FAILURE TO FOLLOW MANDATORY PROVISIONS OF SECTION 144C – WHETHER FATAL TO ASSESSMENT?

Controversy relating to validity of final assessment order passed in the case of 'eligible assessee' without first passing draft order of assessment, *viz.*, whether the same is jurisdictionally defective or merely procedurally irregular, has recently been decided by the Delhi High Court in judgment[1] rendered in a batch of cases.

Factual background

The facts emanating in majority of the cases forming part of the batch of matters before the High Court were similar inasmuch as final assessment orders were passed in the case of the 'eligible assessees' under section 143(3) read with section 144C(13) of the Act in the first round of proceedings, which were challenged in appeal before the Income-tax Appellate Tribunal ("**ITAT**"). Said final assessment orders were remanded to the TPO/ assessing officer with directions for de-novo assessment/ re-computation of total income.

In set aside proceedings, in compliance with the directions of the ITAT, the TPO/ assessing officer were required to pass draft assessment orders as the assessees qualified as 'eligible assessees' under section 144C(15). The assessing officer, however, straight away passed final assessment orders under section 143(3) read with section 254 of the Act, which was accompanied by notice of demand and notice for initiating penalty proceedings.

Challenge before the Delhi High Court

Since draft assessment order was not passed by the assessing officer, no opportunity was provided to the assessees to file objections before the DRP under section 144C(2) of the Act. Moreover, the assessees were fastened with liability to pay the income-tax demand as well as burden to defend themselves against levy of penalty. Aggrieved by such actions of the assessing officer, the assessees challenged the final assessment orders before the Delhi High Court.

Reliance was placed by the assessees on catena of decisions passed by various High Courts wherein final assessment orders passed in similar circumstances were quashed, with no second innings provided to the assessing officer to rectify their mistake and pass draft assessment orders.

The Revenue, on the other hand, vociferously argued that the impugned final assessment orders may be set aside and assessing officer may be allowed to pass draft assessment orders on the ground that error, if any, in finalizing the assessments was a mere irregularity/ procedural error. Relying on judgment of Full Bench of the Delhi High Court in the case of *Sarabjit Singh vs*

[1] *Pr CIT vs Sumitomo Corporation India (P) Ltd* ITA 52/2023 & Ors

CIT 1998 SCC OnLine Del 975, it was argued that section 144C was comparable to the erstwhile section 144B introduced by Taxation Laws (Amendment) Act, 1975 w.e.f. 01.04.1976, which laid down a similar procedure for assessment wherein an assessee could prefer objections before the Inspecting Assistant Commissioner ("**IAC**") against draft assessment order passed in the first instance and that the assessing officer would be bound to pass final assessment order as per directions issued by the IAC for guidance of the assessing officer. In the said case, the Full Bench had held that provisions of section 144B were merely procedural; the inherent jurisdiction of the assessing officer to assess could not be doubted and in absence of change of forum, failure to abide by the procedure prescribed would be mere procedural irregularity. On the strength of the aforesaid, the Revenue sought directions for setting aside of impugned final assessment orders with liberty to the assessing officer to pass draft assessment orders.

Judgment of the Delhi High Court

Re: Erstwhile section 144B not on the same pedestal as section 144C of the Act

The argument that erstwhile section 144B was *pari materia* to section 144C was categorically rejected by the High Court. It was held that the powers of the DRP are not only corrective but extend to enhancing or reducing the proposed variations, subject to the rider that the DRP is not empowered to set aside a proposed variation. It was held that the extent of jurisdiction which stands conferred upon the DRP by virtue of sub-sections (6), (7) and (8) of section 144C, viz., power to admit evidence, call for reports, direct further enquiries and power to confirm, reduce or enhance the proposed variations are clearly distinct from the powers for guidance conferred upon the IAC under the erstwhile section 144B of the Act, which was merely in the nature of an additional tier of internal review and oversight mechanism.

The High Court further held that the judgment in *Sarabjit Singh (supra)* was founded on the bedrock that erstwhile section 144B of the Act was merely procedural since there was no change of forum; the section was in the nature of an internal safeguard created by the statute.

In contrast, assessment mechanism under section 144C was held by the High Court to be unique and distinct, i.e., a self-contained code for assessment in respect of 'eligible assessees', which entails two separate components merging to form a composite assessment, i.e, power of computation and assessment conferred upon the TPO under section 92CA as well as the power of the assessing officer to rule upon other segments of income earned, thereby, constituting an amalgam of decisions taken by the TPO and the assessing officer. It was, accordingly, held that section 144C cannot be countenanced to be one which does not constitute change of forum and was not comparable to erstwhile section 144B of the Act.

Re: Court cannot extend/ confer limitation provided in the statute

On the issue whether in absence of limitation available, the High Court was empowered to set aside the impugned final assessment orders and allow the assessing officer to pass draft assessment orders beyond limitation, it was argued by the Revenue that the statute itself provided, in terms of section 153(6) of the Act, period of 12 months to the assessing officer to pass draft assessment orders as the same would be passed "in consequence of or to give effect to any finding or direction contained in … an order of any court …".

The said argument was negated by the High Court holding that assessment consequent to remand by the ITAT would be regulated by sub-sections (3) and (4) of section 153 whereas provisions of sub-section (6) are itself subjected to, *inter alia*, provisions of sub-section (3) of section 153 of the Act. Considering that period for completion of assessment exercise in terms of sub-sections (3) and (4) of section 153 of the Act had already expired in the batch of cases, it was held that it would be wholly impermissible for the High Court to expand or enlarge the period prescribed for completion of assessment.

Moreover, elaborating on the meaning of '*finding*' and '*direction*' by referring to the judgment of the apex Court in *ITO vs Murlidhar Bhagwan Das* 1964 SCC OnLine SC 18, the High Court held that '*finding*' would mean conclusion arrived at on a material question necessary for the disposal of a case and essential for according relief in an assessment year and that '*direction*' would mean one which the appellate authority was empowered to issue under the Act. It was held that the *finding* recorded in the present batch of cases was that the assessing officer was required to first pass draft assessment order in the case of 'eligible assessees' and that any *direction* which could be issued by the Court had to be in consonance with the aforesaid *finding*. A '*direction*', in terms as suggested by the Revenue, to set aside the matters and direct the assessing officer to pass fresh draft assessment orders was, thus, held by the High Court to be outside the scope of section 153(6) of the Act.

Conclusion

The Delhi High Court held that failure to frame a draft order not only curtails the right of an 'eligible assessee' to adopt corrective measures, but it also deprives such assessee of a salutary right to challenge the draft assessment in terms of the statutory mechanism laid in place.

It was further held that limitation cannot be enlarged/ conferred by High Courts and that the same would be governed by the statutory provisions itself; while the Courts may, where legally permissible, consider condonation of delay, the Courts are not entitled to expand or enlarge the period of limitation as statutorily prescribed.

VA Comments

The judgment of the High Court fortifies the view taken by various High Courts repeatedly that provisions of section 144C of the Income-tax Act, 1961 ("**the Act**") are mandatory; that failure to follow the same is fatal to assessments and cannot be cured. The submission of the Revenue regarding applicability of the ratio of Full Bench decision in *Sarabjit Singh (supra)* has also been effectively considered, examined and duly rejected.

It is pertinent to note that the issue is presently sub-judice before the Supreme Court in a batch of SLPs filed by the Revenue and the dust will finally settle once the apex Court pronounces its verdict.

One of the key takeaways of the High Court judgment is the findings recorded regarding section 144C of the Act being a self-contained code and the assessment mechanism provided thereunder being unique and distinct, applicable in special class of cases of 'eligible assessees', which is not merely procedural in nature but is mandatorily to be followed.

It is also worthwhile to note the findings regarding power of the High Court to extend/ confer limitation beyond the statutory mandate. The expressions '*finding*' and '*direction*' have been explained succinctly, which will have a bearing on similar cases in the future.

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