Concealment penalty imposed for claiming interest paid under Income-tax Act as business expenditure

Summary – The Mumbai ITAT in a recent case of Mitsuba Systems (India) (P.) Ltd., (the Assessee) held that where assessee-company had committed an error in preparing its return of income and its action in claiming impugned interest levied and paid under sections 234A, 234B and 234C as a business expenditure was a misrepresentation, levy of penalty in respect of impugned claim was justified.

Facts

- The assessee was a company in the business of manufacturing and supply of automatic powder coating systems.
- During the course of assessment proceedings it was observed that the company had claimed interest levied and paid under sections 234A, 234B and 234C, at Rs.10.52 lakhs in aggregate, as business expenditure per its return of income for the year.
- Assessee, on being called upon to justify the said claim, agreed to the disallowance. Assessee pleaded that he had assigned this work to a firm of Chartered Accountants who had committed an error by not reflecting the said sum in Form 3CD in reply to Q. No. 17(f), seeking disclosure of the amount disallowable under section 40(a), resulting in a consequential error in the return of income.
- Same was not found satisfactory in-as-much as the firm of CA's was a reputed firm, so that the claim could not be considered to be a result of a *bona fide* mistake and hence penalty proceedings were initiated.
- On appeal, penalty was confirmed.
- On second appeal:

Held

- The argument of the assessee that error had occurred at the end of the company's auditor, which found manifestation in the return and also adopted before the revenue, fails on scrutiny. This is as section 40(*a*)(*ii*) speaks of non-deductibility of rates and taxes on or based on profits and gains of business or profession. There has thus occurred no mistake in the audit report and, accordingly, by the auditors, who are independent professionals, in the conduct of audit and reporting on its basis.
- Reliance placed on the Guidance Note to the revised Schedule VI to the Companies Act, 1956, which advocates classification of the interest expense on the short fall in the payment of the advance income tax as a financial cost was also immaterial, as firstly it is a new explanation, not before the authorities below and, thus, not considered by them. The same is thus not admissible.
- Secondly, the same is even otherwise defeative of the assessee's case in-as-much as it only shows that the reflection of the interest paid under sections 234A, 234B and 234C as an interest expense of the business was a deliberate, well considered action.

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- At this stage, it may be relevant to clarify that it is the company which is by law obliged to prepare its accounts and, further, for the preparation and presentation of its final accounts. The task of the Auditor is only to audit the same, seeking explanations and evidences, and report his findings in the form of an audit report, duly defined by law, both under the Companies Act and the Act. In fact, the separate disclosure of such interest cost, as enjoined by the said Guidance Note, would impact the working of the 'book profit' under section 115JB, toward which no adjustment has been made in assessment.
- Continuing further, the error has in fact occurred for and on behalf of the assessee company in preparing the return, and toward which the law does not authorize assignment to any independent professionals, as an Auditor in the case of financial statements, who would thus also appropriate upon himself any penal action arising out of misreporting. The disallowance of the impugned interest is not under section 40(*a*), as being contended, but under section 36(1)(*iii*) in-as-much as the same is not incurred for any business purpose. The tax under the Act as well as the interest on the short fall in its payment is paid by the assessee not in his capacity as a trader, but as a taxable entity under the Act, levying tax on income or profits from any activity, including from business or profession. The same, thus, does not qualify to be an outgoing of the business, which has to be adjudged in the light of the accepted commercial practices and trading principles. The same cannot by any stretch of imagination be considered as incidental to trade or justified by commercial expediency.
- On consideration of the assessee's case from the stand point that there has, in making the impugned claim of interest under sections 234A, 234B and 234C, occurred a mistake, albeit *bona fide,* so that the same would not attract penalty under section 271(1)(*c*). Firstly it is observed that a 'mistake' is itself an admission of a wrong claim and, thus, of an inability to explain the same, so that there is by definition concealment and/or furnishing inaccurate particulars of income. The same thus would not stand to be excluded under *Explanation* 1(B), if not, also under *Explanation* 1(A). However, it needs to be realized that the said explanations, inter alia, only enunciate rules of evidence. There is, thus, no question of being able to meet or satisfy the said rules where there has indeed occurred a honest or a *bona fide* mistake. In fact, the words 'honest' and 'bona fide' are superfluous in-as-much as these attributes are implicit in the very notion of a 'mistake' - a conjunction of the words 'mis' and 'take'. Could, one may ask, a mistake be deliberate, and yet qualify to be a 'mistake'? The same would no longer entitle it to be so described. It is for this reason that the hon'ble courts of law, as also the tribunal have, where convinced that a mistake has occurred, disqualifying the assessee's case under *Explanation* 1(B), deeming concealment or furnishing inaccurate particulars of income, yet ruled against the levy of penalty under section 271(1)(*c*), which penalizes the same.
- The line of distinction between 'gross negligence' or an 'unfounded statement' on one hand, and 'mistake' on the other, is very thin, with the law, per the rules of evidence, deeming concealment and/or furnishing of inaccurate particulars of income in the former case, implying deliberateness. It

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needs to be borne in mind, that but for the assessee's case being selected for scrutiny, the default would not be detected and, further, that only a meager fraction of the returns are selected for being subject to the verification procedure. As such, it is only where the adjudicating authority is, on a conspectus of the facts and circumstances of the case, including conduct, convinced as to the assessee's bona fides, that an inference of a mistake is drawn.

- On examination of the facts of the case in this respect, it can be seen that the assessee's action in claiming the impugned interest cannot be said to be a 'mistake'. The said interest stood paid under the provisions of the income-tax, *i.e.,* a statute providing for levy of tax on income, on default in complying with its provision, so that it would, from the business stand point, assume the same character as that of tax under the Act. The assessee is well conscious thereof, but yet chooses to represent it as a business expenditure for the year in its accounts. What, one may ask, is the business purpose of the expenditure? The same is clearly a misrepresentation. A separate disclosure would in any case be necessitated, which would be so also for the reason that the interest would relate, if only in part, to a preceding year, assessment for which would have been finalized during the current year; interest being compensatory and, as such, relating to the period of the default. Again, even so, the company's auditors and its tax counsel is the same and, thus, aware of the booking of the impugned interest as a finance cost for the year. As such, the claim that it is the booking of the said interest in accounts that led to the wrong claim in the return is not correct.
- Further on, the assessee's stand in respect of its disallowance under section 14A was that no expenditure, including on interest, stands incurred. Thus is not possible as interest gets included as an organizational expense by 'mistake', the same would also likewise stand to be included in working the disallowance under section 14A. There was also no justification by the assessee for the exclusion of interest on the ground that the same does not finance, either in whole or in part, the investments yielding income not forming part of the total income.
- Accordingly, the assessee's plea of a mistake was unacceptable, the onus to establish which, forming only a part of its explanation, is only on the assessee. In fact, by its very nature, an inference as to it should ordinarily flow from and agree with the facts and circumstances of the case. As such, though assessee's pleading in principle are correct, but they are inapplicable in the facts of the case. Accordingly the levy of penalty in respect of the impugned claim is confirmed.
- In the result, the assessee's appeal is dismissed.

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