

Review on the effectiveness of Search and Seizure operations

2.1 Introduction

2.1.1 With economic liberalization, the stress is on voluntary compliance with tax laws. Consistent failure on the part of assesseees or entities to declare correct income invites penal provisions of the Act as also search and seizure operations. The method of search and seizure for unearthing black money is adopted by the Income Tax Department only in cases where there is sufficient reason to believe that the person concerned would not disclose the true picture of his income in the normal course of filing of return and regular assessment.

2.1.2 In order to make the procedure of assessment of search cases cost effective, efficient and meaningful and with the object of unearthing black money and bringing it to tax expeditiously, the Finance Act, 1995 inserted Chapter XIV-B of the Act (Section 158 B to 158 BH) to provide a special procedure for assessment of search initiated on or after 1 July 1995. The assessment so made is known as 'block assessment'.

2.1.3 'Block period' means the period from 1 April to the date of search and the period comprising previous years relevant to ten (six with effect from 1 June 2001) assessment years preceding the previous year in which the search was initiated. The undisclosed income would be the income determined on the basis of any money, valuables or entries in the books of accounts maintained or other documents or transactions representing wholly or partly any income or any property which has not been or would not have been disclosed to tax but for the search, or any expense, deduction or allowance claimed under this Act which is found to be false.

2.1.4 The special procedure as per Chapter XIV- B was abolished after 31 May 2003 by inserting a new section 158 BI in the Income Tax Act. Three new sections 153 A, 153 B and 153C along with consequential amendments in sections 132, 132 B, 140 A, 234 A, 234 B, 246 A and 276 CC were inserted in the Income Tax Act by the Finance Act, 2003 to provide for assessment in case of search or requisition with effect from 1 June 2003.

2.1.5 A review in audit of the assessment of search cases, made on or after 1 July 1995, under the Income Tax Act, 1961 was undertaken and included in the Report of the Comptroller and Auditor General of India as Para 3.1 of Report No. 12 of 2000 (Direct Taxes). The review was undertaken to assess the post-search performance of the department, particularly the timeliness, finality and productivity of assessments made under the new procedure of "block assessment" and also to examine the quality of the investigation conducted by the investigating officers as

reflected in the appraisal reports prepared by them are indicated in succeeding paragraphs.

2.1.6 The study showed that details and amounts of undisclosed income indicated by the investigating officer in the appraisal report were not eventually sustained during the assessment proceedings. In most of the cases reasons for non-inclusion of the amounts mentioned in the appraisal reports were not recorded in the assessment orders inspite of existing instructions.

2.1.7 It was also noticed that an important lacuna in the Act was that in cases where search was conducted till 31.12.1996, the assessee was charged to tax at a flat rate of 60 per cent inclusive of all penalties and interest whereas under normal provisions of the Act the amount of tax together with interest and penalty worked out to a much higher figure. Thus, a search could put an assessee in a relatively advantageous position.

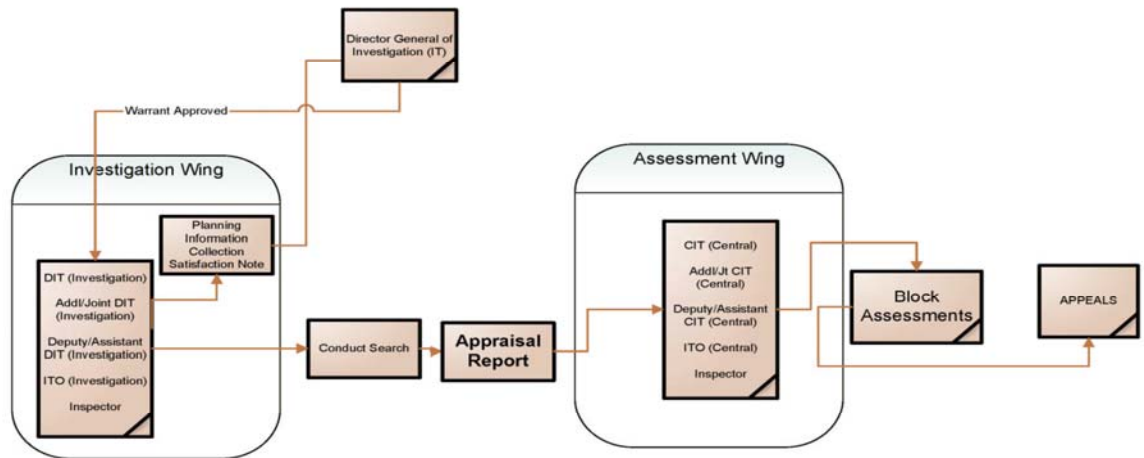
2.1.8 Further delayed completion of assessments and non-completion of block assessment within the stipulated period had resulted in loss of revenue. Provisions of section 158BD were not invoked which had a revenue impact. Ineffective search and defective assessments revealed loss of revenue, etc.

2.2 Law and Procedure

Section 132 of the Income Tax Act empowers certain income tax authorities to carry out a search and seizure of books of accounts, documents, cash, jewellery, etc. Section 132A empowers certain income tax authorities to requisition books of accounts, documents etc.

2.2.1 Organization and Process of Search and Seizure Operations

The entire process of collecting information, planning and conducting the search, preparing the Appraisal Report and the consequent assessment as per Chapter XIV-B as well as the subsequent appeal process has been presented in the flow chart below. This also incorporates the organisational set up of the 14 Directorates General of Income Tax (DGIT) (Investigation) who report to the Member (Investigation), Central Board of Direct Taxes (CBDT).



The Directorate is headed by the Director General of Income Tax (Investigation) with a Director of Income Tax (DIT) (Investigation) below him for conducting the searches, which is the investigation wing, and a Commissioner of Income Tax (CIT) (Central) for carrying out the search assessment, which is the assessment wing. The Director and the Commissioner are assisted by other levels of officers and officials as detailed in the flow chart. The major steps in the process are:

- The presearch **planning** as well as collation of the information gathered in a **Satisfaction Note** and submitted to the DGIT (Investigation) for approval.
- The material including seizures, documents, information etc gathered during the search is put together in an **Appraisal Report** and sent to the assessment wing for assessment of undisclosed income.
- The assessee is then required to file **a return** on receipt of a notice from the assessing officer under section 158 BC.
- The **Block Assessment** under section 158BA is completed by the assessment wing.
- Assessments can be **appealed** against in law and in fact at the level of Appellate Commissioners, Tribunal Members, the High Court and the Supreme Court.

Search

2.2.2 A search warrant is issued by the competent authority after approval by the DGIT (Investigation), calling upon the authorized officer to carry out search and seizure operations. The search is conducted as per the procedure laid down in Rule 112 of the Income Tax Rules. A Panchnama is prepared at the conclusion of the search giving, in a specified format, all the details of the search operation including a list of all the books of accounts, other documents, money, bullion, jewellery and any other valuable article or thing found at the premises during the search and also a list of the statements recorded under section 132 (4).

2.2.3 An appraisal report is prepared by the investigation wing summarizing the findings of undisclosed income during the search and suggesting follow up action. The appraisal report and seized documents are then handed over to the assessment wing for finalizing the assessment under the special provisions of the Act as per Chapter XIV-B. The appraisal report comprises the investigation wing's findings on the search and may include a note on the modus operandi of tax evasion adopted by the searched parties and their associates, tentative computation of undisclosed income in the hands of various assessees, overview of seized materials and suggestions for further enquiries. Wherever there is a major deviation between the income estimated in the appraisal report and the income proposed to be assessed, the reasons for the variation should be recorded.

2.2.4 Prior to 2003 appraisal reports contained a quantification of the concealed income found during search. However the CBDT issued guidelines in 2003 stating that the appraisal report should give only a broad estimate of concealed income and suggest further lines of investigation. No consistency has been found during audit in the quantification of appraisal reports; in certain cases part of the undisclosed income consisting of seized assets has been quantified and other undisclosed income left out and in other cases no quantification has been attempted at all.

Assessment

2.2.5 Where any search has been conducted under section 132, or books of account, other documents or assets are requisitioned under section 132A, the assessing officer shall serve a notice to the person against whom the warrant was issued. The notice would require the person to furnish a return within such time as may be specified (not less than fifteen days and not more than forty-five days) in Form 2B. This return is distinct from the regular return. Though there is no time limit for issue of such notice the assessment should be completed within two years from the end of the month in which the last of the authorizations for search was executed.

2.2.6 Prior to 1st June 2003, the assessment under section 158 BC would cover a six years block period. The undisclosed income of the block period was the aggregate of the total income of the previous years falling within the block period

computed on the basis of evidence found as a result of search and in the manner laid down under section 158BB(1). The concept of block assessment was for searches conducted with effect from 1 June 2003. Sections 158BC and 158BD are now replaced by sections 153 A and 153C respectively. The single block assessment is now replaced by the assessment or reassessment of each assessment year falling within six assessment years.

2.2.7 Where the assessing officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search was made, then, the books of account, other documents or assets requisitioned shall be handed over under section 158 BD to the assessing officer having jurisdiction over such other person and that assessing officer shall proceed under section 158 BC against such other person.

2.2.8 Reports and Registers

The range Additional CIT/JCIT should send a progress report in all search and seizure cases to the CIT every 3 months from the end of the month in which the search was conducted. A similar progress report should be sent to DGIT/CCIT half yearly. The range Additional CIT/JCIT should maintain registers for each search and seizure case incorporating the relevant details. Periodical reports are also sent by the jurisdictional CIT/CCIT/DGIT to the Member (Investigation) in the Board who is the nodal authority for monitoring search and seizure cases.

2.3 Objectives, period and sample size of the review

2.3.1 Audit reviewed the operation and implementation of the provisions in respect of search and seizure with the following objectives:

- I. Examine broadly the planning of search operations and their outcomes in terms of incomes disclosed as a result of search.**
- II. Examine whether the concealed income arrived at in the appraisal reports was based on appropriate evidence and whether in the assessment order this evidence had been correctly considered to arrive at the assessed income.**
- III. Examine the extent to which assessments made were upheld at appellate stage and identify the reasons for these being struck down.**
- IV. Attempt an analysis of the resources used for conducting searches as against the revenue gain therefrom.**
- V. Ascertain the extent of improvement/deterioration on the points mentioned in Para 3.1 of Audit Report No.12 of 2000.**

2.3.2 Period covered

The review covered searches conducted and consequential assessments completed during the financial years 2001-02 (from 1.06.2001) to 2004-05 and upto September 2005.

2.3.3 Sample Size

10 Directorates General out of a total of 14 were selected for the purpose of the review keeping in mind the important revenue collecting areas and the necessity for a judicious mixture of the smaller and larger stations. The selection criteria was as mentioned below.

Number shown against the States denotes the number of Directors of Income Tax (Investigation)

A.

Maharashtra – 4 (Mumbai – 2, Pune – 1, Nagpur – 1)

Delhi – 2

Tamil Nadu – 1

Gujarat – 1

Karnataka – 1

Andhra Pradesh – 1

Sl. No.	Undisclosed income	Percentage selected
1.	Below Rs.1 crore	10
2.	Rs.1 crore to Rs.5 crore	50
3.	Rs.5 crore and above	100

B.

West Bengal – 1

Uttar Pradesh – 1

Chandigarh (Panchkula) – 1

Kerala – 1

Sl. No.	Undisclosed income	Percentage selected
1.	Below Rs.50 lakh	10
2.	Rs.50 lakh to Rs.2 crore	50
3.	Rs.2 crore and above	100

C. Apart from the selection mentioned above a few draft paragraphs issued to the department in the course of normal audit relating to the period prior to the period of audit coverage have been included. Draft paragraphs issued to the department in the course of normal audit by offices in other states where this review was not carried out have also been included.

2.3.4 Constraints

In Para 3.1.8 of C&AG's Report No. 12 of 2000 (Direct Taxes) it was pointed out that the Public Accounts Committee desired that in the light of non-detection of concealed income in a large number of cases, the Ministry of Finance should take specific steps and ensure that thorough groundwork is done before undertaking search and seizure operations and make a more detailed examination of each of the cases. It was also mentioned in the Para that audit checks could not be carried out thoroughly due to non-production of appraisal reports in some cases and non-availability of seized documents. Similar problems were faced in this review due to non-production of 'Satisfaction Notes' and relevant details of groundwork done by the department before taking up search and seizure operations.

The matter was taken up demi-officially with the Member (Investigation) in the Board in June 2005 and Revenue Secretary, Ministry of Finance in September 2005. In reply they have stated that 'as the secrecy of the satisfaction note is a functional requirement and even the law courts do not insist for producing the same in open court, it will not be proper to part with it even for audit purpose. As the source information is vital to the intelligence – working of the department, it would not be practicable and in public interest to provide the satisfaction note for the audit purposes. The satisfaction note may not have any nexus with the assessment order or appraisal report except for the reasons for search. It cannot be used to decide the quantum of the concealed income'.

The Board also stated in its reply in January 2006 that search and seizure operations involve processing of information received from different sources including those gathered by the Intelligence Wing, called the Investigation Wing of the Department through reconnaissance, secret inquiries and also through informants whose identity has to be kept a closely guarded secret etc. For a case which is found suitable for action under section 132(1), a note is prepared for the satisfaction of the competent authority for issue of warrant for conduct of search and seizure operation. The process of collection of information, and its analysis, is a secret process shared only by the officers concerned, as is the practice of the various intelligence organizations of the Government of India. The intelligence gathered is not an evidence which can be used in any proceedings. As had been replied earlier, the information gathered, and the analysis thereof, is not material for framing of assessments.

The reply is not tenable as in terms of section 132 of the Income Tax Act, "reason to believe" is the basis for carrying out search operations, and it is this which is set out in the satisfaction note. In the absence of the satisfaction notes, the rationale for undertaking the search and the extent to which the expectations based on which searches were carried out actually materialized could not be satisfactorily done.

2.4 Audit findings

2.4.1 Audit findings during this review are arranged here with reference to the objectives set. Audit test checked 3320 cases in 10 States and noticed omissions/irregularities in 669 cases involving tax effect of Rs.352.91 crore. Audit findings have been arranged as follows:

- Cases where the tax effect involved was Rs.1 crore or more have been placed in one category and a few significant cases are described in the body of the para. The remaining cases are listed in **Appendix 5**.
- The cases where the tax effect is less than Rs 1 crore have been summed up and the number of cases as well as the total tax effect has been mentioned in the para itself with a few important cases described in the body of the para.

Objective - I

2.4.2 Planning and outcomes of search operations

Information was sought from the Member (Investigation) regarding the various facets of macro planning, if any, within the Department, for search and seizure operations. Audit sought to ascertain if there was any attempt at identifying those sectors of the economy where a concentration of undisclosed income could be expected, whether any risk analysis for the same is being done by the department and if inputs are taken from reputed studies done in this regard. The method of analysis of in-house reports received from all the Directorates as inputs for the planning process were also asked for as were details of planning processes at the operational level.

The Board stated in January 2006 that micro and macro planning, including identification of the sectors of economy and risk analysis definitely exist, and such factors are constantly under process and consideration in the Intelligence Wing of the Department. The actual decision for the search is based on the intelligence gathered in a particular group or a particular case. The Investigation Wing headed by D.Gs.I.T. do the planning. Even in case of a micro trade it cannot be decided that particular trade can be searched as a policy. As such, the decision for search and planning has to be at micro/local level.

Specific details of macro level or micro level planning have not been indicated in the reply, nor was it noticed in the course of audit. Further, satisfaction notes detailing the rationale for search in individual cases were not produced to audit. Audit also noticed cases, which are discussed below where the searches were not successful. In the absence of relevant satisfaction notes the basis on which the searches were carried out could not be ascertained.

2.4.3 In Tamil Nadu, six out of 222 searches conducted during the period covered in audit were not successful as there was no revenue potential as per the Additional

DITs reports. In one search, conducted in the premises of an assessee in CIT Central I Tamil Nadu charge, the department could not find evidence of any unaccounted business. No undisclosed asset was unearthed as per the Appraisal Report.

2.4.4 In CIT Central-III, Mumbai charge, a search and seizure operation was carried out in the business premises of M/s Asian Paints (I) Ltd on 21 March 2002. A disclosure of Rs.20 crore was made by the assessee company under section 132(4) on 23 March 2002 during the course of search. This disclosure was on grounds of claim of capital expenses as revenue expenses, non-moving credit balances and proportionate disallowance of interest on dividend income. Subsequently, by an affidavit, the assessee retracted from the above disclosure and filed its return for 'Nil' disclosed income. This was subsequently assessed to Rs.21.34 crore in November 2003.

2.4.5 Audit noticed that the appraisal report did not bring out any undisclosed income. During the assessment under section 158BC, undisclosed income was assessed on account of false claim of capital expenses as revenue expenses at Rs.20.46 crore. This was rejected by CIT (A) in his order dated 26 December 2003 as erroneous on the ground that the assessment could have been done under regular provisions and special provisions under Chapter XIVB were not applicable. This resulted in incorrect determination and assessment of undisclosed income of Rs.21.34 crore involving tax effect of Rs.13.06 crore. In view of CIT (A)'s orders, the department had reopened all the assessments pertaining to the block period in the month of March 2005. Orders under section 147 are awaited.

2.4.6 Audit also attempted to examine the outcome of search operations by analyzing the figures of incomes disclosed at four important stages. Details of figures collected from selected States are depicted below:

(Rs. in crore)

Table 1: Details of disclosed income as a result of search

	As per assessee's statement at the time of search	As per appraisal report of DIT (Inv)	As per assessee's return for the block period	Undisclosed income assessed
(1)	(2)	(3)	(4)	(5)
Undisclosed income	456.96*	2067.71 [#]	434.84	2454
Percentage with reference to undisclosed income assessed	18.62%	N.A.	17.72%	100
Percentage with reference to Appraisal Report	22%	100%	21%	N.A.

*Figures are from states of Andhra Pradesh, Karnataka, Kerala, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal

[#]Excluding unquantified amounts

N.A. Quantification of percentage at Col.3 and 5 was not possible due to absence of quantification in appraisal report

2.4.7 A study of this Table indicates that there is a wide variation between the assessee's estimation of undisclosed income and that finally assessed to tax. This is despite the fact that non-disclosure of correct income at the stage of filing the return for the block period invites a stiff penalty under section 158 BFA(2) of a maximum of 300 per cent of the tax sought to be evaded. One factor explaining the low level of compliance at this stage could be the low rate of upholding of departmental orders during appeal stage (15 per cent), an issue which is discussed later in this report.

2.4.8 Further, an overall comparison of the estimates of undisclosed income in the appraisal report with that finally assessed to tax was not possible as the recent instruction of CBDT requires only partial quantification of income at the appraisal report stage. However, an analysis in the state of Maharashtra where the appraisal reports did contain quantification of concealed income revealed that the assessed income was, on an average, 65 per cent less than the income as per the appraisal report (**Appendix-6**).

2.4.9 The Board stated in January 2006 that the appraisal report is advisory in nature and the computation made therein, if any, is only indicative so that all aspects which have come to the knowledge of the DDIT (Investigation) are brought on record for necessary consideration at the assessment stage. The assessment is made after considering the material evidence brought on record as a result of search & seizure operation, further investigations and inquiries carried on and the submissions of the assessee. This evidence is also considered at the appellate stage. Sometimes the assessee produces evidence at the final stage of the assessment wherein it may not be possible for the assessing officer to examine the same fully to arrive at appropriate conclusion. Further, though the focus is on bringing to tax undisclosed income or investment/expenditure as borne out by 'material evidence', in quite a few cases certain additions are made to protect the interest of revenue even where sufficient and complete material may not be available or not produced due to non-cooperation of the assessee. The Commissioners Appeal and the Tribunal further examine such additions in the light of 'material evidence' on record.

While it is possible that there could be some variation between the figures of undisclosed income in the appraisal report and that finally assessed to tax as also what is upheld after appeal, test check by audit in one state showed a high percentage (65 per cent) of variation between the income indicated in the appraisal report and that finally brought to tax. Audit findings also reveal a low rate (15 per cent) of upholding of departmental orders at appellate stage. Further, the reply does not discuss the issue of low level of compliance under section 158 BC commented upon by audit.

Objective - II

2.4.10 Statements under section 132(4) not correctly considered in the Appraisal Report

Section 132(4) of the Act empowers the investigating officer to record statements of any person during the course of search that can be used as evidence in any proceeding under the Act and be the basis for the assessing officer to compute the aggregate of the total income of the previous years. In the cases discussed below these statements were not correctly considered in the appraisal report, and consequently in the assessment order.

2.4.11 In Tamil Nadu, CIT-Central-I, audit noticed that during the course of search in the premises of Shri C. Subba Reddy (Ceebros Group) on 26.03.03 several issues were raised before the assessee as questions in the sworn statements recorded under section 132(4) of the Income Tax Act, 1961 for which assessee could not furnish any explanation at that time. One issue was that total expenditure, as per the seized documents, incurred for 384 flats in a project from 25 September 2001 to 24 March 2003 was only Rs.20.32 crore whereas the sales consideration received as per the booking register of the project was Rs.42.99 crore. The reasons for the huge profit of Rs.22.67 crore were not explained.

2.4.12 Further, the reasons for showing a debit balance of Rs.8.00 crore under sundry creditors due to wrong debit of a bank account instead of head office account was also not explained. These issues were not considered either in the appraisal report or consequently in the assessment order.

2.4.13 In Tamil Nadu, CIT Central I charge, a search was conducted during April 2003 in the residence of Shri S.N. Vadivelu and the appraisal report was forwarded within nine days of search. The call sheet manager of the assessee certified in the sworn statement that the assessee had purchased a car worth Rs.16 lakh in 2003, whereas this did not figure in the annual statement of account of the assessee as on March 2003. However this issue was not taken up in the appraisal report.

2.4.14 Audit noticed in Tamil Nadu, CIT Central I charge, in three cases, the assessing officer considered the suggestions made in the appraisal reports but stated that they could not be implemented for reasons such as lack of proof, and insufficient information. These transactions involve a money value of Rs.2.51 crore and a possible tax effect of Rs.1.51 crore.

During 'exit conference' the Board agreed to examine the specific cases and reply to them.

2.4.15 Seized documents not properly taken into account in the appraisal report

Information gathered from the documents available during the course of search needs to be properly correlated with evidence / regular returns already submitted to arrive at a decision while preparing the appraisal reports. Omissions noticed in two cases in verifying non-disclosure of income or disclosure in regular books of accounts leading to under assessment or overestimation are described below.

2.4.16 In Tamil Nadu, a search was carried out on the residential premises of an assessee, Shri Ajith Kumar on 17 July 2002. A set of financial statements of the assessee for the year 2000-01 was seized. There the assessee exhibited his professional income of the year as Rs.2.31 crore and advance receipts as Rs.16.40 lakh. However, in the regular return filed in October 2001 for the financial year he had reported professional income and advance receipts as Rs.1.45 crore and Rs.1.50 crore respectively. This evidence gathered during the search in the form of a document containing financial statements should have been considered at the time of making the appraisal report and the differences of the professional income of Rs.0.86 crore and advance receipts of Rs 1.34 crore should have been appropriately taken into account. However appraisal report did not take this into account leading to consequent underassessment at the time of block assessment of the like amount, involving tax effect of Rs.1.32 crore.

2.4.17 In Maharashtra, CIT Central-Pune charge, search and seizure operations were carried out on 13 September 2001 in the premises of Shri Desai Brothers, Bhat & Belwalkar group comprising 61 assessees that culminated in estimation of income of Rs.12.69 crore. Audit noticed in the case of Shri Jayant R Desai, one of the assessees of Desai brothers group, that a major part of the unexplained investment and unrecorded expenses forming the basis for the estimation of undisclosed income by the investigating officers was found to be explained and recorded in the regular books of accounts of the assessee during the course of assessment proceedings. Thus the amounts appearing on the papers seized were not properly correlated with assets, investment, expenditure etc at the appraisal report stage. As against the estimated undisclosed income of Rs.12.69 crore in the appraisal report, undisclosed income of Rs.2.48 crore only (19.52 per cent) could be assessed leading to an overestimation of Rs.10.21 crore.

2.4.18 Non-recording of reasons for variation between appraisal report and assessment order

As per C.B.D.T. Instruction No. 1886 of July 1991, the reasons for any variation in the quantum of undisclosed income between block assessment orders and appraisal report was to be carefully recorded. Audit noticed in nine cases involving tax effect of **Rs.9.08 crore** that reasons for not considering the items mentioned in the appraisal reports at the time of assessment were not recorded in writing in spite of clear instruction from the Board. One case is illustrated below.

2.4.19 In West Bengal, C.I.T Central-II, Kolkata charge, in the case of an assessee Sri Rajendra Kumar Bachhawat relating to 'Bachhawat group', the assessing officer was requested, in the appraisal report, to verify whether a fixed deposit of Rs.3.05 crore held in the assessee's name which had matured on 19 June 2001 was disclosed or not. The assessing officer had made no remarks in the block assessment records of Sri R.K. Bachhawat or Deeplok Securities Ltd. (main office of the Bachhawat group from where the fixed deposit was seized), which was required as per the above instruction.

The department did not accept the audit observation stating that interest out of the fixed deposit upto 19 June 2001 amounting to Rs.460 lakh was reflected in the regular accounts and hence the fixed deposit stands disclosed. The reply is not accepted in view of the fact that the fixed deposit was found only during search which took place on 7 September 2001 and the disclosure of interest does not necessarily ensure that the source of investment in fixed deposit was disclosed. Further no reasons were recorded for the variations from the appraisal report. The omission had led to short levy of tax of Rs.1.87 crore.

Two other cases involving similar mistakes are given at **serial numbers 1 & 2 in Appendix-5.**

The Board stated in January 2006 that the reasons for not considering any issue mentioned in the appraisal report in the assessment is recorded separately in the "Office note, not for assessee" or in the internal correspondences between the assessing officer and the Additional/Joint CIT with whose approval the assessment orders were passed in respect of searches conducted upto 31 May 2003.

However, in the specific nine cases cited, such reasons were not found recorded in the office note.

2.4.20 Mistakes at the Assessment Level

Audit noticed mistakes in assessments in **160** cases involving tax effect of **Rs.37.14 crore**. A few important cases are illustrated below:

2.4.21 In West Bengal, CIT Central-II, Kolkata charge, audit noticed that in the case of an assessee M/s Gujral Restaurants and Hotels relating to the Gujral group, a search was conducted on 21 March 2002. In the appraisal report, the assessing officer was requested to examine whether receipts from 'billing for short Km' amounting to Rs.1.51crore and 'outstanding transportation charges' of Rs.2.06 crore noticed from the seized documents were duly reflected in the turnover disclosed to the department. During the block assessment the assessee did not comply and as no regular books of accounts were made available, it was decided by the assessing officer to verify the receipts in the regular assessment for the assessment year 2002-03 in the case of two other members of the group conducting transport business, viz. Gujral Roadways Pvt. Ltd. and G. B. Enterprises Transport

Pvt. Ltd. Scrutiny of the regular assessment of the above mentioned assessees, however, revealed that no such examination was undertaken even though the cases were selected for scrutiny. No mention was made in this regard in the block or regular assessment records.

2.4.22 Audit noticed, in Tamil Nadu Central I and II charges, that in eight cases, transactions involving money value of Rs.4.74 crore (possible tax effect of Rs.2.87 crore) suggested in the appraisal report for verification by the assessing officers, were not considered at all, as there was no discussion while completing the assessment records.

2.4.23 Similarly, in Tamil Nadu CIT Central I charge, the father of the assessee, Shri Ajith Kumar, stated that he and his wife did not have any income of their own and the assessee was meeting their expenses. The assessee admitted in his sworn statement and in the return for the financial year 2001-02 that a sum of Rs.42.90 lakh was borrowed from M/s. Synergy Investments owned by his mother. When the omission to invoke the provisions under section 158 BD was pointed out in audit, the assessing officer replied that the block assessments could not be made on oral statement alone without credible evidence. The reply is not tenable as the provisions of section of 158 BD are attracted in the light of a sworn statement mentioning otherwise.

2.4.24 In Tamil Nadu, CIT Central I charge, audit noticed that as per the appraisal report the assessee, M/s Ceebros Property Development (P) Ltd had stated that a complex was sold to a company for Rs.5.59 crore. A receipt of Rs.1.75 crore was disclosed as “sale proceeds of flats” and though the sum was a business receipt of his company, the same was received in the assessee’s personal bank account. An amount of Rs.1.55 crore was shown in the cash flow statement of the company as sale consideration of the commercial complex. The difference of Rs.4.04 (Rs.5.59 – Rs.1.55) crore was not considered to be brought to tax either in the regular assessment or in the block assessment.

2.4.25 In Andhra Pradesh, CIT Central Hyderabad charge, the block assessment of an assessee, M/s Sigma Online Ltd for the period 1.04.1995 to 5.02.2002 was completed under section 158 BC in February 2004. Audit noticed from the appraisal report that the assessee had claimed a depreciation of Rs.8.36 crore on the total value of assets of Rs.18.74 crore. It was mentioned in the appraisal report that as all the assets were not in existence, the entire depreciation was required to be disallowed. Though the transaction was indicated as bogus in appraisal report, the assessing officer verified assets to the extent of Rs.7.77 crore only. The omission to consider the balance resulted in short disallowance of depreciation to the extent of Rs.3.26 crore involving tax effect of Rs.1.99 crore.

2.4.26 In Maharashtra, CIT Central Nagpur charge, in the case of M/s. Vidarbha Construction Company pertaining to MHKS Mohd. Ali Group, an amount of Rs.1.05 crore was estimated to be undisclosed income on account of inflated claim

of expenses in the profit and loss account. Audit noticed that the genuineness and reasonableness of expenses allegedly inflated was not examined properly and the income was assessed as nil. The estimation was made on the basis of documents titled as 'Statement of accounts' found and seized during the course of search from the premises of two existing partners of the firm and their statements recorded under section 132(4). The disallowance under section 40A (3) as suggested by the investigating officer was also not considered by the assessing officer based on the assessee's statement that disallowance under section 40A(3) could not be considered in block assessment proceedings. This is not correct as per provisions of Chapter XIVB and led to a loss of revenue of Rs.64.32 lakh.

Five other cases involving similar mistakes are given at **serial numbers 3 to 7 in Appendix-5.**

2.4.27 Statements recorded under Section 132(4) not adequately taken into account at assessment stage

As per the provisions of section 132(4) of the Income Tax Act any statement recorded under this section may be used as evidence under the Income Tax Act.

2.4.28 It was noticed in audit in five cases that revised statements were taken under section 131 at the stage of assessment. As the post search statements recorded under section 131 cannot supersede the statements recorded under oath under section 132 (4), this led to loss of revenue as discussed below.

2.4.29 In Himachal Pradesh, CIT Shimla charge, the assessment of the Goyal Brothers group, Solan (3 HUF and 8 individual assesseees) for the block period 1.4.1989 to 29.7.1999 was completed under section 158BC for the search conducted on 29.7.1999. Audit noticed that the assesseees had shown sale of jewellery/gold valuing Rs.2.27 crore during the financial years 1997-98 and 1998-99 and disclosed that this amount had been further invested in Goyal Motors Pvt. Ltd. Shimla. Scrutiny of statements made by some members of the group before the investigating officers during search revealed that the sale of jewellery/gold had not actually been made. The appraisal report had also pointed out these issues and indicated a figure of concealed income of Rs.2.27 crores. However, the assessing officer during assessment proceedings allowed the assesseees to change their earlier statements given to the investigating officer even though there was no proof that those statements had been made under duress. As such the investment of Rs.2.27 crore in Goyal Motors Pvt. Ltd. was not added as income from undisclosed sources. This resulted in consequential loss of tax of Rs.1.50 crore excluding interest and penalty.

2.4.30 In CIT (Central) Nagpur charge, search was conducted at another assessee, M/s Vidarbha Construction (Firm) pertaining to MHKS Mohd. Ali Group in February 2002. During the course of search a set of papers titled as 'statement of account' was found and seized from the premises of Shri. Juber Amin and Shri S.

S. Johar, two partners of the searched firm. On the basis of the above seized statement of account and other documents and statements of the partners under oath under section 132 (4) of Income Tax Act, 1961 the investigating officer worked out undisclosed income of Rs.57.57 lakh on account of old and new accounts and Rs.14.55 lakh on account of pool money totalling to Rs.72.12 lakh for the block period. Audit noticed that during the course of block assessment proceedings completed under section 158 BC in February 2004, the assessing officer did not consider the amount of Rs.72.12 lakh as undisclosed income of the assessee, relying on the statements of the two partners of the firm recorded under section 131 of Income Tax Act, 1961, leading to loss of revenue of Rs.44.14 lakh.

2.4.31 Similarly, in CIT (Central) Pune charge, search and seizure operations were carried out in the premises of M/s. J.B.Saraf & Sons (P) Ltd. pertaining to Chandu Kaka group on 16.11.2001. During the course of search, in his statement recorded under section 132(4) the Director of the company declared undisclosed income of Rs.50.00 lakh on account of unexplained investment in land at Boribell (Daund) and unexplained expenditure covered under section 69 and 69-C of Income Tax Act, 1961. Audit noticed that during the course of assessment proceedings completed under section 158 BC in September 2003 for undisclosed income of Rs.4.01 lakh the assessee company declined to abide by the declaration made by its director and refused to declare the undisclosed income of Rs.50.00 lakh. The assessee retracted from the above declaration during the course of assessment proceedings which was accepted by the assessing officer on the grounds that the investment in land at Malad Taluka (Daund) was fully explained. This is not acceptable as the appraisal report referred to unexplained investment in Boribell Taluka (Daund).

2.4.32 In another case of Maharashtra, CIT Central III Mumbai charge, audit noticed that statement made under Section 132(4) was not agreed to by the assessing officer citing inadequacies in the evidence gathered at the stage of investigation. During the course of search the assessee had declared and made a statement of undisclosed income of Rs.6 crore under section 132(4) of Income Tax Act, 1961 towards bogus purchases and unsubstantiated production expenses in cash. In response to notice under section 158 BC the assessee filed the return for undisclosed income of Rs.1.14 crore which was subsequently assessed under section 158 BC in December 2003 for Rs.6.33 crore including addition of Rs.4.71 crore under section 2(22)(e) of Income Tax Act, 1961 which was earlier included in the undisclosed income as per appraisal report. Thus keeping aside the addition of Rs.4.71 crore made under section 2(22)(e), there was a variation of Rs.4.48 crore between the undisclosed income as per the appraisal report and that assessed under section 158 BC.

On being pointed out by audit, the assessing officer replied that the disclosure of Rs.6 crore by the assessee was prima-facie and ad-hoc and neither in the appraisal report nor in the seized material was there a break up of such disclosure given. It was noticed by audit that the assessee had retracted from the statement made during

the search during assessment although the records do not show that the statement was made under duress or threat. Reliance upon statements made under section 132(4) by assessing officers has been upheld by Kerala High Court*.

2.4.33 In Maharashtra, CIT (Central) Nagpur charge, search and seizure operations were conducted in the premises of M/s MHKS Mohd. Ali group on 27.2.2002. Audit noticed that during the course of search a document containing balance sheets for the years 1995 and 1996 were seized. The seized documents also indicated cash loans from the market at Rs.60 lakh and Rs.70 lakh for the year 1996 as on 24.6.1996. During the course of assessment proceedings under section 158 BC completed in February 2004, the assessing officer, accepting the statement of the assessee stating that the above seized documents did not pertain to their group, did not consider the undisclosed income of Rs.70 lakh estimated by the investigating officer.

As the documents containing the details of assets and liabilities of the concern/individual pertaining to MHKS Mohd. Ali Group were seized from the premises of the assessee it should have been deemed to be the document pertaining to the assessee group under section 132(4A) and the denial of the assessee should not have been accepted without further investigation in this regard. Failure to do so resulted in loss of revenue of Rs.85.68 lakh.

The Board stated in January 2006 that the statement by any person under section 132(4) of the Income Tax Act 1961 given before the authorized officer is considered in the assessments with reference to other 'material evidence' brought on record. Thus the statement is in respect of the material evidence found in course of search. Hence, mere declarations by assessee under section 132(4) are not sufficient for assessment.

Reply is not tenable as the objective of section 132(4) is to use the statements recorded at the time of search as evidence to bring undisclosed income to tax, and enough evidence needs to be gathered at the time of search in accordance with the statement made to substantiate the findings at the time of assessment.

2.4.34 Mistake in set off of undisclosed investment

There are no specific provisions in chapter XIV B for any set off of undisclosed investments against the undisclosed income without establishing a close nexus. Karnataka High Court[#] has held that investments detected during search and seizure which were found to be not covered by entries in books produced during regular assessment, are to be treated as undisclosed income

Audit noticed irregular set off of undisclosed investment from undisclosed income in **three** cases involving tax effect of **Rs.4.93 crore**. An illustration is given below.

* (219 ITR235)

[#] [Dy. CIT v. H.V. Shantharam (2003) 261 ITR 435 (Kar)].

2.4.35 In Maharashtra, CIT-Central, Pune charge, block assessment of M/s Ranka Jewellers (RF), searched on 24.10.2002, was completed under section 158 BC in December 2004 at an undisclosed income of Rs.5.23 crore including protective addition of Rs.2.53 crore. Audit noticed that in the assessment order the assessing officer has assessed undisclosed income of Rs.3.67 crore on account of undisclosed profit, Rs.2.70 crore on account of unexplained investment and Rs.2.53 crore on protective basis in the hands of the assessee. Thus the total undisclosed income as stated above would work out to Rs.8.90 crore. However by allowing set off of undisclosed investment against the undisclosed income, the taxable undisclosed income has been assessed at Rs.5.23 crore resulting in under assessment of income to the extent of Rs.3.67 crore with consequent short levy of tax of Rs.2.34 crore.

Another case involving a similar mistake is given at **serial number 8 in Appendix-5.**

The Board stated in January 2006 that the Chapter XIV B brings to tax the undisclosed income. Acquisition of an asset is application of income. The value of the undisclosed asset can be brought to tax only if there is no sufficient explanation regarding the source for acquisition of the asset. Undisclosed income can reasonably form the source for undisclosed asset. Hence such set off is permissible. Besides, income cannot be assessed twice, or in the hands of two persons. Hence, a “matching” is made following either the income and investment/expenditure method or the assets and liabilities method. If any income is considered as undisclosed income, and there is no evidence on record to suggest that this undisclosed income is not utilized for the undisclosed investment/expenditure, necessary consideration is given to the effect that the undisclosed investment/expenditure is not added again to the extent of the income already considered as undisclosed, which would amount to double jeopardy.

The reply is not tenable in the absence of any legal provision to this effect or specific instructions from Board.

2.4.36 Incorrect assessment of undisclosed income

Audit noticed various mistakes in computation of undisclosed income in **70** cases involving tax effect of **Rs.65.40 crore**. One case with maximum tax effect is illustrated below:

2.4.37 In Maharashtra, CIT Central Pune charge, a search and seizure operation was carried out on M/s. Ranka Jewellers (RF) pertaining to Ranka Group on 24 October 2002. During the course of search incriminating documents in the form of ‘Jama Kharcha Pannas’ were seized showing huge transactions of purchase and sale of gold amounting to Rs.172.21 crore which were found to be unaccounted, unrecorded and made in cash. The assessment of the above assessee was completed under section 158 BC in December 2004 for taxable undisclosed income of Rs.5.23 crore as against the returned income of Rs.2.70 crore. As calculated by

the assessing officer the initial purchase in the year 1999-00 was for Rs.13.93 crore. Audit scrutiny revealed that the initial investment of Rs. 13.93 crore made in the year 1999-00 for purchase of gold and silver, being unexplained, should have been treated as undisclosed income and taxed which was not done. The omission resulted in underassessment of Rs.13.93 crore involving tax effect of Rs.8.89 crore.

Six other cases involving similar mistakes are given at **serial numbers 9 to 14 in Appendix-5.**

2.4.38 As per provisions of section 158 BB(1) of the Income Tax Act, 1961, the undisclosed income of the block period shall be the aggregate of the total income of the previous years falling within the block period computed in accordance with the provisions of the Act on the basis of evidence found as a result of search or requisition of books of accounts or other documents and such other material and information as are available with the assessing officer and shall be charged to tax.

Audit noticed various mistakes in computation of undisclosed income in **17** cases involving tax effect of **Rs.129.02 crore**. One case is illustrated below.

2.4.39 In Delhi, CIT Central-III charge, the block assessment in the case of M/s Swell International (P) Ltd, was completed in December 2003 for the search conducted in December 2001. Audit noticed that the assessing officer in the assessment order stated that the assessee had shown purchases of Rs.6.46 crore although he had never made these purchases. Therefore, the unaccounted purchases of Rs.6.46 crore were required to be disallowed under section 69 C. However, the assessing officer assessed undisclosed income at Rs.1.71 crore only being the money in circulation estimated at one-third of the peak turnover, without any justification. This was not correct as either the entire amount of purchases should have been added back under section 69 or the peak credit worked out in detail as per the accounts of the assessee. This resulted in under assessment of undisclosed income of Rs.4.75 crore with consequential short levy of tax of Rs.3.05 crore.

11 other cases involving similar mistakes are given at **serial numbers 15 to 25 in Appendix-5.**

2.4.40 Mistakes relating to issue of notice under section 158-BD to related assesseees

Under the provision of section 158 BD, where the assessing officer is satisfied that any undisclosed income belongs to any person, other than the person with respect of whom search was made or whose books of accounts, other documents or any assets were requisitioned then, the books of accounts or other documents or assets seized or requisitioned shall be handed over to the assessing officer having jurisdiction over such other person and that assessing officer shall proceed under section 158 BC against such other person. The above assessment shall be completed

within two years from the end of the month in which the notice under section 158 BC was served on such person.

2.4.41 Audit noticed non-invocation of provisions of section 158 BD in **82** cases involving tax effect of **Rs.11.89 crore**. A few instances are illustrated below.

2.4.42 In Maharashtra, CIT-Central Nagpur charge, search and seizure operations were carried out on Gurbaxani and MHKS Mohd. Ali group on 5.12.2002 and 27.2.2002 respectively. As per the appraisal report, four assesseees in respect of Gurubaxani group having estimated undisclosed income of Rs.15.00 lakh and 12 assesseees in respect of MHKS Mohd. Ali Group having estimated income of Rs.2.58 crore, were to be covered under section 158 BD of Income Tax Act, 1961.

Audit noticed that identification of assessment charges of the above 16 assesseees have not so far been made with the result that seized materials relating to the above assesseees having estimated income of Rs.2.73 crore (as per appraisal report) was yet to be transferred to the respective assessment charge (October 2005) even though assessment of the group cases under section 158 BC were completed during the month of December 2004 and February 2004 respectively. This resulted in non-assessment of undisclosed income of Rs.2.73 crore with consequent loss of revenue of Rs.1.67 crore.

2.4.43 In Tamil Nadu, CIT Central I charge, audit noticed that searches were conducted at various premises as a group case of the assessee during July 2002. It was ascertained that the premises searched was in the name of the assessee and cost of land and building was reported as Rs.27.26 lakh which included two amounts of Rs.7 lakh and Rs.5 lakh received from the assessee's two brothers towards settlement of property of their parents. As the transaction falls within the block period, the amount should have been considered as undisclosed income under section 158 BD. This was omitted to be considered.

Another case involving similar mistake is given at **serial number 26 in Appendix-5**.

The Board stated in January 2006 that in respect of these cases suitable reply would be given after ascertaining complete facts.

2.4.44 There is no overall time limit for issue of notice under section 158 BD nor is there any time limit for transferring the records to the jurisdictional assessing officer before or after completion of assessment under section 158 BC. Moreover, audit noticed that there is also no system for confirmation either in the investigating unit or the assessing unit whether the assessments of all persons having undisclosed income revealed as a result of search have been finally completed.

The Board stated in January 2006 that the DIT (Inv.) and the CIT (Central) have been advised to have quarterly meetings for necessary coordination and review, as also to have discussions and coordinate wherever any point of dispute with regard to assessability of any income/ investment/expenditure arise.

2.4.45 Other mistakes in computation of income and tax

Audit noticed various mistakes in computation of income and tax on various accounts e.g. omission to consider assets disclosed during the search for wealth tax, non levy of surcharge, non levy/short levy of interest under section 158 BFA (1), non disallowance under section 40A (3) and incorrect allowance of capital gains, etc., involving short levy of tax/loss of revenue of **Rs.77.30 crore** in **272** cases of which details of 18 categories are given in **Appendix -7**

2.4.46 Non levy of penalty

Under the provisions of section 158 BFA (2) of the Income Tax Act, 1961, the assessing officer or Commissioner (Appeals) in the course of proceedings may direct that a person shall pay by way of penalty a sum which shall not be less than the amount of tax so leviable but which shall not exceed three times the amount of tax so leviable in respect of the undisclosed income determined by the assessing officer under clause (c) of section 158 BC. The penalty is imposable on that portion of assessed undisclosed income which is in excess of the income shown in the return.

Audit noticed non levy of penalty on various accounts involving non levy of penalty of **Rs.10.97 crore** in **32** cases as depicted in the Table below.

(Rs. in lakh)

Table 2: Non levy of penalty

Sl. No.	Subject	State(s)	No. of cases	Tax effect
1	Non levy of penalty under section 158 BFA(2)	Gujarat, Maharashtra	2	26.05
2	Non levy of penalty under section 271D read with section 269 SS	Gujarat, Maharashtra, Tamil Nadu	10	148.83
3	Non levy of penalty under section 271C	Gujarat	1	4.30
4	Non levy of interest/penalty for deferment of self assessment tax/advance tax under section 221(1)	Maharashtra	19	918.08
	Total		32	1097.26

Objective - III

2.4.47 Appeal cases

The following table gives the status of assessment orders at the stage of first appeal, at the level of CIT(A):

Total number of cases	Decided in favour of assessee	Decided in favour of Department	Decided partly in favour of assessee and partly in favour of Department
851	381 (44.77)	129 (15.16)	341

The figures above indicate that only 15.16 per cent of the cases in the selected samples were upheld in favour of revenue and that 44.77 per cent (state wise position shown in **Appendix 8**) of the cases are decided in favour of the assessees at the first stage of appeal.

2.4.48 A detailed analysis of selected cases from West Bengal, Kerala, Uttar Pradesh, Delhi, Tamil Nadu and Haryana revealed the following:

(Rs. in crore)

Sl. No.	Reasons for relief	Number of cases	Amount
1	Deficiency in investigation and preparation of appraisal report	55	71.02
2	Deficiency in assessment	60	15.34
3	Legal issues/interpretation of facts	90	61.84

In 40 per cent of the cases analysed, additions to undisclosed income were not upheld due to deficiencies during the search, or at the time of preparing the appraisal report, or due to deficiencies in assessment. A few cases are discussed below.

2.4.49 In Kerala, in the case of Shri Raja Shekhar Nair out of a total undisclosed income of Rs.2.80 crore assessed, only Rs.48 lakh was upheld in appeal largely on account of lack of evidence to support the contentions in the assessment order.

2.4.50 In West Bengal, in the case of Mahadev Jute and Industries Ltd. additions of Rs.7.14 crore were deleted by the CIT (A) as the assessing officer had not enough shown evidence to substantiate the additions.

2.4.51 In Tamil Nadu, CIT Central-I, Chennai Central Circle IV(3) charge, the residence and business premises of a leading cine producer under sole proprietary concern, M/s Super Goods Films, were searched on 27 June 2002. The assessee filed a return declaring undisclosed income of Rs.20 lakh. The assessment was completed under section 158 BC at Rs.11.57 crore of which CIT (A) upheld only Rs.69 lakh.

An analysis of the appeal order revealed that the relief granted was due to deficiencies in investigation and preparation of appraisal report, deficiency in assessment, as also relief allowed by CIT (A) on legal issues/ interpretation of facts. The department had preferred 2nd appeal with ITAT in June 2005.

2.4.52 Similarly, in Tamil Nadu CIT Central I charge, lapses/omissions in connection with the investigation of transactions/evidence were noticed in three more cases. The appellate authority deleted the additions of Rs.6.30 lakh made by the assessing officer on grounds of failure to raise any query regarding the transactions recorded in the loose sheets and gather evidence at the search stage itself to establish that the items recorded therein were indeed made use of in purchase of a building.

14 other cases involving similar issues are given at **serial numbers 41 to 54 in Appendix-5.**

During 'exit conference' the Board agreed to look into the matter.

2.4.53 Applications preferred by assesseees to Settlement Commission

CBDT Instruction No. 1962 of 12.02.99 clarified that "cases" as defined under Section-245 A (b) which were under the purview of Settlement Commission would include block assessments to be made in search cases.

The CBDT Instruction mentioned above was in contravention of an earlier Supreme Court decision in the case of C.I.T Vs. Express Newspaper Ltd. (206 ITR 443)(1994) which held that income not disclosed earlier cannot be held as disclosed by the applicant for the purpose of admission of application to the Settlement Commission. In the said judgment, the honourable Apex Court among other things held "if the assessing officer (or the Income Tax Authority) has already discovered it and either has gathered material to establish the particulars of such income or fraud, the assessee cannot be allowed to defeat or forestall, as the case may be, the entire exercise of the income tax authorities just by approaching the Settlement Commission. In such a case, it cannot be said that he is acting voluntarily or in good faith. He should not be allowed to take advantage of the comparatively easy course of settlement".

The Hon'ble Court further held that Chapter-XIXA (containing provisions of settlement of case) "is a part of the Income Tax Act and must be construed consistent with the overall scheme and object". Further the Hon'ble Court added "It is not meant for those who come after the event, i.e., after the discovery of the particulars of income and its source, or discovery of particulars of fraud perpetrated by the assessee".

2.4.54 Audit noticed that in West Bengal, out of 317 assesseees (belonging to 25 groups & 1 individual) covered by block assessment procedure in consequence of search and seizure operations conducted on them, 40 assesseees (relating to 5

groups) made application to the Settlement Commission for settlement of their claims.

In 9 out of 16 assesseees relating to one group viz Kharkia Group, the cases were decided and block assessment completed on the basis of the Settlement Commission's order. In these cases, as per the Settlement Commission's order, undisclosed income was reduced to Rs. 1.87 crore from Rs. 46.86 crore as per the appraisal report and Rs.50 crore as per Rule 9. In the case of the balance 7 members of the group who did not go to the Settlement Commission, the amount involved was marginal (Rs.2.59 lakh).

2.4.55 In Haryana, 28 assesseees belonging to 5 groups had moved Settlement Commission having undisclosed income of Rs.31.24 crore. Though the last date on which the assessments would have become time barred was 31 May 2005 all the cases are still pending with the Commission, leading to delay in completion of the assessments under Section 158 BC. Similarly, in Maharashtra, in the case of two groups involving seven assesseees, the decision of the Commission is still awaited where the undisclosed income amounts to Rs.9.98 crore. The cases would have become time barred on 31 May 2004 in six cases and on 30 September 2004 in one case.

2.4.56 In Tamil Nadu, in the case of M/s Compass Shipping and Trading (P) Ltd, Chennai an undisclosed income of Rs.4 crore was detected. Final order under section 245D(4) was passed determining total undisclosed income of Rs.70.97 lakh (tax effect Rs.43.43 lakh).

The Board stated in January 2006 that as per clause (b) of Section 245A of the Income Tax Act 1961, "case" means any proceeding under this Act for the assessment or reassessment of any person in respect of any year or years, or by way of appeal or revision in connection with such assessment or reassessment, which may be pending before an income-tax authority on the date on which an application under sub-section (1) of section 245C is made. There is no clause in Chapter XIV B of the Income Tax Act 1961 which excludes the applicability of provisions of Chapter XIX A to cases covered by Chapter XIV B. Rather, Section 158 BH of the Income Tax Act, 1961 states that all other provisions of this Act shall apply. Further, Chapter XIVB was inserted in the Act by the Finance Act 1995, i.e. after the decision of the cases cited in para 2.4.53.

As chapter XIV B has been abolished from 1 June 2003, the decision of the Apex Court should be considered in its letter and spirit by bringing in suitable amendments in the new scheme for search and seizure as per section 153A.

Objective -IV**2.4.57 Comparison of expenditure incurred on search operations against revenue gains**

Audit attempted an analysis of the resources used for conducting searches as against the revenue gain therefrom relating to the selected 10 states. The expenditure figures collected from these states for search and seizure relate to the charges of DIT (Inv) and CIT/Central circle. Details in respect of the expenditure relating to persons deployed from outside the investigation wing are not available separately. The expenditure figures also do include the payments made towards rewards to informers and departmental staff, details of which were not available with the department.

(Rs. in crore)

Table 5: Comparison of expenditure and receipts

Year	Expenditure of search and seizure	Total expenditure of selected states	Percentage of column (2) to (3)	Revenue collection as a result of search and seizure	Total revenue collection of selected states	Percentage of column (5) to (6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2001-02	87.44	775.42	11.28	878.60	55943.84	1.57
2002-03	95.40	815.65	11.70	743.75	68209.23	1.09
2003-04	101.87	865.78	11.77	2676.61	86220.84	3.10
2004-05	100.52	961.77	10.45	1332.95	102537.08	1.30
Total	385.23	3418.62	11.27	5631.91	312910.99	1.80

The overall figures in respect of expenditure incurred by the investigation wing of 10 states as well as by the wing conducting assessment of search cases is 11.27 per cent of the total expenditure of the Department in those states. However the average revenue gain out of block assessment cases forms only 1.80 per cent of the total revenue collection of the department in these states. Further, revenue collection through search and seizure as a percentage of total revenue collection in selected states has declined from 1.57 per cent in 2001-02 to 1.30 per cent in 2004-05 except for an increase in the year 2003-04.

2.4.58 The state wise picture break up of these figures is also shown below:

(Rs. in crore)

Table 6: State wise position.

State	Expenditure for search and seizure	Total expenditure	Percentage of col.(2) to (3)	Revenue collection as a result of search	Total revenue collection	Percentage of col.(5) to (6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Andhra Pradesh	17.61	197.76	8.90	447.46	10249.06	4.37

Delhi	38.14	794.38	4.80	213.13	60508.51	0.35
Gujarat	23.49	292.19	8.04	39.92	14611.00	0.27
State	Expenditure for search and seizure	Total expenditure	Percentage of col.(2) to (3)	Revenue collection as a result of search	Total revenue collection	Percentage of col.(5) to (6)
Haryana	4.92	61.98	7.94	76.67	4364.44	1.76
Karnataka	20.14	186.72	10.79	175.56	27797.40	0.63
Kerala	13.83	92.23	14.99	147.86	5864.00	2.52
Maharashtra	152.61	820.40	18.60	3997.49	139438.14	2.87
Tamil Nadu	34.85	274.84	12.68	330.52	24239.24	1.36
Uttar Pradesh	30.83	296.23	10.40	40.35	8559.20	0.47
West Bengal	48.81	401.90	12.14	162.96	17280.00	0.94
Total	385.23	3418.63	11.27	5631.91	312910.99	1.80

Thus expenditure incurred by the investigation wing of each state as well as by the wing of individual states as well as by the wing carrying out assessment of search cases varied between 4.8 per cent and 18.6 per cent of the total expenditure of the department in that state. However, the revenue gain out of block assessment cases varied from only 0.27 per cent to 4.37 per cent of the total revenue collection of the department in those states.

The Board stated in January 2006 that the provisions of search & seizure operation are intended as a deterrence against concealment of income, and, through deterrence, fosters voluntary compliance. The search and seizure action has a salutary and cascading effect on all other assesseees engaged in the same economic activity/vocation and generates an atmosphere of voluntary compliance. The search and seizure activity is like a preventive action and the cost cannot be compared with the normal revenue measures and cost thereof. This is essentially a machinery to combat tax evasion and acts as a tool for prevention of economic crimes. Hence, the cost-benefit factor has to be judged in the light of these activities and the impact and revenue effect of the search & seizure action cannot be limited to measurement or evaluation in quantitative terms, least being compared to the overall revenue collection in terms of contribution as a percentage. The expenditure incurred on the manpower engaged to carry out search & seizure activity too cannot be evaluated or weighed against other factors quantitatively.

Given the low ratio of revenue generated to expenditure incurred as pointed out by audit, Board may like to examine the possibility of benchmarking/carrying out inter year and inter state comparisons to monitor performance in the area.

Objective - V

2.4.59 An earlier review on assessment of search cases made on or after 1 July 1995 under the Income Tax Act, 1961 appeared in para 3.1 of Audit Report No12 of 2000 of C&AG of India. Audit noticed that mistakes similar to those which had been commented on earlier such as incorrect estimation in appraisal reports,

mistakes leading to incorrect assessments, non invocation of provisions of section 158 BD continued to be found.

2.4.60 Differences also continued to be seen between figures shown in the appraisal reports and those adopted in the block assessment and cases were noticed where the variations were not explained by the assessing officers. Audit scrutiny also revealed several instances of mistakes in assessments which have been discussed at para 2.4.43.

2.4.61 No time limit has yet been fixed under section 158BD/153C for handing over books of accounts, documents, etc. to the assessing officer of the other persons as a result of which completion of block assessments are delayed for a period beyond five years. There is absence of any mechanism for confirmation that the undisclosed income of the related persons have been duly assessed.

During 'exit conference' the Board stated that the issue would be examined.

2.4.62 The PAC had desired that in the light of non-detection of concealed income in a large number of cases, the Ministry of Finance should take specific steps and ensure that a thorough groundwork was done before undertaking search and seizure operations. The audit checks to determine whether the department has since initiated concrete steps on the recommendations of the PAC as was mentioned in para 3.1.8 could not be carried out thoroughly due to non-production of satisfaction notes.

2.4.63 Lacuna in the Income Tax Act

No time limit has been fixed under section 158 BD/153 C for handing over books, accounts, documents etc. to the assessing officer of the other persons as a result of which completion of block assessment are delayed. Further there is no mechanism to ensure that the proceedings have been initiated. Necessary legislation should be introduced to ensure that assessments under section 158 BD/153 C are also completed expeditiously to make the results of the search operations effective.

The Board stated in January 2006 that section 153C has been amended whereby the limitation for initiating action under section 153C would start from the date of receipt of the books of account etc. by the assessing officer having jurisdiction over such other person.

The reply is not tenable as the same limitation is applicable in the case of section 158BD when compared to the completion of assessment. A time limit for the issue of notice under section 158 BD/153C has still not been put in place.

2.4.64 Wealth Tax Act does not have any special provisions for dealing with undisclosed cash or assets liable to wealth tax, found or seized during the course of search.

The Board stated in January 2006 that the recommendation of Audit is being considered by the Board.

Conclusions and recommendations

2.5.1 Several mistakes have been pointed out by audit during the process of search and preparation of appraisal report, as also at the assessment stage. An analysis of appeals has also revealed that only 15 per cent of the department's assessments are upheld while 44.7 per cent of assessee's appeals are upheld. Examination of the reasons for relief granted to assessee's has revealed that in 40 per cent of the cases, additions to undisclosed income are not upheld due to deficiencies in investigation and assessment. The lacuna in investigation and assessment dilute the effectiveness of search and seizure operations.

Board may examine the reasons leading to relief allowed at appellate stage due to deficiencies in investigation and assessment and take suitable steps in this regard.

2.5.2 It has also been noticed in audit that assessee's filing returns under section 158 BC/section 153 A declared incomes amounting to only 20 per cent of the undisclosed income arrived at in the appraisal reports and later, in the assessment orders. The high rate of success of assessee's appeals (44.7 per cent) as a result of lacuna in investigation and assessment could be a factor behind the low levels of declaration of undisclosed income under section 158 BC/153A.

Board may like to study this issue in more detail and examine measures to strengthen the provisions under section 158 BC/153 A.

2.5.3 Audit analysis reveals that the proportionate resources spent on the search and assessment process are approximately six times the revenues accruing from it.

Board may examine the possibility of setting up appropriate benchmarks to judge performance in this area.

2.5.4 Statements recorded under section 132 (4) could not be effectively used for assessing undisclosed income due to mistakes at investigation and assessment stage.

Board may take steps to strengthen procedures at investigation and assessment stage to make the provisions of section 132 (4) more effective.

2.5.5 Audit noticed that mistakes similar to those which had been commented on earlier such as incorrect estimation in appraisal reports, mistakes leading to incorrect assessments, non invocation of provisions of Section 158 BD continue to be found.

Board should take suitable steps to improve the system so that similar mistakes do not repeatedly occur.

2.5.6 Certain lacuna in the Income Tax Act have been pointed out such as non specification of time limit for issue of notice under section 158 BD and lack of specific provisions for assessment of search cases in the Wealth Tax Act.

Government may consider introducing a time limit under section 158 BD for issuing notices and appropriate provisions in the Wealth Tax Act for assessment of search cases.

New Delhi
Dated:

(SUDHA KRISHNAN)
Principal Director of Receipt Audit
(Direct Taxes)

Countersigned

New Delhi
Dated:

(VIJAYENDRA N. KAUL)
Comptroller and Auditor General of India