

Discussion on Penalty u/s 270A and Directors liability of IT Act

Inherent meaning of penalty

Penalty is distinct from tax and interest (1/2)

- Tax, penalty and interest are different concepts under Income-tax Act, 1961
- Definition of “tax” under Section 2(43) does not include penalty or interest
- SC in **C.A. Abraham v. Income Tax Officer AIR 1961 SC 609** had noted in the context of S. 44 of Indian Income Tax Act, 1922 that it includes the assessment of penalty as an additional tax. The same was for a limited purpose:
 - Section 44: Assessment of a firm where business has been closed
 - No separate machinery provision for imposing penalty in such a case
 - Expression “assessment” used in Section 44 was construed of wide connotation and it was held to include penalty proceedings also since assessment is a part of machinery provision for computing the tax due

Penalty is distinct from tax and interest (2/2)

- In **Bhikaji Dadabhai & Co., 42 ITR 123 (SC)**, the Court followed C.A. Abraham's case despite the fact that under the Hyderabad Income Tax Act (which it was concerned with), distinct provisions were made for recovery of tax due and penalty
- In **Anwar Ali 76 ITR 696**, the Court referred to C.A. Abraham's case and explained the distinction between the penalty to be considered as additional tax for the purposes of machinery provisions and penalty to be dealt with as the part of substantive law
 - “One of the principal objects in enacting Section 28 is to provide a deterrent against recurrence of default on the part of the assessee. The Section is penal in the sense that its consequences are intended to be an effective deterrent which will put a stop to practices which the legislature considers to be against the public interest. It is significant that in C.A. Abraham's case this Court was not called upon to determine whether penalty proceedings was penal or of quasi penal nature and the observations made with regard to penalty being an additional tax were made in a different context and for a different purpose.”

Penalty is not automatic (1/2)

- Imposition of penalty is not automatic
- Levy of penalty is not only discretionary in nature, but such discretion is required to be exercised on the part of the Assessing Officer keeping the relevant factors in mind
- Some of those factors apart from being inherent in the nature of penalty proceedings as has been noticed in some of the decisions of this Court, inheres on the face of the statutory provisions
- Penalty proceedings are not to be initiated, as has been noticed by the Wanchoo Committee, only to harass the Assessee

Penalty is not automatic (2/2)

- In **Hindustan Steel Ltd. v. State of Orissa AIR 1970 SC 253**, the SC made the following observations:

*“An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi criminal proceedings and **penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the Authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the Authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute.**”*

“Shall” to be read as “may”

- Proceedings for imposition of penalty are declared to be quasi criminal in character
- Issuance of SCN to the assessee is an opportunity given to the assessee to show that the penalty is not warranted in the given set of facts
- Levy of penalty despite the assessee proving its case against the levy of penalty would be an empty formality
- In **Mahaveer Conductors v. ACTO, 104 STC 65 (Raj)**, the HC observed:
 - Opportunity of being heard against the proposed levy of penalty is not empty formality to make an order as a matter of course as foregone conclusion
 - Fair opportunity to show that no penalty can be levied in the facts and circumstances of the case

Scope of Section 270A

Scope and Applicability

- Penalty for concealment and furnishing of inaccurate particulars was earlier levied u/s 271(1)(c) of the Act
- Finance Act 2016 introduced sub-section (7) in 271 to restrict its applicability to AY 2016-17
- 270A introduced with effect from 01st April 2017
- Object for introduction
 - Explanatory Notes - rationalize and bring objectivity, certainty and clarity in the penalty provisions,

Arrangement of the section

- Sub-sec. (1) – charging section
 - The Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner may, during the course of any proceedings under this Act, direct that any person who has under-reported his income shall be liable to pay a penalty in addition to tax, if any, on the under-reported income.
- Sub-sec (2) and (3) define under reporting of income, and the computation of amount of under reported income
- Sub-sec (4) and (5) – penalty in cases of amount added in earlier years
- Sub-sec (6) – exclusions of levy of penalty
- Sub-section (7), (8) and (10)– quantum of penalty
- Sub-sec (9) – definition of mis-reporting of income

Under reporting of Income

- What constitutes under-reporting:
 - Assessed Income (under normal provisions or MAT) greater than income determined in return processed under S.143(1)(a)
 - Assessed income (under normal provisions or MAT) exceeding basic exemption limit where no return is filed or return is filed for the first time under S.148
 - Income reassessed (under normal provisions or MAT) greater than income previously assessed or reassessed
 - Assessment results in reduction of loss or conversion of loss into profit

Quantum of Under-reporting

- $(A-B) + (C-D)$
 - A = Total income assessed as per normal provisions
 - B = Total income chargeable had amount assessed been reduced by under-reported income
 - C = Total income assessed as per 115JB
 - D = Total income chargeable had amount assessed been reduced by under-reported income

Mis-reporting of Income

- What constitutes mis-reporting?
 - Misrepresentation or suppression of facts
 - Failure to record investment in books of accounts
 - Claim of expenditure not substantiated by evidence
 - Recording of false entry in books
 - Failure to record receipts having bearing on total income
 - Failure to report international transaction or SDT

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Under reporting not to include

- (a) the amount of income in respect of which the assessee offers an explanation and the AO is satisfied that the explanation is *bona fide* and the assessee has disclosed all the material facts to substantiate the explanation offered;
- (b) the amount of under-reported income determined on the basis of an estimate, if the accounts are correct and complete to the satisfaction of the AO, but the method employed is such that the income cannot properly be deduced therefrom;
- (c) the amount of under-reported income determined on the basis of an estimate, if the assessee has, on his own, estimated a lower amount of addition or disallowance on the same issue, has included such amount in the computation of his income and has disclosed all the facts material to the addition or disallowance;

Under reporting not to include

- (d) the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer, where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction under Chapter X, and, disclosed all the material facts relating to the transaction; and
- (e) the amount of undisclosed income referred to in section 271AAB.

Directors liability

Liability of Director and Partner - Scope

- The liability under this section is on every director who was, at any point of time, a director of the company for the previous year in respect of which the taxes are sought to be recovered.
- To illustrate, if Mr A was a director during the financial year 2018-19, and additional tax demand in respect of that financial year is raised pursuant to a tax assessment that is completed in 2021, Mr A can be held liable under Section 179 of the IT Act, even if he had resigned from directorship in 2020.

Liability of Director and Partner - Scope

- The section does not restrict its applicability to directors in charge of accounting or finance but casts the net wide.
- The Hon'ble Gujarat High Court in Suresh Narain Bhatnagar v. ITO [2014] 367 ITR 254 (Guj.), held that merely because an individual is a technical director, that would, ipso facto, not mean that liability cannot be enforced on that director under Section 179 of the IT Act.
- Even director who is a foreign citizen can be held liable under the section.
- The provision would equally apply to nominee directors or directors appointed by interested parties like lender/ technology partner, etc.

Liability of Director and Partner - Notice of Demand

- In case of *S. Basant Singh v. TRO [1998] 233 ITR 508 (Punjab & Haryana)*, the High Court held that no separate notice of demand is required to be issued for the purposes of recovery of taxes from the director, where a notice of demand had already been issued to the company.
- The Calcutta High Court in the case of *UOI v. Satyanarayan Khan [1961] 42 ITR 42* and in *Ramgopal Khemka v. Union of India [1966] 60 ITR 659*, held that it is not necessary to issue a notice of demand separately to the partner of an unregistered firm for recovery of tax from the partner of the firm. Moreover, the taxes due from the firm. The above position of law was approved by the Hon'ble Supreme Court in the case of *Sahu Rajeshwar Nath v. ITO [1969] 72 ITR 617 (SC)*.