

Union Budget 2016-17

Union Budget 2016-17 (“the Budget”) has courageously taken the challenge to displace one of the frequently litigated legal provisions, viz. Section 271(1)(c) dealing with the concealment penalty that had plethora of amendments by way of appending explanations in addition to conflicting interpretations at various points of time. Any assessee who has been subject to assessment proceedings would confirm that the levy of penalty under Section 271(1)(c) was a regular feature, though in most cases, the appellate forum used to delete the penalties. Now, this good old Section is proposed to be replaced by a new Section 270A/270AA to be introduced with applicability from the assessment year 2017-18 onwards.

Replacement of Section 271(1)(c) with proposed Section 270A and 270AA of the Act

With the proposed amendment, the provisions of Section 271 would not apply from the assessment year 2017-18 and onwards, and a penalty would be levied under the newly inserted Section 270A with effect from the assessment year 2017-18 and onwards. The Budget speech mentions: - *“At present, the Income Tax Officer has discretion to levy penalty at the rate of 100% to 300% of tax sought to be evaded. I propose to modify the entire scheme of penalty by providing different categories of misdemeanour with graded penalty and thereby substantially reducing the discretionary power of tax officers.”*

The proposed new Section 270A has classified the penalty into two types, one being the cases of *underreporting of income* and second being the cases of *misreporting of income*. Penalty would be leviable at rate of 50% of tax in cases involving underreporting of income and in cases involving misreporting of income, penalty is proposed to be levied at rate of 200% of tax.

Cases of Underreporting of Income

A person shall be considered to have *under reported his income* if:

- the income assessed is greater than the income determined in the return processed under clause (a) of sub-Section (1) of Section 143;
- the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;
- the income reassessed is greater than the income assessed or reassessed immediately before such re-assessment;

The proposed new Section 270A has classified the penalty into two types, one being the cases of underreporting of income and second being the cases of misreporting of income. Penalty would be leviable at rate of 50% of tax in cases involving underreporting of income and in cases involving misreporting of income, penalty is proposed to be levied at rate of 200% of tax.

- the amount of deemed total income assessed or reassessed as per the provisions of Section 115JB or 115JC, as the case may be, is greater than the deemed total income determined in the return processed under clause (a) of sub-Section (1) of Section 143;
- the amount of deemed total income assessed as per the provisions of Section 115JB or 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been filed; and
- the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

Thus, a perusal at the six instances of underreporting of income reveals that the additions in the assessment/reassessment order shall be generally treated as underreporting of income. However, if an addition is specifically covered under misreporting of income, the tax authority may initiate penalty by treating the same as misreporting of income. To avoid penalty in bona fide cases, some exclusions have been provided from the penal provisions in respect of the following additions:

Exclusions from the Scope of Under-Reported Incomes

Statutory provision proposed to be inserted also lists out instances which would not be treated as underreporting of income. They are:

- Where the assessee offers an explanation and the income tax authority is satisfied that the explanation is *bona fide and all the material facts have been disclosed*;
- The income assessed to tax is determined on the basis of *estimate* if the books of accounts are correct and complete but the income cannot be properly deduced therefrom due to the method employed by the taxpayer;

- (iii) Where the assessee himself has *estimated* a lower amount of addition or disallowance in the computation of income and disclosed all facts material to the addition or disallowance;
- (iv) Where the assessee has maintained documents as prescribed under Section 92D and declared the international transactions under Chapter X and disclosed all material facts relating to the transaction;
- (v) The undisclosed income is detected on account of search operation and penalty is leviable under Section 271AAB.

These exclusions indicate that the intention of the legislature is not to levy penalty in bonafide cases where all material facts have been disclosed or where additions have been made on revision of estimates by a tax authority.

Cases of Misreporting of Income

The cases of *misreporting of income* have been specified as under:

- (i) misrepresentation or suppression of facts;
- (ii) non-recording of investments in books of accounts;
- (iii) claiming of expenditure not substantiated by evidence;
- (iv) recording of false entry in books of account;
- (v) failure to record any receipt in books of account having a bearing on total income;
- (vi) failure to report any international transaction or deemed international transaction under Chapter X.

One of the conditions for treating misreporting is 'misrepresentation or suppression of facts', which has not been defined in the Act. To have clarity on the issue, let us take some instances. For instance, an assessee voluntarily offers disallowance under Section 14A of ₹5,00,000/-. While doing so, he does not consider stock-in-trade of shares as being subject matter of disallowance. While passing the assessment order, the assessing officer ("the AO") consider the stock-in-trade too for the purpose of calculating disallowance. In this instance, the assessee has given full particulars of disallowance, and the addition made by the AO is not on account of misrepresentation or suppression. This instance would be treated as underreporting of income. However, as per existing Section 271(1)(c), penalty may not be leviable at all in this circumstance in view of landmark Supreme Court judgment in *CIT vs. Reliance Petroproducts Private Limited* [322 ITR 158

(SC)] case. Taking another instance, if additions have been made on account of deemed dividend under Section 2(22)(e) wherein all details were available with the AO, it shall be a case of underreporting of income.

Regarding non-recording of investments, reference is made to Section 69 of the Act, which provides that if the investments made by the assessee are not recorded in the regular accounts, or if the explanation regarding source of such investments is not satisfactorily explained by the assessee, then the value of such investments shall be treated as income of such financial year. Thus, all additions under Section 69 would be hit by the penalty provisions as applicable for misreporting of income. However, additions under Section 56(2)(vii) or (viii), where an assessee acquires a property at a price which is less than the fair market value of such property, may not be covered by the penalty provisions, unless the AO concludes that the difference represents unexplained investment.

Calculation of Underreported Income

The proviso to proposed Section 270A(3) has prescribed the mode of determination of underreported income in different scenarios:

- (a) If no return has been furnished, the difference between amount of income assessed and the maximum amount not chargeable to tax.
- (b) If the return has been furnished and the earlier order was under Section 143(1) (a) – in that case, the underreported income shall be the difference between amount of income assessed under Section 143(3) and the income determined as per Section 143(1)(a).
- (c) If the return has been furnished, and where assessment has earlier been made, say, under section 143(3) in that case, the difference between amount of income reassessed under Section 147 and the income determined as per Section 143(3).
- (d) In a case where underreported income arises out of determination of deemed total income under Section 115JB or 115JC, the method of computation of underreported income will be:
The amount of underreported income = (A – B) + (C-D)
A = Total income assessed as per the general provisions of the Act.
B = Total income that would have been

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chargeable had the total income assessed as per the general provisions reduced by the amount of underreported income.

C = Total income assessed as per the provisions of Section 115JB or Section 115JC.

D = Total income that would have been chargeable had the total income assessed as per the provisions of Section 115JB or Section 115JC been reduced by the amount of underreported income.

In a case where the amount of underreported income is considered both under the general provisions and under the provisions of Section 115JB/JC, the said amount is not to be deducted from the total income assessed for computing the amount under item D.

In the Memorandum explaining the Finance Bill 2016, illustrations have been given to explain the mode of calculation of underreported income. The same are being discussed below:

Illustration 1: Case is of an individual below 60 years of age and no return of income has been furnished:

Particulars	(Figures in ₹)
Total income assessed under Section 143(3)	10,00,000
Underreported income	10,00,000-2,50,000* =7,50,000
Tax payable on underreported income	30 % of 7,50,000 = 2,25,000
Penalty leviable**	50 % of 2,25,000 = 1,12,500

*Being maximum amount not chargeable to tax

**Considering underreported income is not on account of misreporting.

Illustration 2: Case is of a firm liable to tax at the rate of 30 percent:

Particulars	(Figures in ₹ lakh)
Returned total income	100
Total income determined under Section 143(1)(a)	110
Total income assessed under Section 143(3)	150
Total income reassessed under Section 147	180

Considering that none of the additions or disallowances made in assessment or reassessment as above qualifies under sub-

Section (6) of Section 270A, the penalty would be calculated as under:

Particular	Assessment under Section 143 (3)	Re-assessment under Section 147
Under-reported income	(150-110) = 40	(180-150) = 30
Tax payable on under-reported income	30 % of 40 = 12	30 % of 30 = 9
Penalty leviable*	50 % of 12 = 6	50 % of 9 = 4.5

* Considering under-reported income is not on account of misreporting

Illustration 3: Case is of a company liable to tax at the rate of 30 percent:

Particulars	(Figures in ₹ lakh)
Returned total income (loss)	(-)100
Total income (loss) determined under Section 143(1)(a)	(-)90
Total income (loss) assessed under Section 143(3)	(-)40
Total income reassessed under Section 147	20

Considering that none of the additions or disallowances made in assessment or reassessment as above qualifies under sub-Section (6) of Section 270A, the penalty would be calculated as under:

Particular	Assessment under Section 143 (3)	Re-assessment under Section 147
Underreported income	(-)40 minus (-)90 = 50	20 minus (-)40 = 60
Tax payable on underreported income	30 % of 50 = 15	30 % of 60 = 18
Penalty leviable*	50 % of 15 = 7.5	50 % of 18 = 9

* Considering under-reported income is not on account of misreporting

These exclusions indicate that the intention of the legislature is not to levy penalty in bonafide cases where all material facts have been disclosed or where additions have been made on revision of estimates by a tax authority.

Immunity from Penalty in Cases of Underreporting Of Income under Proposed Section 270AA

The Budget proposes to insert Section 270AA empowering the AO to grant immunity from penalty under Section 270A subject to conditions such as:

- (i) the taxpayer pays the tax and interest payable as per the assessment order,
- (ii) the taxpayer does not prefer an appeal against such assessment order; and
- (iii) the taxpayer makes an application within one month from the end of the month in which the assessment order is received in such form and manner as may be prescribed.

If the application has been made as aforesaid fulfilling the conditions as specified above, the AO shall grant immunity from imposition of penalty and consequent prosecution proceedings. However, this immunity will not apply to 'misreporting of income' and could be availed only in respect of 'underreporting of income.'

Amendment has been proposed in Section 249 to provide that where an assessee makes application under Section 270AA, the period beginning from the date of application to the date on which the order rejecting the application is served on the assessee shall be excluded for calculation of the time limit of filing appeal to CIT(A).

Now, under the proposed penalty regime, it may be advisable to first apply for immunity under this provision (provided of course, he could pay the tax in dispute) and if the application is rejected, then he may file an appeal. However, one may contemplate not going into appeal and pay reduced rate of penalty in cases involving underreporting of income. It is relevant to refer the Supreme Court decision in *Sir Shadilal Sugar Mill (168 ITR 7051)* holding that there may be a hundred and one reasons for not protesting and agreeing to an addition but that does not follow to the conclusion that the amount agreed to be added was concealed income. Indeed, there

Thus, all additions under Section 69 would be hit by the penalty provisions as applicable for misreporting of income. However, additions under Section 56(2) (vii) or (viii), where an assessee acquires a property at a price which is less than the fair market value of such property, may not be covered by the penalty provisions, unless the AO concludes that the difference represents unexplained investment.



may be numerous reasons with the taxpayer for not approaching the first appellate authority for justice, for example:

- To avoid the pains of further litigations, numerous hearings and mental tensions borne in it;
- The risk of enhancement at the first appellate authority on various technical issues;
- Nowadays commonly seen attitude of assessment in appellate proceedings;
- Heavy litigation cost of representative;
- Withdrawn of appeal at instance of assessee is the discretion of appellate authority.

Summing up, it is expected that with the immunity provided in proposed Section 270AA, there will be lesser litigations in future.

Section 271(1)(c) vis-a-vis proposed Section 270A

As mentioned by our Hon'ble Finance Minister in his Budget speech, "Levy of heavy penalty for concealment of income has over the years resulted in large number of disputes despite a number of decisions of the Apex Court on interpretation of statutory provisions and principles guiding imposition of penalty." It is admitted fact that presently, AOs initiate penalty proceedings in most of the cases, in view of Hon'ble Supreme Court judgment in the case of *UOI vs. Dharmendra Textiles Processors [306 ITR 277 (SC)]*, irrespective of the fact whether or not there has been any actual concealment of income or furnishing of inaccurate particulars of income. However, the assessee generally used to get relief in appellate proceedings on the ground of 'reasonable cause' in terms of Section 273B which provides that no penalty shall be imposed under various provisions of Section 271 and 272, if the assessee proves that there was reasonable cause for the failure. The term

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'reasonable cause' has not been defined in the Act, though it has been interpreted by various courts.

The Delhi High Court has enunciated the meaning of the term 'reasonable cause' in the case of *Azadi Bachao Andolan vs. Union of India* 252 ITR 471. It was held that 'reasonable cause' can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of bona fides.

In *Woodward Governors India (P) Ltd. vs. CIT 118 Taxman 433 (Delhi)*, the Delhi High Court considered the meaning of 'reasonable cause' and held that reasonable cause as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It can be described as a probable cause. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

The proposed Section 270A does not feature in Section 273B, implying that the argument of 'reasonable cause' shall not be allowed in the new penalty regime. However, clause (a) of sub-Section (6) of the proposed Section specifically indicates that where an assessee offers an explanation and a tax authority is satisfied that the explanation is bona fide, the case will not be treated as underreporting of income. In the opinion of the author, whether explanation is bona fide or not may again be prone to a number of litigations.

It has been noticed that even in the cases of difference in interpretation of provisions or wherever there are two views arising, the penalty proceedings are initiated.

It is important to mention that in the cases covered under underreporting, presently, Courts have been taking view that in similar circumstances, penalty is not leviable at all. The major litigations started with *Dilip N. Shroff case [291 ITR 519 (SC)]*, which held that penal provision must be strictly construed and that *mens rea* is necessary ingredient for imposition of penalty. But, in *Dharmendra Textiles (supra)*, Supreme Court partly overruled *Dilip N. Shroff's* case and held that the penalty under Section 271 is only a civil liability and *mens rea* is not an essential

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ingredient for attracting civil liability. However, this position has again been revisited in *Reliance Petroproducts* case (*supra*), and it was held a mere making of the claim, which is not sustainable in law, by itself, will not amount to a case as to furnishing inaccurate particulars and the law laid down in *Dilip N. Shroff's* case as to the meanings of the words 'conceal' or 'inaccurate' continues to be good law. Thus, when the law on the scope of penalty is about to get settled by a number of judgments, quite few of them from the Apex Court, we find that the new provision of law includes within its scope, penalty provisions which were hitherto excluded. It is to be seen whether the Department takes liberal view on *mens rea* by following Apex Court judgments in cases discussed above.

As mentioned above, the proposed penalty provisions shall take effect from the assessment year 2017-18 and thus, shall apply to assessments which are being passed perhaps in the financial year 2019-20. Hence, this Section may not have an immediate impact. It is expected that by the time this Section becomes operative, there will be more clarity on the proposed provisions.

Penalty for Search Cases [Section 271AAB]

Presently, Section 271AAB provides for penalty ranging from 30% to 90% of the undisclosed income in respect of search cases, in case where the assessee fails to admit his undisclosed income in the course of search and also fails to declare such income in his return of income and pays tax thereon on or before specified date.

In order to rationalise the rate of penalty and to reduce discretion, it is proposed to amend clause (c) of sub-Section (1) of Section 271AAB to provide for levy of penalty on such undisclosed income at a flat rate of sixty per cent of such income.

It is mentioned that the proposed amendment shall be applicable from 1st April 2017. Unlike Section

270A in which there is a clear mention that the said Section shall apply from the assessment year 2017-18, here in this Section, there is no such specific mention. As per Section 271AAB(1), this Section is applicable for assessee covered under search after 1st July 2012. Thus, by necessary implication, it can be reasonably inferred that the amended provisions shall apply for all penalty levied after 1st April 2017.

Amendment in Section 272A consequent to Non-Applicability of Section 271(1)(b)

It is proposed to amend sub-Section (1) of Section 272A to further include levy of penalty of rupees ten thousand for each default or failure to comply with a notice issued under sub-Section (1) of Section 142 or sub-Section (2) of Section 143 or failure to comply with a direction issued under sub-Section (2A) of Section 142.

This amendment will take effect from the 1st day of April, 2017 and will accordingly apply in relation to the assessment year 2017-2018 and subsequent years.

This is a consequential amendment. The proposed insertion of clause (d) in Section 272A(1) is similar to Section 271(1)(b) which provides for penalty for non-compliance of certain notices as mentioned above. Since Section 271 shall not apply from the assessment year 2017-18, amendment has been proposed in Section 272A to cover the cases of Section 271(1)(b).

Time Limit to pass Order under Section 273A

Presently, Section 273A empowers the Principal Commissioner or Commissioner to use discretion for waiver of penalty imposable on the taxpayer in certain cases. However, there is no time limit prescribed for accepting or rejecting the petition for waiver of penalty.

The Finance Bill, 2016 mandates that the order of granting or rejecting immunity from penalty under Section 273A must be passed within a period of 12 months from the end of the month in which the application was received. Further, no order rejecting the application shall be passed without giving an opportunity of being heard to the taxpayer.

Time Limit to pass Order under Section 273AA

Presently, the proceedings before the Settlement Commission could be abated in the circumstances

mentioned in Section 245HA. The Principal Commissioner or Commissioner may grant immunity from penalty to the taxpayer under Section 273AA. However, there is no time limit within which the application for immunity from penalty is to be decided.

The Finance Bill, 2016 proposes to amend Section 273AA by mandating that such order accepting or rejecting the application should be passed within a period of 12 months from the end of the month in which such application was received. No order rejecting the application shall be passed without providing an opportunity of hearing to the assessee. The proposed amendment shall take effect from 1st June 2016. However, this amendment would also apply in respect of all applications pending as on 1st June 2016 with the time limit for disposal of such applications by 31st May 2017.

Penalty not to be imposed where there is Reasonable Cause [Section 273B]

Section 273B provides for the waiver of majority of the penal provisions if reasonable cause for failure is proved. Section 273B is proposed to be amended to include the newly inserted Section 271GB (imposing penalty on international group for not furnishing the details within the prescribed time).

It may be noted that the newly inserted Section 270A does not find place in Section 273B which means that the power vested with the AO under Section 270AA is final though non-discretionary and the taxpayers cannot take recourse to the Commissioner for waiver of such penalty.

To Sum Up

To conclude this article, considering the fact that the word 'shall' has been used in proposed Section 270A, we may find an era where levying of penalty becomes a rule as against exception under Section 271(1)(c). The intention to rationalise the rate of penalty and reduce discretionary powers of the tax authority is a welcome step. ■

The proposed Section 270A does not feature in Section 273B, implying that the argument of 'reasonable cause' shall not be allowed in the new penalty regime. However, clause (a) of sub-Section (6) of the proposed Section specifically indicates that where an assessee offers an explanation and a tax authority is satisfied that the explanation is bona fide, the case will not be treated as underreporting of income.