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Clear and unambiguous direction is a must to initiate penalty proceedings

In brief

The Karnataka High Court (HC) in the case of M/s. MWP Limited¹ (since amalgamated with United Breweries Holdings Limited) has held that where conditions regarding penalty are not mentioned in the assessment order, mere mention of “*Penalty proceedings u/s 271(1)(c) initiated separately*” does not comply with the provisions of section 271(1)(c) of the Income-tax Act, 1961 (the Act) even in light of the deeming provision of section 271(1B)².

¹ CIT v. M/s MWP Ltd [TS-617-HC-2013(KAR)]

² Section 271(1B) states that “*where any amount is added or disallowed in computing the total income or loss an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under clause (c) of sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of penalty proceedings under the said clause (c)*”

Facts

- The assessee, a company incorporated in India, carrying on the business of investment, provided for a diminution in the value of investments. The assessing officer (AO) sought an explanation from the assessee as to the reasons for providing for the diminution. The assessee responded, conceding the fact that while the diminution was provided based on Accounting Standard 13, it was not allowable under the provisions of the Act. The assessee subsequently withdrew the claim.
- While passing the assessment order, the AO disallowed the claim of the assessee and stated at the end of the order that “*Penalty proceedings u/s 271(1)(c) initiated separately*”. Overruling the objection of the assessee that the claim was withdrawn with the intention to buy peace, the AO

imposed a penalty. The Commissioner of Income Tax (Appeals) [CIT(A)] confirmed the penalty.

- The Income-tax Appellate Tribunal (ITAT) reconsidered the entire material on record and held that the final position of the income returned by the assessee was 'nil'. The ITAT also noted that the claim was withdrawn to buy peace and avoid litigation even before a meaningful investigation was carried out by the AO. Relying on the ruling of the Supreme Court in the case of *K C Builders & Another*³, the ITAT held that there was no case for concealment as there was no loss of revenue.
- The Revenue approached the HC against the order of the ITAT.

Issue

The substantial question of law before the HC was, “*whether the Tribunal was correct in holding that penalty under section 271(1)(c) of the Act could not be levied as there was no concealment, no loss of revenue and the subsequent withdrawal was with no ulterior motive?*”

Revenue's contentions

- The Revenue claimed that the assessee was aware that diminution of the value of investment was not allowable under the provisions of the Act. It was only when an explanation was sought during the 143(3) proceedings that the claim was withdrawn.
- Even in absence of a direction in the assessment order to initiate penalty proceedings, the same can be initiated under the deeming provisions of section 271(1B).

Assessee's contentions

- To attract the deeming provisions of section 271(1B), satisfaction of concealment had to be found in the assessment order and direction for initiation of penalty proceedings had to be passed.

- Where there was no direction in the order, the entire penalty proceedings were vitiated.
- It was also argued that there was no intention of concealment, since the claim was withdrawn to buy peace and avoid litigation.

High Court ruling

- Relying on the Supreme Court ruling in the case of *Rajendranath*⁴ and the subsequent HC ruling in the case of *Manjunatha Cotton & Ginning Factory*⁵, the HC held that the phrase ‘*penalty proceedings under section 271(1)(c) are initiated separately*’ did not comply with the word ‘direction’ as contemplated under section 271(1)(c) of the Act.
- The HC observed that ‘*A direction by a statutory authority is in the nature of an order requiring positive compliance. When it is left to the option of the ITO whether or not take action, it cannot be described as a direction.*’
- Ruling in favour of the assessee, the HC held that since, in the present case, no direction as discussed above was given in the assessment order, the deeming provisions of section 271(1B) were not attracted. Therefore, it was held that conditions prescribed under section 271(1)(c) were not satisfied. The Revenue's appeal was dismissed.

Conclusion

The HC has reiterated the principle that in order to initiate penal proceedings under section 271(1)(c) of the Act, satisfaction in relation to concealment of income had to be made clear in the assessment order.

Assessee could rely on this ruling in cases where penalty proceedings have been initiated or confirmed based on phrases like ‘*penalty proceedings under section 271(1)(c) are initiated separately*’ without any clear and unambiguous direction in the assessment order.

³ *K C Builders & Another v. ACIT* [2004] 265 ITR 562 (SC)

⁴ *Rajendranath v. CIT* [1979] 120 ITR 14 (SC)

⁵ *CIT v. Manjunatha Cotton & Ginning Factory* [2013] 35 taxmann.com 250 (Karnataka-HC)

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