

COMMISSIONER OF INCOME-TAX, GUJARAT

v.

A. RAMAN & COMPANY

July 18, 1967

[J. C. SHAH, S. M. SIKRI AND V. RAMASWAMI, JJ.]

Indian Income-tax Act, 1961, s. 147—Conditions for the exercise of power to re-open assessment.

Constitution of India, 1950, Art. 226—Powers of High Court to issue writ when Income-tax Officer's jurisdiction to issue notice under s. 147 of the Indian Income-tax Act, 1961 is questioned—High Court must not re-appraise evidence.

The assessee firm consisted of two partners who were managers of their respective Hindu Undivided Families. The firm sold its goods to the aforesaid families and the families again sold the goods on their own account. In income-tax proceedings for the years 1959-60, 1960-61 and 1961-62 the firm and the Hindu Undivided Families were separately assessed in respect of their incomes. Subsequently the Income-tax Authorities took view that the sale of goods by the firm to the families was only a device to divert the profits of the firm and on this view issued notices under s. 147 of the Income-tax Act, 1961 requiring the assessee to show cause why the assessments for the years 1959-60, 1960-61 and 1961-62 should not be re-opened. The High Court of Gujarat in a petition for a writ under Art. 226 of the Constitution quashed those notices and restrained the Income-tax Officer from taking proceedings in pursuance thereof. With special leave granted by this Court, the Revenue appealed.

Held: (i) The High Court may issue a high prerogative writ prohibiting the Income-tax Officer from proceeding with reassessment when it appears that the Income-tax Officer had no jurisdiction to commence proceedings because the conditions precedent do not exist. [12G-H; 13B-C]

Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District I, Calcutta, & Anr. 41 I.T.R. 191, followed.

It is however not open to the High Court exercising powers under Art. 226 to set aside or vacate the notice for reassessment by itself re-appraising the evidence. [15B]

(ii) The condition which invests the Income-tax Officer with jurisdiction has two branches: (i) that the Income-tax Officer has reason to believe that income chargeable to tax has escaped assessment; and (ii) that it is in consequence of information which he has in his possession and that he has reason so to believe. The expression 'information' in the context of which it occurs must mean instruction or knowledge derived from an external source concerning facts or particulars, or as to law relating to a matter bearing on the assessment. If he has such information the Income-tax Officer may commence proceedings under s. 147(1)(b). But to commence such a proceeding it is not necessary that on the materials which came to the notice of the Income-tax Officer, the previous order of assessment was vitiated by some error of fact or law. [13C-G]

(iii) In the present case however the pre-conditions for the issue of a notice of re-assessment did not exist. The law does not oblige a trader to make the maximum profit that he can out of his

- A** trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned is not made taxable as income accrued to him. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. [15D-G]

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 768 of 1966.

- B** Appeal by special leave from the judgment and order dated December 18, 1964 of the Gujarat High Court in Special Civil Application No. 332 of 1964.

B. Sen, S. K. Aiyar, R. N. Sachthey and S. P. Nayar, for the appellant.

- C** *S. T. Desai and O. C. Mathur*, for the respondent.

The Judgment of the Court was delivered by

- Shah, J.**—The assessee—M/s A. Raman & Company—are dealers in “mill stores” in the course of their business they sell “mill stores” to other dealers including two concerns trading in the names of M/s A. M. Shah & Co. and M/s R. Ambalal & Co., which are owned by the Hindu undivided families, managers of which are the only partners of the assesseees. For the assessment years 1959-60, 1960-61 and 1961-62 the assesseees were originally assessed by the Income-tax Officer, Circle-I, Ward-A, Ahmedabad, while the partners of the assesseees and the Hindu undivided families which traded in the names of M/s A. M. Shah & Co. and M/s R. Ambalal & Co. were assessed by Income-tax Officers in other Circles. The cases of assesseees, of the partners of the assesseees and of the two Hindu undivided families trading in the names of A. M. Shah & Co. and R. Ambalal & Co. were later transferred to the Income-tax Officer, Group Circle-J, Ahmedabad. That Officer by letter dated March 20, 1964 informed the assesseees that he was convinced from a perusal of the assessment records of the assesseees, their partners and their individual Hindu undivided families, that the partners of the assesseees had contrived to divert profits of the assesseees to their respective Hindu undivided families and had tried to “evade proper taxation”, and on that ground he called upon the assesseees to submit their objections, if any, to the reopening of the assessments for the years 1959-60, 1960-61 and 1961-62.
- D** The assesseees in reply contended that the Income-tax Officer had no jurisdiction to reopen the assessments since the Hindu undivided families of the two partners and the assesseees had submitted “correct and complete returns of income” supported by their books of account, “quantity details” of purchases, sales and expenses, and had given all material facts and relevant information necessary for assessment at the time of each assessment.
- E**
- F**
- G**
- H**

The Income-tax Officer issued three separate notices under s. 147 of the Income-tax Act, 1961, requiring the assesseees to show cause why the assessments for the years 1959-60, 1960-61

and 1961-62 should not be reopened. The High Court of Gujarat in a petition for a writ under Art. 226 of the Constitution quashed those notices and restrained the Income-tax Officer from taking proceedings in pursuance thereof. With special leave granted by this Court, the Commissioner of Income-tax has appealed to this Court. A

In support of the claim of the Income-tax Officer, to reopen the assessments, reliance was placed in the High Court on cl. (b) of s. 147(1), of the Income-tax Act, 1961. The material part of s. 147(1)(b) may be read: B

"If—

- (a) C
- (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, D

he may, subject to the provisions of sections 148 to 153, assess or reassess such income or recompute the loss or the depreciation allowance as the case may be, for the assessment year concerned.

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:— E

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

Under s. 147(1)(b) reason to believe that income chargeable to tax has escaped assessment in consequence of information in the possession of the Income-tax Officer is a condition precedent to the exercise of his jurisdiction to assess or reassess the income of the assessee. If that condition does not exist, steps taken by the Income-tax Officer to assess or reassess the income will be without jurisdiction. F

It was held by this Court in *Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District I, Calcutta & Another*⁽¹⁾ that the High Court in appropriate cases has power to issue an order prohibiting the Income-tax Officer from proceeding to reassess the income when the conditions precedent do not exist. At p. 207, K. C. Das Gupta, J., delivering the majority judgment of the Court observed: G

"It is well-settled however that though the writ of prohibition or certiorari will not issue against an executive H

(1) 41 I.T.R. 191.

- A** authority, the High Courts have power to issue in a fit case an order prohibiting an executive authority from acting without jurisdiction. Where such action of an executive authority acting without jurisdiction subjects or is likely to subject a person to lengthy proceedings and unnecessary harassment, the High Courts, it is well settled, will issue appropriate orders or directions to prevent such consequences".
- B**

The High Court may, therefore, issue a high prerogative writ prohibiting the Income-tax Officer from proceeding with re-assessment when it appears that the Income-tax Officer had no jurisdiction to commence proceeding.

- C**
- D** The condition which invests the Income-tax Officer with jurisdiction has two branches: (i) that the Income-tax Officer has reason to believe that income chargeable to tax has escaped assessment; and (ii) that it is in consequence of information which he has in his possession and that he has reason so to believe. Since the learned Judges of the High Court have concentrated their attention upon the second branch of the condition and have reached their conclusion in favour of the assessee on that branch, it would be appropriate to deal with the correctness of that approach. The expression "information" in the context in which it occurs must, in our judgment, mean instruction or knowledge derived from an external source concerning facts or particulars, or as to law relating to a matter bearing on the assessment. If as a result of information in his possession, the Income-tax Officer has reason to believe that income chargeable to tax had escaped assessment, the Income-tax Officer has jurisdiction to assess or reassess income under s. 147(1)(b) of the Income-tax Act, 1961. Information in his possession that income chargeable to tax has escaped assessment furnishes a starting point for assessing or reassessing income. If he has that information, the Income-tax Officer may commence proceedings for assessment or reassessment. To commence the proceeding for reassessment it is not necessary that on the materials which came to the notice of the Income-tax Officer, the previous order of assessment was vitiated by some error of fact or law.
- E**
- F**

- G** The High Court exercising jurisdiction under Art. 226 of the Constitution has power to set aside a notice issued under s. 147 of the Income-tax Act, 1961, if the condition precedent to the exercise of the jurisdiction does not exist. The Court may, in exercise of its powers, ascertain whether the Income-tax Officer had in his possession any information: the Court may also determine whether from that information the Income-tax Officer may have reason to believe that income chargeable to tax had escaped assessment. But the jurisdiction of the Court extends no further. Whether on the information in his possession he should commence
- H**

a proceeding, for assessment or reassessment, must be decided by the Income-tax Officer and not by the High Court. The Income-tax Officer alone is entrusted with the power to administer the Act: if he has information from which it may be said, *prima facie*, that he had reason to believe that income chargeable to tax had escaped assessment, it is not open to the High Court, exercising powers under Art. 226 of the Constitution, to set aside or vacate the notice for reassessment on a re-appraisal of the evidence.

The High Court in this case was apparently of the view that the information in consequence of which proceedings for reassessment were intended to be started, could have been gathered by the Income-tax Officer in charge of the assessment in the previous years from the disclosures made by the two Hindu undivided families. But that, in our judgment, is wholly irrelevant. Justification of the Income-tax Officer to reassess income arises if he has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment. That information, must, it is true, have come into the possession of the Income-tax Officer after the previous assessment, but even if the information be such that it could have been obtained during the previous assessment from an investigation of the materials on the record, or the facts disclosed thereby or from other enquiry or research into facts or law, but was not in fact obtained, the jurisdiction of the Income-tax Officer is not affected.

The High Court was also of the view that the inference raised by the Income-tax Officer that the Hindu undivided families of the assesseees had made profit by sale of articles purchased from the assesseees larger than the profit which the assesseees had made, was not justified, since there was no evidence on the record about the price at which similar goods were sold by the assesseees to other merchants and about the profit which those other merchants made by sale of those goods. But in a petition under Art. 226 of the Constitution the taxpayer may challenge the validity of a notice under s. 147 of the Income-tax Act, 1961, on the ground that either branch of the condition precedent does not exist, but an investigation whether the inferences raised by the Income-tax Officer from the information are "correct or proper" cannot be made. Counsel for the Commissioner is, therefore, right in contending that the High Court entered upon an investigation of matters which were not within their competence.

But the appeal of the Commissioner must still fail. The case of the Commissioner on the materials placed before the High Court, suffers from a serious infirmity on the first branch of the jurisdictional condition. The averments made in the affidavit filed by the Income-tax Officer in that behalf do not establish the existence of that branch of the condition. In reply to the averment by the

- A** assessees that the Income-tax Officer had no reason to believe that income had escaped assessment, the Income-tax Officer stated:

B "In the course of the discussions I had at the several meetings hereinabove referred, I also learnt that in the earlier years also the petitioners (the assesseees) had effected such sales to the said Hindu undivided families, and that over and above the margin of profits earned by the petitioners (the assesseees) from the Hindu undivided families, the Hindu undivided families had earned substantial profits on the resale of such goods. I, therefore, came to the conclusion that the creation of the Hindu undivided family business was merely a subterfuge or a contrivance by the partners of the petitioner firm (the assesseees) to divert the huge profits made by the petitioners (the assesseees) on imported articles".

D The plea raised by the Income-tax Officer is that income which could have been earned by the assesseees was not earned, and a part of that income was earned by the Hindu undivided families. That according to the Income-tax Officer was brought about by "a subterfuge or contrivance". Counsel for the Commissioner contended that if by resorting to a "device or contrivance", income which would normally have been earned by the assessee is divided between the assessee and another person, the Income-tax Officer would be entitled to bring the entire income to tax as if it had been earned by him. But the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment under s. 147(1)(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.

H If the goods were nominally transferred to the Hindu undivided families, the latter acting merely as *benamidars* for the assesseees, and the profits were earned in truth by the assesseees, income earned by sale of the goods by the Hindu undivided families may be held chargeable to tax as income which has escaped assessment to tax in

the hands of the assesseees. In the present case, no such case was attempted to be made out in the affidavit filed by the Income-tax Officer. We hold, therefore, that on the materials on the record, the Income-tax Officer had no reason to believe that income chargeable to tax had escaped assessment for the three years in question. **A**

The order passed by the High Court is therefore confirmed. There will, however, be no order as to costs in this Court and the High Court. **B**

G.C.

Appeal dismissed.