Section 147/148- Income Escaping Assessment an effective tool to curb black money

Executive Summary

Under Income tax Act a complete set of assessment vehicles are provided to the Income Tax officers to assess and examine the filed returns of the assesses in order to ensure that there should be no loss of the revenue to the government. Assessment under Income tax Act includes Scrutiny assessment (143(3)), income escaping assessment (147/148), best judgment assessment (144), and assessment under section 153A and 153 C in case of search. However, one of the most important and highly debated is **'Income Escaping Assessment'** under section 147/148. Section 147 and 148 of Income Tax Act is a well designed and assembled vehicle for the Assessing officers empowering them to assess, re-assess or re-compute the income which has escaped assessment. The objective of carrying out assessment u/s 147 is to bring under the tax net, any income which has escaped assessment. However Section 147 also contains the pre-requisite conditions which are to be fulfilled for invoking the jurisdiction to reopen the assessment.

Overview of Section 147

From a bare reading of the provisions of Section 147 of the said Act, it is evident that for reassessment or assessment under Section 147 of the Act the below conditions are required to be satisfied

(1) The Assessing Officer must have '***reason to believe'*** that income chargeable to tax has escaped assessment; and

(2) He must also have a '***reason to believe'*** that such escapement occurred by reason of either;

(a) Omission or failure to make a return of income under section 139 or in response to the notice issued under sub-section (1) of Section 142 or Section 148 or

(b) Omission or failure to disclose fully and truly all the material facts necessary for his assessment for that purpose.

‘Reason to Believe’ is the most important leg of Income Escaping Assessment under sections 147/148

The provisions of section 147 provide for the reopening of assessment and reassessment of income in cases where the assessing officer has ‘Reason to believe’ that income had escaped assessment. This aspect of the matter has been long settled by a series of judgments of the supreme court as well as the high courts commencing from ITO Lakhmani Mewal Das [1976] 102 ITR 437 (SC) to the judgment of the supreme court in the case of CIT v. Kelvinator of India Ltd. [2010] The Hon’ble Supreme court held as under: “Power to reopen is much wider. However one needs to give a schematic interpretation to the words ‘***Reason to believe***’ failing which, we are afraid, section 147 would give arbitrary powers to the assessing officers to reopen assessment on the basis of ‘mere change of opinion’, which cannot be perceive reason to reopen . We must also keep in mind the conceptual difference between power to review and power to reassess. The assessing officer has no power to review; he has the power to reassess. But reassessment has to be based on fulfilment of certain preconditions. Reasons must have a live link with the formation of the belief.

'Reason to believe' suggest that the belief must be that of an honest and reasonable person based upon reasonable grounds and that the Income-tax Officer may act on direct or circumstantial evidence but not on mere suspicion,

gossip or rumour. The Income tax Officer would be acting without jurisdiction if the reason for his belief that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section. The court can always examine this aspect through the declaration; however sufficiency of the reasons for the belief cannot be investigated by the court. Therefore, formation of reason to believe and recording of reasons were imperative before the assessment officer could re-open a completed assessment.

Earlier erroneous conclusions of Assessing Officer is not a ground for Reassessment under Section 147

It is well-settled that the responsibility of the assessee is limited to the disclosure of all primary facts and nothing beyond that vide Calcutta Discount Co. Ltd. v. ITO and Anr. (1961) 41 ITR 191 (SC). Once the assessee has disclosed all the primary facts that is the end of his duty. It is then for the assessing authority to draw the proper conclusions from those facts. If the conclusions drawn by the AO from the primary facts disclosed by the assessee are erroneous, the assessing authority cannot reopen the assessment merely on the basis of a change of opinion. This principle has been reiterated by the Supreme Court in ITO v. Lakhmani Mewal Das, (1976) 103 ITR 437 (SC), CIT v. Bhanji Lavji (1971) 79 ITR 582 (SC), Parashuram Pottery Works Ltd. v. CIT, (1977) 106 ITR 1 (SC) and CIT v. Burlop Dealers Ltd. (1971) 79 ITR 609 (SC).

Time Limit for notice under section 148

An assessment based on the time barred notice would be invalid and the entire proceedings taken in pursuance are thereof liable to be quashed. The time limits for issue of notice under section 148 are given in section 149.

Taxable Income escaped assessment	Time Limit for issue of Notice
Is < Rs.1,00,000	4 years from end of the relevant AY.
Is >= Rs.1,00,000 or more	6 years from the end of the relevant AY.
Income in relation to any asset (including financial interest in any entity) located outside India.	16 years from the end of the relevant AY.

Summary of Guidelines by Various Courts

In the case of Hemjay Construction Co. Pvt. Ltd v. Income Tax Officer, Gujarat High court have summarised the following principles of law have emerged from the various decisions of courts.

(i) The Court should be guided by the ***reasons recorded*** for the reassessment and not by the reasons or explanation given by the Assessing Officer at a later stage in respect of the notice of reassessment. To put it in other words, having regard to the entire scheme and the purpose of the Act, the validity of the assumption of jurisdiction under Section 147 can be tested only by reference to the reasons recorded under Section 148(2) of the Act and the ***Assessing Officer is not authorized to refer to any other reason*** even if it can be otherwise inferred or gathered from the records. He cannot record only some of the reasons and keep the others up to his sleeves to be disclosed before the Court if his action is ever challenged in a court of law.

*(*ii) At the time of the commencement of the reassessment proceedings, the Assessing Officer has to see whether there is prima facie material, on the basis of which, the department would be justified in reopening the case. ***The sufficiency or correctness of the material is not a thing to be considered at that stage.***

*(*iii) The validity of the reopening of the assessment shall have to be determined with reference to the reasons recorded for reopening of the assessment.

*(*iv) The basic requirement of law for reopening and assessment is ***application of mind by the Assessing Officer***, to the materials produced prior to the reopening of the assessment, to conclude that he has reason to believe that income has escaped assessment. Unless that basic jurisdictional requirement is satisfied-a post-mortem exercise of analysing the materials produced subsequent to the reopening will not make an inherently defective reassessment order valid.

*(*v) The crucial link between the information made available to the Assessing Officer and the formation of the belief should be present. ***The reasons must be self evident, they must speak for themselves.***

*(*vi) The tangible material which forms the basis for the belief that income has escaped assessment must be evident from a reading of the reasons. The entire material need not be set out. To put it in other words, something therein, which is critical to the formation of the belief must be referred to. Otherwise, the link would go missing.

*(*vii) The reopening of assessment under ***Section 147 is a potent power and should not be lightly exercised***. It certainly cannot be invoked casually or mechanically.

(viii) If the original assessment is processed under Section 143(1) of the Act and not Section 143(3) of the Act, the proviso to Section 147 will not apply. In other words, although the reopening may be after the expiry of four years from the end of the relevant assessment year, yet it would not be necessary for the Assessing Officer to show that there was any failure to disclose fully or truly all the material facts necessary for the assessment. Another view point is that language employed in section 147 of the Income Tax Act, 1961 does not make any distinction between an order passed under section 143(3) and the intimation issued under section 143(1) and therefore, it is not permissible to adopt different standards while interpreting the words "reason to believe" vis-a-vis section 143(1) and section 143(3).

(ix) In order to assume jurisdiction under Section 147 where assessment has been made under sub-section (3) of section 143, two conditions are required to be satisfied;

(i) The Assessing Officer must have reason to believe that the income chargeable to tax has escaped assessment;

(ii) Such escapement occurred by reason of failure on the part of the assessee either (a) to make a return of income under section 139 or in response to the notice issued under sub-section (1) of Section 142 or Section 148 or (b) to disclose fully and truly all the material facts necessary for his assessment for that purpose.

(x) The Assessing Officer, being a quasi judicial authority is expected to arrive at a subjective satisfaction independently on an objective criteria.

(xi) While the report of the Investigation Wing might constitute the material, on the basis of which, the Assessing Officer forms the reasons to

believe, the process of arriving at such satisfaction should not be a mere repetition of the report of the investigation. The reasons to believe must demonstrate some link between the tangible material and the formation of the belief or the reason to believe that the income has escaped assessment.

(xii) Merely because certain materials which is otherwise tangible and enables the Assessing Officer to form a belief that the income chargeable to tax has escaped assessment, formed part of the original assessment record, per se would not bar the Assessing Officer from reopening the assessment on the basis of such material. The expression "tangible material" does not mean the material alien to the original record.

(xiii) The order, disposing of objections or any counter affidavit filed during the writ proceedings before the Court cannot be substituted for the "reasons to believe.

(xiv) The decision to reopen the assessment on the basis of the report of the Investigation Wing cannot always be condemned or dubbed as a fishing or roving inquiry. The expression "reason to believe" appearing in ***Section 147 suggests that if the Income Tax Officer acts as a reasonable and prudent man on the basis of the information secured by him that there is a case for reopening, then Section 147 can well be pressed into service and the assessments be reopened***. As a consequence of such reopening, certain other facts may come to light. There is no ban or any legal embargo under Section 147 for the Assessing Officer to take into consideration such facts which come to light either by discovery or by a fuller probe into the matter and reassess the assessee in detail if circumstances require. (*Department favour*)

*(*xv) The test of jurisdiction under Section 143 of the Act is not the ultimate result of the inquiry but the test is whether the income tax officer entertained a "bona fide" belief upon the definite information presented before him. Power under this section cannot be exercised on mere rumours or suspicions.

*(*xvi) The concept of "change of opinion" has been treated as a built in test to check abuse. If there is tangible material showing escapement of income, the same would be sufficient for reopening the assessment.

*(*xvii) It is not necessary that the Income Tax Officer should hold a quasi judicial inquiry before acting under Section 147. It is enough if he on the information received believes in good faith that the assesee's profits have escaped assessment or have been assessed at a low rate. However, nothing would preclude the Income Tax Officer from conducting any formal inquiry under Section 133(6) of the Act before proceeding for reassessment under Section 147 of the Act. **(***Department favour*)

*(*xviii) The "full and true" disclosure of the material facts would not include that material, which is to be used for testing the veracity of the particulars mentioned in the return. All such facts would be expected to be elicited by the Assessing Officer during the course of the assessment. The disclosure required only reference to those material facts, which if not disclosed, would not allow the Assessing Officer to make the necessary inquiries. (*Department favour*)

*(*xix) The word "information" in Section 147 means "instruction or knowledge derived from the external source concerning the facts or particulars or as to the law relating to a matter bearing on the assessment. An information anonymous is information from unknown

authorship but nonetheless in a given case, it may constitute information and not less an information though anonymous. This is now a recognized and accepted source for detection of large scale tax evasion. The non-disclosure of the source of the information, by itself, may not reduce the credibility of the information. There may be good and substantial reasons for such anonymous disclosure, but the real thing to be looked into is the nature of the information disclosed, whether it is a mere gossip, suspicion or rumour. If it is none of these, but a discovery of fresh facts or of new and important matters not present at the time of the assessment, which appears to be credible to an honest and rational mind leading to a scrutiny of facts indicating incorrect allowance of the expense, such disclosure would constitute information as contemplated in clause (b) of Section 147. (*Department favour*)

(xx) The reasons recorded or the material available on record must have nexus to the subjective opinion formed by the A.O. regarding the escapement of the income but then, while recording the reasons for the belief formed, the A.O. is not required to finally ascertain the factum of escapement of the tax and it is sufficient that the A.O had cause or justification to know or suppose that the income had escaped assessment [vide Rajesh Jhaveri Stock Brokers (P.) Ltd.'s case]. It is also well settled that the sufficiency and adequacy of the reasons which have led to the formation of a belief by the Assessing Officer that the income has escaped the assessment cannot be examined by the court.

Procedural Guidelines

(xxi) While communicating the reasons for reopening the assessment, the copy of the standard form used by the AO for obtaining the approval of the Superior Officer should itself be provided to the Assessee. This

would contain the comment or endorsement of the Superior Officer with his name, designation and date. In other words, merely stating the reasons in a letter addressed by the AO to the Assessee is to be avoided;

(xxii) The reasons to believe ought to spell out all the reasons and grounds available with the AO for re-opening the assessment especially in those cases where the first proviso to Section 147 is attracted. The reasons to believe ought to also paraphrase any investigation report which may form the basis of the reasons and any enquiry conducted by the AO on the same and if so, the conclusions thereof;

(xxiii) Where the reasons make a reference to another document, whether as a letter or report, such document and/ or relevant portions of such report should be enclosed along with the reasons;

(xxiv) The exercise of considering the Assessee's objections to the reopening of assessment is not a mechanical ritual. It is a quasi-judicial function. The order disposing of the objections should deal with each objection and give proper reasons for the conclusion. No attempt should be made to add to the reasons for reopening of the assessment beyond what has already been disclosed.

The above guidelines suggest that the powers of the assessing officers under section 147 are not abundant. Assessing Officer cannot mechanically issue notice **under** section 148. The re-assessment under section 147 has to be based on fulfilment of certain pre-condition. Reassessment cannot be resorted to on mere suspicion or for carrying out fishing or roving inquiries. The assessing officer would be acting without jurisdiction, if there is no rational and intelligible nexus between the reasons and the belief, so that on such reasons the conclusion would be drawn that there is deliberate concealment by the assessee or there is income that has escaped assessment.

Safeguards available with Assessee

For reopening of assessment under proviso to section 147, it is required that the assessee fails to perform its duties in the original assessment; this could *inter alia* be failure on the part of the assessee to make a return under section 139 or to disclose fully and truly all material facts necessary for his assessment. If the

assessee proves that he has fulfilled his duties provided under section 147, then the reassessment proceedings under section 147 will be declared invalid. It is open to an assessee to establish that there in fact existed no belief or that the belief was not at all a bona fide one or was based on vague, irrelevant and nonspecific information.

The supreme court in the case of **Gkn Driveshafts (India) Ltd vs Income Tax Officer suggested that** proper course of action on the part of assessee and assessing officer, in case a notice under section 148 of the Income-tax Act, is issued :

1) File the return
2) If he so desires, to seek reasons for issuing the notice. The Assessing Officer is bound to furnish reasons within a reasonable time.
3) On receipt of reasons, the assessee is entitled to file objections to issuance of notice, and the Assessing Officer is bound to dispose of the same by passing a speaking order.
4) The assessee if desires can file a writ challenging the order or can proceed with the assessment. However the assessee has still a right to challenge the reopening of assessment after the assessment order is passed, before Appellate Authority.

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Conclusion

In spite of the above, it has been observed that many times Assessing officers initiate reassessment proceedings in haste, ignoring the CBDT guidelines and various judicial precedents. There is no doubt that the provisions of section 147/148 are inclined towards the revenue authorities as the ultimate mission of the Income Tax Act is to avoid the revenue losses to the exchequer but at the same time the contention of the law makers is not to harass taxpayers by

reopening assessments in a mechanical and casual manner. Also, it has been observed that on a routine basis, a large number of writ petitions are filed challenging the reopening of assessments by the Revenue under Sections 147 and 148 of the Act and despite numerous judgments on this issue, the same errors are repeated by the concerned Revenue authorities. Thus, the assessing officer should act in a reasonable manner to sub serve the purpose of guidelines by CBDT and various courts. However in the present scenario, , the assessee should disclose fully and truly all relevant information and material evidence necessary for his assessment to substantiate its claim, even if it seems to be remote, in order to, avoid being hassled again and again.