

**THE HON'BLE SRI JUSTICE L.NARASIMHA REDDY
AND
THE HON'BLE SRI JUSTICE CHALLA KODANDA RAM**

I.T.T.A Nos.10, 12 & 19 OF 1999

% 31.07.2014

I.T.T.A.No.10 of 1999

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The Commissioner of Income Tax,
Andhra Pradesh – II, Hyderabad .. Appellant

And

\$ Sri E. Sudhir Reddy, M-22/3RT,
Vijayanagar Colony, Hyderabad .. Respondent

! Counsel for the Appellants : Sri J. V. Prasad

Counsel for Respondents : Sri S. Dwarakanath

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COMMON JUDGMENT: *(Per Hon'ble Sri Justice L.Narasimha Reddy)*

These three appeals are filed by the Revenue, feeling aggrieved by three separate orders passed by Hyderabad Bench 'B' of the Income Tax Appellate Tribunal (for short, 'the Tribunal') in the appeals presented by three different assessees. The common feature of the appeals is that all of them are the result of a search conducted by the officials of the Income Tax Department *vis-à-vis* M/s.IVR Constructions Limited, the respondent in I.T.T.A.No.19 of 1999.

The respondent in I.T.T.A.No.19 of 1999 is a Company. It commenced its activities, initially as a private company and later on, it has gone for public issues after following the procedure under the Companies Act, 1956. As a part of its activity, it acquired share capital by issuing shares. It has been submitting the returns year after year under the Income Tax Act, 1961 (for short, 'the Act'). The respondents in I.T.T.A.Nos.10 and 12 of 1999 are its Managing Director and Executive Director, respectively, of the Company. They too are the assesses under the Act.

A search was conducted in the premises of the Company on 23.01.1996 under Section 132 of the Act. On the basis of the recoveries said to have been made in the search, the respondents were required to file returns for the block period 1986-87 to 1996-97. In the process, the respondents themselves came forward with a plea that there was an undisclosed income to a tune of Rs.35.00

lakhs. The assessing officer, however, took the view that the share certificates pertaining to the Company are in the premises or in the custody of the Directors, though issued in the name of some third parties. The value of these shares was treated as undisclosed income. The assessing officer has also disallowed certain perquisites, which were claimed by the Managing Director and Executive Director, and treated that amount as undisclosed income. A block assessment order was passed, levying the corresponding tax. Aggrieved by that, the respondents filed I.T.A.Nos.42, 43 and 90/Hyd/97 before Hyderabad Bench 'B' of the Income Tax Appellate Tribunal. Through a common order, dated 27.01.1999, the Tribunal allowed the appeals setting aside the findings recorded by the assessing officer on certain important aspects. Hence, these appeals.

Sri J. V. Prasad, learned counsel for the appellants, submits that the definition of undisclosed income under Section 158B(b) of the Act is wide enough, to cover every unexplained item of income and the share certificates that were found to be in possession of the respondents fall into that definition. He contends that the assessing officer scrupulously followed the procedure prescribed under Chapter XIVB of the Act and the Tribunal has interfered with the order of assessment on certain assumptions. He contends that the exercise of passing a block assessment order is wide enough and there was no justification for the Tribunal in restricting such powers.

Sri S. Dwarakanath, learned counsel for the respondents, on the other hand, submits that whatever may have been the justification in including certain items in the category of undisclosed income, there was no basis for the assessing officer to add the value of the shares to the income, that too of the Company itself, as undisclosed

wealth. He contends that the assessing officer has virtually proceeded on imagination that the Company has purchased its own shares and thereby avoided income tax. Learned counsel further submits that in the name of making a block assessment, an assessing officer cannot decide the legality or otherwise of the assessments, which were already made in the earlier years, whether within the block period, or outside thereof.

Successful legislations have acknowledged the fact that many a time, the disclosures made in a return submitted by an assessee are not totally reliable, but also accurate. Various procedures are evolved to handle situations of that nature. If an inaccurate statement is noticed in the returns of an assessee, the assessing officer is conferred with power to lay penalty under Section 271 (1) (c) of the Act. Another method of dealing with the situation of this nature is to pass order of rectification under Section 148 of the Act, by reopening the assessment, which was already made. Third method of rectification is the one, under Section 154 of the Act. The superior authority, namely, the Commissioner is conferred with the power to cause *suo motu* revision under Section 263 of the Act. The methods, referred to above, are mostly on the basis of the facts and figures furnished in the returns and the result is almost in the form of re-verification.

Section 132 of the Act empowers the authorities of the Company to conduct a search in the premises of not only an assessee, but also of the persons associated with him. If, during the course of the search, any incriminating material or undisclosed income is noticed, a block assessment order covering a period of ten years (which, at present is six years), is to be passed. The procedure, to be followed in this regard, is broadly prescribed under Section 158BB and 158BC of the Act. Once the authority, who conducted the search, arrives at a particular figure, as to

undisclosed income, the block assessment order is to be passed in accordance with law.

Broadly stated, the aggregate of the total income pertaining to the block period, which is arrived at on the basis of the search, is taken as standard. In case the assessee has any income to his credit for the aggregate of block period, as disclosed in the returns, it is to be deducted from that amount. If, on the other hand, loss was posted, it is to be added. To illustrate, let it be assumed that the search yielded undisclosed income of 15.00 lakhs and the income of the assessee shown in the returns over the block period is Rs.7.00 lakhs. Then the taxable amount, as a result of block assessment, would be Rs.8.00 lakhs (15 - 7). If, on the other hand, the assessee has posted losses of Rs.4.00 lakhs over the block period, the taxable amount for the block period would be Rs.19.00 lakhs (15 + 4).

The entire controversy revolves around the meaning to be ascribed to the expression 'undisclosed income'. The same is defined under Section 158 B (b) of the Act. It reads:

“undisclosed income” 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 documents or transactions, where such money, bullion, jewellery, valuable article, thing, 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 this Act (or any expense, deduction or allowance claimed under this Act which is found to be false).”

The manner, in which the undisclosed income must be computed, is provided for under Section 158BB of the Act. It reads:

“158BB. Computation of undisclosed income of the

block period.- (1) The undisclosed income of the block period shall be the aggregate of the total income of the previous years falling within the block period computed, in accordance with the provisions of this Act on the basis of evidence found as a result of search or requisition of books of account or other documents and such other materials or information as are available with the Assessing Officer and relatable to such evidence, as reduced by the aggregate of the total income, or, as the case may be, as increased by the aggregate of the losses of such previous years determined,-

- (a) where assessments under section 143 or section 144 or section 147 have been concluded prior to the date of commencement of the search or the date of requisition, on the basis of such assessments;
- (b) where returns of income have been filed under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 but assessments have not been made till the date of search or requisition, on the basis of the income disclosed in such returns;
- (c) where the due date for filing a return of income has expired, but no return of income has been filed,-
 - (A) on the basis of entries as recorded in the books of account and other documents maintained in the normal course on or before the date of the search or requisition where such entries result in computation of loss for any previous year falling in the block period; or
 - (B) on the basis of entries as recorded in the books of account and other documents maintained in the normal course on or before the date of the search or requisition where such income does not exceed the maximum amount not chargeable to tax for any previous year falling in the block period;
- (ca) where the due date for filing a return of

- income has expired, but no return of income has been filed, as nil, in cases not falling under clause (c);
- (d) where the previous year has not ended or the date of filing the return of income under sub-section (1) of section 139 has not expired, on the basis of entries relating to such income or transactions as recorded in the books of account and other documents maintained in the normal course on or before the date of the search or requisition relating to such previous years,
 - (e) where any order of settlement has been made under sub-section (4) of section 245D, on the basis of such order;
 - (f) where an assessment of undisclosed income had been made earlier under clause (c) of section 158 BC, on the basis of such assessment.
- (2) In computing the undisclosed income of the block period, the provisions of section 68, 69A, 69B and 69C shall, so far as may be, apply and references to “financial year” in those sections shall be construed as references to the relevant previous year falling in the block period including the previous year ending with the date of search or of the requisition.
- (3) The burden of proving to the satisfaction of the assessing Officer that any undisclosed income had already been disclosed in any return of income filed by the assessee before the commencement of search or of the requisition, as the case may be, shall be on the assessee.
- (4) For the purpose of assessment under this Chapter, losses brought forward from the previous year under Chapter VI or unabsorbed depreciation under sub-section (2) of section 32 shall not be set off against the undisclosed income determined in the block assessment under this Chapter, but may be carried forward for being set off in the regular assessments.”

From a perusal of this, it becomes clear that the items, such as, money, bullion, jewellery and other residuary items, which

constitute the wealth or income, would be treated as an undisclosed income, provided that such items were not disclosed for the purpose of the Act. It means such items were not the subject matter of any returns filed under the Act. Once the items mentioned in the definition were the subject matter of the returns filed under the Act, they cannot be treated as undisclosed income. Another aspect is that the returns need not be those filed by the concerned assessee alone. The provision does not indicate or that the returns insist covering those items must be that of the concerned assessee alone. It is too well established that the provisions of a taxation law, that too of the punitive nature, need to be interpreted in a strict manner. The intention of the Legislature is to ensure that no undue hardship is caused to the assessee nor an assessee is subjected to any detriment contrary to law.

A significant part of the block assessment was the share certificates said to have been found in the premises of the Company. It is not in dispute that the share certificates were issued in the name of third parties. In the course of enquiry conducted during the block assessment, the authorities verified from the persons whose names were shown in the share certificates. The record discloses that such persons stated that the share certificates belong to them and they have also filed returns disclosing the same. The basis for the assessing officer to disbelieve those statements was that the filing of returns, though before the search was conducted, was done as an afterthought, in some cases, or that filing of returns was not warranted at all, having regard to the financial status of the concerned assessee.

The Tribunal took the view that the scope of powers of an officer conducting search cannot be expanded to cover the adjudication or verification of the assessments already made.

It has already been mentioned that Section 158BB of the Act takes away any item of wealth discovered in the course of search, from the purview of 'undisclosed income', if it had been the subject matter of proceedings under the Act, which may include a mere filing of return or a detailed order of assessment. If the authority, who conducted a search, is permitted to determine the correctness or otherwise of the returns or the orders of assessment passed earlier in respect of concerned assessee or a third party, virtually the exercise tends to partake the character of the one under Section 263 of the Act. In case the earlier proceedings were the subject matter of appeal before the Tribunal or this Court, the power gets widened even to cover such orders also. That was not, and can never be, the intention of the Parliament. It is only when the cash, bullion, negotiable instruments or other similar items of wealth which did not constitute the subject matter of returns under the Act, that the authorities can make an attempt to treat them as undisclosed income. This is exactly what, the Tribunal had observed in its order.

Certain defects were also pointed out by the Tribunal in the context of making the block assessment. We have already observed that the block assessment is to be made strictly in accordance with Section 158BB of the Act. Many a time, the assessing officers, propose to treat the undisclosed income as an independent entity and subject to making tax without following the provision under Section 158BB of the Act. Such a course would push the assessee to a further hardship and result in denial of the very safeguard that was prescribed by the Legislature.

The discussion undertaken by us in the preceding paragraphs, cover questions 1 to 4 that were framed in the grounds

of appeal. The 5th question pertains to Managing Director and Executive Director. The assessing officer took the view that substantial number of share certificates were found with the Managing Director, Executive Director and thereby they are enjoying the benefits in respect of the shares allotted to the promoters. It has already been mentioned that the persons, in whose names they were issued, have stated that they belong to them and it was also found in the search itself, that shareholders have submitted their returns. That being the case, there was no basis for treating the share certificates as belonging to anybody else.

The assessing officer added the benefit under Section 224 (4) r/w Section 17 of the Act, as a perquisite. This aspect is covered by the judgment of the Supreme Court in **Commissioner of Income Tax v. Lovely Exports Private Limited**^[1], in favour of the respondents.

Hence, the appeals are dismissed. There shall be no order as to costs.

The miscellaneous petitions filed in these appeals shall stand disposed of.

L. NARASIMHA REDDY, J

CHALLA KODANDA RAM, J

31.07.2014

Note:- L.R. Copy to be marked.

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^[1] 229 ITR 268

