A ASSISTANT DIRECTOR OF INSPECTION INVESTIGATION

v.

KUM. A.B. SHANTHI

MAY 3, 2002

B [R.P. SETHI AND K.G. BALAKRISHNAN, JJ.]

Income Tax Act, 1961:

C *Sections 269 SS and 271 D—Prescribed mode of taking or accepting loan and penalty in violation thereof—Ascertained in respect of borrower and not the lender—Whether discriminatory—Held provisions are not discriminatory, draconion or exproprietory—Hence constitutionally valid—Constitution of India, 1950—Article 14.*

D *Section 269 SS—Enactment of under entry 82 in List I of Seventh Schedule—Legislative competence challenged—Plea that enactment is on the subject outside scope of Income Tax Act—Held, since law relating to tax can be enacted under Schedule 7, List I, Entry 82, it is within the competence of Parliament and the same is not colourable legislation—Enactment of any ancillary or subsidiary provision which transgresses over jurisdiction of* E *legislature for achieving the object of such legislation, would be a valid piece of legislation—Doctrine of colourable legislation.*

Judicial Review—Tax legislation—Held, it is a policy decision and hence it is for Parliament to decide in which manner legislation should be made—Hence no judicial interference called for.

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Interpretation of Constitution—VII Schedule—Legislative list—Entries—Interpretation of—Held, entries should be given their fullest meaning and widest amplitude and to extend to all ancillary and subsidiary matters.

G **High Court quashed prosecution against the respondent holding Section 269 SS of Income Tax Act, 1961 as violative of Article 14 of the Constitution.**

In connected appeal, wherein constitutional validity of Sections 269 SS and 271 D of the Act was challenged before High Court, the matter was dismissed by Single Judge as well as Division Bench.

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In appeal to this Court, appellant contended that the policy behind enactment of Section 269 SS debarring and penalising the borrower and not the lender is illegal and violative of Article 14 of the Constitution vis-a-viz. the lender; and if the intention of legislature was to unearth black money it was really black money of the lender that was involved in the transaction, and thus the classification was artificial and had no nexus with objects sought to be achieved by the enactment; that Parliament had no legislative competence to enact Section 269 SS, the source of which was traceable to entry 82 in List I of Seventh Schedule of the Constitution which relates only to tax on income other than agricultural income and expression 'income' in the Entry has to be interpreted according to its natural and grammatical meaning and the amount received may necessarily be not the income and hence treating the loan as income is not a valid constitutional legislation; and that Section 276 DD and 271 D was unconstitutional, the same being draconion and exproprietory in nature.

Allowing the appeal of the Revenue and dismissing the connected appeal of the assessee, the Court

HELD : 1. Section 269 SS is, in any way, not violative of Article 14 of the Constitution and consequently quashing of the proceedings by the Single Judge of High Court is not legally sustainable. The object of introducing Section 269 SS is to ensure that a tax payer is not allowed to give false explanation for his unaccounted money, or if he has given some false entries in his accounts, he shall not escape by giving false explanation for the same. During search and seizures, unaccounted money is unearthed and the tax payer would usually give the explanation that he had borrowed or received deposits from his relatives or friends and it is easy for the so-called lender also to manipulate his records later to suit the plea of the tax-payer. The main object of Section 269 SS was to curb this menace. As regards the tax legislations, it is a policy matter, and it is for the Parliament to decide in which manner the legislation should be made. Of course, it should stand the test of constitutional validity. [771-G; 772-A; 770-D, E]

S.K. Dutta, ITO v. *Lawrence Singh Ingty,* 68 (1968) ITR 272; *K.R.M.V Ponnuswamy Nadar Sons* v. *Union of India,* 196 (1992) ITR 431 (Madras) and *Sukhdev Rathi* v. *Union of India,* 211 (1995) ITR 157 (Guj.), relied on.

2.1. Section 269 SS was not enacted without legislative competence. It cannot be said that Section 269 SS was enacted in respect of a subject which

A is outside the scope of the Income Tax Act or that this Section relates to a topic not within the competence of the legislature. When the principle in a statute is challenged on the ground of colourable legislation, what has to be proved to the satisfaction of the Court is that though the Act ostensibly is within the legislative competence of the legislature in question, in substance and in reality, it covers a field which is outside its legislative competence. [744-A; 773-D, C]

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Jaora Sugar Mills (P) Ltd. v. *State of M.P.*, AIR (1966) SC 4161 and *P.N. Krishna Lal* v. *Govt. Kerala*, [1995] Supp. 2 SCC 187, referred to.

C 2.2. Heads of legislation given in the list should not be constructed in a narrow of pedantic way. If any legislature makes any ancillary or subsidiary provision which incidentally transgresses over its jurisdiction for achieving the object of such legislation, it would be a valid piece of legislation. The entries in a legislative list would be given their fullest meaning and the widest amplitude and be held to extend to all ancillary and subsidiary matters which D can fairly and reasonably be said to be comprehended in them. It is only when a legislature which has no power to legislate, or the legislation is camouflaged in such a way as to appear to be within its competence when it knows it is not, then alone it can be said that the legislation so enacted is a colourable legislation and that there is no legislative competence. The law relating to taxation can E very well be enacted under Entry 82 in List 1 of the 7th Schedule. If any legislation which intended to achieve the collection of income tax and to make it easier and systematic is enacted, such legislation would certainly be within the competence of the legislature. [772-D-G]

Union of India v. *A. Sanyasi Rao and Ors.*, 219 (1996) ITR 330, referred F to.

3. Section 269 SS or Section 271 D or the earlier Section 276 DD is not unconstitutional on the ground that it was draconion or expropriety in nature. Undue hardship is mitigated by the inclusion of section 273 B in the G Act. If there was a genuine and *bona fide* transaction and if for any reason the tax payer could not get a loan or deposit by account-payee cheque or demand draft for some *bona fide* reasons, the authority vested with the power to impose penalty has got discretionary power. [774-D-E]

CRIMINAL APPELLATE JURISDICTION : Criminal Appeal Nos. 601 H of 1992.

From the Judgment and Order dated 21.4.1992 of the Chennai High Court in Crl. M.P. No. 2854 of 1988.

Soli J. Sorabjee, Attorney General, S. Ganesh, T.L.V. Iyer, Rajiv Nanda, B.V.B. Das, Manish Singhvi, P. Parmeshwaran, Dhruv Mehta, Ms. Shobha, Ms. Anu Mehta, K.L. Mehta and R.A. Perumal for the appearing parties.

The Judgment of the Court was delivered by

K.G. BALAKRISHNAN, J. In both these appeals, the constitutional validity of Sections 269SS and 271D of the Income Tax Act, 1961 (for short, "the Act") is challenged. In Criminal Appeal No. 601 of 1992, the learned Single Judge of the Madras High Court quashed the prosecution initiated against the respondent by holding that Section 269SS is violative of Article 14 of the Constitution and, therefore, the prosecution initiated against the respondent was not legal. The learned Single Judge granted certificate under Article 134A of the Constitution and the present appeal has been filed by the Department.

In Civil Appeal No. 4478 of 2000, the appellant had challenged the constitutional validity of Sections 269SS and 271D of the Act before the High Court. The learned Single Judge dismissed the writ petition. Thereupon the appellant filed an appeal before the Division Bench. The Division Bench in Writ Appeal No. 5447 of 1999 affirmed the order of the learned Single Judge. The judgment of the Division Bench is now challenged before us in this appeal.

Section 269SS was inserted in the Income Tax Act by Finance Act 1984 with effect from 1.4.1984, but the same was made operative from 1.7.1984. The Income Tax Department, in course of searches carried out by them from time to time recovered large amounts of unaccounted cash from certain tax payers and often the tax payers gave explanation for their unaccounted cash to the effect that they had borrowed loans or received deposits made by other persons. Sometimes, it was noticed, that the unaccounted income was also brought into the books of accounts in the form of loans and deposits and later they would obtain confirmatory letters from other persons in support of their explanation. The Department was not able to unearth the source of such unaccounted cash. Therefore, in order to plug the loopholes and to put an end to the practice of giving false and spurious explanation by tax payers, a new provision was inserted in the Income Tax Act debarring persons from taking or accepting from any other person any loan or deposit otherwise than

A by account-payee cheque or account-payee bank draft, if the amount of such loan or deposit or the aggregate amount of such loan or deposit is Rs. 10,000 or more. The amount of Rs. 10,000 was later revised as Rs. 20,000 with effect from 1.4.1989.

Section 269SS of the Act 1981 reads as follows:

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"S. 269SS. Mode of taking or accepting certain loans and deposits- No person shall, after the 30th day of June, 1984, take or accept from any other person (hereafter in this section referred to as the depositor) any loan or deposit otherwise than by an account payee cheque or account payee bank draft, if

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(a) the amount of such loan or deposit or the aggregate amount of such loan and deposit; or

(b) on the date of taking or accepting such loan or deposit, any loan or deposit taken or accepted earlier by such person from the depositor is remaining unpaid (whether payment has fallen due or not), the amount or the aggregate amount remaining unpaid; or

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(c) the amount or the aggregate amount referred to in clause (a) together with the amount or the aggregate amount referred to in clause (b),

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is twenty thousand rupees or more:

Provided that the provisions of this section shall not apply to any loan or deposit taken or accepted from, or any loan or deposit taken or accepted by—

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(a) Government;

(b) Any banking company, post office savings bank or cooperative bank;

(c) Any corporation established by a Central, State or Provincial Act;

(d) Any Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)

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(e) Such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette:

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Provided further that the provisions of this section shall not apply to

any loan or deposit where the person from whom the loan or deposit is taken or accepted and the person by whom the loan or deposit is taken or accepted are both having agricultural income and neither of them has any income chargeable to tax under this Act. A

Explanation——For the purposes of this section —

(i) "banking company" means a company to which the Banking Regulation Act, 1949 (10 of 1949) applies and includes any bank or banking institution referred to in section 51 of that Act; B

(ii) "co-operative bank" shall have the meaning assigned to it in Part V of the Banking Regulation Act, 1949 (10 of 1949); C

(iii) "loan or deposit" means loan or deposit of money."

Section 276DD was inserted in the Act by the Finance Act, 1984 which came into effect from 1.4.1984 and which reads as under :

"S. 276DD. Failure to comply with the provisions of section **269SS** — If a person takes or accepts any loan or deposit in contravention of the provisions of section 269SS, he shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine equal to the amount of such loan or deposit.". D

Subsequently, Section 271D, which is the penal clause in the Act which provides for imposition of penalty for failure to comply with the provisions of Section 269SS was introduced with effect from 1.4.1989 omitting Section 276DD with effect from the same date. In the original Section 276DD, in case of imposition of punishment, the term of imprisonment was also prescribed which could extend to two years. But, subsequently, by the introduction of Section 271D, the punishment of imprisonment was taken away and the failure to comply with the provisions of Section 269SS could only be visited with a penalty of fine equal to the amount of loan or deposit to be taken or accepted. Section 271D as incorporated with effect from 1.4.1989 reads as follows : E F

"271D. Penalty for failure to comply with the provisions of section 269SS —(1) If a person repays any deposit referred to in section 269T otherwise than in accordance with the provisions of that section, he shall be liable to pay, by way of penalty, a sum equal to the amount of the deposit so repaid. G

(2) Any penalty imposable under sub-section (1) shall be imposed by H

A the Deputy Commissioner."

The main attack against Section 269SS of the Act is made on the basis that it violates Article 14 of the Constitution. The contention of the appellant's counsel in civil appeal is that taking a loan or receiving a deposit is a single transaction wherein a lender and borrower are involved and by the impugned B Section the borrower alone is sought to be penalized and the lender is allowed to go scot-free. It is contended that if the intention of the Legislature is to unearth black money, it is really the black money of the lender that is involved in the transaction and, therefore, the policy behind the enactment to find fault with the borrower is illegal and violative of Article 14 of the Constitution vis-C a-vis the lender. It is also contended that classification made by Parliament is an artificial one and has no nexus with the objects sought to be achieved by the enactment.

The contention of the appellant's counsel has no force. The object of introducing Section 269SS is to ensure that a tax payer is not allowed to give D false explanation for his unaccounted money, or if he has given some false entries in his accounts, he shall not escape by giving false explanation for the same. During search and seizures, unaccounted money is unearthed and the tax payer would usually give the explanation that he had borrowed or received deposits from his relatives or friends and it is easy for the so-called lender also to manipulate his records later to suit the plea of the tax-payer. E The main object of Section 269SS was to curb this menace. As regards the tax legislations, it is a policy matter, and it is for the Parliament to decide in which manner the legislation should be made. Of course, it should stand the test of constitutional validity.

F A Constitution Bench of this Court in S.K. Dutta, ITO vs. Lawrence Singh Ingty 68 (1968) ITR 272 held :

> "It is not in dispute that taxation laws must also pass the test of article 14. That has been laid down by this Court in *Moopil Nair* v. *State of Kerala,* [1961] 3 SCR 77. But as observed by this court in *East* G *India Tobacco Co.* v. *State of Andhra Pradesh,* [1963] 1 SCR 404, in deciding whether the taxation law is discriminatory or not it is necessary to bear in mind that the State has a wide discretion in selecting persons or objects it will tax, and that a statute is not open to attack on the ground that it taxes some person or objects and not others; it is only when within the range of its selection, the law H operates unequally, and that cannot be justified on the basis of any

valid classification, that it would be violative of article 14. It is well settled that a State does not have to tax everything in order to tax something. It is allowed to pick and choose districts, objects, persons, methods and even rates for taxation if it does so reasonably." A

The above dictum applies in full force as regards the present case. The object sought to be achieved was to eradicate the evil practice of making of false entries in the account books and later giving explanation for the same. To a great extent, the problem could be solved by the impugned provision. B

The very same provision was earlier challenged in another writ petition before the High Court of Madras and the Division Bench of the Madras High Court had upheld the constitutional validity of Section 269SS in *K.R.M.V. Ponnuswamy Nadar Sons* v. *Union of India,* 196 (1992) ITR 431 (Madras) decided on Sept. 11, 1989. Despite this decision of the Division Bench, the learned Single Judge quashed the proceedings initiated against the respondent under Section 269SS of the Income Tax Act. C

A Division Bench of the Gujarat High Court in *Sukhdev Rathi* v. *Union of India,* 211 (1995) ITR 157 (Guj.) also upheld the constitutional validity of Section 269SS. Speaking for the Bench, Acting Chief Justice G.T. Nanavati (as he then was) held : D

"A borrower by adopting the device of giving a false explanation or making false entries or by obtaining confirmatory letters is found evading payment of tax. Thus, the borrower as a class is found to be indulging in such practices. By making such false entries or by giving explanations or by creating false evidence, it is the borrower who was found to be evading payment of tax. In the case of a lender, we fail to appreciate how while lending money by not making payment by a cheque or a draft, he would evade payment of income tax. Therefore, though the transaction of loan can be regarded as a single transaction, and the borrower and the lender can be said to be equal integral parts, when we view them from the angle of tax evasion, we find that they cannot be regarded as equal or similarly situated. Compared to the class consisting of lenders, the class consisting of borrowers can be said to be in a position to evade tax by adopting the device, for curbing which provisions have been made in Chapter XX-B by inserting Section 269SS and other sections." E F G

In view of the aforesaid circumstances, we do not think that Section H

A 269SS is, in any way, violative of Article 14 of the Constitution and consequently quashing of the proceedings by the learned Single Judge of the Madras High Court for this reason is not legally sustainable.

Another contention urged by the appellant's counsel in Civil Appeal No.4478 of 2000 is that the Parliament had no legislative competence to enact B Section 269SS. The source of power for enactment of Section 269SS is traceable to Entry 82 in List I of the 7th Schedule and this according to the appellant's counsel can relate only to tax on income other than agricultural income and the expression "income" in that Entry has to be interpreted according to its natural and grammatical meaning and if that be so, the Union has no legislative C power to enact Section 269SS.

Entry 82 in List I of the 7th Schedule reads as follows :

"Taxes on income other than agricultural income."

The contention of the appellant's counsel is that the amount which is D received as loan or deposit need not necessarily be the "Income" of the tax payer and, therefore, any legislation made by treating the loan or deposit as "income" is not a valid constitutional legislation. It is settled law that the heads of legislation given in the list should not be constructed in a narrow or pedantic way. If any legislature makes any ancillary or subsidiary provision E which incidentally transgresses over its jurisdiction for achieving the object of such legislation, it would be a valid piece of legislation. The entries in a legislative list should be given their fullest meaning and the widest amplitude and be held to extend to all ancillary and subsidiary matters which can fairly and reasonably be said to be comprehended in them. It is only when a legislature which has no power to legislate, or the legislation is camouflaged F in such a way as to appear to be within its competence when it knows it is not, then alone it can be said that the legislation so enacted is a colourable legislation and that there is no legislative competence. The law relating to taxation can very well be enacted under Entry 82 in List I of the 7th Schedule. If any legislation which intended to achieve the collection of income tax and G to make it easier and systematic is enacted, such legislation would certainly be within the competence of the legislature.

In *Union of India* v. *A. Sanyasi Rao and Ors.*, 219 (1996) ITR 330, Section 44AC and 206C of the Income Tax Act were challenged. It was held by this Court :

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"The heads of legislation in the lists should not be construed in a narrow and pedantic sense, but should be given a large and liberal interpretation. The word "income" occurring in entry 82 in List I of the Seventh Schedule to the Constitution should be construed liberally and in a very wide manner and the power to legislate will take in all incidental and ancillary matters including the authorization to make provision to prevent evasion of tax, in any suitable manner."

When the principle in a statute is challenged on the ground of colourable legislation, what has to be proved to the satisfaction of the Court is that though the Act ostensibly is within the legislative competence of the legislature in question, in substance and in reality, it covers a field which is outside its legislative competence [See : *Jaora Sugar Mills (P) Ltd.* v. *State of M.P.*, AIR (1966) SC 416].

Applying the above principle, it cannot be said that Section 269SS was enacted in respect of a subject which is outside the scope of the Income Tax Act or that this Section relates to a topic not within the competence of the legislature. This Court in *P.N. Krishna Lal* v. *Govt. of Kerala,* [1995] Supp. 2 SCC 187 held :

"An entry in the Seventh Schedule to the Constitution is not a power given to the legislature but is a field of its legislation. The legislature derives its power under Article 246 and other related articles in the Constitution. The language of an entry should be given the widest meaning fairly capable to meet the need of the Government envisaged by the Constitution. Each general word should extend to all ancillary or subsidiary matters which can fairly and reasonably be comprehended within it. When the vires of an enactment is impugned, there is an initial presumption of its constitutionality. If there exists any difficulty in ascertaining the limits of the legislative power, it must be resolved, as far as possible, in favour of the legislature, putting the most liberal construction on the legislative entry so that it is *intra vires*. Narrow interpretation should be avoided and the construction to be adopted must be beneficial and cover the amplitude of the power. The broad liberal spirit should inspire those whose duty it is to interpret the Constitution to find out whether the impugned Act is relatable to one or the other entries in the relevant list. The allocation of the subjects of the entries in the respective lists is not done by way of a scientific or logical definitions but it is a mere enumeration of broad and comprehensive categories.

A Therefore, we do not think that Section 269SS is either violative of Article 14 of the Constitution, or it was enacted without legislative competence.

The next contention urged by the counsel for the appellant is that original Section 276DD is draconian in nature as penalty imposed for violation of Section 269SS is imprisonment which may extend to two years and shall B also be liable to fine equal to the amount of loan or deposit. This Section was subsequently omitted and a new Section 271D was enacted. The penalty of imprisonment was deleted in the new Section. The new Section 271D provides only for fine equal to the amount of loan or deposit taken or accepted.

It is important to note that another provision, namely Section 273B was C also incorporated which provides that notwithstanding anything contained in the provisions of Section 271D, no penalty shall be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provision if he proves that there was reasonable cause for such failure and if the assessee proves that there was reasonable cause for failure to take a D loan otherwise than by account-payee cheque or account-payee demand draft, then the penalty may not be levied. Therefore, undue hardship is very much mitigated by the inclusion of Section 273B in the Act. If there was a genuine and *bona fide* transaction and if for any reason the tax payer could not get a loan or deposit by account-payee cheque or demand draft for some *bona fide* reasons, the authority vested with the power to impose penalty has E got discretionary power.

In that view of the matter, we do not think that Section 269SS or 271D or the earlier Section 276DD is unconstitutional on the ground that it was draconian or exproprietory in nature.

F In view of the foregoing, Criminal Appeal No. 601 of 1992 is allowed and the impugned judgment is set aside. Civil Appeal No. 4478 of 2000 is without any merit and dismissed, however, without costs.

K.K.T. Crl. Appeal No. 601/92 allowed.
Crl. Appeal No. 4478/2000 dismissed.