

EY Tax Alert

Central Government announces Faceless Penalty Scheme, 2021 for conducting penalty proceedings in faceless mode under the Income Tax Laws

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Executive summary

This Tax Alert summarizes the Faceless Penalty Scheme, 2021 (FPS), a recent scheme notified¹ and implemented by the Central Government (CG) for conducting penalty proceedings in a faceless manner under the Income Tax Laws² (ITL). FPS is largely in line with earlier schemes notified by the CG for conducting assessment³ and appeal⁴ proceedings and is intended to impart greater efficiency, transparency and accountability by eliminating the interface between taxpayers and the tax authority and by making optimal utilization of the administrative resources with dynamic jurisdiction. FPS involves a stepwise process to conduct penalty proceedings by harnessing the use of technology for communication between taxpayers and the tax authority and a team-based penalty process in lieu of the existing manual interface.

¹ Notification Nos. 2 and 3 of 2021 dated 12 January 2021

² Income Tax Act, 1961 read with Income Tax Rules, 1962

³ Refer our alert dated 16 September 2019, "CBDT notifies E-assessment Scheme 2019 for conducting faceless assessment" and our alert dated 14 August 2020, "Prime Minister of India unveils Transparent Taxation-Honouring the Honest platform (Part II)".

⁴ Refer our alert dated 26 September 2020, "Central government announces Faceless Appeal Scheme, 2020 effective from 25 September 2020.

Background

- ▶ Under the CG's e-governance drive for automation of various proceedings conducted under the ITL in a faceless manner, various steps have been taken in the past, such as substantial amendments in the ITL for enabling the CG to notify faceless schemes, introduction of the Faceless Assessment Scheme, 2019, Faceless Appeal Scheme, 2020 etc.
- ▶ The Finance Act, 2020 introduced a new provision in the ITL to enable the CG to frame a scheme for conducting penalty proceedings so as to impart greater efficiency, transparency and accountability by:
 - ▶ Eliminating the interface between the tax authority and taxpayers during penalty proceedings to the extent it was technologically feasible.
 - ▶ Optimizing utilization of resources through economies of scale and functional specialization.
 - ▶ Introducing a system for conducting penalty proceedings with dynamic jurisdiction in a team-based manner.
- ▶ The CG is further empowered to issue directions by 31 March 2022 to the effect that any provision of the ITL shall not apply/or shall apply with exception, modification and adaptions for giving effect to such scheme.
- ▶ Taking one more step forward in this direction and pursuant to the powers granted under the ITL, the CG has now notified FPS, effective from 12 January 2021, by publishing the following notifications dated 12 January 2021 in the official gazette:
 - ▶ **Notification No. 2/2021 dated 12 January 2021:** Introduction of FPS, infrastructure of FPS, mode of communication, process of conducting penalty proceedings, authentication and delivery of electronic record, option for personal hearing etc.
 - ▶ **Notification No. 3/2021 dated 12 January 2021:** Directions from the CG to the effect that any provision of the ITL shall not apply/or shall apply with exception, modification and adaptions for giving effect to FPS.

Scope of the CG notifications

- ▶ The notification that introduces FPS shall apply to disposal of penalty proceedings under the ITL in respect of such territorial area, or persons or class of persons, or income or class of income or cases or class of cases, or penalties or class of penalties as may be specified by the Central Board of Direct Taxes⁵ (CBDT).
- ▶ FPS comes into effect from the date of its publication in the official gazette i.e., 12 January 2021.

Infrastructure of FPS

- ▶ FPS empowers the CBDT to set up the following units to collectively carry out penalty proceedings and to specify their respective jurisdictions:
 - ▶ **National Faceless Penalty Centre (NFPC):** To facilitate the conduct of penalty proceedings in a centralized manner and to have jurisdiction to dispose of penalty in accordance with FPS.
 - ▶ **Regional Faceless Penalty Centres (RFPC):** To facilitate conduct of penalty proceedings and to have jurisdiction to dispose of penalty in accordance with FPS.
 - ▶ **Penalty Units (PU):** The functions of PUs are: (a.) To facilitate the conduct of faceless penalty proceedings. (b.) To draft penalty orders, including identification of points or issues for imposition of penalty under the ITL. (c.) To seek any information or clarification on points or issues so identified. (d.) To provide the taxpayer an opportunity of being heard. (e.) To analyze the material furnished by the taxpayer. (g.) Such other functions as may be required for the purposes of imposing penalty.
 - ▶ **Penalty Review Units (PRU):** The functions of PRUs are: (a.) To facilitate the conduct of faceless penalty proceedings. (b.) To review draft penalty order, including checking whether the relevant material evidence has been brought on record, whether the relevant points of fact and law have been duly incorporated in draft penalty order, whether the issues on which penalty is to be imposed have been discussed in the draft penalty order, whether the applicable judicial decisions have been considered and dealt with in the draft penalty order, checking arithmetical correctness of computation of penalty. (c.)

⁵ Apex body of direct tax administration in India

Such other functions as may be required for the purposes of review.

- ▶ The notifications state that until specific units are set up under FPS, the CBDT may direct certain units of Faceless Assessment Scheme, 2019 to perform the functions of various units under FPS. For instance, National Faceless Assessment Centre⁶ (NFAC) will act as NFPC, Regional Faceless Assessment Centre will act as RFPC, Assessment Unit will act as PU and Review Unit will act as PRU.

Mode of communication under FPS

- ▶ All communication between PU and PRU or with the taxpayer/any other person/NFAC/Jurisdictional Tax Authority (JTA), as the case may be, shall be exclusively through NFPC.
- ▶ Such communication shall be exclusively by electronic mode.

Procedures for conducting penal proceedings in faceless manner as laid down in FPS

- ▶ JTA/NFAC shall refer cases to NFPC in the prescribed form where: (a) Penalty proceedings are initiated and show-cause notice is issued by JTA/NFAC; or (b) Penalty proceedings are recommended by JTA/NFAC
- ▶ NFPC shall assign such case to any PU in any RFPC in randomized manner⁷.

Stage 1: Preparation of draft penalty order

- ▶ Cases where initiation of penalty proceedings is recommended by JTA/NFAC:
 - ▶ PU is required to draft and provide a show cause notice to be served on the taxpayer
- ▶ PU, if so required, may take the following action:

to NFPC if it agrees with the recommendations for levy of penalty. If it disagrees with such recommendation, then it would be required to provide reasons for the same in writing to NFPC.

- ▶ On receipt of such show cause notice or reasons, NFPC, in cases where penalty is recommended to be initiated by PU, shall serve the show cause notice to the taxpayer, specifying the date and time for filing a response. In other cases, no penalty should be initiated by NFPC.
- ▶ Cases where penalty proceedings are already initiated by JTA/NFAC:
 - ▶ PU shall draft and provide a show cause notice as to why penalty should not be levied on the taxpayer to NFPC and NFPC shall serve the said show cause notice to the taxpayer, specifying the date and time for filing a response.
 - ▶ The taxpayer shall file a response to the show cause notice to NFPC within the specified time or the extended time so granted on application by the taxpayer. If the response is filed by the taxpayer, NFPC shall send such response to the concerned PU and if no response is filed by the taxpayer, NFPC shall inform the same to PU.

⁶ Cadre authority established under Faceless Assessment for managing faceless assessment proceedings. Refer our alert dated 16 September 2019, "CBDT notifies E-assessment Scheme 2019 for conducting faceless assessment".

⁷ It means an algorithm for randomized allocation of cases by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimize the use of resources.

Sr. no.	Action by PU	Addressed to	Notice to be issued by	Response submitted to NFPC
1.	Obtain further information/ document/ evidence	JTA or NFAC	Request NFPC to issue notice/requisition	JTA or NFAC shall submit the information within specified time or extended time so granted
2.	Obtain further information/ document/ evidence	Taxpayer or any other person	Request NFPC to issue notice/requisition	Taxpayer or any other person shall submit details within specified time or extended time so granted
3.	Seek certain enquiry or verification or seeking technical assistance	NFAC	Request NFPC to issue notice/requisition	NFAC shall submit report within specified time or extended time so granted
NFPC shall forward aforesaid response/report to PU or shall inform PU if no such response/report is received				

► **Preparation of draft penalty order**

- PU shall prepare a draft penalty order in writing after considering all relevant evidences/documents available on record, including any response filed by the taxpayer/any other person, any report furnished by JTA/NFAC for imposition or non-imposition of penalty.
- PU shall forward the draft penalty order to NFPC.

Stage 2: Processing of draft penalty order into final penalty order

- NFPC shall examine⁸ the draft penalty order in accordance with risk management strategy specified by the CBDT and decide:
 - In a case where imposition of penalty has been proposed, to pass the penalty order as per draft order and served thereon to the taxpayer.
- In a case where non-imposition of penalty has been proposed, not to impose penalty and, accordingly, intimate the taxpayer.
- Assign the draft penalty order to PRU⁹ in randomized manner¹⁰ for its review.
- **Review of draft penalty order** – PRU may review the draft penalty order and decide to:
 - Concur with the draft penalty order and intimate NFPC about such concurrence
 - In such a case, NFPC shall finalize the penalty order in case of imposition of penalty and served thereon to the taxpayer or intimate the taxpayer if no penalty is imposed.
 - Suggest necessary modification to the draft penalty order and send such suggestions to NFPC.
 - In such a case, NFPC shall forward the suggestion to another PU¹¹ (other than original PU) in a randomized

⁸ The examination shall be based on an algorithm for standardized examination of draft order by using suitable technological tools, including artificial intelligence and machine learning, with a view to reduce the scope of discretion.

⁹ Through system-generated automated manner

¹⁰ It means an algorithm for randomized allocation of cases by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimize the use of resources.

¹¹ Other than the PU who has prepared draft penalty order.

manner¹². In such a case, the new PU may:

- If modifications are prejudicial to the interest of the taxpayer, follow the entire procedure as noted above and then pass revised draft order for imposition of penalty.
- If modifications are not prejudicial to the interest of the taxpayer, shall pass the revised draft order for imposition of penalty.
- Propose non-imposition of penalty with reasons in writing.

- ▶ On receipt of draft order from PU (after review as the case may be), NFPC shall pass the final penalty order as per such draft and serve thereon to the taxpayer for imposition of penalty and send intimation to the taxpayer if no penalty is imposed.
- ▶ Communicate such penalty order to JTA/NFAC, as the case may be, as required under the ITL.

Premature exit of penal proceedings from FPS

- ▶ Without prejudice to FPS, NFPC may transfer the proceedings to JTA/NFAC having jurisdiction over the taxpayer with prior approval of the CBDT at any stage of the penalty proceedings, if considered necessary.

Procedure for conducting rectification proceedings for an order passed under FPS

- ▶ NFPC may amend any order passed under FPS for rectification of any mistake apparent from record upon application. Such rectification application can be filed by (a) taxpayer (b) PU (c) PRU (d) JTA/NFAC, as the case may be.
- ▶ NFPC shall assign rectification application to any PU in a randomized manner¹³. Such PU shall examine the rectification application and send a notice to the applicant through NFPC for granting an opportunity to show cause as to why rectification of mistake should not be carried out under the ITL.

¹² It means an algorithm for randomized allocation of cases by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimize the use of resources.

- ▶ On receipt of such notice, the applicant shall furnish its response to NFPC within the specified time or extended time so granted. NFPC shall forward the said response to PU or inform PU if no response is received.
- ▶ PU shall, after taking into consideration such application and response, prepare a draft order for:
 - ▶ Rectification of mistake; or
 - ▶ Rejection of the application citing reasons thereof.
- ▶ Upon receipt of draft order, NFPC shall finalize the order and communicate the same to:
 - ▶ Taxpayer/any other person; and
 - ▶ JTA/NFAC to take further actions under the ITL.

Appellate proceedings against order passed by NFPC

- ▶ An appeal against the penalty order passed by NFPC shall lie before the Commissioner of Income-tax (Appeals) having jurisdiction over JTA or National Faceless Appeal Centre, as the case may be.

Authentication and delivery of electronic record

- ▶ An electronic record shall be authenticated by the originator, being NFPC, by affixing its digital signature or being the taxpayer or any other person, by affixing his/her digital signature or through electronic verification code.
- ▶ Every notice or order or any other electronic communication under FPS shall be delivered to the taxpayer, by way of:
 - ▶ Placing an authenticated copy thereof in the taxpayer's registered account on designated portal;
 - ▶ Sending an authenticated copy thereof to the registered email address of the taxpayer or his/her authorized representative;

¹³ It means an algorithm for randomized allocation of cases by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimize the use of resources.

- ▶ Uploading an authenticated copy on the taxpayer's mobile app and followed by a real time alert.
- ▶ A notice or order or any other electronic communication can be delivered to any other person, by sending an authenticated copy thereof to the registered email address of such person, followed by a real time alert.
- ▶ The taxpayer shall file its responses to any notice or order or any other electronic communication under FPS through its registered account and the response shall be deemed to be authenticated once an acknowledgement is sent by NFPC.
- ▶ Time and place of dispatch and receipt of electronic record shall be determined in accordance with the provisions of Information Technology Act, 2000.

No personal appearance before any unit under FPS

- ▶ The taxpayer or its authorized representative or any other person is not required to appear personally for proceedings before any unit under FPS, though it can request for personal hearing so as to make oral submissions or present their case before the PU.
- ▶ On receipt of request for personal hearing, Chief Commissioner of Income-tax or Director General of Income-tax (in-charge of RFPC) may approve the request for personal hearing if it falls under specified circumstances¹⁴. Such personal hearing shall be conducted exclusively through video conferencing and in accordance with the procedure to be laid down by the CBDT¹⁵.

Powers are granted to NFPC to lay down standards, procedures and processes, including format, mode, procedure and processes for effective functioning of penalty proceedings under FPS, with prior approval of the CBDT.

Comments

The structure and functioning under FPS are largely in line with the Faceless Assessment Scheme 2019. Further, till the various units are set up under FPS, units established under the Faceless Assessment Scheme 2019 may perform functions under FPS.

Though FPS is made effective from 12 January 2021, the CBDT is yet to notify the scope of the scheme. Additionally, it is not clear how ongoing penalty proceeding will be transitioned under FPS.

Though this new digital era for conducting proceedings under the ITL may have some teething and practical problems, it is the need of the hour for the taxpayers and other stakeholders including tax professionals to adapt to and be convergent of online proceedings.

¹⁴ These circumstances are to be specified by NFPC with prior approval of the CBDT.

¹⁵ The CBDT shall establish suitable facilities for video conferencing at such locations, as may be necessary, so as

to ensure that the taxpayer or his/her authorized representative or any other person is not denied the said benefit.

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