EXECUTIVE SUMMARY

Several companies that were having large profit from business and distributing substantial portion of the income to their shareholders as dividend, were reducing their tax liability by availing various deductions and exemptions available in the Act. Such companies referred to as "Zero Tax Companies", were attempted to be brought into tax net by introduction of section 115J by Finance Act 1987. This provision was withdrawn by Finance Act 1990. It was re-introduced as section 115JA by Finance Act, 1996. Section 115JA was further revised from 1 April 2001 by introducing a new section 115JB whereby companies had to pay tax on their book profit/deemed income at a rate prescribed by the Government from time to time. Section 115JAA provided for allowance of credit of tax paid by the companies under section 115JA/115JB in subsequent years.

We conducted performance audit of 'Payment of tax by certain companies under special provision of section 115JB' also referred to as Minimum Alternate Tax (MAT) with the objectives of examining whether:

(i) there are any systemic issues including any ambiguity or lacuna in the special provisions resulting in nullifying/reducing the tax liability;
(ii) Income Tax Department (ITD) was complying with the provisions relating to MAT and, if not, determining the underassessment/loss of revenue and other irregularities due to mistakes in assessment;
(iii) ITD has taken adequate steps to identify the companies not filing tax returns and bring them into tax net;
(iv) the objective of introduction of special provision to bring zero tax-paying companies into tax net have been achieved.

The performance audit covered cases of scrutiny assessments, appeal and rectification completed during the financial years 2012-13 to 2015-16. We also checked summary assessment records in respect of the selected cases where scrutiny assessment was not completed till the date of audit.

Audit requisitioned 15,677 records in 877 assessment units in 150 selected CIT charges, out of which ITD produced 11,293 records only which were audited for this performance audit.

While conducting performance audit, we identified 195 assessment cases where systemic issues including ambiguities/lacunae in provisions of section

115JB of the Act were noticed. Some of them are indicated in subsequent paragraphs**:** **[Para 2.2]**

ITD did not consider incomes in 22 assessment cases for tax under MAT though the same were considered for tax under normal provision. Omission resulted in tax effect of ₹ 74.10 crore. **[Para 2.4.1]**

In 16 assessment cases, ITD did not consider the extraordinary/exceptional items* for computation of book profit. Omission resulted in underassessment of income aggregating ₹ 126.57 crore involving tax effect of ₹ 23.13 crore. **[Para 2.4.2]**

In three assessment cases though ITD adjusted the profit/loss against the General Reserve as per the directions prescribed in the approved scheme of amalgamation, their treatment for the purpose of MAT varied according to the convenience of the assessee. Omission resulted in short computation of book profit of ₹ 99.39 crore involving tax effect of ₹ 15.36 crore. **[Para 2.4.3]**

ITD allowed in eight assessment cases deduction in respect of Debenture Redemption Reserve/Loan Redemption Reserve charged to the 'Appropriation Account' as claimed by assessee in computation of book profit under MAT involving tax effect of ₹ 331.14 crore. **[Para 2.5]**

ITD on one hand reduced excess depreciation pertaining to earlier years due to change in method of depreciation credited to the profit and loss account in computation of book profit in eight assessment cases. On the other hand in six assessment cases, ITD did not add shortfall in depreciation due to change in method of accounting. This involved tax effect of ₹ 5.16 crore. **[Para 2.6]**

Amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account is reduced from the net profit in computation of book profit. During this performance audit, Audit came across certain irregularities in computation of brought forward loss and unabsorbed depreciation as below:

(i) Apportioning the profit as per profit and loss account in the ratio of brought forward loss and unabsorbed depreciation

* Extraordinary items included receipts/payments which are not derived through normal course of business of the companies. They are accounted under a separate head to show the companies earnings before and after such items.

(ii) Previous year's brought forward loss/unabsorbed depreciation considered for reduction instead of their cumulative position as on date

(iii) Same amount of business loss/unabsorbed depreciation as per books was claimed in successive years including current year

[Para 2.7]

ITD allowed bad debts actually written off as deduction in computation of income under normal provisions in six assessment cases. However, while computing book profit under section 115JB, bad debts actually written off was not reduced. **[Para 2.8.1]**

ITD made disallowances on account of bogus purchases/undisclosed income/unaccounted income under normal provisions in 18 assessment cases, and not under special provisions of MAT, there being no provision for addition of such items under special provisions. **[Para 2.8.2]**

ITD made transfer pricing adjustments with respect to items which had direct bearing on the profit as per profit and loss account in 36 assessment cases during computation of income under normal provisions but were not considered for computation of book profit under MAT. This involved tax effect of ₹ 93.05 crore. **[Para 2.8.3]**

ITD disallowed statutory dues in the form of taxes in 39 assessment cases during computation of income under normal provisions but were not considered under MAT. Allowance of statutory dues in computation of MAT involved tax effect of ₹ 75.89 crore. **[Para 2.8.4]**

ITD did not add back corporate social responsibility (CSR) expenses under MAT in 12 assessment cases though the same were debited to the profit and loss account involving tax effect of ₹ 15.49 crore. **[Para 2.8.5]**

ITD allowed MAT credit of amalgamating company in spite of discontinuance of the business of amalgamating unit after amalgamation in one assessment case. **[Para 2.8.6]**

Audit came across several issues/instances of non-compliance to the provisions of Act/Rules in 589 assessment cases. Some of them are indicated in subsequent paragraphs**:** **[Para 3.1]**

ITD disallowed income tax paid under normal provision in 28 assessment cases but did not consider the same for computing book profit. This involved tax effect of ₹ 13.28 crore. **[Para 3.2.1]**

ITD did not add back expenses relatable to income not forming part of total income to book profit in 84 assessment cases which involved tax effect of ₹ 102.03 crore. **[Para 3.2.2]**

ITD did not add back the amount set aside as provision for diminution in value of asset in 47 assessment cases while computing book profit. This involved tax effect of ₹ 1827.86 crore. **[Para 3.2.3]**

ITD did not consider provision for unascertained liability in computation of book profit in 22 assessment cases. Omission resulted in tax effect of ₹ 50.02 crore. **[Para 3.2.4]**

ITD reduced book profit by the deductions which are not prescribed in the Act in 28 assessment cases which involved tax effect of ₹ 48.60 crore. **[Para 3.3]**

ITD allowed incorrect set off/carry forward/non set off of MAT credit of ₹ 1,559.21 crore without verifying the updated status of the claims of assessee made in the ITR with reference to the assessment records in 277 assessment cases. **[Para 3.4]**

ITD did not correctly reduce brought forward loss or unabsorbed depreciation as per the books of account in computing book profit in 37 assessment cases which involved tax effect of ₹ 22.97 crore. **[Para 3.5]**

Different type of mistakes in computation of book profit in 43 assessment cases resulted in short levy of tax of ₹ 88.91 crore. **[Para 3.9]**

The difference between the number of working companies registered with Registrar of companies (ROC) and those reported by DGIT (Logistics, Research & Statistics) ranged from 2.94 lakh (33.3 *per cent*) to 3.94 lakh (36.4 *per cent*) during FYs 2012-13 to 2015-16 which indicated the extent of non filing/stop filing of the return of income by the companies. About one third of the companies registered with the ROC were not in the database of the ITD. **[Para 4.2]**

Out of 12,750 non filers identified through Non filers Monitoring System (NMS), ITD issued notices in 9013 (70.69 per cent) cases only. Of them, only 29.73 per cent of the corporate non filers identified by the ITD had filed their income tax return in response to the notices issued by the ITD whereas no returns has been filed in remaining 6,208 cases. **[Para 4.2.1]**

In 34 assessment cases ITD levied tax under normal provisions of the Act though tax was leviable under special provisions. Omission resulted in short levy of tax of ₹ 127.86 crore. **[Para 5.3]**

Summary of Recommendations

Systemic issues including ambiguities/lacunae in the special provisions

(a) CBDT may like to insert enabling provisions under Explanation (1) to sub section (2) of section 115JB clarifying the treatment of following items in computation of book profit:

- (i) Interest accrued on Inter Corporate Deposit (ICD) and fixed deposit made out of advances received from Government etc. which were considered for taxation under normal provisions
- (ii) Grant in aid etc., directly taken to balance sheet and not routed through profit and loss account
- (iii) Profit/loss on sale of long term investment of the amalgamating company
- (iv) Debenture Redemption Reserve/Loan Redemption Reserve considering its complexity involving element of reserve as well as ascertained liability
- (v) Excess/short depreciation due to change in method of depreciation **(Para 2.4.1 to 2.4.3, 2.5 and 2.6)**

(b) CBDT may like to clarify the manner of setting off brought forward business loss/unabsorbed depreciation in computation of book profit. **(Para 2.7.1 to 2.7.3)**

(c) CBDT may like to prescribe an adjustment for reduction of the bad debts actually written off in the books of accounts in computation of book profit, as the same is considered for reduction under normal provisions. **(Para 2.8.1)**

(d) CBDT may like to prescribe an adjustment for additions of the following items in computation of book profit, which were considered for addition under normal provision:

- (i) Bogus purchases/undisclosed income/unaccounted income
- (ii) Transfer pricing adjustments on items having direct bearing on the profit and loss account
- (iii) Statutory dues not paid within due date of filing of return of income
- (iv) Expenditure on Corporate Social Responsibility (CSR)

(Para 2.8.2. to 2.8.5)

(e) CBDT may like to introduce a provision in the Act for disallowance of MAT credit of the amalgamating company on discontinuance of their business by the amalgamated company after amalgamation.

(Para 2.8.6)

The CBDT during exit conference agreed to examine all the issues above and stated that feasibility of issuing a circular/clarification if required will be explored.

Extent of non-compliance of MAT provisions

CBDT may like to append a schedule or an annexure showing year wise bifurcated details of business loss and unabsorbed depreciation as per the Companies Act as well to Form 29B/Tax Audit Report/ITR 6 so that their updated status is considered at the time of assessment. **(Para 3.5)**

The CBDT during exit conference stated that it may be difficult to have a separate annexure/schedule but agreed to have a view in the Assessment Information System (AST) where the details of brought forward business loss and unabsorbed depreciation as per the Companies Act will also be visible.

Bringing Zero Tax Companies into the tax base

(a) The ITD may devise a framework for accountability where AOs may be made accountable for the effective use of Non-filers Monitoring System for identification of both corporate and non corporate non filers separately so that they effectively pursue the non filers to bring them into tax net.

(Para 4.2.1)

The CBDT during exit conference agreed to have a suitable framework in this regard.

(b) ITD may pursue the cases where ITRs were not filed so as to bring them into tax net. **(Para 4.2.1)**

The CBDT during exit conference agreed to look into the matter.