

A THE COMMISSIONER OF SALES TAX, U.P.

v.

M/S. BHAGWAN INDUSTRIES (P) LTD. LUCKNOW

B October 10, 1972

[K. S. HEGDE, P. JAGANMOHAN REDDY AND H. R. KHANNA, JJ.]

*U.P. Sales Tax Act and Rules, s. 21—Ex-parte assessment—Notice of assessment of escaped turnover—When can be issued—‘Reason to believe’, scope of.*

C For the assessment year 1957-58, the assessee (respondent) was assessed to sales tax, under the U.P. Sales Tax Act and Rules, on a turnover which included the turnover of a flour mill of the assessee. The assessment was made *ex-parte*. On account of food shortage the Government had fixed a quota for the flour mill in 1953 on the basis of the average grinding done during the previous three years. In view of the turnover according to the account books of the assessee for the years 1955-56 and  
 D 1958-59, the sales-tax officer thought that the turnover for the year 1957-58 was underestimated and that some turnover had escaped assessment. He accordingly issued a notice in September 1961 and a memorandum on 13th March 1962 calling upon the assessee to produce the account books but no account books were produced. On 24th March, 1962, a notice was issued under s.21 of the Act. It was served on the assessee on 26th March 1962. On March 19, 1963, the sales tax officer made an assessment order under s. 21 estimating the turnover at a higher  
 E figure. Section 21 provides that if the assessing authority has *reason to believe* that the whole or part of the turnover of a dealer had escaped assessment, he may reassess the dealer to tax, that such re-assessment shall not be made for any assessment year after the expiry of four years, and that where notice under the section had been served within four years, the re-assessment may be made within one year of the date of service of the notice even if the period of four years is thereby exceeded.

F The High Court, on reference under s.11 of the Act, held that : (1) the first notice and memorandum were not notices under s.21 so as to attract the period of limitation of one year for making the re-assessment, but (2) that the assessing officer could not in the circumstances of the case, be said to have *reason to believe* that some turnover of the assessee had escaped assessment.

G In appeal to this Court,

H HELD : (1) The High Court was right in holding that the first notice and memorandum were of a preliminary nature and did not constitute notices under s.21. All that was stated in them was to call upon the assessee to produce account books, and a threat, in case of non-compliance, that action may be taken under s.21 of the Act. It was only on March 24, 1962, that notice under that section was given to the respondent. The re-assessment made on March 19, 1963, was within one year of the dates of service if the notice and hence, the re-assessment was not barred by limitation. [635C-E]

(2) The High Court was in error in holding that the assessing authority did not act within the ambit of his powers in initiating proceedings under s. 21. [634F] A

(a) The words 'reason to believe' convey that there must be some reasonable grounds for the assessing authority to form the belief that the turnover had escaped assessment. Reasonable grounds necessarily postulate that they must be germane to the formation of the belief regarding escaped assessment. The belief must be held in good faith and should not be a pretence. At the stage of the issue of notice the only consideration which has to weigh with the assessing authority is whether there is some relevant material giving rise to the *prima facie* inference that some turnover has escaped assessment. If the grounds are of an extraneous character, they would not warrant initiation of proceedings under the section. But if they are relevant and have a nexus with the formation of the belief regarding escaped assessment, the assessing authority would be clothed with jurisdiction to take action under the section. Whether the grounds are adequate or not is not a matter which would be gone into by the High Court or this Court, for, the sufficiency of the grounds which induced the assessing authority to act is not a justiciable issue. What can be challenged is the existence of the belief, but not the sufficiency of reasons for the belief. [632D-H] B

*S. Narayanappa v. Commissioner of Income Tax*, [1967] 63 I.T.R. 219, applied. C

In the present case, the facts show that the assessing authority had valid grounds for forming the belief that part of the turnover of the respondent had escaped assessment, and that the belief was formed in good faith. [634C-F] D

(b) There is nothing in s.21 to support the contention that proceedings for re-assessment cannot be initiated under the section in the case of *ex-parte* assessments. Such a construction would put a premium on contumacy and afford protection to dealers who avoid appearing before the assessing authority. [634G-H; 635A-B] E

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2032 of 1969. F

Appeal by special leave from the judgment and order dated February 26, 1969 of the Allahabad High Court in Sales Tax Reference No. 440 of 1967.

*S. C. Manchanda* and *O. P. Rana*, for the appellant.

*N. D. Karkhanis*, *Ram Awtar Garg* and *Ram Lal*, for the respondent. G

The Judgment of the Court was delivered by

KHANNA, J. This appeal by special leave by the Commissioner of Sales Tax Uttar Pradesh is directed against the judgment of Allahabad High Court whereby it answered the following two questions referred to it under section 11 of U.P. Sales Tax Act (hereinafter referred to as the Act) in the negative : H

A (I) Whether the assessing officer under these circumstances could be said to have had an honest belief that the turnover had partially escaped taxation so as to start proceedings under section 21?

B (II) Whether the aforesaid two preliminary notices asking for the production of accounts can be taken to be notices under Sec. 21 for the starting of the proceedings so as to warrant passing of the assessment within one year of the service thereof?"

C The matter relates to the assessment year 1957-58. The respondent assessee, Bhagwan Industries (P) Ltd., carries on the business of selling atta, maida and sooji. Its business comprises various units including Venkateshwar Flour Mills, Lucknow. It was assessed on December 26, 1958 for the purpose of sales tax for the year 1957-58 under rule 41(5) of the U.P. Sales Tax Rules. The estimated turnover was determined to be Rs. 46,00,000, out of which the net turnover of Venkateshwar Flour Mills for atta, maida and sooji was estimated at Rs. 43,00,000. The assessment was *ex-parte* and the respondent did not produce the account books.

D On account of food shortage the Government banned the purchase of wheat by rolling flour mills from the open market in August 1958. The Government further fixed quota of wheat to be supplied by the Central Government for each such mill on the basis of average of grinding done in the past three years. The quota of Venkateshwar Flour Mills was fixed at 1,192 tons, i.e. 32,000 maunds per month. With that quota the respondent in the assessment year 1958-59 disclosed a turnover of Rs. 75,70,840. On September 13, 1961 the Sales Tax Officer issued the following notice to the respondent

F "Certain items of sales and purchases made by you during the year 57-58 & 58-59 have come to my notice which need verification. You are required to appear before me on 27-9-61 with all your account books of the year 57-58 and 58-59 for the above mentioned verification.

G 2. Please note that in case you fail to appear it will be presumed that the Sales and Purchases under reference are not entered in your books and action under section 21 of the U.P. Sales Tax Act may be taken against you."

H The above notice was served upon the respondent on September 19, 1961. Appearance was put in on behalf of the respondent in pursuance of the notice, but the account books were not produced.

On March 13, 1962 the Sales Tax Officer sent the following memorandum to the respondent : A

“M/s Bhagwan Industries Private Ltd., Aishbagh Lucknow deal in atta, maida and sooji which are manufactured by them in their rolling flour mills Shree Venkateshwar Flour Mills. They have been finally assessed for the years 1956-57 and 1957-58 on estimated turnover of Rs. 42,75,000/- (tax assessed Rs. 98,046-94) and Rs. 45,00,000 (tax assessed Rs. 72,875.00) respectively. Both these assessment orders were passed *ex parte*. The case of the year 1956-57 was reopened under section 21 on the basis of certain information and an escaped turnover of Rs. 35,532/- was again assessed under section 21 of the U.P. Sales Tax Act. At the time of this assessment also the account books were not produced. B

2. The above mentioned firm is on record for the last many years. The sale of atta, maida and sooji was exempt under section 4 of the U.P. Sales Tax Act upto 31-3-56 but was declared taxable with effect from 1-4-56. According to the assessment order of the year 1955-56 their sales of atta, maida and sooji had amounted to Rs. 58,18,425-15-6. The assessment case of the firm for the year 1958-59 has also been completed and during that year according to the account books the turnover of atta, maida and sooji had amounted to Rs. 75,70,840/- Keeping in view the turnover according to the account books during the year 1955-56 and 1958-59 it appeared that the turnover determined in the *ex parte* orders of the year 1956-57 and 1957-58 was estimated at a lesser amount and thus some turnover escaped assessment during each of these two years. It was, therefore, considered necessary that the actual position be ascertained from the assessee. Some information received from other Sales Tax Officers regarding the sales made by this firm during the year 1957-58 also needed verification as was done in the year 1956-57 resulting in the assessment of the firm under section 21 during that year. C

3. A notice was, therefore, issued to the firm on 13-9-61 for the production of the account books of the year 1957-58 but the firm failed to produce the account books. Again summons were issued under rule 78 of the U.P. Sales Tax Rules to Shri Keshoe Pd. Vaid, Managing Director of the firm requiring him to appear in person and to produce the account books of the D

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A firm for the year 1956-57 and 1957-58 but again neither the account books were produced nor Shri Vaid appeared in person. One application dated 27-12-1961 was, however, received from one of the directors of the firm informing that Shri Kesheo Pd. Vaid was out of station and requesting that the summons be issued in the name of the concern M/s. Bhagwan Industries Private Ltd. rather than in the name of any individual. This application has been kept on record.

C 4. The hesitation on the part of the firm to produce the account books and even to disclose their actual turnover during the years 1956-57 and 1957-58 as per their account books confirms the presumption that they have been under-assessed for these two years. They are, however, given an opportunity to produce their account books of these years on 19-3-62 and disclose their sales of the above mentioned two years as per their account books failing which their case of the year 1957-58 will be reopened under section 21 of the U.P. Sales Tax Act and penalty or prosecution proceedings as permissible under the U.P. Sales Tax Act shall be started for the year 1956-57 the assessment of which has already become time barred.

E 5. A copy of this order shall be kept in the file of the dealer pertaining to the years 1956-57 and another shall be kept in the file pertaining to the year 1957-58."

F The memorandum was received by the respondent on March 16, 1962, but the account books were not produced by the respondent. On March 24, 1962 the following notice was issued under section 21 of the Act to the respondent and the same was served on March 26, 1962 :

G "As I have come to know that a part of your sale proceeds relating to the assessment year 1957-58, has been left over from being taxed. Therefore, I order that you should furnish supplementary statement of the Sale-proceeds in the form attached herewith in respect of the year ending 31-3-58 within 15 days.

H 2. You are further informed that you should be present at the Sales Tax Office, Golaganj on 27-4-62 at 10.30 O'clock, along with all the account books and your other business papers in respect of the year the

sale proceeds whereof are mentioned by you in the above mentioned statement. If you fail to turn up on the fixed date tax shall be levied on you *ex-parte*.”

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On October 5, 1962 the accountant of the respondent made a statement before the Sales Tax Officer that the account books for the years 1956-57 and 1957-58 had been displaced in the head office at Bombay and no books, registers or vouchers regarding the business of the years 1956-57 and 1957-58 were available. On March 19, 1963 the Sales Tax Officer made an assessment order under section 21 of the Act for the assessment year 1957-58 estimating the total net turnover for that year at Rs. 84,50,000. The amount of escaped turnover was estimated to be Rs. 38,50,000.

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Appeal filed by the respondent against the above order was dismissed.

The respondent then went up in revision and contended that there was no material on which the Sales Tax Officer could have reason to believe that turnover had escaped assessment. The proceedings initiated under section 21 of the Act were said to be without jurisdiction. It was also urged on behalf of the respondent that notice issued on September 13, 1961 as also the memorandum dated March 13, 1962 constituted valid notices under section 21 of the Act and as the assessment had not been completed within one year of the service of those notices, the assessments were barred by limitation. The Judge (Revisions) rejected these contentions. He was, however, of the opinion that the quantum of turnover needed redetermination. At the instance of the respondent, the Judge (Revisions) referred the questions reproduced at the commencement of this judgment to the High Court.

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The High Court while answering the first question in the negative, referred to the words “reason to believe” in section 21 of the Act and observed that the reason must be that of an honest and reasonable person based upon reasonable grounds and that it was not sufficient that the Sales Tax Officer should have reason to suspect that the turnover had been under-assessed. In the opinion of the High Court, it could not be said that the Sales Tax Officer had reason to believe that the turnover had been under-assessed. As regards the second question, the High Court held that notice dated September 13, 1961 and the memorandum dated March 13, 1962 were of a preliminary nature and could not be considered to be notices under section 21 of the Act.

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In appeal before us Mr. Manchanda on behalf of the appellant has assailed the correctness of the answer given by the High

**A** Court to the first question. It is submitted that there was rational basis for the Sales Tax Officer to believe that the turnover of the respondent had been under-assessed and that the finding of the High Court that the Sales Tax Officer could not be said to have reason to believe that the turnover had been under-assessed was incorrect. As against that Mr. Karkhanis on behalf of the respondent has canvassed for the correctness of the view of the High Court in answer to question No. (1). There is, in our opinion, considerable force in the submission of Mr. Manchanda. Section 21 of the Act deals with assessment of tax on assets and levy of licence fees incorrectly assessed, and reads as under :

**C** “(1) If the assessing authority has reason to believe that the whole or any part of the turnover of a dealer has, for any reason, escaped assessment to tax for any year, the assessing authority may, after issuing notice to the dealer, and making such enquiry as may be necessary, assess or re-assess him to tax :

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

**E** *Explanation.*—Nothing in this sub-section shall be deemed to prevent the assessing authority from making an assessment to the best of its judgment.

(2) No order of assessment under sub-section (1) or under any other provision of this Act shall be made for any assessment year after the expiry of four years from the end of such year :

**F** Provided that where the notice under sub-section (1) has been served within such four years the assessment or re-assessment to be made in pursuance of such notice may be made within one year of the date of the service of the notice even if the period of four years is thereby exceeded :

**G** Provided further that nothing contained in this section limiting the time within which any assessment or re-assessment may be made shall apply to an assessment or re-assessment made in consequence of, or to give effect to, any finding or direction contained in an order under section 9, 10 or 11.

**H** *Explanation.*—Where the assessment proceedings relating to any dealer remained stayed under the orders

of any Civil or other competent Court, the period during which the proceedings remained so stayed shall be excluded in computing the period of limitation for assessment provided under this sub-section.”

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Perusal of sub-section (1) of the section reproduced above shows that the assessing authority can assess or re-assess a dealer to tax if such authority has reason to believe that the whole or any part of the turnover of a dealer has, for any reason, escaped assessment to tax for any year. In such an event, the assessing authority before making the assessment or re-assessment must issue notice to the dealer. The said authority may also make such enquiry as may be necessary in the circumstances of the case.

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The controversy between the parties has centered on the point as to whether the assessing authority in the present case had reason to believe that any part of the turnover of the respondent had escaped assessment to tax for the assessment year 1957-58. Question in the circumstances arises as to what is the import of the words “reason to believe”, as used in the section. In our opinion, these words convey that there must be some rational basis for the assessing authority to form the belief that the whole or any part of the turnover of a dealer has, for any reason, escaped assessment to tax for some year. If such a basis exists, the assessing authority can proceed in the manner laid down in the section. To put it differently, if there are, in fact, some reasonable grounds for the assessing authority to believe that the whole or any part of the turnover of a dealer has escaped assessment, it can take action under the section. Reasonable grounds necessarily postulate that they must be germane to the formation of the belief regarding escaped assessment. If the grounds are of an extraneous character, the same would not warrant initiation of proceedings under the above section. If, however, the grounds are relevant and have a nexus with the formation of belief regarding escaped assessment, the assessing authority would be clothed with jurisdiction to take action under the section. Whether the grounds are adequate or not is not a matter which would be gone into by the High Court or this Court, for the sufficiency of the grounds which induced the assessing authority to act is not a justiciable issue. What can be challenged is the existence of the belief but not the sufficiency of reasons for the belief. At the same time, it is necessary to observe that the belief must be held in good faith and should not be a mere pretence.

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It may also be mentioned that at the stage of the issue of notice the consideration which has to weigh is whether there is some relevant material giving rise to *prima facie* inference that some turnover has escaped assessment. The question as to

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- A** whether that material is sufficient for making assessment or re-assessment under section 21 of the Act would be gone into after notice is issued to the dealer and he has been heard in the matter or given an opportunity for that purpose. The assessing authority would then decide the matter in the light of material already in its possession as well as fresh material procured as a result of the
- B** enquiry which may be considered necessary.

- The import of the words "reason to believe" has been examined by this Court in cases arising out of proceedings under section 34 of the Indian Income Tax Act, 1922 wherein also these words were used. The aforesaid section dealt with income escaping assessment and conferred jurisdiction on the Income Tax Officer
- C** to make assessment or re-assessment if he had reason to believe that income, profits or gains chargeable to income tax had been under-assessed and that such under-assessment had occurred by reason of either omission or failure on the part of the assessee to make a return of his income or to disclose fully and truly all material facts necessary for his assessment. Certain other conditions
- D** were also necessary, but we are not concerned with them. Dealing with that section in the case of *S. Narayanappa v. Commissioner of Income Tax*(<sup>1</sup>) this Court observed :

- "But the legal position is that if there are in fact some reasonable grounds for the Income-tax officer to believe that there had been any non-disclosure as regards any fact, which could have a material bearing on the question of under-assessment, that would be sufficient to give jurisdiction to the Income-tax Officer to issue the notice under section 34. Whether these grounds are adequate or not is not a matter for the court to investigate. In other words, the sufficiency of the grounds which induced the Income-tax Officer to act is not a justiciable issue. It is of course open for the assessee to contend that the Income-tax Officer did not hold the belief that there had been such non-disclosure. In other words, the existence of the belief can be challenged by the assessee but not the sufficiency of the reasons for the belief. Again the expression "reason to believe" in section 34 of the Income-tax Act does not mean a purely subjective satisfaction on the part of the Income-tax Officer. To put it differently, it is open to the court to examine the question whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent,
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(1) (1967) 63 I. T. R. 219.

the action of the Income-tax Officer in starting proceedings under section 34 of the Act is open to challenge in a court of law." A

Reliance was placed in the above context upon an earlier decision of this Court in the case of *Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District I, Calcutta.*<sup>(1)</sup> The above observations regarding the import of the words "reason to believe" though made in the context of section 34 of the Indian Income Tax Act, 1922 have, in our opinion, equal bearing on the construction of those words in section 21 of the U.P. Sales Tax Act. B

In the light of the view we have taken of the import of the words "reason to believe", we have no doubt that the assessing authority in the present case had valid grounds for initiating proceedings under section 21 of the Act against the respondent. It would appear from the memorandum dated March 13, 1962 sent by the assessing authority that for the assessment year 1955-56 the sales of atta, maida and sooji of the respondent amounted to over rupees fiftyeight lakhs. Account books of the respondent also showed that during the year 1958-59 the turnover of the respondent for sale of atta, maida and sooji amounted to over rupees seventyfive lakhs. The assessing authority had also material with it to show that the quota of wheat for the respondent had been fixed in August 1958 on the basis of the average of grinding done in the past three years. There was also the additional fact that the respondent had in spite of repeated notices not produced its account books for the assessment year 1957-58. These facts, in our opinion, were germane to the formation of the belief of the assessing authority that part of the turnover of the respondent had escaped assessment to tax. It cannot be said that the above belief was not formed in good faith or was mere pretence for initiating action under section 21 of the Act. [The assessing authority in the circumstances, in our opinion, acted within the ambit of its powers in initiating proceedings under section 21 of the Act. C D E F

We are unable to accede to the contention of Mr. Karkhanis that as the assessment sought to be reopened was *ex-parte* assessment under rule 41(5) of the Uttar Pradesh Sales Tax Rules, no proceedings in respect of that assessment can be initiated under section 21 of the Act. There is nothing in that section to restrict its operation to assessments other than those which have been made *ex-parte* under rule 41(5). The language of the section makes it plain that the assessing authority can take action if such authority has reason to believe that the whole or part of the turnover of a dealer has, for any reason, escaped assessment G H

(1) (1961) 41 I. T. R. 191.

- A** to tax for any year. To accede to the contention of Mr. Karkhanis would be tantamount to affording protection, so far as the operation of section 21 is concerned, to dealers who avoid to put in appearance and produce their account books before the assessing authority. Such a construction is not only not warranted by the language of the section, it is manifestly unreasonable inas-
- B** much as it puts a premium on contumacy.

- Mr. Karkhanis has also assailed the answer of the High Court to question No. (II) and has contended that the notice dated September 13, 1961 and the memorandum dated March 13, 1962 should be construed as notices under section 21 of the Act. As the re-assessment was not completed within one year
- C** of the service of these notices, the re-assessment, according to the learned counsel, should be held to be barred by limitation. There is, in our opinion, no force in this contention, we agree with the High Court that the above notice and the memorandum were of a preliminary nature and did not constitute notices under section 21 of the Act. All that was stated in the said notice and
- D** the memorandum was to call upon the respondent to produce account books. Threat was also held out that in case of non-compliance by the respondent, proceedings would be taken under section 21 of the Act. The above notice and the memorandum could not consequently be construed as notices under section 21 of the Act. It was only on March 24, 1962 that notice under
- E** section 21 of the Act was given to the respondent and the same was served on March 26, 1962. The assessment under section 21 was made on March 19, 1963 which was admittedly within one year of the date of the service of the notice under section 21 of the Act.

- We accordingly accept the appeal and discharge the answer
- F** given by the High Court to question No. (I). In our opinion, the assessing authority had an honest belief that the turnover of the respondent had partially escaped taxation so as to justify initiation of proceedings under section 21 of the Act. We accordingly answer the said question in the affirmative and in favour of the department. The appellant shall be entitled to the
- G** costs of this Court as well as in the High Court.

V.P.S.

*Appeal allowed.*