IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 05-02-2026

CORAM

THE HON'BLE DR.JUSTICE ANITA SUMANTH

AND

THE HON'BLE MR.JUSTICE MUMMINENI SUDHEER KUMAR

TCA Nos. 64 and 65 of 2014

Commissioner Of Income Tax
Chennai

..Appellant in both T.C.(A)s

Vs

Indian Overseas Bank
No.763 Anna Salai,
Chennai 600 002.

..Respondent in both T.C.(A)s

Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Madras A Bench, dated 14-02-2013 in ITA.Nos.1990 & 1991 of 2011.

In both T.C.(A)s.

For Appellant: Mrs.V.Pushpa
Senior Standing Counsel

For Respondent: Mr.A.S.Sriraman
for Mr.S.Sridhar

COMMON JUDGMENT

(Judgment of the Court was delivered by Dr.Anita Sumanth J.)

The revenue is in appeal as against the common order of the Income Tax Appellate Tribunal (in short, ITAT/Tribunal) setting aside the levy of penalty under Section 271(1)(c) of the Income Tax Act, 1961 (in short, Act) by confirming the order of the Commissioner of Income Tax (Appeals) (in short, CIT(A)) for assessment years (AYs) 2006-07 and 2007-08.

2. Mrs.V.Pushpa, learned Senior Standing Counsel appearing for the Department advances the following submissions. The assessee, a Nationalised Bank (in short, bank/assessee/respondent), had availed the benefit of the Double Taxation Avoidance Agreement (in short, DTAA) between India and China in respect of income earned by the branch of the bank situated at Hong Kong.

3. She would argue that the bank was fully aware of the position that the DTAA between India and China could not be extended to entities in Hong Kong and hence the very premise of the claim was compromised. Hong Kong was a Special Administrative Region (in short, SAR) from 01.07.1997 onwards and Section 90 does not provide for the execution of a DTAA between India and a SAR, till its amendment in 01.10.2009.

4. The intention of the Legislature was thus clear, to the effect that there was no double taxation relief intended in respect of entities located within a

SAR. It is only pursuant to the amendment of Section 90 on and with effect from 01.04.2009 providing for a treaty with a SAR, that India entered into a treaty with Hong Kong on 21.12.2018. Thus, treaty relief, if at all, should have been availed by the assessee only on and from 21.12.2018 and not earlier. She relies on the judgment of the Supreme Court in *Union of India V. Dharmendra Textile Processors*[1].

5. Moreover, the disallowance made in the quantum assessment had been confirmed at the stage of first appeal and the assessee had accepted the order of the CIT(A). Hence, the assessee has acquiesced to the position of having put forth a wrongful claim, and the Assessing Authority was correct in levying penalty under Section 271(1)(c) of the Act for concealment of income, and the Tribunal ought not to have reversed the same.

6. Mr.A.S.Sriraman, learned counsel for the assessee cannot deny the position that in the quantum assessment, the assessee has accepted the disallowance, having not contested the order of the CIT(A) confirming the order of assessment. However, according to him, the levy of penalty should be viewed from the aspect of whether there had been satisfaction of the conditions under Section 271(1)(c) of the Act.

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[1] 306 ITR 277

7. In the present case, there had been no concealment by the assessee. It is true that the assessee had claimed the benefit of the DTAA between India and China, but the error had been bonafide and in genuine belief that the DTAA with China would be applicable in respect of Hong Kong as well. He produces before us a document entitled '*General Outline of the Hong Kong Special Administrative Region'*, extracted from the website of the Ministry of Foreign Affairs, People's Republic of China, updated on 13.10.2003[2].

8. Per the above document, Hong Kong was under the control of the British Government till its handover to the People's Republic of China on 01.07.1997. On and from the aforesaid date, it is part of the People's Republic of China and it is hence that the assessee had proceeded on the basis of the DTAA with China.

9. It is only when there had been a specific amendment to Section 90 in 2009 (with effect from 01.10.2009), enabling India to negotiate and execute DTAAs with SARs also, that the assessee realised that the DTAA with China would not encompass a SAR.

10. Hence, when the order of the CIT(A) had been passed on 09.09.2011 adverse to its interest, the assessee was advised that it need not pursue its claim for DTAA benefit, as its earlier understanding qua the treaty with China, had

[2] https://www.mfa.gov.cn/eng/wjb/zzjg_663340/gats_665294/xgxw_665296/202406/t20240606_11405838.html

been found to be misplaced. However, there had been no concealment or furnishing of inaccurate particulars of income in the context of Section 271(1)(c) of the Act.

11. We have heard both learned counsel and have perused the appeal papers and other documents placed before us.

12. In the returns of income for AYs. 2006-07 and 2007-08, the assessee had claimed double taxation relief in respect of the income earned by its branches at various foreign jurisdictions. We are, in these appeals, only concerned with the relief claimed qua the branch at Hong Kong. Hong Kong was under the control of the United Kingdom till 30.06.1997 when it was handed over to the People's Republic of China.

13. In light of the above position, the assessee has proceeded on the basis that taxability of transactions involving Indian entities in Hong Kong prior to 01.07.1997, would be governed by the DTAA qua India and United Kingdom, and post 01.07.1997, by the DTAA between India and China. In fact, the DTAA between India and China has been in effect on and with effect from 21.11.1994.

14. It is true that Section 90 did not, at the relevant point in time, specifically refer to a DTAA with a SAR, as Section 90, as it stood then, provided only for the Central Government to enter into an agreement with the Government of any Country outside India for the grant of double taxation relief.

The phrase *'specified territory'* was inserted in Section 90, only on, and with effect from 01.10.2009, and hence it was only from that date that India had the option to execute a DTAA with Hong Kong. The view of the assessee in regard to the applicability of the DTAA with China was thus clearly erroneous.

15. However, such clarity was available only on and from 01.04.2009, and having considered the matter, we are of the view that it was only the amendment in 2009 that revealed the error in the assessee's claim and till then, it was certainly a plausible view for the assessee to have taken, invoking the protection available under the DTAA with China.

16. The amendment inserting Section 90 providing for double taxation relief with specified territories came on 01.10.2009 and in first appeal, the CIT(A) had confirmed the order of quantum assessment on 09.09.2011. The assessee has not pursued the matter thereafter on the basis of the clarity provided by the Legislature. In our view, this would enure to the credit of the assessee in not perpetrating a claim that stood against the express language of Section 90 post amendment on 01.10.2009.

17. The liability to penalty under Section 271(1)(c) applies in situations where the officer concerned is satisfied that any person has concealed the particulars of income or furnished inaccurate particulars of income. In the present case, it has never been the Department's case, as seen from the record,

that the assessee had either concealed or furnished inaccurate particulars of the income earned by the Hong Kong branch.

18. In fact, the disallowance effected in the quantum assessment is fully based on the return of income filed by the assessee and the claim made thereunder. The only reason for which the disallowance had been made, was that it was not supported by the DTAA with China. This error, a pure error of law and interpretation, would not attract the penal provisions of Section 271(1)(c).

19. The judgment in *Dharmendra Textile Processors*[3] was rendered in the context of the Central Excise Act, 1944 when the Court held that mens rea is an essential feature of criminal offences but not civil obligations.

20. Doubting the correctness of the judgment in *Dilip N.Shroff V. Joint CIT*[4], the issue as to whether Section 11AC of the Central Excise Act, 1944 should be read to involve mens rea as an essential ingredient, or whether there was scope for the Assessing Authority to levy penalty below the prescribed limit, was referred to the larger Bench in *Dharmendra Textile Processors*[5]. The revenue contended that the authority has no such discretion, whereas, the

[3] Foot Note Supra (1)
[4] 291 ITR 579
[5] Foot Note Supra (1)

assessee case relied on *Dilip N.Shroff*[6], since the provisions of Section 271(1)(c) of the Act were analogous to Section 11AC of the Central Excise Act.

21. After a detailed exposition on the subject and upon considering the jugments in *Dilip N.Shroff*[7], *Chairman, SEBI v. Shriram Mutual Fund*[8], *Director of Enforcement v. MCTM Corpm. (P) Ltd.*[9], *J.K.Industries V. Chief Inspector of Factories & Boilers*[10], *R.S.Joshi V. Ajit Mills Ltd.*[11], *Gujarat Travancore Agency V. CIT*[12], *Swedish Match AB V. SEBI*[13], *State of MP V. Bharat Heavy Electricials*[14] and *SEBI V. Cabot International Capital Corpn.*[15], the Court concluded that mens rea, as understood in criminal law, is not an essential ingredient for holding a delinquent liable to pay penalty for contraventions under the Foreign Exchange Regulation Act.

22. A distinction was made between mens rea, being an essential ingredient to determine the commission of a criminal offence but a non-essential feature for imposing penalty for breach of civil obligation or liabilities, the Court noting the existence of two distinct liabilities, civil and criminal under the same Act.

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[6] Foot Note Supra (4)
[7] Foot Note Supra (4)
[8] (2006) 5 SCC 361
[9] (1996) 2 SCC 471
[10] (1996) 6 SCC 665
[11] (1977) 4 SCC 98
[12] (1989) 3 SCC 52
[13] (2004) 11 SCC 641
[14] (1997) 7 SCC 1
[15] (2005) 123 Comp. Cases 841

23. Coming to the present case, Section 271(1)(c) is a penal provision that is premised upon the satisfaction of the officer that the assessee has either concealed or furnished inaccurate particulars of income. The pre-conditions are not satisfied in this case as the income in respect of which treaty relief had been sought, had been disclosed in its accounts. It was neither concealed, nor was it inaccurately reported.

24. The error was purely one of interpretation and in such cases, it is the judgment in the case of *Commissioner of Income Tax V. Reliance Petroproducts Pvt. Ltd.*[16] that would be apposite. Therein, the Court has considered the disallowance of expenditure for meeting interest payments on loans. In that case too, the case of the revenue hinged on concealment and furnishing of inaccurate particulars of income, which argument was rejected on the ground that the pre-conditions under Section 271(1)(c) had not been satisfied.

25. The judgment in *Reliance Petroproducts*[17] is dated 17.03.2010 and makes specific reference to the 2008 judgment in *Dharmendra Textile Processors*[18]. The discussion at paragraph 8 in *Reliance Petroproducts*[19] is extracted below to illustrate the distinction made by the Court:-

> *8. Therefore, it is obvious that it must be shown that the conditions under Section 271(1)(c) must exist before the penalty is imposed. There can be no dispute that everything would depend upon*

[16] 322 ITR 158
[17] Foot Note Supra (16)
[18] Foot Note Supra (1)
[19] Foot Note Supra (16)

the Return filed because that is the only document, where the assessee can furnish the particulars of his income. When such particulars are found to be inaccurate, the liability would arise. In Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. [2007(6) SCC 329], this Court explained the terms "concealment of income" and "furnishing inaccurate particulars". The Court went on to hold therein that in order to attract the penalty under Section 271(1)(c), mens rea was necessary, as according to the Court, the word "inaccurate" signified a deliberate act or omission on behalf of the assessee. It went on to hold that Clause (iii) of Section 271(1) provided for a discretionary jurisdiction upon the Assessing Authority, inasmuch as the amount of penalty could not be less than the amount of tax sought to be evaded by reason of such concealment of particulars of income, but it may not exceed three times thereof. It was pointed out that the term "inaccurate particulars" was not defined anywhere in the Act and, therefore, it was held that furnishing of an assessment of the value of the property may not by itself be furnishing inaccurate particulars. It was further held that the assessee must be found to have failed to prove that his explanation is not only not bona fide but all the facts relating to the same and material to the computation of his income were not disclosed by him. It was then held that the explanation must be preceded by a finding as to how and in what manner, the assessee had furnished the particulars of his income. The Court ultimately went on to hold that the element of mens rea was essential. It was only on the point of mens rea that the judgment in Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. was upset. In Union of India Vs. Dharamendra Textile Processors (cited supra), after quoting from Section 271 extensively and also considering Section 271(1)(c), the Court came to the conclusion that since Section 271(1)(c) indicated the element of strict liability on the assessee for the concealment or for giving inaccurate particulars while filing Return, there was no necessity of mens rea. The Court went on to hold that the objective behind enactment of Section 271(1)(c) read with Explanations indicated with the said Section was for providing remedy for loss of revenue and such a penalty was a civil liability and, therefore, willful concealment is not an essential ingredient for attracting civil liability as was the case in the matter of prosecution under Section 276-C of the Act. The basic reason why decision in Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. (cited supra) was overruled by this Court in Union of India Vs. Dharamendra Textile Processors (cited supra), was that according to this Court the effect and difference between Section 271(1)(c) and Section 276-C of the Act was lost sight of in case of Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. (cited supra). However, it must be pointed out that in Union of India Vs. Dharamendra Textile Processors (cited supra), no fault was found with the reasoning in the decision in Dilip N. Shroff Vs. Joint Commissioner of Income Tax,

Mumbai & Anr. (cited supra), where the Court explained the meaning of the terms "conceal" and inaccurate". It was only the ultimate inference in Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. (cited supra) to the effect that mens rea was an essential ingredient for the penalty under Section 271(1)(c) that the decision in Dilip N. Shroff Vs. Joint Commissioner of Income Tax, Mumbai & Anr. (cited supra) was overruled.

26. The levy of penalty under Section 271(1)(c) is thus not automatic, and has to be evaluated on the facts and circumstances of every case. It has also to be seen as to what the basis of the levy is. In this case, the levy of penalty is based on a disallowance of a claim which is a question of law. Though erroneous, the error is bonafide and is based on a plausible understanding of the law at the relevant point of time.

27. There is thus no merit in the argument of the Revenue that the levy of penalty under Section 271(1)(c) would stand triggered, merely on the making of a disallowance. If that were to be so, there would be no relevance of the requirement of '*satisfaction*' of the Assessing Officer, as penalty would become leviable on the mere act of addition or disallowance in an assessment order. The provision does not support such a conclusion.

28. Those offences that would attract levy of penalty under Section 271(1)(c) would thus have to be circumscribed by the language and purport of that provision, and unless the Department is able to establish concealment or furnishing of inaccurate particulars, neither of which has been established in the present case, Section 271(1)(c) does not stand attracted at all.

29. On 11.01.2016, the substantial question of law framed by the Department has been admitted and reads as follows:

> *'Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in deleting the penalty under Section 271(1)(c) when the fact remains that the assessee has made an inflated claim of double taxation relief, in the absence of Double Taxation Avoidance Agreement (DTAA) between India and Hong Kong?'.*

30. Upon hearing the parties, we are of the considered view that the question of law does not reflect the correct legal issue that arises in this case. The term 'inflated' connotes a claim that was consciously or deliberately enhanced, knowing that it may not be correct. The Oxford Dictionary[20] defines 'inflated' in the context of prices to be *higher than is acceptable or reasonable* or *believing or claiming that (prices) are more important or impressive than they really are.*

31. In this matter, it is nobody's case that the claim made by the assessee was inflated. True, it may have been erroneous, in its invocation of treaty benefit, but certainly not inflated. Hence, we, with the concurrence of both assessee and revenue counsel, reframe the substantial question of law to read as follows:

[20] Oxford Advanced Learner's Dictionary of Current English – AS Hornby- Ninth edition

'Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in deleting the penalty under Section 271(1)(c) when the fact remains that the assessee has made an erroneous claim of double taxation relief, in the absence of Double Taxation Avoidance Agreement (DTAA) between India and Hong Kong?'.

32. The re-framed question of law is answered in the affirmative, in favour of the assessee and these Tax Case (Appeals) stand dismissed. No costs.

(A.S.M.,J.) (M.S.K.,J.)
05-02-2026

Index: Yes
Speaking order
Neutral Citation: Yes
SL

To

Indian Overseas Bank
No.763 Anna Salai,
Chennai 600 002.

DR.ANITA SUMANTH J.

AND

MUMMINENI SUDHEER KUMAR J.

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