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Kind Regards,

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World

World Bank releases transfer pricing handbook

The World Bank has released a Handbook setting out relevant aspects that countries need to consider when introducing or strengthening transfer pricing regimes.

Entitled, *Transfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners*, the handbook provides guidance on analytical steps that can be taken to understand a country's potential exposure to inappropriate transfer pricing (transfer mispricing) and outlines the main areas that require attention in the design and implementation of transfer pricing regimes.

It includes a discussion of relevant aspects of the legislative process, including the formulation of a transfer pricing policy, with examples, and the role and content of administrative guidance, It covers the practical application and implementation of the arm's length principle and on operating an effective transfer pricing audit program. – *Courtesy tax-news.com*

Sweden

Sweden proposes tax break for start-ups

The Swedish Government is to ease tax rules for start-up companies to better enable them to recruit skilled workers.

Under the proposals, announced by the Finance Ministry on December 20, shares granted to employees as part of their pay packages would not be considered remuneration for tax purposes, and therefore would not attract social security contributions. These shares would then be taxable as a capital gain when sold.

Small and start-up companies in Sweden, particularly in the technology sector, have long been calling for changes to the taxation of employee stock options, which are subject to income tax and social security contributions, for a combined rate of almost 70 percent.

Earlier in the year, Spotify co-founders Martin Lorentzon and Daniel Ek implored the Government to change these tax rule, stating that existing regime makes it "impossible" for Swedish companies to reward employees with stock options.

"In the US, stock options are taxed to the employee as income from capital at a rate of 15-20 percent, in Germany the level is 25

percent. In Sweden it is considered today as income from employment and thus taxed at 70 percent," they wrote.

The new rules would apply to companies that are no more than 10 years old and employ no more than 50 staff.

The Government intends for the changes to be introduced on January 1, 2018, although the amendments first need state aid approval from the European Commission. – *Courtesy tax-news.com*

Switzerland

Switzerland consults on implementation of AEOI agreements

The Swiss Federal Department of Finance (FDF) has launched a consultation on the introduction of the automatic exchange of information in tax matters with a series of other countries.

The consultation will run until March 15, 2017. The Swiss Government intends for the AEOI with these countries to enter into force on January 1, 2018, with the first exchanges to take place in 2019.

The FDF said that the introduction of the AEOI with these countries confirms Switzerland's international commitment to implementing the AEOI standard. The FDF expects that extending the network of AEOI partner states will help strengthen the competitiveness, credibility, and integrity of Switzerland's financial center.

The list of countries includes: Andorra, Argentina, Barbados, Bermuda, Brazil, the British Virgin Islands, the Cayman Islands, Chile, the Faroe Islands, Greenland, India, Israel, Mauritius, Mexico, Monaco, New Zealand, San Marino, the Seychelles, South Africa, Turks and Caicos, and Uruguay.

The FDF said that these countries adhere to the principle of speciality and have appropriate measures in place for safeguarding the confidentiality of the data exchanged.

From a legal point of view, implementation of the AEOI will be based on the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information.

Switzerland will introduce the AEOI in 2017 with EU member states, Australia, Iceland, Norway, Japan, Canada, South Korea, and the British crown dependencies of Jersey, Guernsey, and the

Isle of Man. Parliamentary approval is required for the AEOI with these countries to enter into force. – *Courtesy tax-news.com*

Costa Rica

Costa Rica urged to adopt VAT

The International Monetary Fund has urged Costa Rican lawmakers to agree on much-needed consumption tax and income tax reforms.

The report said that the country has increased its income tax revenues and approved laws to tackle tax evasion. Corporate tax reforms are also before Congress.

However, the country's lawmakers have yet to green light the implementation a value-added tax in place of the current general sales tax, with the adoption of the levy beset by delays. – *Courtesy tax-news.com*

United States

Obama 'rescued' US economy with tax cuts

According to a report on his time in office, US President Barack Obama "stabilized an economy in crisis and laid the groundwork for long-term growth," partly through the provision of tax relief and tax cuts.

The report, entitled "Economic Rescue, Recovery, and Rebuilding on a New Foundation," says the Obama Administration "provided tax relief that gave the typical American family a tax cut of USD3,600 over [its] first four years – helping to restart job growth – and further cut taxes for low-income working families and families with college students."

In particular, it was added that the Administration "made permanent tax cuts for 98 percent of Americans as part of the bipartisan fiscal cliff agreement in January 2013, while allowing tax cuts to expire for those with the highest incomes – which will reduce deficits by more than USD800bn billion over the next ten years – [and] made permanent expansions to tax credits for working and middle-class families, providing a tax cut averaging about USD1,000 to roughly 24m families each year."

Furthermore, it was reported that the child tax credit (CTC) and the earned income tax credit (EITC) were expanded and made

permanent for low-income working families – "together, the EITC and CTC improvements reduce the extent or severity of poverty for more than 16m people – including about 8m children – each year."

It was also noted that an expiration date was placed "on dozens of business tax breaks that have been extended repeatedly for years without much scrutiny, which would save more than USD200bn over the next decade, [and] made the research and experimentation tax credit permanent, bringing certainty to companies investing in innovation." – *Courtesy tax-news.com*

Poland

Poland withdraws 'single tax' proposal

The Polish Government has decided not to proceed with a proposal to restructure the tax regime for self-employed taxpayers.

At present, self-employed taxpayers can opt to pay a 19 percent flat tax plus social security and health contributions, instead of normal progressive income tax rates of 18 percent and 32 percent.

A proposal first announced by Prime Minister Beata Szydlo in April 2016 would have combined the 19 percent flat tax and additional contributions into a single tax charge.

However, Deputy Prime Minister Mateusz Morawiecki announced on December 21 that following an analysis of the proposal by Economic Committee of the Council of Ministers, the Government no longer intends to implement the "single tax" regime.

Morawiecki said that the proposal for the single tax was "not well founded" and could have been detrimental to the self-employed and small businesses. – *Courtesy tax-news.com*

Benami transactions: Senate body approves legislation

Senate Standing Committee on Finance has approved a proposed legislation aimed against holding property in Benami transactions with some minor amendments and award for whistle blowers. A meeting of Finance Committee attended by only three members and presided over by Senator Saleem Mandviwalla on Thursday withdrew majority of its amendments, including reservations to allow a freehand to the government to have full access to any premises, place, account documents or computer to enforce any provision of the proposed Act.

Secretary Finance Dr Waqar Masood and Chairman Federal Board of Revenue (FBR) Nisar Muhammad Khan argued that without having this power, the proposed legislation can not be implemented. The chairman FBR further contended that "this provision exists in all the laws, customs sales tax and income tax of the FBR." The chairman of the committee expressed his concern over misuse of the provision but the secretary finance and FBR chairman stated that sufficient provisions have been incorporated in the proposed law to prevent misuse of the law and maintain a check.

However, the government accepted committee's suggestions to include a provision for whistle blower with a reward to make the law more effective and limit 65 years age for appointment of serving or retired chairperson and members of the tribunal with one-time three-year term.

State Bank of Pakistan representatives have also expressed their reservations over the clause in the Benami law for entry and search of premises of a banking company and stated that "this would create panic and we are trying to protect banks' reputation by opposing this clause." The SBP officials said that they have no objection to the powers of seeking information from a banking company but they would have reservations on any action beyond that level.

The secretary finance and chairman FBR, however, stated the section specific to banking company in the proposed law was not different in any way from Income Tax and Customs Laws.

The committee chairman, however, suggested to the representatives of the SBP to consult their high-ups on the matter and inform the committee. The chairman FBR also suggested a parliamentary committee to oversee the implementation and stated that the government is seeking time because an entire

structure would be required to develop, including appointments of officials as well as establishment of adjudicating tribunals for the Benami Law. – *Courtesy Business Recorder*

FBR won't pursue recovery of GST on tariff subsidy, ministry told

The Federal Board of Revenue (FBR) has assured the Ministry of Water and Power that the FBR would not pursue recovery of sales tax on tariff subsidy provided by the federal government to electricity consumers till the matter is decided by the appellate fora. Sources told here on Thursday that the assurance has been given by the FBR to the Ministry of Water and Power (ministry) during the last meeting on tax issues of power sector entities held at the FBR House.

The first issue was related to the payment of sales tax on subsidy provided by the federal government. On this issue, the Ministry of Water and Power contended that the tariff subsidy is actually provided to electricity consumers and is not part of the total sales tax and that the appellate tribunal inland revenue (ATIR), Islamabad, accepted the appeal of Peshawar Electric Supply Company (PESCO) in this regard. The FBR suggested that DISCOs may pursue their cases in respective appellate fora on the strength of cited ATIR judgement. However, the FBR shall not force recovery till the matter is decided by such appellate fora.

The FBR has also decided to provide technical assistance to the power distribution companies (DISCOs) for complete filing of sales tax returns which is mandatory for these companies. On the issue of non-filing of Annexure-C by DISCOs, sources said that in spite of the previous assurances, most of the DISCOs are not filing complete annexure C of the sales tax returns which is mandatory for all the registered persons. It was decided that filing of the said annexure would be ensured and if DISCOs are facing any problem, the FBR will render technical assistance.

Sales Tax on cash Collection Basis: Ministry of Water and Power was of the view that the sales tax be charged on the basis of actual cash collection and not on the billed amount or accrual basis. The FBR contended that as per the statute, sales tax is charged on accrual basis which is prevalent for all the taxpayers and that any deviation may open a new Pandora's box. The ministry presented a copy of earlier note in which FBR had agreed to the proposal to exempt supplies for which payment is not received in 180 days.

The FBR opined that proposal in the said note was complicated and not practical. Accordingly, it was agreed that the ministry may refer the matter to ECC for appropriate decision. Sales Tax not charged on supply to AJ&K: As per distribution companies, the President on 26.09.2002 decided that electricity generated and supplied to AJ&K will be exempted from levy of sales tax. – *Courtesy Business Recorder*

Offshore assets: TRC member for introducing 'Income Declaration Scheme'

Pakistan can benefit by introducing an 'Income Declaration Scheme' for persons having offshore assets on the pattern of successful experience of India and Indonesia to bring concocter money into the documented economy. According to a communication of Ashfaq Tola, Member Tax Reform Commission (TRC) and Senior Partner Naveed Zafar Ashfaq Jaffery & Co, Chartered Accountants to Finance Minister Ishaq Dar here on Thursday, he referred to last meeting with the Finance Minster on a scheme for declaration of undeclared assets/income.

An 'Income Declaration Scheme' was launched in India on June 01, 2016. Under the scheme, those who had evaded taxes were given the opportunity to avoid punishment by paying tax, penalty and cess totalling 45 percent of the undisclosed income. Up to October 1, 2016, declarants (64,275) declared approximately $97.5 billion. The scheme is expected to get approximately $44.8 billion as tax revenue from scheme.

Indonesia also introduced a tax amnesty scheme recently. The amnesty helped collect $7.45 billion during the first phase of the scheme which expired on September 30, 2016. Around 366,757 taxpayers signed up for the first phase of the scheme declaring approximately $277 billion. Pakistan can also benefit by introducing a scheme on similar lines to bring concocter money into the documented economy. The scheme may be inspired by the Indonesian model as follows:

Declaration filing date (1 January, 2017 to 31 March, 2017); clearance levy rate of 5 per cent for onshore assets declared and offshore assets declared and repatriated (if repatriated by 30 June 2017) and 10 per cent rate for offshore assets declared but not repatriated.

Declaration filing date (1 April, 2017 to 30 June, 2017); clearance levy rate of 7 per cent for onshore assets declared and offshore assets declared and repatriated (if repatriated by 30 September 2017) and 14 per cent rate for offshore assets declared but not repatriated. Declaration filing date (1 July, 2017 to 30 September, 2017); clearance levy rate of 10 per cent for onshore assets declared and offshore assets declared and repatriated (if repatriated by 30 September 2017) and 20 per cent rate for offshore assets declared but not repatriated.

He said proposed scheme will inject a fresh blood in the documented economy not only in the year of its implementation (due to repatriation of assets) but also for coming years as the income generated each year on assets declared will be charged to tax and will add to the reserves (ever if repatriation is not opted). Modus operandi and legal requirements will be followed.

Furthermore in addition to the scheme, a cap should be introduced to remit moneys outside Pakistan as available in India, ie, amounts to be remitted outside India are restricted up to $500,000 in a financial year. Moreover, 100 percent penalties may be imposed on transfer of moneys through informal channels, the member TRC added. – *Courtesy Business Recorder*

32 percent increase in IT returns

The Federal Board of Revenue (FBR) has received a total of 810,031 income tax returns for tax year 2016 as compared to 615,416 filed during tax year 2015, reflecting an increase of 32 percent. Sources told here on Thursday that the number of income tax returns would further increase after feeding data of 60,000 more manually filed returns. So far, 69,354 returns have been manually filed in tax year 2016 as compared to 104,918 for tax year 2015. Another 60,000 would be fed in the FBR's system, which would increase the number of return filers.

The data of return filing is encouraging because there is an increase of 32 per cent during the period under review. Breakup of data revealed that within the category of individuals, the FBR has received 764,887 returns for tax year 2016 as compared to 581,172 in tax year 2015. This category of individuals including salaried class has shown positive response in filing of annual income tax return/statement.

Under the category of Association of Persons (AOPs), a total of 37,760 returns have been filed for tax year 2016 against 29,156 returns for tax year 2015. So far, a total of 7,384 companies have filed returns for TY-2016 as compared to 5,088 during tax year 2015. – *Courtesy Business Recorder*

Ministry asked to remain consistent with existing practice of tariff determination

Economic Co-ordination Committee (ECC) of the Cabinet has directed the Ministry of Water and Power to make withholding tax on dividends as per actual payments and Rate on Return during Construction (RoEDC) as part of Policy Framework for private sector transmission line projects, 2015 in order to be consistent with the existing practice of tariff determination.

Ministry of Water and Power, in its summary informed the ECC on December 20, 2016 that the Government of Pakistan had announced the Policy Framework for Private Sector Transmission Line Projects, 2015 to attract private sector investment for augmentation of transmission network in the country to transmit electricity from upcoming power projects to the load centers.

Accordingly, National Transmission & Dispatch Company Limited (NTDCL) and State Grid Corporation of China (SGCC) entered into a Co-operation Agreement on April 20, 2015. As per the Co-operation Agreement, the Matiari-Lahore HVDC Transmission Project will be implemented under Agreement on China-Pakistan Economic Corridor (CPEC) between China & Pakistan and the Transmission Policy 2015 along with the guidelines. Under the Co-operation Agreement, SGCC has nominated its subsidiary ie China Electric Power Equipment & Technology Co Ltd (CET) to develop the transmission line projects on a BOOT model.

Ministry of Water and Power further revealed that NEPRA determined the tariff for the project on August 18, 2016. However, CET had requested PPIB to file Motion for Leave for Review, as the tariff and cost allowed by the Authority were un-acceptable to CET. Subsequently, PPIB filed a review petition on September 2, 2016. NEPRA provided its decision on November 24, 2016 on a review petition on which CET had certain reservations and requested PPIB to seek/provide clarifications on the tariff determined by NEPRA. The following clarifications/requests of CET required policy directives to NEPRA as NEPRA has previously rejected PPIB's request in the tariff and review

petitions: (i) NEPRA has neither allowed the withholding tax on dividends as a pass-through item nor grossed up (increased) the ROE to provide 17% net of tax IRR to CET. Disallowing withholding tax on dividends would be a policy deviation and discriminatory treatment for this project as other CPEC projects have been allowed withholding tax on dividends either as a pass-through for cost plus tariff-based projects such as Karot and Kohala Hydropower projects or the ROE has been grossed up for projects under upfront tariff both for imported and local coal based projects to provide desired IRR net of withholding tax. Therefore, consistent with its previous determinations for CPEC projects and as agreed under Co-operation Agreement (i) 17% IRR net of withholding tax on dividends should be allowed and (ii) CET has requested to allow Return on Equity during Construction (RoEDC) from actual construction start date in order to meet the tight timelines and upon the request of GoP CET plans to start construction before financial close. CET has proposed NEPRA may allow 27 months ROEDC from the actual start date of construction without any adjustment for actual draw downs at COD to mitigate risks inherent with a pre-financial closing equity injection, subject to submission of verifiable documentary evidence to NEPRA.

Ministry of Water and Power argued that as a matter of precedence, ECC on July 23, 2009 already approved the framework for the implementation of hydropower projects under 1995 Hydel Policy which states that for hydropower projects, a 30-month period prior to construction start, may be allowed for Internal Rate of Return (IRR) calculation subject to provision of related audited accounts.

Ministry of Water and Power made following proposals for consideration of the ECC for issuance of policy guidelines to NEPRA: (i) NEPRA to allow withholding tax on dividends as pass-through item in the tariff as per actual payments or gross up the IRR as per precedent of other CPEC projects to provide 17% IRR on net of withholding tax basis; and (ii) NEPRA to allow ROEDC from actual construction start date to COD for the Project based on 27 month construction time without adjustment for actual draw downs at COD.

During the ensuing discussion, the Secretary, Water and Power Division informed the meeting that the exemption proposed by the Ministry in the summary had been granted by NEPRA in Guidelines For Determination of Tariff for Independent Power

Producers, 2005, however, the same was being refused by NEPRA for the Matiari-Lahore HVDC transmission project. He stated that this decision of NEPRA was discriminatory and requested that the said proposal be made part of Policy Framework for Private Transmission Sector Transmission Line Projects, 2015 in order to be consistent with the existing practice of tariff determination.

After a brief discussion, the ECC allowed withholding tax on dividends as a pass-through item in the tariff as per actual payments or gross up the IRR to provide 17 per cent IRR on net withholding tax and ROEDC from actual construction start date to COD for the project subject to submission of verified documentary evidence to NEPRA on equity injected and actually utilised before the financial close of the project. The ECC also directed the Ministry of Water and Power to take above decisions a part of Policy Framework for Private Sector Transmission Line Projects 2015 in order to be consistent with the existing practice of tariff determination. – *Courtesy Business Recorder*

PTAA urges FBR to extend tax return deadline

Pakistan Tax Advisors Association (PTAA) has approached the Federal Board of Revenue (FBR) for extension in date for filing of income tax returns by the companies up to January 31, 2017. In a communication to the FBR here on Thursday, Chairman PTAA Javed Iqbal Qazi requested for extension in date for filing of returns of total income in the case of companies to January 31, 2017 instead of December 31, 2016.

It is requested to extend the last date in respect of companies to January 31, 2017 as all the tax practitioners/advocates/chartered accounts engaged in the profession of taxation are busy in the preparation of Returns of Individuals/AOP's, who have failed to submit their returns by 15.12.2016 while the accounts in respect of companies are under finalisation/audit. We also understand the target in respect of Individuals/AOP's has not been achieved for Tax Year 2016 even today by FBR. All the professionals are very much pre-occupied for the submission of returns since 30.09.2016 without any reasonable rest/gap. Also provide them some relief to finalise / prepare the returns of their clients for companies in a smooth & peaceful atmosphere. "However, we have requested the PTAA members to direct their clients to deposit the tax liability in respect of limited companies by 31.12.2016," Javed Iqbal Qazi added. – *Courtesy Business Recorder*

2016 TRI 605 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "E" BENCH, MUMBAI

B.R. Baskaran, Accountant Member and Ramlal Negi, Judicial Member

FACTS/HELD

S. 271(1)(c): The law in Dilip Shroff 291 ITR 519 (SC) & Kaushalya 216 ITR 660 (Bom) requires a show-cause notice u/s 274 to be issued after due application of mind. The non-specification in the notice as to whether penalty is proposed for concealment or for furnishing of inaccurate particulars reflects non-application of mind and renders it void. The fact that the assessee participated in the penalty proceedings does not save it u/s 292B/292BB

(i) A careful perusal of the notice issued u/s 274 would show that the contents of the notice are primarily meant to ask the assessee to furnish a return of income. However, the assessing officer appears to have modified the last paragraph by show causing the assessee to explain as to why an order imposing a penalty should not be made u/s 271(1)(c) of the Act. There should not be any doubt that the provisions of section 271(1)(c) prescribes two types of charge viz., (a) concealment of particulars of income and (b) furnishing of inaccurate particulars of income. However, in the above said notice the AO did not specify the type of charge for which the penalty proceedings have been initiated.

(ii) The Hon'ble Supreme Court has observed in Dilip N Shroff (291 ITR 519)(SC) that the AO, while issuing a notice should apply his mind and make it clear as to whether he had proceeded on the basis that the assessee had concealed his income or he had furnished inaccurate particulars of income. The Hon'ble Supreme Court has clarified in the case of Reliance Petro products (322 ITR 158) that the observations made by it in the case of Dilip N Shroff with regard to "mens rea" alone have been overruled in Dharmendra Textile processors (306 ITR 277), meaning thereby that the above said observations made by the Hon'ble Supreme Court in the case of Dilip N Shroff shall continue to prevail.

(iii) Hence, we are of the view that the application of mind on the part of the assessing officer at the time of issuing notice for initiation of penalty is a mandatory requirement and the non-application of mind would vitiate the penalty proceedings. We notice that the Hon'ble Bombay High Court has also expressed identical view in the case of CIT Vs. Smt. Kaushalya and others (216 ITR 660) on which the revenue has placed heavy reliance. In that case also, it was contended that the AO has not indicated the appropriate charge for which the penalty proceedings were initiated. The Hon'ble Bombay High Court, thereafter, considered various decisions relied upon by the parties and came to the conclusion that there should be application of mind on the part of assessing officer.

(iv) A combined reading of the decision rendered by Hon'ble Bombay High Court in the case of Smt. B Kaushalya and Others (216 ITR 660) and the decision rendered by Hon'ble Supreme Court in the case of Dilip N Shroff (supra) would make it clear that there should be application of mind on the part of the AO at the time of issuing notice. In the case of Lakhdir Lalji (supra), the AO issued notice u/s 274 for concealment of particulars of income but levied penalty for furnishing inaccurate particulars of income. The Hon'ble Gujarat High Court quashed the penalty since the basis for the penalty proceedings disappeared when it was held that there was no suppression of income. The Hon'ble Kerala High Court has struck down the penalty imposed in the case of N.N.Subramania Iyer Vs. Union of India (supra), when there is no indication in the notice for what contravention the petitioner was called upon to show cause why a penalty should not be imposed. In the instant case, the AO did not specify the charge for which penalty proceedings were initiated and further he has issued a notice meant for calling the assessee to furnish the return of income. Hence, in the instant case, the assessing officer did not specify the charge for which the penalty proceedings were initiated and also issued an incorrect notice. Both the acts of the AO, in our view, clearly show that the AO did not apply his mind when he issued notice to the assessee and he was not sure as to what purpose the notice was issued.

(v) The Hon'ble Bombay High Court has discussed about non-application of mind in the case of Kaushalya (216 ITR 660) and observed as under:- "….The notice clearly demonstrated non-application of mind on the part of the Inspecting Assistant Commissioner. The vagueness and ambiguity in the notice had also prejudiced the right of reasonable opportunity of the assessee since he did not know what exact charge he had to face. In this back ground, quashing of the penalty proceedings for the assessment year 1967-68 seems to be fully justified." In the instant case also, we are of the view that the AO has issued a notice, that too incorrect one, in a routine manner. Further the notice did not specify the charge for which the penalty notice was issued. Hence, in our view, the AO has failed to apply his mind at the time of issuing penalty notice to the assessee.

(vi) The Ld D.R submitted that the assessee has participated in the penalty proceedings and hence the error, if any, that has occurred would be cured in view of the provisions of sec. 292B/292BB of the Act. Opposing the said contention, the Ld A.R placed reliance on the decision rendered by the Bangalore bench of Tribunal in the case of Shri K Prakash Shetty vs. ACIT (ITA Nos.265 to 267/Bang/2014 dated 05-06-2014) wherein it was held that the provisions of sec. 292BB would not come to the rescue of the revenue, when the notice was not in substance and effect in conformity with or according to the intent and purpose of the Act. In our view, the notice issued by the AO, which is extracted above, was not in substance and effect in conformity with or according to the intent and purpose of the Act, since the AO did not specify the charge for which penalty proceedings were initiated and further there was non-application of mind on the part of the AO.

Order accordingly.

I.T.A. No. 2187/Mum/2014 (Assessment Year 2009-10) & I.T.A. No. 1789/Mum/2014 (Assessment Year 2009-10).

Heard on: 6th October, 2016.

Decided on: 21st December, 2016.

Present at hearing: Vijay Kothari, for Assessee. B. Pruseth, for Department.

JUDGMENT

Per B.R. Baskaran:– (Accountant Member)

These cross appeals are directed against the order dated 30-12-2013 passed by Ld CIT(A)-38, Mumbai for assessment year 2009-10 partially confirming the penalty levied by the AO u/s 271(1)(c) of the Act.

2. The facts relating to the case are set out in brief. The assessee is a practicing doctor specialised in pain and weight management. The assessee filed her return of income for the year under consideration declaring a total income of Rs.36,19,140/-. The revenue carried out search and seizure operations in the hands of the assessee u/s 132 of the Act on 12.1.2010. Subsequently the assessee filed a revised return of income on 31.3.2010 declaring a total income of Rs.2,56,11,923/-.

3. Consequent to the search operations, the assessing officer issued notice u/s 153A of the Act to the assessee. In response to the notice, the assessee filed her return of income for the year under consideration declaring a total income of Rs.2,64,52,643/-.

4. During the course of search action, the search team found cash balance of Rs.7.95 crores at the residence of assessee's sister named Ms. Sangeeta Koyal. In the statement taken u/s 132(4) of the Act, Ms. Sangeeta Koyal stated that the above said cash balance belongs to the assessee herein. In the statement taken from the assessee, she also admitted that the above said cash balance belongs to her and the source there of was her professional receipts. The assessee also agreed to offer the above said amount as her income in the Assessment years 2009-10 and 2010- 11 at Rs.1.95 crores and Rs.6.00 crores respectively. Accordingly the assessee offered the sum of Rs.1.95 crores in the return of income filed for AY 2009-10. The assessee also admitted a sum of Rs.30.00 lakhs towards the additional amount paid on purchase of a property at Shivanand CHS Ltd. The assessing officer assessed the aggregate amount of Rs.2.25 crores (1.95 + 0.30) on which penalty u/s 271(1)(c) of the Act was levied for concealment of particulars of income at 150% (wrongly stated as 300%) of the tax sought to be evaded, which worked out to Rs.1,11,71,360/-.

5. The Ld CIT(A) confirmed the view taken by the AO, but reduced the quantum of penalty to 100% of tax sought to be evaded as against 150% levied by the AO. The assessee is aggrieved by the decision of Ld CIT(A) in confirming the penalty to the extent of 100% and the revenue is aggrieved in granting relief to the assessee.

6. The Ld A.R raised a preliminary issue first. He submitted that the assessing officer has not issued a proper notice to the assessee by specifying the charge u/s 271(1)(c) of the Act. He submitted that the notice issued by the AO is normally issued to call for a return of income from the assessee. He submitted that the AO has simply added a paragraph in that notice by stating that why an order imposing a penalty

u/s 271(1)(c) of the Act should not be imposed on the assessee. He submitted that there is total non-application of mind on the part of the AO and hence the impugned penalty order is vitiated. He submitted that the penalty is levied u/s 271(1)(c) of the Act under two different charge and the Courts have held that non-specification of the charge will vitiate the penalty proceedings, i.e., the assessee should be appraised of specific charge. In this regard, he placed reliance on the decision rendered by co-ordinate bench of Tribunal in the case of M/s M.G Contractors Pvt. Ltd Vs. DCIT (ITA No.7034 to 7038/Del/2014 dated 19-09-2016), wherein the Tribunal has followed the decision rendered by Hon'ble Karnataka High Court in the case of Manjunath Cotton Mills (359 ITR 565). He submitted that the AO, in the instant case, has not specified any charge in the impugned notice and thus has not apprised the assessee of any charge for which the penalty proceedings have been initiated.

7. The Ld D.R, on the contrary, submitted that the provisions of sec. 274 provides that the assessee should be given an opportunity before imposing penalty. He submitted that the assessee has been provided with an opportunity and she has also participated in the penalty proceedings. Accordingly he submitted that the deficiencies, if any, in the proceedings is automatically made good by the provisions of sec. 292B/292BB of the Act. He submitted that the AO has specified in the assessment order that he is initiating penalty proceedings u/s 271(1)(c) of the Act for concealing the income. He placed reliance on the decision rendered by Hon'ble jurisdictional Bombay High Court in the case of CIT Vs. Smt. Kaushalya and others (216 ITR 660) and submitted that the Hon'ble Bombay High Court has held that mere mistake in the language used or mere non-striking of the inaccurate portion cannot by itself invalidate the notice.

8. In the rejoinder, the ld A.R submitted that the AO, in the instant case, did not issue proper notice and he did not apprise the assessee about the charge for which the penalty proceedings were initiated. He submitted that this matter goes to the root of the matter and the same cannot be cured by the provisions of sec. 292B/292BB of the Act. In this regard, he placed reliance on the decision rendered by the co-ordinate bench in the case of Shri K Prakash Shetty Vs. ACIT (ITA Nos.265 to 267/Bang/2014 dated 05-06-2014), where in it was held as under:–

> *"16. It is clear from the aforesaid decision that on the facts of the present case that the show cause notice u/s 274 of the Act is defective as it does not spell out the grounds on which the penalty is sought to be imposed. The show cause notice is also bad for the reason that in the A.Ys 2008-09 and 2009-10 the show cause notice refers to imposition of penalty u/s 271AAA, whereas the order imposing penalty has been passed u/s 271(1)(c) of the Act. In our view, the aforesaid defect cannot be said to be curable u/s 292BB of the Act, as the defect cannot be said to be a notice which in substance and effect in conformity with or according to*

the intent and purpose of the Act. Following the decision of the Hon'ble Karnataka High Court, we hold that the orders imposing penalty in all the assessment years have to be held as invalid and consequently penalty imposed is cancelled."

9. We have heard the rival contentions on this legal issue and perused the record. We have gone through the notice issued by the AO for initiating the penalty proceedings. For the sake of convenience, the scanned copy of the notice is given below:–

"Whereas in the course of proceedings before me for the assessment year 2009-10 it appears to be that you:–

**have without reasonable cause failed to furnish me return of income which you were required to furnish by a notice given under section 22(1)/22(2)/34 of the Indian Income-tax Act, 1922 or which you were required to furnish under Section 139(1) or by a notice under Section 139(2)/148 of the Income-tax Act, 1961, No._____ dated_____ or have without reasonable cause failed to furnish it within the time allowed and the manner required by the said Section 139(1)or by such notice.*

"have without reasonable cause failed to comply with a notice under Section 22(4)/23(2) of the Indian Income tax Act. 1922 or under Section 142(1)/143(2) of the Indian Income-tax Act,1961.No._____dated _____.

You are hereby requested to appear before me at 11.30 A.M. on 10.01.2012 and show cause why an order imposing a penalty on you should not be made under Section 271 of the Income-tax Act, 1961. If you do not wish to avail yourself of this opportunity of being heard in person or through authorized representative, you may show cause in writing on or before the said date which will be considered before any such order is made under Section 271(1)(c)."

A careful perusal of the notice would show that the contents of the notice are primarily meant to ask the assessee to furnish a return of income. However, the assessing officer appears to have modified the last paragraph by show causing the assessee to explain as to why an order imposing a penalty should not be made u/s 271(1)(c) of the Act. There should not be any doubt that the provisions of section 271(1)(c) prescribes two types of charge viz., (a) concealment of particulars of income and (b) furnishing of inaccurate particulars of income. However, in the above said notice the AO did not specify the type of charge for which the penalty proceedings have been initiated.

10. In this regard, it is pertinent to refer to the following observations made by Hon'ble Supreme Court in the case of Dilip N Shroff (291 ITR 519)(SC).

> *"83. It is of some significance that in the standard proforma used by the Assessing Officer in issuing a notice despite the fact that the same postulates that inappropriate words and paragraphs were to be deleted, but the same had not been done. Thus, the Assessing Officer himself was not sure as to whether he had proceeded on the basis that the assessee had concealed his income or he had furnished inaccurate particulars. Even before us, the learned Additional Solicitor General while placing the order of assessment laid emphasis that he had dealt with both the situations.*
>
> *84. The impugned order, therefore, suffers from non-application of mind. It was also bound to comply with the principles of natural justice. [See Malabar Industrial Co. Ltd. v. Commissioner of Income Tax, Kerala State, (2000) 2 SCC 718]".*

The Hon'ble Supreme Court has observed that the AO, while issuing a notice should apply his mind and make it clear as to whether he had proceeded on the basis that the assessee had concealed his income or he had furnished inaccurate particulars of income. The Hon'ble Supreme Court has clarified in the case of Reliance petro products (322 ITR 158) has clarified that the observations made by it in the case of Dilip N Shroff with regard to "mens rea" alone have been overruled in Dharmendra Textile processors (306 ITR 277), meaning thereby that the above said observations made by the Hon'ble Supreme Court in the case of Dilip N Shroff shall continue to prevail.

11. Hence, we are of the view that the application of mind on the part of the assessing officer at the time of issuing notice for initiation of penalty is a mandatory requirement and the nonapplication of mind would vitiate the penalty proceedings. We notice that the Hon'ble Bombay High Court has also expressed identical view in the case of Smt. Kaushalya and Others (supra), on which the revenue has placed heavy reliance. In that case also, it was contended that the AO has not indicated the appropriate charge for which the penalty proceedings were initiated. The Hon'ble Bombay High Court has expressed the following view:–

> *"The issuance of notice is an administrative device for informing the assessee about the proposal to levy penalty in order to enable him to explain as to why it should not be done. Mere mistake in the language used or mere non-striking inaccurate portion cannot by itself invalidate the notice. The entire factual background would fall for consideration in the matter and non one aspect would be decisive. In this context, useful reference may be made to the following observation in the case of CIT Vs. Mithila Motors (P) Ltd (1984)(149 ITR 751)(Patna) (head note):*
>
> > *"Under section 274 of the Income tax Act, 1961, all that is required is that the assessee should be given an opportunity to*

> *show cause. No statutory notice has been prescribed in this behalf. Hence, it is sufficient if the assessee was aware of the charges he had to meet and was given an opportunity of being heard. A mistake in the notice would not invalidate penalty proceedings."*

The Hon'ble Bombay High Court, thereafter, considered various decisions relied upon by the parties and came to the conclusion that there should be application of mind on the part of assessing officer. For the sake of convenience, we extract below the relevant observations made by Hon'ble Bombay High Court.

> *"11. The case of CIT v. Lakhdhir Lalji [1972] 85 ITR 77 (Guj) is the other decision upon which the Tribunal has placed reliance. In that case a notice under section 274 was issued on the footing of concealment of income by suppression of sales whereas the penalty was levied on the footing that there was furnishing of inaccurate particulars of income since the stock at the closing of the year was undervalued. The penalty was quashed upon a view that the very basis for the penalty proceedings had disappeared when it was held that there was no suppression of income by the assessee. Thus, it would be seen that the ratio of that decision cannot be applied to this case.*
>
> *12. The last decision relied upon is the case of N. N. Subramania Iyer v. Union of India [1974] 97 ITR 228 (Ker). The following passage from the said decision would demonstrate how entirely different the background of that case was and, therefore, the ratio of that decision also could not be applied (at page 231):*
>
> > *"The penalty notice, exhibit P-2, is illegal on the face of it. It is in a printed form, which comprehends all possible grounds on which a penalty can be imposed under section 18(1) of the Wealth-tax Act. The notice has not struck off any one of those grounds; and there is no indication for what contravention the petitioner was called upon to show cause why a penalty should not be imposed. Even in the counter-affidavit filed by the second respondent, he has not stated for what specific violation he issued it. It is not that it would have saved his action. Apparently, exhibit P-2 is a whimsical notice issued to an assessee without intending anything."*
>
> *13.* ***No doubt, there can exist a case where vagueness and ambiguity in the notice can demonstrate nonapplication of mind by the authority and/or ultimate prejudice to the right of opportunity of hearing contemplated under section 274****. Take for example; the notice dated March 28, 1972, for the assessment year 1967-68. This show-cause notice was issued even before the assessment order was made. The assessee*

had no knowledge of the exact charge of the Department against him. In the notice, not only there is use of the word "or" between the two groups of charges but there is use of the word "deliberately". The word "deliberately" did not exist in section 271(1)(c) when the notice was issued. It is worthwhile recalling that the said word was omitted by the Finance Act, 1964, with effect from April 1, 1964, and the Explanation was added. The notice clearly demonstrated non-application of mind on the part of the Inspecting Assistant Commissioner. The vagueness and ambiguity in the notice had also prejudiced the right of reasonable opportunity of the assessee since he did not know what exact charges he had to face. In this background, quashing of the penalty proceedings for the assessment year 1967-68 seems to be fully justified."

12. A combined reading of the decision rendered by Hon'ble Bombay High Court in the case of Smt. B Kaushalya and Others (supra) and the decision rendered by Hon'ble Supreme Court in the case of Dilip N Shroff (supra) would make it clear that there should be application of mind on the part of the AO at the time of issuing notice. In the case of Lakhdir Lalji (supra), the AO issued notice u/s 274 for concealment of particulars of income but levied penalty for furnishing inaccurate particulars of income. The Hon'ble Gujarat High Court quashed the penalty since the basis for the penalty proceedings disappeared when it was held that there was no suppression of income. The Hon'ble Kerala High Court has struck down the penalty imposed in the case of N.N.Subramania Iyer Vs. Union of India (supra), when there is no indication in the notice for what contravention the petitioner was called upon to show cause why a penalty should not be imposed. In the instant case, the AO did not specify the charge for which penalty proceedings were initiated and further he has issued a notice meant for calling the assessee to furnish the return of income. Hence, in the instant case, the assessing officer did not specify the charge for which the penalty proceedings were initiated and also issued an incorrect notice. Both the acts of the AO, in our view, clearly show that the AO did not apply his mind when he issued notice to the assessee and he was not sure as to what purpose the notice was issued. The Hon'ble Bombay High Court has discussed about non-application of mind in the case of Kaushalya (supra) and observed as under:–

"….The notice clearly demonstrated non-application of mind on the part of the Inspecting Assistant Commissioner. The vagueness and ambiguity in the notice had also prejudiced the right of reasonable opportunity of the assessee since he did not know what exact charge he had to face. In this back ground, quashing of the penalty proceedings for the assessment year 1967-68 seems to be fully justified."

In the instant case also, we are of the view that the AO has issued a notice, that too incorrect one, in a routine manner. Further the notice did not specify the charge for which the penalty notice was issued. Hence, in our view, the AO has failed to apply his mind at the time of issuing penalty notice to the assessee.

13. The Ld D.R submitted that the assessee has participated in the penalty proceedings and hence the error, if any, that has occurred would be cured in view of the provisions of sec. 292B/292BB of the Act. Opposing the said contention, the Ld A.R placed reliance on the decision rendered by the Bangalore bench of Tribunal in the case of Shri K Prakash Shetty (supra), wherein it was held that the provisions of sec. 292BB would not come to the rescue of the revenue, when the notice was not in substance and effect in conformity with or according to the intent and purpose of the Act. In our view, the notice issued by the AO, which is extracted above, was not in substance and effect in conformity with or according to the intent and purpose of the Act, since the AO did not specify the charge for which penalty proceedings were initiated and further there was non-application of mind on the part of the AO.

14. In view of the foregoing discussions, we are of the view that assessee should succeed on this legal issue. Accordingly the penalty proceedings initiated by the AO without application of mind is liable to be set aside and we order accordingly.

15. On merits, the ld A.R contended that the Explanation 5A to sec. 271 will not be applicable to the assessee on the reason that the "Cash" found during the course of search will not fall in the category of "assets" specified in Explanation 5A, which reads as under:–

> *"(i) any money, bullion, jewellery or other valuable article or thing (hereafter in this Explanation referred to as assets) and the assessee claims that such assets have been* ***acquired by him by utilizing (wholly or in part) his income*** *for any previous year"*

The Ld A.R submitted that the penal provisions should be construed strictly. He submitted that the expression "such assets have been acquired by him by utilizing (wholly or in part) his income for any previous year" should be given proper meaning. The A.R submitted that "Cash" cannot be acquired by utilizing income of the assessee" and accordingly contended that the provisions of Explanation 5A would fail in the cases where "cash" is found during the course of search. The Ld A.R also placed reliance on the decision rendered by Hon'ble Bombay High Court in the case of Sheraton Apparels Vs. ACIT (2002)(256 ITR 20), wherein the Hon'ble High Court has explained the intention of introducing Explanation 5 (identical to Explanation 5A) under the head "Legislative intention". He submitted that the Explanation 5/5A has been introduced to curb the practice of explaining the sources of undisclosed

assets as income of earlier years. He submitted that Explanation5/5A introduces legal fiction and hence they should be interpreted strictly. On the contrary, the Ld D.R submitted that the expression "money" used in Explanation 5A would refer to "Cash" only and he submitted that Explanation 5A should be given purposive interpretation.

16. The Ld A.R also contended that the cash balance found during the course of search would be normally assessable in AY 2010-11, since it was found on 12-01-2010. Had the assessee offered the same in AY 2010-11, she would have got immunity from penalty u/s 271AAA of the Act. He further submitted that the offer made in AY 2009-10 of Rs.1.95 crores out of cash balance was a voluntary offer. Further the Rs.30.00 lakhs offered by the assessee in respect of flat purchase was also a voluntary offer only. Accordingly he submitted that the penalty could not have been levied for the income voluntarily offered by the assessee.

17. Since we have held that the penalty proceedings are liable to be quashed on the reasoning that there was non-application of mind on the part of the AO while issuing notice to the assessee, we do not find it necessary to address the arguments urged on merits.

18. In view of the above, Revenue's appeal does not require consideration.

20. In the result, the appeal filed by the assessee is treated as allowed and the appeal of the Revenue is dismissed.

Order has been pronounced in the Court on 21.12.2016