

(1979) 10 AHC CK 0026

In the Allahabad High Court

Case No : Civil Miscellaneous Writ Petition No"s. 685, 691 to 703, 707 to 715, 749, 759, 825 and 826 of 1975

Seth Satish Kumar Modi

APPELLANT

Vs

Wealth-tax Officer

RESPONDENT

Date of Decision : 19-10-1979

Acts Referred:

Wealth Tax Act, 1957 — Section 17

Wealth Tax Rules, 1957 — Rule 1D, 2, 2(1)

Citation : (1980) 15 CTR 340 : (1983) 139 ITR 373 : (1980) 4 TAXMAN 463

Hon'ble Judges : R.R. Rastogi, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : Debi Pal, A. Gupta and Sudhir Chandra, for the Appellant; R.K. Gulati and R.S. Dhawan, for the Respondent

Judgement

C.S.P. Singh, J.—The petitioner, who was a partner in the firm, M/s. Synfibre Sales Corporation, filed his wealth-tax return for the assessment year 1970-71, disclosing his net wealth at Rs. 2,21,653.58. The net wealth shown included an amount of Rs. 42,209.26, deposited in current account with M/s. Synfibre Sales Corporation, and an amount of Rs. 4,500, which represented the investment of the petitioner in the firm. The WTO assessed the petitioner in a net wealth of Rs. 2,38,227. In doing so, he added an amount of Rs. 16,573 to the returned wealth on account of the difference between the value of certain shares as returned and as calculated by him. The value of the petitioner's interest in the firm of M/s. Synfibre Sales Corporation appears to have been accepted by the WTO. Subsequently, a notice was issued u/s 17 of the Act stating that the WTO had reason to believe that the net wealth of the assessee for the assessment year in question had escaped assessment, and calling upon the assessee to file a return within five days of the receipt of the notice. The petitioner sent a reply to this notice objecting to the reopening of the assessment and requesting that the material on the basis of which the proceedings u/s 17 of the Act were being started be supplied. It is alleged that no reply was received to this letter, and,

subsequently, the present petition was filed challenging the notice u/s 17, and a prayer has been made for the issue of a writ of prohibition, restraining the WTO from taking further proceedings consequent to the notice.

2. The assessment file of the petitioner was produced in court, as there was a dispute as to whether action has been taken u/s 17(1)(a) or Section 17(1)(b) and also in regard to the reasons for initiating the proceedings. We have looked into the file, and it is clear that on November 22, 1974, the WTO, Central Circle III, Meerut, passed two orders stating the reasons for initiating proceedings u/s 17. The first order purports to have been passed u/s 17(1)(a). The second order, which has been filed as annex. 1 to the supplementary affidavit filed by Sri S. C. Jain, ITO, Central Circle II, Meerut, does not mention any specific clause of Section 17 and relates to the assessment years 1970-71, 1971-72 and 1972-73. It is necessary to mention here that the order purporting to have been passed u/s 17(1)(a), was not a composite order for all the three years, but the reason has been recorded separately for each year. Considerable argument was advanced before us on the jurisdiction of the WTO to convert the proceedings started u/s 17(1)(a) into proceedings u/s 17(1)(b) and our attention was also drawn to the genuineness of the second order stating the reason for initiating proceedings u/s 17 of the Act. On the view we propose to take, it is not necessary to resolve this controversy. The order on which the Department relied, and which records the reason for initiating proceedings u/s 17 of the Act, runs as under :

" Reasons for initiating action u/s 17 for the assessment years 1970-71, 1971-72 and 1972-73.

Name of assessee :

The assessee was a partner in M/s. Synfibre Sales Corporation on the valuation date 21-3-1970/71-72 having 4.5%, 6% 6% shares therein respectively. As a result of enquiries made by me from M/s. Indofil Chemicals Ltd. and Synfibre Sales Corporation, by calling for their relevant balance-sheets, I have come to know that M/s. Synfibre Sales Corporation, amongst others, owned 17,000 shares of M/s. Indofil Chemicals Ltd. which were acquired at cost price of Rs. 13,60,000. The face value of each share was Rs. 100 and the paid up value of each share was Rs. 80. These shares were not quoted at the stock exchanges. The market value of these shares was thus to be computed in accordance with Rule 1D of the W.T. Rules, 1957. The market value of such share in accordance with the aforesaid rule was Rs. 97.13 on 31-3-70, Rs. 121.81 on 31-3-71 and Rs. 177.82 on 31-3-72. The assessee had disclosed his interest in the firm at Rs. 46,709 for A.Y. 1970-71, Rs. 43,159 for A.Y. 1971-72 and Rs. 21,568 for A.Y. 1972-73 only and in the absence of the above information at the time of the making the assessment, the same was accepted to be correct. Thus, the value of interest in the firm, M/s. Synfibre Sales Corporation, was under-assessed to the extent of Rs. 13,104 for A.Y. 1970-71, Rs. 42,647 for A.Y. 1971-72 and Rs. 99,777 for A.Y. 1972-73. Further, the assessee did not file a copy of the firm's balance-sheet, either along with the returns or in the course of the aforesaid

assessment proceedings, nor did he disclose the aforesaid facts which have now come to light which were material and necessary for the purpose of correct assessment of the value of the assessee's interest in the firm, M/s. Synfibre Sales Corporation. Thus, in consequence of information which has come into my possession, I have reason to believe that the assessee's wealth, chargeable to tax, had been under-assessed and also that the under-assessment was due to the assessee's omission to disclose fully and truly the aforesaid material facts necessary for assessment of wealth for the above mentioned years. In view of these facts, action is necessary u/s 17 for the A.Ys. 1970-71, 1971-72 and 1972-73.

(For information see valuation file of shares with the WTO).

Sd. G.N. Srivastava, Wealth-tax Officer, Central Circle, III, Meerut. Dated 22-11-1974."

3. A perusal of this order indicates that the assessment was being reopened on the ground that the value of the shares of M/s. Indofil Chemicals Ltd., which were held by M/s. Synfibre Sales Corporation, was calculated at their cost price, as shown in the firm's book, and not in accordance with Rule 1D of the W.T. Rules. Further, the assessee had not filed copies of firm's balance-sheets along with the returns in the assessment proceedings nor disclosed the fact that M/s. Synfibre Sales Corporation, of which he was a partner, owned 17,000 shares of M/s. Indofil Chemicals Ltd. It was for these reasons that the WTO issued notice u/s 17. There is no dispute that assessment has been reopened on the ground that the value of the shares of M/s. Indofil Chemicals Ltd., if calculated in accordance with Rule 1D, will exceed their cost price, and the excess according to the WTO was Rs. 13,104 for the assessment year 1970-71, Rs. 42,647 for the assessment year 1971-72 and Rs. 99,777 for the assessment year 1972-73.

4. Counsel for the assessee urged that the petitioner had correctly valued his interest in the firm as he had shown his interest in the firm on the basis of the firm's books. It was urged that so far as the valuation of shares is concerned, they are valued at their cost price in accordance with settled principles of valuation and the petitioner having based the valuation of his interest in M/s. Synfibre Sales Corporation on this basis, there is no error in the valuation given by him in respect of his interest in the firm. It was also urged that the WTO never required of the assessee to file the balance-sheets of the firm, and, in any event, the balance-sheet was available with the WTO as he was the same officer who was making assessment of the firm, M/s. Synfibre Sales Corporation. It was also urged that the assessee had disclosed all the primary facts necessary for the assessment, and there was no omission on his part to disclose fully and truly all material facts, as alleged by the WTO, and as such the notice u/s 17 of the Act is invalid.

5. Sri R. K. Gulati, appearing on behalf of the Department, has urged that the shares held by M/s Synfibre Sales Corporation in M/s. Indofil Chemicals Ltd. had

to be evaluated in accordance with Rule 1D and as the shares had been valued according to the cost price, the returns filed by the assessee, as regards the interest in M/s. Synfibre Sales Corporation, was incorrect, and as a result thereof a part of the net wealth of the assessee had escaped assessment. He also contended that the balance-sheet of the firm was a primary document which should have been filed by the assessee along with his returns, in order that the WTO may be in a position to decide the correct evaluation of the assessee's interest in the firm, and, in the absence of the balance-sheet, the assessee could be said to have failed to disclose all material facts necessary for assessment. The case, according to him, was clearly covered by Section 17(1)(a). In any event, it was argued that it will fall u/s 17(1)(b), for, the WTO came to know of the fact that M/s. Synfibre Sales Corporation owned 17,000 shares in M/s. Indofil Chemicals Ltd., and that these shares were valued at their cost price, and not in accordance with Rule 1D, only on an enquiry made from M/s. Synfibre Sales Corporation, and a perusal of the balance-sheet of these two concerns.

6. Section 17(1)(a) and (b) are in pari materia with Section 34 of the Indian I.T. Act, 1922. Section 17(1)(a) and (b) of the WT Act are in the following terms:

" 17. (1) If the Wealth-tax Officer-

(a) has reason to believe that by reason of the omission or failure on the part of any person to make a return u/s 14 of his net wealth or the net wealth of any other person in respect of which he is assessable under this Act for any assessment year or to disclose fully and truly all material facts necessary for assessment of his net wealth or the net wealth of such other person for that year, the net wealth chargeable to tax has escaped assessment for that year, whether by reason of under-assessment or assessment at too low a rate or otherwise ; or

(b) has, in consequence of any information in his possession, reason to believe, notwithstanding that there has been no such omission or failure as is referred to in Clause (a) that the net wealth chargeable to tax has escaped assessment for any year, whether by. reason of under-assessment or assessment at too low a rate or otherwise;

he may, in cases falling under Clause (a) at any time within eight years and in cases falling under Clause (b) at any time within four years of the end of that assessment year, serve on such person a notice containing all or any of the requirements which may be included in a notice under Sub-section (2) of Section 14, and may proceed to assess or reassess such net wealth, and the provisions of this Act shall, so far as may be, apply as if the notice had issued under that sub-section."

7. However, before either Section 17(1)(a) or 17(1)(b) can come into play, there must be an escapement from tax of the net wealth, for, till then, the WTO has no jurisdiction to act under these provisions. The belief of the WTO that the net wealth had escaped assessment must be a reasonable one, founded on some

objective facts set out in Clauses (a) and (b). Mere fanciful belief that the net wealth has escaped assessment, which has no basis in law, will not justify action u/s 17 of the Act. (See The Commissioner of Sales Tax, U.P. Vs. Bhagwan Industries (P) Ltd., Lucknow, . In this context, Mr. Gulati, appearing on behalf of the Department, drew our attention to the following observation of the Supreme Court in Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, :

" To commence the proceedings for reassessment it is not necessary that on the materials which came to the notice of the Income Tax Officer, the previous order of assessment was vitiated by some error of fact or law."

8. On the strength of these observations, it was urged that at the initial stage it is not necessary that the earlier assessment order should be demonstrated to be patently erroneous, for all that is necessary is that the ITO should entertain the belief that the net wealth chargeable to tax has escaped assessment. In view of the recent decision of the Supreme Court in the case of Commissioner of Income Tax, West Bengal-1, Calcutta Vs. Simon Carves Limited, , these observations must be read with a rider. In Simon's case, their Lordships of the Supreme Court observed as under (p. 219):

" The order made by the Income Tax Officer at the time of the original assessment was a legally correct order and was not vitiated by any error. The absence of an error in that order would justify the inference that the present is not a case of income escaping assessment. There is necessarily an element of error in cases of income escaping assessment mentioned in Section 147(b) of the Act of 1961. Such error resulting in income escaping assessment becomes manifest in the light of information coming subsequently into the possession of the Income Tax Officer."

9. Thus, if the earlier order is legally correct, the WTO could not initiate proceedings u/s 17 of the Act, for, if he does so, it can be said that the belief formed by him is not a reasonable one.

10. As has been noticed earlier, the proceeding u/s 17 has been initiated solely on the ground that the shares of M/s. Indofil Chemicals Ltd. had to be evaluated by reference to Rule 1D and not at their cost price, as has been done by M/s. Synfibre Sales Corporation of which the assessee was a partner. In order to examine the correctness of this view, it is necessary to refer to Section 4(1)(b) and Rule 2(1) of the Rules. Section 4(1)(b) is to the following effect:

"4. (1) In computing the net wealth of an individual there shall be included, as belonging to that individual--.....

(b) where the assessee is a partner in a firm or a member of an association of persons (not being a co-operative housing society), the value of his interest in the firm or association determined in the prescribed manner."

11. Thus, the interest of a partner in the firm has to be determined as laid down in the rules. Rule 2 of the rules sets out the method of calculating the net wealth

of the firm. Rule 2(1) of the rules runs as under:

"2. (1) The value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member, shall be determined in the manner provided herein. The net wealth of the firm or the association on the valuation date shall first be determined. That portion of the net wealth of the firm or association as is equal to the amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them. The residue of the net wealth of the firm or association shall be allocated among the partners or members in accordance with the agreement of partnership or association for the distribution of assets in the event of dissolution of the firm or association, or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share profits. The sum total of the amounts so allocated to a partner or member shall be treated as the value of the interest of that partner or member in the firm or association."

12. This rule lays down that to begin with the net wealth of the firm should be calculated, and thereafter the interest of the partners worked out as set out therein. Neither the Act nor the Rules lay down any particular procedure for calculation of the net wealth of a firm. This court, however, has considered the matter in two cases, Commissioner of Wealth Tax Vs. Padampat Singhania, and Commissioner of Wealth Tax Vs. Laxmipat Singhania, . In Padampat Singhania's case, the assessee, as karta of a Hindu undivided family, had 1/3rd share in a partnership firm and his interest in the firm had to be calculated for purposes of computing his net wealth. In computing the net wealth of the firm, the ITO ignored the arrears of Income Tax due against the firm, in view of Section 2(m) of the W T. Act. It was held that as the net wealth of the firm was being determined and not of the assessee, the provisions of Section 2(m) of the Act could not be relied upon for excluding the Income Tax liabilities. It was also laid down that the net wealth of a firm had to be calculated under Rule 2 in accordance with commercial principles, and the special provision in the Act for the computation of net wealth cannot be applied for purposes of computing the net wealth of a firm under Rule 2. Same is the position in the other case. In Advanced Accountancy by Batliboi, it has been stated on page 574, that fixed assets are to be valued at cost. There is nothing on the record in the case, that the firm, while preparing its balance-sheet, did not value the shares held by it in M/s. Indofil Chemicals Ltd. on this basis. Thus, the firm had valued its shares in accordance with the settled principles of accountancy, as prevailing in commercial circles. Rule 1D is a special rule for calculating the market value of unquoted shares of a company. However, inasmuch as Rule 2 does not require the net wealth of a firm to be calculated as laid down in the Act or the Rules, the market value of the shares could not have been calculated in accordance with Rule 1D. The shares had to be valued at their cost price in accordance with settled commercial principles. This being so, the firm could value the shares in M/s. Indofil Chemicals Ltd. at their cost price. The assessee had shown the value of

his interest in the firm on the basis of the valuation adopted by the firm, which was based on the commercial method of accountancy. The only ground given by the WTO for forming the belief that net wealth had escaped assessment is that the valuation of the shares of M/s. Indofil Chemicals Ltd. held by the firm, of which the assessee was a partner, had not been calculated in accordance with Rule 1D, with the result that they have been undervalued. But on the view expressed earlier that the net wealth of the firm has to be calculated not in accordance with the Act or Rules, but on the principles of commercial accountancy, the belief which the WTO entertained that the net wealth has escaped assessment was based on no relevant material and was arbitrary, as the shares had been correctly valued and the earlier order determining the valuation of the assessee's interest in the firm was correct. The notice as such has to be quashed. On this view, it is not necessary to consider the other contentions raised on behalf of the assessee and the Department.

13. The petition is, accordingly, allowed. The notice issued u/s 17 of the Act is quashed, and the respondent is restrained from taking proceedings against the petitioner in pursuance of the notice. The petitioner is entitled to his costs.

14. The judgment shall govern Misc. Writ Petition Nos. 691 to 703 of 1975, 707 to 715 of 1975, 749 and 759 of 1975 and 825 to 826 of 1975.