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(1986) 03 GUJ CK 0012

In the Gujarat High Court

Case No : Special Civil Application No''s. 2068 and 2069 of 1985

Rajkot Engineering Association — APPELLANT

Vs

Union of India — RESPONDENT

Date of Decision : 31-03-1986

Acts Referred:
Companies Act, 1956 — Section 226, 619(2)
Constitution of India, 1950 — Article 133(1), 133(1)(a), 134A, 14, 19
Factories Act, 1948 — Section 2(m)
Gujarat Co-operative Societies Act, 1961 — Section 81, 84(1)
Income Tax Act, 1922 — Section 34(3)
Income Tax Act, 1961 — Section 131, 132, 132(1)(5), 132(5), 139(1)
Payment of Wages Act, 1936 — Section 15

Citation : (1986) 26 TAXMAN 60

Hon'ble Judges : D.H. Shukla, J;B.K. Mehta, J

Bench : Division Bench

Advocate : J.M. Thakore and K.H. Kaji, for the Appellant; R. Krishnamurthi, G.N. Desai, S.N. Soparkar, R.P. Bhatt and R. Muthukumar Swami, for the Respondent

Judgement

B.K. Mehta, J.—Since common questions of law and facts arise in these two petitions, we intend to dispose them of by this common judgment, though we will shortly set out the relevant facts and circumstances in which the respective petitioners have moved these petitions challenging the validity of section 44AB of the income tax Act, 1961 (''the Act'') which has been placed on the statute book by the Finance Act, 1984, with effect from 1-4-1985, rule 6G as well as Forms 3CA to 3CB of the income tax Rules, 1962 (''the Rules''), inserted by the income tax (Amendment) Rules, 1985 [promulgated on 31-1-1985 and made effective from 1-4-1985], and section 271B providing penalty for not getting the accounts audited, broadly on the ground of the impugned provisions being violative of articles 14 and 19(1)(g) of the Constitution of India and, consequently, therefore, praying for appropriate writs, orders and directions to quash and set aside the said provisions. Special Civil Application No. 2068 of 1985 has been moved by two registered associations of engineers and oil millers, being petitioners Nos. 1

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and 2, respectively, having membership of more than 50 and 250 persons, respectively, as well as by different partnership firms being petitioner Nos. 3 to 6, carrying on business in different commodities with a turnover of each of them exceeding Rs. 40 lakhs. The petitioners claim that the members of the first and second petitioners-associations as well petitioner Nos. 3 to 6 are represented by non-chartered accountant authorised representatives in preparations of their accounts, various statements and returns of income to be filed before the ITO for purpose of their assessments as permitted by section 288 of the Act. Broadly stated, the case of the petitioners is that the Act does not make any distinction whatsoever between various categories of authorised representatives specified in section 288(2) while discharging their functions and duties under the Act. The authorised representatives comprise mainly of advocates, chartered accountants or commerce graduates as permitted to appear in the proceedings under the Act. Before the impugned provisions were put on the statute book, the Act did not prescribe for any compulsory audit of the accounts of the assessee or a class of assessee except in those cases where the ITO so directs after obtaining previous approval of the Commissioner, and having regard to the nature and complexity of the accounts of the assessee to get his accounts audited by a chartered accountant. The main grievance of the petitioners is that Parliament has, after due deliberations, thought fit not to put a similar provision of compulsory tax audit on the statute book; when an attempt was made by clause 39 of the Taxation Laws (Amendment) Bill, 1973 to introduce such a provision since the Select Committee to which the Bill was referred felt, on consideration of a large number of representations and memorandums of objections received in that behalf that the proposed provision requiring compulsory audit of assessees, not being companies, by chartered accountants was likely to cause harassment, inconvenience and unnecessary expenses to assessees particularly in the mofussil and other places where chartered accountants are not readily available without any corresponding substantial benefit to the Government revenue. Instead by the Taxation Laws (Amendment) Act, 1975, section 142(2A) to (2C) was introduced with effect from 1-4-1976 providing for a statutory audit in case where the ITO was of the opinion that it was necessary to do so having regard to the nature and complexity of the accounts of the assessee, and the interest of the revenue, as stated hereinabove. The petitioners point out that this power of enforcing statutory audit u/s 142(2A) has not been resorted to, except in a few exceptional cases, during all these years. According to the petitioners, the fact that the income tax authorities have thought fit to resort to this power of statutory audit only in exceptional cases, indicates that the provisions of the income tax Act were found to be adequate and satisfactory all these years in order to effectuate the purpose of the Act. According to the petitioners, the introduction of the provision was not called for since there is no apparent and material change in the circumstances which would warrant the necessity of the impugned provisions. The grievance of the petitioners is that their right to carry on and manage their business including their right to be represented by the authorised representatives for the purposes of their tax assessment under the

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Act before the concerned authorities is virtually rendered nugatory by the impugned provisions inasmuch as they would be constrained to represent their cases through those chartered accountants to whom they would be required to entrust the work of audit of their accounts and obtain their reports of audit containing the particulars as prescribed under the impugned provisions. According to them, for all practical purposes, they would be denied the choice of selecting their authorised representatives from non-chartered accountant practitioners. The impugned provisions, insofar as they tend to restrict this right, would cause harassment, inconvenience and unnecessary expenses to them, and particularly in mofussil and other places where the services of the chartered accountant would not be readily available without conferring any correspondent substantial benefit to the Government revenue, which was a raison de etre for the Select Committee of the Parliament to drop the provision of compulsory audit sought to be introduced by clause 39 of the Taxation Laws (Amendment) Bill, 1973. The impugned provisions, according to the petitioners, entail unreasonable restriction and not justified in the public interest and, therefore, violative of article 19(1)(g) of the Constitution. Their further grievance is that the impugned provisions, insofar as they require the tax audit to be carried out only by chartered accountants and deny privilege to non-chartered accountant''s authorised representatives, are discriminatory inasmuch as there is no intelligible classification having rational nexus with the object of the amended statute, particularly when the authorised representatives consisting of legal practitioners, commerce graduates and persons having educational qualifications as prescribed by the Board, or who were entitled to practise under the 1922 Act, or in certain specified territories, are authorised under rule 12A of the Rules to file particulars of accounts, statements or other documents furnished by the assessee for the preparations of the return of income and also to report on the scope and result of their examination of such accounts in course of preparations thereof. This classification, according to the petitioners, has become more unintelligible in view of the amendment of proviso to section 44AB permitting a class of assessees which is required to have the accounts audited under the special Act governing them to produce the report of their non-chartered accountant auditors in compliance of the obligation prescribed u/s 44AB. The amended proviso, therefore, perpetuates a hostile discrimination which is inbuilt in the impugned provisions. It is in this back-drop that the petitioners of this petition have prayed for the reliefs of quashing and setting aside the impugned provisions and restraining the respondents from enforcing the same.

2. Special Civil Application No. 2069 of 1985 is moved by petitioner Nos. 2 to 15 who are advocates practising as authorised representatives and income tax practitioners at Ahmedabad and by a commerce graduate being petitioner No. 16 as well on behalf of the unregistered association of advocates practising as tax practitioners at Ahmedabad being petitioner No. 1. The circumstances which compelled these petitioners to move this petition are same as those averred in Special Civil Application No. 2068 of 1985 since the impugned provisions have a

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direct and immediate impact on their fundamental right to practise and appear on behalf of the assessees and represent them in the assessment proceedings before the tax authorities as permitted u/s 288. The purpose and the intention of the impugned provisions is apparent in so far as the same require the tax audit to be carried out by chartered accountants only and, therefore, there is a clear hostile discrimination against them. The impugned provisions are irrational, arbitrary and do not subserve public interest as considered by the Select Committee of the Parliament in 1973. The objects and reasons of the impugned provisions, as stated by the Finance Minister on the floor of Parliament, are not capable of being achieved by the same. The impugned rules and the Forms go beyond the purpose of section 44AB enjoining for a prescribed class of assessees the audit of accounts which even in the extended sense of the term would not include the tax audit required under the Rules. They have also, therefore, prayed for appropriate writs, orders and directions to quash and set aside the impugned provisions and restraining the respondents from enforcing the same.

3. In Special Civil Application No. 2068 of 1985 three chartered accountants prayed for being joined as parties vide their Civil Application No. 1127 of 1985, and by the order of this Court dated 1-5-1985 they have been joined as respondents Nos. 4 to 6. Similarly in Special Civil Application No. 2069 of 1985, the income tax Bar Association moved this Court for being joined as a party vide their Civil Application No. 2567 of 1985 and this Court by its order of 5-8-1985 directed the said Association to be joined as respondent No. 4. In both these petitions, the petitioners have prayed for permission to file the petitions under Order 1, rule 8 of the CPC and which permission was granted in pursuance of which about 450 assessees have appeared and have been joined as party-respondent in Special Civil Application No. 2068 of 1985.

4. In pursuance of the rule nisi on behalf of the respondents, reply affidavit of Shri Kalyan Chand, who happened to be Under Secretary, Ministry of Finance, Government of India, Department of Revenue, has been filed resisting all or any of the reliefs as prayed for. One Shri Gordhanbhai S. Patel has filed his affidavit-in-reply on behalf of respondent Nos. 4, 5 and 6 in Special Civil Application No. 2068 of 1985. An affidavit-in-rejoinder of one Shri Ashok L, Trivedi, partner of petitioner No. 6, has been filed in rejoinder to the affidavit of the Union Government.

5. In Special Civil Application No. 2069 of 1985 on behalf of respondent Nos. 1 to 3 a short reply affidavit of Shri Kalyan Chand, who happened to be Under Secretary, Ministry of Finance, Government of India, Department of Revenue, has been filed maintaining and confirming what the deponent has stated in the affidavit in reply filed in Special Civil Application No. 2068 of 1985. It appears that the affidavit in reply of chartered accountant, Shri Gordhanbhai Patel, has been put on the record as affidavit on behalf of respondent Nos. 4, 5 and 6.

6. At the time of hearing of these two petitions, the learned Advocate General of Gujarat, Shri J.M. Thakore, made detailed submissions on behalf of the

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petitioners of Special Civil Application No. 2068 of 1985 which were adopted and elaborated further by Mr. Kaji who appeared on behalf of the petitioners in Special Civil Application No. 2069 of 1985 and 450 intervening assessee-respondents of Special Civil Application No. 2068 of 1985. On behalf of the Union Government, the learned Advocate General of Tamil Nadu Shri R. Krishnamurthi advanced the arguments and was supported by the learned Advocate Shri G.N. Desai appearing on behalf of the chartered accountant-respondent Nos. 4 to 6 of Special Civil Application No. 2068 of 1985.

7. Broadly stated, four questions were raised for our consideration and decision. A number of subsidiary contentions and counter contentions have been urged in support or opposition of the rival contentions. The said four broad contentions raised before us are as under:

1. Whether, the impugned rule 6G and Forms 3CA to 3CE [inserted by] the income tax (Amendment) Rules, 1985, are ultra vires of section 44AB of the income tax Act, 1961, inasmuch as the obligations and functions prescribed for the chartered accountants are beyond the obligations and functions associated with the auditors in the classical sense since the main enactment in the section enjoins audit for a prescribed category of assessees.

2. Whether the impugned rule and the Forms insofar as they require the auditors to furnish statements about (a) the taxability of income, and (b) the admissibility of expenses, on behalf of their clients would, even if they are prejudicial, estop the assessees concerned to plead against such statements which would be more or less in the nature of opinion.

3. Whether section 44AB, read with rule 6G and Forms 3CA to 3CE is ultra vires of article 14 of the Constitution of India inasmuch as:

(a) they are arbitrary and unreasonable,

(i) because the prescribed limit of turnover or gross receipt for an assessee carrying on business or gross receipt for an assessee carrying on profession has no relation to the income under the income tax Act and would operate most unreasonably in the scheme of the present Act where the liability of filing return is on the basis of the income as defined in the Act;

(ii) because they would not be just and fair because an absolute time limit has been laid down for obtaining a report without any corresponding provision for extension of time limit with the result that the assessees whose previous year ended on 31-12-1984 or 31-3-1985 would not have reasonable time to prepare and finalise the accounts in the manner which the auditors would require them for purposes of tax audit;

(iii) because the failure to obtain certificate within the prescribed time limit exposes the defaulting assessee to penalty which is without any relation to the period of delay;

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(iv) because the impugned provisions, particularly those contained in the rules which were published in January 1985 are sought to be operated retroactively to the prejudice of the assessee;

(v) because the obligation of compulsory audit is without corresponding safeguards as to the empanelling of auditors and the schedule of maximum fees; and

(vi) because the likelihood of the auditors not giving clear certificate, namely, books are maintained in the proper manner as may be required by the auditors, which requirement having not been prescribed under the Act, would cause serious prejudice to such assessees.

(b) They are discriminatory,

(i) because they perpetuate the unintelligible classification without any reasonable nexus with the objects between different types of authorised representatives; and particularly they amount to constitute a hostile discrimination qua the legal practitioners on income (sic);

(ii) because the sub-classification makes the main classification absolutely unintelligible since the amendment to the proviso to section 44AB treats the audit made by the persons who are non-chartered accountants and permitted to audit under the special statutes as sufficient compliance of the main enactment.

4. Whether the impugned provisions of the Act and the Rules are ultra vires of article 19 of the Constitution inasmuch as they prescribe unreasonable restriction on the right to carry on business or profession.

8. Before we deal with these contentions, we may set out the impugned provisions, namely, section 44AB and rule 6G:

44AB. Every person,-

(a) carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds forty lakh rupees in any previous year or years relevant to the assessment year commencing on the 1st day of April, 1985, or any subsequent assessment year; or

(b) carrying on profession shall, if his gross receipts in profession exceed ten lakh rupees in any previous year or years relevant to the assessment year commencing on the 1st day of April, 1985, or any subsequent assessment year, get his accounts of such previous year or years audited by an accountant before the specified date and obtain before that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:

Provided that in a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession

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audited under such law before the specified date and obtains before that date the report of the audit as required under such other law and a further report in the form prescribed under this section.

Explanation: For the purposes of this section,-

(i) ''accountant'' shall have the same meaning as in the Explanation below sub-section (2) of section 288;

(ii) ''specified date'' in relation to the accounts of the previous year or years relevant to an assessment year, means the date of the expiry of four months from the end of the previous year or, where there is more than one previous year, from the end of the previous year which expired last before the commencement of the assessment year, or the 30th day of June of the assessment year, whichever is later.

" 6G. Report of audit of accounts to be furnished u/s 44AB. - (1) : The report of audit of the accounts of a person required to be furnished u/s 44AB shall,-

(a) in the case of a person who carries on business and who is required by or under any other law to get his accounts audited by an accountant, be in Form No. 3CA;

(b) in the case of a person who carries on business, but not being a person referred to in clause (a), be in Form No. 3CB;

(c) in the case of a person who carries on profession, be in Form No. 3CC.

(2) The particulars which are required to be furnished u/s 44AB shall,-

(a) in the case of a person carrying on business, be in Form No. 3CD;

(b) in the case of a person carrying on profession, be in Form No. 3CE.

9. We will refer to the impugned Forms, namely, 3CA to 3CE, at the appropriate time while dealing with the relevant contentions relating to the respective Forms. For the present purposes, it should be noted that Form No. 3CA is a proforma of audit report under the impugned section to be furnished in case where the business accounts of a person have been audited under any special law by an accountant. Form No. 3CB is a proforma of the report applicable in case of a person carrying on business. Form No. 3CD is a statement which a tax-auditor has to file containing particulars prescribed in the form in case of a person carrying on business, while Form No. 3CE is a statement of particulars in case of a person carrying on profession.

10. What is the power of judicial scrutiny in case where a taxing statute or a provision thereof has been challenged as violative of article 14 and/or article 19 of the Constitution? A taxing statute or a provision thereof does not enjoy absolute immunity from attack on the ground that it is violative of article 14. It is settled position in law that the Courts are not concerned with the policy or purpose of a taxing statute, or any other manner of taxing a subject or article in

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a different way which the Court might think fair and just in the circumstances of a given case. A taxing statute cannot be assailed which classifies persons or properties into different categories and subjects them to different rates of taxation with reference to income or property on the ground that the tax incidence flowing from a classification is unequal. It is not capable of being disputed that different kinds of property may be subjected to different rates of tax. A classification resting on a rational basis imposing unequal burdens on different classes of persons or properties is not capable of being challenged under article 14 though similarly situated properties, if subjected to equal incidence of tax by a law, is likely to be struck down as treating equals as unequals- Kunnathat Thathunni Moopil Nair Vs. The State of Kerala and Another, . In Suraj Mall Mohta and Co. Vs. A.V. Visvanatha Sastri and Another, , where the Court was concerned with the vires of sections 5(1), 5(4), 6, 7 and 8 of the Taxation on Income (Investigation Commission) Act, 1947, Mahajan, CJ. (as he then was) speaking for the Court found that the classification made in the aforesaid provisions was bad and had no rational basis as both the kinds of persons sought to be classified have common properties and have common characteristics and, therefore, require equal treatment. The Court observed in this context as under:

...The State can by classification determine who should be regarded as a class for purposes of legislation and in relation to a law enacted on a particular subject, but the classification permissible must be based on some real and substantial distinction bearing a just and reasonable relation to the objects sought to be attained and cannot be made arbitrarily and without any substantial basis. Classification means segregation in classes which have a systematic relation, usually found in common properties and characteristics...." (p. 10)

The Court, therefore, held section 5(4) as offending the equality clause because the procedure prescribed by the said section in regard to the persons similarly situated should have the advantage substantially of the procedure prescribed by the Indian income tax Act, 1922 (''the 1922 Act'') and they should not be deprived of it. In Commissioner of Income Tax, Madhya Pradesh, Nagpur and Bhandara Vs. D''costa Brothers, , the Court was concerned with the vires of the second proviso to section 34(3) of the 1922 Act, as being bad on the ground that it violated article 14, The Division Bench of the Bombay High Court from the decision of which the appeal was preferred to the Supreme Court had struck down the said proviso. The majority of the Judges of the Supreme Court in that case agreed with the decision of the High Court as in their opinion the persons with regard to whom a finding or direction was given and the person with regard to whom no finding or direction was given really belonged to the same category, namely, category of the persons who are liable to pay tax and had failed to pay it for one reason or the other, as the persons who were liable to pay tax and had not paid it could not be proceeded against after the period of limitation, unless a finding or direction with regard to them was given by some Tribunal under various sections mentioned in the proviso, and, therefore, out of the large

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category of people who were liable to pay tax but failed to pay it, a certain number was selected for action by the proviso and with regard to that small number the right of limitation given to them was taken away. In the opinion of the majority Judges, therefore, there was no rational basis for distinguishing between persons who were liable to pay tax and had failed to pay it and with regard to whom a finding or direction was given, and persons who were liable to pay tax and had failed to pay and with regard to whom no finding or direction was given. The majority Court, therefore, following the earlier decision in Suraj Mall Mohta & Co.''s case (supra) held that the second proviso to section 34(3) was unconstitutional and, therefore, bad in law. The observations in the dissenting judgment of Justice Hidayatullah in S.C. Prashar''s case (supra) as to what approach the Court should adopt when confronting with the problem of discrimination is worth bearing in mind. It provides as under:

One must first find out the object of the impugned provision and compare it with the topic of legislation and then try to discover if there is a connection between the two and a reasonable basis for making a difference between different classes of persons effected by the law, in keeping with the topic of legislation and the object of the enactment. A difference which is aimless, arbitrary or unreasonable and which is unconnected with the object in view must remain a discrimination and incapable of being upheld. In all cases in which laws were struck down under article 14 this was the approach. It is hardly necessary to refer to the previous cases because each provision to be tested must be tested in its own setting, and no two cases can be alike.

11. It is no doubt true that the validity of a taxing statute is open to attack on the ground that it infringes fundamental rights- The State of Kerala Vs. Haji K. Haji K. Kutty Naha and Others etc., . It is equally true that a State cannot make any law which takes away or abridges the equality clause contained in article 14 which enjoins upon a State not to deny to any person equality before law or equal protection of law - KHANDIGE SHAM BHAT AND ANOTHER Vs. AGRICULTURAL Income Tax OFFICER, KASARAGOD, AND ANOTHER., . The principles which the Courts have to bear in mind while considering such challenge to the denial of equality before law or equal protection of law particularly are also well settled. As has been often said what article 14 prevents is a class legislation and not classification and such classification in order to be put beyond the prohibition of article 14, must be founded on intelligible differentia which distinguishes the persons grouped together with those who are left out and that differentia must have rational nexus with the object sought to be achieved by the Act. In matters of challenge to fiscal measures on the ground of article 14, the Courts have laid down more rigorous considerations which must be borne in mind while considering a challenge under article 14. In The Twyford Tea Co. Ltd. and Another Vs. The State of Kerala and Another, , where the Court was considering a challenge under article 14 to the provisions of the Kerala Plantation (Additional Tax) Act, 1960 as amended by the Kerala Plantation (Additional Tax) Amendment Act, 1967, Mr. Justice Hidayatullah (as he then was) speaking for the Court

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observed in paragraphs 15 and 16 as under:

We may now state the principles on which the present case must be decided. These principles have been stated earlier but are often ignored when the question of the application of article 14 arises. One principle on which our Courts (as indeed the Supreme Court in the United States) have always acted is nowhere better stated than by Wills in his Constitutional Law, p. 587. This is how he put it:

''A State does not have to tax everything in order to tax something. It is allowed to pick and choose districts, objects, persons, methods and even rates for taxation if it does so reasonably.... The Supreme Court has been practical and has permitted a very wide latitude in classification for taxation.''

This principle was approved by this Court in East India Tobacco Co. v. State of Andhra Pradesh [1962] 13 STC 529. Applying it, the Court observed:

''If a State can validly pick and choose one commodity for taxation and that is not open to attack under article 14, the same result must follow when the State picks out one category of goods and subjects it to taxation.''

This indicates a wide range of selection and freedom in appraisal not only in the objects of taxation and the manner of taxation but also in the determination of the rate or rates applicable. If production must always be taken into account there will have to be a settlement for every year and the tax would become a kind of income tax.

12. The next principle is that the burden of proving discrimination is always heavy and heavier still when a taxing statute is under attack. This was also observed in the same case of this Court approving the dictum of the Supreme Court of the United States in Madden v. Kentucky [1940] 309 US 83:

In taxation even more than in other fields, Legislatures possess the greatest freedom in classification. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

As Rottschasefer said in his Constitutional Law at p. 668:

'' A Statute providing for the assessment of one type of intangible at its actual value while other intangible are assessed at their face value does not deny equal protection even when both are subject to the same rate of tax.'' The decisions of the Supreme Court on this field have permitted a State Legislature to exercise ''an extremely wide discretion'' in classifying property for tax purposes ''so long as it refrained from clear and hostile discrimination against particular persons or classes.''

The burden is on a person complaining of discrimination. The burden is of proving not possible ''inequality'' but hostile ''unequal'' treatment. This is more so when uniform taxes are levied. It is not proved to us how the different plantations can be said to be ''hostilely or unequally'' treated. A uniform wheel

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tax on car does not take into account the value of the car, the mileage it runs, or in the case of taxi, the profits it makes and the miles per gallon it delivers. An Ambassador taxi and a Fiat taxi give different outturns in terms of money and mileage. Cinemas pay the same show fee. We do not take a doctrinaire view of equality. The Legislature has obviously'' thought of equalising the tax through a method which is inherent in the tax scheme. Nothing has been said to show that there is inequality much less ''hostile treatment''. All that is said is that the State must demonstrate equality. That is not the approach. At this rate nothing can ever be proved to be equal to another."

[Emphasis supplied] (p. 1137)

In Vivian Joseph Ferreira and Another Vs. The Municipal Corporation of Greater Bombay and Others, , the Court was concerned with the validity of certain provisions of the Bombay Buildings Repairs and Reconstruction Board Act, 1969 as being ultra vires article 14 of the. Constitution. In that context, the Court summarised the principles emerging from different decisions where fiscal statutes were under challenge on the ground of violation of the equality clause. The Court summarised the principles thus:

It is well recognised that a Legislature does not have to tax everything in order to tax something. It can pick and choose districts, objects, persons, methods and even rates of taxation as long as it does so reasonably-Will''s Constitutional Law of the United States 587. A taxing statute is not invalid on the ground of discrimination merely because other objects could have been but are not taxed by the Legislature- V. Venugopala Ravi Varma Rajah Vs. Union of India and Another, . When a statute divides the objects of tax into groups or categories, so long as there is equality and uniformity within each group, the tax cannot be attacked on the ground of its being discriminatory, although due to fortuitous circumstances or a particular situation some included in a class or group may get some advantage over others, provided of course they are not sought out for special treatment - Khandige Sham Bhat and Others Vs. The Agricultural Income Tax Officer, . Likewise, the mere fact that a tax falls more heavily on some in- the same group or category is by itself not a ground for its invalidity, for then hardly any tax, for instance, sales tax and excise tax, can escape such a charge- The Twyford Tea Co. Ltd. and Another Vs. The State of Kerala and Another, ." (p. 851)

13. In Pooran Mal Vs. The Director of Inspection (Investigation), New Delhi and Others, , the Court was concerned with the validity of section 132(1)(5) of the Act relating to search and seizure on the ground of it being violative of article 14 inasmuch as it discriminated between evaders of tax, distinguishing those who are believed to be in possession of undisclosed income or property from those evaders of tax who are not believed to be in possession, and the former category was subjected to exceptional procedure u/s 132(5). In that context, the Court held that sub-section (5) of section 132 does not contemplate a different procedure in the matter of regular assessment, it only contemplates a provisional summary enquiry with a view to determine how much of the seized wealth can

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be legitimately and reasonably retained to cover the tax liability already incurred, and thereafter regular assessment follows under the law in the same manner as in the case of tax evaders who are not found in possession of concealed income. In one set of cases the fiscal authorities make sure of recoveries, in the other, they are unable to do so not because the provisions of section 132 do not operate on them, but because action under that section by search and seizure is futile. The Court rejected the challenge because all evaders of tax can be proceeded against u/s 132 and only in some cases search may be useful, in others it may not be. The Court did not find any substance in the contention that two different procedures for assessment are adopted, and hence, there was a discrimination under article 14.

14. In The State of Gujarat and Another Vs. Shri Ambica Mills Ltd., Ahmedabad and Another, , the State of Gujarat was in appeal against the decision of this Court holding that section 3(1) of the Bombay Labour Welfare Fund Act of 1953 as amended by the Gujarat Act of 1961 insofar as it related to unpaid accumulations specified in section 3(2)(b), section 3(4) and section 6(A) of the said Act and the Rules 3 and 4 of the Rules, was unconstitutional and void. Section 3(1) and section 3(2)(b) of the Bombay Labour Welfare Fund Act, 1953, which was enacted by the Legislature of the State of Bombay, were declared invalid on the ground that they violated the fundamental right of the employer under article 19(1)(i) by the Supreme Court in Bombay Dyeing and Manufacturing Co. Ltd. Vs. The State of Bombay and Others, . After the bifurcation of the State of Bombay into State of Maharashtra and State of Gujarat, the said Act was amended by the Gujarat Legislature and some of the provisions of the Amending Act were made applicable retrospectively. Section 2(2) defined ''employer'' as a person who directly or indirectly either on behalf of himself or any other person has employed one or more employees in an establishment. Section 2 (4) defined ''establishment'' to mean a factory, a tramway or motor omnibus service and any establishment including a society or a charitable or other trust registered under the Bombay Public Trusts Act and carrying on any business or trade or ancillary activity and which employs or had employed on any working day during the previous 12 months more than 50 persons. The unpaid accumulations were defined to mean all payments due to the employees but not made to them within a period of three years from the date on which they became due. Section 3 was retrospectively amended which empowers the State Government to constitute a Fund called the Labour Welfare Fund and would consist, inter alia, of unpaid accumulations. Section 6A was a new provision inserted by the Amending Act with retrospective effect that all unpaid accumulations would be deemed to be abandoned property and that on payment of such accumulations to the Welfare Board in accordance with the provision of section 3 shall discharge an employer of the liability to make payment to any employee in respect thereof. Sub-section (3) of section 6A provided that as soon as possible after any unpaid accumulation is paid to the Board, the Board shall by public notice call upon the interested employees to

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submit to the Board their claims for any payment due to them. The method of publication of the notice is also prescribed in sub-section (4). Sub-section (5) provided for repeated publication of the notice. Sub section (6) provided that the certificate of the Board that the notices were duly published and republished to be conclusive evidence thereof. Sub-section (7) provided that any claim received whether in answer to the notice or otherwise within a period of four years from any worker would be transferred by the Board to the authority appointed u/s 15 of the Payment of Wages Act. On adjudication of the claim, the authority would order the Board to pay the claimant the amount of the claim as allowed by it. Appeal is also provided against the decision of the authority. The section also made consequential provisions in that behalf. This amendment was made in view of the reasons which weighed with the Court in Bombay Dyeing & Mfg. Co. Ltd.''s case (supra) to declare the original section 3(1) and section 3(2)(b) as ultra vires article 19. One of the grounds on which the provisions were challenged was that discrimination was read large in the definition of the term ''establishment'' in section 2. This Court held that there was no intelligible differentia to distinguish establishments grouped together under the definition of ''establishment'' u/s 2 (4) and establishments left out of the group, and that in any event the differentia has no rational relations or nexus with the object sought to be achieved by the Act and that the impugned provisions as they affected the rights and liabilities of employer and employees in respect of the establishment defined in section 2 (4) were, therefore, violative of article 14. What weighed with the Court was that all factories falling within the meaning of section 2(m) of the Factories Act were brought within the purview of the definition of ''establishment'' while establishments carrying on business or trade and employing less than 50 persons were left out, and that out of this letter class of establishments, an exception was made by including all establishments carrying on business of tramways or motor omnibus service but at the same time leaving out Government establishment. The explanation given by the State Government that unpaid accumulations would be more in the establishments employing more than 50 persons was not accepted by the Court since it has no reasonable nexus with the object of the impugned provision which was to get all the unpaid accumulations and utilise them for the benefit of labour. This Court emphasised that the Government has thought fit to include all establishments carrying on business of tramway or motor omnibus services without regard to the number and, therefore, the explanation was not convincing. The Supreme Court was, therefore, concerned as to whether this view of the Court was correct. Mathew, J., speaking for the five Judges Bench of the Court, did not think fit to recapitulate the principles laid down in various cases in their factual context. Some of the observations of the Court while examining the challenge under article 14 are worth reminding ourselves:

52. The equal protection of the laws is a pledge of the protection of equal laws. But laws may classify. And the very idea of classification is that of in quality. In tackling this paradox the Court has neither abandoned the demand for equality

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nor denied the legislative right to classify. It was taken a middle course. It has resolved the contradictory demands of legislative specialization and constitutional generality by a doctrine of reasonable classification - Joseph Tussaman and Jacobus ten Breck ''The Equal Protection of the Laws'', 37 California Rev. 341.

53. A reasonable classification is one which includes all who are similarly situated and none who are not. The question then is : what does the phrase ''similarly situated'' mean? The answer to the question is that we must look beyond the classification to the purpose of the law. A reasonable classification is one which includes all persons who are similarly situated with respect to the purpose of the law. The purpose of a law may be either the elimination of public mischief or the achievement of some positive public good.

54. A classification is under-inclusive when all who are included in the class are tainted with the mischief but there are others also tainted whom the classification does not include. In other words, a classification is bad as under-inclusive when a State benefits or burdens persons in a manner that furthers a legitimate purpose but does not confer the same benefit or place the same burden on others who are similarly situated. A classification is over-inclusive when it includes not only those who are similarly situated with respect to the purpose but others who are not so situated as well. In other words, this type of classification imposes a burden upon a wider range of individuals then are included in the class of those attended with mischief at which the law aims. Herod ordering the death of all mal children born on a particular day because one of them would some day bring about his downfall employed such a classification.

55. The first question, therefore, is, whether the exclusion of establishments carrying on business or trade and employing less than 50 persons makes the classification under-inclusive, when it is seen that all factories employing 10 or 20 persons, as the case may be, have been included and that the purpose of the law is to get in unpaid accumulations for the welfare of the labour. Since the classification does not include all who are similarly situated with respect to the purpose of the law, the classification might appear, at the first blush, to be unreasonable. But the Court has recognised the very real difficulties under which the Legislatures operate difficulties arising out of both the nature of the legislative process and of the society which legislation attempts perennially to reshape and it has refused to strike down indiscriminately all legislation embodying classificatory inequality here under consideration. Mr. Justice Holmas, in urging tolerance of under-inclusive classifications, stated that such legislation should not be disturbed by the Court unless it can clearly see that there is no fair reason for the laws which would not require with equal force its extension to those whom it leaves untouched, see, Misspuri K. and T. Rly. v. May [1903] 194 US 267, at p. 269. What, then are the fair reasons for non-extension? What should a Court do when it is faced with a law making an under-inclusive classification in areas relating to economic and tax matters? Should it, by its judgment, force the Legislature to choose between inaction or perfection?

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56. The Legislature cannot be required to impose upon administrative agencies'' tasks which cannot be carried out or which must be carried out on a large scale at a single stroke.

''If the law presumably hits the evil where it is most felt, it is not to be overthrown...to which it might have been applied. There is no doctrinaire requirement that the legislation should be couched in all embracing terms.''-(see West Coast Hotel Co. v. Parrish [1936] 300 US 379 at p. 400.)

57. The piecemeal approach to general problem permitted by under- inclusive classifications, appears justified when it is considered that legislative dealing with such problems is usually an experimental matter. It is impossible to tell how successful a particular approach may be, what dislocations might occur, what evasions might develop, what new evils might be generated in the attempt. Administrative experiments must be forged and tested. Legislators, recognising these factors, may wish to proceed cautiously and Courts must allow them to do so. (37 California Rev. 341)

58. Administrative convenience in the collection of unpaid accumulations is a factor to be taken into account in adjudging whether the classification is reasonable. A legislation may take one step at a time addressing itself to the phase of the problem which seems most acute to the legislative mind. Therefore, a Legislature might select only one phase one field for application of a remedy- (see Two Guys from Harrison-Allentown v. Meginley [1961] 366 US 582, 592)

59. It may be remembered that article 14 does not require that every regulatory statute apply to all the same business; where size is an index to the evil at which the law is directed, discriminations between the large and small are permissible and it is also permissible for reform to take one step at a time addressing itself to the phase of the problem which seems most acute to the legislative mind.

60. A legislative authority acting within its field is not bound to extend its regulation to all cases which it might possibly reach. The Legislature is free to recognise degree of harm and it may confine the restrictions to those classes of cases where the need seemed to be clearest - (see Mutual Loan Co. v. Martall [1911] 56 L.Ed. 175 at p. 180.)

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62. Once an objective is decided to be within legislative competents, however, the working out of classifications has been only infrequently impeded by judicial negatives. The Court''s attitude cannot be that the state either has to regulate all businesses, or even all related businesses, and in the some way, or, not at all. An effort to strike at a particular economic evil could not be hindered by the necessity of carrying on its wake a train of vexations, troublesome and expensive regulations covering the whole range of connected or similar enterprises.

63. Laws regulating economic activity would be viewed differently from laws which touch and concern freedom of speech and religion, voting, procreation,

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rights with respect to criminal procedure, etc. The prominence given to the equal protection clause in many modern opinions and decisions in America all show that the Court feels loss cons trained to give judicial to legislative judgment in the field of human and civil rights then in that of economic regulation and that it is making a vigorous use of the equal protection clause to strike down legislative action in the area of fundamental human rights (see Developments - Equal Protection ''...clause rests upon two largely subjective judgments : one as to the relative invidiousness of particular differentiation and the other as to the relative importance of the subject with respect to which equality is sought''-(see Cox, The Supreme Court Forward, 1965 Term, 80 Harv, Lal Rev. 91, 95).

64. The question whether, under article 14, a classification is reason able or unreasonable must, in the ultimate analysis depend upon the judicial approach to the problem. The great divide in this area lies in the difference between emphasising the actualities or the abstractions of legislation. The more complicated society becomes the greater diversity of its problems and the more does legislation direct itself to the diversities.

''Statutes are directed to less than universal situations. Law reflects distinctions that exist in fact or at least appear to exist in the judgment of legislators those who have the responsibility for making law fit fact. Legislation is essentially empiric. It addresses itself to the more or less crude outside world and not to the neat logical model of the mind. Classification is inherent in legislation. To recognise marked differences that exist in fact is living law; to disregard practical differences and concentrate on some abstract identities is lifeless logic'' -(see the observations of Justice Frankfurther in Morey v. Boud [1957] 354 US 457, 472).

65. That the legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry, that exact wisdom and nice adaptation of remedies cannot be required, that judgment is largely a prophecy based on meagre and uninterpreted experience, should stand as reminder that in this area the Court does not take the equal protection requirement in a pedagogic manner-(see Joseph Tussaman and Jacobus ten Breck, The Equal Protection of the Law, 37 California Rev. 341).

66. In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial difference to legislative judgment. The Legislature after all has the affirmative responsibility. The Courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events - self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability- see Joseph Tussaman and Jacobus ten Breck The Equal Protection of the Law, 37 California Rev. 341." (p. 1312)

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15. It is well settled that in order to claim successfully the charge of discrimination, an aggrieved party has to show that similarly situated or equally circumstanced persons like him are treated differently- Pathumma and Others Vs. State of Kerala and Others, . In other words, the discrimination so as to violate the bound of article 14, it must be one between equals and not where unequals are treated differently- The State of Jammu and Kashmir Vs. Shri Triloki Nath Khosa and Others, . The principle underlying the guarantee under article 14 only means that all persons similarly circumstanced shall be treated alike both in privileges conferred and liabilities imposed. In other words, there should be no discrimination between one person and another, if as regards the subject-matter of legislation their position is substantially the same- The State of West Bengal Vs. Anwar Ali Sarkar, . The validity of a legislation is not to be determined merely on the basis of affidavits but must be judged from all the relevant circumstances and from what the Legislature has said- Sanjeev Coke Manufacturing Company Vs. Bharat Coking Coal Limited and Another, . In this connection what the United States'' Supreme Court has said in United States of America v. C.T. Doremus [1919] 249 US 86 (C) in the context of the challenge to the levy of excise tax is worth remembering:

...This Court recognises that where Congress has acted clearly in the exercise of its taxing power (as in the case of the Act now under consideration), the means employed to effectuate this legitimate functioning are in their nature practical, belonging to the field of experiment and experience, and outside of the field of judicial knowledge. Hence, if it once be determined that the main provision of the Act levying the tax and defining its incidence is constitutional (as it is undoubtedly in the Act now under consideration), the means devised by Congress for the collection of the tax and the prevention of frauds in connection with it will, except in the most extraordinary cases, be held to be within the proper scope of the legislative power."

[Emphasis supplied]

16. No doubt, this is said in the context of the legislative power and the incidental matters in connection with a legislative topic. Nonetheless, it throws a great light on the contour of the power of judicial scrutiny.

17. Article 14 has, according to the Supreme Court, a wider content and reach inasmuch as it not only forbids discrimination but it strikes at arbitrariness in the State action and ensures fairness and equality of treatment. The principle of reasonableness is an essential element of equality. In other words, non-arbitrariness pervades article 14- Ramana Dayaram Shetty Vs. International Airport Authority of India and Others, . It is now well settled that an arbitrary action negatives the rule of equality. The doctrine of classification is recognised as a formula for determining whether the legislative or executive action under challenge is arbitrary and, therefore, violating the principle of equality. If a given classification is not reasonable and does riot satisfy the two conditions, namely, based on intelligible difference having reasonable nexus with the object of the

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statute, it would plainly be arbitrary and the mandate of article 14 is violated- Ajay Hasia and Others Vs. Khalid Mujib Sehravardi and Others, and E.P. Royappa Vs. State of Tamil Nadu and Another, . What is the test or yardstick which is to be applied for determining whether a statute infringes a particular fundamental right is as to what is its direct and inevitable consequences and effect of the impugned action on the fundamental right of the petitioner and, in a given case, the pith and substance of a State action may deal with a particular fundamental right but its direct and inevitable effect may be on another fundamental right and in that case the State action would have to meet with the challenge of the later fundamental right. The pith and substance doctrine looks only at the object and the subject-matter of the State action but what the Court has to consider in testing the validity of the State action is the direct and inevitable consequence of the State action since otherwise the protection of the fundamental right may be erode- Rustom Cavasjee Cooper Vs. Union of India (UOI), and Mrs. Maneka Gandhi Vs. Union of India (UOI) and Another, .

18. Taxing statutes are not beyond the pale of constitutional limitations prescribed by articles 14 and 19. The power of taxing the people is essential attribute of the Government which may legitimately exercise the power to the utmost extent to which the Government thinks it expedient to do so. The objects to be taxed so long as they happen to be within the legislative competence of the Legislature can be taxed by the Legislature according to the exigencies of its needs. The quantum of the tax levied, the conditions to which it is levied, the manner in which it is sought to be recovered are all matters within the competence of the Legislature. The Court would, therefore, be circumspect and cautious in dealing with the contentions raised by a citizen that the taxing statute contravenes article 19. However, if a given taxing statute is plainly discriminatory or providing no procedural machinery for assessment and levy of tax or is conspicatory in nature, the statute can be impugned and struck down as unconstitutional. In such cases, the charter of the material provision of the impugned statute is such that the Court would feel justified in taking a view that in substance the taxing statute is a cloak adopted by the Legislature for achieving its conspectory purpose- Rai Ramkrishna and Others Vs. The State of Bihar, .

19. It is in the backdrop of this settled legal position that we have to examine the challenge as to whether the impugned provisions are violative of article 14 since we intend to deal with constitutional challenge to the impugned provisions raised in contention Nos. 3 and 4 in the first instance.

20. Contention No. 3(a)(i):

Broadly stated, contention No. 3 is divided into two main parts. They have been assailed in the first instance as arbitrary and unreasonable and secondly they have been challenged as discriminatory. They are incidental contentions in support of these two broad sub-challenges.

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The first limb for assailing these impugned provisions is that they are arbitrary and unreasonable because the prescribed limit of turnover or gross receipt for an assessee carrying on business or gross receipt for an assessee carrying on profession has no relation to the income under the Act and they operate so unreasonably that if real income as determined under the Act may be very small, even then the assessee having the prescribed gross turnover or gross receipt would be within the purview of the impugned provisions. It was also urged that the relevant inquiry committees which had on earlier occasions recommended tax-audit had thought it fit to make these provisions applicable to persons having a prescribed income as determined under the Act.

21. Our attention was invited to Wanchoo Committee''s report, which was set up to examine and suggest the legal and administrative measures for counteracting evasion and avoidance of direct taxes. In its final report submitted to the Government of India in December 1971, one of the recommendations related to compulsory audit of accounts. In paragraphs 2.144 to 2.148 the material part of the recommendations is to be found as under:

2.144 Compulsory audit of accounts.--We think it would facilitate the administration of tax laws to a considerable extent if, simultaneously with the compulsory maintenance of accounts, there is a statutory provision for their mandatory audit, at least in the bigger cases....

2.145 In his report, Nicholas Kaldor had expressed the view that malpractices like the presentation of false and misleading accounts could be checked to a great extent if it were made compulsory for tax payers to present audited accounts in all cases in which income or property exceeded certain limits. The idea of compulsory audit of accounts in large income cases has found support even in quarters which were not otherwise quite favourably inclined towards the suggestion of compulsory maintenance of accounts. The income tax Investigation Commission, while not favouring the imposition of a legal obligation on all to maintain accounts, was of the view that compulsory audit in the case of business with large incomes would be desirable. The Direct Taxes Administration Enquiry Committee also recommended that in the interest of expeditious and proper assessment of taxpayers in higher income group, audit of accounts in all cases of business, profession and vocation, where the total assessed income in any one of the last three years exceeded Rs. 50,000 should be made compulsory by law and that audit should also be made compulsory in those cases or business, profession and vocation where the returned income for the first time exceeds Rs. 50,000. The working group of the Administrative Reforms Commission also favoured compulsory audit by chartered accountants of cases with income over Rs. 50,000. However, the Administrative Reforms Commission, while agreeing that audit by qualified chartered accountants would be helpful in relieving the assessing authority of the need to make routine checks and enabling him to concentrate on the broader aspects of determination of the assessee''s correct liability, felt that the number of chartered accountants being limited, it may not

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be possible for all assessees to secure their services except at heavy cost and that the requirement of compulsory audit might delay the submission of returns. The Commission, therefore, recommended only an amendment of the provisions of rule 12A of the income tax Rules, 1962 so as to provide for furnishing of certain additional information in all cases in which the returned income from business exceeds Rs. 50,000 and the returns are prepared by chartered accountants.

2.146 In the questionnaire issued by us, we had specifically elicited views on this subject. Most of the departmental officers who appeared before us welcome the suggestion and there was near unanimity among them that this would also go a long way in fighting tax evasion. Even among taxpayers, we found a sizeable support for the measure, which they felt would smoothen proceedings before the income tax authorities. Some of the persons who appeared before us have, however, expressed their fears that a provision for compulsory audit of accounts might put an undue burden on the taxpayer. We concede that this may, no doubt, be true in the case of small business or professional men or persons deriving income from other sources. We are, therefore, of the view that such persons should not be required to get their accounts audited. The requirement of compulsory audit of accounts should be applicable to persons engaged in business or profession where the income or turnover receipts exceed certain specified limits.

2.147 Doubts have also been expressed whether enough qualified auditors will be available for undertaking audit in all cases where it is mandatory. Companies are already statutorily required to get their accounts audited. We feel that if suitable limits are prescribed for the non-corporate sector, the work load may not be too great to be tackled by the existing professional accountants. We understand that the number of chartered accountants has increased from eight thou sand in April 1967 to over twelve thousand in October 1971. Further, during the same period the number of chartered accountants solely in practice has risen significantly from 2,900 to 5,400. From the concern voiced from time to time, in the press and elsewhere about a few well known firms of chartered accountants monopolising bulk of the audit work relating to the corporation sector, it appears that there is a considerably large number of practising chartered accountants who can undertake additional work load of audit in the non-corporate sector without much difficulty.

2.148 We are conscious that determination of taxable income is altogether different from that of commercial profits. The scope of audit and examination of accounts for the purpose of determination of taxable income has, therefore, to be wider. Apart from examining the evidence for a particular item of expense or income, an auditor has to ascertain whether the expenditure is allowable or the income taxable. Allowance of a certain expenditure turns on its being reasonable or in consonance with fair market price for similar goods or services. This is a matter which depends on the subjective judgment of the income tax Officer.

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Similarly, about cash credits and other items, inference from facts is likely to differ from person to person. Further, there would well be cases where some bank accounts and payments were omitted to be entered in the books. In the case of non-corporate assessees, imperfect methods of record-keeping in many a case may well hinder the auditor in applying normal audit procedures.

We consider that all these limitations should be taken into account in availing of the services of chartered accountants. Nonetheless, as an auditor can devote more time to examination and verification of accounts than an income tax Officer, auditor''s services would be usefully harnessed for obtaining facts and figures that could be relied upon....

We, therefore, recommend that a provision be introduced in the law making presentation of audited accounts mandatory in all cases of business or profession where the sales/turnover/receipts exceed Rs. 5 lakhs or the profit before tax exceeds Rs. 50,000. We further recommend that a form of audit report be prescribed taking due note of the manner in which documents, records and books are maintained in the noncorporate sector...."

[Emphasis supplied]

22. It was, therefore, urged that all Committees, before the Wanchoo Committee, had recommended the tax audit on the basis of the income or assessed income and not on the basis of the gross receipts or turnover. The learned Advocate General of Gujarat, appearing for the petitioners, forcefully urged that in many cases of business or profession the real profit may be marginal and therefore, the real taxable income is much less than that prescribed for purposes of compulsory audit, even then having regard to gross receipts, they would be within the purview of the provisions. In his submission, the link between the obligation of compulsory audit with the gross turnover or receipts is not only unreal but also unreasonable. In his submission, the assumption that the tax audit will counteract and curb the black economy and/or make speedy assessment possible is highly presumptive since unless the scope and nature of audit is materially changed, the provision is likely to misfire. If the auditors have discharged their function as objectively and in keeping with the high tradition of the profession, the black income would not have assumed such a gigantic proportion It is in this context that we have to determine as to whether the first limb of the contention is justified. We do see force in the contention urged on behalf of the petitioners by the learned Advocate General of Gujarat. Neither the company law nor the statute governing chartered accountants has precisely defined the auditor''s role. Unless, therefore, the Government by appropriate separate legislation or by amending the present legislation relating to auditors ensures independence, impartiality and the accountability of the auditors concerned, the well intended provisions which have been impugned in these petitions may not possibly achieve the real purpose. The absence of any provision circumscribing the right of an auditor from undertaking the role of management consultant or accepting directorship on the board of the

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company has resulted into the present terrific situation that in spite of the statutory provision of commercial audit in the Companies Act, 1956, the black money has proliferated beyond comprehension. We find ourselves in general agreement with the views expressed in the dissenting note by Shri D.K. Rangnekar, member of Wanchoo Committee. We do not think, however, that in spite of some force in this contention of the learned Advocate General of Gujarat, the impugned provisions can be said to be unreasonable because they have been linked up with the gross receipts or turnover. The reasons are obvious. If any other basis like that of income or Taxable income had been adopted as the basis for compulsory audit, such a provision would have been self-defeating. It would have created such an uncertain situation every year because the taxable income varies every year, in which case the assessees would have, apart from not being able to determine by themselves whether they should go for compulsory audit or not, exposed themselves to the consequences since ultimately the obligation of compulsory audit would be entailed on income being determined by the ITO and in case the income determined by the ITO is finally upheld, the assessee would have also exposed themselves to the consequences of penalty. A particular privilege conferred or an obligation entailed with reference to the gross receipts or turnover or with the value of the property is not foreign to the present Act. The privilege of having permanent account number u/s 139A of the Act or initiation of acquisition proceedings u/s 269C are illustrations to the point. We do not think, therefore, that the basis which has been ultimately adopted by the Parliament in the impugned provisions can be said to be unreasonable. It is, no doubt, true that the Committee set up, prior to Wanchoo Committee, had recommended that it should be linked up with the taxable income, bat, in our opinion, with respect, the Wanchoo Committee has advisably recommended that this should be related to gross turnover or receipts of an assessee. In that view of the matter, therefore, we are of the opinion that the first limb of the contention is not well founded and should be rejected.

23. Contention No. 3(a)(ii):

The second limb of the contention is that the impugned provisions are unreasonable and arbitrary because they prescribe an absolute time limit for obtaining a report without any corresponding provision for extension of time for compliance of such obligation with the result that the assessees whose previous year ended on Aso Vad Amas of Samvat year 2040, corresponding to 24-10-1984 or 31-12-1984, relevant to the assessment year 1985-86, would not have reasonable time to prepare and finalise the accounts in the manner in which the auditors would require them for purposes of tax audit. It is no doubt true that a person carrying on business or profession exceeding prescribed turnover or receipts in any previous year has to get his accounts of such previous year audited by an accountant and obtain his report of audit before the specified date. This specified date is defined in the Explanation to section 44AB. It means the last day of the four months from the end of the previous year or where there are more than one previous year, from the end of the previous year which expired

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last before the commencement of the assessment year or 30th June, whichever is later. It should be noted that the impugned provisions, namely, section 44AB, have been put on the statute book by the Finance Act, 1984 but have been made effective from 1-4-1985 while the rules were published on 31-1-1985 and they have been also made applicable from 1-4-1985. It should be further noted that the prescriptions about how audit report should contain are provided for the first time by the aforesaid Rules. Now these Rules were published, as stated earlier, on 31-1-1985 by which time the previous year relevant to the assessment year 1985-86 of a majority of the assessees in the State would have ended either on 24-10-1984 or 31-12-1984 or 31-3-1985 with the result that these assessees, particularly the non-corporate assessees, would not have sufficient time to present the accounts as would he required by the auditor for purposes of tax audit. Even in cases of the corporate assessees, though the accounts might have been maintained as to satisfy the commercial audit they would not necessarily be maintained in the manner required for the income tax audit. The provision of depreciation is one such aspect where the assessee''s accounts may not be such as to satisfy the tax audit. The learned Advocate General for the petitioners, therefore, urged that at least for the assessment year 1985-86, the assessees are prejudiced to such an extent that the provisions become incapable of being complied with and, therefore, work to a great prejudice to the assessees. In any case he urged that non-provision for the extension of time limit for getting the accounts audited and obtaining the report of auditor would cause such an irreparable injury to the assessees that even the assessees who would fail to get the accounts audited and obtain audit report in respect of the assessment year 1985-86 in particular and subsequent assessment years in general for compelling, bona fide and just reasons would also expose themselves not only to penalty u/s 271B which penalty is again related to the total sales, turnover or gross receipts subject maximum to a sum of Rs. 1 lakh but also their returns being treated as defective in view of the provision contained in clause (c) of the Explanation to section 139(9) of the Act since the return in all the aforesaid cases which is to be filed by a specified date would be without being accompanied by copies of audited profit and loss accounts and the balance sheet.

24. These submissions have been sought to be repelled by the learned Advocate General for Tamil Nadu appearing for the Union Government that the consequences of absence of the provision for extending the time limit for obtaining an audit report are not necessarily penal since a defaulting assessee cannot be visited with the penalty u/s 271B because the default which would attract the said provision is one which is committed without reasonable cause. The absence of reasonable cause is to be prima facie established by the revenue since it is one of the elements of the offence as held by the Full Bench of the Gujarat High Court in Addl. Commissioner of Income Tax, Gujarat Vs. I.M. Patel and Co., . In no case the return would be treated as incomplete because u/s 139(9), the ITO has to give an opportunity to remove the defect and, therefore, the contention that the absence of the provision would entail ipso facto the penal

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consequences is not well founded. The learned Advocate General for Tamil Nadu invited our attention in this connection to the circular issued by the CBDT being Circular No. 422, dated 19-6-1985 [see Taxmann''s Yearly Tax Digest & Referencer, 1986, p. 4.47] that on consideration of the representation received from the assessees and various trade associations expressing their difficulties in getting their accounts audited by the specified date, it was decided that 1985-86 being the first year of the operation of the section, and the relevant rule being not notified till 31-1-1985, penalty proceedings u/s 271B should not been obtained by 30-9-1985 and the self-assessment tax u/s 140A of the Act has been paid within normal period prescribed u/s 139(1). We have given anxious consideration to these rival submissions. We are of the opinion that there is a great force in what the learned Advocate General for Gujarat contended that the assessees who were within the purview of the impugned section could not have got their accounts audited and report obtained by the specified date, as the case may be, because for all practical purposes their maintenance of accounts would not necessarily be in the manner as required by the chartered accountants for purposes of tax audit. We should remind ourselves as to the true and correct functions of tax auditors in general and the statement of particulars which a tax auditor is required to file under the impugned rule 6G(2)(a) in Form 3CD which, inter alia, requires to state that the books of account are examined, the method of valuation of opening and closing stock in trade, the quantitative details of finished products and raw material, the capital expenditure debited to profit and loss accounts, entertainment expenses, details of expenditure referred to in section 40A of the Act and the amounts borrowed on hundi. In this connection the Institute of Chartered Accountants of India has issued guidance note having regard to ''the fact that the scope of audit under the tax laws has considerably widened after the introduction of section 44AB, and the Taxation Committee has prepared this guidance note on tax audit for the use of their members''. The following points extracted from the said note make interesting reading:

12. Statement of particulars in the case of a person carrying on business.

12.1 ****

12.2. As stated earlier, the auditor should obtain from the assessee statement of particulars only authenticated by him. It would be advisable for the assessee to take the following general principles into consideration while preparing the statement of particulars:

(a) He can rely upon the judicial pronouncements while taking any particular view about inclusion or exclusion of any items in the particulars to be furnished under any of the clauses specified in Form 3CD.

(b) If there is a conflict of judicial opinion on any particular issue, he may refer to the view which has been followed while giving the particulars under any specified clause.

(c) The general accounting principles and guidelines issued by the Institute from

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time to time should be followed.

(d) If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable reference to such items at the appropriate places.

13. Books of account examined.

13.1 The auditor should obtain from the assessee a complete list of books of account and other documents maintained by the assessee (both financial and non-financial records) and make appropriate marks of identification to ensure the identification of the books and records produced before him for audit. If the books of account examined are not complete, a reference should be made to this effect against this clause. The list of books of account examined by the auditor should be given against this clause.

13.2 Attention is invited to the Institute''s publication ''Monograph on Compulsory Maintenance of Accounts'' dealing with the requirements of provisions of section relating to the books of account to be maintained by the taxpayers falling within the said section. Section 44AA(2) pro vides that persons carrying on business or profession other than those specified in sub-section (1) shall keep and maintain such books of account and other documents as may enable the income tax Officer to compute his total income in accordance with the provisions of income tax Act, if his income from business or profession exceeds Rs. 25,000 or his total sales, turnover or gross receipts in business or profession exceed Rs. 2,50,000 in any one of the three years immediately preceding the previous year. Whereas the CBDT has prescribed the books of account and other documents to be kept and maintained by the specified professional persons in rule 6F, it has not yet prescribed the books of account to be maintained by those falling under sub-section (2). The auditor will have to verify that the assessee has maintained such books of account and documents as prescribed under sub-section (3).

13.3 As for corporate assessee, the requirement about maintenance of books of account is contained in the relevant statutes. In the case of other assessee, normal books of account to be maintained will be cash book/bank book/sales/ purchase journals or register and ledger. Asses- sees engaged in trading/ manufacturing activities should also maintain quantitative details of principal items of stores, raw materials and finished goods. While giving his report in Form 3CB about maintenance of proper books of account, the auditor should ensure that they are maintained in accordance with the above requirements.

25. We need not quote at length the directions given in respect of the different particulars to be included in such statement, but the direction about the method of the stock valuation needs to be referred to:

15.2 There are three methods of stock valuation commonly followed by most of the assessees:

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1. At cost.

2. At cost or market rate whichever is lower.

3. At market price or net realisable value.

The method must be consistently followed from year to year, and the method followed must be brought out clearly. The auditor must examine the basis adopted for ascertaining the cost and this basis also should be consistently followed. The method of determining the cost will be decided having due regard to the type of business or industry of the assessee and should be made on the basis of generally accepted accounting principles. It may be the direct cost or may include an element of factory overheads and, in some cases, also administrative overheads.

26. Similarly in respect of capital expenditure debited to the profit and loss account, the direction at point 17.2 is worth noting:

17.2 Some tests which, however, are generally applied to determine whether a particular item of expenditure is of capital nature are set out hereunder:

(i) Whether, it brings into existence an asset or advantage of enduring benefit. The question whether a particular benefit is of an enduring or permanent nature will depend upon the facts and circumstances of each case, the concept of permanency being relative.

(ii) Whether, it is referable to fixed capital of fixed assets in contrast to circulating capital or current assets.

(iii) Whether, it relates to the very framework of the assessee''s business.

(iv) Whether, it is an initial expenditure or an expenditure incurred in setting the profit earning machinery into motion.

(v) Whether, it is an expenditure to acquire a concern or goodwill.

The nature of receipt in the hands of the recipient is not a determinative factor to determine the nature of payment in the hands of payer. If the amount is in the nature of capital receipt in the hands of the payee, it does not imply that it is a capital expenditure for the payer and vice versa. The case of the payer has to be considered independently based on the facts concerning him."

27. As regards particulars of payments, the directions contained in paragraphs 33.1 and 33.2 are worth repeating:

33.1 Section 40A(3) provides for the disallowance of payments exceeding Rs. 2,500 otherwise than by way of crossed cheque or bank draft except under certain circumstances. The cases and circumstances in which payment of a sum exceeding Its. 2,500 in cash or otherwise than by crossed cheque or draft is permitted are specified in rule 6DD. The details regarding the payments made in cash or otherwise than by crossed cheque or bank draft are to be specified under

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this clause.

33.2 There may be practical difficulties in verification of payments made through crossed cheques or bank drafts. If no proper evidence for verification of the payment by crossed cheque or draft is available such a fact could be brought out by appropriate comments in the following manner:

''It is not possible for me/us to verify whether the payments in excess of Rs. 2,500 have been made otherwise than by crossed cheque or bank draft as the necessary evidence is not in the possession of the assessee.''

28. As regards the particulars of the amounts borrowed on hundi and repaid otherwise than by cheque, the directions in paragraphs 40.1, 40.2 and 40.3 are worth noting:

40.1 Details of the amount borrowed on hundi (including interest on such amount borrowed) and details of repayment otherwise than through a cheque are required to be indicated under this clause. In this context, a reference may also be made to Circular No. 208 dated 15-11-1976 issued by the CBDT explaining the provisions of section 69D. The statutory provision is contained in section 69D. It may be noted that section 69D refers to borrowing and repayment otherwise than by an ''account payee cheque'' but for the purpose of this clause the information is to be given about borrowing and repayment otherwise than by ''cheque''.

40.2 For this purpose the auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than by cheques and verify the same with the books of account.

40.3 There will be practical difficulties in verifying the loan taken or repaid on hundi by cheque. In such cases the auditor would verify the borrowings/ repayments with reference to such evidence which may be available and in the absence of conclusive or satisfactory evidence he should make a suitable comment in his report as suggested in paragraph 33.2.

29. As regards the particulars about quantitative details of the raw materials and finished products, the directions contained in paragraphs 46.1, 46.3 and 46.4 are worth noting:

46.1 This information should be given only in respect of those items where it is practicable to do so having regard to the records maintained by the assessee. In other cases, the auditor may be well advised to indicate in his report that the relevant records were either not maintained or inadequate for the purpose of furnishing the relevant information.

46.2 In a large concern it may be difficult for the auditor to verify each and every item of purchase, consumption and production. In such cases, he may verify the figures on a sampling method and satisfying himself as to the correctness of the figures furnished. This clause requires that quantitative details of ''principal

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items'' of raw materials and finished goods should be given. Therefore, information about petty items need not be given. What would constitute principal items, will depend on the facts of each case. Normally items which constitute more than 10 percent of the aggregate value of purchases, consumption or turnover may be classified as principal items. In this connection reference may be made to the Institute''s Statement on Amendments to Schedule VI to the Companies Act, 1956.

43.3 The note in the statement of particulars under this item requires quantitative details on the above lines to be given in respect of by-products also.

43.4 The information about ''yield'', ''percentage of yield'' and ''shortages'' is required to be given only to the extent that such information is available in the records of the assessee.

30. This note, therefore, indicates as to the complexity of the task of a tax auditor particularly in case of a non-corporate assessee. The failure to satisfy a tax auditor may result into unqualified report being given which may expose an assessee to best judgment assessment. In this connection, our attention was invited to section 44AA which was put on the statute book by the Taxation Laws (Amendment) Act, 1975, which is inserted in the 1951 Act with effect from 1-4-1976, whereunder the persons specified therein are required to keep and maintain such books of account and other documents as may enable the ITO to compute his total income in accordance with the provisions of the Act. Under sub-section (1) of section 44AA, every person carrying on legal, medical, engineering or architectural profession or profession of accountancy or technical consultancy or interior decoration or any other profession as notified by the Board have to keep and maintain such books of account and other documents as may enable the ITO to compute his total income in accordance with the provisions of the Act. Sub-section (2) requires that the persons carrying on business or profession other than those mentioned above are also liable to maintain such books of account as aforesaid, if their income from the business or profession exceeds Rs. 25,000, or their total sales, turnover of gross receipts, as the case may be, in respect thereof exceeds Rs. 2,50,000 in any one of the three years immediately preceding the previous year, and if the business or profession is newly set up in any previous year, the income therefrom is likely to exceed as aforesaid during such year. However, the CBDT have by Circular No. 205 dated 27-7-1976 [see Taxmann''s Direct Taxes Circulars, 1986 edn., Vol. 1, p. 422] clarified that the requirements contained in sub-sections (1) and (2) of section 44AA regarding maintenance of books of account and documents would apply only in relation to the books of account and documents in respect of the accounting years commencing on or after 1-4-1976. It should be noted that what type of books of account and documents are to be maintained in respect of the profession specified in sub-section (1) have been prescribed by rule 6F of the Rules. In respect of the persons governed under sub-section (2), no such rules have been formed to prescribe what kind of books of account and documents should be

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maintained. What would be the necessary records of accounting and what would be the mechanics of accounting is also indicated by the Institute of Chartered Accountants of India in Monograph on Compulsory Maintenance of Accountants, Chapter 4, paragraph 4.13.2 is instructive. It reads as under:

4.13.2 Vouchers or documentary evidence : The reliability placed on accounts prepared by a firm will depend on the manner in which the accounts have been written up and on the evidence that there is in support of the entries made in the books of account. The evidence is mostly available in the form of voucher-''the written piece/or paper, often properly printed and ruled, given by one party to the other when a transaction between them takes place''. The proforma of voucher is given as Form 1 in the appendix. The following are examples of voucher:

Expenditure:

(i) Cash memo issued by suppliers on cash purchases;

(ii) Invoices, delivery boxes, etc., issued by the suppliers when goods are purchased on credit;

(iii) Receipts issued by : (a) railway and other transport authorities on payment of freight or demurrage; (b) municipal authorities on payment of octroi duty; (c) customs authorities on payment of customs duty;

(iv) Receipts obtained when wages are paid to casual labourers or cartage is paid;

(v) Receipted electricity, water and telephone bills;

(vi) Wages and salary sheets or registers containing acknowledgement by the employees concerned for payment of the wages or salaries due to them;

(vii) Any other acknowledgement by a third party of payment made to it or a document showing that benefit has been received by the firm, the party concerned;

(viii) Demand notes issued by a taxation authorities, such as the Sales Tax Officer, indicating the amount due by the firm in respect of the concerned tax and receipted challans issued by the Treasury or the Reserve Bank of India.

N.B. -A receipt for an amount exceeding Rs. 20 will not be considered proper unless it bears a twenty paise revenue stamp except when it is a receipt issued by the Government.

Receipts:

(i) Copies of cash memos (these must be carbon copies) issued to customers on cash sales.

(ii) Copies of invoices made out against the customers who have purchased goods on credit;

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(iii) Counterfoils of receipts issued to those who have made payments of amounts to the firm (it would be better also to preserve the letters, if any, accompanying the remittances);

(iv) Other pieces of evidence showing the authenticity of the amount received, e.g., the memo showing junk sales signed by the purchaser of the junk.

In all the above cases, third parties or outsiders are involved. There is good deal of internal evidence also which is of relevance for accounting work, for example:

(i) The Oak Despatch Register which is not only evidence of letters sent to various parties but also shows the amount spent as postage during the period concerned.

(ii) The memos that accompany the finished goods from the factory to the finished goods godown.

(iii) Goods inward books.

(iv) Goods outward books.

(v) One should take care to:

(i) get the cash memos, invoices, receipts and the memos to accompany finished goods transferred, printed and prenumbered;

(ii) see that the stock of such stationary is kept under lock and key with some responsible person who should issue only the requisite quantity at one time; and

(iii) ensure that all the leaves in a book are properly accounted for, in other words, there should be no number missing from the cash memos book or from the receipt book.

All vouchers should be kept in good order serially. All vouchers showing payments, should be signed by someone in authority and then stamped prominently to prevent their being produced again as evidence for payment. Cash memos, invoices, counterfoils of receipts, etc., should also be initialled by the person whose duty is to see that all these have been properly accounted for.

Paragraph 4.20.1 is also important which reads as under:

4.20.1 Most of the difficulties arising on account of non-maintenance of accounts or maintenance of incomplete or incorrect records as per the accounts would be to the disadvantage of the firm and it is in his interest that he takes every care to see that all his transactions on capital as well as revenue accounts related to the business or profession carried on are properly recorded in the relevant books of account and adequate documents, vouchers and other records are also maintained.

31. It does not require much of knowledge of accountancy that the books of account of the non-corporate assessees are not maintained in the manner in

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which the accounts are maintained by the corporate assessees and required by auditors for purposes of commercial audit much less for tax audit. The fact that the impugned section 44AB was placed on the statute book by the Finance Act, 1984 and was not made effective till 1-4-1985 coupled with the Rules being published for the first time on 31-1-1985, as rightly contended by the learned advocate general, would cause great inconvenience to the assessees within the purview of the section. We have not been able to appreciate as to how the non-corporate assessees liable to tax audit can switch over their manner and method of accounting so as to satisfy the tax auditors. It is difficult for the assessees whose previous year ended on 24-10-1984 or 31-12-1984 and whose specified date being 24-2-1985 or 30-4-1985, and for that matter those assessees whose previous year ended on 31-3-1985 and whose specified date being 31-7-1985 to satisfy these provisions by getting their accounts audited and obtain the auditor''s report, particularly when their turnover were so high as to exceed the prescribed limits. The learned Advocate General for the petitioners was, therefore, more justified particularly in respect of the assessment year 1985-86, In spite of our agreement on this aspect of inconvenience to the assessees, we are not able to agree with the learned Advocate General for the petitioners that this will by itself ipso facto expose the defaulting assessees to the consequences of penalty and/or for their return being treated as defective. The reason is that section 271B justifies imposition of penalty where an assessee fails to get his accounts audited and obtain the report by the specified date without reasonable cause. It will be for the department to prima facie show that there was want of reasonable cause on the part of the assessee for committing the default as held by the Full Bench of this Court in I.M. Patel & Co.''s case (supra). We do not think that the return can also be treated as incomplete merely because the assessee has committed default in annexing the auditors'' report with the return. The ITO has to give him time to remove the defect and if within the stipulated time of a fortnight or the extended time the assessee is able to comply with the requirement, we do not think that his return can be treated as defective or incomplete. We are sure that the income tax authorities will bear in mind this peculiar situation as it preyails particularly in relation to the assessment year 1985-86 and will not be unmindful of the hardships of the assessee in not complying with this provision for some time to come particularly with reference to the assessment year 1985-86. In that view of the matter, therefore, the second limb of the contention, though no doubt has some force in it insofar as it causes hardship to the assessee, particularly for the assessment year 1985-86, it cannot be said that the provision is unreasonable because it does not expose ipso facto to the penalty nor to the consequences flowing from the return being treated as incomplete entailing for reasons beyond control. The power to levy penalty is only when the ITO is satisfied that there was no reasonable cause for the default and the return can be treated as defective only if the defect is not removed within the stipulated time which cannot, therefore, be said to be an inevitable consequence of the default and, in any case, would not make the provision unreasonable. In order to mitigate the inconvenience and hardship to

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the advisability of issuing directions on the lines contained in Circular No. 205, dated 27-7-1976 [see Taxmann''s Direct Taxes Circulars, 1985 edn., Vol. 1, p. 422] in respect of the requirement of maintenance of account books as enjoined u/s 44AA of the Act (sic). The second limb of the contention, therefore, stands rejected.

32. Contention No. 3(a)(iii):

The impugned provisions have been assailed on the ground that the effect of the failure on the part of the assessee to get his accounts audited in respect of any previous year or years relevant to the assessment year or to obtain a report of such audit as required u/s 44AB would render him liable, if the failure is without reasonable cause, to penalty of one-half percent of the total sales, turnover or gross receipts, as the case may be, or Rs. 1,00,000, whichever is less, and insofar as this penalty provision contained in section 271B can be enforced, irrespective of the period of delay, it becomes arbitrary and unreasonable. In other words, an assessee in default, even for one day, would be visited with the same amount of penalty as an assessee in default for a period of one year or more. On the face of it, it was submitted that the effect of such a provision on the delinquent assessee would be arbitrary since no discretion is left to the ITO in the matter of quantum of penalty. It was further urged that the arbitrary nature of the penal provision is discriminatory also inasmuch as persons who are not alike are treated in a like manner. The learned Advocate General of Gujarat for the petitioners further contended that though section 246 of the Act provides for an appeal to the Commissioner (Appeals) against an order imposing penalty u/s 271B, the subject-matter of the appeal can be only as to whether the assessee has defaulted without reasonable cause and not about the quantum of penalty since the section provides a flat amount of penalty. In this connection, he invited our attention to sections 271, 271A, 272, 272A, 272B and 273 of the Act where the ITO has been invested with the discretion as to the quantum of penalty of its link up with the period of default. Insofar as section 271B does not leave any discretion to the ITO, or does not link the quantum of penalty with the period of default, nor any appeal is competent in respect of the quantum of penalty by the very nature of the provision contained in section 271B, the substantive and procedural provisions relating to penalty contained in these sections have become too onerous and, therefore, the penalty provision is arbitrary and unreasonable and a fortiori, the main provision also becomes arbitrary and unreasonable to that extent. On the face of it, the contention appears to be very attractive. We have, therefore, to closely scrutinise it in order to find out whether the same is well-founded. It is no doubt true that the penalty which has been prescribed in section 271B is a flat penalty in sense that a defaulting assessee is liable to pay penalty of one-half percent of the total sales, turnover or gross receipts, as the case may be, or Rs. 1,00,000, whichever is less. It should be noted that section 246(2)(gg) has provided an appeal against the order of penalty made u/s 271B. No doubt the Commissioner (Appeals) has a power u/s 256 of the Act, in an appeal against an order imposing penalty, inter alia, to vary

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it so as to enhance or reduce the penalty. The contention is that the Commissioner can exercise this power of variance of or reduction in penalty only if the substantive provision contained in the Act in respect of a specified default leaves any discretion in the authority. If the specified provision does not leave any discretion in the authority, nor does it relate to the period of default, the Commissioner (Appeals) can also not reduce the penalty. We do see force in this contention. It is axiomatic to say that the constitutionality of a provision is to be assumed and the effort of the Court must be to save the provision from the challenge even by reading it down. We are of the opinion that on close reading of the substantive provision contained in section 271B, the ITO has to determine the penalty only if he is satisfied that the specified default is without reasonable cause.

33. In Hindustan Steel Ltd. Vs. State of Orissa, , the Supreme Court was concerned with certain provisions of the Orissa Sales Tax Act providing for penalty under certain circumstances. The Supreme Court, speaking through Shah, Actg. CJ. (as he then was) ruled as under:

Under the Act penalty may be imposed for failure to register as a dealer : section 9(1), read with section 25(1)(a) of the Act. But the liability to pay penalty does not arise merely upon proof of default in registering as a dealer. An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding, and penalty will not ordinarily be imposed unless the party obliged, either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute...."

[Emphasis supplied] (P. 29)

It should be noted that section 12(5) of the Orissa Sales Tax Act provided penalty for failure to apply for registration without sufficient cause and the Commissioner was empowered to levy by way of penalty a sum not exceeding one and a half times that amount.

34. In I.M. Patel & Co.''s case (supra) the Full Bench of this Court in the context of the failure to furnish return without reasonable cause ruled that u/s 271(1)(a), failure ''without reasonable cause'' to furnish the return is an ingredient of the offence and section 271(1)(a) would be attracted where the assessee has acted deliberately in defiance of law or was guilty of conduct, contumacious or dishonest, or acted in conscious disregard of his obligation. The expression

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''reasonable cause must receive a liberal interpretation so as to advance substantial justice - Saurashtra Cement and Chemical Industries Ltd. Vs. Commissioner of Income Tax, Gujarat, . Therefore, the absence of reasonable cause being a sine qua non of the penalty provision, mere failure to get the accounts audited or to obtain the report of such audit as required under the impugned section would not be enough - Commissioner of Income Tax Vs. Gujarat Travancore Agency, . When an assessee having exceeded a turnover or the receipts prescribed under the impugned section gets his accounts audited or produces a certificate of such audit after an inordinate delay in spite of notice, it can be said that there was an absence of reasonable cause in complying with the statutory obligation and, therefore, his inaction may be considered deliberate. In our opinion, therefore, the expression, ''reasonable cause'' if interpreted in a liberal manner so as to advance cause of justice, the ITO is necessarily required to consider all the attendant circumstances including the period of default, the conduct or the intention of the assessee, etc. We have, therefore, no hesitation in saying that the ITO is under an obligation to consider all the relevant circumstances, inter alia, as indicated above, for purposes of determining whether there is want of reasonable cause on the part of the assessee for non-compliance of the statutory obligation. If that is the necessary implication of the section, which we are of the opinion is, the Commissioner (Appeals) is also required to consider all these aspects and determine about the quantum of penalty. In any case an aggrieved assessee can move the Commissioner u/s 273A(4) of the Act for reduction or waiver of penalty, in case the ITO or the Commissioner (Appeals) fails to act according to law or for any other justifying reasons. A similar question arose before this Court in Rahimbhai Karimbhai Nagriwala Vs. B.B. Patel and Others, . The Division Bench of this Court was concerned in Rahimbhai Karimbhai Nagriwala''s case (supra) with the validity of section 271(1)(c) on the ground of it being violative of article 14 inasmuch as the extent of the guilty and the extent of the penalty were not co-related resulting into unreasonable hardship. The Division Bench speaking through Diwan, CJ. (as he then was), rejected this contention on the ground that the apparent harshness of the provision arises on account of the different levels of taxation for different levels of income. In any view of the matter and, particularly, since we are reading down this penal provision contained in section 271B, we must reject this third limb of the contention.

35. Contention No. 3(a)(iv):

The learned Advocate General appearing for the petitioners urged in support of this contention that insofar as the impugned rules which were published in January 1985 are sought to be operated retrospectively, they cause a great prejudice and are wholly onerous and, there- fore, unreasonable. We must reject this contention for the obvious reason that whether a law offends article 14 does not depend upon whether it is prospective or retrospective - Kangshari Haldar and Another Vs. The State of West Bengal, at p. 466. In that case the Supreme Court ruled as under:

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32. It seems to me that the learned Judges of the High Court were unduly oppressed by considerations of the retrospective operation of the Act. The question is not whether the Act is prospective or retrospective in its operation. Nor is it the question whether the Act deals with procedures or substantive rights. The only question is whether the Act operates in respect only of a class of persons and if so, whether the classification is justifiable.... It is not necessary therefore to consider whether the Act is prospective or retrospective or whether it concerns procedure or substantive rights." (p.466)

So far as the operation of the impugned provision on the affairs of the previous year closed much before the publication of the rules or for that matter their application has been already dealt with by us while dealing with the first limb of this'' contention, it is not necessary for us to dilate more on this point. The fourth limb of this contention, therefore, stands rejected.

36. Contention No. 3(a)(v) and (vi):

The learned Advocate General of Gujarat and particularly Mr. Kaji appearing for the petitioners of Special Civil Application No. 2068 of 1985 urged that there are no adequate safeguard to be found in the Wealth-tax Act, 1957, or the erstwhile Estate Duty Act, 1953, in the scheme contained in the impugned provisions and inasmuch as there is no provision of empanelling of auditors or the schedule of the maximum fees which they can charge for the work of tax audit, the impugned provisions are bound to act in an oppressive manner particularly because the assessees would have no choice in the matter of the representation of their cases before the income tax authorities, and they would be exposed to the professional vagaries in that behalf. Our attention has been invited in this connection to some observation made in the Editorial appearing in Bombay Chartered Accountants Journal, April 1985 issue, under the caption ''Time to Reflect''. It has been, inter alia, observed in this Editorial as under:

We are required to complete the tax audits well within the time-frame provided for it with all the above requisites. One factor that will determine the success is the scale of fees we charge for these new assignments.

Once the fees get fixed a ''high-jump'' for subsequent years becomes difficult, it is, hence imperative that proper thought be given to it right at the beginning and no compromise be made in the quality of work to be done and commensurate fees to be charged for the same.

A lot of loose rumours are making the rounds as to low fees being offered by many assessees, including public sector undertakings, wholesale rates being offered by some groups, fees for tax audit being linked to statutory audit fees, at some low percentage thereof and so on.

It is time to reflect.

The fixation of audit fees depends on so many factors in the light of actual merits of each case. Cost of audit is increasing year after year, with the volume of

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professional work having increased so suddenly, the supply of qualified assistant will be scarce and with that the cost of audits will further go up.

The Company Law Board issued a circular in June 1984 on the subject of fixation of audit fees for statutory auditors appointed u/s 619(2) of the Companies Act, 1956 and conceded that fees need upward revision due to phenomenal increase in the cost of service relating to audit. The Company Law Board also has issued Guidelines for Government Companies regarding fixation of auditor''s remuneration. Members will find the same useful to go through while fixing the tax-audit fees.... The said guidelines list thirteen items to be taken into account for determining the fees. Same include (1) production/sales in terms of quantity and money value, (2) total revenue expenditure, (3) capital employed. (4) total number of vouchers, (5) time spent (likely to be spent) by the auditors and their staff in terms of men-hours.....

For tax audit of non-corporate assessee the auditor will report on the true and fair position of accounts and state other affirmations like in audit of companies and in all cases audit the annexure of particulars in Form 3CD/3CE and give an opinion thereon to the effect whether they are true and correct. If particulars in Form 3CD are listed in a seriatim, they are 40 in number, many of them requiring intricate interpretation of legal position on the point at issue and/or extensive checking of vouchers to quantify the figures in the annexure and so on.

On an average for non-corporate assessees'' business accounts audit, where out of 40 items of Form 3CD, 50 percent are applicable and has volume of work in terms of 6000 primary entries and vouchers, it may take approximately 100 men-hours to complete such an audit and as per the recommended scale the fees have to be between Rs. 7,500 to Rs. 10,000.

37. It was, therefore, urged that having regard to the total number of non-corporate assessees, the aggregate amount of fees which will be disbursed amongst the members of the chartered accountants would be stupendous and will entail onerous economic burden on the assessee and, therefore, in absence of proper safeguard they would operate unreasonably. It was also urged that without the empanelling of auditors and their recognition by the Union Government as in the case of approved valuers there will be no sufficient check on the members of the profession undertaking the tax audit work. We do see some force in the contention of the learned advocate for the petitioners that this provision will work in an onerous manner and, therefore, unreasonable because the suggestions made in the aforesaid Editorial are merely recommendatory and have no binding effect on the members of the profession. Apart from the recommendatory nature of the suggestions, the maximum fees of Rs. 10,000 as suggested in the said Article would hardly come to one-fourth percent in the case of assessees having turnover of Rs. 40,00,000 and it will have a gradual reducing scale of percentage having regard to the total turnover, sales and gross receipts in case of assessees having turnover exceeding Rs. 40,00,000. The learned Advocate Mr. Kaji, urged that there is no guarantee that the tax auditors will

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charge maximum fees of Rs. 10,000 as suggested in the said Editorial and the possibility of charging higher fees than that suggested cannot be ruled out. He also invited our attention to the scale of fees prescribed under rule 8C of the Wealth-tax Rules, where the maximum fee in cases of assets valued at Rs. 1,00,000 more is even less than one-eighth per cent. We appreciate this apprehension expressed by Mr. Kaji. We are of the opinion that it would have been just and fair if the Union Government has prescribed the scale of fees having regard to the overall nature of the work involved in the tax audit so that the asses-sees may not be left to the vagaries in the profession.

38. As regards the grievance for not empanelling of chartered accountants who can undertake this work, we find it difficult to agree with Mr. Kaji because the situation is not comparable to that of engineers and valuers connected with the work of valuation for purposes of the Wealth-tax Act or for that matter the Estate Duty Act. The reason is obvious that there is no statutory professional body invested with the disciplinary as well as supervisory jurisdiction for the profession of engineers as one which we have got for the members in the profession of chartered accountants. The Chartered Accountants Society can, therefore, certainly maintain the professional norms and standards in the matter of tax audit by the chartered accountants and in case of sharp practice of any black sheep in the profession can certainly be brought to book and dealt with properly. Apart from this difference in the situation, we do not think that merely because some observations have been made in the Editorial, we assume that the tax auditors will charge such exorbitant fees for their professional work as to make the impugned provisions onerous and unreasonable. This contention, there fore, stands rejected.

39. Contention No. 3(a)(v):

In submission of the learned Advocate General for Gujarat appearing for the petitioners, the possibility of the auditors giving qualified certificate, namely, books are not maintained in the proper manner as required by the auditors, would cause serious prejudice to the assessees who would be exposed to best judgment assessment in that case. In this connection, our attention has been invited by the learned Advocate General that there is a two-fold obligation on a tax auditor according to the impugned provisions. He is not only required to certify about the accuracy of the financial statements and accounts but he is also required to give report containing the prescribed particulars. The difference between such opinion and the report has been set out in the extracts produced from the publication of the Institute of Chartered Accountants of India, April 1984 edn., under the caption, ''Guidance Note on Audit Reports and Certificate for Special Purposes''. In paragraph 2.2 of the said extracts which have been annexed to the reply affidavit of Shri Gordhanbhai Patel filed on behalf of the respondents Nos. 4, 5 and 6, it has been, inter alia, stated as under:

2.2 A reporting auditor should appreciate the difference between the terms ''certificate'' and ''report''. A certificate is a written confirmation of the accuracy

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of the facts stated therein and does not involve any estimate or opinion. A report, on the other hand, is a formal statement usually made after an inquiry, examination or review of specified matters under report and includes the reporting auditor''s opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual date, that his opinion is in due accordance with facts and that is arrived at by the application of due care and skill.

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8.1 A reporting auditor''s examination of certain records or an audit report or certificate for special purpose also be more intensive than the examination of the same records by the statutory auditor for the purpose of expressing an opinion on the general purpose of financial statement as a whole.

8.2 Certain accounts or items of financial statements are inter-related, e.g., sales and debtors, purchases and creditors, fixed assets and depreciations, etc. Therefore, where reporting auditor is required to examine and report upon or certify a specified account or items of financial statements, he may also need to examine the related accounts or items to discover the inconsistencies, if any, between these interrelated accounts or items.

40. Similarly, our attention is also invited to the observations made in the extracts from Statement on Standard Auditing Practice-Basic Principles Governing an Audit wherein it has been stated that auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. The review and assessment involves forming of an overall conclusion as to whether, inter alia, the financial information has been prepared using acceptable accounting policies and that the financial information complies with relevant regulations and statutory requirements. In paragraphs 22 and 23 it has been stated:

22. The audit report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down in or prescribed under any agreement or statute or regulation the audit report should comply with such requirements. An unqualified opinion indicates the auditor''s satisfaction in all material respects with the matters dealt with in paragraph 21 or as may be laid down or prescribed under the relevant agreement or statute or regulation as the case may be.

23. When the qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons therefor.

41. It was, therefore, submitted that if the auditor finds that the financial

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information furnished to him is not according to the accept able accounting policy and principles or not according to the relevant regulations and statutory requirements, he may refuse to give unqualified opinion in which case an assessee would be exposed to grave consequences of not only best judgment assessment but also to penalty. We can appreciate this apprehension expressed on behalf of the assessee. However, in view of the clarification made by the Union Government in the reply affidavit of Shri Kalyan Chand, Under Secretary in the Finance Ministry to the Government of India, in paragraph 15 that opinions given by the chartered accountants are not binding either on the assessees or on the assessing office, we do not think that the assessees will be prejudiced by the qualified opinion given by the tax auditor in any given case. It is no doubt true that the assessee concerned may be required to persuade the ITO that there was no justification for qualified opinion or that there were valid and compelling reasons for an assessee in his failure or omission to satisfy an auditor. We are sure that the concerned tax authorities will not approach the matter in strictly technical manner so as to make best judgment assessment and/or to levy penalty merely because there is a qualified report of an auditor. The authorities will adopt a judicial approach and consider all attendant circumstances including the fact that the non-corporate assessees were not required to maintain their financial records in the manner in which the corporate assessees maintain as required under the law in force for the time being and the authorities will also bear in mind that non-corporate assessees should have reasonable time to adopt themselves to the changed situation emerging from the insertion of the impugned provisions for the first time in the statute book having far reaching repercussions. This contention, therefore, also stands rejected.

42. Contention No. 3(b)(i) and (ii):

The challenge to the impugned provisions is two-fold. In the first instance, it is urged that the classification is absolutely unintelligible inasmuch as there was no valid or justifying ground for creating two classes amongst the authorised representatives - one of chartered accountants-since for all intents and purposes the non-chartered accountants section of authorised representatives discharge the responsibility and perform the duties, expected from the authorised representatives in the same effective manner as the section of the chartered accountants was doing. There is no justification for the classification of the chartered accountants and non-chartered accountants for the purpose of tax audit since the non-chartered accountants section of the authorised representatives is equally capable and competent, if not more, to undertake the obligation and discharge the functions expected of tax auditors, under the impugned provisions. The classification becomes unintelligible particularly when rule 12 of the Rules enjoins every authorised representative specified in clauses (iii) to (vii) of section 288(2) who has prepared the return of income of the assessee to furnish to the concerned ITO, inter alia, a report on the scope and result of his examination, if any, of the accounts, statements or documents of such assessee for the purpose of preparation of such return. Rule 12A therefore,

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in submission of the learned Advocate General for the petitioners, recognises by necessary implications that non-chartered accountant is required to submit the report on the scope and result of examination of accounts, etc., of an assessee, which would be a sort of a tax audit for all intents and purposes, it is incomprehensible as to how the chartered accountants section has been preferred for purposes of so-called tax audit under the impugned provisions. It was, therefore, submitted that the direct and immediate effect of the impugned provision is that hostile discrimination is practiced against the non-chartered accountants section by picking up chartered accountants for a preferential treatment without any justification. This classification, according to the learned Advocate General for the petitioners, has in any case no reasonable nexus with the object of the impugned provisions of the statute. If the object of the impugned provisions is to safeguard tax avoidance and tax evasion as claimed by the Finance Minister in his Budget Speech for 1984-85, it can be hardly be successfully claimed that the chartered accountants would be the only competent persons to carry out tax audit particularly when rule 12A recognises the competency and capability of non-chartered accountants section also to discharge virtually the similar functions and duties. Secondly, it was urged that insofar as the proviso to the impugned provision of section 44AB as amended by the Finance Act, 1985 with effect from 1-4-1985 permits an assessee required by or under any other law to get his accounts audited by a person authorised under such Act or law to carry out the audit and produce his report and treats it as a sufficient compliance of the main enactment in the impugned section, it creates a sub-classification of what is called special auditors which sub-classification makes the main classification further unintelligible and, therefore, the entire classification arbitrary and without any reasonable nexus to the object of the statute.

43. On behalf of the Union Government, the learned Advocate General for Tamil Nadu sought to repel the above contention by making three submissions. In the first place, it was submitted that the right of representation conferred on authorised representative is merely a statutory right and if in public interest, Parliament enacts that all authorised representatives should only be accountants, such a provision cannot be held to be arbitrary or unreasonable. In the second place, it was urged that in any case the classification of auditors and non-auditors having regard to the functions which are to be carried out cannot be said to be unintelligible and if the function of tax audit is entrusted to chartered accountants only amongst authorised representatives, it cannot be urged successfully that the classification has no reasonable nexus with the object of the statute because if Parliament with a view to safeguard against tax evasion in its wisdom has thought fit to entrust such complicated and onerous work of such a special audit to a class which has the training, experience and expertise in that behalf, no exception can be taken on the ground that the provision is discriminatory or violative of rule of equality. Thirdly, he urged that under the priviso what has been permitted is only the report of a special auditor to be

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sufficient compliance and it has not dispensed with the further report of chartered accountant as required under the main provision of the impugned section 44AB which requires report as well as certificate of accountant which means only chartered accountant.

44. On behalf of the chartered accountants, who are respondent Nos. 4, 5 and 6 of Special Civil Application No. 2068 of 1985, the learned Counsel Shri G.N. Desai, adopted the submission made by the learned Advocate General for Tamil Nadu for the Union Government. He, however, added that the proviso does not create any classification which merely permits assessees who have been subjected to audit under the special statute or Act such as the Co-operative Societies Act, 1912, to furnish report of special auditor by way of compliance of the obligation under the impugned section. According to Union this is merely a con cession and not classification.

45. It is in the backdrop of these rival contentions that we have to decide as to whether the challenge is well-founded.

46. We should remind ourselves as to when the classification becomes suspect classification. As has been often said, article 14 does not forbid classification; it forbids only class-legislation. The classification must be intelligible and must bear rational relation to the object sought to be achieved by the statute in question. The classification can be based, inter alia, on consideration of occupations - Ram Krishna Dalmia Vs. Shri Justice S.R. Tendolkar and Others, . The State, in exercise of its governmental power, has to make laws operating on different groups or classes of persons to achieve particular object in execution of its policies and, therefore, must have large powers of distinguishing and classifying of persons or things to be subject to such laws. Such a power of classification is likely to produce some inequality. The method of classification is to segregate in classes and clubbing persons together having common properties and characteristics on a rational basis but it does not mean that it can herd together persons and classes in an arbitrary manner. Within reasonable bounds the Legislature is permitted to classify according to the needs and exigencies of the situation. It is no doubt true that article 14 forbids conferment of privileges of imposition of liabilities upon persons arbitrarily selected out of a large number of other persons similarly situate. The very idea of classification has an inherent implications of some inequality but that by itself, which is apparently unequal treatment, would not make a provision unconstitutional provided the classification is intelligible and has reasonable relation with the object- Special Courts Bill, 1978, In Re: The Special Courts Bill, 1978, . We are unable to agree with the contentions urged on behalf of the petitioners obviously for the following reasons. In the first place, we do not think that the classification which has been made is unintelligible. It would be profitable to set out a passage from the book, The External Audit-Concept and Techniques by Rodnev J. Anderson:

Auditing is the process of examining evidence regarding a report, statement or other assertion to determine its correspondence to established criteria. The audit

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of a set of financial statements investigates whether these statements reflect underlying business transactions following existing criteria for financial statement preparation. A tax auditor checks a tax return to determine whether it reflects the taxpayer''s tax liability in accordance with legislative rules. A Government auditor may audit a Government departmental report to see whether it properly records that department''s authorised activities in accordance with prescribed recording procedures. An internal auditor may examine operational evidence to determine whether the assertion by a corporate department that prescribed operating procedure have been followed is in accordance with the observed facts. A common thread runs through this wide variety of audits. There must be some report, statement or assertion presented by one party - presumably for use by a second part. There must be some established criteria, some yardstick or set of ground rules, known to all parties, as to how such report, statement or assertion is supposed to be prepared. There must be a third party, the auditor, who examines evidence and forms in objective opinion as to whether the report, statement or assertion indeed meets these criteria.

Each of these different types of audit (external, internal, governmental) fulfils a necessary and important social function....

47. The classical purpose of audit is two-fold-detection and prevention of frauds and detection and prevention of errors. However, with greater financial assistance being made available from financing agencies the present-day purpose has slightly shifted more to ascertaining actual financial conditions and earning of an enterprise rather than detection of fraud and errors. It has been observed in the above book as to how auditors were required to be associated with the task of tax audit in the context of the development of the rule of auditors in wake of imposition of the Federal income tax, 1913 in United States.

"At the turn of century, the balance sheet had been the pre-eminent statement as in the United Kingdom, and the auditor''s report emphasised it accordingly. Solvency, rather than earning power, was the principal characteristics portrayed by financial statements and conservative-valuation of assets were favoured. With the imposition of Federal income tax in 1913, a major new field for public accounts was created. Not only were accountants to be involved increamingly in the preparation of the returns and the provision of tax advice, but the taxability of income brought anew importance to the income statement. Gradually, over the ensuing years, emphasis began to shift to the fairness of presentation of income and earnings per share. Thus, by the 1930''s the auditor''s report of financial statements began to serve primarily the purpose of adding credibility to the statement assertions rather than providing evidence of absence of fraud."

48. It can hardly be contended that the non-chartered accountants section from amongst authorised representatives can discharge this special role envisaged of the auditors and for that matter the tax auditors since with respect the income tax practitioners as defined in rule 49 of the Rules comprise a bulk of non-chartered segment amongst authorised representatives class (sic.) are not

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qualified, trained and experienced as chartered accountants are. Auditing is a specialised function having complex legal, ethical, accountancy and other diverse technical economic implications. A number of social, economic and technological events have influenced auditing in the course of its development. The judicial view now clearly recognises the aspirations and expectations of the society from the chartered accountants for better quality of presentation and reporting of financial statements of business undertakings. The Courts are not only making it easier to sue auditors but are insisting upon established accounting principles and auditing standards. The duty to take care on the part of the auditors has been now well recognised in the context of their liabilities to their clients which in turn requires strict auditing procedure and redefinement of its role and scope of work- See Contemporary Auditing, Second edn., by Kamal Gupta, Joint Director (Studies), Institute of Chartered Accountants of India, New Delhi. Auditing is concerned with the verification and examination of accounting data and an auditor in this process collects and evaluates evidence to establish facts and to draw inferences and reach conclusions. It has been observed in the statement on Auditing Standards issued by the Committee on Auditing Producer of the American Institute of Certified Public Accounts, New York, that sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statement under examination- See p. 5 of the Statement of Auditing Standards. The standard connotes a degree of competence required for a particular purpose. The aforesaid Institute enumerates the following as the generally accepted auditing standards:

General Standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as auditor.

2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Fieldwork

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.

2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statement under examination.

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Standard of Reporting

1. The report shall state whether the financial statement are presented in accordance with the generally accepted accounting principles.

2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

3. Information disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor, should be stated. In all cases where an auditor''s name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor''s examination, if any, and the degree of responsibility he is taking.

It would be noticed that the first category of the standards lay down the personal standards of the auditors. These standards relate to an auditor''s training and proficiency, his independence in mental attitude as well as approach and his exercising due care in his work. These are ''indispensable conditions for the satisfactory attainment of the other standards''.

49. It is, therefore, clear that unless a person has adequate academic and practical training, proficiency and expertise in relation to what is known as auditing, it would be difficult for him to perform his role and adopt measures so as to reach the well-recognised standards in the profession. It is difficult for us to agree with the learned Advocate General for the petitioners that the general role which is envisaged for the authorised representatives which a non-chartered accountant can assume and perform would be sufficient for reaching and maintaining the standards required for an auditor and more so for a tax auditor. The norms and the distinctions which a person has to satisfy and achieve in course of the academic and practical training for being qualified as a chartered accountant go a long way in conferment of proficiency and expertise which a lay person cannot achieve by merely having practical knowledge of the principles of accountancy, and his experience gained in course of his acting as an income tax practitioner dealing with the financial documents and records of his clients. It is no doubt true that under rule 12A even the non-chartered accountants from amongst the various representatives have been permitted and, therefore, considered competent to report about the scope and result of their examination of accounts of the assessees while preparing the return of income, but we are afraid that this cannot, in our opinion, be considered sufficient to endow them with that academic knowledge, practical proficiency and expertise which a person acquires as a result of his intensive academic training and extensive field work before a person is qualified and enrolled as a chartered accountant. The purpose of the impugned provisions appears to be two-fold. It is not only to prevent tax

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evasion and tax avoidance but also to facilitate the ITO in completing his assessment. The certificate which a tax auditor has to furnish under rule 6G(1)(b) or 6G(i)(c) in Form Nos. 3CG and 3CG and the particulars to be furnished in his statement under the impugned rule 6G(2)(a) in Form No. 3CD require him to state whether the financial statements are presented in accordance with the generally accepted accounting principles and the information disclosed in the financial statement are reasonably adequate to give a true and fair view of the financial affairs of an assessee and the particulars given in the statement are true and correct according to the best of the information and explanation detained by him from the assessee concerned. We do not think, therefore, that the learned Advocate General for Gujarat appearing for the petitioners was justified in urging that the non-chartered accountants from amongst the authorised representatives would be competent to discharge this onerous responsibility cast upon the chartered accountants, having regard to expertise achieved as a result of their academic knowledge and practical experience. It should not be lost sight of that the chartered accountant by his very privileged status exposes himself to the consequences of civil liability for negligence, specific statutory liabilities such as misfeasance under the Companies Act, liability for professional misconduct in the disciplinary proceedings under the Chartered Accountants Act and sometimes to the criminal liabilities under the Indian Penal Code, 1860. It, therefore, cannot be said that the Parliament has by selecting chartered accountants from amongst various representatives to act as tax auditors given a preferential treatment to them vis-a-vis the other non-chartered accountants segment of authorised representatives. These two classes cannot be said to be similarly situated so as to make the classification unintelligible or for that matter a suspect classification without having reasonable nexus with the object of the Act.

50. The second limb of this contention that the sub-classification makes the main classification unintelligible appears to be attractive and, therefore, requires to be examined. It should be noted that when section 44AB inserted in 1984, the proviso, as it stood when the Finance Act, 1984 was put on the statute book, read as under:

Provided that in a case where such person is required by or under any other law to get his accounts audited by an accountant, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession audited under such law before the specified date and obtains before that date the report of the audit as required under such other law and a further report in the form prescribed under this section."

[Emphasis supplied]

51. ''Accountant'' according to the explanation is given the same meaning as in the Explanation below sub-section (2) of section 288. Under the Explanation in section 288, the word, ''accountant'' means a chartered accountant within the meaning of the Chartered Accountants Act, 1949, and includes in relation to any

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State, any person who by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, is entitled to be appointed to act as an auditor of companies registered in that State. This proviso was, however, amended by the Finance Act, 1985, by omitting the underlined words ''by an accountant'', with the result that the anomaly which would have arisen if it had not been amended was sought to be removed since otherwise the proviso would possibly have been redundant. The purpose of the proviso appears to be that the report of a special auditor auditing the affairs of a person required by or under any other law to get his accounts audited should be considered to be sufficient compliance of the main provision. One of the illustrative cases where this proviso would be applicable is the audit of co-operative societies under the Gujarat Co-operative Societies Act, 1961. Section 81 of the Gujarat Co-operative Societies Act enjoins the Registrar to get the accounts of every society at least once in a year audited or caused to be audited by persons possessing prescribed qualification and authorised by the Registrar by general or special order in writing in that behalf. Rule 38 of the Gujarat Co-operative Societies Rules prescribes qualifications of this special auditor. The said rule provides, inter alia, that a person who holds a Government diploma in co-operation and accountancy or has served as an auditor in the Co-operative Department of the State Government shall be qualified for being authorised by the Registrar to act as an auditor u/s 84(1). If the impugned proviso permits the co-operative society for purposes of tax audit to get its accounts audited by a non-chartered accountant and to produce his report in compliance with the obligation of compulsory audit under the impugned section, there is no justifying reason to deny that benefit to other non-operate assessees to get their accounts audited, by non-chartered accountant amongst authorised representatives. It was, therefore, urged that if this is permissible in case of certain categories of the assessees subjected to audit under a special Act to tender the report of special auditor who is a non-chartered accountant, by way of compliance with the compulsory tax audit provision, there is apparently no reason for denying that benefit to the non-chartered accountants amongst authorised representatives who are well-versed not only, in the matter of accounts but also from the angle of this requirement of the 1961 Act as compared with the special auditors who do not possess elementary knowledge about the different principles under income tax law. The contention is, therefore, that this sub-classification of special auditors makes the main classification unintelligible. The contention of the learned advocate general for Tamil Nadu appearing on behalf of the Union Government was that on the plain reading of this proviso though a specified category of the assessees subjected to audit under a special law is permitted to tender the report of special auditors, it does not absolve them from producing a further report containing the particulars prescribed under rule 6G(2) a in Form No. 3CD. A debate took place before us as to whether this interpretation canvassed on behalf of the Union Government was justified or not, and our attention was invited on behalf of the parties to the relevant forms, vis., rule 6G read with Form No. 3CA. However, in course of rejoinder, the learned advocate general of Gujarat pointed out that by the income

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tax (Sixth Amendment) Rules, 1985 dated 12-8-1985 in clause (a) of rule 6G(1) the words, ''by an accountant'' have been omitted (see Company Law Journal, Vol. 3, 1985 edn., Rules, Notifications and Circulars section, p. 30). Similarly in Form No. 3CA which is an audit report u/s 44AB in case where the accountants of a business of a person have been audited under any law by an accountant in the heading for the words, ''any law by an accountant'' were substituted by the words, ''any other law''. Similarly in paragraph 1 of the said Form the words ''chartered accountants/auditors of companies'' have been omitted. Similarly in the same Form for the words, "Signed Accountant. The words ''signed'' is substituted. The interpretation which was advanced by the learned advocate general for Tamil Nadu appearing for the Union Government is, therefore, negatived by the amendments which have been made by the income tax (Sixth Amendment) Rules, which have been brought into force retrospectively with effect from 1-4-1985. In other words, the effect of this amendment is that the report and the further report are to be furnished by a special auditor who is competent to audit under a special Act irrespective of the fact whether he is a chartered accountant or not. We do see some force in this limb of the contention. We are surprised as to how this income tax (Sixth Amendment) Rules escaped the attention of the learned advocate general for Tamil Nadu appearing for the Union Government. At the time of rejoinder, we drew the attention of the learned standing counsel for the Union Government in this Court, Mr. R.P. Bhatt, about this amendment which negatives the contention urged by the learned advocate general for Tamil Nadu in his reply. Shri Bhatt admitted that the income tax (Sixth Amendment) Rules had escaped the attention and, therefore, the argument was advanced by the learned advocate general for Tamil Nadu as he did. Apart from this inadvertent omission what we are trying to emphasise is that if the counsel representing the Union Government are not aware of this important amendment in the rules, we have merely to imagine the plight of the assessees in that behalf. The authorities should, therefore, when called upon to determine about the failure of the assessees to carry out the legal obligations in the matter of tax audit, determine the questions in proper perspective and not merely on the technical infractions of law. On merits of the contention what appears to us is that the amended proviso does not create a further sub-classification of special auditors as was sought to be urged on behalf of the petitioners; it is merely an enabling provision so as to save the category of the assessees like co-operative societies from being subject to audit under the statute by which it is governed and also to get its accounts again audited by the chartered accountant for purposes of satisfying the provisions of compulsory tax audit. The purpose appears to be, as has been rightly contended by Mr. G.N. Desai, the learned counsel appearing on behalf of the chartered accountants, that the provision is an enabling provision which saves the special categories of the assessees like co-operative societies from the burden of audit twice-over. This contention, however, was sought to be repelled, on behalf of the petitioners, by urging that inasmuch as this concerns a privilege of a class of the assessees it does create a further sub-classification which, if it is not intelligible and without

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any reasonable nexus, to the object, will render the impugned section violative of article 14. It is axiomatic that a reasonable classification is one which includes all who are similarly situate and none who are not. The crux of the problem in the first instance would, therefore, be that what is the meaning of the phrase ''similarly situate''. In Shri Ambica Mills Ltd.''s case (supra) Mathew, J., answered this question by stating that a reasonable classification is one which includes all persons who are similarly situate with respect to the purpose of law. The purpose of law as indicated by Mathew, J., may be either the elimination of a public mischief or the achievement some positive good. A classification becomes under classification when the State benefits or burdens persons in a manner that furthers a legitimate purpose but does not confer the same benefit or place the same burden on others who are similarly situated- Shre Ambica Mills Ltd.'' case (supra).

52. The next question, therefore, which would arise is whether the exclusion of non-chartered accountants from amongst the authorised representatives from the privilege of being entitled to carry out the tax audit or for that matter entailing burden of tax audit on the assessees through chartered accountants while permitting special category of the assessees to have special audit is sufficient compliance, makes the classification inclusive. In order, therefore, to determine whether the chartered accountants can be said to be similarly situate as the non-chartered accountants, we have to look to the purpose of the impugned provisions. The purpose of the impugned provisions as pointed out by the Finance Minister in the Budget Speech is to safeguard against the tax avoidance and tax evasion and also to facilitate the assessment of tax. It is no doubt true that the chartered accountants and non-chartered accountants have been clubbed together in the class of authorised representatives. Broadly stated the function of the authorised representatives is to attend and act on behalf of the assessees who are entitled or required to attend before any income tax authority or Tribunal in connection with any proceedings under the Act, except where personal attendance of an assessee is necessary as required u/s 131 of the Act. The privilege conferred on the authorised representatives u/s 288 and the privilege conferred on the chartered accountants for tax audit do not operate in the same field. The purpose of section 288, as observed above, is to enable an assessee to appear and act through his authorised representative except where his personal attendance is obligatory while the purpose of the impugned provision is not only to facilitate the assessment but to safeguard against tax avoidance and tax evasion. In our opinion, therefore, it is difficult to successfully contend that the different persons specified in section 288(2) to be entitled to be authorised representative makes those persons similarly situate for the purpose of tax audit provided under the impugned provisions. The purposes of both these provisions are different and if in course of acting in pursuance of the respective privilege some work is of similar nature for the authorised representatives and tax auditors that fact would not by itself make them similarly situate persons with regard to the other work. The second limb of the contention urged on behalf

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of the petitioners that a sub-classification of special auditors make the main classification unintelligible though appears to be attractive is on close scrutiny cannot be sustained. The main classification, in view of the sub-classification, might appear at the first blush, to be unreasonable inasmuch as there is no reasonable nexus between the sub-classification of special auditors and the object of the impugned statute. In this context it is worthwhile to remind ourselves at the cost of repetition of the following observation of Mathew, J. in Shri Ambica Mills Ltd.''s case (supra). The Court was considering in that case as to whether exclusion of an establishment carrying on business or trade and employing less than 50 persons makes the classification inclusive when it is seen that all factories employing 10 or 20 persons, as the case may be, have been included and that the purpose of the law is to get in unpaid accumulations for the welfare of the labour. Mathew, J. recognising this as apparent discrimination negatived the challenge on the following grounds:

55. ...Since the classification does not include all who are similarly situated with respect to the purpose of the law, the classification might appear, at first blush, to be unreasonable. But the Court has recognised the very real difficulties under which Legislatures operate-difficulties arising out of both the nature of the legislative process and of the society which legislation attempts perennially to re-shape-and it has refused to strike down indiscriminately all legislation employing classificatory inequality here under consideration. Mr. Justice Holmes, in urging tolerance of under-inclusive classifications, stated that such legislation should not be disturbed by the Court unless it can clearly see that there is no fair reason for the law which would not require with equal force its extension to those whom it leaves untouched. See, Missouri K. and T. Rly. v. May [1903] 194 US 267 at p. 269. What, then, are the fair reasons, for non-extension? What should a Court do when it is faced with a law making an under-inclusive classification in areas relating to economics and tax matters? Should it, by its judgment, force the Legislature to choose between inaction or perfection?

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64. The question whether under article 14, a classification is reasonable or unreasonable must, in the ultimate analysis, depend upon the judicial approach to the problem. The great divide in this area lies in the difference between emphasising the actualities or the abstractions of legislation. The more complicated society becomes, the greater the diversity of its problems and the more does legislation direct itself to the diversities.

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66. In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restrain if not judicial difference to legislative judgment...."

[Emphasis supplied] (p. 1313)

53. If, therefore, the Parliament in its legislative wisdom has thought fit to

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extend the special privilege, if there is any, of being entitled to carry out tax audit to special auditors who are recognised under a special law to be auditors for a category of the assessees, we do not think that we would be justified in treating this impugned provision as violative of article 14 since in our opinion there is a fair reason for granting this preferential treatment to the special categories of the assessees who are required under the special law to get their accounts audited as per example co-operative societies under the relevant Co operative Societies Act since otherwise these welfare agencies would be subjected to the burden of audit twice over - one being commercial audit and another being tax audit. It cannot be said that there is no fair reason underlying the proviso for giving preferential treatment to specified category of the assessees. This apparent preferential treatment does not militate against the rule of equality enshrined under article 14. The non corporate assessees who are not required to get their accounts audited under any law cannot, therefore, press this proviso in support of their plea of under classification, because the Parliament having recognised that these welfare agencies constituted under the special Act subjecting them to commercial audit thought it fit to exclude them from the obligation of the tax audit by the chartered accountants and to treat the report of the special auditor as sufficient compliance with the obligation under the impugned section we do not think that it can be said that there is no fair reason for the apparent under classification. We are, therefore, unable to agree with the two-fold contentions urged by the learned Advocate-General of Gujarat appearing for the petitioners.

54. Contention No. 4:

We do not think that this contention should detain us any more. It has been urged on behalf of the assessees as well as the income tax practitioners who are the respective petitioners in these two petitions before us that the impugned provisions are violative of article 19 of the Constitution inasmuch as they amount to the interference with the rights of the assessees to select their authorised representatives and that they virtually create a situation where the assessees subject to tax audit would not have option to be represented by non-chartered accountants, and, therefore, constitute an unreasonable restriction on their fundamental right to trade. On behalf of the income tax practitioners it has been urged that the inevitable effect of the impugned provisions would be to deprive the non-chartered accountants segment of the authorised representatives of their right to represent the assessees whom they may be hitherto representing before the income tax authorities and would, in future, deny them virtually the right to appear in case of those assessees subject to tax audit since there would be no option left to them but to nominate their tax auditor to represent their cases before the tax authorities. We have not been able to appreciate this contention. There is no restriction on the right of the assessees to select their own authorised representatives whomever they like whether the same chartered accountants who have carried out the tax audit or other chartered accountants or other income tax practitioners. If this is the situation, which in our opinion is, we

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do not think that the non-chartered accountants authorised representatives would be denied the right to represent the case of the assessees subject to tax audit. It may be true that the assessees subject to tax audit appearing through tax practitioners other than chartered accountants would expose themselves to more expenses. It is possible to conceive that the ill-informed assessees who are subject to tax audit may like to appear only through their tax auditors thinking it to be wise course in their own interest. These impugned provisions, however, in our opinion, do not lead to inevitable consequence as sought to be urged on behalf of the petitioners before us in both these petitions that this will deprive the assessees of their causes being represented by non-chartered accountants to represent the case of such assessees. In the present state of income tax law, the interpretation and development of which has become very intricate and complex, it is not difficult to anticipate that a situation has arisen where more and more assessees would like to be assisted both by the chartered accountants as well the income tax consultants and practitioners who may be non-chartered accountants in arranging their financial affairs and the maintenance of their accounts, records and documents for preparation of the returns and in course of assessment before tax authorities. We are afraid that the contention advanced about the provision being violative of article 19(1)(g) is too spacious to which we can adhere to. The obligation of the tax audit can hardly be assailed on the ground that it constitutes an unreasonable restriction particularly when the provision has been inserted in the statute as indicated by the Finance Minister in his budget speech for the purpose of safeguarding tax evasion and tax avoidance. In our opinion it is a measure which is in the public interest and we do not think that it can be said to be so unreasonable. The guidelines to determine the question of reasonableness of restriction in public interest on a fundamental right under article 19 has been laid down by the seven Judges'' Bench in Pathumma''s case (supra). The Court has to bear in mind (i) the directive principles of Stats Policy; (ii) that the restrictions must not be arbitrary or of an excessive nature so as to go beyond the requirement of the interest of general public; (iii) that there is no straight-jacket formula capable of universal application and it may vary from case to case; (iv) a just balance has to be struck between the restriction imposed and the social control envisaged by article 19(6); (v) the prevailing social values whose needs are to be satisfied; (vi) the legislative point of view and the objective sought to be achieved, and (vii) whether the restriction imposed on the rights of the citizens fulfils or frustrates the objectives of the statute. The object of the impugned provision is to safeguard against tax evasion and tax avoidance which will ensure that the economic system does not result in concentration of wealth to the common detriment. It, therefore, fulfils the directive principles laid down under article 39(e) of the Constitution. It is not capable of being urged successfully that the obligation of compulsory tax audit prescribed for the assessees exceeding the prescribed limit of turnover, sales or gross receipts which are fairly high can be said to be of arbitrary or excessive nature so as to go beyond the requirement of the interest of general public in a country where the majority of people live below poverty line. We do not think that since the

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method prescribed for the purposes of tax audit is not full proof the object of the impugned statute would be frustrated. The report which an auditor has to submit containing the statement of particulars as prescribed under rule 6G(2)(a) in Form No 3CD would certainly advance the purpose of the statute. Nothing has been pointed out to us that the prescribed method of tax audit would frustrate the purpose.

55. The contention was urged that the impugned provisions would not really achieve the purpose since unless the measures are adopted as pointed out in the dissenting note of Rangnekar, a member of the Wanchoo Committee, the purpose of curbing the tax avoidance and tax evasion would not be fulfilled. We do see some force in this contention. But we do not think that the possibility of the provisions being not adequate in the direction can be tantamount to saying that no purpose would be achieved or it would be frustrated. It is possible that the purpose may not be wholly achieved. In that view of the matter, there fore, we must reject this contention.

56. Contention No. 1:

On behalf of the petitioners, it has been urged that the impugned rules and forms are ultra vires the impugned section 44AB, inasmuch as the obligations and functions prescribed for the chartered accountants are beyond the obligations and functions associated with the auditors in the section (sic) enjoins audit for a prescribed category of the assessees. We are not inclined to agree with this submission obviously for two reasons. Firstly, the term ''audit'' cannot be construed in a narrow and restricted meaning as the scope of auditing has been expanded in the last few decades. It is not necessary to elaborate this point. Suffice it for our purposes to quote the following passage from the book, Contemporary Auditing by Kamal Gupta under the caption ''Extension in the scope of Auditing'':

"Developments in the last two decades have extended the scope of auditing. Therefore, a more comprehensive definition of auditing given by Schlosser may also be considered. According to him, auditing is a ''systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies or stated requirements''. The earlier definition of auditing by Mautz emphasises the verification of accounting statements. While retaining that emphasis, Schlosser''s definition extends the scope of auditing by including in it an examination of allied operations. Similarly the purpose of auditing has been extended to cover adherence of financial statements and allied operations to ''management policies'' or ''stated requirements''. Thus, whereas the previous definition also covers cost audit, internal audit, governmental audit, management audit, operations audit and the like." (p. 10)

57. Secondly, the Parliament has provided in the impugned section that the prescribed categories of the assessees would get their accounts audited by an

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accountant and obtain a report for such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed. In other words, the Parliament has extended the scope of the work of auditor for purposes of the tax audit. The Karnataka High Court in T.S. Natraj Vs. Union of India and Others, has elaborated at great length on this point while negativing similar contention and we are in respectful agreement with what has been observed by the Division Bench of the Karnataka High Court in the said case. The contention, therefore, stands rejected.

58. Contention No. 2:

We do not think that contention is well founded since it is ultimately the ITO who has to decide about the taxability of the income and admissibility of the expenses, and the auditor''s report or certificate even if prejudicial to the assessee cannot preclude him from pleading that the auditor''s opinion was not well founded or legally correct. As a matter of fact, in the reply affidavit filed on behalf of the Union Government, it has been clearly conceded that auditor''s report or certificate if prejudicial to the assessee would not stop the assessee concerned from doubting the correctness of it and it will not be binding in the sense that he would be estopped or precluded from pleading against it. The contention, therefore, stands rejected.

59. No other contentions have been urged.

60. The result is that these two petitions fail and are dismissed subject to our observations in course of dealing with the various contentions. Rule in each of these two petitions is discharged with no order as to costs.

61. Mr. J.M. Thakore, the learned advocate General with Mr. K.H. Kaji, the learned advocate for the petitioners of Special Civil Application No. 2068 of 1985 and Mr. K.H. Kaji, the learned Advocate for the petitioners of Special Civil Application No. 2069 of 1985, make oral applications for a certificate for leave to appeal to the Supreme Court under article 133(1) read with article 134A of the Constitution. The learned standing counsel for the Union Government as well as the learned counsel appearing for chartered accountants submitted that neither of the conditions mentioned in article 133(1)(a) and (b) is satisfied, and in any case the condition about the need of the question being decided by the Supreme Court does not arise for the reason that as many as three other High Courts have taken a similar view. Having given consideration to the submission of the learned counsel for the Union Government as well as the chartered accountants, we are of the opinion that the case involves substantial questions of law of general importance and that, in our opinion, the questions raised in these petitions need to be decided by the Supreme Court. In that view of the matter, the certificate as required under article 134A is granted.

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