

Special Procedure for Assessment of Search Cases

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The Finance Act 1995 has introduced a new chapter XIV-B in the IT Act with a view to providing a special procedure for assessment of search cases with effect from 1.7.1995. As per the Memorandum explaining the provisions of the Finance Bill 1995, in the old Scheme; valuable time was lost in trying to relate the undisclosed income to the different Assessment Years (A.Y); no finality was reached in respect of legal issues involved; the seized assets remained with the Department for a long time and it took a very long time to finalise the assessments in search cases. In order to overcome these difficulties and to make procedure of assessment in search cases cost effective, efficient and meaningful, the new chapter XIV-B was introduced.

Vide an amendment to S.158B the expression “**period of ten previous years**” was substituted with “**previous years relevant to ten assessment years**”, with retrospective effect from 1.7.'95 i.e right from the inception of this chapter. Later on vide an Ordinance 1996 and subsequently an Amending Act 1997, certain provisions of chapter XIV-B, were modified. This was done partly in response to the wide spread criticism that tax-evaders had been let off very lightly with only 60% of the disclosed income as tax and immunity from penalty for concealment as well as interest leviable under Ss. 234A, 234B and 234C. It was also intended to remove certain problems faced by both the tax paying public as well as the IT Department in the administration of the provisions. The aforesaid modifications were to be effective from 1.1.'97.

Chapter XIV-B, containing Ss.158B to 158BH, provides for a separate code for dealing with the assessment of search cases. This code also contains independent provisions for computing the undisclosed income in addition to the provisions for the assessment of such undisclosed income

2. Definitions

The provisions of chapter XIV-B deal with computation and assessment of undisclosed income of a block period. Both these terms viz “Block Period” and “Undisclosed income” have been defined U/s 158B(a) and 158B(b) respectively.

Block Period

Originally it was defined as “period of ten previous years”. However, as before the adoption of uniform previous year, the assesseees were allowed to have any accounting period as their previous year and as a result the expression “Block Period” could be different in different cases. To remove this problem the definition of “Block Period” was amended as “previous years relevant to ten assessment years” with effect from 1.7.1995, that is, from the very inception of chapter XIV-B. The correct position in this respect has been explained in Board’s Circular No. 717 dt 14.8.1995 -- 215 ITR(St) p.99.

Undisclosed Income

The definition of “Undisclosed income” U/s 158B(b) is inclusive and not exhaustive. As per this definition it “includes any money, bullion, jewellery or other valuable article or thing or any income based

on any entry in the books of account or other document or transactions where such money, bullion, jewellery, valuable article, entry in the books of account or other document or transaction represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of the Act.”

The phrase “ for the purposes of this Act “ used in the aforesaid definition of undisclosed income is quite significant. It would mean that if any books of account or other document or transaction not required “ for the purpose of this Act”, has not been disclosed or would not have been disclosed then the provisions of this chapter will not apply. For instance, the books of account or documents relating to agricultural income would not be relevant for the purposes of the Act as the income from agriculture cannot be included in the “undisclosed income”

From the aforesaid definition it would be clear that if the details in respect of certain items of income have already been disclosed in any return of income, then such items of income, cannot be included in the undisclosed income. The term “undisclosed income” means income which is hidden from the IT Department. -- L.R. Gupta Vs Union of India, 194 ITR p.32(Delhi). Thus the meaning of “undisclosed income” should be correctly understood in order to safe-guard the interest of the tax-payer.

3. Computation of undisclosed income

The method of computation of undisclosed income has been laid down in S.158 BB. For the purpose of simplicity and easy understanding the computation of undisclosed income is divided into various steps which are as follows :

- (i) First of all undisclosed income relating to various A.Ys falling within the block period is required to be determined. This is done on the basis of evidence found as a result of search or requisition of books of account or documents and such other materials or information as is available with the Assessing Officer(A.O).
- (ii) As a second step an account of “regular income” or the “ disclosed income” other than the undisclosed income, for the respective A.Ys falling within the block period, is required to be taken.
- (iii) Thirdly the undisclosed income and the disclosed income so determined are required to be clubbed together for each of the A.Ys in order to determine the aggregate total income of such A.Y.
- (iv) Fourthly the total income of the aforesaid A.Ys is required to be aggregated to determine the aggregate total income or the “gross total income” of the block period.
- (v) As a fifth step this “gross total income” of the block period is required to be reduced by the “disclosed income” or is to be increased by losses. Such “disclosed income or loss” is to be determined in following manner :
 - (a) where assessments under Section 143 or Section 144 or Section 147 have been concluded, then income determined on the basis of such completed assessment.
 - (b) where returns of income have been filed under Section 139 or Section 147 but assessments are pending till the date of search, then the income determined on the basis of the returned income.
 - (c) however, the income will be taken as Nil where the due date for filing a return of income has expired but no return of income was filed by the date of search or requisition.

- (d) where the previous year has not ended or the date of filing the return of income under Section 139(1) has not expired, then the income determined on the basis of entries relating to such income or transactions as recorded in the books of account, and other documents which are maintained in the normal course, provided the recording is made on or before the date of the search or the requisition.
- (e) where an order of settlement is made by the Settlement Commission, then the income determined on the basis of such order.
- (f) where an assessment of an undisclosed income is made under this Chapter in respect of a search which had taken place prior to the search under consideration, then the income determined on the basis of such assessment.

The aforesaid total income is required to be completed in accordance with the provisions of chapter IV of the IT Act. This chapter consists of six parts and Ss. 14 to 59. All the deductions and allowances as are available in respect of each head of income, are to be deducted or allowed. The undisclosed income is also to be computed in the aforesaid manner. Some of the important points for the computation of undisclosed income are as follows:

(I) Current year's losses and unabsorbed depreciation

In this respect we have to look at Explanation (a) to S.158 BB(1) and foot notes 5 and 7 to the Return of Income for block assessment in Form 2B. It would be clear therefrom, that there is no bar to losses under one head of income to be set-off against income under another head of income in the same A.Y. Similar is the position in respect of unabsorbed depreciation.

(II) Set-off of losses and unabsorbed depreciation

There is a specific prohibition as regards the set-off of brought forward losses and unabsorbed depreciation against the undisclosed income. This is made clear by S.158 BB(4) and Explanation (a) to S.158 BB (1). The losses or the depreciation will continue to be carried forward for being set-off against the undisclosed income of the subsequent years in the regular assessments.

As explained earlier the proceedings under chapter XIV - B will relate to undisclosed income only and the regular proceedings for disclosed income will not be disturbed. In some cases two proceedings will be in progress against the same person, one being regular assessment proceedings and the other being computation of the undisclosed income under chapter XIV-B. Thus it should be possible to adjust brought forward losses and unabsorbed depreciation in the block period of A.Ys.

It is also possible to contend that the block period is akin to one single A.Y and all adjustments within the block period should be construed as an act of set - off within the same A.Y only.

(III) Treatment of pending assessments

The question as to what treatment is to be given to pending assessment(s) comprised in the block period; is very important. Suppose in a case return has been filed. Notice U/s 143(2) has been issued, served and accounts have been partly examined but the assessment is yet to be completed. At this stage, the search takes place. The A.Y falls within the block period. The important question here would be whether the assessment should be completed in the normal manner or no assessment should be made separately for this A.Y as it would be covered in the block period. There have been

a variety of opinions on this issue. The question has recently been answered by the decisions of two High Courts. One decision is of Punjab and Haryana High Court in the case of **Raja Ram Kaulwant Rai Vs ACIT 227 ITR p.187 (P & H)**. As per this decision assessment framed for block period debars assessment U/s 143 on the basis of return filed U/s 139. Another decision is of Kerela High Court in the case **N.T. John Vs CIT 228 ITR p.314(Ker)**. As per this decision when search takes place, assessment which are pending and falling within the block period, will be governed only by chapter XIV-B to the exclusion of all other provisions of the IT Act.

From the aforesaid decisions it can be concluded that for each A.Y falling within the block period, the A.O will also be required to compute the disclosed income along with the undisclosed income. **It is, therefore, possible that separate assessments in respect of the same A.Y may be required to be made, one for the disclosed and regular income and other for the undisclosed income.**

(IV) Deduction under chapter VI-A

Chapter XIV- B does not prohibit grant of deductions from gross total income under chapter VI-A. Further S.158 BH provides that all other provisions of the Act shall apply to block assessment. This view is further supported by part III of Form 2B where provision has been made for deduction under chapter VI-A of the IT Act. It is thus clear that deduction under chapter VI-A will be permissible even with regard to the block assessments.

4. Procedure for block assessment

The AO has to issue and serve a notice on the assessee U/s 158 BC calling for a return setting forth “his total income” including the undisclosed income for the block period. The proviso to S.158 BC stipulates that no notice U/s 148 is required to be issued for the purpose of proceedings under chapter XIV-B. The assessee should be given a time of not less than 15 days but not more than 45 days from the date of service of notice for furnishing the return U/s 158 BC. Thereafter the AO shall proceed to determine the undisclosed income for the block period and provisions of S.142, 143(2), 143(3) and 144 shall apply accordingly. Though the block period can be extended upto ten A.Ys in a case where the assessee has not disclosed “ undisclosed income” in any one or more of A.Ys comprised in the block period, it will not be necessary to do the exercise of computing the undisclosed income for the relevant years and the exercise may be limited to the years in respect of which the undisclosed income has been found. After the assessment and issue of notice of demand the assets seized shall be retained to the extent necessary. This aspect shall be dealt with in the manner laid down U/s 132 B.

While computing the undisclosed income the following points have to be kept in view :

(A) No roving enquiries in respect of the completed assessments, are permitted.

As per the decision of ITAT Mumbai in the case **Sunder Agencies Vs DyCIT, 63 ITD p.245 (Mumb-Trib)**; the provisions of S.158 BA do not provide a licence to the Revenue for making roving enquiries connected with completed assessments and it is beyond the power of AO to review completed assessments, unless some direct evidence comes to the knowledge of the Department as a result of search which clearly indicates the factum of undisclosed income.

(B) No addition justified on the basis of papers alone in the absence of corroborative evidence.

For the above proposition the decision the ITAT in the case of **ITO Vs M.A. Chidambaram - 63 ITD p.203 (Mad - Trib -TM)** and the decision of ITAT in the case of **ACIT Vs Shailesh S. Shah 63 ITD p.153 (Mumb-Trib)**; are relevant.

5. Undisclosed income of any other person - S.158 BD

S.158 BD provides that if undisclosed income belongs to any person other than the person in respect of whom search was made U/s 132 or whose books of account or other documents or assets, were requisitioned U/s 132 A, the books of account other documents or assets seized or requisition, shall be handed over to the AO having jurisdiction over such other person. Such AO should proceed against other person according to the provisions of chapter XIV-B. As per this section the applicability of chapter XIV-B can be extended to the person against whom no direct action has taken place or against whom no requisition has been issued, but evidence of undisclosed income is found during the search or requisition.

On account of this section it is likely that different persons carrying on the business at the same place may be covered under this chapter. Even the group companies when transactions are co-related, can also be roped into under this chapter. The AO having jurisdiction over the person who is searched etc, will have to first satisfy that undisclosed income of other person is detected as a result of search and only thereafter he will be able to invoke S.158 BD and will hand over the seized material to the other AO having jurisdiction over the other person.

6. Time limit for completion of block assessments

It will be seen that Section 158 BE provides a period of one year for making assessment for the block period. A question arises, however, as to what would be the consequence if such assessment is not made. Can the assessee be assessed under the normal provisions or by issuing Section 147 notice in respect of the block assessment ? As the procedure provided by Chapter XIV-B is an exclusive procedure, the normal procedure for the assessments cannot be resorted to by the assessing officer in respect of the block period. There is no option available to the assessing officer in this behalf. In other words, he is bound to make assessment for the block period within the statutory period.

The time limit for completion of block assessment in the case of any other person U/s 158 BD, is one year from the end of the month in which notice U/s 158 BC is served on such other person by his AO.

7. Levy of interest and penalty; and prosecution

As already pointed out there was a wide spread criticism of the scheme of chapter XIV-B that tax evaders subjected to search have been let off very lightly with only 60% of undisclosed income as tax and immunity from penalty for concealment as well as interest leviable U/s 234 A, 234 B and 234 C. As a result, the IT (Amendment) Act 1997, has brought in an amendment by incorporating S. 158 BFA to provide for levy of interest and penalty.

But even these provisions are some what selective. The interest will be chargeable if the return of income is delayed and penalty will be leviable if the AO detects undisclosed income over and above what has been disclosed in the return of income. As far as prosecution is concerned the amendment has incorporated S.227 CCC providing for prosecution in a case where the assessee wilfully fails to furnish, in due time, the return of income U/s 158 BC.

No Disclosure U/s 132(4) should be made

There is no purpose in making a disclosure in the course of a statement U/s 132(4) as to that extent it will amount to an admission which will be difficult to get over and retraction in such a case may appear to be suspect and therefore may not be believed. Therefore, as a matter of prudence the assessee should not make any such disclosure U/s 132(4) but he may disclose the undisclosed income at the time of filing the return of income as per S.158 BC.

8. Assessing and Appellate Authorities

Before the amendments brought about by the Ordinance, later replaced by the IT(Amendment) Act 1997, the powers of assessment for the block period were vested in the AO not below the rank of ACIT under the provisions of S.158 BG. However, prior approval of CIT had to be taken before the finalisation of assessment of undisclosed income. This power is now vested in the ADI also. Such an assessment had to be taken in appeal directly to the ITAT.

While the Amending Act has not made any change in the level of AO, yet there has been a departure in vesting the power to grant prior approval. Before the amendment prior approval had to be taken from the CIT/ DIT. This has now been brought to the level of DyCIT / DyDIT. This procedure will be applicable in respect of searches conducted on or after 1.1.'97. The appeal against such assessment orders will now lie before the CIT(A) and thereafter to the ITAT. Thus the old system of appellate hierarchy has been restored.

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