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Civil Misc. Writ Petition (Tax) No. 2062 of 2008
Arun Gupta
Vs.
Union of India and others

Connected with-

Civil Misc. Writ Petition (Tax) No. 2117 of 2008
Shri Ishwar Chandra
Vs.
Union of India and others
And
Civil Misc. Writ Petition (Tax) No. 2118 of 2008
Shri Vineet Chandra
Vs.
Union of India and others
And
Civil Misc. Writ Petition (Tax) No. 2119 of 2008
Shri Raghav Gupta
Vs.
Union of India and others
And
Civil Misc. Writ Petition (Tax) No. 2120 of 2008
Shri Prem Chand Gupta
Vs.
Union of India and others
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Hon'ble Tarun Agarwala, J.
Hon'ble Dr. Satish Chandra, J.

(Per: Tarun Agarwala,J.)

In this group of petitions, the petitioner has challenged the notice issued under Section 148 of the

Income Tax Act (hereinafter referred to as the "Act"). For facility, the facts of Writ Petition No.2062 of 2008, Arun Gupta vs. Union of India and others is being taken into consideration.

The petitioner is an individual assessee and derives his income from salary, house property, capital gains, interest, etc. The petitioner is a partner in various registered partnership firms such as Commercial Instalments, Chandra Brothers, Commercial Body Builders, Kailash Traders and Kailash Auto Centres. In the partnership deed there is a specific clause for payment of interest @ 12% p.a. whether the firm is earning profit or loss in that year. That is to say, in the event, there was a profit, the partners were entitled to receive interest on that capital @ 12% p.a. and, in the case of a negative capital balance, partners were to pay interest to the firm @ 12% on such negative balance.

For the assessment year 2000-01, the petitioner filed his return of income showing a loss of Rs.28,20,280/-. According to the petitioner, the loss was on account of the fact that the capital balance in various partnership firms became negative and the petitioner was obliged to pay interest @ 12% p.a. on such negative capital balance. The above return for the

assessment year 2001-02 was taken up for scrutiny and a notice under Section 143(2) and under Section 142 of the Act was issued along with the questionnaire and the petitioner was required to reply to the show cause notice as well as to the questionnaire. One of the questions raised was that the petitioner had paid more interest than earned during the relevant year. The petitioner submitted his reply and explained the reasons for making the payment of interest to various partnership firm owing to the fact that his various partnership firms were reflecting a negative balance and that under the partnership deed there was a contractual obligation to pay interest to the respective partnership firm. The explanation was found to be satisfactory and the return was accepted and completed without any addition by the Income Tax authorities for the assessment years 2001-02. Similar losses was reflected in the assessment year 2002-03 to 2005-06 which were completed under Section 143(1) of the Act wherein similar payment of interest was made by the petitioner to the partnership firm.

For the assessment year 2006-07, the petitioner filed his return declaring a loss at Rs.84,807/-. The petitioner, in the computation of income, disclosed the net business loss of Rs.11,84,807/- indicating that the

petitioner had paid interest amounting to Rs.31,68,547/- whereas he had earned interest amounting to Rs.2,53,913/- resulting in a net loss at Rs.29,14,634/-. The petitioner, in computation of income, accordingly, declared a net business loss at Rs.11,84,807/- after setting off the loss against the income earned under other heads. This assessment was computed under Section 143(1) of the Act by an assessment order dated 31.7.2006. Thereafter, reassessment proceedings were initiated, under Section 147 of the Act for the assessment year 2006-07, by issuance of a notice dated 17.12.2007 under Section 148 of the Act.

Upon receipt of the notice, the petitioner filed his reply informing the assessing authority that the original return may be treated as the return in response to the notice dated 17.12.2007. The petitioner also prayed that a copy of reasons to believe may also be supplied, which was duly communicated to the petitioner. Upon receipt of the reasons to believe the petitioner filed his objection praying that the re-assessment proceeding should be dropped. The assessing authority, by his order dated 20.10.2008, rejected the petitioner objection and proceeded to reassess the petitioner for the assessment

year 2006-07. The petitioner, being aggrieved, has filed the present writ petition praying for the quashing of the re-assessment proceeding initiated by the assessing authority for the assessment year 2006-07 pursuant to the notice dated 17.12.2007.

The relevant portion of the reasons recorded by the assessing officer is as under:-

> "Since the interest received is much less than interest paid resulting substantial business loss, it transpires that it is a case of diversion of business funds for non-business purpose."

The assessing officer rejected the objections of the petitioner, on the ground, that the interest paid to the partnership firm are controlled and run by the family members/relatives of the petitioner and that such business entities are covered by the provisions of Section 40-A(2)(b) of the Act and, therefore, it is essential that a detailed investigation is to be made to ascertain the justifiability and reasonableness of such transaction, specially where exorbitant amount of interest was paid to the family concerned.

In the counter affidavit, similar plea has been raised by the Income Tax Department, namely, that the partnership entity are controlled and run by the family members/relatives of the petitioner and that such partnership firms are covered by the provisions

contained under Section 40-A(2)(b) of the Act. It was also submitted that paying exorbitant amount of interest to the partnership firm, which was running continuously in losses requires thorough investigation as no prudent businessman would like to be a loss sharing partner of such firm continuously for a long period of time.

In the light of these facts, we have heard Sri S.D.Singh, the learned senior counsel assisted by Sri A.P.Singh, for the petitioner and Sri Bharatji Agarwal, the learned senior counsel assisted by Sri Ashok Kumar, the learned counsel for the Income Tax Department.

The learned senior counsel for the petitioner submitted that even though the original assessment has been made under Section 143(1) of the Act, in order to initiate reassessment proceeding, it is necessary for the assessing officer to have received some tangible material or information subsequent to the completion of the original assessment proceedings in order to claim jurisdiction to re-assess the petitioner. The learned senior counsel contended that, in the instant case, no information or tangible material had been received by the assessing officer after completion of the original assessment under Section 143(1) of the

Act and, consequently, the entire exercise of initiating the proceedings under Section 148 of the Act was wholly illegal and without jurisdiction. The learned senior counsel contended that the reasons to believe recorded by the assessing officer only refers to the facts which were already existing on the original assessment record and which was brought on record by the petitioner himself by filing his return and consequently, on the same information and evidence which has already been brought on record no re-assessment proceedings could be initiated. The learned counsel submitted that in the absence of any material, which has a live nexus, the entire exercise of initiating re-assessment proceeding was wholly illegal and was liable to be quashed.

On the other hand, Sri Bharatji Agarwal, the learned senior counsel for the department submitted that the assessing officer has wide powers to reassess if it has reason to believe that the income had escaped assessment. The learned senior counsel submitted that the assessing officer had a reasonable ground to believe that exorbitant amount of interest was being paid to the family concern and that interest paid was far more than interest earned by the petitioner and that this ground was, by itself, sufficient to reopen the

assessment proceedings. The learned senior counsel submitted that the reasons disclosed by the assessing officer justified his action in issuing a notice under Section 148 of the Act. The learned senior counsel further contended that the payment of exorbitant amount of interest to firms which were being run and managed by the family members and relatives of the petitioner was hit by Section 40-A(2)(b) of the Act, which required investigation to ascertain the justifiability and reasonableness of such transaction and consequently, on this ground also the notice to re-assess the income was justified. The learned senior counsel further contended that the petitioner has an alternative remedy to contest the matter before the assessing officer and, if aggrieved, by the assessment order had a right to file an appeal and thereafter a second appeal and consequently, the remedy to file a writ petition under Article 226 was not an efficacious remedy. In support of his submission, the learned senior counsel relied upon a decision of the Supreme Court in **Commissioner of Income-Tax and others vs. Chhabil Dass Agarwal, [2013]357 ITR 357 (SC)** wherein the Supreme Court held that the writ petition should not have been entertained questioning the correctness of the reassessment order and the notice

issued under Section 148 of the Act.

Taking the plea of alternative remedy, we find that reliance by the department in the case of **Chhabil Dass Agarwal (supra)** is distinguishable and not applicable to the present case. In the said case, against the reassessment order, the writ petition was filed for its quashing. In that scenario, the Supreme Court held that the writ court should not ordinarily entertain a writ petition questioning the veracity of the re-assessment order passed under Section 148 of the Act, especially when an equal, efficacious, alternative remedy was available to the assessee under the Act.

In the instant case, the petitioner has challenged the validity of the notice issued under Section 148 of the Act. No re-assessment order has been passed as yet. The question whether the assessing authority had the jurisdiction to issue a re-assessment notice is a jurisdictional issue which can be entertained and tested in a writ jurisdiction. We also found that the writ petition was entertained in the year 2008 and affidavits have been exchanged and, consequently, at this belated stage, it would not be appropriate to relegate the petitioner to avail the alternative remedy. We are of the opinion that the writ petition is to be decided on merits. The preliminary objection raised by Sri

Bharatji Agarwal is rejected.

A perusal of the provisions of Sections 147 and 148 of the Act indicates that the Assessing Officer has wide powers to reopen the assessment if he has reasons to believe that the income chargeable to tax has escaped assessment. However, this wide power is circumscribed and does not give jurisdiction to the Assessing Officer to reopen a completed assessment on a mere change of opinion. The reasons to believe is not based nor can it be an outcome of a change of opinion. Further, the proviso indicates that if more than four years have elapsed from the end of the relevant assessment year, in addition to the satisfaction of the Assessing Officer that he has reasons to believe, must also indicate that the assessee had failed to disclose fully and truly all material facts necessary for his assessment for that assessment year.

The words "reasons to believe", "change of opinion", "failure to disclose fully and truly material facts" and "material facts" have been a subject of interpretation by various High Courts and also by the Supreme Court of India.

In **Ganga Saran & Sons P. Ltd. Vs. Income-Tax Officer and others, 1981 Vol.130 ITR** 1, the Supreme Court held :

"It is well settled as a result of several decisions of this Court that two distinct conditions must be satisfied before the Income Tax Officer can assume jurisdiction to issue notice under section 147 (a). First, he must have reason to believe that the income of the assessee has escaped assessment and secondly, he must have reason to believe that such escapement is by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment. If either of these conditions is not fulfilled, the notice issued by the Income Tax Officer would be without jurisdiction. The important words under section 147 (a) are "has reason to believe" and these words are stronger than the words "is satisfied". The belief entertained by the Income Tax Officer must not be arbitrary or irrational. It must be reasonable or in other words it must be based on reasons which are relevant and material. The Court, of course, cannot investigate into the adequacy or sufficiency of the reasons which have weighed with the Income Tax Officer in coming to the belief, but the Court can certainly examine whether the reasons are relevant and have a bearing on the matters in regard to which he is required to entertain the belief before he can issue notice under section 147 (a). It there is no rational and intelligible nexus between the reasons and the belief, so that, on such reasons, no one properly instructed on facts and law could reasonably entertain the belief, the conclusion would be inescapable that the Income Tax Officer could not have reason to believe that any part of the income of the assessee had escaped assessment and such escapement was by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts and the notice issued by him would be liable to he struck down as invalid."

In **Sheo Nath Singh Vs. Appellate Assistant Commissioner of Income-Tax (Central), Calcutta and others, 82 ITR 147**, the Supreme Court held :-

"In our judgment, the law laid down by this court in the above case is fully applicable to the facts of the present

> case. There can be no manner of doubt that the words "reason to believe" suggest that the belief must be that of an honest and reasonable person based upon reasonable grounds and that the Income-tax Officer may act on direct or circumstantial evidence but not on mere suspicion, gossip or rumour. The Income-tax Officer would be acting without jurisdiction if the reason for his belief that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section. The court can always examine this aspect though the declaration or sufficiency of the reasons for the belief cannot be investigated by the court."

In **Calcutta Discount Co. Ltd. Vs. Income-Tax Officer, Companies District I, Calcutta and another, 41 ITR 191**, the Supreme Court held :

> "The position, therefore, is that if there were in fact some reasonable grounds for thinking that there had been any non-disclosure as regards any primary fact, which could have a material bearing on the question of "under assessment", that would be sufficient to give jurisdiction to the Income-tax Officer to issue the notices under section 34. Whether these grounds were adequate or not for arriving at the conclusion that there was a non-disclosure of material facts would not be open for the court's investigation. In other words, all that is necessary to give this special jurisdiction is that the Income-tax Officer had when he assumed jurisdiction some prima facie grounds for thinking that there had been some non-disclosure of material facts."

From a perusal of the aforesaid, it is clear that where a notice is issued within four years from the end of the relevant assessment year, the jurisdiction of the Assessing Officer is conferred where he has reasons to believe that income chargeable to income tax on escaped assessment.

It is settled law that the Assessing Officer having reasons to believe that there had been some omission or failure to disclose fully or truly all material facts necessary for the assessment must be based on some material facts which according to the Assessing Officer is based on some reasonable belief and which would have a material bearing on the question of under assessment. If there is no material for the formation of any belief or where the purported belief was nothing but a mere change of opinion, in that case, the Assessing Officer would have no jurisdiction to initiate proceedings u/s 147 and 148 of the Act. The Assessing Officer has the power to reopen the assessment where he has reasons to believe that income chargeable to tax has escaped assessment but such re-assessment cannot be initiated on a mere change of opinion to merely re-examine an issue on the basis of information or material which was already available to the Assessing Officer at the time of the completion of the original assessment. Consequently, before taking any action, the Assessing officer is required to substantiate his satisfaction in the reasons recorded by him.

On the question of relevancy of material facts which is concomitant for the issuance of a notice u/s

147 and 148 of the Act, the Supreme Court in **Calcutta Discount Co. Ltd. Vs. Income Tax Officer and another, 41 ITR 191,** held that the duty of disclosing the primary facts relevant to the decision of the question before the Assessing Authority lies on the assessee and it is the onerous duty of the assessee to disclose truly and fully all the primary facts. The Supreme Court held that once all the primary facts have been disclosed, the assessee was not required to provide any further assistance by way of disclosure to the Assessing Officer. The Supreme Court held :

> "Does the duty, however, extend beyond the full and truthful disclosure of all primary facts ? In our opinion, the answer to this question must be in the negative. Once all the primary facts are before the assessing authority, he requires no further assistance by way of disclosure. It is for him to decide what inferences of facts can be reasonably drawn and what legal inferences have ultimately to be drawn. It is not for somebody else far less the assessee to tell the assessing authority what inferences-whether of facts or law should be drawn. Indeed, when it is remembered that people often differ as regards what inferences should be drawn from given facts, it will be meaningless to demand that the assessee must disclose what inferences-whether of facts or law-he would draw from the primary facts."

In **Commissioner of Income Tax Vs. Kelvinator of India Ltd., 256 ITR 1**, the Full Bench of the Delhi High Court held that Section 147 of the Act did not confer any power upon the Assessing Officer to initiate reassessment proceedings on a mere change of

opinion. In the said case, the assessee in his revised return of income had withdrawn the disallowance in respect of expenses on rent and depreciation of the guest house on the ground that since rent and depreciation were allowable u/S 30 and 32 of the Act, the same cannot be disallowed u/S 37 (4) of the Act. The Assessing Officer accepted the contention of the assessee in the original assessment order and accepted the withdrawal of the disallowance of guest house expenditure as submitted by the assessee in his revised return of income. Subsequently, a notice u/s 148 of the Act was issued on the ground that the tax audit report was not noticed by the Assessing Officer while passing the original assessment order. The Full Bench of the Delhi High Court held :-

> "We are unable to agree with the submission of Mr. Jolly to the effect that the impugned order of reassessment cannot be faulted as the same was based on information derived from the tax audit report. The tax audit report had already been submitted by the assessee. It is one thing to say that the assessing officer had received information from an audit report which was not before the Income Tax Officer, but it is another thing to say that such information can be derived by the material which had been supplied by the assessed himself.
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> We also cannot accept submission of Mr. Jolly to the effect that only because in the assessment order, detailed reasons have not been recorded on analysis of the materials on the record by itself may justify the assessing officer to initiate a proceeding under section 147 of the

> Act. The said submission is fallacious. An order of assessment can be passed either in terms of sub-section (1) of section 143 or sub-section (3) of section 143. When a regular order of assessment is passed in terms of the said sub-section (3) of section 143 a presumption can be raised that such an order has been passed on application of mind. It is well known that a presumption can also be raised to the effect that in terms of clause (e) of section 114 of the Indian Evidence Act the judicial and official acts have been regularly performed. If it be held that an order which has been passed purportedly without application of mind would itself confer jurisdiction upon the assessing officer to reopen the proceeding without anything further, the same would amount to giving premium to an authority exercising quasi judicial function to take benefit of its own wrong."

The aforesaid decision was affirmed by the Supreme Court in Commissioner of Income Tax Vs. Kelvinator of India Ltd., 320 ITR 561 wherein the Supreme Court held that the "reason to believe" indicated in the notice u/s 148 that there was no tangible material to come to a conclusion that there was a escapement of income from the assessment.

In the light of the aforesaid, it is well settled that if a notice under Section 148 of the Act has been issued without the jurisdictional foundation under Section 147 of the Act being available to the assessing officer, the notice and subsequent proceedings would be without jurisdiction and would be liable to be quashed in a writ jurisdiction. If reason to belief is available the Writ Court will not exercise its power of

judicial review to go into the sufficiency or adequacy of the material available.

A Division Bench of this Court in **M/s Rathi Industries Ltd. vs. State of U.P. and another, 2014(7)ADJ 602 (DB)** has held:-

> The question, whether the assessing officer had reasons to believe is a question of jurisdiction, which can be considered and investigated by a Court under Article 226 of the Constitution of India. The words "has reasons to believe" must not be arbitrary or irrational but must be based on reasons which are relevant and germane to the issue. The expression "reasons to believe" is not a subjective satisfaction on the part of the assessing officer. The belief has to be in good faith and must have a rational connection with the issue involved and should not be based on extraneous or irrelevant consideration. The formation of the required opinion and belief by the assessing officer is a condition precedent. Without such formation, the assessing officer will have no jurisdiction to initiate proceedings under Section 21 of the Act. The aforesaid view was also held by a Division Bench of this Court after considering various judgements of the Supreme Court in M/s S. K. Traders, Modi Nagar, Ghaziabad vs. Additional Commissioner, Grade-I, Trade Tax, Zone Ghaziabad and another, 2008 UPTC 392."

and again held-

> "There is no quarrel with the aforesaid proposition. The reason to belief must be based on some rational basis for the Assessing Officer to form a belief that the whole or part of the turnover of a dealer has for any reasons escaped assessment to tax. Such reason or belief must be germane to the formation of the belief regarding the fact that some turnover had escaped assessment of tax. The reasons or the grounds to come to such a conclusion must have a nexus with the formation to such belief, which must be based on certain material."

In the light of the aforesaid decision, we find that in the instant case the reasons recorded by the assessing officer justifying initiation of re-assessment proceeding is that the petitioner has received less amount of interest and had paid more amount of interest resulting in substantial business loss and therefore, it transpires that it is a case of diversion of business fund for non-business purpose.

In our opinion, there is no sufficiency or adequacy of material available with the assessing officer. This information or material was already available in the computation of income filed by the petitioner in his return. Nothing new has been received by way of information or otherwise by the assessing officer. The present case is not a case of testing the sufficiency of material available, but is a case of absence of material, as held by the Supreme Court in Ganga Saran case (supra). There is no direct nexus or live link between the material coming to the notice of the assessing officer and the formation of his belief that there had been escapement of income of the assessee from the assessment in the particular year in question. In our view, there is no rational and tangible nexus between the reason and the belief and the conclusion is inescapable, namely, that in the absence

of material the assessing officer had no jurisdiction to initiate the proceedings under Sections 147/148 of the Act. The reasons to believe recorded by the assessing officer refers to the facts which were already on the file.

In **M/s Vikrant Tyres Limited Vs. State of U.P. and others, 2005 UPTC 501,** a Division Bench of this Court held:-

> "14. Re-assessment on the same material by same authority, if permitted, for no valid reason, will open flood gate for arbitrary action exposing one to unending process, permitting uncertainty, re-opening of closed chapters without assigning good reason, depending upon whims of individuals and in the end precipitating anomalous situations.
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> 15. It, therefore, naturally follows that there has to be some valid ground viz. Some relevant document or material having escaped notice or there has been wrong calculation due to human error bona fide committed, or ignorance of correct and complete facts due to mistake or ignorance of fraud/mis-representation (but not mere change of opinion on same material)."

The contention of the Department that the partners' entities are controlled and run by the family members/relatives of the petitioner and that such partnership firms are covered by the provisions contained under Section 40-A(2)(b) of the Act and, therefore, reassessment proceedings are justified, is patently erroneous.

We are of the opinion, that such ground is not existing in the reasons to believe. This ground was taken by the department while rejecting the objection of the petitioner. Such fresh ground which was not part of the reasons to believe cannot form the basis to initiate the re-assessment proceedings under Sections 147/148 of the Act. Further, there is no material on record to indicate that the partnership entities are controlled and run by the family members or relatives of the petitioner. In the absence of cogent evidence being brought on record, such ground cannot be taken as a reason to reinitiate reassessment proceedings.

In view of the aforesaid, we are of the opinion that there was no fresh material before the assessing officer to form a belief that income had escaped assessment. In the absence of material, we are of the opinion that the assessing officer had no jurisdiction to initiate the proceeding for re-assessment.

Consequently, the impugned notice dated 17.12.2007 issued under Section 148 of the Income Tax Act, for the assessment year 2006-07 is quashed.

The writ petition is allowed.

Dated: 4.2.2015.
AKJ.

(Dr. Satish Chandra, J.) **(Tarun Agarwala, J.)**