PRIVY COUNCIL.

COMMISSIONER OF INCOME-TAX, BENGAL

v.

MAHALIRAM RAMJIDAS.

P. C.*
1940

April 2, 25.

[On Appeal from the High Court at Calcutta.]

Income-tax—*Tax which has escaped assessment—Procedure in assessing—Taxing Act—Section which does not impose a charge—Rule of construction—Income-tax Act (XI of 1922), s. 34.*

Where income, which should have been assessed in the year of assessment, has escaped assessment, to enable the Income-tax Officer to initiate proceedings under s. 34 of the Act, it is enough that the Income-tax Officer, on the information he has before him, in good faith considers that he has good ground for believing that the assessee's profits have for some reason escaped assessment or have been assessed at too low a rate.

Section 34 of the Act does not require that a quasi-judicial enquiry should be held to establish the factum of escapement as a condition precedent to the operation of the section.

Rex v. *Kensington Income Tax Commissioners* (1) referred to.

In interpreting a section of a taxing Act which imposes no charge on the subject and deals merely with the machinery of assessment, the rule is that that construction should be preferred which makes the machinery workable—*ut res valeat potius quam pereat.*

Order of the High Court set aside.

APPEAL (No. 27 of 1939) from a judgment of the High Court (February 24, 1938) on a reference under s. 66 (*1*) of the Income-tax Act (XI of 1922) by the Commissioner of Income-tax, Bengal (April 20, 1936).

The material facts are stated in the judgment of the Judicial Committee.

J. Millard Tucker, K. C., and *W. W. Wallach* for the appellant. This appeal turns on the construction of s. 34 of the Income-tax Act of 1922 and the

**Present*: Lord Thankerton, Lord Russell of Killowen, Lord Normand (Lord President of the Court of Session), Sir George Rankin and Lord Justice Goddard.

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only question in it is whether the Income-tax Officer is bound to hold an inquiry and give the assessee an opportunity to be heard before taking action under the section. The question is one that cannot arise under new Act, but it is of importance, as there are cases pending which will be governed by the decision in this case.

There is no decision exactly on the point, but the section has been considered in *In re Lachhiram Basantlal* (1) and *Rajendranath Mukherji* v. *Commissioner of Income-tax, Bengal* (2). I submit that the general rule that a taxing statute should be construed against the Crown does not apply to such a section as this, which deals only with machinery for collection. The section should be read with ss. 22 and 23. There is nothing in the section which indicates that a preliminary enquiry should be held or requires one to be held and there is no provision in the Act for the holding of such an inquiry.

R. Needham, K. C., J. M. Parikh and *R. Parikh* for the respondents. Various phrases are used in the Act as introductory to provisions for the taking of measures under the Act such as, "if in the opinion "of the Income-tax Officer," "where he has reason "to believe," "where he is satisfied," "where it is "found." When the Income-tax Officer has to do something decisive we find the words used are: "where it is found," "where he is satisfied."

In s. 34 there are no such introductory words. The section, in my submission, is in a real sense a charging section. It can have a reasonable operation where a new set of facts comes into existence if words are read into it such as "where the Income-tax Officer "is satisfied."

Where something entailing grave consequences has to be done under the provisions of a section, to

(1) (1930) I. L. R. 58 Cal. 909, 912.
(2) (1933) I. L. R. 61 Cal. 285; L. R. 61 I. A. 10, 16.

effect a just application of its provisions necessary, words will be read into it in construing it. The Income-tax Officer must find that a case is made out for proceeding under s. 34 before proceeding under it. I submit that this can be done only after an enquiry in which the assessee has been given an opportunity to be heard. If the words "where it is "found" are read into the section as introductory words, a reasonable construction is given to the section and makes it workable.

The judgment of their Lordships was delivered by

LORD NORMAND. This is an appeal by the Commissioner of Income-tax, Bengal, against a judgment of the High Court of Judicature at Fort William in Bengal delivered on a Reference made under s. 66 (*a*) of the Indian Income-tax Act, 1922. The respondents are a registered partnership firm carrying on business in Calcutta.

The question in the appeal turns on the true construction of s. 34 of the Indian Income-tax Act, 1922. That section enacts:—

34. If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year or has been assessed at too low a rate, the Income-tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains, or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-s. (2) of s. 22, and may proceed to assess or re-assess such income, profits or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section:

Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment, or full assessment, as the case may be.

The question at issue was formulated in the Reference as follows:—

Where the Income-tax Officer has, on such materials and informations as are available to him, reason to believe that income from any of the heads of income described under s. 6 of the Indian Income-tax Act—in the present instance, from "business" and "other sources",—which should have been assessed in the year of assessment has escaped assessment, and, as a result of such enquiries and investigations as are possible at that stage, has been satisfied as stated in para. 3 of the statement that a *prima facie* case has been made out against the assessee for assessment under s. 34 of the Act,

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whether, on a true construction of s. 34 of the Act, it is not open for the Income-tax Officer to initiate proceedings under s. 34, affording at the same time ample opportunities to the assessee to produce such evidence to the contrary as he likes, in the course of the proceedings thus initiated, or, on the other hand, does the section contemplate that the factum of such escapement should have been first proved and definitely found and determined by an independent enquiry, before the Income-tax Officer can assume jurisdiction to re-open the assessment under s. 34 ?

The learned Judges of the High Court criticised this formulation, holding that it was not in proper form and that it was made up of several involved questions connected with each other. They, therefore, did not render a positive or negative answer to either of the alternative branches of the question, but the judgment of the Court delivered by the learned Chief Justice construes s. 34 as requiring the Income-tax Officer to indicate to the assessee the nature of the alleged escapement from assessment and to give the assessee an opportunity of being heard, before the Income-tax Officer decides that income has escaped assessment and before proceeding to exercise his powers under s. 34. To put the decision negatively, the Court held that the Income-tax Officer was not entitled to exercise his powers under the section unless he had first held a quasi-judicial enquiry to which the assessee had been convened. The question now is whether that decision is well founded in law.

Though the appeal is concerned with a general question of the construction of s. 34, it is necessary for a clear understanding of it that the facts which give rise to it should be briefly explained under reference to other material provisions of the Act which were in force in 1932-33, the year of assessment. These provisions are to be found in ss. 22 and 23 of the Act. Under s. 22 (*2*), the Income-tax Officer must serve notice on any person, other than a company, whose total income is in the Income-tax Officer's opinion of such an amount as to render such person liable to income tax, requiring him to furnish a return in the prescribed form of his total income during the previous year. Sub-section (*4*) authorises the

Income-tax Officer to serve on any person upon whom a notice has been served under sub-s. (*2*) a further notice requiring him to produce accounts and documents, subject to the limitation that he shall not require the production of any accounts relating to a period more than three years prior to the year previous to the year of assessment. Section 23 provides for the making of the assessment. Sub-section (*1*) requires the Income-tax Officer, if he is satisfied that the return made under s. 22 is correct and complete, to assess the total income and to determine the sum payable. Under sub-s. (*2*) if the Income-tax Officer has reason to believe that the return is incorrect or incomplete he must serve on the person who made the return a notice requiring him either to attend at the Income-tax Officer's office or to produce any evidence relied on in support of the return. Sub-section (*3*) provides that the Income-tax Officer, after hearing such evidence as the person who made the return may produce and such other evidence as the Income-tax Officer may require on specified points, shall by an order in writing assess the total income and determine the sum payable. Sub-section (*4*) makes provision for an assessment by the Income-tax Officer to the best of his judgment if the assessee fails to make a return or to comply with the terms of the notices issued to him. This whole procedure, it may be recalled, not only applies on first assessment but is also prescribed by s. 34 if for any reason income, profits or gains have escaped assessment or have been assessed at too low a rate.

In the present case the procedure under s. 22 was put into operation by the Income-tax Officer and the respondents in reply to the notice issued under sub-s. (*2*) made a return in which they entered under the head "business, trade, commerce, *etc.*" a loss of Rs. 8,54,385. The Income-tax Officer accepted the return as correct and complete and on December 23, 1932, assessed the total income of the respondents at nil for the year 1932-33. But at the beginning of

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January, 1934, the Income-tax Officer received information that the account books of the assessees produced before the department had always been manipulated, that a comparison of the cash book with the bank pass books within recent years would show that they did not agree and that large sums of money which had been shown as received by the assessees in their bank pass books were not entered in the cash book. Specific instances of some of these discrepancies and inaccuracies were supplied by the informant. This naturally gave the Income-tax Officer food for thought, and after receipt of the information and before issuing notice under s. 34 he made such enquiries as were possible about the truth of the information. These enquiries were informal and *ex parte*. As a result of them the Income-tax Officer was satisfied: (1) that the allegations of discrepancies between the assessees' books of accounts produced at the assessment and some of the entries in their bank pass books were not without foundation; (2) that the assessees had withheld or suppressed relevant facts and information and thereby deliberately misled the Income-tax Officer; and (3) that a *prima facie* case that some income chargeable to Income-tax had escaped assessment was made out. Accordingly on February 5, 1934, the Income-tax Officer made an order directing notice to issue under s. 22 (*2*) read along with s. 34, and on February 8, 1934, a notice was issued to the respondents in these terms:—

> Whereas I have reason to believe that your income from business and other sources which should have been assessed in the financial year ending March 31, 1933, has wholly escaped assessment and I therefore propose to assess the said income that has escaped assessment. I hereby require you to deliver to me, not later than March 9, 1934, or within thirty days of the receipt of this notice, a return in the attached form of your income from all sources which was assessable in the said year ending March 31, 1933.

On March 22, 1934, the respondents filed a new return showing the same loss as was shown in the original return. The Income-tax Officer on May 21, 1934, issued further notices under s. 22 (*4*) and

s. 23 (*2*) and thereafter further procedure followed, including applications by the respondents to the High Court for the purpose of preventing the Income-tax Officer from proceeding with a new assessment, on the ground, *inter alia*, that s. 34 had been put into operation without giving the respondents an opportunity of being heard. It is not, however, necessary to discuss these proceedings, because eventually the convenient and competent course was taken of staying proceedings under s. 34 till the question at issue should be settled on a case stated under s. 66 (*1*) of the Act.

Learned counsel for the respondents submitted an argument that the facts alleged did not bring the case within the scope of s. 34. This is an argument which is not open to the respondents on the terms of the reference, which assume a case that falls within the terms of s. 34 and on that assumption raise the general question, what on a sound construction of the section is the duty of the Income-tax authorities before issuing a notice under s. 22.

Section 34 is unhappily and even ungrammatically phrased. It is expressed impersonally, and it fails to state by whom and by what procedure it is to be established that income, profits or gains have escaped assessment or have been assessed at too low a rate. There is fortunately no dispute that the person who must make that decision is the Income-tax Officer, for, apart from the assessee, no one else is in a position to say whether income has been assessed or at what rate it has been assessed. The omission to prescribe expressly what the nature of the decision should be and by what procedure it must be reached is all the more surprising because in other sections of the Act the legislature has been careful to define what is necessary in these respects. This circumstance was founded on by the learned counsel for the respondents, who pointed out that where some fact had to be established merely *prima facie* to the satisfaction of the

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Income-tax Officer in the *bona fide* exercise of his discretion, this was expressed by such phraseology as "when it appears to the Income-tax Officer", or "if "the Income-tax Officer has reason to believe". On the other hand, when the statute requires that the Income-tax Officer shall make a decision, which is final so far as he is concerned, upon a matter of fact, the usual expression is "if he is satisfied". When that expression is used, however, express provision is also made whereby the interested parties may be heard either by the Income-tax Officer himself (s. 25A and s. 28) or by the Assistant Commissioner (s. 23A) before any definitive action is taken. In one place (s. 26) the formula is "where it is found", but in this instance the decision is made by the Income-tax Officer in the course of making an assessment and when an enquiry under s. 23 is open. Learned counsel for the respondents maintained that in a taxing Act the construction more favourable to the assessee should be preferred and he suggested that s. 34 should be read as if it were introduced by the words "if the Income-tax Officer "is satisfied" or the words "if it is found". But this suggestion is not in itself helpful to the respondents, since the words proposed to be implied do not carry with them by a further implication a direction to hold a quasi-judicial enquiry; and the real question is whether the section should be read subject to an implied *proviso* that the Income-tax Officer shall not apply the procedure prescribed by the section except after a decision taken in a quasi-judicial enquiry.

The section, although it is part of a taxing Act, imposes no charge on the subject, and deals merely with the machinery of assessment. In interpreting provisions of this kind the rule is that that construction should be preferred which makes the machinery workable, *ut res valeat potius quam pereat*. In the present instance two considerations are in their Lordships' opinion decisive. First, no powers are imposed by the section on the Income-tax Officer to convene the assessee, or to issue notices calling on

him to produce documents, though these powers are essential if the Income-tax Officer is to conduct a quasi-judicial enquiry before deciding that profits have escaped assessment or have been assessed at too low a rate. In *Rex.* v. *Kensington Income Tax Commissioners*(1), s. 52 of the Taxes Management Act, 1880 (now s. 125 of the Income Tax Act, 1918) came under consideration of the Divisional Court. It was contended on behalf of the subject tax-payer that the section imposed as a condition precedent to the operation of the section an obligation on the part of the surveyor to obtain legal evidence that the return was defective. The words to be construed were "if "the surveyor discovers that any properties or profits "chargeable to tax have been omitted from the first "assessment". Rejecting this contention Lush J. said :—

> It is certainly remarkable that the statute.....contains no machinery for enabling the surveyor to obtain the evidence which it is said he must obtain before his jurisdiction under the section arises. He is not a judicial officer ; he has no power to compel witnesses to give evidence, or to administer an oath if they are willing to give evidence. He has no means of obtaining that evidence without which, according to the contention, the jurisdiction does not arise.

The decision of the Divisional Court in that case ultimately turned on a question not material to the present issue. It was reversed by the Court of Appeal (2), but the Court of Appeal did not differ from the observations of Lush J. cited above, as is made clear by the judgment of Pickford L.J. (at p. 445). Caution is necessary in applying decisions on a British Income Tax Act to the Indian Income-tax Act, but the reasoning of Lush J. is general and is not affected by specialities of the British Act. It is apposite to the respondents' contention in the present case. Their Lordships are of opinion, in accordance with that reasoning, that it cannot be a condition precedent to the operation of s. 34 that the Income-tax Officer should hold a quasi-judicial enquiry, because the

(1) [1914] 3 K. B. 870, 898. (2) [1914] 3 K. B. 429.

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powers necessary for such an enquiry are not conferred upon him. But there is a second consideration which is no less conclusive. The operative part of s. 34 empowers the Income-tax Officer to proceed *de novo* under sub-s. (*2*) of s. 22, and that in turn leads, if there should still be a question of the accuracy of the return, to an enquiry under s. 23 (*2*) and (*3*), and in that enquiry the assessee has a statutory right to appear and to produce evidence. Therefore a construction of s. 34, which requires a quasi-judicial enquiry to be held before the powers under the section can be operated, would result in mere duplication of procedure and in two enquiries of the same kind, into the same matter, conducted by the same official, and without any advantage to the parties. A construction so unreasonable and unpractical ought not to be preferred when another construction is open. Accordingly their Lordships are of opinion that the Income-tax Officer is not required by the section to convene the assessee, or to intimate to him the nature of the alleged escapement, or to give him an opportunity of being heard, before he decides to operate the powers conferred by the section. In the opinion of their Lordships, the view which the learned Judges of the High Court have taken of the section is too narrow, and the notice sent to the respondents on February 8, 1934, is in form a competent preliminary to a new assessment.

The question in the Reference is so framed that an answer to the first branch in the affirmative and to the second branch in the negative might be misleading and fail to give exact effect to the opinion of their Lordships. Their Lordships think that the proper answer to be given is that, to enable the Income-tax Officer to initiate proceedings under s. 34, it is enough that the Income-tax Officer on the information which he has before him and in good faith considers that he has good ground for believing that the assessee's profits have for some reason escaped assessment or have been assessed at too low a rate.

The result is that their Lordships will humbly advise His Majesty that the appeal should be allowed, and that the order of the High Court should be set aside. The respondents should pay the appellant's costs in the proceedings on the Reference before the High Court and before the Board.

Solicitor for appellant: *The Solicitor, India Office.*

Solicitors for respondents: *Stanley Johnson & Allen.*

C. S.