# A Compendium on Impact of Audit on Tax Administration – Union Government

SUPREME AUDIT INSTITUTION OF INDIA
लोकहितार्थ सत्यनिष्ठा
Dedicated to Truth in Public Interest

**COMPTROLLER AND AUDITOR GENERAL OF INDIA**

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Office of the Comptroller and Auditor General of India

# Audit


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*Office of the Comptroller and Auditor General of India*

# Foreword



I am pleased to present this Compendium on the *Impact of the Audit Reports printed in the last 10-12 years on the receipts of the Union Government.* This Compendium highlights significant cases where audit observations on **Direct Taxes, Goods and Services Tax (GST), and Customs** have shaped tax administration, improved compliance, and contributed to strengthening the framework of revenue mobilisation in India.

The compendium serves as a knowledge resource for stakeholders within and outside the institution of the Comptroller and Auditor General of India, illustrating how audit has gone beyond its traditional role of oversight to become a catalyst for systemic reform. The cases documented here outline the tangible outcomes of audit - ranging from recovery of revenue leakages and plugging of compliance gaps, to amendments in tax laws, refinement of procedures.

It is heartening to note that several recommendations of the Comptroller and Auditor General of India, articulated through audit reports on Direct Taxes, GST, and Customs, have led to far-reaching changes in policies and practices of the tax administration. The past years have witnessed instances where audit insights have directly augmented government initiatives for widening the tax base, curbing evasion, rationalising exemptions, enhancing technology-driven compliance, and improving taxpayer services.

This compendium also reflects our continuing commitment to accountability, transparency, and value addition. It seeks to demonstrate the impact of audit not only in terms of immediate tax recoveries but also in the form of long-term policy reforms and institutional strengthening. By documenting these outcomes across all streams of central revenue audits, we aim to provide both executives and policymakers with a reference point on the importance of audit in shaping a fair, efficient, effective and robust taxation system.

I commend the efforts of our audit teams who, through their diligence, intelligence and professionalism, have contributed to strengthening the administration of Direct Taxes, GST, and Customs. It is my hope that this compendium will serve as a catalyst to continue innovating in audit approaches, deepen stakeholder engagement, and sustain our collective pursuit of good governance and public accountability.

**(K. Sanjay Murthy)**
Comptroller & Auditor General of India



# Preface

The Comptroller and Auditor General of India conducts the audit of receipts of the Union Government under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. Based on the audit observations, recommendations are made in the Audit Reports, which include the requirement for amendments in the Income Tax Act, GST Act, and Customs Act, Rules prescribed thereunder and issuance of instructions, Notifications and Circulars etc.

Receipt audit increases government revenue by directly identifying instances of under-assessment of income involving short levy of tax as well as reduces avoidable hardship to the taxpayer by identifying instances of over-assessments of income involving excess levy of tax. Further, audit recommendations/suggestions made to the Ministry by way of Performance Audit/Compliance Audit Reports, enhance compliance through deterrence and system improvements that plug probable tax leakages owing to non-compliance. Audit's risk-based compliance approach emphasizes utilization of limited resources to relatively high-risk cases while ensuring strengthening of tax base and protection of government revenue.

The Ministry of Finance, Government of India, has been making legislative amendments in the Income Tax Act, GST Act, and Customs Act, Rules prescribed thereunder and issuing Circulars /Instructions/Notifications etc. to ensure effective implementation and compliance to the extant provisions of the Act/Rules; system improvement and monitoring etc. While the impact of Audit on tax policy and legislation is highlighted regularly through Compliance Audit Reports, efforts have been made through this compendium to consolidate audit efforts and significant amendments at one place.

This Compendium highlights the major recommendations from recent CAG audit reports, based on which the Ministry has taken corrective measures through necessary amendments to the regulatory Act/ Rules and issuance of Instructions, Notifications and Circulars etc.

This Compendium highlights the role of audit as a Catalyst in policy reforms and system re-design beyond its traditional role of oversight. This Compendium envisages to add valuable insights and comprehensive overview of role of audit in providing independent and credible assurance on public resources.


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# Acknowledgement



This Compendium on the impact of audit in Tax Administration in India is the culmination of the efforts of different field offices under the Central Receipts Audit Wing. The knowledge and expertise of officials and officers who contributed to the audit reports have been indispensable.

I extend my appreciation to all nine Field Audit Offices, viz. DG/PD of Audit (Central) Ahmedabad, Bengaluru, Chandigarh, Chennai, Hyderabad, Kolkata, Lucknow, Mumbai and DGACR, New Delhi, for their contribution of audit observations and recommendations, included in this Compendium.

A special mention must be made for the efforts of the Director General (Direct Taxes), the Principal Director (INDT), and their teams in ensuring the thoroughness and completeness of the audit findings, collating details of all these audit findings, recommendations, and mapping them with the corrective actions taken by the Ministry within a limited time for the creation of this Compendium. They have been instrumental in realising it.

I thank all concerned officers and officials involved in this endeavour for their untiring efforts to bring the Compendium to its present shape.

**(Sandhya Shukla)**
Deputy Comptroller and Auditor General
(CRA)



# Assessing the Impact of Audit on the Tax Administration – Union Government

The Department of Revenue (DoR) of the Ministry of Finance (MoF) under the overall direction and control of the Secretary (Revenue) coordinates matters relating to all the direct and indirect Union Taxes through two statutory boards, namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC), constituted under the Central Board of Revenue Act, 1963.

The impact and value of an audit are determined by how effectively its reports and recommendations lead to enhanced performance, stronger risk management, and improved governance.

This Compendium highlights the impact of audits carried out by the Direct Tax wing, Goods and Services Tax (GST) wing, and Customs wing of the Central Revenue Wing of the C&AG office.

The impact of audit on Direct Taxes is discussed in Section- A of the Compendium.

The impact of audit on Indirect Taxes is discussed in Section- B of the Compendium.



# Section-

# A



# Direct Taxes

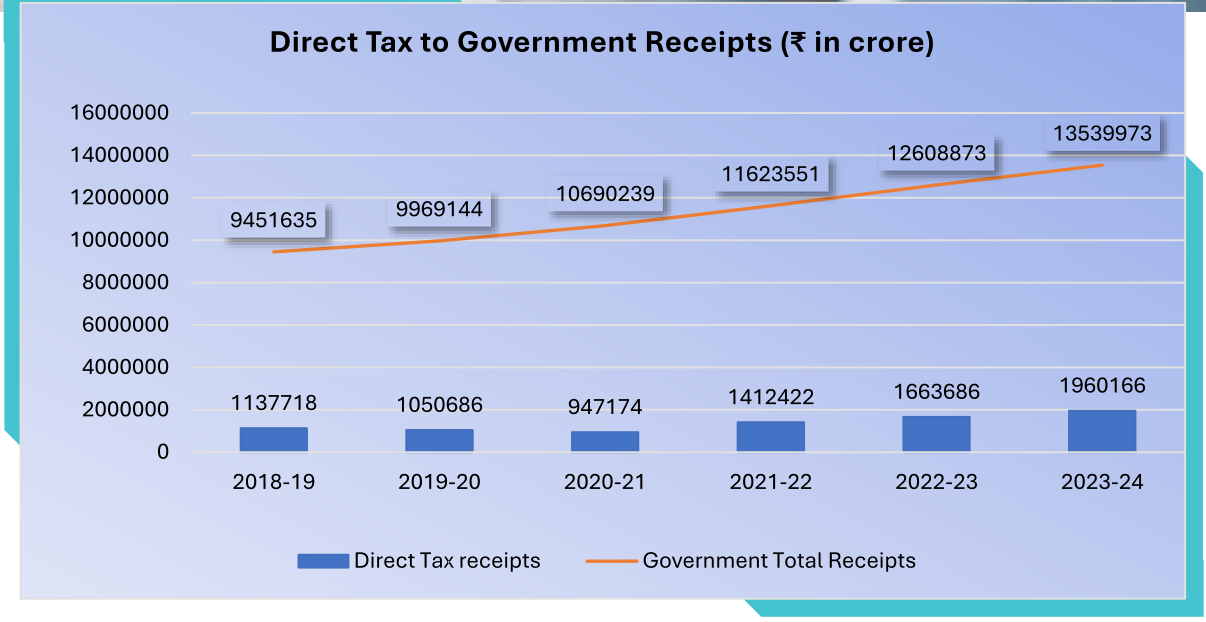

AUDIT

# Section A- Direct Taxes

## Introduction

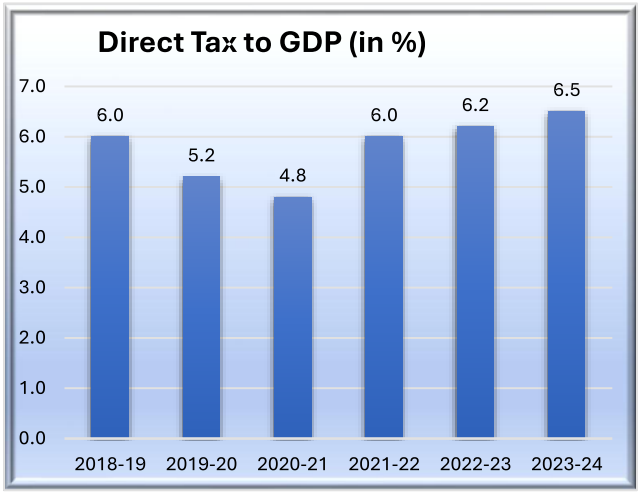
CBDT looks after matters relating to the levy and collection of direct taxes. The Government of India's resources include revenues received by the Union Government, all loans raised by the issue of treasury bills, internal and external loans and moneys received by the Government in repayment of loans. Tax revenue resources of the Union Government consist of revenue receipts from direct and indirect taxes.



## Direct Taxes relation to GDP

Direct taxes exhibit a strong correlation with GDP, as they are levied primarily on income and profits generated within the economy. Higher GDP growth generally translates into increased household incomes and corporate profitability, thereby enhancing direct tax collections. In periods of economic slowdown, a contraction in income and business activity leads to reduced direct tax revenue. The direct tax-to-GDP ratio serves as a key indicator of the government's revenue mobilisation capacity. A rising ratio reflects improved compliance and a broadening of the tax base. Accordingly, direct taxes function both as a measure of economic performance and as a critical source of financing for public expenditure and development initiatives.



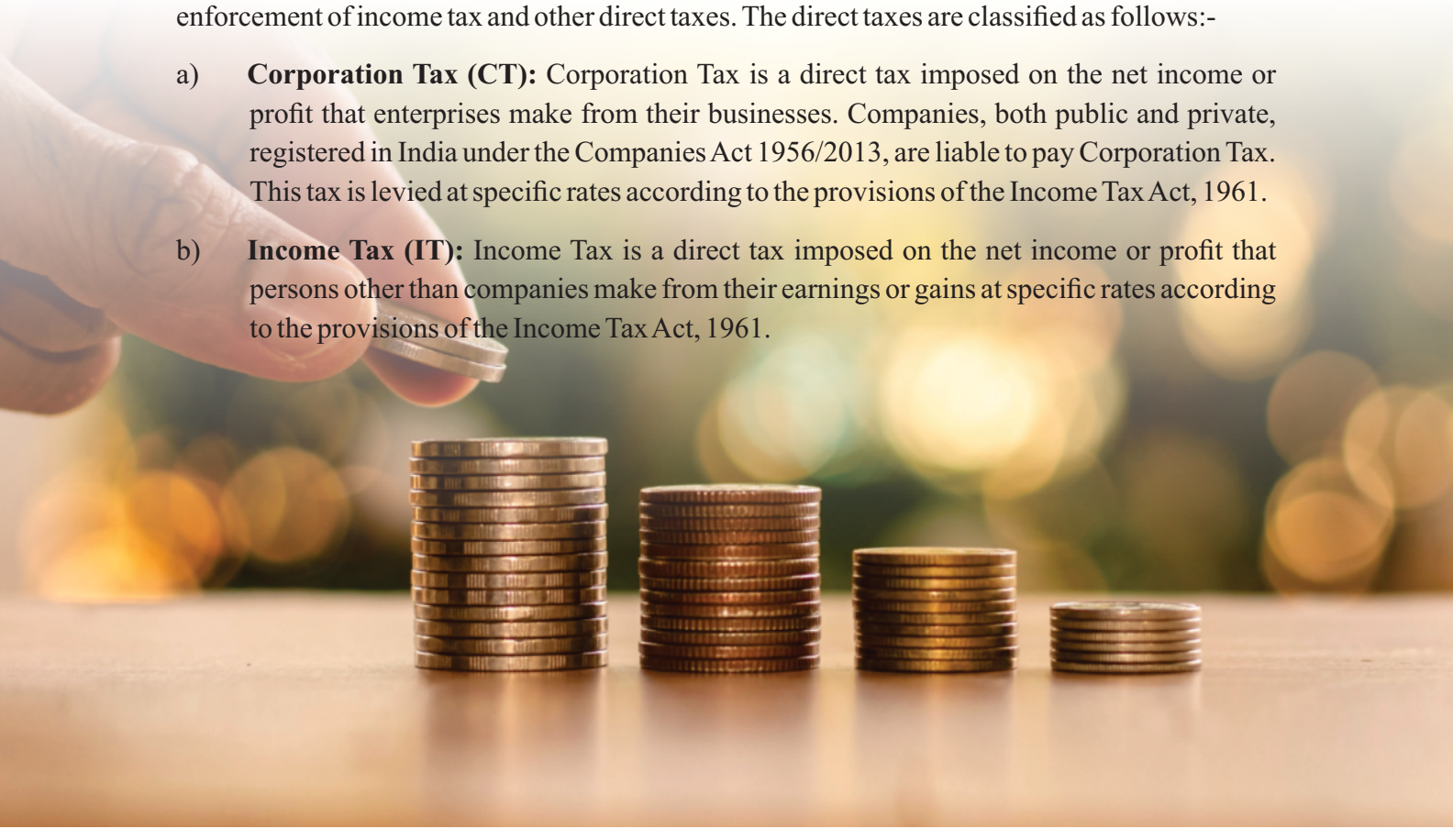

Source- Union Finance Accounts; GDP-Central Statistical Office (CSO), Ministry of Statistics and Programme Implementation

## Direct Tax Administration

The administration of direct taxes in India is governed primarily by the provisions of the Income-tax Act, 1961, which lays down the legal framework for levy, computation, collection and enforcement of income tax and other direct taxes. The direct taxes are classified as follows:-

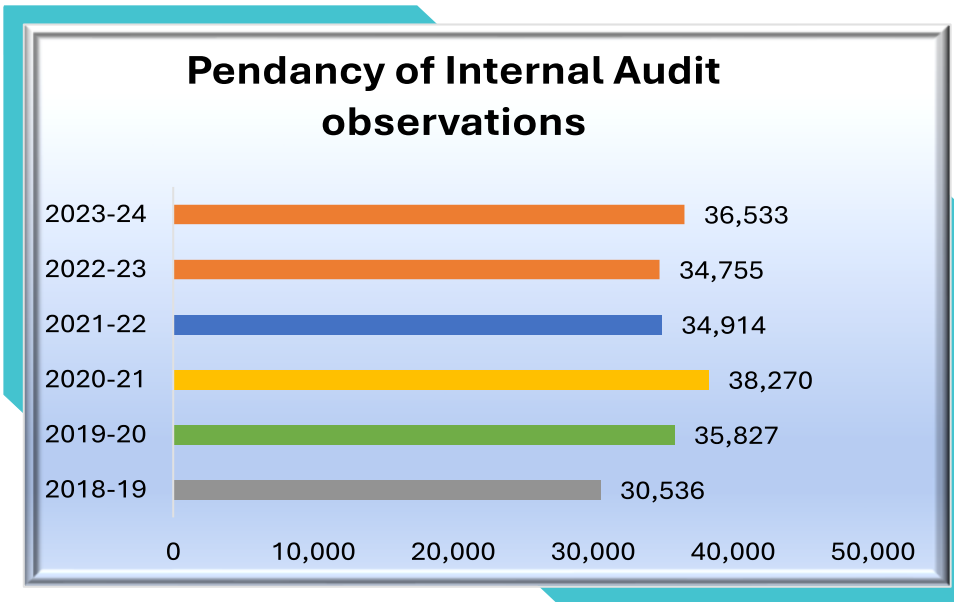
a) **Corporation Tax (CT):** Corporation Tax is a direct tax imposed on the net income or profit that enterprises make from their businesses. Companies, both public and private, registered in India under the Companies Act 1956/2013, are liable to pay Corporation Tax. This tax is levied at specific rates according to the provisions of the Income Tax Act, 1961.

b) **Income Tax (IT):** Income Tax is a direct tax imposed on the net income or profit that persons other than companies make from their earnings or gains at specific rates according to the provisions of the Income Tax Act, 1961.



## Effectiveness of Internal Audit

Internal Audit is an important part of the Departmental control that provides assurance that demands/refunds are processed accurately by correctly applying the provisions of the Act. The pendency of cases referred to Internal Audit has remained at a high level, rising from 30,536 to 38,270 cases before declining marginally. Although there was an initial increase, the subsequent reduction has not been substantial enough to ease the overall burden. The figures reflect a persistent backlog requiring Internal Audit attention, indicating that resolution and assurance processes continue to face capacity and efficiency constraints.




Source- CBDT

## Role of Audit by C&AG

As per the Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 (DPC Act), enacted in accordance with Article 149 of the Constitution of India, it shall be the duty of the Comptroller and Auditor General (CAG) to audit all receipts which are payable into the Consolidated Fund of India and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

C&AG's Compliance and Performance Audit Reports aim to highlight the impact of audit on accountability and transparency of the Income Tax Department (ITD) by providing recommendations for improving the functioning of the ITD and strengthening accountability to protect revenue interests of the Government and increase public trust.

Audit of receipts includes an examination of the systems, rules and procedures and their efficacy in respect of:

**a.** Assessment, collection and allocation of revenue by the Tax Department

**b.** identification of potential tax assessees, ensuring compliance with laws, as well as detection and prevention of tax evasion;

**c.** exercise of discretionary powers in an appropriate manner, including levy of penalties and initiation of prosecution;

**d.** appropriate action to safeguard the interests of the Government on the orders passed by the departmental appellate authorities;

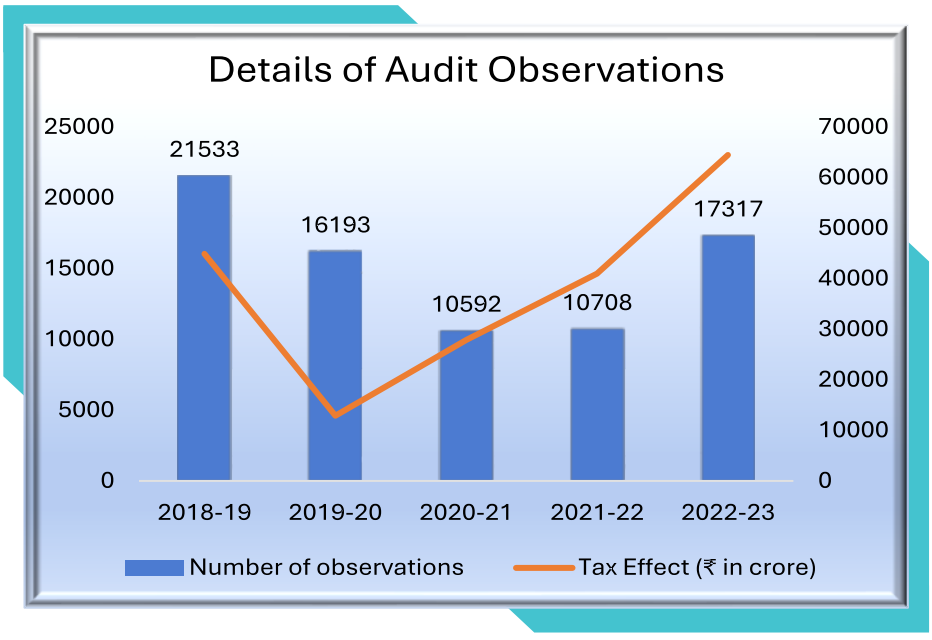
**e.** any measures introduced to strengthen or improve revenue administration;

**f.** amounts that may have fallen into arrears, maintenance of records of arrears, and action taken for the recovery of the arrears;

pursuit of claims with due diligence and to ensure that these are not abandoned or reduced except with adequate justification and proper authority.

## Persistent irregularities in respect of Direct Tax assessment cases

Consequent to the introduction of "Faceless Assessment", adopted by CBDT under the "Faceless Assessment Scheme, 2019" and implementation of the Income Tax Business Application (ITBA), the ITD System undertakes the calculation of tax, calculation of interest under various Sections of the Act, time barring checks, etc. In the case of scrutiny assessments, rectification, and appeal effect orders, figures are data-fed to the system by the AOs based on the orders.




Source- Compliance Audit reports from the year ended March 2019 to March 2023

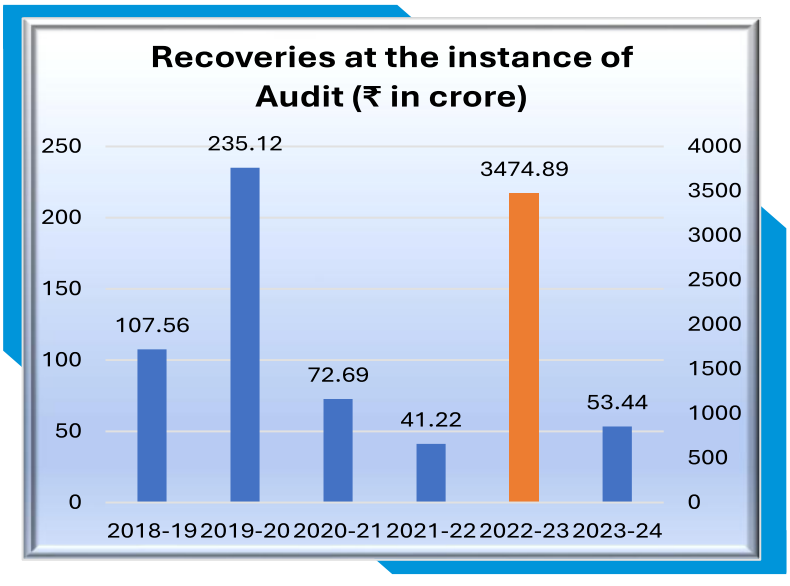
While examining scrutiny assessment cases as part of Compliance Audit, Audit noticed that despite irregularities of certain types being pointed out repeatedly in earlier Audit Reports, these irregularities continue to occur in following the tax laws and instructions and directives of the CBDT during scrutiny assessments completed by the AOs, raising questions about the efficiency of tax administration despite the implementation of ITBA.

The chart below shows the details of audit observations pointed out by the Audit in respect of Direct Taxes. Source- Compliance Audit reports from the year ended March 2019 to March 2023

Audit observations over the period as shown in the chart above highlight persistent deficiencies in key areas of tax administration. This underscores the need for stronger controls in assessment procedures. By bringing such recurring lapses to light, Audit brings out areas where the Department needs to institute more robust checks and strengthen accountability mechanisms.

## Recoveries at the instance of Audit

Audit has played a significant role in strengthening the revenue base of the Income Tax Department by directly contributing to recoveries. Instances of under-assessments, irregular allowances of deductions, etc, identified during audit scrutiny have led to reassessments and recovery of taxes. These recoveries highlight the effectiveness of audit in detecting systemic and procedural deficiencies that result in revenue leakage. They also demonstrate how audit functions as a corrective mechanism, enabling the Department to revisit errors in assessments and enforce compliance. The recoveries[1] achieved at the instance of audit provide measurable evidence of the value addition of C&AG oversight. Such recoveries also serve to improve the credibility of tax administration and deter recurrence of similar lapses. Overall, audit not only safeguards government revenues but also enhances the robustness and accountability of the Income Tax Department's functioning.




Source- Compliance Audit Report-13 of 2024 and 14 of 2025

[1] The recovery for the year 2022-23 includes ₹ 3,388.51 crore (₹ 3,141.00 crore and ₹ 247.51 crore) relating to two Banks respectively , (one for AY 2018-19 and 2019-20) and second for AYs 2015-16, 2016-17 and 2018-19), made at the instance of Audit observations raised during Performance Audit on 'Exemptions and Deductions to Banks and Non-Banking Finance Companies'

## Impact of Performance Audit and Subject Specific Compliance Audit- Direct Taxes

Audit goes beyond recoveries of tax demands to undertake a qualitative evaluation of the administration of the Income Tax Department. This process influences policy decisions, strengthens regulations, and contributes to amendments in the Income-tax Act through various Subject-specific Compliance Audit Reports and Performance Audit Reports issued from time to time.

The impact of audits in direct taxation has been systematically categorised into three-time frames: the last 5 years (2020-2024), 5 to 10 years (2015-2019), and beyond 10 years (Prior to 2015).



# Part-I: Impact of Audit – Last Five Years (2020-2024)

The significant impact of audit based on Audit Reports placed in the Parliament during 2020-2024 is discussed below:

## Report 14 of 2024 Subject Specific Compliance Audit- on Outstanding Demand on Income Tax Assessee

The Income Tax Department (ITD) employs income tax provisions governing Tax demand arrears as crucial tools to recover tax demands and prevent tax evasion. Despite these provisions being in place to safeguard revenue interests, there has been a significant increase in the accumulation of arrears of tax demand over the years, Audit selected this topic to assess the robustness and effectiveness of the procedures in place in the ITD concerning the recovery of outstanding demand and, through a sample check, verified whether the ITD has taken adequate measures to liquidate the outstanding demand.

### Para No. 5.3.3- Mismatch in figures reported to the Custodian, Outstanding Demand as per ITBA and Demands as per the e-filing systems

Audit observed a mismatch in the amounts of outstanding demand as per the Custodian, ITBA and the e-filing system, causing difficulty in the follow-up of the recovery of demands and also an incorrect projection of outstanding demands. If the amount of outstanding demand was incorrect, fixing the target for its reduction would become difficult, and the target so fixed may not be achieved.

Audit recommended that the CBDT to

(i) ensure fixing realistic targets for cash collection and reduction in arrear demand as fixing a uniform percentage of 40 per cent for reduction in arrear demand as per the CAP does not appear to be realistic or practical.

(ii) Consider devising a fast-track process periodically to resolve and settle the high outstanding demand cases under dispute pending in the courts for years.

**Corrective Action**

The target of 40% of reduction in arrear demand as fixed in Central Action Plan for FY 2022-23 has been discontinued in the Central Action Plan for AY 2025-26. In the current Central Action Plans, the reduction targets have been determined using a structured scoring mechanism that evaluates the likelihood of demand reduction. This approach considers two key factors: (i) the Recoverability status assigned by the AO, and (ii) the Age of demand. Scores have been assigned to each demand based on these factors, and the final reduction target has been computed using the scores. The total reduction target for each Principal Chief Commissioner of Income Tax (PCCIT) has been computed by applying the weighted scores from the two criteria i.e., Recoverability status assigned by the AO, and the Age of demand.

# Report 04 of 2023 Subject Specific Compliance Audit on Attachment of Property of an assessee by ITD under Section 281B

Provisional Attachment of properties before the completion of assessment is a critical tool for the Income Tax Department. It facilitates the recovery of tax demands from assessees who attempt to evade tax and thwart collection by using unfair means, and it helps prevent the accumulation of arrears. The provision of Provisional Attachment under Section 281B of the Income Tax Act 1961 (Act) was introduced with a view to protecting the interest of revenue.

To assess the robustness and effectiveness of the procedures in place in the ITD with regard to provisional attachment, a Subject Specific Compliance Audit (SSCA) on the subject was undertaken to examine policy or procedural gaps in the extant provisions of Section 281B of the Act and the extent of compliance or consistent application of the provisions of Section 281B in individual cases.

To strengthen this critical tool, the audit gave some key recommendations, each of which was accepted and implemented by the Central Board of Direct Taxes (CBDT) through Instruction No. 1/2024, dated 03.06.2024.

## 1. Para No. 3.2- Format of Provisional Attachment order

Audit noted that there was no prescribed format for issuing Provisional Attachment orders, resulting in the omission of essential information, such as estimated tax liability and validity period, from the orders, and they were not in conformance with the provisions/rules. The audit suggested a format for Section 281B orders to ensure all elements of essential information are included, maintaining both consistency and legal sustainability.

**Corrective Action**

CBDT accepted and implemented the recommendation by devising a format of order u/s 281B of the Act as given in Annexure A of Instruction No. 1/2024, dated 03.06.2024.

## 2. Para No. 3.3.2- Establishment of the basis for opinion formation

Audit noted that the AOs did not adequately establish and document the basis/grounds for invoking provisions of section 281B, making it difficult for Audit to draw an assurance on the applicability of the provisions and their justification in those cases. Audit recommended specific and clear criteria along with illustrative examples for forming opinions and defining "exceptional circumstances" to help AOs act more transparently and effectively.

**Corrective Action**

CBDT suggested a list of exceptional circumstances to enable the AO to form an opinion to initiate provisional attachment proceedings, thus implementing the recommendation vide Instruction No. 1/2024, dated 03.06.2024.

## 3. Para No. 3.4.2- Notification of order under Section 281B to CERSAI

Audit noted that the AOs failed to notify provisional attachment orders to Registering Authorities, which increased the risk of non-prioritisation of recovery of ITD tax arrears in cases where the attached property(s) are to be liquidated for clearance of the assessee's secured and unsecured dues. Audit recommended issuance of a detailed Standard Operating Procedure (SOP) and making it mandatory to notify relevant authorities, such as the Central Registry for Securitisation Asset Reconstruction and Security Interest (CERSAI), to make note of provisional attachment and monitor assessee's compliance with the directions issued.

**Corrective Action**

CBDT accepted and implemented the recommendation vide Instruction No. 1/2024, dated 03.06.2024, stating that a copy of the order of attachment should be sent to the Regulatory Authorities concerned to place encumbrance on the said movable or immovable property.

## 4. Para No. 4.1- Enquiry into details of all assets of an assessee

Audit noticed that the AOs did not comply with the Board's instructions of ascertaining details of all assets in possession of assessees that could be considered for provisional attachment. Further, deficiencies were noticed in respect of the list of assets provided in the Appraisal, which resulted in the incorrect attachment of a property. Audit recommended enforcement of instructions requiring Assessing Officers (AOs) to conduct thorough enquiries into all assets of an assessee during search and seizure operations, with the goal of selecting appropriate assets for provisional attachment to ensure maximum coverage of tax demands, thereby achieving optimum protection of revenue.

**Corrective Action**

CBDT while implementing the recommendation vide Instruction No. 1/2024, dated 03.06.2024 stated that in search and seizure cases, at the time of preparation of appraisal report, the Deputy Director of Income Tax (Investigation)/ Assistant Director of Income Tax (Investigation) should take particular care in identifying the assets of the assessees for the purpose of section 281B and make a specific mention of the same in the appraisal report.

## 5. Para No. 4.2- Selection of the type of property to be attached

Audit noted that the AOs did not comply with the Board's instructions to ascertain details of all assets in the possession of assessees that could be considered for provisional attachment. Audit recommended to bring out specific guidelines to facilitate AOs in ascertaining details of and recording all the properties available with the assessee for selection of appropriate and sufficient property for attachment to protect the interest of revenue.

**Corrective Action**

CBDT directed AOs to enquire into all assets of the assessee and, by way of a prudential exercise, place under provisional attachment, the properties sufficient to cover the demand in question vide Instruction No. 1/2024, dated 03.06.2024.

## 6. Para No. 4.3- Deficiencies in identification of assessee-owned properties for provisional attachment

Audit observed that the AOs did not establish an evaluation of the property of assessees for their ownership requirements or for their non-encumbrance status before considering them for provisional attachment in most cases. Audit recommended that a mechanism be devised by the CBDT to verify the ownership status of the property to be attached and to take action against assessees who transfer or sell assets just before attachment orders are issued.

**Corrective Action**

CBDT instructed that the property should be free from any subsisting charges, liens, mortgages, or encumbrances, have property tax fully paid up to date, and not be involved in any legal dispute. The assessee must produce the original title deeds and other necessary information relating to the property, for the satisfaction of the AO, thus implementing the recommendation vide Instruction No. 1/2024, dated 03.06.2024.

## 7. Para No. 4.4- Sufficiency and valuation of properties attached

Audit noticed that the value of the attachment was either excessive or insufficient compared to the estimated tax liability, which may have resulted in undue harassment to the concerned assessees or insufficient coverage of the estimated tax liability. The AOs did not ascertain the fair market value of properties in the majority of the cases. To achieve the primary objective of protecting the interest of revenue, Audit stressed the importance of adequacy of provisional attachment of a property by determining the Fair Market Value (FMV) of attached assets for ensuring appropriate protection of interests of revenue.

**Corrective Action**

CBDT implemented the recommendation vide Instruction No. 1/2024, dated 03.06.2024 stating that the AO may make a reference to the Valuation Officer referred to in Section 142A, who shall estimate the fair market value of the property in the manner provided under that section and submit a report of the estimate to the AO within a period of thirty days from the date of receipt of such reference.

## 8. Para No. 5.1.1- Validity period of orders under Section 281B

Audit noted that the validity period of several orders under Section 281B expired either before the tax demands raised were fully recovered or even before the completion of assessments. Audit recommended enforcing the provisions related to the validity period of orders under Section 281B to ensure that the cases remain protected until the tax demand on assessment is fully recovered.

**Corrective Action**

CBDT accepted the recommendation given by Audit vide para 2 of Instruction No. 1/2024 in File No. 402/31/2022-ITCC dated 03/06/2024 by prescribing a pro-forma for the quarterly report on provisional attachment, which will ensure proper monitoring.

# Audit Report No. 12 of 2022 – Performance Audit on Exemptions to Charitable Trusts and Institutions

Charitable organisations/institutions have played a significant role in sharing government responsibility by providing various services to underprivileged people, contributing to the development and welfare of the country through charitable activities, and running non-profit organisations. Such organisations mainly depend upon donations, grants, fees etc. received from corporate houses, governments, voluntary contributions and foreign contributions.

The Income Tax Act 1961 provides for tax exemptions to various Charitable Trusts/Institutions, including Government-funded entities. The receipts of such entities are required to be applied for the objects for which these Trusts/Institutions have been set up. The Income Tax Department is responsible for ensuring that only the incomes of genuine and eligible Trusts/Institutions are exempted from the levy of Income Tax and that they pay the correct amount of tax. Hence, a Performance Audit on Exemptions granted by the Income Tax Department to Charitable Trusts and Institutions was conducted by the Direct Taxes Wing.

## 1. Para No. 5.1.2.6- Inconsistency in assessment while treating administrative and other expenses

The Income Tax Act did not provide clear guidance on the treatment of various expenses classified as "administrative and establishment expenses" while determining the application of income. Since such expenses covered different categories, greater clarity was required in the Act for their treatment. Audit recommended that the Income Tax Department (ITD) issue appropriate instructions or clarifications to establish consistent treatment of administrative and establishment expenses for the purpose of income application.

**Corrective Action**

The Ministry, through the Finance Act, 2022, amended section 12AB and the fifth proviso to Section 10(23C) to provide that if a trust or institution applies any part of its income for purposes other than its stated objects, the Principal Commissioner of Income Tax (PCIT) or Commissioner of Income Tax (CIT) may cancel its registration or approval. Further, it has been stipulated that in such cases, the Assessing Officer shall not make the assessment without first referring the matter to the PCIT/CIT.

## 2. Para No. 5.1.2.7- Absence of provision to restrict donations by a Trust to another Trust out of the current year's income.

Audit noted that there was an absence of provision to restrict donations made by one trust to another out of the current year's income. This gap allowed trusts to take undue advantage by first availing the permissible 15 per cent accumulation on their income and then transferring the balance to other trusts, thereby creating a chain of successive donations. Such practices ultimately resulted in the denial of charity to the intended beneficiaries. Audit recommended that the Income Tax Department (ITD) consider introducing a provision in the Act specifying that voluntary contributions received by a trust or institution from another trust, out of its current year's income, should not be eligible for the 15 per cent accumulation in the hands of the recipient trust or institution.

**Corrective Action**

The Ministry, through the Finance Act, 2023, inserted clause (iii) in Explanation 4 to sub-section (1) of Section 11 of the Income Tax Act. This amendment provides that any donation made by a trust or institution to another trust out of its current year's income shall be treated as an application of income only to the extent of 85 per cent of such donation. A similar provision was also proposed under clause (iii) of Explanation 2 to the third proviso of clause 23C of Section 10 of the Act.

## 3. Para No. 5.3.5- Important information not currently captured in Return of income (ITR-7)

Audit noticed that the Return of Income (ITR-7) did not capture details of contributors or donors. The absence of such information limited the ability to verify the source of funds, increasing the possibility of unaccounted money being routed through trusts, diverted funds, and wrongful claims of exemptions. Audit recommended that the ITD may capture data/information relating to contributors/donors in Form ITR-7, as has been done in respect of Section 80G(5) to bring transparency and accountability for the funds contributed/donated.

**Corrective Action**

CBDT introduced a revised ITR-7, applicable from Assessment Year 2023-24, for Charitable Trusts and Institutions, addressing the concerns highlighted by the audit.

## 4. Para No. 5.3.6- Important information not currently captured in the Auditor's Report

Audit observed that certain critical information was not captured in the Auditor's Report, such as details of receipts under different heads, and income derived from properties wholly held by the trust. The absence of these disclosures limited the ability of the Assessing Officer to verify the correctness of claims made by assessees. Audit recommended that Form 10B be modified to include:

(a) details of receipts under different heads and income derived from property wholly held by the trust,

(b) comprehensive information on corpus donations, including their receipt, utilisation, and any expenditure claimed from such donations,

(c) particulars of deemed application of income claimed in the previous year, which should be adjusted against the application of income in the year of actual receipt, and

(d) certification by the Auditor regarding utilisation of past accumulations as disclosed in the return of income to enable the Assessing Officer to verify the correctness of the claim made by the assessee.

**Corrective Action**

CBDT, through Notification No. 7/2023 in GSR 118(E) dated 21.02.2023 and the Income Tax (3rd Amendment) Rules, 2023, amended Rules 16CC and 17B of the Income Tax Rules, 1962. The Tax Audit Report (TAR) to be furnished by the Charitable Trusts or Institutions registered under Section 12A or approved under Section 10(23C) was revised in Form 10B and Form 10BB to incorporate these requirements.

### 5. Para No. 7.1.12- Provisions for declaration of the purpose of Accumulation under Section 10(23C)

Audit noted that the Income Tax Act did not contain any provision requiring trusts and institutions registered under Section 10(23C) to declare the purpose of accumulation. No statement was made in the Act or Rules for being furnished to the Assessing Officer, intimating the purpose/period of accumulation. There was also no effective system to monitor past accumulations, their utilisation, or to levy tax on unutilized amounts after five years, either through an appropriate column in the return of income or through the Auditor's Report (Form 10BB). Audit recommended that Form 10BB be modified to enable monitoring of amounts accumulated by trusts and institutions registered under Section 10(23C)(iv to via). The Income Tax Department (ITD) should require assessees to make a specific declaration indicating the purpose and period of accumulation. Such declarations, captured automatically, would ensure proper tracking of utilization, and any unspent amount after the specified period may be taxed accordingly.

**Corrective Action**

CBDT vide Notification No. 96 of 2022 dated 17.08.2022 (G.S.R. 632E), amended Rule 17 of the Income Tax Rules and through the Finance Act, 2022, Explanation 3 was inserted into the third proviso to clause (23C) of Section 10 of the Act. The amendment made it mandatory for Trusts and Institutions to furnish a statement in the prescribed form (Form 10) within the due date specified under Section 139(1) of the Act for filing the return of income.

## Audit Report No. 6 of 2022 on "Performance Audit on Assessment of Assessees of Gems and Jewellery Sector"

The Gems and Jewellery sector is one of the fastest-growing sectors and is extremely export-oriented and labour-intensive. India is the largest consumer of gold and dominates diamond cutting and polishing, manufacturing over 65 per cent of the world's polished diamonds in terms of value, 85 per cent in terms of volume, and 92 per cent in terms of number of pieces. The industry is vital for the economy and has tremendous growth potential. However, it is also susceptible to misuse and money laundering due to the high value of transactions and foreign exchange involvement from large diamond and gold imports.

A Performance Audit on Assessment of Assessees in the Gems and Jewellery Sector was conducted to examine the adequacy of rules, regulations, notifications, and circulars concerning assessees of this sector. The audit aimed to identify loopholes or ambiguities in the current laws and procedures, and to assess the efficiency and effectiveness of the Assessing Officers (AOs) in ensuring compliance with the Income Tax Act/Rules. Additionally, it evaluated the robustness of the systems, internal controls, processes, monitoring, and coordination mechanisms within the Department and with external agencies.

The legislative impact of key recommendations made by the Audit, each of which was accepted and implemented by the Central Board of Direct Taxes (CBDT) through the insertion of new sections amending the Finance Act 2023 by the Ministry, is given below.

## 1. Para No. 3.1- Absence of time limit for bringing export proceeds in convertible foreign exchange to India, leading to Irregular allowance of deduction under Section 10AA[2]

Audit noticed that ITD allowed aggregate deductions under Section 10AA against total export turnover even though a significant part of export proceeds was outstanding for more than six months and that no time limit was prescribed for the timely remittance of export proceeds by SEZ Units for claiming deduction under Section 10AA. Audit recommended that the CBDT consider specifying a time limit for bringing consideration against export proceeds into India for claiming a deduction under Section 10AA of the Act.

**Corrective Action**

The CBDT accepted the recommendation, and Section 10AA was amended in the Finance Act 2023 by inserting a new sub-section (4A) to fix the time limit of six months for bringing the export proceeds into the country for claiming deduction under Section 10AA (effective from 1 April 2024).

## 2. Para No. 3.2.1- Absence of provision for taxing share premium received from non-resident investors in excess of Fair Market Value

Audit noticed that although the Government brought an amendment in Section 56(2) by inserting clause (viib)[4] vide the Finance Act 2013 to curb the practice of bringing unaccounted money of Promoters / Directors by issuing shares at a very high premium, the gate was left open for foreign investors, particularly money coming from tax haven countries, and where the investee company did not have much net worth or a business plan to justify the receipt of a huge share premium.

Audit recommended that the CBDT may consider bringing the foreign investors within the ambit of Section 56(2)(viib) to eliminate the possibility of tax evasion in the form of share application money/ share premium.

**Corrective Action**

CBDT accepted the recommendation, and Section 56(2)(viib) was amended vide the Finance Act 2023, to omit the words 'being a resident', thereby extending the provision to the consideration received from any person, including non-residents.

2 Tax holiday under Section 10AA of the Income-Tax Act for 15 years is available to newly established units in SEZ (100 per cent of the profits & gains derived from the export for the first five years, 50 per cent of such profits & gains for next five years and further deduction of 50 per cent for the next five years subject to creation of Special Reserve.

3 Section 56(2)(viib) - where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

### 3. Para No. 4.2.8- Special Audit under Section 142(2A) of Income Tax Act

Audit noted that for assessment cases examined under 360 Degree analysis, namely, the complex nature of business transactions, complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity, and the interests of the revenue, the provisions under Section 142(2A)[4] of the Income Tax Act do not seem to have been invoked for the assessment of any assessees selected by the Audit.

Audit recommended that CBDT consider undertaking a special audit under Section 142(2A) of the assessees and their related parties to examine the issues related to improper disclosure of quantitative details of stocks, abnormal yield/wastage, claims as per records of the main assessee vis-à-vis the disclosure in the records of related parties, etc.

**Corrective Action**

CBDT accepted the recommendation, and Section 142(2A) was amended vide Finance Act 2023 to include a new provision under which the Assessing Officer can direct the assessees to get their inventory valued by a cost accountant and furnish the inventory valuation report in Form 6D.

## Report No. 14 of 2020 Performance Audit on Search and Seizure Assessments in the Income Tax Department

Search and Seizure is an important tool that the Income Tax Department resorts to in cases where there is sufficient reason to believe that the person concerned would not disclose the true picture of their income in the normal course of filing a return and regular assessment.

With the objective to examine the extent of compliance with the existing provisions of the Act/Rules /Circular/Instructions in making assessments on search and seizure, a performance audit in Income Tax Department was conducted. Another objective was to examine the level of coordination with other Government agencies/different wings of the department.

Major impact of Audit is given below where the Ministry agreed to the recommendations given by Audit and took corrective actions:

4 Section 142(2A) of Income Tax Act allows the Assessing Officer to direct an assessee to have their accounts audited by an accountant, as defined in the Explanation below sub-section (2) of section 288, nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in this behalf and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant, based on the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity of the assessee, and the interests of the revenue.

## 1. Para No. 2.4.1- Adjustment of losses under regular assessments with undisclosed income detected in the search and seizure operations:

Provisions of section 153A/153C of the Act under which Search and Seizure operations are carried out by ITD w.e.f. June 2003 do not restrict the assessee from adjusting loss in a regular assessment against the undisclosed income as could be restricted under section 158BA prior to June 2003 due to which assessee is taking undue benefit by adjusting its loss in regular assessment with undisclosed income.

Audit observed that due to an absence of specific provision in the Income Tax Act for prohibiting set off of loss of regular assessment against undisclosed income in section 153A/153C of the Act, the Assessing Officer allowed set off/adjustment of losses of regular assessment against the undisclosed income detected during search.

Audit recommended the CBDT to introduce suitable provision for not allowing set off of losses of previous years/earlier years assessed in regular assessments against the undisclosed income detected during search and seizure.

**Corrective Action**

The Ministry introduced a new Section 79A in the Income Tax Act with effect from 1 April 2022 (Finance Act 2022) disallowing set off of losses of earlier years against the undisclosed income detected during searches and surveys.

## 2. Para No. 2.4.2- Absence of prescribed time limit for issue of notice:

Audit noticed that there was no specific time limit prescribed in the Act for issue of notice under section 153A/153C of the Act. The Assessing Officers issued notices under Section 153A/153C to the assessee after periods ranging from five months to 21 months from the end of the previous year in which the search was conducted. In some cases, notice under Section 153C of the Act was issued just four days before the date of completion of assessment, highlighting considerable delays in the issue of notices.

This resulted in time constraints for the Assessing Officer for an in-depth examination of all the issues pointed out during search operations. The AOs were bound to complete the assessment within the prescribed time of 21 months, which increased the risk of human error and affected the quality of search assessments.

Audit recommended that the CBDT introduce a time limit for issuing notices under amended Section 153A/153C of the Act.

**Corrective Action**

The Ministry amended the Act through Finance Act 2021 and Section 153A/153C would not be applicable in cases where search under Section 132 is initiated or requisition under Section 132A was made on or after 1 April 2021, thereby, removing the condition of completing assessment within 21 months from end of financial year in which last authorization u/s 132 of the Act for search was executed.

## 3. Para No. 2.9- Income escaping due to non-assessment of the relevant assessment year:

*As per section 153A/153C of the IT Act, the Assessing Officer shall assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made and for the relevant assessment year.*

Audit noticed 10 cases where the Assessing Officer did not assess the income of the relevant assessment years covered under search as provided in section 153A/153C of the Act leading to escaping tax of Rs.2.80 crore.

**Corrective Action**

The Ministry vide Finance Act 2022 inserted a new sub-section (1A) in Section 149 of the Act where the income chargeable to tax represented in the form of an asset or expenditure escaped the assessment and the investment in such asset or expenditure about such event or occasion has been made or incurred, in more than one previous years relevant to the assessment years, a notice under Section 148 shall be issued for every such assessment year for assessment, re-assessment or re-computation, as the case may be.

## 4. Para No. 3.1.1- Delay in handing over Appraisal Report to the Assessing Officer:

Audit observed delays ranging from one month to 14 months against prescribed period of 60 days in handing over of Appraisal Report along with seized material to the AO in 39 Groups (out of 185 Groups) which showed the lack of coordination between Investigation and Central Assessment wings of the ITD. This inordinate delay in handing over seized materials resulted in less time for assessment.

Audit recommended the CBDT put in place a mechanism to ensure that Appraisal Report along with seized material be handed over to assessment wing within stipulated time so that Assessing Officer could have sufficient time to examine all the issues pointed out in Appraisal Report.

**Corrective Action**

The Ministry vide Finance Act 2022 inserted explanation 1 (xii) below Section 153 of the Act, enabling the handing over of the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under Section 132 or requisitioned under Section 132A as the case may be to the Assessing Officer having jurisdiction over the assessee, within the period not exceeding one hundred and eighty days commencing from the date on which a search is initiated under Section or a requisition is made under Section 132A.

## Report No. 16 of 2020 Performance Audit on Assessment of Co-operative Societies and Co-operative Banks

A Performance Audit on 'Assessment of Co-operative Societies and Co-operative Banks was undertaken with a view to examine the extent of: Coverage of Co-operative Societies in Income Tax net; Widening and deepening of the tax base; and Compliance of the statutory provisions. Audit issued 20 recommendations to the Ministry of Finance based on which corrective action was taken by the Ministry, as outlined below. In order to ensure better compliances, techniques and assessment practices in the cases of Co-operative Societies and Co-operative Banks, based on recommendations made in the Report, CBDT issued Guidelines to regional Pr.CCsIT in August 2021 for further appropriate action.

### 1. Para No. 2.1 - Co-operative Societies out of Tax Net

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

Audit recommended that CBDT to consider requesting the Central and State-level registering bodies and regulatory authorities governing the Co-operative Societies and Co-operative Banks to institute the seeding of PAN in their databases and facilitate a structured and institutional sharing of information. A process may be devised to track and monitor any change in the status of the assessee. It was also reiterated that the CBDT may devise and monitor structured institutional sharing of PAN registration details and other information with registering bodies and regulatory authorities to prevent the misuse of tax provisions by ineligible assessees.

**Corrective Action**

CBDT informed that the existing mechanism in place in the ITD enabled the sharing of information within the Income Tax Department as well as with other Government agencies. Further, the recommendation of the C&AG had also been forwarded to the Ministry of Co-operation by the OM of an even number on 27 May 2022 for appropriate action.

## 2. Para No. 2.6 - Inadequate mechanism for watching regulatory compliance

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

**Corrective Action**

Guidelines were issued by CBDT to the field formations (Pr.CCsIT) vide F.No. 173/210/2021-ITA-1 to ensure that the provisions of the Income-tax Act, 1961, are complied with. Further evidential proof of a certificate of registration of Co-operative Societies/ Co-operative Banks by the Registrar, along with details of members, is properly checked before completion of assessments."

## 3. Para No. 2.6.4 - Audit of Accounts of Co-operative Societies and Co-operative Banks

Audit observed instances of non-compliance with the regulatory requirements of audit of annual accounts/ financial statements of co-operative societies and co-operative banks by the empanelled Auditors.

Audit recommended that CBDT instruct Assessing Officers to accept the accounts of Co-operative Societies and Co-operative Banks only when their audit was conducted by empanelled auditors. Additionally, instances of non-compliance with this regulatory requirement should also be reported to the relevant regulatory authorities (Registrar of Companies (ROCs), RBI, etc.).

**Corrective Action**

Guidelines were issued by CBDT to the field formations (Pr.CCsIT) vide F.No. 173/210/2021-ITA-1 dated 23 August 2021 to ensure that the accounts of the Co-operative Societies/ Co-operative Banks are accepted by them only when their audit has been found to be conducted by empanelled auditors as per the Act, and non-compliance to this regulatory requirement may be reported to the concerned regulatory authorities, such as Registrar of Companies, RBI etc.

## 4. Para No. 3.1- Irregularities in allowances and deductions under tax provisions specific to Co-operative Societies and Co-operative Banks

Audit observed irregular allowance of deductions specific to Co-operative Societies, despite the assessments having been subjected to detailed examination by Assessing Officers during scrutiny assessments.

Audit recommended CBDT to link the activity code and status code of the assessee with the sub-sections of 80P and 36(1) of the Act under which deduction was claimed at the stage of filing of income tax return. The instances where deductions claimed by assessees engaged in ineligible activities were disallowed during assessment may be used to identify activities, sector(s) and assessees to accord priority in selection for scrutiny in subsequent years. The same may also be reported to the concerned regulatory authorities (ROCS, RBI, etc.).

**Corrective Action**

**Linking of deductions claimed specific to Co-operative Societies/ Banks with Activity Code and Status Code in ITR Form**

ITR forms for AY 2021-22 were notified vide CBDT notification number 21/2021 dated 31.03.2021 wherein details of business code under Section 80P of the Act in relevant Schedule to ITR-5, details of Status Code under Section 80P of the Act provided in ITR instruction for AY 2021-22 and details of deduction under Section 36(1) of the Act are captured in Part A-OI.

## 5. Para No. 3.2.3 - Non-adherence to the principles of mutuality

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

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

**Corrective Action**

A Committee was constituted in May 2022 to prepare Guidance Note for the Assessing Officers covering all the issues and aspects on the Assessment of Co-operative Banks and Societies, and these points were incorporated into the Committee's mandate. The Committee submitted its report in December 2023. Considering recommendation of the Committee the Pr.DGIT(Training), NADT has been asked to conduct training in hybrid mode for the guidance and training of the AOs.

## 6. Para No. 3.9 - Non-uniformity in making assessments of assessees in the Co-operative Sector engaged in banking activities

Audit observed that the Assessing Officers were adopting a differential approach in the allowance of deductions claimed under Section 80P while completing assessments of assessees categorised as Regional Rural Banks, Land Development Banks, and Agriculture and Rural Development Banks.

Audit recommended CBDT to examine the reasons for wide variations in the applicability of the same law under similar conditions and issue directions, if required, to ensure consistency and uniformity in the assessment of a similar class of assessees engaged in similar activities in the Co-operative sector. CBDT may also coordinate with regulatory bodies to align the assessment of such assessees in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies.

**Corrective Action**

Guidelines were issued by CBDT to the field formations (Pr.CCsIT) vide F.No. 173/210/2021-ITA-1 dated 23 August 2021 to ensure that there is consistency and uniformity in the assessment of a similar class of assessees engaged in similar activities in the Co-operative sector, and proper coordination with regulatory bodies is maintained to align the assessment of such assessees in accordance with the categorisation under the structure of cooperative banking as per the regulatory bodies.

## 7. Para No. 3.10- Assessment of Co-operative Societies with high value claims of deduction under Section 80P

Audit observed that there was no mechanism to monitor the nature of income on which deductions were being claimed by Co-operative Societies. The ITR did not capture the sub-section of Section 80P of the Income Tax Act under which the assessee claimed a deduction. Thus, though the Income Tax Act had specified the nature of activities in respect of which Co-operative Societies could claim deduction under section 80P of the Act, it did not have any mechanism to monitor the same in order to assess the fulfilment of legislative intention behind the introduction of the benefit of deduction to Co-operative Societies under the Act.

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

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

**Corrective Action**

**Modification in ITR-5 Form**

The ITR-5 forms for AY 2021-22 had already been notified vide CBDT notification no. 21/2021 dated 31.03.2021 includes a provision for disclosing the details of deduction under sub-section 80P of the Act, which is required to be reported in the Schedule 80P relevant to capturing details of deductions under Section 80P.

## 8. Para No. 3.13- Irregular allowance of expense to Co-operative Societies under Section 36(1)(xvii) of the Income Tax Act for the purchase of sugarcane

Audit noticed irregularities in assessments of Co-operative Societies engaged in the manufacture of sugar, which resulted in incorrect allowance of deductions on account of harvesting and transportation expenses under section 36(1)(xvii) of the Act.

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

**Corrective Action**

**Clarification issued regarding Section 36(1)(xvii) of the Income Tax Act**

CBDT issued clarification vide Circular no. 18/2021 in F.No. 173/210/2021-ITA-1 dated 25 October 2021 that the phrase *'price fixed or approved by the Government'* in clause (xvii) of Section 36(1)(xvii) of the Income Tax Act includes price fixation by State Governments through State-level Acts/Orders or other legal instruments that regulate the purchase price for sugarcane, including State Advised Price, which may be higher than the Statutory Minimum Price/ Fair and Remunerative Price fixed by the Central Government.

## 9. Para No. 4.11– High Value Additions made during assessments

Audit observed in cases of high value additions made during assessment that deduction claimed under Section 80P(4) of the Income Tax Act was disallowed on the pretext that the Co-operative Society was engaged in banking business. The existing Activity Codes did not differentiate the Co-operative Banks from Primary Agricultural Credit Society (PACS).

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

### Corrective Action

**Updation of sub-codes to distinctly capture Co-operative Banks and PACS in e-filing utility for filing ITR 5**

The ITR-5 forms for AY 2021-22 notified vide CBDT notification no. 21/2021 dated 31.03.2021 contain instructions regarding details of status code under section 80P of the Act for the relevant year. In the e-filing utility, separate sub-codes are provided for effective monitoring of the claims of deduction as per the nature of activities undertaken by Co-operative Societies and Co-operative Banks.



# Part- II- Impact of Audit Reports for the year 2015-2019

## Report No. 1 of 2019 Performance Audit on "Assessment of Assessees in Entertainment Sector" in the Income Tax Department

### Background

This Performance Audit covered the assessment of assessees engaged in key sub-sectors of entertainment sector viz. television, radio, music, event management, films, animation & visual effects, broadcasting, sports and amusement. Main objectives of Audit were to assess the effectiveness of the efforts of the Income Tax Department (ITD) to coordinate within the Department as well as with other Central/State Government Departments to identify the probable assessees in the entertainment sector to check evasion of income tax; to check loopholes/ambiguity in the existing provisions applicable to entertainment sector; and to assess the efficiency & effectiveness of the Assessing Officers (AOs) in ensuring compliance with the provisions of the Income Tax Act/Rules.

Major impact of Audit where the Ministry agreed to the recommendations given by Audit and took corrective actions is given below:

### 1. Para No. 3.5- Absence of provision of TDS:

Audit noticed that the assessees had received advances against movies under production, but TDS was not deducted by the payer due to the absence of a provision of TDS on the purchase of distribution rights of movies under production in the Income Tax Act. Though there is a provision of Tax Deducted at Source (TDS) under section 194C on payment against 'production of programmes for broadcasting and telecasting', no such provision for TDS existed for payment against the purchase of distribution rights of movies under production. Thus, there was a risk of escaping the income of the payee (Producer) as details of such payments do not get reflected in Form 26AS of the assessee.

**Corrective Action**

The Ministry vide Finance Act 2020 modified the definition of Royalty in Section 9 of the Income Tax Act, 1961 to include consideration for the sale, distribution or exhibition of cinematographic films so that TDS under Section 194J was deducted against such payments.

### 2. Para No. 3.7- Ineffective utilisation of Form-52A:

*As per Section 285B of the Act, every person carrying on production of cinematograph film is required to furnish to the jurisdictional Assessing Officer a statement in Form 52A providing particulars of all payments made or amount payable by him over Rs.50,000 in aggregate to the persons engaged by him for the production of film, for each financial year or part thereof till completion of production within 30 days from the date of completion of*

*production or within 30 days from the end of the financial year, whichever is earlier. In case of default, penalty under Section 272A(2)(c) is leviable @ Rs.100 per day.*

Audit observed that producers either did not submit Form 52A or submitted it late during the period selected by Audit, which affected the effective verification of expenses claimed by the assessee. The ITD also had not established a system to verify the number of Form 52A received against the number of movies and the details of films certified by the Central Board of Film Certification to determine the exact number of Form 52A that should be filed by the assessees. Without such cross-verification, the ITD was unable to determine the number of Form 52A required to be filed by the assessees.

To ensure effective utilisation of Form 52A, Audit recommended the CBDT to pursue proactively the receipt of Form 52A from all movie producers; extend requirement of Form 52A to the assessees engaged in other emerging sub-sectors of Entertainment Industry; change template of Form 52A to include PAN of payees receiving payments from the movie producers; capturing the details of receipts earned by movie producers from various movie rights/ overflow (surplus receipts); making it mandatory to disclose all details sought as per Form 52A; making it necessary to disclose, separately, details of amounts actually paid during the financial year and amounts due for payment as on the date of filing of Form 52A to facilitate cross verification of receipts in respect of the assessees who are following cash/mercantile basis of accounting.

**Corrective Action**

The Ministry vide Finance Act, 2022 amended Section 285B and CBDT vide Notification No.109/2022 dated 14.09.2022 amended Rule 121A of IT Act, by substituting a new 'Rule 121A-Form of statement to be furnished by producers of cinematograph films or persons engaged in specified activity' and template of Form 52A was changed in line with audit recommendation.

## Chapter V of C&AG Audit Report No. 9 of 2019 on "Assessments relating to Agricultural income"

Tax exemptions serve as critical policy tools to incentivise specific economic activities and achieve broader policy goals, particularly in agriculture, which is the primary income source for most Indians. Article 366(1) of the Constitution defines 'agricultural income' according to the Income Tax enactments. Section 2(1A) of the Income Tax Act, 1961 defines agricultural income as income earned from land used for agricultural purposes in India. Section 10(1) of the Income Tax Act exempts agricultural income from taxation, thereby aiming to improve farmers' economic conditions.

The Subject Specific Compliance Audit aimed to verify whether the Department, through its Assessing Officers (AOs), properly evaluated the genuineness and correctness of the agricultural income exemptions claimed in selected scrutiny assessments.

### Examination of the Subject by the Public Accounts Committee (2021-22) and (2023-24)

Public Accounts Committee's Forty-ninth Report (2021-22, Seventeenth Lok Sabha) focusing on "Assessments relating to Agriculture Income" was based on a detailed examination of the subject; Chapter V of C&AG Report No. 09 of 2019 and presented to both the Houses of Parliament on 05 April 2022. The Sub-Committee IV (Finance) of the PAC (2021-22) examined the subject in detail, and its report contained 13 observations and recommendations, of which six were accepted by the Government. The Ministry subsequently provided Action Taken Notes, which were further scrutinised by Audit.

The impact of the PAC Report is based on a detailed examination and follow-up of actions taken by the Ministry on audit findings, key recommendations, and observations, as discussed below.

## 1. Para No. 5.9.2- Exemption without verification of supporting documents

Audit revealed that 22.50 per cent of agricultural income exemptions were allowed without proper verification of supporting documents such as land records, proof of agricultural receipts and expenses etc. This lack of detailed documentation hindered the assessment of claims's accuracy. Audit recommended a thorough review of the exemptions process, particularly for claims over ₹10 lakh, only allowing exemptions for eligible taxpayers with proper documentation. Additionally, the current exemption system was found vulnerable to misuse, necessitating a need for enhanced due diligence in record verification.

### Observation/ Recommendation of the PAC

The Committee recommended the formulation of SOPs to assist the Assessing Officers in verifying the veracity of agricultural income claimed for exemption.

### Corrective Action

The Ministry stated in the Action Taken Report that the CBDT constituted[5] a Committee in June 2024 to formulate a Guidance Note for examining the veracity of agricultural income claimed for exemption under the Income-tax Act, 1961.

5 CBDT (ITA-1 Division) Order No. F.No.173/49/2022-ITA-1 dated 4 June 2024

## 2. Para No. 5.9.3- Incorrect reflection of agricultural income in ITD Database

Audit found a discrepancy between the exemptions allowed in the assessment order and the information reflected in the ITD database, with the agricultural income in the ITD database reflecting the agricultural income as returned by the assessees or showing irrelevant figures in cases where the agricultural income allowed was different from that claimed by the assessee. The ITD was urged to investigate discrepancies to eliminate potentially fraudulent activities and to address the systemic deficiencies for consistency of the amount of exemption allowed across different records. Audit suggested that the ITD should explore the reasons behind the coexistence of manual processes with electronic systems, particularly when returns were filed electronically, to minimise direct interactions with taxpayers or their representatives, to streamline the assessment process and enhance its efficiency.

### Observation/ Recommendation of the PAC

The Committee recommended identifying the reasons for anomalies in the rectification of lapses, fixing responsibility, and developing an online module for the regular generation of a status report on actions taken regarding pending cases.

### Corrective Action

The Ministry, in the Action Taken Report, stated that most of the assessments and rectifications in the ITD were done in the ITBA with in-built MIS reports and registers that were being used by the Supervisory Officers. For cases specified by Audit, CBDT issued a letter to the concerned Pr. CCsIT to identify the reasons for lapses and to fix responsibility.

## 3. Para No. 5.9.4- Status of Verification by the Department

DGIT (Systems) requested status reports for data entry errors while filling up the return in 2,746 cases, where agricultural income exemption claims were more than rupees one crore. Audit noted that out of 136 PCsIT, where status reports furnished by DGIT(Systems) were sought, only 26PCsIT in ten states furnished the information to Audit.

### Observation/ Recommendation of the PAC

The Committee highlighted the Audit mandate under Section 16 of the CAG (DPC) Act, 1971 which empowered the C&AG of India to conducts the audit of receipts of the Union Government. The Committee sought a detailed account of the reasons for providing Status Reports in respect of only 26 PCsIT of the 136 PCsIT selected by Audit and explanation for the remaining 110 Commisionerates.

**Corrective Action**

The Ministry reported that ITD system had been replaced by ITBA precluding the possibility of such data entry errors. With the introduction of Faceless Assessment Scheme in 2020 new PCIT charges had been created. A report had been received from DGIT(Systems) vide letter dated 09.08.2023, as per which most of the mistakes were input errors due to the entry of an amount many times more than the actual agricultural income. Furthermore, the CBDT issued guidelines[6] in March 2024 to field authorities to ensure prompt furnishing of information/records sought by the auditors from the office of the C&AG. All PCCsIT of ITD were directed[7] in April 2024 to convey to erstwhile PCsIT who did not submit the report to be more careful in future and to ascertain reasons for not providing the Status Report to DIT(Systems).

## Report 04 of 2017 on Performance Audit of Implementation of TDS/TCS Schemes

TDS and TCS are tools in the hands of the Income Tax Department (ITD) designed for quick and smooth collection of tax due to the Government from the taxpayer. TDS and TCS help the Government to ensure collection of revenue at the time of the transactions itself and prevent tax evasion. Regular inflow of TDS/TCS collection ensures a good flow of revenue to government accounts and assists treasury management. TDS/TCS provisions also place a responsibility of deducting and depositing tax on the shoulders of persons other than the payees.

The Performance Audit was conducted to assess the measures initiated by the ITD on the efficacy of the compliance of TDS/TCS provisions for strengthening the TDS administration.

### 1. Para No. 2.4- Failure to initiate prosecution proceedings

Audit noticed that AO(TDS) did not invoke provisions of section 276B/276BB/278A against the deductors, where tax was deducted/collected at source but not deposited within due date attracting prosecution proceedings under the Act. The intention of the provisions of prosecution is to punish the tax defaulter found guilty of non-depositing of tax within the due date and to instil fear of law in the minds of those who may contemplate evading the depositing of legitimate taxes. Such instances of non-compliance indicate the weakness in the implementation of these provisions, thus weakening their deterrent effect.

**Corrective Action**

The CBDT had issued instructions vide F.No.285/51/2013-IT(Inv.)/385, dated 18.10.2016 and Standard Operating Procedure for prosecution in cases of TDS/TCS defaults vide F.No.285/51/2013-IT(Inv.)/471, dated 09.12.2016, by which the Board had set an objective criteria for selection of prosecution cases for completing the Prosecution proceedings in a well-defined manner.

6 CBDT F.No.246/15/2022-A&PAC-II (Part-1) dated 21.03.2024
7 CBDT F.No.246/15/2022-A&PAC-II(Part-1) dated 08.04.2024

## 2. Para No. 4.3 & 4.6 (b)- Resolvable TDS demand

Audit noticed that less than 50 per cent of AOs had utilised the facilities available in the CPC (TDS) portal. The facility of outstanding resolvable tax demand at the AO portal needs to be utilised by all AOs (TDS) to monitor the status of outstanding resolvable tax demand and issue letters to the assessees for filing a corrected/revised statement accordingly. Further, if no action was taken by the assessee in respect of a resolvable demand, the AO were supposed to take recovery measures so that the demand was reduced to 'Nil'. Audit recommended that CBDT take effective steps for the quick recovery of the resolvable demand to ensure it is free from any dispute.

**Corrective Action**

CBDT issued a Standard Operating Procedure for prosecution in cases of TDS/TCS defaults vide F.No.285/51/2013-IT(Inv.)/471, dated 09.12.2016, defining the roles of different TDS Authorities in addressing the issue of resolvable/ collectable TDS demand and disposing all compounding petitions expeditiously and within the time period prescribed in the Central Action Plan for the FY.

# Audit Report No. 27 of 2017 on "Assessment of Private Hospitals, Nursing Homes/Medical Clinics, Medical Colleges/Research Institutes, Diagnostic Centres, Pathological labs and other Medical supplies agencies/stores"

The Indian healthcare sector, one of the fastest-growing service areas, has witnessed significant growth in terms of revenue and employment generation, thereby making it a vital economic sector with corresponding potential for the Government revenue. The Income Tax Act provides specific tax incentives to hospitals, viz., a five-year tax holiday in respect of profits derived from the business of operating and maintaining hospitals, besides a deduction of capital expenditure incurred for setting up new hospitals, and a higher rate of depreciation on medical equipment to incentivise the healthcare sector. The objectives for undertaking this performance audit were to evaluate the effectiveness of tax incentives for the healthcare sector, to ensure compliance with the Income Tax Act and to check if all healthcare institutions were included in the tax net.

### Examination of the Subject by the Public Accounts Committee (2018-19):

The PAC (2017-18) selected the subject and allocated the same to Sub-Committee-III (Direct and Indirect Taxes) for detailed examination and report thereon. The PAC considered and adopted this Report on 10 April 2018.

The One Hundred and Third Report of the PAC (2018-19) (Sixteenth Lok Sabha) on Assessment of Entities engaged in Health and Allied Sector was presented to the Lok Sabha and laid on the table of the Rajya Sabha on 19 July 2018.

Key audit findings & recommendations, key recommendations made by the PAC and their impact are discussed below:

## 1. Para No. 2.3- Need for sector-specific analysis

Audit noticed that businesses in the healthcare sector, such as medical clinics, diagnostic centres, pathological labs, and other medical supply agencies/stores, were not codified under the existing allocation of codes based on their nature of business with respect to healthcare assessees. This negatively impacted the monitoring and vigilance of the healthcare sector as well as the collection and sharing of relevant information on sector-specific issues. Audit recommended that CBDT may consider allocating specific codifications to different businesses in the healthcare sector that were not captured (viz. Medical Clinics, Diagnostic Centres, Pathological labs and other medical supplies agencies/stores) under the existing codes specific to the healthcare sector.

### Observation/ Recommendation of the PAC

The Committee was of the view that sector-specific information would enable the ITD to analyse the sector-specific issues and efficacy/misuse of sector-specific provisions. The Committee further desired that necessary modifications/ additions should be made in the forms to be filled by the assessees to enable sector-specific analysis.

### Corrective Action

Income Tax Return forms for the Assessment Year 2018-19 were modified, and many new sub-codes were provided to entities related to the Health Sector, which inter alia included General Hospitals, Speciality and Super Speciality Hospitals, Diagnostic Centres. The coded categorisation of entities made it easier to do sector-specific analysis.

## 2. Para No. 3.2.3- Overlapping nature of Section 10(23C) and Section 11 of Income Tax Act

Audit noticed the overlapping nature of Section 10(23C) and Section 11 of the Income Tax Act, where Assessing Officers allowed exemption under one section while disallowing exemption on the grounds of the existence of a profit motive under another.

The ITD clarified that the powers regarding approval under Section 10 (23C) and registration under Section 12A of the Act were previously vested in different authorities, which have now been combined and vested in a single authority, namely CIT (Exemption) with effect from FY 2014-15 to decide the eligibility for exemption under both sections to reduce the scope of any assessee availing exemptions under the alternate section if denied exemption under one section. Still, in view of the risks involved, the Audit suggested that this needed careful monitoring.

### Observation/ Recommendation of the PAC

The Committee desired that a robust monitoring mechanism be developed and that Assessing Officers be well anchored to identify and monitor cases so that benefits under both Sections 10(23C) and Section 11 of the Income Tax Act, 1961, to a particular assessee in a given assessment year are ruled out.

### Corrective Action

CBDT accepted the recommendation and inserted the First and second provisos to sub-Section (7) of Section 11 of the Act by Finance Act (No. 12), 2020, applicable with effect from 01/06/2020. In the first proviso, it is provided that registration for purposes of availing exemption under Section 11 shall become inoperative from the date on which the trust or institution is approved under clause (23C) of Section 10 or is notified under clause (46) of the said section, as the case may be, or the date on which proviso has come into force, whichever is later. In the second proviso, it is provided that trust, or institution, whose registration has become inoperative under the first proviso, may apply to get its registration operative subject to the condition that on doing so, the approval under clause (23C) of Section 10 or is notification under clause (46) of the said section shall cease to have any effect from the date on which registration for purposes of availing exemption under Section 11 becomes operative. Thereafter, it shall not be entitled to exemption under Clause (23C) or Clause (46) of Section 10 of the Act.

## 3. Para No. 3.2.5- Donations not being watched properly – Absence of Section 80G Certificates

The audit noticed that there was no provision in the ITD module to enable the validation of Section 80G certificates by Assessing Officers, as was done for TDS certificates under TRACES. While examining the cases in Maharashtra, the Audit noticed that out of eighty-seven cases in the stand-alone hospital category, Section 80G certificates were available in only 10 per cent of cases. In the absence of Section 80G certificates, it was not clear as to how the Assessing Officers cross-verified the donation receipts vis-à-vis the claims.

Audit opined that the 80G donation aspect needed more attention from the Department, as it entailed revenue foregone due to exemptions for recipients and deductions for donors. In the absence of a mechanism for cross-verifying claims made by donors and donees, the possibility of ineligible assessee deductions cannot be ruled out. Audit recommended that the CBDT may consider the possibility of introducing automated generation of section 80G certificates above a certain threshold.

### Observation/ Recommendation of the PAC

The Committee were of the view that the ITD may issue specific instructions to be followed while giving and receiving donations. The list of the donors should invariably have either PAN/ Aadhaar number quoted against each of them, and the ITD, before allowing deduction/ exemption, make a test check of a prescribed percentage of donors on a random basis, and the donees to ensure correctness of the claims.

**Corrective Action**

**CBDT accepted the recommendations and amended the Act as follows:**

Section 80G was amended in 2020, effective from 01 April 2021, to require entities receiving donations to file a statement of the donation received and issue a certificate to the donor.

Rule 18AB of the Income Tax Rules, 1962, was notified vide CBDT Notification No 19 of 2021 dated 26 March 2021, inter-alia providing that a Statement of particulars of donation in Form 10BD is required to be filed by a donee, approved under sub-section (5) of Section 80G of the Act and the Certificate of particulars of donation is required to be provided to the donor in Form 10BE.

New provisions inserted in Section 80G(2)(vii), Section 80G(2)(ix) and Section 35(1A) vide Finance Act, 2020, effective from 01 April 2021, wherein, deduction under Section 80G/35 to a donor shall be allowed only if a statement is furnished by the donee who shall be required to furnish a statement in respect of donations received and in the event of failure to do so, fee and penalty shall be levied.

## Audit Report No. 28 of 2016 Performance Audit on "Allowance of deduction to the assesses engaged in infrastructure development"

Large investment in infrastructure sectors such as power generation, railways, roads, ports, airports, irrigation, water supply and telecommunications services during the last decade or so has helped India to emerge as one of the fastest growing economies in the world. Infrastructure development has also provided a better investment climate in India. Provision of tax holidays for Industrial Undertakings and Enterprises has significantly enhanced the investment in "infrastructure development" in the last two decades.

Section 80IA of the Income Tax Act provides for deductions in respect of profits and gains of industrial undertakings or enterprises engaged in "infrastructure development" or "eligible business" at one hundred per cent for a certain period, subject to the fulfilment of conditions provided in the section. Hence, to assess the robustness and effectiveness of the procedures in place in the ITD on this subject matter, this performance audit was undertaken. The legislative impact of key recommendations made by the Audit is detailed below.

## 1. Para No. 2.7- Inconsistency in setting off brought forward losses and unabsorbed depreciation relating to eligible units:

*As per the provisions of section 80IA(1) and (2), deduction of an amount equal to 100 per cent of profits and gains derived from the eligible business may, at the option of the assessee, be claimed for any 10 consecutive years out of 15 years beginning from the year in which the undertaking or the enterprise begins to operate any infrastructure facility.*

Audit observed that in some cases the AOs disallowed the claim of deduction after setting off brought forward losses pertaining to years prior to the initial assessment year, but in other cases AOs allowed such deduction claimed without setting off of brought forward loss(es). Thus, Assessing Officers were not taking a uniform stand on allowance of brought forward loss(es) in respect of the eligible business. Audit recommended that the CBDT may modify the provisions of section 80IA (5) so that a uniform stand is taken by all AOs on the treatment of setting off brought forward loss(es) pertaining to the period prior to the initial assessment year.

**Corrective Action**

The CBDT vide Circular No. 1/2016 dated 15.02.2016 modified the provision of section 80IA(5) in such a way that a uniform stand is taken by all AOs on the setting off brought forward loss(es) pertaining to the period prior to the initial assessment year.

## 2. Para No. 2.8- Treatment of receipts from sale of carbon credits:

Audit observed that the taxability of the income arising from the sale of carbon credits has been a matter of litigation as to whether the consideration received by an entity for the sale of carbon credits generated by it is of a capital nature or revenue nature, or such amount is taxable or not or such income is eligible for deduction under Chapter-VIA. There are different judicial decisions on the treatment of receipts from the sale of carbon credits. Audit further noticed that the ITD allowed the deduction in respect of income earned through the sale of carbon credits.

Audit recommended that the CBDT may consider taxing the income from the sale proceeds of carbon credits as income from other sources.

**Corrective Action**

The Ministry vide Finance Act, 2017 inserted Section 115BBG to bring to tax the 'Income from transfer of carbon credits' chargeable at the rate of ten per cent.

## Report No. 25 of 2015 Performance Audit on Functioning of Internal Audit in Income Tax Department

Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggesting improvements thereto and adding value to strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system. Internal Audit, being an integral part of the internal control system, has an important role to play in ensuring compliance to prescribed rules, regulations and guidelines.

A new Internal Audit System was introduced in ITD with effect from 1 June 2007, providing for a separate audit structure in the ITD to perform the audit work, assigning well-defined roles to various authorities for effective functioning and management of Internal Audit. The Performance Audit on the Functioning of the Internal Audit was conducted to ascertain the efficiency and effectiveness of the functioning of the Internal Audit wing in the ITD.

### 1 Para No. 2.5, 4.15– Maintenance of Register of Auditable Cases, Ledger Cards and Compliance Cards

Audit observed that coverage of high-risk cases could not be ensured due to the absence of a database related to auditable cases. Further, it was also observed that Audit observed that Ledger Cards and Compliance Cards were not being maintained in CsIT (Audit) charges as prescribed by Audit Manual, 2011. Audit recommended the CBDT to consider utilising the Information Technology tools to aid the functioning of the CsIT (Audit) and DIT (Audit) for effective planning, programming, monitoring and control of Internal Audit.

**Corrective Action**

The Department had rolled out the Audit Manual of ITBA effective from 28.08.2017. The audit module of ITBA covered the entire process of Internal Audit and Revenue Audit in the Department.

### 2. Para No. 2.6– Selection of Auditable cases as per prescribed norms

There was no specific criterion for determining the top 100 auditable cases for Internal Audit. Audit suggested that the norms for selection of top 100 cases of all administrative CsIT in a region may be reviewed vis-à-vis monetary norms for Addl. CsIT, SAPs and IAPs to ensure comprehensive coverage. Audit recommended the CBDT to review the monetary norms fixed for IAPs to ensure mandatory scrutiny of top 100 cases in each administrative CIT as, the then prescribed norms made the 100 cases fall under the purview of Addl. CsIT and SAPs.

**Corrective Action**

The CBDT vide instruction No.6/2017 vide F.No.240/08/2015-A&PAC-II, dated 21.07.2017 reported that target and monetary norms were re-examined and target of auditable cases by Addl. CIT were enhanced from 50 to 150 to cover internal audit of top 100 cases by experienced Officer in May 2015.

## 3. Para No. 3.2– Issue of Internal Audit Memos

The audit noted that the Internal Audit Memos were issued with delays, and the Internal Audit Reports were not prepared for issuance to the administrative CsIT as prescribed under Audit Manual 2011. The audit recommended that the CBDT introduce a centralized monitoring mechanism to ensure the timely issuance of Internal Audit objections and Internal Audit Reports, thereby ensuring effective control.

**Corrective Action**

The CBDT issued instruction No.6/2017 vide F.No.240/08/2015-A&PAC-II, dated 21.07.2017, as per which the function and process of Internal Audit of ITD had been integrated within the Income Tax Business Application (ITBA). As per para 7.3 of this Instruction, each Audit Memo is to be generated through ITBA bearing a unique identification number (UIN) for proper monitoring.

## 4. Para No. 3.2–Scope of Internal Audit

The scope of the functioning of Internal Audit was not revised to correspond to changes in the scope of assessment. This resulted in the exclusion of high-risk assessment units such as Large Taxpayers Units, International Taxation Units, including Transfer Pricing assessments. Audit recommended that the CBDT consider revising the scope of Internal Audit to align with changes in the scope of assessment in recent years. This revision aims to ensure the Internal Audit of high-risk assessment units, such as Large Taxpayers Units and International Taxation Units, including Transfer Pricing Offices.

**Corrective Action**

The CBDT issued instruction No.6/2017 vide F.No.240/08/2015-A&PAC-II, dated 21.07.2017 and F.No. Pr.CCIT (Int. Tax.)/10/2017-18/2011 dated 16.8.2017 introduced the concept of a chain audit for transfer pricing cases, and officers were designated to conduct the Audit of TPO related to other CIT (TP) charges. A universal criterion, viz. Audit Potential Index (API) was devised for generating a list of high-risk cases to be taken up for Audit through ITBA, as outlined in the revised Internal Audit Manual, 2019. Separate norms were also specified for orders where it was not possible to apply the API.

## 5. Para No. 4.1 to 4.4– Achievement of Targets

Audit noticed that due to significant shortages in deployment in IAPs, the annual target of audit of the minimum number of cases, as prescribed by the CBDT, was not met by the Addl. CsIT (Audit), SAPs and IAPs in certain jurisdictions during 2010-11 to 2013-14. Audit recommended that the CBDT consider monitoring the actual deployment of human resources positioned under Addl. CIT, SAPs and IAPs in order to determine the overall shortages and effective utilisation of available manpower.

**Corrective Action**

CBDT issued instruction No.6/2017 vide F.No.240/08/2015-A&PAC-II, dated 21.07.2017, wherein the assignment and monitoring of cases are to be audited by JCIT, SAPs, and IAPs as per specified norms and targets, aided by functionalities provided within ITBA.

# Audit Report No. 05 of 2015 on "Assessment of Assessees in Pharmaceutical Sector"

The Indian Pharmaceuticals Industry witnessed robust growth from 2007 to 2013, reaching a turnover of Rs. 1,21,015 crore in 2013. Government policy for enhancing sectoral growth includes tax exemptions, weighted deductions on expenses for research and development (R&D) and other deductions against business profits in the Income Tax Act 1961, concessional rate of excise duties, State VAT, etc.

The Performance Audit aimed to verify whether the exemptions and deductions allowable to the Pharmaceutical Sector had been allowed as per entitlement; the administrative and procedural adequacy for taxation of Pharmaceutical Sector existed, and the allowance of deduction of Research and Development expenditure to the assessees in the Pharmaceuticals Sector had contributed to the growth in the Industry as well as in tax revenues.

### Examination of the Subject by the Public Accounts Committee (2021-22) and (2023-24)

Public Accounts Committee's One Hundred and Thirty-Sixth Report (2018-19), Sixteenth Lok Sabha) focusing on "Assessments of Assessees in the Pharmaceuticals sector" was based on a detailed examination of the C&AG Report No. 05 of 2015 and presented to both the Houses of Parliament in February 2019. The Sub-Committee III (Direct and Indirect Taxes) of the PAC (2017-18) examined the subject in detail, and its Report contained eight observations and recommendations.

The impact of the PAC Report is based on a detailed examination and follow-up of actions taken by the Ministry on audit findings, key recommendations, and observations, as discussed below.

## 1. Para No. 2.4- Allowance of R&D expenditure without approval from Department of Scientific and Industrial Research (DSIR)

Audit observed that in 22 cases across six States, a tax effect of Rs. 570.59 crore due to weighted deduction on R&D expenses was allowed without verifying claims from Form 3C/3CM issued by the Department of Scientific and Industrial Research (DSIR), the competent authority for approving such claims. The audit recommended that the Ministry develop a mechanism to ensure that a copy of the approved Form 3CM/3CL from DSIR is invariably attached to the ITR and that the date of forwarding the approved Form 3CL by DSIR to DGIT (Exemptions) is prescribed to precede the ITR filing deadline.

### Observation/ Recommendation of the PAC

The Committee desired that the Government make an in-depth study before phasing out deductions from 2021 and take further necessary measures, legal and procedural, to effectively deal with the issue.

### Corrective Action

Ministry informed that with effect from 01.07.2016, substantial changes were made in Rule 6 of Income Tax rules, 1962 to enable tracking of claim of weighted deduction by the taxpayers and fulfilment of conditions for allowance of deduction under Section 35(2AB) claimed in ITR. The amended provision ensured transmission of the report for verification of the claim of the weighted deduction claimed under Section 35(2AB).

## 2. Para No. 2.7 to 2.9- Mechanism for cross verification of turnover declared in Income Tax Return with turnover declared in Excise Return

ITD does not have any mechanism to correlate & verify the turnover declared in Income Tax returns with the turnover declared in Central Excise returns which is part of the Ministry of Finance. Audit recommended that ITD develop a mechanism to collect/receive information related to assessment available with other tax departments and use it to deepen the tax base and bring the correct income to the tax-net. Alternatively, the AIR in Form ER 4 should compulsorily be called for from an assessee who is availing turnover-based deductions under the provisions of the Act.

### Observation/ Recommendation of the PAC

The Committee viewed it seriously that there was no mechanism within the ITD to cross-verify the turnover declared in the ITR with the turnover declared in the Central Excise Return. The Committee desired to know the outcome of steps initiated by the ITD in 2015 for deepening the tax base of the pharmaceutical sector.

**Corrective Action**

An MOU was entered into with the CBEC on 30.11.2015 on the exchange of information. Details of Excise turnover as per ER-4 obtained from CBEC were being cross-verified with turnover as per the Profit and Loss Account of ITR.

## 3. Para No. 3.1.1 to 3.1.3- Allowance of expenditure towards gifts, freebies etc. to Medical Professionals

In 36 cases involving a tax effect of Rs. 55.10 crore, the expenditure on gifts/freebies to medical professionals was allowed despite being irregular under the Income Tax Act. Audit recommended that the CBDT issue instructions to clarify the nature of expenses to be treated as freebies, including physicians' samples. Further, a suitable mechanism may be devised for the assessees claiming deduction of such expenses, to provide details of expenses in the nature of freebies from the sales promotion expenses. Further, CBDT may clearly specify the effective date of disallowance of expenses towards freebies to put the disputed and varied interpretations in this regard to rest.

**Observation/ Recommendation of the PAC**

The Committee recommended that not only the cases highlighted by Audit, but also similar cases should be thoroughly inquired into to find out how and why such lapses occurred, and the Ministry should initiate disciplinary action against the officers concerned. Also, the effective date of disallowance of such expenses was to be clearly specified, in the absence of which divergent views were taken by the AOs on the same issue.

**Corrective Action**

Directions were issued to the Chief Commissioners of Income Tax to issue an advisory to officers concerned in suitable cases. Further, Section 37 of the Act was amended to widen the current scope of Explanation 1 to Section 37 of the Act (w.e.f. FY 2021–22) vide the Finance Act, 2022. The said clarificatory amendment sought to disallow any expenditure for the provision of a benefit or perquisite, in whatever form provided, to any person if his or her acceptance is in violation of any law, rule, regulation or guideline governing the conduct of such person.



# Part III- Impact of Audit Beyond 10 years (Prior to 2015)

## Audit Report No. 20 of 2014 Performance Audit on "Allowance of Depreciation and Amortisation"

Income Tax Act, 1961, lays down diverse provisions on depreciation and/or amortisation for tax purposes as a deduction to an assessee/ a company in the course of its business with the intention of promoting economic growth within the Country. It is important to ensure that these provisions are properly utilised as per the existing tax laws to avoid any major revenue loss.

Hence, a performance audit was conducted to examine whether the systems and procedures are sufficient and in place to ensure compliance with the provisions of the Act/Rules and instructions issued by the Central Board of Direct Taxes (CBDT). Another objective was to seek assurance that adequate internal control mechanism exists within the ITD for monitoring the allowance of depreciation in general and under special circumstances, viz., amalgamation, demerger, reconstruction, etc.

The legislative impact of the recommendation made by Audit is detailed below.

### 1. Para No. 2.4- Inconsistencies in allowance of depreciation on assets owned by Charitable/Religious Trusts and Association of Persons:

Section 11 of the Act provides for exemption to a Charitable or Religious Trust, subject to certain conditions, in respect of income from property held thereunder, to the extent such income is applied or accumulated for charitable or religious purposes. The Central Board of Direct Taxes has clarified that for the purpose of such exemption, the income of a trust is to be taken in the commercial sense, and not as computed under the provisions of the Act. In other words, the income that is eligible for exemption is the one that has been determined as per the books of account.

Audit observed that in the case of Charitable / Religious Trusts, few Assessing Officers disallowed the depreciation claims on the cost of assets already allowed as application of income, whereas others allowed the depreciation claims of the assessees, on the strength of varied judicial decisions (including Appellate/Tribunal orders). Absence of enabling provisions and often conflicting judicial decisions on similar issues had an adverse impact on tax revenues.

Audit recommended the Ministry clarify whether the depreciation was to be allowed in addition to capital expenditure on assets towards the application of income.

**Corrective Action**

The Ministry vide Finance (No 2) Act, 2014 w.e.f. 01.04.2015 has inserted Sub-Section 11(6) in Section 11, provided that where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

## Audit Report No. 20 of 2013 – Performance Audit on Exemptions to Charitable Trusts and Institutions

Income Tax Act, 1961 (Act) provides for tax exemptions to various trusts, associations, institutions and other organisations engaged in charitable or religious activities in order to encourage and fulfill social objectives relating to areas such as charity, religion, medical and education, etc. The Income Tax Department (ITD) is responsible for enforcing tax exemption provisions. ITD also ensures that only the incomes of genuine and eligible Institutions and Trusts are exempted from the levy of income tax, and that the correct amount of tax is paid by them.

Based on audit findings incorporated in this report and recommendations made by the audit, several amendments have been made in the Income Tax Act or circular/instructions issued by the CBDT in this regard, which are discussed below:

### 1. Para No. 2.3, 2.18, 4.1 to 4.12- Grant of approval/ registration without adequate documents/ Non-correlation of registration/ approval allowed by different exemption authorities/ Non-monitoring of accumulation of income of Trusts

Audit had pointed out that the department granted approval/registration without verifying necessary documents such as copy of trust deed, proper clause in the trust deed, audited accounts, without having any PAN etc. There was no correlation in granting or rejecting approvals/registration among the different authorities. Further, there was no monitoring of the accumulation of income of the Trust.

Audit was of the view that the Ministry may review the exemption granted to the assessee and also develop a system to ensure that no registration is granted to a Trust without requiring the prescribed documents, such as a copy of the Trust deed and copies of audited accounts.

Audit recommended that the Ministry should ensure compliance with the existing mechanism to ascertain whether the competent authorities have verified all the requisite documents as specified in the Act, for registration.

**Corrective Action**

a) ITD, through restructuring, created a separate 'Exemption' wing in ITD (from November 2014) for dealing exclusively with issues relating to exemptions to charitable trusts /Institutions.

b) Online Registration/approval under Section 12AA and 80G(5) were introduced from July 2016, and in case of 10(23C)(iv), (v), (vi) and (via) from September 1016.

c) From AY 2013-14, E-filing of Income Tax Returns and Audit Reports by Trusts/ Institutions having taxable income above the exemption limit became mandatory.

d) From AY 2013-14, disclosure of year-wise details of accumulations, their utilisation and investments, through appropriate columns, is to be mentioned in ITR-7.

e) The ambit of survey operations, under section 133A of the Income Tax Act, was widened to cover Charitable Trusts, vide Finance Act, 2017, to enable the Income Tax Authorities to conduct Surveys at premises where an activity for charitable purpose was being carried out.

## 2. Para No. 2.14 and 2.17; 3.2 to 3.53; and 3.79d- Grant of approval/ registration without adequate documents/ Non-correlation of registration/ approval allowed by different exemption authorities/ Non-monitoring of accumulation of income of Trusts

Audit had noticed that the ITD granted irregular exemptions to Trusts where the activities were not charitable in nature. Audit further noted a different violation of the provisions of the charitable trust.

Audit recommended that the Ministry may initiate action for withdrawal of exemption/cancellation of registration/approvals u/s 12A/10(23C) of the Act in case of violation of the provisions of section 13.

**Corrective Action**

The Ministry, through Finance (No.2) Act, 2014, amended Section 12AA(3) and 12AA(4) of the Act by providing that if -

a) the activities of trusts/institutions are not genuine or the activities are not being carried out in accordance with the objects of the trust/institution, or,

b) the activities are being carried out in a manner that the provisions of sections 11 and 12 of the Act do not apply to exclude either whole or,

c) any part of the income of such trust/institution is due to the operation of Section 13(1)

then, the competent authority i.e. the Pr. The Commissioner or the Commissioner may, by an order in writing, cancel the registration of such trust or institution, provided that no order under this sub-section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.

### 3. Para No. 5.30 and 5.43c 3– Clarification of the phrase 'Substantially financed' under Section 10(23C)

Audit had pointed out that under clause (iiiab) and (iiiac) of Section 10(23C), educational and medical institutions are exempt from tax if such institutions are wholly and substantially financed by the Government. However, the word "substantially financed" was not defined in the Act.

Audit recommended that the Ministry bring a suitable definition for the phrase 'substantially finance' to clarify the provision of section 10(23C).

**Corrective Action**

The Ministry, through the Finance (No.2) Act, 2014, amended the provision of Section 10(23C) of the Act by inserting an Explanation below Section 10 (23C). Rule 2BBB was also inserted in the Income-Tax Rules vide Notification No. 79 /2014 dated 12th December 2014 to prescribe such percentage to be 50 per cent.

### 4. Para No. 5.2 5.43a– Inconsistencies in allowance of depreciation

Audit had pointed out that Charitable Trusts/Institutions were availing deductions on capital expenditure while simultaneously availing depreciation on fixed assets. This amounted to a kind of double benefit.

Audit recommended that the Ministry bring suitable amendments to the Act to streamline the treatment of depreciation.

**Corrective Action**

The Ministry through Finance (No.2) Act, 2014 amended provision of Section 11 and Section 10(23C) to provide that income for the purpose of application shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as application of income under these Sections in the same or any other previous year. This amendment is effective from 1st April, 2015.

### 5. Para No. 3.61 to 3.64– Irregular exemption within exemption relating to Dividend

Audit had pointed out that charitable trusts/institutions were claiming exemption on dividend income on shares and mutual funds under Sections 10(34) and 10(35), though such dividend was not applied for charitable purposes.

**Corrective Action**

The Ministry through the Finance (No.2) Act, 2014, Section 11 of the Income-Tax Act was amended to provide that where a trust or an institution has been granted registration for purposes of availing exemption under Section 11, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption under any provision of Section 10 [other than that relating to exemption of agricultural income and income exempt under Section 10(23C)]. Similarly, entities that have been approved for claiming the benefit of exemption under Section 10(23C) would not be entitled to claim any benefit of exemption under other provisions of Section 10 (except the exemption in respect of agricultural income).

## 6. Para No. 2.7– Non-inclusion of dissolution clause in the Trust Deed

Audit had noticed that there was no provision in the Act to tax a charitable trust/institution in case of its dissolution or merger with a non-charitable entity or transfer its assets to any trust that is non-charitable. In the absence of provision, the fund of the trust is susceptible to misuse.

**Corrective Action**

The Ministry, through the Finance Act, 2016, introduced a new Chapter XII-EB containing Sections 115TD to 115TF titled 'Special provisions relating to tax on accreted income of certain Trusts and Institutions'. It provides that where a Trust or Institution ceases to be a charitable organization by way of its conversion into any form which is not charitable or merges with a non-charitable entity, or transfers its assets to any trust which is non-charitable or does not transfer it to another charitable trust within a period of one year from dissolution, then the amount of net assets based on fair market value as on the date of such conversion or merger or dissolution which represents the income accreted to the trust over period of time shall be charged to additional income-tax at the Maximum Marginal Rate[8].

## 7. Para No. 5.25 to 5.27– Absence of provision in the Act to deduct tax at source in case of Trusts

Audit had pointed out that there was no enabling provision in the Act, similar to Section 40(a)(ia), to disallow expenses on which TDS should have been deducted but has not been deducted by trusts or, after deduction, has not been paid on or before the due date of furnishing of the return of income.

The audit recommended that the Ministry consider making suitable modifications to the provisions to ensure compliance with the TDS provisions by Trusts.

8 The maximum marginal rate (MMR) is the rate of income tax applicable in relation to the highest slab of income

**Corrective Action**

The Ministry through Finance Act, 2018, amended provisions of Section 11 and Section 10(23C) to provide that if any payment on which tax is required to be deducted but has not been deducted or tax has been deducted but not paid within the due date of filing of the return of income, then such amount shall not be considered as application of income.

## 8. Para No. 5.6 to 5.10- Inconsistencies in allowance of deficit of earlier years

Audit had pointed out inconsistencies in the allowance of carry forward of deficit in the case of exempt entities.

Audit recommended that the Ministry bring suitable amendments to the Act to streamline the treatment of deficits.

**Corrective Action**

The Ministry, through the Finance Act, 2021, amended the provisions of Section 11 and Section 10(23C) to clarify that the calculation of income required to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the years preceding the previous year.

## 9. Para No. 5.13 to 5.15- Inconsistencies in allowance of repayment of loans

Audit had pointed out inconsistencies in allowance of repayment of loans in cases of exempted entities and recommended that the Ministry may bring suitable amendments in the Act to bring uniformity in allowance of repayment of loans.

**Corrective Action**

The Ministry, through the Finance Act, 2021, amended provisions of Section 11 and Section 10(23C) to clarify that an application for charitable or religious purposes from any loan or borrowing shall not be treated as an application of income for charitable or religious purposes.

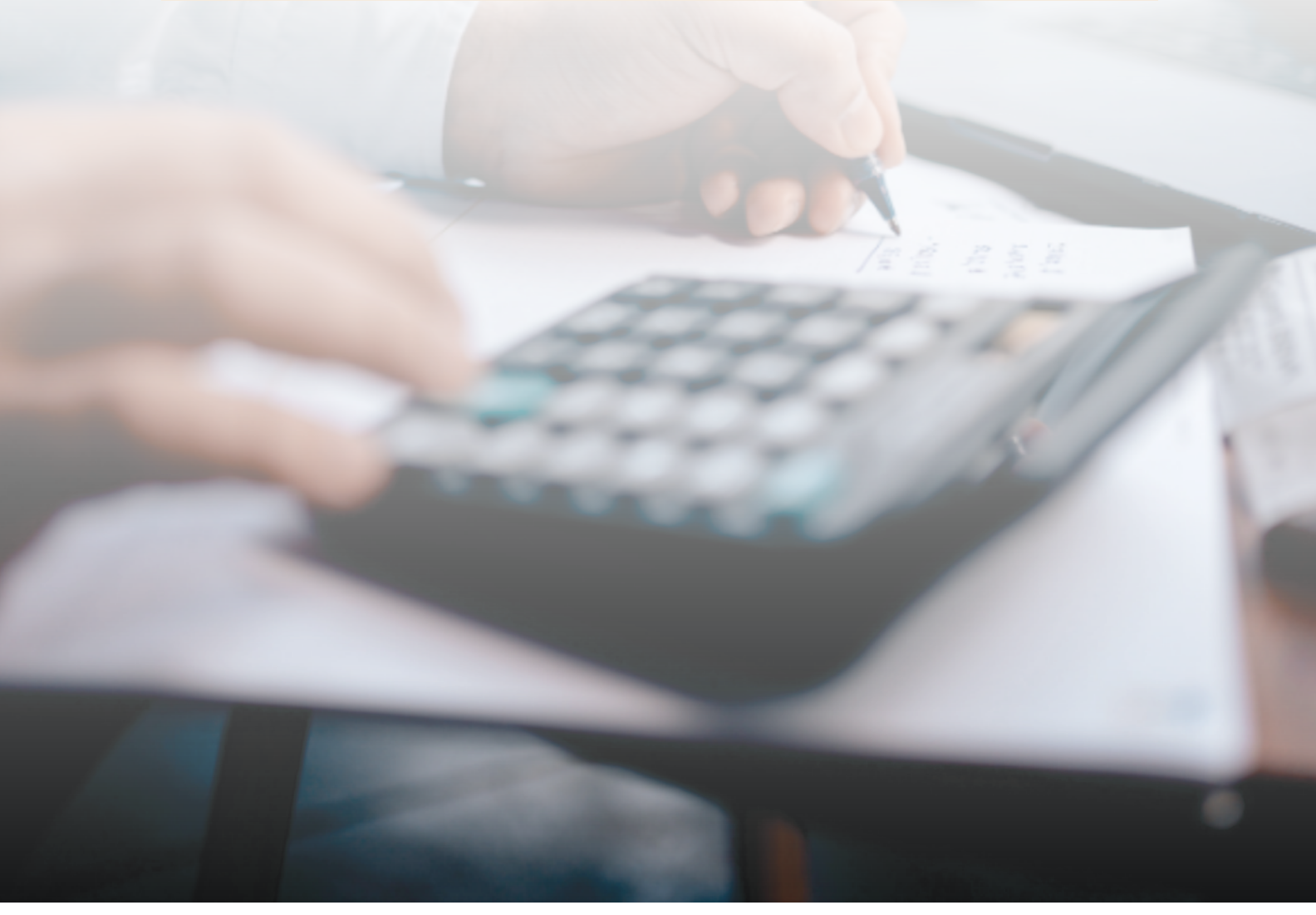
## 10. Para No. 5.18- No monitoring system in respect of donations under Section 80G

Audit had pointed out that there was no internal mechanism within ITD to control the receipts issued by entities registered under Section 80G.

Audit recommended that the Ministry issue suitable instructions to verify the information of major donations received under Section 80G during scrutiny cases to ensure proper accounting of donations.

**Corrective Action**

The Ministry, through the Finance Act, 2020 with effect from 01/04/2021 had introduced a provision in this regard, which states that claim of the assessee for a deduction in respect of any donations made to an institution or fund to which the provision of Section 80G(5) apply, in the return of income for any assessment year filed by him, shall be allowed on the basis of information relating to the said donation furnished by the institution or fund to the prescribed Income Tax authority or the person authorized by such authority, subject to verification in accordance with the risk management strategy formulated by the Board from time to time.




Welcome
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MARKET

# Section-B

# INDIRECT TAX




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# Section B- Indirect Taxes

## Introduction

Reforms in taxation, ranging from rationalisation of taxes and duties, widening the tax base, modernisation and reforms in tax administration, has been a process in continuum over the years. The reforms have delivered palpable outcomes and the indirect taxes collection has steadily grown to assume a sizeable proportion of the overall revenue kitty. For the year ending 2023-24 the indirect tax revenue was 38 per cent of the total revenue receipts of the Government of India. All along, the underlying principle has been an increased adoption of self-assessment and mutual trust. One of the major enablers in this endeavour has been early adoption of technology and digitising core work processes in tax administration, which has been strengthened over the years to adopt an information driven non-intrusive tax administration to improve compliance and effective use of information across all areas of tax administration.

In the realm of indirect taxes, automation of work processes commenced in 1992 with a study conducted by the National Informatics Centre and the Central Board of Indirect Taxes and Customs at a number of Customs Houses across the country, followed by a more detailed study in Delhi Customs House in 1994. The pilot project was launched in Delhi Customs House in 1994-95, which included Electronic Data Interchange as a key component in connecting all players involved in international trade with Customs Houses electronically. After successful implementation of Indian Customs Electronic Data Interchange System (ICES) in Delhi Customs House, the system was rolled out across all Customs Houses in the country. ICES has two aspects – internal automation of customs houses and online, real time interface with various agencies concerned with customs clearance of import and export cargo through Indian Customs Electronic Data Interchange Gateway (ICEGATE).

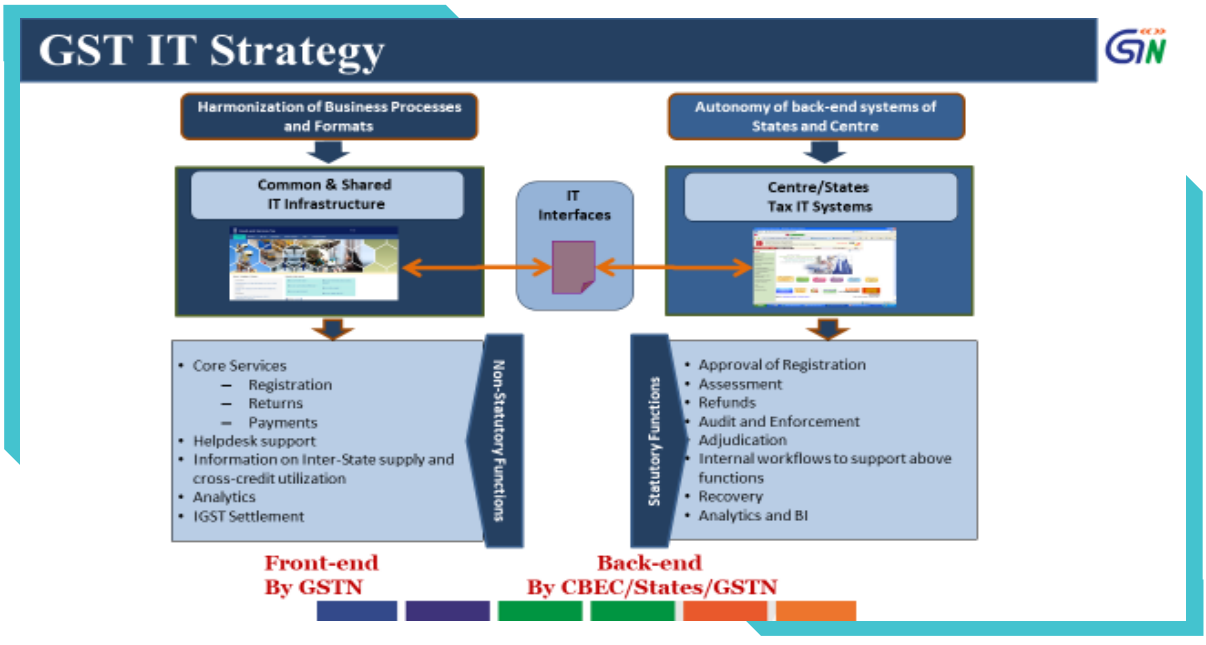
Subsequently, digitisation of services provided by the Directorate General of Foreign Trade (DGFT) commenced in 2015 with the online issuance of Importer Exporter Code, which was subsequently extended to other services and a complete system driven rule based automation was implemented in June 2024.

Similarly, digitisation of Central Excise and Service Tax work processes commenced with Automation of Central Excise and Service Tax (ACES) being taken up as an e-governance initiative, as one of the Mission Mode Projects under the National e-Governance Plan. It was initially rolled out in December 2008, in one Commissionerate in Bengaluru and later implemented across India in phases to all the then 104 Central Excise and Sales Tax Commissionerates.

The introduction of Goods and Services Tax (GST), envisaged as a destination based consumption tax to be levied simultaneously by the Centre and the States across the production - distribution chain of goods and services, has been a landmark reform initiative in the indirect taxation regime towards unification of taxes and markets. Tax moves along with the supply,

providing businesses with a seamless flow of input tax credit by removing the cascading effect and border restrictions on movement of goods.

With technology backbone provided by GSTN undergirding tax administration, the GST has ushered in next generation reforms especially from the from the technology perspective.




GSTN's IT system provides a single point interface for assesses with a common PAN based taxpayer ID, ensuring integration with tax administration systems (back-end applications) of Central and State Governments and other stakeholders, including accounting authorities and functioning as a clearing house mechanism for settlement of IGST amongst the Centre and the States apart from providing analytics and business intelligence to tax authorities.

From an External Auditor's perspective, introduction of the GST brought in both challenges and opportunities.

## Reorientation of Audit

Revenue audit has always focussed on issues that have systemic connotation as well as compliance issues, but was constrained with lack of complete access to Information Systems and granular data. Limited access to backend application and periodic data dumps were available on the Customs side. Therefore, as an institution, we resolved that a data led approach with a predominant systemic orientation should be the way forward on the GST side, so that Audit can replicate the Executive's principle of being as non-intrusive as feasible. The principal challenge of establishing the data led approach was gaining a meaningful access to data and backend IT systems of tax departments.

Pro-active, persistent follow-up and intervention at the apex level yielded results. Ultimately, the GST Council and the GST Implementation Committee accepted our suggestion, paving the way for an institutionalised mechanism providing access to both pan-India and backend IT systems.

The GST data access arrangement finalised with the Government essentially comprises the following:

- Audit will have access to full pan-India data at GSTN premises, and access to backend systems of the tax departments
- Audit would be physically verifying around 10 per cent of the transactions
- In respect of the transactions identified for physical verification (around 10 per cent) the data dump will be provided on IA&AD systems

Consequently, we could formalise the data led approach within the Department in July 2020, which seeks to establish an institutional framework for digital audit of GST revenues and also to overcome the challenges in conventional audit.

Conventional audit, was impaired by lack of access to data. While access to IT systems was not available, access to data sets was also limited to summary level data impairing the quality of audit planning. Risk analysis was limited to a generic assessment at the audit unit level (Ranges, Divisions, Circles) thereby restricting sampling to that level. This inherently impaired the ability of the Department to scope compliance audit endeavours to specific subjects/dimensions. Compliance audits were therefore addressing a broad set of issues/areas in each audit unit, the breadth and depth of which were dissimilar across audit units and audit jurisdictions leading to exception-based reporting.

Conceptually, the data led approach seeks to address this problem statement and establish and sustain an end-to-end risk-based approach - from planning and sampling to determining the nature and extent of substantive audit as well as to establish the rigour of process documentation. The core team constituted for centralised data analysis and extraction comprises both domain and IT personnel. This enables a seamless process of translating the risk parameters into executable data queries. The veracity of the queries is verified before allowing extraction of a pan-India sample. After sample extraction and before commencing substantive audit on the field, a data driven desk review of each case of the selected sample has also been institutionalised to identify red flags/compliance deviations and substantive audit of each sample would only be in furtherance of these identified red flags.

Therefore, the compliance audit in GST regime has transitioned from a generic application of all the defined audit checks in the Audit Design Matrix to a focussed application of only those audit checks, in each case, as reflected by the outcome of risk analysis. GST Audit reporting has moved from exception-based reporting to an assurance-based reporting with the extent of deficiencies reported against the corresponding population. Such assurance-based reporting is being leveraged for every issue or theme considered for reporting, thereby providing a perspective to the Executive both on the quantum and frequency of compliance deviations from a resolution point of view.

Secondly, our approach has been to evaluate the underlying IT systems (even at their evolution stages) simultaneously with compliance audits so as to enable meaningful interventions for the Executive, in terms of systemic corrections/improving validation weaknesses and to gain an assurance on the control environment driven by technology.

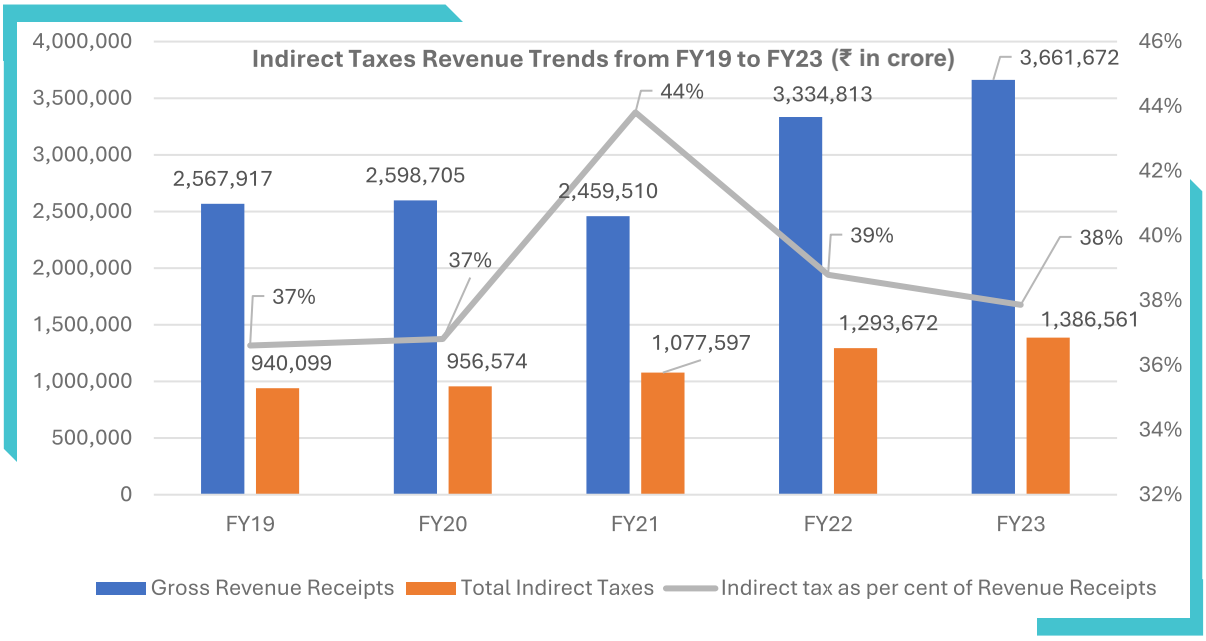
The benefits of the data driven approach to audit of GST have begun to fructify. Benefits have accrued both to Audit and the Executive. On the Audit side, this approach has promoted audit efficiency, enhanced audit outcomes and achieved greater executive acceptability. On the other hand, it has stimulated the Executive in reinforcing controls to enhance compliance and consequently improve revenue collection.

Audit on the Customs side encompasses the audit of Customs field formations under Central Board of Indirect Taxes and Customs (CBIC), Ministry of Finance and field formations of Directorate General of Foreign Trade (DGFT) under Ministry of Commerce and Industry. Data access issues has been partly resolved as DGFT provides data dumps every year and CBIC has been providing access to their backend application and data sets for the selected Performance Audits. However, the data access arrangements, on the lines established for GST, which has been agreed to, needs to be operationalised.

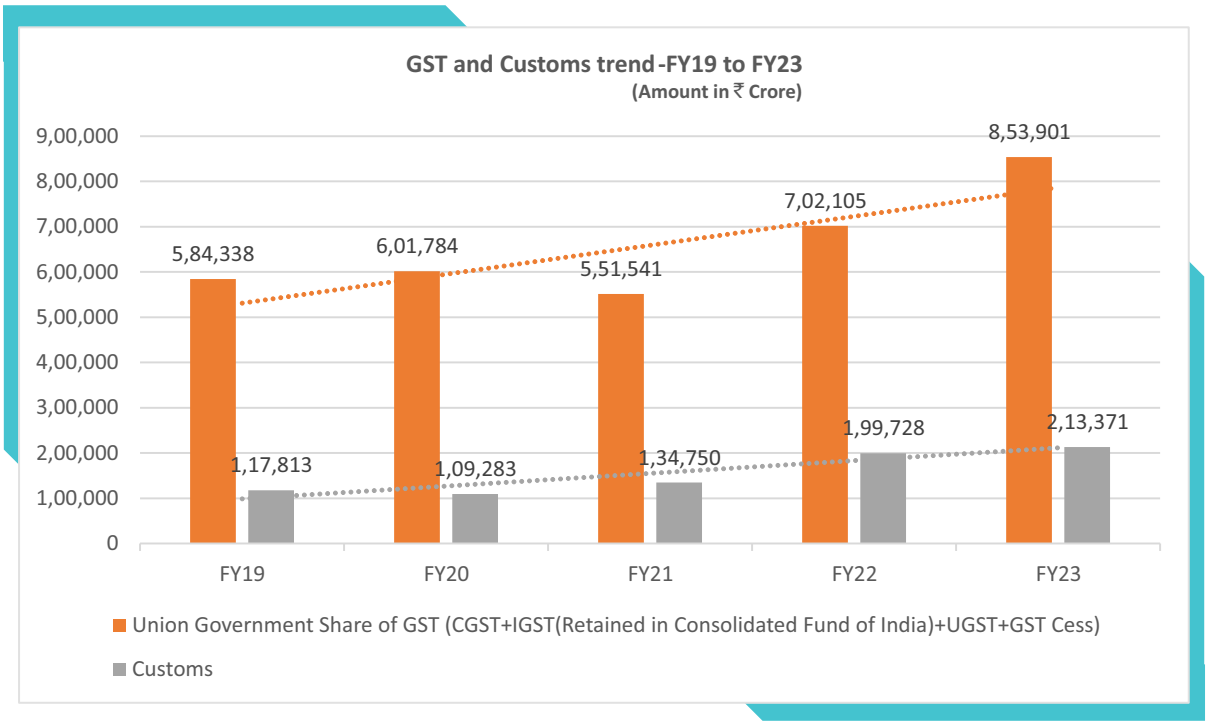
Similar to that of GST, the approach on the Customs side was also towards evaluating systems and performance of the various export promotion and trade simplification schemes so as to reinforce the importance of systemic measures, IT validations and increased co-ordination between the CBIC formations under the Ministry of Finance and DGFT formations under the Ministry of Commerce and Industry as policy formulation and implementation of the schemes are spread across the two Ministries.



## Revenue Trends-Indirect Taxes




Indirect Taxes share in the Gross Revenue Receipts have been consistent from 37 per cent in FY19 to 38 per cent in FY23. However, Indirect taxes collections increased from ₹ 9,40,099 crore in FY19 to ₹ 13, 86,561 crore in FY23. Trends in respect of GST and Customs for the above period is given in chart below.




Similarly, GST revenue (CGST+IGST+UTGST+GST Compensation Cess) had shown an increasing trend and increased from ₹ 5,84,338 crore in FY19 to ₹8,53,901 crore in FY23. With respect to revenue from Customs, Customs receipts increased from ₹1,17,813 crore in FY19 to ₹2,13,371 crore in FY23.

# Impact of Audit

Over the years, the audit of GST and Customs has yielded actionable recommendations at the process and procedural levels, which have found a wider acceptability amongst the Executive. While recognising that the governance ecosystem has a continuous cycle and pace of identifying gaps in processes/procedures and remedying them, the audit recommendations were seeking to underscore their functional expediency and to serve as a catalyst for initiating corrective action. While audit on the taxes side invariably involves revenue implication in terms of either short levy of tax or excess utilisation of Input Tax Credit (ITC), we have reflected upon the impact of audit from a larger perspective of all the recommendations made over the last decade on the indirect taxes side, which having been accepted by the Executive, were either addressed or incorporated as a part of changes in provisions of law, processes, procedures and functionality upgradations.

## Impact of audit - GST

Audit of GST, since inception, has been set against a backdrop of a newly introduced law and newly established systems, both of which are evolving. Over the last eight years since the introduction of GST, we have audited[9] the transitional provisions, the IT system of GSTN and the GST payment and return filing process in two phases and have come up with some pragmatic recommendations. The impact of audit, from the perspective of accepted recommendations, can be categorised under the following broad themes:

a) Technology related – feature enhancements

b) Accounting related – procedural amendments

c) Process related – systemic improvements

d) Compliance issues– rectifications and clarifications

### Technology related – feature enhancements

The Information Technology system developed by GSTN, is the backbone for tax administration under the GST regime. The system designated as a common portal, has been functioning as the front-end interface of the overall GST IT eco-system and provides for filing of registration application and various types of GST returns, creation of challans for tax payment, settlement of IGST payment, and development of Business Intelligence and analytics.

The various functional modules of the Infrastructure Technology infrastructure were rolled out in phases and as such audit was also conducted in phases. The first phase of IT audit, conducted between May and August 2018, covered two modules - Registration and Payments apart from a review of the IGST settlement reports and the second phase, conducted between October 2019 and July 2020, covered the other two modules - Refunds and Returns as well as the E-Way Bill system implemented by NIC Bengaluru. The audit findings from these two phases featured in

9 CAG Report no 11/2019, 1/2021, 5/2022, 7/2024

CAG Audit Report no 11/2019 and 1/2021 respectively contained 56 accepted recommendations, out of which 38 recommendations have been fully implemented, one partly implemented and rectification is in progress in three cases. While details of the implemented recommendations are given in Annexure I, the key rectifications/feature enhancements in each of the modules included the following:

- **Registration:** This module dealing with the processes of applying for registration, verification and approval was allowing registration
  - o of manufacturers of specific products such as ice cream, pan masala, tobacco and manufactured tobacco substitutes under Composition Levy Scheme, though it was not permitted, which has since been rectified.
  - o leaving the selection of GST jurisdiction (Centre or State) to the taxpayers, who were entering them incorrectly, which has been automated based on defined input criteria
  - o with place of business details provided incorrectly, which was amended
- **Payments:** Designed to enable tax payments both in cash from the Electronic Cash Ledger or by using ITC from the Electronic Credit Ledger, this module did not have a feature to accept payment through debit/credit cards, which has been enabled.
- **Refunds:** The Refund module deals with receiving applications from taxpayers for refund of tax paid on account of exports or inverted duty structure etc and processing the refunds as per rules. Audit had highlighted validation weaknesses in the Refund module leading to excess IGST refunds, re-credits to ITC even when deficiency memo was issued, and non-exclusion of ITC credit on capital goods etc, which have been rectified in the system.
- **Returns:** This module facilitating taxpayers to file all periodic returns online, suffered from absence of validations across various returns, incorrect mapping of business rules, permitting ITC availment on ineligible transactions and to ineligible taxpayers and non-computation of interest, which have been rectified.
- **E Way Bills:** Designed to enable generation of E-Way Bills (EWBs) by the consignors, consignees as well as by the transporters for evidencing movement of goods, the inadequacies in this module allowed errors in auto-calculation of distance, deficiencies in rejection or extension of EWBs, deficiencies in recording supply to or by a SEZ and through a multi-vehicle mode of transport. All of these deficiencies were rectified after they were highlighted by Audit.

### Accounting related – procedural amendments

Article 270 (1) of the Constitution of India excludes duties levied under Article 269(A), i.e., Integrated Goods and Service Tax (IGST), from list of taxes and duties to be distributed between the Union and the States.

Further, Section 17 (2A) of the IGST Act, 2017, envisages that the amount not apportioned under

10 Section 10(2)(e) of CGST Act 2017
11 For applicants with turnover less than `1.5 crore- 90% to State and 10% to Centre. 50% each for other applicants

sub-section 17(1) and sub-section 17(2) of the IGST Act, 2017, may be apportioned at 50 per cent to the Central Government and 50 per cent to the State Governments or the Union territories, on the recommendation of the council, on ad-hoc basis and shall be adjusted against the amount apportioned under the said sub-sections.

- **Accounting and treatment of IGST:** When Audit highlighted that the Government had irregularly devolved the IGST of ₹ 67, 998 crore to the States/UTs, using Finance Commission formula, out of the year-end IGST balance of ₹ 1,76, 688 crore in the Consolidated Fund of India during FY18, the Government, in FY20 and FY21, reversed and apportioned the IGST devolved during FY18, as pointed out by Audit, and during FY19. (Para 2.1.3 of AR 11 of 2019).
- **Retention of IGST in the Consolidated Fund of India:** During the FYs 2018-19, 2019-20, 2020-21 and 2021-22, the Central Government had retained year-end IGST balance of ₹ 13,944 crore, ₹ 9,125 crore, ₹ 7,251 crore and ₹ 2,119 crore respectively, in the Consolidated Fund of India as there was no mechanism to treat the un-apportioned balance of IGST left at the end of a year. After Audit reported this, Department of Revenue introduced an accounting procedure for adjustment of un-apportioned amount of IGST at the end of a financial year and its apportionment in the subsequent years. The implementation of the new accounting procedure would ensure proper accounting adjustment of the un-apportioned amount of IGST balances at the end of financial year. (Para 1.3 of AR 7 of 2024).

### Process related – systemic improvements

The Central GST Act and the State/Union Territory GST Acts stipulate, among others, the provisions for registration, valuation of supplies, assessment, levy and collection of taxes, while the accompanying Rules prescribe the procedures to be followed. These have been reviewed in the Subject Specific Compliance Audits that have so far been conducted in the GST regime, which underscored the following pertinent issues. Simplification of returns was significant from the taxpayers' perspective, while other issues contributed to strengthening the functioning of the Department.

### Taxpayers' perspective

- **Simplification of Returns:** Since inception of GST, Audit has been consistently reviewing the progress of implementation of simplified return system based on system-verified flow of ITC and reported gaps (Para 1.6.2 of AR 11 of 2019; Para 1.4.1 of AR 1 of 2021; Para 3.1 of AR 5 of 2022; and Para 3.1 of AR 7 of 2024). The current system, while auto-populating tax liability and eligible ITC in the monthly GST return, allows for changes in the auto-populated amounts with a view to providing flexibility to taxpayers to accommodate corner situations that may necessitate revision/amendment to the auto populated figures.

12 monthly return furnished by all normal and casual registered taxpayers making outward supplies of goods and services or both, and contains details of outward supplies of goods and services

13 monthly summary return of outward supplies and input tax credit claimed, along with payment of tax by the taxpayer to be filed by all taxpayers except those specified under Section 39(1) of the Act. This is the return that populates the credit and debits in the Electronic Credit Ledger and debits in Electronic Cash Ledger

One of the basic deficiencies in the system, highlighted by Audit, was that filing of GSTR-1[12], containing details of outward supplies, was not made mandatory before filing of GSTR-3B[13], through which tax payment is discharged, thereby allowing a mismatch between declaration of supplies and discharge of corresponding tax liability and potentially allowing taxpayers to delay declaring outward supplies and delay/avoid tax payment. As a consequence, the system was exposed to inherent deficiencies in auto-populating tax liability and available ITC, when GSTR-1 has not been filed.

Subsequently, Section 39 of the CGST Act, 2017 has been amended in 2022 (w.e.f 1.10.2022), to provide for mandatory requirement of filing of GSTR-1 before GSTR-3B return for a tax period. Further, Section 37 of CGST Act, 2017 has also been amended to make filing of GSTR-1 sequential i.e., a taxpayer will not be able to file GSTR-1 for a tax period unless the d GSTR-1 returns for earlier periods have been filed.

**Department perspective**

- **Scrutiny of GST Returns:** Another aspect that has consistently been emphasised (Para 1.4.2 of AR 1 of 2021; Para 3.2 of AR 5 of 2022; and Para 3.2 of AR 7 of 2024) is to establish and implement, at the earliest, an effective risk based standardised system of returns' scrutiny (with detailed instructions/standard operating procedure) so that the Department has sufficient time to take action against non-compliant taxpayers before time-barring of cases as per law. Such a scrutiny should involve risk-based selection of returns, and the results of the scrutiny should also be captured in real-time through the CBIC-GST System to ensure transparency and minimize arbitrariness.

  The Department initially issued a Standard Operating Procedure (SoP), in March 2022, for scrutiny of Returns, which was applicable for the years 2017-18 and 2018-19. Subsequently, the Department deployed (May 2023) the Scrutiny module in its CBIC-GST System and revised its Standard Operating Procedure. The Scrutiny Module provides a dashboard and establishes a work flow for the field officers to perform scrutiny of returns and records interaction with taxpayers.

- **Data reliability:** Data reliability and integrity is another facet that has been regularly reviewed (Chapter IV of AR 5 of 2022 and Chapter VI of AR 7 of 2024). During 2021-22, Audit analysed GST returns data pertaining to the period 2017-18 to 2019-20, as filed by taxpayers up to August 2021, and noticed significant data inconsistencies between the taxable value and declared tax liability, CGST and SGST components of GST and between ITC figures captured in monthly return and annual returns.

  During 2022-23, Audit observed persistent data inconsistencies between ITC claim in monthly return (GSTR-3B) and declaration thereof in annual return (GSTR-9), the CGST and SGST components of GST, taxable values, rate and tax liability declared and inconsistency in tax liability between monthly and annual returns.

Audit had recommended that the Ministry should consider introducing appropriate validation controls supplemented by post-facto data analytics in respect of important data elements. The validations have been progressively improved and the data entry errors have also reduced.

- **Refund claims in GST:** The refund related issues were exclusively examined and deficiencies in process were highlighted. Significant among these were the following:

  - o Audit had recommended that a system of real time/near real time red-flagging of high-risk taxpayers/refunds may be implemented in the refund related modules to avoid refunds of fake ITC.

    A system of assigning risk score to various GST refund applications filed on portal based on various risk parameters has been initiated by Directorate General of Analytics and Risk Management (DGARM) since July 2022.

  - o Another recommendation was to implement a robust post-audit system based on checklists and a SoP and develop a module for post-audit of refunds in the GST CBIC system for effective monitoring

    DG (Systems)/ CBIC is working to operationalize on a post-audit electronic module in the system

  - o Audit observed that there was no verification mechanism to ascertain the status of receipt of proceeds from exports after grant of refund and it was recommended that the e-BRC module (for electronic Bank Reconciliation) of DGFT may be integrated with GSTN and cases where export proceeds were not received within the prescribed time may be examined for excess refunds paid.

    GSTN is integrated with ICEGATE (Indian Customs Electronic Gateway) and integration with e-BRC of DGFT is underway.

### Compliance issues – rectifications and clarifications

The focussed application of audit checks in the SSCAs also highlighted a range of compliance issues on the functioning of the departmental formations of CBIC as well as in the GST returns filed by taxpayers. Many of the issues flagged have either been rectified or clarifications provided. To provide a perspective, while compliance deviations reported in CAG Audit Reports in the legacy Central Excise and Service Tax regime over a period of six financial years immediately preceding the implementation of GST involved an average revenue implication of ₹ 650 -₹ 750 crore, the first phase of data driven audit of GST returns on the central side covering the GST returns for 2017-18 alone, disclosed compliance deviations with a revenue implication of ₹ 2,672 crore. Additionally, this approach is being leveraged in all the 31 State GST audits, the results of which are separately reported in the respective State Audit Reports.

# Impact of Audit - Customs



Audit of Customs is set against a backdrop of DGFT framing and administering trade policies and trade promotion schemes and the Customs formations implement the schemes by assessment and levy of Customs Duty, including granting exemption from levy of Customs Duty. Both DGFT and Customs have developed automated workflow systems for conducting business in a digitised environment. While Audit intrinsically involves assessing compliance and identifying shot levy of duty and irregular availment of exemptions, the focus over the last decade has been on Performance Audits to evaluate various trade promotion schemes, specific jurisdictions and their IT systems, with a view to identifying gaps in performance and providing actionable recommendations. The cross-cutting theme was to highlight the extent of manual interventions in implementation of the schemes and inadequate co-ordination between the various departments, thereby emphasising on complete automation of work flows and integration with all participating agencies. Over the years many of these recommendations have been implemented towards simplification of processes and procedures and contributing to enhanced performance levels from a department perspective as well as benefiting trade. A temporal scan of these recommendations discloses that impact of audit has largely come about in the following broad themes:

a) Performance of Schemes – output enhancements

b) Management of Custom bonded premises – process improvements

c) Compliance issues– rectifications and clarifications

## Performance of Schemes – output enhancements

Amongst the various trade promotion schemes launched, our Performance Audits focussed on specific ongoing promotion schemes such as Drawback on deemed exports, Project Imports and Advance Authorisation, an overall assessment of Import Export Trade facilitation and Merchandise Exports from India Scheme (MEIS) and Services Export from India Scheme (SEIS) which have since been discontinued. The key improvements emanating from the performance audit of these schemes included the following:

- **Deemed Exports Drawback – (AR 8 of 2013):** The Terminal Excise duty were being refunded for supplies made to Export Oriented Units, though such supplies were ab-initio exempted from payment of excise duty - (Para 3.75).

  DGFT issued a circular (March 2013) to restrict refund of Terminal Excise Duty in respect of Export Oriented Units.

- **Import Export Trade facilitation – (AR 13 of 2015):** The evaluation of the overall trade facilitation process for imports and exports on a sample selection of Custom ports disclosed pain points from the traders' perspective and systemic deficiencies, which were highlighted and have since been remedied:

  - **Errors in Bills of Entries and Export General Manifest:** Bills of Entries and Export General Manifest filed by filed contained errors, requiring manual amendments thereby leading to delays in processing. Audit had recommended an online amendment facility - (Para 6.2.3).

    The Department enabled (October 2015) online amendment of Bills of Entry and EGMs in Indian Customs Electronic Data Interchange System (ICES) and trade can now submit amendment requests electronically in ICES and minor clerical/ typographical errors of taxpayers will be auto-approved.

  - **Examination at factory premises:** Extant provisions envisage that the goods meant for exports could be examined at factory premises also, and this facility was being poorly utilised by the Department. Audit had recommended extensive utilisation of this facility and simplification of factory stuffing permissions (facility to enable exports to load and seal containers at their factory premise/warehouse).This could facilitate trade as it enables reduction of cost as well as transit time on moving containers for inspection - (para 6.4.2).

    Central Board of Excise and Customs (CBEC) came out with a specific instruction (October 2015) to simplify permission for factory-stuffing under Authorised Economic Operator/Accredited Clients Programme. Commissioners have been directed to grant factory-stuffing permission to AEO clients as a matter of course.

  - **Functioning of Trade Facilitation Committees:** Permanent Trade Facilitation Committees (PFTC) were not meeting monthly and minutes were not being placed online - (para 9.3.2).

The Department issued instructions (June 2015) directing all Commissionerates to hold PTFC meetings monthly and upload minute on Commissionerate websites within seven days, which benefits the trade as issues discussed and proposed resolutions would now be transparently available.

- **Disposal of Unclaimed/Uncleared Cargo:** Large volume of uncleared/unclaimed cargo was getting accumulated congesting Container Freight Stations, which was not being reviewed - (para 10.2.1).

Systems Directorate of CBEC has enabled (September 2015) a functionality in the system to flag uncleared cargo automatically for Commissioner's review.

- **Incentives for Trans-shipment Cargo:** In the case of trans-shipment cargo, which require change of mode of transport or change of vessel at an intermediate location before leaving the shores of India, the export incentive (drawback) was being allowed only when the vessel left Indian shore. Audit recommended that the export benefits could be granted once goods leaves the port of origin - (para 10.5.2).

CBEC issued (July 2015) an instruction that for trans-shipped cargo, drawback shall be admissible upon shipment at the origin port.

- **Project Imports – (AR 42 of 2016):** The Projects Imports Scheme envisaged simplification and faster customs clearance by classifying all imports of machinery, equipment, raw materials, etc. required for initial setting up or for substantial expansion of an existing project, under a single Tariff under CTH 9801 in the Customs Tariff Act, 1975. Audit observed several deficiencies that were plaguing the implementation of the scheme, and the important changes that have since been introduced are featured below:

  - **Inconsistency in instructions:** Audit observed that CBEC was relying on its circular (8 August 1987) for assessing project imports, which envisaged that once a contract was registered under the Projects Imports Scheme, all imports under the contract are liable for classification and assessment under CTH 9801 while the Apex Court rulings had held that assesses are eligible to avail benefit of any exemption notification, which are more beneficial to them. Audit recommended that this inconsistency need to be removed - (para 3.1).

CBEC withdrew (July 2018) the obsolete instructions and aligned project imports classification suitably.

  - **Time bound completion of projects:** No time frame was prescribed in the Scheme for completion of projects and contracts registered under the Project Imports Scheme were left open-ended. Audit recommended mandating a prescribed time frame for completion of projects - (para 3.2).

CBEC prescribed (March 2018) time bound conditions for imports under the Scheme.

  - **Ambiguity in role of Sponsoring Authority:** In case of composite projects that involve multiple authorities of the Government, who are designated as Sponsoring Authorities, there was ambiguity in interpretation of rules, leading to classification

issues for imports under the Scheme. Audit recommended designated a primary sponsoring authority for composite projects - (para 3.3).

CBEC clarified (February 2017) roles of Sponsoring Authorities and prescribed uniform certification requirements.

- **Voluminous documentation and delays in process:** Audit observed that excessive documentation to be produced by importers would discourage SMEs and recommended simplification - (para 5.4).

CBEC simplified (November 2018) documentation requirements for reconciliation and finalisation of Project Imports contracts.

- **Weak automation:** Audit observed that the work flow application ICS had various deficiencies in terms of gaps in data collection, weak monitoring of bonds and manual Telegraphic Release Advice (TRA) in cases where imports are made through Ports other than the Port of registration. Audit recommended developing a dedicated module for management of Project imports, bond monitoring and a centralised database for Project Imports - (paras 6.1 to 6.3).

DG (Systems) of CBEC introduced (October 2018) a centralised bond management module, rolled out Project Import Module in ICES 1.5 and created a centralised Project Import database (April/May 2019).

- **MEIS and SEIS – (AR 5 of 2020):** Merchandise Exports from India Scheme and Services Exports from India Scheme were introduced in the Foreign Trade Policy (2015-2020) to promote export of notified goods manufactured/produced in India and promote export of eligible services from India. Audit highlighted several process related deficiencies in administering these schemes hampering the efficiency of these schemes. The notable changes in processes and procedures introduced to address these deficiencies in the scheme are highlighted below:

  - Deficiencies in the module and delays in issuance of scrips under MEIS and SEIS: The system required manual overrides for basic validations and checks for ineligible claims were inadequate. Significant delays were observed in processing and issuance of scrips due to manual interventions and system deficiencies, defeating the purpose of automation - (paras 2.1 to 2.2).

The DGFT Electronic Data Interchange system was upgraded (March 2021) for MEIS/SEIS with eligibility checks built in and a provision to log and audit manual interventions. Additionally, DGFT extended (September 2020) the validity of scrips issued under MEIS/SEIS to mitigate delays and ensure timely utilization.

  - Non-exclusion of inadmissible components from FOB value: Incentives were being granted on full FOB without deducting commission, freight, etc., leading to over-incentivization - (para 2.10.1).

A notification was issued (September 2020) amending the Handbook of Procedures 2015-20 and prescribing mandatory deduction of Cost, Insurance and Freight components from FOB for MEIS calculations.

- **Ineligible services rewarded under SEIS:** Rewards were granted for services not listed as eligible services (Appendix 3D of the Handbook of Procedures) based on unreliable CA certificates- (para 3.3).

A public notice was issued (August 2021) communicating revised guidelines for SEIS claims, prescribing mandatory pre-verification of service classification against Appendix 3D and envisaging that CA certificates to be cross-checked with RBI data.

- **Failure to distinguish eligible modes of service export:** Incentives are not eligible under the Scheme, where services are provided through commercial presence in other countries or presence of natural persons in other countries. Excess rewards were granted due to non-segregation of eligible modes of services from the ineligible modes of service - (para 3.4).

Department issued a circular (February 2021) providing clarification on modes of service exports under SEIS, stipulated mandatory declaration of mode of service in e-BRC and auto rejection of ineligible modes by the system.

- **Advance Authorisation Scheme– (AR 10 of 2021):** The objective of Advance Authorisation Scheme is to provide registered exporters with their requirement of basic/raw materials at international prices without payment of Customs Duty in India, subject to the condition of export of manufactured goods with specific percentage of value addition. Audit observed process delays, lack of norms and co-ordination, which have since been addressed by the Executive Departments.

  - **Delay in issuance of Advance Authorisations and Export Obligation Discharge Certificate (EODC):** Even with an online mechanism, the Advance Authorisations were being manually and with delays, and mandatory upload of documents was not implemented. Audit recommended full digitisation and that DGFT should align its online module to accept only fully complete applications so that EODC target of 15 days is achievable – (paras 2.2 and 3.2.6).

A policy circular was issued (May 2019) and DGFT came up with a trade notice (November 2020) conveying migration to a new platform effective form December 2020.

- **Lack of Message Exchange Module (MEM) and poor DGFT-Customs coordination:** Non-implementation of MEM caused delays in bond closure and lack of EODC status exchange between DGFT and Customs

The DGFT Trade Notice (November 2020) confirmed migration to the new DGFT e-platform envisaging improved data transfer to Customs for seamless EODC reconciliation.

Management of Custom bonded premises – **process improvements**

The functioning of Special Economic Zones, Inland Container Depots and Container Freight Stations, Customs Bonded Warehouses and Free Trade Warehousing Zones were reviewed over the last decade to review their performance from the perspective of achieving their envisaged outcomes and the gaps that need to be addressed.

- **Performance of Special Economic Zones – (AR 21 of 2014):** A Special Economic Zone (SEZ) is a geographical region within a nation, notified under a SEZ Act, to which comparatively liberal economic policies apply and are outside the normal customs territory of India. To establish a new regulatory framework, Government of India announced a SEZ policy in April 2000 as a part of the EXIM policy, which was followed by dedicated SEZs in February 2006. The objectives of setting up SEZ is to promote economic growth and development, creation of employment and infrastructure. Audit highlighted shortfalls in the envisaged outcomes and inadequate monitoring mechanism and the Ministry has since reviewed the SEZ Act and Rules and addressed these issues.

  - **Inadequate monitoring mechanism:** The envisaged economic impact of establishing a SEZ was in terms of investments, exports and earnings in foreign exchange. Audit while noticing shortfalls in investment, exports and foreign exchange earnings on the part of SEZ developers vis-à-vis their projections observed that there was no monitoring mechanism to ensure that the envisaged economic impact is being achieved. Audit recommended measurable performance indicators so that real socio-economic benefits accrue to citizens and the States – (paras 2.3, 2.4, 2.5 and 6.1.1)

    Ministry of Commerce and Industry constituted a Committee for reviewing SEZ Act/Rules and recommended (Committee recommendations August 2017 and subsequent notification of September 2018 and March 2019) adding Rule 19(B) wherein renewal of Letter of Authorisation would be granted on the basis of projections and evaluation on performance of the unit as per conditions given at 19 (6) (B).

  - **Deemed Exports and Foreign exchange earnings:** The SEZ unit were not achieving the physical export commitments and were resorting to deemed exports and not earning the envisaged foreign exchange earnings as per Rule 53 of SEZ Rules. Further, the sales in Domestic Tariff Area (DTA) on foreign exchange terms was being reckoned as a trading activity and realisation of Net Foreign Exchange Earnings – (paras 5.16 and 5.25)

    The Committee constituted by the Ministry of Commerce and Industry recommended (Committee recommendations August 2017 and subsequent notification of September 2018) comprehensive changes in Rule 53 and incorporated a condition of manufacturing goods in India before extending the benefits of deemed exports to SEZ units. Further, the supply of goods in the DTA counted towards Net Foreign Exchange Earnings were reduced from the exiting 15 categories to 11 categories.

- **Functioning of Inland Container Depots and Container Freight Stations – (AR 16 of 2018):** Inland Container Depots (ICDs) and Container Freight Stations (CFSs), also known as dry ports, are multimodal logistics centres with public authority status in Customs and play important role in trade. They are connected to a sea port either by road or rail and serve as trans-shipment points for import and export cargo. They offer services for handling and temporary storage of import/export laden or empty containers, warehousing and re-export. Audit had observed structural issues with the establishment and performance of ICDs and CFSs, which were accepted and addressed.

  - **Inadequate framework for setting up/approval of ICDs and CFSs:** Apart from an Inter-Ministerial Committee, constituted in 1992, to act as a single window clearance for proposals for setting up of ICDs, CFSs and AFSs (Air freight Stations), there was no formal policy document or notification for setting up ICDs or CFSs. Procedural guidelines containing checklist of steps for granting approval to proposals for setting up ICDs/CFSs were only available. The approval process did not include an assessment of capacities created and utilised - (paras 3.1 and 3.3).

    CBIC came up with a circular (November 2020) to provide a framework of policy and guidelines for setting up and approval of ICDs, CFSs and AFSs, addressing procedural gaps and setting out evaluation principles

  - **Inadequate infrastructure at ICDs:** ICDs were functioning without adequate infrastructure, basic equipment, specified demarcated areas and space for storage of hazardous goods– (paras 4.1 to 4.3).

    CBIC issued a circular (October 2020) specifying the procedure for inspection of ICDs/CFSs/AFSs, to verify compliance with infrastructure requirements, demarcated areas for import/export cargo, fumigation and separate hazardous goods storage.

  - **Inadequate monitoring mechanism:** Audit observed lack of proper monitoring of the movement of export and import cargo pendency of uncleared cargo and undisposed hazardous containers – (paras 5.1.1, 5.2 and 5.3).

    CBIC's circular (October 2020) also prescribed regular inspections to verify operational status of Export Trans-shipment Module/Import Trans-shipment Module, electronic monitoring, inspections to monitor uncleared cargo pendency and specific checks during inspections for hazardous cargo storage and disposal compliance.

- **Working of Customs Bonded Warehouses and Free Trade Warehousing Zones - (AR 19 of 2022):** A Customs Bonded Warehouse (CBW) is a secure, customs supervised facility where imported goods can be stored, processed or repackaged before customs duties are paid. Free Trade Warehousing Zone (FTWZ) is a special category of Special Economic Zone with a focus on trading, warehousing and other related activities. Audit observed process deficiencies with the working of CBWs and FTWZs impeding their performance, which were accepted and addressed.

- **Licensing of CBWs without comprehensive guidelines:** Detailed criteria did not exist for licensing CBWs, leading to approvals without assessing viability and infrastructure, resulting in underutilized warehouses – (paras 3.1 and 3.2).

CBEC issued a circular (September 2024) for digitization of Customs Bonded Warehouse procedures relating to obtaining Warehouse License, mandatory online application with viability assessment via ICEGATE module to ensure compliance and prevent arbitrary approvals.

- **Deficiencies in antecedent verification:** There was no SOP for antecedent verification leading to disparities at field formations.

CBIC issued a circular (February 2023) prescribing a timeline of 45 days for antecedent verification.

### Compliance issues– rectifications and clarifications

Compliance audit of the various field formations of DGFT, Customs, SEZ coupled with the audit of Bills of Entries and Shipping Bills, over the years, have also yielded significant departures from rules/provisions, involving a revenue implication of ₹ 22,250 crore, which have been reported in CAG Audit Reports. The respective Executive Departments have also addressed many of these issues reported in CAG Audit Reports and rectified them.



# List of Abbreviations

| Abbreviation | Full Form |
|---|---|
| AFS | Air Freight Station |
| AO | Assessing Officer |
| AO (Inv.) | Assessing Officer (Investigation) |
| API | Audit Potential Index |
| AY | Assessment Year |
| Addl. CIT | Additional Commissioner of Income Tax |
| C&AG | Comptroller and Auditor General |
| CA | Chartered Accountant |
| CBDT | Central Board of Direct Taxes |
| CBIC / CBEC | Central Board of Indirect Taxes and Customs / Central Board of Excise and Customs |
| CBW | Customs Bonded Warehouse |
| CERSAI | Central Registry for Securitisation Asset Reconstruction and Security Interest |
| CFS | Container Freight Station |
| CIT / CsIT | Commissioners of Income Tax |
| DGFT | Directorate General of Foreign Trade |
| DTA | Domestic Tariff Area |
| DoR | Department of Revenue |
| E-BRC | Electronic Bank Realisation Certificate |
| E-WB / EWB | Electronic Way Bill |
| EODC | Export Obligation Discharge Certificate |
| EXIM | Export-Import (Policy) |
| FTWZ | Free Trade Warehousing Zone |
| FY | Financial Year |
| GDP | Gross Domestic Product |
| GST | Goods and Services Tax |

| Abbreviation | Full Form |
|---|---|
| GST Council | Goods and Services Tax Council |
| GSTN | Goods and Services Tax Network |
| IA&AD | Indian Audit and Accounts Department |
| ICD | Inland Container Depot |
| IGST | Integrated Goods and Services Tax |
| IT | Income Tax |
| ITBA | Income Tax Business Application |
| ITC | Input Tax Credit |
| ITD | Income Tax Department |
| ITR | Income Tax Return |
| JCIT | Joint Commissioner of Income Tax |
| MEIS | Merchandise Exports from India Scheme |
| MEM | Message Exchange Module |
| MoF | Ministry of Finance |
| PAC | Public Accounts Committee |
| PACS | Primary Agricultural Credit Society |
| PAN | Permanent Account Number |
| RBI | Reserve Bank of India |
| SAPs / IAPs | Senior Audit Parties / Internal Audit Parties |
| SEIS | Services Exports from India Scheme |
| SEZ | Special Economic Zone |
| SOP | Standard Operating Procedure |
| TDS | Tax Deducted at Source |
| TRACES | TDS Reconciliation Analysis and Correction Enabling System |
| UIN | Unique Identification Number |



# Notes




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