.

The selected assesseees included assesseees with PAN registration status of Association of Persons(Trust) [AOP Trust], Artificial Juridical Person (AJP), Company, Firm, Local Authority or Body of Individuals (BOI) besides the status of AOPs. While 78.4 *per cent* of the assesseees were registered with the ITD as AOP, 2.6 *per cent* were registered as BOI and remaining 19 *per cent* were registered as non-AOP/BOI viz. Trust, AJP, Firm, Local Authority and Company.

In 96.9 *per cent* of the cases examined in audit, the returns were filed through ITR-5. In rest of the cases¹⁵, ITR 2 (2 cases), ITR 2D (15 cases), ITR 4 (18 cases), ITR 6 (13 cases) and ITR 7 (21 cases) were used by the assesseees to file their returns.

1.11 Acknowledgement

Audit acknowledges the cooperation of the ITD in providing necessary data/ records/ information and facilitating the conduct of this performance audit. At the start of this performance audit, an Entry Conference was held with the CBDT/ ITD on 6 March 2019 wherein audit objectives, scope of audit and main focus areas of the performance audit were explained. Draft performance audit report was first issued to the Ministry/ CBDT on 21 May 2020 for their comments. Post receipt of the CBDT's response in July 2020, an Exit Conference was held with the CBDT on 16 July 2020 to discuss audit findings and audit recommendations vis-à-vis their comments. Revised report, incorporating the response of CBDT and the exit conference discussion, was issued to the Ministry/ CBDT on 19 August 2020. Response to the revised report was received on 1 September 2020. The results of the discussion, the CBDT's comments and the audit comments have been duly incorporated in the performance audit report.

¹⁵ In the remaining 16 cases (0.19 *per cent*) return was not filed and in 177 cases (2.09 *per cent*) the information on ITR form could not be ascertained.

Chapter 2: Tax Base of Co-operative Societies and Co-operative Banks

According to section 139(1) of the Act, a person other than a company or a firm is required to file return of income if his total income exceeds the maximum amount, which is not chargeable to income tax. Thus, it is mandatory for all the Co-operative Sector assesseees to file return of income as per provisions of the Act. The ITD has also institutionalised the Non-Filers Monitoring System (NMS) mechanism to monitor the non-filers.

Audit called for data of Co-operative Societies and Co-operative Banks from the ROCS of the respective States and Regional Office of the Reserve Bank of India, respectively, and tried to cross verify them with the data maintained in the assessment units of the ITD as well as the pan-India data provided by the DGIT(Systems). Audit also analysed and assessed the monitoring mechanism of the ITD towards ensuring that the Co-operative Societies and Co-operative Banks are compliant with the regulatory requirements. The analysis in respect of verification of regulatory compliance during assessment of entities in Co-operative Sector is elucidated in the following paragraphs.

2.1 Co-operative Societies out of Tax Net

2.1.1 The number of Co-operative Societies and Co-operative Banks as per records of the ROCS of the respective states or regions/ RBI/ NABARD and the number of Co-operative Societies and Co-operative Banks available in the data received from the DGIT (Systems) for the period 2014-15 to 2016-17 and details of confirmation on whether the Co-operative Societies/ Co-operative Banks were in the tax net/ filing ITR and the status of availability of PAN are shown in the table 2.1 below.

Table 2.1: Co-operative Societies/ Co-operative Banks as per DGIT(Systems) data vis- a vis Registering Authorities

Sl. No.	Name of the State / Region	Number of Co-operative Societies and Co-operative Banks as per records of the ROCS/ RBI/ NABARD	Number of Co-operative Societies and Co-operative Banks as per data received from DGIT (System) for the period 2014-15 to 2016-17	Percentage (number) of Co-operative Societies and Co-operative Banks not in the database of the ITD during the period 2014-15 to 2016-17
A	B	C	D	E
1	Andhra Pradesh & Telangana	2,195 ¹⁶	168	92.35 (2027)
2	Bihar	24,293	587	97.58 (23706)
3	Chhattisgarh	9950	1325	86.68 (8625)
4	Delhi	5,985	703	88.25 (5282)
5	Goa	2,765	236	91.14 (2427)
6	Gujarat	75,967	10,372	86.35 (65595)
7	Jharkhand	98	33	66.33 (65)
8	Karnataka	41,795	4,583	89.03 (37212)
9	Kerala	6716	1671	65.31 (4386 ¹⁷)
10	Madhya Pradesh	7742	3316	57.17 (4426)
11	Maharashtra	2,04,228 ¹⁸	78,186	61.72 (126042)
12	North East Region ¹⁹	1783 ²⁰	238	86.65 (1545)
13	North West Region ²¹	22,832	16,303	28.60 (6529)
14	Odisha	4678	244	94.78 (4434)
15	Rajasthan	16,449	2406	85.37 (14043)
16	Tamil Nadu and Pondicherry	26,645	2317	91.30 (24328)
17	Uttarakhand	280	177	38.54 (111)
18	Uttar Pradesh	Information not provided by ROCS	1466	-
19	West Bengal & Sikkim	4014	10719	-
	TOTAL	4,58,415	1,35,050	72.32 (3,31,536)

NOTE: i) The total of 4,58,415 and 1,35,050 are the sum total of figures available for all states.

ii) The total of 3,31,536 is the actual deficient number excluding that of UP and WB; The deficient number if compared to the total of 4,58,415 gives a percentage of 72.32 and if compared to the total of 4,54,401 which excludes states having surplus records in DGIT(S), gives a percentage of 72.96.

16 2094 received from ROCS in respect of 2 and 4 districts of AP & TS respectively and 101 Co-operative Banks registered prior to FY 2014-15.

17 Out of 5045 cases, 659 cases have PAN registration.

18 1,98,252 (Only number of societies and list of websites was provided by ROCS without any list of societies) + 5976 banks

19 Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura

20 1762 from 4 out of 7 ROCS and 21 cases from RBI

21 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

Thus, as seen by audit, 72.32 *per cent* of the identified Co-operative Societies/ Co-operative Banks registered with the registering authorities were found to be outside the database of DGIT(Systems) and thus out of tax net.

Even while the law mandates that all Registered Co-operative Societies shall file income tax returns annually by the due date, the table above indicates that majority of the Co-operative Societies and Co-operative Banks were not filing the income tax return. It was further observed that there is no mechanism to ensure that all Co-operative Societies are complying with this requirement at either end i.e., ROCS or the ITD. Procedurally, all registered Co-operative Societies have to obtain PAN and commence filing of returns. However, there is no mechanism of seeding the PANs of the registered Co-operative societies in the databases of the respective ROCS. Further, there is no institutionalised mechanism of sharing of information between ROCS and the ITD, leading to inadequacies and a large number of registered Co-operative Societies still remaining outside the tax net. Except a partial reply in Maharashtra and West Bengal, the ITD have not replied to the letters sent for confirmation of tax registration status/ITR filing status/availability of PAN. Thus, whether these Co-operative Societies/Banks are included in the tax net or not could not be confirmed by audit.

2.1.2 In Karnataka, out of 4,583 assessee filing returns in Karnataka jurisdiction, only 1,620 assessee were registered as Co-operative Societies, leaving 2,963 records unmatched. Out of 2,963 assessee; 2,180 were claiming deduction under section 80P of the Act, meant for registered Co-operative Societies only. Out of this 2963 unmatched records, 676 assessee have the word "Souharda" in their name suggesting their registration under the Karnataka Souharda Act, 1997 and the remaining 2,287 assessee did not have proper registration. This indicates that majority of the Co-operative Societies filing returns and claiming deduction were either not eligible or the regulatory authority was not monitoring the registration process. Out of the 2,180 assessee claiming deduction under section 80P of the Act, 168 assessee pertained to the audit sample, of which, in 125 cases, no data on registration was available on record. Further, in 17 cases out of 168 assessee, though the data on registration was available with the ITD, it did not match with the ROCS data. In two cases, it was seen that the names were featuring as registered under the Karnataka Co-operative Societies Act, 1959 as well as the Multi State Co-operative Societies Act, 2002.

In one case though the Registration Certificate and copy of amendment of Bye-laws approved by the Joint Central Registrar of Co-operative Societies were produced, the name did not feature in the database of Multi State

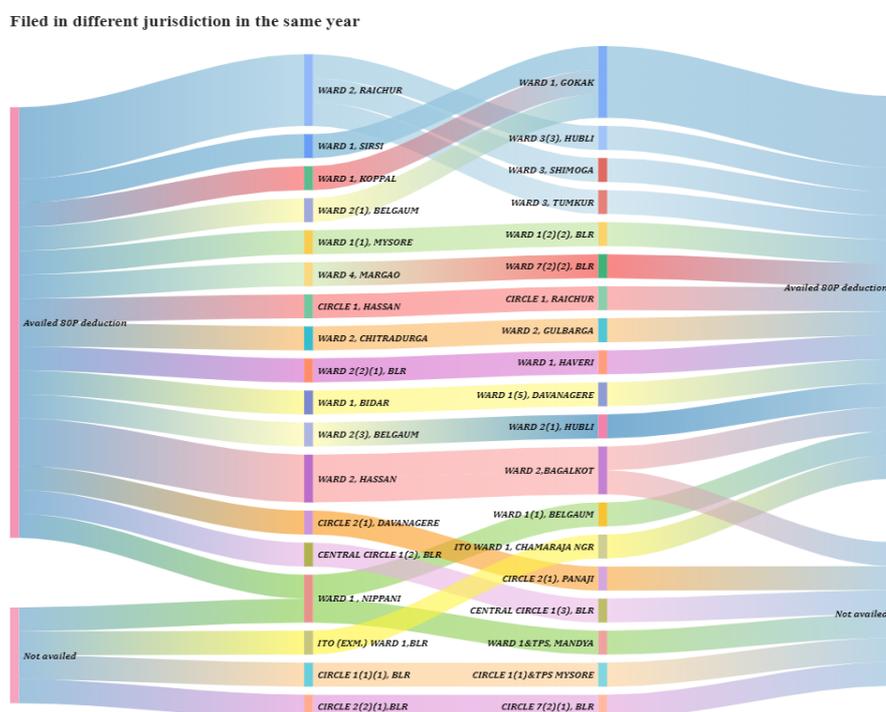
Co-operative Societies. In one case, the name as on the registration certificate and as per assessment records were found to be different.

Further, in another 144 records, where assessees have common names, 90 assessees were filing returns,

- a) without proper registration as they do not feature in the database of the ROCS; or
- b) in a jurisdiction other than the one they were registered; or
- c) having registration under Karnataka Co-operative Societies Act, 1959 as well as the Karnataka Souharda Sahakari Act, 1997 and 77 of them were availing deduction under section 80P of the Act.

Interestingly, 30 of these assessees with common names seem to have multiple PANs and were filing returns in different jurisdictions rendering it difficult for assessing officers to detect such an incidence. Of these, 22 assessees had filed returns with different jurisdictions in the same year(s) and claiming deductions under section 80P of the Act as depicted in the chart given below suggesting a proliferation of PANs.

Chart 2.1: Different jurisdictions in which assessees filed returns for the same year



Note: Each line in the chart denotes an assessee filing in different jurisdiction and the status of availing deduction under section 80P of the Act. For e.g.: one assessee was filing in both Circle 1, Hassan and Circle 1, Raichur and had availed deduction under section 80P of the Act in both jurisdictions.

In the absence of Registration Certificates of these assesseees, the Assessing Officers had no means to identify their genuineness and to ascertain whether the same assesseees are filing returns in different jurisdictions.

In Goa, comparison of assessee's name, filing returns as per the DGIT(Systems) data with the name of the Societies registered with the ROCS, Goa revealed that out of 236 assesseees filing returns in Goa, 61 assesseees did not feature as registered Societies with the ROCS, Goa. Further, during the three year period 2014-15 to 2016-17, these 61 assesseees (137 assessment cases) had claimed deduction under section 80P of the Act, which was allowed by the Assessing Officers even though they were not registered with the ROCS, Goa.

Thus, ITD did not cover all the Co-operative Societies and Co-operative Banks in their tax net, as is evident from the large percentage of Co-operative Societies and Co-operative Banks not found in the database of the ITD during the period 2014-15 to 2016-17, when compared to the data of the registering authorities. Further presence of assesseees, who could not be matched with the ROCS data or with multiple PANs, also indicate towards possible misuse of the claim of deduction under section 80P of the Act. In the absence of reply/confirmation from the ITD regarding the confirmation of tax registration status/ ITR filing status/ availability of PAN of the assesseees, audit is not in a position to arrive at actual number of assesseees who are out of the tax net.

2.2 Non-utilisation of Surveys/Search and Seizure mechanism for strengthening of the Tax base

Section 132, 133 of the Act empowers the Income Tax Authorities to conduct search and survey operations and to gather information relating to financial transactions of the assesseees/ potential assesseees/entities which are out of the tax net. These tools may enable the ITD to identify new assesseees and to detect and unearth the cases of stop filers, non-filers and tax evaders.

2.2.1 Surveys

Audit requisitioned data on number of surveys conducted during the period 2014-15 to 2018-19 from the assessment charges and the concerned wings of the ITD. The details on status of response are given below:

Table 2.2: States/Region-wise details of Surveys conducted during 2014-15 to 2018-19

States/Region where Information on surveys NOT furnished by the ITD	States/Region in which no surveys conducted as per reply of ITD	States/Region in which partial information received from ITD
Andhra Pradesh & Telangana, Chhattisgarh, Goa, Madhya Pradesh and Tamil Nadu	Bihar, Jharkhand, North East Region ²² , Odisha, Uttarakhand, Uttar Pradesh and West Bengal	Karnataka, North Western Region ²³ (4 PCITs)

Source: ITD

The information received in respect of Delhi, Gujarat, Kerala, Maharashtra Rajasthan, and partial information received in cases of above states is tabulated below:

Table 2.3: Surveys conducted during 2014-15 to 2018-19

Year	Surveys conducted during the FY	Surveys conducted on		No. of new assesseees identified in the survey during FY		No. of assesseees out of column (E) and (F) which filed the return of income	
		Co-operative Societies	Co-operative Banks	Co-operative Societies	Co-operative Banks	Co-operative Societies	Co-operative Banks
A	B	C	D	E	F	G	H
2014-15	108	0	0	0	0	0	0
2015-16	132	1	1	0	0	0	0
2016-17	317	31	28	0	2	0	2
2017-18	110	4	3	0	0	0	0
2018-19	139	3	1	0	0	0	0
Total	806	39	33	0	2	0	2

Source: ITD

2.2.2 Search and Seizure

Information on Search and Seizure was called for by audit from all the assessment charges and the DGIT (Investigation)-wings of all states for the period 2014-15 to 2018-19 to study the trend of search and seizure activity to increase the tax base and enforce the tax compliance by the Co-operative Sector assesseees. The details on status of response are given below.

22 Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura

23 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

Table 2.4: States/Region-wise details of Search and Seizure conducted during 2014-15 to 2018-19

States/Region where Information on search & seizure NOT furnished by the ITD	States/Region in which no search & seizure conducted as per reply of ITD	States/Region in which information received from ITD
Goa, Karnataka, Madhya Pradesh, North Western Region ²⁴ and West Bengal.	Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Jharkhand, Odisha, North East Region ²⁵ , Tamil Nadu, Uttar Pradesh, and Uttarakhand.	Delhi, Gujarat, Rajasthan, Kerala and Maharashtra

Source: ITD

The information received in respect of Gujarat, Rajasthan, Kerala, Maharashtra and Delhi is tabulated below.

Table 2.5: Search and Seizure Operations conducted during 2014-15 to 2018-19

Year	Total number of Search and Seizure operations conducted during the FY	No. of Search and Seizure operations conducted under section 132/132A of the Act		No. of new assesseees identified in the search & seizure operations during the FY		No. of assesseees out of column (E) and (F) which filed the return of income		No. of cases in which the information was passed on in respect of other assesseees involved in suspicious transactions to jurisdictional Assessing Officer for further necessary action.	
		Co-operative Societies	Co-operative Banks	Co-operative Societies	Co-operative Banks	Co-operative Societies	Co-operative Banks	Co-operative Societies	Co-operative Banks
A	B	C	D	E	F	G	H	I	J
2014-15	69	1	0	0	0	0	0	1	0
2015-16	52	0	0	0	0	0	0	0	0
2016-17	139	2	0	0	0	0	0	0	0
2017-18	92	3	3	265	0	149	0	56	0
2018-19	100	1	2	0	0	0	0	0	0
Total	452	7	5	265	0	149	0	57	0

Source: ITD

It can be seen that 265 new assesseees were identified during three search & seizure operations conducted in Maharashtra in the year 2017-18. However, in respect of other years no new assesseees could be added to the tax net. The number of surveys and search and seizure operations for the Co-operative Sector, as a proportion of total surveys and search and seizure operations

24 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

25 Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura

conducted by the ITD was minimal. Thus, it is evident that the mechanism of surveys and search & seizure operations has not been utilised effectively by the ITD in identifying more tax defaulters/ potential assesseees in the Co-operative Sector except for one year despite a large number of cases²⁶ being out of the tax net.

2.3 Details of PAN registration status of Co-operative Societies/ Co-operative Banks

The ITD uses 'Status Codes' to identify the status of the taxpayer, being either Individual, Hindu Undivided Family (HUF), Firm, Local Authority, Co-operative Bank, Co-operative Society, any other AOP or BOI, Public Company, Private Company or Others. The DGIT(Systems), however, did not provide the status codes in respect of the cases provided to audit.

Unlike other category of assesseees viz., Individual, HUF, Firm, Company, etc., identified with the fourth alphabet of the PAN, the Co-operative Sector assesseees are not specifically identified by their PAN. However, they are classified, generally, as AOP and hence should have the fourth alphabet of their PAN registration number allotted by ITD as 'A'. As such, the assesseees registered as Trust, AJP, BOI, Firm, Local Authority and Company cannot be assessed as Co-operative Societies. Further, the CBDT has also stated (July 2020) that "for the purpose of the Income-tax Act, 1961, Co-operative Societies are treated as Association of Persons".

Audit noticed that out of 8,470 assessment cases, in 1,826 cases (21.6 per cent) although the assesseees were Co-operative Societies and Co-operative Banks, PANs allotted to them had fourth letter other than 'A', as depicted in table given below.

²⁶ Refer para 2.1.1 on Incomplete tax net

Table 2.6: Region-wise/ State-wise assesseees registered as non-AOP (with fourth letter of PAN other than 'A')

Region/ State	AOP (TRUST) (Fourth letter of PAN as 'T')	AJP (Fourth letter of PAN as 'J')	COMPANY (Fourth letter of PAN as 'C')	FIRM (Fourth letter of PAN as 'F')	LOCAL AUTHORITY (Fourth letter of PAN as 'L')	BOI (Fourth letter of PAN as 'B')
AP & TS	56	21	1	25	2	6
Bihar & Jharkhand	8	23	2	1	0	0
Delhi	39	16	0	4	2	4
Gujarat	61	31	3	24	4	28
Karnataka	23	51	1	38	30	8
Kerala	21	23	6	20	6	18
Maharashtra	148	113	4	40	47	63
MP & Chhattisgarh	34	40	1	14	13	20
North Eastern Region ²⁷	8	3	0	1	2	5
North Western Region ²⁸	60	46	5	16	17	20
Odisha	11	2	0	0	2	16
Rajasthan	35	41	7	18	14	9
Tamil Nadu	23	16	0	8	6	5
UP & Uttarakhand	84	55	4	26	58	11
West Bengal & Sikkim	7	13	0	7	11	11
Grand Total	618	494	34	242	214	224

It is observed from the above that Co-operative Societies are getting registered with fourth letter of PAN being other than 'A'. Such incorrect categorisation of assesseees gives rise to possibility of generation of faulty information pertaining to the assesseees involved in Co-operative Sector activities, apart from possibility of availing benefits by Co-operative Societies and Co-operative Banks, incorrectly.

In Karnataka, Pr. CIT Mangalore charge, in one case an assessee was changing its status every year. While for AY 2014-15 and AY 2015-16, the declared Status was "Co-operative Society", in AY 2016-17 the status declared was "Co-operative Bank" and in AY 2017-18, status declared was "AOP/BOI". The Assessing Officer did not take any action to correctly determine the status of the assessee. Further, in 14 cases, errors existed in determination of status of assesseees. While some of the Co-operative Societies were declaring their status as Co-operative Banks despite their actual status being Co-operative Society. Similarly, some of the Primary Co-operative Agricultural and Rural

27 Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura

28 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

Development Banks whose actual status was Co-operative Society were declaring their status as Co-operative Bank. Thus there seems to be no clarity about the treatment of credit Co-operative Societies and Primary Co-operative Agricultural and Rural Development Bank.

ITD may, while allotting PAN, check for the actual status of the applicant vis-a-vis its name and activity carried out and allot PAN only with fourth letter as 'A' for the Co-operative Societies to enable easy identification and monitoring of exemptions availed by the assesseees. It may also ensure that the change in status of assesseees is adequately examined and justified.

2.4 Mismatch in data provided by the DGIT (Systems) and data as per Assessment Records

The DGIT(Systems) maintains centralised granular information on details of incomes, expenses, exemptions and deductions returned by assesseees through data captured from ITRs furnished by them and the assessments carried out by the Assessing Officers, thereafter. As the systems and processes are designed to capture ITR level data and assessment level data, ideally there should not be any mismatch between data available with the DGIT(Systems) and data available with the assessment units, as they emanate from the same source i.e. the ITR and the assessment process. However, audit scrutiny revealed mismatch between the figures furnished by the DGIT (Systems) and the data collected from the assessment records as discussed below:

2.4.1 Mismatch in the list of cases assessed as per DGIT (Systems) and as per Demand and Collection Register maintained at assessment charges

Audit called for details of Co-operative Societies and Co-operative Banks collected from the Demand and Collection Registers (D&CR) maintained in the assessment charges. As the data of the DGIT(Systems) contained list of only those assesseees who have filed returns and/or were assessed {under section 143(1)/143(3)/154/250} once or more between the year 2014-15 to 2016-17, the comparison could be done only with the D&CR for the assessment years 2014-15 to 2016-17. The numbers of cases though found in the D&CR but not included in the data of the DGIT(Systems), in respect of states/ regions are given below:

Table 2.7: Mismatch between the DGIT (Systems) data and D&CR data.

Sl. No.	State/Region ²⁹	No. of D&CR records that were not a part of data of the DGIT (Systems)
1	Andhra Pradesh & Telangana	45
2	Bihar	2
3	Delhi	3
4	Gujarat	51
5	Jharkhand	12
6	North East Region	76
7	Rajasthan	145
8	West Bengal	26
Total		360

Thus, it is evident that the DGIT(Systems) data provided to audit was not comprehensive and complete and did not map the entire Co-operative Societies/Co-operative Banks assessed in ITD.

Further review of the above cases revealed that the assessees as per the D&CR and not found in the DGIT (Systems) data included 72 assessees (20 per cent of 360) who were not assessed as AOP. Rajasthan accounted for 27 of these assessees, Andhra Pradesh & Telangana accounted for 17, apart from Gujarat, NER and Jharkhand that accounted for 9, 8 and 8 cases, respectively. Bihar, Delhi and West Bengal accounted for one case each. Incorrect categorisation of assessees gives rise to possibility of generation of incorrect and unreliable information, apart from possibility of benefits being availed by ineligible Co-operative Societies and Co-operative Banks.

2.4.2 Mismatch in data as per the DGIT(Systems) and as per the Demand and Collection Register maintained in assessment charge

The number of cases where mismatch of information between the data as per the DGIT(Systems) and data collected from the D&CR were noticed are given below:

²⁹ Data was not received/only partially received in respect of Chhattisgarh, Karnataka, Maharashtra, Madhya Pradesh, North West Region, Odisha, Tamil Nadu, Uttar Pradesh and Uttarakhand.

Table 2.8: Mismatch in data as per the DGIT(Systems) and as per the D&CR

Information wherein mismatch was noticed	No. of PCsIT/ CsIT	No. of states	No. of cases in which difference/ mismatch was noticed
Mismatch in Returned Income	269	16 ³⁰	1170
Mismatch in Assessed Income	249	14 ³¹	613
Mismatch in Demand	248	14 ³²	903
Difference in amount of bad and doubtful debts	247	15 ³³	326
Difference in amount of provision for bad and doubtful debts	247	15 ³⁴	845
Difference in amount of deduction claimed under section 80P of the Act	226	13 ³⁵	561

Thus, it is evident that the DGIT(Systems) data provided to audit was not updated.

2.5 Effectiveness of filing of Income Tax Returns

2.5.1. Non-filers and stop filers

Audit attempted to verify whether the Co-operative Societies registered under the Co-operative Societies Act or any other law for the time being in-force in any State with the registering authority i.e. ROCS were assessed as per the records of ITD. Audit examination of 4,030 assesseees (Unique PAN cases) revealed that, in following number of cases, ITRs were not filed on a regular basis during AYs 2015-16 to 2018-19:

Table 2.9: Non-filers and Stop-filers

Assessment Year	No. of cases examined (Unique PAN)	No. of cases where ITRs were filed	No. of cases where ITRs were not filed			
			Co-operative Societies	Co-operative Banks	Status Not Available	Total
2015-16	4030	3255	250	27	1	278
2016-17	4030	3232	209	23	1	233
2017-18	4030	3056	274	30	1	305
2018-19	4030	2996	309	30	1	339

30 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

31 Andhra Pradesh & Telangana, Delhi, Gujarat, Jharkhand, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

32 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Jharkhand, Madhya Pradesh, Maharashtra, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

33 Andhra Pradesh & Telangana, Bihar, Gujarat, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

34 Andhra Pradesh & Telangana, Bihar, Gujarat, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

35 Andhra Pradesh & Telangana, Bihar, Gujarat, Jharkhand, Madhya Pradesh, Maharashtra, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

The instances of non-filing of ITRs were proportionately higher in case of Co-operative Societies ranging between 89.7 to 91.2 *per cent* as compared to 8.8 *per cent* to 9.9 *per cent* in case of Co-operative Banks during AYs 2015-16 to 2018-19. Audit further noticed that, of cases indicated in the above table, 155 assessee³⁶ comprising 132 Co-operative Societies and 22 Co-operative Banks³⁷ did not file ITRs during all four AYs. Further, out of these 155 non-filer cases, 59.4 *per cent* of assesseees were assessed as AOP; whereas other non-filers were registered as Trust (12.9 *per cent*), AJP (11.6 *per cent*), Firms (7.1 *per cent*), Local Authority (3.9 *per cent*), BOI (3.2 *per cent*) and Company (1.9 *per cent*). The details of action taken against such assesseees could not be ascertained in audit. ITD's reply in this regard is awaited (July 2020).

In Karnataka, out of 263 Co-operative Banks who have obtained license from RBI, 43 banks were not filing returns.

Analysis of the list of Co-operative Societies, obtained from the registering authorities, who did not file their ITRs in Karnataka revealed that "Milk Producer's societies" constituted 41 *per cent* of the total non-filers, followed by "Credit societies" constituting 21 *per cent* of the non-filers. Sector wise details of the registered Co-operative Societies of Karnataka not filing returns are as under:

Table 2.10: Activity wise non-filer Co-operative Societies in Karnataka

Activity Type of Non-Filer Co-operative Society	Number
Milk Producer's Society	14905
Credit Society	7691
Others - Miscellaneous	3354
Water Consumer's Society	2878
Multi-purpose Society	2822
Agriculturist's Society	1446
Housing Society	1196
Consumer's Society	981
Fishermen's Society	538

Similarly, in Goa, analysis of the non-filers Co-operative Societies revealed that "Housing societies" constituted 70 *per cent* of the total non-filers. Sector wise details of the registered Co-operative Societies of Goa not filing returns are as under:

36 Andhra Pradesh & Telangana, Bihar & Jharkhand, Delhi, Gujarat, Karnataka & Goa, Kerala, Madhya Pradesh & Chhattisgarh, Maharashtra, North Western Region, Rajasthan, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

37 In one case of non-filer (Maharashtra) the status of assessee was not available.

Table 2.11: Activity wise non-filer Co-operative Societies in Goa

Activity Type of Non-Filer Co-operative Society	Number
Housing	1811
Credit (credit, urban credit)	296
Service sector (bank, consumer, marketing, service, transport)	151
Agriculture sector (dairy, farming, fisheries, pani vantap, poultry, processing, producers)	181
Industrial Sector (industrial, labour, resources)	98
Other societies (general, union federation, urban societies, blanks)	53

The above analysis clearly points towards the tendency of default in filing of income tax returns on part of Co-operative Societies. This, in turn, highlights the ineffectiveness of the Non-Filers Monitoring System (NMS) of the ITD.

2.5.2 Use of Incorrect ITR forms for filing Returns by Co-operative Sector assesseees

Rule 12 of Income Tax Rules, 1962 prescribes different ITR forms to be filed by different categories of assesseees. Further, as per instructions for filing ITR 5, it can be used by a person being a firm, Limited Liability Partnership (LLP), AOP, BOI, AJP, representative assessee, Co-operative Society, Society registered under Societies Registration Act, 1860 or under any other law of any State, trust other than trusts eligible to file Form ITR-7, estate of deceased person, estate of an insolvent, business trust referred to in section 139(4E) of the Act and investments fund referred to in section 139(4F) of the Act. However, a person who is required to file the return of income under section 139(4A) or 139(4B) or 139(4D) of the Act shall not use this form. Co-operative Societies are required to be assessed as AOPs.

During audit it was noticed that in 69 assessment cases³⁸, appropriate form i.e. ITR-5 for filing the Income Tax Return was not used by the assesseees in cases of Co-operative Sector. These instances of filing of incorrect ITR forms were noticed in respect of 61 cases of Co-operative Societies and 8 cases of Co-operative Banks. Further, out of these 69 cases where incorrect ITR forms were used by assesseees, 73.9 per cent of assesseees were assessed as AOP whereas remaining 26.1 per cent were registered as AJP, Trust, Local Authority, Firms and Company.

Further, audit noticed 11 irregularities in 69 cases that are discussed in Chapter 3 (4 cases³⁹ of irregular allowance of deduction involving tax impact of ₹ 181.77 lakh) and Chapter 4 (7 cases⁴⁰ of mistakes in computation of tax/levy of interest involving tax impact of ₹ 847.97 lakh) of this Report. It is

38 Gujarat, Kerala, Maharashtra, Madhya Pradesh & Chhattisgarh, North Western Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

39 Karnataka(2), Madhya Pradesh(2).

40 Karnataka(1), North Western Region(1), Tamil Nadu(1).

further seen that of the 11 irregularities, 9 pertained to Co-operative Societies and 2 to Co-operative Banks.

In absence of use of appropriate ITRs by the Co-operative Societies, the ITD would not be in a position to generate correct information about the Co-operative Societies and ensure that specific deductions are allowed under the Act.

ITD may examine the action initiated in cases where incorrect ITR forms were filed by the assesseees in the Co-operative Sector and ensure that such returns are treated as invalid at ITR processing stage through Centralised Processing Centre (CPC) Bengaluru.

2.6 Inadequate mechanism for watching regulatory compliance

All registered Co-operative Societies are required to comply with the basic conditions of registrations as prescribed by the respective Co-operative Societies Act. A review of the 8,470 assessment folders of the selected sample cases disclosed that either there was poor documentation or the basic conditions were not being fulfilled by the Co-operative Societies, pointing towards inadequate verification mechanism in the ITD by the respective Assessing Officers. Details are given below:

2.6.1 Evidential proof of a certificate of registration by Registrar

Allowance/ disallowance of any deduction to a Co-operative Society/ Co-operative Bank should be based on the society being registered with the ROCS, as the case may be. The proof of registration is the Registration Certificate issued by the ROCS. Therefore, it is necessary for the Assessing Officer to verify the Certificate of Registration at the time of assessment. However, it was observed that out of 8,470 assessment cases examined in audit, in 4,376 cases⁴¹, the registration certificate was not available in the assessment folders.

In Delhi, in case of four assesseees audit observed that even though they claimed deduction of ₹ 39.97 crore and were allowed ₹ 39.03 crore under section 80P of the Act, neither the registration certificate was found in their assessment records nor their names were found in the data provided by ROCS, Delhi. In this regard, audit queries were issued to the ITD to provide the registration certificate of the four cases. Although in one case ITD provided the copy of registration with ROCS, the date of registration/ name/ registration number was not matching with the list of ROCS. The matter was

⁴¹ Andhra Pradesh & Telangana, Bihar & Jharkhand, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh & Chhattisgarh, Maharashtra, North East Region, North Western Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

referred to ROCS (September 2019) to confirm whether these entities are registered with them. Their confirmation is awaited.

The above indicates that the system of keeping on record evidential proof of registration status of the assessee of Co-operative Sector in the ITD is not foolproof. In absence of the registration certificate, audit could not ascertain as to how the Assessing Officers ensured the genuineness of claim of deduction made by the assessee under section 80P of the Act.

2.6.2 Verification of Registration Status of Assessee

A Co-operative Society's registration should be valid for it to claim deductions under section 80P of the Act, as they can be deregistered or their registration may be cancelled, as per the respective Acts. The registration status of a Co-operative Society is to be verified by the Assessing Officer to determine whether it is eligible for claiming exemption under section 80P of the Act. It was observed that out of 8,470 cases examined in audit, in 842 cases⁴² the status of registration was not examined or verified during assessment whereas in 5,343 cases⁴³, it could not be ascertained in audit from the assessment records whether the verification of status of registration was done during assessment.

Audit attempted to examine whether there exists any mechanism to verify the data/ registration status of the assessee with the registering bodies. The responses received from the ITD were that there was no mechanism to verify the registration status or that the units verify the required documents during assessment. Information on verification of registration status by the assessing units from West Bengal & Sikkim, North East Region, Gujarat and Delhi is as below:

42 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, North Western Region, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal & Sikkim.

43 Andhra Pradesh & Telangana, Bihar & Jharkhand, Delhi, Gujarat, Karnataka, Madhya Pradesh & Chhattisgarh, Maharashtra, North Eastern Region, North Western Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

Table 2.12: Verification of registration status with the registering bodies by the assessing officers

State/ Region	Number of units from whom it was enquired if they verified the registration status of the assessees	Response		
		Received	No mechanism to verify the registration status	Verified during assessment
West Bengal & Sikkim	114	71	46	25
North East Region	21	21	19	2
Gujarat	162	38	32	6
Delhi	81	79	79	-

The above indicates that there is no mechanism to verify the registration status of the Co-operative Societies. However, some assessing officers verified the same during assessment proceedings.

In respect of Charitable Trusts, the ITD amended section 12AA of the Act so as to provide that at the time of granting registration to a trust or institution, the Principal Commissioner or the Commissioner shall, inter alia, also satisfy himself about the compliance of the trust or institution to requirements of any other law which is material for the purpose of achieving its objects. Finance Bill 2020 further amended section 12AA of the Act to provide that the approval or registration or notification for exemption for an entity notified under clause (23C) of section 10 of the Act, section 12AA or section 35 of the Act would be valid only for five years at a time, which would act as check to ensure that the conditions of approval or registration or notification are adhered to for want of continuance of exemption.

The CBDT may consider introducing a similar provision in case of Co-operative Societies/ Co-operative Banks to facilitate ITD to monitor cancellation of registration/ change in status of such assessees by the ROCS/Banks.

2.6.3 Verification of details of Members in ITR from the Register of Members (records being maintained by Registrar)

The details of the new Members of Co-operative Society in case of change in Members during the previous year relevant to the Assessment Year of filing of return is captured in ITR-5 alongwith the details of percentage of shares under "Member's Information" which is then uploaded in the ITD systems. Audit noticed that in 950 cases⁴⁴ the details of Members were not verified

44 Andhra Pradesh & Telangana, Bihar & Jharkhand, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, North Western Region, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal & Sikkim.

during assessment whereas in 6,389 cases⁴⁵, the assessment folder did not contain any information about the verification of details of Members captured from ITR-5 in ITD systems vis-à-vis the Register of Members of the Co-operative Society maintained by the ROCS containing particulars of Members, admission and cessation details, shareholding details etc.

2.6.4 Audit of accounts

Every Co-operative Society shall cause to be audited by an auditor or auditing firms referred to in clause appointed by the general body of the Co-operative Society, provided that such auditors or auditing firms shall be appointed from a panel approved by the State Government or an authority authorised by the State Government in this behalf. The accounts of every Co-operative Society shall be audited within six months of the close of the financial year to which such accounts relate. The details of such audit, under an Act other than the Income Tax Act, 1961, are also supposed to be collected through ITR-5.

2.6.4.1 Accounts of Co-operative Societies not audited by empanelled auditors

During the performance audit of Co-operative Societies it was observed that out of 6,425 cases of Co-operative Societies assessed by ITD during 2014-15 to 2018-19, in 974⁴⁶ cases of Co-operative Societies' annual accounts/ financial statements were not audited by the empanelled auditors.

In Bihar, PCIT Muzaffarpur charge, audit noticed three cases where accounts were audited by a Chartered Accountant (CA) firm, which was not empanelled with ROCS, Bihar. However, the audited accounts were accepted without verification during summary processing of ITRs as well as scrutiny assessment.

In Karnataka, in 53 cases, it was observed that the requirements of getting accounts audited once every year by an empanelled auditor/ auditing firm, were not complied with. Out of the above, deduction amounting to ₹23.16 crore had been allowed in 31 cases under section 80P of the Act.

In Maharashtra, audit examined 2,320 cases and noticed that in none of the cases, the list of empanelled auditors from ROCS or Reserve Bank of India was kept on record. In the absence of such list, audit could not verify whether the Assessing Officers had assured themselves that the accounts of the Co-operative Societies were audited by empanelled auditors before commencing

45 Andhra Pradesh & Telangana, Bihar & Jharkhand, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh & Chhattisgarh, Maharashtra, North Eastern Region, North Western Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

46 Andhra Pradesh & Telangana, Bihar & Jharkhand, Karnataka, Kerala, Madhya Pradesh & Chhattisgarh, North Western Region, Odisha, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

with the assessment. Out of the above, deduction amounting to ₹130.19 crore had been allowed in 1,126 cases under section 80P of the Act.

In Uttar Pradesh and Gujarat, list of empanelled Auditors for the FYs 2014-15 to 2018-19 was called for from the respective ROCs, however the same was not received (November 2019). Audit could not confirm whether annual accounts/ financial statements of Co-operative Societies were audited by auditors from the empanelled list.

2.6.4.2 Accounts of Co-operative Banks not audited by empanelled Chartered Accountants

Consequent upon the signing up of MoU between the Government of India, NABARD and by most of the State Governments for implementing the covenants of Co-operative Reforms Package, State Co-operative Societies Acts have been amended in majority of States so as to facilitate undertaking of statutory audit of Co-operative Banks by the Guidance Note on Audit of Chartered Accountants. The respective Co-operative Banks were given the freedom of selecting the Chartered Accountants out of the panel circulated by NABARD. In view of this, appointment of statutory auditors can be made by Co-operative Banks from the panel of Chartered Accountants circulated by NABARD.

Under the provisions of the respective Acts, the Registrar shall audit or cause to be audited by an authorized person the accounts of State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) at least once every year. As per the guidelines issued by NABARD, now the audit of StCBs and DCCBs will be done by Chartered Accountants empanelled with RBI.

Audit noticed that out of 2,039 assessment cases of Co-operative Banks, assessed by ITD during 2014-15 to 2018-19, annual accounts/ financial statements of 84 cases of Co-operative Banks⁴⁷ were not audited by the Chartered Accountant selected from the approved panel circulated by NABARD. Due to non-compliance of the said requirement, how the ITD ensured the genuineness of the claims made by the assesseees could not be confirmed by audit.

47 Andhra Pradesh & Telangana, Madhya Pradesh & Chhattisgarh, Karnataka, Kerala, North Western Region, Tamil Nadu, Uttar Pradesh and West Bengal.

2.6.5 Co-operative Banks doing their banking business without a license from RBI

For commencing banking business, a Co-operative Bank, as in the case of Commercial Bank, is required to obtain a licence from the Reserve Bank of India, under the provisions of Section 22 of the Banking Regulation Act, 1949 (as applicable to Co-operative Societies).

Audit noticed that out of 2039 assessment cases of Co-operative Banks assessed by ITD during 2014-15 to 2018-19, five Co-operative Banks involving eight assessment cases in two States⁴⁸ did not have license issued by Reserve Bank of India.

Further, as per section 7(2) of the Banking Regulation Act, 1949 no firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words “bank”, “banking”, or “banking company” unless a banking licence has been obtained from the RBI. In Karnataka, it was observed in 33 cases that the assesseees were using the word “Bank” in their name in contradiction to the provisions cited.

2.7 Summary of audit findings

- Audit noticed that the number of Co-operative Societies and Co-operative Banks as per records of respective States/ Regional regulatory authorities/ Registering authorities was much higher as compared to the numbers as per ITD indicating that many Co-operative Societies and Banks were not in the tax net of ITD.
- There was no evidence of action initiated against the non-filers/stop-filers of Income Tax returns. ITD did not utilize the tools available with it through conduct of survey and search & seizure operations to identify and bring into tax net the non-filers and stop filers of income tax returns.
- ITD does not have a mechanism to map the information on Co-operative Societies/ Banks with the registering authorities in order to be able to verify the status of filing of income tax returns. There is no mechanism to seed the PAN in the databases of the ROCS, and to check any change of declared registration status by the assessee, which is a major impediment in institutional and structured sharing of information with ITD.
- While Co-operative Societies/ Co-operative Banks are supposed to be classified as AOP, audit noticed that assesseees classified as Firms, BOIs, Companies, Local authorities etc., were irregularly availing deductions meant for Co-operative Societies/ Co-operative Banks. This also has potential of providing inaccurate information pertaining to the assesseees involved in Co-operative Sector activities.

48 Maharashtra(1), Karnataka(7).

- Audit noticed instances where appropriate form viz. ITR-5 was not used by assessees in cases of Co-operative Sector for filing the Income Tax Return.
- Audit noticed that the verification of registration of the entity as Co-operative Societies/ Co-operative Banks was inadequate and evidential proof of a certificate of registration by Registrar as well as the details of Members of the societies was either not available in the assessment records or not verified by the Assessing Officers. Thus, in such cases, it could not be confirmed by audit whether the deductions were availed by genuine assessees.
- Accounts of the Co-operative Societies/ Co-operative Banks were required to be audited by an empanelled auditor and the details were to be collected through ITR-5. Audit noticed that this essential requirement was not complied with. Thus, the reliability of the accounts could not be confirmed.
- The ITD assessed entities as Co-operative Banks that did not have a valid licence from Reserve Bank of India to operate as a Bank thereby allowing deductions to ineligible assessees.
- Audit noticed instances of inconsistencies and errors in the amounts of incomes and claims or deductions as per the data sets furnished by the DGIT(Systems) vis-à-vis the information available in assessment records. The mismatch in assessment data as furnished by the DGIT(Systems) and data as per the assessment records is not only indicative of poor coordination and control over data updation but also a reflection on accuracy of information.

2.8 Recommendations

Audit recommends that:

a) The CBDT may consider requesting the Central and State level registering bodies and regulatory authorities governing the Co-operative Societies and Co-operative Banks for instituting the seeding of PAN in their databases and facilitate a structured and institutional sharing of information. A process may be devised to track and monitor any change in the status of the assessee.

The CBDT replied (July 2020) that since the matter is an administrative issue, it did not call for legislative amendment.

Audit is of the view that the CBDT may reconsider devising and monitoring structured and institutional sharing of PAN registration details and any other information with the registering bodies and regulatory authorities to prevent misuse of tax provisions by ineligible assessees.

b) Appropriate action as per provisions of the Act may be initiated against the non-filers/ stop-filers to detect the tax evasions. Survey may be utilised to identify Co-operative Societies/ Co-operative Banks still outside tax net and bring them within the tax net.

The CBDT stated (July 2020) that ITD already has a mechanism to identify the non-filers and stop filers through Non- Filers Monitoring System (NMS). If the field authorities have any adverse information, then, survey/ search action are initiated by the field authorities.

Audit is of the view that despite there being a mechanism in place to identify the non-filers and stop-filers audit noticed instances of non-filing of income tax returns. CBDT may review the instances of non-filers and stop-filers while also ensuring action required to be taken in respect of such non-filers and stop-filers.

c) The CBDT may ensure that the ITD checks for the actual status of the applicant vis-a-vis its name and activity carried out while allotting PAN to Co-operative Societies. In order to enable easy identification and monitoring of exemptions availed by the assesseees, ITD may consider affixing fourth letter as 'A' to the PAN of Co-operative Society. It may also ensure that the change in status of assesseees is adequately examined.

The CBDT stated (July 2020) that Permanent Account Number (PAN) is a unique ten digit alpha numeric number allotted by ITD. Application for PAN allotment is received from the applicants through form 49A or 49AA or in the case of companies through a common application form filled through MCA portal. The actual status of the applicant is determined through the Proof of Identity (POI) as specified in Rule 114 of Income Tax Rules,1962. In the case of Co-operative Societies, as per Rule 114 of Income Tax Rules, copy of the certificate of registration issued by the ROCS is the Proof of Identity for allotment of PAN. It further stated that once PAN is allotted to an entity with a particular status the same cannot be changed as this will negate the logic of PAN allotment and will give rise to duplicate PANs. Further, as per the Explanation to section 139A of the Income Tax Act, 1961 permanent account number (PAN) under the new series means a PAN having ten alphanumeric characters. However, the provision does not specify which character stands for what or the meaning of each character.

The CBDT's contention that the Income Tax Act does not specify which character stands for what or the meaning of each character in respect of Permanent Account Number (PAN) under the new series is not acceptable as para 2.5.1 and para 2.5.2 of Manual of Office Procedure,

Volume-II, CBDT clearly specifies that the PAN under new series is based on five constant permanent parameters of a taxpayer (core fields) and uses Phonetic Soundex code algorithm to ensure uniqueness which inter alia include Date of incorporation and Status. As per the structure of PAN the fourth letter of PAN indicated Status of Assessee. Thus, the entities assessed as AOP are required to be allotted PAN with fourth letter as 'A' only. The CBDT has also clarified in response to audit recommendation at para 3.14(e) of this report that, Co-operative Society is assessed as Association of Persons. In view of the same, the CBDT may reconsider the audit recommendation regarding allotting PAN affixing fourth letter as 'A' in case of Co-operative Society. It may be ensured that the Assessing Officers ensure correct status before commencing with assessment and the change in status of assessees, if any, is adequately examined.

d) Evidential proof of a certificate of registration of Co-operative Societies/ Co-operative Banks by Registrar and details of members is essential for completion of assessments. ITD may issue necessary instructions to the Assessing Officers as well as strengthen the internal control mechanism to ensure that the provisions of the Act are being complied with.

The CBDT stated (July 2020) that the Assessing Officers do look into details and documents in respect of registration of Co-operative Societies/ Co-operative Banks by Registrar and details of members as this is basic requirement for completing the assessment. It further stated that the mistakes identified by the C&AG are miniscule in number compared to the total number of assessments conducted by ITD. The CBDT agreed to issue Standard Operating Procedure (SOP) encompassing the manner for completing error-free assessment of Co-operative Societies.

Audit is of the view that the number of cases observed are substantive at 51.7 per cent in proportion to the number of cases checked.

e) The CBDT may instruct Assessing Officers that the accounts of the Co-operative Societies/ Co-operative Banks may be accepted by them only when their audit was found to have been conducted by empanelled auditors. Further, the instances of non-compliance to this regulatory requirement may be reported to the concerned regulatory authorities (ROCS, RBI etc.).

The CBDT agreed (July 2020) to incorporate the audit recommendation in the SOP proposed to be issued for assessment of Co-operative Societies.

f) The CBDT may inquire into the reasons for mismatch between data as per the assessment records and as recorded in the ITD Systems with a view to eliminate weaknesses in the System. Necessary corrective action may be completed in a time bound manner.

The CBDT stated (July 2020) that there may be numerous reasons for difference in data as recorded in the ITBA System on one hand and as per records maintained by Assessing Officer on the other. The probable reasons for mismatch are order of assessment passed manually but not uploaded in the Systems, legacy demands not uploaded in Systems, data/ demand of processing under section 143(1)(a) of the Act by CPC-Bengaluru would be available in System but may not be maintained by Assessing Officer etc. It is further stated that the functionality for uploading order 'manual to system' is already available in ITBA and the Assessing Officers are already uploading these orders so that data/demands/refund, if any, are available in system. It is stated that mismatch between data as present in ITBA system and as per assessment records will be reduced by Assessing Officers soon.

Audit is of the view that the DGIT(Systems) maintains centralised granular information on details of incomes, expenses, exemptions and deductions returned by assessees through data captured from ITRs furnished by them and the assessments carried out by the Assessing Officers. Ideally there should not be any mismatch between data available with DGIT(Systems) and with the assessment units.

g) The CBDT may examine the action initiated in cases where incorrect ITR forms were filed by assessees in the Co-operative Sector and ensure that such returns are treated as invalid at ITR processing stage at CPC Bengaluru. Further, the claims of deductions allowed as Co-operative Societies/Co-operative Banks, if any, may be disallowed in such cases.

Chapter 3: Compliance to Tax provisions specific to Co-operative Societies and Co-operative Banks

The performance audit envisaged to examine the nature and extent of compliance to provisions specific to the assessee of Co-operative Sector under the Act. The Co-operative Societies engaged in specified activities are eligible to claim deduction on specified income as per provisions under section 80P of the Act. Section 80P(2) of the Act specifies that the incomes earned by Co-operative Societies engaged in types of activities specified under this Act on which claim of deduction under section 80P of the Act is admissible. While examining the allowability of claim of deduction specific to Co-operative Societies the Assessing Officers are required to examine the fulfilment of conditions specified under the Act while also determining their eligibility based on adherence to the principles of mutuality⁴⁹.

The allowance of deduction to entities engaged in banking and financial business on account of provision of bad and doubtful debts and in respect of special reserve created and maintained by a specified entity is regulated by sections 36(1)(viia) and 36(1)(viii) of the Act. Also, Co-operative Societies engaged in manufacture of sugar are entitled to claim deduction on expenditure incurred for purchase of sugarcane under section 36(1)(xvii) of the Act. Assessing Officers are required to examine the claims of these deductions while completing the assessments.

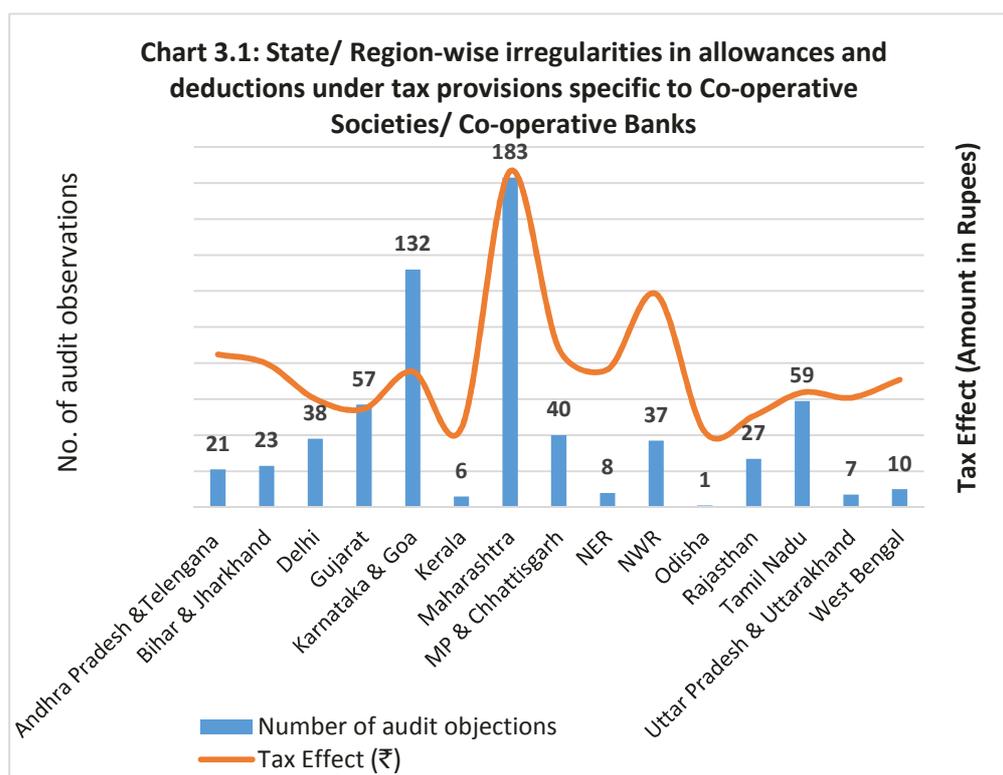
Paras 3.2 to 3.7, 3.11, 3.12 and 3.13 of this Chapter discuss the extent of compliance to provisions under sections 80P, 36(1)(viia), 36(1)(viii) and 36(1)(xvii) of the Act, respectively, as determined by the Assessing Officers during assessment of claims made by assessee. These paras are followed by details and illustration of audit findings noticed during examination of such cases that were subjected to generic checks under the Act and some specific checks as per risk assessment carried out by audit. The assessment particulars of cases subjected to specific checks are discussed in paras 3.8, 3.9 and 3.10 of this Chapter. Audit examination of assessments of Co-operative Societies and Co-operative Banks revealed that the verification mechanism by the Assessing Officers was inadequate in determining adherence to the principles of mutuality and in ensuring fulfilment of the conditions underlying the provisions under the Income Tax Act resulting in allowance of inadmissible claims on ineligible incomes or to ineligible assessee. The instances of

⁴⁹ Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded as profits, which are chargeable to tax [CIT vs Bankipur Club Ltd. 226 ITR p. 97 (SC)].

non-compliance to above-mentioned provisions specific to Co-operative Societies and Co-operative Banks are discussed in this Chapter.

3.1 Profile of irregularities in allowances and deductions under tax provisions specific to Co-operative Societies and Co-operative Banks

The State/ region-wise details of irregularities in allowances and deductions under tax provisions specific to Co-operative Societies and Co-operative Banks noticed during the performance audit and included in this chapter is depicted in Chart 3.1 given below.



Audit noticed instances of irregularities (22.65 per cent of irregularities) in respect of assesseees registered as AJP, AOP(Trust), BOI, Firms, Local Authority and Company. Thus, while the sample contained 18.98 per cent of these cases, the irregularities in respect of these cases were in higher proportion. It is worth noting that the assesseees registered as AJP, BOI, Company, Firm, Local Authority and Trust cannot be assessed as Co-operative Societies. Further, the CBDT has also stated (July 2020) that ‘for the purpose of Income Tax Act, 1961, Co-operative Societies are treated as Association of Persons’. ITD may review the PAN registration status of the assesseees filing income tax returns as Co-operative Societies/ Co-operative Banks to ensure uniformity in PAN registration category of similar class of assesseees registered as taxpayers with ITD and to facilitate effective monitoring of tax compliance by entities in Co-operative Sector.

The section-wise details of irregularities noticed in audit are depicted in Table 3.1 below:

Table 3.1: Irregularities in allowance and deductions under specific sections applicable to Co-operative Societies/ Co-operative Banks

Section of Income Tax Act under which irregularities in allowance of deductions noticed in audit	No. of audit objections	Tax Effect (Amount in ₹ crore)
36(1)(viia)	118	375.20
36(1)(viii)	8	14.01
36(1)(xvii)	19	107.75
80P(2)(a)(i)	115	49.82
80P(2)(a)(ii)	1	0.08
80P(2)(a)(iv)	11	1.16
80P(2)(a)(vi)	2	0.13
80P(2)(a)(vii)	3	0.58
80P(2)(d)	367	145.64
80P(2)(e)	5	0.12
Grand Total	649	694.50

Out of 649 cases of irregularities in assessment of claims and deductions, under tax provisions specific to assessee of Co-operative Sector, the occurrence of errors was relatively higher, in deductions allowed under section 80P(2)(d), 80P(2)(a)(i) and 36(1)(viia) of the Act at 56.6 per cent, 18.2 per cent and 17.7 per cent, respectively. This indicated higher risk of non-compliance in respect of these sections. ITD may review the reasons underlying such irregularities in assessments with greater emphasis on these provisions of the Act to ensure allowance of benefits to eligible assessee on eligible incomes and genuine claims only.

As seen from the activity-wise details of assessments of Co-operative Societies/Co-operative Banks, audit noticed 68.7 per cent of irregularities in assessments of assessee engaged in banking, credit and financial services. This was followed by 6.0 per cent, 5.4 per cent, 5.4 per cent and 4.0 per cent of irregularities in Co-operative Societies engaged in trading, housing, manufacture of sugar and dairy business, respectively. ITD may review the reasons underlying irregularities in allowing deduction under section 80P and 36(1)(viia) of the Act with greater emphasis on the banking, credit and financial services sectors to ensure correct allowance of deductions under the Act.

Of 649 cases where audit noticed mistakes in allowance of deduction, 86.4 per cent of cases (561) were assessed under scrutiny viz. section 143(3) of the Act. Of 561 scrutiny assessment cases, in 380 cases the scrutiny was complete, in 92 it was limited, in three cases it was manual whereas in remaining 86 cases the details of type of scrutiny were not ascertainable. Further, audit observed that out of 453 cases where details of parameters for

selection were available in the assessment records, in 274 cases involving claim and allowance of deduction of ₹ 794.42 crore and ₹ 760 crore, respectively under section 80P of the Act the criteria for selection of case for examination was on account of 'Large deductions claimed under Chapter VI-A' which also includes section 80P of the Act. Thus, audit noticed further irregularities inspite of these assessments having been subjected to detailed examination by the Assessing Officers based on several risk parameters. These instances of incorrect assessments point towards inadequate level of examination of eligibility of incomes and admissibility of claims during assessment.

ITD may consider linking activity classification or nature of business or business codes of Co-operative Society and the status code of assessee with the sub-section of 80P of the Act under which deduction is claimed by assessee at the stage of filing of income tax return to ensure allowance of deduction to eligible assessee only and to minimise possibility of ineligible claims. Linking of activity code and status code with sub-section of 80P of the Act would also enable assessment of impact of deductions in Co-operative Sector besides facilitating effective monitoring of claims. Further, ITD may review the PAN registration status of the assessee claiming deduction admissible to Co-operative Societies to ensure allowance of claims to eligible assessee only.

3.2 Deduction to Co-operative Societies under section 80P(2)(a)(i) of the Act

Section 80P(2)(a)(i) of the Act, provides deduction on Income from banking business or for Income from providing credit facilities to its Members. In the case of a Co-operative Society providing credit facilities to its members, the whole of the amount of profits and gains from such business are deductible. From the assessment year 2007-08 onwards, deduction under Section 80P of the Act is not available to any Co-operative Bank. Further, CBDT has clarified⁵⁰ that Regional Rural Banks are not eligible for deduction under Section 80P of the Act. A PACS or a Primary Co-operative Agricultural and Rural Development Bank will continue to claim the benefit of deduction under Section 80P of the Act. The meaning of Credit facilities and term Members for the purpose of claim of deduction under section 80P(2)(a)(i) of the Act have been subjected to several litigations.

3.2.1 Audit examined 1721 cases⁵¹ of claims of deduction under section 80P(2)(a)(i) of the Act admissible to Co-operative Credit Societies to ascertain whether the assessment of incomes on which deduction is claimed is being done correctly and uniformly by the Assessing Officers.

⁵⁰ CBDT Circular No. 6/2010, dated September 20, 2010

⁵¹ AP&TS, Bihar, Delhi, Gujarat, Jharkhand, Karnataka & Goa, Kerala, Maharashtra, Madhya Pradesh & Chhattisgarh, NWR (Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab), Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal & Sikkim.

- a. Audit found that out of 1,721 cases involving claim of deduction of ₹ 7,038.39 crore, in 1,507 cases (87.56 per cent) the assesseees were eligible to claim deduction amounting to ₹ 5,550.62 crore on income from carrying on banking business for its members or for providing credit facilities to its members as specified under section 80P(2)(a)(i) of the Act whereas in 192 cases (11.16 per cent) involving claim of deduction of ₹ 1,461.74 crore under section 80P(2)(a)(i) of the Act the assesseees were not eligible for the same. In the remaining 22 cases (1.28 per cent) the eligibility of the claims allowed under section 80P(2)(a)(i) of the Act could not be ascertained from the available records.

Table 3.2: Claims of deduction under section 80P(2)(a)(i) of the Act

Eligibility of Claims made under section 80P(2)(a)(i) of the Act	No. of cases where deduction claimed under section 80P(2)(a)(i) of the Act	Amount of deduction claimed under section 80P(2)(a)(i) of the Act (₹ in crore)
Eligible	1507	5550.62
Ineligible	192	1461.74
Not Ascertainable	22	26.03
Total	1721	7038.39

- b. Audit found that out of 1,721 cases, in 1,356 cases (78.79 per cent) the primary objective of the Co-operative Societies was to provide loans and credit facilities to its members whereas in 91 cases⁵² (5.29 per cent) providing loans and credit facilities to members was not the primary objective. Of 1,356 cases, in 83 cases although the Co-operative Societies had claimed deduction of ₹ 83.81 crore under section 80P(2)(a)(i) of the Act, they were not extending credit facilities to their members. In 74 cases out of these 83 cases the Assessing Officers had not examined the fulfilment of conditions specified under section 80P(2)(a)(i) of the Act while allowing deduction of ₹ 79.76 crore.

3.2.2 Audit, further, noticed 115 cases⁵³ (6.7 per cent of 1,721 cases) in 12⁵⁴ states/ regions out of cases examined in audit where the Assessing Officers had incorrectly allowed deductions to Co-operative Societies under section 80P(2)(a)(i) of the Act resulting in under assessment of income of ₹ 119.98 crore and short levy of tax of ₹ 49.82 crore.

52 In the remaining 278 cases (16.19 per cent) involving claim of deduction of ₹ 857.22 crore it was not ascertainable from records whether primary objective of the assessee was to provide loans and credit facilities to its members.

53 The audit objections include irregularities noticed in audit with respect to cases subjected to generic checks and (as discussed in para 3.1.1) and those subjected to specific checks (as discussed in para 3.8 and para 3.10 of this chapter).

54 Andhra Pradesh & Telangana, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North West Region, Odisha, Tamil Nadu, West Bengal

Of 115 cases where audit noticed mistakes in allowance of deduction, 93 per cent of cases (viz. 107 cases) were assessed under scrutiny viz. section 143(3) of the Act. Of 95 cases, where information on type of scrutiny was available, in 69 cases the scrutiny was complete and in 26 it was limited. Although the cases were selected for examination based on risk parameter of large deduction claimed under section 80P of the Act, audit noticed mistakes involving incorrect allowance of deduction under section 80P(2)(a)(i) of the Act. These instances of incorrect assessments point towards inadequate examination of eligibility of incomes and admissibility of claims during assessment.

The irregular allowance of deduction under section 80P(2)(a)(i) of the Act was on account of interest earned from non-members of Co-operative Society, interest earned from nominal members besides primary members, income from service charges, income earned from commission and miscellaneous fees etc. Two cases are illustrated below:

Box 3.1

Illustration of Incorrect allowance of deduction under section 80P(2)(a)(i) of the Act

a) Charge: PCIT-Kozhikode

Assessment Year: 2016-17

The assessee, a PACS, filed its ITR in October 2016 with NIL income. The scrutiny assessment of the assessee was completed in December 2018 at NIL income. Audit noticed that scrutiny assessment of the assessee for the AY 2015-16 was passed in December 2017 by disallowing deduction under section 80P of the Act on the grounds of lack of principle of mutuality and also on disallowing provisions on different expenditures. But, while passing order for the AY 2016-17 claim under section 80P of the Act was not disallowed. No uniform stand was taken during the two assessment years. This had resulted in irregular allowance of deduction of ₹ 10.86 crore under section 80P of the Act involving tax effect of ₹ 4.54 crore. Reply of the ITD is awaited (February 2020).

b) Charge: PCIT-Cuttack

Assessment Year: 2015-16

The assessee is a Co-operative Bank and derives its income from banking activity. Summary processing under section 143(1) of the Act was done in December 2015 with NIL income. But, scrutiny of ITR-5 revealed that the assessee had claimed deduction of ₹ 5.97 crore under section 80P of the Act. As per amended provisions of section 80P of the Act applicable with effect from 01.04.2007 no deduction under section 80P of the Act was

allowable to Co-operative Banks. This had resulted in irregular allowance of deduction of ₹ 5.97 crore under section 80P of the Act involving tax effect of ₹ 2.23 crore. ITD accepted the audit observation (July 2019) and stated that remedial action was being taken.

3.2.3 Non adherence to the principles of mutuality

The principles of mutuality, though not defined under the Act, have been reiterated in the several judicial rulings⁵⁵.

The 97th Constitutional Amendment (2011) mandated State Regulatory Acts to make provisions to ensure functioning of the Co-operative Societies on the principles of voluntary formation, democratic member control, member's economic participation and autonomous functioning. The Apex Court has reiterated fulfilment of these conditions to satisfy the test of the principle of mutuality on various occasions⁵⁶. Thus, the law and the judicial pronouncements make it clear that the credits extended to associate members and nominal members do not meet the Co-operative principles and hence do not satisfy the principle of mutuality. Therefore, deduction under section 80P(2)(a)(i) of the Act should be restricted to the regular members, excluding the nominal and associate members. Further, if a society carries on some activities based on mutuality and other activities not based on mutuality, then the concept would apply to only those activities, which are mutual.

Audit examined 412 cases of credit Co-operative Societies in Karnataka, in light of the above judgements as well as the threshold stipulated in the regulatory acts for admitting members as Associate Members. Audit observed that in 83 cases, as detailed below, the assessing officers had allowed the deduction under section 80P of the Act, without subjecting them to the test of mutuality, leading to short levy of ₹20.95 crore. Further, 35 similar cases involving allowance of deduction of ₹34.67 crore under section 80P of the Act, where tests of mutuality had not been applied are pending with various appellate authorities. The deficiencies in assessments in respect of the credit Co-operative Societies are discussed below:

- a) Audit noticed that in 31 cases (24 distinct assesseees), assesseees have claimed deduction under section 80P(2)(a)(i) of the Act for income from

55 *Commissioner of Income Tax, Bihar v. Bankipur Club Ltd.*, (1997) 226 ITR 97 (SC); *Bangalore Club v. Commissioner of Income Tax and Another*, (2013) 350 ITR 509 (SC); *The Citizen Co-operative Society vs ACIT (2017) 397 ITR 1 (SC)*

56 *Commissioner of Income Tax, Madras v/s Kumbakonam Mutual Benefit Fund Limited* decided on 07 May 1964 53 ITR 241 (SC); *Indian Tea Planters' Association Vs. CIT* 82 ITR, p.322 (Cal.); *Bangalore Club vs Commissioner Of Income Tax (Supreme Court)*, CIVIL APPEAL NO. 125 OF 2007, Dated – 14 January, 2013; *The Citizen Co-Operative Society Limited v. ACIT (2017) 397 ITR 1 (SC)*

credits extended to nominal and associate members beyond the threshold prescribed by the regulatory acts, which have been allowed by the Assessing Officers. Thus, the Assessing Officers were either not examining the fulfilment of the principle of mutuality or continuing to treat the nominal and associate members on par with the regular members, in violation of the law and the judicial pronouncements.

- b) Audit noticed that in 81 cases (61 distinct assessee) of credit Co-operative Societies extending credit to members as well as others, the Assessing Officers had equated them with Co-operative Banks as being in lending business and disallowed the deductions claimed under section 80P(2)(a)(i) of the Act, in full, rather than restricting the disallowance to the portion pertaining to external lending. Twenty-nine of these cases are pending with various appellate authorities.
- c) There seems to be lack of clarity amongst the Assessing Officers as to whether the societies registered under the Karnataka Souharda Sahakari Act are eligible for deductions under section 80P of the Act, in spite of the clarification furnished by the ROCS and the rulings of ITAT⁵⁷ that Co-operatives registered under the Karnataka Souharda Sahakari Act are also eligible to claim deduction. As such, ITD continued to disallow deduction under section 80P of the Act in such cases. In six cases of Credit Societies registered under the Karnataka Souharda Sahakari Act the disallowance of deduction amounting to ₹ 12.41 crore under section 80P of the Act was incorrect and cases were pending before the appellate authorities.

3.3 Deduction to Co-operative Societies under section 80P(2)(a)(iv) of the Act

Under section 80P(2)(a)(iv) of the Act a Co-operative Society is eligible for deduction of the whole of income from the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purposes of supplying them to its members.

3.3.1 Audit examined 79 cases⁵⁸ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(iv) of the Act.

Audit, noticed 11 cases in two⁵⁹ states out of 79 cases examined where the Assessing Officers had allowed deductions for profit earned from retail trading rather than distribution of agricultural implements. This had resulted in under assessment of income of ₹ 2.79 crore and short levy of tax of ₹ 1.16 crore.

57 Udaya Souharda Credit Co-operative Society Ltd. vs. CIT (ITA No. 2831/Bang/2017, August 2018) [ITAT Bangalore]

58 AP&TS, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, Tamil Nadu and West Bengal.

59 Goa, Karnataka

3.4 Deduction to Co-operative Societies under section 80P(2)(a)(vi) of the Act

Income from the activity of collective disposal of the labour of its members is deductible under Section 80P(2)(a)(vi) of the Act. This section has been introduced mainly for the labour Co-operative Societies. These societies consist of the persons who are offering their services as labour through it. The labour can be manual or some technical or other similar services. As per Orissa High Court ruling⁶⁰ Income from the activity of collective disposal of the labour of its members is deductible under section 80P(2)(a)(vi) of the Act.

3.4.1 Audit examined 41 cases to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(vi) of the Act.

- a. Audit found that in 38 cases⁶¹ deduction amounting to ₹ 6.48 crore was claimed under section 80P(2)(a)(vi) of the Act on income of ₹ 56.71 crore from collective disposal of labour through utilisation of actual labour of its members. In 28 cases⁶² out of these 38 cases, the Assessing Officers had allowed entire claim of deduction of ₹ 6.48 crore under section 80P(2)(a)(vi) of the Act on income earned from collective disposal of labour through utilisation of actual labour of its members. In one case⁶³, the Assessing Officer had partially allowed the claim of deduction of ₹ 0.20 crore out of total claim of ₹ 0.63 crore. In eight⁶⁴ cases the Assessing Officers had disallowed entire claim of deduction of ₹ 6.66 crore claimed under section 80P(2)(a)(vi) of the Act on income from collective disposal of labour through utilisation of actual labour of its members.
- b. Audit found that in 2 cases⁶⁵ where deduction was claimed under section 80P(2)(a)(vi) of the Act on income of ₹ 1.04 crore from activity of collective disposal of labour in cases where supervision of work in field was done by paid employees, the Assessing Officer had allowed deduction of ₹ 0.65 crore in one case while in another case the entire claim of deduction of ₹ 0.39 crore was disallowed under section 80P(2)(a)(vi) of the Act.
- c. Audit found one case⁶⁶ where deduction of ₹ 0.46 lakh claimed under section 80P(2)(a)(vi) of the Act was allowed on income from activity of collective disposal of labour in cases where not only members but also

60 Nilagiri Engineering Co-op Society Ltd. v. CIT [1994] 208 ITR 326 (Orissa)

61 AP&TS, Bihar, Madhya Pradesh, Maharashtra, Odisha, Gujarat, Kerala, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

62 AP&TS, Gujarat, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

63 AP&TS, Maharashtra

64 AP&TS, Bihar, Madhya Pradesh, Odisha and Tamil Nadu

65 Odisha

66 West Bengal

a large number of non-members were contributing to collective disposal of labour.

The Assessing Officers took differential stand while assessing eligibility of claim of deduction under section 80P(2)(a)(vi) of the Act on similar incomes such as income earned from collective disposal of labour through utilisation of actual labour of its members and income from activity of collective disposal of labour in cases where supervision of work in field was done by paid employees. The allowability of claims on such incomes needs to be examined to ensure uniformity of assessments in similarly placed cases.

3.4.2 Audit, further, noticed two cases in Karnataka out of 41 cases examined where the Assessing Officers had incorrectly allowed deductions for the collective disposal of the labour of its members. This had resulted in under assessment of income of ₹ 0.34 crore and short levy of tax of ₹ 0.13 crore. One case is illustrated below

Box 3.2

Illustration of Incorrect allowance of deduction under section 80P(2)(a)(vi) of the Act

Charge: PCIT- 4, Bengaluru

AY: 2015-16

It was observed that the membership comprised 595 regular members (defence personnel and ex-servicemen or their spouses), 223 associate members (from the same fraternity as above but resident outside Karnataka) and 275 nominal members (any person or organisation having/intending to have business dealings with the society). Only a few members from all three categories were deployed as security personnel. As such, only a limited number of members were contributing to labour as against collective disposal of labour envisaged by the Act and the assessee was not entitled to claim deduction under section 80P (2)(a)(vi) of the Act. This had resulted in under assessment of income of ₹ 0.19 crore and short levy of tax of ₹ 0.08 crore.

3.5 Deduction to Co-operative Societies under section 80P(2)(a)(vii) of the Act

Section 80P(2)(a)(vii) of the Act envisages that in the case of an assessee, being a Co-operative Society, where the gross total income includes any income from fishing or allied activities (catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members) the whole of the amount of profits and gains of business shall be deducted, provided the rules and byelaws of the society restrict the voting rights to the individuals who carry on fishing or allied activities.

3.5.1 Audit examined 12 cases⁶⁷ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(vii) of the Act.

a. Purchase of material and equipment for fishing and allied activities:

Audit found that in 12 cases⁶⁸ deduction of ₹ 9.47 crore was allowed based on claim made under section 80P(2)(a)(vii) of the Act on income of ₹ 15.16 crore earned by assessee Co-operative Societies from fishing and allied activities. Audit noticed that in three cases⁶⁹ involving claim of deduction of ₹ 5.33 crore purchase of materials and equipment for fishing and allied activities were made for supply to its members whereas in four cases⁷⁰ involving claim of deduction of ₹ 1.88 crore the purchases were not made for supply to its members as shown in table given below. In three cases⁷¹ involving claim of ₹ 6.56 crore no purchases were made as per books of accounts for sale to members. In remaining two cases⁷² involving claim of ₹ 1.39 crore the details of purchases made for fishing activities could not be ascertained from available records.

Table 3.3: Claim of Deduction under section 80P(2)(a)(vii) of the Act.

(₹ in crore)

Claim of deduction made under section 80P(2)(a)(vii) of the Act			Purchase of materials and equipment (for fishing and allied activities) made for supplying to its Members		Purchase not made for supplying to its Members		
No. of cases	Amount of deduction claimed	Amount of deduction allowed	No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	Amount of deduction allowed
12	15.16	9.47	3	5.33	4	1.88	1.32

67 AP&TS, Delhi, Gujarat, Madhya Pradesh, Karnataka and West Bengal

68 AP&TS, Delhi, Gujarat, Madhya Pradesh, Karnataka and West Bengal

69 Gujarat, Madhya Pradesh, Karnataka.

70 AP&TS, Karnataka, West Bengal.

71 Delhi

72 Karnataka

- b. **Allowance of deduction on income from fishing and allied activities:** Audit found that in six cases⁷³ out of 12 cases, entire claim of deduction of ₹ 7.54 crore was allowed under section 80P(2)(a)(vii) of the Act on income from fishing and allied activities. Of these, in two cases involving claim of deduction of ₹ 4.84 crore the purchases of materials and equipment (for fishing and allied activities) were made for the purpose of supplying to its members, in two cases deduction of ₹ 1.31 crore was irregularly allowed (as discussed in para 3.5.2) where purchases were not for supply to Members whereas in remaining two cases involving claim of deduction of ₹ 1.39 crore the same could not be ascertained. In 5 cases out of 12, claim of deduction of ₹ 1.97 crore was partially allowed against total claim of ₹ 7.22 crore whereas in one case entire claim of ₹ 0.44 crore was disallowed as deduction was claimed on ineligible income i.e. income from sale of bio-diesel.
- c. **Voting rights of members:** The proviso below sub- section (vii) of section 80P of the Act provides that the deduction shall be available only to the societies subject to the conditions that the rules and bye-laws of the society restrict the voting rights to the specified classes of its members. Of 12 cases involving claim of deduction under section 80P(2)(a)(vii) of the Act, in four cases⁷⁴ involving claim of deduction of ₹ 1.92 crore the voting rights were restricted to following classes of its members viz. the individuals who carry on fishing or allied activities, the Co-operative Credit Societies which provide financial assistance to the society and the State Government. In 3 cases involving claim of ₹ 1.44 crore the voting rights were not restricted to Members whereas in the remaining five cases the allocation of voting rights within the Co-operative Societies could not be ascertained from the records.

3.5.2 In three cases in Karnataka (Pr.CIT, Mangalore) audit noticed that deduction under section 80P(2)(a)(vii) of the Act was extended to the fisherman's Co-operative Societies even though the societies did not restrict voting rights to the individuals carrying on fishing or allied activities. The incorrect allowance had resulted in under assessment of income of ₹1.44 crore and short levy of tax of ₹0.58 crore. One case is illustrated below:

73 Gujarat and Karnataka.
74 Delhi(3) and Karnataka(1)

Box 3.3**Illustration of Incorrect allowance of deduction under section 80P(2)(a)(vii) of the Act****a) Charge: PCIT, Mangalore****AY : 2015-16**

The scrutiny assessment of the assessee Co-operative Society was concluded during July 2017 accepting the returned income, while allowing deduction of ₹ 0.96 crore.

The bye laws of the society provided for having 3 classes of members as follows:

Category of members	Eligibility criteria	Share capital	Rights
A class	Owners and partners to Trawl boat	500	All rights
B class	State Government	1000	
C class	People engaged in fishing and people transacting with the society	100	Excepting making deposits and obtaining loans, they do not have any other rights.

Thus, individual fishermen are admitted as C class members without voting rights and voting rights are restricted only to members admitted as A class members. As per proviso under section 80P(2)(a)(vii) of the Act, the deduction is allowable to the Co-operative Society provided the rules and bye-laws of the society restrict voting rights to Members only. As the condition under section 80P(2)(a)(vii) of the Act was not fulfilled the incorrect allowance of deduction of ₹ 0.96 crore had resulted in short levy of tax of ₹ 0.39 crore. ITD's reply is awaited (March 2020).

3.6 Deduction to Co-operative Societies under section 80P(2)(d) of the Act

The whole of interest and dividend income derived by a Co-operative Society from its investments in any other Co-operative Society is deductible under Section 80P(2)(d) of the Act. The provisions of this clause are very clear and the terms are clearly defined. However, the term 'whole of interest and dividend' has been subject matter of litigation. The judgments on the issue indicate that the deduction is for the entire income without adjusting the outgoings.

3.6.1 Audit examined 553 cases to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(d) of the Act.

- a. Audit found that in 553 cases in 14 states/regions⁷⁵ deduction of ₹ 455.63 crore was allowed based on claims made on income of ₹ 655.48 crore on account of interest from investment in Co-operative Banks under section 80P(2)(d) of the Act.
- b. Of 553 cases, in 126 cases the Assessing Officers had disallowed entire claim of deduction on interest income amounting to ₹ 150.31 crore derived from investments in Co-operative Banks. In 347 cases entire claim of ₹ 366.15 crore was allowed whereas in 79 cases partial allowance of ₹ 86.93 crore was made against claim of ₹ 136.47 crore. While disallowing the claims of deduction under section 80P(2)(d) of the Act the Assessing officers had placed reliance on decisions as per judicial rulings⁷⁶. The reasons for disallowance *inter alia* included 80P(2)(d) of the Act is not applicable to any Co-operative Bank other than PACS and Rural Development Bank, interest income earned from investment in surplus funds with other Co-operative Societies was not eligible for claim of deduction under section 80P(2)(d) of the Act, interest income from Co-operative Banks was not shown in profit and loss account and other assessment records, deduction claimed on interest received on NABARD bonds etc. Audit found that in eight cases⁷⁷ disallowance of claim of ₹ 1.97 crore was deleted and deduction claimed by assesseees were allowed by CIT(Appeals) or ITAT at different stages of appeal.

3.6.2 Differential Stand taken by Assessing Officers: Audit found that the Assessing Officers were taking differential stands with regard to treatment of interest income earned by Co-operative Societies from their investment in Co-operative Banks. In Karnataka, while in 49 cases, the Co-operative Societies had declared the interest earned as income from other sources, in 50 cases, the assesseees have treated them as business income, which were allowed by the Assessing Officers. In Maharashtra, Assessing Officers took differential stand in 6 cases (3 assesseees) while allowing deduction under section 80P(2)(d) of the Act resulting in tax effect of ₹ 0.72 crore. In case of two assesseees interest income earned from Co-operative Banks was allowed as deduction under section 80P(2)(d) of the Act in one AY although deduction was denied on the same in another AY wherein income earned from investment in Co-operative Banks was assessed under the head “Income from other sources”. Also, income earned from Co-operative Banks was allowed as deduction under section 80P(2)(d) of the Act in one AY whereas deduction

75 AP&TS, Bihar, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, North Eastern Region (NER), Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

76 Pr. CIT, Hubballi vs Totagars Co-operative Sales Society [83 Taxmann.com 140 (Karnataka High Court, 2017), SBI Employees Co-operative credit and supply society limited v/s CIT Ahmedabad-1 [57 Taxman.com 367 (ITAT Ahmedabad, 2015)] and Gujarat State Co-operative Bank Limited [250 ITR 229 (Gujarat High Court, 2000)]

77 Gujarat, Maharashtra, Rajasthan and Uttar Pradesh

was denied in another AY by order under section 263 of the Act for receiving the deposits from non-members. One case is illustrated below:

Box 3.4

Illustration of differential stand taken by Assessing officers

a. Charge: Pr.CIT-20, Mumbai

AY: 2013-14

The scrutiny assessment of the assessee for AY 2013-14 was completed under section 143(3) of the Act in February 2016 after allowing deduction under section 80P(2)(d) of the Act on account of interest of ₹ 1.58 crore earned from investment in Co-operative Banks. The assessee Co-operative Society derived its income from providing credit facilities to its members and accepting deposits from non-members. Audit noticed that the assessee was denied the deduction under section 80P of the Act in AY 2014-15 by order under section 263 of the Act (March 2019) for receiving the deposits from non-members. The facts of the cases being the same, no deduction should have been allowed during AY 2013-14 also. The incorrect allowance had resulted in tax effect of ₹ 0.49 crore. ITD's reply is awaited (February 2020).

3.6.3 Audit further noticed 367 cases⁷⁸ in 12⁷⁹ States, out of cases examined, where Assessing Officers had incorrectly allowed deductions for interest income earned by Co-operative Societies. This had resulted in under assessment of income of ₹ 368.84 crore and short levy of tax of ₹ 145.64 crore.

Of 367 cases where audit noticed mistakes in allowance of deduction, 89.6 per cent of cases (viz. 329) were assessed under scrutiny viz. section 143(3) of the Act. Of 329 cases, in 232 cases the scrutiny was complete and in 46 cases it was limited whereas in the remaining 51 cases the type of scrutiny could not be ascertained. Of 46 cases examined under limited scrutiny, in 33 cases the criteria for selection of case for examination was on account of 'Large deduction claimed under Chapter VI-A'. It can be seen that audit noticed mistakes involving incorrect allowance of deduction under section 80P(2)(d) of the Act in such cases also that were selected for examination based on risk parameter of large deduction claimed under section 80P of the Act. These instances of incorrect assessments point towards inadequate examination of eligibility of incomes and admissibility of claims during assessment.

⁷⁸ These objections include audit objections based on generic checks applied to audit sample (as discussed in para 3.6.1) as well as specific checks applied to the sample as discussed in para 3.8 and 3.10 of this Chapter.

⁷⁹ Andhra Pradesh & Telangana, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North West Region, Odisha, Tamil Nadu, West Bengal

Three cases are illustrated below:

Box 3.5

Illustration of Incorrect allowance of deduction under section 80P(2)(d) of the Act

**a) Charge: Pr. CIT-1, Bhopal
Assessment Year: 2016-17**

The scrutiny assessment of the assessee was completed in December 2018 under section 143(3) of the Act, determining Nil income. The assessee filed its return of income for A.Y. 2016-17 at 'Nil' income on 31.03.2018 claiming deduction of ₹ 9.82 crore under section 80P of the Act. Audit examination revealed that the Assessing Officer allowed the deduction of ₹ 9.82 crore, which included deduction under section 80P(2)(d) of the Act on account of interest received from the Co-operative Bank/Scheduled Bank. As the interest received from the Co-operative Bank/Scheduled Bank amounting to ₹ 9.82 crore is not an allowable deduction under section 80P(2)(d) of the Act, it was required to be disallowed. The mistake had resulted in underassessment of income of ₹ 9.82 crore with a consequent short levy of tax of ₹ 5.06 crore.

ITD stated in its reply that the interest received from Co-operative Society is exempt under section 80P(2)(d) of the Act and that Co-operative Banks are Co-operative Societies registered with ROC. The reply is not acceptable as the Co-operative Societies work for members only and cater to the member's requirements. However, the Co-operative Banks are engaged in commercial banking activity that includes taking deposits and giving loans to non-members also. This fact is also not discussed in records. Further, ITD had also withdrawn the benefits of section 80P of the Act from the Co-operative Banks. Therefore, the interest earned by the assessee from investment or deposits in Co-operative Banks or other banks is not allowable as a deduction under section 80P(2)(d) of the Act.

**b) Charge: Pr.CIT 2, Jaipur
Assessment Year: 2015-16**

The scrutiny assessment of an AOP for AY 2015-16 was completed in December 2017 at 'Nil' returned income after allowing deduction of ₹ 4.15 crore under section 80P(2)(d) of the Act to the extent of available profit of ₹ 3.06 crore. Audit examination revealed that the amount of interest of ₹ 3.69 crore was earned on FDR with Co-operative Bank, which

did not fall in the scope of the provision of section 80P(2)(d) of the Act and was not allowable. However, ₹ 0.45 crore was allowable to the assessee as per the provision. The incorrect allowance of deduction of ₹ 3.69 crore resulted in under computation of income ₹ 2.61 crore (₹ 3.06 crore - ₹ 0.45 crore) involving tax effect of ₹ 1.03 crore, the interest of ₹ 0.11 crore to be withdrawn under section 244 of the Act and ₹ 0.03 crore chargeable under section 234D of the Act. Reply of ITD is awaited (March 2020).

3.7 Deduction to Co-operative Societies under section 80P(2)(e) of the Act

As per section 80P(2)(e) of the Act deduction in respect of any income derived by the Co-operative Society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is allowable. It has judicially been held⁸⁰ that the whole of the income derived by a Co-operative Society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is deductible under section 80P(2)(e) of the Act.

3.7.1 Audit examined 38 cases in 11 states⁸¹ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(e) of the Act. Of 38 cases, in 32 cases⁸² the assessee had made claim of deduction under section 80P(2)(e) of the Act on income derived from letting of godowns or warehouses for purpose other than storage, processing or facilitating the marketing of commodities; in 5 cases⁸³ the claim was made on income derived from letting out of storage for marketing purpose only and in one case⁸⁴ deduction claimed on income was derived from stocking of goods in godown.

It was seen that out of 38 cases, in 15 cases entire claim of ₹ 10.34 crore was allowed, in 18 cases entire claim of ₹ 35.13 crore was disallowed whereas in five cases partial claim was allowed at ₹ 35.75 crore against total claim of ₹ 45.39 crore during assessment of claim of deduction under section 80P(2)(e) of the Act.

3.7.2 Audit noticed five cases in Gujarat, out of 38 cases examined, where Assessing Officers had allowed deductions for rent income earned from a source other than letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities. This had resulted in under

80 *CIT v. District Co-operative Federation [2004] 271 ITR 22 (All.)*

81 AP&TS, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

82 AP&TS, Gujarat, Karnataka, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

83 AP&TS, Gujarat, Karnataka, Madhya Pradesh.

84 Madhya Pradesh

assessment of income of ₹ 0.30 crore and short levy of tax of ₹ 0.12 crore. One of these cases is illustrated below:

Box 3.6

Illustration of Incorrect allowance of deduction under section 80P(2)(e) of the Act

a) Charge: PCIT- 3, Ahmedabad

AY: 2013-14 and 2014-15

The assessee filed return of income at nil for AY 2013-14 and AY 2014-15 in October 2013 and October 2014 respectively. The scrutiny assessment of the assessee for AY 2013-14 and AY 2014-15 was completed under section 143(3) of the Act in November 2015 and December 2016 respectively by accepting returned income. Audit examination revealed that the assessee had claimed deduction of ₹ 16.87 crore during AY 2013-14 and ₹ 13.03 crore during AY 2014-15 which included rent income of ₹ 0.14 crore (AY 2013-14) and ₹ 0.15 crore (AY 2014-15). As rent was not an allowable deduction the same was required to be disallowed. This mistake had resulted in underassessment of income by ₹ 0.14 crore and ₹ 0.15 crore involving short levy of tax of ₹ 0.06 crore and ₹ 0.06 crore during AY 2013-14 and AY 2014-15 respectively. ITD's reply is awaited (June 2020).

3.8 Disallowances in case of assessments of Co-operative Societies

Audit attempted to verify reasons for disallowance in 222 cases⁸⁵ where additions made by Assessing Officers were equal to deduction claimed under section 80P of the Act amounting to ₹ 259.06 crore. Audit noticed that entire claim of deduction of ₹ 0.50 lakh was allowed under section 80P of the Act in one case⁸⁶. In 221 cases of 13 states⁸⁷ the claim of deduction under section 80P of the Act was either disallowed fully or partly. In 210 (94.6 per cent) cases⁸⁸ the entire claim amounting to ₹ 125.79 crore was disallowed whereas in 11 (5 per cent) cases⁸⁹ claim amounting to ₹ 130.66 crore was disallowed partially.

Audit found that of 221 cases where AOs had made disallowance (fully or partially), in 111 cases⁹⁰ the assessee were held as ineligible for claim of deduction admissible to Co-operative Societies as they were engaged in

85 AP&TS, Gujarat, Karnataka, Kerala, Odisha, Madhya Pradesh, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

86 Madhya Pradesh.

87 AP&TS, Odisha, MP, Tamil Nadu, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, NER, UP, and West Bengal

88 AP&TS, Odisha, MP, Tamil Nadu, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, NER, UP, and West Bengal

89 Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh and Odisha

90 Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, NER, Rajasthan and Tamil Nadu.

banking activity; in seven cases⁹¹ the assessees were treated as non-PACS whereas in 24 cases⁹² the claim had been made on ineligible income viz. income from business activity or interest income earned from investment in banks other than those in Co-operative Sector. Thus, the disallowance of deduction claimed under section 80P of the Act was on account of assessee either not being engaged in activities listed out in the Act for Co-operative Societies or being engaged in specified activity to a limited extent compared to principal activity or business. This entailed major risk of entities not fulfilling conditions specified in the Act and claiming benefits wrongfully indicating thereby potential abuse of tax provision introduced with the legislative intention of facilitating the growth of Co-operative Sector.

Audit further found that out of 221 cases, where the disallowance had been made, inter alia, on the pretext that assessee was engaged in banking business or deduction had been claimed on ineligible income viz. interest earned from nationalised banks or assessee not working as PACS, in 47 cases assessees resorted to legal action. Of 47 cases, 32 cases⁹³ were allowed in favour of assessee by CIT(Appeals), one case⁹⁴ was allowed partly in favour of assessee and 14 cases⁹⁵ were pending in litigation before CIT(Appeals). Thus, the disallowances made by the ITD could not be sustained in courts of law.

Audit noticed 05 cases⁹⁶ of irregular allowance of deduction under section 80P of the Act involving tax effect of ₹ 1.14 crore. These mistakes are included in the instances of non-compliance discussed in para 3.2 to 3.7 of this chapter.

3.9 Non-uniformity in making assessments of assessees in Co-operative Sector engaged in banking activities

As per Banking Regulation Act, 1949, Co-operative Bank means State Co-operative Banks (SCBs), Central Co-operative Banks (CCBs) and Primary Co-operative Banks (PCBs). As per section 80P(4) of the Act, the provisions of section 80P of the Act shall not apply in relation to any Co-operative Bank other than a PACS or a Primary Co-operative Agricultural and Rural Development Bank.

Audit examined 336 assessment cases of Co-operative Sector where assessees were engaged in rural banking, agricultural and rural development banking and land development banking. Audit noticed that the Assessing Officers were adopting differential approach in allowance of deduction

91 Kerala.

92 Gujarat, Karnataka, Kerala, Maharashtra, Tamil Nadu and West Bengal.

93 Karnataka, Kerala, Maharashtra.

94 Gujarat.

95 Kerala.

96 Karnataka & Goa and Kerala.

claimed under section 80P of the Act while completing assessments of assesseees categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks as brought out in the table depicted below. Audit analysed the extent of allowance or disallowance amongst assesseees engaged in banking activities as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks. Audit noticed that the deduction claimed under section 80P of the Act was allowed in 106 cases⁹⁷, entire claim of deduction under section 80P of the Act was disallowed in 50 cases⁹⁸ and in 180 cases⁹⁹ nil claims had been made by the assessee under section 80P of the Act. The reasons for disallowance were assessee being engaged in banking activities and held as ineligible for claim of deduction under section 80P(4) of the Act. The extent of allowance of deduction to similar class of assesseees engaged in agricultural, rural and development banking in Co-operative Sector under section 80P of the Act is shown in table 3.4 below.

Table 3.4: Allowance of deduction under section 80P of the Act to assesseees engaged in banking activities.

Nomenclature of Bank	Assessment cases where deduction under section 80P of the Act was claimed and allowed					Assessment cases where entire claim of deduction under section 80P of the Act was disallowed			
	Co-operative Societies (No.)	Co-operative Banks (No.)	Total (No.)	Amount of 80P deduction claimed (₹ in crore)	Amount of 80P deduction allowed by ITD (₹ in crore)	Co-operative Societies (No.)	Co-operative Banks (No.)	Total (No.)	Amount of 80P deduction claimed (₹ in crore)
Gramin Bank/ Rural Bank/ Grameen Vikas Bank	21	7	28	354.6	353.7	20	8	28	1916.7
Bhoomi Vikas Bank/ Land Development Bank	20	20	40	33.0	35.9	4	8	12	5.4
Primary Agricultural & Rural Development Bank/ Co-operative Agricultural Bank/ State Agricultural & Rural Development Bank	33	5	38	914.7	361.9	8	2	10	113.1
Total	74	32	106	1302.3	751.5	32	18	50	2035.3

97 AP&TS, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

98 AP&TS, Bihar & Jharkhand, Karnataka, Kerala, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

99 AP&TS, Bihar & Jharkhand, Gujarat, Karnataka, Kerala, NER, Rajasthan, West Bengal & Sikkim.

As such, the Assessing Officers did not apply the provisions of the Act uniformly while determining allowance of deduction under section 80P of the Act in cases pertaining to similar class of assessee in Co-operative Sector. The reasons for wide variations in the applicability of same law under similar conditions need to be examined to ensure consistency and uniformity in assessment of similar class of assessee engaged in similar activities in Co-operative Sector. It is further required to co-ordinate with regulatory bodies to align the assessment of such assessee in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies.

3.10 Assessment of Co-operative Societies with high value claims of deduction under section 80P of the Act

Audit examined 257 cases involving highest claim of deduction under section 80P of the Act to examine the nature and extent of compliance to specific provision for Co-operative Societies in the Income Tax Act.

- a) Of 257 top cases where deduction of ₹ 7,000.73 crore was claimed under section 80P of the Act, in 82 *per cent* cases deduction was claimed under section 80P(2)(a)(i) of the Act applicable to Co-operative Societies engaged in the business of banking or providing credit facilities to its members (51.36 *per cent*) or under section 80P(2)(d) of the Act i.e. income by way of interest or dividends derived by Co-operative Society from its investments with any other Co-operative Society (30.74 *per cent*).
- b) Out of 257 cases, 115 cases were selected under Computer Assisted Scrutiny Selection¹⁰⁰ (CASS) for large deduction claimed under section 80P / Chapter VIA of the Act. Of 115 cases selected for large deduction claimed under section 80P of the Act / Chapter VIA, 100 cases were selected for complete scrutiny and 15 were selected for limited scrutiny.
- c) Of 115 cases examined by AOs under complete or limited scrutiny, entire claim of deduction was allowed in 32 cases whereas partial claim was allowed in 57 cases. Audit found that in 17 cases entire amount of deduction claimed under section 80P of the Act was disallowed for reasons such as assessee being engaged in banking business or deduction claimed on ineligible income viz. income from other sources. Such high proportion of disallowance in the top cases claiming deduction indicates the tendency for abuse of the deduction provision, especially by those Co-operative Societies engaged in

100 ITD has implemented the Computer Assisted Scrutiny Selection (CASS) system to select income tax returns for scrutiny on a compulsory selection basis using predefined criteria on a centralised basis.

banking business or providing credit facilities to its members or under section 80(2)(d) of the Act.

3.10.1 Audit noticed 38 cases¹⁰¹ of irregular allowance of deduction under section 80P of the Act involving tax effect of ₹ 52.83 crore. These mistakes are also included in the instances of non-compliance to different sub-sections of section 80P of the Act as discussed in para 3.2 to 3.7 of this chapter. Two cases are illustrated below:

Box 3.7

Illustration for irregular allowance of deduction under section 80P of the Act in high value claims

a) Charge : PCIT-1, Bengaluru

Assessment year : 2012-13, 2013-14 & 2014-15

The assessee, an AOP, is an apex Co-operative institution of the state for (1) the distribution of chemical fertilisers, pesticides and seeds, (2) procurement and marketing of agricultural commodities, (3) nodal agency for agricultural commodities procurement under MSP of the Government, and (4) distributes certain consumer products. Scrutiny assessment of the federal Co-operative Society for the AY 2012-13, 2013-14 and 2014-15 were concluded during March 2015, March 2016 and December 2016 respectively disallowing the deduction claimed on interest earned from nationalised bank treating it as “Income from other sources”. Audit observed that the assessee, apart from nationalised bank, has deposited its surplus fund in Apex bank also which is the “central bank” controlling all other Co-operative Banks in Karnataka and is governed by the Banking Regulation Act, 1949. Consequent to insertion of section 80P(4) of the Act, interest earned on surplus fund deposited in Apex bank is taxable. However, assessing officer has allowed deduction amounting to ₹ 0.55 crore, ₹ 4.33 crore and ₹ 3.92 crore for the AY 2012-13, 2013-14 & 2014-15 respectively. As a result, there is loss of revenue of ₹ 0.23 crore, ₹ 1.82 crore and ₹ 1.77 crore for the AY 2012-13, 2013-14 and 2014-15 respectively. ITD stated in its reply (May 2020) that in respect of AY 2012-13 no action is possible as the case is time barred while in respect of other AYs, appropriate remedial action would be taken and intimated to audit in due course.

101 AP&TS, Gujarat, Madhya Pradesh, Karnataka & Goa, Gujarat, Maharashtra, North Western Region, Uttar Pradesh and West Bengal

b) Charge : PCIT-Mangalore

Assessment year : 2012-13, 2013-14, 2014-15 & 2016-17

The assessee, a Co-operative Society registered as an AOP, is engaged in activities of marketing agricultural produce i.e. arecanut, raw rubber grown by its members and produces chocolate from cocoa beans. Scrutiny assessment of the Co-operative Society for the AY 2012-13, 2013-14, 2014-15 and 2016-17 were concluded during September 2014, January 2016, December 2016 and November 2018 respectively. The assessee earned interest income from investments in Co-operative Banks to the extent of ₹ 0.19 crore, ₹ 0.20 crore, ₹ 0.21 crore and ₹ 0.22 crore and claimed the same as deduction under section 80P(2)(d) of the Act. Assessing officer too admitted the deduction leading to loss of revenue of ₹ 0.07 crore, ₹ 0.08 crore, ₹ 0.10 crore and ₹ 0.10 crore for the AY 2012-13, 2013-14, 2014-15 and 2016-17, respectively. ITD while not accepting the audit objection replied (May 2020) and cited the jurisdictional Karnataka High Court decision in the case of Principal Commissioner of Income Tax, Hubli vs Totagar's Co-operative Sale Society, 2017 [392 ITR 74] which has ruled that "for purpose of section 80P(2)(d) of the Act a Co-operative Bank should be considered as a Co-operative Society" and thus the assessee is eligible to claim the deduction under section 80P(2)(d) of the Act for interest earned from Co-operative Banks.

The reply of ITD is not tenable, as the Assessing Officer has quoted jurisdictional High Court order [dated 05.01.2017] in the case of "The Totagar's Co-operative Sale Society Ltd." for AY 2012-13 only. The jurisdictional High Court of Karnataka, Dharwad Bench while deciding the case of the same assessee [Totagar's Co-operative Sale Society] for the AYs 2007-08 to 2011-12 pronounced on 16 June 2017 after considering its own order dated 5 January 2017 [vide para 18 and 19 of the Honorable High Court order], has ruled that the assessee is not eligible to claim deduction under section 80P(2)(d) of the Act for interest earned from Co-operative banks. The allowability needs to be re-examined in view of subsequent judicial ruling made in June 2017.

Audit, further, noticed that there is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the sub-section of section 80P of the Act under which the assessee claims deduction under section 80P of the Act. Thus, it is not clear as to how the ITD is allowing deduction without verifying the eligibility of the assessee or the fulfilment of conditions laid out under the provisions of the Act for specified activities. While Income Tax Act has specified the nature

of activities in respect of which Co-operative Societies can claim deduction under section 80P of the Act, it does not have any mechanism to monitor the same in order to assess the fulfilment of legislative intention behind introduction of benefit of deduction to Co-operative Societies under the Act. ITD should devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies to ensure allowance of claim to eligible assessee only.

3.11 Incorrect allowance of deduction of Provision for bad and doubtful debts

Section 36(1)(viii) of the Act stipulates that provision for bad and doubtful debts allowed to a Scheduled Bank or a Co-operative Bank other than a PACS or a primary co-operative agricultural and rural development bank, shall not exceed seven and one-half per cent of the total income (computed before making any deduction under this clause and Chapter VIA of the Act) and an amount not exceeding ten per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner. Further, as per 36(2)(v) of the Act, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause.

Audit examined 487 cases¹⁰² involving claim of deduction of ₹ 4,085.16 crore to ascertain the eligibility of Co-operative Banks claiming deduction on account of provision of bad and doubtful debts under section 36(1)(viii) of the Act.

- a) Audit found that of 487 cases, entire claim of deduction was allowed in 324 cases (66.5 per cent).

The details of the 324 cases where entire claims were allowed during assessment are presented in the table below.

¹⁰² Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

Table 3.5: Deduction claimed under section 36(1)(viiia) of the Act on account of Provision for Bad and Doubtful Debts

(₹ in crore)

Claims made under section 36(1)(viiia) of the Act		Deduction claimed on gross total income only (fully allowed by ITD)		Deduction claimed on aggregate advances only (fully allowed by ITD)		Deduction claimed on gross total income and aggregate advances where bifurcation not available (fully allowed by ITD)		Deduction claimed on gross total income and aggregate advances (fully allowed by ITD)	
No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed
487	4,085.16	142	815.64	94	772.13	54	430.67	34	740.21

The ITR in the existing format does not capture the distinct figures/ details of deduction claimed under section 36(1)(viiia) of the Act on total income and on rural advances. Audit could not ascertain the same from the available records as brought out above. It was not clear as to how the Assessing Officers were verifying the claim of deduction on account of provision for bad and doubtful debts while allowing the same during assessment. It is, therefore, suggested that the claim amount on total income and rural advances may be captured distinctly for effective monitoring and assessment of impact of deduction allowed to the Co-operative Banks.

3.11.1 Audit noticed 118 cases¹⁰³ in 18¹⁰⁴ states where the Assessing Officers had irregularly allowed deduction under section 36(1)(viiia) of the Act on account of provision for bad and doubtful debts without ensuring fulfilment of the conditions laid down in the Income Tax Act. This had resulted in under assessment of income of ₹ 1,002.78 crore and short levy of tax of ₹ 375.20 crore.

Audit found that out of 118 cases, 71 cases (viz. 60.1 per cent) were examined under complete scrutiny whereas 18 cases were examined under limited scrutiny. In 71 cases involving claim of deduction of ₹ 909.79 crore and allowance of deduction of ₹ 712.58 crore under section 36(1)(viiia) of the Act, though the type of scrutiny examination was complete, audit noticed mistakes involving incorrect allowance of deduction under section 36(1)(viiia)

¹⁰³ The audit objections include irregularities noticed in audit with respect to cases subjected to generic checks and (as discussed in para 3.11) and those subjected to specific checks (as discussed in para 3.11.3 of this chapter).

¹⁰⁴ Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal.

of the Act. These instances of incorrect assessments point towards inadequate examination of admissibility of claims during assessment.

Three cases are illustrated below:

Box 3.8

Illustration of Irregular allowance of deduction for provision under section 36(1)(viiia) of the Act

**(a) Charge: PCIT-Shillong
AY: 2014-15**

The scrutiny assessment of the assessee for AY 2014-15 was completed under section 143(3) of the Act in December 2016 determining income of ₹ 4.83 crore. The assessee preferred an appeal and on the basis of appeal order an effect was given in November 2017 determining income of ₹ 3.79 crore. Audit examination revealed that the assessee had made a provision of ₹ 6.00 crore, under section 36(1)(viiia) of the Act, in the accounts but had claimed deductions of ₹ 87.29 crore which was restricted to ₹ 84.78 crore in the assessment under section 143(3) of the Act. This resulted in excess allowance of deduction of provision of ₹ 78.78 crore and short levy of tax of ₹ 26.78 crore. ITD's reply is awaited (June 2020).

**b) Charge: PCIT-1 Patna,
AY: 2013-14**

The scrutiny assessment of the assessee was completed in February 2016 at an income of ₹ 16.35 crore. Audit noticed that an amount of ₹ 33.91 crore was debited in profit & loss account towards provision and contingencies and net profit was shown at ₹ 65.31 crore. During computation of income, after adjustment made as required, total income was calculated at ₹ 104.34 crore before deduction under Chapter VI and after claiming deduction of ₹ 213.51 crore under section 36(1) (viiia) of the Act including ₹ 205.69 crore as deduction for rural advance, returned income was filed at a loss of ₹ 109.18 crore. During scrutiny assessment returned income of assessee was taken at nil and after addition under two heads, income was assessed at ₹ 16.35 crore. As the assessee had debited total provision of ₹ 33.91 crore hence claimed deduction of ₹ 213.51 crore was required to be restricted up to the amount debited in profit and loss account i.e. ₹ 33.90 crore. However, deduction of ₹ 104.34 crore was allowed. The mistake resulted in excess allowance of deduction of ₹ 70.43 crore involving tax effect of ₹ 21.76 crore. The reply of ITD is awaited (June 2020).

**c) Charge: CIT Jamshedpur,
Assessment Year: 2011-12, 2012-13, 2013-14, 2014-15**

The assessment of the assessee was completed under section 143(3)/147/263 of the Act for the AYs 2011-12 to 2014-15 December 2016, December 2018, March 2016 and December 2016 and assessed at ₹ 3.04 crore, ₹ 5.50 crore, ₹ 3.61 crore and ₹ 2.65 crore respectively. Audit examination revealed that the assessee had made provisions of ₹ 16.23 crore in excess that was allowable under section 36(i)(viia) of the Act. The omission had resulted in irregular allowance of provisions of ₹ 16.23 crore¹⁰⁵ with consequent short levy of tax of ₹ 8.02 crore¹⁰⁶ Including interest. ITD stated (July 2019) in its reply that the issue raised by the audit will be examined and action as per law will be taken. Further details of remedial action taken by ITD are awaited (June 2020).

3.11.2 Monitoring of claims made on account of Provision for Bad and Doubtful Debts through Income Tax Return

The existing format of ITR-5 does not capture the claim made by assessee under section 36(1)(viia) of the Act. Further, the data furnished by the DGIT(Systems) shows amount of provision for bad and doubtful debts as per books of accounts and not the actual amount of claim of deduction under section 36(1)(viia) of the Act. Part A- Other Information of ITR-5 form captures the details of deduction under section 36(1)(viia) of the Act (viz. under amounts debited to the profit and loss account, to the extent disallowable). Audit noticed that in such cases where assessee added back the amount of "Provision for Bad and Doubtful Debts" in its computation of income, the amount claimed and allowed on account of provision for bad and doubtful debts was nil. However, the effective claim of deduction was not getting reflected in ITR. ITD may make a provision to capture the deduction claimed under section 36(1)(viia) of the Act by the assessee in the ITR form.

3.11.3 High value claims of deduction under section 36(1)(viia) of the Act

Audit examined 117 cases¹⁰⁷ of high value claims or deduction amounting to ₹ 1,707.78 crore under section 36(1)(viia) of the Act on account of provision for bad and doubtful debts to ascertain whether the deduction claimed under section 36(1)(viia) of the Act on account of provision for bad and doubtful

105 ₹ 16.23 crore = ₹ 7.69 crore (AY 2011-12) + ₹ 1.85 crore (AY 2012-13) + ₹ 1.51 crore (AY 2013-14) + ₹ 5.18 crore (AY 2014-15).

106 ₹ 8.02 crore = ₹ 4.01 crore (AY 2011-12) + ₹ 1.03 crore (AY 2012-13) + ₹ 0.64 crore (AY 2013-14) + ₹ 2.34 crore (AY 2014-15).

107 AP&TS, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, NER, Rajasthan, Tamil Nadu and West Bengal.

debts had been examined and allowed correctly. Audit found that the Assessing Officers had allowed entire claim of deduction of ₹ 1,144.06 crore in 88 cases while allowing partial claim of deduction of ₹ 125.30 crore against total claim of ₹ 563.72 crore in 29 cases.

Audit noticed 12 cases¹⁰⁸ of irregular allowance of deduction under section 36(1)(viia) of the Act involving tax effect of ₹ 39.36 crore. These mistakes are included in the instances of non-compliance discussed in para 3.10.1 of this chapter. The incorrect allowance was on account of non-restriction of claim to the provision made thereof, mistake in computation of claim due to non-consideration of revised total income etc. One case is illustrated below:

Box 3.9

Illustration of high value claims of deduction under section 36(1)(viia) of the Act

Charge: Pr.CIT-2, Nagpur

Assessment Year: 2013-14

The assessee had claimed and was allowed deduction of ₹ 15.71 crore on account of 'provision for bad and doubtful debts' under section 36(1)(viia) of the Act. Audit noticed that the assessee had made provision for bad and doubtful debts amounting to ₹ 7.04 crore only. Hence, the allowance should have been restricted to that extent. This had resulted in incorrect allowance of deduction by ₹ 8.67 crore involving tax effect of ₹ 2.68 crore. ITD's reply is awaited (June 2020).

There was a risk of non-compliance in high value claims of deduction under section 36(1)(viia) of the Act. As already suggested in para 3.9 of this chapter ITD may consider capturing distinct figures of claim of deduction under section 36(1)(viia) of the Act on total income and on rural advances in ITR for monitoring of extent of claim and compliance thereupon.

3.12 Incorrect allowance of deduction for special reserve under section 36(1)(viii) of the Act

Section 36(1)(viii) of the Act stipulates that in computing income from business, a deduction of 20 per cent of income from eligible business during the year shall be allowed in respect of any special reserve created and maintained by a specified entity. The Explanations below the section further explain the terms –'specified entity' and 'eligible business' which encompasses "development of housing in India" to mean cluster development of housing infrastructure by providing long term finance to the builders and developers. Deduction for providing long term finance for "construction or purchase of houses in India for residential purposes" is exclusively available to the 'Housing Finance Company'. Harmonious reading of

108 Madhya Pradesh, Karnataka & Goa, Kerala, Maharashtra, North East Region and Tamil Nadu

provisions of section 36(1)(viii) of the Act and Explanations thereunder thus makes it abundantly clear that individual housing loan does not qualify for deduction under section 36(1)(viii) of the Act in the case of Banks/Co-operative Banks and Financial Institutions other than a 'Housing Finance Company'. It has been judicially held (March 2019) in the case of South Indian Bank Ltd. Vs. ACIT, ITAT, Cochin Bench that special reserve deduction under section 36(1)(viii) of the Act was not allowable to assessee bank with respect to income from Individual housing loans stating that purchase/construction of individual houses does not amount to Housing Development.

Audit examined 114 cases to ascertain the eligibility of Co-operative Banks claiming deduction under section 36(1)(viii) of the Act.

- a) Audit noticed that of 114 cases in 10 states/ regions¹⁰⁹ where assessees had claimed deduction amounting to ₹ 354.84 crore under section 36(1)(viii) of the Act, of which, the Assessing Officers had made disallowance of ₹ 117.81 crore while allowing claim of ₹ 237.03 crore.
- b) Of 114 cases, in 82 cases the entire claim of deduction of ₹ 212 crore was allowed under section 36(1)(viii) of the Act. Of 82 cases, in 12 cases where deduction of ₹ 5.21 crore was allowed under section 36(1)(viii) of the Act the period for which loans or advances were provided was not ascertainable from the available records. As such, the fulfilment of basic condition of assessee being engaged in providing long term finance could not be ascertained in audit.
- c) Of 114 cases, in 16 cases the AOs had disallowed entire claim of deduction of ₹ 85.98 crore for reasons such as non-creation of any special reserve by assessee or the business of the assessee was not related to only long term finance.
- d) In remaining 16 cases of 114 cases, the claim of ₹ 25.03 crore was partially allowed against total claim of ₹ 56.87 crore.

3.12.1 Of cases examined with respect to claims under section 36(1)(viii) of the Act, audit noticed irregularities in 8 cases in Bihar and Maharashtra where ITD had allowed deductions for provision for special reserve incorrectly violating the conditions laid down in the Income Tax Act. This had resulted in under assessment of income of ₹33.20 crore and short levy of tax of ₹ 14.01 crore. Audit found that out of 8 cases, 3 cases involving tax effect of ₹ 10.43 crore were examined under complete scrutiny.

109 AP&TS, Bihar, Gujarat, Karnataka, Kerala, Maharashtra, North Western Region (NWR), Odisha, Tamil Nadu, Rajasthan, North Eastern Region (NER) and West Bengal.

Two cases are illustrated below:

Box 3.10

Illustration of Incorrect allowance of deduction under section 36(1)(viii) of the Act

a) Charge: PCIT-1 Patna

AY: 2014-15

The scrutiny assessment of the assessee was completed in December 2016 at an income of ₹ 83.03 crore. Audit noticed that the assessee had claimed and was allowed deduction of ₹ 20.75 crore under section 36(1)(viii) of the Act on total income comprising income from interest, income from investment and other income. Audit also noticed that no special reserve was created in books of account in this regard. As the assessee had not created any special reserve for deduction under section 36(1)(viii) of the Act and deduction claimed from all income in place of only from eligible business income, the same was required to be disallowed and added back to total income. The mistake resulted in incorrect allowance of deduction under section 36(1)(viii) of the Act amounting to ₹ 20.75 crore involving tax effect of ₹ 9.78 crore (including interest). ITD's reply is awaited (June 2020).

b) Charge: PCIT-1 Mumbai

AY: 2016-17

In Maharashtra, in the scrutiny assessment for A.Y. 2016-17 of an assessee functioning as a Co-operative Bank, deduction of ₹ 17 crore was allowed as claimed under section 36(1)(viii) of the Act. Audit noticed that as per the details of long term finance loan the amount of ₹ 309.69 crore related to Vastu siddhi, Property loan scheme, Commercial real estate etc. As these loans do not fall under 'eligible business' for qualifying deduction, the allowance of deduction for long term finance on the above amount was incorrect. This had resulted in excess allowance of deduction of ₹ 9.36 crore involving short levy of tax of ₹ 3.18 crore. ITD's reply is awaited (June 2020).

3.13 Irregular allowance of expense to Co-operative Societies under section 36(1)(xvii) of the Act for purchase of sugarcane.

The Central Government fixes the Fair and Remunerative Price (FRP) of sugarcane based on the recommendations of Committee for Agricultural Costs and Prices (CACCP) and after consultations with State Governments and other stakeholders. FRP determined under Sugarcane (Control) Order 1966 is the minimum price that sugar mills have to pay to sugarcane farmers. Besides, the Central Government and State Governments also notify various incentives and schemes for promotion of sugar manufacturing entities/ sugar industry from time to time.

The Central Government by notification fixes the price of sugarcane to be paid by producers of sugar for the sugarcane purchased by them. As per New Price Mechanism, from 22nd October 2009 Fair and Remunerative Price (FRP) came into existence. In consonance with the above, a new clause [section 36(1)(xvii)] has been inserted by Finance Act, 2015, with effect from 1 April 2016. Section 36(1)(xvii) of the Act provides that, deduction provided for the amount of expenditure incurred by a Co-operative Society engaged in the business of manufacture of sugar for purchase of sugarcane at a price which is equal to or less than the price fixed or approved by the Government, shall be allowed in computing the income referred to in section 28 of the Act.

Audit examined 111 cases involving claim of deduction of ₹ 24,664.78 crore under section 36(1)(xvii) of the Act in Gujarat and Maharashtra to ascertain the eligibility of Co-operative Societies claiming deduction under section 36(1)(xvii) of the Act. Audit found that in 111 cases the Assessing Officers had made disallowance of ₹ 6,668.43 crore (27 per cent) due to non-fulfilment of conditions specified under provisions of the Act while allowing deduction of ₹ 17,996.35 crore. The AOs had allowed full claim of deduction under section 36(1)(xvii) of the Act amounting to ₹ 887.05 crore in four cases out of 111 cases whereas in 107 cases partial allowance of deduction of ₹ 17,109.30 crore was made against claim of deduction ₹ 23,777.73 crore under section 36(1)(xvii) of the Act. The Assessing Officers had disallowed the excess sugar purchase price claimed as expenditure by the assessee which was more than Minimum Support Price (MSP) rate fixed by the Government.

Table 3.6: Deduction claimed under section 36(1)(xvii) of the Act on account of expenditure for purchase of sugarcane

(₹ in crore)

Claims made under section 36(1)(xvii)		Entire claim under section 36(1)(xvii) allowed by ITD		Claim under section 36(1)(xvii) partially allowed by ITD		
No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	Amount of deduction allowed
111	24664.78	4	887.05	107	23777.73	17109.30

The state-wise amount of deduction claimed and allowed is given below.

Table 3.7: State-wise amount of deduction claimed under section 36(1)(xvii) of the Act

(₹ in crore)

State	No of cases	Deduction claimed under section 36(1)(xvii)	Deduction allowed under section 36(1)(xvii) by ITD
Gujarat	38	8291.00	5392.35
Maharashtra	73	16373.78	12604.00
Grand Total	111	24664.78	17996.35

The quantum of claim of deduction made by sugar Co-operatives is significantly high [average of around ₹ 220 crore of deduction under section 36(1)(xvii) is being claimed by a sugar manufacturing entity]. The possibility of inflated claims being made by sugar manufacturing Co-operatives is also high (27 per cent of disallowance was made by AOs in 111 cases).

The returned income in respect of the 111 cases was ₹ 135.75 crore, while the assessed income was ₹ 6888.88 crore, indicating addition of ₹ 6753.13 crore. The AOs raised a demand, accordingly, of ₹ 2903.16 crore.

Of 111 cases, audit noticed irregularities in 19 cases of Maharashtra [returned loss ₹ 30.74 crore and assessed income of ₹ 1100.36 crore for the 19 cases], registered as AOP with ITD, where ITD had incorrectly allowed deductions on account of harvesting and transportation expenses under section 36(1)(xvii) of the Act. This had resulted in under assessment of income of ₹ 318.53 crore and short levy of tax of ₹ 107.75 crore. One case is illustrated below.

Box 3.11

Illustration for Irregular allowance of expense to Co-operative Societies under section 36(1)(xvii) of the Act

CIT Charge: Pr.CIT 3 Pune

AYs: 2012-13, 2013-14, 2014-15 and 2015-16

Audit examination revealed that while completing assessments of an AOP for AYs 2012-13, 2013-14, 2014-15 and 2015-16, the Harvesting and Transportation (H&T) expenses were not adjusted while computing the disallowance of excess sugarcane price. The view taken by ITD was not consistent with the case of another assessee. This had resulted in irregular allowance of expenditure of ₹ 180.21 crore¹¹⁰ involving tax effect of ₹ 58.60 crore.

Further, in case of same assessee, while completing assessment for AY 2014-15, the Assessing Officer allowed higher amount of deduction as per FRP rates instead of allowing the deduction for sugarcane purchase at the rate claimed by the assessee. This had resulted in irregular allowance of sugarcane expenses of ₹ 11 crore involving tax of ₹ 4.97 crore. ITD's reply is awaited (June 2020).

Of 19 cases where audit noticed irregular allowance of deduction under section 36(1)(xvii) of the Act in six cases the assessee was engaged in

¹¹⁰ ₹ 180.21crore = ₹ 54.52 crore + ₹ 47.82 crore + ₹ 57.24 crore + ₹ 20.63 crore

agricultural manufacturing whereas in one case the assessee was engaged in manufacturing of power and energy as shown in table below.

Table 3.8: Irregularities under section 36(1)(xvii) of the Act as per activity/ business code.

(₹ in crore)

Business Code	Activity	Returned Income	Assessed Income	No of Cases	Tax Effect
101	Manufacturing- Agro Based Industry	0	500.86	6	30.23
114	Manufacturing- Power and Energy	0	7.6	1	3.99
118	Manufacturing-Sugar	(30.74)	591.90	12	73.53
Total		(30.74)	1100.36	19	107.75

Thus there was a potential of non-compliance or ineligible claims being made by assessee engaged in activities other than manufacture of sugar under section 36(1)(xvii) of the Act. ITD may consider linking the activity code or business code or nature of business with deduction claimed under section 36(1)(xvii) of the Act at ITR stage for monitoring activity-wise impact or sectoral impact of deductions availed under section 36(1)(xvii) of the Act and extent of tax compliance on account of this deduction that was introduced to benefit sugar manufacturing entities.

All 19 cases were assessed under scrutiny. Out of these cases, 14 cases involving returned income of ₹ 63.40 crore and assessed income of ₹ 865.05 crore were assessed under complete scrutiny. While the irregular claims of deduction indicate the extent of attempts of abuse of the provision by the assessee under section 36(1)(xvii) of the Act, the Assessing Officers also failed to examine conditions for selection of the cases for scrutiny in these cases which led to incorrect assessments and undercharge of ₹ 96.11 crore.

3.14 Summary of audit findings

- Verification by the Assessing Officers was inadequate in determining adherence to the principles of mutuality. The Assessing Officers were taking differential stands in assessing similar cases of claims for deduction under section 80P of the Act. This impacted the quality of assessments of Co-operative Societies and Co-operative Banks.
- There were instances of irregular allowance of deductions under sections 36(1)(viia), 36(1)(viii), 36(1)(xvii) of the Act and various subsections of section 80P of the Act., where, conditions specified under the said provisions were not fulfilled, involving tax effect of ₹ 694.50 crore in 649 cases.

- The major reasons for disallowance of claim of deduction were assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of provisions applicable to Co-operative Societies.
- The Assessing Officers are adopting differential approach in allowance of deduction claimed under section 80P of the Act while completing assessments of assessee categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks.
- While conducting scrutiny assessments, it was seen that the assessing officers did not duly examine the parameters specified by the ITD for selection of cases for scrutiny viz. 'large deductions claimed under section 80P of the Act', in 274 cases, resulting in irregular allowance of deduction.
- There is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the information in respect of sub-section of 80P of the Act under which the assessee claims deduction under section 80P of the Act.
- Distinct and actual claim of deduction made under section 36(1)(viiia) of the Act is not getting captured in the existing format of ITR.
- Benefits of claim of deduction as Co-operative Society and Co-operative Bank were availed of by those Co-operative Societies and Co-operative Banks that were registered as other than AOPs viz. AOP(Trust), Artificial Juridical Person, BOI, Firm etc., which was not in order.
- Among the various sub sections under which a Co-operative Society/ Co-operative Bank could avail of deductions, it was seen that there was, relatively, higher risk of non-compliance under the sub-sections 80P(2)(d), 36(1)(viiia) and 80P(2)(a)(i) of the Act, being 56.55 *per cent*, 18.18 *per cent* and 17.72 *per cent* of the total number of irregularities identified during audit, respectively.
- There was, relatively, higher propensity of irregular claims of deduction in respect of assessee engaged in banking, credit and financial services, accounting for 68.7 *per cent* of the total number of irregularities identified.

3.15 Recommendations

a) The CBDT may consider devising a Standard Operating Procedure for testing the principles of mutuality during scrutiny assessments of Co-operative Societies. It may also consider adopting a consistent approach for assessment of Co-operative Societies to address the practice of registering nominal and associate members with unequal rights as regular members, which defeat the principle of mutuality.

The CBDT stated (July 2020) that the Assessing Officers do look into details and documents which is the basic requirement for completing the assessment. However, an SOP will be issued to cover this issue. It further stated that CBDT has formulated the E-assessment Scheme 2019, where the process of assessment has been made faceless reducing the human intervention. Team based assessment procedure has been put in place to avoid the mistakes. Under this scheme the process of Review is also put in place which will ensure that the assessments by the Assessing officers are properly reviewed before the assessment orders are passed to eliminate the error if any.

Audit noticed instances where the Assessing Officers were allowing deduction under section 80P of the Act to assessees that did not meet the Co-operative principles and hence did not satisfy the principles of mutuality. Audit is of the view that devising of Standard Operating Procedure for testing the principles of mutuality during scrutiny assessments would facilitate uniformity and consistency in assessments of Co-operative Societies.

b) The CBDT may devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies/ Banks to ensure allowance of claim to eligible assessee only.

The CBDT stated (July 2020) that monitoring is done through Computer Aided Scrutiny Selection once the case is selected for scrutiny assessment. During the course of scrutiny assessments, the verification of the income on which deductions is claimed by the Co-operative Societies/ Banks is undertaken by ITD. Suitable remedial action would be taken in appropriate cases if any mistake is discovered subsequently during audit. It is further proposed to incorporate these issues in the proposed SOP so that the mistakes do not occur.

Audit noticed that major reasons for disallowance of claim of deduction were on account of assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of

provisions applicable to Co-operative Societies. The CBDT may therefore consider devising a mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The CBDT may also consider making a provision in the ITR form to capture the sub-section of 80P under which the assessee claims deduction under section 80P of the Act.

c) To ensure allowance of deduction to eligible assessee only, minimise possibility of ineligible claims and for effective monitoring of claims, the activity code and status code of assessee may be linked with the sub-sections of 80P and 36(1) of the Act under which deduction is claimed at the stage of filing of income tax return. The instances where deductions claimed by assessee engaged in ineligible activities was disallowed during assessment may be used to identify activities, sector(s) and assessee to accord priority in selection for scrutiny in subsequent years. The same may also be reported to the concerned regulatory authorities (ROCS, RBI etc.).”

The CBDT replied (July 2020) that the recommendation is under consideration by TPL Division of the CBDT.

d) The actual claim of deduction made under section 36(1)(viiia) of the Act may be captured alongwith distinct figures/ details of deduction claimed on total income and rural advances in the relevant schedule of ITR forms for effective monitoring, better MIS and assessment of impact of deduction as the actual claim is not getting captured in the existing format.

The CBDT replied (July 2020) that the recommendation is under consideration by TPL Division of the CBDT.

e) The CBDT may ensure that the PAN status of the assessee claiming deductions as Co-operative Societies to be only AOPs. CBDT may review the PAN registration status and ensure uniformity in PAN registration to identify the assessee pertaining to Co-operative Societies/ Co-operative Banks, to facilitate meaningful information from data available with ITD.

The CBDT stated (July 2020) that for the purpose of Income Tax Act, 1961, Co-operative Societies are treated as Association of Persons (AOPs).

Audit noticed instances where benefits of claim of deduction as Co-operative Society and Co-operative Bank were availed of by those Co-operative Societies and Co-operative Banks who were registered as other than AOPs, viz. AOP(Trust), AJP, BOI, Firm etc., which was not in order. Audit is of the view that the CBDT may review the PAN registration status to ensure uniformity in PAN registration of

assesseees pertaining to Co-operative Sector and to ensure allowance of deduction admissible to Co-operative Societies to assesseees registered as AOPs only.

f) Class of assesseees and sections of the act under which the possibility of irregular allowance of claims were higher may be identified and monitored. ITD may devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance of deductions.

The CBDT replied (July 2020) that the recommendation would be considered in the SOP proposed to be issued in respect of assessment of Co-operative Societies.

g) The CBDT may examine the reasons for wide variations in the applicability of same law under similar conditions and issue directions, if required, to ensure consistency and uniformity in assessment of similar class of assesseees engaged in similar activities in Co-operative Sector. The CBDT may also co-ordinate with regulatory bodies to align the assessment of such assesseees in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies. The instances of ineligible assesseees claiming deductions admissible to Co-operative Societies and engaged in commercial banking business noticed during assessment procedure may be reported to the regulatory authorities (RBI, ROCS etc.).

h) The CBDT may issue SOP for assessment of claims made by sugar manufacturing Co-operative Societies under section 36(1)(xvii) to ensure that the allowance of deduction is in accordance with Government policies with respect to pricing of sugar at Central and State level.

Chapter 4: Compliance Issues related to assessment of Co-operative Societies and Co-operative Banks

The performance audit envisaged to check nature and extent of compliance to the general provisions of the Act during assessment process by the assessees of Co-operative Sector.

During the examination of assessment records in respect of Co-operative Societies and Co-operative Banks, audit noticed mistakes relating to incorrect allowance of deductions, quality of assessments, incomes escaping assessment etc. This chapter deals with audit issues relating to deficiencies in application of general provisions of the Act and relevant Rules/ Judicial pronouncements by the Assessing Officers during assessment in respect of aforesaid assessee. These cases of incorrect assessment point towards weaknesses in internal control in ITD which need to be addressed.

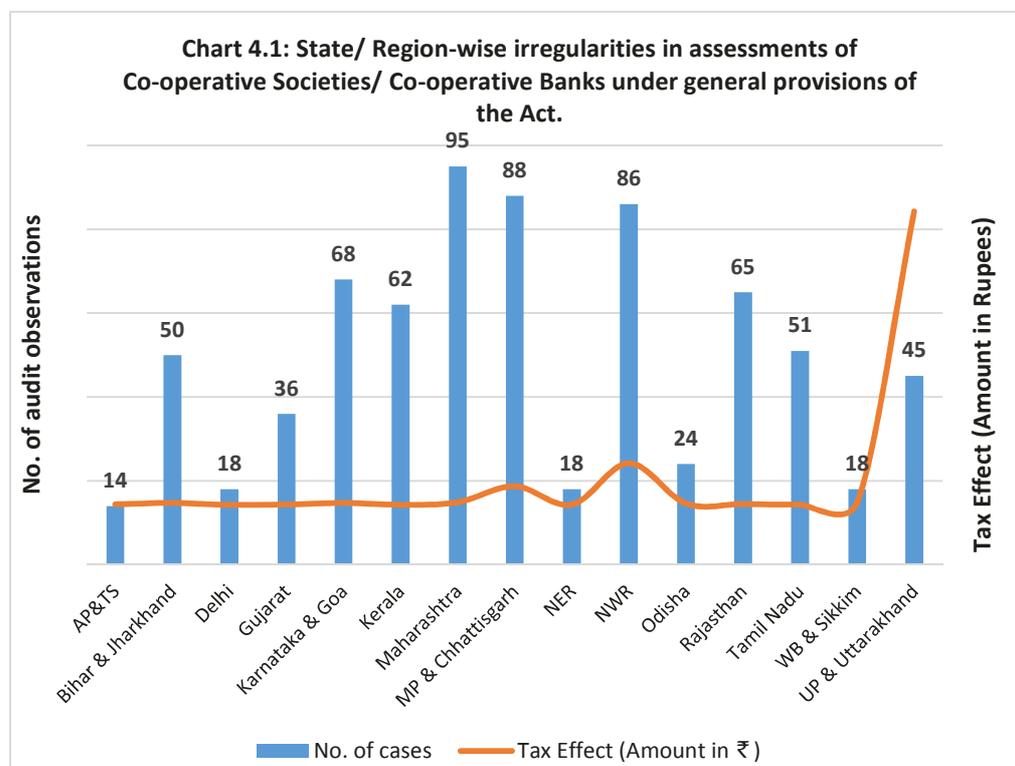
During the performance audit of Co-operative Societies and Co-operative Banks covering a sample of 8,470 cases, audit observed 730 cases wherein the general provisions of the Act were not complied with involving tax effect of ₹12,198.18 crore. The mistakes noticed in assessment and corresponding tax effects are summarised in Table 4.1. Detailed audit findings in this regard are discussed in subsequent paragraphs.

Table 4.1: Types of mistakes noticed in assessment

Sl. No.	Nature of audit observation	No. of cases	Tax Effect (₹ in crore)
1	Mistakes in levy of interest/ penalty etc.	277	40.49
2	Irregular allowance of expenditure, deductions etc.	184	376.07
3	Mistakes in computation of income, tax, surcharge etc.	104	1315.93
4	Income not assessed/ under assessed	43	22.24
5	Mistakes related to TDS provisions	38	45.63
6	Irregular set-off of loss etc.	36	147.89
7	Incorrect allowance of depreciation	22	54.64
8	Other mistakes during assessment	12	1.12
9	Overassessment of income/ Overcharge etc.	11	577.95
10	Unexplained investment/ expenditure etc.	4	9616.23
	Total	730	12,198.18

4.1 Profile of irregularities in assessments of Co-operative Societies and Co-operative Banks

The State/ region-wise details of irregularities in assessments of Co-operative Societies and Co-operative Banks noticed during the performance audit are depicted in Chart 4.1 given below:



As per PAN registration category details of assessments of Co-operative Societies/ Co-operative Banks, audit noticed instances of irregularities (20.7 per cent of irregularities) in respect of assessee registered as AJP, AOP(Trust), BOI, Firms, Local Authority and Company. As pointed out in Chapter 3 of this report, ITD may review the PAN registration status of the assessee filing income tax returns as Co-operative Societies/ Co-operative Banks to ensure uniformity in PAN registration category of similar class of assessee registered as taxpayers with ITD and to facilitate effective monitoring of tax compliance by entities in Co-operative Sector.

As seen from the activity-wise details of assessments of Co-operative Societies/Co-operative Banks, audit noticed 67.6 per cent of irregularities in assessments of assessee engaged in banking, credit and financial services followed by 6.3 per cent, 6.2 per cent, 4 per cent, 3.5 per cent and 3.3 per cent of irregularities in Co-operative Societies engaged in Agricultural and allied activities, Trading, Dairy Business, Housing/ Civil Construction and Manufacturing of sugar, respectively. ITD may review the reasons underlying such irregularities with greater emphasis on the banking, credit and financial

services sectors to ensure correct assessments in respect of Co-operative Societies and Banks.

Of 730 cases where audit noticed mistakes in allowance of deduction, 539 cases (73.8 per cent) were assessed under scrutiny viz. section 143(3) of the Act. Of 543 scrutiny assessment cases, in 364 cases the scrutiny was complete and in 98 it was limited¹¹¹. Further, audit observed that out of 465 cases where details of parameters for selection were available in the assessment records, in 131 cases involving claim and allowance of deduction of ₹ 193.93 crore and ₹ 172.75 crore, respectively, under section 80P of the Act, the criteria for selection of case for examination was on account of 'Large deduction claimed under Chapter VI-A', which included section 80P. Thus, audit noticed further irregularities despite of these assessments having been subjected to detailed examination by the Assessing Officers based on several risk parameters. These instances of incorrect assessments point towards inadequate examination of eligibility of incomes and admissibility of claims during assessment.

4.2 Mistakes in computation of income, tax, surcharge etc.

The Income Tax leviable in the case of Co-operative Societies had been specified under Paragraph B of Part III of the First Schedule to the Finance Act of the relevant Assessment Year. Surcharge on the income tax was also leviable at the specified rate in respect of Co-operative Societies whose total income exceeds one crore rupees. For the assessment year 2014-15 the surcharge is leviable at the rate of ten per cent.

Further, Section 5 of the Act states that the total income of any previous year of a person who is resident includes all income from whatever source derived which is received or deemed to be received in India in such year by or on behalf of such person; or accrues or arises or is deemed to accrue or arise to him in India during such year.

Assessing Officers committed errors in the assessments ignoring clear provisions in the Act. These cases of incorrect assessments involving arithmetical errors in computation of income and tax, application of incorrect rates of tax and surcharge etc. point to weaknesses in the internal controls in ITD which need to be addressed. Audit noticed 104 cases in 13 states¹¹² where mistakes in computation of income, tax and application of incorrect rates of tax and surcharge had resulted in short levy of tax of ₹ 1,315.93 crore. Two cases are illustrated below (see box 4.1).

¹¹¹ In eight cases type of selection was manual scrutiny whereas in 69 cases the details of type of scrutiny was not ascertainable.

¹¹² AP& TS, Bihar, Chhattisgarh, Karnataka & Goa, Jharkhand, Maharashtra, North West Region, Odisha, Rajasthan, Tamilnadu, Uttar Pradesh, West Bengal & Sikkim

Box 4.1: Illustration for mistakes in computation of tax, surcharge etc.

a) Charge: PCIT, Faizabad

AY: 2015-16 and 2016-17

The scrutiny assessment of the assessee, an AOP, for AYs 2015-16 and 2016-17 was completed under section 147 read with section 143(3) of the Act in February 2018 determining income of ₹ 333.57 crore and ₹ 143.96 crore respectively. Audit noticed that while computing tax demand the Assessing Officer did not levy the surcharge although the same was leviable at the rates of 10 *per cent* for AY 2015-16 and 12 *per cent* for AY 2016-17. This had resulted in short levy of tax of ₹ 13.91 crore and ₹ 6.57 crore including interest for AY 2015-16 and AY 2016-17 respectively. ITD accepted the audit objection. ITD informed (March 2020) that remedial action had been completed for both the AYs (December 2019).

b) Charge: PCIT, Rohtak

AY: 2014-15

The scrutiny assessment of the assessee, an AOP, was completed in November 2016 determining income of ₹ 1.29 crore. Audit noticed that assessee had decreased overdue interest reserve account in balance sheet by ₹ 0.70 crore. However, no bad and doubtful debt had been written off. This had resulted in under assessment of income ₹ 0.70 crore involving tax effect of ₹ 0.24 crore. The reply of ITD is awaited (June 2020).

Application of incorrect rates of tax and surcharge and arithmetical errors in computation of income and tax etc. point towards weaknesses in assessment procedure and internal controls of ITD which needs to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors in computation of tax, surcharge etc.

4.3 Mistakes in levy of interest/ penalty

Audit examined assessments to ascertain the correctness of interest charged for returns filed with delay, where the advance tax paid by such assesseees was less than ninety *per cent* of the assessed tax or the advance tax paid was less than prescribed *per cent* of the tax due on the returned income or amount refunded under section 143(1) of the Act exceeds the amount refundable on regular assessment as per the provisions of this Act. Audit noticed 277 cases in 16 states¹¹³ that ITD had not charged interest according to the provisions of this Act. This had resulted in under charge of interest/

113 Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal & Sikkim

non-levy of penalty of ₹ 40.49 crore. Three cases are illustrated below [see box 4.2 and 4.3].

4.3.1 Mistakes in levy of interest

The Act provides for levy of interest for omissions on the part of the assessee at the rates prescribed by the Government from time to time. Section 234A of the Act provides for levy of interest on account of default in furnishing return of income at specified rates and for specified time period. Section 234B of the Act provides for levy of interest on account of default in payment of advance tax at specified rates and for specified time period. Section 234C of the Act provides for levy of interest on account of default in payment of instalments of advance tax at specified rates and for specified time period.

Audit noticed 101 cases involving tax effect of ₹ 26.67 crore where there were mistakes in levy of interest on account of non-furnishing or delay in furnishing of returns of income, default in payment of advance tax, default in payment of instalments of advance tax, default in payment of tax demand raised by ITD etc. Two cases are illustrated in Box 4.2.

Box 4.2 : Illustration of Mistakes in levy of Interest

a) Charge: PCIT 2, Jodhpur, Rajasthan

AY: 2014-15

The scrutiny assessment of the assessee was completed in December 2016 at an income of ₹ 88.66 crore. Audit noticed that the assessee had filed its return of income for AY 2014-15 in November 2014, which was delayed by two months from the due date of filing of the return. While computing tax demand, the interest that was required to be charged under section 234A(1) of the Act for the delayed period was not charged. This had resulted in short levy of interest of ₹ 0.10 crore under section 234A of the Act. ITD accepted the objection (May 2018) and took remedial action under section 154 of the Act.

b) Charge: PCIT-1, Bhopal

AY: 2014-15

The scrutiny assessment of the assessee was completed in November 2016 determining income of ₹ 111.47 crore. Audit noticed that while computing the tax demand the Assessing Officer did not levy interest under section 234C of the Act. This had resulted in non-levy of interest of ₹ 0.46 crore under section 234C of the Act. Further interest under section 234B of the Act was also short levied by ₹ 0.13 crore. This had resulted in total short levy of interest of ₹ 0.58 crore under sections 234B and 234C of the Act. The reply of ITD is awaited (June 2020).

4.3.2 Mistakes in levy of penalty

Section 269SS of the Act provides that no person shall take/ accept from any person, any loan/ deposit exceeding ₹20,000/- otherwise than by bank draft/ accounts payee bank cheque. In violation of this provision penalty under section 271D of the Act is to be levied equal to amount of such loan/ deposit. Section 269T of the Act provides that no person shall repay any person, any loan/deposit exceeding ₹20,000/- otherwise than bank draft/ accounts payee cheque and in contravention of this provision, penalty equal to repaid amount shall be imposed under section 271E of the Act.

Audit noticed 176 cases involving tax effect of ₹ 13.82 crore where there were mistakes in levy of penalty on contravention of provisions laid down under the Act in respect of acceptance or repayment of loans or deposits in specified modes. One case is illustrated in Box 4.3.

Box 4.3: Illustration of Mistakes in levy of penalty

Charge: PCIT-5, Ahmedabad

AY: 2013-14

The scrutiny assessment of the assessee was completed in October 2015 at an income of ₹ 0.53crore. Audit noticed that the assessee had accepted loan or deposit of ₹ 0.88 crore otherwise than by an account payee cheque or account payee bank draft as reported by the CA in the Audit Report but no penalty proceedings was initiated by the AO. This had resulted in non-levy of penalty of ₹ 0.88 crore. ITD's reply is awaited (June 2020).

The errors in levy of interest and penalty on account of mistakes committed by the assessing officers lead to avoidable loss of interest/ penalty, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors in levy of interest and penalty.

4.4 Irregular allowance of expenditure, deductions etc.

As per section 36(1)(vii) of the Act, subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year. Provided that in the case of an assessee to whom clause (vii) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause.

Further, as per section 37(1) of the Act, any expenditure (not being expenditure of the nature described in section 30 to 36 of the Act and not being in the nature of capital expenditure or personal expenditure of the assessee) laid out or expended wholly and exclusively for the purpose of the business or profession shall be

allowed in computing the income chargeable under the head "Profit and gains of business or profession".

Section 43B of the Act states that certain statutory expenses can only be claimed in the year of payment.

The provisions laid down under the Act allow the assessee to claim various expenses and deductions subject to fulfilment of conditions specified under the Act. If these conditions are not fulfilled, the corresponding expense/deductions are required to be disallowed and added back to the taxable incomes by the Assessing Officers. Audit noticed 184 cases in 17 states¹¹⁴ where the AOs had made irregular allowance of expenses and deductions involving tax effect of ₹ 376.07 crore. Two cases are illustrated below:

Box 4.4 : Illustration of Irregular allowance of expenditure, deductions etc.

a) Charge: PCIT-Thrissur

AY: 2015-16

The scrutiny assessment of the assessee, a Co-operative Bank assessed as AOP, was completed in November 2017 at income of ₹ 2.40 crore. Audit noticed that an amount of ₹ 1.40 crore towards provision of bad and doubtful debts for which no credit entry was recorded in Profit and Loss account was deducted while computing the total income. This was not an allowable deduction under the provision of the Act. This had resulted in under computation of income ₹ 1.40 crore and short levy of tax of ₹ 0.65 crore. ITD replied that notice under section 154 of the Act had been issued (August 2019).

b) Charge: PCIT-2, Kolhapur

AY: 2016-17

The scrutiny assessment of the assessee, a Co-operative Bank assessed as AOP, was completed in December 2018 at income of ₹ 16.73 crore. Audit noticed that the assessee had claimed deduction of ₹ 2.22 crore as brought forward allowance for Bonus/ Commission to employees for the AY 2015-16 and same was allowed by Assessing Officer. The amount of deduction was neither shown in computation nor in 3CD report moreover not added back in total income of that year. This had resulted in underassessment of income ₹ 2.22 crore involving short levy of tax of ₹ 1.02 crore. ITD's reply is awaited (June 2020).

ITD may review the reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite there being clear provisions in the Act. ITD may identify such items of expenses and deductions that are erroneously being allowed by AOs and devise a checklist outlining the same

114 Andhra Pradesh & Telengana, Bihar, Chhattisgarh, Gujarat, Jharkhand, Karnataka, Goa, Kerala, Madhya Pradesh, Maharashtra, NWR, North East Region, Odisha, Rajasthan, UP, Uttarakhand, West Bengal

for use by Assessing Officers to prevent recurrence of such irregularities during assessment of claims and deductions.

4.5 Mistakes related to TDS provisions

Under the provision of section 40(a)(ia) of the Act, any payment of interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services on which tax is deductible at source under chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid, shall not to be deducted in computing the income chargeable under the head profit and gains of business or profession.

Audit examined cases to ascertain the deduction of TDS on payment of interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services on which tax is deductible at source under chapter XVII-B. Audit noticed 38 cases in 8 states¹¹⁵, wherein the assessee had not deducted TDS or deducted incorrectly violating the conditions laid down in the Act involving short levy of tax of ₹ 45.63 crore. One of the cases is illustrated below (see Box 4.5):

Box 4.5: Illustration of Irregular Allowance of expenditure under section 40(a)(ia) of the Act

**a) Charge: PCIT-Muzaffarpur
AY: 2014-15**

The scrutiny assessment of the assessee was completed in December 2016 at income of ₹ 176.93 crore. Audit noticed that the assessee had paid commission of GMDS agent amounting to ₹ 2.75 crore. As TDS was not deducted on commission paid thus the same was required to be added back in total income. This had resulted in under computation of income ₹ 2.75 crore involving tax effect of ₹ 0.93 crore. Reply of the department is awaited (June 2020).

Non-levy of tax on non-deduction of TDS or incorrect deduction of TDS indicates towards omissions by the assessing officers leading to avoidable loss of tax, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors.

115 Bihar, Jharkhand, Karnataka, Madhya Pradesh, North East Region, North Western Region, Odisha, Rajasthan.

4.6 Income escaping assessment

Section 143(3) of the Act provides that the Assessing Officers, shall by an order in writing, make an assessment of the total income or loss of the assessee and determine the sum payable by him or refund of any amount due to him on the basis of such assessment after taking into account such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered.

Audit examined cases to ascertain whether the claims and allowances were verified during assessment while computing total income, tax and interest. Audit noticed 43 cases in 6 states¹¹⁶ where ITD had allowed expenditure without verification of return/assessed income/unabsorbed depreciation and brought forward losses of previous years violating the conditions laid down in the Income Tax Act resulting in short levy of tax of ₹ 22.23 crore. Two cases are illustrated in Box 4.6 below:

Box 4.6: Illustration of Income escaping assessment

a) Charge: PCIT-Hubli, Karnataka

AY: 2015-16

This case was not selected for scrutiny assessment and was processed under section 143(1) of the Act at nil income. Audit noticed that the assessee, a Co-operative Society assessed as AOP, had claimed and was allowed deduction of ₹ 8.48 crore under section 80P of the Act. It was further noticed that the assessee was selected for scrutiny for all the years except this year and deduction under section 80P of the Act was being regularly claimed by the assessee and was regularly disallowed during the assessments. Thus, non-selection of the case for scrutiny assessment resulted in incorrect allowance of deduction of ₹ 8.48 crore involving tax effect of ₹ 3.57 crore. ITD's reply is awaited (June 2020).

b) Charge: PCIT, Karnal

AY:2014-15

The scrutiny assessment of the assessee, a PACS assessed as AOP, was completed in August 2016 at a loss of ₹ 0.55 crore. Audit noticed that assessee was following the mercantile system of accounting but amount of overdue interest recoverable during the year amounting to ₹ 7.70 crore was neither routed through profit and loss account nor added at the time of computation of income. This had resulted in under assessment of income of ₹ 7.70 crore having tax effect of ₹ 3.38 crore. ITD's reply is awaited (June 2020).

Non verification of claims and allowances during assessment points towards omissions by the assessing officers leading to avoidable loss of tax, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors.

¹¹⁶ Delhi, Gujarat, Karnataka & Goa, NWR, Rajasthan, Madhya Pradesh

4.7 Incorrect allowance of depreciation

As per section 32(i) of the Act read with Rule 5 of Income Tax Rules, 1962, the depreciation is allowable at prescribed rates on WDV of buildings, machinery, plant or furniture, being tangible assets, owned wholly or partly, by the assessee and used for the business or profession.

Audit examined cases to ascertain the correctness in allowance of depreciation in accordance with and subject to the provisions of this Act. Audit noticed 22 cases in 9 states¹¹⁷ where ITD had incorrectly allowed depreciation in contradiction to the provisions of the Act. This had resulted in under assessment of income of ₹153.91 crore and short levy of tax of ₹54.64 crore. Two cases are illustrated in Box 4.7 below:

Box 4.7: Illustration of Incorrect Allowance of Depreciation

a) Charge: PCIT 1, Mumbai

AY: 2014-15

The scrutiny assessment of the assessee, a Co-operative Bank assessed as AOP, was completed in December 2016 at an income of ₹ 176.24 crore. Audit noticed that assessee claimed and was allowed depreciation on goodwill. However, no such depreciation was debited in the books. This had resulted in incorrect allowance of depreciation of ₹ 121.75 crore involving tax effect of ₹ 41.39 crore. ITD's reply is awaited (June 2020).

b) Charge: PCIT 4, Ahmedabad

AY: 2014-15

The scrutiny assessment of the assessee, an AOP, was completed under section 143(3) of the Act in December 2017 by accepting the returned income of ₹ 11.72 crore. Audit examination revealed that the assessee had claimed additional depreciation of ₹ 0.30 crore on purchase of commercial vehicles viz. tankers and cars worth ₹ 1.59 crore. The claim allowed in the assessment resulted in under assessment of ₹ 0.30 crore and short levy of tax of ₹ 0.15 crore. The Department stated in its reply that as the assets mentioned above fall under the block Plant and Machinery, the additional depreciation is allowable to them. The reply was not acceptable, as the provisions of the Act expressly deny the allowance of additional depreciation to transport vehicles and as they are not used in the manufacture of any article or thing.

The incorrect allowance of depreciation point towards omissions by the assessing officers leading to avoidable loss of tax, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors.

117 Gujarat, Karnataka, Kerala, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamilnadu.

4.8 Irregular set-off of losses

As per section 72(1) of the Act where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year; if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Audit examined cases to ascertain the correctness in allowance of set off of loss in accordance with and subject to the provisions of this Act. Audit noticed 36 cases in 11 states¹¹⁸ where ITD had incorrectly allowed set off of losses in contradiction to the provisions of this Act resulting in short levy of tax of ₹ 147.89 crore. Two cases are illustrated in Box 4.8 below:

Box 4.8: Illustration of Irregular carry forward of loss under section 72(1) of the Act

a) Charge: PCIT-Panchkula

AY: 2016-17

The scrutiny assessment of the assessee, an AOP(Trust), was completed in December 2018 at ₹ 14.08 crore. Audit noticed that assessee in assessment year 2016-17, had shown income of ₹ 0.02 crore after adjusting business loss of ₹ 14.08 crore. However, the assessee had shown the total carry forward loss of ₹ 56.70 crore, out of which he had availed benefit of adjusted loss of ₹ 14.08 crore and carry forward loss of ₹ 42.61 crore during the AY 2016-17. But, as per assessment order for the year 2012-13, 2013-14, 2014-15 and 2015-16, the actual assessed loss of ₹ 3.37 crore was accounted for during the AY 2014-15. Thus, the assessee got excess benefit of brought forward loss of ₹ 14.08 crore which resulted in tax involving of ₹ 6.48 crore and carry forward of loss of ₹ 42.61 crore. Reply of the department is awaited (June 2020).

b) Charge: Pr.CIT-1, Patna, Bihar

AY: 2014-15

The assessment of the assessee, an AOP, was completed under section 143(3) of the Act in December 2016 at loss of ₹ 10.76 crore after addition of ₹ 11.86 crore under section 40(a)(ia) of the Act and addition of ₹ 0.49 crore on

118 Bihar, Delhi, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Uttar Pradesh, West Bengal & Sikkim.

account of add back of provision for fraud and dacoity. It was noticed that the assessee had an income of ₹ 86.06 crore for AY 2014-15, however the return of income (November 2014) was filed at a loss of ₹ 23.11 crore after setting off loss of ₹ 109.17 crore based on returned loss of ₹ 109.17 crore filed for the AY 2013-14. Audit of assessment records for AY 2014-15 in correlation with assessment records for AY 2013-14 revealed that assessed income of the AY 2013-14 was ₹ 16.35 crore and therefore, no loss for the AY 2013-14 was available for set off. However, assessee had claimed loss of ₹ 109.17 crore relating to AY 2013-14 and Assessing Officer allowed the same and determined assessed income at loss of ₹ 10.76 crore. Further, while calculating tax demand, loss of ₹ 10.76 crore was taken as income of ₹ 10.76 crore. The errors resulted in short computation of income of ₹ 87.65 crore (₹ 98.41 crore- ₹ 10.76 crore) and consequent short levy of tax and interest of ₹ 33.74 crore. Reply of the department is awaited (June 2020).

The incorrect allowance of set-off of losses point towards omissions by the assessing officers leading to avoidable loss of tax, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors.

4.9 Unexplained investment/ expenditure etc.

Section 68 of the Act stipulates that where any sum is found credited in the book of an assessee and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not satisfactory, the sum so credited may be charged to income tax as the income of the assessee to establish identity, creditworthiness of the of the lenders and genuineness of the transaction with supporting document to substantiate the claim. As per section 69 of the Act where in the financial year immediately preceding the assessment year the assessee has made investment which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of investment or the explanation offered by him is not, in the opinion of the Officer, satisfactory, the value of the investment may be deemed to be the income of the assessee of such financial year.

Audit noticed 4 cases in 3 states¹¹⁹ where ITD had not taken into account unexplained cash credit and unexplained investment while completing assessment according to the provisions of this Act resulting in short levy of tax of ₹ 9,616.23 crore. Two cases are illustrated in Box 4.9 below:

119 Madhya Pradesh, Maharashtra and Uttar Pradesh

Box 4.9: Illustration of Unexplained Investment/ expenditure under Sections 68 and 69 of the Act**a) Charge: PCIT-1 Lucknow****AY: 2013-14**

The scrutiny assessment of the assessee, a Credit Co-operative Society assessed as AOP, was completed in March 2016 determining total income of ₹ 5,222.52 crore. The AO held that the source of deposits of ₹ 17,877.54 crore received from members and source of shareholder's fund of ₹ 327.75 crore were not fully verifiable. As per para 5 of the assessment order, the Assessing Officer concluded that the assessee had not been able to prove the credit worthiness or genuineness of the transactions in 33 cases of shareholders who had subscribed ₹ 5.00 lakh and above and had nothing to say of the balance 4016150 (4016183-33) shareholders. Therefore, applying 25 per cent on the deposits of ₹ 17877.54 crore and shareholders fund of ₹ 327.75 crore to work out unexplained cash credit of ₹ 4,469.38 crore and ₹ 81.94 crore respectively was irregular.

As the Assessing Officer was not satisfied about either of the identity, credit worthiness or the genuineness of transaction of the deposits from the members and shareholders fund, he should have treated the net deposits collection amounting to ₹ 17,877.54 crore and shareholders fund of ₹ 327.75 crore received during the year as unexplained cash credit under section 68 of the Act. This had resulted in short computation of unexplained cash credit of ₹ 13,653.96 crore and consequent short charge of tax of ₹ 5,737.94 crore including interest of ₹ 1,518.87 crore for 36 months under section 234B of the Act. Reply of the department is awaited (July 2020).

b) Charge: PCIT-I, Bhopal**AY: 2015-16**

The scrutiny assessment of the assessee, a Co-operative Society assessed as AOP, was completed in December 2017 determining income at ₹ 195.70 crore. The Assessing Officer had restricted examination during scrutiny to net profit to turnover ratio and non-deduction of TDS on payments made by the society.

Despite sufficient red flags in respect of significant increase in receipts of member's contributions towards objects of the society from ₹ 105.97 crore in 2013-14 to ₹ 8,161.10 crore, payment of ₹ 648.47 crore to the field workers/ members as commissions for addition of new members without deducting TDS under section 194H of the Act, non-accountal of the interest earned or accrued on ₹ 7,124.67 disbursed as 'Advance to Others' under 'other current assets' and non-current investments by the society amounting to ₹ 580.09 crore during FY 2014-15, the AO did not consider seeking explanations and evidences to examine the possibility of potential escapement of income and possibility of taxing the unexplained credits (₹ 8,161.10 crore), unexplained investment (₹ 7,124.67 crore) and unexplained expenditure (₹ 648.47 crore).

The department stated in its reply (June 2018) that the audit objection was not acceptable as the case was selected for limited scrutiny under CASS and the AO was not supposed to examine any issue other than those mentioned therein. It

was further stated (April 2019) that the objections are realised on certain issues which are suggestive in nature without any clear evidence on record and tentative calculation of escapement of income. Also, the cases cannot be reopened merely on grounds of suspicion or roving enquiry where there is no clear evidence or the reasons to believe that a specified amount has escaped assessment. Therefore, considering the facts and circumstances of the case and also in view of CBDT instruction No. 20/2015 dated 29.12.2015, the contention of the audit is not acceptable and the objections raised deserve to be dropped.

The reply of the ITD is not acceptable, as the AO already had power to get any case of limited scrutiny converted into "Complete scrutiny", if there was potential escapement of income exceeding rupees five lakh. Despite there being a sudden manifold increase in aggregate receipts which raises a suspicion; no effort was taken by the AO to conduct a complete scrutiny or survey or search & seizure to ascertain identity of the members, genuineness of transaction and also their creditworthiness to establish the income and resultant tax dues.

The amount of underassessment of income to the extent of ₹ 7,800 crore as worked out by the audit is based on audited balance sheet and cash flow statements of the assessee for FYs 2013-14 and FY 2014-15 and is only indicative in nature. The omission on part of the ITD also highlights the ineffectiveness of the CASS and the differential stand taken by the AOs as in this case and the case of a Credit Co-operative Society (as illustrated above), wherein the AO had made a disallowance of 25 *per cent* towards unexplained cash credit due to unsatisfactory credit worthiness and genuineness of transactions.

Inadequate examination of unexplained cash credit and unexplained investment point towards omissions by the assessing officers leading to avoidable loss of tax, which need to be addressed. ITD may review such irregularities in order to ascertain the reasons for such errors. ITD may also devise a guideline to, adequately, address issues of unexplained cash, credit and investments during assessments.

ITR-5 in the existing format does not capture list of all Members of a Co-operative Society for the previous year relevant to the Assessment Year of filing of return. A provision may be made in ITR-5 to capture details of all Members along with their PAN. Also, quoting of PAN may be made mandatory for deposits received above a threshold amount by Co-operative Societies for effective monitoring of financial transactions.

4.10 Other mistakes during assessment

Audit noticed other irregularities in 12 cases in 8 states¹²⁰ involving tax effect of ₹ 1.11 crore. Audit also noticed 11 cases of overassessment of income,

120 AP&TS, Chhattisgarh, Gujarat, Jharkhand, MP, NER, Rajasthan, Maharashtra.

overcharge of tax etc. in seven states¹²¹ involving tax effect of ₹ 577.95 crore. One case is illustrated below.

Box 4.10: Illustration of Overassessment of income

a) Charge: PCIT -1, Bhopal

AY: 2016-17

The scrutiny assessment of the assessee, a Co-operative Society assessed as AOP, was completed in December 2018 at an income of ₹ 1,806.18 crore. Audit noticed that during the assessment proceedings Assessing Officer disallowed 30 per cent expenditure of ₹ 433.28 crore which stood at ₹ 129.98 crore. While computing taxable income, the amount of disallowance was erroneously considered as ₹ 1,299.83 crore. This had resulted in over assessment of income of ₹ 1,169.85 crore involving tax effect of ₹ 562.76 crore. ITD's reply is awaited (June 2020).

4.11 High Value Additions made during assessments

Audit examined 286 unique PAN-AY cases where additions made to the returned income during assessment were greater than ₹ 0.50 crore and demand raised was nil to ascertain whether there were errors in assessment and whether the deductions and claims had been allowed correctly.

The reasons for demand reduction at assessment stage were seen to be settlement of demand against TDS and other payments viz. advance tax, self-assessment tax etc. or additions being less than amount of returned loss. In cases where demand became nil at rectification stage the main reason was amount of tax paid being greater than gross demand. In cases where demand became nil at appellate stage it was due to deletion of additions made by Assessing Officers/ appeal being allowed in favour of assessee.

Audit also examined such cases with high value additions to ascertain the nature and extent of compliance to provisions under the Act.

- i. It was seen that the major disallowances made by Assessing Officers were on account of items such as depreciation, provisions on account of law charges, theft and frauds, audit fees, interest expenses on borrowed funds, building fund, income tax, gratuity; interest income on bank deposits to be treated as income from other sources; unexplained cash credits; provision for bad and doubtful debts, provision for Non-Performing Assets; expenses related to exempt income; deduction claimed under section 80P of the Act; amortisation of premium paid on government securities, special reserve, bogus purchase etc.

121 AP&TS, Bihar, Delhi, Karnataka, Madhya Pradesh, NWR, Odisha.

- ii. Of 35 cases where disallowance was made on account of deduction under section 80P of the Act, in seven cases¹²² deduction amounting to ₹ 466.10 crore claimed under section 80P of the Act was disallowed as assessee was engaged in banking business or was held as non-PACS and was therefore held as ineligible for allowance of deduction under section 80P of the Act. Of these, it was seen that deduction under section 80P of the Act was shown as Nil as per DGIT(Systems) data in three cases only. In remaining four cases¹²³ deduction amount under section 80P of the Act is not updated in the DGIT(Systems) data as per deduction allowed. DGIT (Systems) data continued to reflect the amount of claim of deduction at ₹ 461.28 crore as per the claim made by assessee instead of correct amount of deduction allowed at nil.

In such cases where deduction was disallowed on the pretext that the Co-operative Society was engaged in banking business ITD should assign codes as per the nature of business or activity for effective monitoring. The existing activity codes also do not classify the Co-operative Banks from PACS.

Further, the ITD should ensure that the information on deduction claimed and allowed should be distinctly captured in the systems.

4.12 High Value Demands

Audit examined 21 cases¹²⁴ where returned income was equal to assessed income but demand was greater than ₹ one crore to determine the stage at which the demand was raised and whether prepaid taxes were accounted for while computing tax demand.

Audit noticed that in eight cases, the demand was raised at reassessment stage (two cases), rectification stage (two cases) and scrutiny stage (four cases). In 13 cases the demand was raised at the stage of electronic processing of ITR stage itself. The reasons for levy of demand inter alia included disallowance of amounts on account of accumulation or voluntary contribution and accounting of pre-paid taxes at processing of ITR stage, advance tax deposited under wrong head not considered as payment by CPC Bengaluru, disallowance of deduction under section 80P of the Act on account of inadmissible claim made by ineligible assessee viz. Co-operative Bank, tax paid claimed by assessee pertained to another PAN, excess levy of interest under sections 234B & 234C of the Act and deduction claimed by assessee not allowed by CPC Bengaluru.

122 Bihar, Kerala, Tamil Nadu and Uttar Pradesh

123 Kerala, Tamil Nadu and Uttarakhand

124 Andhra Pradesh &Telangana State, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Uttar Pradesh, Uttarakhand and West Bengal

Presence of cases of raising of demand at processing of ITR stage itself points to the fact that ITD should focus on reconciliation of claims, through CPC-Bengaluru, actively to resolve the same and evolve means to avoid possibilities of non-matching of claims and payments.

In one case of Co-operative Bank in CIT-Shimla, North West Region¹²⁵ charge, advance tax of ₹ 1.50 crore deposited in wrong head of account not considered as advance tax payment by CPC Bengaluru. However, the same was allowed as advance tax payment by the CPC Bengaluru after filing of appeal by the assessee.

CBDT stated (July 2020) during Exit Conference that the demand generated erroneously through ITD systems at ITR processing stage on account of input errors made by assessee (which is also beyond control of ITD) at ITR filing stage are rectified as per provision under section 154 of the Act.

4.13 Variations in Additions made by Assessing Officers

Under the provisions of section 142(2A) of the Act, if at any stage of the proceedings before him, the Assessing Officer, having regard to the nature and complexity of the accounts and interest of the revenue, is of the opinion that it is necessary so to do, he may direct the assessee to get the accounts audited by an accountant and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed and such other particulars as the Assessing Officer may require.

Further, section 143(3) of the Act provides that Assessing Officers have to determine and assess the income correctly. Different types of claims together with accounts, records and all documents enclosed with the return are required to be examined in details in every scrutiny assessment. CBDT has also issued instructions from time to time in this regard.

Audit examined 288 unique PAN cases¹²⁶ to ascertain whether the Assessing Officers had taken differential stand while making allowances during assessments in respect of same assessee across assessment years.

Audit noticed that Assessing Officers had taken differential stand in 22 assessment cases (10 unique PAN cases) wherein the allowance or disallowance was not made uniformly across different AYs in case of same assessee e.g. interest received from deposits with Co-operative Banks was treated non-uniformly, i.e. either treated as eligible income or ineligible income for allowance of deduction under section 80P(2)(d) of the Act in different AYs in case of same assessee.

Two cases are illustrated in Box 4.11 below:

125 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

126 1108 assessment cases assessed during FYs 2014-15 to 2018-19

Box 4.11: Illustration for variations in additions made during assessment

**(a) Charge: PCIT-I Lucknow,
AY: 2014-15**

The scrutiny assessment of the assessee, an AOP, was completed in December 2016 at total income of ₹ 0.20 crore by disallowing 'donation & charity' amounting of ₹ 0.02 crore and late payment of tax of ₹ 0.02 lakh and added back the same to the income of the assessee. No inquiry before assessment was made under section 142(2A) of the Act. Scrutiny assessment for AYs 2011-12 and AY 2012-13 was completed in July 2014 and September 2015 at income of ₹ 111.55 crore and ₹ 121.70 crore, respectively, after making disallowances/ additions amounting to ₹ 106.90 crore and ₹ 121.98 crore, respectively, on the basis of inquiry before assessment under section 142(2A) of the Act. Omission not to make inquiry before assessment under section 142(2A) of the Act, resulted in incorrect assessment of income.

ITD stated in its reply (January 2020) that during AYs 2011-12 and 2012-13 the assessee was involved in an embezzlement of ₹ 4.25 crore and ₹12.36 crore, respectively. In view of above, the AO has conducted Special Audit under section 142(2A) of the Act, but no embezzlement matter involved during AY 2013-14. Therefore, the AO had rightly completed assessment for AY 2014-15. The reply of the department is not acceptable as significant fraud was unearthed in two assessment years, which warranted similar level of examination. Further, the case records including the assessment order did not contain any details/ documents which ensure that no embezzlement matter was involved during AY 2014-15.

**(b) Charge: PCIT-I Lucknow,
AY: 2012-13**

The scrutiny assessment of the assessee, a Credit Co-operative Society assessed as an AOP, was completed in March 2015 at income of ₹ 14,436.65 crore after addition of ₹ 14,509.81 crore. As per para 5 of assessment order, the AO held that the deposits received from members during the year of ₹ 13,149.08 crore was unexplained cash credit under section 68 of the Act.

Audit examination of Schedule-11 of Profit & Loss account revealed that the assessee had claimed and was allowed a sum of ₹ 311.10 crore as interest paid on deposits received from the members which were held unexplained cash credit by the AO, hence corresponding expenditure i.e. interest on deposit should have been disallowed and added back to the income of the assessee. The omission resulted in irregular allowance of business expenditure of ₹ 311.10 crore with consequent short charge of tax of ₹ 130.74 crore including interest of ₹ 34.61 crore under section 234B of the Act for 36 months.

During scrutiny assessment of the same assessee for AYs 2013-14 and 2016-17, Assessing Officer treated deposits from members as unexplained income under section 68 of the Act, and disallowed corresponding interest expenditure on the deposits from members.

ITD stated in its reply (January 2020) that proposal under section 263 of the Act had been sent.

4.14 Other observations from regular compliance audits pertaining to Co-operative Societies and Co-operative Banks (Not in Sample)

In addition to the audit observations mentioned in the preceding chapter and this chapter, 128 audit observations (as shown in Appendix 3) were noticed in respect of Co-operative Societies and Co-operative Banks that were assessed during the period of coverage of the Performance Audit i.e. 2014-15 to 2018-19 which did not fall under the selected sample during the regular compliance audit, involving a tax effect of ₹130.22 crore. The irregularities, inter alia, included arithmetical errors in computation of income and tax, mistakes in levy of interest, incorrect allowance of deductions and expenses under several provisions of the Act and irregular set-off of losses. Two cases are illustrated in Box 4.12 below:

Box 4.12: Illustrations for audit objections raised during regular compliance audit

a) Charge: PCIT-2, Ahmedabad

AY: 2013-14

The assessee is a Co-operative Bank engaged in the banking activity filed its return of income for AY 2012-13 on 28 September 2013 declaring income of ₹ 13.90 crore. The same was assessed under section 143(3) of the Act (January 2016) by accepting the returned income. As per the assessment records the assessee had debited an expenditure of ₹ 2.06 crore on purchase of computers and peripherals treating it as revenue expenditure. As the expenditure on purchase of computer has the capability to give enduring benefits over a period of time it is a capital expenditure and cannot be allowed as revenue expenditure. As such revenue expenditure of ₹ 2.06 crore for purchase of computer and peripherals was required to be disallowed. However, assessee was eligible to claim depreciation at prescribed rates under section 32 of the Act on computer so capitalised. Failure to do so resulted in under assessment of income of ₹ 1.44 crore (after allowing depreciation) and consequent short levy of tax of ₹ 0.60 crore including interest of ₹ 0.15 crore under section 234B of the Act. ITD stated (September 2019) in its reply that a notice had been issued to the assessee under section 148 of the Act for reopening of the case.

b) Charge: PCIT-2, Surat

AY: 2014-15

The scrutiny assessment of the assessee, a Co-operative Credit Society assessed as an AOP, was completed under section 143(3) of the Act in June 2016 determining income of ₹ 0.67 crore. Audit noticed that assessee had claimed deduction under section 80P(2)(d) of the Act on interest income of ₹ 0.49 crore earned by depositing surplus funds with Co-operative Banks. As interest income earned from investment in Co-operative Banks is income from other sources, it was required to be disallowed. This omission had resulted in under assessment of income by ₹ 0.49 crore and short levy of tax of ₹ 0.19 crore. ITD has initiated remedial action under section 263 of the Act (March 2019) by setting aside the scrutiny assessment order passed under section 143(3) of the Act with the direction to frame a fresh assessment.

4.15 Summary of audit findings

- Audit noticed instances of non-compliance to provisions laid down in the Act with respect to allowances of deductions/ expenses/ set-off and carry forward of losses, mistakes in computation of tax and interest, non-deduction of TDS, non-levy of penalty etc. involving tax effect of ₹ 12,328.40 crore, in 858 cases. It is pertinent to note that the assessment process was automated and assessments were being completed through ITD systems and applications. This is indicative of there being weaknesses in assessment procedure and internal controls of ITD which need to be addressed.
- Adequate examination of cases during scrutiny was not done. In 131 cases out of scrutiny assessment cases, where the criteria for selection was 'Large Deductions under chapter VIA of the Act', the same was not adequately examined.
- Audit noticed instances of raising of demand, in cases where returned income was equal to the assessed income, at different stages of assessment viz. electronic processing of ITR, rectification, reassessment etc. Audit noticed several reasons for raising these demands such as accounting of pre-paid taxes at processing of ITR stage, advance tax deposited under wrong head not considered as payment by CPC Bengaluru etc. Such cases point to the fact that claims and payments data are not reconciled at the time of assessment.
- Audit examined cases involving high value additions made during assessment and noticed instances where deduction claimed under section 80P(4) of the Act was disallowed on the pretext that the Co-operative Society was engaged in banking business. The existing activity codes do not differentiate the Co-operative Banks from PACS. ITD should assign codes as per the nature of business or activity for effective monitoring.
- 20.7 per cent cases (151 observations) relate to entities which were not registered as AOPs. In absence of uniformity in PAN registration, category of similar class of assessees, in this case registered as Co-operative Society, the ITD will not be in position to derive meaningful information from data available with itself.

4.16 Recommendations

Audit recommends that:

- a) The CBDT may revisit the assessments involving errors and irregularities in computation of income, tax, interest etc. to ascertain the reasons for errors and put in place a robust IT system and internal control mechanism to eliminate possibility of avoidable errors and to ensure compliance to

provisions and conditions laid down under the Income Tax Act by the Assessing Officers. The CBDT may like to introduce a quality assurance mechanism to ensure that errors in computations of tax are minimized.

The CBDT replied (July 2020) that suitable remedial action is taken in cases where audit noticed mistakes. It was further stated during Exit Conference (July 2020) that the CBDT has notified faceless e-assessment scheme in September 2019 which has been introduced and extended to all types of assessees. This scheme has introduced the concept of Group assessment wherein the ITO makes an assessment, seeks approval of Joint Commissioner and thereafter such draft assessment orders are sent to review unit for review of draft assessment order which includes further examination of issues discussed/ additions made in the draft assessment order and checking of arithmetical correctness of modifications proposed. It was further stated that the examination undertaken in the FY 2020-21 would mostly be under e-assessment scheme and under this scheme the occurrence of such kinds of errors and mistakes will be reduced.

- b) The reasons for irregular allowance of inadmissible claims and items of expenditure and deductions despite there being clear provisions in the Act may be reviewed by CBDT. The ITD may identify items of expenses and deductions with higher propensity of irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance.

The CBDT replied (July 2020) that the scrutiny assessments are conducted taking into account all the points as mentioned. However, suitable remedial action is taken in appropriate cases if any mistake is discovered subsequently during audit, review and inspection. It is further proposed to incorporate these issues in the proposed SOP so that the mistakes do not occur.

Audit noticed instances where Assessing Officers had made irregular allowance of expenses and deductions. Audit is of the view that the ITD may identify items of expenses and deductions with higher propensity of irregular allowance and devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance. This may be reviewed periodically. The CBDT may consider inclusion of the same in the Standard Operating Procedure proposed to be issued.

- c) The CBDT may ascertain whether the errors/ irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.

The CBDT replied (July 2020) that it is seen by the supervisory officers, whether the mistake is bona-fide or not. Suitable administrative action is taken wherever necessary.

Audit is of the view that the CBDT may ascertain whether the errors/irregularities are errors of commission and take necessary action as per law in such cases. ITD may take remedial measures to prevent recurrence of errors and irregularities.

- d) The CBDT may ensure that the ITD should focus on reconciliation of claims, through CPC-Bengaluru, actively, to resolve the differences in claims and payments and evolve means to avoid possibilities of non-matching of the same.

The CBDT replied (July 2020) that efforts are being made to proactively resolve the differences in claims and payments to avoid possibilities of non-matching of the same.

- e) The CBDT may consider assigning/ updating codes as per the nature of business or activity ascertained during assessment for effective monitoring of the claims of deduction as per the nature of activities undertaken by Co-operative Societies and Co-operative Banks.

The CBDT replied (July 2020) that in the instructions for filing ITR-5 for AY 2019-20, a Co-operative Society/ Co-operative Bank is required to furnish its status as follows: a) Primary Agricultural Credit Society or Co-operative Bank, b) other Co-operative Society, c) Rural Development Bank, d) other Co-operative Bank. It further stated that an assessee is required to provide its status in the ITR irrespective of its business activity carried out. Thus, necessary details are being captured in the ITR form. Further, a separate category for Primary Agricultural Societies and Co-operative Bank will be provided in the instructions for filing ITR-5 for AY 2020-21.

It was further stated during Exit Conference (July 2020) that the ITR forms of AY 2020-21 have been notified and utility forms are being finalized. In the current format the Co-operative Banks and PACS are kept under different categories and will not be clubbed. It was stated that there are 14 new codes for various deductions under section 80P of the Act. A taxpayer will have to categorise under schedule 80P which will capture appropriate code under which assessee is claiming the deduction. It was stated that implemented utilities are being finalized and once they are operational, it can be confirmed that these suggestions have been implemented.

The CBDT's contention that the status is getting captured in ITR form and as per the instructions for filing ITR-5 for AY 2019-20, a Co-operative Society/ Co-operative Bank is required to furnish its status as follows: a) Primary Agricultural Credit Society or Co-operative Bank, b) other Co-operative Society, c) Rural Development Bank, d) other Co-operative Bank is not acceptable as the status code specified for all AOP/BOI is 3 as per the instructions for filing ITR-5 for AY 2019-20 and the codification has not been specified in respect of categories mentioned in the sub-status under assessees classified as AOP/BOI. Audit is of the view that the codes may be updated to distinctly identify and capture Co-operative Banks and PACS.

- f) ITR-5 may capture list of all Members of a Co-operative Society, along with their PAN, for the previous year relevant to the Assessment Year of filing of return. Quoting of PAN may be made mandatory for deposits received above a threshold amount by Co-operative Societies. Further, the CBDT may consider reporting instances involving significant quantum of unexplained cash credits to the regulatory authorities (RBI, ROCS etc.) to facilitate monitoring of probable financial irregularities.

New Delhi
Dated: 19 November 2020


(Neelesh Kumar Sah)
Principal Director (Direct Taxes-II)

Countersigned

New Delhi
Dated: 20 November 2020


(Girish Chandra Murmu)
Comptroller and Auditor General of India

Appendices

Appendix 1

Region-wise/ State-wise distribution of audit sample

(Reference: Para 1.10)

State/ Region	Number of cases
Andhra Pradesh & Telangana State (AP&TS)	379
Bihar & Jharkhand	182
Delhi	243
Gujarat	829
Karnataka	669
Kerala	764
Maharashtra	2088
Madhya Pradesh & Chhattisgarh	594
North East Region ¹²⁷	134
North Western Region ¹²⁸	462
Odisha	144
Rajasthan	455
Tamil Nadu	478
Uttar Pradesh & Uttarakhand	645
West Bengal & Sikkim	404
Grand Total	8470

127 Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura

128 Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab

Appendix 2

Activity-wise profile of Sample Audited

(Reference: Para 1.10)

Activity Classification of Co-operative Societies/ Co- operative Banks	No. of Cases
Agriculture	301
Banking	3038
Credit	1393
Dairy Business	259
Financial Services	634
Housing/ Civil Construction	401
Manufacturing	171
Sugar	424
Trading	710
Others	1139
Total	8470

Source: Assessment Records of ITD

Appendix 3

LAR Paras pertaining to Co-operative Societies and Co-operative Banks
(Reference: Para 4.14)

Sl. No.	Broad categories of Audit observations	No. of cases	Tax Effect (₹ in crore)
1	Incorrect allowance of additional depreciation	2	0.39
2	Incorrect allowance of deduction of unascertained liability i.e. provision under section 37(1) of the Act	6	1.70
3	Incorrect allowance of deduction on provision of bad and doubtful debts under section 36(1)(viia) of the Act	9	44.63
4	Incorrect allowance of deduction on special reserve under section 36(1)(viii) of the Act	1	0.08
5	Incorrect allowance of deduction under section 36(1)(vii) of the Act	1	0.74
6	Incorrect allowance of deduction under section 36(2)(v) of the Act	2	0.87
7	Incorrect allowance of depreciation under section 32(i) of the Act	1	0.01
8	Incorrect allowance of expenditure under section 36(1)(va) of the Act	2	1.71
9	Incorrect allowance of expenditure under section 40(a)(i) of the Act	3	2.22
10	Incorrect allowance of expenditure under section 43B of the Act	1	0.62
11	Incorrect computation of business income	1	1.14
12	Irregular allowance of deduction under section 80P(2)(a)(i) of the Act	7	0.95
13	Irregular allowance of deduction under section 80P(2)(a)(iii) of the Act	1	1.09
14	Irregular allowance of deduction under section 80P(2)(a)(vi) of the Act	2	0.25
15	Irregular allowance of deduction under section 80P(2)(d) of the Act	55	7.82
16	Irregular allowance/set-off of losses	1	0.06
17	Irregular carry forward due to late filing of return under section 80 of the Act	1	0.75
18	Irregular expenditure allowed under section 37(1) of the Act	9	4.39
19	Irregular set off/carry forward of losses	9	40.72
20	Non levy of surcharge and interest under section 234B of the Act	1	2.31
21	Other Irregularities	3	3.01
22	Short levy of interest under section 234A of the Act	4	12.65
23	Short levy of interest under section 234B of the Act	2	1.50
24	Short levy of interest under section 234C of the Act	1	0.03
25	Surcharge not levied	2	0.14
26	Underassessment of income	1	0.43
	Grand Total	128	130.22

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