+* **THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment Reserved on : 27.04.2009
Judgment Delivered on: 24.07.2009

+ **WP(C) No. 5059 of 2008**

MS. MADHUSHREE GUPTA ..... Petitioner

versus

UNION OF INDIA & ANR. ..... Respondent

WP(C) No. 6272 of 2008

BRITISH AIRWAYS PLC ..... Petitioner

versus

UNION OF INDIA & ORS. ..... Respondent

Advocates who appeared in this case:

For the Petitioner	:	Mr O.S. Bajpai, Mr Bibhuti Singh & Mr V.N. Jha, Advocates in WP(C) No. 5059/2008 Mr M.S. Syali, Sr. Advocate with Mr Satyen Sethi, Ms Mahua Kalra, Mr Peeyoosh Kalra & Ms Vidushi Chandana, Advocates in WP(C) No. 6272/2008
For the Respondent	:	Mr P.P.Malhotra, Additional Solicitor General with Ms Sonia Mathur, Advocate for the UOI. Ms Prem Lata Bansal & Mr Sanjeev Sabharwal, Sr. Standing Counsels for Revenue.

CORAM :-
HON'BLE MR JUSTICE VIKRAMAJIT SEN
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. The captioned writ petitions lay challenge to the provisions of Section 271(1B) of the Income Tax Act, 1961 (hereinafter referred to

as the 'Act') on the ground that it is ultra vires the Constitution of India. The impugned provision which was brought on to the statute book by the Finance Act, 2008 with retrospective effect from (w.r.e.f.) 01.04.1989, has resulted in a grievance in so far as the petitioners/assessees are concerned, in as much as, apropos to its insertion in the Act, the salutary requirement of the Assessing Officer arriving at his own "satisfaction" during the course of assessment proceedings that the assessee has concealed the particulars of his income or has furnished inaccurate particulars before initiating penalty proceedings has been done away, by a deeming fiction encapsulated therein. This, in short, is the kernel of the controversy before us. As is evident on a bare reading of the provisions of Section 271(1B) of the Act that the deeming fiction envisaged in the said provision which is to operate retrospectively, pertains only to clause (c) of sub-section (1) of Section 271 of the Act.

1.1 Consequently, the writ petitioners before us have made the following main prayers in their respective writ petitions:

Writ petition No. 5059/2008

"i) That the impugned sub-section (1B) of Section 271 of the Act may be struck down as constitutionally invalid; or alternatively, it may be read down to the effect that the satisfaction should be deemed to have been recorded only where reasons are specified with respect to specific items of additions or disallowances leading to the initiation of penalty proceedings."

Writ petition No. 6272/2008

"a. A writ of Certiorari or Writ, order of Direction in the nature of Certiorari, or any other appropriate Writ, Order

or Direction under Article 226/227 of the Constitution of India quashing sub-section (1B) to section 271 inserted by Finance Act, 2008 as arbitrary, ultra virus and violative of Article 14 of the Constitution of India.

b. A Writ of Certiorari or Writ, Order of Direction in the nature of Certiorari, or any other appropriate Writ, Order or Direction under Article 226 / 227 of the Constitution of India declaring that sub-section (1B) to section 271 inserted by Finance Act, 2008 cannot be given retrospective effect from 1.4.1989.

c. A Writ of Prohibition or Writ, Order of Direction in the nature of prohibition, or any other appropriate Writ, Order or Direction under Article 226/227 of the Constitution of India restraining the respondents No. 3 & 4/ or their officers, agents, etc., from taking any proceedings by way of rectification or otherwise to give effect to retrospective insertion of sub-section (1B) in section 271 of the Act, in respect of assessment years 1996-97 to 2001-02."

2. In order to adjudicate upon the writ petitions the following facts are required to be noticed.

Writ petition No. 5059/2008

2.1 In respect of Writ Petition No. 5059/2008, we had called for ITA No. 548/2006, which is an appeal filed by the Department against the order of the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') quashing the penalty proceedings, in order to ascertain the bare facts; the writ petition being bereft of facts essential for the

purposes of adjudication. The following facts, which are not disputed, emerge on reading of the file.

2.2 On 29.10.2001 the petitioner filed a return of income declaring a loss of Rs 53,54,135/-. The said return was processed under Section 143(1) of the Act. However, on 25.10.2002 notices under Section 143(2) of the Act were issued. Consequent thereto, even though the Assessing Officer by an order dated 20.02.2004 assessed the taxable income of the assessee as 'nil', he made two adjustments to the returned income. First, an addition of Rs 3,82,636/- as income from undisclosed sources. Second, he restricted the deduction under Section 80HHC of the Act to Rs 53,17,841/- as against the claim of the assessee of Rs 1,03,61,340/-. Importantly, by the very same order, the Assessing Officer initiated penalty proceedings under Section 271(1)(c) of the Act by making the following endorsement at the foot of the order:

> "Initiate penalty proceeding u/s 271(1)(c) of the I.T. Act separately. Issue necessary forms."

2.3 By an order dated 31.08.2004 the Assessing Officer after considering the reply filed by the petitioner imposed a penalty of Rs 18,79,303/- at the minimum rate of 100% of tax evaded. Being aggrieved, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)']. The CIT(A) vide order dated 04.03.2005 sustained the penalty imposed by the Assessing Officer. Aggrieved, the assessee carried the matter further in appeal to the Tribunal. The Tribunal by an order dated 15.07.2005 deleted the penalty imposed on the petitioner. In doing so it posed to itself the following two issues:

(i) Whether penalty under Section 271(1)(c) of the Act could be imposed on the assessee if the taxable income was nil?

(ii) Whether penalty under Section 271(1)(c) of the Act could be imposed in the event the satisfaction arrived at by the Assessing Officer before initiation of the penalty proceedings is not recorded by the Assessing Officer?

2.4 In respect of the first issue the Tribunal relied upon the judgment of the Supreme Court in ***CIT vs Prithipal Singh & Co (2001) 249 ITR 670*** to hold that no penalty under Section 271(1)(c) of the Act could be levied in view of the fact that the assessee's taxable income was nil. We may point out at this stage that this view found resonance in another judgment of the Supreme Court in the case of ***Virtual Soft Systems Ltd vs CIT (2007) 289 ITR 83*** which, however, now stands reversed by a judgment of a larger bench of the Supreme Court in the case of ***CIT vs Gold Coin Health Food Pvt Ltd (2008) 304 ITR 308***.

2.5 As regards the second issue the Tribunal opined, in line with the judgment of this Court, which is the Jurisdictional High Court, in the case of ***CIT vs Ram Commercial Enterprises Ltd (2000) 246 ITR 568 (Del)*** and ***Diwan Enterprises vs CIT (2000) 246 ITR 571 (Del),*** that the Assessing Officer having not recorded his satisfaction that the assessee had concealed particulars of his income or furnished inaccurate particulars before completion of the assessment proceedings, the initiation of penalty proceedings was bad in law and hence the order imposing penalty must fail. The Department being aggrieved preferred an appeal, being ITA No. 548/2006 to this court

under Section 260A of the Act. The said appeal is pending adjudication and is listed for hearing on 28.10.2009.

Writ petition No. 6272/2008

3. The petitioner is a company incorporated in United Kingdom and is engaged in the business of air transportation service. The petitioner has branch offices in India at New Delhi, Mumbai, Chennai and Kolkata.

3.1 The operations of the petitioner in India essentially pertain to the following activities:

(i) air-transportation of passengers, cargo and mail to and from India; and

(ii) rendering engineering and ground-handling services to aircrafts operated by other airlines in India.

3.2 On 11.02.1994, the Government of India as empowered under the provisions of Section 90 of the Act, entered into a Double Taxation Avoidance Agreement (in short 'DTAA') with the Government of United Kingdom.

3.3 It was the claim of the petitioner that by virtue of the provisions of Article 8 of DTAA the profits from both the activities described hereinabove, were not taxable in India in view of the fact that the petitioner was a tax resident of United Kingdom and the profits earned from the said activities were taxable only in United Kingdom.

3.4 The stand taken by the petitioner was not accepted by the Department with respect to engineering and ground-handling services. Consequently, a notice dated 09.06.1998 was issued by the

Assessing officer calling for information with regard to the engineering and ground-handling services, in respect of assessment years 1996-97, 1997-98 and 1998-99. Pursuant thereto, the petitioner filed returns for the aforementioned assessment years on 30.11.1998, offering to tax 15% 'deemed profit' from engineering and ground-handling services.

3.5 The Assessing Officer in March, 1999, completed the assessment of the petitioner. By his assessment order, the Assessing Officer while rejecting the stance of the petitioner that engineering and ground-handling services were not amenable to tax in India by virtue of Article 8(2) of the DTAA, brought to tax petitioner's income in excess of 80% of gross receipts, from engineering and ground-handling services. By the same assessment order the Assessing Officer also initiated penalty proceedings against the petitioner. The CIT(A) sustained the assessment order. The matter was carried further in appeal to the Tribunal. The Tribunal by an order dated 26.03.2003, in-principle, sustained the assessment order in so far as it brought to tax profits which the petitioner-assessee had earned from engineering and ground-handling services. The matter was, however, remanded to the Assessing Officer for re-computation of taxable profits from the said activities.

3.6 The Assessing Officer by an order dated 23.02.2004 gave effect to the order of Tribunal in respect of the assessment year 1996-97, 1997-98 and 1998-99. It is important to note that at the foot of the assessment order, the Assessing Officer made the following endorsement with respect to initiation of penalty proceedings:

"Initiate penalty proceedings under Section 271(1)(c) for furnishing inaccurate particulars of income"

3.7 In the meanwhile, the petitioner had also filed its returns for assessment years 1999-2000, 2000-01 and 2001-02 declaring nil income. In respect of these years too, the Assessing Officer completed the assessment in the same manner as was done in the earlier years. Importantly, the Assessing Officer, as was done in the earlier years, by the very same order initiated penalty proceedings. Consequent thereto, the Respondent No. 4, that is, the Assistant Director of Income Tax, by an order of even date i.e., 30.03.2006 imposed penalty separately, equivalent to 100% of tax sought to be evaded on the aforesaid concealed income, in respect of, all six assessment years mentioned hitherto, that is, assessment years 1996-97 to 2001-02.

3.8 Aggrieved, the assessee preferred an appeal to the CIT(A). The CIT(A) by an order dated 30.12.2006 confirmed the penalty imposed by the Assessing officer under Section 271(1)(c) of the Act.

3.9 Being aggrieved, the petitioner carried the matter further in appeal to the Tribunal. The Tribunal by an order dated 23.11.2007 set aside the order of the CIT(A) confirming the penalty imposed by the Assessing Officer under Section 271(1)(c) of the Act in respect of the six assessment years referred to hereinabove. The Tribunal relied upon the judgment of the Division Bench of this court in ***Ram Commercial*** *(supra)* as also the judgment of the Supreme Court in the case of ***D.M. Manasvi vs CIT (1972) 86 ITR 557***, in coming to the conclusion that the Assessing Officer is required to form his own opinion and record his satisfaction before initiating penalty

proceedings. The Tribunal observed that merely because penalty proceedings have been initiated it cannot be assumed that such satisfaction has been arrived at, in the absence of the same being spelt out, in the order of the Assessing Officer. In order to ascertain whether requisite satisfaction had been arrived at by the Assessing officer the Tribunal was called upon to decide which of the two assessment orders had to be looked at, that is, one which was passed originally or the one which was passed on remand. The Tribunal after due discussion of the case law on the issue, came to the conclusion that since in the present case it had in the first round by its order dated 30.10.2006 sustained the original assessment on principle by agreeing with the Assessing Officer that the income received by the assessee by way of engineering and ground handling services was taxable, and had thus set aside the said assessment order partially only for re-computation of income from the said activities; for the purpose of ascertaining satisfaction of the Assessing Officer with regard to initiation of penalty proceedings only the original assessment order could be looked at. The Tribunal upon perusal of the assessment orders for each of the six assessment years came to the conclusion that the requisite satisfaction with regard to assessee having concealed particulars of his income or having furnished inaccurate particulars of such income having not been recorded by the Assessing Officer in the relevant assessment years before initiation of penalty proceedings under Section 271(1)(c) of the Act, the initiation of penalty proceedings was unsustainable in law. In these circumstances the Tribunal did not examine the matter on merits. Being aggrieved, the Department preferred five separate appeals in respect of the assessment years 1997-98 to 2001-02 to this

Court. These being ITA Nos. 877/2008, 957/2008, 965/2008, 880/2008 & 818/2008. These appeals were disposed of by this Court vide order dated 27.08.2008 by setting aside order of the Tribunal dated 23.11.2007 and remanding the appeals for a decision on merits, in view of the fact that the impugned provision, that is, Section 271(1B) of the Act was already operable. We have not been informed whether the Department has preferred an appeal for assessment year 1996-97. The submissions of the learned counsel for the assessee, however, to the effect that remand of the matter ought not to be construed as, the assessee, having accepted the constitutional validity or the applicability of the impugned provision to its case; as these were the subject matter of the writ petition filed by the assessee, that is, the present writ; was taken note of by this Court.

Submissions

4. Submissions on behalf of the petitioner have been made by Mr.O.S. Bajpai, Advocate in Writ Petition No.5059/2008. The contours of his submissions are as follows:-

(i) It is contended that the only object of the impugned amendment, i.e., insertion of Section 271(1B) of the Act with retrospective effect is to nullify the judgment of the Supreme Court in ***D.M. Mansavi*** *(supra)* and ***CIT vs. S.V. Angidi Chettiar (1962) 44 ITR 739***. The impugned amendment does not seek to cure any defect and as a matter of fact the impugned provision leaves the main penalty provision, i.e., Section 271(1)(c) of the Act intact, in as much as it remains on the statue book.

(ii) The impugned provision is not a validating Act. In this context the judgment of the Supreme Court in the case of ***Shri Prithvi Cotton Mills Ltd vs. Broach Borough Municipality (1989) 2 SCC 283*** was read and sought to be distinguished. It was contended that in the instant case there is no statute or rule which has been declared invalid so as to impinge on the very power to levy tax or penalty. It is submitted that the present case is not one where power to levy penalty is wanting, but is a case where a jurisdictional error has been committed in invoking the power to impose penalty while the power by itself remains undisturbed under the provisions of Section 271(1)(c) of the Act. In short it is submitted that there is no challenge to the validity of Section 271 of the Act except to a limited extent in so far as it pertains to sub-section (1B) of Section 271 of the Act. It is thus submitted that the ratio of ***Shri Prithvi Cotton Mills Ltd*** *(supra)* would not be applicable as there is no challenge to the competence of the legislature to levy penalty or to the provision under which the penalty is levied.

(iii) The well settled principle established by the Courts which includes the Supreme Court and the various High Courts is that, before initiation of penalty proceedings, the Assessing Officer has to arrive at a prima facie satisfaction during the course of any proceedings before him which would include assessment, re-assessment or even rectification proceedings. This is a jurisdictional issue and there is not a single judgment of any Court which propounds a principle contrary to this proposition. It is further contended that the only difference in the judicial opinion of various High Courts is as regards the manner in which such prima facie satisfaction before initiation of proceedings is to be recorded.

Learned counsel relied upon the Full Bench judgment of this Court in the case of ***CIT vs Rampur Engineering Co Ltd (2009) 309 ITR 143(Del)*** in which one of us, (Rajiv Shakdher, J) was a member, as also on the Division Bench Judgment of this Court in ***Ram Commercial*** *(supra)* and ***Diwan Enterprises*** *(supra)* which was affirmed by the Full Bench, to contend that satisfaction should be spelt out in the assessment order.

(iv) In view of the position of law professed by the learned counsel, it was submitted by him that such satisfaction which is required to be arrived at by the Assessing Officer before initiation of penalty proceedings and issuance of notice under Section 274 of the Act, is a question of fact which cannot be legislatively presumed by creating a fiction, as is sought to be done, by the impugned provision. Furthermore, he contends that the decision to levy penalty is discretionary which has to be exercised by the Assessing Officer, acting in his quasi judicial capacity, based on facts and circumstances of each case and hence cannot be substituted by legislative presumption.

(v) The impugned provision is violative of Article 14 of the Constitution as there is no nexus between the object sought to be achieved by the legislature and the impugned provision. He impugned the provisions of Section 271(1B) of the Act on the ground that it confers on the Assessing Officer wholly arbitrary power, there being no in-built guidelines laid down for exercising such power.

(v)(a). To buttress his submissions the learned counsel has given examples such as the following:-

(v)(b) He hypothesizes a situation by suggesting that: suppose an Assessing Officer makes additions or disallowances in respect of say, assessees A and B and initiates penalty proceedings against only one of the two. The learned counsel submits that in the absence of any guidelines as to which of the assessee's case ought to be picked up for initiation of penalty proceedings it would lead to unnecessary harassment and protracted litigation, besides the one who is picked up for initiation of penalty proceedings will be meted with unequal treatment in law.

(v)(c) The learned counsel went on to illustrate the arbitrariness by citing another example: He submitted that say in a given case during the course of assessment proceedings, an Assessing Officer makes five or six additions and disallowances, but prima facie satisfaction is not found to exist in respect of all such additions or disallowances save and except in the case of one or two of such additions or disallowances. The Assessing Officer by taking recourse to the impugned provision would issue notice and initiate penalty proceedings with respect to all additions and disallowances. To drive home the point the learned counsel referred to facts of the instant case. He states that the Assessing officer during the course of assessment has made an addition of a sum of Rs 3,82,656/- on account of undisclosed income and a disallowance under Section 80HHC by restricting deduction to the extent of Rs 50,43,499/- as against the claim made by the assessee of over Rs 1 crore. He submits that the assessee's claim with respect to Section 80HHC was made based on the following judgments: ***CIT vs. Shirke Construction Equipments Ltd (2000) 246 ITR 429 (Bom)*** and ***CIT vs. Smt.T.C.Usha (2004)***

266 ITR 497 (Ker). The position in law was, however, set at rest, according to the learned counsel, by a judgment of the Supreme Court in ***IPCA Laboratory Ltd vs. DCIT (2004) 266 ITR 521(SC).*** According to him there was an honest difference of opinion between the Assessing Officer and the assessee in respect of the claim under Section 80 HHC. Despite, these circumstances penalty to the tune of Rs 18,79,303/- was imposed by the Assessing officer on the entire additional concealed income of Rs 53,54,140/- which included disallowance on account of claim under Section 80HHC.

(vi) The learned counsel submits that the impugned provision deprives the tax payer a right to seek judicial review. The impugned provision, he contends denudes the power of the court to judicially review orders initiating penalty proceedings, and hence, according to him, strikes at the very basic structure of the Constitution. The learned counsel submits that the impugned provision is unconstitutional and, therefore, void ab-initio. It is, thus submitted, that, it can neither be held to be valid prospectively or retrospectively.

(vii) The presumption contained in Explanation 1 of Section 271 being a rule of evidence whereby the onus is shifted on to the assessee is available only at the time of imposition of penalty. The stage of initiation of penalty proceedings being separate and independent to the stage of imposition of penalty, the said presumption provided for in Explanation 1 is not available at the time of initiation of penalty proceedings.

5. Mr M.S. Syali, Senior Advocate appearing for the petitioner in Writ Petition No.6272/2008 while complimenting the submissions made by Mr.O.S.Bajpai, Advocate has submitted that a bare reading of

the Memorandum explaining the Finance Bill, 2008 (hereinafter referred to as the 'Memorandum') and the Notes on Clauses, i.e., Clause 48 would show that the object and reasons stated therein do not get reflected in the impugned provision. He contends that the very fact that sub-section (1B) of Section 271 of the Act deems satisfaction in the order of assessment, re-assessment or rectification, the Revenue would accept that satisfaction is required to be arrived at by the Assessing Officer during the course of any such proceedings. Being a quasi-judicial function the satisfaction should be reasoned. Reliance was placed on ***S.N. Mukherjee vs Union of India AIR 1990 SC 1984 at 1994 (para 31) and at 1997 (para 39).*** The learned counsel further submitted that while he does not question the power of legislature to enact law retrospectively; the retrospective amendment is not only oppressive but also fails to supply any rationale for its applicability from 1.4.1989. In this context he relies on the judgment of the Supreme Court in ***Virender Singh Hooda vs. State of Haryana (2004) 12 SCC 588 at 605 para 33 & 34***, ***Empire Industries Ltd vs. UOI (1985) 3 SCC 314*** and lastly, ***Tata Motors Ltd vs State of Maharashtra & Ors (2004) 5 SCC 783 at 788-790, paragraphs 12 and 15***. The learned counsel further contended that penalty proceedings being penal in nature, the principle of greater latitude in economic matters cannot apply to such like provisions. He also contends that while constitutionality of a provision is presumed and the onus is on the party which challenges its constitutionality; the onus in the instant case would shift, as no plausible reason has been given with regard to the provision coming into force w.e.f. 01.04.1989.

6. As against this Mr.P.P.Malhotra, learned Additional Solicitor General (ASG) appearing for the Revenue contended as follows:-

(i) There is always a presumption with regard constitutionality of a provision. The constitutionality of legislation should be judged from the generality of its provision and not by its crudities or inequities or by the possibilities of abuse of any of its provisions. He submitted that hardship, financial or otherwise cannot be a ground for challenging constitutionality of a legislation, particularly while dealing with complex economic issues.

(ii) He refuted the submissions of the petitioner that there was no nexus between the impugned provision and the objects sought to be attained by the impugned legislation. The learned ASG submitted that the purpose and object of the amendment was to clarify the interpretation of the provisions of Section 271(1)(c) of the Act. It was his contention that the legislative intent in bringing about the amendment was; that the satisfaction is required to be recorded in writing only at the time of levy of penalty and not at the time of initiation of penalty proceedings. He submitted that taxing statute has to be construed strictly. If the words of the statute are clear then one need not look further to determine the purpose, meaning and object of the legislature. He submitted that amendment was clarificatory in as much as it sought to make clear that the Assessing Officer is not required to record his satisfaction in writing before initiating penalty proceedings and such satisfaction can be specifically arrived at and hence recorded, only at the stage of levy of penalty as against prima facie satisfaction which is arrived, at the stage of initiation. He contended that instead of satisfaction at two stages, by virtue of the amendment, satisfaction be arrived at and recorded only

at the stage of imposition. Therefore, according to the learned ASG a simple endorsement in the assessment order that penalty proceedings are initiated would suffice. In this regard reference was made to Clause 48 of Notes on Clauses of the Finance Act, 2008.

(iii) He further contended that the submissions of the petitioners that right of judicial review is foreclosed by the impugned amendment was unsustainable. He submitted that the writ courts were fully competent to exercise their extra-ordinary jurisdiction vested in them in a case where the Assessing Officer acts arbitrarily irrespective of the stage of the proceedings. A mere apprehension of bias or abuse of power would not be a good ground to strike down the impugned provision. He contended that in case the Assessing Officer was asked to record his complete satisfaction as against prima facie satisfaction then the penalty proceedings which are independent of assessment proceedings would become meaningless.

(iv) On the issue of retrospectivity, the learned ASG contended that the amendment was merely procedural and did not deal with substantive rights, as in, the penalty had not been created for the first time. He contended that the impugned amendment will not disturb those cases which had attained finality but will affect only those, where penalty proceedings have been initiated or are pending adjudication before a judicial forum. The learned ASG sought to explain the basis for the retrospective amendment in the following manner: The Direct Tax Laws (Amendment) Act, 1987 was enacted, whereby Section 271(1)(c) was substituted by a new provision. This resulted in the levy of penalty for concealment of income being omitted. The imposition of penalty was substituted by a charge of mandatory additional income tax at the rate of 30% of income under a

new provision, that is, Section 158B, which was, inserted by the very same Amending Act of 1987. He submitted that by the Direct Tax Laws (Amendment) Act, 1989 the Amending Act of 1987 was removed from the statute book and the provision with regard to levy of penalty for concealment of income was restored. It was stated that one of the changes effected was that a new sub-section (5) was inserted in Section 271 to provide for a transitory provision so that the penalties for the assessment year 1988-89 and earlier assessment years could be levied in accordance with the provisions of Section 271 of the Act as they stood prior to 01.4.1989. It was contended that it was in this background that the impugned provision has been made applicable retrospectively w.e.f. 01.04.1989.

OUR ANALYSIS

7. Before we deal with the various contentions raised by both sides it would perhaps be of some relevance to briefly note the legislative history of Section 271 of the Act.

7.1 Section 271 of the Act corresponds to the provisions contained in sub-sections (1), (2) and (6) of Section 28 of the Income Tax Act, 1922 (hereinafter referred to as the '1922 Act'). The relevant provision of the 1922 Act which are pari materia with clause (c) of sub-section (1) of Section 271 reads as follows:-

> *"28. Penalty for concealment of income or improper distribution of profits. – (1) if the income-tax Officer, the Appellate Assistant Commissioner or the Appellate Tribunal* ***in the course of any proceedings under this Act, is satisfied that any person****-*
>
> *(a) has without reasonable cause failed to furnish the return of his total income which he was required to furnish by notice given under sub-section (1) or sub-section (2) of section 22 or section 34 or has without reasonable cause failed to*

furnish it within the time allowed and in the manner required by such notice, or

(b) has without reasonable cause failed to comply with a notice under sub-section (4) of section 22 or sub-section (2) of section 23, or

(c) has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income,

he or it may direct that such person shall pay by way of penalty, *in the case referred to in clause (a), in addition to the amount of the income-tax and super-tax, if any, payable by him, a sum not exceeding one and a half times that amount, and in the cases referred to in clauses (b) and (c), in addition to any tax payable by him, a sum not exceeding one and a half times the amount of the income-tax and super tax, if any, which would have been avoided if the income as returned by such person had been accepted as the correct income:"*

7.2. With the enactment of Income Tax Act, 1961, i.e., the Act, Section 271 was brought on to the statute book. At the relevant time, Section 271 comprised of only sub-section (1), (2), (3) and (4). Section 271(1)(c) at that point in time to the extent it is relevant read as follows:-

"271. Failure to furnish returns, comply with notices, concealment of income, etc. –

(1) If the Income-tax Officer or the Appellate Assistant Commissioner in the course of any proceedings under this Act, is satisfied any person –

(a) has without reasonable cause failed to furnish the return of his total income which he was required to furnish under sub-section (1) of section 139 or by notice given under sub-section (2) of section 30 or section 148 or has without reasonable cause failed to furnish it within the time allowed and in the manner required by sub-section (1) of section 139 or by such notice, as the case may be, or

(b) has without reasonable cause failed to comply with a notice under sub-section (1) of section 142 of sub-section (2) of section 143, or

(c) has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income,

he may direct that such person shall pay by way of penalty"

7.3 Interestingly, by the Finance Act, 1964 the word “deliberately” which preceded the expression ‘furnished inaccurate particulars of income’ appearing in clause (c) of sub-section (1) of Section 271, was omitted. However, by the said Finance Act an explanation to sub-section (1) was inserted which in sum and substance provided that where an assessee’s total returned income was less than 80% of the total income assessed under Section 143 or Section 144 or even Section 147 as adjusted by bonafide expenditure incurred by him for making or earning any income included in the total income, but which had been disallowed as deduction; it shall be presumed by a deeming fiction that the assessee had concealed the particulars of his income or furnished inaccurate particulars of such income for the purpose of clause (c) of sub-section (1) of Section 271, unless the assessee proved that failure to return the correct income was not on account of fraud or any gross or willful neglect on his part. The purpose of this explanation obviously was to shift the onus, which even though rebuttable, on to the assessee as against the Department with respect to a charge of concealment of particulars of income or furnishing inaccurate particulars of income by the assessee. In sum and substance the effect of the Amendment was that in a case of penalty proceedings under Section 271(1)(c) of the Act, where the assessee’s returned income was less than 80% of the assessed income after making due adjustment for expenditure incurred bonafide, the onus lay upon the assessee to establish that his failure to declare in his return the amount of assessed income after due adjustment for expenditure, was not on account of fraud or any gross or any willful neglect on his part. In other words the provision was not to be taken

recourse to where the difference in the returned income and the assessed income was due to a bonafide mistake.

7.4 Thereafter, there were amendments made in 1971, 1974, 1975, 1977 and 1984. We are not referring to the same as they are not presently very material to the issue under consideration. It would, however, be perhaps of some relevance to only note that by way of the Taxation Laws (Amendment in Misc. Provisions) Act, 1986 w.e.f. 10.09.1986 the following amendment in sub-section (1) were made.

> *"(i) In clause (a) as it was then, and clause (b), the words "without reasonable cause", were omitted.*
>
> *(ii) In clause (B) of Explanation I the words "and fails to prove that such explanation is bonafide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him" were inserted.*
>
> *(iii) The proviso to Explanation I, as originally enacted, was omitted.*
>
> *(iv) In explanation 5, the word "unless, -" followed by clauses (1) and (2) as at present were substituted for the earlier words."*

7.5 It is important to note that the expression 'without reasonable cause' was also omitted with respect to other provisions under which penalty was leviable under Chapter XXI, such as, Sections 270 (the expression omitted was 'without reasonable excuse' as against 'without reasonable cause'), 271A, 271B, 272B, 273(1)(b), 273(2)(b) and 273(2)(c). The legislature's intent was, it seems, to put the onus for the default contemplated in each of these provisions on the assessee and unless the assessee was able to show a reasonable cause for his failure, penalty would be attracted. This is evident as with the

amendment in the aforesaid provisions, a new Section 273B was added.

7.6 By the Direct Tax Laws (Amendment) Act, 1987 the existing provisions of Section 271 as then obtaining on the statute book was substituted w.e.f 01.04.1989 with the following provision:

> *"271. Failure to comply with notices. – If the Assessing Officer, in the course of any proceedings under this Act, is satisfied that any person has failed to comply with a notice under sub-section (1) of Section 142 or sub-section (2) of section 143 or with a direction issued under sub-section (2A) of section 142, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum which shall not be less than one thousand rupees but which may extend to twenty five thousand rupees for each such failure."*

7.7 Apart from the above, a new provision for levy of additional tax in the form of Section 158B alongwith a provision for interest under Section 234A was also inserted. The intent being to substitute penalty, on account of failure or delay in filing of returns under clause (a), failure to comply with the notices and directions under clause (b), and on account of concealment of particulars of income or of furnishing of inaccurate particulars income under clause (c) of sub-section (1) of Section 271 of the Act was sought to be supplanted by additional tax under Section 158B and interest under Section 234A of the Act.

7.8 Curiously, the aforesaid amendment was not brought into operation and by virtue of Direct Tax Laws (Amendment) Act, 1989 the provision of Section 271 prior to its substitution by Direct Tax Laws (Amendment) Act, 1987 was re-introduced w.e.f. 01.04.1989, with certain other modifications. Section 158B was also omitted w.e.f. 01.04.1989. Importantly, as contended by the Learned ASG

appearing on behalf of the Revenue, sub-section (5) was introduced as a transitory provision in order to get over the possible hiatus created by Direct Tax Laws (Amendment) Act, 1987.

7.9 Thereafter, amendments were also made in 1998, 2001, 2007 and the present amendment in 2008. Once again amendments in 1998 to 2007 not being material for our purposes the same are not touched upon by us.

8. What is, however, clear to us by virtue of a brief review of the legislative history of Section 271 is that the provision of clause (c) which deals with imposition of penalty for concealment of particulars of income or furnishing of inaccurate particulars of income by the assessee, has remained untouched since the 1922 Act was enacted, (at which point in time, it appeared on the statute book as Section 28(1)(c)) except for a brief interval in 1987 when the Direct Tax Laws (Amendment) Act, 1987 was passed. As noticed above, the same was not brought into force and the original position was reverted to, with the enactment of the Direct Tax (Amendment) Act, 1989. The gap, if any, in the interregnum was sought to be filled up by insertion of sub-section (5) in Section 271 of the Act which reads as follows:

> *"(5) the provisions of this section as they stood immediately before their amendment by the Direct Tax laws (Amendment) Act, 1989 shall apply to and in relation to any assessment for the assessment year commencing on the 1st day of April, 1988 or any earlier assessment year and references in this section to the other provisions of this Act shall be construed as references to those provisions as for the time being in force and applicable to the relevant assessment year."*

8.1 Therefore, the reasoning spelt out both during the course of the hearing and in the counter affidavit filed by the Department for making the impugned provision operable w.e.f. 01.04.1989, does not

hold good because what was sought to be achieved by the Direct Tax Law (Amendment), Act 1987 was restored by Direct Tax Law (Amendment) Act, 1989, in so far as clause (c) of Sub-Section (1) of Section 271 was concerned. There is according to us no cogent reason articulated as to why retrospectivity to the impugned provision was w.e.f. 01.04.1989. It is not the case of the Revenue that this has been done keeping in mind its administrative convenience or for the reason that it did not want to continue with penalty proceedings in respect of stale cases.

8.2 But would the cut off date of 01.04.1989 create an invidious discrimination or result in a class legislation vis-à-vis those whose case is to be considered on the basis of law obtaining prior to 01.04.1989. We are of the view that there would be no violation of the equality clause under Article 14 of the Constitution on this ground alone, for the reason that if an assessee has fallen foul of the law, that is, penalty provisions are otherwise applicable to him, he cannot be heard to say that rigours of law ought not to apply to him because another person similarly placed has not exposed to such a rigour. There is no equality in illegality. This is not the case where a more onerous procedure is applied to him as against an assessee to whom pre-amendment law is applied. While considering a challenge to the vires of a Statute, the Court is required to lean in favour of its validity, preferring an interpretation that would preserve its constitutionality as the legislature, it is presumed, does not exceed its jurisdiction. The onus is squarely on the person challenging the constitutional vires of the Statute. The exception to the Rule is that where a challenge is made on the ground of infraction of fundamental rights, then the State must justify its action. In ascertaining the intention of the Parliament,

the court is required to come to its own view based on the language of the Statute and the not be governed by affidavits filed in court by parties to 'justify and sustain the legislation'. (See ***UOI vs Elphinstone Spinning and Weaving Co Ltd & Ors. JT 2001 (1) SC 536 at page 552, paragraph 9***)

SCHEME OF CHAPTER – XXI

9. This brings us to the scheme of the penalty provisions. Penalty provisions find mention in Chapter XXI of the Act, while the provisions for prosecution are contained in Chapter XXII. For the purposes of the issues raised in the instant case we will limit our discussion only to Sections 271, 271(1B), and 274 of the Act. For the sake of convenience it would be relevant to cull out the relevant parts of Section 271(1), Section 271(1B) and Section 274.

> *"271 (1) If the [Assessing Officer] or the [Commissioner (Appeals)] [or the Commissioner]* ***in the course of any proceedings under this Act is satisfied*** *that any person—*
>
> *(a) xxxxx*
>
> *(b) xxxxx*
>
> ***(c) has concealed the particulars of his income or furnished inaccurate particulars of [such income,*** *or]*
>
> *(d) xxxxx*
>
> ***he may direct that such person shall pay by way of penalty—***
>
> *(i) xxxx*
> *(ii) xxxx*
> *(iii) xxxx*
>
> *Explanation 1 xxxxxx*
>
> *Explanation 2 xxxxxx*
>
> *Explanation 3 xxxxxx*
>
> *Explanation 4 xxxxxx*

Explanation 5 xxxxxx

Explanation 6 xxxxxx

Explanation 7 xxxxxx

[(1A) xxxxxx]

[(1B) Where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under clause (c) of sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings under the said clause (c).]"

***"274** (1) No order imposing a penalty under this Chapter shall be made unless the assessee has been heard, or has been given a reasonable opportunity of being heard.*

(2) No order imposing a penalty under this Chapter shall be made-

(a) by the Income Tax Officer, where the penalty exceeds ten thousand rupees;

(b) by the Assistant Commissioner [or Deputy Commissioner] where the penalty exceeds twenty thousand rupees,

Except with the prior approval of the [Joint] Commissioner]

(3) An income-tax authority on making an order under this Chapter imposing a penalty, unless he is himself the Assessing Officer, shall forthwith send a copy of such order to the Assessing Officer.]"

10. A bare reading of section 271(1)(c) would show that to initiate penalty proceedings following pre-requisites should obtain.

(i) The Assessing Officer should be 'satisfied' that:-

a) The assessee has either concealed particulars of his income; or

b) furnished inaccurate particulars of his income; or

c) infracted both (a) and (b) above

(ii) This ‘satisfaction’ should be arrived at during the course of ‘any’ proceedings. These could be assessment, reassessment or rectification proceedings, but not penalty proceedings.

(iii) If ingredients contained in (i) and (ii) are present a notice to show cause under Section 274 of the Act shall issue setting out therein the infraction the assessee is said to have committed. The notice under Section 274 of the Act can be issued both during or after the completion of assessment proceedings, however, the satisfaction of the Assessing Officer that there has been an infraction of clause (c) of sub-section (1) of Section 271 should precede conclusion of the proceedings pending before the Assessing Officer.

(iv) The order imposing penalty can be passed only after assessment proceedings are completed. The time frame for passing the order is contained in Section 275 of the Act.

11. It is important to note that these provisions of Section 271(1)(c) remain insulated from the amendment brought about by the Finance Act, 2008 whereby the impugned provision, that is, Section 271(1B) was inserted.

11.1 The reasons for bringing about the amendment is contained both in the Memorandum and in Clause 48 of Notes on Clauses. Being relevant they are extracted hereinbelow:-

Notes on Clauses to the Finance Bill, 2008

"**Clause 48** seeks to amend Section 271 of the Income Tax Act, which relates to failure to furnish returns, comply with notices, concealment of income, etc.

Under the existing provisions contained in Chapter XXI the Assessing Officer is required to be satisfied during the course of penalty proceedings. Legislative intent was that such a satisfaction was required to be recorded only at the time of levy of penalty and not at the time of initiation of penalty. However, some of the judicial interpretations on this issue are favouring the view that satisfaction has to be recorded at the time of initiation of penalty proceedings also.

It is therefore proposed to insert a new sub-section (1B) in section 271 of the Income-tax Act so as to provide that where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment and if such order contains a direction for initiation of penalty proceedings under sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings under sub-section (1).

This amendment will take effect retrospectively from 01st April, 1989."

Memorandum Explaining Provisions in the Finance Bill, 2008

Satisfaction for initiation of penalty under section 271(1)

Sub-section (1) of Section 271 of the Income-tax Act empowers the Assessing Officer to levy penalty for certain offences listed in that sub-section. It is a requirement that the Assessing Officer is required to be satisfied before such a penalty is levied.

There is a considerable variance in the judicial opinion on the issue as to whether the Assessing Officer is required to record his satisfaction before issue of penalty notice under this sub-section. Some judicial authorities have held that such a satisfaction need not be recorded. However, Hon'ble Delhi High Court in the case of CIT v. Ram Commercial Enterprises Ltd (246 ITR 568) has held that such a satisfaction must be recorded by the Assessing Officer.

Given the conflicting judgments on the issue and the legislative intent, it is imperative to amend the Income Tax Act to unambiguously provide that where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment; and such order contains a direction for initiation of penalty proceedings under sub-section (1), such an order of assessment or reassessment shall be

deemed to constitute satisfaction of the Assessing Officer for initiation of penalty proceedings under sub-section(1).

Similar amendment has also been proposed in the Wealth-tax Act.

These amendments will take effect retrospectively from 1st April, 1989."

LAW AS IT STOOD PRIOR TO THE AMENDMENT

12. The state of the law prior to the impugned amendment is best enunciated in the two judgments of the Supreme Court in the case of ***D.M. Manasvi*** *(supra)* and ***S.V. Angidi Chettiar*** *(supra)*. Therefore, it is relevant at this stage to examine briefly facts of the said cases and the observation made by the Supreme Court therein.

13 ***S.V. Angidi Chettiar*** *(supra)* is a case where essentially the issue for consideration which arose before the Supreme Court was whether penalty proceedings against a registered firm could continue under the provisions of the 1922 Act even after the firm's dissolution. The Supreme Court while answering the question in the affirmative, also dealt with the submission of the learned counsel for the assessee that the Assessing Officer having not arrived at a satisfaction during the course of the proceedings about existence of conditions contained in clause (a) & (c) of Section 28(1) of the 1922 Act, no penalty could be levied. This ground was repelled by the Supreme Court with following observations:

"Counsel contended that in any event, penalty for the assessment year 1949-50 could not be imposed upon the assessee firm because there was no evidence that the Income-tax Officer was satisfied in the course of any assessment proceedings under the Income-tax Act that the firm had concealed the particulars of its income or had deliberately furnished inaccurate particulars of the income. ***The power to impose penalty under section 28 depends upon the satisfaction of the Income-tax Officer in the course of proceedings under the Act; it cannot be exercised if he is not satisfied about the***

existence of conditions specified in clauses (a), (b) or (c) before the proceedings are concluded. The proceeding to levy penalty has, however, not to be commenced by the Income-tax Officer before the completion of the assessment proceedings by the Income-tax Officer. Satisfaction before conclusion of the proceeding under the Act, and not the issue of a notice or initiation of any step for imposing penalty is a condition for the exercise of the jurisdiction. *There is no evidence on the record that the Income-tax Officer was not satisfied in the course of the assessment proceeding that the firm had concealed its income.* ***The assessment order is dated the 10th November, 1951, and there is an endorsement at the foot of the assessment order by the Income-tax Officer that action under S. 28 had been taken for concealment of income indicating clearly that the Income-tax Officer was satisfied in the course of the assessment proceeding that the firm had concealed its income****."*

(Emphasis is ours)

13.1 Briefly, let us also examine the facts of ***D.M. Manasvi's case*** *(supra)*. The assessee in the said case was an individual. He was assessed to tax for four (4) assessment years, i.e., assessment year 1959-60 to assessment year 1962-63. After completion of assessment for two years it was discovered by Assessing Officer that the assessee had failed to disclose income from one entity, namely, M/s Kohinoor Grain Mills Sales Depot (in short Kohinoor). The Income Tax Officer (in short the 'I.T.O.') was of the opinion that this entity was not a genuine partnership firm but a sole proprietorship concern of the assessee. Accordingly, income from Kohinoor was added to assessee's income in the two assessment years under consideration as well as in the other two assessment years in which assessment had been completed after they were duly reopened. This circumstance propelled the I.T.O. to initiate penalty proceedings. The assessee lost through-out. In the Supreme Court it was contended on behalf of the assessee that the penalty proceedings were not properly commenced, as also, there was no material or evidence before the Tribunal to hold that the assessee

had deliberately concealed particulars of his income or deliberately furnished inaccurate particulars of his income. While answering the question against the assessee the Supreme Court made the following crucial observations:-

> *"According to Clause (c) of Sub-section (1) of Section 271 of the Act, if the Income Tax Officer or the Appellate Assistant Commissioner in the course of any proceedings under the Act is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay in addition to the amount of tax, by way of penalty a sum calculated in accordance with Clause (iii) of that sub-section.....*
>
> *.....Clause (c) of Sub-section (1) of Section 271 shows that occasion for taking proceedings for payment of penalty arises if the Income Tax Officer or the Appellate Assistant Commissioner is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income. It has also to be shown that the Income Tax Officer or the Appellate Assistant Commissioner was so satisfied in the course of proceedings under the Act. In the present case, we find that the Income Tax Officer, while making the assessment orders for the assessment years in question held that Kohinoor Mills had been wrongly shown to be a partnership firm and that the other alleged partners were simply name lenders for the assessee. It was further held that Kohinoor Mills was the Proprietary concern of the assessee and the income from that concern should be considered to be the income of the assessee. Notice was ordered to be issued for proposed penalty Under Section 271(1)(c) of the Act to the assessee* ***"in regard to the concealment of and furnishing inaccurate particulars of income" from Kohinoor Mills.*** *Notices, it would appear, were thereafter issued by the Income Tax Officer to the assessee.*
>
> *The fact that notices were issued subsequent to the making of the assessment orders would not, in our opinion, show that there was no satisfaction of the Income Tax Officer during the assessment proceedings that the assessee had concealed the particulars of his income or had furnished incorrect particulars of such income. What is contemplated by Clause (1) of Section 271 is that the Income Tax Officer or the Appellate Assistant Commissioner should have been satisfied in the course of proceedings under the Act regarding matters mentioned in the clauses of that sub-section. It is not, however, essential that notice to the person proceeded against should have also been issued during the course of the assessment proceedings.*

Satisfaction in the very nature of things precedes' the issue of notice and it would not be correct to equate the satisfaction of the Income Tax Officer or Appellate Assistant Commissioner with the actual issue of notice. The issue of notice indeed is a consequence of the satisfaction of the Income Tax Officer or the Appellate Assistant Commissioner and it would, in our opinion, be sufficient compliance with the provisions of the statute if the Income Tax Officer or the Appellate Assistant Commissioner is satisfied about the matters referred to in clauses (a) to (c) of Sub-section (1) of Section 271 during the course of proceedings under the Act even though notice to the person proceeded against in pursuance of that satisfaction is issued subsequently.....

.....It would, indeed, be the satisfaction of the Income Tax Officer in the course of the assessment proceedings regarding the concealment of income which would constitute the basis and foundation of the proceedings for levy of penalty.....

*.....**It may also be observed that what is contemplated by Sections 271 and 274 of the Act is that there should be, prima facie, satisfaction of the Income Tax Officer** or the Appellate Assistant Commissioner in respect of **the matters mentioned in Sub-section (1) before he hears the assessee or gives him an opportunity of being heard**. **The final conclusion on the point as to whether the requirements of clauses (a), (b) and (c) of Section 271(1) have been satisfied would be reached only after the assessee has been heard or has been given a reasonable opportunity of being heard.***

(Emphasis is ours)

The argument that there was no material or evidence before the Tribunal to hold that the assessee had deliberately concealed the particulars of his income or had deliberately furnished in-accurate particulars of such income is equally bereft of force. The Tribunal while dealing with this aspect of the matter referred to its earlier observations in the appeal relating to the refusal of the Income Tax authorities to register Kohinoor Mills as a firm.....

.....It would thus follow that the Tribunal came to the conclusion on the basis of relevant evidence that the business of Kohinoor Mills was under the control of the assessee and that there was no firm in existence as alleged. The Tribunal also found that the income of the said concern belonged to the assessee himself even though the business was run in the guise of a firm. It was held that the whole scheme was to disguise the profits of the assessee as those of the firm. It cannot, therefore, be said that there was no relevant material or evidence before the Tribunal to

hold that the assessee had deliberately concealed the particulars of his income or had deliberately furnished inaccurate particulars of such income.

Mr. Chagla has referred to the case of Commissioner of Income Tax v. Anwar Ali……..

……..On the basis of the dictum laid down in the above case, it is urged by Mr. Chagla that from the mere fact that the explanation of the assessee in the present case was found to be false it did not follow that the disputed amount represented his income and that the assessee had consciously concealed the particulars of his income or had deliberately furnished inaccurate particulars. In this respect we find that in the present case the inference that the assessee had consciously concealed the particulars of his income or had deliberately furnished inaccurate particulars is based not merely upon the falsity of the explanation given by the assessee. On the contrary, it is made amply clear by the order of the Tribunal that there was positive material to indicate that the business of Kohinoor Mills belonged to the assessee and the whole scheme was to disguise the profits of the assessee as those of a firm of four partners. The present is not a case of inference from mere falsity of explanation given by the assessee, but a case wherein there are definite findings that a device had been deliberately created by the assessee for the purpose of concealing his income. The assessee as such can derive no assistance from Anwar Ali's case"

13.2 To summarize: the Supreme Court held that the 'satisfaction' which the Assessing Officer was required to arrive at during the course of assessment proceedings for initiation of penalty proceedings was 'prima facie' in nature as against a 'final conclusion', that the assessee had committed an act of omission or commission which would bring him within the ambit of the provisions of clause (c) of sub-section (1) of Section 271. The notice under Section 274 was to follow. What was important was that 'satisfaction' had to be arrived at during the course of assessment proceedings and not issuance of notice under Section 274 of the Act. (See ***D.M. Manasvi*** *(supra) and* ***S.V. Angidi Chettiar*** *(supra)*

13.3 Having noted the ratio of the judgment of the Supreme Court in ***D.M. Manasvi*** and ***S.V. Angidi Chettiar*** *(supra),* it would also perhaps be relevant to briefly examine the facts obtaining in ***Ram Commercial*** *(supra)* as the Department is most aggrieved by the observations contained therein which have been subsequently followed by other Division Benches of this Court and is the reason for the impugned amendment. The facts as recorded in ***Ram Commercial*** *(supra)* are briefly as follows:-

13.4 The assessee had filed a return for assessment year 1986-87 declaring an income of Rs 15,700/-. There was a survey conducted on the assessee pursuant to which it was found that assessee had earned additional income. The assessee filed a revised return surrendering an income of Rs 5,50,000 over and above what was declared earlier. This was followed by another communication by the assessee in continuation of his earlier revised voluntary return, surrendering yet another amount of Rs 8,99,000/-. An additional amount of Rs 1000/- which the assessee could not explain was also added to its income. The total additions made to the assessee's income was Rs 24,50,000/-.

13.5 With the completion of assessment proceedings by the very same order, the Assessing Officer directed initiation of penalty proceedings under Section 271(1)(c), separately. Thereupon, after giving the assessee an opportunity of being heard, the Assessing Officer imposed penalty of Rs 9,77,100/- on the ground that he was of the opinion that the assessee deliberately concealed his income by filing inaccurate income to the tune of Rs 15,51,000/-. Based on these facts, the matter travelled to the Tribunal. The Tribunal deleted the penalty primarily on the ground that in the absence of the Assessing Officer having not recorded requisite satisfaction of concealment of income during the

course of the assessment proceedings, the Assessing Officer lacked the jurisdiction for initiation of penalty proceedings. The Tribunal refused to refer the question of law under Section 256(1) of the Act as it obtained at the relevant point of time; consequently a petition under Section 256(2) of the Act was preferred in this Court. A Division Bench of this Court after taking note of the law laid down by the Supreme Court in both ***S.V. Angidi Chettiar*** *(supra)* and ***D.M. Manasvi*** *(supra)* noted very carefully that the law requires that before initiating penalty proceedings it is the Assessing Officer who is required to be satisfied as to whether penalty proceedings have to be initiated. The submission of the Revenue that having regard to the material on record an inference could be made that a requisite satisfaction had been arrived at by the Assessing Officer was expressly rejected by this Court by observing that the Court in the proceedings pending before it, could not based on the material available on record substitute, the requisite finding which the law requires the Assessing Officer to make with its own findings for sustaining the initiation of penalty proceedings by the Assessing Officer. This is quite evident from the submissions made by the Revenue before the Court and the observations thereafter made by the Division Bench. It would be evident from the observations extracted hereinafter that the Division Bench concluded by observing that merely because penalty proceedings have been initiated, it cannot be assumed that such satisfaction was arrived at in the absence of the same being 'spelt out' by the order of the Assessing authority. The Court went on to hold that the assessment order does not record the satisfaction as warranted by Section 271 for initiating penalty proceedings. The relevant extract of the judgment is as follows:-

"Learned senior standing counsel for the Revenue, on the other hand, submitted that all the facts available on record and as pointed out by him coupled with the fact that by the assessment order itself the assessing authority has chosen to initiate proceedings under section 271(1)(c) of the Act leads to an inference that the requisite satisfaction was arrived at by the assessing authority. Therefore, the initiation of penalty proceedings cannot be found fault with and hence a question of law does arise.

Having heard learned counsel for the parties and having given our anxious consideration to the material available on the record, in the light of the law laid down by their Lordships of the Supreme Court, we are of the opinion that no fault can be found with the judgment of the Tribunal and, therefore, the question suggested by the Revenue does not arise as a question of law from the order of the Tribunal.

The law is clear and explicit. Merely because this court while hearing this application may be inclined to form an opinion that the material available on record could have enabled the initiation of penalty proceedings that cannot be a substitute for the requisite findings which should have been recorded by the assessing authority in the order of assessment, but has not been so recorded.

A bare reading of the provisions of Section 271 and the law laid down by the Supreme Court makes it clear that it is the assessing authority which has to form its own opinion and record its satisfaction before initiating penalty proceedings. Merely because the penalty proceedings have been initiated, it cannot be assumed that such a satisfaction was arrived at in the absence of the same being spelt out by the order of the assessing authority. Even at the risk of repetition we would like to state that the assessment order does not record the satisfaction as warranted by Section 271 for initiating the penalty proceedings."

13.6 What is obvious is that in the facts of the said case there was nothing on record which would suggest that the Assessing Officer had applied his mind to the material on record and thereupon arrived at a prima facie satisfaction that it was a fit case for initiation of penalty proceedings against the assessee. The argument of the Department that based on material on record the Tribunal should have inferred that requisite satisfaction had been arrived at by the Assessing Officer, was expressly rejected by the Court, as the provision mandated that it had to be the satisfaction of the Assessing Officer.

13.7 The ratio of ***Ram Commercial*** *(supra)* was applied by the same Division Bench which decided ***Ram Commercial*** *(supra)* in ***Diwan Enterprises*** *(supra).* The observations made therein being relevant are extracted hereinafter:-

> "In spite of the abovesaid plea of the petitioner having been rejected, the penalty imposed under section 271(1)(c) has still to be set aside though for a different reason and because the very foundation for initiation of the penalty proceedings is conspicuous by its absence. The opening clause of sub-section (1) of section 271 itself contemplates a finding as regards satisfaction of availability of grounds under clause (c) being recorded during the assessment proceedings. Recently, in *CIT vs Ram Commercial Enterprises Ltd.* (I.T.C No. 13 of 1996 decided on October 8,1998-since reported in (2000) 246 ITR 568 (Delhi), following the law laid down by their Lordships of the Supreme Court in D.M.Manasvi v. CIT (1972) 86 ITR 557 and CIT v. S.V.Angidi Chettiar (1962) 44 ITR 739 (SC), we have held that unless requisite satisfaction was recorded in the proceedings under the Act, which would mean the assessment proceedings, the jurisdiction to initiate the penalty proceedings could not have been exercised. Satisfaction has to be before the issue of notice or initiation of any step for imposing penalty. In the case at hand we find the Assessing Officer having nowhere recorded till the conclusion of the assessment proceedings his satisfaction that the assessee had concealed the particulars of his income or furnished inaccurate particulars of such income. This is a jurisdictional defect which cannot be cured. The initiation of the penalty proceedings was itself bad and, consequently, all the subsequent proceedings leading up to the passing of the penalty order must fail. C.W.P. No. 3869 of 1997 is, therefore, liable to be allowed."

13.8 A careful reading of the judgment would once again demonstrate that the Court upheld the contention of the assessee that there was nothing to suggest that the Assessing Officer had arrived at a prima facie satisfaction. This is quite clear from the extract of the assessment order in the earlier part of Diwan Enterprises the same being relevant is quoted hereinbelow:-

> "Penalty proceedings under Section 271(1)(c) or furnishing inaccurate particulars of income and under Section 271D for accepting the loan of Rs 30,000 in

cash in violation of the provisions of Section 269SS have been initiated separately."

13.9 It is important to note that in both ***Ram Commercial*** *(supra)* and ***Diwan Enterprises*** *(supra)* there is no mention of the fact that reasons ought to be recorded. The emphasis in both the judgment is recordal of satisfaction. This according to us is an important distinction which is to be borne in mind. Another Division Bench of this Court in ***CIT vs. Vikas Promoters P. Ltd. (2005) 277 ITR 337 (Delhi)*** while dismissing the appeal of the Revenue made note of the fact from the order of the Tribunal that there was no record of satisfaction before initiation of penalty proceedings. The Assessing Officer it seems had perfunctorily initiated the penalty proceedings by simply stating in the assessment order 'penalty proceedings under Section 271(1)(c) are initiated separately'. In this background the Division Bench while applying the ratio of the judgment in ***Ram Commercial*** as follows:-

"Learned counsel appearing for the petitioner while relying upon CIT v. S.V. Angidi Chettiar (1962) 44 ITR 739 (SC) contended that it was not necessary for the authorities to record reasons of satisfaction before issuing the demand notice as the proceedings taken by the Assessing Officer per se reflected the ingredients of section 271(1)(c) of the Act that there was concealment of income and as such the assessee was liable for penal action within the provision of the said Act. Having perused the judgment of the Supreme Court aforereferred, we are of the opinion that the argument of learned counsel appearing for the Department is misconceived. Their Lordships of the Supreme Court have repeatedly emphasized the word "satisfaction" and the satisfaction is not to be in the mind of the Assessing Officer but must be reflected from the record. It is a settled rule of law that the authorities performing quasi-judicial or judicial function must give reasons in support of its order so as to provide in the order itself the ground which weighed with the authorities concerned for passing an order adverse to the interest of the assessee. Furthermore the provisions of section 271(1)(c) are penal in nature thus must be strictly construed, the element of satisfaction should be apparent from the order itself. It is not for the courts to go into the

mind of the authorities or trace the reasons from the files of such authorities."

13.10 As is evident, the observations of the Court make it clear that the satisfaction which the Assessing Officer has reached, must be 'reflected' and/or 'apparent' from the order itself. It is in this context the Division Bench perhaps observed that it is not for the Courts to go into the mind or trace reasons from files of such authorities. A reading of the observations of various Division Benches of this court would show that the Court did not suggest that at the stage of initiation of penalty proceedings reasons had to be recorded. What the Court held in ***Vikas Promoters*** *(supra)* is in line with the view held in ***Ram Commercial*** *(supra)* wherein it observed that the satisfaction of the Assessing Officer should be demonstrable from the order.

13.11 A similar opinion was expressed by other Division Benches of this Court in the following cases: ***CIT vs Super Metal Roller: (2004) 265 ITR 82; CIT vs Auto Lamps: (2005) 278 ITR 32 and Shri Bhagwant Finance Company vs CIT: 280 ITR 412***. The facts in ***Bhagwant Finance Company*** *(supra)* were rather peculiar. Briefly, in the said case assessee's case was taken up for scrutiny wherein it was discovered that there was an increase in fresh unsecured loans to the extent of Rs 16.5 lacs in the assessment year under consideration, which was, 1992-93. The assessee surrendered a sum of Rs 11.10 lacs on account of principal and Rs 1.65 lacs on account of interest in the aforesaid assessment year. Similar amounts were surrendered in respect of earlier assessment years i.e, 1989-90, 1990-91 and 1991-92 amounting to Rs 2 lacs, Rs 7 lacs and Rs 5 lacs respectively. Thus, the total amount which was surrendered, which

included interest as well, for the aforesaid assessment years was Rs 26.75 lacs. The assessee, even before investigation could be launched to ascertain reasons for increase in unsecured loans accepted that it would pay the tax demanded for not only assessment year 1992-93 but also for earlier assessment years i.e, 1989-90, 1990-91 and 1991-92. Importantly, during the course of the assessment proceedings the Assessing Officer had made a record in an 'office note' that: since the Director of the assessee company had filed an indemnity bond undertaking therein to pay tax for the afore-mentioned assessment years; in event of a default penalty proceedings may be initiated under Section 271(1)(c) of the Act. Similarly, in respect of assessment year 1992-93, the office note specifically stated that; if tax for the said assessment year was paid by the stipulated date i.e, 30.06.1995 then penalty proceedings "shall be dropped since the assessee had made a *surrender of its own accord before the entire increase of unsecured loans was investigated".* The Court observed that this office note was not brought to the notice of the authorities below. The Revenue on being confronted with the office note accepted these facts. The Court based on the facts obtaining in the said case, came to the conclusion that it would not only be unjust and unfair but also contrary to the scheme of the Act that the Revenue was 'permitted to use initiation, continuation of penalty proceedings and imposition thereof as a threat to an assessee for recovery of tax due from the concerned assessee.' The Division Bench observed that the Assessing Officer had not recorded his satisfaction before initiation of penalty proceedings, and that, in the said case, it was used as a coercive measure to recover Revenue rather than being founded on a satisfaction in regard to the fact that

the assessee had concealed particular of his income or furnished inaccurate particulars of its income.

13.12 There is one another case decided by a Division Bench of this Court entitled ***CIT vs Rajan & Co : (2007) 291 ITR 340*** to which a reference requires to be made. In this case the matter travelled by way of an appeal to this Court against the order of the Tribunal. The Tribunal in the said case had dismissed the appeal of the Revenue on the ground that the Assessing Officer had made an addition with respect to two items while in the assessment order satisfaction had been reflected vis-à-vis only one item. This Court applying the principles set forth in ***S.V. Angidi Chettiar*** *(supra)* and ***Ram Commercial*** *(supra)* rejected the appeal and sustained the order of the Tribunal by observing that no satisfaction had been returned with respect to one of the two items added to the income of the assessee. The Division Bench of this Court dismissed the appeal holding that the appeal did not raise a substantial question of law and in this regard it applied the judgment of this Court in ***CIT vs S.R. Fragnances Ltd: (2004) 270 ITR 560***. In our view the observations of the Division Bench in ***Rajan & Co*** *(supra)* are distinguishable, as a reading of the judgment seems to suggest that there was no discussion on the aspect of satisfaction in so far as whether or not there is a requirement by the Assessing Officer to arrive at satisfaction vis-à-vis each and every addition or disallowance made by the Assessee Officer. The Division Bench merely affirmed the conclusion of the Tribunal to that effect. The dismissal of the appeal of the Department veered on the question whether or not a substantial question of law was raised which is why reliance was placed by the Division Bench on the judgment in ***S.R. Fragnances*** *(supra)*.

13.13 The Punjab & Haryana High Court seems to have accepted the view held by this Court in ***Ram Commercial*** *(supra)* in the case of ***CIT vs Munish Iron Store (2003) 263 ITR 484***. Briefly, in ***Munish Iron Store*** *(supra)* the Punjab & Haryana High Court approved the order of the Tribunal cancelling the penalty imposed on the assessee on the ground that the satisfaction as regards concealment of income or furnishing of inaccurate particulars by the assessee in order to assume jurisdiction, initiated and levy of penalty was not recorded, as envisaged by law. The Court went on to hold that this was a jurisdictional defect which could not be cured. The relevant observations are found at pages 485 & 486 of the report.

> *"Shri Sawhney argued that failure of the assessee to file a correct return was by itself sufficient for levy of penalty under Section 271(1)(c) of the Act and the Tribunal committed a serious error by setting aside the orders of the assessing authority and the Commissioner of Income-tax (Appeals) only on the ground of non-recording of satisfaction by the Assessing Officer in the order of assessment.*
>
> *In our opinion, there is no merit in the argument of learned counsel. A reading of the order passed by the Tribunal shows that after making a reference to the judgments of the Supreme Court and some High Courts in Jain Brothers v. Union of India (1970) 77 ITR 107(SC), D.M. Manasvi v. CIT (1972) 86 ITR 557 (SC), CIT v. Ram Commercial Enterprises Ltd. (2000) 246 ITR 568(Del) and Diwan Enterprises v. CIT (2000) 246 ITR 571(Del), the Tribunal culled out the proposition of law in the following words :*
>
> > *"It is clear from above that jurisdiction to impose penalty flows from recording of the satisfaction and in case there is a jurisdictional defect in the assumption of jurisdiction, it cannot be cured. With the aforesaid legal quoting, we are to examine the question whether the Assessing Officer assumed proper jurisdiction. It is again to be noted that from the issue of notice under Section 271(1)(c), the recording of legal and valid satisfaction cannot be assumed."*
>
> *The Tribunal then referred to the order of assessment passed by the Assessing Officer and observed :*

> *"It is clear from the above that not a word has been written about concealment of income. The Assessing Officer quietly accepted the revised return and the income disclosed therein. He did not record how and why the revised return was submitted. The statement of the partner on pages 14-16 of the paper book, Shri Ramesh Kumar was recorded and in that statement, he did explain the reasons which led to filing of the revised return. Learned counsel for the assessee contended that those reasons were impliedly accepted by the Assessing Officer. Looking at the assessment order, one cannot challenge the above assertion of learned counsel for the assessee. At any rate, the satisfaction about the concealment of income of furnishing of inaccurate particulars of income to assume jurisdiction to initiate and levy penalty is clearly not recorded as enjoined by law. The above jurisdictional defect in our view cannot be cured. Accordingly, we hold that penalty imposed is not valid and jurisdiction to impose the same was illegally assumed without recording a proper satisfaction. Penalty imposed is cancelled for the above reasons."*
>
> *In our opinion, the reasons assigned by the Tribunal for cancellation of the penalty are legally correct and the order passed by it does not give rise to any question of law, much less a substantial question of law requiring determination by this court under Section 260A of the Act.*
>
> *Hence, the appeal is dismissed."*

14. On the other hand the learned ASG has heavily relied upon the judgment of the High Court of Calcutta in ***Becker Gray and Co. (1930) Ltd vs. Income Tax Officer (1978) 112 ITR 503*** and that of the High Court of Allahabad in ***Shyam Biri Works Pvt. Ltd vs. CIT (2003) 259 ITR 625*** to propound what the Revenue considers is a contra view.

14.1 Briefly, the facts in ***Becker Gray and Co*** *(supra)* are as follows: the assessee who, carried on the business of purchase and sale of jute

fabrics was issued a notice under Section 271/274 of the Act, in the course of assessment proceedings on the ground that he had concealed particulars of income or deliberately furnished inaccurate particulars during the course of assessment. The Assessing Officer, amongst others, had made an addition of Rs 25,10,315/- on account of excess commission alleged to have been paid by assessee to one, White Lamb Finlay carrying on business of jute fabrics in USA. At the foot of the assessment order the Income tax Officer had recorded that a notice under Section 274 had been issued for penalty under Section 271(1)(c) of the Act. Based on these circumstances obtaining in the said case, the Division Bench of the Calcutta High Court while reiterating the principle that the Income Tax Officer should be prima facie satisfied before penalty notice is issued that the assessee infracted the provision of Section 271(1)(c) of the Act; observed that the Assessing Officer need not record such satisfaction in writing in every case. The court went on to hold whether the Income Tax Officer was so satisfied before he issued a penalty notice Section 271(1) depended on the facts and circumstances of each case. As a matter of fact the court returned a finding that the notice was issued by the Income Tax Officer during the course of proceedings and, also that, relevant material was before him at the point in time when he issued notice. The court observed on perusal of the assessment order that there was sufficient evidence to show that the Income Tax Officer was prima facie satisfied before he issued a penalty notice.

14.2 In the case of ***Shyam Biri Works*** *(supra)* the court was concerned with the imposition of penalty under Section 273(2)(a) of the Act for allegedly furnishing false estimate of advance tax. By a

brief order the Division Bench of Allahabad High Court observed that even though the Assessing Officer should have satisfied himself before initiating penalty proceedings it was not necessary for him to record his satisfaction in writing before initiating penalty proceedings under Section 273 of the Act. In this regard the Division Bench of Allahabad High Court disagreed with the views expressed by this Court in ***Ram Commercial*** *(supra)*.

14.3 A perusal of the judgment of Calcutta High Court in ***Becker Gray & Co*** *(supra)* and that of the Allahabad High Court in ***Shyam Biri Works Ltd*** *(supra)* would show that there is a consensus on the issue that before the Assessing Officer issues a notice for initiation of penalty proceedings he must have arrived at satisfaction during the course of assessment proceedings. As regards nature of the satisfaction is concerned, there is no observation with respect to the same, in the aforementioned judgments. While the Calcutta High Court in ***Becker Gray & Co*** *(supra)* was, as a general proposition, of the view that whether or not satisfaction requires to be recorded in writing would depend on the facts and circumstances of the case; however, in the facts of the said case the Court was of the view that having regard to the contents of the assessment order, there was material available with the Assessing Officer, to initiate penalty proceedings. On the other hand, the Allahabad High Court has taken the view it is not necessary for the Assessing Officer to 'record his satisfaction in writing'. Since the background facts and circumstances do not find a mention in the said judgment of the Allahabad High Court, we are unable to gather as to whether, like in the case of ***Becker Gray and Co*** *(supra),* there was material available on record

to demonstrate that before initiating penalty proceedings the Assessing Officer had arrived at a prima facie satisfaction.

14.4 The view in ***Shyam Biri Works*** *(supra)* was reiterated by another Division Bench judgment of the Allahabad High Court in ***Nainu Mal Het Chand vs CIT (2007) 294 ITR 185 (All)***. The Court after taking note of the view of the Delhi High Court in ***Ram Commercial*** *(supra),* the Punjab & Haryana High Court in ***Munish Iron Store*** *(supra)* as also, the Supreme Court judgments in ***D.M. Manasvi*** *(supra)* and ***S.V. Angidi Chettiar*** *(supra)* observed as follows:-

> "*So far as the two decisions of the Delhi High Court are concerned, we find that under the provisions of the Act, the Income-tax Officer is not required to record his satisfaction in a particular manner or reduce it in writing. It can be gathered from the assessment order itself. In D.M.Manasvi (1972) 86 ITR 557, the apex court has clearly held that the Income-tax Officer should be satisfied during the course of the assessment proceedings that the assessee had concealed his particulars of income or has furnished inaccurate particulars of such income. The satisfaction can be gathered from the assessment order. In the present case, we find that the Income-tax Officer had material before him for being satisfied that the applicant has concealed the particulars of his income and, therefore, penalty proceedings have rightly been initiated. We are, therefore, with great respect unable to persuade ourselves to follow the view taken by the Delhi High Court in the aforesaid two cases*."

14.5 A more extreme view was taken by the Division Bench of the Madras High Court in the case of ***M Sajjanraj Nahar vs CIT (2006) 283 ITR 230***. The brief facts of this case were that: an assessee had filed a return declaring his total taxable income in the sum of Rs 88,010/- after deducting therefrom a sum of Rs 61,200/- in respect of interest paid on loans obtained from different parties in earlier assessment years. The assessment was completed under Section

143(1) of the Act. Thereafter a notice under Section 143(2) of the Act was issued. In response to the said notice, the assessee filed a revised return declaring a total income of Rs 1,49,210/- which was arrived at after showing a further sum of Rs 61,200/- as his income. The Assessing Officer while completing the assessment made an endorsement that penalty proceedings should be initiated separately under Sections 271(1)(c) and Section 273(2)(a). In the context of these short facts the Division Bench observed at Pages 243-244 Para 29 as follows:-

> "38 In both the decisions, the Delhi High Court, followed the observations of the apex court in CIT v. S.V.Angidi Chettiar (1962) 44 ITR 739. But, we have already pointed out that the decision of the apex court in *CIT v. S.V. Angidi Chettiar (1962) 44 ITR 739,* that a mere indication as to the initiation of the penalty proceedings separately in the assessment order is tantamount to an indication as to the satisfaction of the authorities that the assessee has concealed income or furnished inaccurate particulars, had not been brought to the notice of the Delhi High Court in (a) ***CIT v. Ram Commercial Enterprises Ltd. (2000) 246 ITR 568****;* (b) *Diwan Enterprises v. CIT (2000) 246 ITR 571 (Delhi); and (c) CIT v. Vikas Promoters P. Ltd. (2005) 277 ITR 337 (Delhi).* For this reason and in the light of the law enunciated in various decisions of this court, referred to supra, with respect, we are unable to agree with the viewed expressed by the Delhi High Court in
>
> (a) *CIT v. Ram Commercial Enterprises Ltd. (2000) 246 ITR 568;*
> (b) *Diwan Enterprises v. CIT (2000) 246 ITR 571 (Delhi); and (c) CIT v. Vikas Promoters P. Ltd. (2005) 277 ITR 337 (Delhi)……."
>
> *"44. ……* Under the facts and circumstances of the case, it is clear that the original return filed by the assessee, when compared with the revised return pursuant to the notice issued under section 143(2) of the Act forms the basis for the satisfaction of the Assessing Officer for initiating penalty proceedings under section 271(1)(c) of the Act. The Assessing Officer, therefore, has rightly reached the satisfaction that the assessee had concealed income in the original return by way of indicating his satisfaction that the penalty proceedings are proposed to be initiated…."

15. As indicated above, ***Ram Commercial*** *(supra)* was referred to a Full Bench of this High Court. The Full Bench dealt with cases to

which law obtaining prior to 01.04.1989 was applicable. The question of law that the Full Bench was called upon to consider was as follows:

> *"whether satisfaction of the officer initiating proceedings under Section 271 of the Income-tax Act can be said to be recorded even in cases where satisfaction is not recorded in specific terms but is otherwise discernoble from the order passed by the authority."*

15.1 The Full Bench after considering judgments of the Supreme Court in the case of ***D.M. Manasvi*** *(supra),* ***S.V. Angidi Chettiar*** *(supra),* ***Ram Commercial*** *(supra),* ***Diwan Enterprises*** *(supra)* and the Bombay High Court judgment in the case of ***CIT vs Dajibhai (1991) 189 ITR 141*** came to the following conclusion.

> *"In our opinion, the legal position is well settled in view of the Supreme Court decisions in CIT vs S.V. Angidi Chettiar (1962) 44 ITR 739 and D.M. Manasvi vs CIT (1972) 86 ITR 557, that power to impose penalty under Section 271 of the Act depends upon the satisfaction of the Income Tax Officer in the course of the proceedings under the Act. It cannot be exercised if he is not satisfied and has not recorded his satisfaction about the existence of the conditions specified in Clauses (a), (b) and (c) before the proceedings are concluded. It is true that mere absence of the words "I am satisfied" may not be fatal but such a satisfaction must be spelt out from the order of the Assessing Authority as to the concealment of income or deliberately furnishing inaccurate particulars. In the absence of a clear finding as to the concealment of income or deliberately furnishing inaccurate particulars, the initiation of penalty proceedings will be without jurisdiction. In our opinion, the law is correctly laid down in Ram Commercial Enterprises Ltd. (2006) 246 ITR 568 (Del) and we are in respectful agreement with the same. The reference is answered accordingly."*

15.2 A bare reading of the aforesaid extract from ***Rampur Engineering*** *(supra)* would show that the Full Bench:

(i) applied the law, as it ought to, as declared in ***D.M. Manasvi*** *(supra) and* ***S.V. Angidi Chettiar*** *(supra)*

(ii) a fortiori the principle for initiation of penalty proceedings being; the prima facie satisfaction of the Assessing Officer during the course of assessment proceedings being discernible from the record, was reiterated.

(iii) the irrelevance of - the Assessing Officer having to say so in so many words that 'I am satisfied' was highlighted.

(iv) the judgment of the Division Bench in Ram Commercial was affirmed which enunciated that: Firstly satisfaction should be that of Assessing Officer. Secondly, the assessment order should reflect such satisfaction.

15.3 In our opinion when the above is juxtaposed with the following observations in Rampur Engineering (supra) "in the **absence of clear finding as to the concealment of income or deliberately furnished inaccurate particulars the initiation of** penalty proceedings will be without jurisdiction" – it could only mean that prima facie satisfaction of the Assessing Officer as reflected in the record as against his 'final conclusion' should be discernible clearly from the order passed during the course of such proceedings.

15.4 Importantly, as observed by us hereinabove, post-amendment these provisions remained untouched. In these circumstances we do not see how it can be argued by the Revenue that prior to the impugned amendment 'satisfaction' at both at the initiation stage as also at the stage of imposition was required, however, with the enactment of the impugned provision, that is, sought to be changed by providing for 'satisfaction' only at the stage of imposition of penalty.

15.5 In our opinion the impugned provision only provides that an order initiating penalty cannot be declared bad in law only because it

states that penalty proceedings are initiated, if otherwise it is discernible from the record, that the Assessing Officer has arrived at prima facie satisfaction for initiation penalty proceedings. The issue is of discernibility of the 'satisfaction' arrived at by the Assessing Officer during the course of proceeding before him.

15.6 As indicated hereinabove, the position is no different post-amendment. The contra-submission of the learned ASG that prima facie satisfaction of the Assessing Officer need not be reflected at the stage of initiation but only at the stage of imposition of penalty is in the teeth of Section 271(1)(c) of the Act. Section 271(1)(c) has to be read in consonance of Section 271(1B). The presence of prima facie satisfaction for initiation of penalty proceedings was and remains a jurisdictional fact which cannot be wished away as the provision stands even today, i.e., post amendment. If an interpretation such as the one proposed by the Revenue is accepted then, in our view, the impugned provision will fall foul of Article 14 of the Constitution as it will then be impregnated with the vice of arbitrariness. The Assessing Officer would in such a situation be in a position to pick a case for initiation of penalty merely because there is an addition or disallowance without arriving at a prima facie satisfaction with respect to infraction by the assessee of clause (c) of sub-section (1) of Section 271 of the Act. A requirement which is mandated by the provision itself.

15.7 Learned ASG also sought to place reliance on the Memorandum as well as Clause 48 of the Notes on Clauses appended to the Finance Act, 2008. Even though both the Memorandum as well as Notes On Clauses refers to the conflict in judicial opinion and gives that, as the

reason for insertion of the impugned provision, in our opinion, in sub-section (1B) of Section 271 does not do away with the principle that the prima facie satisfaction of the Assessing officer must be discernible from the order passed by the Assessing Officer during the course of assessment proceedings pending before him.

15.8 If there is no material to initiate penalty proceedings; an assessee will be entitled to take recourse to a court of law. On the other hand, if the Assessing officer's prima facie satisfaction is discernible from the record ordinarily, an assessee would be required to approach authorities under the statute.

15.9 Therefore, the submission of the petitioners that the court's power of judicial review is taken away is completely unfounded. At the stage of initiation the Assessing Officer cannot be expected to reflect in his order availability of prima facie satisfaction with respect to each and every addition or disallowance. The inter-relation of additions or disallowances, if any, may be unravelled only at the conclusion of the penalty proceedings. It would be sufficient compliance with the law that there is prima facie evidence of concealment of particulars of income or furnishing inaccurate particulars of income. This is so as the legislature does not enjoin a full fledged investigation at the stage of initiation of penalty proceedings. The burden of proof on account of explanation 1 to Section 271 has shifted on to the assessee. To that extent we do not accept the submission of the learned counsel for the assessee that the impugned provision gives arbitrary power to the assessing Officer to pick and chose assessees' against whom penalty proceedings may be initiated even though similar additions and disallowances are made or

that even though there are five or six items of additions and disallowances and infraction of clause (c) of Section 271(1) is vis-à-vis only one or two such items of income or deduction, notice for initiation under the impugned provision will issue in respect of all. To our minds purported hardship cannot be a ground for striking down the impugned provision.

16. In our view the submission of the Revenue that the impugned provision deals with procedural aspect of the matter and hence cannot be challenged on the ground of retrospectivity is a surplusage. Suffice it to say that the legislature had plenary powers to enact a law both prospectively and retrospectively subject to certain constitutional limitations, as long its competency to do so is not under challenge and it is not unfair or unreasonable, i.e., falls foul Article 14 of the Constitution. [See ***Ex Capt. K.C. Arora vs State of Haryana & Ors (1984) 3 SCC 281 at page 288 paragraph 15*** and ***Bhubaneshwar Singh vs UOI; JT 1994 (5) SC 83 at page 87 paragraph 8***]. This holds good also in case of a fiscal statute. [See ***Commercial Tax Officer vs M/s Biswanath Jhunjhunwala; AIR 1977 SC 357 at page 360 paragraph 13*** and ***Additional Commissioner vs M/s JT & Anr.; JT 1998 (8) SC 60 at page 70-71 paragraph 25***] In the instant case the legislature has expressly made a retrospective amendment by inserting Section 271(1B) w.e.f. 01.04.1989. The competency of the legislature to enact the impugned provision is not under challenge before us. In so far as the challenge to the impugned provision is laid on the ground of violation of Article 14; the same is not sustained when read in the manner, in which, we have read and interpreted the impugned provision. The fact that

retrospectivity is limited to 01.04.1989, as indicated hereinabove even though perhaps carried out for obscure reasons, cannot enure to benefit of those to whom the amended law is to apply.

16.1 The learned ASG has submitted that amended law would apply to those proceedings which are not finalised, i.e., are pending before various judicial forums. In our view the Revenue would do well to keep in mind the principle setforth by the Supreme Court in the case of ***CIT vs Onkar Saran & Sons. (1992) 195 ITR 1***: that offence of concealment is committed on the date on which the original return is filed. We need not say more – as facts of each case would have to be examined.

17. Counsel for both sides had cited many cases on the issue of retrospectivity and scope and ambit of a validating statute in support of their respective submission. A brief review of case laws would show that it only brings to fore the principles applied by us hereinabove.

17.1 The lead case on the issue is ***Prithvi Cotton Mills*** *(supra)*. Reliance is placed by Revenue on the observations of the Supreme Court at pages 283 and 287 in paragraph 4 of the judgment. These observations are as follows:-

> *"Before we examine section 3 to find out whether it is effective in its purpose or not we may say a few words about validating statutes in general. When a legislature sets out to validate a tax declared by a court to be illegally collected under an ineffective or an invalid law, the cause for ineffectiveness or invalidity must be removed before validation can be said to take place effectively. The most important condition, of course, is that the Legislature must possess the power to impose the tax, for, if it does not, the action must ever remain ineffective and illegal. Granted legislative competence, it is not sufficient to declare merely that*

the decision of the Court shall not bind for that is tantamount to reversing the decision in exercise of judicial power which the Legislature does not possess or exercise. A court's decision must always bind unless the conditions on which it is based are so fundamentally altered that the decision could not have been given in the altered circumstances. Ordinarily, a court holds a tax to be invalidly imposed because the power to tax is wanting or the statute or the rules or both are invalid or do not sufficiently create the jurisdiction. Validation of a tax so declared illegal may be done only if the grounds of illegality or invalidity are capable of being removed and are in fact removed and the tax thus made legal. Sometimes this is done by providing for jurisdiction where jurisdiction had not been properly invested before. Sometimes this is done by re-enacting retrospectively a valid and legal taxing provision and then by fiction making the tax already collected to stand under the re-enacted law. Sometimes the Legislature gives its own meaning and interpretation of the law under which tax was collected and by legislative fiat makes the new meaning binding upon courts. The Legislature may follow any one method or all of them and while it does so it may neutralise the effect of the earlier decision of the court which becomes ineffective after the change of the law. Whichever method is adopted it must be within the competence of the legislature and legal and adequate to attain the object of validation. If the Legislature has the power over the subject-matter and competence to make a valid law, it can at any time make such a valid law and make it retrospectively so as to bind even past transactions. The validity of a Validating Law, therefore, depends upon whether the Legislature possesses the competence which it claims over the subject-matter and whether in making the validation it removes the defect which the courts had found in the existing law and makes adequate provisions in the Validating Law for a valid imposition of the tax."

17.2 In several judgments following ***Prithvi Cotton Mills*** *(supra)* this principle, has been reiterated, that is, in ***M/s Ujagar Prints & Ors vs UOI 1989 (3) SCC 488***; ***P. Kannadasan & Ors vs State of Tamil Nadu & Ors. 1969 (5) SCC 670; National Agricultural Coop. Marketing Fed. of India Ltd & Anr. vs UOI & Ors. (2003) 260 ITR 548*** and ***State Bank Staff Union (Madras Circle) vs UOI 2005 (7) SCC 584***. We may only observe that the position of law

with respect to the scope of a validating statute is well settled. However, in view of opinion that we have expressed it may not be necessary to dilate upon it further to examine the validity of the impugned provision.

17.3 On behalf of the Revenue the following judgments were also cited***. CIT vs C. Ananthan Chettiar (2005) 273 ITR 401 (Mad); K.P. Madhusudan vs CIT (2001) 251 ITR 99 (SC)***. According to us these judgments do not have any relevance to the issue at hand as they deal with the effect of the explanation to Section 271(1)(c) of the Act. It may be noted that the Madras High Court judgment is based on the opinion expressed by the Supreme Court in ***K.P. Madhusudan*** *(supra)*. To the same effect is the judgment of the Allahabad High Court in the case of ***Saeed Ahmed vs Inspecting ACIT (1971) 79 ITR 28.***

17.4 The learned ASG has also relied upon the judgment of the Supreme Court in the case of ***Gold Coin Health Food P. Ltd*** *(supra)* which, according to us, does not deal with the issue at hand. The said judgment dealt with Explanation 4(a) to Section 271 of the Act. The Supreme Court by that judgment reversed the view taken by it in ***Virtual Soft Systems Ltd*** *(supra)*, by holding that penalty could be levied even in a case where an assessee files a loss return. The Supreme Court went on to hold that the amendment is clarificatory in nature and hence will apply retrospectively. In the instant case the legislature has expressly given retrospective effect to the impugned provision. The limits of its retrospectivity have been earmarked. Furthermore, as submitted by the learned ASG the impugned

provision will not apply to assessments which have already attained finality and are not pending adjudication before any judicial forum.

17.5 The learned ASG also relied upon a judgment of the Supreme Court in the case of ***Pannalal Binjraj vs UOI (1957) 31 ITR 565*** and ***Welfare Association ARP Maharashtra & Anr. vs Ranjit P. Gohil & Ors. 2003 (9) SCC 358***. To buttress his submission that there is a presumption that a statute is constitutionally valid and the burden is on the person who challenges its vires; the courts must strongly lean against reducing a statute to a futility; as far as possible the court should make a legislation effective and operative and that, the possible abuse of power vested in statute cannot be a reason for striking down a provision as the same can be rectified by taking recourse to an appropriate remedy in law.

17.6 The principles enunciated by the said judgments are now fairly well-settled. We have endeavoured, as is evident from our discussion hereinabove, to apply the aforesaid principles by reading the amended provision in a manner that it is in consonance with the safeguards which are contained in Article 14 of the Constitution.

17.7 The reliance is also being placed on the judgment of the Supreme Court in ***CIT vs Shelly Products & Anr. (2003) 261 ITR 367***. The question which came up for consideration in this case was whether the assessee was entitled to refund of income tax paid by it by way of advance tax and self-assessment tax in the event of assessment being nullified by the Tribunal on the ground of jurisdiction and there being no possibility of framing a fresh assessment. In this context the Supreme Court was, amongst others, required to adjudicate as to whether proviso (b) to Section 240 of the

Act which came into force w.e.f. 01.04.1989 was clarificatory and hence retrospective in nature. The Supreme Court held that in the facts and circumstances of the case the amendment was clarificatory in nature and hence retrospective. It is evident that the applicability of this principle will depend on the construction of the provision and the fact situation obtaining in a case.

17.8 Reliance was also placed by the Revenue on the judgment of the Supreme Court in the case of ***UOI vs Dharmendra Textiles Processors (2008) 306 ITR 277***. This matter came to be decided on a reference by a Division Bench of the Supreme Court in ***UOI vs Dharmendra Textiles Processors (2007) 295 ITR 244*** while doubting with the correctness of the view expressed by another Bench of the Supreme Court in the case of ***Dilip N. Shroff vs Joint CIT (2007) 8 SCALE 304***. The three Judge Bench of the Supreme Court was thus dealing with the scope and effect of the various explanations to Section 271(1)(c) of the Act. The Court came to the conclusion that the principle of strict liability would apply to the assessee in respect of concealment or furnishing inaccurate particulars while filing his return. The Court went on to hold that penalty under the said provision was a civil liability and hence wilful concealment is not essential ingredient for attracting civil liability as in the case of matters of prosecution under Section 276C of the Act. The ratio of the judgment has in our opinion no applicability to the facts of the present case.

18 Mr Syali appearing on behalf of one of the petitioners has placed reliance on the judgment of the Supreme Court in ***Virender Singh Hooda & Ors. Vs State of Haryana & Anr. (2004) 12 SCC***

588. Briefly, this case dealt with the validity of the Haryana Civil Services (Executive Branch) and Allied Services and Other Services, Common/ Combined Examination Act, 2002. This Act came into force with retrospective effect i.e. 29.08.1989. The Act sought to repeal essentially the right to seek employment based on his or her position in merit list and/or in the Common/Combined examination test, beyond the number of advertised post. The said Act also sought to repeal circulars dated 22.03.1957 and 26.05.1972. The petitioners before the Court had contended that the act was a case of usurpation of judicial power by the State Legislature with a view to over-rule the decisions of the Supreme Court in an earlier round in the case of the same petitioner ***Virender Singh Hooda vs State of Haryana 1999 (3) SCC 696*** and ***Sandeep Singh vs State of Haryana 2002 (10) SCC 549***. The Supreme Court in paragraph 33 and34 at page 605, in brief, reiterated the principle that the legislatures power to enact cannot be found fault with unless it has acted unreasonably, and in considerating whether it has acted unreasonably or not, various factors have to be considered. The court went on to hold that the power of the legislature to enact a law retrospectively includes the power to affect existing contracts, reopen past, closed and completed transactions as also effect accrued rights and remedies or effect procedure. In other words a legislature can enact a retrospective law which takes away or impairs vested or accrued rights under existing law as long as it is competent to enact the said law and if the same is not unreasonable. In the facts of the said case in paragraph 68 and 69 at page 690 the Supreme Court while applying the law observed as follows:-

"Despite the aforesaid conclusion, the Act [proviso to Section 4(3)] to the extent it takes away the appointments already made, some of the petitioners had been appointed much before the enforcement of the Act (ten in number as noticed hereinabove) in implementation of this court's decision, would be unreasonable, harsh, arbitrary and violative of Article 14 of the Constitution. The law does not permit the legislature to take back what has been granted in implementation of the court's decision. Such a course is impermissible."

"In Lohia Machines Ltd vs UOI on the aspect of reasonableness and arbitrariness of amending law, it was observed that the power and competence of Parliament to amend any statutory provision with retrospective effect cannot be doubted. Any retrospective amendment to be valid must, however, be reasonable and not arbitrary and must not be violative of any of the fundamental rights guaranteed under the Constitution. In considering the question as to whether the legislative power to amend a provision with retrospective operation has been reasonably exercised or not, it becomes relevant to enquire as to how the retrospective effect of the amendment operates."

18.1 The judgment of the Supreme Court in ***Empire Industries Ltd vs UOI 1985 (3) SCC 314*** refers to the same principle. As a matter of fact in paragraph 51 at page 341 the court makes a reference to the statement of law given in the Harvard Law Review, Volume 73 page 692. This statement of law also finds mention, though in truncated form, in paragraph 35 of ***Virender Singh Hooda*** *(supra)*. The statement of law on which reliance has been placed is given in paragraph 51 of ***Empire Industries*** *(supra)* which reads as follows:-

"In the view we have taken of the expression 'manufacture', the concept of process being embodied in certain situation in the idea of manufacture, the impugned legislation is only making 'small repairs' and that is a permissible mode of legislation. In 73rd volume of Harvard Law Review P. 692 at P. 795, it has been stated as follows:

It is necessary that the Legislature should be able to cure inadvertent defects in statutes or their administration by making what has been aptly called 'small repairs'. Moreover, the individual who claims that a vested right has arisen from the

> *defect is seeking a windfall since had the legislature's or administrator's action had the effect it was intended to and could have had, no such right would have arisen. Thus, the interest in the retroactive curing of such a defect in the administration of government outweighs the individual's interest in benefiting from the defect.... The Court has been extremely reluctant to over-ride the legislative judgment as to the necessity for retrospective taxation, not only because of the paramount government interest in obtaining adequate revenues, but also because taxes are not in the nature of a penalty or a contractual obligation but rather a means of apportioning the cost of government among those who benefit from it."*

18.2 Mr Syali also placed reliance on the judgment of the Supreme Court in ***Tata Motors Ltd vs State of Maharashtra & Ors. (2004) 5 SCC 783***. This was a case where the assessee had claimed set off in respect of sales tax payable by them for a certain period by invoking the benefit available under the Rules framed under the Bombay Sales-tax Act, 1959. By virtue of the amendment brought about in Section 26 of the Maharashtra Tax Laws (Levy, Amendment and Repeal) Act, 1989 (Maharashtra Act 9 of 1989) the facility of drawback, set off etc. of tax paid by a manufacture of goods specified in Schedule B of the Act of 1989 was not applicable to manufacture of goods out of waste, scrap goods and products. The Supreme Court in appeal quashed the provisions of Section 26 of the Maharashtra Act 9 of 1989. The Court observed in paragraph 15 at page 789 and 790 of the judgment that while there it can be no dispute that the legislature has an enormous power to enact laws prospectively as also retrospectively, and that, the Government must be allowed leeway in matters of taxation because several fiscal adjustments have to be made by the government depending upon the needs of the Revenue and economic circumstances prevailing in the State; nevertheless, the

State cannot be allowed to act irrationally or arbitrarily so as to withdraw the benefit for a particular period, resulting in a higher burden on the assessee, without any cogent reason. In that case the Supreme Court observed that retrospective withdrawal of the benefit of set off only for a particular period without any cogent or rationale ground was unsustainable. It is to be remembered in the instant case the assessee was not conferred with any benefit and, therefore, its subsequent withdrawal. Therefore, the retrospective amendment cannot be find fault with only on this ground.

18.3 Mr Syali also referred the judgment of the Supreme Court in the case of ***S.N. Mukherjee*** *(supra)* for the proposition that a quasi-judicial authority must give reasons for its orders. In this regard reliance was placed on paragraph 32 at page 1994 and paragraph 38 and 39 at pages 1996 and 1997. Briefly, this is a case where the Supreme Court was called upon to decide as to whether while confirming the findings in sentence of a general court martial the chief of the army staff was required to give reasons and also whether the Central Government while rejecting post-confirmation petition of the petitioner was required to record reasons. The Supreme Court after discussing the scheme of the Army Act, 1950 and the Rules framed thereunder came, to the conclusion that under Section 162 of the said Act reasons had to be recorded only in cases where the proceedings of a court martial are set aside or the sentence is reduced. It observed that section 162 negatives a requirement to give reasons on the part of the confirming authority while confirming findings in sentence of court martial. It held that the confirming authority was not required to give reasons while confirming the

findings of a sentence of court martial. Similarly, with respect to post-confirmation proceedings under Section 164(2) the court observed that since there was no requirement to give reasons at the first two stages, that is, at the stage of recording of findings, and at the stage of confirmation of the findings and sentence of the court martial by the confirming authority; there could be no insistence on giving reasons at the stage of consideration of post-confirmation petition under Section 164(2) of the Act. We find that in the facts of the case, the observation made in paragraph 31, 38 and 39 are elaborated in the subsequent paragraphs of the judgment of the court, that is, in paragraph 45 and 46 at pages 1999 and 2000. In nutshell the ratio of the judgment is that, though the thumb-rule is that reasons are required to be given by authorities performing judicial, quasi-judicial and administrative acts, it can be excluded expressly or impliedly depending on the nature of the inquiry and the scheme of the legislation. Furthermore, in the instant case we are dealing with a stage which relates to the initiation of penalty proceedings. The provision does not call for recording of reasons. Section 271(1)(c) of the Act requires only a manifestation and/or delineation of the Assessing Officer's prima facie satisfaction that the assessee has infracted the provisions of clause (c) of Section 271(1) of the Act. In our opinion the ratio of the ***S.N. Mukherjee*** *(supra)* is not applicable to the facts obtaining in the present case.

CONCLUSIONS:-

19 In the result, our conclusion are as follows:-

(i) Section 271(1B) of the Act is not violative of Article 14 of the Constitution.

(ii) The position of law both pre and post amendment is similar, in as much, the Assessing Officer will have to arrive at a prima facie satisfaction during the course of proceedings with regard to the assessee having concealed particulars of income or furnished inaccurate particulars, before he initiates penalty proceedings.

(iii) 'Prima facie' satisfaction of the Assessing Officer that the case may deserve the imposition of penalty should be discernible from the order passed during the course of the proceedings. Obviously, the Assessing Officer would arrive at a decision, i.e., a final conclusion only after hearing the assessee.

(iv) At the stage of initiation of penalty proceeding the order passed by the Assessing Officer need not reflect satisfaction vis-a-vis each and every item of addition or disallowance if overall sense gathered from the order is that a further prognosis is called for.

(v) However, this would not debar an assessee from furnishing evidence to rebut the 'prima facie' satisfaction of the Assessing Officer; since penalty proceeding are not a continuation of assessment proceedings. [See ***Jain Brothers v. Union of India (1970) 77 ITR 107(SC)***]

(vi) Due compliance would be required to be made in respect of the provisions of Section 274 and 275 of the Act.

(vii) the proceedings for initiation of penalty proceeding cannot be set aside only on the ground that the assessment order states 'penalty

proceedings are initiated separately' if otherwise, it conforms to the parameters set out hereinabove are met.

17. In view of the above we reject the prayers made in the writ petitions with the caveat that provisions of Section 271(1)(c) post-amendment will be read in the manner indicated above.

RAJIV SHAKDHER, J.

VIKRAMAJIT SEN, J.

July 24, 2009
kk/da/mb