सत्यमेव जयते

Report of the Comptroller and Auditor General of India

for the year ended March 2018

लोकहितार्थ सत्यनिष्ठा
Dedicated to Truth in Public Interest

Union Government
Department of Revenue - Direct Taxes
Report No. 9 of 2019

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Comptroller and Auditor General of India

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

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Preface

This Report for the year ended March 2018 has been prepared for submission to the President under Article 151 of the Constitution of India.

The Report contains significant results of the compliance audit of the Department of Revenue-Direct Taxes of the Union Government.

The instances mentioned in this Report are those, which came to notice in the course of test audit for the period 2017-18 as well as those which came to notice in earlier years but could not be reported in the previous Audit Reports; instances relating to the period subsequent to 2017-18 have also been included, wherever necessary.

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

Highlights

The Comptroller and Auditor General of India conducts the audit of receipts of the Union Government under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. This Report primarily discusses compliance to the provisions of the Income Tax Act, 1961 and the associated rules, procedures, directives etc. as applied to all aspects related to the administration of direct taxes. The report is organised into seven chapters, the highlights of which are described below:

Chapter I: Direct Taxes Administration

Direct taxes receipts of Union Government in FY 2017-18 amounted to ₹ 10,02,738 crore grew by 18.0 *per cent* over the FY 2016-17 (₹ 8,49,801 crore). Direct Taxes represented 6.0 *per cent* of the GDP in FY 2017-18. Share of direct taxes in gross tax revenue increased to 52.2 *per cent* in FY 2017-18 from 49.5 *per cent* in FY 2016-17.

Of the two major components of direct taxes, collections from Corporation Tax increased by 17.8 *per cent,* from ₹ 4.85 lakh crore in FY 2016-17 to ₹ 5.71 lakh crore in FY 2017-18. Collections from Income Tax increased to 19.9 *per cent* from ₹ 3.41 lakh crore in FY 2016-17 to ₹ 4.08 lakh crore in FY 2017-18.

The number of non-corporate assessees increased from 4.37 crore in FY 2016-17 to 5.38 crore in FY 2017-18, registering an increase of 23.1 *per cent*. The number of corporate assessees increased from 7.13 lakh in FY 2016-17 to 7.99 lakh in FY 2017-18, registering an increase of 12.1 *per cent*.

The arrears of demand increased from ₹ 10.4 lakh crore in FY 2016-17 to ₹ 11.1 lakh crore in FY 2017-18. The Department indicated that more than 98.2 *per cent* of uncollected demand would be difficult to recover.

Number of appeals pending with CIT (Appeals) increased from 2.9 lakh in FY 2016-17 to 3.0 lakh in FY 2017-18. The amount locked up in these cases was ₹ 5.2 lakh crore in FY 2017-18. The amount locked up at higher levels (ITAT/High Court/Supreme Court) increased from ₹ 4.40 lakh crore (82,806 cases) in FY 2016-17 to ₹ 4.43 lakh crore (82,643 cases) in FY 2017-18.

Chapter II: Audit Mandate, Products and Impact

During FY 2016-17, the ITD had completed 2.73 lakh scrutiny assessments in the units audited as per the audit plan of FY 2017-18, out of which we checked 2.64 lakh cases. Apart from this, we have also audited 0.47 lakh cases out of 1.07 lakh scrutiny assessments completed in the earlier financial years, during FY 2017-18. The incidence of errors in assessments checked in audit during FY 2017-18 was 0.20 lakh cases (6.45 *per cent,* as against 7.2 *per cent* last year).

There have been persistent and pervasive irregularities in respect of corporation tax and income tax assessments cases over the years. Recurrence of such irregularities, despite being pointed out repeatedly in the earlier Audit Reports points to structural weaknesses on the part of Department as well as the absence of appropriate institutional mechanisms to address this. Such irregularities were particularly noticeable in the assessment charges in Maharashtra and Delhi.

We have included 472 high value cases reported to the Ministry in Chapter III and IV of this Report. Of these, we received replies in respect of 325 cases as on 31 March 2019, of which, 302 cases (92.9 *per cent*) were accepted and 23 cases not accepted. In remaining cases the Ministry/ ITD did not furnish replies. In addition, two long draft paras viz. 'Follow up audit of exemptions to charitable trusts and institutions'; and 'Integrated audit of assessments of a group company' have been separately included in Chapter VI and VII of this Report respectively. Besides, the Report also discusses one subject specific compliance audit on 'Assessments relating to Agricultural Income' which has been included in Chapter V.

In the last three years, the ITD recovered ₹ 1,076.06 crore from demands raised to rectify the errors in assessments that we had pointed out. There are 52,417 cases involving revenue effect of ₹ 1.13 lakh crore pointed out in audit which are remaining unsettled as of 31 March 2018 for want of replies from the ITD.

During FY 2017-18, 2,739 cases with tax effect of ₹ 2,735.17 crore became time-barred for initiating any remedial action.

Chapter III: Corporation Tax

We pointed out 340 high value cases pertaining to corporation tax with tax effect of ₹ 4,866.66 crore. We classified these cases in four broad categories viz. (1) quality of assessments involving tax effect of ₹ 1,121.78 crore (118 cases); (2) administration of tax concessions/exemptions/deductions involving tax effect of ₹ 3,149.58 crore (141 cases); (3) income escaping

assessment due to omissions involving tax effect of ₹ 359.47 crore (56 cases) and (4) over-charge of tax/interest involving ₹ 235.83 crore (25 cases).

Chapter IV: Income Tax

We pointed out 132 high value cases of income tax with tax effect of ₹ 331.06 crore. We classified these cases in four broad categories as follows: (1) quality of assessments involving tax effect of ₹ 276.53 crore (85 cases); (2) administration of tax concessions/exemptions/deductions involving tax effect of ₹ 39.23 crore (26 cases); (3) income escaping assessments due to omissions involving tax effect of ₹ 5.17 crore (12 cases); and (4) over charge of tax/interest involving ₹ 10.12 crore (9 cases).

Chapter V: Assessments relating to Agricultural income

i) We audited 6,778 cases and found that in 1,527 scrutiny assessments cases (22.5 *per cent*), claim of exemption on account of agricultural income was allowed without adequate documentation and verification of supporting documents. We noticed that out of 1,527 cases where documentation and verification by Assessing Officer was inadequate, land records were not available in 716 cases (10.6 *per cent*) and proof of agricultural income and expenditure such as ledger account, bills, invoices etc. were not available in 1,270 cases (18.7 *per cent*). As such, it was not possible to determine whether the system in place was robust enough to ensure that assessees were being allowed exemption for agricultural income, only after adequate examination in the process of assessment.

While allowance of exemption of agricultural income claims based on inadequate verification or incomplete documentation has been pointed out in respect of selected sample of scrutiny assessments, ITD needs to re-examine not only the remaining scrutiny cases, but also all cases where income has been allowed as agricultural income above a certain threshold, say ₹ 10 lakh or more, to ensure that exemption has been allowed only to eligible assessees, and is based on appropriate documents and their verification.

ii) We observed that out of 3,133 cases checked in audit across nine states, in 48 cases there was a mismatch between the exemptions allowed in the assessment order vis-à-vis that reflected in the ITD database. The agricultural income in the ITD database continued to reflect the agricultural income as returned by the assessees or depicted irrelevant figures in cases where agricultural income allowed was different from that claimed by the assessee.

iii) DGIT(Systems) had sought status reports regarding data entry errors while filling up the return in respect of 2,746 cases, where returned agricultural income was more than ₹ one crore. Only 26 out of 136 Commissionerates provided the information in respect of 327 cases. Even in this small sample, data entry errors were seen in 36, i.e., 11 *per cent* of the cases. Out of these 36 cases of data entry errors, 12 cases still remained to be corrected (January 2019). Errors in the database imply a dual risk: of loss of tax on one hand, and of harassment of tax payer on the other hand. The Department, therefore, needs to attend to similar cases for all Commissionerates to ensure without exception that data entry errors are corrected in all cases.

Existence of such data entry errors would render the AST data unreliable. Reasons for such persistent data entry errors is a matter of inquiry. The Department also needs to examine why a manual system of assessment is allowed to co-exist with an electronic system of assessment. It should work towards elimination of actual interface with the taxpayers.

iv) Audit also noticed non-compliance to provisions of the Act, such as, incorrect exemption granted for income derived from agricultural land, incorrect allowance of exemption for partial agricultural income, excess allowance of replantation expenditure/due to adoption of incorrect export turnover and exemption granted to non-agricultural income on account of sale of fish, sale of goat, sale of dry grapes, sale of milk etc.

Chapter VI: Follow up audit of Exemptions to Charitable Trusts and Institutions

In a follow-up test check of Exemptions to Charitable Trusts and Institutions during FY 2017-18, Audit noticed instances of irregularities such as (i) diversion of income/property by trusts to related group trusts/institutions as application of income; (ii) exemptions to assessees whose activities were not 'charitable' in nature; (iii) allowance of expenditure and accumulation where exemption was denied; (iv) lack of monitoring the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act; (v) exemptions granted to trust on application of funds given to foreign universities; (vi) exemption to assessee where voluntary contribution including foreign currency donation was considered as corpus fund without specific direction of donor; (vii) non-cancellation of registration where activities of the Trust and Institutions are not in accordance with the provisions of the Act; and (viii) Failure of the Assessment Information System to levy surcharge.

The PAC in their 104th Report on the Action Taken by the Government on the observations/recommendations of the Committee contained in their 27th Report (16th Lok Sabha) on 'Exemptions to Charitable Trusts and Institutions' had also desired C&AG to make recommendations on how to remedy the gaps and prevent recurrences in future. The major recommendations are given below:

(i) CBDT may consider amending the provision to make prior approval a pre-condition for foreign donation by a charitable trust or institution. The CBDT may also specify a limit say, 5 to 10 per cent of income for such donations.

(ii) CBDT may consider including a provision to make the trustee also liable in case where the provisions of the Act are not complied with.

(iii) Some of the provisions for exemptions to charitable trusts and institutions viz. section 11(1)(c) from on or after 1.4.1952, section 13(1)(d)(iii) after 30 November 1983, proviso to section 13(1)(d)(iii) from 1.6.1973 are from specific dates and apply to different trusts differently thereby not providing a level playing field. CBDT may consider bringing in a level playing field by inserting a sunset clause for such provisions applicable to those Trusts that have retained the benefit on ground of actions, having been taken earlier though these are prohibited now. A sunset clause for such provisions would ensure that benefits not available now are not available to anyone, and thus that all types of Trusts and Institutions are treated on similar lines. This will reduce the difficulties in assessing Trusts, when different trusts have to be treated differently, and reduce the "errors" in assessments. CBDT may consider giving a period of say, three years to the affected trusts to comply with the new provisions.

(iv) Since the issues pointed out in the earlier Audit Report no. 20 of 2013 are continuing, ITD is advised to review all the trust cases without exception and ensure that exemptions and concessions allowed to them are as per the provisions of the Act and registration of trusts not fulfilling the prescribed conditions are reviewed.

Chapter VII: Integrated audit of assessments of a Group Company

We observed that there was an absence of effort by the ITD in cross linking material transactions with related parties to ensure the correctness/ genuineness during the assessment of related companies in a group. The ITD lacks a system of information sharing amongst its various charges leading to assessments of group companies getting completed in standalone manner thereby missing sight of important issues which have bearing on determination of taxable income.

General Recommendations

While the Ministry has initiated action in respect of cases pointed out by Audit, it may be noted that these are only a few illustrative cases. In the entire universe of all assessments, including non-scrutiny assessments, there is every likelihood of such errors, of omission or commission, in many more cases. The CBDT not only needs to revisit its assessments, but also put in place a fool proof IT System and internal control mechanism to eradicate, so-called "errors".

The IT system for direct taxes needs to be designed in such a way that it should ensure zero or minimal physical interface between the assessee and the tax officers. Government may consider the IT System for direct taxes being placed at arms length from CBDT, with an independent governmental body or organisation.

CBDT may examine whether the instances of "mistakes" noticed are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.

Chapter I
Direct Taxes Administration

1.1 Resources of the Union Government

1.1.1 The Government of India's resources include all revenues received by the Union Government, all loans raised by issue of treasury bills, internal and external loans and all moneys received by the Government in repayment of loans. Tax revenue resources of the Union Government consist of revenue receipts from direct and indirect taxes. Table 1.1 below shows the summary of resources of the Union Government for the financial year (FY) 2017-18 and FY 2016-17.

Table 1.1: Resources of the Union Government		**(₹ in crore)**
	FY 2017-18	**FY 2016-17**
A. Total Revenue Receipts	23,64,148	22,23,988
i. Direct Taxes Receipts	*10,02,738*	*8,49,801*
ii. Indirect Taxes Receipts including other taxes[1]	*9,16,445*	*8,66,167*
iii. Non-Tax Receipts	*4,41,383*	*5,06,721*
iv. Grants-in-aid & contributions	*3,582*	*1,299*
B. Miscellaneous Capital Receipts[2]	1,00,049	47,743
C. Recovery of Loans & Advances[3]	70,639	40,971
D. Public Debt Receipts[4]	65,54,002	61,34,137
Receipts of Government of India (A+B+C+D)	**90,88,838**	**84,46,839**

Source: Union Finance Accounts of respective years. Direct Tax receipts and Indirect Tax receipts including other taxes have been worked out from the Union Finance Accounts. Total Revenue Receipts include ₹ 6,73,005 crore in FY 2017-18 and ₹ 6,08,000 crore in FY 2016-17, share of net proceeds of direct and indirect taxes directly assigned to states.

1.1.2 In FY 2017-18, the increase in receipts of Government of India have mainly been contributed by increase in public debt receipts and in total revenue receipts. Direct Taxes accounted for 42.4 *per cent* of total revenue receipts in FY 2017-18, growing by 18.0 *per cent* over the last year's receipts.

1.2 Nature of Direct Taxes

1.2.1 Direct taxes levied by the Parliament mainly comprise,

i. **Corporation Tax** levied on income of the companies;

ii. **Income Tax** levied on income of persons (other than companies);

iii. **Other direct taxes** including Securities Transactions Tax[5], Wealth Tax[6] etc.

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1 Indirect taxes levied on goods and services such as customs duty, excise duty, service tax, Central Goods and Services Tax, Integrated Goods and Services Tax etc.;

2 This comprises of value of bonus share, disinvestment of public sector and other undertakings and other receipts;

3 Recovery of loans and advances made by the Union Government;

4 Borrowings by the Government of India internally as well as externally;

5 Tax on the value of taxable securities purchased and sold through a recognized stock exchange in India.

6 Tax chargeable on the net wealth comprises certain assets specified under section 2(ea) of the Wealth Tax Act, 1957. The Wealth Tax has been abolished through the Finance Act, 2015.

1.2.2 Table 1.2 provides a snapshot of direct taxes administration.

Table 1.2: Direct Taxes Administration					
	2013-14	**2014-15**	**2015-16**	**2016-17**	**2017-18**
					₹ in crore
1. Direct taxes collection	6,38,596	6,95,792	7,42,012	8,49,801	10,02,738
a. Corporation Tax	3,94,678	4,28,925	4,53,228	4,84,924	5,71,202
b. Income Tax	2,37,870	2,58,374	2,80,390	3,40,592	4,08,202
c. Other Direct Tax	6,048	8,493	8,394	24,285	23,334
2. Refunds	89,060	1,12,163	1,22,596	1,62,582	1,51,639
3. Interest on refunds	6,598	5,332	6,886	10,312	17,063
					Number in lakh
4. Actual returns filed by					
a. Non-corporate Assessees	304.0	360.6	398.0	436.9	537.9
b. Corporate Assessees	6.4	6.8	6.9	7.1	8.0
5. Revenue expenditure (₹ in crore)	3,687	4,148	4,689	5,623	6,172

Source: Sl. no. 1 and 5 – Union Finance Accounts; Sl. no. 2 - Pr. CCA, CBDT, Sl. no. 3 and 4 – Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing

1.2.3 Table 1.3 below gives the details of non-corporate assessees in different categories of income.

Table 1.3: Non-Corporate Assessees						(Figures in lakh)
Financial Year	**A**[7]	**B_1**[8]	**B_2**[9]	**C**[10]	**D**[11]	**Total**
2013-14	117.23	135.79	34.24	16.72	0.05	304.03
2014-15	76.32	216.31	46.11	21.80	0.01	360.55
2015-16	55.93	264.47	52.94	24.69	0.01	398.04
2016-17	54.17	290.16	61.85	30.69	0.02	436.89
2017-18	61.16	360.63	79.04	37.05	0.02	537.90

Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing. These figures are based on actual returns filed during the respective year.

The number of non-corporate assessees registered an increase of 23.1 *per cent* in FY 2017-18 in comparison to increase of 9.8 *per cent* in FY 2016-17. As can be seen from the Table 1.3 above and Chart 1.1, there has been increase of 24.3 *per cent,* 27.8 *per cent* and 20.7 *per cent* in Category 'B_1', Category 'B_2' and Category 'C' during FY 2017-18 in comparison to FY 2016-17. However, the increases in these categories were 9.7 *per cent,* 16.8 *per cent* and 24.3 *per cent* during FY 2016-17 in comparison to the previous year.

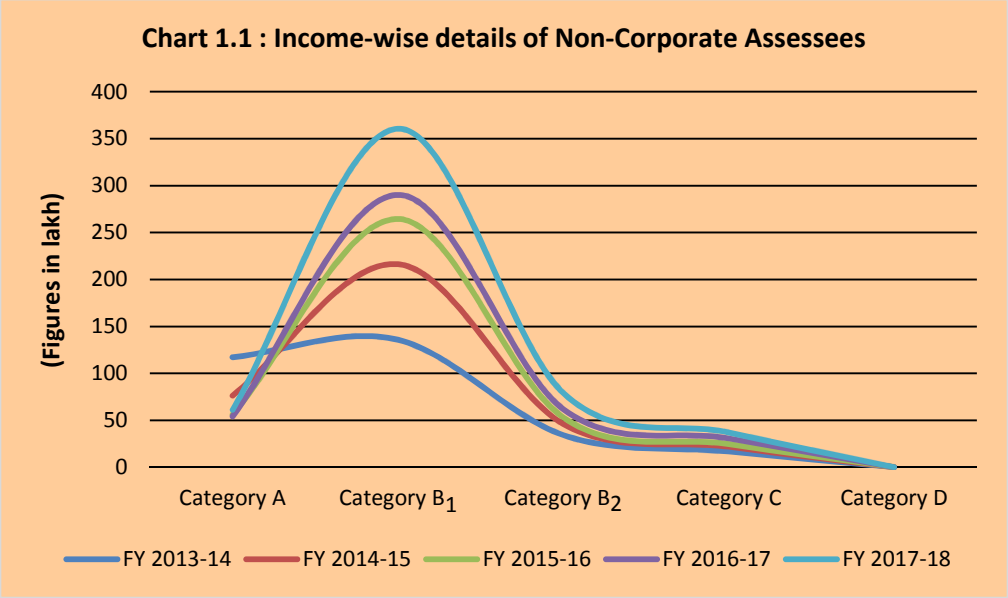
[7] Category 'A' assessees – Assessments with income/loss below ₹ two lakh;

[8] Category 'B_1' assessees (lower income group) - Assessments with income/loss above ₹ two lakh and above; but below ₹ five lakh;

[9] Category 'B_2' assessees (higher income group) - Assessments with income/loss above ₹ five lakh and above; but below ₹ 10 lakh;

[10] Category 'C' assessees - Assessments with income/loss of ₹ 10 lakh and above;

[11] Category 'D' assessees – Search and seizure assessments;



1.2.4 Table 1.4 below gives the details of corporate assessees belonging to the different categories of income.

Table 1.4: Corporate Assessees **(Figures in lakh)**

Financial Year	A[12]	B_1[13]	B_2[14]	C[15]	D[16]	Total	Assessees having income above ₹ 25 lakh	Working companies as per RoC as on 31st March
2013-14	4.14	0.89	0.31	1.01	0.01	6.36	0.65	9.52
2014-15	3.20	1.51	0.48	1.56	0.00*	6.75	0.69	10.16
2015-16	3.08	1.59	0.50	1.71	0.00^	6.88	0.76	10.82
2016-17	3.14	1.65	0.53	1.81	0.00#	7.13	1.44	11.11
2017-18	3.57	1.85	0.58	1.99	0.00$	7.99	1.31	10.49

Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing. These figures are based on actual returns filed during the respective year.

* 256 assessees; ^ 337 assessees, # 134 assessees, $ 195 assessees

The corporate assessees registered an increase of 12.1 *per cent* in FY 2017-18 in comparison to increase of 3.6 *per cent* in FY 2016-17.

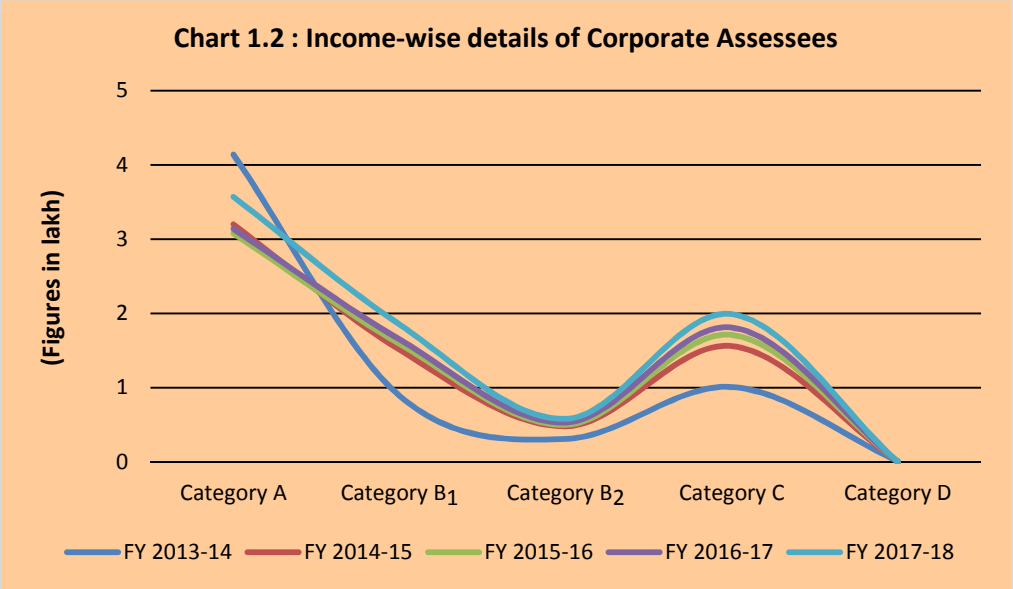
12 Category 'A' assessees – Assessments with income/loss below ₹ 50,000;

13 Category 'B_1' assessees (lower income group) – Assessments with income/loss of ₹ 50,000 and above; but below ₹ five lakh;

14 Category 'B_2' assessees (higher income group) - Assessments with income/loss above ₹ five lakh and above; but below ₹ 10 lakh;

15 Category 'C' assessees - Assessments with income/loss of ₹ 10 lakh and above;

16 Category 'D' assessees – Search and seizure assessments;



1.2.5 A comparison of the figure on total working companies as per the Registrar of Companies (ROCs)[17] data with the total filers as per the ITD would suggest that ensuring compliance by identifying non-filers has not been effective. As in FY 2016-17, there were 11.11 lakh companies registered with ROC, against which it is observed that in FY 2017-18, 8.0 lakh companies only filed income tax returns. Though all working companies (whether profit earning or loss incurring) are required by the provision of the Income Tax Act, 1961 (the Act), to file their return of income, 28.0 *per cent* of such working companies registered with ROC in FY 2016-17 did not file their returns of income against 34.4 *per cent* in FY 2015-16.

1.3 Functions and responsibilities of the CBDT

1.3.1 The Central Board of Direct Taxes (CBDT) under the Department of Revenue (DOR) in the Ministry of Finance provides essential inputs for policy and planning in respect of direct taxes in India. At the same time, it is also responsible for administration of direct taxes laws through Income Tax Department (ITD). ITD deals with matters relating to levy and collection of direct taxes and the issues of tax evasion, revenue intelligence, widening of tax-base, providing tax payers services, grievance redressal mechanism etc.

1.3.2 As on 31 March 2018[18], the overall staff strength and working strength of the ITD was 74,336 and 41,338 respectively. The sanctioned and working strength of the officers[19] was 10,865 and 9,445 respectively. The revenue expenditure for the year 2017-18 was ₹ 6,172 crore[20].

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17 Source: Ministry of Corporate Affairs, Statistics Division, New Delhi.

18 Figures of staff strength and working strength of ACIT/ADIT and above were as on 25 October 2017.

19 Pr. CCIT/Pr. DGIT, CCIT/DGIT, Pr. CIT/Pr. DIT, CIT/DIT, Addl. CIT/Addl. DIT/JCIT/JDIT, DCIT/DDIT/ACIT/ADIT and ITOs.

20 Union Finance Accounts for FY 2017-18.

1.4 Budgeting of Direct Taxation

1.4.1 The Budget reflects the Government's vision and intent. The revenue budget consists of the revenue receipts of the Government (tax revenues and other revenues). Comparison of budget estimates with the corresponding actuals is an indicator of quality of fiscal management. Actuals may differ from the estimates because of unanticipated and random external events or methodological inadequacies or unrealistic assumptions about critical parameters.

1.4.2 Table 1.5 below shows the details of Budget Estimates (BE), Revised Estimates (RE) and Actual collection of Direct Taxes during FYs from 2013-14 to FY 2017-18.

Table 1.5: Budget Estimates, Revised Estimates vis-à-vis Actual collection of Direct Taxes **(₹ in crore)**

Financial Year	Budget estimates	Revised estimates	Actual	Actual minus budget estimates	Actual minus Revised estimates	Difference as *per cent* of budget estimates	Difference as *per cent* of Revised estimates
2013-14	6,68,109	6,36,318	6,38,596	(-) 29,513	2,278	(-) 4.4	0.4
2014-15	7,36,221	7,05,628	6,95,792	(-) 40,429	(-) 9,836	(-) 5.5	(-) 1.4
2015-16	7,97,995	7,52,021	7,42,012	(-) 55,983	(-) 10,009	(-) 7.0	(-) 1.3
2016-17	8,47,097	8,47,097	8,49,801	2,704	2,704	0.3	0.3
2017-18	9,80,000	10,05,000	10,02,738	22,738	(-) 2,262	2.3	(-) 0.2

Source : BE and RE figures are as per respective Receipt Budget and Actual are as per respective Finance Accounts

1.4.3 The variation between RE and actual collection ranged from (-) 1.4 *per cent* to 0.4 *per cent* of RE during the period from FY 2013-14 to FY 2017-18. The variation between BE and actuals were higher as compared to that between the RE and the actuals during the same period.

1.5 Growth of Direct Taxes

1.5.1 Table 1.6 below gives the relative growth of direct taxes (DT) with reference to Gross Tax Receipts[21] (GTR) and Gross Domestic Products (GDP) during FY 2013-14 to FY 2017-18.

Table 1.6: Growth of Direct Taxes **(₹ in crore)**

Financial Year	DT	GTR	DT as *per cent* of GTR	GDP	DT as *per cent* of GDP
2013-14	6,38,596	11,38,996	56.1	1,13,45,056	5.6
2014-15	6,95,792	12,45,135	55.9	1,25,41,208	5.5
2015-16	7,42,012	14,55,891	51.0	1,35,76,086	5.5
2016-17	8,49,801	17,15,968	49.5	1,51,83,709	5.6
2017-18	10,02,738	19,19,183	52.2	1,67,73,145	6.0

Source: DT and GTR - Union Finance Accounts, GDP-Central Statistical Office (CSO), Ministry of Statistics and Programme Implementation; GDP for FY 2017-18 – Press note released by CSO on 31 May 2018.

[21] It includes all direct and indirect taxes.

1.5.2 Though the DT increased by 18.0 *per cent* in FY 2017-18 as compared to FY 2016-17, there was increase (2.7 *per cent*) in the share of DT to GTR in FY 2017-18 as compared to FY 2016-17. DT was 6.0 *per cent* of GDP during FY 2017-18 as compared to 5.6 *per cent* in FY 2016-17.

1.5.3 Table 1.7 below gives the growth of direct taxes and its major components i.e. Corporation Tax (CT) and Income Tax (IT) during FY 2013-14 to FY 2017-18.

Table 1.7: Growth of Direct Taxes and its major components **(₹ in crore)**

Financial Year	Direct Taxes	*Per cent* growth over previous year	Corporation Tax	*Per cent* growth over previous year	Income Tax	*Per cent* growth over previous year
2013-14	6,38,596	14.2	3,94,678	10.8	2,37,870	20.8
2014-15	6,95,792	9.0	4,28,925	8.7	2,58,374	8.6
2015-16	7,42,012	6.6	4,53,228	5.7	2,80,390	8.5
2016-17	8,49,801	14.5	4,84,924	7.0	3,40,592	21.5
2017-18	10,02,738	18.0	5,71,202	17.8	4,08,202	19.9

Source: Union Finance Accounts

1.5.4 There was growth of 19.9 *per cent* in Income Tax and 17.8 *per cent* in Corporation Tax in FY 2017-18 as compared to growth of 21.5 *per cent* in Income Tax and 7.0 *per cent* in Corporation Tax in FY 2016-17.

1.5.5 There are different stages of direct taxes collection such as Tax deducted at source (TDS), advance tax, self assessment tax, and regular assessment tax in respect of both corporation and income tax. The pre-assessment collection through TDS, advance tax and self assessment tax is indicative of voluntary compliance in the system. The collection of tax through regular assessment stage occurs post assessment.

1.5.6 Table 1.8 below shows the collection of Corporation and Income Tax under different stages during FY 2013-14 to FY 2017-18.

Table 1.8: Collection of Corporation and Income Tax **(₹ in crore)**

Financial Year	TDS	Advance Tax	Self assess-ment tax	Pre-assessment collection (Col. 2+3+4)	Percentage of total pre-assessment collection	Regular Assess-ment Tax	Other receipts	Total Collection (Col. 5+7+8)
1.	2.	3.	4.	5.	6.	7.	8.	9.
2013-14	2,48,547	2,92,522	44,123	5,85,192	81.1	72,528	63,884	7,21,604
2014-15	2,59,106	3,26,525	52,050	6,37,681	79.8	80,189	81,589	7,99,459
2015-16	2,87,412	3,52,899	54,860	6,95,171	81.2	63,814	96,940	8,55,925
2016-17	3,44,134	4,06,769	68,160	8,19,063	82.8	74,138	95,886	9,89,087
2017-18	3,80,641	4,70,242	83,219	9,34,102	82.6	92,044	1,04,897	11,31,043

Source: Pr. CCA, CBDT. The other receipts includes surcharge and cess. The figures of collection comprises of refunds also. The figure of TDS collection in FY 2016-17 has been revised from ₹ 3,43,134 crore to ₹ 3,44,134 crore. In FY 2017-18, there is a difference of ₹ 79 lakh in collection of Income Tax as compared with the Union Finance Accounts.

1.5.7 The data of Tax deducted at source as shown in Table 1.8 indicates that the TDS has increased to ₹ 3.8 lakh crore in FY 2017-18 from ₹ 2.5 lakh crore in FY 2013-14, showing an increase of 53.1 *per cent* over the period from FY 2013-14 to FY 2017-18. There was increase of 88.6 *per cent* and 60.8 *per cent* in Self-assessment Tax and Advance Tax respectively over the period.

1.6 Revenue impact of tax incentives

1.6.1 The primary objective of any tax law and its administration is to raise revenues for the purpose of funding government expenditure. The revenues raised are primarily dependent upon the tax base and effective tax rate. The determinant of these two factors is a range of measures which includes special tax rates, exemptions, deductions, rebates, deferrals and credits. These measures are collectively called as "tax incentives or tax preferences". These are also referred as tax expenditure.

1.6.2 The Income Tax Act, 1961 (the Act), *inter alia*, provides for tax incentives to promote exports, balanced regional development, creation of infrastructure facilities, employment, rural development, scientific research and development, growth of the cooperative sector and encourages savings by individuals and donations for charity. Most of these tax benefits can be availed of by both corporate and non-corporate taxpayers.

1.6.3 The Union Receipt Budget depicts statement of revenue impact of major incentives on corporate taxpayers and non-corporate taxpayers based on returns filed electronically. Table 1.9 shows the revenue impact of major tax incentives for FY 2013-14 to FY 2017-18.

Table 1.9: Revenue impact of tax incentives **(₹ in crore)**

Financial Year	Total Revenue impact of tax incentives	Revenue impact as *per cent* of		
		GDP	DT	GTR
2013-14	93,047	0.8	14.6	8.2
2014-15	1,18,593	0.9	17.0	9.5
2015-16	1,38,658	1.0	18.7	9.5
2016-17	1,55,840	1.0	18.3	9.1
2017-18	1,67,603	1.0	16.7	8.7

Note: The figures of revenue impact of tax incentives are actuals except FY 2017-18 (projected). These do not cover Charitable Institutions. However, the amount applied by Charitable Institutions was ₹ 3,33,972 crore in respect of 1,37,869 electronically filed returns till November 2017. Source: Respective Receipt Budget.

As reported in the Receipts Budget for the FY 2018-19, the effective rate of corporation tax for the FY 2016-17 was 26.89 *per cent*, as against the average statutory rate of 34.38 *per cent*.

1.6.4 The major tax incentives given in FY 2017-18 were deductions on account of accelerated depreciation under section 32 (₹ 66,310 crore), certain investments and payments under section 80C (₹ 58,933 crore),

deduction of export profits to SEZ units under section 10AA (₹ 22,344 crore), deductions to undertakings in generation/transmission and distribution of power under section 80-IA (₹ 13,321 crore), deductions under sections 35(1), (2AA) and (2AB) for expenditure on scientific research (₹ 11,022 crore).

1.6.5 During the past five years, the revenue impact of tax incentives has been increasing in absolute terms. However, it has been decreasing in terms of percentage of Direct Tax receipts and Gross Tax receipts since FY 2015-16.

1.7 Disposal of Refund cases

1.7.1 Table 1.10 gives the trend of disposal and pendency of direct refund cases during FY 2013-14 to FY 2017-18.

Table 1.10: Disposal of Direct Refund Cases **(Number in lakh)**

Financial Year	Direct Refund cases due for disposal	Direct Refund cases disposed of	Direct Refund cases pending	Pendency in percentage
2013-14	34.5	25.7	8.8	25.5
2014-15	31.5	22.6	8.9	28.1
2015-16	38.9	33.4	5.5	14.2
2016-17	43.6	38.9	4.7	10.7
2017-18	44.6	39.8	4.8	10.8

Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing

1.7.2 It is seen that there has been significant reduction in pendency of direct refund cases during the period 2013-14 to 2017-18.

1.7.3 The Government has refunded ₹ 1,51,639 crore which included interest of ₹ 17,063 crore (11.3 *per cent*) in FY 2017-18. The interest paid on refunds in FY 2016-17 was ₹ 10,312 crore (6.3 *per cent)* on ₹ 1,62,582 crore refunded.

1.8 Arrears of demand

1.8.1 Table 1.11 gives the trend of arrears of demand pending during the period FY 2013-14 to FY 2017-18.

Table 1.11: Arrears of Demand **(₹ in crore)**

Financial Year	Arrears of earlier year's demand	Arrears of current year's demand	Total arrears of demand	Demand difficult to recover
2013-14	4,80,066	95,274	5,75,340	5,52,538
2014-15	5,68,724	1,31,424	7,00,148	6,73,032
2015-16	6,67,855	1,56,356	8,24,211	8,02,256
2016-17	7,33,229	3,11,459	10,44,688	10,29,725
2017-18	7,36,975	3,77,207	11,14,182	10,94,023

Source: Directorate of Income Tax (Organisation & Management Services), Demand & Collection report (CAP-1) for the month of March of respective FY

1.8.2 Demand & Collection report for the month of March of respective FYs analysed various factors viz. no assets/inadequate assets for recovery, cases under liquidation/BIFR, assessees not traceable, demand stayed by Courts/

ITAT/IT authorities, TDS/prepaid taxes mismatch etc. leading to an estimation of the demands difficult to recover. These demands have been increasing year after year and accounted for 98.2 *per cent* of the total arrears of demands in FY 2017-18 as against 98.6 *per cent* in FY 2016-17.

1.9 Disposal of Appeal cases

1.9.1 Table 1.12 gives the trend of disposal and pendency of appeal cases before CIT (Appeals) during FY 2013-14 to FY 2017-18.

Table 1.12: Disposal of Appeal Cases by CIT(A)

Financial Year	Appeal cases due for disposal	Appeal cases disposed of	Appeal cases pending	Pendency in percentage	Amount locked up in Appeal cases
	(Number in lakh)				(₹ in crore)
2013-14	3.03	0.88	2.15	71.0	2,87,444
2014-15	3.06	0.74	2.32	75.8	3,83,797
2015-16	3.53	0.94	2.59	73.3	5,16,250
2016-17	4.08	1.18	2.90	71.1	6,11,227
2017-18	4.25	1.21	3.04	71.7	5,18,647

Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing

1.9.2 The amount locked up in appeal cases with CIT (Appeals) is more than the revised revenue deficit of the Government of India in FY 2017-18.

1.9.3 Table 1.13 below gives the position of Appeals/Writs and other matters pending with the Income Tax Appellate Tribunals (ITATs)/High Courts and Supreme Court as on 31 March 2018.

Table 1.13: Appeals/Writs and other matters pending with ITATs/High Courts/Supreme Court

Authority with whom pending	Cases pending (Numbers)	Amount locked up (₹ in crore)
ITATs	37,353	2,34,999
High Courts	39,066	1,96,053
Supreme Court	6,224	11,773
Total	**82,643**	**4,42,825**

Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing

1.9.4 The amount locked up at higher levels (ITATs/High Courts/Supreme Court) marginally increased to ₹ 4.43 lakh crore (82,643 cases) as on 31 March 2018 in comparison to ₹ 4.40 lakh crore (82,806 cases) as on 31 March 2017.

1.10 Search & Seizure and Survey

The Search & seizure[22] and survey[23] are amongst the main evidence collecting mechanisms which are used in cases where credible information about tax evasion is in possession of the ITD. Table 1.14 below shows the

[22] Search and Seizure is carried out under section 132 of the Act to unearth any undisclosed income or valuables.

[23] Survey is carried out under section 133A and 133B of the Act for collecting any information, which may be useful for ITD in deterring tax evasion.

details of search & seizure operations and surveys conducted and the undisclosed income admitted/detected during FY 2013-14 to FY 2017-18.

Table 1.14: Status of search & seizure and survey cases				(₹ in crore)
Financial Year	**Number of groups searched**	**Undisclosed income admitted (in search & seizure)**	**Number of surveys conducted**	**Undisclosed income detected (in surveys)**
2013-14	569	10,792	5,327	90,391
2014-15	545	10,288	5,035	12,820
2015-16	447	11,226	4,428	9,700
2016-17	1,152	15,497	12,526	13,716
2017-18	577	15,913	13,487	9,634

Source: Investigation Wing, CBDT

During FY 2017-18, undisclosed income admitted during search & seizure increased by 2.7 *per cent* and undisclosed income detected during survey decreased by 29.8 *per cent* as compared to the respective figures in FY 2016-17.

1.11 Effectiveness of Internal Audit

1.11.1 Internal audit is an important part of the Departmental control that provides assurance that demands/refunds are processed accurately by the correct application of the provisions of the Act. The internal audit of ITD completed audit of 1,89,409 cases in FY 2017-18 as against 1,80,110 cases audited in FY 2016-17.

1.11.2 Table 1.15 shows details of internal audit observations raised, settled and pending for each of the five years from FY 2013-14 to FY 2017-18:

Table 1.15: Details of Internal audit observations								(₹ in crore)
Financial Year	**Opening balance**		**Addition**		**Settled**		**Pending**	
	Cases	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**	**Cases**	**Amount**
2013-14	36,212	10,677	14,423	8,951	26,322	8,610	24,313	11,018
2014-15	20,834^	8,368	9,927	2,292	15,586	3,805	15,175	6,855
2015-16	19,137^	8,023	13,148	6,463	12,891	2,205	19,394	12,281
2016-17	19,405^	12,283	12,972	2,451	11,256	3,352	21,121	11,382
2017-18	21,129^	11,295	13,297	2,562	9,062	1,283	25,364	12,575

Source: Directorate of Income Tax (Income Tax & Audit); ^Figures revised after verification by respective CsIT(Audit) subsequent to submission of quarterly statement for the quarter ending March

1.11.3 Out of 6,267 major finding cases[24] raised by internal audit, the assessing officers (AOs) acted upon only in 1,613 cases (25.7 *per cent*) in FY 2017-18 in comparison to 4,126 cases (33.2 *per cent*) out of 12,439 cases in FY 2016-17. The follow up of the internal audit observations by the AOs need to be improved.

[24] The monetary limit of major internal audit objections has been raised from ₹ Two lakh to ₹ 10 lakh as per instruction no. 6 of 2017 dated 21.7.2017.

Chapter II: Audit Mandate, Products and Impact

2.1 Authority of the CAG for audit of receipts

Article 149 of the Constitution of India provides that the Comptroller and Auditor General of India (CAG) shall exercise such powers and perform such duties in relation to the accounts of the Union and of the states and of any other authority or body as may be prescribed by or under any law made by the Parliament. The Parliament passed the Comptroller and Auditor General's DPC Act (CAG's DPC Act) in 1971. Section 16 of the CAG's DPC Act authorises CAG to audit all receipts (both revenue and capital) of the Government of India and of Governments of each State and of each Union Territory having a legislative assembly and to satisfy himself that the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed. Regulations on Audit & Accounts, 2007 (Regulations) lay down the principles for Receipt Audit.

2.2 Examination of systems and procedures and their efficacy

2.2.1 Audit of receipts includes an examination of the systems and procedures and their efficacy mainly in respect of:

- **a.** identification of potential tax assessees, ensuring compliance with laws as well as detection and prevention of tax evasion;
- **b.** exercise of discretionary powers in an appropriate manner including levy of penalties and initiation of prosecution;
- **c.** appropriate action to safeguard the interests of the Government on the orders passed by departmental appellate authorities;
- **d.** any measures introduced to strengthen or improve revenue administration;
- **e.** amounts that may have fallen into arrears, maintenance of records of arrears and action taken for the recovery of the amounts in arrears;
- **f.** pursuit of claims with due diligence and to ensure that these are not abandoned or reduced except with adequate justification and proper authority.

To achieve the above, we examined the assessments completed by the Income Tax Department in the financial year 2016-17. In addition, some assessments which were completed in earlier years were also taken up for examination.

2.2.2 The ITD undertakes scrutiny assessments in respect of a sample of returns filed by the assessee as per the Income Tax Act, 1961. The scrutiny assessment cases are selected on the basis of parameters identified and pre-defined by the ITD. These cases are then closely examined in respect of claims of deductions, losses, exemptions etc. to arrive at the correct assessments to ensure that there is no evasion of taxes. The assessee is given the opportunity to substantiate his claim with evidence failing which the AO makes the assessment as deemed appropriate.

On the basis of examination of scrutiny assessment cases, Audit noticed that despite irregularities of certain types being pointed out repeatedly in the audit reports, there are continued occurrences of these irregularities in following the tax laws and instructions and directives of CBDT during scrutiny assessments completed by the AOs, raising questions about the efficiency of tax administration. Some of these cases are discussed in the subsequent paragraphs.

2.2.3 A total of 4,44,02,413 returns were filed during the FY 2016-17[25]. In the same FY the ITD completed 2,73,138 scrutiny assessments in those units which were audited during audit plan of FY 2017-18. Out of the 2,73,138 scrutiny assessments, we checked 2,64,125 assessment cases. Apart from this, we also audited during FY 2017-18, 47,147 cases out of 1,06,498 cases of scrutiny assessments completed in financial years prior to 2016-17. Total number of scrutiny assessments audited during 2017-18 was 3,11,272 and the number of scrutiny assessments in which audit noticed mistakes was 20,075. The incidence of errors in assessments checked in audit during FY 2017-18 was 6.45 *per cent* which was less than the previous year's 7.2 *per cent*. Out of cases of scrutiny assessments audited by us, Internal Audit of ITD had checked 11,163 cases. As we have seen only a limited number of assessment cases/records as per our sample, the Ministry needs to verify this in entirety and not only in the cases of sample.

2.2.4 State-wise incidence of errors in assessments are given in *Appendix-2.1*. Table 2.1 below shows details of 10 states with highest percentage of assessments with errors where more than 10,000 assessments were checked in audit during FY 2017-18.

[25] Total number of returns filed during FY 2015-16 were 4,04,92,569

Table 2.1: Details of ten states with highest incidence or assessments with errors where more than 10,000 assessments were checked					**(₹ in crore)**
State	**Assessments**			**Total revenue effect of the audit observations**	**Percentage of assessments with errors**
	completed in units selected for audit during 2017-18	**checked in audit during 2017-18**	**With errors**		
a. Tamil Nadu	23,057	21,983	1,914	1,644.16	8.71
b. Madhya Pradesh	14,710	13,035	1,124	558.00	8.62
c. Karnataka	13,710	13,380	1,071	1,634.84	8.00
d. Andhra Pradesh & Telangana	17,533	16,948	1,343	1,499.00	7.92
e. West Bengal	33,530	32,000	2,398	2,100.19	7.49
f. Gujarat	14,722	14,443	1,002	1,044.63	6.94
g. Maharashtra	1,34,203	79,273	4,311	13,597.38	5.44
h. Delhi	30,264	27,382	1,342	2,556.98	4.90
i. Rajasthan	18,328	17,424	825	134.60	4.73
j. Uttar Pradesh	24,247	23,905	952	776.18	3.98

This indicates that Tamil Nadu (8.71 *per cent*) has the highest percentage of assessments with errors followed by Madhya Pradesh (8.62 *per cent*). The ITD needs to take corrective action in respect of errors noticed in the assessments.

2.2.5 Table 2.2 below shows the details of errors noticed in local audit during FY 2017-18.

Table 2.2: Tax wise details of errors in assessments		**(₹ in crore)**
Category	**No. of errors**	**Tax effect (TE)**
a. Corporation tax (CT) and Income tax (IT)	21,565	28,509.57[26]
b. Other Direct taxes (ODT)	504	61.86
Total	**22,069**	**28,571.43**
Note: The above findings and all subsequent findings are based exclusively on audit of selected assessments.		

2.2.6 Table 2.3 below shows the category-wise details of underassessment in respect of Corporation tax and Income Tax. *Appendix-2.2* indicates details in respect of sub-categories under them.

Table 2.3: Category-wise details of errors		**(₹ in crore)**
Category	**No. of errors**	**Tax effect**
a. Quality of assessments	6,778	5,628.19
b. Administration of tax concessions/exemptions/deductions	7,867	15,435.02
c. Income escaping assessments due to omissions	2,779	3,067.95
d. Others	3,655	3,220.59
Total	**21,079**	**27,351.75**

[26] Includes 486 cases of over assessment with tax effect of ₹ 1157.82 crore.

2.3 Persistent and pervasive irregularities in respect of Corporation Tax and Income Tax assessments cases

The instances of non-compliance and irregularities noticed during audit examination of assessment cases completed by the Assessing Officers (AOs) are brought out in our Compliance Audit Report – Department of Revenue - Direct Taxes every year. An irregularity may be considered persistent if it occurs year after year. It becomes pervasive, when it affects the entire system and is dispersed over many assessment jurisdictions. We have been pointing out various irregularities including those relating to (i) irregularities in allowing depreciation/ business losses/ capital losses etc., (ii) instances of incorrect allowance of business expenditure, (iii) arithmetical errors in computation of income and tax and (iv) mistakes in levy of interest with respect to assessment of corporation and income tax cases in the Compliance Audit Reports year after year, and some of these irregularities seem to be both persistent and pervasive. The audit observations issued to the Ministry as Draft Paragraphs and included in Compliance Audit Report[27] during the years 2014-15, 2015-16 and 2016-17 alongwith Draft Paras issued to the Ministry during 2017-18 were analysed with respect to occurrence in State jurisdictions year after year within each sub-category. Recurrence of such irregularities, despite being pointed out repeatedly in earlier audit reports, is not only indicative of non-seriousness on the part of the Department in instituting appropriate systems to prevent recurrence of such repetitive mistakes, but also points the lack of effective monitoring and absence of an institutional mechanism to respond to the systematic and structural weaknesses leading to leakages of revenue. Cases of such irregularities reported in the above mentioned categories are discussed below.

Though the irregularities noticed in different states showed no distinctive pattern of occurrences among the states, they were occurring more frequently in some states than others; their occurrences were seen to be consistently high in Delhi and Maharashtra.

2.3.1 Administration of tax concessions/exemptions/deductions – Irregularities in allowing depreciation/business losses/capital losses etc.

We noticed irregularities related to incorrect allowance and set-off of business losses, capital losses and unabsorbed depreciation, incorrect allowance of depreciation etc. The nature of such mistakes included incorrect allowance of set-off of brought forward business losses and

[27] C&AG Compliance Audit Report (Union Government – Department of Revenue – Direct Taxes) Nos. 3 of 2016 (for the year ended March 2015), 2 of 2017 (for the year ended March 2016) and 40 of 2017 (for the year ended March 2017).

unabsorbed depreciation where no loss in respect of earlier assessment years was available, adoption of incorrect figures viz. earlier years' business loss adopted as returned loss in current assessment year, incorrect allowance of carry forward of business loss although Income Tax Return for the said assessment year was filed after due date of filing of return, double deduction on account of depreciation etc. Such irregularities occurred due to non-correlation of assessment records indicative of lack of effective co-ordination and weak internal control mechanism. Mistakes noticed in allowance of depreciation/business losses/capital losses etc. during 2014-15 to 2016-17, as brought out in the Compliance Audit Reports of past three years along with findings of the current year Audit Report (2017-18) are summarised in the Table 2.4 below.

Table 2.4: Mistakes noticed in allowing depreciation/ business losses/ capital losses etc. **(₹ in crore)**

Assessment	Audit Report for the year ended							
	March 2015		March 2016		March 2017		March 2018	
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
CT	77[28]	1,359.20	71[29]	590.75	81[30]	1,144.10	66	1,796.86
IT	11	13.70	9	15.72	9	24.41	7	9.19

During 2014-15 and 2015-16, the non-compliance on this account was found highest in Maharashtra at 85 *per cent* and 63 *per cent* respectively of the total tax effect of Draft Paragraphs on Corporation Tax related to incorrect allowance of depreciation/business losses/capital losses etc. During 2016-17, it was found highest in Andhra Pradesh & Telangana (36 *per cent*) and Maharashtra (32 *per cent*). During 2017-18, irregularities on this account was found highest in Maharashtra (58 *per cent*).

In respect of Income Tax, such irregularities were found to be highest in West Bengal at 38 *per cent* of the total tax effect of Draft Paragraphs on Income Tax related to incorrect allowance of depreciation/business losses/capital losses etc. during 2014-15. During 2015-16 the tax effect on this account was found highest in Maharashtra (68 *per cent*) and in Bihar during 2016-17 (67 *per cent*). During 2017-18, these irregularities were highest in Maharashtra (67 *per cent*).

[28] Andhra Pradesh & Telangana, Assam, Delhi, Goa, Gujarat, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal

[29] Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal.

[30] Andhra Pradesh & Telangana, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

2.3.2 Administration of tax concessions/exemptions/deductions - Incorrect allowance of business expenditure

We noticed irregularities related to incorrect allowance of ineligible claims of business expenditure viz. capital expenditure, unpaid claims and provisions deemed as unascertained liability etc. Mistakes in incorrect allowance of expenditure noticed during 2014-15 to 2016-17, as brought out in the Compliance Audit Reports of past three years along with findings of the current year Audit Report (2017-18) are summarised in the Table 2.5 below.

Table 2.5: Mistakes noticed in allowance of business expenditure (₹ in crore)

Assessment	Audit Report for the year ended							
	March 2015		March 2016		March 2017		March 2018	
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
CT	56[31]	299.64	47[32]	514.09	50[33]	478.67	48	875.47

During 2014-15, such irregularities were highest in Tamil Nadu (25 *per cent* of the total tax effect of Draft Paragraphs related to incorrect allowance of business expenditure) and Karnataka (23 *per cent*). During 2015-16 the non-compliance on this account was found highest in Maharashtra (45 *per cent*), Andhra Pradesh & Telangana (30 *per cent*) whereas in 2016-17 such non-compliance was highest in Maharashtra (64 *per cent*). During 2017-18, irregularities on this account was found highest in Maharashtra (60 *per cent*) and Tamil Nadu (28 *per cent*).

2.3.3 Quality of Assessments – Arithmetical errors in computation of income and tax

We noticed irregularities emanating from arithmetical errors in computation of income and tax caused by computing errors, like adoption of incorrect figures while computing assessed income and tax demand, disallowances made in the assessments not added back, allowance of double deductions, omission to disallow claims allowed earlier due to non-correlation of assessment records etc. Assessing Officers had committed such errors in the assessments ignoring clear provisions in the Act which obviously reflect weaknesses in internal controls on the part of ITD which need to be addressed.

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31 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal.

32 Andhra Pradesh & Telangana, Assam, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Punjab, Tamil Nadu and West Bengal.

33 Andhra Pradesh & Telangana, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal.

Mistakes noticed in this category during 2014-15 to 2016-17 as brought out in the Compliance Audit Reports of past three years along with findings of the current year Audit Report (2017-18) are summarised in the Table 2.6 below.

Table 2.6: Arithmetical errors in computation **(₹ in crore)**

Assessment	Audit Report for the year ended							
	March 2015		March 2016		March 2017		March 2018	
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
CT	43[34]	164.63	45[35]	922.95	36[36]	310.04	46	539.34
IT	16[37]	83.40	19[38]	33.44	26[39]	75.89	14	52.03

During 2014-15, such irregularities were highest in Maharashtra (44 *per cent* of the total tax effect of Draft Paragraphs on Corporation Tax related to arithmetical errors in computation) and Madhya Pradesh (24 *per cent*) whereas in 2015-16, it was found highest in Delhi (41 *per cent*) and Maharashtra (28 *per cent)*. During 2016-17, it was found highest in Delhi (33 *per cent*) and Maharashtra (25 *per cent*). During 2017-18, these irregularities were highest in Uttar Pradesh (48 *per cent*)[40].

In respect of Income Tax, such irregularities were found to be highest in Uttar Pradesh (63 *per cent* of the total tax effect of Draft Paragraphs on Income Tax related to arithmetical errors in computation) during 2014-15. The tax effect on this account was found highest in Maharashtra during 2015-16 (39 *per cent*) and 2016-17 (66 *per cent*). During 2017-18, these irregularities were highest in Maharashtra (91 *per cent*). All these cases have been issued as separate draft paragraphs for Audit Report 2017-18.

2.3.4 Quality of Assessments – Mistakes in levying of interest

We noticed irregularities related to mistakes in levying 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. Further, during 2017-18, the Draft Paragraphs pointing out the deficiency noticed in the Assessment Information System (AST) module/ Income Tax Business Applications (ITBA)

[34] Bihar, Delhi, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

[35] Andhra Pradesh & Telangana, Bihar, Delhi, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Tamil Nadu and West Bengal.

[36] Delhi, Goa, Gujarat, Haryana, Maharashtra, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal

[37] Delhi, Gujarat, Kerala, Maharashtra, Punjab, Rajasthan, Uttar Pradesh, West Bengal

[38] Bihar, Delhi, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Uttar Pradesh

[39] Andhra Pradesh & Telangana, Delhi, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Odisha, Punjab and Tamil Nadu

[40] Wherever significance is mentioned, it is only with reference to the total tax effect and not in relation to the number of cases.

with respect to computation of interest under sections 234A, 234B, 234C and 244A of the Income Tax Act, 1961 has been brought out in paras 3.2.4, 3.5.1 and 4.2.4, 4.5.1 of this Report. Mistakes noticed in levy of interest noticed during 2014-15 to 2016-17, as brought out in the Compliance Audit Reports of past three years along with findings of the current year Audit Report (2017-18) are summarised in the Table 2.7 below.

Table 2.7: Mistakes noticed in levying of interest **(₹ in crore)**

Assessment	Audit Report for the year ended							
	March 2015		March 2016		March 2017		March 2018	
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
CT	22[41]	150.10	39[42]	163.84	40[43]	157.46	53	189.37
IT	29[44]	54.65	36[45]	61.97	37[46]	130.12	47	60.84

During 2014-15, the non-compliance on this account was found highest in Maharashtra (52 *per cent* of the total tax effect of Draft Paragraphs on Corporation Tax related to mistakes noticed in levying of interest) and Delhi (37 *per cent*). In 2015-16, the non-compliance was highest in Maharashtra (37 *per cent*) and Uttar Pradesh (30 *per cent*) whereas in 2016-17 such non-compliance was highest in Maharashtra (67 *per cent*). During 2017-18, the non-compliance on this account was found to be highest in Delhi (47 *per cent*).

In respect of Income Tax, such irregularities were found to be highest in Maharashtra (43 *per cent* of the total tax effect of Draft Paragraphs on Income Tax related to mistakes noticed in levying of interest) and Uttar Pradesh (28 *per cent*) during 2014-15. During 2015-16 the tax effect on this account was found highest in Delhi (27 *per cent*) and Andhra Pradesh & Telangana (27 *per cent*) whereas in 2016-17, it was found highest in Delhi (82 *per cent*). During 2017-18, these irregularities were highest in Odisha (33 *per cent*)[47]. These cases have been reported as Draft Paragraphs for Audit Report 2017-18.

Despite there being clear provisions on the levying of interest in the Act, such mistakes were found to be recurring year after year.

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41 Delhi, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Odisha, Tamil Nadu and West Bengal

42 Andhra Pradesh & Telangana, Delhi, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Odisha, Tamil Nadu, Uttar Pradesh and West Bengal.

43 Andhra Pradesh & Telangana, Delhi, Karnataka, Madhya Pradesh, Maharashtra, Odisha, Punjab, Tamil Nadu, UT Chandigarh and West Bengal

44 Andhra Pradesh & Telangana, Delhi, Karnataka, Madhya Pradesh, Maharashtra, Tamil Nadu, UT Chandigarh, West Bengal

45 Andhra Pradesh & Telangana, Delhi, Goa, Gujarat, Haryana, Kerala, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal

46 Andhra Pradesh & Telangana, Assam, Bihar, Delhi, Goa, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Rajasthan, Tamil Nadu, UT Chandigarh, Uttar Pradesh and West Bengal

47 Wherever significance is mentioned, it is only with reference to the total tax effect and not the number of cases.

Non-compliance of tax laws and instructions and directives of CBDT is one of the major risk areas affecting the efficiency of tax administration. In order to improve the same, the departmental systems and processes have significantly been computerised over the years for efficient processing and improved compliance at all stages of assessment. ITD selects cases through Computer Aided Scrutiny Selection (CASS) on the basis of pre-defined parameters for detailed scrutiny to be done by AO. During scrutiny assessment, AO calls for required information from the assessee and examines them in the light of applicable provisions of the Act. However, as seen from the above analysis, the risks of non-compliance still exists in above areas as indicated by the continuing occurrence of the similar types of irregularities over time, despite these being pointed out by audit from year to year and there seems to be no system to make the AOs more accountable for minimising, if not eliminating, repetition of similar or identical mistakes. We also noticed that in respect of 72 assessees, Assessing Officers committed mistakes in assessments in respect of the same assessee in more than one year during the period of four years under consideration.

Conclusion and Recommendation

From the above analysis and also from our past experiences, it is clear that the required systems and processes to minimise the risk of recurrence and repetition of similar types of errors in computation of taxable income, once they are pointed out in audit, is absent in the Department. Once such an irregularity noticed in assessment completed by the AO has been pointed out in audit, it is expected that appropriate checks should be instituted by the Department to prevent recurrence of similar types of irregularities and errors in assessment in future, which is not seen to be the case. We also noticed that in respect of 72 assessees, Assessing Officers committed mistakes in assessments in respect of the same assessee in more than one year during the period of four years under consideration.

It is recommended that the IT Department may fix accountability on the part of the AOs to ensure that the risk of recurrences of similar types of irregularities are minimised, besides instituting systems and procedural checks to ensure this.

2.4 Audit products and response to audit

2.4.1 We elicit response from the audited entities at different stages of audit. As per provision of Regulations 193 on completion of field audit, we issue the local audit report (LAR) to ITD for comments.

2.4.2 Table 2.8 below depicts the position of number of observations included in the LAR issued during FY 2015-16 to FY 2017-18 and replies received thereto and observations accepted (as on 31 March of respective financial year).

Table 2.8: Response to local audit

Financial Year	Observations raised	Reply received		Reply not received	Percentage of Observations accepted	Percentage of reply not received
		Observations Accepted	Observations not accepted			
2015-16	20,737	3,281	5,196	12,260	15.80	59.10
2016-17	22,579	4,074	3,546	15,060	18.40	66.70
2017-18	24,502	3,983[48]	2,882	17,637	16.30	72.00

2.4.3 Table 2.9 below shows the increasing trend of pendency of observations.

Table 2.9: Details of outstanding audit observations **(₹ in crore)**

Period	CT		IT		ODT		Total	
	No.	TE	No.	TE	No.	TE	No.	TE
Upto Mar 2015-16	14,251	48,307.35	11,620	7,596.72	3,556	715.54	29,427	56,619.61
2016-17	5,908	35,735.58	6,180	3,939.31	796	51.85	12,884	39,726.74
2017-18	4,584[49]	13,806.70	5,049	2,457.89	473	69.09	10,106	16,333.68
Total	**24,743**	**97,849.63**	**22,849**	**13,993.92**	**4,825**	**836.48**	**52,417**	**112,680.03**

The accretion in pendency in replies to audit findings each year has resulted in accumulation of 52,417 cases involving revenue effect of ₹ 1,12,680.03 crore as of 31 March 2018.

The Department's efforts to ensure that replies to audit are sent in the prescribed period have not been satisfactory. The provisions of Regulations 202 and 203 which require establishment of system and procedures to ensure adequate, constructive and timely action on audit observations included in Inspection Reports/Audit Notes and establishment of audit committees for monitoring and ensuring compliance and settlement of pending audit observations, need to be observed in letter and spirit.

[48] 1,931 - Observations accepted and remedial action taken; 2,052 - Observations accepted but remedial action not taken

[49] Observations become pending after six months of issue of the observations

2.4.4 We issue significant and high value cases noticed in audit to the Ministry for comments before inclusion in the Audit Report as per provision of Regulations 205 to 209. We give six weeks to the Ministry to offer their comments on cases issued to them before their inclusion in the Audit Report. We have included 472 high value cases in Chapter III and IV of this Report, of which replies were received for 325 cases. The Ministry/ITD accepted 302 cases[50] (92.9 *per cent*) having tax effect of ₹ 3,006.01 crore (82.8 *per cent*) while it did not accept 23 cases[51] having tax effect of ₹ 626.20 crore as of 31 March 2019. Replies to remaining cases were not received. Table 2.10 shows category wise details of these cases[52].

Table 2.10 Category-wise details of errors of high value cases (₹ in crore)

Category		CT		IT		Total	
		No.	TE	No.	TE	No.	TE
a.	Quality of assessments	118	1,121.78	85	276.53	203	1,398.31
b.	Administration of tax concessions/exemptions/ deductions	141	3,149.58	26	39.24	167	3,188.82
c.	Income escaping assessments due to omissions	56	359.47	12	5.17	68	364.64
d.	Overcharge of tax/ interest	25	235.83	9	10.12	34	245.95
	Total	**340**	**4,866.66**	**132**	**331.06**	**472**	**5,197.72**

2.4.5 Chapters III and IV bring out details of errors in assessments in respect of Corporation Tax and Income Tax respectively. These chapters contain paras 3.2.4, 3.5.1 and 4.2.4 bringing out deficiencies noticed in the Assessment Information System module/Income Tax Business Applications with respect to computation of interest under section 234A, 234B, 234C and 244A of the Act. In addition, two long draft paras viz. 'Follow up audit of exemptions to charitable trusts and institutions'; and 'Integrated audit of assessments of a group company' have been separately included in Chapter VI and VII of this Report respectively. Chapter VI brings out the instances noticed by audit where diversion of income/property by trusts to related group trusts/institutions as application of income; exemptions to assessees whose activities were not 'charitable' in nature; lack of monitoring the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act; exemptions granted to trust on application of funds given to foreign

[50] Ministry -256 cases; ITD -46 cases
[51] Ministry -14 cases; ITD - 9 cases
[52] Sub -categories-wise details are given in Appendix-2.3

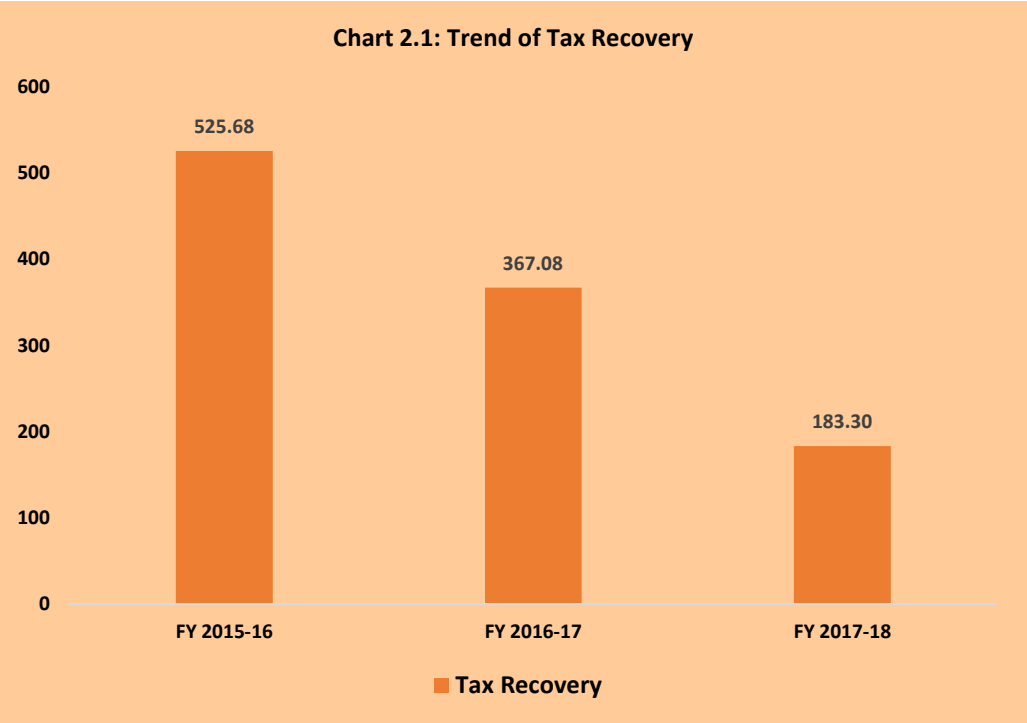
universities; and non-cancellation of registration where activities of the Trust and Institutions are not in accordance with the provisions of the Act. Chapter VII brings out that ITD during the assessment of related companies in a group had not made any efforts to cross link material transactions between the related parties to ensure the correctness/genuineness which could act as a deterrent and also minimise the possibility of escapement of taxable income.

2.4.6 Besides, Chapter V brings out our report on a subject specific compliance audit on 'Assessments relating to Agricultural Income'. The Chapter point out cases where there was mismatch between the exemptions allowed in the assessment order vis-à-vis that reflected in the ITD database. Exemptions allowed for agricultural income during scrutiny assessments had not been reflected correctly in the ITD database.

2.5 Audit impact

2.5.1 Recovery at the instance of audit

ITD recovered ₹ 1,076.06 crore in the last three years (Chart 2.1) from demands raised to rectify the errors in assessments that we pointed out. This includes ₹ 183.30 crore recovered in FY 2017-18.



2.6 Time barred cases

2.6.1 Table 2.11 below shows the details of time-barred cases[53] during FY 2015-16 to 2017-18.

Table 2.11: Details of time-barred cases (₹ in crore)

Year of Report	Cases	Tax effect
2015-16	2,074	1,230.70
2016-17	2,243	1,637.81
2017-18	2,739	2,735.17

2.6.2 During FY 2017-18, 2,739 cases with tax effect of ₹ 2,735.17 crore became time-barred for remedial action, of which Odisha alone account for 34.57 *per cent* of this tax effect followed by Tamil Nadu at 28.51 *per cent*. *Appendix-2.4* indicates state-wise details of such cases for FY 2017-18. Responsibility may be fixed for not taking remedial action in time in such cases. The Department should ensure that remedial action is taken in time so that such incidences do not recur in future.

2.7 Non-production of records

2.7.1 We scrutinize assessment records under Section 16 of the C&AG's (DPC) Act, 1971 with a view to securing an effective check on the assessment and collection of taxes and examining that regulations and procedures are being duly observed. It is also incumbent on ITD to expeditiously produce records and furnish relevant information to Audit.

2.7.2 ITD did not produce 31,196 records out of 3,77,206[54] records requisitioned during FY 2017-18 (8.27 *per cent*) which is a slight improvement over FY 2016-17 (8.29 *per cent*). Non-production of records has increased significantly in Delhi, Haryana, Himachal Pradesh, Kerala, Maharashtra, Punjab and Rajasthan during FY 2017-18 over previous year.

[53] Notice under section 148 cannot be issued for reopening the case after six years from the end of the relevant assessment year.

[54] Includes 29770 records not produced in earlier years and requisitioned again during current audit cycle

Appendix 2.5 shows the details of non-production of records during FY 2015-16 to FY 2017-18. Table 2.12 shows details of records not produced to audit pertaining to same assessees in three or more consecutive audit cycles.

Table 2.12: Records not produced to Audit in three or more audit cycles

	States	Records not produced
a.	Maharashtra	346
b.	Odisha	9
	Total	**355**

In FY 2017-18, 355 records pertaining to same assessees in two states were not produced to audit in last three or more consecutive audit cycles.

2.7.3 Audit wanted to examine the selections for scrutiny and their coverage vis-à-vis income assessed. It appears from the data of scrutiny cases that one *per cent* of the assessees were selected covering 25-30 *per cent* of the Direct Taxes collection. This points to skewness in favour of selection based on high value. Though we called for the information related to CASS for examination in Audit, this was not shared by the ITD. In absence of the same, method of selection of returns for scrutiny through CASS could not be examined by the Audit. Audit therefore could not verify if the CASS selection was objective or if the scrutiny undertaken in the field was as per the CASS selection. The method of selection for scrutiny should be transparent to CAG and PAC.

2.7.4 Non-production of records in respect of Pr. CCIT Mumbai and Nagpur

Article 149 of the Constitution read with Section 13 and 16 of the C&AG (DPC) Act, 1971 empowers the Comptroller and Auditor General (C&AG) to audit all expenditure from and receipts into the Consolidated Fund of India to ascertain whether (i) the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it and that (ii) the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

In consonance with the C&AG's mandate, audit of the offices of Pr. CCIT at Mumbai, Pune, Nagpur, were planned in AAP 2017-18 to ensure that (i) the rules and procedures had been designed to secure an effective check on the assessment, collection and proper allocation of revenue and also that the monitoring mechanisms were in place to see that they were duly observed and (ii) expenditure booked in the accounts were legally available for and

applicable to the service or purpose to which they have been applied or charged and conformed to the authority which governed it.

Pr. CCsIT Mumbai and Nagpur did not produce the requested records despite several reminders and personal meetings at the highest level. The matter was brought to the notice of the Revenue Secretary, Department of Revenue, Ministry of Finance through DO letter (April 2018) and through DP in July 2018.

The Ministry replied (September 2018) that there is no correlation between the items/files requisitioned by the Audit in respect of Pr. CCIT, Mumbai and assessment/collection of taxes. Further orders/directions/ instructions issued by the Board are available in public domain and also with the assessing officers inter alia for the purpose of implementation. Assessment orders passed by the assessing officers in consequence of such direction/instruction/ orders issued by the Board are in any case, routinely subjected to audit by the C&AG.

The Ministry's reply is not tenable in view of the following:

a) One of the most important responsibilities of C&AG is to satisfy himself that rules and procedures are designed to secure an effective check on the assessment, collection and allocation of revenue. The functions of Pr. Chief CIT include budgeting & expenditure control, grievances redressal, computerization, supervision and administrative control, internal control, monitoring the implementation of PAC's recommendations etc. and these are being monitored by the O/o the Pr. Chief CIT. The records called for by the Audit from the O/o Pr. CCIT, Mumbai as mentioned in the reply, were relevant records to satisfy that robust internal control and monitoring systems exist at the top administrative level.

b) Without the examination of records of apex entities at Pr. CCIT level, Audit will not be in a position to assure the stake holders that rules and procedures are in place to have effective check on levy, assessment and collection of income tax and expenditure incurred by the Department for collection of revenue is as per law.

Audit could therefore not discharge its constitutional mandate due to non-production of records.

Chapter III: Corporation Tax

3.1 Introduction

3.1.1 This Chapter discusses the result of audit of assessments related to corporation tax audited during 2017-18. A total of 7,13,139 returns[55] were filed by corporate assessees during the FY 2016-17. ITD completed a total of 1,18,101 corporation tax scrutiny assessments in FY 2016-17 or in earlier years in those units which were audited during audit plan of 2017-18. Out of 1,18,101 corporation tax scrutiny assessments, we checked 97,434 corporation tax scrutiny cases and found mistakes in 7,947 assessments. The incidence of errors in corporation tax scrutiny assessments checked in audit during 2017-18 was 8.15 *per cent*. As we have seen only a limited number of assessment cases/ records as per our sample, the Ministry needs to verify this in entirety and not only in the cases of sample.

3.1.2 A total of 340 high value corporation tax cases were referred to the Ministry during April 2018 to October 2018. Of these, 315 cases involve undercharge of ₹ 4,630.83 crore and 25 cases involve overcharge[56] of ₹ 235.83 crore. These cases of incorrect assessment point towards weaknesses in the internal controls in the assessment processes of the ITD.

3.1.3 The categories of mistakes have been broadly classified as follows:

- Quality of assessments
- Administration of tax concessions/ exemptions/ deductions
- Income escaping assessments due to omissions
- Others – Overcharge of tax/ Interest etc.

The deficiency noticed in the Assessment Information System[57] (AST) module/ Income Tax Business Applications[58] (ITBA) with respect to computation of interest under sections 234A, 234B, 234C and 244A of the Income Tax Act, 1961 has been brought out in Para 3.2.4 and 3.5.1 of this Chapter. Table 2.10 (*Para 2.4.4*) shows the details of broad categories of mistakes in assessments and their tax effect.

3.1.4 The Ministry has conveyed its acceptance of audit observations in respect of 185 cases involving tax effect of ₹ 2,279.60 crore while not accepting 13 cases involving tax effect of ₹ 33.31 crore. In the remaining

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55 Source: Principal Directorate General of Income Tax (Admn. & Tax Payers Services), Research and Statistics wing

56 Overcharge is on account of mistakes in adoption of correct figures, arithmetical errors in computation of income, incorrect application of rates of tax/interest etc.

57 The AST module is an online, menu driven software capable of carrying out all assessment and related functions.

58 ITBA is a software application developed for computerising all internal processes of Income Tax Department.

142 cases, the Department has accepted 37 cases involving tax effect of ₹ 526.87 crore while not accepting eight cases involving tax effect of ₹ 591.59 crore (*referred to in para 2.4.4*). Out of 340 cases, ITD has completed remedial action in 257 cases involving tax effect of ₹ 3,134.02 crore and initiated remedial action in 26 cases involving tax effect of ₹ 85.90 crore.

3.2 Quality of assessments

3.2.1 Assessing Officers (AOs) 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, mistakes in levy of interest, excess or irregular refunds etc. point to weaknesses in the internal controls in ITD which need to be addressed. Table 3.1 shows the details of sub-categories of mistakes (refer *Appendix 2.4*) which impacted the quality of assessments.

Table 3.1: Sub-categories of mistakes under Quality of assessments (₹ in crore)

	Sub-categories	Cases	Tax effect	States
a.	Arithmetical errors in computation of income and tax	46	539.34	Andhra Pradesh & Telangana, Delhi, Haryana, Madhya Pradesh, Maharashtra, Odisha, Rajasthan, Tamil Nadu, UT Chandigarh, Uttar Pradesh, West Bengal.
b.	Application of incorrect rate of tax and surcharge	10	307.50	Delhi, Gujarat, Kerala, Maharashtra, UT Chandigarh, West Bengal.
c.	Mistakes in levy of interest	53	189.37	Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Karnataka, Maharashtra, Odisha, Punjab, Tamil Nadu, UT Chandigarh, West Bengal.
d.	Excess or irregular refunds/interest on refunds	4	30.98	Maharashtra.
e.	Mistakes in assessment while giving effect to appellate order	5	54.59	Karnataka, Maharashtra and West Bengal.
Total		**118**	**1,121.78**	

3.2.2 Arithmetical errors in computation of income and tax.

We give below six such illustrative cases:

Section 143(3) of the Income Tax Act, 1961, 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.

3.2.2.1 In Uttar Pradesh, Pr. CIT Meerut charge, Assessing Officer (AO) completed the assessment of a company for the assessment year (AY) 2013-14, under section 143(3) of the Act in March 2016 determining loss at ₹ 1,127.10 crore. During assessment proceedings the assessee revised its computation of income at loss of ₹ 1,384.82 crore. Audit examination revealed that, while computing taxable income, the AO had erroneously adopted starting figure at loss of ₹ 2,169.02 crore instead of revised loss of ₹ 1,384.82 crore. The mistake had resulted in over assessment of loss by ₹ 784.20 crore involving potential tax effect of ₹ 254.43 crore. *The Department (ITD) rectified the mistake (September 2017) under section 154 of the Act.*

3.2.2.2 In Odisha, Pr.CIT-I, Bhubaneswar charge, AO completed the scrutiny assessment of a company for the AY 2014-15 in December 2016 determining loss at ₹ 86.98 crore after making additions of ₹ 63.70 crore. Audit examination revealed that, while computing total income, the AO had erroneously considered a loss of ₹ 150.68 crore instead of gross total income of ₹ 32.09 crore as returned by the assessee in its original as well as revised returns. Thus, assessed income was erroneously determined as loss of ₹ 86.98 crore instead of income of ₹ 95.79 crore. The mistake had resulted in under assessment of income of ₹ 182.77 crore involving tax effect of ₹ 64.35 crore[59]. *ITD stated (February 2018) that remedial measure was being taken to rectify the mistake as pointed out by audit. Further reply was awaited (March 2019).*

3.2.2.3 In Pr. CIT-5, Delhi charge, AO completed the assessment of a company for the AY 2012-13 under section 144[60] of the Act in March 2015 at a loss of ₹ 86.10 crore. As per the discussion in the assessment order, the expenditure incurred to arrive at the current year loss claimed by the assessee was not substantiated. In the absence of the details of expenditure, the AO determined taxable income at ₹ 16.38 crore as 10 *per cent* of Gross Sales as per Income Tax Return (ITR) filed by assessee while stating that no regard is to be given to the expenditure claimed by the assessee. However, while computing assessed income, the taxable profit of ₹ 16.38 crore was adjusted with returned loss of ₹ 102.48 crore to arrive at a loss of ₹ 86.10 crore. This resulted in under assessment of income by ₹ 16.38 crore and simultaneously, over assessment of loss of ₹ 86.10 crore, involving positive tax effect of ₹ 7.22 crore (including interest) and potential tax effect of ₹ 27.93 crore. *ITD rectified the mistake (December 2017) under section 154 of the Act.*

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[59] ₹ 1,029.49 lakh (positive tax effect) + ₹ 5,405.13 lakh (potential tax effect)

[60] Section 144 of the Income Tax Act, 1961, deals with best judgement assessment in cases where the return of income is not filed by the taxpayer or if there is no cooperation by the taxpayer in terms of furnishing information/explanation related to his assessment or if books of accounts of taxpayer are not reliable or are incomplete.

Section 115BBE(1) of the Income Tax Act, 1961, provides that where the total income of an assessee includes any income referred to in section 68 or 69 of the Act, the income tax payable shall be the aggregate of the amount of income tax calculated on income referred to in section 68 or 69 at the rate of thirty per cent and the amount of income tax chargeable on the remaining income determined under normal provisions. Further sub-section (2) provided that no deduction in respect of any expenditure or allowance shall be allowed under any provisions of this Act in computing the income referred to in section 68 or 69 of the Act.

3.2.2.4 In West Bengal, Pr. CIT-2, Kolkata charge, AO completed the assessment of a company for the AY 2013-14 under section 144 of the Act in March 2016 at 'nil' income after allowing set off of loss of ₹33.68 crore from current year and ₹ 18.08 crore from earlier year. Audit examination revealed that, while finalising the assessment, AO made addition of ₹ 49.44 crore as unexplained cash credit under the provision of section 68[61] of the Act. However, the amount of ₹ 49.44 crore was not separately taxed and was allowed to be set off with the current year's business loss and brought forward business loss, which was not in order. The omission had resulted in under assessment of income by ₹ 49.44 crore involving tax effect of ₹ 16.04 crore excluding interest under section 234B. *ITD rectified the mistake (January 2018) under section 154 read with section 144 of the Act.*

3.2.2.5 In Andhra Pradesh & Telangana, Pr.CIT–5, Hyderabad charge, AO completed the assessment of a company for the AY 2014-15 under section 144 of the Act in December, 2016 determining the income at ₹ 1.61 crore after set off of brought forward loss of ₹ 1.60 crore against estimated income of ₹ 3.21 crore. Audit examination revealed that the AO had estimated the income of the assessee at 5 *per cent* of the gross receipts. The sales/gross receipts of business was shown in the ITR as ₹ 551.42 crore and 5 *per cent* of the same worked out to ₹ 27.57 crore as against ₹ 3.21 crore computed and adopted in the assessment order. Besides the sales receipts, the assessee had also earned 'other income' of ₹ 2.08 crore. Consequently, the total income worked out to ₹ 29.65 crore. After setting off of brought forward loss of ₹ 1.60 crore the taxable income worked out to ₹ 28.05 crore instead of ₹ 1.61 crore as arrived in the assessment order. This resulted in under assessment of income of ₹ 26.44 crore[62] involving tax effect of ₹ 12.16 crore including interest. *The Ministry has accepted the audit objection (December 2018) and rectified the mistake (August 2018) under section 154 of the Act.*

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[61] Section 68 of the Income Tax Act, 1961, provides that where any sum is credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income tax as the income of the assessee of that previous year.

[62] ₹ 28.05 crore - ₹ 1.61 crore

3.2.2.6 In West Bengal, Pr. CIT-3, Kolkata charge, AO completed the assessment of a company for the AY 2014-15 under section 144 of the Act in December 2016 at an income of ₹ 2.26 crore. Audit examination revealed that, while finalising the assessment, AO made an addition of ₹ 2.25 crore stating that the entire investment made by the assessee in the unlisted equities was not explained by the assessee. However, the correct amount of investment made by the assessee in unlisted equities as per the Balance sheet was ₹ 22.49 crore instead of ₹ 2.25 crore. The omission had resulted in under assessment of income of ₹ 20.24 crore involving tax effect of ₹ 9.56 crore. *ITD has initiated remedial action under section 154 of the Act (June 2018).*

3.2.3 Application of incorrect rates of tax and surcharge

We give below three such illustrative cases:

As per section 115BBD of the Income Tax Act, 1961, where the total income of an Indian company includes any income by way of dividends declared, distributed or paid by a specified foreign company, the income tax payable shall be the aggregate of (a) the amount of income tax calculated on the income by way of such dividends, at the rate of fifteen per cent and (b) the amount of income tax with which the assessee would have been chargeable had its total income been reduced by the aforesaid income by way of dividends. Sub-section 3(ii) of section 115BBD defines "specified foreign company" as a foreign company in which the Indian company holds twenty six per cent or more in nominal value of the equity share capital of the company.

3.2.3.1 In Maharashtra, Pr. CIT-LTU Mumbai charge, AO completed the assessment of a company for the AY 2013-14, under section 143(3) read with section 144C(1)[63] of the Act at a loss of ₹ 3,696.63 crore under normal provisions of the Act and book profit of ₹ 390.03 crore which was charged to tax under section 115JB. Audit examination of the computation of income revealed that the assessee company had shown an amount of ₹ 1,422.11 crore as dividend from foreign companies under the head "Income from other sources". The detailed submission made by the assessee on the dividend received showed that this included dividend of ₹ 1,421.98 crore from 'X' company. As per the annual accounts, 'X' company was a wholly owned subsidiary of the assessee and was a specified foreign company as defined under section 115BBD. Therefore, as per the provisions of the said section, the dividend amount of ₹ 1,421.98 crore was required to be taxed separately at the rate of 15 *per cent* which was not done. The omission had resulted in short levy of tax of ₹ 278.54 crore including interest

[63] Section 144C of the Income Tax Act, 1961, provides for procedure for reference to Dispute Resolution Panel. As per section 144C(1) of the Act the Assessing Office shall forward a draft of the proposed order of assessment to the eligible assessee if he proposes to make, on or after the first day of October 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

of ₹ 22.61 crore under section 234B besides excess levy of interest of ₹ 25.25 crore under section 244A and MAT credit of ₹ 71.72 crore, both of which were required to be withdrawn. *ITD replied (November 2017) that the audit objection was acceptable. Further progress was awaited (March 2019).*

Section 4(1) of the Income Tax Act, 1961, provides that income tax is chargeable for every assessment year in respect of the total income of the previous year of an assessee, according to the rates prescribed under the relevant Finance Act. The Finance Act relevant to assessment year 2013-14 provides for levy of surcharge at the rate of two per cent on income tax in the case of foreign companies if net income exceeds rupees one crore.

3.2.3.2 In Delhi, CIT (International Tax)-2 charge, the assessment of a company for the AY 2013-14 was completed after scrutiny in January 2017 determining an income of ₹ 3,859.92 crore and a tax of ₹ 397.57 crore thereon. As per the assessment order, tax was required to be levied at the rate of 10 *per cent* along with applicable surcharge and cess on the royalty income of ₹ 3,859.92 crore. Audit examination revealed that, while computing the tax demand, surcharge leviable at the rate of two *per cent* was not levied. This mistake had resulted in short levy of tax of ₹ 11.61 crore including interest. *ITD rectified the mistake (March 2018) under section 154 of the Act.*

Section 44DA of the Income Tax Act, 1961, provides for taxation of the income by way of royalty or fees for technical services as 'Profits and gains of business or profession' when such income is connected with Permanent Establishment of non-resident in India. The Finance Act relevant to assessment year 2012-13 provides for levy of tax at the rate of 40 per cent on 'Profits and gains of business or profession' in the case of foreign companies.

3.2.3.3 In Delhi, CIT (International Tax)-1 charge, the assessment of a company for the AY 2012-13 was completed in December 2015 at an income of ₹ 35.52 crore and a tax of ₹ 8.76 crore thereon. As per the assessment order, total income of ₹ 35.52 crore was treated as profit and gains in accordance with the provisions of section 44DA and tax was therefore required to be levied at the rate of 40 *per cent*. Audit examination revealed that, while computing tax demand, AO levied tax of ₹ 8.10 crore only instead of leviable amount of ₹ 14.21 crore. The mistake had resulted in short levy of tax of ₹ 6.17 crore. *ITD rectified the mistake (February 2018) under section 154 of the Act.*

The Finance Act relevant to assessment year 2011-12 provides for levy of surcharge at the rate of 7.5 per cent of income tax in the case of companies if net income exceeds rupees one crore.

3.2.3.4 In Pr. CIT-2 Chandigarh charge, the assessment of a company for the AY 2011-12 was completed under section 147[64] read with section 143(3) of the Act in March 2016 at an income of ₹ 49.93 crore. Audit examination of ITNS-150 revealed that although tax demand was computed and generated through AST system, surcharge leviable at the rate of 7.5 *per cent* and interest leviable under section 234A(3) of the Act, for delay of one month, was not levied. The system was, therefore, deficient in computing tax demand including surcharge and interest amount. Further, the correction of the error in computation by the system was also not ensured by the AO. This had resulted in short levy of tax of ₹ 2.02 crore including interest. *ITD stated (September 2018) that the mistake had been rectified (August 2018) under section 154 of the Act.*

3.2.4 Mistakes in levy of interest

We give below four such illustrative cases:

The Income Tax Act, 1961 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.

Further, all ITRs are first summarily processed under section 143(1) at Centralized Processing Centre[65] (CPC), Bengaluru before scrutiny assessments, thus all data pertaining to summary assessments are directly captured in Assessment Information System (AST). The work of processing, rectification, completion of assessment order in respect of scrutiny cases is done by AOs in AST module, part of ITD module, for all returns transferred from CPC. AST undertakes various assessment functions such as calculation of tax, calculation of interest under various sections of Income Tax Act, 1961, time barring checks, deductions limit validations, due date checks, etc. The payments made by assessee in respect of TDS/TCS and Advance Tax etc. are auto populated from 26AS application and OLTAS[66] application, respectively. In the case of scrutiny assessment, rectification, appeal effect orders in the field offices, figures are data-fed to the system by AOs based on the orders. With the new figures entered into different Heads of Income under Additions, computation

[64] As per section 147 of the Income Tax Act, 1961; if the AO has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 or 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned.

[65] Centralised Processing Centre for Income tax returns (CPC ITR) at Bengaluru provides a comprehensive and end to end solution for processing the return using rules as per Income Tax Act to compute the final refund or tax due to the taxpayer.

[66] The Online Tax Accounting System (OLTAS) facilitates near real time reporting, monitoring and reconciliation of tax payments made by taxpayers through banks.

sheet for final demand is generated. If any increase in the value of above heads is to be done by the AO, the permission is needed from next higher authority through the system. However, no permission is required by AO to decrease the value under above heads in AST. AST module allows the AOs to modify the value of interest under section 234A/B/C/D and 244A under the head 'Modified'. These values can be changed (increased/ decreased) without approval of any higher authority. In cases of assessment done under Best Judgment under section 144, data are manually fed under various heads if assessee is non-filer and accordingly, computation is done. If assessee is late-filer, has filed IT return after notice under section 148, then interest under section 234A/B/C has to be calculated based on original due date for concerned Assessment year.

3.2.4.1 In Gujarat, CIT-Central Circle, Ahmedabad Charge, the assessment of a company for the AY 2012-13 was completed under section 143(3) read with section 153A(1)(b)[67] of the Act determining income of ₹ 50.42 crore in December 2016. Audit examination of ITNS-150 revealed that interest for default in payment of advance tax under section 234B was worked out manually and not through the AST, and incorrectly charged as ₹ 2.28 crore instead of ₹ 9.12 crore. Audit could not ascertain the reasons for computing the tax on income and interest manually instead of through AST resulting in levy of lower amount of interest. The omission by the AO to verify the correctness of the interest depicted in ITNS-150 resulted in short levy of interest of ₹ 6.84 crore. *ITD rectified the mistake in computation of interest in August 2017 under section 154 of the Act.*

3.2.4.2 In Gujarat, Pr. CIT-2, Ahmedabad charge, the assessment of a company for the AY 2009-10 was completed in December 2016 under section 143(3) read with section 147 of the Act determining an income of ₹ 15.18 crore. The assessee company had not filed its original return of income for AY 2009-10 as prescribed under section 139(1)[68] i.e. upto 30.9.2009. The case was reopened and a notice was issued under section 148 in March 2016. The assessee had filed its return of income in April 2016 in response to this notice. Audit examination of ITNS-150 revealed that a tax of ₹ 5.16 crore on the assessed income was worked out manually and not through the AST. However, interest under section 234A was not levied for non-filing of the original return of income. As return was not filed, interest as required to be levied for 79 months i.e. from the next day of due date of filing of ITR (1 October 2009) and upto the date of filing of return (28 April 2016). Audit could not ascertain the reasons for computing the tax

[67] Section 153A(1)(b) of the Income Tax Act, 1961, provides that in the case of a person where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003, the AO shall assess or reassess the total income in respect of each A.Y. falling within such six AYs

[68] As per section 139(1) of the Income Tax Act, 1961, every person, being a company or a person other than a company, is required to furnish a return of his income during the previous year, on or before the due date, in the prescribed form and verified in prescribed manner.

on income manually instead of through AST resulting in non-levy of interest under section 234A. The omission had resulted in non-levy of interest of ₹ 4.07 crore. *Reply of the Ministry was awaited (March 2019).*

3.2.4.3 In Delhi, Pr.CIT-2 charge, the assessment of a company for the AY 2013-14 was completed under section 143(3) of the Act in December 2016 determining an income of ₹ 9,441.09 crore and a tax of ₹ 3,058.76 crore thereon. Audit examination of ITNS-150 revealed that interest ₹ 3.61 crore for deferment of advance tax under section 234C was not computed by AST system indicating the fact that system was deficient in computing the interest for deferment of payment of advance tax. This had resulted in non-levy of interest of ₹ 3.61 crore under section 234C of the Act. *ITD while rectifying the mistake (February 2018) in computation of interest under section 154, stated that due to technical problem in AST, the system had not charged interest under section 234C. ITD further stated (July 2018) that the matter of not computing the interest pertains to system division of the Department. Audit is of the view that this issue needs to be addressed to ensure correct determination of tax demand including interest or refund payable to the assessee.*

3.2.4.4 In Pr. CIT-2, Chandigarh charge, the assessment of a company for the AY 2008-09 was completed under section 147 read with section 143(3) of the Act in March 2016 at an income of ₹ 100.29 crore. A notice was issued to the assessee under section 148 on 25 March, 2015 for filing of return of income within 30 days. Assessee stated in its response (January, 2016) that the original return filed on 30 September, 2008 may be treated as return against notice issued under section 148. As the return of income was deemed to be filed on 21 January 2016, the period of delay for levy of interest under section 234A(3) would be 9 months. Audit examination of ITNS-150 revealed that computation of tax demand was done through AST and nil interest was levied for default in furnishing of return under section 234A(3)[69] as against leviable amount of ₹ 2.98 crore for 9 months. The AO therefore made an omission in not considering the period of delay and further this points to the fact that the system was also deficient in computing correctly the period of delay of interest under section 234A(3). This had resulted in non-levy of interest of ₹ 2.98 crore under section 234A(3) of the Act. *ITD rectified the mistake (July 2018) under section 154 of the Act.*

3.2.4.5 In West Bengal, Pr. CIT-1, Kolkata charge, the assessment of a company for the AY 2014-15 was completed after scrutiny in December 2016

[69] Section 234A(3) of the Income Tax Act, 1961, provides for levy of interest for default in furnishing of return in cases where income is determined under section 147 or section 153A at specified rates and for specified time period.

at an income of ₹ 234.46 crore. Subsequently, the assessment was revised under section 154 in February 2017 at an income of ₹ 233.63 crore considering double addition of ₹ 83.03 lakh made in scrutiny assessment under section 143(3). Audit observed that the gross tax liability of the assessee as per return of income was ₹ 79.41 crore after deduction of TDS amounting to ₹ 0.63 lakh. The assessee did not pay advance tax within the scheduled dates as required by the Act and hence was liable to pay interest amounting to ₹ 4.01 crore under section 234C. However, it was found that while passing order (February 2017) under section 154, the system erroneously levied interest of ₹ 1.07 crore instead of correct amount of ₹ 4.01 crore. This showed that the system was deficient in computing interest under section 234C. The omission by the AO to verify the correctness of the interest depicted in ITNS-150 resulted in short levy of interest of ₹ 2.94 crore. *The Ministry has accepted the audit objection (January 2019). The mistake in computation of interest has been rectified (December 2017) under section 154 of the Act.*

3.2.5 Excess or irregular refunds/interest on refunds

We give below one such illustrative case:

Section 244A(1)(a) of the Income Tax Act, 1961, provides for levy of interest on the amount of refund where refund arises due to excess payment of tax, at a specified rate from the first day of the assessment year to the date of grant of refund.

3.2.5.1 In Maharashtra, Pr.CIT-1 Mumbai charge, the AO completed the scrutiny assessment of a company for the AY 2007-08 in December 2010 assessing total income at ₹ 52.88 crore against which the assessee went in appeal. The appeal order was passed in September 2016 which was given effect to vide order issued by the department under section 250 in November 2016 revising the income at ₹ 32.28 crore. Audit scrutiny of ITNS-150 revealed that interest on refund under section 244A was worked out manually and not through the AST, and was incorrectly allowed as ₹ 9.38 crore instead of ₹ 7.79 crore. Audit could not ascertain the reasons for computing the tax on income and interest manually instead of through AST resulting in excess allowance of interest. The omission by the AO to verify the correctness of the interest depicted in ITNS-150 resulted in excess allowance of interest of ₹ 1.59 crore on refund. *ITD rectified the mistake (November 2017) under section 154 of the Act.*

3.2.6 Mistakes in assessment while giving effect to appellate orders

We give below two such illustrative cases:

3.2.6.1 In Maharashtra, Pr.CIT-2, Mumbai charge, AO completed the scrutiny assessment of a banking company for the AY 2004-05 in December 2005

assessing income of ₹ 1,827.19 crore disallowing inter alia assessee's claim of bad debt under section 36(1)(vii)[70] to the extent of ₹ 402.18 crore. On appeal against the assessment order, an order giving effect to CIT (Appeals)'s order was passed in February 2011 allowing the assessee partial relief of ₹ 134.68 crore under section 36(1)(vii) revising assessed income at ₹ 1,496.87 crore. Aggrieved by the above order, the assessee appealed to ITAT which remitted (June 2013) the matter back to the AO for fresh adjudication. The assessable income was further revised (March 2015) to ₹ 1,454.79 crore after giving relief of disallowance under section 14A[71]. Subsequently, the above order of March 2015 was rectified under section 154 on the grounds that deduction allowed earlier to the assessee under section 36(1)(viia)[72] had to be withdrawn proportionately. The income was reassessed at this stage at ₹ 1,457.95 crore. As ordered by ITAT in June 2013, the AO freshly adjudicated (March 2017) the matter and rejected the scrutiny assessment of December 2005 in negating the entire disallowance of ₹ 402.18 crore and by allowing the same under section 36(1)(vii). The income was recomputed at ₹ 1,085.92 crore under section 250[73] of the Act. Audit examination revealed that in the computation of income for order under section 250 of the Act, AO had taken ₹ 1,457.94 crore as the starting point, which was inclusive of partial relief of ₹ 134.68 crore allowed vide CIT(Appeals)'s order of February 2011. Thus, while allowing deduction of ₹ 402.18 crore, the AO had allowed excess deduction of ₹ 134.68 crore. This resulted in under assessment of income of ₹ 134.68 crore involving short levy of tax of ₹ 48.32 crore. *Reply of the Ministry was awaited (March 2019).*

Section 254 of the Income Tax Act, 1961, provides, that the Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit. Further, para 24.1 of Chapter 18 of Manual of Office Procedure (Volume II, Technical) of the Income Tax Department provides that on receipt of the Appellate Order in the Assessing Officer's office, immediate steps should be taken to revise the assessment in the light of the order.

3.2.6.2 In West Bengal, Pr. CIT-2, Kolkata charge, the assessment of an insurance company for the AY 2006-07 was completed after scrutiny in November 2008 determining loss of ₹ 108.20 crore. The assessment was revised for giving effect to the order of CIT(Appeals) in April 2012 at net loss of ₹ 666.21 crore and the same was further revised under section 254 read

[70] As per Section 36(1)(vii) of the Income Tax Act, 1961, amount of any bad debts or part thereof is allowable as deduction subject to fulfilment of conditions specified in the Act.

[71] As per Section 14A of the Income Tax Act, 1961, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income.

[72] As per Section 36(1)(viia) of the Income Tax Act, 1961, provision for bad and doubtful debts made by a scheduled or non-scheduled Indian Bank ia allowable as deduction within limits specified in the Act.

[73] Section 250 of the Income Tax Act, 1961, provides for the procedure to be followed for the hearing and disposal of the appeal preferred before the Commissioner of Income Tax (Appeals).

with sections 251[74] and 143(3) in April 2016 at net loss of ₹ 672.64 crore. Audit examination revealed that the AO, while giving effect to appellate order in April 2016, erroneously allowed a relief of ₹ 6.43 crore under section 14A. However, the ITAT only upheld the CIT (Appeal)'s order in which it was directed to reduce disallowance under section 14A from ₹ 30.28 crore to ₹ 6.43 crore and the effect of that was already given vide order passed under section 251 read with section 143(3) in April 2012. The mistake had resulted in over assessment of loss by ₹ 6.43 crore involving potential tax effect of ₹ 2.17 crore. *The Ministry has accepted the audit objection (September 2018) and stated that remedial action had been taken (July 2017) under section 154 read with sections 254/251/143(3) of the Act.*

3.3 Administration of tax concessions/exemptions/deductions

3.3.1 The Act allows concessions/exemptions/deductions to the assessee in computing total income under Chapter VI-A and for certain categories of expenditure under its relevant provisions. We observed that the Assessing Officers have irregularly extended benefits of tax concessions/exemptions/ deductions to beneficiaries who were not entitled for the same. These irregularities point out weaknesses in the administration of tax concessions/ deductions/exemptions on the part of ITD which need to be addressed. Table 3.2 shows the details of sub-categories which have impacted the Administration of tax concessions/exemptions/deductions.

Table 3.2: Sub-categories of mistakes under Administration of tax concessions/exemptions/deductions **(₹ in crore)**

Sub-categories		Nos.	TE	States
a.	Irregularities in allowing depreciation/ business losses/ capital losses	66	1,796.86	Andhra Pradesh & Telangana, Assam, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Odisha, Rajasthan, Tamil Nadu, UT Chandigarh, Uttar Pradesh, West Bengal.
b.	Irregular exemptions/ Deductions/ Rebates/ Relief/ MAT Credit	27	477.25	Andhra Pradesh & Telangana, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Punjab, Rajasthan, Tamil Nadu, UT Chandigarh, West Bengal.
c.	Incorrect allowance of business expenditure	48	875.47	Andhra Pradesh & Telangana, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu, West Bengal.
Total		**141**	**3,149.58**	

[74] Section 251 of the Income Tax Act specifies the powers of the Commissioner of Income Tax (Appeals) in disposing of an appeal.

3.3.2 Irregularities in allowing depreciation and set off and carry forward of business/capital losses

We give below four such illustrative cases:

Section 72 of the Income Tax Act, 1961, provides that, where the net result of the computation under the head 'Profits and gains of the business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any head of a relevant year, so much loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the 'Profits and gains of the business or profession'.

3.3.2.1 In Maharashtra, Pr.CIT-3, Mumbai charge, the scrutiny assessment of a insurance company for the AY 2014-15 was completed in December 2016 determining taxable income at ₹ 1,124.80 crore after set off of brought forward loss of ₹ 834.95 crore and book profit of ₹ 1,999.70 crore under the special provisions of the Act. The scrutiny assessment was rectified under section 154 in January 2017 determining the final loss to be carried forward after adjusting the income of AY 2014-15 at ₹ 1,333.84 crore. However, examination of the records for the A.Ys. 2012-13 and 2013-14 revealed that after adjusting the available carried forward loss of ₹ 834.95 crore in determining the aforesaid taxable income for AY 2014-15 at ₹ 1,124.80 crore, no loss was available for being carried forward. This mistake had resulted in excess carry forward of loss of ₹ 1,333.84 crore involving potential tax effect of ₹ 453.37 crore. Further, this had also resulted in excess carry forward of MAT credit of ₹ 382.32 crore under section 115JAA of the Act. *The Ministry has accepted the audit objection (September 2018) and stated that remedial action had been taken (July 2017) under section 154 of the Act.*

3.3.2.2 In CIT (Central)-1 Delhi charge, the assessment of a company for the AY 2012-13 was completed in November 2016 under section 143(3) read with section 144C(5)[75] of the Act determining an income of ₹ 324.72 crore and a tax of ₹ 105.35 crore thereon, after allowing set off of unabsorbed depreciation of ₹ 471.71 crore. Audit examination revealed that in the preceding AY i.e. AY 2011-12, assessment was completed (July 2016) under section 143(3) read with section 144C(5) at an income of ₹ 231.96 crore after setting off brought forward unabsorbed depreciation of ₹ 415.88 crore. As such, no brought forward loss relating to AY 2011-12 was available for set off in the AY 2012-13. This omission had resulted in under assessment of income by ₹ 471.71 crore, involving short levy of tax of ₹ 238.75 crore, including interest. *The Ministry has accepted the audit objection (September 2018) and stated that remedial action had been taken under section 154 of the Act in October 2017.*

[75] As per section 144C(5) of the Income Tax Act, 1961, the Dispute Resolution Panel shall, in a case where any objection is received from the assessee under sub-section (2) of this section, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

3.3.2.3 In Gujarat, Pr. CIT-2, Ahmedabad Charge, the scrutiny assessment of a company for the AY 2014-15 was completed in December 2016 determining an income of ₹ 32.26 crore. Audit examination revealed that the assessee had claimed and was allowed set-off of unabsorbed depreciation of ₹ 252.14 crore. As per the assessment orders for AYs 2011-12, 2012-13 and 2013-14 the allowable unabsorbed depreciation available for set-off in AY 2014-15 was ₹ 28.98 crore only as against the claim of ₹ 252.14 crore allowed as set-off. This had resulted in excess allowance of set-off of unabsorbed depreciation of ₹ 223.17 crore and under assessment of income by like amount involving short levy of tax of ₹ 100.89 crore including interest. *Reply of the Ministry was awaited (March 2019).*

3.3.2.4 In Karnataka, Pr. CIT-Mangalore charge, the scrutiny assessment of a banking company for the AY 2011-12, was completed in February 2013 determining income of ₹ 1,349.89 crore. Audit examination of the assessment records, revealed that loss of ₹ 1,025.45 crore[76] was allowed to be set off as against the actual available loss of ₹ 831.72 crore[77] resulting in excess set off of loss to the extent of ₹ 193.73 crore with a consequent tax effect of ₹ 72.28 crore. *The Ministry has accepted the audit observation (July 2018) and stated that remedial action has been taken (March 2017) by passing rectification order under section 154 of the Act.*

3.3.3. Irregular exemptions/deductions/rebate/relief/MAT credit

We give below two such illustrative cases:

Section 115JAA of the Income Tax Act allows carry forward of MAT credit to an assessee when tax payable under normal provisions is more than tax under special provisions. However, such credit shall be limited to the difference of tax under normal provisions of the Act and tax under special provisions of the Act.

3.3.3.1 In Tamil Nadu, under PCIT-1 Chennai charge, the assessment of a company for the AY 2011-12 was completed under section 143(3) of the Act in March 2015 on a total income of ₹ 606.35 crore which was subsequently revised under section 154 in August 2016 at a total income of ₹ 573.25 crore. Audit examination revealed that in the revision order the AO allowed MAT credit of ₹ 38.67 crore although no MAT credit was available for set off in the AY 2011-12. This had resulted in excess allowance of MAT credit of ₹ 38.67 crore with consequential short levy of tax demand of ₹ 38.67 crore. *The Ministry has accepted the audit observation (February 2019) and stated that remedial action has been taken (December 2018) under section 143 r.w.s. 147 of the Act.*

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[76] AY 2008-09: ₹ 341.77 crore, AY 2009-10: ₹ 158.22 crore, AY 2010-11: ₹ 237.75 crore & AY 2011-12: ₹ 287.71 crore

[77] AY 2005-06: ₹ 552.21 crore, AY 2007-08: ₹ 279.51 crore

3.3.3.2 In Delhi, Pr.CIT-1 charge, the assessment of a company for the AY 2013-14 was completed under section 143(3) of the Act in January 2017 determining an income of ₹ 199.30 crore and a tax of ₹ 79.03 crore thereon. The assessee was allowed a tax credit of ₹ 21.38 crore under section 115JAA, out of which ₹ 3.59 crore pertained to AY 2010-11 and ₹ 17.79 crore to AY 2011-12. Audit examination revealed that the assessments for the AYs 2010-11 and 2011-12 were completed in April 2014 and April 2015 determining assessed income of ₹ 86.86 crore and ₹ 63.57 crore respectively under normal provisions of the Act. As such, there was no tax credit relating to AYs 2010-11 and 2011-12 available for set-off in AY 2013-14 under section 115JAA. This mistake had resulted in short levy of tax of ₹ 31.22 crore including interest. *The Ministry has accepted the audit observation (October 2018) and stated that the mistake has been rectified (July 2017) by way of passing an order under section 154 of the Act.*

3.3.4 Incorrect allowance of business expenditure

We give below five such illustrative cases:

Under sub section (1) of section 145 of the Income Tax Act, 1961, the income chargeable under the head 'Profits and Gains of Business or Profession' or 'Income from Other Sources' shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. It has judicially been held[78] *that the previous year adjustments could not be made in the current year under mercantile system of accounting.*

3.3.4.1 In Tamil Nadu, PCIT-3 Chennai charge, the scrutiny assessment of a company for the AY 2012-13 was completed in March 2015 on a total loss of ₹ 13,479.90 crore. Audit examination revealed that the assessee debited net prior period credits/charges of ₹ 576.81 crore in the profit and loss account of the relevant financial year. Since net prior period credits/charges were not related to current assessment year, the claim of ₹ 576.81 crore should have been disallowed. The omission had resulted in under assessment of income of ₹ 576.81 crore with consequential potential tax effect of ₹ 187.14 crore. *The Ministry has accepted the audit observation (February 2019) and stated that remedial action has been taken under section 143(3) read with section 263 of the Act in December 2017.*

Section 35ABB of the Income Tax Act, 1961, provides that deduction shall be allowed for each of the relevant previous years, in respect of any capital expenditure incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a license. The amount of deduction shall be equal to the appropriate fraction of the amount of such expenditure.

3.3.4.2 In Maharashtra, Pr.CIT-14 Mumbai charge, scrutiny assessments of a company for AYs 2013-14 and 2014-15 were completed at an income of

[78] *CIT Vs M/s Southern Cables and Engineering Works (289 ITR 167) (Kerala High Court)*

₹ 2,476.63 crore and ₹ 2,597.93 crore respectively. The assessee had paid onetime 3G and 2G spectrum fees for 20 years amounting to ₹ 5,768.59 crore and ₹ 2,077.92 crore respectively which was amortised in the books of accounts. However, for income tax purposes, the assessee claimed and was allowed depreciation at the rate of 25 *per cent* amounting to ₹ 1,650.74 crore and ₹ 259.74 crore on the 3G and 2G spectrum fees respectively for the period pertaining to AY 2013-14 to AY 2014-15. This was not correct since provisions of section 35ABB are applicable in case of payments made for acquiring right to operate telecommunication services which provides that such expenditure was required to be amortised. Further in AY 2011-12, in the case of same assessee, the department had disallowed depreciation on the spectrum fees and allowed amortisation under section 35ABB. The mistake in allowing depreciation instead of amortisation resulted in underassessment of income amounting to ₹1,281.69 crore with resultant short levy of tax of ₹425.53 crore. *The reply of the Ministry was awaited (March 2019).*

Section 36(1)(vii) of Income Tax Act, 1961, provides that deduction shall be allowed in respect of 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 subject to the provision that, in the case of an assessee to which section 36(1)(viia) applies (scheduled banks etc.), 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.

3.3.4.3 In Kerala, Pr.CIT Thrissur charge, the assessment of a banking company for the AY 2013-14 was completed after scrutiny in February 2016 determining income at ₹ 660.03 crore and a refund of ₹ 7.02 crore was authorised. The assessee claimed and was allowed a deduction of ₹ 234.23 crore under section 36(1)(vii) in respect of bad debts written off pertaining to non-rural branches. As per Schedule 14 of Notes attached to and forming part of Balance Sheet, actual write off debited to the provision account was ₹144.49 crore only. Of this, the bad debts pertaining to non-rural branches was ₹140.84 crore only and the remaining amount of ₹ 3.65 crore written-off pertained to rural branches for which assessee had claimed deduction under section 36(1)(viia). Thus, the amount of ₹ 140.84 crore only was eligible for deduction under section 36(1)(vii) of the Act as against ₹ 234.23 crore actually allowed. The incorrect allowance of deduction has resulted in under assessment of income of ₹ 93.39 crore[79] with a short levy of tax of ₹ 30.30 crore. *The Ministry has accepted the audit objection (July 2018) and rectified the mistake (November 2017) under section 154 of the Act.*

[79] ₹ 234.23 crore – ₹ 140.84 crore

As per section 37 of the Income Tax Act, 1961, any expenditure other than capital expenditure and of the nature described in Sections 30 to 36 laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the head 'Profits and Gains of Business or Profession'. Expenditure incurred on behalf of the subsidiary cannot be stated to have been incurred for the business of the assessee.

3.3.4.4 In Maharashtra, Pr. CIT-2 Mumbai charge, AO completed the assessment of a company for the AY 2012-13 under section 143(3) read with section 144C(3) of the Act in April 2016 determining income of ₹ 601.08 crore under normal provisions and ₹ 1,303.55 crore under special provisions. Pursuant to the scheme of amalgamation sanctioned by the Hon'ble High Court of Hyderabad and Bombay, 'X' company was amalgamated with the assessee in April 2011. Audit examination revealed that while computing taxable income under normal provisions, the AO had wrongly allowed the expenditure of ₹ 59 crore debited to the profit and loss account on account of retirement benefit plan of employees of the subsidiary of 'X' company in USA. 'X' company was amalgamated into the assessee company but not its subsidiary company. Further, the Tax Auditor report had indicated the contention of erstwhile 'X' company that the said liability was primarily incurred by it and the amounts may be recovered from its US subsidiary after receiving the approval to the said corrections. Thus, the expenditure of ₹ 59 crore was not an allowable deduction as it did not pertain to the assessee but to the non-resident subsidiary in USA. As the assessment was completed under special provisions of section 115JB, grant of deduction of inadmissible expenditure of ₹ 59 crore resulted in under-assessment of income by like amount involving excess carry forward of MAT credit of ₹ 19.14 crore*. The Ministry accepted (March 2019) the audit objection and taken the remedial action (December 2018) under section 143(3) read with section 147 of the Act.*

3.4 Income escaping assessment due to omissions

3.4.1 The Act provides that the total income of a person for any previous year shall include all incomes from whatever source derived, actually received or accrued or deemed to be received or accrued. We observed that the AOs did not assess/under assessed total income that require to be offered to tax. Table 3.3 shows the sub-categories which have resulted in Income escaping assessments.

Table 3.3: Sub-categories of mistakes under Income escaping assessments due to omissions				**(₹ in crore)**
Sub-categories		**Nos.**	**TE**	**States**
a.	Income not assessed/ under assessed under special provision	28	100.43	Andhra Pradesh & Telangana, Delhi, Gujarat, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu, West Bengal.
b.	Income not assessed/ under assessed under normal provision	5	50.80	Gujarat, Maharashtra and Odisha.
c.	Incorrect classification and computation of capital gains	4	19.13	Kerala, Maharashtra and Tamil Nadu
d.	Incorrect estimation of Arm's Length Price	11	15.29	Andhra Pradesh & Telangana, Delhi, Gujarat, Maharashtra, Tamil Nadu, West Bengal.
e.	Omission in implementing provisions of TDS/ TCS	3	127.26	Gujarat, Karnataka, West Bengal.
f.	Unexplained investment cash credit	5	46.56	Andhra Pradesh & Telangana, Gujarat, Maharashtra and Punjab
Total		**56**	**359.47**	

3.4.2 Income not assessed/under assessed under special provisions

We give below two such illustrative cases:

Section 115JB of the Income Tax Act, 1961, provides for levy of Minimum Alternate Tax (MAT) at prescribed percentage of book profit if the income tax payable on the total income computed under the normal provisions is lesser than MAT. As per explanation 1 under section 115JB, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year subject to certain additions/ deletions. The additions, inter alia include amounts of expenditure relatable to any income under section 10 to 12. Further from AY 2008-09 onward, the computation of expenses relatable to income not forming part of total income shall be computed as per Rule 8D of Income Tax Rules.

3.4.2.1 In Maharashtra, Pr.CIT-8 Mumbai charge, assessee company filed its return of income for the AY 2012-13 declaring loss of ₹ 3,046.23 crore under normal provisions and book loss of ₹ 340.02 crore under section 115 JB. The assessment under section 143(3) read with section 92CA read with section 144C(13)[80] of the Act was completed in January 2017 assessing loss at ₹ 2,098.93 crore under normal provisions. However book income/loss under section 115JB was not computed by the AO during assessment. Scrutiny revealed that the AO had disallowed an amount of ₹ 402.94 crore under

[80] As per section 144C(13) of the Income Tax Act, 1961, upon receipt of the directions issued by Dispute Resolution panel under section 144C(5) of the Act, the AO shall, in conformity with the directions, complete the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received.

section 14A as per Rule 8D while computing income under the normal provisions of the Act. This disallowance needed to be added to the returned book loss of ₹ 340.02 crore to compute the book profit under section 115JB which was not done. This resulted in non-computation of book profit of ₹ 62.92 crore[81] with resultant non-levy of tax of ₹ 19.89 crore under MAT (including interest under section 234B). *ITD accepted (May 2018) the audit objection regarding non addition of 14A disallowance for computing book profit under section 115JB and stated that the mistake will be rectified. Further progress was awaited (March 2019).*

3.4.2.2 In Gujarat, Pr. CIT-2 Baroda charge, the assessments of a company for AYs 2012-13 and 2013-14 were completed under section 143(3) of the Act determining loss of ₹ 36.12 crore and ₹ 14.24 crore in March 2015 and January 2016 respectively. Audit scrutiny revealed that the assessee has neither computed book profit under section 115JB nor furnished Form 29B[82] for the AY 2012-13 and AY 2013-14. Thus, the AO failed to invoke provisions of MAT under section 115JB. The omission resulted in non-computation of book profit of ₹ 34.99 crore and ₹ 27.11 crore involving short levy of tax of ₹ 12.42 crore (₹ 7 crore: AY 2012-13 and ₹ 5.42 crore: AY 2013-14) respectively. *ITD took remedial action under section 154 in November 2017 for both the AYs 2012-13 and 2013-14.*

3.4.3 Income not assessed/under assessed under normal provisions

We give below two such illustrative cases:

3.4.3.1 In Maharashtra, Pr. CIT (Central)-1 Mumbai charge, AO completed the assessment of a company for the AY 2009-10 in March 2016 under section 153C[83] read with section 143(3) of the Act assessing income at ₹ 1,513.83 crore. Scrutiny of computation of income revealed that the assessee had claimed and was allowed deduction of ₹ 22.22 crore on account of 'Compensation for shortfall in guaranteed performance' treating the same as capital receipt. However, in the previous assessment year i.e. AY 2008-09, AO had rejected the assessee's claim for 'compensation for shortfall in guaranteed performance' of ₹ 19.28 crore to be treated as capital receipt on the grounds that the compensation had not been awarded for any permanent impairment of the windmill or upgradation of the windmills. Omission by the AO to disallow the compensation while computing the assessable income for AY 2009-10 resulted in under assessment of

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81 (-)₹ 340.02 crore+ ₹ 402.94 crore

82 Form 29B, prescribed under Income Tax Rules, 1962; is a Report that is required to be furnished by a Chartered Accountant under section 115JB of the Income Tax Act, 1961 for computing the book profits of the company.

83 Section 153C of the Income Tax Act, 1961, provides for procedure for assessment of income of a person other than the person in whose case search has been initiated as per section 153A of the Act.

income of ₹ 22.22 crore with consequent short levy of tax of ₹ 7.55 crore*. ITD initiated (March 2018) remedial action under section 263 of the Act.*

Section 14A of the Income Tax Act, 1961, provides for disallowance of expenses incurred for earning exempt income in accordance with Rule 8D of Income Tax Rules, 1962.

3.4.3.2 In Maharashtra, Pr. CIT-14 Mumbai charge, AO completed the assessment of a company for the AY 2013-14 under section 143(3) read with section 144C(13) in December 2016 determining income at ₹ 44.20 crore, after disallowing ₹ 25.85 crore under section 14A. Audit scrutiny revealed that the tax audit report had depicted the amount of deduction inadmissible in terms of section 14A at ₹ 35.97 crore. Omission by the AO to adopt the quantum of disallowance under section 14A as per the tax audit report resulted in under-assessment of income by ₹ 10.12 crore involving short levy of tax of ₹ 3.28 crore. *ITD accepted (January 2018) the audit objection. The details of remedial action taken was awaited (March 2019).*

3.4.4 Incorrect computation/classification of capital gains

We give below one such illustrative case:

Section 48 (3rd proviso) of the Income Tax Act, 1961, provides that the benefit of indexation would not be available if the long-term capital gain arose from the transfer of long term capital asset being bond or debenture other than indexed bonds issued by the Government.

3.4.4.1 In Maharashtra, Pr. CIT-2 Mumbai charge, AO completed the scrutiny assessment of a company for the AY 2014-15 in December 2016 determining income at ₹ 4,672.95 crore. Audit examination revealed that the AO had allowed loss from capital gains of ₹ 71.87 crore, as claimed by the assessee, in determining the income of ₹ 4,672.95 crore. The said loss from capital gains of ₹ 71.87 crore included long term capital loss of ₹ 66.89 crore from transfer of bonds and debentures not issued by the government, for which benefit of indexation was not permissible as per the provisions ibid. Omission by the AO to disallow the benefit of indexation resulted in over-assessment of capital loss by ₹ 65.87 crore that was allowed to be carried forward involving potential short levy of tax of ₹ 14.93 crore. *The reply of the Ministry was awaited (March 2019).*

3.4.5 Incorrect estimation of Arm's Length Price

We give below three such illustrative cases:

The computation of Arm's Length Price[84] (ALP) in relation to an international transaction under section 92C of Income Tax Act, 1961, should be referred to the Transfer Pricing Officer (TPO), if the value of international transaction as defined under section 92B of the Act exceeds ₹ 15 crore. The TPO, after hearing the assessee and considering the evidence produced by him as required on any specified points and after taking into account all relevant materials which he has gathered, shall by order in writing determine the ALP in relation to the international transaction in accordance with provisions of section 92C(3) and send a copy of his order to the AO and to the assessee.

3.4.5.1 In Maharashtra, CIT(TP)-4 Mumbai charge, the TPO passed a transfer pricing order on a company for the AY 2013-14 under section 92CA(3) of the Act in September 2016 determining adjustment of ₹ 8.24 crore to the international transactions. The arm's length price (ALP) of "provision of engineering and ancillary services" was determined at ₹ 64.22 crore on which the actual receipt from the associated enterprise (AE) was ₹ 48.08 crore. The adjustment should have been the difference between the ALP of ₹ 64.22 crore and the amount of actual receipt of Rs.48.08 crore which worked out to ₹ 16.14 crore. However, it was seen that the amount of adjustment worked out in the transfer pricing order was ₹ 8.24 crore only resulting in short adjustment of ₹ 7.90 crore with resultant short levy of tax of ₹ 2.56 crore. *The Ministry has accepted the audit objection (September 2018) and stated that remedial action had been taken under section 154 read with section 92CA(5)[85] of the Act in March 2017.*

Section 92C(1) of the Income Tax Act, 1961, provides that the Arm's Length Price(ALP) in relation to an international transaction shall be determined by any of the methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe. The methods specified may be any of a) comparable uncontrolled price method, b) resale price method, c) cost plus method, d) profit split method, e) transactional net margin method, and f) such other method as be prescribed by the Board.

3.4.5.2 In Delhi, PCIT-1 charge, the TPO passed an order on a company for the AY 2011-12 under section 92CA(3) of the Act in January 2016 determining an adjustment of ₹ 86.37 crore, as per the direction of the Dispute Resolution Panel (DRP). Audit examination revealed that while computing the transfer pricing adjustment for Advertising Marketing and

[84] As per section 92F(ii) of the Income Tax Act, 1961, Arm's length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

[85] As per section 92CA(5) of the Income Tax Act, 1961, the TPO may amend any order passed by him under section 92CA(3) with a view to rectifying any mistake apparent from the record, and the provisions of section 154 shall, so far as may be, apply accordingly.

promotion (AMP) expenses, the routine AMP expenses was taken as ₹ 41.75 crore instead of correct amount of ₹ 40.36 crore. The transfer pricing adjustment on AMP expenses was computed as ₹ 84.20 crore instead of correct amount of ₹ 90.59 crore. The mistake resulted in short transfer pricing adjustment on account of AMP expenses by ₹ 6.39 crore involving consequential short levy of tax of ₹ 2.12 crore. *ITD rectified the mistake in August 2016 by way of passing an order under section 154 of the Act.*

3.4.5.3 In Andhra Pradesh & Telangana, Pr. CIT (IT & TP) Hyderabad charge, the TPO passed an order on a company for the AY 2014-15 under section 92CA(3) of the Act in October 2017, proposing the adjustment of ₹ 239.31 crore on IT enabled services and ₹ 99.92 lakh on 'interest on receivables'. Audit examination revealed that Operating Revenue was adopted at ₹ 1,516.72 crore instead of ₹ 1,511.05 crore, due to inclusion of other income in Operating Revenue. This has resulted in determination of adjustment at ₹ 239.31 crore instead of correct adjustment of ₹ 244.98 crore with consequential shortfall in adjustment by ₹ 5.67 crore involving short levy of tax of ₹ 1.93 crore. *The Ministry has accepted the audit objection (February 2019) and stated that the remedial action has been taken under section 92CA(5) read with section 154 of the Act in January 2018.*

3.4.6. Omission in implementation of TDS/TCS provisions

We give below one such illustrative case:

As per section 201 of the Income Tax Act, 1961, where any person, including the Principal Officer of a company who is required to deduct any sum in accordance with the provisions of this Act; does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall be deemed to be an assessee in default in respect of such tax. Section 201(1A) of the Act further provides that such assessee in default shall be liable to pay simple interest at specified rates for specified time period prescribed under the Act.

3.4.6.1 In Karnataka, CIT (International taxation) - 1(1), Bengaluru charge, the scrutiny assessment of the assessee company for AYs 2009-10 to 2012-13 was completed under section 201(1) read with section 201(1A) of the Act in December 2015 determining interest at ₹ 304.43 crore under section 201(1A). Audit examination revealed that survey in respect of the assessee was carried out under section 133A of the Act by the TDS wing. During the course of survey, it was found that the assessee company had deducted TDS under section 195 of the Act amounting to ₹ 375.37 crore[86] for the payment made to non-residents but not remitted to Government account. It was further revealed that the AO had levied interest under section 201(1A) at ₹ 304.43 crore (at the rate of one *per cent* for the period between

[86] ₹ 121.78 crore (2009-10), ₹ 191.29 crore (2010-11), ₹ 37.25 crore (2011-12), ₹ 25.05 crore (2012-13)

AY 2009-10 to 2012-13) instead of leviable amount of ₹ 427.05 crore (at the rate of 1 *per cent* upto 30 June 2010 and 1.5 *per cent* w.e.f. 01.07.2010), resulting in short levy of interest under section 201(1A) to the extent of ₹ 122.62 crore. *The Ministry has accepted (August 2018) the audit objection and stated that remedial action has been taken by passing an order under section 154 of the Act in November 2017.*

3.4.7 Unexplained Investment/cash credit

We give below one such illustrative case:

Section 68 of the Income Tax Act, 1961, provides that if assessee offers no explanation about the nature and source of any sum credited in the books of the assessee, the sum so credited may be charged to income tax as income of the assessee.

3.4.7.1 In Andhra Pradesh & Telangana, Pr. CIT-4 Hyderabad charge, the assessment of a company for the AY 2014-15 was completed under section 144 read with section 143(3) of the Act in March, 2017 determining the total income at ₹ 92.84 crore after estimating the income at 1 *per cent* of gross receipts and adding certain amounts of disallowances for which no explanation was offered by the assessee. Audit examination revealed that Assessing Officer proposed certain disallowances which, inter alia, included an amount of ₹ 49.16 crore pertaining to 'Other loans and advances'. The assessee failed to provide any explanation/any evidence in support of any of the amounts pertaining to the proposed additions. However, the Assessing Officer, while making additions in respect of the other amounts treating them as 'unexplained credits' under section 68, has omitted to disallow the amount of ₹ 49.16 crore pertaining to 'loans and advances'. This has resulted in short computation of income to the extent of ₹49.16 crore with a consequential short demand of ₹ 23.61 crore including interest under section 234B. *ITD stated in its reply (January, 2018 and April, 2018) that assessment was completed under section 144 and the AO has discretion in this matter in view of ex-parte assessment.* ITD's reply was not acceptable as the assessing officer applied his discretion only to add three items out of four proposed additions to the returned income and had left out the fourth item i.e. loans and advances untouched, though the assessee had not responded to any of the proposed additions. Further, the AO has not recorded/discussed his version in the assessment order, for the item, for which no addition was made.

3.5 Over-charge of tax/Interest

3.5.1 We noticed that AOs over assessed income in 25 cases involving over-charge of tax and interest of ₹ 235.83 crore in Andhra Pradesh & Telangana,

Delhi, Gujarat, Madhya Pradesh, Maharashtra, Odisha, Tamil Nadu, Uttar Pradesh and West Bengal. We give below five such illustrative cases:

3.5.1.1 In Maharashtra, Pr. CIT-LTU Mumbai charge, the scrutiny assessment of a banking company for the AY 2013-14 was completed in December 2016 with an assessed income of ₹ 3,567.95 crore. Audit scrutiny of the ITNS-150 form dated 29.12.2016 revealed that the department had levied surcharge at the rate of 10 *per cent* instead of correct rate of 5 *per cent* on the tax amount of ₹ 1,070.38 crore. This resulted in excess levy of surcharge by ₹ 55.12 crore. It was further seen that due to the incorrect rate of surcharge, there was levy of interest of ₹ 56.37 crore under section 234B which was otherwise not leviable since the total prepaid tax was more than 90 *per cent* of the actual demand payable. This had resulted in over assessment of tax by ₹ 111.49 crore[87]. *The Ministry has accepted (August 2018) the audit objection and stated that remedial action has been taken while passing order on giving effect to the order of CIT(Appeals) in April 2018.*

3.5.1.2 In Gujarat, Pr. CIT-Valsad Charge, the assessment of a company for the AY 2012-13 was completed in March 2016 under Section 144 of the Act determining total income of ₹ 58.45 crore inclusive of income from other sources of ₹ 4.54 crore after adjusting brought forward loss of ₹ 68.17 crore. Audit scrutiny revealed the AO has made additions of ₹ 96.39 crore on different grounds. However, while calculating tax, the AO had worked out assessed income as ₹ 58.45 crore instead of ₹ 32.76 crore resulting in over assessment of income of ₹ 25.69 crore with consequent over charge of tax of ₹ 7.94 crore. *ITD accepted the audit objection and took remedial action under Section 154 of the Act in July 2017.*

3.5.1.3 In Madhya Pradesh, Pr. CIT-I Bhopal charge, the assessment of a company for the AY 2014-15 was completed after scrutiny in December 2016 at the loss of ₹ 2.00 crore. Audit examination of Income Tax Computation Form (ITNS-150) revealed that interest for default in payment of advance tax was manually entered by AO in AST system at ₹ 33.83 crore despite the fact that assessee was assessed at loss and hence no tax and interest was to be levied. As such, it amounted to override of the system resulting in excess levy of interest of ₹33.83 crore and thereby withholding of refund due to the assessee. *ITD stated in its reply that (January 2018) the mistake in computation of interest occurred due to clerical mistake and excessive work pressure and necessary remedial action would be taken. Further reply was awaited (March 2019).*

[87] ₹ 55.12 crore + ₹ 56.37 crore

3.5.1.4 In Madhya Pradesh, Pr. CIT-I Bhopal charge, the assessment of a company for the AY 2014-15 was completed after scrutiny in December 2016 at ₹ 11.44 crore under normal provisions and at ₹ 47.63 crore under special provision of section 115JB of the Act. Audit examination of ITNS-150 revealed that interest for default in payment of advance tax was manually entered by AO in AST system at ₹ 22.11 crore despite the fact that there was no default on the part of assessee with respect to payment of advance tax. As such, it amounted to override of the system resulting in excess levy of interest of ₹ 22.11 crore and thereby withholding of refund due to the assessee. *The Ministry has accepted the audit objection (January 2019). The mistake in computation of interest has been rectified under section 154 of the Act in November 2018.*

3.5.1.5 In CIT (Central)-I Delhi charge, the scrutiny assessment of a company for the AY 2014-15 was completed in December 2016 at a loss of ₹ 1.44 crore under normal provisions and minimum alternate tax of ₹ 3.96 crore under section 115JB of the Act. Audit examination of ITNS-150 revealed that interest for default in payment of advance tax under section 234B was incorrectly computed by AST system at ₹ 1.70 crore despite the fact that total of TDS credit allowed to the assessee (₹ 72.08 lakh), relief allowed under section 90 of the Act (₹ 1.97 crore) and advance tax paid (₹ 3.00 crore) was more than the assessed tax of ₹ 3.96 crore. The AO had manually entered the interest amount of ₹ 1.70 crore under section 234B using 'modify' feature available for interest amount in AST system. This had resulted in overcharge of interest of ₹ 1.70 crore under section 234B. *The Ministry has accepted the audit objection (January 2019) and rectified (November 2017) the mistake under section 154 of the Act.*

Chapter IV: Income Tax

4.1 Introduction

4.1.1 This chapter discusses the result of audit of assessments related to income tax audited during 2017-18. A total of 4,36,89,274 income tax returns[88] were filed by non-corporate assessees during the FY 2016-17. ITD completed a total of 2,61,535 non-corporate scrutiny assessments in FY 2016-17 or in earlier years in those units which were audited during audit plan of 2017-18. Out of the 2,61,535 non-corporate scrutiny assessments, we checked 2,13,838 non-corporate scrutiny cases and found mistakes in 12,128 assessments. The incidence of errors in non-corporate scrutiny assessments checked in audit during 2017-18 was 5.67 *per cent*. The nature of the errors points to manual override of the AST. The department needs to investigate such errors and take action as per law against the officials concerned.

4.1.2 A total of 132 high value income tax cases were referred to the Ministry during April 2018 to October 2018. Of these, 123 cases involve undercharge of ₹ 320.94 crore and nine cases involving overcharge of ₹ 10.12 crore. These cases of incorrect assessment point towards weaknesses in the internal controls in the assessment processes of the ITD. Such errors have been continually pointed out in earlier audit reports as well. ITD may ascertain whether the instances of irregularities noticed are errors of omission or commission while ensuring necessary action as per law in cases involving errors of commission.

4.1.3 The categories of mistakes have been broadly classified as follows:

- Quality of assessments
- Administration of tax concessions/exemptions/deductions
- Income escaping assessments due to omissions
- Others-Overcharge of tax/interest etc.

The deficiency noticed in the Assessment Information System (AST) module/ Income Tax Business Applications (ITBA) with respect to computation of interest under sections 234A, 234B, 234C and 244A of the Income Tax Act, 1961 has been brought out in Para 4.2.4 of this Chapter. Table 2.10 (para 2.4.4) of this report shows the details of broad categories of mistakes in assessments and their tax effect. ITD needs to inquire into the reasons for errors in computation of interest through AST and reasons for allowing manual modification to co-exist with IT system particularly without approval

[88] Source: Pr. Directorate General of Income Tax (Admn. & Tax Payers Services), Research & Statistics Wing

of higher authority. The deficiency in the AST needs to be eliminated to ensure accuracy of tax demand generated through system.

4.1.4 The Ministry has conveyed its acceptance in 71 cases involving tax effect (TE) of ₹ 142.59 crore. The Ministry has not accepted one case involving tax effect of ₹ 1.0 crore. In the remaining 60 cases, the ITD has accepted nine cases involving tax effect of ₹ 56.95 crore while not accepting one case involving tax effect of ₹ 0.30 crore (referred to in para 2.4.4 of this report). Out of 132 cases, ITD has completed remedial action in 102 cases involving tax effect of ₹ 213.56 crore and initiated remedial action in 14 cases involving tax effect of ₹ 51.48 crore.

4.2 Quality of assessments

4.2.1 AOs committed errors in the assessments despite clear provisions in the Act. These cases of incorrect assessments point to continuing weaknesses in the internal controls on the part of ITD which need to be addressed on priority. Assessing Officers (AOs) committed errors in the assessments ignoring clear provisions in the Act. The cases of incorrect assessments involving arithmetical errors in computation of income and tax are difficult to accept as mere errors, in the days of calculators and computers. Further, application of incorrect rates of tax and surcharge, mistakes in levy of interest, excess or irregular refunds etc. point to either incompetence, or mischief, as well as weaknesses in the internal controls in ITD which need to be addressed. ITD may ascertain whether the instances of irregularities noticed are errors of omission or commission while ensuring necessary action as per law in cases involving errors of commission.

Table 4.1 shows the sub-categories of mistakes which impacted the quality of assessments.

Table 4.1: Details of errors in quality of assessment **(₹ in crore)**

Sub-categories	Cases	TE	States
a. Arithmetical errors in computation of income and tax	14	52.03	Delhi, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Odisha and Uttar Pradesh
b. Incorrect application of rates of tax, surcharge etc.	24	163.66	Andhra Pradesh, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Odisha, Punjab, Tamil Nadu and Uttar Pradesh
c. Mistakes in levy of interest	47	60.84	Andhra Pradesh, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Punjab, Tamil Nadu, UT Chandigarh, Uttar Pradesh and West Bengal
Total	**85**	**276.53**	

4.2.2 Arithmetical errors in computation of income and tax

We give below two such illustrative cases

The Income Tax Act, 1961 provides that Assessing Officer (AO) is required to make a correct assessment of the total income or loss of the assessee and determine correct amount of tax or refund, as the case may be.

4.2.2.1 In Maharashtra, CIT (Exemptions) Mumbai charge, AO completed the assessment of an AOP for AY 2013-14 after scrutiny in March 2016 at a loss at ₹ 255.78 crore. Audit examination revealed that, AO, in the assessment order, had made an addition of ₹ 111.39 crore on account of 'provision made for un-recovered estate rentals'. However, while computing taxable income of the assessee, had added ₹ 1.11 crore instead of ₹ 111.39 crore. The mistake had resulted in under assessment of income of ₹ 110.28 crore involving potential tax effect of ₹ 34.08 crore. *ITD rectified the mistake (March 2018) under section 154 of the Act.*

4.2.2.2 In Himachal Pradesh, Pr. CIT Shimla Charge, AO completed the assessment of an assessee for AY 2010-11 under the provision of section 143(3) read with section 148 of the Act in February 2015 at income of ₹ 2.15 crore. Audit examination revealed that, while computing the assessed income, AO adopted the figure of 'excess of income over expenditure' at ₹ 1.29 crore instead of correct amount of ₹ 1.92 crore. The mistake had resulted in under assessment of income of ₹ 63 lakh involving tax effect of ₹ 30.95 lakh including interest. *The Ministry accepted the audit observation (January 2019) and rectified the mistake (December 2017) under section 154 of the Act.*

4.2.3 Application of incorrect rates of tax and surcharge

We give below four such illustrative cases:

Section 4(1) of the Income Tax Act, 1961 provides that income tax is chargeable for every assessment year in respect of the total income of the previous year of an assessee, according to the rates prescribed under the relevant Finance Act. The Finance Act relevant to assessment year 2008-09 provides for levy of surcharge at the rate of ten per cent of income-tax in case of Association of Persons (AOP), if net income exceeds ₹ ten lakh. Similarly, the Finance Act relevant to assessment year 2014-15 provides for levy of surcharge at the rate of ten per cent of income-tax in case of Association of Persons (AOP) or local authority, if net income exceeds ₹ one crore.

4.2.3.1 In Haryana, Pr. CIT Panchkula charge, AO completed the assessment of a local authority for AY 2014-15 after scrutiny in December 2015 at an income of ₹ 1,733.09 crore. Subsequently, CIT (Appeals) assessed the income at ₹ 1,355.80 crore after giving relief of ₹ 377.29 crore in January 2017. Audit examination revealed that, while giving effect to the appellate order (February 2017), AO did not levy surcharge leviable at the rate of

10 *per cent* as per the relevant Finance Act provisions. The omission had resulted in short levy of tax of ₹ 50.87 crore including interest. *ITD rectified the mistake (December 2017) under section 154 of the Act.*

4.2.3.2 In Uttar Pradesh, Pr. CIT-Exemption Lucknow charge, AO completed the assessment of an AOP for AY 2008-09 after scrutiny in December 2010 at an income of ₹ 4.24 crore which was subsequently reassessed under section 147 of the Act in March 2016 at income of ₹ 452.36 crore. Audit examination revealed that, while computing tax demand, AO did not levy surcharge at the rate of 10 *per cent* as per the relevant Finance Act provisions. The omission had resulted in short levy of tax of ₹ 36.46 crore including interest. *The Ministry accepted the audit observation (January 2019) and rectified the mistake (October 2017) under section 154 of the Act.*

4.2.3.3 In Odisha, Pr. CIT Cuttack charge, AO completed the assessment of a local authority for AY 2014-15 after scrutiny in December 2016 determining income at ₹ 817.69 crore. Audit examination revealed that while computing tax demand, AO did not levy surcharge at the rate of 10 *per cent* as per the provision of relevant Finance Act. The omission had resulted in short levy of tax of ₹ 33.60 crore. *ITD accepted (October 2017) the mistake and stated that the remedial action under section 154 was being taken.*

4.2.3.4 In Gujarat, Pr. CIT-Exemption, Ahmedabad Charge, AO completed the assessment of an AOP for AY 2014-15 after scrutiny in December 2016 determining income of ₹ 436.16 crore. Audit examination of Income Tax Computation Form (ITNS-150), which was generated through system, revealed that though the assessed income of the assessee had exceeded rupees one crore, the system had not levied surcharge on the income tax on the assessed income. The failure of the system to compute the correct amount of tax and omission by AO to verify the correctness of the tax resulted in non-levy of surcharge of ₹ 18.19 crore including interest. *The Ministry accepted (January 2019) the audit observation and rectified the mistake (September 2017) under section 154 of the Act.*

4.2.4 Mistakes in levy of Interest

We give below five such illustrative cases:

The Income Tax Act, 1961 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 provides for levy of interest on account of default in furnishing return of income at specified rates and for specified time period. Section 234B provides for levy of interest on account of default in payment of advance tax at specified rates and for specified time period.

Further, all Income Tax (IT) returns are first summarily processed under section 143(1) at Centralized Processing Centre (CPC), Bengaluru before scrutiny assessments, thus all data

pertaining to summary assessments are directly captured in Assessment Information System (AST). The work of processing, rectification, completion of assessment order in respect of scrutiny cases is done by AOs in AST module, part of ITD module, for all returns transferred from CPC. AST undertakes various assessment functions such as calculation of tax, calculation of interest under various sections of Income Tax Act, 1961, time barring checks, deductions limit validations, due date checks, etc. The payments made by assessee in respect of TDS/TCS and Advance Tax etc. are auto populated from 26AS application and OLTAS application, respectively. In the case of scrutiny assessment, rectification, appeal effect orders in the field offices, figures are data-fed to the system by AOs based on the orders. With the new figures entered into different Heads of Income under additions, computation sheet for final demand is generated. If any increase in the value of above heads is to be done by the AO, the permission is needed from next higher authority through the system. However, no permission is required by AO to decrease the value under above heads in AST. AST module allows the AOs to modify the value of interest under section 234A/B/C/D and 244A under the head 'Modified'. These values can be changed (increased/ decreased) without approval of any higher authority. In cases of assessment done under Best Judgment under section 144, data are manually fed under various heads if assessee is non-filer and accordingly, computation is done. If assessee is late-filer, has filed IT return after section 148 notice, then interest under section 234A/B/C has to be calculated based on original due date for concerned Assessment year.

4.2.4.1 In Odisha, Pr. CIT Cuttack charge, AO completed the assessment of a firm for AY 2008-09 in March 2016 under the provision of section 144 read with section 147 of the Act determining income of ₹ 38.14 crore. Audit examination revealed that the assessee firm neither filed its return of income under section 139(1) of the Act nor filed the same in response to notice under section 148 of the Act. Thus, the assessee was liable to pay interest under section 234A for 90 months from October 2008[89] to March 2016. However, while computing tax liability, AO levied interest for 12 months instead of 90 months, resulting in under charge of interest of ₹ 10.11 crore. Audit further noticed that the amount of interest was calculated manually and the same was fed into the system (AST). Thus, the manual modification of interest through AST had resulted in incorrect levy of interest. It is not clear why manual modification is permitted, that too apparently without a protocol for seeking senior level clearances if, in exceptional cases, manual intervention is required. In fact, if manual intervention at every level is needed, or continued, it either points to an ill designed IT System, or a deliberate attempt to retain discretion, for no apparent good reason. This also points to the fact that the system was deficient in computing the period of delay. *ITD stated (October 2017) that rectification of mistake in computation of interest was being initiated under section 154 of the Act.*

[89] due date of filing of Return of Income for AY 2008-09 was 30th September 2008

4.2.4.2 In West Bengal, Pr. CIT-15 Kolkata charge, AO completed the assessment of an individual for AY 2009-10 in best judgement manner[90] in December 2016 at income of ₹ 20.12 crore. Audit noticed that the assessee had not filed its return of income for AY 2009-10 and had not also responded to the notice issued under section 148 or 142(1) of the Act. Audit further noticed that while computing tax demand, the system did not compute interest under section 234A for non filing of return of income as the period of delay was not entered by the AO. This showed that the system was deficient in computing interest under section 234A. The omission by AO to enter the period of delay resulted in non-levy of interest of ₹ 6.08 crore. ITD should investigate why the error was committed by the AO and take suitable action as per law. *The Ministry accepted the audit observation (December 2018). The mistake in computation of interest has been rectified under section 154 of the Act (December 2017).* As we have seen only the assessment cases in respect of units planned and audited during audit plan of 2017-18, the Ministry needs to verify all cases of interest levy and not only in the cases pertaining to units covered in audit.

4.2.4.3 In Delhi, PCIT-17 Charge, AO completed the assessment of a firm for AY 2009-10 under section 144 in December 2016 determining an income of ₹ 11.92 crore and a tax of ₹ 4.05 crore thereon. The assessee had neither filed its return of income for AY 2009-10 nor furnished the return in response to notice issued under section 148, till the date of assessment, as such, interest under section 234A was required to be levied for 87 months on the assessed tax of ₹ 4.05 crore. Audit examination of Income Tax Computation Form (ITNS-150) revealed that though the ITNS was generated through AST, interest for default in furnishing of return was not computed by AST system indicating the fact that the system was deficient in computing the interest for default in furnishing of return. The omission by AO to verify the correctness of interest depicted in ITNS resulted in short levy of interest of ₹ 3.53 crore. *The Ministry accepted (February 2019) the audit observation and rectified the mistake (March 2018) under section 154 of the Act.*

4.2.4.4 In Andhra Pradesh & Telangana state, Pr. CIT-Central, Hyderabad charge, AO completed the assessment of an individual for AY 2009-10 in December 2016 determining income ₹ 10.19 crore. Audit examination revealed that the interest for default in payment of advance tax under section 234B was worked out manually and not through the AST, and incorrectly levied at ₹ 94.72 lakh instead of correct amount of ₹ 3.17 crore which resulted in a short demand of tax of ₹ 2.22 crore. Audit could not ascertain the reasons for computing the tax on income and interest manually instead of through AST. The omission by AO to verify the correctness of interest depicted in ITNS resulted into short levy of interest of ₹ 2.22 crore.

[90] under section 147/143(3)/144 of the Income Tax Act, 1961

The Ministry accepted (February 2019) the audit observation and rectified the mistake (October 2017) under section 154 of the Act.

4.2.4.5 In Pr. CIT-2 Chandigarh charge, AO completed the assessment of an individual for AYs 2008-09 and 2009-10 under section 144 read with section 147 in March 2016 at income of ₹ 3.55 crore and ₹ 2.16 crore respectively. Audit noticed that the assessee had not filed the return of income for both the AYs. Notices were issued to the assessee under section 148 in March 2015 requiring him to furnish the return of income for AYs 2008-09 and 2009-10. However, no replies were furnished by the assessee till the date of assessment i.e. March 2016. As the assessee had not filed its returns of income for AYs 2008-09 and 2009-10, the assessee was liable to pay interest amounting to ₹ 1.10 crore and ₹ 57.87 lakh on the tax liability of ₹ 1.20 crore and ₹ 72.34 lakh under section 234A(1) for AYs 2008-09 and 2009-10 respectively. Audit examination of ITNS-150 of AYs 2008-09 and 2009-10 revealed that computation in ITNS-150 was done manually in both AYs and not through AST and interest under section 234A(1) for non-furnishing of return of income was omitted to be charged. Audit could not ascertain the reasons for computing the tax on income and interest manually instead of through AST. This had resulted in non levy of interest of ₹ 1.68 crore under section 234(1) of the Act during AYs 2008-09 and 2009-10. *The Ministry accepted the audit observation (January 2019). The mistake in computation of interest has been rectified under section 154 of the Act (February 2017).*

4.2.4.6 While the Ministry has taken action to initiate correction in these cases, it may be pointed out that these are only a few illustrative cases. In the entire universe of all assessments, including non-scrutiny assessments, there is every likelihood of such errors, of omission or commission, in many more cases. The CBDT not only needs to revisit its assessments, but also put in place a fool proof IT system and internal control mechanism to eradicate, so-called "errors".

The IT system for direct taxes needs to be designed in such a way that it should ensure zero or minimal physical interface between the assessee and the tax officers. Government may consider the IT System for direct taxes being placed at arms length from CBDT, with an independent governmental body or organisation.

4.3 Administration of tax concessions/exemptions/deductions

4.3.1 The Act allows concessions/exemptions/deductions to the assessee in computing total income under Chapter VI-A and for certain categories of expenditure under its relevant provisions. We observed that the Assessing Officers have irregularly extended benefits of tax concessions/exemptions/ deductions to beneficiaries who were not entitled for the same. These irregularities point out weaknesses in the administration of tax concessions/

deductions/exemptions on the part of ITD which need to be addressed. ITD may ascertain whether the instances of irregularities noticed are errors of omission or commission while ensuring necessary action as per law in cases involving errors of commission. Table 4.2 shows the sub-categories which have impacted the administration of tax concessions/exemptions/ deductions.

Table 4.2: Sub-categories of mistakes under Administration of tax concessions/exemptions/deductions (₹ in crore)

	Sub-categories	Nos.	TE	States
a.	Irregular exemptions/ deductions/relief given to individuals	02	0.58	Maharashtra and Tamil Nadu
b.	Irregular exemptions/ deductions/relief given to Trusts/Firms/Societies/AOPs	06	3.66	Goa, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh
c.	Incorrect allowance of Business Expenditure	11	25.80	Assam, Bihar, Gujarat, Himachal Pradesh, Maharashtra, Odisha, Tamil Nadu, Uttrakhand and West Bengal
d.	Irregularities in allowing depreciation/business losses/ capital losses	07	9.19	Bihar, Delhi, Maharashtra, Rajasthan and West Bengal
	Total	**26**	**39.23**	

4.3.2 Irregular exemptions/deductions/relief to Individuals

We give below one such illustrative case.

Under sub-section (1) of section 54F of the Income Tax Act, 1961 subject to the provisions of sub-section (4),where, in the case of an assessee being an individual or a Hindu undivided family, the capital gain arises from the transfer of any long-term capital asset, not being a residential house (hereafter in this section referred to as the original asset), and the assessee has, within a period of one year before or two years after the date on which the transfer took place purchased, or has within a period of three years after that date constructed, a residential house, (hereafter in this section referred to as the new asset), the capital gain shall be dealt with in accordance with the following provisions of this section, - (a) if the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of such capital gain shall not be charged under section 45; (b) if the cost of the new asset is less than the net consideration in respect of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of the new asset bears to the net consideration, shall not be charged under section 45. It has also been provided that nothing contained in this sub-section shall apply where--- (a) the assessee--- (i) owns more than one residential house, other than the new asset, on the date of transfer of the original asset; or (ii) purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset; or (iii) constructs any residential house, other than the new asset, within a period of three years after the date of transfer of the original asset; and (b) the income from such residential house, other than the one residential house owned on the date of transfer of the original asset, is chargeable under the head "Income from house property"

4.3.2.1 In Tamil Nadu, Pr. CIT-7 Chennai charge, AO completed the assessment of an individual for AY 2014-15 after scrutiny in November 2016 determining income of ₹ 61.77 lakh. Audit observed that the assessee had earned Long Term Capital Gain (LTCG) of ₹ 82.46 lakh from sale of vacant lands. In addition, the assessee had offered LTCG of ₹ 20.08 lakh withdrawing exemption under sub-section (3) of section 54F, claimed earlier in assessment year 2013-14. The assessee had claimed and was allowed exemption under section 54F against total LTCG for the year amounting to ₹ 1.03 crore (₹ 82.46 lakh plus ₹ 20.08 lakh), as the assessee had proposed to construct a new house property. Audit examination revealed that the assessee was not eligible for exemption under section 54F since the assessee already had two residential house properties other than the self-occupied property. As the assessee did not fulfill the conditions prescribed for exemption under section 54F, therefore, exemption allowed under section 54F was not in order. The mistake had resulted in incorrect allowance of exemption of ₹ 1.03 crore with consequential short levy of tax of ₹ 23.24 lakh. *The Ministry accepted (February 2019) the audit observation and initiated the remedial action under section 148 (January 2019).*

4.3.3 Irregular exemptions/deductions/relief to Trusts/Firms/Societies/ AOPs

We give below one such illustrative case:

Section 10A(1A) of the Income Tax Act, 1961 provides for deduction of profits & gains derived from an undertaking from the export of article or things or computer software for a period of ten consecutive years subject to certain conditions specified therein. However, the deduction under this section is available up to AY 2011-12 only.

4.3.3.1 In Uttar Pradesh, Pr. CIT Ghaziabad charge, AO completed the assessment of a firm for AYs 2012-13 and 2013-14 after scrutiny in January 2015 and December 2015 determining income of ₹ 3.22 crore and ₹ 3.87 crore respectively. Audit examination revealed that, AO allowed deduction of ₹ 1.59 crore for AY 2012-13 and ₹ 0.22 crore for AY 2013-14 to the assessee under section 10A(1A) of the Act, whereas deduction under this section was available up to AY 2011-12. The mistake had resulted in irregular allowance of deduction of ₹ 1.81 crore involving tax effect of ₹ 74.72 lakh including interest. *ITD accepted (June 2018) the audit observation and rectified the mistake under section 154 of the Act (November 2017).*

4.3.4 Incorrect allowance of Business Expenditure

We give below two such illustrative cases.

As per provision under section 36(1)(vii) of the Income Tax Act, 1961, 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 is deductible. Provided that in the case of an assessee to which clause (viia) of section 36(1) applies, the amount of 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, clause (v) to sub-section (2) of section 36 provides that where such debt or part of debt relates to advances made by an assessee to which clause (viia) of sub-section (1) applies, 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 doubt debts account made under that clause.

4.3.4.1 In Odisha, Pr. CIT Cuttack charge, AO completed the scrutiny assessment of a co-operative bank for AY 2014-15 in December 2016 determining total income at ₹ 23.28 crore. Audit examination revealed that AO had allowed an expense of ₹ 17.03 crore towards loss on 'One Time Settlement' (OTS) which was nothing but the bad debt written off during the year. The assessee had claimed and was allowed the deduction under section 36(1)(vii) of the Act against the OTS though the same had not exceeded the credit balance of ₹ 38.43 crore in the provision for bad and doubtful debts account. Non adherence to the provisions of Act in allowing bad-debt written off resulted in under assessment of income of ₹ 17.03 crore involving tax effect of ₹ 7.89 crore including interest. *ITD accepted (February 2018) the audit observation and stated that remedial action was being taken under section 263 of the Act.*

As per section 43B (f) of Income Tax Act, 1961 any provision made for leave encashment is allowable only when it is actually paid. Further, CBDT has clarified vide Instruction number 17 of 2008 dated 26.11.2008 that section 37 of the Act envisages that an amount debited in the profit & loss account in respect of an accrued or ascertained liability only is an admissible deduction, while any provision in respect of any unascertained liability or a liability which has not accrued, do not qualify for deduction.

4.3.4.2 In Bihar, Pr. CIT I Patna charge, AO completed the assessment of a Co-operative Society for AY 2013-14 after scrutiny in February 2016 determining income at ₹ 16.35 crore. Audit examination revealed that the assessee had claimed and was allowed expenditure of ₹ 8.50 crore on account of provision made towards leave encashment in the books of accounts on ad hoc basis. As provision made on ad hoc basis was not ascertained liability, it was required to be disallowed. The omission had resulted in underassessment of income of ₹ 8.50 crore involving short levy of tax of ₹ 3.55 crore including interest. *The Ministry accepted (February 2019)*

the audit observation and initiated remedial action (March 2018) under section 263 of the Act.

4.3.5 Irregularities in allowing depreciation/business losses/capital losses

We give below one such illustrative cases:

Under section 72 of the Income Tax Act, 1961, where the net result of computation under the head 'Profits & Gains of Business or Profession' is a loss to the assessee and such loss cannot be wholly set off against income under any other head of the relevant year, so much of the loss as had not been set off shall be carried forward to the following assessment year/years, to be set off against the profits and gains of business or profession of those years.

4.3.5.1 In Maharashtra, Pr. CIT-32 Mumbai charge, AO completed the scrutiny assessment of a firm for AY 2014-15 in November 2016 at an income of ₹ 41.42 lakh after allowing set off of brought forward losses of ₹ 9.33 crore pertaining to AYs 2011-12, 2012-13 and 2013-14. Audit noticed that the assessments for AYs 2011-12, 2012-13 and 2013-14 were completed at income of ₹ 26.38 lakh, ₹ 33.41 lakh and ₹ 13.26 lakh respectively. As such, there were no brought forward losses available for set off against the income assessed for AY 2014-15. Incorrect set off of brought forward losses had resulted in under assessment of income of ₹ 9.33 crore involving short levy of tax of ₹ 4.18 crore including interest. *The reply of the Ministry was awaited (March 2019).*

4.4 Income escaping assessments due to omissions

4.4.1 The Income Tax Act, 1961 provides that the total income of a person for any previous year shall include all incomes from whatever source derived, actually received or accrued or deemed to be received or accrued. We observed that the AOs did not assess/under assess total income that was required to be offered to tax. Table 4.3 shows the sub-categories which have resulted in income escaping assessments.

Table 4.3: Sub-categories of mistakes under income escaping assessments due to omissions **(₹ in crore)**

Sub-categories	Nos.	TE	States
a. Incorrect classification and computation of capital gains	08	3.79	Haryana, Jharkhand, Karnataka, Rajasthan and Tamil Nadu
b. Incorrect computation of income	02	0.92	Assam and Gujarat
c. Income not assessed/under assessed under special provisions	01	0.22	Jammu & Kashmir
d. Unexplained Investment/ cash credit	01	0.23	Haryana
Total	**12**	**5.16**	

4.4.2 Incorrect classification and computation of Capital Gain

We give below one such illustrative case:

As per section 45(1) of the Income Tax Act, 1961, any profits or gains arising from the sale or transfer of a capital asset is chargeable to tax under the head "Capital gains". It is deemed to be the income of the previous year in which the transfer of the capital asset takes place. Capital gains arising from the transfer of immovable property are chargeable to tax in the previous year in which the effect of transfer of the title is conveyed and registered. Further, as per section 112 of the Income Tax Act, 1961, in the case of an individual or a Hindu undivided family the rate of tax on long term capital gains is 20 per cent and is subject to surcharge, education cess and secondary and higher education cess.

4.4.2.1 In Jharkhand, Pr. CIT (Central), Patna charge, AO completed the assessment of an individual for AY 2012-13 under section 153A read with section 144 of Act in March 2016 determining income of ₹ 3.55 crore. As per the assessment records, the assessee had earned long term capital gains of ₹ 3.54 crore on sale of an ancestral property (land) during 2011-12 relevant to AY 2012-13. Audit examination revealed that, while computing tax demand, AO erroneously levied tax of ₹ 54.19 lakh on long term capital gains of ₹ 3.54 crore at the rate of ten *per cent* instead of leviable amount of tax of ₹ 1.39 crore at the applicable rate of twenty *per cent*. The mistake had resulted in short levy of tax of ₹ 84.94 lakh including interest. *The Ministry accepted the audit observation (August 2018) and rectified the mistake (April 2017) under section 154 of the Act.*

4.4.3 Incorrect computation of income

We give below one such illustrative case:

Section 145(3) provides that where the Assessing Officer (AO) is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2), the AO may make an assessment in the manner provided in section 144. Further, section 144 provides that, the AO, after taking into account all relevant material which the AO has gathered, shall, after giving the assessee an opportunity of being heard, make the assessment of the total income or loss to the best of his judgement and determine the correct sum payable by him or refundable to him on the basis of such assessment.

4.4.3.1 In Gujarat, Pr. CIT-4 Ahmedabad Charge, AO completed the assessment of a firm for AY 2013-14 under section 143(3) read with section 144 in November 2015 determining income of ₹ 1.34 crore. Audit examination revealed that AO had rejected the books of account under Section 145(3) and assessed the income of assessee at ₹ 1.34 crore at the rate of eight *per cent* of gross receipts of ₹ 16.75 crore. However, AO did not consider the interest income of ₹ 1.95 crore being income from other source for taxation. Omission had resulted in under assessment of income of

₹ 1.95 crore with consequent short levy of tax of ₹ 79.58 lakh including interest. *The Ministry accepted the audit observation (January 2019) and took remedial action (September 2018) under section 147 of the Act.*

4.4.4 Income not assessed under special provisions

We give below one such illustrative case:

115JC of the Income Tax Act, 1961 provides that where the regular income tax payable for a previous year by a person, other than a company, is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of the person for such previous year and he shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

4.4.4.1 In Jammu & Kashmir, Pr. CIT Jammu charge, AO completed the assessment of an individual for AY 2014-15 after scrutiny in October 2016 at income of ₹ 1.59 lakh. Audit examination revealed that the assessee had a net profit of ₹ 1.03 crore as per Profit & Loss account. The assessee had filed revised return for AY 2014-15 on 18 March 2015 at 'nil' income after setting off brought forward business losses and unabsorbed depreciation against the net profit. As alternate minimum tax payable under special provisions was greater than regular income tax payable for the previous year, the assessee was liable to be taxed as per special provisions under section 115JC applicable to a person, other than a company. However, while completing the scrutiny assessment, AO did not compute the alternate minimum tax as per special provisions under section 115JC. The mistake had resulted in non-levy of alternate minimum tax of ₹ 21.61 lakh. *The reply of the Ministry was awaited (March 2019).*

4.4.5 Unexplained Investment/cash credit

We give below one such illustrative case:

As per section 68 of Income Tax Act, 1961, where any sum is found credited in the books of an assessee maintained for any previous year and the assessee offers no explanation about the nature and source of the same or the explanation offered by him is not satisfactory in the opinion of Assessing Officer, the sum so credited may be charged to Income tax as income of the assessee of that previous year.

4.4.5.1 In Haryana, CIT (Exemptions) Chandigarh charge, AO completed the assessment of AOP for AY 2012-13 after scrutiny in March 2015 at an income of ₹ 4.68 lakh. As per Income and expenditure Account for AY 2012-13, against the receipt of ₹ 91.35 lakh, expenditure of ₹ 67.88 lakh was incurred leaving a surplus receipt of ₹ 23.47 lakh. Audit examination revealed that the assessee had shown a liability of ₹ 55.36 lakh on account of university fees payable in the balance sheet (Schedule VI) as on 31 March 2012. After making deduction of a similar provision of ₹ 0.35 lakh made during the preceding previous year, the liability of university fee worked out to

₹ 55.01 lakh for AY 2012-13. Since the expenses payable on account of university fee were not routed through profit and loss account, it was evident that receipts on account of university fee were not accounted for. Thus, the amount equal to the expenses payable at ₹ 55.01 lakh was required to be treated as unexplained cash credit. The omission had resulted in under assessment of income of ₹ 55.01 lakh involving tax effect of ₹ 23.12 lakh including interest. *ITD rectified the mistake (June 2017) under section 147 of the Act.*

4.5 Over Charge of Tax/Interest

4.5.1 We noticed over assessment of income in nine cases involving overcharge of tax/interest of ₹ 10.12 crore in Delhi, Haryana, Madhya Pradesh, Rajasthan, UT Chandigarh, Uttar Pradesh and West Bengal. We give below three such illustrative cases.

4.5.1.1 In Uttar Pradesh, Pr. CIT-Exemption Lucknow charge, AO completed the assessment of local authority for AY 2013-14 after scrutiny in March 2016 at income of ₹ 200.84 crore. Audit examination revealed that while computing tax demand, AO levied interest of ₹ 4.34 crore under section 234A despite the fact that assessee had filed its return of income within due date. The mistake had resulted in overcharge of interest under section 234A of ₹ 4.34 crore. *The Ministry accepted (February 2019) the audit observation and rectified the mistake (January 2017) under section 154 of the Act.*

4.5.1.2 In Madhya Pradesh, Pr. CIT (Central) Bhopal charge, AO completed the assessment of an individual for AY 2013-14 after giving effect to the order of Income Tax Settlement Commission under section 245D(4) of the Act in January 2017 at an income of ₹ 7.55 crore. Audit examination of Income Tax Computation Form (ITNS- 150), which was prepared manually and not generated through AST, revealed that the interest amounting to ₹ 1.34 crore for default in filing of return of income was erroneously levied, despite the fact that the assessee had filed its return of income on 29 September 2013 against the due date of filing of return of 30 September 2013. Audit could not ascertain the reasons for computing the tax on income and interest manually instead of through AST. The mistake had resulted in excess levy of interest of ₹ 1.34 crore under section 234A of the Act. *ITD rectified the mistake in computation of interest under section 154 of the Act (June 2017).*

4.5.1.3 In Rajasthan, Pr. CIT Alwar Charge, AO completed the assessment of an individual for AY 2010-11 under section 147 read with section 144 in November 2016 at income of ₹ 8.64 crore. Audit noticed that AO had made addition of ₹ 6.96 crore to the income of the assessee on account of cash deposited by assessee in bank. However, while computing total income of

the assessee, AO erroneously adopted the figure at ₹ 8.62 crore instead of correct amount of ₹ 6.96 crore. The mistake had resulted in over assessment of income of ₹ 1.66 crore involving tax effect of ₹ 1.31 crore including interest. *ITD accepted the audit observation and rectified the mistake (October 2017) under section 154 of the Act.*

4.6 Conclusion

(i) Assessing Officers (AOs) committed errors in the assessments ignoring clear provisions in the Act. The cases of incorrect assessments involving arithmetical errors in computation of income and tax are difficult to accept as mere errors, in the days of calculators and computers. Further, application of incorrect rates of tax and surcharge, errors in levy of interest, excess or irregular refunds etc. point to either incompetence, or mischief, as well as weaknesses in the internal controls in ITD which need to be addressed. The existing scrutiny assessment procedure is opaque.

(ii) AST module allows manual modification of interest amount which resulted in mistakes in computation of interest. ITD needs to inquire into the reasons for errors in computation of interest through AST and reasons for allowing manual modification to co-exist with IT system. ITD may ascertain whether the instances of irregularities noticed are errors of commission and take necessary action as per law in such cases.

(iii) In view of repetitive nature of the errors, ITD should take remedial steps to prevent recurrence.

Chapter V: Assessments relating to Agricultural income

5.1 Introduction

Article 366(1) of the Constitution provides that the expression 'agricultural income' in the Constitution means agricultural income as defined for the purpose of enactments relating to Indian Income Tax. As per section 2(1A) of the Income Tax Act, 1961 (the Act) 'agricultural income' means (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes; (b) Any income derived from such land by agricultural operations including processing of agricultural produce so as to render it fit for market or sale of such produce; (c) Any income attributable to a farm house subject to fulfillment of conditions specified in the Act; and (d) Any income derived from saplings or seedlings grown in a nursery. As per section 10(1) of the Income Tax Act, 1961, agricultural income is exempted from tax. Taxes on agricultural income falls under Entry 46 in "State List" under the Constitution of India. Thus, only the State Governments are competent to enact legislations for taxation of agricultural income. The Central Government cannot levy income tax on agricultural income. However, agricultural income is considered for rate purposes while determining the income tax liability viz. the rate[91] of tax applicable to other taxable income of Individuals, Hindu Undivided Families (HUF), Association of Persons (AOP), Bodies of individuals (BOI) and artificial juridical persons. Exemption under the Income Tax law may be claimed as agricultural income, income from sale of agriculture land, income earned as compensation received from government for acquiring the agriculture land etc.

5.2 Legal framework

Section 2(1A) of the Act defines agricultural income. Sections 2(2) and 2(13) and Part IV of the First Schedule to the Finance Act deal with computation of net agricultural income for the purposes of determining the rate of Income Tax applicable to certain non-corporate assessees. Section 10(1) provides for the exemption of agricultural income in the computation of the total income of any person. Rules 7, 7A, 7B and 8 of Income Tax Rules, 1962 deal with Income which is partly agricultural and partly from business.

[91] provided net agricultural income exceeds ₹ 5,000 for previous year, and total income, excluding net agricultural income, exceeds the basic exemption limit {*post amendment by Finance (No. 2) Act, 2014}.*

5.3 Why we chose this topic

5.3.1 The third Tax Administration Reform Commission Report (2014) noted that agricultural income of non-agriculturists is being increasingly used as a conduit to avoid tax and for laundering funds, resulting in leakage to the tune of crore in revenue annually. Report on white paper on black money (2012) issued by Ministry of Finance cited that Agriculture contributes around 14 *per cent* of the country's GDP.

5.3.2 As agricultural income is exempt under the provisions of the Income Tax Act, giving credit to agricultural income for income tax purposes without adequate verification of claim may involve risk of allowance of exemption on ineligible incomes resulting in loss of revenue to the Government. To ensure allowance of exemption on eligible incomes only, it is imperative for the ITD to institute a robust mechanism for verification of claims for exemption on account of agricultural income.

5.4 Audit objective

The objective of the Audit was to ascertain that the Department, through its AOs, satisfied itself concerning the *genuineness* and correctness of the exemptions claimed in respect of agricultural income in cases selected for scrutiny assessments.

5.5 Audit coverage

The audit covered scrutiny assessments of a sample of the assessees who had claimed exemption on agricultural income, completed during the FY 2014-15 to FY 2016-17. Coverage in audit was limited to exemptions claimed under section 10(1) read with definition of agricultural income in section 2(1A) of the Act.

5.6 Sample size

ITD furnished the AO (assessment unit) wise aggregate data on scrutiny assessments having agriculture income-claims greater than ₹ 5 Lakhs that were processed between FY 2014-15 and FY 2016-17. The distribution of 22,195 cases in respect of which aggregate data was furnished by DGIT (Systems) is as follows:

State/Region	Total number of assessments involving agricultural income claims greater than ₹ 5 lakh
Andhra Pradesh & Telangana	1,470
Bihar	145
Chhattisgarh	207
Delhi	719
Gujarat	3,196
Jharkhand	44
Karnataka	2,886
Kerala	1,418
Madhya Pradesh	683
Maharashtra	4,077
North Eastern Region	174
North Western Region[92]	2,405
Odisha	97
Rajasthan	680
Tamil Nadu	2,892
Uttar Pradesh & Uttarakhand	666
West Bengal	436
Total	**22,195**

Audit selected 136 Commissionerates with relatively high number of claimants (aggregating the number of claimants in assessment units for each commisionerate) based on DGIT(Systems)[93] data. The Director General of Income Tax (Systems), New Delhi furnished the list of assessees who had claimed exemption under section 10(1) for Agricultural income of ₹ 5 lakh and above and whose scrutiny assessments were completed during the FY 2014-15 to FY 2016-17 for selected Commissionerates. Accordingly, 7,082 cases from 835 units[94] were selected in Audit from the 136 Commissionerates.

5.7 Non-production of records

Out of the 7,082 cases requisitioned, 6,778 cases were produced to Audit. Records not furnished comprised 4.3 *per cent* of the requisitioned records. The non-production of the records was a constraint in complete coverage of the selected sample.

[92] North Western Region comprises states/union territory of Punjab, Haryana, Chandigarh, Himachal Pradesh and Jammu and Kashmir.
[93] Director General of Income Tax (Systems), New Delhi
[94] 266 Circles and 569 Wards

5.8 Study results

During audit basic information, like the returned income, assessed income, agricultural income claimed and allowed, along with the nature of assessee as per their returns were also collected, in respect of the cases reviewed. An analysis of the information collected is discussed as below.

5.8.1 Distribution of agricultural income

The distribution of agricultural income was studied on the two measures, the agricultural income claimed and agricultural income allowed. The same was studied for its distribution across the states.

The distribution of 6,778 cases checked by audit is as follows:

States	Number of cases checked
Andhra Pradesh & Telangana	506
Bihar	122
Chandigarh	129
Chhattisgarh	170
Delhi	462
Gujarat	425
Haryana	592
Himachal Pradesh	223
Jammu and Kashmir	42
Jharkhand	46
Karnataka	502
Kerala	503
Madhya Pradesh	418
Maharashtra	484
North Eastern Region	171
Odisha	102
Punjab	383
Rajasthan	200
Tamil Nadu	565
Uttar Pradesh & Uttarakhand	337
West Bengal	396
Total	**6,778**

The distribution of returned income and assessed income along with agricultural income claimed and allowed in respect of cases audited is as follows:

State	Returned income	Assessed income	Agricultural income claimed	Agricultural income allowed
				(₹ in crore)
Andhra Pradesh & Telangana	340.67	402.80	164.95	145.76
Bihar	43.71	58.36	42.91	23.84
Chandigarh	29.46	42.97	23.04	22.93
Chhattisgarh	59.47	129.25	54.73	53.39
Delhi	642.62	1139.43	548.70	205.12
Gujarat	145.14	509.65	131.14	86.13
Haryana	157.83	232.12	144.49	143.78
Himachal Pradesh	24.66	53.39	61.41	48.82
Jammu & Kashmir	4.16	10.39	9.71	9.71
Jharkhand	47.42	76.96	9.72	9.44
Karnataka	115.36	138.07	141.32	134.37
Kerala	180.04	233.12	271.91	264.32
Madhya Pradesh	198.97	443.24	232.50	220.46
Maharashtra	560.21	723.76	307.94	233.11
North Eastern Region	32.70	70.84	71.90	62.02
Odisha	34.64	59.38	24.79	17.03
Punjab	67.82	716.20	571.63	116.79
Rajasthan	106.93	185.85	43.04	38.02
Tamil Nadu	734.15	876.78	224.15	217.13
Uttar Pradesh & Uttarakhand	141.18	342.99	80.10	59.14
West Bengal	80.22	518.45	496.17	432.89
Grand Total	**3747.36**	**6,964.00**	**3,656.25**	**2544.20**

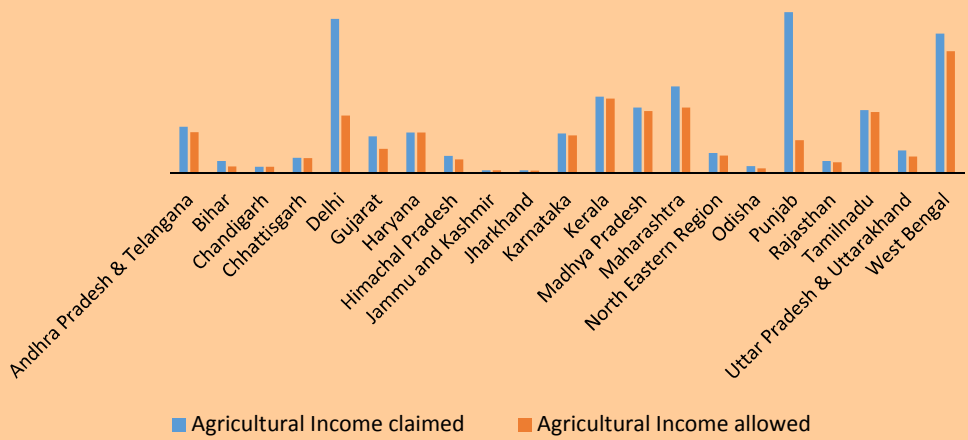
5.8.2 The PAN category-wise distribution of agricultural income claimed and allowed by the AOs in respect of cases audited is as below:

Type of Assessee	Number of Assessees	Agricultural income claimed	Agricultural income allowed
			(₹ in crore)
AOP	13	4.32	4.32
BOI	1	0.15	0.15
Company	729	2,093.82	1,161.47
Firm	160	69.18	68.24
HUF	365	111.73	99.50
Artificial Juridical Person	1	14.63	14.63
Local Authority	1	0.15	0.15
Individual	5,410	1,349.39	1,185.82
Trust	10	6.55	3.63
Non-PAN cases[95]	88	6.33	6.30
Grand Total	**6,778**	**3,656.25**	**2,544.21**

[95] PAN details not available in the assessment records in Haryana-52, Himachal Pradesh-1, Madhya Pradesh – 1, Punjab-33, Uttar Pradesh and Uttarakhand -1.

The distribution of agricultural income claimed and allowed by the AOs in respect of cases audited was shown below in Chart 5.1.

Chart 5.1: Area-wise Agricultural Income claimed and allowed



5.9 Audit Findings

5.9.1 Verification of claims relating to agricultural income

The AOs are required to satisfy themselves that the assessees were eligible for allowance of the exemption claimed under section 10(1) read with section 2(1A) of the Act. Section 2(1A)(b) provides that the agricultural income includes, *inter alia*, any income derived from land in India by agricultural operations including processing of agricultural produce, raised or received as rent in kind or any process ordinarily employed by cultivator or receiver of rent in kind so as to render it fit for the market, or sale of such produce. Agricultural income of this nature will broadly be computed as if it were chargeable to tax under the head "Profit and gains of business or profession". This exemption claimed is indicated under Schedule EI of the ITR filed by the assessees.

Section 143(3) of the Act dealing with detailed scrutiny envisages that after hearing the evidence produced by the assessee and such other evidence as the AO may require and after taking into account all relevant material which he has gathered, the AO shall, by an order in writing, make an assessment of the total income of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment. Thus, AOs are mandated by law to assess the income of the assessee and determine the tax payable by/refundable on the basis of such assessment. Different types of claims together with accounts, records and documents enclosed with the return are required to be examined in detail in scrutiny assessments. For the purposes of computing the net agricultural income of the assessee, the AO

shall have the same powers as he has under the Income Tax Act for the purposes of assessment of the total income.

Further, as per the Manual of Office Procedure[96], the Minutes of a case posted for hearing by issuing a notice during assessment proceedings under section 143(2) or 142(1) or 131 etc. must be entered with date, in the order-sheet. The entry should cover, *inter alia*, the names of the persons attending the hearing on behalf of the assessee and their occupations, documents produced, (specifying documents examined and returned and documents filed), documents called for, Issues discussed and re-posting, if any[97]. Documents produced by the assessee (except those to be returned) must be filed in the MR[98]. Thus, detailed scrutiny as prescribed in law involves not only a detailed examination of records but also the maintenance of proper record of the documents etc. scrutinized in arriving at the assessment order.

Audit observed that there are no instructions from CBDT specific to scrutiny of agricultural income exemption claims. It has been held by the Apex Court in CIT Vs R. Venkataswamy Naidu[99] that the onus lies on the assessee who claims exemption to establish it. While determining the taxable income and tax payable, the AO should insist upon production of material evidence for the exemption claimed on account of Agricultural income. Failure to adopt a system of establishing the veracity of the claim would result in excess allowance of exemptions and under-assessment of taxable income.

5.9.2 Exemption without verification of supporting documents

A review of the scrutiny assessments in the selected cases indicated that in 1,527 (22.5 *per cent*) out of 6,778 scrutiny assessments as tabulated below the claim of exemption on account of agricultural income was allowed without verification of supporting documents such as the land records, income and expenditure statements, crop information, proof of agricultural income and expenditure such as ledger account, bills, invoices etc. or no documentary proof in support of agricultural income claimed by the assessee was available in the assessment records as tabulated below (*Table 5.1*) to establish the veracity of the claim.

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96 Manual of Office Procedure Vol. II (Technical), February 2003, Para 3.4.5 Ministry of Finance, Department of Revenue, CBDT

97 to be initialled by the AO, the assessee and/or his authorised representative.

98 MR - Miscellaneous Record

99 (1956) 29 ITR 529(SC)

Table 5.1: Documentation and verification of agricultural income claims				
State/Region	**Total number of cases checked in Audit**	**Number of cases where documentation and verification by AO was inadequate**	**Number of cases out of col. 3 where land records were not available**	**Number of cases out of col. 3 where other records for proof of agricultural income and expenditure such as ledger account, bills, invoices etc. were not attached**
Col. 1	**Col. 2**	**Col. 3**	**Col. 4**	**Col. 5**
Andhra Pradesh & Telangana	506	164	0	164
Bihar	122	14	7	7
Chhattisgarh	170	28	28	28
Delhi	462	52	28	36
Gujarat	425	44	40	39
Jharkhand	46	13	13	13
Karnataka	502	229	104	157
Kerala	503	57	43	40
Madhya Pradesh	418	47	47	45
Maharashtra	484	303	97	281
North Western Region	1,369	126	49	66
North Eastern Region	171	8	2	6
Odisha	102	35	23	30
Rajasthan	200	56	39	50
Tamil Nadu	565	286	152	264
West Bengal	396	26	13	5
Uttar Pradesh & Uttarakhand	337	39	31	39
Total	**6,778**	**1,527**	**716**	**1,270**

Source: Assessment records of ITD

It was noticed that out of 1,527 cases where documentation and verification by AO was inadequate, land records were not available in 716 cases (10.6 *per cent*) and proof of agricultural income and expenditure such as ledger account, bills, invoices etc. were not available in 1,270 cases (18.7 *per cent*). It was therefore not clear as to how AOs were ensuring that the exemption was provided only to eligible assessees, and that the claims of assessees are genuine.

Audit noticed instances where exemption on account of agricultural income was allowed without taking into account/verifying the expenditure incurred to earn the agricultural income, which could also be a potential undesirable avenue for bringing unaccounted income/black money into the financial

system in the garb of agricultural income. Audit noticed cases where rent or revenue derived from agricultural land was allowed as exemption without proper verification of records. Audit also noticed cases where exemption was allowed inconsistently with respect to different assessment years. Thus, assessees were allowed exemption for agricultural income without verifying the ownership/rights over the agricultural land, cost of cultivation, Cash book and/or Bank statements of the assessee, details of receipts and expenditure claimed by assessee. Notwithstanding the provisions envisaged in Section 143(3) of the Act and Para 3.4.5 of the Manual of Office Procedure, Volume II, neither the assessment order nor the Order sheet indicated that adequate reliance had been placed on such documents/data referred to above or other documents which could have provided assurance about the satisfaction reached by the AO in each instance. Twelve instances where exemption was allowed involving such discrepancies are discussed below:

(a) Charge: Pr. CIT, Kottayam; AY: 2012-13;
Agricultural Income allowed: ₹ 39 lakh

The AO allowed (February 2015) exemption of ₹ 39 lakh to the assessee for AY 2012-13 towards agricultural income earned from Rubber, Cardamom, Coffee and Pepper cultivated in 60 acres of land which included 15 acres of coffee and 20 acres of pepper. As per the income statement for the year 2011-12 furnished by the assessee, the assessee had 60 acres of land against which assessee claimed agricultural income. However, as per the property details furnished by the assessee, the assessee had only 8.88 acres of land for coffee and 9.17 acres of land for pepper which had to be reconciled before allowing exemption. In the scrutiny assessment order, the discrepancy in property details or justification for considering the details as per the income statement was not mentioned. In absence of such details, audit could not confirm the correctness of allowance of exemption. ITD replied that it would look into this matter (March 2018).

(b) Charge: Pr. CIT-1, Madurai, Tamil Nadu: AY: 2012-13;
Agricultural Income allowed: ₹ 68.16 lakh;

The assessee claimed and was allowed (March 2015) exemption of ₹ 68.16 lakh for AY 2012-13 towards agricultural income earned from Coconut, Drumstick, Chilli, Maize and Kanvalli seeds. As per the scrutiny assessment order, the books of accounts of agricultural income was verified and examined. The details were called for, discussed and agricultural income returned by the assessee was accepted. Audit examination revealed that though the assessee derived more than 85 *per cent* of income from the cultivation of Kanvalli seeds, yet the details such as total area of land from which Kanvalli Seeds were produced, yield per acre etc. were not available on

records. Further documents/information such as *Adangal account*, Patta, etc. were also not available on records. As the details of records examined was not mentioned in the assessment order, whether the agricultural income on account of sale of Kanvalli seeds was verified by the AO could not be ascertained. In absence of such details, audit could not confirm the correctness of allowance of exemption. Reply from ITD was awaited (December 2018).

(c) Charge: Pr.CIT-1, Madurai, Tamil Nadu:
AYs: 2012-13, 2013-14 and 2014-15;
Agricultural Income allowed: ₹ 25.38 lakh, ₹ 25.38 lakh, ₹ 25.48 lakh

The assessee claimed and was allowed (March 2015, March 2016 and December 2016) exemption of ₹ 25.38 lakh ₹ 25.38 lakh and ₹ 25.48 lakh, for AYs 2012-13, 2013-14 and 2014-15 respectively towards agricultural income without obtaining and verifying the supporting documents such as sales invoices, agricultural expenses, land ownership/ rights to use the land and data such as crops cultivated, cultivated area, etc. As per the scrutiny assessment order for AYs 2012-13 and 2013-14, the details of agricultural activities and land holds were verified and examined and the agricultural income claims were accepted as returned. However, detailed documentation viz. land documents, Adangal, Patta, sales invoice etc. was not found available in the assessment records of both the years. Further, in the scrutiny assessment order for AY 2014-15, the AO has mentioned that the details were called for and verified, however, documentary evidence was not found available in the assessment records. In absence of such details, audit could not confirm the correctness of allowance of exemption. ITD replied that it would look into this matter (May 2018).

(d) Charge: Pr. CIT-4, Kolkata, West Bengal; AY: 2012-13;
Agricultural Income allowed: ₹ 1.90 crore

AO allowed (March 2015) exemption of ₹ 1.90 crore towards agricultural income without obtaining any records from the assessee except a statement of Agricultural income and expenses and without verifying the correctness and genuineness of the agricultural income. Although the details of various deductions and exemptions claimed by the assessee along with justification and evidence was called for vide notice issued under section 142(1) (November 2014), the scrutiny assessment order did not contain any reference to the claim allowed on account of agricultural income. Further there were no supporting documents available in the records to substantiate the claim allowed in the ITNS-150 to the assessee.

Audit scrutiny further revealed that the assessee's claim of exemption of ₹ 2.19 crore for AY 2013-14 (March 2016) and ₹ 7.20 crore for AY 2014-15 (December 2016) was disallowed as the assessee failed to produce any evidence for agricultural land holdings, details of sales of agricultural produce and agricultural expenses. In absence of such details for AY 2012-13, audit could not confirm the correctness of allowance of exemption.

(e) Charge: Pr. CIT, Muzaffarpur, Bihar; AY 2014-15; Agricultural Income allowed: ₹ 1.60 crore

The AO allowed (August 2016) exemption of ₹ 1.60 crore towards agricultural income accepting the claim on account of agricultural income made by the assessee. As per the notes in the assessment order, "Assessee derived a large amount of agricultural income during the financial year 2013-14 relevant to AY 2014-15. The genuineness of agricultural income was not examined during the assessment proceeding as in the past year the case of assessee for AY 2006-07 to 2011-12 was reopened under section 147 to examine the genuineness of agricultural income and the reason to believe that an income chargeable to tax has escaped assessment. The assessment under section 147 for different years was completed after proper enquiry and the agricultural income of the assessee was accepted". The AO concluded that the assessee had verifiable source to derive such large agricultural income based on revised assessment of earlier years. As such, the exemption for AY 2014-15 was allowed without obtaining and verifying the details such as land usage, transaction details of agricultural produce, purchase of seeds, fertilizers, labour/machinery use in agricultural activity. In absence of such details in respect of AY 2014-15, audit could not confirm the correctness of allowance of exemption.

(f) Charge: Pr. CIT, Cuttack, Odisha; AY 2008-09; Agricultural Income allowed: ₹ 1.47 crore

The assessee's case was re-opened (March 2016) based on the report of ITO, Kullu Ward that no agricultural activities were carried out by the assessee during the previous year relevant to AY 2008-09. During the reassessment proceedings, the assessee claimed that he had acquired six acres of land on lease in Kullu district where apple was grown and another 32 acres at Solan District where tomatoes, onions, potatoes and capsicum were grown. Assessee further stated that no evidence could be produced by him about agricultural produce and expenses incurred on purchase of seeds, pesticides, fertilizers etc. However, the AO allowed exemption of ₹ 147.10 lakh as against the assessee's claim of ₹ 163.10 lakh for AY 2008-09 towards agricultural income after disallowing a portion of agricultural income to the extent of ₹ 16 lakh as bogus income stating as reason the following (a) the

assessee had not produced any substantiating evidence other than Mandi Receipts of HP Agriculture Board, Shimla (b) while confirming the adhoc disallowance of ₹ 5 lakh made during the assessment proceedings for AY 2009-10, CIT (Appeal) mentioned the fact that assessee had submitted copies of lease agreement along with certificate issued by Mandi Samiti regarding sale of agricultural products like apples.

As per the assessment order the assessee had produced Mandi receipts for previous AY viz. AY 2007-08. It was further revealed that the assessee had not claimed any agricultural income during AY 2007-08 and the entire claim of agricultural income of ₹ 40 lakh for AY 2009-10 was disallowed during the assessment proceedings under section 143(3). Subsequently, CIT (Appeal) disallowed only ₹ 5 lakh from the agricultural income of AY 2009-10. Further, the assessee's claims of exemption for agricultural income for AYs 2010-11 to 2014-15 (₹ 37.05 lakh, ₹ 76.77 lakh, ₹ 57.26 lakh, ₹ 36.96 lakh and ₹ 40.26 lakh respectively) were disallowed as the assessee failed to produce any evidence to substantiate his claim. In absence of such details for AY 2008-09, audit could not confirm the correctness of allowance of exemption.

(g) Charge: Pr. CIT, Kozhikode, Kerala; AYs: 2012-13 to 2015-16; Agricultural Income allowed: ₹ 23.50 lakh, ₹ 22.03 lakh, ₹ 22.51 lakh and ₹ 23.01 lakh

The assessee offered revised claim of exemption of ₹ 23.50 lakh, ₹ 22.03 lakh and ₹ 22.51 lakh on account of agricultural income in the returns filed against the notice under section 148 issued after the survey under section 133A as against the earlier claim of ₹ 0.48 lakh, ₹ 4.03 lakh and ₹ 15.51 lakh respectively in the original returns for AY2012-13, 2013-14 and 2014-15. Also, the assessee claimed exemption of ₹ 23.01 lakh for AY 2015-16. Thus, additional income was offered during the course of survey which was not considered by the assessee at the time of filing of return. Audit scrutiny revealed that the exemption was allowed (December 2015- 3 AYs and December 2016) in all the four Assessment years as claimed by assessee for which no documentary evidence was available in the assessment records. In absence of such details, audit could not confirm the correctness of allowance of exemption. ITD replied that it would look into the matter (April 2018).

(h) Charge: Pr. CIT, Hyderabad, Andhra Pradesh and Telangana; AY 2014-15; Agricultural Income allowed: ₹ 32.46 lakh

The assessee claimed and was allowed exemption (December 2016) of ₹ 32.46 lakh towards agricultural income earned from Banana Plantation based on the copies of land records and certificate issued by the jurisdictional

Tahsildar on a plain paper that the assessee was in possession of the land and was in cultivation of Banana plantation, which would yield an annual income between ₹ 1.25 lakh to ₹ 1.50 lakh per acre. Despite the assessee's case having been taken up for limited scrutiny to verify agricultural income, even the statement of agricultural income indicating how the net agricultural income of ₹ 32.46 lakh was arrived at, was not found available. As per the Notes in the assessment order, the assessee was basically an agriculturist and was growing bananas. The assessee had furnished pattadar pass book in support of agricultural income. All the information was placed on record. However the detailed documentation in support of agricultural income claimed was not available on records. In absence of such details, audit could not confirm the correctness of allowance of exemption. ITD replied (March 2018) that care would be taken in future to obtain the documents.

(i) Charge: Pr. CIT-6, Bengaluru, Karnataka; AY: 2013-14; Agricultural Income allowed: ₹ 85.60 lakh

AO allowed (March 2016) exemption of ₹ 85.60 lakh towards agricultural income without verifying the cash deposits made in bank by the assessee out of the sale proceeds of agricultural produce. During the assessment proceedings, a sum of ₹ 9.45 lakh being the difference between the assessee's claim of agricultural income in cash flow statement (i.e.) ₹ 95.05 lakh and in the statement of computation of income (i.e.) ₹ 85.60 lakh was treated as unexplained income. As per the assessee's submission (March 2016) made in response to notice issued under section 143(2) of the Act (March 2016), the cash deposits in bank on account of sale of agricultural produce amounted to ₹ 2.56 crore which was substantially higher than the declared agricultural income of ₹ 85.60 lakh. However, the details of cash deposits as per submission of assessee was neither considered nor discussed in the scrutiny assessment order. Omission to verify the bank deposits as per assessee's submission, agricultural income and expenditure statement had resulted not only in inaccurate allowance of exemption but also underassessment of 'income from other sources'.

(j) Charge: Pr. CIT-6, Bengaluru, Karnataka; AY: 2014-15; Agricultural Income allowed: ₹ 63.43 lakh

In this case the scrutiny assessment was concluded by determining income of ₹ 36.48 lakh and Agricultural Income of ₹ 63.43 lakh after disallowing eight *per cent* of agricultural income for non-production of vouchers/invoices. It was observed that as per computation, assessee had received agricultural income of ₹ 68.95 lakh whereas agricultural income as per cash book was ₹ 4.50 lakh only during the period 01 April 2013 to 31 March 2014, which indicated that the differential amount of ₹ 64.45 lakh relates to income from

other sources. Failure to tax the same as income from other sources resulted in short computation of income by ₹ 58.93 lakh {₹ 64.45 lakh - ₹ 5.52 lakh disallowed in 143(3) order}, having tax effect of ₹ 24.22 lakh.

(k) Charge: Pr. CIT, Mysuru, Karnataka, AY 2014-15; Agricultural Income allowed: ₹ 9.99 lakh

Assessee claimed and was allowed (August 2016) exemption of ₹ 9.99 lakh towards agricultural income. It was observed from the capital account of assessee that he had received ₹ 116.27 lakh on transfer of agricultural land while the asset schedule did not disclose any agricultural land having been sold thereby suggesting that income from other activities was considered as agricultural income and exemption wrongfully allowed. The income should have been treated as income from other sources and taxed. Omission to do so had resulted in short computation of income with a tax effect of ₹ 35.93 lakh.

(l) Charge: Pr.CIT-1, Raipur, Chhattisgarh, AY: 2012-13; Agricultural Income allowed: ₹ 109.06 lakh

Assessee claimed and was allowed (March 2015) exemption of ₹ 109.06 lakh (sale consideration of ₹ 110.65 lakh minus cost of acquisition of ₹ 1.59 lakh) towards the profit earned on transfer of an agricultural land. Neither the documents in support of fulfilment of conditions stipulated in Explanation 1 under section 2(1A) were available in the assessment records nor was it discussed in the in the assessment order. In absence of such details, audit could not confirm the correctness of allowance of exemption.

While allowance of exemption of agricultural income claims based on inadequate verification or incomplete documentation has been pointed out in 1,527 cases (22.5 *per cent*) on the basis of test check of 6,778 cases in sample, ITD needs to get all cases, where agricultural income is above a certain threshold, say ₹ 10 lakh or more, examined internally in all Commissionerates to ensure that exemption is allowed only to eligible assessees based on verification of appropriate documents.

5.9.2.1 Further analysis of the distribution of agricultural income claimed and allowed in respect of 1,527 cases where verification was inadequate/ documentation was non-satisfactory, state wise, is as below:

State/ Region	Number of cases in which verification was inadequate	Agriculture income claimed- (₹ in crore)	Agriculture income allowed- (₹ in crore)
Andhra Pradesh & Telangana	164	18.09	17.85
Bihar	14	3.20	3.11
Chandigarh	1	0.20	0.20
Chhattisgarh	28	8.50	8.44
Delhi	52	39.10	39.11
Gujarat	44	7.73	7.66
Haryana	63	19.18	18.80
Himachal Pradesh	18	10.05	7.15
Jammu and Kashmir	21	6.14	6.14
Jharkhand	13	2.08	1.79
Karnataka	229	65.75	62.03
Kerala	57	30.11	29.51
Madhya Pradesh	47	7.49	7.43
Maharashtra	303	194.44	156.01
North Eastern Region	8	1.87	1.87
Odisha	35	8.26	7.95
Punjab	23	212.77	4.64
Rajasthan	56	11.29	11.28
Tamil Nadu	286	90.81	88.16
Uttar Pradesh & Uttarakhand	39	3.37	3.35
West Bengal	26	17.62	17.50
Grand Total	**1,527**	**758.06**	**499.99**

Further, the type of assessee-wise agricultural income claimed and allowed in respect of 1,527 cases is as below:

Type of Assessee	Agriculture income claimed (₹ in crore)	Agriculture income allowed (₹ in crore)	Number of cases
AOP	1.44	1.44	4
Company	434.28	194.24	142
Firm	12.75	12.63	28
HUF	16.31	15.98	56
Individual	292.05	274.51	1,292
Trust	0.73	0.73	1
Non-PAN	0.50	0.47	4
Grand Total	**758.06**	**499.99**	**1,527**

It was further noticed that of 1,527 cases, in 1,046 cases (68.5 *per cent*) the agricultural income claim was made in Form ITR-4[100] wherein exemption of ₹ 210.19 crore on account of agricultural income was allowed as against claim of ₹ 222.91 crore made[101]. The predominant use of ITR-4 indicates that

[100] ITR-4 is return of Income applicable for presumptive income from Business & Profession

[101] ITR-4 was used predominantly to file return for claim of exemption in respect of agricultural income as 3,643 assessees (agricultural income allowed- ₹ 695.44 crore and agriculture income claimed -₹ 787.01 crore) out of 6780 cases (agricultural income allowed - ₹ 2545.16 crore and agriculture income claimed- ₹ 3657.30 crore) in the sample had filed their return of income in ITR-4 form.

agricultural income is also largely claimed and allowed where presumptive income from business and profession is involved. ITD may ensure thorough verification of claims made through ITR-4 specifically in cases selected under scrutiny.

5.9.3 Incorrect reflection of agricultural income in ITD Database

Audit observed instances where there was a mismatch between the exemptions allowed in the assessment order vis-à-vis that reflected in the ITD database. Exemption allowed for agricultural income during scrutiny assessments had not been reflected correctly in the ITD database. The agricultural income in the ITD database continued to reflect the agricultural income as returned by the assessees or depicted irrelevant figures in cases where agricultural income allowed was different from that claimed by the assessee. Out of 3,133 cases[102] checked in audit across nine states in 48 cases [Bihar (02), Jharkhand (02) Karnataka (12), Kerala (07) Rajasthan (01), West Bengal (06), Tamil Nadu (09), Uttar Pradesh (04), New Delhi (05)], such mistakes were noticed as given in Table 5.2 below:

Table 5.2: Incorrect reflection of agricultural income in IDT database **(₹ in lakh)**

Sl. No.	State	PCIT Charge with full unit details	AY	Returned Agri. Income	Agri. Income after assessment	Agri. Income reflected in database
1	Bihar	PCCIT, Patna/ ITO Ward 2(1) Muzaffarpur	2012-13	14.49	0	14.49
2	Bihar	PCCIT, Patna/ ACIT Circle -1 Muzaffarpur	2014-15	22.03	6.14	22.03
3	Jharkhand	PCCIT – Patna, Circle-I, Ranchi	2015-16	23.62	0	23.62
4	Jharkhand	PCCIT – Patna, ITO ward 3(1), Ranchi	2015-16	48.2	0	20.9
5	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(3)(4)	2014-15	24.51	22.05	24.51
6	Karnataka	PCCIT -6-CIT -6-DCIT Circle 6(3)(1)	2014-15	8.74	4.37	8.74
7	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2013-14	9.7	6.7	9.7
8	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2013-14	25.96	20.77	23.95
9	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	21.74	19.24	21.74
10	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	13	11	13

[102] Bihar-122, Jharkhand-46, Karnataka-502, Kerla-503, Rajasthan-200, West Bengal-396, Tamil Nadu-565, Uttar Pradesh-337, New Delhi-462,

Sl. No.	State	PCIT Charge with full unit details	AY	Returned Agri. Income	Agri. Income after assessment	Agri. Income reflected in database
11	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	8	6.4	8
12	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	27.78	22.22	27.78
13	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	20.16	18.14	20.16
14	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(2)(1)	2014-15	34.63	33.13	34.63
15	Karnataka	PCCIT -6-CIT -6-DCIT Circle 6(2)(1)	2014-15	159.4	144.4	159.4
16	Karnataka	PCCIT -6-CIT -6-ITO Ward 6(3)(2)	2014-15	32.96	32.96	11.02
17	Kerala	PCIT , Kozhikode, ITO Ward 2, Kalpetta	2014-15	450.60	435.60	450.60
18	Kerala	PCIT, Kochi, ACIT Non Corp Cir 1(1), Kochi	2014-15	21.35	16.00	21.35
19	Kerala	PCIT, Kozhikode, ACIT, Circle 1(1), Kozhikode	2013-14	20.83	18.20	20.83
20	Kerala	PCIT, Kozhikode, ACIT, circle 1(1), Kozhikode	2012-13	25.91	20.91	25.91
21	Kerala	PCIT, Kozhikode, ACIT, Circle 1(1), Kozhikode	2012-13	38.37	13.37	38.37
22	Kerala	PCIT, Kozhikode, ACIT, Circle 1, Kannur	2012-13	21.80	11.80	21.80
23	Kerala	PCIT, Kozhikode, ITO Ward 2, Kalpetta	2014-15	59.46	54.46	59.46
24	New Delhi	New Delhi, PCCIT-7, Ward 61(1)	2014-15	23	0	23
25	New Delhi	New Delhi, PCCIT-4, Ward 33(2)	2013-14	15.63	0	15.63
26	New Delhi	New Delhi, PCCIT-7, Ward 61(1)	2014-15	35.09	0	35.09
27	New Delhi	New Delhi, Circle 27(1)	2014-15	20.65	0	20.65
28	New Delhi	PCIT 14, Delhi, Ward 40(3)	2013-14	78.39	78.39	0
29	Rajasthan	PCIT-1, Jaipur, ITO Ward 3(1), Jaipur	2009-10	5.88	4.54	0
30	Tamil Nadu	PCIT-3, Coimbatore, DCIT, NCC-1, CBE	2013-14	36.05	0	36.05
31	Tamil Nadu	PCIT-3, Coimbatore, DCIT, NCC-1, CBE	2013-14	7.92	4.88	7.92
32	Tamil Nadu	PCIT-3, Coimbatore, DCIT, NCC-1, CBE	2013-14	43.8	27.27	43.8
33	Tamil Nadu	PCIT-1 Trichy, Circle-1, Trichy	2012-13	38.41	34.57	38.41

Sl. No.	State	PCIT Charge with full unit details	AY	Returned Agri. Income	Agri. Income after assessment	Agri. Income reflected in database
34	Tamil Nadu	PCIT-3, Coimbatore, Ward 2(1), Tirupur	2014-15	44.33	43.06	44.33
35	Tamil Nadu	PCIT 1, Trichy, Circle 1, Trichy	2013-14	25	21.26	28.74
36	Tamil Nadu	PCIT/CIT 1 Madurai, Ward 1, Dindigul	2013-14	21.2	19.21	21.2
37	Tamil Nadu	CCIT 1, Trichy, Circle 2, Trichy	2013-14	19.77	9.77	19.77
38	Tamil Nadu	PCIT-3, Coimbatore, Circle-1, Tirupur	2014-15	74.88	68.32	74.88
39	Uttar Pradesh	PCIT, Aligarh	2014-15	40.44	38.44	78.88
40	Uttar Pradesh	PCIT, Aligarh	2014-15	27.37	26.37	53.74
41	Uttar Pradesh	PCIT, Aligarh	2013-14	20.99	12.48	20.99
42	Uttar Pradesh	PCIT, Lucknow	2014-15	5.32	3.99	5.32
43	West Bengal	PCIT-2, DCIT, Circle 4(1), Kolkata	2013-14	136.68	138.23	136.68
44	West Bengal	PCIT-2, DCIT, Circle 4(1), Kolkata	2012-13	132.65	143.65	132.65
45	West Bengal	PCIT-2, DCIT, Circle 4(1), Kolkata	2014-15	138.98	142.22	141.24
46	West Bengal	PCIT-2,DCIT, Circle 4(1), Kolkata	2013-14	166.89	163.89	166.89
47	West Bengal	PCIT-2,DCIT, Circle 4(1), Kolkata	2012-13	196.42	187.42	196.42
48	West Bengal	PCIT-2, AC Circle 4(1) Kolkata	2014-15	55.76	55.76	57.99

Audit noticed that out of 48 cases the amount of agricultural income reflected in database was auto-populated through AST in 42 cases and manually in six cases[103]. The agricultural income allowed during assessment was not captured in the ITD database. As such, there is a risk of incorrect reporting of agricultural income and rebate allowed to the assessee for MIS purposes due to non-updation of database.

Although the ITD is seized of discrepancies caused due to data entry errors as discussed in para 5.9.4 below such errors continue to occur.

[103] West Bengal

5.9.4 Status of Verification by the department

Based on a Public Interest Litigation (PIL) filed in the Hon'ble Patna High Court wherein concerns were raised that certain assessees may be engaged in routing their unaccounted/illegal money in the garb of Agriculture not only for claiming exemption but also engaged in the money laundering activities, the ITD had initiated action of verification of returns in cases where assessees had returned income of more than ₹ 1 crore from Agriculture. In order to furnish the factual statistics to Hon'ble Patna High Court, the Directorate of Income Tax (Systems) instructed all PCCITs/CCIT(CCA) to send a Status Report to DGIT after examination of aspects such as whether tax payer may have made a data entry error while filling up the return. In cases where scrutiny assessment is completed, AO was to provide feedback based on assessment records. Where proceedings under section 143(3) were pending, the AO was to verify the claim thoroughly. DGIT(Systems) identified 2,746 cases showing agricultural income above ₹ 1 crore in the ITRs of the assessment years 2007-08 to 2014-15 and directed[104] the AOs to verify the claims of exemption on agricultural income in such ITRs and sought Status Report of such cases.

Of 136 PCsIT selected by audit where status reports furnished to DGIT(systems) were sought, only 26 PCsIT in ten states furnished status reports to audit. As per the Status Report furnished to audit by the PCsIT in respect of 327 cases in Bihar & Jharkhand, Gujarat, Rajasthan, Kerala, North Eastern Region, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim as forwarded to the DGIT(Systems), there was a difference in amount of agricultural income as per the ITR filed by the assessee and the amount entered in AST system due to errors at data entry level in 36 cases as detailed below in *Table 5.3*. As per field verification (January 2019) the data entry errors remained to be corrected in 12 cases[105] out of 36 cases. Audit noticed that the status reports are yet to be furnished by the selected Pr. CITs in Andhra Pradesh & Telangana, Karnataka & Goa, Madhya Pradesh & Chhattisgarh, Maharashtra, New Delhi, North Western Region and Odisha (November 2018).

[104] Instruction issued vide F. No. DGIT(S)/DIT(S)-3/AST/PIL/2015-16 dtd. 10 March 2016
[105] Uttar Pradesh & Uttarakhand -6, Rajasthan-2, West Bengal-2 and North Eastern Region-2

Table 5.3 : Data Entry errors reported in Status Reports furnished to the DGIT(Systems)							
Sl. No.	**PCIT Charge**	**AY**	**Agricultural Income returned as reported by AO to DGIT(S) (in ₹)**	**Agricultural Income as per AST System (in ₹)**	**Whether Data Entry Error**	**Whether assessment completed under section 143(3)/147**	**Agricultural Income determined if assessment completed u/s 143(3)/147**
1	PCIT, Allahabad	2010-11	45000	45000450	Yes	No	NA
2	PCIT, Allahabad	2010-11	58500	58500585	Yes	No	NA
3	PCIT, Allahabad	2010-11	30000	3000030000	Yes	No	NA
4	PCIT, Allahabad	2008-09	NIL	10274780	Yes	No	NA
5	PCIT, Allahabad	2008-09	NIL	1640700	Yes	No	NA
6	PCIT, Allahabad	2008-09	NIL	10274175	Yes	No	NA
7	PCCIT, Bihar & Jharkhand	2010-11	22500	2250026594	Yes	No	NA
8	PCCIT, Bihar & Jharkhand	2009-10	26300	2630096170	Yes	No	NA
9	PCCIT, Bihar & Jharkhand	2008-09	125000	12500033600	Yes	No	NA
10	PCCIT, Bihar & Jharkhand	2010-11	65000	80000262	Yes	NA	NA
11	PCCIT, Bihar & Jharkhand	2009-10	450000	45000023100	Yes	NA	NA
12	PCCIT, Bihar & Jharkhand	2010-11	43400	434000262	Yes	No	NA
13	PCCIT, Bihar & Jharkhand	2010-11	60000	6000015060	Yes	No	NA
14	PCCIT, Bihar & Jharkhand	2010-11	174900	174900121000	Yes	No	NA
15	PCCIT, Bihar & Jharkhand	2010-11	180000	18000060000	Yes	No	NA
16	PCCIT, Bihar & Jharkhand	2010-11	105000	105000155	Yes	No	NA
17	PCCIT, Bihar & Jharkhand	2011-12	34000	34000151	Yes	No	NA
18	PCCIT, Bihar & Jharkhand	2011-12	32400	324007708	Yes	NA	NA
19	PCCIT, Bihar & Jharkhand	2011-12	42000	42000520	Yes	No	NA
20	PCCIT, Bihar & Jharkhand	2011-12	50200	50200154093	Yes	NA	NA
21	PCIT-3, Jaipur	2013-14	268632	23027645	Yes	Yes	268632
22	PCIT-1, Jaipur	2012-13	NIL	82619934	Yes	Yes	Nil
23	PCIT-1, Jaipur	2012-13	NIL	18924521	Yes	Yes	Nil
24	PCIT-1, Jaipur	2009-10	145000	14500000	Yes	Yes	145000
25	PCIT-1, Jaipur	2010-11	NA	57206210912	Yes[106]	Yes	Nil

[106] As per ITR for AYs 2008-09 and 2009-10 agriculture income is shown as ₹ 48,415 and ₹ 50,264. Thus data entry error is evident.

Sl. No.	PCIT Charge	AY	Agricultural Income returned as reported by AO to DGIT(S) (in ₹)	Agricultural Income as per AST System (in ₹)	Whether Data Entry Error	Whether assessment completed under section 143(3)/147	Agricultural Income determined if assessment completed u/s 143(3)/147
26	PCIT-1, Jodhpur	2009-10	149860	149860149860	Yes	No	--
27	PCIT-2, Jodhpur	2008-09	4371122	43711220	Yes	NA	NA
28	PCIT(C)-2, Kolkata	2010-11	28769720	NIL	Yes	Yes	24962330
29	PCIT(C)-2, Kolkata	2007-08	26114750	NIL	Yes	Yes	23103850
30	PCIT(C)-2, Kolkata	2008-09	NIL	39104354	Yes	Yes	Nil
31	PCIT-17, Kolkata	2015-16	NIL	17393270	Yes[107]	No	--
32	PCIT, Burdwan	2008-09	5000	5000105700	Yes	No	--
33	PCIT(C)-1, Kolkata	2011-12	NIL	14644701	Yes	Yes	Nil
34	PCIT-9, Kolkata	2008-09	20000	20000137697	Yes	No	--
35	Pr. CIT, Shillong	2012-13	0	29152800	Yes	No	0
36	PCIT, Dibrugarh	2013-14	16825686	20677808	Yes	Yes	16825686

As the data entry errors reported above are based on information furnished by only few selected Commissionerates in ten states and compliance to furnishing of status reports to DsGIT(System) could not be ascertained in all the Commissionerates selected for audit, the status of corrections in respect of data entry errors in agricultural income in AST database for agricultural income claims greater than ₹ one crore could not be verified.

As observed in audit, out of 36 cases data entry errors in 12 cases were yet to be corrected despite having been identified by the Department. As such, the correctness of AST database vis-à-vis agricultural income returned by the assessee could not be considered reliable. Errors in the database imply a dual risk: of loss of tax on one hand, and of harassment of tax payer on the other hand. The Department, therefore, needs to attend to similar cases for all Commissionerates to ensure without exception that data entry errors are corrected in all cases.

CBDT may initiate action to institute checks for ensuring the correctness of data entered vis-à-vis the data furnished by the assessee to avoid such errors.

[107] Amount received as compensation by assessee on account of acquisition of agricultural land by Government of India was wrongly shown as agricultural income in return of income for AY 2015-16.

5.9.5 Compliance issues - Mistakes in Assessments

Audit noticed non-compliance to provisions of the Act in 20 cases involving incorrect exemption granted for income derived from agricultural land, incorrect allowance of exemption for partial agricultural income, excess allowance of replantation expenditure/due to adoption of incorrect export turnover and exemption granted to non-agricultural income on account of sale of fish, sale of goat, sale of dry grapes, sale of milk etc. Nine such cases are illustrated below:

(a) Charge: Pr. CIT-1, Coimbatore, Tamil Nadu; AY: 2013-14; Agricultural Income allowed: ₹ 734.04 lakh

Section 2(1A)(a) of the Act provides that agricultural income includes any rent or revenue derived from land situated in India and used for agricultural purpose. Explanation 1 under Section 2(1A) envisages that revenue derived from land shall not include any income arising from the transfer of land which forms part of the definition of capital asset.

In case of a company, the AO completed the assessment under section 143(3) in February 2016 at an income of ₹ 2.82 lakh. Audit examination revealed that the assessee sold agricultural lands at Vilpatti Village, Kodaikanal Taluk, Dindigul District for a sale consideration of ₹ 8.74 crore which comprises of ₹ 5.32 crore being the sale consideration shown in the registered sale deeds and a premium of ₹ 3.42 crore which was not disclosed in the registered sale deeds and thereby no stamp duty was paid for the premium payment. The assessee claimed and was allowed exemption of ₹ 7.34 crore under section 2(1A)(a) towards the profit earned on transfer of agricultural lands. As the sale consideration for transfer of immovable property had to be taken as per the registered sale deeds, the premium received by the seller over and above the registered sale consideration had to be treated as 'income from other sources'. Omission to do so had resulted in inadmissible allowance of exemption of ₹ 3.42 crore with a short levy of tax of ₹ 1.11 crore. ITD agreed to look into the matter (October 2018).

(b) Charge: Pr. CIT-2, Pune, Maharashtra ; AY: 2012-13; Agricultural Income allowed: ₹ 23.50 lakh

The AO completed the assessment for AY under section 143(3) in March 2015 at an income of ₹ 3.49 crore. Audit examination revealed that the assessee sold an agricultural land at Deolali and claimed exemption of ₹ 172.74 lakh under section 2(1A)(a) for the profit earned therefrom. As the land sold was situated within the eight kilometers from the Deolali Cantonment Board, the land had to be treated as capital asset. Omission to do so had resulted in inadmissible allowance of exemption of ₹ 172.74 lakh with short levy of tax of ₹ 35.58 lakh.

(c) Charge: Pr. CIT-1, Coimbatore, Tamil Nadu: AY 2012-13, 2013-14 and 2014-15; Agricultural Income allowed: ₹ 246.68 lakh, ₹ 291.85 lakh and ₹ 436.50 lakh

The AO allowed exemption of ₹ 2.47 crore, ₹ 2.92 crore and a sum of ₹ 4.37 crore to the assessee for AYs 2012-13, 2013-14 and 2014-15 in March 2015, December 2015 and December 2016 respectively towards agricultural income from the sale of tea grown and manufactured. *Income derived from the sale of Tea grown and manufactured by the seller in India will be computed as if it were income derived from business and forty per cent of such income will be deemed to be income liable to tax. The word 'derived from' cannot have a wide import so as to include any income which can in some manner be attributed to the business. The derivation of the income must be directly connected with the business and generated therefrom. It has been judicially*[108] *held that interest income, duty drawback receipts and DEPB benefits, freight subsidy/transport subsidy received from Government, insurance claim etc. are not considered to be directly derived from eligible business.*

While computing the taxable profit of the business, Duty Drawback and DEPB license income to the tune of ₹ 80.30 lakh, ₹ 60.44 lakh and ₹ 70.75 lakh for AYs 2012-13, 2013-14 and 2014-15 respectively were incorrectly taken into account as income derived from the business and exemption allowed for 60 *per cent* of such income. Due to non-exclusion of such income, there was an excess allowance of exemption of ₹ 126.89 lakh involving tax effect of ₹ 41.17 lakh.

(d) Charge: Pr. CIT, Dibrugarh, Assam; AY: 2014-15; Agricultural Income allowed: ₹ 11.01 lakh

The AO allowed (December 2016) exemption of ₹ 11.01 lakh towards agricultural income derived from the sale of tea grown and manufactured. While computing the taxable profit of the business income derived from manufacturing of tea out of bought leaves, cultivation expenses of ₹ 39.54 lakh was allowed erroneously. Due to non-exclusion of such expenses, the business income was under assessed to the extent of ₹ 23.48 lakh resulting in short levy of tax of ₹ 7.25 lakh.

[108] Liberty India-[2009] 317 ITR 218 (SC); Pandian Chemicals Ltd., 262 ITR 278(SC); Sterling Foods 237 ITR 53(SC); Cambay Electrical Supply Co. Ltd. 113 ITR 84(SC)

(e) Charge: Pr. CIT-6, Bengaluru, Karnataka; AY 2013-14; Agricultural Income allowed: ₹ 353.37 lakh

The AO allowed (March 2016) exemption to the assessee towards agricultural income of ₹ 3.53 crore which included the income of ₹ 26.86 lakh derived from the sale of shade trees (i.e.) Silver Oak trees and Nilgiri Woods. *It was judicially held*[109] *that the owners of tea/ coffee estates plant grevelia trees not for the purpose of deriving any income therefrom but solely for the purpose of providing shade for the tea/coffee plants and that such shade is essential for the proper cultivation of tea/coffee. The trees were cut down and sold after they had become useless by efflux of time. The Silver Oak trees in the tea/ coffee estate constituted capital assets and the proceeds derived therefrom by sale would not constitute agricultural income under the Act.*

Failure to treat the sale of shade trees as capital in nature had resulted in excess allowance of exemption of ₹ 26.86 lakh and short levy of capital gain tax of ₹ 5.53 lakh besides interest.

(f) Charge - PCIT-3, Pune, Maharashtra; AY-2012-13; Agricultural Income allowed: ₹ 1,294.76 lakh

The AO completed the assessment for AY 2012-13 under section 143(3) in November 2014 at an income of ₹ 95.15 lakh. While computing total income, the income earned from export of floral and ornamental plants was treated as business income and accordingly a sum of ₹ 43.45 lakh out of assessee's claim of agricultural income of ₹ 1338.22 lakh was disallowed. Audit examination revealed that while computing the above business income, the export turnover was incorrectly taken as ₹ 218.80 lakh as against the actual export turnover of ₹ 322.12 lakh. This had resulted in excess allowance of exemption of ₹ 103.32 lakh involving tax effect of ₹ 33.52 lakh.

(g) Charge: Pr.CIT-1, Coimbatore, Tamil Nadu: AY 2014-15; Agricultural Income allowed: ₹ 23.61 lakh

The AO allowed (August 2016) exemption of ₹ 23.61 lakh to the assessee for AY 2014-15 towards agricultural income which included the sale of Goats to the extent of ₹ 7 lakh, that could not be considered as income derived from the agricultural land. It has judicially been held[110] by the Madras High Court the goats held by the assessee cannot be said to be personal effects of the assessee and accordingly the income derived from sale of goats is assessable to income-tax. Incorrect allowance of exemption had resulted in short levy of tax of ₹ 2.16 lakh besides interest.

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[109] (1966) 60 ITR 275(SC) and (1995) 222 ITR 799 (Kar.)

[110] V. Kalirajan vs. ITO, 2001 77 ITD 31 Mad

(h) Charge: Pr. CIT-Burdwan, Kolkata, West Bengal; AY 2012-13; Agricultural Income allowed: ₹ 30 lakh

The AO allowed (March 2015) exemption to the assessee towards agricultural income of ₹ 30 lakh which included the income from sale of fish to the extent of ₹ 16.66 lakh that could not be considered as income derived from the agricultural land. It has been held[111] that income derived from fishing over land covered by water and which is not used for any agricultural purposes cannot be treated as income from agriculture in as much as fish cannot be treated as the produce of the land, since their element is water and therefore, their cultivation and welfare depend, in no sense upon agriculture. Incorrect allowance of exemption for non-agricultural income had resulted in undercharge of tax of ₹ 6.63 lakh.

(i) Charge: Pr.CIT-1, Pune, Maharashtra; AY 2014-15; Agricultural Income allowed: ₹ 117.21 lakh

The AO allowed (December 2016) exemption of ₹ 117.21 lakh to the assessee for AY 2014-15 towards agricultural income which included the sale of dry grapes of ₹ 93.31 lakh and sale of milk of ₹ 0.37 lakh. As dry grapes (kismis) is an agro-based industrial product and milk is a dairy product, the income therefrom could not be considered as income derived from the agricultural land. The Apex Court held[112] that the regularity of the sale of milk was effected and the quantity of milk sold showed that what the assessee carried on was a regular business of producing milk and selling it as a commercial proposition. Omission to disallow the claim had resulted in excess allowance of exemption of ₹ 93.68 lakh involving tax effect of ₹ 28.95 lakh.

5.10 Conclusion

Exemption for agricultural income was allowed without verification of supporting documents such as the land records, proof of agricultural receipts and expenses and cross examination of documentary evidence where available, in 22.5 *per cent* of cases examined in audit. Audit could not ascertain the correctness of claims of exemption on account of agricultural income in absence of detailed records in assessment folders/discussions and reference in the assessment orders by the AOs. As such, it was not possible to determine whether the system in place was robust enough to ensure that assessees were being allowed exemption for agricultural income only after adequate examination in the process of assessment.

While allowance of exemption of agricultural income claims based on inadequate verification or incomplete documentation has been pointed out

[111] Karra Jayabhyarathi vs Income Tax Officer, ITAT, Hyderabad, 2005
[112] CIT vs. R. Venkataswamy Naidu [1956] 29 ITR 529 (SC)

on the basis of test check of 6,778 cases, in a sample drawn from 22,195 scrutiny cases, ITD needs to re-examine not only the remaining scrutiny cases, but also all cases where income has been allowed as agricultural income, as recommended subsequently, to ensure that exemption has been allowed only to eligible assessees, and is based on appropriate documents and their verification.

DGIT(Systems) had sought status reports regarding data entry errors while filling up the return in respect of 2,746 cases, where returned agricultural income was more than ₹ one crore. Only 26 Commissionerates provided the information in respect of 327 cases. The position with respect to remaining 110 Commissionerates is not known. Even in this small sample, data entry errors were seen in 36, i.e., 11 *per cent* of the cases. Even these had not been corrected in toto and the errors remained in one third of these cases.

Thus, there is a cause for concern that the remaining cases where status reports were not provided as well as those cases with returned agricultural income less than ₹ one crore carry similar errors. This would render the AST data unreliable. Reasons for such persistent data entry errors is a matter of inquiry.

It is recommended that:

i) ITD carry out a 100 *per cent* check of all cases, in all Commissionerates, where agricultural income claimed is above a certain threshold, say ₹ 10 lakh or more and examine and ensure that the exemption has been allowed only to eligible assessees, and is based on appropriate documents and verification.

ii) ITD needs to tighten its system to allow exemption of income as agricultural income, as currently the system is porous and open to misuse, as brought out by audit in its test audit. Due diligence in verification of records and appropriate documents needs to be ensured.

iii) ITD needs to inquire into the reasons for mismatch between assessment amount, and amounts as recorded in AST to rule out mala fide. If the errors are bona-fide, then the weakness in the system needs to be eliminated, as the two records must, under all circumstances, match. In fact, ITD needs to examine why, when returns are filed electronically, assessments are not carried out on the same electronic system/ returns, and why a manual process is allowed to co-exist with an IT system. ITD should work towards elimination of actual interface with the assessee or his/her representative altogether.

Chapter VI : Follow up Audit of Exemptions to Charitable Trusts and Institutions

6.1 Introduction

Income Tax Act, 1961 (Act), provides tax exemption to trusts, institutions and other organizations engaged in charitable or religious activities defined in section 2(15) subject to fulfilment of provisions of section 11, 12 and 13 of the Act. The Income Tax Department (ITD) is responsible for enforcement of these tax exemption provisions.

Earlier, we had examined the working of the scheme of tax exemption in the performance audit and included the findings in the C&AG Audit Report No. 20 of 2013 (Exemptions to Charitable Trusts and Institutions). The Report highlighted certain lapses such as (a) grant of approval/registration without adequate documents; (b) irregular exemptions to trusts creating huge surpluses consistently; (c) application of income in prohibited mode of investment; (d) non-monitoring of foreign contributions received by trusts etc.

In July 2018, Public Accounts Committee (PAC) in their 104th Report on the Action Taken by the Government on the observations/recommendations of the Committee contained in their 27th Report (16th Lok Sabha) on 'Exemptions to Charitable Trusts and Institutions' *inter alia* expressed their concern that public charitable trusts were being used to run commercially for profit business and had repeatedly violated provisions of the Income Tax Act. The Committee was concerned over the serious nature of all the violations and failure of the ITD to monitor whether the trusts were fulfilling the objectives under which they have been established and also ensuring that there is no abuse of the concession enjoyed by such trusts.

The Committee also desired the office of the Comptroller & Auditor General of India to submit a report on the violations of the Public Charitable Trusts and make recommendations on how to remedy the gaps and prevent such recurrences in future. In this regard, data/information relating to charitable trusts and institutions was requested for from CBDT in October 2018. The data was received only after six months in April 2019 and was also not in a usable form. CBDT had therefore to be addressed on 22 April 2019 for revised data sets. The information is yet to be received. A pan India performance audit will be conducted once CBDT provides complete and usable data.

In the meanwhile, a limited follow up Audit of Exemptions to Charitable Trusts and Institutions as contained in C&AG's Audit Report no. 20 of 2013 (Exemptions to Charitable Trusts and Institutions) was undertaken, alongwith

Charitable Trusts audit issues noticed in the compliance audit of states of Karnataka, Maharashtra and West Bengal.

6.2 Audit findings

Even in this limited audit, we noticed 99 irregularities involving tax effect of ₹ 723.43 crore. Some of the irregularities found in Audit are (a) Diversion of income/property to related group trusts/institutions considered as application of income; (b) Exemptions to assessees whose activities were not charitable in nature; (c) Lack of monitoring the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act; (d) Exemption to assessee where voluntary contribution including foreign currency donation was considered as corpus fund without specific direction of donor; and (e) Non-cancellation of registration where activities of the Trust and Institutions are not in accordance with the provisions of the Act. These findings had featured in the earlier Audit Report no. 20 of 2013 as well, implying such types of irregularities have continued to occur and exemptions continued to be allowed incorrectly inspite of non-compliance with the provisions of the Income Tax Act. Further, we have noticed errors now such as (a) Allowance of expenditure and accumulation where exemption was denied; (b) Exemptions granted to trust on application of funds given to foreign universities; and (c) Failure of the Assessment Information System (AST) to levy surcharge. The important audit findings are discussed in the subsequent paragraphs.

6.3 Diversion of income/property to related group trusts/institutions considered as application of income

Section 10(23C)(vi) provides that the income of any university or other educational institution existing solely for educational purposes, and not for purposes of profit, shall be exempt provided the institution applies its income, or accumulates it, for application wholly and exclusively to the objects for which it is established.

Further, proviso 12 of section 10(23)(c)(vi) for FY 2014-15 provides that where the fund or Trust or institution does not apply its income during the year of receipt and accumulates it, then any payment or credit out of such accumulation to any trust or institution registered under section 12AA or institution referred to in section 10(23)(C)(iv) to (via), shall not be treated as application of income to the objects for which such fund or trust or the institution, is established. Section 11 of the Act provides for exemption of income derived from the property held under trust if applied or accumulated for charitable or religious purpose in accordance with the Act.

Section 13(1)(c)(ii) of the Act, provides that exemption to charitable Trusts or Institutions under section 11 or 12 would not be available, if any income or property of the trust is applied, directly or indirectly, for the benefit of any specified person referred to in section 13(3). The person specified in section 13(3) are the author of the trust or founder of the institution; any person who has made a substantial contribution to the trust or institution of amount exceeding ₹ 50,000; where such author, founder or person is a HUF; any trustee of the trust or manager; any relative of any such author, founder, substantial contributor, member, trustee or manager.

Audit noticed in Pune and Mumbai charges, three cases involving tax effect of ₹ 60.41 crore where income/ property of institutions were diverted to related group trust and where such diversion was considered as application of income. Two such cases are illustrated below:

6.3.1 In PCIT(E), Pune charge, the scrutiny assessment of a trust for the AY 2015-16 was completed in December 2017 determining income of ₹ 54.50 crore after allowing exemption under section 10(23C)(vi). Audit scrutiny revealed that the assessee, engaged in educational activity, donated ₹ 80.00 crore out of income of ₹ 115.65 crore to one of its related trusts, which was treated as application of income. As explained above, donation of ₹ 80.00 crore made to related party cannot be treated as application of income for education purposes. It should thus been brought to tax. The omission resulted in under assessment of income of ₹ 80.00 crore involving tax effect of ₹ 27.19 crore. The reply of the Ministry was awaited.

6.3.2 In CIT (E), Mumbai charge, scrutiny assessment of a trust for AY 2014-15, was completed in October 2016 allowing exemption under section 11. Audit observed that the assessee had paid an amount of ₹ 27.48 crore towards rent for school building to a company, where the Author-cum-Trustee of the Trust is the Managing Director. As per the lease agreement, the trust was required to pay fixed lease rent of ₹ 7.33 crore (calculated at the rate of ₹ 20 per sq. ft.) or up to 85 *per cent* of the total receipts of the trust depending on the slab wise net revenue, whichever is higher. The 85 *per cent* was to be worked out on a slab based on the yearly total collection of the trust.

Though the assessee has claimed benefit under section 10(23C)(vi), the AO assessed the case invoking the provisions of section 11 in computation of income. Audit observed that, though, the assessee is showing a deficit of ₹ 10.92 crore in its income and expenditure account, the deficit is basically due to the exorbitant rent charged to the Income and Expenditure Account as stated above. Had the rent payment been on the basis of rate based on area used by the school, the assessee would have been paying only ₹ 7.33 crore

and the assessee would have earned sufficient surplus for the trust for application to the object of the trust. However, it could be seen that, the trust, instead of accumulating income for the object of the trust as envisaged in the Act, was diverting surplus earned, in the guise of rent, to the company where the trustee is Managing Director. Therefore, the assessee has violated provisions of section 10(23C)(vi) and section 13(1)(c)(ii). Hence, exemption under section 11 was required to be denied on entire income of ₹ 72.41 crore. The omission resulted in under assessment of income of ₹ 72.41 crore involving short levy of tax of ₹ 24.61 crore.

In reply, department, while not accepting the audit objection, stated that the provisions of section 13(1)(c)(ii) do not apply to the assessee as the assessee claimed exemption under section 10(23C) and not under the section 11 of the Act. Department also stated that the assessee did not violate any provisions of section 10(23C) of the Act and the rent paid by the assessee is reasonable and applied wholly and exclusively for the objects of the trust.

The reply of the department is not acceptable. As per the provisions of section 10(23C), the educational institution shall apply its income or accumulations of it, wholly and exclusively to the objects of the trust. In the instant case, the rent agreement was framed in such a way that the rent payable to the institution increases vis a vis the increase in the income of the Trust assessee. Thus, instead of accumulating income gets diverted to the company in which Author-cum-Trustee is Managing Director, violating the provisions of third proviso to section 10(23C). Rent deed was devised in a manner that the benefit goes to a company, where the Author-cum-Trustee of the Trust is the Managing Director.

Though the assessee claimed exemption under section 10(23C), the department completed the assessment under the provisions of section 11 of the Act. The department needs to confirm which section is applicable in the instant case.

The assessee continues to violate the provision of the Act, in either case.

6.4 Exemptions to assessees whose activities were not 'charitable' in nature

Section 11 of the Act provides that the income derived from the property held under trust for charitable or religious purpose, shall not be included in total income, to the extent it was applied to charitable purpose in India in accordance with the provision of section 11, 12 and 13. Further, section 2(15) amended by the Finance Act, 2010 and 2015 provides that advancement of any other object of general public utility shall not be a charitable purpose, if

(i) it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to thereof for consideration, irrespective of the nature of use or application, or retention of the income from such activity and

(ii) the aggregate receipts from such activity exceed ₹ 25 lakh (20 *per cent* w.e.f. 1.4.2016 of the total receipts).

Audit observed that ITD granted exemptions in two cases in Mumbai and Pune charges involving tax effect of ₹ 12.23 crore where activities of the assessees were not charitable in nature in accordance with section 2(15). One such case is illustrated below:

6.4.1 In PCIT (E), Pune charge, the scrutiny assessment of a trust for AY 2013-14 was completed in March 2016 determining income of ₹ 57.75 crore after allowing deduction of ₹ 16.21 crore under section 11. Audit scrutiny revealed that the assessee engaged in providing securities to properties, giving plots on lease basis and to construct housing colonies, shops and commercial complexes for lease on consideration etc. which fall in the category of trade, commerce or business for a consideration. Further, it was also noticed from the profit and loss account and computation of income that the gross receipt from such activities exceeds the allowable limit of ₹ 25 lakh for charitable activities. Hence, in view of the provisions of section 2(15) the activities of the institution are precluded from the definition of the charitable purpose and therefore, the assessee is not eligible for deduction under section 11. The omission resulted in under assessment of income of ₹ 16.21 crore with short levy of tax of ₹ 5.01 crore. The reply of the Ministry was awaited.

6.5 Allowance of expenditure and accumulation where exemption was denied

Section 11 of the Act provides for exemption of income derived from the property held under trust if applied or accumulated for charitable or religious purpose in accordance with the Act. Further, Section 164(2) provides that in case exemption is denied under section 11, such income of the trust shall be charged to tax at maximum marginal rate.

For the Trusts and Institutions registered under section 12A, provisions of sections 11, 12 and 13 are only applicable for determining income. These sections do not have provision for deduction of expenditure, but allow entire income as exempt, provided provisions of the relevant sections are followed.

Audit noticed in 12 cases in Maharashtra and Karnataka that ITD denied exemptions under section 11, but allowed deductions for expenditure to the

extent of ₹ 322.42 crore involving tax effect of ₹ 108.29 crore. One such case is illustrated below:

6.5.1 In CIT (E), Mumbai charge, the scrutiny assessment of a trust for AY 2014-15 was completed in December 2016. The AO has denied the exemption under section 11. Audit scrutiny revealed that the expenditure of ₹ 70.82 crore was allowed by the AO while computing the total income. Since there is no provision for allowing expenses from the disallowed income, the entire income should have been charged to tax. The omission resulted in under assessment of income of ₹ 70.82 crore involving short levy of tax of ₹ 24.07 crore.

In fact, the ITD itself, in case of another assessee (AY 2014-15), in an assessment completed under section 143(3) in December 2016, denied exemption under section 11 and did not allow any expenses while computing the total income. The reply of the Ministry was awaited.

6.6 Lack of monitoring the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act

Section 11(1)(a) of the Act provides that (i) the income derived from the property held under trust for charitable or religious purpose, shall not be included in total income, to the extent it was applied to charitable purpose in India; and (ii) where any such income is accumulated or set apart for application to such purpose in India to the extent to which the income so accumulated or set apart is not in excess of 15 *per cent* of the income from such property. Section 11(5) prescribes that the forms and modes of investing or depositing the money so accumulated or set apart by charitable trusts will be investment in Government savings certificates; deposit in any account with Post office savings bank/scheduled bank; investment in units of the Unit Trust of India, investment in any Central Government or state Government securities; investment or deposit in bonds issued by financial corporation, public sector company etc.

Section 13(1) of the Act, provides that exemption to charitable Trusts or Institutions under section 11 or 12 would not be available, if any income or property of the trust is applied, directly or indirectly, for the benefit of any specified person referred to in section 13(3). The person specified in section 13(3) are the author of the trust or founder of the institution; any person who has made a substantial contribution to the trust or institution of amount exceeding ₹ 50,000; where such author, founder or person is a HUF; any trustee of the trust or manager; any relative of any such author, founder, substantial contributor, member, trustee or manager. Section 13(1)(d)(i) prescribes that exemption under section 11 or 12 is not applicable if any

funds of the trust are invested or deposited or remain invested or deposited after 30 November 1983 otherwise than in any one or more of the forms or modes specified in section 11(5). Section 13(1)(d)(iii) also provides for non-availability of exemption to a charitable trust if shares in a company other than shares in a public sector company or shares prescribed as form or mode of investment under section 11(5) are held by the trust or institution after 30 November 1983.

Further, section 12AA(4) inserted w.e.f. 1.10.2014, stipulates that if the activities of the trusts are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of section 13(1) then, Principal Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution.

6.6.1 In CIT(E), Mumbai charge, Audit noticed that four trusts invested ₹ 4,034.95 crore during AYs 2009-10 to 2014-15 and one trust invested ₹ 2.02 crore in AY 2012-13 in shares of its group of companies, which is a prohibited mode under section 13(1)(d)(iii) read with section 11(5). The ITD disallowed assessee's claims of exemption in four trusts under section 11. However, in another case of a trust for AY 2012-13, ITD did not disallow the exemption.

In view of the fact that these trusts continued to flout the provisions of the Act governing investments year after year and also since the AO has been disallowing the exemption year after year without taking steps to check this irregularity, continuation of registration under section 12A granted to these assessees needs to be reviewed. Further, there is a need to check whether such errors were errors of omission or commission. If these were errors of commission, necessary action as per law needs to be taken. The reply of the Ministry was awaited.

6.6.2 As per proviso (i) and (ia) to section 13(1)(d)(iii), provisions of section 13(1)(d)(iii) shall not apply to any assets held by trust where such assets form part of the corpus of the trust as on 1.6.1973 or any accretion to the shares, forming part of the corpus by way of bonus shares allotted to the trust.

In CIT(E), Mumbai charge, three trusts continued to hold investment in modes other than those prescribed under section 11(5). These trusts held collectively 55.55 *per cent* of shares (2,24,478 shares valuing ₹ 76.90 lakh) in a group company as on 31.3.2014 which were invested prior to June 1973. Audit noticed that there is nothing on record to show that the investments were made from corpus/income of these trusts as on 1.6.1973 or before.

The corpus fund of the trusts is being utilized to control the business of the group companies by holding majority stake in a group company, instead of applying funds for charitable purpose. Therefore, the continuity of exemption provisions for investment by such trusts prior to 1.6.1973 needs to be reviewed. The reply of the Ministry was awaited.

6.7 Exemptions granted to trust on application of funds given to foreign universities

Section 11(1)(c) provides for exemption to trusts created on or after the 1st day of April 1952, for charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India provided that the Board, by general or special order, has directed that it shall not be included in the total income of the person in receipt of such income.

In, CIT(E), Mumbai charge, in the case of a trust, Audit noticed that during AY 2009-10 to 2014-15, the trust (established in July 2008) donated equivalent of ₹ 430.03 crore to two foreign universities, ₹ 232.89 crore for creation of an Endowment Fund and ₹ 197.14 crore for financing a building in the campus.

Audit noticed that CBDT had initially rejected (June 2014) the claim of the trust for exemption made in May 2010, stating that, *'The proposed activities of the Trust are not tending to promote "international welfare in which India is interested" and the same are not covered for the purpose of section 11(1)(c) of the Act".* Audit further noticed that the assessee was aggrieved by the decision of rejection of claim for exemption. Thereafter, CBDT reversed its earlier order and issued another order (November 2015) allowing the exemption to the Trust on foreign donations retrospectively from the AY 2009-10 to AY 2016-17 for an amount of $100 million. Following the order of CBDT, exemption was allowed to the trust in respect of such foreign donations from AY 2009-10 onwards.

Audit observed that the exemption granted based on the order of CBDT is irregular for the following reasons.

(i) The reversal of earlier rejected order is erroneous as the Board has no power to review its own earlier rejected order. The CBDT in its noting has itself brought out the clarification by Ministry of Law in another case that;

"It is well settled law that the power to review is not an inherent power. It must be conferred by law either specifically or by necessary implication (some High Courts are of the view that only courts have inherent power to review their orders). As there is no provision in the Act

indicating that the prescribed authority has the power to review its earlier order, hence it is felt that prescribed authority is not in a position to use the power of review of its earlier order".

The CBDT has further noted that the above view had been consistently adopted by it in all such reconsideration requests.

(ii) After the CBDT passed the order dated 10 November 2015 under section 11(1)(c), the approach adopted by the AO in granting exemption for different AYs was not consistent. For AY 2009-10, AO granted exemption by passing order under section 143(3) read with section 147 in March 2016. For AY 2011-12 and AY 2012-13, AO granted exemption by passing order under section 154 in December 2015. Further, for reopening of the assessments under section 154 for AY 2011-12 and 2012-13, the condition of mistake apparent from records was not made out as the CBDT's order issued subsequent to passing of assessment orders, cannot be treated as a mistake apparent from record.

In view of the fact that the CBDT has no power to review its own earlier order rejecting the claim of the assessee, the exemption granted on the income applied outside India by CBDT was not correct. The tax impact on account of the order passed by the CBDT is to the extent of ₹ 135.62 crore.

6.8 Exemption to assessee where voluntary contribution including foreign currency donation was considered as corpus fund without specific direction of donor

Section 11(1)(d) provides that a donation could be treated as corpus donation, only when the donor makes a specific direction to make it part of the corpus and such donation shall not be included in the total income of the trust.

In CIT (E), Mumbai charge, scrutiny assessment of a trust for AY 2014-15 was completed in November 2016 allowing exemption of ₹ 75.45 crore under section 11. Audit noticed that trust received corpus of ₹ 39.14 crore including foreign currency donation of ₹ 13.89 crore. However, details of donors as well as reports required under Foreign Contribution Regulation Act (FCRA) on donation received in foreign currency to verify the genuineness of corpus donation were not found on records. Therefore, the specific direction to make it a part of corpus was not available. Further, since source of foreign currency donation was not known, ITD needs to verify this to preclude the chances of round tripping.

As per provision of the section 11(1)(d), amount can be taken to corpus with specific direction of the donor. In this case in the absence of such direction the amount should have been treated as income for the year. Hence, the

entire surplus of ₹ 38.76 crore earned during the year should have been charged to tax as accumulation under section 11(2) was not sought by the assessee. This resulted in short levy of tax of ₹ 13.17 crore. The reply of the Ministry was awaited.

6.9 Non-cancellation of registration where activities of the Trust and Institutions are not in accordance with the provisions of the Act

Section 11(2) provides that where 85 *per cent* of the income is not applied or is not deemed to have been applied to charitable or religious purposes but is accumulated or set apart, such income so accumulated or set apart shall not be included in the total income, provided such person furnishes a statement in the prescribed form in the prescribed manner to AO stating the purpose for which the income is being accumulated or set apart and the period for such accumulation. Section 12AA(3) empowers CIT to cancel the registration, if he is satisfied that activities of the trust are not genuine or activities are not carried out in accordance with the objects of the trusts. Further, section 12AA(4), inserted w.e.f. 1.10.2014, provides for cancellation of registration in case the activities of the trust or the institution are being carried out in a manner that provisions of section 11 and 12 do not apply to exclude either whole or part of the income of such trust or institution, due to operation of sub-section (1) of section 13. Further, section 2(15) amended by the Finance Act, 2010 and 2015 provides that advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention of the income from such activity and the aggregate receipts from such activity or activities during the previous year, exceed ₹ 25 lakh (20 *per cent* w.e.f. 1.4.2016 of the total receipts) from such activity or activities.

6.9.1 Audit observed that in 15 cases in CIT(Exemptions), Mumbai charge, due to the amendment to section 2(15) w.e.f. AY 2009-10, the ITD, at the time of assessments, observed that the activities of these trusts were held non charitable due to violations of Section 11(2) read with Section 2(15) and treated them as not valid Trusts for the purpose of the Act. The ITD cancelled registration of three such trusts. Since, these trusts lost the character of charitable trust for the purpose of the Act, the income accumulated or set apart under section 11(2) for future application on charitable purpose was required to be taxed. Further, audit could not ascertain such accumulation by these trusts for want of details and also whether the department taxed such accumulation on cancellation. The ITD has been asked to clarify the

action taken on taxing the accumulation in respect of the Trusts where registration was cancelled. The reply is awaited.

In remaining 12 cases, Audit observed that although the department has held the activities of these trust as non-charitable for the purpose of the Act, the registration under section 12A of these trusts had not been cancelled. Therefore, registration of these entities needs to be reviewed and if deemed fit, funds accumulated out of exempt income may be brought to tax.

6.9.2 In CIT (E), Mumbai charge, the scrutiny assessment of a trust for AY 2014-15 was completed in November 2016 after allowing exemption of ₹ 11.38 crore under section 11(2). Audit noticed that during the year trust applied ₹ 1.91 crore (i.e. 10.64 *per cent*) for charity against receipts of ₹ 17.95 crore. This accumulation is in addition to corpus fund of ₹ 21.23 crore. Audit further observed from assessment records of AY 2012-13 and AY 2013-14 that trust applied ₹ 3.69 crore (i.e. 31.86 *per cent*) and ₹ 1.64 crore (i.e. 11.17 *per cent*) for charity against receipts of ₹ 11.58 crore and ₹ 14.68 crore respectively. This accumulation is in addition to corpus fund of ₹ 15.06 crore and ₹ 18.10 crore received during AY 2012-13 and AY 2013-14 respectively. This shows that trust had not been applying income for charity and rather accumulating it by misusing the provision of accumulation. The meagre application on charity over the years indicates that assessee has no motive or plan for charity. Since, trust failed to discharge its primary responsibility for application of income towards charity, continuation of registration of the trust under section 12AA needs to be reviewed. The reply of the Ministry was awaited.

6.10 Failure of the Assessment Information System (AST) to levy surcharge

The Finance Act, 2014 introduced levy of surcharge at the rate of 10 *per cent* on taxable income of Association of Persons, if the income exceeds ₹ 1.00 crore. Audit observed that in 33 cases of trust, surcharge was not levied even though the income exceeded rupees one crore. The omission resulted in non-levy of surcharge of ₹ 212.38 crore including cess. Two such cases are illustrated below:

6.10.1 In CIT(E), Mumbai charge, a Trust for AY 2014-15 was assessed at ₹ 1,894.92 crore. Income Tax Computation Form revealed that the ITD system (AST) failed to levy surcharge of ₹ 58.55 crore including cess. The reply of the Ministry was awaited.

6.10.2 In CIT (E), Mumbai charge, a Trust for AY 2014-15, was assessed at ₹ 893.24 crore. Income Tax Computation Form revealed that the ITD system

failed to levy surcharge of ₹ 27.60 crore including cess. The reply of the Ministry was awaited.

As we have seen only a limited number of assessment cases relating to Trusts, ITD needs to ascertain the dates between which the surcharge was leviable by the system and to identify all the assessees who did not pay surcharge during that period and take action to recover the same.

6.11 Other irregularities in assessments

Under the provisions of Income Tax Act, 1961, in scrutiny assessments the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment. The CBDT has issued instructions in this regard from time to time.

We noticed irregularities in assessment while allowing exemption to trusts/ institutions in 23 cases in Haryana, Karnataka, Maharashtra and West Bengal involving tax effect of ₹ 181.33 crore. Five such cases are illustrated below:

6.11.1 In CIT (E), Mumbai charge, in a Trust for AY 2014-15, the assessing officer denied the assessee's claim for exemption. Audit scrutiny, however, revealed that while computing total income, assessing officer erroneously allowed exemption under section 10(23C)(iv) to the extent of ₹ 125.57 crore. The mistake resulted in under assessment of income of ₹ 125.57 crore involving short levy of tax of ₹ 42.68 crore. In reply (February 2018), department accepted the audit observation. The reply of the Ministry was awaited.

6.11.2 Explanation (2) below section 11(1) provides that if, in the previous year, the income applied to charitable or religious purposes in India falls short of eighty-five *per cent* of the income derived during that year from property held under trust, or as the case may be, held under trust in part, by any amount for any other reason, then income may, at the option of the person in receipt of the income be deemed to be income applied to such purposes during the previous year in which the income was derived and the income so deemed to have been applied to such purpose shall not be taken into account in calculating the amount of income.

In PCIT-(E), Kolkata charge, the assessment of a trust for AY 2015-16 was completed under section 143(3) in August 2017 at 'nil' Income. The AOP was registered under section 10(23C)(vi) having its objective to impart education and thus fall under definition of charitable purpose under section 2(15). The assessee was allowed exemption of ₹ 126.97 crore under section 10(23C) as accumulation of Income for application in next previous year. Audit noticed that the assessing officer while completing the assessment erroneously

mentioned the surplus of income at ₹ 151.47 crore instead of ₹ 45.04 crore. This resulted in excess allowance of exemption of ₹ 106.43 crore having a potential tax effect of ₹ 36.16 crore. On being pointed out by audit, the error was rectified under section 154 in October 2018.

6.11.3 Section 40(a)(ii) provides that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains is not deductible.

In CIT (E), Mumbai charge, in a trust (company) for AY 2014-15, the assessing officer denied the assessee's claim for exemption. Audit observed that in computation of income the assessee claimed reduction of ₹ 27.91 crore on account of Tax Deducted at Source (TDS) and Advance Tax. The department, while computing taxable income, had again reduced the above amount of ₹ 27.91 crore from taxable income instead of adding the same to taxable income in view of the provision of section ibid. Error resulted in underassessment of income of ₹ 55.82 crore involving short levy of tax of ₹ 18.97 crore. In case, this is an error of omission, the ITD should take action against the AO for gross incapacity and if such error is of commission, then action as per law needs to be taken. The reply of the Ministry was awaited.

6.11.4 In CIT(E), Bengaluru charge, the assessment of a trust engaged in the activity of running educational institutions, for AY 2015-16 was completed at an income of ₹ 11.35 crore in September 2017. Audit noticed that the AO passed the order by disallowing the brought/carry forward of excess expenditure to the subsequent years. The CIT(A) in para 5.2 and 5.3 of its order dated 12.2.2018 directed the AO to allow the carry forward of excess expenditure (pertaining to earlier years) of ₹ 58.99 crore to subsequent years as application of income after due verification of the figures with the assessment records. It included the deficit of ₹ 31.14 core pertaining to AY 2009-10. Audit noticed from the assessment orders for the AY 2009-10 passed under section 143(3) read with section 147 in December 2016 and the order giving effect to CIT(A) in January 2018 that there was no deficit to be carried forward. Thus, incorrect set-off and carry forward of deficit of ₹ 31.14 crore resulted in short levy of potential tax effect of ₹ 10.58 crore.

6.11.5 In CIT(E), Bengaluru charge, the assessments of a Trust for AY 2014-15 and AY 2015-16 were completed at a loss of ₹ 55.64 crore and ₹ 54.16 crore respectively. The assessee, established for providing public transport service, was registered under section 12AA of the Act. The AO denied the claim of deduction under section 11 in view of section 2(15) read with section 13(8) and its income was brought to tax as normal business income. Audit noticed that while computing the income, the provisions of business income was not

applied in totality; instead computation was done by adopting income as per section 11. The error resulted in under assessment of income of ₹ 8.23 crore and ₹ 37.84 crore involving potential tax of ₹ 3.66 crore and ₹ 16.78 crore for the AY 2014-15 and AY 2015-16 respectively.

6.12 Conclusion

Despite having been featured in earlier performance Audit Report no. 20 of 2013, Audit still noticed instances of irregularities where

- ITD considered diversion of income/property by trusts to related group trusts/institutions as application of income;
- ITD allowed exemptions to assessees whose activities were not charitable in nature;
- ITD has not taken action to cancel registration of the trusts whose activities were held as non-charitable;
- the internal control mechanism to monitor the investment of accumulated money by the trusts in the forms or modes other than those specified in the Act is weak; and
- ITD granted exemption to asseessee where voluntary contribution including foreign currency donation was considered as corpus fund without specific direction of donor.

Audit, further noticed instances where

- ITD allowed expenditure and accumulation though exemption was denied;
- In contravention of the rules, ITD granted exemptions to trust constituted after 1952 on charitable grounds though the investment was in a foreign universities. They did not have powers to review and pass such an order; and
- AST of ITD failed to levy surcharge.

CBDT needs to provide the data/information needed by audit to submit report on the violations of the Public Charitable Trusts in the Parliament. CBDT needs to review not only those cases pointed out by Audit but all Trusts cases without exception.

6.13 Recommendations

The PAC in their 104th Report on the Action Taken by the Government on the observations/recommendations of the Committee contained in their 27th Report (16th Lok Sabha) on 'Exemptions to Charitable Trusts and Institutions'

had also desired C&AG to make recommendations on how to remedy the gaps and prevent recurrences in future. The following recommendations are therefore made:

i. *CBDT may ensure that the various conditions prescribed in the Act are complied with by the Trusts before granting exemptions and registration of trusts not fulfilling the prescribed conditions are reviewed.*

ii. *CBDT may consider amending the provision to make prior approval a pre-condition for foreign donation by a charitable trust or institution. The CBDT may also specify a limit say, 5 to 10 per cent of income for such donations.*

iii. *CBDT may consider including a provision to make the trustee also liable in case where the provisions of the Act are not complied with.*

iv. *Some of the provisions for exemptions to charitable trusts and institutions viz. section 11(1)(c) from on or after 1.4.1952, section 13(1)(d)(iii) after 30 November 1983, proviso to section 13(1)(d)(iii) from 1.6.1973 are from specific dates and apply to different trusts differently thereby not providing a level playing field. CBDT may consider bringing in a level playing field by inserting a sunset clause for such provisions applicable to those Trusts that have retained the benefit on ground of actions, having been taken earlier though these are prohibited now. A sunset clause for such provisions would ensure that benefits not available now are not available to anyone, and thus that all types of Trusts and Institutions are treated on similar lines. This will reduce the difficulties in assessing Trusts, when different trusts have to be treated differently, and reduce the "errors" in assessments. CBDT may consider giving a period of say, three years to the affected trusts to comply with the new provisions.*

v. *Since the issues pointed out in the earlier Audit Report no. 20 of 2013 are continuing, ITD is advised to review all the trust cases without exception and ensure that exemptions and concessions allowed to them are as per the provisions of the Act.*

vi. *CBDT may examine whether the instances of "mistakes" noticed are errors of omission or commission and if these are errors of commission, then ITD should ensure necessary action as per law.*

Chapter VII : Integrated Audit of assessments of a Group Company

7.1 Introduction

Assessment of Large Tax Payer assessees is a complex issue and has become vexatious to Income Tax Department (ITD) due to the diversified nature of business, numerous deductions, transactions with related parties, different accounting policies followed and its consequential impact on taxable income.

We conducted integrated audit of assessments of a large company along with group companies[113] and its various subsidiaries on test check basis. The flagship company (FC) was carrying out a number of financial transactions of amalgamation/demerger which has huge impact on tax revenue and significant area for audit. FC at present is assessed in CIT(LTU), Mumbai charge and its group companies/entities are assessed across various charges like CIT-II, CIT-III, CIT-VIII, CIT-XVII, CIT-(Exem.) etc. The group could be primarily classified into various segments like the flagship company carrying on the business of extraction of oil and gas, refining, petrochemicals, treasury operations and the group associates primarily operating in verticals like oil retail, gas transportation, investments etc. The primary objective of this integrated audit was to ascertain whether there was exchange of relevant information relating to companies of a group amongst the various assessment charges of the ITD for accomplishing quality assessment.

Audit Findings

7.2 Cross linking of records of companies of a group

Section 143(3) provides that AOs have to determine and assess the income correctly and determine the tax payable or refundable, as the case may be. Different types of claims together with accounts, records and all documents enclosed with the return are required to be examined in detail in scrutiny assessments. CBDT has also issued instructions from time to time in this regard.

A test check of assessment records of related parties[114] assessed in other charges like CIT-III, CIT-VIII, CIT-XVII and CIT(Exemption) revealed that FC had made numerous transactions with related parties in the form of sale and purchase of investment/fixed assets, extending of loans and advances, sale and purchase of goods and services, other income, donations etc. We noticed gaps in few sample transactions recorded in the books of FC and books of related parties as shown in Table7.1 below:

[113] Group company is collection of companies controlled by a common apex company

[114] As per Companies Act, related party with reference to a company means any company which is a holding, subsidiary or an associate company of such company

Table 7.1: Cross linking of records of group companies							**(₹ in crore)**
Sl. No.	**Name of the related party**	**AO in charge**	**AY**	**Nature of transactions**	**Amount in FC's books**	**Amount recorded in related party's books**	**Difference**
1	Group Company (GC)-1	DCIT-3(3)(1), Mumbai	2012-13	Loans extended by FC during the year	2,625	2,113	512
2	GC-1	DCIT-3(3)(1), Mumbai	2013-14	Loans extended by FC during the year	7,684	7,735.14	51.14
3	GC-2	DCIT-3(3)(1), Mumbai	2012-13	Payment of professional fees by FC	9.0	18.63	9.63
4	GC-2	DCIT-3(3)(1), Mumbai	2013-14	Payment by FC on account of purchases	68.49	52.51	15.98

It is seen from the assessment records that ITD had not made any efforts to cross link the above material transactions with related parties to ensure the correctness/genuineness as desired by CBDT. This indicates that ITD may explore feasibility of integrated assessment of such group companies.

ITD while accepting (April 2018) the importance of sharing of information and cross linking of transactions across different assessment charges stated that during the course of assessment proceedings of AY 2015-16, the reconciliation of the books of the assessee for the purpose of Related Party Transactions (RPT) has been scrutinized. ITD further submitted the reconciliation of transactions which were showing gaps in related parties books of accounts.

ITD stated with reference to sl. no. 1 and 2 that the assessee company was asked to reconcile the difference between figures reported in RPT Schedule of FC vis-à-vis figures reported in RPT Schedule of GC-1. In response, the assessee company FC submitted that the difference in the related party transactions (RPT) was on account of 'interest accrued but not due'.

In this regard, it is stated that though the ITD furnished the reason of difference of amounts, it did not give details of assessment years in which the said item, i.e. 'interest accrued but not due' will be chargeable to tax.

With respect to sl. no. 3, ITD replied that assessee company was asked to reconcile the difference and assessee submitted that GC-2 had received ₹ 27.63 crore from FC which comprises ₹ 9 crore on account of Revenue from Operations and ₹ 18.63 crore being reimbursement of expenses. Since FC in its RPT Schedule shows transactions excluding reimbursement, the

reimbursement of expenses of ₹18.63 crore is not reflected in the RPT Schedule of FC. The reimbursement of expenses has been netted off against expenditure on account of Professional Fees details of which were verified during the course of assessment proceedings of GC-2. With respect to sl. no. 4, ITD while taking the stand of assessees' submission, stated that GC-2 had received ₹ 61 crore from FC which comprises of Income from Operations of ₹ 52.51 crore and Principal Portion of lease rent of ₹ 8.29 crore offered to tax separately rounding off difference of ₹ 0.2 crore.

In this regard, it is stated that though ITD furnished the reason of difference as stated by assessee, however, the records on which ITD relied while accepting the assessees' version were not furnished to audit. As such, audit could not verify the details of related party transactions and hence unable to offer any comment.

For the cross linking/verification of related party transactions, an Information Technology (IT) driven mechanism for sharing of information within the ITD which will enable utilization of information effectively, is required to be evolved and put in place to bring in reconciliation of significant related party transactions as it would act as a deterrence and would also minimise the possibility of escapement of taxable income. Though, reconciliation of gaps in transactions is furnished by the ITD, it is felt that such exercise should have been carried out regularly.

7.3 Earning of huge dividend disproportionate to Investment

Audit also cross verified the records on test check basis of four shareholders (SH), having the status of Limited Liability Partnership[115](LLP) (incorporated in April 2010), each holding more than one *per cent* of FC shares namely SH-1 (3.93 *per cent*), SH-2 (3.93 *per cent*), SH-3 (4.17 *per cent*), and SH-4 (3.86 *per cent*). The majority of shares of above LLPs were further held by other LLPs which are part of the group. As the cases of above LLPs were not selected for scrutiny, a copy of Income Tax Returns (ITRs) of AY 2012-13 to 2014-15 were called for from the ITD. It was observed from the ITRs that the registered office of these LLPs and partners LLPs were same. In this context, it was observed from sources (as per Registrar of Companies data in public domain) that on the above address, more than 350 companies and LLPs were found registered but it was not known whether these entities were filing their ITRs regularly and regular business activities were being carried on by these entities. As such, the whole universe of such companies and the combined income offered/losses claimed by them was not known. Thus, the genuineness of companies should have been verified by the ITD.

[115] LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. It is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP

Verification of ITRs for AY 2012-13 in respect of two LLPs namely SH-1 and SH-2 by audit indicated that they had received dividend of ₹ 102.14 crore each. However, balance sheet of the LLPs showed that partners' capital were ₹ 0.09 crore and ₹ 0.12 crore and investments were at ₹ 0.09 crore and ₹ 0.11 crore respectively. Thus, it appeared that the assessees' investment as reflected in balance sheet were not commensurate with huge dividend received. Even going by the face value of ₹ 10 per share, the assessees' investment portfolio should ideally reflect investment of more than ₹ 125 crore. It is pertinent to mention that during the relevant period, the market price of FC share ranged between ₹ 885 to ₹ 1,149. In view of above apparent discrepancies, ITD should have initiated action to verify the source of investment and reasons for not reflecting the same in the books. Further, despite receipt of huge dividend (more than ₹ 100 crore per year) in two successive years, the above cases have also escaped scrutiny under CASS selection. The above audit findings are in respect of test checked cases only. Such disproportionate dividend receipts could be present in remaining cases as well which needs to be verified by the ITD.

ITD in reply stated that cases of SH-1, SH-2 and SH-3 were not selected for scrutiny, however, cases have now been selected for scrutiny and reopened under section 147 (April 2019).

7.4 Loans and advances among group companies

7.4.1 We noticed that there were numerous transactions of loans, advances and share subscriptions amongst the group companies. In CIT-III charge, while completing assessment of GC-3 for AY 2014-15, ITD had inter-alia allowed to carry forward capital loss of ₹ 90.24 crore from redemption (October 2013) of 9.20 lakh preference shares of GC-4. Audit examination revealed that these preference shares so received (January 2012) from GC-5 were carrying huge premium of ₹ 4,990 per share i.e. 499 times of the face value even though there was no identifiable business of the GC-4 and had shown meagre income over the years and had negative basic earnings per share (₹ 76.44) after exception items. Further GC-4 was under the process of amalgamation with the assessee.

ITD replied (May 2017) that above preference shares were received by the assessee on demerger of investment division of GC-5 and the said shares were redeemed at its cost of acquisition by GC-4*. These shares being long term capital asset, the cost of acquisition was indexed which led to capital loss of ₹ 90.24 crore.*

ITD's reply is not acceptable as the objection was regarding huge premium paid (₹ 4990 per share) by the group companies which was not commensurate with the underlying business or net worth of GC-4.

Incidentally it was also observed that during the relevant period, the shares of FC having huge turnover and profits were quoted around ₹ 800 per share. In this backdrop the payment of huge premium to preference shares of GC-4 having negative net worth was not justifiable. Therefore, ITD was expected to verify the complete audit trail of the shares so received/subscribed in order to disallow excessive premium paid by the group companies. Even though transaction was layered through different group companies, the same was not referred to concerned charges and it therefore appeared that the different assessment charges of ITD acted as if they were working in standalone manner rather than as a cohesive unit.

7.4.2 In another case, it was noticed that GC-6 had invested (during the period November 2012 to April 2013) ₹ 8,304 crore for purchase of equity shares of GC-7 from FC & related parties (RP) RP-1, RP-2. Upon the merger of GC-7 into GC-8 w.e.f. April 2012 (vide HC order of June 2013), GC-6 transferred shares of GC-8 (received upon merger) to GC-9, with a capital loss of ₹ 3,321.60 crore subsequent to which GC-6 merged (September 2013) into GC-1. Thus with a web of companies shares were purchased, swapped and short term capital loss (STCL) was created under the garb of corporate restructure.

ITD while not accepting (May 2017) the audit observation stated that both the amalgamating (creator of the loss) and the amalgamated company are not industrial undertaking and as such amalgamated company is not eligible for carry forward of losses of amalgamating company as per provisions of section 72A of the Act. Also, GC-1 *had neither set off nor carried forward this short term capital loss.*

ITD's reply was not tenable since section 72A only deals with the carry forward of business losses and unabsorbed depreciation and does not debar assessee from carry forward of capital losses. The fact that such losses have not been claimed by amalgamated company in first year does not debar assessee from claiming such STCL in remaining seven succeeding years[116]. Further in this case, ITD should have questioned the transaction, where shares of GC-7 were swapped with GC-8 in adverse ratio of 5:3, thus creating loss for GC-6 which was holding shares of GC-7.

7.4.3 We noticed from FC's assessment records that during FY 2011-12, it had extended interest free loans of ₹ 6,615 crore to GC-1. We further noticed from assessment records of GC-1 that it had extended ₹ 2,261.85 crore loan to RP-3. However, ITD had not made any effort to verify the genuineness of loan transactions. In order to verify the

[116] Section 74 of the Income Tax Act provides that short term capital loss (STCL) can be carried forward for eight assessment years (AY) immediately succeeding the AY in which the loss was first computed. Further STCL can be set-off against any capital gains.

genuineness of loan, records of RP-3 were called for by audit from the ITD. In response, ITD replied that RP-3 had not filed its ITR for AY 2012-13 to AY 2014-15 as there was no taxable income.

In this regard, we also observed that non filer management system (NMS) data was not utilised effectively to ensure filing of return which indicates that the high money value transaction was either not captured or even if it had been captured the same was not utilised by DIT/CIB/FIU[117] for further investigation. Therefore, a system needs to be put in place where non-filers involved in high money value transaction are tracked and their sources and application of funds are verified. Reply from ITD is awaited (March 2019).

7.5 Quality of assessment of Flagship Company and its group companies

7.5.1 Incorrect allowance of deduction under section 80-IA

As per section 80-IA(1) of the Income Tax Act, where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any eligible business, a deduction shall be allowed in computing the total income of the assessee, of an amount equal to hundred per cent of the profits and gains derived from such business for ten consecutive assessment years subject to the other conditions prescribed in the section. Further it applies to any enterprise carrying on the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility which fulfils inter-alia the condition that the entity has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility.

7.5.1.1 In CIT-III, Mumbai, charge while completing scrutiny assessment for AY 2014-15 in the case of GC-2**,** ITD allowed deduction of ₹ 6.87 crore under section 80-IA. The assessee was engaged in the business of raw water supply through pipeline from river 'X' to petrochemical complex of FC, against a tripartite agreement executed by FC with other parties. Audit examination revealed that during the relevant period, the assessee had received product transportation services charges of ₹ 19.53 crore and ₹ 17.31 crore as support services from FC. Moreover, entire revenue of ₹ 84.83 crore was received either from FC or related companies. It emerged from the facts available on the record that the assessee was primarily a sub-contractor for FC as it was not party to tripartite agreement entered with municipal body and hence was ineligible for deduction under section 80-IA. Omission to disallow the same

[117] DIT-Directorate General of Income Tax (Investigation) , CIB-Central Information Branch, FIU- Financial Intelligence Unit

had resulted in underassessment of ₹ 6.87 crore involving short levy of tax of ₹ 2.23 crore. Similar observation on deduction under section 80-IA for period prior to AY 2012-13 was already reported in Performance Audit Report of C&AG on section 80-IA.

ITD replied (May 2017) that the assessee company is owner of infrastructure facility and had charged transport charges to beneficiary of facility i.e. FC*. Further as per agreement dated 25 April 2008 between* FC *and assessee company, the assessee was providing services to* FC *by using its transport system, thus the assessee cannot be called a subcontractor of* FC*.*

Reply of ITD was not tenable as the assessee had not entered into tripartite agreement with the municipal body as required. Further, reply was silent on the issue of private facility whereas for development of infrastructure, concept of public utility is always embedded. The assesse, in instant case, had not made any investment for creating infrastructure for wider public use and was merely transporting raw water to its sister concern FC.

7.5.1.2 In CIT-III, Mumbai, charge in the case of GC-10**,** for the AY 2012-13, ITD allowed deduction under section 80-IA on gross total income which was inclusive of capital gain of ₹ 6.23 crore and Income from other sources of ₹ 111.29 crore. Omission to restrict deduction under section 80-IA to the income under the head 'Profits and Gains of Business' resulted in excess allowance of deduction of ₹ 117.52 crore leading to excess carry forward of MAT credit of ₹ 38.13 crore.

The ITD replied (July 2018) that total eligible deduction under section 80-IA is of ₹ 1,748.67 crore and it was restricted to the Gross total income of ₹ 1,226.22 crore.

Reply of ITD was not tenable since out of the eligible deduction under section 80-IA of ₹ 1,748.67 crore, the assesses' income under the head 'Income from Business and Profession' was only ₹ 1,108.71 crore and the income of ₹ 6.23 crore relates to income from capital gains and ₹ 111.29 crore to income from other sources which were not related to earning of income from infrastructure development. Allowance of ₹ 1,226.22 crore deduction would result in allowance of deduction against capital gain and income from other sources which was not the legislative intent meant for income from developing, operating and maintaining infrastructure facilities under section 80-IA.

7.6 Mistakes in assessment of Book Profit

Section 115JB of the Act provides that all income shall be routed through profit and loss account for the purposes of computation of book profit. It has

been judicially[118] held that interest received on Income Tax refund is to be accounted for in the year of receipts.

7.6.1 In the scrutiny assessment of FC of AY 2009-10 to 2013-14 under CIT(LTU), Mumbai charge, we noticed that the assessee offered the interest on Income Tax refund under normal provisions of the Act, but did not route it through profit and loss account, resulting in short computation of book profit of ₹ 346.57 crore with consequential short levy of tax under MAT of ₹ 64.80 crore for the above five assessment years.

The ITD replied (May 2018) that the AO does not have power to go beyond the certified books of accounts maintained by the assessee. It further stated that as per decision of ITAT Mumbai in 100 ITD 131, the interest on income tax refund would be assessable in the year in which it is granted and not in the year in which it becomes due holds good only for normal provisions and not MAT provisions. It further stated that as the finality in case of proceedings were not reached; the income was offered under normal provisions but not credited to books of accounts.

The reply of the ITD was not tenable as interest on income tax refund is to be categorised under income from other sources and that being so should have been part of Profit and Loss (P&L) accounts. Further, the books of accounts were not prepared in accordance with the clause 2 (b) of Part-II of Schedule VI of the Companies Act which, inter-alia, states that P&L account shall disclose every material feature including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of exceptional nature as it was held by the Hon'ble Bombay High Court in the case of CIT vs. Veekaylal Investment Co. (P) Ltd., 116 Taxman 104. Hence, the AO had the option to reject the accounts which were not prepared in accordance with provisions of the Act.

7.6.2 In CIT-III, Mumbai, charge while completing assessment in the case of GC-11 for AY 2014-15, ITD omitted to add back provision for standard asset, and income from other sources to book profit. The omission led to short computation of book profit by ₹ 0.86 crore involving short levy of tax of ₹ 0.18 crore.

ITD stated (May 2017) that assessee being an NBFC had created provision for standard assets as per RBI guidelines. However, as section 115JB is a separate code, the above provision not being contingent in nature is required to be added to book profit. As regards not routing of income from other sources through Profit & Loss account, it was contended that the said income

[118] ITAT Mumbai special bench in the case of M/s Avada Trading Company Trading Ltd. (100 ITD 131)
ITAT Mumbai in the case of Growth Avenue Securities Vs. DCIT

was booked in FY 2014-15 since the intimation from venture fund in respect of the same was received after the end of financial year.

Reply of the ITD was not acceptable as it was held by Hon'ble Supreme Court in the case of M/s Southern Technologies Ltd. vs. Joint CIT Coimbatore 187 Taxman 346 that RBI guidelines cannot override the provisions of the Act. Further, it has been held by ITAT Mumbai in the case of M/s Growth Avenue Securities vs DCIT that even exempt capital receipt should be routed through Profit & Loss Account.

7.7 Mistakes in computation of Capital gain

7.7.1 In CIT(LTU), Mumbai charge, in the scrutiny assessment of FC for AY 2013-14, the Transfer Pricing Officer (TPO) held that the transaction of transfer of preference shares by FC to foreign Associate Enterprises (AEs) was basically loan transaction and made adjustment of ₹ 104.60 crore towards interest chargeable on the said loan transaction. However, the Assessing Officer (AO) did not take cognizance of findings of TPO and allowed LTCL ₹ 566.86 crore arising out of transfer of preference shares of these AEs. The mistake had potential tax impact of ₹ 122.61 crore.

ITD while not accepting the audit objection contended (May 2018) that as per section 92CA(4) of the Act AO has to compute total income in conformity with ALP determined by TPO. Since, transaction value on redemption of preference shares was accepted by TPO, there was no occasion to disallow LTCL of ₹ 566.85 crore claimed by asseessee. Further, investment in non-cumulative compulsorily convertible preference shares (NCCPs) was made in AY 2009-10 was accepted by TPO without re-characterization.

The reply was not tenable as the issue of investment in NCCPs was examined in detail by TPO after considering all facts of the case and it was inferred that investment in NCCPs of AEs was nothing but mutual arrangement of advancing loan under the garb of preference shares to avoid taxability of interest income. As per Hon'ble SC decision in the case of M/s Mcdowell co Ltd. vs CTO 154 ITR 148, the AO should have initiated the logical action of disallowing the fabricated LTCL which was a colourable device resorted to by assessee. Hence, ITD may re-examine the issue in the interest of revenue.

7.7.2 *As per third proviso below section 48, the benefit of indexation is not admissible on bonds or debentures other than capital indexed bonds issued by the Government.*

In the case of FC, the ITD allowed the benefit of indexation on Bonds (other than capital indexed bonds) during AY 2012-13 in contravention of provision of the Act which led to irregular computation of LTCL of ₹ 123.78 crore involving potential tax impact of ₹ 26.78 crore. Reply from ITD is awaited.

7.8 Incorrect computation of Business Income

The Assessing Officers are expected to avoid mistakes while completing scrutiny assessments and exercise due care in implementing orders of appellate authority. Further, *the Board has issued instructions from time to time to all field formations to compute income and tax correctly while completing scrutiny assessment.*

7.8.1 In case of GC-12, (now merged with FC) ITD in AY 2003-04 held certain expenditure (₹ 102.28 crore) claimed as revenue expenditure, as capital expenditure and allowed depreciation on the same. However, in April 2015 decision of the Bombay High Court went in favour of GC-12 and the expenditure was allowed as revenue expenditure. We noticed that the said depreciation allowed from AY 2003-04 onwards remained to be withdrawn in AY 2007-08, 2010-11 and 2012-13 resulting in underassessment of income of ₹ 15.79 crore with consequent short levy of tax of ₹ 5.30 crore.

The ITD stated (May 2018) that the audit objection is acceptable. Further progress on remedial action taken is awaited.

7.8.2 We noticed that while working out depreciation for deduction under section 80-IB(9)[119] of a unit of FC during AY 2010-11 and 2011-12, ITD apart from allowing regular depreciation had also allowed additional depreciation in respect of additions to block of Plant and Machinery made during the relevant previous years. However, while working out above deduction during AY 2012-13 and 2013-14, ITD omitted to consider allowance of additional depreciation. The net additions under plant & machinery during the period relevant to AYs 2012-13 & 13-14 was at ₹ 2,066.40 crore and ₹ 2001.95 crore respectively.

ITD replied (May 2018) that even if additional depreciation is worked out , it will be tax neutral as deduction allowable under 80-IB(9) would be reduced however, there will be corresponding increase in depreciation allowance under section 32 and consequently there will be no change in total income and as such there is no loss to revenue.

The reply needs reconsideration as higher depreciation in initial years would lead to carry forward of reduced WDV in subsequent years and consequential higher taxable income once the deduction under 80-IB(9) is lapsed.

7.8.3 In CIT-VIII, Mumbai Charge, the assessee GC-13 for AY for 2013-14 had filed its original return of income for a loss of ₹ 27.97 crore and same was revised for a loss of ₹ 18.05 crore. However, while completing assessment, ITD omitted to take cognisance of revised return of income. As a result there

[119] The amount of deduction to an undertaking shall be hundred *per cent* of the profits, if the undertaking is engaged in refining of mineral oil

was excess carry forward of loss of ₹ 9.92 crore involving potential tax impact of ₹ 3.22 crore. *The ITD accepted the para (September 2017) and rectified the mistake.*

7.9 Conclusion

We observed that there was an absence of effort by the ITD in cross linking material transactions with related parties to ensure the correctness/ genuineness. The ITD lacks a system of information sharing amongst its various charges leading to assessments of group companies getting completed in standalone manner thereby missing sight of important issues which have bearing on determination of taxable income. The problem further gets aggravated in case of merger/demerger on account of corporate restructuring of groups. Had there been robust/dedicated system in place, the quality of assessment would have been better.

ITD may also put in place an IT driven mechanism for sharing of information regarding group companies within the ITD so as to utilize information effectively and plug the leakage of revenue.

We referred this to the Ministry of Finance in July 2018 for its comments. Response of the Ministry was awaited (March 2019).

New Delhi **(Sanjay Kumar)**
Dated: 03 July 2019 **Principal Director (Direct Taxes-I)**

Countersigned

New Delhi **(Rajiv Mehrishi)**
Dated: 03 July 2019 **Comptroller and Auditor General of India**

Appendices

Appendix 2.1 (Reference: Paragraph 2.2.4)

State-wise incidence of errors in assessments						
State	**Assessments completed in units selected for audit during 2017-18**	**Assessments checked in audit during 2017-18**	**Audit observations[120] (Nos.)**	**Assessments with errors (Nos.)**	**Total revenue effect of the audit observations (₹ in crore)**	**Percentage of assessments with errors (Col. 5/ Col. 3x100)**
1	**2**	**3**	**4**	**5**	**6**	**7**
Andhra Pradesh & Telangana	17,533	16,948	1,394	1,343	1,499.00	7.92
Assam	4,766	4,738	430	430	27.95	9.08
Bihar	4,196	4,052	247	247	184.46	6.10
Chhattisgarh	5,443	4,310	184	123	91.62	2.85
Delhi	30,264	27,382	1,521	1,342	2,556.98	4.90
Goa	1,947	1,934	87	87	83.58	4.50
Gujarat	14,722	14,443	1,118	1,002	1,044.63	6.94
Haryana	6,566	6,306	740	670	457.01	10.62
Himachal Pradesh	1,231	1,202	249	219	94.16	18.22
Jammu & Kashmir	1,346	1,329	91	87	15.46	6.55
Jharkhand	1,881	1,851	168	139	82.68	7.51
Karnataka	13,710	13,380	1,151	1,071	1,634.84	8.00
Kerala	9,779	9,339	724	675	658.79	7.23
Madhya Pradesh	14,710	13,035	1,124	1,124	558.00	8.62
Maharashtra	1,34,203	79,273	5,150	4,311	13,597.38	5.44
Odisha	7,935	6,581	518	497	460.99	7.55
Punjab	5,619	5,554	485	408	712.71	7.35
Rajasthan	18,328	17,424	825	825	134.60	4.73
Tamil Nadu	23,057	21,983	2,025	1,914	1,644.16	8.71
UT Chandigarh	1,643	1,642	144	116	28.27	7.06
Uttarakhand	2,980	2,661	98	95	127.79	3.57
Uttar Pradesh	24,247	23,905	1,040	952	776.18	3.98
West Bengal	33,530	32,000	2,556	2,398	2,100.19	7.49
Total	**3,79,636**	**3,11,272**	**22,069**	**20,075**	**28,571.43**	**6.45**

[120] This includes all audit observations of under assessment as well as over assessment in corporate tax, income tax and other direct taxes.

Appendix 2.2 (Reference: Paragraph 2.2.6)

Category wise details of underassessment in respect of Corporation tax and Income tax detected during local audit

(₹ in crore)

Sub category		No. of errors	Tax effect
A.	**Quality of assessments**	**6,778**	**5,628.19**
a.	Arithmetical errors in computation of income and tax	1,867	2,513.51
b.	Incorrect application of rate of tax, surcharge etc.	907	870.39
c.	Non/short levy of interest/penalty for delay in submission of returns, delay in payment of tax etc.	3,875	1,716.67
d.	Excess or irregular refunds / interest on refunds	84	145.43
e.	Mistake in assessment while giving effect to appellate orders	45	382.19
B.	**Administration of tax concessions/exemptions/ deductions**	**7,867**	**15,435.02**
a.	Irregular exemptions/deductions/reliefs given to Corporate	419	1,735.21
b.	Irregular exemptions/deductions/reliefs given to Trusts/Firms/Societies	341	131.49
c.	Irregular exemptions/deduction/reliefs given to individuals	310	64.48
d.	Incorrect allowance of Business Expenditure	5,617	10,954.95
e.	Irregularities in allowing depreciation/business losses/Capital losses	1,155	2,534.83
f.	Incorrect allowance of DTAT relief	25	14.06
C.	**Income escaping assessments due to omissions**	**2,779**	**3,067.95**
a.	Under Special Provisions including MAT/Tonnage Tax etc.	289	760.35
b.	Unexplained investments/ cash credits etc.	439	405.41
c.	Incorrect classification and Computation of Capital Gains	710	811.96
d.	Incorrect estimation of arm's length price	64	1.82
e.	Omission to club income of spouse, minor child etc.	58	49.51
f.	Incorrect computation of Income from House Property	254	117.82
g.	Incorrect computation of salary income	350	379.73
h.	Omission in implementing provisions of TDS/ TCS	615	541.35
D.	**Others**	**3,655**	**3,220.59**
	Total	**21,079**	**27,351.75**

Appendix 2.3 (Reference: Paragraph 2.4.4)

Category wise details of observations in respect of Draft Paragraphs sent to the Ministry			
Sub category		**Cases**	**Tax Effect (₹ in crore)**
A. Quality of assessments		**203**	**1398.31**
a.	Arithmetical errors in computation of income and tax	60	591.37
b.	Incorrect application of rate of tax, surcharge etc.	34	471.16
c.	Non/short levy of interest/penalty for delay in submission of returns, delay in payment of tax etc.	100	250.21
d.	Excess or irregular refunds/interest on refunds	4	30.98
e.	Mistake in assessment while giving effect to appellate orders	5	54.59
B. Administration of tax concessions/exemptions/deductions		**167**	**3188.82**
a.	Irregular exemptions/deductions/reliefs given to Corporate	27	477.25
b.	Irregular exemptions/deductions/reliefs given to Trusts/ Firms/Societies	6	3.66
c.	Irregular exemptions/deductions/reliefs given to individuals	2	0.58
d.	Incorrect allowance of Business Expenditure	59	901.27
e.	Irregularities in allowing depreciation/business losses/ Capital losses	73	1806.06
C. Income escaping assessment due to omissions		**68**	**364.64**
a.	Under special provisions including MAT/Tonnage Tax etc.	29	100.65
b.	Incorrect classification and Computation of Capital Gains	12	22.92
c.	Incorrect Computation of Income	7	51.73
d.	Omission in implementing provisions of TDS/TCS	3	127.26
e.	Unexplained investment/ cash credit	6	46.79
f.	Incorrect estimation of Arm's Length Price	11	15.29
D. Others		**34**	**245.95**
	Over charge of tax/interest	34	245.95
	Total	**472**	**5197.72**

Appendix 2.4 (Reference: Paragraph 2.6.2)

Cases where remedial action has become time barred in FY 2017-18		
State	**Audit observations where remedial action became time barred**	
	Cases	**Tax effect (₹ in crore)**
Andhra Pradesh & Telangana	-	-
Assam	52	4.21
Bihar	505	78.88
Chhattisgarh	40	12.00
Delhi	6	0.14
Goa	10	10.62
Gujarat	155	221.81
Haryana	73	51.02
Himachal Pradesh	148	7.25
Jammu & Kashmir	18	0.15
Jharkhand	20	7.57
Karnataka	34	118.39
Kerala	102	46.65
Madhya Pradesh	62	14.63
Maharashtra	407	242.98
Odisha	387	945.58
Punjab	119	9.25
Rajasthan	53	65.44
Tamil Nadu	288	779.83
UT Chandigarh	5	0.01
Uttarakhand	-	-
Uttar Pradesh	50	22.86
West Bengal	205	95.90
Total	**2,739**	**2735.17**

Appendix 2.5 (Reference Paragraph 2.7.2)

Details of non-production of records during FY 2015-16 to FY 2017-18					
States	**Records requisitioned in FY 2017-18**	**Records not produced in FY 2017-18**	**Percentage of records not produced in FY 2017-18**	**Percentage of records not produced in FY 2016-17**	**Percentage of records not produced in FY 2015-16**
Andhra Pradesh & Telangana	18,715	985	5.26	5.10	N.A
Assam	4,766	28	0.59	0.03	0.36
Bihar	4,389	299	6.81	8.26	14.05
Chhattisgarh	4,339	13	0.30	1.12	0.00
Delhi	35,961	7,713	21.45	18.60	23.20
Goa	1,748	43	2.46	6.01	2.79
Gujarat	25,460	610	2.40	4.14	2.71
Haryana	6,639	317	4.77	0.86	7.87
Himachal Pradesh	1,297	68	5.24	0.00	17.75
Jammu & Kashmir	1,346	17	1.26	0.16	1.39
Jharkhand	1,918	39	2.03	1.45	5.37
Karnataka	14,066	793	5.64	7.10	7.31
Kerala	10,251	514	5.01	3.11	11.36
Madhya Pradesh	14,651	1,710	11.67	13.85	17.56
Maharashtra	99,643	8,557	8.59	6.80	6.74
Odisha	7,795	541	6.94	9.44	29.36
Punjab	5,862	298	5.08	0.12	15.49
Rajasthan	17,586	1,713	9.74	7.96	6.38
Tamil Nadu	36,165	4,115	11.38	16.18	13.16
UT Chandigarh	1,649	1	0.06	3.01	45.90
Uttarakhand	1,800	28	1.56	0.63	21.35
Uttar Pradesh	24,384	408	1.67	3.47	4.86
West Bengal	36,776	2,386	6.49	7.43	5.30
Total	**3,77,206**	**31,196**	**8.27**	**8.29**	**10.74**

Abbreviations

ACIT	Assistant Commissioner of Income Tax
Act	Income Tax Act, 1961
ALP	Arm's Length Price
AO	Assessing Officer
AOP	Association of Person
AST	Assessment Information System
AY	Assessment Year
CASS	Computer Aided Scrutiny Selection
CBDT	Central Board of Direct Taxes
CCIT	Chief Commissioner of Income Tax
CIT	Commissioner of Income Tax
CIT(A)	Commissioner of Income Tax (Appeals)
CSO	Central Statistical Office
CT	Corporation Tax
DGIT (Systems)	Director General of Income Tax (Systems)
DOR	Department of Revenue
DRP	Dispute Resolution Panel
DT	Direct Taxes
FC	Flagship company
FCRA	Foreign Contribution Regulation Act
FY	Financial Year
GDP	Gross Domestic Product
GTR	Gross Tax Receipts
IT	Income Tax
ITAT	Income Tax Appellate Tribunal
ITBA	Income Tax Business Application
ITD	Income Tax Department
ITO	Income Tax Officer
ITR/Return	Income Tax Return
JCIT	Joint Commissioner of Income Tax
LLPs	Limited Liability Partnerships
LTCL	Long term capital loss
PAC	Public Accounts Committee
PAN	Permanent Account Number
PIL	Public Interest Litigation
Pr. CCA	Principal Chief Controller of Accounts
Pr. CCIT	Principal Chief Commissioner of Income Tax
MAT	Minimum Alternate Tax
MOP	Manual of Office Procedure
MR	Miscellaneous Records
NBFC	Non-banking finance company
NMS	Non-filer management system
RPT	Related Party Transactions
ROC	Registrar of Companies
Rules	Income Tax Rules, 1962
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
TP	Transfer Pricing
TPO	Transfer Pricing Officer