CHAPTER – VII
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ANALYSIS OF COMPTROLLER AND AUDITOR GENERAL OF INDIA'S REPORT

Comptroller and Auditor General of India (CAG) is a constitutional authority appointed by the President of India. The CAG submits his report to the Parliament of India. After its submission to the Parliament the report is treated as a public document. In the following paragraphs the excerpts of the CAG's report on the mistakes committed by the Income-tax department in allowing deductions for establishing industries in backward areas are reproduced.

Comptroller and Auditor General of India's Report for the year 1994

Chapter VI-A of the Income Tax Act, 1961, allows certain deductions from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. 'Gross total income' has been defined in the Act as the total income computed in accordance with the provisions of the Act before making the deductions under chapter-VIA, but after setting off unabsorbed losses, depreciation etc. of earlier years.

1. In the assessment of a registered firm for the assessment years 1988-89 and 1990-91, completed in December 1991, the gross total income was computed at Rs.13.64 lakhs and Rs.9.44 lakhs respectively and deduction of Rs.5.46
lakhs and Rs.3.77 lakhs respectively were allowed under chapter VI A. However, as per the provisions of the Act, the gross total income, computed after setting off unabsorbed depreciation of Rs.13.29 lakhs and Rs.7.31 lakhs (net), worked out to only Rs.35,863 and Rs.2.13 lakhs respectively. The assessee was thus entitled to deduction of Rs.14,345 and Rs.85,130 respectively under chapter VI A of the Act for assessment years 1988-89 and 1990-91, as against Rs.5.46 lakhs and Rs.3.77 lakhs allowed. These mistakes resulted in aggregate excess allowance of deduction of Rs.8.24 lakhs involving short levy of tax of Rs.4.54 lakhs in the hands of the firm and its partners.

2. Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking which goes into production within a period of nine years next following 31 March 1981, the assessee is entitled to a deduction of twenty per cent of such profits and gains for a period of eight years including the year in which the assessee begins to manufacture or produce articles or things. Where the assessee is also entitled to deduction in respect of profits and gains from newly established industrial undertaking in backward areas in addition to the deduction mentioned above, effect shall first be given to the latter deduction before allowing the former deduction.

The Ministry has accepted the audit observation.
3. Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking in a backward area, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to twenty percent of the profits and gains. A further deduction at twenty five percent is admissible if the industrial undertaking goes into production within a period of ten years from 1 April 1981. One of the conditions for the grant of deductions is that the industrial undertaking is not formed by transfer of machinery and plant previously used for any purpose.

In Madhya Pradesh a private limited company, engaged in dairy business, was allowed deductions of Rs.2.36 lakhs, Rs.2.38 lakhs and Rs.1.61 lakhs in assessment years 1989-90 to 1991-92, from its profits and gains as applicable for a newly established industrial undertaking in a backward area and of Rs 2.94 lakhs and Rs.2.98 lakhs in assessment years 1989-90 and 1990-91 respectively as applicable to a new industrial undertaking going into production after 31 March 1981. Audit scrutiny revealed that the assessee was disallowed investment allowance in the first assessment year 1983-84 itself as it had transferred to the new industrial undertaking machinery and plant previously used by other persons and the disallowance had been upheld in appeal. Accordingly, both the above deductions were also not admissible to the industrial undertaking. The incorrect allowance of aggregate deductions of
Rs.12.27 lakhs resulted in short levy of tax aggregating Rs.13.67 lakhs (including interest).

The Ministry has accepted the audit observation.

Comptroller and Auditor General of India’s Report for the year 1997

4. Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking established in a backward area, the assessee is entitled, subject to certain provisions, to a deduction of twenty per cent of such profits and gains for a period of ten assessment years including the one relevant to the previous year in which the assessee begins to manufacture or produce articles or things. A further deduction of twenty five per cent of such profits and gains is also admissible if the industrial undertaking goes into production after 31 March 1981. It has been judicially held (Cambay Electric Supply Industrial Co. Ltd. Vs CIT, Gujarat 11-113 ITR 84 (SC)) that the use of the term 'derived from' in the relevant provisions of the Act indicates the restricted meaning given by the Legislature to cover only the profits and gains directly accruing from the conduct of the business undertaking.

(i) In Andhra Pradesh the assessment of a widely held company for the assessment year 1991-92 was completed after scrutiny in January 1994 allowing deductions aggregating Rs.32.42 lakhs under the above provisions. Audit scrutiny revealed that the profit of Rs.72 lakh
included Rs.53.51 lakh being interest income and income from sale of replenishment licences. As the deductions were admissible only in respect of profits and gains derived from the business activity, the deduction allowed in respect of other incomes was not in order. After excluding the above amounts, the aggregate admissible deductions would work out to Rs.8.34 lakh as against Rs.32.42 lakh allowed by the department leading to excess allowance of deduction of Rs.24.08 lakh with resultant underassessment of income by an identical amount and short levy of tax of Rs.14.29 lakh (including excess payment of interest on refund).

The Ministry has accepted the audit observation.

(ii) In Madhya Pradesh the assessment of a closely held company for the assessment year 1992-93 was completed after scrutiny in March 1995 at an income of Rs.17.48 lakh after allowing deductions in respect of newly established industrial undertaking in backward area and newly established industrial undertaking after 31 March 1981. Audit scrutiny revealed that ‘other income’ and ‘interest income’ aggregating Rs.29.05 lakh not derived directly from industrial activity was not deducted while computing the profits from business. This omission resulted in excess allowance of a total deduction of Rs.11.62 lakh involving short levy of tax of Rs.11.49 lakh (including interest).

The reply of the Ministry to the audit observation has not been received.
5. Under the Income Tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from newly established industrial undertaking in a backward area, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to twenty percent of such profits and gains. The Act further states that nothing contained in the said provision shall apply in relation to any undertaking engaged in mining.

In West Bengal the assessment of a widely held company for the assessment year 1992-93 was completed after scrutiny in February 1995, allowing a deduction of Rs.35.05 lakhs towards profits and gains from newly established industrial undertaking in backward areas. Audit scrutiny revealed that the assessee company did not fulfill requisite conditions for grant of such claim and the assessing officer had disallowed such claim in the assessment for the earlier assessment year 1991-92. Further, since the company was engaged in the business of mining activity, the above provisions were not applicable and it was not entitled to the deduction.

The incorrect allowance of deduction of Rs.35.05 lakh resulted in short levy of tax of Rs.30.83 lakhs (including interest).

The Ministry has accepted the audit observation
6. In West Bengal the assessments of a widely held company for the assessment years 1993-94 and 1994-95 were completed after scrutiny in September 1995 and March 1997 allowing deductions aggregating Rs.142.42 lakhs and Rs.84.35 lakhs under the above provisions in the two assessment years respectively in respect of ceiling fan division situated in a backward area. Audit scrutiny revealed that the company started manufacturing and selling of ceiling fans from the assessment year 1984-85 and was allowed deductions under the provisions of the Act from the same assessment year. As deductions were admissible only for ten and eight assessment years respectively which expired in assessment years 1993-94 and 1991-92 no further deductions were admissible under the above-mentioned provisions of the Act. The irregular deduction of Rs.226.77 lakhs in aggregate resulted in underassessment of income by a like amount with consequent short levy of tax of Rs.183.92 lakhs (including excess payment of interest on refund).

The reply of the Ministry to the audit observation has not been received.

7. The Act further provides that in determining the quantum of deduction, the profits and gains of the industrial undertaking shall be computed as if such profits and gains from the business were the only source of income of the assessee during the previous year relevant to the initial assessment year and
every subsequent assessment year up to and including the assessment year to
which determination is to be made. The Central Board of Direct Taxes while
explaining the scope and effect of section 80 I, had explained in September
1980 that losses, depreciation and investment allowance of earlier years of the
new industrial undertaking will be taken into account in determining the
quantum of deduction even though they may have actually been set off against
the profit of the assesseee from other source. Further, it was judicially held that
similar procedure is to be followed for the deduction under section 80 HH also.
In Trivandrum, Kerala the assessment of a widely held company for the
assessment year 1992-93 originally completed after scrutiny in March 1995
was revised in July 1995 allowing deductions of Rs.32.60 lakhs and Rs.40.75
lakhs in respect of profits and gains of its two industrial units under the
provisions as applicable to new industrial undertaking established in backward
area and new industrial undertaking gone into production after 31 March 1981.
Audit scrutiny revealed that the two units had no profit left after set off of
unabsorbed depreciation and investment allowance relating to those units and
as such, the assesseee would not be entitled to the above deductions. The
mistake resulted in incorrect allowance of deduction of Rs.73.35 lakhs in
aggregate with consequent tax effect of Rs.57.91 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.
8. It has been judicially held by Rajasthan High Court that in order to arrive at the profit under the above provisions, effect shall first be given to the deduction admissible, if any, in respect of profits and gains from newly established undertaking in backward area. In Rajasthan in the assessments of 2 companies for the assessment years 1990-91, 1993-94 and 1994-95 completed after scrutiny in July 1995, January 1997 and March 1997, the assessee were allowed deductions aggregating Rs.145.87 lakhs at 25 percent of profits and gains from newly established industrial undertaking established after 31 March 1981. These assessee were also allowed aggregate deductions of Rs.116.69 lakhs at 20 percent towards profits and gains from newly established industrial undertaking in backward areas. Accordingly, the aggregate admissible deduction worked out to Rs.116.69 lakhs as against Rs.145.87 lakhs allowed by the department. The mistakes resulted in excess allowance of deductions aggregating Rs.29.18 lakhs leading to total underassessment of income of an identical amount with consequent short levy of tax of Rs.26.19 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

Comptroller and Auditor General of India’s Report for the year 2001

9. In Tamilnadu the assessments of a company (M/s. Sundaram Fasteners) for the assessment years 1994-95 and 1996-97 were revised in March 1999
allowing deductions aggregating Rs.71.99 lakhs under the above provisions. Audit scrutiny revealed that as per notification issued by the Central Government in December 1986 with retrospective effect from 1st April 1983, "Hosur Block" in which the assessee's undertaking was located was not specified as a backward area. The assessee was, therefore, not entitled to special deduction in respect of profits derived from the new unit set up in Hosur. The irregular deduction resulted in under-assessment of income of Rs.71.99 lakhs with consequent short levy of tax of Rs.53.38 lakhs (including interest). As the deduction was allowed from the assessment year 1991-92 onwards, the withdrawal of relief allowed for earlier years was also required to be examined.

The reply of the Ministry to the audit observation has not been received.

Comptroller and Auditor General of India’s Report for the year 2002

10. In Delhi the assessment of M/s B.R. Industries Ltd. for the assessment year 1996-97 was completed after scrutiny in February 1998 allowing a deduction of Rs. 125.19 lakhs under the above provision. Audit scrutiny revealed that the assessee company was incorporated during the year by reconstruction of business already in existence with the main object to acquire and take over the running business and the value of transferred plant and machinery was Rs.6.07 lakhs against the total value of plant and machinery of Rs. 6.70 lakhs. As the value of transferred plant and machinery was also more than 20 percent of the
total value thereof, the assessee was not eligible for this deduction. The irregular deduction resulted in underassessment of income of Rs. 125.19 lakhs with consequent short levy of tax of Rs. 84.08 lakhs (including interest).

The reply of the Ministry to the audit observation has not been received.

11. In 6 other cases in Maharashtra, Tamilnadu and West Bengal non-observance of the above provisions led to short levy of tax aggregating to Rs.103.36 lakhs.

The Ministry has accepted the audit observation in 1 out of 6 other case.

The complexity involved in interpreting the provisions of section 80HH has lead to mistakes which resulted in reopening of the already closed cases as it is obligatory on the part of the Income-tax department to reopen the cases in which audit objection has been raised by the CAG.