

REPORTABLE

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA No.1165/2007**

% Date of Hearing: 26.07.2010
Decision of Decision: 14.09.2010

Commissioner of Income-Tax, Delhi-II Appellant

through: Mr.Sanjeev Sabharwal,
Advocate

VERSUS

Leisure Wear Exports Limited Respondent

Through: Mr.Ajay Vohra with
Ms.Kavita Jha,
Ms.Akansha Aggarwal
and Mr.Amit Sachdeva
Advocates

CORAM :-

HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. On filing the return of income by the respondent assessee for the assessment year 2001-02, assessment was completed and original assessment order under Section 143(3) of the Income Tax Act was passed on 6.2.2004 at an income of ₹ 49,63,590/- as against nil income declared by the assessee. However, the Commissioner of Income Tax vide his

orders dated 21.3.2006 passed under Section 263 of the Income-Tax Act (in short 'the Act') set aside the aforesaid assessment order of the Assessing Officer describing the same as erroneous and prejudicial to the interest of the Revenue with direction to the AO to conduct fresh assessment after giving proper opportunity to the assessee. Feeling aggrieved by this order, the assessee preferred the appeal before the Income-Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') in which the assessee has succeeded as the order passed by the Commissioner under Section 263 of the Act has been set aside by the Tribunal vide impugned judgment dated 28.2.2007. The order of the Tribunal is the subject-matter of the present appeal preferred under Section 260-A of the Act by the Commissioner of Income-Tax.

2. One of the issues on which the Commissioner exercised his revisionary powers under Section 263 of the Act, pertains to the claim of deduction by the assessee under Section 80HHC of the Act. The assessee had claimed a deduction under this provision amounting to ₹32,25,486/-. However, in spite of various opportunities given by the AO the assessee did not furnish the particulars/documents and took the plea that it had lost the books of accounts. The required information was not given. The AO disallowed the entire claim of deduction under Section 80HHC of the Act. The Commissioner in his orders passed under Section 263 of the Act opined that non-supply of the information was deliberate non-compliance on the part of the assessee and therefore, the assessment should have been completed under Section 144 of the Act and not under Section 143(3) of

the Act. The Commissioner also recorded in his order that the AO had not raised queries on under noted issues:-

- a) As per the papers on record, the assessee has claimed that there are finished goods in the closing stock to the tune of Rs.5.28 crores. Considering the facts that the total turnover of the assessee was only Rs.6.13 crores, it was necessary to obtain the details of the closing stock, but no details were called for from the assessee;
- b) The assessee has shown insurance claim receivable amounting to Rs.1.21 crores but no details have been furnished by the assessee. The Assessing Officer has also not made any inquiries in respect of this issue, from the insurance company which would be having the details of the claim;
- c) The assessee has shown M/s Meghna Overseas as a Sundry Debtors to the extent of Rs.6.99 crores. It appears that export have been made to this firm, but no details are on record, which would details the export sales made. It is pertinent to point out that the requirements of section 80 HHC (4) is as follows:

“(4) The deduction under sub-section (1) shall not be admission unless the assessee furnishes in the prescribed form, alongwith the return of income, the report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

and as there is such a large balance outstanding, and in view of the fact that no certificate u/s 80 HHC has been filed from which it could be deduced that such huge exports have been made, it was incumbent on the Assessing Officer to make enquiries from the Directorate of Foreign Trade, but no such enquiries have been made.

- d) The assessee has shown income at Rs.1.61 crores as exchange variation and this has been export/sales of crores. It is pertinent to note that in the immediate previous year no such gain was shown. Therefore, this is a point which needed examination by the AO.”

3. According to the order passed by the Commissioner, there was no application of mind on the part of the AO in respect of the aforesaid issues which had not even been raised with the assessee. No reasons were recorded by the AO in the order and there was not even an office note in this behalf which could justify the omission to consider these important facts. The Commissioner went to the extent of observing that the AO was satisfied with making a flimsy addition disallowing a claim of ₹17,38,106/- debited under the head “selling & distributing expenses” and in further holding that the deduction under Section 80 HHC was unwarranted. These additions were sustained at the appeal stage by the CIT(A) which accepted the plea of the assessee. The AO had not made third party inquiries as a result of which he had passed a very weak order. The Commissioner, thus, referring to the judgment of the Supreme Court in the case of *Malabar Industrial Co. Ltd. vs. Commissioner of Income-Tax*, 243 ITR 83 (SC) and Allahabad High Court in *Jugdish Kumar Gulati vs. Commissioner of Income-Tax*, 269 ITR 71 set aside the order of the AO with the direction to pass fresh assessment order *de novo* after giving adequate opportunity to the assessee to represent his case and after making requisite inquiries from the other Government agencies.
4. The Tribunal went into each of the issues which were highlighted by the Commissioner in his order observing that these were not taken into consideration by the AO. In so far as the claim of the assessee under Section 80 HHC is concerned, the Tribunal was of the view that as the AO had disallowed the entire claim, there was no reason for alleging that the

AO did not make any third party inquiry in so far as the export business of the assessee was concerned, that is regarding its purchase of stock, sundry debtors on account of export sales etc. With regard to income of ₹ 1.61 crores on account of difference of rate of foreign exchange on the date of booking the export sales vis-à-vis date of realization of export proceeds the Tribunal held that the view that there was no occasion for doubting the income offered by the assessee only because of the reason that in the immediately preceding year the assessee was not in receipt of any such income. With regard to making additions in respect of the amount of insurance claim, loss of goods/loss in transit, the Tribunal observed that by mere filing of a claim with the insurance company, there does not accrue any income in favour of the assessee as the assessee had not claimed any right to receive such income. More so, when neither the claim was accepted nor any assurance given by the insurance company for making payment on account of such loss. Therefore, by mere filing of a claim no income had accrued, which was taxable.

5. In this factual backdrop, present appeal was admitted on 26.7.2010 on the following substantial question of law:-

“Whether the learned Income Tax Appellate Tribunal erred in law and on merits by setting aside the order of the Commissioner of Income Tax under Section 263 of the Income Tax Act, 1961?”

6. We heard detailed arguments advance by the learned counsel for the parties appearing on either side. In so far as the law relating to powers of the Commissioner of Income-Tax under Section 263 of the Income-Tax

Act are concerned, legal position has been sufficiently crystallised by various pronouncements of the apex court. It goes without saying that pre-requisite to the exercise of *suo motu* jurisdiction under this provision by the Commissioner is that the order of the AO is erroneous in so far as it is prejudicial to the interest of the Revenue. Two conditions are to be satisfied, namely, (i) the order of the AO sought to be revised is erroneous; and (ii) the error committed by the AO in the order is prejudicial to the Revenue. Both these conditions are to be satisfied simultaneously and the connotation of both these expressions was explained by the Supreme Court in ***Malabar Industrial Co. Ltd. vs. Commissioner of Income-Tax*** (supra) in the following manner:-

“The phrase “prejudicial to the interest of the Revenue” has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interest of the Revenue. For example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of Revenue; or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue, unless the view taken by the Income-tax Officer is unsustainable in law. It has been held by this court that where a sum not earned by a person is assessed as income in his hands on his so offering, the order passed by the Assessing Officer accepting the same as such will be erroneous and prejudicial to the interests of the Revenue. Rampyari Devi Saraogi v. CIT [1968] 67 ITR 84 (SC) and in Smt. Tara Devi Aggarwal v. CIT [1973] 88 ITR 323 (SC).

In the instant case, the Commissioner noted that the Income-tax Officer passed the order of nil assessment without application of mind. Indeed, the High Court recorded the finding that the Income-tax

Officer failed to apply his mind to the case in all perspective and the order passed by him was erroneous. If appears that the resolution passed by the board of the appellate-company was not placed before the Assessing Officer. Thus, there was no material to support the claim of the appellant that the said amount represented compensation for loss of agricultural income. He accepted the entry in the statement of the account filed by the appellant in the absence of any supporting material and without making any inquiry. On these facts the conclusion that the order of the Income-tax Officer was erroneous is irresistible. We are, therefore, of the opinion that the High Court has rightly held that the exercise of the jurisdiction by the Commissioner under Section 263(1) was justified.”

7. It is also well-settled principle that provisions of Section 263 of the Act would not be invoked merely to correct a mistake or error committed by the AO unless it has caused prejudice to the interest of the Revenue. If an order is based on incorrect assumption of facts or on incorrect application of law or without applying the principle of natural justice and without application of mind, it would be treated as erroneous. Likewise, the expression “prejudicial to the interest of the Revenue” is of wide import and is not confined to loss of tax. If due to an erroneous order of the AO the Revenue is losing tax lawfully payable by a person, it would be certainly prejudicial to the interest of the Revenue.

At the same time, as held in ***Malabar Industrial Co. Ltd. vs. Commissioner of Income-Tax*** (supra) where two views are possible and the AO has taken one view with which the Commissioner does not agree, that cannot be treated as erroneous order prejudicial to the interest of the Revenue. It has to be shown that the order of the AO was not in

accordance with law, to term it as erroneous. It is also the principle of law, now well accepted, that an order passed by the AO cannot be set aside for making roving inquiry without pointing out any error in his order. The Commissioner has to specifically demonstrate that the order of the AO is erroneous.

The power of revision is not meant to be exercised for the purpose of directing the AO to hold another investigation without describing as to how the order of the AO is erroneous. From this it also follows that where the assessment order has been passed by the AO after taking into account the assessee's submissions and documents furnished by him and no material whatsoever has been brought on record by the Commissioner which showed that there was any discrepancy or falsity in evidences furnished by the assessee, the order of the AO cannot be set aside for making deep inquiry only on the presumption and assumption that something new may come out.

For making a valid order under Section 263 it is essential that the Commissioner has to record an express finding to the effect that order passed by the AO is erroneous which has caused loss to the Revenue. Furthermore, where acting in accordance with law the AO frames certain assessment order, same cannot be branded as erroneous simply because according to the Commissioner, the order should be written more elaborately. All these principles are highlighted in the judgments noted hereinafter.

8. In *Gee Vee Enterprises v. Addl. Commissioner of Income-Tax, Delhi and others*, 99 ITR 375 it was explained that the Commissioner was to only take *prima facie* view as to how the order of the AO was erroneous and leave the matter at that with direction to the AO to conduct *de novo* inquiry and pass fresh orders. This is how the principle was explained:-

“These two decisions show that it is not necessary for the Commissioner to make further inquiries before cancelling the assessment order of the Income-tax Officer. The Commissioner can regard the order as erroneous on the ground that in the circumstances of the case the Income-tax Officer should have made further inquiries before accepting the statements made by the assessee in his return.

The reason is obvious. The position and function of the Income-tax Officer is very different from that of a civil court. The statements made in a pleading proved by the minimum amount of evidence may be accepted by a civil court in the absence of any rebuttal. The civil court is neutral. It simply gives decision on the basis of the pleading and evidence which comes before it. The Income-tax Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further inquiry. It is his duty to ascertain the truth of the facts stated in the return when the circumstances of the case are such as to provoke an inquiry. The meaning to be given to the word “erroneous” in section 263 emerges out of this context. It is because it is incumbent on the Income-tax Officer to further investigate the facts stated in the return when circumstances would make such an inquiry prudent that the word “erroneous” in section 263 includes the failure to make such an inquiry. The order becomes erroneous because such an inquiry has not been made and not because there is anything wrong with the order if all the facts stated therein are assumed to be correct.”

9. This principle was reiterated in *Commissioner of Income-Tax v. Seshasayee Paper and Boards Ltd.*, 242 ITR 490 in the following manner:-

“It is no doubt true that for making a valid order under section 263 of the Act, it is essential for the Commissioner to record an express finding that the order sought to be revised was erroneous as well as prejudicial to the interests of the Revenue. In the instant case, the Commissioner had recorded such a finding and with reference to some of the items he positively found that the orders were erroneous and prejudicial to the interests of the Revenue. But, in our opinion, there is nothing in section 263 of the Act to show that the Commissioner of Income-tax should in all cases record his final conclusion on the points in controversy before him. The above position of law is well-settled by the decision of Gujarat High Court in the case of *Addl. C IT v. Mukur Corporation* [1978] 111 ITR 312, wherein the Gujarat High Court held as under (page 325):

“Now, even on this question, we find that there is nothing in section 263(1) to show that before passing the final order under that section, the Commissioner must necessarily and in all cases record final conclusions above the points in controversy before him. As already noted by us above, we would have expected him to record final conclusions, which he thought proper if he was to settle the assessment finally but since he has not settled the assessment finally, and has preferred to direct the Income-tax Officer to make an order for fresh assessment, it was proper that he did not express any final conclusions and recorded only prima facie conclusions at which he had arrived with reference to the facts of the case. Here it should be noted that, as the assessment was to be freshly made by the Income-tax officer, the only proper course for the Commissioner was not to express any final opinion as regards the controversial points.”

10. At the same time it is also recognised that there is no universal power with the Commissioner to provoke an inquiry as held in *Commissioner of Wealth-tax v. Prithvi Raj and Co.*, 199 ITR 424 as under:-

“It is true that ordinarily the Commissioner has been given jurisdiction to examine, under section 25(2), whether the order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the Revenue, but in the instant case, however, the Commissioner has nowhere formed an opinion that the assessment order was prejudicial to the interests of the Revenue. Apart from that jurisdictional infirmity, the Commissioner overlooked the fact that the rate of Rs.1,800 per square yard was in respect of commercial property. The Commissioner himself has referred to two different rates fixed by the D.D.A. in respect of industrial land and commercial land. This clearly shows that the rate of the commercial land is not necessarily the same as the rate of an industrial plot of land. Furthermore, the rate for an industrial plot is lower than that of the land for commercial use. What is more striking is that the two Governmental authorities, viz., the Ministry of Works and Housing and the D.D.A., have given rates for land which are at great variance with each other. Whereas the rate for commercial land has been fixed at Rs.1,800 per square yard by the Ministry of Works and Housing, the D.D.A., on the other hand, has fixed the value for the said land between Rs.287 and Rs.315 per square metre. This itself shows divergence in the opinion of the authorities with regard to the valuation of land. In the absence of specific instances of purchase and sale, it is obvious that certain amount of guess work is involved in determining the price of the land.”

11. To the same effect is the judgment in the case of *J.P. Srivastava and Sons (Kanpur) Ltd. v. Commissioner of Income-Tax, UP*, 111 ITR 326, which can be found in the following observations of the Court:-

“Section 33B contemplates a notice to the assessee. In response to the notice the assessee may show to

the Commissioner that the order sought to be revised is not prejudicial to the interests of the revenue. In that event, the Commissioner would have no jurisdiction to take any further action. He would be competent to take action only if he rejects the plea of the assessee. It thus becomes necessary for the Commissioner to examine the merits of the objection raised by the assessee. He cannot delegate that power to the Income-tax Officer by setting aside the assessment order and directing him to make a fresh assessment after taking into consideration the objection of the assessee.

Now, in the instant case, the assessee claimed that a sum of rupees one lakh was not taxable. The Commissioner should have examined that plea on merits. He could take the action that he did only if he rejected the plea of the assessee. It must not be forgotten that under section 33B the Commissioner can himself modify or enhance the assessment and that he can only do if he considers and decides on merits the objection raised by the assessee. We are, therefore, of opinion that without going into the merits of the claim of the assessee it was not possible for the Commissioner to say that the order of the Income-tax Officer had caused any prejudice to the interests of the revenue and, as such, he was not competent to set aside the assessment order and remand the matter to the Income-tax Officer.”

12. Keeping in mind the aforesaid principles, we proceed to discuss the issue at hand. It was argued by the learned counsel for the assessee that in the entire order passed by the Commissioner under Section 263 of the Act it is not mentioned as to how the order was erroneous and prejudicial to the interest of the Revenue. After scrutinising the said order minutely we are inclined to agree with the aforesaid argument of the learned counsel. In the entire order emphasis laid by the Commissioner is that in respect of four issues mentioned by him, no queries were raised by the AO. On this

premise, though it is observed that there was no application of mind on the part of the AO and the AO has not recorded any reasons to justify the omission to consider the said facts, the Commissioner does not take the said order to its logical conclusion which was the prime duty of the Commissioner in order to justify exercise of power under Section 263 of the Act. There is not even a whisper that the order is erroneous. Even if we infer that non-consideration of the issues pointed out by the Commissioner would amount to an erroneous order, it is not stated as to how this order is prejudicial to the interest of the Revenue. The penultimate paragraphs of the orders, at best, contain the observations that the AO was satisfied with making flimsy additions which were deleted by the CIT(A). This is stated in the following terms:-

“7. In the instant case, the Assessing Officer was satisfied with making a flimsy addition disallowing the claim of Rs.17,38,106/- debited under the head, “selling and distributing expenses”, and after further holding that the deduction under section 80HHC of Rs.32,25,486/- was unwarranted. These additions were not sustained at the appellate stage by the CIT (Appeals), who accepted the plea of the assessee *“The Director being out of the country and the matter having not been properly attended to at the earlier stage as per the requisition is highly regretted.”*

8. The point which bears consideration is that the Assessing Officer made no third party enquiries, as a result of which he has passed a very weak order, which ignored the major issues involved, and left the assessee to benefit from its own non-compliance.”

13. Thus, according to the Commissioner proper exercise was not done while making the assessment; deeper inquiries were not made; major issues

involved were ignored and a weak order was passed. There is not a whisper as to how this order was prejudicial to the interest of the Revenue.

14. That apart, we find that the approach of the Tribunal in discarding the observation of the Commissioner about not making proper inquiries in respect of the said four issues are also justified and without blemish.

15. First comment of the Commissioner was in respect of finished goods in the closing stock. The Commissioner found that these were to the tune of ₹5.28 crores. According to the Commissioner, when the total turnover of the assessee was ₹6.13 crores, the AO should have satisfied himself by calling for more details as to how there was closing stock of such a magnitude of ₹ 5.28 crores. Thus, the Commissioner has not doubted the statement of finished goods in the closing stock furnished by the assessee. He has only remarked that there should have been a deeper probe by calling for more details. This is neither here nor there, when we keep in view the ingredients of Section 263 of the Act.

16. In so far as the insurance claim is concerned, the Commissioner observed that the assessee had shown receivable on this account to the tune of ₹1.21 crores but no details had been furnished. The AO had also not made any inquiries. In the detailed discussion on this aspect the Tribunal has observed that insurance claim was lodged for the goods lost in transit. The assessee at that time had merely filed a claim with the insurance company. This claim had not been approved as the insurance company had neither accepted the same nor given any assurance for making payment.

Therefore, no income had “accrued” which could be taxed. The Tribunal rightly held that ordinarily the income is said to have accrued to a person when he acquires the right to income and this should be enforceable right, though actual quantification or receipt may follow in due course. The mere claim to income without any enforceable right cannot be regarded as an accrued income for the purpose of Income-Tax Act. The Tribunal referred to the following judgments in support:-

- i) In *CIT Vs. Finance (P) Ltd. 124 ITR 619(P&H High Court)*, held as under:

“Income-tax is levied on income whether the accounts are maintained on mercantile system or on cash basis. If income does not result at all, there cannot be levy of tax. Even if an entry of hypothetical income is made in the books of accounts, where the income does not result at all as there is neither accrual nor receipt of income, no tax can be levied. Even in mercantile system of accountancy an assessee could forge the whole or part of a debt, which was irrecoverable, and the same could not be added to the income of the assessee”.

Hon’ble Supreme Court in the case of Godhra Electricity Co. Ltd. vs. CIT (SC) 225 ITR 706, held that “income-tax is a levy on income. No doubt, the Income-Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If the income does not result at all, there cannot be a tax, even though in book keeping, an entry is made about a hypothetical income, which does not materialize”. At page 748 and 749, the Supreme Court further observed as under:

“Even though the assessee company was following the mercantile system of accounting and had made entries in the books regarding enhanced charges for the supply made to the consumers, no real income had accrued to the assessee company in respect of those enhanced charges. The Tribunal had rightly held that the claim at the increased rates as made by the assessee company on the basis of which necessary entries were made,

represented only hypothetical Income, and the amounts in question brought to tax by the Income-Tax Officer did not represent income which had really accrued to the assessee company during the relevant previous year.”

17. Coming to the claim under Section 80HHC of the Act, we are again inclined to agree with the Tribunal that it was totally uncalled for on the part of the Commissioner to say that the AO did not make requisite inquiries because of the simple reason that the AO had, in fact, declined and rejected this claim of the assessee. If the AO himself disallowed the deduction claimed by the assessee on this account under Section 80 HHC of the Act, we fail to understand what further inquiries were needed by the AO.

18. Lastly, the observations of the Commissioner are in respect of the income of ₹1.61 crores shown by the assessee on account of variation in exchange rate. The Commissioner has only observed that in the immediate previous year no such gain was shown and therefore, it needed examination by the AO. However, the moot question would be examination for what purpose? It is an income shown by the assessee. Whether the Commissioner was of the opinion that there was no such income or he was nurturing an impression that income on this account as shown was lesser? There is no such indication in the order. The Commissioner also does not at all state as to what was the reason for doubting the income offered by the assessee. Even if it is found that part of such income was claimed as deduction under Section 80 HHC, no benefit enured to the

assessee on this account as claim under Section 80 HHC was fully disallowed by the AO. We state at the cost of repetition that it is not at all observed as to how the order of the AO on this account was erroneous and further as to how it was prejudicial to the interest of the Revenue.

19. We, thus, are of the opinion that order of the Commissioner was rightly set aside by the Tribunal. As a result, we answer the question in the negative, that is, in favour of the assessee and against the Revenue and dismiss the appeal.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

SEPTEMBER 14, 2010.
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