

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

WRIT PETITION NO. 947 OF 2014

Vaman Prestressing Co. Pvt. Ltd.
a Company incorporated under the
Companies Act, 1956 and having
its registered office at 303, Elphinstone
House, 17, Marzban Road,
Mumbai – 400 001.

....Petitioner

V/s.

1. The Additional Commissioner of
Income Tax – Rg 2(3), Mumbai
having his office at Room No.546,
5th Floor, Aayakar Bhavan, M.K. Road,
Mumbai – 400 020.

2. The Commissioner of Income Tax -2
Mumbai having his office at
Room No.344, 3rd Floor, Aayakar
Bhavan, M.K. Road,
Mumbai – 400 020.

3. The Union of India,
Through the Secretary,
Department of Revenue, Ministry
of Finance, North Block,
New Delhi – 110 001.

...Respondents

**ALONGWITH
WRIT PETITION NO. 961 OF 2014**

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...Respondents

Mr. P.J. Pardiwalla, Senior Advocate a/w Mr. Nitesh Joshi i/b Mr. Atul K.
Jasani for Petitioner.
Mr. Suresh Kumar for Respondents.

**CORAM : K.R. SHRIRAM &
DR. N.K. GOKHALE, JJ.
RESERVED ON : 8th SEPTEMBER 2023
PRONOUNCED ON : 15th SEPTEMBER 2023**

ORAL JUDGMENT : (PER : K.R. SHRIRAM, J.)

WRIT PETITION NO. 947 OF 2014

1. Petitioner is engaged in the business of manufacture and sale of prestress concrete sleepers used in laying of railway tracks. As stated in the petition there is an internal understanding amongst the members of Concrete Sleeper Manufacturer Association of India that a company having its manufacturing facility in a particular zone will cater to the requirements of the railways in their own zone, thereby saving on the transportation cost. In the year 2007, Rail Vikas Nigam Limited (RVNL) had awarded petitioner

a contract for manufacture and supply of PSC mono block sleepers for broad gauge for ADB funded project of Aligarh to Ghaziabad, 3rd Line which is in the Northern zone. It was also mandated that petitioner should set up a new manufacturing facility at an agreed location. Petitioner therefore incorporated a new company ICON Sleeper Track Pvt. Ltd. (ICON) on 28th August 2007 as a subsidiary of petitioner. Petitioner assigned the contract for the work received from RVNL to ICON for which an assignment deed was executed on 19th July 2008. ICON has set up a manufacturing facility for manufacture of PSC sleepers at Sholaka on Northern Railway. For this purpose, petitioner had granted loans and advances and also invested in the share capital of ICON which, as on 31st March 2008, stood at Rs.7,67,91,417/- and Rs.20,00,000/-, respectively and Rs.8,05,30,529/- and Rs.1,00,00,000/- as on 31st March 2009, respectively. It is this deployment of fund to associate concerns which, according to the Revenue, was for a non business purpose.

2. For the first time in the previous year relevant to Assessment Year 2003-04, Respondent No.1 alleged that the amount deployed by petitioner towards making investment in extending loans and advances to associate concerns was out of borrowed funds and made a disallowance of interest expenditure incurred on its borrowings on the ground that borrowed funds to the extent deployed in such activity were not used for the purpose of its business. Aggrieved by the assessment order, petitioner had filed an appeal before the Commissioner of Income Tax (Appeals)

(CIT[A]), who held that such deployment of funds were for business purpose and that such funds were deployed out of interest free funds available with petitioner. The Revenue's appeal to the Income Tax Appellate Tribunal (ITAT) and to this court have been dismissed where they have approved the view taken by the CIT[A], i.e., investments and lending of funds were made for the purpose of petitioner's business and that the said investments were made out of own funds and not out of borrowed funds.

It is petitioner's case that though petitioner continued to place funds by way of investing in and granting of loans and advances to the sister and associate concerns for Assessment Years 2004-05 to 2008-09, the Revenue has not made any disallowance of interest expense in those years thereby accepting that the deployment of funds is for business purpose and/or made out of interest free funds.

3. Petitioner's investment in ICON by way of share application money and by granting loans and advances stood at Rs.9,05,30,529/- as on 31st March 2009. As against this, the interest free funds available stood at Rs.10,86,31,647/-. Petitioner filed its return of income on 30th September 2009 for Assessment Year 2009-10 declaring a total income of Rs.1,79,98,700/-. Intimation was received from the Income Tax Department accepting return of income and granting consequential refund on 21st March 2011.

4. Thereafter petitioner received a notice dated 18th March 2013 from Respondent No.1 under Section 148 of the Income Tax Act (the Act) alleging that he had reason to believe that petitioner's income chargeable to tax for Assessment Year 2009-10 has escaped assessment. Petitioner was also provided with reasons to believe vide communication dated 15th March 2013. The reasons to believe read as under :

Date : 15.03.2013

A survey u/s. 133A of the IT Act was conducted in the case of M/s.Gita Refractories Pvt. Ltd. In this regard information is received from ITO, Ward 11(2), Bangalore that M/s. Vaman Prestressing Co. Pvt. Ltd. is a group company of M/s. Gita Refractories Pvt. Ltd. During the course of Survey u/s. 133A of the IT Act it was seen that M/s. Vaman Prestressing Pvt. Ltd. had advance a loan of Rs.8.05 crores as on 31.03.2009 to associate and sister concerns without charging any interest. Similarly an amount of Rs. 1 Crore as on 31.03.2009 was advanced to sister concerns without charging interest as share application money. It is also seen that the assessee company had borrowed an amount of Rs.6.18 crores as on 31.03.2009 and interest of Rs.1.21 crores is charged off for A.Y. 2009-10. Considering the above, it is seen that the borrowed capital is advanced to sister concerns and associate concerns without charging any interest. Therefore, interest claimed on borrowed capital is not allowable u/s. 36(1)(iii) of the IT Act.

Hence, I have reason to believe that income has escaped assessment within the meaning of section 147 of the I.T. Act.

Issue notice u/s. 148 of the I.T. Act.

*(Abhyuday A Anand, I.R.S)
Asstt. Commissioner of Income Tax 2(3)
Mumbai*

5. Petitioner filed its objections vide its communication dated 13th July 2013 and 16th October 2013 explaining that the advances to sister concern and associate concern have been made by utilizing its own funds and there are no borrowed capital that was advanced to sister concern. It

was also stated that even for the Assessment Year 2003-04 in petitioner's own case the Bombay High Court had dismissed the appeal filed by the department where the department had taken similar plea that assessee has utilized interest bearing funds for the purpose of advancing an amount of Rs.2.20 Crores towards share application money. It was also pointed out that for Assessment Years 2007-08 and 2008-09 orders have been passed under Section 143(3) of the Act where, on identical facts, no addition has been made on account of interest in respect of share application money and loans and advances to associate concern as the same have been accepted as having been made out of assessee's own funds and therefore, the reason for forming the belief that income has escaped assessment for Assessment Year 2009-10 is incorrect and consequential notice issued under Section 148 of the Act is invalid.

6. Petitioner's objections were rejected by an order dated 27th November 2013 without considering any of the submissions of petitioner. Though the submissions have been reproduced in the order it has been rejected only on the ground that since there was no assessment done in the aforesaid case the department had no occasion to verify the veracity of the claim made in the income tax return. The Assessing Officer (A.O.) concluded, relying upon *Assistant Commissioner of Income-Tax vs. Rajesh Jhaveri Stock Brokers Pvt. Ltd.*¹ that where no regular assessment was done

1 2007 (291) ITR 500 (SC)

and only summary order under Section 143(1) of the Act was done, the case can be re-opened under Section 147 of the Act. The A.O. also held that the proceedings of earlier years and findings of the Appellate Authority in the year 2003-04 or by A.O. in the year 2007-08 and 2008-09 have a bearing only at the time of assessment to be undertaken in those proceedings and not on the issuance of notice under Section 148 of the Act as the requirement of law is that the A.O. should have reasons to believe that income has escaped assessment and sufficiency of reason is not required for issuance of notice.

7. It is this order dated 27th November 2013 along with notice dated 18th March 2013 that was issued under Section 148 of the Act, which are impugned in the petition. Subsequently, a notice under Section 142(1) of the Act was also issued to petitioner.

8. The petition came to be admitted by an order dated 25th June 2014 and Ad-interim relief was granted. Respondent no.1 was directed not to take further steps pursuant to the notice issued under Section 148 and Section 142(1) of the Act. During the pendency of the petition proceedings under Section 153(A) of the Act against petitioner was commenced and assessment order dated 27th March 2015 under Section 153(A) read with Section 143(3) of the Act has been passed. By the said assessment order the returns of petitioner for Assessment Year 2009-10 has been accepted as

filed. Pursuant to the leave granted by this court, the petition was amended on 23rd February 2022. No reply has been filed at all either to the petition as originally filed or to the amended portion.

9. Mr. Pardiwalla submitted as under :

(a) The A.O. must have formed belief that assessee's income chargeable to tax has escaped assessment, such belief formed by the A.O. must be based on relevant material and unless the jurisdictional requirements are fulfilled the assumption of jurisdiction to reassess petitioner's income is illegal.

(b) No part of income chargeable to tax has escaped assessment. Petitioner had advanced a loan of Rs.8.05 Crores as on 31st March 2009 to associate and sister concern without charging any interest. Similarly as on that date an amount of Rs.1 Crore was advanced to the sister concern without charging interest as share application money. Petitioner had borrowed funds which as on 31st March 2009 stood at Rs.9.48 Crores and it had claimed deduction towards interest for Assessment Years 2009-10 of Rs.1.21 Crores.

According to Respondent No.1 since the borrowed capital of petitioner was advanced to sister and associate concern without charging any interest, the interest paid on borrowed capital was not allowable as a deduction under Section 36(1)(iii) of the Act which showed that petitioner's income chargeable to tax as escaped assessment. There is no basis for this belief to be formed. Similarly stand of Revenue has been rejected by the CIT[A] as

well as the ITAT in petitioner's own case for Assessment Year 2003-04.

(c) As held by the Hon'ble Apex Court in *S.A. Builders Ltd. Vs. Commissioner of Income Tax (Appeals) and Another*², in order to decide whether interest on funds borrowed by the assessee to give an interest free loan to sister concern should be allowed as a deduction under Section 36(1) (iii) of the Act, one has to enquire whether the loan was given by the assessee as a measure of commercial expediency. The expression "commercial expediency" is one of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. Even if the expenditure may not have been incurred under any legal obligation, yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency.

(d) In *S.A. Builders Ltd.* (supra) the court held that where there was nexus between the expenditure and purpose of the business (which need not necessarily be the business of assessee itself) the A.O. cannot justifiably claim to put himself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is the reasonable expenditure having regard to the circumstances of the case.

In the case at hand the fact that the amount was advanced as interest free loan to associate concern is not disputed by the Revenue for the Assessment Year 2003-04. The CIT[A] and the ITAT have accepted that those were commercial expediency for 2007-08 and 2008-09 as assessment

² [2007] 288 ITR 1 (SC)

orders under Section 143(3) have been passed accepting returns as filed and therefore the commercial expediency could not be disputed.

(e) In *Prashant S. Joshi vs. Income Tax Officer and Another*³, the court held that the basic postulate which underlines Section 147 of the Act is the formation of belief by the Assessing Officer that any income chargeable to tax has escaped assessment for any assessment year. The Assessing Officer must have reasons to believe that such is the case before he proceeds to issue a notice under Section 147 of the Act. The reasons which are recorded by the Assessing Officer for reopening an assessment are the only reasons which can be considered when the formation of the belief is impugned. The touchstone to be applied is whether there was reason to believe that income had escaped assessment. The sufficiency of the evidence or material is not open to scrutiny by the court but the existence of the belief is the *sine qua non* for a valid exercise of power. In the facts and circumstances of the case and as per the law laid down by the court it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment. The reasons which have been recorded could never have led a prudent person to form an opinion that income had escaped assessment within the meaning of Section 147 of the Act.

10. Mr. Suresh Kumar submitted as under :

(a) Since there is no assessment done in the aforesaid case the

³ [2010] 324 ITR 154 (Bom)

department had no occasion to verify the veracity of the claim made in the income tax returns. As held by the Hon'ble Apex Court in *Rajesh Jhaveri Stock Brokers Pvt. Ltd.* (supra) where no regular assessment was done and only summary order under Section 143(1) of the Act was done, the case can be re-opened under Section 147 of the Act.

(b) The proceedings of earlier years and findings of the Appellate Authority for Assessment Year 2003-04 or by the A.O. in the year 2007-08 and 2008-09 have a bearing only at the time of assessment to be undertaken in those proceedings and not on the issuance of notice under Section 148 of the Act. This is because the requirement of law is that the A.O. should have reason to believe that the income has escaped assessment and sufficiency of reason is not required for issuance of notice.

(c) Let the proceedings continue further and petitioner can go and make all submissions.

Findings/Conclusions :

11. The law as laid down by the Hon'ble Apex Court in *S.A. Builders Ltd.* (supra) is very clear that where the loan has been given to sister concern or associate concern of the assessee as a measure of commercial expediency by using borrowed funds, the interest on such borrowed funds should be allowed as deduction under Section 36(1)(iii) of the Act. The Hon'ble Apex Court in *S.A. Builders Ltd.* (supra) has also held that the expression "commercial expediency" is one of wide import and

includes such expenditure as a prudent businessman incurs for the purpose of business. Even if the expenditure may not have been incurred under any legal obligation yet it is allowed as business expenditure if it was incurred on grounds of commercial expediency. But what is commercial expediency depends on facts and circumstances of each case. In fact in *S.A. Builders Ltd.* (supra) the Hon'ble Apex Court also has put a caveat "We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case."

12. In *Prashant S. Joshi* (supra) the Division Bench of this court held that the Assessing Officer must have reasons to believe that income has escaped assessment and at that stage an established fact that income has escaped assessment is not required. The only question, at the stage of issuing notice is whether there was relevant material on which a reasonable person could have formed a requisite belief and whether the materials would conclusively prove the escapement is not the concern at that stage because formation of belief by the Assessing Officer is within the realm of subjective satisfaction. The court held that some time the touchstone to be applied is whether there was reason to believe that income had escaped assessment. The Division Bench also held that the act of taking notice cannot be at the arbitrary whim or caprice of the Assessing Officer and must be based on a reasonable foundation. The sufficiency of the evidence or

material is not open to scrutiny by the court but the existence of the belief is the *sine qua non* for a valid exercise of power. In the facts and circumstances of that case, the Division Bench held that it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment.

13. In *Commissioner of Income Tax vs. Kelvinator of India Ltd.*⁴ the Hon'ble Apex Court held that the Assessing Officer has power to reopen provided there is tangible material to come to the conclusion that there is escapement of income from assessment. The reasons must have a live link with the formation of the belief.

14. In *Export Credit Guarantee Corporation of India Ltd. vs. Additional Commissioner of Income Tax and Others*⁵, the court held that when an assessment is sought to be reopened within a period of four years from the end of the relevant assessment years, the test to be applied is whether there is tangible material to do so. What is tangible is something which is not illusory, hypothetical or a matter of conjecture. Something which is tangible need not be something which is new. An Assessing Officer who has plainly ignored the relevant material and arrived at an assessment acts contrary to the law. If there is an escapement of income in consequence, the jurisdictional requirement of Section 147 of the Act would

4 (2010) 320 ITR 561 (SC)

5 (2013) 350 ITR 651 (Bom)

be fulfilled on the formation of a reason to believe that income has escaped assessment.

15. Did the A.O. have any tangible material to reopen the assessment in this case is a question which we have to answer. The reasons to believe is purely on the basis that petitioner has advanced borrowed capital to sister concern and associate concern without charging any interest and therefore the interest claimed on borrowed capital is not allowable under Section 36(1)(iii) of the Act.

16. The law on this is settled in as much as in *S.A. Builders Ltd.* (supra), the Hon'ble Apex Court was considering an almost identical situation. The assessee in that case had transferred a huge amount of Rs.82 Lakhs to its subsidiary company out of the Cash Credit Account of the assessee in which there was a huge debit balance. The Assessing Officer held that since the assessee had diverted its borrowed funds to a sister concern without charging any interest, proportionate interest relating to the said amount out of total interest paid to the bank deserved to be disallowed and he disallowed a particular sum. The Hon'ble Apex Court held that extending such a loan would fall under the expression used for the purpose of business. If the amount has been advanced as a measure of commercial expediency, the interest on funds borrowed by the assessee should be allowed as deduction under Section 36(1)(iii) of the Act. Paragraph Nos. 19

to 36 of *S.A. Builders Ltd.* (supra) read as under :

19. *We have considered the submission of the respective parties. The question involved in this case is only about the allowability of the interest on borrowed funds and hence we are dealing only with that question. In our opinion, the approach of the High Court as well as the authorities below on the aforesaid question was not correct.*

20. *In this connection we may refer to Section 36(1)(iii) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') which states that "the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession" has to be allowed as a deduction in computing the income tax under Section 28 of the Act.*

21. *In Madhav Prasad Jantia vs. Commissioner of Income Tax U.P. AIR 1979 SC 1291, this Court held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains", and this has been the consistent view of this Court.*

22. *In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income Tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) on interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.*

23. *In our opinion, the decisions relating to Section 37 of the Act will also be applicable to Section 36(1)(iii) because in Section 37 also the expression used is "for the purpose of business". It has been consistently held in decisions relating to Section 37 that the expression "for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.*

24. *Thus in Atherton vs. British Insulated & Helsby Cables Ltd (1925)10 TC 155 (HL), it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case (supra) has been approved by this Court in several decisions e.g. Eastern Investments Ltd. vs. CIT (1951) 20 ITR 1, CIT vs. Chandulal Keshavlal & Co. (1960) 38 ITR 601 etc.*

25. *In our opinion, the High Court as well as the Tribunal and other Income Tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister*

company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

26. The expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent business-man incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency.

27. No doubt, as held in Madhav Prasad Jantia vs. CIT (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under Section 36(1)(iii) of the Act. In Madhav Prasad's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this Court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

28. Thus, the ratio of Madhav Prasad Jantia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under Section 36(1)(iii) of the Act.

29. In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.

30. It has been repeatedly held by this Court that the expression "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits" vide CIT vs. Malayalam Plantations Ltd. (1964) 53 ITR 140, CIT vs. Birla Cotton Spinning & Weaving Mills Ltd. (1971) 82 ITR 166 etc.

31. The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done.

32. It is true that the borrowed amount in question was not utilized by the assessee in its own business, but had been advanced as interest free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is whether the assessee advanced such amount to its sister concern as a measure of commercial expediency.

33. Learned counsel for the Revenue relied on a Bombay High Court decision in Phaltan Sugar Works Ltd. Vs. Commissioner of Wealth-Tax (1994) 208 ITR 989 in which it was held that deduction under Section 36(1)(iii) can only be allowed on the interest if the assessee borrows capital for its own business. Hence, it was held that interest on the borrowed amount could not be allowed if such amount had been advanced to a subsidiary company of the assessee. With re-

spect, we are of the opinion that the view taken by the Bombay High Court was not correct. The correct view in our opinion was whether the amount advanced to the subsidiary or associated company or any other party was advanced as a measure of commercial expediency. We are of the opinion that the view taken by the Tribunal in Phaltan Sugar Works Ltd (supra) that the interest was deductible as the amount was advanced to the subsidiary company as a measure of commercial expediency is the correct view, and the view taken by the Bombay High Court which set aside the aforesaid decision is not correct.

34. Similarly, the view taken by the Bombay High Court in *Phaltan Sugar Works Ltd. vs. Commissioner of Wealth-Tax*(1995) 215 ITR 582 also does not appear to be correct.

35. We agree with the view taken by the Delhi High Court in *CIT vs. Dalmia Cement (Bhart) Ltd. (2002) 254 ITR 377* that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

36. We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.

(emphasis supplied)

17. In this case, from 2003-04 itself petitioner has been granting loans and advances to sister and associate concerns. Even for Assessment

Years 2004-05 to 2008-09, the Revenue has not made any disallowance of interest expense in those years thereby accepting that the deployment of funds is for business purpose. The disallowance made during Assessment Year 2003-04 has been set aside in appeal by CIT[A] as well as the ITAT. Moreover there can be no other reason but commercial expediency for petitioner to give loans and advances and capital to ICON. The Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how a prudent businessman should act. The authorities must not look at the matter from their own point of view but that of a prudent businessman.

In view of what is recorded above, it is evident that there was absolutely no basis to respondent no.1 to form a belief that any income chargeable to tax has escaped assessment within the meaning of substantive provisions of Section 147 of the Act. As held by this court in *Prashant S. Joshi* (supra) Explanation 2 to Section 147 creates a deeming fiction of cases where income chargeable to tax has escaped assessment. Clause (b) deals with a situation “where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the A.O. that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.” For the purpose of Clause (b) to Explanation 2, the Assessing Officer must notice that the assessee has understated his income or has claimed excessive loss, deduction, allowance or relief in the return and taking of such notice must be consistent with the

provisions of the applicable law. It cannot be at the arbitrary whim or caprice of the Assessing Officer and must be based on a reasonable foundation. Though the sufficiency of the evidence or material is not open to scrutiny by the court but the existence of the belief is the *sine qua non* for a valid exercise of power. Paragraph No. 20 of *Prashant S. Joshi* (supra) reads as under :

20. For all these reasons, it is evident that there was absolutely no basis for the first respondent to form a belief that any income chargeable to tax has escaped assessment within the meaning of the substantive provisions of section 147. Explanation 2 to section 147 creates a deeming fiction of cases where income chargeable to tax has escaped assessment. Clause (b) deals with a situation “where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.” For the purpose of clause (b) to explanation 2, the Assessing Officer must notice that the assessee has understated his income or has claimed excessive loss, deduction, allowance or relief in the return. The taking of such notice must be consistent with the provisions of the applicable law. The act of taking notice cannot be at the arbitrary whim or caprice of the Assessing Officer and must be based on a reasonable foundation. The sufficiency of the evidence or material is not open to scrutiny by the Court but the existence of the belief is the sine qua non for a valid exercise of power. In the present case, having regard to the law laid down by the Supreme Court it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment. The reasons which have been recorded could never have led a prudent person to form an opinion that income had escaped assessment within the meaning of section 147. In these circumstances, the petition shall have to be allowed by setting aside the notice under section 148.

(emphasis supplied)

19. In the present case, having regard to the law laid down by the Hon’ble Apex Court in *S.A. Builders Ltd.* (supra) it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment. The reasons which have been recorded could never have led a

prudent person to form an opinion that income had escaped assessment within the meaning of Section 147 of the Act.

20. Even when those points were raised in the objections to the reopening notice filed by petitioner, Respondent No.1 instead of dealing with the objections and submissions simply dismissed the same by saying that since there was no assessment done in the aforesaid case the department had no occasion to verify the veracity of the claim made in the income tax returns and all those points only have a bearing at the time of assessment to be undertaken in the proceedings and not on the issuance of notice under Section 148 of the Act. We fail to understand why these decisions could not have been taken at this stage itself so that the A.O., having regard to the law laid down by the courts and on the submissions made by petitioner, could have discharged the notice dated 18th March 2013 issued under Section 148 of the Act. There is no reason to postpone it to the assessment proceedings stage.

21. In these circumstances, the petition shall have to be allowed by setting aside the notice under Section 148 of the Act as well as the impugned order dated 27th November 2013.

22. Rule is made absolute accordingly. There shall be no order as to costs.

23. Petition disposed.

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24. The facts and circumstances in this case are almost identical to that in Writ Petition No. 947 of 2014 except it pertains to the Assessment Year 2010-11 and the amounts vary. The reasons to believe there is escapement of income from assessment is identical to that in the Writ Petition No. 947 of 2014 except that the amounts vary.

25. Rule was issued in this petition also on 25th June 2014.

26. Our discussion and conclusion in Writ Petition No. 947 of 2014 will squarely apply here also. Hence, Rule is made absolute. No order as to costs.

27. Petition disposed.

(DR. N.K. GOKHALE, J.)

(K.R. SHRIRAM, J.)