



## About Audit Eye

**Objectives** - *Audit Eye seeks to investigate into different issues related to Government Audit and associated areas. Its objective is to ignite the minds of auditors with issues of concern which may or may not be reflected in our Audit Reports. It would also serve as a discussion forum for related areas of Government Audit like accounts, office administration etc. Pertinent developments in different areas related to government audit would also be discussed in the different issues.*

**Policy** - *Audit Eye is proposed to be published on a bi-annual basis from the Office of the Principal Director of Audit, Central, Kolkata. The periodicity may be changed depending on response from the readers. Audit Eye welcomes all officials of all offices of the Indian Audit and Accounts Department to contribute articles which can serve as a launching pad for initiating discussions on different issues of concern. The articles may be sent to any member of the Editorial Board.*

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### *From the Desk of the Principal Director*

*The Office of the Principal Director of Audit, Central, Kolkata is involved in the audit of the receipts for the Government of India in the state of West Bengal and as well as the North Eastern states through the audit of Customs Department, Central Excise Department as well as Income Tax Department. This office is also auditing the expenditure of all Central Government Ministries and of their constituent units as well as several autonomous institutions under the different ministries of the Central Government located in the state of West Bengal and the union territory of Andaman and Nicobar Islands. Over the decades this office has shown a consistent performance of the highest order in terms of audit observations published in the reports of the Comptroller and Auditor General of India. It has pointed out many system deficiencies and lacunae in the statutes leading to a number of amendments in those, apart from highlighting numerous transaction audit observations aimed at improving the general control framework of the audited units. It is indeed a pleasure and a privilege to work with the extremely competent, knowledgeable, highly motivated and dedicated officials in this office.*

*Over the years, this office has developed institutional expertise in many areas, and its expertise in areas especially relating to revenue audit is appreciated and often sought by the auditee departments. Audit is nothing but intensive and focussed research, and in the course of my sustained interaction with the officials of this office over nearly the last two years, I have strongly felt a need for harnessing the immense analytical abilities and research potentials of such officials. With this aim in mind, this journal related to analysis and research of audit and related issues has been conceived and brought out.*



*This humble and limited attempt on our part seeks to highlight issues which could not be featured in the audit reports of the Comptroller and Auditor General of India or projected through our routine official reports and correspondences. Articles in this inaugural issue has been contributed by different officials, based on the substantial data, utilized as well as unutilized, collected through audit and their analysis. The journal is based on the theme of analysis of data collected through research and all articles in this issue as well as those that will feature afterwards in this journal will possess the attribute of originality backed by the analysis of actual research data available with an office and collected through the usual process of audit.*

*The journal is our humble effort towards throwing up issues that need to be addressed in the context of audit in the fast changing and evolving socio-economic scenario of our country. Given the usual constraints, we start with a target of bringing out this journal twice a year with the intention of discussing issues which may be of concern for all our sister offices across the department. Fellow officials from all our sister offices are requested to contribute their inputs to this journal, whether by contributing articles or feedback or in any other form.*

*I take this opportunity to thank and congratulate the young and energetic group of officers led by the editor and their associates for taking all the troubles and the endless extra hours of work that they have put in to make this journal see the light of the day.*

**Principal Director of Audit (Central), Kolkata**



## Editorial

*Audit is a constantly evolving discipline in respect of both the Government as well as private sector. Effective audit output is sustained by a scientific analysis of extant statutes as well as efficient utilization of audit resources. The past and current audit practices also contribute towards effective audits in the future.*

*'Audit Eye' seeks to analyse all the above issues in this inaugural as well as forthcoming issues. This inaugural issue has suffered from birth pangs leading to its belated publication. The Editorial Board will strive to maintain a high level of timely output in the future, and solicits feedback, suggestions and most important, contributions from the entire fraternity of the Indian Audit and Accounts Department. Constructive criticisms are most welcome.*

*In this inaugural issue, we have selected articles which include introduction to the functional wings of this office, analysis of extant statutes and analysis of extant executive as well as audit procedures. A section to list out some pertinent developments in the international sphere has also been incorporated.*

*We look forward to the co-operation, help and support from all in our humble endeavour to bring out a research publication from a field office.*

**Editor**



### Acknowledgement

*The Editorial Board is extremely grateful to the Principal Director of Audit, Central, Kolkata for conceptualizing the instant journal. It is also thankful to all the contributors of the different articles which have been featured in this issue. The Editorial Board is also thankful to all other officials who have worked in a direct and indirect manner towards the printing and publishing of this journal.*





## Contents

<b>Subject</b>	<b>Page</b>
<b>1. Investigative Audit</b>	7--9
<b>2. Income Tax Receipt Audit in West Bengal - A functional overview</b>	10--21
<b>3. Role of Chartered Accountants in administration of Income Tax laws A Critical Analysis</b>	22--30
<b>4 Around the World</b>	31--33
<b>5 Registrar of Companies and administration of Income Tax Laws Need for Revenue Audit</b>	34--38
<b>6. Central Excise Duties—Reforms revisited</b>	39--48
<b>7. Security policy for IT assets adopted in the Office of the Principal Director of Audit (Central), Kolkata</b>	49--53
<b>8. Contributors in this issue</b>	54



## *Investigative Audit*

*Investigative audit, unlike regular audit, is far more extensive and actually searches out information necessary for uncovering misuse, manipulation or alleged violation of established statutes and conventions. While a limited examination of a sample of transactions is routinely carried out in a regular audit, investigative audit goes deeper and attempts to find out irregularities, frauds and illegalities keeping in mind the intended objective.*

### **1. Objective of the article**

This article seeks to examine various issues related to 'Investigative Audit' by studying a case study pertaining to the audit of Customs Department in West Bengal. An investigative audit was taken up during the year 1999-2000 by the Customs Receipt Audit Department (CRAD) of the Office of the Principal Director of Audit, Central, Kolkata, in order to unearth various irregularities on import of vegetable oil through Kolkata port.

### **2. Introduction**

Vegetable Oils like Palm Oil, Sunflower Oil, Soya Oil etc. when hydrogenated in a plant, solidifies to produce a semi solid substance, which is commonly known as "Vanaspati". In India, particularly in West Bengal, be it rural or urban area, "Vanaspati" has its demand in bakeries and sweetmeat shops for frying crispy snacks or preparing biscuits, cakes as well as in restaurants to add taste to foods. Margarine, a popular modern day substitute for butter contains "Vanaspati". A large quantity of such vegetable oil is being imported in bulk quantity by "Vanaspati"-manufacturers or traders mainly from the south Asian countries like Indonesia, Malayasia etc.

### **3. Government Notifications**

To ease the unpleasant burden of customs duty, Ministry of Finance, Govt. of India issued four notifications between November 1998 and February 2000, allowing concessional rate of basic customs duty at 15% ad valorem as against the usual tariff rate of 65% ad valorem along with full exemption

from payment of special additional duty of customs (SAD) equivalent to 4% ad valorem that were otherwise leviable on edible grade vegetable oil imported for manufacture of "Vanaspati". But the concession and exemption from payment of duties to be allowed initially at the time of import of oil was subject to observance of certain procedures detailed in a supplementary rule named Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996. The rule was designed to ensure proper utilization of the imported goods for the intended purpose for which the duty was foregone by the Govt. of India. Under the rule, the follow up action of the post-import conditions was entrusted to the central excise authority, under whose jurisdiction the factory of the Vanaspati manufacturer-importer was registered, while the duty was forgone by its sister organization, the customs. For the purpose of monitoring, after clearance of the imported goods at concessional rate of duty, the customs authority is to forward a copy of the bill of entry to the jurisdictional central excise authority to facilitate counter checks, in order to ensure that the same quantity of imported oil as declared by the importer has been received in the importer's factory for use in the manufacture of Vanaspati. In case of short-receipt, the central excise authority has to recover the full amount of duty that was leviable on the goods but for the exemption availed by the importer.

### 3. **Problem of Co-ordination**

In the middle of 1999, Customs Appraising Group-I in Customs House, Kolkata which *inter alia*, appraises and collects duty on imported vegetable oils was inspected under the routine audit programme. It was noticed that duty exemption granted against at least 170 consignments of different vegetable oils valued at Rs.103.66 crore imported by eight importers had remained unprotected due to non-observance of the prescribed procedure. Scrutiny revealed that the Appraising Group did not forward the copy of the bills of entry as prescribed in the rule to the respective central excise authority. As a result, the central excise authority was not in a position to ascertain whether the same quantity as cleared on payment of concessional rate of duty had been received in the importer's factory premises, thus leaving the scope for misuse of the oil imported at concessional rate. This raised a doubt whether the central excise authority had exercised the prescribed checks as envisaged in the Rule. Since the final product "Vanaspati" was exempted from payment of central excise duty, the use of duty-exempted oil might have remained virtually unverified by the central excise authority. This further raised doubt in audit whether the importers had misused this opportunity by diverting the goods in the market instead of actually using it for the manufacture of Vanaspati which was the main purpose behind exemption notification.

In the past, CRAD had observed, particularly in the course of system reviews like VBBAL, EPCG etc., that whenever concession of duty or exemption was allowed and two authorities were jointly responsible for monitoring the post-importation follow up as regards the actual usages of imported goods for the intended purpose, the beneficiaries had misused it. This was mainly due to the lack of co-ordination between the two authorities and weak or ineffective monitoring mechanism.

In order to ascertain the facts, five reputed Vanaspati manufacturing units in West Bengal were selected for visit and for conducting detailed scrutiny of records maintained at their factory site. Among those were:-

M/s Kusum Products, Rishra (Brand Dalda)

M/s Shree Madhav Edible Products Ltd., Midnapore

M/s Rasoi Ltd., Kolkata (Rasoi Brand), Vanaspati

M/s Kanchan Oil Industries Ltd., Jhargram

M/s Bharat Margarine Ltd., (MeriGold Brand Margarine)

The scrutiny of records revealed the following irregularities:

a) Total 911.17 MT oil were received short in the factories of the five importers, resulting in inadmissible exemption of duty of Rs.13.61 lakh that stood recoverable since the imported quantities were not used for the manufacture of Vanaspati.

b) Two manufactures had either sold or transferred a total quantity of 740 MT of imported RBD Palmolien to other companies without using it for the manufacturing of Vanaspati. Thus, exemption of duty of Rs.6.01 lakh was clearly inadmissible.

c) 3451.26 MT of oil were sent to other manufactures to get Vanaspati manufactured by them and were then processed to margarine by one importer. Since the processing of vegetable oil was not done by the importer himself in the premises registered with the jurisdiction of central excise authority, the exemption of duty on the above quantity of oil amounting to Rs.38.19 lakh was inadmissible.

d) Three Vanaspati manufactures had purchased 1,07,369 MT of imported RBD Palmolien from two traders without payment of sales tax by virtue of a special exemption order issued by the State Govt. (West Bengal). Since the transaction had raised doubt, the records of the two companies selling the oil were cross-examined and this exposed that they had enjoyed the exemption from special additional duty (SAD) of customs on the basis of declaration required under a notification that goods shall not be sold in a place where sales tax is exempted. Thus for violation of the condition, those importers were liable to pay an amount of Rs. 142 lakh that was availed of as exemption from SAD at the time of importation of the said oil. Such fraudulent

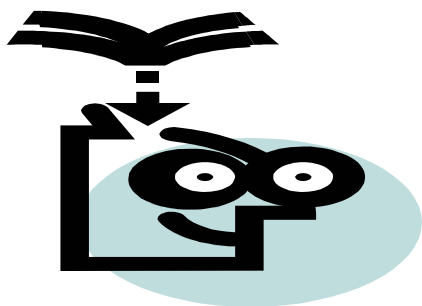


practices had remained unnoticed by both the authorities.

These irregularities involving Rs.199.81 lakh were unearthed through extensive examination/ verification of records in the premises of the beneficiaries, correlating the transactions with that of other related companies to expose indirect misuse of the benefit, thus going beyond only the examination records available with the customs authorities where the regular audit was initially taken up.

#### **4. Conclusion and Recommendations**

The above-mentioned points reflect an urgent need to go beyond the face value of initial records and investigate the details of any perceived irregularity and follow the entire trail to its logical conclusion. In order to achieve the desired objectives, coordination between different audit wings in the same office as well as sister offices is also necessary. This would help in detecting leakages in revenue on account of lack of coordination between different functional departments. The ultimate benefit would be strengthening the revenue collection system through proper co-ordination and synergy between different agencies.



## *Income Tax Receipt Audit in West Bengal - A functional overview*

*Income Tax Receipt Audit (ITRA) wing of the office of the Principal Director of Audit, Central, Kolkata is primarily auditing the receipts of Income Tax Department in West Bengal. The wing is trying to aid the Income Tax Department in augmenting its net collections by examining different aspects of its functioning. Apart from directly showing up leakages in revenue collections, the audit observations also seek to point out the systemic defects to the department.*

### **Objective of the Article**

**T**his article seeks to examine the functional significance of the ITRA wing with regards to the functioning of the Income Tax Department in West Bengal. Different functional indicators of the wing have been examined in this regard. Apart from that, this article also seeks to serve as an introductory guide to the reader on some aspects of the functioning of the wing and serves to introduce the reader to the different facets of the wing.

### **Introduction**

The ITRA wing conducts the audit of receipts and refunds of Income Tax Department in West Bengal every year on the basis of C&AG's duties and powers conferred under Articles 149 to 151 of the Constitution of India as well as section 17 of the C&AG's DPC Act 1971.

The wing mainly conducts test check of the assessments of income tax and wealth tax assessed by various assessing officers (AC/DC/ITO) of the Income Tax Department to see whether the assessments have been done correctly according to the provisions of Income Tax Act, 1961 and the related rules as amended from time to time. The wing conducts the audit of income tax

with the help of 30-32 field audit parties formed every year in the month of April as per the audit plan to complete the audit of 580 Auditable units all over West Bengal. The basic objective of such audit is not to find faults of the assessing officers but to assist the department to improve the efficiency of tax administration and augment the collection of revenues of the Government in the form of income tax and wealth tax.

The audit conducted by this wing is confined to the assessment records in the context of the Income Tax Act and related rules. The wing checks the assessment records for information pertaining to recovery of tax, tax deducted at source, fringe benefit tax, transaction tax and refunds. For this purpose, the wing prepares a biennial audit plan and detailed audit plan for the next year in advance on the basis of existing staff strength. The audit plan is required to be approved by the Headquarters' Office. The audit programme for each field audit party is prepared on a quarterly basis for conducting audit. Simultaneously an intimation is sent to the concerned assessing Officer of the auditee unit so that he has ample time to be ready with the records when the field party actually arrives to conduct the audit.

Revenue audit parties select the assessment folders in accordance with

the sampling norms prescribed by the Office of the Comptroller and Auditor General of India. Audit checks are exercised on the assessments as per the Income Tax Act and related rules. Audit observations are finalized on detection of irregularities and after eliciting the views of the department in relation to those irregularities.

### **Process of Audit Reporting**

After completion of audit of each unit, the party prepares Local Audit Reports along with folders containing all relevant papers like selection sheets, audit queries, replies to audit queries and audit evidence in the form of documents etc. The Test audit report is required to be submitted by the field audit party to the ITRA Headquarters within five working days of closure of audit of a particular unit.

The audit observations which are included in the report will belong to one of the following two categories:

- i) Ordinary para which involves tax effect less than Rs. 5 lakh each for the non-corporate assessee and effect less than Rs. 10 lakh for the corporate assessee.
- ii) Potential Draft Paras which involve tax effect of Rs. 5 lakh and above in the case of a non-corporate assessee and Rs. 10 lakh and above in the case of a corporate assessee.

In the case of the latter category of paras, the audit party is further required to prepare Statement of Facts (SoF) in a separate folder and submit the same along with the audit report which is vetted by the ITRA Headquarters' Before it is approved by the Group Officer. While preparing an audit report, any relevant pronouncements by any

court of law is always considered. Copies of the approved LAR are sent to the assessing officers as well as the concerned Commissioner of Income Tax requesting for final comments in the form of a Broad Sheet Reply. A Third Copy is kept at the ITRA Headquarters. At the same time Statement of Facts in respect of the Draft Paras are sent to the assessing officer for reply. In broad sheet reply, the department intimates its views to audit regarding the paras. In respect of paras the contentions of which are accepted by the Department, it rectifies the assessment as per the audit observation and raises additional demands for realization. In respect of paras where the Department does not agree with the contention of audit, audit either persists with the observation in which case it issues a rebuttal to the Department's views and processes the objection further. If the reply of the Department is justified as per IT Act and the relevant rules and pronouncement of Courts, audit objection is not pursued further. In respect of accepted paras and those involving SoFs, the paras are converted into draft paragraphs depending on their money values after due approval of the Principal Director of Audit, Central. These paras are then uploaded along with the relevant key documents to the C&AG's Office between January and June every year, as per the monthly targets fixed by them. The Draft Paragraphs forwarded to the Headquarters Office are then examined thoroughly and sent to the Ministry of Finance for their acceptance and comments. After obtaining the views of the Ministry and any further information regarding the follow up action/realization of revenue in relation to these paras, these are printed in the C&AG's Audit Reports submitted, in accordance

with Article 151(1) of the Constitution of India, to the President of India who causes it to be laid before each House of Parliament.

We shall now examine the data relating to the Office of the Principal Director of Audit (Central) Kolkata in the remaining sections of this article and establish the trends which are found therein.

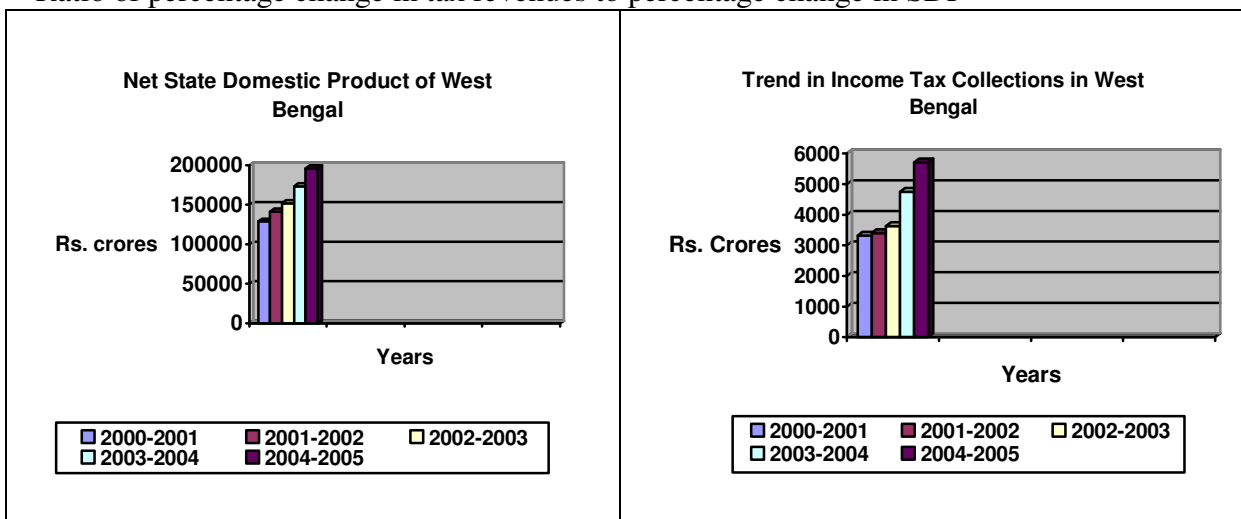
## Income Tax Collection in West Bengal

The trend in the net collection of Income Tax (Total Collection – Refunds) in the state of West Bengal over the last five years is compared in the following table with the trend in the Net State Domestic Product.

**Table 1:** Trends in Net Domestic Product and Net Income Tax Receipts from West Bengal

Year	Net State Domestic Product(Rs. crore)	Increase over last year in SDP	Net Revenue (Rs. crore)	Increase in Net Revenue over last year	Buoyancy*of Income Tax Collections
2000-2001	128974.83	-	3306.35	-	-
2001-2002	141357.45	12382.62	3397.16	90.81	0.28
2002-2003	152084.18	10726.73	3631.89	234.73	0.91
2003-2004	173674.09	21589.91	4742.10	1110.21	2.15
2004-2005	196246.89	22572.80	5708.34	966.24	1.57

\*Ratio of percentage change in tax revenues to percentage change in SDP



Review of the above data reveals that there has been an uptrend in the Income Tax Collections in West Bengal over the last five years. However substantial

increase has been noticed only in the years 2003-04 and 2004-05. In respect of the Net State Domestic Product the increase has been steady over the last five years. The comparison of the trend

in Income Tax Collection with the State Domestic Product is done by calculating the buoyancy of Income Tax Collections. It is clearly revealed that in the year 2001-02, the proportionate growth in the SDP has been much better as compared to the growth in Income

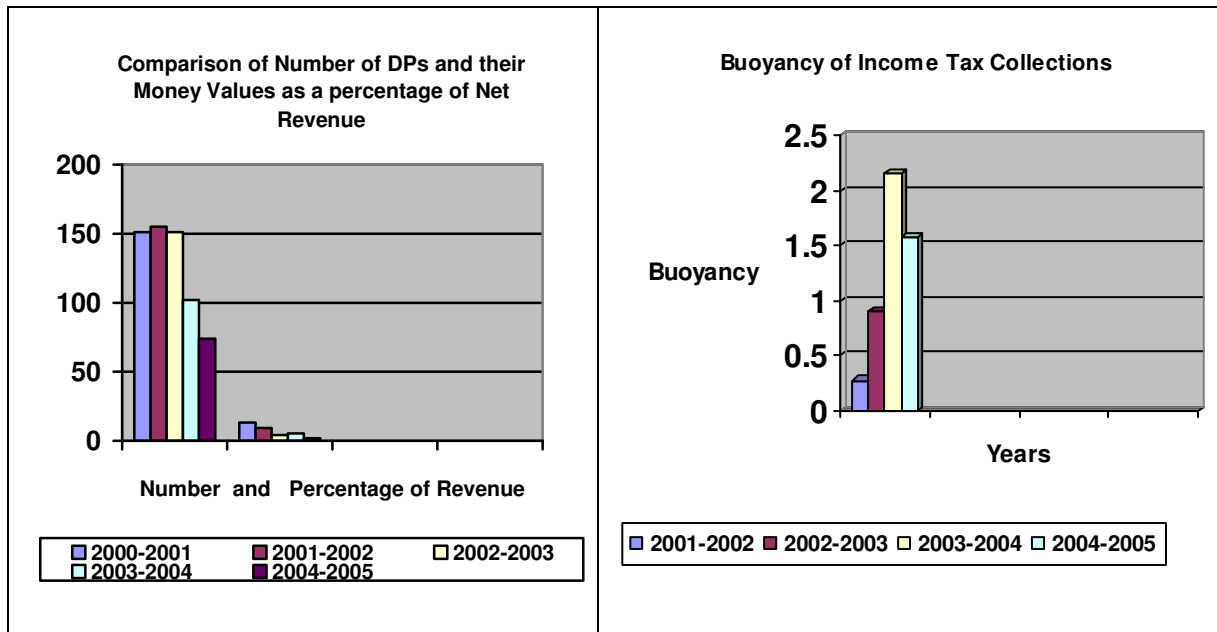
Tax Collections. In 2002-03, the growth in SDP and Income Tax Collections in West Bengal have been comparable-buoyancy figure being close to 1. However, in the next two years the growth in Income tax Collections has improved.

### Trends in Audit

Data presented in the table below pertain to the draft paras (DP) processed by the office during the last few years.

**Table2: Draft Paragraphs contributed by Income Tax Receipt Audit Wing, Kolkata**

Year	No.of D.P.s (IT+ WT)	Total Money Value (Rs crore)	Net Revenue (Rs.crore)	DPs as a percentage of revenue
2000-2001	151	Rs. 443.33	3306.35	13.40
2001-2002	155	Rs. 324.05	3397.16	9.54
2002-2003	151	Rs. 158.87	3631.89	4.37
2003-2004	102	Rs. 267.79	4742.10	5.65
2004-2005	74	Rs. 107.92	5708.34	1.89



### Areas of concern:

Break up of draft paras pertaining to different heads, over the period of last five years are presented in the following tables:

**Table No.3: Breakup of Draft paras pertaining to different heads under Income Tax**

Period (Audit Report)	2000-01	2001-02	2002-03	2003-04	2004-05
Incorrect computation of House Property Income	0	1	0	0	0
Incorrect Computation of Business Income	21	10	7	10	25
Irregularities in allowance of depreciation	4	2	6	0	1
Irregular computation of Capital Gain	4	2	2	1	0
Mistake in assessment of firms	1	0	0	1	0
Non levy/Short levy of interest	11	9	11	7	1
Failure to deposit TDS	0	3	4	1	1
Other topics of interest	21	27	24	16	17
Irregular Payment of Interest by Government	1	5	2	2	1
Non/Short levy of Interest Tax	5	21	22	23	5
Income not assessed	11	9	11	7	1
Irregular allowance of deduction	41	28	40	15	4
Incorrect Carry forward / set off of losses	16	15	5	7	3
<b>Total</b>	<b>133</b>	<b>137</b>	<b>133</b>	<b>87</b>	<b>62</b>

**Table No.4: Breakup of Draft paras pertaining to different heads under Other Direct Taxes**

Period (Audit Report)	2000-01	2001-02	2002-03	2003-04	2004-05
Wealth not assessed/ Wealth escaping assessment	14	11	14	11	11
Incorrect Valuation/ Undervaluation of asset/wealth	2	5	4	2	1
Non/Short levy of penalty	1	0	0	2	0
Irregular Exemption	1	0	0	0	0
Gift Tax	0	2	0	0	0
<b>Total</b>	<b>18</b>	<b>18</b>	<b>18</b>	<b>15</b>	<b>12</b>

As mentioned above, the Draft Paras constitute important materials for audit report. However it must be borne in mind that these observations are only a

fraction of the overall audit observations that include the ordinary paras and system reviews (described in subsequent sections). It can be seen from table 2 that

the money value of Draft Paras has been varying between 1.89% to 13.40% of the net revenue collections during the period of five years from 2000-01. In absolute terms the money value of Draft paras has been varying from Rs.108 crores to Rs. 443 crores. The figure has also progressively decreased both in terms of number as well as the money value. Different reasons may be attributed for this decline. Since the year 2003-04, the number of DPs has come down on account of the fact that the floor limit of money value for the DPs was revised from that year. A progressively declining money value also probably indicates that audit has succeeded to an extent in strengthening the controls in the Income Tax Department to bring down the leakages in tax collection.<sup>1</sup> While analyzing the trends depicted in table 2, one also needs to look at table 5 wherein the system reviews have been analysed.

Analysis of the data presented in tables 3 and 4 would show the different areas of concern for the Income Tax Department in terms of the number of DPs emanating each year over the last five years under different sub-heads.

‘Irregular allowance of deductions’ is a major area of concern and over the last five years has contributed a major share of DPs, including more than 25% of the total DPs in the years 2000-01 and 2002-03. It may be seen that ‘Incorrect computation of Business Income’ is also a major area of concern. As many as 25 DPs pertaining to this head have been printed for the year 2004-05. This comprises about 2/3 of the total DPs for

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<sup>1</sup> However the data for the year 2004-05 do not reflect an trend since a large number of DPs pertaining to that year have been included in a review of the ‘Summary assessment scheme and procedure of selection of cases for scrutiny’.

that year. Even in the previous years substantial number of DPs have been developed in this area. ‘Non levy/ Short levy of interest’ has also led to substantial leakages especially in the years 2001-02 and 2002-03. ‘Carry forward of losses’ has also led to leakages especially in 2000-01 and 2001-02.

In respect of ‘Other Direct Taxes’, the incorrect assessment or non-assessment of wealth has been a major area of concern. Majority of Draft Paras pertaining to ‘Other Direct Taxes’ have been on account of such omissions.

## **Reviews**

In addition to the above, the ITRA wing also conducts systems reviews on the different aspects of functioning of the Income Tax Department. The review topics are selected by the Headquarters’ office every year. Pilot Studies on review topics are conducted generally from August-September each year by some selected field offices and on the basis of the Pilot Study reports, Headquarters’ Office frames the guidelines and prescribes the sample size and cut off date for submission of the final review report. The main outlook of a review is to examine and report on the deficiencies in the application of the IT Act and the related rules that may lead to the leakage of government revenues.

A consolidated report combining the audit observations from all over the country is prepared by Headquarters’ Office and sent to each field office for the confirmation of facts and figures. After obtaining the Ministry’s views and replies, the report is then included as in Report of the Comptroller and Auditor General of India (Direct Taxes).

Some of the reviews conducted and published, over the last few years are shown in the following table:

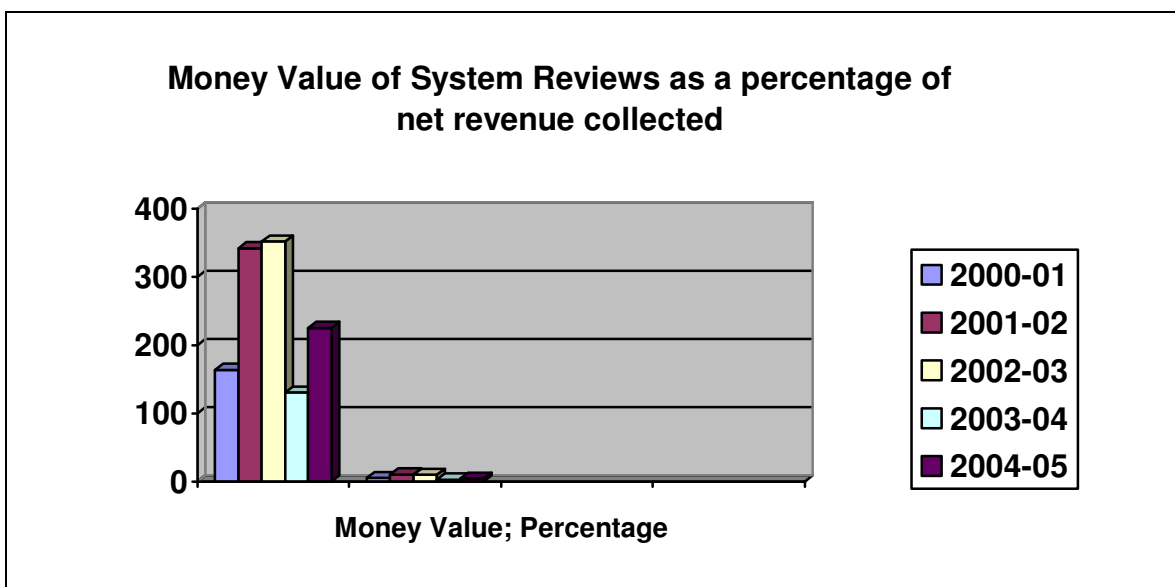
**Table 5: ITRA System Reviews**

Year	Name of Review	Money Value
2000-2001	<ol style="list-style-type: none"> <li>1. Joint venture abroad by Indian Enterprises.</li> <li>2. Private Banking Companies and NBFC.</li> <li>3. Assessment of Co-operative Societies</li> <li>4. Refunds under chapter XIX of I.T.Act.</li> <li>5. Review on Top Companies</li> <li>6. Private Hospital and Nursing Home</li> </ol>	No money value Rs. 1143.43 lakh Rs. 1398.25 lakh Rs. 7145.52 lakh Rs. 6617.17 lakh Rs. 41.16 lakh
2001-02	<ol style="list-style-type: none"> <li>1. Arrear of Tax Demand of Rs. 50 lakh and above pending as on 1 April 2001</li> <li>2. Landmark Judgements of Supreme Court and their implementation</li> <li>3. Functioning of the judicial wing in I.T. Department</li> <li>4. Audit of companies in select sector</li> </ol>	No money value Rs. 7626.87 lakh No money value Rs. 2658.7 lakh
2002-03	<ol style="list-style-type: none"> <li>1. Assessment of the business of civil construction</li> <li>2. Assessment of Public/Private Schools, Colleges and Coaching center.</li> <li>3. Effectiveness of operation of the scheme of MAT, u/s 115 JA/JB</li> </ol>	Rs. 1982.76 lakh Rs. 3722.59 lakh Rs. 29488.00 lakh
2003-04	<ol style="list-style-type: none"> <li>1. Restructuring of I.T. Department</li> <li>2. Administration and implementation of Double Taxation Available Agreements (DTAA) and Taxation of Non-resident</li> <li>3. Implementation of selected deductions &amp; Allowances</li> <li>4. Adequacy of follow up action in post –VDIS assessment.</li> </ol>	No money value Rs. 875.80 lakh Rs. 12131.59 lakh No money value
2004-05	<ol style="list-style-type: none"> <li>1. Effectiveness of Search &amp; Seizure operations</li> <li>2. Efficiency of Summary assessment scheme &amp; process of selection of Cases.</li> </ol>	Rs. 30.52 Crore Rs. 194.95 Crore.



**Table 6: Showing the year wise analysis of the Total Money Value of the reviews listed in table no 5**

Year	Total Money Value	Percentage of Net Revenue
2000-01	163.45	4.94
2001-02	342.14	10.07
2002-03	351.93	9.68
2003-04	130.07	2.74
2004-05	225.47	3.94



Apart from examining and analyzing the prevalent system vis-a vis the different facets of working of the Income Tax Department, the reviews also seek to point out any lacunae in the Income Tax Act as well as the related rules. In Para 4(c) of the review report on “Interest, penalties and prosecution under the Direct Tax Acts” conducted for the assessment year 1994-95, non-levy of interest for non-payment of advance tax due to an existing lacuna in the act was categorically pointed out. The cases showed that refund was made to the assessee consequent upon the initial processing of the return of income

but in the event of tax becoming payable on any subsequent regular assessment, the assessee was given credit for the entire amount of advance tax and TDS, although a part or whole of it was retained by the assessee for a considerable period between summary and regular assessment without paying any interest to government. Consequent to this being pointed out in the review report, w.e.f. 1/06/2003, Section 234D of the IT Act was inserted by the Finance Act, 2003 to provide for the charging of interest when excess tax is

refunded and providing for assessment by intimation u/s 143(1).

Apart from the above, some other interesting observations pointed out in the above-mentioned reviews are presented below:

#### **Review of Private Banking Companies and Non-Banking Financial Companies (2000-01)**

- Provision for Rs. 217 lakh debited in the P/L A/C on account of non-performing assets (net) was incorrectly allowed as deduction involving tax effect of Rs. 76.15 lakh. TDS of Rs. 65.03 lakh against dividend Income of 24.63 lakh was credited in the accounts and allowed as deduction from tax. However, scrutiny revealed that the amount of TDS corresponded to total dividend of Rs. 300 lakh. The mistake thus resulted in under-assessment of income of Rs. 276.03 lakh involving tax effect of Rs. 149.56 lakh (including interest).

#### **Review of Refund under the Income Tax Act, 1961 (2000-01)**

- While arriving at the demand during scrutiny assessment, the refund of Rs. 355.64 lakh already made at summary stage was not considered and added back to the net demand raised as per demand notice. The mistake resulted in short demand of Rs. 355.64 lakh. In course of the review, 9 cases involving a money value of Rs. 552.94 lakh were noticed.

#### **Review of Co-operative Societies (2000-01)**

- The entire interest earned from Government securities was allowed as deduction. The mistake resulted in underassessment of income of Rs. 1185.77 lakh involving tax effect of Rs. 578.75 lakh in respect of two cases. In the assessment year 1995-96 to 1997-98, the Burdwan Central Co-operative Bank Ltd. was incorrectly allowed a deduction of Rs. 21.26 lakh in respect of income from locker rent. The irregular deduction resulted in under assessment of income of the same amount involving tax effect of Rs. 26.79 lakh including interest.

#### **Review of Companies in Cement, Automobile and Textile Sectors (2000-01)**

- Incorrect adoption of gross of loss as Rs. 1595.36 lakh instead of Rs. 688.52 lakh resulted in excess computation of loss involving tax effect of Rs. 426.35 lakh. The deduction in respect of the corporate dividends was allowed even though the gross total income was nil. The mistake resulted in tax effect of Rs. 98.64 lakh.

#### **Review of Implementation of selected Judgments of Supreme Court (2001-02)**

- The assessee claimed technical knowledge fees as business expenditure through it should have been treated as capital expenditure as per Supreme Court Judgment [232 ITR 359] resulting in tax effect of Rs. 84.97 lakh. Royalty paid to a foreign company was treated as revenue expenditure which was not allowable as per Supreme Court Judgment [232 ITGR 344] involving tax effect of Rs. 56.82 lakh.

### **Review of Assessment of companies in the select sectors of Pharmaceuticals, Food Processing, Paints and Varnish and Cigarettes (2001-02)**

- The amount of liability of Rs. 271.12 lakh relating to conversion charges and bank commitment charges written back had neither been taken into account on the credit side nor set off against the expenses charged to account. The omission had resulted in under-assessment of income with short levy of tax of Rs. 124.31 lakh including interest.

### **Review of Operation of the scheme of taxation of companies under special provision of Income Tax Act (Section 115JA/JB) (2002-03)**

- An amount of Rs. 957.80 crore was credited to the P/L A/C of the assessee on account of interest on government loan for earlier years while computing book profit under the special provisions of the I.T. Act, the said amount was deducted from the book profit. The amount was not deductible from book profit as it was not an exempted income under chapter III of I.T. Act. The incorrect deduction had thus resulted in the underassessment of income involving tax effect of Rs. 127.55 crore.

### **Review of Assessment of Private Schools, Colleges and Coaching Centres (2002-03)**

- Educational institutions working as trusts had not obtained registration under Section 12A of the Act. However, assessing officers allowed irregular exemption to these unregistered Educational Institutions under Section 11 and 12 of the IT Act.

### **Review of Assessment of Business of Civil Construction (2002-03)**

- In the assessment year 1999-2000, an assessee had debited Rs. 15 crore being 1/10<sup>th</sup> of the Gold Bond Issues expenses. Scrutiny revealed that the total expenditure relating to issue of Gold Bonds was to the extent of Rs. 15.01 crore. Since the total tenure of Gold Bond was 2 years, expenses had been spread over 2 years and accordingly Rs. 7.5 crore was allowed as expenditure in each of the assessment years 1997-98 and 1998-99. As the entire expenditure had already been allowed in 1997-98 and 1998-99, there was no scope for allowing 1/10<sup>th</sup> of the expenditure again in 1999-2000. Therefore, the irregular allowance of deduction of Rs. 1.5 crore had resulted in short levy of tax of Rs. 69.85 lakh

### **Review of Some Aspects of Non-Resident Taxation with Reference to Double Taxation Avoidance Agreements (2003-2004)**

- The assessee, M/s Price Waterhouse Coopers Ltd.(USA) had received Rs. 1.95 crore per month from M/s Reliance Industries Ltd. (RIL) Mumbai on account of consultancy carried out in India. This amount was remitted directly by RIL to the assessee in USA on the basis of 'no objection certificate' obtained from the Department in Mumbai without *actual* deduction of the withholding tax, neither was the income of Rs 1.95 crore disclosed by the assessee leading to underassessment involving short levy of tax of Rs. 58.61 lakh.

**Review of Efficiency and Effectiveness  
of Administration and**

**Implementation of Selected  
Deductions and Allowances under  
Income Tax Act (2003-2004)**

- Calculation of depreciation using the straight line method instead of WDV of fixed asset tantamounts to claiming arrears of depreciation at a time. Further, pre-operative expenses included in the capital cost of fixed asset were not related to purchase/installation of asset. Moreover, incorporation expenses were allowed irregular depreciation under section 32 of the Act as the same was not a part of cost of the fixed asset. All these had resulted in enhanced cost of asset as well as excess allowance of depreciation involving tax effect of Rs. 13.00 Crore

#### **Review of Efficiency of Summary Assessment Scheme and Process of Selection of Cases for Scrutiny (2004-2005)**

- 227 cases of irregularities amounting to Rs. 194.95 crores were detected in the operation of the above-mentioned scheme.

#### **Review of Effectiveness of Search and Seizure Operations (2004-2005)**

- An assessee had disclosed gross profit @ 3.5470 per cent in the last returned income. The assessing Officer adopted 2.55 per cent on undisclosed income arbitrarily on undisclosed rate of Rs. 11.31 crore involving tax effect of Rs. 1.36 crore.

### **Concluding Observations**

The audit conducted by the ITRA wing is focused on the assessments made by the assessing officers and the observations with regard to the deficiencies in the functioning of the department are spread across a wide gamut of issues

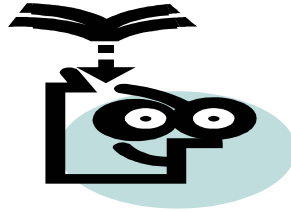
revolving around the Income Tax Act and its administration by the Income Tax Department. Audit has made an effort to identify the problem areas in the working of the IT Department. Some areas of audit concern have effectively been addressed by the department, as reflected in the reduction of audit observations in respect of those areas. The statutes have also been amended in an effort to plug the leakages in revenue as pointed out by audit. Substantial under assessment and collection of revenue have been pointed out by the ITRA wing of the office over a period of years through the DPs floated and Reviews undertaken by the wing.

However, concerted and sustained efforts are required by the wing to aid the department in guarding against leakages in future. Efforts are required to focus on areas that have been neglected by the department as well as audit like salary units and non-corporate taxes and wealth tax, which on account of their low-value transactions do not feature in audit reports. This is in spite of the fact that the total quantum of such low value transactions is huge and contributes in a major way to the generation of revenue.

Cross referencing with other related acts like Companies Act etc. is also required in order to detect new areas of leakages in revenue. Increased information sharing between different revenue audit wings in the same state as well as with those in the other states would also help in detecting newer areas of revenue leakages.

Overall improvement in the quality and content of the Audit Reports of the Comptroller & Auditor General of India in relation to direct taxes can be achieved only with a combination of such measures, along with a continuous evaluation and refining of our

methods. Increasing use of technology and computers by the field audit parties will also help in realizing our objectives in a much more meaningful manner.



## *Role of Chartered Accountants in administration of Income Tax laws*

### *A Critical Analysis*

*The Chartered Accountants have been mandated to be facilitators for the Income Tax Department in administering the provisions of the Income Tax Act. The Tax Audit Report submitted by them on behalf of the assessee serves as a valuable reference guide for the assessing officers in making assessments, especially in the context of summary assessments. However, sometimes the inability or what may seem as reluctance on the part of some Chartered Accountants in presenting the true and fair picture of the assessee to the Income Tax Department expressly defeats the mechanism of tax administration.*

#### **Objective of the Article**

Income Tax collections made from both corporate as well as non-corporate assesses have increased phenomenally over the past few years, both as a result of expansion of tax base as well as better tax compliance by the assessee due to lowering of the tax rates as well as strengthening of the tax administration machinery. A major fallout of increasing the tax base is an increased strain on the resources of the Income Tax Department. This article seeks to analyze the role of one of the major facilitators for the Income Tax Department i.e. the Chartered Accountants of the assessee vis-à-vis the assessments being processed by the Assessing Officers of the Income Tax Department. In this context, various provisions of the Income Tax Act and the related rules, statutes, circulars etc. have been examined with regards to the level of reliance being placed by the Assessing Officers on the different documents originating from the Chartered Accountants and the accountability of the latter in that regard and shortcomings have been analyzed with reference to some illustrative examples.

#### **Introduction**

##### **Legal Provision**

Section 44AB of the Income-Tax Act, 1961, inserted by Finance Act 1984 with effect from April 01, 1985 (Assessment Year 1985-86) required the audit of accounts of any person carrying out any business or profession, by designated Chartered Accountants. This section was amended in the very next year by Finance Act 1985, relaxing the requirement of such audit by a qualified Chartered Accountant, if an audit had been done under any other law. The Tax Audit Report is to be filed on the basis of such audit by the concerned Chartered Accountant. The Finance Act 1988 has amended sections 44AB, 139 and 271B to ensure filing of Tax Audit Report along with the Income Tax return and to enable levy of penalty for failing to adhere to this requirement. The final seal of approval upon the provision by upholding its constitutional validity was given in the Hon'ble Supreme Court Judgment in the case of TD Venkata Rao Vs Union of India [1999] 237 ITR 315 (SC). The Section was inserted making it obligatory for a person carrying out any business to get his accounts audited before the specified date by an accountant if the total sales, turnover or gross receipts in business for the previous year exceeded forty lakh rupees. A person carrying on profession

will also have to get his accounts audited before the specified date, if his gross receipts in profession for a previous year or years relevant to any assessment year exceeded Rs 10 lakh.

**Objective of the Section**

The Objective of the Section has been elaborated in the CBDT Circular explaining the amendment carried out by Finance Act, 1984. Paragraph 17.2 of Circular No. 387 dated July 6, 1984 read as under,

“A proper audit for tax purposes would ensure that the books of accounts and other records are properly maintained. That they faithfully reflect the income of the tax payer and claims for deduction are correctly made by him. Such audit would also help in checking fraudulent practices. It can also facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities and considerably save the time of assessing officers in carrying out routine verification, like checking correctness of totals and verifying whether purchases and sales are properly vouched or not. The time of the assessing Officer, thus, saved could be utilized for attending to important investigation aspects of the case.”

**Penalty Provision**

Section 271B provides that if any person fails without reasonable cause, to get his accounts audited in respect of any previous year or years relevant to an assessment year or obtain a report of such audit as required under the aforesaid provision, the Income Tax Officer may direct that person to pay, by way of penalty, a sum equal to half percent of the total sales, turnover or gross receipts, as the case may be in case of a business or the gross receipt, in case of a profession in

such previous years, subject to a maximum of one lakh rupees.

**Extended Coverage**

An assessee carrying on business shall also have to get his accounts of such previous year audited by an accountant before the specified date and furnish the Tax Audit Report as per requirements if the profits and gain from the business are deemed to be the profits and gains of such person under Section 44AD, 44AE or Section 44AF as the case may be and if he has claimed his income to be lower than the profits or gains so deemed,

**Time limit for filing the Report:**

Tax Audit Report should be filed by the specified date being the last date fixed under Section 139(1) of the Act for filing the return.

**Relevance of the Provision:**

Even though the proforma of the Tax Audit Report has been updated recently on 04-06-1999 after deletion of Section 143(1 A) and 143(1 B) (w.e.f.1/6/1999), the same is inadequate in many respects. This provision has been in statute now for the last two decades and its effectiveness has not been objectively evaluated by the revenue department through any systematic study.

Some of the important deductions/exemptions, which can be claimed by the assessee on the basis of the tax audit report certificate given by the Accountant are listed in the following table:

Sl. No.	Section	Deduction / Exemption	Form No.	Rule	Furnished by
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1	32(i)(ia)	Deduction towards additional depreciation	3AA	5A	A Chartered Accountant of the Company
2	35D(4) / 35E(6)	Amortization of certain preliminary expenses or expenditure on prospecting etc. for certain minerals	3B	6AB	A non company assessee, other than co-operative society.
3	44AB	With a view to facilitating the determination of the assessee's income from business or profession	3CA	6G(i)(a)	In the case of both corporate and non corporate assessee carrying on business or profession. (Statement of Partialness)
4	44AB		3CD	6G(2)	
5	50B	Computation of capital gain in the case of slump sales	3CEA	6H	A Chartered Accountant and includes in relation to any state, any person who is authorised by virtue of the provisions of section 226(2) of the Companies Act.
6	142(2A)	To be furnished by the assessee in respect of whom a direction for special audit of accounts have been issued by the assessing officer.	6B	14A	By the chartered accountant nominated by the chief commissioner or commissioner.
7.	80HH	For claiming deduction from profit in respect of newly established undertakings or noted business in back ward area	10C	18B	Should be furnished by a non company assessee other than a co-operative society
8	80HHB	Deduction in respect of profit and gains from project outside India	10CCA	18BBA(1)	To be given by a Chartered Accountant of Indian company or a person who is resident in India
9	80HHBA	Deduction in respect of profit and gains from housing project	10CCAA	18 BBA (1A)	- Do -
10	80HHC and 4(A)	Deduction in respect of profits retained for export business	10CCAC	18BBA(3)	Certificate to be given by the chartered accountant determining the entitlement of the quantum of deduction
11	80HHD	Deduction in respect of earning in convertible foreign exchange by hotel operator or travel agent	10CCAD	18BBA(4)	Amount of deduction allowable is to be certified by the chartered accountant of the assessee.
12	80HHE (4) 80HHE	Deduction in respect of profit from export of Computer Software etc.	10CCAF	18BBA(7)	Certificate to be given by the accountant of the company determining



	(4A)				quantum of deduction to which the assessee is entitled
13	80HHF (4)	Deduction in respect of profits and gains from export or transfer of films/software etc.	10CCAI	18BBA(9)	- Do -
14	80I(7) / 80-IA(7) / 80IB	Deduction in respect of profits and gains from industrial undertaking or enterprises engaged in infrastructure development (ii) other than infrastructure development under taking	10CCB	18BBB	From A.Y. 2003-04 The assessee including companies and Co-operative societies must mandatorily furnish this audit report with the return of income.
15	80IB(7A)	Deduction in respect of the profits and gains derived from the business of building owning and operation a multiplex theatre.	10CCBA	18DB	The report is to be obtained from a chartered accountant and furnished along with the return of income in which the deduction is claimed.
16	115JB	Computation of Book Profit for determination of Minimum Alternate Tax	29 B	40B	To be furnished by the chartered accountant certifying that book profits have been computed in accordance with the provision of the Act.
17	10A	Exemption on profit & gains from export in free trade zone	56F	16D	Amount of deduction is to be certified by the chartered accountant stating that Section 10A has been correctly claimed.
18	10B	Special provision in respect of newly established hundred percent export oriented under taking	56G	16E	-Do- Exemption under section 10B will not be allowed without certificate by the chartered accountant
19	35AC	Deduction for Expenditure on eligible projector scheme	58B	11-O(2)	The certificate from a chartered accountant within the meaning of Chartered Accountant Act, 1949.

From the above table it is evident that apart from meeting the limited objectives of Section 44AB of the Income Tax Act, the Tax Audit Report Certificate by the

Chartered Accountant also entitles the assessee to a host of other deductions and exemptions under other provisions of the

Income Tax Act as well as the Income Tax Rules.

### **Role of the Chartered Accountant**

The statement of particulars required to be furnished under Section 44AB of the Income Tax Act, 1961 in Form 3CD is most important for completion of assessment by the assessing officer in connection with determination of the taxable income of an assessee for income from business or profession. The accountant plays a pivotal role in computation of the business or professional income of the assessee. Thus, when a reporting accountant issues a certificate, he is responsible for the factual accuracy of what is stated therein. The Tax Audit Report assumes greater importance on account of the fact that nowadays in most of the cases assessment is completed by the assessing officer in a summary manner [u/s 143(1)] solely on basis of the return furnished by the assessee.

Thus the assessing officer will have to depend on the accountant of the company for allowing deductions with regards to the following items:

- Particulars of depreciation allowable as per the Income Tax Act.
- Different sums debited to profit and loss account or claimed separately in computation towards claiming deductions allowable u/s 33AB, 33BA, 33AC, 33AD, 33AE, 33B and 33C.
- Any sum paid to an employee as bonus or commission for service rendered, any sum received from employees towards contribution to any provident fund or superannuation fund or any other fund mentioned in Section 2(24)(X) and due date for payment and the actual date of payment to the concerned authorities under Section 36(i)(va)
- Amount debited to the profit and loss account being expenditure of capital nature. Expenditure by way of penalty

or fine for violation of any law. Amount debited to the profit and loss account being expenditure of capital nature.

- Item 21 of Form 3CD supplies information in respect of any sum referred to in Clause (a), (c), (d), or (e) of Section 43 B where certain deductions are to be allowed only on actual payment basis.
- The accountant is also liable to certify whether particulars of each loan or deposit is an amount exceeding the limit specified in section 269 SS taken or accepted during the previous year .
- The quantitative details of the principal items of goods traded or principal items of raw materials, finished products and by products, opening balance, closing stock, purchase and sales of finished product during the year are shown by the accountant in item 28 of Form 3CD .

### **Accountability and Responsibility of the Accountants**

The discussion till now has focused on the role of the Chartered Accountants in the context of the overall administration of the Income Tax Assessment Laws and specifically with regard to the provisions of Section 44AB of the Income Tax Act, 1961. It is evident that the accountability of the accountants is paramount in administering the tax laws especially in relation to summary assessments. The shortcomings on this account are described in the subsequent paragraphs with the help of some examples to drive home the points.

#### **(i) Action point No. 5(ii) u/s Form 3CA**

In connection with Section 44AB of the act [Rule 6 G(i)(a)] specifies the norm that the designated person (accountant) has to indicate his membership number / certificate of

practice number / authority under which he is entitled to sign this report.

furnished by the assessee with the return of income. However the authorization details of the accountant as required were not mentioned.

In the following cases pertaining to assessments in West Bengal, Form 3CA (Certificate) along with form 3CD were

Sl. No.	Name of the assessee	Assessment Year	Name of the Accountant	Ward / Circle
1	Ansu Trade and Fiscals Pvt. Ltd.	2004-05	Baheti & Company	Ward 9(i)
2	M/S Hara Commercial Pvt. Ltd.	2004-05	Anoop Tiwari & Associates	Ward 7(1)
3	M/S Micky Metals Ltd.	2001-02	Sushil Sharma & Co.	Ward 9(1)
4	Deepak Metal Works (P) Ltd.	2002-03	B. N. Mukherjee & Co.	Ward 9(1)
5	M/s Moongipa Transport (P) Ltd.	2003-04	G.L. Singhal & Co.	Ward 9(1)
6	United Sales Agencies (Cal) Pvt.Ltd.	2004-05	R.N. Kapoor & Co.	Ward9(1)

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**ii) Item No. 28 of Form No. 3CD :**

The accountant of the company is required to report the opening stock, purchase and sales during the year. Assessing Officer is entirely dependant on this report because of the fact that he does not get any opportunity to verify the documents in connection with the sales, purchases, stock etc. of a corporate house in the course of assessment. The assessment of M/s Alestein Furniture Private Limited was completed u/s 143(1) on the basis of the accounts certified by the accountant of the company in Ward 7(1). In the Trading and Profit & Loss A/c for the year ended 31<sup>st</sup> March 2003, closing stock of leather and other materials was shown as Rs.13,68,110/- whereas in the Trading and Profit & Loss Accounts for the year ended 31<sup>st</sup> March 2004, figures for the previous year (*Opening Balance*) was reflected as 14,06,610/-. Thus the accountant did not reflect the correct position of the assessee's stock position and the assessing officer was also

handicapped in his assessment to that extent as he had to rely solely on form 3CD.

**(iii) Item No. 17(h) of Form No. 3CD**

Amount inadmissible under section 40A(3) read with rule 6DD and computation thereof is to be certified by the accountant of the company. Here, a very common certificate as given by the accountant of a company reads: "It is not possible for us to verify whether the payments in excess of Rs.20,000/- have been made otherwise than in crossed cheque or bank draft as necessary evidence is not with the possession of the Company." This amounts to shirking of responsibility, as the accountant is supposed to verify all the relevant details in Form 3CD before the same is submitted. Different items of the form have different levels of revenue implications. The accountant needs to impress upon the assessee to maintain such records failing which, efforts may be made for cross verification with the bank branches where

the assessee maintains his accounts. The provision is very important on account of the fact that it helps to keep a tab on transactions involving 'Black Money'.

**(iv) Item 15 of Form 3CD**

Section 35DD pertaining to amortization of expenditure in case of amalgamation or demerger was inserted by Finance Act 1999, with effect from 1/4/2000 and 35 DDA pertaining to amortization of expenditure incurred under Voluntary Retirement Scheme from 1/4/2001. Item 15 of the Form 3CD has not been suitably amended to certify the amount admissible for the purpose of deduction under each section.

As per the provision of the Section 35DDA where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee at the time of his voluntary retirement, in accordance with any scheme or scheme of voluntary retirement, one fifth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance shall be deducted in equal installment, for each immediately succeeding previous year. In the absence

of any specific provision to certify the quantum of allowable deduction by the accountant, the assessing officer allows the deduction claimed by the assessee on his own accord. This example seeks to point out the lack of updation of Form 3CD, which is preventing the Accountants from certifying the expenditure.

**(v) As per provision of Rule 18BBB,** a separate report is to be furnished by each undertaking or enterprise of the assessee claiming deduction under section 80 IA or Section 80IB. From the assessment year 2003-04, assesses including companies must mandatorily furnish this audit report along with the return of income failing which the deduction will not be allowed. In the following cases deduction under section 80IB was allowed without the required audited report from the Accountant. The allowance of such amounts without the accountant's certificate was a definite act of omission on part of the assessing officer. However the accountants also need to be held accountable for their failure towards furnishing the report and guiding the assessing officers appropriately.

SL. No.	Name of the Company	CIT	A.Y.	Assessed u/s	Deduction allowed	Tax effect (in Rs. lakhs)
1	Ashiana Housing Finance Ltd.	III	2003-04	143(1)	3,19,78,300	130.13
2.	Nagreeka Foils Ltd.	I	2003-04	143(1)	3,09,99,556	113.92
3.	M/s Balmer Lawrie & Company	II	2003-04	143(1)	1,09,11,636	40.10

**(vi) Item 14 of the Form 3CD** empowers the accountant of the company to give a report on the particulars of depreciation allowable u/s 32. But several cases have since been detected by audit where excess

depreciation was allowed by the Assessing Officers owing to incorrect adoption of rate of depreciation as certified by the accountant of the company.

**Some cases pertaining to West Bengal charges are illustrated below:**

Name of assessee	CIT	Section under which assessed	Assessment Year	Nature of Mistake	Tax effect in Rs. lakh
Damodar Valley Corporation	III	U/s 143(3)	2000-01	Depreciation claimed on furniture (office) and furniture (School Canteen) 15% and 10% instead of 10% and 15% respectively resulted in excess allowance of depreciation.	12.12
Do	III	143(1)	2001-02		19.84
Do	III	143(3)	2002-03		More than 10
Ananda Bazar Patrika	III	143(3)	2000-01 2001-02	Depreciation claimed at 60% on communication equipment and photo type setting machines upon being treated as Computers instead of being allowed depreciation @ 25%.	5.72 75.17

## **7. Role of the Income Tax Department**

The role of the chartered accountants with regards to the administration of certain provisions of the IT Act has been examined in the above paragraphs. It is suggested that all cases where the information provided in the Tax Audit Report is inadequate or the remarks in the report are inconclusive or ambiguous should be referred by the assessing officers to the Commissioners of Income Tax to see whether the case reflects any professional negligence on the part of the chartered accountants who have signed the reports. The Central Board of Direct Taxes has issued instructions to the field offices to forward such cases of professional negligence for further follow up with the Institute of Chartered Accountants of India, which is the disciplining body for the Chartered

Accountants. Delinquent the Chartered Accountants can be dealt in terms of the provisions contained in Section 288 of the Income Tax Act, 1961.

However, in spite of such enabling provisions available to the Income Tax Department, one rarely comes across any case of any action being initiated against the chartered accountants. The position of the Income Tax Department can be further illustrated with the following example, wherein the mistake in assessment by the assessing officer had resulted on account of the reliance on the accountants report in case of a summary assessment.

Income of M/s Sahara India Commercial Corporation Ltd.(under CIT Kolkata-III) for the assessment year 1999-2000 was assessed in a summary manner on 18-9-2000. It was apparent from assessment records for assessment years 1997-98, 1998-99 and 1999-00 that the Gold Bond expenses to the tune of Rs154

lakh was irregularly allowed in 1999-2000 even though the same amount had already been allowed in the previous two years. The observation was featured in para no.2.13.3, in the C&AG's Audit Report No.13 of 2004. The assessment was rectified at the instance of audit by the DCIT Circle-8 on 29-03-2004. In this case the assessing officer had no scope to see the past years' assessment records as the same was not obligatory in terms of the provisions for summary assessment. However, he was inappropriately guided by the faulty report by the chartered accountant. In spite of this the assessing officer did not report against chartered accountant. In the instant case, without the audit observation, the fact of the faulty assessment would not have come to light.

## **8. Suggestions and Recommendations**

As seen from the above discussion, the efforts of the Income Tax Department towards streamlining the tax administration vide the provisions of Summary Assessment are sometimes frustrated by the chartered accountants who sometimes give their professional reports without adequate care. To arrest tax evasion the department has to issue a notice u/s 142(1) for further clarifications, but then often the reports are accepted by the Department without increasing their workload further by issuing such notices. To avoid such situations the department should be extra-cautious while accepting the returns accompanied by Form 3CD. If warranted the returns may be treated as defective as per section 139(9) of the income Tax Act, 1961. The assessing officers should not rely on the defective certificates from the chartered accountants. Revenue audit parties should also not lose sight of any possible gap in the tax audit report furnished by the chartered accountants.

## **9. Conclusion**

The form 3CD has not been designed in such a manner so as to show at a glance the gross total income of the assessee or the taxable income of an assessee. Further, the different requirements as envisaged in case of Form 3CD are not always followed scrupulously by the chartered accountants. Assessing Officers have not been particularly eager to initiate any proceedings against any chartered accountant for failure to comply with the requirements as specified in section 44AB.

In many cases, the accountants submit their report certifying the items as "Nil" or "Not Applicable". But the effect of such incomplete certificates and inadequate accountability in terms of revenue loss has not been estimated either by the Income Tax Department or by revenue audit.

It may not be entirely out of context to refer to the recent debate of doing away with the Comptroller and Auditor General of India's statutory audit in respect of Public Sector Undertakings. The same is based on the premise that the initial audit by the chartered accountants nominated by the C&AG will serve as adequate audit control. However, in the light of the above discussion, this issue probably requires a deeper examination.



## *Around the World*

*In this section we propose to highlight some important developments in the International Community of Government Auditors*

### *Inaugural Meeting of the INTOSAI Capacity Building Committee*

In March 2006, officials from 32 SAIs, including 10 auditors general, gathered in London for the inaugural meeting of INTOSAI's Capacity Building Committee (CBC). Established by the Governing Board to implement goal 2 of the INTOSAI strategic plan, the committee is chaired by Dr. Ahmed El-Midaoui, President of the Court of Accounts of Morocco. The opening session of the meeting included remarks from Sir John Bourn, meeting host; Dr. Arpad Kovacs, President of INTOSAI; Mr. David Walker, goal 2 board liaison; and Dr. El-Midaoui. Dr. El-Midaoui began the working sessions by explaining the proposed structure for the CBC and outlining the terms of reference for the full committee, its steering committee, and three subcommittees. Subcommittee 1, chaired by the United Kingdom with the Cayman Islands as vice-chair, will promote capacity building activities among SAIs. Subcommittee 2, chaired by Peru with Kazakhstan as vice-chair, will develop advisory and consultant services. Subcommittee 3, chaired by Germany with Bangladesh as vice-chair, will promote best practices and quality assurance through voluntary peer reviews. During their discussions, committee members confirmed the importance of fully integrating the INTOSAI Development Initiative (IDI) into the CBC's work and developing close links with other INTOSAI committees and regional organizations. The committee will also seek to address the needs of the different types of SAIs.

Members generally agreed on the current terms of reference but commented that subcommittees should be allowed to move beyond them, if necessary, to achieve the CBC's overall goals. Specific comments on the individual subcommittees stressed the voluntary nature of peer reviews. Members also agreed to change the second task of the first subcommittee from "coordinating all SAIs' capacity-building projects" to "facilitating the coordination of SAI capacity-building projects."

#### **Subcommittee 1: Promoting Increased Capacity-Building Activities**

The first subcommittee discussed the need to facilitate the long-term sustainable development of SAIs and not to duplicate existing technical activities of other INTOSAI working groups or IDI. All SAIs can benefit from continuous improvement and should identify their own development needs based on their own mandates and traditions. Following the discussion, the subcommittee agreed to a set of outputs and a timetable. The subcommittee will first identify tools available to determine development challenges for SAIs; a draft paper on this subject will be circulated for comment from committee members and others who have used the tools. The goal is to produce a final paper and case studies by April 2007. The subcommittee will also draft a paper identifying key successes and major risk factors in capacity-building, with a final paper to be prepared by March 2007. After completing activities 1 and 2, the

subcommittee will consider developing a survey of SAIs' experiences as both recipients and providers of capacity-building. Finally, the subcommittee will compile a directory of current capacity-building projects in SAIs worldwide by December 2006; this directory will be updated every 6 months.

### **Subcommittee 2: Developing Advisory and Consultant Services**

The second subcommittee discussed each of its three areas of responsibility. First, the SAI of Peru agreed to lead an effort to develop a database of experts from various SAIs. The database is to be an open access tool, with contact information for experts broken down by language capability and general categories of expertise, such as financial, performance, compliance, and IT auditing. Areas of special expertise, such as human capital or strategic planning, will also be identified. The SAI of the United States, in its role as goal 2 liaison, agreed to assist the chair with this work. The subcommittee's second activity is to encourage joint and coordinated or parallel auditing programs. The SAI of Fiji volunteered to draft a two-part survey on SAIs' experiences in joint auditing, if any, and areas in which SAIs are interested in working together in the future. Since this activity involves knowledge sharing, the subcommittee will need to coordinate with the goal 3 liaison (India). The subcommittee then discussed the potential cost and preparatory work required for its third activity--encouraging internships and visit programs. The subcommittee agreed that a survey might be needed to identify the demand for internship and visit programs and that it could likely

determine the demand by using the same categories identified for the database of experts to be compiled under its first activity. The survey would also address supply questions, such as the nature, frequency, number, and length of programs that SAIs might be able to host. The SAI of Fiji agreed to link this survey with the survey for the subcommittee's second activity and prepare a draft of both before the end of 2006.

### **Subcommittee 3: Promoting Best Practices and Quality Assurance through Voluntary Peer Reviews**

The subcommittee discussed different forms and methods of peer review and compared experiences and issues, including such practical aspects as how peer reviews are paid for and terms of reference are agreed upon. While agreeing that peer reviews are a positive tool, the subcommittee noted that there has been little evaluation or feedback from the SAIs that have undergone them. The subcommittee agreed that prior to the next INTOSAI congress, it will assess SAIs' prior experiences of peer reviews through a survey; organize a symposium for those with experiences of peer reviews to share, identify, and develop best practices; and publish a best practices guide to be disseminated, after standard due process, at the next congress.

### **Strategic Issues and Next Steps for the CBC**

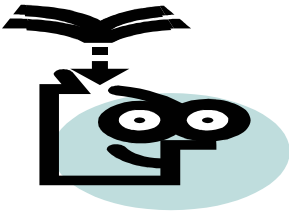
The CBC will consider the proposed activities of each subcommittee and their likely costs. Through the steering committee, these activities and costs will be prioritized and likely funding partners identified. The CBC's financial requirements, along



with requests from other INTOSAI committees, will then be considered by the INTOSAI Finance and Administration Committee and the INTOSAI Governing Board. This will

enable INTOSAI to present a unified approach to global international organizations when making requests for limited funds.

**Source:** INTOSAI Strategic Plan FOCUS  
International Journal of Government Auditing–July 2006



## *Registrar of Companies and administration of Income Tax Laws*

### *Need for Revenue Audit*

*Registrar of Companies, in their capacity of being the regulator of private entrepreneurships is supposed to scrutinize closely certain returns furnished by such companies who also happen to be 'Corporate' Income Tax assesseees. As mandated by the Government of India and judicial pronouncements, the Income Tax Department is supposed to rely on the Registrar of Companies for authenticity of certain information, which is used for processing the Income Tax returns. Laxity on part of the Registrar of Companies is rendering the system vulnerable to leakages.*

#### **1. Objective of the Article**

The revenue collecting machinery of the Government of India is a networked system involving different agencies like the Income Tax Department, Customs Department, Central Excise Department etc. These agencies often have to work in tandem with certain regulatory agencies. One such agency is the Registrar of Companies, which is involved in regulating the activities of private companies and entrepreneurships. The common thread between the tax collecting agencies and regulatory agencies is the information furnished by the companies in different returns that are submitted to the different agencies. This information is supposed to be checked at multiple levels by the different agencies to prevent any leakages.

This article seeks to evaluate some aspects of the functioning of the Income Tax Department wherein close coordination is required with the Registrar of Companies for tax administration in respect of the private entrepreneurships.

#### **2. Introduction**

The Ministry of Company Affairs is primarily concerned with the administration of the Companies Act, 1956 and other related acts, rules and regulations mainly for regulating the functioning of the Corporate Sector in accordance with law.

Offices of Registrars of Companies are the functional representatives of the Ministry in various States and Union Territories. The Registrars of Companies are appointed under Section 6 of the Companies Act and have the mandate of registering companies floated in the respective states and Union Territories and ensuring the companies' compliance with the statutory requirements under the Act. In course of exercising their control over the operation of companies in a lawful manner, the Registrars of Companies are in receipt of different returns from the companies. These returns, apart from conveying the basic information regarding the registration details, details regarding the management of the companies etc., also carry information regarding the different macro and micro financial indicators of the different companies. These companies by default also fall under the

operational purview of the Income Tax Act, 1961 and the related rules etc. as 'Corporate Assesseees'.

The Registrar of Companies in its capacity as regulators of the companies in accordance of the provisions of the Companies Act are authorized to scrutinize the returns furnished by the companies. They are also authorized to invoke penal provisions against the companies in case of any deficiencies in the returns furnished by the assesseees.

In the subsequent paragraphs, this article seeks to examine the role and position of the Registrar of Companies with regards to the administration of an important section of the Income Tax Act.

### **3. Minimum Alternate Tax u/s 115 JB of the Income Tax Act, 1961**

Section 115JB of the Income Tax Act, 1961 is an amended provision of Section 115J of the same act which was inserted in the act in the year 2001 by the Finance Act, 2001. The purpose of introduction of the provision can be ascertained from the then Finance Minister's Budget Speech advocating a need for such a section for the Income Tax authorities to widen their tax net and bring under the purview of taxation certain companies which were maneuvering their accounts in such a manner so as to pay very little or no tax at all. The Hon'ble Minister had stated in his Budget speech:

"It is only fair and proper that the prosperous should pay at least some tax. The phenomenon of so-called 'zero-tax' of highly profitable companies deserves attention. In 1983, a new section 80VVA

was inserted in the Act so that all profitable companies pay some tax. This does not seem to have helped and is being withdrawn. I now propose to introduce a provision whereby every company will have to pay a 'minimum corporate tax' on the profits declared by it in its own accounts."

In this perspective, it may be mentioned that similar provisions also exist in the tax laws of other countries .e.g. in the United States of America, where there are similar provisions in the form of 'Alternative Minimum Tax'. The same is based on a similar premise that the tax law gives preferential treatment to some kinds of income and allows special deductions and credits for some kinds of expenses. Taxpayers who benefit from these provisions of the law may have to pay an additional tax called the alternative minimum tax. It is a separate tax computation that, in effect, eliminates many deductions and credits and creates a tax liability for an individual who would otherwise pay little or no tax.

Section 115J of the Income Tax Act, 1961 provides that if an assessee being a company other than the one engaged in the business of generation or distribution of electricity, has its total income, less than thirty per cent of its book profit, then its total income chargeable to tax for the relevant previous year shall be deemed to be an amount equal to thirty per cent of such book profit. The section was applicable for the assessment years beginning on 1/4/1988 to 1/4/1991.

The modified section i.e. Section 115JB is relevant from the assessment year beginning 1/4/2001 and provides that if the income tax payable by a corporate assessee is less than seven and

a half percent of its book profit, then the book profit is to be treated as the total income and is to be taxed at seven and a half percent.

But the most important requirement of this section is that every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (1 of 1956).

It is also stipulated that while preparing the annual accounts including profit and loss account,

- (i) the accounting policies;
- (ii) the accounting standards adopted for preparing such accounts including profit and loss account;
- (iii) the method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956.

For the purposes of this section, “book profit” means the net profit as shown in the profit and loss account for the relevant previous year, as increased by—

- (a) the amount of income-tax paid or payable, and the provision therefor; or
- (b) the amounts carried to any reserves, by whatever name called [, other than a reserve specified under section 33AC]; or

(c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or

(d) the amount by way of provision for losses of subsidiary companies; or

(e) the amount or amounts of dividends paid or proposed ; or

(f) the amount or amounts of expenditure relatable to any income to which section 10 [(other than the provisions contained in clause (23G) thereof)] or section 10A or section 10B or section 11 or section 12 apply.

#### **4. Role of Registrar of Companies**

As is evident from the above summarized position of Sections 115J and 115JB of the Income Tax Act, 1961, the administration of the same is strongly intertwined with the administration of different provisions of the Companies Act, 1956.

In this context, the role of Registrar of Companies is examined in light of the Hon’ble Supreme Court’s judgment in the case of Apollo Tyres Ltd. v/s Commissioner of Income Tax {[2002] 255ITR 0273W}. One of the salient points of reference of the case was whether the assessing officer, while assessing a company under section 115J of the Income Tax Act is authorized to question the correctness of the profit and loss account prepared by the assessee-company and certified by the statutory auditors of the company, as having been prepared in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act. The Hon’ble Court had ruled in the negative on the grounds that the very mention of

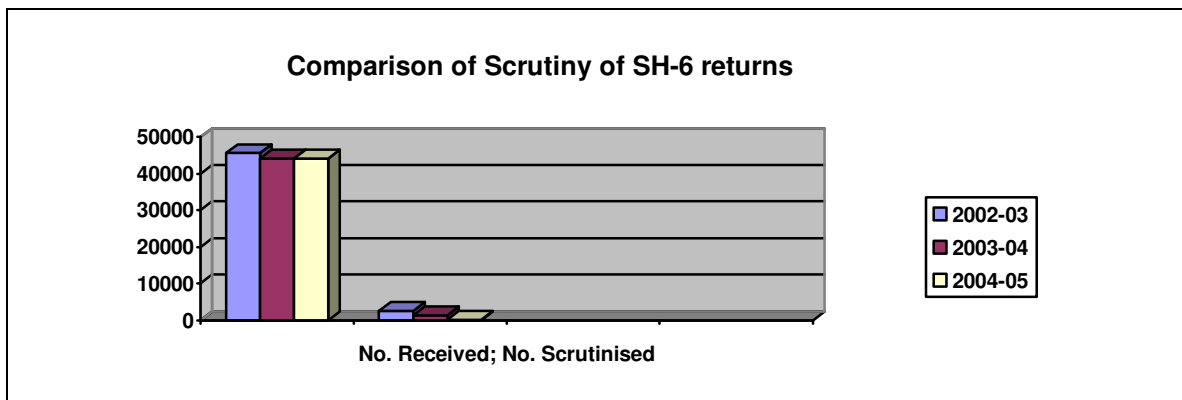
the provisions of the Companies Act in the body of the section 115J implied that the assessing officer had to rely on the accounts that were prepared in accordance with the Companies Act, placed in the General Body and finally scrutinized by the Registrar of Companies with regards to their correctness.

It is also fairly evident that the essence of determining the payable income tax in such cases is the correct determination of the book profit after due adjustments to the net profit of the company as reported in the Profit and Loss Accounts. As the assessing officer is not empowered to question the correctness of the relevant indicators reported by the company in its returns submitted to the Registrar of Companies, revenue audit is also handicapped to the extent that the scope of its scrutiny remains restricted to the authority and

operation of the assessing officer. As such, a question arises with regards to the level of scrutiny being exercised by the Registrar of Companies and the need for audit of the same in the perspective of the financial data being utilized for determining huge amounts of minimum tax payable by the companies. Apart from the simple logic of revenue audit scrutinising the returns filed at the Registrar of Companies in light of the above discussion, the urgent need for revenue audit of such returns would be clear if we have a look at table: 1 that lists the details of technical scrutiny of form SH-6 (containing the details of Balance Sheet and Profit and Loss Accounts of the companies which are treated as sacrosanct in context of Section 115J/JB of the Income Tax Act, 1961). The figures pertain to the office of Registrar of Companies, Kolkata.

**Table 1:** Status of technical scrutiny of SH-6 returns at Registrar of Companies, Kolkata.

Year of Submission of returns	Number of SH-6 forms received	Number on which Technical Scrutiny was conducted	Percentage of the total SH-6 forms scrutinised
2002-03	45616	2562	5.62
2003-04	44087	1272	2.89
2004-05	44145	48	0.11



Analysis of the data in the above table clearly reveals that the Registrar of Companies, Kolkata has been a major defaulter in respect of scrutiny of SH-6 returns of the Corporate assesses. In spite of that, there is no avenue for the Income Tax Department to verify the correctness of the financial indicators, submitted by the assesseees in the SH-6 returns. Hence in light of the above discussion there is a major possibility of the Income Tax Department making assessments on the basis of unverified and faulty financial indicators.

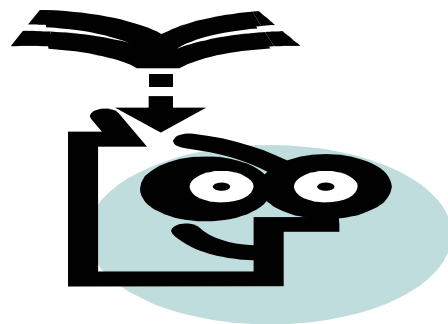
## **5. Conclusion and Recommendations:**

There is an urgent need for revenue audit to examine the SH-6 returns being filed with the Registrar of Companies. This need emerges from the Hon'ble Supreme Court's judgment in debarring the assessing officers from exercising a check on the same. The Registrar of Companies' has also not been able and vigilant enough in this regard, as shown in the above discussion. Revenue audit needs to be organized in order to strengthen the Registrar of Companies' controls over SH-6 returns. This may be ensured through a two pronged strategy whereby a test audit should first be conducted on the scrutiny of SH-6 returns before the information contained therein is utilized by the Income Tax Department. Further, a backward linkage may also be established in respect of selected income tax assessments for establishing the authenticity of certain information..

Sample audit scrutiny of the SH-6 returns may be conducted at the Registrar of Companies during an annual audit. The details of such audit may be

forwarded to the audit parties engaged in the audit of Income Tax assessment units. Revenue audit can assume the correctness of the financial indicators in respect of the assesseees whose SH-6 returns have already been scrutinized. However in respect of the assesseees, whose SH-6 returns have not been audited as part of the sample audit at Registrar of Companies, a backward trail may be established by the concerned revenue audit parties engaged in audit of the Assessment units.

The limited aim of such revenue audit would be to verify the authenticity of the financial statements of the assesseees in order to arrive at the correct Book Profit for determining the Minimum Alternate Tax. However, the audit will also check the financial indicators reported by the companies to the Registrar of Companies for various purposes. This will go a long way in establishing controls over leakages in revenue on account of incorrect payment of Minimum Alternate Tax on the basis of incorrect book profit returned by the assessee companies.



## *Central Excise Duties—Reforms revisited*

*Over the last two decades, with the onset of globalization and liberalization, the Government of India has embarked on a twin journey of reforming and rationalizing the tax structures and related statutes. The Central Excise Tariff Act (CETA), 1985 is a major statute in the scheme of tax administration in the country. This article seeks to examine some of the macro level reforms that have been effected thereto in order to rationalize the same.*

### **Objective of the Article:**

Numerous changes have been effected in the Central Excise Tariff Act, 1985 in order to streamline and rationalize its administration. However the problem areas have not been redressed completely. This article seeks to analyse the changes that have been effected over the last few years alongwith the grey areas which require further attention. This article is a prelude to a follow up in the next issue which will focus on issues related to the audit of Central Excise receipts.

### **Introduction:**

The structure of excise duty, which emerged in the early 1980s could not be considered rational and conducive to growth of the economy. There were many problems including: multiplicity of tax rates, many exemptions, tax cascading, the discretion of the Finance Minister to make ad hoc changes in the duty rates, and complex administrative procedures. Reform of the excise system began in earnest in the mid 1980s. The excise duty reforms focused on mitigation of tax cascading, rationalization of duty rates, and simplification of rules and procedures.

### **The Beginning of reforms:**

As a first step at mitigating tax cascading, a scheme of MODVAT

(Modified Value Added Tax) credit, though with limited scope, was introduced in 1986. This permitted the manufacturers to avail of tax credit for the excise duty paid on their purchase of specified raw materials (and not capital goods) used in the manufacturing of specified goods. Over time, scope of the MODVAT scheme was enlarged to reduce tax cascading by expanding the list of inputs as well as end products eligible for MODVAT credit (Table I). The rate structure has been rationalized along with reduction in the number of rates and their spread. Rules and procedures have been simplified, though much remains to be done.

### **Chronology of reforms:**

Goods subjected to excise duty are only those goods which are specified in the schedules to Central Excise Tariff Act, 1985 (CETA), the authority for levy of excise. Central excise duty is levied by the Union Government by virtue of the power in Entry 84, List I, Seventh Schedule and Entry 97 of the same list to the constitution of India. Entry 84 empowers central government to levy duty of excise on all articles produced or manufactured in India excluding alcohol for human consumption. Entry 97 gives residuary powers under the Union List. A taxable event is the act of manufacture, though duty can be collected at a later stage such as clearance from depot. Classifications are matched upto

four digits with chapters in the Customs Tariff

Gradual reforms in tax structure over the years are as under:

**TABLE-I: Chronology of reforms**

<b>1986-87</b>	MODVAT introduced for selected raw materials when used in production of specified goods.
<b>1987-88</b>	Most of the raw materials covered under MODVAT
<b>1988-89</b>	Minor expansion in the coverage of MODVAT
<b>1989-90</b>	Minor expansion in the coverage of MODVAT
<b>1990-91</b>	Minor expansion in the coverage of MODVAT
<b>1991-92</b>	Minor expansion in the coverage of MODVAT
<b>1992-93</b>	Minor expansion in the coverage of MODVAT
<b>1993-94</b>	Capital goods. Petroleum products and specified spun yarns covered under MODVAT
<b>1994-95</b>	Small Scale Industrial (SSI) enterprises given the option to pay normal excise duty in place of concessional duty.
<b>1995-96</b>	1 The scheme extended to cut tobacco. Plastic woven sacks. Specified textiles and equipments,
	2 Scope of SSI concessions enlarged, Turnover limit for availing SSI concessions raised from Rs.2 crore to Rs 3 crore
	3 Conditions of matching raw materials/capital goods with output for allowing MODVAT credit withdrawn,
<b>1996-97</b>	1 MODVAT credit in respect of some capital goods has been denied,
	2 In the case of processed textile fabrics, a deemed MODVAT credit has been allowed without production of duty paying documents.
	3 The scope of availing MODVAT credit in the case of production of exempt goods supplied to specified buyers such as 100% EOUs has been extended.
	4 The rule for reversal of MODVAT credit in respect of exempted final product has been simplified to 20% of value of such goods.
	5 When the manufacturer clears inputs or partially processed inputs for job work. MODVAT credit availed of on this account should be reversed.
	6 MODVAT credit on the basis of invoices issued by third and subsequent dealers denied to check evasion.



	7	In the case of invoices issued by the second stage dealer. Credit will be admissible only if the same has been signed by the proper officer.
	8	Mandatory penalty of 100% and interest to be charged in case of wrong availment of MODVAT credit on inputs
<b>1997-98</b>	1	Duty rates have been restructured with basic rates of 8, 13 and 18%.
	2	Some exemptions have been withdrawn.
	3	Exemption scheme for SSIs has been modified with exclusion of certain goods from its purview. If MODVAT credit is not availed then duty rates are 0, 3 and 5% respectively on clearances up to Rs.30 lakh, next Rs.20 lakh and next Rs.50 lakh.
	4	Accumulated MODVAT credit as on 1.3.1997, with the manufacturers of bulk drugs to lapse.
	5	MODVAT credit allowed to the extent of 75% of the CVD paid on goods imported under project imports.
	6	Invoices issued by the depot or consignment agent of an importer made eligible for availing credit.
<b>1998-99</b>	1	MODVAT credit in respect of inputs restricted to 95% of the excise paid on inputs, with effect from June 2, 1998.
	2	Exemption scheme for SSIs has been liberalized; Duty rates have been modified to 0 and 5% respectively on clearances up to Rs.50 lakh and next Rs.50 lakh. SSI benefit has been extended to computers while withdrawn on copper alloys.
	3	Maximum retail sale price (MRP) based assessment has been extended to many products such as chocolates, malt extract, pan masala and glazed tiles.

<b>1999-00</b>	1	MODVAT credit in respect of inputs restored to 100%.
	2	The restriction on taking MODVAT credit to the extent of 10% or the amount of CVD in respect of certain petroleum products has been removed.
	3	The scope of capital goods credit has been extended to duty paid on certain machines.
	4	The exemption in respect of independent processors of yarn has been withdrawn. The duty is fixed at Rs.5 per Kg. with no benefit of MODVAT credit.
	5	The excise duty on packaged tea has been withdrawn. However, on bulk tea, a duty of Rs.2 per Kg. has been imposed

	6	Eleven existing excise rates have been compressed into three: 8, 16 and 24% with two non- rebatable special duty rates: 6 and 16% to make up for the existing rates of 30 and 40%.
	7	MRP based assessment has been extended to 27 more products.
	8	SSIs have been allowed to pay duty on monthly basis instead of daily.
	9	The discretion to grant ad hoc exemptions has been given up, excepting in the case of goods for security, strategic or charitable purposes.
2000-01	1	MODVAT has been renamed as CENVAT with a single CENVAT rate of 16%. In addition there will be non-rebatable special duty at the rates of 8, 16 or 24%.
	2	MODVAT credit has been extended to all inputs except (HSD) oil and motor spirit (petrol)
	3	MODVAT credit has been made available in respect of all finished goods except matches
	4	MODVAT credit has been extended to all capital goods. Restriction of 75% in respect of capital goods credit (CVD) on project imports has been removed. The condition of installation has been done away with. However, availment of capital goods credit has been liberalized to allow it to be spread over a period of two years.
2001-02	1	Three Special excise duty rates of 8%, 16%, and 24% have been converged into a single rate of 16%.
	2	A new levy called National Calamity Contingent Duty (NCCD) has been imposed on certain tobacco products
	3	Section 3A on capacity and production based assessment of iron and steel product has been abolished.
	4	Section 11A and 11AA on demand and interest respectively has been amended to mitigate dilatory tactics.
2002-03	1	Central Excise Rules have been made compact and concise.
	2	Likewise, Cenvat Credit Rules have been revised and re-issued with certain changes.
	3	Excise duty exemption on 45 numbers of item has been withdrawn and duty has been imposed.
2003-04	1	Scheme for payment of duty on monthly basis has been introduced.

	2	SSI exemption on 6 items has been withdrawn.
	3	Tea and tea waste has been exempted from CE duty with effect from 01.03.2003
2004-05	1	In addition to excise duty an education cess at the rate of 2% has been imposed.
	2	Textile sector has been excluded from general SSI exemption
	3	Cenvat Credit Rule has been amended to provide credit of AED (GSI) paid on inputs on or after 01.04.2000 eligible for utilization towards payment of duty on finished goods

The abovementioned changes have rationalized the excise administration to a great extent. However, there are other areas of concern which require further rationalization.

**Additional reforms:**

With an objective of promoting certain industries, the Government of India provides exemptions to certain sectors.

Apart from that, the exemptions are also directed towards certain essential items in order to regulate their prices towards easy affordability. Though the tariff rates are prescribed in the schedule of CETA, the effective rates can be lower because of exemption. The different types of exemptions are:

1	<b>Exemption/concessional rates for small scale industry (SSI).</b>
2	Specified products of village industry, and marketed with the assistance of KVIC. Specified goods made in rural areas-areas comprised in a village as defined in the land revenue records.
3	Specified goods supplied to public funded research institutions, non commercial institutes, universities.
4	Goods produced by ordnance factories, defence related exemptions.
5	Goods donated to National Defence Fund.
6	Specified goods produced without the aid of power (i.e, electricity, steam or any other motive power operated machines, equipments or tools)
7	All goods made in factories in the North-East and commencing production after 24.12.1997.

8	Tea cleared by factories belonging to cooperative society.
9	A number of food products; khandsari sugar, bread, spices, coffee, certain unbranded food items Fertilizers, cereals, edible oils. Aircraft, ship, boat etc, Ready made garments, Clocks, watches of Maximum Retail Price (MRP) upto Rs.500 per piece, Electric bulbs of MRP upto Rs.20 each.

However, this is not the exhaustive list. The rate of duty structure has been streamlined and most goods are now taxed at the main rate of 16 percent advalorem (i.e, at a specified percentage of the transaction value of the goods removed for clearance)

**Potential for further reforms:**

In spite of the reforms mentioned above, a number of issues need further redressal. Excise as a levy was being collected since the time of British India. However, it was only in 1894 that a beginning was made towards modern excise system when duty was imposed on cotton yarn and gradually more and more items were introduced under levy of different types of duty during the subsequent years through self contained

pieces legislation. Eventually, these independent legislations were merged into a single Central Excise Act, 1944 which also embodied subsequent Finance Acts imposing levy of additional duties on specified products. As a matter of fact, on such specified products sometimes also other levies were in force. These multiplicities of levy are discussed hereunder:

**A. Multiplicities of levy**

1	<b>Central Value Added Tax (called CENVAT) and special duty of excise commonly known as Basic and Special excise duty leviable on all goods at specified rates set forth in the first and second schedule respectively to the Central Excise Tariff Act, 1985.</b>
2	AED (ST): Additional Duty of Excise (Goods of Special Importance) Act, 1957. This is in lieu of sales tax on sugar, fabrics, tobacco products.
3	Additional duty and Special Additional duty on motor spirit (petrol) and diesel under respective Finance Acts with effect from 1998 and 2003.
4	AED (T&T): Additional Duty of Excise (Textiles and Textiles Articles), 1978-on fibres, yarns and fabrics and embroidery items and are levied with a view to subsidizing controlled

	cloth scheme.
<b>5</b>	Additional duty of excise leviable under Customs Tariff Act, 1975 and is equivalent to the duty of excise for the time being leviable on the like articles if produced or manufactured in India.
<b>6</b>	Cesses leviable under miscellaneous enactments on various items like Tea, Rubber, Textile and textile machinery, Crude oil, Beedi, Jute and Jute products, Automobiles . This levy is intended for raising fund for the development of Industry and welfare of the workers associated with the Industry.

**B. The concept of ‘Manufacture’ as applicable for levy of Central Excise.**

is defined in Section 2(f) of Central Excise Act, and includes any process:

For the levy of central excise duty, there has to be manufacture. "Manufacture"

<b>(i)</b>	Incidental or ancillary to the completion of a manufactured product, and
<b>(ii)</b>	Which is specified in relation to any goods in the section or chapter notes, as amounting to manufacture. This is an extended definition. For example, labeling or repacking is "manufacture" with respect to medicines.
<b>(iii)</b>	The Supreme Court has held that even if a process covered by the extended definition does not appear to amount to manufacture in conventional sense of the term, the definition would still be constitutionally valid under Entry 97 of List I (if not under Entry 84) { <b>Ujagar Prints Vs UOI 1988 (38) ELT 535 (SC)</b> }.
<b>(iv)</b>	But in general, the twin test is (a) new articles should come into existence; and (b) it should be marketable.

However, the concept hardly has uniform acceptability. The applicability of the concept has been challenged in case of many assessments.

As an illustrative example the following case references deserve mention while the apex court held that “Merely because of some extra process like coating carried out on the product {**2004 (164) ELT 390 (SC)-Tega India Ltd Vs CCE**}or rolling of hot rolled strips into cold rolled strips {**2004 (164) ELT 372 (SC)-Tata Iron and Steel Co Ltd Vs**

**UOI**}, it would not mean that a new commodity came into existence when the tariff entry does not make difference between coated and un-coated goods or there is no separate heading for cold rolled strips or hot rolled strips”.

Therefore, the concept of ‘manufacture’ needs to be crystallized in respect of its applicability vis-à-vis the CETA.

**C. Control Methods:**

In so far as Central Excise duty is concerned the leviability arises as soon as

an excisable commodity is manufactured. However, collection of such duty is deferred till its clearance/removal from the factory. Accordingly the technique of

excise control is to be attuned with the collection machinery within the limit of its administrative convenience to achieve any meaningful excise control.

### Types of Excise Control:

<b>I</b>	Physical Control	For cigarettes:- Control commences right from the stage of manufacture
<b>II</b>	Compounded Levy	Stainless steel patti, embroidery:-Since dispensed with
<b>III</b>	Collection at point of consumption	Only for molasses where the user pays the duty at the point of consumption.
<b>IV</b>	Production based levy	Independent processors processing fabric and Duty is determined by the capacity of the stentering machine
<b>V</b>	Self Removal Procedure	All other goods on the basis of statutory returns submitted by the assessee.

### D) Value of assessments:

The value for assessment is based on transaction price which is the price actually paid or payable i.e. the invoice price, and includes all payments by reasons Various situations arise from this practice:

of or in connection with sale but does not include duty of excise, sales tax actually paid, or actually payable on such goods.

<b>1</b>	Sales to non related persons where price is the sole consideration. Transaction price is the "value"	Applies to both clearances from factory and depot. In respect of sales from depots, the duty is payable at the factory but the relevant value is the value prevailing at or about that time at the depot.
<b>2</b>	Price is not the sole consideration	For example, raw materials are supplied by buyer: Value will include the cost of money value of such consideration.
<b>3</b>	Goods used captively:	Value will be 115 percent of cost of production.
<b>4</b>	Goods sold through related persons:	Value will be the transaction value of the sale through related persons.
<b>5</b>	Sales from depot etc.	Value will be the normal transaction values of such goods sold from such place
<b>6</b>	Any other case	To be determined using reasonable means consistent with the above principles.

Valuation may be based on tariff values which government may fix independent of sale price, but this method is rarely used now. For more than 70 items, it is based on MRP, being used more and more on items which are subject to declaration of retail sales price under the standards of Weights and Measures Act, 1976. However, there is an abatement varying between 30-55 percent of MRP in price fixation. For most items, assessment is based on transaction price. This is the general pattern for assessment.

There is also a production based levy for independent processors. It applies to textile fabrics processed by independent processors and the duty liability depends on chamber capacity of the machine, and on the average values of the fabrics, which is decided by the previous year's clearance of processed fabrics. No input/capital goods tax credit is given.

For exports, all the taxes paid are refunded. For example, for export under rebate, duties already paid are refunded, for both (1) duty paid on finished goods; and (2) duty paid on inputs used in finished goods.

For export under bond, for (1) removing finished goods without payment of duty and (2) processing raw materials without payment of duty, the procedure is as follows:

1. Examination is generally carried out at port. But there is an option for examination in the factory under excise supervision.
2. Documents needed are: (a) Form AR-4 for "Application for Removal"; (b) excise invoice; and (c) shipping bill at the point of export.

Rebate is given, or bond discharged, on proof of export. The proof of export generally is a customs endorsed copy of Form AR-4 and the shipping bill.

Rebate can be given by the Maritime Commissioner where available or the jurisdictional excise officer.

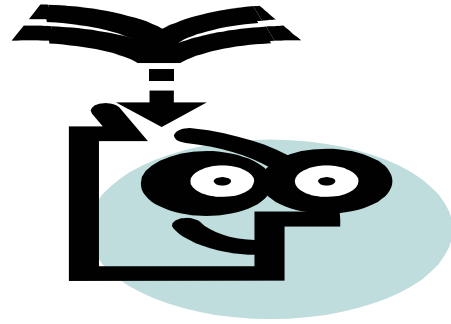
#### **E) CENVAT and other credits:**

CENVAT (Central Value Added Tax) credit is given for CENVAT duty (Commonly known as Cenvatable Basic excise duty applicable in general to all goods as well as Special Excise Duty (SED) applicable to selected consumer goods. Credit is also given for AED (ST), AED (T& T) and additional duty under Customs Tariff Act, 1975 known as Countervailing Duty (CVD). Almost all goods (except matches) are covered under the CENVAT Scheme. Inputs include all goods (except HSD and petrol) and fuel used in or in relation to manufacture (whether directly or indirectly). Credit is given for capital goods used in the factory of manufacture but excludes office equipment. Credit for capital goods is given in two stages-50 percent in the first and 50 percent in the next year. No input tax credit is given if inputs are used for making exempt products (some exceptions are exports and clearances to Export Oriented Units (EOU's). No declaration for availing is necessary. Credit can be taken on the strength of excise invoices of purchase. Credit is given instantly on receipt of goods. Credit can be used for payment of duty on any final product, or on inputs cleared as such. Normally no cash refund of credit is given. A facility exists for sending inputs, partially processed, to job worker without reversal of credit, and for sending inputs directly to job worker. There is an exemption on intermediates produced capitively. Credit on inputs manufactured in the North-East fall under a special exemption scheme and is allowed to users even though no duty is effectively paid on such inputs.

## **Conclusion:**

Central Excise Act, 1944, is more than 60 years old, a conscious ageing of the statute and an increasing awareness in the backdrop of rapid changes in the socioeconomic scenario. This propelled the tax systems towards reformation to keep pace with the situation. Government is aware of the situation. The process of reformation is on its leap. Advancement of information technology and its unlimited applicability not only in the Industry but also in the Tax Administration accelerated the reform process. Fitting to the situation audit has taken its stance and strived to identify the problem areas in the working of the Central Excise Department. But task ahead is not complete.

Keeping in mind with the important reformation and policy behind it, concerted and sustained efforts are required by the wing to aid the department in guarding against leakages in future. Efforts are also required to focus on areas that have been neglected by the department as well as in audit. Increased information sharing between different revenue audit wings in the same state as well as with those in the other states would also help in detecting newer areas of revenue leakages. Overall improvement in the quality and content of the C&AG's Audit Report in relation to indirect taxes can be achieved only with a combination of such measures, along with a continuous evaluation and refining of our methods. Increasing use of technology and computers by the field audit parties will also help in realizing our objectives in a much more meaningful manner.





## *Security policy for IT assets adopted in the Office of the Principal Director of Audit (Central), Kolkata*

### **Introduction:**

Information Technology assets have become major facilitators for the office of Principal Director of Audit (Central), Kolkata. As most of the functional output is slowly becoming dependant on IT Assets there is an immense and urgent need for protecting such assets from unauthorized use and breakdown. However, given the fact that the computer systems operating in the office are in a relatively nascent stage and all officials have not achieved the desired levels of expertise in handling computers, a simple to understand and easy to implement Security Policy has been prepared for this office.

### **Policy:**

Each official is responsible for the security and protection of electronic information resources over which he or she has control. Resources to be protected include networks, computers, software, and data. The physical and logical integrity of these resources must

be protected against threats such as unauthorized intrusions, malicious misuse, or inadvertent compromise.

### **Roles and Responsibilities:**

Responsibilities range in scope from administration of security controls for a system to the protection of one's own access password. A particular individual often has more than one role. The same have been duly mentioned in the policy.

### **List of Hardware Assets**

The hardware presently available in this office consists of the following items:

- 1) Desktop Computers (CPU and Monitor)
- 2) Printers of different denominations and configurations
- 3) Note Book Computers and Pen Drive
- 4) Mid-range Server (2 nos.)
- 5) Scanner
- 6) CD Writer

The following issues are to be addressed with regard to the security policy of the office.

### **Physical and Access Controls**

Measure	Timeframe for implementation	Responsibility
1) With regard to the stationary assets like PCs Printers, Scanners etc, a list of personnel authorised to use the same is to be pasted on each hardware item. The list is to be countersigned by the Branch officers in charge of respective wings.	30 Sept,2006 Review after 3 months	Sr.AO/AO (Coordination) of different wings
2) Mid-range Server should be located under strict security in the EPBX room. The access thereto is to be strictly regulated. Keys to be in the	30 Sept,2006 Review after 3 months	Sr.AO/AO(Record), AO (Admin.

custody of Gp. Officer(Admin.)(EDP), Branch Officer (EDP)(Record)(Admin.Wizard), SO EDP and EPBX operator.		Wizard)
3) The Note book computers and Pen Drive are to be inventorised in the respective functional wings after the same have been issued by the EDP wing. The Note book computers would be allocated to field parties by the concerned Branch Officers in charge of the functional wing after due noting in the control register.	In Place; Review on every purchase and issue	Sr.AO/AO (Coordination) of different wings, SO(EDP)
4) A Master List of all IT Hardware and it's location is to be maintained and updated	In Place; Review on every purchase and issue	SO(EDP)
5) All PCs to have uniform desktop scheme and screen savers	In Place; Review after 3 months	Sr.AO/AO (Coordination) of different wings /SO(EDP)

### **Fire Protection**

A Fire Protection system is to be kept up-to-date by the Record/Welfare wing and any defects thereto may be communicated to the EDP wing from time to time.	In Place; Review after 3 months	Welfare Officer
Wide publicity may be arranged by the welfare wing regarding use of specified type of fire extinguishers applicable in case of fire hazards of IT assets.	In Place; Review after 3 months	Welfare Officer

### **Security of Software and Applications**

#### Access Control

User authorization and Password protection

Sr. AO(EDP) /SO (EDP) to function as System Administrators

Measure	Timeframe for implementation	Responsibility
1) User profiles have been allotted by the EDP wing to different users of the operating systems and applications running in this office.	In place; review after 3 months	The Master list of user profiles would be maintained in the custody of Sr.AO/SO, EDP.

<p>2) Strict Password control to be employed for accessing different operating systems. Passwords would be held in the custody of the BO of the respective wings. A copy of the list should also be held in the custody of Sr.AO/SO, EDP for trouble shooting purposes.</p> <p>3) The passwords should be alpha-numeric and the minimum length should be 6 characters.</p>	<p>Passwords to be re-set by the respective Branch Officers by October, 2006</p>	<p>Sr.AO/AO(Coordination) of different wings, SO(EDP)</p>
<p>4) <i>Password Ageing</i> It will be the responsibility of the BO of the respective wings to ensure that the password of each PC and its operating system is changed at an interval of one month and the same is communicated confidentially to the Sr.AO/SO, EDP.</p>	<p>Every month from November, 2006</p>	<p>Sr.AO/AO(Coordination) of different wings</p>
<p>5) <i>Password Secrecy</i> To be limited to the extent mentioned above, as the passwords would be shared by the users, BOs and SO EDP.</p>		<p>BO/SO, EDP</p>
<p>6) <i>Password Expiry</i> <b>Any password not used for above 15 days would automatically be disabled.</b></p>	<p><b>November, 2006</b></p>	<p><b>BO/SO, EDP</b></p>
<p>7) <i>Password Encryption</i> However the password should be encrypted i.e. it should not be displayed on the screen Any software to be installed in any IT hardware of this office is to be verified by Sr. AO/SO , EDP and a certificate obtained from them before installation. The same applies in case of softwares which can be downloaded from the</p>		<p>BO/SO, EDP</p>

Internet.

**Network Security (LAN and Internet)**

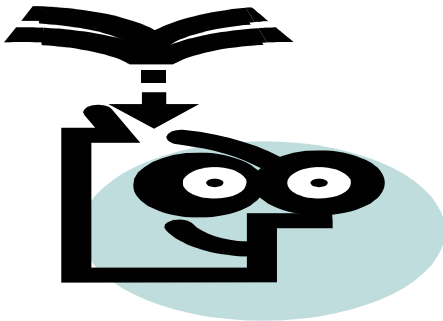
Measure	Timeframe for implementation	Responsibility
1)The network typology and mapping should be readily available with EDP wing. A copy should be made available for the Record wing in order to redress any problems with the network or cables that has been laid in the different floors of this office.		Sr.AO/SO EDP
2) Sr.AO, EDP will function as the Network Administrator for this office. In his absence SO, EDP will take over.		Sr.AO
3) As in the case of operating systems, specific user profiles with specific access restrictions have been created and would be updated in respect of use of the Intra net.	In Place. Review on further additions of users to the LAN/ 3 months whichever is earlier	Sr.AO/SO EDP
4)Password policy as mentioned under Access Controls with specific reference to the Intranet/ Server Access accounts	As mentioned above in r/o Access Controls	Sr.AO/SO EDP
5) Strict Password controls would also be made applicable in respect of accessing the Internet by different officials		
7) Reasonable level of firewalls would be enabled in the Server to block undesirable data download from the Internet.	Windows Server Firewall in place. Review in every “even” month	Sr.AO/SO EDP
8) At the interval of two weeks, the EDP wing will conduct surprise verification of the Internet Logs of the different machines to verify the details regarding the sites accessed.		Sr.AO/SO EDP
9) The Internet access logs of the different machines would be deleted by the different users only in the presence of the personnel from the EDP wing and a certificate obtained thereto.		Sr.AO/SO EDP

### **Power Protection**

<b>Measure</b>	<b>Timeframe for implementation</b>	<b>Responsibility</b>
1) Enable UPS for all machines	In Place	Sr.AO/SO EDP

### **Virus Protection**

<b>Measure</b>	<b>Timeframe for implementation</b>	<b>Responsibility</b>
1)Update the latest version of Anti-Virus Software in the servers and all PCs	In place. Half yearly review.	Sr.AO/SO EDP
2)Disabling of Floppy and CD drives and USB Ports - All PCs excepting PDAC, GOs, BOs and EDP Cell and one PC in each wing to be kept out of LAN (Softwares to be loaded through external CD drives/ USB Ports to be procured by EDP)	To be enforced in all machines connected to the LAN by December, 2006	Sr.AO/SO EDP



*Contributors in this issue (In alphabetical order)*

*Shri Nikhil Kumar Ghosh, Dy. Director (RA-IDT)*

Shri Ghosh has a long exposure in Central Excise Revenue Audit as well as Customs Revenue Audit 28 years. He was posted to the India Audit Office, Washington DC, for 3 years.

*Shri R.C. Singh Sardar, Senior Audit Officer (Retired)*

Shri Sardar joined the department in 1967. After working in Treasury Accounts and thereafter in Central Excise Revenue Audit Wing as well as in OAD, he was posted to our branch office at Andaman and Nicobar Islands. From 1996 till his retirement in 2005, he had worked as a Sr. Audit Officer in the Income Tax Receipt Audit Wing of this office and had held different responsibilities in field parties as well as at the Head Office.

*Shri Shourjo Chatterjee, Dy. Director (RADT-I) –*

Shri Chatterjee had joined the IA&AS in 2001. After his promotion to the senior time scale of the IAAS, he was posted to this office in May, 2005 after serving in the Offices of Accountant General (A&E) West Bengal and Principal Accountant General (Audit) West Bengal.

*Shri Subrata Lahiri, Sr. Audit Officer, CERA (DP)-*

Shri Lahiri had joined the Department in 1970. Apart from a short spell in Branch Office at Andaman and Nicobar Islands, he has spent the major portion of his career in Central Excise Receipt Audit. For the past few years, he has been instrumental in preparing the material for the Audit Reports.

*Shri Swapan Kumar Bandyopadhyay, Sr. Audit Officer*

Shri. Bandyopadhyay had joined this office in 1973 and worked for 19 years in Central Excise Receipt Audit before being posted in the Income Tax Receipt Audit Wing. Apart from making substantial contribution to the audit report, he has also been associated with the in-house training in this office.