



**DRAFT REPORT**

# **INCOME TAX ENFORCEMENT IN INDIA**

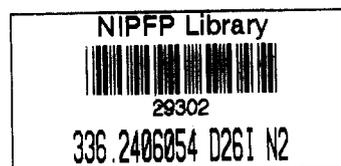
## **A Preliminary Analysis**

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## EXECUTIVE SUMMARY

### CHAPTER 1: DESCRIPTION AND EVALUATION OF ENFORCEMENT IN THE INCOME TAX DEPARTMENT

The major shortcomings of different components of assessment in the Income Tax Department identified by us are listed below.

**Information System:** The main problems here are the poor utilisation of CIB information; the ineffectiveness of surveys under section 133B of the Income Tax Act; the lack of an adequate system of taxpayer identification numbers; the lack of an adequate system of third-party information collection; the problems with security of officers engaged in search or survey; and, finally, the poor state of records and deficiencies in the record keeping system. Most of these problems can be alleviated only with substantial computerisation of the information system.

**Workload and Manpower for Assessment:** The main issues of concern are the following: wide fluctuations in workload across ranges; a possible decline in manpower devoted to assessment relative to workload in recent years; the low fraction of manpower engaged in assessment; the small fraction of time of assessing staff devoted to assessment; the large fraction of assessment time devoted to summary rather than scrutiny assessment; and the lack of suitable motivating factors for Assessing Officers to pursue revenue goals resulting partly from a poorly conceived system of targets and partly from the absence of positive incentive mechanisms.

**Assessment:** The main findings here are the increased collection yields from assessment over time; the wide variations in these yields across ranges and across Investigation circles, circles and wards; the significantly lower yields from summary rather than scrutiny assessments; and finally the design and operation of the scrutiny assessment procedure that significantly erodes its ability to detect or deter tax evasion. The probability of detection and punishment of evasion is estimated to be at most .007 during 1989-91. For taxpayers reporting below Rs 2 lakh income, assessed in the normal course, this falls to at best .00045.

**Penalties and Prosecution:** A sharp drop in the number of concealment penalty cases initiated in the last five years has been observed. An overall increase in prosecution efforts but a smaller fraction of cases dealing with tax evasion is shown by the data. A low overall scale of prosecution efforts continues to be seen despite this increase. There is an increase in the success of prosecution efforts if compounding of cases is also counted as a success though not if convictions alone are the indicator used. There has been an increase in the pendency of prosecution cases in the courts. The power of the Settlement Commission to grant immunity from prosecution, which appears to have been utilised less frequently in the last three or four years, nevertheless, weakens the deterrent effect of enforcement. The use made of powers to grant immunity under the Income Tax Act has a similar effect.

Overall, we note with concern that there appears to be a marked drop in enforcement efforts over the last five years or so, judging by a variety of indicators (manpower allocated to assessment, number of scrutiny assessments, surveys under Section 133A, penalty proceedings initiated, and prosecution complaints filed). Nevertheless, this period also witnessed an increase in yields. Whether this merely reflects the principle of diminishing returns to collection (fewer cases implying greater returns per case), or whether it reflects a significant reduction in the levels of tax compliance, is difficult to assess without further detailed analysis.

It is, nevertheless, clear that there is a bias towards pursuit of technical violations, and away from detection and deterrence of tax evasion. By and large, the design and operation of the assessment system ignores the potential for taxpayers to strategically conceal their incomes and evade tax liability. Moreover, the system provides inadequate motivation to AOs to act in the primary interest of the Department, namely the collection of revenues.

## **CHAPTER 2: PRINCIPLES AND SUGGESTIONS FOR REFORM OF INCOME TAX ENFORCEMENT IN INDIA**

A synopsis of the more important observations and suggestions with regard to the information system, assessment and manpower for assessment and post-assessment proceedings is given below. Suggestion marked with an asterisk should first, if otherwise acceptable, be tried on a limited scale and evaluated

before full-scale adoption. A pilot experiment designed to enable evaluation of various reforms in assessment practices and modifications in the organisation of assessment charges is proposed in Chapter 3 of the report.

**General suggestions and comments:** The CBDT must draw up a detailed implementation plan before commencing a reform programme. To improve enforcement, the eventual introduction of computers is absolutely necessary. Computerisation may be done initially in areas where staff perceive only benefits and no costs.

**The Information System: Basic Principles and General Suggestions:** The four key areas in an information system are collection, verification and collation, storage and retrieval. Information should as far as possible, be gathered without the need for face to face contact between the Department and assessees.

The information storage system should ensure that essential records on assessees: last for a sufficiently long time; are tamper proof; and facilitate easy retrieval of information on assessees when required.

The efficiency of any information system depends crucially on effective and regular use of taxpayer numbers. A good system of identification numbers will: have wide coverage; be permanent; have safeguards against fraudulent numbers; be in wide use to identify commercial transactions; be desired by citizens; and be easily obtained.

Third-party information should, in the course of time, become the mainstay of the information system of the Department. As third-party matching gains ground, reliance on search and survey should diminish.

Measures which reduce the need for information on assessees are to be encouraged. Foremost among such measures is presumptive taxation.

It is essential that a perspective plan with year-wise targets be drawn up with respect to storage space and storage media requirements.

## **The Information System: Specific Suggestions**

It is essential that a system of feedback from assessing charges and a review procedure for information from the Investigation Wing be instituted forthwith.

The most important ingredient of a modern information system on tax evasion is a Taxpayer Monitoring Programme. We recommend that a separate arm of the Investigation Wing be created to engage in scrutiny assessment for the Taxpayer Monitoring Programme.

Economists and statisticians should be employed by the Department for the Taxpayer Monitoring Programme. They could also be used for assessment of broad economic trends to aid effective assessment.

The emphasis of intelligence operations in the Department should shift from reliance on informants to systematic and suo-moto intelligence-gathering through covert investigations and surveillance. A system of outright purchase of information should replace the extant time-consuming process.

Consideration should be given to possible solutions to the problem of security of income tax staff.

The emphasis on quantitative targets for the Central Information Branch should be replaced by greater attention to quality. A mixture of supervision and eligibility for liberalised rewards may be tried out for this. However, these measures must be supplemented by computerised information management before any substantial gains can be expected.

Legislative amendments which would make the flow of information to the CIB from institutional third-party sources automatic should be explored. Such a system will work well only if it is linked with an efficient taxpayer number system.

All information relating to an assessee should ideally be consolidated so that all of these are simultaneously considered during assessment. The CIB should spend relatively more time in collating information as compared to its verification.

A consolidated direct tax return may be designed.

Consideration should be given to the creation of statistical cells at the range level under a statistics officer. Record-keeping units should also be set up at this level under the charge of a trained cadre of officers who will be able to supervise the work of cross-indexation and collection of records. Manpower for record-keeping and statistical cells can be drawn from other central government departments that are in the process of being pruned.

An internal committee within the Department should be set up to devise measures to curb malpractices and punish erring Chartered Accountants.

**Reform of Assessment: Basic Principles and General Suggestions:** In searching for an appropriate pattern of organisation of assessment charges, 3 requirements must be kept in view.

- i. The organisation should be flexible enough to permit manpower redeployment in response to year to year fluctuations in workload. It should, furthermore be consistent with the expansion plans of the Department to cope with the secular increase in workload which may be expected.
- ii. "Similar" cases should be within the jurisdiction, as far as possible, of the same AO so that gains from specialisation can be reaped by the Department.
- iii. Assesseees should not be able to influence to their advantage the assessing jurisdiction to which they are assigned (for example by reporting a higher or lower income): Different charges should be classified on the basis of characteristics that are not easily alterable by the taxpayer.

The allocation of manpower should be on the basis of realised returns to assessment effort. The correct allocation of manpower across different ranges should equalise the net additional returns per hour of assessment activity.

There is considerable scope for reforming the current target setting system in the direction of greater flexibility and uniformity in the setting of targets, combined with the greater use of positive incentive schemes.

Recent theoretical research suggests the value of monetary reward schemes in combating the problem of low revenue realization owing to corruption though empirical verification has not, so far, been carried out.

The overall staff strength of the Income Tax Department should periodically be reviewed and adjusted with forecasted growth in the aggregate workload in accordance with a systematic manpower plan.

The revenue return per rupee of collection costs or per assessing officer, seems fairly high so that an expansion in enforcement resources may actually enhance the net budgetary revenues of the government.

It is likely that additional outlay on proper infrastructural facilities will be more than recovered through higher revenue gains.

#### **Assessment: Specific Suggestions**

\* The most important change in the current assessment procedure is the proposed time gap of 8 months to a year between the date of submission of returns and the commencement of scrutiny assessment for the year.

\* We propose the concept of a "cellular" structure wherein similar assesseees are grouped into cells of about one hundred assesseees each.

A coherent policy designed to deter strategic concealment of income must ensure that within any homogenous stratum of taxpayers the likelihood of scrutiny increases as the reported income becomes lower:

\* Such a policy can be realized if the current distinction between wards and circles is replaced by distinctions based purely on occupation, territory, etc.

OR

\* A procedure which allows greater flexibility in work planning is to do away with wards and circles altogether. The jurisdiction of AOs will be decided afresh each year with the DC having concurrent jurisdiction over cases assigned to AOs under him. An added attraction is that it may permit greater 'distancing' of AOs from taxpayers, thereby making the system less vulnerable to corruption.

\* "Cases with high revenue potential" may continue to be assessed in special assessing charges as at present. DCs (Assessment) may be utilised to undertake assessments of difficult cases including investigation cases, assessments of cases pertaining to new lines of business or cases involving newly introduced provisions under the various direct tax acts. The number of DCs (Assessment) should be increased.

\* In the interim, till manpower deployment is streamlined, the Department may explore the possibility of developing a pool of 'roving' AOs and support staff in different regions that can be redeployed at short notice.

\* Consideration should be given to ways in which tax recovery and arrears work can be taken out of assessment charges to enable additional time to be spent on assessment activities.

OR

\* Delegate authority and responsibility for these activities from an AO to lower level staff, say at the level of inspector.

OR

\* Another possibility is the creation of a separate Collections/Recovery Wing which will be responsible for all cash transactions with taxpayers.

\* The summary checking of returns, even if there is a consolidated direct tax return, is routine enough to be delegated to an Inspector with the AO having only supervisory responsibility. This is an interim measure that is proposed till the introduction of computer based checking of prima facie errors.

\* Before the commencement of scrutiny assessment it is important that a number of pre-assessment activities are completed. Such activities include arithmetic and prima-facie checks of returns; identification of stop-filers and

non-filers; matching information in returns with past records and third-party information from the CIB; selection of cases for scrutiny; and manpower reallocation.

\* An essential element of a better scrutiny selection system would be the use of a systematic procedure rather than subjective judgment. A scoring system for a number of criteria on which information is available can initially be experimented with. The scores may increase with a designated set of presumptive factors which may be modified subsequently on the basis of experience gained.

\* We recommend that a random sample of all filed returns first be drawn. The scoring system can then be applied to the returns in this sample and files with the highest scores selected for scrutiny.

\* Most scrutiny cases should be required to undergo a routine "desk audit" by AOs while a few cases should go through intensive scrutiny, or "field audit", including detailed field enquiries.

\* Disposal targets could be set by the DC of the range in consultation with the AO in question, and after learning of the local conditions prevailing.

OR

\* A 'bottom up' decentralized targeting system may be used, as recommended by management experts.

\* A system of monetary rewards at a fraction of additional revenues realised, with a higher fraction for cases with concealment penalties being initiated, may replace the current system.

AND/OR

\* A more general system of *incentive pay*, where AOs are rewarded in terms of good performance in terms of aggregate collections, not just in terms of concealed income discovered, can also be instituted.

\* Under *self policing* a case scrutinised by one AO may be scrutinised by others as well within the same year. If such a system is successful, it will greatly reduce the need for external vigilance, inspection and audit though vigilance cannot be dispensed with altogether.

\* Besides a somewhat stepped up infrastructural outlay, a degree of decentralisation should be introduced for routine purchases instead of the current system.

**Post-Assessment Proceedings:** The objective of reform of post-assessment should be to ensure that:

- i. Penalties are imposed automatically for a larger range of technical tax offences;
- ii. The bias against small and technical offenders is removed; and
- iii. Only selected cases with high 'visibility', which would create a substantial demonstration effect, are relentlessly prosecuted to establish the seriousness of the government to punish tax evasion. Other than these cases, imposition of stiff monetary penalties and compounding of prosecution cases are resorted to;
- iv. The time taken in post-assessment proceedings is substantially reduced.

It should be considered as to whether scope exists to extend the coverage of additional tax to a broader range of technical offences.

Discretion as to the amount of monetary penalties for cases of concealment of income should continue to be vested only with officers of at least the rank of CIT but restricted further to only the conditions laid down in section 273A(4).

In order that appeals may be disposed of quickly, the feasibility of moving to a system of ex parte appeals should be explored.

\* In order to save both on manpower and time, direct admission of an appeal by the assessee before the ITAT, without the need for a prior first appeal, should be allowed if either the assessee or the Department desire it.

\* In cases with low revenue effect where no substantive legal issue is involved, it should be considered whether the CIT(A) could be made the final appeal without permitting a second appeal stage.

\* Publicity rather than punishment is the role being proposed for prosecutions. Only cases involving concealment of income or other wilful attempts to evade tax, should be considered for the launching of prosecutions. Only a small fraction of cases with high 'visibility' should actually be taken to court. For other prosecution cases, it should be the aim of the Department to settle them, as far as possible, out of court.

The provision whereby large assesseees can suo moto approach the Settlements Commission for the Commission to decide on the assesseees liability to the Revenue - and, perhaps, the Settlements Commission itself, should be done away with.

Amnesties should never be resorted to. Loopholes in the Income Tax Act, most notably the "once-in-a-life amnesty" which, due to the current state of record-keeping, may have become a "running amnesty", should be removed.

In order to improve the enforcement machinery of the Income Tax Department, it is necessary to set out a procedure for evaluating the performance of the Income Tax Department. The procedure should be designed to shed light on the effectiveness of income tax enforcement and enable areas of weakness to be pinpointed. A framework which makes use of relevant external indicators is, therefore, proposed in Chapter 2 of the report.

### **CHAPTER 3: DESIGN OF A RANGE LEVEL PILOT EXPERIMENT FOR ASSESSMENT**

Two experiments are proposed. The first one is designed to test the effectiveness of alternative organisation patterns for assessment ranges, different packages of incentives for assessment staff and different procedures for scrutiny selection. The second experiment is designed to evaluate the value of presumptive information in assessment.

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It should be mentioned that this is a preliminary study. Several issues which have not been gone into here will, it is expected, be taken up in depth in a longer study to be conducted by the National Institute of Public Finance and Policy in association with the Income Tax Department for the Central Board of Direct Taxes. However, the responsibility for any deficiencies in the report rests solely with the study team and not with those acknowledged. Here and on the title page, names of members of the study team are listed alphabetically.

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### **List of Abbreviations**

<b>AC, ACIT</b>	<b>: Assistant Commissioner of Income Tax.</b>
<b>ADI</b>	<b>: Assistant Director of Income Tax.</b>
<b>AO</b>	<b>: Assessing Officer</b>
<b>ARMF</b>	<b>: Annual Report of the Ministry of Finance,</b>
<b>CAG</b>	<b>: Comptroller and Auditor General of India.</b>
<b>CBDT, Board</b>	<b>: Central Board of Direct Taxes.</b>
<b>CC, CCIT</b>	<b>: Chief Commissioner of Income Tax.</b>
<b>CIB</b>	<b>: Central Information Branch, Income Tax Department.</b>
<b>CIT</b>	<b>: Commissioner of Income Tax.</b>
<b>CIT(A)</b>	<b>: Commissioner of Income Tax (Appeals).</b>
<b>DC, DCIT</b>	<b>: Deputy Commissioner of Income Tax.</b>
<b>DC(A)</b>	<b>: Deputy Commissioner of Income Tax (Appeals).</b>
<b>DDI</b>	<b>: Deputy Director of Income Tax.</b>
<b>DG</b>	<b>: Director General of Income Tax.</b>
<b>DI</b>	<b>: Director of Income Tax.</b>
<b>DOMS</b>	<b>: Directorate of Organisation and Management Services, Income Tax Department.</b>
<b>EARC</b>	<b>: Economic Administration Reforms Committee.</b>
<b>ITAT</b>	<b>: Income Tax Appellate Tribunal.</b>
<b>ITO</b>	<b>: Income Tax Officer.</b>
<b>RSP&amp;PR</b>	<b>: Directorate of Research, Statistics, Publications and Public Relations, Income Tax Department.</b>

## **CHAPTER 1**

### **DESCRIPTION AND EVALUATION OF ENFORCEMENT IN THE INCOME TAX DEPARTMENT**

#### **1. OBJECTIVES AND SOURCES**

This brief analysis of the workings of selected aspects of the Income Tax Department is carried out to discover deficiencies in current assessment practices and scope for improvement. Recommendations on these aspects, based in part on the review, are in later parts of the study. The analysis is not exhaustive, given the limited time, and leaves out or deals cursorily with several potentially important areas of enquiry such as tax recovery, computerisation, handling of questions of law, the judicial machinery and receipt and despatch of 'dak' and refunds.

After a brief description of the organisation of the Income Tax Department, a discussion of sources of information on assessee and assessable income follows. Next there is a discussion of manpower for assessment purposes. In the fifth section there is a description and evaluation of assessment. Section 6 examines follow up action on assessment including levy of penalty and prosecutions.

The study is based on a field survey of 5 assessing ranges in the Income Tax Department (See Appendix 1), meetings with senior officers in the Income Tax Department and secondary data from government sources such as the Ministry of Finance, the Office of the Comptroller and Auditor General and the Income Tax Department.

#### **2. ORGANISATION OF THE INCOME TAX DEPARTMENT**

In order to describe the current working of the Income Tax Department it is necessary to first describe certain features of its organisational structure. The

main functions of the Income Tax Department, from the perspective of tax enforcement and compliance, can be enumerated as follows.

- a. Design and modification of the legal framework for income tax collection.
- b. Identification of new taxpayers (or Survey).
- c. Collection of information relevant to the determination of taxes due by taxpayers (or Investigation).
- d. Determination of taxes due by taxpayers (or Assessment).
- e. Collection of taxes.
- f. Dealing with deliberate and unintended mistakes by taxpayers or the Income Tax Department through redressal of taxpayer grievances, revision and rectification of mistakes, appeals, imposition of penalties, prosecution for tax offences, inspection, audit and vigilance.

The vesting of powers for the design and modification of the legal framework, not being a part of administration, per se, is beyond the scope of this study. The following assignment of other functions currently exists in the Income Tax Department:

- a. Survey and investigation in general are the function of the Investigation Wing of the Income Tax Department. Some surveys and the bulk of investigation on a case by case basis is carried out in assessing charges.
- b. Assessment and tax collection are carried out in assessing charges which are headed by CCsIT<sup>1</sup>. There are 25 CCsIT each of whom is in charge of a specified territory.
- c. Audits are carried out by the Internal Audit Wing of the Income Tax Department and also externally by the CAG. Inspection of assessments is done both by a separate Inspection Division of the CBDT and within assessing charges by senior officers. Work within Investigation Directorates is also subject to an inspection procedure by senior officers. The Income Tax Department also has an elaborate vigilance machinery under a separate Directorate. While some powers to rectify mistakes and redress taxpayer grievances has been given to officers in assessing charges, there is a separate two stage appeals machinery, the second stage being under the Law Ministry, to redress taxpayer grievances. The first stage of appeal is to CITs(A) or DCITs(A); the

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1. A list of abbreviations used is given at the beginning of the study.

second appeal is to the ITAT. The CBDT also has a Grievance Cell. Prosecutions are, by and large, the responsibility of CsIT and CCsIT, though active supervision and control is provided by the Board with an officer of the rank of DC (the Officer on Special Duty (Legal)) attending to these matters. The CBDT also plays an active role in compounding offences.

The Income Tax Department is overseen by the CBDT, an apex body within the Ministry of Finance consisting of six members and a Chairman. The various Directorates and assessing charges report to various members or the Chairman of the CBDT. An organisational chart which focuses on the assessment and investigation machinery is in Appendix 2.

It may be seen from this discussion that there is a great deal of functional specialisation in the Income Tax Department. While this is clearly appropriate for watchdog or grievance redressal functions there is, equally clearly, a trade-off between gains from specialisation and costs of communication or coordination between assessment and investigation.

### **3. INFORMATION FOR ENFORCEMENT: SOURCES, UTILISATION AND THE RECORD KEEPING SYSTEM**

This section deals with the collection, verification, utilisation and storage of information. Section 3.1 discusses collection of information relevant to the identification of new taxpayers. Section 3.2 deals with information sources on existing assessees. Section 3.3 discusses utilization of information and Section 3.4 contains a discussion of record-keeping and information retrieval systems.

#### **3.1 Identification of New Taxpayers: Surveys and Third Party Information Matching under the Income Tax Act**

In India income tax payers constitute a small fraction of the country's population (see Table 1)<sup>2</sup>. A large number of persons having taxable income do not pay any income tax. Needless to say, this results in loss of tax revenue to the government and in an extra financial burden on taxpayers and promotes non-compliance. There is, therefore, an imperative need to widen income tax coverage by increasing the number of effective taxpayers.

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2. Figures in the table refer to individuals. The total number of assessees of all types is roughly 40 per cent more.

There are three main sources of information concerning identification of new taxpayers: surveys under Section 133B, surveys under Section 133A(1), and the Central Information Branch (CIB). We discuss these in turn.

### *Survey Under Section 133B*

Section 133B empowers DCsIT, ADsIT, AOs and also Inspectors of Income tax if authorised by the AO, to enter any building or place, within the limits of his jurisdiction, at which a business or profession is carried on and require any proprietor, employee or other person who may be attending to the business or profession, to furnish information in a form prescribed for this purpose (Form No. 45D).

Information in Form No. 45D covers various aspects of business or profession like its nature and the year in which it was started, number of employees, list of the books of account maintained, nature and number of bank accounts, gross sales or receipts, value of stock, particulars of cars and other vehicles owned by the business or profession and income from all sources.

The government has, from time to time, augmented the staff of the Directorates of Income tax (Investigation), which are mainly responsible for surveys under this section under current administrative arrangements. As a result, the number of surveys has shown an upward trend. Achievements in terms of new assesseees have, however, not been commensurate (Table 2)<sup>3</sup>.

From the responses of the officers of the Income Tax Department interviewed, we find that the Department's inadequate performance in detecting new assesseees through surveys under Section 133B can be attributed to a variety of factors, some of which are now discussed<sup>4</sup>.

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3. The figures given in the fourth column of Table 2 appear to be on the high side. The impression gained from discussion with officers of the Income Tax Department is that the ratio of new assesseees detected to surveys conducted hardly exceeds 25 per cent.
  4. A detailed examination of the working of the Investigation Directorates has not been carried out for this study. Such an examination is proposed to be carried out in the longer NIPFP study.

Under section 133B income tax authorities can collect only such information as is given by the person surveyed. They do not have any legal power to inspect books of account and documents or make detailed enquiries. We were informed that in some cases the persons surveyed refuse to furnish complete information in Form 45D. While Section 272AA does provide for penalty (upto Rs 1000) for failure to comply with section 133B, this provision is rarely invoked.

Another reason for the Department's inadequate performance is that the focus of the efforts of the Directorates of Income Tax (Investigation) is merely on achieving quantitative targets for conducting surveys. While a target for detecting new assesseees has been laid down for CCs charges which do not conduct surveys under section 133B, there is no such target for Directorates of Income Tax (Investigation) the agency which actually conducts such surveys. As a result, the qualitative aspect (reflected in terms of the final outcome of a survey) does not get adequate attention. Furthermore, in many Directorates, surveys are not evenly spread throughout the year. Most surveys are conducted in a hurry towards the end of the year. This affects the quality of surveys.

We were informed during field visits that there have been several instances in the past where re-surveys were conducted within a short period of time merely to achieve quantitative targets. Needless to say, this does not yield fruitful results and generates, instead, complaints of harassment from members of public. The CBDT has recently issued instruction to the effect that re-survey of an area should be made only after a reasonable interval of time, depending on the phase of commercial development and number of new businesses set up in the area. During the course of re-survey of the same area, only such premises may be covered which were not covered by an earlier survey. This seems to be a step in the right direction.

Inspectors conducting survey are required to give a brief supplementary report, estimating, inter alia, the income of the person covered by survey, if such estimate varies substantially from the estimate given by the person in Form 45D. As inspectors acting under section 133B do not have powers to

make detailed enquiries, examine books of account and documents and verify stock, their reports are generally based on a mere visual inspection of the place surveyed. It becomes difficult to translate this into evidence strong enough to make out a case against a person who, despite having substantial taxable income, chooses to under-report his income or not file a return of income.

#### *Survey Under Sub-section (1) of Section 133A*

A survey under section 133A(1) can be conducted at any place of business or profession. The survey powers are available to DCsIT, ADsIT and AOs. An Inspector of income tax can also exercise some of these powers, if so authorised by any of the authorities mentioned above. An income tax authority acting under section 133A(1) has the power to inspect books of account and other documents available at the place of survey; check and verify the cash, stock or other valuable article or thing found in the place surveyed; and obtain information and record a statement of any person which may be useful for any proceeding under the Income Tax Act. However, he cannot remove or cause to be removed any books of account, cash or other valuable item from the place surveyed. In the first column of Table 3, the number of surveys conducted under this section during the period 1985-86 and 1989-90 are given. Due, probably, to the recent problems with ensuring the safety of Income Tax Department staff engaged in survey, the number of surveys conducted has fallen sharply during the last three years for which data are available. It should be mentioned that most surveys under this section are currently carried out for existing assesseees.

#### *Third Party Information Matching: The Central Information Branch*

The CIB is responsible for collecting information from external and internal sources, verifying and communicating it to assessing officers for utilisation in identifying non-filers, as well as in assessing tax liabilities of filers. This system has been in existence in the Income Tax Department for the last three decades. In the late 1950's a Collection Branch was set up with a single office in Madras. Subsequently this was decentralised in the form of Special Investigation Branches attached to the office of each Commissioner. In 1976 the

Special Investigation Branches were replaced by Central Information Branches in each Commissioner's charge. Presently Central Information Branches function within the Directorates of Income Tax (Investigation). While the old Collection Branch, Special Investigation Branch and Central Information Branches were basically concerned only with collection, collation and dissemination of information, the present Central Information Branches have also been assigned the function of verification of information. Sources of information to be tapped in a financial year, as also annual quantitative targets for verification of information, are laid down by the CBDT in the Annual Action Plans for the Investigation Directorates.

In principle, matching through the CIB should form the main plank of the strategy of the Income Tax Department to identify non-filers and detect tax evasion by existing assesseees. The impression gained from our discussion with officers of the Department is that CIB verification is not very successful. Most officers interviewed did not regard CIB information as a useful source for identification of new assesseees and cases for scrutiny or detection of tax evasion.

Under the extant procedure, Central Information Branches, spread all over the country, collect information from pre-determined sources, verify them and communicate relevant extracts to assessing officers. The assessing officer are required to utilise the information in assessment. Currently about 85 external sources are listed in the Long Term Action Plan for Survey formulated by the CBDT.<sup>5</sup> In addition, eleven internal sources of information are also listed, pertaining to the outcomes of searches and surveys, transfers of immovable properties, as well as information regarding incomes, expenditures and wealth of individuals dealing with various divisions of the Income Tax Department.

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5. These include other government departments (such as excise and customs, sales tax, Directorates of Industries, municipal corporations, Central and State Public Works Departments, the Registrar of Companies and the Registrar of Cooperative Societies), banks and financial institutions, hotels, clubs, travel agents, newspapers and magazines, jewellers, interior decorators, house building companies, vehicle manufacturers, nursing homes and hospitals, professional institutes (for example of chartered accountants, doctors, architects and engineers), public residential schools, publishers, postal authorities, stock exchanges and so on.

Sections 133 (power to call for information) and 131 (power regarding discovery, production of evidence, etc.) constitute the main legal base for the process.

The process starts with collection of information, mainly from external sources. We were informed about several hurdles in this area. First, the flow of information is not automatic in the sense that the CIB first issues letters to various agencies, calling for information under sub-section (6) of section 133 of the Income Tax Act. Not all agencies respond promptly. In such cases summons under section 131 are issued. Even then many agencies try to stall or even resist communication of information. Refusal to part with information by banks and some other financial institutions is a case in point. This strains CIB resources and delays verification and dissemination of information. Second, because of limited manpower and infrastructure - including, importantly, the lack of automation and also the long delays just discussed, the CIB is not able to collect information from even the major external sources every year. Furthermore the coverage of most sources tapped is incomplete. For example, an analysis of the figures reported in a study made by Ashok Bal (1990) shows that during the financial year 1989-90, the Delhi CIB collected 1,00,040 information-pieces from 22 sources (22.92 per cent of all identified sources). Three of these sources (that is, 13.64 per cent of the sources tapped) account for 56.28 per cent of the information collected. Three information-sources yielded less than 10 information pieces each. Inability to annually collect comprehensive information from all or at least the major sources dilutes the efficacy of CIB verifications.

The verification process starts with the issue of an enquiry letter (sent by ordinary post) to the concerned person, confronting him with the information collected and seeking his explanation in the matter. The system is deficient in as much as it basically depends on the response of the affected person, who has a motive for stalling enquiries, concealing information or even furnishing false information. There is no system for independent checking of information. Many income tax officials interviewed maintained that prompt responses are received in only a small fraction of cases. Summons under section 131 may be issued to defaulters. This too is time consuming.

Because of the lack of a computerised information system resulting in the current inability of the CIB to tap even the major information sources every year and the time-lag between collection and verification of information, consolidation of all information in sources tapped on a person for a given year is not currently possible. This may lead to acceptance by the Department of questionable claims and unexplained financial dealings in a case. Consider a hypothetical case of a person whose financial dealings (only with reference to the prescribed CIB information-sources) during a given year are spread over  $m$  sources. For simplicity, assume that each source generates only one information-piece, each involving an identical amount of investment/expenditure (say, 1 monetary unit). Thus, the total number of information pieces generated is  $m$  and the total investment/ expenditure made by the affected person is  $m$  monetary units. We also assume that the investment/expenditure involved in  $n$  information pieces ( $0 < n < m$ ) (amounting to  $n$  monetary units) has been made from unexplained or unaccounted income sources. The CIB can detect tax evasion (or if the affected person is not an existing assessee, detect a non-filer) only if it collects and verifies information in respect of all these sources and is able to bunch all the  $m$  information pieces for simultaneous verification/follow up action in assessment. It may not be able to detect tax violations in the given case if either verified information is only for  $(m - n)$  or less information pieces or the collection and verification process is spread over a number of years, making it difficult to ensure their simultaneous utilisation in assessment within the limitation period.

A final issue regarding collection and verification of information is that the focus of the efforts of the CIB is on maximising the number of verifications as this is the only prescribed action plan target for it and constitutes the main basis on which its performance is evaluated. As a result, quality (for example, amount of tax evasion detected, number of tax evaders detected and number of new assessees identified) gets neglected. We were given to understand that, in the CIB, verification is generally not evenly phased out throughout the year and there is a hurry towards the end of the year<sup>6</sup>. This affects the quality of verifications.

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6. According to Bal (1990) his field study found in Delhi that, excepting despatch, more than 50 per cent of CIB activity took place in the fourth quarter of the financial year, the busiest quarter for the Income Tax Department.

Since the activity of the CIB is integral to both identification of non-filers as well as assessment of existing assesseees and, in addition, the usefulness of CIB information depends on its utilisation by assessing officers, we postpone further discussion of the performance of the CIB to Section 3.3.

### **3.2 Information Sources on Existing Assesseees**

Information pertaining to existing assesseees currently collected by the Income Tax Department may be classified into three main categories: (i) information that assesseees are required to provide to the Income Tax Department; (ii) information that third parties are obliged to provide to the Income Tax Department on an ongoing basis; and (iii) information and evidence collected by the Income Tax Department from assesseees and third-parties including through investigations, surveys and searches.

#### *Information that Assesseees are Required to Provide*

Assesseees provide information to the Income Tax Department through filed returns for the income tax and, in certain cases, other direct taxes and through documents required to accompany returns. These returns contain information regarding address, occupation, nature of business or profession, sources of income, deductions and exemptions, gross profit rate, investment expenditures, loans, etc. All this information can potentially be used to help assess taxes due by assesseees. In addition, Sections 44AA and 44AB of the Income Tax Act oblige professionals and business persons to maintain accounts and to have these accounts audited by professionals if the total turnover exceeds a certain amount (Rs 40 lakhs for businesses and Rs 10 lakhs for professionals). Film producers must furnish particulars concerning every payment exceeding Rs 5000 in connection with the production of any film (under section 285B). Intending transferors of property are required to furnish information concerning

the transfer in an appropriate form to an income tax authority (distinct from assessing officers) empowered to pre-emptively acquire the property.

### *Information from Third-parties*

Information that third-parties are required to provide to the Income Tax Department includes statements from employers concerning salaries paid to employees, as well as the payment of taxes deducted at source (under section 192). Deduction at source is also required from interest on securities (under section 193), dividends, certain payments to contractors, subcontractors and non-residents, and winnings from horseraces, lotteries and crossword puzzles (under section 194), provided that the amounts paid exceed stipulated sums. As discussed in connection with non-filers, under Section 133, income tax authorities may require firms, dealers, brokers, agents, banks and so on to provide the CIB with names and addresses of their owners as well as of those engaging in transactions with them. However, this is at the discretion of the Income Tax Department rather than on an ongoing basis.

### *Survey Under Sub-section (5) of Section 133A*

It is a matter of common knowledge that black money amassed through tax evasion is freely used for lavish and ostentatious expenditure. Sub-section (5) of section 133A empowers DCsIT, ADsIT and AOs and also, if so authorised by any of these authorities, Inspectors of Income tax to make enquiries and obtain information about the nature and scale of expenditure on a function or ceremony incurred by an assessee. An income tax authority acting under section 133A(5) can also record statements of the assessee or any other person, which may be used as evidence in any proceeding under the Act. A survey can be conducted at any time after the function, ceremony or event. Under the extant administrative arrangement, surveys under section 133A(5) are conducted only by the Directorates of Income Tax (Investigation). After completion of a survey, the information is passed on to the concerned AO through his Commissioner.

The income tax department conducted 868 and 939 surveys under section 133A(5) during the financial years 1989-90 and 1990-91 respectively according to their own figures<sup>7</sup>.

However, the impression gained from discussion with some officers of the Income Tax Department is that, generally, these surveys have not been found to be very effective in detecting unaccounted expenditure. This impression is partially borne out by the evaluation of this source of information by assessing officers reported in Table 4. We have been given to understand that some of the factors which generally dilute effectiveness of surveys are (i) hotel and other bookings for functions made in fictitious names, (ii) splitting-up of the bills, (iii) under-billing of expenditure and (iv) unaccounted cash payments for expenses. As powers under sub-section (5) of section 133A can be exercise only after a function, ceremony or event, it becomes difficult to overcome these hurdles and make meaningful investigations.

Another point which merits mention is regarding the ambit of section 133A(5). The use of the words, "Where, having regard to the nature and scale of expenditure incurred by an assessee...." in section 133A(5) suggests that the survey powers can be exercised only in the case of an assessee. This leaves persons not assessed to tax, including non-filers, outside the ambit of this provision.

### *Search and Seizure*

Search and seizure is a powerful tool for unearthing tax evasion. The main objectives of search and seizure are to get hold of evidence bearing on the tax liability of a person which the person is seeking to withhold from the assessing authority, to get hold of assets representing income believed to be

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7. Details from the Report of the CAG on surveys under this section where evidence was collected between 1985-86 and 1989-90 are in the second column of Table 3. The figure for 1989-90, at 116 cases, is far lower than the figure for the number of surveys conducted under this section reported in the text.

undisclosed and applying as much of the assets as may be necessary in discharge of the existing and anticipated tax liability of the person concerned<sup>8</sup>.

The power to conduct searches and effect seizures of property is available under section 132 of the Income Tax Act. Section 132A of the Income Tax Act empowers certain income tax authorities to requisition books of account, other documents or assets taken into custody by any officer or authority under any other law, if certain conditions laid down in the Act are fulfilled.

A search can be conducted on the basis of a warrant of authorisation issued by the DG, DI, CCIT, CIT, or any empowered DDI or DC. They can, on satisfaction of certain conditions, authorise certain income tax authorities to enter and search any building, place, vessel, vehicle or aircraft. The authorised officer is empowered to requisition the services of any police officer or any officer of the Central government to assist him executing the warrant of authorisation. A search and seizure operation is conducted in the presence of two or more witnesses<sup>9</sup>.

The authorised officers have wide powers of search and seizure. Among the main powers are: the authority to break open the lock of any door or any receptacle if needed; search any person entering or leaving the location covered by the search operation; and seize any books of account, other documents or valuable articles found as a result of the search. Section 132(4) also empowers the authorised officer to examine on oath any person who is found to be in possession of any books of account documents or assets. This may be used as evidence under the Income Tax Act.

Under the existing arrangements, search and seizure operations are mainly organised and conducted by the Directorates of Income Tax (Investigation). However, search parties may also comprise officers from units functioning under Chief Commissioners or Commissioners. Evidence and

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8. Venkata Reddy (C) versus Income Tax Officer (1967) 66 Income Tax Reports 212, 234 (Mysore).

9. Under the existing Income Tax Rules, witnesses should be from the same locality as the building to be searched.

material gathered as a result of searches is utilised by assessing officers in assessment and other proceedings like penalties and prosecutions. Thus, one set of Departmental officials organises and conducts searches while another set utilises the information and material gathered.

If any asset is seized during a search, the assessing officer is required to make an order under section 132(5) with the previous approval of the Deputy Commissioner estimating the undisclosed income in a summary manner to the best of his judgement on the basis of the available material. He is required to retain only such assets as are sufficient to satisfy the amount of tax, penalty and interest on the undisclosed income estimated and any existing liability and return the rest to the person(s) from whom they were seized. The order must be made within one hundred and twenty days of the seizure.

The seized books of account and documents must be returned within a period of one hundred and eighty days from the date of the seizure unless reasons for retention are recorded in writing and approval of the Chief Commissioner or Commissioner is obtained.

An officer empowered to authorise a search can do so only if he has in his possession information, gathered from internal or external sources, justifying the search under Clauses (a), (b) and (c) of section 132(1) of the Income Tax Act. We understand that the main external source of information is informants, most of whom furnish information to the income tax authorities in the expectation of monetary rewards<sup>10</sup>. Other informants generally include disgruntled employees, business associates or business adversaries.

The Income Tax Department's dependence on informants for gathering information cannot be regarded as satisfactory. We have been given to understand that most informants furnish unreliable, exaggerated and often totally

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10. The Income Tax Department has a scheme for rewarding informants. Rewards are generally paid on the amount of extra taxes levied and realised directly attributable to the informants' information.

false information. Some do not even hesitate to cheat the Department and blackmail both income tax officials and taxpayers.

Theoretically, the Income Tax Department can control the tendency to furnish false information as it makes a person liable to prosecution under section 182 of the Indian Penal Code. However, hardly any prosecution has been launched for this offence since the complexity of the law for such prosecutions, the degree of proof required for establishing guilt and time-consuming procedures make it extremely difficult to successfully prosecute this offence.

We understand that the time-lag between provision of information and payment of reward is great, as a final reward becomes payable only after finalisation of all relevant proceedings, including assessments, appeals and levy and collection of extra taxes.

Column (2) of Table 5 gives information about the number of searches conducted by the Income Tax Department during the last ten years. The percentage increase in the number of searches in a given year, as compared to the immediately preceding year, is in column (3). An upward trend is visible upto the financial year 1987-88. Furthermore, while the percentage increase during the years 1982-83, 1983-84 and 1984-85 is low, the number rose sharply in 1985-86 (48 per cent more than in 1984-85 and 50 per cent over 1981-82). This marks the beginning of what is sometimes described as the 'raid raj'. The increasing trend continued upto the financial year 1987-88. when the maximum number of searches were conducted. (8464 searches or 98 per cent over 1981-82). The trend reversed thereafter.

We understand that the declining trend, which started in 1988-89, is mainly because of stiff resistance from searched persons and the public in many parts of the country, particularly in the northern region, and the consequent boycott of search work by officers and staff associations at several places. While there had been stray incidents of resistance and even violence earlier, the problem assumed alarming proportions only towards the end of the last decade when income tax personnel detailed for certain searches at Muzzaffarnagar (Uttar

Pradesh) became the target of mob-fury and were severally beaten and humiliated. The security arrangements made by the Department proved to be totally ineffective and inadequate. One can perhaps attribute the growing disrespect for law and order and overemphasis on field operations. However, no detailed study of this phenomenon has yet been made. We would, nevertheless, like to highlight the urgent need to develop an effective system of security and protection for income tax search and survey parties.

Income tax authorities do not have magisterial or even police powers. However, the law does contain provisions for security and protection of income tax personnel detailed for searches. The authorised officer is, as discussed above, empowered to requisition the service of any police officer or officer of the Central government to assist him executing the warrant of authorisation. We have been given to understand that inadequate police force is generally provided to income tax search parties and that senior police officers have displayed indifference on several occasions in the past when, faced with a crisis, income tax officials approached them for assistance.

The Income Tax Department bases claims of successful search performance on the number of searches conducted and the value of the assets seized. These hardly constitute reliable indicators for assessing the effectiveness of searches. Search is not an end in itself and can be meaningful only if it brings revenue, directly or indirectly, through extra taxes and leads to imposition of sanctions in suitable cases. How far have income tax searches been successful in this role? We evaluate this using secondary data in the next section.

### **3.3 Utilization of Available Information**

#### *Keeping Track of Assesseees and Potential Assesseees: Use of Taxpayer Numbers*

A key requirement of a viable information system is a method to keep track of dealings of assesseees and potential assesseees on an ongoing basis. Taxpayer identification numbers are in use in most modern tax systems the world over to accomplish this. The Indian income-tax also has its system of Permanent Account Numbers (PANs) to serve this end. However, allotment of PANs is

haphazard and the use made of them is limited. For example, PANs are not required to be quoted by assesseees for most transactions. Consequently, consolidation of information on existing and potential assesseees, a task greatly facilitated by a functioning number system, is greatly hampered. This weakness has been remarked on before by various tax review committees.

*Surveys Under Section 133B*

We have been given to understand that one reason why the number of new taxpayers detected is not commensurate with the survey efforts is that generally there is no effective utilisation by assessing officers of survey reports and information sent to them by the Investigation Directorates. In many cases no follow up action is taken.

One reason why assessing officers attach low priority to processing and utilisation of survey information is that new assesseees add to the workload relating to existing assesseees. The CBDT has recently issued instructions for centralisation of all new cases of a charge in selected income tax wards and circles. This, it is their hope, will bring about significant improvement in utilisation of survey information. This should also facilitate better interaction and co-ordination between investigation units and assessing units.

Long time-lags between the date of completion of surveys and communication of information to assessing officers also hinder prompt and effective utilisation of information in assessments. Under the CBDT's extant instruction, Forms 45D pertaining to those persons in whose cases action by the assessing officer is called for, should be forwarded every month to the concerned range Deputy Commissioner who should send them to the concerned assessing officers. However, in practice, delays do occur. According to a study by the DOMS<sup>11</sup> based on a sample of 520 cases, there was a delay of more than three months in forwarding Form 45D to range DCs in about 30 per cent of cases. In 0.97 per cent of the cases, the time-lag exceeded one year. The role of the range Deputy Commissioner is limited to forwarding the forms to assessing officers.

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11. DOMS (1990).

This should not take much time. However, the DOMS study indicates that there was a failure by DCs to transmit the information to assessing officers within one month in about 27 per cent of the cases.

Another problem is that many newly detected assesseees again cease to file returns within a few years. The effect of detection of new assesseees through surveys is considerably diluted by the Department's failure to monitor the filing behaviour of existing assesseees and retain them within its folds.

Inadequate end results of surveys are attributable to a variety of other factors as well like inadequate planning in selection of areas for survey, lack of effective supervision at various levels, collusion between income tax officials and potential assesseees, lack of effective co-ordination between Investigation Directorates and Commissioners' organisations and decline in efficiency of survey units.

We would not like to jump to any hasty conclusion about the effectiveness of surveys under section 133B on the basis of the preliminary material available to us. We would, however, like to add that the impression which we got from the responses of the officers interviewed and the available secondary data is that the end results achieved through 133B surveys are not commensurate with the resources allocated to this operational area. An important research need for the forthcoming NIPFP study is to examine various issues germane to the matter.

#### *Information on Existing Assesseees*

While the law permits a large amount of information to be made available to income tax authorities, the use of these powers leave a lot to be desired. One set of problems arises with respect to the way information is actually collected. Examples include the lack of integrated income, wealth and gift tax returns and the lack of a better system of ongoing supply of information by third parties such as banks, brokers, firms paying interest and dividends, and

those paying large sums to contractors. The latter set of problems is due to insufficient use of Permanent Account Numbers and due to the lack of a computerised information network in the country. The practice of splitting large transactions or accounts into several small ones to avoid deductions at source or third-party reporting is a problem that the existing information system cannot deal with adequately. There are also problems with respect to collection and utilisation of information by the CIB .

Within the current setup of the Income Tax Department there appear to be major organisational problems with respect to the utilisation of available information by assessing officers. The results of our sample survey of assessment procedures in selected ranges in Jaipur, Bombay and Bangalore provide indirect evidence of this. Assessing officers were asked to describe and rank sources of information they deemed most important in their scrutiny. The eleven most important sources on average according to this scale are listed in order of importance in Table 4.

The most important feature of these data is the insufficient importance of CIB reports (with a mean score of 2.25). More useful sources of information are search and survey (especially under section 133A(1)) reports; information on investment in immovable properties; information contained in filed returns pertaining to large investment expenditures, large gifts received, or undue changes in financial data supplied in comparison to previous years; and tax evasion petitions (by, for example, disgruntled employees or trading partners). Other sources seemed to be of insignificant importance from their point of view<sup>12</sup>

The net result is that insufficient use is made of information pertaining to large consumption expenditures and large income receipts, information on which is collected by the CIB from involved third parties. Presumptive information of a non-monetary nature, which is also collected by the CIB, is also

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12. These data ought to be viewed with caution as assessing officers tend to use a lot of subjective factors in scrutiny assessments and their consciousness of the relative importance of different information sources may differ from actual practice.

underutilised. Discussion with various members of the Income Tax Department, both in the Investigation Wing and assessment charges, has reinforced this impression.

It is possible for the Income Tax Department to utilise the information currently collected in a far more efficient manner for assessment. Computerisation of the flow of information into the Income Tax Department will greatly facilitate this<sup>13</sup>. A computerised information system will permit assessing officers to instantaneously draw upon: information contained in the return filed by the assessee in both current as well as a selection of past years; that provided by third parties; as well as information collected on the basis of CIB reports and survey and search operations. This can be used to develop systematic procedures for the selection of scrutiny cases (on the basis of statistical and economic models of past behaviour of taxpayers), for conduct scrutinies and to provide evidence in tribunals and courts based on better information. Computerisation can also lead to a better system of performance evaluation for assessing officers as well as to form better predictions, reports and plans with respect to revenue mobilisation. It should be noted that such computerised systems are already in use in a number of other developing countries such as Mexico, Colombia and Panama<sup>14</sup>. Given the availability of high quality equipment and manpower, as well as the precedent of computerisation of railway and airline reservations, there is no reason for computers not to be effectively utilised by the Income Tax Department in India.

### *The CIB*

The first step after collection of information to enable its utilisation is that of communication of information (in suitable cases) to the assessing officer. Under the extant procedure, this involves two steps, first, communication of

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13. Lack of political will or vested interests of Income Tax Department staff are clearly behind the slowness to computerisation. It has been learnt that a pilot range in Bombay was successfully computerised as early as 1975 and that a Films Division documentary exists on this range. This clearly demonstrates the technical feasibility of computerisation at least up to a point.

14. International Bureau of Fiscal Documentation (1985).

information by the CIB to the Deputy Commissioner and second, communication of the information by the Deputy Commissioner to the assessing officer. Generally, both these involve long time-lags, which can be easily avoided by improving the despatch system in these offices.<sup>15</sup> However, what is more disquieting is that many information pieces are lost in transit. In many cases the information pieces do reach the assessing officer but do not reach assessee's files. Whether this is due to corruption, manpower shortages or lack of motivation, both these situations indicate a virtual collapse of systems of accountability and supervision in the Income Tax Department.

Next comes the stage of utilisation of CIB information in selection of cases for scrutiny and framing of assessments. A Commissioner of Income Tax we interviewed candidly admitted that this was one of the weakest areas in his charge. Our own experience in the course of the field study at Jaipur also points in this direction. We requested the Deputy Commissioner to let us know whether any follow up action was taken by the assessing officers on certain identified CIB extracts received during the previous two years. Not a single file could be traced even after about two to three hours search by the staff. According to Bal's sample study for Delhi, covering 1987-88 and 1988-89, for 40 per cent of existing assessees for whom extracts arrive, assessments had already been completed and could rarely be reopened; no action was taken for about 40 per cent of all received extracts; for another 17 per cent there was no revenue impact; and only for about 3 per cent of extracts received were notices issued under section 139(2) or under section 148.<sup>16</sup>

Inadequate utilisation of CIB information, in the opinion of many officers in assessment charges, is because of its poor quality - a feature which could be mitigated if information from various sources was consolidated for each

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15. According to Bal (1990) there were considerable delays involved between the despatch of extracts upon which action is recommended, and receipt of these by the assessing officer in question. 80 per cent of all despatched extracts took more than two months, 40 per cent more than four months, and 24 per cent more than five months to reach the assessing officer.

16. These figures may not reflect the All-India position.

assessee. Whether or not this is true, our field study showed that there are severe problems in assessing charges in the processing of CIB extracts as has just been pointed out. In many cases information, even if it is not lost in transit or misplaced, is either lost sight of or ignored while selecting cases for scrutiny or making assessments. Factors like collusion between income tax officials and affected persons, poor records management, lack of motivation of income tax officials and shortage of manpower could all contribute to a possible explanation.

The long time-lags involved at various stages of collection, verification and dissemination of information also hinder effective utilisation of information. The sample-based finding of Bal on this score have already been reported above.

The CIB and assessing units function almost independently of each other and there is little co-ordination between their activities. The CIB is satisfied if it is able to achieve the annual quantitative target and the assessing officer is not worried if no useful CIB information comes to him before selecting assessments for scrutiny or framing assessments. This sometimes leads to a situation where information in a case reaches the assessing officer after the selection process is over and the relevant assessment finalised. As the CIB information cannot always form a sufficiently strong legal basis for reopening assessments, verification efforts fail to bring in revenue in such cases.<sup>17</sup>

An important item which requires study is the appropriate scale of information collection and of the CIB in particular, in terms of manpower and infrastructure. The scale of the CIB should, in principle, depend on the (direct and indirect) increase in revenue forthcoming per incremental manhour or rupee spent on CIB work. This, in turn, depends on the ability of assessing officers to utilise CIB information and the efficiency with which it is utilised. Given current practice, verification itself appears to have a deterrent effect so that this too would influence the proper size of the CIB. This issue is to be taken up in the longer NIPFP study.

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17. Bal (1990) reports the following sample study based figures: the number of new assessee detected or existing assessee for whom concealment of income was detected was, in either case, about 1 per cent. The amount of concealed income detected from existing assessee averaged Rs 620, Rs 120 and Rs 153 per extract in different years. These figures may not be representative of the All-India position but are still suggestive.

## *Search and Seizure*

Column (5) of Table 5 gives figures of average seizure per search during the last ten years. The figures, barring those for the financial years 1982-83, 1983-84 and 1984-85, show an upward trend. The average seizure per search during the financial year 1990-91 is 5.8 times that for the financial year 1981-82. However, as pointed out above, this is not a reliable indicator for assessing the effectiveness of searches. Seized assets do not necessarily represent unaccounted income or wealth: The possibility of the affected person satisfactorily explaining the seized assets is always present. Further, there is no guarantee that additions to the disclosed income made in assessment would be sustained in appeals. The increasing trend in the average value of assets seized per search (even in real terms) could easily reflect a tendency to make indiscriminate seizure to brighten chances of getting rewards under the reward scheme.

Reliable indicators are extra taxes levied and sustained, successful imposition of concealment penalty and punishment through prosecutions (NIPFP, 1985). Information about the extra taxes levied and collected in search case after finalisation of all the relevant proceedings is not compiled by the Income Tax Department on a regular basis. We have also not been able to make a sample study because of the paucity of time. However, as regards penalty and prosecution indicators, the position seems to be rather dismal. We first quote NIPFP (1985) before examining recent aggregate data. The NIPFP study analysed a sample of 425 assessments relating to searches carried out during the three calendar years 1976-78 involving seizure of assets of more than Rs 5 lakh in each case. We reproduce their findings:

"Out of a total of 425 assessments involved in the sample, concealment was determined in 310 cases, that is, in about two-thirds of the cases. But out of these 310 assessments, in only 66 cases (that is, in a little over a fifth of the cases) was penalty levied. As for prosecutions, the results are even more disquieting. While a total of 60 prosecutions had been launched, 58 of these related to 10 assesseees involved in just two cases of search and seizure involving companies in Madras. And of these, 29 had been discharged, dismissed or acquitted, while in the remaining 29 (plus two other cases from other jurisdictions), the cases were still pending. What is truly alarming is that out of all the search

and seizure cases covered in our sample, not a single conviction had been obtained some five to seven years after the searches were originally conducted".[p 326]

The NIPFP sample analysis suggests that a little over 15 per cent of the search assessments lead to levy of concealment penalties. Only about 14 per cent of bigger search assessments result in launching of prosecutions. The percentage of cases leading to successful enforcement of civil and criminal sanctions would be of a much lower order as not all penalties levied and prosecutions launched succeed in appeal and court proceedings.

We now attempt to analyse aggregate all India figures. Because of long time-lags between the date of search, completion of assessment and institution of prosecution proceedings in most cases and the fact that the Income Tax Department does not compile information about search assessments resulting in prosecution, it is not possible to relate the number of search assessments completed in a given year with the number of prosecutions for tax-evasion launched in that year. However, cumulative figures for 5 to 10 years may give some idea about the Department's ability to translate search efforts into tax evasion prosecutions.

Informal discussion with officers of the Department suggests that 20 to 25 per cent of the tax evasion prosecutions launched by the Department pertain to search assessments. Though this range of estimates is based only on impressions of these officers, we use this in the absence of more reliable information in analysing available data.

From columns (7) and (9) of Table 5, 1.2 lakh search assessments were made and 8445 tax evasion prosecution complaints filed between 1981-82 and 1990-91. If 25 per cent of these prosecutions relate to search assessments, the number of prosecutions attributable to search assessments works out to about 2111. This suggests that only 1.77 per cent of the search assessments led to tax-evasion prosecutions<sup>18</sup>. The five year cumulative figures for the financial

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18. Even if all the tax evasion prosecution complaints filed related to search assessments, the percentage of search assessments leading to tax evasion prosecutions works out to 7.07.

years 1981-82 to 1985-86 and 1986-87 to 1990-91 yield percentages of 2.67 per cent and 1.31 per cent respectively which suggests a decline in the quality of search assessments during the decade. This belies the CBDT's expectation (NIPFP, 1985) that a successful search should invariably lead to prosecution.

The analysis made above suggests either that searches conducted by the Income Tax Department are ineffective or that the Department does not file prosecutions even in detected cases of tax evasion. Because of the unavailability of information about the outcome (in assessments, appeals, penalties, prosecutions, etc.) of search cases, there seems to be no reliable and direct evidence to evaluate the effectiveness of search operations in the Income Tax Department. We, therefore, turn to indirect evidence.

We had informal discussions with a number of officers of the Income Tax Department to ascertain their views on effectiveness of searches and utilisation of search material for levy of extra taxes and enforcement of civil and criminal sanctions. Most of them feel that while searches are quite effective and also lead to levy and collection of extra taxes (including surrender or disclosure of income), penalties are levied and prosecutions launched only in a small number of cases. One reason is that while, in many search cases, the material gathered by the Department is sufficient to make additions in assessment, it is not strong enough to justify imposition of monetary penalty for concealment or launching of prosecution for tax evasion. Another reason is that many tax evaders manage to get their cases settled and obtain immunity from penalty and prosecution. Section 245H (Power of Settlement Commission to grant immunity from prosecution and penalty), sub-sections (1) and (4) of section 273A (Power to reduce or waive penalty etc. in certain cases) and certain provisions of Explanation (5) to section 271(1)(c) of the Income Tax Act are the main statutory provisions under which immunity from penalty and prosecution can be given. Under the law, as it is generally interpreted today, these provisions have become safe havens for detected tax evaders. In many cases immunity is granted to facilitate quick levy and collection of extra taxes based on agreements with the assesseees because income tax authorities are pessimistic of the final outcome of appeal, penalty and prosecution proceedings. Besides a low probability of tax

offenders getting punished and protracted delays, income tax officials have to appear in innumerable hearings (over fifty in some cases) which is itself a deterrent. Several income tax officials we interviewed expressed these views.

Coming to the workload of search assessments, columns (6) of Table 5 indicates that the workload, which was 13240 assessments during 1981-82 rose to 36014 in the financial year 1990-91, despite the fact that the disposal rate rose from 36.65 per cent in financial year 1981-82 to 64.04 per cent in 1985-86, 56.37 per cent in 1988-89 and 54.14 per cent in 1990-91. This suggests that the workload of search assessments cannot be effectively handled by the available manpower, a conclusion which the EARC (1983) had also arrived at<sup>19</sup>. Thus, it appears that the Department has been over-reaching itself in carrying out searches without paying adequate attention to its ability to follow up searches with timely assessments and quick punishment where merited. The deterrent effect of searches is, therefore, dubious. Fewer searches and greater relative deployment of manpower to search assessments and prosecution of search cases appears warranted. Further support for this finding is reported in section 5 below.

### **3.4 Record Keeping and Information Retrieval in Assessing Changes**

A proper system of record-keeping is clearly a prerequisite for an effective tax enforcement machinery. There are at least 7 functions a proper record-keeping system serves.

- i. It permits ready linking of information and records pertaining to an assessee to permit proper assessment and also ascertaining that an assessee has met all statutory obligations.
- ii. It prevents proceedings or tax demands against an assessee from remaining outstanding for a long time.
- iii. It permits cross verification of information and records between different assessees.

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19. The EARC pointed out:  
"First, the numbers of such cases are large and beyond the capacity of the available manpower to cope with. As a result enormous delays occur in the processing of cases after search and seizure. This gives plenty of time to parties concerned to invent explanations, fabricate evidence etc.....".[p 85]

- iv. It facilitates proper marshalling of evidence and documents relating to an assessee in case of an appeal or prosecution.
- v. It aids in monitoring the honesty and efficiency of Income Tax Department staff.
- vi. It aids quick and timely compilation of management control information and allows monitoring of revenue collection.
- vii. It aids in evaluation and planning of workload distribution.

The current system of record-keeping at the level of the range, however, leaves a lot to be desired especially in view of the growing number of taxpayers. While a detailed study of this has not been made, several problems came to light in the course of our field survey. The manner of storage of Income Tax Returns and the way in which information is to be compiled is laid down in the Income Tax Department's "Handbook of Office Procedures". This Handbook provides for several registers to be kept of which the most important is the "Demand and Collection Register" (both current and arrears). Other important registers include the Control Register (Blue Book), the General Index Register (GIR), the Daily Collection Register and Penalty Register. Records of assesseees are maintained in assessee-wise files which are supposed to have a docket for each assessment year. Each docket is supposed to have papers filed by date of receipt/issue. Furthermore, each docket is supposed to have "order sheets" which give details of actions taken on the file. Record-keepers are supposed to maintain a register wherein a file issued out of the record room or returned is recorded along with details the issuing authority.

A list of problems identified is as follows:

**Infrastructure:** In all ranges visited, especially in Bombay, space available for storage of files, cupboards, etc., were inadequate. Likewise, availability of stationery and supplies (files, order sheets, file tags, typewriters, typewriter ribbons, etc.) was below requirements according to several AOs. The quality of paper on which official forms were printed and file covers was inadequate having poor shelf life and legibility - a source of complaint by ward/circle staff.

**File and register maintenance:** Files examined by us, in almost all cases, were physically appalling. A similar comment about the quality of other Department forms and returns can also be made. the Department does not appear to have given sufficient thought to the sturdiness of stationery needed in view of the level of usage of files and the number of years for which it is necessary for records to be available for proper enforcement<sup>20</sup>. Secondly, in no case was a file examined by us properly maintained. In several cases important documents, including in one case, a tax return, were not available. Thirdly, as has been pointed out, certain important files we requested for examination were untraceable. A similar though marginally better situation prevailed with respect to maintenance of registers and their availability.

**Use of Records and Movement of Files:** It has been reported to us that, since the file issue register is not properly maintained, files can often not be traced. Files thus move, often without record, from the record room not only within the ward/circle, but also to the DC, the CIT, Investigation Directorate, to the Appeals Commissioner, etc. Very often, this involves physical movement of records to various places within a town and even, for mofussil charges, between towns. It should be noted that most records have no duplicates.

Secondly, it has been reported that the same information is called repetitively from wards and circles by different supervisory offices and the various directorates thus leading to additional workload at the ward/circle level and reducing the time available for enforcement work. This clearly shows that the problem of record-keeping is not limited to assessing charges alone.

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20. As shall be pointed out below, the cost of collection of the income-tax is small and falling relative to collection. Thus, even if no additional revenue is forthcoming due to better record-keeping, and we believe the gains will be substantial, there seems to be no justification for such severe economy on stationery and supplies. It has been alleged by some persons interviewed in the field that funds for stationery and supplies are largely siphoned off by dishonest elements.

Thirdly, ward/circle staff displayed unfamiliarity with records available with them. Thus, for example, many AOs handed in questionnaires to us with important and readily available information missing<sup>21</sup>.

Overall, therefore, the picture that emerges is one of utter chaos of records. The extent to which this impairs the efficiency of the Department is clearly great even if no quantitative estimates are available. It is, therefore, imperative that a better system of record-keeping be devised and implemented on a priority basis and that infrastructural and manpower constraints be eased<sup>22</sup>. In the long run, of course, there is no substitute to computerisation.

#### **4. ASSESSMENT WORKLOAD AND MANPOWER IN THE INCOME TAX DEPARTMENT**

In this section we discuss issues pertaining to manpower planning within the Income Tax Department: the powers and responsibilities of the Department with respect to assessment (Section 4.1); the structure of assessing charges (Section 4.2); the nature of workload and manpower available, the allocation of time of AOs across different responsibilities, and experience and training of AOs (Section 4.3); work norms and performance evaluation of AOs (Section 4.4); remuneration and incentives (Section 4.5); and work culture within the Department (Section 4.6). A detailed appraisal of assessment itself is in Section 5.

##### **4.1 Powers of AOs, DCs and CITs**

Before embarking on an examination of manpower for assessment and the assessment workload it will be useful to briefly describe the legal powers of the Income Tax Department insofar as these relate to assessment. It is also useful to describe the types of assessment that AOs are empowered to carry out.

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21. The ready availability of information was ensured by the member of the study team from the Income Tax Department.

22. A separate study by management experts of this aspect should be given serious consideration even if computerisation of records is held to be infeasible in the short term given staff opposition.

Statutory powers of AOs, DCs and CITs are laid down in the Income Tax Act, 1961, Chapters XIII to XVI, XIX, Sections 263 and 264, Chapter XXI and Chapter XXIII. Relevant provisions from the point of view of assessment are those empowering AOs to

- i. Require a potential assessee to file a return;
- ii. Ask to examine any accounts or documents he considers necessary for assessment;
- iii. Ask assesseees to give written statements on any matter relevant to assessment subject to certain conditions;
- iv. Ask assesseees to have their accounts audited;
- v. Compel persons to appear before him and examine them on oath;
- vi. Retain or impound documents and books of account for upto 15 days without explanation and, subject to restrictions, longer if needed;
- vii. Levy interest, tax, additional tax or penalty or grant refunds;
- viii. Reopen assessments in case it is believed that some income was unassessed.

Three types of assessment are possible under the Income Tax Act:

- a. Under section 143(1), the AO can summarily assess returns of income by allowing or disallowing claims which are prima facie allowable or wrong from the information available in the return and by correcting arithmetical errors in the return or accompanying documents. No tax or interest demand can be made two years after the year in which the return is filed. Mistaken assessment orders under this section can be rectified by AOs, DCs or CITs under section 154.
- b. Under section 143(2) or 143(3), "Scrutiny" or regular assessment can be carried out by the AO after examining all relevant information available and after, if he desires, giving the assessee a hearing.
- c. Under section 144 the AO can make a best judgement assessment if the assessee does not respond to notices under other assessment provisions.

Assessments under section 143(2) or 144 are done only in special circumstances. This note concentrates therefore, on section 143(1) and 143(3) assessments.

CITs may revise assessment orders "prejudicial to the interest of the Revenue" under section 263 or, under certain other conditions, under section 264. There is also a two stage appeals procedure in case an assessee disagrees with an assessment, the first stage before DCs (Appeals) or CITs (Appeals) and the second appeal before the Income Tax Appellate Tribunal (ITAT). The monetary amount involved determines if the DC (Appeals) or CIT (Appeals) hears the first appeal. The Income Tax Department may also file appeals before the ITAT in case of adverse first appeal decisions. While the ITAT is the final authority on matters of fact, questions of law can be referred to High Courts and, on a judgement of the High Court in a case which the High Court certifies to be suitable, to the Supreme Court under section 261. Special leave petitions can also be filed under Article 136 of the Constitution. With this background, assessment practices and performance may now be examined.

#### **4.2 Structure of Assessing Charges**

Assesseees with reported incomes exceeding Rs 5 lakh<sup>23</sup> are assessed directly by DCsIT (Special Range) or DCsIT (Assessment). Assesseees with declared income below Rs 5 lakh are assessed by AOs within the jurisdiction of DCsIT (Range). Assessment ranges are subdivided into wards and circles. Circles have assesseees with reported incomes above Rs 2 lakh<sup>24</sup>. Circles are headed by ACsIT and wards are overseen by ITOs. In addition, there are one or more Investigation Circles within assessment ranges. ACsIT of Investigation Circles deal mainly with search and seizure cases identified by the Investigation Directorates of the income tax department. There were a total of 46 field CIT charges within the Income Tax Department in 1989-90. While the exact number of DCsIT, ACsIT and ITOs engaged in assessment work was not ascertainable, the cadre strengths of these posts were respectively 794, 1679 and 2379 in 1990-91. However, many of these officers were engaged in non-assessment duties. Details of cadre strength are in Table 6. According to whatever data is available, there were 1891 officers actually performing the duty of Assessing

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23. Now Rs 10 lakh.

24. This is for individual assesseees. Different limits exist for other types of assesseees.

Officers in 1990-91. What is inexplicable is the fact that the total number of working AOs, if the reported figures are reliable, has actually halved from the level that prevailed in 1985-86 or 1986-87<sup>25</sup>.

Whatever the exact numbers may be, it may be inferred that:

- i. Less than 50 per cent of the gazetted officers of the income tax department are engaged in assessment work or direct supervision of assessment work.
- ii. The workload per assessing officers (AO) is at least 3000 assessments per year.

However, even within assessing charges, ward/ circle officers and staff have a number of duties to perform in addition to making income tax assessments and passing assessment orders with the result that much of the time of officers and staff, even in assessing charges, is spent on duties other than assessment. Duties are broadly classified into the following categories:

- a. Assessment and Assessment related: Assessment of Income Tax; Assessment of Other Direct Taxes; Processing of Material from Investigation Wing; Processing of Penalties and Prosecution Cases; Tax Recovery and Collection.
- b. Duties relating to mistakes in assessment, etc: Processing of Audit Objections; Giving Effect to Appeal Orders; Rectifications; and Revision Orders.
- c. Other Duties: Housekeeping (i.e. maintenance of registers, etc.); Statistics and Reporting; Conduct of Surveys; Examination and Search Duties; etc.

### **4.3 Manpower and Workload**

#### *Aggregate Statistics*

According to the Annual Reports of the Ministry of Finance (ARMF) for 1989-90 and 1990-91 there were respectively 71.31 lakh assessees in 1988-89, 70.27 lakh assessees in 1989-90 and an estimated 74.81 lakh in 1990-91. Of these assessees, about 51 lakh assessees are individuals according to the Report of the

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25. Such data as are available to us from published sources is in Table 7. However, these data suffer from differences in scope, definition and coverage across years.

CAG (Table 1). The number of individual assesseees has been growing at 4.12 per cent per annum since 1970-71, though there are large year to year variations. More relevant from the point of view of evaluating the workload of the department is the number of (summary plus scrutiny) assessments for disposal, including arrears carried over from previous years. For individual assesseees this stood at 66.83 lakh in 1989-90. Assessments for disposal have been growing, if unevenly, at 2.12 per cent per year (Table 1).

To deal with this assessment workload, the CBDT employs over 50,000 persons of whom 5700 are gazetted officers (ARMF, 1990-91). However, not all personnel are engaged in assessment related duties. Assessment and collection are mainly handled within Chief Commissioner's Charges of which there were 25 in the country in 1990-91. CCs oversee CITs who, in turn, oversee DCsIT. Most assessments are actually carried out in ranges headed by DCsIT.

The Income Tax Department has recently been completing between 80 per cent to 85 per cent of assessments pending for disposal at the beginning of the year or added during the year (Table 8). Assessments may be carried forward to the following year for substantive reasons or because of manpower problems. It is worth noting that the rate of completed assessments out of assessments for disposal has risen sharply over the last 10 years. However, the fact still remains that, even now, more than 10 lakh assessments are carried over every year.

### *Sample Data*

In the study of 5 DC ranges in Bangalore, Bombay and Jaipur, the average workload per ward/circle in 1990-91 was found to be 4541 assessments (see Table 11). The average workload in 1990-91 showed an increase of 21 per cent over 1989-90 with the burden being entirely in wards where, in 1990-91, there were 5898 cases per assessing officer. The workload in assessing circles was 2324 and in investigation circles it was 261 cases.

Assisting ITOs in coping with this workload there were, on average (Table 9), 6 other staff as follows:

- 0.9 Inspectors of Income Tax;
- 0.3 Head Clerks;
- 0.7 Stenographers;
- 1.6 Upper Division Clerks;
- 0.7 Lower Division Clerks;
- 0.9 Tax Assistants; and
- 0.9 Notice Servers/Peons.

The staff position in circles and investigation circles was not very different. These staff levels were in some cases, marginally below the sanctioned strength of the wards/circles (Table 9). Assessing Officers, by and large, complained of being under-staffed. As Table 9 testifies, assessing officers currently feel the need for a 123 per cent increase in the number of head clerks, 83 per cent in lower division clerks, 37 per cent in tax assistants, 27 per cent in notice servers, 25 per cent in stenographers and 18 per cent in upper division clerks.

One way of evaluating these data is to compare the workload of the Department under the counterfactual assumption that all available staff were engaged in assessment to the situation found in the field study:

- a. If all DCsIT, ACsIT and ITOs were engaged in assessment there would be about 1520 assessments per officer as against 4541 found in the field study.
- b. For AOs plus persons in other posts listed above there would be 170 assesseees per employee compared to 649 per employee found in the field study.

These figures suggest the possibility of redeployment of staff to assessment to reduce the burden of assessment under existing arrangements, though more detailed examination (for example of revenue returns from different activities, as well as from different jurisdictions) is needed before a firm

conclusion can be drawn. This issue is discussed further in later sections of this report<sup>26</sup>. Other disturbing aspects of manpower deployment, seen in our field study, are, however, worth pointing out.

- a. There are wide variations in workload across DC's ranges and between different wards or different circles: The case load per AO varied between 5754 per AO in Range C, Bombay and 3446 per AO in Range E Jaipur<sup>27</sup>.
- b. Several AOs had concurrent responsibilities in addition to their responsibility for wards or circles during the two years for which data was collected by us.
- c. The average duration of posting of an AO in the charge currently held by her/him was 7 months 21 days (Table 10). This varied between 4 months and 14 months 18 days across ranges. It has been ascertained that most transfers take place in April or May (except where promotions are involved). Also, the field survey took place in October. If all officers were transferred once a year in May the field study would have found an average duration of 5 months per AO in their current charge. If 50 per cent of officers were transferred each year in May implying an average duration per posting of 2 years, the field survey would have found an average duration of posting of 11 months. Consequently, it may be inferred that the average duration of posting per office was approximately 17 months in the ranges surveyed, with, however, wide variations across ranges. To the extent that local experience helps ensure better quality assessments, this limited duration of posting is not very satisfactory<sup>28</sup>.

Taken together, these points clearly indicate scope for rationalising the distribution of workload across charges, the frequency of transfers and responsibilities assigned concurrently to Assessing Officers.

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26. It may be mentioned that wards/circles studied had broadly similar territorial jurisdiction in terms of area to be covered. Thus it cannot be said that territorial coverage was a factor in the workload variation observed.

27. Manpower planning in the Income Tax Department is looked after by the DOMS. Several studies by them have gone into relevant matters. These studies are proposed to be examined in greater detail in the longer NIPFP study as are the proposals of the Standing Cadre Review Committee of the Department.

28. Frequent transfers, however, have merit if the integrity of most AOs is suspect.

### *Time Utilisation of Ward/Circle Staff*

Tables 11 through 13 give details of time allocation of staff in assessing charges studied by us. Table 11 shows that, on average 26 per cent of the time of AOs is spent on non-assessment duties. Furthermore only about 27 per cent of the time of AOs is spent on in-depth (scrutiny) assessments. The percentage of time spent on scrutinies in circles is higher than time spent on scrutinies in other charges by about 10 percentage points. In circles and investigation circles, where the case workload is lower, time spent on assessment decreases and time spent on other duties increases. Thus, 38 per cent of time was devoted to other duties by ACs in investigation circles in 1990-91. While the time spent on non-assessment duties by other staff is higher in general than time spent by AOs (at 34 per cent) the same disturbing trend across types of charges is found in the time allocation of other staff (Table 12).

Inspectors of Income Tax are supposed to be "the eyes and ears" of the Department, serving essentially to keep AOs abreast of key information relating to assesseees in their charges. It is therefore, a cause for concern that, on average, only 18 per cent of the time of Inspectors was spent on field enquiry (Table 13). Inspectors were utilised more for tax recovery work (33 per cent) and for other, within the office, duties (49 per cent). Furthermore, field enquiry time of inspectors was least (8 per cent) in investigation circles.

Thus, in the charges sampled by us, less than 33 per cent of manpower time available in the Department as a whole is spent on actual assessment work. Furthermore, in assessment charges, 20 per cent of the time is spent on tasks which result in no direct impact on taxpayer compliance or no improvement in the information available on taxpayers (see the last column of Tables 13 and 14).

### *Experience and training of AOs and staff*

About 15 per cent of the Assessing Officers surveyed were directly recruited as ACs while 85 per cent were promotees to ITO/AC from subordinate posts. Wards were, by definition, under the charge of promotee ITOs having on

average about 6 years experience as ITOs and 23 years overall experience in the Income Tax Department (Table 10)<sup>29</sup>. Investigation Circles were also, by and large, manned by promotee officers. Approximately 50 per cent of other circles were looked after by promotee officers. The common presumption is that promotee officers have, due to their long experience, superior skills in scrutinising account books and other evidence relating to assessments. Direct recruits, due to their recent training, are well versed in theory and the law. It appears to us that this deployment of AOs is appropriate for proper assessment, given the presumptions that (a) promotees should be skilled at detection of evasion in cases where reported income is low and evasion is relatively large, while (b) direct recruits should be more adept at dealing with tax avoidance based on technicalities.

One lacuna in the Department appears to be the absence of technically qualified persons who could advise AOs on various technical points which are bound to arise given the rapid pace of change of modern technology. Several AOs interviewed in the field also complained about the poor and inadequate training of their staff. There does not, furthermore, appear to be any formal method of recording and transmitting important information and tips relating to the jurisdictions of each charge, to safeguard against hard earned knowledge being wasted if an officer or other staff member is transferred or retires.

#### **4.4 Work Norms and Performance Evaluation**

The Central Action Plan formulated by the CBDT every year lays down, among other things, norms for disposal of assessments and other work by AOs including DCs (Assessment). Besides laying down general targets, specific thrust areas are identified each year. Thus, for example, reduction in income tax demand was the thrust area in 89-90 and settlement of major audit objections was the thrust area in 1990-91 (ARMF, 1989-90 and 1990-91). Progress in the achievement of targets is monitored on a monthly basis through the 'CAP-I' and 'CAP-II' statistical returns.

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29. Unless additional charge of a ward is held by an ACIT.

Besides numerical disposal norms, revenue ("budget") targets are also laid down. However, the impression has been gained during the field survey that less difficulty is faced in the achievement of these targets. It has been alleged to us by one Income Tax Department officer that it is possible for assessing charges to indulge in a species of window dressing and meet these targets, a process resulting in refunds in the next financial year.

The chief method of evaluating the performance of Income Tax Department staff is the Annual Confidential Report (ACR) which is prepared, in the first instance, by the immediate superior of the employee. For AOs, non-achievement of numerical targets can lead to an adverse report. However not all numerical targets are taken note of in the ACR. As Bal (1990) points out, one omission is disposal of CIB extracts received. In fact, there is no explicit means of linking performance evaluation with non-utilisation of external information, though this aspect is taken note of in inspections of AOs. Inspection by DCs of assessment orders made by AOs is carried out, usually, with reference to assessments of earlier years - by which time the AO concerned could very well have been transferred. However, the DC is supposed to and usually does examine some assessments carried out by AOs before preparing the ACR. Overall, the quality of work done plays a less important role in performance evaluation than achievement of numerical targets.

In the current system AOs have substantial discretion about utilisation of information, as to selection of cases for scrutiny and over the actual conduct of the assessments. They have less discretion over the number of scrutiny assessments, and over other targets such as tax recovery and disposal of pending assessments. On the other hand, there are relatively few incentive mechanisms to encourage AOs to unearth undisclosed income, to collect additional revenues, to appear at Appellate Tribunals to argue the Income Tax Department's case in case of appeals, or to pursue penalties and prosecution. It is therefore quite likely that AOs are motivated to ensure satisfaction of set targets in terms of the number of assessments completed or in tax recovery, rather than to track down tax evasion. Moreover, the relative rigidity of targets set for the number of assessments to be completed and other technical areas may also prove to be dysfunctional. In

conversations with AOs and DCs in the ranges selected for our field study, we frequently heard the following complaints:

- i. Too many different variables are currently targeted, including a number of areas which will not contribute to revenue. The Action Plans for 1989-90 and 1990-91 are in Appendix 3.
- ii. Targets are too high in most areas such as the number of scrutiny assessments (varying between 120 and 150 per year) and the percentage of tax recovery (50 per cent).
- iii. Targets for certain areas of considerable revenue potential are not set, such as for collections of wealth tax or gift tax.
- iv. Targets are often expressed in the wrong units, such as percentage of outstanding dues recovered, rather than the total amount of dues recovered.
- v. Targets are not only unrealistic but also too inflexible given varying conditions in different wards and circles, such as the level of initial pendency or the efficiency of support staff.

Another distressing feature of performance evaluation in the department is the irrelevance of history. Thus, for example, no statistics are available, AO by AO, on the percentage of good and bad assessment orders made by him. Additional revenue demands which are subsequently quashed (on appeal or rectification) should play a role in performance evaluation but do not.

#### **4.5 Remuneration and Incentives**

Income Tax Department compensation and promotion scales are similar to that of other central government services<sup>30</sup>. However, it has been reported that promotions in the Department are generally slower than in many other central services including the Indian Audits and Accounts Service, Indian Railways Traffic Service and Customs and Central Excise Service. Regarding remuneration, there are certain categories of special pay for duties or postings considered abnormal or difficult. The Department also has a reward scheme

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30. Why parity with other central staff should be maintained, given that tax collection has characteristics unlike other administrative functions, is unclear.

under which various types of meritorious performance get special monetary benefit.

The amount of rewards for detection of concealed income appears to be generous enough: 10 per cent of the extent of concealed income discovered and reported by the AO. This compares markedly with the meagre amount of Rs 15.67 lakh disbursed under all reward schemes by the CBDT (ARMF, 1990-91). This is because the rewards are only paid upon satisfaction of an excessively stringent and flawed set of conditions: they are paid only if at least 50 per cent of the additional demand is upheld at the second appeal stage (if appeals are filed) and, in addition, if prosecution is launched. Furthermore no reward is paid if income is voluntarily surrendered, even if this is clearly due to the efforts of Department officers. The decision concerning the launching of a prosecution, however, does not rest with the concerned AO or DC alone. It is based on a cumbersome process wherein the DC informs the corresponding CIT of the desirability of launching prosecution. Ultimately, only if the concerned AO, DC, CIT and CCIT all agree does the prosecution process get instituted. Moreover, every case where rewards are to be paid are to be authorized individually by the CBDT. Complaints made about the current scheme are the following:

- i. AOs are not eligible for rewards in cases where the taxpayer voluntarily surrenders income.
- ii. The time lag between performance and rewards is too long;
- iii. Transferred officers are not informed about the fate of their past cases, so they are denied the ability to pursue cases eligible for rewards,
- iv. Transferred officers are not given the opportunity to plead cases in their previous charges at the appellate stage; and
- v. AOs are not eligible for rewards when a taxpayer for whom concealed income has been discovered, dies, and the government claims additional dues without any appeal by the taxpayer's heirs.

The other component of the compensation package of the officers and staff of the Department which merits comment is promotion prospects. While no data have been collected by us to verify this complaint, complaints have been made in the field that promotion avenues for certain groups of staff are limited,

effecting their motivation. From officers the complaint was heard that promotion after the rank of DC was slower in the Department compared to other central services including the rate of promotions among Customs and Excise officers. This was alleged to be a cause of frustration.

Consequently, by and large, compensation and performance evaluation are not linked to the fundamental role of the Income Tax Department which is to raise tax revenue.

#### **4.6 Relation Between Superior and Subordinate Staff in the Income Tax Department (work culture)**

Two DCsIT and some AOs interviewed in the field expressed the view that senior officers, including CITs, had lost touch with problems in the field and, furthermore, were only interested in the achievement of Action Plan Targets. Usually, it was stated, inter- action consisted of reminders or reprimands for non-achievement of these targets. Praise or commendation was rare or non-existent as was constructive help. Furthermore, relations between officers at the same level were reported to be competitive and geared to gaining the favour or notice of seniors and not mutually supportive. If true, these complaints point to an unhealthy work culture in the Department which could demotivate officers and staff and hamper effective functioning.

While no inquiry into labour relations has been made by us, it has also been reported that workers in the Income Tax Department have a powerful labour association which blocks computerisation efforts.

### **5. INCOME TAX ASSESSMENT**

Assessment of income tax refers to the process of examining and either accepting or objecting to income tax returns filed with AOs. The process of assessment culminates with the AO passing an assessment order. After briefly reviewing (in Section 5.1) the evolution of the assessment system in recent decades, we evaluate the overall revenue performance of assessment procedures

in Section 5.2. This is followed by a more detailed evaluation of the system of summary assessment (Section 5.3) and of scrutiny assessment (Section 5.4).

### **5.1 Assessment: A Capsule History**

Section 143 of the Income Tax Act had been recast in 1971<sup>31</sup>; amended further in 1975, 1976, 1980 and 1988; completely recast in 1989 and further amended in 1991. Numerous circulars issued by the CBDT regarding specific points clarify the scope of assessments under the various sub-sections especially under section 143(1).

The summary assessment scheme (under section 143(1)) was introduced in 1971 to cope with the growing workload of the Income Tax Department. Instead of scrutinising all returns filed, this introduced the practice whereby AOs were required to check a filed return for arithmetical mistakes, as well as to disallow those adjustments claimed by the taxpayer to reduce tax liability that are prima facie inadmissible, and insert adjustments (excluded by the taxpayer) that are prima facie admissible. The distinguishing characteristic of a summary assessment was that the presence of the taxpayer at the time of assessment was not required. If the assessee objected to a 143(1) assessment demand, the case was automatically assessed under 143(3) with a hearing being given to the assessee.

Initially all returns declaring an income of upto Rs. 25,000 were covered by the summary assessment scheme. The monetary limits defining the demarcation between summary and scrutiny assessment have been revised in later years, partly in response to the workload of the Income Tax Department. The limit was raised to Rs 1 lakh in 1981-82, lowered to Rs 50,000 in 1984-85, increased again to Rs 1 lakh in 1985-86, and then increased to Rs 2 lakhs in 1986-87. Until 1985, those returns falling within the prescribed limit were excluded from the ambit of scrutiny assessment except for a small number of randomly sampled cases (CAG, 1991b)<sup>32</sup>.

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31. That is, amended to take effect from April 1st of this year. A similar interpretation also holds for other years listed.

The authority given to assessing officers concerning prima facie adjustments was withdrawn in 1980. AOs were required from 1980 onwards to restrict adjustments solely to arithmetical mistakes. There appears to have been considerable confusion within the Income Tax Department concerning the precise authority granted to AOs under section 143(1). It was not until May 1985 that the CBDT issued a circular clarifying that only the arithmetical accuracy of filed returns was to be checked. Except for the sample of 5 per cent of the returns selected for scrutiny, the circular clarified that no form of checking other than for arithmetical accuracy was required. A further circular in July 1986 also instructed AOs not to reopen completed summary assessments in the light of information available later (which was carried out previously under section 143(2)(b)). In 1987 the right of an assessee to appear before the AO, if he disagreed with a 143(1) assessment, was withdrawn.

The provision for random scrutiny under 143(3) of 5 per cent of summarily assessed cases was introduced by the CBDT in 1985. This was done in view of the extremely limited examination of returns and accompanying documents under summary assessment and, possibly, because of the feeling that AOs would not be able to easily identify all potential evaders with their growing workload. The CBDT hoped that, in intensive scrutiny cases, there would be no scope for audit objections and rectifications of assessment orders. It also hoped that each AO could identify about a half-dozen evaders against whom prosecutions could be launched. These hopes were belied (CAG, 1988).

Following severe criticism of the summary-cum- random sampling assessment scheme by the Comptroller and Auditor General and Parliamentary Accounts Committees<sup>33</sup>, the law was once again amended in 1989. Currently, summary assessment under section 143(1) is supplemented by scrutiny assessment under section 143(3), with scrutiny assessment cases being selected

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32. For extensive detail concerning the Summary Assessment scheme, see the 173rd Report of the Public Accounts Committee of the Eighth Lok Sabha (1989).

33. See the review in the Appendix 4.

non-randomly in accordance with instructions laid down by the Board in the annual Central Action Plans<sup>34</sup>. Furthermore, under summary assessment, both arithmetical mistakes and prima facie errors can, once more, be corrected.

## 5.2 Returns to Assessment Activity

A point frequently made by watchdog organisations like the CAG is that reduction in assessment work involved in each case had not led to a decrease in pending assessments. As shown in Table 8, the number of assessments pending at the end of year in 1989-90 was about the same as in 1971-72. In percentage terms, however, the situation improved in the late 1980s. While the possibility that a genuine manpower problem continues to exist cannot, as has been discussed, be discounted, the fact that time "wasted" on non-assessment functions has been found to be inversely related to the workload of a charge, as also discussed earlier, shows that available manpower is not effectively utilised.

Be that as it may, it is still worth examining the returns to assessment activity by the Income Tax Department given the existing levels of efficiency and existing procedures. In Table 14, columns 6 and 7 present available data on prepaid income taxes and total collection from income taxes on non-company assesseees<sup>35</sup>. Total collection net of prepaid taxes is in column 8 in aggregate and on a per completed assessment basis in column 9. Column 10 gives the figures in column 9 in constant (1960) rupees. As can be seen, additional realisation per assessment was around Rs 959 (Rs 144 in 1960 rupees) in 1989-90. Furthermore, this has shown an upward trend over the five years for which data are available. Additional realisation equalled 7.9 per cent of prepaid taxes or 7.3 per cent of total collection in 1989-90. To the extent that additional collection over prepaid taxes can be attributed to assessment<sup>36</sup> additional realisation was about Rs 21

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34. See below for a discussion. See also CAG (1991b).

35. The data can only serve as a rough and ready guide since total collection may relate, in part, to assessments of previous years. Furthermore, both prepaid taxes and total collection are gross of refunds.

36. A portion is attributable to tax recovery (see Table 15). However appeals/settlements etc., are not reflected.

lakh per AO in 1989-90 (about Rs 3 lakh in 1960 prices). These figures too show a rising trend over time. Since both prepaid taxes and the number of assessments show a rising trend over the period, the returns to assessment activity appear to have improved over time. Though this does not preclude the possibility of further improvement, it also suggests that additional deployment of manpower to assessment is warranted.

A second indicator of the return to assessment is the cost of collection of income tax relative to total collection. From Table 16 it may be seen that, per rupee of expenditure by the Income Tax Department, Rs 71.63 was realised in 1989-90<sup>37</sup>. This too has a rising trend over the years (in real or nominal terms). The situation would have further improved for both types of indicators above if arrears of assessment had not mounted in real terms (Table 17). Of course, like pendency of assessment, arrears of assessment point to scope for further improvement. On the other hand, the decrease in tax demand outstanding (in 1960 rupees: Table 15) indicates that realisation per rupee of cost cannot entirely be attributed to assessment. For the five year period for which data on collection net of prepaid taxes were available, however, no trend in tax demand outstanding is apparent.

These data have to be interpreted with considerable caution while attempting to draw inferences about the deterrent effect of enforcement which they reflect. A rise in the returns per assessment or per rupee of enforcement cost, may simply be the result of **weaker** deterrence of tax evasion, resulting from a lower intensity of enforcement effort. The reason for this is that an increase in enforcement effort has two opposing effects on additional revenues collected. First, for a given degree of tax evasion, higher enforcement effort results in higher additional collections owing to detection of a larger fraction of tax offenses. Second, the higher enforcement effort has a higher deterrence effect, lowering the extent to which taxpayers understate their tax liability thereby lowering the additional yield from assessment through additional taxes, interest

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37. This reveue-cost ratio reflects the impact of the Department on the combined budgets of the Union and States. As such, costs are in terms of actual outlays without any correction to reflect true economic costs.

and penalties. An increase in the additional revenue yield could thus reflect either improved enforcement effort (if the first effect described dominates) or reduced enforcement effort (if the second effect dominates instead).

It is difficult, in consequence, to infer whether the intensity of enforcement effort has increased or decreased over time by simply examining additional returns to assessment. We propose to make a careful study of compliance behaviour and the deterrent effects of enforcement in the longer study.

Nevertheless, we would like to briefly draw attention to other evidence, to be presented later, which tends to support the hypothesis that the past 5 year period has witnessed a sharp reduction in enforcement effort. The evidence includes the observed decline in the number and proportion of scrutiny assessments, the manpower allocated to assessment, surveys under Sections 133A and 133B, the number of searches and seizures and the number of prosecutions initiated for tax evasion offenses.

Before summing up, data from the field survey may be examined to study inter-charge variation. From Table 18, the following are the main findings.

- i. Net additional demand per return was about Rs 1248 or about Rs 153 in 1960 rupees. This compares favourably with the aggregate data but it may be noted that the survey data pertain to tax demand and not collection.
- ii. Additional demand was also a much higher fraction of prepaid taxes (about 40 per cent) than in the aggregate data. This may be because the charges studied dealt mainly with business and professional assessees.
- iii. Additional demand per AO worked out to be, on average Rs 49 lakh or about Rs 6 lakh in 1960 prices again higher than in the aggregate data.
- iv. Total demand per AO was Rs 1.7 crore of which prepaid taxes were about two-thirds.
- v. The level of additions and prepaid taxes per AO varied widely across ranges. The variations within a range were much smaller.

- vi. Finally, additional revenues collected in investigation circles were higher than in wards or circles by several orders of magnitude<sup>38</sup>. This suggests that increased investigation efforts would generate a high return and additional deployment of manpower to investigation cases would pay dividends.

Overall therefore, one may reach the following tentative conclusions.

- i. There is clear scope for improvement in performance and rationalisation of manpower allocation and workload within the department.
- ii. Nevertheless, even at existing levels of efficiency and revenue there appears to be adequate justification, from a revenue point of view to increase the number of AOs in the department<sup>39</sup>.

An evaluation of summary and scrutiny assessment may now be undertaken in order to identify the efficiency with which each kind of assessment is carried out per se and to study if the relative time allocation between the two types of assessment is appropriate or not from the revenue point of view.

### **5.3 Evaluation of Summary Assessment: Field Data**

Under current administrative directives of the CBDT, all returns have, at the first instance, to be summarily assessed in order to discover prima facie and arithmetical mistakes. Summary assessment involves an examination of the return filed and accompanying documents only. Additional demands are made if any mistake become apparent from these records.

There is confusion among AOs and DCs (Assessment) as to what constitutes a mistake apparent from the record. This persists despite a manual on prima facie adjustments prepared by the Directorate of Research, Statistics,

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38. This conclusion will hold even if a correction is applied for the extra time and effort on investigation cases in Investigation Directorates.

39. Economic theory teaches that revenue gains and costs should be compared at the margin. Recent research suggests that this is true even when strategic responses by tax evaders to enforcement efforts are taken into account (Melumad and Mookherjee, 1990). While we lack data regarding the added costs of deploying additional AOs, almost any reasonable estimate of this will fall far below the corresponding revenue gains. This suggests that deployment of additional AOs would lead to net revenue gains.

Publications and Public Relations of the Income Tax Department in 1990. Consequently, a number of additional demands made after assessment under this sub-section subsequently get rectified under Section 154.

According to the field survey, extra demands are made, on average, in 35 cases out of an average of 2892 summary assessments (1.2 per cent) per ward or circle (Table 19). Of these at least 13 extra demands (37 per cent) get cancelled on rectification. Thus sustained additions are made in less than 1 per cent of summarily assessed cases. A study by the DOMS for the year 1988-89 covering all but 3 CCIT charges found prima facie adjustments to be 3.8 per cent of summarily assessed returns and rectifications to be 27 per cent of returns with adjustments. If field survey results can be taken to reflect the position in the Department as a whole, the sharp fall in additions and increase in rectifications since 1988-89 is cause for concern<sup>40</sup>.

The average (net) addition per summarily assessed return, before taking account of rectifications and revisions, worked out to be Rs 217 in the field survey (Table 20) compared to Rs 198 found in the DOMS study (Rs 27 compared to Rs 24 in 1960 prices). The total demand per return, on the other hand, works out to Rs 3241 per return. The best performance by type of charge was in investigation circles both with regard to rectifications and with regard to average additions per return (Rs 65,332 in 1990-91).

The aggregate revenue implications of additions resulting from summary assessment can therefore be estimated at approximately Rs 110 crore in 1989-90, before rectifications and revisions. If 70 per cent of these are subsequently upheld, the net overall revenue addition after rectification and revisions amount to approximately Rs. 77 crore in 1989-90, or 1.4 per cent of total collections in that year. Compared to the fraction of assessment time devoted to summary assessment, which we now discuss, this figure appears to be rather low<sup>41</sup>.

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40. The fall in sustained additions is statistically significant at the 1 per cent level of significance.

AOs spent an average of 28 per cent of their time on summary assessment though time spent went up to as much as 36 per cent in wards in 1990-91 (Table 11). Other staff spent about 40 per cent of their time on this activity though this went up to nearly 48 per cent in wards (Table 12). This implies<sup>42</sup> about 11 minutes spent by AOs per summary assessment and 67 minutes by staff per assessment (Table 21). Thus, the total additional revenue (before rectification) per hour of summary assessment per AO was Rs 1184.

Most adjustments under this sub-section were made due to disallowance of certain deductions claimed without supporting evidence under section 43B - a finding of both the field study and the DOMS study. These additions, due to their nature, would usually end up being cancelled on rectification or allowed as a legitimate deduction in subsequent years.

The data from the field survey and the DOMS only provide information about mistakes in summary assessment going against assessees (who then apply for rectification). According to test audits conducted by the CAG, mistakes prejudicial to the revenue are also plentiful<sup>43</sup>. The first type of error would create the impression that AOs harass blameless taxpayers given that over one out of every four assessment demands are cancelled. The second type of mistake would tend to erode the belief of taxpayers in the Department's ability to protect the interests of revenue. In view of the fact that most AOs and DCs find summary assessment irksome and have no confidence in the scheme, it may be apprehended that summary assessment cannot improve much with existing facilities.

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41. While the low level of additional returns may, in fact, reflect a strong deterrent effect for the class of errors that summary assessment can detect, misallocation of manpower vis-a-vis scrutiny assessment is still indicated if additional returns to the latter are higher.

42. Assuming, following the DOMs study, 1900 working hours in a year.

43. See, for example, CAG (1991a) or CAG (1991b). Also see the discussion below and Appendix 3.

## **5.4 Evaluation of Scrutiny Assessment: Field Data**

### *Preliminary Discussion*

Scrutiny assessment is the first operational step by which tax offenders are brought to book and also the main operational step in the discovery of loopholes facilitating tax avoidance. Good scrutiny assessments should, in principle, deter underreporting or concealment of taxable income. On the other hand poor scrutiny assessments would virtually spell the end of the Income Tax Department's ability to curb non-compliance. It is, for these reasons, the main administrative task of the Income Tax Department.

The proportion of man-hours and manpower in the Department devoted to assessment has already been commented on. Furthermore, it would already have become clear from the discussion of summary assessment that about 50 per cent of assessment time is taken up by summary assessment. Consequently, it is clear that the time deployment pattern in the Department results in self imposed handicaps in its ability to perform its central task efficiently. What has not been highlighted yet is that assessments in 99 per cent of cases are done by officers below the rank of DC. Thus even on the score of maturity and competence of AOs, the Department ends up shackling itself.

Before describing and analysing scrutiny assessment further, the steps involved in scrutiny may briefly be described. When a return is selected for scrutiny, a date for hearing the assessee and affording the assessee an opportunity to bring all relevant financial and commercial documents to the AO is fixed. On the basis of prior information (if any) information contained in documents or books examined and further field enquiries (if any), the AO decides on the correctness and accuracy of the income declared and makes an assessment. He then demands from the assessee tax, additional tax and interest - giving credit for taxes already paid - and issues "show cause" notices prior to imposition of penalties, if merited. In the bulk of cases, scrutiny assessment reduces to the AO conducting an examination for internal consistency and reasonableness of financial books and documents of the assessee in relation to information in them

and in returns filed in earlier years. Availability of other prior information and field enquiries are brought to bear in relatively few cases. Scrutiny assessment, as it is currently practised in most cases, is essentially an accounting exercise. Consequently, if an assessee is advised properly by a Chartered Accountant, who is aware of the accounting checks the AO will perform<sup>44</sup>, the chance of concealment of income by him being detected by the AO is virtually non-existent. That evasion is detected at all is due to the cases, primarily in investigation circles, where external information is available, due to poor advice from some Chartered Accountants and due to the inexperience of assesseees<sup>45</sup>.

### *Criteria and Procedure for Selection of Scrutiny Cases*

We initially consider the overall framework within which cases for scrutiny assessments are selected, in terms of its broad qualitative features. Later we shall evaluate the quantitative revenue returns to scrutiny assessments, as well as examine data pertaining to the quality of such assessments.

A good scrutiny selection procedure should satisfy the basic criterion of securing the highest possible revenue realization (net of the cost of collection) - either directly in terms of additional collections from tax evaders, or indirectly in terms of inducing high levels of voluntary tax compliance which increases the level of prepaid taxes. In addition, it should be designed to be fair, in the sense of distributing the burden of taxes and costs incurred in the process of being assessed equitably between different categories of taxpayers. Finally, it should limit the scope for corruption as far as possible, not only to reduce revenue losses, but also to promote general respect for the law, and faith of citizens in government.

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44. This can easily be ascertained from the Income Tax Department's manual on Examination of Accounts.

45. The absence of a reliable system for matching of information from third parties is the main way in which the situation in India differs from that in other countries. See, for example, National Tax Research Center (1982).

These general principles imply the following specific criteria that any good scrutiny system should satisfy:

- i. In the interests of fairness, no category of taxpayers should be able to altogether avoid the possibility of being scrutinised. Conversely, no particular category should be especially singled out for repeated scrutinies other than, possibly, confirmed past offenders.
- ii. All prior information available which increases the likelihood of detection of evasion should be utilised, combining information provided by assessee themselves, by third parties, and information collected by different parts of the Income Tax Department.
- iii. The population of taxpayers should be stratified into different blocks on the basis of criteria such as occupation and location that are relatively unalterable by taxpayers, where different blocks differ significantly in their propensities or opportunities for evasion. Insofar as scrutiny procedures appropriate for each separate block are distinct, the system should allow enough flexibility to pursue diverse strategies for different blocks. Enforcement resources should be allocated across different blocks in accordance with relative returns from assessment in them.
- iv. Within any given taxpayer block, the chances of being selected for a scrutiny should be higher for those who declare a lower level of taxable income, claim excessive exemptions and deductions, take large cash loans, or spend large amounts on consumption or investment relative to their reported income. The overall logic underlying the selection procedure should be to deter strategic underreporting of income, as well as to increase the likelihood of collecting additional revenues. The latter also implies that, everything else remaining the same, cases that are more transparent should be more likely to be selected.
- v. The selection procedure should be centralised and impersonal to the greatest feasible extent, rather than based on subjective judgments, so as to ensure that AOs are obliged, by and large, to keep assessee at arms-length and vice versa. An added benefit of such a system is that it would allow efficient marshalling of all relevant information pertaining to the likelihood of tax evasion that is available to the Income Tax Department. Insofar as local information and experience of AOs is deemed an important input, it may be used to augment rather than substitute impersonally selected cases. Moreover, evaluation norms and reward schemes should be designed to induce congruence between the personal interest of the AOs and the revenue goal of the Income Tax Department.

We will now argue that the existing selection procedure in the Income Tax Department fails almost all these criteria.

### *Evaluation of the Existing Scrutiny Selection System*

According to the CBDT's instructions for the year 1990-91 to wards and circles, selection of scrutiny cases is to be done as follows:

- i. All arrears assessment cases were to be disposed of.
- ii. a. From current cases, all cases on which information was available from the Investigation Wing (including the CIB) were to be selected. So also all 133A(1) and 133A(5) survey cases.  
b. All cases which the AO feels are "fit cases for scrutiny" should be selected if the DC approves in writing the reasons given by the AO.  
c. If, by following the steps (a) and (b), targets for case selection are not met, assessees whose returns show the maximum income or loss in the charge should be selected in descending order.  
d. Cases which did not result in significant additions in previous years should not ordinarily be selected.

Additional relevant information about scrutiny assessments is as follows.

- i. DCs (Range) have to approve cases selected by AOs before these can be scrutinised. Apart from this, there are no effective checks and balances on the cases selected by AOs (CAG 1990).
- ii. In 1990-91, ITOs in wards had an action plan target of 120 scrutinies (100 in 1989-90) and ACs in circles had a target of 150 scrutinies.
- iii. DCs (Special Range) and Central Charges usually had to scrutinise all cases in their charges (these cases had reported income or losses above Rs 5 lakh).
- iv. The target of 120 scrutinies in wards was substantially higher than the target in 1986 (75 cases).
- v. CITs had been issued instructions to guide officers in their charges by providing them economic information about the performance of different sectors in the local economy.
- vi. According to DCs of Ranges A, B and D the default (income) criterion ended up as the basis for selection of the bulk of scrutiny cases. CIB information was seldom utilised. The DC of Range B felt that prior examination of returns to select cases fit for scrutiny could be done by AOs in at best 100 odd cases per year given existing (manual)

procedures. Officers of Range C, Bombay, however, felt that they had no difficulty in examining relevant information in the, on average, 5754 returns filed with each of them<sup>46</sup>. A form (Appendix 5) has been introduced in Range E (and, we understand, in other ranges in Jaipur charge) which was to be filled up by each AO for about 200 cases for his ward/circle. This forms the main basis for the selection of scrutiny cases.

- vii. Turning to field data, as Tables 13 and 14 show, about 27 per cent of time available to AOs and about 7 per cent of time available to other staff is spent on scrutiny. ACs in circles spend relatively more time out of this on examining books of account and other documents than officers of wards or investigation circles though total time spent is roughly the same. On average 5 hours was spent by AOs per scrutiny assessment (Table 21). There has been a marked drop between 1989-90 and 1990-91 on time spent per return given the increase in the scrutiny target. In Investigation circles ACs were found to spend about 6 hours per scrutiny case. Time spent per return by other staff was about the same (Table 21). Clearly, with such limited time available, thorough field enquiries are not possible though it may be the case that a careful examination of accounts can be done in this time.
- viii. Besides technical additions, presumptive norms<sup>47</sup> form the basis for many additions. Other information in books and documents leading to further enquiries include evidence of capital build-up in accounts; investment in immovable property; undue changes in financial data (over the previous year); and large gifts received (Table 4).

The scheme may be evaluated now, point by point, in relation to the desiderata laid out previously.

- i. It is clear that assesseees who report low income - or choose not to file at all - had lower, almost zero, chances of being selected for scrutiny than those with high returned income, except, to some extent, in Range E. On the other hand, the ward/circle/special range organization ensures that cases with returned income close to Rs. 2 lakh, Rs 5 lakh and above, get selected repeatedly. Furthermore, a DC (Range) in Delhi informed us that cases of prominent persons -- "high-fliers" -- were invariably selected to avoid public criticism. Thus, the existing scheme fails the first test of a good system that every assessee should have a fair chance of selection, other things being equal. Moreover, the

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46. The patent absurdity of this claim is a negative reflection on the competence of the officers.

47. For example a fall in the assesseees gross profit rate compared to the previous year or a low gross profit rate compared to other similar assesseees. Provided corroborative figures from similar cases are cited or other relevent evidence is brought to bear, such additions are likely to be upheld on appeal.

scheme has a built in incentive to encourage underreporting by assesseses.

- ii. Selection procedures under-utilize many sources of information actually or potentially available to AOs, such as, we understand, CIB extracts, or information contained in wealth or gift tax returns. Also, the fact that past evasion history has little bearing on the selection of scrutiny cases<sup>48</sup> suggest that information use could be improved.
- iii. The existing classification between ranges, and to some extent between different wards and circles within a range, does correspond to a pattern of stratification of the taxpayer population according to innate characteristics such as occupation or location. However, the distinction between wards and circles is based on level of reported income, something that can be easily manipulated by taxpayers, and something that often changes from year to year for many taxpayers. Moreover, there is considerable scope to improve the allocation of manpower across ranges, or across wards/circles/ investigation circles.
- iv. Given that the workload for a ward tends to be heavier than in a circle, and given the nature of the summary assessment scheme, the probability of being selected for a scrutiny in a ward is considerably smaller than in a corresponding circle. Table 22 indicates that 2.02 per cent of all returns in wards were scrutinised, as against a corresponding figure of 4.8 per cent in circles, and 36.9 per cent in investigation circles. This will obviously encourage taxpayers to report an income below Rs. 2 lakhs to reduce their chances of being scrutinised. The procedure of selecting higher income cases with higher priority perhaps reflects the notion that technical errors are more important than detection of deliberate concealment since the quantum of additional taxes demanded on detection of technical errors is likely to be positively related to declared income. Indeed, the current system of scrutiny assessment does seem geared toward technicalities, ignoring considerations of deterrence.
- v. The selection procedure is, in effect, based almost entirely on the subjective judgment of the concerned AO and supervising DC since no effective checking of cases selected is done (CAG, 1991). It affords excessive discretion, with limited incentives offered to reduce losses arising from corruption. No regular procedure exists to incorporate any information learned from statistical analysis of evasion trends or of industry conditions.

Overall, detection of technical errors is the focus of the current system of scrutiny assessments. Other than this, the experience of the field survey, as also the indirect evidence to be presented below, shows that there is no awareness

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48. In the field survey, not even a single officer mentioned past history as an important reason for selection of scrutiny cases.

of the need to maximise direct and indirect returns per hour spent on assessment. Moreover, no attention is paid by the Department to possible strategic reactions by assessees to modifications in assessment practices of the Department.

### *Evaluation of Scrutiny Assessment: Monetary Aspects*

How successful has the existing scrutiny scheme been? As Table 14 shows, there has been a marked drop in the scale of the scrutiny assessment programme, especially over the last five or six years. This is true both in absolute terms - the number of scrutiny assessments has fallen from roughly one million to three or four lakhs per year - and as a proportion of the number of assessees. The fraction of assessees scrutinised has fallen from approximately 60 per cent in the late 60s, to approximately 30-40 per cent in the late 70s, and down to 5.6 per cent in 1989-90. However, we understand that the thoroughness of examination of an assessee's circumstances in scrutiny assessments has increased in recent years moderating, to an extent, the drop in the deterrent effect of scrutiny caused by the falling scrutiny proportion. Moreover, the fraction of assessees scrutinised in 1989-90 compares favourably with the corresponding proportions in certain developed countries such as USA or UK (around 3-4 per cent), though it is not as high as in certain underdeveloped countries such as Mexico (10 per cent) or Indonesia (33 per cent)<sup>49</sup>.

It is therefore more fruitful to examine the additional collections resulting from scrutiny assessments. We turn, accordingly, to the financial data from the field survey (Table 23).

The average net additions per scrutiny assessment (before appeals) works out to Rs 29,129. However if only 38 per cent of these demands are sustained on appeals, as our data show for the sample, then returns drop to Rs 11,069. The demand is higher in circles than in wards and in investigation circles compared to circles. This works out to Rs 5885 per hour spent on scrutiny

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49. This is circa 1982. See National Tax Research Centre (1985).

assessment by AOs, about 4 times as high as the return per hour to summary assessment<sup>50</sup>. It is also significant that additions made exceed prepaid taxes on average by over 50 per cent for the range as a whole though this finding does not hold good for wards and circles taken separately.

Thus even though scrutiny assessment per se has scope to be improved, redeployment of manpower and man hours in the department to scrutiny assessment from summary assessment appears to be advisable from a revenue point of view. Similarly, increased scrutiny in investigation circles is likely to pay dividends.

#### *Evaluation of Scrutiny Assessment: Quality Indicators*

Of, on average, 105 scrutiny assessment per charge (2.5 per cent of cases as compared to over 5 per cent for 1989-90 observed in the aggregate statistics in Table 14), extra demands were made in 78 cases, with 3 of these demands being cancelled subsequently (Table 24). However, concealment penalty was initiated in only 17 of these cases. Penalties were imposed in only 6 of these cases (prior, that is, to appeals decisions). 75 per cent of cases in which penalty proceedings are initiated go to appeal (Table 24). While separate data are not available on appeals against the assessed quantum and appeals against penalty, especially concealment penalty, figures for appeal orders received during the two years for which data were gathered are in Table 25. If relative weightage of 100:75:25:0 is given, respectively, to cases in which additions made were fully sustained; cases in which 50-99 per cent of addition were sustained; cases in which 1-49 per cent of additions were sustained; and cases which were set aside or where the entire addition was deleted, the weighted average of successful appeals from the Department's point of view is 38 per cent for appeals before DCs(A) or CITs(A). If this percentage is taken to be approximately valid for

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50. The figures for wards, circles and investigation circles in 1990-91 are respectively Rs 3692, Rs 7038 and Rs 25,116. It should be noted that the return to scrutiny conducted by investigation circles is dependent on prior work by the Investigation Directorates. However, unless the additional time devoted to investigation in these Directorates is more than 250 per cent of the time taken in investigation circles, the relative profitability of investigation cases remains highest.

appeals against concealment penalty, then the average number of cases in which concealment penalty is sustained upto the first appeal stage is below 2 (Table 24). This still leaves open second appeal decisions where the percentage of cases going in the Departments favour is even lower (Table 25) and references to High Courts and Supreme Courts on questions of law.

The figures above imply a probability of an evader being brought to book of 0.007. That is, if only 1 out of 10 assessee evades taxes then on average, one out of every 140 evaders are brought to book if penalties being sustained on first appeal<sup>51</sup> is the criterion used. If on the other hand all (business and professional) assessee evade tax, then only 7 assessee in every 10,000 are brought to book (Table 24). If any assessee brought to book are not genuine offenders, there is also cause for alarm insofar as innocent taxpayers are being harassed with the threat of concealment penalties<sup>52</sup>.

To find out the reasons for this dismal performance of scrutiny, even granted the selection procedure, 22 scrutiny files were selected for examination in Bangalore and Delhi. A summary of the findings of this examination is in Table 26. The salient features are as follows:

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51. Or where no appeal is filed and the penalty is imposed.

52. The following paragraph from the CAG (1991b) is worth quoting in full with respect to the performance of scrutiny assessment in earlier years:

"Another study of 32,871 selected scrutiny assessments in different Commissioners' charges, for the five years period 1984-85 to 1988-89, revealed that a substantial part of the additions made to the returned income in those cases was by way of normal (routine) adjustments required to be made under the various provisions of the law, and the extent of concealment/evasion detected by the department during the course of investigations was only 17 per cent. The Department has not evolved any bench mark to determine the level of efficiency of scrutiny assessments. Moreover, in respect of demands raised for levy of tax as a result of both the above additions, only 11 per cent of the gross demands had been confirmed in appeals. The position regarding prosecution and penalty was also not appreciable since the department was able to obtain convictions in only 8 out of 172 cases (4.6 per cent) for which prosecutions were launched, though it was able to sustain about 50 per cent of the penalty imposed for concealment, etc." [page 7]

- i. In only one case were files reasonably well maintained; in 3 cases, key documents including the return were missing; This hinders appeals against assessment being decided in the Departments favour and also makes it difficult for who are AOs transferred in to become conversant with key details of past assessments.
- ii. All documents which (patently) ought to have been examined were examined in only 4 of the 12 cases where files contained relevant information.
- iii. In no case for which information was available did it appear to us that the assessment or the drafting of the assessment order was properly done from the point of view of carefully marshalling relevant evidence and ensuring that key features of the order could be identified by the AOs successor.
- iv. Of the 20 cases selected (most of which pertain to the assessment year 1984-85), 13 had been settled by September 1991, while the remaining 7 were still in the appeals stage or pending for other reasons.
- v. Three files examined provided support for the belief that a tendency exists for the same set of people to be scrutinised year after year (where possible, data for 9 assessment years were examined).

An additional factor reducing the deterrent effect of scrutiny assessment, which came to light during field visits, was the fact that AOs, on average, appeared in appeals courts to give evidence in 1.4 cases per year (Table 22).

The situation described pertains to average performance. However, if investigation circles are excluded, the situation looks even more bleak for scrutiny assessment. Thus in wards, in 1990-91 in only 4.5 cases out of every 1 lakh assessments were evaders brought to book (Table 24). Thus if only 1 in 10 assessee is an evader, the probability of bringing the evader to book is a laughable 0.00045 (i.e. 0.045 per cent).

The analysis just presented suggests that scrutiny assessment has little deterrent effect.

## *Audit Objections*

According to the CAG, outstanding audit objections and income determined to be underassessed<sup>53</sup> by them have been growing over the years (Table 27 and Figure 1). A similar picture is evident with respect to internal audit (Table 28). As a percentage of assessments completed, in fact, new (internal) audit objections have been increasing. While the CAG is critical of the functioning of internal audit itself<sup>54</sup> the mounting audit objections indicate serious problems with the effectiveness of assessment. Mistakes reported in the CAG for summary assessment, it should be mentioned are with respect to allowable adjustments as per section 143(1). Additional income which could have been detected on scrutiny are reflected, however, in figures on under-assessment. One aspect defying rational explanation is that the Income Tax Department refuses to act on under-assessed income identified by the CAG in summarily assessed cases if the scope of re-assessment goes beyond summary assessment. It is worth quoting the CAG (1991b) on this point:

"The department has been declining to take cognizance of mistakes pointed out by Audit in Summary Assessment cases, which fall outside the purview of the prescribed adjustments, though serious lapses and even evasion of tax do occur in assessments covered by the Summary Assessment Scheme, and many of these are noticed by Audit by verification of returns and accompanying records. The fact that these cases escape the attention of the Department largely due to the deficiencies in the procedure for selection of cases for scrutiny, itself suggests the need for taking remedial action in such cases, after they are pointed out by audit." [pg x]

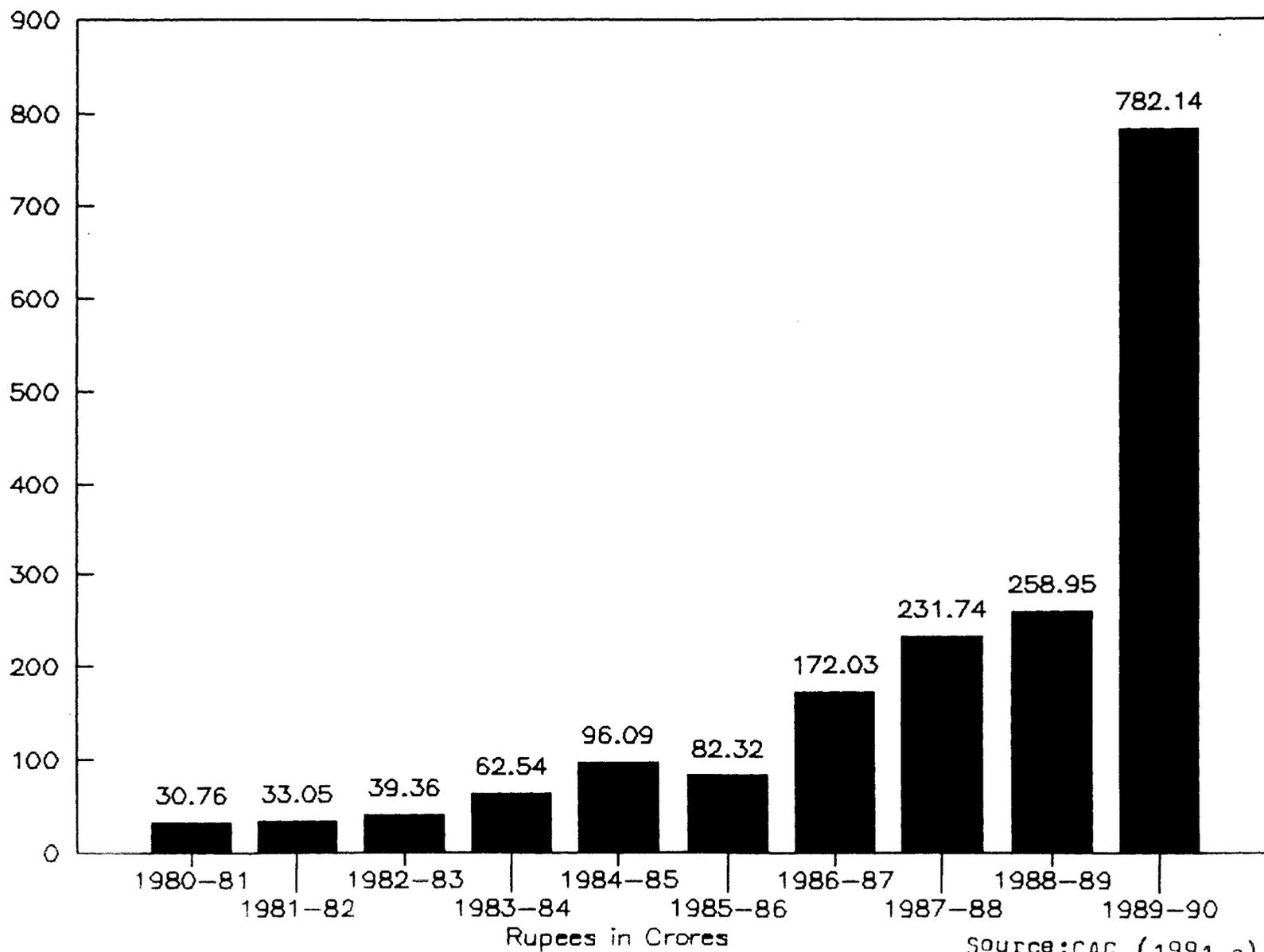
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53. Data in Figure 1 pertain only to mistakes actually detected by the CAG: No projection is involved.

54. See Appendix 3.

Figure 1

# INCOME TAX UNDER – ASSESSMENT



Source: CAG (1991 a)

## **6. PENALTIES, PROSECUTION, SETTLEMENT OF CASES AND IMMUNITY FROM SANCTIONS**

Two kinds of punishments can be meted out to tax offenders: imposition of civil penalties, and imposition of criminal penalties. A variety of schemes for out-of-court settlement, amnesty and immunity from penalty or prosecution also exist as an alternative to the imposition of civil and criminal sanctions.

### **6.1 Civil Penalties**

Concealment of income, as well as a number of other offenses, invite monetary penalties. The amount of penalty imposed varies between one and three times the amount of tax sought to be evaded.

Some of the categories which invite civil sanctions (apart from concealment of income) are the following: defaults in payment of advance tax, failure to deduct tax at source, failure to maintain books of account, failure to comply with certain notices, or to answer questions, furnish information etc., among others. A number of recent regulatory changes have made it somewhat easier for such penalties to be imposed: for certain defaults the burden of proof has been shifted to the assessee, while in certain other situations (covered by Explanations to Section 271(1)(c)) a person is deemed to have concealed particulars of his income, and in cases of advance-tax defaults mandatory interest has replaced monetary penalties.

Table 29 provides data on the number of penalty proceedings since 1984-85, while Table 30 presents the figures of penalty imposed and collected during this period. The number of fresh penalty proceedings in different years displays a marked drop over this period. Even if one excludes the exceptional year 1988-89, the number of new cases in 1989-90 is less than half the corresponding figure four or five years ago. Disposal figures have also halved, but have retained roughly the same proportion (about 45-50 per cent) to the total number of cases to be disposed.

The magnitude of penalties levied and collected has, on the other hand, increased three and a half times (approximately two and a half times in inflation adjusted terms) over this five year period. The magnitude of penalties collected amounted to 1.57 per cent of the aggregate net collections from the income tax in 1989-90. This suggests that the Income Tax Department has in recent years been pursuing fewer penalty cases, but of considerably higher penalty potential.

Sample results provide some evidence regarding the extent to which penalties for concealment of income are imposed in relation to the number of scrutinies in which the assessing officer imposes additional tax demands. This information has been discussed earlier. One relevant detail which may be added is that penalty for concealment is apparently almost never levied on persons who are arguably the major tax evaders detected by the Income Tax Department: persons who, having evaded taxes till date, are detected by survey operations of the Department and file a tax return for the first time.

## **6.2 Prosecutions<sup>55</sup>**

Chapter XXII (sections 275A to 280) of the Income Tax Act deals with 'Offences and Prosecutions'. The range of offences for which a person may be prosecuted include willful attempt to evade tax (section 276C) and related offences such as a false statement in verification (section 277) and abetment of false return (section 278), as well as a number of other tax violations like failure to pay the tax deducted or collected at source (sections 276B and 276BB), failure to furnish returns of income (section 276CC) and failure to produce accounts and documents (section 276D). For certain income tax violations prosecution can also be launched under the Indian Penal Code.

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55. The discussion here is mainly in the context of offences and prosecutions under the Income Tax Act. Certain wealth tax and gift tax violations may also lead to prosecutions. Conclusions similar to those reached here were also reached for an earlier period by NIPFP (1985).

Under the existing scheme, firstly, the Income Tax Act provides deterrent punishments for tax offences, including rigorous imprisonment for periods ranging between three months and seven years. The scale of punishment for many 'technical' offences is the same as that for tax evasion. For, certain offences, the courts have no discretion to award monetary fine in lieu of imprisonment or reduce the term of imprisonment below the prescribed minimum. Second, as a result of certain legislative amendments made with effect from the 10th September, 1986, the burden of proof in several areas has been shifted on the assessee. Third, a prosecution under the Act cannot be launched except with the previous sanction of the Commissioner or Commissioner (Appeals) or the Appropriate Authority. Fourth, a court inferior to that of a presidency magistrate or a magistrate of the first class cannot try any offence under the Income Tax Act. Finally, a person can get immunity from prosecution under certain circumstances to be discussed further in section 6.4.

In principle, the deterrent effect of prosecution is greater than that of monetary penalties. This is so, as the Wanchoo Committee puts it, the "prospect of landing in jail ... is a far more dreaded consequence"<sup>56</sup>. The deterrent effect of the threat of prosecutions is diluted, however,

- i. By immunities against prosecution that may be granted by the Settlement Commission and at the discretion of senior officials of the Income Tax Department which is discussed further in the next section;
- ii. By amnesty programs adopted from time to time<sup>57</sup>; and
- iii. Possibly, by compounding of the case (against payment of a large fee) at the discretion of senior officers of the Income Tax Department or by officials in the CBDT.

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56. The Direct Taxes Enquiry Committee (1971).

57. Besides the amnesty program during the current, 1991-92, financial year, four amnesty have been tried in India in recent times. The results of these programs have been dismal without exception. See NIPFP (1985) and Chugh and Uppal (1986)

The Income Tax Department has received a number of uncomplimentary comments on its dismal performance in prosecutions.<sup>58</sup>

We now review the Department's performance in prosecution and the effectiveness of the scheme mainly on the basis of the available secondary data<sup>59</sup>. This we do mainly with reference to four indicators: number of prosecutions launched for tax evasion and other offences, the extent of the Department's success in prosecution cases, time-lag between commission of offence and punishment and sentences awarded by courts in the cases resulting in conviction.

Prosecution has been an integral part of the Indian income tax system for a number of years<sup>60</sup>. However it seems that till recently the tendency in the Income Tax Department was not to launch prosecutions even in serious cases of tax evasion. During the financial years 1961-62 to 1969-70, only 102 complaints for tax evasion were filed<sup>61</sup>. Subsequent criticism appears to have motivated the department to launch more and more prosecutions in the mid 1970's and 1980's. The total number of prosecutions launched during 1989-90 is, for example, 686.8 times that for 1971-72 (Tables 32 and 34).

An analysis of the figures of the complaints in Table 32 shows, however, that a progressively smaller fraction of them are for tax evasion (from 82.11 per cent in 1981-82 to 6.7 per cent in 1989-90). Several income tax officials we interviewed, told us that most of the complaints are for mild technical defaults, with only slender chances of success in courts.<sup>62</sup>

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58. For example see the Wanchoo Committee (1971), the EARC (1983) and NIPFP (1985).

59. The data relating to prosecution have been presented in Tables 32, 34 and 35. The figures culled from the CAG's Reports differ considerably from those put out by the Income Tax Department.

60. Gaur (1987) points out that the income tax statutes in Indian provided criminal sanctions long before they recognised the feasibility of imposing administrative sanctions. Gaur refers, *inter alia*, to certain provisions of the Income Tax laws of 1869, 1886 and 1918 in this regard.

61. Gaur (1987) (p.77).

62. We have been given to understand that during 1990-91 the CBDT emphasised prosecutions for tax evasion and fraud and discouraged filing of complaints in small

The pendency of prosecution cases in courts, appears to be rapidly assuming alarming proportions in the last few years. Table 35 shows that the pendency in 1989-90 was almost three and a half times the level of 1985-86, and nine times the 1983-84 level. A more alarming picture emerges when we look at the CAG data at Table 34.

It seems from the figures reported in Table 35 that both the Courts and the Department have responded to the growing pendency by progressively better quantitative disposal (including by way of compounding offences) in absolute terms. However, as annual additions of complaints is far in excess of the disposal, the pendency has gone up. The position would seem to be all the more alarming if we also take into account the time consumed in appeals against trial court's decisions. We are not in a position to make even a rough estimate in this regard as the pendency figures given in Tables 34 and 35 pertain to cases pending before the trial courts and we have not made any study of the number of cases going in appeals<sup>63</sup>.

On the recommendation of the Wanchoo Committee (1971), special courts for trying economic offences were set up in several States: In principle, this should go a long way in accelerating the rate of disposal and also improving the quality of judgements. We have not been able to examine whether this has brought about any significant improvement in the working in this study. It is, however, possible that concentration of all tax offence cases in one or two courts

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cases of technical violations. As a result, only 3786 prosecutions were launched during 1990-91 (a decrease of 57.6 per cent 1989-90). Of these, 844 complaints (22.3 per cent of the total complaints filed) were for tax evasion. This seems to be a step in the right direction.

63. However, the pendency of 36,934 prosecution complaints, as on 31.3.1990. (Table 35) (30,413, according to the CAG - Table 34) includes a large number of multiple complaints (particularly in respect of TDS offence under section 276B) involving the same accused and similar facts. The disposal-rate can be significantly accelerated if all such multiple complaints are, as a rule, consolidated and decided simultaneously. We have not been able to work out the 'effective number of prosecutions' after adjusting for multiple complaints. We understand that the CBDT does not compile this information on a regular basis.

in a State may cause great inconvenience to persons (including witnesses) residing at places far away from where the special court is located.

One way of assessing the intensity of prosecution effort in combating tax evasion is to examine the number of prosecution complaints filed in relation to search and seizure figures. Table 33 presents the data contained in CAG reports pertaining to the latter. The figures reported in the Income Tax Departments' publications are given in Table 5<sup>64</sup>. We have analysed the issue in section 3.3. Our analysis suggests that only a small fraction of search assessments lead to institution of prosecution proceedings for tax evasion.

We now come to the sentences awarded by courts in cases resulting in conviction. For a number of income tax offences, courts do not have any discretion to award monetary fine in lieu of imprisonment or to reduce the term of imprisonment below the prescribed minimum. But despite these safeguards, the courts have, in many cases, imposed only monetary fines or reduced the term of punishment below the limit prescribed under the law. The information given in Table 37 points in this direction. Our discussions with several income tax officials also confirm this. This obviously dilutes the deterrent effect of prosecution.

Table 34 and 35 present data on the outcomes of prosecutions by the Income Tax Department. The success rate (with respect to securing convictions) has fallen sharply in the past five years. The success rate has fallen below 40 per cent since 1986-87, from a level of above 70 per cent in the early 1970s, and of between 45 and 60 per cent between the mid 70s and the mid 80s. This picture is however altered considerably if compounded cases are also treated as successes,

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64. These two sets of figures differ considerably. The discrepancy is probably accounted for by the practice of the Income Tax Department to report the number of search warrants issued instead of the number of taxpayers who are searched (a single search case may be associated with many search warrants for different premises). Nevertheless, even the estimated value of assets seized differ significantly between the two sources, with the Income Tax Department reporting almost twice as much as the CAG figures in 1987-88 and 1988-89.

as the number and proportion of cases compounded in recent years have both grown substantially in the last five years.

One possible interpretation of the events of the past five years is that the Income Tax Department has responded to the tightening of punishment standards since 1986 by substituting away from prosecution towards compounding of cases. If compounding carries a substantial deterrent effect as some officers of the Income Tax Department believe, then this may, in fact, be the 'correct' response to a sharp increase in the pendency of prosecution cases.

Nevertheless, this view is consistent with the view that the scale of prosecution effort is negligible in absolute terms<sup>65</sup>. There are some indications (see Table 37) that most of the prosecutions pertain to tax offenses of small magnitude, rather than to 'big' evaders. Comparison with prosecution efforts in other countries will be useful in this regard, but we have not pursued this so far.

We now briefly enumerate some problems which generally come in the way of speedy and successful enforcement of criminal sanction against tax offenders. This is largely based on our informal discussion with a number of officers of the Department and our analysis of the issue involved.

One reason for the long delays in disposal of prosecution cases is the cumbersome legal procedure. While the Income Tax Act contains substantive law relating to various offences, the procedure for trial is governed by the Criminal Procedure Code. Most income tax officials we interviewed, feel that delay is inherent in the procedure prescribed. Another reason is that both the accused and the Department seek frequent adjournments. While the accused may have a motive for stalling prosecution proceedings, income tax authorities seek

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65. Commenting on the inadequacy of prosecutions in the Income Tax Department, one DC (Range) expressed the following views: "Generally the AOs are shy of diligently following up prosecution matters. Besides, resolving concealment cases takes a long time in appeals and so the matters are lost sight of. Protracted correspondence like serving show cause notices, etc., also hinders progress. Delay in decisions of appeals against additions and penalty is another factor." The number of prosecutions in ranges included in the field survey are in Table 36.

adjournments mainly because of non-availability of records and witnesses. Generally by the time a prosecution case comes up for hearing, the officer who had filed the complaint or made the relevant assessment would have been transferred or would have retired. The problem becomes all the more acute in the cases of retired officers, who are required to appear in court. Many of them are reluctant to attend multiple court hearings because their expenses are not sanctioned in time. Apart from that, attending multiple court hearings is, by no means, a pleasant experience even for serving department officials. An income tax official informed us that he has attended more than fifty court hearings in a prosecution case during the last more than ten years but it has not yet been decided. Because of these problems, retired and serving departmental officials are generally reluctant to attend court hearings.

Delay in filing a complaint after the detection of offence also dilutes the deterrent effect of prosecution. One reason for such delays is that in tax evasion cases, prosecutions are generally launched only after the concealment penalty has been confirmed in the first appeal. Legally, prosecutions for such offences can be launched even before the completion of the relevant assessment proceedings. However, the income tax authorities generally prefer to await the outcome of the first appeal. Several other problems in launching prosecution caused by the poor state of record keeping, motivation of personnel and the operation of immunity provisions can also be cited<sup>66</sup>.

A more detailed study of prosecutions, the poor success of the Department in securing convictions, and the effectiveness of prosecutions in deterring evasion is to be made in the longer study.

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66. Commenting on the inadequacy of prosecutions in the Income Tax Department, one DC expressed the following view:

"Generally the AOs are shy of diligently following up prosecution matters. Besides, resolving concealment cases takes a long time in appeals and so the matters are lost sight of. Protracted correspondence like serving show cause notices etc., also hinders progress. Delay in decisions of appeals against additions and penalty is another factor". The number of prosecutions in ranges included in the survey are in Table 36.

Summing up, it seems to us that while in principle prosecution is a powerful deterrent against tax evasion and other tax offences, its deterrent effect has been considerably diluted by the Income Tax Department's inability to use it effectively, coupled with other factors like immunity provisions and schemes, which, in practice, have been found to provide shelter even to detected tax offenders; long delays in disposal of cases; and the tendency of courts to take a lenient view in favour of tax offenders.

### **6.3 Settlement of Cases<sup>67</sup>**

A recommendation made by the Wanchoo Committee led to the insertion of provisions<sup>68</sup> for settlement of income tax and wealth tax cases and creation of the Settlement Commission. The scheme should provide a mechanism for quick and final settlement of complicated tax cases, which would otherwise become enmeshed in protracted litigation. It also opens a door for compromise with errant taxpayers who wish to make a full and true disclosure of their income.

The Settlement Commission consists of a Chairman and as many Vice-Chairmen and other members as the Central government thinks fit. It functions within the Department of Revenue in the Ministry of Finance. Presently there are four benches of the Settlements Commissioner - one each at Delhi, Bombay, Calcutta and Madras. The Delhi bench (Principal bench) has a Chairman and two other members. Each of the other benches (Additional benches) consists of a Vice Chairman and two other members. Several posts (for example Secretary, Director of Investigation and Deputy Director of Investigation)<sup>69</sup> have been created to assist the Settlement Commission.

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67. The discussion in this sub-section is mainly in the context of settlement of income tax cases. There are corresponding provisions of the Wealth Tax Act.

68. Chapter XIX-A of the Income Tax Act, 1961 inserted by the Direct Tax Laws (Amendment) Act, 1975, with effect from 1.4.1976.

69. This is only an administrative arrangement. These officers do not perform any statutory function.

Originally, any assessee in whose case tax proceedings were pending could approach the Settlement Commission for settlement. However, subsequent legislative amendments have placed some restrictions, the important ones of which are:

- i. An assessee cannot approach the Settlement Commission unless he makes a full and true disclosure of his income, which had not been disclosed before the assessing officer and the additional amount of income tax payable on the income disclosed in the application exceeds fifty thousand rupees;
- ii. No application for settlement can be made unless the assessee has furnished the return of income which he is or was required to furnish, and
- iii. In a search case which has resulted in the seizure of any books of account, other documents or assets, the assessee is not entitled to make a settlement application before the expiry of one hundred and twenty days from the date of the seizure.

Till March, 1979, the Commissioner could veto the admission of a settlement application on the grounds of establishment or likelihood of establishment of concealment of income in the case. The Finance Act, 1979 diluted this power by empowering the Settlement Commission to overrule his objection (after giving the Commissioner an opportunity of being heard) if it was not satisfied with its correctness. We understand that because of the difference in perception between the income tax authorities, on the one hand, and the Settlement Commission on the other, regarding the intended connotation of the expression "concealment of particulars of income on the part of the applicant ... has been established or is likely to be established by any income tax authority, in relation to the case" appearing in the relevant section of the Income Tax Act - a factor on which the admission of a settlement application depended - objections raised by Commissioners against admission of settlement applications have been overruled in most cases by the Settlement Commission. The process of deciding admissibility of settlement applications consumed a lot of time as the Settlement Commission could not summarily accept or reject the Commissioner's objection and was required to allow a reasonable opportunity to be heard both to the Commissioner and the applicant. We have been given to understand that the problem of the difference of perception affected, for some time, the working

within the Settlement Commission also, with the principal bench following one view and the Bombay bench another. The Finance Act, 1991 has, with effect from the 27th September, 1991, withdrawn the Commissioner's power to object.

On receipt of a settlement application, the Settlement Commission is required to call for a report from the Commissioner and decide the admissibility of the application on the basis of the report, having regard to the nature of the case or the complexity of the investigations involved. As per a provision inserted by the Finance Act, 1991, the Commissioner is required to report within one hundred and twenty days of the receipt of the communication from the Settlement Commission. If he fails to do so, the Settlement Commission can make an order without a report. No application can be rejected unless a hearing has been given to the applicant.

A settlement order is passed after hearing the applicant and the Commissioner (either in person or through an authorised representative) and examination of records and evidence.

The Settlement Commission has the power to grant immunity from prosecution for any offence under the Income Tax Act or the Indian Penal Code or any other Central Act in force and also, wholly or in part, from the imposition of any penalty under the Income Tax Act with respect to the case covered by the settlement if it is satisfied that the applicant had co-operated in the proceedings and made a full and true disclosure of his income and the manner in which such income had been derived. As per a provision inserted by the Finance Act, 1987, with effect from 1.6.1987, the Settlement Commission cannot grant immunity in a case where the proceedings for prosecution for an offence were instituted before the date of receipt of the settlement application. Immunity granted to an applicant can be withdrawn in certain circumstances.

The Settlement scheme has clearly become a safe harbour for detected tax evaders. A series for legislative amendments, first taking away the Commissioner's power to veto admission of settlement applications (coupled with the self-evolved norms of the Settlement Commission on what constitutes concealment of income or the likelihood of its establishment) and then the withdrawal of the Commissioner's power to make objection have, in conjunction with the Settlement Commission's power to grant immunity from penalty and prosecution on satisfaction of conditions having no direct relevance to the nature and gravity of offence, made a mockery of tax investigations and the scheme of civil and criminal sanctions<sup>70</sup>. Second, the scheme of settlement benefits only big tax evaders who can disclose previously undisclosed income on which taxes exceed Rs 50,000. The focus of the scheme has obviously shifted from 'settlement' of tax cases involving complex investigation to the purchase of immunity from penalty and prosecution on disclosure of concealed income.

Data pertaining to cases settled by the Settlements Commission were presented in Table 31. No overall trend is discernible in the number of cases settled between 1979-80 until 1985-86; however, a substantial amount of income tax was settled in 1985-86 compared with previous years. Since 1985-86, there is a sharp drop in settlements: in particular the amounts of tax settled have almost disappeared! The source of the data should perhaps be examined more carefully before drawing any firm conclusions.

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70. NIPFP (1985), p. 285, had this to say:

"Has the Settlement Commission become an escape hatch for "detected" tax evaders? There are some indications which point in this direction. First, several revenue officials expressed this concern to us. Second, and more concretely, the Income Tax Department had, by the end of 1983-84, filed a dozen or so special leave petitions to the Supreme Court to plead against improper admission of applications to the Settlement Commission. These are, presumably, cases where the Department felt it had very strong possibilities for bringing assessee to book for concealment ..... Third, CBDT officials estimated that nearly 80 per cent of applications filed before the Settlement Commission related to search/seizure cases. The review suggests that the Settlement Commission may indeed have provided a safe haven to tax evaders who might otherwise face severe penalties and prosecution".

## **6.4 Immunity from Penalty and Prosecution<sup>71</sup>**

In the section devoted to settlement of cases, we discussed the Settlement Commission's power to grant immunity. We now discuss other ways in which immunity from prosecution and penalty can be obtained by tax evaders.

Section 273A(1) empowers Commissioners (and also Chief Commissioners though, in practice, the power is not exercised by Chief Commissioner) to reduce or waive concealment penalty imposed or imposable on a person if he makes a voluntary disclosure of his income, prior to the detection of concealment of income by the assessing officer and fulfills certain other conditions. This relief is admissible only once in the life-time of an assessee<sup>72</sup>. Under section 273A(4), Commissioners can reduce or waive penalty (or stay or compound proceedings for their recovery) on the grounds of genuine hardship. Successive reliefs under this sub-section are permissible, provided these do not follow a relief under sub-section (1) of section 273A. Reduction or waiver of concealment penalty under section 273A leads to automatic immunity from tax evasion prosecutions under sections 276C and 277.

In principle, a detected tax evader should not be able to walk away with immunity under section 273A(1) because of the insistence of the provision on voluntary disclosure, prior to the detection of concealment by the assessing officer. We have, however, been given to understand that, in practice, disclosures made as a sequel to the acquisition by the Department of incriminating material, pointing to the assessee's guilt are also accommodated under section 273A(1) and even detected tax evaders manage to get immunity. This is mainly because there is a difference between 'detection' of concealment of income and its establishment in appeal so that officers of the Department welcome offers of surrender of additional income.

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71. The discussion in this sub-section is mainly in the context of the income-tax penalties and prosecutions. Similar provisions also appear in the Wealth Tax Act.

72. Twice, if the first relief has been allowed on or before the 24th July, 1991 and the second relief is claimed before the 1st April 1992.

In certain search cases, immunity from imposition of concealment penalty is also available under the Explanation 5 of section 271(1). This Explanation is basically a device for bringing within the penalty net certain types of concealment cases which otherwise fall outside its ambit. The manner in which the income tax authorities generally apply the provision, to secure more and more surrenders of income, has converted the provision into a safe sanctuary for detected tax evaders.

Compounding of offences under section 279(2) of the Income Tax Act is a mechanism under which a tax offender buys immunity from prosecution on payment of a fee. It results in termination of criminal proceedings in respect of compounded offences against offenders. The power to compound offences vest in Chief Commissioners and Directors General. The Central Board of Direct Taxes continues to oversee compounding matters<sup>73</sup>. As discussed earlier, many officers of the Income Tax Department believe that compounding provides a solution to the problem of protracted litigation in which most prosecution proceedings get enmeshed.

Section 291 of the Income Tax Act invests the Central government with the power to tender immunity from prosecution under the Income Tax Act or under the Indian Penal Code or under any other Central Act in force. It can be tendered if the Government is of the opinion that it is necessary or expedient to do so to obtain from a person evidence relating to concealment of income or tax evasion. This power is rarely used.

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73. An instruction issued by the Central Board of Direct Taxes (Instruction No. 1317 dated the 11th March, 1980) laying down guidelines for compounding of offences was challenged before the Delhi High Court (*M.P. Tiwari v. Y.P. Chawla, ITO and Others: Criminal Writ No. 348/87 dated the 30th November, 1987*). The court quashed several CBDT guidelines including the one prohibiting composition of offences in the cases of assessee belonging to monopoly or large industrial house and directors of companies belonging to or controlled by such houses. It also quashed the directions for seeking the approval of the Board/Minister for compounding of offences. Sub-section (2) of section 279 of the Income Tax Act has since been amended, with retrospective effect, to overcome the High Court's decision.

Voluntary disclosure and amnesty schemes, introduced from time to time, have provided immunity from penalty and prosecution to tax offenders. These schemes have been severally criticised<sup>74</sup> for diluting the deterrence of tax enforcement.

Summing up, it is clear that schemes for immunity from penalty and prosecution and the manner in which these have been applied, have considerably diluted the deterrent effect of measures like searches, surveys and tax investigations and penalty and prosecution provisions. However, some of these (like compounding of offences, especially technical offences) ensure expeditious settlement of time consuming and uncertain tax proceedings without significant dilution of deterrence, provided these are used with caution and their benefit is not extended indiscriminately to glaring cases of tax evasion.

## 7. OVERALL EVALUATION

We summarize our discussion of the major shortcomings of different components of the activities of the Income Tax Department.

- a) **Information System:** The main problem areas here pertain to the utilization of CIB and investigation information; the effectiveness of 133B surveys; the lack of an adequate system of taxpayer identification numbers and of third party information collection; public resistance to search operations; and finally of an organized system of record keeping. These problems can be alleviated only with substantial computerisation of the information system and organisational restructuring.
  
- b) **Workload and Manpower for Assessment:** The main issues of concern are the following: wide fluctuations in workload across ranges; a possible decline in manpower devoted to assessment in recent years despite an increase in workload; the low fraction of manpower engaged in assessment; the small fraction of time of assessing staff devoted to assessment; the large fraction of assessment time devoted to summary rather than scrutiny assessment; and finally the lack of suitable motivating factors for AOs to pursue revenue goals resulting partly from a poorly conceived system of targets, and partly from the absence of positive incentive mechanisms.

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74. For example by the Wanchoo Committee, Public Accounts Committees and NIPFP(1985).

- c) **Assessment:** The salient issues here are the increased collection yields from assessment over time; the wide variations in these yields across ranges and across Investigation circles, circles and wards; the significantly lower yields from summary rather than scrutiny assessments; and finally the design and operation of the scrutiny assessment procedure that significantly erodes its ability to detect or deter tax evasion.
  
- d) **Penalties, Prosecution, Settlement and Immunity:** We noted here the sharp drop in the number of concealment penalty cases initiated in the last five years, but increasing amounts of penalties collected; an overall increase in prosecution efforts but a smaller fraction of cases dealing with tax evasion; the continuing low overall scale of prosecution efforts despite this increase; an increase in the success of prosecution efforts if compounding of cases is counted as a success though not if convictions are the indicator of success used; and finally, the increasing pendency of prosecution cases in the courts. Regarding settlement of cases, the power of the Settlement Commission to grant immunity from prosecution has been increased in stages over the years. Combined with amnesty schemes and the use made by the Income Tax Department of powers to grant immunity from penalty and prosecution, this may explain the low level and declining trend in prosecution of concealment cases. The consequent dilution in the deterrent effect of penalty and prosecution is a matter of serious concern.

Overall, we note with concern that there appears to be a marked drop in enforcement efforts over the last five years or so, judging by a variety of indicators (manpower allocated to assessment, number of scrutiny assessments, surveys under Section 133A, penalty proceedings initiated, and prosecution complaints filed). Nevertheless, this period also witnessed an increase in collection and yields. Whether this merely reflects the principle of diminishing returns to collection (less effort implying greater returns per case), or whether it reflects a significant reduction in the levels of tax compliance, is difficult to assess without further detailed analysis.

It is, nevertheless, clear that there is a trend toward targetting of technical violations, and away from detection and deterrence of tax evasion. By and large, the design and operation of the assessment system ignores the potential for taxpayers to strategically conceal their incomes and evade tax liability. Moreover, the design of the system provides inadequate motivation to AOs to act in the primary interest of the Department, namely the collection of revenues.

## **CHAPTER 2**

### **PRINCIPLES AND SUGGESTIONS FOR REFORM OF INCOME TAX ENFORCEMENT IN INDIA**

#### **1. OVERVIEW**

Our discussion of reform recommendations concentrates primarily on the identification of principles and guidelines for reform, though specific recommendations are also provided. Broadly speaking, two alternative philosophies inform our suggestions. One set of suggestions keeps in view the objective of altering current administration only in ways that will not necessitate a sea change in the administrative culture of the Income Tax Department. The other set of alternatives proposed draws upon modern management methods of motivating employees and reducing dysfunctional behaviour, and will therefore necessitate substantial changes in the work culture of the Income Tax Department. The latter approach includes recommendations concerning, for example, self-targeting and self-policing in assessment charges and a form of "profit sharing". Suggestions specifically concerned with the organisation of assessment charges and assessment procedures form the basis of a proposed range level experiment whose design is laid out in Chapter 3.

Section 2 of this chapter discusses the potential importance of computers in the activities of the Income Tax Department in broad terms. Section 3 then discusses specific reform suggestions of the taxpayer identification number system, as well as aspects pertaining to the information system of the Department. Section 4 contains suggestions for the reform of different aspects of workload, manpower and assessment procedures. It also contains a proposal (Section 4.8) for a system of monitoring, control and feedback that is essential to the efficient internal management of the operations of the Department. Section 5 then considers the reform of post-assessment activities including appeals, penalties, prosecution efforts and settlement of cases. Section 6 outlines a scheme for annually evaluating the performance of the Income Tax Department as a

whole, which can help identify broad areas of weakness in enforcement. Section 7 concludes with a detailed summary of the main recommendations.

## **2. THE USE OF COMPUTERS IN THE INCOME TAX DEPARTMENT**

Computerisation of the Income Tax Department is sufficiently important to deserve to be dealt with right at the outset. In the Department, resistance to computerisation on the part of the staff arises not only because of the usual fear, born largely of ignorance, of job displacement but also, it is alleged, because automation will greatly reduce the scope for corrupt practices. However, no attempt to improve enforcement efforts in the Income Tax Department will amount to anything substantive in the long run without the eventual introduction of computers.

One suggestion which should be considered is the computerisation, initially, of areas where staff perceive only benefits from a streamlining of workload as this may be the path of least resistance.<sup>1</sup> Such areas include receipt/despatch of returns and notices ("dak"), arrears and refunds, statistical reporting, tax recovery, the information system including the CIB, taxpayer numbers and Board circulars/appeal orders/ court decisions. The availability in India of expertise about modern computer technology such as Optical Character Recognition technology, tamper-proof storage media and telecommunications networks makes it possible to greatly speed up information collection and dissemination and improve managerial control of workflow without the need for external experts.

## **3. TAXPAYER IDENTIFICATION AND THE INFORMATION SYSTEM OF THE INCOME TAX DEPARTMENT**

### **3.1 Overall Objectives of a Good Information System on Assesseees**

The four subdivisions of an information system are collection, verification-collation, storage and retrieval. Before making specific suggestions,

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1. This idea, as well as some of the other suggestions in this section on computerisation are due to Arbind Modi.

broad requirements to be kept in view during the design of each of these subsystems are outlined.

### *Collection of Information*

Information should as far as possible, be gathered without the need for face to face contact or postal communication between the Department and assessees. This implies substantial strengthening of the information base covering third-parties and presumptive sources. Direct information from assessees through the filing of returns or other items required to be filed are also worth strengthening to the extent that an increase in the amount of face to face interaction does not result. The fact that search and survey are still currently the most important means of detecting evasion should, in this light, be seen as a weakness of the current information system of the Department.

### *Verification and Collation*

A distinction may be made between information that prima facie leads to suspicion of evasion (when sufficient evidence accumulates) and information which may be used as evidence in legal proceedings. Verification of the former type of information is not crucial except to eliminate gross errors. For most third-party and presumptive sources of the former kind of information, it is relatively straightforward to ensure that verification is unnecessary or automatic.

Information should ideally be sorted and collated so that all relevant information on an assessee or potential assessee is available in one place for all direct taxes and including both past and current records. Furthermore, the information on an assessee should be cross-indexed in a way which permits transmission of information on assessees or others with whom the assessee in question has economic dealings to the files of other assessees. Information should be indexed, furthermore, to facilitate compilation of statistical and control reports.

### *Storage of Information*

It is essential that a perspective plan with year-wise targets be drawn up with respect to storage space and storage media. The information storage sub-system should ensure that essential records on assessee: last for a sufficiently long time; are tamper proof; and facilitate easy retrieval of information on assessee when required.

### *Retrieval and Dissemination of Information*

The retrieval and dissemination system should keep in view two objectives.

- i. All information relevant to assessment of an assessee should be retrievable both in detail and in precis form at the time of assessment or other proceedings.
- ii. Compilation of regular information for control or statistics should be quick and routine yet flexible.

### **3.2 Taxpayer Identification Numbers**

The need for a system of unique taxpayer identification numbers has been pointed out repeatedly by tax experts.<sup>2</sup> Such numbers form the cornerstone of a modern and efficient information system on taxpayers. A good system of identification numbers will have the following properties.

- i. It will automatically cover all potential assessee even if they are not assessee or filers at present.
- ii. Numbers will permanently identify assessee.
- iii. There will be limited scope and harsh penalties for fraud through 'benami' numbers or multiple numbers.

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2. In fact, Kabra and Sachdeva (1988) even propose a broader concept of citizen identification numbers and an identity card with a photograph. These numbers should, according to the authors, form the basis of all social, economic and political dealings of citizens. The administrative burden of issuing citizen numbers should be little different from a ration card system.

- iv. Quoting identification numbers at the time of undertaking a wide variety of transactions, would be compulsory.
- v. Assesseees would have an incentive to obtain numbers. This can be done, for example, by making eligibility to engage in certain transactions, services or investments contingent on the assessee having an identification number.
- vi. The numbers would be obtainable without difficulty. Furthermore identification of assesseees with particular taxpayer numbers should be possible with no difficulty at every Income Tax office<sup>3</sup>. Taxpayer number records would be tamperproof. For example, a master list could be kept at a central location<sup>4</sup>.

It should be emphasised that the efficiency of any information system depends crucially on effective and regular use of taxpayer numbers. While the design or the reform of the information system which meets these requirements is best carried out by Management Information System (MIS) experts in collaboration with the Department, some suggestions may nevertheless, now be offered.

### **3.3 Some Specific Suggestions for the Information System**

#### *Information Collection*

The powers given to the Department to call for information from various sources appear to be, by and large, adequate except for the deficiencies pointed out in the descriptive part of this study. We now deal separately with information that (potential) assesseees are required to provide, information that third parties are required to provide and information that the department collects in other ways.

**Information from Assesseees or Potential Assesseees:** The Income Tax Department does not collect through its income tax returns certain important types of information on assesseees. Such information includes details of assets and liabilities, names of family members, location of houses and other premises

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3. The possibility of using appropriate computer technology, such as 'Write Once Read Many' (WORM) disks could be explored.

4. A full scale administrative proposal is not worked out here.

owned and so on. While a balance has to be struck between taxpayer convenience and filing requirements, three measures may be considered which will impose only limited extra burden on potential assesseees.

In the first place, a consolidated direct tax return may be designed. Those who claim no liabilities under a particular direct tax may be exempted from completing parts of the form which relate to that tax.

Secondly, all persons or entities who are assigned taxpayer numbers should be required to complete and file Form 45D<sup>5</sup> every five years if they do not file tax returns<sup>6</sup>. Imposition of penalty under section 272AA should be made automatic if the form, completely filled in, is not received within a specified time, by the Department. However, it should be the responsibility of the Department to intimate non-taxpayers, by post, as to their obligation to file Form 45D. Verification of information thus obtained is discussed below.

Thirdly, as has been discussed above, it has been alleged during the field survey that Chartered Accountants indulge in various collusive practices to aid assesseees in tax evasion. This makes a mockery of financial details filed under Sections 45AA and 45AB in many cases. An internal committee within the Department should be set up to devise measures to curb these malpractices and punish erring Chartered Accountants. Furthermore, to encourage voluntary compliance by lowering the cost of compliance while, at the same time furthering employment, the possibility of training "Recognized Tax Preparers", to be drawn from among unemployed graduates, could be explored.

The proposals given here will largely eliminate the need for door to door survey under section 133B as it is currently carried out. This will, of course, reduce the scope for harrassment of potential assesseees to an extent.

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5. A design is proposed in Appendix 7.

6. No specific suggestions are made as to organisational arrangements to receive and process these forms in the Department. After due processing, these should be available in the concerned assessing charges.

**Information from Third Parties:** Third party information should, in the course of time, become the mainstay of the information system of the Department. This, therefore, calls for great strengthening of the existing CIB machinery and extensive use of taxpayer numbers. It is also understood that computerisation of the CIB will present few obstacles as compared to computerisation of assessment. Thus, computerisation of the CIB ought to be taken up immediately. Besides these brief remarks, we refrain from making additional recommendations on the internal organization of the CIB till a more detailed evaluation is undertaken in the longer study. It is, however, worth recapitulating the factors identified earlier in the report as these must, in any case, be taken note of in any re-organisation.

- i. Only four of the eighty and odd sources of information received in the CIB were utilised to a significant degree by them.
- ii. Not all types of information require detailed verification by the CIB especially if the information is to be used only to form presumptions as to taxable income.
- iii. There are currently inordinate delays in CIB information reaching AOs.
- iv. There is no procedure for routinely providing feedback to the CIB as to the usefulness of extracts sent to assessing charges.

The recent expansion of the scope of tax deduction at source (TDS) is a welcome feature from the perspective of third-party information. Hurdles to the retention of the expanded TDS provisions, discussed earlier, should be overcome on a priority basis by the Department. In addition, the Department should consciously strengthen its public relations activities with respect to TDS in two ways. Firstly, it should popularise TDS with those required to deduct tax and with assesseees through suitable incentive schemes<sup>7</sup> and advertising campaigns. More importantly, the Department should, through its public relations Department, actively engage in promoting computerisation of tax deduction records by tax deductors and the use of formal financial agencies by businessmen in general. This could be done both by designing incentive schemes and by actively putting

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7. For example, a tax rebate from their own taxes - to cover costs - could be allowed to persons required to deduct tax at source.

forward the Department viewpoint in relevant government Committees, Industry Associations and the like.

The economic rationale for recommending greater efforts by the Department to promote the use of the formal financial system is as follows. As economic development proceeds, the average size of economic transactions engaged in by economic agents, as well as the number of transactions, increases. The need to develop efficient cash management and information systems to handle these transactions is a major impetus to the development of the financial system. Reliance on transactions in cash alone becomes increasingly hazardous and costly. With proper third-party matching, it is mainly the cash transactions which continue to escape detection. As the cost of concealment through cash transactions increases with growing transactions, agents increasingly view a greater degree of tax compliance as less costly than concealment efforts. Consequently, it is in the Revenue's interest to display foresight and promote financial development in selected ways<sup>8</sup>.

**Information which the Department Collects Suo Moto:** Given that no in-depth study has been made, recommendations on surveys under 133A(1), 133A(5) are not made except to note that, even in the best of situations, some survey operations will always be necessary. We do, however, make some observations on search below given that some search operations will always be required. However, as third-party matching gains ground reliance on search and survey should diminish: the rate of reduction of reliance on search and survey to detect concealment should be viewed as a barometer of modernisation of the Department. Having said this, however, there appears to be scope for rationalising the manpower allocation and responsibilities within the Department for search and survey in the short run, a matter to be dealt with in the longer study. To recapitulate deficiencies in survey already noticed:

- i. Targets for surveys are in terms of surveys conducted rather than evaders or nonfilers discovered.

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8. For example, the Department would have displayed foresight if it had sent a proposal to the Rangarajan Committee on bank computerisation.

- ii. Survey operations are not evenly spread out over the year.
- iii. Section 133A(5) does not permit survey of non-filers.
- iv. There are grave delays in utilisation of information from surveys conducted by the Investigation wing.

An important deficiency in the current information system of the Income Tax Department is the absence of a regular mechanism to provide constructive feedback to the Investigation Wing, including the CIB. As has been discussed, this has led to a situation wherein the Investigation Wing concentrates on achievement of quantitative growth in extracts or cases rather than qualitative improvement. It is essential that a system of feedback from assessing charges and a review procedure for the Wing be instituted forthwith.

We now put forward some suggestions for consideration regarding search operations and intelligence operations. First, the emphasis of intelligence operations in the Department should shift from reliance on informants to systematic and suo-moto intelligence-gathering through covert investigation and surveillance. To streamline intelligence gathering in the Department, the feasibility of setting up Intelligence Cells exclusively for intelligence gathering needs consideration. Officers working in these cells should not normally take direct part in search and survey operations and should, as far as possible, remain outside the public gaze. Training courses on covert surveillance and investigation techniques could also be designed for this purpose. Only officers of known integrity and proven track record having a flair for intelligence gathering and investigation work should be identified for long term attachment to the proposed Cells.

Second, while it may not be possible and even desirable to totally disregard information from informants on payment of monetary rewards, a system of outright purchase of information should increasingly replace the extant time-consuming process under which the amount of reward is linked with the ultimate revenue gain.

Thirdly, adequate security arrangements should be made for search and survey parties. The government should give serious consideration to possible workable solutions like deployment of special units of the Central Reserve Police<sup>9</sup> for the Income Tax Department. Having, said this, we reiterate our view that the overall thrust of information gathering in the Department should be towards less direct action.

**The CIB:** Regarding the CIB, some suggestions for rationalising its working are now offered.

The emphasis on quantitative targets for CIB verifications should be replaced, if possible by greater emphasis on quality. Though it is probable that no satisfactory package of incentives can be designed, a mixture of supervision and eligibility for rewards, the latter as part of a scheme to be suggested below, should lead to improved performance. However, these measures must be supplemented by computerised information management before any substantial gains can be expected.

Legislative amendments which would make the flow of information to the CIB from institutional third-party sources automatic and overcome problems like that faced with commercial banks or the Karnataka Sales Tax Department should be explored. However, such a system will work well only if it is linked with an efficient taxpayer number system and if these numbers are quoted in various transactions. Needless to say, a balance has to be struck between the right to privacy of individuals and the need to prevent tax fraud.

To reduce the existing time delays, it is suggested that CIB information be sent directly to AOs, where possible, with copies to the DC and CIT for monitoring.

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9. The deployment of Central police during a search is likely to be seen as an infringement of the sovereignty of States only if they are deployed to maintain law and order but not, perhaps, if they are deployed to protect income tax staff.

All information relating to an assessee should ideally be consolidated so that all of these are simultaneously considered during assessment. The CIB should spend relatively more time in collating information.

The CIB should, we would conjecture, not verify individual pieces of information and devote time so saved to collation. The process of verification, besides harrasing taxpayers by adding a new layer of tax officers whose queries have to be faced, also constitutes duplication of effort to the extent that AOs also verify the same information. However, since there are counter-arguments to this position, presented earlier, a pilot experiment ought to be carried out before a decision is taken on this point.

Abandoning verification would also enable the CIB to collect information from more third-party sources instead of the current 23 per cent of identified sources found by Bal (1990).

We do not recommend Action Plan targets for proper utilisation of information including CIB extracts. However, supervision by DCs and CITs should be strengthened by requiring them to compile annual reports on the utilisation of information by assessing officers in their charges and remedial steps taken by them. Also, the Audit should routinely evaluate utilisation of CIB information.

At present one organisation (under DGs (Investigation)) collects and verifies the information and another (under CCs) utilises it in assessment. Better coordination of these functions may be achieved if information collection, verification and utilisation are all placed under the CC. This will also ensure better supervision and monitoring and reduce time-lags and under utilisation of information.

Finally, a study of the appropriate pattern of manpower deployment to the CIB, taking into account the direct and indirect deterrence and revenue gain from its activity, keeping in view the use made of CIB information by AOs,

should be undertaken. To study this problem, the direct and indirect gains to CIB verification will, of course, also require to be evaluated.

**Compliance Monitoring:** The measures suggested above, with the exception of search and survey, are not designed to actually detect tax offenders but to make tax evasion increasingly difficult or costly. It is, however, imperative for the Department to have up-to-date information on characteristics of evasion prone groups and the ever-changing modus operandi of tax evaders. It is also extremely important for the Department to obtain feedback on the effectiveness of various information sources and anti-evasion measures adopted by it. The most important ingredient of a modern information system on tax evasion is a Taxpayer Monitoring Programme<sup>10</sup>. Under such a system a statistically adequate and representative sample of persons with taxpayer numbers (not just filers) is drawn every few years and subjected to detailed scrutiny<sup>11</sup>. Findings of this survey can be used to:

- i. Prepare material for training courses to make officers aware of new methods employed to evade taxes;
- ii. Improve methods of scrutiny;
- iii. Design statistical models to select cases for scrutiny so as to maximise the return to scrutiny;
- iv. Identify systematic deficiencies in existing information collection, manpower allocation and assessment procedures in the Department; and
- v. Discover and close loopholes facilitating tax avoidance.

We recommend that a separate arm of the Investigation Wing be created to engage in scrutiny assessment for the Taxpayer Monitoring Programme. The new division should be staffed not only by serving officers who

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10. For example, the Internal Revenue Service of the USA places great reliance on its ongoing monitoring programme in designing assessment strategy. Their scheme is described in more detail in Section 4. The questionnaire used by them for their survey is given in Appendix 8.

11. A Taxpayer Monitoring Programme was earlier recommended by the EARC (Jha Committee)

would engage in survey, assessment and analysis but also statisticians and economists with the proper background to develop statistical models and assess financial returns to scrutiny. The database from which the sample for a year could be selected could be from completed Forms 45D<sup>12</sup>. Of course, to avoid duplication, assessments under this programme should be treated as regular assessments.

In the initial years of the programme it may be necessary to devise appropriate training programmes in statistical analysis for Income Tax Department officers, in income tax administration to statisticians and economists and in carrying out monitoring programmes to both groups. The National Academy of Direct Taxes should be able to provide training in tax administration and institutes such as the Indian Statistical Institute should be able to provide training in statistics. A time-bound collaborative arrangement with a country which has already carried out taxpayer monitoring surveys may be considered for the last mentioned training need.

Economists and statisticians employed by the Department could also be used to rectify another deficient area of information collection within the Income Tax Department: the assessment of broad economic trends. Currently, only a small Research Cell exists within the Investigation Wing to monitor inter alia sectoral and regional trends in the economy. Such information can, of course, prove to be very useful in refining the procedure of selection of cases for scrutiny and in providing estimates of profit rates, royalties and so on at a macro level.

**Measures to Reduce The Need for Information on Assesseees:** Measures which reduce the need for information on assesseees are to be encouraged, unless other considerations dictate otherwise, as they lower the cost of collection of the tax and also improve the potential efficiency of the information system. Foremost among such measures is presumptive taxation. Presumptive taxation may be defined as a method of income taxation wherein tax liability is fixed with reference to taxpayer characteristics which are difficult for the taxpayer to alter in

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12. Some changes in the provisions of Sections 133B and 143(2) may be necessary to provide a legal base for the programme.

contrast with reported income. The scope of presumptive taxation within the Income Tax Act should be broadened, especially with respect to occupations for which taxable income is difficult to ascertain such as unorganised manufacturing and trade<sup>13</sup>.

With these brief suggestions we now turn to verification and collation of information.

### *Verification and Collation of Information*

Some suggestions for verifications of information have already been outlined in the previous discussion of filing requirements under Section 45AA and 45AB and of the Taxpayer Monitoring Programme. We now outline some principles for collation of information.

Information should be collated in a way which facilitates efficient utilisation by the various arms of the Income Tax Department. Besides assessment, information on assessee or revenue is required for revenue collection and recovery, managerial control, manpower planning and review, appeals and prosecution and to amend the law or procedures as needed.

The information base falls into two categories: information specific to particular entities (i.e. assessee or potential assessee) and information of a more general nature. We use the term 'message' for each document providing information on particular entities. The Department should work towards a system wherein each message contains the taxpayer number of the entities to which it relates. Messages from all information sources should then be sorted and collated according to taxpayer number in the assessee's file<sup>14</sup>. As at present, the file should be the fundamental unit for collation of information. If the message deals with more than one entity, the message should be duplicated and sent to the files of all concerned entities. A system of reporting forms (or computer files) should be

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13. Bagchi (1988) and Tanzi and Casanegra de Jantscher (1987) are two recent works advocating increasing reliance on presumptive taxation.

14. The file will, on computerisation, have a computerised part and a collection of physical documents.

instituted such that information required on a regular basis for other purposes (managerial control, revenue planning, etc) can be culled and sent periodically to the concerned units. These principles are in fact, being followed by the Income Tax Department. However, the examples of inefficiency identified earlier, such as delay and inaccuracy in furnishing information required outside assessment charges, transmission delays for CIB information, improperly maintained assessee's file and so on show that a need exists for a review by management experts of current collation, storage and utilisation systems and procedures so as to improve their efficiency.

For information of a more general nature<sup>15</sup> the basic principle, that information should go to files of relevant assessee's, is the same as for messages. However a somewhat different procedure must be devised for this type of information. It is suggested that a system of classification numbers be devised, similar to library subject classification numbers, for various types of information. The system of numbers could include: occupations code; house ownership code; location of business code; residency status code; wealth tax status code; and so on. For each assessee or potential assessee, a set of classification numbers should be assigned on the basis of information in Form 45D. Codes could then be cross-indexed with the help of a catalogue (whether on cards or on a computer) similar to a library subject catalogue. Reports containing general information should also be assigned classification numbers. On receipt of the report at the location where files are stored, slips (or computer messages) could then be inserted in the files of all assessee having identical classification numbers to alert AOs as to the relevance of the reports to these assessee's.

### *Information Storage and Retrieval*

From our discussion of problems of space, supplies, maintenance and availability of assessee files in Chapter 1, it is clear that a review by management experts of the information storage system, embodying the principles outlined

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15. Eg. information on the modus operandi of evasion of particular groups of assessee's or information on economic trends.

above, is required. Two additional considerations which need to be kept in view may be highlighted.

First, consideration has to be given to the number of locations where original documents are stored and making records tamper proof. While respecting the constraints imposed by the needs of assessment and other functions, a principle to be kept in view is that of minimising the number of storage locations. Thus, it may be advisable to store records at the range level or even the level of the Commissioner's charge rather than at the ward level as at present. A second principle is that, as far as possible, after an assessment is completed, original records on assessee's pertaining to that assessment year should not leave the record room except for use in court proceedings where original documents may be required. Instead, photocopies or microfiches of documents and returns should be issued. The exact system for storage of records and the technology appropriate for the system should be part of the study entrusted to management specialists.

Secondly, even if storage of data on assessee's in computers is considered infeasible in the short run, record keeping units should be under the charge of a trained cadre of officers who will be able to supervise the work of cross-indexation and collection of records. Additionally, consideration should be given to the creation of statistical cells at the range level under a specially trained statistics officer. These officers will be responsible for preparing periodic and ad hoc statistical returns required for monitoring, control and economic analysis by the CCs office or the Board. For Statistical cells there is no reason as to why computers cannot be phased in and appropriately trained staff appointed. Manpower for record-keeping and statistical cells can be drawn from other central government departments that are in the process of being pruned (this suggestion is discussed further below). This will simultaneously reduce the non-assessment workload of trained Income Tax Department officers and absorb surplus staff from elsewhere.

## *Continuous Performance Evaluation of the Information System of the Department: Some Guidelines*

Having put forward some suggestions for reform and expert advice for the information system of the Income Tax Department, it remains to propose guidelines for monitoring its performance. In order to judge the quality of an information system, information scientists have evolved two concepts: 'Precision' and 'Recall'. Precision is inversely related to the amount of irrelevant information in the information system while Recall refers to the amount of relevant information not in the system<sup>16</sup>. These concepts can be used by qualified experts to design a framework which could be used to evaluate the entire information system as well as the collection, collation, storage and retrieval subsystems individually.

### **4. REFORM OF ASSESSMENT**

#### **4.1 The Assessment Procedure: A Proposed Long Run Design**

There is little doubt that assessment is the heart of the income tax enforcement system. Even the most far reaching reforms in the system of information collection and organisation will fail to have much impact unless assessing officers have the time and motivation to utilise this information to track down tax evasion.

An ideal assessment procedure is first outlined to serve as a long run goal for various short and medium run measures that may be introduced. All measures proposed by us thereafter, whether experimental or not, keep this goal in view. The procedure is described with the help of a flow chart and accompanying clarificatory paragraphs. The flowchart is in Figure 2.

The most important change in the current assessment procedure is the proposed time gap of at least 8 months to a year between the date of submission of returns and the commencement of scrutiny assessment for the year. The advantages and disadvantages of such a procedure are discussed in detail later.

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16. Precision and Recall approximately correspond, in the language of hypothesis testing, to the absence of Type I and Type II Errors respectively.

The flowchart, furthermore, identifies areas related to assessment which would ideally be computerised. Such areas include optical (computer) scanning of at least the summary sheets at the time of receipt of returns; automated checking of returns for arithmetical accuracy and absence of selected prima facie errors after matching with past returns; automatic preparation of demand notices in case of deficient taxes discovered; and preparation of statements for despatch to statistical units and tax collection units (whether the latter are separated from assessment charges or not). The technology for automation of these tasks has been developed nearly a decade ago and is available in India. The software development required for these tasks, even checking for the arithmetical and prima facie accuracy of most returns, is not very complicated and should require less than a year. Furthermore, it is possible to build in software checks so that the computer is able to indicate returns requiring additional manual checking.

Co-ordination problems within the Income Tax Department must be ironed out before third-party information can be cross-matched with returns automatically. Furthermore, quoting of Taxpayer Identification Numbers (PANs) in information returns received regularly from third parties must become routine. The Department should, however, work towards achieving this in the long run. Development of a computer model to aid selection of scrutiny cases is, in contrast, less difficult, though this and other procedures listed above will require refinement in the light of experience.

#### **4.2 The Organisation of Assessment Charges**

In searching for an appropriate pattern of organisation of assessment charges, 3 requirements must be kept in view.

- i. The organisation should be flexible enough to permit manpower redeployment in response to year to year fluctuations in workload. It should, furthermore be consistent with the expansion plans of the Department to cope with the secular increase in workload which may be expected.
- ii. "Similar" cases should be within the jurisdiction, as far as far as possible, of the same AO so that gains from specialisation can be reaped by the Department.

- iii. Assesseees should not be able to influence to their advantage the assessing jurisdiction to which they are assigned (for example by reporting a higher or lower income).

### *Taxpayer Cells*

We propose the concept, therefore, of a "cellular" structure wherein similar assesseees are grouped into cells of about one hundred assesseees each<sup>17</sup>. Similar assesseees may be defined as those having broadly the same primary source of income or nature of business; the same geographical location; the same assessee classification (i.e. individual, registered firm, company, etc.); and those assesseees, such as members of a partnership or members of the same corporate group, in whose cases assessment in the same charge would curtail collusion or lead to avoidance of duplication in assessment work. The grouping principles proposed are already in use in the Department or, in the case of the last principle, have been suggested to us repeatedly during field visits. These cells should be permanent unless there is a change in one of the factors leading to the assessee's assignment to a particular cell. Cells can then be grouped to form ranges, as well as intra-range AO charges as described below.

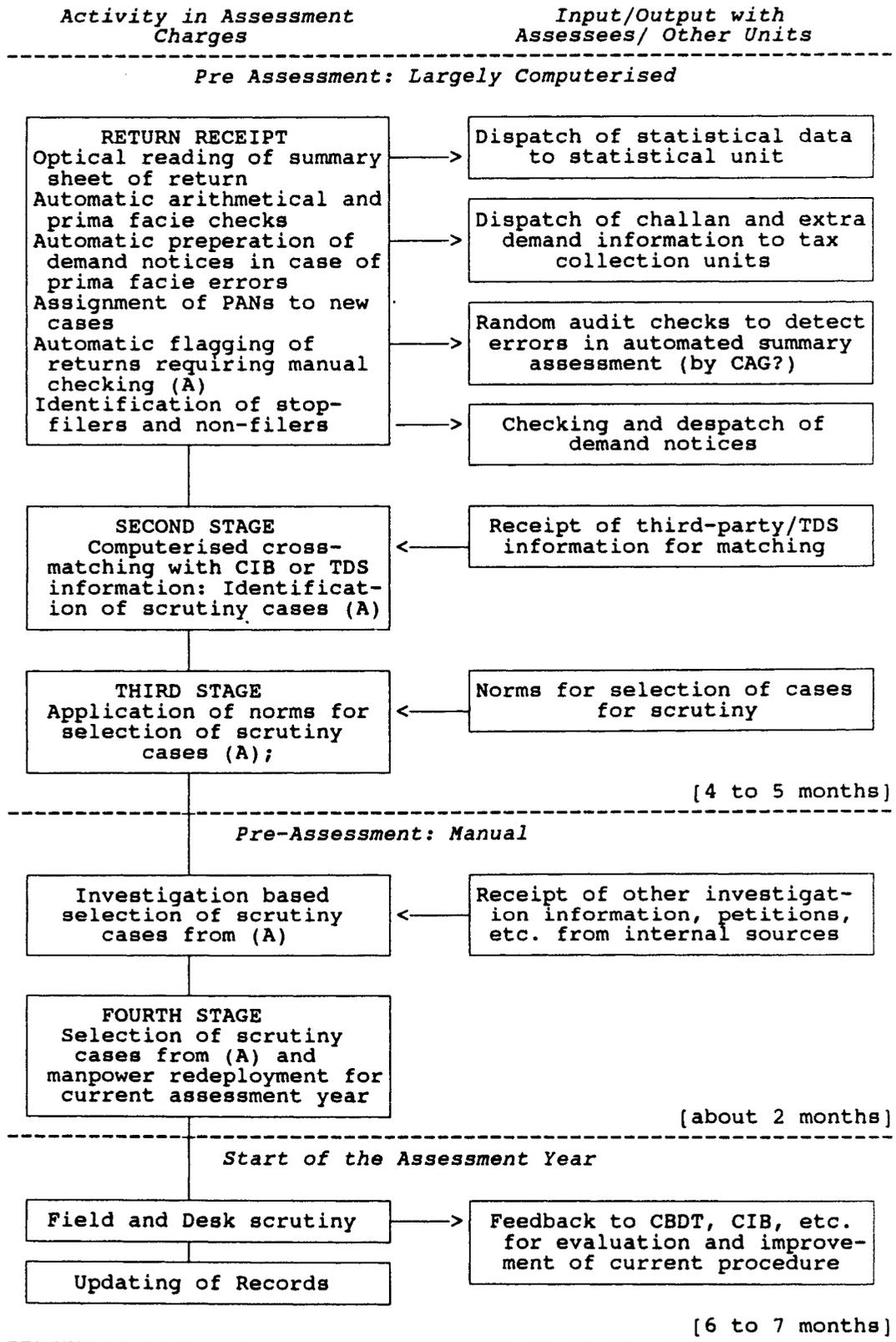
### *Allocation of Workload and Manpower Across Ranges*

The scope for reallocating caseload across ranges may be limited, especially given the jurisdictional divisions that lie at the basis of the difference between different ranges, and the returns from concentrating specialised expertise concerning a given occupation or geographical area in a given range. A proper division of workload across ranges should, as far as possible, also be based on the way the taxpayer population is stratified into different cells, with each broad category corresponding to a particular range. The range should then be viewed as the basic unit for the design of assessment policy. This organisation will enable the pursuit of diverse enforcement strategies appropriate to different categories of the population in different ranges, reap benefits from specialisation, and also avoid manipulation by taxpayers. With such an approach, it is only natural to

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17. The norm may be varied, if necessary, with regard to the nature of assesseees - for example company/non-company - depending on the expected workload per case.

**FIGURE 2. FLOWCHART OF IDEAL ASSESSMENT PROCEDURE**



expect variations in the total workload across ranges, as the size of the taxpayer population in different cells may well vary considerably. While recognising possible problems arising from an excessively large span of control of DCs, it is suggested that range to range variations in caseload be allowed to exist unless some ranges become too unwieldy to manage: in such cases a new range ought to be constituted to distribute the workload more evenly across ranges.

In contrast the manpower allocation across different ranges should be consciously adjusted in line with their perceived relative returns from assessment activity (for example per unit AO time). To a first approximation, the correct allocation of manpower across different ranges should equalize the net additional returns per hour of assessment activity. From this perspective the existing allocation of manpower across different ranges appears to admit of considerable improvement. For instance, while the sanctioned staff strengths of Range C and D in Bombay in our field study do not appear to differ significantly (see Table 10), the net additional demand generated in Range D is significantly higher (Rs 72.44 lakhs rather than Rs 40.11 lakhs: see Table 20). This suggests the possible value of moving manpower from Range C to D, both from the standpoint of short-run returns, as well as long run deterrence. The DOMS (or any other designated Directorate) should periodically review the relative returns to assessment in different ranges in order to plan manpower reallocation. In the interim, the Department may explore the possibility of developing a pool of 'roving' AOs and support staff in different regions that can be redeployed at short notice across different ranges in that region.

#### *Organisation of Assessing Officers' Charges*

If the current system of subdividing the range into different AO charges is retained, similar qualitative principles also apply to the allocation of workload and manpower across AO charges. Different charges should be classified on the basis of characteristics that are not easily alterable by the taxpayer. This ensures that consistent enforcement strategies can be implemented within a particular unit without the possibility of deviant taxpayers influencing the AO to whom their case is allocated (by, for example, altering his returned

income). This will overcome a major weakness in the current organisational set-up. For example, in the current setup, a stepped up level of enforcement in any given circle can be sidestepped by an adroit taxpayer by simply reporting an income below Rs. 2 lakhs. If different units within a range are organised on the basis of occupation or line of business, it is relatively difficult for a taxpayer to ensure that his file is switched from one intra-range unit to another.

A coherent policy designed to deter concealment of income must ensure that among similar taxpayers the likelihood of scrutiny increases as the reported income becomes lower. Given the unlikelihood of coordination across different wards and circles in this respect, such a policy can be realised only if the current distinction between wards and circles is replaced by jurisdictions based purely on occupation, territory and the other factors outlined earlier. Each intra-range unit can then work out a policy where the likelihood of scrutiny relates to the level of income returned in a systematic manner, without worrying about the spillovers of the chosen policy for other units in the same range through strategic entry and exit of taxpayers.

A more extreme procedure, one which allows greater flexibility in work planning and centralisation of records, is to do away with permanent ITO or AC level jurisdictions altogether. In such a set-up the jurisdiction of AOs will be decided afresh each year (in terms of the cells to be allocated to him) by the DC in accordance with the estimated workload and scrutiny strategy for the year, with the DC having concurrent jurisdiction over cases assigned to AOs under him<sup>18</sup>. An additional advantage of concurrent jurisdiction and range-level assessment is that it does away with the infructuous and time-consuming need to transfer files frequently between charges. This benefit will also flow, though perhaps to a lesser extent, if the ward/circle distinction is removed.

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18. The feasibility of this reform is intimately linked to the feasibility of setting up a rangewise record-keeping system. A system with range level record-keeping has apparently been tried out in a range in Madras, though we have not been able to procure details regarding this experience.

Once units within a range have been reorganised suitably, the allocation of manpower should, in any given year, be on the basis of realised returns to assessment effort to different intra-range units in recent years. Ideally this decision should be decentralised to the DC or the CIT level. It may be recalled that, as Table 20 indicates, there are possible gains to be made from consciously allocating workload or personnel across AOs charges along the lines suggested.

It is important to urge caution with the use of such a method of manpower allocation without proper reorganisation of the units within a range. In the existing system, we have mentioned that there are wide discrepancies between the average net additions per hour on scrutiny assessment spent by AOs between wards, circles and investigation circles. This does not necessarily imply the usefulness of reallocating manpower away from wards in favour of circles, since the result may be to strengthen the incentives of high income taxpayers to report below Rs. 2 lakh to take advantage of the lower likelihood of scrutiny in a ward.<sup>19</sup> The principle can only be applied safely if the workload within a range is reorganized suitably, where the distinction between different units is not based on the level of reported income. This will avoid the strategic 'entry' and 'exit' of taxpayers from a circle to a corresponding ward, or vice versa.

Two exceptions to this structure are, however, suggested. It is understood that the scope for additional revenues is high in cases, especially company cases, with high reported taxable income. This is more on account of the scope for detection of technical errors or tax avoidance measures rather than the detection of concealed income. If this is true, "cases with high revenue potential" may continue to be assessed in special assessing charges as at present. However, criteria for the identification of such cases should not lead to the frequent transfer of files in and out of these special charges. Secondly, as would be obvious, the criticism made above of the ward/circle distinction is equally applicable to the further grouping of cases with reported incomes above Rs 10

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19. The problem arises only because of the existence of a third category of assessee having income above Rs 10 lakh. with only two categories, that is no DCs (Assessment), equalising returns at the margin is still appropriate.

lakh with DCs (Assessment). Instead, DCs (Assessment) may be utilised to undertake assessments of difficult cases including investigation cases, assessments of cases pertaining to new lines of business or cases involving newly introduced provisions under the various direct tax acts. These cases may be drawn from cases in a range by the concerned CIT depending on the workload. Assessments by DCs can then be a regular source of training materials or advice for assessment of such cases by less experienced AOs in later years.

### **4.3 Allocation of Assessment and Non-Assessment Duties**

We have noted earlier that a significant fraction of time in assessment charges is spent on activities not directly connected with assessment such as tax recovery, record-keeping, and information reporting. This prompts consideration of greater specialisation within a given range. The suggestion given earlier, that record-keeping and statistics be made the responsibility separate range level or CIT level cells may be reiterated here. Consideration should also be given to ways in which tax recovery and arrears work can be taken out of assessment charges. This would enable AOs and their support staff to spend additional time on assessment activities.

An alternative solution may be to delegate authority and responsibility for these activities from an AO to lower level staff, say to inspectors or upper division clerks, in order to enable the AO to undertake more assessment activity. An increase in the size of support staff, if this is forthcoming, will enable inspectors to devote more time to field enquiries as well as other responsibilities such as summary assessment (discussed further below) that may be delegated to them instead of to assessing officers.

As far as tax recovery is concerned, yet another possibility is the creation of a separate Collections/Recovery Wing within the Income Tax Department, which will be responsible for all cash transactions with taxpayers. Tax recovery demands can then be sent by AOs to this Wing. Insofar as computerisation of the operations of the Income Tax Department may most conveniently start with collections and recovery, the separation of this set of

activities from the rest of the Department may appear attractive. The reform may, however, give rise to communication delays<sup>20</sup>.

#### **4.4 Reform of the Summary Assessment Procedure**

It has been noted that the revenue returns from summary assessment are low compared with the returns from scrutiny assessment in terms of the average return to an hour of the AOs time. Moreover, there is some confusion concerning the authority that AOs have over prima facie adjustments, as a result of which a significant fraction of additional demands made get subsequently rectified. Our sample study revealed that sustained additions are made in less than 1 per cent of summarily assessed cases. Since the law permits checking only of arithmetical accuracy and prima facie errors under summary assessment, it seems natural to suggest that the activity of summary assessment be delegated to inspectors, thereby freeing up time of AOs for scrutiny assessments. Almost one-third the time of AOs is currently spent on summary assessment: there is no need for this much of their time to be wasted on such a routine procedure. The summary checking of returns, even if there is a consolidated direct tax return is routine enough to be delegated to an official below the rank of AO with the AO having only supervisory (rather than direct) responsibility. This, it will be clear, is an interim measure that is proposed till the introduction of computer based checking of prima facie errors.

The more extreme approach, to do away with the system of summary assessment altogether, is not advocated. It is conceivable that this will encourage taxpayers to take advantage by submitting returns with arithmetical mistakes in their own favour. Since it is inconceivable that significant penalties can be imposed for arithmetical 'mistakes', taxpayers will have nothing to lose from such a strategy, and everything to gain. The low current returns to summary assessment could testify to the high deterrence of prima facie errors by the existing system. As long as the activity can be delegated to support staff below the rank of an AO, we feel that the system should continue with clear and explicit

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20. It is understood that a detailed proposal along these lines is being worked out by Arbind Modi.

instructions from the CBDT regarding the nature of adjustments that are permissible. Officers we discussed the possibility of delegation with felt that it was certainly feasible, as long as the signing authority was also delegated.

#### **4.5 Reform of Scrutiny Assessment**

This area is in need of particularly urgent reform. We have noted a number of major weaknesses earlier; the excessive discretion afforded to AOs in selection and conduct of scrutiny assessments, the underallocation of AO time to the conduct of assessments, the dismal performance in terms of success in initiating and sustaining penalties for concealment of income, poor utilisation of third-party information and the misconceived guidelines issued by the CBDT concerning selection of scrutiny cases.

**The Assessment Year:** Before the commencement of scrutiny assessment it is important that a number of pre-assessment activities are completed. As indicated in the flow-chart above, such activities include arithmetic and prima-facie checks of returns; identification of stop-filers and non-filers; matching information in returns with past records and third-party information from the CIB; selection of cases for scrutiny and manpower reallocation. The existing uneven distribution of workload over the year, problems with time-barring of assessments, lopsided distribution of scrutiny cases, uneven manpower distribution across charges, non-use of CIB information due to delays in communicating information and several other problems may be avoided if sufficient time is allowed to elapse between the date on which returns are due and the commencement of scrutinies for that year. Besides, a globally optimal selection of cases requiring scrutiny will become possible rather than having to select cases on an ongoing basis throughout the year.

There is almost<sup>21</sup> no reason why scrutinies must be conducted in the year of filing itself, which gives little time for the selection of cases to be carried out on the basis of all necessary information. Such delays are standard practice in some advanced countries. For example, in the USA for the selection to be carried out at least seven or eight months after all returns have been filed, with the assessments typically carried out anywhere between one and three years following the filing. A transition benefit that would arise in the year in which the date for commencement of scrutinies was put forward, is the availability of additional time to deal with the backlog of pending assessments and arrears. Such a measure, with attendant modification of time-bars in the law, is strongly to be recommended for these reasons.

**Selection of scrutiny cases:** Considerable improvement is possible in the method of selection of cases for scrutinies. One essential element of a better system would be to use some systematic procedure rather than rely on the subjective judgment and discretion of AOs. To reduce the extent of corruption, it is important in particular to reduce the extent of discretion afforded AOs in the use of CIB information, and in selection of scrutiny cases. What kind of system could replace the current one?

In the long run, the Income Tax Department ought to aim for a system based on a scoring rule as advocated by expert committees earlier and as used in advanced countries such as the USA. In the USA the returns received are automatically checked for arithmetical accuracy and routinely cross-matched with third-party information. Based on statistical studies of individual taxpayer files scrutinised in the past (under the Taxpayer Compliance Measurement Program or TCMP), the computer develops a method of assigning scores to different pieces of information contained in the taxpayer's return, as well as information received from third-party sources. These scores are used along with the information available about each taxpayer to construct an aggregate score

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21. A counter-argument to delayed scrutinies is that assesseees have additional time to doctor their books and, furthermore, manipulate their closing inventories thus making detection of evasion more difficult. Neither argument is persuasive since, even under existing conditions, assesseees can, by engaging in a little advance planning, suppress telltale evidence equally well.

(called a Discriminant Function or DIF score). The selection of taxpayers whose return is to be audited, is then based to a large extent upon the assigned DIF scores. The formula by which these scores are computed is a closely guarded secret. The formula is frequently updated on the basis of new information received from TCMP studies. In India in the short run, where the Income Tax Department is not computerised and studies based upon responses of individual taxpayers are not available, such a scheme does not appear practicable in the immediate future. Nevertheless, a system of the following kind may be introduced.

A scoring system for a number of criteria on which information is available can be tried, based upon any statistical information that may be available, failing which intuitively reasonable scores can be experimented with. The scores may increase with a designated set of presumptive factors. The following is an illustrative list of criteria: low reported income relative to the income of taxpayers in a similar occupation and territory, large expenditures on properties or other fixed assets relative to declared income, any CIB information concerning large transactions or purchase of expensive items, any information about wealth that may be available on the wealth tax return, large gifts or loans, tax petitions, and past records of the taxpayer<sup>22</sup>. The list of presumptive factors used may be modified in subsequent years on the basis of experience gained.

The CIT of a charge may set down the scoring system to be used by all ranges in that charge, and attempts should be made to keep the formula confidential. It is likely to be quite time-consuming and difficult for the AO to go through all the returns filed in his ward or circle, apply the scoring system, and then select returns with the highest score. In view of this, we recommend that a random sample of all filed returns first be drawn<sup>23</sup>. The scoring system can then

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22. When the assignment of taxpayer numbers and receipt of information called for in Form 45D becomes fairly widespread, these criteria may also be applied to non-filers to the extent that Form 45D provides the necessary information.

23. For example every fourth or sixth successive entry in the demand and collection register, with the first element of the sample from the first four (or six) entries could be selected randomly by the concerned CIT - in order that no one can predict the entries that will eventually be selected. Alternatively, the CBDT could send each charge a set of random numbers, with file entries corresponding to those numbers being selected.

be applied carefully to the returns in this sample and files with the highest scores selected for scrutiny. This work can be distributed to AOs. Alternatively, since the application of the scoring system should be a fairly routine task, it may also be delegated to a subordinate staff such as inspectors. If the range rather than the AO charge forms the basic unit, cases selected by the scoring system will be sent to the DC, who will subsequently allocate them across AOs. On the other hand, if AOs retain jurisdictions, then the application of the scoring system would naturally occur within each AO charge separately. In any case, the faithful application of the scoring system to select scrutiny cases should be subject to internal and external audit (for example by the CAG).

If it is desired to allow some discretion to the AO in the selection of cases for scrutiny, the AO may be allowed to add other taxpayers to be scrutinised, apart from those selected by the scoring rule. Under no circumstances should an AO be allowed to drop a case selected by the scoring system. After deciding the overall number of scrutinies to be conducted by any given AO (or alternatively a certain minimum number), the number of files selected for scrutiny by the scoring system can be adjusted flexibly. For example, if it is felt that the AO having jurisdiction over a certain collection of taxpayer cells should conduct at least 60 scrutinies in a year, the scoring system may be used to select 50 files, with the expectation that the AO will supplement this with at least 10 additional files. Whatever the number required from the scoring system, the corresponding number of cases with the highest scores can be selected.

The system described above could be used for selecting the great majority of scrutiny cases. In addition, cases with high revenue potential and the various types of cases to be scrutinised by DCs (Assessment) may, as discussed earlier, be selected for scrutiny. In order to have an adequate number of scrutinies by DCs, it would be advisable to have at least one DC (Assessment) per DC (Range). This would result in greater experience being brought to bear, overall, in scrutiny cases in the Department. Finally, cases thrown up by investigation and cases under the taxpayer monitoring programme, once the latter is introduced, will have to be scrutinised.

**Scrutiny Procedure:** The next major issue concerns the actual conduct of scrutinies. It is far more difficult and perhaps not desirable to reduce the discretion available to the AO with respect to the procedures followed for scrutiny<sup>24</sup>. The three pronged approach used to deal with this problem in the Income Tax Department can continue to be used, with certain modifications. The approach consists of:

- i. Laying down a set of revised norms for the conduct of scrutiny assessments, including some field enquiries.
- ii. Reliance on a substantially altered system of rewards for AOs, which should motivate the AOs to carry out the assessment carefully in their own self interest. This will be described further below.
- iii. Finally, auditing by the CAG and vigilance to detect inadvertent and deliberate mistakes respectively. However, audit findings and not just vigilance proceedings should influence decisions concerning increments and promotions. Furthermore, the vigilance machinery and procedure may need to be strengthened along the lines suggested by the CAG (1990).

We discuss reforms of these three areas further below. First, however, we address the question of the nature and number of scrutiny assessments that AOs should be expected to carry out in a year. We have noted earlier that, on average, an AO devotes about 5-6 hours to a scrutiny. While this may be adequate to verify supporting documents and check the consistency of the return from an accounting standpoint, it is quite insufficient to conduct an intensive investigation. AOs interviewed in the field were unanimous in claiming that the target for scrutinies was excessive, not allowing them enough time to pursue cases with high revenue potential.

Most AOs interviewed by us felt that a two-tiered system of the following kind may work reasonably well: about 50 or so cases should be required to undergo a routine scrutiny or "desk audit" (along the lines currently followed in most cases), while 15 or 20 cases should go through intensive scrutiny including detailed field enquiries or "field audit"<sup>25</sup>. The norms for the

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24. However, no discretion is allowed to tax examiners in at least 3 countries: Australia, Indonesia and Japan. See Table 13, National Tax Research Center (1982).

two kinds of scrutinies can be laid down separately keeping in view manpower constraints, reforms undertaken to reduce non- assessment duties and improvements made in the information system. The decision regarding the division between intensive and routine scrutinies can be based either on the scoring system, or the discretion of the AOs (if the latter then the AO will have to explain his or her choice in a written explanation which is to be kept in the assessee's file).

#### **4.6 Target Setting and Performance Incentives for AOs**

**Targets:** Complaints and problems of the type discussed earlier in connection with Action Plan targets are commonly heard in most organisations relying upon quantitative, centrally determined targets to motivate employees and evaluate their performance. One has to decipher, therefore, which targets are genuinely dysfunctional, and which others are desirable in order to motivate AOs adequately.

In our judgement there is considerable scope for reforming the current target setting system, in the direction of greater flexibility and uniformity in the setting of targets, combined with the greater use of positive incentive schemes such as monetary rewards (the latter is described below in more detail). Some targetting is perhaps desirable, in terms of the control that DCs and CITs of the range exercise over the scale and direction of enforcement efforts in their charges, and in terms in aiding their planning and organisation. Nevertheless, there is scope for:

- i. Reducing the number of different performance areas where targets are set to three or four at the most, for example with respect to aggregate collections, the number of summary and scrutiny assessments (where both targets are adjusted for the level of initial pendency), and clearance of pendency. In case, as discussed below, remuneration can be conditioned on aggregate collections, then there may be no need for a collections target.

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25. The terms desk audit and field audit are borrowed from National Tax Research Center (1982).

- ii. Allowing greater flexibility in the setting of targets, for variations in workload, in initial pendency, and in the quality of support staff. This may be accomplished by either of two methods:
- (a) Targets should be set by the DC of the range in consultation with the AO in question, and after learning of the local conditions prevailing. This will also allow the DC to better balance the workload across AOs. The problem with this system is that the DC will be besieged with complaints of adverse conditions and attempts to persuade him to lower the targets set. It can work only if the DC is pressured by suitable incentive mechanisms by his CIT and the CIT in turn is similarly pressured by the corresponding CCIT.
- (b) A 'bottom up' decentralized targeting system is used, as recommended by modern management experts. In such a system, AOs set their own targets at the beginning of the year, and are later evaluated on the basis of the level of ambitiousness of the targets they set for themselves, as well as their achieved performance at the end of the year in relation to these targets. Provided that the compensation and advancement of the AO depends in a direct, tangible manner upon these two components of performance, this system motivates AOs to set realistic targets for themselves based on their information regarding conditions prevailing in their unit, and then to attempt to achieve and surpass these targets. The targets set by the AOs also provide the DC (and thereafter the corresponding CIT) with accurate information concerning the amount of expected collections, the number of assessments to be conducted and the extent of pendency to be cleared in the coming year, thereby improving the quality of their planning and organisation<sup>26</sup>. The AOs we discussed this scheme with generally felt that if designed properly it may work well.

**Monetary Incentives:** We now come to the topic of monetary reward schemes for AOs. This is a potentially important tool for encouraging better collection performance. It is possible, however, that greater use of monetary rewards may lead simply to greater levels of corruption, as AOs will demand higher bribes from tax evaders to compensate them for higher rewards foregone. Nevertheless, even if this is the case, such a system will tend to discourage tax evasion, as AOs will be motivated to unearth concealed income more actively in the lure of higher bribes so that the 'effective cost' of underreporting income for a tax evader will increase. Recent theoretical research suggests the value of such reward schemes

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26. Such a system has been used in various private as well as public sector organisations in different countries: for example by IBM for its sales force in Brazil in 1976, and Soviet plant managers in the 'New Incentive Scheme' introduced in 1975.

in combating the problem of low revenue realisation owing to corruption though verification of this is not yet available<sup>27</sup>.

Possible problems with the use of improperly designed monetary reward schemes, which have been carefully taken account of in the suggestions made below, are the following:

- i. AOs may be motivated to harass innocent taxpayers by pressurizing them to pay more than they actually owe, or to assess additional demands which are likely to be later rectified or overturned on appeal; and
- ii. Envy and non-cooperation may follow from the greater inequality resulting in the compensation earned by AOs in different wards and circles, and between the earnings of those engaged in assessment and non-assessment activities respectively.

If within the next few years large scale computerisation of assessment activity is infeasible, it is difficult to reduce the amount of discretion available to AOs in assessment activity and the prevalence of widespread corruption in the Income Tax Department today continues, such a system of monetary rewards is an essential prerequisite for improving revenue realisations. It is conceivable that a bold initiative in this respect may have a dramatic effect upon levels of tax compliance in the country.

It is worthwhile, therefore, to experiment with a substantially revamped reward scheme. The following possibilities can be explored:

- i. A system of monetary rewards set at fraction (about 10 per cent is suggested) of additional revenues realised, with a higher fraction for cases with concealment penalties being initiated, may be instituted. Rewards should be payable automatically on additions (whether extra tax or penalty) upheld at the second appeal stage. A lower fraction of the amount sustained at the first appeal stage can be paid in the interim, which may be deducted from future rewards accruing to the officer in the event of the first appeal order being overturned at the second appeal stage. The payment should not be conditional on the initiation of prosecution proceedings, though an added bonus could be payable upon completion of successful prosecution. Where income is voluntarily surrendered by a taxpayer through the efforts of an AO and

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27. For example see Mookherjee and Png (1992).

his staff, payment of the corresponding reward should be immediate. A certain fraction of the reward should be set aside in a pool which to be distributed to concerned staff of the Investigation Wing whose information was useful in the selection of the case or in making the assessment and staff of the concerned range and CIT charge. The authority for sanctioning rewards should be delegated to the concerned CIT or CCIT.

Transferred officers should be informed about the status of cases where additional demands were made, and allowed to plead their case at the Appellate stage.

In addition, penalties should be imposed on AOs for poor performance with respect to rectifications and audit objections recorded against earlier assessments. Such penalties can be deducted from current or future rewards that the officer may be eligible for. More severe penalties can be used for cases where the appeal order deems the taxpayer to have been unduly and unjustifiably harassed by the officer.

- ii. We have mentioned above the possibility of altering the current system of target setting to a 'bottom up' target setting system, where the AO is evaluated on the target he sets for himself at the beginning of the year, and on his year-end performance relative to these targets. This could be combined with a more general system of *incentive pay*, where AOs are rewarded in terms of good performance in terms of net aggregate collections, not just in terms of concealed income discovered. Performance would thus be judged in terms of net aggregate additions of the corresponding ward or circle, including routine additions and better tax recovery, but adjusted downward for rectifications and appeals upheld. Such a system promotes congruence of revenue raising goals of assessing staff and the Department.

There is the question of how such a system could mesh with the system of rewards for discovery of concealed income described above. One possibility is in terms of two separate incentive provisions, one concerned with revenues realised from discovery of concealed income, and the other concerned with aggregate collections from all other sources (with suitable corrections for possible rectifications or appeals upheld later). For the former a system of monetary rewards along the lines of the first type of scheme described could be used while, for the latter, a self-target-setting system could be used.

It should be noted that these incentive schemes will necessarily require an improvement in the system of record-keeping, for example to ensure that information concerning the outcome of a case at the appeals stage can be used to evaluate an AO who may have been transferred from that charge, or where rectifications of routine additions in summary assessments carried out in past years are used to update performance evaluations or influence the incentive pay

computation. What is feasible with the current state of record-keeping is, however, unclear. It is obvious that the choice of an operational incentive scheme in the short run will depend on whatever reforms are possible in the system of record-keeping.

**Vigilance and Audit:** An attraction of the assessment scheme in which DCs have concurrent jurisdiction, discussed earlier, is that it may permit greater ‘distancing’ of AOs from taxpayers, thereby making the system less vulnerable to corruption. For instance, it may permit the development of a system of ‘group’ assessments, where different AOs within a range have concurrent jurisdictions over all taxpayer files in that range. Such a system could conceivably work as follows: any case within the range may be picked up for scrutiny assessment by any AO in that range subject, for reopened scrutinies, to certain restrictions to prevent undue harassment of taxpayers. Moreover, any case scrutinised by one AO may be scrutinised by others as well within the same year<sup>28</sup>. A major tax evader will then have to bribe more than one AO to avoid being scrutinised, or to avoid initiation of penalty and prosecution - thereby making such evasion less attractive. Such a system of *self-policing*, if it is successful, will greatly reduce the need for external vigilance, inspection and audit though they cannot be dispensed with altogether. Needless to say, such a self-policing mechanism must be linked to the reward and performance evaluation of both AOs and DCs. AOs will clearly resist such a system of group assessments. Indeed, we found that most AOs when asked about the feasibility of a similar scheme felt it would lead to ‘too much chaos’.

#### **4.7 The Overall Scale of Assessment Manpower**

While the number of taxpayers filing income tax returns have more than doubled since the early 70’s, we have noted above how the number of assessing officers (either sanctioned or working on assessments) has increased only marginally. This has resulted in a shortage of manpower capacity, which

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28. With the caveat that the assessee may be called upon to provide additional documents or appear before the second AO only in exceptional circumstances with the prior approval of a designated superior.

subsequently manifested itself in the expansion in the scope of the summary assessment program, and a reduction in the proportion of returns being assessed under scrutiny. It is also consistent with the observed increase in the returns to assessment activity, expressed as net collections from assessment per assessing officer (at constant prices), insofar as this may be a result of weaker deterrence caused by shrinking enforcement efforts.

One way of increasing the scale of enforcement activity is therefore to expand the size of the staff of the Income Tax Department, particularly that for assessment activity. In the current budgetary crisis of the government it may however be difficult to recruit additional staff for the Income Tax Department in the short run. One alternative that may be explored is to relocate personnel rendered redundant in other parts of the Central government as a result of the various recent deregulation initiatives, for example from the Controller of Imports and Exports or the Director General of Trade Development. The relocated personnel will of course have to be trained for their new jobs.

It should be possible for a large part of the manpower shortage to be mitigated by redeploying employees in various clerical positions and delegating more routine activities of the department (that is activities other than assessment, investigation and tax recovery) to them. This will reduce the requirement for long and expensive training programs for the redeployed employees and release more time for assessment and investigation related tasks by current employees.

One specific area that appears to be in need of strengthening is the number of DCs (Assessment). This can be accomplished by reducing the number of DCs (Appeal) and deploying them in assessing charges. The consequent reduction in the number of officers dealing with first appeals can be tackled by converting some posts of DC (Appeal) to CIT (Appeal). Besides having the benefit of increasing the average level of experience of officers dealing with both assessments and first appeals it is likely, especially if rewards to AOs are negatively affected by rectifications or adverse appeal orders, that the additional number of posts will be less than the number of additional DCs (Assessment). This should happen both because of the falling number of appeals and because of

the likelihood that capacity of senior officers to dispose of appeals quickly is greater.

The overall staff strength of the Income Tax Department should be periodically reviewed and adjusted with forecasted growth in the aggregate workload in accordance with a systematic manpower plan. We have not noticed any attempts in this direction so far in the past. In many other countries, systematic attempts to reduce the overall size of government have coexisted with expanded resources devoted to tax enforcement. Moreover, the revenue return per rupee spent on collection costs, or per assessing officer, seems fairly high, so that an expansion in enforcement resources may actually enhance the net budgetary revenues of the government (though perhaps with a time lag).

#### **4.8 Transfers, Training and Infrastructure**

**Transfers:** That there is rapid turnover, due to transfers of officers and staff, in assessing charges has been pointed out in Chapter 1. Frequent transfers have three potential drawbacks. First, DCs, AOs, inspectors and other staff have little chance to familiarise themselves with local conditions and, therefore, cannot bring local experience to bear in making assessments. Secondly, AOs making out assessment orders are usually transferred by the time the Department's representative has to prepare the Department's arguments in case of appeals against these orders. This tends to reduce the chances of appeals being decided in favour of the Revenue. Thirdly, poor assessments by an AO, as evidenced by a high rate of upholding of rectification or revision petitions and a high rate of appellate orders adverse to the assessment order cannot, under the current system of record-keeping, be brought to bear in evaluating the AO's performance. The argument for frequent transfers is that AOs and other staff do not have a chance to consolidate collusive arrangements with assessees to defraud the Revenue.

If it is possible to overhaul the existing system of rewards and scrutiny assessments to better motivate staff in assessment charges and remove the semi-permanent allocation of assessees to particular wards (as suggested above) there is much to be said for extending the average duration of a posting to about

three years. Substantially longer postings, especially for officers, may not be advisable given the need for officers to acquire experience in all or most activities of the Income Tax Department to prepare them for the higher echelons of the Department.

**Training:** Diverse complaints on the score of training and information were made to us during field visits including: poor training of subordinate staff; tardy or missing information on changes in procedures or the law (for example CBDT Circulars or appellate/court decisions); uncertainty as to the correct adjustments to be made under section 143(1); poor training of AOs in examination of accounts; lack of relevance of Departmental training courses; and absence of a systematic procedure by which officers could pass on vital knowledge of local conditions to their successors. While we have no suggestions to offer, at this stage, to deal with these these problems, it is clearly of importance for the Department to sufficiently revamp its training and information dissemination systems to overcome them.

**Infrastructure:** The poor availability and quality of office stationery and supplies and the cramped working conditions have already been commented on. Lack of proper buildings and transportation equipment has also received adverse notice from a former Chairman of the Central Board of Direct Taxes<sup>29</sup>. As with additional manpower, it is likely that additional outlay on proper infrastructural facilities will be more than recovered through higher revenue gains. It is suggested that, besides a somewhat stepped up infrastructural outlay, a degree of decentralisation be introduced in purchases instead of the current system whereby requisitions, which are subject to higher approval, have to be made even for minor items of stationery. Thus, officers could be allocated a fixed annual budget for office supplies, which they are allowed to spend in any way they desire, without being subject to accounting control save the requirement that vouchers or accounts should be submitted annually<sup>30</sup>. The amount of the budget could

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29. See the article by T.N. Pandey in the Economic Times, February 4, 1992.

30. However in case of complaints from other staff, vigilance enquiries may be initiated.

initially be fixed according to norms to be designed by the DOMS, and then updated annually to account for price increases.

#### **4.9 Monitoring, Control and Feedback**

It is apparent that the success of any administrative reform of assessment will depend greatly on effective monitoring, coordination and control of tax enforcement effort in their respective charges by DCs, CITs and CCITs. While we lack the expertise to design a proper supervisory system and indicate the appropriate level at which various supervisory tasks are to be performed, some desiderata from the perspective of enforcement can, nevertheless, be indicated.

**Monitoring:** The following activities should, inter alia be monitored within the charge:

- i. Utilization of CIB and Investigation Wing information.
- ii. The state of record-keeping.
- iii. Penalties, rectifications and first appeals.
- iv. Delays and bottlenecks affecting extent of time spent by AOs and DCs on assessment and direct follow-up.
- v. The progress and pace of implementation of reform of the enforcement system and the success or failure of various newly introduced measures.
- vi. Overall performance of different ranges and units in terms of collections.

**Control:** The following should, inter alia be controlled at the appropriate level:

- i. Appropriate allocation of manpower across ranges and intra-range units, in line with information concerning collections and returns from assessment in different ranges and units.
- ii. Transfers of personnel.
- iii. Movement of records within and outside the charge.
- iv. Second appeals by the Department and prosecution efforts.

- v. Receipt and despatch of "dak".

**Feedback:** It is widely accepted in modern management that, to keep an organisation functioning efficiently and obtain improved performance, the role of feedback is vital. Information flows in the Income Tax Department are currently largely "top down" with no feedback being sought from field units at the planning stage of reforms or targets and no effective performance feedback given to field units (examples are the lack of feedback to the CIB regarding extracts, and the fact that poor assessment orders have little or no effect on the performance evaluation of the AO). While some channels for the provision of feedback have been proposed above, it should be stressed that the responsibility for overseeing the smooth functioning of feedback systems should rest, ultimately with the CCIT. Some important areas where feedback is needed are:

- i. To the CIB, survey units and other Investigation Wing concerning the usefulness of their information.
- ii. To AOs and DCs concerning both the quantity and quality of their assessments (the latter on the basis of, say, additional demands sustained or growth in prepaid taxes relative to other AOs)
- iii. To treasury units concerning the progress of collections and recoveries relative to other units.
- iv. To the CBDT, concerning the progress and viability of reforms, as well as concerning bottlenecks and delays affecting information collection, assessment and follow up.

##### **5. REFORM OF POST-ASSESSMENT: PENALTIES, PROSECUTION, SETTLEMENT AND APPEALS**

It is apparent from our discussion in the previous section that the scale of imposition of penalties and also, perhaps, the scale of prosecutions for serious tax offenses is woefully inadequate, in particular for cases involving tax evasion (rather than technical offenses). Consequently, the deterrent effect for such offenses is negligible. A second cause of worry identified was that prosecutions and penalties were concentrated more heavily on small rather than big offenders.

On the other hand, the pendency of income tax prosecution cases in the courts is growing rather alarmingly in recent years. Moreover, both appeals and

prosecutions are time consuming and expensive in terms of the resources of the Income Tax Department. These problems pose obvious constraints on increasing deterrence of tax offenses via expansion of the overall scale of imposition of penalties<sup>31</sup>, and of prosecution efforts.

While a detailed examination of the pros and cons of different options for intensifying deterrence must await the later study, we feel that, in the current context, the right approach is to rationalise current procedures, institute certain legal reforms and suitably reallocate efforts of the Income Tax Department so as to secure higher levels of deterrence without substantially increasing the administrative load on the Income Tax Department, the ITAT or the courts.

The objective of these reforms, for which some possibilities are suggested for consideration below, should be to ensure that:

- i. Penalties are imposed automatically for a larger range of technical tax offences;
- ii. The bias against small and technical offenders is removed; and
- iii. Only selected cases with high 'visibility', which would create a substantial demonstration effect, are relentlessly prosecuted to establish the seriousness of the government to punish tax evasion. Other than these cases, imposition of stiff monetary penalties and compounding of prosecution cases are resorted to;
- iv. The time taken in post-assessment proceedings is substantially reduced.

**Penalties:** It should be considered as to whether scope exists to extend the coverage of additional tax to a broader range of technical offences, or, where tax is not directly involved, introduce a similar automatic levy. If feasible, these could replace several penalty provisions in the Income Tax Act and thus reduce the need for the lengthy procedure prescribed before penalties are imposed<sup>32</sup>. For example, penalty under sections 271(1)(b), 271A, 271B, 271BB, 271C, 271D, 271E, 272AA or 272BB could possibly be replaced. The quick penalties resulting

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31. It may be recalled that concealment penalties imposed are mostly appealed: Table 21.

32. Of course, the usual remedies against the levy will continue to apply.

on commission of technical offences may act as a greater deterrent than at present. On the other hand, discretion as to the amount of monetary penalties (and interest) for cases of concealment of income should continue to be vested only with officers of at least the rank of CIT but restricted further to only the conditions laid down in section 273A(4).

**Appeals:** In order that appeals may be disposed of quickly, the feasibility of moving to a system of ex parte appeals should be explored. Under such a system, arguments by the Department and assessee, including one rebuttal each of the arguments of the other party, would have to be filed within a fixed time of the filing of the appeal. The appeal could then be decided within a designated time period by the appeal authority without the need for the representatives of the Department or the assessee appearing before him. If desired, the appeal authority may have the power to permit the parties to appear before him, if one of them desired to do so, in exceptional circumstances. Besides reducing the time taken, this would save the cost to the assessee of the representative's appearance fees and would, likewise save the Department an equivalent amount (at least in terms of opportunity cost)<sup>33</sup>.

In order to reduce the number of appeals stages and thus save both on manpower and time, direct admission of an appeal by the assessee before the ITAT, without the need for a prior first appeal, should be allowed if either the assessee or the Department desire it. This, it would appear, does not represent a substantive abridgement of the rights of the assessee.

However, in cases with revenue effect below a certain sum (say Rs. 5000) where no substantive legal issue is involved, it should be considered whether the CIT(A) could be made the final appeal without permitting a second appeal stage.

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33. The possibility of extending the ex parte principle to courts, at least for a selection of technical matters, may also be examined especially if a National Tax Court comes into being. Additionally, though this has not been raised earlier, the possibility of removing or curtailing the right of an assessee to be heard at the time of assessment should be explored. However, due to the nature of enquiries to be made by them, the power of AOs to require assessee to appear before him cannot easily be curbed.

**Prosecutions:** The focus of the Department's efforts should be on prosecutions for tax evasion and fraud. The Department should develop and implement a system whereby every detected case of tax evasion is examined from the prosecution angle. Results of such examinations should be recorded and regularly checked and monitored by Commissioners and Chief Commissioners. The identification system should be more or less automatic.

Of potential cases identified only cases normally involving grave offences or with high 'visibility' should actually be taken to court. Publicity rather than punishment is thus the role being proposed for prosecutions which, even with tremendous improvement in the speed of the legal process, will continue to be lengthy and time consuming. Once a tax evasion case is taken to court, it should be pursued relentlessly. It should not ordinarily be compounded. However the remaining cases in the 'consideration zone' (that is, cases identified for prosecution but not taken to court under the proposed policy) should be compounded. As offences are compounded only on payment of a large composition fee, this itself seems to have a reasonable element of deterrence. Any identified case which is neither taken to court for prosecution nor compounded should require special justification by the concerned officer and approval of the Commissioner.

As regards 'technical' offences, the objective should be to compound most of them without filing a prosecution complaint. The administrative requirements of seeking the Board's previous approval for compounding may be dispensed with in such cases. However, the Board may issue guidelines in the matter including guidelines for special conditions for compounding of second and subsequent technical offences.

We have earlier pointed out that the existing pendency includes a number of multiple complaints (particularly in respect of TDS offences under section 276B). To liquidate the existing pendency, the Department should immediately prepare a list of pending cases which can be compounded and compound all those cases in which applications for composition have been made by the affected persons. In cases in which compounding applications are not

pending, feasibility of the Department making an offer to the affected persons to have the offence compounded needs consideration. The proposed liberal compounding of all 'technical' offences should also lead to expeditious disposal of most of the multiple complaints. However, if all of these cannot be compounded, the Department should prepare a list of such remaining complaints and approach the courts with a request for their bunching and simultaneous disposal. This could lead to quick reduction of the pendency.

We suggest that the Government review the working of special courts for economic offences to identify deficient areas, if any and take appropriate measures for improvement. In case it is decided to retain the special courts, it should be ensured that the magistrates/judges are not frequently transferred out to other courts. Special training courses on tax matter should be conducted for them. We suggest that the Income Tax Department should, in consultation with the Ministry of Law and other concerned Departments of the Central and State governments, examine the possibility of appointing officers of the Income Tax Department (with necessary legal qualifications) as magistrates/judges for handling income tax offence cases.

We have pointed out earlier that delays in disposal of cases are partly attributable to the cumbersome legal procedure under the Criminal Procedure Code. As economic offences differ substantially from other offences, it needs examination whether a separate set of rules and procedures can be framed for trying such offences and inserted in the relevant tax statutes. This may, inter alia, take into account avoidable practical difficulties faced by the Department and the affected persons under the existing procedure and the special requirements for quick and effective disposal of such cases.

We have already pointed out that the existing training facilities for income tax officials on prosecutions and other related matters are totally inadequate. Also, there is no scheme for training prosecution counsels of the Department on tax matters. We suggest that suitable training programmes in this regard be designed and introduced.

We have pointed out earlier the problem of lack of effective supervision and monitoring of the work of prosecution counsels. The Income Tax Department should evolve a suitable system for this purpose. The possibility of engaging retired officers of the Income Tax Department (with necessary qualifications) as prosecution counsels also needs consideration. With their rich experience in tax matters, they should, at least in principle, be able to show results.

We have already pointed out earlier that while income tax officials have a motive (reward entitlements, good reports etc.) for launching prosecutions, there is hardly any for pursuing the proceedings relentlessly and putting in their best efforts for securing conviction of the accused. If delays in disposal of courts are significantly reduced; the number of fresh complaints substantially reduced and the outcome of prosecution cases linked to the performance evaluation of the officers concerned, they will, we hope, have a motive for maximising their efforts for securing a favourable outcome in the relevant proceedings. As a further (and a more concrete) incentive, we suggest introduction of a scheme of rewarding (in monetary terms) officers whose efforts lead to the Department's in prosecutions. Similarly, a monetary reward should be paid to an officer who detects an offence, which is ultimately compounded on payment of composition fee.

These reform proposals should also curb bunching of prosecution proposals at year end though further monitoring of this may be necessary.

**Settlement of cases:** We therefore also propose that the powers of the Settlement Commission to grant immunity from prosecution be withdrawn. It appears that in such a case the Commission will effectively become defunct. If for some reason it is considered necessary to retain the Commission, its role can then be reduced to being an arbitration board for negotiations between assessee and Income Tax Department representatives, somewhat akin to the role of arbitration bodies in management-labour negotiations. However, this role can also be served by the CBDT, in case it is decided to do away with the Settlement Commission.

In the new system, then, there should be a single system for out-of-court settlement/compounding of both penalties and prosecution, in which the Income Tax Department representative (preferably the concerned AO or supervising DC or CIT) retains the right to decide whether to pursue prosecution or not, and to negotiate with the assessee concerning the level of settlement. This activity should be overseen by either the CBDT or the Settlement Commission.

**Amnesties:** Regardless of whether received theoretical wisdom as to the effectiveness of amnesties, the experience with general amnesties in the past or principles of equity are consulted, amnesty programs find no justification. They should, therefore, never be resorted to. Likewise, loopholes in the Income Tax Act, most notably the "once-in-a-life amnesty" which, due to the current state of record-keeping, may have become a "running amnesty", should be removed. Such loopholes exist due to the use made of explanation 5 to section 271(1)(c) read with section 132(4) and due to the provisions of section 273A(1).

## **6. A PROPOSED PERFORMANCE EVALUATION SYSTEM FOR THE INCOME TAX DEPARTMENT**

In order to improve the enforcement machinery of the Income Tax Department, it is necessary to set out a procedure for evaluating the performance of the Income Tax Department. The procedure should be designed to shed light on the effectiveness of income tax enforcement and enable areas of weakness to be pinpointed. Evaluation of the Income Tax Departments' performance is currently available in three publications: The Report of the CAG, the Annual Report of the Ministry of Finance and the Income Tax Department's Annual Performance Statistics. All three evaluations are deficient in that none of them use any external yardstick to evaluate performance<sup>34</sup>. A framework which makes use of relevant external indicators is, therefore, proposed.

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34. In the language of hypothesis testing, these evaluations can detect Type I errors but not Type II errors.

## **What Areas Should be Evaluated?**

If all taxpayers complied voluntarily with income tax provisions and there was no ambiguity about income tax law, the role of the department would be limited to that of a tax collection agency. Even this function could, in fact, be entrusted to the post office or the banking system. Clearly then, the justification for an Income Tax Department is twofold: to promote compliance on the part of those who do not comply voluntarily and to remove ambiguity in the tax law through references to courts and periodic exercises to simplify and rationalise the tax structure.

One source of non-compliance can simply be because of ambiguity in the tax law. Efforts to simplify tax laws and procedures require monitoring and evaluation, therefore, even from the point of view of enforcing compliance. A second cause of non-compliance is ignorance of the law or required procedures. Consequently, efforts to remove ignorance of the law and procedures are a second area requiring monitoring and evaluation. The third and most important cause of non-compliance is deliberate attempts to evade tax. Deliberate tax evasion can occur either because some otherwise honest taxpayers may perceive the costs of compliance (apart from taxes due) to be too high or because dishonest taxpayers may simply desire to evade tax.

Non-compliance due to ignorance or deliberate evasion results in a four-fold 'compliance-gap'. Efforts by the Income Tax Department to curb non-compliance due to ignorance and, more importantly, deliberate evasion can be monitored by measuring these gaps. The gaps may be described as follows.

- i. The identification gap: Some persons required to file may not be known to the Income Tax Authorities.
- ii. The filing gap: Of those known to the Department and required to file returns some may not file.
- iii. The reporting gap: Of filers, some may not report dues correctly.

- iv. The tax recovery gap: Those reporting correctly may not actual pay taxes<sup>35</sup>.

Finally, it is necessary to know at what cost to the nation the Income Tax Department operates. Keeping these goals in view, a set of eight indicators to monitor the performance of the Department can be suggested.

**i. Indicator of simplification efforts:** This could be constructed by examining the ratio of appeals and court references on questions of law or procedure to total assessments in a year and the ratio of assessments with prima facie adjustments to total assessments in the year.

**ii. Indicator of public awareness of income tax law and procedure:** This index could be constructed by commissioning an independent organisation to conduct annual sample surveys of taxpayer awareness.

**iii. Indicator of the identification gap:** The number of assessees required to pay taxes could be econometrically estimated and the ratio of assessees on the books of the Department, (as reported annually to the CAG) to the econometrically estimated figure could be used as the indicator.

**iv. Indicator of the filing gap:** Filers plus those who are not required to file under the provisions of section 139 of the Income Tax Act, taken as a proportion of total assessees, can serve as an indicator of this gap.

**v. Indicator of the reporting gap:** The starting point for this indicator should be an econometric estimate of income taxes due. This should be scaled down by the indicators of the identification gap and the filing gap. The ratio of income reported to the scaled down estimate may serve as an indicator of the reporting gap.

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35. This structure is based on a classification used in a seminar by Carlos Silvani. It should be mentioned that these compliance gaps are nested. For example, tax recovery may continue to be a problem if unreported income is subsequently detected but this will not figure in the recovery gap.

**vi. Indicator of the recovery gap:** Statistics on tax demand outstanding and recovery are already collected by the Income Tax Department. The ratio of recovery to the sum of demand outstanding and written off could serve as the indicator for this gap.

**vii. The benefit-cost indicator:** This could be the incremental cost of collection to incremental collection by the Department where the increment is over a weighted average of (say, five) previous years.<sup>36</sup>

**viii. Taxpayer compliance cost indicator:** Data for this indicator should be gathered, once again, through an annual sample survey by an independent research organisation<sup>37</sup>.

Annual variation in these indicators could be used to identify areas of weakness in the administration of the Income Tax<sup>38</sup>. However, the Department is unlikely to be able to respond speedily and flexibly to perceived areas of weakness and the changing economic environment unless it has a greater degree of autonomy in deciding on such things as infrastructure; staff strength, deployment and remuneration; and enforcement strategy. Greater autonomy, therefore, requires serious consideration. Certain features of the current system lead to a perpetuation of inefficiency. These features include: the archaic and mistrustful system of cost control; the inability of the Board to take independent decisions about manpower; the Board's inability to decide on remuneration and promotion policy (why parity should be maintained between income tax and, say, forest department salaries and promotion is not at all clear); and the use of the

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36. However, the method of computing cost of collection of the Department by the CAG, which used no market value or opportunity cost imputations, should be reviewed. Furthermore, the cost of auditing by the CAG, etc., should be added to total cost of collection.

37. If this is felt to be too expensive, surveys of public awareness and taxpayer compliance cost could be conducted biennially or quinquennially.

38. Some misgivings may be raised about the use of econometric estimation in arriving at indicators. Firstly, annual percentage variation in indicators will be less sensitive to deficiencies in estimation than actual values of indicators. Secondly, once a beginning is made, estimation can always be improved as experience is gained.

Audit as a mechanism to "whip" the Department rather than to aid them to identify mistakes committed and areas of weakness.

## **7. SUMMARY**

### **7.1 General**

1. It is essential that the CBDT draw up a detailed implementation plan before commencing a reform programme.
2. No attempt to improve enforcement efforts in the Income Tax Department will amount to anything substantive without the eventual introduction of computers.
3. Computerisation may be done initially, in areas where staff perceive only benefits from a streamlining of workload.
4. The availability in India of expertise about modern computer technology makes it possible to greatly speed up information collection and dissemination and improve managerial control of workflow without the need for external experts.

### **7.2 The Information System**

#### *Basic Principles and General Suggestions*

5. The four key areas in an information system are collection, verification and collation, storage and retrieval.
6. Information should as far as possible, be gathered without the need for face to face contact or postal communication between the Department and assessees.

7. Information on an assessee or potential assessee should, as far as possible, be available in one place for all direct taxes and including both past and current records.
8. The information on an assessee should be cross- indexed in a way which permits transmission of information on assesseees or others with whom the assessee in question has economic dealings
9. It is essential that a perspective plan with yearwise targets be drawn up with respect to storage space and storage media.
10. The information storage subsystem should ensure that essential records on assesseees: last for a sufficiently long time; are tamper proof; and facilitate easy retrieval of information on assesseees when required.
11. All information relevant to assessment of an assessee should be retrievable both in detail and in precis form at the time of assessment or other proceedings.
12. Compilation of regular information for control or statistics should be quick and routine yet flexible.
13. The efficiency of any information system depends crucially on effective and regular use of taxpayer numbers.
14. A good system of identification numbers will have the following properties.
  - i. It will automatically cover all potential assesseees even if they are not assesseees or filers at present.
  - ii. Numbers will permanently identify assesseees.
  - iii. There will be limited scope and harsh penalties for fraud through 'benami' numbers or multiple numbers.
  - iv. Quoting identification numbers at the time of undertaking a wide variety of transactions, would be compulsory.
  - v. Assesseees would have an incentive to obtain numbers.

- vi. The numbers would be obtainable without difficulty. Furthermore identification of assesseees with particular taxpayer numbers should be possible with no difficulty at every Income Tax office. Taxpayer number records would be tamperproof.
15. The design/reform of the information system which meets these requirements is best carried out by Management Information System (MIS) experts in collaboration with the Department.
16. Third party information should, in the course of time, become the mainstay of the information system of the Department.
17. Measures which reduce the need for information on assesseees are to be encouraged. Foremost among such measures is presumptive taxation.
18. As at present, the assessee's file should be the fundamental unit for collation of information.
19. A need exists for a review by management experts of current collation, storage and utilisation systems and procedures so as to improve their efficiency.
20. A principle to be kept in view is that of minimising the number of information storage locations.
21. A second principle is that after an assessment is completed, original records on assesseees pertaining to that assessment year should not leave the record room except for use in proceedings where original documents may be required.
22. The Department should consciously strengthen its public relations activities with respect to TDS.
23. As third-party matching gains ground, reliance on search and survey should diminish.

24. Manpower for record-keeping and statistical cells can be drawn from other central government departments that are in the process of being pruned.

25. The information science concepts of precision and recall can be used by qualified experts to design a framework which could be used to evaluate the entire information system as well as the collection, collation, storage and retrieval subsystems individually.

### *Specific Suggestions*

26. It is essential that a system of feedback from assessing charges and a review procedure for the Investigation Wing be instituted forthwith.

27. The emphasis of intelligence operations in the Department should shift from reliance on informants to systematic and suo-moto intelligence-gathering through covert investigations and surveillance.

28. A system of outright purchase of information should replace the extant time-consuming process.

29. Consideration should be given to possible solutions to the problem of security of income tax staff (such as deployment of special units of the Central Reserve Police).

30. The emphasis on quantitative targets for CIB should be replaced by greater attention to quality. A mixture of supervision and eligibility for liberalised rewards may be tried out for this. However, these measures must be supplemented by computerised information management before any substantial gains can be expected.

31. Legislative amendments which would make the flow of information to the CIB from institutional third-party sources automatic should be explored. Such a system will work well only if it is linked with an efficient taxpayer number system.

32. To reduce time delays, it is suggested that CIB information be sent directly to AOs, where possible, with copies to the DC and CIT for monitoring.

33. All information relating to an assessee should ideally be consolidated so that all of these are simultaneously considered during assessment. The CIB should spend relatively more time in collating information.

34. The CIB should, we would conjecture, not verify individual pieces of information and devote time so saved to collation. Abandoning verification would enable the CIB to collect information from more third-party sources.

35. Supervision by DCs and CITs of utilisation of information should be strengthened by requiring them to compile annual reports on the utilisation of information by assessing officers in their charges and remedial steps taken by them. Also, the Audit should routinely evaluate utilisation of CIB information.

36. At present one organisation (under DGs (Investigation)) collects and verifies the information and another (under CCs) utilises it in assessment. Better coordination of these functions may be achieved if information collection, verification and utilisation are all placed under the CC. This will also ensure better supervision and monitoring and reduce time-lags and under utilisation of information.

37. A study of the appropriate pattern of manpower deployment to the CIB, taking into account the direct and indirect deterrence and revenue gain from its activity and keeping in view the use made of CIB information by AOs, should be undertaken.

38. The most important ingredient of a modern information system on tax evasion is a Taxpayer Monitoring Programme. We recommend that a separate arm of the Investigation Wing be created to engage in scrutiny assessment for the Taxpayer Monitoring Programme.

39. Economists and statisticians employed by the Department could also be used for assessment of broad economic trends.

40. A consolidated direct tax return may be designed.

41. All persons or entities who are assigned taxpayer numbers should be required to complete and file Form 45D every five years.

42. An internal committee within the Department should be set up to devise measures to curb malpractices and punish erring Chartered Accountants.

43. Record keeping units should be under the charge of a trained cadre of officers who will be able to supervise the work of cross-indexation and collection of records.

44. Consideration should be given to the creation of statistical cells at the range level under a statistics officer.

### **7.3 Reform of Assessment**

#### *Basic Principles and General Suggestions*

45. In searching for an appropriate pattern of organisation of assessment charges, 3 requirements must be kept in view.

- i. The organisation should be flexible enough to permit manpower redeployment in response to fluctuations in workload. It should, furthermore be consistent with the expansion plans of the Department to cope with the secular increase in workload which may be expected.
- ii. "Similar" cases should be within the jurisdiction, as far as far as possible, of the same AO so that gains from specialisation can be reaped by the Department.
- iii. Assesseees should not be able to influence to their advantage the assessing jurisdiction to which they are assigned.

46. Different charges should be classified on the basis of characteristics that are not easily alterable by the taxpayer.
47. The allocation of manpower should, in any given year, be on the basis of realised returns to assessment effort in different intra-range units in recent years.
48. A proper division of workload across ranges should, as far as possible, also be based on the way the taxpayer population is to be stratified (by occupation, territory and type of assesseees) with each broad category corresponding to a particular range.
49. The correct allocation of manpower across different ranges should equalize the net additional returns per hour of assessment activity.
50. One essential element of a better scrutiny selection system would be to use some systematic procedure rather than rely on the subjective judgment and discretion of AOs.
51. There is considerable scope for reforming the current target setting system in the direction of greater flexibility and uniformity in the setting of targets, combined with the greater use of positive incentive schemes.
52. Recent theoretical research suggests the value of monetary reward schemes in combating the problem of low revenue realization owing to corruption.
53. An attraction of the assessment scheme in which DCs have concurrent jurisdiction is that it may permit greater 'distancing' of AOs from taxpayers, thereby making the system less vulnerable to corruption.
54. The overall staff strength of the Income Tax Department should periodically be reviewed and adjusted with forecasted growth in the aggregate workload in accordance with a systematic manpower plan. The revenue return per rupee spent on collection costs, or per assessing officer, seems fairly high so

that an expansion in enforcement resources may actually enhance the net budgetary revenues of the government.

55. If it is possible to overhaul the existing system of rewards and scrutiny assessments there is much to be said for extending the average duration of a posting to about three years.

56. It is clearly of importance for the Department to revamp its training and information dissemination systems.

57. It is likely that additional outlay on proper infrastructural facilities will be more than recovered through higher revenue gains.

#### *Specific Suggestions*

58. The most important change in the current assessment procedure is the proposed time gap of at least 8 months to a year between the date of submission of returns and the commencement of scrutiny assessment for the year.

59. We propose the concept of a "cellular" structure wherein similar assessees are grouped into cells of about one hundred assessees each.

60. A coherent policy designed to deter strategic concealment of income must ensure that within any homogenous stratum of taxpayers the likelihood of scrutiny increases as the reported income becomes lower:

Such a policy can be realized only if the current distinction between wards and circles is replaced by distinctions based purely on occupation, territory and the other factors outlined.

OR

A more extreme procedure, one which allows greater flexibility in work planning, is to do away with wards and circles altogether. The jurisdiction of AOs will be decided afresh each year with the DC having concurrent jurisdiction over cases assigned to AOs under him.

61. "Cases with high revenue potential" may continue to be assessed in special assessing charges as at present.

62. DCs (Assessment) may be utilised to undertake assessments of difficult cases including investigation cases, assessments of cases pertaining to new lines of business or cases involving newly introduced provisions under the various direct tax acts. The number of DCs (Assessment) should be increased.

63. In the interim, the Department may explore the possibility of developing a pool of 'roving' AOs and support staff in different regions that can be redeployed at short notice across different ranges in that region.

64. Consideration should be given to ways in which tax recovery and arrears work can be taken out of assessment charges. This would enable AOs and their support staff to spend additional time on assessment activities.

OR

An alternative solution may be to delegate authority and responsibility for these activities from an AO to lower level staff, say at the level of inspector.

OR

Another possibility is the creation of a separate Collections/Recovery Wing which will be responsible for all cash transactions with taxpayers.

65. The summary checking of returns, even if there is a consolidated direct tax return, is routine enough to be delegated to an Inspector with the AO having only supervisory (rather than direct) responsibility. This is an interim measure that is proposed till the introduction of computer based checking of prima facie errors.

66. Before the commencement of scrutiny assessment it is important that a number of pre-assessment activities are completed. Such activities include arithmetic and prima-facie checks of returns; identification of stop-filers and non-filers; matching information in returns with past records and third-party

information from the CIB; selection of cases for scrutiny; and manpower reallocation.

67. A scoring system for a number of criteria on which information is available can initially be experimented with. The scores may increase with a designated set of presumptive factors. The list of presumptive factors used may be modified in subsequent years on the basis of experience gained.

68. We recommend that a random sample of all filed returns first be drawn given time and staff constraints. The scoring system can then be applied to the returns in this sample and files with the highest scores selected for scrutiny.

69. In addition, cases with high revenue potential and the various types of cases to be scrutinised by DCs (Assessment) may be selected for scrutiny.

70. The current three-pronged approach to ensure high quality scrutiny assessment in the Income Tax Department can continue to be used, with certain modifications.

71. Most cases should be required to undergo a routine scrutiny or "desk audit" (along the lines currently followed in most cases), by AOs while a few cases should go through intensive scrutiny, or "field audit", including detailed field enquiries.

72. Disposal targets could be set by the DC of the range in consultation with the AO in question, and after learning of the local conditions prevailing.

OR

A 'bottom up' decentralized targeting system may be used, as recommended by modern management experts.

73. A system of monetary rewards set as a particular fraction of additional revenues realised, with a higher fraction for cases with concealment penalties being initiated, may be instituted.

AND/OR

A more general system of *incentive pay*, where AOs are rewarded in terms of good performance in terms of aggregate collections, not just in terms of concealed income discovered, can also be instituted.

74. Under self policing a case scrutinised by one AO may be scrutinised by others as well within the same year. If such a system is successful, will greatly reduce the need for external vigilance, inspection and audit though vigilance cannot be dispensed with altogether.

75. Besides a somewhat stepped up infrastructural outlay, a degree of decentralisation should be introduced for routine purchases instead of the current system.

76. The following activities should, inter alia be monitored within the charge:

- i. Utilization of CIB and Investigation Wing information.
- ii. The state of record-keeping.
- iii. Penalties, rectifications and first appeals.
- iv. Delays and bottlenecks affecting extent of time spent by AOs and DCs on assessment and direct follow-up.
- v. The progress and pace of implementation of reform of the enforcement system and the success or failure of various newly introduced measures.
- vi. Overall performance of different ranges and units in terms of collections.

77. The following should, inter alia be controlled at the appropriate level:

- i. Appropriate allocation of manpower across ranges and intra-range units, in line with information concerning collections and returns from assessment in different ranges and units.
- ii. Transfers of personnel.
- iii. Movement of records within and outside the charge.
- iv. Second appeals by the Department and prosecution efforts.
- v. Receipt and despatch of "dak".

78. It is widely accepted in modern management that, to keep an organisation functioning efficiently and obtain improved performance, the role of feedback is vital.

Some important areas where feedback is needed are:

- i. To the CIB, survey units and other Investigation Wing concerning the usefulness of their information.
- ii. To AOs and DCs concerning both the quantity and quality of their assessments.
- iii. To treasury units concerning the progress of collections and recoveries relative to other units.
- iv. To the CBDT, concerning the progress and viability of reforms, as well as concerning bottlenecks and delays affecting information collection, assessment and follow up.

#### **7.4 Post-Assessment Proceedings**

79. The objective of reform of post-assessment, should be to ensure that:

- i. Penalties are imposed automatically for a larger range of technical tax offences;
- ii. The bias against small and technical offenders is removed; and
- iii. Only selected cases with high 'visibility', which would create a substantial demonstration effect, are relentlessly prosecuted to establish the seriousness of the government to punish tax evasion. Other than these cases, imposition of stiff monetary penalties and compounding of prosecution cases are resorted to;
- iv. The time taken in post-assessment proceedings is substantially reduced.

80. It should be considered as to whether scope exists to extend the coverage of additional tax to a broader range of technical offences.

81. Discretion as to the amount of monetary penalties (and interest) for cases of concealment of income should continue to be vested only with officers of at least the rank of CIT but restricted further to only the conditions laid down in section 273A(4).

82. In order that appeals may be disposed of quickly, the feasibility of moving to a system of ex parte appeals should be explored.

83. In order to save both on manpower and time, direct admission of an appeal by the assessee before the ITAT, without the need for a prior first appeal, should be allowed if either the assessee or the Department desire it.

84. However, in cases with revenue effect below a certain sum where no substantive legal issue is involved, it should be considered whether the CIT(A) could be made the final appeal without permitting a second appeal stage.

85. Only cases involving concealment of income, overstatement of expenses or other wilful attempts to evade tax, should be considered for the launching of prosecutions.

86. Only a small fraction of cases where prosecutions are launched, cases with a high 'visibility', should actually be taken to court. Publicity rather than punishment is thus the role being proposed for prosecutions.

87. To liquidate the existing pendency, the Department should immediately prepare a list of pending cases which can be compounded and compound all those cases in which applications for composition have been made by the affected persons. In cases in which compounding applications are not pending, feasibility of the Department making an offer to the affected persons to have the offence compounded needs consideration.

88. For other prosecution cases, it should be the aim of the Department to settle them, as far as possible, out of court.

89. If all technical offences cannot be compounded, the Department should prepare a list of such remaining complaints and approach the courts with a request for their bunching and simultaneous disposal. This could lead to quick reduction of the pendency.

90. We suggest that the Government review the working of special courts for economic offences to identify deficient areas, if any and take appropriate measures for improvement.

91. The provision whereby large assesseees can suo moto approach the Settlement Commission for the Commission to decide on the assesseees liability to the Revenue and perhaps even the Settlement Commission, should be done away with.

92. Amnesties should never be resorted to. Loopholes in the Income Tax Act, most notably the "once-in-a-life amnesty" which, due to the current state of record-keeping, may have become a "running amnesty", should be removed.

93. In order to improve the enforcement machinery of the Income Tax Department, it is necessary to set out a procedure for evaluating the performance of the Income Tax Department. The procedure should shed light on the effectiveness of income tax enforcement and pinpoint areas of weakness. A scheme which makes use of relevant external indicators is, therefore, proposed.

94. Greater autonomy of the Department to decide on manpower, infrastructure and enforcement strategy is required to ensure that the Department can respond flexibly and speedily to changing conditions and identified weaknesses.

## CHAPTER 3

### DESIGN OF A RANGE LEVEL PILOT EXPERIMENT FOR ASSESSMENT

#### 1. GENERAL CONSIDERATIONS

In this Chapter, two separate experiments are described. The first and main experiment, described in the next two sections, involves six or more ranges spread over 3 cities and is designed to help to evaluate the practical merit of a variety of alternative measures to improve the efficiency and deterrent quality of Income Tax assessment. The second, much smaller, experiment takes advantage of a recent study and is designed to assess the usefulness of presumptive information in selection of scrutiny cases. It is described in Section 4.

##### 1.1 Limitations in experimental design

It is necessary to first point out limitations that will be present in the design of any experiment aimed at evaluating the worth of various reform measures. Having done this, we will next indicate the broad design of the experiment taking into account the limitations present. Specific features of the proposed experiment are described in Section 2. In order to draw completely reliable inferences from experimental measures introduced to improve the effectiveness of assessment, it would ideally be possible to have replication, variation, continuity and credibility. The ideal will only be partially attainable in an actual assessment experiment for the reasons we now set out.

**Replication** implies that the same set of experimental factors must be tried in a number of more or less homogenous charges<sup>1</sup>, in order to be able to statistically discount the possibility that the success or failure of these experimental factors is not merely a fluke. Usually, 5 is the minimum number of replications (or charges in this case) considered reasonable for each set of experimental factors. This

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1. The exact meaning to be assigned to the word "charges" will be clarified later. for the present it may be taken to be synonymous with "wards".

means, for example, that if only 1 measure is to be experimentally evaluated, 10 charges are required (5 as a control sample and 5 in which the measure is introduced). If 2 measures are to be tried, singly or in combination, then 20 charges are needed (5 control, 5 with the first measure only, 5 with the second measure only and 5 with both measures). The number of charges mounts very rapidly as the number of measures increases. Thus with 10 measures, 5120 ( $=2^{10} \times 5$ ) charges are needed<sup>2</sup>. Clearly, statistical reliability can only be achieved, given that so many charges cannot be subjected to experimentation, if the experiment is of sufficiently long duration and each year is treated as a replication.

**Variation:** To the extent that all charges in the country are not homogenous, the number of charges needed will further increase. This is so to ensure that the success of an experimental measure can be generalised to the country as a whole and is not limited to the particular type of charge in which it is tried. This requirement can be met to some extent by trying the same reform measures out simultaneously in charges located in at least three cities or CCIT charges.

**Continuity:** The novelty of any administrative reform must be allowed to wear off, and teething troubles overcome, before it can be fairly evaluated. This means that any reform measure has to be tried out in a charge for at least 2 years. It is also desirable to have minimal staff transfers not only in the experimental charge but also in the immediate supervisory level (e.g. for a ward level experiment, the concerned DC as also ward level staff should not be transferred). This requirement should present no great difficulty.

**Credibility:** Experimental conditions must not be viewed as temporary by either staff in the experimental charge or assesses in the jurisdiction of the charge. Otherwise, success or failure of the experiment will both be misleading. This can only be achieved if the measure is introduced, so far as the experimental charge is concerned, as a permanent reform, introduced on a pilot basis in the

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2. Some saving in the number of charges is possible with careful experimental design.

charge, before being implemented in the country as a whole. The charge need not be made aware of the time-bound nature of the experiment.

## **2. KEY FEATURES OF THE RANGE LEVEL EXPERIMENT**

### **2.1 Types of experimental measures**

The experiments are limited to the level of the range and to measures which maybe implemented without the need for changes in direct tax acts. Even so, three types of measures can be distinguished: **Measures affecting the range as a whole, measures affecting particular AO charges and measures affecting groups of assessment cases.** As indicated at the beginning of Chapter 2, proposed measures are either in line with "modern management" precepts or reflect only "limited departure" from existing procedures. Consequently, there is a natural division of measures of each kind into two groups. Measures in either of the two groups need not be mixed with measures from the other group. The chart in Figure 3 lists various experimental measures in the two groups.

All permutations of component measures for range organisation cannot be tried in different ranges, given the limited number of experimental ranges likely to be available. The two sets of measures may thus be taken to be complete packages. However, staff measures can be varied across groups of AOs in a range and some assessment procedures can also be permuted across AOs or cases, while noting the need to avoid confusion. The experimental combinations are detailed later. First we outline the proposed scope of the experiment and a method to monitor its progress.

### **2.2 Scope of the Experiment**

**Number of Charges:** A minimum of six assessment ranges, two each in three different cities, will be needed for the experiment. In addition, there should be at least one other range dealing with similar cases in each city which can function as a control range for the experiment. Each range should have at least 8 ITOs or ACs in it and a workload of per ITO/AC which is in line with the

Department average. It is recommended that, to achieve a reasonable degree of homogeneity rather than pursue the goal of range level diversity, ranges with only business or professional cases be chosen. The staff strength per ITO or AC will, it is further assumed, correspond to the averages found by us in the field survey as reported in Table 9 except as indicated below in the case of inspectors. It would, in fact, be desirable to use the same ranges and the same officers present during the field survey conducted for this study, plus an additional range in Jaipur or another similar non-metropolitan CCIT charge. This is so that the experiment can be tailored, to an extent, to the receptiveness of range staff to various measures as ascertained during the field survey (see Appendix 9). The remaining business/professional range(s) in the city could then serve as the control range(s) where normal practices could continue to be followed. In the event (in Jaipur) that three business or professional ranges are not available, two alternatives are possible. Firstly, the experimental area could encompass ranges from neighbouring cities (e.g. Jaipur and Ajmer). Alternately, a fresh range could be carved out of the two existing ranges for the duration of the experiment to act as the control range for the area.

**Duration:** The experiment will have to run for a minimum of two assessment years. In the first year after introduction of experimental measures, the DCs and CIT concerned should meet at regular intervals with AOs to help streamline procedures in order to overcome difficulties being faced by AOs and their staff. In the second year the experiment may continue as far as possible under normal conditions in order to permit an evaluation of the practicality and usefulness of the various experimental measures. No transfers of personnel from or to the experimental ranges should normally be allowed for the two year period though the same restriction should not be imposed in control ranges.

If additional experimental ranges or a longer duration for the experiment are considered feasible, then the experimental design could be replicated in these additional ranges or during the additional years.

### **2.3 Monitoring and Evaluation of the Experiment**

At the end of each quarter, information on costs, revenue collection and staff response to measures would have to be collected from experimental ranges as well as, in the second year, control ranges. The response of assessees to the new measures may also be collected on a sample basis at the end of the year. During the first year, the information would be used to provide feedback to staff in experimental ranges, as to errors and mistakes being committed by them. In the second year, the information collected may be used to evaluate the various measures. Five criteria are suggested to evaluate measures: prepaid taxes per AO (denoted by R1 below); revenue collection net of cost of collection per ITO or case (R2) additional revenue collection per ITO or case (R3); An index of acceptability of the measure based on responses of officers and staff of control and experimental ranges (R4); a questionnaire based index of taxpayer harrassment (R5). It is suggested that monitoring, feedback and most especially evaluation be done with the advice and collaboration of external experts by the Income Tax Department.

### **3. EXPERIMENTAL DESIGN**

Ranges are labelled L (for limited departure) and M (for modern management). There should be a range L and a range M in each CCIT charge/city in which the experiment is being conducted in addition to a control range (labelled C). ITOs or ACs will be labelled L1, L2 and so on and similarly M1, M3, etc, where each numeral refers to a particular AO level experimental package.<sup>3</sup> AOs required to do investigation cases will be labelled I. Figure 4 sets out the design of the proposed experiment. The two methods of scrutiny selection to be tried out in range M are labelled a and b.

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3. In case additional ITOs or ACs are present in the range the number of replications could be increased. For example with 10 ACs/ITOs in range L there could be two L1s and two L2s.

FIGURE 3

Measures Proposed for Range Level Experiments

"Limited Departure"	"Modern Management"
<b><u>Range Organisation</u></b>	
Territory/Profession based wards and removal of income based ward/circle distinction	Concurrent jurisdiction for DC
Flexible assignment of scrutiny cases by DC to AOs	Range level Record-keeping Cell
	Abolition of wards and circles
	Difficult cases assigned to DC
	Special Range (not income based)
	Appointment of ITO (Collections)*
	Forming of Range Statistical Cell
	Range level Survey Cell
<b><u>AO Level Measures</u></b>	
Fewer targets	Bottom-up targeting
Improved supplies/infrastructure for AOs	Decentralised supplies budgets for AOs
Revised annual performance report	Performance evaluation against own targets
Liberalised rewards	Liberalised rewards
Less frequent transfers	Less frequent transfers
Half an additional inspector per AO	Incentive pay
	Additional inspectors
	Self-policing
<b><u>Procedures for Assessment</u></b>	
Delayed start of scrutiny	Delayed start of scrutiny
Simplified summary assessment	Simplified summary assessment
Delegation of summary assessment to Inspectors/TAs	Delegation of summary assessment to Inspectors/TAs
Delegation of other routine tasks to Inspectors/TAs	Delegation of other routine tasks to Inspectors/TAs
Desk audit/field audit division	Desk audit/field audit division
Revised scrutiny guidelines	Random-cum-scoring method of selection of scrutiny cases
Cellular grouping of assessees	Cellular grouping of assessees
More stress on investigation cases	More stress on investigation cases

Figure 4 is to be read as follows. For each city, the assignment of AOs and cases in three ranges, control (C), limited departure (L) and modern management (M) are indicated in separate columns. In the C range, the status quo continues with no experimental measures being adopted. In the L range two AOs each will be subjected to (one of three) different packages of AO related experimental measures which are denoted L1, L2 and L4. In addition, two AOs will be assigned to deal with investigation cases. A similar design holds in the M range. Furthermore, in the M range, each AO other than those assigned investigation cases, will select scrutiny cases in two different ways for 50 per cent of the cases each. The experiment will be exactly replicated in each city. The experimental packages are described in more detail below.

The effect of different measures on the indicators of success R1 to R4 can be isolated through the statistical technique of Analysis of Variance (ANOVA) which is commonly used for experimental evaluation. This will permit evaluation of the following effects on the indicators R1 to R5 after controlling for city specific variation:

- i. The impact of different range specific packages.
- ii. The Impact of different packages to be implemented at the level of AOs.
- iii. The impact of different scrutiny selection procedures proposed.
- iv. Additional variation in the effect of packages in (i), (ii) and (iii) across cities (i.e. the interaction effects).
- v. Additional variation in the effect of AO level packages induced by different range level packages; variation in the effect of different scrutiny selection procedures induced by different range level packages; and variation in the effect of different scrutiny selection procedures induced by different AO level packages.
- vi. Additional variation in the effect in different cities of different AO level packages induced by different range level packages<sup>4</sup>;

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4. Or, equivalently, variation in the effect in different cities of different range level packages induced by different AO level packages: the second order interaction effects.

- vii. Additional variation in the effect of different scrutiny procedures induced by simultaneously varying both AO and range level packages. The ANOVA can be described in equation form as follows.

$$R_{ijklmn} = \text{Constant} + \text{CITY}_j + \text{RANGE}_k + \text{REWARD}_l + \text{CR}_{jk} + \text{CW}_{jl} + \text{RW}_{kl} + \text{RW}_{jlk} + \text{SCRUTINY}_{km} + \text{WS}_{klm} + \text{Random}_n,$$

where<sup>5</sup>:

$R_i, i = 1,2,3,4$  or 5 are the five evaluation indices;

$\text{CITY}_j, j = \text{Bangalore, Bombay or Jaipur}$  is the city-specific effect;

$\text{RANGE}_k, k = \text{C,L or M}$  is the effect of the different range level measures;

$\text{REWARD}_l, l = 1,2$  or 3 is the effect of incentives, targets, and other AO level measures<sup>6</sup>;

$\text{CR}_{jk}, \text{CA}_{jl}$  and  $\text{RA}_{kl}$  are the effect of interaction between CITY-and-RANGE, CITY-and-REWARD and RANGE-and- REWARD respectively;

$\text{CRW}_{jkl}$  is the effect of interaction between CITY-and-RANGE- and-REWARD; and

$\text{SCRUTINY}_{km}, m = 1,2$  or 3 is the effect of different scrutiny selection procedures which are range specific aside from the status quo procedure.

$\text{WS}_{klm}$  is the interaction effect between REWARD-and-SCRUTINY.

$\text{Random}_n, n = 1$  to 60, is the effect of random variation in the skills of specific AOs and cases assigned to AOs.

With the structure of the experiment now laid out, specific parts of each experiment may be described in detail taking each package of measures in turn.

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5. In evaluation of experimental effects a modified ANOVA may be necessary keeping in view data limitations. These technicalities are not addressed here.

6. Increased investigation should have an effect on the whole range rather than on the investigation ward/circle alone: Performance of investigation wards themselves is not of separate interest.

FIGURE 4

Design of the Range Level Experiment

City	Range C	Range L				Range M			
<b>Bangalore</b>									
AOs	C1	L1	L2	L4	I	M1	M3	M4	I
Case groups						a,b	a,b	a,b	
No of AOs	eight	two	two	two	two	two	two	two	two
% of cases per group						50	50	50	
<b>Bombay</b>									
AOs	C1	L1	L2	L4	I	M1	M3	M4	I
Case groups						a,b	a,b	a,b	
No of AOs	eight	two	two	two	two	two	two	two	two
% of cases per group						50	50	50	
<b>Jaipur</b>									
AOs	C1	L1	L2	L4	I	M1	M3	M4	I
Case groups						a,b	a,b	a,b	
No of AOs	eight	two	two	two	two	two	two	two	two
% of cases per group						50	50	50	

### **3.1 The Package C1**

This package of measures is a combination of normal range level organisation (C) and normal ward/circle organisation (1). The word "normal" means that no distinction should exist between arrangements in the control range and arrangements that exist in any other (non-experimental) range in the Income Tax Department.

### **3.2 The Packages L1, L2, and L3**

These experimental ranges have common range level design (L) but varying AO level measures. The common or range-level measures proposed are as follows.

- i. Territory/profession/status based wards and removal of income based ward/circle distinction and compilation of assessee cells: This implies grouping of different cells of assessee into designated wards each of which will include all cases which are not slated for assignment to DCs (Assessment) in the normal course regardless of income. Cases assigned to different wards should be, firstly, according to the distinction company/non-company; second, according to related groups (e.g. members of a partnership); third, according to profession/salary/business/other; and finally according to territory. Furthermore, no ward for new cases need be instituted as part of the experiment, though such a ward may be retained in the range if felt to be advisable.
- ii. Flexible assignment of scrutiny cases by DC to AOs: This implies that the DC should have the power to instruct AOs from one ward to carry out scrutiny of a case from another ward if cases fit for scrutiny according to scrutiny guidelines in the latter ward is very large and if either the number of cases fit for scrutiny in the former ward is smaller or if cases in the former ward are expected to yield marginal additional revenue. Additionally, performance evaluation should include a component covering forwarding and utilisation of external information such as CIB extracts received by the DC. The exact procedure for implementation of this measure requires to be worked out in detail.
- iii. More stress on investigation cases: This is to be achieved by having two investigation circles to enable greater attention to be paid to careful scrutiny of search cases. However, the tendency for AOs in investigation circles to spend more time than other AOs on non-assessment duties should be rectified.

- iv. Simplified summary assessment; delegation of summary assessment to Inspectors/TAs; delegation of other routine tasks to Inspectors/TAs; appointment of an additional inspector (half- time) per AO: The scope of prima facie adjustments should be limited to checking for arithmetical accuracy, checking that deductions claimed are within applicable ceilings and perhaps a few other adjustments. Prima facie adjustments required to be carried out should be exhaustively listed in a check-list which should not exceed 2-3 pages. This check-list should be made available to every inspector or TA carrying out summary assessment. Though under current law inspectors and TAs cannot formally be given final responsibility for assessments, in experimental ranges it should be made clear that AOs need not check through summary assessments drafted by inspectors/TAs even though they are formally responsible. Designated additional routine tasks should also be assigned to inspectors/TAs. Appendix 6 contains a list of tasks which AOs and DCs interviewed in the field felt could most readily be delegated. To cope with this additional workload, a half time inspector is suggested. However, in view of the fact that AOs, under extant conditions felt that the targets for scrutiny assessments were too high, scrutiny targets need not be revised upward even after their workload is reduced.
- v. **Additional measures for the package L2:** Fewer targets; revised annual performance report; liberalised rewards; improved supplies and infrastructure for AOs; delayed start of scrutiny; desk audit/field audit division; revised scrutiny guidelines. These measures, to be elaborated below, are in addition to the range level measures for the L range just described.

A revised system of targets with at most 5 targets, including desk and field scrutiny assessment target, a tax recovery/arrears target and a net revenue target (i.e. a target for additional revenue demands sustained after rectification/revision or first appeal) should be instituted. Performance evaluation of the AO should not depend on tasks delegated to inspectors/TAs. However, performance evaluation should include a component covering the utilisation of external information such as CIB extracts received by the AO.

The conditions determining eligibility for rewards should be relaxed and rationalised to remove as many of the grievances of AOs, listed in Chapter 1 above, as possible. Interim rewards should also be paid to AOs within a month of an assessment being completed as far as possible. The power to grant interim rewards should be given to the concerned CIT or even the DC.

In order to improve availability of supplies and infrastructure, AOs and the DC in the L ranges should be allowed to place an order for supplies and other items (including, for example, petty cash for tea and coffee, if they wish it) up to a specified overall ceiling at the beginning of each year of the experiment. The ceiling should be generous enough to permit, for example, the purchase of one motor vehicle for the range if this is desired.

The major changes in assessment procedures to be tried out are the requirement that all summary assessments and processing of information from the investigation wing should be completed as far as possible before commencing scrutiny assessment. Secondly, guidelines for selection of scrutiny cases should avoid any reference to the high income criterion. In fact, AOs in all L2, L4, M2 or M4 experiments should be made aware of the fallacy of selecting cases on the basis of high reported income.

- vi. **Additional measures for the package L3:** Bottom-up targeting; performance evaluation against own targets; liberalised rewards; less frequent transfers; incentive pay; self-policing; decentralised supplies budgets for AOs; delayed start of scrutiny; desk audit/ field audit division; revised scrutiny guidelines. This package consists of the entire set of radical reforms for the level of the AO. These measures, to be elaborated below, are in addition to the range level measures for the L range described above.

AOs covered by this package should be asked to set their own targets at the beginning of the year for the same items as are designated for the revised system of targets under L2. Incentive pay and performance evaluation should (i) be linked to achievements relative to targets in any sphere; (ii) also be linked to shortfall in targets (if any) set relative to the average targets set by other AOs covered by either the L3 or the M3 (described below) packages in all cities; and (iii) be adversely affected, unless the AO is not at fault, by assessment orders rectified, revised, reduced, cancelled, set aside or found faulty under self-policing. Such pay should be payable with minimal delay, according to prescribed rates, at least on a quarterly basis.

The system for keeping track of incentive pay accrued requires to be worked out<sup>7</sup>. The liberalised reward scheme described in connection with L2 should also be instituted. The system of self-policing implies that AOs be allowed to scrutinise cases already scrutinised by other AOs. These scrutinies should count towards achievement of their targets and earn incentive pay or rewards just like other scrutiny assessments. A prescribed ceiling and specific conditions may be necessary, however, to prevent harassment of assessees.

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7. Ultimately, though this may not be possible for the experiment, incentive pay requires computerisation to work effectively. An additional accountant in each city may be considered as a temporary measure during the experiment.

Finally, as has been described, the DC and AOs should be given reasonably generous budgets for supplies, consumables, transport, etc. This will enable them to be independent of the central stores even for Departmental forms if they so choose. While they may be required to produce bills or vouchers for, say, 95 per cent of their budgets, they should not be liable to be questioned on the kinds of items purchased or activities financed except for irregularities which are both blatant and large. In fact, AOs should be informed that innovative use of their budgets to improve assessment or collection of revenues would be noted favourably in their performance evaluation. The range should only, thereafter, have access to the central stores against payment.

### **3.3 The packages M1, M3 and M4**

Measures under the radical "Modern Management" package are to be implemented for AOs covered by these packages. The measures at the range level include: Concurrent jurisdiction for DC; range level Record-keeping Cell; abolition of wards and circles; difficult cases assigned to DC Special Range (not income based); appointment of ITO (Collections); forming of Range Statistical Cell; forming of Range level Survey Cell. These measures have been described in some detail in Chapter 1. To implement this package, certain procedures need to be carefully spelt out. These include the procedure for assignment of cases to the DC (Special Range) from the M range; handling and routing of information from the investigation wing and the range level survey cell; timing of different activities such as summary assessment, processing of investigation information; and selection of scrutiny cases. Since it is not necessary, for example, that the same AO who applies the scoring rule to select cases for scrutiny from an assigned set of files actually performs the assessment, the DC will have to play a much more active managerial role in M ranges. In M ranges, only the application of a scoring rule, designed by the concerned CCIT or CIT, to select 50 per cent of scrutiny cases (packages M1a, M3a, and M4a) with the other 50 per cent of cases being selected according to the normal guidelines (packages M1b, M3b and M4b) causes assessment practices to differ from the C and L ranges. To ensure uniformity of principles used in designing the scoring rule in different experimental cities, it would be advisable for the concerned CCsIT or CsIT to

meet and jointly decide principles for the scoring rule. Measures at the level of the AO for the M1, M3 and M4 packages are as follows:

- i. **Additional Measures for the M1 package:** None (status quo or control AO level package).
- ii. **Additional Measures for the M3 package:** As for the package L4 but without bottom-up targeting or self-policing; with the normal target system instead; and with scoring-cum-status quo scrutiny selection replacing the revised scrutiny guidelines for L4. The package seeks basically to assess the affects of monetary incentives alone, without explicit targeting given that at the level of the range, the modern management package is implemented. These measures were explained above in connection with the L4 package or inthe range level discussion. They are in addition to the range level measures for the M range just described.
- iii. **Additional Measures for the M4 package:** As for the package L4 but with scoring-cum-status quo selection of scrutiny cases replacing the revised scrutiny guidelines for L4. Package M4 will have the entire package of modern management measures both at the range and at the AO level. Cases under M4a will be selected, in addition by the scoring rule.

#### **4. THE VALUE OF PRESUMPTIVE INFORMATION: AN ASSESSMENT EXPERIMENT FOR DOCTORS IN DELHI**

##### **4.1 The Study of Doctors in Delhi: A Brief Description**

A study of doctors in Delhi, which estimates their income on the basis of a selection of presumptive indicators, has recently (1990-91) been carried out by Professor S.M. Kansal. Before outlining the experiment, it is useful to decribe this study.

Kansal selected a sample of 250 private medical practitioners from a list of 4173 practitioners given in the directory of the Delhi Medical Association (DMA), with at least 30 doctors in North, South, East, West and Central Delhi. Doctors were classified into three categories according to their qualifications - MBBS, MD (or equivalent), and MS (or equivalent) - with at least four doctors from each category in each zone.

These doctors were contacted and asked to cooperate in a research study. They were assured of complete confidentiality. They were sent a questionnaire with various questions regarding their practice. The questionnaire was designed to avoid giving the impression that the object of the study was to measure their incomes. Instead, there were a variety of questions concerning their fees, the quantum of medical services provided by them in the recent past, and the costs (operating, equipment and overhead charges) incurred in running their practice. It also elicited information concerning a number of characteristics of the practitioner, such as the specialisation, educational qualifications, ownership or association with a nursing home, or with a clinic and number of years in practice. The questionnaire was designed with the help of a private practitioner.

Positive responses were received from about 200 doctors, of whom 177 provided complete information<sup>8</sup>. The study, which estimated incomes of the doctors under certain reasonable assumptions, was based on these responses. It should be noted that any bias resulting from missing responses or from mis-statement of business details is likely to result in understatement of income: exceptionally high income practitioners are the ones likely not to respond and responding practitioners are likely to understate revenues and exaggerate costs.

The average monthly income worked out to Rs 39,200 per month or over Rs 4.5 lakhs per year. About 38 per cent of doctors had incomes below Rs 20,000 per month and 31 per cent earned above Rs 40,000 a month. When contrasted with the information given to us by the DC of the Professional range in Delhi that the majority of doctors in Delhi are filing incomes under Rs. 2 lakhs a year, this suggests a very significant extent of tax evasion.

While a multiple regression analysis is appropriate for this task, some indication of the importance of this information is provided by the following summary information. First, the monthly income of a doctor practising in a clinic is Rs. 29,810, while that of a nursing home doctor is Rs. 79,960. Second, post-graduates earn higher than MBBS graduates, but the difference is not that

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8. Some of these however necessitated a return visit by the research team to fill in missing details or to clarify other responses.

large (the monthly income figures are respectively Rs. 44080 and Rs. 33950). On the other hand, specialists in gynaecology and general surgery earn significantly more than general practitioners or specialists in medicine. Even within MBBS practitioners, gynaecologists earn almost two and a half times more than others. Finally, on the whole, variations in income across different zones in the city are not significant. However, incomes of nursing home doctors do vary significantly across zones: from Rs. 51,670 in the North to Rs.1,24,800 in the South.

#### **4.2 An Experiment to Assess Presumptive Information**

This study can be used to develop certain presumptions concerning incomes earned by private medical practitioners in Delhi, based on characteristics such as nursing home or clinic association, education, specialisation, years of experience, and zone - all of which information should be available to the Income Tax Department from a suitable survey. In fact, regression analysis can be applied to the study data in order to predict the income of a doctor with a given set of characteristics. While this regression has not been carried out so far, it is likely to be available shortly.

Levels of income predicted by the regression can then be compared with the incomes declared by different practitioners on their income tax returns. Those with a low declared income relative to the predicted income should be picked up for scrutiny assessment.

The exact experimental design is as follows.

1. A survey of at least 200 randomly selected medical practitioners and clinics in Delhi should be carried out in Delhi. A census survey of all doctors associated with nursing homes may also be carried out along similar lines.
2. The survey should collect the same details collected by Kansal (1992) some of which were listed above. Also, the random sample should be stratified in the same manner as was used in the study.
3. The income of the doctors surveyed should be estimated using the regression results based on Kansal (1992) and sent to the professionals range in Delhi.

4. The 200 survey cases showing the greatest discrepancy between estimated and reported income should be picked for scrutiny and distributed to the concerned AOs. It should, however, be ensured that no AO scrutinises an excessive number of survey cases to avoid the efficiency or lack of efficiency of the AO affecting the results. Also to provide comparative evidence, AOs should also conduct other scrutinies selected in the normal manner.
5. The average return to scrutiny in the range can be compared, AO by AO, in survey and non-survey cases to assess the value of presumptive data and the worth of similar studies.

If found to be successful, such studies may provide an invaluable additional tool in the estimation of income, for a variety of businesses and professions.

Table 1

Income Tax Assessment Workload:  
(Individual Assesseees)

Year	Assesseees		Assessments for Disposal	
	Number (000)	Growth over prev- ious year (%)	Number (000)	Growth over prev- ious year (%)
1970-71	2426	NA	4731	NA
1971-72	2569	5.90	4968	5.01
1972-73	2692	4.80	4991	0.46
1973-74	2751	2.20	5156	3.30
1974-75	2885	4.85	5518	7.04
1975-76	2981	3.35	5734	3.91
1976-77	2877	-3.50	5691	-0.76
1977-78	3038	5.59	5581	-1.92
1978-79	3052	0.48	5236	-6.19
1979-80	3160	3.54	5789	10.56
1980-81	3489	10.41	6591	13.86
1981-82	3521	0.91	7208	9.36
1982-83	3412	-3.10	7015	-2.68
1983-84	3638	6.63	6893	-1.75
1984-85	3647	0.24	6645	-3.60
1985-86	4082	11.95	7068	6.37
1986-87	4741	16.13	8515	20.47
1987-88	4940	4.21	7573	-11.06
1988-89	5125	3.74	7127	-5.90
1989-90	5128	0.06	6683	-6.22
Average	-	4.12	-	2.12
Std. Dev.	-	4.75	-	7.71

Source: Report of the Comptroller and Auditor General, various years.

**Table 2**  
**Surveys Under Section 133B**

Financial year	Number of surveys conducted under section 133B	Number of new assesseees added	Number of new assesseees detected per survey
1987-88	6,19,032	5,23,376	0.845
1988-89	7,29,459	4,98,176	0.683
1989-90	8,17,803	4,67,711	0.572
1990-91	8,92,438	5,23,052	0.586

Source: Income Tax Department Performance Statistics, 1989-90 and Annual Report of the Investigation work done in the Income Tax Department, 1990-91.

Table 3

Surveys Conducted Under  
Section 133A

	Number of Cases where Premises 133A(5) Surveyed evidence (133A(1)) collected	
1985-86	44531	236
1986-87	42816	40
1987-88	9659	220
1988-89	8156	116
1989-90	8620	221

Source: Report of the Comptroller  
And Auditor General of  
India, various years.

Table 4

Eleven most Important Sources of Information Leading Levy of Extra  
Tax or Penalty in the Opinion of Assessing Officers

(Averages score across Wards and Circles)

Item	Average Score Given by Assessing Officers in Wards	Average Score Given by Assessing Officers in Circles
Search reports from Investigation Wing of IT Dept.	1.33	1.50
Survey u/s 133A(1) (Survey of Business Establishments)	1.39	1.13
Evidence of capital build-up in Accounts	1.64	2.00
Investment in immovable property	1.67	2.00
Importance of Survey u/s 133A(5) (Marriages, etc.)	1.79	1.75
Undue Changes in Financial Accounts or Bata	1.88	2.00
Large Gifts Received shown in Accounts	1.94	2.38
Of Survey u/s 133B (Door to Door)	2.03	2.13
Tax evasion Petitions	2.19	2.00
Reports from the Central Info. Branch of the IT Dept.	2.25	2.25
Fall in Gross/Net Profit Rate over the Previous Year	2.47	2.62

Notes: (1) The Eleven Sources Reported are the Only Sources with  
Scores Greater than 3.

Source: Field Survey.

(2) Scores: 1-Very Important; 2-Important; 3-Not Very Important;  
4-Useless

Table 5

**Effectiveness of Search Seizure  
in the Income Tax Department**

Financial year	Number of searches	Percentage change compared to the preceding year	Value of assets seized  (Rs crore)	Average seizure per search  (Rs lakh)	Workload of search assess- ments  (Nos)	Disposal of search assess- ments	Liquida- tion of pendency (percen- tage of workload)	Additional income disclosed/ surren- dered  (Rs crore)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1981-82	4282	--	30.66	0.716	13240	4853	36.65	
1982-83	4291	0.21	27.96	0.651	15162	6991	46.11	
1983-84	4332	0.95	27.99	0.646	14327	5956	41.57	
1984-85	4345	0.3	25.07	0.577	17400	8754	50.31	
1985-86	6431	48.01	50.32	0.782	21330	13659	64.04	
1986-87	7054	9.69	100.70	1.427	19358	10816	55.89	
1987-88	8464	19.99	145.02	1.713	21148	10546	49.87	147.49
1988-89	7505	-11.33	152.70	2.034	36047	15977	44.32	249.35
1989-90	3984	-46.91	128.02	3.213	39812	22443	56.37	193.44
1990-91	5474	37.42	227.85	4.162	36014	19498	54.14	328.00
<b>TOTAL</b>	<b>56162</b>		<b>916.29</b>			<b>119493</b>		

Source: Income Tax Department.

Table 6

Cadre Strength of the Income Tax Department

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Gazetted (Rank of Commissioner & above)	
Chief Commissioners of Income Tax	25
Directors General of Income Tax	9
Additional Director General, NADT	1
Commissioners of Income Tax	109
Commissioners of Income Tax (Appeals)	140
Members, Appropriate Authority	14
Directors of Income Tax (Investigation)	10
Directors of Income Tax (Other)	11
Total	320
Gazetted (Below the rank of Commissioner)	
Deputy Commissioners	794
Assistant Commissioners	1679
I.T.Os	2379
Others	237
Stenographers(Grade I)	274
Total	5363
Non-Gazetted	
Income Tax Inspectors	6444
Stenographers (Grades II and III)	4934
Head Clerks	1726
Tax Assistants	4647
Upper Division Clerks	10058
Lower Division Clerks	7070
Other Group C Posts	1608
Record Keepers/Notice Servers	3107
Staff Car Drivers	446
Group D Total	8536
Total (Non-Gazetted)	48576

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Source: Summarised from Ministry of Finance,  
Annual Report, 1990-91.

Table 7

**Number of Assessing Officers  
(As on 31st March)**

Year	Income Tax Officers		Asst. Commissioners		Total		Officers	
	Sanctioned	Working	Sanctioned	Working	Sanctioned	Working	Working	Available
1	2	3	4	5	6	7	8	9
1970-71	NA	NA	NA	NA	NA	NA	NA	2311
1971-72	NA	NA	NA	NA	NA	NA	NA	2182
1972-73	NA	NA	NA	NA	NA	NA	NA	2150
1975-76	NA	NA	NA	NA	NA	NA	NA	2484
1980-81	NA	NA	NA	NA	NA	NA	NA	2754
1981-82	NA	NA	NA	NA	NA	NA	2818	2818
1982-83	NA	NA	NA	NA	NA	NA	2832	NA
1983-84	NA	NA	NA	NA	NA	NA	2956	NA
1984-85	NA	NA	NA	NA	NA	NA	2978	NA
1985-86	3523	3417	123	179	3646	3596	3449	NA
1986-87	2564	2747	155	151	2719	2898	3745	2506
1987-88	2558	2057	172	161	2730	2218	2717	2717
1988-89	2427	1947	167	149	2594	2096	2343	NA
1989-90	2147	1740	208	194	2355	1934	2500	NA
1990-91	NA	NA	NA	NA	NA	NA	1891	NA

Sources: Cols 2-7: Report of the Comptroller and Auditor General.  
 Col 8 : Income Tax Department Performance Statistics.  
 Col 9 : 173rd Report, Public Accounts Committee,  
 Eighth Lok Sabha.

Table 8

Completion and Pendency of Assessments  
(Company and Non-company cases)

(in '000)

Year	ASSESSMENTS FOR DISPOSAL			ASSESSMENTS COMPLETED			ASSESSMENTS PENDING			FOR DISPOSAL AS A % OF CASES:NON- COMPLETED (% of total)	COMPANY
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	Scrutiny	Summary	Total		
1970-71	NA	NA	4731	NA	NA	3492	NA	NA	1239	73.62	NA
1971-72	NA	NA	4968	1532	2312	3644	NA	NA	1124	77.38	NA
1972-73	NA	NA	4991	945	2653	3598	754	639	1393	72.09	NA
1973-74	NA	NA	5156	930	2506	3436	817	902	1720	66.65	99.15
1974-75	NA	NA	5518	1211	2630	3841	1029	649	1677	69.60	99.05
1975-79	NA	NA	5734	1527	2401	4008	1231	496	1727	69.89	98.99
1976-77	NA	NA	5691	1345	2604	3949	1126	616	1742	69.39	98.94
1977-78	NA	NA	5581	1056	2988	4044	675	662	1538	72.45	98.97
1978-79	NA	NA	5236	698	2412	3310	910	1016	1926	63.22	98.91
1979-80	NA	NA	5789	918	2572	3490	1027	1272	2299	60.28	98.91
1980-91	NA	NA	6591	954	3081	4035	800	1676	2556	61.22	98.99
1991-82	NA	NA	7208	1090	3458	4548	988	1673	2661	63.09	98.96
1992-93	NA	NA	7015	1137	3298	4435	1086	1494	2580	63.22	98.92
1983-94	NA	NA	6893	972	3840	4812	755	1326	2081	69.61	98.93
1984-95	NA	NA	6645	NA	NA	5389	NA	NA	1256	91.10	98.81
1985-96	754	6314	7068	462	5455	5917	293	658	1151	63.71	99.14
1989-97	932	7983	9515	366	6670	7056	247	1213	1459	82.86	98.96
1987-88	530	7044	7573	342	6124	6466	168	920	1108	95.37	98.61
1989-99	431	6695	7127	293	5600	6173	139	615	953	66.62	98.03
1969-90	432	9251	6683	268	5221	5509	144	1031	1174	92.43	98.12

- Sources: 1. Report of the Comptroller and Auditor General of India, various years.  
2. Annual Report of the Ministry of Finance, various years.  
3. 34th Report, PAC (1980-91): Arrears of assessment.

Table 9

## Average Staff Strength of Wards and Circles

Item	Case work-load	Inspectors	Head clerks	Stenographers	Upper division clerks	Lower division clerks	Tax assistants	Notice servers
<b>WORKING STRENGTH OF WARDS AND CIRCLES</b>								
No/charge	4149	0.90	0.28	0.72	1.59	0.66	0.85	0.87
<b>SANCTIONED STRENGTH OF WARDS AND CIRCLES</b>								
No/charge	4149	0.92	0.30	0.84	1.87	0.71	0.92	0.84
% of working strength		102	107	117	118	108	108	97
<b>STAFF DESIRED BY ASSESSING OFFICERS OF WARDS AND CIRCLES</b>								
No/charge	4149	1.47	0.67	1.05	2.21	1.30	1.26	1.07
% of working strength		163	239	146	139	197	148	123

Source: Field Survey.

Table 10

## Experience Profile of Assessing Officers

(Average years of experience)

Item	In Income Tax Department		As Inspector		As Income Tax Officer, Group B		As ITO, Group A/ Asst. Commissioner		In other Capacities		Total months in present post 89-91		Promotee Officers	
	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.	Number	Out of
All Ranges	23.07	0.47	8.33	0.52	5.90	0.84	0.69	1.90	7.32	0.96	7.69	1.18	42	49
Range A Bangalore	26.16	0.44	8.50	0.47	4.95	1.08	0.29	1.88	9.79	0.86	5.25	0.96	7	8
Range B Bangalore	24.50	0.55	8.07	0.51	4.48	1.38	0.43	1.84	8.00	1.32	3.94	1.11	6	7
Range C Bombay	20.10	0.50	7.20	0.57	6.45	0.78	1.20	1.65	5.35	0.84	14.60	0.94	8	10
Range D Bombay	21.56	0.41	8.40	0.52	6.52	0.77	0.70	2.00	6.18	1.05	7.32	1.47	13	14
Range E Jaipur	24.68	0.52	9.42	0.56	6.23	0.65	0.65	1.78	8.39	0.77	5.50	1.47	8	10
By Charge														
Wards	26.42	0.32	10.39	0.26	5.10	0.78	0.46	2.25	9.57	0.72	8.58	1.17	33	33
Circles	11.56	1.07	2.89	1.52	4.56	1.29	0.94	2.09	2.56	2.00	7.60	1.14	4	9
Investigation Circles	22.07	0.43	5.64	0.49	11.00	0.46	1.43	0.96	2.79	1.59	4.71	1.32	6	7

Notes: 1. Total months in present post shows the average of the number of months which responding ITOs/ACs had been there between 1-4-1989 and 31-3-1991. Source: Field Survey.  
C.V.: Coefficient of Variation or the ratio of the Standard Deviation divided by the Average.

2. Experience of ward ADs as ITO group A arises on account of additional charge held by some ACs

Table 11

## Time Allocation of Assessing Officers

(percentage of total time: average per ward/circle)

Item	Case Work- Load (Nos)	Summary Assess- ment	Scrutiny Assesant		Assess- ment Related Tasks	Other Duties
			Exam. of Ac Accounts	Other Tasks		
All Ranges	4149	27.66	20.00	7.17	19.59	25.58
Range A Bangalore	4727	37.92	25.63	1.00	16.50	18.96
Range B Bangalore	3559	27.90	20.00	6.77	17.58	27.03
Range C Bombay	5754	29.54	10.86	9.76	22.14	27.69
Range D Bombay	3486	31.36	21.23	7.08	11.79	28.54
Range E Jaipur	3446	17.47	27.01	6.57	24.88	23.26
Yearwise by Type of Charge						
1989-90	3739	27.88	19.56	7.89	19.68	24.99
Wards	4123	34.17	10.62	7.48	16.09	23.64
Circles	2792	13.03	25.28	9.17	23.62	28.90
Investigation Circles	276	13.37	15.97	9.40	31.47	29.78
1990-91	4541	27.92	20.54	6.52	19.51	25.51
Wards	5098	36.25	19.00	5.76	16.38	22.61
Circles	2324	20.40	26.62	7.06	21.96	23.16
Investigation Circles	261	4.60	17.90	10.27	29.58	37.72

Note: Assessment Related Tasks: Processing of (a) material from Investigation Wing, (b) penalty matters and (c) prosecution cases; collection of taxes; and assessment of other direct taxes. Of other duties, approximately 60 per cent of the time is spent on housekeeping and statistical reporting.

Source: Field Survey.

Table 12

## Time Allocation of Ward and Circle Staff

(percentage of total time: average per ward/circle)

Item	Case Work- Load (Nos)	Summary Assess- ment	Scrutiny Assessment		Assess- ment Related Tasks	Other Duties
			Exam. of Ac Accounts	Other Tasks		
All Ranges	4149	39.27	2.61	4.28	18.57	35.27
Range A Bangalore	4727	50.39	3.49	3.01	11.94	31.17
Range B Bangalore	3559	40.67	0.80	3.78	21.44	34.11
Range C Boabay	5754	27.89	0.56	4.61	21.14	45.80
Range D Bombay	3486	55.31	10.21	5.11	9.69	19.68
Range E Jaipur	3446	34.29	1.80	4.85	24.20	34.06
Yearwise by Type of Charge						
1989-90	3739	37.97	2.28	4.42	18.74	36.59
Wards	4123	45.95	1.47	4.06	14.23	34.29
Circles	2792	29.28	4.63	3.73	25.90	36.46
Investigation Circles	276	15.00	1.67	10.00	29.50	43.83
1990-91	4541	40.44	2.80	4.11	18.42	34.15
Wards	5898	47.38	1.16	3.89	14.61	32.96
Circles	2324	33.81	8.24	3.20	23.51	31.24
Investigation Circles	261	15.63	1.67	7.71	29.50	45.49

Source: Field Survey.

Table 13

## Time Allocation of Inspectors in Wards and Circles

(Average Figures in Percentage)

Item	Case Workload (Nos)		Field Enquiries		Recovery of Taxes		Other Tasks	
	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.
All Ranges	4149	0.60	18	0.59	33	0.55	49	0.38
Range A Bangalore	4727	0.58	25	1.25	40	5.00	35	6.00
Range B Bangalore	3559	0.61	8	0.50	34	0.56	58	0.33
Range C Bombay	5754	0.29	24	0.46	18	0.28	58	0.19
Range D Bombay	3486	0.17	12	0.33	21	0.38	67	0.16
Range E Jaipur	3446	0.61	15	0.73	47	0.45	38	0.66
By Charge								
Wards	5270	0.31	18	0.61	33	0.52	48	0.42
Circles	2543	1.00	19	0.47	26	0.31	56	0.20
Investigation Circles	223	0.30	8	1.00	28	1.04	64	0.42

Source: Field Survey.

Table 14

## Realisation from Assessment

Year	Assessments Completed per AD			Scrutiny Assessments (% of cases)	Prepaid Taxes (Rs Cr)	Total Collection (MCo) (Rs Cr.)	Additional Collection (7-6) (Rs Cr.)	Net Collection per Assessment (Rs)		Net Collection per Working AD (Rs '000)	
	Summary	Scrutiny	Total					(Current)	(1960)	(Current)	(1960)
1	2	3	4	5	6	7	8	9	10	11	12
1971-72	NA	NA	NA	59.63	NA	NA	NA	NA	NA	NA	NA
1972-73	NA	NA	NA	35.89	NA	NA	NA	NA	NA	NA	NA
1973-74	NA	NA	NA	33.81	NA	NA	NA	NA	NA	NA	NA
1974-75	NA	NA	NA	41.97	NA	NA	NA	NA	NA	NA	NA
1975-76	NA	NA	NA	51.22	NA	NA	NA	NA	NA	NA	NA
1976-77	NA	NA	NA	46.75	NA	NA	NA	NA	NA	NA	NA
1977-78	NA	NA	NA	34.76	NA	NA	NA	NA	NA	NA	NA
1978-79	NA	NA	NA	29.42	NA	NA	NA	NA	NA	NA	NA
1979-80	NA	NA	NA	29.84	NA	NA	NA	NA	NA	NA	NA
1980-81	NA	NA	NA	27.33	NA	NA	NA	NA	NA	NA	NA
1981-82	1227	387	1614	30.94	NA	NA	NA	NA	NA	NA	NA
1982-83	1165	481	1566	33.32	NA	NA	NA	NA	NA	NA	NA
1983-84	1299	329	1628	26.71	NA	NA	NA	NA	NA	NA	NA
1984-85	NA	NA	1818	NA	NA	NA	NA	NA	NA	NA	NA
1985-86	1582	134	1716	11.31	1354	1518.50	164.84	267.20	58.23	458.48	86.17
1986-87	1781	103	1884	8.13	2938	3152.96	215.27	394.25	69.41	742.82	138.78
1987-88	2254	126	2380	6.91	3338	3566.40	236.30	447.78	73.83	1065.37	173.88
1988-89	2518	125	2635	5.71	4482	4643.18	248.71	435.87	65.25	1148.43	171.92
1989-90	2888	115	2284	5.62	5169	5577.55	488.73	959.08	132.47	2113.39	291.98

Notes: Prepaid Taxes= Tax Deducted at Source + Advance Tax + Self-Assessment Tax.

Net Collections: Total Collections less refunds.

Source: Report of the Comptroller and Auditor General, various years.

Table 15

## Tax Demand and Recovery

(Rs crore)

Year	Demand Certified		Demand Outstanding		Demand Recovered (Current Rs)	Demand recovered as percentage of outstanding
	As on 1st April (Current Rs)	Added during the year (Current Rs)	(Current Rs)	(1960 Rs)		
1970-71	425.25	181.36	606.61	363.24	143.37	24
1971-72	483.53	208.79	692.32	397.89	167.52	24
1972-73	530.57	264.90	795.55	441.97	189.86	24
1973-74	590.15	192.62	798.77	411.86	161.93	20
1974-75	616.07	180.16	804.23	363.90	176.29	22
1975-76	616.35	333.92	950.27	351.95	290.56	31
1976-77	678.72	330.30	1009.02	364.27	370.67	37
1977-78	638.80	258.80	896.60	323.47	244.00	27
1978-79	655.80	309.00	964.80	325.68	267.80	28
1979-80	703.96	323.65	1027.61	335.02	207.61	29
1980-81	752.07	301.70	1053.77	319.32	258.58	25
1981-82	861.58	400.24	1261.82	341.96	273.33	22
1982-83	964.96	349.30	1314.34	318.24	376.72	29
1983-84	1267.66	289.45	1557.11	349.13	388.38	20
1984-85	1240.73	359.00	1607.73	326.77	534.36	33
1985-86	512.37	169.10	681.47	128.10	184.51	27
1986-87	496.90	114.66	611.56	107.67	169.32	20
1987-88	442.24	203.13	645.37	185.28	106.13	29
1988-89	458.24	334.22	792.46	110.63	190.10	24
1989-90	668.51	135.58	804.09	111.06	NA	NA

Source: Report of the Comptroller and Auditor General of India, various years.

Table 16

## Collection Costs and Yield Ratios for the Income Tax

(in Rs Crore)

Year	Cost of Collection		Total Collect. (Co & NCo)	Total Collect. (NCo)	Net Collect. (NCo)	Total Collect. (1960 Rs)	Ratio of Total to Cost
	Nominal	Real					
1970-71	16.53	16.53	NA	NA	NA	NA	NA
1971-72	18.12	17.16	NA	NA	NA	NA	NA
1972-73	19.72	16.96	NA	NA	NA	NA	NA
1973-74	21.76	15.58	1304.53	NA	NA	679.44	59.95
1974-75	27.31	15.61	1544.00	NA	NA	698.64	56.54
1975-76	33.96	19.63	2031.52	NA	NA	752.41	59.82
1976-77	34.38	19.47	2285.98	NA	NA	825.26	66.49
1977-78	36.28	19.53	2222.77	NA	NA	802.44	61.27
1978-79	47.59	25.60	NA	NA	NA	NA	NA
1979-80	41.48	19.06	2462.87	NA	NA	804.86	59.37
1980-81	47.50	18.46	2614.62	NA	NA	792.31	55.04
1981-82	53.48	19.01	NA	NA	NA	NA	NA
1982-83	63.17	21.88	3604.13	NA	NA	872.67	57.05
1983-84	72.60	22.97	4001.33	NA	NA	897.16	55.11
1984-85	80.81	23.88	NA	NA	NA	NA	NA
1985-86	89.30	24.96	4788.76	1518.58	1315.98	900.14	53.63
1986-87	127.01	33.71	6829.31	3152.96	2878.05	1202.34	53.77
1987-88	131.15	32.35	7703.54	3566.40	3192.10	1256.69	58.74
1988-89	148.42	34.10	9794.41	4643.10	4238.16	1466.23	65.99
1989-90	164.10	NA	11753.99	5577.55	5008.29	1623.48	71.63

Notes: Conversions into constant Rupees are with the Wholesale Price Index (1970-71=100).  
Co: Company cases; NCo: Non-Company Cases.

Source: 1. Report of the Comptroller and Auditor General of India, various years.  
2. Annual Report, Ministry of Finance, various years.

Table 17

## Arrears of Assessment

(Rs Crore)

YEAR	INCOME	INTEREST	PENALTIES	TOTAL ARREARS	
				CURRENT RS	1968 RS
1971-72	482.26	83.1	77.21	642.57	369.29
1972-73	470.17	98.03	74.48	642.68	357.04
1973-74	465.95	117.68	82.12	665.75	346.74
1975-76	538.47	174.23	60.98	773.68	350.08
1976-77	473.54	156.58	97.37	727.49	296.44
1977-78	497.44	203.93	102.54	803.91	290.22
1979-80	481.91	223.65	115.95	821.51	296.57
1980-81	480.94	236.89	104.11	821.94	277.68
1982-83	532	350.35	127.3	1009.65	329.95
1983-84	616.08	450.36	124.26	1190.7	360.82
1985-86	900.13	694.09	143.61	1737.83	470.96
1986-87	961.99	971.37	200.67	2134.03	516.71
1987-88	987.79	1191.63	286.83	2466.25	552.97
1988-89	1163.31	1554.37	377.15	3094.83	629.03
1989-90	1377.76	1702.46	418.82	3579.04	672.75

Source: Report of the Comptroller and Auditor General of India, various years.

Table 18

## Revenue Contribution of Sampled Charges

Item	Case Workload		Prepaid Taxes		Gross Additional Demand		Net Additional Demand		Gross Additional Demand per Return		Net Additional Demand per Return		Total Demand per Return	
	Average (Nos)	C.V.	Average (Rs '000)	C.V.	Average (Rs '000)	C.V.	Average (Rs '000)	C.V.	Average (Rupees)	C.V.	Average (Rupees)	C.V.	Average (Rupees)	C.V.
All Ranges	4149	0.60	12054	0.64	6793	1.35	4944	1.90	1669	2.87	1248	3.06	4510	2.10
Range A Bangalore	4727	0.58	15344	0.58	11712	1.25	9783	1.79	2478	1.96	2070	2.05	5508	1.76
Range B Bangalore	3559	0.61	12590	0.66	6262	0.84	4133	1.47	1759	1.20	1161	0.90	5296	1.86
Range C Bombay	5754	0.29	8281	0.56	5201	0.86	4011	1.13	904	2.55	697	2.65	2343	2.11
Range D Bombay	3486	0.17	16208	0.40	9107	1.25	7244	1.54	2612	2.58	2078	2.71	7277	2.23
Range E Jaipur	3446	0.61	7592	0.52	3297	0.52	1514	0.73	957	0.42	439	1.00	3096	1.27
By Type of Charge														
1989-90	3739	0.58	10160	0.72	5317	1.11	3669	1.63	1464	3.01	1043	3.16	4122	2.39
Wards	4123	0.31	9136	0.63	4177	1.05	2510	1.64	1013	1.09	609	1.54	3254	1.10
Circles	2792	1.00	18064	0.72	5079	0.65	2674	1.26	1819	0.55	958	0.55	8209	0.88
Investigation Circles	276	0.30	5509	0.54	12933	0.45	12625	0.45	46859	1.28	45743	1.00	63489	0.73
1990-91	4541	0.61	13858	0.57	8225	1.50	6179	2.17	1831	3.30	1410	3.57	4816	2.16
Wards	5898	0.35	13034	0.56	6998	1.49	4911	2.20	1107	1.41	833	1.56	3352	1.34
Circles	2324	0.66	21233	0.36	7011	0.55	4633	1.06	3017	1.03	1994	1.06	12153	0.73
Investigation Circles	261	0.40	19054	0.83	19054	1.38	18594	1.41	73004	1.53	71241	2.19	104709	0.63

Source: Field Survey.

Table 19

## Indicators of Quality of Summary Assessments

(Average Numbers per Ward/Circle)

Itea	Case Workload		Summ. Assessments		Rectifications		Summ. Assessments with Extra Demands		Rectified/Revised Cases of Col (0)	
	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.	Average	C.V.
1	2	3	4	5	6	7	8	9	10	11
All Ranges	4149	0.60	2092	0.60	02	0.95	35	1.45	13	1.90
Range A Bangalore	4727	0.50	3502	0.63	60	1.07	45	0.95	26	1.25
Range B Bangalore	3559	0.61	2590	0.66	22	1.10	23	0.09	0	1.72
Range C Bombay	5754	0.29	3557	0.52	79	0.94	17	1.14	0	2.49
Range D Bombay	3486	0.17	2225	0.41	117	0.72	63	1.30	13	2.23
Range E Jaipur	3446	0.61	2056	0.64	101	0.75	17	1.66	20	1.35
By Type of Charge										
1989-90	3739	0.50	2643	0.60	04	1.03	20	1.63	13	1.91
Wards	4123	0.31	3220	0.34	100	0.94	39	1.36	17	1.61
Circles	2792	1.00	2229	0.04	69	0.76	11	1.37	5	2.17
Investigation Circles	276	0.30	47	0.79	16	1.30	2	1.44	0	NA
1990-91	4541	0.61	3126	0.60	79	0.07	43	1.27	14	2.05
Wards	5090	0.35	4094	0.29	99	0.72	52	1.17	16	1.05
Circles	2324	0.66	1796	0.79	40	0.04	37	1.00	14	2.27
Investigation Circles	261	0.40	04	0.77	23	1.20	9	1.39	2	2.44

Source: Field Survey.

Table 20

## Revenue Contribution of Summary Assessment

Item	Summary Workload (Nos)		Prepaid Taxes	Additional Demand		Additional Demand per Return (Rs)	
	Average	C.V.		-----		Gross	Net
			(Rs '000)	Gross	Net		
All Ranges	2892	0.60	8761	2385	611	731	217
Range A Bangalore	3582	0.63	11274	4509	2369	1259	661
Range B Bangalore	2590	0.66	9556	2361	271	912	105
Range C Bombay	3557	0.52	5521	1187	1	334	0.25
Range D Bombay	2225	0.41	12418	3307	1831	1486	823
Range E Jaipur	2856	0.64	5616	1415	-295	495	-103
By Type of Charge							
1989-90	2643	0.60	7465	2110	609	720	228
Wards	3220	0.34	9136	1935	454	601	141
Circles	2229	0.84	12367	2364	12	1061	5.19
Investigation Circles	47	0.79	1884	2997	2873	63321	60701
1990-91	3126	0.60	9997	2665	610	740	208
Wards	4894	0.29	13034	2250	193	550	47
Circles	1796	0.79	13939	2340	38	1303	21
Investigation Circles	84	0.77	3080	5792	5516	68601	65332

Source: Field Survey.

Table 21

## Time Spent per Assessment by Staff of Wards and Circles

(Averages in hours and minutes)

Item	Case Work- Load (Nos)	By Assessing Officers		Overlap (months)	Other Staff Strength (Nos)	By Other Staff	
		Summary	Scrutiny			Summary	Scrutiny
All Ranges	4149	0.11	4.57	7.69	4.31	1.07	5.23
Range A Bangalore	4727	0.12	4.37	5.25	4.64	1.14	5.14
Range B Bangalore	3559	0.12	5.29	3.94	3.17	0.57	2.27
Range C Bombay	5754	0.09	4.18	14.60	4.37	0.39	4.43
Range D Bombay	3486	0.16	5.04	7.32	4.15	1.58	11.22
Range E Jaipur	3446	0.07	5.24	5.50	4.90	1.07	5.07
Yearwise by Type of Charge							
1989-90	3739	0.12	5.17	7.69	4.31	1.11	5.33
Wards	4123	0.12	5.23	8.58	4.50	1.13	5.08
Circles	2792	0.07	5.34	7.60	4.31	1.05	5.50
Investigation Circles	276	5.22	4.18	4.71	3.48	20.56	6.52
1990-91	4541	0.10	4.38	7.69	4.31	1.04	5.10
Wards	5898	0.10	4.13	8.58	4.50	0.59	3.52
Circles	2324	0.13	5.03	7.60	4.31	1.33	7.14
Investigation Circles	261	1.02	6.12	4.71	3.48	12.14	7.10

Note: (1) Computations are based on an assumed 1900 hours available per year. Source: Field  
(2) Overlap: Months during which interviewed Assessing Officers had been Survey.  
in the charge during 1989-91.  
(3) Other staff figures are combined figures for inspectors, upper and lower division  
clerks and tax assistants.

Table 22

## Indicators of the Quality of Scrutiny Assessment

(Averages per Assessing Officer in Numbers of Cases)

Item	Case Workload		Scrutinies Completed		Extra Demand Cases	Addit'nal Demands Cancelled	Penalties			No. of AD Appeal Appears
	Average	C.V.	Average	C.V.			Init'ed	Imposed	Dropped	
All Ranges	4149	0.60	105	0.31	77.63	2.74	17.38	5.54	11.89	1.40
Range A Bangalore	4727	0.58	110	0.30	72.58	9.22	18.25	3.09	5.71	0.00
Range B Bangalore	3559	0.61	93	0.46	60.40	1.67	16.08	3.00	2.61	2.20
Range C Bombay	5754	0.29	91	0.19	75.18	NA	14.17	4.33	2.28	1.78
Range D Bombay	3486	0.17	106	0.23	69.20	0.35	12.63	8.78	21.90	1.31
Range E Jaipur	3446	0.61	121	0.23	105.30	4.02	27.20	5.40	17.40	1.67
Yearwise by Type of Charge										
1989-90	3739	0.58	99	0.35	67.27	2.47	17.84	5.13	10.98	1.86
Wards	4123	0.31	92	0.35	65.33	2.03	13.29	4.90	8.28	0.96
Circles	2792	1.00	117	0.31	53.00	1.13	9.25	2.88	25.38	1.57
Investigation Circles	276	0.30	112	0.32	96.00	6.33	46.83	9.33	6.17	0.00
1990-91	4541	0.61	111	0.27	87.76	3.00	17.72	5.96	12.80	1.74
Wards	5890	0.35	111	0.24	91.53	2.38	12.35	6.17	8.71	1.54
Circles	2324	0.66	130	0.15	85.63	1.88	17.08	4.38	27.38	3.58
Investigation Circles	261	0.40	86	0.48	74.00	7.50	41.29	6.86	14.29	0.00

Note: Penalties imposed and dropped are not strictly comparable with other items: They relate to penalties imposed or dropped during the period rather than to cases assessed during the period. Source: Field Survey.

Table 23

## Revenue Contribution of Scrutiny Assessment

Item	Scrutiny Workload		Prepaid Taxes (Rs '000)	Additional Demand		Additional Demand per Return (Rs)	
	Average	C.V.		Gross	Net	Gross	Net
			(Rs '000)	(Rs '000)	(Rs '000)		
All Ranges	105	0.31	3074	4918	4072	29868	29129
Range A Bangalore	110	0.30	4173	5179	4996	47277	45607
Range B Bangalore	93	0.46	3034	4059	4019	43779	43348
Range C Bombay	91	0.19	2760	4079	4010	44768	44010
Range D Bombay	106	0.23	3058	2834	2755	26659	25916
Range E Jaipur	121	0.23	1902	1883	1010	15549	14946
Yearwise by Type of Charge							
1989-90	99	0.35	2210	2891	2826	26682	26086
Wards	92	0.35	1143	1320	1287	14334	13975
Circles	117	0.31	5698	2715	2662	23128	22669
Investigation Circles	112	0.32	3301	10424	10220	92930	91112
1990-91	111	0.27	3938	4011	3986	37037	36588
Wards	111	0.24	2791	1053	1735	16626	15568
Circles	130	0.15	7295	4607	4607	35540	35540
Investigation Circles	86	0.48	5195	19054	13459	220456	155721

Survey: Field Survey.

Table 24

## Factors Affecting the Deterrent Effect of Scrutiny Assessment

(Average Figures in Percentage)

Item	Case Workload (in Nos)		Percent of Cases under Scrutiny	Cases with Extra Demands (% of a)	Cases with Conceal. Penalty Init'ed (% of b)	Cases in which Penalty Imposed (% of c)	Conceal. Penalty Cases going to Appeal (% of c)	Percent Appeals in which ITD succeeds	Effective Detection Rate (%)
	Average	C.V.							
			a	b	c	d	e	f	
All Ranges	4149	0.60	2.53	74.10	22.39	31.78	75	38.32	0.072
Range A Bangalore	4727	0.58	2.32	66.18	25.17	35.00	95	21.01	0.034
Range B Bangalore	3559	0.61	2.60	65.15	26.49	53.48	20	46.38	0.215
Range C Bombay	5754	0.29	1.58	82.42	18.86	65.52	75	33.64	0.081
Range D Bombay	3486	0.17	3.05	65.10	18.24	28.62	67	47.11	0.067
Range E Jaipur	3446	0.61	3.51	86.95	25.83	23.68	92	42.25	0.087
Yearwise by Type of Charge									
1989-90	3739	0.58	2.64	68.15	25.33	31.84	76	40.16	0.079
Wards	4123	0.31	2.23	70.94	20.34	37.18	72	40.44	0.068
Circles	2792	1.00	4.21	45.13	17.45	10.19	88	37.94	0.015
Investigation Circles	276	0.30	40.64	85.58	48.78	60.19	83	41.88	5.286
1990-91	4541	0.61	2.44	79.18	20.19	31.77	82	36.36	0.059
Wards	5898	0.35	1.89	82.13	13.49	41.47	80	40.45	0.045
Circles	2324	0.66	5.58	66.06	20.88	13.79	87	40.38	0.051
Investigation Circles	261	0.40	33.11	85.62	55.80	32.43	86	31.46	2.107

Notes: (1) Weighted average of successful appeal cases (Column f): Weights are in the ratio 1:0.75:0.25 for appeal cases in which 100%, 50%-99% and 1%-49% of additional demand was sustained. The index only considers appeals before Deputy Commissioners or Commissioners (Appeals). One index has been worked out for both years combined.

(2) Effective Detection Rate is computed as:  $[abcd\{(1-e)+ef\}]$  where a to f refer to proportions in the columns above identified by these alphabets.

Source: Field Survey.

Table 25

Analysis of Decisions on Appeals before Deputy Commissioners (Appeals),  
Commissioners (Appeals) and the Income Tax Appellate Tribunal

(Averages per Ward/Circle in Numbers and Percentages)

Item	Deputy Commissioners (Appeals)/Commissioners Appeals						Income Tax Appellate Tribunal					
	Number of cases in which the percentage of additions made by Assessing officers sustained on appeal was				Cases in which assessment order was set aside	Appeal orders received	Number of cases in which the percentage of additions made by Assessing officers sustained on appeal was				Cases in which assessment order was set aside	Appeal orders received
	100 per cent	50 to 99 per cent	1 to 49 per cent	Entirely deleted			100 per cent	50 to 99 per cent	1 to 49 per cent	Entirely deleted		
All Ranges (% of total)	3.01 -8.81	9.42 -27.56	12.00 -35.34	6.02 -19.95	2.04 -8.31	34.18 -100.00	0.28 -15.82	0.51 -20.01	0.53 -29.94	0.23 -12.99	0.21 -11.80	1.77 -100.00
Range A Bangalore	2.67	4.92	19.83	23.58	2.83	53.83	0.09	0.54	0.09	0.18	0.09	1.00
Range B Bangalore	1.50	15.50	11.50	3.67	2.33	34.50	0.09	0.27	0.91	0.00	0.00	3.27
Range C Bombay	0.89	2.67	4.89	1.61	2.17	12.22	0.00	0.00	0.00	0.00	0.00	0.00
Range D Bombay	4.32	8.41	6.32	5.36	1.50	25.91	0.23	0.23	0.18	0.05	0.14	0.60
Range E Jaipur	4.64	16.00	21.05	4.84	5.37	51.94	0.04	1.42	1.47	0.04	0.60	5.20
Yearwise by Type of Charge												
1989-90 (% of total)	3.38 -8.74	11.36 -30.26	12.69 -33.00	6.74 -17.95	3.36 -8.95	37.54 -100.00	0.39 -16.78	0.76 -32.76	0.63 -27.16	0.29 -12.50	0.24 -10.10	0.30 -100.00
Wards	3.96	7.63	9.48	5.93	2.81	29.01	0.54	0.92	0.58	0.35	0.35	0.70
Circles	3.74	15.43	15.29	11.14	3.86	48.86	0.14	0.71	1.29	0.29	0.00	2.40
Investigation Circles	0.60	25.00	26.40	5.00	5.60	63.40	0.00	0.00	0.00	0.00	0.00	0.00
1990-91 (% of total)	2.68 -8.52	7.70 -24.68	11.55 -37.02	6.88 -22.05	2.38 -7.63	31.20 -100.00	0.19 -14.64	0.28 -22.05	0.44 -34.38	0.19 -14.84	0.19 -14.84	1.20 -100.00
Wards	2.53	6.90	9.13	4.33	1.80	24.70	0.24	0.31	0.38	0.14	0.17	0.24
Circles	4.14	13.14	20.42	2.14	2.57	60.43	0.14	0.42	1.14	0.14	0.00	1.80
Investigation Circles	1.86	5.71	13.00	4.57	4.71	29.86	0.00	0.00	0.00	0.43	0.47	0.80

Source: Field Returns

Table 26

## Summary Details of Income Tax Return Files Examined

Case No	Year of Scrutiny	Assessee Status	Nature of Business	143(3)	143(3)	Ave Inco Declared		No of Times & Average Addition Made				Income in Normal Year			Current Status of Assessment	No of Assesmt Hearings	Adjournments sought		Time elapsed (months) from Filing upto					
				before Scrutiny Year	after Scrutiny Year	before Scrutiny Year	after Scrutiny Year	before Scrutiny	Scrutiny	in	after Scrutiny	Declared	Assessed	Current			by AO	by Assesmt	Assess-ment	1st Appeal	2nd Appeal	Other		
				Rs	No	Rs	No	Rs	No	Rs	No	Rs	No	Rs			No	Rs	No	Rs	No	Rs	No	
1	84-85	RF	Film Distribution	2 of 2	1 of 3	100968	283200	12064	2	302130	2600	1	101230	523360	523360	3	NA	NA	NA	NA	NA	NA	NA	
2	84-85	RF	Silk & Sari Dealer	0 of 0	NA	NR	NA	NR	NR	300520	NA	NA	43650	374230	374230	5	NA	NA	NA	Reopened	23	NR	Ongoing	
3	84-85	RF	Tool Manufacturer	1 of 4	NA	41085	NA	10350	3	1205000	NA	NA	152340	1357340	157340	1	1	0	0	0	40	2	NR	
4	88-87	RF	Auto Filter Maker	2 of 2	0 of 4	78300	172604	011	NR	453230	011	NR	204060	747690	747690	1	3	2	3	17	0	NR	NR	
5	82-83	Individl	Partner in firm	0 of 5	NR	43320	NR	011	NR	31600	NR	NR	82321	124310	174800	1	1	0	0	5	NR	NR	NA	
6	88-87	RF	Assembly of wheels	1 of 1	1 of 4	82400	loss	NR	NR	114190	0663	1	414900	520000	520000	1	5	4	4	10	0	NR	NR	
7	84-85	RF	Dealer: Pump sets	4 of 4	2 of 2	NR	NR	NR	NR	214763	NR	NR	534800	620753	620753	1	2	0	0	6	16	4	NA	5
8	72-73	Individl	Pots and pans maker	4 of 4	4 of 4	NR	NR	NR	NR	21000	NR	NR	32500	53500	150500	4	NR	NR	NR				Reopened Assessment	
9	83-84	RF	Cinema Hall	NA	2 of 4	NA	223054	NA	NA	011	753	1	53200	53200	53200	1	2	0	0	36	NR	NR	NR	
10	84-85	RF	Film Distrib & Prod	2 of 2	4 of 4	Loss	8250	011	NR	120750	011	NR	011	120750	24600	1	3	0	0	15	NR	NR	3	
11	84-85	RF	Film Production	NA	1 of 2	Loss	Loss	011	NR	733775	011	NR	-613775	120000	120000	3	0	0	0	15	30	NR	NR	
12	85-88	Individl	Advocate	0 of 4	0 of 4	17115	23748	011	NR	130010	011	NR	23800	163000	Set aside	5	5	0	0	23	NR	NR	NR	0.5
13	87-88	RF	Chartered Acctants	4 of 4	2 of 3	163523	315000	2300	3	011	011	NR	313610	313610	313610	1	1	0	0	3	NR	NR	NR	
14	87-88	Individl	Advocate	4 of 4	3 of 3	204870	476573	-200	1	011	011	NR	405490	405490	405490	1	1	0	0	4	NR	NR	NR	
15	85-86	Individl	Doctor & RF partner	1 of 4	0 of 4	50000	423030	00092	1	011	011	NR	202120	202120	202110	1	2	0	0	24	NR	NR	NR	
16	85-86	RF	Hotel	3 of 3	4 of 4	100378	440904	48497	3	10445	11076	4	261094	200540	200540	1	2	0	0	17	NR	NR	NR	
17	66-87	RF	Textile trader	4 of 4	2 of 3	300420	772852	011	NR	30661	5	1	455150	405020	455100	1	2	0	0	6	22	NR	NR	
18	84-85	Individl	Radio sales/repairs	4 of 4	0 of 4	156011	50728	011	NR	40100	011	NR	220200	276170	276170	4	2	3	0	10	24	Pending	NR	
19	87-88	RF	Textile trader	1 of 3	1 of 1	66307	10430	011	NR	011	1000	1	307750	307750	307750	1	2	1	0	6	NR	NR	NR	
20	85-88	Individl	Glass/Plywood trade	1 of 1	3 of 3	160970	210504	001050	1	142050	111401	3	163730	326700	307500	4	6	4	1	3	10	pending	NR	

## Notes: 1. Abbreviations Used:

- RF: Registered Firm
- RFV: Registered Firm
- NA: Not Available
- NR: Not Relevant
- D: Deleted
- C: Confirmed

CIY(A): Commissioner of Income Tax (Appeals)

ITAT: Income Tax Appellate Tribunal

2. Current Status: 1: Completed  
 2: Rectification Pending  
 3: 1st Appeal Pending  
 4: 2nd Appeal Pending  
 5: Pending; Other

Table 26 (Contd.)

Case No	Year of Scrutiny	Assessee Status	Concealment Penalty		Other Penalty		Interest		Other Actions: Assessee	Other Actions: Deptt.	All Relevant Documents Examined?	Assessment Quality	Any Audit Objection	Remarks <sup>3</sup>
			Initiated?	Status	Initiated?	Status	Initiated?	Status						
1	84-85	RF	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	File not available in circle.
2	84-85	RF	Yes D:	CIT(A)	Yes D:	CIT(A)	Yes C:	CIT(A)	No	Prosecution launched	NA	NA	No	Search based on complaint in 18/1987. Explan 5 immunity denied. No quantum appeal by assessee.
3	84-85	RF	No	NR	No	NR	Yes D:	ITAT	No	No	NA	Poor	Yes	Routine addition due to audit obj. CIT (A) deplored assmt order by ITO. 2nd Appeal by Dept. due to CBDT instruction: but had to fail.
4	86-87	RF	No	NR	Yes	Rs 8167	Yes	Rs 16387	No	No	NA	NA	No	Routine expense disallowance but of a large sum.
5	82-83	Individl	No	NR	Yes	Paid	Yes	Rs 44770	No	u/s 263	No	Poor	Yes	Assmt set aside u/s 263. Reassmt faulty also.
6	86-87	RF	No	NR	Yes	Dropped	Yes	Rs 6615	No	No	NA	NA	No	Routine disallowance. Assessee's appeal dismissed.
7	84-85	RF	No	NR	Yes	NA	Yes	Rs 53540	No	u/s 263	NA	Poor?	Yes	Routine Assmt. Other ITO mistakes; Tax return not in file.
8	72-73	Individl	Yes	2nd Appl	Yes	2nd Appl	Yes	Rs 56212	No	Search; Prosecuta	NR	NR	No	Assessee kept no books.
9	83-84	RF	No	NR	No	NR	No	NR	No	No	NA	NA	No	Reopening after a key document was furnished.
10	84-85	ORP	No	NR	Yes	Dropped	Yes	Rs 1718	No	No	No	Poor	No	Loss set-off wrongly disallowed by AO.
11	84-85	ORP	No	NR	Yes	NA	Yes	Rs 31365	No	Tax. Rec.	No	NA	Yes	Assessee dead; Dues written off; Exparte assmt.
12	85-88	Individl	No	NR	No	NR	Yes	NA	No	u/s 263	Yes	Poor	No	Set Aside u/s 263 due error by AO; Unexplained source of investment makes it a fit case for prosecution u/s 276DD.
13	87-88	RF	No	NR	No	NR	No	NR	No	No	No	Not good	No	Assmt using documents furnished; no enquiry.
14	87-88	Individl	No	NR	No	NR	Yes	Rs 2289	No	No	No	Poor	No	Clues in return, etc. of possible evasion not pursued.
15	85-86	Individl	No	NR	Yes	Dropped	Yes	Rs 38637	No	No	NA	NA	No	Recent widow; Non compliance due to oversight.
16	85-86	RF	No	NR	Yes	Dropped	Yes	Paid	No	No	No	Not Good	No	All additions routine.
17	86-87	RF	No	NR	No	NR	Yes	Concid.	Appeal	No	Yes	Not Good	No	Addition due to low GP rate; poor order by AO.
18	84-85	Individl	No	NR	Yes	Rs 7522	Yes	Rs 28319	2nd Appl	No	No	Poor	No	Casual assmt order by AO based on GP estimate; entire addition deleted on 1st appeal.
19	87-88	RF	No	NR	Yes	Dropped	Yes	Dropped	No	No	No	Not Good	No	Technical addition; no proper scrutiny made.
20	85-86	Individl	No	NR	Yes	Dropped	Yes	Paid	See note	No	Yes	Poor	No	No assets seized on raid; poor order by AO.

3. In no case were files and noting sheets properly maintained. In some cases necessary documents, including in one case the income tax return, were missing.

4. Assessee claimed immunity u/s 271(1) (c) Explan 5 after his premises were raided.

Source: Field Survey.

Table 27

## Disposal of Internal Audit Objections

	For Disposal on April		Disposed during year		Pending on March 31	
	Cases (Nos)	Amount (Rs.Cr.)	Cases (Nos)	Amount (Rs.Cr.)	Cases (Nos)	Amount (Rs.Cr.)
1979-80	15261	118.69	4487	20.60	10774	98.09
1980-81	16114	131.19	3894	21.50	12220	109.69
1981-82	18036	141.86	5039	23.56	12977	118.30
1982-83	17218	143.85	5516	49.16	11702	94.69
1983-84	16226	122.92	5174	33.79	11052	89.14
1984-85	16154	126.24	7073	45.01	9801	81.24
1985-86	15569	194.87	7765	67.77	7804	127.09
1986-87	15666	414.44	5514	94.46	10152	319.98
1987-88	18284	451.22	7189	234.49	11095	216.73
1988-89	18840	411.75	7974	200.89	10866	210.86
1989-90	18578	479.25	8907	156.39	9671	322.86

Source: Comptroller and Auditor General of India, various years.

Table 28

Outstanding Statutory Audit  
Objections with no Final  
Action Taken

Year	Total Items (Nos)	Income Tax Revenue Effect (Rs. crore)
1983-84	108542	190.62
1984-85	80024	197.95
1985-86	73836	210.58
1986-87	72609	201.31
1987-88	58315	262.03
1988-89	58319	383.78
1989-90	53741	552.00

Source: Report of the Comptroller and Auditor General of India, various years.

Table 29  
Progress of Penalty Proceedings

(In Numbers)

Year	Pending at the beginning of the year	Added during the year	Total Cases for Disposal	Cases Disposed during the year
1984-85	981163	598210	1579373	817555
1985-86	761818	623440	1385258	698428
1986-87	686830	462870	1149700	573201
1987-88	581697	412005	993702	530777
1988-89	466111	44646	510757	480613
1989-90	420438	268537	688975	312140

Source: Report of the Comptroller and Auditor General of India, various years.

Table 30  
Levy and Collection of Penalties and Composition Money

Year	Levied during the year		Collected during year		Balance Outstanding	
	Penalty (Rs lakh)	Composition Money (Rs 000)	Penalty (Rs lakh)	Composition Money (Rs 000)	Penalty (Rs lakh)	Composition Money (Rs 000)
1984-85	2140	44915	1390	40986	5024	13806
1985-86	3217	4587	1356	5820	6851	12573
1986-87	3463	13054	1538	6125	8674	19502
1987-88	4215	4189	2155	6287	12138	7961
1988-89	11717	6206	2626	4443	21573	11696
1989-90	7866	27464	4554	15083	244415	30246

Source: Report of the Comptroller and Auditor General of India, various years.

Table 31

Details of Cases Going to the  
Settlement Commission

	Cases for disposal (Nos)	Cases disposed (Nos)	Cases pending (Nos)	Income Tax determined in settled cases (Rs Crore)
1979-80	1189	210	979	NA
1980-81	1276	294	982	NA
1981-82	1231	159	1072	124.90
1982-83	1430	186	1244	207.02
1983-84	1799	224	1575	373.91
1984-85	1988	270	1718	225.19
1985-86	1890	204	1686	741.75
1986-87	863	59	804	0.07
1987-88	1011	71	940	0.02
1988-89	1210	193	1017	1.94
1989-90	795	153	642	0.05

Source: Report of the Comptroller and Auditor General of India, various years.

Table 32

Details of Income Tax Prosecution Cases

(In Numbers)

Year	PROSECUTION COMPLAINTS FILED			OUTCOME OF PROSECUTION CASES					
	Tax Evasion	Others	Total	Conviction	Cases Acquitted /Quashed	Total Cases Decided	Convictions Rate (%)	Cases Compounded	Convict+ Compound. Rate (%)
1971-72	13	0	13	10	4	14	71.43	NA	71.43
1972-73	30	0	30	7	2	9	77.78	NA	77.78
1973-74	100	0	100	7	4	11	63.64	NA	63.64
1974-75	61	0	61	10	3	13	76.92	NA	76.92
1975-76	111	303	414	15	6	21	71.43	8	79.31
1976-77	283	275	558	13	10	23	56.52	23	78.26
1977-78	132	565	697	13	13	26	50.00	16	69.05
1978-79	118	904	1022	17	12	29	58.62	18	74.47
1979-80	116	620	736	29	26	55	52.73	10	60.00
1980-81	200	254	454	23	18	41	56.10	32	75.34
1981-82	390	85	475	29	31	60	48.33	30	65.55
1982-83	748	345	1093	23	66	89	25.84	21	40.00
1983-84	671	1085	1756	27	31	58	46.55	13	56.34
1984-85	812	1299	2111	58	34	92	63.04	23	70.43
1985-86	1676	2403	4079	70	43	113	61.95	34	70.75
1986-87	1426	3832	5258	66	250	316	20.89	80	36.87
1987-88	562	6799	7361	53	189	242	21.90	191	56.35
1988-89	721	6707	7428	130	207	337	38.58	444	73.49
1989-90	595	8334	8929	131	234	365	35.89	223	60.20

Source: Panta (1990).

Table 33

## Details of Searches and Seizures by the Income Tax Department

(In numbers)

	Data from the Report of the Comptroller and Auditor General						Excess of ITD data over CAB data (%)	
	Total Search and Seizures	Cases in which assets seized	Cases in which no assets seized	Value of Assets Seized (Rs crore)	Additional Tax Demand (Rs crore)	Additional Penalty Demand (Rs crore)	Total Search & Seizures	Value of Assets Seized
1984-85	3380	1840	1540	29.16	20.60	0.69	22.21	-16.31
1985-86	5600	2814	2778	96.26	75.81	4.13	12.92	-91.30
1986-87	6782	4376	2406	76.97	50.26	0.49	3.86	23.57
1987-88	6871	3735	3136	14.17	81.53	8.51	18.82	90.23
1988-89	6253	3292	2961	11.91	12.78	8.37	16.68	92.20
1989-90	2663	1428	1235	55.78	90.05	7.32	33.16	56.43

Source: Report of the Comptroller and Auditor General of India, various years.

Table 34

## Pendency and Disposal of Income Tax Prosecutions

(In Numbers)

Year	Pending at the beginning of the year	Complaints filed during the year	Total	Cases Disposed	Cases Convicted	Cases Compounded	Cases Acquitted	Balance at end of year
1982-83	2428	994	3432	69	28	41	NA	NA
1983-84	251	172	423	26	13	7	NA	397
1984-85	397	778	1175	37	9	26	NA	1138
1985-86	1138	711	1849	321	16	303	NA	1528
1986-87	8081	4543	12624	663	56	258	349	11961
1987-88	12801	6622	19423	812	297	251	274	18611
1988-89	18292	7985	26277	998	187	604	207	25279
1989-90	24508	8518	33026	2613	1906	169	538	30413

Source: Report of the Comptroller and Auditor General, various years.

Table 35

## Court Disposal and Pendency of Prosecutions

	Complaints Filed during the year			Cases Decided during the year			Cases	
	Pending as on 1st April	Tax Evasion	Others	Total	Convictions	Acquittals	Compounded as on 31st March	
1983-84	2543	671	1085	1756	27	31	13	4228
1984-85	4228	812	1299	2111	58	34	23	6224
1985-86	6224	1676	2403	4079	70	43	34	10156
1986-87	10156	1426	3832	5258	66	250	80	15018
1987-88	15018	562	6799	7361	53	180	191	21946
1988-89	21946	721	6707	7428	130	207	444	28593
1989-90	28593	595	8334	8929	131	234	223	36934

Source: Panta (1990).

Table 36

Prosecutions Launched in Surveyed Ranges

Range	Number of assessees		Prosecutions launched			
	89-90	90-91	Tax evasion		Other offences	
	89-90	90-91	89-90	90-91	89-90	90-91
Range A Banglore	52018	50258	1	4	3	0
Range B Banglore	69777	75181	0	0	0	0
Range C Bombay	41730	45132	0	0	13	14
Range E Jaipur	64912	36689	17	4	19	11

Source: Field Survey.

Table 37

Successful Prosecution Cases for Income Tax  
Violations Decided During 1989-90

Sl. no.	Date of offence	Offence	Where	Sentence imposed	Remarks
1.	February 83	Understatement of property sale price	Chief Metropolitan Magistrate Bombay	3-6 months RI each count Fine: Rs 2100	Concurrent sentences
2.	AY 64-65 and 67-68	Concealment of income of Rs 14500/ Rs 19600/-	N.A.	Fine: Rs 3000 1 year RI	Third accused (partner) died during proceedings
3.	AY 81-82 and 82-83	Overstatement of expense of Rs 38080 and Rs 45160	N.A.	a. Fine Rs 100 and 1 year RI b. Fine Rs 1000 and till rising of court	Court did not have discretion to award less than 3 months
4.	N.A.	Understatement of 27963	N.A.	Fine Rs 5000 and till rising of the court	See case (3) above
5.	N.A.	False verification in evasion case (277)	A.P.	Till rising of the court	See case (3) above
6.	AY 77-78	Non-disclosure of income	U.P.	1 year RI	
7.	N.A.	Failure to deposit tax deducted at source	Punjab	Rs 500 fine	See case (3) above

Table 37 (Contd.)

Sl. no.	Date of offence	Offence	Where	Sentence imposed	Remarks
8.	N.A.	Failure to deposit tax deducted at source	Amritsar	Rs 500 fine	See case (3) above
9.	AY 65-66 to AY 74-75	Failure to deposit tax deducted at source (118 complaints)	Delhi	Fine Rs 25,100	See case (3) above
10.	N.A.	Failure to deposit tax deducted at source Rs 25000	Delhi	Fine Rs 20,000 4 months RI	
11.	AY 84-85 and 86-87	Delay in deposit of tax deducted at source	Vijaya-wada	Rs 1000 fine and till rising of court	See case (3) above
12.	AY 85-86 and 86-87	Delay in deposit of tax deducted at source	Vijaya-wada	Rs 1000 fine and till rising of court	See case (3) above
13.	AY 83-84	Delay in deposit of tax deducted at source	Secunderabad	Rs 2000 fine and till rising of court	See case (3) above

Source: Panta (1991)

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**THE FIELD SURVEY OF SELECTED INCOME TAX RANGES**

The objective of the field survey was to gather information which would enable the study team to evaluate the quality and returns to income tax assessment. Specific areas that were to be explored included the following.

- i. Appropriateness and adequacy of manpower deployment and utilisation from a revenue perspective.
- ii. Information input into assessment and the mode of selection of scrutiny cases.
- iii. Practices followed in scrutiny and the quality of scrutinies.
- iv. The state of record-keeping and adequacy of infrastructure.
- v. Time lags, bottlenecks and delays preventing efficient disposal of work.

A second objective was to discuss possible reforms with surveyed officers in order to gauge their views of the proposals.

On the advice of senior officers of the Income Tax Department, 5 assessment ranges were selected purposively for the survey: 2 each in Bangalore and Bombay and one in Jaipur. Salient characteristics of selected ranges are in Table A1. Data were collected for the two most recent years, 1989-90 and 1990-91. The total number of assessees covered by the survey was about 2.77 lakh representing about 3.9 per cent of all non-company assessees during the relevant years and an estimated 4.75 per cent of all assessees with income from business or profession. Only ranges with general business and professional cases were selected. Furthermore, it was decided to exclude DCs (Assessment) from the survey.

Two questionnaires were devised, one each for Assessing Officers and DCs (Assessment). These questionnaires were pre-tested in Delhi in two ranges, a general business range and a professional range. The

- 
1. The estimate is based on data in the All India Income Tax Statistics for 1989-90 and the figures as on 31 March 1990 from the Report of the Comptroller and Auditor General for the year ended March 31 1990.

final questionnaires are annexed to this Appendix. Furthermore, on the basis of an examination of a selection of assessee files in Delhi a proforma was devised to collect information from files of assessees in Bangalore. The proforma is also annexed.

Initially, questionnaires were mailed to the concerned Chief Commissioner who was requested to identify appropriate range(s) for the survey and have the questionnaires completed. Completed questionnaires were collected during field visits. This was done after ensuring the accuracy and completeness of information furnished by assessing officers and DCs during the field visit. In addition, meetings were held with concerned CCs, CITs DCs and AOs to ascertain their views on problems with existing systems and procedures and on possible reform measures. A meeting was also held with one DI (Investigation). Finally, about 20 cases where scrutiny was conducted in or around 1984-85 were selected from Demand and Collection Registers in Bombay and the case files studied.

While the response was, by and large, satisfactory, one DC and 4 AOs either failed to provide information or provided information that was very incomplete. In the 49 usable questionnaires from AOs, the average response rate across questions was 91 per cent varying between 61 per cent and 100 per cent.

The information from the field survey was supplemented by secondary information from published sources and various Directorates of the Income Tax Department. Unfortunately, information requested from Directorates was not received in most cases despite several months having elapsed and reminders having been sent.

**Table A1**

**Description of Sample**

Item	Bangalore	Bombay	Jaipur	Total
<b>Number of Ranges</b>	2	2	1	5
Wards	11	15	7	33
Circles	2	6	1	9
Investigation Circles	2	3	2	7
<b>Average Number of Assesseees</b>				
Wards	5527	5533	4005	5270
Circles	842	2034	5820	2543
Investigation Circles	327	179	300	223

**Annexure**

**Questionnaires for DCs and AOs  
and Proforma for Collection of Case by Case Information**

- (i) Information collected on the basis of this questionnaire will be compiled to prepare a report as desired by the Tax Reforms Committee.
- (ii) You are requested to complete this questionnaire.
- (iii) PLEASE RESPOND FRANKLY. RESPONSES WILL BE TREATED AS CONFIDENTIAL AND THE IDENTITY OF RESPONDENTS WILL NOT BE REVEALED TO ANYONE NOT CONNECTED WITH THE COMMITTEE.

1. Range you are DC for : -----
2. Date of posting to this Range : -----
3. Total number of assessees in the range:  
(a) 1989-90 : ----- cases  
(b) 1990-91 : ----- cases
4. Type of assessees and jurisdiction : -----
5. Number of assessees added in the range:

Year	Attributable to Surveys u/s 133B	Revenue effect of cases in column (2) (Rs)	Attributable to other measures/ voluntary compliance	Revenue effect of cases in column (4) (Rs)
1989-90				
1990-91				

6. Please give your best estimate of time spent in the range for the different duties listed below.

Nature of duty	1989-90		1990-91	
	Prescribed norms if any for	Time spent during the year	Prescribed norms if any for	Time spent during the year
	ITO's	AO's	ITO's	AO's
		by DC*		by DC*

Summary Assessment

Scrutiny Assessment  
 u/s 144A  
 Approval of cases  
 Other

Audit Objections

Processing of material sent by the Investigation Wing (eg. CIB extracts, survey reports)

Appeals and References

Prosecution cases

Tax collection/recovery

Survey u/s 133A(1)

Approval of Refunds

Assessment of Taxes other than Income Tax

Reporting/Statistical requirements

Inspection

Housekeeping tasks

Miscellaneous\*\*

Search/Examination duty

\* Time spent: percentage of your total working time during the year.  
 \*\* If time spent exceeds 10% please indicate nature of duties below:

7. Please give your opinion as to the quality of summary assessments done in this range. If there are any obstacles due to the IT Act/Rules, administrative directions or practical considerations in the way of high quality assessment please describe these.
8. Please give your opinion as to the quality of scrutiny assessments done in this range. If there are any obstacles due to the IT Act/Rules, administrative directions or practical considerations in the way of high quality assessment please describe these.
9. How many surveys were conducted in this range under Section 133A(1)
- During 1989-90 : -----  
 During 1990-91 : -----

10. For surveys (whether covered by question 9 or not) please provide the following information for the range:

Item	1989-90	1990-91
No. of cases being taken on scrutiny as a result of survey (nos.)		
Revenue effect of these cases (Rs '000)		

11. Have you initiated a survey u/s 133A(1) while in this range during 1990-91? Yes No
12. If you answered 'Yes' to Question. 11 please indicate briefly how the need for the survey was identified by you.
13. How important are each of these sources in identifying scrutiny cases which result in initiation of penalty proceedings?

Source	Importance*
CIB Reports	1 2 3 4
Survey u/s 133A(1)	1 2 3 4
Survey u/s 133A(5)	1 2 3 4
Survey u/s 133B	1 2 3 4
Search reports from Investigation Wing	1 2 3 4
Tax evasion petitions	1 2 3 4
Undue changes in financial data supplied by assessee as compared to previous years	1 2 3 4
Others (specify) (i) -----	1 2 3 4
(ii) -----	1 2 3 4
(iii) -----	1 2 3 4

\* Please encircle the appropriate number according to the following scale:  
 1. Very important; 2. Important; 3. Not very important; 4. Useless.

14. Please provide details of the number of prosecutions launched below:

---

Offence	1989-90	1990-91
Tax evasion		
Other offences		

---

15. If the number of prosecutions launched is, in your opinion, inadequate, please give the reasons.

16. Please suggest important administrative measures which could be used to increase revenue collections by improving the quality of assessment of existing assesseees so as to uncover evasion.

17. Please suggest important administrative measures which could be used to increase revenue collections by expanding the number of assesseees.

18. Please provide the break up of total strength of your range for the following categories during 1990-91.

(Nos.)

---

Category	DC(s)	ACs	ITOs	Inspec- tors	Head clerk(s)	Tax assis- tants & UDCs	LDCs	Others
----------	-------	-----	------	-----------------	------------------	----------------------------------	------	--------

---

19. What was the total number of working days for which officers in your range were absent from regular duty on account of casual leave/leave/training.

During 1989-90 : ----- working days  
During 1990-91 : ----- working days

20. Please give your opinion and suggestion, if any, about the effectiveness of the existing system of inspection by DCs.

21. Any other remarks or suggestions.

**TAX REFORMS COMMITTEE**

**Questionnaire for Assessing Officers of Selected Ranges**

- (i) Information collected on the basis of this questionnaire will be compiled to prepare a report as desired by the Tax Reforms Committee.
- (ii) You are requested to complete this questionnaire.
- (iii) A researcher/officer connected with the report to be based inter alia on this questionnaire will meet you to discuss your responses to this questionnaire.
- (iv) PLEASE RESPOND FRANKLY. RESPONSES WILL BE TREATED AS CONFIDENTIAL AND THE IDENTITY OR WARD/CIRCLE OF RESPONDENTS WILL NOT BE REVEALED TO ANYONE NOT CONNECTED WITH THE COMMITTEE.

**PART A: INFORMATION REGARDING THE WARD/CIRCLE**

**Block I : Duties, Time Allocation and Assessment Load**

- 1. Ward/circle : -----
- 2. Total income tax assessment workload in the ward/circle during: (a) 1989-90 : -----  
(b) 1990-91 : -----
- 3. What class of assesses fall under this ward/circle (e.g. salary earners having income below Rs 2 lakh) : -----
- 4. Jurisdiction of ward/circle : -----

5. Please give relevant details regarding staff in the ward/circle

-----  
Strength during 1-4-90 to 31-3-91  
-----

Post	Sanctioned	Working	Desirable*
------	------------	---------	------------

-----

Inspector  
Head clerk  
Stenographer  
Upper division clerk  
Lower division clerk  
Tax assistant  
Notice server  
Peon

-----

\* Indicate here the number of posts which should be sanctioned for effective functioning.

6. Please provide the details indicated for the different duties listed in the table below.

Nature of duty	1989-90	1990-91
	No. of cases disposed during the year	No. of cases disposed during the year
(1)	(2)	(3)
Summary Assessment		
Scrutiny Assessment		
Giving Appeals effect		
Rectifications		
Audit Objections		
Penalties		
Processing of prosecution cases		
Survey u/s 133A(1)		

7. If the number of summary assessment/scrutiny assessment cases in the ward was below the prescribed target please indicate reasons.

8. Please indicate the fraction of the time of Inspectors devoted to the following duties:

Nature of duty	During 1-4-89 to 31-3-90	During 1-4-90 to 11-3-91
(1)	(2)	(3)
Field enquiry		
Recovery of taxes		
Penalty orders		
CIB extracts		
Help in summary assessment		
Help in scrutiny assessment		
Others		

**Block II : Assessment**

9. In how many assessments did prima facie adjustments result in extra tax/ interest demand?

During 1989-90 : ----- assessments  
 During 1990-91 : ----- assessments

10. Number of assessments in which extra tax demand was cancelled after rectification/revision:

Year	Summary assessment	Scrutiny assessment
1989-90		
1990-91		

11. Please supply the following figures for your ward/circle:

(in Rupees '000)

Item	1989-90		1990-91	
	Summary assess- ment	Scrutiny assess- ment	Summary assess- ment	Scrutiny assessment
(1)	(2)	(3)	(4)	(5)
Total final tax demanded (after appeals/rectifica- tion, etc., if any)				
Total prepaid taxes				
Total additional tax u/s 143(1A)				
Total refunds				
Total interest				
Total penalty demand of which total concealment penalty				

12. What were the three most important sections of the Income Tax Act under which adjustments under summary assessment were made and sustained after rectification/revision?

Sections	No. of cases
During 1989-90	
a)	
b)	
c)	
During 1990-91	
a)	
b)	
c)	

13. Please provide details of scrutiny assessment cases in this ward/circle during the indicated years in the table below:

Period	Total no. of assessments resulting in extra tax	No. of assess- ments in col. (2) resulting in initiation of concealment penalty	No. of assessments in col. (2) which have gone to appeal	No. of assessments in col. (3) which have gone to appeal
(1)	(2)	(3)	(4)	(5)
1989-90				
1990-91				

14. Please furnish information regarding appeals in the table below:  
 (Nos.)

Item	1989-90			1990-91		
	DC(A)	CIT(A)	ITAT	DC(A)	CIT(A)	ITAT
a. Appeal orders (against assessments) received during the year						
b. Appeal orders out of (a) in which: The entire addition in dispute was confirmed						
Upto 50% of the addition was confirmed and the balance deleted						
Less than 50% of the addition made was confirmed						
Entire addition was deleted						
Assessment was set-aside						

15. For cases in which penalty proceedings u/s 271(1)(c) were decided please furnish the following information:

Item	1989-90	1990-91
Number of penalty proceedings dropped		
Number of cases which resulted in imposition of concealment penalty		

16. For assessments mentioned in question 13 col. (4) please indicate the nature of additions (e.g. cash credits) which resulted in initiation of penalty proceedings under Section 271(1)(c).

Year	S.No.	Nature of additions	No. of assessments
During 1989-90			
	a)		
	b)		
	c)		
During 1990-91			
	a)		
	b)		
	c)		

**PART B**

**INFORMATION REGARDING THE ASSESSING OFFICER**

**Block III : Basic Details**

17. Your total years of experience since joining the Income Tax Department not counting initial training if any : ----- Years
18. Please provide details about your years of experience as:
- |                  |               |
|------------------|---------------|
| Inspector        | : ----- Years |
| ITO (Group B)    | : ----- Years |
| ITO (Group A)/AC | : ----- Years |
| Other (specify)  | : ----- Years |
19. Your designation: ITO/AC/Other (Specify) : -----
20. Date of posting to this ward/circle : -----
21. Additional charges if any, held during the year. Also indicate the time period.

22. Please give your best estimate of time spent by you and ward/circle staff on the different duties listed in the table below.

Nature of duty	1989-90		1990-91		Tasks which can be delegated to inspectors in your opinion
	Time spent by*		Time spent by*		
	Assessing Officer	Ward/Circle Staff	Assessing Officer	Ward/Circle Staff	

-----  
**Summary Assessment**

**Scrutiny Assessment:**

- i. Examination of books of accounts
- ii. Other
- Giving Appeals effect
- Rectifications
- Audit Objections
- Processing of material sent by the Investigation Wing (e.g., CIB, survey reports)
- Appeals and References
- Penalties
- Processing of prosecution cases
- Collection and recovery of tax
- Survey u/s 133A(1)
- Assessment of Taxes other than Income Tax
- Reporting/Statistical requirements
- Housekeeping tasks
- Miscellaneous\*\*
- Search/Examination duty

-----  
 \* Time spent: percentage of total working time during the year.

\*\* If time spent exceeds 10% please indicate the nature of duties below:

**Block IV : Assessment**

23. Briefly describe the procedure, if any, you follow in identifying mistakes in returns under summary assessment (if a check list is used please furnish a copy).

24. How important are each of these sources in identifying scrutiny cases which result in initiation of penalty proceedings or levy of extra tax?

Source	Importance*
CIB Reports	1 2 3 4
Survey u/s 133A(1)	1 2 3 4
Survey u/s 133A(5)	1 2 3 4
Survey u/s 133B	1 2 3 4
Search reports from Investigation Wing	1 2 3 4
Tax evasion petitions	1 2 3 4
Undue changes in financial data supplied by assessee as compared to previous years	1 2 3 4
Evidence of capital building	1 2 3 4
Fall in gross profit rate	1 2 3 4
Large gifts received	1 2 3 4
Investment in immovable property	1 2 3 4
Others (specify) (i) -----	1 2 3 4
(ii) -----	1 2 3 4
(iii) -----	1 2 3 4

\* Please encircle the appropriate number according to the following scale:  
 1. Very important; 2. Important; 3. Not very important; 4. Useless.

25. Other than sources of information listed in Question (24) is there any procedure you follow in selecting cases of suspected evasion for scrutiny? (Circle the correct answer) Yes No

26. If you answered 'Yes' to Question (25) please describe the procedure briefly.

27. Number of cases in which you appear before the appellate authority:

During 1989-90 : -----  
 During 1990-91 : -----

**Block V : Opinions of Assessing Officers**

28. Number of surveys u/s 133A(1) conducted:

During 1989-90 : -----  
 During 1990-91 : -----

29. Please indicate briefly how you selected the assessees for the surveys.

30. In scrutiny cases completed by you during 1990-91 please give the percentage of cases in which, in your personal judgement, you were able to ensure that, of the actual taxable income of the assessee

80% - 100% was disclosed : percentage of cases -----  
 50% - 79% was disclosed : percentage of cases -----  
 30% - 49% was disclosed : percentage of cases -----

31. What was, in your judgement, the average amount of extra tax demand from scrutiny cases which you, personally, completed between 1-4-90 and 31-3-91. Rupees -----

32. Please give your opinion as to the usefulness of various training programmes you have attended in improving your skills in carrying out Scurting Assessment\*.

Basic Training Course at NADT	1	2	3	4
Refresher Courses (please give name, duration and venue)				
a)	1	2	3	4
b)	1	2	3	4
c)	1	2	3	4
'On the job' Training	1	2	3	4

\* Encircle the appropriate number according to the following scale:

a. Very useful; b. Useful; c. Not very useful; d. Useless

33. Please give your opinion as to the effectiveness of distribution of cases between wards/circles and DC(Special ranges) and also between different wards. Please also give suggestions for reorganisation, if any.

34. Please suggest important administrative measures which could be used to increase revenue collections by improving the quality of assessment of existing assessees so as to uncover evasion.

35. Please suggest important administrative measures which could be used to increase revenue collections by expanding the number of assessees.

36. What, in your opinion, are the main Sections of the Income Tax Act, Income Tax Rules, Board directions or practical difficulties which prevent better quality assessments being made by Assessing Officers. Please list the important items and outline how they hinder assessment.

37. Any other comments or suggestions.

**Tax Reform Committee**

**Form for Collection of Information from Scrutiny Files**

Date:----- Serial No.-----

1. Case Details : a) Place : b) CIT Charge :  
                   c) Range : d) Ward/Circle :
2. Assessment Year : \_\_\_\_\_
3. Status of Assessee : Individual/HUF/Registered firm/Company/AOP/Others
4. Nature of business/profession of assessee:
5. Whether assessed to Wealth Tax:    Yes                    No
6. Assessment history:

Sl. no.	Assessment year	Total income				
		Disclosed	Assessed u/s 143(1)	Assessed u/s 143(3)	Assessed as per present status	Present status*
1						1 2 3 4 5
2						1 2 3 4 5
3						1 2 3 4 5
4						1 2 3 4 5
5**	As per Q.2					1 2 3 4 5
6						1 2 3 4 5
7						1 2 3 4 5
8						1 2 3 4 5
9						1 2 3 4 5

Notes:    \*    Pleases circle a number according to the following code:  
           1. All relevant proceedings have become final; 2. Rectification pending; 3. First appeal pending; 4. Second appeal pending; 5. Pending for other reasons.

          \*\*    Columns for serial no. 5 must be filled in for the assessment year in Question 2. Please give details for 4 years prior to this year or from the year of filing first return whichever is later. Also give details for upto 4 assessment years after the year mentioned in Question 2.

7. For the assessment year mentioned in Question 2 please give the following additional details if relevant to the case:

- |   |   |
|---|---|
| <p><b>i. Total Income (Rs)</b></p> <p>a. After rectification : -----</p> <p>b. After first appeal : -----</p> <p>c. After second appeal : -----</p> <p>d. After revision : -----</p> <p>e. After Section 263 : -----</p> <p>f. After reference : -----</p> <p>g. After appeal before<br/>before supreme court : -----</p> <p>h. After settlement by<br/>Settlements<br/>Commissions : -----</p> <p><b>ii. Tax (Rs)</b></p> <p>a. On income disclosed : -----</p> <p>b. As per present status : -----</p> <p><b>iii. Extra Tax (Rs)</b></p> <p>a. After rectification : -----</p> <p>b. After first appeal : -----</p> <p>c. After second appeal : -----</p> <p>d. After revision : -----</p> <p>e. After Section 263 : -----</p> <p>f. After reference : -----</p> <p>g. After appeal before<br/>Supreme Court : -----</p> <p>h. After settlement by<br/>Settlements Commission: -----</p> <p><b>iv. Tax on Assessed Income<br/>After Settlement by<br/>Settlements<br/>Commissions (Rs) : -----</b></p> <p><b>v. Additional Tax u/s<br/>143(1A) (Rs) : -----</b></p> | <p><b>vi. Concealment penalty u/s 271(i)(C)</b></p> <p>a. Whether initiated Yes N</p> <p>b. Amount as per present<br/>status (Rs) : -----</p> <p><b>vii. Other penalties:</b></p> <p>a. Whether initiated Yes N</p> <p>b. Amount as per present<br/>status(Rs) : -----</p> <p><b>viii. Interest:</b><br/>Amount as per present<br/>status (Rs) : -----</p> <p><b>ix. Immunity from penalty:</b></p> <p>a. Relief allowed u/s 273A (Rs)</p> <p>i. Concealment<br/>penalty : -----</p> <p>ii. Others : -----</p> <p>b. Relief allowed by Settlements<br/>Commission (Rs)</p> <p>i. Concealment<br/>penalty : -----</p> <p>ii. Others : -----</p> <p><b>x. Remarks</b></p> |
|---|---|

8. Chronology of scrutiny. Please enter the following dates/details where relevant  
Date of:

- |  |   |       |   |   |       |
|--|---|-------|---|---|-------|
| 1. Filing return                                     | : | ----- | 25. Filing of second appeal in respect of penalty   | : | ----- |
| 2. Service of notice if not filed voluntarily        | : | ----- | 26. Appellate order by Tribunal   | : | ----- |
| 3. Selection for scrutiny                            | : | ----- | 27. Giving effect to appeal   | : | ----- |
| 4. First hearing                                     | : | ----- | 28. Filing of reference for High Court for penalty  | : | ----- |
| 5. Dates on which case was heard                     | : | ----- | 29. Final judgement of High Court for penalty   | : | ----- |
| 6. Assessment  | : | ----- | 30. Filing petition u/s 273A  | : | ----- |
| 7. Rectification petition                            | : | ----- | 31. Order u/s 273A  | : | ----- |
| 8. Rectification order                               | : | ----- | 32. Sending of proposal for launching prosecution by Assessing Officer  | : | ----- |
| 9. Notice u/s 263                                    | : | ----- | 33. Launching of prosecution  | : | ----- |
| 10. Order u/s 263                                    | : | ----- | 34. Decision of court   | : | ----- |
| 11. Application u/s 264                              | : | ----- | 35. Filing settlement application before Settlements Commission   | : | ----- |
| 12. Notice u/s 264                                   | : | ----- | 36. Admission/rejection of Settlements Commission   | : | ----- |
| 13. Filing of first appeal in respect of assessment  | : | ----- | 37. Settlement order by Settlements Commission  | : | ----- |
| 14. Appellate order by DC (Appeals)/ CIT (Appeals)   | : | ----- | 38. In case of undue delay in giving appeals effect please indicate if this was due to delay in respect of order: |   |       |
| 15. Giving effect to appeal                          | : | ----- | a. First appeal   | : | ----- |
| 16. Filing of second appeal in respect of assessment | : | ----- | b. Second appeal  | : | ----- |
| 17. Appellate order by Tribunal                      | : | ----- | 39. No. of times assessee sought adjournment during assessment hearing  | : | ----- |
| 18. Giving effect to appeal                          | : | ----- | 40. No. of times hearings were adjourned by Assessing Officer   | : | ----- |
| 19. Filing of reference for High Court               | : | ----- |   |   |       |
| 20. Final judgement of High Court                    | : | ----- |   |   |       |
| 21. Imposition/dropping of concealment penalty       | : | ----- |   |   |       |
| 22. Filing of first appeal in respect of penalty     | : | ----- |   |   |       |
| 23. Appellate order by DC (Appeals)/ CIT (Appeals)   | : | ----- |   |   |       |
| 24. Giving effect to appeal                          | : | ----- |   |   |       |

9. Please report briefly the reasons given by Assessing Officer for selecting t case for scrutiny:

10. Details of investigation conducted/documents examined/field enquiries; (indica inter alia, how and where discrepancies were found)

11. Amounts of major additions made by the Assessing Officer and present status

	By Assessing Officer (Rs)	As per present status (Rs)
<b>On Account of:</b>		
1. Unexplained cash credits		
2. Inflation of purchases		
3. Incriminating documents/ duplicate books		
4. Suppression of receipts		
5. Suppression of sales		
6. Inflation of expenses		
7. Investment outside books		
a. Properties		
b. Other investments		
8. Stocks/purchases outside books		
9. Loans and repayments outside books		
10. Total suppression of profit earning activities		
11. Other additions (specify)		
i.		
ii.		
iii.		

12. General remarks (please give here inter alia your evaluation of scrutiny investigation conducted by assessing officer; evaluation of department representation before appellate authorities and courts; whether assessing officer appeared before appellate authorities; evaluation of remand report assessment officer if asked for; evaluation of appeal orders):



**CENTRAL ACTION PLANS OF THE INCOME TAX DEPARTMENT  
FOR 1989-90 AND 1990-91**

**Central Action Plan - 1989-90**

Key result areas are as under:

**1. Disposal of Income Tax Assessments**

- i. Prima facie adjustments/summary assessments u/s 143(1)
- ii. Income Tax Scrutiny Assessments.

**2. Demand and Collection**

**3. Rectifications**

**I. Disposal of Income Tax Assessments**

- i. No change in existing work norms
- ii. As per last year, a small percentage of cases in each income group to be scrutinised as the working capacity of available manpower permits.
- iii. Categories of assessments A, B, C & D to remain the same as last year.
- iv. Category 'A' Assessments

(Company assessments with income/loss below Rs. 50,000 and non-company assessments with income/loss below Rs 2 lakhs).

- a. Disposal of prima facie adjustments/ summary assessments u/s 143(1) as under:

Arrear company and non-company assessments	100%
Current salaries workload	100%
Current non-company workload (other than salaries)	90%
Current company workload	60%

- b. Disposal of 100 selected assessments u/s 143(3) per annum per Income Tax Officer.

Notes:1. Apart from the arrear scrutiny assessments brought forward on 1.4.1989 each ITO should select 100 assessment for scrutiny out of current workload. However, he would be required to dispose of only a total of 100 scrutiny assessments as per work norms, i.e., 100% of arrear assessments + as many current scrutiny assessments as total upto the work norm of 100 per ITO. The balance, if any, are to be carried forward and disposed of in the next year.

- 2. In company cases as the returns would be due only in December 1989, no current scrutiny disposal may be possible. As per Chairman's D.O.F.No. DIR(HQRS)/CH(DT)A./Plan/89-504-24 dated 15.2.1989 all arrear scrutiny assessments have to be disposed of by 31.7.89. Action u/s 147, wherever called for, should be taken early, so that these cases are completed during the current financial year and shortfall in the disposal as per work norms is made up. There is,

however, no bar to disposal of current company scrutiny assessments if possible, especially where returns are received much before the due date of filing of return.

3. The time limits laid down in Chairman's aforementioned D.O. letter of 15.2.1989 must be adhered to.

v. Category `B' Assessments

(Company assessments with income/loss of Rs 50,000 - Rs 4,99,999 and non-company assessments with income/loss of Rs 2 lakhs - Rs 4,99,999).

a. Disposal of prima facie adjustments/ summary assessments u/s 143(1) as under:

Arrear company and non-company assessments	100%
Current salaries workload	100%
Current non-company workload (other than salaries)	100%
Current company workload	100%

b. Disposal @ 150 selected assessments u/s 143(3) per annum per Assistant Commissioner.

Notes: 1. Apart from arrear scrutiny assessments brought forward on 1.4.1989 each AC should select 150 assessment for scrutiny out of current workload. However, each AC should be required to dispose of only a total of 150 assessments as per work norms, i.e., 100% of arrear assessments + as many current scrutiny assessments as total upto the work norm of 150 per AC. The balance, if any, are to be carried forward and disposed of in the next year.

2. In company cases as the returns would be due in December 1989, no current scrutiny disposal may be possible. As per Chairman's D.O.F.No. DIR(HQRS)/CH(DT)A./Plan/89-504-24 dated 15.2.1989 all arrear scrutiny assessments have to be disposed of by 31.7.89. Action u/s 147, wherever called for, should be taken early, so that these cases are completed during the current financial year and shortfall in the disposal as per work norms is made up. There is, however, no bar to disposal of current company scrutiny assessments if possible, especially where returns are received much before the due date of filing of return.

3. The time limits laid down in Chairman's aforesaid D.O. letter of 15.2.1989 must be adhered to.

vi. Category `C' Assessments

(All assessments with income/loss of Rs 2 lakhs and above)

a. Disposal of prima facie adjustments/ summary assessments u/s 143(1) as under:

Arrear company and non-company assessments	100%
Current salaries workload	100%
Current non-company workload	100%
Current company workload	100%

b. Disposal of selected assessments u/s 143(3) per Deputy Commissioner (Asstt.) according to following norms:

35 core asstts.	-	without any ITO
60 core asstts.	-	without one ITO
75 core asstts.	-	with two ITOs and one AC
100 core asstts.	-	With one ITO and one AC
120 core asstts.	-	with two ACs

- Notes:1. Apart from arrear scrutiny assessments brought forward on 1.4.1989 each DC(Asstt.) should select assessments for scrutiny out of current workload as per work norms i.e. 35/60/75/100 etc. However, each DC(Asstt) should be required to dispose of total scrutiny assessments in accordance with work norms only (out of both arrear and current asstts.). The balance, if any, are to be carried forward and disposed of in the next year.
2. In company cases, as the returns would be due only in December 1989, no current scrutiny disposal may be possible. As per Chairman's D.O.F.No. DIR(HQRS)/CH(DT)A.PLAN/89/504/25 dated 1.5.2.1989 all arrear scrutiny assessments have to be disposed of by 31.7.1989. Action u/s 147, wherever called for, should be taken early so that these cases are completed during the current financial year, and short-fall in the disposal as per work norms is made up. There is, however, no bar to disposal of current company scrutiny assessments, if possible, especially where returns are received much before due date of filing of return.
3. The time limits laid down in Chairman's aforementioned D.O. letter of 15.2.1989 must be adhered to.

vii. Category 'D' Assessments  
(Search and seizure assessments)

Disposal of minimum 50 core assessment per annum per Assistant Commissioner subject to the following conditions:

1. Disposal of 100% assessments relating to searches conducted upto 31.3.1988.
2. Pendency to be carried forward as on 1.4.1990 should not be more than the pendency as on 1.4.1989.

- Notes:
1. Core Asstts. means assessment year to which seized books/documents pertain.
  2. Re-deployment of the Assistant Commissioners wherever necessary may be made as suggested in Chairman's forwarding D.O. letter.
  3. ACs deployed on this work should be posted in the beginning of the year with minimum changes subsequently.
  4. In view of the new provisions of law all current search and seizure assessments would also have to be processed u/s 143(1)(a) for prima facie adjustments. But notices u/s 143(2) should be issued and served simultaneously because of the limitation in section 143(3).

viii. Quarterly targets of disposal of I.T. assessments

a. Prima facie adjustments/summary asstts. u/s 143(1)

	Ist qtr.	IInd qtr.	IIIrd qtr.	IVth qtr.
1. <u>Salary Asstts.</u>	100% of arrear workload	30% of current work- load	70% of current work- load	100% of current work- load
2. <u>Non-company Asstts.</u> (other than salaries)				
i. Category 'A' Asstts.	100% of arrear work- load	10% of current work- load	45% of current workload	90% of current workload
ii. Category 'B' Asstts.	100% of arrear work- load	10% of current work- load	50% of current workload	100% of current workload
3. <u>Company Asstts.</u>				
i. Category 'A' Asstts.	100% of arrear workload	-	-	90% of current workload
ii. Category 'B' & 'C' Asstts.	100% of arrear work- load	-	-	100% of current workload
1. <u>I.T. Scrutiny Asstts.</u> <u>Non-company Asstts.</u>	80% of arrear work- load	100% of arrear work- load	40% of current workload required to be disposed of as per work norms	100% of current workload required to be disposed of as per work norms
2. <u>Company Asstts.</u>	80% of arrear work- load	10% of arrear work- load	40% of Sec. 147 workload required to be disposed of as per work norms	100% of Sec. 147 workload required to be disposed of as per work norms

II. *Reduction of I.T. Demand and I.T. Demand Entries*

i. Reduction of I.T. Demand

Following targets laid down for reduction of I.T. demand (both arrear and current)

- a. Reduce 60% of the gross arrear demand.
- b. Reduce 85% of the gross current demand.

c. The above two targets are subject to the conditions that the total I.T. demand (arrear + current to be carried forward as on 1.4.90 should be 10% less than the arrear demand brought forward as on 1.4.89.

ii. Quarterly targets for reduction of arrear demand

1st quarter	10% reduction
IInd quarter	30% reduction
IIIrd quarter	45% reduction
IVth quarter	60% reduction

iii. Reduction of entries of I.T. demand

Same target as last year to continue i.e., the total I.T. demand entries (arrear and current) to be carried forward as on 1.4.90 should be 30% less than such entries brought forward on 1.4.89.

III. Rectifications

- i. No rectification application to be pending for more than 2 months.
- ii. Annual target - 100% disposal of rectification applications received upto end of January, 1990.
- iii. Separate record/register in respect of applications u/s 154 against prima facie adjustments, must be maintained to have proper control over receipt and disposal thereof.

## Central Action Plan 1990-91

Key result areas are as under:

1. **Disposal of Income Tax Assessments**
  - i. Income tax scrutiny assessments.
  - ii. Processing of returns u/s 143(1)(a) after ensuring full attention to the work relating to making prima facie adjustments.
2. **Reduction of Income Tax Demand and Income Tax Demand Entries**
3. **Disposal of Rectification Applications against Prima Facie Adjustments u/s 143(1)(a)**
4. **Disposal of Major Revenue Audit Objections**
1. **Disposal of Income Tax Assessments**
  - i. Categorisation of assessments, A,B,C and D to remain the same as last year.
  - ii. As per last year a small percentage of cases in each income group to be scrutinised as the working capacity of available manpower permits.
  - iii. All returns for assessment year 1989-90 and 1990-91 including those selected for scrutiny must be processed for making prima facie adjustments as per the provisions of section 143(1)(a).
  - iv. Scrutiny Assessments

Selection and disposal of scrutiny assessments as under:

- a. **Category 'A' Assessments**  
(Company assessments with income/loss below Rs 50,000 and non-company assessments with income/loss below Rs 2 lakhs).
  - i. Selection of 100 returns for scrutiny per ITO per annum.
  - ii. Disposal of minimum 120 scrutiny assessments per ITO per annum.
- b. **Category 'B' Assessments**  
(Company assessments with income/loss of Rs 50,000 - Rs 499999 - and non-company assessments with income/loss of Rs 2 lakhs - Rs 499999).
  - i. Selection of 120 returns for scrutiny for Assistant Commissioner per annum.
  - ii. Disposal of minimum 150 scrutiny assessments per Assistant Commissioner per annum.
- c. **Category 'C' Assessments**  
(All assessments with income/loss of Rs 5 lakhs and above)
  - i. Selection of 75 returns for scrutiny per Deputy Commissioner (Asstt.) per annum.
  - ii. Disposal of minimum 80 scrutiny assessments per Deputy Commissioner (Asstt.) per annum.

- d. Selection of returns for scrutiny may be either out of arrear or current returns.
- e. Disposal of scrutiny assessments should include 100% of such assessments brought forward as on 1.4.1990.
- f. *Category 'D' Assessments*  
(Search and seizure assessments)  
  
Disposal of minimum 50 core assessments per annum per Assistant Commissioner subject to the following conditions.
  - i. Disposal of 100% assessments relating to searches conducted prior to 1.4.89.
  - ii. Pendency to be carried forward as on 1.4.1991 should be less than the pendency as on 1.4.1990.
- g. All current search and seizure assessments are also to be processed u/s 143(1)(a) for prima facie adjustments. However, notices u/s 143(2) should be issued and served simultaneously because of the limitation in section 143(3).
- v. Non-company disposal u/s 143(1)(a) as under:
  - a. Returns brought forward as on 1.4.1990 - 100% by 30th June, 90
  - b. Returns received during 1990-91
    - Non-company (category A,B&C) - 90%
    - Company (category A,B&C). - 70%

**II. Reduction of Income Tax Demand and Income Tax Demand Entries**

*i. Reduction of Income Tax Demand*

Following targets laid down for reduction of income tax demand

- a. Reduce 60% of the gross arrear demand
- b. Reduce 85% of the gross current demand
- c. The above two targets are subject to the condition that the total income tax demand (arrear + current) to be carried forward as on 1.4.91 should be 10% less than the arrear demand brought forward as on 1.4.90.

*ii. Reduction of Entries of Income Tax Demand*

The total income tax demand entries (arrear & current) to be carried forward as on 1.4.91 should be 25% less than such entries brought forward on 1.4.90.

**III. Disposal of Rectification Applications Against Prima-Facie Adjustments u/s 143(1)(a)**

- i. No rectification application should remain pending for more than 2 months.
- ii. Annual target - 100% disposal of rectification applications received upto end of January, 1991.

iii. The Register of applications u/s 154 must be maintained in two parts.

a. For applications against prima facie adjustments u/s 143(1)(a)

b. For other rectification applica- tions.

IV. *Disposal of Major Revenue Audit Objections*

i. Major Revenue Audit Objections (arrear) 100% settlement of all cases brought forward

ii. Major Revenue Audit Objections (current) 90% of the objections raised upto December 1990 must be replied by 31.3.91.

Regarding (i) above, where a final report has been sent by the Assessing Officer after taking remedial action if called for, the case shall be treated as settled so far as the Assessing Officer is concerned.

**Quarterly Targets**

	Ist qtr.	IIInd qtr.	IIIrd qtr.	IVth qtr.
<b>1. Disposal of Income Tax Asstts.</b>				
<b>a. Scrutiny Asstts.</b>				
i. Category `A'	20	55	90	120 (asstts.)
ii. Category `B'	30	75	120	150 (asstts.)
iii. Category `C'	10	40	70	80 (core asstt.)
iv. Category `D'	10	25	40	50 (core asstt.)
<b>b. Non-scrutiny Disposal         u/s 143(1)(a)</b>				
i. Non-company	100% of brought forward workload	30% of current work- load	70% of current workload	90% of current workload
ii. Company	100% of brought forward workload	-	10% of current workload	70% of current workload
<b>c. Arrear I.T. Demand</b>	15% reduc- tion	30% reduc- tion	45% reduc- tion	60% reduc- tion
<b>d. Current I.T. Demand</b>	85% reduc- tion	85% reduc- tion	85% reduc- tion	85% reduc- tion
<b>e. Major Revenue Audit         Objections</b>				
i. Arrear	30%	60%	100%	-
ii. Current (upto Dec. 90)	-	30%	70%	90%

**Excerpts from The Operational Instructions to the  
Central Action Plan 1990-91**

**C. Selection of Cases for Scrutiny**

1. The selection of cases for scrutiny should be suitably staggered so that returns filed late especially towards the end of the year do not escape selection of scrutiny.
2. the selection of scrutiny cases may be either out of arrear of current returns.
3. Individual Commissioners should lay down the guidelines as to how the selection of cases is to be carried out keeping in view the conditions prevailing in their charges.
4. The Commissioners may take into consideration the following suggestions in regard to selection of scrutiny assessments:

a. *In Salary Cases*

- i. Selection of 80% assessments by September, 1990, out of arrear and current returns file upto 31st August, 1990 (including returns filed prior to 31st March, 1990).
- ii. Selection of balance 20% assessments by January 1991 out of returns filed upto 31st December, 1990.
- iii. Selection out of returns filed from January to March 1991 may be done in April next year so that unnecessary pendency of scrutiny assessments is not carried forward at the end of the year. At the same time, the returns filed in the last quarter of the year will not escape selection. There may however, be no bar to selection of cases out of returns filed from January to March if these assessments can be completed by 31st March.

b. *In Non-company Case (Other than salary)*

- i. Selection of 50% of assessments by 30th September out of arrear and current returns file upto 31st August 1990 (including returns filed prior to 31st March, 1990).
- ii. Selection of balance 50% assessments by 31st January, 1991 out of returns filed upto 31st December, 1990.
- iii. Selection out of returns filed from January to March 1991 may be done in April next year so that unnecessary pendency of scrutiny assessments is not carried forward at the end of the year. At the same time, returns filed in the last quarter of the year will not escape selection/

There may, however, be no bar to selection of cases out of returns file from January to March if the assessments can be completed by 31st March.

c. *In Company Cases*

- i. Selection of 90% assessments by 30th June out of arrear returns filed prior to 31st March, 1990.
- ii. Selection of the balance 10% assessments by 31st January 1991 out of returns filed upto 31st December, 1990.
- iii. Selection out of returns filed from January to March 1991 may be done on April next year so that unnecessary pendency of scrutiny assessment is not carried forward at the end of the year. However, there may be no bar to selection of cases after January 1991 provided the assessments are completed by 31st March, 1991.

- d. Alternatively selection may be done partly on the basis of past record or any information received, without waiting for the current return to be filed and partly on the basis of current returns:

*In non-company Cases (salary and others)*

- i. Selection of 50% assessments by 31st July, 1990 on the basis of past records/information received or returns filed prior to 31st March, 1990.
- ii. Selection of further 25% assessments by September 1990 out of returns filed upto 31st August, 1990.
- iii. Selection of balance 25% assessments by 31st January, 1991 out of returns filed upto 31st December, 1990.
- iv. Selection out of returns filed from January to March 1991 may be done in April next year so that unnecessary pendency of scrutiny assessments is not carried forward at the end of the year. At the same time the returns filed in the last quarter of the year will not escape selection.

*In Company Cases*

- i. Selection of 90% assessments by 31st July, 1990 on the basis of returns filed prior to 31st March, 1990 or past records or any information received.
- ii. Selection of the balance 10% assessments by 31st January out of returns filed upto 31st December, 1990.
- iii. Selection out of returns filed from January to March 1991 may be done in April next year to avoid unnecessary pendency being carried forward at the end of the year. At the same time returns filed in the last quarter will not escape selection.

- c. However, while following the suggestion of (d) above (i.e. pre-selection without waiting for the returns to be filed) the selection may have to be kept confidential lest such assessee choose not to file their returns.

It is emphasised again that the above procedure is only suggestive. The Commissioners have full discretion to lay down the guidelines in this regard.

5. To facilitate the process of selection some data base on the basis of past record may be prepared.
6. The Assessing Officers should not normally select assessments for scrutiny in excess of the quota fixed as per Para B-5 above.
7. The assessments shall be picked up for scrutiny on the basis of error/evasion/concealment potential.
8. Some of the criteria which may be kept in view while selecting assessments for scrutiny are given below. These criteria listed below are only illustrative and not exhaustive:
  - i. Low gross profit/decline in gross profit/turnover
  - ii. Adverse points in the past history of the case, including existence of material points on which the assessee or the Department is in appeal/reference in earlier year.
  - iii. Specified outside information e.g.
    - a. Complaints of tax evasion.
    - b. Local enquiries/survey reports u/s 133B/CIB reports.
    - c. Surveys u/s 133A or cases having potential for such surveys.
  - iv. Existence of qualification in Auditors Report including Compulsory Tax Audit Report u/s 44AB.
  - v. Industries/Trades making abnormal profits in the accounting year (CITs should obtain information about such industries/trades and pass on to the Assessing Officers).
  - vi. Inadequate incomes declared in the past as compared to wealth.
  - vii. Claims of material inadmissible deductions, or exemptions which cannot be disallowed u/s 143(1)(a), or exempted incomes (e.g., abnormal increase in agricultural income).
  - viii. Large scale investments or increase in assets or increase in loan liabilities (e.g., cash credits, investment in properties etc.).
  - ix. Expansion in cases belonging to one group.
  - x. Abnormally low withdrawals for household expenses over a period of years.
  - xi. Personal knowledge (reduced to writing by the assessing authority).
  - xii. Inordinate delay in filing the return.

- xiii. Assessments where notice u/s 147 or 139(2)/142(1) have been issued.
- xiv. Arrear assessments where investigation so far conducted indicates possibility of establishing concealment.
- xv. Cases where the size of the turnover is suspect with reference to the available working capital.
- xvi. Cases recommended for scrutiny by the Investigation Wing.

It is emphasised once again that the selection criteria listed above is only illustrative. CITs are at liberty to add to the selection criteria. For example, new cases, cases where gifts have been received year after year, cases where returns have been filed on estimated income year after year, cases with Major Audit Objections, cases where major defects were noticed during inspections, cases showing losses year after year, substantial investments by persons in new shares or debentures floated by companies, net wealth of taxpayer exceeding, say Rs 50 lakhs etc., may be picked up for scrutiny depending upon the local conditions. The ultimate criteria for selection, however, should be potential for investigation.

- 9. A case which was selected for scrutiny last year but resulted in no additions should not ordinarily be picked up again this year unless there are special reasons for the same.
- 10. The emphasis should be on the scrutiny of cases with higher revenue potential. Therefore, 50% of the quota in Categories A, B & C should be selected out of the top 75 to 100 cases. The top cases are to be determined on the basis of the assessed income or the income declared in any pending return, whichever is higher.
- 11. In all cases the reasons for identifying the cases for scrutiny should be recorded in writing.
- 12. i. The assessments picked up for scrutiny by the ACs and ITOs shall be approved by the Range DC.  
ii. The assessments picked up for scrutiny by the DCs(Asstt.) shall be approved by the CIT.
- 13. A higher number of potential assessments should be initially selected for scrutiny by the Assessing Officers so that the DCs/CITs have a wider range of cases to select from.
- 14. The potential cases should be sent in convenient batches for the approval of DC/CIT to enable them to select cases after due application of mind.
- 15. The DCs/CITs should carry out a random check of the balance returns/cases (other than the potential assessments initially selected for scrutiny) to see whether by worthwhile case has been left out from the scrutiny basket. The percentage of random check (say 5% - 20%) may be fixed by the CIT.
- 16. The process of selection of cases for scrutiny should be closely monitored by the Range DCs/CITs in view of the limited period available within which notice u/s 143(2) can be issued under the new law.

17. A register of cases selected for scrutiny should be maintained by each Assessing Officer in the format suggested in Annexure-III. This register should be periodically inspected by Supervisory Officers.

**D. Rectification Applications Against Prima Facie Adjustments**

1. No rectification application shall remain pending for more than two months. All such applications received upto end of January 1991 shall be disposed of by end of March 1991.
2. The Register of rectification applications should be maintained in two parts:
  - i. For applications against prima facie adjustments u/s 143(1)(a).
  - ii. For other rectification applications.
3. The Range DCs and Commissioners should carry out periodically inspections of this register to see that all such applications are properly accounted for in this register, the total number tallies with the statistics furnished in the CAP-II statement, and, necessary action is being taken.

**E. Major Revenue Audit Objections**

1. All major arrear audit objections (revenue) must be got settled during the year.
2. Where the Assessing Officer has sent the final report, after taking remedial action, if called for, the case shall be treated as settled so far as the Assessing Officer is concerned.
3. In respect of major current audit objections (revenue) raised upto December 1990, replies must be sent by the Assessing officers by 31st March, 1990.
4. The Range DCs and Commissioners should carry out periodical inspections of Registers of Major Revenue Audit Objections. The number of Audit Objections as per these Registers should tally with the number of objections pending with DCs(Audit).

**A Review of Official Evaluations of the Working  
of the Income Tax Department<sup>2</sup>**

**1. Manpower and Workload Problems**

**i. Pendency of Assessments**

Public Accounts Committees (PACs) of various Lok Sabhas have repeatedly drawn attention to the low rate of disposal of assessment cases. Figures relating to yearwise position of pendency of income tax assessments published in the Report of the Comptroller and Auditor General of India, show a high level of pendency of income tax assessments. It has also been observed that there have been delays in the settlement of internal and statutory audit objections, in the issue of refund orders, in giving effect to appellate orders, mistakes in assessment - and many other such manifestations of inefficiency. One of the explanations given by the Ministry of Finance for these problems has been that the Income Tax Department has a high workload and that the manpower available to deal with this workload is inadequate<sup>3</sup>. This has not been accepted by the Public Accounts Committees as an adequate explanation. As early as in 1980-81 the PAC had noted that "for the purpose of collection of revenue, adequate and efficient staff is sine qua non and therefore an evaluation is immediately necessary to make the working of the Department more efficient". However, despite subsequent measures to reduce pendency like enlarging the scope of the summary assessment scheme and a substantial increase in staff strength, it was observed that the number of pending assessments had not been brought down, as is shown in Table A2.

It has therefore been recommended by PACs that norms of work for the Income Tax Department should be set on a more realistic basis.

**ii. Audit objections**

In their 150th Report (1988-89) the PAC remarked, with reference to heavy outstandings in the settlement of internal and statutory audit objections, that

"The Committee are unable to comprehend how the creation of additional posts in the Internal Audit Wing can solve the problem of delay in the settlement of outstanding audit objections. The

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2. This Appendix has been written by Radhika Lahiri.

3. PAC (1989-90).

Committee recommend that the utility of creation of additional posts for the settlement of outstanding audit objections may be reviewed to ensure that creation of these posts is fully justified".

"There are in all 2262 Assessing Officers functioning in the country and the number of recorded outstanding objections is of the order of 134 lakhs. Thus on the average, the number of outstanding cases per assessing officer is about 60. In this context the Committee are of the opinion that if all the assessing officers make earnest efforts to clear the outstanding objections, the number of outstanding audit objections can be brought down substantially within a short time".

The Report of the Comptroller and Auditor General of India (CAG) for the year ending 31st March 1990 gives the following information regarding internal and statutory audit objections:

**a. Internal audit:** According to information furnished by the Directorate of Inspection (Income Tax and Audit) of the Income Tax Department to the CAG the number of major objections (with tax effect of Rs 10,000 and above under the income tax and Rs 1000 and above under other direct tax laws) of the internal audit disposed off during the four year period 1986-87 to 1989-90 and the number pending at the end of these years are in Table A3.

**b. Statutory audit:** Table A4 shows yearwise particulars of pendency of objections as compared to the position on 31st March, 1989.

### **iii. Valuation cell**

The PAC (1977-78) also found the claim of inadequacy of staff strength in the valuation cell inconsistent with the fact that some of its staff was diverted by the Department and put on an entirely different type of work, the survey of posh localities.

### **iv. Refunds**

With reference to delays in issues of refund vouchers, the PAC (1986-87) stressed that it was "imperative to streamline the functioning of the income tax wards/circles to intensify inspection by Commissioners of Income Tax and to award suitable deterrent punishment to erring officials". The Committee also pointed out that in a review undertaken of refunds made during the three years from 1980-81 to 1982-83 in selected wards of certain charges, it was found that refunds amounting to Rs 284.59 lakhs in respect of 4133 refund vouchers were authorised after delays ranging from 6 months to more than three years.

Also, despite recommendations of PACs and the recommendations of the Estimates Committee (in its Twenty Ninth Report, 1981-82), the system of payment of refunds in the Income Tax Department continued to be dilatory and inefficient. The Committee was again unable to accept the "acute shortage of staff" as an adequate explanation.

Information on outstanding direct refund claims as on 31 March, 1990 is in Table A5.

#### **v. Scrutiny and summary assessment**

In its 173rd Report, the PAC (1989-90) of the Eighth Lok Sabha observed that the average number of cases handled under scrutiny was about 1500 by each assessing officer. The committee was not convinced by the stand of the Ministry that an assessing officer is capable of doing only 100 scrutiny cases, and that the remaining cases had to be taken under the summary assessment scheme without any scrutiny. Furthermore, the Committee did not agree with the claim that to conduct scrutiny in all cases as many as 70,000 assessing officers would be needed. It was reiterated that a work study team of the Department of Personnel should be entrusted with an objective study on the workload of assessing officers to be based on an actual watch on performance and the expected turnover of assisting staff in order to estimate requirements of staff. The Committee was also surprised to note a decrease in staff from 2764 assessing officers in 1980-81 to 2717 in 1987-88, this information being furnished by the Ministry (Table A6).

#### **vi. Training and incentives**

As far as mistakes in assessment detected by revenue audit/ internal audit are concerned, the PAC (1977-78), had recommended strengthening of training arrangements and computerisation in the Department as remedies.

The National Academy of Direct Taxes (NADT) at Nagpur and four Regional Training Institutes have been set up at Bombay, Calcutta, Bangalore and Lucknow to train the officers and staff of the Income Tax Department. According to the Annual Reports of the Ministry of Finance, the NADT has organised several programmes both at Nagpur and at the four regional institutes in order to utilise existing training resources optimally. There has been an attempt to suitably equip officers and staff for effective supervision/operation of computer centres with a view to realigning the administrative set up with computerisation.<sup>4</sup>

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4. Ministry of Finance (1988).

Incentive schemes for officers and staff of the income tax department are not discussed very frequently in the PAC reports.

In its Thirty-Fourth Report (1980-81), the Public Accounts Committee remarked:

"As a result of the Public Accounts Committees' recommendation to improve the performance of assessment work and in order to encourage the ITOs to give their best, an incentive scheme for quality work in assessment has been introduced from 1st April, 1976. The scheme contemplates 20 cash awards, 8 of Rs 2000 each, 12 of Rs 1000 each to be given annually to the assessing officers whose assessments are rated to be the best of the year.

"The incentive scheme designed to encourage the ITOs to give their best does not appear to have enthused the department. According to the Ministry, the reason perhaps is that the ITOs are afraid that mistakes might be detected during inspection by Inspecting Assistant Commissioners or during scrutiny by Internal Audit. Since the reason for introduction of the scheme is precisely to encourage quality work, it is difficult to see what other criteria could be introduced and indeed how a really competent and conscientious officer could feel discouraged or hesitant to meet the required stipulations. In any case, there is need for reviewing the whole matter".

## **2. Assessment Procedure**

The general policy of the government with respect to direct tax assessment procedures has been to encourage voluntary compliance by taxpayers. The summary assessment scheme was instituted in 1971 in order to fulfill this objective. The procedure, broadly described, entailed an assessment of income returned by taxpayers in a summary manner by carrying out only routine adjustments such as correcting arithmetical errors and allowing certain 'prima facie adjustments' to be made. There is also a provision for the assignment of important assessments to senior officers of the department. Apart from this the Central Board of Direct Taxes is authorised to issue instructions as to the kind of cases to be decided under the summary assessment procedure and the cases that are to be assessed by senior officers. The Central Board of Direct Taxes (CBDT) has also prescribed a sample scrutiny of 5% of the cases decided under the summary assessment, in order to ensure that the summary assessment procedure was not abused. The objective of the scheme was to ensure speedy disposal of assessments in the face of limited manpower resources of the department.

The PACs have reviewed these provisions from time to time in order to assess whether the objectives for which they were instituted had been achieved. The reports of the Comptroller and Auditor General of India and of the Public Accounts Committees have not taken a favourable view of the level of efficiency of the department; it is generally held by them that the summary assessment scheme has failed to bring about the desired level of efficiency in terms of a decline in the pendency of tax assessments.

A comparison of remarks made by the Public Accounts Committee at two different points of time serves to illustrate that there has been no appreciable change over the years in the view regarding the effectiveness of the summary assessment scheme. Ten years after the institution of the scheme, the PAC (34th Report, 1980-81) noted that "the number of summary assessments completed during 1978-79 registered a decrease of 9 lakhs over the previous 6 years. As compared to the Action Plan target of Rs 26.40 lakhs the performance fell short by over 21 per cent. The disposal of scrutiny assessments during the year 1978-79 is also far below the prescribed targets. The main rationale of the summary assessment scheme was to utilise the manpower saved to make detailed investigations in all the cases left for scrutiny. This objective has not been pursued." It was suggested that "since the scheme has been in operation for over 10 years, an overall evaluation of the scheme may be made with a view to finding out how far it has succeeded in expediting the disposal of cases, reducing the cost of collection, saving in manpower etc.". In 1989-90 the PAC (173rd Report) remarked: "The Committee are deeply concerned to note that despite subsequent relaxations made in the treatment of assessment cases as summary assessments whereby over 97 per cent of cases are stated to be covered under the summary scheme, the pendency of assessments which was 12.56 lakh cases in 1984-85 has only marginally come down to 11.08 lakh cases in 1987-88..... a relook into the effectiveness of the scheme may be conducted, preferably by reputed experts in the field including economists (but not by the concerned Ministry/CBDT)".

The CBDT has substantially revised its instructions from time to time so that the primary objective of the summary assessment scheme - reducing the pendency of assessments - may be achieved. In its review of the assessment procedure the Report of the Comptroller and Auditor General of India (1987) observed that the CBDT revised instructions regarding the summary assessment procedure in June 1984 and May 1985 "and brought within its fold company cases with higher income/loss upto Rs 25000, all trust cases and cases where, prima facie, incorrect deductions and exemptions were claimed and even first assessment cases, with certain exceptions". The instructions also

directed the officers to link returns with assessment records. Assessing officers were authorised to check only the arithmetical accuracy of computation of total income and taxes and liability of penalty interest etc. Barring these no other checking of any sort would be necessary.

In July 1986, the Central Board of Direct Taxes issued instructions that assessments completed under the summary assessment scheme could not be reopened to verify the completeness or correctness of a return or to correct obvious mistakes on the basis of returns of previous years. The Audit Review concluded that these liberalisations in the assessment procedure "had not led to any appreciable reduction in the pendency of summary assessment cases".

The following observation regarding CBDT instructions was made in Chapter III of the Report of the CAG for the year ending 31 March, 1987.

"These instructions of the Board led the assessing officers to treat the summary assessment cases in a routine manner and to accept the incomes as returned without any check. This also encouraged a large number of assessees to resort to tax evasion by deliberate understatement of income.

The types and extent of irregularities noticed during test audit revealed that the omissions were, by and large, apparent from records or deliberate understatements by assessees taking advantage of the scheme and could have been corrected by reference to the return and the accompanying documents. The Income tax Act also provided for adequate remedial safeguards to set right such omissions. The instructions of the Board of July 1986 were, apparently not consistent with the provisions of the Act as they frustrated any possible retrieval of revenue"

The Public Accounts Committee (1989-90) also expressed disapproval of the CBDT instruction of May 1985 and July 1986. The Committee felt that the May 1985 instructions had eroded the powers of assessing officers considerably, apart from being "at variance with the spirit and letter of legal provisions". It further recommended that action be taken against those responsible for the issue of such instructions and that "all such instructions which are inconsistent with law must be withdrawn forthwith and should be netted by the Ministry of Law before issue".

The instructions issued by the CBDT have enlarged the scope of the summary assessment scheme with the result that accumulated arrears of assessment under scrutiny have come under the summary assessment scheme. The PAC pointed out that, because of this practice, the treatment of assessees of the same assessment year has

not been uniform - it was with reference to the operative instructions at the time a particular assessment is taken up. It was suggested that "a consistent set of instructions must apply for all cases relating to a particular assessment year, irrespective of the data on which the assessment is taken up by the assessing authority for examination and that it would not be proper to modify the instructions during the course of an assessment year".

### 3. Internal Audit

The audit review of the efficiency and effectiveness of Internal Audit<sup>5</sup> revealed various deficiencies in the procedures followed, record keeping, follow up action on statutory audit objection, etc. To ensure that no auditable case is unchecked by Internal Audit the procedure requires the Commissioners of Income Tax to obtain the list of priority cases and forward it to the Deputy Commissioner (Audit) within 15 days of the end of the month of assessment. The audit parties then independently verify the correctness of the list with reference to the Demand and Collection Register before commencement of Audit. However, the test check conducted by audit revealed that the procedure of timely finishing of a list of auditable cases was not followed - and this omission hadn't even been pointed out by the Internal Audit Parties. In cases where lists were finished, the internal audit parties did not tally them with the assessment registers to verify their accuracy leading to the omission of important cases.

The test check also revealed the "absence of systematic planning, inadequate programming of audit, lack of coordination with Receipt Audit, omission to assess the workload properly, random selection of wards and omission in conducting audit of many important wards/circles and auditable cases apart from considerable delays in taking up important audits, and the non-achievement of prescribed targets".

Even in the case of immediate and priority cases, there were delays in the conducting of Internal Audit leading to a bunching of Internal and Receipt Audits. The Audit Review pointed out that "neither the monthly quota nor the annual targets fixed were reached and the periodicity of audit was not maintained on an annual basis in many charges".

Internal audit parties are expected to draw up a Local Audit Report in the same pattern as Receipt Audits, Local Audit Report, the emphasis being on the most vulnerable areas where mistakes have generally occurred and their revenue implications, interesting

audit objections for the information and guidance of assessing officers, typical mistakes that occur year after year. In addition ITOs and Internal Audit Parties are to maintain Control Registers. The data included in Control Registers is to be reconciled with the entries in the registers of field offices periodically. It was found that Internal Audit Reports were generally not issued - nor were Control Registers properly maintained - if maintained at all. Regarding the maintenance of Control Registers the Audit Review made the following statement:

"A number of control registers have been presented to organise, watch the monitoring and control the programming of audit, of the auditable cases and of audit objections. While the test check brought out many cases of non-maintenance of the prescribed registers, many omissions were also noticed in the registers wherever maintained. The need for maintaining such a large number of registers, and revising their format to make them compact may require detailed analysis by the Department".

It was also observed that there were delays in remedial action on audit objections, mistakes in assessment pointed out by statutory audit after completion of internal audit, delays in completing or raising internal audit objections.

As per the 'Internal Audit Manual', internal audit parties are required to ensure that procedures and terms presented by the Income Tax Department are satisfactory and adequate. The test check conducted by statutory audit, however revealed that "internal audit had not so far undertaken any system audit of the departmental procedures and practices".

#### **4. Drafting of Tax Laws**

There is a considerable body of literature on delays and loss of revenue caused due to complexities in tax laws<sup>6</sup>. The procedures involved have been found to be far too complex and tend to slow down the assessment and collection of taxes. There also exist problems relating to legislative drafting, leading to misinterpretation of the relevant law by the authorities concerned.

Various reports of the PAC have drawn attention to the problems arising on account of complexities in tax laws. In their 136th Report (1987-88) the Public

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6. See, for example, PAC Reports, listed in the references of the following years: 1977-78, 1978-79, 1980-81, 1982-83, 1983-84, 1986-87 and 1987-88.

Accounts Committee discuss a case where the lack of suitable definition for the term 'Industrial Undertaking' led to confusion regarding the interpretation of the relevant law:

"There are several provisions (section 32, 32A, 33B, 80HH, 80HHA, 80I, 80J, 280ZA) in the Income Tax Act, 1961 containing the term 'Industrial Undertaking' which is nowhere defined except for the purposes of section 33B. The absence of the expression in the Income Tax Act, 1961, has given rise to doubts as to its real connotation in the context of section 10(15)(iv)(c). What had added to the confusion was the meaning given to the term in the Industries (Development and Regulation) Act, 1951 and the classification of 'shipping' in the seventh schedule to the Constitution of India where it appears under Entry 30 - 'Carriage of goods and passengers by rail sea or air or by natural waterways in mechanically propelled vessels and not under Entry 52 'Industries'... Section 10(15)(iv)(c) of the Income Tax Act, 1961 is one of the very important provisions of the Act and the slightest misinterpretation thereof may lead to loss of considerable amounts of revenue to the exchequer because foreign lenders are involved. The Committee feel that such a term should not be left undefined".

Reviewing the findings of the Economic Administration Reforms Commission (1981-83) (EARC), the Committee observed that the EARC did not find uniformity in the definitions given, language used and terms appearing in the Direct Tax Laws. Even within the same statute, the same term had different meanings for different purposes, while different words were used in different sections, even though meant to convey the same sense. In view of the fact that a greater measure of uniformity would make the law more intelligible and less prone to distortions in interpretation and consequent litigation, the Commission recommended that a common code of definitions and procedures applicable to the administration of all direct taxes should be evolved except where the special purpose of a particular Act or provision warranted a departure. The PAC felt that prompt action should be taken to implement the recommendations of the EARC.

Problems with legislative drafting have also been pointed out by the PAC in their 75th Report (1981-82) with reference to tax relief for newly established undertakings.

Complexities in tax laws relating to valuation of properties have been frequently discussed in various PAC Reports<sup>7</sup>. The PAC concluded in their 211th Report

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7. PAC 1981-82, 1983-84, 1987-88.

(1983-84) that "the multitude of legal provisions, modes of valuation and valuation authorities in the valuation of some properties has created a situation where property taxes have become a matter of great harassment as well as abuse. In the circumstances, the Committee reiterate their entire views that the only solution to overcome this problem is to set up an autonomous valuation authority for the valuation of some properties, which could apply a common principle of valuation and determine objectively the values of all real estate properties at least in the urban centres of the country". The PAC again reiterated these observations in its 116th Report (1987-88).

Table A2

Financial year	No. of assessments for disposal (in thousands)			No. of assessments pending at the end of the year (in thousands)		
	Scrutiny	Summary	Total	Scrutiny	Summary	Total
1983-84			6892.8			2081.0
1984-85			6644.9			1255.7
1985-86	754.5	6313.7	7068.2	292.9	858.3	1151.3
1986-87	632.4	7883.0	8515.4	246.7	1212.6	1459.4
1987-88	529.8	7043.6	7573.3	188.2	919.6	1107.7
1988-89	431.3	6695.3	7126.7	138.5	814.8	953.4
1989-90	432.1	6251.2	6683.3	143.7	1030.6	1174.3

\* Provisional. Sources: 1. Report of the Comptroller and Auditor General of India for the year ending 31st March, 1988, No. 6 of 1989, Union Government (Revenue Receipts - Direct Taxes).  
2. Report of the Comptroller and Auditor General of India for the year ending 31st March, 1990, No. 5 of 1991, Union Government (Revenue Receipts - Direct Taxes).

Table A3

Financial year	No. of cases for disposal and amount (Rs crores)	No. of cases disposed and amount (Rs crores)	Percentage of total no. of cases for disposal	No. of pending cases and amount
				(Rs crores)
1986-87	15666	5514	35	10152
	414.44	94.46	21	319.98
1987-88	18284	7189	39	11095
	451.22	234.49	52	216.73
1988-89	18840	7974	42	10866
	411.75	200.89	49	210.86
1989-90	18528	8907	48	9671
	479.25	156.39	33	322.86

Source: Report of the Comptroller and Auditor General of India for the year ending 31st March, 1990 No. 5 of 1991, Union Government (Revenue Receipts - Direct Taxes).

Table A4

Year	Income tax		Other direct taxes*		Total	
	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
Upto 1986-87 and earlier years	36295 (48334)	167.52 (211.76)	8500 (10241)	30.47 (33.64)	44795 (58575)	197.9 (245.4)
1987-88	7535 (9985)	137.18 (172.02)	1729 (2359)	9.46 (10.69)	9264 (12344)	146.64 (182.71)
1988-89	9911	247.3	1836	7.76	11747	255.06
Total	53741 (58319)	552.00 (383.78)	12065 (12600)	47.69 (44.33)	65806 (70919)	599.69 (428.11)

- Notes: i. The figures do not include the position of Jammu & Kashmir circle.  
 ii. The figures in brackets indicate the position as on 31st March, 1989.

Source: As for Table A7.

Table A5

Financial year in which application was made	No. of cases pending*
1985-86 and earlier years	45
1986-87	36
1987-88	22
1988-89	511
1989-90	13876
Total	14490**

- \* Figures furnished by the Ministry of Finance and provisional. Source: Report of the Comptroller and Auditor General of India for the year ending 31 March, 1990, No.5 of 1991 Union Govt. (Reserve Receipts - Direct Taxes).
- \*\* Figures are under reconciliation by the Ministry of Finance.

Table A6

Year	Total assess- ments for dis- posal (in lakhs)	No. of officers available for assessment work
1970-71	47.31	2311
1971-72	49.68	2182
1972-73	49.90	2150
1975-76	57.34	2484
1980-81	65.91	2754
1981-82	72.07	2818
1986-87	85.15	2506
1987-88	75.73	2717

Source: PAC, Eighth Lok Sabha,  
173rd Report.

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Proforma Used in Range E, Jaipur

Strictly Confidential

Proforma for Selection of Cases for Scrutiny

- Imp. 1. To be filled in by Assessing Officer only with 100% accuracy at the time of processing the return u/s 143(1)(a).
2. In salary cases column 11 only be filled up elaborately.
3. DC (Spl. Ranges)/Assessing Officers dealing with Company cases may add further information considered necessary.
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1. Serial No. \_\_\_\_\_ (same as 2. Permanent Account No. \_\_\_\_\_ in the return Receipt Register).
3. Name of the assessee : \_\_\_\_\_
4. Nature of business : \_\_\_\_\_
5. Assessment year for which scrutiny proposed : \_\_\_\_\_
6. Date of receipt of return and income declared :

Date

Income declared

7. Data necessary for scrutiny:

- a. Turnover, Rs \_\_\_\_\_ b. Commission or other incomes etc., credited to Trading account Rs \_\_\_\_\_  
Last year Rs \_\_\_\_\_
- c. Gross profit (Amount & percentage) Rs \_\_\_\_\_ % \_\_\_\_\_  
\* Last year Rs \_\_\_\_\_ % \_\_\_\_\_
- d. Net profit (Amount & percentage) Rs \_\_\_\_\_ % \_\_\_\_\_  
\* Last year Rs \_\_\_\_\_ % \_\_\_\_\_
- e. Any other income credited to P & L a/c: Rs \_\_\_\_\_  
\* Last year Rs \_\_\_\_\_

f. Amount of fresh credits in the balance sheet:

i. Capital a/c Rs \_\_\_\_\_ Nature \_\_\_\_\_

\* Last year Rs \_\_\_\_\_

ii. Loan creditors : Rs \_\_\_\_\_ \* Last year \_\_\_\_\_

g. Any other liabilities: Rs \_\_\_\_\_ \* Last year \_\_\_\_\_  
e.g., contingent liabilities

8. Whether prima-facie adjustments made and date of issue of intimation/refund **Yes/No Date of issue of refund**

9. Reasons for recommending the case for scrutiny (tick the item which are applicable and also mention amounts wherever necessary), such as:--

(i) High turn over and low g.p., and net profit not commensurate with turnover (ii) High Agricultural income

(iii) Large amount of gifts/winning from lotteries. (iv) Items of expenditure apparently excessive.

(v) Heavy fresh loans/large scale investments. (vi) Tax evasion complaints/CIB slips/133A/131 (impounded books) (give extent of enquiry required).

(vii) Cases of tax avoidance/any special device employed for reduction of tax liability (viii) Any other category (Also see instructions of the Board).

(ix) Recurring points on which decisions of Appellate Authority in favour of department.

(x) Habitual late filing of return (giving assessment year and date of filing returns)

Assessment Year

Date of filing of return

\* [Last years figures may be given only in cases recommended for scrutiny or in any other case deemed fit]

(xi) Show marginal income (e.g., Rs 22,200/- earlier Rs 18,100/-, 1,95,000/-, Rs 4,87,000/-)

Assessment Year

Income declared

(xii) Adverse report of auditors u/s 44AB if any.

(xiii) Information about squared up accounts, if any.

10. Whether case selected in earlier years for scrutiny Yes/No

Assessment year (if yes) \_\_\_\_\_

11. Remarks of the Assessing Officer recommending scrutiny.

12. Decision of the DC/CIT (with reasons).

Note:-

(1) This proforma will be filled up by the Assessing Officer and sent to the DC. The DC with his remarks would send it to the Assessing officer. A notice u/s 143 (2) in cases selected for scrutiny would be sent within 2 days of the receipt of this proforma by the Assessing Officer and record of service will be kept. The proforma would be placed in the file and would be available for inspections..

(2) **Examination Notes**

The Assessing Officer will examine in detail the points for which case is selected for scrutiny. Examination would mean collection of all relevant evidence from the assessee and from outside sources, analysis of the evidence, confronting the assessee with tentative conclusion and passing of a speaking order. If the case is selected for verification of loans, and credits, complete name and address. PAN/GIR No., details of cheques/drafts with the names of banks and complete addresses of the loanee will be taken and kept in the file. Some of the credits which may look prima-facie suspicious would be independently verified. The squared up accounts would be like-wise scrutinised in suitable cases. Bank reconciliation statements/net wealth reconciliation may be prepared for verification in important cases. The assessing officer will record an office note regarding points investigated by him in a scrutiny case.

## Appendix 6

### Opinions of Assessing Officers and DCs (Range) Surveyed

#### I. How to improve the Quality of Assessment of Existing Assesseees so as to Uncover Evasion

##### Legal Structure

1. An amendment in IT Act needed for the purpose of referring to Valuation Cell to ascertain cost of construction.
2. Issue of Demand Draft above Rs 20,000/- may be made through cheques instead of the limit prescribed (Rs 50,000) as of now.
3. Any addition made by an officer during scrutiny should be accountable to him and he should be able to defend this before Appellate Authority.
4. In cases of voluntary returns, tax and interest payable should be compulsorily paid in advance. In case of additions, 50 of the tax on disputed quantum should be paid before filing of appeal.
5. All pre-assessments information called for u/s 143(2) or 142(1) or u/s 131 should be submitted within 30 days of receipt of notice failing which non-deletable minimum penalty of Rs 1000 for every working day elapsed be levied. These conditions be incorporated in the Act.
6. The powers vested in IT authorities are much lesser than needed. They do not have any directive power to use police whenever required and most of the time the police is totally useless.
7. Avoid frequent changes in provisions of IT Act, ITRs.
8. AOs be given the power to call any person without mentioning the proceedings in connection with any assessment he is being called for.
9. All assesseees be provided identity card with permanent account numbers. Secondly, it be made compulsory to traders or persons who transact more than Rs 10,000/- to note the permanent account number on bill and all such transactions be reported to income tax department within specific intervals. All transactions in a year by permanent account number holder be known from computer

section. These things will make transactions difficult for those who are not assessed and will make them come forward to pay taxes.

10. 100% deduction u/s 80HHC be reduced to 50%.
11. All expenses/payments above Rs 5,000/- be made payable in crossed account payee cheque or draft.
12. Issuing bogus cheques be made a cognizable offence with maximum imprisonment.
13. Every assessee to open income tax account in the bank like pension account, from which only credit is possible from assessee's side, which will be permanent record of payments by assessee.
14. Section 143(1)(a) should be confined to arithmetical mistakes in calculation of tax and interest only. The prima- facie adjustment as enacted at present section 143(1)(a) will involve the department in endless litigation (DC).
15. The return of all the taxes should be one so that co-ordinated investigation may be done (DC).

#### **Information Related**

1. Survey u/s 133A and search operations u/s 132 be increased.
2. Literature on various business activities, GP rate, tricks of different types of trade etc., to be made available.
3. A list of CIB officers throughout India may be made available to all AOs in order to cross-verify out-station sales and purchases - especially in metros - in scrutiny cases.
4. An advisory panel of Senior Officers of the Department be formed to advice the AOs on complicated matters regarding assessments. The Department to furnish a consolidated list of case laws and Boards circulars/directions to the AO.
5. To bring out statistical data regarding (i) valuation of stock of different articles on the last day of the year i.e., 31st March; (ii) Comparative figures of house hold expenses shown according to different income groups having different numbers of dependents and other relevant factors such as own house/use of car/telephone/education, etc.
6. Administration to arrange group discussion among the AOs in regard to detection of concealment of income.

7. Proper co-ordination between search wings and assessment wings needed.
8. ITOs to report periodically regarding new constructions, functions, marriages etc., in his area.
9. Regular co-ordination meetings between sister departments and information exchanged.
10. Separate survey wing for 2 or 3 wards/circles working in close liaison with the ward/circle/range.
11. Heavy investment in real estates, shares, heavy expenditure on marriages and other functions: All these cases (filers or non filers) to be picked for scrutiny.
12. 45D form be filled in as and when the inspectors visit and not afterwards.
13. Computer software be developed to ascertain at any point of time whether a particular assessee has filed the return for any particular year.
14. Every year the CBDT to publish the booklet containing all the circulars and instructions issued by it (section-wise and subject-wise) and a manual be published containing all the circulars, instruction etc., issued by the Board.
15. Full details of all accounts operated by every person/ assessee be incorporated in income tax returns.
16. Creating a data bank of all the big assessee of each circle/ ward (DC).

#### **Assessment Procedure**

1. Summary assessments be reduced and scrutiny increased.
2. All hearings and/or submissions of information be concluded at least 3 months before the time barring date so as to enable the AO to go through the voluminous material frequently furnished by the assessees. Not to allow the assessees or their representatives any delaying tactics.
3. Frequent transfer of files to be avoided.
4. Present system of selection of cases (largely in accordance with the total income returned) should be done away with.
5. Any case which is error prone and/or in which concealment is suspected be scrutinised.

6. Any addition made by an officer during scrutiny should be accountable to him and he should be able to defend this before Appellate Authority.
7. Search and seizure cases to be assigned to respective Investigation Units.
8. The summary assessment scheme be partly cancelled. Regarding the number of cases and what cases to be picked for scrutiny, to some extent, be left to discretion of A.O.
9. Total turnover can be adopted as a criterion for distribution of cases amongst DCITs/ACITs/ITO in place of returned income.
10. Big groups and sensitive cases be manned in Central Changes and Special Investigation Circles.
11. All cases for a group of assessees (partners, etc) be centralised with one AO.
12. Cases pertaining to same trade be centralised in one ward/circle.
13. No. of files be reduced to 3000 per ITO, 750 to ACs and 250 to DCs in order to have a good control and effective administration.
14. Cases with seizure of greater than Rs 50 lakh be entrusted to DC (Assts.)/DC (Special Range).
15. Cases to remain with one AO for a considerable period of time to enable proper handling of the records.
16. New cases be given to ITOs only and allowed to be scrutinised.
17. Distribution is uneven. ITOs overburdened while ACs and DCs do not have a wide choice to select cases.
18. All cases (besides 2 to 10 lakh returned income) having turnover of Rs 1 crore or more be notified to AC. Also, all new cases to fall within the jurisdiction of AC.
19. In Investigation Circles, number of search assignments not to be more than 50 per year with limited groups.
20. A certain percentage of cases (say 1%) below 2 lakh also should be assessed by the ACs, DCs by rotation.

21. The cases of income/loss exceeding Rs 2 lakh and search and seizure cases not to be handled by ITO. Search and seizure to be exclusively given to DC (Assessment).
22. At appellate stage, especially at CIT(A) level, where the involvement of the amount is high (Rs 5 lakh), the presence of the concerned AO be made compulsory to assist the department.
23. All connected cases of relatives and groups of higher income be centralised in Central Circles. All other cases except company and taxable salary incomes be assessed in territorial wards.
24. Distribution according to territorial jurisdiction and each AO's not to have more than 3000 effective cases.
25. To avoid bogus claims of refunds by contractors, in their case a net profit rate be fixed and made applicable and receipts be taxed accordingly. Similar provision be made in LIC cases also.
26. Avoidance of concentration of high income cases with ACs who do not have adequate field experience and instead entrusting these cases to AOs with adequate experience and proven track record (DC).
27. Frequent change of AC (Investigation) and his inspector to be avoided (DC).
28. In all scrutiny assessments, before the scrutiny assessments are concluded, a survey be conducted u/s 133A and stock inventory, list of books of accounts and other documents found at the place of business be made (DC).
29. The summary processing of returns u/s 143(1)(a) is done in bulk and constant effort is made to meet the Action Plan target. Shortage of staff, space and other constraints makes the problem much more acute. Action Plan targets need to be made more realistic as adjustments u/s 143(1)(a) requires detailed scrutiny of return and accounts furnished by assessee (DC).
30. The scheme of section 143(1)(a) have generated lots of additional workload in the department and hardship on the assesseees. Instead, it is suggested that the assessee is either to be trusted and do assessment u/s 143(1) accepting the return and/or thereafter take up the case for scrutiny and make assessment u/s 143(3) hearing the assessee and quantify the income after scrutiny of the assesseees claim for reliefs and deductions and calculate the tax thereon. This will eliminate the cumbersome procedure of

resorting to Section 154 and thereafter appeal and revision by CIT and tax calculation again and again for the same assessment year for the same assessee, especially in view of the great difficulty/controversy in deciding whether the case is prima-facie admissible or not. Also, the operation of section 143(1)(a) requires processing the returns after linking with past records which the staff are not doing normally (DC).

31. No. of files per ITO should not be more than 2500. Also, processing should be done only after linking with records (DC).
32. Quota fixed for summary assessments by Action Plan for ITO/ACs and also the target for 1991-92 is too excessive. The quotas for summary assessment should be reduced by about 50% of what is laid down in Action Plan for quality scrutiny assessment to be possible (DC).
33. In the Action Plan for 1990-91, restricted discretion is left to ITO or DCIT to select cases for scrutiny but the bulk of selection will be income based, as this is the soft option left to ITOs/ACITs. Not many cases will be selected on other grounds. In fact, in case of higher income there may not be any scope for addition but in a case where the income is shown just above the taxable limit there may be evasion. More discretion should be given to ITOs/ACs to select the cases, (though there could possibly be cases of abuse of such powers) and give them a chance to prove their mettle (DC).
34. ACs should not be confined to higher income cases only for these cases might require experiences which they lacked for scrutiny. ITOs also to be allowed to handle such cases, depending on their experience. No distinction to be kept between ACs or ITOs in this regard. Fresh ACs should handle both lower and higher income groups in their first few years (DC).
35. The upward and downward movement of files, every year can be taken advantage of by an assessee by manipulating in such a way that this file goes away from ITO to AC or AC to ITO and in the process take away the jurisdiction of the AO who is investigating the case (DC).
36. Instead of just monitoring the particular quota of assessments made by ITOs, the DCIT or CIT should involve themselves with the cases, so that they can pass the assessment orders themselves instead of issuing orders, instructions regarding ways to assess (DC).

### **Staff Position**

1. Sufficient and well trained staff be posted.
2. Inspectors be given adequate conveyance allowance and one peon to accompany while on field duty.
3. One extra Inspector be posted in ward solely for enquiry purposes.
4. Corresponding increase in staff to match the increase in workload.
5. The summary processing of returns u/s 143(1)(a) is done in bulk and constant effort is made to meet the Action Plan target. Shortage of staff, space and other constraints makes the problem much more acute. Action Plan targets need to be made more realistic as adjustments u/s 143(1)(a) requires detailed scrutiny of return and accounts furnished by assessee (DC).
6. Shortage of stenographers and their preoccupation with miscellaneous work as well as lack of compliance and delaying tactics of tax payers comes in the way of better scrutiny results (DC).

### **Manpower Related**

1. Frequent transfers and posting be avoided.
2. Special pay by way of incentive to ACs/staff in Investigation Circles.

### **Infrastructural Facilities**

1. Inspectors be given adequate conveyance allowance and one peon to accompany while on field duty.
2. Independent phone facilities to AOs.
3. Accurate maps in respect of each assessing authority's jurisdiction be made available.
4. Adequate transport and communication facilities to AOs to conduct on spot enquiry or conduct survey in their respective jurisdictions periodically.
5. Computer software be developed to ascertain at any point of time whether a particular assessee has filed the return for any particular year.
6. Better working conditions in terms of more space, availability of stationary in time, sufficient forms, transport facilities etc.

7. The summary processing of returns u/s 143(1)(a) is done in bulk and constant effort is made to meet the Action Plan target. Shortage of staff, space and other constraints makes the problem much more acute. Action Plan targets need to be made more realistic as adjustments u/s 143(1)(a) requires detailed scrutiny of return and accounts furnished by assessee (DC).

#### **Training Related**

1. Periodical training/updating courses to be organised to tell processing scrutiny cases.
2. Update training in Training Institutes to all officers and staff in field offices, irrespective of age.
3. Initial training for IRS Officers at NADT be more practically oriented. On the job training be incorporated compulsorily in their training schedule.
4. Suitable training in examination of accounts and scrutiny of statements, marshalling of evidence supporting addition by adequate reasons and materials and drafting of orders should be given to field officers, not in abstract way but with illustrations and live examples (DC).

#### **Miscellaneous**

1. Correct jurisdiction of each assessing authority be made available at each counter where returns are submitted.
2. The present reward system be liberalised and made more practicable and workable to encourage AOs to work harder. Also, recognition of outstanding work done.
3. Posting of ITO and AC with DC (Special Range) be withdrawn and more than one Inspector be posted.
4. ITOs not to be changed/transferred before 3 years.
5. Separate survey wing for 2 or 3 wards/circles working in close liaison with the ward/circle/range.
6. Spot assessments be introduced. The field officers to camp in business areas and complete assessments there and then by
7. Proper co-ordination of AOs of Assessment Wards and CIB Wards. booking new cases.
8. Board should avoid issuing instructions too often.

9. Lesser stress on prosecutions.
10. Formation of protection force within the department itself to avoid frequent untoward/ugly incidents during the survey and search action.
11. Appeals involving large sums (say more than Rs 5 lakh) should be expeditiously taken up and decided (say within 3 months of their being filed). Thereafter the confirmed demand should be vigorously followed up, even by resorting to coercive action (DC).
12. The Income Tax Inspectors to be entrusted only with the work of survey, enquiry, recovery and gathering market intelligence and not be used to draft reports, audit objections, draft report on revision petitions and prepare dossier reports etc (DC).

**II. Main Sections of IT Act, ITRs, Board Directions or Practical Difficulties which Hinder Quality Assessment**

1. Rule 6DD and u/s 44AC, 37(2)(a) and 42(2) etc.
2. Board's instruction issued in September, 1990 which directs payment u/s 43B without proof, to be considered as not a mistake apparent from record, has resulted applications u/s 154 in many cases. This need to be altered.
3. Delay in centralisation of cases and notifying the cases to one particular officer because of change of charges.
4. To plug the loopholes clarify the misinterpretations of Section 80HHC and Section 54F.

**III. How to Expand the Number of Assesseees?**

**Information Related**

1. Surveys in territorial jurisdiction made the responsibilities of the territorial AOs and they be provided with more man-power. In this way, immediately after survey, the AO can initiate assessment proceedings (DC).
2. Door-to-door survey as in the past of the business premises in important localities be authorised and done by Inspectors or a squad of inspectors. They be authorised to go through the account books, take extract from account books, check the cash, check the stock if possible and give their report as to whether the assessee can be enlisted as new assessee or not (DC).

## **Staff Position**

1. Surveys in territorial jurisdiction made the responsibilities of the territorial AOs and they be provided with more man-power. In this way, immediately after survey, the AO can initiate assessment proceedings (DC).

### **IV. Tasks Which can be Delegated to Inspectors in the Assessing Officer's Opinion**

	<u>Number of AOs making the suggestion</u>
1. Summary assessment	22
2. Collection and recovery of tax	18
3. Processing of Penalties	14
4. Giving appeals effect	11
5. Rectifications	11
6. Processing of material sent by the Investigation Wing (e.g, CIB, survey reports)	10
7. Process of audit objections	9
8. Assessment of taxes other than Income tax	8
9. Processing of appeals and references	5
10. Reporting/statistical requirements	5
11. Processing of prosecution cases	5

- Notes: 1. Total number of Assessing Officers Surveyed : 49
2. Delegation implies that legal powers and primary responsibility be given to Inspectors. AOs would then only have supervisory responsibility.











Appendix 8

<b>TCMP Individual Audit Evaluation Document - 1976</b>				2. Occupation Code		Data Center Use	
1. Taxpayer				3. Method Used to Examine Return		Office Audit	
						Field Audit	Office
				Assigned	(1)	(3)	(5)
				Closed	(2)	(4)	(6)
<b>PART I - TCMP RELATED DATA</b>							
4. TCMP Return Prepared By	(1) <input type="checkbox"/> No Assistance	Unpaid Assistance	(2) <input type="checkbox"/> IRS Assistance Only	(3) <input type="checkbox"/> IRS Preparation	(4) <input type="checkbox"/> IRS Reviewed	(5) <input type="checkbox"/> VITA Assisted	(6) <input type="checkbox"/> Other
	Paid Assistance						Check One (Where Appropriate)
	(7) <input type="checkbox"/> CPA	(9) <input type="checkbox"/> Attorney	(11) <input type="checkbox"/> Local Tax Service	(13) <input type="checkbox"/> Other		(1) Yes	(2) No
	(8) <input type="checkbox"/> Public Acct	(10) <input type="checkbox"/> CPA & Atty.	(12) <input type="checkbox"/> Nat'l. Tax Service			(3) N/A	
5. Did preparer sign or stamp return?				5			
6. Was signature or stamp of preparer legible?				6			
7. Did preparer enter his/her EIN or SSN?				7			
8. Did taxpayer use IRS plain language publications listed in Publication 900?				8			
9. Did taxpayer receive classroom instruction prior to Return Preparation?				9			
10. If Item 9 is yes, enter year of most recent training: 19 _____				10			
11. Indicate how foreign accounts question was answered. (N/A means "Not Answered")				11			
12. Did taxpayer(s) actually have a foreign account?				12			
13. Did activity in foreign accounts lead to a tax adjustment?				13			
14. If yes, enter portion of total tax change due to adjustment \$ _____				14			
15. Was TCMP return the subject of a fraud investigation and/or referral?				15			
16. Did TCMP examination result in any other fraud investigation and/or referral?				16			
17. Was income verified or corrected by use of indirect method (Net Worth etc.)?				17			
18. If a deduction was claimed on Schedule C or F for Employee Benefit Plan, was a Form 5500, 5500 C or 5500 K filed?				18			
19a. Did taxpayer receive a lump-sum distribution from an employee benefit plan(s)?				19a			
19b. If yes, was a Form 1099R received?				19b			
19c. If taxpayer received a lump-sum taxable distribution, was all or part of it a rollover into a qualified plan or an Individual Retirement Savings Program?				19c			
<b>PART II - CONTROL DATA</b>							
20. Examining Officer's Name		21. Grade		22. Time on TCMP Return		10	
23. Group Manager's Initials		24. Date		25. Form 3628 Reviewed by Group Manager 1 <input type="checkbox"/> Yes    2 <input type="checkbox"/> No			
26. TCMP Reviewer's Initials		27. Date	28. Time	10		29. Disposal Code	
31. Conferee's Initials		32. Date	33. Time	10		30. Closing District Code	
				10		34. Principal Issue Number	
Remarks (Use Reverse of Page 5 for Additional Space)							

**PART III - TAX BASE DATA**

		(1) Reported	(2) Corrected
<b>SECTION A - INCOME</b>			
Wages, Tips, etc.	36.		
Dividends	36.		
Interest	37.		
Schedule C (Item 144)	38.		
Schedule D (Item 179)	39.		
Form 4797	40.		
Pensions and Annuities	41.		
Rents (Item 150)	42.		
Royalties	43.		
Form 1066	44.		
Form 1041	46.		
Form 11208	48.		
Schedule F (Item 172)	47.		
State Income Tax Refund	48.		
Alimony	49.		
Other _____	50.		
Total (Items 35-50)	81.		
<input type="checkbox"/> Not Applicable	52.		
Moving Expenses	53.		
Employee Business Expenses	54.		
Payments to IRA	55.		
Payments to Keogh	56.		
Sick Pay	57.		
Other _____	58.		
<b>ADJUSTED GROSS INCOME</b> <i>(Item 51 Minus 53-58)</i>	59.		
Standard Deduction	60.		
<b>SECTION B - ADJUSTMENTS</b>			
<b>SECTION C - DEDUCTIONS</b>			
<b>ITEMIZED</b>			
Deductible X Medical Insurance Premium	61.		
Other Deductible Medical	62.		
State & Local Income Taxes	63.		
Real Estate Taxes	64.		
Other Taxes	65.		
Home Mortgage Interest	66.		
Other Interest	67.		
Contributions	68.		
Cash	68.		
Other	69.		
Casualty/Theft/Losses	70.		
Alimony	71.		
Other	72.		
Total (Items 61-72)	73.		
<b>SECTION D - EXEMPTIONS</b>			
Taxpayer	Regular	74.	
	65 or Over, Blind	75.	
	Regular	76.	
Spouse	65 or Over, Blind	77.	
	Same Address	78.	
Children	Different Address	79.	
	Same Address	80.	
Parents	Different Address	81.	
	Different Address	81.	
Other Dependents		82.	
Total (Items 74-82)		83.	
<b>TAXABLE INCOME</b> <i>(Item 59 minus 60, 73, 83)</i>			
<b>FILING STATUS (Code)</b>			
<input type="checkbox"/> Not Applicable	86.		
Tax Table	87.		
Tax Rate Schedule	88.		
Schedule D	89.		
Schedule Q	90.		
Form 4728 (Maximum)	91.		
Other	92.		
Elderly	93.		
Investment	94.		
Foreign Tax	95.		
Child Care	96.		
General Tax	97.		
Other	98.		
<b>NET INCOME TAX</b> <i>(Item 87-92 Minus 93-98)</i>			
Minimum Tax	100.		
Salt Employment Tax	101.		
Other Taxes	102.		
Total (Items 99-102)	103.		
Income Tax Withheld	104.		
Earned Income Credit	105.		
Estimated Tax	106.		
Excess FICA	107.		
Other	108.		
Total Credits and Pre-payments (Items 104-108)	109.		
<b>BALANCE DUE</b> <i>(Item 103 Minus 109)</i>	110.		
Tax Paid with Return	111.		
Balance Due After Payment in Item 111	112.		
<b>OVERPAYMENT</b> <i>(Item 109 Minus 103)</i>	113.		
Penalties	114.		
114a. <input type="checkbox"/> Fraud <input type="checkbox"/> Negligence <input type="checkbox"/> Other			

<b>SECTION F</b>		<b>SECTION H</b>	
<b>SCHEDULE C</b> 118. <input type="checkbox"/> Not Applicable P.I.A. Code 118. Accounting System 117. (1) <input type="checkbox"/> Single Entry (2) <input type="checkbox"/> Double Entry Gross Receipts 118. (1) Reported (2) Corrected Less: Returns and Allowances 119. Net Receipts 120. Plus: Beginning Inventory 121. Merchandise Purchases 122. Other 123. Plus: Closing Inventory 124. Gross Profit 126. Other Income 126. Total Income 127. Depreciation 128. Taxes 128. Rent 130. Repairs 131. Salaries 132. Insurance 133. Legal & Prof. Fees 134. Commissions 135. Amortization 136. Pensions & Profit Sharing Plans 137. Employee Benefit Plans 138. Interest 139. Bad Debts 140. Depreciation 141. Other 142. <b>TOTAL (Items 128-142)</b> 143. <b>NET PROFIT (LOSS) (Should equal Item 38)</b> 144.		<b>SCHEDULE F</b> 151. <input type="checkbox"/> Not Applicable P.I.A. Code 152. Accounting System 153. (1) <input type="checkbox"/> Single Entry (2) <input type="checkbox"/> Double Entry Gross Receipts 154. Plus: Agriculture Program Payments 155. Cash Sales: Less Cost of Livestock or Other Items Sold 155. Less: Beginning Inventory 157. Livestock and Other Purchases 158. Closing Inventory 159. Gross Profit 160. Labor Hired 161. Repairs 162. Maintenance 163. Interest 163. Rent 164. Gasoline, Fuel, Oil 165. Taxes 166. Pension & Profit Sharing Plans 167. Employee Benefit Plans 168. Depreciation 169. Other 170. Total 171. <b>NET PROFIT (LOSS) (Should equal Item 47)</b> 172. <b>SCHEDULE D</b> 173. <input type="checkbox"/> Not Applicable Net Short Term Gain (Loss) 174. Net Long Term Gain (Loss) 176. Combine Items 174 & 176 above 176. Section 1202 Deduction Schedule D Line 15a 177. Section 1211 Limitation Schedule D Line 15a 178. <b>Total Net Gain (Loss) (Should Equal Item 39)</b> 179.	
<b>SECTION G</b> <b>SCHEDULE E -</b> 145. <input type="checkbox"/> Not Applicable Rental Income 145. Gross Rental 146. Depreciation 147. Repairs 148. Other Expense 149. <b>NET RENTAL INCOME (Item 42)</b> 150.		<b>SECTION I</b> <b>PREPARER PENALTIES</b> Was return prepared for compensation? 180. If "yes" - were penalties assessed to? 180. Negligent understatement IRC-6694 (a) 181. Willful understatement IRC-6694 (b) 182. Failure to furnish copy IRC-6695 (a) 183. Failure to sign return IRC-6695 (b) 184. Failure to furnish TIN IRC 6695 (c) 185. Negotiation of check IRC-6695 (f) 186.	
<b>PART IV - EMPLOYMENT TAX DATA</b>			

Indicate whether the following returns were required to be filed:

187. Form 940	188. Form 941	189. Form 942	190. Form 943
(1) <input type="checkbox"/> Yes (2) <input type="checkbox"/> No	(1) <input type="checkbox"/> Yes (2) <input type="checkbox"/> No	(1) <input type="checkbox"/> Yes (2) <input type="checkbox"/> No	(1) <input type="checkbox"/> Yes (2) <input type="checkbox"/> No

## VIEWS OF ASSESSING OFFICERS IN DIFFERENT RANGES ABOUT REFORM MEASURES

f: Unanimously favourably disposed to measure.      n: Unanimously not favourably disposed to measure.  
 m: Mixed response by AOs.                                      a: AOs in favour, DC not in favour.

Description of Measure	Range				
	A	B	C*	D	E
<b>Organisational Reforms</b>					
Concurrent jurisdiction of DC	n	n	f	n	n
Range level record-keeping	n	n	f	n	n
2-3 AO assessment teams	m	f	n	n	n
Abolition of intra-range charges	n	n	f	n	n
Change income basis of intra-range charges to area/profession/etc.	m	f	f	n	n
Scrutiny cases selected at range level	n	f	f	n	f
Survey/CIB decentralised to DC/CIT level	f	f	f	f	f
<b>Manpower and Workload Reforms</b>					
Delegation of routine duties of DC	f	f	n	n	n
Range DC to do some assessments	f	n	n	n	n
Delegation of summary assessment to inspectors	f	f	n	f	f
Delegation to inspectors of routine duties of AOs	f	f	f	f	f
Reallocation of cases and staff across wards by DC given scrutiny selection	f	n	f	n	m
More Inspectors	f	f	f	f	f
More stenographers & tax assistants	f	f	f	f	f
Less frequent personnel transfers	f	f	f	f	f
More stress on 133A(1) survey at range	f	f	f	f	f
<b>Assessment</b>					
Simplified summary assessment	f	f	f	f	f
No summary assessment	n	f	n	n	n
Computerised summary assessment	m	m	n	m	f
Lower Scrutiny Targets per AO	f	f	f	n	f
Separate field and desk audit targets	f	f	f	f	f
Random scrutiny selection	n	n	n	n	n
Scoring model for scrutiny selection	f	n	f	n	f
Random plus scoring selection	f	n	f	n	f
<b>Infrastructure</b>					
More storage space and supplies	f	f	f	f	f
Access to vehicles	f	-	-	-	f
Less frequent transfer of files	f	f	f	f	f
Consolidated CBDT Instructions/circulars list	f	f	f	f	f
Computerisation of arrears/refunds	f	n	f	f	f
<b>Performance monitoring and Incentives</b>					
Fewer and rationalised targets	f	f	f	f	f
Only budget targets	n	n	n	n	n
Liberalised and rationalised rewards	f	f	f	f	f
Incentive pay	n	f	n	a	f
Incentive pay with pool for non-assessment staff	f	n	n	n	n
Incentive pay with "negative points"	n	a	n	n	f

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