INTERPRETATION OF SECTION 147 OF THE INCOME TAX ACT, 1961: JUDICIAL TRENDS

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Section 147 of the Income Tax Act, 1961 provides for the reopening of assessment proceedings. This section gives discretion to the Assessing Officer (AO) to reopen the assessment proceedings when he/she has reason to believe that some of the income has escaped assessment. This section has been under judicial scrutiny because the words of the section give opportunity for subjective exercise of the power. Sometimes, this could go further and lead to arbitrary use of power. The judicial interpretation of this section has been very interesting. The courts have constantly strived to ensure that the AO does not misuse the discretion given to him under the provision. Further, the amendments to the wordings of the section have also been extensively discussed and debated. The words of the section such as "reason to believe" and "material information" have been the objects of judicial scrutiny. In this paper, an attempt has been made to understand the meanings of these words. Further, the judicial trends in the interpretation of this section have also been discussed so far as understanding the reasons for reopening proceedings go.

1. Introduction

Section 147 of the Income Tax Act, 1961 (hereinafter referred to as "the Act") talks about the reopening of assessment proceedings.[1] In simple words, the section lays down the requirements of reopening the assessment proceedings when the Assessing Officer (AO) has reason to believe that the income has escaped assessment. Section 147 is similar to Section 263 of the Act where the Commissioner can reopen the assessment proceedings if he/she feels that the proceedings were decided prejudicial to the revenue. This is how it differs from Section 147: it requires the Commissioner and not the Assessing Officer to reopen the proceedings.

The section essentially deals with income escaping assessment. It empowers the AO to reopen the proceedings if he has reason to believe that the whole income or part of the income has not been taken into consideration during assessment proceedings. The section identifies two essentials to the reopening of assessment proceedings. The AO must have "sufficient reason to believe" that

the income had escaped assessment and, secondly, there may be income which has come to his notice subsequently after the assessment proceedings have been closed.

There can be a failure on part of the AO during the initial assessment proceedings to account for a portion of the income, or there was failure to take into account depreciation etc. due to which there was wrong assessment. In such a case, the provisions of Section 147 would be applicable and the proceedings can be reopened and examined again. Explanation 2 to Section 147 enlists other conditions under which the section is applicable; which is when the income has been assessed but there has been under-assessment, the income has been assessed at too low a rate, excessive relief has been provided and/or excessive loss, depreciation allowance or any other allowance has been computed under the provisions of the Act.

At the very outset, it must be mentioned that the Apex Court has also laid down three stages in the assessment process. Firstly, the primary or material facts are disclosed by the Assessee. Then, inferences are drawn from the primary facts. The last stage is to draw legal inferences from the primary facts.[2]

2. Judicial Trends in Interpreting Section 147

The Supreme Court has held that two conditions have to be satisfied for the Assessing Officer to issue a notice under Section 148 of the Act, as a consequence of the requirement to reopen assessment proceedings. They are as follows:

(*i*) The Income Tax Officer must have reason to believe that income chargeable to tax has escaped assessment;

(*ii*) He must have reason to believe that such income has escaped assessment by reason of the omission or failure on the part of the Assessee to disclose fully and truly material facts necessary for his assessment for that year.[3]

In the same case where the court laid down the aforementioned conditions, depreciation allowance had not been calculated correctly. The Appellant had pleaded before the High Court that it had disclosed fully all the relevant and material facts. However, this petition was dismissed

by the High Court as it was found that some information regarding the acquisition of assets by the company had not been furnished by the Appellant.

The Court has constantly been of the view that it is the duty of the Assessee to make a full and complete disclosure of the primary facts. The Assessee has a duty, therefore, to furnish all the material facts before the AO at the time of assessment proceedings. However, the Assessee does not have any duty beyond this. It is then the work of the AO to draw inference from all the material facts and act accordingly.[4] The duty of the Assessee does not extend beyond making a full and complete disclosure.

What amounts to a material fact is dependent on the unique circumstances of every case. Producing the account books or other evidence from which material evidence could with due diligence have been discovered by the Income-tax Officer will not necessarily amount to disclosure under the Income Tax law.

The Direct Tax Amendment Act, 1987, which came into effect in 1989, brought about changes in the interpretation of Section 147. Instead of laying down two conditions which had to be fulfilled in order for the AO to reopen assessment proceedings, it laid down that if the AO has reason to believe that the income has escaped assessment, he can reopen the proceedings.[5]

2.1 Interpretation of "Reason to Believe"

Another significant aspect to be noted is that the AO must ensure that he has sufficient reason to believe that the income escaped assessment for fault on part of the Assessee. This is essentially failure of the Assessee to disclose information which affects the assessment proceedings. Obviously, the acquisition of a capital asset would affect the income of the Assessee and failure to inform the AO of acquisition regarding the same would mean that there has been non-disclosure of an essential fact. The AO will have jurisdiction to reopen the proceedings only when the above conditions are fulfilled. The judiciary has time and again thrown light on the meaning of this term. The standard laid down has been that of an honest and reasonable person, who will act on reasonable grounds and come to a rational conclusion.

A very important conclusion that flows from the above case law is that mere change in opinion will not give the Officer reason to reopen assessment proceedings.[6] If he forms an opinion during the original assessment proceedings on the basis of the material facts and subsequently finds it to be erroneous; it is not a valid reason under the law to reopen assessment.[7] If at the time of the original proceedings, the AO had examined all the facts on record and come to a decision, belief on his part that there was some error in the decision and use this as a basis for reopening of proceedings.[8] Even if any other officer believes, due to a change in opinion, that the proceedings should be reopened, this is not a reason to evoke Section 147.[9]

The Court has been of the opinion that the term "reason to believe" is not the subjective satisfaction of the AO. It means an objective view of the kind of information that is required to be disclosed in that particular case.[10] The term is to be interpreted as reason to believe and not "reason to suspect". This means that mere instinct on part of the officer that there has been some error in assessment is not enough to evoke reopening under this section. It has to be based on a firm and concrete belief based on facts that the income had escaped assessment.

It is interesting to note that Section 34 of the 1922 Act, which dealt with reopening of assessment proceedings, made use of the words "definite information". This was amended in 1948. Non-usage of these words however does not mean that the information used as a basis of reopening can be vague.[11] It was amended in order that the scope of the section can be widened. In other words, the information that is required to be disclosed can be changed according to the circumstances of the case, for instance the kind of business the parties are involved in.

The AO is expected to act mechanically and deduce what amounted to non-disclosure, when he makes out a case for reopening of assessment proceedings. The use of the words "change in opinion" is therefore to act as an internal check on the exercise of power by the Officer.

It has been observed that:

> "The function of the Assessing Officer is to administer the Act with solicitude for public treasury and with fairness to the taxpayers. If the conclusive and final judicial decision is holding the field then, the identical issue cannot be a subject-matter of administrative decision

under Sections 147 and 148. Thus, the impugned notice issued under Section 148 and reasons recorded in support thereof were liable to be quashed and set aside".[12]

2.2 What Amounts to Material Information?

The focus of the court has been on analysing the information which was furnished during the assessment proceedings; and then deciding as to whether it amounted to a full disclosure. Every case requires disclosure of different information. For instance, when the party is a company which has purchased shares (or is involved in a share transfer agreement), the information regarding the company such as information in the memorandum and articles of association becomes material information.

Further, if the income is still undergoing assessment it cannot be said that income has escaped assessment. This was also held in a decision of the Supreme Court.[13] While the case or the assessment proceedings are going on, the AO cannot declare that the income or some portion of the income has escaped assessment, and cannot reopen the assessment proceedings. This is evident because the "reopening" can be done only when the proceedings have been closed. An important point to be noted is that while reopening of the proceedings under Section 147 cannot take place when the income is undergoing assessment, information which has come to the notice of the Assessing Officer during the assessment proceedings can be the basis of reopening the proceedings.[14]

It is evident that gaping holes in information such as failure to disclose transactions involving giving and taking of loans, or payment of interest, would amount to a non-disclosure of material information. As mentioned before, the materiality of the information would differ from case to case.

However, it is a well-settled position of law that the reassessment is for the benefit of the revenue and not of the Assessee. Therefore, any reassessment which would lead to reduction of the income which was originally assessed would be, in effect, void.[15]

2.3 Limitation Period for Reopening of Proceedings

Section 147 can be evoked within a period of four years from the relevant assessment year. A recent judgment has also highlighted the fact that the Assessee has to be given a reason for reopening of the reassessment proceedings within a period of six years. If the same is not furnished, then the reopening of the assessment proceedings will be invalid.[16]

Under the first proviso to Section 147 where an assessment has been made under Section 143(3),[17] the assessment cannot be reopened after expiry of four years from the end of the relevant assessment year unless if income has escaped assessment by reason of failure on the part of the Assessee to disclose fully and truly all material facts necessary for his assessment.

2.4 Power to Review versus Power to Reassess

It must be understood that the AO has the power to reopen assessment proceedings or reassess the income; but this cannot be confused with the power to review. The AP does not have the power to review the assessment proceedings. The Supreme Court has held that there is a very basic conceptual difference between the two.[18] From a bare reading of the language, power to review involves revision of the decision given after the assessment whereas reopening of the proceedings means that the entire income is re-examined and the assessment process is conducted afresh.

3. Changes in the Law and Analysis

One of the new additions to the interpretations of Section 147 and 148 is that the reopening to assessment proceedings is now time bound. If the reasons supplied for reopening of the proceedings are given late, then even if the requirement of serving notice has been fulfilled; the reopening would be void. It was perhaps the intention of the legislature to leave open a wide scope of interpretation of the proviso under Section 147. However, this also leaves room for misuse of power by the officer and the Court has time and again emphasised the importance of curtailment of the same.

3.1 Check on Arbitrary Use of Power

A recent decision of the Supreme Court has laid down that the Income Tax Department cannot reopen the assessment proceedings arbitrarily. The change that can be seen in the law is that the

use of the word “arbitrarily” has widened the scope of the section. Initially, the Courts followed a very basic interpretation of the section. We have seen that the in the initial stages, the section was interpreted in the strict sense. Though it depended on individual circumstances, the court restricted itself to enlisting the conditions under the section and seeing whether they were fulfilled so as to warrant evoking the legal provision. The condition “reason to believe”, as explained earlier, was confined to a reasonable understanding of the material or primary facts placed on record.

Though the court has kept in mind situations where the ITO may reopen the assessment on a mere change in opinion (based on the same facts), but the use of the word “arbitrary” came much later. It points to the widening interpretation as the judicial understanding has moved further to accommodate the arbitrary use of power by the Officer (ITO or AO).

This arbitrary use of power has been encompassed under Section 147 and the court has done so in order to give a schematic interpretation to the legal provision. This has been a very important point which was time and again reiterated by the Apex Court. Especially after the amending Act of 1989, since the only ground for reopening of assessment proceedings is that the AO must have sufficient reason to believe that the income has escaped reassessment. Therefore, utmost care must be taken that the advantage given to the AO to open proceedings on the basis of a reason to believe is not taken lightly and misuse and abuse of this power is checked. In a writ petition, the writ court is allowed to examine on the facts of the case whether the AO was acting in good faith.**19** This has been held in many Supreme Court decisions.

Another very important bar that has been put on the section is that the AO cannot assess any other income except the one which is not connected with the issues which have been given in the initial notice under Section 148.**20** Further, the AO cannot launch an inquiry for grounds which are not covered by the reassessment notice.**21**

3.2 Interpretation of Conditions Encompassed under the Section by the Courts

The word “opinion” of the AO, it was felt, would give the Officer the freedom to subjectively view the information available to him and arbitrarily decide whether the assessment proceedings should be reopened. It was felt that removal of the term “reason to believe” would lead to the

same. This was held by the Supreme Court in *CIT* v. *Kelvinator of India Ltd.* The change of opinion, however, is not a straightforward issue. If the AO has not taken a conscious decision on the material available to him, the change of opinion cannot be a reason to curtail the reopening of assessment proceedings. In this regard, it has been held by the Apex Court that:

> "The principle that a mere change of opinion cannot be a basis for reopening completed assessments would be applicable only to situations where the Assessing Officer has applied his mind and taken a conscious decision on a particular matter in issue. It will have no application where the order of assessment does not address itself to the aspect which is the basis for reopening of the assessment, as was the position in the instant case."**22**

Further, the court has also held that:

> "If conscious application of mind is made to the relevant facts and material available or existing at the relevant point of time while making assessment and again a different or divergent view is sought, it would tantamount to "change of opinion", whereas, in the case of existing material, no conscious attempt has been made, it would tantamount to mistake in not considering the relevant point or proposition and it would not be a "change of opinion"..."**23**

In other words, if the AO in the first place had not taken a conscious decision based on the material facts put forth by the Assessee, the reopening cannot be challenged on the grounds that there was a "mere change in opinion".

It must be kept in mind that though it is the duty of the Assessee to disclose all the material facts before the authority, the conclusion drawn from these facts was up to the AO.**24** The AO cannot act on a mere suspicion or instinct that there has been error in assessment. The standard that has been laid down is that there must be a nexus between the material placed on record and the decision arrived at the AO regarding reopening of the assessment proceedings. The Court has observed that if the AO has *prima facie* reasonable grounds to believe that income has escaped assessment, this is enough to give him jurisdiction to evoke his powers under Section 147. The standard of proof required is not the same as that required for coming to a final decision.**25**

In a recent judgment of the Supreme Court, the question before the Court was whether the concept of "change of opinion" stands obliterated with effect from 1st April, 1989, i.e. after substitution of Section 147 of the Income Tax Act, 1961 by Direct Tax Laws (Amendment) Act, 1987.**26** The Court in this case observed that there was much resistance to the amendment to the wordings of the section when the words "reason to believe" was omitted. This is the reason why the words were re-introduced in 1989, in order to ensure that the AO does not exercise power in an arbitrary fashion.**27** This case was a landmark ruling and indicates the settled position of the law as regards Section 147.

However, it has also been held that the assessment cannot be reopened on the basis of an Apex Court judgment where the Assessee had fully and completely disclosed all the material facts.**28**

4. Conclusion

As we have observed, Section 147 evolved and changed over time by interpretation of the courts. The amendments in the Income Tax Act, 1961 also brought about significant changes in the understanding and application of the section. Earlier, the section covered two major conditions under which the provisions could be evoked. However, from an analysis of the case laws involving the same, it can be seen that an amendment was required. This was because the scope of the section was widened to suit the individual circumstances of each case.

The focus earlier had largely been on the duty of the Assessee to make a full and complete disclosure of the material facts. This remains a very crucial limb of interpretation of the section. Even now, the courts stress on the fact that the Assessee has to make a *bona fide* disclosure of all the facts and circumstances which are likely to affect the outcome of the proceedings. Now, there is also an emphasis on what amounts to this "material information" and on what ground can the proceedings be validly reopened. However, future events which the Assessee cannot foresee cannot become a reason for challenging the assessment and reopening the assessment proceedings. This implies that the section does not have retrospective application.

The change in the law in 1989, as we have seen, was to include the words "reason to believe". Subsequent judgments have pointed to the fact that these are the operative words of the section.

So long as the AO has sufficient reason to believe that there has been some error on the material placed before the authority, he can reopen the assessment proceedings.

Another important test laid down by the Apex Court is that caution must be taken to ensure that the AO is not arbitrarily exercising the power. Because the scope of the section has been widened, this point has been stressed. The AO cannot give frivolous reasons behind the reopening of assessment. The use of the word "opinion" gives freedom to the AO to make an assessment and base the reopening of assessment proceedings on his own findings. There is scope for misuse of the power and in such cases it must be ensured that this misuse and abuse do not occur. Therefore, on trend that the courts have constantly followed is to make an effort to read this into the language of the section to ensure that the AO does not make arbitrary or frivolous use of this power.

1.147. Income escaping assessment: If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of Sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in Sections 148 to 153 referred to as the relevant assessment year):

Provided that where an assessment under Sub-section (3) of Section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the Assessee to make a return under Section 139 or in response to a notice issued under Sub-section (1) of Section 142 or Section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year.

2. Calcutta Discount Co. Ltd. v. ITO MANU/SC/0113/1960: [1961] 41 ITR 191 (SC); Sheth Bros. v. Jt. CIT MANU/GJ/0298/2001: [2001] 251 ITR 270 (Guj).

3. Parshuram Pottery Works Co. Ltd. v. CIT MANU/SC/0250/1976: [1977] 106 ITR 1 (SC)

4. Income Tax Officer v. Lakhmani Mewal Dass MANU/SC/0241/1976: 103 ITR 437

5. After the Amending Act, 1989, Section 147 reads as under: Income escaping assessment. 147. If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of Sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in Sections 148 to 153 referred to as the relevant assessment year).

6. Jindal Photo Films Ltd. v. Dy. CIT MANU/DE/0729/1998: [1998] 234 ITR 170 (Del)

7. ITO v. Lakmani Mewal Das MANU/SC/0241/1976: 1976 AIR 1753, 1976 SCR (3) 956

8. Sita World Travel (India) Ltd. v. CIT MANU/DE/1562/2004: [2004] 140 Taxman 381 (Del)

9. Supra n.7.

10. Chhugamal Rajpal v. S. P. Chaliha MANU/SC/0241/1971: 79 ITR 603, Calcutta Discount Co. Ltd. v. ITO MANU/SC/0113/1960: 41 ITR 191 and S. Narayanappa and Ors. v. CIT MANU/SC/0124/1966: 63 ITR 219.

11. Supra n.4.

12. Ador Technopack Ltd. v. Dr. Zakir Hussein, DCIT, Writ Petition No. 2228 of 2003 at para 31.
13. Lachhiram Basantalal, In re AIR 1931 Cal. 545; Sir Rajendranath Mukerjee v. CIT [1934] 2 ITR 71 (PC); Hargovindsing Narainsing v. CIT MANU/MH/0008/1972: [1973] 90 ITR 435 (Bom.).
14. Consolidated Photo & Finvest Ltd. v. Asst. CIT [2006] 151 Taxman 41 (Del.).
15. CIT v. Sun Engineering Works (P.) Ltd. MANU/SC/0707/1992: (1992) 198 ITR 297 (SC).
16. CIT v. Tirathram Ahuja (HUF) (2008) 6 DTR (Del) 335.
17. 143(3) On the day specified in the notice issued under Sub-section (2), or as soon afterwards as may be, after hearing such evidence as the Assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the Assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.
18. CIT, Delhi v. Kelvinator of India Limited [2002] 256 ITR 1
19. Consolidated Photo & Finvest Ltd v. Asst. CIT [2006] 151 Taxman 41 (Del), para 9; Kantamani Venkata Narayana & Sons v. First Addl. ITO MANU/SC/0143/1966: [1967] 63 ITR 638
20. Explanation 3 to s. 147 was inserted to supersede the judgments in Vipin Khanna MANU/PH/2123/2001: 255 ITR 220 (P&H) & Travancore Cements 305 ITR 170 (Ker) where it was held that the AO could not assess income in respect of issues unconnected with the issue for which the notice was issued.
21. Vipin Khanna v. CIT (2001) 251 ITR 782 (Del.)
22. Id.
23. Gruh Finance Ltd. v. Jt. CIT MANU/GJ/0027/2000: [2000] 243 ITR 482
24. Calcutta Discount Co. Ltd. v. ITO MANU/SC/0113/1960: 1961] 41 ITR 191 (SC)
25. Praful Chunilal Patel v. M.J. Makwana, Asstt. CIT MANU/GJ/0059/1998: [1999] 236 ITR 832
26. CIT v. Kelvinator Of India Ltd.
27. See Income Tax Circular No. 549, dated October 31, 1989
28. Indra Co. Ltd. v. ITO MANU/WB/0150/1970: (1971) 80 ITR 559 (Cal)