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TAX FLASH NEWS

9 October 2017

Delhi High Court lays down guidelines for reopening of assessment proceedings

Background

Recently, the Delhi High Court in the case of Sabh Infrastructure Ltd[1] (the taxpayer) while quashing reassessment proceedings under Section 147 of the Income-tax Act, 1961 (the Act), laid down four guidelines for the tax department for reopening of re-assessment proceedings. The High Court observed that on a routine basis, a large number of writ petitions were filed challenging the reopening of assessments by the tax department under Sections 147 and 148 of the Act. Despite numerous decisions on this issue, the same errors are repeated by the tax department.

It is well settled that the reasons to believe have to be self-explanatory. The reasons cannot be thereafter supported by any extraneous material. Further, the reasons could not be based on mere surmise and conjecture. There have to be reasons to believe and not reasons to suspect that income has escaped assessment. In the present case, the reasons to believe contained the names of five companies which were disclosed by the taxpayer during the assessment proceedings. The number of shares subscribed to by the said companies is the same and the amount received has been disclosed by the taxpayer. There is no new material which has been found or mentioned in the reasons to believe which were not contained in the information provided by the taxpayer prior to the conclusion of assessment under Section 143(3) of the Act.

[1] Sabh Infrastructure Ltd v. ACIT (W.P.(C) 1357/2016) – Taxsutra.com

Facts of the case

- The taxpayer is a company engaged in the business of real estate and property development. The taxpayer filed its return of income for the Assessment Year (AY) 2008-09 on 30 September 2008 declaring a total income. During the AY 2008-09, the taxpayer had received share premium from five companies wherein share premium of INR400 per share was received on the nominal value per share of INR100 each. The sum total of the value of the shares so subscribed was INR10 million in the taxpayer.

- During the assessment proceedings, the Assessing Officer (AO) sought details and documents with respect to share premium received during the year. The taxpayer disclosed the details of share capital allotted during the year for the five companies. Subsequently, the taxpayer submitted the confirmation from the said five companies along with their Income Tax Returns (ITRs) and Permanent Account Number (PAN) cards. Further, the auditor's reports, balance sheets, particulars of P&L accounts, and schedules of the balance sheet and P&L account of the five companies were also submitted.

- An assessment order under Section 143(3) of the Act was passed by the AO, after the details regarding the five companies and their confirmations were submitted. The assessment order, however, did not contain any discussion in respect of the share premium. The AO accepted the information furnished by the taxpayer and did not raise further doubt or queries with respect to the same.

- Subsequently, after four years, a reassessment notice was issued under Section 148 of the Act on the ground that income had escaped assessment. Reasons to believe were extracted and also furnished. It has been established that these five companies, from whom share premium has been received by the taxpayer are not genuine. The taxpayer has not disclosed fully and truly all material facts in its income tax return resulting in under assessment of income on account of share premium. Hence, the AO has reasons to believe that the income has escaped assessment within the meaning of Section 147 of the Act.

- The taxpayer objected to the reopening of assessment under Sections 147 and 148 of the Act. The taxpayer contended that the reasons to believe do not contain any allegation as to what material facts and information the taxpayer had failed to disclose. Apart from raising various jurisdictional objections, the taxpayer also raised objections on merits. However, these objections were rejected by the AO.

- Aggrieved, the taxpayer filed a writ petition before the High Court.

High Court's decision

- The law on this subject[2] is well settled. As held in the case of Kelvinator[3], the powers under Section 147 of the Act have to be exercised after a period of four years only if there is a failure to disclose fully and truly all material facts and information, by the taxpayer. This legal position has been reiterated recently by the Court in various decisions[4].

- It is also now well settled that the reasons to believe have to be self-explanatory. The reasons cannot be thereafter supported by any extraneous material. The order disposing of the objections cannot act as a substitute for the reasons to believe and neither can any counter affidavit filed before this court in writ proceedings.

- In the present case, the reasons to believe contained the names of the very same five companies which were initially disclosed by the taxpayer during the assessment proceedings. The number of shares subscribed to by the said companies is the same and the amount received has been disclosed by the taxpayer. There is no new material which has been found or mentioned in the reasons to believe which were not contained in the information provided by the taxpayer prior to the conclusion of assessment under Section 143(3) of the Act.

- In fact, the taxpayer, after initially submitting the details of the companies and the shares subscribed to, further provided confirmations from the said companies. The taxpayer also submitted copies of the balance sheets of the said companies for the relevant AYs showing that these amounts were duly reflected therein. The said companies were also assessed to tax. Thus, it appears that the AO was satisfied with the details and information provided by the taxpayer.

- A perusal of the order disposing of the objections reveals that it proceeds on the basis that the information sought for by the taxpayer which formed the basis for the reasons to believe, including the evidence collected, was required to be provided only in the further assessment proceedings. The said order overlooks the fact that the reasons for reopening do not mention as to what fact or information was not disclosed by the taxpayer. This is very vital and in fact, goes to the root of the matter. An allegation that the companies are `paper companies' without further facts is by itself insufficient to reopen assessments that stand closed after passing of orders under Section 143(3) of the Act.

- The assessment proceedings, especially those under Section 143(3) of the Act, have to be accorded sanctity and any reopening of the same have to be on a strong and sound legal basis. It is well settled that a mere conjecture or surmise is not sufficient. There have to be reasons to believe and not merely reasons to suspect that income has escaped assessment. In this case, the reasons failed to mention what facts or information was withheld by the taxpayer.

- Merely relying upon the statement of company officer that the companies in question were 'paper companies', by itself, is insufficient to reopen the assessment, unless the AO had further information that these companies were non-existent after making further inquiries into the matter. It is clear that the AO did not make any inquiry or investigation, if these companies were in fact 'paper companies'. No effort has been made to establish the connection between the statement of the company officer and the five companies.

[2] Reassessment proceedings
[3] CIT v. Kelvinator of India Ltd. [2010] 187 Taxman 312 (SC)
[4] Oracle India Pvt. Ltd. v. ACIT 2017 SCC OnLine Del 9360, Unitech Limited v. DCIT 2017 SCC OnLine Del 9408, BDR Builders and Developers Pvt. Ltd. v. ACIT 2017 SCC OnLine Del 9425 and Swarovski India Pvt. Ltd. v. DCIT (W.P.(C) 5807/2014, dated 30 August 2017)

- The tax department's contention that the Court cannot dictate the manner and content of what is to be written in the reasons to believe is correct as a legal proposition. However, the High Court has to examine the reasons to believe to see if it satisfies the rigour of the provisions. The observations of the High Court in the case of Multiplex[5] are relevant in this respect. In the facts of this case, the primary facts have not been shown to be false. The five companies do exist. They did subscribe to the share capital of the taxpayer. They did pay the money to the taxpayer. All the five companies are assessed to tax.

- If the tax department had any basis to show that the primary facts were incorrect, the same ought to have been set out in the reasons to believe. That has not been done in the present case. Thus, the taxpayer cannot be said to have failed to disclose fully and truly all the material facts. This being a jurisdictional issue, the assumption of jurisdiction under Sections 147 and 148 of the Act was erroneous. The notice for reopening the assessment and the subsequent order has been quashed.

- Before parting with the case, the Court would like to observe that on a routine basis, a large number of writ petitions are filed challenging the reopening of assessments by the tax department under Sections 147 and 148 of the Act. Further, despite numerous decisions on this issue, the same errors are repeated by the concerned tax authorities. In this background, the Court would like the tax department to adhere to the following guidelines in matters of reopening of assessments:

  - While communicating the reasons for reopening the assessment, the copy of the standard form used by the AO for obtaining the approval of the Superior Officer should itself be provided to the taxpayer. This would contain the comment or endorsement of the Superior Officer with his name, designation, and date. In other words, merely stating the reasons in a letter addressed by the AO to the taxpayer is to be avoided.

  - The reasons to believe ought to spell out all the reasons and grounds available with the AO for re-opening the assessment - especially in those cases where the first proviso to Section 147 is attracted. The reasons to believe ought to also paraphrase any investigation report which may form the basis of the reasons and any enquiry conducted by the AO on the same and if so, the conclusions thereof.

  - Where the reasons make a reference to another document, whether as a letter or report, such document and/or relevant portions of such report should be enclosed along with the reasons.

  - The exercise of considering the taxpayer's objections to the reopening of assessment is not a mechanical ritual. It is a quasi-judicial function. The order disposing of the objections should deal with each objection and give proper reasons for the conclusion. No attempt should be made to add to the reasons for reopening of the assessment beyond what has already been disclosed.

Our comments

The scope and effect of a reopening of assessment under Section 147 of the Act have been a matter of debate before the courts.

The courts[6] have consistently warned the tax department not to harass taxpayers by reopening assessments in a mechanical and casual manner. The PrCIT were directed to issue instructions to the AOs to strictly adhere to the law explained in various decisions and made it mandatory for them to ensure that an order for the reopening of an assessment clearly records compliance with each of the legal requirements. The AOs were also directed to strictly comply with the law laid down in GKN Driveshafts[7] as regards disposal of objections to reopening the assessment.

The Delhi High Court decision lays down the information and documentation to be supplied to the taxpayer for reopening of assessment. The guidelines may help to reduce reopening of assessments in a routine manner and consequent litigation.

[5] CIT v. Multiplex Trading & Industrial Co. Ltd. [2015] 378 ITR 351 (Del)

[6] Pr.CIT v. Samcor Glass Ltd. (ITA No. 768/2015) (Delhi High Court), CIT v. Trend Electronics [2015] 379 ITR 456 (Bom)

[7] GKN Driveshafts (India) Ltd. v. ITO [2003] 259 ITR 19 (SC)

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