

KANTAMANI VENKATA NARAYANA & SONS

v.

**FIRST ADDITIONAL INCOME-TAX OFFICER,
RAJAHMUNDRY**

October 27, 1966

[J. C. SHAH, V. RAMASWAMI AND V. BHARGAVA, JJ.]

Income-tax Act (11 of 1922), s. 34—Escaped assessment—Notice, whether necessary to state clause—Grounds of challenge.

During the assessment proceedings of a company, the Income-tax Officer discovered that there was a large accretion to the wealth of the assessee, which had not been disclosed in the assessment proceedings of the assessee, and the Officer issued notices under s. 34 for the reassessment of income during that period. The assessee filed writ petitions in the High Court, in reply to which the Income-tax Officer filed affidavits stating that relying on the information received by him, he had reason to believe that the assessee had not disclosed fully and truly all material facts and in consequence, income chargeable to tax had escaped assessment. The writ petitions were rejected and the order was confirmed in appeal by the High Court. In appeals by the assessee, this Court,

HELD : The appeals must be dismissed.

From the affidavit of the Income-tax Officer it clearly appeared that there had been considerable increase in the investments in the transactions and the wealth of the assessee. The Income-tax Officer was not seeking to reassess the income on a mere change of opinion. [1989 B]

The Income-tax Officer had *prima facie* reason to believe that information material to assessment had been withheld, and that on account of withholding of that information income liable to tax had escaped assessment. From the mere production of the books of account, it could not be inferred that there had been full disclosure of the material facts necessary for the purpose of assessment. Sections 23 and 24 of the Act lay that the assessee is under a duty to disclose fully and truly material facts necessary for the assessment of the year and that duty is not discharged merely by the production of the books of accounts or other evidence. It is the duty of the assessee to bring to the notice of the Income-tax Officer particular items in the books of account or portions of documents which are relevant. Even if it be assumed that from the books produced, the Income-tax Officer, if he had been circumspect, could have found out the truth, the Income-tax Officer may not on that account be precluded from exercising the power to assess income which had escaped assessment. [1989 G-990 B]

It is not necessary or imperative that a notice under s. 34 must specify under which of the two clauses—cl. (a) or cl. (b) of sub-s. (1) of s. 34, the notice is issued. [1986 A]

P. R. Mukherjee v. Commissioner of Income-tax, West Bengal, 30 I.T.R. 535, approved.

Two conditions precedent must co-exist, before a notice under s. 34 (1)(a) of the Act may be issued: the Income-tax Officer must have reason to believe (1) that income, profits or gains had been under assessed, and (2) that such under assessment was due to non-disclosure of material facts by the assessee. Where the Income-tax Officer has *prima*

A *facie* reasonable grounds for believing that there has been a non-disclosure of primary material fact, that by itself gives him jurisdiction to issue notice under s. 34 and the adequacy or otherwise of the grounds of such belief is not open to investigation by the Court. [1987 C]

Calcutta Discount Company Ltd. v. Income-tax Officer, Companies District I [1961] 2 S.C.R. 241 and *S. Narayanappa v. The Commissioner of Income-tax, Bangalore* [1967] 1 S.C.R. 596 relied on.

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CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 154 to 165 of 1966.

Appeals by special leave from the judgment and order dated February 3, 1965 of the Andhra Pradesh High Court in Writ Appeals Nos. 117 to 128 of 1964.

C

P. Ram Reddy and A. V. V. Nair, for the appellants (in all the appeals).

S. V. Gupte, Solicitor-General, R. Ganapathy Iyer and R. N. Sachthey, for respondent (in all the appeals).

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The Judgment of the Court was delivered by

Shah, J. M/s. Kantamani Venkata Narayana & Sons—hereinafter referred to as ‘the assessee’ is a Hindu undivided family, which was assessed to tax on income derived principally from money-lending. In the course of proceedings for assessment of a private limited company styled “Motu Industries Ltd.,” the Income-

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tax Officer, Rajahmundry discovered that there was a large accretion to the wealth of the assessee which had not been disclosed in proceedings for its assessment. On March 12, 1959, the Income-tax Officer issued a notice seeking to reopen the assessment for the year 1950-51. The assessee filed a return under protest. On March 14, 1960 the Income-tax Officer issued notice of re-assessment for the year 1951-52, and on December 19, 1960, the

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Income-tax Officer intimated the reasons that had prompted him to issue the notices of re-assessment. On March 24, 1962 the Income-tax Officer issued notices under s. 34 for re-assessment of income of the assessee for the years 1940-41 to 1949-50. The assessee then presented petitions in the High Court of Andhra Pradesh for writs of *prohibition* directing the Income-tax Officer to refrain from proceeding in pursuance of the notices for the assessment years 1940-41 to 1949-50 and 1950-51 and 1951-52. A single Judge of the High Court rejected the petitions and the order was confirmed in appeal by a Division Bench of the High Court. The assessee has appealed with special leave.

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The notice issued by the Income-tax Officer did not specifically refer to s. 34(1)(a) of the Income-tax Act : it did not set out the clause under which it was issued. But on that account the proceeding under s. 34 is not vitiated. It was held by the Calcutta

High Court in *P. R. Mukherjee v. Commissioner of Income-tax, West Bengal*(1), that it is not necessary or imperative that a notice under s. 34 must specify under which of the two clauses—cl. (a) or cl. (b) of sub-s. (1) of s. 34, the notice is issued. The main notice to be issued in a case under s. 34 is the notice under s. 22(2), and s. 34 merely authorises the issue of such a notice.

The proceedings for re-assessment cover a period of 12 years : 1940-41 to 1951-52. Section 34 of the Income-tax Act has undergone some changes during that period, but the basic scheme of the section has remained substantially the same. Power to re-assess income under s. 34(1) as amended by Act 7 of 1939 could be exercised if "definite information" had "come into" the possession of the Income-tax Officer, and in consequence of such information it was discovered that income chargeable to tax had escaped assessment. By the Income-tax and Business Profits Tax (Amendment) Act 48 of 1948, s. 34(1) was recast to read as follows :

"(1) 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 of his income under section 22 for any year or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income-tax have escaped assessment for that year, or have been under-assessed, or assessed at too low a rate, 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, profits or gains chargeable to income-tax have escaped assessment for any year, or have been under-assessed, or assessed at too low a rate,

he may in cases falling under clause (a) at any time and in cases falling under clause (b) at the time within four years of the end of that year, 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 22 and may proceed to assess or re-assess such income, profits or gains"

A An Explanation was also added which states :

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

B Since on the matter canvassed in these appeals there is no material change in the section, we will only refer to the section as amended by Act 48 of 1948.

C This Court in *Calcutta Discount Company Ltd. v. Income-tax Officer, Companies District I and Another*⁽¹⁾ observed that before the Income-tax Officer may issue a notice under s. 34(1) (a) of the Indian Income-tax Act, two conditions precedent must co-exist : the Income-tax Officer must have reason to believe (1) that income, profits or gains had been under-assessed, and (2) that such under-assessment was due to non-disclosure of material facts by the assessee. The Court further held that where the Income-tax Officer has *prima facie* reasonable grounds for believing that there has been a non-disclosure of a primary material fact, that by itself gives him jurisdiction to issue a notice under s. 34 of the Act, and the adequacy or otherwise of the grounds of such belief is not open to investigation by the Court.

E In a recent judgement of this Court in *S. Narayanappa & Others v. The Commissioner of Income-tax, Bangalore*,⁽²⁾ Ramaswami J., speaking for the Court observed :

F “ . . . the legal position is that if there are in fact some reasonable grounds for the Income-tax Officer to believe that there had been any non-disclosure as regards any fact, which could have a material bearing on the question of under-assessment that would be sufficient to give jurisdiction to the Income-tax Officer to issue the notice under s. 34. Whether these grounds are adequate or not is not a matter for the Court to investigate. In other words, the sufficiency of the grounds which induced the Income-tax Officer to act is not a justiciable issue. It is of course open for the assessee to contend that the Income-tax Officer did not hold the belief that there had been such non-disclosure. In other words, the existence of the belief can be challenged by the assessee but not the sufficiency of the reasons for the belief. Again the expression “reason to believe” in section 34 of the Income-tax Act does not mean a purely subjective satisfaction on the part of the Income-tax Officer. The belief must be held in good

(1) [1961] 2 S.C.R. 241.

(2) [1967] 1 S.C.R. 596.

faith: it cannot be merely a pretence. To put it differently it is open to the Court to examine the question whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent, the action of the Income-tax Officer in starting proceedings under s. 34 of the Act is open to challenge in a court of law."

It is clear from the affidavits filed in the Court of First Instance that the Income-tax Officer had received information relying upon which he had reason to believe that the assessee had not disclosed fully and truly all material facts necessary for the assessment and in consequence of non-disclosure of that information, income chargeable to tax had escaped assessment. In his affidavit, the Income-tax Officer stated :

"A scrutiny of the money-lending 'statements' filed by the assessee for the years ended 31-3-50 and 31-3-51 revealed that there were large investments made by the assessee in his money-lending business in those two years. The assessee did not file balance sheets for the said two years, or for the earlier assessment years and consequently it was not clear from the statements filed by him, how he could make heavy investments in money-lending business in those two years."

The Income-tax Officer also stated that in the year of account 1949-50 the total investments in money-lending business had increased by Rs. 1,33,000/- and in the following year by Rs. 49,000/-, and the plea of the assessee that growth in the investments of the assessee in those years was mainly due to "the cash balance" held by the manager out of his share received on partition between him and his brothers, and cash gifts from his father-in-law which were till then kept uninvested even in the money-lending business, was not supported by any evidence, that the assessee had suppressed the account books for the periods prior to April 1, 1949, and that the assessee had not produced the deed of partition relied upon. According to the Income-tax Officer, the net wealth of the family on April 1, 1937, inclusive of investments in the money-lending business was less than Rs. 50,000/- and the investments made by the assessee in money-lending business were approximately of the order of Rs. 21,000/-, that the assessments made on the family from 1937-38 till 1948-49 showed that the assessee's aggregate income for those years was Rs. 30,000/-, that taking into account the manager's professional income and the agricultural income of the assessee, the aggregate could not exceed Rs. one lakh, and that possession of large wealth on April 1, 1949 which was not explained justified him in inferring that there "was escapement of

- A assessment of huge income or in any event it had resulted in under-assessment on account of the failure of the assessee in not disclosing the material facts fully and truly for the assessment years 1940-41 to 1949-50."

- B The averments made by the Income-tax Officer in his affidavit which have been accepted by the Court of First Instance, *prima facie*, establish that the Income-tax Officer had reason to believe that by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment, income chargeable to income-tax has escaped assessment.

- C It was urged on behalf of the assessee that year after year account books and statements of account were produced by the assessee before the Income-tax Officer, and the Income-tax Officer had computed to taxable income on the materials furnished, no case for exercising the power of the Income-tax Officer under s. 34 was made out, since power to re-assess may not be exercised merely because on the same evidence the Income-tax Officer or his successor entertains a different opinion. In our view there is no force in this contention. From the affidavit of the Income-tax Officer it clearly appears that there had been considerable increase since 1938 in the investments in the money-lending transactions of the assessee and in the wealth of the assessee. The Income-tax Officer was not seeking to re-assess the income on a mere change of opinion. The increase in the wealth discovered was wholly disproportionate to the known sources of income of the assessee. That was *prima facie* evidence on which he had reason to believe that the assessee had omitted to disclose fully and truly all material facts and that in consequence of such non-disclosure income had escaped assessment. The Income-tax Officer has said that no attempt was made by the assessee to furnish some reasonable proof of the source of the additional wealth : the partition deed was not produced; the books of account prior to 1948-49 were withheld on the plea that all the books were lost; no evidence was tendered to show that the father-in-law of the manager was possessed of sufficient means to give and did give any large cash amounts to him; and there was also no explanation why a large amount exceeding a lakh of rupees was not invested in the money-lending or other business.

- G The Income-tax Officer had therefore *prima facie* reason to believe that information material to the assessment had been withheld, and that on account of withholding of that information income liable to tax had escaped assessment. From the mere production of the books of account it cannot be inferred that there had been full disclosure of the material facts necessary for the purpose of assessment. The terms of the Explanation are too plain to permit an argument being reasonably advanced, that the duty of the assessee to disclose fully and truly all material facts is discharged when he produces the books of account or other evidence which has a material
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bearing on the assessment. It is clearly implicit in the terms of ss. 23 and 34 of the Income-tax Act that the assessee is under a duty to disclose fully and truly material facts necessary for the assessment of the year, and that the duty is not discharged merely by the production of the books of accounts or other evidence. It is the duty of the assessee to bring to the notice of the Income-tax Officer particular items in the books of account or portions of documents which are relevant. Even if it be assumed that from the books produced, the Income-tax Officer, if he had been circumspect, could have found out the truth, the Income-tax Officer may not on that account be precluded from exercising the power to assess income which had escaped assessment.

It was urged that since the High Court in appeal did not decide whether any primary facts on which the determination of the issue of reasonable belief in non-disclosure of material facts necessary for the assessment of the previous year and escapement of tax in consequence thereof depended, were not disclosed, the judgment of the High Court should be set aside. The learned Trial Judge has dealt with in detail the affidavits of both the assessee and the Income-tax Officer and has come to the conclusion that there was *prima facie* evidence of non-disclosure fully and truly of all material facts necessary for the assessment and on the materials placed before the Income-tax Officer he had reason to believe that as a consequence of that non-disclosure income had escaped assessment. The High Court in appeal after referring to the judgment in *Calcutta Discount Company's case*(¹) observed :

"... without the enquiry being held by the concerned Income-tax Officer it is not possible, on the material on record, to decide whether or not the assessee omitted to or failed to disclose fully and truly all material facts necessary for his assessment for the respective year."

The High Court has pointed out that no final decision about failure to disclose fully and truly all material facts bearing on the assessment of income and consequent escapement of income from assessment and tax could be recorded in the proceedings before them. It certainly was not within the province of the High Court to finally determine that question. The High Court was only concerned to decide whether the conditions which invested the Income-tax Officer with power to re-open the assessment did exist, and there is nothing in the judgment of the High Court which indicates that they disagreed with the view of the Trial Court that the conditions did exist.

These appeals therefore fail and are dismissed with costs. There will be one hearing fee.

Y.P.

Appeals dismissed.

(1) [1961] 2 S.C.R. 241.