

SAHARA INDIA (FIRM), LUCKNOW
v.
COMMISSIONER OF INCOME TAX, CENTRAL-I & ANR.
(Civil Appeal No. 2783 of 2008)

APRIL 11, 2008

[B.N. AGRAWAL, P.P. NAOLEKAR & D.K. JAIN, JJ.]

Income tax Act, 1961 – s. 142(2A) – Special audit of accounts – Pre-decisional hearing – Requirement of – Held: Even in absence of express provision for affording or barring an opportunity of pre-decisional hearing to assessee, the requirement of observance of principles of natural justice to be read into s. 142(2A) since the order entails civil consequences – It would apply prospectively – However, it would be open to assessee to question the correctness of material gathered on basis of audit report.

Principles of natural justice – Concept and applicability of – Held: Rules of 'natural justice' implies duty to act fairly – It is to secure justice or to prevent miscarriage of justice – Unless statutory provision either specifically or by necessary implication excludes its applicability, requirement of giving reasonable opportunity of hearing before an order is made, is generally read into the provisions, particularly when the order has adverse civil consequences – Power conferred on a statutory body or tribunal may be administrative or quasi-judicial – However, there is no general rule of universal application as to its applicability – With regard to its application express language, basic scheme of the provision conferring the power, nature of power conferred, its purpose and final effect

A of the exercise of that power are to be considered.

The two Judge Bench which heard the matter earlier, doubted the correctness of *Rajesh Kumar's* case on the ground that it may not be necessary to afford opportunity
B of hearing to assessee before ordering Special audit in terms of S.142(2A) and referred the matter to larger Bench. Hence, the present appeals are before the three-judge Bench.

C Partly allowing the appeals, the Court

HELD: 1. The exercise of power under Section 142 (2A) of the Income Tax Act, 1961 leads to serious civil
D consequences and, therefore, even in the absence of express provision for affording an opportunity of pre-decisional hearing to an assessee and in the absence of any express provision in Section 142 (2A) barring the giving of reasonable opportunity to an assessee,
E the requirement of observance of principles of natural justice is to be read into the said provision. (Para 24) [453-E-F]

F *Rajesh Kumar and Ors. Vs. Deputy Commissioner of Income-Tax and Ors* 2006 (287) ITR 91 (SC) – explained and reiterated.

2.1 A bare perusal of the provisions of sub-section
G (2A) of s. 142 of the Income Tax Act, 1961 Act would show that the opinion of the Assessing Officer that it is necessary to get the accounts of assessee audited by an Accountant has to be formed only by having regard to: (i) the nature and complexity of the accounts of the
H

assessee; and (ii) the interests of the Revenue. The word 'and' signifies conjunction and not disjunction. In other words, the twin conditions of 'nature and complexity of the accounts' and 'the interests of the Revenue'; are the prerequisites for exercise of power under section 142 (2A) of the Act. Undoubtedly, the object behind enacting the said provision is to assist the Assessing Officer in framing a correct and proper assessment based on the accounts maintained by the assessee and when he finds the accounts of the assessee to be complex, in order to protect the interests of the Revenue, recourse to the said provision can be had. [Para 6] [440-F, G; 441-A, B]

2.2 The word 'complexity' used in Section 142 (2A) is not defined or explained in the Act. Complexity it is a nebulous word. Its dictionary meaning is: "*The state or quality of being intricate or complex or that is difficult to understand.* However, all that is difficult to understand should not be regarded as complex. What is complex to one may be simple to another. It depends upon one's level of understanding or comprehension. Sometimes, what appears to be complex on the face of it, may not be really so if one tries to understand it carefully." Thus, before dubbing the accounts to be complex or difficult to understand, there has to be a genuine and honest attempt on the part of the Assessing Officer to understand accounts maintained by the assessee; appreciate the entries made therein and in the event of any doubt, seek explanation from the assessee. But opinion required to be formed by the Assessing Officer for exercise of power under the said provision must be based on objective

- A criteria and not on the basis of subjective satisfaction. There is no gainsaying that recourse to the said provision cannot be had by the Assessing Officer merely to shift his responsibility of scrutinizing the accounts of an assessee and pass on the buck to the special auditor.
- B Similarly, the requirement of previous approval of the Chief Commissioner or the Commissioner in terms of the said provision being an inbuilt protection against any arbitrary or unjust exercise of power by the Assessing Officer, casts
- C a very heavy duty on the said high ranking authority to see to it that the requirement of the previous approval, envisaged in the Section is not turned into an empty ritual. Needless to emphasise that before granting approval, the
- D Chief Commissioner or the Commissioner, as the case may be, must have before him the material on the basis whereof an opinion in this behalf has been formed by the Assessing Officer. The approval must reflect the application of mind to the facts of the case. (Para 6)
- E [441-B-G; 442-A]

Swadeshi Cotton Mills Co. Ltd. vs. C.I.T. 1988 (171) ITR 634 (All) – approved.

- F 3.1 Rules of ‘natural justice’ are not embodied rules. The phrase ‘natural justice’ is also not capable of a precise definition. The underlying principle of natural justice, evolved under the common law, is to check arbitrary
- G exercise of power by the State or its functionaries. Therefore, the principle implies a duty to act fairly, i.e. fair play in action. [Para 11] [444-C, D]

- H 3.2 The aim of rules of natural justice is to secure justice or to put it negatively to prevent miscarriage of

justice. These rules can operate only in areas not covered by any law validly made. They do not supplant the law but supplement it. (Para 11) [444-E] A

A.K. Kraipak and Ors. Vs. Union of India and Ors. 1969 (2) SCC 262 *Income Tax Officer and Ors. Vs. M/s Madnani Engineering Works Ltd., Calcutta* 1979 (2) SCC 455 – relied on. B

3.3 It is trite that unless a statutory provision either specifically or by necessary implication excludes the application of principles of natural justice, because in that event the Court would not ignore the legislative mandate, the requirement of giving reasonable opportunity of being heard before an order is made, is generally read into the provisions of a statute, particularly when the order has adverse civil consequences for the party affected. The principle will hold good irrespective of whether the power conferred on a statutory body or tribunal is administrative or quasi-judicial. However, no general rule of universal application can be laid down as to the applicability of the principle *audi alteram partem*, in addition to the language of the provision. Undoubtedly, there can be exceptions to the said doctrine. The question whether the principle has to be applied or not is to be considered bearing in mind the express language and the basic scheme of the provision conferring the power; the nature of the power conferred and the purpose for which the power is conferred and the final effect of the exercise of that power. It is only upon a consideration of all these matters that the question of application of the said C
D
E
F
G
H

A principle can be properly determined. (Paras 15 and 16) [447-C-G]

Swadeshi Cotton Mills Vs. Union of India 1981 (1) SCC 664; *State of Orissa Vs. Binapani Dei and Ors.* 1967 (2) S.C.R. 625; *Canara Bank vs. V.K. Awasthy* 2005 (6) SCC 321; *Union of India Vs. Col. J.N. Sinha and Ors.* 1970 (2) SCC 458 – relied on.

Mohinder Singh Gill and Anr. Vs. The Chief Election Commissioner, New Delhi and Ors. 1978 (1) SCC 405; *Olga Tellis and Ors. vs. Bombay Municipal Corporation and Ors.* 1985 (3) SCC 545; *C.B. Gautam vs. Union of India and Ors.* 1993 (1) SCC 78 – referred to.

4.1 With regard to the question whether the requirement of affording an opportunity of hearing is to be read into section 142(2A) of the Act, in *Rajesh Kumar's* case it has been held that prejudice to the assessee is apparent on the face of the said statutory provision. It was observed that on account of the special audit, the assessee has to undergo the process of further accounting despite the fact that his accounts have been audited by a qualified auditor in terms of Section 44AB of the Act. An auditor is a professional person. He has to function independently. He is not an employee of the assessee. In case of mis-conduct, he may become liable to be proceeded against by a statutory authority under the Chartered Accountants Act, 1949. Besides, the assessee has to pay a hefty amount as fee of the special auditor. Moreover, during the audit of the accounts again by the special auditor, he has to answer a large number

of questions. It was held that by virtue of an order under Section 142 (2A) of the Act, the assessee suffers civil consequences and the order passed would be prejudicial to him and, therefore, principles of natural justice must be held to be implicit. It was further observed that if the assessee was put to notice, he could show that the nature of accounts is not such which would require appointment of special auditors. He could further show that what the Assessing Officer considers to be complex is, in fact, not so. It was also open to him to show that the same would not be in the interest of the revenue. Thus, the decision of this Court in *Rajesh Kumar's* case that an order under Section 142 (2A) does entail civil consequences is concurred with. (Paras 20 and 21) [450-D-G; 451-C-E]

State of Orissa Vs. Binapani Dei and Ors. 1967 (2) S.C.R. 625 – referred to.

4.2 The proviso to section 142 (2D) inserted with effect from 1st June, 2007, provides that the expenses of the auditor appointed in terms of the said provision shall, henceforth, be paid by the Central Government. It is true that the payment of auditor's fee is a major civil consequence, but it cannot be said to be the sole civil or evil consequence flowing from directions under Section 142 (2A). Special audit has an altogether different connotation and implications from the audit under Section 44AB. Unlike the compulsory audit under Section 44AB, it is not limited to mere production of the books and vouchers before an auditor and verification thereof. It would involve submission of explanation and

A clarification which may be required by the special auditor on various issues with relevant data, document etc., which, in the normal course, an assessee is required to explain before the Assessing Officer. Therefore, special audit is more or less in the nature of an investigation and in some cases may even turn out to be stigmatic. Therefore, even after the obligation to pay auditor's fees and incidental expenses has been taken over by the Central Government, civil consequences would still ensue on the passing of an order for special audit. (Para 21) [451-D-H; 452-A]

4.3 In *Rajesh Kumar* it has been held that in view of Section 136 of the Act, proceedings before an Assessing Officer are deemed to be judicial proceedings. Though having regard to the language of the provision, there are some reservations on the said view expressed in *Rajesh Kumar's case*, but having held that when civil consequences ensue, no distinction between quasi judicial and administrative order survives, it is unnecessary to dilate on the scope of Section 136 of the Act. It is the civil consequence which obliterates the distinction between quasi judicial and administrative function. Moreover, with the growth of the administrative law, the old distinction between a judicial act and an administrative act has withered away. Therefore, even a purely administrative order which entails civil consequences, must be consistent with the rules of natural justice. (Para 22) [452-C, D, E, F]

Mrs. Maneka Gandhi vs. Union of India and Anr. AIR 1978 SC 597; *S.L. Kapoor vs. Jagmohan and Ors.* 1980 (4) SCC

379 – relied on.

A

4.4 The expression 'civil consequences' encompasses infraction of not merely property or personal rights but of civil liberties, material deprivations and non pecuniary damages. Anything which affects a citizen in his civil life comes under its wide umbrella. Accordingly, an order under Section 142 (2A) does entail civil consequences, the rule *audi alteram partem* is required to be observed. (Para 22) [452-G; 453-A, B]

B

C

4.5 It cannot be said that since a post-decisional hearing in terms of sub-section (3) of Section 142 is contemplated, the requirement of natural justice is fully met. Apart from the fact that ordinarily a post-decisional hearing is no substitute for pre-decisional hearing, even from the language of the said provision it is plain that the opportunity of being heard is only in respect of the material gathered on the basis of the audit report submitted under sub-section (2A) and not on the validity of the original order directing the special audit. It is well settled that the principle *audi alteram partem* can be excluded only when a statute contemplates a post decisional hearing amounting to a full review of the original order on merit, which, is not the case here. (Para 23) [453-B, C, D, E]

D

E

F

4.6 There is no denying the fact that the law on the subject was in a flux in the sense that till the judgment in *Rajesh Kumar* was rendered, there was divergence of opinion amongst various High Courts. Additionally, even after the said judgment, another two-Judge Bench of this Court had expressed reservation about its

G

H

A correctness. Having regard to all these peculiar
circumstances and the fact that on 14th December, 2006,
this Court had declined to stay the assessment
proceedings, it is opined that this Court should be loathe
B to quash the impugned orders. Hence, the law on the
subject, as clarified will apply prospectively and it will not
be open to the appellants to urge before the Appellate
Authority that the extended period of limitation under
C Explanation 1 (iii) to Section 153 (3) of the Act was not
available to the Assessing Officer because of an invalid
order under Section 142 (2A) of the Act. However, it will
be open to the appellants to question before the appellate
authority, if so advised, the correctness of the material
D gathered on the basis of the audit report submitted
under sub-section 2A of Section 142 of the Act. (Para 29)
[454-G-H; 455-A, B, C, D]

Rajesh Kumar and Ors. Vs. Deputy Commissioner of
E *Income-Tax and Ors* 2006 (287) ITR 91 (SC) – explained and
reiterated.

CIVILAPPELLATE JURISDICTION : Civil Appeal No. 2783
F of 2008.

From the Judgment and Order dated 17.10.2006 of the
High Court of Delhi at New Delhi in W.P. (Civil) No. 9545/
2006.

G WITH

Civil Appeal No. 2784 of 2008.

P.P. Malhotra, A.S.G., Soli J. Sorabjee, Mukul Rohatgi,
H Dr. R.G. Padia, Aarohi Bhalla, Satyen Sethi, Pritesh Kapur, Sunil

Kumar Singh, Sujata Kurdukar, T. Srinivasan Murthy, Rahul Kaushik, Deb Kumar, B.V. Balaram Das for the appearing parties. A

The Judgment of the Court was delivered by

D.K. JAIN, J. 1. Leave granted. B

2. These matters have been placed before the three-Judge Bench in view of a common order dated 14th December, 2006, passed by a two-Judge Bench of this Court. The Order reads as follows: C

"When the matter was taken up, learned counsel for the petitioner placed reliance on a decision of this Court in **Rajesh Kr. & Ors. Vs. Deputy Commissioner of Income Tax & Ors.** According to learned counsel for the petitioner, before any direction can be issued under Section 142 (2A) of the Income Tax Act, 1961 (in short 'the Act') for special audit of the accounts of the assessee, there has to be a pre-decisional hearing and an opportunity has to be granted to the assessee for the purpose. A close reading of the decision shows that the observations in this regard appear to have been made in the context of the assessments in terms of Section 158 BC (Block Assessment) of the Act. Such assessments are relatable to a case when raid has been conducted at the premises of an assessee. Had that been so, limited to the facts involved in that case, we would have negated the contentions of learned counsel for the petitioner. But, certain observations of general nature have been made. The effect of these observations appear to be that in every case where the Assessing Officer issues a direction in terms of Section 142 (2A) of the Act, the assessee has to be heard before such order is passed. This does not appear to us to be the correct position of law. Therefore, we refer the matter to a larger Bench. The records be placed before Hon'ble the Chief Justice of India for H

A constituting an appropriate Bench.”

3. Although no specific question has been formulated for determination by the larger Bench but from the afore-extracted order it is discernible that the Bench had doubted the correctness of the decision of this Court in **Rajesh Kumar & Ors. Vs. Deputy Commissioner of Income-Tax & Ors.**¹, to the extent that it tends to lay down as an absolute proposition of law that in every case where the Assessing Officer issues a direction under Section 142 (2A) of the Income Tax Act, 1961 (for short the Act), the assessee has to be heard before such an order is passed.

C In other words, the Bench of two learned Judges have felt that it may not be necessary to afford an opportunity of hearing to an assessee before ordering special audit in terms of Section 142 (2A) of the Act. This is the short controversy before us.

D 4. As a common question of law is involved in both the cases and even the background facts are identical, these are being disposed of by this judgment. However, before adverting to the factual matrix, we propose to address ourselves on the afore-noted question of law on which the latter Bench has expressed its reservations. At the outset, we may also note that

E in **Rajesh Kumar** (*supra*), while observing that the principles of natural justice must be held to be implicit in Section 142 (2A) of the Act, learned Judges finally held as under:

F “The hearing given, however, need not be elaborate. The notice issued may only contain briefly the issues which the Assessing Officer thinks to be necessary. The reasons assigned therefor need not be detailed ones. But, that would not mean that the principles of natural justice are not required to be complied with. Only because certain consequences would ensue if the principles of natural

G justice are required to be complied with, the same by itself would not mean that the court would not insist on complying with the fundamental principles of law. If the principles of natural justice are to be excluded, Parliament

H ¹ [2006] 287 ITR 91 (SC)

could have said so expressly."

A

5. Sub-sections (2A), (2B), (2C), (2D) and 3 of Section 142 of the Act run as follows:

"(2A) – If, at any stage of the proceedings before him, the Assessing Officer having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue, is of the opinion that it is necessary so to do, he may, with the previous approval of the Chief Commissioner or Commissioner, direct the assessee to get the accounts audited by an accountant, as defined in the Explanation below sub-section (2) of Section 288, nominated by the Chief Commissioner or Commissioner in this behalf and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed and such other particulars as the Assessing Officer may require.

B

C

D

***[Provided that the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.]**

E

(2B) – The provisions of sub-section (2A) shall have effect notwithstanding that the accounts of the assessee have been audited under any other law for the time being in force or otherwise.

F

(2C) – Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within such period as may be specified by the Assessing Officer.

[Provided that the Assessing Officer may, on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit; so, however, that the aggregate of the period originally fixed and the period or periods so extended shall not, in any case,

G

H

A exceed one hundred and eighty days from the date on which the direction under sub-section (2A) is received by the assessee.]

B (2D) - The expenses of, and incidental to, any audit under sub-section (2A) (including the remuneration of the accountant) shall be determined by the Chief Commissioner or Commissioner (which determination shall be final) and paid by the assessee and in default of such payment, shall be recoverable from the assessee in the manner provided in Chapter XVII-D for the recovery of arrears of tax.

C
D ***[Provided that where any direction for audit under sub-section (2A) is issued by the Assessing Officer on or after the 1st day of June, 2007, the expenses of, and incidental to; such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the expenses so determined shall be paid by the Central Government.]**

E (3) The assessee shall, except where the assessment is made under Section 144, be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry under sub-section (2) or any audit under sub-section (2A) and proposed to be utilized for the purposes of the assessment.

F **[* Inserted by the Finance Act, 2007 w.e.f. 1-6-2007]."**

G 6. A bare perusal of the provisions of sub-section (2A) of the Act would show that the opinion of the Assessing Officer that it is necessary to get the accounts of assessee audited by an Accountant has to be formed only by having regard to: (i) the nature and complexity of the accounts of the assessee; and (ii) the interests of the revenue. The word "and" signifies conjunction and not disjunction. In other words, the twin conditions of "nature and complexity of the accounts" and "the interests of the revenue"

H

are the prerequisites for exercise of power under Section 142 A
(2A) of the Act. Undoubtedly, the object behind enacting the said
provision is to assist the Assessing Officer in framing a correct
and proper assessment based on the accounts maintained by
the assessee and when he finds the accounts of the assessee
to be complex, in order to protect the interests of the revenue, B
recourse to the said provision can be had. The word "complexity"
used in Section 142 (2A) is not defined or explained in the Act.
As observed in **Swadeshi Cotton Mills Co. Ltd. Vs. C.I.T.**², it
is a nebulous word. Its dictionary meaning is: "*The state or* C
quality of being intricate or complex or that is difficult to
understand. However, all that is difficult to understand should
not be regarded as complex. What is complex to one may be
simple to another. It depends upon one's level of understanding
or comprehension. Sometimes, what appears to be complex D
on the face of it, may not be really so if one tries to understand it
carefully." Thus, before dubbing the accounts to be complex or
difficult to understand, there has to be a genuine and honest
attempt on the part of the Assessing Officer to understand
accounts maintained by the assessee; appreciate the entries
made therein and in the event of any doubt, seek explanation E
from the assessee. But opinion required to be formed by the
Assessing Officer for exercise of power under the said provision
must be based on objective criteria and not on the basis of
subjective satisfaction. There is no gainsaying that recourse to
the said provision cannot be had by the Assessing Officer merely F
to shift his responsibility of scrutinizing the accounts of an
assessee and pass on the buck to the special auditor. Similarly,
the requirement of previous approval of the Chief Commissioner
or the Commissioner in terms of the said provision being an
inbuilt protection against any arbitrary or unjust exercise of power
by the Assessing Officer, casts a very heavy duty on the said G
high ranking authority to see to it that the requirement of the
previous approval, envisaged in the Section is not turned into
an empty ritual. Needless to emphasise that before granting

² (1988) 171 ITR 634 (All)

A approval, the Chief Commissioner or the Commissioner, as the case may be, must have before him the material on the basis whereof an opinion in this behalf has been formed by the Assessing Officer. The approval must reflect the application of mind to the facts of the case.

B 7. However, the question for adjudication is whether in view of the fact that the said provision does not postulate the requirement of a hearing before an order for special audit is passed, a pre-decisional hearing is required to be given to the assessee or not?

C 8. Mr. Soli J. Sorabjee, learned senior counsel appearing on behalf of the appellants vehemently submitted that the decision of this Court in **Rajesh Kumar (supra)** lays down the correct proposition of law and, therefore, does not require reconsideration. In support of the proposition that previous pronouncements should not be lightly dissented from, learned counsel placed reliance on the decisions of this Court in **Maganlal Chhaganlal (P) Ltd. Vs. Municipal Corporation of Greater Bombay & Ors.**³; **Kattite Valappil Pathumma & Ors. Vs. Taluk Land Board & Ors.**⁴; **Mishri Lal Vs. Dhirendra Nath & Ors.**⁵. It was contended that even an administrative order, assuming one under Section 142 (2A) of the Act to be so, if it operates to the prejudice of an assessee and entails civil consequences, the elementary principles of natural justice and fair play have to be applied and consequently, an opportunity of hearing has to be afforded to the assessee before an order under the said provision is passed. Learned counsel, however, conceded that the extent and ambit of the opportunity of hearing may not require a complete comprehensive hearing or inquiry but the bare modicum of natural justice has to be observed. It was contended that an order requiring special audit does affect a person because of the pecuniary prejudice as also on account

³ (1974) 2 SCC 402 at 427

⁴ (1997) 4 SCC 114 at 120

H ⁵ (1999) 4 SCC 11 at 20

of severe inconvenience caused in his business by virtue of the intrusion of the special auditor. Besides, even the vested right of limitation is affected by the appointment of special auditor inasmuch as the period of limitation thereby stands extended. In this behalf, reference is made to the decisions of this Court in *Ramlal Motilal & Chhotelal Vs. Rewa Coalfields Ltd.*⁶ and *M.K. Prasad Vs. P. Arumugam*⁷. In nutshell, the stand of the learned counsel was that an order under Section 142 (2A) of the Act entails serious civil consequence and, therefore, the principles of natural justice have to be complied with before an order under the said provision is made.

9. Mr. P.P. Malhotra, learned Additional Solicitor General of India appearing on behalf of the respondent/revenue, on the other hand, has contended that the power under the said provision, which is found in Chapter XIV of the Act, prescribing procedure for assessment, relates to the inquiry before the assessment and the special audit is to facilitate the assessment to protect the interests of the revenue, which is of paramount consideration and cannot be defeated or delayed by affording a hearing to the assessee to decide the question whether there should be a special audit or not. The stand of the learned senior counsel is that since order of special audit is only a step towards the assessment and is an inquiry before assessment, no liability in terms of the said order is created and, therefore, such an order does not lead to any civil consequences. Learned counsel submitted that the assumption of prejudice and civil consequence to the assessee on account of an order for special audit, on the basis whereof the case of *Rajesh Kumar (supra)* has been decided, is erroneous and, therefore, the said decision requires reconsideration. Lastly, it was submitted that any interpretation which may now be given by this Court should be prospective in nature as the interests of the revenue will be seriously prejudiced by a retrospective interpretation. It is

⁶ 1962 (2) S.C.R. 762

⁷ (2001) 6 SCC 176

- A pleaded that while interpreting the said provision, the decided cases should not be disturbed. In support of the plea, reliance has been placed on the decisions of this Court in **Steel Authority of India Ltd. & Ors. Vs. National Union Waterfront Workers & Ors.**⁸, **P.V. George & Ors. Vs. State of Kerala & Ors.**⁹, **M.A. Murthy Vs. State of Karnataka & Ors.**¹⁰, **Ram Lal, Moti Lal & Chhotelal Vs. Rewa Coalfields Ltd.**¹¹.
- B

10. Before dealing with the rival submissions to determine whether the principles of natural justice demand that an opportunity of hearing should be afforded to an assessee before an order under Section 142 (2A) of the Act is made, we may appreciate the concept of "natural justice" and the principles governing its application.
- C

11. Rules of "natural justice" are not embodied rules. The phrase "natural justice" is also not capable of a precise definition. The underlying principle of natural justice, evolved under the common law, is to check arbitrary exercise of power by the State or its functionaries. Therefore, the principle implies a duty to act fairly, i.e. fair play in action. As observed by this Court in **A.K. Kraipak & Ors. Vs. Union of India & Ors.**¹², the aim of rules of natural justice is to secure justice or to put it negatively to prevent miscarriage of justice. These rules can operate only in areas not covered by any law validly made. They do not supplant the law but supplement it. (Also see: **Income Tax Officer & Ors. Vs. M/s Madnani Engineering Works Ltd., Calcutta**¹³).
- D
- E
- F

12. In **Swadeshi Cotton Mills Vs. Union of India**¹⁴, R.S. Sarkaria, J., speaking for the majority in a three-Judge Bench,

⁸ (2001) 7 SCC 1

G ⁹ (2007) 3 SCC 557

¹⁰ (2003) 7 SCC 517

¹¹ (1962) 2 S.C.R. 762

¹² (1969) 2 SCC 262

¹³ (1979) 2 SCC 455

H ¹⁴ (1981) 1 SCC 664

lucidly explained the meaning and scope of the concept of "natural justice". Referring to several decisions, his Lordship observed thus (SCC p.666; Headnote):

"Rules of natural justice are not embodied rules. Being means to an end and not an end in themselves, it is not possible to make an exhaustive catalogue of such rules. But there are two fundamental maxims of natural justice viz. (i) *audi alteram partem* and (ii) *nemo iudex in re sua*. The *audi alteram partem* rule has many facets, two of them being (a) notice of the case to be met; and (b) opportunity to explain. This rule cannot be sacrificed at the altar of administrative convenience or celerity. The general principle – as distinguished from an absolute rule of uniform application – seems to be that where a statute does not, in terms, exclude this rule of prior hearing but contemplates a post-decisional hearing amounting to a full review of the original order on merits, then such a statute would be construed as excluding the *audi alteram partem* rule at the pre-decisional stage. Conversely if the statute conferring the power is silent with regard to the giving of a pre-decisional hearing to the person affected and the administrative decision taken by the authority involves civil consequences of a grave nature, and no full review or appeal on merits against that decision is provided, courts will be extremely reluctant to construe such a statute as excluding the duty of affording even a minimal hearing, shorn of all its formal trappings and dilatory features at the pre-decisional stage, unless, viewed pragmatically, it would paralyse the administrative process or frustrate the need for utmost promptitude. In short, this rule of fair play must not be jettisoned save in very exceptional circumstances where compulsive necessity so demands. The court must make every effort to salvage this cardinal rule to the maximum extent possible, with situational modifications. But, the core of it must, however, remain, namely, that the person affected must have

A reasonable opportunity of being heard and the hearing must be a genuine hearing and not an empty public relations exercise."

13. Initially, it was the general view that the rules of natural justice would apply only to judicial or quasi-judicial proceedings and not to an administrative action. However, in **State of Orissa Vs. Binapani Dei & Ors.**¹⁵, the distinction between quasi-judicial and administrative decisions was perceptively mitigated and it was held that even an administrative order or decision in matters involving civil consequences, has to be made consistently with the rules of natural justice. Since then the concept of natural justice has made great strides and is invariably read into administrative actions involving civil consequences, unless the statute, conferring power, excludes its application by express language.

14. Recently, in **Canara Bank Vs. V.K. Awasthy**¹⁶, the concept, scope, history of development and significance of principles of natural justice have been discussed *in extenso*, with reference to earlier cases on the subject. Inter alia, observing that the principles of natural justice are those rules which have been laid down by the Courts as being the minimum protection of the rights of the individual against the arbitrary procedure that may be adopted by a judicial, quasi-judicial and administrative authority while making an order affecting those rights, the Court said :

"Concept of natural justice has undergone a great deal of change in recent years. Rules of natural justice are not rules embodied always expressly in a statute or in rules framed thereunder. They may be implied from the nature of the duty to be performed under a statute. What particular rule of natural justice should be implied and what its context should be in a given case must depend to a great extent

¹⁵ (1967) 2 S.C.R. 625

¹⁶ (2005) 6 SCC 321

on the fact and circumstances of that case. the frame- A
work of the statute under which the enquiry is held. The old
distinction between a judicial act and an administrative
act has withered away. Even an administrative order which
involves civil consequences must be consistent with the
rules of natural justice. Expression 'civil consequences' B
encompasses infraction of not merely property or personal
rights but of civil 'liberties, material deprivations, and non-
pecuniary damages. In its wide umbrella comes everything
that affects a citizen in his civil life."

15. Thus, it is trite that unless a statutory provision either C
specifically or by necessary implication excludes the application
of principles of natural justice, because in that event the Court
would not ignore the legislative mandate, the requirement of
giving reasonable opportunity of being heard before an order D
is made, is generally read into the provisions of a statute,
particularly when the order has adverse civil consequences for
the party affected. The principle will hold good irrespective of
whether the power conferred on a statutory body or tribunal is
administrative or quasi-judicial.

16. We may, however, hasten to add that no general rule E
of universal application can be laid down as to the applicability
of the principle *audi alteram partem*, in addition to the language
of the provision. Undoubtedly, there can be exceptions to the
said doctrine. Therefore, we refrain from giving an exhaustive F
catalogue of the cases where the said principle should be
applied. The question whether the principle has to be applied
or not is to be considered bearing in mind the express language
and the basic scheme of the provision conferring the power;
the nature of the power conferred and the purpose for which the
power is conferred and the final effect of the exercise of that G
power. It is only upon a consideration of all these matters that
the question of application of the said principle can be properly
determined. (See: *Union of India Vs. Col. J.N. Sinha & Ors.*¹⁷)

¹⁷ (1970) 2 SCC 458

A 17. In ***Mohinder Singh Gill & Anr. Vs. The Chief Election Commissioner, New Delhi & Ors.***¹⁸, explaining as to what is meant by expression 'civil consequence', Krishna Iyer, J., speaking for the majority said:

B "Civil Consequences' undoubtedly cover infraction of not merely property or personal rights but of civil liberties, material deprivations and non-pecuniary damages. *In its comprehensive connotation, everything that affects a citizen in his civil life inflicts a civil consequence.*"

(emphasis supplied)

C 18. The question in regard to the requirement of opportunity of being heard in a particular case, even in the absence of provision for such hearing, has been considered by this Court on a number of occasions. In ***Olga Tellis & Ors. Vs. Bombay Municipal Corporation & Ors.***¹⁹ while dealing with the provisions of Section 314 of the Bombay Municipal Corporation Act, 1888, which confers discretion on the Commissioner to get any encroachment removed with or without notice, a Constitution Bench of this Court observed as follows:

E "It must further be presumed that, while vesting in the Commissioner the power to act without notice, the Legislature intended that the power should be exercised sparingly and in cases of urgency which brook no delay. In all other cases, no departure from the audi alteram partem rule ('Hear the other side') could be presumed to have been intended. Section 314 is so designed as to exclude the principles of natural justice by way of exemption and not as a general rule. There are situations which demand the exclusion of the rules of natural justice by reason of diverse factors like time, place the apprehended danger and so on. The ordinary rule which regulates all procedure is that persons who are likely to be affected by

¹⁸ (1978) 1 SCC 405

H ¹⁹ (1985) 3 SCC 545

the proposed action must be afforded an opportunity of being heard as to why that action should not be taken. The hearing may be given individually or collectively, depending upon the facts of each situation. A departure from this fundamental rule of natural justice may be presumed to have been intended by the Legislature only in circumstances which warrant it. Such circumstances must be shown to exist, when so required, the burden being upon those who affirm their existence."

19. Again in **C.B. Gautam Vs. Union of India & Ors.**²⁰ a question arose whether in the absence of a provision for giving the concerned parties an opportunity of being heard before an order is passed under the provisions of Section 269-UD of the Act, for purchase by the Central Government of an immovable property agreed to be sold on an agreement to sell, an opportunity of being heard before such an order could be passed should be given or not. Relying on the decision of this Court in **Union of India Vs. Col. J.N. Sinha**²¹ and **Olga Tellis (supra)** it was held that:

"Although Chapter XX-C does not contain any express provision for the affected parties being given an opportunity to be heard before an order for purchase is made under Section 269-UD, not to read the requirement of such an opportunity would be to give too literal and strict an interpretation to the provisions of Chapter XX-C and in the words of Judge Learned Hand of the United States of America "to make a fortress out of the dictionary." Again, there is no express provision in Chapter XX-C barring the giving of a show cause notice or reasonable opportunity to show cause nor is there anything in the language of Chapter XX-C which could lead to such an implication. The observance of principles of natural justice is the pragmatic requirement of fair play in action. In our view,

²⁰ (1993) 1 SCC 78

²¹ (1970) 2 SCC 458

A therefore, the requirement of an opportunity to show cause
being given before an order for purchase by the Central
Government is made by an appropriate authority under
B Section 269-UD must be read into the provisions of
Chapter XX-C. There is nothing in the language of Section
269-UD or any other provision in the said Chapter which
would negate such an opportunity being given. Moreover,
if such a requirement were not read into the provisions of
the said Chapter, they would be seriously open to challenge
on the ground of violations of the provisions of Article 14
C on the ground of non-compliance with principles of natural
justice. The provision that when an order for purchase is
made under Section 269-UD-reasons must be recorded
in writing is no substitute for a provision requiring a
reasonable opportunity of being heard before such an
order is made."

D 20. Dealing with the question whether the requirement of
affording an opportunity of hearing is to be read into Section
142 (2A), in **Rajesh Kumar** (*supra*) it has been held that
prejudice to the assessee is apparent on the face of the said
statutory provision. It has been observed that on account of the
E special audit, the assessee has to undergo the process of
further accounting despite the fact that his accounts have been
audited by a qualified auditor in terms of Section 44AB of the
Act. An auditor is a professional person. He has to function
independently. He is not an employee of the assessee. In case
F of mis-conduct, he may become liable to be proceeded against
by a statutory authority under the Chartered Accountants Act,
1949. Besides, the assessee has to pay a hefty amount as fee
of the special auditor. Moreover, during the audit of the accounts
again by the special auditor, he has to answer a large number
G of questions. Referring to the decision of this Court in **Binapani
Dei** (*supra*) wherein it was observed that when by reason of an
action on the part of a statutory authority, civil or evil
consequences ensue, the principles of natural justice are
required to be followed and in such an event, although no express
H provision is laid down in this behalf, compliance with the

principles of natural justice would be implicit, the learned Judges held that by virtue of an order under Section 142 (2A) of the Act, the assessee suffers civil consequences and the order passed would be prejudicial to him and, therefore, principles of natural justice must be held to be implicit. The Court has further observed that if the assessee was put to notice, he could show that the nature of accounts is not such which would require appointment of special auditors. He could further show that what the Assessing Officer considers to be complex is, in fact, not so. It was also open to him to show that the same would not be in the interest of the revenue.

21. In the light of the aforementioned legal position, we are in respectful agreement with the decision of this Court in **Rajesh Kumar** (*supra*) that an order under Section 142 (2A) does entail civil consequences. At this juncture, it would be relevant to take note of the insertion of proviso to Section 142 (2D) with effect from 1st June, 2007. The proviso provides that the expenses of the auditor appointed in terms of the said provision shall, henceforth, be paid by the Central Government. In view of the said amendment, it can be argued that the main plank of the judgment in **Rajesh Kumar** (*supra*) to the effect that direction under Section 142 (2A) entails civil consequences because the assessee has to pay substantial fee to the special auditor is knocked off. True it is that the payment of auditor's fee is a major civil consequence, but it cannot be said to be the sole civil or evil consequence flowing from directions under Section 142 (2A). We are convinced that special audit has an altogether different connotation and implications from the audit under Section 44AB. Unlike the compulsory audit under Section 44AB, it is not limited to mere production of the books and vouchers before an auditor and verification thereof. It would involve submission of explanation and clarification which may be required by the special auditor on various issues with relevant data, document etc., which, in the normal course, an assessee is required to explain before the Assessing Officer. Therefore, special audit is more or less in the nature of an investigation and in some cases may even turn out to be stigmatic. We are,

A therefore, of the view that even after the obligation to pay auditor's fees and incidental expenses has been taken over by the Central Government, civil consequences would still ensue on the passing of an order for special audit.

B 22. We shall now deal with the submission of learned
counsel appearing for the revenue that the order of special audit is only a step towards assessment and being in the nature of an inquiry before assessment, is purely an administrative act giving rise to no civil consequence and, therefore, at that stage a pre-decisional hearing is not required. In **Rajesh Kumar** (*supra*) it
C has been held that in view of Section 136 of the Act, proceedings before an Assessing Officer are deemed to be judicial proceedings. Section 136 of the Act, stipulates that any proceeding before an Income Tax Authority shall be deemed to be judicial proceedings within the meaning of Sections 193 and
D 228 of Indian Penal Code, 1860 and also for the purpose of Section 196 of I.P.C. and every Income Tax Authority is a court for the purpose of Section 195 of Code of Criminal Procedure, 1973. Though having regard to the language of the provision, we have some reservations on the said view expressed in
E **Rajesh Kumar's case** (*supra*), but having held that when civil consequences ensue, no distinction between quasi judicial and administrative order survives, we deem it unnecessary to dilate on the scope of Section 136 of the Act. It is the civil consequence which obliterates the distinction between quasi judicial and
F administrative function. Moreover, with the growth of the administrative law, the old distinction between a judicial act and an administrative act has withered away. Therefore, it hardly needs reiteration that even a purely administrative order which entails civil consequences, must be consistent with the rules of
G natural justice. (Also see: **Mrs. Maneka Gandhi Vs. Union of India & Anr.**²² and **S.L. Kapoor Vs. Jagmohan & Ors.**²³. As already noted above, the expression "civil consequences"

²² AIR 1978 SC 597

H ²³ (1980) 4 SCC 379

encompasses infraction of not merely property or personal rights but of civil liberties, material deprivations and non pecuniary damages. Anything which affects a citizen in his civil life comes under its wide umbrella. Accordingly, we reject the argument and hold that since an order under Section 142 (2A) does entail civil consequences, the rule *audi alteram partem* is required to be observed.

23. We are also unable to persuade ourselves to agree with the proposition canvassed by learned counsel for the revenue that since a post-decisional hearing in terms of sub-section (3) of Section 142 is contemplated, the requirement of natural justice is fully met. Apart from the fact that ordinarily a post-decisional hearing is no substitute for pre-decisional hearing, even from the language of the said provision it is plain that the opportunity of being heard is only in respect of the material gathered on the basis of the audit report submitted under sub-section (2A) and not on the validity of the original order directing the special audit. It is well settled that the principle *audi alteram partem* can be excluded only when a statute contemplates a post decisional hearing amounting to a full review of the original order on merit, which, as explained above, is not the case here.

24. The upshot of the entire discussion is that the exercise of power under Section 142 (2A) of the Act leads to serious civil consequences and, therefore, even in the absence of express provision for affording an opportunity of pre-decisional hearing to an assessee and in the absence of any express provision in Section 142 (2A) barring the giving of reasonable opportunity to an assessee, the requirement of observance of principles of natural justice is to be read into the said provision. Accordingly, we reiterate the view expressed in *Rajesh Kumar's case* (*supra*).

25. It is pertinent to note that by the Finance Act, 2007, a proviso to Section (2A) has been inserted with effect from 1st June, 2007, which provides that no direction for special audit

A shall be issued without affording a reasonable opportunity of hearing to the assessee.

B 26. In the light of the afore-noted legal position, we may now advert to the facts of both the cases to consider the validity of orders dated 14th March, 2006, requiring the appellants to have their accounts for the assessment year 2003-04 audited by a chartered accountant, named in the order.

C 27. Indubitably, before passing the said orders, no show cause notice was given to the appellants. On the contrary, it appears from the record that on 9th March, 2006, the appellants were required to furnish by 20th March, 2006 details/explanation in respect of queries raised vide order sheet entry dated 16th February, 2006 but in the meanwhile, the impugned orders were passed on 14th March, 2006 itself. It is manifestly clear that when the impugned orders were made, the Assessing Officer had no occasion to have even a glimpse of the accounts maintained by the appellants. Therefore, in the light of the legal position noted above, we have no option but to hold that the impugned orders dated 14th March, 2006, are vitiated by the failure to observe the principle *audi alteram partem*.

E 28. The next crucial question is that keeping in view the fact that the time to frame fresh assessment for the relevant assessment year by ignoring the extended period of limitation in terms of explanation 1 (iii) to sub-section (3) of Section 153 of the Act is already over, what appropriate order should be passed. As noted above, the learned Additional Solicitor General had pleaded that if we were not inclined to agree with him, the interpretation of the provision by us may be given prospective effect, otherwise the interest of the revenue will be greatly prejudiced.

G 29. There is no denying the fact that the law on the subject was in a flux in the sense that till the judgment in **Rajesh Kumar** (*supra*) was rendered, there was divergence of opinion amongst various High Courts. Additionally, even after the said judgment, H another two-Judge Bench of this Court had expressed

reservation about its correctness. Having regard to all these A
peculiar circumstances and the fact that on 14th December,
2006, this Court had declined to stay the assessment
proceedings, we are of the opinion that this Court should be
loathe to quash the impugned orders. Accordingly, we hold that B
the law on the subject, clarified by us, will apply prospectively
and it will not be open to the appellants to urge before the
Appellate Authority that the extended period of limitation under
Explanation 1 (iii) to Section 153 (3) of the Act was not available
to the Assessing Officer because of an invalid order under
Section 142 (2A) of the Act. However, it will be open to the C
appellants to question before the appellate authority, if so
advised, the correctness of the material gathered on the basis
of the audit report submitted under sub-section 2A of Section
142 of the Act.

30. In the result, both the appeals are allowed to the extent D
indicated above leaving the parties to bear their own costs.

N.J.

Appeals partly allowed.