IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA Nos.793/2006 and 805/2006

COMMISSIONER OF INCOME TAX ..... Appellant
Through Mr. R.D. Jolly, Sr. Standing Counsel

versus

P.H.I.SEEDS INDIA LTD. ..... Respondent
Through Ms. S.M. Kapila with Mr. P.C. Yadav, Advs.

Date of Decision : 17th November, 2006

CORAM:
HON'BLE MR. JUSTICE VIKRAMAJIT SEN
HON'BLE DR. JUSTICE S. MURALIDHAR

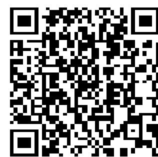
1. Whether reporters of local papers may be allowed to see the Judgment? Yes
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

JUDGEMENT

1. These Appeals have been filed by the Revenue in respect of the Assessment Years 1995-96 and 1996-97 of the Respondent which is indisputably engaged in agricultural activity. The Assessing Officer (AO) has imposed penalties on the Assessee holding that it had earned income by way of interest on Fixed Deposit Receipts (FDRs) amounting to Rs.12,07,217/-, assessable under the head 'Income from other Sources', but the Assessee

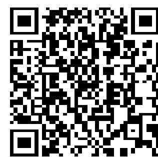
had incorrectly deducted therefrom a sum of Rs.8,89,897/-, being interest paid by it on its overdraft account. The Assessee had in this manner shown only a sum of Rs.3,17,319/- as "Income from Other Sources". While framing the Assessment, the AO had calculated the income of the Assessee by deducting the interest paid by it on its overdraft borrowings from its 'agricultural' earnings, which are exempt from taxation. The entire interest earned from the FDRs has been taxed as income from other sources. The Assessment had been unsuccessfully challenged, but not pursued further since, according to Ms. S.M. Kapila, the learned Counsel for the Assessee, the quantum of the levied tax was not commercially commensurate with the costs of further litigation.

2. So far as the Order of the AO dated 23.3.2000 imposing penalty under Section 271 (1) (c) of the Income-Tax Act (IT Act) is concerned, it has been upheld by the CIT(A) – XVII, New Delhi observing inter alia that -"Had there been no scrutiny of the accounts, the incorrect claim of deduction of interest from income under the head Other Sources could have been allowed, leading to tax evasion". This is fallacious reasoning since in our opinion every assessee is expected to file its Return honestly and



diligently regardless of whether a scrutiny is in order or not. It would indeed be detrimental to the interests of the Revenue to enable an assessee to file a Return which it knows to be legally incorrect, on the premise that it was for the Department to order a scrutiny or to otherwise detect the legal incongruity of its Return. The CIT(A) was of the further opinion that interest paid on borrowed money could be considered as an allowable expenditure only if the money borrowed has been invested in the Fixed Deposit Receipts(FDRs) from which the interest is earned; that there was, therefore, no nexus between the money borrowed and the investment in the FDRs. The CIT(A) has further observed that while the income of the Assessee was exempt from levy of income tax by virtue of Section 10 of the IT Act, the interest paid on borrowed money was required to be debited as expenditure against agricultural income instead of claiming the same against the interest earned from FDRs. It was further observed that if the surplus funds are deployed in a different activity, the Return from such funds has to be decided as per the heads of income defined under the I.T. Act.

3. Mr. Jolly, learned Senior Standing Counsel for the Revenue, has assailed the impugned Order of the ITAT and has vehemently



contended that the ITAT has grossly erred in taking into consideration the explanation of the Assessee that there was a printing error in the Return inasmuch as instead of stating "interest paid on investments", it should have read as "interest paid on bank overdraft". Mr. Jolly has painstakingly taken us through the ten reasons furnished by the Assessee in order to highlight that the 'printing error' explanation has been tendered for the first time before the ITAT. The ITAT had allowed the Assessee's Appeal after noting its contention that the borrowing of funds was made on grounds of commercial expediency and that the interest paid thereon was necessary for preserving and maintaining the source of income, i.e. the FDRs placed with banks and others; that the only alternative open to the Assessee was to liquidate its FDRs, in which case the interest income would either not have been earned or would have been lower than the amount actually earned by the Assessee. These grounds would apply with equal force to the assault on the quantum, which, however, is no longer in consideration, quietus having been imparted upon it by the decision of the Assessee to abide by the ITAT decision on that score. We shall, therefore, refrain from going further than saying that it is certainly an arguable dialectic.

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4. It is plain to us that in the context of Section 271 of the IT Act, the ITAT was fully mindful of the fact that even if a Return of Income is found to be incorrect and the Assessment that is eventually framed by the AO is for a larger income, penalty proceedings are not an inexorable or inevitable consequence. It is axiomatic that Section 271(1)(c) is attracted only in those instances where the Assessee has concealed the particulars of his income, or has furnished inaccurate particulars of such income with an intent to mislead the Revenue into accepting its Return for an income offered for taxing which is lesser than the income actually exigible to tax. Since all the transactions had been mentioned by the Assessee in its Return, concealment is obviously not made out. Even if the Assessee's version of the occurrence of a printing error is totally discounted and ignored, the Revenue would be unfair to contend that the matter was absolutely free of doubt. Where two opinions are possible, adopting one of them can scarcely be viewed as malafide, with an intent to evade payment of Income-Tax. Recompense has been provided for in Section 234 of the I.T. Act by way of levy of interest, which, in the present case, has been paid without demur. In ***Dr. Prannoy Roy vs. Commissioner of Income-Tax***, [2002] 254 ITR 755 His Lordship S.B. Sinha, as Chief Justice of this Court, has observed

for the Division Bench that interest is not charged for failure to perform a statutory obligation; rather it is paid either by way of compensation or damages. In several cases where the Return is not accepted by the AO because of complicated legal reasoning imposition of interest would sufficiently serve the purposes of the Revenue. Initiation of penalty proceedings should be treated by the Department as a comeuppance to the assessee for filing a Return which has not been fully accepted by the Department. It is relevant to draw upon the rationale in C.B.D.T. Circular 530 dated 6.3.1989 which clarifies that the AO should exercise discretion under Section 220 of the IT Act so as to treat an assessee as not being in default if the demand in dispute has arisen because of the existence of conflicting decisions of one or more High Courts or the High Court of jurisdiction has adopted a contrary interpretation but the Department has not accepted that Judgment.

5. The IT Act does not envisage or explicitly provide that in every case where the Return is not accepted as correct, and the Assessment is framed at an income higher than that presented and offered for taxation by an Assessee in the form of its Return, penalty proceedings must be initiated. This proposition must

logically follow from the use of the word "may" in Section 271 in contradistinction to "shall" in Section 234. This Court has already expressed the view in ***CIT vs. Maya Rani Punj***, [1973] 92 ITR 394 and ***CIT vs. Sardar Amarjit Singh***, [1981] 132 ITR 365 (Delhi) that the employment of the word "may" in Section 271(1) is clearly indicative of the position that the authority concerned has a discretion in the matter of imposing a penalty; this appears also to be the opinion of the High Courts of Andhra Pradesh, Orissa, Madhya Pradesh, Madras and Karnataka. The Constitution Bench has highlighted, in ***CIT vs. Anjum M.H. Ghaswala***, [2001] 252 ITR 1 that the word used in Section 234 is "shall" which cannot be construed as "may". Hence, imposition of interest is mandatory. The Securities and Exchange Board of India Act, 1922 also prescribes that the relevant Authority "shall" impose penalty and, therefore, the decision in ***The Chairman, SEBI vs. Shriram Mutual Fund***, JT 2006 (11) SC 164 which will be referred to later in this Judgment.

6. Mr. Jolly has stressed the point that *mens rea* is not an essential element for the imposition of penalty under Section 270. However, it is trite that *mens rea* is an essential ingredient in every offence, but this presumption can be effaced by the statute

creating the offence, as has been opined by the Supreme Court in ***State of Maharashtra vs. Mayer Hans George***, AIR 1965 SC 722. Equally, a penalty imposed for a fiscal transgression partakes of the character of a civil obligation dissimilar to a punishment imposed under penal law. ***Hindustan Steel Ltd. vs. State of Orissa***, [1972] 83 ITR 26 was decided by a Three Judge Bench called upon to construe Sections 9(1) and 25(1)(c) of the Orissa Sales Tax Act which empowered the imposition of a penalty for failure to register as a 'dealer'. Their Lordships recorded the following opinion:-

> But the liability to pay penalty does not arise merely upon proof of default in registering as a dealer. An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceedings, and penalty will not ordinarily be imposed unless the party obliged, either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the

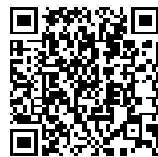
penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute. Those in charge of the affairs of the company in failing to register the company as a dealer acted in the honest and genuine belief that the company was not a dealer. Granting that they erred, no case for imposing penalty was made out.

7. A Two Judge Bench of the Apex Court has very recently delivered a perspicuous analysis, if we may say with humility and respect, in ***The Chairman, SEBI***. Their Lordships explained this aspect of the law, (obviously bound by the ratio of ***Hindustan Steel Ltd.***) in these words:-

> 35. In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulation is established and hence the intention of the parties committing such violation becomes wholly irrelevant. A breach of civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention must made by the defaulter with guilty intention or not. We also further held that unless the language of

> the statute indicates the need to establish the presence of *mens rea*, it is wholly unnecessary to ascertain whether such a violation was intentional or not. On a careful perusal of Section 15(D) (b) and Section 15-E of the Act, there is nothing which requires that *mens rea* must be proved before penalty can be imposed under these provisions. Hence once the contravention is established then the penalty is to follow.

8. A Two Judge Bench in the case of ***Gujarat Travancore Agency vs. CIT, Kerala***, [1989] 177 ITR 455(SC), without reference to ***Hindustan Steel Ltd.***, has observed that mens rea is not a necessary concomitant of the offence of late filing of a Return punishable under Section 271 (a) of the IT Act. Similarly, their Lordships have concluded in ***The Chairman, SEBI*** that the Scheme of the SEBI is that "defaults for failure are nothing but failure or default of statutory civil obligations provided under the Act and the Regulations made thereunder". However, as we have already noted the SEBI Act employs the word "shall" in its penalty provision, whereas the IT Act uses the word "may", thereby bringing about an appreciable difference in the ambit of the statutes.



9. We are mindful of the view preferred by the Apex Court in ***Commissioner of Income-Tax vs. Dr. V.P. Gopinathan,*** [2001] 248 ITR 449 which is extremely topical. Dr. Gopinathan had put moneys in FDRs and had then borrowed on this collateral. He sought to deduct from the income earned on the FDRs the interest paid by him on loans. Their Lordships held that the interest earned by him was income in his hands and there was no provision permitting its diminution to the extent of interest paid on loans. In ***Assistant Commissioner of Income-Tax vs. South India Produce Company,*** [2003] 262 ITR 20 the Kerala High Court had arrived at the contrary conclusion. In ***Commissioner of Income-Tax vs. Punit Commercial Ltd.,*** [2000] ITR 550 the Bombay High Court had, in the context of Section 80 HHC, opined that where interest is paid by an assessee which is exclusively engaged in export business, such income could only be computed as export income. It would, therefore, be impermissible, if not impossible, to conclude that where an assessee claims a deduction from its income in the manner that the Respondent has adopted, it would constitute a perversity for which penal action in addition to the levy of interest is the requisite retribution and that it could not be seen as a bonafide error caused as a consequence of an erroneous

appreciation of the legal position.

10. It would be perilous not to take heed of the enunciation of the law as found in ***K. Ravindranathan Nair vs. Commissioner of Income Tax, Ernakulam***, (2001) 1 SCC 135 to the effect that the ITAT is a final fact finding Authority, and its decision can be questioned in the High Court only if it partakes of 'perverse' character. Their Lordships have defined perversity as indicative of an action, opinion or conclusion which could not reasonably be arrived at. An incorrect conclusion is not invariably perverse or malafide unless it is palpably deliberate. Nuances and inferences on the factual matrix, as appreciated by the ITAT, should not be disturbed except in exceptional circumstances. We would be loathe to do so in the present case.

11. No substantial question of law arises in these Appeals which are dismissed.

(VIKRAMAJIT SEN)
JUDGE

(S. MURALIDHAR)
JUDGE

November 17th, 2006
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