

(2011) 02 GUJ CK 0011
In the Gujarat High Court

Case No : Special Civil Application No. 16261 of 2010 A.Y. 2003-04

I.P. Patel and Co.

APPELLANT

Vs

Dy CIT

RESPONDENT

Date of Decision : 01-02-2011

Acts Referred:

Constitution of India, 1950 — Article 226

Income Tax Act, 1961 — Section 139(1), 142(1), 142(3), 143(3), 147

Citation : (2011) 02 GUJ CK 0011

Hon'ble Judges : Harsha Devani, J;H.B. Antani, J

Bench : Division Bench

Advocate : Deepak Shah with Tej Shah, for the Appellant; M.R. Bhatt with Mrs. Mauna M. Bhatt, for the Respondent

Final Decision : Dismissed

Judgement

Ms. Harsha Devani, J.—Rule. Mrs. M.M. Bhatt, learned senior standing counsel, waives service of rule on behalf of the respondent. Having regard to the controversy involved in the present case, the matter is taken up for hearing and final disposal today.

2. This petition under Art. 226 of the Constitution of India challenges notice dt. 15th Feb., 2010 issued by the respondent herein u/s 148 of the IT Act, 1961 (the Act) seeking to reopen the petitioners assessment for asst. yr. 2003-04.

3. The facts of the case as stated in the petition are that the petitioner is a firm engaged in the business of import, export and manufacture of diamonds. For the asst. yr. 2003-04, the petitioner filed return of income on 30th Nov., 2003 u/s 139(1) of the Act at Rs. 2,50,86,610. The return was accompanied by statement of total income, audit report, audited financial statements and Form No, 10CCAC for claim of deduction u/s 80HHC of the Act. The case was taken for scrutiny assessment and notice was issued u/s 142(1) of the Act calling for various details including details of purchase of rough diamonds and sale of polished diamonds in respect of each party, lot-wise details of rough diamonds issued for

manufacturing with the details of polished diamonds received from labour parties and details of export sales in the prescribed form. By an order dt. 27th March, 2006, the assessing officer framed assessment u/s 143(3) of the Act determining total income at Rs. 2,92,95,220.

4. Subsequently, after a period of about six years, the assessing officer has sought to reopen the assessment u/s 147 of the Act by issuing the impugned notice dt. 15th Feb., 2010 u/s 148 of the Act. Pursuant to the notice, the petitioner addressed a letter dt. 19th March, 2010 to the respondent asking him to treat the original return as a return filed in response to the notice u/s 148 of the Act and requested him to furnish a copy of the reasons recorded for assuming jurisdiction u/s 148 of the Act. Subsequently, the respondent furnished the reasons recorded for reopening the assessment, pursuant to which the petitioner filed its objections which came to be disposed of by an order dt. 3rd Dec, 2010, whereby the objections came to be rejected. It is at this stage that the petitioner has approached this Court by way of the present petition challenging the impugned notice u/s 148 of the Act.

5. Assailing the impugned notice on the ground that the assumption of jurisdiction u/s 147 of the Act was invalid, Mr. Deepak Shah, learned advocate appearing on behalf of the petitioner invited attention to the reasons recorded by the respondent to point out that the respondent has formed an opinion that the income has escaped assessment on two grounds; the first ground being based upon a letter received from the Jt. Commr. of Customs and the second upon a newspaper report of the year 2003. It was submitted that the report of the Jt. Commr. of Customs is of the month April, 2003 and the newspaper report is of the year 2003 and as such, both the documents were within the knowledge of the assessing officer while framing the original assessment proceedings of which cognizance is now sought to be taken in the impugned proceedings without any finding to the effect that based on the show-cause notice issued by the customs authority, any income has escaped assessment. It was submitted that the information as contained in the show-cause notice was in the possession of the respondent at the time of the original assessment and the reopening is only to investigate the facts without a belief that any income has escaped assessment. According to the learned advocate the newspaper report dt. 20th Jan., 2003 was also very much available to the respondent at the time of framing the original assessment and it was not as if the respondent was in possession of any tangible information that there was any out of book production or unaccounted profits and as such, the newspaper report cannot be a basis for forming an opinion that any income has escaped assessment.

5.1 The learned advocate further submitted that the assessment year under consideration is 2003-04, whereas the notice u/s 148 of the Act has been issued on 15th Feb., 2010 which is clearly beyond a period of four years from the end of the relevant assessment year. It was contended that in the present case, since earlier assessment had been framed u/s 143(3) of the Act, for the purpose of

reopening the assessment after the expiry of a period of four years from the end of the relevant assessment year, twin conditions are required to be satisfied. Firstly, there must be reason to believe that income chargeable to tax has escaped assessment and secondly that such escapement must be by reason of failure on the part of the petitioner to (i) file a return u/s 139(1); (ii) to respond to a notice u/s 143(3) or section 148 of the Act; or (iii) to disclose fully and truly all material facts necessary for its assessment for that assessment year. It was submitted that in the facts of the present case, neither of the conditions exists and as such, the proceedings u/s 147 of the Act having been initiated after the expiry of a period of four years from the end of the relevant assessment year on the basis of review of existing material, are without jurisdiction.

5.2 Next It was submitted that insofar as the second requirement is concerned, neither of the first two contingencies can be pressed into service by the respondent. Hence, for the purpose of valid assumption of jurisdiction, there must be failure on the part of the petitioner to disclose fully and truly all material facts. Inviting attention to the reasons recorded, it was submitted that there is nothing in the reasons recorded to indicate that there is any failure on the part of the petitioner to disclose fully and truly all material facts necessary for assessment for the said year and as such, the impugned notice which has been issued beyond a period of four years from the end of the relevant assessment year is without jurisdiction and deserves to be quashed and set aside.

5.3 The learned advocate has further submitted that the AO has merely placed reliance upon the show-cause notice and no exercise has been carried out on the basis of the information to ascertain as to whether any income has in fact escaped assessment. In the circumstances, there is nothing on record to indicate that the assessing officer has formed any opinion as regards escapement of income. Referring to the order disposing of the objections, it was pointed out that according to the: AO, there was definitely a fat chance that the assessee benefited from: the power theft especially when the culprits were its own labour contractor and also that the power meters belonged to the assessee, to submit that the assessing officer was not sure about any income having escaped assessment and even according to the AO, there was only a fat chance of the income having escaped assessment. It was accordingly submitted that in the present case, the assessing officer seeks to reopen the assessment and then verify the veracity of the facts of the case. Adverting to the contents of the order disposing of objections, it was submitted out that there is no formation of opinion that income has escaped assessment and that even according to the AO, the possibility of smuggling in earlier years cannot be denied and that the facts narrated in the show-cause notice need to be investigated to bring out the correct revenue implications. According to the learned advocate, there is an admission on the part of the assessing officer that the show-cause notice needs to be investigated and that the assessing officer is not certain about the revenue implications and as such there is no basis for formation of belief that any income has escaped assessment which is the basic requirement for initiation of

proceedings u/s 147 of the Act. As regards the second ground stated in the reasons recorded, viz., theft of electricity, the learned advocate submitted that the assessing officer has merely placed reliance upon a newspaper report of the year 2003 and that nothing has been brought on record to suggest out of book sales or purchase to indicate any escapement of income from assessment.

5.4 The next contention raised by the learned advocate for the petitioner was that in the present case, it is an accepted fact that both the materials namely (i) the show-cause notice issued by the Jt. Commr. Of Customs of April, 2003, as well as (ii) the newspaper report of 20th Jan., 2003 were available on the file of the respondent at the time of original assessment. After receiving copy of the show-cause notice and the newspaper report, the respondent did not make any enquiry on his own for formation of the belief that income has escaped assessment but has accepted the contents thereof as gospel truth. According to the learned advocate, for the purpose of invoking section 147 of the Act, it was for the respondent to form a belief that such material results into escapement of income chargeable to tax, whereas, the respondent has only examined the record as available on the file of the original assessment, which amounts not only to a mere change of opinion but review of the original order, which in either case, is not sustainable in law.

5.5 Inviting attention to the affidavit-in-reply filed on behalf of the respondent wherein it has been stated that the petitioner had been claiming depreciation on machinery at more than Rs. 25 lakhs in the asst. yr. 2003-03 and even in the earlier asst. yr. 2002-03, thus the petitioner was using stolen electricity to run its machinery, it was clarified that depreciation has been claimed in relation to machinery which has been given by the petitioner to the contractors on lease. It is the case of the petitioner that it does not use the machinery personally and that since it has leased the machinery to the contractors, the rates are decided accordingly. Referring to the order disposing of the objections, it was pointed out that according to the respondent, the petitioner has not stated in its audit reports, the facts about any penalty being levied by GEB to submit that the petitioner is required to disclose information, which affects computation of his income. When the petitioner has not claimed any expenditure in relation to payment of penalty in respect of electricity theft, it is not necessary for the petitioner to show the same in the audit report. It was submitted that since the petitioner has not used the electricity, it was not necessary for the petitioner to disclose the same in the audit report.

5.6 In support of his submissions, the learned advocate placed reliance upon a decision of the Supreme Court in the case of Parashuram Pottery Works Co. Ltd. Vs. Income Tax Officer, Circle I, Ward A, Rajkot, for the proposition that two conditions have to be satisfied before the assessing officer acquires jurisdiction to issue notice u/s 148 in respect of an assessment beyond the period of four years from the end of the relevant year, viz., (i) the assessing officer must have reason to believe that income chargeable to tax has escaped assessment and (ii) he

must have reason to believe that such income has escaped assessment by reason of the omission or failure on the part of the assessee (a) to make a return u/s 139, or (b) to make a return in response to a notice u/s 142(1} or section 148 of the Act or (c) to disclose fully and truly all material facts necessary for his assessment for that year. Both these conditions must co-exist to confer jurisdiction on the ITO. Strong reliance is placed upon the concluding para of the said decision which reads thus :

It has been said that the taxes are the price that we pay for civilization. If so, it is essential that those who are entrusted with the task of calculating and realising that price should familiarise themselves with the relevant provisions and become well-versed with the law on the subject. Any remissness on their part can only be at the cost of the national exchequer and must necessarily result in loss of revenue. At the same time, we have to bear in mind that the policy of law is that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce, repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity. So far as the income tax assessment orders are concerned, they cannot be reopened on the score of income escaping assessment u/s 147 of the Act of 1961 after the expiry of four years from the end of the assessment year unless there be omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment. As already mentioned, this cannot be said in the present case. The appeal is consequently allowed, the judgment of the High Court is set aside and the impugned notices are quashed. The parties in the circumstances shall bear their own costs throughout.

Reliance was also placed upon the decision of the Supreme Court in the case of Income tax Officer, Calcutta and Others Vs. Lakhmani Mewal Das, for the proposition that the grounds or reasons which lead to the formation of the belief contemplated u/s 147(a) must have a material bearing on the question of escapement of income of the assessee from assessment because of failure or omission to disclose fully and truly all material facts. The reasons for the formation of belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the ITO and the formation of his belief that there has been escapement of income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. The powers of the ITO to reopen assessment, though wide, are not plenary. The words of the statute are "reason to believe" and not "reason to suspect". It was submitted that the reasons recorded, at best, can be said to reflect reason to suspect, but there is nothing to indicate the formation of any belief that income has escaped assessment.

5.7 It was urged that the reasons recorded by the assessing officer should indicate that there was failure on the part of the assessee to disclose fully and

truly all material facts necessary for the assessment of that assessment year and that in the facts of the present case, the reasons are totally silent in this regard. In support of his submission, the learned advocate placed reliance upon a decision of the Bombay High Court in the case of *Hindustan Lever Ltd. v. R.B. Wadkar* (2004) 190 CTR (Bom) 166 wherein the Court has held thus :

20. The reasons recorded by the assessing officer nowhere state that there was failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment of that assessment year. It is needless to mention that the reasons are required to be read as they were recorded by the AO. No substitution or deletion is permissible. No additions can be made to those reasons. No inference can be allowed to be drawn based on reasons not recorded. It is for the assessing officer to disclose and open his mind through" reasons recorded by him. He has to speak through his reasons. It is for the assessing officer to reach the conclusion as to whether there was failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for the concerned assessment year. It is for the assessing officer to form his opinion. It is for him to put his opinion on record in black and white. The reasons recorded should be clear and unambiguous and should not suffer from any vagueness. The reasons recorded must disclose his mind. Reasons are the manifestation of mind of the AO. The reasons recorded should be self-explanatory and should not keep the assessee guessing for the reasons. Reasons provide link between conclusion and evidence. The reasons recorded must be based on evidence. The AO, in the event of challenge to the reasons, must be able to justify the same based on material available on record. He must disclose in the reasons as to which fact or material was not disclosed by the assessee fully and truly necessary for assessment of that assessment year, so as to establish vital link between the reasons and evidence. That vital link is the safeguard against arbitrary reopening of the concluded assessment. The reasons recorded by the assessing officer cannot be supplemented by filing affidavit or making oral submission, otherwise, the reasons which were lacking in the material particulars would get supplemented, by the time the matter reaches to the Court, on the strength of affidavit or oral submissions advanced.

5.8 Reliance was also placed upon a decision of the Punjab & Haryana High Court in the case of *Duli Chand Singhania v. Asstt. CIT* (2004) 136 Taxman 725 (P&H) , wherein the Court observed that there was not even a whisper of an allegation that escapement had occurred by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment, and held that absence of this finding, which is a sine qua non for assuming jurisdiction u/s 147 of the Act in a case falling under the proviso thereto, makes an action taken by the assessing officer wholly without jurisdiction. Reliance was placed upon another decision of the Punjab & Haryana High Court in the case of *Mahavir Spinning Mills Ltd. Vs. Commissioner of Income Tax and Another*, for the same proposition as in *Duli Chand Singhania's* case (supra). The decision of the Delhi High Court in the case of *Wei Intertrade (P) Ltd. v. ITO*, was cited wherein the

Court agreed with the observations of the Punjab & Haryana High Court in Duli Chand Singhania's case (*supra*) and quashed the proceedings u/s 147 of the Act as there was no whisper as regards any failure on the part of the assessee to disclose fully and truly all material facts in the reasons recorded by the AO. Reliance was also placed upon the decision of the Delhi High Court in the case of *Haryana Acrylic Manufacturing Co. v. CIT* (2008) 175 Taxman 262 (Del), wherein the Court had held that the requirement of recording reasons, communicating the same to the assessee, enabling the assessee to file objections and requirement of passing a speaking order are all designed to ensure that the assessing officer does not reopen assessments which have been finalised on his mere whim and fancy and that he does so only on the basis of lawful reasons. These steps are also designed to ensure complete transparency and adherence to the principles of natural justice. Thus, a deviation from these directions would entail the nullifying of the proceedings. Reliance was also placed on the decisions of the Delhi High Court in the case of *JSRS Udyog Ltd. & Anr. v. ITO* (2009) 180 Taxman 477 (Del) as well as of the Allahabad High Court in the case of *Vishwanath Prasad Ashok Kumar Sarraf Vs. Commissioner of Income Tax and Others*, wherein the Courts have taken a similar view.

6. On the other hand, Mr. M.R. Bhatt, learned senior advocate, appearing on behalf of the respondent vehemently opposed the petition. Inviting attention to the reasons recorded by the respondent, it was submitted that though reliance has been placed on the letter received from the Jt. Commr. of Customs, the assessing officer has, in fact, formed an opinion on the basis of the said letter that income had escaped assessment. It was pointed out that from the report, it is apparent that the details of dispatches of polished diamonds from the petitioners factory from Surat to Mumbai were not entered in the stock book of Surat or Mumbai office and that the same were entered at Surat only when the labour; bills were issued. That the assessing officer had also found that on the facts stated in the show-cause notice, the assessee was maintaining an accounting system which leads to manipulation of stock book to suppress its yield and profits. It was pointed out that from the report, it was also revealed that the diamonds exported from Surat were exported from Surat despite the fact that the closing stock of cut and polished diamonds at Surat was nil at the relevant time. Thus, cut and polished diamonds were clearly procured from sources other than its own. It was accordingly submitted that the aforesaid material contained in the show-cause notice is sufficient for the formation of belief that income has escaped assessment.

6.1 As regards the second issue namely, the theft of electricity worth Rs. 48 lakhs as reported in the newspaper Loktej on 20th Jan., 2003 is concerned, it was submitted that in respect of the said power theft, the assessee had paid the penalty which was not shown in the statement filed along with the return and as such, the said fact had been suppressed by the assessee. According to the learned advocate, the fact that there was theft of electricity clearly indicates that there was unaccounted production. Referring to the audit report in Form No. 3CB

which had been filed along with the return of income, it was pointed out that under item No. 17 in relation to expenditure by way of penalty or fine for violation of any law for the time being in force or any other penalty or fine, the endorsement made is nil to submit that the petitioner had not brought out the fact as regards payment of penalty in relation to electricity theft in the said audit report.

Referring to Annexure A Form No. 3CD, which pertains to the particulars of depreciation allowable as per the Act and relates to item No. 14 on Form No. 3CD, it was pointed out that the petitioner had claimed depreciation in respect of plant and machinery to the tune of Rs. 27,22,305. It was submitted that the said machinery on which the petitioner has claimed depreciation, must have been put to use by the petitioner as a result of which there would be some consumption of electricity. However, the petitioner has not shown any consumption of electricity in respect to the factory premises and as such, it is evident that the petitioner was indulging in unaccounted production. The learned counsel accordingly submitted that from the reasons recorded, it is apparent that the petitioner has failed to disclose fully and truly all material facts necessary for its assessment. In the circumstances, the assumption of jurisdiction u/s 147 of the Act by the assessing officer is valid.

6.2 Dealing with the submission made by the learned advocate for the petitioner that the machinery was given on lease to the contractors and rates were decided accordingly, it was submitted that no material has been brought on record by the petitioner to indicate any such arrangement with the contractor. It was submitted that the electricity meters stood in the name of the petitioner, the penalty had been paid by the petitioner, however, the expenditure incurred towards penalty for electricity theft had not been disclosed, which makes it amply clear that the petitioner must be having undisclosed income. Referring to Form No. 3CD submitted by the petitioner along with the return of income and more particularly item No. 17 thereto, it was submitted that by not debiting the expenditure by way of penalty in the Profit and Loss account and consequently not showing the same in Form No. 3CD, the petitioner has deliberately suppressed the aspect of electricity theft.

6.3 It was further submitted by the learned counsel that there is nothing on record to indicate that the attention of assessing officer had been drawn to the show-cause notice issued by the customs authorities, hence, merely because the notice was issued prior to conclusion of the regular assessment proceedings does not mean that the assessing officer was aware of it while framing the assessment. Inviting attention to para 8 of the reasons recorded, it was pointed out that before the Settlement Commission, the petitioner had paid Rs. 83 lakhs as duty @ 50 per cent on the seized diamonds which indicates that it is not the case of the petitioner that the seized goods do not belong to it, hence there is justifiable reason for the assessing officer to believe that income has escaped assessment. It was submitted that the facts stated in the reasons recorded were

within the exclusive knowledge of the petitioner and it was for the petitioner to disclose the same to the AO, in absence of the said facts having been brought to the notice of the AO, it is not open for the petitioner to contend that the said material was already within the knowledge of the assessing officer while framing the original assessment. It was accordingly submitted that the reasons recorded clearly disclose sufficient material for formation of the belief that income has escaped assessment by reason of failure on the part of the petitioner to make full and true disclosure and as such the initiation of proceedings u/s 147 of the Act by issuance of the impugned notice is legal and valid and does not call for any intervention by this Court.

7. Mr. Deepak Shah, learned advocate for the petitioner, in rejoinder submitted that the show-cause notice issued by the customs authorities pertains to a subsequent period and as such, the same would not be reflected in the return for the year under consideration. Referring to the reasons recorded, it was submitted that the search and seizure action had taken place on 21st April, 2003 which was after the end of the relevant assessment year and as such, the diamonds seized during the search operation would not be reflected in the stock of the financial year 2002-03 and that till March, 2003, the stock was fully disclosed. Referring to the objections submitted by the petitioner, it was pointed out that the rough diamonds are not processed at the petitioners factory but at the premises of the contractors who had incurred electricity expenses. Reiterating that on the material on record, there is nothing to suggest that there is extra production on the part of the petitioner; it was submitted that the second ground for reopening of assessment is also without any substance and as such the assumption of jurisdiction by the assessing officer is not valid and as such the impugned notice is required to be quashed and set aside.

8. The basic principles that have to be kept in mind while considering a challenge to the validity of proceedings u/s 147 of the Act have been enunciated by the Supreme Court in several cases. In *Sri Krishna Private Ltd. Etc. Vs. I.T.O., Calcutta and Others*, the Supreme Court has laid down thus :

4. Section 139 places an obligation upon every person to furnish voluntarily a return of his total income if such income during the previous year exceeded the maximum amount which is not chargeable to income tax. The obligation so placed involves the further obligation to disclose all material facts necessary for his assessment for that year fully and truly. If at any subsequent point of time, it is found that either on account of an omission or failure of the assessee to file the return or on account of his omission or failure 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, the ITO is entitled to reopen the assessment in accordance with the procedure prescribed by the Act. To be more precise, he can issue the notice u/s 148 proposing to reopen the assessment only where he has reason to believe that on account of either the omission or failure on the part of the assessee to file the return or on account 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 has escaped assessment. The existence of the reason(s) to believe is supposed to be the check, a limitation, upon his power to reopen the assessment. [See the leading decision on this subject in *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, Section 148(2) imposes a further check upon the said power, viz., the requirement of recording of reasons for such reopening by the ITO. Sec. 151 imposed yet another check upon the said power, viz., the CIT or the Board, as the case may be, has to be satisfied, on the basis of the reasons recorded by the ITO, that it is a fit case for issuance of such a notice. The power conferred upon the ITO by section 147 and 148 is thus not an unbridled one. It is hedged in with several safeguards conceived in the interest of eliminating room for abuse of this power by the AOs. The idea was to save the assessee from harassment resulting from mechanical reopening of assessment but this protection avails only those assessed who disclose all material facts truly and fully.

9. In section *S. Narayanappa and Others Vs. Commissioner of Income Tax, Bangalore*, the Supreme Court observed thus :

It is true that two conditions must be satisfied in order to confer jurisdiction on the ITO to issue the notice u/s 34 in respect of assessments beyond the period of four years, but within a period of eight years, from the end of the relevant year. The first condition is that the ITO must have reason to believe that the income, profits or gains chargeable to income tax had been under assessed. The second condition is that he must have reason to believe that such underassessment had occurred by reason of either (i) omission or failure on the part of an assessee to make a return of his income u/s 22, or (ii) omission or failure on the part of the assessee to disclose fully and truly all the material facts necessary for his assessment for that year. Both these conditions are conditions precedent to be satisfied before the ITO acquires jurisdiction to issue a notice under the section. But the legal position is that if there are in fact some reasonable grounds for the ITO to believe that there had been any non-disclosure as regards any fact, which could have a material bearing on the question of underassessment that would be sufficient to give jurisdiction to the ITO to issue the notice u/s 34. Whether these grounds are adequate or not is not a matter for the Court to investigate. In other words, the sufficiency of the grounds which induced the ITO to act is not a justiciable issue. It is of course open for the assessee to contend that the ITO did not hold the belief that there had been such non-disclosure. In other words, the existence of the belief can be challenged by the assessee but not the sufficiency of the reasons for the belief. Again the expression reason to believe in section 34 of the IT Act does not mean a purely subjective satisfaction on the part of the ITO. The belief must be held in good faith : it cannot be merely a pretence. To put it differently it is open to the Court to examine the question whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent, the action of the ITO in starting proceedings u/s

34 of the Act is open to challenge in a Court of law. [See Calcutta Discount Co. Ltd. v. ITO].

10. Keeping in mind the aforesaid legal principles, the facts of the present case may be adverted to. The reasons recorded by the assessing officer for reopening the assessment for asst. yr. 2003-04 are to the following effect:

Reasons for reopening the case of M/s LP. Patel & Co. (PAN AAAF 16501 Q) for asst. yr. 2003-04

1. A letter No. F. No. SD/INT/AIU/27/2003 AP c STF/S/14-7-3/2003 AD J was received from the Jt. Commr. of Customs, AIR Intelligence Unit, Mumbai (Office of the Commr. of the Customs, Chhatrapati Shivaji International Airport, Sahar, Mumbai-400009). The said letter mentions about an action of search and seizure by the AIR Intelligence Officials on the assessee which resulted after the arrest of Shri Manish H. Kalvadiya at Sahar Airport Mumbai on 21st April, 2003 with 5877 carats of cut and polished diamonds. The AIR officials searched the premises of the assessee at Mumbai and Surat. A copy of show-cause notice, which is in fact a complete report on the investigation carried out by the AIU officials was received by this office vide the above-referred letter. They found a number of discrepancies in the books of accounts and the stock of the assessee.

2. As per the show-cause notice the assessee had deliberately kept its accounting system in such manner, that illegally procured or smuggled diamonds could be adjusted to evade detection by any of the law enforcement agencies. The investigation by the AIU inshowed that the details of despatches of polished diamonds from factories at Surat to Mumbai were not entered in the stock book of Surat Or Mumbai office. The same were entered at Surat only when labour bills were issued. It was also found that only on receipt of labour bills, the Mumbai office made entries in the production register and stock book. The entries in production register and stock was made on the same day, however, it was found that in some instances like on 14th June, 2002, 29th June, 2002, 30th Oct., 2002 and 29th March, 2003 for diamonds weighing 52,284 carats the entries in stock book was made a day after the entry in the production register. It was also found that as per the Chief Financial Office, chief sorter and partner of M/s LP. Patel & Co., at any given time there is a floating stock of cut and polished diamonds which is neither physically present at their head office at Surat nor at the branch office at Mumbai. Both these facts show that the assessee had maintained an accounting system which leads to manipulation of stock book to suppress its yield and profits.

3. The show-cause notice also draws attention to the dates of the entries of the polished diamonds stock as mentioned earlier weighing 52,284.34 carats. It has been pointed out that the dates of entries closely match with the dates of arrivals of the arrested carrier Shri Manish H. Kalvadiya, Bharat Bodra and Girish Bodra (his accomplices). The dates of arrivals from Dubai on 11th June, 2002, 26th Oct., 2002 and 29th Sept., 2003. These coinciding dates point out that out of the

52,284.34 carats of polished diamonds almost 41,451.6 carats appear to be directly linked to the visits of the aforesaid persons.

4. It was also revealed that 1,961.20 carats of polished diamond exported from Surat under invoice Nos. 128 to 135 dt. 26th Dec, 2002 and 4,953.23 carats covered by invoice Nos. 140 to 146 dt. 20th Jan., 2003 were exported from Surat despite the fact that the closing stock of cut and polished diamonds at Surat from 14th Dec, 2002 to 26th Dec, 2003 and 30th Dec, 2002 to 27th Jan., 2003 was at nil. Therefore 6,914.45 carats of cut and polished diamonds were clearly procured from sources other than its own.

5. It was also pointed out that the carrier Manish H. Kalvadiya who was arrested with 5,877 carats of polished diamonds on 21st April, 2003 had already visited Dubai 5 times since June, 2002. It was also pointed out that the fact that a person with lowly means was visiting Dubai showed that he had been working as a carrier for Mahesh V. Savani, partner of the assessee, long before his arrest.

6. Further it has been noted that during the financial year 2002-03 the officials of the GEB conducted an action of the factories of the assessee located at Siddhkutir at Varaccha Road. The action resulted in detection of theft of electricity worth Rs. 48 lakhs. The information was carried in the newspaper Loktej on 20th Jan., 2003 as is seen from this new item that the assessee has been indulging in power theft and out of books production which has resulted in unaccounted profits.

7. During the course of the regular assessment proceedings of the assessee the above facts were not taken into consideration. In view of the above, I am of the opinion that income of the assessee has escaped assessment for asst. yr. 2003-04 by not taking the above facts into consideration and making the necessary additions/disallowances. Hence, the case needs reopening u/s 147 of the IT Act, 1961 and necessary notice u/s 148 is issued herewith.

Thus the above reasons due to which your case has been reopened are being given to you.

11. The question that now arises for consideration is whether on the basis of the facts recorded, the assessing officer had reason to believe that on account of the petitioners omission/failure to disclose fully and truly all material facts necessary for its assessment for that year, income chargeable to tax has escaped assessment for that year. In the reasons recorded by the assessing officer as required u/s 148(2) of the Act, the assessing officer has stated that he had received a letter from the Jt. CIT, AIR Intelligence Unit mentioning a search and seizure action on the petitioner after the arrest of Shri Manish H. Kalvadiya on 21st April, 2003 with 5,877 carats of cut and polished diamonds. It is further stated that a copy of a show-cause notice which is in fact a complete report of the investigation carried out by the AIU officials was also received with the said letter. The said officials had found a number of discrepancies in the books of account and the stock of the assessee. The assessing officer has, inter alia

referred to the following noteworthy aspects mentioned in the show-cause notice :

(i) The assessee had deliberately kept its accounting system in such a manner, that illegally procured or smuggled diamonds could be adjusted to evade detection by any of the law enforcement agencies.

(ii) The investigation showed that details of dispatches of polished diamonds from factories at Surat to Mumbai were not entered in the stock book at Surat or Mumbai office and were entered at Surat only when the labour bills were issued. Only on receipt of labour bills, the Mumbai office made entries in the production register and stock book;

(iii) The entries in the production register and stock were made on the same day, however, in some instances like on 14th June, 2002, 29th June, 2002, 30th Oct., 2002 and 29th March, 2003 for diamonds weighing 52,284 carats the entries in the stock book were made a day after the entry in the production register. There was a floating stock of cut and polished diamonds, which was neither physically present at the head office at Surat, nor at the branch office at Mumbai. Both these facts lead to an inference that the assessee is maintaining an accounting system; which leads to manipulation of stock book to suppress its yield and profits.

(iv) Matching the dates of arrival of arrested carrier Shri Manish H. Kalvadiya and his accomplices with the dates of entries of the above-mentioned 52,284 carats of diamonds, the coinciding dates indicate that almost 41,451.6 carats appear to be directly linked to the visits of the said persons.

(v) Polished diamonds exported from Surat under the invoices indicated therein were exported from Surat despite the fact that the closing stock of cut and polished diamonds at Surat during the said period was at nil. Thus, 6,914.45 carats of cut and polished diamonds were clearly procured from sources other than its own.

(vi) The information carried in the newspaper Loktej on 20th Jan., 2003, indicated that the petitioner had been indulging in power theft and out of book production which has resulted in unaccounted profits.

12. From the facts recorded in the reasons, what is required to be examined is as to whether the twin conditions precedent for the purpose of assuming valid jurisdiction u/s 147 of the Act have been satisfied.

13. Insofar as fulfillment of the first condition for invocation of powers u/s 147 of the Act, namely whether income chargeable to tax has escaped assessment is concerned, on behalf of the petitioner it has been contended that the assessing officer has merely placed reliance on the show-cause notice and the newspaper report for the purpose of reopening the assessment without any finding to the effect that based on the show-cause notice and newspaper report any income has in fact escaped assessment. In this regard it may be pertinent to refer to

certain decisions of the Supreme Court.

14. In the case of *Sri Krishna (P) Ltd. v. ITO* (supra) the ITO had in his recorded reasons relied upon the fact as found by the customs authorities that the assessee had under-invoiced the goods it exported. The Court held that it is no doubt correct that the said finding may not be binding upon the IT authorities but it can be a valid reason to believe that the chargeable income has been under assessed. The Court further held that the final outcome of the proceedings is not relevant. What is relevant is the existence of reasons to make the ITO believe that there has been underassessment of the assessee's income for a particular year.

15. In *INCOME TAX OFFICER Vs. SELECTED DALURBAND COAL CO. (P) LTD.*, the ITO had issued notices u/s 148 of the Act on the basis of a letter addressed by the Chief Mining Officer to him wherein it was stated that on a joint inspection of the colliery of the assessee it was revealed that the colliery company under-reported the raising figure and that shortage of surface coal stock was also detected to the extent stated in the letter, and that it was decided to charge royalty on the said quantity of coal by the Government of West Bengal. The question before the Supreme Court was whether the letter of the Chief Mining Officer did not constitute relevant material upon which the ITO could have formed the requisite belief. The Court held thus :

4. After hearing the learned counsel for the parties at length, we are of the opinion that we cannot say that the letter aforesaid does not constitute relevant material or that on that basis, the ITO could not have reasonably formed the requisite belief. The letter shows that a joint inspection was conducted in the colliery of the respondent on 9th Jan., 1967 by the officers of the Mining Department in the presence of the representatives of the assessee and according to the opinion of the officers of the Mining Department, there was under-reporting of the raising figure to the extent indicated in the said letter. The report is made by a Government Department and that too after conducting a joint inspection. It gives a reasonably specific estimate of the excessive coal mining said to have been done by the respondent over and above the figure disclosed by it in its returns. Whether the facts stated in the letter are true or not is not the concern at this stage. It may well be that the assessee may be able to establish that the facts stated in the said letter are not true but that conclusion can be arrived at only after making the necessary enquiry. At the stage of the issuance of the notice, the only question is whether there was relevant material, as stated above, on which a reasonable person could have formed the requisite belief. Since we are unable to say that the said letter could not have constituted the basis for forming such a belief, it cannot be said that the issuance of notice was invalid. In as much as, as a result of our order, the reassessment proceedings have now to go on, we do not and we ought not to express any opinion on merits.

16. In the light of the aforesaid decisions it is apparent that reports of the

customs authorities, or Government officials, while discharging their official/statutory duties can be placed reliance upon if on the basis of the same there is sufficient reason to believe that income chargeable to tax has escaped assessment. From the facts noted hereinabove, it is not possible to state that on the basis of the facts reflected in the show-cause notice issued by the customs authorities, the assessing officer could not have formed a belief that income has escaped assessment. Moreover, the reasons recorded, though reproduce extracts from the show-cause notice issued by the customs authorities upon completion of the investigation, clearly indicate an application of mind on the part of the assessing officer to the facts stated in the show-cause notice as well as formation of belief that income chargeable to tax has escaped assessment.

17. Coming to the second requirement for assumption of jurisdiction u/s 147 of the Act, viz., whether there is any failure on the part of the petitioner to disclose fully and truly all material facts necessary for its assessment for that assessment year, on a plain reading of the reasons recorded, it is apparent that the same do not expressly state that income has escaped assessment on account of the failure on the part of the petitioner to disclose fully and truly all material facts. On behalf of the petitioner, various decisions have been placed reliance upon which have been referred to hereinabove for the proposition that when there is not even a whisper of an allegation as regards escapement of income from assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary, the action of the assessing officer is wholly without jurisdiction. It is true that for the purpose of invoking s.147 of the Act beyond a period of four years, the assessing officer is required to record twofold satisfaction. Firstly, that income has escaped assessment and secondly, that such assessment is on account of failure on the part of the assessee to disclose fully and truly all material facts. It is equally true that the reasons recorded should reflect the belief of the assessing officer that there is escapement of income from assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts. However, there is no requirement in law that in the reasons, such failure should be expressly stated in the words of the proviso to section 147 of the Act. If on a reading of the reasons, it is possible to infer or draw a logical inference that there is failure on the part of the assessee to disclose fully and truly all material facts, the requirement of the provision would stand satisfied. Neither sub-section (2) of section 148 of the Act nor the proviso to section 147, require the assessing officer to expressly state in the reasons that income has escaped assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts. If on the face of the reasons recorded, it is apparent that failure to disclose is made out, merely because a specific expression as noted hereinabove does not find place therein, it cannot be said that the assessing officer has not recorded satisfaction in this regard.

18. In the present case, from the language of the reasons recorded, failure to disclose fully and truly all material facts is writ large on the face of it, in as much as the reasons reflect discrepancies in books of accounts and the stock of the

assessee; manipulation of stock book to suppress yield and profits; as well as out of books production resulting in unaccounted profits which lead to the logical conclusion that there is failure on the part of the petitioner to disclose fully and truly the material facts. Thus, on the face of the reasons recorded, though not specifically stated, by implication the allegation of failure to disclose fully and truly all material facts is evident. In the circumstances, it is not possible to hold that the second condition for invoking the provisions of section 147 of the Act after the expiry of four years from the end of the relevant assessment year is not fulfilled.

19. It has been vehemently argued by the learned advocate for the petitioner that the fact regarding the show-cause notice issued by the customs authorities as well as the report in the newspaper and the electricity theft were well within the knowledge of the assessing officer while framing the original assessment. Since the said material was already there before the AO, it could not be said to be tangible material for the purpose of reopening assessment. According to the learned advocate, only on the basis of existing material, an opinion is formed by the assessing officer and as such the reopening is based on a change of opinion and as such, is not sustainable in law. In this regard, it may be noticed that neither does the fact regarding the investigation carried out by the customs authority, nor the fact regarding theft of electricity, find place in the original assessment order. In the circumstances, the assessing officer while framing the original assessment u/s 143(3) of the Act has not formed any opinion in respect of the income which is alleged to have escaped assessment in the reasons recorded by the AO. In the present case, apart from the fact that there is nothing to indicate that the aforesaid facts were before the assessing officer while framing the original assessment, as held by the Supreme Court in the case of Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, jurisdiction of the ITO to reassess income arises if he has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment. That information, must, it is true, have come to the possession of the ITO after the previous assessment, but even if the information be such that it could have been obtained during the previous assessment from an investigation of the materials on the record, or the facts disclosed thereby or from other enquiry or research into facts or law, but was not in fact obtained, the jurisdiction of the ITO is not affected. In the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, the Supreme Court after considering various decisions in this regard, held that the statute does not require that the information must be extraneous to the record. It is enough if the material, on the basis of which the reassessment proceedings are sought to be initiated, came to the notice of the ITO subsequent to the original assessment. If the ITO had considered and formed an opinion on the said material in the original assessment itself, then he would be powerless to start the proceedings for reassessment. Where however, the ITO had not considered the material and subsequently came by the material from the record itself, then such a case would fall within the

scope of section 147(b) of the Act. In the circumstances, the said contention also does not merit acceptance.

20. Though various other contentions have been advanced by the learned advocate for the petitioner contending that the electricity was being used only by the contractors and that the petitioner was not utilizing the electricity for production and that the machinery on which depreciation had been claimed by the petitioner was leased out to the contractors and as such, the petitioner did not have any unaccounted production on account of theft of electricity, all those contentions relate to the sufficiency of the reasons recorded by the AO. It is well-settled legal position that while examining the validity of proceedings u/s 147 of the Act, the Court is only required to see whether there was prima facie some material on the basis of which the assessment could be reopened. The sufficiency or the correctness of the material cannot be considered at this stage. In the facts and circumstances of the case, as noted hereinabove, the Court is of the view that the reopening cannot be struck down. It is, however, clarified that the Court has not expressed any opinion on the merits of the case. The questions of law and fact are left open to be decided by the AO. The petitioner will be entitled to take all contentions before the AO.

21. For the foregoing reasons, the pre-requisite conditions necessary for assumption of jurisdiction u/s 147 of the Act after the expiry of a period of four years from the end of the relevant assessment year, having been satisfied, no case is made out for intervention by this Court. The petition, therefore, fails and is accordingly dismissed. Rule is discharged.