

(1990) 08 PAT CK 0016

In the Patna High Court

Case No : Taxation Case No's. 39 and 40 of 1978

Commissioner of Income Tax

APPELLANT

Vs

Agarwalla Brothers

RESPONDENT

Date of Decision : 21-08-1990

Acts Referred:

Income Tax Act, 1961 — Section 147, 148, 149, 150, 151

Citation : (1990) 38 BLJR 1343 : (1990) 88 CTR 133 : (1991) 189 ITR 786

Hon'ble Judges : G.G. Sohani, C.J;G.C. Bharuka, J

Bench : Division Bench

Advocate : K.K. Vidyarthi and S.K. Sharan, for the Appellant; Pawan Kumar, for the Respondent

Judgement

G.C. Bharuka, J.—The present two tax cases are being disposed of by a common judgment because the answer to the question referred in Tax Case No. 40 of 1978 is intimately dependent on the answer to the question involved and referred in Tax Case No. 39 of 1978. The Income Tax Appellate Tribunal has referred the following questions of law u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") only :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in law in cancelling the entire assessment u/s 147(a) of the Income Tax Act, 1961 for the assessment year 1962-63 ? (referred in Tax Case No. 39 of 1978)

2. Whether, on the facts and in the circumstances of the case, the cancellation of the penalty u/s 271(1)(c) of the Income Tax Act, 1961, by the Tribunal was legal ? (referred in Tax Case No. 40 of 1978)."

2. For the assessment year 1962-63 pertaining to the accounting year ending on December 31, 1961, the assessment of the assessee, namely, Agarwalla Brothers, had been completed on May 25, 1964, by determining a loss of Rs. 7,361. During the assessment proceedings as disclosed by the assessee, the

Income Tax Officer noted that the assessee had started construction of four buildings during this year and an investment of Rs. 1,15,100 was shown during the year under assessment. While computing the income, he also assessed the rental income arising out of the said buildings.

3. Subsequently, it appears that, on the basis of some complaints, enquiries were made in respect of the investments made in the constructions undertaken by the assessee and investments made therein in the year on hand as well as in subsequent years. According to the Inspector who enquired into the matter by visiting the buildings to ascertain the nature of the construction and went through the municipal records, the total investment made in the construction in all the years was Rs. 9,18,519 out of which, as per his estimate, the investment during the previous year relevant to the assessment year 1962-63 was to the extent of Rs. 7,79,805. This report of the Inspector was dated June 16, 1969. Since there was a wide difference between the cost of construction estimated by the Inspector and the cost as shown by the assessee, the Income Tax Officer referred the matter to the valuation cell in order to get the cost of construction valued by an expert. The valuer, after making local inspection along with the Income Tax Officer, submitted his report some time in March, 1971. According to the report of the valuer, the cost of construction was Rs. 7,19,000.

4. In view of the aforesaid facts, the Income Tax Officer initiated reassessment proceedings u/s 147(a) of the Act by recording the following reasons :

"The assessee constructed a number of houses in Ashok Nagar, Dhanbad, and showed in his books a sum of Rs. 1,15,100 only as investment towards construction during the relevant accounting period. Taking into consideration all the relevant facts, the cost of construction as per the estimate of the Department comes to Rs. 6,79,805 during this period. Thus, a sum of Rs. 5,64,705 is taken as investment in house construction not accounted for. In the absence of satisfactory explanation from the assessee regarding the source of this sum, this is treated to have come out of the assessee's undisclosed income during the year.

I have reason to believe that, by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for its assessment for that year, income chargeable to tax amounting to Rs. 5,64,705 has escaped assessment. I, therefore, propose to assess this income u/s 147 of the Income Tax Act, 1961."

5. After recording the aforesaid reason as required u/s 148(2), sanction of the Commissioner was obtained u/s 151(2) of the Act on the basis of the reason so recorded. Thereafter, a notice dated March 16, 1971, was issued u/s 148(1) of the Act which was served on the assessee on March 17, 1971.

6. In response to the said notice, the assessee filed its return showing income as "nil". During the assessment proceedings, the assessee, inter alia, challenged the initiation of reassessment proceedings u/s 147(a) on the ground that all the necessary particulars had been furnished during the course of the original

assessment proceedings. The Income Tax Officer rejected the objection and assessed the income of the assessee at Rs. 2,61,815. The assessee preferred an appeal before the Appellate Assistant Commissioner and assailed the order of assessment both on the ground of jurisdiction as well as the quantum of the income assessed. The Appellate Assistant Commissioner also negated the contention raised in relation to jurisdiction but granted nominal relief in the quantum. Thereafter, both the assessee as well as the Department preferred appeals before the Income Tax Appellate Tribunal which was disposed of by a common order. Question No. 1 arises out of this order of the Tribunal.

7. The Tribunal, while considering the validity of the proceedings and the consequential order of assessment, examined the necessary facts and held that, at the time of the original assessment, the assessee had filed balance-sheets for the period ending December 31, 1960, as well as for the period ending December 31, 1961. The Tribunal, after perusing the records, recorded a finding that a copy of the accounts of Agarwalla Brothers showing the amounts of investments was also filed. The plan of the building and the remark that it was sanctioned on February 9, 1961, was also found on the records. The assessee, in a letter dated May 22, 1964, had given the details of the floor area of the flats and this was considered by the Income Tax Officer. In the assessment year itself, the fact of construction has been found noted and the nature of buildings has also been indicated. The period of construction of office buildings had been given as between April 1, 1961, and December 31, 1961. The Tribunal also found that the Income Tax Officer had examined the investments made by the assessee in the building stated to have been constructed by him and he found the cost as shown in the balance-sheet and the books to be reasonable both in respect of the office building as well as the residential buildings. While analysing the facts further in order to examine the jurisdictional issue, the Tribunal opined that it was only as a result of further enquiry that it transpired that the cost of construction of the buildings in question would be much more if the nature of construction is taken into consideration and, in these circumstances, it needs to be legally determined whether there was any escapement as a result of omission or failure on the part of the assessee to disclose full and true facts. The Tribunal further held that, at the time of the original assessment, the fact of construction, the plan of construction, the area of construction and the cost of construction were given by the assessee and the Income Tax Officer found the investments shown to be reasonable and, on consideration of all these factors, it cannot be said that the primary facts were not disclosed by the assessee.

8. Another important fact noticed by the Tribunal in its order is that, as per the report of the Inspector, one particular construction had not been shown by the assessee in the accounts though this construction also had been undertaken in this very year. It has proceeded to hold that this omission on the part of the assessee has not formed the basis for taking action u/s 147(a) of the Act, inasmuch as this reason has not been recorded as envisaged u/s 148(2) of the Act, and, therefore, this cannot be taken to be a basis for sustaining the validity

of the impugned action and, accordingly, it held the proceedings to be invalid and cancelled the order of reassessment.

9. On the above premise, it has to be seen, whether, for determining the validity of the assumption of jurisdiction by the Income Tax Officer u/s 147(a) of the Act, the Tribunal was to confine itself only to the recorded reasons and in case the recorded reasons fail to stand the test of "reasons to believe" within the meaning of Section 147(a) of the Act as judicially laid down, then, whether the very initiation of the proceedings can be said to be ab initio void rendering all consequential actions including the order of reassessment as ineffective and non est.

10. Section 147 of the Act authorises the Income Tax Officer to initiate proceedings in order to assess or reassess the income of any assessee provided the conditions contemplated under either of the two clauses of the said section can be shown to be in existence. In the present case, we are concerned with Section 147(a) of the Act which reads as under :

"147(a). If the Income Tax Officer has reason to believe that by reason of the omission or failure on the part of an assessee to make a return u/s 139 for any assessment year to the Income Tax Officer or to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, or ...

he may, subject to the provisions of Sections 148 to 153, assess or reassess such income or recompute the loss or the depreciation allowance, as the case may be, for the assessment year concerned (hereafter in Sections 148 to 153 referred to as the relevant assessment year)."

11. From a bare reading of the aforesaid provision, it is apparent that the jurisdiction of the Income Tax Officer to assess or reassess u/s 147(a) is, inter alia. founded on the existence of reason to believe that the assessee has failed to disclose fully or truly all material facts necessary for his assessment for the relevant assessment year and, secondly, on the compliance with the mandates contained in Sections 148 to 153. Section 148 casts an obligation on the Income Tax Officer to issue a notice before making any assessment or reassessment, and Sub-section (2) thereof provides that before issuance of any notice under Sub-section (1), the Income Tax Officer is required to record his reasons for doing so.

12. Section 151 of the Act provides a further important safeguard to the assessee against any arbitrary or illegal assessment or reassessment u/s 147 of the Act by providing that, if notice u/s 148 is sought to be issued after the expiry of eight years from the end of the relevant assessment year, it can be issued only if the Central Board of Direct Taxes, after examining the reasons recorded by the Income Tax Officer, is satisfied that it is a fit case for issue of such notice. In case the notice is sought to be issued after the expiry of four years from the end of the relevant assessment year a similar satisfaction is required to be arrived at by the Commissioner of Income Tax on the basis of the reasons recorded by the

Income Tax Officer.

13. Therefore, the legislative scheme is that the Income Tax Officer can clothe himself with the jurisdiction to assess or reassess u/s 147(a) of the Act only if he records the reasons which can stand the test of relevance in accordance with the judicial pronouncements and after obtaining necessary sanction as stated above notices are issued by him but if, in any case, it is found that the reasons recorded by him are not germane to the exercise of jurisdiction u/s 147(a) of the Act, then the very assumption of jurisdiction will be ab initio void rendering the entire process of assessment as a nullity. There can be hardly any doubt in holding that the recording of the reasons is a pre-requisite to the assumption of jurisdiction by the Income Tax Officer for initiating the proceedings u/s 147(a). The reasons so recorded acquire much significance when the action is taken under Clause (a) of Section 147 because it is only the recorded reasons which can indicate as to why the Income Tax Officer was made to believe that income has escaped assessment for the relevant assessment year. Further, the language employed in Section 151 clearly leads to the conclusion that the Board or the Commissioner of Income Tax, while according sanction for issuance of notice u/s 148 and for coming to an objective conclusion authorising the Income Tax Officer to take action u/s 147(a), are required to confine themselves only to the reasons recorded by the Income Tax Officer.

14. Therefore, looking at the entire scheme and purpose of the Act, I am of the considered view that the validity of the assumption of jurisdiction u/s 147(a) can be tested only by reference to the reasons recorded u/s 148(2) of the Act and the Income Tax Officer is not authorised to refer to any other reason even if it can be otherwise inferred and/or gathered from the records. If the reasons so recorded are such that, on their basis, it can possibly be said that income chargeable to tax has escaped assessment for a certain assessment year because of the omission or failure on the part of the assessee to make a return for that year or to disclose fully and truly all material facts necessary for such assessment, there can be a valid case for invoking the jurisdiction conferred by Clause (a) of Section 147. If, on the contrary, the reasons recorded by the Income Tax Officer cannot lead to such a conclusion, the proceedings initiated by the Income Tax Officer under that clause must be declared as ab initio void.

15. In *S. Narayanappa and Others Vs. Commissioner of Income Tax, Bangalore*, , the Supreme Court, while dealing with a case of reopening of an assessment u/s 34(1)(a) of the Indian Income Tax Act, 1922, has observed (p. 222) :

"The proceedings for assessment or reassessment u/s 34(1)(a) of the Income Tax Act start with the issue of a notice and it is only after the service of the notice that the assessee, whose income is sought to be assessed or reassessed, becomes a party to those proceedings. The earlier stage of the proceeding for recording the reasons of the Income Tax Officer and for obtaining the sanction of the Commissioner are administrative in character and are not quasi-judicial. The scheme of Section 34 of the Act is that, if the conditions of the main section are

satisfied, a notice has to be issued to the assessee containing all or any of the requirements which may be included in a notice under Sub-section (2) of Section 22. But, before issuing the notice, the proviso requires that the officer should record his reasons for initiating action u/s 34 and obtain the sanction of the Commissioner who must be satisfied that the action u/s 34 was justified."

16. In *Union of India and Others Vs. Rai Singh Deb Singh Bist and Another*, , the Supreme Court has held that (p. 202) :

"The recording of the reasons in support of the belief formed by the Income Tax Officer and the satisfaction of the Central Board of Revenue on the basis of reasons recorded by the Income Tax Officer that it is a fit case for issue of notice u/s 34(1)(a) are extremely important circumstances to find out whether the Income Tax Officer had jurisdiction to proceed u/s 34(1)(a)."

17. In *JAMNA LAL KABRA Vs. Income Tax OFFICER, B WARD, BAREILLY, AND OTHERS.*, , it has been held at p. 464 that:

To justify action by reference to Clause (a) of Section 147, it is not open to the Income Tax Officer, in my opinion, to refer to reasons other than those recorded by him pursuant to Sub-section (2) of Section 148. If the reasons recorded by the Income Tax Officer cannot lead to the conclusion that income chargeable to tax has escaped assessment for the relevant assessment year because of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for such assessment, the proceedings initiated by the Income Tax Officer by reference to that clause must be struck down as invalid.

I may point out here that, in this judgment at page 464, it has also been said that Sub-section (2) of Section 148 requires the Income Tax Officer to record his reasons for issuing a notice under that section and it is necessarily envisaged that he will record all the reasons. The Calcutta High Court, in the case of *H.A. Nanji and Co. v. ITO* [1973] Tax LR 567, has dissented on this limited aspect by holding that Section 148(2) merely requires that, before issuing any notice, the Income Tax Officer should record his reasons for doing so and it does not state that it is necessary to record all the reasons. In appeal, this decision was affirmed by the Division Bench, *H.A. Nanji and Co. Vs. Income Tax Officer, "A" Ward and Others*, . I respectfully agree with the view expressed by the Calcutta High Court in this regard. But then the reason so recorded must be a valid and relevant reason providing a foundation for assumption of jurisdiction by the Income Tax Officer u/s 147(a) of the Act

In the case of *C.M. Rajgharia and Another Vs. Income Tax Officer and Others*, , a Bench of this court has held that "the existence of the belief itself being challenged either for the purpose of Section 147(a) or Section 147(b), nothing has been said in the counter-affidavit filed on behalf of the respondents to justify any reason to believe. Nor was anything shown to us from the original records of the Department which could justify the existence of any such reasonable belief. It is true that the communication of any such, reasons to hold a belief to the

assessee is not necessary, but they have to be disclosed to this court and the Income Tax Officer may be confined to those recorded reasons to support the assumption of jurisdiction", (underlining is mine).

In the case of H.A. Nanji and Co. Vs. Income Tax Officer, "A" Ward and Others, which has been referred to above on another point, it has been held at page 606 that, "it appears that since the satisfaction of the Commissioner on the recorded reasons that the case is a fit one for issue of notice is mandatory, it is obvious that the affidavit cannot disclose facts which travel beyond the ambit and scope of the recorded reasons. Though it is not necessary to state all the facts in the disclosed reasons, the genesis of the facts stated in the affidavit must have some place in the reasons, however brief or short it may be. In a given case where the recorded reasons refer to only fictitious loans in short, it may not be necessary to state all such loans which the Income Tax Officer had in his mind. But the Income Tax Officer cannot be heard to say in his affidavit that he had in mind also at the time of recording reasons the suppression of sales committed by the assessee in his return since such facts were not before the Commissioner to ensure that the case is a fit one for issue of notice u/s 147."

18. A Bench of the Calcutta High Court, by placing reliance on its earlier judgment in the case of East Coast Commercial Company Ltd. Vs. Income Tax Officer and Others, , held that, "it is true that Section 148(2) of the Income Tax Act does not say that the Income Tax Officer shall record all the reasons which he had in his mind for reopening the assessment or for formation of his belief that income of the assessee had escaped assessment or has been under-assessed on account of the assessee not having made full and true disclosure of his income but the section does not also say that the Income Tax Officer would record only some of the reasons and keep the others up his sleeves to be disclosed before the court if his action is ever challenged in a court of law. The recording of reasons, in our opinion, is not an idle formality but is a mandatory requirement of the statute casting a duty and obligation on the Income Tax Officer to record his reasons for issuing a notice for reopening an assessment and the Central Board of Direct Taxes or the Commissioner, as the case may be, being satisfied that it is a fit case for issue of such notice solely on the basis of the said reasons recorded, accords its sanction to the issue of such notice."

19. At page 356 of the said report, the court has further held that "the Income Tax Act does not provide that, for the issue of a notice u/s 34 of the old Act or Section 148 of the new Act, satisfaction of the court was necessary but such satisfaction under the statute had to be that of the Board or of the Commissioner, as the case might be. Thus, if any additional reasons were disclosed by the Income Tax Officer in his affidavit before the court in support of his action in reopening the assessment on which the court might be satisfied as to the validity of the proceedings, that would not, in our opinion, validate the proceedings, if the reasons recorded under Clause (iii) of the first proviso to Section 34(1) of the old Act or Section 148(2) of the new Act were not sufficient

for the initiation of the proceedings or for the grant of sanction by the Board or the Commissioner, as the case might be.

20. The same view has been taken by the Calcutta High Court in the subsequent case of *EQUITABLE INVESTMENT CO. (P.) LTD. Vs. Income Tax OFFICER, G. WARD, AND OTHERS.*, .

21. At the Bar, reference was also made to the case of *Chunnilal Surajmal Vs. Commissioner of Income Tax*, decided by a Bench of this court but, in my view, this case is not relevant for deciding the question involved in this case because though, in that case, the reassessment proceedings were found to be illegal, the ground of challenge was not founded within the parameters of recorded reasons. Rather, the proceedings were sought to be challenged by reference to certain materials collected subsequent to the initiation of the proceedings and it was held by this court that the Revenue cannot be allowed to initiate reassessment proceedings u/s 147 of the Act which is not in conformity with law and then start a fishing enquiry.

22. In view of the above discussions, I am clearly of the view that the Tribunal was right in holding that though, as per the report of the Inspector, one particular construction was not shown by the assessee in the accounts, since this circumstance has not been recorded as one of the reasons for initiating the proceedings u/s 147(a), it cannot be taken, in aid for sustaining the assumption of jurisdiction by the Income Tax Officer.

23. Now, the next question that immediately falls for consideration is whether the reasons recorded by the Income Tax Officer, as quoted above, can be said to be legally relevant for conferring the jurisdiction on the Income Tax Officer. In the case of *Johri Lal (H.U.F.), Agra Vs. The Commissioner of Income Tax*, , it has been held by the Supreme Court that:

"The formation of the required opinion by the Income Tax Officer is a condition precedent. Without formation of such an opinion, he will not have jurisdiction to initiate proceedings u/s 34(1)(a). The fulfilment of this condition is not a mere formality, but it is mandatory. The failure to fulfil that condition would vitiate the entire proceedings. As held by this court in *Sheo Nath Singh Vs. Appellate Assistant Commissioner of Income Tax, Calcutta*, , the Income Tax Officer would be acting without jurisdiction if the reason for his belief that the conditions are satisfied, does not exist or is not material or relevant to the belief required by this section. It is true that the court will not go into the sufficiency of the reasons which persuaded the Income Tax Officer to initiate proceedings u/s 34(1)(a) of the Act, but the court will examine the relevancy of the reasons which persuaded the Income Tax Officer to take proceedings u/s 34(1)(a). The formation of the required belief is not the only requirement. The Income Tax Officer is further required by Section 34 to record his reasons for taking action u/s 34(1)(a) and obtain the sanction of the Central Board of Revenue or the Commissioner, as the case may be."

24. In view of the law laid down by the Supreme Court as quoted above which holds the field till this date, the court can always enquire and ascertain whether the reasons to believe entertained by the Income Tax Officer can validly afford a foundation for assumption of jurisdiction by him or it is a mere pretence and an effort to undergo a change of opinion.

25. In the present case, it is not necessary for this court to come to an independent finding to ascertain whether, by reason of any omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for the assessment year in question, any income chargeable to tax has escaped or not because it is essentially a question of fact and, in the present case, the Tribunal, after examining the entire records, have recorded that, at the time of the original assessment, the fact of construction, the plan of construction, the area of construction and the cost of construction were given by the assessee and the Income Tax Officer found the investments shown to be reasonable. It also held that, on consideration of all these factors, it cannot be stated that the primary facts were not disclosed by the assessee and, accordingly, it further held that even if this is not written in the assessment order, but is indicated otherwise by the Income Tax Officer is immaterial. Accordingly, the Tribunal took the view that the action u/s 147(a) was not legally justified on the basis of the reasons recorded by the Income Tax Officer. It was a case of a change of opinion on the basis of further information gathered by the Income Tax Officer and, in such circumstances, the escapement cannot be held to be due to any omission or failure on the part of the assessee to disclose fully and truly all material facts. Consequent upon these findings of fact, the Tribunal held the impugned action u/s 147(a) to be invalid and cancelled the assessment.

26. In the case of Commissioner of Income Tax Bombay North Vs. Lakhiram Ramdas, , it has been held that (at p. 730) :

"The pre-requisite condition for the initiation of a proceeding u/s 34(1)(a) is that "the Income Tax Officer has reason to believe that by reason of the omission or failure on the part of the assessee ... to disclose fully and truly all material facts necessary for his assessment for that year", income, profits or gains chargeable to Income Tax have escaped assessment, etc. That condition must be fulfilled before the Income Tax Officer can take action u/s 34(1)(a)." : See Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, . Therefore, what the Tribunal had to consider was whether the assessee had fully and truly disclosed all material facts necessary for the assessment... In our opinion, in the circumstances of this case, the question whether the assessee had or had not failed to disclose fully and truly all material facts necessary for his assessment was a question of fact and we are unable to accept the argument of the learned advocate for the appellant to the contrary."

27. At this stage, I may also refer to Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, for the purpose that, in this case, the assessee had challenged the issuance of reassessment notices

under writ jurisdiction before the Calcutta High Court and having failed, went in appeal to the Supreme Court. During the pendency of the writ application, the Income Tax Officer passed the assessment orders with the permission of the court. The Supreme Court, while allowing the appeals, inter alia, held that the issuance of notice was without jurisdiction since there was no non-disclosure of material facts by the assessee by reason of which any under-assessment had taken place. The Supreme Court, accordingly, quashed the assessment orders as well.

28. Respectfully following the dictum of the Supreme Court, I am of the view that the Tribunal was justified in law in cancelling the entire assessment u/s 147(a) of the Act for the assessment year 1962-63.

29. So far as Tax Case No, 40 of 1978 is concerned, its result is just consequential without requiring any elaboration either on facts or in law. On the basis of the addition made to the cost of the construction and passing of the assessment order determining income from other sources, the Inspecting Assistant Commissioner passed an order of penalty u/s 271(1)(c) of the Act and imposed a penalty of Rs. 2,53,239. The assessee preferred an appeal to the Tribunal. The Tribunal cancelled the order of penalty in view of its earlier order (which is the subject-matter of the connected Tax Case No. 39 of 1978) that the very initiation of reassessment proceedings were invalid.

30. In view of the findings recorded in the connected case, it has to be held that the order of the Tribunal cancelling the penalty levied u/s 271(1)(c) of the Act was also legal.

31. I, accordingly, answer both the questions in the affirmative and in favour of the assessee. Under the facts and circumstances of the case, there will be no order as to costs.

32. Let a copy of this judgment under the seal of this court and the signature of the Registrar be forwarded to the Income Tax Appellate Tribunal, Patna Bench.

G.G. Sohani, C.J.

I agree.