IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "A", MUMBAI

Before Shri R.S.Syal, AM and Ms.Sushma Chowla, JM

ITA No.4524/Mum/2006 : Asst.Year 2000-2001

The Asstt.Commissioner of Income-tax Central Circle 32 Mumbai.	Vs.	M/s.VIP Industries Limited DGP House, 88C Old Prabhadevi Road Mumbai - 400 025. **PA No.AAACV0177G.**
(Appellant)		(Respondent)

ITA No.4383/Mum/2006 : Asst.Year 2000-2001

M/s.VIP Industries Limited DGP House, 88C Old Prabhadevi Road Mumbai – 400 025.	Vs.	The Asstt.Commissioner of Income-tax Central Circle 32 Mumbai.
(Appellant)		(Respondent)

Revenue by : Shri Ajay
Assessee by : Shri J.P.Bairagra

ORDER

Per R.S.Syal (AM) :

These two cross appeals – one by the Revenue and the other by the assessee arise out of the order passed by the Commissioner of Income-tax (Appeals) on 7th June, 2006 partly confirming the penalty u/s.271(1)(c) in relation to the assessment year 2000-2001.

2. The first ground of the Revenue's appeal is against the deletion of penalty levied by the Assessing Officer u/s.271(1)(c) on expenses allocated for earning tax free dividend income and on wrong claim made u/s.80IIIC in respect of interest income.

3. After considering the rival submissions and perusing the relevant material on record we find that the first aspect of this ground on which the penalty has been deleted by the learned CIT(A) is against the allocation of expenses for earning of tax free dividend income for the purposes of deduction u/s.80M. The Assessing

Officer made the addition of Rs.2,43,948 by estimating such expenses at 5% of the dividend income received during the year. When the matter finally came up before the Tribunal in quantum proceedings, the said addition was deleted having been made on the basis of estimation of expenses. Copy of the order passed by the Tribunal in ITA No.3877/Mum/2004 & 5036/Mum/2004 has been placed at page 24 onwards of the paper book. The relevant discussion is made in para 3 by which such disallowance has been deleted. In view of the fact that the addition for which the penalty was imposed by the Assessing Officer does not stand, in our considered opinion, the very foundation for the penalty ceases to exist. We, therefore, uphold the impugned order on this issue.

4. The second aspect of this ground is against the deletion of penalty on the claim made by the assessee u/s.80HHC in respect of interest income. The learned Counsel for the assessee submitted that the similar penalty imposed u/s.271(1)(c) with reference to claim of deduction u/s.80HHC on gross or net interest was deleted by the Tribunal in assessment year 1999-2000. He placed on record a copy of the order passed in ITA No.1033/Mum/2006. The learned D.R. fairly conceded the factual position. Respectfully following the precedent we uphold the impugned order on this score.

5. Ground No.2 is against the deletion of penalty on wrong claim for deduction u/s.80-IA. Here again we find that penalty was imposed by the Assessing Officer under similar circumstances in assessment year 1999-2000 i.e. the immediately preceding year ant the Tribunal vide afore-noted order has deleted the penalty. The relevant discussion has been made in para 21 of the order dated 10th June, 2008. In the absence of any distinguishing feature having been brought to our notice by the ld. DR, we uphold the impugned order on this score.

6. The second component of ground no. 2 is against the deletion of penalty in respect of deduction claimed by the assessee u/s. 35 in respect of motor car not related to R&D activity. Briefly stated the facts of this issue are that the assessee claimed deduction u/s.35 for scientific research expenses at hundred percent *inter alia* towards the cost of motor car purchased in this year. In the Schedule 6 of the Tax Audit Report it was categorically mentioned that deduction was claimed on R&D expenses including depreciation. Copy of Schedule 6 of the Tax Audit Report has been placed at page 43 of the paper book. The Assessing Officer added back this amount and allowed depreciation at 20% by treating it as car used for ordinary business purposes not connected with the scientific research and development activity. The said addition was confirmed up to the tribunal level. The penalty imposed by the Assessing Officer on this count has been overturned by the learned CIT(A), against which the Revenue is aggrieved.

7. Before us the ld. DR contended that the ld. CIT(A) erred in deleting the penalty because the assessee had concealed the income by claiming deduction at hundred percent, which was not otherwise available to it. He heavily relied on the judgment recently rendered by the Hon'ble Supreme Court in *Union of India & Ors. Vs. Dharmendra Textiles Processors and Ors. [(2008) 306 ITR 277 (SC)]* to bolster his submission that penalty is sustainable even where the income has remained undisclosed with or without the conscious act of the assessee. In his opinion the scenario of penalty u/s 271(1)(c) has drastically changed with the advent of this judgment in as much as now the penalty can be levied when the assessee claims deduction by disclosing the correct particulars of his income but still the addition is made. He further stated that with the confirmation of the addition by the tribunal in the quantum proceedings, it has become crystal clear that the assessee had wrongly claimed the deduction for which the penalty must be imposed. In the opposition the ld. AR submitted that the ld. CIT(A) was right in deleting the penalty on this item because the assessee had made proper disclosure

in the return of income when it claimed deduction at hundred percent of the cost of the car, which was purchased and used in connection with the work relating to Research and development.

8. We have heard the rival submissions and perused the relevant material on record. A great deal of emphasis had been laid by the ld. DR on the fact that since the addition has been upheld by the tribunal, then the penalty should also be confirmed. In our considered opinion the mere fact of confirmation of addition cannot *per se* lead to the confirmation of the penalty. It is obvious that both the quantum and the penalty proceedings are independent of each other. In the penalty proceedings the assessee is given chance to show that why the penalty be not imposed with reference to the addition made or confirmed in the quantum proceedings. If the assessee succeeds in explaining his case then no penalty can follow and *vice versa*. It is, therefore, amply clear that the confirmation of the addition by the Tribunal in quantum proceedings cannot mean that the penalty be automatically confirmed. If the contention of the ld. DR is taken to the logical conclusion then the penalty proceedings would require obliteration from the statute and the very act of making addition in quantum should entitle the A.O. to impose penalty simultaneously.

9. Section 271(1)(c) provides that if the Assessing Officer or the Commissioner (Appeals) or the Commissioner, in the course of the proceedings in this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty a sum which shall not be less than but which shall not exceed three times the amount of tax sought to be evaded by reason of the concealment of particulars of his income. Seven Explanations are there to section 271(1). *Explanation (1)* states that where in respect of any facts material to the

computation of the total income of any person under this Act, such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false, or such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him, then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed. The effect of this *Explanation* is that if the necessary ingredients as stated herein are satisfied then the amount disallowed in computing the total income shall for the purposes of clause (c) of this section, be deemed to represent the income in respect of which the particulars have been concealed. The necessary elements for attracting this *Explanation* are three-fold.

(a) the person fails to offer the explanation, or
(b) he offers the explanation which is found by the authorities to be false, or
(c) the person offers explanation which he is not able to substantiate and fails to prove that such explanation is bonafide and that all the facts relating to the same have been disclosed by him.

If the case falls in any of these three ingredients, then the deeming provision comes into play and the amount added or disallowed in computing the total income is considered as the income in respect of which particulars have been concealed for the purposes of clause (c) of section 271(1) and the penalty follows. If the assessee successfully comes out of the above three constituents then he cannot be deemed to have concealed the particulars of his income with reference to the amount added or disallowed in computation of total income.

10. With this background in mind, now we will proceed to test the facts of our case on the touchstone of the above referred three ingredients of *Explanation 1* to section 271(1) one by one. It is vivid that the first element is not satisfied because the assessee has offered the explanation about the claim of deduction. The case of the assessee also does not fall in the second category. He made a claim for deduction at one hundred percent u/s.35 in respect of the car used by it for the purposes of research and development and the Assessing Officer has not found that such car was not used for the purpose of R&D. Further section 35(1)(iv) states that the deduction "in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, shall be allowed". Thus if capital expenditure is incurred on scientific research relating to the business carried on by the assessee, the entire amount is deductible u/s.35(1)(iv). Albeit the assessee has lost its claim under this section at hundred per cent deduction on the motor car purchased and used by it for scientific research and development but the AO had allowed depreciation at 20% on the cost of car purchased. It has not been denied by the AO that the car was not used in connection with the activities relating to R&D. Thus it is clear that the assessee offered explanation, which was not found to be false by the AO. The third ingredient for the applicability of the deeming provision is that the person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bonafide. The assessee's case does not fall within the parameters of this provision also for the reason that he offered explanation that the car was used for the purposes of scientific research and development. His explanation is bonafide and this fact has not been refuted by the Assessing Officer. Simply because the Assessing Officer chose to negative the assessee's claim in entirety it would not *ipso facto* mean that the explanation is not bonafide. Whether an explanation is bonafide or not depends on the cumulative effect of the attending circumstances prevailing in each case. No straitjacket formula can be devised for ascertaining whether or not the explanation offered by the assessee is bona fide. We are dealing with a case in which the assessee is

undisputedly engaged in the R&D activity, for which deduction u/s.35 was claimed at Rs.47.40 lakhs, which included a sum of Rs.3.23 lakhs towards purchase of Maruti car for the R&D staff. The Assessing Officer allowed the deduction u/s.35 in entirety except for disallowing 80% of Rs.3.23 lakhs by treating it as not used for R&D activity. The facts that the assessee had carried out R&D activity and the car was also purchased by it for the use by the R&D staff have not been denied by the AO. The explanation of the assessee for claiming full deduction u/s.35 cannot be said to be fanciful. Further the assessee disclosed all the facts relating to its claim by way of Statement No. 6 annexed to the Audit report, which forms part and parcel of the return of income, in which it has been specifically mentioned about the R&D expenses debited to the P&L account '(including depreciation)'. Hence the case of the assessee cannot be covered in the third category also. Under these circumstances it is patent that the necessary conditions for invoking *Explanation 1* to section 271(1)(c) are lacking.

11. The Hon'ble Supreme Court in *Dharmendra Textiles Processors and Ors. (supra)* has held that the penalty u/s.271(1)(c) is a civil liability and the "willful concealment is not an essential ingredient for attracting civil liability as is the case in the matter of prosecution u/s.276C of the Income-tax Act." It has further been held that the *mens rea* is not an essential ingredient for imposing penalty under this section. On the circumspection of this case we find that it has been laid down that willful concealment is not necessary and hence *mens rea* (guilty mind) is not essential for invoking provisions of section 271(1)(c). The Hon'ble Summit Court has not held that in all cases where addition is confirmed. the penalty shall mechanically follow. The *ratio decidendi* of the judgement is confined to treating the willful concealment as not vital for imposing penalty u/s.271(1)(c). It is austere from the language of section 271(1)(c) that the penalty is imposable for the concealment of the particulars of income or furnishing of inaccurate particulars of such income. The literal meaning of the word 'conceal' is 'to hide'. Be that as it

may, in order to be covered within the mischief of this section, the act (intentional or unintentional) of the assessee should result into the concealment of income. Where an assessee genuinely makes claim for a particular deduction by disclosing all the necessary facts relating to the same, that will not amount to concealment even if the assessee's claim is rejected. There may be a situation in which the assessee earns income but unintentionally fails to disclose the same in the return. Such types of cases are covered by the judgment in Dharamendra Textiles (supra). So the scope of this judgment extends to roping in the cases of concealment of income even if the assessee did not have the guilty mind but still there is failure to disclose the income. For example an assessee may have ten bank accounts from which interest income is received. The assessee files a return by declaring interest income from nine bank accounts but omits to include such interest income from the tenth bank account and further this omission is and not willful. Such would be the cases caught within the sweep of the ratio laid down in the case of *Dharmendra Textiles Processors and Ors. (supra)*. In this case the concealment of income by not offering the interest income for taxation from the tenth bank account is there, even though inadvertently, and the penalty will follow notwithstanding the fact that the assessee was not aware of having earned interest income from the tenth bank account. But in a case where a genuine claim is made for deduction which is not accepted by the Revenue but all the necessary particulars are declared by the assessee in the return of income, it cannot be said by any stretch of imagination that the assessee has concealed his income or furnished inaccurate particulars of income in respect of the claim of deduction which stands repelled by the authorities. If penalty is imposed under such circumstances also then probably there will remain no course open to the assessee for genuinely claiming a deduction which in his opinion is admissible, because the fear of such claim being rejected in eventuality will expose him to the rigor of penalty. Obviously such a proposition is beyond any recognized canon of law.

12. We have noted above that the penalty proceedings are distinct from the assessment proceedings and hence it becomes amply clear that any addition made does not automatically lead to the imposition of penalty u/s.271(1)(c). In the penalty proceedings the assessee is given a chance to explain his case. If he successfully explains his position and is not trapped within the parameters of clause (c) of section 271(1) along with the *Explanations* deeming the concealment of income, the penalty cannot be imposed. Adverting to the facts of the instant case we find that the assessee had *bona fidely* made a claim for deduction u/s 35 in respect of cost of car purchased for the purpose of R&D activity by disclosing all the necessary particulars in the audit report. The facts that the car was purchased by the assessee and also used for the purpose of the business have not been controverted by the AO. Further the granting of depreciation at 20% instead of hundred percent deduction claimed by the assessee shows that there was a genuine difference of opinion between the assessee and the AO on this aspect of the matter. It cannot be said that the assessee, under such circumstances, has concealed his income and is caught within the four corners of section 271(1)(c). We, therefore, hold that the learned CIT(A) has rightly not imposed penalty on this addition.

13. Ground No.3 of the Revenue's appeal is against the deletion of penalty on interest accrued but not disclosed by the assessee. Here we find that the assessee successfully assailed the sustenance of the addition in quantum proceedings before the Tribunal. The copy of the order is available at page 24 onwards of the paper book and the relevant discussion has been made in paras 7 to 16 and finally the addition on account of such notional interest has been deleted. In view of the fact that the very addition for which penalty was imposed stands deleted by the Tribunal, no penalty can be imposed on it.

14. The second component of this ground is against the deletion of penalty on the addition u/s. 41(1) on cessation of liability. The assessee was called upon to

explain sundry creditors along with the ageing of outstanding for more than three years. A sum of Rs.18.20 lakhs was found to be due in the account of M/s Reliance Industries Limited for more than three years. The assessee agreed to the proposal of the AO for writing back of this amount in this year and consequently offering it for taxation subject to the condition that it shall claim deduction whenever in future the amount becomes payable. Under these circumstances the Assessing Officer made addition and levied the penalty, which came to be deleted in the first appeal.

15. Having heard the rival submissions and perused the relevant material on record we again notice that there is no concealment of income by the assessee on this issue. Strictly speaking section 41(1) is attracted when there is cessation or remission of a trading liability. Simply because a period of three years has expired and the creditor cannot lawfully enforce his claim, it does not mean that there is a cessation or remission of liability. Suppose in the fourth year or thereafter the creditor demands the money and the assessee agrees to pay, which is otherwise rightfully payable to him based on a genuine and existing liability, can it be said that the assessee should be prevented from making the payment because the lawfully enforceable right vested in the creditor does not exist? In our considered opinion the answer is in negative. There may be several situations when the money is not claimed or paid by one party to another within three years and thereafter the claim is made and honored by the other. So simply because a particular amount is outstanding for a period of more than three years, that does not constitute income u/s.41(1). The act of the assessee in agreeing for the inclusion of such amount in the total income during the course of assessment, subject to the condition that the deduction will be claimed as and when the amount is paid to the third parties, manifests that the assessee had not concealed its income or furnished inaccurate particulars of its income for which he could be visited with the penalty. The discussion made supra qua the confirmation of deletion of penalty on deduction

claimed by the assessee under section 35 holds good here also. Thus we approve the view taken by the learned CIT(A).

16. The assessee is aggrieved against the penalty confirmed by the learned CIT(A) u/s.271(1)(c) on the reduction in deduction u/s.80HHC by Rs.79,331. The facts apropos this issue are that on the perusal of the details filed by the assessee it was observed by the A.O. that the assessee claimed deduction for bad debts amounting to Rs.35,94,777. It was noticed that such sum also included the non-realization of export proceeds for assessment years 1997-98 and 1998-99. The assessee had obtained the necessary permission from the Reserve Bank of India for writing off these bad debts, which was placed before the A.O. The Assessing Officer came to the conclusion that the assessee had claimed higher deduction u/s.80HHC in respect of assessment year 1997-98 and 1998-99 to the tune of Rs.69,758 and Rs.9,573 respectively. He held that : "since, these excessive claims of Rs.79,331/- has already been claimed by the assessee in the form of deduction u/s.80HHC, therefore, the net amount of Rs.35,25,019 (3594777 – 79331) is only allowed to the assessee as bad debts". Resultantly he made the addition of Rs.79,331 on this count and thereafter penalty was levied u/s.271(1)(c) which came to be upheld in the first appeal.

17. After considering the rival submissions and perusing the relevant material on record we find that the Assessing Officer found that the assessee had claimed higher deduction u/s.80HHC in respect of assessment years 1997-98 and 1998-99 for Rs.79,331 in total, because of the bad debts claimed as deduction in this year as relating to those years. He thus reduced the excess claim of deduction u/s.80HHC in earlier years from the amount of bad debts claimed by the assessee in the instant year. In other words he proceeded to reduce the claim of deduction in this year instead of the right course available to him for rectifying orders for the earlier two assessment years in which deduction u/s.80HHC was found to have been over

claimed. Be that as it may there is no dispute that the amount of bad debts was deductible in entirety as having been written off in the books of account for this year itself. How penalty u/s. 271(1)(c) can be imposed in this year qua the reduction of claim for deduction u/s.80HHC in respect of earlier assessment years is beyond our comprehension. The learned CIT(A) too mechanically upheld the penalty on this aspect without applying his mind to the real controversy. If the claim for deduction in an earlier years is found to be untenable, the proper course available to the A.O. is to make rectification of such earlier years' orders and consider the imposition or otherwise of the penalty in those years. The Assessing Officer committed primary mistake by reducing the claim of bad debts in this year by Rs.79,331 and then again the mistake was repeated by imposing penalty u/s.271(1)(c) on this amount. In our considered opinion, the learned CIT(A) erred in upholding the imposition of penalty of Rs.79,331. We, therefore, order for the deletion of penalty to this extent.

18. In the result, the appeal by the assessee is allowed and that of the Revenue is dismissed.

Order pronounced on this 20th March, 2009

Sd/-	Sd/-
(Sushma Chowla)	**(R.S.Syal)**
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai : 20th March, 2009.
Devdas*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT concerned
4. The CIT(A) Central VIII, Mumbai.
5. The DR/ITAT, Mumbai.
6. Guard File.

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By Order

Assistant Registrar, ITAT, Mumbai.

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(J.M.) **(A.M.)**