

(1990) 02 AHC CK 0036

In the Allahabad High Court

Case No : Civil Miscellaneous Writ No"s. 11 and 12 of 1990

Elgin Mills Co. Ltd.

APPELLANT

Vs

Commissioner of Income Tax and Another

RESPONDENT

Date of Decision : 22-02-1990

Acts Referred:

Constitution of India, 1950 — Article 226
Income Tax Act, 1961 — Section 147, 148

Citation : (1990) 184 ITR 326

Hon'ble Judges : Madan Mohan Lal, J;Amarendra Nath Varma, J

Bench : Division Bench

Advocate : Sudhir Chandra, for the Appellant; Standing Counsel, for the Respondent

Judgement

Amarendra Nath Varma, J.—These two petitions raise the perennial question, viz., whether the Inspecting Assistant Commissioner of Income Tax had any reason to believe that the income of the petitioner in the years relevant for the assessment years 1981-82 and 1982-83 had escaped assessment.

2. The impugned notices have been issued by the Inspecting Assistant Commissioner of Income Tax (Assessment), Range II, Kanpur, in the purported exercise of his powers u/s 148 of the Income Tax Act, respectively, on November 20, 1986 and September 15, 1986 for the two assessment years in question, namely, 1981-82 and 1982-83. They are assailed on the ground that there was no material which could legitimately form the basis for the belief that any income of the petitioner chargeable to tax had escaped assessment by reason of the petitioner's failure to disclose truly and fully all material facts necessary for assessment. In order to examine the correctness of this contention, this court directed learned standing counsel for the department to produce the relevant record containing the material forming the basis for such belief. In compliance, the relevant record was produced before us. The reasons recorded by the Inspecting Assistant Commissioner (Assessment), based on which the impugned

notices have been issued, find place in the record produced before us by the department.

3. The main ground of attack urged by Sri Sudhir Chandra, learned counsel for the petitioner, against the impugned notices was that the material on the basis of which the Inspecting Assistant Commissioner has issued the notices bears no real and rational nexus to the belief that any income of the petitioner chargeable to tax had escaped assessment. In support, learned counsel placed reliance on *Indian Oil Corporation Vs. Income Tax Officer, Calcutta and Others*, , *Ganga Saran and Sons P. Ltd. Vs. Income Tax Officer and Others*, and *Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another*, . These authorities lay down the parameters of the power of the assessing officer to reopen assessments u/s 147/148 of the Income Tax Act.

4. The material facts necessary for appreciation of the submissions made at the Bar may be summarised thus. The petitioner, a public limited company, filed a return on October 1, 1981, for the assessment year 1981-82 showing a loss of Rs. 2,15,72,376. The Inspecting Assistant Commissioner completed the assessment, vide his order dated March 23, 1984, on a loss of Rs. 82,19,602. In the appeal filed by the assessee, the Commissioner of income tax gave relief of Rs. 64,255. In the meantime, the petitioner also filed the return of its income for the assessment year 1982-83 on September 15, 1982, showing a loss of Rs. 10,19,61,008. The Inspecting Assistant Commissioner completed the assessment for this year on October 29, 1984, on a net loss of Rs. 5,22,94,008. Again, the Commissioner of Income Tax (Appeals) partly allowed the petitioner's appeal by giving a relief of Rs. 98,985.

5. It is noteworthy to mention at this point that in the profit and loss account submitted by the petitioner for the assessment year 1982-83, a note was appended stating that the system of purchases of cotton in the company underwent a change towards the close of 1980 as some of the directors had expressed from time to time that the purchases of cotton during the years 1980-81 and 1981-82 suffered from infirmities as a result of which the impugned transactions were got examined by two firms of chartered accountants in February/March, 1982. It was further stated that the board of directors have appointed a committee for a further examination of the matter and the report of the committee was awaited. Meanwhile, it was decided that an outside agency be assigned the task of examination.

6. After the close of the assessments for the two years, on the basis of certain information, the Inspecting Assistant Commissioner asked the petitioner to furnish certain information/documents through a letter "dated July 21, 1986. The petitioner furnished its reply on September 1, 1986. Soon thereafter, the petitioner received a notice dated September 15, 1986, u/s 148 from the Inspecting Assistant Commissioner stating that the petitioner's income chargeable to tax for the assessment year 1981-82 has escaped assessment and, accordingly, it was proposed to reassess/recompute the income/loss/

depreciation allowance for the said assessment year. In response to the said notice, the petitioner filed a return under protest and asked for a copy of the reasons based on which the impugned notice was issued. Some correspondence was exchanged thereafter which it is not necessary to elaborate here. Thereafter, the petitioner received a notice dated October 6, 1989, fixing the case for hearing for the assessment year 1981-82 on October 29, 1989. A similar notice dated November 20, 1986, u/s 148 was received by the petitioner also for the assessment year 1982-83 followed by the same pattern of events. The petitioner filed its return under protest and thereafter received a notice dated November 6, 1989, fixing November 29, 1989, for the hearing of the assessment proceedings for the assessment year 1982-83.

7. It is in this background of facts that the petitioner approached this court under Article 226 of the Constitution for quashing the aforesaid notices u/s 148.

8. The legal position and the scope of judicial review in regard to action initiated u/s 147/148 of the Income Tax Act is no longer in doubt. Right from the case of *Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another*, , the consistent view of the Supreme Court is that existence of reason to believe that income chargeable to tax has escaped assessment by reason of the failure/omission of the assessee to disclose fully and truly all material and relevant facts for the assessment is the sine qua non for the exercise of power under those provisions. It has been further stressed that the reason must bear a rational and intelligible nexus to the belief that the assessee's income has escaped assessment by reason of the failure/omission on the part of the assessee to disclose fully and truly all material facts. His Lordship Sabyasachi Mukharji J. (as he then was) summed up the legal position in the case of *Indian Oil Corporation Vs. Income Tax Officer, Calcutta and Others*, as under :

"The principles on this branch of law are well-settled.

To confer jurisdiction under Clause (a) of Section 147 of the Act beyond the period of four years but within a period of eight years from the end of the relevant year u/s 148 of the assessment year, two conditions were required to be fulfilled ; the first is that the Income Tax Officer must have reason to believe that the income, profits or gains chargeable to tax had been under-assessed or escaped assessment; the second was that he must have reason to believe that such escapement or underassessment was occasioned by reason, so far as relevant for the present purpose, to disclose fully and truly all material facts necessary for the assessment of that year. Both these conditions are conditions precedent to be satisfied. See, in this connection, the observations of this court in *Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another*, ."

9. In *Ganga Saran and Sons P. Ltd. Vs. Income Tax Officer and Others*, , the hon'ble Bhagwati J. (as he then was) stressed that the reason to believe must

not be arbitrary or irrational. It must be reasonable, i.e., it must be based on reasons which are relevant and material, bearing a rational and intelligible nexus between the reasons and the belief. In both these decisions, it has been categorically ruled that the court cannot investigate into the adequacy or sufficiency of the reasons which have weighed with the Income Tax Officer in coming to the belief that income has escaped assessment on account of the failure/omission on the part of the assessee to disclose fully and truly all material facts. The applicable principles and approach are too well-settled to require further elaboration.

10. It is from these legal perspectives that we proceed to examine whether the reasons recorded by the Inspecting Assistant Commissioner for reopening the assessment for the two years" in question were relevant and could sustain the belief that the petitioner's income has escaped assessment by reason of its failure to disclose truly and fully all material facts. For the assessment year 1982-83, the reasons recorded by the Inspecting Assistant Commissioner are :

"The assessment in this case was made on October 29, 1984, at a loss of Rs. 5,22,94,800. It came to my notice that the assessee-company had paid excess amount of expenses, carrying charges, commission and insurance on purchases of cotton made through Ganga Prasad Purshottam Lal during the period relevant to the assessment year 1982-83. Accordingly, the assessee was asked to file a copy of the report submitted by the auditors in this respect. This report was called for u/s 133(6) of the Income Tax Act and had been supplied by the assessee. A perusal of this report and the minutes of the Board meeting held on July 8, 1985, shows that during the period February 1981, and October 1981, the assessee-company made an excess payment of Rs. 4,10,570 to Ganga Prasad Purshottam Lal on account of commission and expenses paid to that party. Out of this amount, an amount of Rs. 24,575 (Rs. 12,575 on account of commission and Rs. 12,000 on account of expenses) relate to the assessment year 1981-82. Hence, Rs. 3,85,995 (Rs. 4,10,570 minus Rs. 24,575) were paid in excess by the assessee-company to Ganga Prasad Purshottam Lal during the period relevant to the assessment year 1982-83. The report of the auditors has further pointed out that carrying charges and insurance have been reimbursed to Ganga Prasad Purshottam Lal without verifying the relevant documents to ensure that the payment has in turn been made by that party.

The assessee-company did not disclose this fact to the Income Tax Department till the same was specifically called for in the month of September, 1986, even though the report was submitted by the auditors to the company on January 29, 1983, and the report was clear on the issue that excess payment has been made.

From the above discussion it is clear that by reason of the failure on the part of the assessee to disclose all material facts necessary for its assessment, income of at least Rs. 3,85,995 for the assessment year 1982-83 has escaped assessment. Issue notice u/s 148 read with Section 147(a) of the Income Tax Act.

(Sd.) I. A. C. (A)-II, Kanpur. 20-11-1986"

11. Similar reasons have been recorded for the assessment year 1981-82. The same are extracted here :

"Return in this case declaring a loss of Rs. 35,85,846 was filed on October 1, 1981, and assessment was completed on a loss of Rs. 82,19,602 and capital gains of Rs. 81,019 on March 23, 1984. It was further held that this loss would not be carried forward because return filed by the assessee was out of time.

It has now come to my notice that the assessee-company had indulged in various malpractices in the purchase of cotton and thereby inflated its loss by several lakhs, of rupees. In view of the various complaints, the assessee-company had appointed one Sri Prabhakar Mehrotra, chartered accountant, to go into the details of certain items of cotton purchases. Only certain transactions of cotton purchases relating to the period December 18, 1980 to March 11, 1981, were referred to him. The chartered accountant studied in detail the 26 transactions in respect of purchases of 4,710 bales of cotton relating to the above referred period and held that there was misappropriation to the extent of Rs. 8,56,167 in respect of the impugned transactions. The assessee-company did not disclose to the Department either in the return of income or during the assessment proceedings that any misappropriation has been detected by the chartered accountant. It is important to note that the report of the chartered accountant was submitted on January 29, 1983, whereas the assessment was completed on March 23, 1984. In the accounts filed along with the return for the assessment year 1982-83 a note was given as under :

"The system of purchases of cotton in the company underwent a change towards the close of 1980, Sri Anand Prakash, Director (Finance), B. I. C. and Sri D.N. Dikshit, Managing Director, B. I. C., both directors on the board of Elgin Mills Co. Ltd. have expressed from time to time that the purchases of cotton during the periods 1980-81 and 1981-82 have suffered from infirmities. Accordingly, some impugned transactions were got examined jointly by two firms of chartered accountants in the month of February/March, 1982. The board of directors have appointed a committee for further examination of the matter. The report of the committee is awaited. The board of directors have considered the matter again and decided that an outside agency be assigned the task of further examining this matter."

Since the matter related to the period relevant for the assessment year 1981-82, the note given in the return for the assessment year 1982-83 is not relevant for the assessment year 1981-82. It is very clear that though it was in the notice of the assessee-company that its loss has been inflated to the extent of Rs. 8,56,167 due to excess payment to the parties from whom the cotton was purchased, this fact was never brought to the notice of the Department either in the return of income or during the assessment proceedings.

It is also noticed that in the board's meeting dated March 5, 1982, one of the

directors, namely, Sri Anand Prakash, has estimated the loss due to deviation from the established procedure for purchase of cotton (resulting in inflation of returned loss to that extent) in the latter part of 1980-81 to an amount of Rs. 1 crore or more. This was also not brought to the notice of the Department.

Further, the chartered accountant, Mr. Prabhakar Mehrotra, has submitted a report on carrying charges, commission and insurance charges paid by the assessee-company to Ganga Prasad Purshottam Lal on cotton purchases during the period February '81, to October '81. It has been held by the chartered accountant that Rs. 4,10,570 were excess paid to the above referred firm as commission. It has also been held that Rs. 7,58,890 as carrying charges and Rs. 69,463 as insurance charges were paid to the above referred firm without verifying the relevant documents. Since this report relates to the period from February '81, to October '81, and the date-wise details are not available, the excess commission, carrying charges, etc., cannot be bifurcated into the periods relevant to the assessment years 1981-82 and 1982-83.

From the above discussion, it is very clear that loss has been over-assessed at least to the extent of Rs. 56,167 for the reason that all the material facts necessary for the assessment of the company were not disclosed fully and truly by it. Therefore, permission to issue notice u/s 148 for the assessment year 1981-82 may kindly be granted. The assessment record for the assessment year 1981-82 in one volume is enclosed. Also enclosed with this pro forma is one file cover containing the copies of the minutes of the board meetings, reports of the auditors, etc., in respect of cotton purchases made by the assessee-company. These details were obtained from the assessee-company u/s 133(6) of the Income Tax Act.

(Sd.) V.K. Singal 9-9-1986 Inspecting Assistant Commissioner of Income Tax (Asstt.) Range-II, Kanpur."

12. The reasons recorded by the Inspecting Assistant Commissioner having received the approval of the Commissioner of Income Tax, Kanpur, the impugned notices were issued to the petitioner for the two assessment years u/s 148. From a perusal of the record produced before us, we find that the impugned notices were under Clause (a) of Section 147 of the Income Tax Act, i.e., on the ground that the petitioner had not disclosed fully and truly all material facts necessary for assessment as a result of which its income chargeable to tax had escaped assessment.

13. It is impossible to conclude from the reasons disclosed that the Inspecting Assistant Commissioner had no reason to believe that the income of the assessee had escaped assessment or that the material relied on by him for initiating action could not constitute a legitimate basis to sustain such belief. The reasons speak for themselves. Undeniably, the assessee had, in its possession, the auditor's report prior to the completion of the assessment of either of the two years in question. The report, whether right or wrong, revealed that the company had

indulged in diverse malpractices in the purchases of cotton and thereby inflated its loss by several lakhs of rupees. The auditor who was invited to investigate only some of the transactions found that the assessee had inflated its loss to the extent of at least Rs. 56,167 during the assessment year 1981-82. Likewise, for the assessment year 1982-83, the loss had been inflated by at least Rs. 3,85,995. These facts were specifically mentioned in the auditor's report which the assessee already had in its possession on January 29, 1983, whereas the assessment was completed for the two years subsequently in the year 1984. The Inspecting Assistant Commissioner states that he came to know about these facts subsequently and that the report was not filed until after the Inspecting Assistant Commissioner invoked the provisions of Section 133(6) of the Income Tax Act. The Inspecting Assistant Commissioner has further mentioned in the reasons that, on account of the failure of the assessee to disclose all material facts fully and truly, the petitioner's income chargeable to tax had escaped assessment at least to the extent that losses had been inflated by the assessee as mentioned above.

14. In the face of the reasons disclosed by the Inspecting Assistant Commissioner, it is difficult to see how it can be urged with any justification that the Inspecting Assistant Commissioner had no material which could reasonably form the basis of the belief that the income of the assessee chargeable to tax had escaped assessment. If the revenue losses had been unduly inflated on account of the malpractices indulged in by the assessee, it is indisputable that, to the extent that such losses were inflated in the return, the income of the assessee chargeable to tax would be deemed to have escaped assessment. We, however, hasten to add that our observations should not be confused with any concluded finding on whether the facts disclosed either in the reasons or in the report showing that the company had inflated its losses are correct. As observed earlier, our enquiry is restricted to the question whether the Inspecting Assistant Commissioner had any material which could reasonably form the basis of belief that the income of the assessee chargeable to tax had escaped assessment from the failure of the assessee to disclose full and true facts. Judged from that limited point of view, there is no doubt that the Inspecting Assistant Commissioner did have such material.

15. Sri Sudhir Chandra for the petitioner, however, vehemently contended that the petitioner had truly and fairly discharged its obligation by declaring all material facts vide the note appended by the assessee in the profit and loss account filed along with the return for the year 1982-83 (quoted in the reasons recorded by the Inspecting Assistant Commissioner for the assessment year 1981-82). If in spite of this note, the Inspecting Assistant Commissioner did not probe the matter further, the company could not be charged with the failure to disclose fully and truly all material facts so as to issue a notice u/s 147/148 of the Act.

16. The submission suffers from a basic fallacy. It omits to take into account that

the requirement of law is not that if the assessee had disclosed some facts, the rest should be left to be uncovered by the assessing officer. The mandate of Section 147(a) is that the assessee must disclose truly all primary facts necessary for his assessment. We are fortified here by a decision of the Supreme Court in the case of Indo-Aden Salt Mfg. and Trading Co. Pvt. Ltd. Vs. Commissioner of Income Tax, Bombay, . This is how their Lordships dealt with an identical submission at page 628 :

"The assessee"s contention is that the Income Tax Officer could have found out the position by further probing. That, however, does not exonerate the assessee to make full disclosure truly. Explanation 2 to Section 147 of the Act makes the position abundantly clear. The principles have also been well-settled and reiterated In numerous decisions of this court: See Kantamani Venkata Narayana and Sons Vs. First Additional Income Tax Officer, Rajahmundry, , and Income tax Officer, Calcutta and Others Vs. Lakhmani Mewal Das, . Hidayatullah J., as the learned Chief Justice then was, observed in Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, that mere production of evidence before the Income Tax Officer was not enough, that there may be omission or failure to make a true and full disclosure, if some material for the assessment lay embedded in the evidence which the Revenue could have uncovered but did not, then it is the duty of the assessee to bring it to the notice of the assessing authority. The assessee knows all the material and relevant facts -- the assessing authority might not. In respect of the failure to disclose, the omission to disclose may be deliberate or inadvertent. That was immaterial. But if there is omission to disclose material facts, then, subject to the other conditions, jurisdiction to reopen is attracted. It is sufficient to refer to the decision of this court in Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, where it had been held that if there are some primary facts from which a reasonable belief could be formed that there was some non-disclosure or failure to disclose fully and truly all material facts, the Income Tax Officer has jurisdiction to reopen the assessment. This position was again reiterated by this court in Malegaon Electricity Co. P. Ltd. Vs. Commissioner of Income Tax, Bombay, ."

17. In this very decision, it has also been stressed that whether or not there has been non-disclosure of primary facts causing escapement of income from assessment is essentially a question of fact. It has been further ruled that the fact that the Income Tax Officer could have found out the correct position by further probing did not exonerate the assessee from his duty to make a full and true disclosure of material facts. Similar observations are to be found in the case of West India Cotton Association Ltd. Vs. V.K. C. Rao, Income Tax Officer, Companies Ward, Ahmedabad, . Their Lordships held that certain material for assessment not furnished nor known to the Income Tax Officer at the time of assessment but coming to his knowledge subsequently could legitimately form the basis of a reasonable belief u/s 147. In the present case, indubitably the auditor"s report containing important disclosures having a bearing on the

assessment and indicating that losses had been inflated by the assessee in respect of cotton purchases was known to the assessee. It constituted a relevant primary fact. The Inspecting Assistant Commissioner could hence treat that as a basis for issuing a notice u/s 148.

18. Sri Sudhir Chandra then advanced a submission which, at the first blush, seemed to carry some conviction but for the reasons stated below cannot be accepted. The submission was that whether the losses were incurred as a result of the negligence of or misappropriation by the employees or otherwise, the company none the less did suffer loss, and the same were, therefore, rightly reflected as losses in its return. In support, learned counsel cited a decision laying down that loss arising from misappropriation by the employees of the assessee could be claimed as a loss liable to be deducted from the profits.

19. The submission ignores that it is not every loss suffered by the assessee that is liable to be deducted from profits. The basic question to be examined in each case would be whether the loss caused was incidental to the conduct of the trade. For the present, it is sufficient that the auditors have pointed out that the losses have been inflated as a result of overpayments/non-deductions arising from diverse factors. The report is elaborate in attacking the whole system then prevailing in regard to purchases of cotton. The auditors have also fixed the responsibility for these losses on various committees through which the company acts. To what extent the losses were referable to misappropriation by the employees or agents of the assessee and whether the losses were occasioned in the course of business or were incidental to the conduct thereof are matters which have yet to be determined by the Inspecting Assistant Commissioner. We are refraining from making any further comments as the same may prejudice a fair trial of these issues. Suffice it to say that, on the material existing on the record, it cannot be said that the Inspecting Assistant Commissioner had no reason to believe, nor is it possible to hold that there was no intelligible nexus between the reason and the belief.

20. That brings us finally to the last submission which was that the company had sustained huge losses in the successive years following the year of assessment and inasmuch as these business losses could not be carried forward for more than eight years immediately succeeding the assessment year, the losses sustained in the years in question could never be converted into income. That being so, it could not be said that any income chargeable to tax has escaped assessment.

21. We regret that the submission cannot be accepted. The Inspecting Assistant Commissioner has observed in the reasons recorded that at least to the extent that the loss has been inflated, the income of the assessee chargeable to tax has escaped assessment for that year. Jurisdiction u/s 147(a) would be available if the Assessing Officer has reason to believe that, as a result of non-disclosure, income chargeable to tax "has escaped assessment in that year". And this issue, we do venture to think, cannot be determined with reference to profits and

losses in the subsequent years.

22. In the premises, the petitions fail and are dismissed. The interim orders are discharged. No order as to costs.