



IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 21ST DAY OF JANUARY 2016

PRESENT

THE HON'BLE MR.JUSTICE N K PATIL

AND

THE HON'BLE MRS.JUSTICE S SUJATHA

ITA Nos.68/2014 c/w 67/2014

BETWEEN

1. The Commissioner of Income-tax
C R Building
Queens Road
Bangalore
2. The Assistant Commissioner of Income-Tax
Circle-1(1)
No.59, HMT Bhavan
6TH Floor, Bellary Road
Ganganagar
Bangalore-560 032.Common Appellants

(By Sri.K.V. Aravind, Advocate)

AND

M/s. Saravana Developers
No.357, 3RD Cross
Cambridge Layout, Ulsoor
Bangalore-560 008.Common Respondent

(By Sri. A. Shankar & M.Lava, Advocates)

ITA No.68/2014 is filed under Section 260-A of Income-tax Act, 1961, praying to set aside the order passed by the ITAT, Bangalore in ITA No.48/Bang/2013

dated:06/09/2013 and confirm the order of the Appellate Commissioner confirming the order passed by the Assistant Commissioner of Income-tax circle-1(1), Bangalore.

ITA No.67/2014 is filed under Section 260-A of Income-tax Act, 1961, praying to set aside the order passed by the ITAT, Bangalore in ITA No.620/Bang/2011 dated:06/09/2013 and confirm the order of the Appellate Commissioner confirming the order passed by the Assistant Commissioner of Income-tax circle-1(1), Bangalore.

These appeals having been heard and reserved for Judgment on 18TH January 2016, coming on for pronouncement of Judgment this day, **S. Sujatha J.**, delivered the following

JUDGMENT

These appeals are filed by the revenue under Section 260A of the Income Tax Act, 1961 (the "Act" for short) assailing the common order passed by the Income Tax Appellate Tribunal (ITAT), Bangalore Bench – C relating to the assessment year 2006-07.

2. The facts in brief:

- the assessee is a firm engaged in the business of formation and development of residential layouts and sale of sites. The assessee filed a return of income of Rs.37,34,104, subsequently, revised at Rs.2,77,39,713/-. In the course of assessment proceedings, the assessee filed a revised computation of income of Rs.37,34,104/-. The assessment

under Section 143(3) of the Act was concluded on 31.12.2008 accepting the return income of Rs.37,34,014/-. The Commissioner of Income Tax (CIT) initiated proceedings under Section 263 of the Act as the assessment concluded by the Assessing Officer was erroneous and prejudicial to the interest of revenue. An order was passed under Section 263 of the Act on 21.03.2011, setting aside the assessment order and directed the Assessing Officer to adopt the work-in-progress at Rs.3,01,65,044/- instead of Rs.1,09,29,265/- adopted by the assessee. This order of the CIT was assailed by the assessee before the ITAT. In the meantime, pursuant to the directions of the CIT, (order under Section 263 of the Act), the Assessing Officer took up assessment proceedings for assessment year 2006-07 and passed an order of assessment under Section 143(3) of the Act determining the total income of the assessee at Rs.2,29,69,433/- as against the income of Rs.37,34,014/-. Aggrieved by the said order, the assessee preferred an appeal before the CIT (Appeals), which was dismissed against which, assessee preferred an appeal before the ITAT. These two cases were clubbed and heard together before the ITAT. The ITAT after considering

the rival submissions made by both the parties, set-aside the order under Section 263 passed by CIT dated 21.03.2011. As far as the challenge made by the assessee to the CIT order, relating to the consequential order passed giving effect to the order under Section 263 of the Act, assessee's appeal is allowed since the order passed under Section 263 of the Act is set-aside by the Tribunal in the connected ITA No.620/Bang/2011.

3. Being aggrieved by the said judgment passed by the ITAT, revenue has preferred these appeals, raising the following substantial questions of law:

ITA No.67/2014

1. *"Whether the Tribunal was correct in canceling the order of the CIT Under Section 263 of the IT.Act as bad in law holding that it was not in accordance with the conditions prescribed u/s 263 for initiation of the proceedings without appreciating that the AO had not brought out anything on record while accepting the valuation of closing stock of work-in-progress to indicate he had applied his mind?"*

2. *"Whether the Tribunal was correct in holding that it was right in canceling the order u/s 263 as being bad in law as it was not in accordance with the conditions prescribed in section 263*

and the very initiation of the proceeding was made without appreciating the decisions of the facts on record without appreciating the decisions of the SC in the case M/s. Malabar Industrial Co Limited V/s CIT(2000) 243 IRT 83 and the High Courts in the cases of Mukur Corporation (1978) 111 ITR 312, (Gujarat) and CIT V/s Daga Entrade Private Limited [2010] 327 IRT 467 Guwahati?

ITA No.68/2014

1. "Whether the Tribunal was correct in holding that the assessment u/s 143/(3) r.w.s 263 is rendered infructuous as order u/s 263 has been cancelled without appreciating that the AO had not brought out anything on record while accepting the valuation of closing stock of work-in-progress to indicate he had applied his mind?"

4. Learned counsel Sri K V Aravind, appearing for the revenue would contend that the Assessing Officer had blindly accepted the valuation of closing stock of work-in-progress as submitted by the assessee, without application of mind. Having noticed the same, CIT being satisfied that the assessment order is erroneous and prejudicial to the interest of revenue, passed an order under Section 263 of the Act, after considering the reply filed by the assessee to the show cause notice issued under Section 263 of the Act

and hearing the authorized representatives of the assessee. The Tribunal failed to appreciate the fact that the closing value of work-in-progress has to be worked out based on the development charges during the year and the Assessing Officer, has brought on record that the project developed by the assessee was a single one on a contiguous land area. The assessee has not maintained any separate expenditure for site sold and retained. As such, in the absence of any valid evidence, the action of the Assessing Officer in working out the value of work-in-progress in the assessment order after remand was justifiable. The Tribunal without appreciating the same, set-aside the order passed by the CIT under Section 263 of the Act, allowing the appeals filed by the assessee.

5. The learned counsel placed reliance on the judgment of the Apex Court in the case of **Malabar Industrial Co. Ltd. vs Commissioner of Income Tax** reported in **2000(243) ITR 83** in support of his contention that the Assessing Officer passed the order of assessment accepting the work-in-progress statement of the assessee without application of mind to the case in all perspective.

The order passed by the Assessing Officer is not only an erroneous order, but, is prejudicial to the interest of the revenue, the revenue losing tax lawfully payable by the assessee.

6. Per contra, learned counsel Sri A Shankar, appearing for the assessee supporting the orders passed by the Tribunal would contend that the twin test required to be satisfied for exercising the power under Section 263 of the Act are:

- (i) the order to be revised (Assessment Order) is erroneous
- (ii) it is prejudicial to the interest of the revenue.

However, the two conditions are not satisfied in the present case.

7. The original order passed by the Assessing Officer is in conformity with the provisions of the Act. The Assessing Officer had verified the material placed by the assessee in detail as regards the work-in-progress report. Considering the detailed explanation filed by the assessee for the queries made by the Assessing Officer, the closing work-in-progress report was accepted. This figure of closing work-in-progress was accepted by the departmental

authorities while concluding the assessment under Section 143(3) of the Act for the Assessment year 2007-08. The learned counsel pointing out the distinction between 'lack of inquiry' and 'inadequate inquiry' would contend that even if there was inadequate inquiry, that would not itself be a ground to the CIT to invoke Section 263 of the Act, merely because he has a different opinion in the matter.

8. It is further contended that explanation to Section 263 of the Act inserted by the Finance Act, 2015 with effect from 01.06.2015 provides that the order passed without making enquiries or verification which should have been made, would be a ground for the CIT to invoke the provisions of Section 263 subsequent to 01.06.2015, not relating to the assessment year in question.

9. Learned counsel also contended that the computation made by the CIT to arrive at the value of work-in-progress if considered to be correct, the same would result in declaring the profit of the assessee at 31.80% as against the net profit of more than 8% declared by the assessee. The mode of calculation adopted by the assessee

is explained through the tabular chart depicting the development charges incurred for the assessment years 2005-06 to 2008-09 vis-à-vis land area sold and unsold. It is pointed out that the development charges declared by the assessee for the relevant assessment year in question, works out to Rs.251.11 per sq. ft. whereas, the same is accepted at Rs.299.41/- by the department for the assessment years 2007-08. The computation, if made considering the figures for the four assessment years relating to the issue of development charges, the same comes to more than Rs.251.11/- as claimed by the assessee and in any event, there is no loss to the revenue to initiate proceedings under Section 263 of the Act. In such circumstances, the Tribunal setting aside the order passed by the CIT, does not call for interference by this Court.

10. In support of his contention learned counsel placed reliance on the following Judgments:

(1) *COMMISSIONER OF INCOME TAX vs SUNBEAM AUTO LTD.* ([2011] 332 ITR 167 (Delhi))

(2) *COMMISSIONER OF INCOME-TAX AND ANOTHER vs D.G.GOPALA GOWDA.* ([2013] 354 ITR 501(Karn))

(3) *COMMISSIONER OF INCOME-TAX AND ANOTHER vs DIGITAL GLOBAL SOFT LTD.* ([2013] 354 ITR 489 (Karn))

(4) *CIT AND ANOTHER vs Dr.L.NARENDRA PRASAD* (ITA No.473/2009 disposed of on 18.08.2015)

11. In the light of the above facts and rival contentions advanced by the learned counsel appearing for the parties, we have considered the questions of law raised by the revenue.

12. The assessee firm is in the business of formation and development and sale of sites. The assessee had purchased lands measuring about 16.07 acres in survey numbers 52, 103 and 106 at Neralur, Balegaranahalli Village, Attibele Hobli, Anekal Taluk, The firm as stated to have developed a portion of the land of about 22407 sq. ft. during the period relevant to assessment year 2005-06. Subsequently, the assessee entered into an agreement with M/s Best Constructions for marketing the sites. The project was approved by BMRDA to an extent of 3,84,000 sq. ft. out of which the assessee had already developed and sold sites to the extent of 22,400 sq. ft. in the assessment year 2005-06 and 1,40,000 sq. ft. in the assessment year 2006-07.

The CIT has invoked the provisions of Section 263 of the Act only for the reason that the Assessing Officer has not spelt out in his order regarding the verification of the work-in-progress report and the reasons for accepting the valuation of work-in-progress report declared by the assessee. In this background, we have examined the case on hand with reference to the tabulation chart furnished by the assessee which reads thus:

<u>M/s.SARAVANA DEVELOPERS</u>				
PARTICULARS	ASST-YEAR	ASST-YEAR	ASST-YEAR	ASST-YEAR
	2005-06	2006-07	2007-08	2008-09
Turnover (A)	3,365,000	44,220,398	43,882,100	11,781,000
Development Charges	10,342,310	41,260,000	35,927,100	2,755,000
Add:Opening W.I.P		8,010,730	10,929,625	10,326,700
	10,34,310	49,270,730	46,856,725	13,081,700
Less:Closing W.I.P	8,010,730	10,929,625	10,326,700	3,773,378
Net Development charges	2,33,580	38,341,105	36,530,025	9,308,322
% Profit on Turnover	9.00	10.00	10.70	8.05
Land Area Sold (SFT)	22,400	140,400	113,557	15,240
Unsold Land Area (SFT)	361,600	221,200	107,643	92,403

13. The CIT while computing closing work-in-progress for the assessment year 2006-07 has worked as under:

Total area developed during the year	3,61,600 Sq.ft
Total developmental charges incurredRs.	4,12,60,000
Rateper Sq.ft.Incurred	4,12,60,000/3,61,000= Rs.114.10 Per Sq.Ft
Area of unsold sites is 2,21,200 Sq ft.	
Developmental Charges relating to unsold Sites to be taken as closing work in progress	2,21,200*114.10=Rs.2,52,38,920
Land cost of unsold sites	Total Cost/Total land 85,55,060/3,84,000*2,21,200= Rs.49,26,124
Closing work in progress	Land cost+Developmental Charges 49,26,124+2,52,38,920=Rs.3,01,65,044

14. It is also noticed by us that the ITAT has called for the records of assessment of the relevant assessment year and examined the various details, questionnaire (1) called by the Assessing Officer along with notice under Section 142(1) of the Act and additional details vide questionnaire (2) vis-à-vis the assessee's reply to the said questionnaire. We have considered carefully the figures shown in the chart furnished by the assessee for the assesment years 2005-06 to 2008-09. The development charges for these four years works out to be Rs.9,02,84,410/- (Rs.10342310 + Rs.41260000 + Rs.3592700 + Rs.2755000), deducting

closing stock of Rs.37,73,378/-, the net development charges would be Rs.8,65,11,032/-. The total land area sold + unsold is $22400 + 361600 = 384000$ sq. ft. The total unsold area as per the assessment year 2008-09 is 92403 sq. ft. Deducting the same from 384000 sq.ft., total sold area is 291597 sq. ft. Thus, the development expenses works out to Rs.296.68/- per sq. ft. $(8,65,11,032/2,91,597)$.

15. The method of computation adopted by the assessee is as follows:

Net development expenses in respect of sites sold Rs.3,52,56,499/- (Rs.4,12,60,000-Rs.60,03,501 closing work-in-progress) vis-à-vis, the sites sold of 1,40,400 sq. ft. which works out to Rs.251.11/- per sq. ft.

16. For the assessment year 2007-08, the development expenses allowed by the Assessing Officer are Rs.3,40,01,131 relating to the sites sold of 1,13,557 sq. ft. The expenses works out to Rs.299.41/- per sq. ft. An examination of these figures as reflected in the computation made above establishes that the development charges claimed by the assessee per sq. ft. is Rs.251.11/- which is

lower than Rs.299.41/- accepted by the department for the assessment year 2007-08 while concluding the assessment under Section 143(3) of the Act. One mode of computation which we have examined, stated above at para.14, works out to Rs.296.68/- per sq. ft. The development charges of Rs.251.11/- per sq. ft. claimed by the assessee is just and reasonable and does not result in any loss to the revenue. Thus, the CIT invoking the provisions of Section 263 of the Act, is uncalled for as the order passed by the Assessing Officer is no way prejudicial to the interest of the revenue. The revenue has miserably failed to satisfy us that the valuation of the work-in-progress accepted by the Assessing Officer, is erroneous and prejudicial to the interest of the revenue. Yet another important aspect which is significant to notice is that the Assessing Officer, accepting the valuation of the work-in-progress of the assessee for the assessment year 2007-08, while concluding the assessment under Section 143(3) of the Act. CIT, committed an error in taking the amount incurred in the current year of Rs.4,12,60,000/- and dividing it by entire area of the project

of 3,84,000 sq. ft. While computing the work-in-progress value.

17. In **Sunbeam's** case (*supra*), Delhi High Court placing reliance on the Judgments of the Apex Court in the case of **Parashuram Pottery Works Co.Ltd. vs ITO ((1977)106 ITR 1)** and **Malabar Industrial Co. Ltd. (*supra*)** has held that the Commissioner having conceded the position that the Assessing Officer made enquiries, elicited replies and thereafter passed the assessment order, the grievance of the Commissioner that the Assessing Officer should have made further enquires rather than accepting the explanation and in such situation, it cannot be said that it is a case of 'lack of inquiry'. In this context, it is held that the opinion of the assessing officer in treating the expenditure as revenue expenditure was plausible and thus, there was no material before the CIT to vary that opinion and ask for fresh inquiry by invoking Section 263 of the Act. The Division Bench of this Court in the case of **D G Gopala Gowda (*supra*)** while considering the power of revision conferred under Section 263 of the Act has held that the condition precedent for exercising the revisional power

under Section 263 of the Act is that the order under revision should not only be erroneous, but such erroneous order should result in prejudice to the interest of the revenue. Mere error would not confer the jurisdiction to exercise the revisional power under Section 263 of the Act. In the Judgment of this Court in the case of **Digital Global Soft Ltd.** (*supra*), considering the judgment of this Court in “**Malabar Industrial Co. Ltd.**” (*supra*) it is categorically held that even if an order of the Assessing Officer is erroneous, unless the said erroneous order is prejudicial to the interest of the revenue, the Commissioner could not have exercised the suo moto revisional power under Section 263 of the Act.

18. The Apex Court in the case of “**Malabar Industrial Co. Ltd.**” (*supra*) has laid down the principles in the context of Section 263 of the Act. The relevant portion of para 5 of the said Judgment is reproduced below:

A bare reading of this provision makes it clear that the prerequisite to exercise of jurisdiction by the CIT suo motu under it, is that the order of the ITO is erroneous insofar as it is prejudicial to the interests of the Revenue. The CIT has to be satisfied of twin conditions, namely, (i) the order of the AO 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 ITO is erroneous but is not prejudicial to the Revenue or if it is not erroneous but is prejudicial to the Revenue-recourse cannot be had to s.263(1) of the Act.

There can be no doubt that the provision cannot be invoked to correct each and every type of mistake or error committed by the AO; it is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind.

The phrase 'prejudicial to the interests of the Revenue's is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not (conferred) to loss of tax.

19. In the light of the Judgments discussed above, we are of the firm view that the twin test propounded by the Hon'ble Courts for invoking the provisions of Section 263 of the Act, are not satisfied in the present case. As discussed above, the CIT proceeded to initiate proceedings under Section 263 of the Act only on the ground that the Assessing Officer has not assigned any reasons for accepting the valuation of the work-in-progress declared by the assessee.

As per the materials placed before the Tribunal in the records pertaining to the assessment year in question, a detailed examination is made by the Tribunal, Tribunal is of the view that the Assessing Officer has applied his mind before accepting the figure declared by the assessee in the work-in-progress report. Such an order cannot be held to be erroneous and prejudicial to the interest of the revenue. It is not a case of 'lack of inquiry'. Further inquiry ordered by the CIT would amount to fishing/roving inquiry in the matter already concluded.

20. Learned counsel placed reliance on the Judgment of this Court in the case of **Dr.L.Narendra Prasad (supra)** to contend that generally in the business of real estate, the net profit would be 8% as accepted by the Department. In the present case, the profit declared by the assessee works out to More than 8% that is normally adopted and accepted by the Department. However, in the computation of work-in-progress made by the, Appellate Commissioner, the profit margin works out to more than 31.8% which is practicably not acceptable. Accordingly, on this count also, we are not inclined to accept the order passed by the CIT computing

the margin at more than 31% which is not normally workable in the business of real estate as pointed out by the learned counsel for the assessee and this view is also supported by the Division Bench Judgment of this Court in ***Dr.L.Narendra Prasad's*** case (*supra*)

21. The ITAT having considered the material placed before it, rightly set-aside the order passed under Section 263 of the Act, as not sustainable. Accordingly, the assessee's appeal is allowed as the consequential order passed under Section 143(3) read with Section 263 of the Act does not survive for consideration as having become infructuous. No exception can be found with the well reasoned order passed by the ITAT.

22. We have also noticed the amendment brought to Section 263 of the Act by Finance Act, 2015 with effect from 01.06.2015 by introducing an explanation which provides for invoking Section 263 even in cases where the order is passed by the Assessing Officer is without making inquiries or verifications but the same is not applicable to the case on hand.

23. For the foregoing reasons, the substantial questions of law raised in both the appeals are answered in favour of the assessee and against the revenue. Accordingly, the appeals stand dismissed.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

Brn