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W.P. No.10673 of 2021

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 23.02.2024

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THE HONOURABLE MR.JUSTICE MOHAMMED SHAFFIQ

W.P. No.10673 of 2021

and

W.M.P. Nos.11291, 11294, 11295 and 11298 of 2021

Madras Craft Foundation Society,
Represented by its Authorised Signatory
G-3, Madhuras Flats, 6, Urur Olcott Road,
Besant Nagar, Chennai-600 090,
Tamil Nadu, India.

..Petitioner

Vs.

1.Commissioner of Income Tax (Exemptions),
Chennai.

2.Income Tax Officer,
Exemptions Ward 4,
Chennai.

..Respondents

PRAYER: Writ Petition filed under Article 226 of the Constitution of India, praying to issue a Writ of Certiorarified Mandamus calling for the records of the 1st Respondent contained in its order dated 31.03.2021 for PAN:AAATM4780D with respect to Assessment Year 2016-17 bearing DIN and Letter No:ITBA/COM/F/17/2020-21/1032120554(1) and quash the same as arbitrary, unjust and illegal and consequently direct the



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cancellation of the additions made in the assessment order contained in Order No:ITBA/AST/S/143(3)/2018-19/1013545851(1) dated 09.11.2018 for PAN:AAATM4780D with respect to Assessment Year 2016-17 issued by the 2nd Respondent.

For Petitioner : Mr.Suhrith Parthasarathy

For Respondents : Mr.V.Mahalingam
Senior Standing Counsel

ORDER

The writ petition is filed challenging the order of the 1st Respondent under Section 264 of the Income Tax Act, 1961 (hereinafter referred to as “the Act”) on the premise that the impugned order fails to see that the order of assessment under Section 143(3) of the Act dated 09.11.2018 insofar as the order travels beyond the limited scrutiny issue is contrary to Instruction No.20 of 2015 dated 29.12.2015 and Instruction No.5 of 2016 dated 14.07.2016, thereby rendering it illegal and bad.

2. The petitioner is a society registered under Section 12AA of the Act. The petitioner filed its return of income electronically for the assessment year 2016-17 on 27.09.2016 reporting “NIL” income with gross receipts of Rs.2,50,80,909/-. Subsequently, the petitioner's case



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was selected for “limited scrutiny” under CASS specifically, to examine “whether depreciation had been correctly claimed in its return of income”. A notice under Section 143(2) of the Act was issued on 27.07.2017, followed by a notice under Section 142(1) of the Act issued on 04.05.2018 calling for specific details. In response to the said notice, the petitioner's authorized representative appeared on more than one occasion and produced the details called for. In the meantime, the 2nd Respondent issued a notice under Section 142(1) of the Act dated 09.05.2018 in which it sought for certain other details. Thereafter, the 2nd Respondent passed an assessment order dated 09.11.2018 under Section 143(3) of the Act, and determined the petitioner's income as Rs.32,72,038/- after disallowing / modifying the petitioner's claim of exemption under Section 11(2) of the Act. The claim of exemption under Section 11(2) of the Act was modified / disallowed on the premise that a sum of Rs.26,86,786/- represents accumulation during the relevant financial year, with regard to which the petitioner had not filed Form No.10 which is stated in the order of assessment as necessary to claim exemption under Section 11(2) of the Act. It was further found in the order of assessment that set off of excess expenditure over income



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incurred in earlier years can be adjusted against the income of the current year provided the excess expenditure is over and above the total revenue receipts during the year. However, there is no excess application in any of the earlier years and thus the adjustment during the assessment year 2016 - 17 is unsustainable. The following portions of the impugned order of assessment is relevant and thus extracted hereunder :

“3.2. Set off of excess expenses over income incurred in earlier years can be adjusted against the income of the current year. It is explicitly clear that, the excess expenditure over and above the income means that excess expenditure over and above the total revenue receipts during the year. It is noticed from the accumulation schedule that, there is no excess application in any of the earlier years. The assessee trust has taken expenditure in excess of 85% of the gross receipts, for the purpose of carry forward of excess application of funds and adjustment. Only when the total application of income exceeds 100% of the gross receipts, the excess application of income is allowed to be carried forward and adjusted from the shortfall in the subsequent years. In the instant case, there is no question of excess application in any of the earlier years and hence, no adjustment of excess application against the shortfall is possible during this year.”

3. Aggrieved by the order dated 09.11.2018 passed by the 2nd

Respondent, the petitioner filed a petition under Section 264 of the Act before the 1st Respondent on 12.02.2020. It was submitted that the



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assessment order passed under Section 143(3) of the Act was without jurisdiction inasmuch as the 2nd Respondent expanded the scope of the scrutiny which was limited to examining whether the depreciation has been correctly claimed in its return of income by proceeding to examine the claim of the petitioner under Section 11(2) of the Act without obtaining the approval of the Principal Commissioner as contemplated in Instruction No.20 of 2015 and 5 of 2016 issued under Section 119 of the Act. It was thus submitted in expanding its jurisdiction beyond “limited scrutiny issue”, the 2nd Respondent had acted in breach of a slew of circulars issued by the Central Board of Direct Taxes (hereinafter referred to as “CBDT”).

3.1. The impugned order is passed under Section 264 of the Act by the 1st Respondent rejecting the above contentions raised by the petitioner on the following premise viz.,

a) That the assessing officer had only reworked the computation part at the time of completion of the scrutiny assessment.

b) That the requirement of approval of the Principal Commissioner in expanding the scope of limited scrutiny is required only in cases where



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“potential escapement of income” is noticed by the assessing officer on the basis of information and not for computation of income.

3.2. The relevant portion of the order of the 1st Respondent is extracted hereunder:

“the assessing officer has reworked the computation part at the time of completion of the scrutiny assessment. As per Circular No.5/2016, the approval is required wherein potential escapement of income is noticed by the assessing officer on the basis of information and not for computation of income. Hence this ground of the assessee is not acceptable and the stand of the assessing officer is correct.”

3.3. It is this order of the 1st Respondent which is assailed in this writ petition.

4. Before proceeding further, it may be relevant to extract the relevant portions of the notice issued to initiate limited scrutiny and also the order of assessment dated 09.11.2018 which was challenged on the ground of travelling beyond the scope of “limited scrutiny”.

(i) Notice under Section 143(2) of the Act

Limited Scrutiny (Computer Aided Scrutiny Selection)

Following issue(s) have been identified for examination:

“Whether depreciation has been correctly claimed in return of income”



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ii) Assessment order under Section 143(3) of the Act:

“2. The assessee is engaged in the charitable activity. The issue of discussed and the AR filed the details of expenses claimed under Section 57.

3. During the course of assessment proceedings, it is seen that there is an accumulation of Rs.26,86,786/- during the relevant financial year. In order to claim the accumulation as exempt under Section 11(2) of the Act, the assessee has to file the Form No.10.

.....

In the instant case, the assessee has not filed the Form no.10 electronically. Hence, it is seen that, the assessee has failed to comply with the provisions as laid in Section 11(2) and Rule 17.

3.1. However, the assessee trust has requested to adjust the shortfall in application against the excess application made during the earlier years.

.....

3.2. Set off of excess expenses over income incurred in earlier years can be adjusted against the income of the current year. It is explicitly clear that, the excess expenditure over and above the total revenue receipts during the year. It is noticed from the accumulation schedule that, there is no excess application in any of the earlier years. The assessee trust has taken expenditure in excess of 85% of the gross receipts, for the purpose of carry forward of excess application of funds and adjustment. Only when the total application of income exceeds 100% of the Gross receipts, the excess application of income is allowed to be carried forward and adjusted from the shortfall in the subsequent years. In the instant case, there is no question of excess application in any of the earlier years and hence, no adjustment of excess application against the shortfall is possible during this year.”

4.1. From a reading of the notice issued under Section 143(2) of the Act for “limited scrutiny”, and the order of assessment dated 09.11.2018, it appears that while the limited scrutiny was to examine whether depreciation has been correctly claimed in the return of income,



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the impugned order of assessment proceeds to examine and modify the claim of exemption under Section 11(2) of the Act by making additions.

4.2. The reasoning of the 1st Respondent that the requirement of approval of the Principal Commissioner to expand the scope of limited scrutiny is required only in cases “where potential escapement of income is noticed” by the assessing officer is erroneous. While Instruction No.20 of 2015 provided that the scope of enquiry shall be confined to limited scrutiny issues, it provided that, if in the course of assessment proceedings in limited scrutiny there is potential escapement of income requiring substantial verification then the same may be taken up for complete scrutiny after obtaining the approval of Pr.CIT/CIT. The CBDT vide subsequent Instruction/ Circular No. 5 of 2016 dated 14.07.2016 has provided that conversion of limited scrutiny to complete scrutiny shall be made after obtaining the approval even in a case where there is possibility of under-assessment, if the case is not examined under complete scrutiny. The relevant portions of the above Instructions are extracted hereunder:

i) Instruction No.20 of 2015 dated 29.12.2015:

“3. As far as the returns selected for scrutiny through CASS-



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2015 are concerned, two type of cases have been selected for scrutiny in the current financial year - one is “limited scrutiny” and other is “complete scrutiny”, the assessee concerned have duly been intimated about their case falling either in “limited scrutiny” or “complete scrutiny” through notices issued under Section 143(2) of the Act. The procedure for handling “limited scrutiny” cases shall be as under:

a. In “limited scrutiny” cases, the reasons/ issues shall be forthwith communicated to the assessee concerned.

b. The questionnaire under Section 142(1) of the Act in “limited scrutiny” cases shall remain confined only to the specific reasons/ issues for which case has been picked up for scrutiny. Further, the scope of enquiry shall be restricted to the “limited scrutiny” issues.

.....

d. During the course of assessment proceedings in “limited scrutiny” cases, if it comes to the notice of the assessing officer that there is potential escapement of income exceeding Rs.5 lakhs (for metro charges, the monetary limit shall be Rs.10 lakhs) requiring substantial verification on any other issue(s), then, the case may be taken up for “complete scrutiny” with the approval of the Pr.CIT/CIT in writing after being satisfied about merits of the issue(s) necessitating “complete scrutiny” in that particular case. Such cases shall be monitored by the range head concerned. The procedure indicated at points(a), (b) and (c) above shall no longer remain binding in such cases. (For the present purpose, “metro charges” would mean Delhi, Mumbai, Chennai, Kolkata, Bengaluru, Hyderabad and Ahmedabad).”

ii) Instruction No.5 of 2016 dated 14.07.2016:

“2. In order to ensure that maximum objectivity is maintained in converting a case falling under “limited scrutiny” into a “complete scrutiny” case, the matter has been further examined and in partial modification to para. 3(d) of the earlier order dated 29.12.2015, Board hereby lays down that while proposing to take up “complete scrutiny” in a case which was originally earmarked for “limited scrutiny”, the assessing officer (“AO”) shall be required to form a reasonable view that there is possibility of underassessment of income if the case is not examined under “complete scrutiny”. In this regard, the monetary limits and requirement of administrative approval from Pr.CIT/ CIT/ Pr.DIT/ DIT as prescribed in para. 3(d) of earlier Instruction dated 29.12.2015, shall continue to remain applicable.”

(emphasis supplied)



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5. If one bears in mind that right to exemption is a substantive right, it appears that the impugned order of assessment travels beyond the scope of “limited scrutiny”, which was confined to examine the correctness of the claim of depreciation insofar as it proceeds to examine the claim of exemption under Section 11(2) of the Act. Admittedly, the claim of depreciation which was the limited scrutiny issue and that of exemption under Section 11(2) of the Act are distinct and independent. It is not in dispute that the approval of the Pr.CIT / CIT was not obtained while expanding the scope of limited scrutiny as provided under Instructions No.20 of 2015 and No.5 of 2016. The above instruction makes it clear that under limited scrutiny, the scope of enquiry shall be confined to limited scrutiny issue which in the present case is whether the depreciation has been correctly claimed in the return of income. Thus, the order of assessment insofar as it proceeds to examine the claim of exemption under Section 11(2) of the Act travels beyond the limited scrutiny issue and thus contrary to Instruction No.20 of 2015 dated 29.12.2015 and Instruction No. 5 of 2016 dated 14.07.2016 thereby vitiating the order of assessment which was lost sight of by the 1st



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Respondent while rejecting the petitioner's application under Section 264 of the Act.

5.1. It may be relevant to refer to Section 119(1) of the Act, which reads as under:

“119. Instructions to subordinate authorities.—(1) The Board may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act, and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board:

Provided that no such orders, instructions or directions shall be issued—

(a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or

*(b) so as to interfere with the discretion of the *** [Commissioner (Appeals)] in the exercise of his appellate functions.”*

5.2. A reading of the above provision would show that the authorities under the Act shall observe and follow the instructions and the directions of the Board made in exercise of the power under Section 119 of the Act which are binding. It may be relevant to refer to the following judgments of the Hon'ble Supreme Court in this regard:

i) Union of India v. Azadi Bachao Andolan reported in [(2004) 10 SCC 1],

wherein a circular was issued by CBDT under Section 119 of the Income Tax Act,



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1961. It was challenged inter alia on the ground that it was ultra vires the provisions of Section 119(1). The argument was rejected by the Hon'ble Supreme Court in the following words:

“47. It was contended successfully before the High Court that the circular is ultra vires the provisions of Section 119. Sub-section (1) of Section 119 is deliberately worded in a general manner so that CBDT is enabled to issue appropriate orders, instructions or directions to the subordinate authorities ‘as it may deem fit for the proper administration of this Act’. As long as the circular emanates from CBDT and contains orders, instructions or directions pertaining to proper administration of the Act, it is relatable to the source of power under Section 119 irrespective of its nomenclature. Apart from sub-section (1), sub-section (2) of Section 119 also enables CBDT

‘for the purpose of proper and efficient management of the work of assessment and collection of revenue, to issue appropriate orders, general or special, in respect of any class of income or class of cases, setting forth directions or instructions (not being prejudicial to the assessee) as to the guidelines, principles or procedures to be followed by other Income Tax Authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties’.

In our view, the High Court was not justified in reading the circular as not complying with the provisions of Section 119. The circular falls well within the parameters of the powers exercisable by CBDT under Section 119 of the Act.”

27. Lastly, the binding effect of the said Circular No. 16/98 needs to be kept in mind. As stated above, the said circular was issued by the Board by exercising statutory powers vested in it under Section

3(1-A). As stated above, Section 3(1-A) provides for an enabling power of the Board which was recognised as an authority under the 1963 Act. The said power was to be exercised in special cases. As stated above, granting of administrative reliefs by the Board came within its authority. As stated above, the said circular was issued for just and



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fair administration of the 1963 Act. As stated above, Section 3(1-A) is similar to Section 119(1) of the 1961 Act. The circulars of this nature are issued by the Board consisting of highest senior officers in the Revenue Department. These circulars are to be respected by the officers working under the supervision of the Board. These circulars are binding on all the authorities administering the Tax Department. The power of the Board to issue such circular is traceable to Section 3(1-A)(c) of the Act. The said circular is statutory in nature. Therefore, it is binding on the Department though not on the courts and the assesseees. In the present case, as stated above, completed assessments were sought to be reopened by the AO on the ground that the said Circular No. 16/98 was not binding. Such an approach is unsustainable in the eye of the law. If the State Government was of the view that such circulars are illegal or that they are ultra vires Section 3(1-A), which it is not, it was open to the State to nullify/withdraw the said circular under Section 60 of the 1963 Act. Till today, the circular continues to remain in force. Till today, it has not been withdrawn. In the circumstances, it is not open to the officers administering the law working under the Board of Revenue to say that the said circular is not binding on them. If such a contention was to be accepted, it would lead to chaos and indiscipline in the administration of tax laws.

(emphasis supplied)

ii) UCO Bank v. CIT, reported in (1999) 4 SCC 599 :

“17. We do not see any inconsistency or contradiction between the circular so issued and Section 145 of the Income Tax Act. In fact, the circular clarifies the way in which these amounts are to be treated under the accounting practice followed by the lender. The circular, therefore, cannot be treated as contrary to Section 145 of the Income Tax Act or illegal in any form. It is meant for a uniform administration of law by all the Income Tax Authorities in a specific situation and, therefore, validly issued under Section 119 of the Income Tax Act. As such, the circular would be binding on the Department.”

5.3. The judgment of the Hon'ble Supreme Court in the case of

Azadi Bachao Andolan was followed in the case of *State of Kerala v.*



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Kurian Abraham (P) Ltd., reporeted in (2008) 3 SCC 582.

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6. As found supra, the assessment order under Section 143(3) of the Act is made in disregard and contrary to the binding instructions viz., Instruction No.5 of 2016 and Instruction No.20 of 2015, insofar as the impugned order travels beyond the scope of limited scrutiny admittedly without obtaining the approval of the Pr.CIT / CIT, an aspect overlooked by the 1st Respondent. The order of assessment dated 09.11.2018 insofar as it travels beyond the scope of “limited scrutiny” without obtaining the approval of Pr.CIT / CIT, is contrary to the binding Circular / Instructions an infirmity which is fatal to the very validity of the order of assessment which is lost sight of by the 1st Respondent insofar as it confirms the order of assessment dated 09.11.2018. The impugned order passed by the 1st Respondent is thus liable to be set aside.

7. In view of the above, the impugned order of the 1st Respondent insofar as it rejects the challenge to the order of assessment is set-aside. Consequently, the order of assessment dated 09.11.2018 insofar as the additions made by modifying the claim of exemption under Section 11(2)



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of the Act is also set-aside inasmuch as it travels beyond the limited scrutiny issue without obtaining the approval of Pr.CIT/ CIT. The writ petition is disposed of on the above terms. It is however open for the Respondents to proceed in accordance with law. No costs. Consequently, connected miscellaneous petitions are closed.

23.02.2024

Speaking (or) Non Speaking Order

Index: Yes/No

Neutral Citation: Yes/No

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To:

1. The Commissioner of Income Tax (Exemptions),
Chennai.
2. The Income Tax Officer,
Exemptions Ward 4,
Chennai.



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MOHAMMED SHAFFIQ, J.

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