

Civil Misc. Writ Petition No.1587 of 2011

M/s District Cooperative Bank Ltd..... Petitioner

Vs.

Deputy Commissioner of Income Tax.....Respondent

Hon'ble Tarun Agarwala, J.

Hon'ble Surya Prakash Keserwani, J.

(Per: Tarun Agarwala, J.)

The petitioner has challenged the reassessment proceeding under Sections 147 and 148 of the Income Tax Act (hereinafter referred to as the Act). For the said assessment year 2007-08, the assessee filed a return declaring a net loss of Rs. 7,48,180/-. The return was processed under Section 148(1) of the Act, but subsequently, the case was taken under scrutiny and a notice under Section 148(2) of the Act was issued along

with a questionnaire. The petitioner filed its reply along with supporting documents. The Assessing Officer examined the profit and loss account from the books of account and other documents and, thereafter, made an assessment declaring a net loss of Rs. 66,70,410/-. Thereafter, it transpires that the Assessing Officer issued a notice under Section 154 of the Act alleging that an error had occurred in the assessment order, which was apparent on the face of the record. On an objection being filed, the proceedings were dropped and, thereafter, a notice dated 23.02.2011 was issued under Section 148 of the Act contending that the internal Revenue Audit Party in its report had submitted that the petitioner had debited an amount of Rs. 5,87,16,00/- and Rs.31,63,868/-, which was not allowable under Section 36 (1) (vii) of the Act and, therefore, the Department has “reasons to believe” that an income of Rs. 6,18,79,868/- had escaped assessment. The petitioner filed his objection contending that reassessment proceedings were patently erroneous and that reasons to believe was nothing but a change of opinion on which no reassessment proceedings could be initiated. By

an order dated 19.09.2011, the objection of the petitioner was rejected.

We have heard Sri Shakeel Ahmad, the learned counsel for the petitioner and Sri Ashish Agarwal, the learned counsel for the Income Tax Department.

The learned counsel for the petitioner submitted that the reassessment proceedings could not be initiated on the basis of an audit report. According to the learned counsel, such audit report does not amount to "information" nor does it give any "reasons to believe" that income had escaped assessment to tax. The learned counsel contended that on the basis of an audit report, assessment proceedings could not be reopened, inasmuch as the Assessing Officer had not applied its own mind nor came to any conclusion that based on such audit report, income had escaped assessment. The learned counsel submitted that since the Assessing Officer did not hold any belief that income had escaped assessment, consequently, the reassessment proceedings were without jurisdiction. The learned counsel submitted that reopening of assessment proceedings on the basis of an audit

report amounts to a change of opinion. In support of his submission, the learned counsel has placed reliance upon the decisions in **Indian And Eastern Newspaper Society, New Delhi Vs. Commissioner of Income Tax, New Delhi, 1979 AIR SC 1960, Commissioner of Income Tax Vs. Lucas T.V.S.Ltd, 234 I.T.R. 296 (Mad.), Commissioner of Income Tax Vs. Lucas T.V.S. Ltd., 249 I.T.R. 306 SC** and **Indian Oil Corporation Limited Vs. Income Tax Officer, Central Circle V, Calcutta, AIR 1987 SC 1897.**

On the other hand, the learned counsel for the Department submitted that the condition precedent for initiating reassessment proceedings existed in the instant case and that the Assessing Officer had reasons to believe that the income had escaped assessment, which was based on the audit report. It was also submitted that in the instant case, it was not the internal audit report but the report given by the Comptroller and Auditor General. The learned counsel further submitted that the decisions cited by the petitioners are not applicable as they relate to the interpretation of Section 147 of the Act, which existed prior to 01.04.1989, which provision underwent a

substantial change from 1.4.1989. The learned counsel in support of his submission has relied upon a decision of the Supreme Court in **Assistant Commissioner Vs. Rajesh Jhaveri Stock Brokers Pvt. Ltd., 2007 AIR SC 2163.**

Having heard the learned counsel for the parties, we find that Section 147 of the Act authorises and permits the Assessing Officer to assess or reassess the income chargeable to tax, if he has reasons to believe that the income for any assessment year has escaped assessment. The phrase “reasons to believe” would mean cause or justification. If the Assessing officer has cause or justification to know that income had escaped assessment, it can then be said that the Assessing Officer had reasons to believe that an income had escaped assessment.

The scope and effect of Section 147 of the Act as substituted with effect from 01.04.1989 and also Section 148 of the Act are substantially different from the provisions as they stood prior to such substitution. Clause (a) and (b) of Section 147 of the Act laid down the circumstances under which income escaped assessment could be assessed or reassessed. Section 147

contemplated two conditions which were required to be satisfied, namely, that the Assessing Officer must have reasons to believe that income, profit or gain chargeable to tax have escaped assessment, and secondly, he has reasons to believe that such escapement had occurred by reason of omission or failure on the part of the assessee to disclose fully or truly all material facts necessary for the assessment. Both these conditions are conditions precedent and are required to be satisfied before the Assessing Officer could assume jurisdiction under Section 148 of the Act read with Section 147 of the Act. After 01.04.1989 only the first condition is required, namely, “reasons to believe”, but both the conditions are required to be fulfilled in the event the case falls within the ambit of the proviso to Section 148 of the Act. In the instant case, the case is covered by main section and not by the proviso.

In the light of the aforesaid, the Supreme Court while considering the provision of Section 147 of the Act, as existed prior to 01.04.1989, held in **Indian And Eastern Newspaper Society, New Delhi (Supra)** as follows:

“9. In that view, therefore, when section

147 (b) of the Income Tax Act is read as referring to "information" as to law, what is contemplated is information as to the law created by a formal source. It is law, we must remember, which because it issues from a competent legislature or a competent judicial or quasi-judicial authority, influence the course of the assessment and decides any one or more of those matters which determine the assessee's tax liability.

10. In determining the status of an internal audit report, it is necessary to consider the nature and scope of the functions of an internal audit party. The internal audit organisation of the Income Tax Department was set up primarily for imposing a check over the arithmetical accuracy of the computation of income and the determination of tax, and now, because of the audit of income-tax receipts being entrusted to the Comptroller and Auditor-General of India from 1960, it is intended as an exercise in removing

mistakes and errors in income tax records before they are submitted to the scrutiny of the Comptroller and Auditor-General. Consequently, the nature of its work and the scope of audit have assumed a dimension co-extensive with that of Receipt Audit. The nature and scope of Receipt Audit are defined by section 16 of the Comptroller and Auditor General's-(Duties, Powers and Conditions of Services) Act, 1971.

11. Under that section, the audit by the Comptroller and Auditor General is principally intended for the purposes of satisfying him with regard to the sufficiency of the rules and procedures prescribed for the purpose of securing an effective check on the assessment, collection and proper allocation of revenue. He is entitled to examine the accounts in order to ascertain whether the rules and procedures are being duly observed, and he is required, upon such examination, to submit a report. His powers in respect of the audit of

income-tax receipts and refunds are outlined in the Board's Circular No. 14/19/ 56-II dated July 28, 1960. Paragraph 2 of the Circular repeats the provisions of section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. And paragraph 3 warns that "the Audit Department should not in any way substitute itself for the revenue authorities in the performance of their statutory duties." Paragraph 4 declares:

"4. Audit does not consider it any part of its duty to pass in review the judgment exercised or the decision taken in individual cases by officers entrusted with those duties, but it must be recognised that an examination of such cases may be an important factor in judging the effectiveness of assessment procedure. It is however, to forming a general judgment rather than to the detection of individual errors of assessment, etc. that the audit

enquiries should be directed. The detection of individual errors is an incident rather than the object of audit."

Other provisions stress that the primary function of audit in relation to assessments and refunds is the consideration whether the internal procedures are adequate and sufficient. It is not intended that the purpose of audit should go any further. Our attention has been invited to certain provisions of the Internal Audit Manual more specifically defining the functions of internal audit in the Income Tax Department. While they speak of the need to check all assessments and refunds in the light of the relevant tax laws, the orders of the Commissioners of Income Tax and the instructions of the Central Board of Direct Taxes, nothing contained therein can be construed as conferring on the contents of an internal audit report the status of a declaration of law binding on the Income Tax Officer. Whether it is the

internal audit party of the Income Tax Department or an audit party of the Comptroller and Auditor- General, they perform essentially administrative or executive functions and cannot be attributed the powers of judicial supervision over the quasi-judicial acts of income tax authorities. The Income Tax Act does not contemplate such power in any internal audit organisation of the Income Tax Department; it recognises it in those authorities only which are specifically authorised to exercise adjudicatory functions. Nor does section 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971 envisage such a power for the attainment of the objectives incorporated therein. Neither statute supports the conclusion that an audit party can pronounce on the law, and that such pronouncement amounts to "information" within the meaning of section 147(b) of the Income Tax Act,

1961.

12. But although an audit party does not possess the power to so pronounce on the law, it nevertheless may draw the attention of the Income Tax officer to it. Law is one thing, and its communication another. If the distinction between the source of the law and the communicator of the law is carefully maintained, the confusion which often results in applying section 147(b) may be avoided. While the law may be enacted or laid down only by a person or body with authority in that behalf, the knowledge or awareness of the law may be communicated by anyone. No authority is required for the purpose.

13. In the present case, an internal audit party of the Income Tax Department expressed the view that the receipts from the occupation of the conference hall and rooms did not attract section 10 of the Act and that the assessment should have been made

under section 9. While sections 9 and 10 can be described as law, the opinion of the audit party in regard to their application is not law. It is not a declaration by a body authorised to declare the law. That part alone of the note of an audit party which mentions the law which escaped the notice of the Income Tax officer constitutes "information" within the meaning of section 147 (b); the part which embodies the opinion of the audit parts in regard to the application or interpretation of the law cannot be taken into account by the Income Tax Officer. In every case, the Income Tax officer must determine for himself what is the effect and consequence of the law mentioned in the audit note and whether in consequence of the law which has now come to his notice he can reasonably believe that income has escaped assessment. The basis of his belief must be the law of which he has now become aware. The opinion

rendered by the audit party in regard to the law cannot for the purpose of such belief, add to or colour the significance of such law. In short, the true evaluation of the law in its bearing on the assessment must be made directly and solely by the Income Tax officer.

*14. Now, in the case before us, the Income Tax officer had, when he made the original assessment, considered the provisions of sections 9 and 10. Any different view taken by him afterwards on the application of those provisions would amount to a change of opinion of material already considered by him. The Revenue contends that it is open to him to do so, and on that basis to reopen the assessment under section 147(b). Reliance is placed on *Kalyaniji Mavji & Co. v. Commissioner of Income Tax*, 1976 102 ITR 287 SC, where a Bench of two learned Judges of this Court observed that a case where income had escaped assessment due to the "oversight, inadvertence or*

mistake" of the Income Tax officer must fall within section 34 (1) (b) of the Indian Income Tax Act, 1922. It appears to us, with respect, that the proposition is stated too widely and travels farther than the statute warrants in so far as it can be said to lay down that if, on reappraising the material considered by him during the original assessment, the Income Tax officer discovers that he has committed an error in consequence of which income has escaped assessment it is open to him to reopen the assessment. In our opinion, an error discovered on a reconsideration of the same material (and no more) does not give him that power. That was the view taken by this Court in Kamal Singh v. Commissioner of Income Tax (supra), Commissioner of Income Tax v. Raman and Company (supra) and Bankipur Club Ltd. v. Commissioner of Income Tax, 1971 82 ITR 831 SC, and we do not believe that the law has since taken a different course. Any observations in

Kalyanji Mavji & Co. v Commissioner of Income Tax (supra) suggesting the contrary do not, we say with respect, lay down the correct law”

The Supreme Court held that the audit report whether given by the internal audit party or Comptroller and Auditor-General would not make any difference and that the said report was intended for the purpose of satisfying itself with regard to the sufficiency of the rules and the procedures prescribed for the purpose of securing an effective check on the assessment, collection and proper allocation of revenue and to ascertain whether the rules and the procedures were duly observed. The Supreme Court further held that whether it is the internal audit party of the Income Tax Department or an audit party of Comptroller and Auditor General, they perform essentially administrative or executive functions and cannot be attributed the powers of judicial supervision over the quasi-judicial acts of income tax authorities. The Supreme Court also held that the opinion of the audit party in regard to their application is not law nor was a declaration by a

body authorised to declare the law. The Supreme Court held that the part which embodied the opinion of the audit party with regard to the application or interpretation of the law could not be taken into account by the Income-tax Officer and that the Income Tax Officer must determine as to what is the effect and consequence of the law mentioned in the audit note and whether in consequence of the law which had not come to his notice he could reasonably believe that income had escaped assessment. The Supreme Court held that the basis of this belief must be recorded.

In the light of the aforesaid decision, the Gujarat High Court in **Adani Exports Vs. Deputy Commissioner of Income Tax (Assessments)**, 240 ITR 224 held that merely on the basis of the opinion of the audit report reassessment proceedings could not be initiated and, accordingly, quashed the reassessment proceedings.

The aforesaid decisions are squarely applicable in the instant case. The decision cited by the Department in the case of **Rajesh Jhaveri (Supra)** is not applicable in the instant case, as it was a case under Section 143 (1) of the Act.

In the instant case, we find that there has been an assessment under Section 143(3) of the Act. The books of account were produced and the same were scrutinized. The profit and loss account was checked and only thereafter net loss of Rs.66,70,410/- was determined. Merely, because the audit report has opined that certain expenses were not allowable under Section 36(1) (viiia) does not entitle the Assessing Officer to issue a notice under Section 148 of the Act. We find from a perusal of the reasons to believe that the Assessing Officer had not applied its own mind and has not considered as to what would be the effect of the audit report nor had come to any conclusion which he could reasonably believe that an income had escaped assessment. Consequently, merely on the basis of the opinion rendered by the audit party, the Income Tax Officer could not assume jurisdiction to issue a notice under Section 148 of the Act. He must, on its own wisdom, come to a conclusion and hold a belief that an income had escaped assessment to tax. Since this belief was not recorded by the Assessing Officer the issuance of the notice was done mechanically without any application of

mind. Such action amounts to change of opinion, which is not permissible. Since the foundational requirement for issuance of a notice was lacking and the condition precedent for initiating a valid reassessment proceedings were not existing, we are of the opinion that the impugned notice issued under Section 148 of the Act initiating reassessment proceeding for the assessment year 2007-08 could not be sustained and is quashed. The order dated 19.09.2011 rejecting the objections is also quashed. The writ petition is allowed.

Dt: 08.09.2015

MAA/-

(Surya Prakash Kesarwani,J.) (Tarun Agarwala,J.)