Supreme Court of India
Income Tax Officer, I Ward, Dist, ... vs Lakhmani Mewal Das on 30 March, 1976
Equivalent citations: 1976 AIR 1753, 1976 SCR (3) 956
Author: H R Khanna
Bench: Khanna, Hans Raj

PETITIONER:
INCOME TAX OFFICER, I WARD, DIST, VI, CALCUTTA & ORS.

Vs.

RESPONDENT:
LAKHMANI MEWAL DAS

DATE OF JUDGMENT30/03/1976

BENCH:
KHANNA, HANS RAJ
BENCH:
KHANNA, HANS RAJ
GOSWAMI, P.K.

CITATION:
1976 AIR 1753 1976 SCR (3) 956
1976 SCC (3) 757
CITATOR INFO :
F 1977 SC 429 (10)
R 1986 SC1857 (7)
RF 1987 SC1897 (32)

ACT:
Income Tax Act , 1961-S. 148-Scope of-Words & Phrases-"Reason to believe" meaning of 'rational nexus'-What postulates.

HEADNOTE:
In March 1967, after obtaining the satisfaction of the Commissioner the appellant issued a notice under s. 148 of the Income Tax Act, 1961 stating that he had reason to believe that the respondent's income chargeable to tax for the assessment year 1958-59 had escaped assessment. The respondent replied that the I.T.O. had no competence or jurisdiction to reopen the assessment under s. 147 of the Act on a mere change of opinion. Since there was no reply from the appellant, the respondent moved the High Court for a writ. The High Court held that the conditions precedent for the exercise of jurisdiction by the Income Tax Officer were not fulfilled because the report submitted by the Income Tax Officer to the Commissioner under s. 147(a) was defective. On appeal to this Court it was contended that the

High Court was not right in holding that the Income Tax Officer's report was defective.

Dismissing the appeal,

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HELD: The High Court was right in holding that the material before the Income Tax Officer could not have led to the formation of the belief that the income of the assessee had escaped assessment because of his failure or omission to disclose fully and truly all material facts. [965H]

1. (a) The two conditions required to be satisfied before the Income Tax Officer issued a notice under s. 148 of the Income Tax Act are that he must have reason to believe (i) that the income chargeable to tax had escaped assessment and (ii) that such income had escaped assessment by reason of the omission or failure on the part of assessee, to disclose fully and truly material facts necessary for assessment for that year. Both these conditions must co-exist in order to confer jurisdiction on the Income Tax Officer. Further the Income Tax Officer should record his reasons before initiating proceedings under s. 148(2); before issuing the notice after the expiry of four years from the end of the relevant assessment year, the Commissioner should be satisfied on the reasons recorded by the Income Tax Officer that it was a fit case for the issue of such notice. [962C-D]

(b) The duty cast upon the assessee does not extend beyond making a true and full disclosure of the primary facts. It is then for the Income Tax Officer to draw the correct inference from the primary facts. Where his inference subsequently appears to be erroneous, mere change of opinion with regard to that inference would not justify initiation of action for reopening the assessment. [962F-G]

(c) The grounds or reasons leading to the formation of the belief under s. 147(a) must have a material bearing on the question of escapement of income. Once there exist reasonable grounds for the Income Tax Officer to form the above belief, that would be sufficient to clothe him with jurisdiction to issue notice. While the sufficiency of grounds which induce the Income Tax Officer to act is not justiciable, it is open to the assessee to contend that the Income Tax Officer did not hold the belief that there was such non-disclosure. The expression "reason to believe" does not mean a purely subjective satisfaction on the part of the Income-Tax Officer. It is open to the Court to examine whether the reasons for the formation of the belief have a rational connection with or relevant bearing on the formation of the belief and are not extraneous or irrelevant for the purpose of the section. [962H]

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Chhugamal Rajpal v. S. P. Chaliha 79 I.T.R. 603, Calcutta Discount Co. Ltd. v. Income-Tax Officer, 41 I.T.R. 191 and S. Narayanappa & Ors. v. Commissioner of Income Tax 63 I.T.R. 219 followed.

In the instant case the grounds given by the Income Tax Officer for reopening the assessment were (i) that the three persons whose names were mentioned in the list of creditors, were known name lenders and (ii) that another person shown as a creditor of the assessee had since confessed that he was doing only name lending. The first ground mentioned by the Income Tax Officer could not have led to the formation of the belief that the income of the respondent had escaped assessment for that year because of his failure or omission to disclose fully and truly all material facts. The High Court was justified in excluding that ground from consideration. [963D-E]

As regards the second ground there is nothing to show that the confession of another person related to a loan to the assessee and not to someone else. There is no indication as to when the confession was made and whether it related to the assessment year sought to be re-opened. To infer from that confession that it related to the period of assessment and that it pertained to the loan shown to have been advanced to the assessee would be far-fetched. [964G]

2(a). Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income Tax Officer and the formation of his belief that there had been escapement of income of the assessee from assessment in the particular year. It is not any and every material, howsoever vague and indefinite or distant, remote and far-fetched which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment. The fact that the words "definite information" in s. 34 of 1922 Act before its amendment in 1948 do not find a place in s. 147 would not lead to the conclusion that action could now be taken for reopening assessment even if the information was wholly vague, indefinite, far-fetched and remote. [965B-D]

(b) The powers of the Income Tax Officer to reopen assessment, though wide, are not plenary. The words are "reason to believe" and not "reason to suspect". The provisions of the Act depart from the normal rule that there should be finality about orders made in judicial and quasi-judicial proceedings. It is, therefore, essential that before such action is taken the requirement of the law should be satisfied. [965E-F]

In the instant case the live link or close nexus between the material before the Income Tax Officer and the belief which he was to form regarding the escapement of the income was missing or at any rate the link was too tenuous to provide a legally sound basis for reopening the assessment. [G]

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 2526 of 1972.

Appeal from the Judgment and Order dated the 13th January, 1972 of the Calcutta High Court in Matter No. 326 of 1967.

G. C. Sharma and S. P. Nayar, for the Appellant. D. Pal, B. Sen, (Mrs.) Leila Seth, P. K. Pal, S. R. Agarwala and Parveen Kumar for the Respondent.

The Judgment of the Court was delivered by KHANNA, J. This appeal on certificate is against the Full Bench judgment of the Calcutta High Court whereby on petition under article 226 of the Constitution of India filed by the respondent that court by majority quashed notice under section 148 of the Income-tax Act, 1961 (hereinafter referred to as the Act) issued by appeallant No. 2 (Income-tax Officer E Ward, Hundi Circle, Calcutta) (hereinafter referred to as the appellant) for the purpose of reopening assessment of the income of the respondent for the assessment year 1958-

59. The respondent was assessed for the assessment year 1958-59 under section 23(3) of the Indian Income-tax Act, 1922 on June 14, 1960. His total income was assessed to be Rs. 37,872. While making the assessment the Income-tax Officer allowed deduction of a sum of Rs. 15,991 by way of expenses claimed by the respondent. The expenses included Rs. 10,494/4 As/3 Pies by way of interest. According to the respondent, he produced through his authorised representative all books of accounts, bank statements and other necessary documents in connection with the return. On March 14, 1967 the respondent received notice dated March 8, 1967 issued by the appellant under section 148 of the Act stating that the appellant had reason to believe that the respondent's income which was chargeable to tax for the assessment year 1958-59 had escaped assessment within the meaning of section 147 of the Act and that the notice was being issued after obtaining the necessary satisfaction of the Commissioner of Income-tax. The respondent was called upon to submit within 30 days from the date of the service of the notice a return in the prescribed form of his income for the assessment year 1958-59. On May 2, 1967 the respondent through his lawyer stated that there was no material on which the appellant had reason to believe that the respondent's income had escaped assessment and, therefore, the condition precedent for the assumption of jurisdiction by the appellant had not been satisfied. The appellant was said to have no competence or jurisdiction to re-open the assessment under section 147 of the Act on a mere change of opinion. The appellant was also called upon to furnish all the materials on which he had reason to believe that income had escaped assessment. As, according to the respondent, there was no satisfactory response from the appellant, he filed petition under article 226 of the Constitution for quashing the impugned notice.

It was denied in the affidavit on behalf of the appellant that all materials relevant and necessary for the assessment of the respondent's income for the assessment year 1958-59 had been produced before the Income-tax Officer at the time of the original assessment. It was further stated:

> "Subsequent to the assessment for the assessment year 1958-59, it was discovered, inter alia, that some of the loans shown to have been taken and interests alleged to have been paid thereon by the petitioner during the relevant assessment year were not genuine. The Income-tax Officer had reason to believe and bona fide believed

> that the said alleged loans and the interest alleged to have been paid thereon are not genuine. If necessary, I crave leave to produce before the hon'ble Judge hearing the application, the relevant records on the basis of which the said Income-tax Officer had reason to believe that the income of the petitioner escaped assessment as aforesaid at the hearing of the application."

During the pendency of the proceedings the High Court directed that a copy of the report made by the appellant to the Commissioner of Income-tax for obtaining latter's sanction under section 147 be produced. The report was accordingly produced, and the same reads as under:

> "There are hundi loan credits in the name of Narayan singh Nandalal, D. K. Naraindas, Bhagwandas Srichand, etc., who are known name-lenders, and also hundi loan credit in the name, Mohansingh Kanayalal, who has since confessed he was doing only name-lending. In the original assessment these credits were not investigated in detail. As the information regarding the bogus nature of these credits is since known, action under section 147 (a) is called for to reopen the assessment and assess these credits as the undisclosed income of the assessee. The assessee is still claiming that the credits are genuine in the assessment proceedings for 1962-63. Commissioner's sanction is solicited to reopen the assessment for 1958-59, under section 147(a)."

All the three Judges who constituted the Full Bench found that the assessee was not being charged with omission to disclose all facts: he was charged for having made an untrue disclosure because the assessee had stated that he had received certain sums of money from certain persons as loans when, in fact, he had not received any sum at all from these persons. It was also stated by the assessee at the time of the original assessment that he had paid interest to certain persons when, in fact, he had not, if the information received later was true. The duty of the assessee, it was held, was not only to make a full disclosure of all material facts, his duty was also to make a true disclosure of facts and not to mislead the assessing officer by disclosing certain things which did not represent facts. The High Court accordingly held that once an assessee infringes this rule, any subsequent discovery of fact by the assessing officer which would raise a resonable belief in his mind that the assessee had not made a true and correct disclosure of the facts and had thereby been responsible for escapement of his income from assessment would attract section 147 of the Act. Two of the learned Judges, A. K. Mukherjea and S. K. Mukherjea JJ., however, took the view that the conditions precedent for the exercise of jurisdiction by the Income-tax Officer under section 147 of the Income-tax Act were not fulfilled in the case as the report submitted by the Income- tax Officer to the Commissioner for sanction under section 147(a) was defective. The defects in the report, in the opinion of the High Court, were the same as had been pointed out by this Court in the case of Chhugamal Rajpal v. S. P. Chaliha.(1) The Commissioner, while according permission for taking action under section 147, it was observed, acted mechanically because the Commissioner had not expressly stated that he was satisfied that this was a fit case for the issue of notice under section 148. As against the majority, Sabyasachi Mukherji J. held that notice under section 148 of the Act was valid and did not suffer from any infirmity. It was also observed that the Commissioner of Income-tax had not acted improperly in giving sanction.

In the result, by majority the High Court quashed the notice issued by the appellant to the respondent.

In appeal before us Mr. Sharma on behalf of the appellants has assailed the judgment of the majority of the learned Judges in so far as they have held that the report submitted by the Income-tax Officer to the Commissioner of Income-tax for sanction was defective. As against that, Dr. Pal on behalf of the assessee-respondent has canvassed for the correctness of the view taken by the majority regarding the defective nature of the report. Dr. Pal has in his own turn assailed the finding of all the three learned Judges of the High Court in so far as they have held that the assessee was being charged with omission to disclose true facts. Contention has also been advanced by Dr. Pal that the material on the basis of which the Income-tax Officer initiated these proceedings for reopening the assessment did not have a rational connection with the formation of the belief that the assessee had not made a true disclosure of the facts at the time of the original assessment.

Before dealing with the points of controversy, it would be useful to reproduce the relevant provisions of the Act. Sections 147 and 148 which deal with income escaping assessment and issue of notice where income has escaped assessment read as under:

"147. Income escaping assessment.-If-

(a) the Income-tax Officer has reason to believe that, by reason of the omission or failure on the part of an assessee to make a return under section 139 for any assessment year to the Income-tax Officer or to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, or

(b) notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the assessee, the Income-tax officer has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of section 148 to 153, assess or ressess such income or recompute the loss or the depreciation allowance, as the case may be, for the assessment year concerned (hereinafter in sections 148 to 153 referred to as the relevant assessment year). Explanation 1.-For the purposes of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely:-

(a) where income chargeable to tax has been under assessed; or

(b) where such income has been assessed at too low a rate; or

(c) where such income has been made the subject of excessive relief under this Act or under the Indian Income-tax Act, 1922 (XI of 1922); or

(d) where excessive loss or depreciation allowance has been computed.

Explanation 2.-Production before the Income-tax Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Income-tax Officer will not necessarily amount to disclosure within the meaning of this section.

148. Issue of notice where income has escaped assessment.-

(1) Before making the assessment, reassessment or recomputation under section 147, the Income-tax Officer shall serve on the assessee a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 139; and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section.

(2) The Income-tax Officer shall, before issuing any notice under this section, record his reason for doing so."

Sub-section (1) of section 149 prescribes the time limit for notice and reads as under:

> "(1) No notice under section 148 shall be issued"
>
> (a) in cases falling under clause (a) of section 147-
>
> (i) for the relevant assessment year, if eight years have elapsed from the end of that year, unless the case falls under sub-clause (ii);
>
> (ii) for the relevant assessment year, where eight years, but not more than sixteen years, have elapsed from the end of that year, unless the income chargeable to tax which has escaped assessment amounts to or is likely to amount to rupees fifty thousand or more for that year;
>
> (b) in cases falling under clause (b) of section 147, at any time after the expiry of four years from the end of the relevant assessment year."

Section 151 pertains to the sanction for issue of notice and reads as under:

> "151. Sanction for issue of notice.-(1) No notice shall be issued under section 148 after the expiry of eight years from the end of the relevant assessment year, unless the Board is satisfied on the reasons recorded by the Income-tax Officer that it is a fit case for the issue of such notice.
>
> (2) No notice shall be issued under section 148 after the expiry of four years from the end of the relevant assessment year, unless the Commissioner is satisfied on the reasons recorded by the Income-tax Officer that it is a fit case for the issue of such notice."

The provisions of sections 147 to 153 of the Act correspond to those of section 34 of the Indian Income-tax Act, 1922. There have been some points of departure from the old law, but it is not necessary for the purpose of the present case to refer to them.

It would appear from the perusal of the provisions reproduced above that two conditions have to be satisfied before an Income-tax Officer acquires jurisdiction to issue notice under section 148 in respect of an assessment beyond the period of four years but within a period of eight years from the end of the relevant year, viz., (1) the Income-tax Officer must have reason to believe that income chargeable to tax has escaped assessment, and (2) he must have reason to believe that such income has escaped assessment by reason of the omission or failure on the part of the assessee (a) to make a return under section 139 for the assessment year to the Income-tax Officer, or (b) to disclose fully and truly material facts necessary for his assessment for that year. Both these conditions must co-exist in order to confer jurisdiction on the Income-tax Officer. It is also imperative for the Income-tax Officer to record his reasons before initiating proceedings as required by section 148(2). Another requirement is that before notice is issued after the expiry of four years from the end of the relevant assessment years, the Commissioner should be satisfied on the reasons recorded by the Income-tax Officer that it is a fit case for the issue of such notice. We may add that the duty which is cast upon the assessee is to make a true and full disclosure of the primary facts at the time of the original assessment. Production before the Income-tax Officer of the account books or other evidence from which material evidence could with due diligence have been discovered by the Income-tax Officer will not necessarily amount to disclosure contemplated by law. The duty of the assessee in any case does not extend beyond making a true and full disclosure of primary facts. Once he has done that his duty ends. It is for the Income-tax Officer to draw the correct inference from the primary facts. It is no responsibility of the assessee to advise the Income-tax Officer with regard to the inference which he should draw from the primary facts. If an Income-tax Officer draws an inference which appears subsequently to be erroneous, mere change of opinion with regard to that inference would not justify initiation of action for reopening assessment.

The grounds or reasons which lead to the formation of the belief contemplated by section 147(a) of the Act must have a material bearing on the question of escapement of income of the assessee from assessment because of his failure or omission to disclose fully and truly all material facts. Once there exist reasonable grounds for the Income- tax Officer to form the above belief, that would be sufficient to clothe him with jurisdiction to issue notice. Whether the grounds are adequate or not is not a matter for the court to investigate. The sufficiency of grounds which induce the Income-tax Officer to act is, therefore, not a justiciable issue. It is, of course, open to the assessee to contend that the Income-tax Officer did not hold the belief that there had been such non-disclosure. The existence of the belief can be challenged by the assessee but not the sufficiency of reasons for the belief. The expression "reason to believe" does not mean a purely subjective satisfaction on the part of the Income-tax Officer. The reason must be held in good faith. It cannot be merely a pretence. It is open to the court to examine whether the reasons for the formation of the belief have a rational connection with or a relevant bearing on the formation of the belief and are not extraneous or irrelevant for the purpose of the section. To this limited extent, the action of the Income-tax Officer in starting proceedings in respect of income escaping assessment is open to challenge in a court of law [see observations of this Court in the cases of Calcutta Discount Co. Ltd. v. Income-tax Officer

and S. Narayanappa & Ors. v. Commissioner of Income-tax while dealing with corresponding provisions of the Indian Income-tax Act, 1922].

Keeping the above principles in view, we may now turn our attention to the facts of the present case. Two grounds were mentioned in the report made by the Income-tax Officer for reopening the assessment of the assessee respondent with a view to show that his income had been under-assessed because of his failure to disclose fully and truly material facts necessary for the assessment. One was that Mohansingh Kanayalal, who was shown to be one of the creditors of the assessee, had since confessed that he was doing only name- lending. The other ground was that Narayansingh Nandalal, D. K. Naraindas, Bhagwandas Srichand, etc., whose names too were mentioned in the list of the creditors of the assessee, were known name-lenders. So far as the second ground is concerned, neither the majority of the Judges of the High Court nor the learned Judge who was in the minority relied upon that ground. Regarding that ground, the learned Judge who was in the minority observed that no basis had been indicated as to how it became known that those creditors were known namelenders and when it was known. The majority while not relying upon that ground placed reliance upon the case of Chhugamal Rajpal (supra). In that case the Income- tax Officer while submitting a report to the Commissioner of Income-tax for obtaining his sanction with a view to issue notice under section 148 of the Act stated:

> "During the year the assessee has shown to have taken loans from various parties of Calcutta. From D.I.'s Inv. No. A/P/Misc. (5) D.I./63-64/5623 dated August 13, 1965, forwarded to this office under C.I.T., Bihar and Orissa, Patna's letter No. Inv. (Inv.) 15/65- 66/1953-2017 dated Patna September 24, 1965 it appears that these persons are name-lenders and the transactions are bogus. Hence, proper investigation regarding these loans is necessary. The names of some of the persons from whom money is alleged to have been taken on loan on hundis are:
>
> 1. Seth Bhagwan Singh Sricharan
>
> 2. Lakha Singh Lal Singh
>
> 3. Radhakissen Shyam Sunder The amount of escapement involved amounts to Rs. 1,00,000."
>
> In dealing with that report this Court observed: "From the report submitted by the Income-tax Officer to the Commissioner, it is clear that he could not have had reasons to believe that by reason of the assessee's omission to disclose fully and truly all material facts necessary for his assessment for the accounting year in question, income chargeable to tax has escaped assessment for that year, nor could it be said that he, as a consequence of information in his possession, had reasons to believe that the income chargeable to tax has escaped assessment for that year. We are not satisfied that the Income-tax Officer had any material before him which could satisfy the requirements of either clause (a) or clause (b) of section 147. Therefore he could not have issued a notice under section 148".

Reference to the names of Narayansingh Nandalal, D. K. Naraindas, Bhagwandas Srichand, etc., in the report of the Income-tax Officer to the Commissioner of Income-tax in the instant case does not stand on a better footing than the reference to the three names in the report made by the Income-tax Officer in the case of Chuugamal Rajpal. We would, therefore, hold that the second ground mentioned by the Income-tax Officer, i.e., reference to the names of Narayansingh Nandalal, D. K. Naraindas, Bhagwandas Srichand, etc., could not have led to the formation of the belief that the income of the respondent assessee chargeable to tax had escaped assessment for that year because of the failure or omission of the assessee to disclose fully and truly all material facts. All the three learned Judges of the High Court, in our opinion, were justified in excluding the second ground from consideration.

We may now deal with the first ground mentioned in the report of the Income-tax Officer to the Commissioner of Income-tax. This ground relates to Mohansingh Kanayalal, against whose name there was an entry about the payment of Rs. 74 Annas 3 as interest in the books of the assessee, having made a confession that he was doing only name- lending. There is nothing to show that the above confession related to a loan to the assessee and not to someone else, much less to the loan of Rs. 2,500 which was shown to have been advanced by that person to the assessee-respondent. There is also no indication as to when that confession was made and whether it relates to the period from April 1, 1957 to March 31, 1958 which is the subject-matter of the assessment sought to be reopened. The report was made on February 13, 1967. In the absence of the date of the alleged confession, it would not be unreasonable to assume that the confession was made a few weeks or months before the report. To infer from that confession that it relates to the period from April 1, 1957 to March 31, 1958 and that it pertains to the loan shown to have been advanced to the assessee, in our opinion, would be rather far-fetched.

As stated earlier, the reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income-tax Officer and the formation of his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. It is no doubt true that the court cannot go into the sufficiency or adequacy of the material and substitute its own opinion for that of the Income-tax Officer on the point as to whether action should be initiated for reopening assessment. At the same time we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and far- fetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment. The fact that the words "definite information" which were there in section 34 of the Act of 1922 at one time before its amendment in 1948 are not there in section 147 of the Act of 1961 would not lead to the conclusion that action cannot be taken for reopening assessment even if the information is wholly vague, indefinite, far-fetched and remote. The reason for the formation of the belief must be held in good faith and should not be a mere pretence.

The powers of the Income-tax Officer to reopen assessment though wide are not plenary. The words of the statute are "reason to believe" and not "reason to suspect". The reopening of the assessment after the lapse of many years is a serious matter. The Act, no doubt, contemplates the reopening of

the assessment if grounds exist for believing that income of the assessee has escaped assessment. The underlying reason for that is that instances of concealed income or other income escaping assessment in a large number of cases come to the notice of the income-tax authorities after the assessment has been completed. The provisions of the Act in this respect depart from the normal rule that there should be, subject to right of appeal and revision, finality about orders made in judicial and quasi- judicial proceedings. It is, therefore, essential that before such action is taken the requirements of the law should be satisfied. The live link or close nexus which should be there between the material before the Income-tax Officer in the present case and the belief which he was to form regarding the escapement of the income of the assessee from assessment because of the latter's failure or omission to disclose fully and truly all material facts was missing in the case. In any event, the link was too tenuous to provide a legally sound basis for reopening the assessment. The majority of the learned Judges in the High Court, in our opinion, were not in error in holding that the said material could not have led to the formation of the belief that the income of the assessee respondent had escaped assessment because of his failure or omission to disclose fully and truly all material facts. We would, therefore, uphold the view of the majority and dismiss the appeal with costs.

P.B.R. Appeal dismissed.