(1992) 09 KL CK 0036

High Court Of Kerala

Case No: IT Reference No. 43 of 1981 R.A. No. 265 (Coch.) of 1980 Arising out of It Appeal No. 88 (Coch.) of 1978-79

Commissioner of Income Tax		APPELLANT
	Vs	
Kerala State Cashew Development Corporation		RESPONDENT

Date of Decision: Sept. 18, 1992

Acts Referred:

- Income Tax Act, 1922 - Section 34, 34(1)(a), 34(1)(b)
- Income Tax Act, 1961 - Section 139, 147, 147(a), 147(b), 148

Citation: (1993) 68 TAXMAN 3

Hon'ble Judges: T.L. Viswanatha Iyer, J; L. Manoharan, J

Bench: Division Bench

Advocate: G. Sivarajan and C. Kochunni Nair, for the Respondent

Judgement

T.L. Viswanatha Iyer, J.
This reference u/s 256(1) of the income tax Act, 1961 (''the Act'') is at the instance of the revenue and concerns the reopening of the assessment made on the respondent-assessee for the assessment year 1972-73. The question referred is:

Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that no reasons had been recorded within the meaning of section 148(2) and so the reopening is not valid?

The assessee, which is a public limited company wholly owned by the Government of Kerala, carries on business in the processing of cashew nuts. The original assessment was completed on 28-2-1974. The audit party made a note on 20-8-1974 which reads as follows:

2. In the assessment order, weighted deduction u/s 35B is allowed on an amount of Rs. 3,66,547 being commission paid to foreign commission agents. From the details

furnished by the assessee it is seen that the amount of Rs. 3,66,547 on which weighted deduction u/s 35B has been claimed and allowed includes an amount of Rs. 1,77,181 being commission paid to Drew Brown Ltd., Toronto, Canada. This party does not appear to be a commission agent; but is only a direct buyer of goods from the assessee and what is paid to him as commission is actually ''trade discount'' which does not qualify for weighted deduction u/s 35B. Therefore, the weighted deduction allowed u/s 35B on the commission of Rs. 1,77,181 paid to Drew Brown Ltd. has to be withdrawn. 1/3rd of Rs. 1,77.181 viz. Rs. 59,060.

3. Development rebate on plant & machinery costing Rs. 1,40,041 is seen allowed at 25 per cent on the ground that processing of cashew nuts is a priority industry eligible for development rebate at higher rate. Processing of cashew nuts is not a priority industry. Please see decision of the AAC, TVM in Appeal No. ITA 202-Q/72-73 dated 20-7-1973 in the case of K. Ravindranathan Nair. A Ward, QuilonPX4144. So development rebate is allowable only at 15 per cent. Excess Development Rebate allowed at Rs. 14,002.

According to them, there were certain mistakes in the deduction allowed u/s 35B of the Act as also in the rate at which development rebate was allowed.

2. An office note was thereafter made in the order sheet on 28-12-1974 reading as follows:

Please see IAP''s objections. 154 notice put up.
Hearing on 10-1-1975.

In the notice issued to the assessee u/s 154, proposing rectification of the assessment, the ITO referred to the alleged mistakes in the order of assessment mentioned by the audit party as also another, pertaining to the amount of loss computed, and called upon the assessee to show cause why the assessment shall not be rectified. The assessee objected to the proposal with detailed objections, both regarding the merits as well as the jurisdiction to rectify the alleged mistakes, except in regard to the correct amount of loss, which they admitted. The ITO thereupon rectified the amount of loss arrived at in the assessment, but dropped the proceedings in relation to the mistakes pointed out by the audit party, with the note: ''not to be rectified'' on the assessee''s letter of objections. Over one year thereafter, an entry appeared in the order sheet on 15-3-1976, namely ''148 notice put up''. Pursuant to this, the ITO issued notice of even date stating that he had reason to believe that income chargeable to tax for the year 1972-73 had escaped assessment within the meaning of section 147 of the Act and calling upon the assessee to file a return of his income. The assessee objected. But the assessment was made in accordance with the audit note, withdrawing the weighted deduction u/s 35B of the Act on certain amounts originally allowed, and reducing the development rebate from 25 per cent to 15 per cent.

3. The assessee appealed to the AAC, who upheld the claims of the assessee on the merits and restored the benefits granted in the original order of assessment. Since the assessee was entitled to succeed on the merits, and there was no escapement of income, the other question of jurisdiction to reopen, did not really arise for consideration. But the AAC entered a finding, with the observation that the audit note constituted ''information'', and, therefore, the reopening was valid.

4. The revenue appealed to the Tribunal. The Tribunal went into the question of the validity of the reopening in the first instance and since it upheld the contention of the assessee on this point, the Tribunal did not consider the case on the merits. The Tribunal noted that two conditions had to be satisfied before an assessment could be reopened u/s 147. One was that the Assessing Officer must have reason to believe that income had escaped assessment. This condition was satisfied going by the contents of the notice issued by the ITO on 15-3-1976, wherein he had stated that he had reason to believe that Income had escaped assessment. The other condition was the requirement of section 148(2) of the Act that the ITO shall before issuing notice for making a reassessment u/s 147, record his reasons for doing so. The Tribunal perused the records of the case and came to the conclusion that this requirement had not been satisfied. The Tribunal stated:

The learned departmental representative in the background which we have set out, wanted us to construe that reasons have been recorded. He submitted that it is not necessary that the reason should be recorded at one single place in the order sheet or elsewhere. As long as the entirety of the records went to show that reasons had been recorded he submitted the condition was satisfied. We agree with the learned departmental representative that it is not necessary that the reasons should be recorded at a single place in the order sheet. Nevertheless, we have to see whether on the materials set out a reasonable inference can be drawn that reasons have been recorded. The assessee sent the reply to the 154 notice on 6-1-1975. After that for one year there is a gap. On 15-3-1976 there is the entry in the order sheet'' 148 notice put up? which was followed by the issue of the notice. We have already come to the conclusion that the ITO had reason to believe that income had escaped assessment within the meaning of section 147(b) but we do not find any material to warrant the inference, even on a combined reading of all the correspondence to which we have referred, that the ITO had recorded his reasons for issuing the notice. He had proposed rectification u/s 154 for which he had set out reasons and on receipt of the assessee''s reply he had passed the order ''not to be rectified''. The matter stood there. Thereafter the notice u/s 148 was issued after a lapse of one year. It is not possible to infer that the reasons recorded and the notice issued u/s 154 in respect of which proceedings were eventually dropped has to be considered as reasons recorded for reopening the assessment u/s 147 after the dropping of such proceedings without any further notation or reference to that aspect by the income tax Officer. We have, therefore, to come to the conclusion that reasons had not been recorded within the meaning of the provisions of section 148(2) before

issuing the notice u/s 148.

The reopening of the assessment was, therefore, without Jurisdiction. The departmental appeal was, accordingly, dismissed. The question of law mentioned earlier was thereafter referred for the opinion of this Court.

We shall recount the notings in the notes paper as culled out by the Tribunal. The note of the audit party is dated 20-8-1974. We have already extracted it. The first entry thereafter in the order sheet is on 28-12-1974. and it reads as follows:

Please see IAP''s objections. 154 notice put up. Hearing on January 10, 1975.

Evidently, this is by the office. The next entry is "not to be rectified", by the officer, which appears on the side of the letter of objections of the assessee. The next entry in the order sheet is on 15-3-1976, and it reads "148 notice put up", obviously by the office. It is on the basis of these entries that we have got to see whether reasons have been recorded to satisfy the requirement of section 148(2) of the Act. Section 148 reads:

148. Issue of notice where income has escaped assessment ?(1) Before making the assessment, reassessment or recomputation u/s 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within such period, not being less than thirty days, as may be specified in the notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed; and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished u/s 139.

(2) The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so.

Sub-section (2) requires the ITO to record his reasons ''fordoing so'' before issuing any notice under the section. In Johri Lal (H.U.F.), Agra Vs. The Commissioner of Income Tax, the Supreme Court was dealing with a reopening u/s 34(1)(a) of the Indian income tax Act, 1922. It may be mentioned here that under that Act after its amendment in 1956, reasons had to be recorded only for a reopening under sub-section (1)(a) of section 34 corresponding to section 147(a) and not for a reopening u/s 34(1)(b) corresponding to section 147(b), namely, reopening consequent on information. The 1961 Act has departed from this provision and made recording of reasons obligatory for any action taken u/s 147, whether it be under sub-clause (a) or sub-clause (b). The Court observed that the formation of the required opinion by the ITO that income had escaped assessment was a condition precedent for reopening an assessment. But that was not the only requirement. The officer was further required to record his reasons for taking action under the section

and obtain the sanction of the CBR or the Commissioner, as the case may be. What is significant is that the Supreme Court considered the requirement to record reasons as Important a condition as the formation of the opinion itself, to confer the necessary Jurisdiction on the ITO, to reopen the assessment u/s 34. In P. DOSHI Vs. COMMISSIONER OF Income Tax, GUJARAT, , the Gujarat High Court held that the three conditions precedent, namely, (a) formation of the required opinion regarding escapement of income, (b) recording of reasons u/s 148(2) and (3) sanction of the appropriate authority u/s 151 had to be fulfilled before initiating any proceedings for reassessment. They have been introduced by way of safeguards in wider public interest by way of fetters on the Jurisdiction of the ITO to reopen a finally concluded assessment. They could not be said to be merely for the benefit of the individual assessee concerned, so that there was no question of these requirements being waived by an assessee. All these conditions were mandatory and had to be fulfilled before the ITO could exercise the jurisdiction to reopen an assessment In COMMISSIONER OF Income Tax, M.P. Vs. THAKURLAL., , the Madhya Pradesh High Court dealt with an analogous case with a mere noting by the ITO that the payment of Rs. 45,000 was not an allowable expenditure. It was held insufficient to be a recording of reasons for the purpose of section 148(2). The Court affirmed that recording of reasons before issuing a notice u/s 147(b) was a mandatory requirement. S.P. Divekar and A.P. Divekar (Legal Representatives of P.K. Divekar) Vs. Commissioner of Income Tax (Central), is another case where the Bombay High Court held the requirement to record reasons to be mandatory. Inter alia, they referred to the decision of the Supreme Court in Chhugamal Rajpal Vs. S.P. Chaliha and Others, , where it was noted that when the provision required the ITO to give reasons for issuing a notice, it required him to show that he had prima facie grounds before him for doing so, this being an important safeguard to the assessee.

5. It is clear from the scheme of sections 147 and 148 that the prescription of recording of reasons in section 148(2) is mandatory, and is an essential condition required to be fulfilled to vest jurisdiction in the ITO to proceed to reopen an assessment u/s 147. This is all the more so because the belief which the ITO should entertain before issuing the notice should be based on materials. It is true that the sufficiency or the adequacy of the reasons will not be gone into by a Court. But the existence of the belief, and as to whether they were based on relevant factors and circumstances is a matter which could be gone into by a Court. The reasons which the ITO records constitute material on which the validity of the belief entertained by him can be tested. They constitute an important and essential part of the proceedings, the absence of which will nullify the entire proceedings as without jurisdiction.

6. We have already extracted the notings in the order sheet. Nowhere in the notings can we find any recording of reasons by the ITO for the reopening u/s 148, as required under sub-section (2) thereof. The first note made after the report of the audit party was one evidently made by the office when they put up the notice u/s

154. The next noting ''not to be rectified'' is no doubt an order of the ITO. But that is not a recording of reasons, but a decision to drop the rectification proceedings. The next note on 15-3-1976 is again one made by the office. The ITO follows it up with a notice u/s 148. Admittedly, there was no recording of reasons at the time the notice u/s 148 was issued? or even earlier, according to us. But then, the counsel for the revenue maintains that the earlier notings will do justice for a record of reasons, and according to him, the finding of the Tribunal is that there was a recording of reasons at the time of the issue of notice u/s 154. We are unable to agree.

7. Even the very first note made was one made by the office which merely referred to the audit party''s objections. At that stage the officer did not record his reasons for concurring with the audit party or as to why the assessment requires either rectification or reopening. He had no occasion to apply his mind to the question at that stage. In fact, the recording of reasons required u/s 148 should not merely relate to the reasons which lead the officer to the belief that income had escaped assessment, but also should indicate the existence of the other ingredients of section 147 justifying the reopening. All that is lacking in the case.

8. Actually there was no recording of reasons at all at any stage, though the counsel for the revenue was at pains to infer a recording of reasons at the stage the notice u/s 154 was issued. According to him, the finding recorded by the Tribunal is that there was a recording of reasons when the notice u/s 154 was issued, and that is a finding of fact which is conclusive. We cannot agree. For one thing, we have the entire notes paper extracted in the order of the Tribunal which does not show any recording of reasons at any time. What the Tribunal had indicated was only the narration of the mistakes made in the notice u/s 154 and no more.

9. Even otherwise, we are of the opinion that the recording of reasons, if any, in the proceedings u/s 154 is not sufficient to sustain the independent proceedings u/s 148. In fact, initiation of proceedings u/s 154 does not require any prior recording of reasons at all. The assessee has only to be apprised of the mistake and afforded an opportunity to show cause against the rectification. The proceedings u/s 148 are of a different nature hedged in by conditions and resulting in the reopening of a concluded assessment. The officer has then to apply his mind to the question with reference to sections 147 and 148 and record his reasons for the reopening. The alleged anterior recording of reasons in the proceedings u/s 154 will not, therefore, suffice for, or be in compliance with section 148(2). What the provision requires is a record of the reasons which prompts the ITO to reopen the assessment u/s 148. He must record his reasons at that stage. Any anterior note by the officer in the order sheet without any indication as to whether the officer''s attention had been drawn to it is not sufficient for the purpose of section 148(2). The requirement is mandatory and unless there is a strict compliance with the same the entire action will stand vitiated. [See Commissioner of Income Tax, Gujarat II Vs. Kurban Hussain Ibrahimji Mithiborwala,].

10. The counsel for the revenue argued, based on the statement in paragraph 9 of the order, that the issue of the notice on 15-3-1976 with the recital that the ITO had reason to believe that income chargeable to tax had escaped assessment, leads to the inference that reasons had actually been recorded by the officer. Such a contention cannot stand in the light of the admitted notings in the order sheet which we have extracted earlier. The fact that the officer had reason to believe that income had escaped assessment does not lead to any inference that reasons had actually been recorded. That is a separate requirement which had got to be satisfied by the ITO, before clutching at jurisdiction to reopen an assessment. We overrule this contention. The Tribunal was, therefore, justified in holding that the assessment proceedings were lacking in jurisdiction inasmuch as the essential condition precedent for the issuance of the notice u/s 148, namely, the recording of reasons under sub-section (2) thereof had not been complied with. We are in agreement with the view taken by the Tribunal. The question referred to us has, therefore, to be answered in the affirmative, that is, in favour of the assessee and against the revenue. We do so.