

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**SPECIAL CIVIL APPLICATION No. 12243 of 2009****For Approval and Signature:****HONOURABLE MR.JUSTICE AKIL KURESHI : Sd/-****HONOURABLE MS.JUSTICE HARSHA DEVANI : Sd/-**

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1 Whether Reporters of Local Papers may be
allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the
fair copy of the judgment ?

4 Whether this case involves a substantial
question of law as to the interpretation
of the constitution of India, 1950 or
any order made thereunder ?

5 Whether it is to be circulated to the
civil judge ?

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HARSHADBHAI NARANBHAI BAGADIA - Petitioner(s)
Versus

ASSTT. COMMISSIONER OF INCOME TAX - Respondent(s)

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Appearance :

MR MANISH J SHAH for Petitioner(s) : 1,
NOTICE SERVED for Respondent(s) : 1,
MR SUDHIR M MEHTA for Respondent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE AKIL KURESHI**and****HONOURABLE MS.JUSTICE HARSHA DEVANI**

Date : 16/07/2012

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE AKIL KURESHI)

1. Petitioner has challenged a notice dated 05.03.2009, by which, the Assessment Officer sought to reopen the assessment of the petitioner for the assessment year 2005-06.

2. Facts may be noted in brief.

2.1 Petitioner is an individual. He is engaged in diamond processing. For the A.Y. 2005-06, he filed his return of income on 28.10.2005. In the return, the petitioner showed labour charges payment of Rs.3,07,59,872/-. The Assessing Officer framed the assessment after scrutiny under Section 143(3) of the Act on 21.12.2007. In the assessment order, he made no disallowance on such charges.

2.2 Subsequently, the impugned show cause notice under Section 148 of the Act came to be issued seeking to reopen the assessment previously framed after scrutiny. At the request of the petitioner, the reasons which the Assessing Officer had recorded for issuance of notice came to be supplied. Such reasons read as under :-

"1. In this case, the return of income was filed on 28.10.2005 by assessee for A.Y. 2005-

06 showing total income at Rs. 7,83,400/-. The assessment u/s.143(3) completed on 21.12.2007, determining total income at Rs. 38,59,387/-.

2. The assessee engaged in cutting and polishing of diamonds. In this case, the assessee had claimed labour charges payment of Rs. 3,07,59,872/- to labour contractors. But the assessee had not deducted TDS @ 2.091% on the total payment of Rs.3,07,59,872/- u/s.194C of the Act.

3. In view of the above, I have reasons to believe that the assessee became defaulter, and the entire amount of labour charges payment of Rs.3,07,59,872/- made by him to Labour contractors shall not be deducted in computing the income chargeable under the head "profit and gains of Business or profession" as per Section 40(a)(ia) of the I.T. Act and is taxable as the income of the Assessee for A.Y. 2005-06. Thus there is escapement of income, which is required to be taxed by re-opening the Assessment U/s.147 of the I.T. Act. Thus it is a fit case for issuing notice U/s.148 of the I.T. Act."

2.3 From the reasons, it can be seen that there was only one issue, on the basis of which, the Assessing Officer formed an opinion that income chargeable to tax had escaped assessment. He was of the opinion that on the labour charges paid by the petitioner, he was required to deduct tax at source at specified rate in terms of Section 194C of the Act. Since the assessee had not done so, according to the Assessing Officer, he had become defaulter and in terms of Section 40(a)(ia) of the Act, the petitioner was not entitled to claim deduction of such payment while computing his income

chargeable to tax under the head of profit and gains of business or profession.

2.4 The petitioner raised detailed objections to the proposal for reopening under communication dated 13.04.2009. The petitioner contended that he was required to deduct tax at source only if in the financial year immediately preceding the financial year in which such payments were made, he was covered under Section 44AB of the Act. The petitioner contended that the Assessing Officer wrongly believed that the petitioner was required to deduct tax at source on the payment of labour charges, which he made during the financial year relevant to A.Y. 2005-06.

2.5 Such objections were disposed of by the Assessing Officer vide order dated 06.11.2009. The Assessing Officer was of the opinion that the petitioner's interpretation of Section 194C of the Act was erroneous. At that stage, the petitioner approached this Court by filing present petition.

3. Learned counsel, Mr.J.P. Shah for the petitioner submitted that under Section 194C of the Act and particularly sub-section (2) thereof, the petitioner was not required to deduct tax at source on the payment of labour charges which he had paid. He submitted that

in the immediately preceding financial year, the petitioner was not covered under Section 44AB of the Act. In fact, the financial year relevant to the A.Y. 2005-06 was first year of the petitioner's business. That being so, Section 194C of the Act was wrongly applied.

4. Counsel submitted that when the sole reason recorded by the Assessing Officer to reopen the assessment lacked validity, reopening notice be quashed being without jurisdiction.

5. On the other hand, Shri Mehta for the Revenue opposed the petition contending that the notice for reopening has been issued within a period of four years from the end of the relevant assessment year. Admittedly in the original assessment framed by the Assessing Officer, the question of deduction of tax at source was not examined. Notice for reopening is thus validly issued. The proceedings must be allowed to be completed.

6. Having thus heard learned counsel for the parties, we find that undisputedly the notice for reopening has been issued within four years from the end of relevant assessment year. Equally undisputedly in the original assessment, the Assessing Officer had not examined the question of petitioner's liability of

deduction of tax at source under Section 194C of the Act. The question however, is whether the petitioner had any such legal responsibility to do so. This question we are inclined to consider from the limited point of view of examining whether the Assessing Officer could be stated to have reason to believe that income chargeable to tax has escaped assessment. We are conscious that at this stage we are not required to go into the sufficiency of such reasons. Nevertheless, the existence of such reasons can always be looked into by the Court while examining the challenge of the assessee to notice for reopening of assessment previously framed after scrutiny.

7. Though there is plethora of case law on the subject, we may refer to one of the decisions of the Apex Court. In case of **Ganga Saran & Sons P. Ltd. Vs. Income-Tax Officer & Ors.**, reported in 130 ITR Page 1.

The Apex Court held and observed as under :-

“It is well settled as a result of several decisions of this court that two distinct conditions must be satisfied before the ITO can assume jurisdiction to issue notice under s. 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 or 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 IOT would be without jurisdiction. The important words under s. 147(a) are "has reason to believe" and these words are stronger than the words "is satisfied". The belief entertained by the ITO 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 ITO 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 s.147(a). If 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 ITO 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 be struck down as invalid."

8. Coming back to the facts of the case, we may record that in the objections raised by the petitioner and in the order of the Assessing Officer disposing of such objections, both sides referred to the statutory provisions contained in Section 194C(1)(k). However, it is not disputed that it is not this provision but subsection (2) of Section 194C is at issue in the present case.

9. Relevant portion of Section 194C as stood at the relevant time reads as under :-

- (1) Any person responsible for paying any sum to any resident (hereafter in this section referred to as the contractor) for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and --
- (a) the Central Government or any State Government; or
 - (b) any local authority; or
 - (c) any corporation established by or under a Central, State or Provincial Act; or
 - (d) any company; [or]
 - [(e) any co-operative [society]]
 - [(f) any authority, constituted in India by or under any law, engaged either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; or
 - (g) any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India; or
 - (h) any trust; or
 - (i) any University established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a University under section 3 of the University Grants Commission Act, 1956 (3 of 1956); [or]
 - (j) any firm,]

shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, [deduct an amount equal to-

(i) one per cent in case of advertising,
(ii) in any other case two per cent,
of such sum as income-tax on income comprised therein.]

(2) Any person (being a contractor and not being an individual or a Hindu undivided family) responsible for paying any sum to any resident (hereafter in this section referred to as the sub-contractor) in pursuance of a contract with the sub-contractor for carrying out, or for the supply of labour for carrying out, the whole or any part of the work undertaken by the contractor or for supplying whether wholly or partly any labour which the contractor has undertaken to supply shall, at the time of credit of such sum to the account of the sub-contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to one per cent of such sum as income-tax on income comprised therein:

[**Provided** that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the sub-contractor, shall be liable to deduct income-tax under this sub-section.]

[Explanation I.- For the purposes of sub-section (2), the expression "contractor" shall also include a contractor who is carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the Government of a foreign State or a foreign enterprise or any association or body established outside India.]

[Explanation II] – For the purposes of this

section, where any sum referred to in sub-section (1) or sub-section (2) is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.]

[Explanation III. - For the purposes of this section, the expression "work" shall also include--

- (a) advertising;
- (b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
- (c) carriage of goods and passengers by any mode of transport other than by railways;
- (d) catering.]"

10. It does not appear to be debatable that the case of the petitioner does not fall in sub-section (1) of Section 194C. Sub-section (1) of Section 194C would cover the cases of payments made by any person to a contractor pursuant to a contract between the contractor and authorities specified in clauses (a) to (j).

11. If at all, the case of the petitioner needs to be examined in terms of sub-section (2) of Section 194C of the Act. Main body of sub-section (2) provides that any person being a contractor and not being an individual or Hindu undivided family responsible for paying any sum to any resident in pursuance of a

contract with the sub-contractor in case of specified contract, shall have to at the time of credit of such sum at the account of sub-contractor or at the time of payment thereof in cash or by issuance of cheque or draft or any other mode, whichever is earlier, deduct tax at source at specified per cent.

12. Proviso to sub-section (2) of Section 194C however provides that an individual or Hindu undivided family whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the sub-contractor, shall be liable to deduct income-tax under the said sub-section.

13. From the above, it can be seen that sub-section (2) of Section 194C under ordinary circumstances does not cover an individual or Hindu Undivided family for the liability of deducting tax at source on the payments credited or made to the sub-contractor. However, proviso brings such individual or HUF within the fold of sub-section (2) if in the financial year immediately preceding the financial year during which

such sum is credited or paid, such individual or HUF was covered by clause (a) or clause (b) of Section 44AB. Therefore, to insist that an individual or HUF should deduct tax at source under sub-section (2) of Section 194C on payments made to a sub-contractor, it must be established that in the financial year immediately preceding the financial year in which such sum is paid or credited, total sales, gross receipts or turnover of such individual or HUF from profession or business exceeded the limits provided in Section 44AB of the Act and the accounts were thus compulsorily auditable.

14. In the present case, admittedly such condition was not satisfied in the preceding financial year. The AO however interpreted that liability to deduct tax at source would arise even if the case of the assessee fell under clauses (a) or (b) of Section 44AB in the current financial year. We do not see how such interpretation is possible. Firstly, proviso to sub-section (2) of Section 194C clearly refers to financial year immediately preceding the financial year in which sum is credited or paid to the sub-contractor. Statutory provisions do not permit any ambiguity.

15. Even otherwise the interpretation put forth by the Revenue would lead to anomalous situation. The

assessee as an individual or HUF may be required to make the payments to a sub-contractor on the first date of the financial year or at any rate in the early part of the financial year. At that stage, the assessee would obviously not be in position to foresee whether total sales, gross receipts or turnover would exceed statutory limits and his accounts would be therefore required to be audited under Section 44 AB of the Act. In such a situation, the assessee could not be expected to deduct tax at source. If out of abundant caution, he did deduct the tax at that stage, the recipient of the payment would legitimately object to any such deduction. Moreover, eventually during the financial year under consideration, if the assessee's total sales, gross receipts or turnover did not exceed statutory limits, the entire exercise of deduction of tax at source would be unauthorized. On the other hand, if the assessee did not deduct the tax and by the year end, found that his total sale, gross receipts or turnover had exceed the limit, he would be liable to be declared a defaulter with grave consequences of such payments though actually made, being discarded for deduction under Section 40(a) (ia) of the Act. Surely, the statute never intended to bring about such strange results. It is precisely for

this reason that the liability of an individual or HUF to deduct tax at source upon the payments being made to the sub-contractor, is made relatable to his gross receipts, sales or total turnover of the financial year immediately preceding the year when such payment is made or credited.

16. In the result, we are of the opinion that the Assessing Officer's reason to believe that the income chargeable to tax in case of the assessee has escaped assessment is without any foundation and lacks validity. When the sole reason of reopening of the assessment fails, the notice itself is rendered invalid and the same is therefore quashed. Rule is made absolute. No cost.

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THE HIGH COURT
OF GUJARAT
WEB COPY

Sd/-
(AKIL KURESHI, J.)

Sd/-
(HARSHA DEVANI, J.)

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