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debts were irrecoverable or not. The Assistant Commissioner allowed sums to be written off as irrecoverable when payments had been made to account in January or March 1931, but he was not prepared to treat the loans in which part repayments had been made in 1930 as being on the same basis, which is illogical. We consider that there were no materials before the Income-tax Officer from which he could hold that these debts should have been written off before 12th April 1931.

As the assessee has succeeded in three out of the four questions, which refer to the main items, we consider that he is entitled to his costs and these we fix at Rs. 250.

A.S.V.

INCOME-TAX REFERENCE.

Before Sir Lionel Leach, Chief Justice, Mr. Justice Madhavan Nair and Mr. Justice Varadachariar.

1938, October 27.

GUNDA SUBBAYYA, PETITIONER,

v.

THE COMMISSIONER OF INCOME-TAX, MADRAS.*

Indian Income-tax Act (XI of 1922), sec. 23 (3)—Assessee's failure to produce evidence on which Income-tax Officer can make proper assessment of his income—Procedure to be followed by Income-tax Officer in case of—Propriety of making assessment in such a case as in a case falling under sec. 23 (4)—Sec. 13 of Act—Effect of—Income-tax Officer making assessment under sec. 23 (3) on material gathered by himself—Disclosure of material to assessee—Necessity—Reference to such material in order of assessment—Desirability of.

Where in a case falling under sub-section 3 of section 23 of the Indian Income-tax Act of 1922 the assessee fails to

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* Original Petition No. 126 of 1937.

produce evidence on which the Income-tax Officer can make a proper assessment of the assessee's income, the Income-tax Officer must himself take steps to procure material for the purpose if it is not already in his possession. He has power under section 37 to call witnesses and he can make his own inquiries. When he has material (which is not confined to what would be evidence in a Court of law) on which he can assess, he must consider it and make an assessment to the best of his judgment.

Commissioner of Income-tax, Bihar and Orissa v. *Maharajadhiraj of Darbhanga*(1) relied upon.

Difference between an assessment under sub-section 3 of section 23 in a case where the assessee's books are rightly rejected as being unreliable and he fails to produce other evidence and an assessment under sub-section 4 of section 23, pointed out.

The view held in *Ganga Ram-Balmokand* v. *Commissioner of Income-tax, Punjab*(2) and *Chan Low Chwan* v. *The Commissioner of Income-tax*(3), that section 13 must be read in conjunction with section 23 (3) and that the effect of so doing is to bring sub-section 3 of section 23 in line with sub-section 4 of that section, dissented from.

All that section 13 says is that, if the method of accounting employed by the assessee is a method which does not properly disclose the income, profits and gains of the assessee, the Income-tax Officer can adopt his own method. But in doing so he must have reference to the accounts before him as section 13 does not contemplate the rejection of the accounts. Section 13 adds nothing to and takes nothing away from section 23 (3).

The Income-tax Officer when making an assessment on material which he himself has gathered should disclose it to the assessee before making his assessment and give him an opportunity to adduce material in rebuttal. The Income-tax Officer is not, however, bound to disclose the source of his information. It is desirable that the Income-tax Officer should in such a case indicate in his order of assessment the material on which he has made his assessment, but he cannot be compelled to do so.

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(1) (1933) I.L.R. 12 Pat. 318 (P.C.).
(2) (1937) I.L.R. 19 Lah. 10. (3) (1929) I.L.R. 7 Ran. 281.

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In the matter of the Indian Income-tax Act XI of 1922 and in the matter of the assessment of Gunda Subbayya.

Ram Mohan Rao (with him, *S. Venkatesa Ayyangar*) for assessee.—"Best judgment" means a mere guess. The Income-tax Officer must have some data for disbelieving the evidence produced by the assessee. He may make a local inquiry or under section 37 of the Indian Income-tax Act of 1922 summon witnesses.

[THE CHIEF JUSTICE.—Let us look at *Gopinath Naik* v. *Commissioner of Income-tax*(1) which supports you.]

Against an assessment under section 23 (3) of the Act there is a right of appeal while there is none against an assessment under section 23 (4). Unless there is some record an appellate Court cannot find out whether the assessment is right or wrong.

[VARADACHARIAR J.—Suppose the Income-tax Officer records no evidence but merely says that his assessment is the result of inquiries made by him of several persons. Even then the appellate Court will have no material to go upon.]

[THE CHIEF JUSTICE.—Take a case in which an assessee submits a return and causes his account books to be produced but does not appear before the Income-tax Officer. What is the Income-tax Officer to do? He can only make such inquiry as he can and assess on the basis of the result of that inquiry. What is it that he is to put to the assessee in such a case?]

The Income-tax Officer can put to the assessee the points on which he requires to be satisfied as the result of the private inquiries made by him and require the production of any account books which the assessee can produce to clear up those points.

[THE CHIEF JUSTICE.—Is there anything in the Act to show that the Income-tax Officer is under a duty to put to the assessee the result of his private inquiries?]

Section 23 (3) does not provide for an arbitrary assessment. [Reference was made to *Muhammad Hayat-Haji Muhammad Sardar* v. *Commissioner of Income-tax*(2).]

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(1) (1935) I.L.R. 58 All. 200.
(2) (1930) I.L.R. 12 Lah. 129, 134 (F.B.).

[THE CHIEF JUSTICE.—There is a substantial difference between section 23 (3) and section 23 (4). In the former case the Income-tax Officer must have some material upon the basis of which he can make an assessment. If necessary, he must make his own inquiries. The question however is whether he is bound to disclose the result of his inquiries.]

An appeal lies against an assessment under section 23 (3) and unless there is some material on which the Income-tax Officer has proceeded and there is a record of it, the appellate Court will have no material to go upon. The Income-tax Officer may make his own inquiries, avail himself of the provisions of section 37 of the Act or even of the powers conferred by section 23 itself and give the assessee an opportunity of clearing up points which the Income-tax Officer thinks require to be explained by the assessee. He cannot in any event proceed in an arbitrary manner. There must be a material difference between an assessment made under section 23 (3) and one made under section 23 (4). [Reference was made to *In re Binjraj Hukumchand*(1) and *Muhammad Hayat-Haji Muhammad Sardar* v. *Commissioner of Income-tax*(2).]

M. Patanjali Sastri for Commissioner of Income-tax.—In ordinary cases no doubt there would be a substantial difference between an assessment under section 23 (3) and one under section 23 (4) because in the former case there must be material upon which the assessment is based. In certain cases however the position and powers of the Income-tax Officer under section 23 (3) will be assimilated to his position and powers under section 23 (4). If the assessee submits a return and produces certain account books which the Income-tax Officer considers to be unreliable, the position would be very much the same as under section 23 (4). The Income-tax Officer can assess according to his best judgment. The assessee can then appeal against the assessment and in the appeal try to displace the Income-tax Officer's estimate. That is a valuable right. [Reference was made to *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga*(3) which was on

(1) (1931) I.L.R. 58 Cal. 1446, 1451.
(2) (1930) I.L.R. 12 Lah. 120, 134 (F.B.).
(3) (1933) I.L.R. 12 Pat. 318, 333-4 (P.C.).

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appeal from *Maharajadhiraja of Darbhanga* v. *Commissioner of Income-tax, Bihar and Orissa*(1).]

[THE CHIEF JUSTICE.—What do you say about the question of disclosure ?]

The Income-tax Officer is not bound to disclose unless the assessee wants him to do so. As stated already, the Income-tax Officer's estimate can be displaced in appeal.

[*Ram Mohan Rao* intervening : Section 30 does not allow any additional evidence to be adduced.]

Patanjali Sastri continuing : On the other hand, section 31 (2) empowers the Assistant Commissioner to make a further inquiry or to cause a further inquiry to be made by the Income-tax Officer.

[THE CHIEF JUSTICE.—The sub-section merely says "may". It does not confer a right.]

"May" in the circumstances should be held to impose a duty. The Assistant Commissioner cannot arbitrarily decline to make or order a further inquiry. There is therefore no hardship at all. [Reference was made to section 121 of the English Act corresponding to section 23 (3) and (4) of the Indian Act.] Section 121 of the English Act clubs cases falling under section 23 (3) and section 23 (4) of the Indian Act together and a right of appeal is given in both cases.

[MADHAVAN NAIR J.—But the Indian Legislature has made a difference between cases under section 23 (3) and section 23 (4).]

In certain exceptional cases such as those referred to by me above there is really no difference between section 23 (3) and section 23 (4) except as to the right of appeal.

[THE CHIEF JUSTICE.—The three points are : (i) whether there is any difference between section 23 (3) and section 23 (4) ; (ii) whether there must be some material upon which the Income-tax Officer can act and whether it should appear on the record ; and (iii) whether he should disclose the material to the assessee so as to give him an opportunity of meeting the points relied upon against him. "Judgment" implies the consideration of some material.]

[*Ram Mohan Rao* intervening : Material under section 23 (3) means something different from material under section

(1) (1929) 4 I.T.C. 283 ; I.L.R. 9 Pat. 240 (S.B.).

23 (4). Material under section 23 (3) means material on record.]

Patanjali Sastri continuing : The next question is whether the materials collected by the Income-tax Officer should be disclosed in his order of assessment itself.

[THE CHIEF JUSTICE.—It is in accordance with natural justice that the assessee should be given an opportunity of rebutting the materials collected by the Income-tax Officer. Further, there being a right of appeal the material should be disclosed so as to enable the appellate authority to judge whether the Income-tax Officer was right or not.]

There are cases conceivable in which the position under section 23 (3) will be parallel to that under section 23 (4).

[THE CHIEF JUSTICE.—If the Income-tax Officer proposes to act upon information collected by himself he should disclose to the assessee the nature of that information though not the source of it.]

That position is conceded by the Commissioner. Though there is no statutory provision imposing such a duty on the Income-tax Officer, fairness to the assessee requires him to do so ; *Chan Low Chwan* v. *The Commissioner of Income-tax*(1).

[*Ram Mohan Rao* intervening referred to *Duni Chand-Dhani Ram* v. *Commissioner of Income-tax*(2) at page 204 for the position that the material should be put to the assessee and he should be given an opportunity to rebut it.]

[THE CHIEF JUSTICE.—That case is different.]

[*Ram Mohan Rao* : I rely upon the observation at page 207.]

M. Patanjali Sastri continuing : It is not necessary for the Income-tax Officer to deal with the material at any length in his order. No hard and fast rule should be laid down as to the extent to which he should deal with the material in his order. The assessment order would not be invalidated on the ground that the Income-tax Officer did not refer in his order to the material on which he acted provided he discloses the information at some stage, though a later stage.

[THE CHIEF JUSTICE.—Section 13 of the Indian Income-tax Act does not enlarge the powers of the Income-tax Officer under section 23 (3).]

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(1) (1929) I.L.R. 7 Ran. 281, 287. (2) (1926) I.L.R. 7 Lah. 201.

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It has been held that section 13 applies also to cases in which the assessee's account books are incomplete and considered unreliable by the Income-tax Officer. [Reference was made to *Chan Low Chwan* v. *The Commissioner of Income-tax*(1) and *Ganga Ram-Balmokand* v. *Commissioner of Income-tax, Punjab*(2).]

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The JUDGMENT of the Court was delivered by LEACH C.J.— In accordance with the direction of the Court given under section 66 (3) of the Indian Income-tax Act the Commissioner of Income-tax has referred the following question for the Court's decision :

"When there is evidence on which the Income-tax Officer can base a finding that the assessee's books are unreliable and consequently rejects them and the assessee fails to produce other evidence, can the Income-tax Officer assess under section 23 (3) of the Act to the best of his judgment ? "

The words "to the best of his judgment" are used only in sub-section 4, which requires the Income-tax Officer to make the assessment to the best of his judgment when there has been a default of the nature contemplated by the sub-section. Sub-section 3 directs the Income-tax Officer to make the assessment after hearing such evidence as the assessee may produce and such other evidence as the Income-tax Officer may require him to produce on specified points. No direction is given to the Income-tax Officer when assessing under sub-section 3 and the assessee fails to produce evidence or produces evidence which the Income-tax Officer considers unreliable or incomplete. The question is whether in such a case the Income-tax Officer should proceed to assess as he would do in a case falling under sub-section 4.

The provisions of the two sub-sections have been frequently debated in the Courts, but it is not necessary for the purpose of deciding the question referred to

(1) (1929) I.L.R. 7 Ran. 281, 286–7. (2) (1937) I.L.R. 19 Lah. 10, 19.

enter upon a discussion of the reported cases. When assessing under either of the two sub-sections the Income-tax Officer must have material on which to base his assessment. An order of assessment made under sub-section 3 is appealable, whereas an order made under sub-section 4 is not, but this does not mean that the Income-tax Officer can make an assessment under sub-section 4 capriciously. The assessment must be to the best of his judgment, and the word "judgment" itself implies consideration of something. Here it must be the consideration of facts relating to the income of the assessee. And the same principle applies when the Income-tax Officer is acting under sub-section 3. Where in a case falling under that sub-section the assessee has failed to produce evidence on which the Income-tax Officer can make a proper assessment of the assessee's income, the Income-tax Officer must himself take steps to procure material for the purpose if it is not already in his possession. He has power under section 37 to call witnesses and he can make his own inquiries. When he has material on which he can assess, he must consider it and make an assessment to the best of his judgment. I use the word "material" advisedly because the Income-tax Officer is not confined to what would be evidence in a Court of law. The only difference between an assessment under sub-section 3 in a case like the one mentioned in the reference and an assessment under sub-section 4 is that the Act contemplates a more summary method when the Income-tax Officer is acting under sub-section 4 and this is by reason of the deliberate default of the assessee.

The interpretation to be placed on sub-section 3 is to be gathered from the judgment of the Privy Council in the case of the *Commissioner of Income-tax,*

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Bihar and Orissa v. *Maharajadhiraj of Darbhanga*(1). In that case the assessee stated that he had an income of Rs. 4,364 from a certain source. The Income-tax Officer did not accept this figure, and passed an order assessing him on an income from this particular source of Rs. 1,04,364. In due course the Commissioner of Income-tax referred the following question to the Patna High Court for its decision :

"Whether the assessing Officer was right in making an estimate of Rs. 1,04,364 under this head as he has done ?"

The High Court answered this question in the affirmative and TERRELL C.J. in the course of his judgment observed:

"Learned counsel for the assessee has argued that the Officer is not entitled to make a guess without evidence and I agree with that contention, but in this case the state of affairs in the previous years, coupled with the fact that the assessee had a large mortgage loan business and must have enforced mortgages by sale on many occasions, afford ample material for the assessment made."

The other Judges concurred and the Privy Council also agreed,

"adding only that, if the assessee wished to displace the taxing officer's estimate, it was open to him to adduce evidence of all his purchase transactions during the year and of the financial results thereof, which he apparently made no attempt to do".

The Income-tax Officer had assessed the assessee to the best of his judgment on the material before him and the material was sufficient for the purpose.

There are two other questions which are bound up with the question under discussion, namely, whether the Income-tax Officer when making an assessment on material which he himself has gathered shall disclose it to the assessee before making his assessment and give him an opportunity to adduce material in

(1) (1933) I.L.R. 12 Pat. 318 (P.C.).

rebuttal and whether the Income-tax Officer should in his order of assessment set out the facts which he has taken into consideration when estimating the assessee's income for the year. There is nothing in the Act itself which requires the Income-tax Officer to disclose to the assessee the material on which he proposes to act or to refer to it in his order but natural justice demands that he should draw the assessee's attention to it before making the order. Information which the Income-tax Officer has received may not always be accurate and it is only fair when he proposes to act on material which he has obtained from an outside source that he should give the assessee an opportunity of showing, if he can, that the Income-tax Officer has been misinformed, but the Income-tax Officer is obviously not bound to disclose the source of his information.

An order made by an Income-tax Officer under section 23 (3) is appealable. When considering whether an order is right, the appellate authority must, of course, know on what it is based and if the basis of the order is not disclosed in the order itself it means that the appellate authority will have to refer the matter back to the Income-tax Officer in order to find out what the position is. Moreover, this Court has often to consider an order of an Income-tax Officer and it is convenient to this Court to know from the order itself why it was passed. From every point of view it is desirable that the Income-tax Officer should indicate in his order the material on which he has made his assessment, but I realize that he cannot be compelled to do so.

In the reference made by the Commissioner of Income-tax and also in the course of the arguments, mention has been made of section 13. The Commissioner of Income-tax suggests that section 13 can be

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read in conjunction with section 23 (3) and that the effect of so doing is to bring sub-section (3) of section 23 in line with sub-section (4). In *Ganga Ram-Balmokand* v. *Commissioner of Income-tax, Punjab*(1) the Lahore High Court appears to have read the section in this way and the Rangoon High Court appears to have done the same in *Chan Low Chwan* v. *The Commissioner of Income-tax*(2). I find myself unable to take the same view. Section 13 reads as follows :

"Income, profits and gains shall be computed, for the purposes of sections 10, 11 and 12, in accordance with the method of accounting regularly employed by the assessee ;

Provided that, if no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine."

It seems to me that all the section really says is that, if the method of accounting employed by the assessee is a method which does not properly disclose the income, profits and gains of the assessee, the Income-tax Officer can adopt his own method. But in doing so he must have reference to the accounts before him as section 13 does not contemplate the rejection of the accounts. Section 13 adds nothing to and takes nothing away from section 23 (3).

The reference will be answered in the sense I have indicated and the Income-tax authorities will carry out the assessment in the light of the observations made in this judgment. We consider that this is a case in which there should be no order as to costs, but we direct that the deposit made by the assessee be returned to him.

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(1) (1937) I.L.R. 19 Lah. 10, 13. (2) (1929) I.L.R. 7 Ran. 281.