"Penalty Provisions, immunity provisions along with Decriminalization of certain Prosecution Provisions of the Income- Tax Act, 2025"

Dr. K. Shivaram, Senior Advocate.

Bombay Chartered Accountants Society, in association with 14 other professional organisations, has arranged a **"Direct Tax Home Refresher Course-7 (DTHRC)"** from 25th April 2026 to 9th May, 2026. Over 1700 professionals enrolled in the lecture series, where Dr. K. Shivaram, Senior Advocate, gave a lecture on the conceptual issues of *"Penalty Provisions, immunity provisions along with Decriminalization of certain Prosecution Provisions of the Income- Tax Act, 2025"*. On 9th May, 2026 (Saturday).

Ms. Anagha Pandit, a law student from Government Law College, Mumbai, has prepared the summary of the lecture for the benefit of the tax professionals. The summary is published in the form of an article.
Editorial Board; itatonline.org.

Dr. Shivram, in his introductory remark, highly appreciated the concept behind designing the lecture series, and extended his gratitude to the organizing team of various participating organizations, including Mr. Deepak R. Shah and Mr. Anil Sathe, Chairman and Co-Chairman, Taxation Committee of the Bombay Chartered Accountants Society. (BCAS)

Dr. Shivram structured his lecture into 10 parts, which are as follows;

1. An overview of the provisions under the Income-tax Act, 2025.
2. Conceptual changes under the Income-tax Act relating to the penalty provisions under the Income-tax Act, 2025 –
3. Combining the assessment order and the penalty order.
4. Waiver of penalties and their effect on prosecution.
5. Landmark cases which apply to penalty provisions of the Income-tax Act, 2025.
6. Offences and Prosecution – Conceptual issues.
7. Reply to show cause notices, grounds of appeal, and statement of facts.
8. Jurisdictional issues in appellate proceedings.
9. Constitutional remedies.
10. Conclusion.

1. An overview of the provisions under the Income-tax Act, 2025.

1.1. When there was a transition from the Indian Income-tax Act, 1922, to the Income-tax Act, 1961, there were substantial changes in the law. The Indian Income-tax Act, 1922, contained only 67 sections, whereas the Income-tax Act, 1961, contained 298 sections, making it a substantially new enactment. At that time, several other tax laws were also in force, such as the Wealth-tax Act, 1957, the Gift-tax Act, 1958, the Business Profits Tax Act, 1947, the Expenditure-tax Act, 1987, the Excess Profits Tax Act, 1940, the Estate Duty Act, 1953, the Companies (Profits) Surtax Act, 1964, the Super Profits Tax Act, 1963, the Interest-tax Act, 1974, and the Securities Transaction Tax under the Finance (No. 2) Act, 2004, etc.

It is pertinent to note that the transition from the Income-tax Act, 1961, to the Income-tax Act, 2025, does not involve any major conceptual changes. The provisions have been simplified for easier understanding, and several provisos and explanations have been removed. Now we only have to deal with: Income-tax Act, 1961 for all pending assessments, Income -tax Act, 2025 wef 1st April 2026, and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of tax Act, 2015.

1.2. The Indian Income-tax Act, 1922, remained in force for over 39 years. The Income-tax Act, 1961, which came into effect on 1 April 1962, remained operative for more than 64 years and underwent over 4000 amendments.

The Income-tax Act, 1961, contained over 819 effective sections, 15 Schedules, and 47 Chapters. In contrast, the Income-tax Act, 2025 has been streamlined into 536 sections, 16 Schedules, and 23 Chapters, thereby eliminating nearly 300 sections and making the statute more comprehensive and less cluttered.

The Income-tax Act, 1961, also contained approximately 1200 provisos and 900 explanations. The Income-tax Act, 2025, contains approximately 2.60 lakh words, which is nearly 50% of the text of the Income-tax Act, 1961.

The expressions “previous year” and “assessment year” have been removed and replaced by the term “tax year”.

1.3. When the new Income-tax Bill, 2025, was introduced, the CBDT issued a set of questions and answers explaining the scope of the proposed legislation in order to help educate taxpayers and bring clarity to several provisions. The Bill was thereafter referred to the Select Committee on the Income-tax Bill, 2025. The Select Committee considered suggestions from stakeholders as well as from the Ministry of Finance and submitted its report to the Lok Sabha on 21st July 2025.

The Select Committee Report runs into approximately 4575 pages and contains mainly three parts:

i. Clause-by-clause examination of the Income-tax Bill, 2025;
ii. Consolidated observations; and
iii. Recommendations of the Committee.

The Committee reproduced the proposed sections, the corresponding provisions under the existing Income-tax Act, stakeholder suggestions, and the reasons or justification given by the Ministry of Finance.
Let me share one example. In the case of total partition of an HUF, the Karta is required to intimate the total partition to the concerned Assessing Officer, who is then required to pass an order recognising the partition.

Under Section 315 of the Income-tax Act, 2025 (corresponding to erstwhile section 171), no time limit has been prescribed either for informing the Assessing Officer or for passing the order. Stakeholders suggested that a time limit should be prescribed both for the assessee and for the Assessing Officer. It was further suggested that if the Assessing Officer does not pass an order within six months from the date of intimation, the partition should be treated as deemed accepted. However, the Revenue did not accept the suggestion because it involved a policy change and was beyond the scope of the Bill.

1.4. After the Bill became an Act, the Directorate of Income Tax (Organisation & Management Services), CBDT, New Delhi, published FAQs on the interplay and transition from the Income-tax Act, 1961, to the Income-tax Act, 2025. My humble request to the participants is that, to better understand the Income-tax Act, 2025, it is desirable to read all the following documents together:

i. The Income-tax Bill, 2025;
ii. The CBDT Questions and Answers;
iii. The Parliamentary Committee Report; and
iv. The FAQs issued by the Ministry of Finance – Explaining the proposals of the budget 2026 -27 [(2026) 308 Taxman 241 to 284 (St)].
v. Directorate of Income Tax (Organisation & Management Services), CBDT, New Delhi, published FAQs on the interplay and transition from the Income-tax Act, 1961, to the Income-tax Act, 2025.

1.5. Accountability under the Income-tax Act, 2025

One of the important provisions missing in the Income-tax Act, 2025 is the provision relating to accountability. Let me illustrate this with a simple example:

An appeal was filed before the CIT(A) in the year 2016. Only one notice was issued in the year 2025, pointing out that no application for the condonation of the delay of 45 days had been filed. The appeal was dismissed without verifying whether the notice had been properly served. On appeal, the Tribunal set aside the matter to the CIT(A). However, there is no time limit prescribed as to when the CIT(A) should decide the matter.

Before the Parliamentary Committee, a suggestion was made that a time limit should be prescribed for the disposal of appeals by the CIT(A). Though the Parliamentary Committee agreed with the suggestion, the Ministry of Finance did not accept it. The Parliamentary Committee

specifically suggested insertion under Section 357 (corresponding to erstwhile section 249) as follows:

"*For the disposal of appeal under this section, the Central Government may notify a scheme so as to dispose of appeals in an expeditious manner with transparency and accountability, by eliminating the interface between the Commissioner (Appeals) and the appellant, to the extent technologically feasible, and direct that any of the provisions of this Act relating to jurisdiction and procedure for disposal of such appeals shall not apply or shall apply with such exceptions, modifications and adaptations."*

Representations were made by various organisations to the Honourable Finance Minister and the Chairman, CBDT. Very recently, the ITAT Bar Association, Mumbai, also made a representation to the Honourable Prime Minister of India. Those interested may visit https://itatonline.org/digest/assonnews/itat-bar-association-submits-representation-to-honble-prime-minister-for-speedy-disposal-of-appeals-before-first-appellate-authority/.

Dr. Raja Chelliah, in his report [*(1992) 197 ITR 177 (St) 257, para 5.9*], suggested the introduction of accountability provisions. He observed:

"The Assessing Officers should be made accountable for their actions. If the percentage of demands not upheld by the Tribunals is higher than a reasonable figure, say 50 per cent, the officer should be given a black mark and reprimanded. On the other hand, an Assessing Officer should be protected and defended if he has obeyed instructions of the Board and followed case law even though an audit may raise concerns about his actions."

It is pertinent to note that when Hon'ble Justice K. R. Sriram was heading the tax bench at Mumbai, writ petitions were filed where refunds were not granted to assessees. In few matters, the Honourable Judge summoned the Assessing Officer and the Principal Commissioner and observed that the delay in granting refunds amounts to utilisation of taxpayers' money by the Revenue. The Court further warned that if

refunds with interest were not issued within a few days, orders may be passed directing recovery of interest from the salary of the concerned Assessing Officer, and contempt proceedings may also follow.
Reference may be made to:
Laqshya Media Ltd. v. Dy. CIT (2024) 298 Taxman 774 (Bom.) (HC).
Thereafter, whenever writ petitions were filed, refunds were often granted even before admission of the matter.

In *Sicom Ltd. v. DCIT (WP No. 2460 of 2018 dated 01.10.2018) (Bom.) (HC*), while dealing with interest on refunds, the Court observed that the Department should bring order and discipline to the process of granting refunds. All pending refund applications should be processed in chronological order. It is the bounden duty of the Revenue to grant refunds arising out of orders passed by higher forums and disburse the same expeditiously. The Court further observed that in the absence of a clear policy, the Courts may impose interest on refunds at such rates as may be determined by the Court. The Registrar of the High Court was directed to forward a copy of the order to the Principal Chief Commissioner and the Chairperson of the CBDT.

Accountability in adjudication is therefore not merely an administrative necessity; it is a constitutional imperative. Therefore, unless accountability provisions are introduced, honest taxpayers may continue to suffer.

1.6.Drafting Committee.

The drafting committee ought to have included at least one representative from each of the following:

i. The judiciary;
ii. The legal profession; and
iii. The accountancy profession.

Ideally, the Chairman of the Committee should have been a retired Judge of the Supreme Court or a High Court having experience in taxation matters. The Income-tax Act, 2025, should ideally serve the nation for at least another 50 years. However, had the Government included representatives from the profession in addition to tax officials, the legislation would perhaps have been much more effective and balanced

1. 7.Instability in tax law

The legendary tax professional, Padma Bhushan Dr. N.A. Palkhivala, in his article titled "Maddening Instability of Income-tax Law", published on itatonline.org on 21 April 2012, explained several reasons why the Income-tax Act, 1961, became increasingly complicated.

One of the major reasons was the frequent amendment of laws with retrospective effect to overcome judgments of the Supreme Court, High Courts, and sometimes even orders of the Appellate Tribunal. Another important reason was not merely the complexity of the law itself, but the manner in which it was implemented by the tax administration.

The Finance Bill 2026 has many amendments that are retrospective, of which certain amendments are proposed to come into effect through the Income-tax Act, 2025, which forms a change in the approach taken by the Government as in his Budget Speech for *2014 [(2014) 365 ITR 4 (St)]*, the then Finance Minister Shri Arun Jaitley stated:

"*This Government will not ordinarily bring about any change retrospectively which creates a fresh tax liability.*"

The Hon'ble Finance Minister in the Budget speech on 23rd July, 2024 *(2024) 465 ITR 30 (St)* stated "*comprehensive review of the Income-tax Act,1961*". The purpose is to make the Act ***"concise, lucid, easy to read and understand." This will reduce disputes and litigation, thereby providing tax certainty to the taxpayers. It will also bring down the demand embodied in the litigation. It is proposed to be completed in six months."***

Though an extremely laudable objective, it is the implementation of the Income-tax Act, 2005 by the tax administration, which will be the deciding factor whether we can achieve the desired outcome that the Hon'ble Finance Minister optimistically emphasises.

2. Conceptual changes under the Income-Tax Act, 2025- Relating to penalty provisions.

2.1. The Philosophy of Penalties: Compliance and Deterrence.

Under the Income-Tax Act 2025, there are various provisions for compliance with taxing provisions and the collection of taxes. The Income-tax Act earlier sought to enforce tax-compliance through a three-fold process; Namely:

i. Imposition of interests
ii. Imposition of penalties and
iii. Prosecutions,

The Income-tax Act, 1961, contained various sections dealing with penalties in different Chapters, whereas the Income-tax Act 2025 contains all these sections under one chapter XXI, ranging from Sections 439 to 472, amounting a total of 34 Sections, dealing with penalties.

In the Income-Tax Bill 2025, when it was introduced, it had some provisions referring to it as **"*Shall*", for example, Clause 441- Failure to keep, maintain or retain books of account.** Although after taking into consideration the various suggestions, the Parliamentary Committee suggested **"*shall'*** to be replaced by **"*May*",** ensuring the discretionary implementation of the provision**.** [**S. 441, Referred to as "May"]**

a. **Clause 451**- Penalty for failure to comply with provisions of section 186- Mode of undertaking transaction, (Except where he proves that there were good and sufficient reasons for the said contravention). Now the section is worded as S. 451 (Erstwhile S. 271DA) "The Assessing Officer may impose on a person, a penalty equal to the sum

received by him in contravention of the provision of section. 186. (Erstwhile S. 269ST).

b. S. 463: Penalty for furnishing incorrect information in reports or certificates- Refers to **"*Shall be liable*".**

c. S. 465: Penalty for failure to answer questions, sign statements, furnish information, returns or statements, allow inspection, etc., **"*Shall be liable*".**

d. **Section 470: Penalty not to be imposed in certain cases. [Erstwhile section 273B]:** Irrespective of anything contained in the provisions of section 441or 442, or 446 or 447 or 448 or 449 or 450 or 451 or 452 or 453 or 455 or 456 or 457 or 458 or 459 or 460 or 461 or 462 or 463 or 465 (1)(c) or 456(10)(d) or 465 (2) or 466 or 467 or 468. **No penalty shall be imposed** on a person or Assessee for any failure referred in the said provisions, if he proves that there was reasonable cause for the said failure.

e. **Section 471: (Erstwhile section 274). Procedure to be followed while imposing the penalty order.** No order imposing a penalty under this Chapter shall be made unless the assessee has been heard, or has been given a reasonable opportunity of being heard.

f. **S. 472: Bar of Limitation for imposing penalties. [Erstwhile section 275]. Section simplified.** The substituted provision brings clarity on time limits for imposing penalties by providing a single time limit. (2025) 474 ITR 64 (St).

g. Uniform time limit: As per the substituted provision, no penalty order imposing a penalty under Chapter XXI shall be passed after 6 months from the end of the **quarter.**

h. S.536 (2)(d). Repeal and savings: Penalty-Any proceedings for the imposition of a penalty in respect of any tax year beginning before the 1st April 2026, may be initiated and any such penalty may be imposed under the repealed Income-tax Act as if this Act had not been enacted.

2.2. Rationalisation of Penalties to Fee.

Another important amendment was introduced in the Finance Act, 2026, S. 427 (Fee for default in furnishing statements) (Erstwhile S. 234 E, 271FA), S. 428 (Erstwhile S. 234F 234I, 271B) S. 429 (Fee for default to statement or certificate [Erstwhile S. 234G], S. 430 [Fee for default relating to intimation of Aadhar number. [Erstwhile S. 234H]. The word penalty is replaced with a fee. – Impact on assesses.

Clause 83 of the Finance Bill, 2026, *(2026) 308 Taxman 194 (St) / (2026) 308 Taxman 217 (St).* Conversion of Penalty to fee, *(2026) 308 Taxman 253 (St.) FAQs).*

Sections 446 (Failure to get accounts audited), S. 447 (Failure to furnish report, S. 454 (failure to furnish report of financial transactions, provide penalties.

Clause 4. states that. In this regard, it is considered that penalties for technical delays should be converted into a mandatory fee, as the fee reduces litigation for technical defaults. A fee, by its very nature, is regulatory or compensatory and is generally linked to the period of default. Penalty is punitive and deterrent. By changing to a fee, the legislature has potentially removed the discretionary power of the Assessing Officer and the reasonable cause defense, thereby making the liability stricter and automatic.

In section 273B, Penalty not to be imposed in certain cases, it covers Section 271BA and Section 271FA., However, the new section 470 corresponding to section 273B does not cover sections 427, 428, 429, 430.

Under the erstwhile section 246A (q), An order imposing a penalty under chapter XXI is appealable. However, Section 357, which deals order which are appealable, does not refer to sections on the levy of fees, 427, 428, 427,428,429 and 430.

Questions and answers by Revenue. *(2026) 308 Taxman 254 (St).*

"*Q.12: Will the reasonable clause under section 470 of the Income -Tax Act, 2025 be available for the levy of fee?*

Ans: No. As the fee is proposed to be charged automatically, the need for a reasonable clause is not required."

The only remedy for the assesse is a writ before the High Court. The assessee cannot afford to approach the High Court for small matters. Furthermore. the change from penalty to fee was not discussed in the Income-tax Bill 2025 or before the Parliamentary committee.

3. <u>Most Important Procedural Shift: Combining the assessment order and penalty order. Finance Act, 2026, subsections 4& 5 into section 274 of the Income -Tax Act,1961. Income -Tax Act,2025, Section 471 Sub-sections 4 & 5.</u>

3.1. The Honourable Finance Minister, in her speech, para 11.3., discussed the provisions regarding the Rationalising Penalty and Prosecution, *(2026) 308 Taxman 28 (St*).

"*Multiplicity of proceedings are hindrance to the ease of doing business. I propose to integrate assessment & penalty proceedings by way of a common order for both. There will be no interest liability on the tax payer on the penalty amount for the period of appeal before the first appellate authority irrespective of the outcome of appeal process. Further, quantum of pre-payment is being reduced from 20 percent to 10 percent and will continued to be calculated only on core tax demand*".

This major amendment was done without referring the matter to select committee or interacting with stakeholders. When the Income -tax Bill,2025, was introduced, this proposal was not there. Even in the Finance Bill,2026, this provision was not there. In the Act, this provision was introduced.

Rationalising penalty and prosecution, (*2026) 308 Taxman 251 to 252 (St)* Six questions and answers.

a. All assessments or penalty proceedings that are pending as on 1-4-2026 are not covered. Where an assessment under section 143 or reassessment under section 147 or any draft order proposed order of assessment under section 144C is made on or after 1st April,2027, where a penalty is proposed to be levied under section 270A of the Act.
b. For the Income -tax Act, 2025, the proposed amendment will be applicable where any draft of the proposed order of assessment under section 275 is made, or an assessment order under section 270 or reassessment under section 279 is made on or after 1st of April, 2027, where a penalty is proposed to be levied under section 439 of the Act.
c. Proposal would be applicable for the draft assessments made under section 144C of the Income -Tax Act,1961, those draft assessments which are made on or after 1st of April, 2027.
d. The new provision will be effective for the Income-tax Act,1961 as well as the Income -tax Act, 2025 in respect of any draft assessment, assessment or reassessment made on or after 1st April, 2027.

3.2. The old law: a two-stage model

Under the Income -tax Act,1961, or under the Indian Income-tax Act, 1922, the usual sequence followed was:

i. Assessment order passed
ii. Satisfaction recorded for the penalty
iii. Separate notice under section 274
iv. Assessee replies specifically to the penalty
v. Separate penalty order was passed:

This gave an assessee a second substantive opportunity after the quantum addition crystallised.

vi. The law that prevailed for more than 103 years was done away with by the Finance Act, 2026, without discussing with stake holders.

3.3. Practical Implications of the Common Assessment-Cum-Penalty Order.

3.3.1. Loss of the traditional "*second opportunity*"

Earlier, after the assessment order, the assessee could:

i. study the final reasoning,
ii. examine the exact addition,
iii. gather additional material,
iv. distinguish legal dispute from concealment,
v. rebut "*misreporting*" separately.

That post-assessment penalty window is now narrowed or eliminated.

3.3.2. When the penalty proceedings were separately initiated, the assessee had the following legal defences to oppose the levy of penalty.

a. If the Assessing Officer does not specify the specific charge, the penalty is not valid. Mohd. A Farhan. A. Shaik v. Dy. CIT (2021) 434 ITR 1 (Bom) (HC)(FB)
b. Not striking off the irrelevant limb, the levy of penalty is held to be bad in law. PCIT v. Goa Dourado Promotions Pvt Ltd. [2020] 113 taxmann.com 630/ (2021) 433 ITR 268 (Panji) (Bom.) (HC)
c. Substantial question of law admitted by High Court in quantum proceedings. Levy of penalty is not valid. CIT v. Nayan Builders & Developers (2014) 368 ITR 722 (Bom.)(HC).
d. The assessment order and penalty is initiated by issuing a separate order.

   The assessee had the opportunity to produce new evidences or legal propositions in penalty proceedings. In a good number of cases the Assessing officers have dropped the penalty proceedings after considering the reply. When the single order is passed such an opportunity is not available to the assessee.
e. Same officer will hear the appeal on quantum and penalty.

When the same officer or CIT(A) hears the quantum and penalty, the mind may be prejudiced; the deletion of the penalty is very remote.

f. Tribunal's same bench has to hear quantum and penalty.
   At present, when the quantum is argued before the Bench and penalty will come for hearing after the quantum order is decided. It may come before a different bench; the demerits in the quantum may be improved while arguing the penalty appeal. This defence may not be available when the one combined order is passed by the Assessing Officer or Tribunal.

g. Question is asked can this provision be challenged?
   The provision is passed by the Parliament; there is no violation of Article 14 or 19 of the Constitution of India; hence, the petition may not be entertained.

h. Representation to the Honourable Finance Minister.
   This is one of the provisions that requires serious discussion by the tax professionals and detailed representation, to bring back the law as it existed in the 1922 Act and also the 1961 Act.

4. Waiver of penalties and their effect on prosecution.

4.1. Waiver of penalties under section 469 of the Act. [Erstwhile section 273A of the Act]

Powers are given to the Principal Commissioner or Commissioner to waive the penalties on his own motion or otherwise to reduce or waive a penalty, penalty imposed or imposable under section 439 of the Act. (Erstwhile Section 270A) – Conditions are:

a. Doing otherwise would cause genuine hardship to the assessee, having regard to the circumstances of the case; and

b. The assessee has cooperated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Waiver application for several years, and not restricted to only one year. *Asha Pal Gulati v. CBDT (2014) 361 ITR 73 / 98 DTR 361 / 265 CTR 332 / 226 Taxman 97 (Delhi)(HC).*

Pendency of an appeal is no bar to the exercise the power of waiver. Laxman v. CIT *[1988] 174 ITR 465 / [1989] 42 Taxman 47 / 75 CTR 76 (Bom.) (HC).*

When an application is rejected, the only remedy is a writ petition and not an appeal. *Satish Kapur v. CIT (2004) 265 ITR 673 / 136 Taxman 288 (Cal.)(HC).*

Section 491: Prosecution to be at the instance of Principal Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

Section 491 (3). (Erstwhile S. 279(IA): A person shall not be proceeded against for an offence under section 478 (Willful attempt to evade tax) Erstwhile S. 276C) or 482 (False statement in verification, etc., (Erstwhile S. 277) in relation to the assessment for a tax year for which the penalty imposed or imposable on him under section 439 (Penalty for under-reporting and misreporting of income (Erstwhile, 270A) has been reduced or waived by an order under section 469. Once a penalty is waived partly or fully, no prosecution can be launched by the Commissioner.

Illustration; The penalty levied upon one of the assesses was 10 lakhs. If assesee approachs the commissioner to waive the penalty, the commissioner waives only I lakh. Thereafter, no prosecution can be launched. *P. Jayappan v. S.K. Perumal, First ITO (1984) 149 ITR 696 (SC),*

Though the Supreme Court held that prosecution and assessment can proceed independently, it clarified that where the penalty is waived under the section. 273A, the bar under section 279(IA) applies and prosecution cannot be pursued.

5. Landmark cases which apply to the Income-tax Act, 2025

As per section 536(2) (j) of the Income-tax Act, 2025, circulars, notifications, instructions, approvals, etc., issued under the 1961 Act will remain valid as long as they do not conflict with the provisions of the 2025Act. Accordingly, the case laws under the Income-tax Act, 1961, pertaining to the interpretation of provisions will also hold good while determining the provisions of the Income-tax Act, 2025.

The judiciary has consistently emphasised certain fundamental principles in penalty proceedings. These principles, rooted in natural justice and legislative intent, will continue to be crucial. Some of the important case laws that are referred to in day-to-day practice are referred to for the reference of the tax professionals.

5.1. Mens Rea / Genuineness of the explanation.

5.1.1. CIT v. Reliance Petroproducts Pvt Ltd. (2010) 322 ITR 158 (SC)

This landmark Supreme Court judgment clarified that merely making an incorrect claim in the return of income would not, by itself, attract a penalty for furnishing inaccurate particulars. The burden is on the Revenue to establish that the assessed acted deliberately or with a guilty mind. This case is crucial because it distinguished between a mere "*claim*" and a "*furnishing of inaccurate particulars."* While Section 270A (and by extension, Section 439 of the 2025 Act) explicitly refers to "*under-reporting*" and "*misreporting*," the underlying principle of *mens rea* (guilty mind) in misreporting cases will continue to be debated and interpreted in light of such judgments.

5.1.2. Dilip N. Shroff v. CIT (2007) 291 ITR 519 (SC)

Supreme Court judgment was rendered under the erstwhile Section 271(1)(c), its emphasis on the requirement of "*concealment of income*" or "*furnishing of inaccurate particulars of income*" to be established by the Revenue, and that a mere claim which is later disallowed does not automatically invite penalty, holds significant persuasive value. The 2025 Act, in Section 439, differentiates between "*under-reporting*" (50%

penalty) and "*misreporting*" (200% penalty), with misreporting having an exhaustive list of actions.

5.1.3. UOI v. Rajasthan Spinning & Weaving Mills (2009) 180 Taxman 609 (SC)

The Court observed as under: "*At this stage we need to examine the recent decision of this court in UOI v. Dharmendra Textiles (2008) 306 ITR 277 (SC). In almost every case relating to penalty, the decision is referred to on behalf of the Revenue as if it laid down that in every case of non-payment or short payment of duty, the penalty clause would automatically apply and the authority had no discretion in the matter. One of us (Aftab Alam, J) was a party to the decision in Dharmendra Textile, and we see no reason to understand or read that decision in that matter*".

5.2. Discretionary Nature of Penalty:

5.2.1. CIT v. Anwar Ali (1970) 76 ITR 696 (SC)

This Supreme Court judgment, though older, established that penalty proceedings are distinct from assessment proceedings and the mere fact that an assessment has been made does not automatically warrant a penalty. The use of "***may***" on facts and circumstances, guided by the principles of reasonableness.

5.2.2. Hindustan Steel Ltd. v. State of Orissa (1972) 83 ITR 26 (SC)

This Supreme Court case laid down the principle that "*An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding, and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct virtually amounting to a contumacious or dishonest disregard of its obligation.*" This fundamental principle of *mens rea* being necessary for penalty, unless the statute specifically dispenses with it, remains highly relevant.

5.2.3. CIT v. Khoday Easwaras and Sons (1972) 83 ITR 369 (SC)

Though original assessment proceedings, for computing tax, may be a good item of evidence in penalty proceedings, but penalty cannot be levied solely based on the reasons given in the original order of assessment.

S. 470 (Erstwhile S. 273B) reasonable cause, **Assistant Director of Inspection v. Kum. A.B. Shanthi [2002] 122 Taxman 574/255 ITR 258 (SC)**

5.3. Procedural Aspects and Natural Justice:

5.3.1. Sahara India (Firm) v. CIT (2008) 300 ITR 403 (SC)

Principle of natural justice and due process of law. While the Income-Tax Act 2025 aims for more digital and faceless assessments, the underlying requirement for procedural fairness remains.

This Supreme Court case, though not directly on penalties, is relevant for all quasi-judicial proceedings under the Income-Tax Act, including penalty proceedings. It emphasised the importance of granting a proper opportunity to be heard, stating that a post-decisional hearing cannot substitute a pre-decisional hearing unless explicitly provided by the statute. The ratio of the judgment is that the tax authorities to follow due process before imposing penalties.

5.4. Bonafide mistake.

5.4.1. Price Waterhouse Coopers Pvt Ltd. v. CIT (2012) 348 ITR 306/211 Taxman 40 (SC)

Reintroduced the idea of bona fide error or absence of fraudulent intent. No penalty can be imposed.

5.5. Faceless Regime and due opportunity.

Faceless schemes must adhere to natural justice, else orders are liable to be quashed. **Refer Section 471,** No order imposing penalty under this chapter (Chapter XXI) shall be made unless the assessee has been heard or has been given a reasonable opportunity of being heard.

S. 439: Under-reporting and misreporting [S. 270A], ***GM Modular Pvt Ltd v. PCIT (2026) 185 taxmann.com 495.*****www.itatonline.org.**

5.6. Claim made on the basis of the judgment of High Court, no penalty can be levied.

Prem Brothers Infrastructure LLP v. NFAC (2022) 288 Taxman 768 (Delhi)(HC); Disallowance u/s 14A. Difference in quantum of disallowance cannot be held to be misreporting of income.

5.7. Specific sections.

Chapter XXII of the Act – Offences and Prosecution. [Section 473 to 498 (Erast while sections 275A to 280D Chapter XXII.)- Conceptual issues.

Guide to offences and prosecutions under the Income Tax Act, 1961 Dr. K. Shivaram, Senior Advocate dt. January 27, 2018.

S. 490: Presumption as to culpable mental state. (Erstwhile S. 278E). The Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986, inserted S. 278E with effect from 10th September, 1986. The scope and effect of this provision have been explained by the Board Circular No. 469 dated. 23rd September1986, *(1986) 162 ITR 21 (St)(39).*

Section. 490 (Erstwhile S. 278E):

(1) In any prosecution for any offence under this Act, which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state on the part of the accused, the court shall presume the fact that he had no such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the Act charged as an offence in that prosecution.

(2) For the purpose of this section, the expression "*culpable mental state*" includes intention, motive or knowledge of a fact or belief in, or reason to believe, a fact.

(3) For the purpose of this section, a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

Constitutional validity of the said provision was challenged before Madras High Court in *Selvi J. Jayalaitha v. UOI and Ors (2007) 288 ITR 225 (Mad.) (HC)*, *Selvi J. Jayalalitha & Ors v. ACIT (2007) 290 ITR 55 (Mad.) (HC)* which was affirmed by Apex court in *Sasi Enterprises v. ACIT (2014) 361 ITR 163 (SC). (180)*. The Apex Court in the said decision observed that, in every prosecution case, the Court shall always presume culpable mental state and it is for the Accused to prove the contrary and that too beyond reasonable doubt. This is a drastic provision which makes far reaching changes in the concept of the provisions of means rea as necessary ingredients and radical departure from the concept of the traditional criminal jurisprudence. According to this section, wherever *mens rea* is a necessary ingredient in an offence under the Act, the Court shall presume its existence. No doubt, this presumption is a rebuttable one. The explanation to the section provides for an inclusive definition of culpable mental state which is wide in its field so as to include intention, motive, knowledge of a fact and belief in or reason to believe a fact. The presumption arising under sub section (1) may be rebutted by the accused, but the burden that is cast upon the accused to displace the presumption is very heavy. The accused has to prove absence of culpable mental state not by preponderance of probability. In *Prakash Nath Khanna v. CIT (2004) 266 ITR 1(SC) (12)*, the Court observed that the Court has to presume the existence of culpable mental state, and absence of such mental state can be pleaded by an accused as a defence in respect of the Act charged as an offence in the prosecution it is open to the appellants to plead absence of culpable mental state when the matter is taken up for trail. In *J. Tewari v. UOI (1997) 225 ITR 858 (Cal)(HC) (861)*, the court observed that the rule of evidence regarding presumptions of culpability on the part of the accused does not differentiate between a natural person and a juristic person and the court will presume the existence of culpable state of mind, unless the accused proves contrary.

In *ACIT v Nilofar Currimbhoy (2013) 219 Taxman 102 (Mag.) (Delhi) (HC)*, prosecution was launched u/s. 276CC for failure to file the return, the court held that the onus on the assesse to prove that delay was not wilful was on the assesse and not on the department (SLP of assesse is admitted *Nilofar Currimbhoy v. ACIT (2015) 228 Taxman 57 (SC)*. The amendment, being penal in nature is not applicable to those offences committed on or before 9th September1986, even if the prosecution proceedings are launched after the said date.

Section 491: Prosecution to be at instance of Principal Chief Commissioner or Principal Commissioner or Commissioner (Erstwhile Section 279).

One of the suggestion was made by the stake holder before the Committee was before giving an approval for sanction, an opportunity of hearing may be given, and he should pass speaking order. Ministry has not agreed with the suggestion, the ministry stated that the accused can challenge all the grounds, including sanction before the Judicial Magistrate, hence the suggestion was negatived.

6. <u>Limitation for initiation of proceedings.</u>

Chapter XXXVI of the Code of Criminal Procedure 1973, lays down the period of limitation beyond which no court can take cognizance of an offence which is punishable with fine only or with imprisonment not exceeding three years. But, the Economic offences (applicability of Limitation Act, 1974) provides that nothing in the aforesaid chapter XXXVI of the Code of Criminal Procedure 1973, shall apply to any offence punishable under any of the enactments specified in the Schedule. The Schedule referred to includes Income tax, Wealth tax, etc. In *Friends Oil Mills & Ors. v. ITO (1977) 106 ITR 571 (Ker.) (HC)*, dealing with S. 277 of the Act, held that bar of limitation specified in section 468 of the Code of Criminal Procedure 1973 would not apply to a prosecution, under the Income tax Act, also refer, *Nirmal Kapur v. CIT (1980) 122 ITR 483 (P&H) (HC)*.

In view of this, as there is no period of limitation for initiation of proceedings under the Act, the sword of prosecution can always be hanging on the head of the assessee for the offences committed by him. It may be noted that this may result in an injustice to the assessee because a person who is in a better position to explain the issue or things in the initial stage, may not be able to do so later on if he is confronted with the act of commission of an offence under a lapse of time. In *K.M.A Ltd v. ITO (1996) Tax LR 248 (Bom) (HC),*the court held that complaint filed after 13 to 14 years after the date of alleged offences was liable to be quashed on the ground of in ordinate and un reasonable delay, also refer *Gajanand v State (1986) 159 ITR 101 (Pat.)(HC)*. Further, in *State of Maharashtra v Natwarlal Damodardas Soni AIR 1980 SC 593*, the Court held that a long delay, with other circumstances, should be taken into consideration in mitigation of the sentence.

Instruction No 5051 of 1991 dated February 7, 1991 wherein it is stated that prosecuting officers are not to initiate prosecution against a person who had attained the age of seventy at the time of commission of offence. Refer: *Rajindra Kumar v. State and another (2023) 451 ITR 338 (Mad)(HC).*

S. 484: Abatement, (erstwhile S. 278): Concerned to professionals.by instigation:

a. by conspiracy; or
b. by intentional aid

Circular No.179 dt 30/1975 (1975) 102 ITR 9 (St)(25)

In *Jamuna Singh v. State of Bihar, AIR 1967 SC 553*, the Court held that a person can be convicted of abating an offence even when the person alleged to have committed that offence in consequence of abatement has been acquitted.

In Mohana Raj Nair (Smt.) v. CBI &Ors (Bom) (HC) (UR) (WP No. 727 of 2012 dt 24-09 2013):

A panel of advocates gave a legal opinion about the title of immovable property, based on which the bank gave to loans. CBI launched the prosecution against the lawyer for Criminal conspiracy. On writ, the court quashed the proceedings on the ground that the criminal conspiracy is not established merely on suspicion, surmise or inference unsupported by cogent and acceptable evidence.

6.1. Consequences of the launch of prosecution.

a. When prosecution is launched in Mumbai. It takes nearly 20 years to frame a charge. In the meantime, the accused has to attend every three months or request an exemption,
b. As per the order passed by the Government of India, Ministry of External Affairs, New Delhi, August 25th 1993,
c. When prosecution is launched, if you are going abroad, you have to take permission of the Court every time,
d. If you go for a renewal of a passport, it can be renewed for only one year.

Though the assesse may have a good case of success before the Magistrate Court, we always advise the assesse to compound offences for the reason of peace of mind and uncertainty when the matter will be decided.

There is a circular of the Board that if the assessee is 70 years and above, no prosecution should be launched. *Hemant Mahipatray Shah v. Anand Upadhyay [2024] 165 taxmann.com 605 /(2025) 482 ITR 1(Bom)(HC)*

S. 276B: Offences and prosecutions- Failure to pay to the credit tax deducted at source-Sanction for prosecution source-Delay in depositing with Revenue-Tax deposited with interest-Circulars issued by the Central Board of Direct Taxes.

Interpretation of provisions of section 276B to include delay in deposit of tax deducted at source manifestly arbitrary Prosecution quashed- Non-issue of notice and order to treat any of them as principal officer of

assessee No order imposing penalty as "deemed to be an assessee-in-default" on assessee or its directors- Criminal complaints against directors of assessee not stating consent, connivance or negligence on their part as required under section 278B(2)- Directors of assessee cannot be prosecuted- Conduct of business of company must have nexus with offence committed-Amendment in law from year 1997- Use of phrase "*as required by or under provisions of Chapter XVII-B*" Linked only with and explains manner of deduction of tax and payment-Assessee deposited entire tax deducted at source with Revenue for assessment years 2012-2013 to 2018-2019 with interest belatedly–Prosecution quashed.

6.2. Compounding of offences.

S. 279(2) empowers the Chief Commissioner or Director General can compound an offence under the Act, either before or after the initiation of proceedings. The Department has issued new set of guidelines for compounding of offences under direct taxes vide notification F.NO 185/35/2013 IT (Inv. V) / 108, dated December 23rd, 2014 *(2015) 371 ITR 7 (St) (www.itatonline.org)*. These guidelines replace the existing guidelines issued vide F. No. 285/90/2008, dated May 10 2008 ITR (St), with effect from January 1, 2015. However, cases that have been filed before this date shall continue to be governed by earlier guidelines. Under S.279(2), the offence can be compounded at any stage and not only when the offence is proved to have been committed. Once compounding is effected, the assessee cannot claim a refund of the composition amount paid on the ground that he had not committed any of offence (*Shamrao Deshmukh vs. Dominion of India (1955) 27 ITR 30 (SC*) The requirement under sec. 279(2) is the person applying for a composition must be alleged to have committed an offence. The compounding charges might be paid even before a formal show cause notice has been issued. On the other hand, even if the accused is convicted of an offence, an appeal has been preferred against the same, there seems to be no bar to effect a composition during the pendency of such appeal and the accused shall not have to undergo the sentence

awarded if he pays the composition money. Prosecution initiated under Indian Penal Code, if any cannot be compounded, however, S. 321 of the Criminal Procedure Code, 1973 provides for withdrawal of such offences. Partial Decimalisation of certain Prosecution of the Income tax Act, 2025, *(2026) 308 Taxman 254 (St).*

7. Reply to show cause notices, grounds of appeal, and statement of facts.

We are in the era of faceless assessment and faceless appeal. If a proper reply to the show cause notice is filed, it will help in the appeal proceedings. We have observed in some of the matters that the revenue is relying on the statement of third parties, and the assesseee have neither asked for a copy of the statement nor an opportunity of cross-examination. The reply to the show cause notice must be based on facts and not on law. Whether a penalty is leviable or not is always a question of fact. In spite of filing confirmation, if the AO is not satisfied with the explanation, the assessee can request the assessing Officer to issue a summons. Once a request is made in writing, the burden shifts on to the revenue. It may be possible that the assessee may not be in a position to produce certain documents in the Assessment proceedings. The assessee should produce the same in penalty proceedings. *Mehta Parikh & Co v. CIT (1956) 30 ITR 181 (SC).*

In the case of *CIT v. Sun Engineering Works, (1992) 198 ITR 297 (SC),* it was held that the judgment of the Court has to be read as a whole in the context it was delivered. It is neither desirable nor permissible to pick out a word or a statement from the judgment, divorced from the context of the question under consideration by the court, to support their reasoning.

In *Arasmeta Captive Power Company P. Ltd. v. Lafarge India Pvt. Ltd., AIR 2014 SC 525,* the Court held that while reading a judgment, the ratio decidendi must be understood in the background of the facts of the case. Judgments rendered by a court are not to be read like.

While preparing a reply to a show cause notice, one has to rely on facts and not on case laws:

The Statement of Facts and the Grounds of Appeal before the Commissioner (Appeals) are very important documents when appeals are filed before the Appellate Tribunal, the High Court and even the Supreme Court. This is because in appeals before the Tribunal or the High Court, or the Supreme Court, Statement of Facts and Grounds of Appeal before the Commissioner (Appeals) form part of the record. Before the Appellate Tribunal, there is no provision permitting a Statement of Facts.

Delay in filing an appeal:

When an appeal is filed before CIT(A) or the Tribunal. The assessee should refer corrects facts. We have seen in a number of matters, though there is a delay in the column, the assessee mentions no delay. When Registry points out the delay, then the assessee files an application for condonation of the delay. In a few matters, the Tribunal dismissed the appeal without condoning the delay only on the ground that the assessee has not correctly stated the facts. The Tribunal and Courts are very liberal in condoning the delay but the assesssee should come before the Court with clean hands.

The Courts should have a pragmatic and liberal approach in condoning the delay. The Court has to exercise its discretion, keeping in mind that the principle of advancing justice is of prime importance , keeping in mind that the principle of advancing justice is the prime importance and the expression "*Sufficient cause*" should receive a liberal construction. The approach of Courts should be pragmatic so as to impart substantial justice. *Collector of Land Acquisition v. MST Ktaji & Ors (1987) 167 ITR 471(SC), N. Balakrishnan v. M. Krishna Murthy (1998) 7 SCC 123.*

8. <u>Jurisdictional issue in appellate proceedings.</u>

Jaidyal Pyare Lal v. CIT 1972 UPTC 596 (All)(HC) / Manu /UP/ 0454 / 1972, Para 10:

"*The regular assessment is not the final word upon, the pleas taken therein or which might have been taken at that stage. The assessee is entitle to*

show cause in penalty proceedings and to establish by the material and relevant facts which may go to effect his liability or the quantum of penalty. He cannot be debarred from taking appropriate pleas simply on the ground that such a plea was not taken in the regular assessment proceedings".

Tidewater Marine International Inc v. Dy CIT (2005) 96 ITD 406 (Delhi)(Trib): It was held that the jurisdiction of reassessment proceedings can be challenged in penalty proceedings, though not challenged in quantum proceedings. Where notice under section 148 had been issued beyond the statutory period prescribed under section 149(3), an assessment made based on such notice would be null and void. Since the very basis of imposition of penalty ceased to exist by virtue of the void assessment order, the penalty imposed under section 271(1)(c) was liable to be cancelled.

Shri Manish Manmohardas Asrani v. ITO (2025) 170 taxmann.com 792 (Mum)(Trib):
Not specifying the charge. Section 270A(8) or 270A(9)- Penalty was deleted Revision of Limited scrutiny. Not issuing the mandatory notice u/s 143(2) in the assessment proceedings. Though not challenged the assessment order, in penalty proceedings the assessee can argue that as the revision itself being without jurisdiction, penalty levied on such order may be quashed.

9. Constitutional Remedies.

When there are impossibilities of performance or gross violations of natural justice, evidence is used against the assessee without giving an opportunity of hearing. Failure to pass the speaking order. It may be possible to approach the High Court by filing a writ petition in an appropriate case.

10. Conclusion

One thought for the consideration of the organisers, in the 75th year of the BCAS, they have published a publication titled "*75 Laws relevant to* Direct

taxes" which was dedicated as a Tribute to Late Shri Naryan Varma Past President of the BCAS and one of the great visionaries of our time.

The Income-Tax Act, 1961, referred to 106 other Acts. The Income-tax Act 2025 also refers to 116 other Acts. Knowing the general law, especially the fundamental principle of the Constitution of India, Transfer of Property Act, Indian Registration Act, Hindu law, etc., will help the tax professionals to make better representations before the Assessing Officer, Commissioner (Appeals) and Appellate Tribunal. The organisers may consider holding a lecture series on the subject of general law that is applicable to the Income -Tax Act, 2025.

In the era of a faceless regime, only 0.2% returns are selected for scrutiny. We have a moral duty to follow the mandate of the Constitution of India, i.e.. Article 265 of the constitution "***No tax shall be levied or collected except authority of law***" and Article 51 of the Constitution of India, "*Fundamental duties of every citizen of India-Duty to the Nation Clauses (a) to (J). let me refer only clause (J).* ***"to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rise to higher level of endeavour and achievement."***

Hon'ble Justice S.H .Kapadia, former Chief Justice of India, addressed the National Tax Conference at Mumbai in the year 2002. While addressing the National convention at Mumbai stated that *"Every wrong advice given by the Tax Professionals has economic consequences. It is the duty of the Tax Professionals not to encourage tax evasion in the garb of tax planning. There is a very thin line between legitimate tax litigation and illegitimate tax evasion. I recommend one article of the Constitution of India.ie. '****Duty to the Country'".***

We are stakeholders in the justice delivery system of taxation. Our role is to contribute to the evolution of a fair, transparent, and accountable tax regime. We hope the tax professionals will respect the vision of the Honourable Mr. Justice S. H. Kapadia and follow his advice.

Disclaimer :

The gist of the lecture in the form of an article has been prepared solely for educational and academic purposes. The views and opinions expressed herein are the personal views of the speaker/author. Readers are advised to independently verify the citations, legal provisions, and contents before relying upon the same or using them for rendering professional advice or opinions.

Neither the speaker/author nor itatonline.org, shall be held responsible or liable for any inaccuracies, omissions, or errors in the citations or contents of the article.

Editorial Board

www.itatonline.org