CHAPTER FOUR

COMMITTEE REPORTS AND CASELAW

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4.1 Introduction:

The penal provisions under the direct tax laws are significant because they act as deterrents for those who violate the law for tax evasion. The matter regarding penalties has received the attention of various tax reform committees. The views expressed by these committees and the recommendations submitted by them to the Goverrment are very important. In the following pages an attempt is made to examine such recommendations.

4.2 Wanchoo Committee's Recommedations:

By a Resolution dated 2nd March, 1970, of the Government off India, a committee of experts, headed by Shri.Justice K.N.Wanchoo was appointed to examine and suggest legal and and administrative measures for countering evasion and avoidance of direct taxes and to recommend concrete and effective measures for, inter-alia, unearthing black money and preventing its proliferation through further evasion.

It will not be out of place to quote, in the words of the committee itself, what it felt about the penal provisions and its recommendations about the need for amendments thereto.

"2.71. As the number of taxpayers increases, the tax administration has of necessity to rely more and more on voluntary compliance of tax laws by the assessee. Appropriate penal provisions form a necessary complement to this approach as they impel compliance with the tax laws by imposing additional monetary burden on those who happen to go astray either inadvertently or by design. It is in this context that we have considered it necessary to review the penal provisions in the direct tax laws .....

"2.73. Penalty serves its purpose only so long as it is within reasonable limit. Once it crosses that limit, it is more likely to increase the rigidity of a taxpayer's recalcitrance than to reform him. If a tax evader is really unable to pay a heavy penalty, he would prefer to go underground and start business in benami names. Unduly harsh penalties thus breed only defiance of the law and have to be eschewed. ... The purpose of penalty should, however, be only to bend and not to break the taxpayer. We recommend that the quantum of penalty imposable for concealment of income should be with reference to the tax sought to be evaded, instead of the income concealed. Moreover, the minimum penalty imposable for concealment of income should be the amount of tax sought to be evaded and the maximum penalty imposable should be fixed at twice the said amount. It may also be clarified that 'tax sought to be evaded' in this context means the difference between the tax determined in respect of total

income assessed and the tax that would have been payable had the income other than the concealed income been the total income. This would ensure that the taxpayers are not made to pay penalty in respect of certain additions to income, which are not in the nature of concealment but are made only for certain technical reasons.

"2.74. We are not unaware that linking concealment penalty to tax sought to be evaded can, at times, lead to some anomalies. We would recommend that in cases where the concealed income is to be set off against losses incurred by an assessee under other heads of income or against losses brought forward from earlier years, and the total income thus gets reduced to a figure smaller than the concealed income or even to a minus figure, the tax sought to be evaded should be calculated as if the concealed income were the total income.

"2.75. Several persons who appeared before us urged the need for deleting the Explanation to clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961, for various reasons. The primary objection against this Explanation is that it is being invoked indiscriminately and penalty proceedings are initiated in all cases where the income shown in the return is less than eighty per cent of the assessed income.

We **recommend** that Explanation to clause (c) of sub-section (1) of section 271 of the Income-tax, 1961, and also Explanation 1 to clause (c) of sub-section (1) of section 18 of the Wealth-tax Act, 1957, may be deleted.

"2.77. In regard to other penalties under section 271, which do not relate to concealment of income, our **recommendations** are as under:

(i) Where a return of income is filed under sub-section (1) of section 139 of the Income-tax Act, 1961, after the prescribed time-limit but within the period of limitation for completion of assessment, the assessee should be liable to pay only interest at the rate of 1 per cent, per month on the tax due for the period of delay. There should be no liability for penalty or prosecution.

(ii) Where a return of income is filed beyond the time prescribed under sub-section (2) of section 139 or section 148, but within the time allowed, if any, by the income-tax officer, the assessee should be liable to pay interest at the rate of 1 per cent per month on the tax due for the period of delay.

(iii) Where a return of income is filed beyond the time prescribed under sub-section (2) of section 139 or section 148 and also beyond the time allowed, if any, by the income-tax officer, the assessee should be liable to pay interest at the rate of 1 per cent per month and, in addition penalty at the rate of 1 per cent

of the tax due for every month during which the default continued.

(iv) Where a person fails to submit a return of income in response to a notice under sub-section (2) of section 139 or section 148 and on assessment his income is found to be above taxable limit, he should be liable to pay interest at the rate of 1 per cent per month and, in addition, penalty at the rate of 1 per cent of the tax due for every month during which the default continued. He should also be liable to prosecution.

(v) Where a person fails to submit a return as required under sub-section (1) of section 139 but submit it in response to a notice under sub-section (2) of section 139 or section 148, he should be liable to pay interest at the rate of 1 per cent of the tax due for every month during which the default continued.

In the case of a person not hitherto assessed to tax, where the failure has continued beyond the normal period of limitation for completing the assessment under section 143, he should, in addition to interest, be liable to a penalty under clause (c) of sub-section (1) of section 271 as recommended earlier, as also prosecution.

(vi) For the purpose of levy of interest at the rate of 1 per cent, the period of delay or default should always be counted from the due date for filing the return

of income under sub-section (1) of section 139, notwithstanding the extension of time, if any, granted by the Income-tax Officer".

4.3 Raja Chelliah Committee's Recommedations:

The Government of India constituted another committee of experts to examine the structure of direct and indirect taxes, through its Resolution dated 29th August 1991, under the Chairmanship of Dr.Raja J.Chelliah. This committee was appointed to make the tax system simple and credible yet progressive, which people realise that 'honesty is the best policy'. The committee's observations and recommendations as regards penalties and prosecutions under the direct tax laws are as under.

"5.50. We note that there are a large number of prosecutions which have been launched in respect of technical offences such as delay in depositing tax deducted at-source and that often the amounts involved are not very large. We are given to understand that the proportion of prosecutions against technical offences is coming down; nevertheless, they are sufficiently large to cause concern and to necessitate a change in approach. First of all, it is necessary for the Department to concentrate on large cases and to be selective in launching prosecutions where cases are strong so that with conservation of effort and concentration on strong cases,

the Department could be successful, and through the punishment of the guilty can produce the desired deterrent effect. Second, we would suggest that in respect of most of the technical violations of the law, a late fee or penal interest should replace discretionary penalty or attempt at punishment through successful prosecution. The imposition of late fee or penal inetrest should be statutorily laid down and be automatic. Since it would be automatic, the level of penalty should be moderate. Third, there should be substantial delegation of power to compound to the Chief Commissioner, who should compound if he is satisfied that that would be in the best interests of revenue. Fourth, if it is decided to launch a prosecution in a particular case, the job must be undertaken seriously and must be executed efficiently. Sufficiently qualified counsel should be hired wherever necessary to supplement the departmental representative and the necessary documents should be provided to him in time. The department should follow the twin strategy of reducing the number of prosecutions launched, particularly for technical offences, and bringing down the existing pendency of prosecutions in the Courts. Towards this end, we **recommend**:

(a) In the case of offences referred to in secs.276B and 276BB, an automatic penalty in the form of additional interest of an appropriate magnitude should be imposed; the rate of interest should vary with the length of the period of default. A possible scale of interest charges should be as follows:

(i) where the period of default does not exceed six months, half per cent of the amount outstanding (taxes, fines and all interest other than additional interest and interest under sec.220(2)) for the period of default;

(ii) where the period of default exceeds six months but does not exceed twelve months, one per cent of the amount outstanding for the period of excess of six months; and

(iii) where the period of default exceeds twelve months, two per cent of the amount outstanding for default in respect of the period in excess of twelve months.

Sections 276B and 276BB empowering the launching of prosecution for failure to pay tax deducted at source should be withdrawn. However, if the tax deducted at source along with interest and additional interest imposed remains unpaid after a specified period of time, the person could be considered to be in default of payment of tax and the department could consider launching prosecution for wilful attempt to evade payment of tax.

The discretionary penalty under section 221(1) of the Income-tax Act for default in making payment of tax should be replaced by an additional interest in the nature of an automatic penalty whereby all persons who fail to make payment of any arrear (i.e. tax, interest other than interest under section 220(2) or penalty) arising under the Act within

the statutory limit allowed for payment of such arrears, should be deemed to be an assessee in default from the date following the expiry of the statutory time period. He should thereafter be liable to pay alongwith the amount of arrears and the amount of interest payable under sub-section (2) of section 220, additional interest at the appropriate rates to be specified, which could be the rates mentioned in (a) above.

(c) The existing scheme of automatic penalty against late filers and non-filers in the form of penal interest under sec.234A and prohibition to carry forward the loss (sec.139(3)) should be both replaced by a new system of an automatic penalty in the form of late fee:

(i) if an assessee has paid all the tax due, but delays filing the return by more than a month but less than six months, a penalty in the form of late fee of Rs.500 should be imposed on him; if the delay is more than six months but less than a year, the late fee should be Rs.1,000 and if it is more than one year, it should be Rs.5,000 (thereafter, the late fee arrear should be treated as arrear interest);

(ii) if the return is not filed in time and there is tax due, then besides the additional interest on the amount of tax due, the penalties mentioned in (i) above for late filing should also be imposed; and

(iii) if those earning income from business and professions

having turnover exceeding the amounts specified for the obligation to file a return do not file a return but also do not have income exceeding the exemption level, they should again be asked to pay only the penalty mentioned in (i) above.

(d) The discretionary penalty under sec.271(1)(b) of the Income-tax Act should be replaced by a fine/late fee in the nature of an automatic penalty:

(i) at the rate of Rupees fifty per week of failure to comply with a notice under section 142(1). However, this fine should not be levied in cases where part information is furnished in response to notice under sec.142(1) or where adjournment is granted by the tax administration on its own, or where the notice under sec.142(1) requires the taxpayer to furnish the return of income; this should be raised to Rupees.one hundred after the fourth week;

(ii) at the rate of rupees.one hundred per week of default reckoned from after the 15th day of the order appointing the auditor under sec.142(A) to the day when the taxpayers's communication submitting himself for audit is received by the Tax Department. This should be increased to rupees.five hundred per week after four weeks of default.

(e) The discretionary penalty under sec.271(B) of the Income-tax for failure to get accounts audited or obtain audit

report as required under sec.44AB or furnish such reportt along with return under sec.139(1) or in response to notic under sec.144(1) should be replaced by a late fee in the nature of an automatic penalty of an appropriate magnitude in line with our suggestions above.

(f) The discretionary penalty under sec.272A(2) of the Income-tax Act should be replaced by a system of late fee in the nature of an automatic penalty at the rates specified in (a) above:

"5.51 With a view to reducing the number of prosecutions launched for technical offences, we **recommend:**

(a) The prosecutions under sec.276C(2) should be launched only if the assessee fails to make the payment for a considerable period, say over one year and not merely because the statutory time period for payment of tax has lapsed. This is because for the first year, additional interest will be charged.

(b) Even where the prosecutions are launched for technical offences in accordance with the scheme recommended by us, the Department should generally take a liberal view in compounding prosecutions for such technical offences.

"5.52 We consider that reducing the number of pending prosecutions is an important step towards preparing for the new system of automatic penalties and reduced scope and need

for launching prosecutions. Towards this end, we recommend the scaling down of compounding fees and the launching of a drive for compounding in respect of prosecutions for technical offences.

"5.53 The power to compound should be delegated to the Chief Commissioner/Director-General for all prosecutions for technical offences. In cases where tax evasion is involved, the power to compound should be delegated to the Chief Commissioner/Director-General except where the amount of tax evaded exceeds, say, Rs.1.0 lakh. In tax evasion cases, it could be required that the compounding would be done by Chief Commissioner in consultation with a Commissioner."

SUMMARY OF RECOMMENDATIONS:

It is seen that the prosecution cases initiated under the Income-tax Act take unduly long time for their ultimate disposal. The effectiveness of prosecution is considerably diluted. For improving the matters in this regard, the following recommendations were made:

(1) The department should concentrate on large cases and be selective in prosecutions;

(2) Prosecution cases, when they are launched, should be taken up seriously by engaging competent counsel for expeditious disposal, serious effort should be made to bring down the existing pendency of prosecution cases;

(3) The general power for launching prosecution for failure to pay in time the tax dues under secs.276B and 276BB be withdrawn and replaced by a specific power for launching prosecution in those cases only, where interest remains unpaid after a specified period of time;

(4) The department should impose late-fee or penal interest for technical violations such as those contained in sec.276B and 276BB of the Income-tax Act, instead of launching prosecution proceedings. The levy of such penal interest should be statutorily laid down automatic;

(5) The discretionary penalties under sec.221(1), 271(1)(b), 271B and 272A(2) of the Income-tax Act may be replaced by the imposition of additional interest or late fee;

(6) Automatic penalty in the form of late fee may be imposed in place of penal interest under sec.234 and 139(3);

(7) The department should launch prosecution under sec.276(1)(2), only if the assessee fails to make the payment for over one year and where prosecutions are launched for technical offences should be compounded;

(8) There should be substantial delegation of powers to the Chief Commissioner/Director-General for compounding the penalties where necessary; and

(9) The levy of penal/additional interest/fine should be as per the scales indicated earlier in this respect.

4.4 Select Case Law:

We have seen earlier that the main direct tax laws enacted by the Central Government are the Income-tax Act, 1961; the Wealth-tax Act, 1957; and the Gift-tax Act, 1958. The penalty provisions under these laws are contained in each of these statutes. These penal provisions have already been discussed in the earlier Chapters, with relevant sections of each statute reprooduced. Sometimes, however, these penalty provisions give rise to controversy and are challenged under the appellate provisions of the Acts. The assessee and the department adopt diverse views and the litigation is finally settled by the highest court of the country, the Supreme Court of India. The trend, the direction and the nature of litigation, the issue agitated and the final inferences drawn by the court are very significant in this context. Therefore, an attempt is made to review the latest case law at this point. To grasp the issues, the case law quoted from the "Income-tax Reports" is reproduced verbatim.

1. In the Supreme Court of India April 28. 1992.

Commissioner of Income-tax (Additional)
v.
I.M.Patel and Co.

"Penalty-Failure to file return within time-Mens Rea-Need not be established by Department-Assessee to prove reasonable cause for delay- [Income-tax Act, 1961, s.271(1)(a)].

HELD

There is nothing in section 271(1)(a) of the Income-tax Act, 1961, which requires that mens rea has to be established by the department before penalty can be levied under that section for delay in filing the return. It is for the assessee, should be file a belated return, to show "reasonable cause" for the delay.".

2. In the Supreme Court of India - March 25, 1992

Banwari and others
v.
Income-tax Officer and another

"Offence - False statement in verification - Firm - Ceasing to do business with effect from December 31, 1972 - Returns submitted in 1973 indicating that firm had ceased to do business from December 31, 1969 - Statement corrected in August, 1974 - Complaint in 1977 - Magistrate discharging accused on the ground that statement was a bona fide mistake - Revision - High Court holding magistrate could not so discharge without recording evidence - Appeal to Supreme Court in 1980 - Proceedings stayed - Long lapse of time - Order of discharge restored [Income-tax Act, 1961, s.277; Indian Penal Code, 1860, s.420 - Code of Criminal Procedure, 1973, s.245(2)].

HELD

The appellants were carrying on business in manufacture of bidis in partnership. The firm had ceased to do

business with effect from December 31, 1972. But, in their returns filed on August 16, 1973, the date of cessation was given as December 31, 1969. The mistake was noticed on August 17, 1974, and it was corrected on August 26, 1974. In 1977, the Income-tax Officer filed complaints against the appellants that false statement had been made in the verification which was punishable under sec.277 of the Income-tax Act, 1961, and sec.420 of the Indian Penal Code. After perusing the averments in the complaint and supporting documents, the Magistrate came to the conclusion that the mention of December 31, 1972, as the date of cessation was a bona fide mistake and directed discharge of the accused. In revision, the High Court set aside the order of discharge on the ground that the magistrate could not order discharge of the accused without recording evidence. The appellants preferred appeals to the Supreme Court on certificates granted by the High Court, and the Supreme Court admitted the appeals and granted stay of further proceedings.

HELD

(i) that, for more than a decade, the proceedings were pending in the trial court and no useful purpose would be served by proceeding with the complaint after the lapse of such a long time; the matter had become stale;

(ii) that, on the facts, the magistrate could not be said to have been grossly in inferring that the mention of the wrong date was merely a bona fide mistake.

[The Supreme Court, accordingly, set aside the order of the High Court and restored the order of discharge passed by the Magistrate]."

3. In the Bombay High Court September 11, 1989.

Commissioner of Income-tax
v.
H.G.Dalal

"Penalty - Quantum of Penalty - Computation - Total tax reduced by advance-tax to be taken into account - (Income-tax Act, 1961, s.271(1)(a)].

HELD

The quantum of penalty is liable to be computed with reference to the total tax payable by the assessee as reduced by the advance tax paid by him.".

4. In the Bombay High Court August 17, 1990

Commissioner of Income-tax
v.
S.D.Pande

"Penalty - concealment of income - jurisdiction of IAC to levy penalty - Date of reference to IAC is the deciding factor [Income-tax Act, 1961, ss.271(1)(c),274(2)].

HELD

The material date with reference to which it can be decided whether or not the order of the IAC imposing penalty is valid is the date on which reference to the IAC was made.".

5. In the Punjab and Haryana High Court January 13, 1992

Income-tax Officer
v.
Anil Kumar Gupta and others

"Offences and prosecution - deduction of tax at source - interest - failure to deduct tax at source on interest - tax must be deducted at source when interest is credited to the account of the payee - [Income-tax Act, 1961, ss.194A, 276B].

A bare reading of section 194A of the Income-tax Act, 1961, shows without any manner of doubt that the tax is to be deducted at the source itself at the time when interest is credited to the account of the payee. The word "or" has been used by the Legislature in the section making it clear that, in any such eventuality as is mentioned therein, the tax has to be deducted by the assessee from the interest credited to the account of payee. No doubt the word "credit" used in the section has not been defined in the Act. But there is no ambiguity about the meaning of the word "credit".

HELD

that the trial court had not decided the case on merits, since it took an erroneous view of the effect of section 194A.".

The aforesaid caselaws supplement the law and provide the direction in respect of the penal provisions.

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