IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN

Before Shri Sanjay Arora, AccountantMemberand
Shri Manomohan Das, JudicialMember

ITA No. 885/Coch/2022
(Assessment Year: 2017-18)

Harikuttan T. 1, Edayilaveetil Tharayil Njakkanal P.O., Pathiyoor Kayalmulam 690533 [PAN:ALRPT7536J] (Appellant)	vs.	The Income Tax Officer (2) Aayakar Bhavan Alappuzha Co0llectorate Alappuzha 688011 (Respondent)

Appellant by: Shri M.S. Venkitachalam, CA
Respondent by: Smt. J.M. Jamuna Devi, Sr. D.R.

Date of Hearing:08.08.2023
Date of Pronouncement:03.11.2023

O R D E R

Per Sanjay Arora, AM

This is an Appeal by Assessee challenging the confirmation of penalty levied under section 270A of the Income Tax Act, 1961 (the Act) for Assessment Year (AY) 2017-18 vide order dated 17/02/2022, by the first appellate authority, being the Commissioner of Income Tax, NFAC [CIT(A)] vide it's Order dated 06.07.2022.

2.1 The brief background facts of the case are that the assessee, a retired defence personnel, is a registered money lender under the Kerala Money Lenders Act (KML Act), lending money on interest against mortgage of loan. For the relevant year he returned, besides pension, income from this business at Rs.2,05,691. On verification, it was found by the Assessing Officer (AO) that the assessee was maintaining six bank accounts, i.e., three each with two banks, being South Indian Bank (SIB) and State Bank of India (SBI). *Transactions with the former were undisclosed*. The reason explained was that the gold pawned by his customers with him for availing loan, was in turn mortgaged with this bank to source funds for further lending. These

transactions, being illegal, i.e., in violation of the provisions of KML Act, were therefore not disclosed, for which a separate set of accounts was being maintained. The assessee had, after incurring bank interest and bank charges in its respect at Rs.5,77,151, earned a net profit of Rs.3,64,842 on this business. The AO, while assessing the said profit, also brought to tax the said expenditure, being bank interest (Rs.4,95,496) and bank charges (Rs.81,655), in view of section 37(1) read with *Explanation 1* thereto, which reads as under:

> "**37.** (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".
>
> *Explanation 1*.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose *which is an offence or which is prohibited by law* shall not be deemed to have been incurred for the purpose of business or profession and *no deduction or allowance shall be made in respect of such expenditure*."

2.2 Notice u/s. 270A r/w s. 274 of the Act for 'misreporting' income was issued on 24.12.2019, i.e., the date of the assessment u/s.143(3), upon recording satisfaction in its respect. In the penalty proceedings, initiated thus, the assessee pleaded his *bona fides* inasmuch as bei.ng from a non-business background, he had no experience or knowledge of the Act. He had merely mortgaged gold of his customers to increase his money lending business. It was accordingly not fair to include the expenditure incurred in this business as income, even as assessment was not appealed as he was under a *bona fide* impression that no penalty would be charged. The same did not find favour with both the AO and the first appellate authority, leading to the instant appeal.

3. We have considered the rival contentions, and perused the material on record.

3.1 The assessee's principal contention, also advanced before the Revenue authorities, was that the notice u/s. 274, show causing him for the said levy, did not specify the limb of section 270A of the Act under which the AO deemed misreporting of income.

3.2 We, accordingly, proceed by reproducing the relevant sections:

Penalty for under-reporting and misreporting of income

270A. (1) The Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner may, during the course of any proceedings under this Act, direct that any person who has under-reported his income shall be liable to pay a penalty in addition to tax, if any, on the under-reported income.

(2) A person shall be considered to have under-reported his income, if—

(*a*) the income assessed is greater than the income determined in the return processed under clause (*a*) of sub-section (1) of section 143;

(*b*) the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished or where return has been furnished for the first time under section 148;

(*c*) the income reassessed is greater than the income assessed or reassessed immediately before such reassessment;

(*d*) the amount of deemed total income assessed or reassessed as per the provisions of section 115JB or section 115JC, as the case may be, is greater than the deemed total income determined in the return processed under clause (*a*) of sub-section (1) of section 143;

(*e*) the amount of deemed total income assessed as per the provisions of section 115JB or section 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been furnished or where return has been furnished for the first time under section 148;

(*f*) the amount of deemed total income reassessed as per the provisions of section 115JB or section 115JC, as the case may be, is greater than the deemed total income assessed or reassessed immediately before such reassessment;

(*g*) the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

(3) The amount of under-reported income shall be,—..

(4) – (6)

(7) The penalty referred to in sub-section (1) shall be a sum equal to fifty per cent of the amount of tax payable on under-reported income.

(8) Notwithstanding anything contained in sub-section (6) or sub-section (7), where under-reported income is in consequence of any misreporting thereof by any person, the penalty referred to in sub-section (1) shall be equal to two hundred per cent of the amount of tax payable on under-reported income.

(9) The cases of misreporting of income referred to in sub-section (8) shall be the following, namely:—

(*a*) misrepresentation or suppression of facts;

(*b*) failure to record investments in the books of account;

(*c*) claim of expenditure not substantiated by any evidence;

(*d*) recording of any false entry in the books of account;

(*e*) failure to record any receipt in books of account having a bearing on total income; and

(*f*) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X apply.

Procedure

274. (1) 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.

(2) No order imposing a penalty under this Chapter shall be made—

(*a*) by the Income-tax Officer, where the penalty exceeds ten thousand rupees;

(*b*) by the Assistant Commissioner or Deputy Commissioner, where the penalty exceeds twenty thousand rupees,

except with the prior approval of the Joint Commissioner.

(3) An income-tax authority on making an order under this Chapter imposing a penalty, unless he is himself the Assessing Officer, shall forthwith send a copy of such order to the Assessing Officer."

3.3 The scheme of the Act *qua* penalty on concealment of, or furnishing inaccurate, particulars of income, representing commission and omission in reporting income, which was hitherto subject to penalty u/s. 271(1)(c) of the Act r/w *Explanation 1* thereto, stands modified w.e.f. AY 2017-18, to under-reporting of income subject to penalty of 50% of the tax on the under-reported income. The assessment of income at a sum higher than that reported or processed is *per se* regarded by law as liable to penalty for under-reporting income u/s. 270A(2). That is, deliberateness, which is implied inasmuch as it is the assessee, in the intimate know of his affairs, who nevertheless returns a lower income, and brought forth specifically per *Explanation 1* to section 271(1)(c) of the Act, is thus presumed (*Cement Marketing Company of India vs. Asst. CST* [1980] 124 ITR 15 (SC)). Saving is, further, provided for a *bona fide* explanation which is substantiated by disclosure of material facts or difference of estimate based duly disclosed material (s. 270A(6)). Further still, an immunity from penalty is provided u/s. 270AA(1) of the Act on application by the assessee within 30 days of the assessment, where the assessee pays

tax on the unreported income as well as interest thereon and, further, does not appeal there-against. To the extent, however, 'under-reporting' of income is on account of 'misreporting' thereof, defined u/s.270A(9), laying objective tests therefor, penalty is leviable at the rate of 200% of the tax on such income. No immunity is provided in respect of this penalty (s. 270AA(3)).

3.4 The assessee in the instant case has no case of under-reporting income as being *bona fide*. He is an educated person, successfully undertaking money lending business, which involves a basic understanding of law, at least that incident thereon, besides a fair degree of documentation, with extensive dealings with bank. He, conscious of violating the provisions of KML Act, knowledge of which is even otherwise presumed for a person licensed there-under, chose not to disclose the transactions of his illegal business to the Revenue. *Rather, the same, i.e., this knowledge, forms the basis of the non-disclosure*. Section 18A(7) of the KML Act proscribes selling or otherwise disposing of any pledged pawned with a money lender except at such time and in such manner as is authorized by or under the Act, which also provides for all pledges by the pawnbroker being open to inspection at any time by the licencing authority or by the Inspectors/authorized officials by the Government. There is no contention, much less case made out, at any stage, of the same being consistent with s. 18A(7). The same surely would not include mortgage of pawned gold, without the pawner's consent. Both the removal of the pledge and its subsequent pawning for personal gain is illegal, carried out systematically in a clandestine manner by routing the transactions through a different bank. One offence or default cannot be an explanation for another violation of law, i.e., not reporting income truly and correctly. It is a clear case of concealment of income. The evasion of tax being patent, it does not therefore lie in the assessee's mouth to say that there is no misreporting of income, or that he was not aware of it. *On what basis, then, does it return income of one segment of the business and not of the other*? To be fair to the assessee though, he does not dispute it on merits, except *qua* the expenditure of

Rs.5.77 lakhs – on the incurring of which there is no doubt, disallowed u/s. 37(1), in bringing the income of his undisclosed money lending business to tax (refer para 2.2).

3.5 To contend, as the assessee does, of it being, though admittedly a case of misreporting, not clear as to which clause of the provision (s. 270A(9) of the Act), it falls under, only needs to be stated to be rejected. The different clauses of section 270A(9) only represent the different forms in which misreporting of income may manifest itself. Why could not, one may ask, the assessee state that his case does not, for the reasons that may be advanced by him, not fall under any of the clauses of s. 270A(9). *This is as it is surely not open to an assessee to say that while his case does indeed falls under one of the clauses thereof, but yet penalty thereunder could not be levied inasmuch as it is not specified in the notice*! The notice is only a device for extending opportunity to the assessee to state his case *qua* a specific charge, precisely defined. Indeed there could be an overlap or more than one clause attracted in a particular case, which may even change on the basis of the assessee's explanation. If the assessee's explanation could operate to save penalty – that being the purport of hearing, it could surely cause a change in the applicable clause of the provision. This is precisely what the Hon'ble jurisdictional High Court clarifies when it says in *T.A. Abdul Khader vs. CWT* in [2008] 296 ITR 20 (Ker) that opportunity of hearing causes to remove any prejudice that may otherwise have been caused. What,one may ask, where there is more than one adjustment to the returned income in assessment, which may attract different clauses of s. 270A(9). *Does the AO issue multiple notices in such a case*? The law does not contemplate specification of the clause under which the assessee's action may attract the relevant charge. Finally, prejudice, where shown, the onus for which would be on the assessee, would make the proceedings irregular, with it being trite law that proceedings in such a case shall revert to the stage where the irregularity had intervened (*Suptd., Central Excise v. Pratap Rai* [1978] 114 ITR 231(SC); *Guduthur Bros. v. ITO* [1960] 40 ITR 298 (SC)). There is no question even in such case of penalty being without jurisdiction, even as in the facts of a case, a

case for remand could be made with some justification to the AO to allow the assessee to state his case, which may be different with reference to different clauses.

3.6 Coming to the facts of the case, the assessee's conduct, under the given facts and circumstances, *is not only of a conscious disregard of law, but also a deliberate defiance thereof*. His only case, under the circumstances, could beto show that his conduct does not fall under any of the clauses of s. 270A(9), as indeed he claims, for which reference be made to the assessee's written submissions before the ld. CIT(A), reproduced at para 2.2 (pgs. 3-4) of his order, in relation to Gds. 1& 2 before him. That apart, the assessee, who has not placed the copy of the notice u/s. 274 on record, states per his said Gd. 2 that the AO has invoked u/s. 270A(9) under clauses (a) & (e) thereof, as indeed in his Gd. 2 before us. *No wonder, then, this issue was not raised by the assessee before the Revenue authorities, and in fact is de hors the facts of the case*. We have already clarified that more than one clause may be attracted in the facts of a case. The assessee's case, therefore, would stand modified from that stated above (para 3.5) to his conduct being not covered under the said clauses (a) and (e) of s. 270A(9), which we agree to be the clauses applicable. The assessee has, in his reply before the ld. CIT(A), claimed so. And which stands decided by him on merits, a different matter though, and which we shall take up in due course. Suffice to state here that the plea raised by Sh. Venkitachalam, the ld. counsel for the assessee, before us, is thus misleading and unfortunate.

3.7 Next, we may take up the assessee's case on merits, i.e., w.r.t. the explanations furnished. His pleading that he was not aware of the provisions of the Act, viz. s. 37(1) of the Act, which is to be read along with the *Explanation* thereto, may well be true. How, we wonder, that is relevant? The only thing relevant is the explanation furnished, on being show caused u/s. 270A(9) r/ws. 274 of the Act in respect of the non-disclosure of a part of his money lending business, which has led to assessment being at a sum higher than that returned. Even as wilful default is not

necessary (*UoI v. Dharmendra Textile Processors* [2008] 306 ITR 277 (SC)), in the instant case it is so. The disallowance u/s. 37(1) is again only toward computing the income of such business as per the provisions of the Act; it being trite that it is only the real income, subject to the provisions of the Act, which is to be assessed [*Poona Electric Supply Co. Ltd. vs. CIT* [1965] 57 ITR 521 (SC)]. The assessee's case could thus only be of its action in not disclosing a part of it's money lending business, and, thus it's income, for which it maintains separate set of accounts, does not fall under the stated limbs of s.270A(9) of the Act, defining the term 'misreporting' of income, which we find as correctly specified and understood as under clauses (a) & (e), to though no consequence inasmuch as the same form part of the single charge, i.e., misreporting of income. Without doubt, there has been both, suppression of facts as also failure to account for receipt, even as held by the ld. CIT(A) at para 7 (pg. 12) of his order; the same forming the basis of the penalty.

3.8 Continuing further, in our view the assessee's case *qua* the income of Rs.5,77,151 and Rs.3,64,842 stand on different footings. To begin with, the AO himself, and fairly, does not recover tax on the income relatable to the extent Rs. 5.77 lacs; the decision of the Hon'ble jurisdictional High Court in *CIT v. Arun Thomas* (in ITA 100/2016, dated 03/10/2017) having been stayed by the Hon'ble Apex Court (see office note to the assessment order). The matter is no longer *res integra* in view of the decision by the Hon'ble Apex Court in *CIT vs. Prakash Chand Lunia (Decd.)*[2023] 454 ITR 61 (SC). In the facts of that case, silver was confiscated from the assessee, a dealer in silver bullion, on a search by the Directorate of Revenue Intelligence (DRI) Wing of the Customs Department, which levied personal penalty on him. In the assessment proceedings under the Act, the silver seized was brought to tax u/s. 69A of the Act. The assessee claimed loss on account of confiscation. The Hon'ble Apex Court reversed the decision by the Hon'ble High Court, which had earlier reversed the decision of the Tribunal upholding the assessment. In it's view, the silver having been seized from the assessee, it was definitely his income, and the loss on its confiscation

by DRI, clearly a business loss. The parallel in this case is striking. The assessee admits income from its illegal unaccounted (in the regular books of account) business, but pleads for deduction of expenditure incurred in its conduct. The two judges of the Hon'ble Apex Court, agreeing in principle, wrote separate judgements. In the view of J. Shah, smuggling, as inferred by the Customs Department, was not the assessee's business. He had, in an attempt to make a larger profit, indulged in smuggling of silver, causing infraction of law. The claim of loss by way of confiscation of silver was thus unsustainable. (*Haji Aziz and Abdul Shakoor Bros vs. CIT* [1961] 41 ITR 350 (SC)). J. Sunder relied on *Explanation 1* to section 37(1) as the basis of his decision. The word 'expenditure' in section 37(1) of the Act would take in its sweep the loss incurred in the course of business. There cannot be a situation where the assessee carrying an illegal business can claim deduction of expenditure or loss incurred in the course of that business, while another carrying on a legitimate one cannot seek deduction on the loss incurred on account of confiscation or penalty. Such an expenditure or loss incurred for any purpose which is an offence was deemed not to have been incurred for the purpose of business or incidental to it. The decision in *Dr. T.A. Qureshi vs. CIT*[2006] 287 ITR 547 (SC) was held as *perincuriam*, and the decision in *CIT vs. Piara Singh*[1980] 124 ITR 40 (SC) as no longer good law in view of the decision in *Haji Aziz and Abdul Shakoor Bros*. (supra) and *Explanation 1* to section 37(1). The similarity with the instant case is striking. The assessee incurs expenditure by way of bank interest & charges in the conduct of his illegal business, the pawning of mortgage of gold of others by him being an illegal act as per the provisions of KML Act.

So, however, it can be nobody's case that the assessee had, while not disclosing the income of his illegal business, intended to avoid tax on the expenditure of such business. There is no question of non-disclosure thereof, which becomes an incident of non-disclosure of income, evasion of which is patent. There is, thus, a qualitative difference in the assessee's explanation, which is to be considered on the anvil of

section 270A(6) of the Act qua *non-reporting* of income of his undisclosed business, and the expenditure incurred for earning the said income. As afore-noted, the law, with effect from AY 2017-18, segregates cases of commission (misreporting) and omission (under-reporting) of income, subject to a single charge earlier, by shifting the basis of the charge from its cause to the effect thereof. Though a concomitant of the money lending business carried illegally, the same is disallowable only in view of *Explanation 1* to section 37(1) of the Act. That is, the same would stand to be disallowed even if the assessee had disclosed the income of such business (*Apex Laboratories P. Ltd. v. Dy. CIT* [2022] 442 ITR 1 (SC)). Further, even as the said *Explanation* has been on the statute for several years now, its application qua an illegal business gets resolved only now by the Hon'ble Apex Court decision in *Praksash Chand Lunia* (supra); the Hon'ble Apex Court itself granting stay on recovery of tax in the case of *Arun Thomas* (supra).

3.9 In our opinion, therefore, while being surely recorded as mis-reporting, the same would qualify to be under-reporting. The penalty on the sum of Rs.5,77,151 shall accordingly stand levied @ 50%. Tax thereon has, however, been itself stayed by the AO. Had he levied penalty as under-reporting, it would be open for the assessee to, within 30 days of his order, apply for immunity on such penalty in terms of section 270AA of the Act, i.e., where so advised, and where made, the AO shall consider the same in accordance with law.

3.10 The assessee has also placed certain decisions on file, which were though not referred to during hearing. That being the case the same cannot be considered to form part of record (refer r. 18(6) of the Appellate Tribunal Rules). We are therefore under no obligation to advert thereto, particularly also considering that the same leads to denial of opportunity to the other side to respond thereto. We may yet, in the interest of justice refer thereto.

(i) In *Schndeider Electric South East Asia (Hq) PTE Ltd. vs. Asst. CIT*[2022] 443 ITR 186 (Del), the issue was whether the assessee was entitled to immunity u/s. 270AA of the Act inasmuch as the Revenue has failed to specify the charge, i.e., of 'under-reporting' or 'mis-reporting' of income under which the penalty had been initiated. This is as immunity is applicable for 'under-reporting' and not for 'misreporting' of income. The Hon'ble Court did not hold the notice as bad in law, though, on facts, found the assessee's case as falling under 'under-reporting' of income, and was therefore entitled to immunity u/s. 270AA inasmuch as he fulfilled the conditions for immunity. Inasmuch as the penalty is confirmed in principle, albeit under a different sub-section of s. 270A, the decision, in its ratio, is against the assessee. The reference to non-specification of the limb of sec. 270A(9) of the Act in para 7, is not with reference to the notice u/s.274, but to the assessment order recording the facts and satisfaction on the basis of which penalty is initiated. The AO in the instant case has specified the clauses of s. 270A(9), as indeed recorded the factum of suppression of facts and omission to record receipt in the assessment order, making the reliance on the said decision misplaced, both on facts and in law.

(ii) In *Ultimate Infratech (P) Ltd. vs. National Faceless Assessment Centre* [2022] 213 DTR 249 (Del), the question was whether the assessee could be denied immunity u/s. 270AA of the Act on it's petition u/s. 270AA(2) of the Act being undisposed by the AO, so that the Court found the assessee could not be prejudiced where he otherwise satisfied the conditions, and the non-passing of the order cannot be construed as the rejection of it's petition for immunity. The decisions is thus completely distinguishable on facts.

3.11 We may, before parting, though hasten to add that if at any time tax is held by the Hon'ble High Court or by the Hon'ble Apex Court – the matter being sub-judice before it, as not liable on the expenditure on the act constituting an offence, i.e., on the sum of Rs.5.77 lakhs, no penalty would be levied. The reason is simple. Penalty under section 270A of the Act is only toward an attempt to evade tax on income,

otherwise due. Where, therefore, no tax is considered by the higher courts as payable, the question of penalty *qua* the said sum, which is reckoned w.r.t. tax payable, does not arise. We are conscious of the words 'if any' following the words 'any addition to tax' in section 270A(1) of the Act. The same would nevertheless have to be interpreted meaningfully, and not to render the words "in addition to tax" as superfluous. *If the penalty is to follow in all cases irrespective of tax liability, what, one may ask is the purpose of the assessee being heard in the matter in the first place*? The same, as explained, is only in the event of tax liability, despite direct tax implications, not arising, as in the case of deduction of loss, etc.

In Sum

4. Even as ignorance of law is no excuse, the assessee in the instant case claims, owing to his non-business background, not being knowledgeable about the Act. The non-disclosure of a part of his business, transactions whereof are maintained separately, being admitted, his plea fails to pass muster. His explanation is only to be with reference to his conduct in returning income to the extent and in the manner done, and which is admitted as on account of contravening the KML Act. The segregation of the undisclosed business, routing it through different bank account/s and, therefore, its non-disclosure, arising on account of he being conscious of the contravention of the KML Act, the same is clear case of evasion of tax, a deliberate defiance of law, both under the KML Act and the Act.

The second limb of the assessee's explanation is the non-specification of the limb of s. 270A(9) in the penalty notice. The same, contrary to the assessee's Gd. 2 raised before us, the plea is misleading, and it is unfortunate that the Revenue did not bring it to our notice during hearing. Given the clear facts and the conscious conduct of the assessee, the plea is misconceived inasmuch as explanation *qua* acts specified in s. 270A(9) is essentially a matter of fact. No case of prejudice has been made up, even as confirmed with Sh. Venkitachalam during hearing. The issue principally is whether the notice would be defective and two, even if so, whether it would render

the proceedings as ill-conceived or, denial of proper opportunity to state it's case, irregular, so that the matter would go back to the stage where the irregularity, in the denial of proper opportunity, intervened. It is in this context that the decisions in *Dr.Pratap Rai* (supra) and *Guduthur Bros*. (supra) were earlier referred to. The decisions on defective notices are again legion, and of which the decision in *T.A. Abdul Khader* (supra) is a specie. The decisions forming part of the assessee's compilation are completely distinguishable on facts. The assessee, nevertheless, has a case *qua* the expenditure admittedly incurred for his illegal, undisclosed business. The reason is simple. The same is a concomitant of suppression of income, and the disallowance by virtue of the provision of the Act. There is no separate or independent suppression *qua* the same. *Per contra*, the expenditure, falling under *Explanation* to s. 37(1), would stand to be disallowed even if the business was disclosed. The penalty in its respect would therefore stand to be levied as under-reporting of income. Further, as this change arises at this stage, the assessee, who has not appealed, has been effectively denied opportunity to seek immunity. The assessee, accordingly, may at his option do so within 30 days of the receipt of this order and, where so, the AO shall decide thereon in accordance with law. We decide accordingly.

5. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on November 03, 2023 under Rule 34 of The Income Tax(Appellate Tribunal) Rules, 1963.

Sd/-	Sd/-
(Manomohan Das)	(Sanjay Arora)
Judicial Member	Accountant Member

Cochin, Dated: November 03, 2023

Copy to:

1. The Appellant
2. The Respondent
3. The CIT concerned
4. The Sr. DR, ITAT, Cochin
5. Guard File

By order

Assistant Registrar,
ITAT, Cochin

n.p.