

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: 05.12.2016

PRONOUNCED ON: 19 .12.2016

CORAM

THE HONOURABLE MR. JUSTICE HULUVADI G. RAMESH

AND

THE HONOURABLE DR. JUSTICE ANITA SUMANTH

Tax Case (Appeal) No.1426 of 2007

M/s.TANMAC India,
19,Vysyal Street,
Pondicherry

.. Appellant

Vs

Deputy Commissioner of Income Tax,
Circle I,
Pondicherry.

.. Respondent

Prayer: Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Chennai "C" Bench dated 29th June 2007 in I.T.A.No.118 of 2005 in respect of the assessment year 1998-1999.

For Appellant: Mr. Muralidharan

For Respondent: Mr. J. Narayanasamy

Standing Counsel

J U D G M E N T

(Order of the Court was pronounced by Dr.Anita Sumanth, J.)

This Tax Case (Appeal) filed by the assessee raises the following two substantial questions of law admitted for consideration of this Court.

1. Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law on holding that the appellant is not entitled to claim the expenditure of Rs.5,50,000/- paid to the retiring partner under section 37 of the Act as the same was made out of business exigencies?

2. Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the Assessing Officer is justified in reopening the assessment by issuance of notice under section 148 of the Act when no new material was unearthed justifying the re-opening of the assessment?

2. The assessee is a partnership firm. One of the partners Sri.P.C.Kapur retired from the firm on 1.4.1997 and the deed of retirement provided for a sum of Rs.5,50,000/-(Rupees five lakhs and fifty thousand) to be paid by the firm to the retiring partner 'as compensation for his agreeing to retire from the firm'. The aforesaid sum of Rs.5.5 lakhs was claimed as a deduction for the purposes of

computation of tax under the provisions of the Income Tax Act (hereinafter referred to as 'Act') by the firm.

3. The return of income filed in respect of A Y 1998-99 was processed and an intimation under Section 143(1)(a) of the Act issued. No notice under section 143(2) of the Act dated 9.12.2002 was issued and the matter was allowed to rest. Thereafter, a notice under section 148 of the Act was issued initiating proceedings for re-assessment. The assessee claimed that the sum of Rs.5.5 lakhs represented non-compete fee and an allowable deduction. The assessing officer disallowed the same holding it to be capital in nature. He also concluded that the amount had been categorized as *'lump sum payment made as a compensation for future profits forgone by the retiring partner'* in the Profit and Loss account and was, at best, contingent.

4. The appeal before the Commissioner of Income Tax (Appeals) was rejected vide order dated 30.9.2004, which order was confirmed by the Income tax Appellate Tribunal on 18.8.2006. It had been contended by the assessee before both appellate authorities that the re-assessment lacked requisite jurisdiction under section 147 of the Act and was thus erroneous in law. The authorities

upheld jurisdiction on the ground that the original proceeding had been an intimation under section 143 (1)(a) in respect of which re-assessment was permissible and on merits for the reason that the amount had, as per the deed, been expended only for the retirement of the partner which, does not constitute allowable business expenditure.

5. We have heard Mr.M.R.Muralidharan appearing for the assessee and Mr.J.Narayanasamy, appearing on behalf of the Income Tax Department.

6. We first address the question of jurisdiction. The present re-assessment is pursuant to a prima facie intimation in terms of section 143 (1) (a) of the Act. Tribunal concludes the issue adverse to the appellant based on the judgment of the Supreme Court in the case of DCIT *Vs. Rajesh Jhaveri Stock Brokers Pvt. Ltd.* (295 ITR 499) that has been rather mechanically applied. The question that now arises for our consideration is whether the assessing officer could, having taken cognizance of the return of income and annexures, issued an intimation under section 143(1) and allowed the matter to rest, thereafter now proceed to issue

a notice for re-assessment simply based on the same material that had been available to him all along.

7. The sine qua non for the initiation of proceedings in terms of section 147 of the Act is '*reason to believe*' on the part of the assessing officer that income chargeable to tax has escaped assessment. While the court cannot examine the sufficiency of reasons on the basis of which re-assessment is initiated, the existence or otherwise such '*reason to believe*' is certainly open to verification and would be evident from the reasons recorded prior to issue of notice under section 148 as required in terms of section 148(2) of the Act. In order to examine this aspect of the matter, the records were called for and have been duly produced for our perusal by Mr..Narayanaswamy. The reasons recorded are as follows:

'The debit claimed towards lump sum payment made as a compensation for future profits forgone by the retiring partner Rs.5,50,000/- is not allowable for the following reasons:

1. *The payment has not been authorised by partnership deed.*
2. *Serving of future profit is contingent one. Contingent expenditure cannot be allowed.*
3. *Future profits does not relate to the AY in question. And so, the*

expenditure cannot be allowed in this AY.'

8. A perusal of the Reasons would indicate that the assessing officer proceeds solely on the basis of the return of income and the enclosures thereto, being the financials and the deed of partnership, to initiate proceedings for re-assessment. The aforesaid documents however are part of record and the basis on which the intimation under section 143(1)(a) has been issued on 1.12.98. Let us bear in mind that the intimation dated 1.2.1998 has been manually issued, being prior to the electronic era which came into force on and with effect from 2003. The assessing officer has thus evidently applied his mind to the return and annexures even at that stage.

9. The scheme of assessment as set out in section 143 requires an assessing officer to process the return by issue of an intimation (which has been done in the present case) and thereafter issue a notice under sub-section (2) of section 143 to the assessee if the assessing officer considers it necessary or expedient to ensure that the assessee has not understated income, computed excessive loss or underpaid tax calling upon him to attend his office

and require him on a date to be specified therein, to produce or cause to be produced any evidence on which the assessee may rely in support of such claim. Having done so, an assessment is to be completed in terms of section 153(1) of the Act within a period of two years from the end of the assessment year in which the income was first assessable, in this case, on or before 31.3.2001.

10. Let us now see the sequence of events that have transpired in this case. The assessee filed a return of income pursuant to which, an intimation dated 1.12.1998 under section 143(1) (a) of the Act was issued. The provisions of section 143(2) require that if the assessing officer considered it necessary or expedient to ensure that the assessee has not understated income, claimed excessive loss or underpaid tax in any manner, the assessment is to be subject to further scrutiny, a notice under section 143(2) is liable to be issued and the assessment completed on or before 31.3.2001. This was not done in the present case. Subsequently, a notice under section 148 has been issued on 9.12.2002 under section 148 of the Income Tax Act taking advantage of the now extended limitation of four years to re-assess income on the basis of the same materials that were available with

the authority as part of the record.

11. The phrase 'reason to believe' in section 147 relates to such other new or tangible material as may have come to the knowledge of the assessing officer pursuant to the original proceedings for assessment. The Supreme Court in *CIT Vs. Kelvinator of India* (320 ITR 561) states thus in the context of the 'belief' that should form the basis for a re-assessment;

'We must also keep in mind the conceptual difference between power to review and power to reassess. The Assessing Officer has no power to review, he has the power to reassess. But reassessment has to be based on fulfillment of certain pre-conditions and if the concept of 'change of opinion' is removed, as contended on behalf of the Department, then, in the garb of reopening the assessment, review would take place. One must treat the concept of 'change of opinion' as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989, the Assessing Officer has power to reopen, provided there is 'tangible material' to come to the conclusion that there is escapement of income from assessment. Reasons must have a link with the formation of the belief.'

12. If the assessing officer, after issuing intimation u/s section 143(1) does not to issue a notice u/s 143(2) of the Act to

initiate proceedings for scrutiny of the return of income, the obvious conclusion is that he does not consider it necessary or expedient to do so, the inference being that the Return of Income filed in order. It is this opinion that cannot be arbitrarily changed by the assessing officer, to re-assess income on the basis of stale material, already on record. If we thus keep in the mind the above fundamental requirement of section 147, it would be apparent that the exercise undertaken by the Revenue in this case is not one of re-assessment, but of review. The reasons make it abundantly clear that the re-assessment is sought to be initiated on the basis of the return of income and the enclosures which were available with the assessing officer since 2.11.1998 and which ought to have prompted him to issue a notice under section 143(2) of the Act to conduct the proceedings under scrutiny. What is sought to be done by the re-assessment ought to have been achieved by scrutiny assessment proceedings. Having missed the bus earlier, the Department cannot be permitted to avail of the extended time limit in the absence of any new or tangible material, when the time for scrutiny assessment has elapsed on 31.3.2001, prior to issue of notice u/s 148. The notice under section 148 dated 9.12.2002 is

thus an arbitrary exercise of power and a review of proceedings impermissible in law.

13. The Division Bench of the Delhi High Court in the case of *Commissioner of Income Tax Vs. Orient Craft Ltd (354 ITR 546)* deals specifically with this aspect of the matter. The substantial question of law that was dealt with by the High Court is as follows;

‘Was the Tribunal right in law in holding that in the absence of any tangible material available with the Assessing Officer to form the requisite belief regarding escapement of income, the reopening of the assessment made under section 143(10) is bad in law?’

14. The Division Bench notes that the Supreme Court in the case of *Asst. CIT V. Rajesh Jhaveri stock Brokers P. Ltd, (supra)* only deals with the formation of an opinion at the time of issuance of prima facie intimation and does not indicate anywhere that a re-assessment can be initiated in the absence of a reason to believe.

To conclude, the Division Bench holds thus:

‘This judgment, contrary to what the Revenue would have us believe, does not give a carte blanche to the Assessing Officer to disturb the finality of the intimation under section 143(1) at his whims and caprice; he must have reason to believe within the meaning of the section.’

15. There is yet another relevant aspect. Mr.Kapur, to whom the payment was made in the present case, also retired from two other firms simultaneously, M/s.Jarvis International (hereinafter referred to as ‘Jarvis’) and M/s Aryavartha Impex (hereinafter referred to as ‘Aryavartha’). The facts in the case of Jarvis, Aryavartha and TANMAC, the appellant before us, are identical. However, it appears that the Department, in the cases of Jarvis and Aryavartha, issued notices u/s.143(2) of the Act and completed scrutiny assessment proceedings within time. Thus, in those cases, when proceedings for re-assessment were initiated by issue of notice under section 148, the Tribunal in the case of Jarvis and the Commissioner of Income Tax (Appeals) in the case of Aryavartha as confirmed by the Income Tax Appellate Tribunal, took the view that the assumption of jurisdiction under section 148 was bad in law.

16. The facts as well as the law remain identical in all three cases. Thus merely by virtue of the non-action on the part of the

assessing officer in the case of the present assessee, i.e. by his failure to issue a notice under section 143 (2) of the Act, the Department gets the advantage of another four years from 31.3.2002 to initiate proceedings for re-assessment. This obviously can neither be the proper interpretation of section 147 nor the intention of Legislature. The CIT (A) in order dated 30.09.2004 distinguishes the present case from the two others on precisely the ground stating thus:-

“In my opinion, the Appellant’s case stands on a different footing than that of Jarvis International. In that case, the original assessment was completed under section 143(3) and the Assessing Officer had duly examined the allowability of payment of Rs.5,50,000/- to Sri P.C.Kapur at the time of his retirement. After such examinations, the Assessing Officer had taken a conscious decision to allow the same as a revenue expenditure. On the other-hand, in the present case, the Appellant’s assessment was not completed after scrutiny u/s.143(3). That means, the Assessing Officer did not have the opportunity to examine the allowability of Rs.5,50,000/- paid to Sri P.C.Kapur. Since there was no application of mind and consequently no

conscious decision on the part of the Assessing Officer to allow this amount, it cannot be said that the reopening of the assessment was due to change of opinion.”

It is incorrect to state that the Assessing Officer had no opportunity as the statute grants him full opportunity to scrutinize the assessment if he felt it was necessary and expedient for him to do so. Having chosen not to, he cannot resort to the provisions of S.147 in the absence of any new or fresh material indicating escapement of income.

17. A decision of the Delhi High Court in the case of *CIT Vs Orient Craft Limited (354 ITR 536)* had occasion to consider a similar question and the Division Bench, at Page 546, holds as follows;

“Having regard to the judicial interpretation placed upon the expression reason to believe”, and the continued use of that expression right from 1948 till date, we have to understand the meaning of the expression in exactly the same manner in which it has been understood by the courts. The assumption of the Revenue that somehow the words “reason to

believe” have to be understood in a liberal manner where the finality of an intimation under section 143(1) is sought to be disturbed is erroneous and misconceived. As pointed out earlier, there is no warrant for such an assumption because of the language employed in section 147; it makes no distinction between an order passed under section 143(3) and the intimation issued under section 143(1). Therefore, it is not permissible to adopt different standards while interpreting the words “reason to believe” vis-à-vis section 143(1) and section 143(3). We are unable to appreciate what permits the Revenue to assume that somehow the same rigorous standards which are applicable in the interpretation of the expression when it is applied to the reopening of an assessment earlier made under section 143(3) cannot apply where only an intimation was issued earlier under section 143(1). It would in effect place an assessee in whose case the return was processed under section 143(1) in a more vulnerable position than an assessee in whose case there was a full-fledged scrutiny or is accepted without demur is not a matter which is within the control of the assessee; he has no choice in the matter. The other consequence, which is somewhat graver, would be that the entire rigorous procedure

involved in reopening an assessment and the burden or proving valid reasons to believe could be circumvented by first accepting the return under section 143(1) and, thereafter, issue notices to reopen the assessment. An interpretation which makes a distinction between the meaning and content of the expression “reason to believe” in cases where assessments were framed earlier under section 143(3) and cases where mere intimations were issued earlier under section 143(1) may well lead to such an unintended mischief. It would be discriminatory too. An interpretation that leads to absurd results or mischief is to be eschewed.”

.....

The reasons recorded by the Assessing Officer reached the belief that there was escapement of income “on going through the return of income” filed by the assessee after he accepted the return under section 143(1) without scrutiny, and nothing more. This is nothing but a review of the earlier proceedings and an abuse of power by the Assessing Officer, both strongly deprecated by the Supreme Court in CIT v. Kelvinator (supra).”

18. The above extracts are applicable on all fours to the present case in the facts and circumstances pointed out earlier. In

the light of the aforesaid discussion, we answer question of Law No.2 in favour of the assessee. In view of our conclusion on the aspect of assumption of jurisdiction, we do not see any need to go into the merits of the case and refrain from answering the substantial question of law relating to the same. No costs.

[H.G.R.J.] [A.S.M.J.]

19. 12.2016

msr

HULUVADI G. RAMESH, J.
and
Dr.Anita Sumanth, J.

Pre-delivery judgment in
Tax Case (Appeal) No.1426 of 2007

19.12.2016