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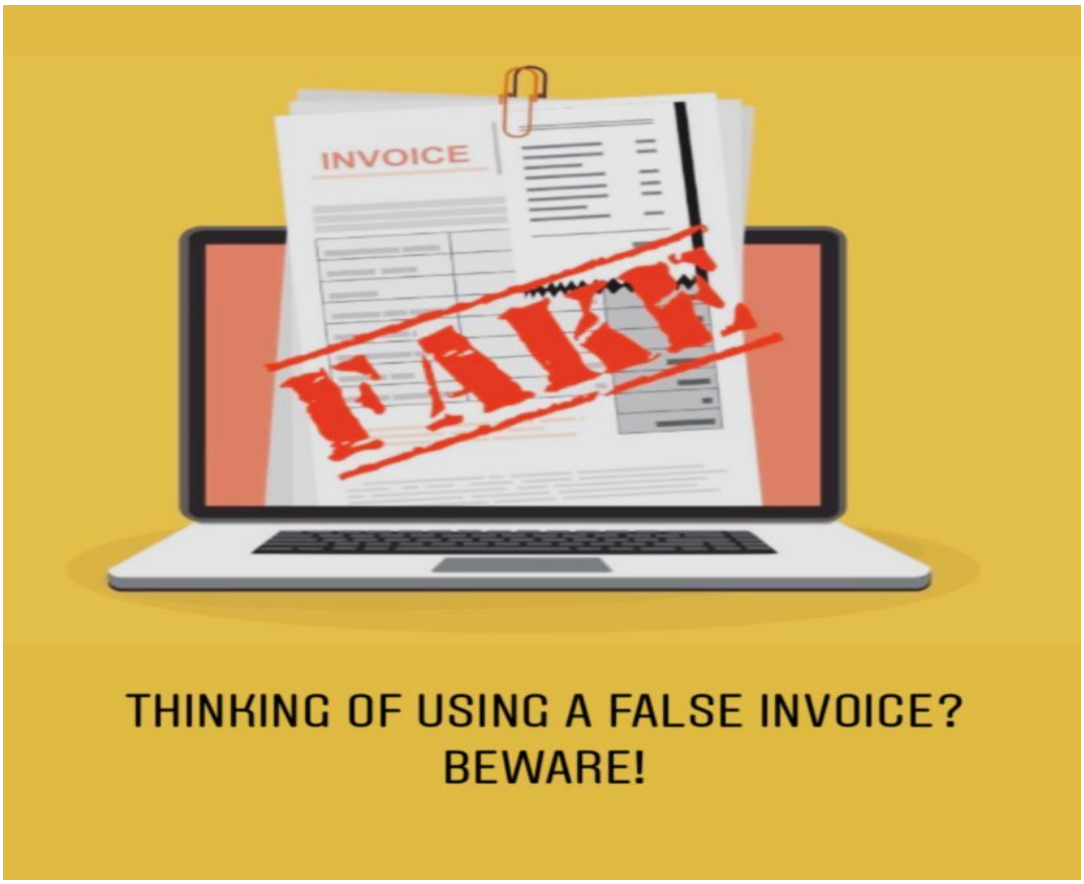

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Decoding Section 271AAD of the Income Tax Act, 1961

Yes, we are talking about the newly inserted provision in the Income Tax Act, 1961 which is specially designed to penalize mis-endeavours such as recording fake invoices in books to avoid tax. Section 271AAD introduced by the Finance Act, 2020 has become the talk of the town. The objective of the Legislature to introduce the Section as apparent from the Memorandum explaining the Finance Bill is to discourage taxpayers from manipulating their books by recording false entries and fraudulently claiming input tax credit (ITC) under the GST Act. However, one only realizes the scope and spread of the provision while reading the Section from the Statue Book, which reads as under:

"271AAD. (1) Without prejudice to any other provisions of this Act, if during any proceeding under this Act, it is found that in the books of account maintained by any person there is—

(i) a false entry; or

(ii) an omission of any entry which is relevant for computation of total income of such person, to evade tax liability,

the Assessing Officer may direct that such person shall pay by way of penalty a sum equal to the aggregate amount of such false or omitted entry.

(2) Without prejudice to the provisions of sub-section (1), the Assessing Officer may direct that any other person, who causes the person referred to in sub-section (1) in any manner to make a false entry or omits or causes to omit any entry referred to in that sub-section, shall pay by way of penalty a sum equal to the aggregate amount of such false or omitted entry.

Explanation.—For the purposes of this section, "false entry" includes use or intention to use—

(a) forged or falsified documents such as a false invoice or, in general, a false piece of documentary evidence; or

(b) invoice in respect of supply or receipt of goods or services or both issued by the person or any other person without actual supply or receipt of such goods or services or both; or

(c) invoice in respect of supply or receipt of goods or services or both to or from a person who does not exist."

The Memorandum suggests that "This amendment will take effect from 1st April, 2020", whereas in relation to various other amendments, the Memorandum explicitly states that "This amendment will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-22 and subsequent assessment years." This means that there is a deliberate delinking of the applicability of Section 271AAD to any assessment year and therefore, the provision is meant to apply for Financial Year 2020-21 and onwards.

Let us now decode the language of the law.

<u>"Without prejudice to any other provisions of this Act"</u>

The provision starts with the expression "Without prejudice to any other provisions of this Act" therefore, the penalty under Section 271AAD can be levied parallelly with other penalties provided under the Act. Section 270A provides for penalty in case of under-reporting and mis-reporting of income. A claim of expenditure not substantiated by any evidence, for example, is covered under the cases of mis-reporting of income under Section 270A. Now, if a person records a bogus purchase in his books, he may be charged with a penalty under Section 270A equivalent to 200% of the tax payable on such purchase amount. Also, penalty under Section 271AAD can be invoked simultaneously wherein he can be penalized for the entire amount of bogus purchases booked.

It may be noted that Section 270AA empowers the Assessing Officer to grant immunity from imposition of penalty under section 270A subject to fulfillment of conditions such as payment of tax and interest payable as per assessment order within the period specified in such notice of demand, and waiver of right to appeal. However, unlike for Section 270A, there exists no provision under the Act which could provide immunity from levy of penalty under Section 271AAD. Further, Section 273B provides that no penalty under the specified sections shall be imposable if assessee

proves that there was reasonable cause for the failures/ defaults envisaged under the penalty provisions specified therein. Section 271AAD does not find any mention in the specified penalty provisions under Section 273B which allows waiver of the penalty on establishing a reasonable cause for default.

But can there be two penalties for the same offence under an Act? Whether dual punishment is constitutionally valid? The rule 'double jeopardy', which implies that a person cannot be punished twice for the same offence, finds its place in Article 20(2) of The Constitution of India which lays down that 'no person shall be prosecuted and punished for the same offence more than once'. This rule is also embodied in Section 26 of the General Clauses Act which, in more specific terms, provides that where an act or omission constitutes an offence under two or more enactments, then the offender shall be liable to be prosecuted and punished under either or any of those enactments, but shall not be liable to be punished twice for the same offence.

The Hon'ble Calcutta ITAT in Titagarh Steels Ltd. [2001] 79 ITD 532 (Cal) which dealing with dual imposition of penalty u/s 221 and 271C held that "A fortiorari, an assessee cannot also be punished twice for the same act or omission, by way of two separate penalties which, in nature, belong to the same genus. Penalty proceedings are quasi criminal proceedings and we see no reason for non-application of the underlying principle of article 20(2), of the Constitution of India, as also of section 26 of General Clauses Act, to the penalty proceedings under the Income-tax Act…. we are of the considered view that even under the Income-tax Act, an act or an omission of the assessee, even if technically covered by two separate defaults, cannot be punished twice under the penal provisions. No doubt an act or omission of the assessee can be visited with several consequences, which may have different purposes and different objects such as recovery of taxes, interest compensation for late realisation of taxes and even separate criminal proceedings, but it cannot be visited with two or more penalties which are identical in effect and belong to the same genus….We may also mention that being punished 'twice may not mean that a punishment may not have more than one limb, but it does imply that there is more than one judicial or quasi-judicial proceeding for the same offence."

However, whether the argument for defending parallel imposition of penalties is strong enough to be sustained in relation to Section 271AAD, only time will tell.

"if during any proceeding under this Act"

The Section becomes effective from 1st April, 2020 and can be invoked by the Assessing Officer during any proceeding under the Act. Therefore, for invocation of the penalty provision, there must pre-exist a proceeding that has been initiated under the Income Tax Act. "Proceeding" in itself is a wide term and can include assessment/reassessment proceeding, search proceeding, recovery proceeding, appeal/revision proceeding etc. A proceeding can be initiated by mere issuance of a valid Notice under the Act by the jurisdictional authority. However, the "proceeding" must be a proceeding initiated under the Income Tax Act only. The Act does not envisage invocation of penalty under Section 271AAD if during a proceeding under the GST Act it is found that false invoices have been used to claim input tax credit.

Although the Section confers huge powers upon the Assessing Officers and also the enforcement date of the provision not being linked to any assessment year, itself is controversial, however, it is felt that the provisions may not be invoked to penalize any wrong-doings of the past, notwithstanding that the proceedings continue in the present. It has been laid down that penal provision cannot have retrospective operation; as at the time of commitment of the misdeed, the provision did not exist in the Statue Book and an assessee cannot be imputed with clairvoyance i.e. he could not have foreseen such penal consequences for his doing.

"it is found that in the books of account maintained by any person there is"

The word "found" suggests that there has to be a specific finding by the Assessing Officer to proceed with the penalty. He may take cognizance of any external source such as any report forwarded by the GST Department etc. , however, he has to apply his own mind to record a finding that a false entry is made in the books of the assessee.

For the Assessing Officer to make such a finding, “books of accounts” must pre-exist. The term “books or books of accounts” is defined under Section 2(12A) of the Income Tax Act, 1961 which reads as “"books or books of account" includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device.” As the definition is not exhaustive and only inclusive, one needs to examine the connotation of the term in ordinary commercial parlance. The following judicial rulings deal with ordinary commercial parlance meaning of the term:

♦ A book which merely contains entries of items of which no account is made at any time, is not a 'books of account' in commercial sense. To account means to reckon, and it is difficult to conceive any accounting which does not involve either additions or subtractions or both of these operations of arithmetic. A book which contains successive entries of items may be a good memorandum book; but until those entries are totaled or balanced, or both as the case may be, there is no reckoning and no accounts. A book which merely contains entries of items of which no account is made at any time, is not a 'books of account' in commercial sense. - Sheraton Apparels v. Asstt. CIT [2002] 123 Taxman 238 (Bom.)

♦ 'Books of Account' means such books of account as are usual in the business and do not extend to letters, cheques and vouchers from which books of account can be made up. (Per Cave, J., Re. Winslow, 55 LJQB)

♦ Loose sheets or scraps of papers cannot be termed as 'book' because they can easily be detached and replaced. Where loose sheets seized from assessee's premises consist of pages torn out of diary and contain no closing balances nor opening balances and is no reconciliation of these entries, such loose sheets cannot be termed as books maintained by the assessee during the previous year as these loose sheets - S.P. Goyal v. Dy. CIT [2002] 82 ITD 85 (Mum.)(TM).

♦ The two words 'books of account' and 'documents' do not carry the same meaning. A document may necessarily be not books of account.

♦ Books of accounts do not include Balance Sheet and profit and loss account – JK Industries Ltd. 80 SCL 283 (SC)

♦ Mere bank statement which is issued by bank to its client/account holder can't be elevated to status of books maintained by assessee within the meaning of section 2 clause 12A and section 44AA of the Act. A credit in bank account simply or any other raw information available to Assessing Officer cannot be loosely called as books of account - VineshMaheswari v. Income Tax Officer, Ward 61(3), New Delhi [2019] 103 taxmann.com 274 (Delhi - Trib.).

It is also noteworthy that according to the language deployed in the provision, the books of accounts must be maintained by the assessee concerned. If an assessee is not required to maintain books under Section 44AA of the Act or in a case, where he is so required, does not maintain books of accounts, he may escape the rigours of Section 271AA, notwithstanding that in the latter case, he may attract penalty under Section 271A for not maintaining books of accounts.

<u>“(i) a false entry;”</u>

The word "false" in its juristic use implies something more than a mere untrue. The Explanation to the Section 271AAD defines “false entry” for the purpose of the section (reproduced above). A false entry includes using any forged or falsified documents such as a false invoice or, in general, a false piece of documentary evidence; or invoice in respect of supply or receipt of goods or services or both where the person issuing such invoice or person to whom invoice is issued does not exist or the supply or receipt of such goods or services or both does not actually take place.

Therefore, the first limb includes use of any false document. A “document” as defined under Section 2(22AA) includes an electronic record as defined in Section 24(1)(t) of the Information Technology Act, 2000. According to Section 24(1)(y) of the Information Technology Act 2000, an electronic record means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche. Therefore, even a whatsapp image is also a “document” even though it may not physically exist.

Therefore, the question is - is the use of a false invoice the only 'mischief sought to be remedied' by the introduction of this Section? The use of the words "in general, a false piece of documentary evidence" with reference to a "false entry" however, makes the scope of the Section much wider in scope than the object and intent of the Legislature enshrined in the Memorandum explaining the introduction of the Section. Prima facie, it appears that the menace of accommodation entries viz. bogus capital formation, unsecured loans etc. can also fall within the ambit of this Section.

Also, the manner in which the provision is written suggests that the penalty for "false entry" under the Section is independent of the condition "to evade tax liability" unlike in the case of omission of any entry. Hence, it is immaterial as to whether the false entry has any impact on the computation of income of the assessee or not, whether it results in tax evasion or not. The penalty for false entry can indiscriminately be levied.

What makes the provision even more draconian is the use of the words "intention to use". Yes, a false entry does not only include "use" of a false document but also "intention to use" one. Mere existence of a false invoice or a false document found in possession of a person appears to be sufficient to invite the penalty.

However, it will be incumbent upon the Assessing Officer to prove that there was a malafied intention or deliberate attempt on the part of the assessee to make a false entry. Since the primary onus to prove the existence of "mensrea" lies upon the penalty imposing authority, he may have to rely on circumstantial evidences, besides direct evidences to prove the presence of a guilty mind on the part of the assessee.

"or (ii) an omission of any entry which is relevant for computation of total income of such person, to evade tax liability,"

Penalty under Section 271AAD can also be attracted for omission of an entry, provided such omission is to evade tax liability. It may be very difficult to draw the thin line of difference between an inadvertent or accidental omission and a malafide & intentional omission of an entry, where in both scenarios there may be a reduction in tax liability of the assessee.

"the Assessing Officer may direct that such person shall pay by way of penalty a sum equal to the aggregate amount of such false or omitted entry."

The quantum of penalty that can be imposed under Section 271AAD is not linked to the tax payable, but it is equal to the aggregate amount of such false or omitted entry itself. It may be noted that an entry in the books shall consist of a debit and a corresponding credit entry. Logically, the penalty imposable shall be equivalent to either of the two, and not both of them taken together.

"(2) Without prejudice to the provisions of sub-section (1), the Assessing Officer may direct that any other person, who causes the person referred to in sub-section (1) in any manner to make a false entry or omits or causes to omit any entry referred to in that sub-section, shall pay by way of penalty a sum equal to the aggregate amount of such false or omitted entry."

It is interesting to note that the Legislature has introduced a penal provision so wide in amplitude that it can, not only penalize the assessee but also the person, who abets or assists the assessee in his wrongdoing (herein referred to as "the other person"), with an equal amount. The levy of penalty on such other person however, appears to be discretionary and not mandatory.

By a plain reading of the provision, we understand that the Assessing Officer referred to in clause (2) is the same person as the Assessing Officer referred under clause (1), i.e. the Assessing Officer having jurisdiction over the assessee. The penalty on the other person shall also be supposedly levied by the same Assessing Officer. No Officer can pass an Order under the Act on a person without jurisdiction. The Section confers the power to the jurisdictional Assessing Officer of the assessee to simultaneously pass an Order imposing penalty on such other person who causes the assessee to make a false entry/ omit an entry. Section 274 which lays down the procedure for imposing penalty envisages a situation where an order imposing penalty can be passed upon a person by an income-tax authority who is not the Assessing Officer w.r.t such person. Clause (3) of Section 274 directs such income tax authority to forthwith send the copy of such penalty order to the Assessing Officer.

The scope of the Section is thus very wide and it cuts down on the time taking procedure of passing of information from one Assessing Officer to another for assumption of necessary jurisdiction to take any action.

Nevertheless, the Penalty Order passed by the Assessing Officer can be appealed against before the appellate authorities by any person (the assessee or the other person) on whom the penalty has been imposed. If in an appeal, penalty levied on the assessee is deleted, then there could be a deletion of the penalty levied on the other person accused of causing the assessee to make a false entry.

Needless to say that the once at the time of proceedings on a person A, penalty under Section 271AAD is levied on both the persons concerned (A and B), say, the supplier (A) as well as the recipient (B) of goods, for a false invoice with no actual supply of goods, there cannot be a levy of penalty under Section 271AAD for the second time during any proceeding initiated on person B.

The Section therefore confers huge powers upon the Assessing Officers and at the same time, provides enough room for discussions and arguments on the legal side, but on the other hand, comes down heavily on those indulging in manipulation of books, providing accommodation entries, bogus billing etc. fastening them with a severe penalty that goes way higher than the tax amount. Since there is no relief through immunity from levy of penalty under Section 271AAD, the only door that remains for the assessee to knock is of the appellate forums. Therefore, considering the quantum of penalty, litigations can be prognosticated.