

# Old & New Penalty Provisions - Analysis & Interpretation

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### Introduction

Section 271(1)(c), provided for levy of penalty on account of concealment of Income and/or furnishing inaccurate particulars of Income, for more than 5 decades. During this period due to almost automatic initiation and consequent levy of penalty by Assessing Officers for additions or disallowances made under scrutiny assessment there were numerous legal issues which led to proliferation of litigation. Hence in order to reduce litigation and infuse responsibility and accountability, the Finance Act, 2016 effectively replaced Section 271 by inserting a new Section 270A under Chapter XXI which provides for penalty on under-reporting of income and misreporting of income. Hence, from AY 2017-18 levy of penalty for concealment of income or furnishing inaccurate particulars of income u/s. 271(1)(c) has been replaced by penalty for under-reporting of income and misreporting of income u/s 270A. According to the memorandum to the Finance Bill this amendment has been done in order to rationalise and bring objectivity, certainty and clarity in the penalty provisions. Whether, the two limbs introduced to replace the old provision, have achieved the desired object or it's simply a case of unsettling settled laws, resulting in more litigation, only time will tell. However, in case both the tax-payer and the AO are facing any difficulty in interpretation, then the discussion below would be fruitful as it's an effort to iron out any difficulties in application of the right provision and thus the right amount, as the quantum of penalty is grossly different in both the cases.

### Section 270A

The Finance Act, 2016, introduced section 270A, applicable from the assessment year 2017-18 onwards, and it is a disconnect / departure from section 271(1)(c). Under the new section, the cases for levying penalty have been bifurcated as under-reporting of income and misreporting of income.

The terms "under-report" or "misreporting are not defined in the Income Tax Act. Hence, for interpretation and deciding legal issues one has to refer to the ordinary or dictionary meaning. In common parlance, under-reporting is **to report as less or fewer than is correct**. As per Cambridge Dictionary, Merriam Webster, Oxford Dictionary also the word Under-reporting suggests some sort of deliberate attempt to under-report income. On the other hand Mis-reporting is to give **a false or inaccurate account/report**. The Act only specifies exhaustive list of six cases which constitute misreporting (Sub-section (9)) and cases which do not constitute under-reporting (sub-section (6)). The sub-section(6) uses the term "shall not include" thus the situations which are not specifically excluded by sub-section (6) would be the ones where penalty would be imposed.

Section 271(1)(c) has been providing a strong framework through six decades of legal interpretation. Through plethora of judgements legal ingredients have been provided which have to be followed before penalty is levied. Let's see how some of these ingredients are still relevant for interpretation of various provisions of section 270A by both the assessee and the AO.

### 1. Recording of satisfaction before initiation of penalty:

**Bombay High Court in CIT v. Dajibhai Kanjibhai** [\[TS-5223-HC-1991\(BOMBAY\)-O\]](#) after duly considering the decision of **Apex Court in CIT v. S. V. Angidi Chettiar** [\[TS-5006-SC-1962-O\]](#) held recording of satisfaction before initiation of penalty under old provision i.e. Section 271(1)(c) as mandatory. The provisions of Section 271(1)(B) inserted by the legislature w.r.e.f. 01-04-1989 by the Finance Act 2008, was not of much assistance as, the Delhi High Court in **Ms. Madhushree Gupta v. Union of India** [\[TS-5580-HC-2009\(DELHI\)-O\]](#) laid down that both post and pre-amendment, recording of satisfaction is essential. It stressed on the words used in Section 271(1B) which is Direction- the said order contains a direction for initiation of penalty proceedings-This shows that there had to be clear directions in the Assessment Order by the AO to initiate penalty. The direction to initiate proceedings should be clear and not be ambiguous. Thus recording of satisfaction and clear, unambiguous direction to initiate penalty were essential under section 271(1)(c)

There is no corresponding provision u/s 270A of the Act in the form of section 271(1)(B). However, it can be inferred from a holistic reading of the Section 270A that recording of satisfaction is still mandatory. The section 270A begins as *-The Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner may, during the course of any proceedings under this Act.* It is settled law that a discretionary power granted to a quasi-judicial authority has to be exercised with due care and based on independent satisfaction.

## 2. Onus/Burden Of Proof

The burden of proof under section 271(1)(c) has shifted over the years. In the initial years it was on the AO and the judicial decisions during that time supported this stand. However, Explanation 1 to section 271(1)(C) shifted the onus on the assessee to establish that income has not been concealed by him as he had to offer an explanation which he had to substantiate and prove that is bona fide and prove that he has disclosed all facts which are material to computation of total income. The Explanation was overworked by the Assessing Officers, so as to justify penalty in each and every case of difference, even where an addition was merely on estimated basis or for bona fide omissions. In this context two landmark judgments were given by Apex Court in **Dilip N. Shroff v Joint CIT** [\[TS-57-SC-2007\]](#) and **T Ashok Pai v CIT** [\[TS-1-SC-2007-O\]](#). The Apex Court announced rules for the purpose of imposition of penalty stating that:

- *imposition of penalty is not automatic but discretionary and such discretion is required to be exercised on the part of the Assessing Officer keeping the relevant factors in mind. The approach of the Assessing Officer in this behalf must be fair and objective.*
- *Primary burden of proof, therefore, is on the Revenue that there is primary evidence to establish that the assessee has concealed the amount or furnished inaccurate particulars and this onus is to be discharged by the Department.*
- *The Assessing Officer while considering levy of penalty should consider whether the assessee has been able to discharge his part of the burden. He should not begin with the presumption that the assessee is guilty.*
- *Though penalty proceedings under the income-tax law are quasi-criminal requiring the Department to establish that the assessee has concealed his income.*
- *Where the assessee reports an income on the basis by valuation of market value as on 1-4-1981, as permitted by the statute, there can be no presumption of understatement with reference to such valuation, even if the market value may be found to be different having regard to the location of the property.*

Similarly, in **CIT v/s Sati Oil Udyog Ltd.** [\[TS-136-SC-2015\]](#) the hon'ble court held that the burden of proving that the assessee has attempted to evade tax is on the revenue which it has to discharge by establishing facts and circumstances from which a reasonable inference can be drawn that, the assessee, attempted to evade tax lawfully payable by it.

The provisions of Section 270A is different as in under-reporting a very specific and automatic process has been laid down to compute the amount of penalty. Clause (a) of sub-section (6) requires assessee to offer a bona fide explanation and substantiate such explanation with material facts. In case of mis-reporting it's for the AO to prove that the case is of mis-reporting and not of under-reporting. It is thus on the revenue to prove that there is misrepresentation, suppression, in terms of six cases of misreporting. Thus in case of misreporting the primary onus is on the AO, once the primary burden of proof is

discharged, the secondary burden of proof would shift on to the assessee and the assessee will need to discharge his onus by producing material on the basis of which he can contend that all necessary disclosures of material facts were made and that the explanation of assessee was bona fide.

### 3. Mens Rea or Mala Fide Intention

In number of case laws, existence of mensrea as an essential condition under section 271(1)(c) have been clearly spelled

- The Apex Court in *Dilip N. Shroff v. CIT* [(2007) 291 ITR 519] held that in order to attract penalty under Section 271(1)(c), mensrea was necessary, as according to the Court, the word "inaccurate" signified a deliberate act or omission on behalf of the assessee. The Court held that the element of mens rea was essential.
- The hon'ble Supreme Court in the case of ***Dharmendra Textiles*** - [\[TS-1-SC-2008\]](#) held: "Object behind enactment of section 271(1)(c), read with the Explanations thereto, indicates that the said section has been enacted to provide for a remedy for loss of revenue. The penalty under that provision is a civil liability. Wilful concealment is not an essential ingredient for attracting civil liability, as is the case in the matter of prosecution under section 276C..."
- In ***CIT v. Reliance Petroproducts Ltd*** [\[TS-37-SC-2010-O\]](#), the Apex court held that: Merely because assessee had claimed expenditure, which claim was not accepted or was not acceptable to revenue, that by itself would not attract penalty under section 271(1)(c).
- Hon'ble Madras High Court in the cases of ***CIT vs. C. Anantharaman Chettiar*** [\[TS-5907-HC-2003\(MADRAS\)-O\]](#) and ***Christopher vs. CIT*** (286 ITR 511), held that Disclosure of additional income by filing revised return with an assertion that disclosure is to buy peace is not bar on penalty and penalty can be imposed even in the case of so-called voluntary disclosure.
- In the case of ***CIT Vs. Zoom Communication Pvt. Ltd.*** [\[TS-38-HC-2010\(DEL\)\]](#), the Delhi High Court upheld the penalty addition on the ground that income tax paid could never have been availed as a deduction in view of the provisions of Section 40(ii) of the Act, and that equipment written off could never fall within the purview of Section 32(1)(iii) of the Act. The case of Reliance Petroproducts(supra) was distinguished. The Court held that a mere claim in the return if not bona fide would attract a penalty. The penalty was sustained and the appeal was allowed by the Court. In cases where the claim is so absurd so as to lead the Court to believe that the only reason why the assessee made the claim was to prevent paying excess tax, in those cases, even a wrongful claim could be the subject matter of penalty proceedings.
- In ***CIT vs. S.M. Construction*** [\[TS-5771-HC-2015\(BOMBAY\)-O\]](#), the Hon'ble Bombay High Court observed that if the claim is made bona-fide, then the ratio in Zoom Communications(supra) would not apply.
- In *Price Waterhouse Coopers Pvt. Ltd. Vs. CIT* [2012] 348 ITR 306 (SC), it was held that if the explanation provided by the assessee is proven to be bona-fide, the penalty addition would necessarily have to be deleted. Further, even if the assessee has not offered certain amounts to tax and a strong case of inadvertence on the part of one of the officers of the assessee is proven, then since the assessee has acted bona-fide there cannot be a case of furnishing inaccurate particulars of income or concealment of income.

The requirement of mensrea seems to be absent in the case of under-reporting. In case of under-reporting the decision ***Union of India v. Dharamendra Textile Processors*** [\[TS-1-SC-2008-O\]](#) seems to be more relevant as the section is for providing remedy for loss of revenue and, therefore, wilful concealment is not an essential ingredient. Mensrea is definitely required to be shown in the cases of mis-reporting. Thus AO needs to show besides mensrea misrepresentation, and suppression, on the part of the Assessee and a bona-fide mistake would continue as a defence for assessee.

### 4. Debatable Issue

In the case of under-reported income, where a debatable issue is involved or an incorrect legal claim is involved then penalty under section 270A for under-reporting of income would not be leviable. The Supreme Court in the case of ***Reliance Petroproducts (P.) Ltd.***, [\[TS-37-SC-2010-O\]](#) held that penalty provisions cannot be invoked unless the case is strictly covered by the provision. Same would be the case of mis-reported income.

## 5. Agreed Addition

The apex Court in **MAK Data P Ltd. v. CIT** [TS-545-SC-2013] held that the words "voluntary disclosure", "buy peace", "avoid litigation", "amicable settlement", etc. are not important. The question is whether the assessee has offered any explanation for concealment of particulars of income or furnishing inaccurate particulars of income. Explanation to Section 271(1)(c) raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the Revenue to show that the amount in question constituted the income and not otherwise." Thus in CIT v. Reliance Petro Products 322 ITR 158, the Supreme Court stated: "If we accept the contention of the revenue then in case of every return where the claim made is not accepted by the Assessing Officer for any reason, the assessee will invite penalty under Section 271(1)(c). That is clearly not the intendment of the legislature". Same facts would be applicable in the case of mis-reported income-which is more akin to section 271(1)(c).

## 7. Conclusion

The analysis of new section 270A indicates that there might be still issues on which both the assessee and revenue will not be in agreement. In-fact some of these issues might be the ones which are already settled through legal interpretation u/s 271(1)(c). Hence, to a substantial extent section 270A will rely on past judgements for interpretation. However, by defining exhaustive situations in respect of the cases of misreporting of income under section 270A(9) i.e. cases of mis-reporting, the Government of India has focussed on reducing the tax litigation:

- misrepresentation or suppression of facts; failure to record investments in the books of account;
- claim of expenditure not substantiated by any evidence;
- recording of any false entry in the books of account;
- failure to record any receipt in books of account having a bearing on total income; and
- failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X apply

Section 270A thus aims to bring certainty in the law of penalties by removing the discretion of assessing officers in deciding the quantum of penalty and by trying to iron out the points of conflict between the AO and the assessee.

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