

PENALTIES

Some key points

Burden of proof lies on the assessee [Section 271(1)(c)]

Any amount added or disallowed in the computation of total income as a result of unsatisfactory or false statement of the assessee would be deemed to represent concealed income in respect of which inaccurate particulars were furnished by the assessee.

The burden is on the assessee to prove that the explanation is bonafide and where the assessee fails to prove that the explanation is bonafide, the Revenue is justified in levying penalty.

Explanation 5 relating to admission of income in respect of search providing immunity from concealment penalty is not applicable where the search is initiated on or after 01.06.2007.

Explanation 5A expanded retrospectively w.e.f 01.6.2007 is intended to cover cases where the assessee has filed return of income for any previous year before the date of search and the income found during the course of search relating to such previous year is not disclosed in the return of income. In such cases also, the assessee would be deemed to have concealed the particulars of income and would be liable for penalty under section 271.

Penalty in respect of any search initiated on or after 01.06.2007 [Section 271AAA]

(i) Where a search is initiated on or after 01.06.2007 penalty under this section could be imposed at 10% of the undisclosed income of the specified previous year.

(ii) 'Undisclosed income' means –

- (a) any income represented by any asset or entry in the books of account or other documents or transactions found in the course of search under section 132 which has –
 - (1) not been recorded in the regular books of account or documents on or before the date of search; or
 - (2) otherwise not been disclosed to the Chief Commissioner or Commissioner before the date of search.
- (b) any income represented by any entry in respect of an expense recorded in regular books of account or documents, which is found to be false as a result of search.

(iii) "Specified previous year" means –

- (1) the previous year which has ended before the date of search, but the due date of filing the return of income under section 139(1) has not expired before the date of search; or
 - (2) the previous year in which the search was conducted.
- (iv) Therefore, this section covers the previous year for which the due date of filing the return has not expired on the date of search and the year of search.
- (v) No penalty under section 271(1)(c) is leviable in respect of such undisclosed income.
- (vi) This section grants immunity from imposition of penalty, if:
- (1) the assessee admits disclosed income in a statement under section 132(4) during the course of search and,
 - (2) specifies the manner in which such income has been derived;
 - (3) substantiates the manner in which the undisclosed income was derived; and
 - (4) pays the tax, together with interest, if any, in respect of the undisclosed income.

The provisions of section 274 relating to the procedure for levying penalty and section 275 relating to bar of limitation for imposing penalties shall, to the extent relevant, be applicable to the penalty referred to in this section.

Question 1

Sumit voluntarily filed a revised return of income within the prescribed time limit after discovering that interest received from bank was not disclosed in the original return. Can he be absolved of penalty under section 271(1)(c)?

Answer

On this issue, the Gujarat High Court, in *CIT v. Manibhai & Brothers (2007) 294 ITR 501 (Guj.)*, observed that for imposition of penalty under section 271(1)(c), there should be a deliberate concealment of particulars or furnishing of inaccurate particulars by the assessee. For this purpose, the conduct of the assessee from the beginning till the end of the assessment proceedings in totality should be considered. If a revised return of income is filed by the assessee after the omission or wrong statement in the original return is discovered by the Assessing Officer in the course of assessment proceedings, then the Assessing Officer can impose penalty under section 271(1)(c). **However, if the assessee voluntarily files a revised return of income suo motu before the assessment order is passed, after he himself discovers an omission or wrong statement in the original return, then, penalty cannot be levied under section 271(1)(c).**

In view of above legal position, Sumit can be absolved of penalty under section 271(1)(c).

Question 2

A notice to levy penalty u/s 271(1)(c) was issued on 11.6.10. The assessee in response thereto filed on 13.7.10 a written submission requesting to decide the matter. The Assessing Officer before whom this reply was filed retired on 31.8.10 and the officer, who succeeded him passed the penalty order without providing any further opportunity, but by taking into cognizance the reply filed by the assessee. Whether the order by the Assessing Officer is valid?

Answer

As per the provisions of section 129, whenever an Assessing Officer ceases to exercise jurisdiction and he is succeeded by another, then, the authority so succeeding may continue the proceedings from the stage at which the proceedings were left by the predecessor provided the assessee does not demand that before the proceeding is so continued he may be re-heard by the successor officer. **In the present case, the assessee had only filed a written submission in respect of the notice for levy of penalty. However, he had not specifically requested to be reheard at the time of change in office. Accordingly, the penalty order passed by the successor officer without providing any further opportunity to be reheard, is a valid order.** This was also held by the Apex Court in the case of *Pradip Lamp Works v. CIT (2001) 249 ITR 797*.

Question 3

What is the quantum of penalty that could be levied in each of the following cases:

- (i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act within the time prescribed under the Act.*
- (ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) of the Income-tax Act.*
- (iii) Failure to furnish audit report as required under section 92E of the Income-tax Act.*

Answer

The penalty that could be levied in each case is:-

- (i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act - a sum equal to $\frac{1}{2}\%$ of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs.1,50,000, whichever is less [Section 271B].
- (ii) Failure to get books of accounts audited in response to the notice issued under section 142(2A) – a sum of Rs.10,000 [Section 271(1)].
- (iii) Failure to furnish audit report under section 92E of the Income-tax Act - a sum of Rs.1,00,000 [Section 271BA].

Question 4

The assessment of B, an individual, for the assessment year 2009-10 was made under section 143(3) of the Income-tax Act, 1961 on 18.3.2010. The assessment has become final and is not the subject-matter of an appeal or revision. The Assessing Officer issued a show cause notice for levy of penalty under section 271(1)(c) to B on 25.3.2010. B furnished a reply to the said notice on 30.3.2010. There was a change in incumbent and the Assessing Officer, who made the assessment and issued the show cause notice, was succeeded by another. The successor-Assessing Officer suo motu issued a notice under section 129 to B on 20.9.2010. B did not respond to the said notice. The successor-Assessing Officer passed an order on 24.10.2010 levying penalty under section 271(1)(c). Examine the validity of the order of penalty passed with reference to the aspect of limitation.

Answer

Section 275(1) provides for the time limit for passing an order of penalty. Clause (c) thereof requires that the order of penalty should be passed before the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later. The time limit in this case, as per section 275(1)(c), is 30.9.2010. *Explanation* to section 275(2) states that in computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 shall be excluded. A plain reading of the proviso to section 129 indicates that it is the assessee who may demand to be re-heard before any order is passed against him. In the instant case, notice under section 129 was not issued by the successor- Assessing Officer at the instance of B. B did not request him to provide an opportunity of re-hearing. **The Supreme Court has in *Pradip Lamps Works v. CIT (2001) 249 ITR 797* ruled that where the assessee replied to the show cause notice issued by the predecessor-Assessing Officer, the successor-Assessing Officer can levy penalty without giving a fresh notice of hearing to the assessee in the absence of a demand by the assessee for re-hearing.** The Karnataka High Court, in *B. N. Amarnath v. CIT (2003) 259 ITR 590*, held that the *Explanation* to section 275(2) could not be invoked by the Department unilaterally to compute the period of limitation on its own, by issue of notice under section 129, without there being any request for re-hearing by B.

Therefore, in this case, the order of penalty should have, therefore, been passed by the successor-Assessing Officer on or before 30.9.2010 as per the provisions of section 275(1)(c). The order of penalty having been passed on 24.10.2010 is barred by limitation and therefore, invalid.

Question 5

X, an individual whose total sales in the business of food grains for the year ending 31.3.2011 was Rs.66 lakhs, did not maintain books of account. The Assessing Officer levied penalties

under section 271A for non-maintenance of books of account and section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X has not maintained books of account though he was required under the Income-tax Act to do so since his gross sales exceeded Rs.60 lakhs. He is liable to pay penalty under section 271A for such default. Accordingly, the action of the Assessing Officer in levying penalty under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In *Surajmal Parsuram Todi v. CIT* (1996) 222 ITR 691, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 6

Can penalty under section 271(1)(c) of the Income-tax Act for concealment of income or particulars thereof be imposed on “intangible” additions to income made by the Assessing Officer. Can these additions be utilised by the assessee to explain investments made in the subsequent years?

Is there any time limit for initiation of penalty proceedings in such cases? Discuss.

Answer

In many cases, the Assessing Officer makes additions to the returned income purely on account of certain technical reasons. For example, he calculates the total income of the assessee by assuming a certain rate of gross profit or yield, or he disallows a portion of certain expenses on estimated basis. These are called intangible additions.

The Supreme Court, in *Anantharam Veerasighaiah and Co. v. CIT* (1980) 123 ITR 457 observed that the secret profits or undisclosed income of an assessee earned in an earlier assessment year, commonly described as intangible additions, are also the real income of the assessee. Therefore, the assessee can explain the unexplained investment etc. of the current year to have been met out of intangible additions made in the past.

Explanation 2 to section 271(1) enables the Assessing Officer to initiate penalty proceedings in respect of intangible additions made in the past which are claimed by the assessee to be a

source of any receipt, deposit or outgoing or investment in any subsequent year. **The penalty proceedings shall be initiated for the assessment year in which such intangible additions were made and shall be leviable only on such intangible additions made in the past years which have been claimed to be a source of receipt, deposit, outgoing or investment of the subsequent year.**

According to section 271(1A), where any penalty is imposable by virtue of *Explanation 2* to section 271(1), the proceedings for imposition of such penalty may be initiated at any time, even if assessment proceedings in the course of which such penalty could have been initiated have been completed.

Question 7

GK Ltd. filed its return of income for the assessment year 2009-10 on 30.4.2011. The assessing officer levied a penalty of Rs. 5,000 under section 271F. The assessee makes a submission to the CIT (Appeals) that he has furnished the return of Income within the due date specified in section 139(4) and hence no penalty should be levied under 271F. Discuss.

Answer

Penalty of Rs.5,000 under section 271F is imposable on a person who is required to furnish return of income under section 139(1) for failure to furnish such return before the end of the relevant assessment year. It is true that the assessee can file a belated return under section 139(4) within one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier. However, right to file a belated return after the end of the assessment year does not mean that the liability to pay penalty ceases. The Supreme Court's decision in *Pradip Lamps Works vs. CIT (2001) 249 ITR 797* supports this view. Hence, the assessee is liable for penalty under section 271F for late filing of the return.

Question 8

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) of the Income-tax Act, 1961 regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

- (i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its circular No 784 dated 22-11-99 has clarified that

genuine hardship should exist both at the time of making the application and at the time the Commissioner passes the order under section 273A(4) of the Act.

- (ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Therefore, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers and is bound to grant relief under the above section. In case the quantum of penalty exceeds Rs.1 lakh the Commissioner cannot grant relief without the previous approval of the Chief Commissioner or the Director General, as the case may be.

Question 9

KP Madhusudan & Co., a partnership firm, had taken certain bank drafts for payments to suppliers of rice and it had made entries in the accounts a few days later, but not on the dates on which the bank drafts were obtained. The explanation of the assessee was that since sufficient cash balance was not available on those dates, it had obtained hand loans from friends and, as it had expected to repay such loans within a short time, no entries were made in its books of account in respect thereof. Due to inability to furnish evidence for such loans, the assessee offered the amount of Rs.93,000 as additional income towards unexplained investment. Penalty proceedings were initiated by Assessing Officer under Section 271(1)(c) read with Explanation 1B of Income-tax Act and levied a penalty of Rs.37,975. Is the levy of penalty justifiable?

Answer

Clause (B) of Explanation 1 to section 271(1)(c) says that when an assessee offers an explanation which he is not able to substantiate and fails to prove such explanation is bona fide, then the amount added or disallowed in computing the total income of such person as a result thereof shall be deemed to represent the income in respect of which particulars have been concealed. However, nothing contained in the Explanation shall be applicable to a case referred to in clause (B) in respect of any amount added or disallowed as a result of the rejection of any explanation offered by such person, if such explanation is bona fide and all the facts relating to the same and material to the computation of his total income have been disclosed by him.

In this legal background, as the firm was unable to produce evidence for the loans, it had offered Rs 93,000 as additional income and paid the taxes. In the circumstances, the case clearly falls within the jurisdiction of Explanation 1(B) and hence the levy of penalty is justified. [*K.P. Madhusudan vs. CIT 251 ITR 99 (SC)*].

Question 10

An appeal against an assessment order for Assessment Year 1997-98 is decided by the Income-tax Appellate Tribunal against the assessee and the order is served on the Commissioner on 27.12.2010. The Assessing Officer levies penalty under Section 271(1)(c)

Direct Tax Laws

of the Income-tax Act, 1961 vide his order dated 27.6.2011 for the aforesaid Assessment Year for which the appeal has been decided against the assessee. The assessee seeks your advice on the following:

- (i) *Is the Assessing Officer empowered under the Act to impose penalty after a period of ten years?*
- (ii) *What remedial action can be taken against the order and what is the prescribed time limit thereof?*

Answer

- (i) The penalty imposed under section 271(1)(c) is to be examined with reference to the provisions of limitation in section 275(1)(a) which states that in calculating the period of limitation for imposition of penalty, the time taken in deciding the order by the Appellate Authorities shall be excluded. **A penalty can be imposed within a period of 6 months from the end of the month in which the order was received by Commissioner of Income Tax. In the present case the order of penalty is within the time limit and therefore a correct order.**
- (ii) The remedy available to the assessee against the order of penalty is to present an appeal under section 246A before Commissioner of Income Tax (Appeals) within 30 days from the date of receipt of the penalty order as the same is an appellable order under section 246A(1)(j) of the Act.

Question 11

An assessee had credited a sum of Rs.50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of Rs.50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of Rs.60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be Rs.50,000. **Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing officer happens to be a Joint Commissioner the levy of penalty will be invalid.** Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self contradictory. The moment the amount of Rs.50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. [*Diwan Enterprises v. CIT and Others 246 ITR 571*].

Question 12

Anurag Traders, a partnership firm, for the assessment year 2009-10, filed its return of income disclosing an income of Rs.40,000. The assessment was completed on an income of Rs.1,20,000 in the month of June, 2010. The additions included (a) profit on suppressed sales of Rs.40,000, (b) disallowance of expenses Rs.40,000. The assessment became final as no appeal was preferred. Penalty proceedings were initiated on the charge of concealment of income of suppressed profits. After considering the explanation to the notice to the penalty, penalty was levied on the charge that inaccurate particulars were furnished. M/s. Anurag Traders contends that the order of penalty is bad in law. Is the contention justified?

Answer

In the given facts of the case, the Assessing Officer has issued notice towards concealment of income in terms of suppression of sales. However, penalty was levied on the charge of furnishing of inaccurate particulars of income. Therefore, the penalty order is bad in law.

The Gujarat High Court had the occasion to consider a similar issue in the case of *A.M.Shah & Co v. CIT* (1999) 238 ITR 415. The High court held that the charge and the levy of penalty should be for the same reason i.e. the basis for issue of notice and for imposition of penalty should be the same. In this case, penalty proceedings were initiated on the charge of concealment of income. However, the penalty was finally levied on the ground that the assessee has furnished inaccurate particulars. Such change of stand for imposition of penalty is not valid in law.

Question 13

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act:

- (i) *Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.*
- (ii) *Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs.10,000. They have not furnished the requisite information in spite of various reminders.*
- (iii) *An assessee whose turnover in the previous year was Rs.30 lacs had neither opted to be taxed as per section 44AD of the Act nor had kept and maintained books of account.*

Answer

- (i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors.

- (ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of Rs.100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Director or Commissioner, as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Director or Commissioner before exercising this power.

- (iii) In this case, since the assessee has not opted for presumptive taxation under section 44AD, he has to maintain books of accounts as prescribed under section 44AA. Since he has not maintained the books of accounts, he is liable to pay a penalty of Rs.25,000 under section 271A for default in complying with the provisions of section 44AA.