

**IT : Where assessee claimed depreciation on non-existent assets, penalty under section 271(1)(c) was to be levied for filing inaccurate particulars of income**

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**[2018] 93 taxmann.com 250 (Madras)**

**HIGH COURT OF MADRAS**

**Sundaram Finance Ltd.**

**v.**

**Assistant Commissioner of Income-tax, Co. Circle VI(4), Chennai\***

**T.S. SIVAGNAM AND N. SESHASAYEE, JJ.**

**T.C. (APPEAL) NOS. 876 & 877 OF 2008†**

**APRIL 23, 2018**

**Section [271\(1\)\(c\)](#), read with section [32](#), of the Income-tax Act, 1961 - Penalty - For concealment of income (Disallowance of claim, effect of) - Assessment year 1994-95 - Assessee-company, engaged in business of leasing of assets, purchased air pollution control equipment from company, PE and leased back same to company, PIL - During search conducted upon premises of PE, Assessing Officer found that no such equipment was supplied by PE to assessee and purchase and lease back transaction entered into between assessee and PIL was not a genuine transaction; rather it was simply a case of providing finance to PIL by assessee and, therefore, assessee was not entitled to depreciation on such equipment - Whether by claiming depreciation on asset/equipment which did not exist or which was never supplied, assessee had not only concealed particulars of its income, but had also furnished inaccurate particulars of income - Held, yes - Whether, therefore, penalty under section 271(1)(c) was to be levied upon assessee for furnishing inaccurate particulars and concealment of income - Held, yes [Paras 12 and 13] [In favour of revenue]**

## **FACTS**

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- The assessee was engaged in the business of hire purchase, equipment leasing and allied activities. The assessee purchased air pollution control equipment from company, PE and leased back same to company, PIL. A search under section 132 was conducted in the case of PE by the Investigation Wing during which a sworn statement was recorded from a Managing Partner of the said company, that his company had not sold any air pollution control equipment to any leasing company including the assessee-company. It was found that various current accounts were opened in the name of PE company showing different proprietors at different addresses and amounts received from various finance companies were deposited in those accounts and such amounts were withdrawn in cash or through cheque and major portion of the amount was transferred in favour of PIL, with whom the assessee had entered into lease transaction.
- Based on the information received, the Assessing Officer found that no air pollution control equipment was supplied and even though it was stated that the assessee-company sent a person for inspection, the inspection report was vague and therefore, concluded that no inspection was in fact carried out. The Assessing Officer

treated the lease transaction entered into with PIL, by the assessee, as finance transaction. The Assessing Officer pointed out that the primary condition for claiming depreciation was not only that the asset must be owned by the assessee used for business and, therefore, before claiming depreciation, it was a duty of the assessee to ensure that the assets existed. Therefore, it was held that merely relying on the version of the lessee or on a self-serving inspection report did not exonerate the assessee from its obligations. Thus, it was concluded that by claiming depreciation on machinery which did not exist or which was never supplied, the assessee had not only concealed particulars of its income, but had also furnished inaccurate particulars of income. Thus, the Assessing Officer disallowed the depreciation and levied penalty under section 271(1)(c).

- Before the appellate authority, the assessee had admitted that they had claimed depreciation on an asset which was not in existence and therefore, the finding of the Assessing Officer was confirmed. The levy of penalty was also upheld on the ground that the assessee concealed particulars of its income and furnished inaccurate particulars.
- On appeal, the Tribunal also upheld the order of the Commissioner (Appeals).
- On appeal to the High Court:

## **HELD**

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- Penalty under the said section is a civil liability, *mens rea* is not an essential element for imposing penalty for breach of civil obligations or liabilities, wilful concealment is not an essential ingredient for attracting civil liability, existence of conditions stipulated in section 271(1)(c) is a *sine qua non* for initiation of penalty proceedings under section 271 and the existence of such conditions should be discernible from the assessment order or order of the appellate authority or revisional authority, the imposition of penalty is not automatic, imposition of penalty even if the tax liability is admitted is not automatic and if explanation offered is not substantiated, an order imposing penalty could be passed. Notice proposing to impose penalty should specifically state the grounds mentioned in section 271(1)(c) and findings recorded in the assessment proceedings insofar as concealment of income and furnishing of inaccurate particulars would not operate as *res judicata* in penalty proceedings and it is open to the assessee to contest the said proceedings on merits. [Para 10]
- The assessee's case before the authorities and the Tribunal was that it claimed depreciation on a genuine belief that the transaction was *bona fide* and that the depreciation was claimed on the basis of documents and other evidence made available to it at that point of time in good faith. Therefore, the assessee contended that it has neither concealed any particulars of income nor furnished any inaccurate particulars of income. [Para 11]
- The entire issue came to light on account of a search under section 132 was conducted in the case of PE company by the Investigation Wing during which a sworn statement was recorded from a Managing Partner of the said company, who had stated that his company had not sold any air pollution control equipment to any leasing company including the assessee-company. It was found that various current accounts were opened in the name of company, PE showing different proprietors at different addresses and amounts received from various finance companies were deposited in those accounts and such amounts were withdrawn in cash or through

cheque and major portion of the amount was transferred in favour of PIL, with whom the appellant/assessee had entered into lease transaction. Based on the information received, the Assessing Officer found that no air pollution control equipment was supplied and even though it was stated that the assessee-company sent a person for inspection, the inspection report was vague and therefore, concluded that no inspection was in fact carried out. The Assessing Officer pointed out that the primary condition for claiming depreciation was not only that the asset must be owned by the assessee used for business and therefore, before claiming depreciation, it was a duty of the assessee to ensure that the assets exist. Therefore, it was held that merely relying on the version of the lessee or on a self-serving inspection report does not exonerate the assessee from its obligations. Thus, it was concluded that by claiming depreciation on machinery which did not exist or which was never supplied, the assessee had not only concealed particulars of its income, but had also furnished inaccurate particulars of income. [Para 12]

- The appellate authority, who confirmed the order passed by the assessing authority, held that there was no asset in existence and the assessee themselves accepted said fact and reversed the claim for depreciation and therefore, the assessee had concealed particulars of its income and furnished inaccurate particulars. The correctness of this order was tested before the Tribunal. The Tribunal confirmed the order of levying penalty. Thus, if the facts are tested on the anvil of the legal principles as has been stated above, it is not necessary that there should be wilful concealment for attracting a civil liability of penalty under section 271(1)(c). The existence of the condition mentioned under section 271(1)(c) are writ large on the face of the order of the Assessing Officer as well as the first appellate authority. The authorities concurrently rejected the explanation offered by the assessee. One is in agreement with the factual findings rendered by the authorities since the petitioner is a leasing company as it is very hard to believe a case where the leasing company had made advances for leasing out a machinery, which never in existence. That apart, the assessee has not mentioned either before the lower authorities or before this Court as to what action they had initiated against the lessee, who is alleged to have committed fraud. The entire issue would not have come to light but for the search conducted in the case of PE company and when the assessee was confronted with the findings, they have voluntarily reversed depreciation claimed by them. Thus, the Assessing Officer, first appellate authority and the Tribunal rightly held that the assessee is liable for penalty. [Para 13]
- The assessee further seeks to contend that the notices issued under section 274 read with section 271 are vitiated since it did not specifically state the grounds mentioned in section 271(1)(c). [Para 15]
- The relevant columns of the notice have been marked, more particularly, when the case against the assessee is that they have concealed particulars of income and furnished inaccurate particulars of income. Therefore, the contention raised by the assessee is liable to be rejected on facts. That apart, this issue can never be a question of law in the assessee's case, as it is purely a question of fact. Apart from that, the assessee had at no earlier point of time raised the plea that on account of a defect in the notice, they were put to prejudice. All violations will not result in nullifying the orders passed by statutory authorities. If the case of the assessee is that they have been put to prejudice and principles of natural justice were violated on account of not being able to submit an effective reply, it would be a different matter. This was never the plea of the assessee either before the Assessing Officer or before the first

appellate authority or before the Tribunal or before this Court when the Tax Case Appeals were filed and it was only after 10 years, when the appeals were listed for final hearing, this issue is sought to be raised. Thus on facts, one could safely conclude that even assuming that there was defect in the notice, it had caused no prejudice to the assessee and the assessee clearly understood what was the purport and import of notice issued under section 274 read with section 271. Therefore, principles of natural justice cannot be read in abstract and the assessee, being a limited company, having wide network in various financial services, should definitely be precluded from raising such a plea at this belated stage. [Para 16]

- Thus, for the above reasons, substantial questions of law are answered against the assessee and in favour of the revenue. [Para 17]

## CASE REVIEW

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*CIT v. Manjunatha Cotton & Ginning Factory* [\[2013\] 359 ITR 565/218 Taxman 423/35 taxmann.com 250 \(Kar.\)](#) (para 10) followed.

*CIT v. Jindal Equipments Leasing and Consultancy Services Ltd.* [\[2010\] 325 ITR 87 \(Delhi\)](#) (para 10) distinguished.

## CASES REFERRED TO

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*CIT v. Jindal Equipments Leasing & Consultancy Services Ltd.* [\[2010\] 325 ITR 87 \(Delhi\)](#) (para 7), *CIT v. Manjunatha Cotton & Ginning Factory* [\[2013\] 359 ITR 565/218 Taxman 423/35 taxmann.com 250 \(Kar.\)](#) (para 7), *CIT v. SSA's Emerald Meadows* [\[2016\] 73 taxmann.com 248/242 Taxman 180 \(SC\)](#) (para 7), *Muninaga Reddy v. Asstt. CIT* [\[2017\] 396 ITR 398/88 taxmann.com 545 \(Kar.\)](#) (para 7) and *Lakshmi Vilas Bank Ltd. v. CIT* [\[2006\] 284 ITR 93/154 Taxman 301 \(Mad.\)](#) (para 13).

**R. Vijayaraghavan**, Adv. for the Appellant. **Karthik Ranganathan**, Sr. Standing Counsel, **D. Prabu Mukunth Arunkumar** and **Vijayakumar Punna**, Junior Standing Counsel for the Respondent.

## JUDGMENT

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**T.S. Sivagnanam, J.** - These appeals by the Assessee are directed against the order passed by the Income Tax Appellate Tribunal, Madras 'C' Bench in I.T.A.No.1497/Mds/2003 and I.T.A.No.1498/Mds/2003 for the Assessment Years 1995-96 and 1996-97.

2. These appeals have been admitted on 31.07.2008 on the following substantial questions of law:

- "1. Whether on the facts and in the circumstances of the case, the Tribunal was right in confirming the levy of penalty under Section 271(1)(c) without appreciating the evidences filed by the appellant?
2. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the appellant had claimed depreciation by furnishing inaccurate and false particulars and therefore liable to penalty under Section 271(1)(c) of the Act?"

3. Mr. R. Vijayaraghavan, learned counsel for the appellant filed a memo seeking permission to raise additional substantial question of law with regard to the defect in the notice issued under Section 271(1)(c) of the Income Tax Act, 1961.

4. We have heard the learned senior counsel for the Revenue on the prayer made and subject to the

objection by the Revenue the following additional substantial question of law is also framed for consideration:

"Whether a notice issued under Section 27(1)(c) of the Act which does not show the default which assessee was required to explain is a valid notice for levy of penalty?"

5. The appellant is in the business of hire purchase, equipment leasing and allied activities. For the Assessment year 1995-96, the Assessing Officer treated the lease transaction entered into with M/s. Prakash Industries Ltd., by the appellant, as finance transaction. As there were certain irregularities with regard to supply of machinery, the Assessing Officer disallowed the depreciation and levied penalty under Section 271 (1)(c) of the Act. Aggrieved by the same, the appellant preferred appeal before the Commissioner of Income Tax (Appeals). Before the Appellate Authority, the appellant had admitted that they had claimed depreciation on an asset which was not in existence and therefore, the finding of the Assessing Officer was confirmed. The levy of penalty was also upheld on the ground that the appellant concealed particulars of its income and furnished inaccurate particulars. The appellant preferred appeal to the Tribunal for both the Assessment years and by the common impugned order, the appeals have been dismissed. Challenging the said order, the appellant has filed these appeals raising above two substantial questions of law and one additional substantial question of law.

6. The learned counsel for the appellant submitted that the Tribunal ought to have appreciated that the appellant had entered into the transaction in a bonafide manner, in the normal course of business and came to know of the irregularities on the part of the lessee only during the course of reassessment proceedings and therefore, penalty was not leviable. It is further submitted that the assessee had entered into the lease transaction by obtaining invoices, making payment directly to a supplier and getting relevant documents that were necessary at that point of time and there was no reason to doubt the genuineness of the transaction. Further it is submitted that the assessee had voluntarily withdrawn the claim of depreciation when it came to know that the transaction was not genuine. Further it is submitted that there is no fraud or negligence on the part of the assessee and the assessee had offered explanation which was neither disproved nor found to be lacking in bonafides. Therefore, it is submitted that the impugned order passed by the Tribunal requires to be interfered and the questions of law be answered in favour of the appellant.

7. Learned counsel placed reliance on the decision of the High Court of Delhi in the case of *CIT v. Jindal Equipments Leasing and Consultancy Services Ltd.* [\[2010\] 325 ITR 87](#) for the proposition that though the third substantial question of law which has been framed for consideration was not raised earlier, that being a pure question of law, can be allowed to be raised by amendment to the appeal memo. Reliance was placed on the decision of the High Court of Karnataka in *CIT v. Manjunatha Cotton & Ginning Factory* [\[2013\] 359 ITR 565/218 Taxman 423/35 taxmann.com 250](#) to support the contention that the notice issued under Section 274 of the Act should specifically set the grounds mentioned in Section 271(1)(c) of the Act i.e., whether it is for concealment of income or furnishing of inaccurate particulars of income and mere sending of printed form where all grounds mentioned in Section 271 are mentioned would not satisfy the requirement of law. It is submitted that the decision in the case of Manjunatha Cotton Mills has been confirmed by the Hon'ble Supreme Court in *CIT v. SSA's Emerald Meadows* [\[2016\] 73 taxmann.com 248/242 Taxman 180 \(SC\)](#). Reliance was also placed on the decision of High Court of Karnataka in *Muninaga Reddy v. Asstt. CIT* [\[2017\] 396 ITR 398/88 taxmann.com 545](#) to support the submission that the assessee should know the grounds for which notice under Section 271(1)(c) of the Act was issued, otherwise principles of natural justice would be violated.

8. Mr. Karthik Ranganathan, learned Senior Standing Counsel appearing for the revenue pointed out that three authorities have rendered concurrent findings and found that the order of penalty is sustainable and

the grounds raised by the petitioner are entirely factual and no substantial questions of law arises for consideration in these appeals. With regard to the third question, which has been framed for consideration, it is submitted that it was never an issue which was raised by the Assessee at an earlier point of time and therefore, the said question should not be permitted to be raised by the Assessee at this stage. Without prejudice to such submission, it is submitted that the notice issued under Section 274 r/w. Section 271 of the Act on 28.03.2002 has clearly indicated that the assessee has concealed particulars of income and furnished inaccurate particulars and both aspects are attracted. In any event, it being a factual issue and not raised by the assessee at any earlier point of time, cannot be permitted to be raised at this juncture.

**9.** Heard the learned counsels' for both sides.

**10.** The Division Bench of the Karnataka High Court in *Manjunatha Cotton mills's (supra)* after taking note of the decision of the Hon'ble Supreme Court, summarized the principles with regard to levy of penalty under Section 271(1)(c) of the Act. It held that penalty under the said Section is a civil liability, mens rea is not an essential element for imposing penalty for breach of civil obligations or liabilities, wilful concealment is not an essential ingredient for attracting civil liability, existence of conditions stipulated in Section 271(1)(c) is a sine qua non for initiation of penalty proceedings under Section 271 and the existence of such conditions should be discernible from the Assessment order or order of the Appellate Authority or Revisional Authority, the imposition of Penalty is not automatic, imposition of penalty even if the tax liability is admitted is not automatic and if explanation offered is not substantiated, an order imposing penalty could be passed. Notice proposing to impose penalty should specifically state the grounds mentioned in Section 271(1)(c) and findings recorded in the assessment proceedings insofar as concealment of income and furnishing of inaccurate particulars would not operate as resjudicata in penalty proceedings and it is open to the Assessee to contest the said proceedings on merits.

**11.** Bearing the above legal principle in mind, we examined the factual position of the case on hand. The Assessee's case before the authorities and the Tribunal was that it claimed depreciation on a genuine belief that the transaction was bonafide and that the depreciation was claimed on the basis of documents and other evidence made available to it at that point of time in good faith. Therefore, the assessee contended that it has neither concealed any particulars of income nor furnished any inaccurate particulars of income.

**12.** The entire issue came to light on account of a search under Section 132 of the Act conducted in the case of Pioneer Engineering Company by the Investigation Wing at Ranchi, during which a sworn statement was recorded from a Managing Partner of the said Company, who had stated that his company has not sold any air pollution control equipment to any leasing company including the assessee company. It was found that various Current Accounts were opened in the name of Pioneer Engineering Company showing different Proprietors at different addresses and amounts received from various finance companies were deposited in those accounts and such amounts were withdrawn in cash or through cheque and major portion of the amount was transferred in favour of M/s. Prakash Industries Ltd., with whom the appellant/assessee had entered into lease transaction. Based on the information received, the Assessing Officer found that no air pollution control equipment was supplied and even though it was stated that the Assessee company sent a person for inspection, the inspection report was vague and therefore, concluded that no inspection was in fact carried out. The Assessing Officer pointed out that the primary condition for claiming depreciation was not only that the asset must be owned by the assessee used for business and therefore, before claiming depreciation, it was a duty of the assessee to ensure that the assets exist. Therefore, it was held that merely relying on the version of the lessee or on a self-serving inspection report does not exonerate the assessee from its obligations. Thus, it was concluded that by claiming depreciation on machinery which did not exist or which was never supplied,

the assessee has, not only concealed particulars of its income, but has also furnished inaccurate particulars of income.

**13.** The Appellate Authority, who confirmed the order passed by the Assessing Authority, held that there was no asset in existence and the assessee themselves accepted the fact and reversed the claim for depreciation and therefore, the assessee had concealed particulars of its income and furnished inaccurate particulars. The correctness of this order was tested before the Tribunal. The Tribunal by referring to the decision of this Court in the case of *Lakshmi Vilas Bank Ltd. v. CIT* [2006] 284 ITR 93/154 Taxman 301 (Mad.) confirmed the order of levying penalty. Thus, if the facts are tested on the anvil of the legal principles as has been stated above, it is not necessary that there should be wilful concealment for attracting a civil liability of penalty under Section 271(1)(c) of the Act. The existence of the condition mentioned under Section 271(1)(c) of the Act are writ large on the face of the order of the Assessing Officer as well as the first appellate authority. The authorities concurrently rejected the explanation offered by the assessee. We are in agreement with the factual findings rendered by the authorities since the petitioner is a leasing company as it is very hard to believe a case where the leasing company had made advances for leasing out a machinery, which never in existence. That apart, the assessee has not mentioned either before the lower authorities or before this Court as to what action they had initiated against the lessee, who is alleged to have committed fraud. The entire issue would not have come to light but for the search conducted in the case of Pioneering Engineering Company and when the assessee was confronted with the findings, they have voluntarily reversed depreciation claimed by them. Thus, we find that the Assessing Officer, first appellate authority and the Tribunal rightly held that the assessee is liable for penalty.

**14.** With regard to the third substantial question of law, which has been framed for consideration, firstly we wish to point out that such a contention was never raised by the assessee at any point of time. The argument of the learned counsel for the petitioner is that this being a question of law can be allowed to be raised at this stage. To support his contention, learned counsel placed reliance on the decision in *Jindal Equipments Leasing and Consultancy Services Ltd.*, case. We find that the said decision does not in any manner assist the case of the assessee for the reason that the contention before the High Court of Karnataka was that initially a question of law was raised with regard to the addition under Section 41 of the Act and the appellant/revenue conceded that Section 41 has no applicability to the facts of the case. This was the reason for amending the memo of appeal and as the attempt of the revenue was that the said amount could still be treated as income at the hands of the assessee within the meaning of Section 28 of the Act is not applicable. The Court, having considered the question which was raised, held that though the Tribunal held that Section 41(1) does not apply to which legal position was conceded by the counsel for revenue. Revenue still wanted that the addition be sustained under provisions of Clause (iv) of Section 28 of the Act and the submissions was on these very facts, provisions of Section 28(iv) of the Act shall be attracted, this will still hold to be a pure question of law and therefore, the amendment of the grounds sought for by the revenue was allowed.

**15.** Before us, the assessee seeks to contend that the notices issued under Section 274 r/w. Section 271 of the Act are vitiated since it did not specifically state the grounds mentioned in Section 271(1)(c) of the Act.

**16.** We have perused the notices and we find that the relevant columns have been marked, more particularly, when the case against the assessee is that they have concealed particulars of income and furnished inaccurate particulars of income. Therefore, the contention raised by the assessee is liable to be rejected on facts. That apart, this issue can never be a question of law in the assessee's case, as it is purely a question of fact. Apart from that, the assessee had at no earlier point of time raised the plea that on account of a defect in the notice, they were put to prejudice. All violations will not result in nullifying the orders passed by statutory authorities. If the case of the assessee is that they have been put to



prejudice and principles of natural justice were violated on account of not being able to submit an effective reply, it would be a different matter. This was never the plea of the assessee either before the Assessing Officer or before the first Appellate Authority or before the Tribunal or before this Court when the Tax Case Appeals were filed and it was only after 10 years, when the appeals were listed for final hearing, this issue is sought to be raised. Thus on facts, we could safely conclude that even assuming that there was defect in the notice, it had caused no prejudice to the assessee and the assessee clearly understood what was the purport and import of notice issued under Section 274 r/w, Section 271 of the Act. Therefore, principles of natural justice cannot be read in abstract and the assessee, being a limited company, having wide network in various financial services, should definitely be precluded from raising such a plea at this belated stage.

**17.** Thus, for the above reasons, Substantial Questions of law Nos. 1 and 2 are answered against the assessee and in favour of the revenue. The additional substantial question of law, which was framed is rejected on the ground that on facts the said question does not arise for consideration as well as for the reasons set out by us in the preceding paragraphs.

In the result, Tax Case Appeals are dismissed. No costs.

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\*In favour of revenue.

†Arising out of order of ITAT, in IT Appeal Nos. 1497 & 1498 (Mds.) of 2003, dated 25-1-2007.