

THE HON'BLE SRI JUSTICE C.V. NAGARJUNA REDDY
AND
THE HON'BLE SRI JUSTICE CHALLA KODANDA RAM

REFERRED CASE NO.18 OF 2001

DATED:22-12-2017

Between:

The Commissioner of Income Tax
Visakhapatnam ... Applicant

And

M/s. V. Dhana Reddy & Co.
Visakhapatnam ... Respondent

COUNSEL FOR THE APPLICANT: Mr. K. Raji Reddy,
Senior Standing Counsel
for Income Tax Department

COUNSEL FOR THE RESPONDENT: Mr. A.V.A. Siva
Kartikeya

THE COURT MADE THE FOLLOWING:

JUDGMENT: (per the Hon'ble Sri Justice C.V. Nagarjuna Reddy)

On the direction issued by this Court by its judgment dt.18.9.2000, on the application of the Commissioner of Income Tax, Visakhapatnam, under Section 256(2) of the Income Tax Act, 1961 (for short, "the Act"), the Tribunal has referred the following question of law arising out of order dt.26.2.1996 in I.T.A. No.1059/Hyd/1996, for the assessment year 1987-88, for the opinion of this Court.

"Whether in the facts and in the circumstances of the case, the Tribunal is justified in coming to the conclusion that the Commissioner acted beyond the scope of powers conferred to him under Sec. 263 of the Income Tax Act in passing the impugned order and whether the order of the Commissioner satisfies the requirements of Section 263?"

2. The facts as culled out from the record are as follows.

The assessee firm was carrying on the business of stevedoring, clearing and forwarding agents at Visakhapatnam Port. It has involved in the allied activities of handling of imported cargos, like fertilizers, sugar etc. on behalf of the importers/principals, namely, Indian Potash Ltd., and State Trading Corporation, by way of storage, packaging and dispatch of materials, according to instructions. In order to facilitate such activities and services, the firm has constructed storage godowns from time to time in an extent of Acs.8.57 cents of land, taken on long lease for 30 years from the Port Trust.

3. For the assessment year 1987-88, the assessment was completed under Section 143(3) of the Act whereunder the total income of the assessee was determined at Rs.84,32,760/-. The Commissioner of Income Tax (for short, “the CIT”) on examining the relevant record opined that the assessment made by the Assessing Officer (for short, “the AO”) was erroneous and prejudicial to the interests of the Revenue. The CIT felt that the AO did not scrutinize the reasons for the said reduction of the assessee’s income which got down by 50% compared to the immediately preceding assessment year and did not examine the arrangement of leasing out of the godowns to the two trusts, namely, M/s. V.B.R. & K.G.R. Family Trust (for short, “the family trust”) and M/s. V.B.R. & K.G.R. Grand Children Trust (for short, “the Grand Children Trust”). Based on the above reasons, the CIT passed orders under Section 263 of the Act, setting aside the assessment order, with a direction to the AO to make a fresh assessment in accordance with law after causing necessary investigation and enquiries. Feeling aggrieved thereby, the assessee filed the appeal (ITA No.1059/Hyd/1991) before the Income Tax Appellate Tribunal, Hyderabad Bench.

4. By its order dt.26.2.1996 the Tribunal has set aside the order of the CIT. In its order, the Tribunal held that the CIT failed to bring out specifically any material into the record disclosing any error in the assessment order of the AO prejudicial to the interests of the Revenue. It has further held that the order of the CIT was purely based on surmises and conjectures and that however strong such surmises and conjectures may be, they cannot take the place of proof.

5. On receipt of the order of the Tribunal, the CIT has made an application requiring the Tribunal to refer the following questions of law.

1. *“Whether, on the facts and circumstances of the case, the Tribunal was right in holding that there were no materials before the Commissioner to justify his finding that the assessment order for the A.Y. 87-88 was erroneous insofar as it was prejudicial to the interests of the Revenue?”*
2. *Whether, on the facts and circumstances of the case, the Tribunal has rightly held that the assessment order, having been passed after proper enquiries was not erroneous so as to enable the Commissioner of Income Tax to assume jurisdiction u/s.263 of the I.T. Act, 1961?*
3. *Whether, on the facts and circumstances of the case, the Tribunal has rightly held that the ratio laid down in the case of Mc. Dowell & Co. Ltd. Vs. C.I.T. (154 ITR 148)(SC) is not applicable to the present case?”*

Evidently, the Tribunal has refused to refer the case to this Court. On the CIT approaching it, this Court by its order dt.18.9.2000 directed the Tribunal to state the facts of the case

and refer the question of law extracted supra arising out of the order of the Tribunal dt.26.02.1996 in ITA No.1059/Hyd/1991 for the assessment year 1987-88 for its opinion.

6. Accordingly, the statement of facts has been sent by the Tribunal to this Court upon which the case has been registered as Referred Case No.18 of 2001.

7. Mr. K. Raji Reddy, learned Senior Standing Counsel for the Income Tax Department, submitted that the Tribunal has committed a serious error in interfering with the order of the CIT, that the facts of the case satisfied the twin ingredients of Section 263 of the Act, namely, (i) the assessment order being erroneous and (ii) same being prejudicial to the interests of the Revenue, inasmuch as the AO failed to examine the issue whether the transactions entered into by the assessee firm with the two Trusts involved diversion of part of income hitherto earned by the former in favour of the latter and also whether the considerations received from the Trusts purportedly for achieving the efficiency in firm's business were genuine, reasonable, adequate and without involving any artificial arrangement and dubious methods. The learned Standing Counsel further argued that by the tax planning devise incorporated in the impugned transactions, the partners could,

however, be providing for income as well as funds or accumulation thereof to their respective spouses and children and that it was necessary for the AO to enquire and determine whether the Trust has actually used the assets or undertaken the activities that were purportedly entrusted to them by the firm or there was an artificial arrangement of diversion of the real income earned by the firm to the hands of the Trusts. These aspects, the learned Senior Standing Counsel urged, compelled the CIT to set aside the order of the AO with a direction to him to examine these aspects and make a fresh assessment order. In support of his submissions, the learned counsel has referred to and relied upon the following judgments on the scope of Section 263 of the Act.

(i) *Commissioner of Income Tax v. Kvality Steel Suppliers Complex*¹.

(ii) *Malabar Industrial Co. Ltd. V. Commissioner of Income Tax*².

(iii) *Commissioner of Income Tax v. Varanasi Khanta Rao, Prop. Sri Sai Srinivasa Modern Rice Mill*³.

(iv) *Spectra Shares and Scrips Pvt. Ltd. V. Commissioner of Income Tax*⁴.

(v) *Commissioner of Wealth Tax v. N.T. Rama Rao (Decd.)*⁵

¹ [2017] 395 ITR 1 (SC)

² [2000] 243 ITR 83 (SC)

³ [2015] 377 ITR 602 (T & AP)

⁴ [2013] 354 ITR 35 (AP)

⁵ [2003] 261 ITR 611 (AP)

8. Opposing the above submissions, Mr. Mr. A.V.A. Siva Kartikeya, learned counsel for the respondent – assessee commended the correctness of the decision of the Tribunal in setting aside the order of the CIT. He has submitted that as per the settled legal position, where two views are possible and the AO has taken one view with which the CIT does not agree, the assessment order cannot be treated as an order erroneous or prejudicial to the interests of the Revenue and that the approach of the CIT as reflected from the order passed by him shows that he has played the role of the appellate authority and therefore such approach not being permissible, the Tribunal has rightly set aside the order, as he has exercised his jurisdiction not vested in him under Section 263 of the Act.

9. We have carefully considered the respective submissions of the learned counsel for the parties with reference to the record.

10. Before proceeding further, it would be useful to look into Section 263(1) of the Act, which is relevant for the present purpose and the same reads as follows:

“263. Revision of orders prejudicial to revenue. – (1) The Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and

after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or canceling the assessment and directing a fresh assessment.”

11. The scope of Section 263 of the Act is the subject matter of a slew of judicial pronouncements. In *Malabar Industrial Co. Ltd.* (2 supra), the Supreme Court held that while exercising jurisdiction *suo motu* under Section 263 of the Act, the Commissioner has to be satisfied with two conditions, namely, (i) that the Order of the AO sought to be revised is erroneous; and (ii) it is prejudicial to the interests of the revenue. That if either of the two conditions is absent, the Commissioner cannot exercise his jurisdiction under the said provision. The Supreme Court further held that Section 263 of the Act cannot be invoked to correct each and every type of mistake or error committed by the AO unless such mistake leads to an erroneous order causing prejudice to the interests of the Revenue. The Supreme Court held that an incorrect assessment of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. It has further held that the order passed without applying the principles of natural justice or without application of mind also falls in the same category of erroneous orders. Dealing with the phrase “prejudicial to the interests of the Revenue”, the

Supreme Court held that it is not an expression of art and that understood in its ordinary meaning it is of wide import and is not confined to mere loss of tax. That if due to an erroneous order of the Income Tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue, and that this phrase has to be read in conjunction with an erroneous order passed by the Assessing Officer.

12. In *C.I.T. v. Max India Ltd.*⁶ the Supreme Court held that 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.

13. In *C.I.T. v. Vikas Polymers*⁷ the Delhi High Court held that the power of *suo motu* revision exercisable by the Commissioner under Section 263 of the Act is supervisory in nature and that if the Income Tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as “erroneous”

⁶ [2007] 295 ITR 282 (SC)

⁷ [2012] 341 ITR 537 (Delhi)

by the Commissioner simply because, according to him, the order should have been written differently or more elaborately, that the section does not visualize the substitution of the judgment of the Commissioner for that of the Income Tax Officer, who passed the order unless the decision is not in accordance with law.

14. In *C.I.T. v. Sunbeam Auto Ltd.*⁸ the Delhi High Court held that if there was an enquiry, even if it is inadequate that would not by itself give occasion to the Commissioner to pass orders under Section 263 merely because he has a different opinion in the matter, that it is only in cases of lack of inquiry that such a course of action would be open.

15. In *C.I.T. v. Gabriel India Ltd.*⁹ the Bombay High Court held that the conclusion of the Commissioner that an order is erroneous must be based on material on record of the proceedings called for by him and that if there is no such material on record, it can be said that the very initiation of proceedings by him would be illegal and without jurisdiction. It has further held that the Commissioner cannot initiate proceedings with a view to start fishing and roving inquiries in matters or orders which are already concluded and that the

⁸ [2011] 332 ITR 167 (Delhi)

⁹ [1993] 203 ITR 108 (Bom.)

Department cannot be permitted to begin fresh litigation because of new views they entertain on facts or new versions which they present as to what should be the inference or proper inference either of the facts disclosed or the weight of the circumstance and that if this is permitted, litigation would have no end except when legal ingenuity is exhausted.

16. In *Kwality Steel Suppliers Complex* (1 supra) the Supreme Court after referring to the judgment of the Gujarat High Court in *C.I.T. v. Arvind Jewellers*¹⁰, reiterating the principle that Section 263 of the Act cannot be invoked to correct each and every type of mistake or error committed by the AO, further held that the order of the AO cannot be termed as prejudicial, simply because he has adopted one of the courses permissible in law and it has resulted in loss of revenue, or where two views are possible and the AO has taken one view with which the Commissioner did not agree.

17. On an exhaustive consideration of the case law, a Division Bench of this Court in *Spectra Shares and Scrips Pvt. Ltd.* (4 supra) summarized the legal position regarding the scope of jurisdiction of the Commissioner under Section 263 of the Act, as under:

¹⁰ [2003] 259 ITR 502 (Guj.)

a) *The Commissioner has to be satisfied of twin conditions, namely, (i) the order of the Assessing Officer sought to be revised is erroneous; and (ii) it is prejudicial to the interests of the Revenue. If one of them is absent - if the order of the Income Tax Officer is erroneous but is not prejudicial to the Revenue or if it is not erroneous but it is prejudicial to the Revenue - recourse cannot be had to Sec. 263 (1) of the Act.*

b) *Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests 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.*

c) *To invoke the suo motu revisional powers to reopen a concluded assessment under Sec. 263, the Commissioner must give reasons; that a bare reiteration by him that the order of the Income Tax Officer is erroneous in so far as it is prejudicial to the interests of the Revenue, will not suffice; that the reasons must be such as to show that the enhancement or modification of the assessment or cancellation of the assessment or directions issued for a fresh assessment were called for, and must irresistibly lead to the conclusion that the order of the Income Tax Officer was not only erroneous but was prejudicial to the interests of the Revenue. Thus, while the Income Tax Officer is not called upon to write an elaborate judgment giving detailed reasons in respect of each and every disallowance, deduction, etc., it is incumbent upon the Commissioner not to exercise his suo motu revisional powers unless supported by adequate reasons for doing so; that if a query is raised during the course of the scrutiny by the Assessing Officer, which was answered to the satisfaction of the Assessing Officer, but neither the query nor the answer were reflected in the assessment order, this would not by itself lead to the conclusion that the order of the Assessing Officer called for interference and revision.*

e) *The Commissioner cannot initiate proceedings with a view to start fishing and roving inquiries in matters or orders which are already concluded; that the department cannot be permitted to begin fresh litigation because of new views they entertain on facts or new versions which they present as to what should be the inference or proper inference either of the facts disclosed or the weight of the circumstance; that if this is permitted, litigation would have no end except when legal ingenuity is exhausted.*

f) *Whether there was application of mind before allowing the expenditure in question has to be seen; that if there was an inquiry, even inadequate that would not by itself give occasion to the Commissioner to pass orders under Sec. 263 merely because he has a different opinion in the matter; that it is only in*

cases of lack of inquiry that such a course of action would be open; that an assessment order made by the Income Tax Officer cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately; there must be some prima facie material on record to show that the tax which was lawfully exigible has not been imposed or that by the application of the relevant statute on an incorrect or incomplete interpretation, a lesser tax than what was just, has been imposed.

g) The power of the Commissioner under Sec. 263 (1) is not limited only to the material which was available before the Assessing Officer and, in order to protect the interests of the Revenue, the Commissioner is entitled to examine any other records which are available at the time of examination by him and to take into consideration even those events which arose subsequent to the order of assessment.

18. Keeping in mind the settled legal position as discussed above, we need to consider the question of law framed by this Court and referred by the Tribunal.

19. A perusal of the original assessment order shows that the AO has taken into consideration the fact that the godowns were previously leased out by the assessee itself to its principals, i.e., Indian Potash Limited and State Trading Corporation and that during the current assessment year, the godowns were let out to its sister concern, namely, M/s. VBVR & KGR Family Trust. He has also considered the findings rendered by the CIT (A) during the previous assessment year during which the assessee itself has let out the godowns and that in view of the change in factual position during the current assessment year, the rental receipts are taxable under the head “property income”, and not as “business income”, as claimed by the

assessee and treated as such during the previous assessment year.

20. In his order, the CIT took note of the fact that the AO has called for certain details and clarifications regarding the receipts from the Trusts with reference to the agreements and that it does not appear from the record that the transactions of substantial payments to the Trusts relating to operational activities, styled as “profits from handling” of specific cargos, like potash, sand, sugar etc., were examined and verified. He has further observed that with regard to godowns’ rents, the AO has not examined as to how the Family Trust has utilized the godowns and that whether there was any termination of pre-existing lease agreements of the said premises with the original tenants, who were the principals of the assessee firm. Referring to the leasing of two Terexes to the Grand Children Trust, the CIT observed that there was absolutely no application of mind in the course of the assessment proceedings as to whether the earning from hiring out two Terexes for the entire year to the Trust for Rs.8.4 lakhs was real and adequate and that the AO has also not noticed that if the same Terexes purportedly given on hire to the Trust were wholly used and maintained by the assessee while paying hire

charges exceeding Rs.20.00 lakhs during the year to the said Trust. On the said premises, the CIT felt that the order of the AO was erroneous insofar as it is prejudicial to the interests of the Revenue is concerned as the AO had not properly and fully examined the transactions between the assessee and the Trusts and also not applied his mind to the implications of tax avoidance by way of suppression of real income of the firm or diversion thereof to the Trusts as involved in these transactions. In the show cause notice issued by him, the CIT pointed out that the AO failed to cause necessary enquiries into the genuineness and realities of the three categories of the transactions entered into by the assessee firm exclusively for the benefits of the spouses and minor children of the partners and that it was incumbent on him to enquire and investigate into the apparent transactions with the Trusts in the light of the settled position of law in *Mc. Dowell & Co. Ltd. Vs. C.I.T.*¹¹.

21. In our opinion, the whole premise on which the CIT has invoked his revisional powers is the purported improper and incomplete examination of the transactions between the assessee and the Trusts. No findings have been rendered by the CIT that the AO has made an incorrect assessment of facts or incorrect application of law to satisfy the requirements of the order being

¹¹ [1985] 154 ITR 148 (SC)

erroneous and prejudicial to the interests of the Revenue, as held in *Malabar Industrial Company Ltd.* (2 supra). In the opinion of the CIT, the AO ought to have made a further probe into the nature of the transactions between the assessee and the two Trusts. In other words, the CIT has desired a fishing and roving enquiry which is not permissible as per the settled legal position as discussed above. The CIT has arrogated to himself the role of appellate body forgetting that he was only exercising his revisional power, the scope of which is far narrower than the scope of appeal. It is not as if from the material on record the CIT has found the transactions between the assessee and the two Trusts as sham or nominal, or any material was found revealing fraudulent nature of the transactions. He only wanted to know on a further appreciation/examination whether the transactions suffer from any such features. Therefore, the Tribunal, in our opinion, is justified in terming the order of the CIT as based on mere conjectures and surmises, and not on the facts borne out by the record. The Tribunal also recorded a finding that the assessments for the relevant assessment year relating to the two Trusts were carefully scrutinized after calling for the details and examining the same by the AO. Interestingly, the CIT having expressed his suspicion about the genuine nature of the transactions between the assessee and the Trusts, has not exercised his revisional powers under Section 263 of the Act with regard to the assessments

completed under Section 143(3) of the Act pertaining to the two Trusts. It would be incongruous to interfere with the assessments completed in respect of the assessee, while leaving aside the assessment orders passed in respect of the two Trusts, whose returns of income are intricately connected with the suspected transactions of the assessee. The action of the CIT thus suffers from inherent contradiction.

22. Regarding the judgment in *Mc. Dowell & Co. Ltd.* (11 supra), the concept of colourable tax planning device to reduce the tax liability (as propounded in the said judgment) is not applicable to the facts of the present case, as the CIT has not suspected the bona fides in creation of the Trusts and their activities or that no material is found showing that the assessee had made an effort to reduce the tax liability on the transactions entered with the two Trusts.

23. On a careful scrutiny of the orders of the CIT and the Tribunal, we have no hesitation to hold that the foremost requirement that the order must be erroneous for invoking the revisional jurisdiction under Section 263 of the Act by the CIT, has not been satisfied in the instant case. Once the order is not found erroneous, the CIT is denuded of his power to invoke Section 263 of the Act to revise the assessment order.

24. On the analysis as above, we answer the reference against the Revenue.

C.V. NAGARJUNA REDDY, J

CHALLA KODANDA RAM, J

22-12-2017

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Note: LR copies to be marked.

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