Welcome Message

I am immensely happy to welcome all the delegates to this full day seminar on 'Taxation of Construction Industry' being organized by the Ernakulam Branch of ICAI.

In this complex and globalised economic environment, to meet the challenges and threats we the professional accountants must keep ourselves abreast with the latest laws and regulations and must develop and maintain an attitude of learning. Conferences and seminars provide us with a platform to interact and exchange our ideas and feelings with others and sharpen our skills. It is a place where we get to listen and appreciate other's viewpoints and broaden our horizons.

The faculties selected for this conference are of high repute and the selection of topic for the discussions are also very relevant and useful to our members.

On behalf of the Ernakulam Branch of ICAI, I have immense pleasure to welcome our Chief Guest Sri Thomas Kutty P J , IRS, Chief Commissioner of Income Tax, Kochi. Sri. Thomas Kutty P J is a dynamic and seasoned administrator par excellent and will in the inaugural session share his pearls of wisdom emanating out of his vast practical experience.

I am also happy to welcome our Central Council Member and Chairman, Fiscal Laws Committee CA. G. Ramaswamy and all other dignitaries and resource persons to this seminar.

I am sure that the seminar will throw light on the emerging issues to groom the members with technical aspects involved. The seminar will also help to develop the core competencies of the participants with specific reference to 'Taxation of Construction Industry' and search, seizure and assessment under the Income Tax Act.

With warm regards,

CA.REJI A GEORGE, FCA, DISA (ICA)
CHAIRMAN, ERNAKULAM BRANCH OF SIRC OF ICAI.

Chief Guest

Sri. P.J. Thomas Kutty , IRS
Chief Commissioner of Income Tax, Kochi

BIODATA

Born : 10.05.1948 at Vallicode Kottayam, Pathanamthitta

S.S.L.C from Nethaji High School, Pramadom, Pathanamthitta
B.Sc degree in 1965 from Mar Evanios College, Trivandrum
M.Sc (Physics) from U.C. College Aluva in 1967
LL.B from Maharajas Law College Ernakulam in 1989
All under University of Kerala
M. Sc Fiscal studies from University of Bath, U.K. in 1994

Work History :

Lecturer in Physics in Mar Evanios College, Trivandrum From 1967 to 1972

Joined Income Tax Department in 1972, at National Academy of Direct Taxes, Nagpur, as an Officer Trainee

Training at Lal bahdur Shastri Academy of Public Administration, Mussorie.

Worked as Assessing officer at Trivandrum, Thiruvalla and Ernakulam from 1973 to 1979

Member of teaching faculty in NADT, Nagpur during 1979 – 80

Deputation in Company Law Board Regional Office at Kolakata from 1980 to 1982

IAC, AAC (JCIT) at Ernakulam from 1982 to 1987 discharging appellate and administrative work in Ernakulam, Central, Special and Acquisition Ranges.

Additional CIT at Chennai from 1987 to 1993 in Central Range, vigilance, investigation etc.

CIT (Appeals) at Chennai in 1994 (From 12/01/1994)

CIT (Appeals) at Bangalore from 1995 to 2001.

CIT at Bangalore and Mysore from 2001 to 2003.

CIT at Trivandrum from 2003 to 2006

Promoted as CCIT in 2006 and posted at Trivandrum

Worked as CCIT Nashik in 2005-2006

Director General of Income Tax, Kochi from January 2007 onwards

PROFILE

CA. K. SHIVARAJAN FCA FCS
Grad CWA, Chennai

- Mr. K. Sivarajan is a fellow member of the Institute of Chartered Accountants of India and is a commerce graduate. He is also a graduate member of the Institute of Cost & Works Accountants of India.
- He is the partner of a Chartered Accountant firm in Chennai.
- He has more than 10 years of experience in practice
- He specializes in Indirect Taxation and his areas of practice includes:
  - Consulting and tax planning
  - Representation
  - Compliance Reviews
  - Procedural Manuals
  - Corporate Training programs
  - Documentation
- He has been associated in various professional forums in different capacities
  - Member of Expert Committee on Indirect Taxes - Madras Chamber of Commerce and Industry (MCCI)
  - Member of Expert Committee on VAT - Madras Chamber of Commerce and Industry (MCCI)
  - Member – Executive Committee & Editorial Board – The Chartered Accountants Study Circle, Chennai
- He is a regular speaker on Central Excise, Service Tax and Value Added Tax at various Forums including:
  - Chambers of Commerce
  - Industry Associations
  - Professional Institutes
- He has co-authored a book on '**User Guide to Tamilnadu VAT**' published by the Chartered Accountants Study Circle (Regd.), Chennai
- He contributes articles on indirect taxation to various Professional Books and journals including Service Tax Today, The Chartered Accountant Journal, Consolidated Commercial Digest and Vat and Service Tax cases, The Hindu Business Line, The Hindu etc.

VAT and Service Tax Implications Construction & Real Estate Transactions

CA. K.Sivarajan

SECTION I - SERVICE TAX IMPLICATIONS

Commercial or Industrial Construction Service

Section 65(105)(zzq) defines taxable service as service provided or to be provided "to any person, by any other person, in relation to commercial or industrial construction service";

Section 65(25b) defines "commercial or industrial construction service" as to mean —

" (a) construction of a new building or a civil structure or a part thereof;

or

(b) construction of pipeline or conduit; or

(c) completion and finishing services such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services, in relation to building or civil structure; or

(d) repair, alteration, renovation or restoration of, or similar services in relation to, building or civil structure, pipeline or conduit,

which is —

(i) used, or to be used, primarily for; or

(ii) occupied, or to be occupied, primarily with; or

(iii) engaged, or to be engaged, primarily in,

commerce or industry, or work intended for commerce or industry, but does not include such services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams;"

Construction of Residential Complex

Section 65(105)(zzzh) defines taxable service as service provided or to be provided "to any person, by any other person, in relation to construction of complex;"

Section 65(30a) states that "construction of complex" means —

(a) construction of a new residential complex or a part thereof; or

(b) completion and finishing services in relation to residential complex such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services; or

(c) repair, alteration, renovation or restoration of, or similar services in relation to, residential complex;

Section 65(91a) states that "residential complex" means any complex comprising of —

(i) a building or buildings, having more than twelve residential units;

(ii) a common area; and

(iii) any one or more of facilities or services such as park, lift, parking space, community hall, common water supply or effluent treatment system, located within a premises and the layout of such premises is approved by an authority under any law for the time being in force, but does not include a complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person.

Explanation. — For the removal of doubts, it is hereby declared that for the purposes of this clause, —

(a) "personal use" includes permitting the complex for use as residence by another person on rent or without consideration;

(b) "residential unit" means a single house or a single apartment intended for use as a place of residence;

Erection, Commissioning and Installation Service

Section 65(105) (zzd) of the Finance Act defines taxable service as any service provided or to be provided "to a customer, by a erection, commissioning and installation agency in relation to commissioning or installation"

Section 65(29) defines "commissioning and installation agency" as to mean "any agency providing service in relation to erection, commissioning or installation"

Section 65(39a) defines "erection, commissioning or installation" as "any service provided by a commissioning and installation agency, in relation to,

(i) erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise; or

(ii) installation of —

(a) electrical and electronic devices, including wirings or fittings therefor; or

(b) plumbing, drain laying or other installations for transport of fluids; or

(c) heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work; or

(d) thermal insulation, sound insulation, fire proofing or water proofing; or

(e) lift and escalator, fire escape staircases or travelators; or

(f) such other similar services;"

Works Contract Service

65(105) (zzzza) defines taxable service as taxable service as service provided or to be provided "to any person, by any other person in relation to the execution of a works contract, excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams".

Explanation — For the purposes of this sub-clause, "works contract" means a contract wherein, —

(i) transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods, **and**

(ii) such contract is for the purposes of carrying out,—

a) erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or

b) construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or

c) construction of a new residential complex or a part thereof; or

d) completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to *(*b) and *(*c); or

e) turnkey projects including engineering, procurement and construction or commissioning *(EP*C) projects

Valuation of Works Contract

Rule 2A has been inserted in Service Tax (Determination of Value) Rules, 2006 vide Notification No.29/2007-Service Tax dated 22.05.07, to provide subject to Section 67 of the Act that:

- Value of works contract service shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.
- Gross amount charged shall not include Value Added Tax or Sales Tax paid, if any, on the transfer of property in goods involved in the execution of the works contract
- The Value adopted for the payment of VAT or Sales Tax shall be taken as the value of transfer of property in goods involved in the execution of the works contract if the VAT or Sales tax has been paid on the actual value of transfer of property in goods.
- Value of Works contract service shall include

1. labour charges for execution of the works;
2. amount paid to a sub-contractor for labour and services;
3. charges for planning, designing and architect's fees;

4. charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;
5. cost of consumables such as water, electricity, fuel, used in the execution of the works contract,
6. cost of establishment of the contractor relatable to supply of labour and services;
7. other similar expenses relatable to supply of labour and services;
8. profit earned by the service provider relatable to supply of labour and services;

Composition Scheme or Works Contract

The service provider has been given an option to adopt the composition scheme for payment of service tax on works contract service. The Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 has accordingly been notified vide Notification No.32/2007-Service Tax dated 22.05.07. The scheme provides for the following:

- The service provider shall have an option to pay an amount equivalent to **two per cent** of the gross amount charged for the works contract instead of paying service tax at the rate specified in section 66.
- Gross amount charged for the works contract shall not include VAT or sales tax paid on transfer of property in goods involved in the execution of the said works contract.
- The provider of taxable service shall not take CENVAT credit of duty paid on inputs, used in or in relation to the said works contract
- The option in respect of a works contract shall be exercised prior to payment of service tax in respect of the said works contract. The option so exercised shall be applicable for the entire works contract and cannot be withdrawn until the completion of the said works contract.
- In the TRU Letter it has been stated that where VAT / Sales tax is not paid on actual value, value of works contract service shall be determined based on the actuals. So, in respect of a works contractor opting for composition under the State Sales Tax / VAT law, the value for the purpose of service tax would be determined based on the actuals

Site Formation and Clearance Agency

Section 65(105)(zzza) defines taxable service as "any service provided or to be provided to any person, by any other person, in relation to site formation and clearance, excavation and earthmoving and demolition and such other similar activities"

Section 65(97a) defines "site formation and clearance, excavation and earthmoving and demolition" as to include, —

(i) drilling, boring and core extraction services for construction, geophysical, geological or similar purposes; or

(ii) soil stabilization; or

(iii) horizontal drilling for the passage of cables or drain pipes; or

(iv) land reclamation work; or

(v) contaminated top soil stripping work; or

(vi) demolition and wrecking of building, structure or road,

but does not include such services provided in relation to agriculture, irrigation, watershed development and drilling, digging, repairing, renovating or restoring of water sources or water bodies;

Renting of Immovable Property

Section 65(105)(zzzz) – Taxable Service means service provided or to be provided "to any person, by any other person in relation to renting of immovable property for use in the course of furtherance of business or commerce."

Explanation 1 – "Immovable property" includes:-

(i) building and part of a building, and the land appurtenant thereto;

(ii) land incidental to the use of such building or part of a building

(iii) the common or shared areas and facilities relating thereto; and

(iv) in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate,

but does not include-

(a) vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes;

(b) vacant land, whether or not having facilities clearly incidental to the use of such vacant land;

(c) land used for educational, sports, circus, entertainment and parking purposes; and

(d) building used solely for residential purposes and buildings used for the purposes of accommodation, including hotels, boarding houses, holiday accommodation, tents, camping facilities

Explanation 2. – For the purposes of this sub-clause, an immovable property partly for use in the course or furtherance of business or commerce and partly for residential or any other purposes shall be deemed to be immovable property for use in the course of business or commerce.

Section 65(90a) – "Renting of Immovable property" includes renting, letting, leasing, licensing or other similar arrangements of immovable property for use in the course or furtherance of business or commerce but does not include-

(i) renting of immovable property by a religious body or to a religious body; or

(ii) renting of immovable property to an educational body, imparting skill or knowledge or lessons on any subject or field, other than a commercial training or coaching center

Explanation:- For the purpose of this clause, "for use in the course or furtherance of business or commerce" includes use of immovable property as factories, office buildings, warehouses, theatres, exhibition halls and multiple-use buildings;

Real Estate Agent's Service

Section 65(105)(v) of the Finance Act defines taxable service as "any service provided or to be provided to a client, by a real estate agent in relation to real estate";

Section 65(88) defines "real estate agent" to mean "a person who is engaged in rendering any service in relation to sale, purchase, leasing or renting, of real estate and includes a real estate consultant";

Section 65(89) defines "real estate consultant" to mean "a person who renders in any manner, either directly or indirectly, advice, consultancy or technical assistance, in relation to evaluation, conception, design, development, construction, implementation, supervision, maintenance, marketing, acquisition or management, of real estate"

SECTION II - VAT ON WORKS CONTRACT- KERALA

Section 2(lv) - "Works contract" includes any agreement for carrying out for cash or for deferred payment or other valuable consideration the construction, fitting out, improvement, repair, manufacture, processing, fabrication, erection, installation, modification or commissioning of any movable or immovable property

Section 2(xiv) - "Contractor" means any person who undertakes any works contract for execution and includes a sub-contractor

Section 2(vii) - "Awarder" means any person who awards any works contract to a contractor for execution.

Section 2(xliii) - "Sale" with all its grammatical variations and cognate expressions means any transfer whether in pursuance of a contract or not of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or for other valuable consideration, but does not include a mortgage, hypothecation, charge or pledge.

Explanation IV: - A transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract shall be deemed to be a sale.

Explanation VIII: - (c) For the purpose of this Act, the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract shall be deemed to have taken place in the State, if the goods are within the State at the time of such transfer irrespective of the place where the agreement of works contract is made, whether the assent of the other party to the contract is prior or subsequent to such transfer.

Section 6 – Levy of Tax

Every dealer whose total turnover for a year is not less than Rs.10,00,000/- shall be liable to pay tax on his sales or purchases of goods as provided in this Act. The liability to pay tax shall be on the taxable turnover -

- Where transfer of goods involved in the execution of works contract where transfer is in the form of goods - At the rates specified for such goods
- Where transfer of goods involved in execution of works contract, is **not** in the form of goods, but in some other form - At the rate of 12.5 per cent and when the transfer is in the form of goods at the rates prescribed under the respective Schedules.

Section 8 - Composition

Works contractor not being a dealer registered under the provisions of the Central Sales Tax Act, 1956 may, at his option pay tax at 2% of the whole contract amount.

Any works contractor who undertakes works of the Government Departments or Local Authorities or

Kerala Water Authority shall not be liable to tax under sub-section (2) of section 6, if he pays compounded tax at the rate of 3% on the whole contract amount.

Works contractor who intends to pay tax at compounded rate in respect of all the works undertaken by him during a year, may instead of filing separate application for, compounding for individual works may, file a single option for payment of tax under the said clause before 30th April of the year to which the option relates subject to eligibility.

In the case of any work which remains unexecuted or part of which remains to be executed at the end of the year, the contractor shall continue to pay tax in respect of such works in accordance with the provisions of clause (a) of this section.

Any works contractor, other than those undertaking electrical, refrigeration or air conditioning contracts or contracts relating to supply and installation of plant, machinery, rolling shutters, cranes, hoists, elevators(lifts), escalators, generators, generating sets, transformers, weighing machines, air conditioners and air coolers, deep freezers , laying of all kinds of tiles (except brick tiles) , slabs and stones (including Marble) , and not falling above, may, at his option, instead of paying tax in accordance with the provisions of the said sections, pay tax at 4% of the whole contract amount.

Explanation: "Whole contract amount" shall not include that portion of a contract which represents amount paid to sub-contractors for execution of works contract provided that the sub-contractor is a registered dealer liable to tax under sub-section (1) or sub-section (1A) of section 6, and the contractor claiming deduction in respect of such amount furnishes certificates in such form as may be prescribed.

Section 10 & Rule 42 – TDS on Works Contract

- Every awarder shall deduct from every payment, including advance payment, made by him to any works contractor liable to pay tax under section 6, in relation to any works contract awarded, the tax payable by the contractor in respect of such contract under that section, whether the transfer of goods involved in the execution of works contract is in the form of goods or not
- Pay the amount so deducted to the assessing authority, with whom the contractor is registered as a dealer.
- If he is not so registered, to the assessing authority having jurisdiction over the area where the works contract is executed
- Challan along with a statement in Form No. 20C on or before the 5th day of the month succeeding the month in which such deduction is made.
- Every such awarder shall also file such return as may be prescribed.
- The awarder shall obtain from the contractor a declaration in the prescribed form, showing his tax liability in relation to such works contract.
- The awarder shall obtain from the contractor quarterly certificate issued by the assessing authority showing the tax liability or tax remittances, as the case may be, of the contractor in relation to the contract up to the end of the previous quarter.
- The awarder shall, before making final payment to the works contractor in respect of any contract, obtain a liability certificate from the assessing authority.
- The awarder shall not insist from the contractor, not being a dealer registered under the provisions of the Central Sales Tax Act, 1956 any certificate issued by the assessing authority showing the tax liability or tax remittances, as the case may be, of the contractor, in relation to the contract, if he has opted for payment of tax in accordance with the proviso to sub-clause (i) of clause (a) of section 8.

No deduction if:

- No transfer of goods involved in the execution of the works contract or
- Goods transferred are only those falling under the First Schedule or
- Payment relates to that portion of a contract which relates to works contract other than those executed in the state.

TDS in case of composition

Where a contractor has opted for payment of tax at compounded rates in respect of a works contract in accordance with the provisions of section 8, the assessing authority shall specify, in the permission granted in Form No. 4D, the rate of compounded tax to be paid in respect of each contract. No certificate in Form No. 20A or Form No. 20B shall be required in respect of a contract for which the assessing authority has permitted payment of tax under section 8. The tax so recovered shall be remitted to government as provided for under sub-rule (2) above.

Payment without TDS

Any contractor who pays tax regularly in accordance with the rules, on production of a certificate issued to that effect by the assessing authority in Form. No. 20 E**,** shall be entitled to payment of the contract amount without deduction of sales tax due on the contract for a period of six months, to the extent of the works contract specified in the certificate, provided that final payment shall not be made unless the contractor produces a liability certificate issued by the assessing authority in Form No. 20B.

Supply of material by awardee

Where the awarder supplies any material to the contractor for use in the works contract and the price of the goods is deducted from the payment made to the contractor, the awarder shall furnish the details to the assessing authority along with the return filed under Rule 32.

Rule 9 - Determination of total turnover

The total turnover of a dealer for the purposes of these rules shall be the aggregate of-

(a) the amount for which goods are sold by the dealer;

(b) the amount for which goods, which is liable to tax under sub- section(2) of section 6 , are purchased by the dealer.

(c) total contract receipts, in the case of a works contract.,

(d) all receipts from 'transfer of right to use.'

Amount for which goods included in the Fourth Schedule are sold by the dealer shall not be included in the total turnover.

SUPPLY OF GOODS BY AWARDEE

Where the awarder supplies a portion of the goods involved in the execution of the works contract and deducts the value of the material from the payment made to the contractor, the turnover of the goods so supplied shall form part of the total turnover of the awarder as well as the contractor.

Transfer of goods in some other form

Taxable turnover in respect of the transfer of property involved in the execution of works contract shall be arrived at after deducting the following amount from the total amount received or receivable by the dealer for the execution of the works contract such as;

- labour charges for the execution of work,
- charges for planning and designing and the architect's fee;
- charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract, or where the machinery is owned by the contractor, the interest paid on any loan taken for the purchase of the machinery;
- cost of consumables used;
- cost of establishment and overhead charges of the dealer to the extent it is relatable to the supply of labour and service;
- profit earned by the dealer to the extent it is relatable to supply of labour and services.

Turnover not below cost

When the turnover arrived at after deducting the amounts mentioned in clause (a) falls below the cost of goods transferred in the execution of works contract, an amount equal to the cost of the goods transferred in the execution of works contract together with profit, if any, shall be the taxable turnover in respect of such works contract.

Explanation.- For the purpose of the proviso, **cost of goods** means the price of goods together with all expenses incurred by the contractor in bringing the goods to the work site.

Turnover not ascertainable from books

Where the actual turnover in relation to a works contract, in which the transfer of goods takes place not in the form of goods but in some other form, is not ascertainable from the books of accounts of the dealer or where the dealer has not maintained any accounts, the total turnover in respect of such works contract shall be computed after deducting labour and other charges as prescribed in the Table from the total amount of contract.

SECTION 6(2) (C) - PURCHASE TAX

Every awarder, not being a Government department or Local Authority, who purchases taxable goods from any person, other than a registered dealer, within the State for execution of works contract and issues the same for incorporation in the work, without including its value in the gross contract amount, shall pay tax on the purchase turnover of such goods at the rates specified, if the cost of the work including the value of materials supplied by the awarder exceeds one crore rupees.

IInd Technical Session

PROFILE

CA. G. RAMASWAMY BCOM, FCA, FCS

The Institute Of Chartered Accountants Of India (ICAI), New Delhi
Central council member 2007-2010

Present portfolio :-

Chairman	• Fiscal Laws committee
Vice Chairman	• Continuing Professional Education committee
Member	• Auditing & Assurance Standards Board • Committee on Ethical standards • Professional development committee • Research committee • Audit committee • Committee on Corporate governance
Nominee of the Council	**Quality Review Board – a newly constituted body**
Chairman	SIRC audit committee
Convenor	PDC's Professional development task force-Kerala State

Chairman - SIRC [1999], Chairman - SICASA [1996]
Chairman - Coimbatore Branch [1990-1991]

PERSONAL PROFILE

Hailed from Industrial city of Coimbatore born in Vellakinar village in the year 1954 in an agricultural family.

EDUCATION:

- Fellow Member of the Institute of Chartered Accountants of India [ICAI]
- Fellow Member of the Institute of Company Secretaries of India [ICSI]
- Associate Member of the Institute of Internal Auditors (IIA USA)

EXPERIENCE IN PROFESSIONAL AREAS:

Practicing as a Chartered Accountant since 1984

- Experience in the field of taxation, Company Law matters, Company

  Audit, Internal Audit, Bank Statutory Audit, Inspection Audit,Insurance Audit, Revenue Audit, Tax Audit, Company Formation,

  Conversion of Companies, Exposure Project Finance, Management & tax consultancy, Exposure in handling Trust, AOP, for more than two decades
- Representation Before The Income-tax Tribunal, Sales-tax Tribunal, BIFR, Company law affairs and Income-tax and Sales-tax Authorities

OTHER INTERESTS

- **He has interests in other fields viz. Agriculture, Industries, Banking etc.**
- Widely traveled across India, foreign countries
- Professional Golfer and winner of many tournaments
- Past Secretary-Lions Club of Coimbatore North.
- Acted as a Election Observer for the local body election held on 12th October 1996

ISSUES IN SURVEY, SEARCH, SEIZURE AND ASSESSMENT UNDER INCOME TAX ACT

G. Ramaswamy
Council Member ICAI
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Introduction

The department is conducting surveys and searches in order to unearth undisclosed income and to make proper assessment of income to levy tax on the asseessee's.

No doubt, these provisions, which are enabling the Income tax department to issue summons, conduct survey, search & seizure a serious intrusion is being done into the personal rights of a citizen. But in public interest, it becomes necessary that these provisions are applied without resentment.

Survey Under Section 133A

The Income tax authorities may not be in a position to unearth the undisclosed income in every case by resorting to search operations. They can conduct survey and bring out the undisclosed or unrecorded income under the tax net. Survey means, examination in a comprehensive manner or measuring the area etc., and for this purpose "Survey" under the Income-tax Act, 1961 means

"The collection and appraisal of information, for the purpose of proper assessment."

Income Tax Authorities Who Can Conduct The Survey

As per the clause (a) of explanation to section 133A the following persons are empowered to conduct the survey.

- Commissioner of Income tax
- Joint Commissioner /Addl. commissioner of Income tax
- Director IT
- Joint Director
- Deputy Director IT
- Assistant Director IT
- Assessing Officer
- Tax recovery officer
- TDS officer

If authorised by the authorities the Inspector of Income-tax can also conduct survey for the following purposes:

- Clause (i) of sub-section (1) of section 133A i.e. inspection of the books of accounts and other documents available at the place of business or profession.
- Clause (i) of sub section (3) of section 133A i.e placing of marks of identification on the books of accounts or documents etc. inspected by him, and taking extracts there from.
- Sub-section (5) of section 133A authorizes inspectors to collect information and record statements from any person concerned or in connection expenditure incurred in any function, ceremony or event even before the assessment, to use the information in the assessment proceedings. This can be exercised only after the function or the ceremony is over.

Proviso to Sec 133A (6) whereby the Joint Commissioner/Joint Director should give prior approval for conducting surveys by other Income-tax authorities.

The Tax Recovery Officer has been included under the definition 'Income Tax Authority and he has the power to conduct surveys.

Whether Income-tax officer appointed to do the functions of TDS can conduct survey under section 133A and issue summons under sections 131?

Yes, since CBDT has authorised such prescribed authorities to conduct survey and issue summons for production of books and documents. Reckitt and Colman of India ltd., Vs Asst. CIT (TDS) (2001) 251 ITR 306

The power has been given to the Income tax authorities to impound any books of accounts and other documents inspected at the time of survey. But the stock and other valuables cannot be seized in a survey operation.

Jurisdiction

Income-tax Inspector can exercise the power of survey vested in him only if he is authorized by Assessing officer who is having jurisdiction over the area. As per clause (a) and (b) of sub section (1) of Sec 133A, the powers of survey extends only in respect of the place of business or profession falling within the limits of the area assigned to the assessing officer. But the words "Place of business "also cover the place where books of accounts or such articles or goods or documents relating to business are kept.

Under Section 133A the Income-tax authority should be offered the facility to inspect the books of accounts. If the assessee does not offer such facility the IT

Authority can exercise such power U/S 131(1) and (2) which makes it obligatory on the assessee to afford such facility to IT authority. But the inspector of IT does not have such powers, vide Om Prakash Chopra & Co Vs Asst Commissioner of Income Tax. (4DTC 140) (UP –Trib)(1998) P.140

The inspector has no power to record a statement on valuation of stock ITO Vs Jewels Emporium (1994) 48 ITD 164 (Ind-Trib)

It was observed in the case of ITO Vs Jewels Emporium (1994) 48 ITD 164 (IND Tri) that the Income-tax Inspector will be acting beyond his powers vested under the Act to take an inventory of stock and record a statement on oath from an assessee while acting under the powers of survey U/ S 133A. The Inspector can claim facility to inspect such books of accounts or documents as may be available at the place of business under Clause (i) of subsection (1) and place marks of identification in the books of accounts or documents inspected by him and take extracts there from under clause (i) of sub sec (3) and collect information in respect of any function, ceremony or event after such occasion U/ S/ 133A(5). Even for performing the functions he has to be authorised by the IT Authorities stated in Sec133A (6)(a).

There is no specific provision for cross-examination of persons who have given the statements during the survey operations. Ref: Rameshwar lal Mali Vs CIT (2002) 256 ITR 536 (Raj)

Place Of Survey

The authorities authorised under the Section 133A can enter:

- Any place within the limit of the area assigned to them
- Any place occupied by any person in respect of whom he exercises jurisdiction

Any place in respect of which, he is authorised for the purposes of this section by such income tax authority having jurisdiction over such territory or such place at which the business or profession is carried on. The survey can be conducted only at the business premises. However, survey can be conducted at any other place where the following articles are kept:

- Books of accounts or other documents
- Any cash or stock or other valuable articles
- Things relating to his profession or business.

"Residential premises of the assessee and the business or residential premises of third party including Chartered Accountants and advocate and income tax practitioner of whom the assessee may be a client are not the places which could be entered into for the purposes of section 133A."

As per the circular no. 7/03-05-1967, a survey cannot be conducted at the office of the Chartered Accountant. However, if the assessee informs the department that the books of accounts are laying in the office of his Chartered Accountant, the department can enter the office of the concerned Chartered Accountant and request the books concerned for verification in this regard. A survey can be conducted in godown, branch or part of residential premises and also other places, where he is conducting business or profession.

Timing For Survey

The power of survey is limited, only to enter the place of business or profession of the assessee. Further, the authorities can enter only during the business hours.

In the case of survey of any other place where the books of accounts, valuables etc are kept, entry can be made only after sunrise, but before sun set. After entering, the authorities can continue the survey with out any time limit.

Powers Of Surveying Authority (Section 133A (3))

The surveying authority is vested with the following powers

- Inspection of the books of accounts and other documents available at the place of survey.
- Placing of marks of identification and taking of extracts there from. But he is barred from making entry in such books in his own hand.

  Ref: Gyan chand Bhajanlal Vs ITO (1987) TLR 233(Asr-Trib).

Finance Act, 2002 has given power to the Income-tax authority to impound any books of accounts and other documents inspected at the time of survey. Still stock and other valuables cannot be seized in a survey operation.

Clause (ia) has been inserted w.e.f 01-06-2002 and reads as follows: -

"Impound and retain in his custody for such period as he thinks fit any books of accounts or other documents inspected by him".

Under the then provisions of section 133A an income tax authority could impound and retain books of accounts produced for 15 days only without any approval from the CIT or Director. The Finance Act, 2003 has reduced the period of retention from 15 days to 10 days. The powers for according approval, for retention or impounding of books of accounts has been taken away from the Commissioner/ Director and the powers are now vested with the Chief Commissioner or Director General.

Further, an Income-tax authority has the power of:

- Verifying the cash, stock/other valuables found in the premises & making an inventory of the same.
- Requiring the proprietor/ employee to furnish information & recording the statement of any person, which is relevant to any proceeding under the act.

As the tribunal being a fact-finding authority, has powers to call for records which are confidential viz statements recorded during survey or the inference of a search officer in an appraisal report might help the tax-payer. These can be cancelled for and claimed.

Section 133A (5)

To collect information regarding nature/scale of expenditure in connection with personal functions from the assessee/ any other person likely to posses such information. On the basis of such information, addition can be made u/s 69C for unexplained expenditure. This addition cannot be made on estimated basis. The onus of proving the non-incurrence of expenditure lies on the assessing officer. Reference in this regard can be made to the decision in Rajkumar Jain Vs Asst. CIT (1994) ITD 1 (All – Trib). The decision in Dr. Vijayakumar Vs ITO (1994) 48 TTJ (JP-Trib) 411, refers to the circumstance in which expenditure need not be treated as unexplained expenditure, even if the assessee does not show certain expenditure.

Section 133A (6)

If a person does not co-operate with the income tax authorities as required under this section, they can enforce his compliance u/s 131(1) as per the law.

Statement during the survey

The statement given by an assessee in the course of survey u/s 133A is not under oath as in the case of search u/s 132(4). Hence, the statement recorded u/s 133A cannot be given any evidentiary value obviously for the reason that the officer is not authorized u/s 133A to administer oath and to take any sworn statement which alone has evidentiary value as contemplated under law – held in the case Paul Mathews and Sons vs CIT – 263 ITR 101 KER.

Survey And Search

In case there is a survey and the same assessee, some times survey can be converted in the search. The amount accepted during survey cannot form part of undisclosed income. The decision was rendered by Nagpur Bench of ITAT in Prakash Tulsidas Vs ACIT 73 ITD 446(2000) is in favour of the above view.

Sealing Of Business Premises

There is no provision of sealing business premises either under section 133A or any other section of the Income-tax Act. 1961.

Operations Of Search & Seizure: Section 132

The search and seizure operations under the Income-tax Act are a plan of action prepared by the investigation wing with utmost secrecy based on the materials gathered by them either from their own dept. or through some informers. The entire materials collected are to be verified by the higher authorities before granting any sanction to an authorized officer to conduct the search.

Under the general meaning of the word "Search" is "taking possession of records etc., for the purpose of inspection. The "seizure" precisely means the authority could take into possession records, documents, or other valuables from the possession of the assessee.

The search and seizure operations are covered u/s.131, 132, 132A, 132B and rules 112,112A, 112B, 112C & 112D of the Income-tax Act,1961.

Powers Regarding Discovery, Production Of Evidence Etc

Sec 131(1A) of the Income-tax Act,1961, authorizes the Income-tax authorities specified therein for inspecting, discovering and enforcing the attendance of any person, compelling the production of books and other documents and for issuing summons. The authorities can exercise these powers only when the circumstances specified u/s.132 of the IT Act warrant.

Granting Of Authorization – A Background

The Director General/ Director /Chief Commissioner / Commissioner or any such Joint Director or Joint Commissioner empowered under section 132(1) in this behalf by the BOARD in consequence of information in his possession has reason to believe that :

a) Any person to whom summons was issued u/s.131 (1) or notice u/s.142 (1) were issued has omitted or failed to produce the books of accounts or other documents.

(Or)

b) Any person to whom a summons or notice has been or might be issued will not or would not produce books of accounts or other documents as specified.

(Or)

c) Any person who is in possession of any money, bullion, jewellery or other valuable articles or things represents either wholly or partly income or property which has not been or would not have been disclosed for purposes of IT Act.

If any of the above condition exists, the Director General or the Director, Chief Commissioner or Commissioner as the case may be, may authorise any Joint Director, Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner or Deputy commissioner or Income Tax officer,

(Or)

Such Joint Director or Joint Commissioner may authorise any Assistant Director or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income tax Officer to conduct search and seizure of the assets or documents.

The person officer who has been authorized to conduct the search and seizure is the Authorized officer.

- Whether Non Resident Indian is subject to search under the Income-tax Act,1961?

  An interesting point was raised by a person claiming that, he would not be liable to tax in India who was an NRI and was therefore not subject to tax in India. Hence not subject to search proceedings. The Rajasthan High Court held in the case of Ram Kumar Dhanuka V. Union of India that even a NRI would have income earned in India, which might have to be taxed, or which might not have been disclosed. Ref: (2001) 252 ITR 205. Hence a NRI is also subject to search proceedings.

- Whether Additional Director can authorize the search?

  There are two views about the powers of Additional Director as to whether he is authorized to issue search warrant or not? As per the decision of Punjab and Haryana High Court in Vinod Goel Vs. Union of India (2001) 252 ITR 29 (P&H), the Additional Director can also be considered under the inclusive definition of Sec 2(21) & 116(cc) for the definition of Director General. But in the case of Dr. Nalini Mahajan Vs. DIT 257 ITR 123 the Delhi High Court held the view that the sec 2(21) when independently applied ignoring sec 132(1), the Additional Director is not an authority having power to issue a search warrant. Now it is open for the assessee to argue that the beneficial view can be considered in an appeal before the appellate authorities, where two views are possible.

Where petitioner questioned the legality of search pointing out that authorisation for search was by Additional/Deputy Director of Income-tax whereas no such post was in existence, and records clearly revealed that authorisation was given by Additional Director and there was an innocuous omission to delete word "Deputy" such clerical mistake or omission could not be said to be fatal to legality of search.

Ref: Arti Gases Vs Director of Income-tax (Inv) [2000] 113 Taxman 68 (Guj)

Authorisation /Search Warrant

The basic document, which is to decide the entire search proceedings and subsequent assessment, is issue of search warrant. It requires proper legal sanction and preparation under the provisions of section 132 and relevant rules 112 A, 112B, 112C in form no 45, 45A, 45B and 45 C. If the search warrant issued without mentioning the name of the persons, the warrant cannot be considered as enforceable one.

The application of mind is to be gone through from the issue of search warrant. The search warrant issued in the name of the firm cannot be used to seize the assets of the individual partners.Ref: Nenmal Shanlalal former vs. ACIT (1992) 195 ITR 582(Karn)

The blank search warrant issued by the Commissioner and later on filled by another officer can be considered as illegal warrant.Ref: Jagmohan Mahajan VS CIT (1996) 103 ITR 579

Where original order before issuing authorisation, showed that Director of Investigation had reasonable information and there was no mala fides attributed in issuing the authorisation, search warrants could not be held to be invalid.

(i) Vipan Kumar Jain Vs Union of India [2001] 249 ITR 728

(ii) Narendra Kumar Jain Vs Dy. CIT [2001] 119 Taxman 213 (Luck) (Mag)

Search warrant in the case of a company cannot be treated to be authorisation of search in case of individual directors

As per section 132 (1) (iii) the power of seizure has to be exercised with the warrant of authorization issued. In all cases the seizure will be authorised in the warrant. The constructive seizure by passing prohibitory order u/s 132 (1) and restraint order u/s 132 (3) is made if it is not possible to seize such books or documents etc., of the owner or any such person in control of the materials. Sonu Systems (P) Ltd., Chairman CBDT [2001] 250 ITR 268 (Delhi)

Where there was sufficient material on record and sufficient application of mind on the part of income tax authorities for issuance of warrants of authorisation for carrying out search and seizure operations against petitioners, the contention that search and seizure proceedings were bad would be unsustainable Validity of a search and seizure under section 132 has to have a clear-out nexus with warrant of authorisation, which is the main foundation of entire proceedings of search and seizure and thus where warrant of authorisation had been issued in the name of "A" it could not be treated as one taken to be in the name of B or C, such as issuance of notice and completion of block assessment which will render it defective, illegal and invalid. Verma Roadways Vs Asst. CIT (2000) ITD 183 (AII)

Information

For the purpose of taking an action u/s.132, there should be proper information leading to reason to believe that income would not be disclosed or capable of giving inference that there exists undisclosed income. The information may arise out of the following circumstances,

i) Seizure of cash & jewellery by the police, customs & central excise department.

ii) Bogus address/ transaction found out by any of the intelligence wings.

iii) Information gathered from informers.

iv) Information from employees.

v) Persons regularly disclosing very low income found with heavy cash or other valuables.

vi) Anonymous and pseudonymous petitions.

vii) Survey by the department.

Reasons To Believe

For the purpose of authorizing the search the authority must come to the conclusion that there's a " Reason to believe " that there is an undisclosed income or income escaping assessment.

The Delhi High Court in the case of Subhir Ray Vs S.K. Chattopadhyay (1986) 156 ITR 472 (Delhi) has held that:

"There could be rational connection between the information in possession and the belief formed thereon which would not be influenced by extraneous or irrelevant considerations. The existence of belief is necessary but not the sufficiency of the belief. The Court cannot substitute it's own reason and thereby step into the shoes of the concerned authority. "

This belief, of course cannot be mere pretence nor can it be a mere doubt or suspicion. It is something much more than that. Thus Section 132 speaks of "Reason to believe" and not "Reason to suspect " or "Reason to Doubt."

In the case of Union of India Vs Ajit Jain and another (2003) 260 ITR 80 (SC) the Apex Court held that the decision rendered by the Delhi High Court in (2000) 242 ITR 302 was valid. In this case merely on the basis that money was found by the CBI with the assessee, without any valid information, requisition under section 132A was made. For a valid search which provides a reason for believing that the person concerned was in possession of money or other assets representing either wholly or partly income which has not been or which would not be disclosed by such person and in the absence of such information search could not be validly authorized. The Supreme Court dismissed the appeal filed by the department.

In the case of Dr.A.R. Bansal Vs Asst Commissioner of Income Tax Vide ITAT (B) Allahabad Bench (Vol III P. 179) Taxman

A Block assessment was made following the search. The assessee contended as the conditions as per clause (a) or (b) or (c) of Sec 132 (1) were not satisfied, no search could be conducted and consequently no Block Assessment could be made. His further contention was that the satisfaction note of the Authorizing authority to issue search warrant was not met. It was held in this case that before having " Reason to believe "and issue of search warrant that authority should satisfy itself with respect to existence of circumstances enumerated in Sec 132 (1).

A search conducted under Section 132 of the Income-tax Act,1961, is a serious intrusion into the privacy of a citizen. Section 132 (1) has to be strictly construed and the formation of opinion or reason to believe by the authorizing officer must be apparent from the note recorded by him. The opinion or the belief so recorded must clearly show whether the belief falls under sub-clause (a), (b) or (c) of Section 132(1). No Search can be ordered except for any of the reasons contained in sub-clause (a), (b) or (c). The satisfaction note should itself show the application of mind and the formation of opinion by the officer ordering the search.

The ITAT in the case of C. Ramaia Reddy vs Asst. CIT [Blore] also held that the Tribunal can look into the matters referred in sec. 132.

The information regarding the search need not be handed over to the assessee. Southern herbals Ltd [1994] 207 ITR 55. The decision of Delhi ITAT in the case of Virander Bhatia vs Dy CIT [2001] 79 ITD 340 supports. Hence ITAT has no power to scrutinize the same.

If the reasons, which are recorded, do not fall under clause (a), (b) or (c), then the authorization under Section 132(1) will have to be quashed as was held in the case of L.R.Gupta Vs Union of India (1992) 194 ITR 32 (Delhi). References in this regard can be made to: Kusum Lata Vs CIT (1989) 180 ITR 365 (Rajasthan)

Recording Of Information And Belief

Before issuing the authorisation to conduct the search, the authorities must record the reasons and belief for issuing a warrant of search.

The issue of search warrant is not a judicial or quasi-judicial process. If the authority is satisfied about the information and in consequence of this, formed a necessary belief, he can issue a warrant. The court cannot interfere or scrutinize the same.

ITO Vs SETH Brothers (1969) 74 ITR 836.

Ajit Jain Vs Union of India [2000] 242 ITR 302 (Delhi)

A mere intimation by the CBI to the income-tax authorities about the recovery of cash from the petitioner could not constitute information within the meaning of section 132(1) of the Act particularly when the petitioner had also stated on oath that the entire money found in his possession was reflected in the books of account of the company which was a regular assessee. Rajendra kumar Jain Vs Union of India [2000] 245 ITR 574 (Raj)

Where third party claims that material seized during search belongs to him, Assessing Officer must issue notice under rule 112A to the third party and give him an opportunity of hearing

Powers Of The Authorised Officer

The authorized officer under this section, if he has reason to suspect can

(i) Enter and search any building, place, vessel, vehicle, or aircraft where he has reason to suspect that such books of account, other documents, money, buillion, Jewellery or other valuable article or thing are kept

(ii) Break open the lock of any door, box, locker, safe, almirah, or other respectable for exercising the powers conferred on him

Search any person who has got out of or is about to get into or is in the building, place, vessel, vehicle or aircraft, if the authorised officer has reason to suspect that such person has secreted about his person any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing.

Require any person who is found to be in possession or control of any books of accounts or other documents maintained in the form of electronics record as defined in clause (f) of sub-section (1) of section 2 of The Information Technology Act 2000 to afford the authorized officer the necessary facility to inspect such books of account or other documents.

Seize any such books of accounts, other documents, money, bullion, Jewellery or other valuable article or thing found as a result of such search.

"The Finance Act 2003 has inserted a proviso to section 132 (1) (iii) so as to provide that any bullion, Jewellery or other valuable article or thing being stock-in-trade of the business found as a result of search shall not be seized but the authorized officer shall make a note or inventory of such stock-in-trade of the business."

1. Place marks of identification on any books of accounts or other documents or make or cause to be made extracts or copies there from.
2. Make a note or an inventory of any such money, bullion, Jewellery or other valuable article or thing.

Proviso – Jurisdiction

The first proviso of 132 (1) empowers the authorised officer to conduct a search on any person, any building, place, vessel etc., coming under the jurisdiction of any other Chief Commissioner or Commissioner but who is not having jurisdiction over the person on whom such warrant was issued can exercise the power without following the procedure u/s 120 if he has a reason to believe that the delay in getting authorization will be prejudicial to the interest of revenue.

Seizure

The seizure of the asset specified under 132(1) (iii) is only the physical seizure effected by the authorised officer.

The seizure is an expression, which implements forcible ex-action or taking possession. The department cannot seize the assets declared to the department during the search operations. Ref: L.R. Gopal Vs Union of India 1991 59 A Taxman 305 Delhi.

The seizure of immovable property is a seizure resolved by the Kerala High Court CIT Vs M K Gabriel Babu (1991) 188 ITR 464(Ker)

Authorization issued as per the information received from police without application of mind is a clear case for absence of pre – condition as contained in section 132A and the amount seized has to be refunded as was held in B.R. Metal Ltd. & others vs. C.I.T (1999) 239 ITR 329 (Guj).

CIT Vs Vindya Metal Corporation (1997) 224 ITR 614 (SC) Mere possession of cash recorded in books cannot be a ground for action u/s 132A.

Constructive Seizure

The second proviso authorizes that if it is not practicable or possible to take physical possession of any valuable article or thing or remove it to a safe place due to its being of dangerous nature to handle, voluminous in terms of number or weight or other physical characteristics, the authorised officer may serve an order on the person in charge or in the immediate ownership or possession of the article or thing, that he should not remove or part with or otherwise deal with it without the prior permission of the authorised officer. It should be deemed to be a seizure of such valuable article or thing under clause (iii).

"The Finance Act 2003 has inserted a proviso after the second proviso to sub-section (1) of the aforesaid section so as to provide that nothing contained in the second proviso shall apply in the case of any valuable article or thing, being stock-in-trade of the business."

Sec 132A - Power Of Requisition Of Books Of Accounts

Similar to sec 132 of the Act, the Income tax department can apply Section 132A to unearth the undisclosed income. They can issue requisition to any authority or Officer who has in his custody books of Accounts or documents or assets. Ref: Abdul Khader Vs Sub-Inspector of Police [1999] 240 ITR 489 (Ker)

Section 132A does not empower the Commissioner to require the court to deliver the assets. The provision refers only to an "officer" or "authority" referred to under sub-section (1) and not the court.. Ref: Janardan Das Vs Bindeshwari Prasad Sah [1999] 238 ITR 65 (Pat).

Power under section 132A should be exercised immediately after the assets are seized by making a requisition to police, u/s 132A(1) which will not be applicable in the proceedings before a court Ref: "Samta Construction Vs. Pawan Kumar Sharma [1999] 107 Taxman 198 (MP)"

A bank draft, when presented by a customer to the bank for clearing, cannot be requisitioned from bank by Competent Authority. Ref: Amandeep Singh Vs Director of Income-tax [2001] 252 ITR 139 (Punj. & Har).

Without obtaining order of Magistrate under section 457 of CR.P.C.Police Officer cannot deliver custody of seized cash to income-tax authorities under section 132A (2).

Prohibitory Order

In the case of Sec 132 (3) the Authorised Officer has power to pass prohibitory order, if it's not practicable to seize any such books, documents etc on the owner or the person in control of the material specified, prohibiting him from removing or parting with the asset except with the approval of the Authorizing Officer. This prohibitory order will not amount to seizure of the articles or things under any of the provisions of this Act.

The explanation under this section is very clear that the prohibition order cannot be treated as seizure under clause (iii) of 132 (1).

Panchanama Vs Prohibitory Order U/S 132 (3) r.w.s 158 BD

The PANCHANAMA is an important document to decide the fate of the assessment order. The authorised officer merely stating in the Panchanama that the search was temporarily suspended and authorized officer cannot keep the search operation open by passing prohibitory order.

The block assessment order passed on the basis of the last prohibitory order is treated as time barred u/s 158BE read with explanation in section 132(3). Ref: CIT Vs Sandhya P. Naik (2002) 124 Taxman 384 (Bom).. Ref: C. Ramaia Reddy vs Asst. CIT [2004] 268 ITR 49 [AT] [Blore]

Witness To Search

Search which spans over a long period, need not be witnessed by same person. Ref: T.S.Chandrashekar Vs Asst. CIT [2000] 66 TTJ (Bang) 360.

Statement U/S.132 (4) Confession Statement:

The Finance Minister while presenting the Finance Bill, 2003 has assured to the Members of the Parliament that there will not be any confession statement from the persons on whom search operations are initiated. The subsequent circular in F No. 0286/2003 issued by the CBDT also confirmed the same. As per the circular even for the pending assessment also, the Department must rely on the material, not only for search cases but also for the survey cases.

However, section 132(4) is still in the statute book without any amendment and the statement recorded under this section will be used for preparing the appraisal report by the department.

During the search operations, the Authorised officer may record a statement from any person who is found to be in possession of books of accounts, documents, bullion, money etc and he may record any other statement for the purpose of investigation under the Income Tax Act.

The admissions made by the person in the statement recorded as undisclosed income will be binding on the person unless retracted by him subsequently or otherwise proved that no material evidence existed for the statement admitted during the search or the statement was recorded under threat in a coercive manner by the Department.

Can, the assessee can declare or surrender the concealed or undisclosed income by way of statement under section 132(4) of the Act, before the authorized officer, to avail the benefit of penalty under explanation 5 to section 271 (1)(c) of the Act?

Generally after recording the statement, the department will not supply the copies recorded to the persons. However it's the duty of the Assessing Officer to supply a copy of the same before using it for the assessment of the assessee. The assessee must always apply for a copy of the statement recorded by the Department during the course of search operations.

In Pullangode Rubber & Produce Co Ltd [1973] 91 ITR 18 [SC] Hon'ble Supreme Court has held that "an admission is an extremely important piece of evidence but it cannot be said that it is conclusive. It is open to the person who made the admission to show that it is correct". Ref: Alapati Venkata Ramaiah vs CIT [1965] 57 ITR 85 [SC]

Reference in this regard can also be made to:

- Chuharmal vs CIT (1998) 172 ITR 250 (SC).
- J.S.Parker vs. V.B.Parker (1974) 94 ITR 616 (SC)

After giving the statement u/s 132(4), the assessee can retract the admission within a reasonable time. The department cannot make addition on the basis of admission alone. But at the same time the assessee must prove that the admission is not correct. The assessee can cite the following decision in his favour.

Karam Chand Vs. Assistant Commissioner of Income tax 73 ITD 434

Nagindas Dayabhai Patel Vs. Assistant CIT (1999) 104 Taxman 80 (Ahd- Trib) Pullagode Rubber Products Co. Ltd.,

"An admission is an extremely important piece of evidence but it cannot be said that it is conclusive. It is open to the assessee who made the admission to show that it is incorrect."

Krishan Lal Shiv Chand Rai Vs CIT (1973) 88 ITR 293 (P&H)

"It is an established principal of law that a party is entitled to show and prove that the admission made by him probably is in fact not correct and true."

-Jagdish Chand Gupta Vs Assistant CIT (1996) 58 ITD 142 (Chd-Trib)

-Baidev Krishan Kapoor Vs Assistant CIT (1999) 68 ITD 37 (Chd-Trib)

-Nagindas Dayabhai Patel Vs Assistant CIT (1999) 104 Taxman 80 (Ahd)

-Hotel Kiran Vs Asst. CIT [2002] 82 ITD 453 (Pune)

Where statement under section 132(4) was voluntarily made and there was no coercion or threat whatsoever and contents of statement were clear and unambiguous, same would be binding on assessee even if it were subsequently retracted.

Evidentiary value of admissions

ACIT Vs Mrs. Sushiladevi S.Agarwal, (50 ITD 524).

"There is every likelihood of a statement recorded on the search day being incoherent. All that is stated by the defendant on search day should not be taken as the truth. Such statements undoubtedly have evidentiary value and credibility in law, but the same should be viewed with great caution, particularly when denied, varied or retracted or established by the defendant to have been obtained or given under mental stress, coercion, undue influence or due to any other abnormal condition, etc., Therefore, a statement made u/s 132 (4) of any income on behalf of the assessee has to be discounted to a large extent and in any case, in the absence of there being any material to support such declaration, it could not have been relied by the department".

In the case of Joem & V.Subramanyam Vs Returning Officer, AIR 1977 SC 1724

The SC while dealing with the value of an admission have observed that an admission, if clearly and unequivocally made, is the best evidence against the party making it and though not conclusive, shifts the onus on to the maker, on the principle that what a party himself admits to be true may reasonably be presumed to be so and until the presumption was rebutted the fact admitted must be taken to be established."

Ref: Nathoolal Vs Durga Prasad, AIR 1954 SC 355.

What a party admits must be presumed to be true unless contrary is shown.

Avadh Kishore Das Vs Ram Gopal, AIR 1979 SC 861.

Evidentiary admissions are not conclusive proof of the facts admitted and may be explained or shown to be wrong, but they do raise an estoppels and shift the burden of proof on to the person making them or his representative in interest; unless shown or explained to be wrong, they are an efficient proof of the facts admitted.

The Punjab & Haryana High Court held in Krishanlal Shiv Chand Rai Vs CIT, 88 ITR 293 (P & H)

That it is an established principle of law that a party is entitled to show and prove that the admission made by him probably is in fact not correct and true.

Whether Retraction Of Admission Is Possible

The observation of Pune Bench in Kasat Paper & Pulp (74 ITD 455) is as under: -

There cannot be estoppels against legal principles and therefore if the income does not accrue to the assessee, the same cannot be taxed merely on the ground that it was offered for taxation. The assessee can always retract if the amount offered cannot be taxed under the law". Jagadish Chand Gupta Vs ACIT (Chd) 58 ITD 142.

The alleged admission/confession statement of the assessee admitting payment of Rs. .48 lacs to J was subsequently denied and the circumstantial evidence supported the case of the assessee. Karamchand Vs ACIT (Chd) 73 ITD 434

The assessee had surrendered certain amount of his UDI in the statement u/s 132(4) but later on, after going through the record and relevant facts, he found that the income kept away from the eyes of the department was much more and he partly offered the same for settlement before the Settlement Commission and balance in the return filed for the assessment year 1988-89. On the facts of the case, the reasons given by the assessee for showing a figure lower than the figure declared as UDI in the statement u/s 132(4) in the return of income were valid, cogent and plausible and there was no material on record brought to the notice to hold otherwise. Hence, addition stood deleted. Baldev Krishnan Kapoor Vs ACIT 68 ITD 37 (Chd) ™

A statement induced by misrepresentation of facts or without confronting assessee with those documents, which formed subject matter of surrender, could not be treated as valid and legal and an assessee is within his rights to resile from it subsequently. An addition made by the assessing officer on the basis of surrender obtained by misrepresenting facts was liable to be deleted.

Sec 132(4A) – Legal Presumption

As per section 132(4A) the department can make a presumption that the books of accounts, other documents, money, bullion, Jewellery or other assets found in possession or control of a person in the course of search can be presumed to belong to that person. This presumption u/s.132 (4A) is rebuttable and the person in whose possession the above said materials are found alone can give the proof. The supporting decisions are rendered in the following cases.

- D.K.Gupta Vs Deputy CIT (1998) 60 TTJ (Del-Trib)
- Pushkar Narain Sarraf Vs CIT (1990) 183 ITR 388 (All)
- R.N.Ghiya (Late) Vs CIT 91995) 54 ITD 269 (Jp-Trib)
- Mansukhlal Nanjibhai Patel Vs Dy. CIT [2001] 251 ITR 341 (Guj).

Where certain documents were seized from residence of director of company and there had been no enquiry as to whether money mentioned in documents belonged to the petitioner director or company Tribunal was not justified in holding that income disclosed in documents belonged to such director

Prathana Construction (P) Ltd., Vs Dy. CIT [2001/ 118 Taxman 112 (Ahd)

Presumption under the provisions of sub-section (4A) of section 132 will not be applicable to third party from whose possession such papers and documents have not been found by revenue.

Unique Organisers & Developers (P) Ltd., Vs Dy. CIT [2001] 118 Taxman 147 (Ahd) (Mag)

Presumption under section 132(4A) would not be applicable to a third party who has not been found in possession of such paper/document by the revenue.

Section 132(4A) is having limited application with reference to summary assessment u/s.132 (5). Since this section has been omitted with effect from 1.6.2002, it has an implication for block assessment and also for the purpose of section 132B.

As per Sec 132 (8) w.e.f. 1.6.2002 the seized articles books of accounts or other documents shall not be retained by the Authorised Officer for a period of more than 30 days after the completion of block assessment order u/s. 158BC.

As per Sec 132(8A), the prohibitory order passed, cannot be in force for more than 60 days from the date of the order.

As per Sec 132(9), the person from whom the books and documents have been seized can have the right to take copies of the same with the permission of the authorised officer.

Sec 132(9A) - Prior to the amendment, the authorised officer must hand over the books of accounts and other documents or assets seized to the assessing officer having jurisdiction over the person within 15 days from the date of seizure. The present amendment authorises the authorised officer to hand over the books of accounts or other documents or assets seized u/s. 132 or 132 A and 132 B within a period of 60 days from the date on which the last day of authorisation for search is executed.

All redundant sections like 132(5) to (7), 132(11), 132(11A) and 132(12) have been removed.

Sec 132B - Application Of Seized Or Requisitioned Assets

That the amount of any existing liability including the one raised under chapter XIVB for the block period, as also interest and penalty in respect of which such person is in default has to be collected first.

Provided the assessee explains to the satisfaction of the assessing officer the nature and source of acquisition of asset. In such case the existing liability may be recovered first and the remaining asset being released after obtaining approval from chief commissioner.

1. Assets mentioned above have to be released within a period of 120 days from the date on which the last day of the authorisation for search u/s.132/132A was executed.
2. If the assets consist solely of money or partly of other assets the assessing officer may apply such money in the discharge of existing liabilities as stated above.
3. The assets other than money has also to be applied for the discharge of any such liability stated above that are not discharged. For this purpose such assets may be deemed to be distrait proceedings and the TRO on being authorised by Commissioner of Income-tax, or chief Commissioner of Income-tax can proceed to recover the liabilities by effecting sale in the manner provided in the third schedule of the Income-tax Act.
4. The assets that remain after adjusting against the liabilities can be returned to the person from whom these were seized.
5. The Government shall pay simple interest @ 8% per annum on the excess of assets seized over liabilities.
6. Interest will be charged on the date of expiry of 120 days from the last day of authorization for search u/s.132 was executed to the date of completion of assessment.

Finance Act, 2003 –amended to cover the assessments made u/s 153A and a proviso that the application for the purpose of release of assets and explaining the source should be filed within thirty days from the end of the month in which the asset was seized.

As per this new proviso there is no power to condone the delay in filing the application. The assessee may not have ready details to file the application within thirty days. The delay in filing or the rejection order is not appealable. Only writ remedy is possible.

Legal Assistance

Whether the persons, whose premises are searched, can have their advocates and Chartered Accountants present during the search operations or while recording statement?

As per the decision of the Madras High Court in V. Datchinamoorthy Vs ADI (1984) 149 ITR 341 (Mad) and the Supreme Court's decision in Poolpandi Vs Superintend of Central Excise (1992) 62 Taxman 447.

It's open to the assessing officer to refuse assistance of a counsel during search examination.

In the case of Abdul Razak Haji Mohammed Vs Union of India (1986) 126 Taxman 234 (Bom), it was held that the person under interrogation is entitled to have an advocate present but he cannot interfere with the proceedings.

Seizure Of Third Party Articles Etc.

In the case of seizure, the authorities have no power to seize the pledged articles in possession of the pawnbrokers who mostly handle jewellery of third parties as security for the loans given to them. The decision rendered in

Madras Pawn Brokers Association Vs State of Tamilnadu (1995) 98STC 457 (Mad) and

Alleppy Financial Enterprise Vs ADI (1998) 233 ITR 210 (Ker) and 236 ITR 562(Ker) are useful in this respect.

Illegal Search Vs Use Of Evidence/Materials

As per decision rendered in Pooran Mal Vs Director of Inspection (Investigation) (1974) 93 ITR 509(SC) held that the evidences and other materials collected in the illegal search can be used in other Income-tax proceedings. This View was subsequently endorsed in Dr.Partap Singh Vs Director of Enforcement (1985) 155 ITR (SC)

The block assessment also can be considered as invalid if they do not observe the administrative procedures in conducting the search u/s.132.

Ref: Ajit Jain Vs Union of India (2000) 242 ITR 302 (Del)

However the different view was given by the Supreme court in State of Punjab Vs balder Singh (2000) 155 Taxation 93 (SC) that under section 50 of NDPS Act the materials gathered and its admissibility would depend upon the relevance of that material and facts of the case.

Finance Act, 2003

The search assessments procedures are always vulnerable to litigations. To avoid the litigations and cumbersome process and to achieve the revenue collection, the Government has introduced a single compartmental assessment procedure through Finance Act 1995 known as Block Assessment Procedure by introducing Chapter XIV B in the Income-tax Act,1961.

Chapter XIV B Block Assessment Procedures were tested by various judicial authorities and it was amended through Finance Act 1996, Income Tax (Amendment) Act 1997, Finance Act 2002 and finally withdrawn through Finance Bill 2003, as it has not achieved the objectives of cost effective, efficient, less litigation and meaningful assessment. Now the new assessment procedures are introduced through Finance Act 2003 by inserting new Sections 153A, 153B, and 153C in the Income-tax Act,1961.

These new search assessment procedures are applicable for searches conducted u/s 132 or books of accounts or other documents requisitioned u/s 132A on or after 01.06.2003 onwards.

1. The Finance Minister has assured in his budget speech that, there shall not be any confession statement obtained from the persons on whom search and seizure operations are initiated. Hence, the search assessment procedures are mainly based on the search materials, documents, assets and other valuable things seized, verified and noted during the search proceedings and based on the appraisal report prepared by the authorised officers.
2. The statements recorded during the search u/s 132(4) of the Income-tax Act,1961 from any person will be a ground for making the assessment of the undisclosed income.
3. The amendment to proviso to sec 132(1)(iii) provides that any bullion, jewellery or other valuable article or thing being stock in trade of the business found as a result of search shall not be seized but the authorised officer shall make a note or inventory of such stock in trade of the business. It is the duty on the persons on whom search or requisition proceedings are initiated to explain, if there is any stock variation on the date of search.
4. The constructive seizure specified in the newly inserted third proviso to section 132(1) does not cover bullion and jewellery. Hence, the authorised officer may still pass an order on stock-in-trade and the persons can deal with these assets only with the permission of the authorised officer. The proviso proposed is that " nothing contained in the second proviso shall apply in the case of any valuable article or thing, being stock-in-trade of the business". Hence the above controversy may arise.
5. As per the new amendment to Section 132B every person who is subject to the proceedings u/s 132 or 132A can file an application to the assessing officer about the source of acquisition of the seized asset within 30 days from the end of the month in which the seizure was made. Otherwise, the assessing officer can treat the assets as undisclosed income.
6. As per section 153A, the assessing officer will issue notice to the person on whom a search warrant was issued, to furnish returns of income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted u/s 132 or requisition is made u/s 132A of the Income-tax Act,1961 within such period as may be specified in the notice.

   The new Section 153A overrides Section 139 relating to filing of returns, Sections 147, 148, 149 & 151 relate to reassessment procedures and Sec 153 relates to time limit for completion of assessments. The returns filed in response to sec 153A will have the characteristics of returns filed u/s139.

   Since all the provisions of the Act are applicable there is every possibility that the assessee can revise the return before completion of assessment. The assessee can file a fresh loss return and the loss can be carried forward. The carry forward loss can be adjusted within six assessment years and subsequent years. It is a debatable issue.
7. Since no time limit is specified to file the returns in response to notice u/s 153A at least a reasonable time should be given to file the returns. The Income tax Act recognises the period of 30 days under various provisions of the Act as a reasonable time. Hence, we can expect a reasonable time will be given to file the six years returns.
8. On initiation of search proceedings u/s 132 or requisition u/s 132A all the pending assessments or reassessments relating to all six years abate immediately.

   The meaning of the word "Abate" is " to nullify", "to bring down", or "put an end to". Since the proviso to Sec 153A will abate all the pending assessments, if an assessee fails to disclose entire income in the original return but subsequently after the search, discloses all the undisclosed income in the new return, can he be absolved from the penal consequences specified u/s 271(1)(c)? It is another controversial area to understand the new procedure.
9. In the assessment or reassessment made in respect of an assessment year under new assessment procedure, tax will be chargeable at the rate or rates applicable to such assessment year.

10 Time limit for completion of assessments in search cases.

As per Section 153B, the assessing officer shall make an order of assessment or reassessment in respect of each assessment year falling within six assessment years in which search or requisition issued are within a period of two years from the end of the financial year in which the last day of the authorisation issued for search under section 132 or for requisition under section 132A was executed. It has been provided that, in computing the period of limitation for completion of such assessment or reassessment the following time taken can be excluded,

- The period during which the assessment proceeding is stayed by an order or injunction of any court or
- The period commencing from the day on which the assessing officer directs the assessee to get his accounts audited under sub section (2A) of section 142 and ending on the day on which the assessee is required to furnish a report of such audit under that sub section or
- The time taken in reopening the whole or any part of the proceeding for giving an opportunity to the assessee of being reheard under the proviso to section 129 of the Act or
- In a case where an application made before the Settlement Commission under section 245C of the Act is rejected by it or is not allowed to be proceeded with, the period commencing on the date on which such application is made and ending with the date on which the order under sub-section 245D of the Act is received by the commissioner under sub-section (2) of that section.

Further, after excluding the above time limit the remaining time available for the assessing officer is less than 60 days, then the assessing officer can have a minimum period of 60 days to complete the assessment.

Now, as per the new procedure, the time limit fixed is two years from the end of the financial year in which the last Panchanama was executed. The maximum number of cases taken up for completion of assessment by the department is only during the month of March. It will be difficult for the department as well as the assessee to complete the time barring assessments during the end of the financial year, which may lead to an arbitrary assessment.

11 Third Party Assessment in Search cases.

After the search or requisition is made the investigating officers will hand over the materials to the concerned assessing officer who is having jurisdiction over these persons. The assessing officer who is completing the assessment of the person covered u/s132 or u/s132A finds that any money, bullion, Jewellery or other valuable article or thing or books of accounts or documents seized or requisitioned belong or belongs to third parties on whom no action u/s132 or 132A was taken, then u/s 153C the assessing officer who is making the assessment of the main person covered u/s 132/132A should hand over such books of accounts or documents or assets seized or requisitioned to the assessing officer having jurisdiction over such other person and that assessing officer shall proceed against such third parties and issue notice on such third parties and assess or reassess income of such third parties in accordance with the provisions of section 153A

The third party assessment specified u/s153C which is similar to section 158BD under Chapter XIVB is another area for litigations. As per the new provisions the books or documents or assets seized may not indicate any undisclosed income but the plain reading of the Act says, in such cases jurisdictional assessing officers shall proceed against each of such third parties as per provisions of Sec153A.

The time limit for completing the third party assessment is not clear. Though the assessing officer is required to proceed u/s 153A, the completion of assessment or reassessment should be in accordance with the provisions of Section 153B. The proposed amendment by the Finance bill 2005 provides that the third party assessments can be made within two years from the date of receipt of seized documents of that party, by the jurisdictional assessing officer of that particular person.

Penalty In Search Cases

On the initiation of search proceedings u/s 132 or requisition u/s 132A all the pending assessments or reassessments relating to all six years abate immediately.

The meaning of the word specified in section 153 A "Abate" is " to nullify", "to bring down", or "put an end to". Since the proviso to Sec 153A will abate all the pending assessments, if an assessee fails to disclose entire income in the original return but subsequently after the search, discloses all the undisclosed income in the new return, can he be absolved from the penal consequences specified u/s 271(1)(c).

The explanation 5 to sec 271 [1] [c] provides the circumstances under which an assessee can disclose his undisclosed income and escape from the penalty.

The normal presumption during the search operation is that if the assessee discloses certain undisclosed income which was not disclosed in the previous returns he cannot get the benefit, because of the interpretation that if the assessee has not filed the return so long he can get this benefit since he has not filed the return with the IT dept. If a person has already disclosed certain income but revised his return after the search, he is subject to penal provision.

A very interesting decision has come from the Madras High court in the case of CIT vs S.D.V. Chandru [2004] 266 ITR 175 with ref. to explanation to sec. 271 [1] [c] that in view of the new assessment procedures in search cases if any person discloses the undisclosed income even if he has already filed the return for any previous year he can escape from the penalty provisions.

Section 132(4) is still in the statute without any amendment and the statement recorded under this section will be applied for preparing the appraisal report by the department. Now the assessee can declare or surrender the concealed or undisclosed income before the authorised officer to avail the benefit of wavier of penalty as per explanation 5 to section 271(1)(c) of the Act.

Points for discussion

1. The new assessment of total income should consider afresh not only the undisclosed income but also the disclosed income for proper assessment.
2. There may be legal disputes pending before the appellate authorities, which are not accepted by the department, may again be considered in framing the assessment.
3. The assessing officer must issue separate assessment notices for each assessment year and there will be six assessment orders, which have to be completed within two years. A separate assessment order for the previous year in which the search was conducted has to be passed along with other orders. The past experience shows that in all the cases, there may be arbitrary additions. For each assessment year, the assessee has to file separate appeal with appeal fee. For each assessment year, there will be levy of interest under section 234A, 234B, and 234C and also under the new section 234D.
4. Section 153A is not a separate provision for making an assessment. The assessment has to be completed under 143(3). All the other matters relating to giving opportunities, rights to producing evidence, judicious examination and application of legal provisions are applicable for completing assessments.
5. The appeal provision u/s Section 246A was amended to include Section 153A though there is no separate order passed under this section.
6. The re-assessment of the assessed income with reference to section 153A is also possible but however the time limit specified under section 147 relating to the completed assessment under section 143(3)/147 has to be considered before making re-assessment.
7. The scheme provides multiple assessments, multiple penalties and also multiple appeals.
8. There is no time limit under this section to issue notices for filing of returns. However, once notice is issued, the assessing officer must specify the time limit in the notice to file the return. The new assessment procedure does not grant any immunity from prosecution.

Gold Jewellery

The instruction given by the CBDT dated 11/05/94 relating to the seizure of jewellery is still in force and applicable for present search cases also. The assessee can explain the jewellery to the extent possible and in case there is no wealth tax assessment involved in the search cases the following limits are available for them, the search officer need not seize the same.

Even the circular issued before the block assessment scheme the principle laid down in

> Smt. Pati Devi vs ITO & others (1999) 240 ITR 727 by the Karnataka High court will be applicable for the present scheme also.

Additions Made On The Basis Of Loose Sheets / On Money.

The assessee admitted that he has received on money on the sale of flats on the basis of piece of paper seized during the search. The assessing officer added the same percentage of income on all the flats sold and arrived at a figure of Rs.1, 47,91,840 against the admission of Rs.17 lakhs by the assessee. The tribunal was of the view that the "on money receipt" is a fact and was accepted by the assessee. But the assessing officer is not justified to treat entire receipt as income. Further, held that what can be taxed under chapter X IV - B is undisclosed income and not the undisclosed receipt. The assessing officer can add reasonable profit on the undisclosed receipt. The 8% of income offered on the undisclosed receipt is reasonable.

(Kishore Mohanlal Telwala vs ACIT (1999) 12 DTC 660 – Addl. Trib).

Multiplication Formula

The assessing officer cannot apply the multiplication formula to arrive at the undisclosed income for the whole year with the help of records seized for part of the year without proving the investment in assets etc.

Dr.R.M.L.Mehrotra vs Asst.CIT (1999) 11 DTC 295 (Ahd.trib).

Piece Of Paper

The assessing officer cannot make an addition on the basis of a piece of paper found in third party's residence. It will be an arbitrary addition and liable to be deleted.

Pankaj Dahyabhai Patel (HUF) Vs ACIT (1999) 11 DTC 547 (Ahd.trib).

Unrecorded Income Vs Unrecorded Expenditure

The assessee is entitled to claim the unrecorded expenditure against the unrecorded income. The net has to be considered as "undisclosed income". The statement-recorded u/s 132 (4) alone cannot be a guiding factor for the assessment.

The decision in Parava Constructions Co. Vs. ACIT (1998) 61 TTJ (Mum.trib)

Held, that the assessee is entitled to claim expenditure against the on money receipts.

Presumptive Taxation 44AD/44AE

The assessee who is filing the returns under the presumptive taxation must have at least some basic details about the expenses etc. In the case of Balaji Construction Vs ACIT (2000 DTC 277) the Pune Tribunal held that in the case of a Contractor who has offered 8% income under 44AD the entire amount held, cannot be treated as undisclosed income. The legislature has recognised 92% as expenditure.

No Penalty On Income Offered In Revised Return :

In the normal course, the assesses are entitled to file revised return u/s.139[5] if they found any omission or misstatement in the original return. Then there will not be any penalty if the revised return is filed before the completion of assessment. But some times during the assessment proceedings, after the enquiry by the assessing officer the assessees are filing their revised return to avoid the complications. In all such cases, the penalty proceeding can be initiated by the AO. The bona fide revised return can be filed without any penalty. Ref. CIT vs JV Appadurai Chettiar Co [1996] 221 ITR 849.

Agreed Additions :

In the course of assessment proceedings the assesses may not be able to substantiate their claim. They may agree with the AO to disallow certain items. Merely to avoid complications they might have agreed for the additions. In all these cases, the penalty is not automatic but the AO must prove beyond doubt that there exist concealment. Refer CIT vs Jugal Kishore Hargopal Das [200] 243 ITR 220 [Ker] and CIT vs D.K.B. & Co [2000] 243 ITR 618 [Ker]

Recently, the Supreme Court in CIT vs Suresh Chandra Mittal 251 ITR 9 and in K.P. Madhusudan vs CIT 251 ITR 99 have considered the issue in the light of explanation 1 to sec.271 [1] [c]. In K.P.Madhusudan vs CIT 251 ITR 99, the Hon'ble supreme Court has referred to its judgement given in Sir Shadilal's case in 261 ITR 9. In CIT vs K.P.Madhusudan 246 ITR 218 [Ker], it was held "in Sir Shadilal's case., what the supreme court observed was that there may be several reasons for which the assessee may have offered an amount for addition, but that itself is not sufficient to infer concealment. It has not laid down as rule of general application that whenever such is the case, penalty cannot be imposed.

On the contrary, in such case also the assessee was required to discharge the burden placed by the explanation appended to sec.271 [1] [c]". the apex court in K.P. Madhusudan Vs CIT 251 ITR 99 affirmed the above decision and held that by reason of the addition of the explanation to sec. 271 [1] [c], the view in Sir Shadilal's case can no longer be said to be applicable. The main issue in the said case was whether explanation 1 needs to be specifically invoked and also applicability of the same where the addition is on agreed basis.

The assessee can argue that explanation to sec. 271 [1] [c] is not applicable as the explanation given by the assessee is bona fide. Thus mere failure on the part of the assessee to substantiate the explanation does not warrant levy of penalty.

In Kalpalatha Vs ACIT (1992) 44 TTj (Hyd-Trib) 225 it was held that simply because the assessee did not dispute the additions in quantum appeal no adverse inference can be drawn that the amount agreed to be added was concealed income.

In order to impose penalty in such cases, the addition should not be construed as an admission that there was deliberate concealment. – Vide Sir Shadilal Sugar & General Mills Ltd., & Anr. Vs CIT (1987) 168 ITR 705 (SC).

In V Rajasekharan Nair V ITO (1992) 40 ITD 125 (Coch-Trib) the assessee was anxious to purchase peace with the revenue by agreeing for additions. In such circumstances, it was held that no penalty was leviable.

Additions On Estimated Basis :

There are number of cases where the additions might have been agreed or assessment made on estimated basis but without any proof of concealment, the penalty cannot be levied. Ref. Shivlal Tak vs CIT 251 ITR 373 [Raj], CIT Vs Bhuramal Manikchand (1981) 130 ITR 129 (Cal)

The mere estimate made, however, well founded it may be, by itself would not normally constitute material for holding that the income that has been added on the basis of the estimate was the income that has been concealed. The assessment order can furnish certainly an item of evidence. But, the estimate would not be sufficient for saying that certain amount of income had been concealed for which stricter proof is always insisted upon. There must also be cogent evidence on record on the basis of which the assessing officer will be able to say that certain amount of income had been concealed and this is also necessary before any question of penalty can be determined vide. Bombay Hardware Syndicate Vs CIT (1978) 114 ITR 586 (Mad).

In CIT Vs Aarkay Saree Museum (1991) 187 ITR 147 (Bom), the Bombay High Court observed that mere addition to income on estimate basis would not constitute basis for levy of penalty under section 271(1)(c) unless the revenue proves the ingredients of concealment or that of furnishing inaccurate particulars.

In Bangla Sweet House Vs ITO (1992) 109 Taxation 55 (Del-Trib), the addition made by the assessing officer was based on a rough estimate, but on appeal, the Deputy Commissioner (Appeals) resorted to another estimate that was based not on an appreciation of material by the Deputy Commissioner (Appeals) himself, but on the orders passed in the sales-tax proceedings and he resorted to different rates of profits in respect of the items of sale. Then the Tribunal resorted to a third estimate, which too was based on an estimate by the Sales Tax Tribunal. It was held on these facts that a reading of all the three orders in quantum proceedings would reveal that there is no positive material to show that the assessee did conceal the particulars of his income and the income assessed was the only true income of the assessee and not what was declared by it. Therefore, the levy of penalty under section 271 (1)(c) was held not justified.

Conditional Offer :

Some times, the assessee's may surrender the income for taxation with a condition that the assessing officer should not levy penalty. Though there is no mandatory provision for offer and acceptance of income but the circumstances may warrant that penalty need not be levied. Ref. CIT vs Johibai Mangalbai 193 ITR 404 [Bom] CIT vs Kiren & co 217 ITR 326 [Bom]

Books of accounts impounded by the department - where assessee's books of account were impounded by the department, penalty was not justified since there was a reasonable cause for not filing the return in time as well as in getting his accounts audited u/ s 44AB. Ref. CIT Vs Ramakrishna Stores (2002) 253 ITR 175 (Cal.) (2002) 172 CTR (Cal.) (525)

As far as filing of the revised return after the survey, the law has been settled that merely filing of the revised return does not necessarily give the immunity for penalty for concealment of income in the original return. G.C.Agarwal vs CIT [1996] 186 ITR 571 [SC}

Otherwise it may be presumed that filing of the revised return is an admission of concealment. A revised return can be filed only for the omission or misstatement of bonafied nature.

The decision rendered by the Kerala High Court in CIT vs. A. Sreenivasan Pai [2000] 242 ITR 29 held that the revised return filed after impounding the books of accounts is not voluntary return and that penalty leviable for concealment.

The other decisions can be relied on are: Krishna kumari Cahamapalal vs CIT [1996] 217 ITR 645 [Bom]; CIT vs K.P. Sampathreddy [1992] 1971 ITR 232 [Ker]

A revised return can be considered as bonafide-CIT vs. Suresh Chandra Mittal [2001] 119 Taxman 433 [SC] if it is filed for the purpose of purchasing peace and to avoid litigation.

IIIrd Technical Session

PROFILE

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- Mr. Sriram Seshadri entered the professional scene at the young Age of 22 finishing Inter and Final Exams of the ICAI in single sitting and in the first attempt. After Qualification, he joined as a partner in a Chartered Accountant firm having office at Chennai and Coimbatore.
- He is **Visiting Faculty** sharing his expertise in International, Corporate and Domestic Taxes at the ICAI and ICSI.
- He assumed responsibilities of being a **Member in Editorial Boards** of "**Consolidated Commercial Digest**" of the ITR Group and on the Board of CA Study Circle, Chennai. He was the Chairman of the Publication Committee of the Study Circle for 2 years.
- He is the **Chairman of Direct Tax Expert Committee** of **Madras Chamber of Commerce and Industries**, actively involved in organizing meetings & seminars with bureaucrats, leading professionals and top companies. He is involved in the exercise of presenting pre-budget and post-budget memoranda and is a commentator on the Budgets and its Impacts.
- He has spoken in various seminars, work shops or conferences of
  - Professional Institutes such as ICAI, ICWAI, ICSI
  - Chambers of Commerce such as Indo American Chamber, South India Chamber, Madras Chamber, Hindustan Chamber, Malabar Chamber etc.
  - International Fiscal Association & Klaus Vogel Club
  - Industrial Programs organized by TIDEL Park, Airport Authority of India, Southern Railways, Neyveli Lignite Corporation, Port Trust etc
- His Areas of Work and expertise include Advice on International Taxation, Appellate Representation and Opinions on Tax Issues, Corporate Advisory Services, Business Valuation, Transfer Pricing, Due Diligence and Financial Reviews.
- Now at the age of 35, he carries 13 years of post qualification experience in various facets of profession, industry, commerce, academics and public life.

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COMPUTATION OF BUSINESS INCOME OF CONSTRUCTORS, DEVELOPERS AND INCENTIVE FOR THE INDUSTRY

CA. Sriram Seshadri, FCA

Section 145 provides that the business income of the assessee for an assessment year shall be computed based on the method of accounting consistently followed by the assessee. An assessee, who is in construction business, is normally concerned about the Accounting Standard 7 of the Institute of Chartered Accountants of India.

Arising complexities in Modern Business – O&M Contracts

- EPC contractors are also loaded with the responsibility of Operation and Maintenance Contracts. Many of these contracts are long-term contracts, where the responsibility of replacing the capital equipments is also loaded in the contract and the pricing is inclusive of this cost factor. The certainty of replacements increase in the long term contracts and since the cost incurred for these replacements are much larger, there will be a huge variation in the surpluses earlier on, when there is no replacement and negative profits when the replacements happen at a later stage. Some of these contracts may even run for 25 years, but a typical contract is for a period of 7 – 10 years.
- The rates also vary significantly based on the periodicity of the O&M contract. If the contract is for a longer period, then the certainty of replacement of equipments increases dramatically as compared to a shorter period of contract.
- These changes are reflected in the pricing of the contract. When the contract is for longer periods, say more than 7 or 8 years, then a price is fixed for replacements and this is recovered over the period of the contract irrespective when the replacements are likely to occur.
- In these long term contracts, the probability of replacements increases from year to year and reaches near certainty around 7 or 8 years. Hence, there is a timing mismatch of revenue. While the revenues are received each month, inclusive of the price for replacements, the related expenses are incurred only at a later time, which is uncertain.
- For longer period contracts, these expenses do not assume the nature of a contingent liability, as it is almost certain that these expenses would be incurred, given the life of the equipment. The question is only over the timing of these expenses and not on whether the expenses would be incurred.

However, the factor of certainty, of these expenses being incurred for shorter period contracts (say 4 or 5 years), diffuses. There is greater uncertainty of these expenses since the life expectancy of many of the equipment would be greater than the life of the project. This expectancy is reflected in the pricing policy. The choices are

- to make a provision for these replacements – but that will be more than 60% of the project revenues.
- To defer the taxation based on completed contract method, but can the revenues be deferred for 10 years etc??

These types of typical problems arise in the new generation businesses and there does not seem to be direct answers for these accounting treatments and tax provisions.

ISSUE # 1: CAN THE ASSESSEE ADOPT COMPLETED CONTRACT METHOD FOR IT AND % OF COMPLETION METHOD FOR BOOKS AND CLAIM IT TO BE CONSISTENT?

- Section 145 provides for the income to be chargeable under the head 'Profits and Gains from business or profession' or 'income from other sources' shall be subject to the provisions of subsection (2), be computed in accordance with either **cash or mercantile system of accounting regularly employed by the assessee**.
- Now, when the entries in the books of accounts are mandated by ICAI to be following AS7 revised, which deals with the % of completion method, can we follow completed contract method for the purpose of the income tax act. It may be borne in mind that the IT Act does not prescribe AS7. It may also be borne in mind that the Completed Contract Method has been upheld as an accepted method for the purpose of IT Act. Let us see the judicial trend
- **Judicial Trend**:

a. **Sri Sukhdeodas Jalan V. Commissioner Of Income-tax, Bihar And Orissa – 26 ITR 617 (Patna)**: In that case, 90% of the works were completed and the assessee stated that the income cannot be assessed unless the project is complete. It was held that the Profits and gains must be ascertained on ordinary principles of commercial trading" and the word "profits" has to be understood, as observed in that very case, "in its natural and proper sense, in a sense which no commercial man would misunderstand". But that means only this much "that no gain or profit could be said to arise unless and until a balance had been struck between the cost of construction and the proceeds of contract". It, however, cannot be disputed that as a rule the balance between the cost of construction and the proceeds of contract for the purpose of assessment under the Income-tax Act has to be struck at an interval of every accounting year because that is the unit of time stipulated under the Act. The exception may arise when the balance cannot be struck between the cost of acquisition and the proceeds of sale on any method known in the field of commercial trading for in that case no profit can be said to arise in that period as in the case of a solitary adventure in the nature of trade.

b. **Commissioner Of Income Tax V. V. S. Dempo & Co. Pvt. Ltd. – 131 CTR 203 (Mum)** – The assessee had followed completed contract method and the department challenged this. The court dismissed the challenge of the department on the ground that the assessee had consistently followed the same method for several years.

c. **Abode constructions – 95 TTJ 35 (Bombay)** – The project went for 4 years and there were no other projects. Huge monies were collected and no income was offered. The AO sought to assess the income at an estimate. Assessee showcased the fact that a huge claim has been made by the client against the assessee-company, which was a subject matter of litigation and if the claim is awarded there would be a huge loss. The ITAT relying on case of V.S. Dempo & Co. (P) Ltd. recognized, completed contract method for determination of income.

d. **Heeral Constructions (P) Ltd. – 85 TTJ 49 (Mad)**- Here also, the assessee had followed completed contract method even prior to the introduction of AS7 by ICAI in 1983. The bench held that it was not a case of the accounts being unreliable or that you cannot deduce the correct income from the accounts. It also held that That the assessee has been regularly employing the method of accounting, if from the regularly adopted method of accounting, true and correct profit could be deduced, the accounts are maintained correctly and no defect whatsoever has been noticed, and that the accounts maintained are complete and there is no significant omission. If the AO's findings on all these four aspects are in the affirmative, the assessee's profits are to be computed only on the basis of his accounts and no other method could be adopted.

e. **SI Property Development Ltd – 256 ITR 601 (Mad)**: It had two projects, one of which had been completed in the previous years relevant to the assessment years and the other project was incomplete. AYs are 1987-88 and 1988-89. The overheads of the head office was shown in the books of account as having been allocated to the project which was complete and no part of the administrative expenses was shown against the project which was incomplete. Assessing Officer found fault with that method. Method followed by the assessee is a method which had been followed by it consistently and which had been accepted by the Revenue in the earlier years

f. **Chunilal Mehta – SC – 82 ITR 54**: Method of maintaining accounts is one thing and the actual entries in the accounts maintained is a different thing. What is relevant is the method of accountancy and not the actual entries.

g. **Shoorji Vallabhdas and Co. [1962] 46 ITR 144, 148 (SC):** It has been laid down that "Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a hypothetical income, which does not materialize.

ISSUE #2 – WHETHER AS 7 REVISED IS APPLICABLE FOR BUILDERS / DEVELOPERS?

Revenue recognition standards of AS 9 are not normally applicable for certain specific categories of revenues as various specific and special considerations apply to such categories of revenues. One of them is construction contract, for which AS 7 is applicable. AS 7 was initially applicable for all categories assessees, irrespective of their verticals in the construction industry, such as builders or contractors.

With the revised AS 7 being introduced, the language suggests that AS7 is inapplicable for a builder who undertakes construction activities on their own account. This is confirmed by the 'Opinion of Expert

Advisory Committee of the ICAI'[1] states that revised AS 7 would not apply to builders carrying on construction on their own account.

The nature of business of a builder is different from the business of a construction contractor, with the only similarity of both undertaking construction activities. A construction contractor undertakes civil construction on behalf of others under a contract, which fixes the revenues. Whereas a builder or a developer purchase and sell land as well and constructs buildings and sells such houses as end products. While civil construction is a significant part, it is not the whole.

Income accrues to a builder or developer only when transaction of sale is complete and any advances received under the agreement for sale are mere earnest money and cannot be taxed as income before the transaction of sale is complete[2]. The transaction for sale is complete for a builder only when the house to be sold under an agreement is constructed, completed and delivered.

Till such time, even if the builder has right to collect advance payments in terms of agreement for sale, they are advances and the same cannot be appropriated as income till the transaction is complete by at least handing over of possession. Even if a builder has right to receive progress payments in terms of the agreement, they are not due as income but as advances and it accrues as income only on completion of transaction.

But this can depend on the terms and conditions of the contract. The revenue recognition has been one of the oldest controversies in the Income Tax Act and continues to haunt us even today. AS 9 dealing with revenue recognition also has the **Completed contract method and Percentage of completion method** for service contracts as well, which again may not apply to the builders / developers.

ISSUE #3: WHETHER THE RETENTION MONEY WILL BE TAXABLE IMMEDIATELY ON THE RAISING OF BILLS OR WOULD BE TAXED ON ACTUAL RECEIPT EVEN IN A MERCANTILE SYSTEM OF ACCOUNTING?

In many contracts, the contractee reserves the right to accept the bill and make the payment, after verification of the work done against milestone billing. The assessee raises the bill, but states that the income does not arise in that year. Is this tenable?

It is also relevant to note that in the case of **Simplex Concrete**[3], the Calcutta High Court had referred to the Supreme Court's judgment reported as **A. Gajapathy Naidu**[4] and had held that having regard to the terms and conditions of the contract, it could not be held that the retention money became legally due to the assessee on the completion of the work. Only after the assessee fulfilled the obligations under the contract, the retention money would be released and the assessee would acquire the right to receive such retention money. Therefore, on the date when the bills were submitted, no enforceable right accrued or arose and, accordingly, it could not be said that the assessee had any right to receive the entire amount on the completion of the work or on the submission of bills. The assessee had no right to claim any part of the money till the verification of satisfactory execution of the contract. In the case of **Janatha Contract Co**[5], the Kerala High Court held that when there is a stipulation postponing the time for payment of the whole or part of the balance, until after the expiration of a period during which the contractor is liable for defects or for repairs, payment would not have become due to that contractor.

However, not all retentions are postponed from taxation. In the case of **Amarshiv Constructions,** [6]the bench was concerned with the case of withholding of certain monies due to the contractor as security deposit. The contract also had the option of receiving the money by providing a bank guarantee. This is a typical case for many contracts. *In this case, the bench held that the income withheld has in fact accrued, as the assessee had the right to receive the money on provision of a bank guarantee and the legal right of receiving the money had accrued*.

In fact the Supreme Court had in the case of **CIT v. K.R.M.T.T. Thiagaraja Chetty & Co. (1953) 24 ITR 525 (SC)**, considered the issue of assessee owing certain sums to a person and that other person also owing certain sums to the assessee. Due to litigation in the former, the latter was withheld by that person and the assessee claimed that the income has not accrued. But the SC held that there was no uncertainty in the computation or the legal right of the assessee in receiving the latter amount and in such circumstances, the income should be taken as accrued.

ISSUE #4: WHETHER INTEREST ON BORROWED CAPITAL IS ALLOWABLE AS A PERIOD COST IRRESPECTIVE OF THE COMPLETION OF THE PROJECT OR SHOULD IT FORM A PART OF THE PROJECT COST?

According to Standard AS 7, contract costs are of the following types:

- Direct Costs relating to specific contract

- Costs attributed to contract activity in general & can be allocated to specific contracts
- Other costs specifically chargeable to the customer under the terms of the contract

Paragraph 17 of the standard provides that Costs that may be attributable to contract activity in general and can be allocated to specific contracts also **include borrowing costs as per Accounting Standard (AS) 16, Borrowing Costs**.

Wall Street Construction Ltd's case – Mumbai Special Bench Decision[7]

- The assessee was following project completion method of accounting, which means that the profits arising from a particular project are offered for taxation in the year in which that project is complete or substantially complete.
- The assessee's was simultaneously constructing multiple projects and accounts are separately maintained for each project. The assessee has borrowed on interest substantial funds, which are used as working capital for execution of the various construction projects.
- In respect of the interest expenditure referable to the borrowed funds, during the assessment years under appeal, it was claimed before the Assessing Officer that such interest expenditure is not in the nature of direct cost of the project and therefore this expenditure has to be treated as "period cost". **It was claimed that the interest expenditure accrued in a particular year must be deducted by way of expenditure against the assessee's income for that particular year**. In other words, while the income from a particular project will be offered for taxation in the year of completion, the interest expenditure is claimed year to year on the basis of accrual of interest during the particular year. The assessee consistently followed this.
- The Assessing Officer rejected this claim and held that interest expenditure has to be **added to the value of work-in-progress** because the assessees are following project completion method of accounting.
- In the books of account, the interest expenditure is allocated to different projects and the interest expenditure referable to a particular project, is added to the value of work-in-progress in respect of that project.
- Relying on the fact that the interest has been allocated over different projects as work in progress and has been consistently so done in the books, the ITAT Special Bench has concluded that the interest should not be allowed as a deduction in the year of accrual of the interest.

This is against the specific provision of the IT Act and therefore is not sustainable. Section 36(1)(iii) provides for the deduction of the interest paid in respect of capital borrowed for the purpose of the business or profession. While so, there can be no recourse to an accounting treatment to decide the deduction. Combined reading of the decisions of the Supreme Court in the cases of **Tuticorin Alkali – 227 ITR 172 & Kedarnath Jute – 82 ITR 363**. India cements also would help.

- The Gujarat High Court has in the case of **Alembic Glass Industries**[8] has considered many decisions in the allowability of interest and has held as under:

(a) Where a borrowing is made for the purposes of a business, the interest paid on such a borrowing becomes eligible to deduction contemplated by section 10(2)(iii) of the Act of 1922 or section 36(1)(iii) of the Act of 1961.

(b) This would be so, even if the capital is invested in order to acquire a revenue asset or a capital asset, because the act of borrowing capital is distinct from the act of investment of that capital to acquire an asset.

(c) However, the business for which an asset of enduring nature is purchased with the borrowed capital should not be an altogether different business.

(d) If there is no existing business for the assessee on the date of borrowing, then the interest is to be capitalized, as there would be no business income and there would be no deduction.

ISSUE #5: HOW SHOULD THE VALUATION OF STOCK BE DONE WITH CENVAT AND VAT CREDITS AVAILABLE?

Cenvat Credit

- Any taxes, which are reimbursable, should not be included in the value of inventory. This is as per AS2 and is called the exclusive method.
- As per 145A, inclusive method is to be adopted. So, any credit for inputs, namely, input services or capital goods or materials should be included in the valuation of WIP of projects, even though it is eligible for credit under **Cenvat Credit Rules 2004** subject to conditions prescribed therein.
- Where the assessee takes the advantage of the Composition scheme under the Service Tax Notifications and exclude 67% as pertaining to materials, then the Cenvat credit on the input of materials and capital goods

VAT Credit

- Where an assessee carries on a project in a VAT state, it may be entitled to chose one of the methods, depending on the State Laws, namely – Compounded Levy or Merit Route. Where the assessee opts for a compounded levy, it shall not be eligible for input tax credit.
- But where the assessee opts for the merit route, it would be eligible to take credit for input tax paid on materials purchased within the state and used in the execution of works contract. Input tax credit is not available for CST purchases.
- So, any credit on such material will not be included in the value of closing stock for the purpose of books as per AS2, whereas it should be included for the purpose of s.145A.

ISSUE #6: WHETHER THE COMPOUNDING CHARGES PAID UNDER REGULARIZATION SCHEMES FOR VIOLTION OF BUILDING NORMS ALLOWED AS A DEDUCTION?

We had regularization schemes floated by the Government wherein the erring builders were allowed to regularize any infirmity in the building construction by paying a compounding charge. The issue of whether this expenditure would be allowed as a deduction is to be examined. The **Karnataka High Court has in the case of Mamta Enterprise**[9] considered this issue. It held that the order passed by the competent authority of Town Planning in unmistakable terms stated that he had permitted for compounding of the offence of un-authorized construction. There could not be any doubt that what had been done was to permit the assessee to compound the offence committed by it by putting up un-authorized construction.

When Explanation to S. 37 defines that the expenditure incurred for any purpose which is an offence or which is prohibited by law is not entitled to deduction, it is not possible to take the view that the compounding of the offence or violation of the provisions of the Corporation Act, for the purpose of saving the offender of the law from the consequences of the commission of such an offence or violation of law should also be given the benefit of S. 37(1) by permitting the assessee to pay the compounding fee as the fine. Therefore, the compounding of the offence under the Corporation Act cannot take away the rigor of the Explanation given to S. 37 and that the deduction is not available.

But is this a correct interpretation? The section prohibits the allowance of the expenditure, which is incurred for **any purpose**, which is an offence or which is prohibited by law. Therefore, the disallowance would be attracted only if the expenditure is incurred for a purpose, which is an offence or which is prohibited by law. So, the purpose of the expenditure should be prohibited or should be an offence. So the prohibition is on the purpose of the expenditure. In the instant case, the expenditure is for compounding of an offence as a regularization program and this is sanctioned by law and not prohibited by it.

ISSUE #7: WHEN DOES THE ESCALATION MONEY BECOME TAXABLE?

Escalation amount is a part of gross receipts from civil construction business and only 8% is taxable: Pune Tribunal in ITO vs. **VG Chandak** (ITA No. 405/ 406 of 2002). **The recognition of income depends on the approval of the customer for the increase in the price and the amount should be reliably measurable**.

ISSUE #8: WHETHER THE SUNDRY RECEIPTS ARE TO BE NETTED OFF AGAINST THE PROJECT EXPENSES OR TO BE TAXED SEPARATELY AS INCOME FROM OTHER SOURCES?

Many times, there would be sundry receipts such as sale of surplus materials, bags, equipment used in the contract etc. The treatment of such receipts would pose issues. The standard has while dealing with the costs have stated as under:

The costs that relate directly to a specific contract include:

a. Site labor costs, including site supervision;
b. Costs of materials used in construction;
c. Depreciation of plant and equipment used on the contract;
d. Costs of moving plant, equipment and materials to and from the contract site;
e. Costs of hiring plant and equipment;
f. Costs of design and technical assistance that is directly related to the contract
g. Estimated costs of rectification and guarantee work, including expected warranty costs; and
h. Claims from third parties.

These costs may be reduced by any incidental income that is not included in contract revenue, for example income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract. Thus, the mandate of the standard was that these incidental incomes are to be netted off against the project cost.

The Madhya Pradesh High Court has in the case of **Ferro Concrete Construction**[10] examined the issue of sale proceeds of empty bags, containers and drums used in its civil construction works. The assessee claimed the income to be business income. The Assessing Officer treated the income as income from other sources. The Madhya Pradesh High Court allowed the assessee's claim and held that there was no dispute that the assessee in its day-to-day business activities used those goods and that the assessee was engaged in the civil works contract. In order to dispose off these goods after the goods were used in the construction activity, one could not say that it was not connected with business. In other words, it was incidental to the business activity and, hence, any income earned by sale of these empty bags/containers/drums could not be said to be an income from other sources but it was an income from business activity of the assessee.

Support can also be taken from the decision of the Supreme Court in the case of **Bokaro Steel – 236 ITR 314 (SC)** where a receipt is inextricably linked to expenditure it should be netted off against the expenditure

WHETHER INCOME ARISING FROM TRANSFER OF PROPERTY IS A BUSINESS INCOME OR CAPITAL GAINS?

Capital assets

Agricultural land in India

Normally Agricultural lands are also considered as capital asset unless section 2(14)(iii) takes them out of the ambit. Some factors[11] to determine whether the land is agricultural or not are classification in revenue records and payment of land revenue, actual use for agricultural purposes and length of such use, proportionality of income to investment in land etc. Entries in the revenue records are not conclusive. Further evidences on the above lines are t be examined and the onus is on the assessee to establish the nature of the land.

Types of Capital Assets and Gains

Property Constructed on a land purchased earlier[12]

Where the building is constructed on a land purchased earlier, the issue arises as to whether the period of holding the building should be reckoned from the date of completion of the construction of the property or from the date of acquisition of the land. The correct position is that two assets namely Land and Building. When the property is sold, the period of holding has to be reckoned separately for the land and the building. The consideration received can also be split into two parts relating to each component. Land can be considered a separate capital asset even if a building is constructed thereon. Where the land is held for more than a 36 months, the gains should be considered long-term capital gains even though the building thereon, is a new construction of less than 36 months.

Since capital gain on land and building can be taxed separately, the burden of proving the split of the sale proceeds between the land and building will be on the assessee[13].

Lease-cum-sale agreement

Lease-cum-Sale Agreements are common in Industrial clusters. Normally lands are allotted to entrepreneurs as lease cum sale agreement, wherein the entrepreneur, as a lessee makes installment payments over a period of time, at the end of which, the land is conveyed through a registered conveyance. During the period of lease, the allottee is entitled to setup industrial sheds or factory building and install the necessary plant and machinery and carry on the industrial activity. It has been held[14] that the assessee had only one capacity of an absolute owner from the date of sale and it was in that capacity alone that he transferred the title to the purchaser. Therefore, the period of holding could be reckoned only from the date of registration of the property in the name of the assessee.

Joint development Agreement

Development agreement is an executory agreement, whereby the developer undertakes to put up a superstructure on that part or portion of land retained by the owner in consideration of transfer of remaining part. Development agreement is not a sale simpliciter, because there is an element of builder's contract with the only difference that the consideration is not cash, but in kind i.e. constructed portion on the retained land. But the Madras High Court[15] treated the development agreement as an agreement for sale. But the Calcutta High Court[16] dissented.

It is in the above context that care must be taken to avoid transfer of property on mere signing of the agreement. The date of possession is critical. Some agreements provide a limited possession with right of access only. In these cases, part performance[17] is not triggered. If the agreement grants unqualified, uninterrupted and irrevocable right of possession to the developer, such possession will be treated as transfer[18]. But, an agreement to sell with limited power of attorney to obtain various permissions does not amount to transfer even when substantial part of sale price was paid, where vendor retained control over property. If the contract read as a whole indicates passing of or transferring of complete control over the property in favor of the developer then the date of the contract would be relevant to decide the year of chargeability[19]. To trigger section 53A of the Transfer of property Act, the conditions to be fulfilled[20] are:

- there should be a contract for consideration;
- it should be in writing;
- it should be signed by the transferor;
- it should pertain to transfer of immovable property;
- the transferee should have taken possession of property; and
- the transferee should be ready and willing to perform his part of the contract.

Damages for breach of contract[21]

Where in a breach of contract, the assessee gives up claim to specific performance of the contract by the defaulting party, but retains right to receive damages, it was held that the right to receive damages was non-transferable under section 6(e) of the Transfer of Property Act and, therefore, the damages received would not be chargeable to tax as capital gains.

Relinquishment of specific performance

The assessee entered into an agreement to purchase a property and the parties thereto had right to specific performance of the agreement. Later, deed of cancellation was entered in to wherein the assessee agreed to terminate the earlier agreement and allowed the owner to sell the property to any third party. As a consideration for the cancellation of the agreement, the assessee received a compensation of Rs. 6 Lakhs was given with the refund of advance paid of Rs.40000/-. It was held that right, title and interest acquired under the agreement is a capital asset and its relinquishment results in transfer and consequent capital gains tax. It was held[22] that the amount of Rs. 6,00,000 (Rs. 6,40,000 -40,000) could be treated, as capital gain in the hands of assessee and the cost of acquisition for such acquisition was Rs. 40,000/-.

Extinguishment of right in an asset

Position before insertion of section 45(IA) by Finance Act, 1999

Prior to the insertion of s. 45(1A), it was settled[23] that the term "Extinguishment of any rights therein" pre-supposes the existence of the asset during the process of transfer and immediately thereafter, as a result of the transfer in the hands of the transferee. This was so settled in the context of the assessee receiving insurance compensation.

Position after insertion of section 45 (1A) by Finance Act, 1999

A new section was introduced wherein it has been provided that any person receiving at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of any capital asset, as a result of—

(i) Flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or

(ii) Riot or civil disturbance; or

(iii) Accidental fire or explosion; or

(iv) Action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head Capital gains and shall be *deemed to be the income of such person of the previous year in which such money or other asset was received* and for the purposes of section 48, value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

The observations of the Supreme Court in Vania Silk Mills case have been disapproved by a larger bench of the Supreme Court[24] in a recent case where it has been held that the definition of "transfer" in section 2(47) clearly contemplates the extinguishments of rights in a capital asset distinct from and independent of such extinguishments consequent upon the transfer thereof. It is not correct to view the expression "extinguishments of any rights therein" as not extending to mean the extinguishments of rights independent of or other wise than on account of transfer. To read so is to render the express ineffective and its use meaningless.

The expression includes the extinguishments of rights in a capital asset independent of and otherwise than on account of transfer. When an amalgamation takes place, the right of the assessee in the shares held in the amalgamation company stood extinguished and therefore there is a transfer within the meaning of section 2(47).

Section 50C for real estate transactions

Section 50C inserted w.e.f. AY 2003-04, provides that where the *consideration declared* to be received or accruing as a result of the transfer of land or building or both, is less than the value adopted or assessed by any authority of a State Government (*i.e.* " stamp valuation authority") for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed shall be deemed to be the full value of the consideration, and capital gains shall be computed on the basis of such consideration under section 48.

If the following conditions are satisfied, the Assessing Officer may refer the valuation of the relevant asset to a Valuation Officer in accordance with section 55A of the Income Tax Act:

(i) Where the assessee claims before the Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer; and

(ii) The value so adopted or assessed by stamp valuation authority has not been disputed, in any appeal or revision or reference before any authority or Court,

If the fair market value determined by the Valuation Officer is less than the value adopted for stamp duty purposes, the Assessing Officer may take such fair market value to be the full value of consideration. If the fair market value determined by the Valuation Officer is more than the value adopted or assessed for stamp duty purposes, the Assessing Officer shall not adopt such fair market value and will take the full value if consideration to be the value adopted or assessed for Stamp duty purposes. If the value adopted or assessed for stamp duty process is subsequently revised in any appeal, revision or reference, the assessment made shall be amended to re-compute the capital gains by taking the revised value as the full value of consideration and the provision of Section 154 shall apply thereto and the period of 4 years shall be reckoned from the end of the previous year in which such order revising the value was passed in the appeal/revision/reference.

Previously section 52, introduced with effect from 1-4-1964 to 1-4-1988, provided that Assessing Officer the power to adopt fair market value according to his opinion, as sale consideration, subject to the valuation by Valuation Cell in specified circumstances on his reference. This was struck down by the Apex Court[25].

SECTION 80IA – INCENTIVES FOR INFRA-STRUCTURE PARKS / INFRASTRUCTURE FACILITIES

Section 80IA provides 100% deduction of '**Profits and Gains'** derived by an undertaking from any eligible business such as infrastructure facilities (roads, dams, bridges, water treatment plants, sewerage plants), infrastructure parks, telecom business or generation, transmission and distribution of power for a period of 10 years out of 15 years (20 years for infrastructure facility).

ISSUE #1: WHETHER THE INCOME DERIVED FROM LEASING OUT OF INFRASTRUCTURE FACILITY BE TREATED AS BUSINESS INCOME? CAN 80IA DEDUCTION BE AVAILABLE EVEN WHEN THE INCOME IS ASSESSED AS HOUSE PROPERTY INCOME?

- The wordings used in the section reads as '**Profits and Gains'** derived by an undertaking from any eligible business.
- While an assessee could carry on the business of infrastructure facilities, the assessment of this income is escalated as an issue by the Income tax department. The department claims that these incomes are to be charged to tax as income from house property and not as income from business.
- But, even if the income is taxed as income from house property, whether the deduction u/s 80IA would be available is an issue to be deliberated.
- The words 'profits and gains' has been interpreted by the Supreme Court in the case of **Virmani Industries**[26] to mean profits and gains under any head. This could be an useful case to canvass the theory that notwithstanding the head under which the income is assessed, the income should be subject to deduction u/s 80IA.

ISSUE #2: HOW SHOULD THE COMPUTATION OF DEDUCTION U/S 80IA SHOULD BE DONE IN THE SITUATION OF CARRY FORWARD OF LOSSES

There are two independent things here.

- One is the carry forward of losses under the source covered by section 80IA, to which subsection (5) of the section applies. If the source, for instance, an infrastructure project has a loss in a particular year, subsection (5) provides that the income for the subsequent year should be computed as if that source is the only source of income. This means that, notwithstanding that the loss from this source has been absorbed by another source or head in a previous year, such a loss would be artificially available for computing the deduction as per s.80IA(5).
- In fact this position has been upheld by the Mumbai Bench of the ITAT in the case of **Ashok Alco Chem Ltd - 96 TTJ 1000 (Mum)**. It has held that it is a legal fiction for the purpose of applying the provisions of s.80IA, the profits or gains of eligible business shall be computed as if the eligible business were the only business of the assessee right from the initial year and the losses, depreciation allowance or development rebate in respect of such eligible business for

the past assessment years were not set off against the profits from other business. The Supreme Court had in the case of **Patiala Flour Mills – 115 ITR 640 (SC)**, held while interpreting the provisions of s.80J that devoid of a legal fiction, the undertaking cannot be deprived of the deduction, for losses of the earlier years, which stand absorbed in the earlier assessments. These two things cannot co-exist. **Therefore, in 80IA we have a legal fiction enabling this**.

- The other is carried forward loss in the overall assessment of the assessee. For instance, if the assessee has a carried forward loss from the overall assessment, which has been set off against the profits for the year, should the net be available for deduction or should the loss be ignored. In effect, what is the impact of s.80AB on 80IA? Can the same Patiala decision of the Supreme Court, not be applicable to state that when the legal fiction already hits the assessee's deduction, s.80AB cannot be interpreted to have losses within its scope.

ISSUE #3: WHAT IS THE POSITION OF INTEREST ON MARGIN MONEY DEPOSITS FOR 80IA PURPOSES?

- The Cuttack bench of the ITAT considered this issue in the case of **Maxcare Lab**[27]. It held that the margin money deposits were made only by way of a business need. The assessee entered into an agreement for manufacture of goods on behalf of its client. The Client arranged for term loan and bank guarantee required by the assessee, but the assessee was under compulsion to make deposit with the client. The interest arose out of these deposits. The assessee is required to pay interest to bank for the term loan arranged by the client. It was held that the income from deposit has close nexus with the loan arranged and since the deposit made was made under business compulsions, the interest derived is eligible for exemption u/s 80-IA and the interest is to be netted off with the interest paid by the assessee to the bank.
- It relied on the decision of the Supreme Court in the case of **Vellore electric corporation**[28] which was a decision rendered in the context of s.80I, where only the words '**attributable to**' was used. This may be a misplaced reliance.
- In fact, the Madras High Court has in the case of **Menon Impex**[29] held that the interest on deposit for opening letter of credit is not derived from the undertaking for s. 10A.

SECTION 80IB – INCENTIVE FOR HOUSING PROJECTS

'The provisions of section 80IB(10) read as under:

"The amount of deduction in the case of an **undertaking** developing and building housing projects **approved before the 31st day of March, 2007 by a local authority** shall be hundred per cent of the profits derived in the previous year relevant to any assessment year from such housing project if,

(a) such undertaking has commenced or commences **development and construction of the housing project** on or after the 1st day of October, 1998 and **completes such construction**,—

(i) in a case where a housing project has been approved by the local authority before the 1st day of April, 2004, **on or before the 31st day of March, 2008**;

(ii) in a case where a housing project has been, or, is approved by the local authority on or after the 1st day of April, 2004, within four years from the end of the financial year in which the housing project is approved by the local authority.

Explanation: For the purposes of this clause,

(i) in a case where the approval in respect of the housing project is obtained more than once, such housing project shall be deemed to have been approved on the date on which the building plan of such housing project is first approved by the local authority;

(ii) the date of completion of construction of the housing project shall be taken to be the date on which the completion certificate in respect of such housing project is issued by the local authority;

(b) the project is on the size of a plot of land which has a **minimum area of one acre**:

Provided that nothing contained in clause (a) or clause (b) shall apply to a housing project carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas under any law for the time being in force and such scheme is notified by the Board in this behalf;

(c) the **residential unit** has a **maximum built-up area of one thousand square feet** where such residential unit is situated within the city of Delhi or Mumbai or within twenty-five kilometers from the municipal limits of these cities and **one thousand and five hundred square feet at any other place**; and

(d) the **built-up area** of the shops and other commercial establishments included in the housing project does not exceed **five per cent of the aggregate built-up area** of the housing project or two thousand square feet, whichever is less."

The issue here boils down to the concept of 'built up area'. In the commercial world of construction the following concepts prevail:

Carpet Area: This is the area of the apartment/ building which does not include the area of the walls.

Built up Area: This includes the area of the walls also.

Super Built up Area: This includes the built up area along with the area under common spaces such as the lobby, lifts, stairs, etc. This term is therefore only applicable in the case of multi-dwelling units.

In s. 80IB, this commercial concept appears to have been imported as a regulation. Clause (a) of sub-section 14 provides the definition of 'built-up area' as under:

"Built-up area" means the inner measurements of the residential unit at the floor level, including the projections and balconies, as increased by the thickness of the walls but does not include the common areas shared with other residential units;

Thus, the commonly understood concept of built up area only has been imported in to the provisions by an amendment by Finance Act 2004 with effect from 1.4.2005.

- The deduction is for an undertaking carrying on the development of the housing project, which is approved before the 31st day of March, 2007 by a local authority
- Project is on the size of a plot of land, which has a minimum area of one acre. Ownership of the land is not the criteria
- The undertaking has commenced development and construction on or after the 1st day of October, 1998
- Construction should be completed on or before the 31st day of March 2008, which should be evidenced by a completion certificate from the local authority.
- The Residential unit has one thousand square feet for places such as Delhi and Mumbai and 25 kms from municipal limits of these cities and a one thousand and five hundred square feet at other places

ISSUE #1: OWNERSHIP OF LAND IS NOT MATERIAL. IF SO, WHETHER THE DEDUCTION CAN BE CLAIMED BY THE DEVELOPER AS WELL AS THE LAND OWNER FOR THEIR RESPECTIVE INCOMES?

Section 80IB(10) is not seized of the issue of ownership. The deduction envisaged is allowable, if the profits are derived from the business of developing and constructing residential units on the stated minimum plot size. **There is no requirement in the provision that the assessee carrying on the business should own the land. Such a requirement cannot be read in to the section**. Hence, the deduction should be allowed in the hands of even a partnership firm, which is the developer of the project if other conditions prescribed in s. 80IB(10) are satisfied.

The three events governing the applicability of the provision are:

- Approval of the project from concerned local authority
- Commencement of construction and
- Completion of project

HOWEVER, it appears difficult for the owner of the land, who has not ventured in to the business of developing the housing projects to claim the deduction. The term '**derived**' was interpreted by the Supreme Court in the case of **Sterling Foods**[30] examined the concept of income 'derived' from an undertaking. It held that the word 'derived' is usually followed by the word 'from' and it means: *get to trace from a source: arise from, originate in, show the origin or formation of.* There must be for the application for the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. If the nexus is not direct but only incidental, such a profit cannot be treated as profits derived from export. In that case, the Supreme Court was examining whether the import entitlements can be held as derived from the industrial undertaking and held against it is not so, on the ground that the source for the entitlement is the export promotion scheme and not the undertaking.

Applying this ratio to the instant case, the income in the hands of the owner of the land would be derived from his ownership of the land and not from the industrial undertaking developing the land. Hence, it will not be possible for the landowner to claim the deduction.

ISSUE 2: WHERE THE UNDERTAKING TAKES A POWER FROM THE OWNER OF THE LAND, TAKES POSSESSION, DEVELOPS AND THEN REGISTERS THE LAND IN THE NAME OF THE BUYER, WHETHER S.50C WOULD HAVE ANY BEARING?
The answer will be a resounding no. Sec 50C comes in to play only when computing capital gains. In the instant case, the income for the developer arising from the transfer of lands would be business income and s.50C has no role to play in such a case.

Completion Certificate – A shortcoming

One of the conditions for claiming deduction is obtaining the certificate of completion. In the initial years of claiming the deduction, one would not know whether the project would be completed within the date set. So, the approach of the department towards the assessment of the initial years is to be awaited. Also, if the deduction is to be allowed in the initial years, the mechanism to deny the deduction in the later years is not available, if the set date is not met.

Whether the construction can span over two floors?

Sometimes, premium flats are designed to be constructed over 2 floors, the total of which comes to more than 1500 sq ft, divided in to lower and upper level. This issue is significant because the concept of whether two portions could be taken as a single unit or not has been a matter of controversy in the past. Let us examine the ratio of this concept from the perspective of the Courts.

The Calcutta High court in the case of **B B Sarkar**[31] had to examine whether a new house had come in to existence or not. For this, the court held that if a floor is constructed to a house or if it is renovated it remains as a house and it will not be two houses. It also held that in that case there was no evidence that two different houses were constructed with two *different municipal numbers*, that is to say, giving two different municipal numbers in respect of two houses. Hence, the court laid emphasis on the municipal numbers to determine whether there were two houses or not.

The Allahabad High court has in the case of **Shiv Narain Chaudhri**[32] was considering the exemption available for a house under the Wealth Tax Act. In that case, the court held that both portions are contiguous to each other and are within a common boundary and a common compound. They are connected by a common passage and the building has unity of structure. That one portion of the building bears one door number, while the other portion bears another door number and that these two portions are assessed separately by the municipality, are no doubt relevant circumstances in considering whether these two portions constitute one house or two different houses, but these circumstances are **not decisive**. As these two portions of the building are contiguous and situate in the same compound and within common boundaries and have unity of structure there is no reason why they should not together be regarded as constituting one house. Thus a combined reading of the cases, show that:

- Different Municipal numbers are important consideration for determining whether the units are independent or not. But that is not decisive.
- If the units are contiguous in terms of being bounded commonly and they are inter-connected and inter-woven, with unity of structure, there may be a chance in the future that it may be held to be a single unit.
- If they are held to be a single unit, it would violate the section

Hence, care must be taken that they are not merely registered separately and be built with different doors, but they must be capable of independent usage, be registered with two different municipal numbers and should not have a common passage at least as per preconceived plan. The common passages if any, may be created with a service agreement for the same with the buyer, apparently after the completion of the sale.

PRESUMPTIVE TAXATION U/S 44AD

Provisions of section 44AD are available as an option to assessee engaged in business of civil construction or supply of labor for civil construction if the gross receipts paid or payable to such assessee in a previous year do not exceed Rs.40 lacs. The incentive provided is that such an assessee by declaring 8% of such receipts or higher amount as income can avoid maintenance of books of account. Disincentive is also there for the assessees who wish to declare income from such business at a rate lower than 8% as in such cases books of account have to be maintained, audit u/s. 44AB becomes applicable and assessment is done u/s. 143(3).

Explanation to section 44AD provides inclusive definition of 'civil construction' to include (a) construction or repair of any building, bridge, dam or other structure or any canal or road, (b) the execution of any works contract.

Thus activities which are integral parts of civil construction are covered for e.g. RCC work, brick work, excavation, plumbing, electrification, painting, drainage, water proofing, fabrication, landscaping etc. The works may be related to new buildings or roads etc. or may be related to existing buildings or roads etc.

Intention of legislature is to include only contractors and not the builders and developers. This is abundantly clear from speech of the Finance Minister while introducing this provision and the CBDT circular No.685 while clarifying the provisions in Para 31 have referred to the contractors only.

Although section allows the assessee an option to declare 8% of gross receipts or a higher amount, when the assessee is aware is evident from the books of account or other records maintained by the assessee that income is higher than 8% and, it is submitted that higher income would have to be declared by him. This is also an implied condition when the assessee signs the verification in the return of income.

In case when an assessee carries on many businesses and only one of them can be covered by section 44AD or other such presumptive section then for the purpose of application of section 44AD etc. turnover of such business covered by 44AD etc. should be separable.

Then common expenditure would have to be apportioned by an acceptable method for e.g. on the basis of turnover of each business, space occupied by each business etc. All receipts which are assessable as income would be included in Gross Receipts. Therefore advances received from contractee would not be a part of gross receipts. Further in view of clarifications issued in Para 31 of CBDT circular no 684 dated 10 06 1994 208 ITR (St) 30 the gross receipts in civil construction will not include value of material supplied by the contractee.

ISSUE #1: WHETHER AN ASSESSEE COULD ESTIMATE THE 8% INCOME EVEN IF THE TURNOVER HAS EXCEEDED RS.40 LAKHS?

Though the turnover exceeds 40 Lakhs and therefore the assessee falls outside s. 44AD for construction business, the estimation of 8% is fair. **Sriram Jhanwarlal – 98 TTJ 639 (Jodhpur)**. Even the Authority for Advance Ruling while dealing with an International Tax Matter, held in the case of **Lloyds Helicopters International – 249 ITR 162**, that fixation of rate of gross receipts as the net assessable profit only indicates statutory attempt at estimating the expenses normally incurred.

ISSUE #2: WHERE THE CONSTRUCTION TURNOVER IS 35 LAKHS, OTHER MANUFACTURING BUSINESS TURNOVER IS 30 LAKHS AND 44AD IS OPTED, WHETHER TAX AUDIT NEEDS TO BE CONDUCTED OR NOT?

No. The turnover of 35 lakhs would not be reckoned for 44AB since 44AD is opted. This is clarified by the guidance note on tax audit as well.

This material is clearly not an exhaustive material on these subjects, but is intended to be a basic discussion material.

(Footnotes)

[1] The Chartered Accountant (Vol. 52, No. 3) at page 232
[2] CIT v. Motilal C. Patel & Co., (1988) 173 ITR 666 (Guj)
[3] CIT vs. Simplex Concrete Piles (India) (P) Ltd. - 179 ITR 8 (Cal)
[4] CIT vs. A. Gajapathy Naidu (1964) 53 ITR 114 (SC
[5] Janatha Contract Co. vs. CIT (1976) 105 ITR 627 (Ker)
[6] Amarshiv Constructions - – 84 TTJ 347 (Ahm)
[7] Wall Street construction Limited - 5 SOT 103 – MUM SB
[8] Commissioner of Income Tax, Gujarat Vs Alembic Glass Industries Ltd - 103 ITR 715 (Gujarat)
[9] Mamta Enterprises – 135 Taxman 393 (Karnataka)
[10] Ferro Concrete Construction (India) (P.) Ltd. v. CIT 144 Taxman 885 (MP)
[11] CIT v Siddharth J. Desai (1983) 139 ITR 628 (Guj)
[12] CIT v Dr. D.L. Ramachandra Rao (1999) 236 ITR 51 (Mad)
[13] CIT v Estate of Omprakash Jhunjhunwala (2002) 254 IT 152 (Cal)
[14] CIT v Mody (VV) (1996) 218 ITR 1 (Kar)
[15] Ashok Leyland Finance Ltd. v Appropriate Authority (1997) 230 ITR 398 (Mad)
[16] Mahabodhi Society of India v Union of India (1994) 209 ITR 412 (Cal)
[17] 53A of the Transfer of Property Act
[18] s.2(47) of the Income Tax Act, 1961
[19] Chaturbhuj Dwarkadas Kapadia v CIT (2003) 260 ITR 491 (Bom)
[20] Zuari Estate Development & Investment Co. Pvt. Ltd. - (2004) 271 ITR 269 (Born)
[21] CIT v Dalmia (J.) (1984) 149 ITR 215 (Del)
[22] K.R. Srinath v Asstt. CIT (2004) 268 ITR 436 (Mad)
[23] in the case of - Vania Silk Mills (P) Ltd v CIT (1991) 191 ITR 647 (SC)
[24] CIT v Mrs. Grace Coollis and Others (2001) 248 ITR 323 (SC)
[25] Varghese (K.P.) V ITO (1981) 131 ITR 597 (SC)
[26] Virmani Industries – 216 ITR 607 (SC)
[27] Maxcare Lab – 92 ITD 11 (Cuttack Bench)
[28] Vellore Electric – 227 ITR 557 (SC)
[29] Menon Impex P Ltd – 259 ITR 403 (Mad)
[30] CIT vs Sterling Foods – 237 ITR 579 (SC)
[31] BB Sarkar – 132 ITR 150 – Calcutta
[32] Shiv Narain Chaudhri – 108 ITR 104