B K KHARE & Co
CHARTERED ACCOUNTANTS

Monthly Newsletter
Direct Tax
Friday, 10th Dec 2021
Volume 7, Issue 12

House Features

u/s 132- Power of Search and Seizure- Part II

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In the present article we cover inter alia the principles governing the issue of a warrant of authorization, conditions attached to retention of seized assets, consequences of an illegal search, release of seized assets and the practical importance of Rule 112 for the taxpayer. →

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Introduction

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In the present article we cover *inter alia* the principles governing the issue of a warrant of authorization, conditions attached to retention of seized assets, consequences of an illegal search, release of seized assets and the practical importance of Rule 112 for the taxpayer.

Warrant of authorization

In the landmark judgment of *ITO v. Seth Bros 74 ITR 836 (SC)*, the Supreme Court re-affirmed that the issue of a warrant for search and seizure, is not ordinarily a justiciable matter. Thus, a carefully drafted satisfaction note expressing reason to believe that statutory conditions had been satisfied, cannot be challenged in a writ petition [Dipin *G. Patel v. DGIT 339 ITR 636 (Guj)*]. It is not necessary that the warrant should specify the books of account or documents to be seized [*ITO v. Seth Bros 74 ITR 836 (SC)]*, or supply a copy of the warrant to the affected party [*Jain and Jain v. UoI 134 ITR 655 (Bom)*] or disclose to him the reasons for the search [*Southern Herbals v. DIT 207 ITR 55 (Kar)*] or give him notice to produce the impugned books and documents [V.K. *Jain v. UoI 98 ITR 469 (Delhi)*].

The warrant may specify the name of one person or a number of persons to be searched [Madhupuri *Corporation v.Prabhat Jha 256 ITR 498(Guj)*]. When a number of persons reside at a premises which is not partitioned, a warrant in the name of any of them would suffice to cover the entire premises [Harbhajan Singh Chadha v. DIT 380 ITR 100 ((All)]. But it must specify at least one person and cannot be in the name of a dead person or a company that no longer exists [B.D.R. *Builders and Dev Pvt Ltd v. ACIT 397 ITR 52((Delhi)]*.

Seizure of assets or documents

The power of seizure u/s 132(1)(iii) cannot be exercised in respect of assets or documents lying in the custody of the court [*Choyi v. Syed Abdulla Bafakki 91 ITR 144 (Kerala), in appeal 123 ITR 435(SC)*], or a government department under legal authority, such as the police [*CIT V. Ramesh Chander 93 ITR 450 (P and H)*] or the customs or central excise departments of the Central Government *[CIT v. TarsemKumar and Another 161 ITR 505(SC)]*. Nor is it possible to pass a prohibitory order u/s 132(3) in such a case *[Choyi v. Syed Abdulla Bafakki 91 ITR 144 (Kerala), in appeal 123 ITR 435(SC)]*.

This lacuna in the law was removed through the enactment of u/s 132A by the Taxation Laws (Amendment) Act, 1975. This section now empowers Income-tax authorities to requisition documents and assets lying in the control of any Officer or authority, except a court of law; the expression “any Officer or authority”, it is submitted, does not include a court of law [*Balbir Singh(decd) v. CIT 146 ITR 266* (P and H)].

There are other restrictions as well to the exercise of the power of seizure u/s 132(1) (iii) and u/s 132A: this power cannot be exercised where the source of the acquisition of the asset has been explained *[Laljibhai v. DCIT 213 ITR 114]*. Equally, the order of requisition would lack validity if the assessee has been able to offer a reasonable explanation to the police on the source of the seized cash and there is no evidence to suggest that this would not be disclosed to the tax authorities [Prakash *Jaichand Shah v. DIT 350 ITR 336 (Guj)*].

Under the proviso to u/s 132 (1) (iii), the authorized officer cannot seize, bullion, jewellery and other valuable article or things if they comprise stock in trade of the assessee. He may however inventorise the same, if required. Also, small amounts of gold ornaments below a certain weight specified by the Board cannot be seized. But cash representing the undisclosed income of the assessee can be removed, irrespective of the location where it is found- even if, for instance, it is situated in the bank where the assessee has an account [Sardar *Santosh Singh v. CIT 248 ITR 532(Pat)*]. But this decision does not consider the argument that the money lying in the assessee's own bank account cannot be seized because the assessee as well as the bank are different entities and they are engaged in a debtor – creditor relationship; the section does not contemplate attachment or seizure of debt [This argument was considered in *Devarajan v. Tamilnadu Farmers Service Cooperative Federation 131 ITR 506 (Madras)*].

Prohibitory orders – u/s 132(3)

Where it is impractical to seize a document, books of account, gold, bullion, jewellery, or other valuable articles or things, the authorized officer may issue an order prohibiting its owner or the person or immediate holder from removing it or parting possession with it, without the permission of the authorized officer. But he must record his reasons before he takes this step. [Maa *Vaishnavi Sponge Ltd. V. DGIT 339 ITR 413*(*Orissa*)]. Where such an order relates to moneys lying in bank, the prohibitory order must be served on the assessee and not the bank itself, although a copy of the order may be forwarded to the bank also *[ITO v. Shah Jahan 104 ITR 347((Ker)*]. Attachment under this section can only be made when the assessee is satisfied that the asset is undisclosed [*Sriram Jaiswal v. UoI 176 ITR261 (All)*], for a reasonable period [*Om Prakash Jindal v. UoI 104*

ITR 389 (P and H)] , not exceeding 60 days under the current law [u/s 132(8A)]. Explanation below u/s 132(3) stipulates that a prohibitory order does not amount to seizure, and the aforesaid time limit applicable to such an order cannot be extended further.

Retention of seized documents

Seized documents and assets can be retained up to 180 days. Further retention has to be approved by the Commisioner of Income-tax; and such approval must be given before the expiry of the retention period [u/s 132(8)]. Further the reasons for such retention must be communicated to the assessee expeditiously [CIT *v.Oriental Rubber Works 145 ITR 477(SC)*]. It is not incumbent upon the Commissioner to give an opportunity to the assessee [*CIT v. Mahabir Prasad 93 ITR 215(Cal)*] before he passes an order in this regard; but he must have special reasons to accord his approval for the retention of records beyond the time limits laid down under this section.

If the authorized officer is himself not the AO, he must hand over the seized documents and assets to the AO within two months of the search. All further action including retention of assets and documents beyond the stipulated statutory limit (30 days beyond the date of completion of the assessment) has to be taken by the AO. If such action is taken by the authorised officer, it would be illegal; so too, in such circumstances would be the approval given by the Commissioner [Krishnaswami *v. CIT 166 ITR 244(Mad), affirmed in CIT v.Krishnaswamy v. CIT 249 ITR 794(SC)*].

Consequences of an illegal search

An assessment made on the basis of an illegal search would be invalid [*CIT V. Chitra Devi Soni 313 ITR 374 (Raj)-SLP dismissed 313 ITR (St) 28 (SC)*]. Thus where the valid explanation given by the assessee for the jewellery found in his possession was ignored, both the search and the assessment were declared illegal; and costs were ordered by the Supreme Court [*DGIT v.*

Diamondstar Exports Ltd 293 ITR 438(SC)]. Rejection, in a mechanical manner, while issuing an authorization for search, of the assessee's explanation, for cash found during a survey at the assessee's premises, rendered the search illegal. [*Jignesh Farshubhai Kakkad v. DIT 264 ITR 87 (Guj)*] Articles found during the search cannot be used ex- post facto to justify the search [*Kavita Aggarwal v. DIT(Inv) 264ITR 472(All)*].

Release of seized assets

Retained assets can only be applied for the discharge of the tax liabilities of the owner for years prior to the date of the search [*Shobha Sengar v.CIT 244 ITR 10 (All)*]. Where assets are seized from a premises not belonging to the assessee, the owners of the assets and the premises from where the seizure took place have to apply to the authorities for release; and the latter have to deal with such applications according to the law [Wakil *Kumar v. CIT 259 ITR 698 (Patna)*]. Jewellery recovered from the premises of a person who has been searched and to whom it was pledged against an advance, must be taken as belonging to the person who pledged it, because he still retains the rights of ownership, despite the fact that the pledgee may have been found in possession of it [Allepey *Financial Enterprises v. ADIT 236 ITR 562*]. When no liability for tax or penalty is outstanding, the assessee cannot be asked to give a bank guarantee to the extent of the seizure before the release of the seized goods [*Bhawna Lodha v.DGIT 354 ITR 134*( )].

A person who is searched is entitled to inspection and obtain copies of the departmental record in his case [New *Kashmir Trans v. CIT 92 ITR 334]*. Within the terms of this section, a debt is a valuable article or thing. A fixed deposit receipt or title deed of immovable property, on the other hand, is only a document [Bhagwandas *v. CIT 98 ITR 194 (Guj)*].

The authorities concerned- first the Authorised officer and later, after the seized assets and documents have been transferred to him, the AO – are duty bound to ensure their safe custody.

As soon as a valid explanation is provided for the seized goods, they should be released [Manik *Chand v. DCIT 216 ITR 552.*

Presumptions U/S 132(4A)

u/s 132(4A) raises certain presumptions in favour of the revenue regarding books of accounts, documents, money, bullion, jewellery or other valuable articles or things found in possession or control of any person during a search. These presumptions are to the effect:

- That such documents and goods , enumerated above, actually belong to such person;
- That the contents of such books of accounts and other documents are true;
- That signatures and hand writing in the account books and documents purported to be of particular persons, are of those persons,
- That if documents are stamped, executed and attested by certain persons, these were genuinely stamped, executed and attested on the specified date, by the specified persons.

These presumptions can u/s 278(D) be used for prosecution purposes also. But they are rebuttable [CIT *v. SMS investments 207 ITR 364 (Raj)*]; it is within the discretion of the court whether to invoke them or not [ITO *v.T. Abdul Majeed169 ITR 440(Ker)*]. In *Prem Dass v. ITO 236 ITR 683(SC)*, the Supreme Court held *inter alia* that these presumptions in themselves are not enough to establish the guilt of the accused and must be corroborated by independence evidence.

Rule 112

The rights and obligations of the department and the assessee who is subjected to a search have been stipulated in Rule 112. Some important provisions of this rule are set out below:

- Any person in charge of any building, place, vehicle, vessel or aircraft authorized to be searched shall on production of the warrant of authorization and identity card allow free access to the authorized officer and allow him to carry out the search
- If such access is not possible, the authorized officer may break open any door or window to gain access, whether belonging to the assessee or any other person
- If such premises is in the occupation of a woman who does not appear in public, the authorized officer may give enough time to such a person the option to withdraw from the premises, before he enters the same.
- If any entry cannot be effected because the vehicle, vessel or aircraft to be searched, is moving, the authorized officer, may with the help of the police or/and officers of the Central Government, stop the same (and in the case of an aircraft, compel it to land); and thereafter, search it. In the process of carrying out his duties, he may break open any outer or inner door or window of the vehicle, vessel or aircraft (whether belonging to the assessee or anyone else), if he cannot gain   entry.
- The search has to be carried out in the presence of two respectable witnesses of the locality
- Where a vehicle, vessel or aircraft is searched, the authorized may order any two respectable persons to witness the search.
- The inventory lists, duly signed by the witnesses, must indicate the details of the articles found and also the place where they were found. The occupants of the premises must be handed over a copy   of these lists
- If a person is searched personally a copy of the list of items found on his person and seized must also be made available to him

- Bullion, jewellery and other valuable articles and things will be placed in separate packets and inventorized, every such packet shall bear the seal and signature of the of the authorized officer, and the occupant of the premises.
- Later, the books of accounts, documents, packages of valuables etc. seized, are to be handed to the custodian. If any seized package is to be opened, this act must be carried out in the presence of two witnesses and the assessee himself.
- The relevant books of accounts and are discus documents are to be handed over to the AO who exercises the powers of the custodian, with regard to them.

Conclusion

This concludes our discussion on the powers of search and seizure u/s 132 of the Act.

Are Taxes Paid Outside India Deductible?

Ever since the start of the century or even earlier too, it was government's endeavour to create a higher foreign currency reserve by increasing exports and minimizing imports. This meant that Indian entities earned income from outside India which was subjected to tax / withholding tax in foreign jurisdiction in accordance with the provisions of law in those jurisdictions.

Issue

Sections 90/90A/91 of the Income Tax Act, 1961 (the Act) provide for credit for the taxes paid in foreign countries against Indian income tax liability, under normal provisions or under deeming provisions of Minimum Alternate Tax under section 115JB. However, there are instances, when there is no income tax liability say for example, the assessee incurred a loss or had brought forward loss etc. In such cases credit for taxes paid in the foreign country is lost. In the absence of any provision dealing with this situation tax payers claimed deduction for foreign taxes paid as business expenditure. Certain others claimed double benefit - deduction as expenditure and also credit against tax liability.

Legal Position

Until 2006, the said position was litigated and there were decisions both in favour and against the assessee.

Having regard to the litigation, Finance Act 2006 inserted Explanations 1 and 2 in s 40(a)(ii).

Explanation 1 clarified that any sum paid outside India and eligible for relief of tax under section 90 or deduction from the income-tax payable under section 91 was not allowable, and shall be deemed never to have been allowable as a deduction in computing income under the head ‘profits and gains of business or profession’. Needless to say, section 90 and 91 continued to be available for relief or deduction as the case may be.

Explanation 2 provided that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession (deduction of which as a business expenditure is prohibited by s 40(a)(ii)) includes any sum eligible for relief of tax under section 90A of the Act. .

Section 40 deals with amounts not deductible in computing the income chargeable to tax under the head profits and gains of business or profession and operates notwithstanding anything to the contrary in sections 30 to 38 of the Act. So deduction for any sum, even if otherwise allowable under these sections could still be denied by operation of section 40. But it appears that a debate continues whether deduction would be allowable where the assessee was not eligible for credit.

Contentions of tax payer

The case of the tax payers is that they should be allowed deduction as business expenditure for foreign taxes paid if credit thereof is not available. This argument is based on the following contentions:

- As per section 2(43) of the Act, 'tax' means income tax chargeable under the provisions of the Act and section 40(a)(ii), when it refers to tax, should be deemed to referring to ‘tax’ so defined.
- Explanations 1 & 2 to section 40(a)(ii) were inserted to deter tax payers claiming double benefit (supra);
- These Explanations would apply only to tax which is eligible for the benefits of sections 90 and 91 of the Act but not other taxes;
- Further, only tax that is eligible for relief under section 90/90A/91 is hit by section 40(a)(ii).

It is noteworthy that various courts have given divergent rulings on the subject some of which are analysed as under:

The Ahmedabad Tribunal in the case of Mastek Limited[1] for AY 2002-03 held that foreign income-tax was allowable as normal expenditure u/s 37 of the Act. The ITAT also held that such tax is not tax on profits but a necessary condition precedent to the earning of profits in foreign countries.

In the case of R. Systems International Ltd[2], the Delhi Tribunal allowed deduction for turnover tax collected by the overseas customer on the premise that it was not a tax or rate on the profit and gains of the business.

Bombay High Court in the case of Reliance Infrastructure Ltd. Vs. CIT [3]held that:

- tax paid abroad is not tax under section 2(43) and hence not 'tax' for the purposes of section 40(a)(ii);
- Explanation to section 40(a)(ii) restricted the disallowance to tax which is eligible for benefit under sections 90 or 91 but nothing more than that; Mumbai Tribunal in the case of Bank of India v. Asstt. CIT [4] followed the decision of the Bombay High Court in the case Reliance Infrastructure Ltd. Vs. CIT (supra) and while doing so, considered the decision of the Ahmedabad Tribunal in the case of Dy. CIT v. Elitecore Technologies (P.) Ltd. [5](discussed below).

[1] [2013] 36 taxmann.com 384 (Ahmedabad - Trib.)
[2] TS-609-ITAT-2019(DEL)
[3] (2017) 390 ITR 271 (Bom)
[4] [2021] 125 taxmann.com 155
[5] [2017] 80 taxmann.com 6/165 ITD 153

Contentions of the tax authorities

The case of the Revenue is that taxes are in the nature of appropriation of income rather than charge on income, as taxes are levied only after income is earned and not for the purpose of earning such income. Foreign tax does not lose its colour as income tax which is never allowable as business expenditure.

We may now examine the decision of the Ahmedabad Tribunal in the case of Elitecore Technologies (P.) Ltd. (supra). The Hon'ble Tribunal noted that the word "tax" used in section 40(a)(ii) is used in conjunction with the words "any rate or tax". The word "any" goes both with the rate and tax. The expression is further qualified as a rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. The Tribunal was of the view that if the word "tax" was understood as in section 2(43) of the Act, the word "any" would be otiose. Thus, the Tribunal held that the words "any tax" in Section 40(a)(ii) refers to any kind of tax levied or leviable on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. Thus, for the purposes of section 40(a)(ii), tax would include foreign tax also provided other condition were met. The Tribunal relied on the decision of Lubrizol (India) Ltd. v. CIT [6] (approved by Smithkline & French India Ltd.[7]).

The Tribunal also noted that if the assessee was allowed credit of taxes and deduction (on which credit was not available), it may lead to a situation of refund of foreign taxes by the India tax authorities. Say for example:

[6] (1991) 187 ITR 25 (Bom.)
[7] (1996) 219 ITR 581

"Assuming that the assessee earned an income of Rs 100 from outside India, and the taxes withheld abroad are Rs 60 and the admissible tax credit available to the assessee under section 90 and/or 91, in respect of these taxes withheld, is Rs 40 as the effective tax rate in India in respect of the said income is 40%, the benefit available to the assessee should be as follows:

Tax credit to be adjusted against tax liability under the Income Tax Act, 1961 Rs 40 Deduction under section 37(1) in respect of taxes paid or withheld outside India Rs 20 In effect thus, the assessee gets a tax benefit of Rs 48 (i.e. Rs 40 plus 40% of Rs 20 which is allowed as deduction) as against a related tax liability of Rs 40"

Furthermore, the Tribunal also considered the decision of Tata Sons Ltd. [TS-6004-ITAT-2010(MUMBAI)-O], which did not allow deduction of US federal taxes.

Recently, the Hyderabad Tribunal in the case of Infor (India) Private Limited [TS-941-ITAT-2021(HYD)], after considering the above decisions (both for and against the assessee), followed the decision of Elitecore Technologies (P.) Ltd. (supra) and held that deduction of foreign taxes is also governed by the provisions of section 40(a)(ii). Furthermore, the Tribunal noted that if the tax payer were to be allowed the credit of taxes under section 91 and also deduction under section 37, the same would render the specific provision (section 91) otiose. Thus, the Tribunal adopted a strict interpretation and held that the tax payer shall not be allowed deduction for foreign taxes.

Conclusion

Tax, which is levied on the profits of any business, would appear to be case of an outgo which arises only after the profit is earned and not during the course of earning of that profit. So, perhaps from a common sense point of view, tax should not be deductible from that profit, not being expenditure wholly and exclusively incurred for the purposes of business.

Explanation 1 refers to ‘any sum eligible for relief of tax under section 90 …….’. So it would appear that this refers to the gross amount of tax which is eligible for relief and not the actual amount of relief allowed as part of the process of computation of tax liability.

The controversy could have been avoided with better drafting. A somewhat similar controversy is raging as regards deductibility of education cess – whether the word tax includes a cess and if not, whether the cess is deductible u/s 37(1) read with section 40(a)(ii).

One thing appears to be clear – both deduction and credit cannot be allowed in respect of the same amount.

Appropriate legislation alone would douse this controversy which in itself results in loss of revenue to the Government. In the meantime, till the position gets certainty, tax payers, based on favourable decisions and the amounts involved, may consider claiming the deduction of foreign taxes or, more conservatively, make a claim during assessment proceedings, especially where scrutiny assessment is inevitable.