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IN THE HIGH COURT OF DELHI AT NEW DELHI
Writ Petition (Civil) No. 6966/2007

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Reserved on: 9th July, 2013
Date of Decision: 22nd August, 2013

G.S. ENGINEERING & CONSTRUCTION CORPORATIONPetitioner
Through Mr.Salil Kapur with Mr. Vikas Jain,
Advocates.

Versus

DEPUTY DIRECTOR OF INCOME TAX CIRCLE 1(2)
INTL. TAXATION, NEW DELHI & ORS. ...Respondents
Through Mr. Sanjeev Sabharwal, Sr. Standing
Counsel with Mr. Puneet Gupta,
Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J.

G.S. Engineering & Construction Corporation (formally known as LG Engineering & Construction Corporation) by this writ petition challenges validity of the reassessment notice dated 29th March, 2007 for assessment year 2002-03, which was issued under Section 148 read with Section 147 of the Income Tax Act, 1961 (the Act, for short). As the objections filed by the petitioner to the reassessment notice stand dismissed vide order dated 23rd August, 2007, the said order is also impugned.

2. The undisputed factual position is that for the assessment year 2002-03, the petitioner had filed their return on 31st October, 2002, declaring income of Rs. 2,14,07,600/- which was made subject matter

of regular assessment order, dated 18th March, 2005, under Section 143(3) of the Act. The assessment order records that the petitioner, a non-resident foreign company incorporated in Korea, was engaged in business of execution of construction contracts. At the time, the petitioner Company had five different contracts or projects in India and, in respect of two projects namely Catalytic Dewaxing Project, Haldia, West Bengal and NH2 Project, Bihar, details of expenses incurred were filed. During the course of assessment proceedings, on 4th February, 2005, the assessee filed revised computation of income, enhancing the declared income by Rs.1,73,51,761. The income was recomputed at Rs.4,36,52,621/-.

3. Before we dwell into the contentions, at this juncture it is necessitated that a clarification should be made. Notice under Section 148 of the Act enclosed with the writ petition is dated 29th March, 2007, whereas along with the affidavit filed on 21st April, 2012, the respondents have enclosed the reassessment notice dated 24th March, 2007. Both notices relate to the assessment year 2002-03. However, there is one difference between the two notices. Notice dated 29th March, 2007 is addressed to the petitioner c/o S.R. Batliboi & Co., 2nd Floor, The Capital Court, LSC Phase III, Olof Palma Marg, Munirka, New Delhi, but notice dated 24th March, 2007 has been addressed to the petitioner at 1st Floor, Building No. 9, D Block, LSC 2, Poorvi Marg, Vasant Vihar, New Delhi. In view of the aforesaid, we accept the stand of the Revenue that reassessment notice dated 24th March, 2007 is the relevant notice as it was first in point of time. The second notice, dated

29th March, 2009, was issued as a matter of abundant caution and to ensure service.

4. The first contention before us is regarding the reasons or grounds recorded by the Assessing Officer before issue of notice. The dispute in this regard is largely attributable to the reply filed by the respondents and a product of the confusion created for which they themselves (i.e. the respondents) are to be blamed. On 28th May, 2007, Ms. Nishtha Tiwari, Asstt. Director of Income Tax, Circle 1(2), International Taxation, New Delhi, communicated "Reasons to believe" to the petitioner which read as under:-

**"M/S LG Engineering and Construction Corporation A
Y 02-03**

The assessee has filed Return of Income declaring income of Rs.2,14,07,600/- on 31.10.2002, further, filing revised return on 8.3.04 declaring income at Rs.2,00,24,920/-. The case was taken into scrutiny by issuing notice u/s 143(2) of the Income Tax Act, 1961. The assessee filed the revised computation of the income on 04.02.2005 declaring income at Rs.2,63,00,860/-. The assessment was completed on 18.03.05 at the assessed income of Rs.4,36,52,621/-.

The assessee is a non-resident foreign company incorporated in Korea and is engaged in the business of execution of construction contracts. During the assessment year under consideration, the assessee has undertaken the following projects:-

NH-I project Haryana, Catalytic Dewaxing Project Kolkata, WH2 Project Bihar, AV2 project & SM Project.

LG Engineering & Construction was awarded a contract by Indian Oil Corporation which entails supply, installation & commissioning of catalysis Dewaxing Project in its refinery at Holdia in West Bengal.

The assessee was awarded a Turnkey Project (Catalytic Dewaxing Unit) at Haldia Refinery by Indian Oil Corp. in September 2000. The project involved Basic and detailed Engineering Construction, Installation, Testing Commissioning and total project management to be completed in 18 months. Total amount of project was (US Dollar 11,595,000) Rs.13488.701 Lakhs, which included Rs.605.34 lakh (US Dollar 11,50,000) for Design and detailed Engineering. Out of this (US Dollar 11,50,000) for Engineering Consultancy an amount of Rs.436.53 lakh was offered to tax @ 15% as offshore consultancy by assessee during the AY 2002-03. However the CDU project through which assessee had earned this income is a permanent establishment as per Article 5(3) of DTAA between India Korea.

Considering the above, it is evident that income chargeable to tax has escaped assessment.”

5. Ms. Nishtha Tiwari, was not the Assessing Officer and had not recorded reasons for reopening before issuing notice. The petitioner contends that no reasons were recorded by the Assessing Officer before the re-opening. The Revenue’s contention is that Ms. Nishtha Tiwari had not recorded “reasons to believe” but had merely communicated the reasons recorded earlier, under her signature appended on letter dated 28th May, 2007.

6. In these circumstances, the respondents were directed to produce the original records. The order dated 6th March, 2012 passed in the present writ petition reads:

“Standing Counsel has produced original assessment records before us. The “reasons for reopening” have been recorded by Ms. Nishtha Tiwari who has signed the same but has not ascribed or written the date on which she written or signed the same. There is a letter of Deputy Director of Income tax dated 19th

March, 2007 to the Additional Director of Income Tax soliciting his approval under Section 151 of the Act. This letter refers to reopening in the case of the petitioner, in addition to other cases. We may notice that this letter is issued by Vijay Kumar Chadha, Deputy Director of Income Tax, Circle 1(2), International Taxation, New Delhi. Ms. Nishtha Tiwari was the Assistant Director of Income Tax, Circle 1(2), International Taxation, New Delhi.”

The respondents were asked to clarify the confusion and state the true position.

7. Pursuant to the order dated 6th March, 2012, an affidavit sworn by Amit Kumar Jain, Assistant Director of Income Tax, Circle 1(2), International Taxation was filed on 21st April, 2012. The said officer on oath has stated that reason to believe or satisfaction was recorded prior to 19th March, 2007 and was forwarded to Additional Director of Income Tax Range – I (International Taxation), New Delhi under cover of letter No. DDIT/CIR-1(2)/International Taxation/2006-07/180. The said letter mentions that records, with separate reasons, were enclosed. Approval was received from the office of the Additional Director, Range-I vide letter dated 23rd March, 2007. This letter dated 23rd March, 2007 mentions that administrative approval stands granted in the case of L G Engineering & Construction. Thereafter, Mr. Vijay Kumar Chadha, Deputy Director, Income tax, Circle 1(2), International Taxation, New Delhi had issued notice after recording in the order sheet:-

“M/s LG Engineering and Construction Corporation A
Y 02-03

The assessee has filed Return of Income declaring income of Rs.2,14,07,600/- on 31.10.2002,

further, filing revised return on 8.3.04 declaring income at Rs.2,00,24,920/-. The case was taken into scrutiny by issuing notice u/s 143(2) of the Income Tax Act, 1961. The assessee filed the revised computation of the income on 04.02.2005 declaring income at Rs.2,63,00,860/-. The assessment was completed on 18.03.05 at the assessed income of Rs.4,36,52,621/-.

The assessee is a non-resident foreign company incorporated in Korea and is engaged in the business of execution of construction contracts. During the assessment year under consideration, the assessee has undertaken the following projects:-

NH-I project Haryana, Catalytic Dewaxing Project Kolkata, WH2 Project Bihar, AV2 project & SM Project.

LG Engineering & Construction was awarded a contract by Indian Oil Corporation which entails supply, installation & commissioning of catalysis Dewaxing Project in its refinery at Holdia in West Bengal.

The assessee was awarded a Turnkey Project (Catalytic Dewaxing Unit) at Haldia Refinery by Indian Oil Corp. in September 2000. The project involved Basic and detailed Engineering Construction, Installation, Testing Commissioning and total project management to be completed in 18 months. Total amount of project was (US Dollar 11,595,000) Rs.13488.701 Lakhs, which included Rs.605.34 lakh (US Dollar 11,50,000) for Design and detailed Engineering. Out of this (US Dollar 11,50,000) for Engineering Consultancy an amount of Rs.436.53 lakh was offered to tax @ 15% as offshore consultancy by assessee during the AY 2002-03. However the CDU project through which assessee had earned this income is a permanent establishment as detailed below:-

As per Article 5(3) of DTAA between India Korea the term permanent establishment encompasses a building site a construction assembly or installation project or supervisory activities in connection therewith of such project or site continues for more than nine months. As per article 13(5) of

DTAA of a non resident earns his income under head Royalties and fees for technical services through a permanent establishment its income shall be taxed as business income under article 7 of DTAA. Further a non-resident can opt to pay tax @ 20% on its gross earning from Royalties and fees for technical services u/s 44 D of Income Tax Act if it is more beneficial to it.

Considering the above, I have reasons to believe that after thorough application of mind that income chargeable to tax has escaped assessment.

I hereby record my satisfaction that to protect and safeguard the interest of revenue, it is mandatory to issue notice u/s 148 of the IT Act 1961, hence notice u/s 148 of the IT Act is issued.”

8. The said noting is dated 24th March, 2007. Interestingly, the claim and categorical stand of the revenue is that the aforesaid noting does not represent and were not the “reasons to believe” recorded before issue of notice but rather is an order-sheet entry made by Mr. Vijay Kumar Chadha recording that he had issued notice under Section 148 of the Act, on 24th March, 2007. It is also stated that reasons to believe in original are neither available in the assessment file nor are they available in the office of Additional Director of Income Tax, Range-I, International Taxation. It is stated that there was a fire in the office of the Additional Director of Income tax in 2009, in which the records were destroyed. The aforesaid affidavit leaves several questions unanswered and is debatable. It is not stated how and on what basis Ms. Nishtha Tiwari has communicated the “reasons to believe” under her signature and why these reasons are different from the noting dated 24th March, 2007 which, in fact, is the only document available on record which can be called and treated as “reasons to believe”, but the respondents have vehemently denied and stated that these are not the

“reasons to believe”. Further, it remains unanswered as to why approval from Additional Director of Income Tax was required when notice was issued by Deputy Director. From where and how Ms. Nishtha Tiwari come to know/ascertain and had communicated the “reasons to believe” is not stated.

9. Fire in the office of the Additional Director of Income Tax, Range-I, is one aspect but it does not answer why the reasons to believe are not on record of the Assessing Officer. It reflects that the record and file maintenance of the respondents is poor, faulty and not as per the acceptable standard. The original file produced is not page numbered or indexed, which means papers can be removed or added, as per convenience or mischievously. It is time that the respondents take corrective steps to digitize their records and that the physical files are indexed and page numbered. Debate as to the correctness of the reason to believe produced before the court leads to unnecessary challenges and creates doubt. In the present case too, the petitioner has challenged and questioned the stand of the respondents on recording of reasons.

10. Section 151 of the Act requires that no notice under Section 148 of the Act will be issued by the Assessing Officer below the rank of Assistant Commissioner or Deputy Commissioner, unless the Joint Commissioner is satisfied on the reasons recorded that it is a fit case to issue notice. The proviso applies and requires satisfaction of the Chief Commissioner or the Commissioner when the notice is issued after the expiry of four years from the end of the relevant assessment year. Sub-section (2) states in cases other than those falling under sub-section (1),

no notice will be issued by the Assessing Officer who is below the rank of Joint Commissioner, after the expiry of four years from the end of the relevant assessment year. In the present case, notice was issued before the expiry of four years from the end of relevant assessment year. It is noticed that notice was issued by an officer of rank of Deputy Commissioner. Approval from Assistant Director is for administrative satisfaction and not statutorily mandated. This aspect/point is completely missed by the respondents. If note dated 24th March, 2007 of the Deputy Commissioner was available then the respondents have to explain why different set of reasons to believe was communicated to the petitioner. The respondents must and should rely upon the reasons communicated and the reasons should be true and correct reasons which were recorded under Section 147/148 of the Act.

11. In nutshell we have a note purportedly dated 24th March, 2007 under signature of Mr. Vijay Kumar Chadha and undated "reasons to believe" under the signatures of Ms. Nishtha Tiwari. The first four paragraphs of the note and 'reason to believe" are identical but the last two paragraphs are different. We may have taken the note recorded on 24th March, 2007, by Mr. Vijay Kumar Chadha as the reasons which were recorded before the issue of notice but the stand and stance of the Revenue is to the contrary. They have stated that reasons are not available on the assessment records but the same were recorded prior to 19th March, 2007 and were communicated to Additional Director of Income Tax, after which the approval was received on 23rd March, 2007. The stand of the Revenue is that note of Vijay Kumar Chadha dated 24th March, 2007, are not the reasons but this note was recorded by him as

a noting on the order sheet at the time of issue of notice. They have pleaded and argued that the reasons to believe actually recorded before the issue of notice, were communicated to the petitioner under signature of Ms. Nishtha Tiwari and the present writ petition should be decided on the basis of the said reasons.

12. In view of the specific stand taken by Revenue, we proceed to examine the reasons relied by them. These were also the reasons communicated to the petitioner. Sections 147, 148 and 149 of the Act mandate that reasons must be recorded before issue of notice. It is for the respondents to produce and satisfy the court on the “reasons to believe” recorded before the notice was issued. Recording of reasons has been emphasized and adverted to as the foundation of the jurisdiction of an Assessing Officer who initiates reassessment proceedings. This onus must be discharged by the Assessing Officer, otherwise reassessment proceedings would be quashed. Validity of the reassessment proceedings is tested on the basis of the underlying reasoning stated and recorded for opening of the reassessment.

13. Coming to the merits, we feel that the petitioner is entitled to succeed in the present writ petition if we take the reasons under signatures of Ms. Nishtha Tiwari as the reasons which were recorded by the Assessing Officer before issue of notice. “The reasons to believe” record the factual position in the first four paragraphs regarding the income declared, assessment made, projects undertaken and the fact that the petitioner was a non resident foreign company. It records that turnkey project at Haldia Refinery was awarded to the petitioner by the Indian Oil Corporation in September, 2000 and the project required

engineering, construction, installation, testing commissioning etc. The total cost of the project included Rs.605.34 lakhs for design and detailed engineering. Engineering consultancy, from the offshore entity, amounted to Rs.436.53 lakh which was offered as tax @ 15% by the petitioner in the assessment year 2002-03. The said narrations are mere statement of facts and do not make any reference to or inference regarding escapement of income. Thereafter, one single sentence is stated, which reads as under:

“However the CDU project through which assessee had earned this income is a permanent establishment as per Article 5(3) of DTAA between India Korea.

Considering the above, it is evident that income chargeable to tax has escaped assessment.”

14. From these two sentences no one can gauge or comprehend why and on for what basis it is stated that income chargeable as tax has escaped the assessment. The reasons recorded are inchoate, appear to be mere surmise and fail to clearly define why the bifurcation of Rs 605.34 lakhs and Rs 436.53 lakhs was relevant and prima facie not permissible, or how in view of Article 5(3) DTAA this amount should have been taxed differently. Thus, the reasons to believe relied on by the Revenue do not show why and for what reasons income chargeable to tax had escaped assessment because the CDU project through which the assessee had earned income, was a permanent establishment as per Article 5(3) of DTAA between India and Korea. They are silent and do not show any nexus and link between the facts recorded and how and why income chargeable to tax has not been taxed or under taxed. No reasonable person on reading the reasons can understand the ground

why reassessment notice has been issued. In fact, they appear to be incomplete and incomprehensible, as after recording the observation that the petitioner had a permanent establishment in India, they do not indicate or state why and how the permanent establishment had adversely impacted the tax payable or income assessed in the original assessment made under Section 143(3) of the Act.

15. The effect of reopening is to partly vacate or set aside the original order of assessment and to substitute it. Escapement of income includes both non-assessment or under-assessment but it is mandated that “Reasons to believe” must necessarily show, indicate and communicate why and for what grounds/ cause any income has escaped assessment. Reasons recorded must be germane, pertinent and disclose prima facie belief that income has escaped assessment. Reasons to believe though subjective to this extent must satisfy this test. Relevancy of reason can be and should be established. When the reasons do not show any nexus or connection with the allegation of underassessment they fall in the realm of suspicion, surmise and conjecture. Reasons to believe must have a rational connection and should be relevant for the formation of a belief regarding escapement of income and should not be extraneous or irrelevant, otherwise they will be considered as invalid since they do not meet the statutory preconditions/prerequisites. The policy of law is that there should be finality in all legal proceedings. Thus stale or irrelevant issues should not and cannot be a ground to reactivate closed and concluded proceedings. [*Parshuram Pottery Works Co. Ltd. Vs. ITO* (1977) 106 ITR 1 (SC)]. Formation of rational belief that income chargeable to tax had

escaped assessment is a condition precedent for validly initiating re-assessment proceedings.

16. We reiterate, the language of Section 147 of the Act stipulates that there should be reasons coupled with the belief and both the conditions have to be satisfied. Law requires that there should be rational connection between the reason and the belief that income chargeable to tax had escaped assessment. Reasons to believe as recorded in the present case are vague, unreasonable, incomplete and irrational. No rational or reasonable person can form or decipher from the reasons that income had escaped assessment.

17. In ***Income-tax Officer Vs. Lakhmani Mewal Das***, [1976] 103 ITR 437 reference was made to ***Calcutta Discount Company Limited Vs. ITO***, [1961] 41 ITR 191 (SC) and ***S. Narayanappa Vs. CIT***, [1967] 63 ITR 219 (SC) and it was observed that re-opening provisions require that the officer must have “reason to believe” that income chargeable to tax had escaped assessment and this is a condition precedent for initiating re-assessment proceedings. The formation of belief contemplated by Section 147 requires existence of reasonable grounds, which would clothe the Assessing Officer to issue re-assessment notice. Adequacy or sufficiency of the grounds is not a matter for the Court to investigate and, therefore, is not a justiciable issue, but the expression “reason to believe” postulates that the belief or reason must be held in good faith and not on mere pretence. It is open to the Court to examine whether the reasons for formation of belief have a rational connection with or relevant bearing on the formation of belief and are not extraneous or irrelevant. The words “reason to believe” are not reason to suspect,

therefore, it is essential before re-assessment proceedings are initiated that the requirements of law should be satisfied i.e. live link or close nexus between the material and the reasons recorded by the Assessing Officer and that the belief formed by him should be there on record and when the link exists, re-assessment proceedings will be valid but where the link is too tenuous and irrational to provide a legally sound basis, re-assessment proceedings would be quashed.

18. In ***Assistant Commissioner of Income-tax Vs. Rajesh Jhaveri Stock Brokers P. Ltd.*** [2007] 291 ITR 500 (SC), Supreme Court has affirmed that the expression “reason to believe” would mean cause or justification, though the said expression cannot be read to mean that the Assessing Officer should have finally ascertained under-assessment or reached the final conclusion to the said effect as the final outcome is not relevant, but the “reason to believe” must be germane and relevant and it has to be examined whether a reasonable person would have formed the requisite belief that income had escaped assessment on the basis of the reasons recorded.

19. Similarly, in ***Commissioner of Income-Tax Vs. Kelvinator of India Ltd.***, [2010] 320 ITR 561 (SC), Supreme Court reiterated that under the amended Section 147 applicable with effect from 1st April, 1989, the Assessing Officer has power to re-open assessment provided there is “tangible material” to come to conclusion that there is escapement of income from assessment. In other words, reasons must have live link with the formation of the belief, thus reference to tangible material. “Reasons to believe” in the present case falter on this account. They are incomplete. No conclusion or formation of a belief is possible from

the said reasons that income chargeable to tax has escaped assessment. The reasons do not show any link, which is a pre-requisite and essential condition for re-opening the assessment.

20. In view of the aforesaid, we hold that the petitioner is entitled to succeed. The reassessment notice dated 24th March, 2007/29th March, 2007 and the impugned order dated 23rd August, 2007 issued under Section 148 read with Section 147 of the Act for the assessment year 2002-03 is hereby set aside. The writ petition is, therefore, allowed.

(SANJIV KHANNA)
JUDGE

(SANJEEV SACHDEVA)
JUDGE

AUGUST 22nd, 2013

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