

# Penalty u/s. 271(1)(c): Initiation, Satisfaction & Levy – The Unwritten Mandates



*Section 271(1)(c) of the Income-tax Act, 1961 prescribes two faults or omissions which exposes the assessee to concealment penalty. These are, concealment of particulars of income and furnishing inaccurate particulars of such income. This article critically analyses the unwritten procedural route for making the assessee liable to face the penal consequences. The procedural mandates regarding initiation of penal proceedings, recording of satisfaction regarding concealment/furnishing of inaccurate particulars of income and finally levy of penalty for specifically any of the two faults are discussed with the help of judicial precedents.*

## **A. Initiation of Penalty Proceedings u/s 271(1)(c):**

Clause (c) of Section 271(1) reads as follows:

271. (1) If the Assessing Officer or the Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person—

(a) .....

(b) .....,or

(c) has concealed the particulars of his income or furnished inaccurate particulars of [such income, or

(d).....

he may direct that such person shall pay by way of penalty.....

Before we discuss the hidden mandates in the above written letters of penal provisions, it is

necessary to dwell upon the provision of Section 271(1B) as inserted by Finance Act 2008 w.r.e.f. 01-04-1989 as follows:

(1B) Where any amount is added or disallowed in computing the total income or loss of 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 the penalty proceedings under the said Clause (c).

There is no direct mandate prescribed under the Act or Rules regarding how and where to initiate the penalty proceedings under Section 271(1)(c). However, the combined reading of both the above provisions makes it clear, that an assessment order should contain at least a direction for initiation of penalty proceedings to constitute satisfaction of the AO for initiation of penalty proceedings under Section 271(1)(c). Even post Section 271(1B), still a *prima facie* satisfaction of Assessing Officer that the case may deserve imposition of penalty should



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be discernible from order passed during the course of assessment proceedings. (*Madhushree Gupta vs. Union of India* [2009] 183 TAXMAN 100 (DELHI))

Thus, to initiate a penalty proceedings or not is a matter of application of mind and satisfaction to that effect by the assessing officer. If after applying his mind, the AO made himself satisfied that there was no concealment/furnishing of inaccurate particulars of income and accordingly, did not initiate the penalty proceedings in the body of assessment order, he cannot proceed for penalty proceedings. The absence of direction for initiation of penalty proceedings under Section 271(1)(c) in the body of assessment order, cannot even be ratified by issue of notice under Section 271(1)(c) r.w.s. 274 along with assessment order or by taking recourse to Section 154/292B otherwise it will render Section 271(1B) meaningless and *otiose*.

The recent decision in the case of *CIT vs. Manjunatha Cotton & Ginning Factory* [2013] 359 ITR 565 (Kar.) also affirmed the above stand and clarified as follows:

- i) That existence of conditions stipulated in Section 271(1)(c) is a *sine qua non* for initiation of penalty proceedings.
- ii) The existence of such conditions should be discernible from the assessment order or the order of the appellate authority.
- iii) Even if there is no specific finding regarding the existence of the conditions mentioned in Section 271(1)(c), at least the facts set out in explanations 1(A) and 1(B) should be discernible from the said order *which would by legal fiction constitute concealment because of deeming provisions*.
- iv) Even if these conditions do not exist in the assessment order, at least a direction to initiate proceedings under Section 271(1)(c) is a *sine qua non* for the AO to initiate the proceedings because of the deeming provision contained in Section 271(1B).
- v) Notice under Section 274 r.w.s. 271(1)(c) should specifically state grounds mentioned in Section 271(1)(c) *i.e.*, whether it is for concealment of income or for furnishing of inaccurate particulars of income.
- vi) Sending printed form where all the grounds mentioned in Section 271 are mentioned would not satisfy the requirement of law.

The view that initiation of penalty proceedings

**As observed by the Court, post-amendment the mandates of penal provisions u/s 271(1)(c) remained intact. The Court saw no merit in the argument of the Department that prior to the impugned amendment "satisfaction" both at the initiation stage and at the stage of imposition was required, however, with the insertion of the Section 271(1B), 'satisfaction' only at the stage of imposition of penalty is required.**

in assessment order is a precondition for levy of penalty has also been affirmed by various tribunals in past in *Lalit Calendaring Works vs. ITO* (1998) 60 TTJ (Ahd) 12, *ITO vs. Bhagwandas* (1982) 13 TTJ (DEL) 261, *ITO vs. Audyogik Tantra Shikshan Sanstha* (ITA No. 106/PUNE/2010) etc.

Recently, the Hon'ble Bombay High Court in *Gangadhar N. Agrawal, HUF vs. ITAT* [2013] 35 *taxmann.com* 292 (Bombay) held that where core issue raised before the Tribunal was about the jurisdiction of the Assessing Officer to levy penalty without initiation of penalty proceedings, without deciding the said issue, the matter of penalty could not be remanded to Commissioner (Appeals) on merits.

### **Who Can Initiate Penalty Proceedings?**

As a general rule the authority making additions/disallowances can only initiate the penalty proceedings under Section 271(1)(c) during the course of assessment/reassessment proceedings. As a natural corollary, if CIT(A) makes the enhancements, he shall be authorised to initiate the penalty proceedings in respect of the enhanced portion. Same is the case for CIT for order passed under Section 263. However, if the AO has not recorded any satisfaction or has not issued any direction to initiate the penalty proceedings, in appeal, if the appellate authority records satisfaction, then the penalty proceedings have to be initiated by the appellate authority & not the assessing officer. [*CIT vs. Manjunatha Cotton & Ginning Factory* [2013] 359 ITR 565 (Kar.).] Probably, the court has taken this view, in view of the principle that powers of CIT(A) are coterminous with that of assessing officer and the entire assessment is open before him.

### **Exception to the above mandate: Explanation 2 r/w section 271(1A):**

Where the source of any receipt, deposit, outgoing

or investment in any asst. year is claimed to be out of the amount added to the total income of any preceding year but no penalty was initiated/imposed thereon then to the extent of such adjustment, the assessee shall be deemed to have concealed or furnished inaccurate particulars of income of that year in which the said addition was made and the AO would be entitled to initiate penalty proceedings notwithstanding that the assessment of that year has been completed/completed without initiating the penalty proceedings.

## B. Recording of Satisfaction:

**Legislative history:** In the context of levy of penalty under Section 271 of the Income-tax Act, 1961, there has been an ongoing dispute between the Income-tax department and the taxpayers on whether an Assessing Officer is required to record his satisfaction before initiating penalty proceedings. The Income-tax department has held the view that no separate satisfaction is required to be recorded before initiating penalty proceedings. In the case of *CIT vs. S.V. AngidiChettiar (1962) 44 ITR 739 (SC)*, the Supreme Court has, while dealing with penalty under Section 28 of the Indian Income-tax Act, 1922, held that "satisfaction before conclusion of proceeding under the Act, and not the issue of a notice or initiation of any step for imposing penalty is a condition for the exercise of the jurisdiction." Following this decisions, wherever additions are made, the Assessing Officers have, without separately recording any satisfaction, been issuing directions for initiating penalty proceedings.

However, interpreting the aforesaid Supreme Court decision, the Delhi High Court has, in the case of *CIT vs. Ram Commercial Enterprises Ltd. (2001) 167 CTR (Del) 321* held that "It is the assessing authority which has to form its own opinion and record its satisfaction before initiating penalty proceedings."

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**If there is no explanation at all from the assessee as required by explanation (1A) or (1B) to Section 271(1), no burden lies on the AO to record separate satisfaction/prove concealment to the hilt and accordingly by simple mentioning of the fact position of no explanation from the assessee in view of explanations 1(A) and 1(B) would by legal fiction constitute satisfaction as to concealment because of deeming provisions.**

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Subsequently, the Allahabad High Court went into this issue in the case of *ShyamBiri Works (P) Ltd. vs. CIT (2003) 185 CTR (All) 510*. After considering all the above decisions, it has held that "With profound respect to the Delhi High Court decision, we are unable to agree.... We are, therefore, of the opinion that although the Assessing Officer must have satisfaction as required under section 273 of the Act, it is not necessary for him to record that satisfaction in writing before initiating penalty proceedings under section 273 of the Act."

In view of conflicting judicial opinion on this issue, a new sub-Section (1B) in Section 271 of the Income-tax Act, 1961 has been inserted by Finance Act 2008 w.r.e.f. 01-04-1989 to protect the interest of the revenue. As per the amendment, a mere direction for initiating of penalty proceedings under sub-Section (1) of Section 271, shall be deemed to constitute satisfaction of the Assessing Officer for initiating penalty proceedings under sub-Section (1) of that Section. [CBDT circular No. 1/2009 dated 27-03-2009]

However, the Hon'ble Delhi High Court in the case of *Madhushree Gupta vs. Union of India (2009) 317 ITR 107 (Del.)* has clearly held that the Position of law both pre and post amendment [i.e. pre and post Section 271(1B)] is similar, in as much, the AO will have to arrive at a prima facie satisfaction during the course of proceedings with regard to the assessee having concealed particulars of income or furnished inaccurate particulars, before he initiates penalty proceedings. At the stage of initiation of penalty proceedings, the order passed by the AO need not reflect satisfaction vis-a-vis each and every item of addition or disallowance if overall sense gathered from the order is that a further prognosis is called for.

To summarise, as observed by the Court, post-amendment the mandates of penal provisions under Section 271(1)(c) remained intact. The Court saw no merit in the argument of the Department that prior to the impugned amendment "satisfaction" both at the initiation stage and at the stage of imposition was required. However, with the insertion of the Section 271(1B), 'satisfaction' only at the stage of imposition of penalty is required.

The High Court pointed out that Section 271 S(1) (c) has to be read in consonance of Section 271 (1B). If Section 271(1B) is read in isolation, the Assessing Officer would in such a situation be in a position to pick a case for initiation of penalty merely because

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**Initiation of penalty proceedings in the assessment order is a sine qua non for initiation of penalty proceedings u/s 271(1)(c). Further, the initiation of proceedings should be clear i.e. whether it is for concealment of income or for furnishing of inaccurate particulars of income.**

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there is an addition or disallowance without arriving at a *prima facie* satisfaction with respect to infraction by the assessee of clause (c) of sub-Section (1) of Section 271 of the Act: A requirement which is mandated by the provision itself.

The above decision has been followed by the Hon'ble ITAT Delhi in *Global Green Company Ltd. vs. DCIT (ITA No.1390/Del/2011) Dt. 13.07.12* and held that: "Despite the insertion of sub-section (1B) to s.271, the necessity for "prima facie satisfaction" for initiation of penalty proceedings continues to be a jurisdictional fact. The AO has to record the finding that there was concealment of income. In the s. 43(3) assessment order, the AO has not mentioned a word that there was furnishing of inaccurate particulars or concealment of income. He made the addition merely on the ground that the assessee was not able to produce any evidence for writing off of the amount in the books of account. As the satisfaction that the assessee had concealed income or furnished inaccurate particulars of such income is not discernible from the assessment order, the penalty order suffers from lack of jurisdiction."

**What amounts to prima facie satisfaction as discernible from assessment order?**

The issue is very peculiar and can be decided, depending on the facts and circumstances of each case. However, as guided by the Hon'ble Karnataka High Court in case of *Manjunatha Cotton (supra)*, even if there is no specific finding regarding the existence of the conditions mentioned in Section 271(1)(c), *at least the facts set out in explanations 1(A) and 1(B) to section 271(1)(c) should be discernible from the assessment order which would by legal fiction would constitute concealment because of deeming provisions.*

The latest and startling judicial view on the issue is that of the Hon'ble Karnataka High Court in *CIT vs. MWP Ltd. [2014] 41 taxmann.com 496* wherein the term *direction* as appearing in Section 271(1B) has been interpreted by the court and held as follows:

**Held:**

*...Merely saying that penalty proceedings are being initiated will not satisfy the requirement. The direction to initiate proceedings should be clear and not be ambiguous. It is well settled law that fiscal statutes are to be construed strictly and more so the deeming provisions by way of legal fiction are to be construed more strictly. They have to be interpreted only for the said issue for which it has deemed and the manner in which the deeming has been contemplated to be restricted in the manner sought to be deemed. As the words used in the legal fiction or the deeming provisions of Section 271(1B) is Direction, it is imperative that the assessment order contains a direction. Use of the phrases like (a) penalty proceedings are being initiated separately and (b) penalty proceedings under Section 271(1) (c) are initiated separately, do not comply with the meaning of the word direction as contemplated even in the amended s. 271(1B). A direction by a statutory authority is in the nature of an order requiring positive compliance. When it is left to the option and discretion of the ITO whether or not take action, such writing cannot be described as a direction. [RajinderNath vs. CIT [1979] 120 ITR 14(SC) followed]*

**Exception to above mandates regarding recording of satisfaction:**

As in case of Explanations (1A)/(1B) (discussed above), the above mandate need not be followed by the AO if the case being squarely covered by and the AO invokes any of the explanations [Expln. 2 read with Section 271(1A), Expln. 3, 5, 5A or 7] to Section 271(1) because of deeming fictions created by the respective explanations. *[It is to be noted that Explanation being part of the main provision, can be invoked by the AO at the time of levy of penalty even if it is not invoked at the time of initiation of penalty proceeding/in the notice u/s. 271.—K. P. Madhusudhanan vs. CIT 251 ITR 99 (SC)]*

**C. Levy of Penalty under Section 271(1)(c)**

This is the last stage of the penalty proceedings (which is independent of assessment proceedings) and as a general rule; authority initiating penalty proceedings can only levy the same by way of separate order to that effect. Obviously, it is incumbent upon the Assessing Officer to record his satisfaction beyond doubt before levying the penalty, as clarified by CBDT *vide* its circular No. 1/2009 (*supra*).

To elaborate, the Hon'ble Allahabad High court in the case of *Crossings Infrastructure (P.) Ltd. vs. CIT [2014] 41 taxmann.com 474 (Allahabad)* went a step further and clarified that *AO's satisfaction isn't enough to levy penalty, he should state reasons for his being satisfied in his order.* It was held that, "reasons" and "conclusions" are two different things and "reasons" must show mental exercise of authorities in arriving at particular conclusion. It is not enough for the AO to merely state his "satisfaction" i.e. conclusion that conditions attracting penalty under Section 271AAA are satisfied. The AO should also state his "reasons" for the 'conclusion'/'satisfaction'.

Though the decision was in the context of penalty under Section 271AAA, the ratio can be applied to penalty proceedings under Section 271(1)(c) in view of the various precedents of the Hon'ble Apex court on the subject matter discussed by the High Court in its order.

However, Explanation (A)/(B) to Section 271(1) raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the Revenue to show that the amount in question constituted the income by recording a satisfaction to that effect. And, the question of recording of separate satisfaction at the time of initiation or levy of penalty does not arise if assessee has not discharged the initial onus placed on him as above. [*MAK Data Pvt. Ltd. vs. CIT, Oct. 30, 2013, (SC)*]

In other words, if there is no explanation at all from the assessee as required by explanation (1A) or (1B) to Section 271(1), no burden lies on the AO to record separate satisfaction/prove concealment to the hilt and accordingly by simple mentioning of the fact position of no explanation from assessee in view of explanations 1(A) and 1(B) would by legal fiction constitute satisfaction as to concealment because of deeming provisions.

**Who can levy the penalty under Section 271(1)(c)?**  
The penalty can be levied by the assessing officer, the CIT (Appeals) and/or the commissioner of Income Tax.

The AO shall levy the penalty for concealment of income on account of additions/disallowances etc. made by him in assessment order. The CIT(A)

shall levy penalty for concealment of income on the enhancements made by him in his appellate order passed under Section 250. And the CIT shall levy the penalty for concealment of income on the additions/disallowances etc. made by him in an order passed under Section 263.

The Hon'ble Allahabad High Court in case of *Shadiram Balmukund (1972) 84 ITR 183* held in clear terms that, the Assessing officer can levy penalty under Section 271(1)(c) on the additions made by him and not on the additions made by CIT(A). Similarly, the CIT(A) can levy penalty on the additions made by him.

**Penalty should be levied for specific default:**

In the order levying the penalty, there should be clear finding and satisfaction to that effect as to whether penalty is levied for "Concealment of Income" or for "Furnishing inaccurate particulars of income". Initiating the penalty proceedings for one limb of the Section and levying the penalty by finding assessee guilty for another limb is illegal. In other words, if proceedings are initiated on charge of concealment then penalty cannot be levied for furnishing of inaccurate particulars of income and vice versa. [*Penalty under Section 271(1)(c) having been initiated for concealment, cannot be sustained on the ground of furnishing of inaccurate particulars of income- Padma Ram Bharali vs. CIT, 110 ITR 54 (Gau.)*]

In the case of *CIT vs. Jyoti Ltd. [2013] 34 taxmann.com 65*, the assessing officer in his penalty order noted as under:-

*"In view of the above facts, it is clear that the assessee concealed income/furnished inaccurate particulars of income. I, therefore, consider it a fit case for levy of penalty under Section 271(1)(c)"*

The Hon'ble Gujrat High Court in the above case held that, where the Assessing Officer in order of penalty did not come to a clear finding regarding the penalty being imposed on concealment of income or on furnishing inaccurate particulars of income, the

**In the order levying the penalty, there should be clear finding as to whether penalty is levied for "Concealment of Income" or for "Furnishing inaccurate particulars of income". Initiating the penalty proceedings for one limb of the Section and levying the penalty by finding assessee guilty for another limb is bad in law.**

Tribunal was justified in setting aside the impugned penalty order. [*New Sorathia Engg. Co. vs. CIT* [2006] 282 ITR 642 (GUJ) followed]

#### Similar views:

- **The Hon'ble ITAT, Jodhpur bench in the case of *Kansara Bearings Ltd vs. ACIT* [2013] 35 *taxmann.com* 188.**

**Held:** Whether Assessing Officer has to clearly show-cause assessee as to which of two defaults, [i.e., assessee has concealed particulars of his income or furnished inaccurate particulars of such income] have been committed by assessee and only when assessee is put to that defence penalty under Section 271(1)(c) can be imposed - Held, yes

- ***DCIT vs. B.J.D. Paper products* [2012] 17 *taxmann.com* 11 (Luck.)**

**Held:** In case of imposition of penalty under Section 271(1)(c), it is incumbent upon the Assessing Officer to come to a positive finding as to whether there was concealment of income by assessee or whether any inaccurate particulars of such income had been furnished by assessee.

#### Conclusion

Initiation of penalty proceedings in the assessment order is a *sine qua non* for initiation of penalty proceedings under Section 271(1)(c). Further, the initiation of proceedings should be clear *i.e.* whether it is for concealment of income or for furnishing of inaccurate particulars of income.

Despite the insertion of sub-Section (1B) to Section 271, the necessity for “*prima facies satisfaction*” for initiation of penalty proceedings continues to be a jurisdictional fact & the same should be discernible from the body of assessment order.

In the order levying the penalty, there should be clear finding as to whether penalty is levied for “Concealment of Income” or for “Furnishing inaccurate particulars of income”. Initiating the penalty proceedings for one limb of the Section and levying the penalty by finding assessee guilty for another limb is bad in law.

#### References:

- 1) *Income-tax Act, 1961*
- 2) *CTR Encyclopedia on Indian Tax Laws* by CCH
- 3) [www.taxmann.com](http://www.taxmann.com) . ■

