

ITAT: 270A penalty SCN invalid sans specific charge for levy; Quashes consequent penalty order

May 30, 2024

Enrica Enterprises Pvt. Ltd [TS-369-ITAT-2024(CHNY)]

Conclusion

Chennai ITAT sets aside and deletes the penalty of Rs. 10.92 Cr levied under Section 270A(9) for 'under reporting of income and under reporting as a consequence of misreporting of income'; Holds the penalty order, consequent to show cause notice, to be unsustainable on the ground of failure of the Revenue to specify in the penalty notice issued under Section 274 r.w. Section 270A, as to which limb of Section 270A, the penalty is initiated, i.e. for 'under reporting of income' or 'misreporting of income'; Further holds that the penalty notice, without specifying the charge under which penalty is proposed under Section 270A, is a clear case of non-application of mind at the time of issuing show cause notice; Observes that in absence of specific charge against the Assessee, the Assessee is not in a position to counter the show cause notice and to file a cogent reply to the same; Opines that, *"In absence of proper notice, which is mandatory, the AO cannot impose penalty, because, it is a clear violation of principles of natural justice, because, issuing a vague notice without specifying the charge under which limb the proposed penalty proceedings is initiated, would vitiate the entire proceedings, because, the assessee was not given an opportunity to explain its case on specific charge"*; Revenue initiated the penalty proceedings against the Assessee with respect to unaccounted money recovered during the search operation on the Assessee's premises, and later accepted the additional income admitted by the Assessee; Explains that 'under reporting of income' and 'misreporting of income' shall not be used interchangeably, nor are they synonymous, but each operates under strict definition and do not overlap each other, thus the Revenue, before initiating penalty proceedings, should specifically arrive at a satisfaction to the effect that, for which charge, AO has initiated penalty Sec.270A; Relies on SC judgment in [SSA's Emerald Meadows](#), Madras HC judgment in [Babuji Jacob](#), Karnataka HC in [Manjunatha Cotton & Ginning Factory](#), Delhi HC judgment in [Prem Brothers Infrastructure](#) wherein it was held that in view of vague notice without any whisper as to which limb of section 270A is attracted and how ingredients of Section 270A(9) is specified, initiation of penalty under Section 270A for 'misreporting of income' is not only erroneous, but also arbitrary and bereft of any reason and consequently, penalty order, cannot be sustained; Observes that the Revenue accepted income admitted by the Assessee with categorical statement without any allegation against the income admitted or incorrectness of the books of accounts or evidence for the expenditure, thus opines that, *"income voluntarily admitted by the assessee does not constitute 'under reporting of income' or 'misreporting of income"*. Therefore, holds the penalty order to be unsustainable, even on merits; Opines that, *"show cause notice issued by the AO u/s.274 r.w.s.270A of the Act, is vague, non specific to charge and thus, is illegal and liable to be quashed."*; Thus allowed Assessee's appeal;;ITAT CHNY

Decision Summary

The ruling was delivered by the Division Bench of Chennai ITAT comprising Shri Manjunatha. G, Accountant Member and Shri Manomohan Das, Judicial Member.

Advocate D. Anand appeared for the Assessee while the Revenue was represented by Mr. R. Clement Ramesh - Kumar, CIT.

Assessee-Company, engaged in the business of manufacture and sale of Indian Made Foreign Liquor, was subject to search and seizure operation under Section 132. Revenue, during the course of the search operation, recovered and seized unaccounted cash Rs. 55.27 Cr from the residential premise of one Mr. M. Kothandarami Reddy, and six other individuals who identified themselves as associates of the Assessee and claimed that they have held the cash for and on behalf of the Assessee. Revenue further recorded a statement of Mr. S.D. Rami Reddy, director of the Assessee, under Section 132(4), explaining the modus operandi of generation of cash found and seized during the course of search and he also

admitted to additional income of Rs. 113.99 Cr which includes cash seizure of Rs.55.27 Cr. Revenue further noted that MR. Reddy also explained the modus operandi of generation of unaccounted cash by way of inflated expenditure booked under the head marketing expenses being 'gift articles' and admitted that on an average 1/3rd of actual expenditure accounted in the books of accounts, has been received back in cash from the suppliers. Accordingly, Assessee was served with notices under Section 153A for AYs AYs 2017-18 and 2018-19, in response Assessee filed the returns admitting to additional income of Rs. 25.73 Cr and Rs.32.46 Cr, respectively towards additional income offered during the course of search on account of inflated expenditure under the head 'gift articles'. Revenue completed the assessment proceedings by accepting the additional income voluntarily offered by the Assessee and also initiated penalty proceedings under Section 270A and issued notice under Section .274 r.w.s.270A for 'under reporting of income and under reporting as a consequence of misreporting of income'. Accordingly, Revenue levied penalty of Rs. 10.92 Cr under Section 270A, which was upheld by CIT(A). Aggrieved, Assessee preferred the present appeal.

ITAT noted Assessee's contention that the penalty notice under Section 274 r.w. Section 270A issued in a routine manner without referring under which limb of Section 270A, the assessee is liable for penalty. Observed that Section 270A has two limbs, first is 'under reporting of income' and second is 'under reporting of income as consequence of misreporting of income', and in the present case, the Revenue invoked second limb of Section 270A. Further observed that the penalty order under Section 270A is an appealable order under Section 246A, thus it is not mandatory in nature and since the penalty is not mandatory in nature the Revenue is required to give an opportunity to the Assessee to show cause 'as to why' penalty should not be levied in terms of Section 274. Perused the penalty notice served on Assessee under Section 274 r.w.s.270A and observed that the Revenue therein stated 'under reporting of income and under reporting as a consequence of misreporting of income', however it is not discernible whether penalty has been initiated for 'under reporting of income' as per section 270A (1) to (6) or 'misreporting of income' as per section 8 & 9 of Sec.270A. Found that the Revenue, although, imposed penalty under Section 270A(9), but no such ground was specified in the show cause notice. Opined that, "In absence of proper notice, which is mandatory, the AO cannot impose penalty, because, it is a clear violation of principles of natural justice, because, issuing a vague notice without specifying the charge under which limb the proposed penalty proceedings is initiated, would vitiate the entire proceedings, because, the assessee was not given an opportunity to explain its case on specific charge". Thus held the penalty notice under Section 274 r.w. Section 270A to be not a valid notice on the ground that the Revenue did not specify the satisfaction as to whether the Assessee had under reported the income or misreported the income and accordingly held the penalty levied on the basis of invalid or vague notice is invalid and void ab initio.

Explained that the concepts of 'under reporting of income' and 'misreporting of income' are two different charges with very clear boundaries, for which separate rate of penalty is provided under Section 270A(2) to (9). Thus, opined that the terms, 'under reporting of income' and 'misreporting of income', shall not be used interchangeably nor are they synonymous, but each operates under strict definition and do not overlap each other, therefore, the Revenue, before initiating penalty proceedings, should specifically arrive at a satisfaction to the effect that, for which charge, he has initiated penalty Sec.270A;

Pointed out that even the assessment order does not for which charge the Assessee is directed to pay penalty under Section 270A and in absence of such particulars, the mere reference to the word 'misreporting of income' in the assessment order or in the penalty notice makes the impugned order manifestly arbitrarily. Thus opined that the show cause notice under Section 274 r.w. Section 270A without specifying the charge under which penalty is proposed under Section 270A, is a clear case of non-application of mind at the time of issuing the show cause notice. Observed that in absence of specific charge against the Assessee, the Assessee is not in a position to counter the show-cause notice and cogently reply to the same. Relied on SC judgment in [SSA's Emerald Meadows](#), Madras HC judgment in [Babuji Jacob](#), Karnataka HC in [Manjunatha Cotton & Ginning Factory](#), Delhi HC judgment in [Prem Brothers Infrastructure](#) wherein it was held that in view of vague notice without any whisper as to which limb of section 270A is attracted and how ingredients of Section 270A(9) is specified, initiation of penalty under Section 270A for 'misreporting of income' is not only erroneous, but also arbitrary and bereft of any reason and consequently, penalty order, cannot be sustained. Opined that, "show cause notice issued by the AO u/s.274 r.w.s.270A of the Act, without specifying the charge under which penalty is proposed u/s.270A of the Act, is a clear case of non-application of mind at the time of issuing show cause notice and thus, in absence of specific charge against the assessee, the assessee is not in a position to

counter the show cause notice issued by the AO as well as cogent reply to the show cause notice”.

Observed that assessment proceedings and penalty proceedings are two separate proceedings and the findings in the assessment proceedings cannot be considered as conclusive and final for the purpose of imposing penalty. Relied on Jurisdictional HC judgment in [Gem Granites](#) and SC judgment in [Anwar Ali](#), wherein it was held that observed that the findings in assessment proceedings may constitute evidence in the penalty proceedings, but it does not follow that penalty is mandatory whenever addition or disallowance is made. Thus opined that, “there should be an independent finding from the AO regarding under reporting of income or misreporting of income in the penalty proceedings which alone can lead to conclusion that it is a fit case for levy of penalty”.

On merits, ITAT observed that, Revenue, except for unaccounted cash found during the search operation, had no other evidence to allege that the Assessee has inflated marketing expenses and generated unaccounted cash and said unaccounted cash pertains to specified previous year.

Further found that except for the statement of the director stating that Assessee inflated marketing expenses, Revenue made no specific reference to any material unearthed during the course of search which shows the amount of cash received back by the Assessee from any supplier. Also noted that cash seized during the course of search could not be identified with a particular AY either by the Assessee or the Revenue and the additional sum offered by the Assessee of Rs.58.72 Cr was not identified with any FY. Stated that allocation of 1/3rd of marketing expenses on estimated basis is purely on the basis of admission of the Assessee under Section 132(4) but such admission was not corroborated by any evidences found during the course of search. Emphasised that the Revenue has not made out any case of ‘under reporting of income consequent to inflation of expenditure under the head ‘marketing expenses’ with reference to replies received from suppliers qua total amount of purchases made from them and year of such purchase. Noted that the allocation of amount over the years was only on ad hoc basis and there was no evidence with the Revenue as regards the accuracy. Observed that the Assessee admitted the additional income which was accepted by the Revenue and that the quantification made towards additional income was purely on ad hoc estimation basis by considering Assessee’s statement, thereby disallowing 1/3rd of total expenditure incurred under the head ‘marketing expenses’. Observed that the Assessee has not misrepresented facts with regard to marketing expenditure, as the Assessee has disclosed total expenditure incurred under the head marketing expenses in the regular return of income. Opined that it is not a case of misrepresentation or suppression of facts based on any evidences, but admission of additional income is purely on the basis of Assessee’s statement recorded under Section 132(4) without any reference to incriminating material found as a result of search. Thus held that Section 270A(9)(c), which deals with misrepresentation or suppression of facts is not applicable to the present case.

Observed that the present case is also not covered under Section 270A(9)(d) which deals with failure to record investment in the books of accounts, as it is not a case of any investment which is not recorded in the books of accounts. Further observed that Section 270A(9)(e) as invoked by the CIT(A), is also not applicable as no allegations for the failure to record any receipt in books of accounts of the Assessee having a bearing on total income in so far as estimated disallowance of proportionate marketing expenses, was made. Pointed out that there cannot be any reasons for uniformity in inflation of expenditure for all assessment years as alleged by the Revenue. Further stated that it cannot be uniformly 1/3rd of total expenditure incurred under the head was inflated and further, it cannot be the case of receipt of 1/3 rd amount from all suppliers. Thus in absence of any findings as to quantification of inflated expenditure qua each assessment year with reference to total purchase from each party, amount of inflated expenditure, actual cash received back by the Assessee.

Opined that, “*merely because addition was made on the basis of voluntary surrender of income by the assessee, penalty for ‘under reporting of income’ or ‘misreporting of income’ cannot be fastened on the assessee.*”. Thus held that even on merits, penalty levied by the Revenue under Section 270A cannot be sustained. Hence, sets aside the penalty under Section 270A(9) holding the same to be unsustainable on two counts i.e. for failure to specify in the penalty notice as to which limb of Section 270A, the penalty is initiated and that income voluntarily admitted by the assessee does not constitute ‘under reporting of income’ or ‘misreporting of income’. Allowed Assessee’s appeal.

Case Law Information

Taxpayer Name

- Enrica Enterprises Pvt. Ltd

Judicial Level & Location

- Income tax Appellate Tribunal Chennai

Appeal Number

- ITA Nos.1166 & 1167/Chny/2023

Date of Ruling

- 2024-03-06

Ruling in favour of

- Assessee

Section Reference Number

- [274](#)
- 270A
- 270A(9)

Nature of Issue

- Penalty

Judges

- G. Manjunatha, Accountant Member
- Manomohan Das, Judicial Member

Counsel for Tax Payer

- Shri D. Anand

Counsel for Department

- Shri. R. Clement Ramesh Kumar, Addl. CIT