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SHEO NATH SINGH

V.

APPELLATE ASSISTANT COMMISSIONER OF
INCOME TAX, CALCUTTA

August 12, 1971

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[K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922. s. 34(1-A)—Preconditions for issue of notice—‘Reason to believe’—Belief must be of honest and reasonable person and must not be based on mere suspicion—Court can examine this aspect in writ petition.

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Supreme Court Appeal—Practice—High Court sustaining preliminary objection to petition under Art. 226 but nevertheless proceeding to decide on merits question of validity of notice under s. 34 (1-A)—This Court in appeal is not barred from considering High Court’s decision on validity of section.

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The assessee appellant was at all material times a shareholder of a number of companies engaged in the business of managing hotels. Gradually he came to own a large block of shares of Spence’s Hotel Ltd. and also became its managing director. He was in charge of the management thereof at the material time. He further purchased interest in Associated Hotels of India Ltd. and Hotels (1938) in association with M. S. Oberoi. In 1944 Oberoi purchased from the assessee his share holding in the Associated Hotels of India Limited for an amount of Rs. 20,657,05/13/0. The assessee maintained that he had filed returns of income in respect of the relevant assessment years and that during the assessment for the year 1944-45 he had disclosed to the Income-tax Officer that he had received the aforesaid amount for the sale of the shares of the Associated Hotels. That amount was held to be a capital receipt on which no income-tax was payable. Subsequently the Income-tax Officer issued seven notices dated 5th November 1954 to the assessee under s. 34 (1-A) of the Income-tax Act, 1922 in respect of assessment years 1940-41 to 1946-47 alleging therein that the income of the appellant had partly escaped assessment. In spite of the assessee’s objections relating to jurisdiction the Income Tax Officer made assessments in respect of the years 1942-43 to 1945-46. In appeal the Appellate Assistant Commissioner remanded the case to the Income-tax Officer to submit a report on various matters. Thereafter the appellant submitted a petition under Art. 226 in the High Court challenging *inter alia* the validity of the notice under s. 34 (1-A). The High Court accepted the preliminary objection of the Revenue that since the appellant had invoked the remedy under the Act a petition under Art. 226 did not lie. Nevertheless it proceeded to hold that the notice under s. 34 (1-A) was valid and the required preconditions were satisfied. Appeal was filed by the assessee in this Court by special leave.

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HELD : (i) The correct course for the High Court to follow after sustaining the preliminary objection was to have dismissed the writ petition. Since the High Court gave a decision in the matter which

would be binding on the Appellate Assistant Commissioner, the contention of the Revenue that this Court should decline to go into the question arising out of the provisions of s. 34 (1-A) could not be accepted. [179 D-E]

(ii) There can be no manner of doubt that the words '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 and circumstantial evidence but not on mere suspicion gossip or rumour. The Income-tax Officer would be acting without jurisdiction if the reason for this 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 though the declaration or sufficiency of the reasons for the belief cannot be investigated by the Court. [182 F-H]

Chhugamal Rajpal v. S. P. Chaliha & Ors., 1971 (79) I.T.R. 603. referred to.

There was no material or fact which had been stated in the reasons for starting proceedings in the present case on which any belief could be founded of the nature contemplated by s. 34 (1-A). The so called reasons were stated to be beliefs, thus leading to an obvious self contradiction. Therefore the requirements of s. 34(1-A) were not satisfied and, the notices which had been issued were wholly illegal and invalid.

[183 B]

In the result the appeal must be allowed and the impugned notices were quashed.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1477 of 1967.

Appeal from the judgment and order dated October 6, 1966 of the Calcutta High Court in Matter No. 236 of 1961.

M. C. Chagla, *M. L. Aggarwal*, *N. K. Aggarwal* and *M. N. Pombara*, for the appellant.

S. D. Desai, *A. N. Kirpal*, *R. N. Sachthey* and *B. D. Sharma*, for the respondents.

The Judgment of the Court was delivered by.

Grover, J.—This is an appeal by certificate from the judgment of the Calcutta High Court.

The assessee who is the appellant was at all material times a share-holder of a number of companies engaged in the business of managing Hotels. He had also been a Director and Managing Director of various companies. Gradually he came to own a large block of shares of Spence's Hotel Limited and also became its Managing Director. He was incharge of the Management thereof at

- A the material time. He further purchased interest in Associated Hotels of India Limited & Hotels (1938) in association with M. S. Oberoi. In 1944, M. S. Oberoi purchased from the assessee his share holding in the Associated Hotels of India Limited for an amount of Rs.20,657,05/13/0. Similarly in or about 1949, the holding in Hotels (1938) Limited was purchased by the said M. S. Oberoi. It was maintained by the assessee that he has filed returns of his income in respect of the relevant assessment years and that during the assessment for the year 1945-46, the assessee had disclosed to the Income-tax Officer, District II (2) Calcutta that he had received the aforesaid amount for the sale of the shares of the Associated Hotels. The amount was held to be a capital receipt on which no income tax was payable. During the subsequent years, the assessee continued to show in his returns the interest received on the amount of Rs. 20,657,05/13/0.

- It appears that the case of M. S. Oberoi was referred to the Investigation Commission set up under the Taxation on Income (Investigation Commission) Act, 1947. The assessee was also served a notice by the Commission on or about 18th August, 1951 under section 5(4) of the aforesaid Act, in respect of the assessment year 1940-41. The assessee filed a Writ Petition in March, 1953 in the Punjab High Court (Circuit Bench) Delhi to quash the proceedings before the said Commission. According to the assessee, the Solicitor General, who appeared in the High Court after a rule had been issued, gave an undertaking that all proceedings against the assessee would be dropped. Upon such undertaking being given, the rule was discharged. The Income-tax Officer, District II (2) Calcutta issued seven notices dated 5th November, 1954 to the assessee under s. 34(1-A) of the Income Tax Act, 1922 in respect of assessment years 1940-41 to 1946-47 alleging therein that the appellant had partly escaped assessment. In spite of the objection of the assessee that in the absence of any material on record, the Income Tax Officer had no jurisdiction to issue any notice under 34(1-A), the said Officer proceeded to make assessment in respect of the assessment years 1942-43, 1943-44, 1944-45 and 1945-46. The assessee filed an appeal to the Appellate Assistant Commissioner of Income Tax who remanded

the case to the Income Tax Officer to submit a report on various matters. One of such matters was that the Income Tax Officer should state as to what fresh material was before him to satisfy him that the sum of Rs. 20,00,000/- which was previously treated as capital should be treated as income. In 1961, the assessee filed a petition under Art. 226 of the Constitution in the Calcutta High Court challenging the order of the Appellate Assistant Commissioner. This Writ Petition was dismissed on 6th October, 1966.

In clause (v) of Para (22) of the Writ Petition, the assessee had stated that at the time when the notice had been issued under s. 34(1-A) of the Act, the Income Tax Officers concerned did not have any material before them constituting reason to believe that any income, profits or gains of the assessee had escaped assessment for any year. It was asserted that the only material before the Income Tax Officers concerned on which they had purported to issue the notices consisted of the fact of the receipt of about Rs. 22,00,000/- which the assessee had received for the sale of his shares in the Associated Hotels of India Limited in the year 1944 that receipt had already been disclosed to the Income Tax Officer who had made the original assessment relating to the year 1945-46 and he had held that the said amount was a capital receipt. There was merely a denial in the affidavit in reply with reference to paragraph 22(v), that the conditions precedent to the exercise of power under s. 34(1-A) had not been fulfilled. An objection was also taken that it was not open to the assessee to urge the said ground in a petition under Art. 226 when he had already invoked the remedy available under the Act against the assessment order pursuant to the notice under s. 34 (1-A) of the Act. In para (29) it was stated that "all necessary information regarding the reasons for which the proceedings were started under s. 34 was available from the records of the Income Tax Department relating to the assessment of the assessee.

The High Court dealt with several points which were raised on behalf of the assessee which included the question whether the Income Tax Officer had the jurisdiction to make an assessment under the provisions of s. 34 unless the conditions contained in s. 34 (1-A) were satisfied. In

- A other words, unless he had "reason to believe" that income profits or gains chargeable to income had escaped assessment, he could not have proceeded under the aforesaid provision. The High Court in the first place sustained a preliminary objection which had been raised on behalf of
- B the revenue that because the assessee had filed appeals to the Appellate Assistant Commissioner, he could not pursue his petition under Art. 226 of the Constitution before the High Court. The other points which had been canvassed related to the validity and constitutionality of s. 34(1-A). The High Court held that it had been settled by a series of
- C decisions of this Court that it was not unconstitutional. Indeed that point was subsequently abandoned by the learned counsel for the assessee. But after holding that preliminary objection had substance, the High Court proceeded to decide the question relating to the satisfaction of the pre-conditions under s. 34 (1-A), although the
- D correct course for it to follow after sustaining the preliminary objection was to have dismissed the Writ Petition. Since the High Court gave a decision on that matter, which would be binding on the Appellate Assistant Commissioner, we are unable to accede to the submission made by the learned counsel for the revenue that we should decline to
- E go into the question arising out of the provisions of s. 34 (1-A).

- The impugned notices which were issued under s. 34 (1-A) stated that the Income Tax Officer had "reason to believe" that income, profits and gains assessable to income
- F tax had escaped assessment. There was also a note at the foot of the notices that they had been issued after necessary satisfaction of the Central Board of Revenue. The High Court observed that the Income Tax Officer had obtained the sanction of the Board upon reasons recorded in writing, and although the record containing those reasons
- G was sought to be produced before the Court, an objection was raised on behalf of the assessee that the recorded reasons should not be looked into. The High Court felt that there was no necessity to travel beyond the order of the Appellate Assistant Commissioner read with the assessment orders which were under challenge. The
- H Appellate Assistant Commissioner, it was felt, had looked into the records which included the statements and other materials filed with the Income Tax Investigation Commis.

sion by the petitioner. The High Court proceeded to say that although the Appellate Assistant Commissioner had looked at all the material, he had expressed some difficulty in coming to a conclusion without further material on the question as to what fresh evidence was available before the Income Tax Officer to convince him that the sum of Rs. 20,00,000/- which was previously treated as capital should be treated as income. It was finally held that the assessee had failed to establish that the pre-conditions contained in s. 34 (1-A) had not been fulfilled and consequently there was an initial lack of jurisdiction.

Section 34 (1-A) to the extent it is necessary, may be reproduced.

“34 (1-A). If, in the case of any assessee, the income-tax officer has reason to believe—

- (i) that income, profits or gains chargeable to income-tax have escaped assessment for any year in respect of which the relevant previous year falls....., and
- (ii) that the income, profits or gains which have so escaped assessment for any such year or years amount or are likely to amount to one lakh of rupees or more; he may..... serve on the assessee.....a notice containing.....and may proceed to assess or reassess the income, profits or gains of the assessee.....;

Provided that the Income-tax Officer shall not issue a notice under this sub-section unless he has recorded his reasons for doing so and the Central Board of Revenue is satisfied on such reasons recorded that it is a fit case for the issue of such notice”.

Since nothing had been disclosed which was relevant for the purpose of finding out whether the Income Tax Officer had any reason to believe that the income, profits or gains of the assessee chargeable to income-tax had escaped assessment, we gave an opportunity to the Revenue to produce the records containing those reasons. All that

A have been found in the records are reports in Form 'B'
 made in connection with starting of proceedings under
 s. 34(1-A), each report relating to a different assessment
 year. Items (7) and (8) of this form relate to brief reasons
 for starting proceedings and whether the Central Board
 B of Revenue was satisfied that it was a fit case for issue of
 notice. Against item (7) it is stated "reasons as per separate
 sheet attached". Against item (8), the Secretary of the
 Central Board of Revenue signed after writing "Yes,
 satisfied". The reasons for starting the proceedings given in
 the separate sheet may be fully reproduced.

C "For the reasons hereinafter recorded I
 believe that income, profits and gains earned by the
 assessee in his personal capacity and in conjunction
 with others and chargeable to income-tax have
 escaped assessment and that the amount of such
 D concealed income relating to the Accounting years
 covering the period beginning on the 1st day of
 September, 1939 and ending on the 31st day of
 March, 1949, amount to or is likely to amount to
 Rs. 1,00,000/-. The reason for such belief, *inter*
 E *alia*, is as follows :—

- (1) The assessee who is or was at the relevant
 time a Managing Director in about a dozen
 limited companies, along with "Oberois" is
 believed to have made some secret profits
 F which were not offered for assessment.
- (2) The assessee is believed to have received a
 sum of Rs. 22 lakhs from "Oberois" and this
 sum or at least part of which represents
 income has escaped assessment.

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Sd/- (A. K. BHOWMIK)
Income-tax Officer
 Distt. II (2), Calcutta"

H It is abundantly clear that the two reasons which
 have been given for the belief which was formed by the
 Income Tax Officer hopelessly fail to satisfy the require-
 ments of the statute. In a recent case—*Chhugamal Rajpal*

v. *S. P. Chaliha and Others* ⁽¹⁾ which came up before this Court, a similar situation had arisen and under the directions of the Court, the Department produced the records to show that the Income Tax Officer had complied with the conditions laid down in the statute for issuing a notice relating to escapement of income. There also, the report submitted by the Officer to the Commissioner and the latter's orders thereon were produced. In his report, the Income Tax Officer referred to some communications received by him from the Commissioner of Income-tax, Bihar and Orissa from which it appeared that certain creditors of the assessee were mere name-lenders and the loan transactions were bogus and, therefore, proper investigation regarding the loans was necessary. It was observed that the Income Tax Officer had not set out any reason for coming to the conclusion that it was a fit case for issuing a notice under s. 148 of the Income Tax Act, 1961. The material that he had before him for issuing notice had not been mentioned. The facts contained in the communications which had been received were only referred to vaguely and all that had been said was that from those communications it appeared that the alleged creditors were name-lenders and the transactions were bogus. It was held that from the report submitted by the Income Tax Officer to the Commissioner it was clear that he could not have had reasons to believe that on account of assessee's omission to disclose fully and truly all material facts, income chargeable to tax had escaped assessment.

In our judgment, the law laid down by this Court in the above case is fully applicable to the facts of the present case. There can be no manner of doubt that the words "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 though the declaration or sufficiency of the reasons for the belief cannot be investigated by the court.

(1) 1971 (79) I.T.R. 603.

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There is no material or fact which has been stated in the reasons for starting proceedings in the present case on which any belief could be founded of the nature contemplated by s. 34 (1-A). The so-called reasons are stated to be beliefs thus leading to an obvious self-contradiction. We are

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satisfied that the requirements of s. 34 (1-A) were not satisfied and, therefore, the notices which had been issued were wholly illegal and invalid.

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In the result, the appeal is allowed and the judgment of the High Court is set aside. The writ petition succeeds to the extent that the impugned notices shall stand quashed. The assessee shall be entitled to his costs.

G. C.

Appeal allowed.