

R.M. AMBERKAR
(Private Secretary)

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O.O.C.J.

WRIT PETITION NO. 3550 OF 2018

Multi Commodity Exchange of India
CTS-255 Exchange Square, Suren Road,
Andheri (East), Mumbai - 400 093.

.. Petitioner

Versus

1. Deputy Commissioner of Income Tax
Central Circle - 8(3), 6th Floor,
Room No. 659, Aykar Bhavan,
M.K. Road, Mumbai - 400 020.

2. Pr. Commissioner of Income Tax - Central 8,
Aykar Bhavan, Mumbai - 20.02.2019

3. Union of India
Aaykar Bhavan, M.K. Road,
Churchgate, Mumbai - 400 020

.. Respondents

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- Mr. Percy Pardiwala, Senior Advocate, Mr. Riyaz Padevkar & Shri. Tanzil Padvekar i/by Dave & Padvekar Associates for the Petitioner
 - Mr. N.C. Mohanty for the Respondents
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CORAM : AKIL KURESHI &
B.P. COLABAWALLA, JJ.

DATE : FEBRUARY 20, 2019.

ORAL JUDGMENT (Per Akil Kureshi, J.)

1. The petitioner has challenged an order dated 12.11.2018 and further order dated 9.11.2018 under which the Revenue Authorities have ordered special audit of the petitioner's accounts for the assessment year 2015-16 in

terms of Section 142(2A) of the Income Tax Act, 1961 ("the Act" for short).

2. Brief facts are as under:

2.1 Petitioner is a public limited company registered under the Companies Act, 1956. The petitioner is a recognized National Commodity Exchange. The petitioner provides platform for trading in Commodity futures contracts across segments including Bullion, Ferrous and Non Ferrous Metals, Energy and Agricultural Commodities.

2.2 The Deputy Commission of Income Tax issued a show cause notice on 5.9.2018 calling upon the petitioner why the petitioner's accounts for the assessment year 2015-16 should not be sent for special audit as per the provisions of Section 142(2A) of the Act. In such show cause notice, the said Authority highlighted different issues on the basis of which he was prima facie of the opinion that the special audit of the accounts of the petitioner was called for. In this context, he had recorded the following discrepancies:-

- "a) The assessee has claimed to have paid professional charges to Financial Technologies Knowledge Management Company Ltd (FTKMC), a related concern. Information available on record indicates that the said amounts are merely in the nature of accommodation and further are also in any case above the contracted rates.
- b) The assessee has entered into several agreements with NHBC, a related concern for payment of rent of warehouses. There are also several non-agreement based monies paid by the assessee. Details available on record also indicate that the warehouses for which rent has been claimed to have been paid were used by certain other persons.
- c) The assessee has claimed to have awarded multiple technological agreement to FTIL, a related concern. The assessee has also entered into a contract with FTIL for sub-letting premises. The rationale of these charges paid to FTIL is not established. Further, amounts paid to FTIL also are above the market rates.
- d) The assessee has entered in multiple related party transactions. The identification of related parties along with determination of fair market value also required determination."

In background of such discussion, the said Authority after referring to the provisions of Section 142(2A) of the Act conveyed to the petitioner as under:-

- "4 As per the facts and circumstances enumerated in para 2 above, it is noted that the assessee company is engaged into a specialized business of an Exchange and its nature of accounting is complex. Further, it is observed that the accounts

of assessee company are voluminous. The above instances also indicate that there exist serious doubts about the correctness of the accounts. There are also multiple related party transactions entered, the reasonableness and genuineness of which is under question. In entirety of the fact and reasons stated herein, it is in the interest of the revenue that an audit u/s. 142(2A) of the Act be directed in your case.

5. In view of above, this is to inform you that the special audit of your books of accounts, as per the provisions of Section 142(2A) of the Act is being proposed in your case in respect of AY 2015-16.
6. You are therefore given an opportunity of being heard. You are therefore requested to state your views on the above either in person or by an authorized representative on or before 14.9.2018 at 12.30 p.m. Please note that in case of no response from you within the specified time limit, it will be presumed that you have no objection to the proposed action and accordingly, the matter will be decided as proposed."

2.4 The petitioner filed a detail reply to the said show cause notice under communication dated 25.9.2018 opposing the proposal for special audit. In such reply, the petitioner contended that the requirements of Section 142(2A) of the Act for special audit were not specified in the present case. It was contended that there was no honest attempt on the part of the Assessing Officer to understand the books of accounts of the assessee company or

application of mind on his part. With respect to discrepancies mentioned in the show cause notice, it was contended that the Financial Technologies Knowledge Management Company Limited (FTKMC) was not a party related to the assessee as per Section 40A(2)(b) of the Act. It was further contended that several transactions had already been subjected to transfer pricing mechanism and the Transfer Pricing Officer ("TPO" for short) had already examined such transactions. On such grounds, the proposal for special audit of the accounts was opposed.

2.5 The Deputy Commissioner of Income Tax passed the order on 6.11.2018 disposing of the objections of the petitioner, dealing with each objections.

2.6 Under communication dated 8.11.2018, the Deputy Commissioner of Income Tax sought approval from the Principal Commissioner of Income Tax for special audit of the accounts of the petitioner under Section 142(2A) of the Act. In such letter, the Deputy Commissioner had given full details of the complexity in the petitioner's accounts and the

reasons why he was of the opinion that special audit was necessary. On 9.11.2018, the Principal Commissioner of Income Tax granted his approval to the Deputy Commissioner of Income Tax for special audit of the petitioner's accounts. On 12.11.2018, the Deputy Commissioner passed the impugned order. The reasons for passing the impugned order may be reproduced hereunder:-

- "1. M/s. Multi Commodity Exchange of India Ltd is a commodities exchange and an erstwhile subsidiary of M/s Financial Technologies (India) Ltd. (FTIL).
2. During the course of proceedings, it was observed that the assessee had incurred various expenses to related and non-related parties, which need to audited. Some of these expenses are as follows:
 - a) The assessee has entered into several agreements with NBHC, a relate concern, for payment of rent of warehouses. There are also several non-agreement based monies paid by the assessee. Details available on record also indicate that some of the warehouses for which rent has beet claimed to have been paid were used by certain other persons.
 - b) The assessee has claimed to have awarded multiple technological agreements to M/s Financial Technologies India Ltd (FTIL), a related concern. The rationale of charges paid to FTIL is not established. Further, amounts paid to FTIL also are above the market rates.

- c) The assessee has entered into multiple related party transactions. The identification of related parties along with genuineness of transactions and the factor of arms length pricing or reasonableness of expenditure also requires determination.

Besides the above transactions, assessee has entered into various transactions in other years, which may have a bearing in AY 2015-16 too. Some of these transactions are as follows:

- a) The assessee has claimed to have paid divestment fees to MPPL Enterprises Pvt. Ltd. and Ovira Logistics Pvt. Ltd. Documents available on record indicate that these amounts paid are mere book entries
- b) The assessee has also claimed to have paid expenses to Financial Technologies Knowledge Management Company Ltd. (FTKMC), a related concern. Information available on record indicates that the said amounts are merely in the nature of accommodation and further are also in any case above the contracted rates.
- c) The assessee has claimed to have engaged Vardhaman International for creating a traders database. The aspect of actual work being performed is not established.
- d) The assessee has claimed deduction u/s. 80G of donation paid to Arunodaya Charitable Trust. The existence and activities of Arunodaya Charitable Trust have been doubted.
- e) The assessee has claimed to have engaged Splash Media and Infra Ltd to display hoardings at Mahim Causeway and Haji Ali locations in Mumbai. There are no documents on record to

establish the genuineness of the activities carried out by Splash Media and Infra Ltd.

- f) The assessee has claimed to have engaged Mediacom Communications as its media agency for outdoor, print and TV campaigns. These payments are not established beyond doubts.

3. In entirety of the fact and reasons stated herein, you are required to conduct the special audit u/s. 142(2A) of the Act on the following terms of reference:-"

The terms of reference for special audit were as under:-

3.1 The auditors need to audit books of accounts of M/s. Multi Commodity Exchange of India Ltd for the A.Y. 2015-16. They have to examine and report on the following aspects in general.

- 1. Whether proper books of accounts are maintained and verifiable?
- 2. Whether all bills / Vouchers and other relevant original documents are maintained and verifiable?
- 3. Whether all statutory requirements have been met?

3.2 In addition to the above, the auditors need to critically examine the following issues in the light of the facts as discussed above.

- i. Genuineness of the business activity undertaken by the assessee company.
- ii. Detailed examination of parties covered u/s 40A(2)(b) of the Income Tax Act, 1961 and the nature, genuineness and reasonableness of payments made to these parties.
- iii. Detailed examination as regard to major expenses exceeding Rs. 10 lakhs and the tax deduction/collection thereon apart from

those referred in subsequent points and allowability thereof as per the provisions of the Act.

- iv. Detailed examination as regard the Trade payables, their existence, genuineness and subsequent payments thereof.
- v. In respect of the expenditure incurred by the assessee towards advertisement, business promotion, marking, sponsorship, etc whether expenditure incurred is genuine? Whether it is commensurate with the services rendered by other party?
- vi. Details of donation paid along with genuineness and allowability of the same under the provisions of the Act.
- vii. Allowability of Warehousing Charges having regard to the provisions of the Act.
- viii. Allowability of Technological Service charges having regard to the Act.
- ix. Any other issues arising in the course of audit, which ought to have been offered as income in the return of income but not offered by the assessee
- x. Any other issue which in the opinion of the auditor is relevant for this office for completion of the assessment

3.3 It is noted that similar issues have been involved in preceding years also i.e A.Y. 2010-11 to AY 2014-15 and accordingly the audit shall be conducted in accordance with the terms of reference referred above even in those years. Certain discrepancies were noted in the report of the Pricewaterhouse Coopers ("PWC Report") which is also significant to be considered while deciding the above terms of references for the A.Y. 2010-11 to 2015-16. Copy of the said report along with all its annexure (3 volumes) are also enclosed with this letter"

This is the order, the petitioner has challenged in the present petition.

3. Learned counsel Shri. Pardiwala for the petitioner took us painstakingly through the documents and materials on record and raised following contentions:-

- i. The impugned order contains a direction to the auditor to audit the accounts whereas under Section 142(2A) of the Act, the powers of the Deputy Commissioner are to ask the assessee to have the audit of the accounts carried out;
- ii. He contended that the requirements of Section 142(2A) of the Act were not satisfied. The Deputy Commissioner, therefore, committed an error in exercising the powers without satisfaction of the necessary requirements;
- iii. Learned counsel contended that the order suffers from non-application of mind. The Deputy Commissioner had proceeded on the basis of several inaccurate or erroneous grounds. Even when pointed out in the objections, the Deputy Commissioner refused to accept such errors;
- iv. It was contended that several of the transactions referred to in the impugned order were already subjected to transfer pricing mechanism. The TPO had already examined the transactions minutely.

No useful purpose would be served by sending such transactions for special audit;

- v. The learned counsel also drew our attention to the judgment of this Court in Writ Petition No. 143 of 2018 and connected petitions dated 1.10.2018 filed by this petitioner in which the Court had quashed the order for special audit with respect to several earlier assessment years.

4. On the other hand, Mr. Mohanty, the learned Counsel for the Revenue opposed the petition contending that the Deputy Commissioner had issued a show cause notice calling upon the objections from the petitioner to the proposal of special audit of the accounts. The objections were disposed of by speaking order. The impugned order was passed after taking necessary approval from the Principal Commissioner. The Deputy Commissioner has recorded proper reasons for exercise of the powers. He pointed out that the provisions of Section 142(2A) of the Act has been amended w.e.f 1.6.2013 substantially widening the scope for special audit. He contended that in facts of the present case, the necessary ingredients of Section 142(2A) were fully satisfied and the order was, therefore, correctly passed by the Deputy

Commissioner.

5. Both sides have referred to the judgments, reference to which would be made at the appropriate stage.

6. From the material on record, it may be seen that the Deputy Commissioner after issuing the show cause notice recording his grounds why he proposed to call for special audit, considered the objections of the petitioner to such proposal. He passed a detail order disposing of the objections citing reasons. Subsequently, he also obtained the approval from the Principal Commissioner before passing the impugned order. In such order, he recorded that the assessee had entered into several agreements with a related concern for payment of rent of warehouses. Some of the warehouses for which the rent was claimed to have been paid were used by other persons. He also recorded that the assessee had claimed to have awarded multiple technological agreements to FTIL as a related concern and the rational of charges paid to FTIL was not established. The amounts paid to FTIL were also above the market rates. He

also recorded that the assessee had entered into multiple related party transactions and identification of related parties along with genuineness of the transactions and the factor of arms length pricing or reasonableness of expenditure was required to be determined. He also recorded that divestment fees claimed to have been paid by the assessee appeared to be mere book entries. He also recorded that some of the payments were in the nature of accommodation entries and the claims of the donation etc. were doubtful. On such grounds, he formed the belief that special audit would be necessary. He, therefore, laid down the terms of reference for special audit.

7. Section 142 of the Act pertains to inquiry before the assessment. Sub-section (2A) of Section 142 reads as under:

" If, at any stage of the proceedings before him, the [Assessing] Officer, having regard to [the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity 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 [Principal Chief Commissioner or] Chief Commissioner or [Principal 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 [Principal Chief Commissioner or] [Chief Commissioner or [Principal 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 :

[**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.]

We may notice that the group of words, "the nature and complexity of the accounts, volume of the accounts, doubts about correctness of the accounts, multiplicity of the transactions in the accounts or specialized nature of business activity of the assessee and" was substituted by the legislature by Finance Act, 2013 w.e.f. 1.6.2013 for the following group of words : "the nature and complexity of the accounts of the assessee and". It can thus be straight away seen that prior to this amendment, the power of the Assessing Officer to call for special audit would have to be exercised having regard to the nature and complexity of the accounts of the assessee and the interest of the revenue. The legislature has now considerably widened the scope of exercise of such powers by including several other situations besides the nature and complexity of the accounts of the

assessee. Thus, additional expressions which now finds way into Section 142(2A) of the Act are volume of the accounts, doubts about correctness of the accounts, multiplicity of the transactions in the accounts or specialized nature of business activities of the assessee. The correctness of the decision of the Deputy Commissioner, therefore, shall have to be considered from such widened scope of his powers. We are conscious that the requirement of the formation of the opinion as the special audit being in the interest of the Revenue continues to apply before and after the amendment. Nevertheless, the basic essential requirements of exercising the powers have been substantially widened by the legislature by way of such amendment. We are also conscious that the proposition that special audit would result into serious legal consequences to the assessee and therefore, even if there was no statutory requirement, the principle of natural justice must be followed before the Assessing Officer could exercise the powers, would continue to govern the situation. In case of **Sahara India (Firm) Vs. CIT¹**, the Supreme Court has held and observed that the exercise of power under Section 142(2A) leads to serious civil

¹ [2008] 300 ITR 403 (SC)

consequences, and, therefore even in the absence of any express provision for affording an opportunity of per-
decisional hearing to the assessee, requirement of observance of the principle of natural justice is to be read into the said provision.

8. In the present case, we have already noted that the detail grounds on which the Assessing Officer formed an opinion that special audit was necessary and the final order that he passed calling for such special audit. As noted, final audit proceeds on various grounds of genuineness of the transactions and payments by the assessee. We may recall, doubts about correctness of the accounts, multiplicity of transactions and specialized nature of business activities are some of the additional grounds, now recognized by the legislative for special audit. We do not find that the order requires any interference.

9. Merely because the impugned order contains a narration that the special auditor should conduct the audit, would not destroy the very essence of the order nor would

the same be fatal to the order itself. It is true that Section 142(2A) of the Act envisages the direction to the assessee to get the accounts audited by an accountant as defined in the explanation below sub-section (2) of Section 288 of the Act as may be appointed by the Principal Commissioner. However, inconsequential inaccuracy in the language used in the impugned order, would not be fatal to the order itself.

10. The decisions cited by Shir. Pardiwala in respect of the contention that the requirements of Section 142(2A) were not satisfied, are all rendered before the amendment in Section 142(2A) w.e.f. 1.6.2013. In case of **Delhi Development Authority & Anr. Vs. Union of India & Anr.**², the Division Bench of Delhi High Court in background of the per-amended provisions had quashed the order of special audit. It was in this background observed that in order to direct special audit under Section 142(2A) of the Act, the Assessing Officer must form an opinion with regard to twin conditions namely nature and complexity of the accounts and interest of the revenue. As noted, this expresses "nature and complexity of the accounts" has now

² (2013) 350 ITR 432 (Delhi)

been substantially widened by the legislature. The amended provision of Section 142(2A) came up for consideration before this Court in case of **Sharad Kantilal Shah Vs. Deputy Commissioner of Income Tax, Central Circle 8(3)**³ wherein it was observed as under:-

"7. As far as the third grievance of the petitioner is that the Assessing Officer did not examine the books of account before ordering/directing the special audit is concerned, on facts we find that the show-cause notice as well as the impugned direction proceed on the basis that on verification of the books of account and vouchers that the issue of special audit arose. Thus, this grievance of non-examination of the books of account is without any substance. Moreover after the amendment to section 142(2A) of the Act with effect from 2013, a special audit is not restricted only to complexity of the accounts. The special audit can now be directed not only if the accounts are complicated but also if there is doubt to the correctness of the account or multiplicity of transactions or volume of transaction or specialized nature of the accounts. Moreover the other grievance that the notice did not indicate the reasons which led him to a prima facie view directing a special audit stands belied by the fact that the show-cause notice dated July 25, 2016, issued to the petitioner, in fact, indicated the basis for directing special audit on the basis of the volume of the total trades executed by the petitioner, multiplicity of transactions in the accounts, including the nature and complexity of the accounts and doubts about the correctness of the accounts. Therefore, this grievance is also without substance.

10. We find that the impugned order dated 10 March 2016 directing a special audit is not without jurisdiction. The procedural

3 [2017] 393 ITR 594 (Bombay)

safeguards of notice, approval of the Chief Commissioner and hearing have undisputedly been complied with. Besides, the satisfaction recorded by the Assessing Officer before directing a special audit is his opinion on the basis of the facts before him and such opinion is not shown to be perverse. We are not a court of appeal to substitute the opinion of the Assessing Officer to exercise power under section 142(2A) of the Act by our opinion to the contrary. We find that the opinion reached by the Assessing Officer to direct special audit on the present facts is a reasonable and possible view."

11. In case of **Takshashila Realities (P) Ltd Vs. Deputy Commissioner of Income Tax, Circle 4(1)(2)**⁴, the Gujarat High Court also referred to the amended provisions of Section 142(2A) and observed as under:-

"17.1 Now so far as submission made on behalf of the petitioner that the Assessing Officer cannot direct special audit under Section 142 [2A] of the Act before calling for the accounts from the petitioner in the assessment proceedings and without doubting the accounts and/or considering the complexity in the accounts is concerned, it is required to be noted that as per amended Section 142 [2A] of the Act, apart from the nature and complexity of the accounts, etc., even in case of multiplicity of transactions in the accounts or specialized nature of business activity of the assessee and the interests of the Revenue, the Assessing Officer can pass an order for special audit in exercise of powers conferred under Section 142 [2A] of the Act. Therefore, while forming an opinion to get the accounts audited by special auditor; considering the specialized nature of business activities of the assessee, there need not be any books of account before the Assessing Officer. In the present case, having found that there are complex issues relating to introduction of land by the

4 [2017] 34 taxmann.com 172(Gujarat)

partners into the firms; revaluation of land; credit of partners in capital account equal to revalued amount of land; conversion of capital account to loan account of shareholders and issues relating to issuance of equity shares against the balances of revaluation credits at an unreasonable premium, and after having been satisfied that considering the specialized nature of business activities of the assessee, the Assessing Officer has passed an order of special audit in exercise of powers under Section 142 [2A] of the Act."

12. Karnataka High Court in case of *Habitat Shelters Pvt. Ltd Vs. Pr. CIT, Bangalore*⁵ after referring to the amended Section 142(2A) of the Act observed as under:

"7. Obviously, this Court cannot go into the sufficiency of reasons assigned by the Assessing Authority for directing such Special Audit. Only if there were no reasons assigned and objections of the petitioner assessee were not considered, perhaps, the breach of principles of natural justice, as required under Section 142(2A) of the Act and Proviso thereto could be so contended by the assessee, but from the record, it does not appear to be either absence of an opportunity of hearing altogether or the absence of any reasons at all.

8. Thus, this Court cannot draw any inference of breach of principles of natural justice or arbitrariness in the impugned order passed by the respondent Authority. Accordingly, the requirement of Section 142(2A) of the said Act cannot be said to have been not complied by the respondent Authority. The same requires no interference under Article 226 of the Constitution of India. Therefore, the Writ Petition is liable to be dismissed and is accordingly dismissed. No costs."

⁵ [2018] 254 Taxman 160

13. Merely because some of the transactions were subjected to transfer pricing mechanism, would not debar the Assessing Officer from exercising powers under Section 142(2A) of the Act, if the conditions for exercising such powers were otherwise satisfied. The Transfer Pricing Officer would be essentially concerned with the assessment of the arm's length price of the specified transactions with an associated enterprise.

14. Reference to the judgment of this Court in case of this very assessee would also be of no avail. It was a case in which the assessee had challenged the orders passed by the Assessing Officer calling upon for special audit of the petitioner's accounts for several assessment years. However, the decision of the Court was not on merits. The judgment records that the Court had put it to both the counsel for the petitioner and the respondent why the whole gamut of the special audit be followed. Instead, during the course of assessment, that will be undertaken pursuant to the notice under Section 148 of the Act and when the petitioner was possessed a copy of the report of PWC, all

contentions in relation to such proceedings can be raised and thereafter, orders can be passed after hearing the petitioner. This suggestion was accepted by both sides. It was, in this background, the Court disposed of the petition with following directions:-

" The Petitions can be disposed off with a direction that the special audit in terms of the impugned notice and the approval need not be undertaken for all the materials in relation to the petitioner's transactions, their share holdings, are already referred to in the PWC report as also the pending proceedings under Section 148 of the I.T. Act. There is a return of income filed under protest by the petitioners on 26th April, 2017 and that is under assessment. If during the course of assessment and pursuant to this return, the petitioner desires to raise objections with regard to the contents of the PWC report and to be relied upon by the Assessing Officer, then, the Assessing Officer shall allow the petitioner to raise the necessary contentions and after dealing with them, he shall pass an order in accordance with law."

15. Firstly, as noted, the Court did not decide the petitioner's objection to the special audit on merits, instead proceeded on consensus. Secondly, the assessment years involved in the said orders besides others were 2010-11, 2011-12 and 2014-15. For the assessment years 2010-11 and 2011-12 unamended provisions of Section 142(2A) would apply. In the result, we do not find merit in this petition. The same is dismissed. Ad-interim relief, if any,

stands vacated.

[B.P. COLABAWALLA, J.]

[AKIL KURESHI, J]