**Commissioner of Income-tax Vs. Union Carbide Corporation**

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**Court** : Kolkata

**Decided On :** Jul-06-1992

**Reported in** : [1994]206ITR402(Cal)

**Judge** : Ajit K. Sengupta and ;J.N. Hore, JJ.

**Acts** : Income Tax Act, 1961 - Section 147

**Appeal No.** : Income-tax Reference No. 86 of 1979

**Appellant** : Commissioner of Income-tax

**Respondent** : Union Carbide Corporation

**Advocate for Def.** : D. Pal and ;M. Seal, Advs.

**Advocate for Pet/Ap.** : S.K. Mitra and ;R.C. Prasad, Advs.

**Judgement** :

Ajit K. Sengupta, J.

1. The Tribunal has referred the following question of law to this court under Section 256(2) of the Income-tax Act, 1961, for the assessment year 1965-66 :

'Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that proceedings initiated by the Income-tax Officer under Section 147 of the Income-tax Act, 1961, were illegal ?'

2. Shortly stated, the facts leading to the question are as under :

The assessee, Union Carbide Corporation (hereinafter referred to as 'the U.C.C.') is a corporation existing under the law of the State of New York in the U. S. A. and is a company within the meaning of Section 2(17)(ii) of the Income-tax Act, 1961. It has been assessed in the status of a non-resident company. In the past, jurisdiction over the Union Carbide Corporation lay with the first Income-tax Officer, Non-resident Refund Circle/Bombay, who made assessments on it for and up to the assessment year 1965-66. The jurisdiction was then transferred to the Income-tax Officer, B-Ward, Companies Dist. IV, Calcutta. The Union Carbide Corporation rendered technical services to Union Carbide India Ltd. (hereinafter referred to as 'the U.C.I.L.') under two separate technical service agreements. One is dated November 7, 1950, and relates to the manufacture of electric batteries. The second relates to the manufacture of chemicals and plastics and was executed on November 1, 1956. The Union Carbide Corporation received technical service fees from the Union Carbide India Ltd. The technical service fees received from the Union Carbide India Ltd. were not included in the total income but these fees were regularly and consistently shown by the assessee year after year in the part of the return showing exempted receipts. Thus, for the assessment year 1965-66, the assessee showed in section 'F' of the return Rs. 8,16,000 as the technical service fees in respect of batteries and Rs. 5,77,416 in respect of chemicals and plastics. The original assessment for 1965-66 was completed by

Shri R. Kannan, Income-tax Officer, Bombay, who, however, did not include these service fees in the total income. The present Income-tax Officer at Calcutta was, however, of the opinion that the action of the Income-tax Officer who made the said original assessment was wrong in so far as it related to technical service fees.

3. At this stage, it may be useful to recall that, for the assessment year 1962-63, the Union Carbide Corporation claimed a loss said to have arisen out of the contracts for rendering technical services to the Union Carbide India Ltd. This claim was rejected by the then Bombay Income-tax Officer, Shri R. Krishnan, who observed in the assessment order for that year that the technical services were rendered by the assessee to the Indian company mostly outside India and not in India. Therefore, he held that there was no loss arising in India in relation to the services rendered by the Union Carbide Corporation to the Union Carbide India Ltd.

4. Thereafter, the Bombay Income-tax Officer made the assessment up to the assessment year 1965-66 consistent with the view taken for the assessment year 1962-63.

5. The original assessment for 1965-66 was made by the Income-tax Officer, Shri Kannan, on April 1, 1966. He then addressed a letter dated October 14, 1966, to the auditors of the Union Carbide Corporation stating that a part of the consideration for the technical services relating to chemicals and plastics was assessable in India. Another letter was written by Shri Kannan, Income-tax Officer at Bombay, on March 13, 1967, to the assessee wherein it was put across to the assessee-company that the technical service fees related to the use of know-how supplied by the Union Carbide Corporation to the Union Carbide India Ltd, and were akin to royalties and were taxable. The Income-tax Officer observed in the letter dated March 13, 1967, that reassessment would henceforth be necessary. This contemplated action on the part of the Income-tax Officer was resisted by the assessee. Thereafter, as late as on March 30, 1970, the present Income-tax Officer served the notice under Section 147(b) in relation to the assessment year 1965-66 for reopening in respect of technical service fees which had not been considered taxable at the time of the original assessment.

6. The Income-tax Officer completed the assessment under Section 147(b) and mentioned that the basis for the reassessment was the Central Board of Direct Taxes Circular No. 21 of 1969 which deals generally with the admissibility and taxation of royalties, service fees, etc., in the case of foreign collaboration agreements. The said circular is published in [1969] 73 ITR 19.

7. The assessee challenged before the Appellate Assistant Commissioner that the said circular could not have induced any belief about escapement of income and that the Income-tax Officer had not stated in his order in a detailed way as to why he entertained such a belief. It was argued that the circular was only general in nature and no particular information in the sense of a judicial pronouncement was available to the Income-tax Officer in that circular. It was admitted that, in subsequent years, the assessee agreed to be taxed on a part of the technical service fees in order to buy peace and avoid litigation. It was, however, pointed out that the reassessment proceedings were invalid and illegal as they were based on a mere change of opinion.

8. The Appellate Assistant Commissioner turned down the assessee's plea but reduced the quantum in line with the agreement between the assessee and the Department for subsequent years.

9. On appeal by the assessee, the Tribunal, on hearing the rival contentions, observed as follows :

'We have carefully considered the rival contentions advanced by both the sides and are in entire agreement with the submissions made by the assessee's counsel. In view of the judgments relied upon by the assessee's counsel and mentioned above and also on going through the history of the case, we find that the Income-tax Officer only changed his opinion when he made a fresh assessment. The circular relied upon by the Income-tax Officer is general in nature and the reasons recorded by the Income-tax Officer do not form the factual foundation on which the superstructure of belief could be erected. The taxability of technical fees had been present in the mind of the predecessor Income-tax Officer right from the assessment year 1962-63. The opinion of the Central Board of Direct Taxes in the circular does not tantamount to an expression of the

correct state of the law by a body or an authority competent or authorised to pronounce upon the law in a judicial capacity. It cannot also fetter the judicial discretion of the Income-tax Officer. In view of the catena of decisions relied upon by the assessee's counsel and in view of the circumstances surrounding the reassessment, we are of the opinion that the reassessment proceedings are illegal and cannot stand. We, therefore, vacate the order under Section 147(b). In that view of the matter, we do not consider it necessary to deal with the quantum.'

10. Before us, learned counsel of the parties reiterated the contentions urged before the lower authorities. What appears to us to be the crucial material on which the whole issue turns is the reasons recorded by the Income-tax Officer in terms of Section 148(2) which appear at page 41 of the paper book.

11. Reasons recorded by the Income-tax Officer in terms of Section 148(2):

'Messrs. Union Carbide Corporation has received technical service charges amounting to Rs. 13,93,416 during the year relevant to the assessment year 1965-66. At the time of original assessment, this was not taxed. The original assessment was completed on January 11, 1967. Since then, the Central Board of Direct Taxes, in their Circular No. 7A/40/08-IT (All) dated July 9, 1969, has explained the correct-position of law with regard to the assessment of non-resident assessees entering into/or having entered into technical collaboration with resident assessees and who are in receipt of technical service fees from Indian companies. In terms of this circular which is fresh information coming into my possession, I have reason to believe that income has escaped assessment for the assessment year 1965-66. The assessment, therefore, requires to be reopened. Issue notice under Section 148 read with Section 147(b).'

12. The Income-tax Officer recording the reason has observed that he had been guided by the correct position of law enunciated by the Central Board of Direct Taxes with regard to the assessment of non-resident assessees entering into technical collaboration with resident assessees in consideration of technical service fees received from such resident assessees. The explanation as contained in the said circular of the Central Board of Direct Taxes has been treated by the officer as the proclamation of law. Learned counsel for the assessee has concentrated his contentions on the point that the Central Board of Direct Taxes cannot be a formal source of law and its opinion as to what the law is cannot be treated as a declaration of law. It is argued that, unless the construction of law comes from a formal source, such opinion cannot constitute 'information' within the meaning of Section 147(b). According to the assessee's learned counsel, the Central Board of Direct Taxes cannot be treated as a source of law except where the Central Board of Direct Taxes acts as an appellate forum. It is only the opinion on the import and effect of law coming from a judicial authority or an appellate authority that can be treated as information for the purpose of initiating proceedings for reassessment under Section 147(b). Support was drawn' for this purpose from the decision of Indian and Eastern Newspaper Society v. CIT : [1979]119ITR996(SC) , wherein the Supreme Court explored the special significance and the import of the word 'information' in the setting in which the word occurs in that provision. 'Information', according to the Supreme Court, in the context means instruction or knowledge. Thin instruction or knowledge could be concerning the facts or other particulars. Where it concerns facts, there is little difficulty. By its inherent nature, a fact has concrete existence not requiring forensic interpretation. It influences the determination of an issue by the mere circumstance of its relevance. To quote from the decision (at page 1001) :

'It requires no further authority to make it significant. Its quintessential value lies in its definitive vitality.'

13. But the Supreme Court found particular difficulty with regard to instruction or knowledge as to law. Where information is regarded as instruction or knowledge as to law, the position presents complexity. The Supreme Court in that connection observed at pages 1001 and 1002 of 119 ITR as follows :

'But when 'information' is regarded as meaning instruction or knowledge as to law, the position is more complex. When we speak of 'law', we ordinarily speak of norms or guiding principles having legal effect and legal consequences. To possess legal significance for that purpose, it must be enacted or declared by a

competent authority. The legal sanction vivifying it imparts to it its force and validity and binding nature. Law may be statutory law or, what is popularly described as judge-made law. In the former case, it proceeds from enactment having its source in competent legislative authority. Judge-made law emanates from a declaration or exposition of the content of a legal principle or the interpretation of a statute, and may in particular cases extend to a definition of the status of a party or the legal relationship between parties, the declaration being rendered by a competent judicial or quasi-judicial authority empowered to decide questions of law between contending parties. The declaration or exposition is ordinarily set forth in the judgment of a court or the order of a Tribunal. Such declaration or exposition in itself bears the character of law. In every case, therefore, to be law it must be a creation by a formal source, either legislative or judicial authority. A statement by a person or body not competent to create or define the law cannot be regarded as law. The suggested interpretation of enacted legislation and the elaboration of legal principles in text books and journals do not enjoy the status of law. They are merely opinions and, at best, evidence in regard to the state of the law and in themselves possess no binding effect as law. The forensic submissions of professional lawyers and the seminal activities of legal academics enjoy no higher status. Perhaps the only exception is provided by the writings of publicists in international law, for in the law of nations the distinction between formal and material sources is difficult to maintain.

In that view, therefore, when Section 147(b) of the Income-tax Act is read as referring to 'information' as to law, what is contemplated is information as to the law created by a formal source. It is law, we must remember, which, because it issues from a competent Legislature or a competent judicial or quasi-judicial authority, influences the course of the assessment and decides any one or more of those matters which determine the assessee's tax liability.'

14. In the passage, the Supreme Court observed in emphatic terms that any statement by a person or body not competent to create or define the law cannot be regarded as law.

15. In any case, it is by now settled that declaration of law must be made by an authority which could be treated as a formal source of law. Before the Supreme Court, the issue was whether the audit party, either of the Department's household audit wing or the audit party deputed by the Comptroller and Auditor-General could pronounce upon what the law should be or what the true purport of the law is. The Supreme Court came to a definite decision that the audit party, whether from the Revenue's own internal audit system or from the office of the Comptroller and Auditor-General, performs an essentially administrative or executive function and the audit cannot be invested with the power of judicial supervision over the quasi-judicial acts of the income-tax authorities. No such power is contemplated to be conferred either on the internal audit organisation or on the Comptroller and Auditor-General. While deciding the question of what the import of the word 'information' is, the Supreme Court, in the case, laid down a broad proposition that no authority performing a function which is essentially administrative or executive and not judicial supervision of the work of the income-tax authority can pronounce on law and any pronouncement coming from an administrative or executive source could not amount to information within the meaning of Section 147(b).

16. In the above cited case, the Supreme Court observed further as follows (at page 1002) :

' In determining the status of an internal audit report, it is necessary to consider the nature and scope of the functions of an internal audit party. The internal audit organisation of the Income-tax Department was set up primarily for imposing a check over the arithmetical accuracy of the computation of income and the determination of tax, and now, because of the audit of income-tax receipts being entrusted to the Comptroller and Auditor-General of India from 1960, it is intended as an exercise in removing mistakes and errors in income-tax records before they are submitted to the scrutiny of the Comptroller and Auditor-General. Consequently, the nature of its work and the scope of audit have assumed a dimension co-extensive with that of Receipt Audit. The nature and scope of Receipt Audit are defined by Section 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971.

Under that section, the audit by the Comptroller and Auditor-General is principally intended for the purposes of satisfying him with regard to the sufficiency of the rules and procedures prescribed for the purpose of securing an effective check on the assessment, collection and proper allocation of revenue. He is entitled to examine the accounts in order to ascertain whether the rules and procedures are being duly observed, and he is required, upon such examination, to submit a report. His powers in respect of the audit of income-tax receipts and refunds are outlined in the Board's Circular No. 14/19/56-II dated July 28, 1960. Paragraph 2 of the circular repeats the provisions of Section 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, And paragraph 3 warns that 'the audit Department should not in any way substitute itself for the Revenue authorities in the performance of their statutory duties'. Paragraph 4 declares :

'4. Audit does not consider it any part of its duty to pass in review the judgment exercised or the decision taken in individual cases by officers entrusted with those duties, but it must be recognised that an examination of such cases may be an important factor in judging the effectiveness of assessment procedure. . . . It is, however, to forming a general judgment rather than to the detection of individual errors of assessment, etc., that the audit enquiries should be directed. The detection of individual errors is an incident rather than the object of audit.' Other provisions stress that the primary function of audit in relation to assessments and refunds is the consideration whether the internal procedures are adequate and sufficient. It is not intended that the purpose of audit should go any further. Our attention has been invited to certain provisions of the Internal Audit Manual more specifically defining the functions of internal audit in the Income-tax Department. While they speak of the need to check all assessments and refunds in the light of the relevant tax laws, the orders of the Commissioners of Income-tax and the instructions of the Central Board of Direct Taxes, nothing contained therein can be construed as conferring on the contents of an internal audit report the status of a declaration of law binding on the Income-tax Officer. Whether it is the internal audit party of the Income-tax Department or an audit party of the Comptroller and Auditor-General, they perform essentially administrative or executive functions and cannot be attributed the powers of judicial supervision over the quasi-judicial acts of income-tax authorities. The Income-tax Act does not contemplate such power in any internal audit organisation of the Income-tax Department; it recognises it in those authorities only which are specifically authorised to exercise adjudicatory functions. Nor does Section 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, envisage such a power for the attainment of the objectives incorporated therein. Neither the statute supports the conclusion that an audit party can pronounce on the law, and that such pronouncement amounts to 'information' within the meaning of Section 147(b) of the Income-tax Act, 1961.'

17. It is true that the Supreme Court, in the said judgment, qualified its construction of the word 'information' only to the extent that, where an extra-judicial authority like the audit party merely brings to the Assessing Officer's notice a particular provision of law, that might very well be information provided such a course does not involve any pronouncement or declaration of the law. Even any note drawing the Assessing Officer's attention to a particular fact would also constitute 'information' irrespective of whether the note comes from a non-judicial authority.

18. In any case, if the Central Board of Direct Taxes, while explaining the law, engages in a forensic exercise and wants the officers to understand its view of the provision of law as though it was declaring law as a competent judicial or quasi-judicial authority empowered to decide questions of law between contending parties, that would be of no effect and the instruction issued on that basis cannot be elevated to the status of 'information' in its special significance in the context of Section 147(b).

19. We have perused the circular of the Board and we find that the Board has made its own interpretation as to how the law relating to the assessability of technical service fees should be understood by the Assessing Officer. If the amount received by the foreign participant is a revenue receipt in his hands and the amount is received by him outside India, the further questions that would arise are, whether the payment is :

(i) for services rendered abroad, or

(ii) for services rendered in India, or

(iii) representing royalty.

20. If the amount received by the foreign participant is for services rendered entirely outside India, that sum will not be subject to tax in India, because the income will be accruing to the non-resident wholly outside India. Where the payment received is for services rendered in India, the amount will be taxable in India, subject of course, to the deduction of legitimate expenses of a revenue nature incurred by the foreign participant for the purpose of earning such income. If the payment received is royalty, the question of allocating the income between India and outside India would not arise and the whole amount would be liable to tax in India where the patent has been exploited. Deduction will, however, be admissible against the royalty income for the cost of current services rendered in order to earn the royalty.

21. It is not that the circular merely draws the attention of the Assessing Officers to existing judge-made law in the form of judicial decision orproclamation in the shape of decisions coming from quasi-judicial authority competent to decide questions of law between contending parties.

22. The opinion of the Board can be information for the purpose of the relevant section only where it expresses the opinion while performing its appellate function. This position was also acknowledged by the Supreme Court (at page 1006 of 119 ITR) :

'In Asst CED v. Nawab Sir Mir Osman Ali Khan Bahadur : [1969]72ITR376(SC) , this court held that the opinion of the Central Board of Revenue as regards the correct valuation of securities for the purpose of estate duty to be 'information' within the meaning of Section 59 of the Estate Duty Act, 1953, on the basis of which the Controller of Estate Duty was held entitled to entertain a reasonable belief that property assessed to estate duty had been undervalued. The circumstance that the opinion of the Board was rendered in an appeal filed before it under the Estate Duty Act against the assessment made by the Assistant Controller of Estate Duty was apparently not brought to the notice of this court when it heard R.K. Malhotra, ITO v. Kasturbhai Lalbhai : 1975CriLJ1545 . The . opinion of the Board represented its view as a quasi-judicial authority possessing jurisdiction to lay down the law. Although the Board did not enhance the valuation of the securities in the appellate proceedings because of the argument advanced by the appellant, none the less its observations amounted to information as to the law. It was not a case where the Board was functioning as a extra-judicial authority, performing administrative or executive functions, and not competent or authorised to pronounce upon the law.'

23. The initiation of the proceedings under Section 147(b) in this case cannot be saved from its infirmity being contrary to the requirement of Section 147(b), also on the ground that the Income-tax Officer's own discovery of the wrong appreciation of law in the original assessment could not be information for the purpose unless such discovery comes from a court or a Tribunal. The expression 'information' cannot be given such a wide amplitude as to comprehend a case where, subsequent to completion of assessment, the officer becomes wiser and on his own finds that his reading of law in the original assessment was wrong or mistaken. It is interesting to note in this connection that earlier, the Supreme Court, in Kalyanji Mavji and Co. v. CIT : [1976]102ITR287(SC) , enlarged the scope of Section 147(b) by expounding that the result of a research into facts or law undertaken by the officer subsequent to assessment can also constitute information but a larger Bench of the Supreme Court in Indian and Eastern Newspaper Society : [1979]119ITR996(SC) had the occasion to review this proposition and it observed on that decision as follows (at page 1004) :

'Reliance is placed on Kalyanji Mavji and Co. v. CIT : [1976]102ITR287(SC) , where a Bench of two learned judges of this court observed that a case where income had escaped assessment due to the 'oversight, inadvertence or mistake' of the Income-tax Officer falls within Section 34(1)(b) of the Indian Income-tax Act, 1922. It appears to us, with respect, that the proposition is stated too widely and travels farther than the

statute warrants in so far as it can be said to lay down that if, on reappraising the material considered by him during the original assessment, the Income-tax Officer discovers that he has committed an error in consequence of which income has escaped assessment, it is open to him to reopen the assessment. In our opinion, an error discovered on a reconsideration of the same material (and no more) does not give him that power. That was the view taken by this court in Maharaj Kumar Kamal Singh v. CIT : [1959]35ITR1(SC) ; CIT v. A. Raman and Co. : [1968]67ITR11(SC) and Bankipur Club Ltd. v. CIT : [1971]82ITR831(SC) and we do not believe that the law has since taken a different course. Any observations in Kalyanji Mavji and Co. v. CIT : [1976]102ITR287(SC) suggesting the contrary do not, we say with respect, lay down the correct law.'

24. In our view, the Tribunal has taken the correct approach in the matter. It is not open to the Income-tax Officer to take the instruction contained in the administrative circular of the Central Board of Direct Taxes as though it stands on the same plane as judge-made law which could authorise him to initiate the reassessment proceeding.

25. Even the proceeding cannot be justified under Section 147(a) since it has never been the case of the Department that there was non-availability of any of the particulars that constitute primary facts in the nature of materials necessary for proper assessment. It is only on a changed view of the true effect of the law that the Income-tax Officer proceeded in the case under Section 147(b). The view is changed not because of the pronouncement on law by a court or any authority formally empowered to interpret law. The first circumstance under Section 147(b) necessary to exist as a condition precedent is the fact that there should be an information subsequent to assessment. If that information itself is not existing, the other conditions precedent are immaterial.

26. There are three categories for the opinions on law which may be expressed by the Central Board of Direct Taxes. Where the opinion is expressed by the Central Board of Direct Taxes as an appellate authority, the said opinion will constitute information, as happened to be the case in Asst. CED v. Nawab Sir Mir Osman Ali Khan Bahadur : [1969]72ITR376(SC) . In that case, the Board gave its opinion regarding the correct valuation of securities for purposes of estate duty in an appeal preferred by the accountable person.

27. The other circumstance may be that the Central Board of Direct Taxes, on its own, does not express any opinion on law but merely communicates the judicial pronouncement through a circular in order to invite the attention of the taxing authorities. In such a situation, it cannot be said that the contents of the circular do not constitute information. This was the case we found in CIT v. West Coast Industrial Co. Ltd. : [1987]168ITR72(Ker) . There the Income-tax Officer acted on a circular of the Central Board of Direct Taxes which contained information regarding the decision of the Supreme Court in V.S.S.V. Meenakshi Achi v. CIT : [1966]60ITR253(SC) , The Kerala High Court approved the initiation of proceedings treating the contents of the circular as information.

28. The other situation which resembles the case before us is where the Central Board of Direct Taxes expressed its opinion on the law. In Union of India v. Arvind N. Mafatlal, Trustee of Seth Hemant Bhagubhai Trust : [1986]160ITR420(Bom) , the original estate duty assessment was made on the basis of a Circular L-D-ED of 1968 dated March 26, 1968, providing that the value of assets comprised in the dutiable estate should be taken at the same value as was determined for the purpose of wealth-tax. The Board revised its stand later by its Instruction No. 771 dated October 29, 1974, wherein it was observed that the earlier circular of 1968 is not correct and that valuation of shares was governed by the Board's original instruction contained in its letters dated May 3, 1965, and July 5, 1965. The reassessment was initiated treating the latest circular as information within the meaning of Section 59(b) of the Estate Duty Act. The Bombay High Court, after recording the facts, held that the instruction cannot but be treated as a declaration of law leading to a change of view on the part of the Central Board of Direct Taxes regarding the valuation of the type of shares referred to therein. This opinion is not expressed on any appeal but merely represents the Board's own opinion of the position of law. Such opinion cannot be information to form the basis of a notice of reassessment to be issued under Section 59(b) of the Estate Duty Act corresponding to Section 147(b) of the Income-tax Act.

29. The view that the Bombay High Court has taken in Union of India v. Arvind N. Mafatlal, Trustee of Seth Hemant Bhagubhai Trust : [1986]160ITR420(Bom) is the only view to be taken in the light of the pronouncement of the larger Bench of the Supreme Court in Indian and Eastern Newspaper Society [1979] 110 ITR 906. We, accordingly, hold that the Tribunal was right in holding the initiation of the reassessment proceedings to be invalid. We, therefore, answer the question in the affirmative and against the Revenue.

30. There will be no order us to costs.

J.N. Hore, J.

31. I agree.